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March 29, 2007

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Commissioner Mike Gleason, Chairman
Commissioner William A. Mundell
Commissioner Jeff Hatch-Miller
Commissioner Kristin K. Mayes
Commissioner Gary Pierce
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007-2996

Arizona Corporation Commission
DOCKETED
APR 10 2007
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Re: Docket Nos. W-01303A-05-0405
W-01303A-05-0910

Dear Commissioners:

Thank you for allowing us, the general managers of the Sanctuary on Camelback Mountain, the Camelback Inn and the Scottsdale Renaissance (collectively, the "Resorts"), the opportunity to express our serious concerns at the Open Meeting held March 14, 2007. We wanted to alert you to the rate shock that has occurred as a result of the recent implementation of various surcharges by Arizona American Water Company ("AAWC") and the deleterious financial impact of the rate shock on the Resorts. We reiterate that the Resorts do not oppose the concept of an equitably applied Public Safety Surcharge ("PSS") to pay for increased fire flow, an Arsenic Cost Recovery Mechanism ("ACRM") surcharge to pay for infrastructure to achieve compliance with the new federal arsenic standard, or conservation tiered rates to promote water conservation. However, we take issue with the way the HUS and PSS are being applied to the Resorts as we believe the second tier, which is set at 400,000 gallons, arbitrarily penalizes and unfairly impacts resorts by establishing a "conservation" surcharge at a threshold limit that does not take into consideration the unique water use characteristics of a large resort and applies standards that are more appropriate for conventional commercial customers, thereby failing to achieve the intended conservation goals.

We would like to follow up with a summary of this impact and offer our assistance in any way possible to resolve what we perceive as an unintended and inequitable result.

Impact of Rate Increase

We prepared and attach a chart titled Paradise Valley Water District Tier 2 Commercial Rate: Dollars per 1,000 Gallons,[1] that depicts the increase in the commodity rate for commercial customers from $1.46 to $5.17, or 254%. The tier 2 rate is the primary source of the rate shock.

In addition, we have included additional charts below that summarize the deleterious impact that the new rates will have on the Resorts, primarily through the HUS and the impending PSS.

The Sanctuary faces a 234% increase in rates, or an additional $154,905 per year in its water costs, which breaks down as follows:

Effect of New Rates on the Sanctuary		
Source	$ Annual Increase	% of Total Increase
Base Rate	$4,784	7%
High Usage Surcharge	$85,140	129%
Public Safety Surcharge	$39,600	60%
ACRM Step 1	$25,381	38%
Total:	**$154,905**	**234%**

The Camelback Inn faces a 221% increase in rates, or an additional $221,173 per year in its water costs, which breaks down as follows:

[1] Chart is attached as Exhibit A.

Effect of New Rates on the Camelback Inn		
Source	$ Annual Increase	% of Total Increase
Base Rate	$7,400	7%
High Usage Surcharge	$118,783	119%
Public Safety Surcharge	$55,248	55%
ACRM Step 1	$39,742	40%
Total:	**$221,173**	**221%**

The Scottsdale Renaissance faces a 191% increase in rates or an additional $106,601 per year in its water costs, which breaks down as follows:

Effect of New Rates on the Renaissance Scottsdale Resort		
Source	$ Annual Increase	% of Total Increase
Base Rate	$4,274	8%
High Usage Surcharge	$54,309	97%
Public Safety Surcharge	$25,260	45%
ACRM Step 1	$22,758	41%
Total:	**$106,601**	**191%**

The Resorts do not believe they received adequate notice.

In relying upon the discussions held at the Open Meeting, we believe that the Commission shares our concern that the notice was inadequate. Based upon our reading of the Notice, which specifically mentioned a 9% increase in rates, we did not anticipate a doubling of our current rates. If the Resorts were aware that a potential 190-234% rate increase was possible, we would have certainly intervened in this matter.

