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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF ARIZONA-AMERICAN
WATER COMPANY - AGUA FRIA DIVISION
SEWER HOOK-UP FEE TARIFF REVISIONS

DOCKET NO. SW-01303A-02-0628

IN THE MATTER OF ARIZONA-AMERICAN
WATER COMPANY - AGUA FRIA DISTRICT -
WATER FACILITIES HOOK-UP FEE TARIFF
REVISIONS

DOCKET NO. W-01303A-02-0629

NOTICE OF FILING
OF STAFF REPORT

I. INTRODUCTION.

Decision No. 65800 granted the Utilities Division Staff's motion to dismiss Arizona-American Water Company's application for approval of hook-up fee tariffs for its Agua Fria District water and wastewater operations. Instead of considering the hook-up fee tariff applications on their own, Decision No. 65800 ordered Staff to review the hook-up fee tariffs in the Company's pending rate case.

This matter comes again before the Commission in the current proceedings to determine whether the Commission's previous order, Decision No. 65800, should be amended pursuant to A.R.S. § 40-252. A July 3, 2003 procedural order requires Staff to file a Staff Report on the issues raised for amendment of Decision No. 65800, with the opportunity for other parties to respond. The procedural order indicates that the Hearing Division will review these filings and determine what proceedings may be necessary in order to make further recommendations to the Commission. This filing is the Staff Report required by the July 3, 2003 procedural order.

In general summary of the discussion below, upon further review Staff believes that setting rates for hook-up fee tariffs does not require a new fair value finding. In several instances, the Commission considers and approves similar matters without making a fair value finding. If,

1 however, the Commission determines a new fair value finding should be made in setting rates for
2 hook-up fee tariffs, then the fair value finding should be made in the context of a rate case.

3 As to the specific matter of Arizona-American application for approval of hook-up fee tariffs,
4 Staff believes the tariffs filed by the Company are appropriate and may be approved by an
5 amendment to Decision No. 65800. However, because the Company has a rate case pending,
6 amendment of Decision No. 65800 to approve the tariffs may be moot. The tariffs can be considered
7 for approval in the context of the pending rate case, as ordered in Decision No. 65800.

8
9 **II. A HOOK-UP FEE TARIFF CAN BE CONSTRUED AS AN EXCEPTION TO A
REQUIRED FAIR VALUE FINDING.**

10 At the center of this matter is the general question of whether the Commission **must** make a
11 fair value rate base finding in the context of reviewing hook-up fee tariffs in order to approve the
12 tariffs. Additional consideration of the issues raised begins with the court opinions in U.S. West
13 Communications, Inc. v. Ariz. Corp. Comm., 201 Ariz. 242, 34 P.3d 351 (2001) (USWest II) and
14 RUCO v. Arizona Corporation Commission, 199 Ariz. 588, 20 P.3d 1169 (App. 2001) (Rio Verde).

15 Staff has previously asserted that USWest II and Rio Verde require a fair value rate base
16 finding when the Commission sets rates. In response, the Company argued reasons why no fair value
17 rate base finding was required by the cited court decisions. The Staff continues to believe that setting
18 hook-up fee charges in Commission-approved tariffs is rate-setting under the Commission's
19 constitutional powers founded in Article 15, Section 3 of the Arizona Constitution. However, upon
20 reconsideration of the Courts' opinions on USWest II and Rio Verde, the Staff acknowledges that
21 hook-up fee tariffs may be considered as an exception to the fair value finding requirement.

22 Whether hook-up fee tariffs are an exception to a required fair value finding is an instance of
23 first impression. Almost all rate-setting requires a fair value finding under the cited opinions, but
24 there are exceptions noted by the Courts. See Rio Verde at 591-92, 20 P.3d at 1172-1173. No
25 language in the cited opinions specifically addresses hook-up fee tariffs, or similar tariff charges like
26 hook-up fees. However, factors exist related to hook-up fee tariffs that result in a logical exception to
27 a required fair value rate base finding for approval of the tariffs.

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1 Funds received by a utility from hook-up fee tariffs are recorded as contributions in aid of
2 construction (CIAC) to the utility. Because the funds from hook-up fee tariffs are treated as CIAC,
3 the utility does not earn a rate of return on hook-up fees. In other words, hook-up fee tariffs are
4 charges that are revenue requirement neutral for the Company, and do not increase or decrease
5 operating income. As discussed in the next section of this report, hook-up fee tariffs do not affect the
6 utility's revenues or expenses. Under these circumstances, it does not appear that a fair value finding
7 by the Commission is required by the Courts in order to approve hook-up fee tariffs.

8 Further, there are certain categories of charges that the Commission has universally treated
9 outside the revenue requirement calculations over the years without controversy or challenge. The
10 most common of these charges are "add-on" charges, such as sales taxes and service line installation
11 charges. The Commission has approved these charges without fair value rate base findings, usually
12 by rule, *See* A.A.C. R14-2-405. The rationale for authorizing these "add-on" charges without a fair
13 value finding rests in their disconnection from utility earnings. Hook-up fees follow this same
14 pattern. Like the above charges, they will not become a part of the of the utility's rate of return. In
15 light of these factors, hook-up fee tariffs can be construed as an exception to a required fair value
16 finding.

