BEFORE THE ARIZONA CORPORATION COMMISSION

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CHAIRMAN
WILLIAM A. MUNDELL
COMMISSIONER
JEFF HATCH-MILLER
COMMISSIONER
KRISTIN K. MAYES
COMMISSIONER
GARY PIERCE
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER AND ANTHEM/AGUA FRIA WASTEWATER DISTRICTS.	Docket No. WS-01303A-06-0403

EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer Office ("RUCO") makes the following Exceptions to the Recommended Opinion and Order ("ROO") on Arizona American Water Company's ("Arizona American" or "Company") application for a rate increase for its Anthem Water and Anthem/Agua Fria Wastewater Districts.

INTRODUCTION

In order to achieve "Paradise in the Desert," as the Company refers to it, the Company claims construction costs will reach \$76.133 million for its water facilities and \$45.400 million for its wastewater facilities. Company Closing Brief at 22. An intricate refund arrangement was originally conceived between Anthem's developer, Del Webb Corporation ("Del Webb") and the Company's predecessor, Citizen's Utilities Company ("Citizens") wherein Del Webb would advance the majority of the infrastructure costs and Citizens would refund the costs to Del Webb as the number of homes Del Webb sold in the district increased. Company Closing Brief at 23. Del Webb's refunds were tied to its success in building and selling homes. Id. at 24. Build-out was not expected until at least 2014 which everyone at the time thought would allow for gradual and reasonable rate increases. Id. at 23-24. Unfortunately for the ratepayers, build-out has now occurred more quickly than expected, and the developer wants to recover its costs. Id. at 25.

The ROO recommends an increase in gross revenues of $3,002,864 or 43.73% for the Anthem Water District and $1,854,136 or 30.22% increase in gross revenues for the Anthem/Aqua Fria Wastewater District. The Company has already filed its next rate case for these districts[1]. The Company is requesting an increase in gross revenues of $9,192,203 for the Aqua Fria Water district, of $6,174,183 for the Anthem Water District[2], of $4,590,485 for the Aqua Fria Wastewater District and of $1,686,320 for the Anthem Wastewater District. See Direct Testimony of Thomas Broderick, at page 4 dated April 30, 2008, Docket No. SW-01303A-08-0227. The new rate case seeks recovery of the Company's refund to Del Webb made on March 31, 2008 for $20,226,122. The $20,226,122 is one refund installment which represents 75% of the amount then owing and the other 25% will be paid two years later. See Direct Testimony of Paul G. Townsley at 8, dated April 30, 2008, Exhibit Schedule B-2, of the testimony of Linda Gutkowski, Ratebase Adjustment LJG-10, Docket No. SW-01303A-08-0227. The Aqua Fria water ratepayers have also seen higher rates as a result of the

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[1] Docket Nos. SW-01303A-08-0227 et. al., filed May 1, 2008.

Company's step-one ACRM surcharge which is now recovering Arsenic treatment related costs. See Decision Nos. 68310 and 68825. Those same Agua Fria ratepayers will see a further increase from the Company's future step-two ACRM surcharge request.

There is little doubt that the ratepayers of Anthem/Agua Fria will be paying some of the highest water and sewer bills in the state as a result of this and the recently filed applications. Throughout the proceeding there has also been a lot of public comment on this Application. The simple truth is there is no room for creative and/or non-traditional ratemaking that favors the Company's shareholders. The Commission would be remiss to consider this rate case in a vacuum and should take whatever measures are possible to cut the fat out.

NORTHWEST REGIONAL WASTEWATER TREATMENT FACILITY ("NWVTF") ALLOCATION.

The ROO recommends that a portion of the NWVTF (32%) be included in the Company's rate base. ROO at 12. During the test year, 2.25% of the NWVTF capacity was used to treat Agua Fria's wastewater and Staff's engineer believes it is "not unreasonable to expect flows from the Northeast Agua Fria service area to be 32% of the total NWVTF flows within five years." ROO at 7. The NWVTF is physically located in the Sun City West District. ROO at 5. The ROO's allocation recommendation is unusual and based on an unprecedented ratemaking approach, which will have the effect of **increasing** Anthem/Aqua Fria District's ratebase by $1,160,900. ROO at 6. In addition to the 32% ratebase allocation, the ROO recommends that a similar allocation be made for the operation and maintenance expenses associated with the NWVTF used to treat the Anthem/Aqua Fria wastewater. ROO at 12, 26.

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[2] The Company is proposing deconsolidation of the Anthem/Aqua Fria District. See Direct Testimony of Thomas Broderick, Executive Summary at page iv dated April 30, 2008, Docket No. SW-01303A-08-0227.

The ROO's recommendation goes outside traditional ratemaking and unnecessarily results in higher rates to the ratepayers of the Anthem/Agua Fria District. Anthem Wastewater has no ownership interest in the NWVTF and it therefore should not be afforded rate base treatment. A company which owns several districts should not be allowed to trade and transfer portions of each district's ratebase among each other. The fact that each district has the same parent company does not make such treatment of rate-base plant appropriate. Regardless of who owns Sun City West Wastewater, each of Arizona-American's (the parent company) certificated districts has its own set of rates, rate base, and tariffs. R-3 at 14. Each district should be afforded its own ratemaking treatment.

