BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 PARADISE VALLEY WATER DISTRICT.	DOCKET NO. W-01303A-05-0405
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY FOR APPROVAL OF AN AGREEMENT WITH THE PARADISE VALLEY COUNTRY CLUB.	DOCKET NO. W-01303A-05-0910 DECISION NO. **70488**

OPINION AND ORDER AMENDING DECISION NO. 68858

DATES OF HEARING:	March 10, 2008 (Procedural Conference), May 15 and 16, 2008
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Wolfe
IN ATTENDANCE:	William A. Mundell, Commissioner Kristin K. Mayes, Commissioner
APPEARANCES:	Mr. Paul M. Li, on behalf of Arizona-American Water Company; Mr. Timothy J. Casey, SCHMITT, SCHNECK, SMYTH & HERROD, P.C., on behalf of the Town of Paradise Valley; Mr. Daniel Pozefsky, Chief Counsel, on behalf of the Residential Utility Consumer Office; Mr. Robert J. Metli and Mr. Jeffrey Crockett, SNELL & WILMER, L.L.P., on behalf of The Sanctuary on Camelback Mountain, Camelback Inn and the Scottsdale Renaissance Resort; and Ms. Maureen Scott, Senior Staff Attorney, and Mr. Charles Hains, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On June 3, 2005, Arizona-American Water Company ("Arizona-American" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a rate increase for its Paradise Valley Water District ("District" or "Paradise Valley"). The application requested approval of a public safety surcharge for investments by the Company related to improvement of fire flow facilities; approval of an Arsenic Cost Recovery Mechanism ("ACRM") for investments required to comply with federal water arsenic reduction requirements; and approval of a conservation surcharge that would be imposed for usage in the highest consumption block.

On July 28, 2006, the Commission issued Decision No. 68858 in these dockets. The parties to Decision No. 68858 were the Company, the Residential Utility Consumer Office ("RUCO") and the Commission's Utilities Division Staff ("Staff").[1] Decision No. 68858 approved the ACRM, and also approved implementation of the two surcharges, the High Block Usage Surcharge ("HBU Surcharge") and the Public Safety Fire Flow Surcharge ("PSFF Surcharge"). Decision No. 68858 required both the HBU Surcharge and the PSFF Surcharge to be treated as contributions in aid of construction ("CIAC") for the purpose of providing funding for fire flow improvements desired by the Town of Paradise Valley ("Town"). The HBU Surcharge was set at $2.15 per thousand gallons, to apply to residential third tier usage (over 80,000 gallons/month), in addition to the normal third tier residential commodity rate charge, and to all commercial second tier usage (over 400,000 gallons/month), in addition to the normal second tier commercial commodity rate charge. The PSFF Surcharge was set at $1.00 per thousand gallons, to apply to residential usage on both the second tier (from 25,001 to 80,000 gallons/month), and third tier residential commodity rate (over 80,000 gallons/month) and to commercial usage on the second tier commercial commodity rate (over 400,000 gallons/month), in addition to the normal tier charges. Decision No. 68858 required the PSFF Surcharge to be collected from October 1, 2007, until recovery of the District's fire flow projects is complete.

Subsequent to implementation of the HBU Surcharge and the PSFF Surcharge, the Town and

[1] The Town of Paradise Valley requested intervention in the rate case on March 20, 2006, but later filed a letter on the date of the hearing, March 27, 2006, withdrawing its intervention request. No other intervention requests were filed in the rate case.

the Resorts expressed concern regarding the resulting increase in some residential and commercial water utility bills. On January 16, 2008, the Town, through its Town Manager, filed in these dockets a letter and an agreement dated January 4, 2008, ("Rate Design Agreement" or "RDA") signed by the Town, the Sanctuary on Camelback Mountain, the Camelback Inn, and the Scottsdale Renaissance (collectively, "Resorts"), and some homeowners' association members.

On February 27, 2008, the Commission voted to reconsider Decision No. 68858 pursuant to A.R.S. § 40-252 for the limited purpose of reviewing the RDA.

At a procedural conference held on March 10, 2008, intervention in these dockets was granted to the Town, and the Resorts.

On March 14, 2008, a Procedural Order was issued setting a hearing for May 15, 2008, to reconsider Decision No. 68858 for the limited purpose of reviewing the proposed RDA.

In accord with the March 14, 2008, Procedural Order, the Town, the Resorts, RUCO, Staff and the Company prefiled direct testimony of their witnesses. The Resorts, RUCO, and the Company prefiled rebuttal testimony of their witnesses.

