BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

JUL 20 2005

IN THE MATTER OF THE APPLICATION OF FOREST HIGHLANDS WATER COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. W-02493A-04-0701 DECISION NO. 67983 **OPINION AND ORDER**

DATE OF HEARING:	April 21, 2005
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Wolfe
APPEARANCES:	Mr. Todd C. Wiley, GALLAGHER & KENNEDY, P.A., on behalf of Forest Highlands Water Company; and Mr. David Ronald, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

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Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. Forest Highlands Water Company ("Forest Highlands" or "Company") is an Arizona public service corporation engaged in the provision of water utility service to approximately 663 residential and commercial customers in the Forest Highlands subdivision located south of the City of Flagstaff in Coconino County, Arizona.

2. Forest Highlands is owned by the Forest Highlands Association, a homeowners' association. Commission Decision No. 55903 (March 9, 1988) granted Forest Highlands a Certificate of Convenience and Necessity and approved the rates the Company is currently charging.

3. Commission Decision No. 57715 (February 20, 1992) retained the Company's original rates and charges.

4. On September 27, 2004, Forest Highlands filed the above-captioned rate application with the Commission.

5. On October 26, 2004, the Commission's Utilities Division Staff ("Staff") filed a letter informing the Company that its application had not met the sufficiency requirements of the Commission's rules.

6. On October 26, 2004 and November 12, 2004, Forest Highlands filed amendments to the September 27, 2004 rate application.

7. On November 17, 2004, Staff filed a letter indicating the Company's rate application was sufficient, and classifying the Company as a Class C utility.

8. By Procedural Order issued November 18, 2004, a hearing date and associated procedural deadlines were set on the application.

9. On February 15, 2005, the Company filed Certification of Publication and Mailing certifying that the public notice requirements set forth in the November 18, 2004 Procedural Order had been met.

10. On April 1, 2005, in accordance with the schedule set forth in the November 18, 2004 Procedural Order, Staff filed its direct testimony.

11. Included in Staff's direct testimony was a recommendation that any rate increase approved by the Commission become effective upon proof that the Company's water system is in compliance with Arizona Department of Environmental Quality ("ADEQ")'s drinking water quality standards and that any major deficiencies are corrected.

12. On April 13, 2005, also in accordance with the schedule set forth in the November 18, 2004 Procedural Order, the Company filed its Response to Staff's testimony ("Response"). Attached to the Response was an April 12, 2005 ADEQ Drinking Water Compliance Status Report indicating that ADEQ has determined that the Forest Highlands system is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4, and that the system has no major deficiencies. Forest Highlands requested in the Response that since its

system meets ADEQ's drinking water quality standards and any major deficiencies have been corrected, that its requested rate increase be approved by the Commission to be effective as soon as possible.

13. The hearing on the application was held on April 21, 2005. No members of the public appeared to make public comment.

14. At the hearing, the Company presented a witness who testified that although there were some issues on which the Company and Staff differed that the Company stipulates to and agrees to the recommendations set forth in the Staff testimony.

15. Staff presented a witness at the hearing who testified that based on the ADEQ documentation attached to the Company's Response, the Company is in total compliance with ADEQ requirements with no major deficiencies, and that it is therefore not necessary to delay the effective date of new rates for the Company.

16. The Company's reported test year ended December 31, 2003 results, as filed, show test year revenue of $383,776 and expenses of $494,441 for an operating loss of ($110,665). Staff's adjusted test year results show revenues of $383,776 and expenses of $492,025 for an operating loss of ($108,249).

17. In its application, the Company proposed a revenue requirement of $564,709, for an increase of $180,933, or 47.15 percent, over adjusted test year revenues of $383,776. The Company's proposal would result in an operating income of $70,268, for a 9.00 percent rate of return on an OCRB of $780,753.

18. Staff recommends rates that increase the adjusted test year revenues from $383,776 to $570,813, for an increase of $187,037 or 48.73 percent. Staff's proposal would result in an operating income of $78,787, for an 8.10 percent rate of return on an OCRB of $972,672.

