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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
ROBERT BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF GRANITE MOUNTAIN WATER CO., INC., FOR A RATE INCREASE.

DOCKET NO. W-02467A-14-0230

NOTICE OF FILING REJOINDER TESTIMONY

Granite Mountain Water Co., Inc. ("Granite Mountain") hereby provides notice of filing its rebuttal testimony in the above-captioned case.

Respectfully submitted on September 18, 2015, by:

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF GRANITE MOUNTAIN WATER COMPANY, INC. FOR APPROVAL OF A RATE INCREASE	DOCKET NO. W-02467A-14-0230

REJOINDER TESTIMONY
OF
RAY L. JONES
ON BEHALF OF
GRANITE MOUNTAIN WATER COMPANY, INC.
SEPTEMBER 18, 2015

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RAY L. JONES
ON BEHALF OF
GRANITE MOUNTAIN WATER COMPANY, INC.
September 18, 2015

<u>TABLE OF CONTENTS</u>

EXECUTIVE SUMMARY

Mr. Jones responds to the surrebuttal testimony of the Arizona Corporation Commission's Utilities Division Staff. Mr. Jones addresses the allocation of costs between Chino and Granite and differences in post-test year plant positions.

The Company's proposed revenue requirements, associated rate increases and all other positions are unchanged from its rebuttal testimony.

I INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE NUMBER.

A. My name is Ray L. Jones. My business address is 18835 North Thompson Peak Parkway, Suite 215, Scottsdale, AZ 85255, and my business phone is (623) 341-4771.

Q. ARE YOU THE SAME RAY L. JONES WHO PREVIOUSLY SUBMITTED REBUTTAL TESTIMONY IN THIS DOCKET??

A. Yes.

II RESPONSE TO STAFF'S SURREBUTTAL TESTIMONY

Q. HAVE YOU REVIEWED STAFF'S SURREBUTTAL TESTIMONY IN THIS CASE?

A. Yes, I reviewed the testimony provided by Teresa B. Hunsaker and Dorothy Hains.

Cost Allocation Issue

Q. WHAT WAS YOUR ASSESSMENT OF STAFF'S SURREBUTTAL POSITION REGARDING COST ALLOCATIONS BETWEEN GRANITE AND CHINO?

A. Staff's surrebuttal position includes some movement on the cost allocation between Chino and Granite toward the position advocated by the Company. The revenue requirement and required rate increase for Granite recommended by Staff are appropriately lower to reflect this change in cost allocation. However, as I discuss at greater length in my Chino Rejoinder Testimony in Docket No. W-02370A-14-0231, Staff did not update Chino's recommended revenue requirement, which remains unchanged from its direct testimony, to reflect these changes in its position.

In the end, Staff's surrebuttal testimony is nothing more than a collection of seemingly reasonable responses to the Company's rebuttal position—actually wholly ignored—

which ultimately produce the absurd outcome where Staff's seemingly reasonable response leave the combined operations of Chino and Granite worse off than if Staff had not "updated" its position.

Q. WOULD YOU EXPLAIN?

As more fully explained in the Company's rebuttal testimony, the Company's most significant overall concern is the allocation of common costs between Chino and Granite. The Company has historically allocated costs based on customer counts, which are currently 88% Chino 12% Granite. Staff's direct position, allocating only 70.12% of costs to Chino and 26.93% to Granite, dramatically shifted a very significant $49,006 in costs and related revenue from Chino. The Company was concerned with this shift because Granite has fewer customers, lower water sales, higher levels of plant investment and higher rates. Shifting costs to Granite would create revenue instability for the water companies as a whole. Since Granite's water sales are only 15.5% of the combined total sales for Chino and Granite, each $10,000 shift in costs lowers rates for Chino by about $0.25 per 1,000 gallons while increasing rates in Granite by about $1.06 per 1,000 gallons. Due to this disparate impact to rates, aggressive shifting of costs to Granite is certain to increase revenue instability because Granite would almost certainly under-collect its authorized revenue by a significant magnitude.

Staff has responded to the Company's concerns by altering its cost allocation model to allocate more costs to Chino and fewer to Granite. Staff's current recommendation is 74% to Chino and 25% to Granite. This recommendation results in an additional $10,634 in expense allocated to Chino compared to Staff's original recommendation. This, on its face, appears to at least partially address the Company's cost allocation concerns. However, because Staff failed to increase Chino's revenue requirement to recover these additional expenses, neither Chino nor Granite will be able to recover these expenses. So instead of Granite being unlikely to recover $10,634 in common expenses, Staff would instead guarantee that neither Granite nor Chino would recover these $10,634 in common expenses. The net effect of Staff's incomplete allocation would be to make the combined operations of Chino and Granite are worse off.

