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OPEN MEETING

ORIGINAL

MEMORANDUM

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TO: THE COMMISSION

2006 MAY 11 P 4: 06

FROM: Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: May 11, 2006

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR AUTHORITY TO IMPLEMENT AN ARSENIC COST RECOVERY MECHANISM FOR ITS HAVASU WATER DISTRICT (DOCKET NOS. W-01303A-05-0280, WS-01303A-02-0867, WS-01303A-02-0869, AND WS-01303A-02-0870)

Introduction

On April 4, 2006, Arizona American Water Company ("Company" or "Applicant") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to implement Step One of the Arsenic Cost Recovery Mechanism ("ACRM") authorized under Decision No. 68310, dated November 14, 2005.

The average residential customer bill would increase by approximately \$12.30 from \$25.53 to \$37.83 (48.2 percent) under the Company's proposed Step One filing.

Background

On January 23, 2001, the Environmental Protection Agency ("EPA") reduced the drinking water maximum contaminant level of arsenic from 50 parts per billion ("ppb") to 10 ppb. All community water systems and non-transient non-community water systems needed to comply with the new federal rule by the January 23, 2006 deadline.

On November 22 and December 13, 2002, the Company filed applications with the Commission for fair value determinations of its utility plant and for permanent rate increases for five of its districts (Sun City West Water and Wastewater, Sun City Water and Wastewater, Havasu and Mohave Water, Agua Fria Water and Wastewater, and Tubac Water). On June 30, 2004, the Commission issued Decision No. 67093 establishing permanent rates for these five districts.

On February 15, 2005, the Commission issued Decision No. 67593 granting the Company's request to reopen the record in Decision No. 67093 for the limited purpose of serving as evidentiary basis for future ACRM filings for the affected Arizona-American water districts.

By Procedural Order issued March 29, 2005, Arizona-American was directed to file a new application indicating the relief sought regarding the ACRM, and to consolidate the new

application with those existing dockets from Decision No. 67093 that would be affected by the specific relief request in its filing.

On April 15, 2005, the Company filed the above captioned application (Docket No. W-01303A-05-0280) for authority to implement ACRMs for its Agua Fria Water, Sun City West Water, Havasu Water, and Tubac Water Districts.

On May 4, 2005, the Company filed a Motion to Delete the Tubac Water District from its application.

By Procedural Order issued May 6, 2005, the Company's request to delete the Tubac Water District from its application was approved.

On November 14, 2005, the Commission issued Decision No. 68310 granting Arizona-American Water Company's application for authority to implement an Arsenic Cost Recovery Mechanism and a Havasu District Arsenic Impact Fee Tariff subject to the terms and conditions contained in that Decision.

On April 4, 2006, Arizona-American Water Company, Inc. filed an application with the Commission requesting authorization to implement Step One of the ACRM.

Decision No. 68310

Decision No. 68310 conditioned approval of an ACRM surcharge on the following criteria:

1. Arizona-American shall comply with all requirements discussed in this Order as a condition of approval of the Arsenic Cost Recovery Mechanism.
2. Arizona-American shall file a plan with Docket Control by December 31, 2005 that describes how the Company expects to attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60 percent of total capital.
3. Arizona-American shall file, by April 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with the Utilities Division Director showing the Company's ending capital structure by month for the prior year.
4. Arizona-American shall modify the rate base calculation for the Havasu Water District to explicitly show a deduction for Arsenic Impact Fee collections.
5. That as part of the Earnings Test schedule filed in support of the ACRM, Arizona-American shall incorporate adjustments conforming to Decision No. 67093.

