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MEMORANDUM RECEIVED

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TO: Docket Control
Arizona Corporation Commission

2006 SEP 29 P 4: 16

FROM: Ernest G. Johnson
Director
Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: September 29, 2006

RE: STAFF REPORT FOR ARIZONA-AMERICAN WATER COMPANY, INC.'S APPLICATION FOR A FINDING OF NO JURISDICTION, OR FOR A WAIVER OF THE AFFILIATED INTERESTS RULES PURSUANT TO A.A.C. R-14-2-806, OR IN THE ALTERNATIVE FOR APPROVAL OF AN AFFILIATED INTERESTS TRANSACTION PURSUANT TO A.A.C. R-14-2-801 et seq. - DOCKET NOS. SW-01303A-06-0274, W-01303A-06-0274 AND WS-01303A-06-0274.

Attached is the Staff Report for Arizona-American Water Company, Inc.'s application for a finding of no jurisdiction or for a waiver of the affiliated interests rules pursuant to A.A.C. R-14-2-806 or in the alternative for approval of an affiliated interests transaction pursuant to A.A.C. R-14-2-801.

Staff recommends approval of an affiliated interests transaction, subject to certain conditions, pursuant to A.A.C. R-14-2-803.A.

EGJ:JJD:tdp

Originator: James J. Dorf

Arizona Corporation Commission

DOCKETED

SEP 29 2006

DOCKETED BY

Service List for: Arizona-American Water Company, Inc.
Docket Nos. SW-01303A-06-0274, W-01303A-06-0274 & WS-01303A-06-0274

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**ARIZONA-AMERICAN WATER COMPANY, INC.
DOCKET NOS. SW-01303A-06-0247, W-01303A-06-0247 AND
WS-01303A-06-0247**

**APPLICATION FOR A FINDING OF NO JURISDICTION, OR FOR A WAIVER OF
THE AFFILIATED INTERESTS RULES PURSUANT TO A.A.C. R-14-2-806, OR IN
THE ALTERNATIVE FOR APPROVAL OF AN AFFILIATED INTERESTS
TRANSACTION PURSUANT TO A.A.C. R-14-2-801**

SEPTEMBER 29, 2006

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona-American Water Company, Inc. ("Company"), Docket Nos. SW-01303A-06-0274, W-01303A-06-0274 and WS-01303A-06-0274 was the responsibility of the Staff member James J. Dorf.

A handwritten signature in black ink that reads "James J. Dorf". The signature is written in a cursive style with a large initial "J" and a distinct "D".

James J. Dorf
Chief Accountant

EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NOS. SW-01303A-06-0274 ET AL

Arizona-American Water Company, Inc. ("Arizona-American" or "Company") is a public service corporation engaged in providing water and wastewater services in portions of Maricopa, Mohave, and Santa Cruz Counties, Arizona. The Company currently serves approximately 97,000 water customers and 47,000 wastewater customers. The Company is the largest investor-owned water and wastewater utility in Arizona.

The Company's application requests a finding of no jurisdiction or for a waiver of the affiliated interests rules pursuant to A.A.C. R-14-2-806 or, in the alternative, for approval of an affiliated interests transaction pursuant to A.A.C. R-14-2-801. The Company's parent is being divested from its current owner and will seek capitalization via an initial public offering on the New York Stock Exchange.

Staff concluded that the proposed transaction will provide benefits to Arizona ratepayers and is in the public interest. The transaction will not impair the financial status of Arizona-American, otherwise prevent it from attracting capital at fair and reasonable terms, or impair its ability to provide safe, reasonable and adequate service.

Staff recommends approval, subject to the conditions below, pursuant to A.A.C. R-14-2-803.A.

1. Arizona-American shall not allow the transaction to diminish local (Arizona) staffing that would result in service degradation.
2. Arizona-American will continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its services.
3. Arizona-American agrees that it will not seek regulatory recovery in a future rate proceeding of the costs incurred to implement the proposed transaction.
4. Arizona-American agrees it will not change its equity improvement plan.
5. Arizona-American and its affiliates shall provide their books and records, upon request, where such documents are maintained.
6. Arizona-American will make available, during Arizona-American's general rate application subsequent to the completion of the proposed transaction, information related to the financing and administration of Arizona-American to permit a review of the reasonableness of any cost allocations among its affiliates.

