BEFORE THE ARIZONA CORPORATION COMMISSION
DOCKETED JUL 20 1999

IN THE MATTER OF THE APPLICATION OF PARADISE VALLEY WATER COMPANY FOR AN INCREASE IN RATES.

DATE OF HEARING: April 29, 1999
PLACE OF HEARING: Phoenix, Arizona
PRESIDING OFFICER: Lyn Farmer

APPEARANCES: Mr. Norman D. James, FENNEMORE CRAIG, P.C. on behalf of Paradise Valley Water Company, Ms. Karen E. Nally, on behalf of the Residential Utility Consumer Office, and Ms. Janet Wagner, Staff Attorney, Legal Division on behalf of the Arizona Corporation Commission.

BY THE COMMISSION:

On August 14, 1998, Paradise Valley Water Company ("Company" or "Applicant") filed a rate application with the Arizona Corporation Commission ("Commission").

On September 14, 1998, the Utilities Division Staff ("Staff") of the Commission filed a letter indicating the Company's rate application was sufficient and classifying the utility as a Class A utility.

On September 22, 1998, Staff filed a Request for Procedural Order and Hearing Date.

On September 23, 1998, the Residential Utility Consumer Office ("RUCO") requested intervention, which was granted on October 5, 1998.

On September 24, 1998, the Company Responded to Staff's request for Procedural Order.

On September 29, 1998, a Procedural Order was issued setting the hearing and establishing deadlines. The matter was set for hearing beginning May 5, 1999. Subsequently, the Company filed a Motion for Order modifying hearing date and related relief.
On October 29, 1998, Paradise Valley Country Club ("PVCC") requested intervention, which was granted on November 9, 1998.

On November 18, 1998, an Amended Procedural Order was issued setting a hearing for April 29, 1999.

This matter came before a duly authorized Hearing Officer of the Commission at the Commission's offices in Phoenix, Arizona on April 29, 1999. Applicant, RUO, and Staff appeared through counsel. No member of the public appeared to make public comment. Evidence was presented and, after a full public hearing, this matter was adjourned pending submission of a Recommended Opinion and Order by the Presiding Officer to the Commission.

On May 25, 1999, Staff filed its Supplemental Staff Report and RUO filed its Audit Report. On June 8, 1999, Paradise Valley filed its final schedules. No party requested additional hearing on these post-hearing filings.

I. INTRODUCTION

Applicant provides water service within portions of the Town of Paradise Valley, the City of Scottsdale, and certain unincorporated areas within Maricopa County, Arizona. All of the Company's certificated area is located within the Phoenix Active Management Area. Paradise Valley's most recent rate increase was approved by the Commission in Decision No. 60220 (May 27, 1997). During the test year ended June 30, 1998 ("TY"), the Company provided water service to approximately 4,600 customers. The majority of Applicant's customers are residential customers, many of whom own large dwellings situated on large lots with extensive landscaping and improvements. Applicant serves the PVCC and two other turf-related facilities, as well as several resorts, hotels, and other commercial customers that use relatively large quantities of water.

II. DISCUSSION

In its Application, the Company initially requested an increase in operating revenues of $1,097,568, or a 27.18 percent increase. The Company accepted the Staff Report filed on May 25, 1999, and made corresponding adjustments to depreciation expense and income taxes. The staff's final post-test year pro forma plant additions/deletions adjustment was $2,195,582, which the Company accepted.
Company and Staff agree that during the TY, the Company had adjusted operating income of $556,475 based on adjusted operating expenses of $3,481,630 and operating revenues of $4,038,105. Both Staff and the Company agree that an $850,238 increase in operating revenues (21.06 percent) is appropriate. This revenue increase is based upon an adjusted original cost rate base ("OCRB") of $11,497,759, and a rate of return on rate base of 9.33 percent.

RUCO presented testimony on two contested issues at hearing: the Company’s inclusion of post-TY plant additions in rate base and its request for authority to implement a new surcharge to recover costs associated with the use of its Central Arizona Water Project ("CAP") allocation.

