

RESIDENTIAL UTILITY CONSUMER OFFICE (RUCO)



**Serving the Arizona Residential Utility Consumer
Since 1983**

**TWENTY-FOURTH ANNUAL REPORT
2005-2006**

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DIRECTOR'S LETTER
RESIDENTIAL UTILITY CONSUMER OFFICE

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Janet Napolitano
Governor

Stephen Ahearn
Director

October 31, 2006

The Honorable Janet Napolitano, Governor
The Honorable Ken Bennett, President, Arizona Senate
The Honorable James P. Weiers, Speaker, Arizona House of Representatives

Re: Fiscal Year 2006 RUCO Annual Report

Dear Governor, President and Speaker:

I am pleased to report the activities of RUCO for the period ending June 30 of this year.

This has been another successful year for our advocacy before the Arizona Corporation Commission. RUCO actively participated in numerous lengthy and complex rate case litigations and successfully advocated residential consumer positions that were reflected in the Commission's ultimate decisions in those cases.

We realize that RUCO is no longer required to assemble Annual Reports. However, we continually capture data about our activities in an effort to improve our agency performance and in anticipation of future audits and requests for historical agency information. Our continuing to publish this report is a simple and efficient method to memorialize this collection of recent agency data, and requires virtually no incremental time or expense to compile.

Sincerely,

Stephen Ahearn

Stephen Ahearn

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RUCO ADMINISTRATIVE AND SUPERVISORY PERSONNEL

DIRECTOR

Stephen Ahearn was appointed by Governor Janet Napolitano as Director of the Arizona Residential Utility Consumer Office (RUCO) on January 6, 2003. He is a native Arizonan, born on Davis-Monthan Air Force Base in Tucson, and raised in Phoenix. He received his undergraduate degree (B.A., International Relations) from Pomona College in Claremont, California, and his graduate degree (MBA, International Finance) from UCLA.

Mr. Ahearn spent his early career after undergraduate school in operational, finance and management positions for Los Angeles-based manufacturing firms. In the mid-1980's, he moved back to Arizona and co-founded companies that manufactured non-toxic, environmentally-sensitive pesticides, building materials and recycled plastics products.

In 1990 he joined the Arizona Department of Commerce Energy Office as the Manager of Planning and Policy. In that capacity he was responsible for implementation of the legislatively-mandated state Energy Policy. He began to write and speak extensively about electric industry restructuring as early as 1994, and was recruited to the Arizona Corporation Commission in late 1997 to advise the staff on electric industry competitive matters and to act as the agency's liaison to the Legislature.

He left the staff of the Corporation Commission in late 1999 to run for the office of Corporation Commissioner. In the period just prior to being appointed Director of RUCO, he had founded Ahearn & Associates, a consulting firm specializing in general business planning with a focus on renewable energy project development and representation of renewable energy firms.

Since coming to RUCO, Mr. Ahearn has participated in numerous energy-related boards, work groups and task forces at state, regional and federal levels. He chaired the Governor's Working Group on Renewable Energy and Energy Efficiency, and was a member of the Governor's Essential Service Task Force and the Consumer Energy Council of America's 2004 Transmission Forum project. He is currently a committee member of the North American Electric Reliability Council and the Committee on Regional Electric Power Cooperation.

DEPUTY DIRECTOR

Ernest Nedd has been Deputy Director of RUCO for the past three years. He is a native Phoenician who attended elementary school in Phoenix and graduated from Phoenix Union High School. After attending Brown University in Providence, RI, Mr. Nedd served in the U.S. Army, including a tour of duty in Vietnam. Mr. Nedd then returned to Arizona and earned a B.S. degree in Political Science from Arizona State University and a J.D. degree from the College of Law at Arizona State.

Mr. Nedd has previously held positions with the State of Arizona as an Assistant Attorney General, Assistant Commissioner of the Real Estate Department and Chief Hearing Officer of the Department of Liquor Licenses and Control. He has served as a member of the City of Phoenix Board of Adjustment, the Phoenix Inner City Planning Committee and the Phoenix Surface Transportation Advisory Committee. Mr. Nedd also is a former Chairman of the Board of Directors of Valle del Sol, Inc. and he has served on the Board of Directors of the Valley Christian Centers. He currently is a member of the Natural Gas Committee of the National Association of State Utility Consumer Advocates and the Public Interest Advisory Committee of the National Gas Institute.

Mr. Nedd is a resident of the Coronado Historic Neighborhood in Central Phoenix and is active in the Greater Coronado Neighborhood Association.

CHIEF COUNSEL

Scott Wakefield has been RUCO's Chief Counsel since 1998. He came to RUCO after serving as a Hearing Officer at the Corporation Commission, where he handled numerous rate case proceedings, consumer complaint hearings, and matters involving competition in the utility industry.

Mr. Wakefield received his Juris Doctorate cum laude from Arizona State University in 1990, and his Bachelor of Science degree in accounting magna cum laude from Arizona State in 1987. He has served on the board of directors for two non-profit organizations. He grew up and continues to live in Tempe.

Prior to his tenure as a hearing officer, Mr. Wakefield investigated and prosecuted investment fraud with the Corporation Commission's Securities Division. His work there resulted in caselaw outlining when investments in limited liability companies can be considered securities under the Arizona Securities Act.

Mr. Wakefield is knowledgeable on the process to appeal decisions of the Corporation Commission, and led the first RUCO success in appealing a Commission decision. He participates in RUCO's speaker's bureau, and has made numerous presentations on utility regulation and practice before the Arizona Corporation Commission in legal continuing education seminars.

CHIEF ACCOUNTING & RATES

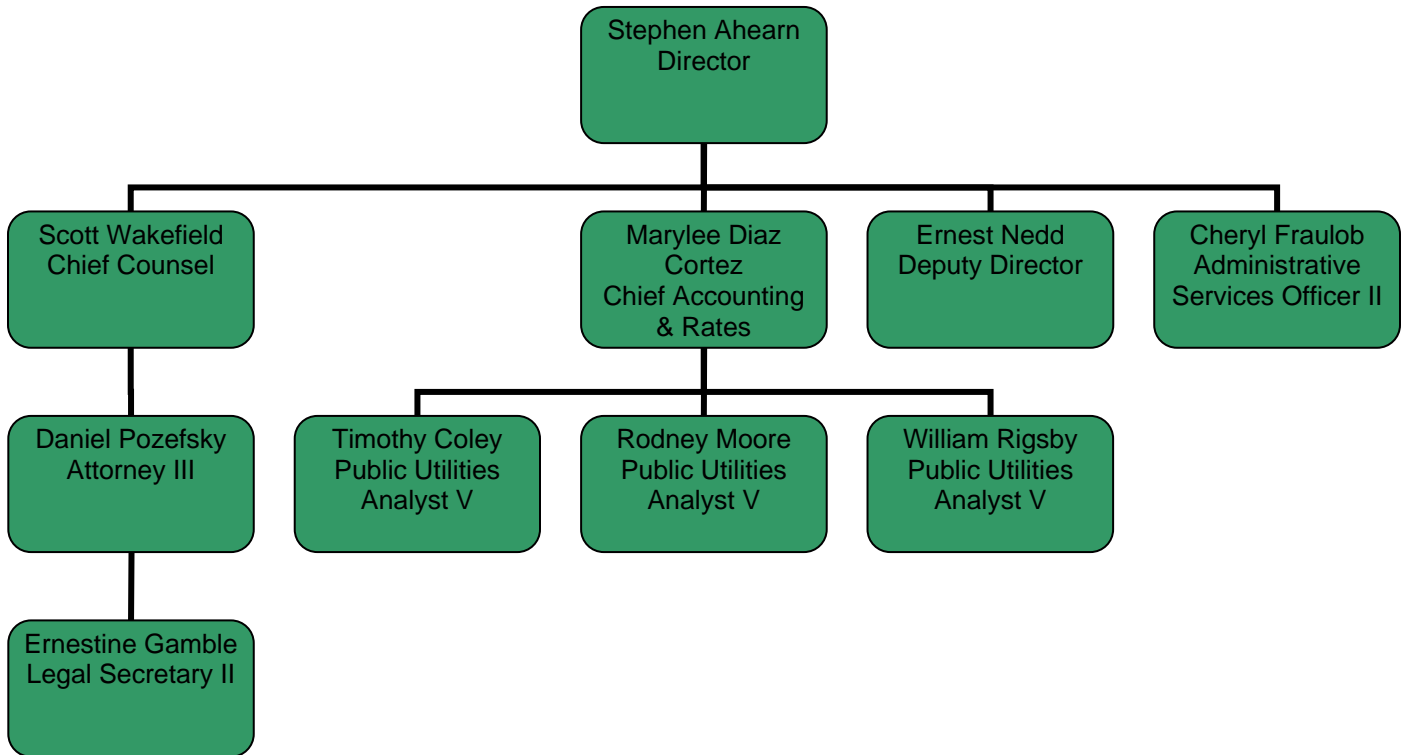
Marylee Diaz Cortez joined the Residential Utility Consumer Office in 1992, and has served as head of the technical division for the past 12 years. She is a graduate of the University of Michigan and a Certified Public Accountant licensed in Arizona and Michigan.

