

OPEN MEETING



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Arizona Corporation Commission

DOCKETED

JUL 8 2014

TO: THE COMMISSION

FROM: Utilities Division

AZ CORP COMMISSION
DOCKET CONTROL

DATE: July 8, 2014

DOCKETED BY	
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RE: ARIZONA-AMERICAN WATER COMPANY'S (NOW EPCOR) APPLICATIONS FOR AN INCREASE IN RATES FOR ITS WATER AND WASTEWATER RATES (DOCKET NOS. W-01303A-09-0343 AND SW-01303A-09-0343)

ORIGINAL

I. INTRODUCTION

The Commission has received a significant number of customer complaints and petitions concerning EPCOR's Agua Fria District's rates and charges for water and wastewater services. The purpose of this Utilities Division Staff ("Staff") memorandum is provide an overview of these customer complaints and petitions in the context of prior Commission decisions and to make recommendations to the Commission on the process that could be used to address the issues raised by EPCOR's customers.

II. BACKGROUND

Arizona-American was Arizona's largest investor-owned water and wastewater utility, operating twelve water and wastewater systems in Arizona, and serving approximately 158,000 customers located in portions of Maricopa, Mohave, and Santa Cruz Counties. In Decision No. 72668 in Docket No. W-01303A-11-0101, the Commission approved the purchase of Arizona-American's stock by EPCOR USA, an indirect wholly-owned subsidiary of EPCOR, a municipally owned Canadian corporation and holding company headquartered in Edmonton, Alberta, that builds, owns and operates water and wastewater facilities and infrastructure and electrical transmission and distribution networks in Canada.

The customers' complaints regarding the water and wastewater rates in Corte Bella, Cross River, Dos Rios and Coldwater Ranch relate primarily to the combined impacts of two rate cases filed by Arizona-American Water Company ("Arizona-American" or the "Company") with the Commission in July 2009 and in November 2010. The first case filed in July 2, 2009, in Docket Nos. W-01303A-09-0343 and SW-01303A-09-0343, was an application for a rate increase in the Company's Anthem Water District and Sun City Water District, and included consideration of possible rate consolidation of all of Arizona-American's water districts. The case also included a request by Arizona-American for an increase in its rates and charges for its Anthem/Agua Fria Wastewater District, its Sun City Wastewater District and its Sun City West Wastewater District and possible rate consolidation for all of Arizona-American's wastewater districts.

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Intervenors in the case included the Residential Utility Consumer Office ("RUCO"), Camelback Inn, Sanctuary of Camelback Mountain, the Intercontinental Montelucia Resort and Spa, and the Scottsdale Cottonwoods Resort and Suites (collectively, the "Resorts"), the Town of Paradise Valley ("Paradise Valley"), the Anthem Community Council ("Council"), the Sun City West Property Owners and Residents Association ("PORA"), the Water Utility Association of Arizona ("WUAA"), Anthem Golf and Country Club ("Anthem Golf"), Marshall Magruder, W.R. Hansen, Larry D. Woods Philip H. Cook, DMB White Tank ("DMB"), and Mashie, LLC dba Corte Bella Golf Club.

The hearing in the case was bifurcated, with the first phase focusing on the revenue requirement requested by the Company for the various districts and second phase ("Phase II") consisting of Commission consideration of rate design and rate consolidation issues. There was extensive public comment submitted in this case, both written and oral. The Commission adopted Decision No. 72047 on January 6, 2011, setting new rates for the districts involved in the 09-0343 case.

An issue considered in the rate case in Docket 09-0343 was whether to deconsolidate the Anthem-Agua Fria Wastewater district into two new separate districts: an Anthem Wastewater District and an Agua Fria Wastewater District. Decision No. 72047 left the docket open for the sole purpose of considering the implementation of stand-alone revenue requirements and rate designs for separate Anthem Wastewater and Agua Fria Wastewater Districts, as agreed to in the settlement reached by the Company, Anthem, RUCO and Staff during the Open Meeting at which Decision No. 72047 was considered.