19. Forest Highlands' present and proposed rates, and the rates proposed by Staff, are as follows:

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	Present Rates	Proposed Rates Company	Staff
MONTHLY USAGE CHARGE:			
5/8" x ¾" Meter	$ 20.00	N/A	$ 20.00
¾" Meter	25.00	35.00	35.00
1" Meter	50.00	70.00	70.00
1 ½" Meter	100.00	140.00	140.00
2" Meter	160.00	224.00	224.00
3" Meter	300.00	420.00	420.00
4" Meter	500.00	700.00	700.00
5" Meter	700.00	980.00	980.00
6" Meter	1,000.00	1,400.00	1,400.00
Commodity Rate – per 1,000 Gallons			
5/8 x ¾-inch Meter			
0-6,000 Gallons	$2.00	$2.50	$2.50
6,001-15,000 Gallons	2.00	3.20	3.20
15,001-25,000 Gallons	2.00	4.00	-
Over 15,000 Gallons	2.00	-	4.50
Over 25,000 Gallons	2.00	5.00	-
¾-inch Meter			
0-6,000 Gallons	$2.00	$2.50	$2.50
6,001-15,000 Gallons	2.00	3.20	3.20
15,001-25,000 Gallons	2.00	4.00	-
Over 15,000 Gallons	2.00	-	4.50
Over 25,000 Gallons	2.00	5.00	-
1-inch Meter			
0-14,000 Gallons	$2.00	$2.50	$2.50
14,001-50,000 Gallons	2.00	3.20	3.20
Over 50,000 Gallons	2.00	4.00	4.50
1 ½ -inch Meter			
0-50,000 Gallons	$2.00	$2.50	$2.50
50,001-150,000 Gallons	2.00	3.20	3.20
Over 150,000 Gallons	2.00	4.00	4.50
2 -inch Meter – Commercial			
0-100,000 Gallons	$2.00	$2.50	$2.50
100,001-175,000 Gallons	2.00	3.20	3.20
Over 175,000 Gallons	2.00	4.00	4.50
2 -inch Meter - Irrigation			
0-1,500,000 Gallons	$1.75	$2.50	$2.50
1,500,001-3,000,000 Gallons	1.75	3.20	3.20
Over 3,000,000 Gallons	1.75	4.00	4.50

3 -inch Meter – Irrigation			
0-1,500,000 Gallons	$1.75	$2.50	$2.50
1,500,001-3,000,000 Gallons	1.75	3.20	3.20
Over 3,000,000 Gallons	1.75	4.00	4.50
4 -inch Meter – Irrigation			
0-1,500,000 Gallons	$1.75	2.50	$2.50
1,500,001-3,000,000 Gallons	1.75	3.20	3.20
Over 3,000,000 Gallons	1.75	4.00	4.50
5-inch Meter – Irrigation			
0-1,500,000 Gallons	$1.75	$2.50	$2.50
1,500,001-4,500,000 Gallons	1.75	3.20	3.20
Over 4,500,000 Gallons	1.75	4.00	4.50
6 -inch Meter – Irrigation			
0-1,500,000 Gallons	$1.75	$2.50	$2.50
1,500,001-4,500,000 Gallons	1.75	3.20	3.20
Over 4,500,000 Gallons	1.75	4.00	4.50
Standpipe	$3.00	$5.00	$5.00

SERVICE LINE AND METER INSTALLATION CHARGES:
(Refundable pursuant to A.A.C. R14-2-405)

5/8" x ¾" Meter	$ 225.00	$ 475.00	$ 475.00
¾" Meter	270.00	550.00	550.00
1" Meter	300.00	650.00	650.00
1 ½" Meter	425.00	900.00	900.00
2" Meter	550.00	1,550.00	1,550.00
3" Turbine Meter	750.00	2,200.00	2,200.00
4" Turbine Meter	1,375.00	3,400.00	3,400.00
5" Turbine Meter	2,138.00	4,800.00	4,800.00
6" Turbine Meter	2,900.00	6,200.00	6,200.00

