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BEFORE THE ARIZONA CORPORATION COMMISSION

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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 AGUA FRIA WATER DISTRICT, HAVASU WATER DISTRICT, MOHAVE WATER DISTRICT, PARADISE VALLEY WATER DISTRICT, SUN CITY WEST WATER DISTRICT, AND TUBAC WATER DISTRICT.

DOCKET NO. W-01303A-08-0227

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 MOHAVE WASTEWATER DISTRICT.

DOCKET NO. SW- 01303A-08-0227

**NOTICE OF FILING
REPLY BRIEF**

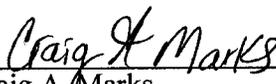
1 Arizona-American Water Company hereby files its reply brief in the above-captioned
2 dockets.
3

Arizona Corporation Commission
DOCKETED

MAY 15 2009

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1 RESPECTFULLY SUBMITTED on May 15, 2009.
2
3

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By:



Courtney Appelhans

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
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DOCKET NO. SW- 01303A-08-0227

REPLY BRIEF OF ARIZONA-AMERICAN WATER COMPANY

1 I **INTRODUCTION**

2 In its Initial Brief, Arizona-American has already thoroughly discussed the major issues
3 in this case. Rather than repeat those discussions, Arizona-American will only reply to
4 arguments that it did not address in its Initial Brief.

1 **II REPLY TO STAFF**

2 **A RATE BASE**

3 **1 CWIP IN RATE BASE (Agua Fria Water)**

4 Staff recommended denial of Arizona-American’s request to include \$25 million of
5 CWIP in rate base associated with the White Tanks Plant.¹ Arizona-American stands by its
6 discussion of this issue in its Initial Brief, but will also provide a brief additional reply.

7 Arizona-American does takes issue with two Staff statements:

8 1. “The Company placed its financing hopes on the continued boom in the real
9 estate market.”²

10 2. “The Company took the chance that the continuing boom in real estate in
11 Maricopa County would continue unabated.”³

12 Neither of these statements is accurate.

13 As discussed in its Initial Brief, Arizona-American had no other financing options, but
14 trying to fund the plant with hook-up fees. This was recognized by both Staff and RUCO. Both
15 Staff and RUCO acknowledged that the White Tanks Plant would provide significant public
16 benefits. The record is also clear that the plant will benefit current customers.

17 Arizona-American is fulfilling its public-service obligation. Through no fault of its own,
18 the real-estate market has made it impossible to fund construction entirely with hook-up fees.
19 Allowing a portion of the plant construction costs (\$25 million) to be included in rate base as
20 CWIP will mitigate, but not eliminate, significant financial harm to Arizona-American. Because
21 the Company will have no alternative but to quickly file a rate case to include the full cost of the
22 plant in rate base, including \$25 million of associated CWIP in rate base will also reduce future
23 rate shock.

¹ Staff Brief at 3-6.

² *Id.* at 4:25-26.

³ *Id.* at 6:11-12.

1 intended this reference to refer to \$1,167,268 associated with the Sierra Montana Plant. “Staff
2 believes that the Waddell Haciendas Plant of \$2,046,765 provides a benefit to current ratepayers
3 by creating operational efficiencies and increasing reliability.”⁹

4 *b* **Sierra Montana Plant**

5 As discussed above, Staff recommends disallowance of costs associated with the Sierra
6 Montana Reservoir. This plant was in service on December 8, 2008, at a cost of \$1,794,728.¹⁰
7 This means that the plant will be in service on and after the date rates go into effect in this case.
8 Therefore, it is appropriate to include the cost of this plant in rate base.

9 *c* **Wishing Well Wastewater Treatment Plant**

10 Staff recommends disallowance of all costs associated with Arizona-American’s
11 rehabilitation and upgrade of its Wishing Well Wastewater Treatment Plant.¹¹ Arizona-
12 American stands by its discussion of this issue in its Initial Brief.

13 **4** **ARSENIC TREATMENT VESSEL SIZING (Agua Fria Water,**
14 **Havasu Water, Sun City West Water)**

15 Staff recommends disallowance of a portion of the costs associated with Arizona-
16 American’s arsenic-treatment plants.¹² Arizona-American stands by its discussion of this issue
17 in its Initial Brief.

18 **5** **AMORTIZATION OF IMPUTED REGULATORY ADVANCES (All**
19 **districts except Paradise Valley Water)**

20 Staff recommends no recognition in rates in this case of the final six months amortization
21 of imputed regulatory advances, which was completed in 2008.¹³ Arizona-American stands by
22 its discussion of this issue in its Initial Brief.