7. Upon completion of the transaction, Arizona-American will provide reasonable notice regarding the Initial Public Offering ("IPO") and any subsequent offering within 90 calendar days.

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Introduction

Arizona-American Water Company, Inc. ("Arizona-American" or "Company") is a public service corporation engaged in providing water and wastewater services in portions of Maricopa, Mohave, and Santa Cruz Counties, Arizona pursuant to various certificates of public convenience and necessity granted by the Arizona Corporation Commission ("Commission"). The Company currently serves approximately 97,000 water customers and 47,000 wastewater customers. The Company is Arizona's largest investor-owned water and wastewater utility.

On April 25, 2006, the Company filed an application with the Commission for a finding of no jurisdiction, or for a waiver of the affiliate interests rules pursuant to A.A.C. R-14-2-0806, or in the alternative for approval of an affiliated interests transaction pursuant to A.A.C. R-14-2-801, *et seq.* The proposed transaction is described below and will involve the Company's immediate parent, American Water Works Company, Inc. ("American Water"), its parent Thames Water Aqua US Holdings, Inc. ("TWAUSHI"), and its parent Thames Water Aqua Holdings GmbH ("Thames GmbH"). Thames GmbH is in turn a wholly-owned subsidiary of the ultimate parent company, RWE Aktiengesellschaft ("RWE").

On May 26, 2006, the Company notified Commission Staff that it "agreed that the Commission may have until July 25, 2006, to review and rule on the Notice of Intent and Finding of No Jurisdiction, Waiver or Approval."

On July 7, 2006, Staff filed an Open Meeting Memorandum which briefly summarized the proposed divestiture of the Company's parent and its subsequent listing on the New York Stock Exchange via an initial public offering. Pursuant to Decision No.68856, dated July 28, 2006, Commission Staff was granted additional time to review the transaction and suspended the filing so as to permit the Commission to render its decision on the proposed transaction by September 30, 2006.

Ownership Summary

RWE is a foreign corporation organized and existing under the laws of the Federal Republic of Germany whose offices are located in the town of Essen, Germany. Thames GmbH is a wholly owned subsidiary of RWE and also a foreign corporation organized and existing under the laws of the Federal Republic of Germany. Thames GmbH is the holding company for most of RWE's water operations, both in the United States and in several foreign countries.

Thames Water Aqua US Holdings, Inc ("TWAUSHI") is a wholly owned subsidiary of Thames GmbH and is a Delaware corporation with its principal offices located in Voorhees, New Jersey. Including Arizona-American, TWAUSHI subsidiaries have approximately 7,000 employees and provide water and wastewater services to approximately 18 million customers in 29 states and Canada.

Arizona-American is a wholly-owned subsidiary of American Water. American Water is a corporation organized under the laws of the State of Delaware. Its principal offices are located in Voorhees, New Jersey. American Water owns regulated operating subsidiaries in 18 states, including Arizona. Until its acquisition in 2001 by TWAUSHI, American Water was one of the largest publicly traded water companies in the United States and its shares were listed on the New York Stock Exchange ("NYSE").

See Schedule JJD-1 for a summary of the current and proposed ownership hierarchy.

Transaction Overview

RWE is planning to divest its American Water subsidiary in an Initial Public Offering ("IPO") on the NYSE. The proposed transaction consists of:

1. the sales by Thames GmbH of up to 100% of the shares of common stock of American Water, and
2. prior to the closing of the IPO, the merger of TWAUSHI with and into American Water.

Thames GmbH wishes to sell 100% of the shares in the IPO; however, market conditions may not permit all shares to be sold. Any unsold shares would be sold in a subsequent offering or offerings as soon as reasonably practicable.

The shares will be sold through one or more underwritten public offerings to a broad group of investors, including institutional and retail investors. The IPO and any subsequent filings will be conducted according to the rules mandated by the Securities and Exchange Commission ("SEC").

An initial registration statement to be filed with the SEC is anticipated to occur in late 2006. After the SEC's review of the registration and the state regulatory process (including Arizona) has been completed, the shares will then be marketed.

RWE has decided to dismantle its international water interests that cost approximately \$10 billion to assemble and spanned 40 countries. Its water company divestiture plan includes initial public offerings for American Water and Thames Water, the largest British water company. According to RWE, it was unable to achieve acceptable returns on its water investments.

