BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS PARADISE VALLEY WATER DISTRICT	DOCKET NO. W-01303A-05-0405
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR APPROVAL OF AN AGREEMENT WITH THE PARADISE VALLEY COUNTRY CLUB	DOCKET NO. W-01303A-05-0910 DECISION NO. 69396 ORDER

Open Meeting
March 13 and 14, 2007
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACTS

I. INTRODUCTION

1. On December 19, 2006, Arizona-American Water Company, Inc. ("Arizona-American" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to implement Step-One of the Arsenic Cost Recovery

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Mechanism ("ACRM") authorized under Decision No. 68858[1] for its Paradise Valley Water District. The application proposed a surcharge of $15.67 on the monthly minimum charge and $0.4788 per 1,000 gallons on the commodity charge.

2. On February 14, 2007, Arizona-American filed a revised application that incorporated several adjustments[2] and proposed two revenue requirements. One of the proposals would be adopted contingent upon the in-service status of the sludge handling facility at the time this matter comes before the Commission.

3. The Company's first proposal ("Plan A") excludes the $399,715 sludge handling facility and its related depreciation expense from the revenue requirement. The Step-One ACRM surcharge under Plan A would be $14.48 on the monthly minimum charge and $0.4425 per 1,000 gallons on the commodity rate. Under the Company's Plan A proposal, the average residential customer bill[3] would increase by approximately $34.06 (or 56.84 percent) from $60.30 to $94.36.

4. The Company's alternate proposal ("Plan B") includes the $399,715 sludge handling facility and its related depreciation expense in the revenue requirement. The Company provided adequate support for $399,715 amount in its original application. The Company does not plan to revise the cost to reflect any increase in the actual cost of the sludge handling facility. The Step-One ACRM surcharge under the Plan B proposal would be $14.84 on the monthly minimum charge and a $0.4534 per 1,000 gallons on the commodity rate. Under the Company's Plan B proposal, the average residential customer bill would increase by approximately $34.91 (or 57.89 percent) from $60.30 to $95.21.

5. Staff's recommended surcharges for Plan A are shown on Schedule CSB-4. Staff's adjustments increase the Company proposed monthly minimum surcharge per equivalent billing unit (5/8-inch meter) from $14.48 to $14.65 and the commodity surcharge rate from $0.4425 to $0.4476 per 1,000 gallons. The Staff recommended Step-One ACRM surcharge rates would increase the average monthly residential customer bill by $34.46 (or 57.15 percent) from $60.30 to

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[1] Dated July 28, 2006
[2] Discussed in detail in the "Company's Revisions of the Original Application" section of this memorandum
[3] Average customer consumption: 44.27 (kGal) per Typical Bill Analysis in Original Application

$94.76 as shown on CSB-4. Staff recommends that Plan A be used if the sludge handling facility is not placed in service by the time this matter comes before the Commission.

6. Staff's recommended surcharges for Plan B[4] are shown on Schedules CSB-8. Staff's adjustments increase the Company proposed monthly minimum surcharge per equivalent billing unit (5/8-inch meter) from $14.84 to $15.05 and the commodity surcharge rate from $0.4534 to $0.4598 per 1,000 gallons. The Staff recommended Step-One ACRM surcharge rates would increase the average monthly residential customer bill by $35.40 (or 58.71 percent) from $60.30 to $95.70 as shown on CSB-4. Staff recommends Plan B if the sludge handling facility is placed in service and is verified by Commission Staff by the time this matter comes before the Commission. On March 12, 2007, Commission Staff verified the installation of the sludge handling facilities, as documented by Staff's March 13, 2007 memorandum to this docket.

II. BACKGROUND

7. The United States Environmental Protection Agency reduced the drinking water standard for arsenic from 50 parts per billion ("ppb") to 10 ppb effective January 23, 2006.

8. On June 3, 2005, Arizona-American filed an application with the Commission for a rate increase in its Paradise Valley Water District. On July 28, 2006, the Commission issued Decision No. 68858 establishing permanent rates for the Paradise Valley Water District.