Original Public Notice[2]

The official Public Notice (Notice) in this case read in relevant part:

> **The Company's request would increase average 5/8-inch and 3/4-inch residential customers' base rates by approximately 9 percent.** The Company is also seeking the Commission's approval of: a public safety surcharge for investments by the Company related to improvement of fire flow facilities; an arsenic cost recovery mechanism for investments required by the Company to comply with federal water arsenic reduction requirements; and approval of a conservation surcharge that would be imposed for usage in the highest consumption block. The actual amount of the Company's proposed rate increase varies depending on the customer's usage and the zone in which the customer is located. (emphasis added).

The Notice stated that the rate increase sought would increase residential rates by about 9%. Although the notice mentioned the proposed PSS, ACRM and HUS, there was no quantification for these surcharges. A reasonable person reading the Notice would have anticipated a general rate increase of approximately 9%. The Resorts' business decision not to intervene in the rate case was based upon its reliance on the Public Notice. Nowhere in the Notice was information that would reasonably have lead the Resorts to conclude that a 200-250% rate increase was sought and that intervention would be necessary. The notice did not even disclose that AAWC was seeking a $2.15 per 1000 gallon HUS or a $1.00 per 1000 gallon PSS, which ***far*** exceeded the published rate increase.

Brian Biesemeyer Notice[3]

Furthermore, Arizona American Water Company provided additional notice that only confirmed the Pubic Notice. Attached is a letter by Brian Biesemeyer, P.E., General Manager of the Company, sent to customers on September 6, 2005 and docketed on September 16, 2005. That letter alerts readers to a potential 5.4% base rate increase and represents the effect of the full rate increase including the PSS and the ACRM to be a $62.70 increase for the typical residential consumer phased in annually over the next five years based on Arizona American Water's capital expenditures. It also discusses the Arsenic Cost Recovery Mechanism and the Public Safety Surcharge in their own paragraphs. **However, the letter of notice fails to mention the proposed High Usage Surcharge amount of $2.15**[4] **that far exceeds the $1.57 Commercial tier 2 base rate of water requested.** The only warning about the High Usage Surcharge is a reference to a "conservation surcharge" in a trailing paragraph under the base rate increase paragraph rather than in its own titled paragraph and no dollar figure is provided. As far as one could tell, that conservation surcharge could refer to the incremental rates that already exist in the final conservation tiers..

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[2] Notice is attached hereto as Exhibit B.

[3] Letter is attached hereto as Exhibit C.

[4] The Company's original proposal and the adopted surcharge are mathematically equivalent. The original proposal was apparently $2.00 on 95% of consumption in the final block and $5 on the remaining 5% of consumption in the final block. This structure is the same as simply applying $2.15 to the final block.

These omissions were prejudicial to the Resorts' interests, as we would have intervened had we been given complete and accurate information regarding the size of the proposed increases. Now, the Resorts cannot simply raise room rates to cover the surcharges; if we could raise room rates we would have done so already. We must compete with other resorts in Paradise Valley, Scottsdale and Phoenix who do not face these surcharges. The rates you set affect our competitiveness.

Setting the HUS at 400,000 gallons will not achieve conservation.

The Commission has authorized an HUS which sets the penalty tier at any consumption amount over 400,000 gallons per month. The Sanctuary, the Camelback Inn and the Scottsdale Renaissance use approximately 3,700,000, 5,700,000 and 3,256,250 gallons on average per month, respectively. Resorts have certain minimum water needs that far exceed 400,000 gallons per month. At the Open Meeting, we understood how the Commission might have considered minimum health and safety water need data for households in formulating tier breaks for residential consumers, and we would ask for the same consideration so the tier breaks have some relation to our basic health and safety needs. A resort that can host 300 families a night would have basic health and safety needs in the millions of gallons. Establishing an arbitrary "one-size-fits-all" tier of 400,000 gallons without taking into consideration the unique water needs of the Resorts including their relative size, serves no conservation purpose. In fact, not only will it result in penalizing the Resorts despite the efforts made towards conservation (see below), there is no incentive for smaller establishments to conserve water as long as they stay below the 400,000 gallon threshold.