Capital Structure

The debt of Arizona-American consists of third party debt issued in the capital markets and inter-company debt owed to American Water Capital Corp. ("AWCC"), which is a wholly-owned subsidiary of American Water. As of December 31, 2005, third party debt totaled \$13.2 million and inter-company debt owed to AWCC totaled \$194 million.

Arizona-American has utilized AWCC as a financing vehicle for many years and predates RWE's acquisition of American Water. AWCC borrows funds for the benefit of American Water and then loans such funds to subsidiaries. The advantage of utilizing AWCC for all of American Water borrowings is due to the economies of scale associated with group-wide debt financing and lower administrative costs.

AWCC's debt consists primarily of corporate loans from RWE and a small amount issued in the capital markets. As of December 31, 2005, AWCC had \$2.4 billion in loans from RWE and \$226.6 million in third party debt. AWCC is currently rated A- by Standard and Poor's and Baa1 by Moody's Investor Services, Inc.

American Water has indicated that all inter-company financial relationships with RWE will be terminated. Depending on the transaction timing and resultant proceeds, the refinancing of AWCC's debt with RWE may require changes to the inter-company debt between AWCC and Arizona-American. Arizona-American will seek Commission approval for any changes necessary related to the refinancing transaction.

Arizona-American has a financing application currently pending at the Commission in Docket No. WS-01303A-06-0263. The Company owes \$158.45 million to AWCC which matures in November, 2006. The Company proposes to borrow \$165.45 million to repay the amount due in November, 2006, and an additional \$7 million to fund new projects. Staff has issued its report on September 15, 2006, which recommends approval of the Company's request to borrow an amount not to exceed \$165.45 million in new funds from AWCC. The Company has indicated that it does not anticipate any changes in its relationship with AWCC as a result of the IPO.

In November, 2005, the Company submitted an equity improvement plan and completed an equity infusion of \$35 million to Arizona-American in March, 2006. The Company asserts that the pending IPO will have no impact on the relationship between Arizona-American, American Water and AWCC.

Governance

As a publicly traded company, American Water will be subject to federal securities laws and regulations in addition to the stock exchange on which its shares will be traded. American Water will be required to file annual, quarterly and other reports with the SEC. The annual financial reports will be required to be audited. American Water will also be subject to the requirements imposed by the federal Sarbanes-Oxley legislation. As a result, American Water will be subjected to a much greater degree of transparency than existed under its current ownership structure. All filings with the SEC will be immediately available to investors and the public at large.

American Water asserts that its current Board of Directors possesses the capabilities and experience appropriate for the board of a large, publicly-traded company. The Board will have a

majority of independent directors and the audit, compensation and nominating committees consist of entirely independent directors.

Public Interest

American Water asserts that the proposed transaction will result in a well managed company with a sound financial structure and will be focused on the water and wastewater business in the U.S. American Water, for over 60 years, has been one of the largest publicly-traded water companies in the U.S. Previously being publicly-traded has served American Water and its customers well in the past and will do so in the future.

American Water will have access to the public equity and debt capital markets in the U.S. American Water is committed to maintaining a sound capital structure and its ability to finance necessary investments in water and wastewater infrastructure. Presented below is a partial summary of the Company noted public benefits:

1. As a publicly traded company, American Water is better positioned to focus solely on maintaining, developing and growing its water and wastewater businesses, including Arizona-American.
2. American Water will be subject to the extensive disclosure and filing requirements of the SEC, resulting in greater transparency with respect to its operations and ownership.
3. American Water is committed to maintaining a sound capital structure and maintain its ability to access equity and debt capital markets.
4. American Water will continue to provide its existing corporate services to Arizona-American under the service agreement currently in place.
5. The proposed transaction will not adversely impact employees or employment level in Arizona.
6. The proposed transaction will not impact Arizona-American's rates or its policies with respect to customer service, operations, financings or current investment and capital plans.
7. The proposed transaction will not affect the Commission's powers with respect to Arizona-American or the authority of other Arizona government agencies.

American Water asserts that Arizona-American will not seek recovery of the cost of the proposed IPO including SEC registration fees, National Association of Securities Dealer filing fees, stock exchange listing fees, legal fees or expenses associated with the proposed transaction, accounting fees, printing, engraving for registration statements, Blue Sky fees and expenses, transfer agent fees and expenses, and any legal fees for state regulatory process.

