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BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
CHAIRMAN
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COMMISSIONER
JEFF HATCH-MILLER
COMMISSIONER
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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY, INC.,)
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 SUN CITY WEST WATER AND)
WASTEWATER DISTRICTS.)
_____)
AND RELATED MATTERS.)
_____)

DOCKET NOS.:
WS-01303A-02-0867
WS-01303A-02-0868
WS-01303A-02-0869
WS-01303A-02-0870
~~WS-01303A-02-0868~~
W-01303A-020908

OPENING BRIEF

The Town of Youngtown (Youngtown), by and through its attorneys undersigned, pursuant to the direction of Administrative Law Judge Teena Wolfe, files this Opening Brief outlining its position regarding the request of Arizona-American Water Company, Inc. (Company) for a determination of the current fair value of its utility plant and property and for increases in its rates and charges based thereon.

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

	Page
I. SUMMARY OF YOUNGTOWN'S POSITION	3
II. INTRODUCTION	4
A. Arizona American Water Company	4
B. Youngtown	5
III. ORIGINAL COST RATE AS FAIR VALUE RATE BASE	6
A. Historical Background on Determination of Fair Value Rate Base	6
B. Public Policy Has Been Established by Decision Nos. 62993 and 63584	8
C. OCRB as the Fair Value Rate Base in this case	9
IV. EXPANSION OF IRRIGATION TARIFF TO ENCOMPASS YOUNGTOWN	12
V. STEPPED RATE INCREASE	14
VI. FIVE YEAR AMORTIZATION OF RATE CASE EXPENSE	15
VII. CONCLUSION	16

1 I. **SUMMARY OF YOUNGTOWN'S POSITION.**¹
2 (Sun City Water and Wastewater Districts)

	<u>WATER</u>	<u>SEWER</u>
4 Fair Value Rate Base	\$22,014,473	\$8,709,672
5 Change in Gross Revenue	\$ 2,055,466	\$ (729,062)
6	(Maximum Increase)	(Minimum Decrease)

7 Youngtown's primary issue in this case is the Company's request to use the
8 Reconstruction Cost New Depreciated Rate Base (RCRB) as synonymous with the Fair
9 Value Rate Base (FVRB). The Company's approach results in unjust and unreasonable
10 rates for the Sun City Water and Wastewater Districts and side-steps Decision No.
11 63584's requirement that any acquisition adjustment be supported by quantifiable benefits
12 flowing to the public from the acquisition. Therefore, Youngtown recommends that the
13 Company's Fair Value Rate Base (FVRB) be based on the Original Cost Less
14 Depreciation Rate Base (OCRB). (TR. VII, pp.1250, 1251) Mr. Burton testified that the
15 OCRB provides a reasonable measurement of the current value of the property dedicated
16 to public service. (TR. VII, p. 1295)

17
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19
20 The changes in gross revenues set forth above constitute the maximum
21 increase and the minimum decrease because they accept the Company's requested return
22 and, to a large degree, the Company's claimed operating income and operating expenses
23 (adjusted primarily to reflect a FVRB based on OCRB and amortizing rate case expense
24

25 ¹ Even though Youngtown may state no position on an issue at this time, it reserves the right to
26 adopt and advance the position of other parties in its Reply Brief, after reviewing the position as

1 over a five year period). If the Company's proposed return or its proposed operating
2 expenses are not accepted, then the increase in water revenues would be less and the
3 decrease in sewer revenues would be greater.

4
5 Youngtown further recommends:

- 6 1. The Company revise its irrigation water rate tariff to include service to
7 Youngtown, including the Maricopa Lake maintained by Youngtown (Id., p.
8 1252);
- 9 2. Changes in rates (up or down) be implemented in one step if less than a 20%
10 change; in two equal steps if between a 20% and a 40% change; and in three
11 equal steps if the total change exceeds 40%, with a new step taking effect each
12 year (Id., p.1213, 1214); and
- 13 3. Amortizing the allowed rate case expense over a 5-year period. (Id., p. 1227)²

14
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16 **II. INTRODUCTION.**

17 **A. Arizona-American Water Company, Inc.**

18 Arizona-American Water Company, Inc. acquired the assets of Citizens
19 Communications Company (formerly Citizens Utility Company) in January 2002. (TR. I,
20

21
22 advocated in the Opening Briefs.