17 **III. UTILITY HOOK-UP FEE TARIFFS ARE REVENUE NEUTRAL.**

18 The actual nature and purpose of hook-up fees, as well as their accounting treatment,
19 demonstrates why no fair value finding is required when the Commission sets rates for these tariffs.
20 Hook-up fee receipts do not affect utility revenue in any way. Funds received by a utility from hook-
21 up fee tariffs are like a plant reduction such as in a sale of asset. An example to illustrate this would
22 be a \$100 plant item that is sold on the day it is acquired (to fairly compare it to a hook-up fee that is
23 booked on the day it is received). In the case of the plant sale, a plant account is reduced by \$100 and
24 cash is increased by \$100. The \$100 plant reduction leads to a \$100 net plant reduction and a \$100
25 rate base deduction. The accounting for funds received from hook-up fee tariffs has the same effect:
26 a \$100 hook-up fee is received, CIAC is increased by \$100 and cash is increased by \$100. The \$100
27 CIAC increase then leads to a \$100 rate base reduction because it is a deduction from rate base. The
28

1 Commission does not make a fair value finding every time it rules on an asset sale, and likewise a fair
2 value finding should not be required on accounting entries that are substantially the same.

3 Hook-up fees, being booked as CIAC, are also similar to main or line extension agreements
4 ("MXAs") booked as advances in aid of construction ("AIAC"). AIAC results from advances of
5 plant or funds to build plant that is required before end-use customers are served. These advances are
6 memorialized in MXAs. The relevant difference between a hook-up fee as a CIAC and an MXA
7 booked as an AIAC, is that the hook-up fee is set forth in a tariff and an MXA is negotiated between
8 the utility and a developer. No fair value finding is made when a MXA is reviewed by Staff, none
9 should be required for approval of hook-up fees which serve a similar purpose.

10 There is another comparison that is helpful in understanding the underlying basis for hook-up
11 fee tariffs. Hook-up fees can be considered a tariffed investment by customers in the utility's system,
12 similar to a financing. Therefore, they may be treated like a financing, which does not require a fair
13 value finding by the Commission for approval.

14 **IV. THE COMMISSION HAS BROAD DISCRETION TO DETERMINE IF A FAIR**
15 **VALUE FINDING IS REQUIRED IN ORDER TO APPROVE A SPECIFIC HOOK-**
16 **UP FEE TARIFF.**

17 An important point should be noted concerning the Commission's discretion in rate setting
18 matters, including setting rates for hook-up fee tariffs. Although a fair value finding may not be
19 mandated, Staff believes it is within the Commission's **discretion** as to whether a specific application
20 for approval of a hook-up fee tariff filing should be considered and approved without a fair value rate
21 base finding. See Simms v. Round Valley Light and Power Co., 80 Ariz. 145, 154, 294 P.2d 378,
22 384 (1956) (Commission has broad discretion in rate setting). Individual applications may require
23 different review processes depending on the specific situation in which the application is made.

24 In some cases, like the present instance, there is a contemporaneous rate case pending, with a
25 procedural schedule in place for testimony and hearing. Under these circumstances, the Commission
26 may find in its discretion that it is appropriate to review all tariffs and charges in the context of the
27 rate case. Similarly, if a public service corporation has not filed a rate case in the last decade, for
28 example, the Commission may decide that the filing of any tariff, including a hook-up fee tariff,
requires a rate case filing for appropriate consideration. On the other hand, because it appears that a

1 fair value rate base finding is not mandated and the tariff will have no effect on a company's revenue
2 requirement, the Commission could in its discretion approve a hook-up fee tariff without a new rate
3 case fair value finding.

4 **V. THE COMMISSION IN ITS DISCRETION MAY FIND THAT FAIR VALUE FOR**
5 **PURPOSES OF CONSIDERING A HOOK-UP FEE TARIFF IS THE FAIR VALUE**
6 **ESTABLISHED IN THE COMPANY'S LAST RATE CASE.**

7 There is another alternative for setting rates for hook-up fee tariffs that complies with the
8 cited court opinions. The Commission in its discretion may find that for purposes of setting a rate
9 for a hook-up fee tariff, the fair value finding is as established in the Company's last rate case.
10 Because of the hook-up fee's nature, purpose and accounting treatment, the Company's most recent
11 fair value rate base may be used as the fair value finding in the Commission's consideration of the
12 application for approval of a hook-up fee tariff. The Staff Report in an individual application could
13 make a recommendation to the Commission to use the existing fair value finding from the last rate
14 case, when Staff's review indicates that a new rate case with a new fair value finding is not necessary
15 for its analysis of the appropriateness of the proposed hook-up fee tariff. This would be the
16 circumstance when the fair value finding from the last rate case continues to be representative of the
17 Company's current situation.