The Company has also provided all information required pursuant to A.A.C. R-14-2-803.A. in its application.

Arizona-American Impacts

American Water asserts that Arizona-American will continue to be a wholly-owned subsidiary of American Water and will continue to be operated by its current management. As it currently does, American Water Service Company, Inc. will continue to provide customer service, accounting, administration, engineering, financial, human resources, information systems, operations, risk management, water quality and other service to Arizona-American under the existing service agreement.

American Water indicates that the proposed transaction will have no effect on employment levels in Arizona and notes that it has several open positions that are actively being pursued.

The Company plans to maintain and improve each of its existing Arizona offices.

As a result of the proposed transaction, customers will be able to invest in their water utility by buying American Water common stock.

Other Jurisdictions

American Water has other subsidiaries in several state jurisdictions and to date has received three regulatory approvals. See Exhibit A for a summary of the jurisdictions, the related docket numbers and noted approvals.

Decision No. 65453

Decision No. 65453, dated December 12, 2002, approved the acquisition of American Water by a subsidiary of RWE. The Decision also imposed several conditions which are summarized at Exhibit B.¹ The conditions imposed were intended to protect ratepayers from any potential adverse effects of the proposed acquisition.

Staff Analysis

The primary result of the proposed transaction is to have American Water return to its pre-RWE acquisition ownership structure as a publicly traded NYSE company. As such, Staff's primary concern is American Water's ability to maintain a sound capital structure, retain its ability to attract equity and debt capital, continue to adequately serve Arizona ratepayers, and maintain its current support for Arizona-American and future planned Arizona infrastructure.

¹ Condition #13 was changed to three years rather than Staff's recommended ten years and Condition #15 was changed to three years versus Staff's recommended one year moratorium.

Returning American Water to a publicly traded entity will subject American Water and Arizona-American to additional levels of scrutiny due to the greater corporate transparency required by SEC regulations (including Sarbanes-Oxley-related requirements) and investor concerns.

American Water also asserts that the proposed transaction will result in a publicly-traded company that is more focused on water and wastewater performance in the U.S. It will make corporate decision making more transparent.

Arizona-American will remain a wholly-owned subsidiary of American Water and continue to receive financial, technical, managerial, accounting, human resources, risk management, water quality and other services from American Water Services Company, Inc. It will continue to receive debt financing and cash management services through AWCC.

The proposed transaction will not affect Arizona-American rates or its policies regarding customer service, proper operations and will not affect the Commission's power to regulate Arizona-American's activities.

Arizona-American customers and employees will have an opportunity to invest in another local utility by purchasing American Water stock. Arizona-American employees could benefit through employer sponsored stock ownership plans, if adopted by American Water, thus giving employees a greater interest in the successful performance of the Company.

Arizona-American has agreed to maintain its current Arizona offices, it anticipates increases in its employment opportunities, it will not change its equity improvement plan, and it agrees not to seek recovery of the cost associated with the proposed transaction.

Based upon the above, Staff concludes that the proposed transaction will provide benefits to Arizona ratepayers and is in the public interest. The transaction will not impair the financial status of Arizona-American, otherwise prevent it from attracting capital at fair and reasonable terms, or impair its ability to provide safe, reasonable and adequate service.

Requested Approvals

The Company requests that the Commission either find that it has no jurisdiction over the proposed transaction involving Arizona-American's parent, or the Commission waive compliance with the requirements of A.A.C. R-14-2-801, *et seq.* (Affiliated Interests Rules), or approval of the proposed transaction.

Staff recommends approval of the proposed transaction pursuant to A.A.C. R14-2-803.A. This Rule provides that:

“Any utility *or affiliate* intending to organize a public utility holding company *or reorganize* an existing public utility holding company will notify the Commission’s Utility Division in writing at least 120 days prior thereto.” (emphasis added)
Reorganize is defined in A.A.C. R-14--2-801.5. as:

“The acquisition or divestiture of a financial interest in an affiliate or a utility, or reconfiguration of an existing affiliate or utility’s position in the corporate structure or the merger or consolidation of an affiliate or a utility.”

The Company has provided, in its application, responses to each of the 11 items of information required by A.A.C. R-14-2-803.A.

