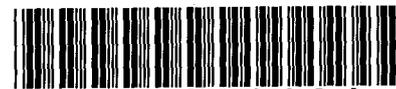


ORIGINAL NEW APPLICATION



0000049121

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

2006 APR 26 P 4:03

AZ CORP COMMISSION
DOCUMENT CONTROL

APPLICATION OF ARIZONA-AMERICAN
WATER COMPANY, INC., AN ARIZONA
CORPORATION, FOR AUTHORITY TO
INCUR LONG-TERM DEBT THROUGH ITS
AFFILIATE, AMERICAN WATER CAPITAL
CORPORATION

DOCKET NO. WS-01303A-06-WS-01303A-06-0283

FINANCING APPLICATION

FINANCING APPLICATION ARIZONA-AMERICAN WATER COMPANY APRIL 26, 2006

1 1. **Introduction.** As more fully set forth below, Arizona-American Water Company
2 (“Arizona-American” or the “Company”) hereby applies in accordance with A.R.S. § 40-301 *et.*
3 *seq.*, for authority to be obligated for up to \$174.01 million in debt not previously approved by
4 the Commission.

5 2. **Supporting Exhibits.** As more fully discussed below, Arizona-American
6 provides the following exhibits in support of its application:

- 7 • **Exhibit A** – Capital Budget 2006-2010.
- 8 • **Exhibit B** – Current Promissory Note.
- 9 • **Exhibit C** – 2005 Balance Sheet with *Pro Forma* Adjustments.
- 10 • **Exhibit D** – 2005 Income Statement with *Pro Forma* Adjustments.
- 11 • **Exhibit E** – 2005 Equity Plan.
- 12 • **Exhibit F** – Certificate of Resolution.
- 13 • **Exhibit G** – Tolleson Obligation
- 14 • **Exhibit H** – Form of Public Notice.

1 3. **Company Description.** Arizona-American is a public service corporation
2 engaged in providing water and wastewater utility services in portions of Maricopa, Mohave, and
3 Santa Cruz Counties, Arizona, pursuant to various certificates of public convenience and
4 necessity granted by the Arizona Corporation Commission (the "Commission") to Arizona-
5 American and its predecessors in interest. The Company presently provides utility service to
6 approximately 97,000 water customers and 47,000 sewer customers in Arizona and is Arizona's
7 largest investor-owned water and wastewater utility. Arizona-American is a wholly-owned
8 subsidiary of American Water Works, Inc. ("American Water"). American Water's ultimate
9 corporate parent is RWE AG.

10 4. **Principal Office.** The Company's principal business office is located at 19820
11 North Seventh Street, Suite 201, Phoenix, Arizona 85024, and its telephone number is (623) 445-
12 2400.

13 5. **Authorized Representative.** The person authorized to receive notices and
14 communications regarding this application is:

15 Thomas M. Broderick
16 Manager, Rates and Regulations, Western Region
17 Arizona-American Water Company
18 19820 N. 7th Street
19 Suite 201
20 Phoenix, Arizona 85024
21 Telephone: (623) 445-2420
22 Telecopier: (623) 445-2454
23 Thomas.Broderick@amwater.com
24

25 **All discovery, data requests, and other requests for information concerning this**
26 **Application should be directed to Mr. Broderick, with a copy to undersigned counsel for**
27 **the Company.**

28 6. **Description of Lender.** Arizona-American proposes to borrow from its affiliate
29 American Water Capital Corporation ("AWCC"). AWCC is also a subsidiary of Arizona-
30 American's parent company, American Water, and is the primary funding vehicle for all of
31 American Water's subsidiary utility companies. AWCC's current credit rating is A- from

1 Standard & Poor's. AWCC expects to obtain the funds that it loans to Arizona-American from
2 the open market.

3 7. **Purpose of Borrowing.** Arizona-American currently owes \$158.45 million to
4 AWCC through two promissory notes that mature in November 2006.¹ The purpose of this
5 application is to request approval to borrow \$165.45 million in new funds from AWCC to pay
6 off the \$158.45 million in maturing debt and to borrow up to an additional \$7.0 million to fund
7 new capital projects. These new capital projects include arsenic-treatment facilities, and other
8 water and wastewater facilities. Exhibit A is a copy of Arizona-American's capital budget for
9 the years 2006-2010.

10 Also, to the extent required by law, Arizona-American requests approval of an \$8.56
11 million obligation to the City of Tolleson.

12 8. **Proposed Interest Rate.** Based on AWCC's current credit rating, Arizona-
13 American expects to borrow these funds at a rate of 5.865%, not to exceed 6.5%.

14 9. **Financing Term.** The Company expects that the financing term will not exceed
15 30 years, likely including staggered terms with an average 10-year maturity.

16 10. **Debt Security.** The proposed debt will be unsecured.

17 11. **Financing Costs.** There are no expected financing costs or issuance expenses.
18 No person is expected to receive any fees as a result of this transaction.