Prior to joining RUCO, Ms. Diaz Cortez worked for the public accounting firm of Larkin and Associates in the Detroit, Michigan area. Her private practice included regulatory consulting services. Between her experience at Larkin and Associates and RUCO she

has audited over 100 public utility companies including electric, gas, telephone, water, and sewer. She has provided expert testimony in as many cases.

Ms. Diaz Cortez works with a staff of three in-house auditors as well as outside expert witnesses. She is responsible for overseeing all testimony filed before the Arizona Corporation Commission. In her 14 years with RUCO, she has worked diligently and successfully to protect consumers from unjust utility rates.

RESIDENTIAL UTILITY CONSUMER OFFICE ORGANIZATION CHART



RUCO AND THE REGULATORY PROCESS

The Residential Utility Consumer Office (RUCO) was established by the Arizona Legislature in 1983 to represent the interests of residential utility ratepayers in rate-related proceedings involving public service corporations before the Arizona Corporation Commission (Commission).

Historically, utilities have had the exclusive right to provide services in designated areas. As legal monopolies, utilities are regulated to ensure that the public is charged just and reasonable prices. To establish the utilities' rates and charges, the Commission conducts public hearings and examines evidence and testimony presented by various concerned parties. RUCO represents the interests of Arizona's residents in these proceedings.

Every utility rate increase application filed with the Commission, regardless of the size of the utility, receives a preliminary review by RUCO. As a matter of policy, RUCO always intervenes and participates in rate cases involving Arizona's largest utilities. Intervention in the cases of smaller companies is decided on a case-by-case basis, with particular attention to the size of the increase sought, the rate history of the utility, and the availability of resources at RUCO. Generally, RUCO does not formally intervene in small cases to avoid causing unnecessary legal expenses for the small utility and its ratepayers.

RUCO is authorized 12 full-time employees, and often contracts with consultants for assistance in analyzing utilities' requests for changes in rates and preparing testimony.

THE RATEMAKING PROCESS

The rates charged by Arizona's investor-owned utilities are established by the Commission. The Commission authorizes a utility to charge rates, which will recover expenditures which are appropriate and prudently incurred, and which provide an opportunity to earn fair return on the utility's capital investment.

A utility initiates the process to obtain a rate increase by filing an application with the Commission. The application must be based on a "test year" of actual expenses and investment during a recent twelve-month period. All of the utility's cost data are drawn from its own records. The Commission requires that the utilities follow a standardized system of accounting procedures that assures that the data can be easily reviewed and verified by the Commission, RUCO and others.

In its application, a utility may propose certain adjustments to its actual test year costs and investment. Historical costs and investment may be adjusted by annualizing changes which occurred during the test year, such as payroll increases or tax changes, making them appear as if they had been in effect for the entire year. In addition, historical costs may be normalized to eliminate the effects of abnormal

variations that actually occurred during the test year, such as weather-related changes in consumption. Other adjustments may be proposed to include the effects of known and measurable changes that occurred after the end of the test year, such as wage increases and certain costs related to recently completed construction projects.

Upon receiving the utility's application and written summary or testimony, the Commission's Staff reviews the application to confirm that it contains all the necessary accounting information. If the application is complete, the Commission's Staff prepares a letter of sufficiency. The determination of sufficiency triggers the Commission's "time clock" rule, which establishes a deadline by which the Commission Staff must file its Staff Report or testimony on the application, and a deadline by which the Commission must issue a final order on the application. A hearing date is fixed for an application that requires a hearing.

After the application is determined sufficient, RUCO and other interested parties are permitted to intervene in the case. As intervenors, parties have the right to obtain additional information from the utility to assist in their review of the application. In addition, intervenors may present evidence of their own on the application and may have their attorneys cross-examine other parties' witnesses and submit written briefs, which present their positions on the issues in the case.

When the Commission Staff has completed its investigation, it issues recommendations in a Staff Report or written testimony. Intervenors also provide their recommendations in the form of written testimony prepared by their analysts or consultants. The utility has the opportunity to respond through the filing of additional written testimony of its own.

In many cases, prior to the hearing on the application, the Commission holds public comment sessions in the service territory of the utility. These meetings are intended to allow customers to express their opinions about the rate request and to provide the Commission with information that the customers feel is relevant to the case. It is not required, nor is it expected, that customers making comments at these meetings be represented by counsel.

The Commission then holds a formal hearing on applications that require hearings. At the hearing, the utility, the Commission Staff, RUCO, and other intervenors present witnesses, offer evidence, and conduct cross-examination of other parties' witnesses on the issues raised in the filed reports and testimony. Issues commonly disputed in rate cases include: which expenses should be charged in rates to ratepayers; what a normal or prudent level of expenses should be; whether all of the utility's investments in physical facilities were prudently made and whether the facilities are needed for the provision of utility services; how much of a return the utility's shareholders should be allowed to earn on their investment; and how the cost of providing service should be allocated to, and recovered from, the utility's various classes of customers.

After the hearing is concluded, the Commission's Administrative Law Judge reviews the evidence and the parties' arguments and issues a Recommended Order. The Recommended Order sets forth a recommended decision on all contested issues and recommends how much of a rate increase, if any, the utility should receive. The parties are permitted to file exceptions to the Recommended Order, asking the Commission to disregard the conclusions of the Recommended Order and suggesting an alternate resolution. At a public meeting, the Commission considers the Recommended Order, and the parties' exceptions to it. The Commission can adopt or deny the Recommended Order as originally written, incorporate any of the suggested exceptions, or make its own amendments.

After the Commission issues its final decision, the parties have twenty days to request the Commission to reconsider its decision. If the Commission declines to grant a rehearing, the parties may appeal the decision to the Arizona Court of Appeals. Decisions of the Court of Appeals may be appealed to the Arizona Supreme Court. Filing an appeal does not prevent the rates approved by the Commission from taking effect.

RUCO'S BUDGET

RUCO receives no money from the general tax fund. Rather, RUCO receives 100 percent of its operating budget from assessments of large utility companies that may, in turn, pass those charges on to their residential customers. In this way, those who benefit from RUCO's work fund its work. The utility ratepayers who pay these small assessments should consider their money well spent. The following reflects FY 2006 activity for the appropriation year 2006 and the approved amount for FY 2007.

EXPENDITURE CATEGORIES	ACTUAL 2006	APPROVED 2007
PERSONAL SERVICES	685,200	722,100
EMPLOYEE EXPENSES	197,600	219,000
ALL OTHER	323,400	334,300
TOTAL	1,206,200	1,275,400

RUCO'S FUNDING MECHANISM

Pursuant to A.R.S. § 40-401.01, funding of RUCO is accomplished through an assessment made annually by the Commission. Each utility with annual residential revenues in excess of \$250,000, except those not required to hold Certificates of Convenience and Necessity, is assessed.

The disposition of assessment proceeds is governed by A.R.S. § 40-409. All monies received by the Commission under the provisions of A.R.S. § 40-401.01 are paid to the State Treasurer and placed in the RUCO Revolving Fund. Monies in the fund are used, subject to legislative appropriation, to operate RUCO pursuant to A.R.S. § 40-461. Appropriated funds not spent by the end of a fiscal year do not revert to the General Fund. They revert to the RUCO Revolving Fund and are used to calculate the ratepayer assessment for the next fiscal year. Based on the information available at the end of FY 2006, the assessment for FY 2007 was \$1,275,400.

