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MEMORANDUM

2006 OCT 27 P 1:21

AZ CORP COMMISSION
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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: October 27, 2006

RE: STAFF REPORT FOR ARIZONA-AMERICAN WATER COMPANY, INC. REVISED APPLICATION FOR APPROVALS ASSOCIATED WITH A PROPOSED TRANSACTION WITH MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE TO ALLOW THE CONSTRUCTION OF A SURFACE WATER TREATMENT FACILITY DOCKET NO. W-01303A-05-0718

Attached is the Staff Report for the Arizona-American Water Company, Inc. ("Company") revised application for approvals associated with a proposed White Tanks surface water treatment facility. The Company requests approval of an adjustment to its existing water facilities hook-up fee and an accounting order related to its construction of a water treatment facility. Staff recommends approval of its hook-up fee and accounting order.

Also enclosed as Attachment 1 is Staff's Recommended Order.

EGJ:JJD:red

Originator: James J. Dorf

Attachment: Original and sixteen copies

Arizona Corporation Commission
DOCKETED
OCT 27 2006

DOCKETED BY	

Service List for: Arizona-American Water Company, Inc.
Docket No. W-01303A-05-0718

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. W-01303A-05-0718

ARIZONA-AMERICAN WATER COMPANY, INC. REVISED APPLICATION FOR APPROVALS ASSOCIATED WITH A PROPOSED TRANSACTION WITH MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE TO ALLOW THE CONSTRUCTION OF A SURFACE WATER TREATMENT FACILITY

OCTOBER 27, 2006

(W-01303A-05-0718)

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona-American Water Company, Inc. ("Company"), Docket No. W-01303A-05-0718, was the responsibility of the Staff members listed below. James J. Dorf was responsible for the review and analysis of the Company's application. Jian Liu was responsible for the engineering and technical analysis.

James J. Dorf
Chief Accountant

Jian Liu
Staff Engineer

EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY, INC.
DOCKET NO. W-01303A-05-0718

Arizona-American Water Company ("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 100,000 water customers and 50,000 wastewater customers. The Company is the largest investor-owned water and wastewater utility in Arizona.

The Company previously requested certain approvals associated with a proposed transaction with Maricopa County Municipal Water Conservation District Number One ("MWD"). The Company and MWD had executed a Memorandum of Understanding ("MOU") that outlined the framework under which MWD would finance, build, and own a White Tanks surface water treatment facility. The facility would treat Central Arizona Project ("CAP") surface water for three or more entities, one of which is the Company.

On September 1, 2006, the Company revised its application and requested approval of an adjustment to its existing water facility hook-up fee ("WFHUF") and an accounting order related to its construction of a water treatment plant and a Commission Order that the Company make certain associated filings as part of its previously ordered 2008 rate case filing for its Agua Fria District.

Staff recommends approval of its WFHUF of $3,280 for a 5/8 x ¾ inch meter and graduated for other meter sizes as indicated on Schedule JJD-1.

In recognition of the potential public benefits in developing a regional water treatment facility that utilizes CAP and other surface water supplies, Staff further also recommends approval of an accounting order that permits the Company to record post-in service allowance for funds used in construction on the unfunded balance, if any, associated with the White Tanks treatment facilities.

Also in recognition of the potential public benefits, Staff further recommends that any cumulative over collections of WFHUFs will not be considered contributions until the corresponding eligible plant enters service.

Staff recommends that the Company be required, in its 2008 rate case, to include an update of the assumptions used to develop the WFHUFs in order for the Commission to make any necessary adjustments to the hook-up fee amounts.

Staff further recommends that the Company prepare continuing evaluations of the WFHUF in any subsequent rate application to determine if the WFHUFs are appropriate.

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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 100,000 water customers and 50,000 wastewater customers. The Company is Arizona's largest investor owned water and wastewater utility.

The Company previously requested certain approvals associated with a proposed transaction with Maricopa County Municipal Water Conservation District Number One ("MWD"). The Company and MWD had executed a Memorandum of Understanding ("MOU") that outlines the framework under which MWD would finance, build, and own a White Tanks surface water treatment facility. The facility will treat Central Arizona Project ("CAP") surface water.