Post-Test Year Plant Additions

In the Company’s last rate case, Decision No. 60220, the Commission allowed post-TY plant additions. In this application, the Company is also requesting post-TY plant additions in the amount of $2,195,582.

Staff recommended allowing the $2,195,582 in post-TY plant additions through March 31, 1999, but has concerns that allowing additions so far outside the test year violates the historical test year rate making methodology and creates a mismatch of revenues and expenses. Staff recommended that the Commission order the Company, in its next rate filing, to include only the proforma plant additions and deletions it will complete by Staff Engineering’s approximate inspection date.

RUCO also had the same concerns, and recommended disallowing the pro forma adjustments. RUO does not believe that the circumstances cited in Decision No. 60220 that supported the allowance of post-TY plant additions are present in this application, and therefore, recommended that the TY plant level should be used to establish rate base.

In Decision No. 60220, we expressed our shared concern regarding matching of rate base and operating expense levels. The Commission normally uses a TY cut-off date for including plant additions, although in unique circumstances, the Commission has allowed post-TY plant additions in rate base. In Decision No. 60220, we used a plant cut-off date that would allow Staff and the parties time to audit and review the Company’s proposal prior to filing surrebuttal testimony. Although we will allow the Staff and Company’s agreed-upon level of post-TY plant additions in rate base, we agree with RUO and Staff that we should set guidelines for the Company’s next and future rate
filings. The Company controls the timing and filing of its rate applications and should time its
applications so as to minimize pro forma adjustments for plant additions. Further, in order to allow
Staff and intervenors an adequate time to review and audit any such adjustments, the Company shall
limit its adjustments to add post-TY plant to include only plant that is used and useful and in service
within 90 days of the date that the rate application is deemed sufficient.

Central Arizona Project Costs

In 1985, the Company entered into a subcontract with the U.S. Bureau of Reclamation and the
Central Arizona Water Conservation District ("CAWCD") providing for the annual delivery to the
Company of 3,231 acre feet of M & I (municipal and industrial) water from the CAP. Although the
Company has not accepted delivery of any of its allocation, the terms of the subcontract require it to
make annual capital payments.² Annual payments were made from 1986 through 1995. In its 1994
rate application, the Company requested rate recovery of its annual capital payments to CAWCD.
Staff and RUCO objected because the CAP water was not being used, and Commission policy
required that CAP water be used and useful in order to be afforded rate recovery. The Company then
proposed the use of the "CAP 2000" ratemaking alternative whereby the Company would recover its
accrued CAP expenses through a surcharge over 25 years, while agreeing not to seek recovery from
ratepayers for future CAP expenses. In Decision No. 59079 (May 5, 1995), the Commission
authorized this ratemaking treatment for the Company. Since that time, the Company has not made
any of the required capital payments, but has continued to retain its CAP allocation.

According to the Company, new circumstances would allow it to use its CAP allocation
through an exchange with the Salt River Project ("SRP"). SRP will take delivery of the Company’s
CAP allocation in exchange for the Company’s use of the groundwater withdrawn from an SRP well
and treated at the Company’s Miller Road treatment facility.³ The Company proposed a CAP
surcharge to recover the costs associated with the CAP water use. It would apply to all residential
consumption over 45,000 gallons per month and to all commercial gallonage, and would be trued-up

² The payments ranged from a low of $2 per acre foot in the early years to $39 per acre foot in 1997.
³ The Company currently has a water exchange agreement with SRP to contain contamination in a nearby aquifer and
prevent the Company’s wells from becoming contaminated. The Company pumps water from an SRP well and treats it, and delivers water pumped from the Company’s wells into the SRP canal.
annually. Consisting of the total annual CAP charge of $433,723; an annual deferred CAP charge of
$150,718 (total deferred charges of $753,591, including the $99,000 deferred CAP 2000 balance,
capital costs due CAWCD of $533,115, and late fees due CAWCD of $121,476, amortized over five
years); and a $188,112 reduction in power and AWDR fees, the total annual cost would be $396,329,
or a surcharge of $0.2390 per 1,000 gallons.

