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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

JUN 13 2008

MIKE GLEASON - Chairman  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
KRISTIN K. MAYES  
GARY PIERCE

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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC. FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER AND ANTHEM/AGUA FRIA WASTEWATER DISTRICTS.

DOCKET NO. WS-01303A-06-0403

DECISION NO. 70372

OPINION AND ORDER

DATES OF HEARING:

May 24, 2007 (Pre-Hearing Conference), May 29, 30, and 31, 2007; June 1 and 4, 2007; July 13, 2007; October 31, 2007; November 1, 2007 (Evidentiary Hearing); and March 28, 2008 (Oral Argument on Motion to Reopen Record).

PLACE OF HEARING:

Phoenix, Arizona

DATE OF PUBLIC COMMENT HEARING:

May 24, 2007

PLACE OF PUBLIC COMMENT HEARING:

Anthem, Arizona

ADMINISTRATIVE LAW JUDGE:

Teena Wolfe

IN ATTENDANCE:

Mike Gleason, Chairman  
William A. Mundell, Commissioner  
Kristin K. Mayes, Commissioner  
Gary Pierce, Commissioner

APPEARANCES:

Mr. Craig A. Marks, CRAIG MARKS, P.L.C., and Mr. Paul Li, Arizona-American Water Company, on behalf of Arizona-American Water Company;

Ms. Michelle Molinario, Mr. John P. Kaites, and Mr. Geoffrey M. Khotim, RIDENOUR, HIENTON, KELHOFFER, LEWIS AND GARTH, on behalf of the Anthem Community Council;

Ms. Michele Van Quathem, RILEY CARLOCK AND

APPLEWHITE, on behalf of Pulte Homes, Inc.;

Mr. Daniel Pozefsky, Staff Attorney, on behalf of the Residential Utility Consumer Office; and

Ms. Maureen Scott, Senior Staff Counsel, Ms. Kenya Collins and Mr. Keith Layton, Staff Attorneys, on behalf of the Utilities Division of the Arizona Corporation Commission.

**BY THE COMMISSION:**

**I. INTRODUCTION**

On June 16, 2006, Arizona-American Water Company ("Arizona-American" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a determination of the current fair value of its utility plant and property and for increases in its rates and charges for utility service in its Anthem Water and Anthem/Agua Fria Wastewater Districts. On August 4, 2006, the Company filed a revised application, which was found sufficient on September 28, 2006.

Arizona-American's Anthem Water District provides water utility service to the Anthem community ("Anthem"), and its Anthem/Agua Fria Wastewater District provides wastewater utility service to the Anthem community service area, the Northeast Agua Fria service area, the Russell Ranch service area, and the Verrado service area.

The Anthem Water District and the Anthem/Agua Fria Wastewater District provide water and wastewater utility service pursuant to a Certificate of Convenience and Necessity ("CC&N") granted to Citizens Utilities Company by Decision No. 60975 (June 19, 1998).<sup>1</sup> Decision No. 60975 set initial minimum monthly charges for a 5/8 x 3/4" meter in the Anthem Water District of \$16.00 per month plus \$2.00 per thousand gallons of water used for all usage. For the Anthem Wastewater District customers, Decision No. 60975 set initial minimum monthly rates for residential customers at \$16.00, plus a usage charge of \$2.00 per thousand gallons of water usage up to 7,000 gallons. The combined initial monthly charge for water and wastewater services was estimated to be \$70.00. Decision No. 60975 ordered the filing of the first rate application for the districts by June 30, 2004, using a test year of 2003, or within six months of the time when the Company served 3,500

<sup>1</sup> At the time authority was granted, Arizona-American had not yet purchased the districts from Citizens Utilities Company.

1 equivalent residential units ("ERUs"), using the appropriate test year, whichever came first.

2 The districts are currently charging rates authorized by the Commission in Decision No. 67093  
3 (June 30, 2004). Decision No. 67093 lowered rates for the Anthem Water District to minimum  
4 monthly charges for a 5/8 x 3/4" meter of \$15.00 per month, and instituted tiered commodity rates  
5 beginning at \$1.13 per thousand gallons and ranging to \$2.04 per thousand gallons of usage. For the  
6 Anthem/Agua Fria Wastewater District customers, Decision No. 67093 increased the minimum  
7 monthly rate for residential customers to \$20.30, plus a usage charge of \$2.5450 per thousand gallons  
8 of water usage up to 7,000 gallons.

9 Intervention in this proceeding was requested by and granted to the Residential Utility  
10 Consumer Office ("RUCO") and the Anthem Community Council ("Council").

11 On May 24, 2007, the Commission held a public comment hearing at the Boulder Creek High  
12 School Auditorium in Anthem, Arizona. Public comment was also taken several times during the  
13 course of the hearings held at the Commission's offices, and numerous written public comments were  
14 filed in this docket.

15 Public comments, both oral and written, in opposition to the rate increase requested by  
16 Arizona-American's application expressed displeasure that the Company's proposed rates reflect  
17 repayment by Arizona-American to Pulte for infrastructure costs paid by Pulte, and particularly, that  
18 existence of the advances was not disclosed to homebuyers at the time of purchase. Pulte is not a  
19 party to this case, but responded to data requests, and agreed to have two witnesses appear during the  
20 course of the hearings for the purpose of responding to questions from the parties and  
21 Commissioners.

## 22 **II. APPLICATION**

23 The current application is based on a test year ending December 31, 2005. The Company's  
24 application requests an increase in annual revenues for the Anthem Water District of 51.22 percent.  
25 For its Anthem/Agua Fria Wastewater District, the application requests an increase in annual  
26 revenues of 35.83 percent.

27 Arizona-American's application states that since Decision No. 67093's 2001 test year, the  
28 Company has added \$33.8 million to its Anthem Water District rate base, and \$21.9 million to its

1 Anthem/Agua Fria Wastewater District rate base. The Company explains that a large portion of the  
2 rate base additions come from accumulated amortizations of imputed regulatory advances and  
3 contributions approved by Commission Decision No. 63584 (April 24, 2001), which approved the  
4 acquisition of the water and wastewater assets of Citizens Utilities Company ("Citizens") by Arizona-  
5 American. Under the terms of the settlement agreement approved by Decision No. 63584, Citizens'  
6 liabilities related to advances in aid of construction ("AIAC") and contributions in aid of construction  
7 ("CIAC") were to be imputed to Arizona-American, but amortized in order to reduce the balances  
8 over a period of six and a half years for AIAC and a period of 10 years for CIAC, beginning in  
9 January 2002, in order to allow the imputed AIAC and CIAC balances to be slowly reduced.

10 The application states that known and measurable 2005 test year refunds to Del Webb  
11 Corporation, the developer of the Anthem community, and the predecessor of Pulte Homes, Inc.  
12 ("Pulte"), under the September 29, 1997, Agreement for the Villages at Desert Hills  
13 Water/Wastewater Infrastructure between Citizens Water Resources and Del Webb Corporation  
14 ("Anthem Agreement")<sup>2</sup> total \$3,068,719 for the Anthem Water District and \$1,315,165 for the  
15 Anthem/Agua Fria Wastewater District. The application further states that Arizona-American will  
16 soon owe more payments to Pulte for the Anthem community's water and wastewater infrastructure,  
17 because since 2001, Del Webb had funded over \$80 million in advances and contributions for new  
18 plant in service, and Arizona-American has not yet refunded much of that amount. The application  
19 states that the Company anticipated the total amount of refunds of advances from 2006 to 2008 to be  
20 \$39 million.

21 The Anthem Agreement also calls for a series of payments from Del Webb to the Company  
22 starting in 2004 and ending in 2013, which payments offset revenues that would otherwise be  
23 recovered from customers in tariffs. The application reduces the revenue requirement in this case  
24 using the three-year, forward looking methodology for the subsidy revenue that was established in  
25 Decision No. 67093. Another offset to the revenue requirement in this case comes from the Capacity  
26 Reservation Charges ("CRC") tariff, by which a \$765 per ERU hook-up fee is charged separately for

27 <sup>2</sup> The Anthem Agreement, was entered into the record of this proceeding as Hearing Exhibit A-16. The Anthem  
28 Agreement and amendments thereto, which were also admitted as hearing exhibits, are described more fully below in  
Section X.

1 each new water and wastewater connection. The Company stated in the application that when the  
2 Anthem community reaches build-out, no more building permits will be issued and the Company will  
3 cease collecting CRC revenues, such that the offset will cease in the Company's next rate case.

### 4 **III. RATE BASE ISSUES**

5 For the Anthem Water District rate base, Arizona-American proposes \$36,721,140. The  
6 Council proposes \$36,696,140, RUCO proposes \$32,579,264, and Staff proposes \$36,509,151.

7 For the Anthem/Agua Fria Wastewater District rate base, Arizona-American proposes  
8 \$20,234,880. The Council proposes \$19,071,603, RUCO proposes \$18,895,465, and Staff proposes  
9 \$20,188,782.

10 The Company accepted several proposed rate base adjustments, which will be adopted.  
11 Proposed adjustments remaining in dispute are discussed below.

#### 12 **A. Plant in Service - Northwest Regional Wastewater Treatment Facility Allocation**

13 The Northwest Regional Wastewater Treatment Facility ("Northwest Plant") treats  
14 wastewater flows from both the Anthem/Agua Fria Wastewater District and the Sun City West  
15 Wastewater District. In December 2004, Arizona-American expanded the Northwest Plant, which  
16 was formerly known as the Sun City West Water Reclamation Facility, to accommodate flows from  
17 the Northeast Agua Fria service area of the Anthem/Agua Fria Wastewater District in addition to Sun  
18 City West flows. The expansion increased the capacity of the Northwest Plant from 3.14 million  
19 gallons per day ("mgd") to 5.0 mgd. Decision No. 70209, issued in the recent rate case that included  
20 the Sun City West Wastewater District, ordered the Company to allocate 68 percent of the Northwest  
21 Plant's costs to the Sun City West Wastewater District, and to report the results of plant operations in  
22 the Company's annual report. Decision No. 70209 also ordered that the Sun City West Wastewater  
23 District's allocation of the Northwest Plant might be revisited in future rate cases if the relative use of  
24 the Northwest Plant by the Sun City West Wastewater District changes, or if circumstances warrant  
25 otherwise. Decision No. 70209 specifically stated that it did not determine how to treat the remaining  
26 32 percent of the Northwest Plant.

27 In this case, Staff and the Company propose that 32 percent of the Northwest Plant's costs be  
28 allocated to the Anthem/Agua Fria Wastewater District. The 32 percent allocation would result in an

1 increase to plant in service of \$1,772,728 and an increase to accumulated depreciation of \$611,828,  
2 for a net plant in service increase of \$1,160,900 (Staff Final Schedule GWB-8b); an increase to  
3 operating expense of \$404,150 (Tr. at 1238); and an increase to depreciation expense of \$89,186 (Tr.  
4 at 1238).

5 As it did in the Sun City West Wastewater case, RUCO recommends rejection of any  
6 Northwest Plant rate base allocation, including the 2.25 percent rate base and expense allocation  
7 included in the Company's application as filed. According to RUCO's final schedules, RUCO's  
8 proposed ratemaking treatment would result in a decrease to the Company's proposed gross utility  
9 plant in service of \$1,906,569 and an addition of \$658,021 to accumulated depreciation for an  
10 aggregate decrease from the Company's proposed adjusted test year rate base of \$1,248,548. (RUCO  
11 Final Schedule RLM-2.) RUCO's proposal also includes waste disposal operating expense of  
12 \$28,507 to reflect 2.25 percent of the Northwest Plant's test year operating expenses of \$1,266,963,  
13 as those expenses were reflected in the Sun City West Wastewater District's rate application in  
14 Docket No. WS-01303A-06-0491, in which Decision No. 70209 was issued. (Direct Testimony of  
15 RUCO witness Rodney L. Moore, Exh. R-3 at 28-29; Surrebuttal Testimony of RUCO witness  
16 Rodney L. Moore, Exh. R-4 at 15.) Additionally, RUCO states that "[t]he treatment facilities Sun  
17 City West utilizes to process some of Agua Fria/Anthem's sewage should appropriately be reflected  
18 as an asset on Sun City West's books and records". (*Id.* at 28.)

19 Staff Engineering inspected the Northwest Plant and analyzed the capacity needs of both the  
20 Sun City West Wastewater District and the Anthem/Agua Fria Wastewater District. Staff determined  
21 that the expansion and accompanying upgrades are used and useful. (*See* Decision No. 70209 (March  
22 24, 2008), citing to the Engineering Report of Staff witness Dorothy Hains in Docket No. WS-  
23 01303A-06-0491 (Exh. S-21 in this proceeding) at 1; Tr. at 1257-1270.) Staff's used and useful  
24 determination is based on design capacity over a five year planning horizon. (Hearing Transcript in  
25 Docket No. WS-01303A-06-0491 at 646; Tr. at 1258.) Staff explains that it makes its used and  
26 useful determinations by reviewing all available data, including data for projected growth, prior to  
27 and at the time a utility makes its investment. (Staff Br. at 18, 19.) Staff further explains that when it  
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1 analyzes data, Staff utilizes the “prudently invested” standard set forth in the Commission’s rules.<sup>3</sup>  
2 (*Id.*)

3 Staff states that professional engineering judgment and application of accepted industry  
4 standards are indispensable to determining an appropriate design capacity; and that applicable  
5 industry standards in this case include compliance with Arizona Department of Environmental  
6 Quality (“ADEQ”) regulations, which require utilities to submit a plan for wastewater treatment plant  
7 expansion when the capacity factor reaches 80 percent, and to begin expansion construction when  
8 capacity reaches 90 percent. (Staff Br. at 20.) Staff’s witness testified that to estimate the minimum  
9 design capacity and used and usefulness of a wastewater treatment plant, Staff normally uses peak  
10 day flow and a five year planning horizon. (Tr. at 1258, 1276.) In 2002, the test year for  
11 Anthem/Agua Fria Wastewater’s previous rate case, the reported peak day flow for the Northwest  
12 Plant reached 4.037 mgd, while design capacity was 3.14 mgd. (Exh. S-23 at 4.) Staff’s witness  
13 testified in this proceeding that based on the 2002 peak flow data, the Company’s expansion to 5.0  
14 mgd in 2004 was a conservative plant addition, and that it would have also been prudent to expand to  
15 6.0 mgd, because flows occurring above the capacity of a wastewater treatment plant result in health  
16 and safety issues, and cause a utility to be in violation of state and federal regulations. (Tr. at 1260-  
17 1261.)

18 Staff’s witness testified that it is not unreasonable to expect flows from the Northeast Agua  
19 Fria service area of the Anthem/Agua Fria Wastewater District to be at 32 percent of total Northwest  
20 Plant flows within five years. (Tr. at 1272.) For its growth projections, Staff evaluated historical  
21 data for the test year for the Northeast Agua Fria service area, and beginning in 2003 for the Sun City  
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23 <sup>3</sup> The Commission’s rules define “Prudently invested” as follows:

24 Investments which under ordinary circumstances would be deemed reasonable and not  
25 dishonest or obviously wasteful. All investments shall be presumed to have been  
26 prudently made, and such presumptions may be set aside only by clear and convincing  
27 evidence that such investments were imprudent, when viewed in light of all relevant  
28 conditions known or which in the exercise of reasonable judgment should have been  
known, at the time such investments were made.

A.A.C. R14-2-103A.3(1).

1 Wastewater District. (Staff Br. at 18.) Staff explains that while it uses a scientifically accepted  
 2 method for projecting growth, projections are not perfect, and actual growth may be higher or lower.  
 3 (Staff Br. at 18.) Staff projects growth to 15,040 customers in the Sun City West Wastewater District  
 4 by 2010, and to 4,800 customers in the Northeast Agua Fria service area of the Anthem/Agua Fria  
 5 Wastewater District by 2010, for a total projection of 19,840 customers. (Exh. S-21 at 5; Exh. S-17  
 6 at 6.) Staff points out that multiplying the five-year projected number of connections by the peak day  
 7 use per connection of 214.35<sup>4</sup> results in a capacity of 4.25 mgd,<sup>5</sup> or 88 percent of the 5.0 mgd rated  
 8 capacity for the Northwest Plant, when the required flows from the Sun City West arsenic treatment  
 9 plant are included, (Staff Br. at 20.), and that therefore, by 2010, the capacity of the Northwest Plant  
 10 could already be within 2 percent of the 90 percent capacity threshold at which ADEQ regulations  
 11 would require construction to be undertaken to further expand the Northwest Plant. (Staff Br. at 20.)

12 The Council states that it opposes the 32 percent allocation of the Northwest Plant, and  
 13 supports only 2.5 percent of the costs of the Northwest Plant being recovered from Anthem/Agua  
 14 Fria Wastewater District ratepayers. (Council Br. at 7; Reply Br. at 2-3.) The Council urges the  
 15 Commission to re-evaluate and adjust the cost percentage according to the percentage of wastewater  
 16 flows to the Northwest Plant during the next rate case in that test year. (*Id.*)

17 RUCO asserts in this case, as it did in the Sun City West Wastewater case, that the  
 18 Company's proposed allocation of the Northwest Plant to the Anthem/Agua Fria Wastewater District  
 19 is actually a proposal to treat the Northwest Plant as a capital lease. (RUCO Br. at 3.) At the same  
 20 time, RUCO asserts that because the criteria for recording the Northwest Plant as a capital lease are  
 21 not met, treating the Northwest Plant as a capital lease would violate generally accepted accounting  
 22 principles ("GAAP"). (RUCO Br. at 4-5.) RUCO contends that because the Anthem/Agua Fria  
 23 Wastewater District does not have a contractual arrangement for wastewater treatment at the  
 24 Northwest Plant, and because the Anthem/Agua Fria Wastewater District does not own the Northwest  
 25 Plant, the costs associated with treatment should be classified as an operating expense, and no rate

26 <sup>4</sup> Exh. S-21, Table 3 shows peak day flow to be 214.35 mgd during the test year in February 2005, when there were  
 27 15,582 service connections (3,340,000 gallons peak day flow/15,582 connections = 214.35 peak day flow per  
 connection).