19 12. **Other Borrowing Terms.** Exhibit B is a copy of a current promissory note
20 between Arizona-American and AWCC. The Company expects that the new borrowing will be
21 made under similar terms. The Company will file a copy of all executed documents associated
22 with the authorized financing.

23 13. **Equity Injection.** Arizona-American received an injection of \$35 million in new
24 equity from American Water on March 21, 2006.

¹ One note is for \$3.5 million and the other for \$154,948,119.

1 14. **Financial Statements.** Exhibit C is a copy of the Company's 2005 balance sheet,
2 with pro-forma adjustments for the expected 2006 borrowing and equity injection. Exhibit D is a
3 copy of the Company's 2005 income statement, with pro-forma adjustments for the expected
4 2006 borrowing and equity injection.

5 15. **DSC and TIER.** Page 2 of Exhibit D derives Arizona-American's Debt Service
6 Coverage Ratio ("DSC") and its Times Interest Earned Ratio (TIER"). As of December 2005,
7 the Company's DSC was 2.67 and TIER was 1.64. After adjusting for the effects of the expected
8 2006 borrowing and equity injection, Arizona-American's DSC is estimated to be 2.04 and TIER
9 to be 0.87. TIER is not a particularly useful yardstick for Arizona-American at this time because
10 the Company currently has over \$125 million of its investment excluded from rate base and is
11 incurring over \$2.0 million in annual depreciation and amortization without regulatory recovery.
12 Both of these items contribute to a drag on the earnings figure used in the numerator of the TIER
13 calculation. On the other hand, the DSC ratio measures operating cash flow and is more
14 representative of the Company's ability to service debt going forward. Based on its DSC, the
15 Company should be able to adequately cover its expected debt payments from operating cash
16 flow.

17 16. **Equity Plan.** On November 30, 2005, as ordered by the Commission, Arizona-
18 American filed an Equity Plan with the Commission to improve its equity ratio. A copy of that
19 plan is attached for the Commission's convenience as Exhibit E.

20 17. **Sale of American Water by RWE.** RWE's sale of American Water through an
21 initial public offering will not affect the terms of Arizona-American's requested borrowing,
22 because the initial public offering will not occur until 2007, well after the borrowing is
23 completed. AWCC will continue to hold the Company's debt after the sale. For further
24 information concerning the sale of American Water, please see the Company's "Notice Of Intent
25 And Request For A Finding Of No Jurisdiction, Waiver Or Approval" filed on April 25, 2006,
26 with the Commission.

1 18. **Corporate Powers.** Exhibit F is a certificate of resolution of Arizona-
2 American's Board of Directors authorizing the proposed borrowing.

3 19. **Compliance.** Arizona-American currently has no outstanding compliance issues
4 with the Commission, the Arizona Department of Environmental Quality, or the Arizona
5 Department of Water Resources.

6 20. **Compatibility.** The proposed transaction is needed to refinance existing
7 Company debt and to provide funds for new capital projects. The new borrowing is being
8 provided by AWCC at competitive rates and net of any underwriting costs or fees. Absent the
9 refinancing by November 2006, Arizona-American would be in default under its current
10 borrowings with AWCC and would be unable to invest in new capital projects required to deliver
11 adequate, safe drinking water, and provide reliable, safe sewer service, to its customers. For
12 these reasons, the requested financing approval is compatible with

- 13 • the public interest;
- 14 • sound financial practices; and
- 15 • the proper performance by Arizona-American of service as a public service
16 corporation (and will not impair the Company's ability to perform that service).

17 21. **City of Tolleson.** Arizona-American is the successor in interest to Sun City
18 Sewer as the purchaser of sewage treatment services from the City of Tolleson under a Sewage
19 Treatment and Transportation Services Agreement ("Services Agreement").² To finance the
20 facilities needed to provide service under the Services Agreement, the City of Tolleson has
21 issued \$8.56 million in bonds. Payments for the bonds are made from revenues received under
22 the Services Agreement and Arizona-American guarantees these payments. Arizona-American's
23 outside auditors are now requiring it to book this payment obligation as long-term debt. Because
24 of this reclassification, Arizona-American now asks for approval, to the extent necessary, from

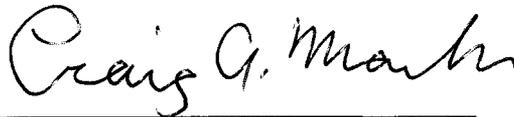
² See further, Decision No. 67093, dated June 30, 2004, pp. 42-46.

1 the Commission of this \$8.56 million obligation. A copy of the City of Tolleson obligation is
2 attached as Exhibit G.

3 22. **Public Notice.** Exhibit H is a copy of the notice that Arizona-American intends
4 to publish in a newspaper of general circulation in its service areas. Arizona-American will file
5 proof of publication when it is available.

6 23. **Requested Relief.** As more fully set forth in this Application Arizona-American
7 Water Company asks that the Commission approve its request under A.R.S. § 40-301 *et. seq* to
8 incur up to \$165.45 million in new debt, and to be obligated for the \$8.56 million Tolleson
9 bonds.

