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BEFORE THE ARIZONA CORPORATION COMMISSION

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

Arizona Corporation Commission

DOCKETED

MAR 22 2007

DOCKETED BY *NR*

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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1 Mechanism ("ACRM") authorized under Decision No. 68858¹ for its Paradise Valley Water
2 District. The application proposed a surcharge of \$15.67 on the monthly minimum charge and
3 \$0.4788 per 1,000 gallons on the commodity charge.

4 2. On February 14, 2007, Arizona-American filed a revised application that
5 incorporated several adjustments² and proposed two revenue requirements. One of the proposals
6 would be adopted contingent upon the in-service status of the sludge handling facility at the time
7 this matter comes before the Commission.

8 3. The Company's first proposal ("Plan A") excludes the \$399,715 sludge handling
9 facility and its related depreciation expense from the revenue requirement. The Step-One ACRM
10 surcharge under Plan A would be \$14.48 on the monthly minimum charge and \$0.4425 per 1,000
11 gallons on the commodity rate. Under the Company's Plan A proposal, the average residential
12 customer bill³ would increase by approximately \$34.06 (or 56.84 percent) from \$60.30 to \$94.36.

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

21 5. Staff's recommended surcharges for Plan A are shown on Schedule CSB-4. Staff's
22 adjustments increase the Company proposed monthly minimum surcharge per equivalent billing
23 unit (5/8-inch meter) from \$14.48 to \$14.65 and the commodity surcharge rate from \$0.4425 to
24 \$0.4476 per 1,000 gallons. The Staff recommended Step-One ACRM surcharge rates would
25 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

28 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

1 \$94.76 as shown on CSB-4. Staff recommends that Plan A be used if the sludge handling facility
2 is not placed in service by the time this matter comes before the Commission.

3 6. Staff's recommended surcharges for Plan B⁴ are shown on Schedules CSB-8.
4 Staff's adjustments increase the Company proposed monthly minimum surcharge per equivalent
5 billing unit (5/8-inch meter) from \$14.84 to \$15.05 and the commodity surcharge rate from
6 \$0.4534 to \$0.4598 per 1,000 gallons. The Staff recommended Step-One ACRM surcharge rates
7 would increase the average monthly residential customer bill by \$35.40 (or 58.71 percent) from
8 \$60.30 to \$95.70 as shown on CSB-4. Staff recommends Plan B if the sludge handling facility is
9 placed in service and is verified by Commission Staff by the time this matter comes before the
10 Commission. On March 12, 2007, Commission Staff verified the installation of the sludge
11 handling facilities, as documented by Staff's March 13, 2007 memorandum to this docket.

12 **II. BACKGROUND**

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

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

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

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

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

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28 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.

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

3 12. Decision No. 68858⁵ approved an ACRM surcharge for Arizona-American Water
4 Company's Paradise Valley Water District conditioned upon compliance with the following Staff
5 recommendations:

- 6 a. ". . . Arizona-American Water Company shall comply with all requirements
7 discussed in this Order as a condition of approval of the Arsenic Cost Recovery
8 Mechanism."
9 b. ". . . Arizona-American Water Company shall file, by July 1st of each year
10 subsequent to any year in which it collects surcharges under an ACRM, a report
11 with Docket Control showing the Company's ending capital structure (equity, long-
12 term debt, and short-term debt) by month for the prior year."
13 c. ". . . as part of the Earnings Test schedule filed in support of the ACRM, Arizona-
14 American Water Company shall incorporate adjustments conforming to Decision
15 No. 67093, as discussed in Staff's recommendation set forth herein."
16 d. ". . . Arizona-American Water Company shall file in this docket hard copies of the
17 schedules discussed in its application, as set forth in Staff's recommendations
18 herein, and shall concurrently provide Microsoft Excel or compatible electronic
19 versions of the filings and all work papers to Staff with all ACRM filings."
20 e. ". . . ACRM surcharges shall be designed to apply rate design volumetric charges
21 equally to all usage tiers."
22 f. "Arizona-American Water Company shall file the schedules and information
23 described above, as well as any additional relevant data requested by Staff, as part
24 of any request for an Arsenic Cost Recovery Mechanism step increase."
25 g. "Arizona-American Water Company shall file a permanent rate application for its
26 Paradise Valley Water District no later than September 30, 2008."