Therefore, Staff recommends approval pursuant to A.A.C. R-14-2-803.A., subject to certain conditions summarized in Staff’s recommended conditions.

Hearing

Although certain American Water subsidiaries have experienced service quality or rate increase issues², Arizona-American has relatively few service or water quality complaints. As of September 19, 2006, the Company has 3 outstanding complaints related to billing and service quality issues.

Arizona-American is currently in compliance with its filing requirements at the Commission.

There have been no interventions filed related to this filing.

The proposed transaction will simply return American Water to the same publicly-traded entity it was in 2001. There are no significant changes affecting Arizona ratepayers and Staff recognizes several benefits.

Staff Recommended Conditions

In developing Staff’s recommended conditions for approving the transaction, Staff recognizes that Arizona-American and American Water financial capabilities will be thoroughly evaluated during the IPO process. Therefore, Staff recommends the following conditions with that prospect in mind.

² See Wall Street Journal, “Dry Hole”, Mike Esterl, June 26, 2006.

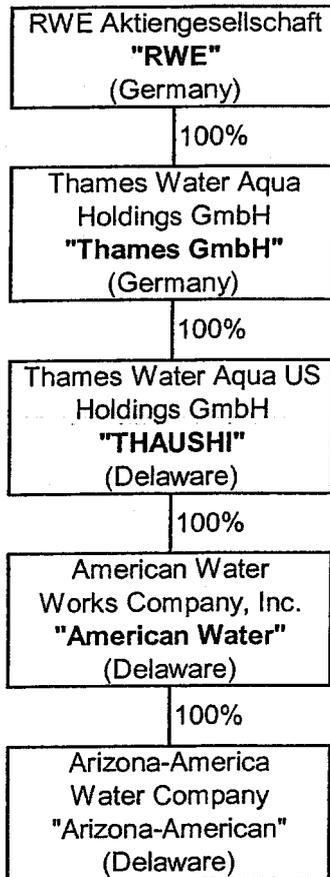
1. Arizona-American shall not allow the transaction to diminish local (Arizona) staffing that would result in service degradation.
2. Arizona-American will continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its services.
3. Arizona-American agrees that it will not seek regulatory recovery in a future rate proceeding of the costs incurred to implement the proposed transaction.
4. Arizona-American agrees it will not change its equity improvement plan.
5. Arizona-American and its affiliates shall provide their books and records, upon request, where such documents are maintained.
6. Arizona-American will make available, during Arizona-American's general rate application subsequent to the completion of the proposed transaction, information related to the financing and administration of Arizona-American to permit a review of the reasonableness of any cost allocations among its affiliates.
7. Upon completion of the transaction, Arizona-American will provide reasonable notice regarding the IPO and any subsequent offering within 90 calendar days.

Several conditions were imposed in Decision 65453 related to affiliate concerns, such as customer information sharing. Staff concludes that the existing affiliated interests rules, as contained in A.A.C. R-14-2-801. *et seq.*, are adequate to provide oversight on future affiliate transactions.

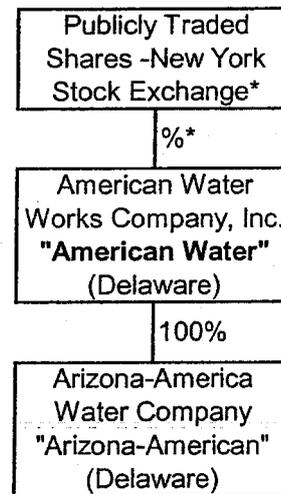
Staff Recommendations

Staff recommends approval of the proposed transaction pursuant to A.A.C. R-14-2-803.A., subject to the conditions summarized above.

CURRENT



PROPOSED



*Although RWE intends to sell 100% of the shares offered in the IPO, market conditions may require RWE (THAUSHI) to retain some percentage for later sale.

