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AZ CORP COMMISSION
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1 CARL J. KUNASEK
CHAIRMAN
2 JIM IRVIN
COMMISSIONER
3 WILLIAM A. MUNDELL
COMMISSIONER

4 **BEFORE THE ARIZONA CORPORATION COMMISSION**

5
6 IN THE MATTER OF THE JOINT
APPLICATION OF CITIZENS UTILITIES
7 COMPANY; AGUA FRIA WATER
DIVISION OF CITIZENS UTILITIES
8 COMPANY; MOHAVE WATER DIVISION
OF CITIZENS UTILITIES COMPANY;
9 SUN CITY WATER COMPANY; SUN
CITY SEWER COMPANY; SUN CITY
10 WEST UTILITIES COMPANY; CITIZENS
WATER SERVICES COMPANY OF
ARIZONA; CITIZENS WATER
11 RESOURCES COMPANY OF ARIZONA;
HAVASU WATER COMPANY AND
12 TUBAC VALLEY WATER COMPANY,
INC., FOR APPROVAL OF THE
13 TRANSFER OF THEIR WATER AND
WASTEWATER UTILITY ASSETS AND
14 THE TRANSFER OF THEIR
CERTIFICATES OF PUBLIC
15 CONVENIENCE AND NECESSITY TO
ARIZONA-AMERICAN WATER
16 COMPANY AND FOR CERTAIN
RELATED APPROVALS.

DOCKET NOS. W-01032A-00- 0192
W-01032B-00- 0192
W-01032C-00- 0192
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W-02276A-00- 0192
WS-02334A-00- 0192
WS-03454A-00- 0192
WS-03455A-00- 0192
W-02013A-00- 0192
W-01595A-00- 0192
W-01303A-00- 0192

**JOINT APPLICATION FOR AUTHORITY
TO TRANSFER ASSETS AND RELATED
APPROVALS**

18 Pursuant to A.R.S. § 40-285, Citizens Utilities Company, a Delaware
19 corporation, together with its wholly-owned subsidiaries that provide water and
20 wastewater services within Arizona (collectively "Citizens"), and Arizona-American
21 Water Company (formerly Paradise Valley Water Company), an Arizona corporation
22 ("Az-Am"), hereby apply for an order authorizing the transfer of all water and
23 wastewater utility plant, property and other assets in Arizona and the transfer of all
24 related Certificates of Public Convenience and Necessity ("CC&Ns") by Citizens to
25 Az-Am, and for such related approvals as may be necessary for Az-Am to acquire
26

MISCELLANEOUS FILINGS

___ 04 AFFIDAVIT
___ 12 EXCEPTION
___ 18 REQUEST FOR INTERVENTION
___ 48 REQUEST FOR HEARING
___ 24 OPPOSITION
___ 50 COMPLIANCE ITEM FOR APPROVAL

___ 29 STIPULATION
___ 38 NOTICE OF INTENT
___ (Only notification of future action/no action necessary)
___ 43 PETITION
___ 46 NOTICE OF LIMITED APPEARANCE
___ 39 **OTHER**
Specify:

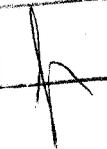
Print Name of Applicant/Company/contact person

Citizens Utilities Company, et al./Craig Marks, Carl J. Dabelstein

Arizona-American Water Company/Norman D. James, Fennemore Craig

Arizona Corporation Commission
DOCKETED

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1 such assets and to thereby obtain the right to furnish water and wastewater
2 services within the geographic areas covered by the CC&Ns. Such utility plant,
3 property, assets and the CC&Ns, and all rights related thereto, are collectively
4 referred to hereinafter as the "AZ Acquired Assets." In support of this application,
5 Citizens and Az-Am jointly state:

6 1. Citizens is a diversified public utility which, through its various
7 divisions and subsidiaries, provides telecommunications, electric, gas, water and
8 wastewater services to customers in 22 states, including Arizona. Under authority
9 of its CC&Ns issued by the Commission, Citizens currently provides water and
10 wastewater utility service through various operating divisions and subsidiaries to
11 approximately 110,000 customers (service connections) in Arizona. Attached at
12 Tab A is a schedule setting forth the Citizens operating divisions and subsidiaries
13 that collectively own the AZ Acquired Assets and with respect to which approval to
14 transfer the AZ Acquired Assets is sought herein.

15 2. Az-Am is an Arizona corporation presently engaged in providing water
16 for public purposes within portions of the Town of Paradise Valley, the City of
17 Scottsdale and certain unincorporated areas in Maricopa County, Arizona. Az-Am
18 is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW").
19 Az-Am holds a Certificate of Public Convenience and Necessity, which was first
20 granted in Decision No. 19729 (June 28, 1950).

21 3. Az-Am presently provides water utility service to approximately 4,600
22 customers (service connections) and has a service area population in excess of
23 10,000 persons. At this time, Az-Am is a "Class B" water utility, with annual
24 revenues from water sales between \$1,000,000 and \$5,000,000.

25 4. The name of the corporation was changed from Paradise Valley Water
26 Company to Arizona-American Water Company effective January 1, 2000. The

1 change was adopted by the sole shareholder and the Board of Directors of the
2 corporation on November 29, 1999 and approved by the State of Arizona pursuant
3 to provisions of A.R.S. § 10-1006 on November 30, 1999. Az-Am's Articles of
4 Incorporation were subsequently amended pursuant to provisions of A.R.S. § 10-
5 1006 and are attached to this Joint Application at Tab B.

6 5. Az-Am's local business office is located at 7500 East McDonald Drive,
7 Suite 200-A, Scottsdale, Arizona. Its mailing address is P. O. Box 158, Scottsdale,
8 Arizona, 85252, and its telephone number is (480) 948-5410.

9 6. Citizens, AWW, and Az-Am entered into an Asset Purchase Agreement
10 dated as of October 15, 1999 ("the Agreement"). A true copy of the Agreement
11 will be provided to the Utilities Division ("Staff") of the Arizona Corporation
12 Commission ("the Commission") pursuant to a confidentiality agreement made
13 between Citizens, Az-Am and Staff.¹ The Agreement sets forth the terms and
14 conditions for the sale and purchase of Citizens' rights, title, and interest in the AZ
15 Acquired Assets. Pursuant to the Agreement and upon satisfaction of the terms
16 and conditions stated therein, including approval by the Commission, Citizens will
17 convey at closing all of the AZ Acquired Assets to Az-Am. Specifically, the
18 Agreement provides that Az-Am will acquire good, valid, and marketable title free
19 and clear of any and all liens subject only to certain "permitted exceptions" per the
20 Agreement; acquire the associated contracts, rights, and business records; and will
21 assume and be responsible for performing the related public service obligations of
22 Citizens within the geographic areas covered by the CC&Ns. The background and
23 circumstances relating to the negotiation of the Agreement are summarized in the
24

25 ¹ Citizens is presently negotiating to sell its natural-gas utility properties. Disclosure of the
26 terms of the Agreement to potential purchasers could affect the ability of Citizens to
negotiate the best terms for such sales.

1 Direct Testimony of Joseph F. Harnett, Jr., attached hereto at Tab C and
2 incorporated herein by this reference. The purchase price is \$231,310,000,
3 including the assumption of \$10,635,000 of certain debt in the form of outstanding
4 Industrial Development Revenue Bonds ("IDRBs").

5 7. In order to complete the acquisition of Citizens' water and wastewater
6 assets, properties and associated rights, the debt and equity in Az-Am's capital
7 structure will be increased. Az-Am contemplates obtaining additional equity capital
8 from its parent company, AWW as well as debt financing in connection with this
9 transaction. Az-Am will file an application for authority to issue additional common
10 stock and to incur additional indebtedness pursuant to A.R.S. §§ 40-301 and 40-
11 302 within the next 30 days. The resulting capital structure will consolidate the
12 IDRBs being assumed by Az-Am as well as the current debt and equity structure of
13 Az-Am, and will be comparable to the capital structures of publicly traded water
14 utilities. This transaction will not impair Az-Am's financial status, prevent Az-Am
15 from obtaining capital on fair and reasonable terms, or impair Az-Am's ability to
16 provide water service to its existing customers.

17 8. Citizens and Az-Am submit that the approval of the transfer of the Az
18 Acquired Assets is in the public interest. AWW is the largest and most
19 geographically diverse investor-owned water utility enterprise in the United States.
20 AWW's utility subsidiaries currently provide utility service to approximately 10
21 million people through 2.5 million service connections in 22 states. The customers
22 of Citizens AZ will receive significant benefits as a result of the transaction, as
23 described below and in the attached pre-filed testimony.

24 9. AWW, through its wholly-owned subsidiary American Water Works
25 Service Company, Inc. ("Service Company"), provides a wide range of professional
26 services to its operating affiliates, including Az-Am. These services include

1 accounting, management, engineering, finance, water quality, personnel
2 administration and training, human resources, information systems, operations,
3 rates and revenues, cash management, risk management and public and customer
4 communications. As a subsidiary of AWW and because of its affiliation with the
5 Service Company, Az-Am will be able to take advantage of various operating
6 efficiencies, including:

- 7 • Operating efficiencies associated with the integration of management,
8 centralization of administrative functions and spreading consolidated
9 costs over a wide ratepayer base.
- 10 • Enhanced purchasing power resulting in overall lower costs.
- 11 • Enhanced managerial and technical skills by selecting and
12 implementing best management practices of each entity.
- 13 • Enhanced ability to fund increasing infrastructure needs driven by
14 aging plant, technology changes and increasingly rigorous water
15 quality and other regulations.
- 16 • Enhanced ability to enter into operations and maintenance ("O&M")
17 contracts, thereby improving efficient utilization of assets.
- 18 • Positioning the combined entity to be an active participant in
19 increasingly active water industry consolidation and to continue to
20 focus upon the water and wastewater industry.
- 21 • Enhanced ability of the combined entity to acquire small and/or
22 distressed water and wastewater companies.
- 23 • Enhanced ability, through its increased geographic diversity and its
24 large nationwide employee base of trained professionals, to respond to
25 natural disasters and other emergencies.

