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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

- KRISTIN K. MAYES - Chairman
- GARY PIERCE
- PAUL NEWMAN
- SANDRA D. KENNEDY
- BOB STUMP

FEB - 3 2010

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IN THE MATTER OF THE APPLICATION OF 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. 71482

OPINION AND ORDER

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

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Sarah N. Harpring

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

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

**BY THE COMMISSION:**

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

\* \* \* \* \*

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

FINDINGS OF FACT

Background

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

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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.<sup>1</sup> (*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.<sup>2</sup> (*Id.*) Valley hired a consulting firm to conduct an arsenic treatment study using

26 <sup>1</sup> 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 <sup>2</sup> 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.<sup>3</sup> (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  
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26 <sup>3</sup> 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. Since Valley is located in the Phoenix AMA, it will be required to comply with  
4 conservation goals and management practices of ADWR. In light of the need to conserve  
5 groundwater in Arizona, we believe it is reasonable to require Valley to go beyond the ADWR  
6 requirements and submit for Commission approval, within 120 days of the effective date of this  
7 Decision, at least five Best Management Practices ("BMPs") (as outlined in ADWR's Modified Non-  
8 Per Capita Conservation Program). A maximum of two of these BMPs may come from the "Public  
9 awareness/PR" or "Education and Training" categories of the BMPs. The Company may request cost  
10 recovery of actual costs associated with the BMPs implemented.

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

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

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

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

22 13. Staff reported that Valley is in good standing with the Commission's Corporations  
23 Division. (*Ex. S-2.*)

24 14. Valley has an approved curtailment tariff and an approved backflow prevention tariff  
25 on file with the Commission. (*Ex. S-1.*)

26 Pertinent Prior Commission Decisions

27 15. In Decision No. 62908 (September 18, 2000), the Commission granted Valley a  
28 permanent rate increase; authorized Valley to incur long-term debt in the form of a Water

1 Infrastructure Finance Authority of Arizona ("WIFA") loan for \$452,080 ("WIFA Loan #1");  
2 authorized Valley to set aside each month the amount of funds equivalent to 1/12 of the annual debt  
3 service requirement of WIFA Loan #1 and, until that figure was known, \$6.35 per bill per month  
4 ("set-aside funds"); and required Valley to place the set-aside funds in a separate, interest-bearing  
5 account to be used solely for the purpose of servicing WIFA Loan #1. The Decision also required  
6 Valley to submit to Staff, within 60 days after the Decision, information detailing the amount of the  
7 debt service requirement on WIFA Loan #1 and required Valley to file copies of all executed  
8 financing documents within 30 days of obtaining the financing.

9       16. In Decision No. 67669 (March 9, 2005), the Commission authorized off-site facilities  
10 hook-up fees, as arsenic impact fees ("AIFs"), and required Valley to use the AIFs only to pay the  
11 costs of arsenic treatment facilities, to include repayment of loans obtained to install arsenic treatment  
12 facilities to benefit the entire water system. The AIFs were to be used to pay the debt service and/or  
13 principal reduction on a WIFA Loan for \$1,926,100, for which the application was still pending at  
14 that time in another docket. The approved AIFs were \$1,100 for all new 5/8" x 3/4" meter service  
15 connections and larger graduated amounts for larger meter sizes. In the Decision, among other  
16 things, the Commission required that Valley file an annual AIF status report by January 31 of each  
17 year and until the AIF Tariff was no longer in effect, with the first such report due on January 31,  
18 2006.

19       17. In Decision No. 68309 (November 14, 2005), the Commission granted Valley a  
20 permanent rate increase; approved a \$1,926,100 WIFA loan ("WIFA Loan #2"), to be used to pay for  
21 arsenic treatment facilities to bring Valley's water into compliance with the arsenic MCL; denied  
22 Valley's request for an arsenic operating and maintenance recovery surcharge mechanism; and  
23 canceled the authority for Valley to obtain WIFA Loan #1, which had not been drawn on by Valley.  
24 The Commission ordered Valley to file an application for approval of an arsenic removal surcharge  
25 tariff if a surcharge were necessary to allow Valley to meet its principal and interest obligations on  
26 WIFA Loan #2 and the income taxes on the surcharges. The Commission determined that Valley had  
27 been collecting the set-aside funds authorized in Decision No. 62908, and found that it would be  
28 appropriate for Valley to use the collected set-aside funds to pay debt service for WIFA Loan #2, but

1 did not directly order Valley to do so and did not expressly cancel the authority to collect the set-  
2 aside funds. Instead, the Commission ordered Valley to file a report providing detailed information  
3 regarding the set-aside funds collected and analyzing the extent to which application of the collected  
4 set-aside funds would offset the amount of, or the need for, a surcharge to service WIFA Loan #2 and  
5 ordered Valley to file copies of its revenue requirement calculation for WIFA Loan #2, which was to  
6 include the effects of applying both the set-aside funds and the AIFs collected by Valley. The  
7 Commission also ordered Valley to institute operating policies to remove any and all non-arm's-  
8 length transactions between Valley and its owners and ordered Staff to scrutinize Valley's books  
9 carefully in its next rate case and to bring to the Commission's attention any non-arm's-length  
10 transactions, including but not limited to improper lease arrangements and payment of personal  
11 expenses. In addition, the Commission directed Valley to develop and institute a plan to produce a  
12 positive equity position by December 31, 2010 ("Equity Plan"), which Valley was to file as a  
13 compliance item within 90 days, and ordered Staff to bring to the Commission's attention in Valley's  
14 next rate case all evidence of any inappropriate practices contributing to the deterioration of Valley's  
15 equity.

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

22 19. In Decision No. 70138 (January 23, 2008), the Commission granted Valley approval  
23 to incur long-term debt in an amount up to \$250,000 ("WIFA Loan #3") for purposes of drilling a  
24 replacement well to replace its largest well (Well #6), which had failed in August 2007, and also  
25 granted Valley approval to assess an interim emergency well surcharge ("well surcharge") by meter  
26

27 \_\_\_\_\_  
28 <sup>4</sup> 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.

1 size to service the debt on WIFA Loan #3.<sup>5</sup> The Commission also ordered Valley to file, by  
2 December 1, 2008, a full rate case application using a TY ending June 30, 2008, and to file with the  
3 Commission's Business Office a bond or sight draft letter of credit in the amount of \$1,500. The  
4 Decision stated that the well surcharge is interim and subject to refund pending a decision on  
5 Valley's permanent rate application.

