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BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

JUL 20 1999

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

DOCKETED BY *[Signature]*

IN THE MATTER OF THE APPLICATION OF
PARADISE VALLEY WATER COMPANY FOR
AN INCREASE IN RATES.

DOCKET NO. W-01303A-98-0507

DECISION NO. 61831

OPINION AND ORDER

DATE OF HEARING: April 29, 1999
PLACE OF HEARING: Phoenix, Arizona
PRESIDING OFFICER: Lyn Farmer
APPEARANCES: Mr. Norman D. James, FENNEMORE CRAIG, P.C. on behalf
of Paradise Valley Water Company,
Ms. Karen E. Nally, on behalf of the Residential Utility
Consumer Office, and
Ms. Janet Wagner, Staff Attorney, Legal Division on behalf of
the Arizona Corporation Commission.

BY THE COMMISSION:

On August 14, 1998, Paradise Valley Water Company ("Company" or "Applicant") filed a rate application with the Arizona Corporation Commission ("Commission").

On September 14, 1998, the Utilities Division Staff ("Staff") of the Commission filed a letter indicating the Company's rate application was sufficient and classifying the utility as a Class A utility.

On September 22, 1998, Staff filed a Request for Procedural Order and Hearing Date.

On September 23, 1998, the Residential Utility Consumer Office ("RUCO") requested intervention, which was granted on October 5, 1998.

On September 24, 1998, the Company Responded to Staff's request for Procedural Order.

On September 29, 1998, a Procedural Order was issued setting the hearing and establishing deadlines. The matter was set for hearing beginning May 5, 1999. Subsequently, the Company filed a Motion for Order modifying hearing date and related relief.

1 On October 29, 1998, Paradise Valley Country Club ("PVCC") requested intervention, which
2 was granted on November 9, 1998.

3 On November 18, 1998, an Amended Procedural Order was issued setting a hearing for April
4 29, 1999.

5 This matter came before a duly authorized Hearing Officer of the Commission at the
6 Commission's offices in Phoenix, Arizona on April 29, 1999. Applicant, RUCO, and Staff appeared
7 through counsel. No member of the public appeared to make public comment. Evidence was
8 presented and, after a full public hearing, this matter was adjourned pending submission of a
9 Recommended Opinion and Order by the Presiding Officer to the Commission.

10 On May 25, 1999, Staff filed its Supplemental Staff Report and RUCO filed its Audit Report.
11 On June 8, 1999, Paradise Valley filed its final schedules. No party requested additional hearing on
12 these post-hearing filings.

13 I. INTRODUCTION

14 Applicant provides water service within portions of the Town of Paradise Valley, the City of
15 Scottsdale, and certain unincorporated areas within Maricopa County, Arizona. All of the
16 Company's certificated area is located within the Phoenix Active Management Area. Paradise
17 Valley's most recent rate increase was approved by the Commission in Decision No. 60220 (May 27,
18 1997). During the test year ended June 30, 1998 ("TY"), the Company provided water service to
19 approximately 4,600 customers. The majority of Applicant's customers are residential customers,
20 many of whom own large dwellings situated on large lots with extensive landscaping and
21 improvements. Applicant serves the PVCC and two other turf-related facilities, as well as several
22 resorts, hotels, and other commercial customers that use relatively large quantities of water.

23 II. DISCUSSION

24 In its Application, the Company initially requested an increase in operating revenues of
25 \$1,097,568, or a 27.18 percent increase. The Company accepted the Staff Report filed on May 25,
26 1999¹, and made corresponding adjustments to depreciation expense and income taxes. The
27

28 ¹ Staff's final post-test year pro forma plant additions/deletions adjustment was \$2,195,582, which the Company accepted.

1 Company and Staff agree that during the TY, the Company had adjusted operating income of
2 \$556,475 based on adjusted operating expenses of \$3,481,630 and operating revenues of \$4,038,105.
3 Both Staff and the Company agree that an \$850,238 increase in operating revenues (21.06 percent) is
4 appropriate. This revenue increase is based upon an adjusted original cost rate base ("OCRB") of
5 \$11,497,759, and a rate of return on rate base of 9.33 percent.

6 RUCO presented testimony on two contested issues at hearing: the Company's inclusion of
7 post-TY plant additions in rate base and its request for authority to implement a new surcharge to
8 recover costs associated with the use of its Central Arizona Water Project ("CAP") allocation.

