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ORIGINAL

EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

- KRISTIN K. MAYES, Chairman
- GARY PIERCE
- SANDRA D. KENNEDY
- PAUL NEWMAN
- BOB STUMP

2009 NOV 12 A 11:40

DOCKET CONTROL

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

EXCEPTIONS OF ARIZONA-AMERICAN WATER COMPANY

- 1 Pursuant to A.A.C. R14-3-110(B), Arizona-American Water Company ("Arizona-
- 2 American") hereby submits its Exceptions to the November 3, 2009, Recommended Opinion and
- 3 Order ("ROO"):

Arizona Corporation Commission

DOCKETED

NOV 12 2009

DOCKETED BY

[Signature]

1 **Exception 1 – Wishing Well Plant Renovation (Mohave Wastewater District)**

2 The Wishing Well Wastewater Treatment Plant was built many years ago by Sorenson
3 Utilities. Sorenson Utilities was acquired by Citizens Utilities in March 1999.¹ Then, in 2001
4 Arizona-American acquired Citizens Utilities' Arizona water and wastewater assets. By 2005, it
5 became obvious to Arizona-American that the Wishing Well Plant needed to be upgraded for
6 two reasons. First, several of the plant's components needed to be replaced. Although the
7 Wishing Well Plant was permitted by ADEQ at 0.500 mgd, the design capacity was only 0.250
8 mgd, and the operational capacity had shrunk to 0.200 mgd, due to degraded plant components.
9 To restore the design capacity for existing customers, many plant components needed to be
10 replaced. Second, the plant needed to be expanded to the permitted capacity of 0.500 mgd to
11 serve customer growth, which was projected at that time to be substantial.

12 The ROO would disallow \$3,932,080 associated with the rehabilitation and expansion of
13 the Wishing Well treatment plant.² This is not based on a claim of imprudence or that the plant
14 was not in service. Rather, the ROO's argument is that this was post-test-year plant. As a result,
15 the ROO orders a 9.8% rate decrease for the Mohave Wastewater District.

16 The Commission has consistently allowed post-test-year plant in service if the plant costs
17 were verified, construction was prudent, and the plant is used and useful. The Wishing Well
18 Plant rehabilitation/expansion entered service in the summer of 2008, Staff has verified its costs,
19 and, at least as to the plant components replaced, there is no argument whether it is used and
20 useful. By the time rates go into effect in this case, the new construction will have been
21 providing service for almost a year and a half.

22 Excluding the plant from rate base further jeopardizes Arizona-American's health. The
23 remaining rate base for Mohave Wastewater per the ROO is just \$698,320; therefore, excluding
24 several multiples of rate base would bankrupt a stand-alone utility. Further, the record is replete
25 with testimony about how dire Arizona-American's financial health already is. Arbitrarily

¹ This paragraph, Exhibit A-2 at 11:11-21.

² ROO at 23.

1 excluding \$4 million in prudent construction will certainly hurt Arizona-American's financial
2 health further.

3 If it disallows the Wishing Well Plant costs in this case, the Commission will only "kick
4 the can down the road" until the next rate case for Mohave Wastewater. With additional accrued
5 AFUDC, the amount that will have to go into rate base will be even greater and the rate increase
6 larger. To mitigate, the Commission should at least allow into rate base in this case the
7 undisputed costs associated with plant rehabilitation - \$2.9 million.³ This rehabilitation has
8 already been benefitting current customers for a year and one-half, but Arizona-American has
9 not earned any return on or of this badly needed investment. This would leave the balance of
10 costs associated with the plant expansion for evaluation in a later rate case.

11 Although Arizona-American still believes that inclusion of the full expansion costs would
12 be justified, inclusion of just the rehabilitation costs balances – for this case - the interests of
13 Arizona-American and its customers. It would do less harm to Arizona-American's financial
14 health, and current customers would appropriately fund the costs of the rehabilitation. It would
15 also send an important message to Arizona wastewater utilities – the Commission will support
16 utilities that fund plant rehabilitations needed to provide continual, reliable, safe service to their
17 customers.