6 20. In Decision No. 70561 (October 23, 2008), the Commission denied Valley's request  
7 for an accounting order to allow it to defer all of its arsenic operating and maintenance expenses for  
8 purposes of permitting recovery of those costs in future rate cases, reasoning that Valley's existing  
9 AIF Tariff and its authorization to file for approval of an arsenic remediation surcharge mechanism to  
10 collect debt service costs from its customers already served to insulate Valley from the risks  
11 associated with arsenic-remediation-related capital expenditures.

12 21. In Decision No. 70956 (April 7, 2009), the Commission denied Valley an order  
13 confirming compliance with Decision No. 62908, but granted release of the set-aside funds collected  
14 pursuant to that Decision for the sole purpose of servicing the debt for WIFA Loan #2. The  
15 Commission found that Valley had failed to comply with Decision No. 62908 by commingling set-  
16 aside account funds with other funds, using set-aside account funds for purposes other than those  
17 authorized by the Commission, failing to advise Staff of the actual amount of WIFA Loan #1 debt  
18 service, and failing to file copies of the closing documents for WIFA Loan #1. The Commission also  
19 found that Valley had failed to file its AIF status reports for 2005, 2006, and 2007 until February  
20 2008 and that those status reports had been incomplete and, further, that as of March 17, 2009, Valley  
21 had not filed its AIF status report for 2008, which had been due on January 31, 2009. Valley was  
22 ordered to file, within 20 days, complete copies of its bank statements for the set-aside fund account;  
23 was ordered to file, beginning on July 15, 2009, and until further order of the Commission, quarterly  
24 reports documenting the use of the set-aside funds to service WIFA Loan #2; and was ordered to file,  
25 within 30 days, a detailed accounting of how funds withdrawn from the set-aside fund account were  
26 used, for the period from September 2003 to the present. Staff was ordered to review and analyze

27  
28 <sup>5</sup> 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 Valley's detailed accounting of the use of the set-aside funds in the context of the rate case (this  
 2 proceeding) to determine the amount of set-aside funds collected that should offset WIFA Loan #2  
 3 and to determine whether the funds commingled in the set-aside account were used for utility  
 4 purposes. Staff was also ordered to investigate whether Valley was in compliance with Decision No.  
 5 67669 and Decision No. 68309 concurrently with any Order to Show Cause ("OSC") proceeding that  
 6 Staff may choose to initiate in its discretion.

7       22. In Decision No. 71287 (October 7, 2009), the Commission approved Valley's  
 8 application for an arsenic remediation surcharge mechanism ("ARSM") surcharge to cover the costs  
 9 of its debt service for WIFA Loan #2. The ARSM surcharge approved is \$5.51 per month for a  
 10 customer served by a 5/8" x 3/4" meter and is graduated based on meter size.<sup>6</sup> The Commission also  
 11 found, consistent with Staff's determination, that Valley had over-collected a total of \$66,719 in set-  
 12 aside funds, interest, and AIFs, which sum was available to cover Valley's payments on WIFA Loan  
 13 #2 from August 1, 2009, through November 1, 2009. Staff stated that Valley's spending the over-  
 14 collected funds to cover its payments for those four months would bring Valley into compliance in its  
 15 use of set-aside funds and AIFs and thus render it eligible to obtain the ARSM surcharge tariff. The  
 16 Commission approved the ARSM surcharge, effective November 1, 2009, and ordered that the  
 17 ARSM surcharge will expire on the effective date of the rates authorized in a rate proceeding  
 18 subsequent to the currently pending rate proceeding (i.e., subsequent to this docket) or on August 31,  
 19 2013, whichever comes first. Staff did not recommend initiation of an OSC proceeding or any other  
 20 adverse action against Valley, instead "monetiz[ing] the level of non-compliance that still exist[ed]"  
 21 in the form of the over-collected funds and recommending that the ARSM surcharge tariff not  
 22 become effective until after those over-collected amounts had been used to pay debt service on WIFA  
 23 Loan #2. The Decision did not address cancellation of the existing AIF Tariff.

#### 24 **Procedural History**

25       23. On December 2, 2008, Valley filed an application for a permanent rate increase, using  
 26 a TY of July 1, 2007, through June 30, 2008, as required by Commission Decision No. 70138, and  
 27

28 <sup>6</sup> 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.

1 requesting approval of rates and charges that would provide Valley with an operating margin of 15  
2 percent, which Valley asserted would provide it with sufficient cash flow to pay its operating  
3 expenses, to pay for expected capital improvements, and to cover requisite annual debt service on  
4 WIFA loans obtained to construct arsenic treatment facilities and for an emergency replacement  
5 well.<sup>7</sup> Valley proposed to use an operating margin approach to establish its rates because of the  
6 negative equity in its capital structure. (Ex. A-7.) Valley requested that its original cost rate base  
7 (“OCRB”) be used as its fair value rate base (“FVRB”). (*Id.*) For the TY, Valley reported adjusted  
8 gross revenues of \$1,209,703; adjusted operating income of \$12,012; and an adjusted FVRB of  
9 \$1,741,191. (Ex. A-7 at Sched. A-1.) Valley stated that the increase in revenues needed to produce a  
10 15-percent operating margin was approximately \$323,456, a 26.74 percent increase in TY revenues.  
11 (*Id.*) With its Application, Valley filed the Direct Testimony of Robert L. Prince, President, and  
12 Thomas Bourassa, CPA, Consultant.

13         24. On January 6, 2009, Staff issued a Letter of Sufficiency, indicating that Valley’s  
14 Application had met the sufficiency requirements of A.A.C. R14-2-103 and classifying Valley as a  
15 Class B water utility.

16         25. On January 12, 2009, a Procedural Order was issued scheduling a pre-hearing  
17 conference and a hearing in this matter for September 11 and 15, 2009, respectively, and establishing  
18 other procedural requirements and deadlines.

19         26. On March 16, 2009, Staff’s Consumer Services Section filed the comments of a  
20 Valley customer opposing the rate increase for economic reasons.