9. On December 19, 2006, Arizona-American filed an application with the Commission requesting authorization to implement Step-One of the Arsenic Cost Recovery Mechanism ("ACRM") authorized under Decision No. 68858 for its Paradise Valley Water District.

10. On February 14, 2007, Arizona-American filed a revised application.

11. On February 16, 2007, the Residential Utility Consumer Office ("RUCO") filed its report on the audit of the ACRM for the instant case.

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[4] For purposes of the Plan B arsenic rate base, Staff has utilized the Company's $399,715 amount and it shall serve as the maximum allowable plant in service for this recommendation in this proceeding.

III. AUTHORIZATION FOR AN ARSENIC COST RECOVERY MECHANISM (DECISION NO. 68858)

12. Decision No. 68858[5] approved an ACRM surcharge for Arizona-American Water Company's Paradise Valley Water District conditioned upon compliance with the following Staff recommendations:

a. ". . . Arizona-American Water Company shall comply with all requirements discussed in this Order as a condition of approval of the Arsenic Cost Recovery Mechanism."

b. " . . . Arizona-American Water Company shall file, by July 1st of each year subsequent to any year in which it collects surcharges under an ACRM, a report with Docket Control showing the Company's ending capital structure (equity, long-term debt, and short-term debt) by month for the prior year."

c. ". . . as part of the Earnings Test schedule filed in support of the ACRM, Arizona-American Water Company shall incorporate adjustments conforming to Decision No. 67093, as discussed in Staff's recommendation set forth herein."

d. " . . . Arizona-American Water Company shall file in this docket hard copies of the schedules discussed in its application, as set forth in Staff's recommendations herein, and shall concurrently provide Microsoft Excel or compatible electronic versions of the filings and all work papers to Staff with all ACRM filings."

e. " . . . ACRM surcharges shall be designed to apply rate design volumetric charges equally to all usage tiers."

f. "Arizona-American Water Company 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."

g. "Arizona-American Water Company shall file a permanent rate application for its Paradise Valley Water District no later that September 30, 2008."

IV. STAFF ANALYSIS

A. ACRM Schedules

13. Arizona-American's ACRM filing includes the following schedules that conform to the methodologies required by Decision No. 66400 and adopted by Decision No. 68858.

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[5] Page 44, beginning at line 19

a. Balance Sheet – dated September 30, 2006.

b. Income Statement – period ending September 30, 2006.

c. Income Statement Adjustments (Earnings Test) – to conform to Decision No. 68858.

d. Rate Review – a rate review filing for the Paradise Valley Water District.

e. Arsenic Revenue Requirement – an arsenic revenue requirement calculation for Step-One.

f. Surcharge Calculation – a detailed surcharge calculation.

g. Rate Base – a schedule showing the elements and the calculation of the rate base.

h. CWIP Ledger – a ledger showing the construction work in progress account.

i. 4-Factor Allocation for September 30, 2006 – a schedule showing the allocation for all of the Arizona-American Water Company Districts.

j. Typical Bill Analysis – ACRM Step-1 – A typical bill analysis showing the effects on residential customers at various consumption levels.

14. Staff finds that the Company is in compliance with all requirements of Decision No. 68858. Commission records show one outstanding compliance issue regarding Decision No. 68917[6].

15. Staff concludes that the filed schedules conform with the methodologies originally required by Decision No. 66400 and that were subsequently adopted by Decision No. 68858. Staff concludes that the Company's Step-One ACRM filing for its Paradise Valley Water District is complete and in accordance with Decision No. 68858.

16. The ACRM schedules also provide for the calculation of a surcharge based on financial records and an Earnings Test Schedule that limit the ACRM surcharge revenue to an amount that would not result in a rate of return exceeding that authorized in Decision No. 68858.

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[6] Tariff sheets in compliance with Decision No. 68917 were scheduled to be filed September 29, 2006. Staff is working with the Company to resolve the issue.

B. Company's Revisions to Original Application

17. The Company filed a revised application to address Staff's and RUCO's concerns as follows:

The Company reduced its plant in service balance by $735,439, from $19,382,673 in its original application to $18,647,234 in its revised application as shown on Schedule CSB-1.

Structures and Improvements – The Company, in both Plan A and Plan B, removed $41,783 to reflect costs related to non-arsenic uses of the structures and improvements.

