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MEMORANDUM

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FROM: Ernest G. Jefferson
Director
Utilities Division

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Arizona Corporation Commission
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AUG - 6 2007

DATE: August 6, 2007

RE: ARIZONA WATER COMPANY
CERTIFICATE OF FILING CAP WATER USE PLAN
DOCKET NO. W-01445A-04-0650

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In Decision No. 68302, dated November 14, 2005, the Arizona Corporation Commission ("Commission") approved an increase in revenues and adjusted rates for Arizona Water Company ("Arizona Water" or "Company") and its Western Group systems.¹ As part of Decision No. 68302, the Commission approved Central Arizona Project Hook-Up Fee tariffs. The Commission approved the use of these tariffs to allow Arizona Water to begin to recover prudently incurred costs associated with the Company's Central Arizona Project ("CAP") water allocations. The Commission's approval of the Central Arizona Project Hook-Up fee tariffs was conditioned upon the following:

CONDITIONS FOR APPROVAL OF CAP HOOK-UP FEE

1. Arizona Water must submit by December 31, 2006, or six months prior to submission if its next rate case application, whichever comes first, a detailed Central Arizona Project Water Use Plan ("CAPWUP") for its Western Group water systems.
2. Arizona Water must make best faith efforts to include the cities of Casa Grande and Coolidge in the development of the CAPWUP.
3. The CAPWUP must address all the issues outlined below.
4. The CAPWUP must be approved by Staff prior to Arizona Water's next rate case application being declared sufficient under A.A.C. R14-2-103.
5. The CAPWUP shall be approved, disapproved, or modified in Arizona Water's next rate case by the Commission. If the CAPWUP is disapproved, the CAP Hook-up Fee shall be terminated and Arizona Water shall refund all CAP Hook-up Fee monies collected to that point along with six percent (6%) interest. The refund method shall be determined by the Commission.

¹ The Company's Western Group includes five of Arizona Water's systems: Casa Grande, Coolidge, White Tank, Ajo Heights and Stanfield.

6. The approval by Staff or the Commission of the CAPWUP shall mean only that the CAPWUP has adequately addressed all the issues outlined below. CAPWUP approval by Staff or the Commission shall **not** be interpreted as a used and useful determination nor as pre-approval of reimbursement of any future expenditures in completing the plan.
7. In Arizona Water's next rate case the Commission shall reevaluate this CAP Hook-up Fee to determine if it should be continued, eliminated or modified based on the CAPWUP and any other evidence that may be introduced by parties to that case.
8. If in Arizona Water's next rate case the Commission orders continuation of the CAP hook-up fee or any other recovery mechanism designed to recover CAP deferrals, the Commission Staff shall audit the CAP deferral accounts of Arizona Water's systems holding CAP allocations and shall make any necessary adjustments, true-ups, and recalculations to determine the proper values to carry forward.
9. Staff will utilize Arizona Water's annual cost of debt to determine the rate for allowance of funds used during construction included in the CAP deferrals.

CAPWUP REQUIREMENTS

The Commission required that the CAPWUP filed by Arizona Water address the following issues:

1. Existing water supplies and demand patterns for the last two years (such information as required on the Water Use Data Sheet).
2. Future water supplies and demand patterns demonstrating how and when CAP water will be used through the year 2025. All future water sources that the Company plans to use other than CAP should be discussed. All assumptions used to make projections should be clearly explained.
3. All major infrastructure components required to use CAP water through the year 2025 should be listed and described in as much detail as possible. These would include such items as, but not be limited to, treatment plants, transmission mains, storage tanks, pumping stations, etc.
4. Projected capital and Operation and Maintenance costs for all future water supplies (including CAP water) through the year 2025 should be listed in as much detail as possible. All assumptions used to make these projections should be clearly explained.
5. How CAP water will be used to address the arsenic issue (if it will be).

STAFF'S REVIEW OF THE CAPWUP FILED BY ARIZONA WATER

Decision No. 68302 did not specifically require Staff to review the CAPWUP filed by Arizona Water at this time. Staff is submitting this memorandum to confirm that the CAPWUP filed by Arizona Water has addressed the issues listed above under CAPWUP REQUIREMENTS.

On December 29, 2006, Arizona Water filed its CAPWUP. The CAPWUP addressed all the issues listed above, at varying levels of detail. The Company reported in its filing that further study of some of the issues was needed and that specific details would be submitted at a later date.

The CAPWUP addresses how Arizona Water will use its CAP water allocations to serve the Casa Grande, Coolidge, Stanfield and White Tank service areas.² The scope of the CAPWUP (or "Plan") submitted covers each of the issues listed above under CAPWUP REQUIREMENTS. The Plan includes Water Use Data Sheet information for the service areas listed above for 2004 and 2005. The Plan provides an overview of the assumptions used to make projections related to future water supply planning, preliminary estimates are included for capital, operation and maintenance costs. For example, the preliminary engineering design for the first phase of the Pinal Valley CAP Water Treatment Plant, which will treat the Company's Casa Grande and Coolidge CAP Water allocations, is planned to occur this year, therefore, the information contained in the Plan submitted was based on best estimates available at the time the Plan was prepared (however, a detailed schedule of activities related to plant design and construction is provided). For its White Tank service area Arizona Water intends to enter into a long-term agreement with either Arizona-American Water Company ("Arizona-American") or Maricopa Water District ("MWD")³ that would provide treatment capacity for the Company's White Tank service area CAP water allocation (both Arizona-American and MWD have plans to build CAP water treatment plants, Arizona Water's decision on which water treatment plant to participate in will be made depending on the progress of each entity in moving toward plant construction). The Plan discusses the availability and estimated costs of future water supplies which have the potential to become available such as, additional CAP water allocations and treatment facilities, Gila River surface water available through the San Carlos Irrigation and Drainage District, reclaimed water available from wastewater treatment facilities operated by the cities of Casa Grande and Coolidge and additional groundwater production facilities. The Plan discusses how CAP Water (which available test data shows has a lower arsenic concentration than some existing groundwater supplies used by the Company) could be blended with the groundwater at some storage tanks and wells during lower demand months which could reduce overall arsenic treatment and water production costs. A detailed analysis of blending potential at each site is planned prior to treated CAP water becoming available.

Approval of the CAP Hook-Up Fee was conditioned upon Arizona Water including the cities of Casa Grande and Coolidge in the development of its CAPWUP. Arizona Water was to keep the cities informed and make sure the cities were involved so that the cities were not caught off guard by something the Company is going to do with regard to its water system. In the Plan

² The Ajo Water System is not included in the Plan submitted since it lies outside the CAP service territory and does not have a CAP water allocation.

³ Maricopa County Municipal Water Conservation District Number One is an agricultural water district and municipal entity.

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submitted the Company states, "Pursuant to Decision No. 68302, the Company also met and conferred with and had input from the cities of Casa Grande and Coolidge in the development of this Water Use Plan." Staff verified that the City Managers of both Casa Grande and Coolidge had discussions with an Arizona Water representative and were generally aware of the Plan.

CONCLUSIONS

Staff concludes that the CAPWUP filed by Arizona Water adequately addresses the issues listed above under CAPWUP REQUIREMENTS as required in Decision No. 68302. However, Staff recommends that Arizona Water submit updates to its CAPWUP each December and June until further order of the Commission.

Originator: Del Smith

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