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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

Arizona Corporation Commission

DOCKETED

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IN THE MATTER OF THE APPLICATION OF  
VALLEY UTILITIES WATER COMPANY, INC.,  
FOR AN ACCOUNTING ORDER REGARDING  
DEFERRAL OF ARSENIC TREATMENT  
OPERATING AND MAINTENANCE EXPENSES

DOCKET NO. W-01412A-07-0278

DECISION NO. 70561

**ORDER**

Open Meeting  
October 15 and 16, 2008  
Phoenix, Arizona

**BY THE COMMISSION:**

On May 9, 2007, Valley Utilities Water Company, Inc. ("Valley Utilities" or "Company") filed with the Arizona Corporation Commission ("Commission") an Application for an Accounting Order in this docket ("Application"). In the Application, the Company "requests that the Commission set this matter for hearing, only if deemed necessary," and thereafter order the Company to "account for all Operating and Maintenance Expenses association with the Arsenic Treatment Plant constructed pursuant to and in accordance with Decision No. 68309, be recorded in NARUC Account Number 186.2 (Other Deferred Debits), for the purposes of permitting recovery of those costs in future rate case(s) as determined by the Commission in those proceedings."<sup>1</sup>

On October 1, 2007, in Docket No. W-0142A-07-0560 et al., Valley Utilities filed an application for an emergency rate increase in the form of a well surcharge in two phases based on meter size, and an application to obtain financing totaling \$250,000. Subsequently, the Commission issued, on January 23, 2008, Decision No. 70138 in that docket, approving an interim emergency surcharge effective for all service provided on and after the first day of the month following that in

<sup>1</sup> Decision No. 68309 (November 14, 2005) authorized rates for Valley Utilities and approved Valley Utilities' request for a Water Infrastructure Financing Authority ("WIFA") loan in the amount of \$1,926,100 for the purpose of financing proposed arsenic treatment facilities capital expenditures. Decision No. 68309 denied the Company's request to institute an arsenic operating and maintenance ("O&M") expense recovery surcharge mechanism.

1 which the Company closes on and draws on the long term WIFA financing also approved in the  
2 Decision. Decision No. 70138 ordered the Company to file an application for permanent rate relief  
3 with a test year ending June 30, 2008, no later than December 1, 2008.

4 On March 28, 2008, the Commission's Utilities Division Staff ("Staff") filed a Staff Report  
5 on the Application, recommending that the Company's request for an accounting order be denied.

6 On April 10, 2008, Valley Utilities filed Applicant's Response to Staff Report ("Response"),  
7 setting forth its disagreements with Staff's recommendation. The Response requested "that the  
8 Commission set this matter for hearing, only if deemed necessary."

9 By Procedural Order issued June 2, 2008, a Procedural Conference was set for the purpose of  
10 allowing the parties to discuss the necessity for a hearing in this matter, and to discuss scheduling.

11 A Procedural Conference was held on June 18, 2008. The Company and Staff appeared  
12 through counsel and discussed the need for a hearing on the application and the need for additional  
13 filings prior to a hearing. After discussion, the Company stated that it did not wish to put any more  
14 factual evidence on the record; that it believed that a hearing was not necessary for a Commission  
15 determination on the Application; and that the Company wished to submit its request for relief on the  
16 existing pleadings. Staff stated that it did not oppose a hearing, but that Staff would also stand on its  
17 pleadings. As a hearing was not requested, the matter was taken under advisement.

#### 18 APPLICATION

19 The Application requests an accounting order authorizing deferral of arsenic O&M costs. The  
20 Company requests an accounting order authorizing the deferral of any and all arsenic O&M expenses  
21 in the following form: "[T]he Company shall account for all Operating and Maintenance Expenses  
22 associated with the Arsenic Treatment Plant constructed pursuant to and in accordance with Decision  
23 No. 68309, be recorded in NARUC Account Number 186.2 (Other Deferred Debits), for the purposes  
24 of permitting recovery of those costs in future rate case(s) as determined by the Commission in those  
25 proceedings." The Application states that this request is a principal part of the Positive Equity Plan  
26 the Company filed in compliance with Decision No. 68309, which authorized the Company's current  
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1 permanent rates. The Company claims that it demonstrated projected annual arsenic O&M expense  
2 of \$216,000 in its last rate proceeding, but that the expense recovery was not authorized.