That is not to say that the residents of Anthem/Aqua Fria should not pay their fair share of the costs for the service provided. RUCO recommends that the costs associated with the NWVTF treatment of Agua Fria Wastewater be accounted for as an operating lease. In this manner, the Anthem/Aqua Fria ratepayers pay for their share of the treatment costs, but do not pay a return on the ratebase which is owned by another district. The Company is also made whole by recovering its costs associated with the treatment of the wastewater in the Anthem/Agua Fria District.

The ROO's recommendation relies on the efficiencies of treating the Anthem/Aqua Fria wastewater at the NWVTF as opposed to requiring separate, smaller facilities to serve the two areas. ROO at 10. No party, including RUCO, suggested that the Company build a separate facility to treat Anthem/Agua Fria's wastewater. Nor does RUCO suggest that it would be inefficient to treat Anthem/Agua Fria's wastewater at the NWVTF. The ROO misses the point. The issue is what ratemaking treatment should be afforded in a situation where one district's wastewater capacity is being treated in another district. Typically, where one regulated entity has its capacity treated by another entity (regulated or otherwise) outside of its service territory, it is done contractually and treated for ratemaking purposes as an operating lease. The two entities are not the same and should not be treated the same. Anthem/Agua Fria does not own Sun City West's plant and should not have to pay a return on it.

Staff's witness in the Sun City/Sun City West wastewater case, Dorothy Haines testified that "Sun City West basically is reached to its maximum capacity, using capacity." Transcript at 644 in Docket No. WS-01303A-06-0491. The 32% capacity of the NWVTP that is not in use and appears will never be used to treat the service demands of Sun City West's customers, is excess capacity from a ratemaking standpoint. See RUCO's Reply Brief at 4. It is not serving current Sun City/Sun City West customers nor will it serve them in the future. The excess capacity of the NWVTF that will not be serving customers in the Sun City/Sun City West District will be used to serve a select group of Anthem/Agua Fria District customers. Of the 32% allocation, only 2.25% serviced test year customers and the balance, 29.75% will be used to service the needs of future Anthem/Agua Fria customers. Id. In other words, for ratemaking purposes, the 29.75% is not used and useful for either the Anthem/Agua Fria customers or the Sun City West customers. By reallocating the entire 32% to Anthem/Agua Fria's rate base, the ROO would have the current Anthem/Agua Fria customers pay for plant that does not benefit them – it will benefit future ratepayers. Id. Current ratepayers should not have to pay for future growth.

RATE CASE EXPENSE

RUCO recommends the Company recover $183,962. RUCO's recommendation is based on two factors. The Company seeks recovery for its Rate Design and Cost of Service studies of $143,000. However, in the Company's recent Paradise Valley Water District rate case, Mr. Ronald Kozoman charged $20,000 for the Cost of Service Study and $5,000 for the

Rate Design study. Thus, the $43,000 recommended by RUCO to cover the expense of these studies in this case is fair and more than enough to recognize that two systems were involved in this case[3].

The Company sought to recover $143,000 for its consultant to analyze the rate design and cost of service issues in its recent Mohave case.

The Commission rejected the Company's request:

> We believe the Company's proposed expense of $143,000 for a consultant to analyze rate design and cost of service issues is excessive, especially when, as RUCO points out, Arizona-American was able to contract for comparable services in the recent Paradise Valley case at a cost of only $25,000."

Decision No. 69440 at 12. In terms of difficulty, there is nothing special or extraordinary that distinguishes this case from Mohave in analyzing the rate design and cost of service issues.

The other expense which represents the balance of the difference between RUCO and the Company's recommendation is the $16,038 that the Company included to round its estimate up to $300,000. Id. Rounding is a mathematical concept and does not represent a legitimate expense to be recovered from ratepayers.

NORTHWEST PLANT ALLOCATION EXPENSE

For the same reasons cited above, RUCO recommends disallowance of the operating expenses associated with the NWVTF.

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[3] In Paradise Valley there was only the water district at issue.

RESPECTFULLY SUBMITTED this 21th day of May, 2008

Daniel W. Pozefsky
Attorney

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By ______________________________
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Exhibit A
RUCO's Amendment No. 1

DELETE Page 10, line 4 starting with "The districts …" through page 13, line 2.

INSERT New Paragraph

We agree with RUCO that it is appropriate for ratemaking purposes to treat the percentage of Anthem/Aqua Fria District's wastewater treated at the North West Valley Treatment Facility during the test year (2.25%) as an operating lease. It is not appropriate for ratemaking purposes for the Company which owns several districts to trade and transfer portions of each districts ratebase among each other. Therefore, the Company and Staff's request to allocate 32% of Sun City West Wastewater's ratebase to the Anthem/Agua Fria District and the associated operating expenses will also be rejected.

Make all conforming changes.

Exhibit B
RUCO'S Amendment No. 2

Page 20, line 24 through page 21, line 2.

DELETE The Paragraph.

INSERT We agree with RUCO that the Company's proposed rate case expense appears to be excessive considering the facts of this case. We believe the Company's proposed expense of $143,000 for a consultant to analyze rate design and cost of service issues is excessive, especially when Arizona-American was able to contract for comparable services in its recent Paradise Valley rate case at a cost of only $25,000. We also agree it would not be appropriate for the Company to recover $16,038 for a rounding up adjustment. Accordingly, based on the totality of the evidence presented on this issue, we will reduce total rate case expense from $300,000 to $183,962, divided equally between the districts, and normalized over three years.

Make all conforming changes.