

ORIGINAL



0000022604

BEFORE THE ARIZONA CORPORATION CC

1
2 JEFF HATCH-MILLER
CHAIRMAN
3 WILLIAM A. MUNDELL
COMMISSIONER
4 MARC SPITZER
COMMISSIONER
5 MIKE GLEASON
COMMISSIONER
6 KRISTIN K. MAYES
COMMISSIONER

AZ CORP COMMISSION
DOCUMENT CONTROL

2005 MAY 25 A 10: 04

RECEIVED

7
8 IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN ARIZONA
9 CORPORATION, FOR ADJUSTMENTS TO
10 ITS RATES AND CHARGES FOR UTILITY
SERVICE FURNISHED BY ITS WESTERN
11 GROUP AND FOR CERTAIN RELATED
APPROVALS

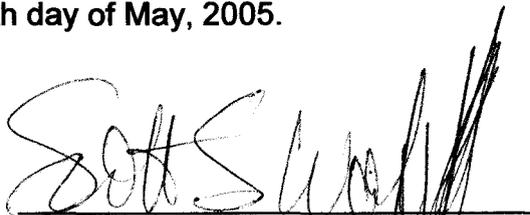
Docket No. W-01445A-04-0650

NOTICE OF FILING

12 The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the
13 Surrebuttal Testimony of Timothy Coley and William Rigsby in the above-referenced matter.

14 RESPECTFULLY SUBMITTED this 25th day of May, 2005.

15
16
17
18
19
20
21
22
23
24


Scott S. Wakefield
Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES of the foregoing filed this 25th day of May, 2005 with:

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

Arizona Corporation Commission
DOCKETED

MAY 25 2005

DOCKETED BY 

1 COPIES of the foregoing hand delivered/
mailed this 25th day of May, 2005 to:

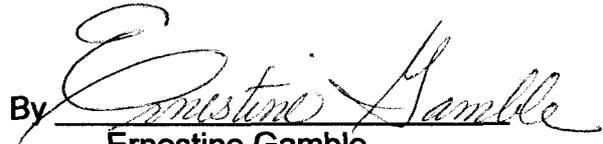
2 Lyn Farmer, Chief Administrative Law
3 Judge
Hearing Division
4 Arizona Corporation Commission
1200 West Washington
5 Phoenix, Arizona 85007

Jeffrey W. Crockett
Deborah R. Scott
Snell & Wilmer
One Arizona Center
400 E. Van Buren
Phoenix, Arizona 85004-2202

6 Christopher Kempley, Chief Counsel
Legal Division
7 Arizona Corporation Commission
1200 West Washington
8 Phoenix, Arizona 85007

Marvin S. Cohen
Sacks Tierney, P.A.
4230 Drinkwater Blvd., 4th Floor
Scottsdale, Arizona 85251

9 Ernest Johnson, Director
Utilities Division
10 Arizona Corporation Commission
1200 West Washington
11 Phoenix, Arizona 85007

By 
Ernestine Gamble

12 Norman D. James
Jay L. Shapiro
13 Fennemore Craig
3003 North Central Avenue
14 Suite 2600
Phoenix, Arizona 85012

15 Robert W. Geake
16 Vice President and General Counsel
Arizona Water Company
17 P. O. Box 29006
Phoenix, Arizona 85038-9006

18 Joan S. Burke
19 Osborn Maledon, P.A.
2929 North Central Avenue
20 Suite 2100
Phoenix, Arizona 85012-2794

21 K. Scott McCoy
22 City of Casa Grande City Attorney
510 E. Florence Blvd.
23 Casa Grande, AZ 85249

24

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650

SURREBUTTAL TESTIMONY
OF
TIMOTHY J. COLEY

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

MAY 25, 2005

| | | |
|---|--|---|
| 1 | INTRODUCTION..... | 1 |
| 2 | RATE BASE..... | 2 |
| 3 | Working Capital – Lead/Lag Days for Federal and State Income Taxes | 2 |
| 4 | OPERATING INCOME..... | 5 |
| 5 | Annualization of Revenues and Expenses | 5 |
| 6 | Property Tax..... | 8 |
| 7 | RATE DESIGN..... | 9 |
| 8 | | |

1 **INTRODUCTION**

2 Q. Please state your name for the record and by whom you are employed.

3 A. My name is Timothy James Coley. I am employed by the Residential
4 Utility Consumer Office ("RUCO").

5
6 Q. Are you the same person named above that filed direct testimony in this
7 docketed case (W-01445A-00-0650) before the Arizona Corporation
8 Commission ("ACC") on behalf of RUCO?

9 A. Yes. I filed direct testimony regarding this case on April 20, 2005.

10
11 Q. What is the purpose of your surrebuttal testimony in this proceeding?

12 A. The purpose of my surrebuttal testimony in this proceeding is to present
13 RUCO's response to Arizona Water Company's (hereafter referred to as
14 "AWC" or "Company") rebuttal testimonies filed by Ms. Sheryl L. Hubbard
15 and Mr. Ralph J. Kennedy. My surrebuttal will supplement and
16 complement my direct testimony, as well as RUCO's, on matters
17 pertaining to the Company's rebuttal positions in this docket.

18
19 Q. Is there another witness on behalf of RUCO presenting responses to the
20 Company's rebuttal testimonies?

21 A. Yes. RUCO witness, Mr. William A. Rigsby, will present RUCO's
22 responses to the Company's rebuttal testimonies on the remaining issues

1 filed by AWC witnesses Mr. William M. Garfield, Mr. Michael J. Whitehead,
2 Dr. Thomas M. Zepp, Mr. Ralph J. Kennedy, and Ms. Sheryl L. Hubbard.

3

4 Q. What areas will your surrebuttal testimony address?

5 A. I will provide surrebuttal testimony in the following areas:

6 1. RUCO's corrected lag days for the federal and state income taxes.

7 2. RUCO's annualization of the Company's revenues and expenses
8 on a going forward basis.

9 3. Property taxes based on gross revenues utilizing the computational
10 methodology agreed upon by the Arizona Department of Revenue
11 (ADOR) and the Water Utilities Association of Arizona.

12 4. RUCO's two-tier rate design.

13

14 Q. Have you included any updated schedules and/or revenue requirements in
15 this surrebuttal filing?

16 A. No. I maintain the same positions as filed in my direct testimony.

17

18 **RATE BASE**

19 **Working Capital – Lead/Lag Days for Federal and State Income Taxes**

20 Q. Did the Company address your corrections for its lag days for federal and
21 state income taxes in its rebuttal testimony?

22 A. Yes. Company witness, Ms Hubbard, stated that RUCO continues to offer
23 the same recommendation for federal and state income tax lag days of

1 61.95 and 99.80, respectively, as RUCO recommended in the Northern
2 and Eastern Group cases, (Hubbard Rebuttal Testimony at 12).

3
4 Q. Do you agree with Ms. Hubbard's statement that RUCO recommended
5 federal and state income tax lag days of 61.95 and 99.80, respectively, in
6 the Northern and Eastern Group?

7 A. Not entirely. The instant case, Western Group, is the first time RUCO has
8 recommended a correction in the state income tax lag days.

9
10 Q. What is the basis of your correction to the Company's lead/lag days as
11 filed in its rate application?

12 A. The basis of the correction is the same as I state in my direct testimony. A
13 company's working capital requirement is the amount of cash the
14 company must have on hand to cover expenses that must be paid before
15 revenues are available, thus received, to make those expense payments.

16
17 Q. Do all public utility companies calculate lead/lag days in a similar manner?

18 A. Yes. First, it is not necessary to distinguish between a public utility
19 company and any other form of company, private or public, to calculate
20 the timing differences between when revenues are received and expenses
21 must be paid to determine lead/lag days. Bankers and other creditors
22 often calculate lead/lag days to compute cash working capital as an
23 indicator of the short-run liquidity of a company to determine if it is

1 financially capable of making the installment loan payments. For the most
2 part, all lead/lag studies concerning income taxes I have analyzed use
3 similar methods with marginal differences resulting.

4
5 Q. How does AWC federal income tax lag days of 2.52 compare with other
6 lead/lag studies that you have reviewed?

7 A. It is extremely lower than other utility companies that have filed lead/lag
8 studies before this Commission.

9
10 Q. Can you provide some other utility companies' lead/lag study comparisons
11 that had rate case proceedings before this Commission?

12 A. Yes. The table below illustrates four of the largest utilities in Arizona that
13 recently had or are in the process of a rate case hearing before this
14 Commission and compares federal/state income tax lag days.

15

| <u>Company</u> | <u>Federal Tax Lag Days</u> | <u>State Tax Lag Days</u> |
|----------------|-----------------------------|---------------------------|
| 16 APS..... | 60 | 62 |
| 17 Qwest..... | 80 | 18 |
| 18 TEP..... | 42.41 * | |
| 19 SWG..... | 37 * | |

20
21 * Note: These Companies provided a composite federal and state lead/lag tax
22 days study.

23

1 Q. Can you explain the enormous difference in income tax lag days between
2 AWC and the companies used in your comparison?

3 A. Yes. In part, the methodology AWC uses assumes it makes payments on
4 both federal and state income taxes on a monthly basis rather than when
5 actually paid on a quarterly basis. The Company's study presumes a cash
6 payment is being made when the Company records the expense on its
7 books each month, not when the actual cash payment is made on a
8 quarterly basis. Booking an expense is not cash payment of a liability.
9 The correct computation of working capital is based on when the actual
10 cash outlay is paid, not booked.

11
12 **OPERATING INCOME**

13 **Annualization of Revenues and Expenses**

14 Q. Did the Company disagree with your annualization of revenues and
15 expenses?

16 A. Yes. The Company took issue with three areas of my revenue and
17 expense annualization.

18
19 Q. What three areas of your revenue and expense annualization did the
20 Company address in its rebuttal testimony?

21 A. First, Ms. Hubbard, in response to RUCO's criticism that AWC failed to
22 recognize the Test Year-end number of customers in its calculation in
23 determining revenues and expenses on a going forward basis, states

1 AWC did recognize the year-end level of customers. Second, the
2 Company is critical of RUCO's use of average revenue per customer
3 using all customer classes versus just the residential class. Third, the
4 Company claimed that a regression analysis performed by RUCO was
5 "theoretically questionable and outdated".

6
7 Q. Please respond to the Company's first argument that it has utilized the
8 Test Year-end customers in its revenue annualization.

9 A. By utilizing the Test Year-end customers in its calculation, the Company
10 understates the actual annual growth. The reason is because the
11 Company is measuring the growth as the difference between Test Year
12 average number of customers to the year-end number of customers,
13 rather than measuring growth from the beginning of the Test Year to the
14 end of the Test Year. Regarding its growth calculation the Company
15 states, "During the test year, the Western Group served an average of
16 19,596 customers, a difference of 670 customers" from Test Year-end
17 customer count of 20,266. The Company's use of an average Test Year
18 customer count fails to recognize revenues and expenses associated with
19 the Test Year growth of an additional 587 customers in the Western
20 Group. The Company's customer count work papers provided in its rate
21 application clearly indicate that the Test Year customer growth count was
22 1,257 rather than the Company's stated average of 670. The Company's

1 methodology only accounts for 6 months of growth rather than a year's
2 worth of growth.

3
4 Q. Please respond to the Company's second criticism regarding your use of
5 average revenue for all classes of customers.

6 A. I do not agree with the Company's argument. Even if I were to modify my
7 calculation so it recognized only the residential average revenues as the
8 Company proposes, the adjustment would still be greater than the
9 Company's because the Company's average residential revenue is
10 significantly understated when compared to the actual average residential
11 revenue.

12
13 Q. Please provide an explanation to the Company's response concerning
14 RUCO's regression analysis.

15 A. The Company complains that RUCO's regression analysis is "outdated".
16 By this reasoning the Company's lead/lag study must also be outdated
17 because it is also vintage 1999 (see Hubbard Direct Testimony page 20,
18 line 16 and 17).

1 **Property Tax**

2 Q. Do you agree with the Company's modification to the Arizona Department
3 of Revenue ("ADOR") property tax valuation method to determine the
4 Western Group's property tax expense?

5 A. No, I do not. It has been and continues to be RUCO's position that a
6 methodology solicited by the water utility association and adopted by a
7 state agency charged with the expertise to determine property tax
8 valuations should be respected until modified or changed by law or that
9 agency. The ADOR property tax valuation method is the result of an
10 agreement by the Arizona Water Association and ADOR to provide the
11 utilities, as well as the Commission, guidance regarding projections of
12 future property tax expense.

13
14 Q. Does RUCO agree that an increase in revenue will undoubtedly lead to an
15 increase in property taxes?

16 A. No. According to ADOR, property tax rates have been decreasing the
17 past several years. With the uncertainty of future tax rates, the Company
18 may experience a tax expense decrease in future years. Besides, AWC
19 has been ordered by the Commission to file a rate case with a Test Year
20 ending 2006 to recover costs associated with the Arsenic Cost Recovery
21 Mechanism ("ACRM").

22

1 Q. When will the Company pay the property tax impacted by the increased
2 revenues approved in this case?

3 A. Assuming that the rates resulting from this case go into effect in the last
4 quarter of 2005, it will not be until the end of 2006 before the Company will
5 have one full year of operating revenues at the new rates. Thus, the 2006
6 revenues will not form the basis of the Company's "Full Cash Value" until
7 2007. The Company's first payment would not be due until October 2007,
8 and the final payment will not be due until March 2008. Further, if the
9 Company receives approval of its proposed ACRM mechanism a rate
10 case will be required by 2007.

11
12 **RATE DESIGN**

13 Q. Please discuss the Company's rebuttal arguments regarding your
14 recommended rate design.

15 A. Company witness, Mr. Kennedy, criticized RUCO's rate design on the
16 grounds that it fails to recognize and adjust rates for price elasticity, fails to
17 provide any protection to the Company for the increased revenue volatility
18 that results from the tiered rate design, fails to justify an intentional
19 subsidy in pricing the first block of water for the 5/8" X 3/4" meter size, and
20 inequitable rates for the larger meter sizes.

1 Q. Please describe RUCO's rationale for its rate design and tiered rates.

2 A. The Commission has strongly supported the use of tiered rates in recent
3 years. Tiered rate structures may or may not effectively promote water
4 conservation.

