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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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JUN 17 2008

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

Docket No. W-01303A-05-0280

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, 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 SUN CITY WEST WATER AND WASTEWATER DISTRICTS.

Docket No. WS-01303A-02-0867

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, 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 MOHAVE WATER DISTRICT AND ITS HAVASU WATER DISTRICT

Docket No. WS-01303A-02-0869

NOTICE OF FILING RUCO'S REPORT ON STEP TWO ARSENIC FILING - SUN CITY WEST DISTRICT

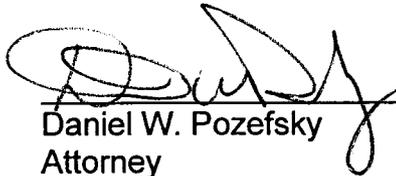
1 IN THE MATTER OF THE APPLICATION OF
2 ARIZONA-AMERICAN WATER COMPANY,
3 INC., AN ARIZONA CORPORATION, FOR A
4 DETERMINATION OF THE CURRENT FAIR
5 VALUE OF ITS UTILITY PLANT AND
6 PROPERTY AND FOR INCREASES IN ITS
7 RATES AND CHARGES BASED THEREON
8 FOR UTILITY SERVICE BY ITS ANTHEM
9 WATER DISTRICT,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

7
8 **NOTICE OF FILING RUCO'S REPORT ON**
9 **STEP TWO ARSENIC FILING - SUN CITY WEST DISTRICT**

10 On April 8, 2008, Arizona American Water Company filed its Step Two ACRM filing
11 for its Sun City West Water District, seeking a surcharge of \$0.89 to the monthly minimum
12 charge, and \$0.1090 per 1,000 gallons to the commodity rate.

13 The Residential Utility Consumer Office ("RUCO") hereby files its Report on its audit
14 of the ACRM filing. RUCO recommends a surcharge of \$0.64 to the monthly minimum
15 charge and \$0.0782 per 1,000 gallons to the commodity rate.

16 RESPECTFULLY SUBMITTED this 17th day of June 2008.

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19 
20 Daniel W. Pozefsky
21 Attorney

1 AN ORIGINAL AND NINETEEN
2 COPIES of the foregoing filed this
3 17th day of June 2008 with:

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

5 COPY of the foregoing hand delivered/
6 mailed this 17th day of June 2008 to:

7 Teena Wolfe
8 Administrative Law Judge
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21 Miles H. Kiger, Rate Analyst
22 Arizona-American Water Company
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TO: Stephen Ahearn, Director
Scott Wakefield, Chief Counsel

FROM: Rodney Moore, Public Utilities Analyst V

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

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the operations and maintenance ("O&M") expenditures of the completed arsenic plant in the Sun City West Water District, to verify the prior 12 months of deferred O&M costs and the ongoing O&M costs, verify compliance with Decision Nos. 68310 and 66400 authorizing the ACRM, and verify the accuracy of the requested ACRM surcharge.

AUDIT PROCEDURES: I performed the following audit procedures:

- 1) Verified that all schedules that are required by Decision No. 66400 are included in the application.
- 2) Reviewed Earnings Test for compliance, accuracy, and determined if the Company had passed the Earnings Test.
- 3) Reviewed all arsenic O&M invoices, looking for such things as misallocations, unreasonable costs, non-arsenic O&M costs, double billings etc.
- 4) Verified accuracy of invoice totals and grand total.
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance.
- 6) Reviewed rate design for accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the instant rate case.

AUDIT FINDINGS:

The Sun City West ACRM filing is accurate and in compliance with Decision Nos. 68310 and 66400 with the following two exceptions:

- 1) Contrary to Decision No. 68310, the Company is requesting recovery of additional arsenic plant. Under Decision No. 68310 the Company is authorized to recover only O&M costs and not capital costs. Decision No. 68310 authorizes the implementation of an ACRM to the extent described within the Order.

On page 8 of Decision No. 68310, Mr. Broderick describes in-depth what costs would be recoverable in each step of the ACRM. Item a) on page 8 states: "In the first step filing.....the Company could seek recovery of capital costs for arsenic treatment facilities that are up and running. Item c) on page 8 states: "In the second step filing.....the Company could seek recognition of the prior 12 months of deferred O&M costs, as well as ongoing O&M costs.