SERVICE CHARGES:

Establishment of Service:			
Regular Hours	$25.00	$25.00	$25.00
After Hours	50.00	50.00	50.00
Re-establishment of service within 12 months:	*	*	*
Reconnection of Service:			
Regular Hours	$25.00	$50.00	$50.00
After Hours		75.00	75.00
Water Meter Test (If Correct)	$20.00	Cost	Cost

Water Meter relocation as Customer Request	-	***	***
Meter Re-Read (If Correct)	$10.00	$10.00	$10.00
NSF Check Charge	10.00	25.00	25.00
Late Fee Charge		1.5% Per Month	1.5% Per Month
Deferred Payment Finance Charge	1% Per Month	1.5% Per Month	1.5% Per Month
Service Call – Regular Hours	-	-	-
Service Call – After Hours	-	$50.00	50.00
Deposit Requirements	**	**	**
Deposit Interest	**	**	**
Water Wheeling Charge – Per Month	$500.00	$675.00	$675.00

* Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).

** Per Commission rule A.A.C. R14-2-403(B).

*** Cost, to include materials, labor and overhead.

20. In the application, the Company proposed an Original Cost Rate Base ("OCRB") of $780,753. By contrast, Staff proposes an OCRB of $972,672. Staff's recommended increase to the Company's OCRB as filed is the result of a net $1,193,459 adjustment to the Company's Accumulated Depreciation account and its Contributions in Aid of Construction ("CIAC") accumulated amortization account to correct for the Company's erroneous use of depreciation rates different from the Commission-authorized 2.50 percent composite depreciation rate, combined with proposed adjustments reducing gross utility plant in service by $173,873. Staff's $173,873 adjustment removes $84,893 of plant retirements the Company did not report in its application and $88,980 comprised of several plant items that the Company had double-counted as plant additions.

21. Staff's adjustments to rate base are reasonable and will be adopted. The Company's OCRB is $972,672. The Company did not file reconstruction cost new less depreciation ("RCND") rate base schedules. Therefore, its fair value rate base ("FVRB") is the same as its OCRB.

22. Staff recommended a reduction to purchased power and water expense of $12,142 to reflect Staff's recommendation to eliminate non-recurring test year purchased water expense. Staff also recommended a $1,285 increase to Operating Expenses to reflect water testing expenses consistent with ADEQ's Monitoring Assistance Program costs. Finally, Staff recommended an increase of $8,441 to Operating Expenses to correct for errors in the Company's calculation of test year depreciation expense.

23. Staff's adjustments to test year Operating Expenses are reasonable and will be adopted, for total test year Operating Expenses of $492,025.

24. With adjusted test year Operating Revenues of $383,776 and adjusted test year Operating Expenses of $492,025, the Company's adjusted test year Operating Income was ($108,249).

25. In its application, Forest Highlands proposed a capital structure consisting of 100 percent equity, and proposed an overall rate of return of 9.0 percent. Staff also proposes a capital structure consisting of 100 percent equity and recommends an 8.1 percent rate of return, based on Staff's cost of equity estimates that range from 7.6 percent to 8.5 percent. In coming to its weighted average cost of capital recommendation, Staff employed a cost of capital analysis consistent with its approach in recent cases, using a capital asset pricing model ("CAPM"), a constant-growth discounted cash flow ("DCF") model, and a multi-stage growth DCF model. Staff's recommended cost of capital is fair and reasonable and we will adopt it.

26. Because the Company's OCRB is the same as its FVRB, the 8.1 percent cost of capital translates into an 8.1 percent fair value rate of return on FVRB of $972,672 as authorized hereinabove. Multiplying the 8.1 percent rate of return by the FVRB produces required operating income of $78,787. This is $187,037 more than the Company's test year adjusted operating loss of ($108,249). Multiplying the deficiency by the gross revenue conversion factor of 1.0 results in an increase in revenues of $187,037, for a revenue requirement of $570,813, a 48.74 percent increase over test year adjusted operating losses.