26

- 1 • Continued regulation of the operations of the combined entity by the
2 Commission.

3 These operating efficiencies and other benefits that customers and shareholders
4 can expect to realize from the combined operations of the two entities are
5 discussed in the Direct Testimony of Daniel L. Kelleher, attached hereto at Tab D
6 and incorporated herein by this reference.

7 10. Az-Am has developed a preliminary analysis and estimate of potential
8 synergies, cost reductions and avoided costs resulting from the transaction. This
9 analysis is discussed in the Direct Testimony of David P. Stephenson, attached
10 hereto as Tab E, and incorporated herein by this reference. As a practical matter,
11 however, the task of fully identifying and quantifying all efficiencies and other
12 savings is an ongoing effort.

13 11. Az-Am will operate the AZ Acquired Assets and furnish utility service
14 in accordance with all rules and orders issued by the Commission and in accordance
15 with the tariffs of Citizens in effect at the time of closing. Az-Am requests
16 authorization to continue to charge the rates and charges existing in the tariffs of
17 each Citizens operating division and subsidiary at the time of closing until such time
18 as Az-Am makes application for, and the Commission approves, changes in those
19 rates and charges.

20 12. In this Joint Application, Az-Am is not requesting that the Commission
21 establish the ratemaking treatment for the difference between the book value of the
22 properties purchased from Citizens and the purchase price paid. Az-Am requests
23 that such acquisition adjustment be considered at a later date in the context of a
24 general rate proceeding or similar proceeding, at which time more detailed financial
25 accounting, and integration information will be available. At that time, Az-Am will
26 be prepared to provide a more complete and updated analysis of the synergies and

1 other benefits that will accrue to customers as a result of the transaction. Az-Am
2 does request the issuance of an accounting order approving Az-Am's proposed 40-
3 year amortization period and use of a mortgage methodology for amortizing the
4 acquisition adjustment, as discussed in Mr. Stephenson's testimony.

5 13. Attached at Tab F in support of this Joint Application is a chart
6 showing the new organization of AWW's Western Region, including Az-Am, that
7 will result from this transaction.

8 14. Citizens will remain responsible for and agrees to satisfy all refund
9 obligations under outstanding main extension agreements, and similar agreements
10 under which funds or property have been advanced to Citizens in connection with
11 the extension of water or wastewater utility service. Az-Am will be responsible for
12 refunding, as may be required, all outstanding customer deposits.

13 15. The sale and transfer of the AZ Acquired Assets to Az-Am is being
14 undertaken pursuant to a plan of reorganization, under which Citizens intends to
15 sell and transfer all of its utility plant, property and other assets used or related to
16 the provision of water, wastewater, electric and natural gas services, and utilize the
17 proceeds thereof to concentrate its business activities and operations in the
18 telecommunications area. The instant transaction will not impair Citizens' financial
19 status, prevent Citizens from obtaining capital at fair and reasonable terms, or
20 otherwise impair Citizens' ability to provide utility service to its remaining
21 customers.

22 16. Citizens will notify its Arizona customers of this Joint Application by a
23 bill insert, and will file an affidavit confirming that notice has been provided as soon
24 as the mailing has been completed.

25 17. Citizens and Az-Am respectfully request that this matter be considered
26 by the Commission at the earliest convenient date. Early Commission action will

1 minimize uncertainty for employees and customers, and help to ensure a smooth
2 transition in operations.

3 18. All communications regarding this Joint Application should be
4 addressed to the following representatives of Citizens and Az-Am:

5 **For Citizens:**

6 Carl J. Dabelstein
7 Vice President - Regulatory
8 Citizens Utilities Company
9 2901 North Central
10 Suite 1660
11 Phoenix, Arizona 85012
12 Telephone: (602) 532-4424
13 Facsimile: (602) 265-3415

14 Craig A. Marks, Esq.
15 Associate General Counsel
16 Citizens Utilities Company
17 2901 North Central
18 Suite 1660
19 Phoenix, Arizona 85012
20 Telephone: (602) 532-4433
21 Facsimile: (602) 265-3415

22 **For Az-Am:**

23 American Water Works Service Co., Inc.
24 1025 Laurel Oak Road
25 P. O. Box 1770
26 Voorhees, New Jersey 08043
Attn: Paul Foran, Esq.
Vice President Regulatory Affairs
Telephone: (856) 346-8371
Facsimile: (856) 346-8229

Arizona-American Water Company
880 Kuhn Drive
Chula Vista California 91914
Attn: Jan S. Driscoll, Esq.
Corporate Counsel
and
David P. Stephenson
Assistant Treasurer
Telephone: (619) 656-2400
Facsimile: (619) 656-2406

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Norman D. James
Fennemore Craig
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Telephone: (602) 916-5000
Facsimile: (602) 916-5546

THEREFORE, Citizens and Az-Am respectfully request that the Commission promptly consider this Joint Application and issue an order granting the following relief:

A. Approving the transfer of all of Citizens' water and wastewater utility plant, property and other assets within Arizona that are used or necessary for the provision of water and wastewater utility service, together with Citizens' CC&Ns, to Az-Am;

B. Authorizing Az-Am to continue to charge the rates and charges for water and wastewater utility service set forth in the filed tariffs of Citizens at the time of closing and until such time that such rates and charges are duly changed by order of the Commission, upon application by Az-Am;

C. Authorizing Az-Am to amortize the acquisition adjustment account balance over a 40-year period and to utilize a mortgage method rather than a straight-line method of amortization.

D. Granting such other and further approvals as may be required for Citizens and its subsidiaries to sell, transfer and convey to Az-Am, and for Az-Am to acquire title to, such water and wastewater plant and other assets in Arizona, and to allow Az-Am to provide water and wastewater utility service as described hereinabove.

1 RESPECTFULLY SUBMITTED this 24th day of March, 2000.

2 CITIZENS UTILITIES COMPANY

FENNEMORE CRAIG

3
4 By Craig A. Marks
5 Craig A. Marks
6 Associate General Counsel
7 Citizens Utilities Company
8 2901 N. Central Avenue
9 Phoenix, Arizona 85012

By Norman D. James
Norman D. James
3003 North Central Avenue
Suite 2600
Phoenix, AZ 85012
Attorneys for Arizona-American
Water Company

10 An original and 10 copies
11 of the foregoing and attached
12 exhibits were filed this 24th
13 day of March, 2000, with:

14 Docket Control
15 Arizona Corporation Commission
16 1200 West Washington Street
17 Phoenix, Arizona 85007

18 A copy of the foregoing
19 and attached exhibits were
20 delivered this 24th day of
21 March, 2000, to:

22 Jerry L. Rudibaugh, Esq.
23 Chief Hearing Officer
24 Hearing Division
25 Arizona Corporation Commission
26 1200 West Washington Street
Phoenix, Arizona 85007

Deborah R. Scott, Esq.
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Lyn A. Farmer, Esq.
Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

1 Linda A. Jaress
2 Manager, Financial Analysis
3 Utilities Division
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85007

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26
By: Mary A. Howard

PHX/NJAMES/1027708.1/73244.021

A

**Citizens Utilities Company
Water & Wastewater Operations in
Arizona**

Name	Type of Utility	Area Served	County	ACC Rate Decision Number	CC&N Decision Number	Arizona Corporation Commission Company Number
Sun City Water Company	Water	Sun City & Vicinity	Maricopa	60172	31860 8-24-59	W-01656B
Sun City Sewer Company	Sewer	Sun City & Vicinity	Maricopa	60172	46641 12-31-75	S-02276A
Sun City West Utilities* Water Division	Water	Sun City West & Vicinity	Maricopa	60172		WS-02334A
Sun City West Utilities* Wastewater Division	Sewer	Sun City West & Vicinity	Maricopa	60172		WS-02334A
Agua Fria Water Division of Citizens Utilities	Water	Surprise & Vicinity	Maricopa	60172	46527 11-3-75	W-01032B
Mohave Water Division of Citizens Utilities	Water	Bullhead City & Vicinity	Mohave	56806	38787 12-20-68	W-01032C
Citizens Water Services Company of Arizona	Water and Sewer	Anthem Community, North of Phoenix	Maricopa	60975	60975 6-19-98	WS-03454A
Citizens Water Resources Company of Arizona	Water and Sewer	Anthem Community, North of Phoenix	Maricopa	60975	60975 6-19-98	WS-03455A
Havasas Water Company	Water	Lake Havasu City Western Arizona	Mohave	57743	56329 1-26-89	W-02013A
Tubac Valley Water Company Inc.	Water	Tubac Valley Southern Arizona	Santa Cruz	60172		W-01595A

*Sun City West Utilities files separate annual report for water and sewer.

B

STATE OF ARIZONA
ACC/FAX
DATE FILED

NOV 30 1999

ARTICLES OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER CO.,
AN ARIZONA CORPORATION

DATE APPR 11-30-99
TERM
BY Mindy Robinson
-0042099-0
Effective date 01-01, 2000

Pursuant to the provisions of A.R.S. § 10-1006, Paradise Valley Water Co., an Arizona corporation, hereby adopts the following Articles of Amendment to its Articles of Incorporation and certifies as follows:

FIRST: The name of the corporation is Paradise Valley Water Co.

SECOND: The Articles of Incorporation shall be amended by deleting Article I and inserting the following in place thereof:

"Article I

The name of the corporation is Arizona-American Water Company. *(initials)*

THIRD: The amendment was adopted by the sole shareholder and the board of directors of the corporation on November 29, 1999, in the manner prescribed by the Arizona Business Corporation Act.

FOURTH: As of the date of adopting the amendment, there were 104,576 shares of voting common stock outstanding and entitled to vote. There were 104,576 votes for and 0 votes against approval of the amendment. The number of votes cast for approval of the amendment was sufficient for approval of the amendment.