18 Exhibit 1 is a proposed amendment to the ROO to allow the Wishing Well rehabilitation
19 costs into rate base.

20 **Exception 2 – Inclusion of AIAC and CIAC for Plant in CWIP (All Districts)**

21 The ROO reduces rate base by including AIAC and CIAC in rate base for projects that
22 are not yet completed, carried as CWIP, and therefore not part of rate base.⁴ Like most water
23 and wastewater utilities, Arizona-American does not normally receive cash from developers — it
24 typically receives plant, such as wells, pumps, tanks, and mains. This was the case for the plant
25 in question. Developers built the plant and then advanced or contributed it. An engineering

³ *Id.*, table at 13.

⁴ ROO at 27-28.

1 estimate was used to temporarily record the developer's costs in CWIP after Company
2 inspections and issuance of an operational acceptance letter to each developer with an offset to
3 either Advances or Contributions. Final acceptance of the project occurred later at the time the
4 Company was satisfied that all available invoices had been received, usually within three
5 months, and at that time, the project was transferred from CWIP to Utility Plant in Service. (TR
6 VI, p.917)

7 When advanced or contributed plant is in Utility Plant in Service, it then becomes
8 appropriate to deduct the associated AIAC and CIAC when calculating rate base. However,
9 when the plant is still in CWIP, it is improper to deduct the associated AIAC and CIAC because
10 the associated plant is not in rate base and thus Plant in Service is not properly matched to the
11 advances and contributions that financed them.

12 There is a fundamental inconsistency in the ROO. Another section of the ROO proposes
13 to disallow a large amount of post test year plant that is actually in service, giving the reason that
14 there are no test year revenue and expenses associated with the plant which would severely
15 violate the matching principle distorting the regulatory process used to determine reasonable
16 rates⁵. Yet, here the ROO would offset Utility Plant in Service by AIAC and CIAC applicable to
17 investment residing in CWIP which is not included in rate base, thereby, effectively and unfairly
18 reducing the Company's invested plant. This would be fundamentally unfair and also violate the
19 matching principle.

20 There are two proper regulatory treatments. One would be to include both the plant
21 residing in CWIP at the end of the test year and the associated offsetting AIAC and CIAC in rate
22 base. The other would be to exclude both the plant residing in CWIP at the end of the test year
23 and the associated offsetting AIAC and CIAC from rate base as the Company has proposed. It is
24 just as inappropriate to include only the AIAC or CIAC and exclude the associated plant residing

⁵ ROO at 23.

1 in CWIP at the end of the test year as it would be to include only the plant and exclude the
2 associated AIAC or CIAC that financed the plant.

3 Exhibit 2 is a proposed amendment to the ROO that excludes non-cash AIAC and CIAC
4 offsets to rate base for plant that is still in CWIP at the end of the test year.

5 **Exception 3 - Plant Lacking Final Invoices (Agua Fria and Mohave Water, Mohave**
6 **Wastewater Districts)**

7 The ROO proposes to disallow plant from rate base that does not have adequate
8 supporting documentation.⁶ Arizona- American still believes that these disallowances would be
9 inappropriate. The projects are in service as of the end of the test year, and there is no
10 determination the projects are not used and useful. The costs are based on certified engineering
11 estimates. It would be punitive not to include million-dollar projects in rate base, just because of
12 difficulties getting paperwork from the developer, or because the developer is bankrupt. The
13 National Association of Regulatory Utility Commissioners (“NARUC”) recognizes the potential
14 difficulty in obtaining the actual costs in its accounting instructions in its Uniform System of
15 Accounts (“USOA”). NARUC USOA Accounting Instruction 18 (D) provides for the use of
16 estimates when the cost of construction associated with utility plant contributed to the utility is
17 not known.

18 18 D. “Utility plant accounts shall be charged with construction costs (estimated, if not
19 known) or the utility plant contributed by others or constructed by the utility using
20 contributed cash or its equivalent.”