28 <sup>5</sup> 19,840 projected connections x 214.35 test year peak day flow per connection = 4.2527 mgd capacity.



1 base treatment should be afforded. (RUCO Br. at 3.) RUCO argues that “a company which owns  
2 several districts should not be allowed to trade and transfer portions of each district’s rate base among  
3 each other.” (RUCO Br. at 4.)

4 RUCO also argues that Staff and the Company failed to show that an allocation of 32 percent  
5 is warranted. (RUCO Br. at 5.) RUCO characterizes the 32 percent capacity of the Northwest Plant  
6 not currently used by Sun City West Wastewater District customers as “Sun City West excess  
7 capacity” which “will be used to service the needs mostly of future Anthem/Agua Fria [Wastewater]  
8 customers.” (RUCO Reply Br. at 4.) RUCO argues that allocating 32 percent of the Northwest Plant  
9 to Anthem/Agua Fria Wastewater would require those customers to pay for service that will not  
10 benefit them, but will benefit future ratepayers instead, and that ratepayers should not have to pay for  
11 service they do not benefit from. (RUCO Reply Br. at 4.) RUCO points to Staff’s admission that  
12 there are uncertainties associated with growth projections, and argues that the uncertainties “almost  
13 ensure that ratepayers will be treated inequitably and unfairly under Staff and the Company’s  
14 proposal” (RUCO Reply Br. at 5), but RUCO does not offer an alternative percentage of the  
15 Northwest Plant capacity that it believes would be fair to the customers of the Anthem/Agua Fria  
16 Wastewater District. Consistent with its position in the Sun City West Wastewater case, RUCO  
17 instead advocates that the costs associated with the Northwest Plant should be treated as an operating  
18 expense, and argues that its proposal is “the only fair and equitable proposal.” (RUCO Reply Br. at  
19 6.)

20 Arizona-American argues that RUCO offered no evidence to support its claim that the  
21 Company was treating the Northwest Plant as a capital lease, and that RUCO did not provide any  
22 precedent or basis for its belief that two wastewater districts should not share the costs or expenses of  
23 a wastewater treatment plant. (Co. Reply Br. at 8.) We agree with the Company. As Decision No.  
24 70209 states, we did not determine in that proceeding how to treat the portion of the Northwest Plant  
25 that was allocated to the Anthem/Agua Fria Wastewater District in the Sun City West Wastewater  
26 District case. However, we find that it is more efficient for the Company to treat the flows from the  
27 Northeast Agua Fria service area of the Anthem/Agua Fria Wastewater District at the Northwest  
28 Plant together with the flows from the Sun City West Wastewater District, than it would be to build

1 separate, smaller treatment facilities to serve the two areas. Common facilities are used throughout  
2 the wastewater treatment industry, and this Commission supports the use of regional wastewater  
3 treatment facilities. The Company designed and built the Northwest Plant expansion and upgrades in  
4 order to serve the wastewater treatment requirements of the customers in both districts. The districts  
5 are both owned by Arizona-American, and are not separate legal entities with the ability or need to  
6 enter into contracts with one another. We therefore find it appropriate in this case to adopt the  
7 Company and Staff's proposal to allocate rate base and expense associated with the Northwest Plant  
8 between the two districts, as opposed to RUCO's proposal to require the Anthem/Agua Fria  
9 Wastewater District to reimburse the Sun City West Wastewater District for operating expenses. We  
10 now consider the issue of whether the percentage of the allocation proposed by the Company and  
11 Staff, 32 percent, is reasonable and appropriate in this case.

12 Staff points out inconsistencies between RUCO's claim in this proceeding that most of the  
13 Northwest Plant expansion is not used and useful, (*see* Tr. at 1315-1316), and RUCO's proposal in  
14 the Sun City West Wastewater rate proceeding that Sun City West Wastewater ratepayers should bear  
15 100 percent of the plant's capital costs, (*see* Tr. at 1329), and RUCO's rate treatment proposal in that  
16 proceeding which RUCO claims would have the effect of including 97.75 percent of the Northwest  
17 Plant's costs in the Sun City West Wastewater District's rate base, (*see* Tr. at 1358-1359). (Staff Br.  
18 at 15-16.) Staff contends that RUCO's assertion that 70 percent of the proposed allocation to the  
19 Anthem/Agua Fria Wastewater District is unused, (*see* Tr. at 1315-1316), is inconsistent with those  
20 RUCO proposals in the prior case, and doesn't tie to the test year flows from the Agua Fria service  
21 area of the Anthem/Agua Fria Wastewater District. (Staff Br. at 15.) Staff asserts that RUCO's  
22 recommendation in the Sun City West Wastewater District case that 100 percent of the plant costs be  
23 included in the Sun City West Wastewater District's rate base precludes RUCO from claiming in this  
24 case that the plant is not used and useful. (Staff Br. at 16.)

25 Staff also contends that RUCO's position is inconsistent with ratemaking principles, the rules  
26 of the Commission, and accepted industry practices, in that the factors that RUCO argues in support  
27 of disallowing the full allocation of the Northwest Plant between the districts are expressly rejected in  
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1 this Commission's definition of "prudently invested." (Staff Br. at 24.) RUCO counters that Staff's  
 2 criticism of RUCO's position on the issue of prudence is a "red herring." (RUCO Reply Br. at 6.)  
 3 RUCO urges that we not consider the prudence of the Company's decision to expand the Northwest  
 4 Plant, and that our determination should be based only on whether plant that RUCO considers excess  
 5 capacity should be recovered in rates. (*Id.*) We disagree. Consideration of the prudence of the  
 6 utility's investment decision is required any time a determination is made regarding inclusion of plant  
 7 in rate base. While RUCO is correct that prudence is determined after the utility makes its  
 8 investment, Commission rules clearly provide that "[a]ll investments shall be presumed to have been  
 9 prudently made, and such presumptions may be set aside only by clear and convincing evidence that  
 10 such investments were imprudent, when viewed in light of all relevant conditions known or which in  
 11 the exercise of reasonable judgment should have been known, at the time such investments were  
 12 made." (A.A.C. R14-2-103A.3(1).) No party claimed that Arizona-American's decision to expand  
 13 the capacity of the Northwest Plant from 3.14 mgd to 5.0 mgd was imprudent. Indeed, in light of the  
 14 record evidence regarding peak daily wastewater flows, it would likely have been imprudent for the  
 15 Company to have failed to construct the expansion. The record demonstrates that the Company  
 16 prudently decided to make the investment necessary in 2004 to expand the capacity of the Northwest  
 17 Plant from 3.14 mgd to 5.0 mgd, in consideration of the known peak daily flows that occurred prior  
 18 to the expansion, in conjunction with ADEQ requirements for utilities to submit a plan for  
 19 wastewater treatment plant expansion when the capacity factor reaches 80 percent, and to begin  
 20 construction when capacity reaches 90 percent. RUCO's arguments against inclusion of the capacity  
 21 Staff and the Company advocate is necessary to meet the needs of the Northeast Agua Fria service  
 22 area of the Anthem/Agua Fria Wastewater District fail to address the requirement that prudence be  
 23 determined based on what a utility knew or reasonably should have known at the time investment  
 24 decisions are made.

25 In addition to a determination of prudence, we must determine whether plant is used and  
 26

27 <sup>7</sup> RUCO testified in this proceeding that it proposed in that case that 100 percent of the plant's capital costs should be  
 28 recovered from Sun City West Wastewater ratepayers, (Tr. at 1329), and that it has advocated a rate treatment proposal in  
 that proceeding which would have had the effect of including 97.75 percent of the Northwest Plant's costs in the Sun City  
 West Wastewater District's rate base, (Tr. at 1358-1359).

1 useful prior to including it in the rate base of a regulated utility. In our consideration of whether the  
2 entire Northwest Plant expansion is used and useful, reliance on RUCO's own stated position in the  
3 Sun City West Wastewater case<sup>7</sup> provides support for Staff's position, based on Staff's engineering  
4 analysis expertise, that the entire Northwest Plant is 100 percent used and useful. RUCO alleges in  
5 this case that the admitted uncertainties in Staff's growth projections will lead to inequitable rates  
6 under the rate base allocation treatment of the Northwest Plant, but RUCO has not offered alternative  
7 projections or recommended any alternative percentage of the allocation. While projections are, by  
8 their nature, uncertain, Staff used a scientifically accepted method for projecting growth. A bare  
9 declaration that the uncertainty inherent to growth projections will "almost ensure" inequitable and  
10 unfair rates, is not sufficient to support excluding from rate base capacity that the Company prudently  
11 built and that Staff and the Company advocate is necessary to meet the needs of the Northeast Agua  
12 Fria service area. RUCO's position also fails to take into account both the five year planning horizon  
13 that is the generally accepted means for utilities to make wastewater plant investment decisions, and  
14 the Northwest Plant peak day flow information from Docket No. WS-01303A-02-0867 that was  
15 introduced in this case. (See Exh. S-23 at 4). The five year planning horizon is also used by ADEQ  
16 to analyze necessary wastewater treatment plant additions.

17 Credible evidence was presented, in the form of Staff's engineering expertise and RUCO's position  
18 in the Sun City West Wastewater case, that the Northwest Plant expansion was prudent under  
19 Commission rules, and that the capacity is used and useful. The weight of the evidence supports the  
20 conclusion that 32 percent of the total capacity of the Northwest Plant has been built to serve  
21 Anthem/Agua Fria Wastewater customers. Allocation of 32 percent of the costs of the Northwest  
22 Plant to the Anthem/Agua Fria Wastewater District as proposed by the Company and Staff is  
23 therefore reasonable and appropriate, and will be adopted. Appropriate adjustments to accumulated  
24 depreciation, operating expense, and depreciation expense are also necessary, as addressed in  
25 discussion below. We will order the Company to report the results of plant operations in the  
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1 Company's annual report. The allocation may be revisited in future rate cases if the relative use of  
2 the plant by the districts changes, or if other circumstances warrant.

3 **B. Phoenix Interconnection**

4 The Anthem Wholesale Water/Wastewater Service Agreement with the City of Phoenix  
5 ("Phoenix Agreement") provides a redundant water supply from the City of Phoenix for peak and  
6 emergency water service to ensure reliability of water service to Anthem. The City of Phoenix has  
7 the capability to receive and treat Ak-Chin water at two separate locations on the Central Arizona  
8 Project ("CAP") system, and the Phoenix Agreement makes an average of 2.5 million gallons per day  
9 ("mgd") of Ak-Chin water available to the Company for distribution to Anthem at a maximum flow  
10 rate of 5.0 mgd. (Exh. A-23). Decision No. 64897 (June 5, 2002) authorized the five \$1,000,000  
11 payments that the Company is obligated to pay the City of Phoenix under the Phoenix Agreement to  
12 be approved as a regulatory asset, with the amortization period and method of recovery to be  
13 determined in a future rate filing. The interconnection was installed in 2005. (Direct Testimony of  
14 Company witness Bradley Cole, Exh. A-3 at 11.)

15 The Company's application reflected only the two \$1 million payments that the Company has  
16 made to the City of Phoenix. (Direct Testimony of Staff witness Dennis Rogers, Exh. S-4 at 8.) Staff  
17 recommends that the full \$5 million value of the Phoenix Agreement be included in rate base, and  
18 that the \$3 million in outstanding debt included in the Company's capital structure as zero-cost debt.  
19 (Exh. S-4 at 8-9.) Staff's proposal includes amortizing \$100,000 of the 25 year value of the  
20 interconnection to account for the half year the facility was in service during the test year. (*Id.*) The  
21 Company agrees with Staff's recommendation. (Co. Reply Br. at 8.)

22 The Council is in agreement with Staff and the Company that the full value of the Phoenix  
23 Agreement should be included in rate base because the interconnection was in service during the test  
24 year. (Surrebuttal Testimony of Council witness Sonn Rowell, Exh. C-5 at 1.) The Council  
25 recommends that the test year amortization be \$125,000, based on its argument that the remaining life  
26 of the Anthem Agreement is only 20 years. (*Id.* at 2.) The Company disagrees with the Council's  
27 shorter amortization period, as the term of the Phoenix Agreement is renewable for another 25 years.  
28

1 RUCO recommends including in rate base only \$1 million of cost of the interconnection,  
2 because it was paid in the test year. (Direct Testimony of RUCO witness Rodney L. Moore, Exh. R-  
3 3 at 13.) RUCO states that including the complete cost of the interconnection in rate base, as  
4 proposed by the Company and Staff, effectively treats it as cost free debt, (Surrebuttal Testimony of  
5 Rodney L. Moore, Exh. R-4 at 6), and that RUCO would not be opposed to such treatment, as long as  
6 a hypothetical capital structure is not adopted, because applying cost-free debt to a hypothetical  
7 capital structure would artificially inflate the revenue requirement, (*Id.* at 7).

8 As discussed below, we do not adopt a hypothetical capital structure in this case, and RUCO's  
9 position is therefore not opposed to the rate base treatment proposed by the Company, Staff and the  
10 Council. Placing the full cost of the interconnection in rate base at this time complies with standard  
11 ratemaking principles and is reasonable, and this treatment will therefore be adopted. As Staff points  
12 out in its reply brief, the Phoenix Agreement, and Decision No. 64897 (June 5, 2002), which  
13 authorized the Company to record the amounts paid by the Company to the City of Phoenix under the  
14 Phoenix Agreement as a regulatory asset, both provide for a 25 year amortization period. We  
15 therefore find the test year amortization proposed by the Company and Staff to be reasonable and will  
16 adopt it.

17 **C. Imputation of AIAC and CIAC per Decision No. 63584**

18 The Company, RUCO and the Council propose AIAC and CIAC imputations of \$11,373,805  
19 and \$649,675, respectively, for Anthem Water; and \$7,445,449 and \$285,258 for Anthem/Agua Fria  
20 Wastewater. Staff proposes AIAC and CIAC imputations of \$11,643,588 and \$656,157,  
21 respectively, for Anthem Water; and \$7,622,053 and \$288,104 for Anthem/Agua Fria Wastewater.

22 Under the terms of the settlement agreement approved by Decision No. 63584 (April 24,  
23 2001), which approved the acquisition of the water and wastewater assets of Citizens Utilities  
24 Company by Arizona-American, Citizens' liabilities related to AIAC and CIAC were to be imputed  
25 to Arizona-American, but amortized over periods of six and a half years for AIAC and 10 years for  
26 CIAC, beginning in January 2002, in order to allow the imputed AIAC and CIAC balances to be  
27 slowly reduced in order to correctly reflect rate base for ratemaking treatment. In this case, the effect  
28 of the amortization will be to reduce the districts' AIAC and CIAC balances, which in turn will result

1 in increases to rate base.

2 Arizona-American used accounting data ending on December 9, 2005, but is proposing  
3 imputed AIAC and CIAC accruals through December 31, 2005. (Rejoinder Testimony of Company  
4 witness Thomas M. Broderick, Exh. A-9 at 2.) Staff opposes the Company's proposed treatment, and  
5 argues that the Company's rate base for both districts should reflect amortization of imputed AIAC  
6 and CIAC only through December 9, 2005, which Staff asserts is properly the end of the test year in  
7 this application. (Surrebuttal Testimony of Staff witness Gerald Becker, Exh. S-7 at 5.) Staff argues  
8 that the twenty-two day difference in the amortization period has a significant effect on overall rate  
9 base, and therefore recommends that the imputed regulatory AIAC and CIAC balances reflect the  
10 period January 15, 2002 through December 9, 2005. (Staff Br. at 11, 27.) Arizona-American argues,  
11 however, that December 31, 2005, is the end of its chosen test year, and that Staff's adjustment  
12 "reinterprets" the Company's test year to end at December 9, 2005. (Co. Br. at 43-44.)

13 Staff argues that the Company chose the test year for its rate case; that Staff did not arbitrarily  
14 define December 9, 2005 as the end of the test year; and that the Company's claim that the test year  
15 ended on December 31, 2005 is an attempt to accelerate imputed AIAC and CIAC. (Staff Reply Br.  
16 at 2.) Staff takes issue with the Company's argument that the test year should end on the December  
17 31, 2005, year-end date recognized by the Company's auditors, despite the fact that the Company  
18 closed its books on December 9, 2005. (Staff Reply Br. at 4.) Staff argues that financial reporting  
19 under GAAP is not followed by the Commission for regulatory accounting. (Staff Reply Br. at 4.)  
20 Staff points out that the Company's methodology of making accruals for expenses after December 9,  
21 2005 through December 31, 2005, is not allowed for under the National Association of Regulatory  
22 Commissioners ("NARUC") uniform system of accounts ("USOA"), under which Arizona-American  
23 is required to maintain its books and records, pursuant to A.A.C. § R14-2-411.D.2. (Staff Reply Br.  
24 at 4.) Staff asserts that accruals are distinct from pro forma adjustments in that they violate the  
25 matching principle and do not result in a more realistic relationship between revenues, expenses and  
26 rate base. (Staff Reply Br. at 4.) Staff argues that it would be inappropriate to accelerate the AIAC  
27 and CIAC amortizations because doing so would upset, to the detriment of ratepayers, the balance of  
28 Company and ratepayer interests that was reached in Decision No. 63584. (Staff Reply Br. at 5.)