Staff concurred with the Company’s proposal, and agreed that the existing CAP 2000
surcharge be eliminated and that the deferred costs associated with that surcharge be recovered under
the new surcharge. RUCO believes that the existing 25 year CAP 2000 surcharge for deferred CAP
costs authorized in Decision No. 59079 should remain in effect; that the Company should recover the
incremental cost of using CAP water since it supports Arizona’s legislative state water policies and
goals; that any changes in the surcharge amount should only be made in a rate case; and that the
Company should not be allowed retroactive recovery of CAP costs that were incurred during the time
that Decision No. 59079 was in effect.

We agree that the proposed use of the Company’s CAP allocation is appropriate, and that
ongoing CAP costs should be recovered through a surcharge mechanism as proposed by the
Company. Because most of the CAP costs are outside of the Company’s ability to control, we agree
with Staff and the Company that an annual true-up is appropriate. Both Staff and RUCO should
review and approve any proposed surcharge changes or true-ups. Although the Company agreed not
to seek recovery of future CAP costs, its retention of its CAP allocation and its use will benefit both it
and its ratepayers, and therefore, we agree that the Company should be allowed to recover those
unpaid CAP capital costs due the CAWCD. However, we agree with RUCO that the Company made
a business decision to continue to incur capital costs during the time it was aware that it would not be
allowed recovery of those costs, and therefore, the Company should not be allowed to recover late
fees or penalties incurred during the time it used the CAP 2000 methodology. Accordingly, the
current CAP 2000 surcharge will remain in place as an annual charge, and the Company will collect a
$0.2124 per 1,000 gallons surcharge from all residential usage in excess of 45,000 gallons per month
and from all non-residential usage.

Miscellaneous
At the time of hearing, the Company was out of compliance with the Maricopa County Environmental Services Department and the Arizona Department of Environmental Quality ("ADEQ"). Staff recommended that the Company make every effort to bring the water system into compliance with Maricopa County and ADEQ as soon as possible, but no later than June 30, 1999. Further, Staff recommended that any rate increase should not be effective until the month after the Company submits a written statement from ADEQ confirming that the Company is delivering water that has no maximum contaminant level violations and meets the quality standards of the Safe Drinking Water Act. On June 28, 1999, Staff filed a memorandum with an attachment from Maricopa County indicating that the Company is delivering water that has no maximum contaminant level violations and meets the quality standards of the Safe Drinking Water Act.

In Decision No. 61307 (December 31, 1998) the Commission approved the sale of assets and transfer of the Certificate of Convenience and Necessity of Mummy Mountain Water Company to Applicant. There was insufficient time for the transaction and its ramifications to be analyzed and included in this rate case, so Staff recommended that the Commission should order a revenue review be performed at the end of a full operating cycle to assess the effects of the Mummy transaction on PV and its rates. We agree.

III. RATE BASE

The Company agreed that its OCRB may be used as its Fair Value Rate Base ("FVRB"). We find Paradise Valley Water Company's FVRB to be $11,497,759.

IV. OPERATING INCOME

Applicant had actual operating revenues of $4,038,105 during the TY. No party proposed adjustments to operating revenues.

Applicant's adjusted TY operating expenses were $3,457,731, including adjustments for depreciation, property taxes, income taxes, rate case expense.

V. COST OF CAPITAL

In its previous rate case, the Commission rejected the Company's capital structure of 96.51 equity, and used a hypothetical capital structure of 49.23 percent equity and 50.77 percent long-term debt in setting rates. The Commission used a cost of equity of 11.0 percent and a cost of long-term
Decision No. 60525 (December 18, 1997) authorized the Company to issue $4.5 million in long-term bonds to retire a portion of its common equity and to refinance certain short-term debt used to fund capital projects. The bonds were issued in August 1998, and in this application, the Company proposed to use its projected December 31, 1998 capital structure for ratemaking purposes. The capital structure consists of 44.96 percent long-term debt at a cost of 7.30 percent, and 55.04 equity at a cost of 11.00 percent, resulting in a weighted cost of capital of 9.33 percent. Staff agreed with the use of this capital structure and composite cost in determining the required rate of return on the Company’s original cost rate base. We concur.