However, circumstances have changed and MWD no longer wishes to finance, build, and own the White Tanks Plant. Most of the approvals originally requested are no longer needed.

Arizona-American can construct, own and operate the White Tanks Plant. However, the Company asserts that it cannot do so using conventional rate making treatment. The Company's revised application indicates that its "current financial situation will not allow it to attract the funds needed for a project of this size."

Arizona-American's Revised Application

The Company is proposing to significantly increase its current hook-up fee tariff charged for new connections in its Agua Fria District. The treated surface water will be used by the Company to serve its Agua Fria Water District which is located in the West Phoenix suburbs (north of I-10, between the White Tank Mountains and the 101 Expressway). The Company's Agua Fria Water District currently has approximately 30,000 customers and is adding about 3,500 new water customers each year.

The Company is also requesting an accounting order to permit a post-in-service allowance for funds used in construction ("AFUDC") on the unfunded balance of the treatment plant. Additionally, the accounting order should provide that collected hook-up fees will not be considered to be contributions until some corresponding eligible plant enters service.

Project Overview

The plant will be located at Cactus and Perryville Roads, will be constructed in phases, and is capable of expanding its capacity to treat up to 80 million gallons per day ("mgd"). The plant may ultimately treat water for other municipal and private water companies in the region.

Although the initial phase would treat approximately 6.7 mgd, the Company is proposing to construct a plant which can treat 13.4 mgd. The Company estimates that it will cost $64,815,000 for a treatment plant to process 6.7 mgd. However, by adding one additional treatment train, the plant could treat a total of 13.4 mgd with an estimated cost increase of $2,510,000. Given the relative small cost difference for twice the treatment capacity, the Company asserts that it would not be prudent to initially build the smaller plant capacity and then add the additional treatment train later. The Company also points out that the operating and maintenance costs will be the same until such time as the additional capacity is actually utilized.

Other entities have approached the Company concerning the purchase of treatment services at the plant. If additional capacity is immediately available, this will make the treatment plant more attractive to other purchasers. In turn, third-party purchasers would reduce the future revenue requirement or hook-up fees paid by Agua Fria customers to recover the cost of the treatment facility.

Three additional phases of 20 mgd each can eventually be added, for a total treatment capacity of 80 mgd at the current facility site. The Company estimates that at full capacity the plant can service approximately 160,000 customers.

The Company has a Central Arizona Project ("CAP") allocation of 11,093 acre-feet per year, which will require treatment before it can be delivered to its Agua Fria District. In addition, the Company has an agreement with MWD whereby MWD will provide Agua Fria River Water it now controls. MWD will provide an additional 21,000 acre-feet available for treatment and delivery at build out of the treatment facility.

Project Benefits

The Company proposes that the project is in the public interest by providing the following benefits to the White Tanks region:

1. The transaction will make it possible to construct a regional surface water treatment facility that can satisfy the demands of it rapidly growing Agua Fria District.

2. A regional treatment plant utilized by several water providers is a least cost solution for treating CAP water.

3. The Company can utilize its CAP allocation.

4. The transaction will also preserve groundwater resources throughout the Company's Agua Fria District.

5. The proposed hook-up fees will minimize rate increases to customers.

Project Schedule

The Company anticipates that additional water production will be needed by the summer of 2009 and that construction will take approximately 24 months. An abbreviated schedule of significant milestones follows:

1. Commission approval in the fourth quarter of 2006.
2. Requests for proposals for the construction contract in the fourth quarter of 2006.
3. Construction begins in the second quarter of 2007.
4. Construction completed by the second quarter of 2009.

Requested Approvals

The Company is requesting Commission approval of either Option 1 or Option 2 of the proposed increases in its current hook-up fee tariff and approval of an accounting order related to the recovery of the treatment plant operating and maintenance costs.

The Company is currently collecting hook-up fees in the Agua Fria District. The Water Facilities Hook-up Fee is $1,150 for a 5/8 x ¾ inch meter and intended to offset the costs of new water facilities needed to serve new customers. The amount is graduated for larger meters. See Schedule JJD-1. The funds collected are treated as contributions in aid of construction ("CIAC") and are non-refundable.

