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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

DEC - 5 2006

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

DOCKETED BY
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY TO
EXAMINE POSSIBLE FORMS OF MITIGATION
OF THE ACRM FOR ITS HAVASU WATER
DISTRICT.

DOCKET NO. W-01303A-05-0890

DECISION NO. 69162

OPINION AND ORDER

DATE OF HEARING: May 8, 2006
PLACE OF HEARING: Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes
APPEARANCES: Craig A. Marks on behalf of Arizona-American Water Company; and
Linda Fisher, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

In Decision No. 68310 (November 14, 2005), the Arizona Corporation Commission ("Commission") approved an Arsenic Cost Recovery Mechanism ("ACRM") for Arizona-American Water Company's ("Arizona-American" or "Company") Agua Fria Water, Sun City West Water, and Havasu Water Districts. Among other things, Decision No. 68310 also directed the Commission's Utilities Division Staff ("Staff") and the Company to "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" (*Id.* at 17).

On December 13, 2005, Arizona-American filed an Application in the above-captioned docket offering two proposals to mitigate the impact of the ACRM on the Havasu system. The first proposal, which the Company claims is preferred by itself and Staff, would reduce the amount of the expected Step 2 increase by capitalizing, and thereby deferring, recovery of eligible O&M costs until the next rate case for the Havasu system. The other proposal would implement impact fees in the

1 Company's Mohave Water District to offset much of the Havasu District ACRM step increases.

2 On January 23, 2006, Staff filed the Direct Testimony of Crystal Brown. Staff indicated that
3 it was in substantial agreement with the Company's first proposal described above, with several
4 modifications.

5 By Procedural Order issued March 23, 2006, this matter was scheduled for hearing on May 8,
6 2006, and the Company was directed to publish notice of the hearing.

7 On April 21, 2006, Arizona-American filed the Direct Testimony of Thomas Broderick,
8 which stated the Company's agreement to two of the three modifications suggested by Staff.

9 On April 26, 2006, Arizona-American filed an Affidavit attesting to the Company's
10 compliance with the notice of publication.

11 On April 28, 2006, Staff filed the Rebuttal Testimony of Crystal Brown.

12 On May 8, 2006, the hearing in this matter was conducted, as scheduled, before a duly
13 authorized Administrative Law Judge of the Commission at its offices in Phoenix, Arizona. At the
14 conclusion of the hearing, the matter was taken under advisement pending submission of late-filed
15 exhibits and issuance of a Recommended Opinion and Order.

16 On May 23, 2006, Arizona-American filed late-filed exhibits requested at the hearing, in the
17 form of schedules reflecting the Company's revised position regarding the Staff recommendations,
18 including the impact on Havasu customers from Step 2 of the ACRM due to the Company's revised
19 proposal.

20 * * * * *

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

23 **FINDINGS OF FACT**

24 1. In Decision No. 68310 (November 14, 2005), the Commission approved an Arsenic
25 Cost Recovery Mechanism for Arizona-American's Agua Fria Water, Sun City West Water, and
26 Havasu Water Districts. Among other things, Decision No. 68310 also directed Staff and the
27 Company to "open a new proceeding to examine other forms of mitigation of the ACRM for the
28 Havasu system, including the use of hook-up fees for adjacent systems" (*Id.* at 17).

1 2. On December 13, 2005, Arizona-American filed an Application in the above-
2 captioned docket offering two proposals to mitigate the impact of the ACRM on the Havasu system.
3 The first proposal, which the Company claims is preferred by itself and Staff, would reduce the
4 amount of the expected Step 2 increase by capitalizing and thereby deferring recovery of eligible
5 O&M costs until the next rate case for the Havasu system. The other proposal would implement
6 impact fees in the Company's Mohave Water District to offset much of the Havasu District ACRM
7 step increases.

8 3. According to the filed testimony of Staff witness Crystal Brown, Staff is in substantial
9 agreement with the Company's first proposal described above, with the following modifications: the
10 start date of AFUDC accrual would be changed; accumulated amortization of CIAC related to arsenic
11 treatment plant in the arsenic rate base calculation would be recognized; and accumulated deferred
12 income taxes related to arsenic treatment plant in the arsenic rate base calculation would be
13 recognized.

14 4. Arizona-American witness Thomas Broderick submitted testimony stating agreement
15 to two of the three modifications suggested by Staff. The Company disagreed with Staff's proposal
16 to reflect deferred taxes on arsenic plant in the ACRM rate base calculation. However, at the hearing,
17 Mr. Broderick testified that the Company accepted Staff's remaining disputed issue with respect to
18 accumulated deferred income taxes (Tr. 8). He also stated that Arizona-American needed to see
19 language in the Order that "gives a very high assurance of recovery, but treats the deferred O&M
20 [operation and maintenance] costs that are going to be capitalized not really like a regulatory asset
21 but more just as directly part of the arsenic plan" (*Id.* at 9).

22 5. At hearing, Staff witness Gordon Fox adopted Ms. Brown's testimony and presented
23 Staff's position regarding this matter. Mr. Fox described Staff's proposed adjustments to the
24 Company's application as follows: the initiation date for recording AFUDC should be changed to the
25 date that the Step 2 increase becomes effective; the Company's rate base should include accumulated
26 amortization of contributions in aid of construction; and, as indicated above, accumulated deferred
27 income taxes ("ADIT") should be included in the calculation of the Company's rate base for the
28 ACRM surcharge calculation (Tr. 22). With respect to ADIT, Mr. Fox explained that accumulated

1 deferred income taxes "were included in the rate base calculation for the ACRM mechanism
2 authorized in Decision No. 68310 (*Id.* at 23).