RUCO'S CASE ANALYSES AND INTERVENTIONS

As previously described, RUCO generally seeks to avoid intervening formally in small rate cases. Nevertheless, these cases are analyzed for potential cost impacts on ratepayers. Generally, rate applications for small utilities do not warrant formal RUCO intervention, which could unnecessarily increase costs to small utility ratepayers. The following table illustrates how RUCO's intervention activity over the past fiscal year compares to prior years:

	2002	2003	2004	2005	2006
NUMBER OF CASES ANALYZED	115	92	86	72	83
NUMBER OF RUCO INTERVENTIONS	14	13	13	10	13

RUCO'S IMPACT

The following table illustrates RUCO's impact on rate requests by utilities over the past fiscal year, compared to prior years:

	2002	2003	2004	2005	2006
AVERAGE UTILITY RATE REQUEST (MILLIONS \$)	8	10.7	2.2	180.2	17.8
AVERAGE RUCO RECOMMENDATION	1.8	7.8	.9	2.9	12.6
AVERAGE ACC APPROVED RATE	3.0	7.7	1.0	79.4	12.9

CONSUMER EDUCATION AND OUTREACH ACTIVITIES

Throughout calendar year 2006, RUCO has continued to engage in several activities designed to reach, interact with and educate residential utility ratepayers. As has been true for several years now, the primary vehicle for this outreach has been the agency's website. During 2005, RUCO has continued to upgrade this website in order to enhance the richness of its content and to make it more user-friendly.

Also throughout 2006, RUCO has continued to publish and distribute a bi-monthly, consumer-oriented electronic newsletter. The RUCO Watchdog is sent to a database of approximately 500 subscribers and contains information about ongoing rate cases and other items that are of interest to the agency's constituents. The Watchdog is published in both HTML and text formats to accommodate individual subscriber preferences.

RUCO maintains a speaker's bureau and responds to groups requesting presentations about the Office. During 2006, RUCO staff members have attended numerous public comment sessions when matters affecting particular communities were pending before the Corporation Commission. RUCO personnel have been present at public comment sessions in Mohave, Yavapai, Cochise, Coconino, LaPaz and Pima counties and these opportunities have been utilized to interact with local residential utility consumers and to provide those consumers with information regarding specific issues in their area.

RUCO will continue to seek out additional opportunities that may become available through technological advances to reach out to larger segments of its constituency in a continuing effort to provide useful information to residential utility ratepayers.

CASE SUMMARIES

(Click [here](#) to review a list of acronyms and terms commonly used throughout the descriptions in these Case Summaries).

ON-GOING CASES

(those not closed by June 30, 2006, listed in order of Docket-opening date).

Arizona-American Water Company, Inc.'s Paradise Valley Water District – Docket No. W-01303A-05-0405 and W-01303A-05-0718

On July 3, 2005, Arizona-American Water Company, Inc. ("Arizona-American" or "Company"), a wholly owned subsidiary of RWE AG, filed an application with the Arizona Corporation Commission ("ACC" or "Commission") requesting approval of a determination of the current fair value of the Company's utility plant and property; and for increases in rates and charges based thereon for utility service by Arizona-American's Paradise Valley Water District. During the test year ended December 31, 2004, Arizona-American provided water service to an average of 4,717 Paradise Valley customers of which approximately 4,411, or 93.5 percent, were residential customers.

Arizona-American requested a total increase of approximately \$277,980, or 5.48 percent more than the Paradise Valley Water District's adjusted test year operating revenues of \$5,070,680. In addition to the Company-proposed increase in revenues, Arizona-American also sought approval for surcharges on both an arsenic cost recovery mechanism ("ACRM") and a public safety ("PS") surcharge mechanism. The ACRM surcharge would allow the Company to recover costs associated with meeting the U.S. Environmental Protection Agency's revised arsenic standard of 10 parts per billion. The PS surcharge would allow Arizona-American to recover all capital related costs for \$16 million in post-test year fire flow improvements scheduled to be completed before the Company's next scheduled general rate case in 2010.

On July 18, 2005, ACC Staff filed a sufficiency letter informing the Company that its application had met the requirement of A.A.C. R-14-2-103, and that the Company had been classified as a Class A water utility¹. RUCO filed a request to intervene in the case on Monday, August 1, 2005, and was granted intervenor status by the ACC's Hearing Division. On August 15, 2005, the Administrative Law Judge ("ALJ") assigned to the case issued a Procedural Order scheduling the evidentiary hearing in the case for 10:00 a.m. on March 27, 2006, at the Commission's offices at 1200 W. Washington Street in Phoenix.

¹ Based on the Company's requested increase over Test Year Revenues. Under the Commission's time clock rules, a decision on the Company's request for rate relief would have to be made within 360 days of the issuance of a letter of sufficiency.

As agreed upon by the parties to the case, RUCO filed direct testimony on January 17, 2006 (the original filing date was delayed in observance of the 2006 MLK holiday). A comparison of Arizona-American's proposed revenue increases and RUCO's recommendations were as follows:

LINE NO.	DESCRIPTION	(A) COMPANY OCRB/FVRB AS FILED	(B) RUCO OCRB/FVRB AS ADJUSTED
1	Adjusted Rate Base	\$ 11,651,216	\$ 10,898,953
2	Adjusted Operating Income (Loss)	\$ 742,769	\$ 1,045,440
3	Current Rate Of Return (Line 2 / Line 1)	6.38%	9.59%
4	Required Operating Income (Line 5 X Line 1)	\$ 913,455	\$ 773,826
5	Required Rate Of Return	7.84%	7.10%
6	Operating Income Deficiency (Line 4 - Line 2)	\$ 170,686	\$ (271,615)
7	Gross Revenue Conversion Factor (Schedule RLM-1, Page 2)	1.6286	1.6286
8	Increase In Gross Revenue Requirement (Line 7 X Line 6)	\$ 277,980	\$ (442,361)
9	Adjusted Test Year Revenue	\$ 5,070,680	\$ 5,070,680
10	Proposed Annual Revenue Requirement (Line 8 + Line 9)	\$ 5,348,660	\$ 4,628,319
11	Required Percentage Increase In Revenue (Line 8 / Line 9)	5.48%	-8.72%
12	Rate Of Return On Common Equity	12.00%	10.00%

The Company filed rebuttal testimony on February 13, 2006. On March 6, 2006, ACC Staff and RUCO filed surrebuttal testimony as scheduled. Arizona-American filed rejoinder testimony on March 16, 2006. The evidentiary hearing on the matter was conducted from March 27 2006 through April 3, 2006. On May 5, 2006, RUCO and the other parties to the case filed closing briefs. Reply briefs were filed on May 26, 2006.

After weighing all of the evidence presented during the proceeding, the ALJ assigned to the case issued her Recommended Opinion and Order ("ROO") on July 11, 2006. RUCO filed exceptions to the ROO on July 20, 2006. On Tuesday, July 25, 2006, an amended ROO was approved by four of the five ACC Commissioners.

Tucson Electric Power Motion to Amend Decision No. 62103 – Docket No. E-0193A-05-0650

In 1999, the ACC adopted Decision No. 62103, which approved with modifications a Settlement Agreement regarding issues arising from the implementation of retail electric competition and froze Tucson Electric Power Company's (TEP) rates through the end of 2008. On September 12, 2005, TEP filed a Motion to Amend Commission Decision No. 62103 to provide for:

1. An extension beyond December 31, 2008, of the existing TEP rate freeze at TEP's Base Rate;
2. The retention of the current CTC amortization schedule;
3. An agreement of TEP not to seek rate treatment for certain generation assets; and
4. Effective after December 31, 2008, implement a mechanism to protect TEP and ratepayers from energy market volatility.

RUCO and other parties filed responses to the Motion. RUCO argued that, regardless of the merits of TEP's four proposals, there was no need to amend Decision No. 62103 to adopt them. On April 20, 2006, the ACC adopted Decision No. 68669, requiring that the Commission's Hearing Division conduct a hearing to resolve the dispute over whether TEP's rates in 2009 will be market based, or set on a cost-of-service basis. A Procedural Order was issued requiring TEP to file a complete explanation of its proposal and scheduling a hearing for January 2007. On August 18, 2006, TEP filed testimony outlining two alternative proposals to market-based rates for 2009. The presiding Administrative Law Judge issued a Procedural Order requesting filings regarding whether the existing procedural schedule was adequate in light of the proposals TEP had made. A procedural conference was held on September 21, 2006, and the parties are awaiting the ALJ's ruling.

Black Mountain Sewer Corporation Rate Case Filing – Docket No. SW-02361A-05-0657

On September 16, 2005, Black Mountain Sewer Corporation ("BMSC" or "Company") filed an application with the Arizona Corporation Commission ("ACC" or "Commission") seeking rate relief in the amount of \$163,279, which represents a 13.52 percent increase over operating revenues of \$1,207,740 recorded during the test year ended December 31, 2004.

RUCO filed a request to intervene in the case with the ACC's Hearing Division on September 26, 2005. On October 7, 2005, the Hearing Division issued a notification granting RUCO's request.

