

OPEN MEETING ITEM



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ARIZONA CORPORATION COMMISSION

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ORIGINAL

DATE: JANUARY 19, 2010

DOCKET NO.: W-01412A-08-0586

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Sarah N. Harpring. The recommendation has been filed in the form of an Opinion and Order on:

VALLEY UTILITIES WATER COMPANY, INC.
(RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

JANUARY 28, 2010

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

FEBRUARY 2, 2010 AND FEBRUARY 3, 2010

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission
DOCKETED

JAN 19 2010

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ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 KRISTIN K. MAYES - Chairman
4 GARY PIERCE
5 PAUL NEWMAN
6 SANDRA D. KENNEDY
7 BOB STUMP

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

DOCKET NO. W-01412A-08-0586

DECISION NO. _____

OPINION AND ORDER

10 DATE OF HEARING: September 11 (Pre-Hearing Conference) and September
11 15, 2009

12 PLACE OF HEARING: Phoenix, Arizona

13 ADMINISTRATIVE LAW JUDGE: Sarah N. Harpring

14 APPEARANCES: Mr. Patrick J. Black, FENNEMORE CRAIG, P.C., on
behalf of Valley Utilities Water Company, Inc.; and

15 Mr. Kevin O. Torrey, Staff Attorney, Legal Division, on
16 behalf of the Utilities Division of the Arizona
Corporation Commission.

17 **BY THE COMMISSION:**

18 This case involves an application for a permanent rate increase, filed with the Arizona
19 Corporation Commission ("Commission") on December 1, 2008, by Valley Utilities Water
20 Company, Inc. ("Valley"), a Class B water utility providing water utility service in unincorporated
21 areas of Maricopa County in the vicinity of Glendale, Arizona. Valley's last permanent rate case was
22 decided in Decision No. 68309 (November 14, 2005).

23 * * * * *

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

26 FINDINGS OF FACT

27 Background

28 1. Valley is a Class B public service corporation providing water utility service to

1 approximately 1,399 customers within an approximately five-square-mile service area consisting of
2 unincorporated portions of Maricopa County just to the east of Luke Air Force Base. (See Ex. S-1.)
3 Valley obtained its Certificate of Convenience and Necessity ("CC&N") from the Commission in
4 Decision No. 54274 (December 20, 1984). Valley's last permanent rate case was decided in Decision
5 No. 68309 (November 14, 2005), using a test year ("TY") ending December 31, 2003.

6 2. As of the Commission's Utilities Division's ("Staff's") initial engineering inspection,
7 Valley's system had six active wells with a combined flow rate of 1,125 gallons per minute ("GPM");
8 six storage tanks with a combined capacity of 2,060,000 gallons; four booster stations; and a
9 distribution system serving approximately 1,400 customers. (Ex. S-1.) For emergency purposes,
10 Valley's system is interconnected with the system of Litchfield Park Service Company ("LPSCO")
11 with a 6" meter, limited to a maximum of 300 GPM. (*Id.*) At the time of Staff's initial field
12 inspection, Valley's old Well #6 was capped, and its new Well #6 was not yet approved for service.
13 (*Id.*) Staff determined at that time that Valley's system had adequate well production and storage
14 capacity to serve its existing connections, but that its wells were near capacity, and its system would
15 need the new Well #6's production in the near future.¹ (*Id.*) Staff stated that the emergency
16 interconnection with LPSCO would provide a supplemental source until the new Well #6 could be
17 placed into service. (*Id.*)

18 3. Prior to the hearing in this matter, Valley received Approval of Construction for Well
19 #6 and placed it into service. (Tr. at 95.) Staff verified that Well #6 is operational and determined
20 that this post-TY plant item is used and useful for this proceeding. (*Id.*)

21 4. Valley's wells are located at three different well sites. (Ex. A-2.) Two of these, the
22 Glendale Well Field and the Bethany Home Well Field, contain three wells each that produce water
23 exceeding the current U.S. Environmental Protection Agency ("EPA") and Arizona Department of
24 Environmental Quality ("ADEQ") Maximum Contaminant Level ("MCL") of 10 parts per billion
25 ("ppb") for arsenic.² (*Id.*) Valley hired a consulting firm to conduct an arsenic treatment study using

26 ¹ Staff explained that the new Well #6 had a problem with sand infiltration and that Valley was evaluating possible
27 remedies. (Ex. S-1.)

28 ² The well at Valley's third well site produces water that complies with the MCL for arsenic. (Ex. A-2.) Valley
reported the following arsenic levels for its wells: Well #1—12 ppb, Well #2—13 ppb, Well #3—7 ppb, Well #4—12
ppb, Well #5—13 ppb, Well #6—11 ppb, and Well #7—13 ppb. (Ex. S-1.)

1 treatment model methods included in ADEQ guidelines and, in May 2004, received a report
2 recommending the use of absorption media treatment to treat the water from five of Valley's wells at
3 a total treatment system cost of \$1,926,100. (*Id.*) Construction on Valley's arsenic treatment
4 facilities began in December 2006, but was suspended in November 2007 because Maricopa County
5 required that a Special Use Permit be obtained before rather than after construction. (Ex. A-2.) A
6 Special Use Permit was obtained in October 2008, and construction resumed in November 2008.
7 (*Id.*) The evidence indicates that neither arsenic treatment facility has received Approval of
8 Construction, although both have been constructed.³ (Tr. at 96; LFE-A1.)

9 5. Valley's system serves primarily residential customers, with the majority of residential
10 customers served by ¾" meters, followed by 1" meters and then 5/8" x ¾" meters. (Ex. A-7; Ex. A-
11 8.) The average and median monthly consumption levels of Valley's residential ¾" meter customers
12 are 9,531 gallons and 8,500 gallons, respectively. (Ex. A-7; Ex. A-8.)

13 6. According to a Maricopa County Environmental Services Department ("MCESD")
14 Public Water System Compliance Status Report dated February 17, 2009, Valley's water system is
15 compliant, with no major treatment plant deficiencies, no major operations and maintenance
16 deficiencies, and no water quality monitoring or reporting deficiencies and is delivering water that
17 complies with state and federal drinking water quality standards as required by the Arizona
18 Administrative Code ("A.A.C.") Title 18, Chapter 4. (Ex. A-1.) Valley has been using water
19 blending techniques and performing monitoring to ensure that its water supply meets the
20 requirements of the Safe Drinking Water Act pending the final approval of its arsenic treatment
21 facilities. (Ex. A-2.) Valley had a regulatory exemption from the arsenic MCL, which expired on
22 January 31, 2009. (*Id.*)

23 7. Valley is located in the Phoenix Active Management Area ("AMA") and is subject to
24 AMA reporting and conservation requirements. (Ex. S-1.) According to the Arizona Department of
25

26 ³ As of September 25, 2009, Valley reported that the arsenic treatment facilities for the Glendale Well Field had passed
27 validation testing and a field inspection and had received an Approval to Commence Operations allowing commencement
28 of commission testing, which is required to receive an Approval of Construction. (Ex. LFE-A2.) Valley expected
commission testing to be completed in October 2009. (*Id.*) Although its construction was completed, the arsenic
treatment facilities for the Bethany Well Field were still awaiting a Special Use Permit, which is required to receive an
Approval to Construct. (*Id.*) Valley was uncertain when the Special Use Permit would be obtained. (*Id.*)

1 Water Resources ("ADWR"), Valley is currently in compliance with ADWR requirements governing
2 water providers and/or community water systems. (*See id.*)

3 8. Valley is subject to mandatory participation in the ADEQ Monitoring Assistance
4 Program ("MAP"), which requires water companies to pay a fixed \$250 per year fee plus an
5 additional fee of \$2.57 per service connection in sampling fees. (*See Ex. S-1.*)

6 9. During the TY, Valley pumped 377,937,000 gallons and sold 355,372,000 gallons,
7 which reflects a water loss of approximately 6 percent, well within the Commission's standard for
8 water loss to be lower than 10 percent. (*Ex. S-1.*)

9 10. Valley has no delinquent compliance items from an engineering standpoint, and
10 Staff's Compliance Database shows no delinquent compliance items. (*Ex. S-1.*) Compliance issues
11 are discussed further below.

12 11. Staff's search of Commission records revealed that Valley was the subject of six
13 complaints in the past four years, all of which have been resolved. (*Ex. S-2.*)

14 12. Staff reported that Valley is in good standing with the Commission's Corporations
15 Division. (*Ex. S-2.*)

16 13. Valley has an approved curtailment tariff and an approved backflow prevention tariff
17 on file with the Commission. (*Ex. S-1.*)

18 Pertinent Prior Commission Decisions

19 14. In Decision No. 62908 (September 18, 2000), the Commission granted Valley a
20 permanent rate increase; authorized Valley to incur long-term debt in the form of a Water
21 Infrastructure Finance Authority of Arizona ("WIFA") loan for \$452,080 ("WIFA Loan #1");
22 authorized Valley to set aside each month the amount of funds equivalent to 1/12 of the annual debt
23 service requirement of WIFA Loan #1 and, until that figure was known, \$6.35 per bill per month
24 ("set-aside funds"); and required Valley to place the set-aside funds in a separate, interest-bearing
25 account to be used solely for the purpose of servicing WIFA Loan #1. The Decision also required
26 Valley to submit to Staff, within 60 days after the Decision, information detailing the amount of the
27 debt service requirement on WIFA Loan #1 and required Valley to file copies of all executed
28 financing documents within 30 days of obtaining the financing.

1 15. In Decision No. 67669 (March 9, 2005), the Commission authorized off-site facilities
2 hook-up fees, as arsenic impact fees ("AIFs"), and required Valley to use the AIFs only to pay the
3 costs of arsenic treatment facilities, to include repayment of loans obtained to install arsenic treatment
4 facilities to benefit the entire water system. The AIFs were to be used to pay the debt service and/or
5 principal reduction on a WIFA Loan for \$1,926,100, for which the application was still pending at
6 that time in another docket. The approved AIFs were \$1,100 for all new 5/8" x 3/4" meter service
7 connections and larger graduated amounts for larger meter sizes. In the Decision, among other
8 things, the Commission required that Valley file an annual AIF status report by January 31 of each
9 year and until the AIF Tariff was no longer in effect, with the first such report due on January 31,
10 2006.

11 16. In Decision No. 68309 (November 14, 2005), the Commission granted Valley a
12 permanent rate increase; approved a \$1,926,100 WIFA loan ("WIFA Loan #2"), to be used to pay for
13 arsenic treatment facilities to bring Valley's water into compliance with the arsenic MCL; denied
14 Valley's request for an arsenic operating and maintenance recovery surcharge mechanism; and
15 canceled the authority for Valley to obtain WIFA Loan #1, which had not been drawn on by Valley.
16 The Commission ordered Valley to file an application for approval of an arsenic removal surcharge
17 tariff if a surcharge were necessary to allow Valley to meet its principal and interest obligations on
18 WIFA Loan #2 and the income taxes on the surcharges. The Commission determined that Valley had
19 been collecting the set-aside funds authorized in Decision No. 62908, and found that it would be
20 appropriate for Valley to use the collected set-aside funds to pay debt service for WIFA Loan #2, but
21 did not directly order Valley to do so and did not expressly cancel the authority to collect the set-
22 aside funds. Instead, the Commission ordered Valley to file a report providing detailed information
23 regarding the set-aside funds collected and analyzing the extent to which application of the collected
24 set-aside funds would offset the amount of, or the need for, a surcharge to service WIFA Loan #2 and
25 ordered Valley to file copies of its revenue requirement calculation for WIFA Loan #2, which was to
26 include the effects of applying both the set-aside funds and the AIFs collected by Valley. The
27 Commission also ordered Valley to institute operating policies to remove any and all non-arm's-
28 length transactions between Valley and its owners and ordered Staff to scrutinize Valley's books

1 carefully in its next rate case and to bring to the Commission's attention any non-arm's-length
2 transactions, including but not limited to improper lease arrangements and payment of personal
3 expenses. In addition, the Commission directed Valley to develop and institute a plan to produce a
4 positive equity position by December 31, 2010 ("Equity Plan"), which Valley was to file as a
5 compliance item within 90 days, and ordered Staff to bring to the Commission's attention in Valley's
6 next rate case all evidence of any inappropriate practices contributing to the deterioration of Valley's
7 equity.

8 17. In Decision No. 70052 (December 4, 2007), Valley received approval to issue 4,000
9 shares of common stock, in an amount not to exceed \$300,000, to Valley's owners, Robert and
10 Barbara Prince, as partial payment for certain real and personal property⁴ with a total appraised value
11 of \$429,000. The Decision stated that Valley's Equity Plan had been filed with the Commission on
12 February 13, 2006, and that the common stock transaction was a result of the Equity Plan and would
13 move Valley toward a positive equity position.

14 18. In Decision No. 70138 (January 23, 2008), the Commission granted Valley approval
15 to incur long-term debt in an amount up to \$250,000 ("WIFA Loan #3") for purposes of drilling a
16 replacement well to replace its largest well (Well #6), which had failed in August 2007, and also
17 granted Valley approval to assess an interim emergency well surcharge ("well surcharge") by meter
18 size to service the debt on WIFA Loan #3.⁵ The Commission also ordered Valley to file, by
19 December 1, 2008, a full rate case application using a TY ending June 30, 2008, and to file with the
20 Commission's Business Office a bond or sight draft letter of credit in the amount of \$1,500. The
21 Decision stated that the well surcharge is interim and subject to refund pending a decision on
22 Valley's permanent rate application.

23 19. In Decision No. 70561 (October 23, 2008), the Commission denied Valley's request
24 for an accounting order to allow it to defer all of its arsenic operating and maintenance expenses for
25 purposes of permitting recovery of those costs in future rate cases, reasoning that Valley's existing
26

27 ⁴ The property included a 2.45-acre parcel (the Maryland Avenue Booster Station) used as an industrial storage site, a
utility vehicle, and a backhoe.

