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AZ CORP COMMISSION  
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FROM: Ernest G. Johnson  
Director  
Utilities Division

DOCKETED BY 

DATE: March 26, 2004

RE: ADDENDUM TO THE STAFF REPORT FOR ARIZONA-AMERICAN WATER COMPANY, INC. APPLICATION FOR APPROVAL OF LONG-TERM DEBT (DOCKET NO. SW-01303A-03-0572)

This is an addendum to the Staff Report for Arizona-American Water Company, Inc.'s application for approval of long-term debt. The addendum is in response to the Procedural Order filed on March 12, 2004, that directed Staff to file comments to address the current status of Arizona-American Water Company's compliance with Arizona Department of Environmental Quality ("ADEQ") regulations; and provide recommendations to the Commission based upon the current compliance status.

**Background**

The initial Staff Report recommended authorization to incur \$25.0 million of long-term-debt through its affiliate American Water Capital Corporation. That report also indicated that there were no environmental quality compliance issues at that time. Subsequent to the Staff Report, and in another Arizona-American Water Company, Inc. case, major deficiencies in the Havasu water system (PWS ID # 08-015) were discovered. The Havasu water system is one of the Arizona American water and wastewater systems, which will be affected by this financing.

Recent water samples from the Havasu system have exceeded the maximum contaminant level (MCL) of 10 milligrams per liter (mg/l) for nitrates. Prior test results were relatively constant at 7 to 8 mg/l when the well concentration suddenly rose to 12 mg/l. The applicant is now reactivating another well which meets the nitrate standard and is preparing a connection to the system which will then enable the non-compliant water source to be retired. Indeed, that interconnection, which will solve the public health problem, is part of this subject financing.

## Current Status

Pursuant to the Procedural Order, Staff has again queried the ADEQ and the Maricopa County Department of Environmental Services for the current status of the Arizona American water systems, which are a part of this financing. Staff previously checked compliance status during the summer of 2003, and ADEQ indicated total compliance for all systems. The current environmental quality compliance status is tabulated below. It should be noted that compliance determinations can be resource intensive for the environmental agencies, and the county and state agencies have always requested an allowance of at least 30 days for this activity.

### Systems Part of Docket No W-01303A-03-0572 Application for Approval of Financing

	System ID	Date Requested	IN COMPLIANCE ? (Yes or No)	Date of status
Drinking Water				
Anthem	07-504	15 Mar 04	Waiting response	
Agua Fria	07-695	15 Mar 04	Waiting response	
Camp Mohave	07-037	15 Mar 04	Waiting response	
Desert Foothills	08-137	Jan 04	Yes. Total	19 Feb 04
Havasu	08-015	15 Mar 04	No. High nitrates	4 Mar 04
Lake Mohave Highland	08-062	15 Mar 04	Waiting response	
Mohave - Main	08-032	Jan 04	Yes. Total	19 Feb 04
Paradise Valley	07-056	15 Mar 04	Waiting response	
Rio Vista	08-333	Jan 04	Yes Total	7 Jan 04
Sun City	07-099	15 Mar 04	Waiting response	
Sun City West	07-150	15 Mar 04	Waiting response	
Tubac	12-001	15 Mar 04	Yes. Total	18 Mar 04
Waddell	07-151	16 Mar 04	Waiting response	
Wastewater				
Anthem	37-184	15 Mar 04	Waiting response	
Sun City West	37-018	15 Mar 04	Waiting response	
Desert Lakes	38-158	15 Mar 04	Waiting response	

## Recommendations

Staff does not change its previous recommendation for the authorization to borrow \$25.0 million for water plant additions and upgrades. \$12,517,000 of the funding is assigned to pay other lenders for money already expended on water plant additions and improvements. The remaining balance of the authorization requested is for projects needed to continue providing safe and reliable water and wastewater services to ratepayers. Specific projects in this request provide for the relief of the high nitrate well at Havasu, relief of overloaded sewer mains and treatment

plants, additional drinking water supplies, additional water pumping stations, and preliminary design efforts for arsenic removal. Without question, delay of this financing request will have an adverse impact on the quantity of water, pressure of delivered water, public health, and environment.

Additionally, the nitrate compliance problem at Havasu was unforeseen and not a longstanding problem created by a negligent or recalcitrant water utility. Since the nitrate problem was discovered, Arizona American has been co-operative with ADEQ and has complied with all interim requests from ADEQ. Because this financing request contains a project which will mitigate the nitrate problem, any delay would only prolong the public health risk at the Havasu water system.

It should be emphasized, however, that Staff is not recommending that this, or any subsequently discovered, environmental quality compliance problem of Arizona American be overlooked. Instead the better venue for addressing a compliance issue is the concurrent rate case found in Docket Numbers W/WS -014303A-02-0867, 0868, 0869, 0870, & 0908 (consolidated). Staff has requested updates on the ADEQ status for those Arizona American systems that are part of the rate case filing, but not included in this financing request. Staff will review all ADEQ updates and make a filing in the rate case Dockets after that review.

EGJ: JHJ:LRH

Originators: J.H. Johnson/L.R. Hammon

Original and fourteen copies

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Docket No. SW-01303A-03-0572

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