On April 30, 2008, the Company filed Notice of Filing Certification of Mailing and Publication, certifying that it had provided notice of the hearing to reconsider Decision No. 68858. No further intervention requests were received. Ten public comments were filed in favor of the RDA.

The hearing on the proposed RDA commenced as scheduled before a duly authorized Administrative Law Judge of the Commission on May 15, 2008, and concluded on May 16, 2008. The Company, the Town, the Resorts, RUCO, and Staff appeared, presented evidence, and cross-examined witnesses. Late-filed exhibits were filed by the Company and the Resorts. On June 13, 2008, the Company, the Resorts, RUCO, and Staff filed their closing briefs, and the matter was taken under advisement.

DISCUSSION

The RDA

The RDA, dated January 4, 2008, memorializes the consensus between representatives of homeowners' associations, the Town, and the Resorts. A copy of the RDA, which was admitted into

evidence at the hearing as Hearing Exhibit T-1, is attached to this Decision as Exhibit A. The RDA requests that the Commission amend Decision No. 68858 to implement the rate design and accounting changes described in the RDA as a transitional measure pending the effectiveness of a final order in Arizona-American's next rate application for the District.[2]

The RDA calls for a reduction in the HBU Surcharge from $2.15 per thousand gallons to $1.00 per thousand gallons. The RDA also proposes resetting the PSFF Surcharge, on March 1, 2008, from the current $1.00 per thousand gallons to $0, and establishing a new Public Safety surcharge on that date. The RDA-proposed new Public Safety surcharge would be implemented in step increases based on the Company's actual investment costs, by means of a mechanism similar to the Company's existing ACRM, and would recover Company investments made after March 1, 2008. A key difference between the current PSFF Surcharge and the RDA-proposed Public Safety surcharge is that the new surcharge would be computed using a revenue requirement formula instead of treating the surcharges as CIAC. The RDA's proposed new Public Safety surcharge would be designed to recover 50 percent of the Company's investment for fire flow improvements phases completed after March 1, 2008, with the remaining 50 percent to be recovered through the reduced HBU Surcharge. The RDA further provides that the parties to the agreement will seek to complete the transition of the HBU Surcharge from CIAC treatment to a revenue requirement formula in the pending rate case.

Positions of the Parties

Of the parties to this case, only the Resorts and the Town are signatories to the RDA, and they support Commission adoption of the RDA in its entirety. The Company is not a signatory to the RDA, but participated in the discussion leading to its development. The Company supports adoption of the RDA with the exception of the second sentence of Section A, the last sentence of Section C, and the last sentence of Section D. Staff and RUCO do not support adoption of the RDA, but they do support a reduction in the HBU Surcharge set by Decision No. 68858, from $2.15 per thousand gallons to $1.00 per thousand gallons, and resetting the PSFF Surcharge set by Decision No. 68858

[2] Arizona-American filed a rate application including its Paradise Valley Water District on May 2, 2008, in Docket No. W-01303A-08-0227 et al. The application was found sufficient on July 23, 2008, and has been set to be heard commencing on March 16, 2009.

from the current $1.00 to $0, until the surcharges are reviewed in the District's pending rate proceeding. The parties' arguments in support of their positions on the RDA are summarized below.

The Resorts

The Resorts support adoption of the RDA in its entirety, including a reduction in the HBU Surcharge from $2.15 per thousand gallons to $1.00 per thousand gallons, and resetting the PSFF Surcharge to $0. The Resorts assert that because the RDA's proposals would apply to the same tier commodity rates as the current surcharges, no ratepayers will be worse off, and many, including the Resorts, will be better off. They argue that the District's current rate design does not take into consideration the Resorts' unavoidable minimum water needs, which far exceed the commercial second tier breakpoint of 400,000 gallons per month, and assert that, in the case of the Resorts, the current rate design therefore does not achieve any of its intended conservation goals. They further argue that because the breakpoint is unusually low for the Resorts' needs, application of the HBU Surcharge and the PSFF Surcharge to their second tier usage unfairly impacts them. The Resorts point out that the top commercial tier, at 400,000 gallons per month, is only five times the top residential tier, which begins at 80,000 gallons per month, but that the Resorts can host hundreds of families a night and must serve hundreds of employees. The Resorts presented credible evidence that they have instituted many water conservation measures, but that their water consumption requirements still exceed the second tier commercial breakpoint in the current rate design.

