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MEMORANDUM

AZ CORP COMMISSION
DOCUMENT CONTROL

TO: THE COMMISSION

FROM: Utilities Division

DATE: June 8, 2006

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY FOR APPROVAL OF TARIFF REVISIONS TO IMPLEMENT A HOOK-UP FEE IN ITS ANTHEM WATER DISTRICT (DOCKET NO. W-01303A-06-0284)

On April 26, 2006, Arizona-American Water Company ("Arizona-American" or "the Company") filed an application for approval of tariff revisions to implement a hook-up fee that would apply to new connections in its Anthem Water District. On May 8, 2006, the Company filed a letter agreeing to waive the 30-day time clock to allow Staff time to complete its review of the filing. The Anthem Water District serves the Community of Anthem which is located north of Phoenix and adjacent to Interstate 17 in Maricopa County. As of April 30, 2006, there were a total of approximately 7,200 water connections in the Anthem Water District. The Company expects to add approximately another 2,100 connections by the end of 2007 at which time the area served will be almost fully developed.¹

Arizona-American modeled its proposed Water Facilities Hook-up Fee tariff for the Anthem Water District after a hook-up fee tariff that is in effect for the Company's Agua Fria Water District. The proposed fees, which are significantly higher than those approved for Agua Fria, would start at \$3,000 for a 5/8- x 3/4-inch water meter and increase volumetrically.² Arizona-American is asking to implement a hook-up fee for the Anthem Water District to reduce the need for future rate relief. Since funds collected from the hook-up fees are treated as contributions for rate making purposes these funds directly offset rate base. The Company's current rates are based on a 2001 test year rate base of \$9,269,095. Later this year, Arizona-American expects to file for an approximate 44 percent water rate increase which would be based on a 2005 test year rate base of over \$31 million. The Company expects this rate base number to exceed \$72 million by the end of 2008. This later increase in rate base is due in large part to the Company's need to make major refunds of advances paid by the developer for prior plant construction. While the proposed hook-up fees will not reduce the revenue requirement for the pending case, the Company believes the proposed fees will help mitigate potential rate increases in subsequent cases.

The purpose of hook-up fees is to equitably apportion the costs of constructing additional off-site facilities to provide water production, delivery, storage and pressure among new service

¹ Arizona-American provided the following forecast for new connections in the Anthem Water District: 1065 (2006), 1014 (2007), 17 (2008), 16 (2009) and 15 (2010).

² Rates approved for the Agua Fria District start at \$1,150 for a 5/8- x 3/4-inch meter and increase volumetrically.

connections. "Off-site Facilities" means wells, storage tanks and related appurtenances necessary for proper operation, including engineering and design costs. Offsite facilities may also include booster pumps, pressure tanks, transmission mains and related appurtenances necessary for proper operation if these facilities are not for the exclusive use of only one applicant and will benefit the entire water system. The determination of a reasonable hook-up fee amount is based on the off-site plant that will be needed to meet future growth divided by the ultimate number of connections that can be served by the required plant. In the case of the Anthem Water District most of the plant that will be needed to serve customers has already been constructed with full development expected by the end of 2007.³ The large increase in rate base in the next three years is related to the need to make major refunds of advances for plant that has already been constructed.⁴ Staff recommends that Arizona-American's application to implement a hook-up fee tariff applicable to the Anthem Water District be denied for the following reasons:

- The Company's tariff is not designed to recover the costs of future off-site plant needed to meet growth. The fee amounts were not based on future off-site plant additions or its capacity.
- The additional revenue collected from the proposed hook-up fees would have limited impact and would not eliminate the need for future rate relief. Assuming the proposed fees were implemented on July 1, 2006, Staff estimates that the Company would collect \$9.4 million in fees through the end of 2008. This amount offsets only about 15 percent of the \$63 million rate base increase expected over the next three years.
- A Capacity Reservation Charge ("CRC") of \$765 per Equivalent Residential Unit⁵ is currently applied to all new connections. The CRC is similar to hook-up fees in that as the name implies the charge covers the cost of facilities needed to serve new growth. If the hook-up fees as proposed by the Company were implemented, Staff is concerned that new customers would feel they are being charged twice for the same facilities.

In the event the Commission decides that additional charges similar to those proposed in this filing are appropriate to help mitigate the need for future rate increases, Staff recommends that they not be referred to as hook-up fees. Staff suggests that name and tariff descriptions be used that are less confusing and misleading. An appropriate name for such a tariff might be "Rate Base Reduction Tariff". Attached is the Rate Base Reduction Tariff that the Commission could approve in lieu of the proposed Water Facilities Hook-Up Fee. In addition, if the

³ According to the Company, new connections and plant additions are expected to be minimal after 2007.

⁴ The Company expects to add \$6.4 million in new plant in the next three years.