1 We agree with Staff that the Company's reliance upon the extra six days of amortization in  
2 Decision No. 69440 is misplaced, because the period for AIAC and CIAC accruals was not at issue in  
3 that case. We find that for the reasons argued by Staff, accepting the Company's approximations for  
4 imputed AIAC and CIAC accruals through December 31, 2005, would be inappropriate in this case,  
5 and will adopt Staff's proposed AIAC and CIAC imputations of \$11,643,588 and \$656,157,  
6 respectively, for Anthem Water; and \$7,622,053 and \$288,104 for Anthem/Agua Fria Wastewater.

7 **D. CIAC Amortization Rate Calculation**

8 In conjunction with our adoption of Staff's proposed methodology for calculating CIAC  
9 amortization expense, discussed under Operating Income Issues, below, we adopt Staff's proposed  
10 reduction to CIAC of \$135,728 for Anthem/Agua Fria Wastewater, resulting in a net CIAC balance  
11 of \$6,086,995. (See Surrebuttal Testimony of Staff witness Gerald Becker, Exh. S-7 at 6-8; Final  
12 Schedules of Staff witness Gerald Becker, Sched. GWB-4 and 5.)

13 **E. Accumulated Depreciation**

14 The Company takes issue with Staff's proposed accumulated depreciation balance for Anthem  
15 Water, stating that it cannot determine the exact source of the \$64,274 difference between the  
16 Company and Staff. (Co Br. at 48.) The Company posits that Staff may have used incorrect  
17 depreciation rates. (*Id.*) Staff responds that the difference is attributable to an adjustment the  
18 Company made in response to a data request from RUCO, in which the Company revised its  
19 accumulated depreciation balance from \$7,533,419 to \$7,469,145. (Staff Reply Br. at 7.) We will  
20 adopt Staff's proposed balance for accumulated depreciation, as it accurately reflects the rate base  
21 adjustments we have adopted.

22 In conjunction with adopting the proposed 32 percent allocation of the Northwest Plant to the  
23 Anthem/Agua Fria Wastewater District's rate base as addressed above, we adopt Staff's proposed  
24 adjustment to accumulated depreciation of \$611,828 for the test year. (See Staff Final Schedule  
25 GWB-4.)

26 **F. Cash Working Capital**

27 Arizona-American did not request an allowance for cash working capital for either district.  
28 The Company and Staff both propose a zero balance for cash working capital in this case, for total



1 working capital of \$60,874 for Anthem Water and \$22,961 for Anthem/Agua Fria Wastewater.  
2 RUCO proposes instead a negative \$241,877 cash working capital allowance for Anthem Water, for  
3 total working capital of negative \$181,003, and a cash working capital allowance of negative \$90,867  
4 for Anthem/Agua Fria Wastewater, for total working capital of negative \$67,906.

5 In developing its cash working capital allowances, RUCO relied on the lead/lag study  
6 developed by Arizona-American for its Mohave Water and Wastewater District in a recent rate  
7 application. RUCO argues that its use is appropriate in this case because a large portion of the  
8 districts' expenses are incurred at the Company's corporate headquarters and are therefore common  
9 to the Mohave District and the districts in this case. (RUCO Br. at 7.) RUCO further argues that  
10 because many expense payments have identical lags for every utility, such as income tax, property  
11 tax, and taxes other than income, RUCO's adjusted lead/lag study is appropriate and the best  
12 indicator of the districts' working capital requirements. (Id.) RUCO asserts that the facts in this case  
13 are almost identical to the facts in Decision No. 68858, where RUCO's cash working capital  
14 recommendation was adopted because it was based on the lead/lag study the Company prepared in  
15 that case prior to the Company's request for zero cash working capital. (RUCO Reply Br. at 6-7.)

16 The Company opposes RUCO's recommendation to base cash working capital on the lead/lag  
17 study the Company performed for its Mohave Water and Wastewater districts; asserts that there is no  
18 Commission requirement that a rate application include a request for cash working capital; and  
19 argues that RUCO has the burden of providing a lead/lag study for the districts if it wishes the  
20 Commission to consider or adopt an amount other than the zero level requested by the Company.  
21 (Co. Br. at 44-45.) The Company is critical of the fact that RUCO adjusted the Mohave lead/lag  
22 study for revenues only, and not for expenses, (Co. Br. at 45, citing to Direct Testimony of RUCO  
23 witness Rodney L. Moore, Exh. R-3 at 23), and states that the lag days for purchased water in the  
24 Anthem Water District are 154 days, rather than the 87 days used in the Mohave study, (Co. Br. at  
25 45, citing to Rebuttal Testimony of Company witness Linda Gutowski, Exh. A-6 at 9). The  
26 Company argues that given that purchased water expense for the Anthem Water District comprises  
27 roughly ten percent of total expenses, it would impact the calculation of cash working capital. (Id.)  
28 However, the Company offered no alternative analysis to address the asserted shortcoming of

1 RUCO's adjustments to the Company's Mohave study.  
 2 A lead/lag study is the most accurate and appropriate means of measuring cash working capital  
 3 requirements of a company of Arizona-American's size. RUCO's recommendation in this case,  
 4 which is based on the lead/lag study developed by Arizona-American for its Mohave District in a  
 5 recent rate application, and adjusted for the districts in this case, is based on a more objective analysis  
 6 of the Company's cash working capital needs than the zero cash working capital allowance proposed  
 7 by the Company. The Company argues that using the Mohave lead/lag study is inappropriate  
 8 because the test year for the Mohave case was the 12 months ending in June 2005. (Co. Br. at 45.)  
 9 As RUCO argues, however, aligning the twelve months of the differing test years for the districts is  
 10 not necessary, because the timing of payments is not typically dependent on test year. (See RUCO  
 11 Br. at 7.) RUCO's proposed negative \$241,877 cash working capital allowance for Anthem Water,  
 12 for total working capital of negative \$181,003, and a cash working capital allowance of negative  
 13 \$90,867 for Anthem/Agua Fria Wastewater, for total working capital of negative \$67,906 is  
 14 reasonable and will be adopted.

15 **IV. ORIGINAL COST RATE BASE**

16 Based on the foregoing discussion, we adopt an adjusted original cost rate base ("OCRB") for  
 17 Arizona-American's Anthem Water District of \$36,267,274, and \$20,097,915 for the Anthem/Agua  
 18 Fria Wastewater District.

	Commission Approved (Anthem Water)
20 <u>OCRB</u>	
21 Plant in Service	\$ 82,072,978
22 Less: Accumulated Depreciation	<u>7,469,145</u>
23 Net Plant in Service	\$ 74,603,833
24 <u>Deductions:</u>	
25 AIAC	\$ 26,012,655
26 Net CIAC	112,890
27 Imputed Regulatory Advances	11,643,588
28 Imputed Regulatory Contributions	656,157
Customer Deposits	2,880
Investment Tax Credits	11,546
Deferred Income Tax Credits (Debits)	(284,160)
<u>Additions:</u>	
Working Capital	(181,003)
Total OCRB	\$ <u>36,267,274</u>

Commission Approved  
(Anthem/Agua Fria  
Wastewater)

<u>OCRB</u>	
Plant in Service	\$ 84,495,788
Less: Accumulated Depreciation	<u>7,834,564</u>
Net Plant in Service	\$ 76,661,224
<u>Deductions:</u>	
AIAC	\$ 42,884,958
Net CIAC	6,086,995
Imputed Regulatory Advances	7,622,053
Imputed Regulatory Contributions	288,104
Customer Deposits	0
Investment Tax Credits	16,377
Deferred Income Tax Credits (Debits)	(403,083)
<u>Additions:</u>	
Working Capital	(67,906)
Total OCRB	\$ <u>20,097,915</u>

**V. FAIR VALUE RATE BASE**

The Company did not request a reconstruction cost new rate base for the districts, so we adopt OCRB as the districts' fair value rate base ("FVRB") in this proceeding.

**VI. OPERATING INCOME ISSUES**

The parties' recommendations regarding test year operating income are as follows: Arizona-American, \$803,353 for Anthem Water and \$282,080 for Anthem/Agua Fria Wastewater; RUCO, \$965,789 for Anthem Water and \$636,138 for Anthem/Agua Fria Wastewater; and Staff, \$836,259 for Anthem Water and \$346,967 for Anthem/Agua Fria Wastewater. The parties reached agreement on many operating income issues. Disputed issues are discussed below.

**A. Rate Case Expense**

The Company is requesting recovery of \$300,000 in rate case expense for the two districts, normalized over a period of three years, and equally shared by the districts. Staff is in agreement.

RUCO agrees that the total rate case expense should be allocated 50/50 between the water and wastewater districts, and that the allowed expense be amortized over three years, but recommends

1 that the Company be allowed to recover a total of \$183,962 for the two districts. RUCO recommends  
2 disallowance of \$100,000 of the \$143,000 the Company is requesting for rate design and cost of  
3 service studies. RUCO notes that the Company's similar request for recovery of \$143,000 for rate  
4 design and cost of service studies was rejected in Decision No. 69440, the Company's Mohave Water  
5 and Wastewater District case. RUCO also recommends disallowance of \$16,038 that the Company  
6 included in rate case expense in order to round its estimate up to \$300,000.

7 Arizona-American asserts that this case has been a much more complicated case than the  
8 recently completed Mohave case, Decision No. 69440, where it was authorized to recover \$201,794  
9 in rate case expense. (Co. Br. at 52.) The Company states that the Anthem districts have more  
10 customers and much larger rate bases than the Mohave districts, and that this case has required  
11 significantly more testimony and hearing time, (*Id.*), and points out that its current request for  
12 \$300,000 is less than 50 percent more than the amount it was authorized to recover by Decision No.  
13 69440. (Co. Reply Br. at 9.) The Company argues that adoption of RUCO's recommendation would  
14 result in the Company recovering less than the \$188,935 that the Company had already spent through  
15 May 7, 2007, prior to the commencement of the hearing. (Co. Br. at 52.) The Company further  
16 asserts that it had spent \$66,191 for rate design and cost of service related expense, and that RUCO's  
17 recommendation would result in recovery of only \$43,000 of that amount.

18 RUCO agrees that there have been an unusual number of days of hearing in this case, due to  
19 the change in the Company's position regarding the Northwest Plant and the Pulte issues, and that a  
20 significant amount of time was spent on those issues, but contends that the circumstances of this case  
21 were not extraordinary. (RUCO Reply Br. at 9.) RUCO believes that its recommendation would  
22 provide the Company with a reasonable amount of rate case expense, even though it is less than what  
23 the Company spent. (*Id.*)

24 This case required a considerable number of hearing days, post-hearing discovery, and post-  
25 hearing exhibits. At the time briefs were filed, the March 13, 2008, joint Motion to Reopen the  
26 Record and Schedule a Hearing filed by RUCO and the Council had not yet required a Company  
27 response and the subsequent oral arguments on March 28, 2008, which led to an increase in costs.  
28 Due to the number of hearing days required and the complexity of the issues in this case, we find it

1 reasonable to authorize recovery of \$300,000 in rate case expense for the two districts, normalized  
2 over a period of three years, and equally shared by the districts.

3 **B. Miscellaneous Expenses**

4 RUCO recommends disallowance of \$70,351 in miscellaneous expenses for the Anthem  
5 Water District and \$11,705 for Anthem/Agua Fria Wastewater District, for award lunches, non-  
6 recurring costs, and tasks now handled in-house. (Direct Testimony of RUCO witness Rodney L.  
7 Moore, Exh. R-3 at 26; Surrebuttal Testimony of Rodney L. Moore, Exh. R-4 at 14.) RUCO  
8 contends that the expenditures are not necessary to provide water and wastewater services, and  
9 ratepayers should not pay for them. (RUCO Br. at 10.) RUCO's proposed adjustments were based  
10 not on an audit, but on the Company's "product code" description of the Company's miscellaneous  
11 expense records. (Rebuttal Testimony of Company witness Linda J. Gutowski, Exh. A-6 at 15.)  
12 Arizona-American reviewed the proposed disallowances and agreed to \$931 of the proposed  
13 adjustments for the Anthem Water District and \$2,534 of the proposed adjustments for the  
14 Anthem/Agua Fria Wastewater District, and provided details supporting the remainder of the  
15 proposed disallowances. (Rebuttal Testimony of Company witness Bradley J. Cole, Exh. A-4 at 6-7  
16 and Exhibit BJC-R2.) Upon examination of the Company's Exhibit BJC-R2, we find its alternative  
17 adjustments reducing expenses by \$931 for Anthem Water and \$2,534 for Anthem/Agua Fria  
18 Wastewater to be reasonable and appropriate, and will adopt these amounts of the disallowances  
19 proposed by RUCO.

20 **C. Property Tax Expense Calculation**

21 The Company is in agreement with Staff concerning the appropriate methodology for  
22 calculating property tax expense for the districts. (Co. Reply Br. at 2.) Based on its adjustments to  
23 the Company's application, Staff proposes property tax expense of \$338,357 for the Anthem Water  
24 District and \$307,546 for the Anthem/Agua Fria Wastewater District. Staff included a factor for  
25 property taxes in the Gross Revenue Conversion Factor ("GRCF") that automatically adjusts the  
26 revenue requirement for changes in revenue in the same way that income taxes are adjusted for  
27 changes in operating income. (Direct Testimony of Dennis Rogers, witness for Staff, Exh. S-4 at 16;  
28 Direct Testimony of Gerald Becker, witness for Staff, Exh. S-6 at 14.) Staff states that its

1 methodology will accurately reflect property tax expense in authorized revenues at any level. (*Id.*)  
2 Staff recommends adoption of its property tax expense estimates, and also recommends that its  
3 GRCF methodology, which includes a factor for property tax expense, be adopted.

4 RUCO recommends decreases in operating expense of \$1,909 for the Anthem Water District  
5 and \$90,589 for the Anthem/Agua Fria Wastewater District, based on RUCO's estimate of property  
6 tax expense using a formula that has been repeatedly rejected by the Commission. RUCO compared  
7 its estimates for 2006 property tax expense using its preferred formula with its estimates for 2006  
8 property tax expenses using the Company's formula and with actual 2006 property tax expenses for  
9 the districts. RUCO concluded that its property tax estimation procedure is superior because its  
10 estimates for 2006, using RUCO's preferred formula, are closer to the actual 2006 property tax  
11 expenses than RUCO's 2006 estimates using the Company's proposed methodology.

12 Arizona-American opposes RUCO's methodology because it is based on a methodology that  
13 this Commission has repeatedly rejected. (Co. Br. at 49.) The Company argues that it is irrelevant to  
14 compare actual 2006 property taxes to what RUCO's methodology would have calculated for 2006,  
15 because this case requires estimating property taxes after setting rates to recover the 2005 test-year  
16 revenue deficiency, (Co. Reply Br. at 10), and that RUCO's proposal in this case continues to largely  
17 rely on historical data. (Co. Br. at 50.) We agree with the Company that RUCO's property tax  
18 expense adjustments should be rejected. We are not convinced by RUCO's calculations regarding  
19 2006 property tax expenses, because, as the Company points out, this decision will increase revenues  
20 and thereby increase property taxes, and RUCO's calculations will not appropriately reflect the  
21 effects of the revenues authorized in this case on future property tax expense.

22 The purpose of a property tax estimation methodology is to provide the best estimate of what  
23 future property taxes will be. While no future property tax estimation methodology is perfect, we  
24 find that the forward-looking methodology used by the Company and Staff in this case, and approved  
25 in numerous prior rate decisions, is appropriately balanced and provides a reasonable and logical  
26 means of estimating the future property tax expenses of the districts. RUCO has not demonstrated  
27 the existence of a need for divergence from our prior determinations on this issue. We will therefore  
28 adopt the recommendations of the Company and Staff to follow Commission precedent and use

1 adjusted test year revenues in determining property tax expense. Staff's proposal regarding inclusion  
2 of a property tax factor in its GRCF methodology in order to calculate the gross revenue required to  
3 obtain the proper level of operating income is reasonable, and will be adopted.

4 **D. Water Conservation Promotion Expenses**

5 RUCO recommends disallowing \$7,500 in expenses that the Company budgeted for  
6 promoting water conservation in Anthem during 2006. RUCO argues that these costs do not have  
7 known, measurable, and verifiable documentation, and were scheduled to be incurred outside the test  
8 year. (Exh. R-3 at 27.) Arizona-American argues that the conservation program expense is known  
9 and measurable, as the program has been in existence for over ten years. (Co. Br. at 53.) The  
10 Company further argues that the program provides benefits to Anthem residents and has their  
11 support. (Rebuttal Testimony of Company witness Thomas Broderick, Exh. A-8 at 9.) We believe  
12 that the Company's promotion of water conservation benefits the ratepayers and should be  
13 encouraged. The expense is known, measurable, and reasonable, and the Company should not be  
14 penalized for publicizing the important concept of water conservation. The proposed amendment  
15 will not be adopted.