⁹ Exhibit S-7 at 21:20-21.

¹⁰ Exhibit A-2 at 5:7-10

¹¹ Staff Brief at 9:10-14.

¹² *Id.* at 9:15 – 10:10.

¹³ *Id.* at 10:11-25.

1 6 **EXCLUSION OF ADVANCES AND CONTRIBUTIONS**
2 **ASSOCIATED WITH CWIP (All Districts)**

3 Staff recommends that the Commission include in rate base AIAC and CIAC associated
4 with plant still in CWIP.¹⁴ Arizona-American stands by its discussion of this issue in its Initial
5 Brief, but will also provide a brief additional reply.

6 Staff makes an erroneous statement: "Further, the Company can record AFUDC to CWIP
7 balances allowing it to earn a return."¹⁵ The plant in question was constructed and
8 advanced/contributed by developers. Because it did not fund the plant, Arizona-American is not
9 allowed to take AFUDC on plant advanced or contributed by a developer.

10 7 **PLANT LACKING FINAL INVOICES (Agua Fria and Mohave**
11 **Water, Mohave Wastewater)**

12 Staff recommends that the Commission disallow the costs of certain plant where Arizona-
13 American could not, for various reasons, obtain final invoices.¹⁶ Arizona-American stands by its
14 discussion of this issue in its Initial Brief.

15 B **COST OF CAPITAL**

16 1 **CAPITAL STRUCTURE**

17 Staff recommends that the Commission include short-term debt in Arizona-American's
18 capital structure.¹⁷ Arizona-American stands by its discussion of this issue in its Initial Brief.

19 2 **RETURN ON EQUITY**

20 Staff recommends that the Commission provide Arizona-American only a return on
21 equity of 10.0%.¹⁸ Arizona-American stands by its discussion of this issue in its Initial Brief, but
22 will also provide a brief additional reply.

23 Staff argues that its recommended return is within the range provided by American Water
24 subsidiaries of 8.8% to 10.8%. However, this 8.8% award is clearly an outlier as it was provided
25 by this Commission only in Decision No. 70372 for Arizona-American's Anthem

¹⁴ *Id.* at 11:1-25.

¹⁵ *Id.* at 11:14-15.

¹⁶ *Id.* at 12:1-11.

¹⁷ *Id.* at 12:12 – 13:3.

¹⁸ *Id.* at 13:4 – 15:6.

1 Water/Anthem-Agua Fria Wastewater Districts. That was based on unique circumstance and the
2 case was based on a 2005 test year, when economic conditions were much different than now. A
3 more representative order was Decision No. 70351 for Arizona-American's Sun City Water
4 District. This was based on a 2006 test year. In that case, Staff recommended and the
5 Commission approved a 10.8% return on equity, which reflected Staff's traditional risk
6 adjustment for Arizona-American's greater financial risk.¹⁹

7 Staff also argues that "it would be counterproductive to make any claim that Arizona-
8 American should have a higher return at this time because of the current market turmoil."²⁰ This
9 is ironic, because it is precisely at this time that the federal government is providing aid to
10 companies to allow them to survive the current market turmoil. It would in fact be
11 counterproductive to further harm the Company by reducing its return on equity.

12 The government is also trying to help companies maintain access to capital markets. It
13 would make no sense to instead discourage capital access through an unreasonably low return on
14 equity.

15 Finally, it would make no sense to deny Arizona-American taxable income at a time
16 when the State of Arizona needs income-tax revenue.

17 **C INCOME STATEMENT**

18 **1 TANK MAINTENANCE**

19 Staff recommends disapproval of Arizona-American's tank-maintenance program.²¹
20 Arizona-American stands by its discussion of this issue in its Initial Brief.

21 **2 METER DEPRECIATION**

22 Staff recommends not changing current depreciation rates for water meters.²² Arizona-
23 American stands by its discussion of this issue in its Initial Brief, but will also provide a brief
24 additional reply.

¹⁹ Decision No. 70351, dated May 16, 2007 at 15:6-9.

²⁰ Staff Brief at 15:15-16.

²¹ *Id.* at 16:4-17.

²² *Id.* at 16:18 – 17:2.