28 ⁵ Repayment on WIFA loan #3 was to commence in May 2009. (Ex. A-7.) The well surcharge amounts range from
\$0.64 for a 5/8" x 3/4" meter to \$73.63 for a 12" meter.

1 AIF Tariff and its authorization to file for approval of an arsenic remediation surcharge mechanism to
2 collect debt service costs from its customers already served to insulate Valley from the risks
3 associated with arsenic-remediation-related capital expenditures.

4 20. In Decision No. 70956 (April 7, 2009), the Commission denied Valley an order
5 confirming compliance with Decision No. 62908, but granted release of the set-aside funds collected
6 pursuant to that Decision for the sole purpose of servicing the debt for WIFA Loan #2. The
7 Commission found that Valley had failed to comply with Decision No. 62908 by commingling set-
8 aside account funds with other funds, using set-aside account funds for purposes other than those
9 authorized by the Commission, failing to advise Staff of the actual amount of WIFA Loan #1 debt
10 service, and failing to file copies of the closing documents for WIFA Loan #1. The Commission also
11 found that Valley had failed to file its AIF status reports for 2005, 2006, and 2007 until February
12 2008 and that those status reports had been incomplete and, further, that as of March 17, 2009, Valley
13 had not filed its AIF status report for 2008, which had been due on January 31, 2009. Valley was
14 ordered to file, within 20 days, complete copies of its bank statements for the set-aside fund account;
15 was ordered to file, beginning on July 15, 2009, and until further order of the Commission, quarterly
16 reports documenting the use of the set-aside funds to service WIFA Loan #2; and was ordered to file,
17 within 30 days, a detailed accounting of how funds withdrawn from the set-aside fund account were
18 used, for the period from September 2003 to the present. Staff was ordered to review and analyze
19 Valley's detailed accounting of the use of the set-aside funds in the context of the rate case (this
20 proceeding) to determine the amount of set-aside funds collected that should offset WIFA Loan #2
21 and to determine whether the funds commingled in the set-aside account were used for utility
22 purposes. Staff was also ordered to investigate whether Valley was in compliance with Decision No.
23 67669 and Decision No. 68309 concurrently with any Order to Show Cause ("OSC") proceeding that
24 Staff may choose to initiate in its discretion.

25 21. In Decision No. 71287 (October 7, 2009), the Commission approved Valley's
26 application for an arsenic remediation surcharge mechanism ("ARSM") surcharge to cover the costs
27 of its debt service for WIFA Loan #2. The ARSM surcharge approved is \$5.51 per month for a
28

1 customer served by a 5/8" x 3/4" meter and is graduated based on meter size.⁶ The Commission also
 2 found, consistent with Staff's determination, that Valley had over-collected a total of \$66,719 in set-
 3 aside funds, interest, and AIFs, which sum was available to cover Valley's payments on WIFA Loan
 4 #2 from August 1, 2009, through November 1, 2009. Staff stated that Valley's spending the over-
 5 collected funds to cover its payments for those four months would bring Valley into compliance in its
 6 use of set-aside funds and AIFs and thus render it eligible to obtain the ARSM surcharge tariff. The
 7 Commission approved the ARSM surcharge, effective November 1, 2009, and ordered that the
 8 ARSM surcharge will expire on the effective date of the rates authorized in a rate proceeding
 9 subsequent to the currently pending rate proceeding (i.e., subsequent to this docket) or on August 31,
 10 2013, whichever comes first. Staff did not recommend initiation of an OSC proceeding or any other
 11 adverse action against Valley, instead "monetiz[ing] the level of non-compliance that still exist[ed]"
 12 in the form of the over-collected funds and recommending that the ARSM surcharge tariff not
 13 become effective until after those over-collected amounts had been used to pay debt service on WIFA
 14 Loan #2. The Decision did not address cancellation of the existing AIF Tariff.

15 Procedural History

16 22. On December 2, 2008, Valley filed an application for a permanent rate increase, using
 17 a TY of July 1, 2007, through June 30, 2008, as required by Commission Decision No. 70138, and
 18 requesting approval of rates and charges that would provide Valley with an operating margin of 15
 19 percent, which Valley asserted would provide it with sufficient cash flow to pay its operating
 20 expenses, to pay for expected capital improvements, and to cover requisite annual debt service on
 21 WIFA loans obtained to construct arsenic treatment facilities and for an emergency replacement
 22 well.⁷ Valley proposed to use an operating margin approach to establish its rates because of the
 23 negative equity in its capital structure. (Ex. A-7.) Valley requested that its original cost rate base
 24 ("OCRB") be used as its fair value rate base ("FVRB"). (*Id.*) For the TY, Valley reported adjusted
 25 gross revenues of \$1,209,703; adjusted operating income of \$12,012; and an adjusted FVRB of

26 _____
 27 ⁶ The ARSM surcharge ranges from \$5.51 for a 5/8" x 3/4" meter to \$88.12 for a 3" meter. The ARSM surcharge for a
 3/4" meter is \$8.26.

28 ⁷ Official notice is taken of the portion of Valley's application other than Direct Testimony and Schedules, as these
 application documents were not entered into evidence as Exhibits.

1 \$1,741,191. (Ex. A-7 at Sched. A-1.) Valley stated that the increase in revenues needed to produce a
2 15-percent operating margin was approximately \$323,456, a 26.74 percent increase in TY revenues.
3 (*Id.*) With its Application, Valley filed the Direct Testimony of Robert L. Prince, President, and
4 Thomas Bourassa, CPA, Consultant.

5 23. On January 6, 2009, Staff issued a Letter of Sufficiency, indicating that Valley's
6 Application had met the sufficiency requirements of A.A.C. R14-2-103 and classifying Valley as a
7 Class B water utility.

8 24. On January 12, 2009, a Procedural Order was issued scheduling a pre-hearing
9 conference and a hearing in this matter for September 11 and 15, 2009, respectively, and establishing
10 other procedural requirements and deadlines.

11 25. On March 16, 2009, Staff's Consumer Services Section filed the comments of a
12 Valley customer opposing the rate increase for economic reasons.

13 26. On March 31, 2009, Valley filed an Affidavit of Publication stating that notice of
14 Valley's application and the scheduled hearing had been published in the *West Valley View* and the
15 *West Valley Business*, newspapers of general circulation in Valley's service area, on February 27,
16 2009, and an Affidavit of Mailing stating that Valley had mailed notice of the application and hearing
17 to its customers on February 20, 2009.⁸

18 27. On April 8 and May 6, 2009, Marlin Scott, Jr., Staff Utilities Engineer, completed a
19 field inspection of Valley's water system. (Ex. S-1.)

20 28. On July 6, 2009, Staff filed the Direct Testimony of Gary T. McMurry, Public Utilities
21 Analyst IV, and Mr. Scott. Staff filed Mr. McMurry's Amended Direct Testimony on July 7, 2009,
22 to include inadvertently omitted pages.

23 29. On August 5, 2009, Valley filed the Rebuttal Testimony of Mr. Prince and Mr.
24 Bourassa.

25 30. On August 26, 2009, Staff filed the Surrebuttal Testimony of Mr. McMurry and Mr.
26 Scott.

27

28 ⁸ Official notice is taken of these Affidavits, which were not entered into evidence as Exhibits in this matter.

1 31. On September 8, 2009, Valley filed the Rejoinder Testimony of Mr. Prince and Mr.
2 Bourassa.

3 32. On September 11, 2009, a pre-hearing conference was held in this matter at the
4 Commission's offices in Phoenix, Arizona. Valley and Staff appeared through counsel and provided
5 matrices of the issues in this case. The parties were informed of several subject areas to address in
6 their presentations at hearing.

7 33. Also on September 11, 2009, the parties filed summaries of their witnesses' testimony.

8 34. On September 15, 2009, a full evidentiary hearing was held before a duly authorized
9 Administrative Law Judge of the Commission at the Commission's offices in Phoenix, Arizona.
10 Valley and Staff appeared through counsel and provided evidence. Valley provided the testimony of
11 Mr. Prince and Mr. Bourassa. Staff provided the testimony of Mr. McMurry and Mr. Scott. At the
12 conclusion of the hearing, Valley was directed to file late-filed exhibits ("LFEs"), to include
13 clarification of the approval status of Valley's Glendale Well Field arsenic treatment facility and a
14 copy of Valley's Central Arizona Project ("CAP") water agreement, and Staff was directed to file,
15 also as an LFE, a complete set of schedules showing Staff's final recommendations, which had
16 changed at hearing. No public comment was provided.

17 35. On September 28, 2009, Staff's Consumer Services Section filed the comments of a
18 Valley customer opposing the rate increase for unspecified reasons.

19 36. On September 30, 2009, Valley filed its LFEs, including an Exhibit 1 ("LFE-A1") and
20 an Exhibit 2 ("LFE-A2"). LFE-A1 includes a copy of Valley's CAP Municipal and Industrial
21 Subcontract, dated May 10, 2007; an Agreement for Payment of Past CAP M&I Water Service
22 Capital Charges, dated November 5, 2007; and CAP invoices for the period from 2007-2009. LFE-
23 A2 includes a narrative description of the current status of the arsenic treatment facilities at the
24 Glendale Well Field and the Bethany Home Well Field as well as a copy of an MCESD Approval to
25 Commence Operations with Stipulations for the Glendale Well Field facilities, dated July 8, 2009.

26 37. On October 13, 2009, Valley and Staff filed their post-hearing briefs. Staff included
27 its LFE as an attachment to its post-hearing brief ("LFE-S1").

28

1 38. On October 23 and 26, 2009, Staff filed corrections to LFE-S1.⁹

2 **Ratemaking**

3 39. Valley was required to file its rate case by Decision No. 70138, but asserts that filing
4 rate cases more frequently is a component of its Equity Plan, as doing so should enable Valley to
5 receive necessary earnings to help it improve its capital position. (Tr. at 171.)

6 40. In its application, Valley stated that its actual TY revenue was \$1,245,428; that its
7 adjusted TY revenue was \$1,209,703; that its adjusted TY operating income was \$12,012; that it
8 requires operating income of \$229,974; that it requires a 15-percent operating margin; that its
9 operating income deficiency is \$217,962; that its gross revenue conversion factor is 1.4840; and that
10 it requires an increase in gross revenue of \$323,456, which represents an increase of 26.74 percent.
11 (Ex. A-7.) In its application, Valley asserted that its actual OCRB at the end of the TY was negative
12 \$663,788, which it adjusted to \$1,741,191 through an increase of \$2,000,500 in plant in service, a
13 decrease of \$416,134 in accumulated depreciation, and an increase of \$11,655¹⁰ to accumulated
14 amortization of contributions in aid of construction ("CIAC"). (*Id.*) Valley did not request use of
15 reconstruction cost new rate base ("RCNRB") to determine its FVRB. (*Id.*)

16 41. The large increase in plant in service proposed by Valley represented \$250,000 in
17 post-TY plant for the new Well #6; negative \$175,600 in post-TY plant for the retirement of the old
18 Well #6; \$1,826,100 in post-TY plant for arsenic treatment facilities; and \$100,000 in arsenic media.
19 (Ex. A-7.)

20 42. In its rebuttal testimony, Valley agreed to exclude the post-TY arsenic treatment
21 facilities from rate base and the related depreciation from operating expenses.¹¹ (Ex. A-8.) In
22 addition, Valley reduced its requested operating margin to 10 percent, to make it consistent with
23 Staff's recommendation. (*Id.*) Valley and Staff agreed on the level of accumulated depreciation,
24 advances in aid of construction ("AIAC"), CIAC, customer meter deposits, and accumulated deferred
25

26 ⁹ All references to LFE-S1 refer to LFE-S1 as corrected.

27 ¹⁰ In its initial schedules, Valley sometimes included an adjustment of \$11,491 for accumulated amortization of CIAC.
It is unclear why the discrepancy exists.

28 ¹¹ Mr. Bourassa stated that this decision was made assuming that the surcharge from the ARSM approved in Decision
No. 68309 would be approved, adequate to service the debt for the arsenic treatment facilities, and in effect until the
conclusion of Valley's next rate case. (Ex. A-8.)

1 income taxes ("ADIT"). (Ex. A-8.)

2 43. Valley and Staff agreed to include \$265,882 for Well #6 in post-TY plant in service,
3 the amount supported by invoices, as Well #6 is now used and useful, although it came into service
4 post-TY. (See Ex. A-9; LFE S-1.) Mr. McMurry explained that the new Well #6 provides
5 replacement capacity for a well that is no longer operational, thereby replacing lost TY well capacity
6 and restoring TY capacity. (Ex. S-4.) Mr. McMurry further explained that because the well
7 surcharge in effect provides recovery of the debt service on the loan used to finance construction of
8 the new Well #6, recognizing Well #6 in rate base does not create a mismatch that is inconsistent
9 with the TY concept. (*Id.*) Valley and Staff agreed that the well surcharge should terminate upon
10 establishment of new permanent rates in this proceeding.¹² (*Id.*; Ex. A-8.)

11 44. Valley and Staff agreed to exclude \$1,771,100 in arsenic treatment plant and \$100,000
12 in arsenic media and to reclassify and exclude \$55,000 for the cost of an easement related to arsenic
13 treatment facilities because the arsenic treatment facilities do not yet have final approval from ADEQ
14 and thus are not yet used and useful. (See Ex. A-9; Ex. A-3; LFE S-1.)