21 However, if the Commission does determine that it will not allow plant lacking final
22 invoices in rate base, the ROO still goes too far. The ROO acknowledges that Arizona-
23 American has provided final invoices for at least some of the plant in question:

24 The Company attached to rebuttal testimony two invoices labeled Mira Monte
25 Classic and Mira Monte Vista dated October 30, 2008, totaling \$134,099, which
26 the Company states is more than the costs Staff audited, because it includes
27 services and hydrants, as well as the main Staff audited.⁷

⁶ ROO at 24-26.

⁷ ROO at 25:11-14.

1 Certainly, the Commission should at least allow this plant in service.

2 Exhibit 3 is a proposed amendment to the ROO that would include the Mira Monte plant
3 in rate base.

4 **Exception 4 - Tank Maintenance Expense (All Water Districts)**

5 The Company proposed, and RUCO accepted, a reserve for tank maintenance expense.
6 A reserve for tank maintenance is funded by an annual allowance for tank maintenance costs in
7 the revenues of a utility. The funds collected through rates are recorded on the balance sheet in a
8 deferred liability account – Reserve for Tank Maintenance. As the Company incurs tank
9 maintenance expenses, the Reserve for Tank Maintenance account is charged reducing the
10 balance of funds reserved. In subsequent rate cases, actual tank maintenance expenditures and
11 the reserve account may be reviewed and the annual allowance can be increased, decreased or
12 remain unchanged on a going forward basis as the circumstances warrant.

13 The ROO rejected the Company’s proposal for advance funding of a Reserve for Tank
14 Maintenance. This was unfortunate and will result in a dramatic reduction in necessary future
15 spending to paint tanks until a reserve can be established following a future rate case. RUCO
16 acknowledged the benefits of a tank-maintenance reserve and recommended its approval:

17 RUCO believes that the cost estimates obtained from the RFP process are
18 reasonable. RUCO also believes that ratepayers will benefit from regular
19 preventive maintenance and upkeep on large plant assets such as water tanks.
20 RUCO has supported similar programs in the past such as one that Arizona Water
21 Company has in place.⁸

22 Exhibit 4 is a proposed amendment to the ROO that would approve Arizona-American’s
23 Reserve for Tank Maintenance.

24 **Exception 5 – Annual Incentive Pay (All Districts) – Clarification**

25 The ROO states: “RUCO proposes disallowance of 30 percent, or \$5,555, of the
26 Company’s \$18,517 Arizona Corporate allocated annual incentive pay (“AIP”) management fees

⁸ Exhibit R-12 at 29:12-17.

1 expenses for the districts in this proceeding.”⁹ Arizona-American asks to correct errors in this
2 sentence (which do not affect the ROO’s revenue requirement calculation).

3 The correct total amount of the disallowance can be computed by adding the disallowed
4 amounts per district in the table at line 14 on page 35. This adds up to \$72,429.

5 Exhibit 5 is a proposed amendment to the ROO that would correct the incorrect total in
6 the text.

7 **Exception 6 – White Tanks Plant O&M Recovery (Agua Fria Water District) -**

8 **Clarification**

9 The ROO would authorize Arizona-American to defer actual White Tanks Plant O&M
10 expenses, which is greatly appreciated. However, Arizona-American would like a clarification
11 in subparagraph 1 to the ordering paragraph beginning on page 78, line 7.

12 As was discussed at the hearing, Arizona-American may sell a portion of the White
13 Tanks Plant to the Maricopa Water District, a municipality, or another regulated utility. In that
14 event, Arizona-American would still be the sole plant operator and would incur O&M expenses
15 not reimbursed by the co-owner. Therefore, Arizona-American would like to clarify the
16 language of subparagraph 1 to cover a co-ownership scenario.

17 Exhibit 6 is a proposed amendment to the ROO that would address how the deferral
18 would work if a portion of the White Tanks Plant is sold to another entity.