5

6 Q. Please further discuss Mr. Kennedy's price elasticity argument.

7 A. Many, if not all, of the arguments and issues presented by Mr. Kennedy
8 are highly academic, speculative, and without empirical evidence. Any
9 argument that I could raise would be laden with the same shortcomings.
10 The full intent of a tiered rate structure is to send price signals that lead to
11 conservation, but without hard empirical data to review and analyze, I
12 cannot say if the customers' behavior will change for a short-term, long-
13 term, or any at all for that matter. Accordingly, an adjustment at this time
14 for lost revenues (or price elasticity) would be speculative at best and
15 most certainly would not meet the "known and measurable" standard of
16 ratemaking.

17

18 Q. Does this conclude your testimony on Arizona Water's Western Group
19 systems?

20 A. Yes, it does.

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650

SURREBUTTAL TESTIMONY
OF
WILLIAM A. RIGSBY

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

MAY 25, 2005

| | | |
|---|--|-----------|
| 1 | INTRODUCTION..... | 1 |
| 2 | CAP COSTS | 3 |
| 3 | CASA GRANDE LEGAL COSTS | 15 |
| 4 | ACCUMULATED DEPRECIATION ADJUSTMENT | 18 |
| 5 | ELIMINATION OF THE PPAM AND PWAM | 21 |
| 6 | COST OF CAPITAL..... | 24 |
| 7 | | |

1 **INTRODUCTION**

2 Q. Please state your name, occupation, and business address.

3 A. My name is William A. Rigsby. I am a Public Utilities Analyst V employed
4 by the Residential Utility Consumer Office ("RUCO") located at 1110 W.
5 Washington, Suite 220, Phoenix, Arizona 85007.

6
7 Q. Please state the purpose of your surrebuttal testimony.

8 A. The purpose of my surrebuttal testimony is to respond to Arizona Water
9 Company's ("Arizona Water" or "Company") rebuttal testimony on RUCO's
10 recommended revenue level, rate base and rate of return on invested
11 capital (which includes RUCO's recommended cost of debt and cost of
12 common equity) for the Company's Western Group. The Western Group
13 is comprised of five separate systems that serve the communities of Ajo
14 Heights ("Ajo"), Casa Grande, Coolidge, Stanfield and White Tank. The
15 Company's rebuttal testimony was filed with the Commission on May 13,
16 2005.

17
18 Q. Have you filed any prior testimony in this case on behalf of RUCO?

19 A. Yes, on April 20, 2005, I filed direct testimony with the Arizona Corporation
20 Commission ("ACC" or "Commission"). My direct testimony addressed the
21 revenue requirement and rate base issues associated with the Casa
22 Grande and Stanfield systems in the Western Group. I also filed, under
23 separate cover, direct testimony on the cost of capital issues for the entire

1 Western Group. RUCO witness Timothy J. Coley filed direct testimony on
2 the required revenue and rate base issues associated with the Ajo,
3 Coolidge and White Tank systems, and presented RUCO's recommended
4 rate design for the entire Western Group. All of the aforementioned issues
5 were raised in Arizona Water's application requesting a permanent rate
6 increase ("Application") based on the Company's chosen test year ended
7 December 31, 2003 ("Test Year"). For purposes of comparison, I have
8 included Surrebuttal Schedule WAR-1, which illustrates the positions that
9 were presented in the direct testimony of the Company, ACC Staff and
10 RUCO.

11
12 Q. How is your surrebuttal testimony organized?

13 A. My surrebuttal testimony is organized by the issues that have been raised
14 in the case and contains six parts: the introduction that I have just
15 presented; the Company's request to recover both deferred and future
16 Central Arizona Project ("CAP") costs in rates; the Company's accounting
17 treatment of legal costs in the Casa Grande system; RUCO's calculation
18 of accumulated depreciation for the five Western Group systems; RUCO's
19 recommendation to eliminate the Company's purchased power adjustor
20 mechanism ("PPAM") and purchased water adjustor mechanism
21 ("PWAM") which also includes an adjustment for increased power
22 expense as a result of the recent Arizona Public Service ("APS") rate

1 increase¹; and RUCO's cost of capital recommendations. The section on
2 CAP costs will address the rebuttal testimony of Company witnesses
3 William M. Garfield, Sheryl L Hubbard and Michael J. Whitehead. The
4 section on Casa Grande legal costs will address Mr. Garfield's rebuttal
5 testimony on that issue. The section on RUCO's accumulated
6 depreciation adjustment will address the rebuttal testimony of Ms.
7 Hubbard. The section on the elimination of the Company's PPAM, PWAM
8 and RUCO's adjustment related to the recent APS rate increase, will
9 address the rebuttal testimony of Mr. Ralph J. Kennedy and Ms. Hubbard.
10 The final section on the cost of capital issues associated with the case will
11 address the rebuttal testimony of Mr. Kennedy and the Company's cost of
12 capital consultant, Dr. Thomas M. Zepp.

13
14 **CAP COSTS**

15 Q. Please give a brief overview of the argument on the CAP cost issues in
16 this case.

17 A. For the most part, the Company has not changed its position on CAP
18 water costs in its rebuttal testimony. As I will explain later in my testimony,
19 the Company's witnesses have misrepresented the intent of ACC Decision
20 No. 62993, dated November 3, 2000, in order to justify why Arizona Water
21 should be able to recover deferred and ongoing CAP M&I costs in rates
22 from the general body of ratepayers in Casa Grande, Coolidge and White

¹ Decision No. 67744, dated April 7, 2005.

1 Tank. If the Commission adopts the Company's proposed ratemaking
2 treatment of its deferred CAP costs, the general body of ratepayers will
3 not receive CAP water in exchange for what they will be paying for in
4 rates. The Company provides additional information on their long-term
5 plans for CAP water treatment facilities, however, none of these facilities
6 are operational at the present time. In the case of Arizona Water's Casa
7 Grande system, the Company is presently providing untreated non-
8 potable CAP water to customers under Arizona Water's NP-260 tariff
9 (which allows the Company to recover all of the costs associated with non-
10 potable CAP water deliveries in Casa Grande).

11
12 Q. Have you reviewed the rebuttal testimony of Company witnesses William
13 M. Garfield, Sheryl L Hubbard and Michael J. Whitehead that addresses
14 the CAP issues related to the case?

15 A. Yes. I have reviewed the Company's rebuttal testimony, filed by the
16 aforementioned Company witnesses, on May 13, 2005.

17
18 Q. Please address the rebuttal testimony of Mr. Garfield.

19 A. The first portion of Mr. Garfield's rebuttal testimony on the CAP issues in
20 this case makes the following points in regard to RUCO's direct testimony
21 and recommendations: first, Mr. Garfield states my position that the CAP
22 allocations are not used and useful and should not be placed in rates
23 because they will place an undue hardship on customers; second, Mr.

1 Garfield incorrectly states that my testimony did not recognize the fact that
2 the Company is presently utilizing a portion of its CAP allocation for non-
3 potable customers in the Casa Grande system; and third Mr. Garfield
4 incorrectly states that the Commission's official policy for the recovery of
5 CAP costs is contained in Decision No. 62993, dated November 3, 2000.
6 The second portion of Mr. Garfield's rebuttal testimony contains
7 background information on the CAP and Arizona Water's contractual
8 obligations with the Central Arizona Water Conservation District
9 ("CAWCD"). The third and final portion of Mr. Garfield's rebuttal testimony
10 on the CAP issues in this case contains his rationale as to why he
11 believes that ratepayers in Casa Grande, Coolidge and White Tank benefit
12 from the Company's CAP allocation and should pay for the Company's
13 deferred and ongoing CAP costs in their rates.

14
15 Q. Have any of the arguments, for the recovery of CAP charges (from
16 customers in Casa Grande, Coolidge and White Tank who require treated
17 potable CAP water) presented in Mr. Garfield's rebuttal testimony caused
18 you to change your position on the recovery of CAP costs?

19 A. No. RUCO's position on Arizona Water's request for the recovery of CAP
20 costs remains unchanged. RUCO believes that, with the exception of the
21 non-potable CAP water being utilized under the Company's CAP contract
22 in the Casa Grande system, the remainder of Arizona Water's CAP
23 allocation costs for Casa Grande, Coolidge and White Tank fails to meet

1 the used and useful standard, and therefore should not be recovered from
2 ratepayers who do not receive CAP water. RUCO strongly recommends
3 that the Commission deny Arizona Water's requests for rate base
4 treatment of the Company's deferred CAP charges, the proposed ten-year
5 amortization of the deferred CAP charges, and the recovery of on-going
6 CAP M&I charges in rates.

7
8 Q. Do you also stand by your position that the recovery of CAP charges will
9 place an undue burden on ratepayers in this case?

10 A. Yes. The Company has not revealed in this case the actual monthly
11 charges that will be passed on to ratepayers in the Casa Grande, Stanfield
12 and White Tank systems through the Company's proposed arsenic cost
13 recovery mechanism ("ACRM"). If the Company's CAP and ACRM cost
14 recovery requests are approved by the Commission, ratepayers requiring
15 potable water in Casa Grande and White Tank will not only have to pay
16 monthly rates that will include costs associated with CAP water that they
17 are not receiving, but will also have to pay the additional ACRM
18 surcharge. This situation very well could result in rate shock, which is
19 unacceptable to RUCO, especially since no actual CAP water treatment
20 facilities exist at the present time, and customers will actually be forced to
21 pay for costs associated with CAP water that they may or may not receive
22 for years to come.

23

1 Q. Mr. Garfield stated in his rebuttal testimony that RUCO did not address the
2 recovery of CAP costs in a future rate case. Is this a true statement?

3 A. Yes. It is true that RUCO did not address the future recovery of CAP
4 costs for the three systems in question. However, RUCO's
5 recommendation to allow cost recovery of CAP charges for Arizona
6 Water's Apache Junction system, during the Company's Eastern Group
7 rate case proceeding, stands as proof that RUCO is not opposed to the
8 recovery of CAP costs as long as the used and useful standard is met and
9 ratepayers actually receive the CAP water that they are paying for in their
10 rates.

11
12 Q. Please explain why RUCO supported the recovery of CAP costs in the
13 Eastern Group proceeding, but opposes the recovery of CAP costs in this
14 Western Group proceeding.

15 A. During the Eastern Group rate case, Arizona Water was using almost all
16 of the Company's Apache Junction CAP allocation. The Apache Junction
17 system's 2001 test year CAP usage can be seen in Attachment A of this
18 testimony, which contains a printout from the CAWCD's website. This
19 printout demonstrates that Arizona Water utilized 5,163 acre-feet or
20 approximately 86 percent of the Company's 6,000 acre-foot allocation
21 during the 2001 operating period. Over the course of the Eastern Group
22 proceeding, it was pointed out by Arizona Water that Apache Junction
23 CAP water is treated at a City of Mesa facility and is then pumped into the

1 Apache Junction distribution system for use by Apache Junction
2 ratepayers.

3 In the case of the Western Group, there are presently no treatment
4 facilities in place to provide potable CAP water to ratepayers in the Casa
5 Grande, Coolidge and White Tank systems. During the Western Group
6 Test Year, Arizona Water utilized approximately 26 percent of the
7 Company's Casa Grande CAP allocation (see Attachment B). However,
8 all 26 percent of the allocation was utilized as non-potable water and
9 Arizona Water's costs for the CAP water deliveries were fully recovered
10 through the Company's cost based NP-260 Tariff, a copy of which can be
11 seen in Attachment C of this testimony.

12 As I pointed out in my direct testimony, the information that I have just
13 presented here comprises the fundamental difference between the reason
14 why RUCO supported CAP cost recovery in the Eastern Group rate case
15 and opposes CAP cost recovery in this proceeding. Quite simply, in this
16 proceeding, Arizona Water wants to charge ratepayers in Casa Grande,
17 Coolidge and White Tank for costs associated with CAP water that they
18 are not using.

1 Q. Why do you say that Mr. Garfield incorrectly stated that your testimony did
2 not recognize that the Company is presently utilizing a portion of its CAP
3 allocation for non-potable customers in the Casa Grande system?

4 A. Because I specifically stated on pages 17, 18 and 21 of my direct
5 testimony that with the exception of providing non-potable CAP water to
6 Casa Grande customers under the Company's cost based NP-260 Tariff
7 (exhibited in Attachment C) Arizona Water was not utilizing the Company's
8 CAP allocation for the Western Group.

9
10 Q. Twice now you have referred to the Company's NP-260 Tariff as being
11 cost based. What exactly do you mean by this?

12 A. As can be seen in the actual document exhibited in Attachment C, the NP-
13 260 Tariff, which was approved by the Commission in Decision No. 66849,
14 states that the customer will be billed for all of the actual costs associated
15 with the delivery of non-potable CAP water including a percentage of the
16 actual costs to cover the Company's administrative costs and overhead.
17 A monthly bill under the NP-260 Tariff includes four different components
18 that allow full recovery of annual demand applicable to CAWCD M&I water
19 service charges (based on the number of acre-feet requested by the
20 customer), a monthly meter charge by meter size which includes no water,
21 a commodity charge designed to pass on all costs of non-potable CAP
22 water delivered to the customer, and a power, maintenance and
23 depreciation charge based on actual costs incurred and on Commission

1 approved rates of depreciation. The first component of the NP-260 Tariff
2 allows Arizona Water to recover the deferred CAWCD M&I charges that
3 are attributable to non-potable customers in Casa Grande. These are the
4 same deferred CAWCD M&I charges that the Company is seeking to
5 recover from ratepayers in Casa Grande, Coolidge and White Tank that,
6 unlike the non-potable customers, will receive no CAP water until the
7 Company finally puts treatment facilities into service.

8 Given the fact that Arizona Water is presently recovering all of the costs
9 for the non-potable CAP water that the Company is taking under its CAP
10 allocation, the Company should not be permitted to also recover CAP
11 costs from the general body of ratepayers in Casa Grande, Coolidge and
12 White Tank, who receive no benefit from the CAP allocation.

13
14 Q. Please explain why Mr. Garfield is incorrect in his statements regarding
15 Decision No. 62993, dated November 3, 2000.

16 A. In the direct and rebuttal testimony of Mr. Garfield and Ms. Hubbard, both
17 Company witnesses purport that Decision No. 62993 constitutes official
18 ACC policy on water utility issues including the recovery of CAP costs.
19 This is not what the Decision says, and is simply untrue.