23 ² Youngtown reached an agreement with the Company on a method to address the Town's
24 concerns regarding service reliability to the fire hydrants in Youngtown and withdrew its request
25 for Commission to order relief in this case. (TR. VII, pp. 1206 -1208) Youngtown also withdrew
26 its issue regarding the treatment of the Company's booked acquisition adjustment due to the
Company's clarification that no ratemaking treatment thereof is sought in this proceeding (Id.,
p.1252), but continues to support a provision in the Commission Decision making it clear that

1 p. 11) The acquisition included seven (7) water districts and three (3) wastewater
2 districts located throughout the State of Arizona. (Id.) The purchase price was
3 \$276,500,000, which included an acquisition premium of \$71 million (TR. II, p. 104)
4 representing 25.7% of the purchase price. The Arizona Corporation Commission
5 (Commission) authorized the transaction by Decision No. 63584. (TR. I, p. 11) Decision
6 No. 63584 included the express condition that any request for an acquisition adjustment
7 for ratemaking purposes must include a showing of a clear and quantifiable public benefit
8 that would not have existed had the sale not occurred. (Exhibit Y-5 (Direct Testimony of
9 Michael Burton), p. 1251) The Company has not initiated a proceeding to secure
10 ratemaking treatment for an acquisition adjustment pursuant to Decision 63584.

11 B. Youngtown

12 The Commission can take judicial notice that the median age in Youngtown
13 (for the year 2000) is 65.3 and the average household income is only \$23,164. (City-data
14 website, www.city-data.com/city/youngtown-arizona.htm) These two facts allow the
15 conclusion that the average Youngtownian is either retired or approaching retirement and
16 lives on a fixed income. The Company's proposal of increasing the existing water rate by
17 72% will be a substantial burden on the modest incomes of the Youngtownians. Their
18 water usage is already modest (about 8,400 gallons per household), even at the current
19 cost of \$11.17 per month. (TR. I, p. 14) Increasing the cost to \$19.42 per month, as the
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the allocation of the acquisition adjustment for accounting purposes is not binding for
ratemaking purposes. Ex. Y-3 (Burnham Pre-filed Surrebuttal, pp. 3-4)

1 Company proposes (Id.), may not seem like much to the Company's well paid
2 consultants, staff and attorneys, but it will constitute a real hardship to the individuals that
3 will be paying the bill.
4

5 **III. ORIGINAL COST RATE BASE AS FAIR VALUE RATE BASE.**

6 A. Historical Background On Determination Of Fair Value Rate Base.

7 As stated last month in *Phelps Dodge v. Arizona Electric Co-op., Inc.*, ____
8 P.3d ____, 2004 WL117253, Ariz. App. Div. 1, Jan 27, 2004:
9

10 "Our constitution requires the Commission to 'prescribe ...
11 just and reasonable rates and charges to be made and
12 collected, by public service corporations for services rendered
13 in the state. Ariz. Const. Art. 15 §3. To assist the Commission
14 in the 'proper discharge of its duties,' the Commission must
15 'ascertain the fair value of the property within the State of
16 every public service corporation doing business therein.' . . .
17 The Commission has traditionally used fair value to set a
18 utility's rate base. *Scates v. Arizona Corp. Comm'n*, 118 Ariz.
19 531, 534, 578 P.2d 612, 615 (App. 1978). Thereafter, the
20 Commission applies a rate of return to the rate base in order
21 to establish just and reasonable rates. *Id.* "

22 The focus of Article 15, Section 3 is *just and reasonable* rates. This
23 requires the rates to be fair both to the consumers and the utility. The fair value of the
24 company's property is established as an *aid* to setting those rates. Article 15, Section 14.
25 There is no constitutional mandate as to precisely how the fair value determination is to
26 be utilized by the Commission. *Id.* at 21-22, citing *U.S. West Communications, Inc. v.*
Arizona Corp. Commission, 201 Ariz. 242, 245, 34 P.3d, 351, 354-55 (2001). The court
in *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 153, 294 P.2d 378, 383