15 45. Valley and Staff agreed to adjust TY revenues by negative \$24,537 to annualize
16 revenues based on the assumption that the number of customers at the end of the TY are
17 representative of the number of customers during the entire TY. (Ex. S-4.) Valley provided
18 schedules supporting these reduced revenues. (See Ex. A-8 at Sched. C-2; Ex. A-9 at Sched. C-2; Ex.
19 A-8 at Sched. H-1.) These schedules establish that bringing Valley's actual figures in line with its
20 end-of-TY customer count would result in a reduction in customer bills of 94 over all customer
21 classes and meter sizes; a reduction in revenue based on current rates and charges of \$24,536; and a
22 reduction in gallons pumped of 5,997,100.¹³ (See Ex. A-8 at Sched. C-2; Ex. A-9 at Sched. C-2; Ex.
23 A-8 at Sched. H-1.)

24 46. Valley and Staff agreed on the method of computing property taxes, which includes
25

26 ¹² Mr. Bourassa asserted that the well surcharge should be canceled only if Well #6 is included in rate base. (Ex. A-8.)
Staff asserted that the well surcharge should be eliminated regardless of the rate base treatment of the new Well #6. (Ex.
27 S-4.)

28 ¹³ Valley did not break out the change in gallons pumped for 5/8" and 3/4" commercial customers, although it did
provide minimally decreased revenue amounts for these customer classes, which implies reduced volume sold. (See Ex.
A-8 at Sched. C-2; Ex. A-9 at Sched. C-2; Ex. A-8 at Sched. H-1.)

1 two years of adjusted revenues plus one year of proposed revenues. (Ex. A-8.) The differences in the
 2 parties' property tax figures result from differences in the parties' proposed revenues. (*Id.*)

3 47. Valley agreed to Staff's recommended upward adjustment to outside services expense
 4 for water testing, reclassification of insurance expenses, and downward adjustment to insurance
 5 expense for non-recurring expense. (Ex. A-8.) Valley and Staff have not reached agreement on a
 6 Valley-proposed negative \$102,966 adjustment to metered revenues; the amount of purchased power
 7 expense adjustment resulting from a rate increase granted to Arizona Public Service Company
 8 ("APS") post-TY;¹⁴ Valley-proposed downward adjustments to purchased power expense and
 9 chemical expense resulting from revenue loss;¹⁵ a Staff-recommended downward adjustment to
 10 normalize repairs and maintenance ("R&M") expense; the adjustment to be made to depreciation
 11 expense;¹⁶ and the adjustments to be made to property tax expense and income tax expense, both of
 12 which are affected by revenues. (*See* Ex. A-8; Ex. A-9.)

13 48. In addition, in its post-hearing final schedules, Staff reclassified \$6,137 in interest
 14 expense incurred by Valley on customer security deposits during the TY from a non-operating (below
 15 the line) expense to an operating (above the line) expense, moved \$22,950 from other water revenues
 16 to metered water revenues to recognize the lost revenue expected to result from Staff's reduction in
 17 Valley's late fee from \$10 to 1.5 percent, and added \$2,660 in other water revenues to reflect and
 18 reclass the increased revenue expected to be realized as a result of increases in miscellaneous service
 19 charges.¹⁷ (LFE S-1.) The \$2,660 adjustment in other water revenues to reflect the increased
 20 revenue that should be realized as a result of increases in miscellaneous service charges is appropriate
 21 and will be adopted herein. The issues of interest expense on customer security deposits and late fees

22 _____
 23 ¹⁴ Staff recommends a purchased power adjustment of \$18,524 due to the APS rate increase, whereas Valley proposes
 24 an adjustment of \$17,219 due to the APS rate increase. (Ex. LFE S-1; Ex. A-9; Tr. at 111-12.) The \$18,524 is the
 25 amount calculated by Valley based on Staff's revenue annualization figure. (Ex. A-9.) Mr. McMurry testified at hearing
 26 that Staff had come to agree with the adjustment after its surrebuttal testimony had been filed. (Tr. at 111-12.) The
 27 adjustment is calculated by multiplying Staff's annualized figure of 319,387 gallons sold (in thousands) by \$0.058 in
 28 increased purchased power costs per thousand gallons. (Ex. A-9.)

¹⁵ Valley proposes an adjustment of negative \$9,656 in purchased power expense and of negative \$540 in chemical
 expense due to revenue loss, whereas Staff recommends no such adjustments. (Ex. LFE S-1; Ex. A-9.)

¹⁶ The parties are less than \$200 apart on adjusted TY depreciation expense. (Ex. A-9; LFE S-1.)

¹⁷ Mr. McMurry testified at hearing that Staff would be revising its schedules to show the lost revenue from reducing
 the late fee from \$10 to 1.5 percent. (Tr. at 113, 123.) Mr. McMurry also testified at hearing that Staff would be revising
 its schedules to include the 6-percent deposit interest expense as an operating expense. (Tr. at 114.) Staff apparently
 decided after the hearing to recommend recognition of the \$2,660 adjustment proposed by Valley.

1 are discussed below.

2 49. Valley and Staff took the following final positions regarding rate base and revenue
3 requirements:

	<u>Valley Proposed</u> ¹⁸	<u>Staff Recommended</u> ¹⁹
4 Adjusted OCRB/FVRB	(\$169,027)	(\$169,027)
5 Adjusted Operating Income	(\$8,449)	\$48,936
6 Required Operating Margin	10.00% ²⁰	10.00%
7 Required Operating Income	\$131,871	\$135,479
8 Operating Income Deficiency	\$140,321	\$86,542
9 Gross Revenue Conversion Factor	1.5107	1.7072
10 Required Increase in Gross Rev.	\$211,977	\$147,741
11 Adjusted TY Revenue	\$1,106,737	\$1,207,044
12 Proposed Annual Revenue	\$1,318,714	\$1,354,785
13 Required Increase in Gross Rev. (%)	19.15%	12.24%

14 50. Valley's current rates and charges,²¹ Valley's proposed rates and charges, and Staff's
15 recommended rates and charges are as follows:

	<u>Present Rates</u>	<u>Company Proposed</u>	<u>Staff Recommended</u>
16 <u>MONTHLY USAGE CHARGE:</u>			
17 5/8" x 3/4" Meter—All Classes	\$ 11.24	\$ 13.24	\$ 12.75
18 3/4" Meter—All Classes	16.87	19.87	19.10
19 1" Meter—All Classes	28.10	33.10	32.00
20 1 1/2" Meter—All Classes	56.21	66.22	64.00
21 2" Meter—All Classes	89.94	105.95	102.00
22 3" Meter—All Classes	179.87	211.89	204.00
23 4" Meter—All Classes	281.05 ²²	331.08	319.00
24 6" Meter—All Classes	562.10 ²³	662.15	638.00
25 Construction Water	179.87	By Meter Size ²⁴	None

16 ¹⁸ The source for this data is Ex. A-9.

17 ¹⁹ The source for this data is LFE-S1. We are disregarding a misstatement of rate base in LFE-S1 apparently caused by
18 the erroneous addition of \$6,137 to Plant-in-Service Account No. 305. (See LFE-S1 at GTM-4.) We also note that if
19 Staff had recognized and reclassified the \$2,660 in other water revenues to reflect its recognition of increased
20 miscellaneous service charge revenues in its adjusted TY figures, Staff's adjusted TY figures would include total
21 operating revenues of \$1,209,704; total operating expenses of \$1,158,968; and adjusted operating income of \$50,736 and
22 would result in a required increase in gross revenues of 11.99 percent.

23 ²⁰ Valley asserts that an operating margin of at least 13 percent should be approved if the Commission does not adopt
24 Valley's proposed additional negative \$102,996 revenue annualization adjustment. (Ex. A-9.) Staff asserts that its
25 recommended 10-percent operating margin reflects consideration of cash flow, debt service coverage, and income. (Ex.
26 S-4.)

27 ²¹ Official notice is taken of Valley's current tariff, as filed in Docket Nos. W-01412A-04-0736 et al. on November 30,
28 2005, and May 4, 2006.

29 ²² Valley's tariff shows a charge of \$262.10 for this meter size, although Decision No. 68309 authorized a charge of
30 \$281.05. It is unclear why the discrepancy exists.

31 ²³ Valley's tariff shows a charge of \$518.50 for this meter size, although Decision No. 68309 authorized a charge of
32 \$562.10. It is unclear why the discrepancy exists.

33 ²⁴ Valley proposes that construction water users be assessed the monthly minimum charge for the meter size used, in
34 addition to the construction water commodity rate. (Tr. at 87-88.)

COMMODITY RATES (Per 1,000 Gallons):5/8" x 3/4" Meter & 3/4" Meter—Residential

1 to 3,000 Gallons	\$1.50	\$1.77	\$1.55
3,001 to 10,000 Gallons	2.31	2.72	2.55
Over 10,000 Gallons	2.53	2.98	3.25

5/8" x 3/4" Meter & 3/4" Meter—Commercial²⁵

1 to 18,000 Gallons	\$2.31		
Over 18,000 Gallons	\$2.58		
1 to 15,000 Gallons		\$2.72	
Over 15,000 Gallons		2.98	
1 to 10,000 Gallons			\$2.55
Over 10,000 Gallons			3.25

1" Meter—All

1 to 50,359 Gallons	\$2.31		
Over 50,359 Gallons	2.53		
1 to 25,000 Gallons		\$2.72	\$2.55
Over 25,000 Gallons		2.98	3.25

1-1/2" Meter—All

1 to 126,054 Gallons	\$2.31		
Over 126,054 Gallons	\$2.53		
1 to 50,000 Gallons		\$2.72	
Over 50,000 Gallons		2.98	
1 to 60,000 Gallons			\$2.55
Over 60,000 Gallons			3.25

2" Meter—All

1 to 151,256 Gallons	\$2.31		
Over 151,256 Gallons	2.53		
1 to 80,000 Gallons		\$2.72	
Over 80,000 Gallons		2.98	
1 to 100,000 Gallons			\$2.55
Over 100,000 Gallons			3.25

3" Meter—All

1 to 403,274 Gallons	\$2.31		
Over 403,274 Gallons	2.53		
1 to 160,000 Gallons		\$2.72	
Over 160,000 Gallons		2.98	
1 to 225,000 Gallons			\$2.55
Over 225,000 Gallons			3.25

²⁵ Irrigation customers are considered to be commercial customers. (See Ex. A-7 at Sched. H-4.)

1	<u>4" Meter—All</u>			
2	1 to 453,722 Gallons	\$2.31		
	Over 453,722 Gallons	2.53		
3	1 to 250,000 Gallons		\$2.72	
	Over 250,000 Gallons		2.98	
4	1 to 365,000 Gallons			\$2.55
5	Over 365,000 Gallons			3.25
6	<u>6" Meter—All</u>			
7	1 to 1,260,313 Gallons	\$2.31		
	Over 1,260,313 Gallons	2.53		
8	1 to 500,000 Gallons		\$2.72	
	Over 500,000 Gallons		2.98	
9	1 to 775,000 Gallons			\$2.55
	Over 775,000 Gallons			3.25
10	<u>Construction Water—All Meter Sizes</u>			
11	Per 1,000 Gallons	\$3.02	\$3.25	\$3.25

SERVICE LINE AND METER INSTALLATION CHARGES:

(Refundable pursuant to A.A.C. R14-2-405)

	<u>Present Charges</u>			<u>Company Proposed & Staff Recommended</u>			
	Service Line Charge	Meter Charge	Total Charge	Service Line Charge ¹	Meter Charge	Total Charge	
17	5/8" Meter	\$ 385	\$ 135	\$ 520	\$ 445	\$ 155	\$ 600
18	3/4" Meter	385	215	600	445	255	700
	1" Meter	435	255	690	495	315	810
19	1 1/2" Meter	470	465	935	550	525	1,075
20	2" Turbine Meter	630	965	1,595	830	1,045	1,875
	2" Compound Meter	630	1,690	2,320	830	1,890	2,720
21	3" Turbine Meter	805	1,470	2,275	1,045	1,670	2,715
	3" Compound Meter	845	2,265	3,110	1,165	2,545	3,710
22	4" Turbine Meter	1,170	2,350 ²⁶	3,520 ²⁷	1,490	2,670	4,160
	4" Compound Meter	1,230	3,245	4,475	1,670	3,645	5,315
23	6" Turbine Meter	1,730	4,545	6,275	2,210	5,025	7,235
	6" Compound Meter	1,770	6,280	8,050	2,330	6,920	9,250
24	8" or Larger Meter	Cost	Cost	Cost	Cost	Cost	Cost

¹ For long-side service line installation, charge will be at actual cost.²⁶ In its tariff, Valley shows \$2,352 for this charge, which slightly exceeds the amount authorized by Decision No. 68309. It is unclear why this discrepancy exists.²⁷ In its tariff, Valley shows \$3,532 for this charge, which slightly exceeds the amount authorized by Decision No. 68309. It is unclear why this discrepancy exists.

<u>SERVICE CHARGES:</u>	<u>Present Rates</u>	<u>Company</u>	<u>Staff</u>
Establishment	\$30.00	\$40.00	\$40.00
Establishment (After Hours)	45.00	60.00	60.00
Reconnection (Delinquent)	40.00	50.00	40.00
Reconnection (Delinquent, After Hours)	40.00	*	60.00
Meter Test	30.00	30.00	30.00
Deposit Requirement	(a)	(a)	(a)
Deposit Interest	6.00%	2.00%	6.00%
Re-Establishment (Within 12 Months)	(b)	(b)	(b)
Re-Establishment (After Hours)	(b)	(b)	(b)
NSF Check	\$25.00	\$25.00	\$25.00
Deferred Payment, Per Month	1.50%	1.50%	1.50%
Meter Re-read	\$10.00	\$10.00	\$10.00
Moving Customer Meter at Customer Request	Cost	Cost	Cost
After Hours Service Charge, per R14-2-403(D)	\$25.00 ²⁸	\$50.00	\$50.00 ²⁹
Late Charge per Month	\$10.00	\$10.00	1.50%
<u>Monthly Service Charge for Fire Sprinkler</u>			
All Meter Sizes	**	N/A	***

* Per R14-2-403(D).