20
21
22
23

1 Q. What do you believe the intent of Decision No 62993 was?

2 A. Decision No. 62993 recognizes the fact that ACC Staff conducted water
3 utility workshops, by order of Decision No. 60829, and later produced a
4 Staff Report that contained recommendations on certain water utility
5 issues including possible ways of recovering CAP costs. Nowhere in
6 Decision No. 62993 is there any language that adopts any of the
7 recommendations or views presented in the ACC Staff report or concludes
8 that the recommendations constitute official ACC policy. Nor is there an
9 ordering paragraph that actually orders Commission Staff to implement
10 any of the recommendations contained in the ACC Staff report. In the
11 final section of the decision, titled "Conclusions of Law," the Decision
12 states the following:

- 13
- 14 1. The Commission as a regulatory body with the longest
15 history and the primary responsibility over private water
16 companies should take the lead in seeking a coordinated
17 solution to the problems of small water companies.
 - 18
 - 19 2. The Commission arranged for the formation of the Task
20 Force for meetings between representatives of regulatory
21 agencies, the water providers, and water consumers in
22 order to address these issues.
 - 23
 - 24 3. The Task Force has issued a report that summarizes the
25 views of its members.
 - 26

27 Mr. Garfield and Ms. Hubbard's testimony completely distorts the intent of
28 Decision No. 62993 and should be given no weight.

29

1 Q. Please describe Ms. Hubbard's rebuttal testimony on the CAP issues
2 associated with the case.

3 A. Other than the fact that Ms. Hubbard's rebuttal testimony contradicts Mr.
4 Garfield's rebuttal testimony by stating that I did recognize the fact that
5 Arizona Water was utilizing a portion of its CAP allocation to serve non-
6 potable customers through the NP-260 Tariff, there is really nothing in her
7 testimony that hasn't already been said or argued by Mr. Garfield on this
8 issue as it relates to RUCO's position in the case. Ms. Hubbard cites
9 several ACC decisions that involved the recovery of CAP costs in rates,
10 including the Eastern Group Decision that I have already discussed,
11 however none of these other decisions have anything in common with this
12 case.

13

14 Q. Have you read the rebuttal testimony of Mr. Whitehead?

15 A. Yes.

16

17 Q. Please describe Mr. Whitehead's testimony?

18 A. Mr. Whitehead's rebuttal testimony describes the plans that the Company
19 has to build CAP treatment facilities for the Casa Grande, Coolidge and
20 White Tank systems. However, none of these plants exist at this time.
21 Therefore, his testimony is completely irrelevant since the ACC did not set
22 any CAP recovery policy pursuant to Decision No. 62993. In fact, his
23 testimony only reinforces my argument that the recovery of CAP charges

1 should be delayed until the Company is actually providing treated CAP
2 water to the three affected systems.

3
4 Q. Why do you believe that Mr. Whitehead's testimony reinforces your
5 argument that the recovery of CAP charges should be delayed until the
6 Company is actually providing treated CAP water to the three affected
7 systems?

8 A. Mr. Whitehead's testimony only provides evidence that Arizona Water *has*
9 *plans to utilize the Company's CAP allocation in Casa Grande, Coolidge*
10 *and White Tank but none of these facilities presently exist.* Mr.
11 Whitehead's testimony reinforces RUCO's argument that customers who
12 require treated CAP water, in the three affected systems, will not receive
13 any CAP water in return for the CAP costs that would be collected in rates
14 until actual treatment facilities are constructed sometime between 2008
15 and 2012. RUCO believes that, with the exception of the NP-260 Tariff
16 customers, no CAP costs should be recovered from ratepayers until the
17 CAP allocation is utilized in a manner that is beneficial to the general body
18 of ratepayers.

19 Once the facilities that Mr. Whitehead discusses in his testimony have
20 been constructed and are providing treated CAP water for a full operating
21 period, the Company should apply for rate relief and make a request for
22 the recovery of CAP costs and related treatment facilities.

23

1 Q. What advantages do you see in waiting until actual treatment plants are
2 constructed and operating?

3 A. Assuming that the customer base continues to grow in the three systems,
4 the impact of the recovery of CAP costs will not be as heavy on affected
5 ratepayers. In addition, costs being recovered under the Company's
6 ACRM surcharge may also fall if treated CAP water is blended with
7 groundwater that contains unacceptable levels of arsenic. Adhering to the
8 accepted method of obtaining rate relief, that I have just described, would
9 also give ACC Staff and RUCO the opportunity to audit the actual costs of
10 the water treatment facilities and the actual operating expenses
11 associated with them to insure that appropriate rates are set for the
12 provision of service.

13
14 Q. Have you calculated what the impact would be on the Casa Grande,
15 Coolidge and White Tank systems if the Commission were to adopt the
16 Company's proposal to recover CAP costs in rates?

17 A. Yes. Surrebuttal Schedule WAR-2 compares a revenue summary
18 exhibiting RUCO's recommended gross revenue increase for the Casa
19 Grande, Coolidge and White Tank systems, with a revenue summary
20 which includes the Company's pro forma adjustments for CAP cost
21 recovery. In the case of Casa Grande, RUCO's recommended gross
22 revenue increase would jump from \$15,481 to \$1,005,606. In the
23 Coolidge system, RUCO's recommended level of gross revenue increase

1 would climb from \$50,532 to \$355,647. For White Tank, RUCO's
2 recommended \$8,568 gross revenue decrease would become a gross
3 revenue increase of \$141,729.

4
5 Q. What is the monthly impact of these increases on individual customers?

6 A. Based on annualized Test Year customer counts, the increases, if applied
7 evenly across the board, would have a monthly impact of \$5.60 per
8 customer in Casa Grande, \$8.43 per customer in Coolidge and \$9.43 per
9 customer in White Tank. Given the fact that ratepayers will not be
10 receiving any direct benefit for what they would be paying for in their rates,
11 RUCO believes that no amount of monthly increase is acceptable. In
12 summary, the best analogy that I can offer is that allowing the Company's
13 CAP costs in rates would be like a financial institution billing your credit
14 card anywhere from \$5.60 to \$9.43 a month (depending on where you
15 lived) for planned services that you may not get to use for another three to
16 seven years, if ever.

17
18 **CASA GRANDE LEGAL COSTS**

19 Q. Please describe Mr. Garfield's rebuttal testimony regarding your
20 recommendation to remove \$824,374 in legal expenses from the Casa
21 Grande system plant in service account.

22 A. Mr. Garfield explains the disputes that Arizona Water had with the City of
23 Casa Grande and argues that the Company should be permitted to

1 recover the legal costs associated with these disputes. However, it is
2 clear that he has either missed the real point for which I recommended the
3 adjustment or he is simply ignoring the reason why I have recommended
4 that the legal costs in question should not be given rate base treatment.
5

6 Q. Please explain in detail why you believe that the Company treated the
7 Casa Grande legal costs incorrectly.

8 A. As I explained in my direct testimony, the Company has booked the Casa
9 Grande legal costs into a non-depreciable plant account. This means that
10 there will never be any decrease in the \$824,374 figure that has been
11 recorded in the account. If my recommendation is not adopted in this
12 case, the full \$824,374 figure will remain in rate base forever and will
13 provide the Company with a return in perpetuity. Should the Commission
14 adopt my recommended 9.17 percent required rate of return, the
15 Company will receive an annual return of \$75,595 on the \$824,374 figure
16 as long as that rate of return is in place. This means that Arizona Water
17 would fully recover the \$824,374 in approximately eleven years but
18 continue to earn a return on the amount forever. Clearly this is not fair to
19 Casa Grande ratepayers.
20
21
22
23

1 Q. Is this the first time that the Company has treated legal costs in this
2 manner?

3 A. No. During the Eastern Group evidentiary hearing, Mr. Kennedy, the
4 Company's treasurer, admitted on the stand that legal costs associated
5 with the Miami System's Pinal Creek Group settlement were booked in a
6 similar manner. As in this case, the Company made no effort to request
7 an accounting order from the Commission on how to book the legal costs.
8 In the Eastern Group proceeding, RUCO attempted to correct this
9 situation, but was unable to do so because the Company's actions were
10 not discovered until Mr. Kennedy made his admission during the
11 evidentiary hearing.

12
13 Q. Does Mr. Garfield's explanation of the cause of the legal costs change
14 your recommendation?

15 A. No. Once again, as I stated in my direct testimony, the reasons for the
16 legal costs are not relevant to my recommended adjustment. The costs
17 should have been booked as operating expenses in the periods in which
18 they were incurred and a determination should have been made if the
19 costs were non-recurring. By treating the Casa Grande legal costs as a
20 non-depreciable component of rate base, the Company has chosen to
21 shift the burden from shareholders to ratepayers, who were innocent
22 bystanders to the legal fight between their city government and Arizona
23 Water.

1 Q. Would you have treated the Casa Grande legal costs as a non-recurring
2 expense if the legal costs had been properly booked as an operating
3 expense?

4 A. Yes. Because I believe Casa Grande ratepayers should not have to pay
5 for disputes between their city government and Arizona Water. These
6 decisions were made by management and appropriately should be borne
7 by shareholders.

8

9 **ACCUMULATED DEPRECIATION ADJUSTMENT**

10 Q. Have you reviewed the rebuttal testimony of Company witness Hubbard
11 that addresses the accumulated depreciation adjustment issue related to
12 the case?

13 A. Yes. Ms. Hubbard disagrees with my adjustment to the Company's
14 accumulated depreciation account, which results in a decrease of \$54,643
15 in accumulated depreciation for the entire Western Group. In support of
16 her argument for adoption of the Company's accumulated depreciation
17 figure, Ms. Hubbard claims that RUCO ignored both the provisions of
18 Decision No. 38733, dated December 2, 1966, and the costs for removal
19 and salvage of assets. Ms. Hubbard also claims that RUCO did not use
20 proper leasehold amortization rates and incorrectly reduced the
21 accumulated depreciation balance by the full original cost of retired non-
22 depreciable plant assets.

23

1 Q. What were the provisions of Decision No. 38733, dated December 2,
2 1966? .

3 A. Decision No. 38733, which is exhibited in Attachment D, orders that a
4 \$368,282,08 deficiency, which occurred over the period March 31, 1955 to
5 December 31, 1965, be amortized over a period of thirty-nine years.
6 RUCO has calculated that this works out to \$9,443 per year for the entire
7 Company, or \$2,675 per year for the entire Western Group (when the
8 Company's 3 factor allocation ratio's are applied). Assuming that the
9 provisions of Decision No. 38733 have never been superceded in any
10 later orders, the amortized amount, over the period covered in this case,
11 would reduce RUCO's \$54,643 adjustment for the entire Western Group
12 to \$30,566.

13

14 Q. Do you agree with Ms. Hubbard's argument that RUCO failed to take the
15 removal and salvage costs of plant assets into consideration?

16 A. No. Removal and salvage costs have never been an issue in any of the
17 Company's prior cases that I have been involved with. In fact, if the
18 Company has been adjusting the Commission ordered plant depreciation
19 rates (which RUCO used in its calculation of accumulated depreciation) to
20 take removal and salvage costs into consideration, then the Company has
21 been incorrectly calculating annual depreciation expense and the resulting
22 accumulated depreciation balances are understated.

23

1 Q. Did RUCO use incorrect leasehold amortization rates?

2 A. RUCO did not amortize the identifiable leasehold improvements included
3 in the Company's plant in service account. In calculating RUCO's going
4 forward level of depreciation expense, RUCO only removed that portion of
5 amortization expense that was related to the ten-year amortization of
6 deferred CAP charges and accepted the Company's remaining pro forma
7 depreciation and amortization expense which contains the Company-
8 proposed level of amortization expense attributed to leasehold
9 improvements. This being the case, if what Ms. Hubbard claims is true,
10 RUCO's accumulated depreciation figure would actually be understated
11 and an error in the Company's favor.

12

13 Q. Did RUCO incorrectly remove the entire original cost of retired non-
14 depreciable plant assets from the Company's accumulated depreciation
15 balance?

16 A. No. Ms. Hubbard is incorrect on this point. The correct ratemaking
17 treatment for retired assets, whether they are depreciable or not, is to
18 remove the entire original cost of the asset from the accumulated
19 depreciation balance (whether that balance is zero or not). This is basic to
20 utility ratemaking and is dictated by the uniform system of accounts.

21

1 **ELIMINATION OF THE PPAM AND PWAM**

2 Q. Have you reviewed the rebuttal testimony of Company witnesses Kennedy
3 and Hubbard that addresses RUCO's recommendation to eliminate the
4 Company's PPAM and PWAM?

5 A. Yes. I have reviewed the Company's rebuttal testimony, which was filed
6 by the aforementioned witnesses.

7
8 Q. Please summarize the positions that Mr. Kennedy and Ms. Hubbard have
9 taken on this issue.

10 A. Mr. Kennedy's rebuttal testimony expresses his opposition to ACC Staff
11 and RUCO's recommendations to eliminate both the PPAM and PWAM.
12 Mr. Kennedy cites Arizona Law, claiming that A.R.S. § 40-370(A) supports
13 his position. Ms. Hubbard's rebuttal testimony focuses on RUCO's related
14 adjustment that increased the cost of pumping power, which was
15 purchased from APS, by 3.5 percent.

16
17 Q. What are ACC Staff and RUCO's positions on the PPAM and PWAM
18 issues in this case?

19 A. Both ACC Staff and RUCO have recommended that the Company's
20 PPAM and PWAM be eliminated as they were in the Company's Eastern
21 Group proceeding. As I stated on page 10 of my direct testimony, the

1 Commission's Decision² in that proceeding was the main reason for
2 RUCO's recommendation to eliminate the PPAM and PWAM in the
3 Western Group.

4
5 Q. Has RUCO changed its position on the elimination of the PPAM and
6 PWAM based on the rebuttal testimony presented by Mr. Kennedy?

7 A. No. RUCO supports ACC Staff's recommendation to eliminate both the
8 PPAM and the PWAM.

9
10 Q. Do you believe that the Commission is required to keep the Company's
11 PPAM and PWAM in place under the provisions of A.R.S. § 40-370(A)?

12 A. This question requires a legal opinion and I am not a lawyer. However,
13 speaking strictly as a financial analyst who has read the statute (as it was
14 cited by Mr. Kennedy) and who has witnessed the Commission's past
15 actions, I believe that the Commission has always relied on its own
16 constitutional authority when making a decision on whether or not to
17 approve an adjustor mechanism. Based on my experience with cases that
18 have come before the Commission, including the prior Arizona Water
19 Eastern Group rate case and the recent APS rate case where a power
20 supply adjustor ("PSA") was central to the proceeding, I don't believe the
21 Commission is required to approve *any* adjustor mechanism that a utility
22 requests. In the APS case, the arguments for the PSA were much more

² Decision No. 66849, dated March 19, 2004.

1 compelling than the arguments presented by Arizona Water in this
2 proceeding and the APS PSA still faced strong opposition by certain
3 members of the Commission. In fact, during the APS case, the provisions
4 of A.R.S. § 40-370(A) were never even raised by APS. It would appear
5 that APS realized what Arizona Water has not, that the Commission has
6 the authority to grant or deny pass-through mechanisms.