### 3 DISCUSSION

#### 4 Staff Report

##### 5 **Overview of Accounting Orders**

6 In its Staff Report, Staff explains that the purpose of an accounting order is to allow a utility  
7 to record transactions differently from normal regulatory accounting requirements. Staff states that  
8 any request for authorization of a variance from normal regulatory accounting treatment should  
9 balance the interests of the Company and its ratepayers, and should be supported by good cause.  
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11 Staff states that the National Association of Regulatory Utility Commissioners ("NARUC")  
12 Uniform System of Accounts ("USOA") requires all expenses to be recognized in the year incurred,  
13 and that the Commission requires water utilities to keep books and records in conformity with the  
14 NARUC USOA. Staff explains that once a utility expense is incurred and recognized, the expense  
15 becomes a historical expense for which a utility cannot seek future recovery, unless it obtains an  
16 accounting order authorizing accounting recognition different from that prescribed by the NARUC  
17 USOA.

##### 18 **Overview of ARSMs and ACRMs**

19 The Staff Report provides an overview of the arsenic cost recovery mechanisms the  
20 Commission has allowed for water utilities in recognition of the potential for significant, detrimental  
21 financial harm related to compliance with the new reduced arsenic maximum contaminant level  
22 standard established by the U.S. Environmental Protection Agency ("EPA"). Staff states that the  
23 Commission has granted authority to affected utilities allowing them to implement either an arsenic  
24 remedial surcharge mechanism ("ARSM") or an arsenic cost recovery mechanism ("ACRM"). Both  
25 an ARSM and an ACRM establish a means for the utility to collect costs of these unusual capital  
26 improvements from ratepayers. The cost recovery mechanism allowed depends on the method the  
27 utility chooses for financing necessary arsenic-related capital improvements. An ARSM allows a  
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1 utility to collect specified funds to pay debt service on a loan to fund arsenic remediation capital  
2 improvements, and an ACRM allows a utility to defer costs expended for arsenic remediation capital  
3 improvements and specified arsenic remediation O&M expenses for potential subsequent recovery.  
4 In order to protect ratepayers, when an ACRM is approved, the utility is required to file a subsequent  
5 rate application in the near term so that the costs can be reviewed. When an ARSM is approved, no  
6 subsequent rate application is required, because the ARSM only authorizes recovery of an amount to  
7 pay debt service on loans taken to fund arsenic-related capital improvements.

### 8 **Staff's Analysis of Valley Utilities' Deferral Request**

#### 9 Decision No. 68309

10 Staff contends that the only support the Company offers for its accounting order request is the  
11 fact that the revenues authorized by Decision No. 68309 do not include recovery of the Company's  
12 claimed \$216,000 in annual arsenic O&M costs. Staff summarized the specific reasons Decision No.  
13 68309 set forth for denying the Company's requested surcharge for recovery of arsenic remedial  
14 O&M expenses, as follows: 1) the \$216,000 figure claimed by the Company was only an estimate,  
15 which by its nature is not known and measurable, and the Company's estimate was overstated due to  
16 an apparent computation error; 2) the Company already had a \$1,100 Arsenic Impact Fee Tariff in  
17 place, approved by Decision No. 67669 (March 9, 2005); 3) Decision No. 68309 authorized an  
18 arsenic remediation-related WIFA loan and authorized the Company to file for approval of an  
19 ARSM-type surcharge if necessary to pay debt service on the WIFA loan; and 4) the rates approved  
20 in Decision No. 68309 were based on an operating margin basis, not on a return on equity basis.  
21 Staff contends that Decision No. 68309's specified reasons for rejecting the arsenic remedial O&M  
22 expense surcharge remain valid in this proceeding.

23 Staff further explains that Decision No. 68309 authorized an ARSM-type surcharge for the  
24 Company, not an ACRM, and therefore the Company was not ordered to file a subsequent rate case  
25 to review the costs. Staff asserts that authorizing deferral of arsenic remediation O&M expenses  
26 now, in combination with the Company's existing ARSM recovery provisions, which required no  
27 subsequent rate proceeding, would increase the likelihood of inequity to ratepayers. Staff states that  
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1 the normal remedy for a Company seeking to recover an increase in its O&M expenses is to file a rate  
2 application, and argues that granting authority to allow recovery of increased arsenic O&M expenses  
3 outside of a rate proceeding would constitute single issue rate-making.

#### 4 Staff Recommendation

5 Staff believes that the Application fails to provide a justification for a variance from the  
6 NARUC USOA prescribed accounting treatment of arsenic O&M expenses. Staff recommends that  
7 the Application be denied, and that the Company file a rate application once its arsenic remediation  
8 O&M expenses are known. In support of its recommendation, Staff asserts that the circumstances  
9 and applicable rate-making considerations are essentially the same now as they were during the rate  
10 proceeding leading to Decision No. 68309; that the Commission appropriately addressed the issue in  
11 that Decision; and that accordingly, the requested variance from the prescribed NARUC USOA  
12 accounting treatment is not warranted at this time.