27. During the test year, the majority of Forest Highlands' approximately 663 metered customers were served by ¾-inch meters.

28. Average and median usage on ¾-inch meters during the test year was 4,038 and 1,313 gallons per month, respectively.

29. The Company's proposed rate schedule would increase the average monthly ¾-inch customer bill by 36.3 percent, from $33.08 to $45.09, and the median monthly ¾-inch customer bill by 38.6 percent, from $27.63 to $38.28.

30. Staff's proposed rate schedule would also increase the average monthly ¾-inch

customer bill by 36.3 percent, from $33.08 to $45.09, and would also increase the median monthly ¾-inch customer bill by 38.6 percent, from $27.63 to $38.28.

31. Staff recommends approval of the Company's proposal to reconfigure its single commodity rate structure to a multi-tiered commodity rate structure. Staff concurs with the Company's assertion that its proposed multi-tiered commodity rate structure will engender conservation and result in a better allocation of costs to customers with higher demand on its system. We also agree, and will adopt the three-tiered rate design as proposed by Staff.

32. The rates and charges proposed by Staff and agreed to by the Company are reasonable and we will adopt them.

33. Staff recommends that the Company be required to conduct a lead-lag study in future rate filings in lieu of utilizing the formula method for determining cash working capital requirements. This is a reasonable recommendation and we will adopt it.

34. The Company has no outstanding compliance issues with the Commission. The Commission's Consumer Service Section reviewed the Company's records and determined that no complaints have been made against the Company in the last three years.

35. The Company is in good standing with the Corporations Division.

36. The Company's water system is in compliance with ADEQ requirements.

37. The Company is not located in any Arizona Department of Water Resources ("ADWR") Active Management Area and is not subject to ADWR monitoring and reporting requirements.

38. Staff's Engineering Section reports that the Company's most recent lab analysis indicates that the arsenic levels in the wells used by the Company are between 2.5 micrograms per liter ("µg/l") and 6 µg/l, which are below the new federal maximum contaminant level ("MCL") of 10 µg/l that becomes effective January 23, 2006.

39. The Company has had an approved Curtailment Tariff in effect since October 26, 2004.

40. Staff recommends that in order to assure that an adequate source of water will be available to Forest Highlands' customers in the future, the Company be required to file, by December

31, 2005, a long term water use agreement with its parent Forest Highlands Association that demonstrates that the Company will have available for its use an adequate supply of water to meet its long term customer needs from the wells owned by Forest Highlands Association. At the hearing, the Company agreed to comply with this recommendation. This is a reasonable recommendation and we will adopt it.

CONCLUSIONS OF LAW

1. Forest Highlands is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. § 40-250 and 40-251.

2. The Commission has jurisdiction over Forest Highlands and the subject matter of the application.

3. Notice of the application was provided in the manner prescribed by law.

4. The rates and charges authorized herein and just and reasonable.

ORDER

IT IS THEREFORE ORDERED that Forest Highlands Water Company is hereby directed to file on or before July 29, 2005, revised rate schedules setting forth the following rates and charges:

MONTHLY USAGE CHARGES:

5/8" x ¾" Meter	$ 20.00
¾" Meter	35.00
1" Meter	70.00
1 ½" Meter	140.00
2" Meter	224.00
3" Meter	420.00
4" Meter	700.00
5" Meter	980.00
6" Meter	1,400.00

Commodity Rate – per 1,000 Gallons

5/8 x ¾-inch Meter	
0-6,000 Gallons	$2.50
6,001-15,000 Gallons	3.20
Over 15,000 Gallons	4.50