7
8 Q. Did RUCO make an adjustment that took the recent APS rate increase
9 into consideration?

10 A. Yes, RUCO's Operating Adjustment #4 – Purchased Power, which is
11 described on Page 27 of my Direct Testimony, increased the cost of
12 pumping power that the Company purchased from APS (during the Test
13 Year) under the Rate 32 Tariff. RUCO's adjustment increased the cost of
14 these Test Year APS purchases by 3.5 percent.

15
16 Q. What was the Company's position on RUCO's adjustment to increase
17 purchased power expense that is attributed to APS?

18 A. Company witness Hubbard did not take issue with RUCO's adjustment,
19 but did point out that the Company also purchases power from APS under
20 the Rate 221 Tariff.

21
22
23

1 Q. Did RUCO's purchased power adjustment include the power purchased by
2 the Company under APS' Rate 221 tariff?

3 A. No. RUCO asked the Company for a breakdown of the total Test Year
4 purchased pumping power expense by electric service provider for each of
5 the five Western Group systems³. The Company referred RUCO to a
6 work paper that only provided information on power purchased under
7 APS' Rate 32 Tariff.

8
9 Q. Is RUCO willing to make an adjustment that takes purchases under APS'
10 Rate 221 Tariff into consideration?

11 A. RUCO is willing to make such an adjustment if Arizona Water will provide
12 RUCO with copies of the APS statements that billed the Company for
13 power that was purchased under the Rate 221 Tariff.

14
15 **COST OF CAPITAL**

16 Q. Has the Company accepted RUCO's recommended capital structure and
17 cost of debt?

18 A. Yes. There is no debate among the parties to the case on these two
19 points. Both ACC Staff witness Alejandro Ramirez and myself have
20 recommended that the Commission adopt the Company-proposed capital
21 structure, which is comprised of 73 percent common equity and 27

³ RUCO Data Request No. 6.2.

1 percent long-term debt, and the Company-proposed 8.43 percent
2 weighted cost of long-term debt.

3
4 Q. Please summarize the estimated costs of common equity being
5 recommended by each of the parties in this case at this stage of the
6 proceeding.

7 A. The estimated costs of common equity being recommended by each of
8 the parties at this stage of the proceeding are as follows:

| | | |
|----|-----------|---------------|
| 9 | | |
| 10 | Company | 11.25 percent |
| 11 | ACC Staff | 9.10 percent |
| 12 | RUCO | 9.44 percent |
| 13 | | |

14 As can be seen above, the parties' estimates range from ACC Staff's low
15 of 9.10 percent to the Company's high of 11.25 percent, a difference of
16 two-hundred and fifteen basis points.

17
18 Q. Has the Company revised its cost of common equity estimate in its
19 rebuttal testimony?

20 A. No.

21
22
23

1 Q. How does Staff witness Ramirez arrive at his recommended cost of
2 equity?

3 A. Mr. Ramirez averaged the results produced by his single and multi-stage
4 DCF models to arrive at an estimate of 9.3 percent and then averaged the
5 results of his CAPM analysis to arrive at an estimate of 9.2 percent. He
6 then averaged these two figures to arrive at an overall estimate of 9.3
7 percent. For his final recommendation, Mr. Ramirez chose a 9.1 percent
8 figure, which represents the low end of his estimates. In comparison, my
9 estimate of 9.44 percent is the unadjusted result that was derived solely
10 from my single stage DCF analysis.

11

12 Q. What would your cost of equity estimate be if you averaged the results
13 produced by your DCF and CAPM models as Mr. Ramirez has?

14 A. The average of the results produced by my CAPM model would equal
15 9.08 percent. An overall average of my DCF result of 9.44 percent and
16 my averaged CAPM result of 9.08 percent would result in the same 9.3
17 percent overall average that Mr. Ramirez calculated.

18

19 Q. Have you recalculated the cost of equity recommended in your direct
20 testimony using more recent data?

21 A. Yes. After filing my direct testimony, I performed a similar DCF and
22 CAPM analysis using updated Value Line Investment Survey ("Value
23 Line") figures that were published on April 29, 2005. The updated Value

1 Line figures produced a DCF result of 9.49 percent and an average CAPM
2 result of 9.11 percent. The overall average of these results equals the
3 same 9.3 percent return calculated in the examples above.

4
5 Q. Are you revising your original 9.44 percent estimate based on the updated
6 results that you just described?

7 A. No. As I explained on page 27 of my direct testimony, Arizona Water's
8 capital structure of 73 percent equity and 27 percent debt is not as
9 leveraged as the capital structures of the water utilities included in my
10 proxy. Even though an argument could be made to make a downward
11 adjustment to my DCF result of 9.44 percent (given the fact that Arizona
12 Water is less risky than the water utilities in my proxy when the
13 Company's equity heavy capital structure is taken into consideration), I
14 decided not to make such an adjustment. Since I elected not to make a
15 downward adjustment at that point in time, I have decided not to make an
16 upward adjustment now. My recommended cost of equity estimate for
17 Arizona Water remains at 9.44 percent.

18
19 Q. Please summarize the weighted costs of capital being recommended by
20 each of the parties in this case at this stage of the proceeding.

21 A. The weighted costs of capital (i.e. weighted cost of debt and weighted cost
22 of equity) being recommended by each of the parties at this stage of the
23 proceeding are as follows:

| | | |
|---|-----------|---------------|
| 1 | Company | 10.50 percent |
| 2 | ACC Staff | 8.90 percent |
| 3 | RUCO | 9.17 percent |

4

5 The weighted costs of capital being recommended by the parties range
6 from ACC Staff's low of 8.90 percent to the Company's high of 10.50
7 percent or a difference of one-hundred and sixty basis points.

8

9 Q. Have you reviewed the Company's rebuttal testimony on cost of capital
10 issues in this case?

11 A. Yes. Both Mr. Kennedy and Dr. Zepp, the Company's cost of capital
12 consultant, addressed cost of capital issues in their rebuttal testimony.

13

14 Q. Please summarize Mr. Kennedy's rebuttal testimony on the cost of capital
15 issues in the case.

16 A. Mr. Kennedy provides a comparison of the estimates being recommended
17 by the parties to the case and then argues that ACC Staff and RUCO's
18 cost of common equity estimates are too low. Mr. Kennedy cites a series
19 of reasons why Arizona Water's cost of common equity should be higher,
20 based on its unique, or company specific, risks. According to Mr.
21 Kennedy, these unique risks include Arizona's use of an historic test year,
22 the elimination of the PPPAM and PWAM, arsenic recovery costs and
23 tiered rate designs. After his discussion of unique risk, Mr. Kennedy

1 averages the actual and authorized returns (which results in range of 10.0
2 percent to 10.4 percent) of six of the sample water utilities that were
3 included in ACC Staff's proxy, and three of the water utilities used in my
4 proxy, for estimating Arizona Water's cost of common equity.

5
6 Q. Do any of Mr. Kennedy's arguments justify an upward adjustment to your
7 recommended cost of common equity?

8 A. No. All of the points raised by Mr. Kennedy were either addressed in my
9 direct testimony and/or were considered by me in arriving at my
10 recommended cost of common equity for Arizona Water. Out of the six
11 sample water utilities used in ACC Staff's proxy, and three of the sample
12 water utilities used in my proxy, whose actual and authorized returns were
13 averaged by Mr. Kennedy, all have capital structures that are heavier in
14 debt than Arizona Water's. Although Mr. Kennedy states that Arizona
15 Water's level of debt will increase to finance arsenic removal equipment,
16 the actual level of debt is not known and measurable at this time, and the
17 Company remains equity rich.

18
19 Q. Has the Company projected what its levels of debt and equity will be?

20 A. The Company's schedule D-1 projects a capital structure of 63 percent
21 equity and 37 percent debt at the end of the 2004 operating period.
22 However, the projected level of 37 percent debt is still below the average

1 of 49.5 percent for the six water utilities used in Mr. Kennedy's example.
2 Thus Arizona Water would still be perceived as having lower financial risk.
3

4 Q. Please describe Dr. Zepp's rebuttal testimony.

5 A. Dr. Zepp's rebuttal testimony takes issue with RUCO's recommended cost
6 of equity capital and the methods that were used to derive my
7 recommended 9.44 percent cost of common equity for Arizona Water. Dr.
8 Zepp states that Arizona Water should be entitled to a 50-basis point
9 adjustment noting the placement of the Company's Series K bonds as
10 support for this claim. He then lists a number of other reasons why Mr.
11 Ramirez' and my estimates of common equity costs are too low. Dr. Zepp
12 then restates the results of both Mr. Ramirez' and my estimates of
13 common equity by injecting his own assumptions and selected forecasted
14 interest rates into our respective models.
15

16 Q. Please address Dr. Zepp's justification for a risk premium based on
17 Arizona Water Company's inability to place bonds at reasonable rates.

18 A. This is a moot point since Arizona Water successfully placed its Series K,
19 8.04 percent general mortgage bonds, due in 2031, during April 2001.

20 While it may have taken Arizona Water longer to place this particular bond
21 issue than others in the past (do to changing market conditions for the size
22 of the issues being offered), the fact remains that the issue was indeed
23 placed by the Company. Given the fact that the placement of debt is not

1 even an issue in this case, and that there is no reason to believe that
2 Arizona Water won't be able to successfully place debt as it did four years
3 ago, no justification for a risk premium exists.

4
5 Q. Do you agree with Dr. Zepp's restatement of the results of your DCF
6 analysis?

7 A. No, I do not. Dr. Zepp has restated the growth component ("g") in my
8 DCF analysis, which is the sum of a utility's internal, or sustainable growth
9 rate ("br"), and the external growth rate estimate ("sv"). As I stated in my
10 direct testimony, my estimate of g is higher than the projections presented
11 by Zacks Investment Research, Inc.⁴ and are more optimistic than the
12 projections of independent analysts at Value Line Investment Survey.
13 This comparison was presented in Schedule WAR-6 of my direct
14 testimony. The numbers of independent analysts exhibited in schedule
15 WAR-6 speak for themselves and are a far better check on my estimate of
16 g than the restatement that Dr. Zepp presents in his rebuttal testimony.

17
18 Q. Do you agree with Dr. Zepp's criticisms of your DCF methodology?

19 A. No. In particular I strongly disagree with Dr. Zepp's views on the method
20 that I used in the calculation of "v" for the external growth rate estimate
21 portion of the DCF's growth component. This calculation takes into

⁴ Zacks Investment Research was formed in 1978 to compile, analyze, and distribute investment research to both institutional and individual investors. Zack's presently compiles investment data that is obtained through its relationships with over 250 different brokerage firms.

1 consideration the fact that, while in theory a utility's stock price should
2 move toward a market to book ratio of 1.0 if regulators authorize a rate of
3 return that is equal to a utility's cost of capital, in reality a utility will
4 continue to issue shares of stock that are priced above book value.

5
6 Q. Can you provide any evidence that water utility stock prices are actually
7 moving to a market to book ratio of 1.0?

8 A. A recent analysis that I performed indicated that they are. Attachment E
9 to my testimony contains line graphs for each of the three water utilities
10 that I included in my proxy. The graphs show that at the present time, the
11 stock prices of all three of the utilities included in my sample appear to be
12 moving in the direction of a market to book ratio of 1.0.

13
14 Q. Please comment on Dr. Zepp's restatement of the results of your CAPM
15 analysis.

16 A. In restating the results of my CAPM analysis, Dr. Zepp has chosen a
17 higher forecasted long-term rate of 5.8 percent as opposed to the average
18 return of 2.70 percent on a 91-day Treasury Bill which I used. The
19 forecasted rate that Dr. Zepp has used is a full one hundred and twenty-
20 eight basis points higher than the most recent 4.52 percent 30-year
21 Treasury yield published in the May 20, 2005 edition of Value Line's
22 Selection and Opinion publication. If the actual 4.52 percent rate were
23 substituted into my CAPM models it would produce an expected return

1 that ranges from 8.8 percent, based on a geometric mean, to 10.3
2 percent, based on an arithmetic mean. An average of this range produces
3 an expected return of 9.6 percent, which is only slightly higher than my
4 recommended 9.44 percent return on common equity.

5
6 Q. What is your response to Dr. Zepp's position that the yields on longer-term
7 instruments should be used in the CAPM model as opposed to the
8 average return on a 91-day Treasury Bill that you used?

9 A. Even though an ongoing debate in the academic community exists over
10 what type of instrument best fits the definition of a risk free asset, I believe
11 that the consistent use of a normalized 91-day Treasury Bill ("T-Bill") rate
12 is the most theoretically correct parameter for use in the CAPM model.

13
14 Q. In his rebuttal testimony, Dr. Zepp explains why he believes that the use of
15 longer-term instruments should be used in the CAPM model. Can you
16 explain why you believe the use of a 91-day T-Bill is more appropriate
17 than longer-term instruments?

18 A. The logic in the use of a 91-day T-Bill has been presented in prior
19 proceedings before the Commission by Mr. Stephen Hill, a cost of capital
20 consultant who has testified for RUCO, whom I cited in the DCF section of
21 my direct testimony. I believe, as does Mr. Hill, that the use of the 91-day
22 T-bill is justified for two reasons. First, investors face no maturity risk with
23 the purchase of the 91-day T-Bill. As stated in my direct testimony,

1 longer-term U.S. Treasury instruments, such as the forecasted long-term
2 yield used by Dr. Zepp in his restatement, have higher yields due to
3 maturity risk. These higher yields compensate investors for forgone future
4 investment opportunities and for future unexpected changes in the rate of
5 inflation. Individuals who invest in 91-day T-bills do not face these risks. I
6 believe that a good argument can be made that when maturity risk is
7 taken into consideration, the yields on 91-day T-Bills emerge as a better
8 proxy for the risk free rate of return that is an integral component of the
9 CAPM.

10 Second, I believe, as does Mr. Hill, that the use of longer-term treasury
11 instruments conflicts with the CAPM model's exclusive reliance on
12 systematic risk. Systematic risk (also referred to as market risk) is defined
13 as that part of a security's risk that is common to all securities of the same
14 general class. It is risk that cannot be eliminated by diversification (the
15 beta coefficient used in the CAPM is the measurement of systematic risk).
16 CAPM theory asserts that the degree of systematic risk that is inherent in
17 any stock, or investment portfolio, is captured by, and reflected in, the beta
18 coefficient. A contributor to overall systematic risk is the risk of
19 unexpected changes in the long-term inflation rate. Since the risk
20 associated with unexpected changes in the long-term inflation rate is
21 already included in the beta coefficient, the use of longer-term U.S.
22 Treasury instruments as a risk free asset accounts for this risk twice –
23 once with the beta and once with the long-term U.S. Treasury instrument

1 yield. In short, I believe that the use of longer-term U.S. Treasury
2 instruments in the CAPM model incorrectly double counts the long-term
3 inflation return requirements of investors and produces overstated results.