#### 13 Staff Alternative Recommendation

14 Staff makes an alternative recommendation in the event that deferral of arsenic O&M  
15 expenses is found to be appropriate. Under that circumstance, Staff recommends that the expense  
16 deferral be consistent with those previously authorized for other utilities' ACRMs. Staff  
17 recommended that in the event an accounting order is issued, that: 1) deferral be allowed for only  
18 media replacement or regeneration costs, media replacement or regeneration service costs, and waste  
19 media or regeneration disposal costs; 2) that the deferral period be limited to no more than the first  
20 twelve months of operation or the first twelve-month period following the effective date of the order,  
21 whichever occurs later; and 3) that Valley Utilities be required to preserve records necessary to  
22 demonstrate that the water provided to customers during the deferral period is in conformity with the  
23 U.S. EPA arsenic maximum contaminant level standard.

#### 24 Company's Response to Staff Report

25 The Company filed its Response on April 10, 2008. Therein, the Company acknowledges that  
26 Decision No. 68309 authorized it to file a surcharge application, if necessary, to pay debt service on  
27 the authorized WIFA loan for arsenic treatment plant construction purposes. Valley Utilities argues  
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1 that its requested accounting order is nonetheless appropriate. The Company is concerned that due to  
2 rate case timing, it may incur arsenic O&M costs for which it will never be able request recovery.  
3 The Company asserts it is likely to incur substantial arsenic O&M costs after the end of the June  
4 2008 test year required by Decision No. 70138,<sup>2</sup> but prior to the test year of its subsequent rate case.

5 Valley Utilities does not yet have any operating history for arsenic O&M costs,<sup>3</sup> and states  
6 that the costs will be incurred with an irregular frequency, and in uneven amounts which cannot be  
7 predicted with any degree of accuracy, because water flows and water quality will have an impact on  
8 the timing of filter media replacement and other O&M costs. The Application states that Valley  
9 Utilities estimates future arsenic treatment O&M costs to be approximately \$200,000 per year. The  
10 Company states that it is not asking for approval of any particular expense amount, but only for the  
11 opportunity to request review and approval of deferred costs in a future rate proceeding. The  
12 Company contends that its ability to recover all its arsenic O&M expenses is important given the  
13 Company's need to improve its equity, as recognized by Decision No. 68309.

14 Company Response to Staff's Alternative Recommendation

15 The Company opposes Staff's alternative recommendations. Valley Utilities argues that the  
16 alternative recommendation's 12 month time period limitation for deferral is inconsistent with the  
17 operation of an arsenic treatment plant. The Company also opposes the alternative  
18 recommendation's limitation of any deferrals to only media replacement or regeneration costs, media  
19 replacement or regeneration service costs, and waste media or regeneration disposal costs, arguing  
20 that deferral of all arsenic O&M costs is necessary, and will permit the Commission to scrutinize the  
21 expenses when determining whether recovery is appropriate. Valley Utilities asserts that until a  
22 definite maintenance cost pattern for a specific arsenic treatment plant has been established, the  
23 deferral of all costs must be allowed to permit the Commission to annualize an appropriate O&M  
24 expense level for future ratemaking purposes.

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26 <sup>2</sup> The Application states that Valley Utilities is set to file a rate case by December 1, 2008, based on a test year ending  
June 30, 2008, as required by Decision No. 70138.

27 <sup>3</sup> The Staff Report states that Staff visited the Company's facilities on January 3, 2008, and that the arsenic remediation  
28 plant was still under construction. The Company stated in its June 19, 2008, letter that it does not expect to incur arsenic-  
related O&M costs prior to the December 1, 2008, deadline for filing the rate case required by Decision No. 70138, but  
expects to incur costs prior to the test year of its next rate case.