While Decision No. 72047 approved an overall rate increase of 53.98 percent for all residential customers in the Company's Anthem-Agua Fria Wastewater District, it made those rates interim, subject to change depending upon the Commission's determination on a deconsolidation petition to be filed by the Company on April 1, 2011. In Decision No. 73227, the Commission found that deconsolidation of the Anthem-Agua Fria Wastewater district as contained in the Company's application was in the public interest. The Commission adopted a deconsolidation rate plan proposed by Dan Neidlinger, a consultant for the Anthem Community Council. The plan provided for a phase-in of the rates over three years. Step 1 of the 3 step rate plan was to begin on January 1, 2013; with Step 2 taking effect in January 2014, and Step 3 taking effect in January 2015.

In Decision No. 73837, the Commission clarified that the Neidlinger rate plan was to be used in light of deconsolidation; and the Winter Average Rate ("WAR") Design approved in Decision No. 72047 was no longer intended to be implemented. Implementation of both deconsolidated rates and a WAR design would have been extremely confusing for customers and could have led to unanticipated results.

The second rate case was filed with the Commission by Arizona-American in November 2010. In that case, Docket No. W-01303A-10-0448, the Company requested increases in its rates to provide water service in its Agua Fria, Havasu and Mohave Water Districts. Intervenors in this case included RUCO, the City of Surprise ("Surprise"), WUAA, Sun City Grand Community Association ("SCGCA") (as class representative for 17 homeowners associations), EPCOR, Verrado Community

Association ("Verrado"), DMB White Tank LLC ("DMB"), Corte Bella, as well as various individuals.

Decision No. 73145 approved a Settlement Agreement among EPCOR, Arizona-American, Staff, RUCO, Verrado, DMB, the City of Surprise, Corte Bella, Cross River Homeowners Association, WUAA and SCGCA on behalf of itself and the Class of Homeowners Associations. The Agreement resulted in a 58 percent rate increase for the Agua Fria Water District with the rates increases phased in over a three year period. The Agreement provided for implementation of approximately 67 percent of the rate increase in year 1 beginning in July 2012; and 16 percent and 17 percent of the rate increase in years 2 and 3, respectively, with the last increase taking effect on July 1, 2014.

III. SUMMARY OF COMPLAINTS FILED WITH THE COMMISSION

On February 25, 2014, customers from the communities of Cross River, Dos Rios, and Coldwater Ranch delivered over 100 letters to the Commission asking the Commission to investigate their rates for water and wastewater service. Included was a letter from State Representatives Phil Lovas and David Livingston and State Senator Judy Burges. The Legislators' letter states that there is a great discrepancy in rates between various communities in the northwest valley. It points out that the water/wastewater rates for the EPCOR Agua Fria District are nearly \$100 more per month than those for the EPCOR Sun City District and nearly \$75 more than rates for several city water services. The letter asks the Commission to review the water/wastewater rates for this area. The letter also states that the communities of Cross River, Dos Rios, and Corte Bella are geographically distant and physically unconnected to the Agua Fria Water District and that they use the NW Valley Regional Water Reclamation Facility even though they are paying for the White Tank Facility. The letter ends with a series of questions which it requests the Commission to investigate.

The second complaint letter was filed with the Commission on March 7, 2014, and included approximately 2,320 signatories who are homeowners in the Corte Bella Subdivision, and Sun City West. The second complaint letter states that the signatories are requesting an immediate investigation and review of their water and wastewater rates. It further states that in the last two years their wastewater rates have more than doubled; and another increase is scheduled to be implemented.

The letter requests deconsolidation of the Corte Bella subdivision from the Agua Fria District and instead consolidation with the Sun City West District based upon the following reasons: 1) Corte Bella shares the NW Valley Regional Water Reclamation Facility with the Sun City West District; 2) Corte Bella is located geographically distant from the Agua Fria District; 3) Corte Bella water is provided by wells on its own community property; the Agua Fria District uses Central Arizona Project "CAP" water; 4) the consolidation of Corte Bella with Agua Fria is inconsistent with cost of service ratemaking principles and contrary to good public policy; 5) consolidation of Corte Bella in the Agua Fria District does not result in just and reasonable rates for Corte Bella residents; 6) the large disparity in rates is based on the NW Valley Plant, the Verrado Reclamation Facility and expansion of the Russell Ranch Reclamation Facility; 7) Corte Bella residents do not and

cannot use the Verrado, Russell Ranch or NW Valley (White Tanks) facilities due to geographical separation and no interconnection facilities; 8) to accurately allocate costs to the cost-causers, Corte Bella must be deconsolidated from the Agua Fria District and joined with the Sun City West District; and 9) the circumstances surrounding the use of wastewater facilities for the prior Anthem-Agua Fria district and Corte Bella are identical and Anthem has been deconsolidated from the Agua Fria District.

