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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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

2008 AUG 18 P 3:26

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF VALLEY UTILITIES WATER COMPANY INC. FOR AN INCREASE IN ITS WATER RATES FOR CUSTOMERS WITHIN MARICOPA COUNTY, ARIZONA

DOCKET NO. W-01412A-99-0615

IN THE MATTER OF THE APPLICATION OF VALLEY UTILITIES WATER COMPANY INC. FOR AUTHORITY TO ISSUE PROMISSORY NOTE(S) AND OTHER EVIDENCES OF INDEBTEDNESS PAYABLE AT PERIODS OF MORE THAN TWELVE MONTHS AFTER THE DATE OF ISSUANCE.

DOCKET NO. W-01412A-00-0023

STAFF'S REVISED RESPONSE TO VALLEY UTILITIES MOTION FOR AN ORDER CONFIRMING COMPLIANCE AND RELEASE OF SET-ASIDE FUNDS

Arizona Corporation Commission, Utilities Division ("Staff") files its Revised Response to Valley Utilities Motion for an Order Confirming Compliance and Release of Set-Aside Funds. Concurrent with this filing, Staff filed a Motion to Withdraw its previous response.

RESPECTFULLY SUBMITTED this 18th day of August, 2008.

Arizona Corporation Commission
DOCKETED

AUG 18 2008

DOCKETED BY *Mm*

Robin R. Mitchell
Ayesha Vohra
Attorneys, Legal Division
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1200 West Washington Street
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1 The original and fifteen (15) copies
2 of the foregoing were filed this
3 18th day of August, 2008 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85007

7 Copy of the foregoing mailed this
8 18th day of August, 2008 to:

9 Richard L. Sallquist
10 SALLQUIST, DRUMMOND & O'CONNOR, P.C.
11 4500 S. Lakeshore Drive, Suite 339
12 Tempe, Arizona 85282
13 Attorney for Valley Utilities Water Company, Inc.

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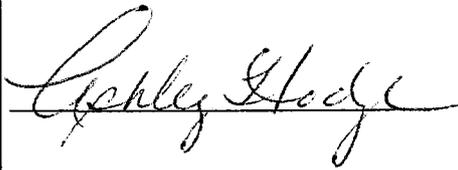
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MEMORANDUM

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGT

DATE: August 18, 2008

RE: STAFF REPORT FOR VALLEY UTILITIES WATER COMPANY, INC.'S
MOTION FOR AN ORDER CONFIRMING COMPLIANCE AND RELEASE
OF SET-ASIDE FUNDS. (DOCKET NO. W-01412A-99-0615 AND
W-01412A-00-0023)

Attached is the Staff Report for Valley Utilities Water Company, Inc.'s motion for an Order confirming compliance and release of set-aside funds. Staff recommends denial in accordance with Staff's recommendations.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 12:00 p.m. on or before August 28, 2008.

EGJ:MEM:kdh

Originator: Marvin E. Millsap

Service List for: Valley Utilities Water Company, Inc.
Docket No. W-01412A-99-0615 and W-01412A-00-0023

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

VALLEY UTILITIES WATER COMPANY, INC.

DOCKET NO. W-01412A-99-0615 AND W-01412A-00-0023

**MOTION FOR AN ORDER CONFIRMING COMPLIANCE AND RELEASE OF SET-
ASIDE FUNDS**

August 18, 2008

STAFF ACKNOWLEDGMENT

The Staff Report for Valley Utilities Water Company, Inc., Docket No. W-01412A-99-0615 and W-01412A-00-0023, was the responsibility of Staff member Marvin E. Millsap.


Marvin E. Millsap
Public Utilities Analyst IV

EXECUTIVE SUMMARY
VALLEY UTILITIES WATER COMPANY, INC.
APPLICATION FOR A PERMANENT RATE INCREASE
DOCKET NO. W-01412A-99-0615 AND W-01412A-00-0023

Valley Utilities Water Company, Inc. ("Valley" or "Company") is a Class B water utility located in Maricopa County with service areas adjacent to and within the city limits of Glendale, Arizona.

Decision No. 62908, dated September 18, 2000, granted Valley a permanent rate increase that required \$6.35 per bill per month be set-aside in an interest-bearing account separate from the operating checking account. The funds in the "set-aside account" were to be used solely for the payment of the debt service on an anticipated Water Infrastructure and Finance Authority of Arizona ("WIFA") loan, which was also approved by Decision No. 62908. Pursuant to the Decision, the Company began funding the set-aside account in December, 2000, based on the number of bills sent in November and continued to deposit funds in the account through October, 2003, when Decision No. 68309 ended the necessity to continue setting aside funds. Decision No. 68309 again approved a WIFA loan and directed the set-aside account be used for debt service for this anticipated loan. Valley did not receive a WIFA loan for which the set-aside monies were to be used relative to either of the Decisions mentioned. Subsequent to October, 2003, the Company periodically used these funds to pay operating expenses although this was never authorized by the Commission. Both Decision No. 62908 and 68309 required Valley to maintain the set-aside account for payment of future WIFA debt service.

