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BEFORE THE ARIZONA CORPORATION COMMISSION
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8 IN THE MATTER OF THE APPLICATION OF
 9 ARIZONA-AMERICAN WATER COMPANY,
 10 INC., AN ARIZONA CORPORATION, FOR
 11 AUTHORITY TO IMPLEMENT ARSENIC
 COST RECOVERY MECHANISMS FOR ITS
 AGUA FRIA WATER, SUN CITY WEST
 WATER, HAVASU WATER, AND TUBAC
 WATER DISTRICTS.

Docket No. W-01303A-05-0280
 Arizona Corporation Commission
DOCKETED
 JUL -8 2008

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12 IN THE MATTER OF THE APPLICATION OF
 13 ARIZONA-AMERICAN WATER COMPANY,
 14 INC., AN ARIZONA CORPORATION, FOR A
 15 DETERMINATION OF THE CURRENT FAIR
 16 VALUE OF ITS UTILITY PLANT AND
 PROPERTY AND FOR INCREASES IN ITS
 RATES AND CHARGES BASED THEREON
 FOR UTILITY SERVICE BY ITS SUN CITY
 WEST WATER AND WASTEWATER
 DISTRICTS.

Docket No. WS-01303A-02-0867

17 IN THE MATTER OF THE APPLICATION OF
 18 ARIZONA-AMERICAN WATER COMPANY,
 19 INC., AN ARIZONA CORPORATION, FOR A
 20 DETERMINATION OF THE CURRENT FAIR
 21 VALUE OF ITS UTILITY PLANT AND
 PROPERTY AND FOR INCREASES IN ITS
 RATES AND CHARGES BASED THEREON
 FOR UTILITY SERVICE BY ITS MOHAVE
 WATER DISTRICT AND ITS HAVASU
 WATER DISTRICT

Docket No. W-01303A-02-0869

**NOTICE OF FILING RUCO'S REPORT
ON STEP TWO ARSENIC FILING -
HAVASU DISTRICT**

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- 24

1 IN THE MATTER OF THE APPLICATION OF
2 ARIZONA-AMERICAN WATER COMPANY,
3 INC., AN ARIZONA CORPORATION, FOR A
4 DETERMINATION OF THE CURRENT FAIR
5 VALUE OF ITS UTILITY PLANT AND
6 PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER DISTRICT, ITS AGUA FRIA WATER
DISTRICT, AND ITS ANTHEM/AGUA FRIA
WASTEWATER DISTRICT.

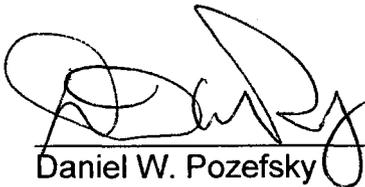
Docket No. WS-01303A-02-0870

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8 **NOTICE OF FILING RUCO'S REPORT ON**
9 **STEP TWO ARSENIC FILING - HAVASU DISTRICT**

10 On April 14, 2008, Arizona American Water Company filed its Step Two ACRM filing
11 for its Havasu Water District, seeking a surcharge of \$2.85 to the monthly minimum
12 charge, and \$0.2885 per 1,000 gallons to the commodity rate.

13 The Residential Utility Consumer Office ("RUCO") hereby files its Report on its audit
14 of the ACRM filing. RUCO recommends a surcharge of \$1.85 to the monthly minimum
15 charge and \$0.1878 per 1,000 gallons to the commodity rate.

16 RESPECTFULLY SUBMITTED this 8th day of July 2008.

17
18 

19 Daniel W. Pozefsky
20 Chief Counsel

1 AN ORIGINAL AND NINETEEN
2 COPIES of the foregoing filed this
3 8th day of July 2008 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85007

5 COPY of the foregoing hand delivered/
6 mailed this 8th day of July 2008 to:

7 Teena Wolfe
8 Administrative Law Judge
9 Arizona Corporation Commission
10 1200 West Washington Street
11 Phoenix, Arizona 85007

Miles H. Kiger, Rate Analyst
Arizona-American Water Company
19820 N. 7th Street, Suite 201
Phoenix, Arizona 85024

10 Janice Alward, Chief Counsel
11 Legal Division
12 Arizona Corporation Commission
13 1200 West Washington Street
14 Phoenix, Arizona 85007

13 Ernest G. Johnson, Director
14 Utilities Division
15 Arizona Corporation Commission
16 1200 West Washington Street
17 Phoenix, Arizona 85007

By 

16 Craig A. Marks
17 Craig A. Marks PLC
18 3420 E. Shea Boulevard, Suite 200
19 Phoenix, Arizona 85028

18 Gary Yaquinto
19 Arizona Investment Council
20 2100 North Central Avenue, Suite 210
21 Phoenix, Arizona 85004

21 Thomas M. Broderick, Manager
22 Government and Regulatory Affairs
23 Arizona-American Water Company
24 19820 N. 7th Street, Suite 201
Phoenix, Arizona 80024

24

MEMORANDUM

TO: Stephen Ahearn, Director
Marylee Diaz Cortez, Chief of Accounting & Rates
Dan Pozefsky, Legal Counsel

FROM: Tim Coley, Public Utilities Analyst V

RE: Report on RUCO's audit of the Arizona-American Water Company filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 2 rate increase for its Havasu Water system.