FIFTH: The amendment does not provide for an exchange, reclassification or cancellation of issued shares.

SIXTH: The effective date for these Articles of Amendment shall be the later of the date of filing with the Arizona Corporation Commission or January 1, 2000.

DATED: November 29, 1999.

Paradise Valley Water Co.,
an Arizona corporation

By: *John S. Driscoll*
Title: SECRETARY

ARTICLES OF INCORPORATION
OF
PARADISE VALLEY WATER CO.

KNOW ALL MEN BY THESE PRESENTS:

That the undersigned, JAMES A. WALSH, MARK WILMER and JOSEPH T. MELCZER, JR., have this day associated ourselves together for the purpose of forming a corporation under and pursuant to the laws of the State of Arizona, and for that purpose do hereby adopt Articles of Incorporation as follows:

3

ARTICLE I

The name of this corporation shall be:

PARADISE VALLEY WATER CO.

3

ARTICLE II

The names, residences and post office addresses of the incorporators are:

<u>Names</u>	<u>Residences</u>	<u>Post Offices</u>
James A. Walsh	5129 Kenmore Dr.	Phoenix, Arizona
Mark Wilmer	41 W. Colter	Phoenix, Arizona
Joseph T. Melczer, Jr.,	3030 N. 7th Street, Phoenix, Arizona	

ARTICLE III

That the principal place of business of this corporation shall be at Phoenix, Maricopa County, State of Arizona, and this corporation shall have such other place or places of business, within or without the State of Arizona, as may be established by the Board of Directors, at which place or places such portion of the corporate business may be transacted as the directors may lawfully assign thereto.

ARTICLE IV

The general nature of the business proposed to be transacted is as follows:

To engage in and carry on a general public utility business in the State of Arizona as a public service corporation, distributing at wholesale and retail water for domestic and commercial purposes, and for such other purposes as the Board of Directors may determine upon;

To make contracts; to purchase, lease, and otherwise acquire, own, possess, sell and exchange real and personal property of all kinds and character, tangible or intangible;

To acquire franchises, certificates of conven-

ience and necessity, and to otherwise acquire all property used and useful in the conduct of said utility business;

To purchase, lease or otherwise acquire other public utility businesses and all property used and useful in connection therewith, tangible or intangible;

To borrow money, and to issue bonds, debentures, notes and other evidences of indebtedness and obligations from time to time for any lawful corporate purpose, and to mortgage, pledge, and otherwise encumber and charge any and all of its properties, rights and privileges, to secure the payment thereof;

To loan money; to purchase, acquire, sell, pledge, hypothecate and otherwise deal in, shares of capital stock, bonds, debentures, notes or other securities or evidences of indebtedness of any other corporation or association, and to exercise all the rights, powers and privileges of ownership, including the right to vote thereon as a natural person might or could do;

To purchase or otherwise acquire from time to time, shares of its own capital stock, and to own, hold, sell, transfer and re-issue the same;

And in furtherance of the general objects and

purposes for which this corporation is formed, to do any and all other acts or things as a natural person might, or could do, as principal, agent, contractor, trustee, or otherwise; and to engage in the general business of buying and selling real and personal property, separate and distinct from its purposes and objects, as a public service corporation, and to otherwise deal in connection with such property as its Board of Directors may from time to time authorize.

ARTICLE V

The total amount of the authorized capital stock of this corporation shall be \$50,000, divided into 500 shares of the par value of One (Hundred Dollars (\$100.00) each. At such time or times as the Board of Directors may by resolution direct, said capital stock shall be paid into this corporation, either in cash or by the sale or transfer to it of real or personal property, contracts, services, or any other valuable right or thing, and the capital stock so issued shall thereupon and thereby become and be fully paid up and be nonassessable forever. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value

of the consideration given for said stock shall be conclusive. *act*

ARTICLE VI

The affairs of this corporation shall be conducted by a Board of not less than three nor more than seven directors, and such officers and agents as the Board of Directors may elect or appoint. The following named shall constitute the Board of Directors to serve until their successors are elected and have qualified:

3
James A. Walsh
Mark Wilmer
Joseph T. Melczer, Jr.

Thereafter, the Board of Directors shall be elected from among the stockholders at the annual stockholders' meeting to be held on the second Tuesday in December of each year, commencing with the year 1949⁵⁸, *act* (or as the By-laws may otherwise provide.) The officers of this corporation shall consist of: a President, a Vice President, a Secretary and a Treasurer. The office of Secretary and Treasurer may be held by one and the same person. Until changed by the Board of Directors of this corporation,) the following named shall constitute the officers of this corporation:

James A. Walsh, President
Mark Wilmer, Vice President
Joseph T. Melczer, Jr., Secretary-Treasurer

ARTICLE VII

The Board of Directors shall have power to adopt, amend, and rescind By-laws for the government of the corporation; to fill vacancies occurring in the Board of Directors from any cause; to elect and appoint such officers, agents, and committees as they may deem necessary, with such powers as they may confer, and generally to do whatever in their judgment may be necessary or advisable to promote the welfare of the corporation, and to further its lawful activities.

ARTICLE VIII

The highest amount of indebtedness or liability, direct or contingent, to which this corporation is at any time to subject itself, shall not exceed the sum of ⁶⁶⁶ Thirty Three Thousand Three Hundred Thirty-two (\$33,332.00) Dollars, provided, however, that whenever at any lawfully held meeting of the stockholders of this corporation, any indebtedness is authorized by not less than three-fourths of the votes cast, in accordance with the provisions of the Articles of Incorporation and By-laws thereof,

and approved by the Corporation Commission of the State of Arizona, such indebtedness shall not be subject to the limitations hereinabove prescribed, and shall not be considered a part of the indebtedness so limited.

ARTICLE IX

The time of the commencement of this corporation shall be the date of the issuance to it of a certificate of incorporation by the Arizona Corporation Commission, and the termination thereof shall be twenty-five years thereafter, with the privilege of renewal as provided by law.

ARTICLE X

The private property of the stockholders, officers, and directors of this corporation shall be, and is made forever exempt from all corporate debts of every kind whatsoever.

ARTICLE XI

MARK WILMER, of Phoenix, Maricopa County, Arizona, who has been a bona fide resident of Arizona for more than three years last past, is hereby appointed the lawful agent in and for the State of Arizona for and on behalf of this corporation to accept and acknowledge

service of, and upon whom may be served all necessary process or processes in any action, suit or proceeding that may be had or brought against this corporation in any of the courts of the State of Arizona, such service of process or notice, or the acceptance thereof by said agent endorsed thereon, to have the same force and effect as if served upon the President and Secretary of this corporation.

IN WITNESS WHEREOF, we have hereunto set our hands and seals this 30th day of December, 1949.

JAMES A. WALSH
James A. Walsh

MARK WILMER
Mark Wilmer

JOSEPH T. MELCZER, JR.
Joseph T. Melczer, Jr.

P 73638

INDEXED
FILED

ARIZONA CORPORATION COMMISSION
Incorporating Division

F I L E D

DEC 30 1949

At 3:30 P. M. at request of
Snell, Wilmer, Walsh, Melczer, & Beauchamp
whose address is 703 Heard Bldg.
Phoenix, Arizona.

Mel D. Michael,
Secretary

By E. Habeich

STATE OF ARIZONA }
County of Maricopa }

I hereby certify that the within
instrument was filed and recorded
at request of Snell, Wilmer, Walsh, Melczer & Beauchamp

1949 DEC 30 4 14 Ark. Inc
In Docket 480
on page 545 to 554
Witness my hand and official seal
the day and year last stated.

ROSEB G. LAYTON
Roseb G. Layton
Clerk, Recorder
Phoenix, Arizona
415
703 Heard Bldg

CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER COMPANY

This is to certify that a meeting of the stockholders of the Paradise Valley Water Company, a corporation, was held at the office of said corporation at the Desert Art School in Paradise Valley, Maricopa County, Arizona, on the 13th day of March, 1951. Notice of the time and place and purpose of the meeting was waived by the holders of all of the issued and outstanding capital stock of the corporation, a copy of said waiver being attached hereto. By unanimous vote of all issued and outstanding stock, a resolution was passed to amend Article V of the Articles of Incorporation to read as follows:

The total amount of the authorized capital stock of this corporation shall be \$150,000.00, divided into 1500 shares of par value of One Hundred Dollars (\$100.00) each. At such time or times as the Board of Directors may by resolution direct, said capital stock shall be paid into this corporation, either in cash or by the sale or transfer to it of real or personal property, contracts, services, or any other valuable right or thing, and the capital stock so issued shall thereupon and thereby become and be fully paid up and nonassessable forever. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value of the consideration given for said stock shall be conclusive.

IN WITNESS WHEREOF, said corporation has caused this certificate to be executed by its president and its corporate seal to be affixed and attested by the secretary this 26th day of March, 1951.

PARADISE VALLEY WATER COMPANY

By S/John C. Adams
President

Attest:

S/Joseph P. Ralston
Secretary

STATE OF ARIZONA)
County of Maricopa) ss

720 PAGE 105

On this, the 26th day of March, 1951, before me, the undersigned officer, personally appeared JOHN C. ADAMS and JOSEPH P. RALSTON, who acknowledged themselves to be the President and Secretary, respectively of PARADISE VALLEY WATER COMPANY, a corporation, and that they as such President and Secretary, respectively, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as President and Secretary.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

S/G. R. Carlock

Notary Public

My commission expires:

11-11-53

(Notarial Seal)

ARIZONA
MAR 28 1951

At 1:30 P. M. at request of
Francis J. Ryley
Title & Trust Bldg.
Phoenix, Ariz.
MEL D. MICHAEL

By E. Eisenhart

22903

INDEXED

STATE OF ARIZONA
County of Maricopa

I hereby certify that the
instrument of Francis J. Ryley
at request of Francis J. Ryley

1951 MAR 29 9 51

In Doc. No. 103-104-720
in page 103-104-720

Witness my hand and official seal
this day and year aforesaid.