The Resorts also argue that the current CIAC treatment of surcharge proceeds results in an inequitable intergenerational transfer, because the time period for collecting the funding is not matched to the time period the assets will be providing benefits. In particular, the Resorts are concerned that under the current surcharge treatment, the Resorts will be required to pay for fire flow infrastructure upgrades that will benefit three new planned resorts in the Districts, but that the new resorts, with whom they will be competing, will not pay for the improvements. The Resorts favor the change from CIAC treatment of the HBU Surcharge and the PSFF Surcharge to a revenue requirement treatment because they believe that depreciating the fire flow assets through a revenue requirement surcharge over the life of the assets (30 to 50 years) will spread costs to ratepayers who will benefit from the improvements, and thereby avoid the intergenerational transfer problem.

The Resorts disagree with RUCO's assertion that the RDA proposes ratepayer funding of undetermined costs. The Resorts state that instead, under the proposed ACRM-like mechanism for the new Public Safety surcharge, the step increases would recover construction costs only after an opportunity for auditing plant already placed in service. The Resorts also argue that any concerns RUCO has regarding the Company's spending for fire flow infrastructure can be addressed in the pending rate proceeding. The Resorts also take issue with RUCO's assertion that the proposed RDA surcharges would shift recovery of costs from high-end users to low-end users, stating that the RDA proposed surcharges would only affect the second and third usage tiers to which they are currently applied, and would leave the residential first usage tier unaffected, as it is now. In response to RUCO's argument that the District's ratepayers will be no better off under the RDA if it is adopted, the Resorts assert that at a minimum, residential customers will be better off under the RDA proposal when the three new resorts are completed and become customers of the Company, because with a revenue requirement surcharge, the new resorts will help current ratepayers pay the costs of fire flow improvements.

The Town

The Town supports adoption of the RDA in its entirety. The Town's witness testified that the Resorts' and Town residents' reactions to the surcharges warranted input from the Town in this proceeding, in an effort to obtain modest interim rate relief for Town residents and the Resorts. The Town's witness Councilwoman Hamway stated that at the time the Town withdrew its Motion to Intervene in the rate case leading to Decision No. 68858, the Town supported the Company's fire flow related rate increase request, but that soon after Decision No. 68858, the Town realized that implementation of the surcharges authorized by that Decision had resulted in unexpected impacts to the Town's residents, and significant unintended consequences for the Resorts. The witness testified that implementation of the surcharges placed the Resorts at a competitive disadvantage to their competitors located outside the District's service area, and that the disadvantage in turn could have a direct and substantial impact on the Town, because resort bed and sales taxes provide approximately 40 percent of the Town's total revenues. Councilwoman Hamway testified that after hearing concerns from the Resorts and Town residents over many months, the Town brought the Resorts and

Town residents together and served mainly as a facilitator to help develop a consensus plan, and eventually the RDA.

Councilwoman Hamway testified that the RDA proposal provides a mechanism to ensure that future beneficiaries of the fire flow improvements, both residential and commercial, will pay for the improvements. She testified that the Town supports the RDA because it rectifies in part the unexpected and unintended effects of the surcharges on the Town's residential ratepayers and on the Resorts, and balances rate increases equally and equitably between the Resorts and the Town's residents. The Town also submits that interim relief in the form of the RDA proposal will allow the Town further time to review, discuss, and implement meaningful water conservation measures intended to strongly encourage high consumption customers to conserve water.

Arizona-American

Arizona-American does not support adoption of the RDA in its entirety. The Company requests that three sentences be deleted from the RDA proposal. Arizona-American believes that adoption of the RDA with those three sentences would limit the Company's application of proceeds from the new surcharges proposed by the RDA, and therefore opposes their adoption. The Company believes that the second sentence of Section A implies that the HBU Surcharge will terminate once Arizona-American recovers all of its Paradise Valley Fire Flow Improvement Project ("FFIP") costs incurred as of February 29, 2008, and that this would inappropriately limit the amount of the Company's costs that can be recovered via the HBU Surcharge. Arizona-American also disagrees with the last sentence of Section C, which limits the use of the proceeds of the new Public Safety surcharge to offset only the Company's FFIP investment made after March 1, 2008. The Company wishes to apply the proceeds from the new Public Safety surcharge to pay for FFIP-related investment made before March 1, 2008, including deferral costs associated with that investment. Finally, the Company is concerned with an ambiguity presented by the last sentence of Section D, which the Company believes could be read to mean that it can only use the new Public Safety surcharge to recover up to 50 percent of the FFIP-related investment it makes after March 1, 2008. The Company believes this would be inappropriate.