On October 14, 2005, ACC Staff issued a deficiency letter informing BMSC that the Company's application failed to meet the sufficiency requirements of A.A.C. R-14-2-103 (because the application did not contain a cost of service study) and that ACC Staff would file a motion seeking administrative closure in the matter if the Company did not correct the deficiency or make other arrangements to remedy the situation by October 31, 2005.

On October 25, 2005, BMSC and ACC Staff filed a stipulation informing the Hearing Division that the parties had reached an agreement to issue a letter of sufficiency on

condition that the Company provides specific information to ACC Staff within sixty days of a Procedural Order approving the stipulation. Both BMSC and ACC Staff also agreed that the rate case would be suspended in the event that the requested information was not provided to ACC Staff during the sixty-day period.

On October 27, 2005, the Administrative Law Judge ("ALJ") assigned to the case issued a Procedural Order that refused to grant approval of the agreement contained in the stipulation.

On November 1, 2005, ACC Staff docketed a sufficiency letter informing BMSC that the Company's application met the sufficiency requirements of A.A.C. R-14-2-103 and that the Company had been classified as a Class B wastewater utility².

On November 2, 2005, the ALJ assigned to the case issued a Procedural Order to govern the proceeding. The evidentiary hearing in the matter was scheduled for Wednesday, June 7, 2006.

During the discovery phase of the proceeding, RUCO's staff issued data requests to obtain further information on BMSC's application and conducted a full audit and cost of capital analysis.

ACC Staff, RUCO and the Town of Carefree filed direct testimony and exhibits on Thursday, March 9, 2006. RUCO recommended the following:

LINE NO.	DESCRIPTION	(A) COMPANY REQUESTED	(B) RUCO RECOMMENDED
1	ADJUSTED RATE BASE	\$ 887,449	\$ 1,372,834
2	ADJUSTED OPERATING INCOME	(14,233)	125,730
3	CURRENT RATE OF RETURN (L2 / L1)	-1.60%	9.16%
4	REQUIRED RATE OF RETURN	11.00%	9.45%
5	REQUIRED OPERATING INCOME (L4 * L1)	97,619	129,733
6	OPERATING INCOME DEFICIENCY (L5 - L2)	111,852	4,003
7	GROSS REVENUE CONVERSION FACTOR	1.4598	1.3663
8	GROSS REVENUE INCREASE	\$ 163,279	\$ 5,470
9	CURRENT REVENUES T/Y ADJUSTED	1,207,740	1,207,740
10	PROPOSED ANNUAL REVENUE (L8 + L9)	1,371,019	1,213,210
11	PERCENTAGE AVERAGE INCREASE	13.52%	0.45%

² Based on the Company's requested increase over test year Revenues. Under the Commission's time clock rules, a decision on the Company's request for rate relief would have to be made within 360 days (October 27, 2006) of the issuance of a letter of sufficiency (November 1, 2005).

The Company filed rebuttal testimony on April 6, 2006. ACC Staff, RUCO and the Town of Carefree filed surrebuttal testimony on May 4, 2006. The Company filed its rejoinder testimony on May 25, 2006.

The evidentiary hearing on the matter began on Wednesday, June 7, 2006, at 10:00 a.m. at the ACC's offices in Phoenix. The ALJ assigned to the case heard public comment on an odor problem from customers of BMSC. RUCO's attorney cross-examined witnesses for BMSC and RUCO's witnesses were cross-examined by the Company's lawyers on Thursday and Friday, June 8 and 9. The hearing concluded on Tuesday, June 20, 2006, after a ten-day break.

On Monday, July 31, 2006, the parties to the case met at the ACC's Phoenix office to discuss post-hearing schedules filed by ACC Staff. The parties to the case jointly filed a Stipulation and Request for Procedural Order to Extend the Briefing Schedule (the original briefing schedule had been established at the end of the evidentiary hearing). On August 1, 2006, the ALJ assigned to the case issued a Procedural Order granting the request.

Attorneys representing the parties to the case filed two rounds of closing briefs. Initial closing briefs were filed on August 21, 2006, and reply briefs were filed on September 5, 2006.

The ALJ is now weighing all of the evidence presented during the proceeding (including any correspondence or public comment from concerned ratepayers) and will write a Recommended Opinion and Order ("ROO"). The ROO will then be voted on by the five ACC Commissioners during a scheduled open meeting at the Commission's office at 1200 W. Washington Street in Phoenix. The five Commissioners can accept, amend or reject the ALJ's ROO. A final decision on BMSC's rate request will probably not be made until sometime during October or November of 2006.

Far West Water and Sewer Company – Application For A Determination Of The Fair Value Of Its Sewer Utility Plant And Property And For Increases In Its Rates And Charges For Sewer Utility Service Based Thereon, ACC Docket No. WS-03478A-05-0801

On November 1, 2005, Far West Water and Sewer Company ("Far West Sewer" or "Company") filed an application requesting a rate increase for sewer service. Far West Sewer provides wastewater service to approximately 5,500 customers in portions of Yuma County, Arizona.

On July 18, 2005, an evidentiary hearing was convened in Phoenix, Arizona.

At the time of the printing of this report, the Hearing Division has not issued its Recommended Opinion and Order ("ROO").

The major issues to be adjudicated by the Administrative Law Judge (“ALJ”) and approved by the Arizona Corporation Commission (“Commission”) are:

Rate Case Expense

RUCO recommends the Commission approve \$70,000 as an appropriate level of rate case expense. The Company proposed updated rate case expenses of \$160,000. The Commission typically looks at a variety of factors when considering rate case expense. Those factors include the complexity of the proceeding, the number of systems involved and a comparison of other cases.

Rate Design

RUCO recommends that the Commission impute a level of revenue to the Company to compensate ratepayers for the lost revenue as the result of the Company agreement to provide the Mesa Del Sol Golf Course with treated effluent water at no charge. The Company provides effluent water to three golf courses within its certified area. As part of this rate application, the Company is proposing an effluent tariff and intends to apply the tariff to two of the three golf courses in its certified area. The Company will continue to provide effluent to the third Golf Course, Mesa Del Sol, at no charge. The Commission will have to make a determination of the value of the effluent and whether or not to allow ratepayers to be credited for that value.

Property Tax Expense

RUCO recommends the Commission adopt its adjustment to property tax expense based on the formula and inputs used by the Arizona Department of Revenue (“ADOR”). The Company has disregarded the revenues required under the ADOR directive and substituted in its place the adjusted test-year revenues twice and its proposed level of revenues once. The Commission will have to decide whether or not to adopt the ADOR methodology using historical inputs.

Cost of Capital

RUCO recommends the Commission adopt its 8.81 percent cost of capital for Far West.

Conclusion

RUCO’s intervention was instrumental in illuminating its position on two rate making elements; specifically:

RUCO states the Company assertion that there are a certain amount of “embedded costs” inherent in any rate case and that most of these costs are outside of the Company’s control is misguided. RUCO explained that even though there are certain costs inherent in the Commission’s process, the costs must still be reasonable. The

Company is under the mistaken impression that just because it expended the time and the costs, its rate case expense must be reasonable.

The pro forma adjustment of property tax expenses should be based on the ADOR formula; when the formula is varied to project an inflated Fair Value Cash Value this increases the risk the Company will over earn.

Arizona Public Service Company Rate Case Filing – Docket No. E-01345A-05-0816

On November 4, 2005, Arizona Public Service Company ("APS" or "Company"), the largest investor owned electric utility in the state, filed an application with the Arizona Corporation Commission ("ACC" or "Commission") for a permanent rate increase. APS is seeking an increase of \$449.6 million in base rates³ or a 21.1 percent increase on average for the Company's jurisdictional electric operations.

On November 22, 2005, RUCO filed a motion to intervene in the case.

After discussions with ACC Staff, APS agreed to file an amended application containing updated operating information on certain generation facilities that were either included in rate base as a result of the Company's prior rate case Settlement Agreement (i.e., the former generation assets of Pinnacle West Energy Corporation) or were acquired on the open market during 2005 (i.e., the Company's Sundance generation facility purchased from PPL Sundance Energy, LLC).

On January 31, 2006, APS filed its amended application, which contains information on a test year ended September 30, 2005 (the Company had originally chosen a test year ended December 31, 2004).

On March 28, 2006, the ACC's Chief Administrative Law Judge ("CALJ") issued a Procedural Order that established the rules for discovery and the original filing dates for testimony.

On March 30, 2006, RUCO filed a motion to modify the procedural schedule.

On April 5, 2006, the CALJ issued an amended rate case Procedural Order revising the dates set forth in the Procedural Order filed on March 28, 2006.