16 **E. Labor Expense**

17 RUCO recommends that the Company's proposed labor expenses be adjusted downward to  
18 reflect salary levels at the end of the test year. (Exh. R-3 at 25.) RUCO's adjustments reject the use  
19 of post-test year labor rates to calculate direct and corporate payroll, and would reduce operating  
20 expenses for the Anthem Water District by \$81,214 and for the Anthem/Agua Fria Wastewater  
21 District by \$69,693. (*Id.* at 25-26.) RUCO argues that its recommendation provides for the matching  
22 of ratemaking elements within the historical test year. (RUCO Reply Br. at 8.)

23 The Company argues that the labor rates it used, and which Staff accepted, in order to  
24 calculate these expenses are known and measurable. We agree. As we stated in Decision No. 70209,  
25 known and measurable labor expense that the Company is incurring on a going-forward basis should  
26 be recognized. This does not result in a mismatch of revenues and expenses, as it is being applied to  
27 employees who were employed during the test year. RUCO's adjustments will therefore not be  
28 adopted.

1 **F. CIAC Amortization Rate Calculation**

2 Staff and the Company are in disagreement over the methodology for calculating the amortization  
3 rate for determining test year CIAC amortization expense. Arizona-American proposes to use proxy  
4 depreciation rates based only on certain assets. (Co. Br. at 55.) For Anthem Water, the Company  
5 proposes a CIAC amortization rate of 1.63 percent, based on the composite depreciation rate for the  
6 plant accounts Mains, Service, Meters, and Hydrants; and for Anthem/Agua Fria Wastewater, the  
7 Company proposes a CIAC amortization rate of 2.04 percent, based on the composite depreciation  
8 rate for the plant accounts Collecting Mains and Services. (Rebuttal Testimony of Company witness  
9 Linda Gutowski, Exh. A-6 at 11-12.) Staff does not disagree with the Company's proposal to use a  
10 composite rate. However, Staff advocates use of composite rates that are based upon the entire rate  
11 base used to calculate depreciation expense in this case. (Surrebuttal Testimony of Staff witness  
12 Dennis Rogers, Exh. S-5 at 7.) For Anthem Water, Staff proposes a CIAC amortization rate of 2.40  
13 percent, and for Anthem/Agua Fria Wastewater, Staff proposes a CIAC amortization rate of 3.34  
14 percent.

15 The Company contends that the depreciation rates proposed by Staff are inappropriate, in that  
16 they are developed using some plant items with high depreciation rates that are rarely or never  
17 contributed to by developers. (Company Br. at 55-56.) Staff explains that when adequate utility  
18 records exist, CIAC received can be matched with corresponding plant so that the plant depreciation  
19 and offsetting CIAC amortization can also be matched within the plant accounts for the CIAC, but  
20 that when a utility does not maintain detailed records, the established and accepted practice is to  
21 calculate a composite depreciation rate for all depreciable plant, and use that rate as the CIAC  
22 amortization rate. (Surrebuttal Testimony of Staff witness Dennis Rogers, Exh. S-5 at 8.) Staff  
23 disagrees with the use of the specific limited accounts proposed by the Company to develop  
24 composite rates, and points out that the Company's failure to keep detailed records in those very  
25 accounts rendered it impossible for Staff to perform an audit to verify the CIAC related to them.  
26 (Staff Reply Br. at 6.)

27 The Company and Staff agree on \$112,890 as the basis for ordinary CIAC for the test year for  
28 Anthem Water; and \$6,305,605 as the basis for ordinary CIAC for the test year for Anthem/Agua



1 Fria Wastewater. Staff's proposed 2.4 percent CIAC amortization rate results in ordinary CIAC  
2 amortization of \$2,706 for the test year, for total CIAC amortization expense of \$110,249, when  
3 added to amortization of imputed regulatory CIAC of \$107,543. (Final Schedules of Staff witness  
4 Dennis Rogers, Sched. DRR-16). For Anthem/Agua Fria Wastewater, Staff proposes a 3.34 percent  
5 CIAC amortization rate, for ordinary CIAC amortization of \$210,564 for the test year, resulting in  
6 total CIAC amortization expense of \$257,784, when added to amortization of imputed regulatory  
7 CIAC of \$47,220. (Final Schedules of Staff witness Gerald Becker, Sched. GWB-13.)

8 Because the Company did not provide the detailed Company records required to support the  
9 most accurate amortization figures for the plant financed by CIAC, Staff's methodology of using a  
10 composite depreciation rate to calculate the CIAC amortization rate is a reasonable and appropriate  
11 alternative. Documentation is within the Company's control, and the Company should not be heard  
12 to complain about use of an alternative methodology to compensate for its own shortcomings in  
13 keeping its books. CIAC balances reflecting the accumulation of the periodic amortizations should  
14 be adopted for Anthem Water and Anthem/Agua Fria Wastewater. Therefore, for Anthem Water,  
15 total test year CIAC amortization expense is \$110,249, and for Anthem/Agua Fria Wastewater, total  
16 test year CIAC amortization expense is \$257,784.

#### 17 **G. Depreciation Expense**

18 The Company proposes depreciation expense for its Anthem Water District of \$1,908,304;  
19 and for its Anthem/Agua Fria Wastewater District of \$2,546,060. (Co. Final Schedules Including  
20 Reallocation of Northwest Plant, Exh. A-33.)

21 Staff recommends net depreciation expense of \$1,961,536 for Anthem Water, (Surrebuttal  
22 Testimony of Staff witness Dennis Rogers, Exh. S-5 at 8, with final calculations in Final Schedule of  
23 Staff witness Dennis Rogers, Final Schedule DRR-16), and \$2,447,937 for Anthem/Agua Fria  
24 Wastewater, (Surrebuttal Testimony of Staff Witness Gerald Becker, Exh. S-7 at 11, with final  
25 calculations in Final Schedule of Staff witness Gerald Becker, Final Schedule GWB-9.)

26 RUCO states on brief that it reviewed the Final Schedules the Company filed on June 22,  
27 2007, which includes a comparison of the depreciation rates used by the Company, RUCO, and Staff,  
28 and notes that the few minor discrepancies between the parties' depreciation rate proposals amount to

1 an overall de minimus difference, and that RUCO accepts the Company's depreciation rates. RUCO  
 2 recommends depreciation expense for Anthem Water of \$1,761,604. (RUCO Br. at 9-10.) RUCO  
 3 explains that the difference between the Company's depreciation expense proposal and RUCO's is  
 4 attributable to RUCO's differing position, discussed above, regarding rate base treatment of the  
 5 Phoenix Agreement. (RUCO Br. at 9-10; RUCO Reply Br. at 9.) RUCO states that it agrees with the  
 6 Company's depreciation expense calculation of \$2,512,013 for Anthem/Agua Fria Wastewater, as  
 7 shown in the Company's June 22, 2007 filing. (RUCO Br. at 9-10.)

8 We agree with RUCO that taken as a whole, the differences between the parties in proposed  
 9 depreciation rates by account are de minimus, and will adopt the Company's proposed depreciation  
 10 rates for use on a going forward basis, as they are depicted in the Company's depreciation schedules  
 11 filed on June 22, 2007. However, because Staff's proposed depreciation expense for the districts  
 12 includes the proper CIAC amortization, as discussed above, as well as the proper depreciation  
 13 expense for the reallocation of the Northwest Plant, (*See* Staff Reply Br. at 8-9, responding to Co. Br.  
 14 at 53-54), we adopt Staff's depreciation expense calculations in this case.

15 For Arizona-American's Anthem Water District, depreciation expense for this case is  
 16 \$1,961,536. For Arizona-American's Anthem/Agua Fria Wastewater District, depreciation expense  
 17 for this case is \$2,447,937.

#### 18 **H. Northwest Plant Allocation Operating Expense**

19 In conjunction with adopting the proposed 32 percent allocation of the Northwest Plant to the  
 20 Anthem/Agua Fria Wastewater District's rate base as addressed above, we adopt Staff's proposed  
 21 adjustment of \$404,149 to operating expense for the test year. (*See* Staff Final Schedules GWB-10,  
 22 GWB-16.)

#### 23 **I. Net Operating Income**

24 Arizona-American's Anthem Water District test year revenues were \$6,867,609. In  
 25 accordance with the discussion herein, the Anthem Water District's adjusted test year operating  
 26 expenses for ratemaking purposes total \$6,033,859, for an adjusted test year operating income of  
 27 \$833,749. For Arizona-American's Anthem/Agua Fria Wastewater District, test year revenues were  
 28 \$6,135,801. In accordance with the discussion herein, the Anthem/Agua Fria Wastewater District's

1 6.7justed test year operating expenses for ratemaking purposes total \$5,788,436, for an adjusted test  
2 year operating income of \$347,365.

### 3 4 **VII. COST OF CAPITAL**

5 The parties to this case recommend a rate of return for the districts as follows: Arizona-  
6 American, 8.07 percent; the Council, 7.16 percent; RUCO, 7.22 percent; and Staff, 7.3 percent. For  
7 the reasons discussed below, we adopt a fair value rate of return for the districts of 6.7 percent.

#### 8 9 **A. Capital Structure and Cost of Debt**

##### 10 1. Capital Structure

11 Arizona-American proposes a capital structure comprised of 58.5 percent debt and 41.5  
12 percent equity. The difference between the Company's capital structure recommendation and that of  
13 Staff is accounted for by the Company's proposal to exclude short-term debt. While the Company  
14 agrees with Staff's proposal to include the Phoenix Agreement obligation in the capital structure, it  
15 proposes that it be treated as zero-cost long-term debt, instead of short-term debt. Arizona-American  
16 argues that it is not using short term debt to finance rate base; that its short-term debt balances vary  
17 over the test year; that including short-term debt in the capital structure makes it more difficult to  
18 maintain a 40 percent equity ratio in accordance with Commission Decision No. 68310 (November  
19 14, 2005);<sup>9</sup> and that Staff's proposal to use a short-term debt balance as of a particular point in time is  
20 inappropriate, unless the balance can be shown to be typical. The Company also argues against  
21 RUCO's capital structure proposal, stating that it is based on old data and imputes more long-term  
22 debt. (Co. Br. at 59.)

23 RUCO is recommending a hypothetical capital structure of 60 percent debt and 40 percent  
24 equity, as the Company initially proposed, prior to updating its capital structure proposal to reflect  
25 debt restructuring and an infusion of equity capital. Based on the position that the events leading to  
26

27 <sup>9</sup> Decision No. 68310 ordered the Company to file an equity plan "that describes how the Company expects to attain and  
28 maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 and 60  
percent of total capital." (Decision No. 68310 at 15.)

1 the Company's change are speculative, RUCO disagrees with the Company's proposed change to its  
2 capital structure. (Surrebuttal Testimony of RUCO witness William A. Rigsby, Exh. R-6 at 5.)

3 Staff recommends a capital structure of 60.8 percent debt and 39.2 percent equity, which  
4 includes outstanding long-term and short-term debt as of April 30, 2007. (Final Schedules of Staff  
5 witness Pedro M. Chaves, Scheds. PMC-3 and PMC-9.) Staff updated the Company's actual capital  
6 structure to include an additional \$3 million in debt (including \$1 million in short-term debt) to  
7 reflect the Phoenix Agreement, and also includes the Company's 2007 equity infusion of \$15 million.  
8 (Final Schedule of Staff witness Pedro M. Chaves, Sched. PMC-9.)

9 In response to the Company's proposal to exclude short-term debt because Arizona-American  
10 is not using short-term debt to finance rate base, Staff states that short-term debt is a component of  
11 the Company's pool of capital, and that dollars cannot be attached to specific uses, and that it is  
12 therefore appropriate to include short-term debt in the capital structure. In further support of  
13 including short-term debt as a component of the cost of capital, Staff points out that Decision No.  
14 68310 contemplated that the Company's capital structure would include short-term debt. (Staff  
15 Reply Br. at 11, citing Decision No. 68310 (November 14, 2005) at 15.)

16 The Council is in agreement with Staff regarding the appropriate capital structure in this case,  
17 because Staff's proposal is based on the Company's most recent debt and equity positions, and  
18 because excluding short-term debt from the capital structure would allow the Company to earn an  
19 equity return on a portion of its capital structure which should be allocated to lower-cost debt.  
20 (Council Reply Br. at 7, 9.)

21 We are not convinced by the Company's arguments for excluding short-term debt from its  
22 capital structure. We agree with the Council that Staff's recommended capital structure provides the  
23 most accurate representation of the districts' actual capital structure. We also find that it is  
24 reasonable to treat \$1 million of the \$3 million in outstanding payments under the Phoenix  
25 Agreement as short-term debt. The Council and Staff are correct that excluding short-term debt from  
26 the capital structure would have the effect of allowing an equity return on debt, thus allowing the  
27 Company to over-earn at ratepayers' expense. Short-term debt is shown as a component of the cost  
28 of capital in the schedules required by A.A.C. R14-2-103, and Decision No. 68310 contemplated that

1 the Company's capital structure would include short-term debt. As discussed below, financial risk  
2 adjustments have been proposed to account for the Company's additional leverage compared with the  
3 proxy companies used to estimate the districts' cost of equity, and we consider those adjustments in  
4 reaching the fair value rate of return approved herein. For purposes of this proceeding, we adopt a  
5 capital structure for the Company of 39.2 percent equity and 60.8 percent debt.

## 6 2. Cost of Debt

7 Arizona-American proposes a cost of long-term debt of 5.45 percent. (Co. Final Schedules D-  
8 1 at 2.) Staff recommends an average cost of debt of 5.4 percent. (Final Schedule of Staff witness  
9 Pedro M. Chaves, Sched. PMC-1.) The Council adopts Staff's recommended cost of debt as its  
10 proposal. (Council Reply Br. at 10.) RUCO recommends a cost of debt of 5.37 percent. (Surrebuttal  
11 Testimony of RUCO witness William Rigsby, Exh. S-6 at 8.) The Company prefers Staff's  
12 calculation of its cost of debt to RUCO's, because RUCO based its calculation on historical data.  
13 The Company points out that Staff's proposed cost of long-term debt is very similar to the  
14 Company's, in that if the \$1 million of the Phoenix Agreement obligation were to be treated as long-  
15 term debt instead of short-term debt, the proposals would be the same. (Co Br. at 60.) Staff's  
16 recommendation of 5.4 percent is based on the districts' actual weighted average cost of total debt  
17 and will be adopted.

## 18 **B. Cost of Equity**

19  
20 The Anthem Water District and the Anthem/Agua Fria Wastewater District do not have  
21 publicly traded stock, so their cost of equity must be estimated. In order to estimate the districts' cost  
22 of equity, the parties analyzed data from selected sample groups of publicly traded companies.  
23 Arizona-American proposes a cost of equity of 11.75 percent, the Council recommends 9.95 percent,  
24 RUCO recommends 10.01 percent, and Staff recommends 10.3 percent.

25 Arizona-American's cost of capital witness arrived at the same cost of equity estimate as she  
26 did in the recent rate proceeding for Arizona-American's Sun City Wastewater and Sun City West  
27 Wastewater Districts leading to Decision No. 70209 (March 20, 2008), using the same  
28

1 methodologies. In reaching its estimate in this case, Staff's cost of capital witness also used the same  
2 methodologies and inputs that Staff's witness used in the recent rate proceeding leading to Decision  
3 No. 70209, and RUCO's cost of capital witness in this case also employed the methodologies and  
4 inputs he used in that recent rate case proceeding to attain his estimate as well. Like the other cost of  
5 capital witnesses, the Council's witness used the discounted cash flow ("DCF") analysis and the  
6 capital asset pricing model ("CAPM") to estimate cost of equity. The Council's witness borrowed  
7 upon Staff's current- and historical market premium analyses in his CAPM analysis.

8 RUCO, the Council and Staff included a financial risk adjustment in their cost of equity  
9 recommendations, in order to account for the higher financial risk reflected in the Company's capital  
10 structure in relation to that of their sample companies. Staff's recommendation includes a 70 basis  
11 point risk adjustment using the methodology developed by Professor Robert Hamada of the  
12 University of Chicago, and RUCO's proposal includes a 50 basis point upward adjustment. The  
13 Council's proposal includes a 45 basis point upward adjustment for risk. While the Council asserts  
14 that RUCO's hypothetical capital structure, along with its 50 basis point risk adjustment will inflate  
15 rates, RUCO disagrees, stating that its proposal fairly compensates the Company for its increased  
16 financial risk. Arizona-American criticizes Staff's risk adjustment methodology, arguing that  
17 whether a company chooses to finance its capital investments with debt or equity should not matter to  
18 a customer as long as the overall cost of capital is not affected. The Company uses its after tax  
19 weighted average cost of capital ("ATWACC") methodology to evaluate the relative risk of Arizona-  
20 American and the sample companies used in its estimates.

21 The Company believes that Staff's evidence supports an equity cost of 10.4 percent, and is  
22 opposed to Staff's updating its recommendation in its final schedules to 10.3 percent. (Co. Br. at 61;  
23 Co. Reply Br. at 3.) Staff responds to the Company's claim there is no record support for Staff's 10.3  
24 percent ROE recommendation except in Staff's final schedules, arguing that Staff's witness, like the  
25 intervenor and Company witnesses, updated his recommendations in response to the various  
26 recommendations made in this case. (Staff Reply Br. at 13.)