9 Post-Test Year Plant Additions

10 In the Company's last rate case, Decision No. 60220, the Commission allowed post-TY plant
11 additions. In this application, the Company is also requesting post-TY plant additions in the amount
12 of \$2,195,582.

13 Staff recommended allowing the \$2,195,582 in post-TY plant additions through March 31,
14 1999, but has concerns that allowing additions so far outside the test year violates the historical test
15 year rate making methodology and creates a mismatch of revenues and expenses. Staff recommended
16 that the Commission order the Company, in its next rate filing, to include only the proforma plant
17 additions and deletions it will complete by Staff Engineering's approximate inspection date.

18 RUCO also had the same concerns, and recommended disallowing the pro forma
19 adjustments. RUCO does not believe that the circumstances cited in Decision No. 60220 that
20 supported the allowance of post-TY plant additions are present in this application, and therefore,
21 recommended that the TY plant level should be used to establish rate base.

22 In Decision No. 60220, we expressed our shared concern regarding matching of rate base and
23 operating expense levels. The Commission normally uses a TY cut-off date for including plant
24 additions, although in unique circumstances, the Commission has allowed post-TY plant additions in
25 rate base. In Decision No. 60220, we used a plant cut-off date that would allow Staff and the parties
26 time to audit and review the Company's proposal prior to filing surrebuttal testimony. Although we
27 will allow the Staff and Company's agreed-upon level of post-TY plant additions in rate base, we
28 agree with RUCO and Staff that we should set guidelines for the Company's next and future rate

1 filings. The Company controls the timing and filing of its rate applications and should time its
2 applications so as to minimize pro forma adjustments for plant additions. Further, in order to allow
3 Staff and intervenors an adequate time to review and audit any such adjustments, the Company shall
4 limit its adjustments to add post-TY plant to include only plant that is used and useful and in service
5 within 90 days of the date that the rate application is deemed sufficient.

6 Central Arizona Project Costs

7 In 1985, the Company entered into a subcontract with the U.S. Bureau of Reclamation and the
8 Central Arizona Water Conservation District ("CAWCD") providing for the annual delivery to the
9 Company of 3,231 acre feet of M & I (municipal and industrial) water from the CAP. Although the
10 Company has not accepted delivery of any of its allocation, the terms of the subcontract require it to
11 make annual capital payments.² Annual payments were made from 1986 through 1995. In its 1994
12 rate application, the Company requested rate recovery of its annual capital payments to CAWCD.
13 Staff and RUCO objected because the CAP water was not being used, and Commission policy
14 required that CAP water be used and useful in order to be afforded rate recovery. The Company then
15 proposed the use of the "CAP 2000" ratemaking alternative whereby the Company would recover its
16 accrued CAP expenses through a surcharge over 25 years, while agreeing not to seek recovery from
17 ratepayers for future CAP expenses. In Decision No. 59079 (May 5, 1995), the Commission
18 authorized this ratemaking treatment for the Company. Since that time, the Company has not made
19 any of the required capital payments, but has continued to retain its CAP allocation.

20 According to the Company, new circumstances would allow it to use its CAP allocation
21 through an exchange with the Salt River Project ("SRP"). SRP will take delivery of the Company's
22 CAP allocation in exchange for the Company's use of the groundwater withdrawn from an SRP well
23 and treated at the Company's Miller Road treatment facility.³ The Company proposed a CAP
24 surcharge to recover the costs associated with the CAP water use. It would apply to all residential
25 consumption over 45,000 gallons per month and to all commercial gallonage, and would be trued-up

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27 ² The payments ranged from a low of \$2 per acre foot in the early years to \$39 per acre foot in 1997.

28 ³ The Company currently has a water exchange agreement with SRP to contain contamination in a nearby aquifer and prevent the Company's wells from becoming contaminated. The Company pumps water from an SRP well and treats it, and delivers water pumped from the Company's wells into the SRP canal.

1 annually. Consisting of the total annual CAP charge of \$433,723; an annual deferred CAP charge of
2 \$150,718 (total deferred charges of \$753,591, including the \$99,000 deferred CAP 2000 balance,
3 capital costs due CAWCD of \$533,115, and late fees due CAWCD of \$121,476, amortized over five
4 years); and a \$188,112 reduction in power and AWDR fees, the total annual cost would be \$396,329,
5 or a surcharge of \$0.2390 per 1,000 gallons.

