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# ORIGINAL EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER COMPANY  
FOR AN AFFILIATE AGREEMENT WITH AWR,  
INC.

DOCKET NO. WS-01303A-05-0170

12

## EXCEPTIONS OF ARIZONA-AMERICAN WATER COMPANY AND AMERICAN WATER RESOURCES, INC.

Arizona-American Water Company ("Arizona-American" or the "Company") and  
American Water Resources, Inc. ("AWR") hereby submit the following exceptions to the  
Recommended Opinion and Order

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1 **I. BACKGROUND - SERVICE LINE PROGRAM<sup>1</sup>**

2 Like Arizona-American, AWR is also a subsidiary of American Water Works Company,  
3 Inc. (“American Water Works”). The Arizona Department of Insurance has issued a permit to  
4 AWR, which states that AWR is qualified under A.R.S. § 20-1095-3 and authorized to transact  
5 business in the State of Arizona as a Service Company, as that term is defined in A.R.S. § 20-  
6 1095.

7 Water and sewer customers own their service lines, although many customers may not be  
8 aware of this fact, or where the service lines are located. In the case of a water line, this is the  
9 line that runs from the water meter to the shut-off valve outside the house. In the case of the  
10 sewer line, this is the line that runs from the property line to the house and, in some  
11 municipalities, from the main in the street to the house. Problems can develop with these service  
12 lines through tree-root incursions, seasonal soil subsidence, aging, or other normal wear-and-tear  
13 causes. Locating a qualified contractor to repair these problems can be a frustrating process, and  
14 the cost, which can be very expensive, is not typically covered by homeowner’s insurance.

15 Currently, when a problem develops in the customer’s service line, the customer is  
16 responsible for making all necessary arrangements to have the line repaired and to pay all of the  
17 repair costs. AWR has developed the Water Line Protection Program and the Sewer Line  
18 Protection Program (collectively the “Service Line Programs”) for residential customers that  
19 provide a convenient and cost-effective means for making repairs to customer-owned water  
20 service lines that leak or break or sewer service lines that become clogged or blocked due to  
21 normal wear and tear. Customers enrolling in one of the Service Line Programs pay a modest  
22 annual fee,<sup>2</sup> and in the event of a covered problem in the customer-owned portion of the line,  
23 AWR obtains the proper permits and arranges to pay for necessary repairs, including basic site  
24 restoration, up to a stated program limit.

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<sup>1</sup> This section, see generally Companies Direct, pp. 6-9.

<sup>2</sup> Water Line Protection Program - \$60/year covers up to \$4,000; Sewer Line Protection Program - \$108/year covers up to 8,000. Late-Filed Exhibits A-3 and A-4.

1 Repair services will be provided by AWR through the use of local independent, licensed,  
2 contractors who operate in or near an Arizona-American district. The relationship between these  
3 contractors and AWR will be similar to the relationships contractors have with home-repair and  
4 installation services being offered by Home Depot and Sears. No Arizona-American or AWR  
5 employees will be used to make any actual service line repairs.

6 Arizona-American will provide additional limited services for AWR. For billing and  
7 remittance services, the Company would be paid \$.10/customer/month (\$1.20 annually).<sup>3</sup> The  
8 Company's additional cost of providing these services should be negligible.<sup>4</sup> The Company  
9 currently pays its affiliate, American Waterworks Service Company, approximately \$1 per year  
10 per customer for billing services.<sup>5</sup> Therefore, the money received from AWR per customer  
11 would exceed the Company's total per customer cost of billing services.<sup>6</sup> Essentially, the funds  
12 received for billing and remittance services would be pure gravy, which would simply reduce the  
13 overall revenue requirement to all customers.<sup>7</sup>

14 AWR operates a dedicated call center facility and is fully responsible for handling  
15 customer inquiries, processing customer enrollments and resolving customer claims.<sup>8</sup> Arizona-  
16 American's remaining costs would be minimal and be compensated at 115% of fully allocated  
17 costs.<sup>9</sup> The only examples of such costs would be an occasional local inquiry and the time spent  
18 by a service technician associated with a call after discovering that the customer was covered by  
19 one of the Service Line Programs.<sup>10</sup> In either case, the covered customer would be referred to

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<sup>3</sup> Companies Direct at 8.

<sup>4</sup> *Id.* at 11. There would be no additional costs for mailing or postage. Tr. at 53-54.