3 6. Regarding the alternative recommendation, which would impose hook up fees on
4 Mohave District customers as a means of mitigating the impact on Havasu customers, Mr. Fox
5 indicated that Staff opposed such a proposal because it would result in a direct subsidy flowing from
6 Mohave customers to Havasu customers. In addition, Mr. Fox testified that the hook up fee method
7 would be an inefficient means of mitigating the impact on Havasu customers because, unlike
8 advances and contributions which are not taxed (if the funds are used to build plant within two years
9 of collection), the hook up fees would be taxed. As an example, Mr. Fox pointed out that at a 40
10 percent income tax rate, only 60 percent of the collected hook up fee funds could actually be used to
11 offset arsenic O&M costs for the Havasu system (*Id.* at 24, 30).

12 7. On May 23, 2006, Arizona-American filed a late-filed exhibit that includes revised
13 schedules to reflect the Company's position as of the date of the hearing, as well as proposed
14 language to be included in the Order to provide assurance of recovery. According to the information
15 provided by Arizona-American, an average residential customer's monthly bill (based on usage just
16 over 10,000 gallons per month) would increase from \$25.53 currently to \$38.01 (48.9 percent) in
17 Step 1 of the ACRM and, if the Company's application (as modified by Staff) is adopted in this
18 proceeding, the average customer's monthly bill would increase from \$38.01 to \$45.76 (20.4 percent)
19 in Step 2 of the ACRM.

20 8. We believe that the Company's proposal, as modified by Staff, is a reasonable means
21 of providing mitigation of the rate impact of arsenic remediation on customers in the Havasu District.
22 We agree with Staff and the Company that imposing hook up fees on the Mohave District customers
23 as a means of offsetting the impact on Havasu customers is not sound public policy because it would
24 result in a direct subsidization of the Havasu customers and would be an inefficient method of
25 mitigation due to the tax consequences associated with such a mechanism. We will therefore adopt
26 the Company's modified proposal which would reduce the amount of the expected Step 2 ACRM
27 increase by permitting Arizona-American to capitalize, and thereby defer, recovery of eligible O&M
28 costs until the next rate case for the Havasu District.

CONCLUSIONS OF LAW

1
2 1. Arizona-American is a public service corporation within the meaning of Article XV of
3 the Arizona Constitution and A.R.S. §§40-250 and 40-251.

4 2. The Commission has jurisdiction over Arizona-American and of the subject matter of
5 the issues raised in the Company's modified ACRM proposal for the Havasu District.

6 3. Notice of the application was provided in the manner prescribed by law.

7 4. Approval of the accounting treatment for the Havasu District ACRM O&M costs as
8 described herein, is consistent with the Commission's authority under the Arizona Constitution,
9 ratemaking statutes, and applicable case law.

10 5. Staff's recommendations described above are reasonable and should be approved.

11 6. Approval of the modified Havasu District ACRM is specifically conditioned on
12 compliance with the Staff recommendations discussed above and approved herein.

13 **ORDER**

14 IT IS THEREFORE ORDERED that Arizona-American's application for a modification of
15 the ACRM for the Havasu District, as modified by Staff's recommendations and as otherwise
16 described herein, is approved.

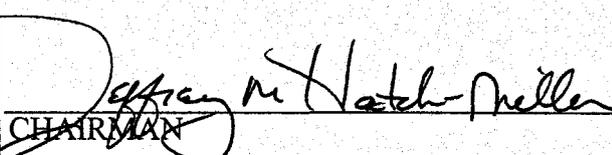
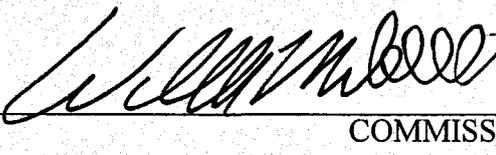
17 IT IS FURTHER ORDERED that the alternative proposal to impose an arsenic impact fee on
18 Mohave District customers is denied.

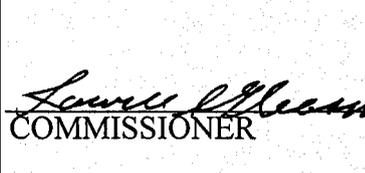
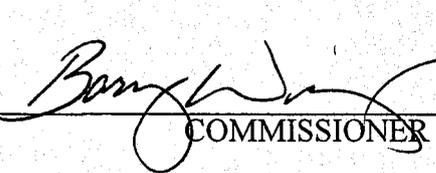
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1 IT IS FURTHER ORDERED that arsenic treatment O&M costs prudently incurred during the
2 12 month deferral period shall be capitalized and accrue AFUDC as of the effective date of the
3 Company's Step 2 filing, and recognized in the cost of service in the Company's next general rate
4 case for the Havasu District.

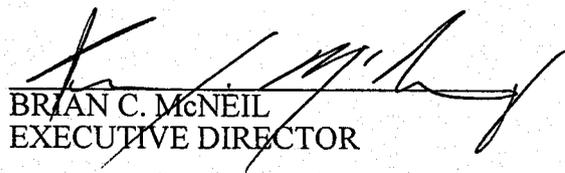
5 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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8 _____
9 CHAIRMAN COMMISSIONER

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11 _____
12 COMMISSIONER COMMISSIONER COMMISSIONER

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14 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
15 Director of the Arizona Corporation Commission, have
16 hereunto set my hand and caused the official seal of the
17 Commission to be affixed at the Capitol, in the City of Phoenix,
18 this 5th day of Dec., 2006.

19 
20 BRIAN C. McNEIL
21 EXECUTIVE DIRECTOR

22 DISSENT _____

23 DISSENT _____

24 DDN:mj

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