19 In addition to the clarification requested, it appears that there are several typographical
20 errors pertaining to the accounting request of the Company on pages 72, 75, and 78. On page 19
21 of the ROO, the accounting entries are adopted as a reasonable means of permitting the
22 Company to recover its White Tanks Plant cost of capital on an ongoing basis but some of the
23 language is omitted in the Findings of Facts and Conclusions of Law sections of the ROO.

24 Exhibit 7 is a proposed amendment to the ROO that would address these typographical
25 errors.

⁹ ROO at 35:4-6. The cited passage was actually from Decision No. 68858, which RUCO relied on for its recommendation.

1 **Exception 7 – Tubac Water Rate Design (Tubac Water District) - Clarification**

2 The ROO would approve the Staff's four-tier rate design for residential customers with
3 5/8 x 3/4 inch meters in the Tubac Water District.¹⁰ However, the ROO's schedules for Tubac
4 Water have just three tiers. The final Order should reconcile the schedules to match the language
5 in the ROO using four tiers. There is no corresponding exhibit for this exception.

6 **Exception 8 – Effective Date of rates**

7 This case's time-clock expired on July 17, 2009. Therefore, rates should be effective not
8 later than August 1, 2009. Exhibit 8 is a proposed amendment to the ROO to this effect.

9 RESPECTFULLY SUBMITTED on November 12, 2009.

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11
12 
13 _____
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¹⁰ ROO at 56.

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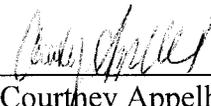
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By: 

Courtney Appelhans

**SUGGESTED AMENDMENT 1
TO RECOMMENDED OPINION AND ORDER**

Page 23, Line 4,

DELETE from sentence beginning on line 4 through end of line 17, and REPLACE WITH:

On balance there is merit to all the arguments concerning the WWTP. Certainly, the WWTP required rehabilitation to continue to provide continuous, reliable, safe service to the Company's customers. Just as certainly, the rehabilitation and the associated capacity expansion projects were completed after the test-year ended. There are also no disputes as to the costs of the rehabilitation and the associated capacity expansion. Further, allowing all of these costs in rate base would dramatically increase wastewater rates for the Mohave Wastewater District. But, deferring all these costs would likely only cause an even larger future rate increase for Mohave wastewater customers. Therefore, to mitigate future rate shock and to account for the fact that the rehabilitation is already benefiting current customers, it is appropriate at this time to include only the \$2.9 million cost of the WWTP rehabilitation in rate base. The expansion cost of the WWTP can be considered in a future rate case.

Page 33 (Table at lines 17 and 18)

In the Mohave Wastewater column, DELETE \$698,320 and REPLACE WITH \$3,598,320.

Page 47, lines 4-8

DELETE table and REPLACE WITH the following:

Fair Value Rate Base	\$3,598,320
Adjusted Operating Income	122,635
Required Fair Value Rate of Return	7.33%
Required Operating Income	263,757
Operating Income Deficiency	141,122
Gross Revenue Conversion Factor	1.4274
Gross Revenue Increase	\$201,438

Page 69, line 26

In Finding of Fact 97, DELETE "\$698,120" and REPLACE WITH "\$3,598,320."

Page 70, line 27

In Finding of Fact 112, DELETE "decrease by \$78,047" REPLACE WITH "increase by \$201,438."

Make all other conforming changes.

**SUGGESTED AMENDMENT 2
TO RECOMMENDED OPINION AND ORDER**

Page 27, line 13

DELETE the paragraph beginning on page 27, continuing through page 28, line 2 and REPLACE WITH the following:

The UNS Gas case cited by Staff is not apt. Like most water utilities, Arizona-American does not normally receive cash from developers – it receives plant, such as wells, pumps, tanks, and mains. The developer builds the plant and then advances or contributes it. It is first recorded in CWIP with an offset to either Advances or Contributions. Later, when advanced or contributed plant is in Utility Plant in Service, it then becomes appropriate to deduct the associated AIAC and CIAC when calculating rate base. However, when the plant is still in CWIP, it is improper to deduct the associated AIAC and CIAC because the associated plant is not in rate base and thus Plant in Service is not properly matched to the advances and contributions that financed them.