DEER G. LAWREN

Ernest R. Morris
1-25
Priority Records

F. J. Ryley
Ph.

CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER COMPANY

940 PAGE 125

This is to certify that the annual meeting of the stockholders of the Paradise Valley Water Company, a corporation, was held at the office of said corporation at the Desert Art School in Paradise Valley, Maricopa County, Arizona, on the 24th day of April, 1952. Notice of the time and place and purpose of the meeting was given as required by law and by the Articles of Incorporation, and all the holders of all of the issued and outstanding capital stock of the corporation were present in person. By unanimous vote of all issued and outstanding stock, a resolution was passed to amend Article V of the Articles of Incorporation to read as follows:

The total amount of the authorized capital stock of this corporation shall be \$600,000.00, divided into 6000 shares of par value of One Hundred Dollars (\$100.00) each. At such time or times as the Board of Directors may by resolution direct, said capital stock shall be paid into this corporation, either in cash or by the sale or transfer to it of real or personal property, contracts, services, or any other valuable right or thing, and the capital stock so issued shall thereupon and thereby become and be fully paid up and nonassessable forever. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value of the consideration given for said stock shall be conclusive.

IN WITNESS WHEREOF, said corporation has caused this certificate to be executed by its president and its corporate seal to be affixed and attested by the secretary this 8th day of June, 1952.

PARADISE VALLEY WATER COMPANY

By John C. Adams
President

Attest:

Joseph P. Ralston
Secretary

STATE OF ARIZONA)
) ss
County of Maricopa)

On this, the 8th day of June, 1952, before me, the undersigned officer, personally appeared JOHN C. ADAMS and JOSEPH P. RALSTON, who acknowledged themselves to be the President and Secretary, respectively, of PARADISE VALLEY WATER COMPANY, a corporation, and that they as such President and Secretary, respectively, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as President and Secretary.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

My commission expires:
(Notary Seal) 11-11-53

G. R. Carlock
Notary Public

ARIZONA CORPORATION COMMISSION
Incorporating Division

F I L E D

Jun 9 1952

At 3:30 P. M. at request of

J. R. Ralston

whose address is Title & Trust Building

Phoenix, Arizona.

Mel D. Michael,
Secretary.

By E. Habeich

44776

STATE OF ARIZONA
County of Maricopa

I hereby certify that this within
instrument was filed and recorded
at request of *J. R. Ralston*

JUN 9 3 47

in Booklet

on page 124-125-126

Witness my hand and official seal
on this day first year aforesaid.

ROGER G. LAVERN

County Recorder

Conrad W. Morris

Deputy Recorder

1952

J. R. Ralston

**CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER COMPANY**

This is to certify that the adjourned annual meeting of the stockholders of the Paradise Valley Water Company, a corporation, was held at the Valley Ho Hotel, Scottsdale, Arizona, on Friday, December 12, 1958. Notice of the time and place and purpose of the meeting was given as required by law and by the Articles of Incorporation, and all the holders of all the issued and outstanding capital stock of the corporation were present in person. By unanimous vote of all issued and outstanding stock, a resolution was passed to amend Article V of the Articles of Incorporation to read as follows:

The total amount of the authorized capital stock of this corporation shall be \$1,000,000.00, divided into 10,000 shares of the par value of One Hundred Dollars (\$100.00) each. At such time or times as the Board of Directors may by resolution direct, said capital stock shall be paid into this corporation, either in cash or by the sale or transfer to it of real or personal property, contracts, services, or any other valuable right or thing, and the capital stock so issued shall thereupon and thereby become and be fully paid up and nonassessable forever. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value of the consideration given for said stock shall be conclusive.

IN WITNESS WHEREOF, said corporation has caused this certificate to be executed by its President and its corporate seal to be affixed and attested by the Secretary this day of March, 1959.

PARADISE VALLEY WATER COMPANY

ATTEST:

Joseph P. Ralston
Secretary

By John C. Adams
President

STATE OF ARIZONA)
) SS
COUNTY OF MARICOPA)

On this 20th day of March, 1959, before me, the undersigned officer, personally appeared JOHN C. ADAMS and JOSEPH P. RALSTON, who acknowledged themselves to be the President and

Secretary, respectively of PARADISE VALLEY WATER COMPANY, a corporation, and that they as such President and Secretary, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as President and Secretary.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

My commission expires: March 2, 1960.

Agnella Widmer
Notary Public

(SEAL)

DKT 2801 PAGE 78

42099

ARIZONA CORPORATION COMMISSION
INCORPORATING DIVISION

FILED

MAR 25 1959

At... 11:50 A. M. at request of
... Ryley, Carlock and Ralston...
Act... Title and Trust Building
Phoenix, Arizona
By... May S. Oates
FRANCIS J. BYRNES, SECRETARY

51339

ART
FILED
MAR 25 1959

RECORDED
INDEXED
MAR 25 1959

Ryley, Carlock and Ralston
1333 MAR 25 5 25 2801

75-70-78 (encl)

FILED
MAR 25 1959

By *May S. Oates*
Francis J. Byrnes, Secretary

40d

EX-5215

**CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER COMPANY**

This is to certify that a special meeting of the stockholders of the Paradise Valley Water Company, an Arizona corporation, was held at the Valley Ho Hotel, Scottsdale, Arizona August 25, 1964. Notice of the time and place and purpose of the meeting was given as required by law and by the Articles of Incorporation, and all the holders of all the issued and outstanding capital stock of the corporation were present in person or by proxy. By unanimous vote of all issued and outstanding stock, a resolution was passed to amend Article V of the Articles of Incorporation to read as follows:

The total amount of the authorized capital stock of this corporation shall be \$3,000,000.00, divided into 600,000 shares of the par value of Five Dollars (\$5.00) each. At such time or times as the Board of Directors may by resolution direct, said authorized stock shall be paid into this corporation, either in cash or by the sale or transfer to it of real or personal property, contracts, services, or any other valuable right or thing, and the capital stock so issued shall thereupon and thereby become and be fully paid up and non-assessable forever. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value of the consideration given for said stock shall be conclusive.

IN WITNESS WHEREOF, said corporation has caused this certificate to be executed by its President and its corporate seal to be affixed and attested by the Secretary this 1st day of September, 1964.

PARADISE VALLEY WATER COMPANY

by John C. Adams
President

ATTEST:

Joseph P. Balston
Secretary

STATE OF ARIZONA)
) SS
County of Maricopa)

On this 2nd day of September, 1964, before me, the undersigned officer, personally appeared JOHN C. ADAMS and JOSEPH P. BALSTON, who acknowledged themselves to be the President and

5215 PAGE 446

Secretary, respectively of PARADISE VALLEY WATER COMPANY, a corporation, and that they as such President and Secretary, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as President and Secretary.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

My commission expires: 2-19-66

Notarial
Seal

F. S. Adams
Notary Public

(SEAL)

DRT 5215 447

42099

ARIZONA CORPORATION COMMISSION
REGULATING DIVISION

FILED

SEP 10 1984

At 11:45 A. M. on request of
Ryley, Carlock and Ralston
Title and Trust Building
Phoenix, Arizona
May S. Oates
S. C. CORBITT SECRETARY

176686

20-ARI

STATE OF ARIZONA }
County of Maricopa }

*Ryley Carlock
& Ralston*
1984 SEP 11 3 54

5215
444 to 447 and

see the day and year above.

CLIFFORD H. WARD

Recorder
By *[Signature]*
Deputy Recorder

400

5215 449

**CERTIFICATE OF AMENDMENT TO THE
ARTICLES OF INCORPORATION OF
PARADISE VALLEY WATER COMPANY**

This is to certify that a special meeting of the stockholders of the Paradise Valley Water Company, an Arizona corporation, was held at the Valley Ho Hotel, Scottsdale, Arizona August 25, 1964. Notice of the time and place and purpose of the meeting was given as required by law and by the Articles of Incorporation, and all the holders of all the issued and outstanding capital stock of the corporation were present in person or by proxy. By unanimous vote of all issued and outstanding stock, a resolution was passed to amend Article VIII of the Articles of Incorporation to read as follows:

The highest amount of indebtedness or liability, direct or contingent, to which this corporation is at any time to subject itself, shall not exceed the sum of Two Million (\$2,000,000) Dollars, provided, however, that whenever at any lawfully held meeting of the stockholders of this corporation, any indebtedness is authorized by not less than three-fourths of the votes cast, in accordance with the provisions of the Articles of Incorporation and By-laws thereof, and approved by the Corporation Commission of the State of Arizona, such indebtedness shall not be subject to the limitations hereinabove prescribed, and shall not be considered a part of the indebtedness so limited.

IN WITNESS WHEREOF, said corporation has caused this certificate to be executed by its President and its corporate seal to be affixed and attested by the Secretary this 9th day of September, 1964.

PARADISE VALLEY WATER COMPANY

John C. Adams
by John C. Adams
President

ATTEST:

Joseph P. Ralston
Joseph P. Ralston
Secretary

5215 450

STATE OF ARIZONA)
) SS
County of Maricopa)

On this 9th day of September, 1964, before me, the undersigned officer, personally appeared JOHN C. ADAMS and JOSEPH P. RALSTON, who acknowledged themselves to be the President and Secretary, respectively of PARADISE VALLEY WATER COMPANY, a corporation, and that they as such President and Secretary, being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by themselves as President and Secretary.

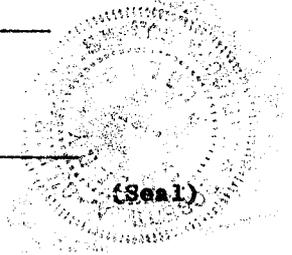
IN WITNESS WHEREOF, I hereunto set my hand and official seal.

