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BEFORE THE ARIZONA CORPORATION COMM

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WS-01303A-02-0867  
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WS-01303A-02-0869  
WS-01303A-02-0870  
W-01303A-02-0908

IN THE MATTER OF THE APPLICATION OF  
ARIZONA AMERICAN WATER COMPANY,  
AN ARIZONA CORPORATION, ASKING THE  
ARIZONA CORPORATION COMMISSION TO:

W-01303A-01-0983

1. REOPEN A PREVIOUS RECORD FOR THE LIMITED PURPOSE OF SERVING AS THE EVIDENTIARY BASES TO ESTABLISH ARSENIC COST RECOVERY MECHANISMS FOR THE COMPANY'S AGUA FRIA WATER, TUBAC WATER, HAVASU WATER, AND SUN CITY WEST WATER DISTRICTS; AND
2. WAIVE AN ORDER'S CONDITION AND ALLOW THE COMPANY'S PARADISE VALLEY WATER DISTRICT TO MAKE A RATE APPLICATION TO SET NEW RATES TO, AMONG OTHER THINGS, RECOVER THE COST OF ARSENIC REMEDIATION INVESTMENT.

Docket No. W-01303A-04-\_\_\_\_\_

1 As more fully set forth below, Arizona American Water Company ("Arizona American"  
 2 or the "Company"), an Arizona corporation, asks the Commission to take two actions:

- 3 1. Reopen the record (Decision No. 67093, dated June 30, 2004) in the recent rate cases for  
 4 Arizona American's Agua Fria Water, Tubac Water, Havasu Water, and Sun City West

1 Water Districts for the limited purpose of serving as the evidentiary basis for future  
2 Arsenic Cost Recovery Mechanism filings for these districts; and

- 3 2. Waive Condition No. 15 in Decision No. 65453, dated December 12, 2002, only for  
4 Arizona American's Paradise Valley Water District, to allow the Company to make a rate  
5 application for the District to set new rates to, among other things, recover the cost of the  
6 Company's arsenic remediation investment.

7 Upon approval of these two requests, Arizona American will dismiss its appeals of Decision  
8 Nos. 65453 and 67093, currently pending in the Maricopa County Superior Court and the  
9 Arizona Court of Appeals, respectively.

10 Granting these requests will allow Arizona American to timely recover the costs needed  
11 to comply with the Environmental Protection Agency's new arsenic regulations, which reduce  
12 the allowable level of arsenic in drinking water from 50 parts per billion ("ppb") to 10 ppb.  
13 Arizona American intends to utilize Arsenic Cost Recovery Mechanisms modeled on those twice  
14 approved by the Commission for Arizona Water Company. As the Commission found, the use  
15 of ACRMs "properly balances the need ... to remain financially sound with the avoidance of  
16 significant rate shock to customers who are affected by the arsenic requirements." (Re Arizona  
17 Water Company, Decision No. 66400, October 14, 2003, p. 14.)

18  
19 **Background**

20 1. Arizona American is a subsidiary of American Water, which serves 20 million  
21 customers in 27 states, and four Canadian provinces. Arizona American provides water and  
22 wastewater service to more than 230,000 customers throughout Arizona.

1           2.     Arsenic is a naturally occurring element, widely prevalent in the western United  
2 States. It is found in several mineral compounds, as part of surface and underground rock  
3 formations. Ground water often contains trace amounts of dissolved arsenic from adjacent  
4 underground arsenic-containing rock formations.

5           3.     The federal Environmental Protection Agency has promulgated new water quality  
6 regulations that reduce the allowable concentration of arsenic in drinking water from 50 to 10  
7 ppb, effective January 23, 2006.

8           4.     Estimates are that universal compliance with this new standard could require \$5  
9 billion in capital investment, and annual costs of \$600 million. These costs will be  
10 disproportionately borne by Western states, such as Arizona, which rely more on groundwater  
11 than do Eastern states. Yet, only very limited federal funds are available to assist water  
12 providers comply with this new federal mandate.

13          5.     The Arizona Department of Environmental Quality (ADEQ), regulates water  
14 quality for all water companies in Arizona and will enforce compliance with the new EPA  
15 standards.

16          6.     The Arizona Corporation Commission requires companies to be in compliance  
17 with ADEQ and EPA standards.

18          7.     ADEQ, with input from the Commission and water utilities, has developed the  
19 Arsenic Master Plan to help Arizona's public water systems comply with the new federal  
20 standard for arsenic in drinking water. The Master Plan provides water systems with cost-  
21 effective solutions tailored to their individual needs.

22          8.     Arizona American has created an arsenic remediation plan that conforms to  
23 ADEQ's Arsenic Master Plan.

1           9.     Arizona American's arsenic remediation plan will require significant investment  
2 in new arsenic remediation facilities. Arizona American estimates that it will spend over \$42  
3 million to construct new facilities to comply with the new EPA rules—\$25 million for its Agua  
4 Fria Water, Havasu Water, Tubac Water, and Sun City West Water Districts, and \$17 million for  
5 its Paradise Valley Water District. Annual operating costs will also significantly increase.

6           10.    On October 12, 2003, the Commission approved an Arsenic Cost Recovery  
7 Mechanism ("ACRM") for Arizona Water Company's Northern Group. (Decision No. 66400.)