The Company indicated that its hook-up fee is substantially less than that charged in other areas in Maricopa County. For example, the City of Peoria's current water hook-up fee for ¾ and one inch meters is $3,497.

The Company has estimated its construction expenditures for back-bone plant (including the cost of the 13.5 mgd water treatment facility) will total $132.9 million through 2012.

Option 1

The Company proposes to increase the hook-up fee to the same level as that charged in its Anthem District and would start at $3,000 for the 5/8 x ¾ inch meter. The fee would also be graduated for larger meters. See Schedule JJD-1.

The Company estimates that this level of hook-up fee will collect approximately $70.8 million through the end of 2009, when the treatment plant will be completed, versus cumulative construction cost of $104.4 million for the same time period.

Option 2

The Company proposes an increase in the hook-up fee to $4,700 for the 5/8 x ¾ inch meter. At this level, the Company estimates that it would recover a total of $103.9 million through the end of 2009 versus the cumulative construction expenditures of $104.4 million.

However, continuation through 2012 of this level of hook-up fee would result in cumulative hook-up fees of $184.9 million versus cumulative capital expenditures of $132.9 million.

Staff Analysis

Water Facilities Hook-up Fee ("WFHUF")

Staff has evaluated the Company's proposed hook-up fee based upon total cumulative construction expenditures through 2012 totaling $132.9 million (which includes the White Tanks Treatment Plant) and determined that the service capacity of the treatment plant and other back-bone plant support an increase of the current hook-up fee. Staff also notes that based on the Company's customer increase estimates, a $4,700 hook-up fee will result in collections exceeding cumulative construction expenditures starting in 2010. See Schedule JJD-1, line 4.

In order to more closely align hook-up fee collections with construction expenditures through 2012, Staff recommends a graduated hook-up starting at $3,280. This will produce cumulative collection of $132.8 million versus $132.9 in cumulative construction costs. See Schedule JJD-1, line 5, and JJD-2.

Therefore, Staff recommends that Company's existing non-refundable water facilities hook-up fee be increased from $1,150 to $3,280 and continue to be used for funding facilities as described in the Company's current tariff. The current tariff includes water treatment plant as an eligible facility expenditure.

At this level of hook-up fee, the Company will collect a total of $76.3 million in hook-up fees through 2009 versus construction expenditures of $104.4 million. Staff addresses this disparity in establishing an accounting order below.

Possible Remedial Actions

Each of the Company's proposed and Staff recommended hook-up fees are the result of numerous assumptions. There could be many inaccurate assumptions such as customer growth rates and meter size, new third party contracts, inflation, construction costs increases, etc. The Company has indicated that when it files its 2008 rate case for Agua Fria using a 2007 test period, it agrees to update its assumptions and propose adjustments to the hook-up fee as appropriate.

Staff also recommends that the hook-up fee collections and expenditures continue to be monitored in each of the Company's subsequent Agua Fria rate cases to determine if intergenerational disparities exist. Staff recommends that the Company provide a reevaluation of the appropriateness of its WFHUF in its 2008 and subsequent rate cases.

Financial Effects

Staff recently completed an evaluation of the Company's request to secure new debt financing to replace maturing obligations and fund new capital projects.[1] The Company's capital structure as of December 31, 2005, is summarized on Exhibit A and indicates that the Company's pro forma total capital is $371.2 million, including $126.9 million of equity (34.2 percent ratio).

The Company has also submitted an equity improvement plan which includes its estimate of exceeding an equity ratio of 40 percent by December 31, 2010.[2]

The Company asserts that approval of the proposed Option 1 or Option 2 hook-up fees will not have an effect on its capital structure, at least through 2012 in the case of Option 1 and 2009 in the case of Option 2. At the end of each of those years, the cumulative hook-up fees meet or are close to exceeding cumulative construction expenditures. Once the hook-up fees exceed construction expenditures, the Company's rate base will begin to decline significantly and ultimately erode the capital structure.

The Company also indicates that if the accounting order, as proposed, is not approved, plant operating expenses may not be timely recovered and will erode both earnings and ultimately its capital structure. Therefore, the Company states that it will request, in its 2008 rate case, a surcharge mechanism approved to recover such costs as discussed below.