The evidentiary hearing on APS' request for an increase in rates is scheduled to begin on Tuesday, October 10, 2006, at the ACC's office at 1200 W. Washington Street in Phoenix.

³ According to the application filed by APS, these figures do not include a Company-proposed Environmental Improvement Charge, which when added to the base rate request would increase the total to \$453.9 million or 21.3 percent.

During the discovery phase of the proceeding (the period prior to hearing), RUCO issued data requests to obtain further information on APS' application and conducted a full audit and cost of capital analysis.

ACC Staff, RUCO and other intervenors to the case filed direct testimony on all issues, except for rate design, on Friday, August 18, 2006. RUCO's recommendations on required revenue are as follows:

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY RCND	(C) COMPANY FAIR VALUE	(D) RUCO ORIGINAL COST	(E) RUCO RCND	(F) RUCO FAIR VALUE
1	ADJUSTED RATE BASE	\$ 4,466,697	\$ 7,774,812	\$ 6,120,755	\$ 4,463,358	\$ 7,728,180	\$ 6,095,769
2	OPERATING INCOME	12,780			82,456		
3	ADJUSTMENT FOR HEDGE VALUE	<u>103,124</u>			<u>103,124</u>		
4	ADJUSTED OPERATING INCOME	115,904	115,904	115,904	185,580	185,580	185,580
5	CURRENT RATE OF RETURN (L4 / L1)	2.59%	1.49%	1.89%	4.16%	2.40%	3.04%
6	REQUIRED OPERATING INCOME (L7 * L1)	389,943	389,943	389,943	327,164	327,164	327,164
7	REQUIRED RATE OF RETURN	8.73%	5.02%	6.37%	7.33%	4.23%	5.37%
8	OPERATING INCOME DE(SUF)FICIENCY (L5 - L2)	377,163			244,708		
9	ADJUSTMENT FOR HEDGE VALUE	<u>(103,124)</u>			<u>(103,124)</u>		
10	ADJUSTED OPERATING INCOME DEFICIENCY	274,039	274,039	274,039	141,584	141,584	141,584
11	GROSS REVENUE CONVERSION FACTOR	<u>1.6407</u>	<u>1.6407</u>	<u>1.6407</u>	<u>1.6407</u>	<u>1.6407</u>	<u>1.6407</u>
12	GROSS REVENUE INCREASE	618,812			401,492		
13	ADJUSTMENT FOR HEDGE VALUE	<u>(169,196)</u>			<u>(169,196)</u>		
14	REQUESTED INCREASE IN GROSS REVENUES	<u>\$ 449,616</u>	<u>\$ 449,616</u>	<u>\$ 449,616</u>	<u>\$ 232,297</u>	<u>\$ 232,297</u>	<u>\$ 232,297</u>
15	ENVIRONMENTAL IMPROVEMENT CHARGE	<u>4,315</u>	<u>4,315</u>	<u>4,315</u>			
16	TOTAL INCREASE IN RATES	\$ 453,931	\$ 453,931	\$ 453,931	\$ 232,297	\$ 232,297	\$ 232,297
17	CURRENT RETAIL REVENUES T/Y ADJUSTED	\$ 2,127,322	\$ 2,127,322	\$ 2,127,322	\$ 2,132,229	\$ 2,132,229	\$ 2,132,229
18	PROPOSED ANNUAL REVENUE (L16 + L17)	\$ 2,581,253	\$ 2,581,253	\$ 2,581,253	\$ 2,364,526	\$ 2,364,526	\$ 2,364,526
19	PERCENTAGE AVERAGE INCREASE	21.34%	21.34%	21.34%	10.89%	10.89%	10.89%
20	INCREMENTAL INCREASE (NET OF EMERGENCY RATES)	14.87%			4.44%		

Direct testimony on rate design was filed on Friday, September 1, 2006. APS filed rebuttal testimony before noon on Friday, September 15, 2006. ACC Staff, RUCO and all other intervenors filed surrebuttal testimony on Wednesday, September 27, 2006. APS filed a final round of rejoinder testimony before noon on Wednesday, October 4, 2006.

After the conclusion of the evidentiary hearing, and the filing of closing briefs by the attorneys who represent the various parties to the case, the CALJ will weigh all of the evidence presented during the proceeding and will write a Recommended Opinion and Order ("ROO").

The five ACC Commissioners will then vote on the ROO, as a final decision, at a scheduled open meeting. The five Commissioners can adopt the ROO as is, adopt an amended ROO, or reject the ROO altogether. Depending on the length of the evidentiary hearing, a final decision on APS' request will probably not be made until late December 2006 or early January 2007.

**Arizona-American Water Company, Inc.'s Mohave Water & Wastewater Districts –
Docket No. WS-01303A-06-0014**

On January 13, 2006, Arizona-American Water Company, Inc. ("Arizona-American" or "Company"), a wholly-owned subsidiary of RWE AG, filed an application with the Arizona Corporation Commission ("ACC" or "Commission") requesting approval of a determination of the current fair value of the Company's utility plant and property; and for increases in rates and charges based thereon for utility service provided by Arizona-American's Mohave Water & Wastewater Districts. Arizona-American sought increases of 21.60 percent and 30.82 percent for the Company's water and wastewater districts, respectively.

On March 9, 2006, RUCO filed a motion to intervene in the case with the ACC's Hearing Division.

On March 10, 2006, ACC Staff issued a Letter of Sufficiency informing the Company that its application met the filing requirements of A.A.C. R14-2-103.

On March 22, 2006, the Administrative Law Judge ("ALJ") assigned to the matter issued the Procedural Order that governs the case.

On April 4, 2006, the parties to the case (i.e., the Company, ACC Staff and RUCO) filed a joint motion to change the dates established in the Procedural Order for the scheduled evidentiary hearing and the filing of testimony.

On April 13, 2006, the ALJ assigned to the case acted on the joint motion filed by the parties to the case and issued an amended Procedural Order.

The rescheduled evidentiary hearing on Arizona-American's request will be held at the ACC's Phoenix office at 10:00 a.m. on Monday, November 13, 2006.

On August 25, 2006, ACC Staff filed a motion seeking an extension on the filing deadline for direct testimony. The ALJ assigned to the case granted the extension and issued a procedural order extending the filing dates for direct and rebuttal testimony.

During the discovery phase of the proceeding, RUCO's analysts conducted an audit of the Company and performed a cost of capital analysis to determine an appropriate rate of return on Arizona-American's investment in the Mohave Water and Wastewater District.

Direct testimony on the Company's application from ACC Staff, RUCO and other intervenors to the case was filed on September 5, 2006.

RUCO's recommendations were as follows:

REVENUE REQUIREMENTS – WATER

LINE NO.	DESCRIPTION	(A) COMPANY REQUESTED	(B) RUCO RECOMMENDED
1	ADJUSTED RATE BASE	\$ 11,020,663	\$ 8,874,569
2	ADJUSTED OPERATING INCOME	331,852	564,654
3	CURRENT RATE OF RETURN	3.01%	6.36%
4	REQUIRED RATE OF RETURN (L2 /L1)	7.93%	6.97%
5	REQUIRED OPERATING INCOME (L4 * L1)	873,939	618,557
6	OPERATING INCOME DEFICIENCY (L5 – L2)	542,087	53,904
7	GROSS REVENUE CONVERSION FACTOR	1.62860	1.62867
8	GROSS REVENUE INCREASE	\$ 882,842	\$ 87,792
9	CURRENT REVENUES T/Y ADJUSTED	4,089,750	4,310,501
10	PROPOSED ANNUAL REVENUE (L8 + L9)	4,972,592	4,398,293
11	PERCENTAGE AVERAGE INCREASE	21.59%	2.04%

REVENUE REQUIREMENTS – WATER

LINE NO.	DESCRIPTION	(A) COMPANY REQUESTED	(B) RUCO RECOMMENDED
1	ADJUSTED RATE BASE	\$ 664,456	\$ 419,390
2	ADJUSTED OPERATING INCOME	(36,607)	(57,937)
3	CURRENT RATE OF RETURN	-5.51%	-13.81%
4	REQUIRED RATE OF RETURN (L2 /L1)	7.93%	6.97%
5	REQUIRED OPERATING INCOME (L4 * L1)	52,691	29,231
6	OPERATING INCOME DEFICIENCY (L5 – L2)	89,298	87,168
7	GROSS REVENUE CONVERSION FACTOR	1.62860	1.26461
8	GROSS REVENUE INCREASE	\$ 145,431	\$ 110,234
9	CURRENT REVENUES T/Y ADJUSTED	472,010	474,629
10	PROPOSED ANNUAL REVENUE (L8 + L9)	617,441	584,863
11	PERCENTAGE AVERAGE INCREASE	30.81%	23.23%

The Company filed rebuttal testimony on October 4, 2006. Arizona-American amended its requested increases in its rebuttal testimony to 19.66 percent and 32.18 percent for the Company's water and wastewater districts, respectively. Surrebuttal testimony from ACC Staff and RUCO was filed on October 18, 2006, and October 17, 2006, respectively. A final round of rejoinder testimony from the Company will be filed on November 1, 2006. After the evidentiary hearing, the ALJ will weigh the evidence presented in the case and write a Recommended Opinion and Order ("ROO") that will be voted on by the ACC Commissioners during a scheduled open meeting. The five Commissioners can vote for the ROO as is, amend the ROO or reject the ROO altogether.