** 1 percent of the monthly minimum for a comparably sized meter connection, but no less than \$5 per month. The service charge for fire sprinklers is only applicable for service lines separate and distinct from the primary water service line.

*** Greater of \$10.00 or 2 percent of the general service rate for a similar size meter

(a) Residential – two times the average bill. Non-residential – two and one-half times the average bill.

(b) Months off the system x monthly minimum bill

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax, per Commission Rule R14-2-409(D)(5).

All advances and/or contributions are to include labor, materials, overheads, and all applicable taxes, including all gross-up taxes for income taxes, if applicable.

All items billed at cost shall include labor, materials, overheads, and all applicable taxes.

...

...

²⁸ Although this charge is authorized by Decision No. 68309, it apparently does not appear in Valley's current tariff.

²⁹ Staff did not address Valley's proposed \$50.00 after hours service charge. We interpret this as acquiescence in the charge proposed by Valley.

1 Contested Issues

2 Downward Adjustment of TY Revenue for Post-TY Water Sales

3 51. Valley proposes that its TY revenues be decreased by \$102,966 more than the
4 negative \$24,537 annualization adjustment agreed upon by Valley and Staff, for a total downward
5 adjustment of \$127,503, based on water sales revenue during the 12-month period post-TY. (Ex. A-
6 9.) Valley asserts that this additional downward adjustment is known and measurable because it is
7 based on actual operating results for the 12 months post-TY. (*Id.*) For the TY, Valley reported actual
8 metered water revenues of \$1,186,115.³⁰ (Ex. A-7 at Sched. C-1.) For the 12 months post-TY,
9 Valley reported actual metered water revenues of \$1,058,682. (Ex. A-9 at Sched. C-2.) The
10 additional downward adjustment requested would bring Valley's adjusted TY metered water
11 revenues down to \$1,058,612. (Ex. A-9 at Sched. C-1.)

12 52. Mr. Prince testified that water sales have declined due to a lack of construction, a
13 declining customer base, and water conservation based on Valley's current rate design. (Ex. A-4.)
14 Mr. Prince stated that there was considerable construction activity in Valley's service area during the
15 TY, primarily in the form of preparing plats and subdivisions for construction of new homes, but that
16 construction and development activity has been virtually nonexistent post-TY, with three specific
17 projects³¹ remaining undeveloped beyond plat preparation. (*Id.*) Mr. Prince also stated that Valley
18 has lost approximately 20 customers since its last rate case. (*Id.*) Furthermore, Mr. Prince states that
19 the rates approved in Valley's last rate case appear to have had a positive effect on water
20 conservation efforts, as the average monthly usage for a 5/8" x 3/4" metered residential customer has
21 gone from 9,624 gallons in the prior rate case TY to 7,376 gallons in this matter's TY, and the
22 average monthly usage for a customer served by a 3/4" meter has gone from 10,243 gallons in the
23 prior rate case TY to 9,531 gallons in this matter's TY. (*Id.*) Mr. Prince asserted that because Staff
24

25 ³⁰ Valley alternately stated this figure as \$1,186,185. (Ex. A-9 at Sched. C-2 at 5.) Because this altered figure appears
26 to be inconsistent with Valley's Rejoinder Schedule C-1 and it is unclear to us why this change was made, we adopt the
original actual TY metered water revenues figure of \$1,186,115.

27 ³¹ Mr. Prince identified Bethany Estates, with 62 lots; Dysart Village, with 39 lots; and Luke Ranch, with 40 lots. (Ex.
28 A-4.) Mr. Prince also provided 10 photographs showing parcels in different beginning stages of development, all on
paved roadways with signage. (Ex. A-4 at ex. 1.) Some parcels appear to be developed only to the point of being graded.
(*Id.*) Others appear to have partial foundations, at least one of which has exposed pipes. (*Id.*) A number of the photos
also show fire hydrants. (*Id.*)

1 and Valley virtually agree on the annual revenue requirement for Valley to maintain a 10-percent
2 operating margin, it is important for the Commission to recognize the sources of declining revenue
3 and make appropriate adjustments. (*Id.*) Mr. Prince stated that Valley has had to cut costs as a result
4 of its declining revenue stream and has done so through letting full-time employees go,³² having
5 remaining employees take on more responsibilities, reducing regular office hours to four days per
6 week to cut down on electricity and fuel expenses, installing two energy-saving soft starts and four
7 variable frequency drives, purchasing chlorine in bulk, having salaried employees work longer hours,
8 and using temporary employees when necessary. (*Id.*) Valley has gone from a staff of seven during
9 the TY to a staff of four currently. (Tr. at 37.) The reduced salaries are not reflected in Valley's
10 adjusted TY figures because the changes occurred post-TY, and Valley believes that it needs a full
11 complement of employees to provide service to its customers. (Tr. at 18, 37.)

12 53. Mr. Bourassa testified that construction water revenues decreased to less than \$27,000
13 during the 12 months post-TY, which is a reduction of more than \$40,000 from the TY, and that
14 metered water revenues other than for construction water declined by approximately \$90,000 during
15 the same period. (Ex. A-8.) Mr. Bourassa attributed the reduced revenues to the current state of the
16 economy and housing, with water usage substantially reduced due both to home vacancies and
17 residents' intentionally reducing usage for landscaping and other purposes, such as filling swimming
18 pools, in order to save money.³³ (*Id.*) Valley expects this revenue loss to continue when its new rates
19 are in effect and asserts that failure to allow the additional downward adjustment will result in its
20 achieving less than a 2.3-percent operating margin rather than the requested 10-percent operating
21 margin. (Ex. A-9.) Mr. Bourassa asserts that Valley should be allowed an operating margin of at
22 least 13 percent in the event that the additional downward adjustment is not allowed. (*Id.*) Mr.
23 Bourassa testified that the additional downward adjustment would result in a more realistic
24 relationship between revenue, expenses, and rate base and that Staff has not objected to such
25 annualization adjustments in the past, such as in the recent Chaparral City Water Company case,³⁴ in
26

27 ³² Mr. Prince clarified that two employees quit, and one was let go. (Tr. at 36.)

28 ³³ Mr. Bourassa indicated that Valley sold approximately 22 million fewer gallons in the 12 months post-TY than during the TY, as adjusted and annualized. (Ex. A-8.)

³⁴ Docket No. W-02113A-07-0551.

1 which Staff adopted a revenue loss adjustment based on both actual (7 months) and estimated (5
2 months) post-TY water usage data. (*Id.*)

3 54. Staff asserts that the additional downward adjustment should be denied. Mr.
4 McMurry testified that the change in revenues for the 12 months post-TY does not represent a known
5 and measurable change, that a known and measurable change in revenue is only relevant if it
6 accurately represents a change in operating income, and that the purpose of an annualization
7 adjustment is to maintain income at the proposed level based on the TY activity when known changes
8 occur that can be reasonably measured. (Ex. S-4.) Mr. McMurry further asserts that the additional
9 \$102,966 downward adjustment proposed creates a mismatch by using the revenue from one year and
10 the expenses from another year to calculate the operating income proposed for the TY. (*Id.*) He
11 reasoned that the purpose of an annualization adjustment is to reflect changes occurring within the
12 TY, which allows measurement of revenues and expenses at the same point in time as the rate base—
13 at the end of the TY. (*Id.*) Mr. McMurry pointed out that in the Chaparral City Water Company
14 case, the annualization that Staff has accepted is due to golf company customers' permanently
15 discontinuing service because they are switching from Chaparral City Water Company's potable
16 water to effluent water. (Tr. at 127.) In contrast, Mr. McMurry stated, while Valley has seen a
17 decrease in customers, it may see an increase in customers next year; they are not permanently gone.
18 (*Id.*) Mr. McMurry also explained that he cannot "bless [Mr. Bourassa's] numbers" because he has
19 not audited Valley's post-TY water data.³⁵ (Tr. at 128.) Mr. McMurry characterized Valley's
20 position as "piecemeal regulation" because Valley seeks to adjust revenue and a couple of expense
21 categories without looking at the rest, which means that it is not looking at the full correlation
22 between income and expenses. (*See id.*) Mr. McMurry further testified that in order to analyze
23 whether the proposed revenue adjustment (assuming the post-TY data were audited) would obtain a
24 more realistic relationship between revenues, expenses, and rate base, Mr. McMurry would also need
25 to analyze all of Valley's post-TY expenses, which essentially would result in using the year post-TY
26 as the TY. (*See Tr.* at 129.)

27 _____
28 ³⁵ Mr. McMurry explained that the post-TY information was "received awfully late" and that he did not have an
opportunity to review it all because of his caseload. (Tr. at 129.)

1 55. Valley asserts that if the additional revenue annualization adjustment of negative
2 \$102,966 is made, corresponding adjustments would need to be made to purchased power expense
3 and chemicals expense, as these are both influenced by the level of gallons pumped and sold. Valley
4 proposes corresponding adjustments to purchased power of negative \$9,656 and to chemicals expense
5 of negative \$540. (Ex. A-9.) Staff's position would not necessitate these adjustments. (LFE S-1.)

6 56. Although Valley asserts that its revenues declined in the 12 months post-TY, probably
7 as a result of the downturn in our nation's and Arizona's economy, it is not possible to determine
8 with any certainty what the duration of such decline will be or whether it will remain generally
9 consistent or will fluctuate. Valley has established that there are a number of properties within its
10 service area that are prepped for further development. In addition, contrary to the situation in the
11 Chaparral City Water Company case, there is no indication in this case that the previously served and
12 now vacant properties within Valley's service area will never need to be served with potable water
13 again. Those vacant properties could be filled with families tomorrow or next month or next year,
14 and the occupants would need to obtain service from Valley. Likewise, the currently inactive
15 partially developed properties could see building activity in the imminent future. Valley has already
16 made cost-cutting efforts due to the change in its revenues, which is appropriate for any business in
17 tough economic times. However, Valley has not asked to have its expenses (other than purchased
18 power and chemicals) annualized to reflect its reduced post-TY expense levels, which would also be
19 affected by reduced customer counts.³⁶ Because of the uncertainty regarding how long the downturn
20 in sales will last and the uncertainty regarding the actual post-TY level of expenses coinciding with
21 the reduced revenues, we find that the additional revenue annualization requested is not known and

22
23 ³⁶ Valley did not reduce its TY salaries and wages expense to reflect fewer employees. (Tr. at 18, 37.) Thus, the most
24 significant change would likely be in salaries and wages, as Valley now has three fewer employees than it did during the
25 TY. While Valley asserts that it needs those three positions to be filled to provide service to its customers, it appears that
26 it is functioning at a satisfactory level without them. It is also likely that the sum of the three salaries for the vacant
27 positions may approach or even exceed the additional revenue adjustment requested. The TY expenses for salaries and
28 wages are \$355,559 for seven employees. (Ex. A-9; Tr. at 37.) If these expenses are averaged, that amounts to more than
\$50,000 per employee. While it is unlikely that the salaries are distributed in this manner (equally to each employee), it is
likely that the salary reduction resulting from the loss of three employees would approach or exceed \$100,000. In
addition, the reduction in customers would reduce the number of bills issued and would likely also reduce the demand for
customer service. Reduced bills and customer service demands could result in reduced office supply expenses and
postage expenses, among other things. However, Valley has not requested a corresponding reduction to reflect those
changes in administrative or customer service demand.

1 measurable, would result in a mismatch of revenues and expenses, and should not be allowed. As a
2 result of our decision not to allow the additional revenue annualization requested, it is unnecessary to
3 make Valley's requested corresponding adjustments to purchased power expense and chemicals
4 expense.

5 Security Deposit Interest

6 57. Valley desires to lower its deposit interest rate to 2 percent, rather than maintaining its
7 current security deposit interest rate of 6 percent. Valley asserts that a 6-percent interest rate is too
8 high given the low interest rates currently provided by banks on certificates of deposit ("CDs") and
9 money market accounts. (Ex. A-9.) Valley stated that, as of the beginning of September 2009, the
10 annual yield on a 5-year CD was 2.66 percent, the annual yield on a 6-month CD was 0.36 percent,
11 and the annual yield on a money market account was 1.16 percent. (*Id.*) Mr. Prince asserts that a 6-
12 percent interest rate on a security deposit is not equitable in today's economy and has not been for the
13 past several years, as no bank savings or money market account available to Valley would earn 6-
14 percent interest, and Valley would not be able to obtain a CD or treasury bill with anything close to a
15 6-percent return. (*Id.*)

16 58. Staff asserts that the 6-percent interest rate should be retained. Staff's position is
17 based on the default interest rate prescribed in A.A.C. R14-2-403(b)(3), which provides: "Interest on
18 deposits shall be calculated annually at an interest rate filed by the utility and approved by the
19 Commission in a tariff proceeding. In the absence of such, the interest rate shall be 6%." Mr.
20 McMurry testified that Staff has no reason not to accept Mr. Bourassa's testimony regarding current
21 interest rates, and that the Commission has the authority to decide what the deposit interest rate
22 should be, but that the 6-percent interest rate is a default rate that Staff has seen no reason to
23 change.³⁷ (Tr. at 124.) Mr. McMurry pointed out that the utilities only hold the deposits for 12
24 months and that if they are paying interest, the interest expense should be included above the line as
25 an operating expense so that the utility will benefit from it. (Tr. at 139.) In its final schedules, Staff
26

27 ³⁷ Mr. McMurry indicated that Staff may desire to change the interest rate, as interest rates change, but observed that
28 the utilities generally do not come in asking for the interest rate to be increased when interest rates rise above 6 percent.
(*See* Tr. at 139.)

1 reclassified the \$6,137 paid by Valley on customer security deposits during the TY from a non-
2 operating (below the line) expense to an operating expense (above the line). (LFE S-1.)