6. Arizona-American shall file the schedules discussed in its application, as modified by Staff's recommendations herein. Microsoft Excel or compatible electronic versions of the filings and all work papers should be filed concurrently with all ACRM filings.
7. Arizona-American shall file permanent rate applications for its Sun City West, Agua Fria, and Havasu districts by no later than April 30, 2008, based on a 2007 test year.
8. For the Havasu District, Arizona-American shall file with Docket Control by January 31st of each year, an annual calendar year status report, until the AIF Tariff is no longer in effect. The status report shall contain a list of all customers that have paid the AIF, the amount each customer has paid, the amount of money spent from the AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.
9. Arizona-American shall file the schedules and information described above, as well as any additional relevant data requested by Staff, as part of any request for an Arsenic Cost Recovery Mechanism step increase.
10. Staff and the Company open a new proceeding to examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems due to the Commission's concern about the impact on the bills of customers served by the Havasu system from the implementation of the ACRM.

Decision No. 68310 Compliance

Staff performed an examination of the ARCM filing and concluded that it conforms to the requirements specified in Decision No. 68310.

The Applicant's ARCM filing includes the following schedules that conform to the methodologies required by Decision No. 66400 and adopted by Decision No. 68310.

1. Balance Sheet – dated December 31, 2005
2. Income Statement – period ending December 31, 2005.
3. Income Statement Adjustments (Earnings Test) – to conform to Decision No. 67093.
4. Rate Review – a rate review filing for the Havasu Water District.
5. Arsenic Revenue Requirement – an arsenic revenue requirement calculation for Step One.

6. Surcharge Calculation – a detailed surcharge calculation.
7. Rate Base – a schedule showing the elements and the calculation of the rate base, including the deduction for Arsenic Impact Fee Contributions dated April 1, 2006.
8. Construction Work In Progress (“CWIP”) Ledger – a ledger showing the construction work in progress account.
9. 4-Factor Allocation for December 2005 – a schedule showing the allocation factors for all of the Arizona-American Districts.
10. Typical Bill Analysis – ACRM Step-1 – A typical bill analysis showing the effects on residential customers at various consumption levels including the Average Residential use of 10,140 gallons.

The ACRM schedules provide a basis for the calculation of a surcharge based on financial records and an Earnings Test Schedule that limit the ACRM surcharge to a rate that would not result in a rate of return exceeding that authorized in Decision No. 67093.

The Applicant filed a plan with Docket Control, on November 30, 2005, that describes how it expects to attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60 percent of total capital.

The Applicant docketed its annual AIF compliance report, on February 2, 2006, for the Havasu District containing a list of all customers that have paid the AIF, the amount each customer has paid, the amount of money spent from the AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.

Docket No. W-01303A-05-0890 is addressing potential forms of mitigation for the Commission’s concern about the impact on the bills of customers served by the Havasu system from the implementation of the ACRM.

Staff Adjustments to Applicant Schedules

Staff adjusted the calculation of the debt and equity rates applied to the CWIP Ledger to conform with Decision No. 67093. The adjustment reduced Arsenic Treatment Plant by \$26,968. The Applicant’s other schedules required conforming changes.

Staff’s adjustment reduced the ACRM revenue requirement by \$3,782 from \$272,294 to \$268,512.

Staff’s adjustment results in a monthly minimum surcharge of \$5.76 and commodity surcharge of \$0.6453 per 1,000 gallons.

Staff's adjustment reduced the average monthly residential customer bill by \$0.18 from \$38.01 to \$37.83.

Conclusion and Recommendations

Staff concludes that the Company's Step-One ACRM filing for its Havasu Water District, as adjusted, is complete and in accordance with Decision No. 68310.

Staff recommends that the Company file, with Docket Control as a compliance item, an arsenic removal surcharge tariff consistent with ACRM Schedule DRR-1.

Staff recommends that the third condition listed for Decision No. 68310 be modified such that the Company file, by April 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with Docket Control (instead of the Utilities Division Director) as a compliance item showing the Company's ending capital structure by month for the prior year.

Staff recommends that Arizona-American Havasu Water District notify its customers of the arsenic cost recovery surcharge tariff approved herein within 30 days of the effective date of this Decision.

Staff recommends that in the event that the Applicant fails to file a permanent rate application for its Havasu Water system by April 30, 2008 based on a 2007 test year as required by Decision No. 66310, the Arsenic Cost Recovery Mechanism surcharge then in place shall be automatically discontinued.