4

5 Q. Have any of the rebuttal testimony arguments advanced by Dr. Zepp
6 persuaded you to make any changes in your recommended 9.44 percent
7 cost of common equity for Arizona Water?

8 A. No.

9

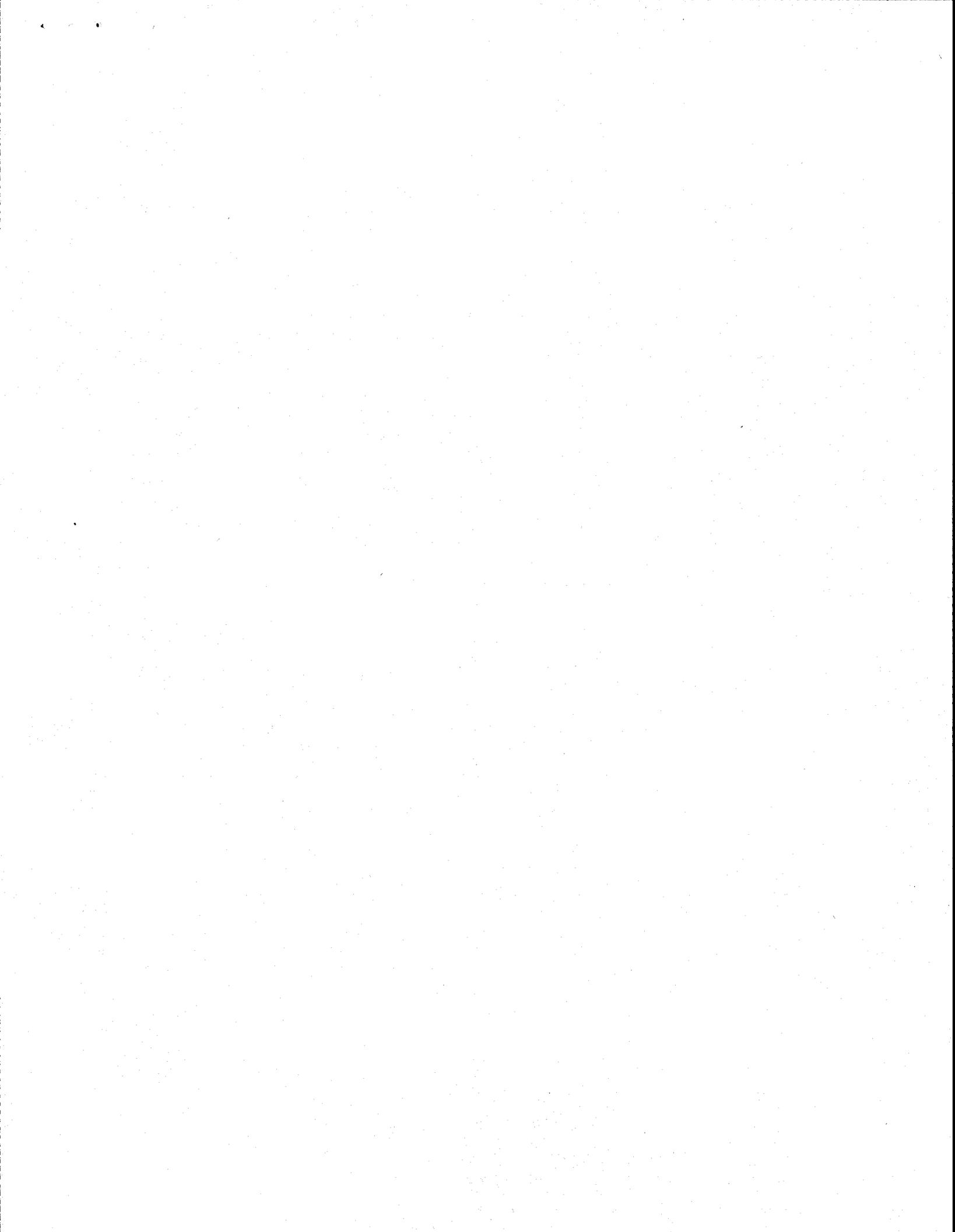
10 Q. Does your silence on any of the issues or positions addressed in the
11 rebuttal testimony of the Company's witnesses constitute acceptance?

12 A. No, it does not.

13

14 Q. Does this conclude your surrebuttal testimony on Arizona Water?

15 A. Yes, it does.



ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
TABLE OF CONTENTS TO SURREBUTTAL SCHEDULES WAR

SCHEDULE #

| | |
|----------------------------|---|
| SURREBUTTAL SCHEDULE WAR-1 | DIRECT TESTIMONY POSITIONS |
| SURREBUTTAL SCHEDULE WAR-2 | REVENUE SUMMARY COMPARISON OF CAP COSTS |

| LINE NO. | DESCRIPTION | AJO | | | CASA GRANDE | | | COOLIDGE | | |
|----------|---|-----------------------------|-----------------------------|----------------------------|-----------------------------|-----------------------------|----------------------------|-----------------------------|-----------------------------|----------------------------|
| | | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED |
| 1 | PLANT IN SERVICE | \$ 1,656,478 | \$ 1,656,478 | \$ 1,656,478 | \$ 48,030,396 | \$ 47,206,022 | \$ 47,206,022 | \$ 6,083,129 | \$ 6,083,129 | \$ 6,083,129 |
| 2 | PHOENIX OFFICE & METER SHOP ALLOCATION | 43,498 | 43,498 | 48,571 | 947,818 | 947,818 | 1,058,334 | 201,010 | 201,010 | 224,449 |
| 3 | DEFERRED CAP CHARGES | - | - | - | 3,525,803 | - | - | 1,046,011 | - | - |
| 4 | ACCUMULATED DEPRECIATION | (624,244) | (624,244) | (630,349) | (12,072,217) | (12,072,217) | (12,241,403) | (2,271,697) | (2,271,697) | (2,163,930) |
| 5 | NET PLANT IN SERVICE | \$ 1,075,732 | \$ 1,075,732 | \$ 1,074,700 | \$ 40,431,800 | \$ 36,081,623 | \$ 36,022,953 | \$ 5,068,453 | \$ 4,012,442 | \$ 4,143,648 |
| 6 | CONSTRUCTION WORK IN PROGRESS (CWIP) | - | - | - | - | - | - | - | - | - |
| 7 | TOTAL NET PLANT | \$ 1,075,732 | \$ 1,075,732 | \$ 1,074,700 | \$ 40,431,800 | \$ 36,081,623 | \$ 36,022,953 | \$ 5,068,453 | \$ 4,012,442 | \$ 4,143,648 |
| 8 | ADVANCES IN AID OF CONSTRUCTION (AIAC) | (36,395) | (36,395) | (36,395) | (8,891,444) | (8,891,444) | (8,891,444) | (406,644) | (406,644) | (406,644) |
| 9 | CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC) | (41,263) | (41,263) | (41,263) | (7,754,812) | (7,754,812) | (7,754,812) | (437,102) | (437,102) | (437,102) |
| 10 | ACCUMULATED AMORTIZATION OF CIAC | 10,797 | 10,797 | 10,797 | 1,348,820 | 1,348,820 | 1,348,820 | 74,970 | 74,970 | 74,970 |
| 11 | DEFERRED INCOME TAXES | (157,495) | (157,495) | (157,495) | (3,387,966) | (3,387,966) | (3,387,966) | (504,369) | (504,369) | (504,369) |
| 12 | WORKING CAPITAL | (4,209) | (4,209) | (3,633) | 250,254 | (43,550) | 43,262 | 32,202 | (26,267) | (1,851) |
| 13 | TOTAL RATE BASE | \$ 847,167 | \$ 837,088 | \$ 846,711 | \$ 21,996,652 | \$ 17,352,671 | \$ 17,380,813 | \$ 3,817,510 | \$ 2,713,030 | \$ 2,868,652 |
| 14 | | | | | | | | | | |
| 15 | | | | | | | | | | |
| 16 | | | | | | | | | | |
| 17 | | | | | | | | | | |
| 18 | PLANT IN SERVICE | \$ 602,560 | \$ 602,560 | \$ 602,560 | \$ 5,580,520 | \$ 5,580,520 | \$ 5,580,520 | \$ 61,953,083 | \$ 61,128,709 | \$ 61,128,709 |
| 19 | PHOENIX OFFICE & METER SHOP ALLOCATION | 14,195 | 14,195 | 15,849 | 90,661 | 90,661 | 101,232 | 1,297,182 | 1,297,182 | 1,446,435 |
| 20 | DEFERRED CAP CHARGES | - | - | - | 506,268 | - | - | 5,078,082 | - | - |
| 21 | ACCUMULATED DEPRECIATION | (195,716) | (195,716) | (187,747) | (1,088,906) | (1,088,906) | (1,083,994) | (16,252,780) | (16,252,780) | (16,307,423) |
| 22 | NET PLANT IN SERVICE | \$ 421,038 | \$ 421,039 | \$ 430,661 | \$ 5,086,543 | \$ 4,582,275 | \$ 4,597,756 | \$ 52,075,566 | \$ 46,173,111 | \$ 46,269,720 |
| 23 | CONSTRUCTION WORK IN PROGRESS (CWIP) | - | - | - | - | - | - | - | - | - |
| 24 | TOTAL NET PLANT | \$ 421,038 | \$ 421,039 | \$ 430,661 | \$ 5,088,543 | \$ 4,582,275 | \$ 4,597,756 | \$ 52,075,566 | \$ 46,173,111 | \$ 46,269,720 |
| 25 | ADVANCES IN AID OF CONSTRUCTION (AIAC) | - | - | - | (1,887,860) | (1,887,860) | (1,887,860) | (11,222,363) | (11,222,363) | (11,222,363) |
| 26 | CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC) | (49,164) | (49,164) | (49,164) | (554,839) | (554,839) | (554,839) | (8,837,180) | (8,837,180) | (8,837,180) |
| 27 | ACCUMULATED AMORTIZATION OF CIAC | 7,813 | 7,813 | 7,813 | 111,896 | 111,896 | 111,896 | 1,554,296 | 1,554,296 | 1,554,296 |
| 28 | DEFERRED INCOME TAXES | (62,528) | (62,528) | (62,528) | (352,670) | (352,670) | (352,670) | (4,465,028) | (4,465,028) | (4,465,028) |
| 29 | WORKING CAPITAL | (3,029) | (6,891) | (357) | 36,105 | (649) | 5,135 | 311,323 | (91,645) | 42,556 |
| 30 | TOTAL RATE BASE | \$ 314,131 | \$ 310,269 | \$ 328,426 | \$ 2,441,155 | \$ 1,898,133 | \$ 1,919,400 | \$ 29,416,615 | \$ 23,111,191 | \$ 23,342,002 |

WESTERN GROUP

WHITE TANK

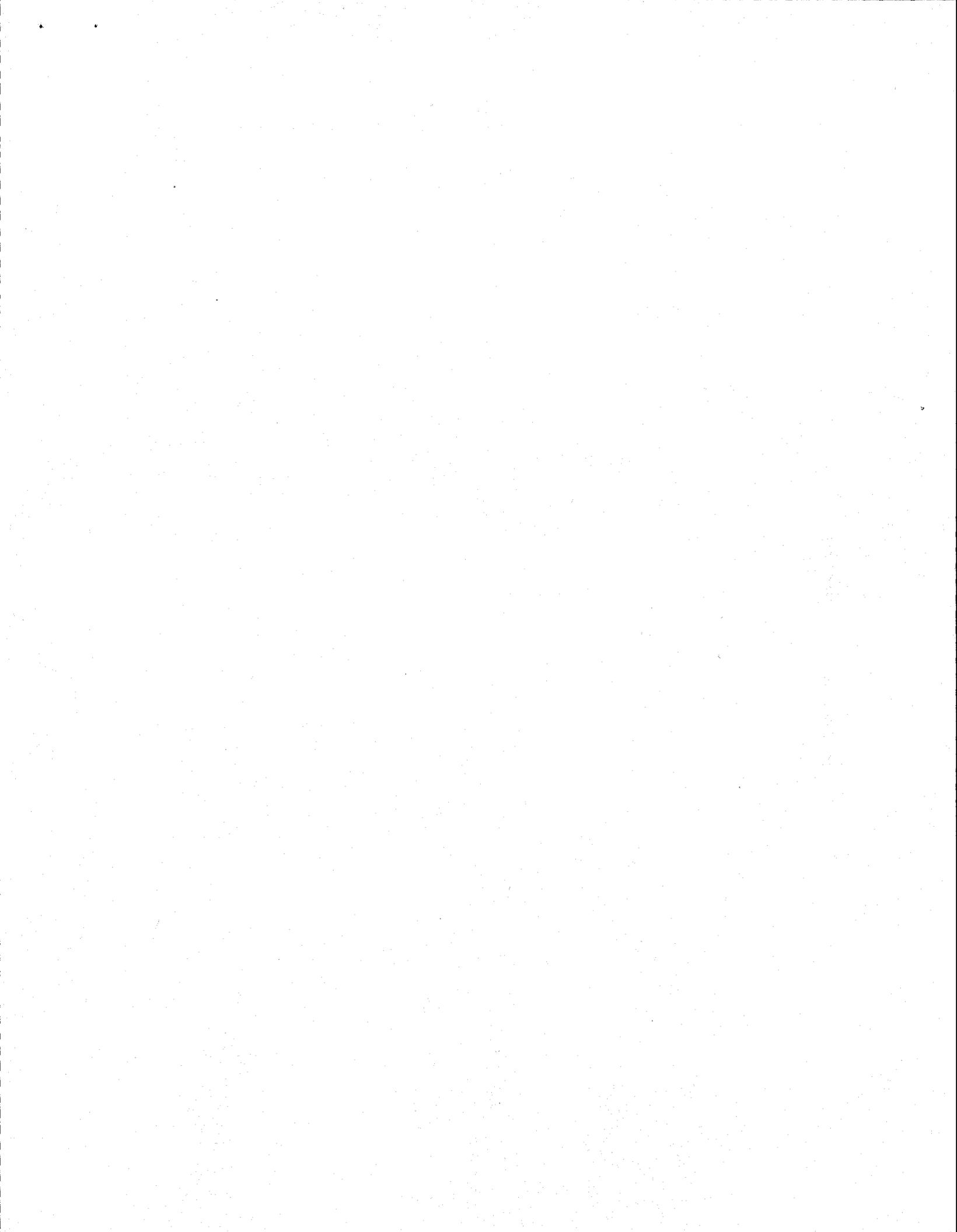
STANFIELD

| LINE NO. | DESCRIPTION | AJO | | | CASA GRANDE | | | COOLIDGE | | |
|----------------------------|-----------------------------|-----------------------------|-----------------------------|----------------------------|-----------------------------|-----------------------------|----------------------------|-----------------------------|-----------------------------|----------------------------|
| | | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED |
| REVENUES - WATER: | | | | | | | | | | |
| 1 | REVENUE FROM WATER SALES | \$ 409,259 | \$ 475,585 | \$ 456,361 | \$ 7,298,464 | \$ 8,354,358 | \$ 7,381,685 | \$ 1,363,049 | \$ 1,551,176 | \$ 1,408,653 |
| 2 | OTHER REVENUES | 2,944 | - | 2,944 | 622,917 | - | 622,917 | 64,236 | - | 64,236 |
| 3 | TOTAL OPERATING REVENUES | \$ 412,203 | \$ 475,585 | \$ 459,305 | \$ 7,921,381 | \$ 8,354,358 | \$ 8,004,602 | \$ 1,427,285 | \$ 1,551,176 | \$ 1,472,889 |
| OPERATING EXPENSES: | | | | | | | | | | |
| 4 | PURCHASED WATER | \$ 162,114 | \$ 162,114 | \$ 162,114 | \$ 498,013 | \$ 338,564 | \$ 338,564 | \$ 56,000 | \$ - | \$ - |
| 5 | OTHER | 316 | 316 | 91 | 45,935 | 45,935 | 58,284 | 7,914 | 7,914 | 7,371 |
| 6 | PURCHASED POWER | 2,976 | 2,976 | 2,982 | 810,343 | 811,810 | 822,257 | 97,408 | 97,691 | 98,496 |
| 7 | PURCHASED GAS | - | - | - | - | - | - | 603 | 603 | 603 |
| 8 | OTHER | 14,594 | 14,594 | 12,586 | 286,696 | 286,696 | 278,354 | 37,838 | 37,838 | 37,807 |
| 9 | WATER TREATMENT | 3,443 | 3,443 | 3,391 | 187,995 | 187,995 | 190,237 | 13,267 | 13,267 | 13,176 |
| 10 | TRANSMISSION & DISTRIBUTION | 38,687 | 38,687 | 38,893 | 786,616 | 786,616 | 755,729 | 196,681 | 196,681 | 195,760 |
| 11 | CUSTOMER ACCOUNTS | 27,613 | 27,761 | 27,288 | 604,959 | 605,973 | 602,122 | 191,070 | 191,360 | 180,344 |
| 12 | SALES | 142 | 142 | 142 | 2,982 | 2,982 | 2,962 | 259 | 259 | 259 |
| 13 | ADMINISTRATIVE & GENERAL | 45,617 | 45,152 | 45,617 | 952,718 | 932,223 | 952,718 | 235,586 | 233,619 | 235,586 |
| 14 | DEPRECIATION & AMORTIZATION | 39,981 | 39,981 | 39,981 | 1,368,007 | 1,368,007 | 1,015,427 | 275,122 | 275,122 | 170,521 |
| 15 | PROPERTY TAXES | 27,099 | 26,901 | 26,452 | 612,639 | 635,569 | 560,835 | 127,110 | 116,516 | 113,345 |
| 16 | OTHER TAXES | 3,759 | 3,759 | 3,759 | 76,751 | 76,751 | 76,751 | 24,577 | 24,577 | 24,577 |
| 17 | FEDERAL INCOME TAXES | 9,756 | 35,257 | 12,999 | 439,020 | 730,869 | 619,973 | 55,589 | 114,269 | 99,647 |
| 18 | STATE INCOME TAXES | 1,409 | - | 5,366 | 68,546 | - | 136,570 | 7,524 | - | 22,341 |
| 19 | TOTAL OPERATING EXPENSES | \$ 377,507 | \$ 401,084 | \$ 381,662 | \$ 6,741,199 | \$ 6,809,970 | \$ 6,410,781 | \$ 1,326,548 | \$ 1,309,716 | \$ 1,209,834 |
| 20 | NET INCOME | \$ 34,696 | \$ 74,501 | \$ 77,643 | \$ 1,180,182 | \$ 1,544,388 | \$ 1,593,821 | \$ 100,737 | \$ 241,460 | \$ 263,055 |
| STANFIELD | | | | | | | | | | |
| 23 | | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED | (A) COMPANY REQUESTED | (B) STAFF RECOMMENDED | (C) RUCO RECOMMENDED |
| 24 | | | | | | | | | | |
| REVENUES - WATER: | | | | | | | | | | |
| 26 | REVENUE FROM WATER SALES | \$ 115,201 | \$ 137,111 | \$ 117,007 | \$ 761,530 | \$ 837,590 | \$ 749,814 | \$ 9,947,503 | \$ 11,355,820 | \$ 10,113,521 |
| 27 | OTHER REVENUES | 15,802 | - | 15,802 | 21,953 | - | 21,953 | 727,852 | - | 727,852 |
| 28 | TOTAL OPERATING REVENUES | \$ 131,003 | \$ 137,111 | \$ 132,809 | \$ 783,483 | \$ 837,590 | \$ 771,767 | \$ 10,675,355 | \$ 11,355,820 | \$ 10,841,373 |
| OPERATING EXPENSES: | | | | | | | | | | |
| 29 | PURCHASED WATER | \$ - | \$ - | \$ - | \$ 37,383 | \$ 10,279 | \$ 10,279 | \$ 753,510 | \$ 510,957 | \$ 510,957 |
| 30 | OTHER | 396 | 396 | 651 | 2,880 | 2,880 | 2,470 | 57,441 | 57,441 | 68,865 |
| 31 | PURCHASED POWER | 17,409 | 17,409 | 18,018 | 78,404 | 78,860 | 81,148 | 1,006,540 | 1,008,746 | 1,022,901 |
| 32 | PURCHASED GAS | - | - | - | - | - | - | 603 | 603 | 603 |
| 33 | OTHER | 4,120 | 4,120 | 4,118 | 27,057 | 27,057 | 26,486 | 370,305 | 370,305 | 359,351 |
| 34 | WATER TREATMENT | 430 | 430 | 453 | 9,655 | 9,655 | 9,609 | 214,790 | 214,790 | 216,867 |
| 35 | TRANSMISSION & DISTRIBUTION | 12,240 | 12,240 | 12,183 | 79,261 | 79,261 | 75,967 | 1,113,485 | 1,113,485 | 1,078,532 |
| 36 | CUSTOMER ACCOUNTS | 8,604 | 8,618 | 8,687 | 54,850 | 54,977 | 54,668 | 887,096 | 888,689 | 883,109 |
| 37 | SALES | 44 | 44 | 44 | 263 | 263 | 263 | 3,670 | 3,670 | 3,670 |
| 38 | ADMINISTRATIVE & GENERAL | 14,451 | 14,301 | 14,451 | 87,371 | 86,411 | 87,371 | 1,335,743 | 1,311,706 | 1,335,743 |
| 39 | DEPRECIATION & AMORTIZATION | 24,713 | 24,713 | 24,713 | 182,626 | 182,626 | 131,999 | 1,890,449 | 1,890,449 | 1,382,640 |
| 40 | PROPERTY TAXES | 13,290 | 13,003 | 12,424 | 41,993 | 49,833 | 37,146 | 822,131 | 841,822 | 750,202 |
| 41 | OTHER TAXES | 1,154 | 1,154 | 1,154 | 6,608 | 6,608 | 6,608 | 112,849 | 112,849 | 112,849 |
| 42 | FEDERAL INCOME TAXES | 7,221 | 13,068 | 3,990 | 46,569 | 79,947 | 57,485 | 558,155 | 973,410 | 794,095 |
| 43 | STATE INCOME TAXES | 1,053 | - | 1,992 | 7,123 | - | 14,259 | 85,655 | - | 180,527 |
| 44 | TOTAL OPERATING EXPENSES | \$ 105,125 | \$ 109,497 | \$ 102,876 | \$ 662,043 | \$ 668,656 | \$ 595,758 | \$ 9,212,422 | \$ 9,298,922 | \$ 8,700,912 |
| 45 | NET INCOME | \$ 25,878 | \$ 27,614 | \$ 29,933 | \$ 121,440 | \$ 168,934 | \$ 176,009 | \$ 1,462,933 | \$ 2,056,897 | \$ 2,140,462 |
| WESTERN GROUP | | | | | | | | | | |

ARIZONA WATER COMPANY
 TEST YEAR ENDED DECEMBER 31, 2003
 WESTERN GROUP
 REVENUE SUMMARY COMPARISON OF CAP COSTS

DOCKET NO. W-01445A-04-0650
 SURREBITTAL SCHEDULE WAR-2

| LINE NO. | DESCRIPTION | CASA GRANDE | | | | COOLIDGE | | | | WHITE TANK | | | |
|----------|---------------------------------------|----------------------------|-------------------------------|---------------------------|--------------------------|----------------------------|-------------------------------|---------------------------|--------------------------|----------------------------|-------------------------------|---------------------------|--------------------------|
| | | (A) RUCO RECOMMENDED | (B) INCLUDING CAP COSTS | (C) DIFFERENCE (\$) | (D) DIFFERENCE (%) | (A) RUCO RECOMMENDED | (B) INCLUDING CAP COSTS | (C) DIFFERENCE (\$) | (D) DIFFERENCE (%) | (A) RUCO RECOMMENDED | (B) INCLUDING CAP COSTS | (C) DIFFERENCE (\$) | (D) DIFFERENCE (%) |
| 1 | ADJUSTED RATE BASE | \$ 17,380,813 | \$ 20,889,061 | \$ 3,510,248 | 20.24% | \$ 2,868,632 | \$ 3,909,906 | \$ 1,041,253 | 36.30% | \$ 1,919,400 | \$ 2,418,960 | \$ 499,560 | 26.03% |
| 2 | ADJUSTED OPERATING INCOME | 1,584,337 | 1,300,449 | (283,888) | -17.92% | 231,813 | 140,683 | (91,130) | -39.31% | 181,559 | 132,674 | (48,885) | -26.93% |
| 3 | CURRENT RATE OF RETURN (L2 / L1) | 9.12% | 6.22% | -2.89% | -31.74% | 8.08% | 3.60% | -4.48% | -55.47% | 9.46% | 5.48% | -3.97% | -42.02% |
| 4 | REQUIRED RATE OF RETURN | 9.17% | 9.17% | 0.00% | 0.00% | 9.17% | 9.17% | 0.00% | 0.00% | 9.17% | 9.17% | 0.00% | 0.00% |
| 5 | REQUIRED OPERATING INCOME (L4 * L1) | 1,593,821 | 1,816,444 | 322,623 | 20.24% | 263,055 | 358,538 | 95,483 | 36.30% | 176,009 | 221,819 | 45,810 | 26.03% |
| 6 | OPERATING INCOME DEFICIENCY (L5 - L2) | 9,483 | 615,995 | 606,511 | 6395.70% | 31,243 | 217,856 | 186,613 | 597.31% | (6,550) | 88,144 | 94,695 | -1706.12% |
| 7 | GROSS REVENUE CONVERSION FACTOR | 1.63249 | 1.63249 | 0.00% | 0.00% | 1.61740 | 1.63249 | 1.63249 | 0.93% | 1.54366 | 1.58888 | 1.63249 | 2.99% |
| 8 | GROSS REVENUE INCREASE | \$ 15,481 | \$ 1,005,606 | \$ 990,125 | 6395.70% | \$ 50,532 | \$ 355,647 | \$ 305,116 | 603.81% | \$ (6,566) | \$ 141,729 | \$ 150,296 | -1754.27% |
| 9 | CURRENT REVENUES TTY ADJUSTED | 7,366,204 | 7,366,204 | - | 0.00% | 1,358,121 | 1,358,121 | - | 0.00% | 758,382 | 758,382 | - | 0.00% |
| 10 | PROPOSED ANNUAL REVENUE (L8 + L9) | 7,381,685 | 8,371,810 | 990,125 | 13.41% | 1,408,653 | 1,713,769 | 305,116 | 21.66% | 749,814 | 900,111 | 150,296 | 20.04% |
| 11 | PERCENTAGE AVERAGE INCREASE | 0.21% | 13.65% | 13.44% | 6395.70% | 3.72% | 26.19% | 22.47% | 603.81% | -1.13% | 18.69% | 19.82% | -1754.21% |



ATTACHMENT A

| Viewpoint RV & Golf Res | 5 | 8 | 18 | 23 | 56 | 52 | 70 | 48 | 35 | 61 | 37 | 13 | 426 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-------|--------|---------|
| Sub Total | 11,362 | 17,468 | 43,627 | 44,780 | 65,485 | 67,731 | 47,481 | 64,025 | 48,349 | 34,937 | 9,824 | 22,416 | 477,485 |

| TEMP. PERMITS | | | | | | | | | | | | | |
|---------------------------|---------------|---------------|---------------|---------------|---------------|----------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|
| \$200, \$100, \$75 | | | | | | | | | | | | | |
| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | TOTAL |
| Temp. Water Permits (3) | 13 | 12 | 19 | 26 | 39 | 40 | 29 | 22 | 38 | 43 | 38 | 33 | 352 |
| Sub Total | 13 | 12 | 19 | 26 | 39 | 40 | 29 | 22 | 38 | 43 | 38 | 33 | 352 |
| TOTAL (M&I) | 23,679 | 31,872 | 57,817 | 66,159 | 91,079 | 100,077 | 67,900 | 92,624 | 75,325 | 60,510 | 23,610 | 36,218 | 726,870 |

- (1) Customers taking all, or part of their water through the SRP interconnect.
- (2) Tucson subcontract and incentive water used by ASARCO, BKW, CAVSARP, Mile-wide GSF, LSC irrigation, plant, & PMR under exchange & recharge agreements.
- (3) Scheduled amount is estimate only, since permit use varies.
- (4) GRIC Pool 3 price is \$34/AF (does not include \$2/AF of Ag capital charge). Also includes San Carlos Lake water.
- (5) Settlement water used on the reservation.
- (6) Settlement water used for lease agreements off the reservation.
- (7) Also includes San Carlos Lake exchange water (if any).
- (8) None of the 4 cities taking Hohokam/Cliff Dam Replacement water exceeded their entitlement in CY01.
- (9) Taking all of RWCD & STID Pool 1 allotments for the year. Also taking 5,000 AF of QCID Pool 1.
- (10) NMIDD & Tonopah will take 1,386 AF & 1,177 AF respectively, of STID Pool 2 water.
- (11) Formerly Sunbelt Ornamental.
- (12) The cities of Glendale & Tempe exceeded their total entitlement in CY01 and had a portion of their December deliveries roll into the excess M&I rate.