Setting the HUS at 400,000 gallons creates a hidden subsidy.

The other concern that the Resorts have is that by setting a 400,000 gallon threshold, there is the appearance that the Resorts are not only paying a disproportionate amount for fire flow, but that the HUS "conservation surcharge" is nothing more than a hidden subsidy, being assessed against the Resorts to pay for increased fire flow protection that benefit other customers.

The Resorts are a class of customer on the forefront of wise water use.

The general managers identified several of the conservation efforts already being made by the Resorts, including the following:

(1) Replacing high water use plants and grass with desert landscaping. The Sanctuary has about 0.58%, or less than 1%, of its square footage in grass. The Camelback went through a major landscape remodel in 2003 that converted grass to xeriscape. Of the Camelback Inn's 118 acres, 16% is not landscaped and only 4% of the acreage is in grass. The Camelback Inn has progressively moved to an extensive xeriscape format consistent with the Sonoran desert.

(2) Upgrading and improving irrigation management systems and infrastructure. The Camelback Inn has invested in a state-of-the-art electronic irrigation system that is the most advanced irrigation system in the world. The Camelback Inn's system has distributed valves that water different vegetation differently. For example, older trees are irrigated once every two weeks while other plants are watered according to their minimum needs. The landscape manager can control the entire irrigation system remotely by laptop from anywhere in the world so that if

any leaks are detected she can immediately shut off valves to conserve water. The Sanctuary has invested $500,000 over recent years to upgrade its water infrastructure, including more efficient irrigation systems, despite the fact that it is almost entirely xeriscaped.

(3) Minimizing water use through efficient delivery systems. The Camelback Inn has already upgraded its water delivery systems to feature 100% drip irrigation to plants, 100% bubblers to flowers, and sprinklers minimized to the limited turf areas. These systems minimize necessary water delivery to various plant species and ages on the property. The property only uses hoses in rare emergencies.

(4) Seasonal and climactic adjustment. The Camelback Inn's landscape manager tailors its irrigation use specifically for seasonality and daily conditions. For example, cacti are not watered at all from November to May and irrigation is shut off remotely if rain is present.

(5) Renaissance Scottsdale Resort has implemented similar irrigation controls and conservation methods. The Scottsdale Renaissance is an Energy Star Leader.[5] Therefore, both inside and out, the Scottsdale Renaissance is at the forefront of water conservation. The resort invested in Eco-Lab's Formula-1 laundry control system that reduces rinse and flush cycles, lowering water use by 11% as well as programs of conservation such as encouraging guests to reuse linens and towels during their stay. In the past year, all guest rooms have been fitted with new low-flow shower heads that reduce use of hot water by 10%. On Earth Day, April 22, the Scottsdale Renaissance will be offering their guests' copies of a new book called "True Green", featuring ways to help the planet. In addition, the resort has a new landscape maintenance service that is charged with reducing water use through conservation, improved irrigation maintenance, drip irrigation, and elimination of overspray. The property also has extensive xeriscape and low-water-use vegetation. Water is also conserved pursuant to Marriott's guide for best practices that mandates a specific energy conservation program, including conservation of water. Much of the property is shut down during the off-season so that no water or energy is used to service those portions of the property. Pools and spas are not heated during the off season, thereby reducing evaporation. Each department has signed an action plan for conservation of water and energy.

These efficiency investments and practices all translate into being better stewards of our precious water resource as well as being wise business decisions. The Resorts are a class of customer at the forefront of prudent water usage.

Yet, the Resorts will automatically be assessed a significant HUS based upon the arbitrary second tier amount of 400,000 gallons, which does not seem to be based upon any empirical data. Based upon the Resorts' water usage patterns, the HUS will not promote any additional significant conservation and is therefore a purely punitive charge.