21         27. On March 31, 2009, Valley filed an Affidavit of Publication stating that notice of  
22 Valley’s application and the scheduled hearing had been published in the *West Valley View* and the  
23 *West Valley Business*, newspapers of general circulation in Valley’s service area, on February 27,  
24 2009, and an Affidavit of Mailing stating that Valley had mailed notice of the application and hearing  
25 to its customers on February 20, 2009.<sup>8</sup>

26         28. On April 8 and May 6, 2009, Marlin Scott, Jr., Staff Utilities Engineer, completed a

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

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

1 field inspection of Valley's water system. (Ex. S-1.)

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

5 30. On August 5, 2009, Valley filed the Rebuttal Testimony of Mr. Prince and Mr.  
6 Bourassa.

7 31. On August 26, 2009, Staff filed the Surrebuttal Testimony of Mr. McMurry and Mr.  
8 Scott.

9 32. On September 8, 2009, Valley filed the Rejoinder Testimony of Mr. Prince and Mr.  
10 Bourassa.

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

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

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

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

27 37. On September 30, 2009, Valley filed its LFEs, including an Exhibit 1 ("LFE-A1") and  
28 an Exhibit 2 ("LFE-A2"). LFE-A1 includes a copy of Valley's CAP Municipal and Industrial

1 Subcontract, dated May 10, 2007; an Agreement for Payment of Past CAP M&I Water Service  
 2 Capital Charges, dated November 5, 2007; and CAP invoices for the period from 2007-2009. LFE-  
 3 A2 includes a narrative description of the current status of the arsenic treatment facilities at the  
 4 Glendale Well Field and the Bethany Home Well Field as well as a copy of an MCESD Approval to  
 5 Commence Operations with Stipulations for the Glendale Well Field facilities, dated July 8, 2009.

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

8 39. On October 23 and 26, 2009, Staff filed corrections to LFE-S1.<sup>9</sup>

9 **Ratemaking**

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

13 41. In its application, Valley stated that its actual TY revenue was \$1,245,428; that its  
 14 adjusted TY revenue was \$1,209,703; that its adjusted TY operating income was \$12,012; that it  
 15 requires operating income of \$229,974; that it requires a 15-percent operating margin; that its  
 16 operating income deficiency is \$217,962; that its gross revenue conversion factor is 1.4840; and that  
 17 it requires an increase in gross revenue of \$323,456, which represents an increase of 26.74 percent.  
 18 (Ex. A-7.) In its application, Valley asserted that its actual OCRB at the end of the TY was negative  
 19 \$663,788, which it adjusted to \$1,741,191 through an increase of \$2,000,500 in plant in service, a  
 20 decrease of \$416,134 in accumulated depreciation, and an increase of \$11,655<sup>10</sup> to accumulated  
 21 amortization of contributions in aid of construction ("CIAC"). (*Id.*) Valley did not request use of  
 22 reconstruction cost new rate base ("RCNRB") to determine its FVRB. (*Id.*)

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

27 <sup>9</sup> All references to LFE-S1 refer to LFE-S1 as corrected.

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

1           43.     In its rebuttal testimony, Valley agreed to exclude the post-TY arsenic treatment  
2 facilities from rate base and the related depreciation from operating expenses.<sup>11</sup> (Ex. A-8.) In  
3 addition, Valley reduced its requested operating margin to 10 percent, to make it consistent with  
4 Staff's recommendation. (*Id.*) Valley and Staff agreed on the level of accumulated depreciation,  
5 advances in aid of construction ("AIAC"), CIAC, customer meter deposits, and accumulated deferred  
6 income taxes ("ADIT"). (Ex. A-8.)

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

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

20           46.     Valley and Staff agreed to adjust TY revenues by negative \$24,537 to annualize  
21 revenues based on the assumption that the number of customers at the end of the TY are  
22 representative of the number of customers during the entire TY. (Ex. S-4.) Valley provided  
23 schedules supporting these reduced revenues. (*See* Ex. A-8 at Sched. C-2; Ex. A-9 at Sched. C-2; Ex.  
24 A-8 at Sched. H-1.) These schedules establish that bringing Valley's actual figures in line with its  
25

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

<sup>12</sup> 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.  
S-4.)

1 end-of-TY customer count would result in a reduction in customer bills of 94 over all customer  
 2 classes and meter sizes; a reduction in revenue based on current rates and charges of \$24,536; and a  
 3 reduction in gallons pumped of 5,997,100.<sup>13</sup> (See Ex. A-8 at Sched. C-2; Ex. A-9 at Sched. C-2; Ex.  
 4 A-8 at Sched. H-1.)

5 47. Valley and Staff agreed on the method of computing property taxes, which includes  
 6 two years of adjusted revenues plus one year of proposed revenues. (Ex. A-8.) The differences in the  
 7 parties' property tax figures result from differences in the parties' proposed revenues. (*Id.*)

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

18 49. In addition, in its post-hearing final schedules, Staff reclassified \$6,137 in interest  
 19 expense incurred by Valley on customer security deposits during the TY from a non-operating (below  
 20 the line) expense to an operating (above the line) expense, moved \$22,950 from other water revenues  
 21 to metered water revenues to recognize the lost revenue expected to result from Staff's reduction in  
 22

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

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

<sup>15</sup> 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.)

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

1 Valley's late fee from \$10 to 1.5 percent, and added \$2,660 in other water revenues to reflect and  
 2 reclass the increased revenue expected to be realized as a result of increases in miscellaneous service  
 3 charges.<sup>17</sup> (LFE S-1.) The \$2,660 adjustment in other water revenues to reflect the increased  
 4 revenue that should be realized as a result of increases in miscellaneous service charges is appropriate  
 5 and will be adopted herein. The issues of interest expense on customer security deposits and late fees  
 6 are discussed below.

7 50. Valley and Staff took the following final positions regarding rate base and revenue  
 8 requirements:

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

19 51. Valley's current rates and charges,<sup>21</sup> Valley's proposed rates and charges, and Staff's  
 20 recommended rates and charges are as follows:

<u>MONTHLY USAGE CHARGE:</u>	<u>Present Rates</u>	<u>Company Proposed</u>	<u>Staff Recommended</u>
21 5/8" x 3/4" Meter—All Classes	\$ 11.24	\$ 13.24	\$ 12.75
22 3/4" Meter—All Classes	16.87	19.87	19.10

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

27 <sup>18</sup> The source for this data is Ex. A-9.