1 Staff incorrectly claims that Arizona-American has not historically replaced meters on a
2 15-year schedule. This is incorrect. Arizona-American provided uncontroverted evidence that
3 over the last three years it has been replacing meters on a 15-year cycle.²³

4 **D RATE DESIGN**

5 Arizona-American stands by its discussion of this issue in its Initial Brief.

6 **E WATER LOSS AND WATER DATA**

7 **1 WATER LOSSES**

8 Arizona-American stands by its discussion of this issue in its Initial Brief.

9 **2 WATER USE DATA**

10 Arizona-American stands by its discussion of this issue in its Initial Brief.

11 **F WHITE TANKS HOOK-UP FEE CHANGES**

12 In response to Staff's discussion of this issue, Arizona-American has revised its proposed
13 hook-up fee tariff, as set forth in Appendix A. Arizona-American has revised both the definition
14 of "Common Facilities" and Paragraph IV(D). With these revisions, Arizona-American
15 believes that it has addressed Staff's few remaining concerns about the proposed hook-up fee
16 tariff.

17 **G RATE CONSOLIDATION**

18 In its initial brief, Arizona-American described its preferred approach for implementing
19 state-wide consolidated rates which would enable completion by not later than December 2010.
20 However, Arizona-American can accept an alternative approach, especially one with the
21 potential to implement consolidated rates earlier, say, by not later than August 2010. This
22 alternative approach would timely implement the rates approved in this docket following the
23 order in this docket, but leave open this docket's record solely on the issue of rate design.
24 Following the filing of Arizona-American's next rate case for Arizona-American's remaining
25 districts not included in this docket, the current docket could be consolidated with the next
26 docket to allow for consideration of rate consolidation. Ordering language in the current rate
27 case order which limits the scope of future action in the current docket to revenue neutral rate

²³ Exhibit A-27 at Exhibit LYG-2RJ.

1 consolidation in the next rate case docket is appropriate. Arizona-American intends to file its
2 next rate case on a timeframe which would permit its completion, including rate consolidation,
3 by not later than August 2010.

4 **III REPLY TO RUCO**

5 **A RATE BASE**

6 **1 CWIP IN RATE BASE (Agua Fria Water)**

7 RUCO recommends not allowing \$25 million of CWIP in rate base associated with the
8 White Tanks Plant.²⁴ Arizona-American stands by its discussion of this issue in its Initial Brief.

9 **2 ACCUMULATED DEPRECIATION (All Districts)**

10 RUCO recommends reducing accumulated depreciation because it does not believe that
11 Arizona-American could change from the mid-month to end-of-month depreciation
12 methodology.²⁵ Arizona-American stands by its discussion of this issue in its Initial Brief.

13 **3 EXCLUSION OF ADVANCES AND CONTRIBUTIONS**
14 **ASSOCIATED WITH CWIP (All Districts)**

15 RUCO recommends reducing rate base by AIAC and CIAC associated with plant still in
16 CWIP.²⁶ Arizona-American stands by its discussion of this issue in its Initial Brief.

17 **4 MISCELLANEOUS RATE BASE ADJUSTMENTS (Agua Fria**
18 **Water, Mohave Water, Paradise Valley Water, Sun City West Water**

19 RUCO recommends making various rate base adjustments.²⁷ Arizona-American accepts
20 these adjustments.

21 **5 WISHING WELL WASTEWATER TREATMENT PLANT**
22 **(Mohave Water)**

23 RUCO recommends excluding 50% of the costs associated with the Wishing Well Plant
24 rehabilitation and upgrade.²⁸ Arizona-American stands by its discussion of this issue in its Initial
25 Brief.

²⁴ RUCO Brief at 3:2 – 4:13.

²⁵ *Id.* at 4:15 – 5:14.

²⁶ *Id.* at 5:15 – 6:11.

²⁷ *Id.* at 6:13 – 7:9.

²⁸ *Id.* at 7:10 – 8:8.

1 **6 CASH WORKING CAPITAL (All Districts)**

2 RUCO recommends reducing cash working capital by \$242,028.²⁹ Arizona-American
3 stands by its discussion of this issue in its Initial Brief.

4 **B INCOME STATEMENT**

5 **1 RATE CASE EXPENSE**

6 RUCO recommends reducing rate case expense by \$124,996.³⁰ Arizona-American
7 stands by its discussion of this issue in its Initial Brief, but will also provide a brief additional
8 reply. RUCO's adjustment is largely based on precluding recovery by Arizona-American of
9 rate-case expenses that the Commission previously approved as recoverable. If RUCO's
10 position were accepted, Arizona-American would be permanently denied recovery of these
11 expenses.