6 Staff concurred with the Company's proposal, and agreed that the existing CAP 2000
7 surcharge be eliminated and that the deferred costs associated with that surcharge be recovered under
8 the new surcharge. RUCO believes that the existing 25 year CAP 2000 surcharge for deferred CAP
9 costs authorized in Decision No. 59079 should remain in effect; that the Company should recover the
10 incremental cost of using CAP water since it supports Arizona's legislative state water policies and
11 goals; that any changes in the surcharge amount should only be made in a rate case; and that the
12 Company should not be allowed retroactive recovery of CAP costs that were incurred during the time
13 that Decision No. 59079 was in effect.

14 We agree that the proposed use of the Company's CAP allocation is appropriate, and that
15 ongoing CAP costs should be recovered through a surcharge mechanism as proposed by the
16 Company. Because most of the CAP costs are outside of the Company's ability to control, we agree
17 with Staff and the Company that an annual true-up is appropriate. Both Staff and RUCO should
18 review and approve any proposed surcharge changes or true-ups. Although the Company agreed not
19 to seek recovery of future CAP costs, its retention of its CAP allocation and its use will benefit both it
20 and its ratepayers, and therefore, we agree that the Company should be allowed to recover those
21 unpaid CAP capital costs due the CAWCD. However, we agree with RUCO that the Company made
22 a business decision to continue to incur capital costs during the time it was aware that it would not be
23 allowed recovery of those costs, and therefore, the Company should not be allowed to recover late
24 fees or penalties incurred during the time it used the CAP 2000 methodology. Accordingly, the
25 current CAP 2000 surcharge will remain in place as an annual charge, and the Company will collect a
26 \$0.2124 per 1,000 gallons surcharge from all residential usage in excess of 45,000 gallons per month
27 and from all non-residential usage.

28 Miscellaneous

1 At the time of hearing, the Company was out of compliance with the Maricopa County
2 Environmental Services Department and the Arizona Department of Environmental Quality
3 ("ADEQ"). Staff recommended that the Company make every effort to bring the water system into
4 compliance with Maricopa County and ADEQ as soon as possible, but no later than June 30, 1999.
5 Further, Staff recommended that any rate increase should not be effective until the month after the
6 Company submits a written statement from ADEQ confirming that the Company is delivering water
7 that has no maximum contaminant level violations and meets the quality standards of the Safe
8 Drinking Water Act. On June 28, 1999, Staff filed a memorandum with an attachment from
9 Maricopa County indicating that the Company is delivering water that has no maximum contaminant
10 level violations and meets the quality standards of the Safe Drinking Water Act.

11 In Decision No. 61307 (December 31, 1998) the Commission approved the sale of assets and
12 transfer of the Certificate of Convenience and Necessity of Mummy Mountain Water Company to
13 Applicant. There was insufficient time for the transaction and its ramifications to be analyzed and
14 included in this rate case, so Staff recommended that the Commission should order a revenue review
15 be performed at the end of a full operating cycle to assess the effects of the Mummy transaction on
16 PV and its rates. We agree.

17 III. RATE BASE

18 The Company agreed that its OCRB may be used as its Fair Value Rate Base ("FVRB"). We
19 find Paradise Valley Water Company's FVRB to be \$11,497,759.

20 IV. OPERATING INCOME

21 Applicant had actual operating revenues of \$4,038,105 during the TY. No party proposed
22 adjustments to operating revenues.

23 Applicant's adjusted TY operating expenses were \$3,457,731, including adjustments for
24 depreciation, property taxes, income taxes, rate case expense.

25 V. COST OF CAPITAL

26 In its previous rate case, the Commission rejected the Company's capital structure of 96.51
27 equity, and used a hypothetical capital structure of 49.23 percent equity and 50.77 percent long-term
28 debt in setting rates. The Commission used a cost of equity of 11.0 percent and a cost of long-term

1 debt of 9.0 percent, resulting in a 9.99 percent cost of capital.