Accounting Order

The Company requests an accounting order that addresses two issues. First, the Company requests the ability to accrue post-in-service allowance for funds used during construction on any unfunded balance of the White Tank Plant. This will allow the Company to be made whole on its investment until the hook-up fees are sufficient to fund the plant.

Second, should cumulative collected hook-up fees exceed cumulative related construction expenditures, the collected hook-up fees should not be considered to be contributions until some corresponding eligible plant enters service.

An accounting order is the rate-making mechanism whereby the Commission provides specific authorization, as permitted under the National Association of Regulatory Utility

[1] Docket No. W-01303A-06-0283.
[2] Docket Nos. W-01303A-05-0280, WS-01303A-02-0867 & W-01303A-02-0869.

Commissioners' ("NARUC") Uniform System of Accounts ("USoA"), to treat costs in a manner that is different than under generally accepted accounting principles. The purpose of any authorized accounting order would be to allow the Company to record an allowance for funds used during construction on its in-service White Tank water treatment facility for future consideration by the Commission to authorize possible recovery, not guarantee future recovery.

Staff acknowledges this unique opportunity to develop a regional water treatment that will utilize significant quantities of surface water. The project can also achieve significant economies of scale as it approaches full build out. This will not only benefit the Company's Aqua Fria District customers, but also other potential customers throughout the White Tanks area.

It is also prudent to immediately size the project to accommodate the Company's and third party growth opportunities. Because of these factors, Staff recommends approval of an accounting order to permit recovery of post-in-service plant AFUDC as an appropriate regulatory tool to prevent possible financial harm to the Company. Therefore, to the extent the Company has cumulative construction expenditures that exceed cumulative hook-up fee collections, the Company is allowed to record post-in-service AFUDC related to the White Tanks water treatment facilities.

Staff also recommends as part of its accounting order that all funds collected be deposited into a separate interest bearing bank account and interest earned on any cumulative hook-up fee collections in excess of cumulative construction expenditures be retained in said account.

With respect to any operating and maintenance costs associated with the treatment facilities, the Company plans to propose a mechanism, similar to the Commission's arsenic cost recovery mechanism procedure, in its 2008 rate filing. Staff will review and evaluate the proposed mechanism at that time.

Engineering Analysis

Staff has reviewed the application and concluded that the estimated capital expenditures are reasonable. However, no "used and useful" determination of the proposed project has been made. See attached Engineering Report.

Staff Recommendations

Staff recommends approval of its WFHUF of $3,280 for a 5/8 x ¾ inch meter and graduated for other meter sizes as indicated on Schedule JJD-1.

In recognition of the potential public benefits in developing a regional water treatment facility that utilizes CAP and other surface water supplies, Staff further recommends approval of an accounting order that permits the Company to record post-in-service AFUDC on the unfunded balance, if any, associated with the White Tanks treatment facilities.

Also in recognition of the potential public benefits, Staff further recommends that any cumulative over collections of WFHUF will not be considered contributions until the corresponding eligible plant enters service.

Staff recommends that the Company be required, in its 2008 rate case, to include an update of the assumptions used to develop the WFHUFs.

Staff further recommends that the Company prepare continuing evaluations of the WFHUF in any subsequent rate application to determine if the WFHUFs are appropriate.

Staff further recommends that the Company be required to submit a calendar year status report each January 31st to Docket Control, as a compliance item in this case, beginning January 31, 2008, until the WFHUF Tariff is no longer in effect. This report should contain a list of all customers that have paid the WFHUF Tariff, the amount each has paid, the amount of money spent from the account, the amount of interest earned on the WFHUF Tariff account, and a list of all facilities that have been installed with the WFHUF Tariff funds.