. . .

Arizona-American believes that Commission adoption of the RDA, with three revisions, will benefit the District's customers by providing an immediate rate reduction, and will benefit Arizona-American by creating a mechanism for the Company to recover and finance the ongoing construction cost of its FFIP. The Company echoes the Resorts' and Town's arguments that the existing CIAC treatment of the surcharge proceeds leads to intergenerational transfer. Like the Resorts and the Town, the Company argues in favor of switching to the revenue requirement based surcharges contemplated by the RDA, which would spread cost recovery of the FFIP-related investments over the life of the assets.

The Company objects to Staff's recommendation, joined by RUCO, that the surcharges be reduced at this time, with further consideration of funding mechanisms for the FFIP deferred to the pending rate case. The Company expresses concern with what it views as decreasing Commission support for the use of revenue-based surcharge mechanisms to fund discretionary projects such as the FFIP. The Company has suspended the construction of Phase 3B, and planning of Phase 4, of the FFIP, stating that it took this step in order to minimize the financial risk of being unable to timely recover its FFIP-related costs in the event the RDA is not approved in this proceeding. Arizona-American states that due to the Company's negative net income, it cannot absorb the regulatory lag on a discretionary project such as the FFIP without assurance of recovery. The Company states that if the surcharges are reduced as Staff and RUCO recommend, without being converted to revenue requirement based surcharges, the surcharge proceeds will not generate sufficient CIAC funding to offset the costs of funding Phase 3B construction and Phase 4 planning of the FFIP.

RUCO

RUCO recommends rejection of the RDA, and approval of Staff's recommendation to reduce the HBU Surcharge from $2.15 per thousand gallons to $1.00 per thousand gallons, and to eliminate the PSFF Surcharge until the fire flow issue can be examined in the Company's pending rate proceeding. RUCO cites several reasons for its opposition to the RDA's ACRM-like surcharge proposal. RUCO believes that the RDA proposal would only consider cost increases in one category of expenses while ignoring changes in other expense categories, revenues, cost of capital, and rate base. RUCO is also concerned that the RDA proposal would fund an unspecified number of future

rate hikes for projects with as-yet undetermined costs, and would unfairly allow the Company to earn a rate of return on plant funded by ratepayer-supplied funds; and therefore opposes it. RUCO asserts that the RDA's proposed surcharge mechanism constitutes single-issue ratemaking, and should not be considered absent extreme circumstances, which do not exist in the case of discretionary fire flow improvements. RUCO is also critical of the RDA's failure to specify how the proposed ACRM-like mechanism would be allocated to end-users, and argues that Paragraph III (E) is ambiguous and subject to interpretation on this point.

Staff

Staff recommends that the Commission approve those portions of the RDA that would reduce the HBU Surcharge and eliminate the PSFF Surcharge at this time, in order to ameliorate the impact of the surcharges, until they can be further examined in the Company's pending rate proceeding. Staff recommends that the HBU Surcharge be reduced to $1.00 per thousand gallons, and that the PSFF Surcharge be reset to $0. Staff believes that it would be inappropriate to alter the CIAC treatment of the surcharges authorized in Decision No. 68858 in this narrow and limited proceeding, and argues that a determination on the RDA proposals, including the ACRM-like mechanism that would fund future fire flow improvements, as well as the reclassification of funds collected pursuant to the surcharges, should be deferred to the pending rate case.

Staff asserts that there is a likelihood of broader based input on the RDA issues in the context of the pending rate case, and that the rate proceeding will allow a comprehensive and full consideration of all options. Staff is in agreement with RUCO that the RDA contains some ambiguities and is subject to interpretation, and believes the pending rate proceeding is the proper venue for clarification.

Staff states that it sees no reason why immediate rate relief cannot be given by reducing the HBU Surcharge to $1.00 per thousand gallons and resetting the PSFF Surcharge to $0 at this time, while awaiting more comprehensive consideration of the proposed change from CIAC treatment to revenue-requirement treatment in the pending rate case. Staff believes that the Company would not be harmed by adoption of Staff's recommendation, as the Company has already suspended some phases of the FFIP where construction costs have exceeded the funding received to date. Staff further

recommends that if the provisions of the RDA are found to be non-severable, the Commission should reject the entire RDA.