My Commission Expires January 31, 1966

My commission expires: _____

Robert A. Gray

Notary Public



5215 451

42099

ARIZONA CORPORATION COMMISSION

SEP 10 1964

At 11:45 A. M. Ryley, Carlock and Ralston
Address Title and Trust Building
Phoenix, Arizona
By May S. Oates
S. C. CORBITT

176687

20-ART

STATE OF ARIZONA
County of Maricopa

I hereby certify that the within
is true and correct to the best of
my knowledge and belief.

*Ryley, Carlock
Ralston*

5215
448 to 451 incl

CLIFFORD D. ...
Deputy Recorder

Clifford D. ...
Deputy Recorder

400

C

DIRECT TESTIMONY OF
JOSEPH F. HARTNETT, JR.
IN THE MATTER OF THE JOINT APPLICATION OF
CITIZENS UTILITIES COMPANY AND CERTAIN OF ITS SUBSIDIARY
COMPANIES
AND
ARIZONA-AMERICAN WATER COMPANY

MARCH 24, 2000

Direct Testimony of Joseph F. Hartnett

1 Q1. State your name and business address.

2 A1. Joseph F. Hartnett, Jr., American Water Works Company, Inc., 1025 Laurel Oak Road,
3 Voorhees, NJ 08043.

4 Q2. By whom are you employed and in what capacity?

5 A2. I am employed by American Water Works Service Company ("Service Company") as the
6 Vice President - Finance. I also serve as the Treasurer of American Water Works
7 Company, Inc. ("AWW").

8 Q3. Please describe your educational background and business experience.

9 A3. I graduated from Georgetown University with a Bachelor of Science degree in Business
10 Administration in 1973. I began my business career with Coopers & Lybrand (currently
11 PriceWaterhouseCoopers), spending seven years in public accounting as a Certified
12 Public Accountant. I then held several positions over eleven years in the securities
13 industry with Butcher & Company and its principal subsidiary, Butcher & Singer. In
14 1992, I joined the Service Company as Vice President and Treasurer and was promoted to
15 Vice President - Finance in 1997. Also in 1997 I was named Treasurer of AWW. I am a
16 member of both the Board of Directors and the Finance Committee of the National
17 Association of Water Companies as well as a member of the American and Pennsylvania
18 Institutes of Certified Public Accountants.

19 Q.4 What is the purpose of your testimony?

20 A4. I am testifying on behalf of Arizona-American Water Company ("Az-Am"), which is
21 AWW's operating subsidiary in Arizona. The purpose of my testimony is to describe the
22 process that led to AWW's decision to purchase all of the water and wastewater utility

1 plant, property and related assets of Citizens Utilities Company ("Citizens"), hereinafter
2 called "Citizens Acquired Assets", and to discuss the arm's length nature of the
3 negotiations and the reasonableness of the purchase price.

4 Q5. What was your involvement in the acquisition of the Citizens Acquired Assets?

5 A5. I was involved in all aspects of the investigation and analysis that led to AWW's decision
6 to purchase the Citizens Acquired Assets. This included initial contact with Citizens'
7 executives, assembly and analysis of public information concerning Citizens' water and
8 wastewater properties, including reports to various state public utility commissions and
9 SEC filings, negotiations with Citizens with regard to a purchase price and other terms
10 and conditions, conduct of due diligence investigations, and development of the financial
11 analyses utilized by AWW in reaching its decision to purchase the Citizens Acquired
12 Assets.

13 Q6. Would you generally describe the process that led to AWW's decision to purchase the
14 Citizens Acquired Assets?

15 A6. In approximately mid-May 1999, AWW noted that Citizens had disclosed in their 10-Q
16 filing with the SEC that they planned to sell their public service businesses, including
17 their water and wastewater utility assets. In early June, we participated in a public
18 teleconference call between Citizens and certain financial analysts during which Citizens
19 discussed their recent acquisition of telecommunications properties from GTE and further
20 discussed their intention to sell their water and wastewater properties. During the
21 teleconference, Citizens executives estimated that based on recent water acquisitions, the
22 combined value of all of Citizens' water and wastewater properties could be as high as \$1
23 billion.

1 During mid-June 1999, we met with Citizens' executives and expressed our interest in
2 their water and wastewater properties. We were informed at that time that if we wished
3 to submit an offer we should feel free to do so.

4 During the months of June and July we accumulated public information on Citizens'
5 water and wastewater properties, including reports to various state public utilities
6 commissions, SEC filings and other documents to determine preliminary valuation of the
7 Citizens Acquired Assets. On July 22, 1999, we submitted a non-binding expression of
8 interest to Citizens to acquire all of their water and wastewater assets and certain related
9 assets.

10 On August 3, 1999, Citizens appointed Morgan Stanley Dean Witter as its advisor in the
11 divestiture of its public service businesses, including its water and wastewater assets.

12 Also in August, we executed Confidentiality Agreements with Citizens, and we requested
13 and obtained certain documents from Citizens needed to conduct our due diligence. Due
14 diligence investigations were conducted throughout August and September of 1999 and
15 involved a review of numerous corporate records and other aspects of Citizens water and
16 wastewater business. On September 10, we began price negotiations with Citizens
17 through their Morgan Stanley Dean Witter representative.

18 Intensive negotiations were conducted between AWW and Citizens from September 10
19 until September 24 when Citizens released an Offering Document to other potential
20 bidders. Further intensive negotiations were conducted from September 24 to October 4,
21 when AWW reached agreement with Citizens on a price for the Citizens Acquired Assets

1 and negotiations then began for a definitive agreement for purchase, which was
2 concluded in mid-October, 1999.

3 The negotiations were at arm's length. Both parties relied upon their own financial and
4 legal advisors. There were no pre-existing business relationships between Citizens and
5 AWW.

6 Q7. What is the purchase price for all of the Citizens Acquired Assets?

7 A7. The purchase price for all of the Citizens Acquired Assets is \$835 million. In arriving at
8 this purchase price we prepared a discounted cash flow (DCF) analysis for the water and
9 wastewater business of Citizens. This cash flow analysis factored in an estimate of the
10 synergies that we believed we could reasonably expect from combining Citizens' water
11 and wastewater operations with AWW's operations. Furthermore, the DCF analysis
12 considered the projected growth that was expected in the various Citizens' service
13 territories involved.

14 Q8. What is the purchase price of the water-related assets of Citizens in Arizona (the "AZ
15 Acquired Assets")?

16 A8. The purchase price for the AZ Acquired Assets is approximately \$231,310,000. The
17 basis for this purchase price is described in Mr. Stephenson's direct testimony.

18 Q9. How will the acquisition be accounted for?

19 A9. It will be accounted for under the purchase method of accounting in accordance with
20 Generally Accepted Accounting Principles.

1 Q10. Will you please describe generally how the acquisition of the AZ Acquired Assets will be
2 financed by Az-Am?

3 A10. The acquisition will be financed with a combination of debt and equity that is most
4 economical at the time of the closing of the transaction, based on then current market
5 conditions. The details of the finance arrangements will be discussed in a separate
6 financing application. We expect to file this application in approximately 30 days.

7 Q11. Does that conclude your direct testimony?

8 A11. Yes, it does.

D

DIRECT TESTIMONY OF
DANIEL L. KELLEHER
IN THE MATTER OF THE JOINT APPLICATION OF
CITIZENS UTILITIES COMPANY AND CERTAIN OF ITS SUBSIDIARY
COMPANIES
AND
ARIZONA-AMERICAN WATER COMPANY

MARCH 24, 2000

Direct Testimony of Daniel L. Kelleher

1 Q1. Please state your name and business address.

2 A1 My name is Daniel L. Kelleher. My business address is 1025 Laurel Oak Road,
3 Voorhees, NJ.

4 Q2. By whom are you employed and in what capacity?

5 A2. I am employed by American Water Works Service Company, Inc. ("Service Company")
6 as Senior Vice President. I am responsible for the regulated utility businesses owned by
7 American Water Works Company, Inc. ("AWW") and for the engineering, water quality,
8 operations and regulatory programs' support services available to those utilities from the
9 Service Company.

10 Q3. Please describe your educational background and business experience.

11 A3. I received a B.S. in Civil Engineering from Northeastern University in 1972, and I am a
12 registered professional engineer in the Commonwealth of Pennsylvania. In June 1972, I
13 joined the Service Company as an engineer. Throughout my career I have held a variety
14 of positions with increasing responsibility. In 1980 I became Director of Water Quality
15 Research and Technology and was responsible for developing and directing the research
16 and application of water treatment technologies throughout the American Water System.
17 In 1985 I became Vice President-Engineering, and was responsible for administering the
18 comprehensive planning, design, construction and materials management programs of the
19 American Water System subsidiaries nationally. In 1991 I became President of New
20 Jersey-American Water Company, the second largest regulated utility subsidiary in the
21 American Water System, serving more than 363,000 water and wastewater customers

Direct Testimony of Daniel L. Kelleher

1 which represents over 1 million people. In February 1999, I assumed my present
2 position, Senior Vice President.

3 Q4. What is the purpose of your testimony?

4 A4. The purpose of this testimony is to describe generally the nature of the transactions
5 between Citizens Utilities Company and Citizens' water and wastewater subsidiaries
6 operating in Arizona ("Citizens AZ"), and Arizona-American Water Company ("Az-
7 Am"), AWW's operating subsidiary in Arizona. In addition, I will discuss the factors
8 that motivate AWW's policy to pursue consolidation through acquisitions and mergers,
9 some of the challenges which the water industry in the United States faces and some of
10 the benefits that customers and shareholders alike can expect from combining the
11 operations of Citizens AZ and Az-Am.

12 Q5. Please describe the business of AWW.

13 A5. The principal business of AWW is the investment in and ownership of the common stock
14 of operating water and wastewater utility companies that provide quality water and
15 wastewater service to millions of consumers in the United States. AWW currently has 23
16 utility subsidiaries which operate in 22 states. AWW's subsidiaries and affiliates now
17 serve approximately 10 million people. Following the closing of the pending merger
18 between AWW's operating subsidiary in California and San Jose Water Company and the
19 pending acquisition of the water and wastewater-related assets of Citizens Utilities
20 Company, AWW's subsidiaries will serve over three million customers, or a population
21 of about 12 million people.