Arizona-America Water Company, Inc.
Docket No. W-01303A-05-0718
In Thousands

Schedule JJD-1

SUMMARY OF PROJECTED CAPITAL EXPENDITURES AND HOOK-UP FEES

Line No.		2005	2006	2007	2008	2009	2010	2011	2012
	CAPITAL EXPENDITURES								
1	Cummulative Capital Expenditures*	15,853	18,685	38,822	74,990	104,397	109,922	114,700	132,893
2									
3	**HOOK-UP FEES**								
4	Existing Cummulative HUF	3,988	12,397	19,905	27,468	34,794	42,000	48,151	54,611
5	Cummulative Option 1 HUF	3,988	12,397	31,983	51,712	70,824	89,620	105,667	122,520
6	Cummulative Option 2 HUF	3,988	12,397	43,081	73,991	103,932	133,380	158,520	184,923
7	**Staff Cummulative HUF**	3,988	12,397	33,810	55,382	***76,277***	96,828	114,373	***132,803***
8	Cummulative White Tank Treatment Plant					67,325			67,325
9	Cummulative Other Back-bone Plant					37,072			65,568
						104,397			***132,893***

PROPOSED HOOK-UP FEES

Line No.	Meter Size	Existing WFHUF	Company Proposed Option 1	Company Proposed Option 2	Staff Proposed
10	5/8 x 3/4 Inch	$1,150	$3,000	$4,700	$3,280
11	3/4 Inch	$1,725	$4,500	$7,050	$4,920
12	1 Inch	$2,875	$7,500	$11,750	$8,200
13	1.5 Inch	$5,750	$15,000	$23,500	$16,400
14	2 Inch	$9,200	$24,000	$37,600	$26,240
15	3 Inch	$18,400	$48,000	$75,200	$52,480
16	4 inch	$28,750	$75,000	$117,500	$82,000
17	6 inch or higher	$57,500	$150,000	$235,000	$164,000

Arizona-American Water Company. Inc.
Docket No. W01303A-05-0718

Schedule JJD-2

CUMULATIVE HOOK-UP FEE COLLECTIONS - STAFF RECOMMENDED

Meter	Factor	2005	2006	2007	2008	2009	2010	2011	2012
5/8"	1.0			706	711	689	677	579	607
3/4"	1.5			1508	1518	1471	1446	1235	1297
1"	2.5			1157	1165	1128	1109	947	995
1.5"	5.0			36	36	35	35	30	31
2"	8.0			61	62	60	59	50	53
5/8"	3,280			2,315,680	2,332,080	2,259,920	2,220,560	1,899,120	1,990,960
3/4"	4,920			7,419,360	7,468,560	7,237,320	7,114,320	6,076,200	6,381,240
1.5"	8,200			9,487,400	9,553,000	9,249,600	9,093,800	7,765,400	8,159,000
1"	16,400			590,400	590,400	574,000	574,000	492,000	508,400
2"	26,240			1,600,640	1,626,880	1,574,400	1,548,160	1,312,000	1,390,720
	Year	3,988,010	8,409,375	21,413,480	21,570,920	20,895,240	20,550,840	17,544,720	18,430,320
	Cumulative		12,397,385	33,810,865	55,381,785	76,277,025	96,827,865	114,372,585	132,802,905

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR APPROVALS ASSOCIATED WITH A PROPOSED TRANSACTION WITH MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE TO ALLOW THE CONSTRUCTION OF A SURFACE WATER TREATMENT FACILITY KNOWN AS THE WHITE TANKS PROJECT	DOCKET NO. W-01303A-05-0718 DECISION NO. __________ ORDER

BY THE COMMISSION:

FINDINGS OF FACT

1. On October 11, 2005, Arizona-American Water Company, Inc. ("Arizona-American" or "Company") filed the above-captioned application.

2. The Company's application requested Commission approval of several actions related to a proposed joint project with Maricopa County Municipal Water Conservation District Number One ("MWD") to build a surface water treatment facility known as the White Tanks Regional Water Treatment Facility. The facility would initially serve the Company's customers in its Agua Fria District.

3. The Company provides 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 presently serves approximately 100,000 water and 50,000 wastewater customers in Arizona and is Arizona's largest investor owned utility.

4. The Company's Agua Fria District is located in the rapidly developing western Phoenix suburbs, generally between the White Tank Mountains and the 101 Expressway. The Company currently serves 30,000 water customers and is adding approximately 3,500 new water customers per

year.

5. The initial application indicated that the Company and MWD had entered into a Memorandum of Understanding ("MOU") under which the treatment plant was to be financed, built and owned by MWD. The Company was to obtain treatment services under a long-term capital lease with MWD and the Company was to operate the facility under a Operation and Maintenance Agreement with MWD.