Q. WHY IS THIS COST ALLOCATION ISSUE IMPORTANT TO CHINO AND GRANITE?

A. Chino and Granite are both small companies facing the numerous challenges and issues faced by small companies throughout Arizona. Like other small water companies, Chino and Granite need to be properly positioned for consolidation and, until that can occur, they need to remain viable and have sufficient earnings to encourage investment in infrastructure.

Chino has increased rates by less than one percent over the past 20 years and is only requesting a modest increase in this case. In contrast, Granite is attempting to recover significant investment in new plant and is facing a large rate increase. Staff proposes to keep Chino rates unchanged by significantly shifting costs to Granite. Both Chino and Granite need sufficient revenue to allow for future improvements and attract new investment into their water systems.

The abrupt cost shift from Chino to Granite proposed by Staff will destabilize the revenue of both companies, further reduce the common operation's ability to cover its common expenses, and further harm the operations of both Chino and Granite. Ultimately, the proposed cost shift could impair the Companies' ability to implement the operational improvements desired by Staff and committed to by the Companies.

Lastly, Staff's proposal moves the companies contrary to industry trends. The Commission and industry are exploring ways to encourage consolidation and to make it easier for small water companies to be acquired by larger, better capitalized companies. Even California has taken steps to improve the financial health of its small water companies and make them more attractive for new investment. Unfortunately, the cost shift embedded in Staff's recommendation runs contrary to these Commission, industry, and neighboring-state regulatory policies.

Post-Test Year Plant Costs

Q. HAVE THE PARTIES MADE ANY PROGRESS REGARDING THE DISPUTED COST FOR THE EASEMENT, STRUCTURES, AND WELL PURCHASED FOR WELL NO. 6?

A. Unfortunately no. Staff surrebuttal position actually decreases its cost for Well No. 6 by $7,768.

Q. WHAT CAUSED THIS REDUCTION BY STAFF?

A. Staff appears to have selectively applied information from the appraisal provided by the Company to reduce the value of certain items while ignoring the remainder of the appraisal.

Q. IS THE COMPANY UPDATING ITS POSITION ON WELL NO. 6 COSTS?

A. No. The Company continues to request recovery of the $75,000 actually paid to acquire Well No. 6, which is less than the $80,000 appraised value of the acquired property and equipment.

Q. HOW WOULD YOU DESCRIBE STAFF'S APPROACH TO DETERMINING THE COST OF WELL NO. 6?

A. Staff seems to have tried to arrive at the lowest possible supportable cost without consideration of the specific circumstances of this well purchase. Staff calculates a theoretical minimum easement area without consideration of the need to drill a replacement well in the future. Staff further discounts the value of outbuildings that were pre-existing on the property, of no use to the previous owners, and that the Company intends to use to support its operations. While I understand the need to assure that the Company's customers are not subsidizing an affiliate, in this case Staff's approach vastly oversimplifies a very complex situation and fails to reflect the value that this well provides to the Company and its customers. Ultimately, Staff has valued an existing well— known to produce high-quality water in sufficient quantity to support Granite Mountain's needs— together with a well house and all required land rights for both the well and connecting water lines at an unrealistically low $29,432. This is less than the $32,625 cost estimate to drill a new well (not including necessary hydogeologic studies and permitting) received from Drill Tech, which would not be guaranteed to provide adequate, high-quality water. Effectively, Staff has assigned a negative value to the total of three positive factors:

1. Unlike a new well in another location, the acquired well is known to produce sufficient quantities of high quality water;
2. To drill a new well, the Company would have to acquire land for the well and associated water lines. The actually-acquired land provides room for one well, with adequate room to drill additional or replacement wells and to run water lines;
3. The existing buildings will be used to support the Company's operations.

Q. CAN YOU FUTHER EXPLAIN THE BASIS FOR THESE POSITIVES, WHICH STAFF VALUES NEGATIVELY?

A. To understand the Company's position it is first necessary to understand the challenge facing the Company. It is not easy to develop a new water supply in the Company's service area. The prospect of drilling a new well is daunting. First a suitable site must be located that is both likely to produce water and, to get a well drilling permit from ADWR, the proposed well cannot negatively impact any existing wells. The Company was not able to locate such a site at any price. Next a well must actually be drilled and there is no guarantee of success. The Company estimated the cost of drilling at $32,625 based on an estimate provided by Drill Tech. This cost could easily escalate, potentially doubling or even tripling, if an initial effort was unsuccessful.

Ultimately the Company became aware of the Well No. 6 property. The property had gone through foreclosure and was listed by Federal National Mortgage Association for $185,000. Granite Mountain believed that the property could be purchased for $155,000. However Granite Mountain did not have $155,000 and could not borrow or otherwise secure $155,000 to purchase the property. But, a purchase had to be done quickly, because the property was "bank owned" and would not likely remain long on the market. Furthermore, Granite Mountain was not in a position to take the risk associated with purchasing a bank-owned property, which would be sold as-is and subject to liens, claims and damages without recourse to the seller, Federal National Mortgage Association.