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## ANALYSIS

The Application requests that Valley Utilities be granted an accounting order allowing deferral of all its arsenic-related O&M expenses in addition to its previously-authorized Arsenic Impact Fee Tariff, and in addition to its previously-granted authority to file an additional ARSM-type surcharge tariff for recovery of Valley Utilities' debt service payments to WIFA for repayment of a loan authorized to finance the capital costs of Valley Utilities' arsenic treatment facilities, as necessary to allow the Company to meet its principal and interest obligations on the amount of the WIFA loan and income taxes on the surcharges. As Staff states in the Staff Report, in order to mitigate financial harm to water utilities resulting from the costs of compliance with the new EPA arsenic standard, we have granted authority to affected water utilities to implement either an ARSM or an ACRM, depending on the financing method chosen by the utility to finance arsenic-related capital improvements. We have authorized ARSMs, which allow utilities to collect specified funds to pay debt service on a loan to fund the capital improvements. We have also authorized ACRMs, which allow utilities to defer both costs expended for capital improvements and specified O&M expenses for potential subsequent recovery, when the utility finances the capital improvements with equity.

Thus far, Valley Utilities has chosen debt financing, not equity financing, to fund the capital improvements necessary to comply with the new EPA arsenic standard. As the Company acknowledges in its Response, Decision No. 67669 authorized the Company to collect fees pursuant to an Arsenic Impact Fee Tariff to assist it in recovery of the arsenic treatment plant capital costs, and the Company is accumulating the proceeds from that tariff in a separate bank account.<sup>4</sup> Decision No. 68309 authorized the Company to also file an additional ARSM-type surcharge tariff for recovery of Valley Utilities' debt service payments to WIFA for repayment of a loan authorized to finance the capital costs of Valley Utilities' arsenic treatment facilities, as necessary to allow the Company to meet its principal and interest obligations on the amount of the WIFA loan and income taxes on the surcharges. According to a Company compliance filing, the WIFA loan closed on October 19, 2006.

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<sup>4</sup> The Application notes that as of December 31, 2007, the Company had accumulated \$108,410.63 in a separate bank account under the Arsenic Impact Fee Tariff.

1 In a May 9, 2007, compliance filing for Decision No. 68309, the Company indicated that no  
2 surcharge was yet necessary to allow the Company to meet its principal and interest obligations on  
3 the amount of the WIFA loan and income taxes on the surcharges. The Company has not yet filed for  
4 approval of the arsenic removal surcharge tariff as authorized by Decision No. 68309.

5 In Decision No. 68309, for the reasons set forth in that Decision, we denied the Company's  
6 request for a surcharge mechanism to collect arsenic O&M expenses. Decision No. 68309 stated that  
7 instead of approving the surcharge mechanism requested in that case, we will consider actual O&M  
8 costs in a future rate filing, where rates can be established based on known and measurable actual  
9 costs. The Application and the Company's Response present no new facts or arguments to support a  
10 change to our determination on the issue in Decision No. 68309.

11 Valley Utilities contends in its Response that until a definite maintenance cost pattern for a  
12 specific arsenic treatment plant has been established, the deferral of all arsenic O&M costs must be  
13 allowed to permit the Commission to annualize an appropriate O&M expense level for future  
14 ratemaking purposes. We disagree. As long as a utility maintains detailed, accurate and adequate  
15 records of expenses, deferral of costs is not a prerequisite to annualization of known and measurable  
16 expenses in a rate proceeding. The Company also contends that its ability to recover all its arsenic  
17 O&M expenses is important given the Company's need to improve its equity. There is no dispute  
18 that the Company needs to improve its equity position. In Decision No. 68309, we required the  
19 Company to develop, submit and implement a plan to increase its equity position. We imposed this  
20 requirement because we found that the Company had been operated in such a way that its negative  
21 equity position had continued to deteriorate, despite the fact that over a period of years, this  
22 Commission has authorized returns that provided the Company with an opportunity to increase its  
23 equity position. (Decision No. 68309 at 11.) We disagree with Valley Utilities' reasoning that the  
24 deficiency of its current equity position supports the issuance of an accounting order deferring all the  
25 Company's arsenic O&M expenses, in addition to the arsenic-related mitigation measures we have  
26 previously authorized for the Company. The Company's approved Arsenic Impact Fee Tariff and its  
27 authorization to file for approval of an ARSM-type surcharge mechanism to collect debt service costs  
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1 from its customers already serve to insulate the Company from the risks associated with arsenic-  
 2 remediation related capital expenditures. Under these circumstances, we do not believe that the  
 3 ratepayers should be presumed responsible, in advance, for Valley Utilities recouping all of its  
 4 arsenic O&M expenses. Valley Utilities' request for a variance from normal regulatory accounting  
 5 treatment of arsenic-related O&M expenses would not properly balance the interests of the Company  
 6 and its ratepayers, and should therefore be denied.

7 \* \* \* \* \*

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

10 **FINDINGS OF FACT**

11 1. Valley Utilities is an Arizona corporation engaged in the business of providing public  
 12 water utility service to approximately 1,400 customers in the vicinity of Luke Air Force Base and the  
 13 City of Litchfield Park in Maricopa County, Arizona.