1 (1956) recognized: "One of the most difficult tasks for a rate-making body is to properly
2 value utility properties to establish a base that when related to the fixed rate of return will
3 be just and reasonable to both the company and the consuming public." The *Simms*
4 court, however, emphasized that the Commission has a range of legislative powers in
5 exercising its ratemaking powers. So long as the Commission does not abuse its power,
6 the court cannot substitute its judgment as to what is fair value or a just and reasonable
7 rate. *Id.* In exercising its legislative powers, the Commission is required to consider all
8 relevant factors to determine the fair value of the utility property. However, the weight
9 given to each of the factors is totally within the discretion of the Commission, so long as
10 that discretion is not abused. *Arizona Corporation Commission v. Arizona Water*, 85
11 Ariz. 198, 202, 335 P.2d 412, 414 (1959). Thus, the courts have upheld the
12 Commission's practice of excluding contributions-in-aid-of-construction in their totality
13 without regard to the value they add to the property dedicated to public use. *Cogent*
14 *Public Service, Inc. v. Arizona Corporation Commission*, 142 Ariz. 52, 688 P.2d 698
15 (App. 1984). In *Cogent*, the court emphasized it was proper to look beyond the pure
16 issue of cost (whether OCLD or RCND) and set FVRB based upon principles underlying
17 the Commission's general public policies. The court held that where customers had
18 contributed the plant (or provided the money to install the plant) as a condition to
19 receiving service, it was reasonable for the Commission to completely exclude that plant
20 from the FVRB and not allow the utility to earn a return thereon. This case raises a
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1 similar policy issue that mandates the exclusion, not of the plant itself, but the RCND
2 value thereof.

3 B. Public Policy Has Been Established by Decision Nos. 62993 and 63584.
4

5 Based upon recommendations of the Water Task Force, the Commission in
6 Decision No. 62993, dated November 3, 2000, directed the Utility Staff to develop an
7 acquisition policy that encourages the consolidation of small water utilities.

8 Decision 62993 establishes a threshold of six general conditions a water
9 company must meet for an acquisition adjustment. The two most salient and applicable
10 conditions are:³
11

- 12 1. The acquired system's customers will receive improved service in a
13 reasonable timeframe.
- 14 2. The acquisition is in the public interest.
15

16 While the acquisition adjustment policy established in Decision No. 62993 only
17 specifically applies to acquisitions of systems with annual revenues under \$250,000, the
18 Commission made these two conditions expressly applicable to the Company and the
19 utility plant in question by Decision No. 63584. (Decision No. 63584, pp. 7, 15, and
20 Exhibit A thereto, p. 3)
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24 ³ The remaining conditions are: the acquired company is a Class "D" or "E"; the
25 acquisition will not negatively affect the viability of the acquirer; the purchase price is fair and
26 reasonable (even though that price may be more than the original cost less depreciation book
value) and conducted through an arm's length negotiation; and the recovery period for the
acquisition adjustment should be for a specific minimum time.

1 As to the first condition, there is no evidence that services will improve
2 from the acquisition by the Company. There has been no evidence that the services were
3 inferior and notwithstanding any claims of the Company, there is no way for the
4 Company to contend that its services will be an improvement over the services provided
5 by Citizens, except with an exception for savings in management costs. The second issue
6 – “public interest” – has been circumvented by the Company. The Company has not
7 demonstrated, in any fashion, how the acquisition costs serve to benefit the existing
8 customers.
9

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11 Thus, from the perspective of the relevant considerations embodied in both
12 Decision No. 62993 and Decision No. 63584, the Company has not justified its request to
13 increase the value of its plant for ratemaking purposes through an acquisition adjustment.
14 Yet use of the RCRB to establish the Company’s FVRB would have the same effect.⁴
15

16 C. OCRB as the Fair Value Rate Base in this Case.

17 Youngtown does not dispute that the Commission must give full and proper
18 consideration to the evidence of reconstruction cost new depreciated rate base (RCRB)
19 presented in this case. Further, Mr. Burton (Youngtown’s expert) testified that RCRB,
20 the income approach, the OCRB and all other relevant factors that pertain to Arizona-
21 American's particular circumstances should be considered by the Commission in setting
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24 ⁴ The Company’s effort to set FVRB is also arguably an improper collateral attack on a final
25 Commission decision. (Decision 63584, p. 3)
26

1 the FVRB for the Company. (Exhibit 4-5, p. 8) Here the circumstances surrounding the
2 acquisition, and in particular the public policy embodied in Decision Nos. 63584 and
3 62993 mandate the Commission's use of OCRB as FVRB. The Commission should
4 consider, but give no weight to the RCRB in setting FVRB.
5