¾-inch Meter	
0-6,000 Gallons	$2.50
6,001-15,000 Gallons	3.20
Over 15,000 Gallons	4.50
1-inch Meter	
0-14,000 Gallons	$2.50
14,001-50,000 Gallons	3.20
Over 50,000 Gallons	4.50
1 ½ -inch Meter	
0-50,000 Gallons	$2.50
50,001-150,000 Gallons	3.20
Over 150,000 Gallons	4.50
2 -inch Meter – Commercial	
0-100,000 Gallons	$2.50
100,001-175,000 Gallons	3.20
Over 175,000 Gallons	4.50
2 -inch Meter - Irrigation	
0-1,500,000 Gallons	$2.50
1,500,001-3,000,000 Gallons	3.20
Over 3,000,000 Gallons	4.50
3 -inch Meter – Irrigation	
0-1,500,000 Gallons	$2.50
1,500,001-3,000,000 Gallons	3.20
Over 3,000,000 Gallons	4.50
4 -inch Meter – Irrigation	
0-1,500,000 Gallons	$2.50
1,500,001-3,000,000 Gallons	3.20
Over 3,000,000 Gallons	4.50
5-inch Meter – Irrigation	
0-1,500,000 Gallons	$2.50
1,500,001-4,500,000 Gallons	3.20
Over 4,500,000 Gallons	4.50
6 -inch Meter – Irrigation	
0-1,500,000 Gallons	$2.50
1,500,001-4,500,000 Gallons	3.20
Over 4,500,000 Gallons	4.50
Standpipe	$5.00

SERVICE LINE AND METER INSTALLATION CHARGES:
(Refundable pursuant to A.A.C. R14-2-405)

5/8" x ¾" Meter	$ 475.00
¾" Meter	550.00
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3" Turbine Meter	2,200.00
4" Turbine Meter	3,400.00
5" Turbine Meter	4,800.00
6" Turbine Meter	6,200.00

SERVICE CHARGES:

Establishment of Service:	
Regular Hours	$25.00
After Hours	50.00
Re-establishment of service within 12 months:	*
Reconnection of Service:	
Regular Hours	$50.00
After Hours	75.00
Water Meter Test (If Correct)	Cost
Water Meter relocation as Customer Request	***
Meter Re-Read (If Correct)	$10.00
NSF Check Charge	25.00
Late Fee Charge	1.5% Per Month
Deferred Payment Finance Charge	1.5% Per Month
Service Call – Regular Hours	-
Service Call – After Hours	50.00
Deposit Requirements	**
Deposit Interest	**
Water Wheeling Charge – Per Month	$675.00

* Months off system times the monthly minimum per Commission rule A.A.C. R14-2-403(D).
** Per Commission rule A.A.C. R14-2-403(B).
*** Cost, to include materials, labor and overhead.

IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service provided to customers on and after August 1, 2005.

IT IS FURTHER ORDERED that Forest Highlands Water Company shall notify its

customers of the rates and charges authorized herein and the effective date of same by means of an insert in its next regular monthly billing, which insert shall have been reviewed and approved by the Commission's Utilities Division Staff, and shall file a copy of the notice with the Commission's Docket Control Center within 60 days.

IT IS FURTHER ORDERED that Forest Highlands Water Company shall conduct a lead-lag study in future rate filings in lieu of utilizing the formula method for determining cash working capital requirements.

IT IS FURTHER ORDERED that Forest Highlands Water Company shall use the individual depreciation rates as shown in Attachment 6 to hearing Exhibit S-3.

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IT IS FURTHER ORDERED that in order to assure that an adequate source of water will be available to its customers in the future, Forest Highlands Water Company shall file in this docket as a compliance item, by December 31, 2005, a long term water use agreement with its parent Forest Highlands Association that demonstrates that the Company will have available for its use an adequate supply of water to meet its long term customer needs from the wells owned by Forest Highlands Association.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 18th day of July, 2005.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

TW:dap

SERVICE LIST FOR: FOREST HIGHLANDS WATER COMPANY

DOCKET NO.: W-02493A-04-0701

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