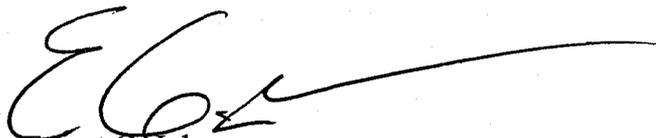
⁵ Equivalent Residential Unit ("ERU") is that portion of a residential or commercial unit that uses an equivalent amount of water as a typical single-family home. ERUs for various facilities (i.e., apartments, commercial uses, schools, parks, etc.) are listed in the tariff.

THE COMMISSION

June 8, 2006

Page 3

Commission approves the Rate Base Reduction Tariff, the Commission should require Arizona-American to submit an annual report to Docket Control that lists the entities that have paid the tariff and how much they have paid. The report should be filed each July beginning in July, 2007, and should cover the previous 12 months.

A handwritten signature in black ink, appearing to read 'EGJ', with a long horizontal line extending to the right.

Ernest G. Johnson

Director

Utilities Division

ORIGINATOR: Del Smith

EGJ:DWS:lhmdr

ANTHEM WATER DISTRICT

Rate Base Reduction Tariff

Applicability

Applicable to all new potable water Service Connections within the Company's CC&N.

Definitions

Unless the context otherwise requires, the definitions set forth in Rule No. 1 shall apply in interpreting this tariff schedule. The following additional definitions apply to this tariff schedule only.

“Main Extension Agreement” means any agreement whereby an Applicant agrees to advance the costs of the installation of on-site water facilities (including distribution mains, valves, fittings, hydrants and other improvements in accordance with Rule No. 5) to the Company to serve new service connections, or install on-site water facilities to serve new service connections and transfer ownership of such water facilities to the Company, which agreement shall require the approval of the Arizona Corporation Commission (same as line extension agreement).

“Service Connection” means and includes all service connections for residential, commercial, industrial, or other uses, regardless of meter size.

ISSUED _____

EFFECTIVE: _____

ISSUED BY: Thomas Broderick, Rates and Regulatory Affairs Manager
19820 N. 7th St. Suite 201, Phoenix, Arizona 85024

ANTHEM WATER DISTRICT

Rate Base Reduction Tariff (Continued)

Rates

Each new service connection shall pay the Rate Base Reduction Charge indicated below based on the meter size to be installed:

Rate Base Reduction Charge		
Meter Size	Factor	Total Charge
5/8" x 3/4"	1.0	\$3,000.00
3/4"	1.5	\$4,500.00
1	2.5	\$7,500.00
1 1/2"	5.0	\$15,000.00
2	8.0	\$24,000.00
3	16.0	\$48,000.00
4	25.0	\$75,000.00
6	50.0	\$150,000.00
8	100.0	\$300,000.00

Special Conditions

1. **Assessment of One Time Charge:** This charge may be assessed only once per Service Connection, or residential lot within a platted subdivision (similar to meter and service line installation charges). However, this provision does not exempt from this charge, any newly created parcel(s) resulting from further subdivision of a lot or land parcel and which do not have a Service Connection.
2. **Time of Payment:**
 - a. In the event that the Applicant is required to enter into a Main Extension Agreement, payment of the charges required hereunder shall be made to the Applicant when operational acceptance is issued for the on-site water facilities constructed to serve the improvement.
 - b. In the event that the Applicant is not required to enter into a main extension agreement, the charges hereunder shall be due and payable at the time the service line and meter installation charge is due and payable.

ISSUED _____

EFFECTIVE: _____

ISSUED BY: Thomas Broderick, Rates and Regulatory Affairs Manager
19820 N. 7th St. Suite 201, Phoenix, Arizona 85024

ANTHEM WATER DISTRICT

Rate Base Reduction Tariff (Continued)

3. Failure to Pay Charges: Delinquent Payments: Under no circumstances will the Company set a meter or otherwise allow service to be established if the Applicant has not paid in full all charges as provided by this Rate Base Reduction Tariff.
4. Rate Base Reduction Tariff: This charge shall be in addition to any costs associated with a main extension agreement for on-site facilities, and are in addition to the amounts to be paid pursuant to charges authorized under other tariffs or other agreements.
5. Use of and accounting for Rate Base Reduction Tariff: Proceeds from this charge shall be accounted for as a contribution in aid of construction. As such, they will be treated as an offset to rate base in any future ratemaking proceeding. The Company shall maintain on its books an accounting of the charges collected pursuant to this tariff.