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

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

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

1	1" Meter—All Classes	28.10	33.10	32.00
1	1½" Meter—All Classes	56.21	66.22	64.00
2	2" Meter—All Classes	89.94	105.95	102.00
2	3" Meter—All Classes	179.87	211.89	204.00
3	4" Meter—All Classes	281.05 <sup>22</sup>	331.08	319.00
3	6" Meter—All Classes	562.10 <sup>23</sup>	662.15	638.00
4	Construction Water	179.87	By Meter Size <sup>24</sup>	None

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

6 **5/8" x 3/4" Meter & 3/4" Meter—Residential**

6	1 to 3,000 Gallons	\$1.50	\$1.77	\$1.55
7	3,001 to 10,000 Gallons	2.31	2.72	2.55
8	Over 10,000 Gallons	2.53	2.98	3.25

9 **5/8" x 3/4" Meter & 3/4" Meter—Commercial<sup>25</sup>**

9	1 to 18,000 Gallons	\$2.31		
10	Over 18,000 Gallons	\$2.58		
10	1 to 15,000 Gallons		\$2.72	
11	Over 15,000 Gallons		2.98	
11	1 to 10,000 Gallons			\$2.55
12	Over 10,000 Gallons			3.25

13 **1" Meter—All**

14	1 to 50,359 Gallons	\$2.31		
14	Over 50,359 Gallons	2.53		
15	1 to 25,000 Gallons		\$2.72	\$2.55
16	Over 25,000 Gallons		2.98	3.25

17 **1-1/2" Meter—All**

17	1 to 126,054 Gallons	\$2.31		
18	Over 126,054 Gallons	\$2.53		
18	1 to 50,000 Gallons		\$2.72	
19	Over 50,000 Gallons		2.98	
19	1 to 60,000 Gallons			\$2.55
20	Over 60,000 Gallons			3.25

21 **2" Meter—All**

22	1 to 151,256 Gallons	\$2.31		
22	Over 151,256 Gallons	2.53		
23	1 to 80,000 Gallons		\$2.72	
24	Over 80,000 Gallons		2.98	

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

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

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

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

1	1 to 100,000 Gallons			\$2.55
	Over 100,000 Gallons			3.25
2	<u>3" Meter—All</u>			
3	1 to 403,274 Gallons	\$2.31		
	Over 403,274 Gallons	2.53		
4	1 to 160,000 Gallons		\$2.72	
	Over 160,000 Gallons		2.98	
5	1 to 225,000 Gallons			\$2.55
6	Over 225,000 Gallons			3.25
7	<u>4" Meter—All</u>			
8	1 to 453,722 Gallons	\$2.31		
	Over 453,722 Gallons	2.53		
9	1 to 250,000 Gallons		\$2.72	
	Over 250,000 Gallons		2.98	
10	1 to 365,000 Gallons			\$2.55
	Over 365,000 Gallons			3.25
11	<u>6" Meter—All</u>			
12	1 to 1,260,313 Gallons	\$2.31		
13	Over 1,260,313 Gallons	2.53		
14	1 to 500,000 Gallons		\$2.72	
	Over 500,000 Gallons		2.98	
15	1 to 775,000 Gallons			\$2.55
	Over 775,000 Gallons			3.25
16	<u>Construction Water—All Meter Sizes</u>			
17	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 &amp; Staff Recommended</u>			
	Service Line Charge	Meter Charge	Total Charge	Service Line Charge <sup>1</sup>	Meter Charge	Total Charge	
23	5/8" Meter	\$ 385	\$ 135	\$ 520	\$ 445	\$ 155	\$ 600
	3/4" Meter	385	215	600	445	255	700
24	1" Meter	435	255	690	495	315	810
	1 1/2" Meter	470	465	935	550	525	1,075
25	2" Turbine Meter	630	965	1,595	830	1,045	1,875
26	2" Compound Meter	630	1,690	2,320	830	1,890	2,720
	3" Turbine Meter	805	1,470	2,275	1,045	1,670	2,715
27	3" Compound Meter	845	2,265	3,110	1,165	2,545	3,710

1	4" Turbine Meter	1,170	2,350 <sup>26</sup>	3,520 <sup>27</sup>	1,490	2,670	4,160
	4" Compound Meter	1,230	3,245	4,475	1,670	3,645	5,315
2	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
3	8" or Larger Meter	Cost	Cost	Cost	Cost	Cost	Cost

4 <sup>1</sup> For long-side service line installation, charge will be at actual cost.

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

18

19 \* Per R14-2-403(D).

20 \*\* 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.

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

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

23 (b) Months off the system x monthly minimum bill

25 <sup>26</sup> 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.

26 <sup>27</sup> 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.

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

28 <sup>29</sup> 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 In addition to the collection of regular rates, the utility will collect from its customers a  
 2 proportionate share of any privilege, sales, use, and franchise tax, per Commission Rule R14-  
 3 2-409(D)(5).

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

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

### 7 Contested Issues

#### 8 Downward Adjustment of TY Revenue for Post-TY Water Sales

9 52. Valley proposes that its TY revenues be decreased by \$102,966 more than the  
 10 negative \$24,537 annualization adjustment agreed upon by Valley and Staff, for a total downward  
 11 adjustment of \$127,503, based on water sales revenue during the 12-month period post-TY. (Ex. A-  
 12 9.) Valley asserts that this additional downward adjustment is known and measurable because it is  
 13 based on actual operating results for the 12 months post-TY. (*Id.*) For the TY, Valley reported actual  
 14 metered water revenues of \$1,186,115.<sup>30</sup> (Ex. A-7 at Sched. C-1.) For the 12 months post-TY,  
 15 Valley reported actual metered water revenues of \$1,058,682. (Ex. A-9 at Sched. C-2.) The  
 16 additional downward adjustment requested would bring Valley's adjusted TY metered water  
 17 revenues down to \$1,058,612. (Ex. A-9 at Sched. C-1.)