The CIAC period to finance the capital improvements should be extended or a traditional recovery mechanism should be developed.

[5] A U.S. Government ENERGY STAR partner who demonstrates continuous improvement organization-wide, not just in individual buildings, can qualify for recognition as an ENERGY STAR Leader.

The main factor that has caused the large rate increases is the short period of mandated Contribution in Aid of Construction ("CIAC") to finance, upfront, the fire flow improvements. Essentially, the HUS and PSS in tandem force current customers over the next four years to entirely finance infrastructure that will last 40 to 50 years. Either the CIAC period should be extended or a more traditional mechanism for recovery of the Company's own investment in the system should be implemented, similar to the ACRM. In addition, there will be two or three additional resorts that will be coming online in approximately 4-5 years that would increase the economies of scale, thereby reducing the impact to current customers. These new resorts will effectively avoid the payment of these higher water rates, but will benefit for years to come from the improvements funded in large part by current ratepayers, including the Resorts.

The Resorts request that the Commission review and investigate the surcharges in this case

It is our understanding that the Commission has the authority to rescind or amend any previous decision. The Resorts request that the Commission revisit this case for the purpose of re-examining the HUS and the PSS and evaluate whether there are options available to mitigate the resultant rate shock. At a minimum, we would seek to have the surcharges spread out over current and future customers so that the economic burden is more fairly distributed. In addition, we would request that the Staff review the commercial tiers and evaluate whether the 400,000 gallon limit is economically appropriate for our class of customer. We would appreciate a response to our request. We would also like an opportunity to discuss these issues with you and will be contacting your office to set up an appointment. **Time is of the essence as we head into the summer off-season with high vacancy rates and low cash flows but heavier irrigation demands and financially burdensome water bills under the surcharges.**