3 59. While the Staff-recommended 6-percent interest rate on security deposits is currently
4 in excess of the rate that Valley would be able to obtain on a deposit account or CD, we are cognizant
5 that interest rates fluctuate over time, sometimes dramatically, and that the 6-percent interest rate
6 could become advantageous to Valley at some time in the future. Yet, it is unlikely that Valley or
7 another utility would come to the Commission to have its deposit interest rate increased when deposit
8 account or CD interest rates increase in the future. Because there is currently no means to ensure that
9 deposit interest rates will change with the market, and allowing Valley to include the security deposit
10 interest paid out as an operating expense, as recommended by Staff, should serve to quell any
11 concerns that Valley may have about paying out interest that is in excess of the interest that it could
12 earn on a deposit account or CD, it is appropriate to adopt Staff's recommendation and retain the 6-
13 percent interest rate on security deposits.

14 Late Fees

15 60. Valley desires to maintain its current late fee charge of \$10.00 per month, while Staff
16 recommends that the late fee be changed to 1.5 percent of the outstanding unpaid balance.

17 61. Mr. Prince stated that the \$10 late charge has been in Valley's tariff for more than 20
18 years without being changed in previous rate case proceedings and that it generated approximately
19 \$25,500 in revenue during the TY. (Ex. A-4.) Mr. Prince also stated that customers are increasingly
20 paying their water bills in an untimely fashion. (*Id.*) Indeed, Mr. Prince testified that for the 12
21 months post-TY, Valley assessed a total of \$26,940 in late fees, which represents assessing a late fee
22 on 16 percent of its bills.³⁸ (Tr. at 9-10.) Mr. Prince testified that delinquent bill payments, and the
23 length of the delinquencies, will increase over time if the late fee is reduced. (*Id.*) According to Mr.
24 Prince, late payment of bills affects Valley's cash flow and its ability to pay its own bills, and the
25 revenue loss that would result from Staff's recommended late fee would impact the need for Valley
26 to increase its rates. (Ex. A-4.) Mr. Prince testified that it would be inequitable to make those who

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28 ³⁸ Mr. Prince testified that Valley sent out 16,798 bills during the 12 months post-TY and that late charges were assessed for 2,694 bills, or 16 percent of the bills. (Tr. at 9-10.)

1 pay their bills in a timely fashion make up for the revenue loss that would result from Staff's
2 recommended change to Valley's late fee. (*Id.*) Mr. Prince also asserted, however, that if the
3 Commission adopts Staff's recommended 1.5-percent late fee, a corresponding adjustment should be
4 made to Valley's annual TY revenue and Staff's recommended rates to account for the lost revenue.
5 (*Id.*)

6 62. Staff recommends that Valley's late fee charge be changed from \$10.00 per month to
7 1.5 percent of the unpaid balance and has recommended transferring \$22,950 from other water
8 revenues to metered water revenues to recognize the reduced amount of other water revenues that
9 would be collected as a result of this change. (LFE S-1; Tr. at 113, 123.) Mr. McMurry testified that
10 a 1.5-percent late fee is appropriate and that it is a typical rate throughout the industry. (Tr. at 113.)

11 63. Late fees have two purposes—(1) to compensate a utility for additional administrative
12 effort that must be expended as a result of sending out additional notices, making other customer
13 contacts, and even resorting to commercial collection efforts when a bill goes unpaid; and (2) to
14 encourage a customer to pay his or her bill in a timely fashion by serving as a deterrent to
15 nonpayment.³⁹ In this case, Valley has a preexisting late fee of \$10.00 per month and has established
16 that approximately 16 percent of its customers currently still fail to pay their bills on time. (Tr. at 9-
17 10.) Valley has also established, and Staff has agreed, that if Staff's recommended late fee is
18 adopted, Valley would collect a late fee of approximately \$1.00 from a customer with a typical bill of
19 approximately \$67.00. If a \$10.00 late fee is not sufficient encouragement for a customer to pay his
20 or her bill in a timely fashion, \$1.00 certainly will not be sufficient encouragement to do so, and may
21 serve more as an invitation to additional customers not to pay their bills on time. Upon considering
22 the evidence in this matter, we find that a 1.5-percent late fee clearly will not serve the second
23 purpose set forth above and that it also very likely would not serve even the first purpose set forth

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³⁹ The Commission recently passed an order setting the late fee for two affiliated utilities at \$5.00 per month, as opposed to the utilities' requested late fee of \$10.00 per month and Staff's recommended late fee of 1.5 percent per month. (Decision No. 71446 (December 23, 2009).) The \$5.00 late fee was adopted through an amendment after the utilities' representative spoke to the Commission during the Open Meeting regarding the loss of revenue that would result from the change in the utilities' late fees and the ineffectiveness, for deterrence purposes, of a late fee set at 1.5 percent of the unpaid balance. In that case, the utilities had preexisting late fees of \$3.00 and \$5.00 and a customer base that was largely seasonal. (Decision No. 71446 at Ex. A.)

1 above.⁴⁰ In addition, we find that it is inappropriate to cause an increase in Valley's metered water
 2 revenues to make up for the anticipated lost revenues in late fees, as doing so passes the burden from
 3 those customers who do not pay their bills in a timely fashion to all customers, including the majority
 4 who do pay their bills in a timely fashion. In light of the above, we find that it is appropriate to retain
 5 Valley's late fee at \$10.00 per month.⁴¹

6 Purchased Power Expense

7 64. Valley and Staff agree that a purchased power expense adjustment is appropriate to
 8 reflect the known and measurable rate increase granted in December 2008 to the Arizona Public
 9 Service Company ("APS"), from whom Valley purchases its power. Valley proposes an adjustment
 10 of \$17,219. (Ex. A-9.) Staff proposes an adjustment of \$18,524. (LFE S-1.) Both adjustments were
 11 calculated based on Mr. Bourassa's testimony that the APS cost increase per 1,000 gallons is \$0.058.
 12 (See Ex. A-9.) Staff's adjustment is based on annualized gallons of 319,387,000 (actual TY gallons
 13 of 325,407,000-6,019,000 corresponding to the agreed-upon \$24,537 revenue annualization), and
 14 Valley's adjustment is based on annualized gallons of 296,878,000 (actual gallons reportedly sold
 15 during the 12 months post-TY). (*Id.*) Both Valley and Staff used Valley's adjusted TY purchased
 16 power expense of \$136,963 in their calculations. (*Id.*)

17 65. We agree with Valley and Staff that it is appropriate to adjust purchased power
 18 expenses for the known and measurable change resulting from APS's approved rate increase.
 19 However, we find that it is appropriate to perform the calculations for the adjustment using actual
 20 rather than adjusted figures where possible. Valley had an actual TY purchased power expense of
 21 \$137,023 and actual TY gallons sold of 325,407,000, resulting in an actual TY purchased power
 22 expense of \$0.42108 per thousand gallons pumped. (Ex. A-7 at Sched. C-2.) Valley reports actual
 23 purchased power costs of \$144,446 during the 12 months post-TY for actual gallons sold of
 24 296,878,000, resulting in an actual purchased power expense of \$0.48655 per thousand gallons. (Ex.

25 _____
 26 ⁴⁰ The anticipated typical \$1.00 late fee would cover the cost of a postage stamp, leaving 56¢ to cover the cost of paper,
 27 printer ink, an envelope, and the administrative time of the staff person who prepares and sends the second notice. We
 28 take official notice that the cost of a first class postage stamp for a letter-size envelope is currently 44¢.

⁴¹ It is arguable that the late fee should actually be increased, in light of the current volume of late payments, but
 increasing the late fee could be overly detrimental to customers already feeling the pinch of Arizona's current economic
 crisis.

1 A-9 at Sched. C-2.) The difference between these expenses is an increased cost of \$0.06547 per
2 thousand gallons. Using Staff's adjusted gallons sold of 319,387,000, this results in an increased cost
3 of \$20,910 for the TY. We find that this is the appropriate purchased power adjustment to apply and
4 will adopt it.

5 Repairs and Maintenance Expense

6 66. Valley asserts that its TY R&M expense of \$14,201 should be allowed, whereas Staff
7 would normalize Valley's TY R&M expense by averaging such expense over a three-year historical
8 period. Staff's normalization results in an R&M expense of \$12,688. Valley argues that Staff's
9 normalization method is subjective, that using different years would have resulted in expenses higher
10 than the actual TY expense, that the actual TY R&M expense falls within the range of normalization,
11 and that Staff uses averaging far more frequently to adjust expenses downward than it does to adjust
12 expenses upward. (Ex. A-8.) In addition, Mr. Bourassa testified that he generally disagrees with the
13 use of averages as a method of normalizing expenses and that averaging does not reflect a known and
14 measurable change to the TY. (Ex. A-8.)

15 67. Mr. Bourassa asserts that averaging R&M expenses for the TY and the preceding four
16 years would result in a normalized expense of \$16,402, that averaging R&M expenses for 2006
17 through 2009⁴² would result in a normalized expense of \$15,258, and that averaging R&M expenses
18 for 2007 through 2009 would result in a normalized expense of \$13,797. (Ex. A-8.) Mr. Bourassa
19 stated that the disparate results, depending on which and how many years are used, demonstrates that
20 normalization through averaging should be avoided and is poor ratemaking policy. (*Id.*)

21 68. Staff asserts that Valley's TY R&M expenses should be normalized because the TY
22 expenses of \$14,210 are not representative of ongoing R&M expenses. (Ex. S-2.) Staff asserts that
23 Valley's R&M expenses vary widely from year to year and recommends that they be normalized by
24 taking the reported R&M expenses for fiscal years 2006, 2007, and 2008 (\$19,641, \$2,964, and
25 \$14,210, respectively) and using the three-year average annual cost per customer (\$8.58) and the TY
26 customer count (1,477). (*Id.*) Staff thus calculated adjusted TY R&M expenses of \$12,668, which
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28 ⁴² Mr. Bourassa stated that the R&M expense for July 2008 through June 2009 was \$24,217. (Ex. A-8.)

1 would necessitate an adjustment of negative \$1,542. (*Id.*) Mr. McMurry testified that he used the
2 three-year period because it corresponds to the three-year period used to normalize rate case expense.
3 (Tr. at 133.) Mr. McMurry acknowledged that the normalization process is somewhat subjective, in
4 that the results will vary depending on the period of time used, and did not dispute Valley's assertion
5 that the five-year average would result in a normalized R&M expense of \$16,402. (Tr. at 133-34.)
6 When asked whether he would be opposed to using a three-year average that takes into account the
7 three most recent years of data, Mr. McMurry testified that he did not audit post-TY expenses and
8 thus would have the same problem that he had with using unaudited figures for purposes of revenue
9 annualization. (Tr. at 133-34.) Mr. McMurry stated that he supposed he could use that method of
10 normalization after auditing them, but that he then might be questioned concerning why he did not
11 stay within the TY. (Tr. at 134.)

12 69. We are not convinced that Valley's TY R&M expenses need to be normalized. While
13 the evidence establishes that the R&M expenses can vary widely (with the figures from fiscal years
14 2006 and 2007 providing an excellent example), it appears that the R&M expenses for the TY are
15 well within the range of expenses that would result from normalization using the past four fiscal
16 years and thus are sufficiently representative of ongoing R&M expenses. Thus, we will adopt
17 Valley's actual TY R&M expense of \$14,210.

18 Rate Design—Commodity Rates and Break-Over Points

19 70. Valley and Staff both recommend rate designs that include tiered commodity rates,
20 with three tiers for residential customers served by 5/8" x 3/4" meters and by 3/4" meters and two tiers
21 for all other customers, except for construction customers, for whom both recommend a flat
22 commodity rate. Valley and Staff agree on the break-over points for residential customers served by
23 5/8" x 3/4" meters and by 3/4" meters and for all customers served by 1" meters, but do not agree on the
24 break-over points for other customers. Where their break-over-point positions differ, Valley's
25 proposed break-over points are generally lower than are those recommended by Staff.⁴³ Both Valley
26 and Staff propose commodity rates that would include a relatively large difference (approximately
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28 ⁴³ The exception is the commercial customer served by a 5/8" x 3/4" meter or by a 3/4" meter, for which Staff recommends a break-over point of 10,000 gallons and Valley a break-over point of 15,000 gallons.

1 \$1) between the first- and second-tier rates for residential customers served by small meters and a
2 smaller difference between the small residential second- and third-tier rates (\$0.26 or \$0.70) for these
3 residential customers and would use the residential second- and third-tier rates as the first- and
4 second-tier rates for all other customers, except construction customers. Staff's rate design includes
5 larger increases between commodity rates than does Valley's rate design.

6 71. Valley asserts that its proposed rate design retains the rate structure recommended by
7 Staff and adopted by the Commission in its last full rate case and applies the rate increase evenly
8 across all monthly minimums and commodity rates. (Ex. A-9.) Valley also states that its rate design
9 sets the break-over points of meters larger than 5/8" x 3/4" relative to the flows of a 5/8" x 3/4" meter.
10 (Ex. A-8.) Mr. Bourassa testified that break-over points should be established based on the relative
11 flows of a 5/8" x 3/4" meter because monthly minimums are set based on relative flows and because
12 this method of establishing rates is logical in the absence of a cost of service study indicating whether
13 certain classes of customers are subsidizing other classes of customers. (Tr. at 81-82.) Mr. Bourassa
14 opined that Staff's recommended rate designs generally tend to shift revenue recovery from
15 residential customers to commercial customers so that residential customers have lower rates,
16 although he acknowledged that he has not done a cost of service study in this particular case and thus
17 cannot definitively state that Staff's recommended rate design in this case would have that result.
18 (Tr. at 83-84.) Mr. Bourassa did assert, however, that Staff's recommended rate design in this case
19 would result in more revenue instability than would Valley's proposed rate design and thus increase
20 the likelihood that Valley will not generate its authorized revenue requirement. (Ex. A-8.)