6. The application proposed to increase certain water facility hook-up fees ("WFHUF"), requested authorization to sell certain assets of the Company to MWD, requested authorization to incur debt in the form of a capital lease, and various other regulatory approvals.

7. By Procedural Order issued on December 19, 2005, a procedural schedule was set for the processing of the application, which included a hearing, public notice requirements, and intervention deadlines.

8. Intervention was granted to the Residential Utility Consumer Office ("RUCO") by Procedural Order issued January 10, 2006.

9. On January 23, the Company filed a Confirmation of Mailing and Affidavit of Publication indicating that public notice of the application was accomplished in accordance with the requirements set forth in the December 19, 2005, Procedural Order.

10. On February 10, 2006, Commission Staff filed a Staff Report in this case.

11. By Procedural Order issued March 2, 2006, the Company's request that the procedural schedule be suspended in the matter was granted.

12. On September 1, 2006, the Company filed a Revised Application in this docket, in which the Company stated that it believes no evidentiary hearing is required to process the Revised Application.

13. The Revised Application requests, for its Agua Fria District, relief in the form of an adjustment to its existing WFHUFs for new home construction, an Accounting Order, and a Commission Order that the Company make certain associated filings as part of its previously-ordered 2008 rate case filing for its Agua Fria District.

14. The Company has estimated that its back-bone plant construction expenditures (related to

its existing WFHUF) will approximate \$65.6 million and the cost to construct the treatment facility (scheduled for completion in 2009) at a cost of \$67.3 million will result in total construction cost of \$132.9 million through the end of 2012. Construction expenditures through 2009 will total approximately \$104.4 million.

15. The Company proposed two options regarding the increase in its WFHUF. Option 1 proposes a \$3,000 per residential unit, 5/8 x ¾ inch meter and graduated for larger meter sizes. The Company estimates that this will result in WFHUF collections of \$122.5 through 2012.

16. Option 2 proposes a \$4,700 per residential unit, 5/8 x ¾ inch meter and graduated for larger meter sizes. The Company estimates that this will result in WFHUF collections of \$132.8 through 2012.

17. The Company requests an accounting order that addresses two issues:

a) First, the Company requests the ability to accrue post-in-service allowance for funds used during construction on any unfunded balance of the White Tank Plant. This will allow the Company to be made whole on its investment until the hook-up fees are sufficient to fund the plant.
b) Second, should cumulative collected hook-up fees exceed cumulative related construction expenditures, the collected hook-up fees should not be considered to be contributions until some corresponding eligible plant enters service.

18. On September 14, a Telephonic Procedural Conference was held for the purpose of discussing the appropriate process for a Commission determination in this docket. The Company, RUCO and Staff attended.

19. On September 25, Staff filed a Joint Request for a Procedural Order ("Joint Request"), which stated that the parties do not believe that an evidentiary hearing is necessary. The Joint Request proposed that Staff file a Staff Report and Staff Recommended Order by October 27, 2006, and that the Company and RUCO file their responses to the filing by November 6, 2006. The Joint Request also recommends that if the responses demonstrate that there are issues in dispute, the Hearing Division would prepare a Recommended Opinion and Order. Regarding the possible need for an evidentiary hearing, the Joint Request included a recommendation that a procedural conference be held if it appears that there is such a need. The Joint Request asked that a Procedural Order be issued adopting its recommendations.

20. On October 5, 2006, a Procedural Order was issued that adopted the Joint Request party's request as being reasonable.

21. On October 23, 2006, Pulte Home Corporation ("Pulte"), through its counsel, applied for an order granting it leave to intervene in these proceedings. Pulte owns several development properties in the Agua Fria District and currently has 1,800 lots under development. Pulte asserts that it will be directly and substantially affected by the proposed hook-up fee. Pulte requests the opportunity to provide evidence supporting Arizona-Americans lower hook-up fee options.