18 53. Mr. Prince testified that water sales have declined due to a lack of construction, a  
 19 declining customer base, and water conservation based on Valley's current rate design. (Ex. A-4.)  
 20 Mr. Prince stated that there was considerable construction activity in Valley's service area during the  
 21 TY, primarily in the form of preparing plats and subdivisions for construction of new homes, but that  
 22 construction and development activity has been virtually nonexistent post-TY, with three specific  
 23 projects<sup>31</sup> remaining undeveloped beyond plat preparation. (*Id.*) Mr. Prince also stated that Valley  
 24 has lost approximately 20 customers since its last rate case. (*Id.*) Furthermore, Mr. Prince states that  
 25 the rates approved in Valley's last rate case appear to have had a positive effect on water

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

<sup>31</sup> Mr. Prince identified Bethany Estates, with 62 lots; Dysart Village, with 39 lots; and Luke Ranch, with 40 lots. (Ex.  
 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 conservation efforts, as the average monthly usage for a 5/8" x 3/4" metered residential customer has  
2 gone from 9,624 gallons in the prior rate case TY to 7,376 gallons in this matter's TY, and the  
3 average monthly usage for a customer served by a 3/4" meter has gone from 10,243 gallons in the  
4 prior rate case TY to 9,531 gallons in this matter's TY. (*Id.*) Mr. Prince asserted that because Staff  
5 and Valley virtually agree on the annual revenue requirement for Valley to maintain a 10-percent  
6 operating margin, it is important for the Commission to recognize the sources of declining revenue  
7 and make appropriate adjustments. (*Id.*) Mr. Prince stated that Valley has had to cut costs as a result  
8 of its declining revenue stream and has done so through letting full-time employees go,<sup>32</sup> having  
9 remaining employees take on more responsibilities, reducing regular office hours to four days per  
10 week to cut down on electricity and fuel expenses, installing two energy-saving soft starts and four  
11 variable frequency drives, purchasing chlorine in bulk, having salaried employees work longer hours,  
12 and using temporary employees when necessary. (*Id.*) Valley has gone from a staff of seven during  
13 the TY to a staff of four currently. (Tr. at 37.) The reduced salaries are not reflected in Valley's  
14 adjusted TY figures because the changes occurred post-TY, and Valley believes that it needs a full  
15 complement of employees to provide service to its customers. (Tr. at 18, 37.)

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

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

28 <sup>33</sup> 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.)

1 Bourassa testified that the additional downward adjustment would result in a more realistic  
2 relationship between revenue, expenses, and rate base and that Staff has not objected to such  
3 annualization adjustments in the past, such as in the recent Chaparral City Water Company case,<sup>34</sup> in  
4 which Staff adopted a revenue loss adjustment based on both actual (7 months) and estimated (5  
5 months) post-TY water usage data. (*Id.*)

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

27 <sup>34</sup> Docket No. W-02113A-07-0551.

28 <sup>35</sup> 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 more realistic relationship between revenues, expenses, and rate base, Mr. McMurry would also need  
2 to analyze all of Valley's post-TY expenses, which essentially would result in using the year post-TY  
3 as the TY. (See Tr. at 129.)

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

9 57. Although Valley asserts that its revenues declined in the 12 months post-TY, probably  
10 as a result of the downturn in our nation's and Arizona's economy, it is not possible to determine  
11 with any certainty what the duration of such decline will be or whether it will remain generally  
12 consistent or will fluctuate. Valley has established that there are a number of properties within its  
13 service area that are prepped for further development. In addition, contrary to the situation in the  
14 Chaparral City Water Company case, there is no indication in this case that the previously served and  
15 now vacant properties within Valley's service area will never need to be served with potable water  
16 again. Those vacant properties could be filled with families tomorrow or next month or next year,  
17 and the occupants would need to obtain service from Valley. Likewise, the currently inactive  
18 partially developed properties could see building activity in the imminent future. Valley has already  
19 made cost-cutting efforts due to the change in its revenues, which is appropriate for any business in  
20 tough economic times. However, Valley has not asked to have its expenses (other than purchased  
21 power and chemicals) annualized to reflect its reduced post-TY expense levels, which would also be  
22 affected by reduced customer counts.<sup>36</sup> Because of the uncertainty regarding how long the downturn  
23

24 <sup>36</sup> Valley did not reduce its TY salaries and wages expense to reflect fewer employees. (Tr. at 18, 37.) Thus, the most  
25 significant change would likely be in salaries and wages, as Valley now has three fewer employees than it did during the  
26 TY. While Valley asserts that it needs those three positions to be filled to provide service to its customers, it appears that  
27 it is functioning at a satisfactory level without them. It is also likely that the sum of the three salaries for the vacant  
28 positions may approach or even exceed the additional revenue adjustment requested. The TY expenses for salaries and  
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

1 in sales will last and the uncertainty regarding the actual post-TY level of expenses coinciding with  
 2 the reduced revenues, we find that the additional revenue annualization requested is not known and  
 3 measurable, would result in a mismatch of revenues and expenses, and should not be allowed. As a  
 4 result of our decision not to allow the additional revenue annualization requested, it is unnecessary to  
 5 make Valley's requested corresponding adjustments to purchased power expense and chemicals  
 6 expense.

7 Security Deposit Interest

8 58. Valley desires to lower its deposit interest rate to 2 percent, rather than maintaining its  
 9 current security deposit interest rate of 6 percent. Valley asserts that a 6-percent interest rate is too  
 10 high given the low interest rates currently provided by banks on certificates of deposit ("CDs") and  
 11 money market accounts. (Ex. A-9.) Valley stated that, as of the beginning of September 2009, the  
 12 annual yield on a 5-year CD was 2.66 percent, the annual yield on a 6-month CD was 0.36 percent,  
 13 and the annual yield on a money market account was 1.16 percent. (*Id.*) Mr. Prince asserts that a 6-  
 14 percent interest rate on a security deposit is not equitable in today's economy and has not been for the  
 15 past several years, as no bank savings or money market account available to Valley would earn 6-  
 16 percent interest, and Valley would not be able to obtain a CD or treasury bill with anything close to a  
 17 6-percent return. (*Id.*)

18 59. Staff asserts that the 6-percent interest rate should be retained. Staff's position is  
 19 based on the default interest rate prescribed in A.A.C. R14-2-403(b)(3), which provides: "Interest on  
 20 deposits shall be calculated annually at an interest rate filed by the utility and approved by the  
 21 Commission in a tariff proceeding. In the absence of such, the interest rate shall be 6%." Mr.  
 22 McMurry testified that Staff has no reason not to accept Mr. Bourassa's testimony regarding current  
 23 interest rates, and that the Commission has the authority to decide what the deposit interest rate  
 24 should be, but that the 6-percent interest rate is a default rate that Staff has seen no reason to  
 25 change.<sup>37</sup> (Tr. at 124.) Mr. McMurry pointed out that the utilities only hold the deposits for 12

26 postage expenses, among other things. However, Valley has not requested a corresponding reduction to reflect those  
 27 changes in administrative or customer service demand.