Gold Canyon Sewer Company – Application For A Determination Of The Fair Value Of Its Utility Plant And Property And For Increases In Its Rates And Charges For Utility Service Based Thereon, ACC Docket No. SW-02519A-06-0015

On January 13, 2006, Gold Canyon Sewer Company ("GCSC" or "Company") filed an application with the Arizona Corporation Commission ("ACC" or "Commission") seeking rate relief in the amount of \$2,474,767, which represents a 101 percent increase over adjusted operating revenues of \$2,451,576 recorded during the test year ended October 31, 2005.

On February 17, 2006, ACC Staff issued a Letter of Sufficiency informing the Company that its application met the filing requirements.

On May 10, 2006, RUCO received approval to intervene in this case.

On August 9, 2006, the ALJ assigned to the case issued a Procedural Order scheduling a public comment session on September 13, 2006, at 6:00 p.m. in the Superstition Room of the Mountainbrook Village Activities Center at 5674 Marble Drive in Gold Canyon, AZ.

The evidentiary hearing on the Company's request for an increase in rates is scheduled to begin in early November.

Under RUCO's recommended rates, residential customers would see an increase of \$14.83 per month as opposed to the Company-proposed increase of \$35.34 per month.

The Company filed rebuttal testimony on July 27, 2006. ACC Staff and RUCO filed surrebuttal testimony on Wednesday, August 30, 2006. GCSC filed a final round of rejoinder testimony on Wednesday, September 13, 2006.

After the conclusion of the evidentiary hearing, and the filing of briefs by the attorneys who represent the various parties to the case, the ALJ will weigh all of the evidence presented during the proceeding and write a Recommended Opinion and Order ("ROO").

The five ACC Commissioners will then vote on the ROO, as a final decision, at a scheduled open meeting. The five Commissioners can either adopt the ROO as is, adopt an amended ROO, or reject the ROO altogether. A final decision on GCSC's request will probably not be made until the first quarter of 2007.

Havasu Water District - Application 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 Step One Arsenic Cost Recovery Mechanism ("ACRM"), ACC Docket No. WS-01303A-06-0491

On April 4, 2006, Arizona-American Water Company submitted its Step-One ACRM filing for its Havasu Water District. This filing supports a Step-One ACRM surcharge of \$5.84 to the monthly minimum charge and \$0.6547 per 1000 gallons to the commodity rate. The average residential bill impact will be \$25.53 per month.

The Company's proposed ACRM is patterned after the ACRM approved by the Commission in Arizona Water Company's Northern Division case. See Decision No. 66400. The ACRM is a step increase mechanism designed to recover the Company's incremental investment in arsenic treatment plant, depreciation, return, and O&M costs associated with media replacement/regeneration/waste disposal.

On May 8, 2006, the Residential Utility Consumer Office ("RUCO") filed a report of its audit findings on the application. RUCO proposed an adjustment of \$45,655 in allocated overhead costs. RUCO's proposed adjustment disallows plant balances amounts related to an allocation of overhead costs that cannot be directly identified with a specific task order related to the arsenic plant. RUCO recommended a surcharge of \$5.62 to the monthly charge and \$0.6302 per 1,000 gallons to the commodity rate.

On May 31, 2006, the Commission discussed this application at the Open Meeting. The Company argued for the inclusion of the overheads that RUCO had disallowed. Another sticking point in this matter was the magnitude of the proposed ACRM surcharge. Several Commissioners wanted to explore the option of implementing a hook-up fee to defray some of the costs. In light of this, the Commission did not vote on this matter and deferred it a later meeting. As of the writing of this report, the Commission still has not voted on this matter.

**CASES CLOSED IN FY 2006
(listed in order of closing date)**

Arizona Water Company Western Group Rate Case – Docket No. W-01445A-04-0650

On August 14, 2004, Arizona Water Company ("Arizona Water" or "Company") filed an application for a permanent rate increase with the Arizona Corporation Commission ("ACC" or "Commission") for each of the five water systems in the Company's Western

Group. The case involved water systems that provide service to customers located in Casa Grande, Stanfield, White Tanks, Ajo and Coolidge.

On October 6, 2004, RUCO filed a request for intervention, which was approved by the ACC's Hearing Division. The case then entered the discovery phase of the proceeding. During this period, RUCO's analysts performed an audit of the Company's books and records and conducted a cost of capital analysis to determine if Arizona Water's proposed increases were justified.

On April 20, 2005, RUCO filed direct testimony, containing its recommended level of revenue and return on invested capital. A comparison of Arizona Water's proposed revenue increases and RUCO's recommendations are as follows:

System	Company Requested Increase (Decrease) (\$)	Company Requested Increase (Decrease) (%)	RUCO Recommended Increase (Decrease) (\$)	RUCO Recommended Increase (Decrease) (%)
Ajo Heights	\$88,571	21.64%	\$52,289	12.94%
Casa Grande	\$1,843,802	25.26%	\$15,481	0.21%
Coolidge	\$489,901	35.94%	\$50,532	3.72%
Stanfield	\$11,601	10.07%	\$534	0.46%
White Tank	\$220,188	28.91%	(\$8,568)	-1.13%

The figures illustrated above do not reflect the additional charges associated with the Company's requested arsenic cost removal mechanism ("ACRM") surcharge which impacted the Casa Grande, Stanfield and White Tank systems (the ACRM allows the Company to recover costs associated with arsenic removal in order to meet the U.S. Environmental Protection Agency's revised standard of ten parts per billion which is now scheduled to go into effect sometime during the latter part of 2007). In addition to the ACRM, the above figures do not reflect any pass through costs for incremental increases or decreases in Arizona Water's purchased pumping power or purchased water costs that were being passed on to Western Group customers through the Company's purchased pumping power adjustor mechanism ("PPAM") and purchased water adjustor mechanism ("PWAM") surcharges. RUCO recommended that the Commission eliminate both the PPAM and PWAM surcharges. RUCO also recommended that the Company not be permitted to recover deferred Central Arizona Project ("CAP") water expenses until ratepayers in the Casa Grande, Coolidge and White Tank systems actually received treated CAP water. RUCO also recommended that \$824,374 in legal costs (associated with disputes over the sale of effluent water) be removed from the Company's proposed rate base for the Casa Grande system.

Arizona Water filed rebuttal testimony on May 13, 2005. RUCO filed surrebuttal testimony on May 25, 2005. The Company filed its rejoinder testimony on June 10, 2005. Because of settlement negotiations involving the Company's request for CAP cost recovery (and a two-day extension on the original filing date for rejoinder testimony); the formal evidentiary hearing on the case was rescheduled for Friday, June 17, 2005, at 9:30 a.m. Public comment on Arizona Water's requested rate increase was heard on Thursday, June 16, 2005, at 10:00 a.m. prior to a pre-hearing conference at the ACC's Phoenix office at 1200 W. Washington Street (the original noticed time, date and location for the hearing).

During the evidentiary hearing, which lasted for six days, RUCO's witnesses were cross-examined by Arizona Water's legal team on all of the major issues in the case. Also during the hearing, RUCO's attorney cross-examined witnesses for the Company, the City of Casa Grande and ACC Staff. At the hearing, RUCO supported ACC Staff recommendations that would allow the Company to recover deferred CAP charges (through a hook-up fee on new connections in areas that will eventually receive treated CAP water) and require the Company to work with the City of Casa Grande on a master plan for water use. The hearing concluded on Friday afternoon, June 24, 2005. Closing briefs and reply briefs were filed, as scheduled, on August 1, 2005, and August 22, 2005, respectively.