AUDIT OBJECTIVE: The purpose of this audit was to verify the operation and maintenance ("O&M") expenses associated with the pre-approved filing of the ACRM Step 1 completed arsenic plant in Arizona-American's Havasu Water District for the ongoing and recurring annual O&M costs that are stipulated in Commission Decision Nos. 66400, 68310, and 69162.

AUDIT STEPS: The following audit steps and procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 were included in the Company's application.
- 2) Reviewed the "Earnings Test" for compliance, accuracy, and determined if the Company was in conformity with it.
- 3) Reviewed all arsenic O&M invoices, looking for such things as misallocations, unreasonable costs, and non-arsenic O&M costs.
- 4) Verified accuracy of invoice totals.
- 5) Reviewed the "Revenue Requirement" calculations for accuracy and compliance.
- 6) Reviewed the "Rate Design" for accuracy of calculations, checked the reasonableness of the billing determinants by comparing to the previous rate case, and made any necessary adjustments as warranted.

AUDIT FINDINGS: With the one exception as follows, the Havasu ACRM filing is accurate and compliant with Decision Nos. 66400, 68310, and 69162:

Stephen Ahearn, Director
Marylee Diaz Cortez, Chief of Accounting and Rates
Dan Pozefsky, Legal Counsel

- 1) Contrary to Decision No. 68310¹, the Company is requesting recovery of additional arsenic plant in its Step 2 ACRM filing. Under Decision No. 68310 the Company is authorized to recover only O&M costs and not capital costs associated with additional arsenic plant that should have been included in the Company's Step 1 ACRM filing. Decision No. 68310 authorizes the implementation of an ACRM to the extent described within the Order.

In addition, page 8 of Decision No. 68310, a Company representative, Mr. Broderick, describes in-depth what costs would be recoverable in each of the two-steps of the ACRM filings as follows: Item a) on page 8 states: "In the step one filing...the Company could seek rate recovery of capital costs for arsenic treatment facilities that are *up and running*... Item c) on page 8 states: "In the second step filing,...the Company could seek recognition of the prior 12 months of deferred O&M costs, as well as ongoing O&M costs." Commission Decision No. 69162 relinquished the Company's ability to recover any deferred O&M costs until the next rate case for the Havasu system,² which the Company's ACRM Step 2 filing adhered.

AUDIT RECOMMENDATIONS: The Company's ACRM request should be adjusted to remove the request for any recovery of additional arsenic plant in service not recovered by the existing Step 1 ACRM Surcharge and only reflect the recovery of the eligible on-going arsenic O&M costs. This recommended adjustment and the resultant RUCO recommended ACRM Step 2 rate increase are displayed on the following attached Schedule RUCO ACRM-1 and 2.

¹ Arizona Corporation Commission Decision No. 68310, page 7, paragraph 11, section 6 states "Recoverable O&M costs would include only media replacement or regeneration, media replacement or regeneration service, and waste disposal."

² Arizona Corporation Commission Decision No. 69162, page 4, paragraph 8, lines 25-28.

RUCO ADJUSTMENT TO ACRM - HAVASU WATER DISTRICT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] RUCO ADJUSTMENT	[C] RUCO AS ADJUSTED
1	Arsenic Plant Revenue Requirement			
	Arsenic Plant in Service/Rate Base Net of AIF	\$ 352,946	\$ (352,946)	\$ -
	Accumulated Depreciation Of Arsenic Plant (Step 1)	(21,701)	21,701	-
2	Net Arsenic Plant in Service/Rate Base	\$ 331,245	\$ (331,245)	\$ -
3	Depreciation rate	3.48%		
4	Depreciation expense	12,271	(12,271)	-
5	Depreciation expense net of tax savings ¹	7,535	(7,535)	-
6	Recoverable O&M costs - Ongoing	88,300	-	88,300
7	Recoverable O&M costs - Ongoing Net Of Tax Savings	54,217	-	54,217
8	Arsenic Operating Income	\$ (61,752)		\$ (54,217)
9	Rate of return	-17.50%		
10	Required Rate of Return ²	6.50%		
11	Required Operating Income	21,531	(21,531)	-
12	Operating Income deficiency	83,283		54,217
13	Gross revenue conversion factor ²	1.62863	-	1.62863
14	Revenue deficiency	\$ 135,638	\$ -	\$ 88,300