2 Decision No. 60525 (December 18, 1997) authorized the Company to issue \$4.5 million in
3 long-term bonds to retire a portion of its common equity and to refinance certain short-term debt used
4 to fund capital projects. The bonds were issued in August 1998, and in this application, the Company
5 proposed to use its projected December 31, 1998 capital structure for ratemaking purposes. The
6 capital structure consists of 44.96 percent long-term debt at a cost of 7.30 percent, and 55.04 equity at
7 a cost of 11.00 percent, resulting in a weighted cost of capital of 9.33 percent. Staff agreed with the
8 use of this capital structure and composite cost in determining the required rate of return on the
9 Company's original cost rate base. We concur.

10 **VI. AUTHORIZED INCREASE**

11 Applicant's adjusted TY operating income is \$580,374. Multiplying the 9.33 percent rate of
12 return on FVRB produces required operating income of \$1,072,741. This is \$492,367 more than the
13 Company's TY adjusted operating income. Multiplying the deficiency by the revenue conversion
14 factor of 1.6469 results in an increase in revenues of \$810,879, or a 20.08 percent increase over TY
15 revenues.

16 **VII. RATE DESIGN**

17 The Company proposed retaining its current rate design⁴ which is intended to encourage
18 conservation by using a three-tier, inverted rate structure for residential customers, and a two-tier,
19 inverted rate structure for commercial customers. Under the Company's proposal, the revenue
20 increase would be spread evenly among all customer classes. Staff agreed that the current rate design
21 should be retained, and that the increase should be spread evenly among all customer classes. We
22 concur.

23 * * * * *

24 Having considered the entire record herein and being fully advised in the premises, the
25 Commission finds, concludes, and orders that:

26 ...

27
28 ⁴The Company also submitted a cost of service study.

FINDINGS OF FACT

1
2 1. Applicant is an Arizona corporation engaged in the business of providing water for
3 public purposes within portions of Maricopa County, Arizona, pursuant to authority granted by this
4 Commission.

5 2. On August 14, 1998, the Company filed an application with the Commission
6 requesting authority to increase its rates and charges for water service.

7 3. On September 14, 1998, Staff filed a letter indicating that the Company's rate
8 application was sufficient.

9 4. Our September 29, 1998 Procedural Order set this matter for hearing commencing on
10 May 5, 1999, and by subsequent Procedural Order, the hearing was rescheduled for April 29, 1999.

11 5. During the TY ended June 30, 1998, the Company served approximately 4,600
12 customers.

13 6. The OCRB and FVRB for Applicant is \$11,497,759.

14 7. Applicant's adjusted TY income is \$580,374, based upon operating revenues of
15 \$4,038,105, and operating expenses of \$3,457,731.

16 8. A rate of return on FVRB of 9.33 percent is appropriate.

17 9. Operating income of \$1,072,741 is necessary to yield a 9.33 percent rate of return on
18 FVRB.

19 10. Applicant must increase operating revenues by \$810,879 to produce operating income
20 of \$1,072,741.

21 11. On June 28, 1999, Staff filed a Memorandum from the Maricopa County
22 Environmental Service Department indicating that the Company is delivering water that has no
23 maximum contaminant level violations and meets the quality standards of the Safe Drinking Water
24 Act.

25 12. In order to analyze the effects of the Mummy Mountain transaction, the Company
26 should file a rate review at the end of a full operating cycle.

27 13. In order to allow Staff and intervenors an adequate time to review and audit any pro
28 forma plant adjustments in its next rate filing, the Company shall limit its adjustments to include only

1 plant that is used and useful and in service within 90 days of the date that the rate application is
2 deemed sufficient.

3 CONCLUSIONS OF LAW

4 1. Applicant is a public service corporation within the meaning of Article XV of the
5 Arizona Constitution and A.R.S. § 40-201, et seq.

6 2. The Commission has jurisdiction over Applicant and the subject matter of the
7 application.

8 3. Notice of this matter was given in accordance with the law.

9 4. The rates and charges authorized herein for the provision of water service are just and
10 reasonable and should be adopted.