18 This approach to setting rates for hook-up fee tariffs is not a case of first impression, unlike
19 the situation for considering hook-up fee tariffs as an exception for finding fair value. It is long and
20 well established that the Commission has broad discretion in rate setting, including the manner in
21 which it determines and uses a fair value finding. Simms, 80 Ariz. at 154, 294 P.2d at 384; Morris v.
22 Arizona Corporation Commission, 24 Ariz.App. 454, 457, 539 P.2d 928, 931 (1975); Ariz. Corp.
23 Comm. v. State ex rel Woods, 171 Ariz. 286, 830 P.2d 807 (1992). Nothing in the Arizona
24 Constitution or case law prohibits the Commission from finding that for purposes of its consideration
25 of a specific hook-up fee tariff application, the existing fair value rate base found in the utility's most
26 recent rate case is the appropriate fair value finding for setting the rate for the tariff.

26 **VI. STAFF'S RECOMMENDATIONS.**

27 Staff analyzed Arizona-American's applications for approval of hook-up fee tariffs in the
28 Agua Fria District and prepared a Memorandum dated December 20, 2002, which was previously

1 docketed in these cases as "Exhibit A" (attached). Staff found the charges proposed by the Company
2 acceptable, and believed (and presently believes) that the hook-up fee tariffs as filed are appropriate
3 for approval by the Commission. See "Exhibit A."

4 In this instance, there is also a pending rate case for Arizona-American with the Staff filing of
5 testimony set by procedural order for September 5, 2003. The September 5, 2003 filing will likely
6 include Staff's analysis of the hook-up fee tariffs as reflected in Staff's December 2, 2002
7 Memorandum. Therefore, whether Decision No. 65800 should be amended is more or less moot,
8 because in any event, the Staff's position is that the company's proposed hook-up fee tariffs are
9 acceptable and should be approved.

10 However, Staff recognizes that these issues will arise again in the future with the filing of
11 other hook-up fee tariffs by public service corporations. From a practical point of reference, Staff is
12 able to analyze the filings and make an appropriate recommendation without a new fair value finding.
13 However, if it is determined by the Commission that hook-up fees tariffs should be considered with a
14 new fair value finding, Staff does not recommend that such a finding be made outside of a rate case.
15 For monopoly water and wastewater public service corporations, fair value rate base findings are
16 most meaningful in the context of a rate case review of a company's operations and rates, as
17 contrasted with the limited usefulness of fair value rate base findings for rate-setting in a competitive
18 environment.

19 **VII. CONCLUSION.**

20 In general, hook-up fees serve a beneficial purpose for existing water and wastewater utility
21 customers. As was discussed at Open Meeting in this matter, hook-up fees set with appropriate
22 charges result in growth paying for growth. Thus, existing customers are not saddled with the burden
23 of supporting infrastructure that supports utility growth to accommodate new customers.

24 Therefore, Staff recommends approval of Arizona-American's hook-up fee tariffs, but
25 believes either venue for approval (amending Decision No. 65800 or review in the pending rate case)

26 ...
27 ...
28 ...

1 accomplishes the same goal of getting appropriate hook-up fee tariffs in place for the Company.

2 **RESPECTFULLY SUBMITTED** this 8th day of August, 2003.

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4 

5 Janice Alward
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11 The original and 15 copies
12 of the foregoing filed this
13 8th day of August, 2003 with:

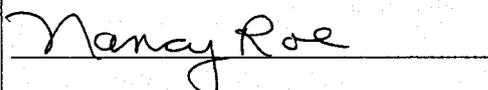
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MEMORANDUM

December 20, 2002

TO: File

FROM: John A. Chelus
Utilities Engineer

RE: ARIZONA-AMERICAN WATER COMPANY – AGUA FRIA DISTRICT FACILITIES
HOOK-UP FEE TARIFF REVISIONS DOCKET NO. W-01303A-02-0628 (SEWER)
AND DOCKET NO. W-01303A-02-0629 (WATER)

Arizona-American filed revised tariffs for their Agua Fria District water and wastewater facilities hook-up fees on August 16, 2002. The facilities hookup fees are identical to the ones already approved by Decision No. 64307 dated December 28, 2001 for the "Whitestone" Certificate of Convenience and Necessity (CC&N). The revisions in these applications will extend the same tariffs to other areas of the Agua Fria District in Maricopa County.

The fees were developed based on typical construction costs for backbone plant in the Agua Fria District. The water hook-up fees are based on meter size. The wastewater hook-up fees are based on equivalent residential units (ERU). The fees will recover a portion of the costs associated with the construction of the backbone plant.

The hook-up fees for water can be used for offsite facilities such as treatment facilities, wells, transmission lines, storage tanks pressure tanks, booster pumps and related appurtenances necessary for proper operation which provide regional or system wide benefits.

The hook-up fees for wastewater can be used for treatment facilities, effluent disposal equipment, sludge disposal equipment, lift stations, force mains, collection mains and appurtenances necessary for proper operation which provide regional or system wide benefits.

Engineering has reviewed the proposed revisions and finds them acceptable as submitted by AZ-American.