Because the Company's need for the well was so great and because the time to acquire the property was short, as an accommodation to her father, Shauna Duke and her husband, Jonathan Duke, purchased the property from the Federal National Mortgage Association for $155,000. The Duke's purchased the property solely to allow Granite Mountain to use the well.

The Duke's and the Company placed a value of $75,000 on an easement that would allow Granite to permanently use the well, the well house and portions of the property for water utility purposes. In agreeing to the $75,000 purchase price, the Company took into consideration the following:

- The difficulty in finding suitable sites within Granite's service area to drill potable wells that will produce an adequate quantity and quality of water.
- The fact that Well No. 6 is known to provide water of suitable quantity and quality for use as a potable water supply.
- The lack of other suitable and available parcels within Granite's service area with an existing well of suitable quantity and quality for use as a potable water supply.
- The Company's inability to finance the purchase a well or well site in advance of placing the well into service and obtaining regulatory recovery.
- The Company's inability to finance the full purchase price of the property on which Well No. 6 was located, particularly in the short time frame available to close a purchase of the bank owned property.
- The willingness of the Duke's to purchase the bank owned property containing the existing Well No. 6 and grant an easement to Granite Mountain that substantially devalues the underlying property.
- The willingness of the Dukes to grant the easement at a significant discount to the full purchase price and market value of the property.
- The willingness of the Dukes to accept deferred payment terms for the value of the easement more closely aligned with the Company's ability to finance and recover the costs of the easement.
- The comparable cost of drilling and developing a new well.
- The price paid by the Duke's for the underlying property.
- The market value of the property, including the existing well.

Due to the inherent value of the well and the significant encumbrance to the property, it is very unlikely that any property owner, other than a relative, would ever grant an easement such as was given to Granite Mountain by the Dukes for less than the full market value of the property. In this case, transacting with an affiliate provided substantial benefits to the regulated utility.

The Company's reference to a "significant discount to the full purchase price" compares the $75,000 to be paid for the easement in the affiliate transaction, *which no unrelated third party would likely accept*, to the $155,000 purchase price for the property paid by the Dukes.

Effectively, the Company saved $80,000 over the minimum price that the Company would have needed to pay even if it could have raised $155,000. This was clearly in its customers' interest. Another reason that the purchase was in the customers' interest is that the purchase allowed use of a badly needed well that could not have been otherwise constructed. If a third party had purchased the property, it may have been impossible to obtain the well site at any price.

Based on the foregoing, the $75,000 paid by the Company for the easement and well is an extremely fair price paid for an existing well with proven water production of drinking water quality. The amount paid is supported by a real estate appraisal supporting a cost for $80,000. The full $75,000 should be included in the Company's rate base.

Q. WHAT IS THE STATUS OF TANK NO. 3?

A. The Company continues to expect to complete the tank in the next couple of months and requests inclusion of the cost a post-test year plant. Staff continues to oppose the inclusion of costs for the tank.

Other Issues

Q. HAS THE COMPANY UPDATED ITS POSITION FROM ITS REBUTTAL TESTIMOMY?

A. The Company's position is unchanged.

Q. WHAT ARE THE CURRENT AREAS OF DISAGREEMENT BETWEEN STAFF AND THE COMPANY?

A. The Company opposes Staff Rate Base Adjustment No. 3 removing 10% of the cost of $96,432 of plant in service from rate base by increasing the Company's CIAC balance by $9,643.

There are three areas of disagreement between the Company and Staff regarding expenses. First, as discussed above, the Company and Staff are recommending different allocation percentages between Chino and Granite. Second the parties disagree on the salary level of Mr. Levie. Lastly the Company and Staff propose differing levels of depreciation expense due to the differing levels of CIAC (Rate Base Adjustment No. 1). Also in regard to depreciation expense, Staff appears to have under calculated depreciation expense for pumping equipment by overstating the amount of fully depreciated plant by the amount of a post-test year retirement.

The Company and Staff are in agreement regarding the methodology for calculating the level of working capital and property tax expense. Staff still appears to be using corporate income tax rates while the company uses personal income tax rates to calculate income tax expense. Since the Company and Staff disagree on their revenue and expense recommendations the specific recommendations for these items are different.

The Company continues to be concerned that Staff's proposed rate design inappropriately shifts revenue from the base charge to both second and third tier commodity charges.

The parties have not altered their positions on penalties, a recommended code of conduct, and related recommendations. Accordingly, several additional items remain in dispute.

Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?

A. Yes.