

EXCEPTION

ORIGINAL OPEN MEETING AGENDA ITEM



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1 Richard L. Sallquist
 Sallquist, Drummond & O'Connor, P.C.
 2 Tempe Office
 4500 S. Lakeshore Drive
 3 Suite 339
 Tempe, Arizona 85282
 4 Phone: (480) 839-5202
 Fax: (480) 345-0412

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AZ CORP COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE APPLICATION)
 OF VALLEY UTILITIES WATER)
 9 COMPANY INC. FOR AN INCREASE IN)
 ITS WATER RATES FOR CUSTOMERS)
 10 WITHIN MARICOPA COUNTY, ARIZONA)

DOCKET NO. W-01412A-04-0736

11 IN THE MATTER OF THE APPLICATION)
 OF VALLEY UTILITIES WATER)
 12 COMPANY, INC. FOR AUTHORITY TO)
 ISSUE PROMISSORY NOTE(S) AND)
 13 OTHER EVIDENCES OF INDEBTEDNESS)
 PAYABLE AT PERIODS OF MORE THAN)
 14 TWELVE MONTHS AFTER THE DATE OF)
 ISSUANCE.)

DOCKET NO. W-01412A-04-0849

APPLICANT'S EXCEPTIONS TO RECOMMENDED OPINION AND ORDER

16 Valley Utilities Water Company, Inc., ("Valley" or the "Company") hereby files
 17 its Exceptions to the Recommended Opinion and Order dated October 25, 2005.

18 The Company Excepts to four areas of the Recommended Opinion and Order.

19 The first is a technical clarification regarding the Arsenic Recovery Surcharge
 20 Mechanism ("ARSM"). The Recommended Order, at Page 26, Lines 23 through 26,
 21 suggests the Company file an "application for approval" of the ARSM. That apparently
 22 was based upon the Staff's recommendation set forth in Mr. Rogers' Direct Testimony at
 23

1 Exhibit S-2, Page 27. Company witness Tom Bourassa restated how the proposed
2 surcharge would work at his Rebuttal Testimony, Exhibit A-3 at Pages 7 through 10.
3 Staff concurred and recommended approval of the ARSM as part of this proceeding at
4 Exhibit S-3 at Page 22.

5 The ARSM would need to be adjusted annually as explained in the above
6 referenced testimony, and a filing with the new surcharge level data would need to be
7 made. The Company is of the opinion that the Recommend Order would better reflect the
8 agreed-upon position of the Staff and the Company, and provide a structure for those
9 filings, if the Recommend Order contained the following language in lieu of the provision
10 on Page 26, Lines 23 to 27:

11 IT IS FURTHER ORDERED that the Arsenic Removal Surcharge Mechanism is
12 hereby granted and that Valley shall file with Docket Control the components of the
13 surcharge on an annual basis commencing 60 days after the WIFA loan closes for the
14 proposed surcharge effective during the ensuing 12 month period. The annual data for
15 each year shall be based upon the 12 month period ending the month in which the WIFA
16 loan closes.

17 The second Exception deals with the Arsenic Operating and Maintenance
18 Recovery Surcharge Mechanism ("AOMRSM", hereinafter the Adjustor). The
19 Company's Closing Brief explained what still appears to be a fact confused by the Staff
20 and Administrative Law Judge. The proposed Adjustor does not seek prior approval of
21 unknown and unmeasurable expenses. It is, in concept, identical to the ARSM.
22 Admittedly, the Company does not know the exact Arsenic Operating and Maintenance
23 Expenses today, just like it does not know the exact principal and interest payment on the
WIFA Loan to be recovered by the ARSM. Mr. Bourassa testified as to the Company's
engineers best estimate of those operating and maintenance expenses, \$216,600. Staff

1 concurred in that estimate. Exhibit S-1, Exhibit MJS-B, Page 2. The actual cost will no
2 doubt be different, but Mr. Bourassa computed a sample surcharge based upon that total
3 estimated cost to be \$.84 per thousand gallons. The Company is requesting that the
4 Commission approve the mechanism, not the \$.84 charge. When the actual costs are
5 known the Company will file the paid invoices for Staff's scrutiny and the Commission's
6 ultimate approval of that surcharge. We envision this as a companion to the ARSM
7 approval which Staff recommends and the Recommended Opinion and Order adopts.