6 The Company purchased utility assets with a known book value. The
7 income being generated by the assets was based upon that book value. Yet, the Company
8 paid an acquisition premium representing 25.7% of the purchase price. Moreover, the
9 Company proceeded to consummate the purchase after the Commission entered Decision
10 No. 63584, a Decision expressly conditioning any acquisition adjustment for ratemaking
11 purposes upon a demonstration that the acquisition had quantifiable benefits to the
12 Company's customers. (Decision No. 63584, pp. 7, 15, and Exhibit A thereto, p. 3) The
13 Company concedes it has made no such demonstration in this case. (TR. VII, pp. 1222-
14 1225)
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17 Youngtown's witness, Michael Burton, explained that an acquisition
18 adjustment and a RCND valuation serve the same function -- to reflect the change in
19 plant value from book (i.e., original cost). An acquisition adjustment is based upon a
20 differential reflected in the purchase price in a sales transaction, while the RCND is
21 hypothetical trending of changes in construction costs.
22

23 As Michael Burton testified, a "condition [of] the recovery of an acquisition
24 premium which is the difference between the price actually paid by Arizona-American to
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1 Citizens and the current book value of the assets ... [was] the demonstration of clear,
2 quantifiable public benefit that otherwise would not have resulted if the sale had not
3 occurred.”(TR III, p. 1251) The Company is not pursuing a hearing for the recovery of
4 the excess acquisition amount in this proceeding and it is not clear that it plans to do so in
5 the future.
6

7 Mr. Burton continued by stating:

8 “[t]he company has admitted it is not making such a
9 demonstration of public benefit in this proceeding. Based upon
10 the position of the company that replacement cost rate base and
11 the purchase price are both representative of current value,
12 reproduction cost or replacement cost rate base implicitly
13 includes all or some level of an acquisition premium or
14 acquisition adjustment. Therefore, the use of RCND rate base,
15 reconstruction rate base, or anything greater than OCRB, which
16 is original cost rate base, excluding an acquisition adjustment in
17 the determination of fair value rate base would in effect recover
18 all or a portion of the acquisition adjustment and recover the
19 premium paid by the company. We believe this would be in
20 direct violation of the prior Commission decision which
21 authorized the acquisition of assets by the company, and would
22 allow the company to sidestep a condition of the Commission
23 Order at the cost of the ratepayers.” (Id., pp. 1251-52)

24 Youngtown's point is that the Company consummated the purchase of these
25 systems with full knowledge that any acquisition adjustment was predicated on it being
26 able to demonstrate that the acquisition provided tangible benefits to the Company's
customers. This was not a novel action by the Commission, since the policy had
previously been announced in Decision No. 62293. The Company should not be able to
do indirectly that which it is prohibited from doing directly. Yet, giving any weight to

1 RCRB will have that precise effect. In order to obtain this adjustment in the value of its
2 plant for ratemaking purposes, the Company must be required to comply with the
3 Commission's mandate and formally request the recovery of the excess acquisition
4 amount predicated on the necessary demonstration of benefit. No Arizona case law has
5 ever held that RCRB must be given weight in determining FVRB where to do so would
6 circumvent Commission policy. *Cogent* stands for the opposite proposition.
7

8 **IV. EXPANSION OF IRRIGATION TARIFF**
9 **TO ENCOMPASS YOUNGTOWN.**

10 The Sun City Water Division has an approved Irrigation Water Rate.
11 (Copy attached hereto as proposed, late-filed Exhibit Y-7) The rate is available "only to
12 the Sun City Agricultural Club, golf courses and irrigated medians south of Grand
13 Avenue" and is subject to interruption. The rate has a higher monthly charge, but a
14 significantly lower gallonage rate (\$0.65 per thousand versus \$0.73 per thousand for the
15 first 8,000 gallons and \$0.92 per thousand thereafter). Youngtown is responsible for
16 securing water for the Maricopa Lake (2.8 acres) and has been paying the general rate.
17 During discussions with the Company in December 2002, the irrigation rate was
18 discussed as a method of reducing Youngtown's water costs. The Company suggested
19 Youngtown intervene in this proceeding and request the scope of the irrigation rate be
20 expanded to include Maricopa Lake. (Y-5, Exhibit 4) The Town has complied with the
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1 Company's suggestion and the Company has not opposed the Town's request.
2 Youngtown's request, however, is predicated on cost savings being achieved.⁵