8           11.    On March 19, 2004, the Commission approved an ACRM for Arizona Water  
9 Company's Eastern Group. (Decision No. 66849.)

10          12.    Arizona American recently completed rate cases for, among other districts, its  
11 Agua Fria Water, Havasu Water, Tubac Water, and Sun City West Water Districts. (Decision  
12 No. 67093, dated June 30, 2004.)

13          13.    While these cases were pending, the Commission approved the acquisition of  
14 Arizona American's corporate parent, American Water Works Company, Inc., by RWE  
15 Aktiengesellschaft. (Decision No. 65453 dated December 12, 2002.) Condition No. 15 of the  
16 Decision, prohibits new rate filings by Arizona American for three years from the date the RWE  
17 acquisition closed—until January 10, 2006.

18          14.    Arizona American's Paradise Valley Water district did not have a rate case  
19 pending at the time the Commission approved the American Water Works Acquisition. Its last  
20 rate order was Decision No. 61831 dated July 20, 1999.

1 **Discussion**

2 15. Arsenic removal is an expensive undertaking for Arizona water utilities, with very  
3 few funds available from federal or state sources to assist compliance.

4 16. The Commission has found that an ACRM “properly balances the need ... to  
5 remain financially sound with the avoidance of significant rate shock to customers who are  
6 affected by the arsenic requirements.” (Re Arizona Water Company, Decision No. 66400,  
7 October 14, 2003, p. 14.)

8 17. To support this capital investment and to avoid rate shock, Arizona American  
9 wishes to implement ACRMs for its Aqua Fria Water, Havasu Water, Tubac Water, Sun City  
10 West Water, and Paradise Valley Water districts to recover prudently invested costs to comply  
11 with the new federal arsenic requirements.\* These ACRMs will be essentially identical to ones  
12 already approved by the Commission for Arizona Water Company’s Northern Group (Decision  
13 No. 66400) and Eastern Group (Decision No. 66849).

14 18. Upon Commission approval of this relief requested in the application, Arizona  
15 American will take the following actions:

- 16 a. Immediately dismiss with prejudice its current appeals of the Decision Nos.  
17 65453 and 67093;
- 18 b. Promptly file a request, with accompanying testimony, to implement ACRMs for  
19 its Aqua Fria Water, Havasu Water, Tubac Water, and Sun City West Water  
20 districts, substantially in the form approved for Arizona Water Company’s  
21 Northern and Eastern Groups; and

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\* Arizona American may request in the alternative for its Paradise Valley Water District that arsenic cost recovery be provided in base rates.

1 c. Promptly file a rate application for Paradise Valley Water—including a request  
2 for timely recovery of arsenic-remediation costs through an ACRM or base  
3 rates—anticipated to be based on a 2004 test year.

4 19. Customer benefits of implementing ACRMS are:

- 5 a. Compliance with federal water-quality standards;
- 6 b. Reduced rate shock;
- 7 c. Rate certainty;
- 8 d. Maintenance of the provider's financial stability; and
- 9 e. Continued reliable, high quality, water service at reasonable rates.

10 20. The benefits to the parties of dismissing Arizona American's current appeals and  
11 providing it a mechanism for arsenic cost recovery are:

- 12 a. Reduced costs associated with protracted litigation needed to recover arsenic costs  
13 through normal rate case procedures; and
- 14 b. Elimination of long, complex litigation by resolving issues associated with prior  
15 Commission decisions that are currently being appealed.

16 21. For these reasons it is in the public interest for the Commission to grant the relief  
17 that Arizona American is requesting in this proceeding.

18  
19 **Requested Relief**

20 Arizona American asks the Commission to take two actions:

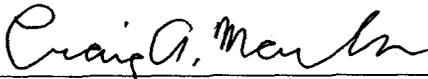
- 21 1. Reopen the record (Decision No. 67093, dated June 30, 2004) in the recent rate cases for  
22 Arizona American's Agua Fria Water, Tubac Water, Havasu Water, and Sun City West

1 Water Districts for the limited purpose of serving as the evidentiary basis for future  
2 Arsenic Cost Recovery Mechanism filings for these districts; and

- 3 2. Waive Condition No. 15 in Decision No. 65453, dated December 12, 2002, only for  
4 Arizona American's Paradise Valley Water District, to allow the Company to make a rate  
5 application for the District to set new rates to, among other things, recover the cost of the  
6 Company's arsenic remediation investment.

7 Upon approval of these two requests, Arizona American will dismiss its appeals of Decision  
8 Nos. 65453 and 67093, currently pending in the Maricopa County Superior Court and the  
9 Arizona Court of Appeals, respectively.

Respectfully submitted,



Craig A. Marks  
19820 N. 7<sup>th</sup> Street  
Suite 201  
Phoenix, AZ 85024  
Attorney for Arizona-American Water Company

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Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

**Copies** of the foregoing delivered  
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**Legal Division**

Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

**Utilities Division**

Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

**Lyn Farmer**

Chief Hearing Officer  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

**Residential Utility Consumer Office**

1110 West Washington Street  
Suite 220  
Phoenix, Arizona 85007

By:

