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Arizona Corporation Commission

BEFORE THE ARIZONA CORPORATION COMMISSION

SEP 25 2000

DOCKETED BY [Signature]

CARL J. KUNASEK  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
WILLIAM A. MUNDELL  
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION BETWEEN CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.

Docket No. W-01032A-00-0192  
Docket No. W-01032B-00-0192  
Docket No. W-01032C-00-0192  
Docket No. W-01656B-00-0192  
Docket No. SW-2276A-00-0192  
Docket No. WS-02334A-00-0192  
Docket No. WS-03454A-00-0192  
Docket No. WS-03455A-00-0192  
Docket No. WS-02013A-00-0192  
Docket No. W-01595A-00-0192  
Docket No. W-01303A-00-0192

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Summary of Testimonies of Gordon Fox, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 25th day of September, 2000.

[Signature]  
Daniel W. Pozefsky  
Attorney, RUCO

1 AN ORIGINAL AND TEN COPIES  
of the foregoing filed this 25<sup>th</sup> day of  
2 September, 2000 with:

3 Docket Control  
Arizona Corporation Commission  
4 1200 West Washington  
Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
6 mailed this 25<sup>th</sup> day of September, 2000 to:

7 Jerry Rudibaugh, Chief Hearing Officer  
Hearing Division  
8 Arizona Corporation Commission  
1200 West Washington  
9 Phoenix, Arizona 85007

10 Lyn Farmer, Chief Counsel  
Legal Division  
11 Arizona Corporation Commission  
1200 West Washington  
12 Phoenix, Arizona 85007

13 Deborah Scott, Director  
Utilities Division  
14 Arizona Corporation Commission  
1200 West Washington  
15 Phoenix, Arizona 85007

16 Craig A. Marks  
Associate General Counsel  
17 Citizens Utilities Company  
2901 North Central Avenue, Suite 1660  
18 Phoenix, Arizona 85012

19 Carl J. Dabelstein  
Vice President - Regulatory  
20 Citizens Utilities Company  
2901 North Central Avenue, Suite 1660  
21 Phoenix, Arizona 85012

22

23

24

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3 American Water Works Service Co., Inc.  
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5 P.O. Box 1770  
6 Voorhees, New Jersey 08043

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8 Corporate Counsel  
9 David P. Stephenson  
10 Assistant Treasurer  
11 Arizona-American Water Company  
12 880 Kuhn Drive  
13 Chula Vista, California 91914

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15 Fennemore Craig  
16 3003 North Central Avenue, Suite 2600  
17 Phoenix, Arizona 85012-2913  
18 Attorneys for Arizona-American Water Company

19 Walter Meek, President  
20 Arizona Utility Investors Association  
21 2100 North Central Avenue, Suite 210  
22 Phoenix, Arizona 85004

23 By *Cheryl Fraulob*  
24 Cheryl Fraulob

**SALE OF ASSETS AND TRANSFER OF CC&N  
(Citizens Communication, Inc. to Arizona-American Water Company)**

Docket Nos. W-01032A-00-0192, W-01032B-00-0192, W-01032C-00-0192, S-02276A-00-0192, WS-02334A-00-0192, WS-03454A-00-0192, WS-03455A-00-0192, W-02013A-00-0192, W-01595A-00-0192, and W-01303A-00-0192

**SUMMARY OF THE DIRECT AND SURREBUTTAL TESTIMONIES  
OF  
GORDON L. FOX  
UTILITIES CHIEF RATE ANALYST  
ON BEHALF OF THE  
RESIDENTIAL UTILITY CONSUMER OFFICE**

The testimonies of Mr. Fox identify the following aspects of the transaction, as proposed, that present significant detrimental impacts for ratepayers. RUCO's support for approval of the transaction is conditioned upon rectification of these detrimental impacts for ratepayers.

Advances-in-Aid-of-Construction (AIAC) and Contributions-in-Aid-of Construction (CIAC) – Citizens proposes to retain \$80.8 million of AIAC and \$4.7 million of CIAC causing Az-Am's rate base to increase by \$85.5 million. Elimination of AIAC and CIAC in the calculation of rate base would have a \$10.0 million upward influence on the revenue requirement, i.e., revenues would increase by approximately one-third over the 1999 revenues of \$31.1 million. The effect of the treatment, as proposed by the joint application, is to cause ratepayers to pay twice for a portion of the plant originally financed with customer advances. RUCO recommends modification of the terms of the agreement to fully compensate ratepayers for all AIAC and CIAC.

Citizens Proposes to Keep 100 Percent of the Gain – Citizens is proposing to deny ratepayers any portion of the estimated gain of \$71.2 million. RUCO recommends an equal sharing of the gain between shareholders and ratepayers. Sharing of the gain is based on the fundamental financial concept that the benefit of the gain should be awarded to the parties that endured the risk. Ratepayers have shared in the economic risk related to the assets. For example, in the normal treatment for the early retirement of an asset, ratepayers absorb the loss and the utility is made whole.

Arizona-American's Acquisition Adjustment – Az-Am is proposing to defer treatment of its \$71.2 million acquisition adjustment until its next rate case. RUCO agrees that deferring the amount, if any, for recovery as a regulatory asset to the next rate case is appropriate. However, RUCO recommends that criteria be established in the current case to objectively measure the amount of the regulatory asset that might be authorized in the next rate case based on the net benefit of Az-Am's synergy savings. Establishing criteria now will benefit Az-

Am by providing the standard upon which the regulatory asset will be measured and ratepayers will benefit by knowing that the regulatory asset is based on objectively measured synergy benefits.

Citizens Retention of Low-Cost Debt, Industrial Revenue Development Bonds (IDRBs) – Citizens is proposing to retain \$13.55 million of IDRBs with a weighted average cost of 6.55 percent. Az-Am will replace the loss of the IDRB financing with the lowest cost capital structure available. Az-Am has not demonstrated that it can, or is likely to, obtain new capital at a cost equivalent to the IDRBs, which receive preferential tax treatment. RUCO recommends modification of the terms of the agreement to compensate ratepayers for the economic loss of the IDRBs.

Loss of Accumulated Deferred Assets (ADIT) and Investment Tax Credits (ITC) – As a result of the transaction, existing ADITs (\$5.9 million) and ITCs (\$2.1 million) that are deductions in the calculation of rate base will be eliminated and cause an upward influence on rates. RUCO recommends that the revenue impact due to the loss of ADITs and ITCs be considered in the overall determination of whether the transaction is in the public interest.

Az-Am Investment in Resource Stressed Utilities – The joint application claims that one benefit of Az-Am's acquisition of the Citizens' Arizona water and wastewater properties is the enhanced ability to acquire small and/or distressed water and wastewater companies. Testimony on behalf of Az-Am states, "AWW understands that, along with the opportunity to expand our water interests in Arizona, comes a responsibility to assist in the resolution of the structural problems plaguing the water industry which impede achievement of safe and reliable service to all consumers in Arizona." RUCO recommends that in the event that the other deficiencies noted are substantially, but not completely, rectified by changes to the purchase agreement, the Commission should consider a pledge by Az-Am's board of directors to invest 15 percent of the purchase price of the current transaction (approximately \$35 million) in "resource stressed" water and wastewater utilities in Arizona in the next 72 months as a "bridge" toward satisfying the requirement that the transaction be in the public interest.

Accounting Order – Az-Am's application requested an accounting order authorizing use of the mortgage amortization method to amortize the acquisition adjustment over 40 years. Subsequently, Az-Am has requested deferral of a determination on its request to the next rate case. RUCO recommends that the Commission defer until Az-Am's first rate case a determination regarding the amount, method, and term for the amortization of a regulatory asset, if any, to be recovered via rates.



**Craig A. Marks**  
Associate General Counsel

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Phoenix, AZ 85012-2736  
Direct Dial: (602) 532-4433  
Fax: (602) 265-3415  
Email: cmarks@czn.com

August 29, 2000

Daniel W. Pozefsky  
Residential Utility Consumer Office  
2828 North Central Ave., Ste. 1200  
Phoenix, Arizona 85004

AUG 29 PM 4:28

**RE: RUCO'S 3<sup>rd</sup> SET OF DATA REQUESTS – SUPPLEMENTAL  
DOCKET NOS. W-01032A-00-0192 et. al.**

Dear Dan:

Enclosed please find Citizens Communications Company's supplemental response to the following data request submitted by your staff in the above-referenced matter.

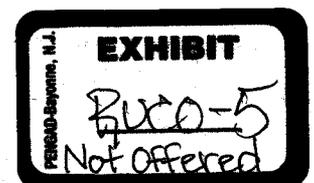
<u>Requestor</u>	<u>Response No.</u>
RUCO	3.01(h)

The data responses identify the person responsible for the information. If you have any questions or comments regarding this matter, please contact me at (602) 532-4433.

Very truly yours,  
*Craig A. Marks*

Enclosures

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**All Arizona**  
**Docket No. W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192;**  
**W-01656B-00-0192; S-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**  
**RUCO's Third Set of Data Requests**

**Witness: Ray Mason**

**Data Request No. 3.1- Supplemental:**

**Industrial Development Revenue Bonds (IDRBs)(FOLLOW-UP 1.7)** -- In response to RUCO data request 1.7, Citizens provided a list of outstanding IDRB loans. That list shows only one loan; Maricopa Series 1988 in the amount of \$10,635,000. Page 4 of the joint application asserts that this \$10,635,000 loan will be assumed by Az-Am and that amount is included in the \$231,310,000 purchase price. Schedule I attached to the "Asset Purchase Agreement" lists the following three additional IDRB's issued by the Industrial Development Authority of the County of Maricopa:

- (1) 1985 Series for \$3,150,000;
- (2) 1991 Series for \$7,000,000;
- (3) 1995 Series for \$13,550,000;

Please provide the following information.

- a. State the remaining outstanding balance on each of the three bonds (specify date).
- b. State the company that will have the obligation to provide the funds to repay each of these three bonds subsequent to the transaction and in accordance with the Asset Purchase Agreement.
- c. Provide the repayment date(s) for each of these three bonds.
- d. Provide the termination date for each of these three bonds.
- e. Provide the issuance date for each of these three bonds.
- f. Specify the type of interest (fixed or variable) for each of these three bonds (specify date).
  - (1) If variable, specify the basis for changing the rate.
- g. For each of the three bonds indicate either that (1) Citizens is retaining or (2) Az-Am is assuming the repayment obligations, as is applicable.
- h. If applicable state the rationale for Az-Am assuming some of the IDRBs and for Citizens retaining others. That is, for each IDRB, state the specific reason for assuming or retaining the IDRB obligation.

**All Arizona**  
**Docket No. W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192;**  
**W-1065B-00-0192; S-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**  
**RUCO's Third Set of Data Requests**

**Witness: Ray Mason**

**Response:**

- h. As a further clarification of how Az-Am's and Citizens' decision was a product of negotiations, it has been confirmed that the main influencing factor for not assuming the three series of bonds in question was a function of the conditions for transferring the three additional IDR B obligations referenced versus the Money Market Maricopa Series 1988 IDR B of \$10, 635,000.

All the bonds require unanimous consent for a transfer. The money market bonds that AZ-Am will assume are re-marketed on a weekly basis so it is easy to obtain all the bonds in the hands of one investment banker on a particular re-marketing date. The banker as bondholder then would vote in favor of the assumption, and re-market the bonds on the next day. However the fixed rate bonds that CZN is retaining do not provide for weekly re-marketing and would require us contacting every bond holder to obtain unanimous consent, which would be administratively difficult if not impossible within the timeframe of the acquisition transaction.



**Craig A. Marks**  
Associate General Counsel

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August 18, 2000

Daniel W. Pozefsky  
Residential Utility Consumer Office  
2828 North Central Ave., Ste. 1200  
Phoenix, Arizona 85004

2000-08-18

Az - Am

**RE: RUCO'S 3<sup>rd</sup> SET OF DATA REQUESTS  
DOCKET NOS. W-01032A-00-0192 et. al.**

Dear Dan:

Enclosed please find Citizens Communications Company's response to the following data request submitted by your staff in the above-referenced matter.

<u>Requestor</u>	<u>Response No.</u>
RUCO	3.01

The data responses identify the person responsible for the information. If you have any questions or comments regarding this matter, please contact me at (602) 532-4433.

Very truly yours,

Enclosures

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**All Arizona**

**Docket No. W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192;  
W-01656B-00-0192; S-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  
RUCO's Third Set of Data Requests**

**Witness: Ray Mason**

**Data Request No. 3.1:**

**Industrial Development Revenue Bonds (IDRBs)(FOLLOW-UP 1.7)** -- In response to RUCO data request 1.7, Citizens provided a list of outstanding IDRB loans. That list shows only one loan; Maricopa Series 1988 in the amount of \$10,635,000. Page 4 of the joint application asserts that this \$10,635,000 loan will be assumed by Az-Am and that amount is included in the \$231,310,000 purchase price. Schedule I attached to the "Asset Purchase Agreement" lists the following three additional IDRB's issued by the Industrial Development Authority of the County of Maricopa:

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- (2) 1991 Series for \$7,000,000;
- (3) 1995 Series for \$13,550,000;

Please provide the following information.

- a. State the remaining outstanding balance on each of the three bonds (specify date).
- b. State the company that will have the obligation to provide the funds to repay each of these three bonds subsequent to the transaction and in accordance with the Asset Purchase Agreement.
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- e. Provide the issuance date for each of these three bonds.
- f. Specify the type of interest (fixed or variable) for each of these three bonds (specify date).
  - (1) If variable, specify the basis for changing the rate.
- g. For each of the three bonds indicate either that (1) Citizens is retaining or (2) Az-Am is assuming the repayment obligations, as is applicable.
- h. If applicable state the rationale for Az-Am assuming some of the IDRBs and for Citizens retaining others. That is, for each IDRB, state the specific reason for assuming or retaining the IDRB obligation.

**All Arizona**

**Docket No. W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192;**

**W-1065B-00-0192; S-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**

**RUCO's Third Set of Data Requests**

**Witness: Ray Mason**

**Response:**

- a-g. Please see Citizens' Response to Data Request LAJ 1-10, previously provided. This provided the requested information for these three bonds. As stated in my response to RUCO Data Request 1.07, and in the application, Az-Am is only assuming the Maricopa series 1988 bonds in the amount of \$10,635,000.
- h. Az-Am's and Citizens' decision was a product of negotiations. For the three series of bonds in question, Az-Am may have been influenced by the fact that the bonds were completely drawn down.

All Arizona

Docket No. W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192;  
W-01656B-00-0192; S-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

Arizona Corporation Commission Staff's First Set of Data Requests

Witness: Ray Mason

Data Request No. LAJ 1-10:

Provide a December 31, 1999, debt schedule for the IDB's to be assumed by Arizona-American. Include date and amount issued, current balance, interest rate, issuance expenses, debt discount or premium, etc. and show the weighted cost of debt.

Response:

Please see the attached debt schedule as of December 31, 1999, that provides the IDB's to be assumed by Arizona-American that includes date and amount issued, current balance, interest rate, issuance expenses, debt discount or premium, and the weighted cost of debt.



CITIZENS UTILITIES COMPANY																
IDRB DEBT - AZ Water / Wastewater																
12/31/99																
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)	(O)	(P)	(Q)
ISSUE	STATED INT. RATE	PRINCIPAL AMOUNT OF ISSUE	DATE OF ISSUE	TENDER DATE	Next Call FROM	Period TO	DATE OF MAT.	ISSUANCE COST	NET PROCEEDS (C)-(K)	PROCEEDS \$100 UNIT (L)/(C)	COST TO MAT.	PRINCIPAL OUTSTANDING 12/31/99	COST AT 12/31/99 (N)-(O)	AVERAGE COST OF DEBT		
VARIABLE RATE BONDS																
MARICOPA Series 1988	3.288%	10,635,000	9/1/91	61	61	-	9/1/28	562,644	10,072,356	94,710	3.546%	10,635,000	377,117			
MOHAVE Series 1988-WWMM	3.438%	3,572,910	9/1/91	100	100	-	9/1/26	167,705	3,405,205	95,306	3.678%	3,572,910	131,412			
MOHAVE 1993 Series - WWV	3.382%	1,499,977	3/10/93	16	16	-	12/1/27	35,980	1,463,997	97,601	3.502%	1,499,977	52,529			
SNTA CRZ Series '88-Tubac	3.411%	43,492	9/1/91	89	89	-	9/1/22	1,572	41,920	96,385	3.606%	43,492	1,568			
TOTAL VAR. RATE BONDS		15,751,379						767,901	14,983,478			15,751,379	562,636			3.570%
TOTAL IDRB		52,361,457						2,124,312	50,237,144			52,361,457	2,960,528			5.650%

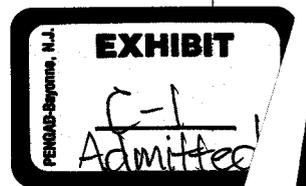
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**CITIZENS COMMUNICATIONS**

**ARIZONA WATER/WASTEWATER PROPERTIES**

**REBUTTAL TESTIMONY OF CARL W. DABELSTEIN**

**SEPTEMBER 2000**



1 Q. Please state your name and address.

2 A. My name is Carl W. Dabelstein. My business address is 2901 North Central  
3 Avenue, Phoenix, Arizona 85012.

4

5 Q. By whom are you employed and in what capacity?

6 A. I am employed by Citizens Communications Company ("Citizens") as Vice  
7 President-Regulatory Affairs for its Public Service Sector, that portion of  
8 Citizens that provides water and wastewater, electric, and gas service  
9 through operating divisions and subsidiaries in ten states, including Arizona.

10

11 Q. Please state your professional qualifications.

12 A. A description of my education and professional qualifications is attached  
13 as Appendix A.

14

15 Q. What is the purpose of your testimony?

16 A. My testimony is submitted in rebuttal to a portion of the direct testimony  
17 filed by Mr. Gordon Fox representing the Residential Utility Consumer  
18 Office. Specifically, I am responding to that portion of Mr. Fox's testimony  
19 beginning at Page 9 concerning the gain on the sale of assets to Arizona-  
20 American.

21

22 Q. Please describe your understanding of Mr. Fox's testimony.

23 A. It is my understanding that Mr. Fox proposes that Citizens be required to  
24 share the projected gain on the sale equally with the customers of the  
25 utility operations whose assets are being sold.

26

27

28

29

1 Q. On what basis is Mr. Fox making that recommendation?

2 A. In his testimony, Mr. Fox states that it is his understanding that the Arizona  
3 Corporation Commission normally provides for a sharing of such gains.  
4 Moreover, he opines that the parties that share in the risks related to utility  
5 assets should be entitled to share in the gains on the sales of those assets.  
6 Finally, Mr. Fox makes references to the Uniform System of Accounts  
7 ("USofA") of the National Association of Regulatory Utility Commissioners  
8 ("NARUC") as containing some support for his proposed sharing of the  
9 gains.

10

11 Q. Do you agree with the sharing of the gains recommendation of Mr. Fox?

12 A. No, I do not.

13

14 Q. Please explain.

15 A. First, I believe that Mr. Fox has misinterpreted the Commission's past  
16 practice concerning the treatment of gains on the sale of assets.

17

18 Q. What is the Commission's practice?

19 A. Typically, when a utility sells an asset that has been included in rate base,  
20 and that asset will no longer be used to provide utility service, the  
21 Commission requires a sharing of the after-tax gain associated with the  
22 disposition.

23

24 Q. Please provide examples of this practice?

25 A. One example is the sale by Arizona Public Service Company of its street  
26 lighting systems to the respective municipalities. Another is more recent,  
27 in 1999, when Citizens sold its office building on San Francisco Street in  
28 Flagstaff. The transaction produced a \$140,650 gain and Citizens recorded

29

1 a regulatory liability in the amount of \$70,325, representing 50% of the  
2 gain, in anticipation of regulatory disposition in a future rate proceeding. At  
3 that time, I sent a letter to the Acting Director of the Utilities Division at the  
4 Commission notifying him of such accounting treatment. What is common  
5 to both examples is that:

- 6 • a discrete asset was sold and removed from rate base;
- 7 • the selling utility continued to provide service in the same
- 8 territory; and
- 9 • the purchaser was not going to use the asset to provide utility
- 10 service to the public.

11  
12 Q. Are any of these circumstances present in this case?

13 A. No. Citizens is selling its entire line of business to Arizona-American ("AZ-  
14 Am"). After the closing, all the assets that were in Citizens' rate base will  
15 be in AZ-Am's rate base and will be used to provide regulated utility  
16 service. In turn, Citizens will have completely exited the water and  
17 wastewater utility business in Arizona. These facts are totally different  
18 from those in the transactions that produced gains that were required by  
19 the Commission to be shared with utility customers.

20  
21 Q. What is the difference to customers between the sale of an asset and the  
22 sale of a business?

23 A. The sale of an asset in rate base to a non-utility means that the asset will  
24 no longer be used to serve utility customers. In contrast, the sale of a  
25 utility business means that the assets will still be used to provide utility  
26 service. The same wells, mains, and trucks will be in service the day after  
27 the transaction closes as were in service the day before.

1 Q. Does the Commission recognize the distinction between the sale of an asset  
2 and the sale of a business?

3 A. Yes. The Commission does not require the sharing of gains on the sale of a  
4 business. Focusing on at least three such decisions, both involving gains  
5 associated with assets representing complete businesses that were  
6 purchased by Citizens from other utilities leaving the State.

7

8 Q. Please discuss the first case.

9 A. In July 1991, Citizens and Southern Union Gas Company ("Southern")  
10 signed an agreement under which Citizens purchased all of Southern's  
11 natural gas transmission and distribution system assets in Arizona. At the  
12 conclusion of that transaction, Southern retained no further business  
13 interests in the State.

14

15 The purchase price was reported as \$46 million, less certain working capital  
16 liabilities assumed and certain prorations after the closing. The net book  
17 value of the assets acquired was approximately \$27.6 million, producing a  
18 gain on the sale of some \$17 million. The asset purchase was approved by  
19 the Commission in Decision No. 57847 issued on December 2, 1991. No  
20 portion of the gain realized by Southern was required to be shared.

21

22 Q. What was the second case?

23 A. In May 1993, Citizens and Contel of the West ("Contel") signed an  
24 agreement under which Citizens purchased all of Contel's telephone  
25 properties and assets located in Arizona. At the conclusion of that  
26 transaction, Contel had no further telephone operations in the State. The  
27 purchase agreement contained a sales price of approximately \$88.6 million,  
28 which produced a gain for Contel on the transaction of approximately \$45

29

1 million. In the hearing that was conducted before the Commission in  
2 response to the parties' application for approval of the transaction, the  
3 Commission Staff recommended that a 50%-50% sharing of the gain  
4 between customers and investors be made. According to the Staff, such  
5 sharing was consistent with what it believed was the Commission's policy  
6 with respect to gains realized on the sale of utility property. RUCO did not  
7 present any testimony on the issue.

8  
9 As cited in the Commission's Order, among the reasons given in the Contel  
10 testimony for opposing any sharing of the gain, were the following:

- 11
- 12 • It is Contel, not the ratepayers, that is the legal owner of the tangible  
13 and intangible assets being sold, and therefore, requiring Contel to  
14 rebate 50% of the gain to ratepayers would constitute a governmental  
15 confiscation of private property and a violation of the constitution.
  - 16 • The Commission policy in transactions involving the sale of the complete  
17 businesses, where the selling utility is exiting the state subsequent to  
18 consummation of the transaction, has been to allow the selling company  
19 to retain 100% of the gain.
- 20

21 On October 17, 1994, the Commission issued Decision No. 58819 approving  
22 the Contel asset sale and agreeing with the Company that a sharing of the  
23 gain was inappropriate. Specifically, the Commission found that such  
24 proposed sharing was not mandated by previous Commission decisions.  
25 Accordingly, there was no sharing of the gains.

26  
27  
28  
29

1 Q. What is the third case?

2 A. This case was very recent. In June 1999, GTE California and Citizens  
3 Utilities Rural Company signed an agreement under which Citizens  
4 purchased the GTE telephone assets in the State of Arizona. The  
5 Commission approved the transfer in Decision No. 62648, issued on June  
6 13, 2000. Although it did not discuss the gain on the sale, no portion was  
7 required to be shared.

8  
9 Q. You have established that the Commission does not require gain sharing  
10 when a utility sells all or part of its line of business to another utility; is that  
11 consistent with U.S. regulatory practice?

12 A. To my knowledge, yes. California has articulated a policy that is consistent  
13 with Arizona's. In a case very similar to this one, the California Public  
14 Utilities Commission ("CalPUC") was asked to approve the sale of an entire  
15 regulated water utility to California-American Water Company (an affiliate  
16 of the co-applicant in this case, Arizona-American Water Company).<sup>1</sup> The  
17 CalPUC rejected arguments that the selling utility should share its gain on  
18 the sale with its customers. Relying on its long-standing policy, it stated:

19  
20 [G]ain on sale of utility plant shall accrue to the shareholders to  
21 the extent that the remaining ratepayers are not adversely  
22 affected when the sale is to a public entity. That same policy  
23 applies when the sale is to other than a public entity when the  
24 conveying utility was relieved of its public utility obligation to  
25 serve the geographic region being conveyed.<sup>2</sup>

26  
27  
28 <sup>1</sup> *Application of Ambler Park Water Utility and California-American Water Company*, 1998  
Cal. PUC LEXIS 936 (1998).

29 <sup>2</sup> *Id.*, at 12-13.

1 Q. Is there any reason in this case to deviate from settled regulatory practice?

2 A. No. The policy is a sound one. It is investors that have provided the  
3 capital and should be entitled to any gain on their investment. As I stated  
4 above, customers should be indifferent because the same assets will be  
5 used to provide service after the sale as before. Moreover, gains  
6 associated with utility asset sales typically reflect the intangible values  
7 associated with the selling company's operations. I am unaware of any  
8 instance where the Arizona Corporation Commission has allowed a utility  
9 under its jurisdiction to charge its customers service rates that are based  
10 on a revenue requirement that reflects the intangible values of utility plant  
11 assets.

12

13 Q. With respect to Mr. Fox's assertion that the parties sharing in the risks  
14 should share in the gains, do you have a opinion?

15 A. Yes. In my opinion, his assertion is incorrect. Under traditional utility  
16 regulation and ratemaking, ratepayers incur no risk for which they are  
17 entitled to compensation, such as Mr. Fox's proposed sharing of the gains  
18 resulting from the sale of Citizens' assets. Unless they become investors,  
19 ratepayers do not acquire an equity interest in the assets of the utilities  
20 that serve them. Through service rates, utility customers pay for the use of  
21 assets, but not for the assets themselves. Such "rent" does not vest in  
22 ratepayers, any legal or equitable interest.

23

24 Q Does the Commission set rates based on asset market values?

25 A. No. Arizona rates are based on fair value, which different from market  
26 value. Rate base is neither marked-up to reflect increases in market value,  
27 nor marked-down to reflect decreases.

28

29

1 Q. Has RUCO or any party to this proceeding ever suggested that customers  
2 should compensate the selling utility if it sold its business below net book  
3 value?

4 A. Not to my knowledge.  
5

6 Q. In his testimony, Mr. Fox refers to the NARUC Uniform System of Accounts  
7 in connection with his proposed sharing of the gains from the sale of assets.  
8 Do you agree with his testimony?

9 A. No, I do not. I believe he is attempting to ascribe greater significance to  
10 the USofA in this instance than is appropriate. Moreover, his example of  
11 the accounting that is required when an asset is prematurely retired as an  
12 illustration of the existence of ratepayer risk is misplaced.  
13

14 Q. Please explain your comment concerning the USoA.

15 A. The NARUC Uniform System of Accounts contains the instructions, account  
16 definitions, and numbering systems necessary for financial accounting and  
17 reporting by utilities. Similar systems have been published by the Federal  
18 Communications Commission and the Federal Energy Regulatory  
19 Commission for telecommunications service providers and energy utilities  
20 under their respective jurisdictional authority. All three systems of  
21 accounts have been adopted by virtually every state utility regulatory  
22 agency, including the Arizona Corporation Commission, with minor  
23 exceptions necessary to address particular informational needs by  
24 individual states.  
25

26 Although the Commission requires the utilities under its jurisdiction to  
27 follow the Uniform Systems of Accounts, it has long held that such  
28 requirements are for regulatory accounting and reporting purposes only,  
29

1 and do necessarily dictate ratemaking policies. Accordingly, any accounting  
2 practice associated with the sale of assets that is contained in the USofA is  
3 not obligatory on this Commission for ratemaking or asset sale approval  
4 purposes.

5  
6 Q. Please explain your comment regarding Mr. Fox's example of the  
7 accounting that is done in connection with assets prematurely retired from  
8 service.

9 A. As I have previously discussed, from the ratepayers' perspective, this  
10 transaction is not a retirement in the traditional sense. It is merely a  
11 transfer of ownership of the assets from Citizens to Arizona-American. As  
12 Citizens removes the original cost of the assets and the related  
13 accumulated depreciation from its balance sheet, Arizona-American will  
14 simultaneously be adding the same amounts to the respective plant  
15 accounts and the depreciation reserve on its balance sheet.

16  
17 The procedure described by Mr. Fox at page 10 of his testimony relates to  
18 the accounting that is performed when an asset is routinely retired from  
19 service, whether prematurely (as stated by Mr. Fox) or later than the  
20 expected average service life. I would agree that when an asset is retired  
21 prematurely, the accounting methodology described would preserve rate  
22 base at its pre-retirement level, reflecting the under-recovered capital cost  
23 of the asset removed. It must be noted, however, that when an asset is  
24 retired after the average service life, rate base is also preserved at the pre-  
25 retirement level, in that instance, an over-recovery of the capital cost of  
26 the respective asset. With depreciation rates based on projections of  
27  
28  
29

1 average service lives, the actual service life of any individual asset may  
2 differ from what was estimated. Conceptually, these differences are  
3 expected to balance out over time.  
4

5 Q. What is your recommendation?

6 A. The Commission should not accept Mr. Fox's recommendation that the gain  
7 on the asset sale be shared with ratepayers.  
8

9 Q. Does this conclude your testimony?

10 A. Yes it does.  
11  
12  
13  
14  
15

16 G:\Craig~docs\Az Water Disposition~Am Water Works\CWD Water sale testimony.doc  
17  
18  
19  
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1 **PROFESSIONAL QUALIFICATIONS**

2 Q. What is your educational background?

3 A. I graduated from the University of Nebraska with a Bachelor of Science  
4 Degree in Business Administration, major in Accounting. I also received a  
5 Master of Business Administration Degree, concentration in Finance from  
6 Rockhurst College in Kansas City, Missouri.

7  
8 Q. What has been your professional experience?

9 A. Upon graduation from college in 1968, I was employed by the international  
10 public accounting firm Arthur Andersen & Co. in its Omaha office. During  
11 such employment, I participated in and directed audits and other  
12 engagements involving commercial banks, healthcare facilities, public  
13 utilities, insurance carriers, and other clients.

14  
15 In 1971, I accepted a position reporting to the controller at Central  
16 Telephone & Utilities Corporation at its then headquarters in Lincoln,  
17 Nebraska. During the five years I was employed by CTU, I directed such  
18 activities as financial and regulatory accounting and reporting, internal  
19 auditing, budgeting, corporate acquisitions and divestitures, rate cases and  
20 other regulatory filings, banking relations, and corporate financings.

21  
22 From 1976 to 1981, I was employed by Kansas City Power & Light  
23 Company. My responsibilities included the corporate audit function,  
24 operations budgeting, and rate case filings in Kansas and Missouri and with  
25 the Federal Energy Regulatory Commission. During that period, I also  
26 served as a member of the Missouri Valley Electric Association, and the  
27 Finance and Accounting Committee of the Standardized Nuclear Unit Power  
28 Plant System.

1 From 1981 to 1991, I was employed as a Senior Project Manager for a  
2 regulatory consulting firm and successor firm, directing rate case,  
3 management audit, and other engagements for a clientele that included  
4 utility companies, public service commissions, and intervenors in regulatory  
5 proceedings.

6  
7 From 1991 through 1996, I was employed as an internal consultant with  
8 Northern States Power Company in Minneapolis. My responsibilities  
9 included accounting, taxation and cost allocation issues in rate cases and  
10 special regulatory proceedings, performing capital investment evaluations,  
11 accounting and tax research, developing cost recovery plans, and advising  
12 senior management in connection with the development of performance-  
13 based ratemaking proposals and strategic policies for a successful transition  
14 to a competitive electric utility industry.

15  
16 In late 1996, I accepted a position as Tax Research Coordinator for Tucson  
17 Electric Power Company. My chief responsibilities included tax research and  
18 planning, preparation, and review of corporate tax returns, and meeting  
19 with representatives of tax authorities. I also served on the corporate  
20 planning team addressing industry deregulation and competitive issues, and  
21 also directed the team charged with responsibility for creating and  
22 implementing a system for strategic business units, and developing the  
23 associated accounting and financial reporting practices.

24  
25 In January, 1997, I was appointed Director of Utilities for the Arizona  
26 Corporation Commission. In that capacity, I directed a staff of  
27 approximately ninety professional and clerical employees responsible for  
28  
29

1 overseeing railroad and pipeline safety in Arizona and for regulating the  
2 water, telephone, electric, and natural gas distribution utilities in the State.

3  
4 I accepted my current position as Vice President-Regulatory Affairs of the  
5 Public Service Sector of Citizens Utilities in February, 1998. In that  
6 capacity, I coordinate regulatory activities in the ten states served by  
7 Sector utilities. In addition, I am a member of the Arizona Utility Tax  
8 Issues Group and the Arizona Corporation Commission's Water Utility Task  
9 Force.

10  
11 Q. What are your professional certifications and affiliations?

12 A. I hold Certified Public Accountant Certificates issued by the respective  
13 Boards of Accountancy in Nebraska and Kansas. I am a member of the  
14 American Institute of Certified Public Accountants, the National Association  
15 of Radio and Telecommunications Engineers ("NARTE"), and the National  
16 Association of Railroad and Public Utility Tax Representatives.

17  
18 Q. What technical licenses do you hold?

19 A. I hold an Advanced Class FCC Radio License and a Technician Class NARTE  
20 certification with regulatory and antennas endorsements.

21  
22 Q. What is your teaching experience?

23 A. I have developed and conducted seminars on a variety of topics for  
24 employees of public utilities and regulatory agencies. I have also taught  
25 classes on behalf of the U.S. Telephone Association. Last May, I was an  
26 instructor at the NARUC Western Utility Rate School, and for the past eight  
27 years, have been a member of the faculty of the NARUC Regulatory Studies  
28 Program at the Public Utility Institute at Michigan State University. In  
29

1 connection with my teaching, I have written three instructional books:  
2 *Public Utility Income Taxation and Ratemaking*, *Public Utility Working*  
3 *Capital*, and *Generally Accepted Accounting Principles for Utilities*.

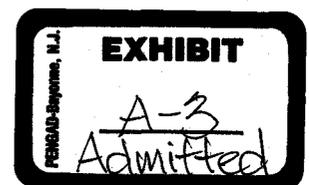
4  
5 Q. What has been your experience in regulatory proceedings?

6 A. During the past twenty-eight years, I have participated in numerous rate  
7 cases and other regulatory and litigation proceedings involving electric, gas  
8 transmission and distribution, telephone, water, and wastewater utilities  
9 conducted in Alaska, Arizona, California, Colorado, Connecticut, District of  
10 Columbia, Florida, Illinois, Indiana, Kansas, Maryland, Minnesota, Missouri,  
11 Nevada, New Mexico, North Carolina, North Dakota, South Dakota, Virginia,  
12 and Wisconsin, as well as proceedings before the Federal Energy Regulatory  
13 Commission and the National Energy Board of Canada. I have also spoken  
14 before legislative bodies in connection with proposed legislation. I have  
15 testified on matters involving financial and regulatory accounting and  
16 reporting, auditing, cost allocation, financial forecasting, capital and  
17 operations budgeting, taxation, corporate acquisitions, holding companies,  
18 valuation and transfer pricing, deregulation, the cost of capital, industry  
19 restructuring, and regulatory policy.

**CORRECTED 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 28, 2000

PHX/NJAMES/1046482.1/73244.021



**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  
20 Q 14 Why was this method chosen?

21 A 14 This method was chosen because the Gross Plant represents Citizens' plant and property  
22 dedicated to the provision of water and wastewater utility service in each state.  
23 Determining the total purchase price by state on the basis of the Gross Plant used for the  
24 provision of utility service in that state is a fair and reasonable methodology. It provides

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.

1

(1) Year	(2) Savings O&M Labor	(3) Purchased Water Savings	(4) Purchased Power Savings	(5) Chemical Savings	(6) Waste Disposal Savings	(7) Management Fee Savings	(8) Group Insurance Savings	(9) Pension Savings	(10) Regulatory Expense
Acq Year	-373,084	0	0	0	0	1,116,464	-89,574	260	0
1	-772,284	0	0	0	0	2,288,752	-200,917	537	0
2	-799,313	0	0	0	0	2,345,971	-225,294	556	0
3	-827,289	0	0	0	0	2,404,620	-252,595	575	0
4	-856,244	0	0	0	0	2,464,735	-283,174	595	0
5	-886,213	0	0	0	0	2,526,353	-317,425	616	0
6	-917,230	0	0	0	0	2,589,511	-355,791	638	0
7	-949,333	0	0	0	0	2,654,249	-398,769	660	0
8	-982,560	0	0	0	0	2,720,605	-446,918	683	0
9	-1,016,949	0	0	0	0	2,788,620	-500,862	707	0
10	-1,052,542	0	0	0	0	2,858,336	-561,303	732	0
11	-1,089,381	0	0	0	0	2,929,794	-629,030	758	0
12	-1,127,509	0	0	0	0	3,003,039	-704,926	785	0
13	-1,166,972	0	0	0	0	3,078,115	-789,984	812	0
14	-1,207,816	0	0	0	0	3,155,068	-885,318	840	0
15	-1,250,089	0	0	0	0	3,233,945	-992,180	869	0
16	-1,293,842	0	0	0	0	3,314,794	-1,111,975	899	0
17	-1,339,127	0	0	0	0	3,397,664	-1,246,279	930	0
18	-1,385,997	0	0	0	0	3,482,606	-1,396,865	963	0
19	-1,434,507	0	0	0	0	3,569,671	-1,565,723	997	0
20	-1,484,714	0	0	0	0	3,658,913	-1,755,089	1,032	0
21	-1,536,679	0	0	0	0	3,750,386	-1,967,475	1,068	0
22	-1,590,463	0	0	0	0	3,844,146	-2,205,706	1,105	0
23	-1,646,129	0	0	0	0	3,940,249	-2,472,951	1,144	0
24	-1,703,743	0	0	0	0	4,038,755	-2,772,778	1,184	0
25	-1,763,374	0	0	0	0	4,139,724	-3,109,192	1,225	0
26	-1,825,092	0	0	0	0	4,243,217	-3,486,699	1,268	0
27	-1,888,970	0	0	0	0	4,349,297	-3,910,363	1,312	0
28	-1,955,084	0	0	0	0	4,458,030	-4,385,878	1,358	0
29	-2,023,512	0	0	0	0	4,569,481	-4,919,648	1,406	0
30	-2,094,335	0	0	0	0	4,683,718	-5,518,872	1,455	0
31	-2,167,637	0	0	0	0	4,800,811	-6,191,650	1,506	0
32	-2,243,505	0	0	0	0	4,920,831	-6,947,090	1,559	0
33	-2,322,027	0	0	0	0	5,043,852	-7,795,440	1,614	0
34	-2,403,298	0	0	0	0	5,169,948	-8,748,228	1,670	0
35	-2,487,414	0	0	0	0	5,299,197	-9,818,424	1,728	0
36	-2,574,473	0	0	0	0	5,431,677	-11,020,623	1,788	0
37	-2,664,579	0	0	0	0	5,567,469	-12,371,249	1,851	0
38	-2,757,839	0	0	0	0	5,706,656	-13,888,786	1,916	0
39	-2,854,363	0	0	0	0	5,849,323	-15,594,038	1,983	0
40	-2,954,266	0	0	0	0	5,995,556	-17,510,423	2,052	0
TOTAL	-65,669,777	0	0	0	0	155,384,148	-159,345,504	45,636	0
Present Value	8.55%	-12,336,442	0	0	0	32,363,974	-13,782,168	8,576	0

(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
Insurance Other	Customer Accounting	Rents	General Office Expense	Miscellaneous Expense	Maintenance Expense	Depreciation Savings	General Tax Savings	Capital Investment Savings	Return on Investment	Total Savings
81,432	200,000	17,808	0	-200,712	0	40,029	87,531	360,000	475,309	1,715,463
162,863	410,000	36,506	0	-411,459	0	160,117	287,043	1,071,000	1,020,796	4,052,954
162,863	420,250	37,419	0	-421,746	0	322,235	515,881	1,782,000	1,103,337	5,244,159
162,863	430,756	38,354	0	-432,290	0	488,405	744,570	2,492,000	1,165,878	6,415,847
162,863	441,525	39,313	0	-443,097	0	658,731	973,103	3,203,000	1,213,062	7,574,412
162,863	452,563	40,296	0	-454,174	0	833,314	1,201,476	3,913,000	1,240,830	8,713,499
162,863	463,877	41,303	0	-465,529	0	1,012,262	1,429,685	4,622,000	1,281,539	9,865,128
162,863	475,474	42,336	0	-477,168	0	1,195,684	1,657,724	5,332,000	1,337,735	11,033,455
162,863	487,361	43,394	0	-489,097	0	1,383,691	1,885,588	6,041,000	1,394,732	12,201,342
162,863	499,545	44,479	0	-501,325	0	1,576,398	2,113,272	6,750,000	1,452,564	13,369,312
162,863	512,034	45,591	0	-513,859	0	1,773,923	2,340,771	7,459,000	1,511,269	14,536,815
162,863	524,835	46,731	0	-526,705	0	1,976,386	2,568,080	8,166,000	1,570,881	15,701,212
162,863	537,956	47,899	0	-539,873	0	2,183,911	2,795,191	8,875,000	1,631,438	16,865,774
162,863	551,405	49,096	0	-553,370	0	2,396,624	3,022,100	9,582,000	1,692,977	18,025,666
162,863	565,190	50,323	0	-567,204	0	2,614,655	3,248,801	10,291,000	1,755,535	19,183,937
162,863	579,320	51,581	0	-581,384	0	2,838,136	3,475,286	10,998,000	1,819,152	20,335,499
162,863	593,803	52,871	0	-595,919	0	3,067,205	3,701,549	11,704,000	1,883,865	21,480,113
162,863	608,648	54,193	0	-610,817	0	3,302,000	3,927,585	12,411,000	1,949,716	22,618,376
162,863	623,864	55,548	0	-626,087	0	3,542,665	4,153,385	13,117,000	2,016,744	23,746,689
162,863	639,461	56,937	0	-631,740	0	3,789,347	4,378,943	13,822,000	2,084,990	24,863,239
162,863	655,448	58,360	0	-637,784	0	4,042,195	4,604,252	14,528,000	2,154,497	25,967,973
162,863	671,834	59,819	0	-644,228	0	4,301,365	4,829,303	15,233,000	2,225,308	27,056,564
162,863	688,630	61,314	0	-691,083	0	4,567,014	5,054,089	15,938,000	2,297,464	28,127,373
162,863	705,846	62,847	0	-708,360	0	4,839,305	5,278,603	16,643,000	2,371,012	29,177,429
162,863	723,492	64,418	0	-726,069	0	5,118,403	5,502,834	17,347,000	2,445,995	30,202,354
162,863	741,579	66,028	0	-744,221	0	5,404,478	5,726,775	18,050,000	2,522,461	31,198,346
162,863	759,118	67,679	0	-762,826	0	5,697,705	5,950,419	18,753,000	2,600,455	32,162,107
162,863	779,121	69,371	0	-781,897	0	5,998,262	6,173,753	19,456,000	2,680,026	33,088,775
162,863	798,599	71,105	0	-801,445	0	6,306,334	6,396,771	20,158,000	2,761,222	33,971,875
162,863	818,564	72,883	0	-821,481	0	6,622,107	6,619,462	20,860,000	2,844,092	34,806,217
162,863	839,028	74,705	0	-842,019	0	6,945,775	6,841,816	21,561,000	2,928,689	35,583,823
162,863	860,004	76,573	0	-863,069	0	7,277,534	7,063,822	22,262,000	3,015,063	36,297,820
162,863	881,504	78,487	0	-884,646	0	7,617,588	7,285,469	22,963,000	3,103,268	36,939,328
162,863	903,542	80,449	0	-906,762	0	7,966,143	7,506,749	23,663,000	3,193,357	37,497,340
162,863	926,131	82,460	0	-929,431	0	8,323,411	7,727,647	24,362,000	3,285,386	37,960,559
162,863	949,284	84,522	0	-952,667	0	8,689,612	7,948,154	25,061,000	3,379,410	38,317,265
162,863	973,016	86,635	0	-976,484	0	9,064,967	8,168,258	25,759,000	3,475,488	38,552,112
162,863	997,341	88,801	0	-1,000,896	0	9,449,706	8,387,943	26,458,000	3,573,678	38,650,928
162,863	1,022,275	91,021	0	-1,025,919	0	9,844,064	8,607,201	27,155,000	3,674,041	38,592,493
162,863	1,047,832	93,297	0	-1,051,567	0	10,248,281	8,826,015	27,852,000	3,776,636	38,358,262
162,863	1,074,028	95,629	0	-1,077,857	0	10,662,603	9,044,374	28,548,000	3,879,231	37,921,790
6,595,432	27,835,083	2,478,381	0	-27,934,266	0	184,142,570	188,051,273	594,601,000	91,789,128	997,973,624
1,763,891	5,797,588	516,209	0	-5,818,240	0	23,234,120	26,932,329	85,871,099	17,393,143	161,944,080

Acquisition Adjustment Analysis

CITIZENS

BOY Balance	BOY	Amortization	EOY	Tax Dep	Def Tax	Acc Def Tax	AVERAGE	Revenue Requirement
71,151,139	71096139	\$55,000	71096139	2371705	933632	933632	70660000	4050000
1	71096139	\$110,000	70986139	4743409	1867264	2800896	69170000	7985000
2	70986139	\$122,500	70863639	4743409	1862226	4663122	67190000	7772000
3	70863639	\$136,400	70727239	4743409	1856625	6519747	65200000	7559000
4	70727239	\$152,000	70575239	4743409	1850338	6370085	63210000	7348000
5	70575239	\$169,300	70405939	4743409	1843366	10213451	61200000	7137000
6	70405939	\$188,600	70217339	4743409	1835588	12049039	59180000	6926000
7	70217339	\$210,000	70007339	4743409	1826964	13876003	57150000	6717000
8	70007339	\$233,900	69773439	4743409	1817332	15693335	55110000	6508000
9	69773439	\$260,600	69512839	4743409	1806572	17499907	53050000	6300000
10	69512839	\$290,200	69222839	4743409	1794643	19294550	50970000	6093000
11	69222839	\$323,300	68899339	4743409	1781304	21075854	48880000	5888000
12	68899339	\$360,100	68539239	4743409	1766474	22842328	46760000	5684000
13	68539239	\$401,100	68138139	4743409	1749951	24592279	44620000	5481000
14	68138139	\$446,700	67691439	4743409	1731574	26323853	42460000	5281000
15	67691439	\$497,600	67193839	2371705	755284	27079117	40740000	5136000
16	67193839	\$554,200	66639639	0	-223343	26855774	39950000	5103000
17	66639639	\$617,300	66022339	0	-248772	26607002	39600000	5126000
18	66022339	\$687,600	65334739	0	-277103	26329899	39210000	5120000
19	65334739	\$765,900	64568839	0	-308658	26021241	38780000	5181000
20	64568839	\$853,100	63715739	0	-343799	25677442	38290000	5212000
21	63715739	\$950,200	62765539	0	-382931	25294511	37750000	5248000
22	62765539	\$1,058,400	61707139	0	-426535	24867976	37160000	5289000
23	61707139	\$1,178,900	60528239	0	-475097	24392879	36490000	5333000
24	60528239	\$1,313,200	59215039	0	-529220	23863659	35740000	5382000
25	59215039	\$1,462,700	57752339	0	-589468	23274191	34910000	5437000
26	57752339	\$1,629,200	56123139	0	-656568	22617623	33990000	5499000
27	56123139	\$1,814,700	54308439	0	-731324	21886299	32960000	5567000
28	54308439	\$2,021,300	52287139	0	-814584	21071715	31820000	5644000
29	52287139	\$2,251,400	50035739	0	-907314	20164401	30540000	5728000
30	50035739	\$2,507,700	47528039	0	-1010603	19153798	29120000	5823000
31	47528039	\$2,793,200	44734839	0	-1125660	18028138	27540000	5929000
32	44734839	\$3,111,200	41623639	0	-1253814	16774324	25780000	6046000
33	41623639	\$3,465,400	38158239	0	-1396556	15377768	23810000	6176000
34	38158239	\$3,860,000	34298239	0	-1555580	13822188	21630000	6323000
35	34298239	\$4,299,400	29998839	0	-1732658	12089530	19190000	6484000
36	29998839	\$4,788,900	25209939	0	-1929927	10159803	16480000	6665000
37	25209939	\$5,334,100	19875839	0	-2149642	8009961	13460000	6867000
38	19875839	\$5,941,400	13934439	0	-2394384	5615577	10090000	7090000
39	13934439	\$6,617,900	7316539	0	-2667014	2948563	6340000	7340000
40	7316539	\$7,316,300	239	0	-2948469	94	2180000	7564000
		71150900	2257532799	71151136		1598360000		249073000

0

**Synergy Analysis - Customer Rate Impact Viewpoint**

Year	(1) Synergy Savings	(2) Acquisition Adjustment Revenue Req.	(3) Cumulative Synergy Savings- Company
1	1,715,463	4,050,000	-2,334,537
2	4,052,954	7,985,000	-6,266,583
3	5,244,159	7,772,000	-8,794,424
4	6,415,847	7,559,000	-9,937,577
5	7,574,412	7,348,000	-9,711,165
6	8,713,499	7,137,000	-8,134,666
7	9,865,128	6,926,000	-5,195,538
8	11,033,455	6,717,000	-879,083
9	12,201,342	6,508,000	4,814,259
10	13,369,312	6,300,000	11,883,571
11	14,536,815	6,093,000	20,327,386
12	15,701,212	5,888,000	30,140,598
13	16,865,774	5,684,000	41,322,372
14	18,025,666	5,481,000	53,867,038
15	19,183,937	5,281,000	67,769,975
16	20,335,499	5,136,000	82,969,474
17	21,480,113	5,103,000	99,346,587
18	22,618,376	5,126,000	116,838,963
19	23,746,689	5,152,000	135,433,652
20	24,863,239	5,181,000	155,115,891
21	25,967,973	5,212,000	175,871,864
22	27,056,564	5,248,000	197,680,428
23	28,127,373	5,289,000	220,518,801
24	29,177,429	5,333,000	244,363,230
25	30,202,354	5,382,000	269,183,584
26	31,198,346	5,437,000	294,944,930
27	32,162,107	5,499,000	321,608,037
28	33,088,775	5,567,000	349,129,812
29	33,971,875	5,644,000	377,457,687
30	34,806,217	5,728,000	406,535,904
31	35,583,823	5,823,000	436,296,727
32	36,297,820	5,929,000	466,665,547
33	36,939,328	6,046,000	497,558,875
34	37,497,340	6,176,000	528,880,215
35	37,960,559	6,323,000	560,517,774
36	38,317,265	6,484,000	592,351,039
37	38,552,112	6,665,000	624,238,151
38	38,650,928	6,867,000	656,022,079
39	38,592,493	7,090,000	687,524,572
40	38,358,262	7,340,000	718,542,834
<b>TOTAL</b>	<b>960,051,834</b>	<b>241,509,000</b>	<b>718,542,834</b>
<b>NPV</b>	<b>160,631,681</b>	<b>70,751,778</b>	<b>89,879,903</b>

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.  
17

DOCKET NOS. W-01032A-00- 0192  
W-01032B-00- 0192  
W-01032C-00- 0192  
S-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

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21 REBUTTAL TESTIMONY OF DAVID P. STEPHENSON  
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September 5, 2000

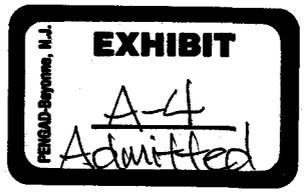


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**REBUTTAL TESTIMONY OF DAVID P. STEPHENSON**

1  
2 Q. State your name and business address.

3 A. My name is David P. Stephenson. I am employed by American Water Works  
4 Service Company, Inc., 880 Kuhn Drive, Chula Vista, California 91914.

5 Q. Have your previously provided testimony in this matter.

6 A. Yes, I provided direct testimony in support of the joint application of Arizona-  
7 American Water Company ("Arizona-American") and Citizens Communications,  
8 Inc. (formerly Citizens Utilities Company) and Citizens' various Arizona water  
9 and wastewater subsidiaries (collectively, "Citizens") for authority for Citizens  
10 to transfer its water and wastewater utility plant, property and Certificates of  
11 Public Convenience and Necessity ("CC&Ns") to Arizona-American. The  
12 application was filed on March 24, 2000 (the "Joint Application").

13 Q. Please state the purpose of your rebuttal testimony.

14 A. The purpose of my rebuttal testimony is to state, on behalf of Arizona-  
15 American, my agreements or disagreements with the Direct Testimony of  
16 Arizona Corporation Commission ("Commission") Staff witness Linda A. Jaress  
17 and Residential Utility Consumer Office ("RUCO") witness Gordon Fox. They  
18 have both provided direct testimony in this matter containing various  
19 recommendaitons regarding the Joint Application.

20 **I. SUMMARY OF ARIZONA-AMERICAN'S POSITION.**

21 Q. Please briefly summarize your agreements with Ms. Jaress and Mr. Fox.

22 A. I agree with both witnesses that this Joint Application should be approved, that  
23 Arizona-American is a suitable owner-operator for the affected Citizens'  
24 systems and that the rate-making and regulatory accounting treatment afforded  
25 to Arizona-American for any acquisition adjustment should be deferred until the  
26 first rate increase application for one of the affected systems.

1 Q. Briefly summarize your disagreements with Ms. Jaress and Mr. Fox.

2 A. Both witnesses have proposed conditions on the transfer of the utility plant and  
3 assets with which I disagree. Put simply, if approved, those conditions would  
4 materially alter the agreement that Arizona-American and Citizens have  
5 negotiated. I will address these proposed conditions and explain why the  
6 Commission should disregard them.

7 Q. Please state the organization of the remainder of your testimony.

8 A. My testimony is organized in three sections. I will first respond specifically to  
9 the recommendations of Ms. Jaress, the Commission's witness in this matter.  
10 Next I will respond specifically to the recommendations of Mr. Fox, RUCO's  
11 witness in this matter. Finally, I will state the rebuttal position of Arizona-  
12 American as it relates to this Joint Application.

13 **II. REBUTTAL TO COMMISSION STAFF.**

14 Q. Please state the conditions concerning the transfer of the Citizens' utility plant  
15 and assets proposed by Ms. Jaress with which you agree.

16 A. Ms. Jaress has recommended six conditions that should be placed on the  
17 transfer of Citizens' utility plant and assets to Arizona-American: 1) that the  
18 Commission defer any decision on the treatment of an acquisition adjustment,  
19 deferred taxes, excess deferred taxes and investment tax credits until a future  
20 rate proceeding; 2) that the decision to allow the recovery of any acquisition  
21 adjustment should be based on Arizona-American's ability to demonstrate that  
22 clear, quantifiable and substantial net benefits exist; 3) that Arizona-American  
23 should file a report comparing the number of customer complaints received by  
24 the Commission under its ownership 13 months after the closing; 4) that  
25 Citizens' advances and contributions in aid of construction, which Citizens will  
26 retain, should be imputed to Arizona-American; 5) that Arizona-American be

1 required to seek Commission approval of any amendment to, or transfer of the  
2 agreements for the purchase of Colorado River water, and 6) that Arizona-  
3 American adopt and utilize the rates and charges and all tariffs currently in  
4 effect in each of the affected Citizens service areas. I agree with all of Ms.  
5 Jares's conditions except for condition 4. I do not believe that the  
6 Commission should impute Citizens' advances and contributions to Arizona-  
7 American, artificially reducing rate base, when Citizens will remain responsible  
8 for refunding pre-existing advances.

9 In addition, I would like to note that our agreement to defer any decisions  
10 on certain issues until Arizona-American seeks new rates in a future proceeding,  
11 does not mean that we agree with these conditions. For example, we believe  
12 that imputing the deferred income taxes and investment tax credits of a prior  
13 owner to Arizona-American in a future rate proceeding would result in a  
14 violation of IRS normalization rules. Nonetheless, we agree with Staff that the  
15 issue can be addressed in the next rate proceeding.

16 Q. Please explain why you believe the Commission should not impute Citizens'  
17 advances and contributions in aid of construction to Arizona-American.

18 A. As I stated in response to RUCO data request 1.10, Arizona-American is  
19 purchasing all the water and wastewater assets of Citizens in Arizona. Arizona-  
20 American is not assuming any of the liabilities of Citizens related to these  
21 assets, except for one series of Industrial Development Revenue Bonds  
22 ("IDRBs"). The agreement between Citizens and Arizona-American was based  
23 on arms-length negotiations, taking into account market conditions for the value  
24 of the assets. Arizona-American believes that it should be allowed to earn a fair  
25 return on its investment in those assets.

26

1 Q. Do you agree with Ms. Jaress' contention that rates will increase significantly if  
2 Citizens' advances and contributions are not recognized by Arizona-American?

3 A. No. The flaw in Ms. Jaress' contention is that she is considering only the effect  
4 of one aspect of the transaction while ignoring other significant aspects. A  
5 utility's rates are set in a case-by-case basis, based on the utility's "fair value"  
6 rate base, operating expenses, capital costs and other circumstances during an  
7 historic test year, with appropriate proforma adjustments. When Arizona-  
8 American seeks new rates in a future rate proceeding, those rates will  
9 necessarily depend on a number of different factors. The impact of eliminating  
10 Citizens' advances and contributions may be offset by changes in operating  
11 expenses, capital costs and other operating efficiencies, as well as changed  
12 circumstances and regulatory developments. It is overly simplistic to assume  
13 that rates will automatically increase, as Ms. Jaress has done.

14 Q. If the Commission were to agree with Ms. Jaress that some imputation of  
15 advances and contributions should be made, do you agree with Ms. Jaress's  
16 recommendation that the advances in aid of construction be amortized over a  
17 10-year period?

18 A. No. I believe that Ms. Jaress has failed to consider all the related facts  
19 regarding Citizens' advances. Ms. Jaress has based her recommendation on the  
20 fact that many main extension agreements in Arizona use 10 years as the  
21 refund period, based on the minimum requirement in A.A.C. R14-2-406.  
22 However, the contracts related to the advances Citizens has received have been  
23 in place for varying periods of time and have varying terms and conditions.  
24 Some of these contracts have refund periods that will expire in one year and  
25 others may have just been executed and the refund period will not expire for 10  
26 years.

- 1 Q. How would you recommend that the amortization period be determined?
- 2 A. I believe that the amortization period should be determined based on a weighted  
3 average of the remaining refund period under the contracts that Arizona-  
4 American will not assume.
- 5 Q. Have you estimated that weighted average?
- 6 A. Yes. The weighted average remaining life for the current advance contracts as  
7 of June 30, 2000 is approximately 6.5 years. Therefore, I believe that the  
8 appropriate period that should be used is 6.5 years.
- 9 Q. What amortization period does Ms. Jaress propose for contributions in aid of  
10 construction?
- 11 A. With respect to contributions, Ms. Jaress proposes an amortization period equal  
12 to the remaining period used for depreciation purposes, i.e., the asset's  
13 remaining useful life. Given that the imputation proposed by Ms. Jaress is  
14 intended to artificially reduce Arizona-American's rate base, notwithstanding our  
15 actual investment in Citizens' utility plant and assets, I see no reason not to use  
16 the same amortization period for contributions - 6.5 years.
- 17 Q. Does this complete your rebuttal to Staff?
- 18 A. Yes, it does.
- 19 **III. REBUTTAL TO RUCO.**
- 20 Q. Please state the conditions concerning the transfer of Citizens' utility plant and  
21 assets proposed by Mr. Fox.
- 22 A. Mr. Fox has proposed seven conditions that should be placed on the transfer of  
23 Citizens' assets to Arizona-American: 1) that the transaction be made  
24 contingent on restructuring the agreement negotiated between Citizens and  
25 Arizona-American to "compensate" ratepayers fully for the loss in economic  
26 value due to the "loss" of advances and contributions; 2) that the transaction

1 be contingent on restructuring the agreement negotiated between Citizens and  
2 Arizona-American to compensate ratepayers fully for the "loss" in economic  
3 value due to the retention by Citizens, if applicable, of any low-cost debt, i.e.,  
4 Citizens' IDRBs; 3) that the gain on sale received by Citizens be divided equally  
5 between the ratepayers and Citizens; 4) that the amount of any acquisition  
6 adjustment be determined and authorized in the context of Arizona-American  
7 next general rate proceeding and that this adjustment to rate base be based on  
8 a formula (to which he refers in his recommendations); 5) that Arizona-  
9 American be required to invest no less than 15% of the final purchase price paid  
10 to Citizens in "resource stressed" water and/or wastewater utilities in Arizona;  
11 6) that Arizona-American and Citizens jointly file documentation for various  
12 items once the transaction has closed, and 7) that Arizona-American's request  
13 for an Accounting Order approving an amortization method for any acquisition  
14 premium be denied. I fully agree with condition 6, and partially agree with  
15 conditions 4 and 7.

16 Q. Please state your partial agreements with his fourth and seventh conditions.

17 A. I agree that the rate-making treatment of the acquisition adjustment should be  
18 determined in Arizona-American's next rate proceeding. I do not agree with his  
19 suggested formula, or even with the concept that a specific formula should be  
20 established in this proceeding. With respect to Mr. Fox's seventh condition, I  
21 agree that the Commission should not, in this proceeding, approve a specific  
22 amortization method of the acquisition adjustment. However, the request  
23 should not be denied. It should instead be deferred until Arizona-American's  
24 next rate proceeding.

25 Q. Please state your disagreement with Mr. Fox's condition 1.  
26

1 A. Mr. Fox believes Citizens' sale of its assets should be conditioned on what he  
2 terms full ratepayer "compensation" for the economic "loss" resulting from  
3 Citizens' retention of advances and contributions in aid of construction.  
4 However, he has not considered impact of the repayment stream for the  
5 advances that would have normally occurred had the advances been assumed  
6 by Arizona-American. In addition, he has not considered any impacts that  
7 retention of the advances and contributions by Citizens will have on future  
8 deferred taxes. He has also not recognized the potential synergies that Arizona-  
9 American may provide to customers, except in his proposed formula. Again, as  
10 stated above, Arizona-American is purchasing the utility plant and assets of  
11 Citizens in Arizona based on a contract negotiated in good faith based on  
12 current market conditions.

13 Like Ms. Jaress, Mr. Fox seems to be ignoring the nature of the underlying  
14 transaction. In summary, Citizens has decided to divest itself of all of its utility  
15 systems and operations except for telecommunications. Citizens therefore  
16 placed its utility plant, assets and property on the market. Arizona-American, in  
17 an arms-length transaction, has agreed to purchase those assets on terms and  
18 conditions that were negotiated between the parties. When the transaction  
19 closes, Arizona-American will pay Citizens approximately \$230 million for  
20 Citizens' water and wastewater plant, assets and other property in Arizona.  
21 Arizona-American's investment in that plant will therefore be approximately  
22 \$230 million. This is not a situation in which affiliated entities are transferring  
23 the ownership of property in order to inflate rate base. Arizona-American will  
24 have a real investment in that plant, and it is entitled to a return on that  
25 investment.

26

1 Q. Doesn't Mr. Fox maintain that the transaction is not in the "public interest"  
2 because Arizona-American's rate base will not be the same as Citizens' current  
3 rate base?

4 A. Yes. However, I believe Mr. Fox's analysis is erroneous. In effect, what he  
5 argues is that Arizona-American's future rate base is likely to be greater than  
6 Citizens' historic, recorded rate base and, therefore, rates are likely to increase.  
7 According to Mr. Fox, if the acquiring entity is likely to have a higher rate base  
8 and, as a result, rates may increase in the future, then the transaction is not in  
9 the "public interest" and should not be approved. Mr. Fox has provided no  
10 authority for this position in his testimony, nor did RUCO provide any authority  
11 in response to data requests that we served.

12 The relevant statute, A.R.S. § 40-285, requires that a public service  
13 corporation - a utility - obtain Commission approval prior to selling,  
14 encumbering or otherwise transferring utility plant or property that is used or  
15 necessary for the provision of service. This statute appears to be intended to  
16 ensure that the ability of the transferring utility to furnish service is not  
17 impaired. It does not indicate that future changes in a utility's rate base should  
18 be a determining factor, particularly when, as in this case, the utility has  
19 decided to sell all of its utility plant. Arizona-American's rate base, including  
20 any acquisition adjustment, should be determined during its next rate case, and  
21 not in this proceeding.

22 Q. Does Mr. Fox contend that Arizona-American is incapable of providing safe,  
23 adequate and reliable water and wastewater service if the transaction is  
24 approved?

25 A. No, nor could he. Arizona American has the experience, expertise and  
26 resources to satisfy Citizens' public service obligations.

1 Q. Applying Mr. Fox's analysis, what would happen if Citizens elected to sell a  
2 portion of its utility plant to a municipality?

3 A. I assume that RUCO would urge the Commission to disapprove the transaction  
4 unless the same terms and conditions Mr. Fox has proposed in this case were  
5 applied to that transaction.

6 Q. Are you aware of any case in which the Commission has imposed conditions  
7 and requirements like those recommended by Mr. Fox on a municipality's  
8 acquisition of a private utility's plant and system?

9 A. No. I should note that in a data request, we asked RUCO to explain the basis  
10 on which the Commission may refuse to allow a public service corporation to  
11 sell its utility plant to a municipality. RUCO refused to answer that data request  
12 on the grounds that it was not necessarily calculated to lead to the discovery of  
13 admissible evidence.

14 Q. On page 7 of his direct testimony, Mr. Fox accuses Arizona-American of  
15 deliberately structuring the transaction to eliminate advances, increase rate  
16 base, and increase rates, thereby causing customers to subsidize "non-  
17 economical development" and to "pay twice" for plant financed by advances.  
18 Is this testimony accurate?

19 A. No. First, as I have already explained, the terms of the purchase agreement  
20 were the product of arms-length negotiations between unrelated entities. Mr.  
21 Fox's suggestion that Arizona-American deliberately structured the transaction  
22 to increase rate base is absurd. Again, Arizona-American will invest  
23 approximately \$230 million in purchasing the utility plant and assets from  
24 Citizens. Under fundamental rate-making principles, a utility is entitled to earn a  
25 reasonable return on its investment. This is not some sort of phantom  
26

1 transaction intended to artificially inflate rate base, as Mr. Fox erroneously  
2 suggests.

3 Second, his contention that existing customers are "paying twice" for plant  
4 originally financed by advances is wrong. Mr. Fox apparently assumes that all  
5 amounts advanced by a developer are automatically passed through to new  
6 home buyers in the form of higher home prices. However, this view is overly  
7 simplistic, and may or may not be accurate depending on a variety of  
8 circumstances. Ultimately, the price of a home depends on any number of  
9 market-driven factors. Assuming, for the sake of argument, that a component  
10 of the price of the home, say \$1,000, is attributable to advances in aid of  
11 construction paid by a developer to Citizens, it is erroneous to argue that the  
12 home buyer is "paying" for utility plant - he is simply buying a home at a price  
13 based on the current market for homes in that area.

14 Q. Accepting Mr. Fox's erroneous premise for the moment, it would seem that the  
15 home buyer will eventually be re-paid that \$1,000, plus a return on his  
16 investment.

17 A. If one accepts Mr. Fox's premise, that is correct. If Mr. Fox purchases a home  
18 in 1990 for \$100,000 and then sells the home in 2000 for \$150,000, he has  
19 received a return of \$50,000 in his investment, a portion of which return would  
20 be attributable to the \$1,000 for advances that the developer included in the  
21 original price of Mr. Fox's home. Mr. Fox is not required to share the return  
22 with the developer or with the utility.

23 This example highlights the fundamental problem with Mr. Fox's argument.  
24 The infrastructure and other improvements installed or paid for by a developer  
25 may affect the price of a home, but also increase the home's value and  
26 marketability. A home located in an unimproved area, with gravel roads, no

1 sidewalks, no parks and other amenities, and no water and wastewater services  
2 is likely to be less expensive than a home in, for example, Sun City Grand or  
3 Anthem. By the same token, a home in Anthem may well appreciate in value  
4 far more quickly and ultimately provide its owner a higher return on his  
5 investment than a home in an unimproved area. Mr. Fox's oversimplistic  
6 analysis ignores this aspect of the real estate market.

7 Q. Are there any other flaws in Mr. Fox's analysis?

8 A. Yes. His contention that customers are somehow "paying twice" is  
9 inconsistent with fundamental rate-making principles. Advances and  
10 contributions in aid of construction are excluded from a utility's rate base  
11 because the utility has not made an investment in those facilities. In other  
12 words, if the cost of constructing a main is paid by a developer, the utility has  
13 no investment in that main and, therefore, is not entitled to earn a return on the  
14 main. Advances and contributions in aid of construction are thus deducted  
15 from rate base because the utility has no investment in the plant financed by  
16 means of advances and contributions, in contrast to plant financed by debt or  
17 equity. Advances and contributions are not deducted based on the belief that  
18 customers might "pay twice" because the sales price of a house may reflect the  
19 developer's infrastructure costs.

20 In this case, Arizona-American will have an investment in utility plant and  
21 property equal to approximately \$230 million. As stated, this is a real  
22 investment resulting from an arms-length transaction. It will be financed initially  
23 by short-term debt and, ultimately, by a mixture of long-term debt and equity.  
24 Arizona-American should be allowed to earn a return on that investment.

25 Q. Are there other areas in Mr. Fox's analysis of the effects of Citizens retaining  
26 the advances and contributions with which you disagree.

1 A. Yes. Mr. Fox in his Direct Testimony has calculated a revenue impact related to  
2 the elimination of Citizens advances and contributions from rate base. I believe  
3 that he has made mistakes in both his calculations and the assumptions he has  
4 used. First, he has assumed a depreciation rate of 4% on plant financed by  
5 advances and contributions. When asked to provide the basis for that assumed  
6 depreciation rate, RUCO simply stated that it was an assumption, i.e., no basis  
7 exists. Given the type of utility plant normally constructed under a main  
8 extension agreement, the use of a 4% depreciation rate is excessive.

9 Second, Mr. Fox has miscalculated the gross-up factor related to operating  
10 income. He has assumed a gross-up factor of 1.5, again without any  
11 explanation or support for that figure.

12 Lastly, Mr. Fox has not considered the gross-up effect on the accumulated  
13 deferred taxes related to the advances and contributions. The accumulated  
14 deferred tax needs to be deducted from the total advances and contributions  
15 before calculating the revenue requirement.

16 Q. Please state your disagreement with Mr. Fox's condition 2.

17 A. Mr. Fox has recommended that the transaction be made contingent on the  
18 recognition of the "loss" in economic value due to Citizens retention of the low-  
19 cost IDRBs. This recommendation is illogical. Arizona-American will finance  
20 this entire transaction with the lowest cost capital structure available.  
21 However, the IDRBs that Arizona-American will not assume are bonds that  
22 require unanimous consent for a transfer. The bonds that Az-Am will assume  
23 are re-marketed on a weekly basis, so it is easy to accumulate all the bonds in  
24 the hands of one investment banker on a particular re-marketing date. The  
25 banker, as the bondholder, would then vote in favor of the assumption, and re-  
26 market the bonds on the next day. However, the fixed rate bonds that Citizens

1 is retaining do not provide for weekly re-marketing and would require us to  
2 contact every bondholder to obtain unanimous consent, which would be  
3 administratively difficult, if not impossible, within the timeframe of the  
4 transaction.

5 Q. Please state whether you agree with Mr. Fox's condition 3.

6 A. No, I do not. The formula Mr. Fox has proposed for recognition of the  
7 acquisition adjustment contains a sharing proposal. The formula would provide  
8 the ratepayers with 50% of any allowed acquisition premium. In addition, Mr.  
9 Fox also proposes that 50% of Citizens' gain from the sale of its property be  
10 refunded to ratepayers. This does not make any economic sense. It is Citizens  
11 and Arizona-American who are at risk in this matter for recovery of their past  
12 and future investments. The ratepayers bear no risk for the investments made  
13 by others to provide service. Corporations rely on their ability to pay a  
14 reasonable return to their investors, and that includes a return for the past  
15 investment and past risks for investing in the utility. Divestiture of holdings  
16 provides the investors with recovery of past forgone returns and the loss of  
17 future possible earnings.

18 Q. Please state your disagreement with Mr. Fox's formula as stated in his  
19 recommendations as part of condition 4.

20 A. I have serious concerns about Mr. Fox's formula. First, as stated in my  
21 response above, Mr. Fox not only has requested that any proven synergy  
22 savings be shared with ratepayers, but he has recommended that the gain on  
23 sale as recognized by Citizens be shared with the ratepayers. This would  
24 provide the ratepayers with a substantial windfall which could possibly exceed  
25 the total gain.

26

1           Second, the formula does not consider synergies that are unrelated to raw  
2 changes in expenses. The formula proposed by Mr. Fox only considers savings  
3 that can be proven relative to historic expenses. Rates that customers must  
4 pay are driven not only by reasonable operating expenses, but also by the  
5 utility's investment in utility plant to serve the customers. Mr. Fox, in his  
6 proposed formula, does not provide any recognition of the savings that may be  
7 realized through lower costs of capital and for savings resulting from Arizona-  
8 American's ability to construct plant at a lower cost. Savings in construction  
9 costs directly reduce rate base.

10           Third, Mr. Fox has not considered the effects of refunds that will be made  
11 by Citizens regardless of this transaction. Mr. Fox has proposed to use the  
12 balance of Citizens' advances and contributions as they existed at December  
13 31, 1999, ignoring the fact that as refunds are made, advances are reduced and  
14 rate base increases. Thus, he overstates the future ratepayer benefit associated  
15 with plant funded by advances and contributions. This proposed treatment of  
16 advances and contributions would impair Arizona-American's future earnings  
17 potential on these assets.

18           Finally, Mr. Fox has not considered any of the impacts of inflation or  
19 mandated changes in operation that would cause changes in expenses  
20 regardless of who operates the water and wastewater systems. Mr. Fox has  
21 proposed that test year expenses be compared to Citizens' recorded 1999  
22 expenses. The only variance that he proposes is for customer growth. There  
23 are far too many variables to compare only recorded expense levels. For  
24 example, if the EPA imposes new guidelines on the level of a certain  
25 contaminant (e.g., arsenic or radon) and the removal of that contaminant causes  
26 increases in operating expenses, Mr. Fox's proposed formula would not consider

1 those circumstances. His proposed formula would consider the new expense to  
2 be a negative synergy caused by Arizona-American's acquisition of the Citizens'  
3 water and wastewater assets, which would clearly not be the case.

4 Q. Do you have any other comments about Mr. Fox's statements concerning an  
5 acquisition adjustment?

6 A. Yes. Mr. Fox has said he is relying on FAS 71 in stating that Arizona-American  
7 should immediately expense any acquisition adjustment. This interpretation of  
8 FAS 71 is incorrect. FAS 71 basically states that the accounting for any asset,  
9 deferred or otherwise, must be viewed in the context of a possible impairment.  
10 In the case of an acquisition adjustment, the National Association of Utility  
11 Regulatory Commissioners (NARUC) Uniform System of Accounts requires that  
12 an acquisition adjustment be recorded in the utility books and records. FAS 71  
13 would only require different accounting treatment if the asset was deemed to be  
14 impaired in accordance with generally accepted accounting principles for  
15 enterprises in general. Mr. Fox is correct in his statement that to record a  
16 deferred asset related to an expense, the utility must have probable assurance  
17 that the public utility commission will allow the recovery of the asset in rates.  
18 However, an acquisition adjustment is not an expense: it is an investment in the  
19 utility.

20 Q. Please state your disagreement with Mr. Fox's condition 5.

21 A. This item will be addressed in the rebuttal testimony of Mr. Daniel Kelleher.

22 Q. Please state your disagreement with Mr. Fox's condition 7.

23 A. As noted above, I agree that this item should be deferred until Arizona-  
24 American's first rate case, but it should not be denied at this time. If the  
25 Commission defers consideration of the appropriate treatment of the acquisition  
26 adjustment until a general rate proceeding, as both Staff and RUCO recommend,

1 then determination of the amortization method for that adjustment should also  
2 be deferred.

3 Q. Is Arizona-American withdrawing its request that the Commission approve a  
4 mortgage amortization method of accounting?

5 A. No, but we agree that accounting consideration should be postponed until  
6 Arizona-American's first rate case.

7 Q. Have you estimated the financial effects of RUCO recommendations in this  
8 case?

9 A. I have made a very rough estimate based on the cursory explanations Mr. Fox  
10 has provided in its testimony. I have based my estimate on a sales price of  
11 \$231 million, net plant of \$168 million, deferred taxes of \$5 million, AIAC and  
12 CIAC of \$86 million, ITC of \$2 million, \$4 million in expense synergies, \$8  
13 million in annual capital synergies and a requirement for Arizona-American to  
14 invest \$35 million in "resource stressed" utilities. Based on these facts, the  
15 ratepayers would: 1) receive a cash rebate of \$78 million, 2) have rates  
16 reduced by the expense reduction of \$4 million, and 3) have rates annually  
17 reduced by \$1.2 million due to the revenue requirement on the annual capital  
18 savings of \$8 million. Citizens would have \$55 million less in cash to invest in  
19 rural telecommunications systems in Arizona. Arizona-American would: 1) be  
20 forced to earn on a rate base of \$75 million (approximately one-third of its  
21 actual investment), 2) have to invest approximately \$6 million annually for six  
22 years in troubled utilities with little chance of any return, and 3) receive no  
23 credit for expenses saved or any capital savings provided to customers. In  
24 total, Arizona-American would be earning on a rate base that may be as little as  
25 30% of its actual investment, which may not be high enough to cover its debt  
26 service requirements. I have not considered the effects of RUCO's imputation

1 of the IRDB's into the capital structure. The imputation would further reduce  
2 Arizona-American's net income and coverages.

3 Q. In your opinion, who would benefit by RUCO's recommendations?

4 A. No one would benefit from a transaction that would result in negative net  
5 income for Arizona-American. In reality, ratepayers would be harmed in the  
6 long run because they would be served by a financially-impaired utility.

7 Q. Does this conclude your rebuttal to the RUCO?

8 A. Yes it does.

9 **IV. RECOMMENDATIONS.**

10 Q. What are your recommendations in this matter.

11 A. I recommend that the Commission approve the transfer of Citizens' water and  
12 wastewater utility plant, assets and CC&Ns to Arizona-American. The transfer  
13 should be based on the following conditions:

14 (1) That the Commission should address the regulatory treatment of Arizona-  
15 American's acquisition adjustment, deferred taxes, excess deferred taxes  
16 and investment tax credits in a future rate proceeding.

17 (2) That the decision to allow the recovery of any acquisition adjustment  
18 should be based on Arizona-American's ability to demonstrate that clear,  
19 quantifiable and substantial net benefits exist, as recommended by Staff.

20 (3) That Arizona-American should file a report comparing the number of  
21 customer complaints received by the Commission under their ownership to  
22 those received by Citizens prior to the transaction 13 months after the  
23 transaction is concluded, as recommended by Staff.

24 (4) That Arizona-American should be required to seek Commission approval of  
25 any amendment to, or transfer of, agreements to purchase Colorado River  
26 water, as recommended by Staff.

1 (5) That Arizona-American should be authorized to charge the rates and  
2 charges, and to provide service under the Citizens' tariffs currently in effect  
3 in each of the affected service areas.

4 (6) That Arizona-American and Citizens should be required to jointly file  
5 documentation of the final purchase price, net book value of the assets  
6 sold at the time of the transaction, the amount of the gain/premium, the  
7 date of the transfer, and supporting documents, as recommended by Staff.

8 (7) That Arizona-American's request for an accounting order to establish the  
9 amortization method for the acquisition adjustment should be deferred until  
10 Arizona-American's first general rate case.

11 Q. Does that conclude your rebuttal testimony?

12 A. Yes, it does.

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BEFORE

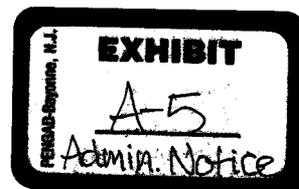
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Petition of Ohio- )  
American Water Company and Citizens )  
Utilities Company of Ohio to Transfer the ) Case No. 00-938-WS-ATR  
Assets of Citizens Utilities Company of )  
Ohio to Ohio-American Water Company )  
Pursuant to Section 4905.48, Revised Code. )

FINDING AND ORDER

The Commission finds:

- (1) On May 30, 2000, as amended on July 12, July 28, August 25, and August 28, 2000, Ohio-American Water Company (Ohio-American) and Citizens Utilities Company of Ohio (Citizens) filed a joint petition seeking authority, pursuant to Section 4905.48, Revised Code, for Ohio-American to purchase the water and sewage disposal systems of Citizens. The agreement provides for a purchase price of \$35,140,000. Ohio-American expects to pay cash for Citizens' assets with short-term borrowing. Ohio-American will replace the short-term debt with long-term financing, subject to the Commission's approval under Section 4905.40, Revised Code. The joint petition states that Ohio-American has agreed to purchase substantially all of Citizens' assets, and that Ohio-American intends to operate the Citizens system with many of Citizens' current employees. Ohio-American proposes to adopt all of the current rates and tariffs for Citizens customers, including the rate steps authorized by the Commission for Citizens' customers in the company's last rate case. *In the Matter of the Application of Citizens Utilities Company of Ohio to Increase Its Rates and Charges for Water and Wastewater Services in Franklin and Portage Counties, Ohio*, Case No. 98-178-WS-AIR (January 14, 1999). The joint petition also states that the transfer of Citizens' assets is in the public interest and will not adversely affect the current customers of Citizens because Ohio-American will continue to provide quality water and sewer service at the same rates.
- (2) Ohio-American is a public utility and water works company under Sections 4905.02 and 4905.03(A)(8), Revised Code. Ohio-American operates in six districts in Ohio under Certificate of Public Convenience and Necessity (Certificate)



No. 12. American Water Works Company, Inc. (American), a holding company, is the parent company of Ohio-American and other water and sewer companies operating in 23 states. American is a non-jurisdictional entity that will not be involved in the ownership or operation of the assets being acquired from Citizens. Citizens is a public utility, and a water works and sewage disposal company, pursuant to Sections 4905.02 and 4905.03(A)(8) and (A)(14), Revised Code. Citizens holds Certificate Nos. 1, 2, 10, 17, and 27. The Commission has jurisdiction over this transaction pursuant to Sections 4905.05, 4905.06, and 4905.48, Revised Code. In accordance with its jurisdiction over the proposed acquisition, the Commission must ensure that the acquiring company possesses the financial and technical capabilities necessary to continue to provide adequate service, and that the transfer of ownership will not harm the public interest. *See, In the Matter of the Joint Petition of Vectren Energy of Ohio, Inc., Indiana Gas Company, Inc., and The Dayton Power & Light Company, to Transfer the Natural Gas Assets of the Dayton Power & Light Company to Vectren Energy of Ohio, Inc. and/or Indiana Gas Company, Inc. Pursuant to Section 4905.48(B) and (C), Revised Code, Case No. 00-524-GA-ATR et al. (July 11, 2000).*

- (3) In the joint petition, Ohio-American and Citizens request that the Commission take the following actions: (1) approve the purchase and sale of the water and sewage disposal system assets from Citizens to Ohio-American pursuant to Section 4905.48, Revised Code; (2) approve, pursuant to Section 4933.25, revised Code, the amendments set forth in Exhibit 2 to the petition by either amending Ohio-American's current Certificate No. 12 to incorporate the acquisition of Citizens' assets, or by issuing a new certificate recognizing the acquisition; (3) remove Citizens from the Commission's rolls of public utilities, effective upon the closing of the purchase and sale of the assets; (4) approve Ohio-American's adoption of Citizens' existing tariffs, effective upon the closing of the purchase and sale of the assets; and (5) grant such other relief to which the joint petitioners may reasonably be entitled.
- (4) By entry issued July 24, 2000, the petitioners were directed to publish notice of the joint petition. Publication was accomplished in accordance with the entry and, on August 3, 2000,

Ohio-American and Citizens filed proofs of publication. No person or entity sought intervention or submitted opposition to the joint petition. At the staff's request, the joint petitioners filed a letter on August 25, 2000. The letter indicates that Ohio-American agrees to make improvements to the "Quarterly Water Company Operating Report" that the company submits to the staff, specifically with respect to operational data and customer contact information. With these commitments, the staff does not oppose the proposed transfer of assets and recommends approval of the transaction in accordance with the amended joint petition.

- (5) The Commission has reviewed the application and supporting exhibits and finds that the proposed transaction is reasonable, will not adversely affect the customers of either petitioner, and should be approved. No hearing has been requested, and we do not believe that a hearing is necessary for approval of the joint petition. Our authority over the rates, services, and operations of Citizens' assets will not change as a result of the acquisition by Ohio-American. Nor will the transaction impair our ability to protect ratepayers. We are also satisfied that the transfer of ownership of Citizens' assets will not impair the quality of service currently provided to Citizens' customers, and that Ohio-American has the ability to adequately manage the acquired assets. Ohio-American has indicated its intent to operate the Citizens system with many of Citizens' current employees and changes in the operation of that system are expected to take place gradually. We believe that Ohio-American has demonstrated the requisite experience, capabilities, and resources necessary to operate the additional water and sewer system assets that will be acquired from Citizens. Given these findings, and the fact that the transaction will not result in a change of rates for current Citizens customers, we conclude that approval of the proposed acquisition should be approved. Accordingly, effective upon closing of the acquisition transfer: Ohio-American's Certificate No. 12 shall be amended to incorporate Citizens' service area; Citizens shall be removed from the rolls of public utilities operating within this state; and Ohio-American shall adopt Citizens' existing tariffs. Ohio-American shall notify the Commission within 10 days of the date that the acquisition transfer is completed. These changes will be effective upon the

filing of four complete printed copies of the tariffs reflecting the changes.

- (6) The joint petitioners have submitted a proposed customer letter that will be sent to the current Citizens customers following closing of the acquisition transaction. The staff has reviewed the letter and the staff agrees that the letter represents an appropriate means of informing customers of the acquisition by Ohio-American. We find that the proposed customer notice letter is reasonable and should be approved. We direct Ohio-American to send the approved letter to current Citizens customers, either as a separate mailing or as a bill insert, concurrent with the first available billing cycle following the closing of the acquisition.

It is, therefore,

ORDERED, That the joint petition of Ohio-American and Citizens to transfer Citizens' water and sewer system assets to Ohio-American is hereby granted. It is, further,

ORDERED, That the joint petitioners notify the Commission in writing within 10 days of the date that the acquisition transaction is completed. It is, further,

ORDERED, That, upon notification to the Commission that the transfer of assets has been completed, Ohio-American's Certificate No. 12 shall be amended to incorporate Citizens' service area; Citizens shall be removed from the rolls of public utilities operating within this state; and Ohio-American shall adopt Citizens' existing tariffs. These changes will be effective upon the filing of four complete printed copies of the tariffs reflecting the changes. It is, further,

ORDERED, That the proposed customer notice letter is approved and that Ohio-American accomplish service of the letter to current Citizens customers in accordance with Finding 6. It is, further,

ORDERED, That Ohio-American undertake the improvements to its "Quarterly Water Company Operating Report," in accordance with the commitments set forth in the August 25, 2000 letter. It is, further,

ORDERED, That a copy of this finding and order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

---

Alan R. Schriber, Chairman

---

Ronda Hartman Fergus

---

Craig A. Glazer

---

Judith A. Jones

---

Donald L. Mason

DDN;geb

Entered in the Journal  
September 7, 2000

Signed by Commissioners  
Schriber  
Fergus  
Glazer  
Jones  
Mason

Gary E. Vigorito  
Secretary

RECEIVED

BEFORE THE ARIZONA CORPORATION COMMISSION

2000 SEP 26 P 4: 18

CARL J. KUNASEK  
Chairman  
JIM IRVIN  
Commissioner  
WILLIAM A. MUNDELL  
Commissioner

AZ CORP COMMISSION  
DOCUMENT CONTROL

IN THE MATTER OF THE JOINT )  
APPLICATION OF CITIZENS UTILITIES )  
COMPANY; AGUA FRIA WATER DIVISION )  
OF CITIZENS UTILITIES COMPANY; )  
MOHAVE WATER DIVISION OF CITIZENS )  
UTILITIES COMPANY; SUN CITY WATER )  
COMPANY; SUN CITY SEWER COMPANY; )  
SUN CITY WEST UTILITIES COMPANY; )  
CITIZENS WATER SERVICES COMPANY OF )  
ARIZONA; CITIZENS WATER RESOURCES )  
COMPANY OF ARIZONA; HAVASU )  
WATER COMPANY AND TUBAC VALLEY )  
WATER COMPANY, INC., FOR APPROVAL )  
OF THE TRANSFER OF THEIR WATER )  
AND WASTEWATER UTILITY ASSETS )  
AND THE TRANSFER OF THEIR CERTIFI- )  
CATES OF PUBLIC CONVENIENCE AND )  
NECESSITY TO ARIZONA-AMERICAN )  
WATER COMPANY AND FOR CERTAIN )  
RELATED APPROVALS. )

DOCKET NOS. W-01032A-00-0192  
W-01032B-00-0192  
W-01032C-00-0192  
S-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

STAFF'S NOTICE OF FILING  
SETTLEMENT AGREEMENT  
BETWEEN ARIZONA CORPORATION  
COMMISSION STAFF AND  
ARIZONA-AMERICAN WATER  
COMPANY

Staff of the Arizona Corporation Commission hereby files the Settlement Agreement between the Arizona Corporation Commission Staff and Arizona-American Water Company, in the above-referenced docket.

RESPECTFULLY SUBMITTED this 26<sup>th</sup> day of September, 2000.

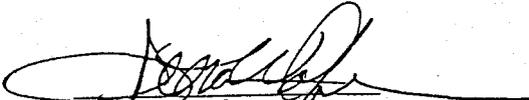
  
Teena Wolfe  
Attorney, Legal Division  
Arizona Corporation Commission  
(602) 542-3402

EXHIBIT  
A-6  
Admitted

1 Original and fifteen copies of  
2 the foregoing document filed  
3 this 26<sup>th</sup> day of September, 2000 with:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 West Washington  
7 Phoenix, Arizona 85007

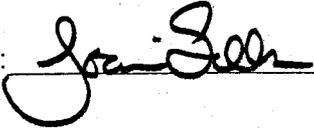
8 Copies of the foregoing will be mailed  
9 the 27<sup>th</sup> day of September, 2000 to:

10 Norman D. James, Esq.  
11 Fennemore Craig  
12 3003 North Central Avenue  
13 Suite 2600  
14 Phoenix, Arizona 85012  
15 Attorneys for Arizona-American  
16 Water Company

17 Craig Marks, Esq.  
18 Citizens Utilities Company  
19 2901 North Central Avenue, Ste 1660  
20 Phoenix, Arizona 85012

21 Scott Wakefield, Esq.  
22 RUCO  
23 2828 N. Central Ave., Suite 1200  
24 Phoenix, Arizona 85004

25 Walter W. Meek, President  
26 Arizona Utility Investors Association  
27 2100 North Central Avenue  
28 Suite 210  
Phoenix, Arizona 85004

By: 

1 CARL J. KUNASEK  
CHAIRMAN  
2 JIM IRVIN  
COMMISSIONER  
3 WILLIAM A. MUNDELL  
COMMISSIONER  
4

5 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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

DOCKET NOS. W-01032A-00- 0192  
W-01032B-00- 0192  
W-01032C-00- 0192  
S-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

**SETTLEMENT AGREEMENT BETWEEN  
ARIZONA CORPORATION  
COMMISSION STAFF AND ARIZONA-  
AMERICAN WATER COMPANY**

17 On March 24, 2000, Citizens Utilities Company (now known as Citizens'  
18 Communications Company), its Agua Fria Water Division, its Mohave Water  
19 Division, Sun City Water Company, Sun City Sewer Company, Sun City West  
20 Utilities Company, Citizens Water Services Company of Arizona, Citizens Water  
21 Resources Company of Arizona, Havasu Water Company and Tubac Valley Water  
22 Company (collectively, "Citizens") and Arizona-American Water Company  
23 ("Arizona-American") filed with the Arizona Corporation Commission  
24 ("Commission") a joint application for the approval of the sale and transfer of  
25 Citizens water and wastewater utility plant, property and assets in Arizona,  
26 including transfer of Citizens' certificates of convenience and necessity

1 ("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

2 The Commission's Utilities Division Staff ("Staff") has investigated the  
3 application and has recommended that the application be approved by the  
4 Commission, subject, however, to certain conditions and requirements, which are  
5 set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August  
6 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has  
7 indicated that it is willing to accept the Staff Recommendations, with the exception  
8 of the recommendation that Citizens' advances in aid of construction ("AIAC") and  
9 contributions in aid of construction ("CIAC") be imputed to Arizona-American.

10 Representatives of Staff and Arizona-American have had discussions  
11 concerning the matters in dispute with respect to the application and have reached  
12 a settlement. The purpose of this Settlement Agreement is to memorialize the  
13 agreement that has been made by and among Staff and Arizona-American, which  
14 resolves all areas of disagreement relating to the terms and conditions under which  
15 Citizens' Arizona water and wastewater assets and Citizens' Certificates may be  
16 transferred to Arizona-American.

17 1. AIAC Imputation; Amortization. As of December 31, 1999, Citizens'  
18 AIAC balance was \$80,818,669. Citizens' AIAC balance as of the date on which  
19 Citizens' water and wastewater assets and Certificates are transferred to Arizona-  
20 American and Arizona-American becomes responsible for the provision of water  
21 and wastewater services will be imputed to Arizona-American. Such imputation  
22 shall be solely for ratemaking purposes. The total amount of AIAC imputed will be  
23 adjusted as more particularly provided below. The adjusted amount of AIAC will be  
24 amortized below the line (i.e., no impact on expenses) over a period of 6.5 years,  
25 with the amortization period beginning on the day on which the transfer takes  
26 place.

1           2.     CIAC Imputation; Amortization. As of December 31, 1999, Citizens'  
2 CIAC balance was \$4,734,430. Citizens' CIAC balance as of the date on which  
3 Citizens' water and wastewater assets and Certificates are transferred to Arizona-  
4 American and Arizona-American become responsible for the provision of water and  
5 wastewater services will also be imputed to Arizona-American. Such imputation  
6 shall be solely for ratemaking purposes. The total amount of CIAC to be imputed  
7 to Arizona-American will also be adjusted as provided below. The adjusted CIAC  
8 balance imputed to Arizona-American will be amortized above the line (i.e., as a  
9 reduction to depreciation expense) over a period of 10 years, with the amortization  
10 period beginning on the day on which the transfer takes place.

11           3.     Adjustment to Recorded AIAC and CIAC Balances. The amounts of  
12 AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be  
13 based on the actual balances shown on Citizens' regulatory books as of the date of  
14 the transfer, adjusted as follows: An amount equal to five percent (5%) of  
15 Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and  
16 added to the CIAC balance, and the same amount will be deducted from Citizens'  
17 AIAC balance in computing the amounts to be imputed to Arizona-American for  
18 ratemaking purposes hereunder.

19           4.     Adoption of Remaining Staff Recommendations. Arizona-American  
20 agrees that the Commission may adopt the remaining Staff Recommendations, as  
21 set forth in the Direct Testimony of Linda A. Jaress.

22           5.     Deferral of Determination of Amortization Method. The parties agree  
23 that Arizona-American's request for an accounting order to establish the  
24 amortization method for any acquisition adjustment resulting from the transaction  
25 should be deferred until a future rate case.

26           6.     Transfer in the Public Interest. Based on the foregoing agreements

1 and understandings, Staff agrees that Arizona-American is a fit and proper entity to  
2 acquire the Certificates and that the Commission should authorize and approve the  
3 transfer of Citizens' Arizona water and wastewater assets to Arizona-American on  
4 the terms set forth herein. No additional terms, conditions or requirements are  
5 necessary or appropriate.

6       7.     Support and Defend. This Settlement Agreement will be introduced as  
7 an exhibit during the hearing on the application, presently set for September 27,  
8 2000. Arizona-American and Staff will jointly request that the Settlement  
9 Agreement be received into evidence, and agree to support and defend this  
10 Settlement Agreement and the transfer of Citizens' water and wastewater assets  
11 and the Certificates to Arizona-American on the terms set forth herein as just,  
12 reasonable and appropriate based on the particular circumstances presented in this  
13 application.

14       8.     Compromise; No Precedent. This Settlement Agreement represents a  
15 compromise in the positions of the parties hereto. By entering into this Settlement  
16 Agreement, neither Staff nor Arizona-American acknowledges the validity or  
17 invalidity of any particular method, theory or principle of regulation, or agrees that  
18 any method, theory or principle of regulation employed in reaching a settlement is  
19 appropriate for resolving any issue in any other proceeding, including (without  
20 limitation) any issues that are deferred to a subsequent rate proceeding. Except as  
21 specifically agreed upon in this Settlement Agreement, nothing contained herein  
22 will constitute a settled regulatory practice or other precedent.

23       9.     Privileged and Confidential Negotiations. All negotiations and other  
24 communications relating to this Settlement Agreement are privileged and  
25 confidential, and no party is bound by any position asserted during the  
26 negotiations, except to the extent expressly stated in this Settlement Agreement.

1 As such, evidence of statements that were made or other conduct occurring during  
2 the course of the negotiation of this Settlement Agreement is not admissible in any  
3 proceeding before the Commission or a court.

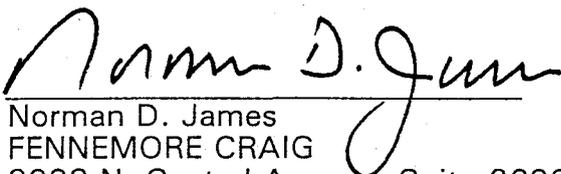
4 10. Complete Agreement. This Settlement Agreement represents the  
5 complete agreement of the parties with respect to its subject matter. There are no  
6 understandings or commitments other than those expressly set forth herein.

7 DATED this 26 day of September, 2000.

8 ARIZONA CORPORATION  
9 COMMISSION STAFF

ARIZONA-AMERICAN WATER COMPANY

10  
11 By:   
12 Steven M. Olear  
13 Acting Assistant Director, Utilities Division  
14 Arizona Corporation Commission  
15 1200 West Washington Street  
16 Phoenix, Arizona 85007

By:   
Norman D. James  
FENNEMORE CRAIG  
3003 N. Central Avenue, Suite 2600  
Phoenix, Arizona 85012-2913  
Attorneys for Arizona-American  
Water Company

14 An original and 10 copies of the  
15 foregoing was delivered this  
16 \_\_\_ day of September, 2000, to:

17 Docket Control  
18 Arizona Corporation Commission  
19 1200 West Washington  
20 Phoenix, AZ 85007

21 A copy of the foregoing  
22 was delivered this \_\_\_ day of  
23 September, 2000, to:

24 Karen E. Nally  
25 Assistant Chief Administrative  
26 Law Judge  
Hearing Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

1 A copy of the foregoing  
2 was telecopied/delivered and mailed this \_\_\_\_  
3 day of September, 2000, to:

3 Daniel W. Pozefsky  
4 Staff Attorney  
5 Residential Utility Consumer Office  
6 2828 North Central Avenue  
7 Suite 1200  
8 Phoenix, AZ 85004  
9 (602) 285-0350  
10 Walter W. Meek, President  
11 Arizona Utility Investors Association  
12 P. O. Box 34805  
13 Phoenix, AZ 85067  
14 (602) 254-4300

9 Craig A. Marks  
10 Associate General Counsel  
11 Citizens Communications Company  
12 2901 N. Central, Suite 1660  
13 Phoenix, AZ 85012  
14 (602) 265-3415

14 By: \_\_\_\_\_

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BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
CHAIRMAN
JAMES M. IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

2100 N. Central, Ste. 210
P. O. Box 34805
Phoenix, AZ 85067
Tel: (602) 257-9200
Fax: (602) 254-4300
Email: info@auia.org
Web Site: www.auia.org

IN THE MATTER OF THE JOINT APPLICATION OF ) DOCKET NOS.
CITIZENS UTILITIES COMPANY, AGUA FRIA WATER ) W-01032A-00-0192
DIVISION OF CITIZENS UTILITIES COMPANY, ) W-01032B-00-0192
MOHAVE WATER DIVISION OF CITIZENS UTILITIES ) W-01032C-00-0192
COMPANY, SUN CITY WATER COMPANY, SUN CITY ) W-01656B-00-0192
CITY SEWER COMPANY, SUN CITY WEST UTILITIES ) S-02276A-00-0192
COMPANY, CITIZENS WATER SERVICE COMPANY OF ) WS-02334A-00-0192
ARIZONA, CITIZENS WATER RESOURCES COMPANY ) WS-03454A-00-0192
OF ARIZONA, HAVASU WATER COMPANY AND ) WS-03455A-00-0192
TUBAC VALLEY WATER COMPANY FOR APPROVAL ) W-02013A-00-0192
OF THE TRANSFER OF THEIR WATER AND WASTE- ) W-01595A-00-0192
WATER UTILITY ASSETS AND THE TRANSFER OF ) W-01303A-00-0192
THEIR CERTIFICATES OF CONVENIENCE AND )
NECESSITY TO ARIZONA-AMERICAN WATER )
COMPANY AND FOR CERTAIN RELATED APPROVALS.)

NOTICE OF FILING

The Arizona Utility Investors Association hereby
provides notice of filing Direct Testimony as required by the
Commission's procedural order in the above-captioned matter.

DATED THIS 14TH DAY OF AUGUST, 2000.

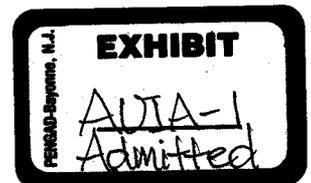
Handwritten signature of Walter W. Meek

WALTER W. MEEK, PRESIDENT

CERTIFICATE OF SERVICE

Original and ten (10) copies of the
referenced Testimony were filed this
14th day of August, 2000, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007



Copies of the referenced Testimony  
were hand-delivered this 14th day  
of August 2000, to:

Lyn Farmer, Legal Division  
Deborah R. Scott, Utilities Division  
Jerry L. Rudibaugh, Hearing Division  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85007

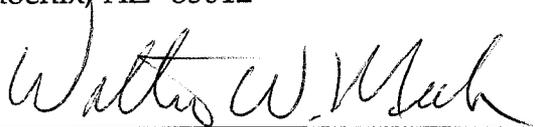
Copies of the referenced Testimony  
were mailed this 14th day of August,  
2000, to the following parties of record:

Ray Jones  
General Manager  
Sun City Water Company  
P.O. Box 1687  
Sun City, AZ 85372

Craig Marks  
General Counsel  
Citizens Utilities Company  
2901 N. Central Ave., Suite 1660  
Phoenix, AZ 85012

Norman D. James  
Fennemore Craig  
3003 N. Central Ave., Suite 2600  
Phoenix, AZ 85012

Scott Wakefield, Chief Counsel  
RUCO  
2828 N. Central Ave., Ste. 1200  
Phoenix, AZ 85004



Walter W. Meek

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DIRECT TESTIMONY

OF

WALTER W. MEEK

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Walter W. Meek. My business address is 2100 North Central Avenue, Suite 210, Phoenix, Arizona 85004.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the president of the Arizona Utility Investors Association ("AUIA" or "Association"), a non-profit organization formed to represent the interests of shareholders and bondholders who are invested in utility companies based in or doing business in the state of Arizona.

Q. ARE SOME AUIA MEMBERS SHAREHOLDERS OF THE JOINT APPLICANTS IN THIS PROCEEDING?

A. Yes. AUIA has approximately 6,500 individual members, including common shareholders of Citizens Communications Company (formerly Citizens Utilities), the parent company of the certificate holders in this application.

Q. WHAT IS YOUR BACKGROUND IN REPRESENTING SHAREHOLDER CONCERNS AND INTERESTS?

A. I have been president of AUIA for more than five years. Prior to that, my consulting firm managed the affairs of the Pinnacle West Shareholders Association for 13 years. During these periods we have represented shareholders in numerous rate cases and other regulatory matters and have published many position papers, newsletters and other documents in support of shareholder interests.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am here to represent the views of the equity owners of Citizens Communications in the sale of Citizens' water and wastewater business to Arizona-American Water Company.

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Q. IN YOUR OPINION, DOES THIS TRANSACTION SERVE THE BEST INTERESTS OF CITIZENS' SHAREHOLDERS?

A. Yes.

Q. WHY IS THAT?

A. Within the past year, Citizens has adopted a business strategy of focusing exclusively on telecommunications while divesting its traditional electric, water and gas businesses. It is expanding its telephone business substantially by acquiring local exchanges from other carriers such as Global Crossing, GTE and Qwest Communications.

Q. WHAT IS THE REASON FOR THIS CHANGE IN STRATEGY?

A. The financial markets view telecommunications as a business that is more dynamic than traditional utility business, with higher risks and higher rewards. In the past, Citizens had difficulty in getting Wall Street analysts to accept the growth and earnings potential of its mixed business portfolio.

Q. ARE THERE OTHER REASONS FOR THIS CHANGE?

A. Clearly, Citizens believes it can achieve management and operational efficiencies in concentrating on a core business rather than operating dissimilar businesses in several regulatory jurisdictions.

Q. FROM THE SHAREHOLDER'S PERSPECTIVE, IS THIS STRATEGY WORKING?

A. So far, the financial markets have given their approval. The value of Citizens' common stock has doubled since the company embarked on this strategy about a year ago.

Q. IS THIS TRANSACTION CRITICAL TO THE OVERALL STRATEGY?

A. All of the proposed sales of utility properties are critical elements in the strategy. Citizens is in the process of acquiring about 2 million access lines from other telephone providers. Income from the sale of utility properties is the underlying source of funds to pay for these acquisitions.

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Q. WHERE DOES THIS SALE FIT IN?

A. American Water Works and its subsidiaries (American) have agreed to buy all of Citizens' water and waste water assets in six states for a total price of \$835 million. The Arizona purchase accounts for \$231.3 million of that total, or 27.7%. In addition, the buyer assumes \$10.6 million of debt in the form of outstanding industrial development revenue bonds.

Q. SHOULD THE COMMISSION FIND THAT THIS SALE IS IN THE PUBLIC INTEREST?

A. Yes.

Q. WHAT ARE YOUR REASONS FOR REACHING THAT CONCLUSION?

A. There are probably a number of reasons, but I will discuss four. *First*, American is well qualified to take over Citizens' business in Arizona. It is the largest investor-owned water service company based in the United States with 10 million customers in 23 states. *Second*, American is on solid financial footing, with a strong balance sheet and \$1.3 billion in operating revenues in the past year. The company asserts that this transaction will not impair its financial status, its ability to obtain capital on reasonable terms or its ability to serve Citizens' customers. *Third*, while Citizens has operated its water business in exemplary fashion, the Commission should consider it a positive opportunity to locate this business within a corporate structure that is focused almost exclusively on water service. *Fourth*, the successful completion of this transaction will help Citizens to concentrate on its telephone business which is expanding in Arizona and which remains under Commission jurisdiction.

Q. IS AMERICAN WATER WORKS PAYING MORE THAN BOOK VALUE FOR CITIZENS' ASSETS?

A. Of course. American is paying for the *market value* of Citizens' assets, including the ongoing value of Citizens' business. Consequently, the gross plant balance of Citizens' Arizona assets is a little over \$167 million, but the pro-rated purchase price is \$231.3 million.

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Q. WHAT DO YOU MEAN BY PRO-RATED?

A. The purchase price of the Arizona assets is 27.7% of the price American is paying for all of Citizens' water business in six states. That percentage is the same as the ratio of Citizens' book value in Arizona to the book value of everything American is buying from Citizens.

Q. SHOULD THE COMMISSION BE CONCERNED ABOUT THE DIFFERENCE BETWEEN BOOK VALUE AND PURCHASE PRICE?

A. This is an arms-length transaction between a willing seller and a willing buyer. The presumption must be that the price is reasonable. However, any consideration of the impact of the sale price is premature. American has proposed that the ratemaking treatment of the difference be addressed in a general rate case at a future date and that is appropriate.

Q. ARE YOU CONCERNED ABOUT CONDITIONS THAT MAY BE ATTACHED TO THE COMMISSION'S APPROVAL OF THE SALE?

A. I will preface my response by saying that AUIA is at a procedural disadvantage in that we must file testimony without knowing what conditions may be proposed by other parties, particularly Commission staff (Staff) and the Residential Utility Consumers Office (RUCO).

Q. THAT BEING THE CASE, DO YOU HAVE SOME CONCERNS?

A. Within the past 18 months, several applications for mergers and/or acquisitions have been filed with this Commission for its approval. In earlier cases, the Staff and RUCO have argued that shareholders of the selling company should share the so-called gain between book value and the sale price with ratepayers.

Q. WHAT IS YOUR OBJECTION TO GAIN SHARING?

A. There is no legal or economic justification for gain sharing. It unlawfully impedes a transaction by altering its negotiated value. It is simply regulatory blackmail based on false assumptions.

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Q. WHAT ARE THESE FALSE ASSUMPTIONS?

A. First, the idea that ratepayers have paid for a portion of a utility's plant and have acquired an ownership interest in it. Ratepayers have paid only for the use of the plant and a reasonable rate of return on the shareholders' investment.

Q. RATEPAYERS PAY FOR DEPRECIATION, DON'T THEY?

A. Yes, but depreciation is an expense item in rates and does not contribute anything toward ownership. If ratepayers had an ownership claim on a utility's assets, they would also have to share in any losses the utility experienced in disposing of those assets.

Q. WHAT IS THE SECOND FALSE ASSUMPTION?

A. That the gain is calculated by subtracting book value from the sale price. Book value is an artificial number produced by applying depreciation rates and has nothing to do with market value. Furthermore, Citizens is selling its ongoing water business, including its future profits and growth potential, which is much more valuable than its hard assets.

Q. DOES AUIA OPPOSE CONDITIONS THAT WOULD REQUIRE CITIZENS TO SHARE THE GAIN ON THE SALE WITH RATEPAYERS?

A. Yes. Gain sharing is simply a method of confiscating shareholder equity.

Q. WHAT IS AUIA'S RECOMMENDATION TO THE COMMISSION?

A. To find that the transfer of assets from Citizens Communications to Arizona-American Water Company is in the public interest and to approve the sale without conditions that would alter the values that were freely negotiated by the applicants.

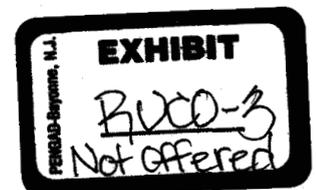
Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

NATIONAL ASSOCIATION  
OF  
REGULATORY UTILITY  
COMMISSIONERS

1996  
Uniform System of Accounts  
For  
Class B  
Water Utilities

Pursuant to action by the National Association of Regulatory Utility Commissioners, this System of Accounts is recommended to the Commissions represented in the membership of this Association for consideration and for adoption in their respective jurisdictions with such modifications only as they may deem necessary in the public interest.



## INCOME ACCOUNTS

### Operating Income

#### 400. Operating Revenues

This is the revenue control account which totals the accounts recorded in water revenue accounts 460 through 480.

#### 401. Operating Expenses

This is the operating expense control account which totals the amounts recorded in operating expense accounts 601 through 675 for water systems.

#### 403. Depreciation Expenses

A. This account shall be charged with depreciation credited to account 108 - Accumulated Depreciation of Water Plant and credited with amortization debited to account 272 - Accumulated Amortization of Contributions in Aid of Construction. Depreciation shall be accrued on a straight-line remaining life basis or straight-line basis, as required by the Commission. A single composite depreciation rate may be used if approval from the Commission is obtained.

Note A:--See Accounting Instruction 27, for more detailed instructions on depreciation accounting.

B. Depreciation for property not used in water operations is charged to account 426 - Miscellaneous Nonutility Expenses, and is credited to account 122 - Accumulated Depreciation and Amortization of Nonutility Property.

#### 406. Amortization of Utility Plant Acquisition Adjustments

This account shall be debited or credited, as the case may be, only upon the approval of the Commission, for the purpose of providing for the extinguishment of the amount in account 114 - Utility Plant Acquisition Adjustments.

#### 407. Amortization Expense

This account shall be the control account for amortization accounts totaling the amounts in accounts 407.1 to 407.3.

##### 407.1 Amortization of Limited Term Plant

This account shall include amortization charges applicable to amounts included in the utility plant accounts for limited term franchises, licenses, patent rights, limited term interests in land, and expenditures on leased property where the service life of the improvements is terminable by action

## BALANCE SHEET ACCOUNTS

C. The records supporting the entries to this account shall be so kept that the utility can furnish information as to the purpose of each donation, the conditions, if any, upon which it was made, the amount of donations from (a) states, (b) municipalities, (c) customers, and (d) others, and the amount applicable to each utility department.

Note:--There shall not be included in this account advances for construction which are ultimately to be repaid wholly or in part (See account 252 - Advances for Construction).

### 272. Accumulated Amortization of Contributions in Aid of Construction

A. This account shall reflect the amortization accumulated on account 271 - Contributions in Aid of Construction, if recognized by the Commission.

B. Specifically, balances in account 271 which represent contributions of depreciable plant shall be amortized by charges to this account over a period equal to the estimated service life of the related contributed asset. A group or overall composite rate may be used for contributed balances that cannot be directly related to a plant asset.

C. The concurrent credit for the amortization recorded in this account shall be made to account 403 - Depreciation Expense.

D. If a regulatory body allows the amortization of any portion of the monies collected to pay the tax obligation caused by the receipt of CIAC, such amortization shall also be reflected in a sub-account of this account. Specifically, balances in account 271 which represent monies collected for the gross-up of CIAC (See Definition 15.) shall be amortized by charges to this account over a period determined by the regulatory body.

### Accumulated Deferred Income Taxes

Before using the deferred tax accounts provided below, refer to Accounting Instruction 28 (B) and (C). Interperiod Income Tax Allocation - Depreciation and Comprehensive Interperiod Income Tax Allocation - Other.

Public utilities shall use the accounts provided below for prior accumulations of deferred taxes on income for additional provisions. Prior to any use of these accounts, the utility must file with the Commission, for the purpose of obtaining authorization, its proposed plan of accounting for deferred taxes on income. The utility shall not use these accounts unless such use has been authorized by the Commission. If deferred tax accounting is initiated with respect to any property such

## BALANCE SHEET ACCOUNTS

accounting shall not be discontinued on that property without prior approval of the Commission.

The utility is restricted in its use of these accounts to the purposes set forth therein. It shall not make any transfers from these accounts or make any use thereof except as provided in the text of the accounts without prior approval of the Commission. It shall not transfer the balance in these accounts or any portion thereof to retained earnings except as provided in the text of this account without prior approval of the Commission.

Upon the disposition by sale, exchange, transfer, abandonment, or premature retirement of plant on which there is a related balance in these accounts, the deferred tax account shall be debited with an amount equal to the related income tax expense, if any, arising from such disposition and account 411 - Provision for Deferred Income Taxes-Credit, shall be credited. When the remaining balance, after consideration of any related income tax expenses, is not significant, the deferred tax account shall be debited and account 411 credited with such balance. If after consideration of any related income tax expense, and the remaining amount is significant, then the Commission shall authorize or direct how such amount shall be accounted for at the time approval for the disposition of account is granted. When plant is disposed of by transfer to a wholly owned subsidiary, the related balance in the deferred tax account shall also be transferred. When the disposition relates to retirement of an item or items under a group method of depreciation where there is no tax effect in the year of retirement, no entries are required in the deferred tax account if it can be determined that the related balances would be necessary to be retained to offset future group item tax deficiencies.

Note:--Public utilities having more than one utility department and/or nonutility property and which have deferred taxes on income with respect thereto shall classify such deferrals in the accounts provided elsewhere so as to allow ready identification of items relating to each utility department and to Other Income and Deductions.

### 281. Accumulated Deferred Income Taxes - Accelerated Amortization

A. This account shall include tax deferral resulting from adoption of the principles of Comprehensive Interperiod Income Tax Allocation - Other described in Accounting Instruction 28 (c) of this system of accounts that relate to property for which the utility have availed itself of the use of accelerated (5-year) amortization of (1) certified defense facilities as permitted by Section 168 of the Internal Revenue Code and (2) certified pollution control facilities as permitted by Section 169 of the Internal Revenue Code.

located on his side of the point of collection in safe operating condition.

D. Easements and rights-of-way

1. Each customer shall grant adequate easement and right-of-way satisfactory to the utility to ensure that customer's proper service connection. Failure on the part of the customer to grant adequate easement and right-of-way shall be grounds for the utility to refuse service.
2. When a utility discovers that a customer or his agent is performing work or has constructed facilities adjacent to or within an easement or right-of-way and such work, construction or facility poses a hazard or is in violation of federal, state or local laws, ordinances, statutes, rules or regulations, or significantly interferes with the utility's access to equipment, the utility shall notify the customer or his agent and shall take whatever actions are necessary to eliminate the hazard, obstruction or violation at the customer's expense.

Historical Note

Adopted effective March 2, 1982 (Supp. 82-2).

R14-2-606. Collection main extension agreements

A. General requirements

1. Each utility entering into a main extension agreement shall comply with the provisions of this rule, which specifically defines the conditions governing collection main extensions.
2. Upon request by a potential applicant for a collection main extension, the utility shall prepare, without charge, a preliminary sketch and rough estimate of the cost of installation to be paid by said applicant.
3. Any applicant for a collection main extension requesting the utility to prepare detailed plans, specifications, or cost estimates may be required to deposit with the utility an amount equal to the estimated cost of preparation. The utility shall, upon request, make available within 90 days after receipt of the deposit referred to above, such plans, specifications, or cost estimates of the proposed collection main extension. Where the applicant accepts the plans and the utility proceeds with construction of the extension, the deposit shall be credited to the cost of construction; otherwise the deposit shall be nonrefundable. If the extension is to include oversizing of facilities to be done at the utility's expense, appropriate details shall be set forth in the plans, specifications and cost estimates.
4. Where the utility requires an applicant to advance funds for a collection main extension, the utility shall furnish the applicant with a copy of the extension tariff of the appropriate utility prior to the applicant's acceptance of the utility's extension agreement.
5. All collection main extension agreements requiring payment by the applicant shall be in writing and signed by each party before the utility commences construction.
6. In the event the utility's actual cost of construction is different from the amount advanced by the customer, the utility shall make a refund to or collect additional funds from, the applicant within 120 days after the completion of the construction.
7. The provisions of this rule apply only to those applicants who in the utility's judgment will be permanent customers of the utility. Applications for temporary service shall be governed by the Commission's rules concerning temporary service applications.

B. Minimum written agreement requirements

1. Each collection main extension agreement shall, at a minimum, include the following information:

- a. Name and address of applicant(s)
- b. Proposed service address or location
- c. Description of requested service
- d. Description and sketch of the requested main extension
- e. A cost estimate to include materials, labor, and other costs as necessary
- f. Payment terms
- g. A clear and concise explanation of any refunding provisions, if appropriate
- h. The utility's estimated start date and completion date for construction of the collection main extension

2. Each applicant shall be provided with a copy of the written collection main extension agreement.

C. Main extension requirements

1. Each main extension tariff shall include the following provisions:
  - a. A maximum footage and/or equipment allowance to be provided by the utility at no charge. The maximum footage and/or equipment allowance may be differentiated by customer class.
  - b. An economic feasibility analysis for those main extensions which exceed the maximum footage and/or equipment allowance. Such economic feasibility analysis shall consider the incremental revenues and cost associated with the main extension. In those instances where the requested main extension does not meet the economic feasibility criteria established by the utility, the utility may require the customer to provide funds to the utility, which will make the main extension economically feasible. The methodology employed by the utility in determining economic feasibility shall be applied uniformly and consistently to each applicant requiring a main extension.
  - c. The timing and methodology by which the utility will refund any advances in aid of construction as additional customers are served off the main extension. The customer may request an annual survey to determine if additional customers have been connected to and are using service from the main extension. In no case shall the amount of the refund exceed the amount originally advanced.
  - d. All advances in aid of construction shall be noninterest bearing.
  - e. If after 5 years from the utility's receipt of the advance, the advance has not been totally refunded, the advance shall be considered a contribution in aid of construction and shall no longer be refundable.

D. Residential subdivision development and permanent mobile home parks

1. Each utility shall submit as a part of its main extension tariff separate provisions for residential subdivision developments and permanent mobile home parks.

E. Ownership of facilities

1. Any facilities installed hereunder shall be the sole property of the utility.

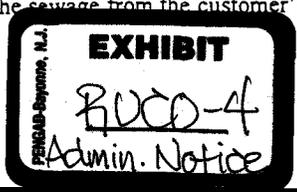
Historical Note

Adopted effective March 2, 1982 (Supp. 82-2).

R14-2-607. Provision of service

A. Utility responsibility

1. Each utility shall be responsible for the safe conduct and handling of the sewage from the customer's point of collection.



water

the customer shall provide and have installed at his expense all piping necessary for relocating the meter and the utility may make a charge for moving the meter and/or service line.

6. The customer's lines or piping must be installed in such a manner as to prevent cross-connection or backflow.
7. Each utility shall file a tariff for service and meter installations for Commission review and approval.

C. Easements and rights-of-way

1. Each customer shall grant adequate easement and right-of-way satisfactory to the utility to ensure that customer's proper service connection. Failure on the part of the customer to grant adequate easement and right-of-way shall be grounds for the utility to refuse service.
2. When a utility discovers that a customer or his agent is performing work or has constructed facilities adjacent to or within an easement or right-of-way and such work, construction or facility poses a hazard or is in violation of federal, state or local laws, ordinances, statutes, rules or regulations, or significantly interferes with the utility's access to equipment, the utility shall notify the customer or his agent and shall take whatever actions are necessary to eliminate the hazard, obstruction or violation at the customer's expense.

Historical Note

Adopted effective March 2, 1982 (Supp. 82-2). Amended subsection (B) effective September 28, 1982 (Supp. 82-5).

R14-2-406. Main extension agreements

- A. Each utility entering into a main extension agreement shall comply with the provisions of this rule which specifically defines the conditions governing main extensions.
- B. An applicant for the extension of mains may be required to pay to the Company, as a refundable advance in aid of construction, before construction is commenced, the estimated reasonable cost of all mains, including all valves and fittings.
  1. In the event that additional facilities are required to provide pressure, storage or water supply, exclusively for the new service or services requested, and the cost of the additional facilities is disproportionate to anticipated revenues to be derived from future consumers using these facilities, the estimated reasonable cost of such additional facilities may be included in refundable advances in aid of construction to be paid to the Company.
  2. Upon request by a potential applicant for a main extension, the utility shall prepare, without charge, a preliminary sketch and rough estimate of the cost of installation to be paid by said applicant. Any applicant for a main extension requesting the utility to prepare detailed plans, specifications, or cost estimates may be required to deposit with the utility an amount equal to the estimated cost of preparation. The utility shall, upon request, make available within 45 days after receipt of the deposit referred to above, such plans, specifications, or cost estimates of the proposed main extension. Where the applicant accepts utility construction of the extension, the deposit shall be credited to the cost of construction; otherwise the deposit shall be nonrefundable. If the extension is to include oversizing of facilities to be done at the utility's expense, appropriate details shall be set forth in the plans, specifications and cost estimates.
  3. Where the utility requires an applicant to advance funds for a main extension, the utility shall furnish the applicant with a copy of the Commission rules on main extension

agreements prior to the applicant's acceptance of the utility's extension agreement.

4. In the event the utility's actual cost of construction is less than the amount advanced by the customer, the utility shall make a refund to the applicant within 30 days after the completion of the construction or utility's receipt of invoices related to that construction.
5. The provisions of this rule apply only to those applicants who in the utility's judgment will be permanent customers of the utility. Applications for temporary service shall be governed by the Commission's rules concerning temporary service applications.

C. Minimum written agreement requirements

1. Each main extension agreement shall include the following information:
  - a. Name and address of applicant(s)
  - b. Proposed service address
  - c. Description of requested service
  - d. Description and map of the requested line extension
  - e. Itemized cost estimate to include materials, labor, and other costs as necessary
  - f. Payment terms
  - g. A clear and concise explanation of any refunding provisions, if applicable
  - h. Utility's estimated start date and completion date for construction of the main extension
2. Each applicant shall be provided with a copy of the written main extension agreement.

- D. Refunds of advances made pursuant to this rule shall be made in accord with the following method: the Company shall each year pay to the party making an advance under a main extension agreement, or that party's assignees or other successors in interest where the Company has received notice and evidence of such assignment or succession, a minimum amount equal to 10% of the total gross annual revenue from water sales to each bona fide consumer whose service line is connected to main lines covered by the main extension agreement, for a period of not less than ten years. Refunds shall be made by the Company on or before the 31st day of August of each year, covering any refunds owing from water revenues received during the preceding July 1st to June 30th period. A balance remaining at the end of the ten-year period set out shall become non-refundable, in which case the balance not refunded shall be entered as a contribution in aid of construction in the accounts of the Company, however, agreements under this general order may provide that any balance of the amount advanced thereunder remaining at the end of the ten year period set out, shall thereafter remain payable in whole or in part and in such manner as is set forth in the agreement.
  1. The aggregate refunds under this rule shall in no event exceed the total of the refundable advances in aid of construction. No interest shall be paid by the utility on any amounts advanced. The Company shall make no refunds from any revenue received from any lines, other than customer service lines, leading up to or taking off from the particular main extension covered by the agreement.

- E. Amounts advanced in aid of construction of main extensions shall be refunded in accord with the rules of this Commission in force and effect on the date the agreement therefor was executed. All costs under main extension agreements entered into after the adoption of this rule shall be refunded as provided herein.
- F. The Commission will not approve the transfer of any Certificate of Public Convenience and Necessity where the transferor has entered into a main extension agreement, unless it is demonstrated to the Commission that the transferor has agreed to