Citizens’ Water Advisory Committee  
c/o Tucson Water Intergovernmental Coordination  
Delivered via Email to: Jessica.Rodriguez@tucsonaz.gov

Re: Tucson Water Cost-of-service Study—Response to Raftelis Memorandum

Dear Chair and Members, Citizens’ Water Advisory Committee:

You received the attached technical memorandum on August 30, 2021 drafted by Raftelis Financial Consultants, Inc., primarily addressing two items raised in my July 30, 2021 letter to you. These relate to appropriateness of applying the utility and return on equity approaches to Tucson Water customers residing in the unincorporated areas of the County.

While I do not dispute that the methodologies discussed in that memorandum are generally correct, they are, however offered devoid of context. In lieu of addressing the validity of the reasons I provided as to why the utility approach is problematic to the Tucson Water context, the Raftelis memorandum instead lists examples of other utilities using this approach as well as citing the American Water Works Association (AWWA) Water Rates Fees and Charges (M1) manual which lists this option to supplement other methods in determining rates. The Raftelis justification assumes all public utilities structure ownership, debt and risk in the same manner. However, clearly that is not the case. Some public utilities generate profit to shareholders; others may structure debt through the municipality general fund, thereby placing liability squarely within the municipal corporate boundaries.

None of these is the case with Tucson Water where the entire utility debt and risk is held by ratepayers and not residents of the municipality. In the event of a force majeure, the City of Tucson would secure mitigating debt against future revenues generated by ratepayers, thereby leaving Tucson Water residents in the unincorporated areas as exposed as Tucson resident ratepayers. City of Tucson residents receiving water from other utilities such as Metro Water, however, would not be exposed to this additional liability since they are not ratepayers. Clearly and based on historical City practice, the criteria of residency within the Tucson Corporate limits has no bearing on assets, risk and debt held by the Tucson Water utility.

The same context applies to the return on equity approach. While the City of Tucson ownership of water infrastructure assets is not in dispute, the manner in which the City has structured the Tucson Water enterprise results in risk borne by Tucson Water ratepayers and not City...
residents. This fact is further evidenced by subsidies for reclaimed water, contaminated City water wells and green infrastructure, all of which are subsidized by all Tucson Water ratepayers to benefit projects within City limits. The reclaimed water system revenue shortfall, contamination mitigation costs, and the Green Stormwater Infrastructure Fee could have been borne by the City General Fund. Instead, Mayor and Council has selected to apply these City liabilities to all Tucson Water ratepayers. This demonstrates an additional burden placed on unincorporated residents in lieu of the converse since they draw no benefit from these liabilities.

Furthermore, the Raftelis memorandum indicates that “...outside City customers could not own such assets due to the lack of enabling legislation for the County to operate a water utility.” While it is correct that counties in Arizona do not have authority to operate a water utility, outside customers could own assets by forming a Domestic Water Improvement District or by requesting service from another water utility. However, Arizona Department of Water Resources and Arizona Corporation Commission rules preclude utilities from enabling service in existing service areas without the approval of the serving utility. Thus, outside City customers cannot own water service assets, not due to lack of county enabling authority but due to control held by the City of Tucson.

Finally and since the Raftelis justifications rely heavily on the AWWA M1 manual, it is appropriate to note two introductory paragraphs in the manual related to rates, fees and charges objectives:

As a manual of standard practice, AWWA advocates the use of the generally accepted cost-based principles and methodologies for establishing rates, charges, and fees contained and discussed within this manual. Establishing cost-based and equitable rates is technically challenging and requires, at some level, knowledge and understanding of finance, accounting, budgeting, engineering, system design and operations, customer service, public outreach and communication, and the legal environment as it may relate to setting rates, fees, and charges.

Water rates developed using the methodologies discussed in this manual, when appropriately applied, are generally considered to be fair and equitable because these rate-setting methodologies result in cost-based rates that generate revenue from each class of customer in proportion to the cost to serve each class of customer. Water rates are considered fair and equitable when each customer class pays the costs allocated to the class and, consequently, cross-class subsidies are avoided. While recovery of the full revenue requirement in a fair and equitable manner is a key objective of a utility using a cost-of-service rate-making process, it is often not the only objective. The following list contains the typical objectives in establishing cost-based rates (Bonbright, Danielsen, and Kamerschen 1988):

- Effectiveness in yielding total revenue requirements (full cost recovery)
- Revenue stability and predictability
- Stability and predictability of the rates themselves from unexpected or adverse changes
- Promotion of efficient resource use (conservation and efficient use)
- Fairness in the apportionment of total costs of service among the different ratepayers
- Avoidance of undue discrimination (subsidies) within the rates
- Dynamic efficiency in responding to changing supply-and-demand patterns
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• Freedom from controversies as to proper interpretation of the rates
• Simple and easy to understand
• Simple to administer
• Legal and defendable

Clearly, the AWWA advocates applying not all available methodologies but appropriate methodologies grounded in a thorough understanding of context and equity as I have outlined in my previous letter to you.

Sincerely,

Yves Khawam, PhD
Assistant County Administrator for Public Works

Attachment

c: C.H. Huckelberry, County Administrator
Jan Lesher, Chief Deputy County Administrator
Carmine DeBonis, Jr., Deputy County Administrator for Public Works
Jackson Jenkins, Director, Regional Wastewater Reclamation Department
Kathy Chavez, Water Policy Manager