1           The Council asserts that while the Company's cost of capital witness, like Staff, the Council  
2 and RUCO, used the DCF methodology and the CAPM in her analysis, her analysis overstates the  
3 cost of equity because she relied solely on analysts' forecasts rather than analyzing historical data.  
4 Staff is critical of the ATWACC methodology that the Company used to reach its 11.75 percent cost  
5 of equity proposal, asserting that it has not been extensively used or reviewed in the regulatory  
6 environment, and that this Commission has previously rejected the Company's use of market-value  
7 structures to determine rates of return in recent proceedings. The ATWACC methodology uses  
8 return on equity as an independent variable that is derived equating the sample companies' market  
9 value capital structure weighted average costs of capital after-tax to the Company's book-value  
10 capital structure weighted average cost of capital after-tax. We find this methodology to be  
11 inconsistent with standard practices known to investors that regulators authorize returns on the book  
12 value of property devoted to public service. We agree with Staff that it would be inappropriate to  
13 authorize a return on equity to match a market value, when market value differs from book value. As  
14 we stated in Decision No. 68858, the ATWACC methodology produces an inflated estimate that  
15 would overcompensate for financial risk and require customers to overcompensate investors.

16  
17           Staff's recommendations are based on market-based financial models widely accepted in the  
18 financial industry for the estimation of cost of equity capital, using inputs that are factors investors  
19 can reasonably be expected to consider in determining their expected rate of return. However, we  
20 find Staff's analysis deficient in one important aspect: it does not consider the impact of the Anthem  
21 Agreements in reducing the risk of the Company. The Company points out in its closing briefs that  
22 the financing of Anthem's water and wastewater infrastructure was "unique" because Del Webb  
23 advanced "virtually all the funds needed . . . to provide water and wastewater service to Anthem" and  
24 "assumed the risk that the Anthem community would not be successful." (Co. Reply Br. at 6). The  
25 Company states that the Anthem Agreements "completely shielded residents from the risk that the  
26 Anthem community would not be successful" because Del Webb would have contributed the entire  
27 water and wastewater infrastructure – and gotten nothing in return – had Anthem been unsuccessful.  
28 (Id. at 7). We believe the Anthem Agreements also shielded the Company from this risk. To reflect

1 this reduced risk, the Staff's cost of equity recommendation should be adjusted down from 10.3  
 2 percent by 150 basis points, resulting in an adjusted cost of equity of 8.8 percent. We note that a  
 3 return on equity of 8.8 percent is consistent with the return on equity allowed in nine of our recently  
 4 decided water utility decisions. As reflected in Table 6 in the direct testimony of the Company's  
 5 cost-of-capital witness, the average return on equity allowed in these nine decisions was 8.9 percent.

6  
 7 Based on the entire record of this proceeding, we find that the adoption of an 8.8 percent cost  
 8 of equity results in a just and reasonable return for Arizona-American and at the same time mitigates  
 9 to some extent the significant rate increase experienced by Anthem residents in this case.

### 10 C. Cost of Capital Summary

	Percentage	Cost	Weighted Cost
Long-term Debt	60.8%	5.4%	3.3%
Common Equity	39.2%	8.8%	<u>3.4%</u>
<b><u>Weighted Average Cost of Capital</u></b>			<b><u>6.7%</u></b>

### 16 VIII. AUTHORIZED INCREASE

17 Based on our findings herein, we determine that Arizona-American's Anthem Water  
 18 District's gross revenue should increase by \$2,642,533, and Arizona- American's Anthem/Agua Fria  
 19 Wastewater District's gross revenue should increase by \$1,654,474.

#### Anthem Water

Fair Value Rate Base	\$36,267,274
Adjusted Operating Income	833,749
Required Rate of Return	6.7%
Required Operating Income	2,429,907
Operating Income Deficiency	1,596,158
Gross Revenue Conversion Factor	1.6556
Gross Revenue Increase	\$ 2,642,533

#### Anthem/Agua Fria Wastewater

Fair Value Rate Base	\$20,097,915
Adjusted Operating Income	347,365
Required Rate of Return	6.7%



1	Required Operating Income	1,346,560
2	Operating Income Deficiency	999,195
3	Gross Revenue Conversion Factor	1.6558
4	Gross Revenue Increase	\$ 1,654,474

5 **IX. RATE DESIGN**

6 **A. Anthem Water District**

7 The Company's application proposes no change to service charges or the existing Anthem  
8 Water District's rate structure, and proposes that authorized increased revenues be spread across all  
9 customer classes, with the exception of fire sprinklers, by increasing monthly usage charges and  
10 commodity charges. RUCO agrees with the Company's rate design proposal.

11 Staff's proposed rate structure is comparable to the current rate structure. It is a conservation-  
12 oriented rate structure designed to encourage efficient use of water and promote a reduction in  
13 average use in the long term. The Staff's rate design recommendation includes a three-tier inverted  
14 block rate structure for the residential 5/8-inch, 3/4-inch, and 1-inch customer classes, with breakover  
15 points at 4,000 gallons and at 10,000 gallons for the 5/8-inch and 3/4-inch classes, and 4,000 gallons  
16 and 40,000 gallons for the 1-inch class. The second tier rate of Staff's proposed rate design for 5/8-  
17 inch meter customers is greater than the rate that would be required to recover the revenue  
18 requirement using a uniform commodity rate, such that these customers will experience a greater  
19 incremental cost for all use exceeding 4,000 gallons. The concept is extended to larger meter sizes as  
20 well, with the breakover points graduating in correlation with meter size. For commercial meter sizes  
21 and for each of the residential meters larger than 1-inch, Staff proposes a two-tier inverted block rate  
22 structure. As is currently the case, no gallonage is included in the minimum monthly charge for any  
23 meter sizes. Under Staff's recommendations, the fire sprinkler class would continue to be charged a  
24 monthly charge only, and wholesale irrigation customers would continue to be charged a flat  
25 commodity rate. The Company recommends adoption of RUCO's recommendation that the  
26 irrigation rate be increased from \$0.62 to \$1.43 in order to promote conservation and mitigate the  
27 revenue increase for other customers. We find this recommendation reasonable and it will be  
28 adopted. As Staff states in its testimony, the quantity of water resources available does not grow with

1 population and customer base, and the cost of developing, treating and delivering water increases  
2 with diminishing supply and increased health and safety regulations. We find that Staff's proposed  
3 rate structure is designed to recognize the growing importance of managing water as a finite resource  
4 and to promote a reduction in average use in the long term, by providing an economic benefit to  
5 customers who limit consumption. Staff's conservation-oriented rate design will therefore be  
6 adopted, along with the Company and RUCO's proposed change to the irrigation rate.

7 The Commission also believes that it is important to measure the effect of the tiered water  
8 rates established in this case. Therefore, we will require Arizona-American to analyze the effect the  
9 tiered water rates are having on water consumption in the Anthem water system. The results of this  
10 study may be used to adjust/modify, if necessary, the tier break-points in the Company's subsequent  
11 Anthem water system rate case.

12 Staff recommends a 3.2 percent water loss adjustment as a penalty for the amount of test year  
13 water loss in excess of 10 percent. Arizona-American opposes any water loss adjustment. However,  
14 in the event an adjustment is found appropriate, the Company proposes 2.7 percent instead, based on  
15 the Company's calculations, which made allowances for authorized, but unmetered, uses of water,  
16 such as flushing mains, Company office use, in-plant use, mixing chemicals, and fire-hydrant  
17 maintenance. (Rebuttal Testimony of Company witness Bradley J. Cole, Exh. A-4 at 4.) Arizona-  
18 American and Staff agree that the water loss adjustment is more appropriately applied only to  
19 revenue generated by the commodity portion of the tariff. (Surrebuttal Testimony of Staff witness  
20 Steve Irvine, Exh. S-11 at 2.) Staff's adjustment would be \$142,738. (*Id.*) The Company agrees that  
21 the water loss adjustment should be calculated at Staff's Commercial Second Block Rate of \$3.02 per  
22 thousand gallons, because unauthorized water consumption by developers accounted for the majority  
23 of excess water losses during the test year, and such uses would have been billed at the Commercial  
24 Second Block Rate had the Company been able to properly meter and bill the consumption.  
25 (Rebuttal Testimony of Company witness Linda J. Gutowski, Exh. A-6 at 17-18.) The Company  
26 believes that if a water loss adjustment is necessary, it should be based on its 2.7 percent penalty  
27 amount reflecting losses of 39,446 thousand gallons, as opposed to Staff's 3.2 percent amount,  
28 reflecting losses of 46,751 thousand gallons, for an adjustment of \$119,126.92.

1 Due to the district's test year water loss, Staff recommends that the Company be required to  
2 reduce its non-account water to 10 percent or less, and to continue to monitor its system and file with  
3 the Commission's Docket Control, as a compliance item in this docket, a report to the Commission  
4 indicating the non-account water data, including quantities of water produced, sold and non-account  
5 water percentages for each of the previous 12 months. Staff's recommendation is reasonable and will  
6 be adopted.

7 We agree with Staff that a water loss adjustment is necessary for losses in excess of 10  
8 percent. The Company's testimony regarding calculations to account for authorized, but unmetered  
9 uses of water is reasonable, and we will adopt a water loss adjustment of 2.7 percent, which will  
10 reduce the Company's revenues for the Anthem Water District by \$119,127.

11 The Commission is concerned about water conservation, therefore, we believe it is in the  
12 public interest to require Arizona-American's Anthem water system implement at least six (6)  
13 Modified Non-Per Capita Conservation Program Water Conservation Measures (also known as Best  
14 Management Practices ["BMPs"]) for the Phoenix Active Management Area, as defined by the  
15 Arizona Department of Water Resources, prior to receiving its next rate increase for the Anthem  
16 water system. Of the BMPs that Arizona-American chooses, at least one (1) but no more than three  
17 (3) shall be from Categories 1, 2 and 3 (Public Awareness/Public Relations; Conservation Education  
18 and Training; and Outreach Services).

19 **B. Anthem/Agua Fria Wastewater District**

20 The present wastewater rates include both a fixed customer charge and a volumetric charge.  
21 The volumetric charges are based on each thousand gallons of water usage up to a volumetric  
22 threshold in each rate class. Currently, the threshold for residential usage is 7,000 gallons, such that  
23 no volumetric charge is assessed for water usage over 7,000 gallons. All residential wastewater  
24 customers, regardless of water meter size, are charged the same fixed charge and volumetric charge.  
25 Commercial rate classes are charged fixed and volumetric charges based on the size of their water  
26 meters, with rates increasing as the size of the water meters increases. Arizona-American proposes  
27 that the current rate design be maintained, with increases to the fixed charges and volumetric rate  
28 charges, and that the current volumetric thresholds remain in place. The Company proposed no

1 changes to service charges.

2 Staff's proposed rate design maintains the present structure, with the minimum monthly  
3 charge and the volumetric charge increased to recover the district's revenue requirement. Staff  
4 designed its proposal to maintain the same ratio of monthly minimum charge revenue to total revenue  
5 existing in present rates. Staff's wastewater rate design proposal is reasonable and will be adopted.

6 **X. OTHER ISSUES**

7 **A. Overview of Anthem Agreements**

8 1. Anthem Agreement

9 The Anthem Agreement, originally executed on September 29, 1997, was entered into the  
10 record of this proceeding as Hearing Exhibit A-16. The original parties to the Anthem Agreement  
11 were the Del Webb Corporation and its subsidiary The Villages at Desert Hills, Inc. (as the Anthem  
12 project was called at the time), Citizens, and Citizens' subsidiaries Citizens Water Services Company  
13 of Arizona ("DistCo"), and Citizens Water Resources Company of Arizona ("TreatCo"). Under the  
14 Anthem Agreement, Del Webb was to:

- 15
- 16 • provide the water supply for the project pursuant to an Option and Lease Agreement with the  
17 Ak-Chin Indian Community with the one-time water lease charge being treated as an AIAC  
advance;
- 18 • design, construct and transfer to TreatCo, as AIAC, Phase I off-site water transmission  
19 facilities, and Phase I water production and water and wastewater treatment facilities;
- 20 • design, construct and transfer to TreatCo, as AIAC, all phases of the backbone water  
21 distribution and wastewater collection facilities;
- 22 • pay TreatCo, as AIAC, its cost for constructing subsequent phases of off-site water  
23 transmission facilities and production and treatment facilities;
- 24 • design, construct and transfer to DistCo, as AIAC, on-site water and wastewater facilities  
within the various subdivisions pursuant to separate line extension agreements; and
- 25 • pay, or cause homebuilders to pay, capacity reservation charges ("CRCs") to TreatCo for each  
26 connection upon issuance of a building permit. (Exh. A-2 at 28-30.)
- 27
- 28

1 Citizens was to provide TreatCo, as AIAC, up to \$24 million, subject to annual limits during  
 2 calendar years 1999-2002, to enable TreatCo to reimburse one-half of Del Webb's AIAC advances  
 3 for design and construction of the Phase I off-site water transmission facilities, Phase I water  
 4 production and water and wastewater treatment facilities, and the backbone water distribution and  
 5 wastewater collection facilities. (*Id.*)

6 Under the Anthem Agreement, TreatCo was to:

- 7
- 8 • design and construct subsequent phases of off-site water transmission facilities and production  
 and treatment facilities;
  - 9 • deliver potable water and provide wastewater treatment services to DistCo;
  - 10 • provide non-potable water services in Anthem;
  - 11 • reimburse one-half of Del Webb's AIAC advances up to a maximum of \$24 million (subject  
 12 to annual limits during calendar years 1999-2002);
  - 13 • refund 100 percent of the unreimbursed Del Webb AIAC advances through annual payments  
 14 based on the number of ERUs connected in the previous year, with a true up refund occurring  
 15 at buildout of Anthem, providing a 100 percent refund of Del Webb AIAC advances; and
  - 16 • refund 100% of the \$24 million AIAC advances provided by Citizens through annual  
 17 payments based on the number of ERUs connected in the previous year, with a true up refund  
 occurring at buildout of Anthem, providing a 100 percent refund of Citizens' advances. (*Id.*)

18 Under the Anthem Agreement, DistCo was to:

- 19
- 20 • enter into line extension agreements with Del Webb for the on-site facilities required within  
 the various subdivisions;
  - 21 • provide retail water and wastewater services in Anthem; and
  - 22 • refund Del Webb's AIAC advances for on-site facilities at the rate of 10 percent of revenue  
 23 generated in each subdivision for a period of twelve years. (*Id.*)

24

## 25 2. Letter Agreement

26 The parties amended the Anthem Agreement by a Letter Agreement effective November 30,  
 27 1998. (Exh. A-17). The Letter Agreement established a ten-year revenue stream from Del Webb to  
 28

1 Citizens. In addition, the Letter Agreement established a framework for the then-proposed Phoenix  
2 Agreement. (Exh. A-2 at 30.)

3 There have been four subsequent amendments to the Anthem Agreement: the First  
4 Amendment, dated May 8, 2000 (Exh. A-18); added a 195-acre parcel acquired by Del Webb to the  
5 Anthem project and required the parties to take certain actions related to the addition of the land  
6 parcel to Anthem. (Exh. A-2 at 31.) The Second Amendment, dated September 21, 2000 (Exh. A-  
7 19); made several updates to the agreement to reflect the withdrawal of the portion of Anthem located  
8 within the City of Phoenix from the Arizona-American CC&N and to reflect the effect of the Phoenix  
9 Agreement. (Exh. A-2 at 31.) The changes made by the Second Amendment included:

- 10 • the adjustment of several connection-based benchmarks downward to reflect lower total  
11 planned ERUs;
- 12 • adjustment of the quantity of water available to Citizens pursuant to the Option and Lease  
13 Agreement with the Ak-Chin Indian Community downward to reflect the lower planned total  
14 ERUs;
- 15 • recognizing that a portion of the potable water supply was to be treated by the City of  
16 Phoenix;
- 17 • enumerating several impacts of the loss of the Phoenix area including a 19.1 percent reduction  
18 of the TreatCo obligation to reimburse up to \$24 million of Del Webb AIAC advances, down  
19 to \$19.416 million; and
- 20 • reclassifying certain plant costs related to providing service to the Phoenix area totaling  
21 \$632,687.71 from AIAC to non-refundable CIAC. (*Id.*)

### 22 3. Second Amendment

23 The Second Amendment also adjusted the value of the land for the production and treatment  
24 facilities to reflect the as-built acreage and obtained approval for Citizens, TreatCo and DistCo to  
25 assign their respective interests in the Anthem Agreement to Arizona-American. (*Id.*)

### 26 4. Third Amendment

27 The Third Amendment, dated December 12, 2002 (Exh. A-20); increased the quantity of  
28 water available to Citizens pursuant to the Ak-Chin Lease to reflect updated planning assumptions

1 and assured water-supply requirements imposed by the Arizona Department of Water Resources  
2 (“ADWR”). (Exh. A-2 at 32.) All of the obligations of Citizens, TreatCo, and DistCo that are  
3 relevant to this case were assigned to Arizona-American except that Citizens retained an AIAC  
4 balance of approximately \$50 million. (Exh. A-2 at 32.) Another relevant agreement related to the  
5 Anthem Agreement is the Refund Coordination Agreement, dated September 27, 2001 (Exh. A-21).