ATTACHMENT B

MONTHLY M&I DELIVERIES
CALENDAR YEAR 2003
 (By Classification)
 Table #1

(Deliveries are actuals through December. Monthly projections for the remainder of the year are not shown.)

| SUBCONTRACT | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | TOTAL | SCHEDULE | ENTITLE- MENT (13) |
|---------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|-----------------|-------------------------------|
| Apache Junction Water Co | 36 | 37 | 36 | 32 | 36 | 42 | 44 | 35 | 31 | 38 | 36 | 44 | 447 | 480 | 2919 |
| Arizona-American/PV | 0 | 260 | 113 | 506 | 290 | 290 | 290 | 290 | 290 | 283 | 287 | 0 | 2899 | 2900 | 3231 |
| Arizona-American/SC | 0 | 0 | 1028 | 2155 | 1833 | 1833 | 2333 | 2333 | 446 | 0 | 0 | 0 | 11961 | 11961 | 17654 |
| AZ State Land/ADOT | 4 | 2 | 4 | 2 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 286 | 298 | 300 | 32076 |
| AWC/Apache Junction | 288 | 225 | 286 | 412 | 501 | 554 | 533 | 498 | 369 | 570 | 420 | 402 | 5058 | 4965 | 6000 |
| AWC/Casa Grande | 180 | 12 | 295 | 280 | 134 | 201 | 205 | 341 | 164 | 193 | 164 | 110 | 2279 | 2256 | 8884 |
| Avondale, City of | 1200 | 750 | 398 | 1574 | 824 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 4746 | 4746 | 4746 |
| Carefree Water Co. | 41 | 25 | 41 | 45 | 43 | 53 | 60 | 51 | 62 | 53 | 44 | 40 | 558 | 560 | 1300 |
| Cave Creek Water Co. | 93 | 83 | 90 | 108 | 140 | 141 | 150 | 133 | 49 | 100 | 96 | 105 | 1288 | 1350 | 1600 |
| Chandler, City of (3) (4) | 210 | 1011 | 1035 | 1874 | 433 | 0 | 0 | 0 | 0 | 985 | 1336 | 1347 | 8231 | 8231 | 8231 |
| Chaparral City Water | 440 | 381 | 435 | 526 | 612 | 655 | 640 | 569 | 506 | 596 | 534 | 489 | 6383 | 5875 | 6978 |
| Eloy, City of | 20 | 9 | 22 | 54 | 69 | 1604 | 63 | 66 | 67 | 107 | 36 | 33 | 2150 | 2136 | 2171 |
| Florence, Town of | 0 | 0 | 0 | 0 | 0 | 2048 | 0 | 0 | 0 | 0 | 0 | 0 | 2048 | 2048 | 2048 |
| Gilbert, Town of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 7235 |
| Glendale, City of (4) | 0 | 0 | 470 | 2076 | 2388 | 2374 | 2444 | 2159 | 2181 | 91 | 0 | 0 | 14183 | 14183 | 14183 |
| Green Valley Water Co | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1900 |
| Maricopa County P&R | 14 | 13 | 27 | 55 | 63 | 125 | 102 | 73 | 61 | 43 | 29 | 19 | 624 | 620 | 665 |
| Mesa, City of | 1681 | 1743 | 2244 | 3129 | 2727 | 1550 | 1062 | 3171 | 3170 | 3472 | 3002 | 3108 | 30059 | 27734 | 49462 |
| Metro Water District | 0 | 0 | 827 | 2320 | 748 | 920 | 2113 | 1217 | 0 | 0 | 0 | 0 | 8145 | 8145 | 8858 |
| Peoria, City of | 1973 | 1899 | 1935 | 525 | 629 | 747 | 805 | 762 | 713 | 719 | 646 | 1054 | 12407 | 12421 | 19709 |
| Phoenix, City of (3) | 4930 | 6504 | 7881 | 7716 | 7134 | 10466 | 11248 | 8628 | 26566 | 18195 | 14554 | 14515 | 138337 | 139770 | 169793 |
| Queen Creek Water Co (4) | 31 | 28 | 17 | 61 | 90 | 121 | 0 | 0 | 0 | 0 | 0 | 0 | 348 | 348 | 348 |
| Rio Verde Utilities | 0 | 36 | 20 | 19 | 25 | 31 | 28 | 26 | 25 | 36 | 7 | 22 | 275 | 276 | 812 |
| Scottsdale, City of | 2878 | 2296 | 3026 | 3638 | 4983 | 5307 | 5467 | 2846 | 4647 | 5024 | 4210 | 3973 | 48295 | 51412 | 58545 |
| Tempe, City of (4) | 611 | 710 | 800 | 900 | 950 | 344 | 0 | 0 | 0 | 0 | 0 | 0 | 4315 | 4312 | 4315 |
| Tonto Hills Utility Co. | 0 | 0 | 0 | 0 | 0 | 2 | 2 | 1 | 1 | 1 | 1 | 1 | 9 | 12 | 71 |
| Tucson, City of (1) | 1474 | 1103 | 1823 | 1771 | 3666 | 5791 | 5426 | 6177 | 6629 | 6299 | 2404 | 34 | 42597 | 42167 | 138920 |
| Sub Total | 16104 | 17127 | 22853 | 29778 | 28318 | 35199 | 33015 | 29376 | 45977 | 36805 | 27806 | 25582 | 347940 | 349208 | 572654 |

MONTHLY M&I DELIVERIES
CALENDAR YEAR 2004
 (By Classification)
 Table #1

(Deliveries are actuals through December. Monthly projections for the remainder of the year are not shown.)

| SUBCONTRACT | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | TOTAL | SCHEDULE | ENTITL MNT |
|--------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|---------------|
| \$74/AF | | | | | | | | | | | | | | | |
| Apache Junction WC | 43 | 40 | 39 | 31 | 33 | 39 | 44 | 52 | 32 | 35 | 34 | 40 | 462 | 480 | 2919 |
| Arizona-American/PV | 0 | 323 | 323 | 323 | 323 | 323 | 323 | 323 | 323 | 323 | 323 | 1 | 3231 | 3231 | 3231 |
| Arizona-American/WV | 0 | 0 | 1500 | 1833 | 1833 | 1833 | 1833 | 1833 | 1833 | 563 | 0 | 0 | 13061 | 13061 | 17654 |
| AZ State Land/ADOT | 34 | 67 | 50 | 37 | 51 | 58 | 70 | 81 | 27 | 12 | 12 | 195 | 694 | 694 | 32076 |
| AWC/Apache Junction | 214 | 231 | 278 | 382 | 521 | 572 | 423 | 480 | 372 | 515 | 245 | 198 | 4431 | 4645 | 6000 |
| AWC/Casa Grande | 135 | 135 | 205 | 176 | 178 | 223 | 310 | 267 | 204 | 213 | 156 | 69 | 2271 | 2356 | 8884 |
| Avondale, City of | 0 | 1128 | 600 | 100 | 120 | 1000 | 1018 | 780 | 0 | 0 | 0 | 0 | 4746 | 4746 | 4746 |
| CAGRD | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Carefree Water Co. | 45 | 38 | 51 | 45 | 63 | 64 | 48 | 60 | 51 | 48 | 44 | 42 | 599 | 610 | 1300 |
| Cave Creek Water Co. | 101 | 92 | 100 | 117 | 151 | 152 | 160 | 153 | 120 | 129 | 104 | 95 | 1474 | 1400 | 1600 |
| Chandler, City of | 0 | 1169 | 1632 | 1296 | 74 | 0 | 0 | 0 | 456 | 1145 | 972 | 1095 | 7839 | 7839 | 7839 |
| Chaparral City Water | 397 | 426 | 485 | 537 | 650 | 650 | 711 | 618 | 479 | 566 | 489 | 452 | 6460 | 6370 | 6978 |
| Eloy, City of | 25 | 14 | 47 | 58 | 72 | 1579 | 71 | 41 | 126 | 87 | 51 | 0 | 2171 | 2136 | 2171 |
| Florence, Town of | 0 | 0 | 0 | 0 | 0 | 2048 | 0 | 0 | 0 | 0 | 0 | 0 | 2048 | 2048 | 2048 |
| Gilbert, Town of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 7235 |
| Glendale, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 14183 |
| Green Valley Water Dist. | 0 | 0 | 82 | 901 | 1411 | 1665 | 1670 | 1770 | 1465 | 1699 | 1712 | 1808 | 14183 | 14183 | 14183 |
| Mariocopa County P&R | 15 | 19 | 25 | 46 | 79 | 76 | 79 | 93 | 69 | 56 | 20 | 15 | 597 | 597 | 1900 |
| Mesa, City of | 2371 | 2990 | 3175 | 3185 | 456 | 3573 | 3737 | 3686 | 3041 | 3138 | 2640 | 2049 | 34041 | 31457 | 665 |
| Metro Water District | 42 | 319 | 54 | 219 | 630 | 567 | 2219 | 2097 | 1199 | 252 | 0 | 1260 | 8858 | 8858 | 8858 |
| Peoria, City of | 648 | 1633 | 2657 | 761 | 736 | 687 | 2790 | 1377 | 1288 | 1151 | 1018 | 911 | 15657 | 15594 | 19709 |
| Phoenix, City of | 8598 | 6352 | 7079 | 9231 | 9622 | 10191 | 8554 | 16434 | 14681 | 14235 | 11192 | 14469 | 130638 | 131757 | 184987 |
| Queen Creek WC | 13 | 12 | 48 | 65 | 190 | 20 | 0 | 0 | 0 | 0 | 0 | 0 | 348 | 348 | 348 |
| Rio Verde Utilities | 0 | 39 | 20 | 20 | 25 | 31 | 28 | 27 | 25 | 25 | 18 | 23 | 281 | 281 | 812 |
| Scottsdale, City of | 2851 | 3045 | 3915 | 4174 | 5377 | 5855 | 5001 | 5488 | 5347 | 4431 | 3310 | 3414 | 52208 | 55059 | 67795 |
| Tempe, City of | 612 | 800 | 800 | 900 | 900 | 303 | 0 | 0 | 0 | 0 | 0 | 0 | 4315 | 4312 | 4315 |
| Tonto Hills Utility Co. | 1 | 1 | 1 | 1 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 2 | 27 | 17 | 71 |
| Tucson, City of (1) | 1393 | 4639 | 4734 | 4306 | 4463 | 6651 | 7549 | 7066 | 6228 | 5969 | 3554 | 38 | 56590 | 56200 | 135966 |
| Sub Total | 17538 | 23512 | 27900 | 28744 | 27961 | 38163 | 36641 | 42729 | 37369 | 34595 | 25897 | 26773 | 367822 | 368899 | 562628 |

MONTHLY M&I DELIVERIES CALENDAR YEAR 2005

(By Classification)
Table #1

(Deliveries are actuals through March. Monthly projections for the remainder of the year are not shown.)

| SUBCONTRACT | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | TOTAL | SCHEDULE | ENTITL | MNT |
|--------------------------|--------------|--------------|--------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|--------------|---------------|---------------|-----|
| Apache Junction WC | 1 | 0 | 21 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 22 | 400 | 2919 | |
| Arizona-American/PV | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2730 | 3231 | |
| Arizona-American/MW | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 14161 | 17654 | |
| AZ State Land/ADOT | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 320 | 32076 | |
| AWC/Apache Junction | 41 | 25 | 264 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 330 | 4192 | 6000 | |
| AWC/Casa Grande | 92 | 98 | 174 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 364 | 2806 | 8884 | |
| Avondale, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 5416 | 5416 | |
| CAGRD | 759 | 312 | 312 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1383 | 7746 | 7746 | |
| Carefree Water Co. | 42 | 31 | 40 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 113 | 660 | 1300 | |
| Cave Creek Water Co. | 80 | 62 | 109 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 251 | 1450 | 1600 | |
| Chandler, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 3971 | 7639 | |
| Chaparral City Water | 165 | 245 | 444 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 854 | 6935 | 6978 | |
| Eloy, City of | 9 | 9 | 38 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 56 | 2136 | 2171 | |
| Florence, Town of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2048 | 2048 | |
| Gilbert, Town of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 86 | 7235 | |
| Glendale, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 14183 | 14183 | |
| Green Valley Water Dist. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 604 | 1900 | |
| Maricopa County P&R | 11 | 2 | 35 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 48 | 660 | 665 | |
| Mesa, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 36388 | 47765 | |
| Metro Water District | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 8858 | 8858 | |
| Peoria, City of | 427 | 2340 | 2959 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 5726 | 17200 | 19709 | |
| Phoenix, City of | 9182 | 11976 | 10785 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 31943 | 121983 | 162537 | |
| Queen Creek WC | 26 | 47 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 73 | 348 | 348 | |
| Rio Verde Utilities | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 285 | 812 | |
| Scottsdale, City of | 1277 | 1559 | 3369 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6205 | 48697 | 57413 | |
| Tempe, City of | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 4315 | 4315 | |
| Tonto Hills Utility Co. | 2 | 2 | 2 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6 | 29 | 71 | |
| Tucson, City of (1) | 5960 | 5269 | 5448 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 16677 | 61300 | 135966 | |
| Sub Total | 18074 | 21977 | 24000 | 0 | 64051 | 369907 | 567439 | |

ATTACHMENT C

WATER RATES

| | | | |
|------------------------------|-----------------------------------|------------------------|------------------|
| ARIZONA WATER COMPANY | | A.C.C. No. | 440 |
| Phoenix, Arizona | | Cancelling A.C.C. No. | (not applicable) |
| Filed by: | William M. Garfield | Tariff or Schedule No. | NP-260 |
| Title: | President | Filed: | March 31, 2004 |
| Date of Original Filing: | March 7, 1994 | Effective: | March 10, 2004 |
| System: | CASA GRANDE, COOLIDGE, WHITE TANK | | |

NON-POTABLE CENTRAL ARIZONA PROJECT WATER

AVAILABILITY:

In the Company's Casa Grande, Coolidge and White Tank water systems, where and when Central Arizona Project ("CAP") water is available.