22 Q6. What is the role of the Service Company?

Direct Testimony of Daniel L. Kelleher

1 A6. The Service Company is a wholly-owned subsidiary of AWW that provides professional
2 and staff services to AWW's utility subsidiaries. These services include management,
3 accounting, engineering, finance, water quality, personnel administration and training,
4 human resources, information systems, corporate legal and regulatory services,
5 operations, cash management, rates and revenues, risk management, public and customer
6 communications and other services. The Service Company allows economies of scale
7 afforded through consolidated purchasing of items such as energy, chemicals, materials,
8 supplies and insurance. These services are provided at cost to the utility subsidiaries
9 pursuant to agreements between them and the Service Company, which agreements have
10 been approved by the various public utility commissions in the states in which the
11 subsidiaries operate.

12 Q7. Please explain the term "American Water System."

13 A7. The term "American Water System" refers to the combination of AWW and all of its
14 subsidiaries. Each subsidiary shares in the benefits of size offered by the American
15 Water System and the economies provided by the Service Company.

16 Q8. Would you please describe Az-Am and its business?

17 A8. Az-Am is a wholly-owned subsidiary of AWW and is a part of the AWW's Western
18 Region, which includes water and wastewater utilities in Arizona, California, New
19 Mexico and Hawaii. Az-Am currently provides water utility service to approximately
20 4,600 customers and has a service area population in excess of 10,000 persons. Az-Am's
21 service area is located in Maricopa County, within portions of the Town of Paradise
22 Valley and the City of Scottsdale. I should also note that Az-Am was formerly named

Direct Testimony of Daniel L. Kelleher

1 Paradise Valley Water Company. The subsidiary's name was changed to Arizona-
2 American Water Company effective January 1, 2000.

3 Q9. Would you describe the transaction for which Citizens and Az-Am seek approval?

4 A9. Under the Asset Purchase Agreement dated as of October 15, 1999, Az-Am has agreed to
5 acquire all of the water and wastewater-related plant, property and assets of Citizens
6 Utilities Company and its operating subsidiaries in Arizona. A copy of the Asset
7 Purchase Agreement will be supplied to the Utilities Division of the Arizona Corporation
8 Commission ("Staff") under the terms of a confidentiality agreement made with Staff.

9 Q10. Does AWW have an overall acquisition strategy?

10 A10. Yes. AWW has a long-standing policy to seek out opportunities that have the potential to
11 enhance customer and shareholder value through beneficial acquisitions which add
12 economies of scale to existing operations and strengthen the financial capability of the
13 existing subsidiaries and the acquired systems so that both will be better able to meet
14 their public service obligations and maintain future financial viability.

15 Q11. Why is AWW pursuing a policy of acquisitions?

16 A11. AWW's motivations are essentially twofold. First, in the face of huge capital investment
17 requirements resulting from infrastructure replacement needs and constantly expanding
18 water quality and other standards, achievement of more effective economies of scale
19 through consolidation resulting from mergers and acquisitions is absolutely essential to
20 achievement of AWW's goal of providing high quality water service to customers in a

Direct Testimony of Daniel L. Kelleher

1 least cost manner. Second, the value brought to customers through consolidation is
2 necessary to protect and increase long-term shareholder value.

3 These customer and shareholder goals are not only consistent with each other, they are
4 also mutually dependent. One goal cannot be achieved without achieving the other.

5 In order for AWW and its operating companies to remain financially viable and able to
6 attract the capital necessary to fund quality service to customers, it is necessary to protect
7 and enhance shareholder value. Shareholder value, however, cannot be maximized
8 without providing value to customers through high quality water service in a long-term,
9 least-cost manner.

10 Q12. Would you describe some of the challenges facing the water industry?

11 A12. Over the next 20 years, much of this country's drinking water and wastewater
12 infrastructure will have to be replaced because it is approaching or has already exceeded
13 its useful life. Additional investment in plant and increases in operating and maintenance
14 costs are also necessary due to more rigorous standards and other requirements of the
15 Safe Drinking Water Act ("SDWA") and Clean Water Act. The SDWA, for example,
16 already requires monitoring and treatment of numerous potential contaminants.
17 However, the SDWA also requires the United States Environmental Protection Agency
18 ("USEPA") to identify and establish standards for additional potential contaminants.

19 A January 1997 USEPA study, based on 1995 dollars, estimated infrastructure investment
20 needs nationwide to be approximately \$140 billion. A more current study by the
21 American Water Works Association, which is more broadly focused than the earlier

Direct Testimony of Daniel L. Kelleher

1 USEPA study, estimates that in excess of \$320 billion may be necessary over the next 20
2 years to meet infrastructure replacement needs and compliance with SDWA requirements
3 alone.

4 Under any scenario, it is clear that massive infrastructure investment will be needed and
5 increases in operational and maintenance expenses will occur in the future. For example,
6 even the more narrowly focused USEPA assessment, based on 1995 dollars, estimates
7 that drinking water infrastructure and SDWA compliance alone will require investment of
8 approximately \$1.35 billion in Arizona over the next 20 years.

9 Q13. Does the basic structure of the water industry pose particular problems in meeting these
10 challenges?

11 A13. Yes. The water industry in the United States is highly fragmented. There are
12 approximately 60,000 water systems in this country, the vast majority of which are small
13 and often financially and technologically nonviable. In addition, the water supply
14 industry is more capital intensive than any of the other public utility services typically
15 regulated by state public utility commissions. A recent study by the National Association
16 of Water Companies ("NAWC") indicated that on a total plant basis, investor-owned
17 water utilities require \$4.38 of investment to produce \$1 of revenue. Electric utilities
18 required \$3.08 of investment per revenue dollar. On a similar basis, local telephone and
19 natural gas utilities require \$2.94 and \$2.46 of investment, respectively for each dollar of
20 revenue. The NAWC study confirmed similar results from an earlier study by the
21 National Regulatory Research Institute ("NRRI") in 1993.

22 Q14. How have these challenges affected the water industry in the United States?

Direct Testimony of Daniel L. Kelleher

1 A14. These and other challenges have led to an ongoing restructuring of the water industry
2 through consolidations, mergers and acquisitions, as well as increasing interest in
3 privatization of government-owned systems through sales or operations and maintenance
4 contracts, and other cooperative, partnering arrangements between government and
5 investor-owned systems. These challenges and opportunities have also led to significant
6 investment in U.S. water companies by foreign corporations such as United Water
7 Resources by the French Company, Suez Lyonnaise des Eaux; Elizabethtown Water Co.
8 by the British firm, Thames Water; and Aquarion by Kelda, also a British company.

9 Q15. What are the implications of these challenges for the U.S. water industry?

10 A15. These infrastructure requirements and increasing quality standards result in severe
11 pressure on the water industry to increase its ability to attract capital as well as its
12 technical and operating capabilities. There is also an obligation on the part of water
13 service providers to do so in a manner that minimizes costs to consumers, consistent with
14 the quality service they have a right to expect.

15 A 1993 NRRI Report emphasized the responsibility of both water utilities and regulators
16 to facilitate achievement of long-term quality service in a least cost manner:

17 "The changing cost profile of the water utility industry marks a
18 'coming of age' for the industry and a new era in water utility
19 regulation. All water utilities, regardless of ownership structure or
20 size, must begin to plan how they will meet additional revenue
21 requirements. Strategic planning, therefore, should become a
22 priority for water utilities and water utility regulators."

Direct Testimony of Daniel L. Kelleher

1 Meeting Water Utility Revenue Requirements: Financing and Ratemaking Alternatives,
2 National Regulatory Research Institute (November 1993).

3 AWW's policy of pursuing consolidation through mergers and acquisitions is integral to
4 its strategic planning for the future and essential to fulfill its responsibilities to its
5 customers and shareholders.

6 Q16. How will acquisition of the water and wastewater assets of Citizens AZ further these
7 goals and benefit customers?

8 A16. First, long-term cost savings will result through achievement of better economies of scale
9 and operating efficiencies associated with spreading consolidated management costs over
10 a much wider customer base. Integration teams composed of representatives of both
11 companies were formed in December of 1999. They have been meeting regularly in
12 order to plan the integration of the operations of the companies in the most efficient
13 manner to achieve the greatest level of synergies consistent with maintaining quality
14 service to all customers.

15 Second, joining Az-Am and Citizens AZ will result in one management structure where
16 there are now two. Moreover, the combination will permit selection of the best
17 management practices and other skills of each company so that the whole will operate
18 more efficiently than each of the companies and their subsidiaries could standing alone.

19 Third, the combined entity will be in a better position to continue its participation in the
20 ongoing water industry consolidation. For the reasons previously stated, such strategic
21 goals are essential if AWW is to fulfill its responsibilities to both its ratepayers and

Direct Testimony of Daniel L. Kelleher

1 shareholders. In addition, such consolidation will permit the combined entity to be better
2 positioned to expand and accelerate the acquisition of, or to provide assistance to, small,
3 nonviable Arizona water and wastewater systems. AWW understands that, along with
4 the opportunity to expand our water interests in Arizona, comes a responsibility to assist
5 in the resolution of the structural problems plaguing the water industry which impede
6 achievement of safe and reliable service to all consumers in Arizona.

7 Fourth, combining the two entities will increase AWW's economies of scale and
8 geographic diversity both in Arizona and nationwide, thus increasing the financial
9 stability of all our systems, thereby making the AWW system more attractive to the
10 investor and lending communities. This will enhance the ability of the combined entities
11 to fund increasing infrastructure needs driven by aging plant, technology changes and
12 increasingly rigorous water quality and other requirements at a more economical cost and
13 thereby contribute to rate stability.