<sup>5</sup> Companies Direct at 8.

<sup>6</sup> *Id.* at 11-12.

<sup>7</sup> Tr. at 54.

<sup>8</sup> Companies Direct at 11, 6.

<sup>9</sup> *Id.* at 8.

<sup>10</sup> *Id.* at 11, 8. Arizona-American originally contracted to provide additional services such as distributing promotional material and providing customer-contact information, which are no longer part of the joint proposal.

1 one of AWR's service representatives,<sup>11</sup> and the employee's time and associated overhead would  
2 be compensated at 115%.<sup>12</sup>

3 **II. EXCEPTION NO. 1 – THE COMMISSION SHOULD APPROVE ARIZONA-**  
4 **AMERICAN'S LIMITED SUPPORT OF THE SERVICE LINE PROGRAM**

5 **A. THE SERVICE LINE PROGRAM OFFERS REAL BENEFITS TO**  
6 **ARIZONA-AMERICAN'S CUSTOMERS**

7 In this case, Arizona-American voluntarily filed with the Commission a copy of the  
8 Agreement for Support Services Between American Water Resources, Inc. and Arizona-  
9 American Water Company ("Affiliate Agreement"). Commission rules did not require filing of  
10 the Affiliate Agreement, except as part of the Company's April 2006 annual filing under R14-2-  
11 805.

12 The Affiliate Agreement provides that Arizona-American would provide customer names  
13 and addresses to AWR. The Commission has already authorized this type of information sharing  
14 in its order approving the RWE acquisition of American Water Works, Inc., Arizona-American's  
15 corporate parent.<sup>13</sup> ("RWE Acquisition Order".) The order included two relevant conditions  
16 (Nine and Ten):

17 #9 If Arizona-American ever plans to share with affiliates, or other entities, any  
18 information made available to Arizona-American solely by virtue of the  
19 company/customer relationship, such as billing information and services received  
20 by a customer, it shall notify the Commission at least 180 days in advance. Such  
21 notice shall, at a minimum, identify the intended use of the information. Arizona-  
22 American shall also, at the time of the filing of the 180-day notice, file a tariff  
23 setting forth appropriate customer notification procedures to inform customers  
24 about the sharing.

25 #10 If Arizona-American ever shares any customer information with affiliates, or  
26 other entities, it shall maintain accurate records of revenues earned as a result and  
27 make those records available to Staff upon request with ten days' notice. For the

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 8.

<sup>13</sup> Docket No. W-01303A-01-0983, Decision No. 65453, December 12, 2002.

1 purposes of this condition and Condition Nine above, customer information that is  
2 prohibited from disclosure does not include a customer's name, address or service  
3 location, and telephone number. (Emphasis added.)

4 Arizona-American believes that the Service Line Programs provide a valuable customer  
5 benefit, that they should be offered to as many of its customers as possible, and that each  
6 customer should decide whether to participate. It is true that AWR could offer the program  
7 without Arizona-American's participation and the Commission's oversight, but this outcome  
8 would be worse for Arizona-American's customers, the Commission, and AWR.

9 If the Commission prohibits Arizona-American's participation, the Commission would  
10 then have no jurisdiction to influence AWR's marketing, billing, or customer service. Arizona-  
11 American would lose the revenue it would otherwise receive for supporting the program. An  
12 Arizona-American customer would lose the popular, low-cost, utility-bill pay option and, in the  
13 event of a service-line problem, would have to remember that he or she was enrolled in the  
14 Programs, find the contact information, and directly contact AWR. Also, a large percentage of  
15 Arizona-American customers would never receive AWR Program mailings because AWR would  
16 not have access to customer names and addresses from Arizona-American. AWR would have to  
17 purchase names and addresses from vendors who sell public lists, which tend to be outdated,  
18 incomplete and, when used, often create customer confusion and complaints.

19 The ALJ has offered no explanation why a less-effective Service Line Program would be  
20 preferable to Arizona-American providing modest assistance to AWR so that:

- 21 1. Customers would be more likely to learn about this popular program;
- 22 2. Customers could enroll in the bill-paying option instead of paying yet another bill  
23 with checks or credit cards; and
- 24 3. Customers could receive initial assistance from Company service technicians to  
25 verify Service Line Program eligibility and to contact AWR to begin the repair  
26 process.