SUITABILITY:

It is the customer's responsibility to determine the initial and continuing suitability of the non-potable CAP water furnished under this tariff for any intended uses. The Company does not treat, test or monitor non-potable CAP water and furnishes it to customers strictly on an "as received" basis from the Central Arizona Water Conservation District ("CAWCD"). The customer agrees to accept non-potable CAP water "as received." Compliance with any requirement of the Arizona Department of Environmental Quality, or any other agency having jurisdiction, concerning the use or quality of non-potable CAP water shall be the sole responsibility of the customer. The Company will not be liable for, and the customer will hold harmless, indemnify and defend the Company against, any injuries or damages arising from its service of non-potable CAP water.

FACILITIES AND DEMAND:

When applying for non-potable CAP water service, the customer shall specify the maximum annual quantity of CAP water in acre feet (AF) that it intends to use under this tariff schedule and pursuant to a Non-Potable Water Facilities Contribution Agreement. This quantity of water will be used to determine the facilities required to serve the customer and will be the customer's maximum demand for non-potable CAP water ("CAP Demand") during any calendar year. The customer will be responsible for both the deferred (including holding costs) and the current annual CAWCD M&I Water Service Capital Charges on the CAP Demand and on any water use in excess of the CAP Demand.

The customer will contribute the funds required to install all facilities needed to provide CAP water. Such facilities will be owned by the Company.

The Deferred CAP Demand Charge includes the deferred annual CAWCD M&I Water Service Capital Charges and associated holding costs for the customer's CAP Demand. The Deferred CAP Demand Charge is payable prior to the start of service or within fifteen (15) days of any approved increase in CAP Demand. The Deferred CAP Demand Charge will be payable only on any future increase in CAP Demand for those customers receiving service under this tariff as of the effective date. The Deferred CAP Demand Charge is not refundable if the customer's CAP Demand is later reduced.

APPROVED FOR FILING
DECISION #: 66849

Effective 3/10/04
Effective 4/6/94
Revised 1/18/95
Revised 1/15/99



MONTHLY BILL:

ORIGINAL

The monthly billing will consist of the following components:

1. A monthly CAP Demand charge equal to 1/12th of the customer's CAP Demand in AF times the applicable CAWCD M&I Water Service Capital Charge per AF plus four percent (4%) of such costs to cover the Company's administrative and handling costs. Should the customer's actual water use exceed the customer's CAP Demand, the customer will be billed an additional demand charge, based on the applicable CAWCD M&I Water Service Capital Charge, on the excess water use, plus a four percent (4%) administrative and handling fee.

2. A meter charge based on the applicable monthly minimum charge by meter size as set forth in each system's General Service tariff schedule. This meter charge shall not include any water.

3. A commodity charge designed to pass on all costs of non-potable CAP water, except the monthly CAP Demand charge, as billed to the Company during the previous month by the CAWCD or any other authorized governmental agency, plus one percent (1%) of such costs to cover the Company's administrative and handling costs.

4. A power, maintenance and depreciation charge based on the specific requirements of each customer.

A. The power component will be the direct and separately metered cost of the power billed to the Company during the previous month for CAP water delivered to the customer, plus one percent (1%) of the power cost to cover the Company's administrative and handling costs. If multiple customers are being served by common facilities, the power component will be prorated based on CAP water actually used during the month by each customer.

B. The maintenance component will be the actual costs of maintaining the facilities required to serve the customer, plus a ten percent (10%) charge to provide for overhead and margin. If multiple customers are being served by common facilities, the maintenance component will be prorated based on each customer's CAP Demand.

C. The depreciation component will be 1/12th of the product of the Company's book depreciation rate, as authorized by the Arizona Corporation Commission, times the original cost of the plant facilities serving the customer. If multiple customers are being served by common facilities, the depreciation component will be prorated based on each customer's CAP Demand.

Late Charge: Any payment not received within fifteen (15) days from the postmark date of the bill will be delinquent and subject to a late charge of one and one-half percent (1 1/2%) per month.

Adjustment: An adjustment for state and local taxes, which will be the applicable proportionate part of any taxes or governmental impositions which are, or in the future may be, assessed on the basis of the gross revenues of the Company and/or the price or revenue from the water or service sold and/or the volume of water pumped or purchased for sale and/or sold hereunder. In the event of any increase or decrease in taxes or other governmental impositions, rates shall be adjusted to reflect such tax increase or decrease.

TERMS AND CONDITIONS:

Subject to the Company's Tariff Schedule TC-243.

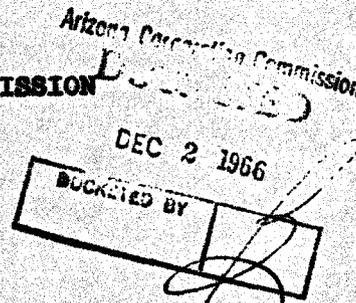
APPROVED FOR FILING
DECISION #: 66849

Effective 3/10/04
Effective 4/6/94
Revised 1/18/95
Revised 1/15/99

ATTACHMENT D

BEFORE THE ARIZONA CORPORATION COMMISSION

MILTON J. HUSKY
Chairman
E. T. "BOB" WILLIAMS, JR.
Commissioner
DICK HARRIS
Commissioner



IN REPLY TO THE APPLICATION OF ARIZONA WATER COMPANY,
AN ARIZONA CORPORATION, FOR A DETERMINATION OF PROPER RESERVE
FOR DEPRECIATION.

DOCKET NO. U-1445

DECISION NO. 38733

OPINION AND ORDER

BY THE COMMISSION:

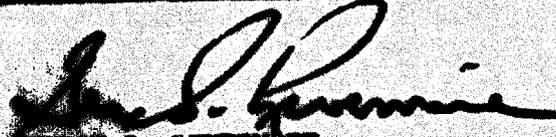
On November 28, 1966, in Phoenix, Arizona, a hearing was held on the above entitled matter, upon the application of Arizona Water Company.

At said hearing evidence was adduced by Petitioners with which the Commission Staff agreed, and upon that evidence the Commission finds that the entire Arizona Water Company reserve for depreciation, as of December 31, 1965, was deficient in the amount of \$514,353.02, and that \$145,970.94 of such deficiency accrued prior to March 31, 1955, and that the Company should charge said deficiency off to capital surplus; further that the reserve for depreciation from March 1, 1955, to December 31, 1965, was inadequate and deficient in the amount of \$368,282.08, and that this deficiency should be amortized over the average remaining life of the assets, which is approximately thirty nine years.

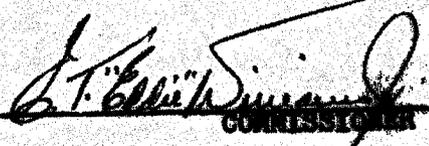
WHEREBY IT IS ORDERED that the \$145,970.94 of deficiency in the reserve for depreciation which accrued prior to March 31, 1955 be charged off to capital surplus, and that the deficiency in the March 31, 1955, to December 31, 1965 reserve for depreciation in the amount of \$368,282.08 be amortized over the remaining life of the assets, which is approximately thirty nine (39) years.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

IN WITNESS WHEREOF, I, GEORGE S. LIVERMORE,
Secretary of the Arizona Corporation Commission,
have hereunto set my hand and caused the official
seal of this Commission, to be affixed at the
Capital in the City of Phoenix, this 2nd day
of December, 1966.

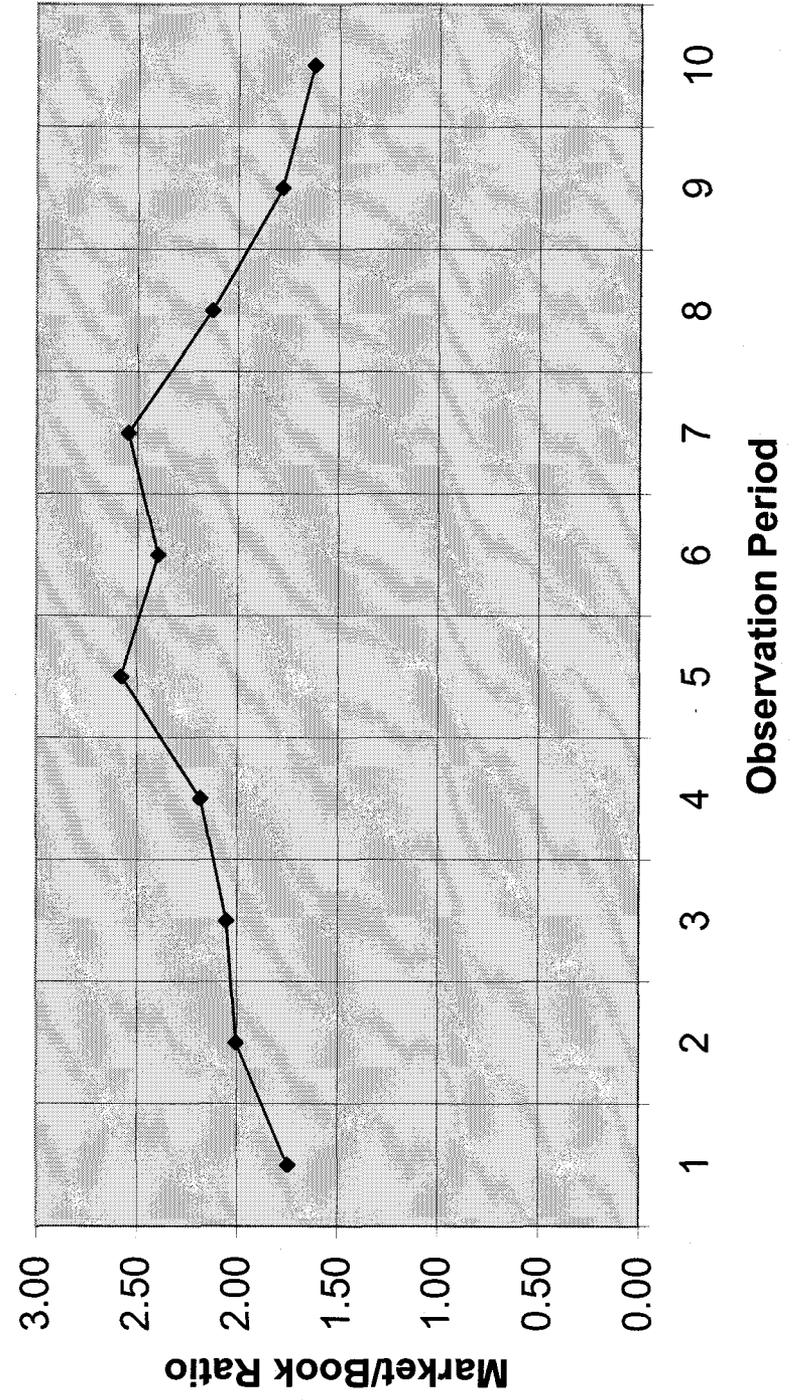

GEORGE S. LIVERMORE
SECRETARY


COMMISSIONER

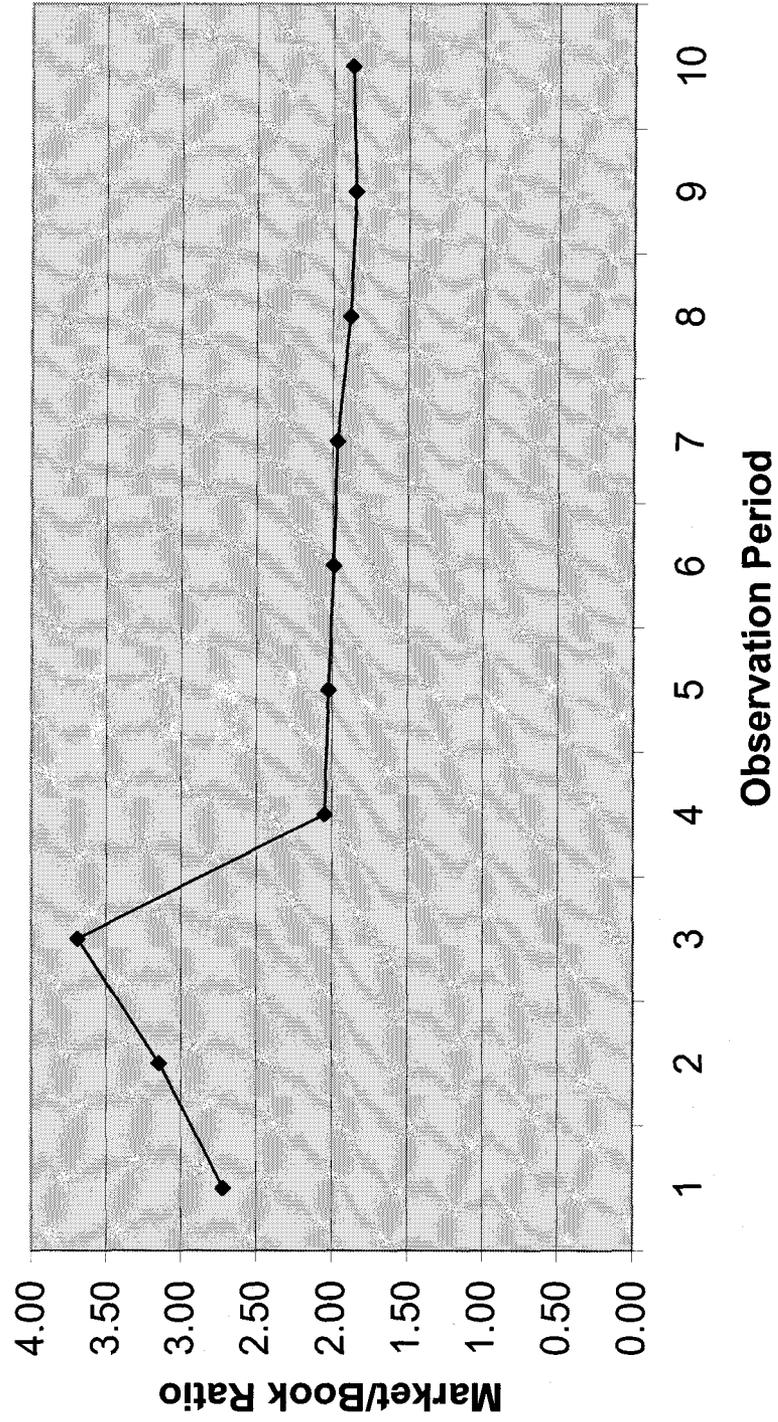

COMMISSIONER

ATTACHMENT E

**Market to Book Ratio Trend - AWR
(1995 thru 2004)**



**Market to Book Ratio Trend - CWT
(1995 thru 2004)**



**Market to Book Ratio Trend - WTR
(1995 thru 2004)**