22 **IV. STAFF ANALYSIS**

23 **A. ACRM Schedules**

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

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28 ⁵ Page 44, beginning at line 19

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- 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. 68917⁶.

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.

1 **B. Company's Revisions to Original Application**

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

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

6 Structures and Improvements – The Company, in both Plan A and Plan B, removed
7 \$41,783 to reflect costs related to non-arsenic uses of the structures and improvements.

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

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

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

14 Sludge Handling Equipment – Under Plan A, the Company removed \$399,715 in sludge
15 handling equipment from arsenic plant in service. Under Plan B, the Company transferred
16 \$399,715 in sludge handling equipment from Account No. 320, Water Treatment Equipment to
17 Account No. 348, other Tangible Plant.

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

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

25 18. The Company incorporated an adjustment proposed by RUCO to retire non-arsenic
26 related pumps.⁷ According to RUCO, the old pumps were replaced by new pumps that the
27

28 ⁷ The retired pumps were not used to treat arsenic.

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

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

11 **D. Plant Retirements Costs**

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

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

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

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

26 24. Staff recommended that in the event that Arizona-American fails to file a
27 permanent rate application for its Paradise Valley Water system by September 30, 2008, as
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1 required by Decision No. 68858, the Arsenic Cost Recovery Mechanism surcharge then in place
2 shall be automatically discontinued.

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

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

10 CONCLUSIONS OF LAW

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

13 2. Pursuant to Decision No. 68858, the Company seeks an arsenic cost recovery
14 mechanism surcharge tariff in this proceeding authorizing a monthly surcharge per customer to aid
15 the Company in its efforts to comply with the EPA's new drinking water standard for arsenic from
16 50 ppb to 10 ppb which went into effect on January 23, 2006.

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

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

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

25 6. It is in the public's interest to approve the Company's revised application for
26 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.

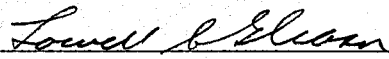
IT IS FURTHER ORDERED that the Company shall file with Docket Control, as a compliance item in this docket, a report showing the Company's ending capital structure by month for the prior year. The first report shall be due on July 1, 2008, and shall be provided each July 1st thereafter until such time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

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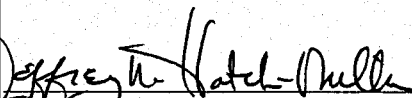
1 IT IS FURTHER ORDERED that in the event that Arizona-American fails to file a new
2 rate case application for its Paradise Valley Water District by May 31, 2008, the Arsenic Cost
3 Recovery Mechanism surcharge then in place shall be automatically discontinued.

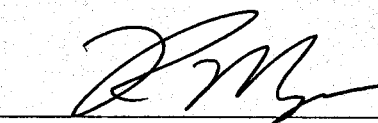
4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

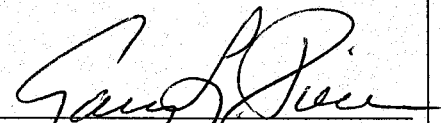
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6 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

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9 CHAIRMAN

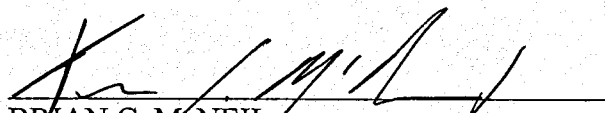

COMMISSIONER

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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 22nd day of March, 2007.

18 
19 BRIAN C. McNEIL
20 Executive Director

21 DISSENT: _____

22 DISSENT: _____

23 EGJ:CSB:lhm\MAS
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1 SERVICE LIST FOR: Arizona-American Water Company
2 DOCKET NOS. W-01303A-05-0405, et al.

3 Mr. Craig A. Marks
4 Arizona-American Water Company
5 101 Corporate Center
6 19820 North Seventh Street, Suite 201
7 Phoenix, Arizona 85024

8 Mr. Ernest G. Johnson
9 Director, Utilities Division
10 Arizona Corporation Commission
11 1200 West Washington
12 Phoenix, Arizona 85007

13 Mr. Christopher C. Kempley
14 Chief Counsel
15 Arizona Corporation Commission
16 1200 West Washington
17 Phoenix, Arizona 85007

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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