After weighing the evidence presented in the case, the presiding Administrative Law Judge issued her Recommended Opinion and Order ("ROO") on October 4, 2005. The ROO adopted several of the key issues that RUCO argued in the case, such as the removal of the Casa Grande legal costs from rate base, the elimination of the PPAM and PWAM surcharges, and the lag in the number of days in which income tax payments are calculated (for the purpose of determining the level of cash working capital that is recovered in rates). The ROO also adopted the ACC Staff recommendation (supported by RUCO) that allows Arizona Water to recover the Company's deferred CAP expenses through a hook-up fee, that will be charged to future homebuyers, as opposed to recovering the CAP expenses in the rates that will be paid by existing customers.

The five ACC Commissioners discussed the ROO during the regular open meeting held on October 18 and 19, 2005. Over the course of the meeting, representatives from Frito-Lay and Abbott Laboratories presented their concerns about the recommended rate design contained in the ROO, and attorneys for AWC argued their exceptions to the ROO. RUCO's attorney urged the Commission to adopt the ROO in its entirety. After approximately two hours the item was rescheduled for further discussion, and a possible vote, at a latter date. During the open meeting, the Company agreed to waive the time clock rules in the case.

After a brief discussion and a favorable vote on an amendment that revised the rate design contained in the original ROO, the amended ROO was approved by a vote of 5-0 at the regular open meeting held on Wednesday, November 9, 2005, at the ACC's office located at 1200 W. Washington Street in Phoenix.

Arizona-American Water Company, Inc. - Request for an ACRM - Docket No. W-01303A-05-0280

On December 14, 2004, Arizona-American Water Company, Inc., a wholly-owned subsidiary of RWE AG, filed a motion asking (1) that the Commission re-open the record in the Company's most recent rate case (filed on December 13, 2002) so as to consider modifying the final decision by adding an arsenic cost recovery mechanism ("ACRM") and (2) to waive a three-year rate moratorium of a prior order, which approved the sale of Arizona-American to RWE, to include the Paradise Valley Water District in the proceeding. In return for approving the request, Arizona-American agreed to drop court appeals that the Company had filed on both the rate case and RWE orders.

RUCO intervened in the proceeding to insure that ratepayers would not be adversely affected by the implementation of the proposed ACRM.

On July 1, 2005, RUCO filed direct testimony. RUCO witness Marylee Diaz Cortez, CPA, recommended approval of Arizona-American's request with the exception of the Company-proposed hook-up fee for the Lake Havasu District. Arizona-American filed rebuttal testimony on July 21, 2005. Both RUCO and ACC Staff presented oral surrebuttal testimony at the evidentiary hearing that took place at 10:00 a.m. on Tuesday, July 26, 2005, at 1200 W. Washington Street in Phoenix. The Company presented oral rejoinder testimony during the hearing.

The presiding Administrative Law Judge will now weigh all of the evidence presented in the case and write a Recommended Opinion and Order ("ROO") that will be voted on by the five ACC Commissioners during a scheduled open meeting. The final decision on the Company's request for an ACRM is not expected until sometime in September or October 2005.

On November 14, 2005, the Commission issued Decision No. 68310, which approved the ACRM as well as a hook-up fee for the Lake Havasu District.

Southwest Gas Corporation Rate Case Filing – Docket No. G-01551A-04-0876

On December 9, 2004, Southwest Gas Corporation ("SWG" or "Company") filed an application with the ACC requesting a permanent increase in rates. SWG, a Class A utility, sought a revenue increase of \$70.8 million, which would result in a 9.40 percent return on invested capital. According to the Company's application, the proposed increase would raise the current average monthly residential bill of \$37.35 by \$5.77 per month or approximately 15.0 percent. SWG also sought approval of a conservation margin tracker ("CMT") mechanism that would allow the Company to recover lost revenues, attributed to customer conservation, through SWG's rates. SWG is the largest local distribution company in the state of Arizona, and provides natural gas to customers in Cochise, Gila, Graham, Greenlee, La Paz, Maricopa, Mohave, Pima, Pinal

and Yuma counties. Fifty-five percent of Las Vegas-based Southwest Gas Corporation's customers are located in Arizona.

On January 3, 2005, RUCO filed a request for intervention, which was approved by the ACC's Hearing Division. During the discovery phase of the proceeding, RUCO's analysts performed an audit of the Company's books and conducted a cost of capital analysis to determine if SWG's proposed increases are justified. On July 26, 2005, RUCO filed direct testimony containing its recommended level of revenue and return on invested capital.

In addition to its recommended level of required revenue, RUCO also recommended that the Commission adopt its recommended rate design in lieu of the Company-proposed CMT. SWG filed rebuttal testimony on Tuesday, August 23, 2005. RUCO filed surrebuttal testimony as scheduled on Tuesday, September 13, 2005. The Company filed rejoinder testimony on September 23, 2005. The formal evidentiary hearing on the matter began on Monday, October 3, 2005, at the ACC's offices at 1200 W. Washington Street in Phoenix, and concluded on Tuesday, October 11, 2005, at 4:30 p.m. During the hearing, RUCO's witnesses were cross-examined by the president of the Arizona Utility Investors Association, attorneys representing SWG, and ACC Staff. Both of RUCO's attorneys cross-examined witnesses for the Company and ACC Staff. Initial closing and reply briefs from the parties to the case were filed on November 4, 2005, and November 14, 2005, respectively.

On January 24, 2006, the presiding Administrative Law Judge ("ALJ") issued his Recommended Opinion and Order ("ROO"). A comparison of the Company and RUCO's recommendations are as follows:

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY RCND	(C) COMPANY FAIR VALUE	(D) RUCO ORIGINAL COST	(E) RUCO RCND	(F) RUCO FAIR VALUE
1	Adjusted Rate Base	\$ 925,212,447	\$ 1,417,642,156	\$ 1,171,427,301	\$ 918,447,207	\$ 1,409,374,691	\$ 1,163,910,949
2	Adjusted Operating Income (Loss)	\$ 44,233,345	\$ 44,233,345	\$ 44,233,345	\$ 50,445,135	\$ 50,445,135	\$ 50,445,135
3	Current Rate Of Return (Line 2 / Line 1)	4.78%	3.12%	3.78%	5.49%	3.58%	4.33%
4	Required Operating Income (Line 5 X Line 1)	\$ 86,957,942	\$ 86,957,942	\$ 86,957,942	\$ 79,378,637	\$ 79,378,637	\$ 79,378,637
5	Required Rate Of Return	9.40%	6.13%	7.42%	8.64%	5.63%	6.82%
6	Operating Income Deficiency (Line 4 - Line 2)			\$ 42,724,598	\$ 28,933,501		\$ 28,933,501
7	Gross Revenue Conversion Factor (Schedule RLM-1, Page 2)			1.6573			1.6573
8	Increase In Gross Revenue Requirement (Line 7 X Line 6)			\$ 70,809,128			\$ 47,952,611
9	Adjusted Test Year Revenue			\$ 322,865,978			\$ 322,865,978
10	Proposed Annual Revenue Requirement (Line 8 + Line 9)			\$ 393,675,106			\$ 370,818,589
11	Required Percentage Increase In Revenue (Line 8 / Line 9)			21.93%			14.85%
12	Rate Of Return On Common Equity			11.95%			10.15%

Exceptions to the ROO were filed on February 7, 2006, by Southwest Gas, ACC Staff, Arizona Utility Investors Association, Southwest Energy Efficiency Project and the Natural Resources Defense Council. During the regular ACC Open Meeting held at 1:00 p.m. on Wednesday, February 15, 2006, the Commissioners adopted an ACC Hearing Division amendment that made minor corrections to the ROO. After three hours of discussion on exceptions dealing with the ALJ's recommendations on cost of common equity, demand side management programs, the denial of the Company-proposed conservation margin tracker mechanism, and several operating expense adjustments, the Commissioners voted to adopt the amended ROO by a vote of 5-0.

Qwest Price Cap Plan – Docket Nos. T-01051B-03-0454 and T-00000D-00-0672

In Decision No. 63487 dated March 30, 2001, the Commission approved, with modifications, a Settlement Agreement resolving an application for a rate increase filed by Qwest Corporation ("Qwest" or the "Company"). The Settlement Agreement included a Price Cap Plan as an alternative to traditional rate of return regulation. The Price Cap Plan allows Qwest to adjust prices for various services within certain limitations. The price for basic residential service can be adjusted downward, but not upward. Prices for certain services for which competitive alternatives exist are permitted to adjust upward or downward, within certain boundaries. The initial term of the Price Cap Plan is three years, and the Plan required Qwest to file any proposal to renew the Plan, and any requested modifications thereto, at least nine months prior to its expiration. Qwest's application in this docket is its proposal to renew the plan with certain modifications.