1           **B. TO ADDRESS STAFF CONCERNS, THE COMPANIES HAVE AGREED**  
2           **TO A NUMBER OF PROGRAM MODIFICATIONS**

3           **1. Additional Services**

4           Staff recommended “[T]hat the Agreement be modified to omit Section 6.1.4 and any  
5 other section that might allow Arizona American and AWR to contract for additional services  
6 other than those specifically related to the water and sewer line Programs.” The Companies  
7 accepted this recommendation. A modified draft agreement that reflected this acceptance was  
8 submitted at the hearing as Exhibit A-2.

9           **2. Net Income Above the Line**

10          Staff recommended “[T]hat any net income derived by Arizona American from the  
11 services it provides AWR for the Programs be considered above-the-line for ratemaking  
12 purposes.”<sup>14</sup> Arizona-American accepted this recommendation.

13          **3. No Arizona-American Endorsement**

14          Staff recommended “[T]hat Arizona American not endorse or promote the Programs and  
15 that the Agreement be modified to so reflect.”<sup>15</sup> Arizona-American accepted this  
16 recommendation. A modified draft agreement that reflected this acceptance was submitted as  
17 Exhibit A-2 and the revised promotional material (Exhibits A-3 and A-4) also reflects this  
18 acceptance.

19          **4. AWR’s Books and Records**

20          Staff recommended that: “The Commission reserves the right to examine the books and  
21 records of AWR in connection with the Programs.”<sup>16</sup> AWR accepted this recommendation.<sup>17</sup>

22          **5. Fully Allocated Costs**

23          Staff recommended that: “The Agreement should be modified to include a definition of  
24 fully allocated or fully distributed costs as including direct costs, a contribution to common costs,

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<sup>14</sup> Staff Recommendation No. 4. *Id.*

<sup>15</sup> Staff Recommendation No. 5. *Id.*

<sup>16</sup> Staff Recommendation No. 7. *Id.* at 24.

<sup>17</sup> The Commission already has this right under the Affiliate Interest Rules. R14-2-804.

1 and overhead.”<sup>18</sup> The Companies accepted this recommendation. A modified draft agreement  
2 that reflected this acceptance was submitted as Exhibit A-2.

3 **6. Payment for Customer List**

4 Staff recommended that “The Agreement be modified to include payment by AWR to  
5 Arizona-American for the use of its customer list.”<sup>19</sup> This would be at the rate of \$0.04875 per  
6 customer initially, and \$0.03247 per customer for updates. Even though this is not required by  
7 the RWE Acquisition Order, AWR accepted this recommendation.

8 **7. Promotional Material**

9 As part of the discovery process, AWR provided sample promotional material to Staff  
10 that was used in New Jersey to promote the Service Line Programs. Based on Staff’s informal  
11 comments, AWR submitted revised promotional material as Exhibits B and C to the Companies’  
12 Direct Testimony. Consistent with Staff Recommendation No. 5, to avoid giving the  
13 impressions that Arizona-American was promoting the Service Line Programs, AWR removed  
14 all references to Arizona-American, except “in the form of references to payment of Program  
15 fees via customer water bill and specific Program terms and conditions.”<sup>20</sup>

16 At the hearing there were several other issues raised concerning the promotional material.  
17 To address these issues, AWR revised the promotional material to include certain requested  
18 disclaimers. Arizona-American submitted the revised promotional material as Exhibits A-3 and  
19 A-4.

20 **C. ARIZONA-AMERICAN’S PARTICIPATION IS IN THE PUBLIC**  
21 **INTEREST**

22 If Arizona-American does not participate in the program, the popular utility-bill-pay  
23 option cannot be made available to its customers. If Arizona-American does not participate, it  
24 will not know if a customer has enrolled in one of the Service Line Programs. Finally, as

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<sup>18</sup> Staff Recommendation No. 8. Staff Direct at 24.

<sup>19</sup> Staff Direct at 8-9; Staff Rebuttal at 6-7.

<sup>20</sup> Companies Direct at 15-16.

1 discussed above, AWR will have to use publicly available mailing lists if Arizona-American  
2 does not participate, so fewer of its customers will even learn about the availability of the  
3 Service Line Programs.

4 The Companies demonstrated the many benefits of the Service Line Programs, which,  
5 after all, is a low-cost, optional program. For these reasons, the Service Line Programs are in the  
6 public interest.