- 2) Through discovery, a calculation error was uncovered in the cost of chemicals. Therefore, the actual O&M cost for chemicals was reduced \$19,463 from \$54,756 to \$35,293.

AUDIT RECOMMENDATIONS:

The Company's ACRM request should be adjusted to remove the request for recovery of additional arsenic plant in service not recovered by the existing Surcharge and only reflect the recovery of the eligible arsenic O&M costs. These recommended adjustments and the resultant RUCO recommended ACRM step 2 rate increases are displayed on the attached Schedule RUCO ACRM-2.

RUCO ADJUSTMENT TO ACRM - SUN CITY WEST WATER DISTRICT

| LINE NO. | DESCRIPTION | [A] COMPANY AS FILED | [B] RUCO ADJUSTMENT | [C] RUCO AS ADJUSTED |
|----------|--|-------------------------|------------------------|-------------------------|
| 1 | Arsenic Plant Revenue Requirement | | | |
| | Gross Arsenic Plant in Service/Rate Base | \$ 979,109 | \$ (979,109) | \$ - |
| | Accumulated Depreciation Of Arsenic Plant (Step 1) | (443,101) | 443,101 | - |
| 2 | Net Arsenic Plant in Service/Rate Base | \$ 536,008 | \$ (536,008) | \$ - |
| 3 | Depreciation rate | 2.78% | | |
| 4 | Depreciation expense | 27,254 | (27,254) | - |
| 5 | Depreciation expense net of tax savings ¹ | 16,734 | (16,734) | - |
| 6 | Recoverable O&M costs - Ongoing | 175,096 | (19,463) | 155,633 |
| 7 | Recoverable O&M costs - Ongoing Net Of Tax Savings | 107,511 | (11,951) | 95,561 |
| 8 | Arsenic Operating Income | \$ (124,246) | | \$ (95,561) |
| 9 | Rate of return | -12.69% | | |
| 10 | Required Rate of Return ² | 6.50% | | |
| 11 | Required Operating Income | 34,841 | (34,841) | - |
| 12 | Operating Income deficiency | 159,086 | | 95,561 |
| 13 | Gross revenue conversion factor ² | 1.62863 | - | 1.62863 |
| 14 | Revenue deficiency | \$ 259,093 | \$ - | \$ 155,633 |

¹ 38.5986 % tax rate per Dec. 67093

² Decision No. 67093

COMPANY PROPOSED

| RATES | CURRENT RATES FOLLOWING ACRM STEP 1 | PROPOSED ACRM STEP 2 BASE SURCHARGE | PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE | TOTAL PROPOSED |
|--------------------------------------|-------------------------------------|-------------------------------------|---|----------------|
| Basic Monthly Minimum Service Charge | | | | |
| 5/8" Meter | \$ 9.57 | \$ 0.53 | \$ 0.36 | \$ 10.46 |
| Commodity Rates Per 1,000 Gallons | | | | |
| 0 to 4,000 gallons | \$ 1.3092 | \$ 0.0650 | \$ 0.0439 | \$ 1.42 |
| 4,001 to 15,000 gallons | 1.7442 | 0.0650 | 0.0439 | 1.85 |
| 15,001 gallons and over | 2.0102 | 0.0650 | 0.0439 | 2.12 |

RUCO PROPOSED

| RATES | CURRENT RATES FOLLOWING ACRM STEP 1 | PROPOSED ACRM STEP 2 BASE SURCHARGE | PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE | TOTAL PROPOSED |
|--------------------------------------|-------------------------------------|-------------------------------------|---|----------------|
| Basic Monthly Minimum Service Charge | | | | |
| 5/8" Meter | \$ 9.57 | \$ 0.32 | \$ 0.32 | \$ 10.21 |
| Commodity Rates Per 1,000 Gallons | | | | |
| 0 to 4,000 gallons | \$ 1.3092 | \$ 0.0391 | \$ 0.0391 | \$ 1.39 |
| 4,001 to 15,000 gallons | 1.7442 | 0.0391 | 0.0391 | 1.82 |
| 15,001 gallons and over | 2.0102 | 0.0391 | 0.0391 | 2.09 |