VI. AUTHORIZED INCREASE

Applicant’s adjusted TY operating income is $580,374. Multiplying the 9.33 percent rate of return on FVRB produces required operating income of $1,072,741. This is $492,367 more than the Company’s TY adjusted operating income. Multiplying the deficiency by the revenue conversion factor of 1.6469 results in an increase in revenues of $810,879, or a 20.08 percent increase over TY revenues.

VII. RATE DESIGN

The Company proposed retaining its current rate design which is intended to encourage conservation by using a three-tier, inverted rate structure for residential customers, and a two-tier, inverted rate structure for commercial customers. Under the Company’s proposal, the revenue increase would be spread evenly among all customer classes. Staff agreed that the current rate design should be retained, and that the increase should be spread evenly among all customer classes. We concur.

* * * * *

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

...
FINDINGS OF FACT

1. Applicant is an Arizona corporation engaged in the business of providing water for public purposes within portions of Maricopa County, Arizona, pursuant to authority granted by this Commission.

2. On August 14, 1998, the Company filed an application with the Commission requesting authority to increase its rates and charges for water service.

3. On September 14, 1998, Staff filed a letter indicating that the Company’s rate application was sufficient.

4. Our September 29, 1998 Procedural Order set this matter for hearing commencing on May 5, 1999, and by subsequent Procedural Order, the hearing was rescheduled for April 29, 1999.

5. During the TY ended June 30, 1998, the Company served approximately 4,600 customers.

6. The OCRB and FVRB for Applicant is $11,497,759.

7. Applicant’s adjusted TY income is $580,374, based upon operating revenues of $4,038,105, and operating expenses of $3,457,731.

8. A rate of return on FVRB of 9.33 percent is appropriate.

9. Operating income of $1,072,741 is necessary to yield a 9.33 percent rate of return on FVRB.

10. Applicant must increase operating revenues by $810,879 to produce operating income of $1,072,741.

11. On June 28, 1999, Staff filed a Memorandum from the Maricopa County Environmental Service Department indicating that the Company is delivering water that has no maximum contaminant level violations and meets the quality standards of the Safe Drinking Water Act.

12. In order to analyze the effects of the Mummy Mountain transaction, the Company should file a rate review at the end of a full operating cycle.

13. In order to allow Staff and intervenors an adequate time to review and audit any pro forma plant adjustments in its next rate filing, the Company shall limit its adjustments to include only
CONCLUSIONS OF LAW

1. Applicant is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. § 40-201, et seq.

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

3. Notice of this matter was given in accordance with the law.

4. The rates and charges authorized herein for the provision of water service are just and reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that Paradise Valley Water Company file on or before July 30, 1999, the following amended schedule of rates and charges:

MONTHLY USAGE CHARGE:

<table>
<thead>
<tr>
<th>Meter Size</th>
<th>Monthly Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>5/8&quot; x ⅜&quot;</td>
<td>$8.41</td>
</tr>
<tr>
<td>⅜&quot; Meter</td>
<td>8.74</td>
</tr>
<tr>
<td>1&quot; Meter</td>
<td>14.01</td>
</tr>
<tr>
<td>1 ½&quot; Meter</td>
<td>28.02</td>
</tr>
<tr>
<td>2&quot; Meter</td>
<td>44.83</td>
</tr>
<tr>
<td>3&quot; Meter</td>
<td>84.06</td>
</tr>
<tr>
<td>4&quot; Meter</td>
<td>140.10</td>
</tr>
<tr>
<td>6&quot; Meter</td>
<td>280.20</td>
</tr>
</tbody>
</table>

COMMODITY CHARGE – PER 1,000 GALLONS:

<table>
<thead>
<tr>
<th>Tier</th>
<th>Commodity Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential -</td>
<td></td>
</tr>
<tr>
<td>Tier One 0 – 25,000 Gallons</td>
<td>$0.73</td>
</tr>
<tr>
<td>Tier Two 25,001 – 80,000 Gallons</td>
<td>1.68</td>
</tr>
<tr>
<td>Tier Three Over 80,000 Gallons</td>
<td>2.17</td>
</tr>
<tr>
<td>Commercial -</td>
<td></td>
</tr>
<tr>
<td>Tier One 0 – 400,000 Gallons</td>
<td>$1.17</td>
</tr>
<tr>
<td>Tier Two Over 400,000 Gallons</td>
<td>1.46</td>
</tr>
</tbody>
</table>
Other General Metered (Public Authority, Fire Service, Construction, misc.) -
For All Usage $1.32