14 Fifth, the combined entities, through increased geographic diversity and AWW's
15 nationwide employee base of trained professionals, can better respond to natural disasters
16 and other emergencies. The American Water System has over 5000 employees
17 nationwide, including numerous experts and professionals in every facet of water service.
18 These resources can be and have been brought to bear in emergency situations that have
19 arisen in various parts of the country. For example, in 1993, the central United States
20 sustained repeated, record rainfall events. All of the major rivers flooded, devastating
21 communities in several states, and causing tremendous challenges to water service
22 providers. American Water System treatment plants in St. Joseph, Missouri and Alton,
23 Illinois were seriously threatened by flooding of the Missouri and Mississippi Rivers

Direct Testimony of Daniel L. Kelleher

1 respectively. Throughout the crisis American Water System experts from the Service
2 Company and several affiliated subsidiaries worked onsite with employees of the affected
3 companies to plan and execute strategies to maintain water service to our customers. In
4 addition, our geographic diversity allowed us to secure from our other service territories
5 emergency resources and equipment which were unavailable in the affected areas. It is
6 this ability to bring to bear the combined resources of our national organization, which is
7 unmatched in the water industry that is so valuable to our customers when an emergency
8 occurs.

9 Sixth, the acquisition provides Az-Am with significant growth potential, which will
10 facilitate achievement of further economies of scale in the future.

11 Seventh, the acquisition will enhance the ability to enter into O&M contracts thereby
12 improving efficient utilization of assets.

13 Q17. Are there other reasons why AWW will be able to bring benefits to the customers of
14 Citizens AZ?

15 A17. Yes. AWW's primary business, through its operating subsidiaries, is the provision of
16 water and wastewater services. Therefore, AWW's primary commitment and the priority
17 of its investment capital is the provision of these services. In a capital intensive industry
18 characterized by rising costs, such as the water industry, it is beneficial to consumers to
19 have a company such as AWW as their water or wastewater provider, whose top priority
20 is the provision of these services.

Direct Testimony of Daniel L. Kelleher

1 On the other hand, diversified companies (e.g., those that provide services in more than
2 one business sector) may not accord the same priority to the provision of water related
3 services as does AWW. A water division of a diversified company, for example, will
4 need to compete with other operating divisions for managerial attention, limited
5 investment dollars and strategic priority, and the assignment of priority might take into
6 account perceptions about relative profitability and the contribution of the sector to the
7 business as a whole.

8 Similarly, the interest of some energy companies in water utilities may be motivated
9 more by a desire to acquire a larger customer base in which to market unbundled energy
10 services in a rapidly restructuring electric market than by a desire to prioritize the
11 provision of water service.

12 Another area in which AWW is uniquely capable of benefiting consumers is through its
13 national research programs centered in AWW's Belleville, Illinois laboratory facility. To
14 my knowledge, no other investor-owned water utility in the United States has a
15 comparable research capability. These research programs and the size of the American
16 Water System have allowed AWW to provide valuable data and input to the USEPA.
17 That data has assisted USEPA with the development of quality standards that are
18 effective in protecting health while remaining affordable to implement. In fact, when
19 over 50 deaths occurred as a result of contaminated water from a City of Milwaukee-
20 owned water treatment facility in April of 1993, the National Centers for Disease Control
21 and the USEPA turned to AWW's Belleville Lab for assistance in identifying the cause of
22 the outbreak. The Belleville Lab successfully identified cryptosporidium as the
23 contaminant. In 1999, the Belleville Lab developed a method for differentiating live

Direct Testimony of Daniel L. Kelleher

1 cryptosporidium cysts from dead ones, which allows for better detection and control of
2 this potentially lethal contaminant.

3 Recent media attention has focused on possible contamination of drinking water supplies
4 with methyl tertiary butyl ether (MTBE), a potentially carcinogenic oxygenate used in
5 gasoline to control air pollution. In January of this year, the AWWA Journal published a
6 study authored by two nationally recognized American Water System research scientists,
7 which reflected the results of a two-year investigation of the incidence of MTBE in the
8 American Water System. Based on the results of this study, AWW concluded that there
9 was no MTBE in Az-Am's system.

10 These are only a few of many examples of the benefits customers derive from AWW's
11 unique and concrete commitment to water quality and related research. The combination
12 of the Citizens AZ systems with the Az-Am system will enhance AWW's ability to
13 continue providing these services in a cost-effective manner, to the benefit of all
14 customers.

15 Q18. Will Az-Am have access to the equity capital necessary to accomplish the benefits you
16 have described?

17 A18. Yes. As I previously indicated, the primary business of AWW is investing in the
18 common stock of its water and wastewater utility subsidiaries so that they can provide
19 quality service to consumers. For example, during the 10-year period ending in 1992,
20 AWW increased its equity investment in all of its regulated subsidiaries from \$314

Direct Testimony of Daniel L. Kelleher

1 million to \$705 million. By 1999 AWW's equity investment in the subsidiaries exceeded
2 \$1.8 billion.

3 The American Water System and its predecessors are over 100 years old. By 1980 AWW
4 subsidiaries had invested \$1 billion in water utility plant. By 1989, the level of
5 investment had reached \$2 billion and by 1994, \$3 billion. At year-end 1999, AWW's
6 investment in water utility plant was approximately \$6 billion. Throughout that entire
7 period, AWW supplied all of the equity portion of the capital to put these facilities in
8 place.

9 Q19. What has been the level of construction expenditures by the American Water System.

10 A19. Throughout the country, the American Water System incurred over \$467 million in
11 construction expenditures in 1999 alone. For the past several years, these expenditures
12 have averaged approximately \$396 million per year. AWW has clearly demonstrated its
13 ongoing commitment to making the investments necessary to provide quality service that
14 complies with all applicable requirements.

15 Q20. Does that conclude your direct testimony?

16 A20. Yes.

E

DIRECT TESTIMONY OF
DAVID P. STEPHENSON
IN THE MATTER OF THE JOINT APPLICATION OF
CITIZENS UTILITY COMPANY AND CERTAIN OF ITS SUBSIDIARY COMPANIES
AND
ARIZONA-AMERICAN WATER COMPANY

MARCH 24, 2000

Direct Testimony of David P. Stephenson

1 Q 1 Please state your name, business address and telephone number.

2 A 1 My name is David P. Stephenson. My business address is 880 Kuhn Drive, Chula Vista,
3 California 91914. My telephone number is (619) 656-2400.

4 Q 2 By whom are you employed and in what capacity?

5 A 2 I am employed by American Water Works Service Company, Inc. ("Service Company")
6 as the Director of Rates and Revenues for the Western Region of American Water Works
7 Company, Inc. ("AWW"). The Western Region is comprised of water and wastewater
8 utilities located in Arizona, California, Hawaii and New Mexico, including Arizona-
9 American Water Company ("Az-Am") (formerly Paradise Valley Water Company). I
10 am also an Assistant Treasurer for Az-Am.

11 Q 3 Please summarize your responsibilities as the Director of Rates and Revenues.

12 A 3 I am responsible for all rate applications and similar filings and various written and face-
13 to-face communications related to rates and charges for utility service with the public
14 utility commissions that regulate AWW's operating utilities in Arizona, California,
15 Hawaii and New Mexico.

16 Q 4 Describe your educational background.

17 A 4 I received a Bachelor of Science in Business Administration, with an emphasis in
18 Accounting, from San Diego State University in 1977.

19 Q 5 Have you had any other formal training?

20 A 5 Yes, I have attended many seminars on various aspects of the water industry and rate
21 applications, including the National Association of Regulatory Utility Commissioners
22 ("NARUC") biannual Utility Rate Seminar.

Direct Testimony of David P. Stephenson

1 Q 6 Please describe your professional experience.

2 A 6 I have been employed by the American Water System since 1978. The various positions
3 I have held within the American Water System are: Accountant - 1978; Accounting
4 Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for
5 the operating utilities in the Western Region - 1983; Assistant Director of Rates and
6 Revenues for the operating utilities in the Western Region - 1984; and Director of Rates
7 and Revenues for the operating utilities in the Western Region since 1986.

8 Q 7 Have you had any other professional experience?

9 A 7 Yes, I served on the Accounting Committee of the California Water Association and have
10 been an instructor at the NARUC biannual Utility Rate Seminar on eight occasions.

11 Q 8 Have you previously testified before utility regulatory commissions?

12 A 8 Yes, I have testified before the Arizona Corporation Commission (the "Commission") in
13 rate proceedings for Az-Am, the California Public Utilities Commission on many
14 occasions in rate proceedings for California-American Water Company and the New
15 Mexico Public Regulation Commission in rate proceedings for New Mexico-American
16 Water Company.

17 Q 9 Please define the terms that you intend to use in this testimony as they relate to Az-Am's
18 purchase of the water and wastewater assets of Citizens Utilities Company and its
19 subsidiaries located within Arizona.

20 A 9 The defined terms that I will use in my testimony are as follows:

- 21 1. Citizens Utilities Company is referred to as "Citizens."
22 2. The various water and wastewater subsidiaries and operating divisions of Citizens in
23 Arizona are referred to as "Citizens AZ."

Direct Testimony of David P. Stephenson

- 1 3. The asset side of Citizens' balance sheet, including all utility plant and related items,
2 non-utility plant, current assets, deferred assets and rights under Citizens' certificates
3 of public convenience and necessity being acquired by AWW's operating
4 subsidiaries, is referred to as the "Acquired Assets."
- 5 4. The Acquired Assets in Arizona are referred to as the "AZ Acquired Assets."
- 6 5. The gross water and wastewater utility plant used by Citizens in the operation of its
7 water and wastewater utilities in all six states is referred to as "Citizens Gross Plant."
- 8 6. The gross water utility plant used by Citizens AZ in the business of storing,
9 supplying, distributing and selling water and in the business of providing wastewater
10 collection, treatment and disposal to the public is referred to as "AZ Gross Plant."

11
12 Q 10 Briefly describe the transaction that is the subject of this Application.