ISSUED _____

EFFECTIVE: _____

ISSUED BY: Thomas Broderick, Rates and Regulatory Affairs Manager
19820 N. 7th St. Suite 201, Phoenix, Arizona 85024

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BEFORE THE ARIZONA CORPORATION COMMISSION

- JEFF HATCH-MILLER
Chairman
- WILLIAM A. MUNDELL
Commissioner
- MARC SPITZER
Commissioner
- MIKE GLEASON
Commissioner
- KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION
 OF ARIZONA-AMERICAN WATER
 COMPANY FOR APPROVAL OF TARIFF
 REVISIONS TO IMPLEMENT A HOOK-UP
 FEE IN ITS ANTHEM WATER DISTRICT

DOCKET NO. W-01303A-06-0284
 DECISION NO. _____
ORDER

Open Meeting
 June 27 and 28, 2006
 Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona-American Water Company ("Arizona-American" or "the Company") is certificated to provide water service as a public service corporation in the State of Arizona.
 2. On April 26, 2006, Arizona-American Water Company ("Arizona-American" or "the Company") filed an application for approval of tariff revisions to implement a hook-up fee that would apply to new connections in its Anthem Water District.
 3. On May 8, 2006, the Company filed a letter agreeing to waive the 30-day time clock to allow Staff time to complete its review of the filing.
 4. The Anthem Water District serves the Community of Anthem which is located north of Phoenix and adjacent to Interstate 17 in Maricopa County. As of April 30, 2006, there were a total of approximately 7,200 water connections in the Anthem Water District. The
- ...
- ...

1 Company expects to add approximately another 2,100 connections by the end of 2007 at which
2 time the area served will be almost fully developed.¹

3 5. Arizona-American modeled its proposed Water Facilities Hook-up Fee tariff for the
4 Anthem Water District after a hook-up fee tariff that is in effect for the Company's Agua Fria
5 Water District. The proposed fees, which are significantly higher than those approved for Agua
6 Fria, would start at \$3,000 for a 5/8- x 3/4-inch water meter and increase volumetrically.²
7 Arizona-American is asking to implement a hook-up fee for the Anthem Water District to reduce
8 the need for future rate relief. Since funds collected from the hook-up fees are treated as
9 contributions for rate making purposes these funds directly offset rate base. The Company's
10 current rates are based on a 2001 test year rate base of \$9,269,095. Later this year, Arizona-
11 American expects to file for an approximate 44 percent water rate increase which would be based
12 on a 2005 test year rate base of over \$31 million. The Company expects this rate base number to
13 exceed \$72 million by the end of 2008. This later increase in rate base is due in large part to the
14 Company's need to make major refunds of advances paid by the developer for prior plant
15 construction. While the proposed hook-up fees will not reduce the revenue requirement for the
16 pending case, the Company believes the proposed fees will help mitigate potential rate increases in
17 subsequent cases.

18 6. The purpose of hook-up fees is to equitably apportion the costs of constructing
19 additional off-site facilities to provide water production, delivery, storage and pressure among new
20 service connections. "Off-site Facilities" means wells, storage tanks and related appurtenances
21 necessary for proper operation, including engineering and design costs. Offsite facilities may also
22 include booster pumps, pressure tanks, transmission mains and related appurtenances necessary for
23 proper operation if these facilities are not for the exclusive use of only one applicant and will
24 benefit the entire water system. The determination of a reasonable hook-up fee amount is based on
25 the off-site plant that will be needed to meet future growth divided by the ultimate number of
26 connections that can be served by the required plant. In the case of the Anthem Water District,

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28 1014 (2007), 17 (2008), 16 (2009) and 15 (2010).

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1 most of the plant that will be needed to serve customers has already been constructed with full
2 development expected by the end of 2007.³ The large increase in rate base in the next three years
3 is related to the need to make major refunds of advances for plant that has already been
4 constructed.⁴

5 7. Staff has recommended that Arizona-American's application to implement a hook-up
6 fee tariff applicable to the Anthem Water District be denied for the following reasons:

- 7 • The Company's tariff is not designed to recover the costs of future off-site plant
8 needed to meet growth. The fee amounts were not based on future off-site plant
9 additions or its capacity.
- 10 • The additional revenue collected from the proposed hook-up fees would have
11 limited impact and would not eliminate the need for future rate relief. Assuming
12 the proposed fees were implemented on July 1, 2006, Staff estimates that the
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15 next three years.
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19 growth. If the hook-up fees as proposed by the Company were implemented, Staff
20 is concerned that new customers would feel they are being charged twice for the
21 same facilities.

22 8. In the event the Commission decided that additional charges similar to those
23 proposed in this filing were appropriate to help mitigate the need for future rate increases, Staff has
24 recommended that they not be referred to as hook-up fees. Staff has suggested that name and tariff
25 descriptions be used that are less confusing and misleading. An appropriate name for such a tariff
26 might be "Rate Base Reduction Tariff". Attached in Staff's Memorandum is the Rate Base
27 Reduction Tariff that Staff has suggested the Commission approve in lieu of the proposed Water
28 Facilities Hook-Up Fee.

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ORDER

IT IS THEREFORE ORDERED that the tariff filing be and hereby is denied.

IT IS FURTHER ORDERED that this decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2006.

BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:DWS:lh\DR

1 SERVICE LIST FOR: Arizona-American Water Company
2 DOCKET NO.W-01303A-05-0588

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4 Manager, Government & Regulatory Affairs
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9 Mr. Craig A. Marks
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15 Mr. Ernest G. Johnson
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19 Phoenix, Arizona 85007

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