6           5.     Fourth Amendment

7           In the application, Arizona-American stated that it had asked Pulte, the successor company to  
8 Del Webb Corporation, to reschedule payment of expected refunds due from the Company to Pulte  
9 under the Anthem Agreement to ten equal payments over ten years. The application proposed  
10 institution of a surcharge mechanism for repayment in the event Pulte would not agree to delay the  
11 refund payments. However, before the conclusion of the hearing, on October 7, 2007, Pulte and  
12 Arizona-American announced that they had executed the Fourth Amendment for Anthem  
13 Water/Wastewater Infrastructure Agreement (“Fourth Amendment”). The Fourth Amendment is  
14 intended to address Commission concerns and Arizona-American’s financial circumstances by  
15 providing further rate relief to Anthem customers, utilizing the following measures:

- 16           1. Pulte agreed to defer the 9,500 ERU true-up payment from the Company and the Build-  
17           Out true-up payment by six months, until March 31, 2008;
- 18           2. Pulte agreed to reduce the total refundable developer advance due from the Company by  
19           \$1.5 million; and
- 20           3. Pulte agreed to defer 25 percent of the true-up payment that would otherwise be due at  
21           build-out for a period of two years, without interest.

22           In exchange for the Pulte concessions, the Company agreed to deliver letters of credit to  
23 secure its payment obligations to Pulte, and to finalize certain of Pulte’s financial obligations to the  
24 Company for the Anthem development. The Company notes in its closing brief in this case that the  
25 customers will not see the benefits of the Fourth Amendment in this rate proceeding, because the test  
26 year in this case ended in December 2005, and the reduced payments to Pulte will be made on March  
27 31, 2008.

28           The Council states that because the Company admittedly intends to apply for another rate

1 increase due to its future obligation to repay the developer its true-up payments, Anthem ratepayers  
2 will be facing another rate case on the heels of this proceeding. The Council takes issue with  
3 Arizona-American's statement, on brief, that Pulte's agreement to defer 25 percent of the true-up  
4 payment will "alleviate potential rate shock" in the next Anthem rate case. The Council states that  
5 the Fourth Amendment may potentially minimize impact, but responds that the two-year deferral of  
6 25 percent of the true-up payment will not prevent ratepayers from eventually paying the Company's  
7 authorized rate of return on 100 percent of the payments by the Company to Pulte. The Council  
8 argues that the only scenario that will alleviate potential rate shock is if the Company files its next  
9 rate case with the 75 percent portion of the payment in the test year instead of the 25 percent portion.

10 (Council Reply Br. at 13.)

11 **B. Notice to Homebuyers/ Reasonableness of Anthem Agreements**

12 Public comments, both oral and written, in opposition to the rate increase requested by  
13 Arizona-American's application expressed displeasure that the Company's proposed rates reflect  
14 repayment by Arizona-American to Pulte for infrastructure costs paid by Pulte, and particularly, that  
15 existence of the advances was not disclosed to homebuyers at the time of purchase.

16 1. Parties' Positions

17 Staff states on brief that it believed it important in this case to develop a record on the Anthem  
18 Agreements and their impact upon utility rates, because of the likelihood that Pulte will have exited  
19 the development by the time Arizona-American files its next rate case for the districts. Staff believes  
20 that the two most significant issues raised in this proceeding in regard to the Anthem Agreements  
21 were notice to ratepayers regarding the allocation of water infrastructure costs, and the  
22 reasonableness of the agreement to refund 100 percent of those costs to Pulte. Staff points out that  
23 Pulte agreed to further concessions in the Fourth Amendment because of concerns raised by  
24 Commissioners during the hearings in this case. Staff further points out that the agreements between  
25 the Company and the developer have never been approved by the Commission, and that the  
26 Commission may wish to address the reasonableness of the Company's agreement to refund to Pulte  
27 almost all of the water infrastructure costs either in this case, or in the next rate case the Company  
28 files for these districts, because the next rate case will likely address the issue of the remaining



1 payment to Pulte.

2 On brief, the Council claims that a random sampling of public subdivision reports that were  
3 admitted as exhibits to this proceeding, (Exh. C-8),<sup>10</sup> confirms why Anthem residents were surprised  
4 by the true-up payments and the potential impact on future rate increases. The Council contends that  
5 language in the subdivision reports demonstrates a failure by the developer to candidly disclose the  
6 future impact of the true-up payments. The Council argues that the excerpted language from its  
7 sampling of reports "indicates that either the public report informed residents that no additional cost  
8 would be assessed and/or failed to inform residents altogether of the future repayment obligations."  
9 The Council argues that Anthem residents were never informed of the utility's obligation to refund  
10 developer advances, (Council Br. at 18), despite the fact that the developer understood at the time it  
11 was negotiating the Anthem Agreement that ratepayers would be held responsible at some point for a  
12 portion of the repayment. (Council Br. at 18, citing Tr. at 962, testimony of witness provided by  
13 Pulte.)<sup>11</sup>

14 Arizona-American states that it has certainly heard the frustration expressed by homebuyers

15 <sup>10</sup> In its Reply Brief, the Council provides excerpts from eight different subdivision reports. (Council Reply Br. at 16-18.)  
16 In a BelAir subdivision report dated October 20, 2000, the Council emphasizes the following language: "[y]ou will pay  
17 no additional costs for installation of service to your lot boundary or extension of service from your lot boundary to your  
18 residence." (Council Reply Br. at 16.) In a BelAir subdivision report dated January 29, 2003, the Council emphasizes  
19 language from the report that indicates a deposit or prepayment may be required and the "[water] facilities to the Lot lines  
20 have been completed, and the cost to purchasers to complete the water facilities from the Lot line to the home is included  
21 in the purchase price." (*Id.* at 17.) In a Pinion subdivision report dated January 29, 2003, the Council emphasizes  
22 language from the report that indicates a deposit or prepayment may be required and the "[water] facilities to the Lot lines  
23 have been completed, and the cost to purchasers to complete the water facilities from the Lot line to the home is included  
24 in the purchase price." (*Id.* at 17.) The Council also points out, that in each of the sample reports it excerpted the report  
25 "also contains a disclaimer that the above costs are subject to change by service providers, certain regulator approvals,  
26 which vary by provider, etc." (Council Reply Br. at 16-17.)

27 <sup>11</sup> Q. [by Ms. Molinaro, representing the Council]. . . I just want to know what was Pulte's understanding. Did it  
28 understand at the time it was negotiating that Anthem customers would be held responsible at some point?

21 A. [by Daniel Christopher Ward, testifying on behalf of Pulte] For a portion, yes.

22 Q. It did?

23 A. Yes, as it determined reasonable.

24 Q. Sorry. Well, despite this understanding, what did Pulte do to make that known to the homeowners that it would  
25 be responsible for a portion of that obligation?

26 A. I don't, I don't think we had an obligation to report that to the homeowners. That's what I would say to you, is I  
27 believe the obligation disclosed – if the Corporation Commission wanted to adopt rules that the homeowners, that it  
28 disclose its future rate increase rules, or to its homeowners, then that would be up to the Corporation Commission.

29 But we are not a party. I don't believe the disclosure obligation fell on Pulte to attempt to disclose to  
30 homeowners what the rate impact would be by a third party. We couldn't forecast what Arizona-American was going to  
31 be doing with respect to Citizens and then Arizona-American.

32 Q. So then the answer to the question what steps did Pulte take to make this information known to the homeowners  
33 would be that there weren't any steps taken?

34 A. That would be correct.

1 to the effect that Pulte/Del Webb did not adequately inform them of the likelihood or magnitude of  
2 expected rate increases. Arizona-American states, however, that this issue has nothing to do with the  
3 Company. The Company states that it could not influence a potential homebuyer's decision, because  
4 it had no involvement in home sales, (Tr. at 81-82), and it becomes aware of a new homeowner only  
5 after the customer requests service. The Company argues that whether the developer provided  
6 appropriate notice to homebuyers is not relevant to a Commission determination on providing a  
7 utility a return on and of its prudent investments. The Company further asserts that if notice is a  
8 genuine issue between homebuyers and Pulte, then the Commission does not appear to be the  
9 appropriate forum to resolve the issue.

10 Arizona-American contends that the evidence shows that the Anthem Agreements were  
11 entirely reasonable, and that without them, the community of Anthem would not exist. The Company  
12 states that Anthem was unique, and that the investments required in order to provide water and  
13 wastewater service to Anthem are far greater than that required to provide those services to Sun City  
14 Grand, a similar sized community constructed at about the same time. (See Tr. at 687.) Arizona-  
15 American states that Del Webb advanced virtually all the funds needed in both communities, but also  
16 assumed the risk that the Anthem community would not be successful, (Tr. 682), and financed the  
17 advances interest free until they were recovered, (Pulte Home Corporation's Response to  
18 Commission Questions docketed on August 17, 2007 (Exh. P-7) at 5, l. 15.) Arizona-American states  
19 that the total amount contributed (not to be refunded) by Del Webb/Pulte totals \$58,400,000, (Co.  
20 Reply Br. at 6, citing to Exh. P-7), and argues that if Pulte's internal salaries or other overhead items  
21 were to be included in the total figure, the total Pulte contribution would likely exceed \$60 million.  
22 Arizona-American further argues that if Anthem had not been a successful development, under the  
23 Anthem Agreements, Pulte would have contributed the entire water and wastewater infrastructure.  
24 (Co. Reply Br. at 7.)

25 2. Discussion

26 In this case, while Staff states that the Commission may wish to address the reasonableness of  
27 the Company's agreement to refund to Pulte almost all of the water infrastructure costs either in this  
28 case, or in the next rate case the Company files for these districts, because the next rate case will

1 likely address the issue of the remaining payment to Pulte, Staff proposes that the Commission adopt  
2 the recommendations in its testimony, and states that its recommendations would result in just and  
3 reasonable rates for the Company. And while the Council argues that Pulte’s failure to disclose the  
4 existence of future true-up payments from Arizona-American constitutes a unique circumstance that  
5 this Commission may consider and “in its broad discretion determine that a just and reasonable rate is  
6 one less than advocated by any of the parties in this matter,” (Council Reply Br. at 18-19), the  
7 Council does not propose changes to the recommendations in its testimony. RUCO did not address  
8 the issue on brief.

9 We take the public comment received in this case seriously and recognize the gravity of the  
10 customers’ concerns regarding the infrastructure costs required to provide water and wastewater  
11 utility services for the Anthem community. At this time, no party has alleged, and we do not find,  
12 that the Company’s repayment of developer advances under the Anthem Agreements has been  
13 imprudent or improper. As suggested by the Council, we believe it will be beneficial to ratepayers if  
14 the Company will ensure that Pulte’s agreement to defer 25 percent of the true-up payment minimizes  
15 rate impact by filing its next rate case with the 75 percent portion of the true-up payment in the test  
16 year instead of the 25 percent portion. We will require the Company to provide notice to potential  
17 customers regarding the Company’s pending rate case, Docket Nos. W-01303A-08-0227 and SW-  
18 01303A-08-0227, and will require that notice to include the rate increase the Company is requesting  
19 for Commission consideration in that filing.

20 Our determination in this case is not intended to have any bearing on our determination in any  
21 subsequent case filed by the Company for these districts regarding the reasonableness of the  
22 Company’s agreement to refund to Pulte almost all of the costs required to construct Anthem’s water  
23 infrastructure.

24 \* \* \* \* \*

25 Having considered the entire record herein and being fully advised in the premises, the  
26 Commission finds, concludes, and orders that:

27 ...

28 ...

**FINDINGS OF FACT**

1  
2 1. Arizona-American is an Arizona public service corporation engaged in the business of  
3 providing water and wastewater utility service to customers in its various water and wastewater  
4 districts located in portions of Maricopa, Mohave and Santa Cruz counties in Arizona pursuant to  
5 authority granted by the Commission. Arizona-American currently provides service to  
6 approximately 131,000 customers throughout its districts. During the test year, the Anthem Water  
7 District provided water services to approximately 7,800 customers, and the Anthem/Agua Fria  
8 Wastewater District provided services to approximately 8,700 customers.

9 2. Arizona-American is a wholly-owned subsidiary of American Water Works Co., a  
10 publicly traded company.

11 3. On June 16, 2006, Arizona-American filed with the Commission an application for a  
12 determination of the current fair value of its utility plant and property and for increases in its rates  
13 and charges for utility service in its Anthem Water and Anthem/Agua Fria Wastewater Districts.  
14 Initial rates were set for the districts by Decision No. 60975 (June 19, 1998), which granted a CC&N  
15 to Arizona-American's predecessor, Citizens Utilities Company. Anthem Water and Anthem/Agua  
16 Fria Water are currently charging rates authorized by Decision No. 67093 on June 30, 2004, based on  
17 a 2001 test year. In that case, rates for the Anthem Water District were reduced by 6.99 percent, and  
18 rates for the Anthem/Agua Fria Wastewater District were increased by 12.15 percent, from the initial  
19 rates.

20 4. Both districts serve Anthem, which is located on nearly 6,000 acres near Daisy  
21 Mountain north of Phoenix, Arizona on Interstate Highway 17. Anthem is one of the largest master-  
22 planned communities in the Phoenix metropolitan area.

23 5. In addition to Anthem, the Anthem/Agua Fria Wastewater District provides  
24 wastewater service to customers in the Northeast Agua Fria service area, the Russell Ranch service  
25 area, and the Verrado service area. The Northeast Agua Fria wastewater service area is an  
26 approximately 7,000 acre portion of unincorporated Maricopa County located immediately north and  
27 east of Sun City West and includes the Cortebella, Rio Sierra, Rancho Silverado, Sundero, Cross  
28 River, Dos Rios, Rancho Cabrillo and Coldwater Ranch development projects. The Russell Ranch

1 wastewater service area includes only the Russell Ranch subdivision, located just north of the City of  
2 Goodyear in unincorporated Maricopa County. The Verrado wastewater service area is an 8,800 acre  
3 master planned community located in the Town of Buckeye.

4         6. Arizona-American provides water utility service to Anthem primarily via a water  
5 supply from the Colorado River obtained through a 100-year lease with the Ak-Chin Indian  
6 Community ("Ak-Chin Lease").<sup>12</sup> The Ak-Chin water is transported from the Waddell Canal,  
7 approximately nine miles west of Anthem, and then treated at the Anthem water campus before  
8 distribution.

9         7. As a back-up water supply for Anthem, in accordance with the Phoenix Agreement,  
10 the Company has contracted to receive treated Ak-Chin water from the City of Phoenix. The City of  
11 Phoenix has the capability to receive Ak-Chin water and treat it at two separate locations on the CAP  
12 system, the Union Hills Water Treatment Plant or the Lake Pleasant Water Treatment Plant, and  
13 deliver it to Anthem. The Phoenix Agreement makes available to the Company an average of 2.5  
14 mgd of treated Ak-Chin water at a maximum flow rate of 5.0 mgd. Arizona-American also operates  
15 a recharge and recovery system at Anthem that allows either Ak-Chin water or reclaimed wastewater  
16 to be recharged into the groundwater aquifer and recovered from recovery wells, Well No. 2 and  
17 Well No. 3, located on the west side of Interstate 17, for delivery to Anthem. The Ak-Chin water, the  
18 water supplied pursuant to the Phoenix Agreement, and the water from Well No. 2 and Well No. 3 all  
19 meet the United States Environmental Protection Agency's maximum contaminant level for arsenic.

20         8. The Company provides wastewater utility service to Anthem at an onsite facility using  
21 an activated sludge process and advanced wastewater treatment, including biological denitrification  
22 and filtration using immersed hollow fiber ultrafiltration membranes. The Company operates a  
23 separate storage reservoir for effluent from the wastewater treatment facility, which meets Class A+  
24 reuse standards. Three pumps draw water from the storage reservoir and supply two different  
25

26 <sup>12</sup>Del Webb Corporation is entitled to 10,000 acre feet of water per year of Colorado River water via a 100 year lease  
27 between the Del Webb Corporation, the Ak-Chin Indian Community, and the United States of America. Under the  
28 Anthem Agreement, Del Webb is required to sell to Arizona-American, at its cost, up to 7,900 acre-feet of Ak-Chin water  
per year to meet the water supply requirements for Anthem. At buildout of Anthem, the Ak-Chin Lease is to be partially  
assigned to Arizona-American, so that Arizona-American will contract directly for the 7,900 acre-feet of Ak-Chin water  
available for Anthem.

1 reclaimed water distribution systems, one of which provides water to two community golf courses  
2 and the Community Park Lake, and the other of which supplies reclaimed water for other community  
3 needs through a looped distribution system.

4 9. Wastewater utility service is provided to the Northeast Agua Fria service area by  
5 gravity feed to the Northeast Agua Fria Lift Station No. 1, where the wastewater is then pumped for  
6 treatment to the Northwest Plant, a 5.0 mgd wastewater treatment plant located in unincorporated  
7 Maricopa County. The Company's Northwest Plant also treats wastewater flows from the  
8 Company's Sun City West Wastewater District. Arizona-American operates an aquifer recharge and  
9 recovery system at the Northwest Plant, which allows the Company to reuse reclaimed water from  
10 the plant.

11 10. The Company provides wastewater utility service to the Russell Ranch service area by  
12 gravity feed flow to the Russell Ranch Water Reclamation Facility, an activated sludge system plant  
13 with a design capacity of 60,000 gallons per day ("gpd"). Effluent from the facility is recharged to  
14 the subsurface via two recharge basins adjacent to the treatment plant.