8 This cost recovery is critical to the Company's continued viability. Experiencing
9 anything close to the \$200,000 in the mandated Arsenic Operating and Maintenance
10 expenses puts the Company in real jeopardy. The Company's Opening Brief suggested
11 that if for some reason the Adjustor is not adopted by the Commission, that the Operating
12 Margin of 10% should be substantially increased. That Operating Margin, without the
13 Adjustor, produces approximate \$95,000 in profit. However, when the Arsenic Operating
14 and Maintenance Expenses and the WIFA Interest are considered it produces a \$40,000
15 Net Loss. We believe the Adjustor is the best way to protect the Company and its
16 customers, but if disallowed, substantial additional revenue must be provided. Please
17 recall that the Company withdrew its two-step proposed increase with higher total
18 revenues, when it proposed in the Adjustor as a more appropriate mechanism to recover
19 those costs.

20 The Staff proposed a Test Year Operating Expenses and Operating Income are
21 virtually identical to the Company's. The Company has been diligent in seeking timely
22 rate relief. Therefore, it is obvious that the historic relief granted has not been adequate
23 to maintain the Company's financial health or increase its equity. The Commission

1 should recognize this fact and approve the Adjustor, or a higher Operating Margin, or
2 both.

3 With either adoption of the Adjustor or the increased Operating Margin, the
4 Commission should authorize in this Order the authority of the Company to defer those
5 expenses so that they can be appropriately recovered in future rate proceedings if not
6 previously recovered through the Adjustor. We urge the Commission to approve the
7 AOMRSM surcharge mechanism.

8 This leads to the third area of concern, the mandated increase in equity contained
9 in the Ordering Paragraph at Page 27, Lines 16 through 18. Staff wants a 30% equity
10 ratio in the Company's Balance Sheet. It is submitted that is totally unrealistic.
11 Presumably Staff wants positive equity to assure that the owners are committed to the
12 Company. The owners are committed, and the Company has substantial value. The
13 Company has a negative Common Equity of \$413,375 as shown on Exhibit A-1, Exhibit
14 A, Schedule E-1, Page 1. However, in reality the net value of the Company is
15 substantially higher. The Company has over \$3 million in Advances in Aid of
16 Construction ("AIAC"), and nearly \$300,000 in Contributions in Aid of Construction
17 ("CIAC")¹. Typically, Advances under the 10% /10-year Commission Regulation, are
18 refunded to about 30 to 40% of the total Advance. Therefore, the "contingent liability" of
19 the Advances is about \$1.2 million maximum, leaving approximately \$2 million that will
20 be converted to CIAC. Those Contributions have no repayment obligation so, in effect,
21 they are owned by the Shareholders. That will provide additional equity, real value of the
22

23 ¹ Page 6, Lines 7 through 11 notes that the Arsenic Impact Fees are a Contribution. It should be noted that treatment exacerbates the negative Rate Base issue.

1 Company, of over \$1.5 million.

2 What the Company does not have is a positive Rate Base. That can be increased
3 by only three things, 1) capital infusion, 2) internal earnings, or 3) repayment of
4 Advances. As indicated, refunds could be over \$1 million during the next 10 years. That
5 will increase Rate Base. Mr. Prince testified that he has no additional capital to invest. In
6 fact, in the past he has borrowed against life insurance policies to pay Property Taxes.
7 Even if he had additional investment capital, it would be imprudent to invest equity in a
8 company that would be wiped out by operating losses caused by the Arsenic Operating
9 and Maintenance Expense. That leaves only internally generated funds to increase equity,
10 although it will not increase Rate Base.