Staff recommends that the Company's request for confirmation of compliance with Decision No. 62908 be denied.

Staff further recommends approval of Valley's request to be released from the obligation to maintain the set-aside account; however Staff recommends that the Company be ordered to use the funds, including the shortage created by utilization of the funds for unauthorized purposes, to prepay \$215,540.07 to WIFA to reduce its existing WIFA debt balance of approximately \$997,000.

Staff also recommends that the Company be fined by the Commission because it did not comply with the requirements of either Decision No. 62908 or Decision No. 68309.

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Background

Valley Utilities Water Company, Inc. ("Valley" or "Company") is a Class B water utility located in Maricopa County with service areas adjacent to and within the city limits of Glendale, Arizona.

Decision No. 62908, dated September 18, 2000, granted Valley a permanent rate increase that required \$6.35 per bill per month be set-aside in an interest-bearing account separate from the operating checking account. The funds in the "set-aside account" were to be used solely for the payment of the debt service on an anticipated Water Infrastructure and Finance Authority of Arizona ("WIFA") loan, which was also approved by Decision No. 62908. Pursuant to the Decision, the Company began funding the set-aside account in December, 2000, based on the number of bills sent in November and continued to deposit funds in the account through October, 2003, when Decision No. 68309 ended the necessity to continue setting aside funds. Staff notes that the deposit amounts were not based on the fluctuation in the number of monthly bills tendered to customers as intended by Decision No. 62908. Decision No. 68309 again approved a WIFA loan and directed the set-aside account be used for debt service for this anticipated loan. Valley did not receive a WIFA loan for which the set-aside monies were to be used relative to either of the Decisions mentioned. Subsequent to October, 2003, the Company periodically used these funds to pay operating expenses although this was never authorized by the Commission. As of December 31, 2007, it appears that Valley has not used the "WIFA Set-Aside Account" to pay debt service on any WIFA loans.

Staff has analyzed Valley's WIFA Set-aside Account activity through December 31, 2007. It appears to Staff that the account balance as of December 31, 2007, should be \$215,540.07 but is actually only \$59,942.10 per the Chase Bank statement. In a report to the Utilities Division Director dated December 28, 2005, Valley reported a balance of \$101,725 as of November 30, 2005. The bank statement for that date indicated a balance of \$101,574.47. There are three reasons for the difference revealed by Staff's analysis:

First, the interest credited by the bank based on the balance each month is \$8,120.65 whereas the calculated interest based on what the monthly balance should have been is \$20,544.27, a difference of \$12,423.62. Some of this difference results because the Company's deposits were not made on a monthly basis, thus the amount credited monthly was lower than it should have been based on the balance at the time.

Second, the difference in set aside deposits appears to be \$25,521.55 based on the Company's deposits of \$169,474.25 from November, 2000, through November, 2003, versus Staff's calculation that the deposits should have totaled \$194,995.80. Staff's calculations are based on the monthly customer count provided by the Company to a Staff data request.

Third, the Company has withdrawn, beginning in August, 2003, a total of \$228,432.02 while only \$110,779.22 has been re-deposited, leaving the Company owing the account \$117,652.80 in re-deposits.

Thus, Staff believes that the WIFA Set-Aside Account is short a total of \$155,597.97.

Conclusion

Based on the Company's ability to pay its current WIFA debt service through its Arsenic Impact Fee, (Decision No. 67699, dated March 9, 2005), Staff recommends that Valley not be required to continue to maintain the set-aside account, but be ordered to prepay \$215,540.07 to WIFA (\$59,942.10 - 12/31/2007, fund balance + \$155,597.97 - fund shortages) to reduce its existing WIFA debt balance.

Staff believes that Valley has continued to suffer from a negative rate base and this recommendation to pay WIFA \$215,540.07 will reduce the Company's heavy debt load and will also infuse some much needed equity into its capital structure.

Staff believes that the Company has demonstrated a flagrant disregard for the Commission's Orders regarding the amounts to be deposited into the WIFA Set-Aside Account and the numerous unauthorized uses of the funds and recommends that the Company be fined.

Staff Recommendations

Staff recommends that the Company's request for confirmation of compliance with Decision No. 62908 be denied.

Staff further recommends approval of Valley's request to be released from the obligation to maintain the set-aside account; however Staff recommends that the Company be ordered to use the funds, including the shortage created by utilization of the funds for unauthorized purposes, to prepay \$215,540.07 to WIFA to reduce its existing WIFA debt balance of approximately \$997,000.

Staff also recommends that the Company be fined by the Commission because it did not comply with the requirements of either Decision No. 62908 or Decision No. 68309.