The AIAC and CIAC associated with plant at issue in this case that is not in service should not be deducted from rate base.

Make all other conforming changes.

**SUGGESTED AMENDMENT 3
TO RECOMMENDED OPINION AND ORDER**

Page 26, line 15

DELETE the sentence beginning of page 26, line 15, and REPLACE WITH the following:

Arizona-American has now provided invoices totaling \$134,099, to properly document the total cost of the Mira Monte Classic and Mira Monte Vista developments. These costs should be included in rate base for the Mohave Water District. With these exceptions, Staff's proposed adjustments are reasonable and will be adopted.

Make all other conforming changes.

**SUGGESTED AMENDMENT 4
TO RECOMMENDED OPINION AND ORDER**

Page 36, line 7

DELETE the paragraph beginning on page 37, line 7, and concluding on line 14, and REPLACE WITH the following:

Consistent with the programs approved for Arizona Water Company, the Commission agrees with the Company and RUCO that Arizona-American should set up a reserve for water tank maintenance expenses. This will provide funds for maintenance, levelize expenses over time, and insure that ratepayers are not overcharged or undercharged for the maintenance work actually performed.

Based on the discussion above, we find Arizona-American should set up a reserve for water tank maintenance to provide funds for maintenance with annual accruals for each of the districts as follows:

District	Agua Fria Water	Havasu Water	Mohave Water	Paradise Valley Water	Sun City West Water	Tubac Water
Reserve for Tank Maintenance – Annual Accrual	117,164	30,259	106,819	31,560	89,677	1,478

Make all other conforming changes.

**SUGGESTED AMENDMENT 5
TO RECOMMENDED OPINION AND ORDER**

Page 35, line 4

DELETE “\$5,555 of the Company’s \$18,517” and REPLACE WITH “\$72,429 of the Company’s”.

**SUGGESTED AMENDMENT 6
TO RECOMMENDED OPINION AND ORDER**

Page 78, line 12

DELETE subparagraph 1 and REPLACE WITH the following:

- (1) The deferral shall be allowed if Arizona-American is the sole owner and operator of the White Tanks Plant. If Arizona-American co-owns the White Tanks Plant and is the sole operator, then the deferral shall be allowed for O&M expenses not reimbursable to Arizona-American by the co-owner(s) of the White Tanks Plant.

**SUGGESTED AMENDMENT 7
TO RECOMMENDED OPINION AND ORDER**

Beginning at Page 72, Line 1

DELETE line 1 and 2 and REPLACE WITH the following:

district after the White Tanks plant goes into service, and to defer post-in-service AFUDC in excess of the associated amortization of those hook-up fees, after the White Tanks Plant

Beginning at Page 75, line 2

BEFORE “post-in-service depreciation expense”, INSERT “post-in-service AFUDC and”

Beginning at Page 79, line 19

AFTER “Company’s Agua Fria Water district after the White Tanks Plant goes into service, and to defer” INSERT “post-in-service AFUDC and”

**SUGGESTED AMENDMENT 8
TO RECOMMENDED OPINION AND ORDER**

Beginning on Page 77, at Line 10 INSERT

A.A.C Rule R14-2-103(B) 11d., states that “the Commission shall issue a final order that disposes of all issues involved in all parts or phases of the proceeding within the following number of days from the date that a filing is accepted pursuant to subsection (B)(7):

- i. For Class A utilities, within 360 days.”

Arizona-American has been classified as a Class A utility and the filing in these dockets was accepted pursuant to 14-2-103(B)(7) on July 21, 2008 which translates in the issuance of a final order by July 17, 2009.

Beginning on Page 77, Line 13 DELETE

“December 1, 2009” and INSERT “August 1, 2009”.