Analysis and Conclusion

While the Company argues that its three areas of disagreement with the RDA are "technical in nature and have no substantive impact on the RDA," it simultaneously argues that the Commission should not adopt the three sentences in the RDA with which it disagrees. Arizona-American argues that the Town and the Resorts oppose Staff's recommendation to reduce the HBU Surcharge and reset the PSFF Surcharge to $0, while deferring consideration of the proposed change to ACRM-like revenue requirements-based surcharges to the pending rate case. A review of the record reveals that while the Resorts support adoption of the RDA in its entirety, the Resorts' witness was not completely satisfied with the RDA. The witness testified that while he supports the RDA, and does not support other proposals in this proceeding, he believes that the RDA is "not an optimal solution."[3] The record is also clear that while the Town's position is supportive of the RDA in its entirety, the issue of choosing between the Staff's proposal or maintaining the status quo with existing surcharges had not been put to a Town Council vote. The Town's witness testified that without going back to the Town Council, she could not give an opinion for the Town other than full support of the RDA, because the Town Council had voted to support the RDA.[4]

No parties to this proceeding oppose the proposed reductions in the HBU Surcharge and the PSFF Surcharge. The Town and the Resorts, like RUCO and Staff, clearly support those portions of the RDA which call for reducing the surcharges pending the rate proceeding. The Town's witness testified that it was the Resorts' and Town residents' reactions to implementation of the surcharges that led the Town to attempt to obtain modest interim rate relief for Town residents and the Resorts. The Resorts presented credible evidence that despite their institution of water conservation measures, their water consumption needs exceed the second tier commercial breakpoint of 400,000 gallons per month in the current rate design, and they believe this unfairly impacts them. While we do not make a finding in this proceeding regarding the commodity break points or the rate design in general, it is

[3] Tr. at 244.
[4] Tr. at 147-148.

clear that the commercial and residential commodity rate design should be analyzed in the pending rate proceeding. While we make no determination on the issue of the RDA's proposed switch from CIAC treatment to revenue requirement treatment of the surcharges, it is clear that it is an issue that also merits a fuller consideration than was afforded in this proceeding.

As recognized by all the parties, regardless of our findings in this proceeding, the issues in this case will be reviewed in the full context of the rate case filed by the Company on May 2, 2008, and set to be heard on March 16, 2009. Even if we were to adopt the RDA in this proceeding, either as proposed by the Company or by the Town and the Resorts, the issues would be open for reevaluation in the pending rate case. Clearly, the pending rate proceeding provides a more reasonable and appropriate venue for a full examination and analysis of all aspects of the rate design, surcharge levels, and other FFIP funding issues. However, based on the evidence presented in this proceeding, we find that it is in the public interest to provide, in this proceeding, the interim relief sought by the Resorts and the Town and supported by RUCO and Staff, pending a more complete review in the rate case. We will therefore require the Company to implement the HBU Surcharge reduction from $2.15 per thousand gallons to $1.00 per thousand gallons, and to reset the PSFF Surcharge from $1.00 per thousand gallons to $0. We will revisit the entirety of the rate design and FFIP funding issues in the pending rate proceeding.

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

FINDINGS OF FACT

1. Arizona-American is an Arizona public service corporation engaged in the business of providing water and wastewater utility service to customers in its various water and wastewater districts located in portions of Maricopa, Mohave and Santa Cruz counties in Arizona pursuant to authority granted by the Commission. Arizona-American currently provides service to approximately 131,000 customers throughout its districts.

2. On June 3, 2005, Arizona-American filed with the Commission an application for a rate increase for its Paradise Valley Water District. The application requested approval for the

District of a public safety surcharge for investments by the Company related to improvement of fire flow facilities; an Arsenic Cost Recovery Mechanism for investments required by the Company to comply with federal water arsenic reduction requirements; and approval of a conservation surcharge that would be imposed for usage in the highest consumption block.

3. On July 28, 2006, the Commission issued Decision No. 68858 in these dockets, addressing the relief requested in the Company's June 3, 2005 application.

4. The parties to Decision No. 68858 were the Company, RUCO and Staff.

5. The Town of Paradise Valley requested intervention in the rate case, on March 20, 2006, but later filed a letter on the date of the hearing, March 27, 2006, withdrawing its intervention request. No other intervention requests were filed in the rate case.

6. Decision No. 68858 set the HBU Surcharge at $2.15 per thousand gallons for all third-tier usage (over 80,000 gallons/month), in addition to the normal third-tier charge.