RUCO analyzed Qwest's application to determine what modifications to the plan the Company is seeking, and the impacts of those modifications on customers. After an abbreviated discovery period, RUCO filed its direct testimony on November 18, 2004. A comparison of the proposed increases in revenue by Qwest and RUCO are as follows:

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY ORIGINAL COST</u>	<u>RUCO ORIGINAL COST</u>
1	ADJUSTED RATE BASE	\$1,643,000	\$1,489,135
2	ADJUSTED OPERATING INCOME	(5,054)	35,579
3	CURRENT RATE OF RETURN (L2 / L1)	-0.31%	2.39%
4	REQUIRED RATE OF RETURN	11.18%	8.73%
5	REQUIRED OPERATING INCOME (L4 * L1)	183,687	130,001
6	OPERATING INCOME DE(SUF)ICIENCY (L5 - L2)	188,741	94,423
7	GROSS REVENUE CONVERSION FACTOR	<u>1.6876</u>	<u>1.6896</u>
8	GROSS REVENUE INCREASE	<u>\$ 318,525</u>	<u>\$ 159,537</u>
9	CURRENT REVENUES T/Y ADJUSTED	\$1,111,068	\$1,165,053
10	PROPOSED ANNUAL REVENUE (L8 + L9)	\$1,429,593	\$1,324,590
11	PERCENTAGE AVERAGE INCREASE	28.67%	13.69%

Qwest filed rebuttal testimony on December 20, 2004. RUCO's surrebuttal testimony was filed on January 12, 2005. The Company filed its rejoinder testimony (the final round of written testimony in the case) on January 27, 2005.

On Wednesday afternoon, February 2, 2005, Qwest filed a motion with the ACC's Hearing Division requesting that the proceeding be suspended so that the Company could conduct settlement negotiations with ACC Staff, RUCO and all other interested parties. Despite objections from several intervenors, Qwest's motion was granted by the Administrative Law Judge ("ALJ") assigned to the case during a pre-hearing conference that was conducted on Thursday, February 3, 2005. The first settlement meeting was held a week later on Thursday, February 10, 2005 (the date that the evidentiary hearing on Qwest's filing was originally scheduled for).

After meeting with representatives from Qwest, ACC Staff and other interested parties over a period of several weeks, RUCO withdrew from the settlement discussions having reached an impasse on several key issues. RUCO did, however, continue to monitor the progress of the negotiations. On August 23, 2005, the Commission's Chief Counsel filed a signed Settlement Agreement ("Agreement") that had been reached between ACC Staff, Qwest, Cox Arizona Telecom, LLC, the Department of Defense (and all other Federal Executive Agencies), the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Investors Utility Association, and XO Communications Services, Inc.

On August 26, 2005, the ACC's Hearing Division issued a Procedural Order laying out the schedule for an evidentiary hearing on the Agreement. The hearing was held on November 1-3, 2006. Throughout the hearing, RUCO argued against the adoption of the Agreement on the ground that it was not in the public interest for several reasons. Most importantly, RUCO believed that the Agreement did not recognize the varying degrees of competition that Qwest faces in its wire centers throughout Arizona (geographic pricing). The Administrative Law Judge issued her Recommended Opinion and Order wherein she recommended the Commission adopt the Agreement.

The matter was scheduled for Open Meeting and the Commission issued its decision on March 23, 2006. The Commission adopted the Agreement at the Open Meeting. The Commission noted that this case was not the case to determine the issues associated with geographic pricing. RUCO was instrumental in bringing the geographic pricing issue to the forefront and assuring its consideration in another docket before the Commission. RUCO was also effective in the negotiation process and several of RUCO's recommendations were ultimately a part of the final Agreement adopted by the Commission.

Arizona Public Service Company – Emergency Interim Rate Increase – Docket No. E-01345A-06-0009

On January 6, 2006, Arizona Public Service Company ("APS" or "Company") filed an application with the Arizona Corporation Commission ("ACC" or "Commission") for an emergency interim rate increase and for an interim amendment to Decision No. 67744, dated April 7, 2005. APS sought an interim increase of \$299 million (14 percent) over the Company's base rates, which were authorized in Decision No. 67744. APS indicated that the increase represented the higher fuel and purchased power costs that it expected to incur in 2006. APS also requested that the \$776 million cap on its Power Supply Adjustor ("PSA") be removed. APS claimed that its bond rating had recently been downgraded to one step above junk status, and that a further downgrade to junk bond status was imminent if interim relief was not granted.

On February 2, 2006, the Commission issued Decision No. 68437 related to APS' earlier application to implement a PSA surcharge. The Commission declined to implement a surcharge, but did accelerate the implementation date for the PSA's annual adjustor, from April 1 to February 1, permitting APS to begin collecting approximately \$112 million over the next 12 months.

When RUCO filed its testimony in the emergency proceeding on February 28, 2006, it opposed an implementation of interim rates. RUCO indicated that, because of the Commission's positive action in Decision No. 68437, a downgrade of APS' bond rating was not imminent, and thus APS did not meet the criteria for an emergency.

In its rebuttal testimony APS modified its request to seek a new base cost of fuel, which would result in \$232 million of increased revenue. The revised request was based on a decrease in fuel prices since the application was initially filed.

The Commission held an eight-day hearing beginning on Monday, March 20, 2006. On May 5, 2006, the Commission issued Decision No. 68685. In that Decision, the Commission declined to find that an emergency existed justifying an interim rate increase, but concluded that some action should be taken to permit more timely recovery of APS' fuel and purchased power costs. The Commission therefore authorized an interim PSA adjustor for fuel and purchased power costs incurred in 2006, to be effective on May 1, 2006.

Agua Fria Water District - Application 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 Step One Arsenic Cost Recovery Mechanism ("ACRM"), ACC Docket No. WS-01303A-06-0403

On April 15, 2006, Arizona-American Water Company submitted its Step-One ACRM filing for its Agua Fria Water District. This filing supports a Step-One ACRM surcharge of \$1.41 to the monthly minimum charge and \$0.1647 per 1000 gallons to the commodity rate. The average residential bill impact will be \$2.81 per month.

The Company's proposed ACRM is patterned after the ACRM approved by the Commission in Arizona Water Company's Northern Division case. See Decision No. 66400. The ACRM is a step increase mechanism designed to recover the Company's incremental investment in arsenic treatment plant, depreciation, return, and O&M costs associated with media replacement/regeneration/waste disposal.

On May 8, 2006, the Residential Utility Consumer Office ("RUCO") filed a report of its audit findings on the application. RUCO proposed an adjustment of \$180,723 in allocated overhead costs. RUCO's proposed adjustment disallows plant balances amounts related to an allocation of overhead costs that cannot be directly identified with a specific task order related to the arsenic plant.

On June 2, 2006, RUCO filed a revised report recommending a surcharge of \$1.37 to the monthly charge and \$0.1598 per 1,000 gallons to the commodity rate.

On June 29, 2006, pursuant to discussions held during the Open Meeting the Arizona Corporation Commission ("Commission") approved in Decision No. 68825 Agua Fria's ACRM surcharge as amended by RUCO and agreed to by Staff.

Conclusion

RUCO intervened in the proceeding to insure that ratepayers would not be adversely affected by the implementation of the proposed ACRM.

The Commission and Staff approved the ACRM as recommended by RUCO and subject to all of the terms and conditions of the ACRM that was approved for Arizona Water Company in Decision No. 66400.



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APPENDIX

COMMONLY-USED ACRONYMS AND TERMS

The following terms are used throughout the case summaries:

ACC – Arizona Corporation Commission
ACRM – arsenic cost recovery mechanism
ADOR - Arizona Department of Revenue
ALJ – Administrative Law Judge
APS – Arizona Public Service Company
BMSC – Black Mountain Sewer
CALJ - Chief Administrative Law Judge
CAP - Central Arizona Project
CMT - conservation margin tracker
Commission – Arizona Corporation Commission
DSM – demand-side management
GCSC – Gold Canyon Sewer Company
PPAM – purchased pumping power adjustor mechanism
PS – public safety
PSA - power supply adjustor
PWAM – purchased water pumping power
RCND – reconstruction cost new depreciated
ROO - Recommended Opinion and Order
RUCO – Residential Utility Consumer Office
Staff – ACC Utilities Division Staff
SWG - Southwest Gas Company
TEP – Tucson Electric Power Company

THE RESIDENTIAL UTILITY CONSUMER OFFICE (RUCO) IS AN EQUAL OPPORTUNITY, REASONABLE ACCOMMODATION EMPLOYER.