Back-up Electricity Generator – The Company, in both Plan A and Plan B, removed $7,230 to reflect costs related to non-arsenic uses of the back-up generator.

Pumps – The Company, in both Plan A and Plan B, removed $141,911 to reflect the retirement of three on-site pumps (i.e., 300 hp, 150 hp, and 100 hp) installed in 1995.

Tanks – The Company, in both Plan A and Plan B, removed $144,800 to reflect 400,000 gallons capacity related to non-arsenic uses of the tank.

Sludge Handling Equipment – Under Plan A, the Company removed $399,715 in sludge handling equipment from arsenic plant in service. Under Plan B, the Company transferred $399,715 in sludge handling equipment from Account No. 320, Water Treatment Equipment to Account No. 348, other Tangible Plant.

The Company did not have Commission approved depreciation rates for three plant accounts. Therefore, Staff recommended that the Company use approved depreciation rates that came closest to the useful lives of the plant in question. The Company accepted Staff's recommendation. The Company also corrected a typographical error. These adjustments reduced Plan A Depreciation Expense by $137,991 from $683,905 to $545,914 and Plan B Depreciation Expense by $118,006 from $683,905 to $565,899.

C. Staff's Analysis and Adjustments to Company's Schedules

18. The Company incorporated an adjustment proposed by RUCO to retire non-arsenic related pumps.[7] According to RUCO, the old pumps were replaced by new pumps that the

[7] The retired pumps were not used to treat arsenic.

Company included as part of its arsenic plant. RUCO indicated that these retirements were not properly recorded. RUCO proposed and the Company accepted the proposal to reflect the retirement by reducing the actual reported cost of the arsenic treatment plant.

19. Staff did not accept the Company's adjustment to reflect the retirements because: (1) the intent of the ACRM was to provide recovery for all arsenic plant that had adequate supporting documentation and was placed in service, (2) the ACRM does not provide for changes in non-arsenic related plant to be reflected in the calculation and contemplates that changes to non-arsenic plant will be made in a subsequent rate proceeding, and, (3) reflecting the non-arsenic plant retirements in the arsenic plant balance would under-state the actual arsenic plant in service balance.

D. Plant Retirements Costs

20. We reject Staff's argument regarding the retirement of pumping equipment. We agree with the Company and RUCO that the ACRM surcharge should include only the *incremental* cost of arsenic plant and therefore all retirements must be netted out of the costs to be recovered. To do otherwise would result in a double recovery of both the retired pumps and the new pumps.

21. Staff concluded that the Company's Step-One ACRM filing for its Paradise Valley Water District, as adjusted, is complete and in accordance with Decision No. 68858.

22. We reject Staff's recommendation that the Company file with the Commission an arsenic removal surcharge tariff consistent with either ACRM Schedule CSB-4 or CSB-8 as approved by the Commission. Further, the Company should file with the Commission an arsenic removal surcharge tariff consistent with the figures contained in the Company's revised application filed on February 14, 2007 as approved by the Commission.

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

24. Staff recommended that in the event that Arizona-American fails to file a permanent rate application for its Paradise Valley Water system by September 30, 2008, as . . .

required by Decision No. 68858, the Arsenic Cost Recovery Mechanism surcharge then in place shall be automatically discontinued.

25. Pursuant to Decision No. 68858, the Company filed the required schedules prior to the implementation of the ACRM.

26. Staff recommended that the Company shall file with Docket Control, as a compliance item in this docket, a report showing the Company's ending capital structure by month for the prior year. The first report shall be due on July 1, 2008, and shall be provided each July 1st thereafter until such time as a subsequent order of the Commission discontinues the ACRM surcharge.

CONCLUSIONS OF LAW

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.

2. Pursuant to Decision No. 68858, the Company seeks an arsenic cost recovery mechanism surcharge tariff in this proceeding authorizing a monthly surcharge per customer to aid the Company in its efforts to comply with the EPA's new drinking water standard for arsenic from 50 ppb to 10 ppb which went into effect on January 23, 2006.

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

4. The Commission approved the ACRM mechanism in Decision No. 68858, conditioned on compliance with Staff's recommendations in that case.