7. Decision No. 68858 set the PSFF Surcharge at $1.00 per thousand gallons, to apply to residential usage on both the second tier (from 25,001 to 80,000 gallons/month) and third tier commodity rate (over 80,000 gallons/month), and to commercial usage on the second tier commercial commodity rate (over 400,000 gallons/month), in addition to the normal tier charges, to be collected from October 1, 2007, until recovery of fire flow projects is complete.

8. On January 16, 2008, the Town of Paradise Valley, through its Town Manager, filed in these dockets a letter and a proposed Rate Design Agreement dated January 4, 2008.

9. At a Commission Staff Meeting noticed for and held on February 27, 2008, the Commission voted to reconsider Decision No. 68858 pursuant to A.R.S. § 40-252 for the limited purpose of reviewing the Rate Design Agreement.

10. On February 28, 2008, a Procedural Order was issued setting a procedural conference for March 10, 2008, for the purpose of allowing the parties to Decision No. 68858 to discuss an appropriate procedural schedule for reconsideration of the Decision.

11. The procedural conference convened as scheduled on March 10, 2008. At the procedural conference, intervention was granted to the Town, Sanctuary on Camelback Mountain, the Camelback Inn, and the Scottsdale Renaissance, and the parties discussed procedural issues related to

the reconsideration of Decision No. 68858 for the limited purpose of reviewing the proposed Rate Design Agreement.

12. On March 14, 2008, a Procedural Order was issued to govern the preparation and conduct of the hearing on the proposed Rate Design Agreement.

13. On March 28, 2008, the Resorts filed direct testimony of its witnesses.

14. On March 31, 2008, the Town filed direct testimony of its witness.

15. On April 24, 2008, RUCO filed direct testimony of its witness.

16. On April 25, 2008, Staff filed direct testimony of its witness.

17. Also on April 25, 2008, the Company filed direct testimony of its witness.

18. On April 30, 2008, the Company filed Notice of Filing Certification of Mailing and Publication.

19. On May 6, 2008, the Company filed rebuttal testimony of its witness.

20. On May 9, 2008, RUCO filed rebuttal testimony of its witness.

21. On May 9, 2008, the Resorts filed rebuttal testimony of its witness.

22. Public comments on the proposed Rate Design Agreement were filed on May 6, May 12, May 15 (seven comments), and June 12, 2008.

23. The hearing on the proposed Rate Design Agreement commenced as scheduled on May 15, 2008 and concluded on May 16, 2008. The Company, the Town, the Resorts, RUCO and Staff appeared, presented evidence, and cross-examined witnesses.

24. On May 21, 2008, the Company filed its late-filed exhibits.

25. On May 27, 2008, the Resorts filed their late-filed exhibits.

26. On June 13, 2008, the Company, the Resorts, RUCO, and Staff filed their closing briefs, and the matter was taken under advisement.

27. There is a likelihood of broader based input on the RDA issues in the context of the pending rate case for the District.

28. The pending rate case for the District provides an appropriate venue for a comprehensive consideration of all the RDA issues raised in this proceeding.

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29. No parties to this proceeding oppose the proposed reductions in the HBU Surcharge and the PSFF Surcharge.

30. As an interim measure pending full review of the issues associated with the RDA in the pending rate case for the District, the Company should be required to implement the HBU Surcharge reduction from $2.15 per thousand gallons to $1.00 per thousand gallons, and to reset the PSFF Surcharge from $1.00 per thousand gallons to $0.

31. Other than the interim reduction of the surcharges, a determination on all aspects of the RDA, including but not limited to the ACRM-like mechanism that would fund future fire flow improvements, and the reclassification of funds collected pursuant to the surcharges, should be deferred to the pending rate case for the District.

CONCLUSIONS OF LAW

1. Arizona-American Water Company is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. Sections 40-250 and 40-241.

2. The Commission has jurisdiction over the Company and the subject matter of the applications.

3. The Commission voted on February 27, 2008, to reconsider Decision No. 68858 pursuant to A.R.S. § 40-252 for the limited purpose of reviewing the proposed RDA.

4. Notice of the applications was provided in the manner prescribed by law.

5. The rates and charges for the Paradise Valley Water District approved herein, are just and reasonable and shall be approved.

ORDER

IT IS THEREFORE ORDERED that pursuant to the authority granted by A.R.S. § 40-252, Decision No. 68858 is hereby amended to reduce the amount of the High Block Usage Surcharge from $2.15 per thousand gallons to $1.00 per thousand gallons and to reset the Public Safety Fire Flow Surcharge from $1.00 to $0, effective September 1, 2008.

