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Arizona Corporation Commission
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IN THE MATTER OF THE APPLICATION)
OF ARIZONA-AMERICAN WATER)
COMPANY'S FOR APPROVAL OF)
AN ACCOUNTING ORDER)
AUTHORIZING THE DEFERRAL OF)
PENSION AND OTHER POST)
EMPLOYMENT BENEFITS EXPENSES)

Docket No: WS-01303A-09-0241

ARIZONA-AMERICAN
WATER COMPANY'S
APPLICATION FOR AN
ACCOUNTING ORDER

Arizona-American Water Company ("Arizona-American" or the "Company"), pursuant to A.R.S. §40-221, respectfully requests that the Arizona Corporation Commission ("Commission") approve an accounting order to defer for future rate recovery the difference between Arizona-American's actual booked pension and other post employment benefits ("OPEB") operating expense and the amount previously authorized in its rates for the same expense categories from January 1, 2009 through December 31, 2013. This request is, in part, due to the recent dramatic decline in investment security prices resulting from the recent economic turmoil which has caused the investment funds supporting defined benefit pension and OPEB payments to lose considerable value. However, additionally Arizona-American's pension and OPEB expense increased substantially in 2008. While earlier we believed pension and OPEB

1 expense in 2009 would decline from the 2008 levels, just the opposite has occurred and
2 we anticipate a continuing high expense level for several more years.

3 **I. BACKGROUND**

4 Since Arizona-American Water acquired the water and wastewater assets of
5 Citizens in Arizona, it has accumulated net income losses totaling more than \$31 million
6 through 2008. The Company suspended paying any shareholder dividends more than
7 five years ago. In recent years, the Company has filed a series of rate cases and
8 surcharge requests in order to recover more of its cost of service to mitigate the
9 deteriorating financial situation. The Company appreciates the Commission's approval
10 of these recent rate increases. The Company has – for a number of years – not recovered
11 its cost of service, including pension and OPEB expense. Beginning in 2008, the
12 Company experienced a substantial increase in pension and OPEB expense, but at that
13 time decided to manage as best as it could. Unfortunately, as a result of recent market
14 turmoil, pension and OPEB expense will increase in 2009 above 2008 levels and the
15 Company's financial condition has deteriorated to such a condition that it simply cannot
16 continue to absorb this pension and OPEB expense increase. Therefore, it must, request
17 an accounting deferral order effective January 1, 2009. Put differently, the Company will
18 absorb the increase for 2008, but cannot for 2009.

19 The Company's parent, American Water Works Company ("American Water")
20 administers the pension and OPEB plans and recently its pension plan's **unfunded**
21 position increased from \$(265.1) million at December 31, 2007 to \$(479.8) million at
22 December 31, 2008. The American Water post retirement welfare **unfunded** position
23 increased from \$(158.2) million at December 31, 2007 to \$(240.4) million at December
24 31, 2008. In order to return to even a minimally acceptable unfunded position, Pension
25 and OPEB operating expense is increasing and expected to stay at this higher expense
26 level for several more years.

1 The Company's pension funding policy is to contribute an amount equal to the
2 minimum required contribution under ERISA. Contributions are generally made each
3 plan year in four installments. The Company may increase its contribution above the
4 minimum and/or change the timing of its contributions if appropriate to its tax and cash
5 position and the plan's funded position. The Company's general policy is to fund at the
6 minimum required level, unless special circumstance would make it advantageous to fund
7 at a higher level. In certain circumstances, additional funding can eliminate large spikes
8 in funding required in subsequent years, which reduces volatility and the resulting rate
9 impact on customer. After July, 2009, the Company will know if funding will be more
10 than the ERISA minimum in order to avoid "at risk" status. "At risk" status entails
11 notices to participants and higher liability measures.

12 The Company uses the funding basis to determine pension expense for ratemaking
13 purposes. FAS accounting cost in excess of the amounts contributed to the pension plan
14 is deferred as a regulatory asset.

15 The Company's OPEB funding policy is to contribute an amount equal to the post-
16 retirement welfare FAS accounting cost. Contributions are generally made each year in
17 four installments. The Company may change its contribution if appropriate to its tax and
18 cash position and the plan's funded position. Funds are held in three Voluntary
19 Employee Benefits Association ("VEBA") trust accounts: a) medical bargaining unit
20 employees; b) medical non-bargaining unit employees; and c) life insurance. For 2009
21 the Company is funding the FAS cost.