5. We reject the Staff position regarding pump retirements and accept the treatment afforded to these retirements in the Company's revised application. Approval of the Company's implementation of the arsenic cost recovery mechanism is consistent with the Commission's authorities under the Arizona Constitution, the Arizona Revised Statutes and applicable case law.

6. It is in the public's interest to approve the Company's revised application for implementation of the ACRM.

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ORDER

IT IS THEREFORE ORDERED that the revised application by Arizona-American Paradise Valley Water District is approved as discussed herein.

IT IS FURTHER ORDERED that the Company-proposed Plan B is approved.

IT IS FURTHER ORDERED that the revised application by Arizona-American Paradise Valley Water District for approval of an arsenic cost recovery mechanism surcharge tariff shall reflect the Company-proposed Plan B surcharges presented in the Company's revised application.

IT IS FURTHER ORDERED that Arizona-American 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 the Company shall file with Docket Control, as a compliance item in this docket, a report showing the Company's ending capital structure by month for the prior year. The first report shall be due on July 1, 2008, and shall be provided each July 1st thereafter until such time as a subsequent order of the Commission discontinues the ACRM surcharge.

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IT IS FURTHER ORDERED that in the event that Arizona-American fails to file a new rate case application for its Paradise Valley Water District by May 31, 2008, the Arsenic Cost Recovery Mechanism surcharge then in place shall be automatically discontinued.

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 22nd day of March, 2007.

BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:CSB:lhm\MAS

SERVICE LIST FOR: Arizona-American Water Company
DOCKET NOS. W-01303A-05-0405, et al.

Mr. Craig A. Marks
Arizona-American Water Company
101 Corporate Center
19820 North Seventh Street, Suite 201
Phoenix, Arizona 85024

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Mr. Christopher C. Kempley
Chief Counsel
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Arizona-American Water Company
Paradise Valley Water District
Docket No. W-01303A-05-0280

Schedule CSB-8

PLAN B
RATE DESIGN
Includes Sludge Handling Facility

	Company Present Rates Without Surcharge	Company Proposed Surcharge	Staff Recommended Surcharge
Monthly Customer Charge Surcharge			
5/8" Meter	$ 9.50	$ 14.84	$ 15.05
Commodity Surcharge			
Commodity Rate 0 to 25,000 gallons (per 1,000 gallons)	0.7600	0.4534	0.4598
Commodity Rate 25,001 to 80,000 gallons (per 1,000 gallons)	1.6500	0.4534	0.4598
Commodity Rate 80,001 gallons and over (per 1,000 gallons)	4.3300	0.4534	0.4598
Average Customer Water Usage (gallons)	44,270	44,270	44,270
Typical Residential Bill			
Under Present Rates Without Surcharge	$ 60.30		
Under Present Rates With Company Proposed Surcharge		$ 95.21	
Under Present Rates With Staff Recommended Surcharge			$ 95.70

CURRENT RATES INCLUDING SURCHARGE - Per Company

	Company Present Rates Without Surcharge	Company Proposed Surcharge	Company Total
Monthly Customer Charge			
5/8" Meter	$ 9.50	$ 14.84	$ 24.34
Commodity			
Commodity Rate 0 to 25,000 gallons (per 1,000 gallons)	0.7600	0.4534	$ 1.2134
Commodity Rate 25,001 to 80,000 gallons (per 1,000 gallons)	1.6500	0.4534	$ 2.1034
Commodity Rate 80,001 gallons and over (per 1,000 gallons)	4.3300	0.4534	$ 4.7834

CURRENT RATES INCLUDING SURCHARGE - Per Staff

	Company Present Rates Without Surcharge	Staff Recommended Surcharge	Staff Total
Monthly Customer Charge			
5/8" Meter	$ 9.50	$ 15.05	$ 24.55
Commodity			
Commodity Rate 0 to 4,000 gallons	0.7600	0.4598	$ 1.2198
Commodity Rate 4,001 to 15,000 gallons	1.6500	0.4598	$ 2.1098
Commodity Rate 15,001 gallons and over	4.3300	0.4598	$ 4.7898