Finally, a third complaint letter and series of petitions included approximately 1,100 signatories of homeowners from the communities of Corte Bella, Cross River, Dos Rios and Coldwater Ranch and was delivered to the Commission on April 9, 2014. The third complaint letter states that these communities request deconsolidation with the Agua Fria Water/Wastewater District and consolidation with the Sun City West Water/Wastewater District. The letter gives the following reasons for the requested relief: 1) there is no substantial reason for the continued consolidation of Corte Bella, Cross River, Dos Rios, and Coldwater Ranch, which are geographically distant and physically unconnected to the Agua Fria District; 2) Consolidation of Corte Bella, Cross River, Dos Rios, and Coldwater Ranch in the Agua Fria District is inconsistent with cost of service ratemaking principles and contrary to good public policy that requires correct assignment of costs; 3) Consolidation of Corte Bella, Cross River, Dos Rios and Coldwater Ranch with the Agua Fria District does not result in fair, just and reasonable rates. They do not use nor can they use the facilities which resulted in the disparity in rates due to geographical separation and no interconnection facilities; 4) Anthem has been deconsolidated under identical factors; and 5) The communities water/wastewater rates have more than doubled in the last three years.

In a June 17, 2014 letter to the Commission, the representatives of the petitioners proposed the following two options for interim relief: 1) that EPCOR defers the wastewater "Sewer Volume" charge until after 10,000 gallons metered usage; or 2) that EPCOR charge all the Agua Fria water district customers only 30 percent of the metered water usage as wastewater. The June 17th letter also expressed concern that on July 1, 2014, the last step in the water rate increase is scheduled to take effect; and on January 1, 2015, the last step of the wastewater rate increase is scheduled to take effect. The letter indicates that an additional approximately \$20 will be added to the average Agua Fria Water District customer's water bill.

For ease of reference, the above discussed customers' letters, complaints and petitions will hereinafter be referred to collectively as the "customer complaints".

IV. INITIAL STEPS TAKEN IN RESPONSE TO THE PETITIONS

The Utilities Division Consumer Services Section issued three inquiries to EPCOR, Inquiry Nos. 2014-115254, 2014-115412, and 2014-115737 regarding the complaints. EPCOR responded on March 14, March 20 and April 18, 2014, respectively.

In response to the inquiries, EPCOR indicated that in its view, any action to further deconsolidate the Agua Fria Wastewater or consolidate with other districts would require a break out of the costs of the new Agua Fria sub-areas into their separate rate bases; with separate operating costs also required. EPCOR estimated that it would cost more than \$350,000 to create the internal

company accounting break out of rate base and expenses for Verrado, Russell Ranch and Northeast Agua Fria. EPCOR also indicated that it believed there would be additional costs if the capital and operating costs for the Agua Fria Water District had to be segregated or other sub districts were evaluated. EPCOR recommended that any possible further action by the Commission not occur until the after the last phase of rates on January 2015 in the Agua Fria Wastewater District have been in effect for at least six months.

With respect to the water facilities, EPCOR indicated that the customers' main concern appears to be with the inclusion of the White Tanks Water Treatment Facility in the Agua Fria District. EPCOR stated that all Agua Fria Water District customers benefit from the White Tanks Water Treatment Facility. According to EPCOR, over the last 50 years, the West Valley has developed largely based upon groundwater resources. As a result, groundwater overdraft and depletion in the area has been severe. EPCOR referred to an October 1996 study by the Arizona Department of Water Resources ("ADWR") that reported past groundwater declines of more than 300 feet and land surface subsidence of more than 18 feet in portions of the West Salt River Valley Basin, which comprises the Company's Agua Fria Water District.

EPCOR stated that the White Tanks Water Treatment Plant is a regional water treatment facility that treats CAP water, a renewable source of water. At a total project cost of \$63.9 million, the White Tanks Regional Water Treatment Plant was placed in service on November 30, 2009. EPCOR states that the plant has allowed the Company to aggressively pursue the reduction of future wells in the Agua Fria Water District. When using the White Tanks treatment plant, EPCOR stated that it is able to reduce groundwater pumping by more than 3.5 billion gallons each year.