22 Compliance with the Pension Protection Act of 2006 ("PPA") will lead to
23 increased minimum funding requirements by raising the funding target to 100% of
24 accrued liability. The Worker, Retiree and Employer Recovery Act ("WRERA") of 2008
25 affords some relief from PPA that the Company will take advantage of to partially
26 mitigate the spike in contributions resulting from the recent downturn in the financial

1 markets. Under the new rules, the funding target will be 92% of the funding target
2 liability in 2008, 94% in 2009, and 96% in 2010 before reaching the 100% target
3 mandated under PPA in 2011. In addition, asset "smoothing" is permitted.

4 The Company's pension investment portfolios have been managed properly and
5 the factor driving the aforementioned decline in the portfolios' value is the economic
6 crisis emerging in 2008. At December 31, 2008, the portfolios were invested
7 approximately 70% in equities and 30% in debt. The pension plan portfolio's 2008 rate
8 of return (negative 24.6%) was approximately equal to or slightly better than a number of
9 other companies. The OPEB plan portfolio's 2008 rate of return was (negative 20.4%).

10 American Water took the following appropriate actions both before and after the
11 recent activity in the financial markets as it relates to its benefit plans:

- 12
- 13 ■ Conducted a comprehensive asset and liability study to determine the best
14 mix of investments for the plans. As a result, American Water rebalanced
15 investments to maintain the desired asset allocation and asset
16 diversification. Assets are spread across 10 different investment managers
17 to reduce risk.
- 18 ■ Closed the defined benefit pension and OPEB plans to new participants,
19 with the exception of union employees at the two customer service centers
20 who participate in the pension plan.
- 21 ■ Proactively sought fee reductions where appropriate from the plans'
22 trustees.
- 23 ■ Selected assumptions available under the Pension Protection Act (PPA) and
24 the Worker, Retiree and Employer Recovery Act (WRERA) for funding
25 purposes to reduce volatility and avoid a large increase in funding in 2010,
26 reducing cash requirements and revenue requirement.

1 American Water has a Benefits/Retirement Committee that administers the plans.
2 The five members of the committee have expertise in finance, accounting, law, and
3 human resources. The Committee meets quarterly with its investment advisor, Callan
4 Associates, to monitor the performance and stability of its investment managers.
5

6 Arizona-American's pension and OPEB costs are determined by Towers Perrin
7 and allocated to Arizona-American, including an allocation from American Water Works
8 Service Company. Towers Perrin is a nationally recognized actuary. The cost not
9 capitalized is an operating expense. In the ratemaking process, Arizona-American's
10 pension and OPEB operating expense is, in turn, allocated to each water and wastewater
11 district on employees' hours charged per district. Because Arizona-American's rates are
12 established at the district level, determining the total Commission authorized pension and
13 OPEB operating expense requires a summation of previously approved amounts at the
14 district level.
15
16

17 The annual pension and OPEB operating expenses approved in existing rates at
18 January 1, 2009, by district are only \$240,476 and \$150,023, respectively:
19

<u>Water</u>	<u>Pension</u>	<u>OPEB</u>	<u>Decision No.</u>
Agua Fria	\$ 0	\$ 20,775	See note
Anthem	\$ 36,611	\$ 7,597	70372
Havasu	\$ 0	\$ 2,522	See note
Mohave	\$ 43,096	\$ 5,629	69440
Paradise Valley	\$ 33,772	\$ 87,862	67093
Sun City	\$ 56,038	\$ 2,893	70351
Sun City West	\$ 0	\$ 8,346	See note
Tubac	\$ 0	\$ 1,496	See note
<u>Wastewater</u>			
Anthem / Agua Fria	\$ 22,770	\$ 5,408	70372

1	Mohave	\$ 7,300	\$ 814	69440
	Sun City	\$ 9,249	\$ 5,885	70209
2	Sun City West	<u>\$ 31,640</u>	<u>\$ 796</u>	70209

3

4 Total \$240,476 \$150,023

5 For noted items, OPEB amounts are based on the request in pending Docket No. W-
6 01303A-08-0227 because the workpapers for the prior rate case (Decision No. 67093) for
7 these districts does not appear to break apart OPEB from other Group Insurance Items.
8 This results in an overstatement above of OPEB expenses in current rates for the period
9 January 1, 2009 through the completion of Docket W-01303A-08-0227 (anticipated
10 August 2009), which understates the deferral for that period.