Yours sincerely,

M. T.

Mike Surguine, General Manager
Sanctuary on Camelback Mountain

Ralph Scatena, General Manager
Camelback Inn Scottsdale

Richard Bibee, General Manager
Scottsdale Renaissance

Exhibit A

Paradise Valley Water District Tier 2 Commercial Rate

Dollars per 1,000 Gallons - a 254% Increase in Commodity Rate

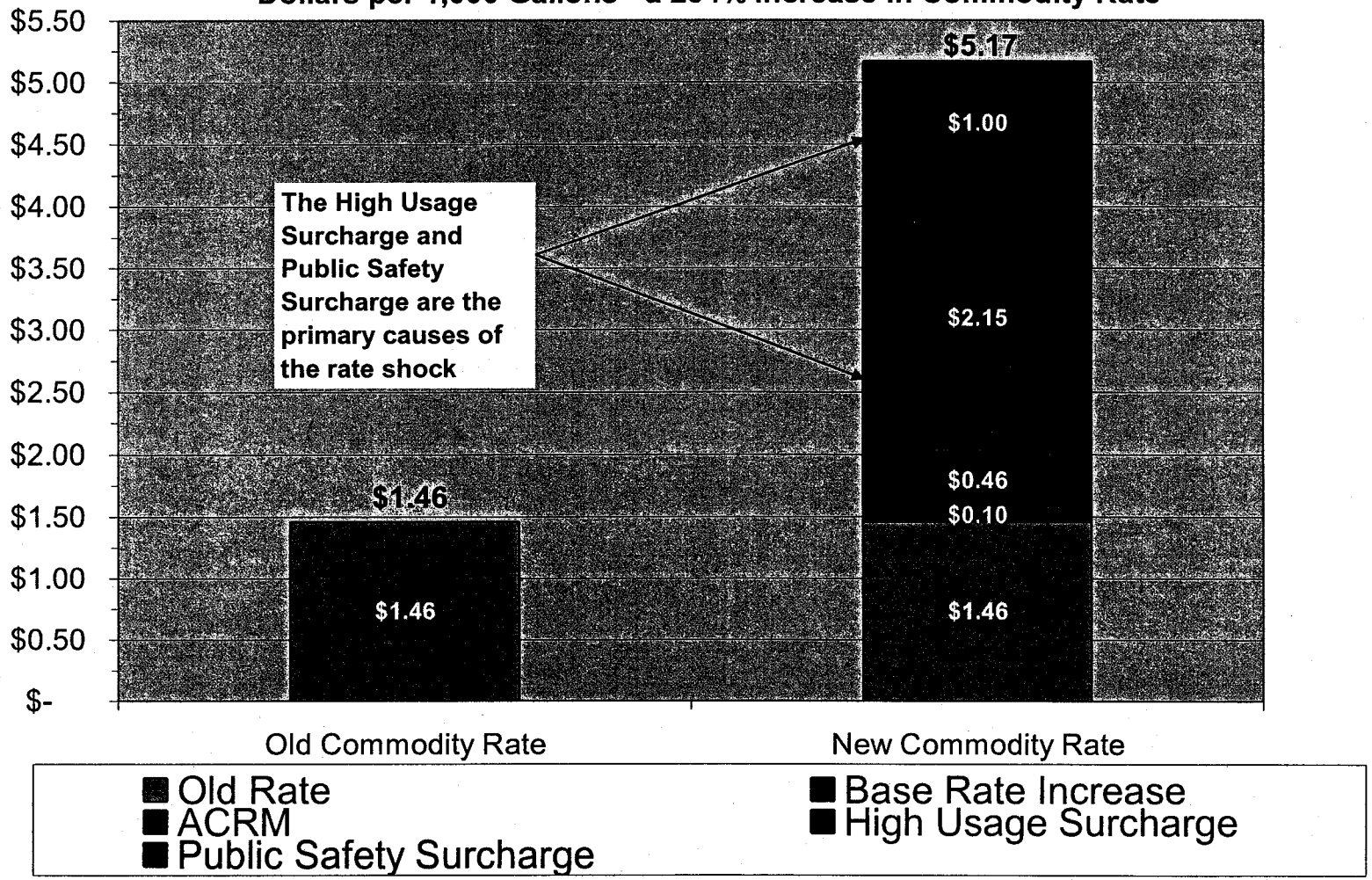

Exhibit B

PUBLIC NOTICE OF HEARING ON THE RATE APPLICATION OF ARIZONA AMERICAN WATER COMPANY FOR ITS PARADISE VALLEY WATER DISTRICT (DOCKET NO. W-01303A-05-0405)

On June 3, 2005, as amended on June 17, 2005, Arizona-American Water Company ("Company") filed with the Arizona Corporation Commission ("Commission") an application for an increase in operating income of approximately 5.48 percent ($278,000) for its Paradise Valley Water District. The Company's request would increase average 5/8-inch and 3/4-inch residential customers' base rates by approximately 9 percent. The Company is also seeking the Commission's approval of: a public safety surcharge for investments by the Company related to improvement of fire flow facilities; an arsenic cost recovery mechanism for investments required by the Company to comply with federal water arsenic reduction requirements; and approval of a conservation surcharge that would be imposed for usage in the highest consumption block. The actual amount of the Company's proposed rate increase varies depending on the customer's usage and the zone in which the customer is located. The Commission's Staff has not yet made its recommendation regarding the Company's rate proposals, and the Commission will determine the appropriate rate relief to be granted based on the evidence of record in this proceeding. The Commission is not bound by the proposals made by the Company, Staff, or any intervenors and, therefore, the final rates approved in this docket may be lower or higher than the rates described above. Copies of the application and proposed tariffs are available at the Company's offices 19820 North 7th Street, Suite 201, Phoenix, Arizona 85024, and the Commission's offices for public inspection during regular business hours.

The Commission will hold a hearing on this matter beginning **March 27, 2006, at 10:00 a.m.**, at the Commission's offices, 1200 West Washington, Phoenix, Arizona. Public comments will be taken on the first day of the hearing.