3 Youngtown also testified that it recommended dealing with rate design in
4 the next rate proceeding. (TR VII, p. 1298) This is due to the large increase already
5 being requested for the Sun City District and the additional burdens related to shifting
6 cost responsibility through rate re-design. Additionally, Youngtown opposes Staff's rate
7 design because break points will not encourage conservation and will not treat customers
8 in an even-handed manner. (TR VII, p. 1301)

9
10
11 After the close of the hearing, the Company offered an alternative rate-
12 design that appears to lessen the economic benefits derived from this rate; however, there
13 appears to be some benefit due to the break points. Based upon the uncertainty involved,
14 Youngtown requests the Irrigation Water Tariff be amended to allow it to elect the
15 Irrigation Water. Youngtown suggests the first sentence of the Tariff under the
16 "Availability" be amended to read: Available only to: 1) the Sun City Agricultural Club,
17 2) golf courses; 3) irrigated medians south of Grand Avenue; and 4) irrigated medians,
18 lakes and golf courses owned by political subdivisions of the State of Arizona and served
19 by Arizona-American Sun City Water District as of the effective date of this Tariff. This
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23 ⁵ Youngtown notes Staff has two objections to this request. First, it believes the request is anti-
24 conservation. However, Maricopa Lake is an existing water use and there is no suggestion water
25 use will increase if Youngtown is able to secure a cost savings. Second, Staff is concerned about
26 cost-shifting. This is a legitimate issue, but Youngtown points out the Lake is open to the public
and may be enjoyed by all Sun City water customers. Youngtown does not believe the same is

1 limits both the expansion of the Tariff's application and the cost-shifting associated
2 therewith.

3 V. STEPPED RATE INCREASE.

4 The Company proposes a two-step rate increase for the Sun City Water
5 District with a 40% increase being implemented immediately and the remainder a year
6 thereafter. Youngtown contends the rate increase being proposed will cause economic
7 hardship on the Company's customers and that the rate increase approved by the
8 Commission should be phased in over a longer period. (TR VII, pp. 1213-1216)

9 Youngtown suggests different phasing: two equal steps provided the approved increase
10 is between 20% and 40%, or three equal steps, if the increase tops 40%. To be fair, the
11 same phasing is proposed for the rate decrease anticipated for the Sun City Sewer
12 District. (TR VII, pp. 1243, 1244)

13 In cross examination of Mr. Barnham, the Company suggested such
14 phasing would not permit the Company to earn its allowed return on fair value. (TR VII,
15 pp. 1213-1216)

16 Youngtown responds thereto. First, *Arizona Community Action Ass'n v.*
17 *Arizona Corp. Commission*, 123 Ariz. 228, 599 P.2d 184, expressly recognizes that
18 stepped rates may be approved by the Commission. Moreover, a phased-in rate merely
19 recognizes that the return allowed by the initial step increase is all that is fair and

20 true with all the amenities currently receiving this reduced rate - even though any revenue
21 shortfall is being shouldered, in part, by Youngtown and its residents.
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1 reasonable to the customer, unless the adverse impacts of a greater return are ameliorated
2 by stepping-in the increase. The alternative to a phase-in approach is to approve only the
3 first step and require the Company to refile. As recognized in *Arizona Community*
4 *Action*, supra, such an approach merely increases regulatory costs.
5

6 Youngtown believes that the step approach it has proposed reflects a
7 reasonable balance between rates that are fair and reasonable to the customer and rates
8 that are fair and reasonable to the Company.
9

10 **VI. FIVE-YEAR AMORTIZATION OF RATE CASE EXPENSE.**

11 Youngtown does not contest the \$715,000.00 in rate case expense requested
12 by the Company, but recommends a five-year amortization period based upon the time
13 between rate cases historically. The Company proposes a three-year amortization which
14 has been accepted by the other parties.
15

16 There is no question that rate case expense is not an on-going annual
17 expense, but is periodically incurred. Since the expense is included in the general rate
18 structure, it will be recovered until a new rate is set. Moreover, it will be recovered from
19 new customers as well as test-year customers. Thus, if the system experiences growth or
20 if a rate case is not filed and new rates set within the amortization period, there is a strong
21 likelihood the Company will over collect this expense. Thus, where, as in this case, the
22 expense is significant, the systems are growing and the historical filing period is longer
23 than three years, a longer amortization period is appropriate.
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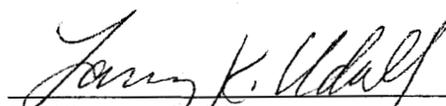
VII. CONCLUSION.