12 **2 WHITE TANKS O&M DEFERRAL MECHANISM**

13 RUCO recommends rejection of the Company's request to defer and recover White
14 Tanks O&M costs.³¹ Arizona-American stands by its discussion of this issue in its Initial Brief.

15 **3 FUEL AND POWER SUPPLY ADJUSTMENT MECHANISM**

16 Arizona-American has withdrawn its request for a fuel and power supply adjustment
17 mechanism.

18 **C RATE DESIGN**

19 Arizona-American and RUCO do not appear to have any rate-design issues.

20 **D RATE CONSOLIDATION**

21 Arizona-American and RUCO do not appear to have any rate-consolidation issues.

22 **E COST OF CAPITAL**

23 **1 RETURN ON EQUITY**

24 RUCO recommends a return on equity of only 8.80%.³² Arizona-American stands by its
25 discussion of this issue in its Initial Brief.

²⁹ *Id.* at 8:9 – 10:15.

³⁰ *Id.* at 10:18 – 11:18.

³¹ *Id.* at 12:1 – 13:10.

³² *Id.* at 16:6 – 17:14.

1 IV REPLY TO MAGRUDER

2 Arizona-American has appreciated Mr. Magruder's participation in this case. However,
3 Mr. Magruder's brief has not persuaded Arizona-American to alter any of its positions in its
4 initial brief.

5 RESPECTFULLY SUBMITTED on May 15, 2009.

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TARIFF SCHEDULE

UTILITY: _____
DOCKET NO. _____

DECISION NO. _____
EFFECTIVE DATE: _____

COMMON FACILITIES HOOK-UP FEE (WATER)

I. Purpose and Applicability

The purpose of the Common Facilities hook-up fee payable to Arizona-American Water Company (“the Company”) pursuant to this tariff is to equitably apportion the costs of constructing additional common water facility infrastructure, including the White Tanks Surface Water Treatment Facility, to provide water production, delivery, treatment, storage and pressure among all new service connections. These charges are applicable to all new service connections established after the effective date of this tariff. The charges are one-time charges and are payable as a condition to the Company’s establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission’s (“Commission”) rules and regulations governing water utilities shall apply interpreting this tariff schedule.

“Applicant” means any party entering into an agreement with the Company for the installation of water facilities to serve new service connections, and may include developers and/or builders of new residential subdivisions.

“Main Extension Agreement” means any agreement whereby an Applicant, Developer and/or Builder agrees to advance the costs of the installation of water facilities, which may include Common Facilities, to the Company to serve new service connections, or install water facilities to serve new service connections and transfer ownership of such water facilities to the Company, in either case which agreement shall require the approval of the Commission pursuant to A.A.C. R-14-2-406, and shall have the same meaning as “Water Facilities Agreement” or “Line Extension Agreement.”

“Common Facilities” means (i) all wells, including engineering and design costs, and (ii) storage tanks, production, treatment, booster pumps, pressure tanks, transmission mains and related appurtenances, including engineering and design costs, constructed for the benefit of the entire water system and not for the exclusive use of the Applicant’s development.

“Service Connection” means and includes all service connections for single-family residential or other uses, regardless of meter size.

III. Common Facilities Water Hook-up Fee

For each new service connection, the Company shall collect a Common Facilities hook-up fee derived from the following table:

COMMON FACILITIES HOOK-UP FEE TABLE				
Meter Size	Size Factor	Component A Offset Eligible	Component B Not Offset Eligible	Total Fee
5/8" x 3/4"	1	\$1,150.00	\$2,130.00	\$3,280.00
3/4"	1.5	\$1,725.00	\$3,195.00	\$4,920.00
1"	2.5	\$2,875.00	\$5,325.00	\$8,200.00
1-1/2"	5	\$5,750.00	\$10,650.00	\$16,400.00
2"	8	\$9,200.00	\$17,040.00	\$26,240.00
3"	16	\$18,400.00	\$34,080.00	\$52,480.00
4"	25	\$28,750.00	\$53,250.00	\$82,000.00
6" or larger	50	\$57,500.00	\$106,500.00	\$164,000.00

IV. Terms and Conditions

(A) Assessment of One Time Common Facilities Hook-up Fee: The Common Facilities hook-up fee may be assessed only once per parcel, service connection, or lot within a subdivision (similar to meter and service line installation charge).

(B) Use of Common Facilities Hook-up Fee: Common Facilities hook-up fees may only be used to pay for capital items of Common Facilities, or for repayment of loans obtained for installation of Common Facilities. Common Facilities hook-up fees shall not be used for repairs, maintenance, or operational purposes.