14 2. On May 9, 2007, Valley Utilities filed the Application.

15 3. On March 28, 2008, Staff filed a Staff Report on the Application, recommending that  
 16 the Company's request for an accounting order be denied.

17 4. On April 10, 2008, Valley Utilities filed its Response, setting forth its disagreements  
 18 with Staff's recommendation. The Response requested "that the Commission set this matter for  
 19 hearing, only if deemed necessary."

20 5. By Procedural Order issued June 2, 2008, a Procedural Conference was set for the  
 21 purpose of allowing the parties to discuss the necessity for a hearing in this matter, and to discuss  
 22 scheduling.

23 6. At the Procedural Conference held on June 18, 2008, the Company stated that it  
 24 wished to submit its request for relief on the existing pleadings. As a hearing was not requested, the  
 25 matter was taken under advisement.

26 7. In recognition of the potential for significant, detrimental financial harm to water  
 27 utilities related to compliance with the reduced arsenic maximum contaminant level standard  
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1 established by the U.S. EPA for arsenic, this Commission has granted authority to affected utilities  
2 allowing them to implement either an ARSM or an ACRM. An ARSM allows a utility to collect  
3 specified funds to pay debt service on a loan to fund the capital improvements, and an ACRM allows  
4 a utility to defer costs expended for capital improvements and specified O&M expenses for potential  
5 subsequent recovery. In order to protect ratepayers, when an ACRM is approved, the utility is  
6 required to file a subsequent rate application in the near term so that the costs can be reviewed.  
7 When an ARSM is approved, no subsequent rate application is required, because the ARSM only  
8 authorizes recovery of an amount to pay debt service on the arsenic-related capital improvements.

9 8. We have previously addressed arsenic-related mitigation measures for the Company in  
10 Decision No. 67669, which authorized an Arsenic Impact Fee Tariff allowing it to collect fees to  
11 assist it in recovery of arsenic treatment plant capital costs.

12 9. Additionally, Decision No. 68309 authorized permanent rates for Valley Utilities and  
13 approved Valley Utilities' request for a WIFA loan in the amount of \$1,926,100 for the purpose of  
14 financing proposed arsenic treatment facilities capital expenditures. Decision No. 68309 authorized  
15 the Company to file an application for approval of an ARSM-type arsenic removal surcharge tariff if  
16 a surcharge is necessary to allow the company to meet its principal and interest obligations on the  
17 arsenic remediation-related WIFA loan and income taxes on the surcharges.

18 10. Decision No. 70138 granted Valley Utilities' October 1, 2007, request for emergency  
19 rate relief, and ordered Valley Utilities to file, no later than December 1, 2008, a permanent rate case  
20 with a test year ending June 30, 2008.

21 11. Valley Utilities has chosen debt financing, not equity financing, to fund the capital  
22 improvements necessary to comply with the new EPA arsenic standard.

23 12. Decision No. 68309 denied the Company's request to institute an arsenic O&M  
24 expense recovery surcharge mechanism. There has been no change in circumstances supporting a  
25 change to that determination.

26 13. The deferral of all arsenic O&M costs is not a prerequisite for annualizing an  
27 appropriate O&M expense level in a future ratemaking proceeding.  
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ORDER

IT IS THEREFORE ORDERED that Valley Utilities Water Company, Inc.'s request for an accounting order as set forth in the Application is hereby denied.

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

BY 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 the Commission to be affixed at the Capitol, in the City of Phoenix, this 23<sup>rd</sup> day of Oct, 2008.

  
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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1 SERVICE LIST FOR: VALLEY UTILITIES WATER COMPANY, INC.

2 DOCKET NO. W-01412A-07-0278

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4 Richard L. Sallquist  
5 SALLQUIST, DRUMMOND & O'CONNOR, P.C.  
6 4500 South Lakeshore Drive, Suite 339  
7 Tempe, AZ 85282-7198  
8 Attorneys for Valley Utilities Water Company, Inc.

9 Janice Alward, Chief Counsel  
10 Robin Mitchell, Staff Attorney  
11 Legal Division  
12 ARIZONA CORPORATION COMMISSION  
13 1200 West Washington Street  
14 Phoenix, AZ 85007

15 Ernest G. Johnson, Director  
16 Utilities Division  
17 ARIZONA CORPORATION COMMISSION  
18 1200 West Washington Street  
19 Phoenix, AZ 85007

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