28 <sup>37</sup> Mr. McMurry indicated that Staff may desire to change the interest rate, as interest rates change, but observed that  
 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 months and that if they are paying interest, the interest expense should be included above the line as  
2 an operating expense so that the utility will benefit from it. (Tr. at 139.) In its final schedules, Staff  
3 reclassified the \$6,137 paid by Valley on customer security deposits during the TY from a non-  
4 operating (below the line) expense to an operating expense (above the line). (LFE S-1.)

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

16 Late Fees

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

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

27 \_\_\_\_\_  
28 <sup>38</sup> 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 revenue loss that would result from Staff's recommended late fee would impact the need for Valley  
2 to increase its rates. (Ex. A-4.) Mr. Prince testified that it would be inequitable to make those who  
3 pay their bills in a timely fashion make up for the revenue loss that would result from Staff's  
4 recommended change to Valley's late fee. (*Id.*) Mr. Prince also asserted, however, that if the  
5 Commission adopts Staff's recommended 1.5-percent late fee, a corresponding adjustment should be  
6 made to Valley's annual TY revenue and Staff's recommended rates to account for the lost revenue.  
7 (*Id.*)

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

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

25 <sup>39</sup> The Commission recently passed an order setting the late fee for two affiliated utilities at \$5.00 per month, as  
26 opposed to the utilities' requested late fee of \$10.00 per month and Staff's recommended late fee of 1.5 percent per  
27 month. (Decision No. 71446 (December 23, 2009).) The \$5.00 late fee was adopted through an amendment after the  
28 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 purpose set forth above and that it also very likely would not serve even the first purpose set forth  
2 above.<sup>40</sup> In addition, we find that it is inappropriate to cause an increase in Valley's metered water  
3 revenues to make up for the anticipated lost revenues in late fees, as doing so passes the burden from  
4 those customers who do not pay their bills in a timely fashion to all customers, including the majority  
5 who do pay their bills in a timely fashion. In light of the above, we find that it is appropriate to retain  
6 Valley's late fee at \$10.00 per month.<sup>41</sup>

7 Purchased Power Expense

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

18 66. We agree with Valley and Staff that it is appropriate to adjust purchased power  
19 expenses for the known and measurable change resulting from APS's approved rate increase.  
20 However, we find that it is appropriate to perform the calculations for the adjustment using actual  
21 rather than adjusted figures where possible. Valley had an actual TY purchased power expense of  
22 \$137,023 and actual TY gallons sold of 325,407,000, resulting in an actual TY purchased power  
23 expense of \$0.42108 per thousand gallons pumped. (Ex. A-7 at Sched. C-2.) Valley reports actual  
24 purchased power costs of \$144,446 during the 12 months post-TY for actual gallons sold of  
25

26 <sup>40</sup> 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¢.

<sup>41</sup> 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.

1 296,878,000, resulting in an actual purchased power expense of \$0.48655 per thousand gallons. (Ex.  
2 A-9 at Sched. C-2.) The difference between these expenses is an increased cost of \$0.06547 per  
3 thousand gallons. Using Staff's adjusted gallons sold of 319,387,000, this results in an increased cost  
4 of \$20,910 for the TY. We find that this is the appropriate purchased power adjustment to apply and  
5 will adopt it.

#### 6 Repairs and Maintenance Expense

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

16 68. Mr. Bourassa asserts that averaging R&M expenses for the TY and the preceding four  
17 years would result in a normalized expense of \$16,402, that averaging R&M expenses for 2006  
18 through 2009<sup>42</sup> would result in a normalized expense of \$15,258, and that averaging R&M expenses  
19 for 2007 through 2009 would result in a normalized expense of \$13,797. (Ex. A-8.) Mr. Bourassa  
20 stated that the disparate results, depending on which and how many years are used, demonstrates that  
21 normalization through averaging should be avoided and is poor ratemaking policy. (*Id.*)

22 69. Staff asserts that Valley's TY R&M expenses should be normalized because the TY  
23 expenses of \$14,210 are not representative of ongoing R&M expenses. (Ex. S-2.) Staff asserts that  
24 Valley's R&M expenses vary widely from year to year and recommends that they be normalized by  
25 taking the reported R&M expenses for fiscal years 2006, 2007, and 2008 (\$19,641, \$2,964, and  
26 \$14,210, respectively) and using the three-year average annual cost per customer (\$8.58) and the TY

27  
28 <sup>42</sup> Mr. Bourassa stated that the R&M expense for July 2008 through June 2009 was \$24,217. (Ex. A-8.)

1 customer count (1,477). (*Id.*) Staff thus calculated adjusted TY R&M expenses of \$12,668, which  
2 would necessitate an adjustment of negative \$1,542. (*Id.*) Mr. McMurry testified that he used the  
3 three-year period because it corresponds to the three-year period used to normalize rate case expense.  
4 (Tr. at 133.) Mr. McMurry acknowledged that the normalization process is somewhat subjective, in  
5 that the results will vary depending on the period of time used, and did not dispute Valley's assertion  
6 that the five-year average would result in a normalized R&M expense of \$16,402. (Tr. at 133-34.)  
7 When asked whether he would be opposed to using a three-year average that takes into account the  
8 three most recent years of data, Mr. McMurry testified that he did not audit post-TY expenses and  
9 thus would have the same problem that he had with using unaudited figures for purposes of revenue  
10 annualization. (Tr. at 133-34.) Mr. McMurry stated that he supposed he could use that method of  
11 normalization after auditing them, but that he then might be questioned concerning why he did not  
12 stay within the TY. (Tr. at 134.)

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

19 Rate Design—Commodity Rates and Break-Over Points

20         71. Valley and Staff both recommend rate designs that include tiered commodity rates,  
21 with three tiers for residential customers served by 5/8" x 3/4" meters and by 3/4" meters and two tiers  
22 for all other customers, except for construction customers, for whom both recommend a flat  
23 commodity rate. Valley and Staff agree on the break-over points for residential customers served by  
24 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  
25 break-over points for other customers. Where their break-over-point positions differ, Valley's  
26 proposed break-over points are generally lower than are those recommended by Staff.<sup>43</sup> Both Valley  
27

28 <sup>43</sup> 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 and Staff propose commodity rates that would include a relatively large difference (approximately  
2 \$1) between the first- and second-tier rates for residential customers served by small meters and a  
3 smaller difference between the small residential second- and third-tier rates (\$0.26 or \$0.70) for these  
4 residential customers and would use the residential second- and third-tier rates as the first- and  
5 second-tier rates for all other customers, except construction customers. Staff's rate design includes  
6 larger increases between commodity rates than does Valley's rate design.

