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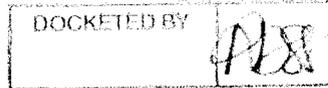
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JAN - 7 2011

Mr. Robert Geake
Arizona Water Company
Post Office Box 29006
Phoenix, Arizona 85038



RE: IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY FOR APPROVAL OF A RATE INCREASE (DOCKET NO. W-01445A-10-0517)

LETTER OF DEFICIENCY

Dear Mr. Geake:

In reference to your rate application received on December 29, 2010, this letter is to inform you that your application has not met the sufficiency requirements as outlined in Arizona Administrative Code ("A.A.C.") R14-2-103. Consistent with the preliminary opinion expressed in our meeting with you on December 22, 2010, Staff is specifically concerned that the test year provided in support of the application does not meet the requirements of A.A.C. R14-2-103(A)(3)(p). That rule defines "test year" as "the *one-year historical period* used in determining rate base, operating income and rate of return." (Emphasis added). This definition clearly incorporates the requirement that the Company use a historic test year as the basis of its rate application. That rule further requires that "[t]he end of the test year shall be the most recent practical date available prior to the filing."

The Company's current rates were authorized in Commission Decision No. 71845, dated August 25, 2010. Pursuant to that decision, those rates became effective for all service rendered on or after July 1, 2010. The test year used to prepare the instant application ended December 31, 2009. While this test year covers a one-year period, it does so prior to the imposition of the Company's current rates, and further imputes current rates to this period. Although pro forma adjustments are routine, the Company's projection of current rates to a prior period amounts to a projected or future test year. Staff believes that a projected or future test year fails to meet the requirements of the rate case management rule.

Further, Staff notes that the rates authorized in Decision No. 71845, and imputed by the Company to the 2009 data, were determined based on a test year ending December 31, 2008. Therefore, in addition to the use of a projected or future test year, the Company has incorporated in its test year underlying data that is not the most recent available. Staff believes that the use of such "stale data" also fails to meet the requirements of the rate case management rule.

As a result of these test year issues, the Company's application is deficient such that it renders all associated schedules invalid. These problems prevent Staff from conducting further

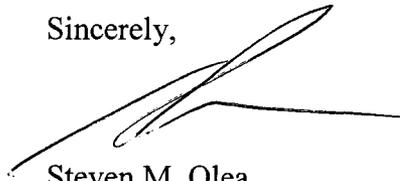
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evaluation of the Company's application at this time, i.e., other sufficiency items cannot be considered and additional issues may arise. Until these test year issues are resolved, Staff is unable to progress any further with regard to sufficiency of your rate application.

In order to resolve these issues, the Company should withdraw its current application as soon as possible and resubmit a new application using a test year that provides at least 12 months of actual data under the most current rates approved by the Commission. If the Company does not withdraw its present rate case (Docket No. W-01445A-10-0517) by January 28, 2011, Staff will request that the docket be administratively closed.

If you have any questions, please feel free to contact Ms. Nancy Scott at 602-542-0743 or Mr. Elijah Abinah at 602-542-6935.

Sincerely,



Steven M. Olea
Director
Utilities Division

cc: Docket Control Center
Lyn Farmer, Hearing Division
Delbert Smith, Engineering
Connie Walczak, Consumer Services
Janice Alward, Legal Division
Elijah Abinah, Utilities Division
Nancy Scott, Utilities Division