22. On October 27, 2006, Staff filed its Staff Report and included the following recommendations:

a) Staff recommends approval of its WFHUF of $3,280 for a 5/8 x ¾ inch meter and graduated for other meter sizes as indicated on Exhibit A. This would result in WFHUF collections of approximately $76.3 million through 2009 versus $104.4 in construction expenditures and through 2012 it will collect a total of $132.8 million versus cumulative construction expenditures of $132.9 million.

b) In recognition of the potential public benefits in developing a regional water treatment facility that utilizes CAP and other surface water supplies, Staff further recommends approval of an accounting order that permits the Company to record post-in service allowance for funds used in construction on the unfunded balance, if any, associated with the White Tanks treatment facilities.

c) Also in recognition of the potential public benefits, Staff further recommends that any cumulative over collections of WFHUFs will not be considered contributions until the corresponding eligible plant enters service.

d) Staff recommends that the Company be required, in its 2008 rate case, to include an update of the assumptions used to develop the WFHUFs and propose, if necessary, adjustments to the hook-up fee amounts.

e) Staff further recommends that the Company prepare continuing evaluations of the WFHUFs in any subsequent rate application to determine if the WFHUFs are appropriate.

f) Staff further recommends that the Company be required to submit a calendar year status report each January 31st to Docket Control, as a compliance item in this case, beginning January 31, 2008, until the WFHUF Tariff is no longer in effect. This report should contain a list of all customers that have paid the WFHUF Tariff, the amount each has paid, the amount of money spent from the account, the amount of interest earned on the WFHUF Tariff account, and a list of all facilities that have been installed with the WFHUF Tariff funds.

CONCLUSIONS OF LAW

1. The Company is a public service corporation within the meaning of Article 15 of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

2. The Commission has jurisdiction over the Company and over the subject matter of the application.

3. The Commission having reviewed the application and Staff's Report of October 27, 2006, concludes that Staff's recommendations are reasonable, in the public interest, and should be adopted.

4. The Company will adopt Staff's recommended WFHUF as depicted on Exhibit A attached hereto.

5. In recognition of the potential public benefits in developing a regional water treatment facility that utilizes CAP and other surface water supplies, the Commission approves an accounting order that permits the Company to record post-in service allowance for funds used in construction on the unfunded balance, if any, associated with the White Tanks treatment facilities.

6. Also in recognition of the potential public benefits, the Commission approves an accounting order that allows for any cumulative over collections of WFHUFs as not being considered contributions until the corresponding eligible plant enters service.

7. The Commission requires that the Company, in its 2008 rate case, shall include an update of the assumptions used to develop the WFHUFs and propose, if necessary, adjustments to the hook-up fee amounts.

8. The Commission requires that the Company prepare continuing evaluations of the WFHUFs in any subsequent rate application to determine if the WFHUFs continue to be appropriate.

ORDER

IT IS THEREFORE ORDERED that the Company will adopt Staff's recommended WFHUF as depicted on Exhibit A attached hereto and file a conforming tariff in Docket Control within 30 days of this Order as a compliance item.

IT IS FURTHER ORDERED that the Commission approves an accounting order that permits the Company to record post-in service allowance for funds used in construction on the unfunded balance, if any, associated with the White Tanks treatment facilities.

IT IS FURTHER ORDERED that the Commission approves an accounting order that allows for any cumulative over collections of WFHUFs as not being considered contributions until the corresponding eligible plant enters service.

IT IS FURTHER ORDERED that the Company be required, in its 2008 rate case, to include an update of the assumptions used to develop the WFHUFs and propose adjustments to the hook-up fee amounts.

IT IS FURTHER ORDERED that the Company prepare continuing evaluations of the WFHUFs in any subsequent rate application to determine if the WFHUFs continue to be appropriate.

IT IS FURTHER ORDERED that the Company be required to submit a calendar year status report each January 31st to Docket Control, as a compliance item in this case, beginning January 31, 2008, until the WFHUF Tariff is no longer in effect. This report should contain a list of all customers that have paid the WFHUF Tariff, the amount each has paid, the amount of money spent from the account, the amount of interest earned on the WFHUF Tariff account, and a list of all facilities that have been installed with the WFHUF Tariff funds.

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IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER COMMISSIONER

COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______ day of ______________, 2006.