13 A 10. Under the terms of the Asset Purchase Agreement, dated as of October 15, 1999, Az-Am
14 has agreed to purchase the AZ Acquired Assets. The Joint Application to which this
15 testimony is attached seeks Commission approval of the transfer of the AZ Acquired
16 Assets to Az-Am, authorization for Az-Am to engage in and carry on the water and
17 wastewater utility business and to provide service to the customers of Citizens AZ, and
18 for Citizens AZ to withdraw from the water and wastewater utility business in Arizona.
19 In addition, Az-Am is seeking an accounting order relating to the transaction, as
20 explained below. Similar Asset Purchase Agreements have been executed relating to the
21 Acquired Assets of Citizens with Az-Am sister entities in the five other states in which
22 Citizens provides water and wastewater utility service.

23 Q 11. What is your general assignment in connection with the Joint Application?

24 A 11. My general assignment is to sponsor the Joint Application and all of the supporting
25 exhibits. I am responsible for supporting the method of allocation of the total purchase

Direct Testimony of David P. Stephenson

1 price for all of the Acquired Assets to each of the AWW operating utilities in the six
2 states involved and the methodology that will be used to account for the difference
3 between the purchase price paid by Az-Am for the AZ Acquired Assets and the book
4 value of the AZ Acquired Assets. In addition, I will briefly discuss the preliminary
5 synergy analysis that has been performed in connection with the transaction. Mr. Joseph
6 F. Hartnett, Treasurer of AWW, and Mr. Daniel L. Kelleher, Senior Vice President of the
7 Service Company, have also provided direct testimony. Mr. Hartnett's testimony
8 discusses the background and negotiations leading up to the acquisition of the Acquired
9 Assets from AWW's perspective. Mr. Kelleher provides testimony describing the
10 reasons for the acquisition from AWW's perspective as well as the trends in the water
11 industry that have led AWW to pursue the acquisition of other water systems.

12 Q 12 Please state the purchase price that AWW agreed to pay for the Acquired Assets.

13 A 12 AWW agreed to pay a total of \$835,000,000 for all of the Acquired Assets in the six
14 states, including Arizona. The negotiations that resulted in this purchase price are
15 discussed in Mr. Hartnett's testimony.

16 Q 13 How was the total purchase price determined for each of the six states?

17 A 13 The purchase price was determined for each of the states based on the portion of the
18 Citizens Gross Plant in that state.

19 Q 14 Why was this method chosen?

20 A 14 This method was chosen because the Gross Plant represents Citizens' plant and property
21 dedicated to the provision of water and wastewater utility service in each state.

22 Determining the total purchase price by state on the basis of the Gross Plant used for the
23 provision of utility service in that state is a fair and reasonable methodology. It provides
24

Direct Testimony of David P. Stephenson

1 a realistic and rational basis for allocating the appropriate portion of the total purchase
2 price to the utility operations in each state.

3 Q 15 Using this methodology, what is the calculated purchase price for the AZ Acquired
4 Assets?

5 A 15 Citizens AZ had an AZ Gross Plant balance of \$167.15 million (M) as of June 30, 1999.
6 Citizens had a Gross Plant balance in the six states of \$603.38M as of June 30, 1999.
7 Therefore, the Arizona property is 27.70% of the total. Multiplying the purchase price of
8 \$835M by 27.70% results in a purchase price of \$231.31M for Az-Am.

9 Q 16 Does the purchase price for the AZ Acquired Assets exceed the AZ Acquired Asset
10 balance as of June 30, 1999?

11 A 16 Yes. The AZ Acquired Asset balance was \$160.2M, based on the June 30, 1999 balance
12 sheet for Citizens AZ. The difference between the purchase price and the AZ Acquired
13 Asset balance will change somewhat based on a final agreement between the parties on
14 the Statement of Net Assets.

15 Q 17 Will the purchase price of the AZ Acquired Assets be adjusted at the time all approvals
16 have been received?

17 A 17 Yes, the actual, final purchase price will be determined based upon the AZ Acquired
18 Asset purchase price of \$231.3M, plus any additions and less any retirements after June
19 30, 1999.

20 Q18 How will Az-Am account for the difference between the purchase price and the AZ
21 Acquired Asset balance for regulatory purposes?

Direct Testimony of David P. Stephenson

1 A18 The difference will be recorded as an acquisition adjustment in accordance with the
2 Uniform System of Accounts. The ratemaking treatment of the acquisition adjustment
3 and the related amortization would be determined in Az-Am's next general rate
4 proceeding. Az-Am is not requesting that treatment for ratemaking purposes be
5 determined at this time. However, Az-Am does seek an accounting order in regard to the
6 amortization period and methodology to be used.

7 Q 19 What is the amortization period that Az-Am proposes to use?

8 A 19 Forty years.

9 Q 20 What method of amortization is Az-Am proposing to use?

10 A 20 Az-Am proposes to use a mortgage amortization method, which uses the same
11 amortization principle as home mortgages. Under this method, Az-Am would recover
12 only a small portion of the acquisition adjustment in the initial years and recover
13 increasingly greater amounts in the later years. The annual amortization increases each
14 year. The proposed amortization of the acquisition adjustment balance is shown on page
15 4 of the schedule attached to this testimony at Tab 1.

16 Q 21 What is the normal method of recovery for utility assets?

17 A 21 The normal method, known as a straight-line method of recovery, involves equal or level
18 recovery in each year of the asset's life.

19 Q 22 Why are you proposing the mortgage method rather than the straight-line method?

20 A 22 Although there are several reasons for this proposal, there is one significant reason that I
21 will address. The mortgage method levels the annual recovery of principal and carrying
22 costs. The mortgage method does not front-end load the revenue requirement as do
23 straight-line recovery methods. Also, level annual principal and carrying cost recovery

Direct Testimony of David P. Stephenson

1 will provide an easier measurement against which to compare the synergy savings to the
2 revenue requirement relating to the acquisition adjustment.

3 Q23 What should the Commission authorize in this proceeding in regard to an acquisition
4 adjustment?

5 A23 Az-Am requests that the Commission authorize a 40-year amortization period and use of
6 a mortgage amortization method, as discussed previously. Az-Am also requests that the
7 Commission defer determination of the ratemaking treatment of the acquisition
8 adjustment and related amortization until a general rate proceeding, at which time we will
9 have a final purchase price and other financial information available, as well as detailed
10 data and information available on the savings and benefits that are expected to accrue to
11 ratepayers. This data and information will be provided to the Commission as part of the
12 rate application.

13
14 Q 24 Has Az-Am attempted to perform an analysis of the savings likely to result from the
15 acquisition of the AZ Acquired Assets?

16 A 24 Yes. This preliminary analysis, which I will refer to as the "Synergy Analysis," is based
17 upon the post-consolidation, combined Az-Am entity that will exist after Az-Am's
18 acquisition of the AZ Acquired Assets. A summary of the Synergy Analysis is attached
19 at Tab 1.

20 Q 25 Please summarize the methodology used to develop the Synergy Analysis.

21 A 25 The Synergy Analysis is based on an objective quantification of savings related to
22 reductions in employee positions and related benefits, reductions in duplicative expenses,
23 avoidance of expenses, cost of capital reductions, savings in material costs, use of
24 existing employees and equipment to replace purchased services, and historical and future

Direct Testimony of David P. Stephenson

1 trend reductions. The expenses of each company (Az-Am and Citizens AZ) were
2 analyzed for possible savings. A summary of the synergy savings is found on pages 2 and
3 3 of the summary attached at Tab 1. However, the synergy savings would still exceed the
4 revenue requirement relating to acquisition adjustment.

5 Q26 What is Az-Am's current estimate of the synergy savings resulting from the transaction?

6 A26 At this time, we estimate total synergy savings of approximately \$960M over a 40-year
7 period. Subject to Commission approval in a subsequent rate proceeding, the synergy
8 savings would be offset by recovery of the acquisition adjustment over the same 40-year
9 period. Assuming that the acquisition adjustment is \$71.1M, based on Citizens AZ's
10 balance sheet as of June 30, 1999 and assuming that there is no adjustment to the
11 purchase price, synergy savings would exceed the revenue requirement relating to the
12 acquisition adjustment by about \$718M over the 40-year period or by a net present value
13 of approximately \$90M, as shown on page 4 of the summary.

14 Q 27 Is the Synergy Analysis complete?

15 A 27 No, it is a work in progress based on the latest information now available to us. The
16 synergy savings that have been provided to the Commission as part of this Joint
17 Application are Az-Am's best estimates of such savings at this time. The intent of the
18 Synergy Analysis is to provide the Commission with supportable evidence that the
19 customers will in fact benefit from this transaction. Az-Am recognizes, and the Joint
20 Application reflects, that actual synergy savings can be fully developed and quantified
21 only after the transaction closes and Az-Am is able to fully integrate the AZ Acquired
22 Assets into Az-Am and, more generally, the American Water System. The Synergy
23 Analysis will be more refined and the results more quantifiable by the time Az-Am files a
24 rate proceeding for the combined Az-Am entity.

Direct Testimony of David P. Stephenson

1 Q 28 Will the synergies you have estimated in connection with the Joint Application change?

2 A 28 Yes, they are only forecasts and there certainly will be deviations from the synergies
3 estimated in the attached schedule. For example, some years may produce greater
4 savings from synergies than we presently forecast, while other years may produce less.
5 However, on a cumulative basis we are confident that the full projected synergy savings
6 will be realized. It necessarily will take time to realize the full savings potential. It will
7 take time to achieve full integration and to fully understand how integration will affect
8 operations. Until the consolidation of the companies is complete and an interim period of
9 post-consolidation operation is experienced, the precise annual amount of synergy
10 savings is difficult to quantify.

11 Q 29 Does this conclude your direct testimony?

12 A 29 Yes it does.

F

WESTERN REGION - Operations (Arizona, Hawaii, New Mexico)