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IT IS FURTHER ORDERED that High Block Usage Surcharge, the Public Safety Fire Flow Surcharge, and all other issues related to the Rate Design Agreement filed in this docket on January 16, 2008, shall be fully examined and analyzed in the pending rate case proceeding in Docket No. W-01303A-08-0227.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN | COMMISSIONER

COMMISSIONER | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 3rd day of Sept., 2008.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY

DOCKET NOS.: W-01303A-05-0405 AND W-01303A-05-0910

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
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GARY PIERCE

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 PARADISE VALLEY DISTRICT	DOCKET NO. W-01303A-05-0405
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR APPROVAL OF AN AGREEMENT WITH THE PARADISE VALLEY COUNTRY CLUB	DOCKET NO. W-01303A-05-0910

RATE DESIGN AGREEMENT

I. INTRODUCTION

On July 28, 2006, the Arizona Corporation Commission ("Commission") issued Decision No. 68858 concerning the Paradise Valley Water District of Arizona-American Water Company ("Arizona-American"). Among other things, the Decision authorized Arizona-American to collect a "High Block'' surcharge, as well as a "Public Safety" surcharge, to fund projects needed to satisfy fire-flow requirements sought by the Town of Paradise Valley, to encourage water conservation, to alleviate future rate increases for customers in the District and to slightly modify Decision No. 68303 which approved an accounting order applicable to the fire-flow project. On November 14, 2005, the Commission issued Decision No. 68303 which approved a deferral of associated depreciation expense and post-in-service AFUDC.

Since the issuance of Decision No. 68858, many customers have objected to the large magnitude of the rate increase imposed on high-usage accounts and timely rate relief is sought. Similarly, several resorts within the Paradise Valley Water District have stated that the surcharges have increased water bills to levels significantly higher than bills for resorts receiving municipal water from the Cities of Phoenix and Scottsdale, thereby putting the Paradise Valley resorts at a competitive disadvantage.

Over the last several months, representatives from Paradise Valley Homeowners' Associations, the Town of Paradise Valley, Paradise Valley resorts, and Arizona-American have been discussing the possible substance of an agreement that would address the various parties' concerns, while preserving the Commission's three goals of funding fire-flow projects, encouraging water conservation, and alleviating future rate increases. The Town of Paradise Valley's preferences were expressed in its Resolution No. 1156 dated September 27, 2007.

This Rate Design Agreement has been reached as a result.

II. PARTIES

The parties to this Rate Design Agreement are described in the following table:

Party	Description	Authorized Signer
Town of Paradise Valley	Municipal Corporation	James C. Bacon, Jr., Town Manager
Arizona-American Water Company	Water Utility	Paul Townsley, President
Sanctuary on Camelback Mountain	Resort	Robert J. Metli, Attorney
Camelback Inn	Resort	Robert J. Metli, Attorney
Scottsdale Renaissance	Resort	Robert J. Metli, Attorney
Camelhead Estates II HOA	Homeowners' Association	Janice D. Stoney, Resident
Clearwater Hills Improvement Association	Homeowners' Association	Mary Lou Reid, Resident and Executive Director
Finisterre HOA	Homeowners' Association	David Pulatie, Resident

These parties may be referred to jointly as the "Parties" or individually as a "Party."

III. AGREEMENT

The Parties ask the Commission, pursuant to A.R.S. § 40-252, to amend Decision No. 68858 to implement the rate design and accounting changes described below on March 1, 2008, as a transitional measure until a final order is effective in Arizona-American's next rate case for the Paradise Valley Water District.[1]

A. On March 1, 2008, reduce the High Block surcharge from $2.15 to $1.00 per 1000 gallons, but continue to account for the proceeds from this surcharge as Contributions in Aid of Construction ("CIAC"). The High Block surcharge would recover all un-recovered fire-flow costs incurred as of February 29, 2008, if any, including the previous Commission authorized accounting cost deferrals.

B. On March 1, 2008, reset the existing $1.00 per 1,000 gallons Public Safety surcharge to $0.00. The proposed Public Safety surcharge would subsequently be re-established in "ACRM" like step increase filings based on actual investment costs which would occur upon completion of each fire-flow construction phase, with step increases subject to an earnings test of 10.4% return on equity. Therefore, the Commission can use the finding of Fair Value in Decision No. 68858 to determine the Fair Value with a subsequent Public Safety step increase – just as presently occurs with ACRM filings.