____

BRIAN C. McNEIL
Executive Secretary

DISSENT: ___________________________

DISSENT: ___________________________

EGJ:JJD:red/KL

SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY, INC.
DOCKET NO. W-01303A-05-0718

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Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arizona-America Water Company, Inc.
Docket No. W-01303A-05-0718

EXHIBIT A

PROPOSED HOOK-UP FEES

Meter Size	Existing WFHUF	Company Proposed Option 1	Company Proposed Option 2	Staff Proposed
5/8 x 3/4 Inch	$1,150	$3,000	$4,700	$3,280
3/4 Inch	$1,725	$4,500	$7,050	$4,920
1 Inch	$2,875	$7,500	$11,750	$8,200
1.5 Inch	$5,750	$15,000	$23,500	$16,400
2 Inch	$9,200	$24,000	$37,600	$26,240
3 Inch	$18,400	$48,000	$75,200	$52,480
4 inch	$28,750	$75,000	$117,500	$82,000
6 inch or higher	$57,500	$150,000	$235,000	$164,000

Arizona-American Water Company
Docket No. WS-01303A-06-0283
Application For Financing

Schedule PMC-1

FINANCIAL ANALYSIS

2005 Income Statement, Capital Structure and Pro Forma
Including Immediate Effects of the Proposed Debt

		[A] *12/31/2005*		[B] *Pro Forma*	
1	Operating Income	$ 6,906,330		$ 6,906,330	
2	Depreciation & Amort.	14,695,302		14,695,302	
3	Income Tax Expense	(1,898,318)		(1,898,318)	
4					
5	Interest Expense	9,576,937		10,844,061	
6	Repayment of Principal	14,857		14,857	
7					
8					
9	**TIER**				
10	[1+3] ÷ [5]	0.52		0.46	
11	**DSC**				
12	[1+2+3] ÷ [5+6]	2.05		1.81	
13	**Cash Coverage Ratio**				
14	[1+2+3] ÷ [5]	2.06		1.82	
15					
16					
17					
18	Short-term Debt	$30,017,995	8.5%	$30,017,995	8.1%
19					
20	Long-term Debt	$207,317,395	58.6%	$214,317,395	57.7%
21					
22	Common Equity	$116,249,739	32.9%	$126,884,955	34.2%
23					
24	Total Capital	$353,585,129	100.0%	$371,220,345	100.0%
25					
26	[A]: Based on 2005 financial statements.				
27	[B]: Column [A] inclusive of the proposed financing.				

MEMORANDUM

DATE: October 24, 2006

TO: James Dorf
Chief Accountant
Utilities Division

FROM: Jian W. Liu
Utilities Engineer
Utilities Division

RE: Arizona–American Water Company
Docket No. W-01303A-05-0718 (White Tanks Hook-up Fees)

Introduction

Arizona–American Water Company ("Arizona–American" or "Company") presently provides utility service to approximately 100,000 water customers and 50,000 sewer customers in Arizona. The Company's Agua Fria District is located in the rapidly developing western Phoenix suburbs, where Arizona–American currently has about 30,000 water customers and is adding approximately 3,500 new water customers per year.

Revised Application

The Company now projects that the White Tanks Plant will be needed in May 2009 to meet customer demands expected for that summer. The White Tanks Plant is designed to be constructed in phases. The capacity of the Phase I(a) plant is 13.4 million gallons per day ("MGD") and is expandable to 20 MGD with the addition of one more treatment-unit train. Three additional phases (20 MGD each) can eventually be added for a total treatment capacity of 80 MGD.

Staff's Hook-up Fee Calculation

The revised application summarizes the latest cost estimates for the White Tanks Plant. For a 13.4 MGD plant the estimated cost is approximately $67,325,000. Arizona–American has estimated that total capital expenditures related to the treatment plant would be $132.89 million through 2012. The 13.4 MGD plant can serve 27,917 potential units assuming 480 gpd per dwelling unit.

Conclusion

Staff has reviewed the list of plant items and costs that comprise the totals above and concludes that the plant additions are appropriate and their estimated construction costs reasonable. However, no "used and useful" determination of the proposed plant was made, and no particular future treatment should be inferred for rate making or rate base purposes.