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November 29, 2018

BY HAND DELIVERY
Commissioner Andy Tobin
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Re: Responses to Commissioner Tobin's November 27, 2018 Letter re Recovery on Freeport Investment in Ajo Improvement Company
Docket Nos. WS-01025A-17-0361, E-01025A-17-0362, WS-01025A-17-0363

Dear Commissioner Tobin:

You have asked Ajo Improvement Company (AIC) to clarify whether AIC's owner is accepting that the equity infusion into AIC that allowed AIC to construct necessary infrastructure upgrades as sunk cost or whether it plans to recover on or subsidize its investments by some other means.

AIC has an obligation as a public service company to provide safe and reliable service to its customers. AIC's parent has provided necessary paid in capital to allow AIC to upgrade its utility service infrastructure to be able to continue to provide safe and reliable service. These necessary upgrades, however, were extensive. For example, AIC effectively was required to completely rebuild its water distribution and wastewater collection systems due to changes in the applicable construction codes since those systems were initially constructed. AIC also had to build a new water treatment plant to meet recent federal arsenic and fluoride MCLs. All of that plant is used and useful and allows AIC to continue to meet its obligation to provide safe and reliable service. The construction of the new plant involved significant cost. This situation is unusual in that the operating utility has a parent that was able and willing to provide the significant necessary capital for needed improvements.

As you have noted, AIC's pre-filed testimony indicates that AIC's parent was aware that it was not likely to be able to earn any significant return on the large equity infusion into AIC for the infrastructure upgrades. And in the current rate case, AIC is not seeking a rate of return on its rate base in order to mitigate impact on its customers. However, much of the new plant has long anticipated operational lives (50 years) and a future AIC rate case may seek a return on the rate base. The large capital infusion is not necessarily a wholly sunk cost.

At this point, AIC is not covering its expenses and is not generating any profit for its parent. Under the revenue requirement and the phase-in periods proposed by Staff and AIC, AIC will not be covering its expenses for another 4 to 6 years after a decision in this rate case. AIC also will not be recovering its lost revenues during the phase-in. Therefore, AIC and its parent will continue to subsidize utility service to its customers for several years, just as they have been doing for many years.

Respectfully,

Michael W. Patten
Counsel for Ajo Improvement Company

Original and 13 copies filed with Docket Control

cc: Commissioners
Judge Martin
Parties of Record

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