21 72. Staff asserts that Valley's present rate design provides 34.5 percent of its metered
22 revenue from monthly minimum charges and that Staff's recommended rate design provides 34
23 percent of metered revenue from monthly minimum charges, thereby maintaining a large degree of
24 revenue stability.⁴⁴ (Ex. S-4.) Staff also points out that the larger increase in its rate design between
25 the small residential second- and third-tier commodity rates and the other customers' first- and
26 second-tier commodity rates sends an appropriate price signal to large water users to use water

27 ⁴⁴ Staff further stated that its recommended ARSM surcharge is recovered 100 percent via a fixed monthly amount, as
28 opposed to being recovered through commodity charges as recommended by Valley, thereby enhancing revenue stability.
(Ex. S-4.)

1 efficiently. (*Id.*) Mr. McMurry testified that the larger difference between commodity rates and
2 break-over points in Staff's rate design will encourage more efficient use of water than would
3 Valley's rate design, while generating approximately the same amount of revenue. (Tr. at 116.) Mr.
4 McMurry testified that he believes Staff's rate design does this more effectively than does Valley's
5 rate design because Valley's rate design has lower break-over points, which means that a customer
6 jumps over into the third tier sooner, and "[t]here is really not any incentive once you are in the third
7 tier." (Tr. at 141-42.) Mr. McMurry later clarified that Staff's rate structure will help customers who
8 do not use a lot of water to pay their bills, while making water usage more costly to those who use
9 more water. (Tr. at 141.) Staff stated that its rate design will, at any usage level, result in a higher
10 monthly bill for a customer served by a larger meter than for a customer served by a smaller meter,
11 which Staff states sends an appropriate economic signal to all customers for all consumption. (Ex. S-
12 2.)

13 73. We find that the larger increase between Staff's recommended tiered commodity rates
14 is more likely to encourage conservation than is the smaller increase between Valley's proposed
15 tiered commodity rates, as a customer is more likely to notice and respond to an increase of \$0.70 per
16 thousand gallons than an increase of \$0.26 per thousand gallons when the customer's usage increases
17 and takes the customer from one tier to another.⁴⁵ In addition, Staff's commodity rates would result
18 in a smaller increase for the small residential customer with only first-tier use than would Valley's
19 commodity rates, which is appropriate because residential first-tier usage (up to 3,000 gallons per
20 month) is largely nondiscretionary. (*See* Ex. S-2.) We find that it is appropriate to adopt a
21 commodity rate structure that has greater differentiation between tier rates than does that proposed by
22 Valley.

23 74. Valley explained that its break-over points were determined based on the relative
24 flows of meter sizes as compared to a 5/8" x 3/4" meter. Staff did not explain its methodology for
25 determining break-over points. Both Valley and Staff have proposed to retain the current break-over
26 points for residential customers served by 5/8" x 3/4" meters and 3/4" meters and to lower the break-
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28 ⁴⁵ This increase would be incurred when going from the second- to third-tier for small residential customers or the first- to second-tier for other customers, except construction customers.

1 over points for all other customers except for construction water customers, who currently pay a flat
2 commodity rate and would continue to do so under either proposed rate design. The lowering of the
3 break-over points to either the levels proposed by Valley or the levels recommended by Staff should
4 encourage further customer conservation over the current rate design. While lower break-over points
5 may generally be preferable to higher break-over points because they may better encourage
6 conservation, we find that the more dramatically lowered break-over points proposed by Valley,
7 coupled with the increased difference between commodity rates we are adopting herein, could result
8 in some degree of rate shock. Thus, we find that it is appropriate to adopt break-over points more
9 consistent with those recommended by Staff.

10 Rate Design—Monthly Minimums for Construction Water

11 75. Currently, Valley's rate design includes a construction meter monthly minimum
12 charge equal to the monthly minimum charge for a 3" meter and a flat commodity rate of \$3.02 per
13 thousand gallons for all construction water usage. Valley proposes to charge construction water
14 customers a monthly minimum charge according to the meter size used to receive construction water,
15 along with a commodity rate of \$3.25. Valley believes that it is appropriate to charge such customers
16 a monthly minimum because there are instances where construction water meters have no monthly
17 use, but Valley must still read the meter and spend administrative time tracking the meter. (Ex. A-9.)
18 Valley believes that charging a monthly minimum will encourage construction meter customers to
19 return a meter when it is no longer being used, thus making it available to others and obviating the
20 need for Valley to purchase another meter to serve additional customers needing construction water.
21 (*Id.*) Valley proposes to apply its monthly minimums per meter size to all customers, including those
22 customers who are using the meters for construction purposes, and to assess the construction
23 commodity rate for all construction water usage regardless of the construction meter size.⁴⁶ (Tr. at
24 87-88.)

25 76. Staff recommends that Valley's rate design be changed so that no monthly minimum
26 charge is imposed for construction water meters, but agrees with Valley's proposed commodity rate

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28 ⁴⁶ Valley currently only issues 3" construction meters, but it could issue other sizes of construction meters at some point and proposes to assess the corresponding monthly minimum charge per the other meter sizes. (Tr. at 86-87.)

1 for construction water. Staff believes that construction meters should be treated like standpipes, for
 2 which no monthly minimum is assessed but the highest commodity rate is assessed for all usage. (Tr.
 3 at 140-41.) Staff acknowledges that this treats construction customers differently than any other class
 4 of customer, (Tr. at 140), but asserts that it is unfair to assess a monthly minimum charge for
 5 construction water meters because their users never receive any water at the cheaper commodity rates
 6 that other customers pay for low levels of usage, (Tr. at 115).

7 77. We find that it is appropriate to assess monthly minimum charges to all customers
 8 who use individually assigned meters, even customers who are using those meters for construction
 9 purposes. Unlike a standpipe, a construction meter is assigned to an individual customer, who may
 10 require customer service, and must be read and billed on a monthly basis even if there is no usage. In
 11 addition, the absence of a monthly minimum charge could encourage a construction customer not to
 12 return a meter even if the meter stands idle for an extended period of time, thereby potentially
 13 causing Valley to incur the additional expense of purchasing and monitoring an additional meter or
 14 meters if additional construction meters need to be issued. Thus, we will authorize monthly
 15 minimum charges for construction meters, according to meter size, as proposed by Valley. We will
 16 also authorize a commodity rate of \$3.15 for all construction water usage.⁴⁷

17 **Establishing Rate Base and Rates**

18 78. We find that Valley's OCRB is negative \$169,027 and, as Valley has not requested
 19 use of reconstruction cost new rate base to determine its FVRB, that Valley's OCRB should be
 20 treated as its FVRB. Thus, we find that Valley's FVRB is negative \$169,027.

21 79. Because Valley's FVRB is negative, we find that Valley's FVRB is not useful in
 22 setting just and reasonable rates and that Valley's rates should instead be set using an operating
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26 ⁴⁷ This reflects an increase of \$0.13 per thousand gallons. We note that a \$2.44 commodity rate for construction water
 27 usage would result in a decrease of \$0.58 per thousand gallons, which would not be appropriate. While construction
 28 water usage has its societal benefits, as does construction itself, and is largely the result of governmental requirements to
 keep down dust for public health reasons, we are fully cognizant that water being used for construction purposes is
 potable water being used for non-potable purposes. The increase approved herein is more likely to result in conservation
 of this potable water than a commodity rate decrease would be.

1 margin. We find that the 10-percent operating margin agreed upon by Valley⁴⁸ and Staff is
2 appropriate, and we will adopt it.

3 80. Under Valley's current rates, the monthly bill for a residential customer served by a
4 ¾" meter with average consumption of 9,531 gallons per month is \$36.46, and the monthly bill for
5 such a customer with median usage of 8,500 gallons per month is \$34.08. (Ex. A-9.) Valley's
6 proposed rates would increase the monthly bill for such a customer with average consumption to
7 \$42.95, an increase of \$6.49, or approximately 17.8 percent, and the monthly bill for such a customer
8 with median consumption to \$40.14, an increase of \$6.07, or approximately 17.8 percent. (*Id.*)

9 81. Under Staff's proposed rates, the monthly bill for a residential customer served by a
10 ¾" meter with average consumption of 9,531 gallons per month would increase to \$40.40, an
11 increase of \$3.94, or approximately 10.8 percent. (LFE S-1.) Likewise, the monthly bill for such a
12 residential customer with median consumption would increase to \$37.78, an increase of \$3.70, or
13 approximately 10.8 percent. (*Id.*)

14 82. Based on the adjustments made herein, we find that Valley should be permitted to
15 recover operating income of \$135,932 and total operating expenses of \$1,223,683, for an overall
16 revenue requirement of \$1,359,615. This overall revenue requirement, which reflects an overall
17 increase of approximately 12.39 percent, is just and reasonable and will be adopted.

18 83. The overall revenue requirement and other modifications adopted herein necessitate a
19 rate design slightly different than Staff's recommended rate design, in part to avoid crossover,
20 wherein a customer served by a larger meter size would pay less than would a customer served by a
21 smaller meter size for the same level of usage. With the rates adopted herein, the monthly bill for a
22 residential customer with average consumption served by a ¾" meter will increase from \$36.46 to
23 \$39.04, representing an increase of \$2.58 or 7.08 percent. Likewise, the monthly bill for a residential
24 customer with median consumption served by a ¾" meter will increase from \$34.08 to \$36.52,
25 representing an increase of \$2.44 or 7.16 percent.

26 ...

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28 ⁴⁸ Valley requests a higher operating margin in the event that it does not receive its requested negative \$102,966 revenue adjustment.

1 **Non-Arm's-Length Transactions**

2 84. As required by the Commission in Decision No. 68309, Staff has scrutinized Valley's
3 records to detect any non-arm's-length transactions. In its review of Valley's records, Staff identified
4 two such transactions—Valley's purchase of easement rights from its shareholders for \$55,000 and
5 Valley's payment/reimbursement of \$10,364 for the medical expenses of Valley's employees,
6 including its shareholders. (Ex. S-2.) Mr. Prince apparently agrees with Staff's characterization of
7 these transactions as "non-arm's length." (See Tr. at 12.)

8 85. On February 13, 2009, Valley paid the Princes \$55,000 for easement rights to the yard
9 for the Bethany Home West Well. (Ex. S-2.) The Princes reported that the purchase price was
10 determined by multiple factors—including devaluation of the sellers' property resulting from the
11 access and egress rights to the plant site, the sellers' loss of use of the property, and the sellers'
12 having been forced into the transaction by Maricopa County. (*Id.*) Although Staff was concerned
13 because the purchase price was not established using a fair market value analysis performed by a
14 reputable real estate appraiser, Staff indicated that no information suggests the transaction price was
15 unreasonable. (*Id.*) Because this \$55,000 easement cost was incurred to accommodate an arsenic
16 treatment facility, Valley and Staff have agreed that it should be excluded from rate base at this time.
17 (Ex. S-4; LFE S-1.) We agree and are adopting this exclusion.

18 86. During the TY, Valley paid \$10,364 in medical reimbursements to its employees,
19 including the shareholders. (Ex. S-2.) Staff stated that medical reimbursements to shareholders may
20 be reasonable, but that Valley should have an established written policy for the medical benefits to be
21 provided to all employees, something that Valley does not have. (*Id.*) Staff added that Valley has no
22 employee benefits manual. (*Id.*) The \$10,364 spent by Valley paid for items such as office visits,
23 prescription copayments, reimbursements to employees for out-of-pocket expenses, and stipends in
24 lieu of premium coverage. (*Id.*) Staff has recommended, and Valley has agreed to, disallowance of
25 the \$10,364 in medical expense payments as nonrecurring expenses. (*Id.*; Ex. A-9.) This exclusion is
26 appropriate and will be adopted.

27 87. Staff determined that Valley has significantly reduced non-arm's-length transactions
28 and acknowledged that it may occasionally be appropriate to engage in non-arm's-length

1 transactions, although they are generally undesirable and avoidable. (Ex. S-2.) Staff recommends
2 that Valley be required to establish and maintain policies to minimize non-arm's-length transaction so
3 that Valley does not regress in this area. (*Id.*) In addition, Staff recommends that Valley develop
4 written policies and procedures regarding employee benefits. (*Id.*) Valley agrees that these
5 recommendations are appropriate. (*See* Tr. at 12-13.) We also find that these recommendations are
6 appropriate and will adopt them.

7 88. While it is encouraging that Valley appears to have reduced the frequency with which
8 it enters into non-arm's length transactions and that Mr. Prince is willing to establish and maintain
9 policies to minimize such transactions further, Valley is put on notice that in future rate cases, we
10 expect to see documentation establishing the fair market value of any easement or other property
11 right purchased by Valley from its shareholders. The Commission disfavors non-arm's length
12 transactions and has broad authority to scrutinize such transactions and to disallow expenses related
13 to them that are not fully justified.⁴⁹

14 Equity Position

15 89. As required by the Commission in Decision No. 68309, Staff examined Valley's
16 operations to determine whether Valley has engaged in any inappropriate practices contributing to the
17 deterioration of its equity position and found that Valley has not engaged in any such practices. (Ex.
18 S-2.) Staff determined that Valley's equity position has improved since its prior rate case (TY ending
19 December 31, 2003), from negative \$413,442 to negative \$6,319. (*Id.*) Staff also observed that
20 Valley has not historically issued dividends and that its Equity Plan states that it will continue to
21 suspend dividends. (*Id.*)

22 90. Staff recommends that Valley be required to continue improving its equity position
23 and to avoid draining equity through large dividend distributions and other distributions to
24 shareholders such as through bonuses, excessive increases in salaries and benefits, and inadequate
25 internal controls over expenditures and misappropriations. (*Id.*) Mr. Prince testified that Valley will
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28 ⁴⁹ See *U.S. West Communications, Inc. v. Arizona Corp. Comm'n*, 185 Ariz. 277, 282 (Ariz. Ct. App. 1996).