C. The Public Safety surcharge would continue to apply only to the commodity portion of the rate and would very likely remain well below the existing amount of $1.00 per 1,000 gallons as a result of its conversion to a revenue requirement surcharge. The first step increase filing is anticipated in late 2008 upon completion of Phase 3 of Paradise Valley's fire flow project (already under construction). An approximate estimate of the first step increase in the Public Safety surcharge is $0.125 per 1,000 gallons. The proposed Public Safety surcharge would recover investments

[1] Arizona-American presently plans to file this rate case not later than May 2008.

made after March 1, 2008, under a cost recovery mechanism using a revenue requirements formula instead of CIAC.[2]

D. For fire flow phases completed after March 1, 2008, the Public Safety surcharge would be designed to recover 50% of the investment. The revised High Block surcharge, therefore, would be allocated the remaining 50% to recover, at least until a final order is effective in Arizona-American's next rate case for the Paradise Valley Water District.

E. All other rate design features of these two surcharges and accounting deferrals would remain as they presently exist until modified by a final order in Arizona-American's next rate case for the Paradise Valley Water District.

F. The Parties will seek to complete the transition of the High Block surcharge from a CIAC to a revenue-requirement formula in proposals to the Commission in the next rate case. The parties will also provide the Commission with proposed enhancements to the existing conservation-oriented rate design.

G. The current construction schedule for the fire-flow projects in the Paradise Valley Water District is set forth in the following table:

Phase	Start	Completion	Cost Estimate
Phase 3	1/1/08	12/31/08	$3.626 M
Phase 4	1/1/09	12/31/09	$4.346 M
Phase 5	1/1/10	12/31/10	TBD
Phase 6	1/1/11	12/31/11	TBD
Phase 7	1/1/12	12/31/12	TBD

[2] As of November 30, 2007, the total un-recovered fire-flow costs remaining (including deferrals) were $795,622. Presently, $3,018,867 of the fire-flow costs are also in rate base and are considered recovered for purposes of determining costs to be recovered in a re-designed High Block surcharge.

IV. GENERAL PROVISIONS

A. The Parties have entered into this Rate Design Agreement to resolve the disputed matters between them and to avoid the time, expense, inconvenience, and uncertainty attendant to litigation of these matters.

B. This Rate Design Agreement represents a compromise in the positions of the parties hereto. By entering into this Rate Design Agreement, no Party acknowledges the validity or invalidity of any particular method, theory or principle of regulation, or agrees that any method, theory or principle of regulation employed in reaching a settlement is appropriate for resolving any issue in any other proceeding, including (without limitation) any issues that are deferred to a subsequent rate proceeding. Except as specifically agreed upon in this Rate Design Agreement, nothing contained herein will constitute a settled regulatory practice or other precedent.

C. All negotiations and other communications relating to this Rate Design Agreement are privileged and confidential, and no party is bound by any position asserted during the negotiations, except to the extent expressly stated in this Rate Design Agreement.

D. The Parties authorize Arizona-American to file this Rate Design Agreement in Docket No. W-01303A-05-0405, *et. al.*, together with a supporting motion and explanatory schedules.

E. This Rate Design Agreement may be executed in counterparts.

F. This Rate Design Agreement is effective as of January 4, 2008.

[Document continues on next page]

V. SIGNATURES

Town of Paradise Valley

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Arizona-American Water Company

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Janice D. Storey, Resident
Dated January __, 2008

Clearwater Hills Improvement Association

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

David Pulatie, Resident
Dated January __, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January __, 2008

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Dated January __, 2008

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Paul Townsley, President
Dated January __, 2008

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Janice D. Storey, Resident
Dated January __, 2008

Clearwater Hills Improvement Association

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

David Pulatie, Resident
Dated January __, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January 4, 2008

EXHIBIT "A"

DECISION NO. 70488

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Town of Paradise Valley

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Arizona-American Water Company

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Janice D. Storey, Resident
Dated January __, 2008

Clearwater Hills Improvement Association

Ermo S. Bartoletti, Resident and President
Dated January 3, 2008

Finisterre HOA

David Pulatie, Resident
Dated January __, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January __, 2008

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Town of Paradise Valley

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Arizona-American Water Company

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Janice D. Storey, Resident
Dated January 3, 2008

Clearwater Hills Improvement Association

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

David Pulatie, Resident
Dated January __, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January __, 2008

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James C. Bacon, Jr., Town Manager
Dated January __, 2008

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Paul Townsley, President
Dated January __, 2008

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Janice D. Storey, Resident
Dated January __, 2008

Clearwater Hills Improvement Association

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

David Pulatie, Resident
Dated January 3, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January __, 2008