11 ORDER

12 IT IS THEREFORE ORDERED that Paradise Valley Water Company file on or before July
13 30, 1999, the following amended schedule of rates and charges:

14 MONTHLY USAGE CHARGE:

15	5/8" x 3/4" Meter	\$8.41
16	3/4" Meter	8.74
	1" Meter	14.01
17	1 1/2" Meter	28.02
	2" Meter	44.83
18	3" Meter	84.06
19	4" Meter	140.10
	6" Meter	280.20

21 COMMODITY CHARGE - PER 1,000 GALLONS:

22	<u>Residential -</u>	
23	Tier One 0 - 25,000 Gallons	\$0.73
24	Tier Two 25,001 - 80,000 Gallons	1.68
25	Tier Three Over 80,000 Gallons	2.17
26	<u>Commercial -</u>	
	Tier One 0 - 400,000 Gallons	\$1.17
27	Tier Two Over 400,000 Gallons	1.46

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1	Other General Metered (Public Authority, Fire Service, Construction, misc.) -	
2	For All Usage	\$1.32
3	Turf Related Facilities -	
4	For All Usage	\$0.90
5	Other Water Utility (Resale) -	
6	For All Usage	\$1.18
7	Paradise Valley Country Club – Per Contract	
8	For All Usage	\$229.42

CENTRAL ARIZONA PROJECT (CAP) SURCHARGE – PER 1,000 GALLONS:

9	Residential -	
10	For All Usage in excess of 45,000 Gallons per Month	
11	For All Usage	\$0.2124

12	All Non-Residential Customers -	
13	For All Usage	\$0.2124

CAP EXPENSE RECOVERY SURCHARGE – PER CUSTOMER:

14	All Classes of Customers -	
15	Charged in January of each year	\$1.04

PRIVATE FIRE PROTECTION:

16 The greater of \$5.00 or one percent of the minimum charge

SERVICE LINE AND METER INSTALLATION CHARGES:

17	5/8" x 3/4" Meter	\$330.00
18	3/4" Meter	360.00
19	1" Meter	411.00
20	1 1/2" Meter	550.00
21	2" Meter	604.00
22	3" Meter	1,062.00
23	4" Meter	1,806.00
24	6" Meter	3,872.00

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1 SERVICE CHARGE:

2	Establishment	\$20.00
3	Establishment (After Hours)	40.00
	Reconnection (Delinquent)	30.00
4	Reconnection (Delinquent – After Hours)	60.00
	Meter Test (If Correct)	15.00
5	Deposit	*
	Deposit Interest	*
6	Reestablishment (Within 12 Months)	**
7	NSF Check	\$12.00
	Deferred Payment	1.50%
8	Meter Reread (If Correct)	\$10.00
9	Late Payment Penalty	1.50%

10 * Per Commission rule A.A.C. R14-2-403(B).

11 ** Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

12 IT IS FURTHER ORDERED that such amended schedule of rates and charges shall be
 13 effective for all service provided on and after August 1, 1999.

14 IT IS FURTHER ORDERED that Paradise Valley Water Company shall notify its customers
 15 of the revised schedules of rates and charges authorized herein and the effective date thereof in its
 16 next regular monthly billing.

17 IT IS FURTHER ORDERED that Paradise Valley Water Company be authorized to
 18 implement a gallonage surcharge to recover the costs resulting from the use of its Central Arizona
 19 Project allocation as authorized herein.

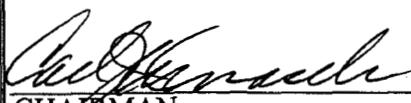
20 IT IS FURTHER ORDERED that in its next rate filing, Paradise Valley Water Company shall
 21 limit any test year proforma rate base adjustments to include only those items that are used and useful
 22 and in service within 90 days of the date that the application is deemed sufficient.

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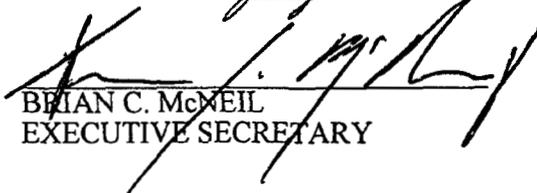
1 IT IS FURTHER ORDERED that Paradise Valley Water Company shall file a rate review at
2 the end of the next full operating cycle to assess the effects of the Mummy Mountain transaction.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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6   
7 CHAIRMAN COMMISSIONER COMMISSIONER
8

9 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
10 Secretary of the Arizona Corporation Commission, have
11 hereunto set my hand and caused the official seal of the
12 Commission to be affixed at the Capitol, in the City of Phoenix,
13 this 20th day of July, 1999.

14 
15 BRIAN C. McNEIL
16 EXECUTIVE SECRETARY

17 DISSENT _____
18 LAF:bbs
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