1 continue to try to improve its equity position every day and expressed no opposition to Staff's
2 recommendation. (See Tr. at 13.)

3 91. As required by its last rate case, Valley filed its Equity Plan on February 13, 2006.
4 (Ex. A-8.) Valley's Equity Plan includes timely filing of new rate cases in order to keep its earnings
5 adequate, suspends all dividends, and requires Valley not to engage in relationships and transactions
6 that are non-arm's length. (*Id.*) Since its last rate case, Valley has used its earnings to fund needed
7 capital improvements, aside from its replacement well and arsenic treatment facilities, including
8 capital repairs to its wells (more than \$207,000), storage tank repairs (\$22,000), and a tie line
9 between Valley and LPSCO (\$53,397). (*Id.*) In addition, the shareholders have transferred land and
10 equipment to Valley in exchange for common stock and a short-term debt totaling \$429,000.⁵⁰ (Ex.
11 A-8.)

12 92. We find that Valley has significantly improved its equity position since its last rate
13 case, but that it still has a long way to go. Valley needs to improve its equity position to the point
14 that its rates can be set using a rate of return on its FVRB as opposed to an operating margin, and
15 Valley can achieve that goal if it continues to make efforts to improve its equity position. Thus, we
16 are ordering Valley to continue following its Equity Plan and, consistent with Staff's
17 recommendation, to update its Equity Plan to ensure that the plan includes prohibitions on draining
18 equity through dividend distributions and other distributions to shareholders such as bonuses and
19 excessive increases in salaries and benefits and that it requires the implementation and maintenance
20 of adequate internal controls over expenditures so as to control expenses and avoid
21 misappropriations.

22 Compliance Issues

23 93. Staff characterizes Valley's compliance with Commission requirements as "less than
24 stellar," observing that no rules and regulations and no measuring and monitoring can ensure that a
25 utility will meet its obligations unless the utility's management has the capacity and desire to meet
26 those obligations. (Ex. S-2.) Staff specifically asserts that Valley has failed to comply with
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28 ⁵⁰ This transaction was approved in Decision No. 70052 (December 4, 2007).

1 Commission decisions or other regulations by (1) filing incomplete and untimely AIF reports, (2)
2 improperly using set-aside funds, (3) untimely transferring title from the Maryland Avenue Booster
3 Station real estate purchase, (4) possibly executing a multi-year financing arrangement to purchase
4 CAP water allocations without Commission authorization, and (5) failing to comply with the
5 Commission-prescribed National Association of Regulatory Utility Commissioners ("NARUC")
6 Uniform System of Accounts ("USOA"). (Ex. S-2.) We address each of these below.

7 AIF Reports

8 94. As stated in Findings of Fact No. 15, Commission Decision No. 67669 authorized
9 Valley to assess an AIF as a hook-up fee for the purpose of providing debt service for WIFA Loan #2
10 and required Valley to file AIF status reports on an annual basis, starting on January 31, 2006.
11 Valley did not file any AIF status reports until February 22, 2008, when it filed a report covering
12 calendar years 2005, 2006, and 2007. (Ex. S-2.) The combined report did not include all of the
13 information mandated by the Commission in Decision No. 67669. (*Id.*) In addition, we found in
14 Decision No. 70956 that Valley had also failed to file its 2008 AIF status report, which was due by
15 January 31, 2009, in a timely fashion. (*See* Findings of Fact No. 20.) Thus, it is clear that Valley has
16 violated Decision No. 67669 by failing to file timely and complete AIF reports.

17 95. Valley continues to collect the AIFs authorized, although collections have dropped off
18 considerably.⁵¹ (*See* Tr. at 53.) In its application, Valley stated that it was not seeking any change in
19 its AIF Tariff. (Ex. A-7.) Staff did not specifically address whether Valley's AIF Tariff should
20 remain in effect or should be canceled in this matter. Nor was the cancellation of the AIF Tariff
21 addressed in Decision No. 71287, in the ARSM docket, although an ARSM surcharge expected to
22 produce revenues sufficient to cover the debt service for WIFA Loan #2 was authorized therein. In
23 that case, Staff monetized the cumulative amount of noncompliance with Commission Orders for the
24 use of both the AIF funds and the set-aside funds, and we ordered Valley to use that amount for debt
25 service on WIFA Loan #2. The AIF status report was designed as a means to ensure that the AIF
26 funds were being used appropriately. As a result of Staff's efforts in the ARSM docket, we now
27

28 ⁵¹ Mr. Prince testified that Valley has collected only \$1,320 in AIFs since July 2008. (Ex. A-3.)

1 know that the AIF funds collected have been used toward debt service on WIFA Loan #2. Thus, we
2 do not need for Valley to provide us with the 2008 AIF status report or to provide us with additional
3 information to supplement the incomplete AIF status reports that have been filed for 2005, 2006, and
4 2007.

5 96. However, because the AIF Tariff remains in effect, we reiterate that Valley must file
6 its annual AIF status reports with the Commission by January 31 of each year, for the previous
7 calendar year, until the AIF Tariff is no longer in effect, as required by Decision No. 67669. While
8 we considered whether it would be appropriate to cancel the AIF Tariff in this matter, both because it
9 may be redundant with the ARSM surcharge approved in Decision No. 71287 and because the
10 continuation of a hook-up fee as a means of funding plant may not be beneficial to Valley's equity
11 position, we find that it is more appropriate to allow the AIF Tariff to stand until Valley's next
12 permanent rate case proceeding⁵² because the issue of canceling the AIF Tariff was not fully
13 adjudicated herein. In making this determination, we are cognizant that AIF collections have
14 dropped off considerably as a result of slowed growth in Valley's service area. Thus, the danger of
15 Valley's collecting substantially more funds than it needs to cover the debt service on WIFA Loan #2
16 appears to be minimal.

17 Use of Set-Aside Funds

18 97. In Decision No. 70956, we found that Valley had failed to comply with Decision No.
19 62908 by commingling set-aside account funds with other funds, using set-aside account funds for
20 purposes other than those authorized by the Commission, failing to advise Staff of the actual amount
21 of WIFA Loan #1 debt service, and failing to file copies of the closing documents for WIFA Loan #1.
22 We also found that Decision No. 62908 had been modified by Decision No. 68309, which required
23 Valley to factor the amount in the set-aside account into its revenue calculation as an offset for any
24 arsenic treatment surcharge to be requested to cover the debt service for WIFA Loan #2. We found
25 that Valley's "surcharge calculation" filed in the docket for Decision No. 68309 did not apply any
26 such offset, however. We also found that Staff should address the transfers to and from the set-aside

27 ⁵² We note that in Valley's next rate case, when the issue of including the arsenic treatment facilities in rate base is
28 addressed, Staff will need to scrutinize closely the sources of the funds used to pay for the arsenic treatment facilities to
ensure that any plant paid for with AIFs is treated appropriately.

1 account in the then-pending ARSM docket and in this docket and ordered Staff to review and analyze
2 Valley's detailed accounting of the set-aside account in the context of this docket to determine the
3 amount of set-aside funds collected that should offset WIFA Loan #2 and to determine whether the
4 funds commingled in the set-aside account were used for utility purposes.

5 98. In this matter, Staff recommended that the set-aside funds issue be addressed in
6 Valley's ARSM docket, which was expected to be concluded before the conclusion of this matter.
7 (Ex. S-2.) Mr. Prince agreed with Staff that the unauthorized use of the set-aside funds should be
8 addressed in the ARSM docket. (Tr. at 14.)

9 99. In the ARSM docket, in Decision No. 71287, Staff monetized the cumulative amount
10 of noncompliance with Commission orders for the use of both the set-aside funds and the AIF funds,
11 and we ordered Valley to use the over-collected amount for debt service on WIFA Loan #2. We
12 determined that Valley had collected \$194,996 in set-aside funds, which would have resulted in
13 accrual of \$20,544 in interest, for a total of \$215,540 that should have been in the set-aside account
14 and available to pay debt service on WIFA Loan #2.⁵³ In Decision No. 70956, we determined that
15 Valley had spent set-aside funds for purposes other than WIFA loan debt service when Valley was
16 running low on funds.⁵⁴ Mr. Prince again acknowledged the unauthorized use of set-aside funds in
17 this matter. (See Tr. at 13.) We did not determine in the ARSM docket that Valley had spent set-
18 aside funds for any purposes other than utility purposes.

19 100. Filings made by Valley in the docket for Decision No. 70956, as compliance items to
20 that Decision, show that Valley has transferred the entire remaining balance of set-aside funds from
21 the set-aside account to its WIFA Arsenic Loan checking account and that Valley has been making
22 payments on WIFA Loan #2 using those transferred set-aside account funds.⁵⁵ Assuming that the
23

24 ⁵³ In Decision No. 70956, we had determined that the set-aside account should have contained \$201,981.45 as of
25 November 2005, while it actually contained only \$101,725, and Valley believed that it should have contained \$141,129.
Staff's number was higher because it included interest and what Staff believed the amount of deposits in the set-aside
account should have been based on customer numbers.

26 ⁵⁴ We take official notice of Valley's detailed accounting of the use of its set-aside funds, filed in this docket and in the
27 dockets for Decision No. 70956 and Decision No. 68309 on May 7, 2009, as required by Decision No. 70956. That
document reveals that set-aside funds were used for myriad purposes unrelated to WIFA loan debt service, including
payroll, health insurance stipends, office supplies, meals, repairs and maintenance, taxes, and others.

28 ⁵⁵ We take official notice of Valley's quarterly set-aside account report filed on October 13, 2009, in the dockets for
Decision No. 70956 and Decision No. 68309.

1 same level of payments made in August and September 2009 continued in subsequent months, those
2 transferred set-aside funds have now been completely depleted in service of WIFA Loan #2. Thus,
3 although we again find that Valley violated the terms of Decision No. 62908 by mishandling and
4 mispending its set-aside funds and Decision No. 68309 by failing to include the set-aside account
5 offset in its surcharge calculation, we also find that Valley's transgressions related to the past
6 mishandling and misuse of the set-aside account funds and the use of the remaining set-aside funds
7 (now depleted) have been adequately addressed. In light of this, we will cancel the set-aside account
8 reporting requirement imposed by Decision No. 70956.⁵⁶

9 Maryland Avenue Booster Station Purchase

10 101. In Decision No. 70052 (December 4, 2007), the Commission approved Valley's
11 purchase of a 2.45-acre parcel known as the Maryland Avenue Booster Station (along with a utility
12 vehicle and backhoe) from Valley's shareholders, the Princes. In the Decision, the Commission
13 required Valley to provide the Commission copies of all executed documents associated with the
14 transaction within 90 days after the effective date of the Decision (by March 3, 2008). The transfer
15 of the Maryland Avenue Booster Station property was not recorded until April 10, 2009, more than a
16 year after the compliance deadline for filing the executed documents and nine months after the end of
17 the TY. (Ex. S-2.) Thus, we find that Valley failed to comply with the filing requirement imposed in
18 Decision No. 70052 and the implicit requirement that the transaction itself actually be completed
19 within 90 days after the Decision's effective date. Valley acknowledges this violation. (See Tr. at
20 13.)

21 CAP Water Purchase Agreement

22 102. On January 12, 2007, Valley's Board of Directors approved the purchase of 250 acre
23 feet of CAP water annually ("CAP agreement"). (Ex. S-2.) Valley had the option of either paying a
24 one-time payment of \$163,000 for the water or paying through five annual installment payments of
25 \$36,000 each, for a total of \$180,000. (*Id.*) Valley chose to pay through the installment payment
26 method, resulting in its incurring \$17,000 in financing charges over five years. (*Id.*) Valley did not
27

28 ⁵⁶ We note that Valley's authority to impose the set-aside fee is no longer effective.

1 seek Commission approval of the CAP agreement because it was not asking for the allocation to be
2 included in its rate base. (*Id.*) Staff determined that the installment payment method suggests that a
3 long-term debt may have been incurred, as the terms of the CAP agreement result in acquisition of
4 the asset over a five-year term with an implied 5.2 percent interest rate. (*Id.*) Staff stated that
5 Commission approval of issuance of evidence of indebtedness is required under A.R.S. §§ 40-301
6 and 40-302 and that, in an abundance of caution, Valley should file an application for Commission
7 approval of the CAP agreement to allow the Commission to determine whether the CAP agreement
8 needs to be approved as a financing. (*Id.*) Valley disagrees with Staff's characterization of the CAP
9 agreement as long-term debt, as Valley asserts that it can "get out of" the CAP agreement at any time.
10 (Tr. at 13-14.)

11 103. During the hearing, in response to a suggestion by Valley, Staff modified its initial
12 recommendation related to the CAP agreement, recommending that Valley not be required to file for
13 Commission approval of the CAP agreement unless the Commission determines in a docket
14 involving Community Water Company of Green Valley ("Green Valley") that a similar CAP
15 agreement entered into by Green Valley requires approval as a financing. The Commission
16 determined in Decision No. 71259 (September 3, 2009) that Green Valley had entered into an
17 agreement to purchase CAP water, opting to pay over five years with interest at 5.2 percent, and
18 adopted Staff's recommendation that Green Valley be required to apply to the Commission regarding
19 whether approval of the agreement is required under A.R.S. §§ 40-301 and 40-302. (Ex. S-3.) Green
20 Valley was ordered to apply within 120 days of the effective date of Decision No. 71259 (i.e., by
21 January 1, 2010). (*Id.*) We take official notice that Green Valley has filed such an application in
22 Docket No. W-02304A-09-0575.

23 104. We find that it is appropriate to follow Staff's modified recommendation, with which
24 Valley agrees, as it will result in the most efficient use of the resources of Valley, Staff, and the
25 Commission as a whole, while still ensuring that the issue is resolved. Thus, we will require Valley
26 to monitor Docket No. W-02304A-09-0575 and, if a Decision is issued in that Docket determining
27 that Green Valley's agreement to purchase CAP water necessitates Commission approval under
28

1 A.R.S. §§ 40-301 and 40-302, to file an application for approval of its own CAP agreement within
2 120 days after the effective date of the Decision in Docket No. W-02304A-09-0575.