11 Based on amounts authorized in existing rates and expected 2009 pension and
12 OPEB expenses, the following chart provides an illustration of the deferral amount.

	<u>2009</u>	<u>In Rates as of 1-1-09</u>	<u>2009 Deferral</u>
13 Defined Pension	\$ 2.012 M ¹	\$0.240 M	\$1.772 M
14 OPEB	<u>\$ 0.101 M</u>	<u>\$0.150 M</u>	<u>(\$0.049) M</u>
15 Total Expense	\$ 2.113 M	\$0.390 M	\$1.723 M

16 In the pending rate case which includes seven water and wastewater districts in
17 Dockets Nos. W-01303A-08-0227 and SW- 01303A-08-0227, the anticipated
18 Commission authorized annual pension and OPEB operating expenses for Arizona-
19 American will increase; thereby bringing the Company total from \$0.390 million to
20 \$0.995 million upon the effective date of a decision in those docket. This will reduce
21 additions to the deferral thereafter.

22 In 2008, the gap between expense and the amount recovered in rates would have
23 been similar even though the 2008 pension and OPEB expense was somewhat less. The
24

25

26 ¹ \$2,090,643 pension cost for 2009 times 89 percent to O&M for Arizona-American plus
\$151,088 for 2009 Service Company allocation equals \$2,011,760.

1 reason it was similar was that the amount recovered in rates was even less than the
2 \$0.390 million displayed above.

3
4 **II. SPECIFIC PROPOSAL**

5 Arizona-American requests that this deferral be effective January 1, 2009,² and end on
6 December 31, 2013, unless the Commission, after monitoring the deferral reports,
7 determines an earlier termination date appropriate.

8
9 The Company will file annually by March 31 of each year that the deferral is in effect,
10 that year's actuarially determined pension and OPEB expense plus the calculated deferral
11 by month for the prior year with supporting information. If this Application is approved,
12 the Company will file the 2010 pension and OPEB operating expense report by March
13 31, 2010.

14
15 The amounts to be deferred from 2009 through 2013 shall be determined on an on-
16 going basis using actual data. As rate cases are completed, the authorized pension and
17 OPEB operating expense amounts will increase by district. These increases shall be
18 reflected to reduce the on-going deferral calculation. If, at any time during the deferral
19 period, the amount collected in rates exceeds the actual expense, the difference shall be
20 credited as a reduction to the accumulated deferral.

21
22 In order for the Company to actually defer pension and OPEB expenses on its
23 books in an amount equal to the requested deferral, the Company's auditors shall require
24

25
26 ² See Decision No. 69912 (authorizing a deferral of costs effective approximately 15 months prior to the date of the Decision).

1 language in the Commission's Order stating that these costs shall be recovered in the
2 future. The Company shall seek approval in future rate cases of an amortization of the
3 accumulated deferred balance. The exact amortization period shall be determined in
4 future rate cases.
5

6 **III. CONTACT**

7
8 Company contact for this Application is:

9 Thomas M. Broderick
10 Director, Rates and Regulation
11 19820 N. 7th Street
12 Suite 201
13 Phoenix, Arizona 85020
14 (602) 445-2420

15 **IV. CONCLUSION**

16 Since an alternative to an accounting deferral order would be a surcharge
17 mechanism, the Company's proposal benefits customers by *delaying the rate recovery of*
18 *these cost increases during a time of economic hardship.* The proposal also reduces
19 further financial harm to the Company, as otherwise these cost increases must be
20 immediately recognized without deferral with the consequential further net income loss.
21 Regulated utilities should have the opportunity to recover prudently incurred costs.
22 Unless special consideration is given to the substantial increase in pension and OPEB
23 costs, the Company will have had no opportunity to recover these costs.

24 Arizona-American respectfully requests that the Commission issue an accounting
25 order that authorizes Arizona-American to record, for accounting purposes, the difference
26

1 between the actual pension and OPEB expenses and the amount authorized in its rates
2 beginning on January 1, 2009.

3 RESPECTFULLY SUBMITTED this 15th day of May, 2009.

4 LEWIS AND ROCA LLP

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6 

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14 ORIGINAL and thirteen (13) copies
15 of the foregoing filed this 15th day
16 of May, 2009, with:

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21 COPY of the foregoing mailed
22 this 15th day of May, 2009, to:

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