¹ 38.5986 % tax rate per Dec. 67093

² Decision No. 67093

COMPANY PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 17.40	\$ 2.85	\$ -	\$ 20.25
Commodity Rates Per 1,000 Gallons				
0 to 4,000 gallons	\$ 1.6802	\$ 0.2885	\$ -	\$ 1.9687
4,000 to 13,000 gallons	2.1852	0.2885	-	2.4737
13,000 gallons and over	2.5002	0.2885	-	2.7887

RUCO PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 17.40	\$ 1.85	\$ -	\$ 19.25
Commodity Rates Per 1,000 Gallons				
0 to 4,000 gallons	\$ 1.6802	\$ 0.1878	\$ -	\$ 1.87
4,001 to 15,000 gallons	2.1852	0.1878	-	2.37
15,001 gallons and over	2.5002	0.1878	-	2.69

Line No.	Growth	[A] Customers	[B] Total Gallons Sold	[C] Gallons Sold Per Cust.	[D] Monthly Minimum	[E] Minimum Multiples	[F] Equivalent Meters	[G] Monthly Fixed Increment	[H] Annual Total
1	Dec. 2006 (Year 1)	1,507	225,336	149.53	1.85	1.0	1,436	\$ 1.85	\$ 31,938
2	Dec. 2007 (Year 2)	1,528	244,777	160.19	1.85	1.0	39	\$ 1.85	\$ 859
3	Year 2 minus Year 1	21	19,441	10.67	3.19	1.7	13	\$ 3.19	\$ 280
4	Percentage Change	1.39%	8.63%	7.13%	4.52	2.4	-	\$ 4.52	\$ -
5	Avg Gallons (Col B Ln 1 + Col B Ln 2 + 2)		235,057		6.27	3.4	57	\$ 6.27	\$ 1,258
6					8.54	4.6	34	\$ 8.54	\$ 749
7					10.80	5.8	6	\$ 10.80	\$ 135
8					37.22	20.1	-	\$ 37.22	\$ -
9					71.98	38.8	-	\$ 71.98	\$ -
10	Meter Size	Average Customers at 12/31/2007	Estimated Customers at 12/31/2008	Estimated Average Customers	Monthly Minimum	Minimum Multiples	Equivalent Meters	Monthly Fixed Increment	Annual Total
11	Resid. 5/8-inch	1,426	1,446	1,436	\$ 1.85	1.0	1,436	\$ 1.85	\$ 31,938
12	Commer. 5/8-inch	38	39	39	1.85	1.0	39	\$ 1.85	\$ 859
13	1-inch	7	7	7	3.19	1.7	13	\$ 3.19	\$ 280
14	1.5-inch	-	-	-	4.52	2.4	-	\$ 4.52	\$ -
15	2-inch	17	17	17	6.27	3.4	57	\$ 6.27	\$ 1,258
16	3-inch	7	7	7	8.54	4.6	34	\$ 8.54	\$ 749
17	4-inch	1	1	1	10.80	5.8	6	\$ 10.80	\$ 135
18	6-inch	-	-	-	37.22	20.1	-	\$ 37.22	\$ -
19	8-inch	-	-	-	71.98	38.8	-	\$ 71.98	\$ -
20	Multi-family 044 1"	1	1	1	40.77	22.0	23	\$ 40.77	\$ 511
21	Multi-family 056 2"	1	1	1	51.89	28.0	29	\$ 51.89	\$ 650
22	Multi-family 064 4"	1	1	1	59.31	32.0	33	\$ 59.31	\$ 743
23	Multi-family 065 2"	1	1	1	60.23	32.5	34	\$ 60.23	\$ 755
24	Multi-family 067 4"	1	1	1	62.09	33.5	35	\$ 62.09	\$ 778
25	Multi-family 089 1"	1	1	1	82.47	44.5	46	\$ 82.47	\$ 1,034
26	Multi-family 102 2"	1	1	1	94.52	51.0	53	\$ 94.52	\$ 1,185
27	Multi-family 129 4"	1	1	1	119.54	64.5	67	\$ 119.54	\$ 1,498
28	Multi-family 153 4"	1	1	1	141.78	76.5	80	\$ 141.78	\$ 1,777
29	Total	1,506	1,527	1,516			1,965		\$ 44,150

Line No.	Calculation of Surcharge	Minimum Surcharge	Commodity Surcharge
32	Calculation of Surcharge		
33	Total costs to be recovered (Rev. Requirement)	\$ 88,300	
34	Minimum Revenue (Col B Ln 33 + 2)	\$ 44,150	\$ 44,150
35	Commodity Revenue (Col B Ln 33 + 2)		
36			
37	Monthly Increment Per Equivalent Meter		
38	Equivalent Meters (Col F Ln 29 x 12 Months)	23,822	
39			
40	Minimum Surcharge (Col C Ln 34 + Ln 38)	\$ 1.85	
41			
42	Average Gallons (Col B Ln 5)		235,057
43			
44	Commodity Surcharge (Col D Ln 35 + Ln 42)		\$ 0.1878