EPCOR has also held a public meeting in Corte Bella with some of the petitioning homeowners to discuss their concerns. This public meeting was held on April 16, 2014.

V. STAFF'S PRELIMINARY REVIEW

In light of the nature and volume of customer complaints, Staff believes that a Commission examination of the customers' issues related to EPCOR's Agua Fria District's rates is warranted. However, it is important to note at the outset of any Commission examination of the customer complaints, that there does not appear to be a dispute as to whether EPCOR is charging its customers the rates that have been approved by the Commission. Instead, the focus of the customer complaints center on concerns that: 1) their water and wastewater rates are unreasonably and unfairly high, and 2) rate design issues related to consolidation and/or deconsolidation need to be addressed by the Commission, particularly for wastewater services.

After Staff's preliminary review of the customer complaints, it appears to Staff that the issues raised in the customer complaints would best be addressed initially by a Commission examination of rate design matters related to the Agua Fria District's rates. Thus, Staff is not recommending that the initial analysis be based upon an assumption that full rate cases need to be conducted for Agua Fria water and wastewater services at the present time. Similarly, Staff believes that the issues raised by the customer complaints are most compelling in regard to wastewater rates. Therefore, in Staff's view, it appears reasonable to move forward with an examination of rate design

issues related to wastewater rates, and as a subsequent step, consider what kind of review of water rates might be undertaken.

Staff has not reached any final opinion on these issues and is interested in ensuring that the Commission has a range of options as it continues to examine these matters. To that end, Staff is requesting that the Commission require EPCOR to make a filing on or before August 8, 2014, that responds to the customers' issues and includes discussion of various rate design options to address customer complaints. The Company's discussion of the rate design options should also discuss the potential timing of an option's implementation and address possible phase in. Moreover, EPCOR should directly address Staff's view that it might be best to limit the present examination to rate design matters related to its wastewater rates, and leave consideration of a review of water rates for a later time.

Set out below are the matters that Staff believes at minimum are necessary to be included in EPCOR's filing, hereinafter referred to as EPCOR's "Response":

1. Response to the customer complaints and requests for relief.
2. Response to Staff's opinion that the Commission's examination of these matters should commence with rate design matters related to wastewater rates.
3. Discussion and analysis demonstrating the rate impacts of full consolidation of all districts, including a potential timeline for consolidation and whether phase in is warranted. This discussion should also address whether a rate case(s) would be warranted for consolidation of all districts.
4. Discussion and analysis demonstrating the rate impacts of full deconsolidation of all districts and systems, including a potential timeline for deconsolidation and whether phase in is warranted. This discussion should also address whether a rate case(s) would be warranted for deconsolidation.
5. Discussion and analysis demonstrating the rate impacts of reversing the deconsolidation of Anthem from the Agua Fria District, including a potential timeline for reversal and whether phase in is warranted.
6. Discussion of any EPCOR identified potential alternative options and the options' rate impacts on affected customers.

VI. PROCEDURAL MATTERS

Staff recommends that the Commission direct the Hearing Division to issue a Procedural Order after the filing of EPCOR's Response that sets a procedural conference to discuss the further processing of these matters. Staff requests that the procedural conference be set for a date and time convenient to the Hearing Division within 7 to 10 calendar days after EPCOR's Response is docketed.

The matters that Staff believes should be addressed at the procedural conference include:

1. Who are the appropriate parties in these proceedings.
2. What are the type, extent and timing of notices that should be provided to EPCOR's customers.
3. What is an appropriate schedule for intervention by interested persons and stakeholders.
4. What is an appropriate schedule for the submission of pre-filed testimony and dates for hearing.

Staff also notes that a possible result of the Commission's examination of these matters may involve Commission consideration of modification of previous decisions. In light of this possibility, Staff believes that the procedural conference should also address whether prior decisions should be reopened pursuant to A.R.S. §40-252 to provide notice and opportunity to be heard concerning the Commission's possible amendment of prior orders. Staff wants to make it clear that at this time, no specific modification to any prior decision is contemplated or recommended by Staff. However, the extent of notice and opportunity to be heard should be a topic discussed at the procedural conference recommended by Staff above.

VII. STAFF'S RECOMMENDATIONS

Staff recommends that the Commission adopt in its ordering paragraphs all of Staff recommendations discussed herein concerning EPCOR's Response and the setting of a procedural conference to address the processing of these matters.



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