7 Arizona-American's participation is also in the public interest. As discussed above, the  
8 Company's participation will ensure that more customers are exposed to the Service Line  
9 Programs and will benefit participants by providing the customer bill-pay option and additional  
10 local support.

11 Finally, the Commission has only had the opportunity to review and comment on the  
12 Service Line Programs because of the arguable jurisdiction provided by the Holding Company  
13 and Affiliate Interest Rules. However, if Arizona-American does not participate in the Service  
14 Line Programs, these rules would not apply to AWR. AWR can directly market the Service Line  
15 Programs, without any Commission involvement. Further, Arizona-American could likewise  
16 partner with a non-affiliate vendor to offer a similar program without any pre-review by the  
17 Commission. It is more in the public interest for Arizona-American to support its affiliate's  
18 Service Line Programs—with the aid of Staff, and Commission oversight—than either of these  
19 alternatives.

20 **D. THE SERVICE LINE PROGRAMS SHOULD BE APPROVED**

21 For all the reasons set forth above, Arizona-American's support of the Service Line  
22 Programs should be approved. A suggested amendment to the Proposed Order to this effect is  
23 attached as Exhibit A to these Exceptions.

1 **III. EXCEPTION NO. 2 – THERE IS NO NEED AT THIS TIME FOR ANY**  
2 **HOLDING COMPANY OR AFFILIATE INTEREST RULE WAIVERS**

3 Staff has consistently recommended that Arizona-American and RWE should be ordered  
4 to file for appropriate waivers of the Holding Company and Affiliate Interest Rules.<sup>21</sup> And just  
5 as consistently, Staff has been unable to identify any appropriate waiver requests. Nonetheless,  
6 the ALJ included an ordering paragraph in the proposed order as follows:

7 *IT IS FURTHER ORDERED* that Arizona-American Water Company shall file  
8 either for an appropriate waiver from the Rules to clarify the type of transaction  
9 for which its parent, American Water Resources, Inc., and its ultimate parent,  
10 RWE AG, must file notice with this Commission or for approval of appropriate  
11 transaction(s).

12 It would not be appropriate for the Commission in this proceeding to impose any sort of  
13 waiver requirement, when Staff has failed to identify any activities by an Arizona-American  
14 affiliate for which a waiver would be necessary or appropriate, or what the nature of the waiver  
15 should be. The condition is so vague that it provides no guidance at all as to how to Company  
16 should comply with it.

17 Arizona-American asks that this condition be deleted. A proposed amendment to this  
18 effect is attached as Exhibit B to these Exceptions.

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<sup>21</sup> Staff Direct at 24; Staff Rebuttal at 6.

1 RESPECTFULLY SUBMITTED on July 17, 2006.

2  
3  
4  
5 

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42 By:

  
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**SUGGESTED AMENDMENT NO. 1**

**Beginning of Page 10, line 13 – Delete paragraphs 34-36.**

**Insert new paragraphs 34-38:**

34. On balance, Arizona-American has demonstrated that its limited support for the Service Line Programs is in the public interest, particularly along with the conditions set forth below. This is a popular program in other jurisdictions and no evidence was presented of any significant issues that have arisen in the jurisdictions where the local utility supports the Service Line Programs. Further, the Company's participation will ensure that more customers are given the opportunity to participate in the Service Line Programs and will benefit participants by providing them with the popular customer bill-pay option and additional local support.

35. The Commission has already considered Staff's concerns about Arizona-American sharing limited customer information with its affiliates. The Commission authorized this type of information sharing in its order approving the RWE acquisition of American Water Works, Inc., Arizona-American's corporate parent.<sup>22</sup> This order included two relevant conditions (Nine and Ten):

#9 If Arizona-American ever plans to share with affiliates, or other entities, any information made available to Arizona-American solely by virtue of the company/customer relationship, such as billing information and services received by a customer, it shall notify the Commission at least 180 days in advance. Such notice shall, at a minimum, identify the intended use of the information. Arizona-American shall also, at the time of the filing of the 180-day notice, file a tariff setting forth appropriate customer notification procedures to inform customers about the sharing.

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<sup>22</sup> Docket No. W-01303A-01-0983, Decision No. 65453, December 12, 2002.

1 #10 If Arizona-American ever shares any customer information with  
2 affiliates, or other entities, it shall maintain accurate records of revenues  
3 earned as a result and make those records available to Staff upon request  
4 with ten days' notice. For the purposes of this condition and Condition  
5 Nine above, customer information that is prohibited from disclosure does  
6 not include a customer's name, address or service location, and telephone  
7 number. (Emphasis added.)