Turf Related Facilities -
For All Usage $0.90

Other Water Utility (Resale) -
For All Usage $1.18

Paradise Valley Country Club – Per Contract
For All Usage $229.42

CENTRAL ARIZONA PROJECT (CAP) SURCHARGE – PER 1,000 GALLONS:

Residential -
For All Usage in excess of 45,000 Gallons per Month
For All Usage $0.2124

All Non-Residential Customers -
For All Usage $0.2124

CAP EXPENSE RECOVERY SURCHARGE – PER CUSTOMER:

All Classes of Customers -
Charged in January of each year $1.04

PRIVATE FIRE PROTECTION:

The greater of $5.00 or one percent of the minimum charge

SERVICE LINE AND METER INSTALLATION CHARGES:

5/8” x ¾” Meter $330.00
¾” Meter 360.00
1” Meter 411.00
1 ½” Meter 550.00
2” Meter 604.00
3” Meter 1,062.00
4” Meter 1,806.00
6” Meter 3,872.00

...
SERVICE CHARGE:

<table>
<thead>
<tr>
<th>Service</th>
<th>Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishment</td>
<td>$20.00</td>
</tr>
<tr>
<td>Establishment (After Hours)</td>
<td>40.00</td>
</tr>
<tr>
<td>Reconnection (Delinquent)</td>
<td>30.00</td>
</tr>
<tr>
<td>Reconnection (Delinquent - After Hours)</td>
<td>60.00</td>
</tr>
<tr>
<td>Meter Test (If Correct)</td>
<td>15.00</td>
</tr>
<tr>
<td>Deposit</td>
<td>*</td>
</tr>
<tr>
<td>Deposit Interest</td>
<td>*</td>
</tr>
<tr>
<td>Reestablishment (Within 12 Months)</td>
<td>**</td>
</tr>
<tr>
<td>NSF Check</td>
<td>$12.00</td>
</tr>
<tr>
<td>Deferred Payment</td>
<td>1.50%</td>
</tr>
<tr>
<td>Meter Reread (If Correct)</td>
<td>$10.00</td>
</tr>
<tr>
<td>Late Payment Penalty</td>
<td>1.50%</td>
</tr>
</tbody>
</table>

* Per Commission rule A.A.C. R14-2-403(B).
** Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

IT IS FURTHER ORDERED that such amended schedule of rates and charges shall be effective for all service provided on and after August 1, 1999.

IT IS FURTHER ORDERED that Paradise Valley Water Company shall notify its customers of the revised schedules of rates and charges authorized herein and the effective date thereof in its next regular monthly billing.

IT IS FURTHER ORDERED that Paradise Valley Water Company be authorized to implement a gallonage surcharge to recover the costs resulting from the use of its Central Arizona Project allocation as authorized herein.

IT IS FURTHER ORDERED that in its next rate filing, Paradise Valley Water Company shall limit any test year proforma rate base adjustments to include only those items that are used and useful and in service within 90 days of the date that the application is deemed sufficient.
IT IS FURTHER ORDERED that Paradise Valley Water Company shall file a rate review at the end of the next full operating cycle to assess the effects of the Mummy Mountain transaction.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 20th day of July, 1999.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

Dissent

LAF:bbs
SERVICE LIST FOR: PARADISE VALLEY WATER COMPANY

DOCKET NO. W-01303A-98-0507

Norman D. James
FENNEMORE CRAIG PC
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Paradise Valley Water Company

Karen Nally
RU CO
2828 North Central Avenue, Suite 1200
Phoenix, Arizona 85004

Philip A. Edlund
PARADISE VALLEY COUNTRY CLUB
7101 North Tatum Boulevard
Paradise Valley, Arizona 85253

Paul Bullis, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Director, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

DECISION NO. 61831