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

22 73. Staff asserts that Valley's present rate design provides 34.5 percent of its metered  
23 revenue from monthly minimum charges and that Staff's recommended rate design provides 34  
24 percent of metered revenue from monthly minimum charges, thereby maintaining a large degree of  
25 revenue stability.<sup>44</sup> (Ex. S-4.) Staff also points out that the larger increase in its rate design between  
26 the small residential second- and third-tier commodity rates and the other customers' first- and

27 <sup>44</sup> 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 second-tier commodity rates sends an appropriate price signal to large water users to use water  
2 efficiently. (*Id.*) Mr. McMurry testified that the larger difference between commodity rates and  
3 break-over points in Staff's rate design will encourage more efficient use of water than would  
4 Valley's rate design, while generating approximately the same amount of revenue. (Tr. at 116.) Mr.  
5 McMurry testified that he believes Staff's rate design does this more effectively than does Valley's  
6 rate design because Valley's rate design has lower break-over points, which means that a customer  
7 jumps over into the third tier sooner, and "[t]here is really not any incentive once you are in the third  
8 tier." (Tr. at 141-42.) Mr. McMurry later clarified that Staff's rate structure will help customers who  
9 do not use a lot of water to pay their bills, while making water usage more costly to those who use  
10 more water. (Tr. at 141.) Staff stated that its rate design will, at any usage level, result in a higher  
11 monthly bill for a customer served by a larger meter than for a customer served by a smaller meter,  
12 which Staff states sends an appropriate economic signal to all customers for all consumption. (Ex. S-  
13 2.)

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

24         75. Valley explained that its break-over points were determined based on the relative  
25 flows of meter sizes as compared to a 5/8" x 3/4" meter. Staff did not explain its methodology for  
26 determining break-over points. Both Valley and Staff have proposed to retain the current break-over  
27

28 <sup>45</sup> 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 points for residential customers served by 5/8" x 3/4" meters and 3/4" meters and to lower the break-  
 2 over points for all other customers except for construction water customers, who currently pay a flat  
 3 commodity rate and would continue to do so under either proposed rate design. The lowering of the  
 4 break-over points to either the levels proposed by Valley or the levels recommended by Staff should  
 5 encourage further customer conservation over the current rate design. While lower break-over points  
 6 may generally be preferable to higher break-over points because they may better encourage  
 7 conservation, we find that the more dramatically lowered break-over points proposed by Valley,  
 8 coupled with the increased difference between commodity rates we are adopting herein, could result  
 9 in some degree of rate shock. Thus, we find that it is appropriate to adopt break-over points more  
 10 consistent with those recommended by Staff.

11 Rate Design—Monthly Minimums for Construction Water

12 76. Currently, Valley's rate design includes a construction meter monthly minimum  
 13 charge equal to the monthly minimum charge for a 3" meter and a flat commodity rate of \$3.02 per  
 14 thousand gallons for all construction water usage. Valley proposes to charge construction water  
 15 customers a monthly minimum charge according to the meter size used to receive construction water,  
 16 along with a commodity rate of \$3.25. Valley believes that it is appropriate to charge such customers  
 17 a monthly minimum because there are instances where construction water meters have no monthly  
 18 use, but Valley must still read the meter and spend administrative time tracking the meter. (Ex. A-9.)  
 19 Valley believes that charging a monthly minimum will encourage construction meter customers to  
 20 return a meter when it is no longer being used, thus making it available to others and obviating the  
 21 need for Valley to purchase another meter to serve additional customers needing construction water.  
 22 (*Id.*) Valley proposes to apply its monthly minimums per meter size to all customers, including those  
 23 customers who are using the meters for construction purposes, and to assess the construction  
 24 commodity rate for all construction water usage regardless of the construction meter size.<sup>46</sup> (Tr. at  
 25 87-88.)

26

27

28 <sup>46</sup> 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           77. Staff recommends that Valley's rate design be changed so that no monthly minimum  
2 charge is imposed for construction water meters, but agrees with Valley's proposed commodity rate  
3 for construction water. Staff believes that construction meters should be treated like standpipes, for  
4 which no monthly minimum is assessed but the highest commodity rate is assessed for all usage. (Tr.  
5 at 140-41.) Staff acknowledges that this treats construction customers differently than any other class  
6 of customer, (Tr. at 140), but asserts that it is unfair to assess a monthly minimum charge for  
7 construction water meters because their users never receive any water at the cheaper commodity rates  
8 that other customers pay for low levels of usage, (Tr. at 115).

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

19 **Establishing Rate Base and Rates**

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

23           80. Because Valley's FVRB is negative, we find that Valley's FVRB is not useful in  
24 setting just and reasonable rates and that Valley's rates should instead be set using an operating  
25

26 <sup>47</sup> 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 Valley<sup>48</sup> and Staff is  
2 appropriate, and we will adopt it.

3 81. 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 82. 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 83. 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 84. 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 ...

27

28 <sup>48</sup> 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 85. 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 86. 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 87. 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 88. 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 89. 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.<sup>49</sup>

#### 14 **Equity Position**

15 90. 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 91. 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  
26  
27

28 <sup>49</sup> *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 92. 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.<sup>50</sup> (Ex.  
11 A-8.)

12 93. 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 94. 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  
27

28 <sup>50</sup> 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 95. As stated in Findings of Fact No. 16, 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. 21.) Thus, it is clear that Valley has  
 16 violated Decision No. 67669 by failing to file timely and complete AIF reports.

17 96. Valley continues to collect the AIFs authorized, although collections have dropped off  
 18 considerably.<sup>51</sup> (*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 <sup>51</sup> 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 97. 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 proceeding<sup>52</sup> 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 98. 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 <sup>52</sup> 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 99. 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.)

9 100. 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.<sup>53</sup> 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.<sup>54</sup> 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.