Ernest G. Johnson
Director
Utilities Division

EGJ:DRR:lh\JG

Originator: Dennis R. Rogers

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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 ARIZON-AMERICAN WATER
 COMPANY, AN ARIZONA
 CORPORATION, FOR AUTHORITY TO
 IMPLEMENT AN ARSENIC COST
 RECOVERY MECHANISM FOR ITS
 HAVASU WATER DISTRICT

DOCKET NOS. W-01303A-05-0280
 WS-01303A-02-0867
 WS-01303A-02-0869
 WS-01303A-02-0870

DECISION NO. _____

ORDER

Open Meeting
 May 31-June 1, 2006
 Phoenix, Arizona

BY THE COMMISSION:

INTRODUCTION

Pursuant to Decision No. 68310, Arizona American Water Company ("Company", "Applicant" or "Arizona-American") filed an application on April 4, 2006, with the Arizona Corporation Commission ("Commission") requesting authorization to implement Step One of the Arsenic Cost Recovery Mechanism ("ACRM"). The average residential customer bill will increase by approximately \$12.48 from \$25.53 to \$38.01 (48.9 percent).

On January 23, 2001, the Environmental Protection Agency ("EPA") reduced the drinking water maximum contaminant level of arsenic from 50 parts per billion ("ppb") to 10 ppb. All community water systems and non-transient non-community water systems needed to comply with the new federal rule by the January 23, 2006 deadline.

On November 22 and December 13, 2002, the Company filed applications with the Commission for fair value determinations of its utility plant and for permanent rate increases for five of its districts (Sun City West Water and Wastewater, Sun City Water and Wastewater,

1 Havasu and Mohave Water, Agua Fria Water and Wastewater, and Tubac Water). On June 30,
2 2004, the Commission issued Decision No. 67093 establishing permanent rate increases for these
3 five districts.

4 On February 15, 2005, the Commission issued Decision No. 67593 granting the
5 Company's request to reopen the record in Decision No. 67093 for the limited purpose of serving
6 as evidentiary basis for future ACRM filings for the affected Arizona-American water districts.

7 By Procedural Order issued March 29, 2005, Arizona-American was directed to file a new
8 application indicating the relief sought regarding the ACRM, and to consolidate the new
9 application with those existing dockets from Decision No. 67093 that would be affected by the
10 specific relief request in its filing.

11 On April 15, 2005, the Company filed the above captioned application (Docket No.
12 W-01303A-05-0280) for authority to implement ACRMs for its Agua Fria Water, Sun City West
13 Water, Havasu Water, and Tubac Water Districts.

14 On May 4, 2005, the Company filed a Motion to Delete the Tubac Water District from its
15 application.

16 By Procedural Order issued May 6, 2005, the Company's request to delete the Tubac Water
17 District from its application was approved.

18 On November 14, 2005, the Commission issued Decision No. 68310 granting Arizona-
19 American Water Company's application for authority to implement an Arsenic Cost Recovery
20 Mechanism and a Havasu District Arsenic Impact Fee Tariff subject to the terms and conditions
21 contained in the Decision.

22
23 **Requirements of Decision No. 68310 for approval of the Arsenic Cost Recovery Mechanism**

- 24 1. Arizona-American shall comply with all requirements discussed in this Order as a
25 condition of approval of the Arsenic Cost Recovery Mechanism.
- 26 2. Arizona-American shall file a plan with Docket Control by December 31, 2005, that
27 describes how the Company expects to attain and maintain a capital structure (equity,
28 long-term debt, and short-term debt) with equity representing between 40 and 60
percent of total capital.