15 11. Wastewater flows from the Company's Verrado service area are gravity-fed to the  
16 Verrado Water Reclamation Facility, a 450,000 gpd wastewater treatment plant that treats the flows  
17 using two parallel trains of sequencing batch reactors. Effluent from the facility provides reclaimed  
18 water for golf course irrigation and other uses.

19 12. On June 27, 2006, RUCO requested intervention in this case, which was granted by  
20 Procedural Order issued October 5, 2006.

21 13. On June 29, 2006, the Company filed a compliance status report from ADEQ for the  
22 Northwest Plant, and filed a revised status report in which ADEQ corrected an error in its letter, on  
23 June 30, 2006.

24 14. On July 17, 2006, Staff filed a Letter of Deficiency.

25 15. On August 4, 2006, the company filed its Response to the Letter of Deficiency; a  
26 Revised Application; Revised Direct Testimony of three of its witnesses; and several Revised  
27 Schedules.

28 16. On August 14, 2006, the Company filed its wastewater flow data for the North Agua

1 Fria Ranch Lift Station.

2 17. On August 18, 2006, the Company filed revised D-1 and D-2 schedules.

3 18. On September 5, 2006, Staff filed another Letter of Deficiency.

4 19. On September 26, 2006, the Company filed a Response to Letter of Insufficiency;  
5 Revised Testimony of one of its witnesses; and several Revised Schedules.

6 20. On September 28, 2006, Staff filed a Letter of Sufficiency.

7 21. On October 5, 2006, a Procedural Order was issued setting the hearing on the  
8 application to commence on May 27, 2007, and setting associated procedural deadlines.

9 22. On January 11, 2007, the Company filed its Notice of Filing Affidavit of Publication.

10 23. On January 18, 2007, the Council filed a Motion for Leave to Intervene, which was  
11 granted by Procedural Order issued March 27, 2007.

12 24. On March 26, 2007, the Company filed a Notice of Filing Affidavit of Customer  
13 Notice.

14 25. Public comment in opposition to the rate increase request was filed on September 13,  
15 2006, March 16, 2007, May 2, 2007, May 4, 2007, May 7, 2007, May 17, 2007, May 25, 2007, May  
16 29, 2007 (two comments), May 30, 2007 (three comments), June 1, 2007 (two comments), June 4,  
17 2007, June 5, 2007 (two comments), June 7, 2007 (five comments), June 8, 2007 (two comments),  
18 June 11, 2007, June 14, 2007, June 15, 2007, June 20, 2007, June 25, 2007, June 29, 2007, July 25,  
19 2007, August 7, 2007 (two comments), August 14, 2007, August 17, 2007, August 20, 2007, August  
20 29, 2007, October 18, 2007, October 19, 2007 (two comments), October 26, 2007, November 5,  
21 2007, November 6, 2007 (two comments), November 7, 2007, November 16, 2007, January 2, 2008  
22 (two comments), January 11, 2008, February 21, 2008, March 11, 2008, March 17, 2008, and March  
23 20, 2008.

24 26. Public comments in opposition to the rate increase expressed displeasure that the  
25 proposed rates reflect repayment by Arizona-American to Pulte for infrastructure costs paid by Pulte,  
26 and that existence of the advances was not disclosed to homebuyers at the time of purchase. Some  
27 comments expressed displeasure with the fact that five of the nine members of the Council are Pulte  
28 employees.

1 27. Also on March 26, 2007, the Council filed Testimony and Exhibits.

2 28. On March 27, 2007, RUCO filed the Direct Testimonies of William A. Rigsby and  
3 Rodney L. Moore.

4 29. On March 30, 2007, Staff filed the Direct Testimony of Dennis Rogers, Steve Irvine,  
5 Gerald Becker, Pedro M. Chaves, and Katrin Stukov.

6 30. On April 12, 2007, the Council filed its First Set of Data Request Responses.

7 31. On April 16, 2007, the Council filed its First Set of Data Requests to Arizona-  
8 American.

9 32. On April 18, 2007, the Council filed its Second Set of Data Request Responses.

10 33. On April 19, 2007, the Council filed its Second Set of Data Requests to Arizona-  
11 American.

12 34. On May 8, 2007, a Procedural Order was issued setting a public comment session to  
13 be held on May 24, 2007 in the Boulder Creek High School Auditorium in Anthem, Arizona.

14 35. On May 17, 2007, RUCO filed the Surrebuttal Testimonies of William A. Rigsby and  
15 Rodney L. Moore.

16 36. On May 17, 2007, Staff filed the Surrebuttal Testimonies of Dennis Rogers, Gerald  
17 Becker, Pedro M. Chaves, and Katrin Stukov.

18 37. On May 17, 2007, the Council filed its Surrebuttal Testimony and Exhibits.

19 38. On May 21, 2007, the Company filed a Motion to Strike the prefiled Surrebuttal  
20 Testimony of John Cassidy filed by the Council on May 17, 2007.

21 39. On May 21, 2007, the Council filed its Response to Arizona-American's Third Set of  
22 Data Requests.

23 40. On May 22, 2007, Staff filed the Surrebuttal Testimony of Steve Irvine.

24 41. On May 23, 2007, the Company filed the Rejoinder Testimony of Thomas Broderick  
25 and Bente Villadsen.

26 42. On May 24, 2007, Council filed its Response to Arizona-American's Motion to Strike.

27 43. On May 24, 2007, public comment was taken by the Commission at a public comment  
28 hearing held commencing at 6:00 p.m. at the Boulder Creek High School Auditorium, 40404 North



1 Gavilan Peak Parkway, Anthem, Arizona.

2 44. On May 24, 2007, the hearing in this matter commenced at the Commission's offices  
3 in Phoenix, Arizona at 10:00 a.m. The hearing continued on May 29, 30 and 31, 2007; June 1 and 4,  
4 2007; July 13, 2007; October 31, 2007; and November 1, 2007.

5 45. On May 25, 2007, the Company filed a Statement in Lieu of Rejoinder Testimony,  
6 stating that it had no issues with the rate design set forth in the Surrebuttal Testimony of Staff witness  
7 Steve Irvine.

8 46. On May 30, 2007, the Company filed the Supplemental Rejoinder Testimony of Bente  
9 Villadsen.

10 47. On June 5, 2007, a public comment was filed requesting that water bills be structured  
11 so those customer who do not conserve are charged more than customers who do conserve.

12 48. On June 22, 2007, the Council filed Revised Schedules and Exhibits.

13 49. On June 22, 2007, the Company filed its Late-Filed Exhibit A-25, a summary of  
14 socioeconomic demographics of the Anthem community.

15 50. On June 22, 2007, the Company also filed a Motion for Admission of Exhibit A-29,  
16 which consists of the Anthem Water System 2003 to 2006 income statements. Exhibit A-29 was  
17 admitted at the hearing on July 13, 2007.

18 51. On June 22, 2007, the Company filed its final schedules A-1, B-1, B-2, C-1, C-2, and  
19 comparison of depreciation rates used by the Company, RUCO and Staff.

20 52. On June 26, 2007, the Company filed a Notice of Filing Affidavit of Publication  
21 indicating that it published notice of the May 24, 2007 public comment session as required by the  
22 May 8, 2007 Procedural Order.

23 53. On June 28, 2007, Staff filed Staff's Request for Procedural Order. Staff's filing  
24 indicated that Pulte had agreed to make a witness available to testify on the morning of July 13, 2007,  
25 and requested that the hearing in this matter be reconvened on that date.

26 54. On July 2, 2007, a Procedural Order was issued setting the hearing to continue on July  
27 13, 2007 at 9:30 a.m.

28 55. On July 13, 2007, the hearing in this matter reconvened and a witness for Pulte was

1 made available to answer questions from the parties and Commissioners.

2 56. On July 17, 2007, Council filed its First Set of Data Requests to Non-Party Witness  
3 Pulte Homes.

4 57. On July 17, 2007, RUCO filed its First Set of Data Requests to Pulte Homes.

5 58. On July 19, Council filed its Late-Filed Exhibit C-8 (Public Reports).

6 59. On July 23, 2007, Staff filed the corrected schedules of Pedro Chaves.

7 60. On July 24, 2007, the Company filed Late-Filed Exhibit A-31, its response to  
8 customer Cindy Drascic.

9 61. On July 30, 2007, the Council filed its Response to Staff's Late-Filed Exhibit S-16.

10 62. On July 30, 2007, Staff filed a Notice of Filing Data Requests. The requests included  
11 Staff's First Set of Data Requests to Pulte Homes, Sixteenth Set of Data Requests to Arizona-  
12 American Water Company, and First Set of Data Requests to Citizens Utilities Company.

13 63. On August 17, 2007, Pulte filed its Response to Commission Questions, its Response  
14 to RUCO's First Set of Data Requests, its Response to Staff's Data Requests, and its Response to  
15 Council's First Set of Data Requests for Non-Party Witness.

16 64. On September 17, 2007, Commissioner Mayes filed a letter to Pulte regarding Pulte's  
17 Response to Commission Questions, its Response to RUCO's First Set of Data Requests, its  
18 Response to Staff's Data Requests, and its Response to Council's First Set of Data Requests for Non-  
19 Party Witness.

20 65. On October 3, 2007, Staff filed the Revised Engineering Report of Katrin Stukov and  
21 the Revised Revenue Requirement Schedules of Gerald Becker.

22 66. On October 4, 2007, Staff filed its revised Typical Bill Analysis and Rate Design  
23 Schedules to reflect the revised allocation of the Northwest Plant. The filing also stated that Pulte  
24 and Arizona-American were in negotiations, and therefore it would be more productive to wait until  
25 conclusion of the negotiations before deciding whether further testimony from Pulte is necessary.

26 67. On October 9, 2007, the Company filed a copy of the executed Fourth Amendment,  
27 and a letter from Paul G. Townsley, President of Arizona-American, explaining the Fourth  
28 Amendment.

1           68.    On October 9, 2007, a Procedural Order was issued setting a procedural schedule for  
2 filing final schedules and briefs.

3           69.    On October 10, 2007, Pulte filed a letter stating that it was in the process of searching  
4 old files for information responsive to Commissioner Mayes' September 17, 2007, letter, and stating  
5 that Pulte planned to file a response to the letter as soon as the results of its search were available.

6           70.    On October 12, 2007, following a telephonic procedural conference convened at the  
7 request of the parties, a Procedural Order was issued granting the parties' request to schedule an  
8 additional day of hearing to allow cross-examination on the Fourth Amendment and on Staff's  
9 revised schedules reflecting the allocation of the Northwest Plant. The Procedural Order set the  
10 additional hearing day for October 31, 2007.

11          71.    On October 19, 2007, Pulte filed a letter responding to Commissioner Mayes'  
12 September 17, 2007 letter.

13          72.    On October 22, 2007, Council filed a notice that it intended to file its final schedules  
14 no later than November 6, 2007 and/or in its closing brief.

15          73.    On October 24, 2007, Staff filed its Status Update by Staff and Request for a  
16 Procedural Order. Staff stated that pursuant to the October 12, 2007 Procedural Order, Staff had  
17 contacted Pulte and arranged for a Pulte witness to voluntarily appear on October 31, 2007, and that  
18 Pulte had requested that the hearing commence at 8:30 or 9:00 a.m. due to other meetings that the  
19 witness had scheduled for later in the day.

20          74.    On October 26, 2007, the Company made a filing in support of Staff's Request for a  
21 Procedural Order.

22          75.    On October 26, 2007, a Procedural Order was issued setting the time for the  
23 commencement of the October 31, 2007, hearing date for 8:30 a.m.

24          76.    On November 6, 2007, the Company filed Late-Filed Exhibit A-34 (Revised Exhibit  
25 TMB R-2).

26          77.    On November 2, 2007, the Company filed its Final Rate Design Schedules.

27          78.    On November 6, 2007, RUCO filed its Final Post Hearing Schedules.

28          79.    On November 6, 2007, Staff filed the Final Schedules of Dennis Rogers, Steve Irvine,

1 Gerald Becker, and Pedro M. Chaves.

2 80. On November 6, 2007, Pulte filed a letter addressing information on two issues  
3 requested by Commissioner Mayes and Commissioner Mundell at the continuation of the hearing on  
4 October 31, 2007.

5 81. On November 7, 2007, Council filed its Final Revised Schedules and Responses to  
6 Late-Filed Exhibits.

7 82. On November 14, 2007, Pulte filed a letter to Commissioner Mayes and  
8 Commissioner Mundell. The letter stated that Pulte had provided the original marketing materials  
9 that the various on-site Anthem sales offices had distributed to potential homebuyers over the years,  
10 to the extent Pulte was able to locate those materials. The letter also included public comment from  
11 Pulte in response to public comment at the hearing on October 31, 2007, regarding two issues: lot  
12 premiums and comparisons of current water rates between Anthem and Phoenix or other Phoenix-  
13 area communities. Pulte's public comment states that there is no mention of water or sewer  
14 infrastructure in either the "Premium Lot Acceptance" statement or in the Sales Agreement. Pulte's  
15 public comment also states that Anthem lands are not enrolled in the Central Arizona Groundwater  
16 Replenishment District ("CAGRDR"), such that Anthem homeowners do not pay additional charges  
17 associated with CAGRDR membership.

18 83. On November 19, 2007, RUCO filed its Revised Final Schedules.

19 84. On November 30, 2007, Arizona-American, Council, RUCO, and Staff filed Closing  
20 Briefs.

21 85. On December 18, 2007, Arizona-American, Council, RUCO, and Staff filed Reply  
22 Briefs.

23 86. On March 13, 2008, RUCO and the Council jointly filed a Motion to Open the Record  
24 and Schedule a Hearing. The Motion requested that the record be reopened in this docket for the  
25 limited purpose of taking additional testimony to supplement the record concerning the allocation of  
26 the Northwest Plant to the Anthem/Agua Fria Wastewater District.

27 87. On March 17, 2008, Arizona-American filed its Response to the March 13, 2008,  
28 Motion. Therein, the Company stated that RUCO and the Council had each been provided ample

1 opportunity to address the Northwest Plant allocation issue while the record was open, and that each  
2 did in fact address the issue while the record was open.

3 88. On March 17, 2008, public comments in opposition to the Company's proposed  
4 irrigation rates and in support of Staff's proposed irrigation rates were filed by the Regional Manager  
5 of the Anthem Golf and Country Club.

6 89. On March 21, 2008, a Procedural Order was issued setting Oral Argument for March  
7 28, 2008, on the March 13, 2008 Motion.

8 90. On March 21, 2008, RUCO filed its Reply to Arizona-American's Response to the  
9 March 13, 2008, Motion.

10 91. On March 25, 2008, Staff filed its Response to the March 13, 2008, Motion.

11 92. On March 27, 2008, the Council filed its Reply in Support of Motion to Open the  
12 Record.

13 93. On March 28, 2008, oral argument was taken from the parties on the Motion to  
14 Reopen the Record. The parties entered appearances through counsel and provided oral argument in  
15 support of their positions.

16 94. On May 12, 2008, a Procedural Order was issued denying the March 13, 2008 Motion.

17 95. As discussed herein, an appropriate and reasonable capital structure for the Company  
18 is 60.8 percent debt and 39.2 percent equity. The cost of debt is 5.4 percent, and an appropriate and  
19 reasonable cost of equity is 8.8 percent.

20 96. In the test year ended December 9, 2005, for its Anthem Water District, the Company  
21 experienced Operating Income of \$833,749, on total revenues of \$6,867,609 for a 2.30 percent rate of  
22 return on FVRB.

23 97. The Company requested rates for its Anthem Water District that would result in total  
24 revenues of \$11,415,796, a revenue increase of \$4,548,026, or 66.22 percent. The Council  
25 recommended rates that would yield total revenues of \$9,600,113, an increase of \$2,732,423, or  
26 39.79 percent. RUCO recommended rates that would yield total revenues of \$9,127,726, an increase  
27 of \$2,260,117 or 32.91 percent. Staff recommended total revenues of \$9,916,628, an increase of  
28 \$3,049,020, or 44.40 percent.

1 98. As discussed herein, the Company's FVRB for the Anthem Water District is  
2 determined to be \$36,267,274.

3 99. For Arizona-American's Anthem Water District, a fair value rate of return on FVRB  
4 of 6.7 percent is reasonable and appropriate.

5 100. The revenue increase requested by the Company for the Anthem Water District would  
6 produce an excessive return on FVRB.

7 101. Arizona-American's Anthem Water District's gross revenue should increase by  
8 \$2,642,533.

9 102. In the test year ended December 9, 2005, for its Anthem/Agua Fria Wastewater  
10 District, the Company experienced Operating Income of \$347,365, on total revenues of \$6,135,801,  
11 for a 1.73 percent rate of return on FVRB.

12 103. The Company requested rates for its Anthem/Agua Fria Wastewater District that  
13 would result in total revenues of \$8,635,984, a revenue increase of \$2,500,183, or 40.75 percent. The  
14 Council recommended rates that would yield total revenues of \$7,544,352, an increase of \$1,408,551,  
15 or 22.96 percent. RUCO recommended rates that would yield total revenues of \$7,322,865, an  
16 increase of \$1,187,064, or 19.35 percent. Staff recommended total revenues of \$8,013,288 an  
17 increase of \$1,877,487, or 30.60 percent.

18 104. For Arizona-American's Anthem/Agua Fria Wastewater District, a fair value rate of  
19 return on FVRB of 6.7 percent is reasonable and appropriate.