The law provides for an open public hearing at which, under appropriate circumstances, interested parties may intervene. Intervention shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in the matter. Persons desiring to intervene must file a written motion to intervene with the Commission no later than **December 16, 2005.** The motion to intervene must be sent to Company or its counsel and to all parties of record, and must contain the following:

1. The name, address, and telephone number of the proposed intervenor and of any party upon whom service of documents is to be made if different than the intervenor.

2. A short statement of the proposed intervenor's interest in the proceeding (e.g., a customer of Company, a shareholder of Company, etc.).

3. A statement certifying that a copy of the motion to intervene has been mailed to the Company or its counsel and to all parties of record in the case.

The granting of intervention, among other things, entitles a party to present sworn evidence at hearing and to cross-examine other witnesses. However, failure to intervene will not preclude any interested person or entity from appearing at the hearing and providing public comment on the application or from filing written comments in the record of the case. You will not receive any further notice of this proceeding unless you request it.

If you have any questions about this application, wish to file written comments on the application, or want further information on intervention, you may contact the Consumer Services Section of the Commission at 1200 West Washington Street, Phoenix, Arizona 85007, or call 1-800-222-7000.

The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting the ADA Coordinator, Linda Hogan, at LHogan@azcc.gov., voice phone number 602/542-3931. Requests should be made as early as possible to allow time to arrange the accommodation.

Exhibit C

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September 16, 2005

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AZ CORP COMMISSION
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Arizona Corporation Commission
Docket Control
1200 West Washington Street
Phoenix, AZ 85007

RE: DOCKET NO. W-01303A-05-0405
ARIZONA AMERICAN WATER COMPANY
PARADISE VALLEY DISTRICT RATE CASE

Dear interested parties:

On September 6, 2005 Arizona American Water Company mailed the attached letter to each of its customers in the Paradise Valley district. This letter is a result of a request by the Town of Paradise Valley that we communicate directly with our customers and explain, in everyday terms, the need and impact of our requested rate increase. Based on the present procedural schedule, customers in Paradise Valley now have approximately a 1-year advance notice of new water rates.

In response to the letter, we have received a number of calls from our customers requesting general information and, in particular, the estimated impact on a monthly bill based on their specific billing determinants. The Company has responded to these particular requests by providing estimates of typical monthly bills calculated at proposed rates, including surcharges. Additionally, Town of Paradise Valley officials are beginning to respond to constituent inquiries.

Arizona American Water and the Town of Paradise Valley continue to meet each month at the Town's Water Committee meetings to discuss the specific details and progress of the Company's public safety/fire flow projects.

We urge representatives of both Staff and RUCO to attend one of these meetings as part of their preparation and analysis in this case.

Sincerely,

Tom Broderick
Arizona American Water

RWE Group

DOCKET NO.
W-01303A-05-0405

Arizona American Water®

September 6, 2005

Dear Valued Paradise Valley Water District Customer,

Brian Biesemeyer
Arizona General Manager

Although the Consumer Price Index has increased 19.2% during the past seven years, Arizona American Water has not increased your base water rates since 1998. In 2004, the Company commenced a six-year capital expenditure program that will result in improved customer health, safety, and welfare by removing more arsenic from drinking water and improving water flow and pressure for fire-fighting activities.

Due to this capital improvement program of more than 35 million dollars, we recently filed a rate increase request with the Arizona Corporation Commission. Arizona American Water requested these rate increases become effective late summer 2006.

If approved, the requested rates would include a 5.4 percent increase in the *"Basic Service"* rate, and two new surcharges titled, *"Arsenic Cost Recovery Mechanism"* and *"Public Safety."* For the typical customer using approximately 22,000 gallons of water per month, the average monthly bill before taxes would increase $62.70 over the next five years. This monthly increase would be phased in annually based on Arizona American Water's capital expenditures.