11 The Company has explained as completely as it can how the mandated Arsenic
12 Operating and Maintenance Expenses will adversely impact on earnings. We argued in
13 our Closing Brief that if the AOMRSM clause is not approved by the Commission in this
14 Docket, it needs to increase the Operating Margin substantially. We understand and
15 concur with Staff that a positive and substantial Rate Base is desirable. However, with
16 the Commission's appropriate policy of requiring Developers to assume the risk of new
17 development and advance the facilities cost accordingly, Rate Base will not grow.
18 Although Return on Rate Base may be the preferred method of providing profit for
19 utilities, there is nothing improper or unsound about establishing revenue levels based on
20 Operating Margins. This Commission, for years before 1980 when it regulated trucks and
21 railways, set rates for those utilities based solely upon Operating Margins. Even today
22 the Commission uses TIERS and DSC for setting rates for Cooperatives. Rate Base is not
23 sacred. In fact, given the wide range of Rate Base per customer in water and wastewater

1 companies operating in Arizona, Operating Margin may be a more equitable method of
2 compensating utility companies.

3 The Company requests that the Discussion at Page 4, Lines 14 through 18, and the
4 requirement set forth at Page 27, Line 16 through 18, be stricken, because the objective is
5 impossible for the Company to meet.

6 The final exception has to do with the tone of the Recommended Opinion and
7 Order. Only one clause in the Discussion section relates to what Staff believes are
8 inappropriate expenses, but three of the 20 Ordering Paragraphs speak to that. The total
9 Staff disallowances are less than \$15,000 of the over \$800,000 in Operating Expenses.
10 That includes \$1,137 for lawn expense for the office (which incidentally was also the
11 owner's residence during the Test Year), \$590 for long-distance telephone expenses, and
12 about \$12,000 for transportation expenses. This may not appear to be a big item to the
13 Staff or Administrative Law Judge, but the suggested impropriety of the Company by
14 including these expenses, slanders the Company and impugns the reputation of the
15 owners. There is no evidence, or even the suggestion, that these costs were not
16 appropriate or within "market" costs, only that they were not "arms-length". This is
17 improper and conclusionary.

18 Staff apparently does not know the reality of operating a small company when a
19 company does not have sufficient resources to own a separate office, lease a truck in the
20 Company's name, or justify a telephone credit card. Small-company operators must "just
21 do it". There is nothing criminal, improper, or nefarious about it.

22 We have noted that in many recent small rate cases the Staff has attacked the
23 companies and their owners suggesting some great impropriety or "looting" of the

1 Company that is disadvantageous to its ratepayers. These attacks must stop. If an
2 adjustment is needed, they should make it, but they should not damage a company's
3 reputation in the process. If there is a real abuse, it should be dealt with, but in this case
4 approximately 1% of the Operating Expenses (which we believe are all legitimate
5 expenses of the Company) are at issue. This does not justify the Staff's over-reaction or
6 the Recommended Order recognition of that emotion.

7 The Company requests that the Commission remove the clause "to remove a non-
8 arm's length transaction involving a vehicle leased from the shareholders and the
9 inclusion of two years registration fees" from Page 3, Line 23, the sentences at Page 4,
10 Lines 14 to 18, and strike the Ordering Paragraphs at Page 27, Lines 8 through 16, and
11 Lines 20 through 23.

12 The Company respectfully requests that the Commission adopt the above
13 suggested changes to the Recommended Opinion and Order.

14 RESPECTFULLY submitted this 3rd day of November 2005.

15 SALLQUIST, DRUMMOND & O'CONNOR, P.C.

16 By: 

17 Richard L. Sallquist

18 SALLQUIST, DRUMMOND & O'CONNOR, P.C.

19 Tempe Office

20 4500 S. Lakeshore Drive, Suite 339

21 Tempe, AZ 85282

22 Attorneys for Valley Utilities Water Company, Inc.

1 Original and fifteen copies of the
2 foregoing filed this 2nd day
of November 2005.

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 Phoenix, Arizona 85007

7 A copy of the foregoing
8 mailed/hand delivered this
9 2nd day of November 2005, to:

10 Executive Secretary
11 Arizona Corporation Commission
12 1200 West Washington
13 Phoenix, Arizona 85007

14 Utilities Division
15 Arizona Corporation Commission
16 1200 West Washington
17 Phoenix, Arizona 85007

18 Legal Division
19 Arizona Corporation Commission
20 1200 West Washington
21 Phoenix, Arizona 85007

22 Hearing Division
23 Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

K. Robert Janis
13043 W. Sierra Vista Drive
Glendale, Arizona 85307

TCCrownover
James Shade
P.O. Box 363
Litchfield Park Arizona 85340