- 1 3. Arizona-American shall file, by April 1st of each year subsequent to any year in
2 which it collects surcharges under an ACRM, a report with the Utilities Division
3 Director showing the Company's ending capital structure by month for the prior year.
- 4 4. Arizona-American shall modify the rate base calculation for the Havasu Water
5 District to explicitly show a deduction for Arsenic Impact Fee collections.
- 6 5. That as part of the Earnings Test schedule filed in support of the ACRM, Arizona-
7 American shall incorporate adjustments conforming to Decision No. 67093.
- 8 6. Arizona-American shall file the schedules discussed in its application, as modified by
9 Staff's recommendations herein. Microsoft Excel or compatible electronic versions
10 of the filings and all work papers should be filed concurrently with all ACRM filings.
- 11 7. Arizona-American shall file permanent rate applications for its Sun City West, Agua
12 Fria, and Havasu districts by no later than April 30, 2008, based on a 2007 test year.
- 13 8. For the Havasu District, Arizona-American shall file with Docket Control by January
14 31st of each year, an annual calendar year status report, until the AIF Tariff is no
15 longer in effect. The status report shall contain a list of all customers that have paid
16 the AIF, the amount each customer has paid, the amount of money spent from the
17 AIF, and a list of all facilities that have been installed with funds from the AIF Tariff.
- 18 9. Arizona-American shall file the schedules and information described above, as well
19 as any additional relevant data requested by Staff, as part of any request for an
20 Arsenic Cost Recovery Mechanism step increase.
- 21 10. The Commission is concerned about the impact on the bills of customers served by
22 the Havasu system from the implementation of the ACRM. Consequently, we direct
23 Staff and the Company to open a new proceeding to examine other forms of
24 mitigation of the ACRM for the Havasu system, including the use of hook-up fees for
25 adjacent systems.

18 Staff Analysis

19 **ACRM Schedules**

20 The Company has provided the following schedules that are in conformance with the
21 methodologies required by Decision No. 66400 which was adopted by Decision No. 68310.

- 22 1. Balance Sheet – as of December 31, 2005
- 23 2. Income Statement – period ending December 31, 2005.
- 24 3. Income Statement Adjustments (Earnings Test) – to conform to Decision No. 67093.
- 25 4. Rate Review – a rate review filing for the Havasu Water District.
- 26 5. Arsenic Revenue Requirement – an arsenic revenue requirement calculation for Step
27 One.

- 1 6. Surcharge Calculation – a detailed surcharge calculation.
- 2 7. Rate Base – a schedule showing the elements and the calculation of the rate base,
3 including the deduction for Arsenic Impact Fee Contributions as of April 1, 2006.
- 4 8. Construction Work In Progress (“CWIP”) Ledger – a ledger showing the construction
5 work in progress account.
- 6 9. 4-Factor Allocation for December 2005 – a schedule showing the allocation factors
7 for all of the Arizona-American Districts.
- 8 10. Typical Bill Analysis – ACRM Step-1 – A typical bill analysis showing the effects on
9 residential customers at various consumption levels as well as the Average
10 Residential change at 10,140 gallons.

11 The ACRM schedules provide for the calculation of a surcharge based on financial records
12 and an Earnings Test Schedule that limit the ACRM surcharge to a rate that would not result in a
13 rate of return exceeding that authorized in Decision No. 67093. The calculated ACRM surcharge
14 would increase the average residential customer bill by \$12.48 from \$25.53 to \$38.01 (48.9
15 percent).

16 The rate design for the ACRM is composed of a 50/50 split of the recovery costs between
17 monthly minimum charges and commodity charges.

18 Staff has performed an inspection of the facilities and an audit and analysis on the
19 schedules provided by the Company and found that they conform to the methodology approved in
20 Decision No. 68310 as well as the various adjustments ordered to conform with Decision
21 No. 67093 with the exception that the debt and equity rates applied to the CWIP Ledger did not
22 conform with Decision No. 67093. Staff’s adjustment to apply the correct rates reduced the
23 ACRM plant by \$26,968; the ACRM revenue requirement by \$3,782 from \$272,294 to \$268,512;
24 and the average monthly residential customer bill by \$0.18, from \$38.01 to \$37.83. Staff’s
25 adjustment results in a monthly minimum surcharge of \$5.76 and commodity surcharge of \$0.6453
26 per 1,000 gallons.