3 Compliance with NARUC USOA

4 105. Valley was unable to provide Staff a schedule of its outstanding CIAC showing the
5 name, date, and amount received from each contributor for reconciliation to the general ledger. (Ex.
6 S-2.) Valley only provided detail regarding CIAC activity during the TY. (*Id.*) NARUC USOA
7 guidelines state that CIAC records should reflect the amount received, the purpose of the
8 contribution, the identity of the contributor, and any conditions regarding the contribution. (*Id.*)
9 Likewise, Valley was unable to provide Staff a schedule of its outstanding AIAC showing the name,
10 date, and amount received from each person along with the amount refunded to date for
11 reconciliation to the general ledger. (*Id.*) Valley only provided detail regarding AIAC activity during
12 the TY. (*Id.*) This also does not comply with NARUC USOA guidelines, which state that each
13 utility shall keep its account books and all other books, records, and memoranda supporting the
14 entries in the account books so that the utility is able readily to furnish full information for any item
15 included in any account and so that each entry is supported by enough detailed information to permit
16 a ready identification, analysis, and verification of the facts related to it. (*Id.*) Valley does not
17 dispute Staff's determination that Valley has failed to maintain its CIAC and AIAC records in
18 compliance with the NARUC USOA and agrees that it should maintain its records in accordance with
19 the NARUC USOA. (Tr. at 13, 15.)

20 106. Commission rules require each utility to maintain its books and records in conformity
21 with the NARUC USOA. (A.A.C. R14-2-411(C)(2).) We find that Valley has failed to do so by
22 failing to maintain adequate records regarding its CIAC and AIAC.

23 Staff's Recommendations Regarding Regulatory Issues

24 107. Regarding regulatory issues, in addition to the specific recommendations set forth
25 above, Staff recommends:

26 (a) That Valley be required to develop and implement policies and procedures to
27 comply with all Commission directives, rules, and statutes;

28

1 (b) That Valley be required to maintain its records in accordance with the
2 Commission-mandated NARUC USOA; and

3 (c) That the Commission place Valley on notice that future indiscretions regarding
4 its obligations as a public service corporation must end. (Ex. S-2.)

5 108. Valley does not object to Staff's recommendations regarding regulatory issues. (Tr. at
6 13-15.) Mr. Prince conceded that Valley has had difficulty tracking and monitoring all of the
7 compliance issues resulting from various Commission Orders and stated that Valley has taken initial
8 steps to address this problem. (Ex. A-3.) Mr. Prince acknowledged that more can be done, however,
9 and agreed with Staff's recommendation to implement formal policies and procedures to ensure that
10 all compliance matters are addressed in a timely fashion. (Ex. A-3.) In addition, Mr. Prince testified
11 that in November 2009 an accountant was to start working with Valley part-time to help Valley
12 ensure compliance with the NARUC USOA. (Tr. at 15-16.)

13 **Emergency Interim Surcharge**

14 109. In Decision No. 70138, as described in Findings of Fact No. 18, the Commission
15 granted Valley authority to impose a well surcharge to cover the debt service on WIFA Loan #3.
16 Valley and Staff agree that the well surcharge should be eliminated when the rates and charges
17 approved in this Order go into effect.⁵⁷ (Ex. A-3; Ex. A-8; Ex. S-4.) We agree that this is
18 appropriate, particularly because Well #6 has been added into plant-in-service and into Valley's rate
19 base and thus factored into the rates to be approved herein. Thus, we will cancel the well surcharge
20 and will also cancel the requirement for Valley to maintain the \$1,500 bond or sight draft letter of
21 credit that was required in the order approving the well surcharge.

22 **Resolution**

23 110. As stated previously, we are modifying Staff's recommended monthly usage charges,
24 Staff's recommended commodity rate tier break-over points, and Staff's recommended commodity
25 rates to accommodate the revenue requirement adopted herein and to avoid crossover. We are also
26

27 _____
28 ⁵⁷ Staff's position is that the well surcharge should be eliminated regardless of whether Well #6 is included in rate base because emergency rates should not continue once permanent rates are adopted. (Ex. S-4.)

1 requiring that a monthly minimum charge be assessed for construction meters, according to meter
2 size, and are maintaining Valley's current late fee of \$10 per month.

3 111. Staff's recommendations set forth in Findings of Fact Nos. 87, 90, 103, and 107 are
4 just and reasonable and in the public interest, and we are adopting them.

5 112. For the reasons set forth previously herein, we are canceling the set-aside account
6 reporting requirement imposed by Decision No. 70956; the interim emergency well surcharge
7 authorized in Decision No. 70138; and the requirement from Decision No. 70138 that Valley
8 maintain a \$1,500 bond or sight draft letter of credit.

9 113. We are concerned by Valley's noncompliance with Commission Orders and rules and
10 want Valley to understand that adverse action against it, such as the institution of an OSC action
11 seeking fines, is likely to be taken if Valley continues to operate in the same manner. We are
12 encouraged that Valley seems to desire to comply with Commission requirements and hope that Mr.
13 Prince's apparent willingness to take action to improve Valley's compliance signals the dawn of a
14 new day in which Valley's compliance with Commission requirements will no longer be "less than
15 stellar." To ensure that Valley takes seriously and acts upon the requirements that we are imposing
16 upon it in this Decision, we will require it to file its new policies and procedures as compliance
17 filings in this Docket within 6 months after the effective date of this Decision.

18 114. In addition, to ensure that Valley's customers will continue to receive water that
19 complies with Safe Drinking Water Act requirements, we will require Valley to file copies of each of
20 the Approvals of Construction received for its arsenic treatment facilities as compliance filings in this
21 Docket within 30 days after receipt of each.

22 115. Finally, because the ARSM surcharge approved in Decision No. 71287 will expire on
23 August 31, 2013, at the latest, we remind Valley that it needs to plan for and prepare to file its next
24 permanent rate case accordingly.

25 CONCLUSIONS OF LAW

26 1. Valley is a public service corporation within the meaning of Article XV of the Arizona
27 Constitution and A.R.S. §§ 40-250, 40-251, and 40-367.

28 2. The Commission has jurisdiction over Valley and the subject matter of the application.

1 3. Notice of Valley's application and of the hearing in this matter was provided in
2 accordance with the law.

3 4. Valley's FVRB is negative \$169,027.

4 5. The rates and charges established herein reflect the adjustments made based upon our
5 determinations set forth in the Findings of Fact herein.

6 6. The rates, charges, and conditions of service established herein are just and reasonable
7 and in the public interest.

8 7. It is just and reasonable and in the public interest to take the actions described in
9 Findings of Fact Nos. 92 and 110 through 114.

10 **ORDER**

11 IT IS THEREFORE ORDERED that Valley Utilities Water Company, Inc. is hereby
12 authorized and directed to file with the Commission's Docket Control, as a compliance item in this
13 docket, on or before March 1, 2010, a revised tariff setting forth the following rates and charges:

14 **MONTHLY USAGE CHARGE:**

15	5/8" x 3/4" Meter—All Classes	\$ 12.40
16	3/4" Meter—All Classes	18.60
16	1" Meter—All Classes	31.00
17	1 1/2" Meter—All Classes	62.00
17	2" Meter—All Classes	99.00
18	3" Meter—All Classes	198.00
18	4" Meter—All Classes	310.00
19	6" Meter—All Classes	620.00
20	Construction Water	By Meter Size

21 **COMMODITY RATES (Per 1,000 Gallons):**

22	<u>5/8" x 3/4" Meter & 3/4" Meter—Residential</u>	
22	1 to 3,000 Gallons	\$1.50
23	3,001 to 10,000 Gallons	2.44
23	Over 10,000 Gallons	3.15

24 **5/8" x 3/4" Meter & 3/4" Meter—Commercial⁵⁸**

25	1 to 10,000 Gallons	\$2.44
25	Over 10,000 Gallons	3.15

26 **1" Meter—All**

27 _____
28 ⁵⁸ Irrigation customers are considered to be commercial customers. (See Ex. A-7 at Sched. H-4.)

1	1 to 23,000 Gallons	\$2.44
	Over 23,000 Gallons	3.15
2	<u>1-1/2" Meter—All</u>	
3	1 to 58,000 Gallons	\$2.44
4	Over 58,000 Gallons	3.15
5	<u>2" Meter—All</u>	
6	1 to 95,000 Gallons	\$2.44
	Over 95,000 Gallons	3.15
7	<u>3" Meter—All</u>	
8	1 to 207,000 Gallons	\$2.44
	Over 207,000 Gallons	3.15
9	<u>4" Meter—All</u>	
10	1 to 335,000 Gallons	\$2.44
	Over 335,000 Gallons	3.15
11	<u>6" Meter—All</u>	
12	1 to 690,000 Gallons	\$2.44
13	Over 690,000 Gallons	3.15
14	<u>Construction Water—All Meter Sizes</u>	
15	Per 1,000 Gallons	\$3.15

16 **SERVICE LINE & METER INSTALLATION CHARGES:**

17 (Refundable pursuant to A.A.C. R14-2-405)

	Service			
	Line	Meter	Total	
	Charge ¹	Charge	Charge	
19	5/8" Meter	\$ 445	\$ 155	\$ 600
	3/4" Meter	445	255	700
20	1" Meter	495	315	810
21	1 1/2" Meter	550	525	1,075
	2" Turbine Meter	830	1,045	1,875
22	2" Compound Meter	830	1,890	2,720
	3" Turbine Meter	1,045	1,670	2,715
23	3" Compound Meter	1,165	2,545	3,710
	4" Turbine Meter	1,490	2,670	4,160
24	4" Compound Meter	1,670	3,645	5,315
25	6" Turbine Meter	2,210	5,025	7,235
	6" Compound Meter	2,330	6,920	9,250
26	8" or Larger Meter	Cost	Cost	Cost

27 **SERVICE CHARGES:**

28	Establishment	\$40.00
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1	Establishment (After Hours)	60.00
	Reconnection (Delinquent)	40.00
2	Reconnection (Delinquent, After Hours)	60.00
	Meter Test	30.00
3	Deposit Requirement	(a)
	Deposit Interest	6.00%
4	Re-Establishment (Within 12 Months)	(b)
5	Re-Establishment (After Hours)	(b)
	NSF Check	\$25.00
6	Deferred Payment, Per Month	1.50%
	Meter Re-read	\$10.00
7	Moving Customer Meter at Customer Request	Cost
	After Hours Service Charge, per R14-2-403(D)	\$50.00
8	Late Charge per Month	\$10.00

9 **Monthly Service Charge for Fire Sprinkler**
 10 All Meter Sizes ***

- 11
- 12 *** Greater of \$10.00 or 2 percent of the general service rate for a similar size meter
- 13 (a) Residential – two times the average bill. Non-residential – two and one-half times the average bill.
- 14 (b) Months off the system x monthly minimum bill

15 In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax, per Commission Rule R14-2-409(D)(5).

16 All advances and/or contributions are to include labor, materials, overheads, and all applicable taxes, including all gross-up taxes for income taxes, if applicable.

17 All items billed at cost shall include labor, materials, overheads, and all applicable taxes.

18

19 IT IS FURTHER ORDERED that the rates and charges set forth above shall be effective for

20 all services rendered by Valley Utilities Water Company, Inc. on and after March 1, 2010.

21 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall notify its

22 customers of the revised schedule of rates and charges authorized herein by means of an insert in its

23 next regularly scheduled billing, or by separate mailing, in a form acceptable to the Commission’s

24 Utilities Division Staff.

25 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall file the

26 following with the Commission’s Docket Control, as compliance items in this docket, within 6

27 months after the effective date of this Decision:

- 28 1. A written policy and procedure to minimize non-arm’s length transactions;

1 2. A written policy and procedure addressing employee benefits;

2 3. An updated version of the equity improvement plan filed as required by Decision No.
3 68309, which shall require Valley to continue improving its equity position; prohibit Valley from
4 draining equity through dividend distributions and other distributions to shareholders such as bonuses
5 and excessive increases in salaries and benefits; and require Valley to implement and maintain
6 adequate internal controls over expenditures so as to control expenses and avoid misappropriations;
7 and

8 4. A written policy and procedure addressing how Valley will ensure that it complies
9 with all Commission directives, rules, and statutes.

10 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall implement and
11 comply with the policies and procedures and equity improvement plan required to be filed under the
12 previous ordering paragraph.

13 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall monitor Docket
14 No. W-02304A-09-0575 and, if a Decision is issued in that Docket determining that Green Valley's
15 agreement to purchase CAP water necessitates Commission approval under A.R.S. §§ 40-301 and 40-
16 302, shall file, within 120 days after the effective date of the Decision in Docket No. W-02304A-09-
17 0575, an application requesting Commission approval of Valley's CAP agreement entered into in
18 2007.

19 IT IS FURTHER ORDERED that the set-aside account reporting requirement imposed by
20 Decision No. 70956 is hereby canceled.

21 IT IS FURTHER ORDERED that the interim emergency well surcharge authorized in
22 Decision No. 70138 is hereby canceled.

23 IT IS FURTHER ORDERED that the requirement for Valley Utilities Water Company, Inc.
24 to maintain a \$1,500 bond or sight draft letter of credit, imposed in Decision No. 70138, is hereby
25 canceled.

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IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall file with the Commission's Docket Control, as compliance items in this Docket, within 30 days after receipt, copies of the Approval of Construction received for each of its arsenic treatment facilities.

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, ERNEST G. JOHNSON, 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 _____ day of _____, 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

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

2 DOCKET NO.: W-01412A-08-0586

3

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