**ARIZONA-AMERICAN WATER COMPANY'S
RESPONSES TO FIRST SET OF DATA REQUESTS**
Docket Nos: SW-01303A-06-0274; W-01303A-06-0274; WS-031303A-06-0274
June 30, 2006

Arizona-American Water Company
Docket Nos: SW-01303A-06-0274
W-01303A-06-0274
WS-01303A-06-0274

EXHIBIT A - Revised

<u>www.address</u>	<u>Jurisdiction</u> ¹	<u>Docket No.</u>	<u>Date Filed</u>
cc.state.az.us	Arizona Corporation Commission	06-0274	4/25/2006
cpuc.ca.gov/	California Public Utilities Commission	A.06-05-025	5/22/2006
hawaii.gov/budget/pub/	Hawaii Public Utilities Commission	06-0095	4/21/2006 ²
icc.illinois.gov	Illinois Commerce Commission	06-0336	4/21/2006
psc.state.ky.us	Public Service Commission of Kentucky	2006-00197	6/5/2006
psc.state.md.us/	Maryland Public Service Commission	ML# 101250	4/21/2006 ³
bpu.state.nj.us	New Jersey Board of Public Utilities	xxxxxxxxxx	5/23/2006
nmprc.state.nm.us	New Mexico Public Regulation Commission	06-00192-UT	5/22/2006
dps.stat.ny.us/	New York Public Service Commission	06-W-0490	4/21/2006
puc.state.pa.us/	Pennsylvania	A-212285F0136	5/5/2006
sate.tn.us/tra/	Tennessee Regulatory Authority	06-00119	4/21/2006 ⁴
scc.virginia.gov/	State Corporation Commission of Virginia	PUE-2006-00057	4/21/2006
psc.state.wv.us/	West Virginia Public Service Commission	06-0597-W-PC	5/8/2006
Other States	Indiana/Iowa/Missouri/Ohio ⁵		

¹ The listing herein is without prejudice to the position that the Proposed Transaction may not be subject to the jurisdiction of certain state commissions.

² The Hawaii PUC issued a Decision and Order approving the Proposed Transaction on June 5, 2006.

³ The Maryland PSC issued a letter noting the Proposed Transaction on May 24, 2006.

⁴ The Tennessee Regulatory Authority approved the Proposed Transaction on June 26, 2006.

⁵ No filings in these or any other states.

1 local staffing, there will be no changes in Arizona-American's rates and charges for service, and
2 Arizona-American's capital structure will not change. Arizona-American's witness testified that
3 there will be no request to recover any acquisition premium or any other costs associated with the
4 proposed transaction, and that the proposed transaction will not cause any additional layer of
5 management overhead to be allocated to Arizona-American. In addition, Arizona-American asserts
6 that there will not be any cross-subsidization of any affiliates, and any transactions between Arizona-
7 American and any "affiliate," as such term is defined in A.A.C. R14-2-801, will continue to be
8 subject to the Affiliated Interests Rules and other regulatory requirements of the Commission.

9 Arizona-American believes that the proposed transaction is likely to generate benefits for
10 Arizona-American and its utility customers. Arizona-American states that in addition to potential
11 reductions in the cost of capital, Thames Water's extensive experience in managing water and
12 wastewater operations throughout the world, when combined with the existing expertise of American
13 Water Works' management, should enhance the quality of service provided to Arizona-American
14 utility customers. Arizona-American states in support of this assertion that Thames Water, which
15 manages water operations on six continents, has considerable experience in operating water systems
16 in regions where security has been a significant concern for decades, and that Thames Water has an
17 outstanding track record in terms of the quality of utility service it provides. Arizona-American
18 claims that American Water Works and its subsidiaries, including Arizona-American, will benefit by
19 becoming a part of an organization with significant expertise, greater access to capital, and greater
20 economies of scale.

21 **B. Conditions Proposed by Staff**

22 Staff has recommended approval of the transaction pursuant to A.A.C. R14-2-803, subject to
23 the following fifteen conditions:

- 24
- 25 #1 Arizona-American shall not seek recovery of any excess of cost over book value
paid pursuant to the reorganization at any time in the future from this Commission.
- 26 #2 Arizona-American shall not seek recovery of any costs associated with the
27 reorganization, including internal corporate costs, in any future Arizona rate
28 proceeding.