20 105. The revenue increase requested by the Company for the Anthem/Agua Fria  
21 Wastewater District would produce an excessive return on FVRB.

22 106. Arizona-American's Anthem/Agua Fria Wastewater District's gross revenue should  
23 increase by \$1,654,474.

24 107. The rate designs proposed by Staff, as modified in the discussion herein, are  
25 reasonable and should be adopted in this proceeding.

26 108. ADEQ or its formally delegated agent, the Maricopa County Environmental Services  
27 Department ("MCESD") reported that the Anthem District drinking water system is currently in  
28 compliance with ADEQ requirements and delivering water that meets State and Federal drinking

1 water quality standards required by the Arizona Administrative Code, Title 18, Chapter 4.

2 109. The Anthem Water District is within the Phoenix Active Management Area ("AMA"),  
3 but is not subject to the Arizona Department of Water Resources ("ADWR") reporting and  
4 conservation requirements because the system uses only surface water.

5 110. The Anthem Water District system has arsenic concentration of less than 10 parts per  
6 billion and is currently meeting the Federal arsenic standard.

7 111. The Anthem Water District has an approved curtailment plan tariff.

8 112. Staff reports that the Anthem Water District's system has a 13.2 percent water loss  
9 during the test year, and recommends the filing of a water loss report, as well as a water loss  
10 adjustment as a penalty for the amount of test year water loss in excess of 10 percent. Both  
11 recommendations are reasonable and should be adopted, as discussed and ordered herein.

12 113. It is in the public interest to require that Arizona-American's Anthem water system  
13 implement at least six (6) Modified Non-Per Capita Conservation Program Water Conservation  
14 Measures (also known as Best Management Practices ["BMPs"]) for the Phoenix Active  
15 Management Area, as defined by the Arizona Department of Water Resources, prior to receiving its  
16 next rate increase for the Anthem water system. Of the BMPs that Arizona-American chooses, at  
17 least one (1) but no more than three (3) shall be from Categories 1, 2 and 3 (Public Awareness/Public  
18 Relations; Conservation Education and Training; and Outreach Services).

19 114. It is reasonable to require Arizona-American to conduct a study of the tiered water  
20 rates approved herein to determine the effect of these rates on water consumption and to require the  
21 results of this study to be filed with Docket Control when the study is complete, but no later than  
22 July, 2010.

23 115. The Anthem Water District and the Anthem/Agua Fria Wastewater District have no  
24 outstanding compliance issues with this Commission.

25 116. Arizona-American should be required to use, on a going-forward basis, the  
26 depreciation rates it proposed in this case, as they are depicted in its depreciation schedules filed on  
27 June 22, 2007.

28 ...

CONCLUSIONS OF LAW

1  
2 1. Arizona-American is a public service corporation pursuant to Article XV of the  
3 Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

4 2. The Commission has jurisdiction over Arizona-American and the subject matter of the  
5 application.

6 3. Notice of the proceeding was provided in conformance with law.

7 4. The fair value of Arizona-American's Anthem Water District rate base is \$36,267,274,  
8 and applying a 6.7 percent rate of return on this fair value rate base produces rates and charges that  
9 are just and reasonable.

10 5. The fair value of Arizona-American's Anthem/Agua Fria Wastewater District rate  
11 base is \$20,097,915, and applying a 6.7 percent rate of return on this fair value rate base produces  
12 rates and charges that are just and reasonable.

13 6. The rates and charges approved herein are reasonable.

ORDER

14  
15 IT IS THEREFORE ORDERED that Arizona-American Water Company is hereby  
16 authorized and directed to file with the Commission, on or before June 30, 2008, the following  
17 schedules of rates and charges for its Anthem Water District and its Anthem/Agua Fria Wastewater  
18 District, which shall be effective for all service rendered on and after June 4, 2008.

ANTHEM WATER

MONTHLY USAGE CHARGE:

Residential

5/8" x 3/4" Meter	\$ 17.53
3/4" Meter	17.53
1" Meter	42.88
1-1/2" Meter	86.41
2" Meter	138.30
3" Meter	276.78
4" Meter	432.63
6" Meter	865.27
8" Meter	1,334.57



1	<u>Commercial</u>	
2	5/8" x 3/4" Meter	17.53
	3/4" Meter	17.53
3	1" Meter	42.88
	1-1/2" Meter	86.41
4	2" Meter	138.30
	3" Meter	276.78
5	4" Meter	432.63
6	6" Meter	865.27
7	8" Meter	1,334.57
8	<u>Irrigation</u>	
	1"	0.00
9	1-1/2"	0.00
	2"	0.00
10	3"	0.00
	4"	0.00
11	8"	0.00
12	<u>Public Interruptible</u>	
	2"	0.00
13	3"	0.00
	6"	0.00
14	10"	0.00
15	<u>Private Fire</u>	
16	3"	\$ 49.67
	4"	84.40
17	6"	126.60
	8"	127.72
18	10"	255.45
19	<u>COMMODITY RATES (per 1,000 gallons):</u>	
	<b>5/8" Meter (Residential)</b>	
20	From 1 to 4,000 Gallons	\$1.54
	From 4,001 to 10,000 Gallons	2.41
21	Over 10,000 Gallons	3.08
22	<b>3/4" Meter (Residential)</b>	
	From 1 to 4,000 Gallons	\$1.54
23	From 4,001 to 10,000 Gallons	2.41
	Over 10,000 Gallons	3.08
24	<b>1" Meter (Residential)</b>	
25	From 1 to 4,000 Gallons	\$1.54
	From 4,001 to 46,000 Gallons	2.41
26	Over 46,000 Gallons	3.08
27	<b>5/8" Meter (Commercial)</b>	
28		

1	From 1 to 10,000 Gallons	2.41
	Over 10,000 Gallons	3.08
2		
	<b>3/4" Meter (Commercial)</b>	
3	From 1 to 10,000 Gallons	2.41
	Over 10,000 Gallons	3.08
4		
	<b>1" Meter (Commercial)</b>	
5	From 1 to 46,000 Gallons	2.41
	Over 46,000 Gallons	3.08
6		
	<b>1-1/2" Meter (Residential/Commercial)</b>	
7	From 1 to 109,000 Gallons	2.41
	Over 109,000 Gallons	3.08
8		
	<b>2" Meter (Residential/Commercial)</b>	
9	From 1 to 185,000 Gallons	2.41
	Over 185,000 Gallons	3.08
10		
	<b>3" Meter (Residential/Commercial)</b>	
11	From 1 to 390,000 Gallons	2.41
	Over 390,000 Gallons	3.08
12		
	<b>4" Meter (Residential/Commercial)</b>	
13	From 1 to 621,000 Gallons	2.41
	Over 621,000 Gallons	3.08
14		
	<b>6" Meter (Residential/Commercial)</b>	
15	From 1 to 1,265,000 Gallons	2.41
	Over 1,265,000 Gallons	3.08
16		
	<b>8" Meter (Residential/Commercial)</b>	
17	From 1 to 1,964,000 Gallons	2.41
	Over 1,964,000 Gallons	3.08
18		
	<u>Irrigation (All Gallons)</u>	
19	1"	\$1.43
	1-1/2"	1.43
20	2"	1.43
	3"	1.43
21	4"	1.43
	8"	1.43
22		
	<u>Public Interruptible (All Gallons)</u>	
23	2"	\$3.08
24	3"	3.08
	6"	3.08
25	8"	3.08
26		
27		
28		

SERVICE LINE AND METER INSTALLATION CHARGES:

(Refundable)	<u>Line</u>	<u>Meter</u>	<u>Total</u>
5/8" Meter	\$ 370	\$ 130	\$ 500
3/4" Meter	370	205	575
1" Meter	420	240	660
1-1/2" Meter	450	450	900
2" Turbine Meter	580	945	1,525
2" Compound Meter	580	1,640	2,220
3" Turbine Meter	745	1,420	2,165
3" Compound Meter	765	2,195	2,960
4" Turbine Meter	1,090	2,270	3,360
4" Compound Meter	1,120	3,145	4,265
6" Turbine Meter	1,610	4,425	6,035
6" Compound Meter	1,630	6,120	7,750
Over 6" Meter	COST	COST	COST

SERVICE CHARGES:

Establishment and/or Reconnection	\$ 60.00
Establishment and/or Reconnection (after hours)	90.00
Meter Test (if correct)	30.00
NSF Check	20.00
Meter Reread (if correct)	10.00
Deposit	(a)
Deposit Interest	(a)
Late Payment Penalty	1.5%
Collection of any privilege, sales, use and franchise taxes	(b)

CAPACITY RESERVATION CHARGES:

Fee per Equivalent Residential Unit (ERU)	\$765 per ERU
	<u>ERU</u>
Single Family Homes	1.00
Apartment Units	0.75
Recreation Centers	32.00
Elementary Schools	35.00
Middle Schools	125.00
High School	125.00
Junior College	125.00
Club House	16.00
Neighborhood Park	5.00
Regional Park	10.00
Church	4.00
Other Commercial Units (per acre)	4.25
Landscape Services	0.00

- 1 (a) Per Commission Rule A.A.C. R-14-2-403(B)  
 2 (b) Per Commission Rule A.A.C. R-14-2-409(D)

3 RATE BASE REDUCTION CHARGE:

Per new potable water service connection

4 <u>Meter Size</u>	<u>Factor</u>	<u>Total Charge</u>
5 5/8 x 3/4"	1.0	\$ 3,000
6 3/4"	1.5	4,500
7 1"	2.5	7,500
8 1 1/2"	5.0	15,000
9 2"	8.0	24,000
3"	16.0	48,000
4"	25.0	75,000
6"	50.0	150,000
8"	100.00	300,000

10 ANTHEM / AGUA FRIA WASTEWATER

11 MONTHLY MINIMUM CHARGE:

12 <u>Rate Schedule</u>	<u>Description / General Sanitary Sewer Rate</u>	
13 E1MS1	Residential - All	\$ 27.76
14 E2MS1	Small Commercial - 5/8"	27.76
15 E2MS2	Small Commercial - 3/4"	41.64
16 E2MS3	Small Commercial - 1"	55.58
17 E2MS4	Commercial Large User - All	111.12
18 E2M2	Anthem/Agua Fria Treatco - All	0.00
19 E2MS5	Anthem/Agua Fria Treatco - All	0.00
20 E4M2	Anthem/Agua Fria Treatco - All	0.00
21 E5M2	Anthem/Agua Fria Treatco - All	0.00

22 COMMODITY RATES:

23 <u>Rate Schedule</u>	<u>Description / General Sanitary Sewer Rate</u>	<u>Per 1,000 gallons</u>	
24		<u>water usage:</u>	
25 E1MS1	Residential - All	First 7,000 gal.	\$ 3.48
26		Over 7,000 gal.	0.00
27 E2MS1	Small Commercial - 5/8"	First 10,000 gal.	3.48
28		Over 10,000 gal.	0.00
29 E2MS2	Small Commercial - 3/4"	First 15,000 gal.	3.48
30		Over 15,000 gal.	0.00
31 E2MS3	Small Commercial - 1"	First 20,000 gal.	3.48
32		Over 20,000	0.00
33 E2MS4	Commercial Large User - All	All gallons	3.48
34 E2M2	Anthem/Agua Fria Treatco - All	All gallons	3.17
35 E2MS5	Anthem/Agua Fria Treatco - All	All gallons	3.17

1	E4M2	Anthem/Agua Fria Treatco - All	All gallons	3.17
2	E5M2	Anthem/Agua Fria Treatco - All	All gallons	3.17

3 SERVICE AND OTHER CHARGES:

4 Annual Fee for Industrial Discharge Service for those customers consuming an amount of water less than or equal to 50,000 gallons per month through one or more water meters to the same facility, inclusive of meters used for irrigation \$ 500

5 For those customers consuming more than 50,000 gallons per month of water through one or more water meters to the same facility, inclusive of meters used for irrigation \$ 1,000

6 Sewer Facilities Hook-Up Fee SHU-1  
7 Fee per Equivalent Residential Unit \$ 765

9			<u>Associated ERU</u>	
10		Single Family Home		1.00
11		Apartment Units		0.50
12		Commercial Units (per acre)		4.00
13		Resorts (per room)		0.50
14		Parks acreage, Golf Courses acreage and Right-of-Way landscaping Acreage		-

15		Establishment		\$ 30.00
16		Establishment (after hours)		45.00
17		Reconnection (delinquent)		40.00
18		Reconnection (after hours)		55.00
19		Deposit		(a)
20		Deposit Interest		(a)
21		NSF Check		15.00
22		Deferred Payment, per month		1.5%
23		Late Payment Charge		1.5%
24		Collection of any privilege, sales, use and franchise taxes		(b)

- 25 (a) Per Commission Rule A.A.C. R-14-2-403(B)
- 26 (b) Per Commission Rule A.A.C. R-14-2-409(D)

27 IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its Anthem  
28 Water District and Anthem/Agua Fria Wastewater District customers of the revised schedules of rates  
and charges authorized herein by means of an insert, in a form acceptable to Staff, included in its next  
regularly scheduled billing.

IT IS FURTHER ORDERED that in addition to the above-ordered notice provided by the  
Arizona-American Water Company regarding the new rates authorized herein, Arizona-American

1 Water Company shall also provide notice to potential customers regarding its pending rate case for  
2 the Anthem Water District and Anthem/Agua Fria Wastewater District that includes the rate increase  
3 that it is requesting in that filing.

4 IT IS FURTHER ORDERED that Arizona-American Water Company shall ensure that the  
5 term of the Fourth Amendment to the Anthem Agreement deferring 25 percent of the true-up  
6 payment due from Arizona-American Water Company inures to the benefit of ratepayers, by the  
7 appropriate choice of test year for filing its next rate case.

8 IT IS FURTHER ORDERED that based on the findings herein, Arizona-American Water  
9 Company shall allocate thirty-two percent of the Northwest Regional Wastewater Treatment  
10 Facility's costs to the Anthem/Agua Fria Wastewater District, and shall report the results of plant  
11 operations in the Company's annual report.

12 IT IS FURTHER ORDERED that the allocation of the Northwest Regional Wastewater  
13 Treatment Facility's costs ordered herein may be revisited in future rate cases if the relative use of the  
14 Northwest Regional Wastewater Treatment Facility by the Anthem/Agua Fria Wastewater District  
15 changes, or if circumstances warrant otherwise.

16 IT IS FURTHER ORDERED that Arizona-American Water Company shall reduce its non-  
17 account water for the Anthem Water District to 10 percent or less by July 31, 2008. Arizona-  
18 American Water Company shall continue to monitor its system and shall file by July 31, 2008, with  
19 the Commission's Docket Control, as a compliance item in this docket, a report to the Commission  
20 indicating the non-account water data, including quantities of water produced, sold and non-account  
21 water percentages for each of the previous 12 months.

22 IT IS FURTHER ORDERED that upon the filing of the above-ordered non-account water  
23 monitoring report, the Commission's Utilities Division Staff shall determine whether non-account  
24 water for the Anthem Water District has been reduced to 10 percent or less, and if Staff determines  
25 that it has not, shall make a filing in this docket no later than August 29, 2008, so indicating and  
26 recommending appropriate Commission action.

27 IT IS FURTHER ORDERED that Arizona-American Water Company shall conduct a study  
28 of the tiered water rates approved by this Decision for its Anthem water system to determine the

1 effect of these rates on water consumption and that the results of this study shall be filed with Docket  
2 Control when the study is complete, but no later than July, 2010.

3 ITS FURTHER ORDERED that Arizona-American Water Company shall demonstrate to the  
4 Commission, prior to receiving its next rate increase for the Anthem water system, that the Anthem  
5 water system has implemented at least six (6) Modified Non-Per Capita Conservation Program Water  
6 Conservation Measures (also known as Best Management Practices ["BMP's"]) for the Phoenix  
7 Active Management Area, as defined by the Arizona Department of Water Resources, and that of the  
8 BMPs chosen by Arizona-American, at least one (1) but no more then three (3) are from Categories  
9 1, 2, and 3 (Public Awareness/Public Relations; Conservation Education and Training; and Outreach  
10 Services).

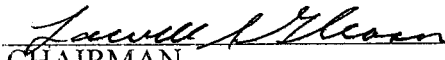
11 IT IS FURTHER ORDERED that Arizona-American Water Company shall use, on a going  
12 forward basis, the depreciation rates it proposed in this case, as they are depicted in its depreciation  
13 schedules filed on June 22, 2007.

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1 IT IS FURTHER ORDERED that Arizona-American Water Company shall annually file as  
2 part of its annual report, an affidavit with the Commission's Utilities Division attesting that the  
3 Company is current in paying its property taxes in Arizona.

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

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

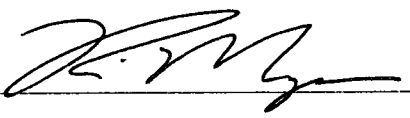
6  
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8   
CHAIRMAN COMMISSIONER

9  
10  COMMISSIONER  
 COMMISSIONER

11  
12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
13 Director of the Arizona Corporation Commission, have  
14 hereunto set my hand and caused the official seal of the  
15 Commission to be affixed at the Capitol, in the City of Phoenix,  
16 this 13<sup>th</sup> day of June, 2008.

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18   
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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DISSENT 

DISSENT   
TW:db



1 SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY, INC.

2 DOCKET NO.: WS-01303A-06-0403

3  
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