Based on the foregoing, Youngtown recommends that the Commission implement the following points in its consideration of Arizona-American's application.

1. Utilize the Original Cost Less Depreciation Rate Base for the Company's Fair Value Rate Base;
2. Revise the Irrigation Water Rate Tariff to include service to Youngtown (for its small lake);
3. Provide for the increases in rates to be implemented in a gradual fashion if the rate increase results in a change in excess of 20%; and
4. Amortize the allowed rate case expense over a five-year period.

RESPECTFULLY SUBMITTED this 4th day of February, 2004.

MARTINEZ & CURTIS, P.C.



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**Original and twenty-one (21) copies of
the foregoing filed this 4th day of February, 2004, with:**

Docket Control Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

**Copies of the foregoing hand-delivered and/or mailed
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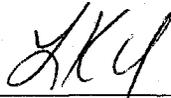
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Proposed Exhibit Y-7

ORIGINAL

Water Service

Table of Contents

G - 1	General Water Service	1 - Ninth Revised
I - 1	Irrigation Water Rate	2 - Eighth Revised
PF - 1	Private Fire Protection	3 - Eighth Revised
PIR/SB - 1	Public Interruptible/Stand By	4 - Fourth Revised
MISC - 1	Miscellaneous Service Charges	5 - First Revised
GW - 1	Groundwater Withdrawal Fees	6 - Original
	Rules and Regulations	ACC No. 1 thru ACC No. 47

ISSUED May 7 1997 EFFECTIVE May 1 1997
MONTH DAY YEAR MONTH DAY YEAR

ISSUED BY Fred L. Kriess, Jr., Vice President and General Manager
NAME OF OFFICER TITLE

15626 North Del Webb Boulevard, Sun City, Arizona 85351
ADDRESS OF OFFICER



Decision No. 60172

APPROVED FOR FILING
DECISION #: 60172

ORIGINAL

Water Service

Irrigation Water Rate

Availability

Available only to the Sun City Agricultural Club, golf courses and irrigated medians, south of Grand Avenue. Subject to interruption if such water service would adversely affect the ability of Sun City Water Company to provide water service to its other classes of customers or if such water service would detrimentally impact the water quality or supply within the aquifers from which the Sun City Water Company extracts water.

Minimum Monthly Charge

Meter Size

Rate

1"	\$13.00
1.5"	28.00
2"	41.00
3"	70.00
6"	141.00

Usage Charge

In addition to the minimum monthly charge above, the following usage charge will be made:

Meter Size

Rate (per 1,000 gal.)

All Sizes All Consumption

\$0.65

Terms and Conditions

Water service provided under this rate schedule is subject to the Company's Rules and Regulations applicable to Water Service and may be subject to the Company's Miscellaneous Service Charges set forth in Rate Schedule MISC-1.

Water service under this Schedule is for the exclusive use of the Customer and water shall not be resold or provided to others.

All rates in this Schedule shall be subject to their proportionate part of any taxes or other governmental imposts which are assessed directly or indirectly on the basis of revenues derived from service under this Schedule, or on the basis of the service provided or the volume of water produced, purchased or sold.

A 1-1/2% late payment penalty will be applied to account balances not paid within 25 days after the postmark date of the bill in accordance with Rule 8 (H).

ISSUED May 7 1997 EFFECTIVE May 1 1997
MONTH DAY YEAR MONTH DAY YEAR

ISSUED BY Fred L. Kriess, Jr., Vice President and General Manager
NAME OF OFFICER TITLE

15626 North Del Webb Boulevard, Sun City, Arizona 85351
ADDRESS OF OFFICER



Decision No. 60172

APPROVED FOR FILING
DECISION #: 60172

ORIGINAL

Water Service

Irrigation Water Rate (con't)

Terms and Conditions (con't)

Water service under this Schedule is for the exclusive use of the Customer and water shall not be resold or provided to others.

All rates in this Schedule shall be subject to their proportionate part of any taxes or other governmental imposts which are assessed directly or indirectly on the basis of revenues derived from service under this Schedule, or on the basis of the service provided or the volume of water produced, purchased or sold.

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