19 101. 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.<sup>55</sup> Assuming that the  
23

24 <sup>53</sup> 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 <sup>54</sup> 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 <sup>55</sup> 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.<sup>56</sup>

9 Maryland Avenue Booster Station Purchase

10 102. 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

22 103. 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 <sup>56</sup> 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       104. 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       105. 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

4 106. 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.)

20 107. 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

24 108. 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.)

5 109. 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

14 110. In Decision No. 70138, as described in Findings of Fact No. 19, 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.<sup>57</sup> (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

23 111. 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 <sup>57</sup> 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.

3 112. Staff's recommendations set forth in Findings of Fact Nos. 88, 91, 104, and 108 are  
4 just and reasonable and in the public interest, and we are adopting them.

5 113. 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.

9 114. 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.

18 115. 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.

22 116. 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. 93 and 111 through 115.

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 **5/8" x 3/4" Meter & 3/4" Meter—Residential**

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—Commercial<sup>58</sup>**

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

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

1	<u>1" Meter—All</u>	
2	1 to 23,000 Gallons	\$2.44
3	Over 23,000 Gallons	3.15
4	<u>1-1/2" Meter—All</u>	
5	1 to 58,000 Gallons	\$2.44
6	Over 58,000 Gallons	3.15
7	<u>2" Meter—All</u>	
8	1 to 95,000 Gallons	\$2.44
9	Over 95,000 Gallons	3.15
10	<u>3" Meter—All</u>	
11	1 to 207,000 Gallons	\$2.44
12	Over 207,000 Gallons	3.15
13	<u>4" Meter—All</u>	
14	1 to 335,000 Gallons	\$2.44
15	Over 335,000 Gallons	3.15
16	<u>6" Meter—All</u>	
17	1 to 690,000 Gallons	\$2.44
18	Over 690,000 Gallons	3.15
19	<u>Construction Water—All Meter Sizes</u>	
20	Per 1,000 Gallons	\$3.15

**SERVICE LINE & METER INSTALLATION CHARGES:**

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

	Service Line Charge <sup>1</sup>	Meter Charge	Total Charge	
20	5/8" Meter	\$ 445	\$ 155	\$ 600
21	3/4" Meter	445	255	700
22	1" Meter	495	315	810
23	1 1/2" Meter	550	525	1,075
24	2" Turbine Meter	830	1,045	1,875
25	2" Compound Meter	830	1,890	2,720
26	3" Turbine Meter	1,045	1,670	2,715
27	3" Compound Meter	1,165	2,545	3,710
28	4" Turbine Meter	1,490	2,670	4,160
	4" Compound Meter	1,670	3,645	5,315
	6" Turbine Meter	2,210	5,025	7,235
	6" Compound Meter	2,330	6,920	9,250
	8" or Larger Meter	Cost	Cost	Cost

1 **SERVICE CHARGES:**

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

11 **Monthly Service Charge for Fire Sprinkler**

12 All Meter Sizes \*\*\*

13  
14 \*\*\* Greater of \$10.00 or 2 percent of the general service rate for a similar size meter

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

16 (b) Months off the system x monthly minimum bill

17 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).

18 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.

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

20  
21 IT IS FURTHER ORDERED that the rates and charges set forth above shall be effective for  
22 all services rendered by Valley Utilities Water Company, Inc. on and after March 1, 2010.

23 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall notify its  
24 customers of the revised schedule of rates and charges authorized herein by means of an insert in its  
25 next regularly scheduled billing, or by separate mailing, in a form acceptable to the Commission's  
26 Utilities Division Staff.

27 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall file the  
28 following with the Commission's Docket Control, as compliance items in this docket, within 6

1 months after the effective date of this Decision:

- 2 1. A written policy and procedure to minimize non-arm's length transactions;
- 3 2. A written policy and procedure addressing employee benefits;
- 4 3. An updated version of the equity improvement plan filed as required by Decision No.  
5 68309, which shall require Valley to continue improving its equity position; prohibit Valley from  
6 draining equity through dividend distributions and other distributions to shareholders such as bonuses  
7 and excessive increases in salaries and benefits; and require Valley to implement and maintain  
8 adequate internal controls over expenditures so as to control expenses and avoid misappropriations;  
9 and
- 10 4. A written policy and procedure addressing how Valley will ensure that it complies  
11 with all Commission directives, rules, and statutes.

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

15 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall monitor Docket  
16 No. W-02304A-09-0575 and, if a Decision is issued in that Docket determining that Green Valley's  
17 agreement to purchase CAP water necessitates Commission approval under A.R.S. §§ 40-301 and 40-  
18 302, shall file, within 120 days after the effective date of the Decision in Docket No. W-02304A-09-  
19 0575, an application requesting Commission approval of Valley's CAP agreement entered into in  
20 2007.

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

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

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

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

1 Commission's Docket Control, as compliance items in this Docket, within 30 days after receipt,  
2 copies of the Approval of Construction received for each of its arsenic treatment facilities.

3 IT IS FURTHER ORDERED that Valley Utilities Water Company, Inc. shall submit for  
4 Commission consideration within 120 days of the effective date of this Decision, at least five Best  
5 Management Practices (as outlined in the Arizona Department of Water Resources' Modified Non-  
6 Per Capita Conservation Program). A maximum of two of these BMPs may come from the "Public  
7 awareness/PR" or "Education and Training" categories of the BMPs. The Company may request cost  
8 recovery of actual costs associated with the BMPs implemented.

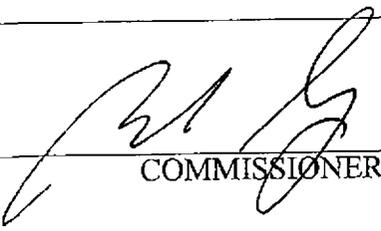
9 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

10 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

11   
12 CHAIRMAN

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14 COMMISSIONER

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16 COMMISSIONER

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18 COMMISSIONER

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20 COMMISSIONER

21 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,  
22 Executive Director of the Arizona Corporation Commission,  
23 have hereunto set my hand and caused the official seal of the  
24 Commission to be affixed at the Capitol, in the City of Phoenix,  
25 this 3rd day of February, 2010.

26   
27 ERNEST G. JOHNSON  
28 EXECUTIVE DIRECTOR

29 DISSENT \_\_\_\_\_  
30  
31 DISSENT \_\_\_\_\_

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

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

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16 Steven M. Olea, Director  
17 Utilities Division  
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