27 Authorization of the Company’s requested ACRM was conditioned upon on three other
28 items.

1. Arizona-American Water Company shall file a plan with Docket Control by
December 31, 2005 that describes how the Company expects to attain an maintain a
capital structure (equity, long-term debt, and short-term debt) with equity

- 1 representing between 40 and 60 percent of total capital. This item was docketed on
2 November 30, 2005.
- 3 2. For the Havasu District, Arizona-American Water Company shall file with Docket
4 Control by January 31st of each year, an annual calendar year status report, until the
5 AIF Tariff is no longer in effect. The status report shall contain a list of all customers
6 that have paid the AIF, the amount each customer has paid, the amount of money
7 spent from the AIF, and a list of all facilities tat have been installed with funds from
8 the AIF Tariff. This item was docketed on February 2, 2006.
- 9 3. The Commission is concerned about the impact on the bills of customers served by
10 the Havasu system from the implementation of the ACRM. Consequently, we direct
11 Staff and the Company to open a new proceeding to examine other forms of
12 mitigation of the ACRM for the Havasu system, including the use of hook-up fees for
13 adjacent systems. Compliance with this condition is met by Docket No. W-01303A-
14 05-0890.

* * * * *

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

14 FINDINGS OF FACT

- 15 1. Pursuant to Decision No. 68310, the Company seeks an arsenic cost removal
16 mechanism surcharge tariff in this proceeding authorizing a monthly surcharge per customer to aid
17 the Company in its efforts to comply with the Environmental Protection Agency's ("EPA") new
18 arsenic maximum contaminant level of 10 particles per billion ("ppb") which went into effect on
19 January 23, 2006.
- 20 2. Pursuant to Decision No. 68310, Arizona-American filed the required schedules
21 prior to the implementation of the ACRM.
- 22 3. Staff's adjustments to the CWIP rates and all conforming adjustments should be
23 adopted.
- 24 4. Pursuant to Decision No. 68310, Arizona-American shall file permanent rate
25 applications for its Sun City West, Agua Fria, and Havasu districts by no later that April 30, 2008,
26 based on a 2007 test year.

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CONCLUSIONS OF LAW

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1. The Company is a public water service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§40-250 and 40-252.

2. The Commission has jurisdiction over the Company and of the subject matter of the application.

3. Approval of an arsenic cost recovery mechanism is consistent with the Commission's authority under the Arizona Constitution, Arizona ratemaking statutes, and applicable case law.

4. It is in the public interest to approve the Company's request for implementation of the ACRM.

ORDER

IT IS THEREFORE ORDERED that the application by Arizona-American Havasu Water District for the implementation of the Arsenic Cost Recovery Mechanism is approved as discussed herein.

IT IS FURTHER ORDERED that the application by Arizona-American Havasu Water District for approval of an arsenic cost recovery mechanism surcharge tariff shall be in accordance with the attached ACRM Schedule DRR-1.

IT IS FURTHER ORDERED that Arizona-American Havasu Water District shall notify its customers of the arsenic cost recovery surcharge tariff approved herein within 30 days of the effective date of this Decision.

IT IS FURTHER ORDERED that Arizona American shall file, by April 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with Docket Control as a compliance item showing the Company's ending capital structure by month for the prior year.

IT IS FURTHER ORDERED that Arizona-American shall file a permanent rate application for its Havasu Water District by no later than April 30, 2008, based on a 2007 test year as per Decision No. 68310.

...

1 IT IS FURTHER ORDERED that in the event that Arizona-American fails to file a new
2 rate case application by April 30, 2008, the Arsenic Cost Recovery Mechanism surcharge then in
3 place shall be automatically discontinued.

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

5
6 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

7
8 _____
9 CHAIRMAN

COMMISSIONER

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11 _____
12 COMMISSIONER

COMMISSIONER

COMMISSIONER

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

18 _____
19 BRIAN C. McNEIL
20 Executive Director

21 DISSENT: _____

22 DISSENT: _____

23 EGJ:DRR:lhmvJG
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1 SERVICE LIST FOR: Arizona-American Water Company
2 DOCKET NOS. W-01303A-05-0280, et al.

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