- 1 #3 Arizona-American and its affiliates shall provide their books and records, upon
2 request, in the Phoenix metropolitan area. Arizona-American and its affiliates
3 shall also provide access to their books and records where such documents are
4 maintained. *
- 5 #4 Arizona-American shall not adjust any existing account mounts as a result of the
6 reorganization. Arizona-American may make normal accounting adjustments that
7 would have occurred absent the reorganization.
- 8 #5 In future rate proceedings filed after the effective date of the reorganization,
9 Arizona-American shall have the burden of demonstrating that any cost overhead
10 allocations and direct charges resulting from the reorganization including, but not
11 limited to, the addition of layers of management, are reasonable and provide a net
12 benefit to Arizona-American and/or its customers.
- 13 #6 Arizona-American shall not allow the reorganization to diminish local (Arizona)
14 staffing that would result in service degradation.
- 15 #7 Arizona-American shall not allow its quality of service to diminish, the number of
16 service complaints should not increase, the response time to service complaints
17 should not increase, and service interruptions should not increase as a result of the
18 reorganization.
- 19 #8 Arizona-American shall continue to maintain its business headquarters in Arizona
20 and fully operational local (Arizona) field offices, as appropriate to maintain the
21 quality of its service.
- 22 #9 If Arizona-American ever plans to share with affiliates, or other entities, any
23 information made available to Arizona-American solely by virtue of the
24 company/customer relationship, such as billing information and services received
25 by a customer, it shall notify the Commission at least 180 days in advance. Such
26 notice shall, at a minimum, identify the intended use of the information. Arizona-
27 American shall also, at the time of the filing of the 180-day notice, file a tariff
28 setting forth appropriate customer notification procedures to inform customers
about the sharing.
- #10 If Arizona-American ever shares any customer information with affiliates, or other
entities, it shall maintain accurate records of revenues earned as a result and make
those records available to Staff upon request with ten days' notice. For the
purposes of this condition and Condition Nine above, customer information that is
prohibited from disclosure does not include a customer's name, address or service
location, and telephone number.
- #11 Arizona-American shall not use any utility plant or other property, that is used or
necessary for the provision of utility service, for any unregulated activity unless
Arizona-American maintains appropriate books and record of account detailing the
nature of such unregulated activity and providing appropriate allocations between

1 activities relating to Anzona-American's provision of utility service and the
 2 unregulated activity. Arizona-American's books and records concerning all
 3 unregulated activities shall be subject to the Commission's review and shall be
 4 made available in the Phoenix metropolitan area or, at the Commission's request,
 5 where the records are maintained, on ten days' notice.

6 #12 Arizona-American shall maintain a minimum common equity ratio of 35 percent
 7 of total capital. Arizona-American's total capital is defined as common equity,
 8 preferred equity, and long-term debt. Arizona-American shall not make
 9 remittances or pay dividends to American Water Works unless Arizona-
 10 American's common equity is at least 35 percent of total capital. If Arizona-
 11 American's common equity falls to 30 percent of total capital, American Water
 12 Works shall provide a cash infusion of equity sufficient to bring Arizona-
 13 American's common equity ratio back to a minimum of 35 percent of total capital.
 14 Arizona-American shall not be prohibited from requesting that the foregoing
 15 equity percentages be decreased based on changes to capital markets or other
 16 conditions that make it prudent to alter Arizona-American's capital structure.

17 #13 The cost of debt issued after the closing date of the reorganization, for purposes of
 18 setting rates in Arizona-American's rate proceedings, filed within ten years from
 19 the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baal
 20 (Moody's) or higher.

21 #14 Arizona-American and its affiliates agree that in future Commission proceedings,
 22 they shall not seek a higher cost of capital than that which Anzona-American
 23 would have been authorized as a stand-alone entity. Specifically, no capital
 24 financing costs (either debt or equity) should increase by virtue of the
 25 reorganization.

26 #15 Arizona-American shall refrain from filing any non-emergency rate increase
 27 requests for one year from the closing date of the reorganization; however,
 28 Arizona-American may file rate increase requests prior to the reorganization's
 closing date, and any such requests shall not be subject to the conditions set forth
 herein.

29 C. Conditions in Dispute

30 Arizona-American and Staff both stated at the hearing that the fifteen conditions
 31 recommended by Staff, that are set forth above, are the result of attempts by Arizona-American and
 32 Staff to resolve the parties' differences regarding the necessity of conditions on Commission approval
 33 of the proposed transaction. The parties are not in complete agreement on the language of Staffs
 34 recommended Conditions Five and Eight, and are in substantial disagreement on the substance of
 35 Conditions Three and Thirteen. Arizona-American believes that Staffs recommended Conditions
 36 Three and Thirteen are unnecessary.