8 We see no reason to depart from this conclusion, particularly when the result would be  
9 that AWR would be forced to rely on inaccurate commercial mailing lists and, as a result,  
10 fewer of Arizona-American's customers would become aware of the Service Line  
11 Programs. Further, as discussed below, even though it is not required by the RWE  
12 acquisition order, AWR has agreed to pay Arizona-Water for the use of its customer list  
13 at the rate of \$0.04875 per customer initially, and \$0.03247 per customer for updates.  
14 This will provide additional revenue to Arizona-Water to offset its future revenue  
15 requirements.

16 36. To address specific Staff concerns, the Companies agreed to a number of  
17 modification to the Affiliate Agreement.

18 a. The services that Arizona-American and AWR can contract for are  
19 now limited to those specifically related to the water and sewer line Programs.

20 b. Any apparent endorsements of the Programs by Arizona-American  
21 have been deleted.

22 c. The Agreement now includes a definition of fully allocated or fully  
23 distributed costs as including direct costs, a contribution to common costs, and  
24 overhead.

25 d. AWR must pay Arizona-American for the use of its customer list  
26 at the rate of \$0.04875 per customer initially, and \$0.03247 per customer for  
27 updates.

1 The revised Affiliate Agreement was submitted at the Hearing as Exhibit A-2.

2 37. AWR submitted revised promotional material as Exhibits B and C to the  
3 Companies' Direct Testimony. Consistent with Staff Recommendation No. 5, to avoid  
4 giving the impressions that Arizona-American was promoting the Service Line Programs,  
5 AWR removed all references to Arizona-American, except "in the form of references to  
6 payment of Program fees via customer water bill and specific Program terms and  
7 conditions." Staff raised several other issues raised concerning the promotional material.  
8 To address these issues, AWR further revised the promotional material to include certain  
9 requested disclaimers and submitted these at the hearing as Exhibits A-3 and A-4.

10 38. To ensure that Arizona-American's participation in the Service Line  
11 Programs is in the public interest, several conditions are needed.

12 a. Any net income derived by Arizona-American from the services it  
13 provides AWR for the Programs shall be considered above-the-line for  
14 ratemaking purposes.

15 b. Within 30 days of the date of this order, Arizona-American and  
16 AWR shall execute a modified Affiliate Agreement in the form submitted in the  
17 Hearing as Exhibit A-2 and file an executed copy in this docket.

18 c. AWR's promotional material shall be in the forms submitted at the  
19 hearings as Exhibits A-3 and A-4.

20 d. The Commission reserves the right to examine the books and  
21 records of AWR in connection with the Programs.  
22

23 **Page 11, line 17, delete existing paragraph 3 and insert:**

24 Arizona-American's participation with its affiliate AWR in the provision of the  
25 Service Line Programs is reasonable and should be approved, as conditioned in Finding  
26 of Fact No. 38.  
27

1 **Page 11, line 21, delete the initial ordering paragraph and insert the following two**  
2 **paragraphs:**

3 IT IS THEREFORE ORDERED that Arizona-American's participation with its  
4 affiliate AWR in the provision of the Service Line Programs is approved, provided that  
5 Arizona-American complies with the Conditions set forth in Finding of Fact No. 38.

6 IT IS FURTHER ORDERED that in the event that Arizona-American does not  
7 timely comply with the Conditions set forth in Finding of Fact No. 38, then this approval  
8 shall be deemed null and void after due process.

**SUGGESTED AMENDMENT NO. 2**

**Page 10, Paragraph 33. Delete the second sentence and insert:**

However, Arizona-American recently filed in Docket Nos. W-01303A-06-0274, *et al.*, for a finding of no jurisdiction, or appropriate waivers, or in the alternative, appropriate approvals in connection with the upcoming initial public offering by RWE of the common stock of American Water Works Company, Inc., Arizona-American's corporate parent. Assuming the divestiture is approved, then there will no longer be any need for filings associated with RWE transactions. Therefore, it would be inappropriate to add a condition at this time requiring any type of affiliate waiver or approval filing.

**Page 11, line 18. Delete Conclusion of Law No. 4.**

**Page 12. Delete Ordering Paragraph beginning on line 1**