(C) Time of Payment:

- 1) In the event that the Applicant that will be constructing improvements is required to enter into a Main Extension Agreement, payment of the Common Facilities hook-up fees required hereunder shall be made by the Applicant no later than within 15 calendar days after receipt of notification from the Company that the Utilities Division of the Arizona Corporation Commission has approved the Main Extension Agreement in accordance with R-14-2-406(M).
- 2) In the event that the Applicant for service is not required to enter into a Main Extension Agreement, the charges hereunder shall be due and payable at the time the meter and service line installation fee is due and payable.

(D) Common Facilities Construction By Developer: The Company and Applicant may agree to construction of Common Facilities necessary to serve a particular development by Applicant which facilities are then conveyed to the Company. In that event, Company shall credit the total cost of such Common Facilities as an offset to Component A of the Common Facilities hook-up fees due under this Tariff. If the total cost of the Common Facilities

Reply Brief of Arizona-American Water
Appendix A

constructed by Applicant and conveyed to Company is less than the applicable Component A of the Common Facilities hook-up fee due under this Tariff, Applicant shall pay the remaining amount of Component A of the Common Facilities hook-up fees owed hereunder. If the total cost of the Common Facilities contributed by Applicant, Developer or Builder and conveyed to Company is more than the applicable Component A of the Common Facilities hook-up fees under this Tariff, Applicant shall be refunded the difference upon acceptance of the Common Facilities by the Company. The Company and Applicant may agree to construction of additional facilities that are not Common Facilities, the cost of which shall not be subject to off-set under this paragraph IV.D, but which will be subject to refund under R14-2-406(D).

(E) Failure to Pay Charges; Delinquent Payments: The Company will not be obligated to provide water service to any Applicant or other applicant for service in the event that such Applicant or other applicant for service has not paid in full all charges hereunder. Under no circumstances will the Company set a meter or otherwise allow service to be established if the entire amount of any payment has not been paid.

(F) Large Subdivision Projects: In the event that the Applicant is engaged in the development of a residential subdivision containing more than 150 lots, and is a party to a Main Extension Agreement with the Company for such development, the Company may, in its discretion, agree to payment of the Common Facilities hook-up fees in installments. Such installments may be based on the residential subdivision development's phasing, and should attempt to equitably apportion the payment of charges hereunder based on the Applicant's construction schedule and water service requirements.

(G) Common Facilities Hook-Up Fees Non-refundable: The amounts collected by the Company pursuant to the Common Facilities hook-up fee tariff shall be non-refundable contributions in aid of construction.

(H) Use of Common Facilities Hook-Up Fees Received: All funds collected by the Company as Common Facilities hook-up fees shall be deposited into a separate interest bearing trust account and used solely for the purposes of paying for the costs of the Common Facilities, including repayment of loans obtained for the installation of Common Facilities that will benefit the entire water system.

(I) Common Facilities Hook-up Fee in Addition to On-site Facilities: The Common Facilities hook-up fee shall be in addition to any costs associated with the construction of on-site facilities or other additional facilities under Paragraph IV.D, above, under a Main Extension Agreement.

(J) Disposition of Excess Funds: After all necessary and desirable Common Facilities are constructed utilizing funds collected pursuant to the Common Facilities hook-up fees, or if the Common Facilities hookup fee has been terminated by order of the Arizona Corporation Commission, any funds remaining in the trust shall be refunded. The manner of the refund shall be determined by the Commission at the time a refund becomes necessary.

Reply Brief of Arizona-American Water
Appendix A

K) Fire Flow Requirements: In the event the Applicant has fire flow requirements that require additional facilities beyond those facilities whose costs were included in the Common Facilities hook-up fee, and which are contemplated to be constructed using the proceeds of the Common Facilities hook-up fee, the Company may require the Applicant to install such additional facilities as are required to meet those additional fire flow requirements, as a non-refundable contribution, in addition to paying the Common Facilities hook-up fee.

(L) Status Reporting Requirements to the Commission: The Company shall submit a calendar year Common Facilities hook-up fee status report each January 31 to Docket Control for the prior twelve (12) month period, beginning January 31, 2011, until the Common Facilities hook-up fee tariff is no longer in effect. This status report shall contain a list of all customers that have paid the Common Facilities hook-up fee tariff, the amount each has paid, the amount of money spent from the account, the amount of interest earned on the tariff account, and a list of all facilities that have been installed with the tariff funds during the 12 month period.