ORIGINAL

MAYES PROPOSED AMENDMENT 1

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TIME/DATE PREPARED: December 10, 2010

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COMPANY: Arizona-American Water Company AGENDA ITEM NO. U-14

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OPEN MEETING DATE: Dec. 14-15, 2010

AZ CORP COMMISSION
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Arizona Corporation Commission
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DEC 10 2010

DOCKETED BY

Page 61, Line 7.5:

DELETE: Lines 7.5 through 19

INSERT: "As RUCO points out, the lower risk of regulated utilities is attractive to investors in a bad economic climate, and the Company's parent relies on low cost debt financing to fund its capital improvements. Given the current economic climate, we find that Staff's financial risk adjustment is not appropriate in this case. We find that of the proposed cost of equity estimates, RUCO's is the more reasonable. Applying the 9.50 percent cost of equity and 4.91 percent cost of debt to the capital structure adopted herein results in an overall weighted cost of capital for Arizona-American of 6.70 percent.

"Even if we were to agree with the Company's arguments about RUCO's recommended return on equity, we would nonetheless adopt it, as we believe that a reduced return on equity is justified under the facts of this case. Our decision in this matter gives rate base treatment to the Anthem plant associated with the balloon payments to Pulte. We recognize the heavy burden that this result will place upon Anthem ratepayers. In our view, the Anthem ratepayers appear to have been caught between a developer that failed to fully inform them of the relevant facts and a water company that failed to keep their best interests at heart.

Unfortunately, we cannot address these issues by taking any action against the developer. Much as we might want to craft a remedy that is comprehensive and directed to all the responsible actors, we do not have jurisdiction over the developer, nor do we have the comprehensive authority of a court of general jurisdiction.

Earlier in this decision, we referred to the Federal District Court case that was initiated by certain Anthem ratepayers against Pulte, among others. In a recent order, the United States District Court for the District of Arizona granted summary judgment to the plaintiffs, concluding that Pulte had failed to disclose to prospective homebuyers the costs of the infrastructure for which they would ultimately be responsible. The Court specifically stated, "the issue is not whether a developer has a duty to predict future utility rates, but whether Pulte was required to disclose the "estimated costs related to the improvements [and facilities] that will be borne by purchasers."[1] This would appear to be a positive outcome for these plaintiffs, and we note that the case is currently on appeal before the 9th Circuit.

Because Arizona-American is not a party to the Federal District Court ruling, the Commission is unable to take direct action herein related to the litigation. That does not mean that we cannot take appropriate regulatory action against Arizona American. While the Company's actions related to the infrastructure agreement may not justify a plant disallowance, we think that the Company nonetheless failed to adequately consider the risks that the infrastructure agreement posed for its ratepayers. The

[1] Grimmelmann v. Pulte Home Corporation, 2010 U.S. Dist. LEXIS 89695, Pg 7, 13-15.

THIS AMENDMENT:

_______ Passed _______ Passed as amended by ____________________

_______ Failed _______ Not Offered _______ Withdrawn

Company appears to have made concessions to the developer in an effort to win the project.[2] The result is an infrastructure agreement that is significantly different from standard agreements; furthermore, these differences tend to place the risk of accelerated build-out and accelerated payments entirely upon the ratepayers. The anticipated build-out schedule—and the corresponding balloon payments—were anticipated to occur over a much longer time period. Actual build-out occurred much more quickly. As a result, the Company has sought rate base treatment for the plant associated with those balloon payments much sooner than expected and over a shorter time period. Although we have not disallowed the plant, we recognize what we believe is unreasonable risk-shifting to the ratepayers. We believe the infrastructure agreement and its corresponding balloon payments are an unreasonable risk shifting to the ratepayers, we believe that this serves as an alternative justification for a lower cost of equity in this case.

D. Cost of Capital Summary

	Percentage	**Cost**	**Weighted Cost**
Short-Term and Long-Term Debt	61.1%	4.91%	3.0%
Common Equity	38.9%	9.50%	3.7%
Weighted Average Cost of Capital			**6.7%**

INSERT at page 37, line 26:

"However, the public interest requires us to consider the risk-shifting effects of the infrastructure agreement, which has resulted in the Company shifting to ratepayers the risks related to the costs of the infrastructure agreement and the timing of the balloon payments. This risk-shifting justifies a lower cost of capital, as is discussed in the cost of capital section of this order."

MAKE ALL CONFORMING CHANGES

[2] *See* Ex. S-1 at 2.