The information below gives an overview of improvements in your quality of service.

Federal Mandate Requires Increased Drinking Water Quality
Arsenic Cost Recovery Mechanism
Arizona American Water has proposed a surcharge to underwrite capital improvements necessary to comply with the new federal drinking water standard.

New federal regulations, effective in 2006, require public and private water providers to make significant investments in the treatment of drinking water to permit no more than 10 parts per billion of arsenic, whereas the current federal standard permits up to 50 parts per billion. Water tests in your district's water supplies detected levels ranging from 8 to 18 parts per billion—well below the old standard but somewhat higher than the new.

This unfunded federal mandate requires Arizona American Water to invest more than 19 million dollars for new drinking water treatment facilities in the Paradise Valley Water District. These improvements, currently under construction at 6237 North Cattletrack Road in Scottsdale, include the installation of new piping, filtration fixtures, pumps, and other infrastructure needed for enhanced drinking water treatment. If you would like to learn about public health benefits identified by the US Environmental Protection Agency, then please visit the agency's website at http://www.epa.gov/safewater/arsenic.html.

Protecting Your Lives and Investments with Better Fire Protection
Public Safety Surcharge
Arizona American Water has also proposed a surcharge related to public safety improvements. This surcharge is intended to underwrite capital expenditures necessary to enhance fire protection for customers and their property.

Arizona American Water implemented the first stages of the Paradise Valley Fire Flow Improvement Program in 2004 and 2005. This program was spearheaded by the Town of Paradise Valley and Arizona American Water in response to concerns from customers and the Town regarding the fire safety and protection of residents' lives and property.

Arizona American Water
Paradise Valley Water District
7500 E McDonald Rd, Ste 102A
Paradise Valley, AZ 85351

T 623-445-2400
F 480-483-8314
I www.amwater.com

RWE Group

In July 2003, Arizona American Water formed Paradise Valley Users Group in order to understand all the fire protection concerns and to solicit customer input to use in formulating possible solutions. The Users Group included citizens from various areas in the district, business representatives, Town elected officials and staff, as well as Arizona American Water representatives and consultants. After months of concerted effort, the Users Group and Arizona American Water established a six-year program for improving Paradise Valley Water District fire protection systems.

Since then, Arizona American Water began implementing the 16 million dollar Paradise Valley Fire Flow Improvement Program. We have acted proactively, addressing specific immediate needs by completing the Jackrabbit-Invergordon Main Replacement and the Tatum-McDonald Realignment; both improvements were identified in the plan. However, due to the magnitude of the continuing investments, Arizona American Water will need approval of this surcharge in order to timely proceed with the balance of the program.

Operations, Maintenance and Improvements of Older Systems
Base Rate Increase of 5.4%
The first of Arizona American Water's Paradise Valley Water District infrastructure was put into service more than half a century ago. This system requires ongoing delivery improvements, replacements, and an aggressive preventative maintenance program. In addition to these operational and maintenance improvements, Arizona American Water, like any other company, is faced with inflationary market conditions.

The Company's proposal also includes a conservation surcharge for residential customers using more than 80,000 gallons per month and commercial customers using more than 400,000 gallons per month. If you meet these criteria and would like to know the potential conservation charges you may see in your monthly bill, please contact Arizona American Water.

What's next?
The Arizona Corporation Commission will hold a public hearing relating to this rate increase request on March 27, 2006.

Thank you for taking time to learn more about what Arizona American Water is doing to improve the service we provide to you. Arizona American Water is committed to our customers' health and welfare, and is constantly working to ensure your water system is reliable and safe. If you have any questions, comments, or wish to learn how your monthly bill may be impacted, please feel free to contact me or Rob Antoniak, Community Relations (623-815-3112, rob.antoniak@amwater.com).

Sincerely,

Brian K. Biesemeyer

Brian K. Biesemeyer, P. E.
General Manager