10 Respectfully submitted on April 26, 2006, by:

11
12 

13
14 Craig A. Marks
15 Corporate Counsel, Western Region
16 American Water
17 19820 N. 7th Street
18 Phoenix, Arizona 85024
19 (623) 445-2442
20 Craig.Marks@amwater.com

21
22 Attorney for Arizona-American Water Company

1 **Original** and 16 copies filed
2 on April 26, 2006, with:

3
4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007

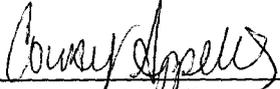
8
9 **Copies** of the foregoing mailed on
10 April 26, 2006, to:

11
12 Legal Division
13 Arizona Corporation Commission
14 1200 West Washington
15 Phoenix, Arizona 85007

16
17 Utilities Division
18 Arizona Corporation Commission
19 1200 West Washington
20 Phoenix, Arizona 85007

21
22 Lyn Farmer
23 Chief Hearing Officer
24 Arizona Corporation Commission
25 1200 West Washington
26 Phoenix, Arizona 85007

27
28 Residential Utility Consumer Office
29 1110 West Washington Street
30 Suite 220
31 Phoenix, Arizona 85007

32
33
34
35 By: 
36 Courtney Appelans

A

STRATEGIC CAPITAL EXPENDITURE PLAN

Summary

Company/State: Arizona American
 Revision Date: Oct 10, 2005
 Status: Approved Budget

Units = \$	Business Plan 5-year total	Total 2005	Plan Total 2006	Plan Total 2007	Plan Total 2008	Plan Total 2009	Plan Total 2010
Line 1	169,479,515	37,177,694	42,622,407	30,129,340	27,788,887	34,428,846	34,510,035
Line 2	71,569,319	46,213,415	30,666,248	13,204,212	12,400,397	8,790,851	6,507,611
Line 3	241,048,834	83,391,108	73,288,655	43,333,552	40,189,284	43,219,697	41,017,646
Line 4	20,946,266	3,256,527	4,023,709	3,434,639	4,118,691	4,572,591	4,796,637
Line 5	132,097,584	30,629,959	34,987,391	23,200,374	21,431,913	26,767,769	25,710,138
Line 6	153,043,850	33,886,486	39,011,099	26,635,012	25,550,604	31,340,359	30,506,775
Line 7	88,004,985	49,504,622	34,277,556	16,698,540	14,638,680	11,879,338	10,510,871
Line 8	64,727,499	11,117,179	11,742,647	40,264,987	4,494,218	4,183,788	4,041,859
Line 9	152,732,484	60,621,802	46,020,203	56,963,526	19,132,899	16,063,126	14,552,730
Acquisitions	0	0	0	0	0	0	0
TOTAL ACQUISITIONS	0	0	0	0	0	0	0
TOTAL COMPANY FUNDED EXPENDITURE (9 plus 10)	152,732,484	60,621,802	46,020,203	56,963,526	19,132,899	16,063,126	14,552,730
TOTAL INVESTMENT IN ASSETS (3 plus 10)	241,048,834	83,391,108	73,288,655	43,333,552	40,189,284	43,219,697	41,017,646
TOTAL GROSS CAPITAL EXPENDITURE (6 plus 11)	305,776,334	94,508,288	85,031,302	83,598,539	44,683,503	47,403,486	45,059,504

Loaded with STEP

Units = \$

Company	District	Project Code	Brief Description of Proposed Expenditures	Stage (P/N, P/A, PCA, New)	Business Plan 5-year total	Prior	Total 2005	Plan Total 2006	Plan Total 2007	Plan Total 2008	Plan Total 2009	Plan Total 2010	Post 2010	Project Total	Project Manager
Arizona American		0080	Mains, Hydrants, Valves, Meters - Deposit/Contribution	New	151,804,243		33,922,177	39,199,043	26,293,757	24,527,834	30,931,644	30,852,166			
Arizona American		0081	Network - Replacement Renewal	New	3,135,253		295,788	499,393	748,805	591,995	621,080	673,980			
Arizona American		0082	Network - Extension	New			95,388								
Arizona American		0083	Hydrants - Replacement	New			46,062								
Arizona American		0084	Hydrants - New	New	1,300,685		203,014	233,580	242,760	255,015	269,880	295,460			
Arizona American		0085	Services - Replacement	New	2,231,585		139,586	42,880	44,880	48,865	47,320	49,680			
Arizona American		0086	Services - New	New	2,230,586		418,732	464,580	464,580	485,365	432,120	383,940			
Arizona American		0087	Meters - Replacement	New	3,171		3,171								
Arizona American		0088	Meters - New	New	1,784,063		446,575	320,586	292,434	320,639	384,384	466,020			
Arizona American		0090	ITS Equipment & Systems	New	36,990		174,940	9,180	9,270	9,270	9,360	9,360			
Arizona American		0091	Offices and Operations Centers	New	143,710		48,517	61,200	12,240	25,750	21,840	22,680			
Arizona American		0092	Vehicles	New	420,979		81,645	74,838	76,166	85,042	85,042	105,287			
Arizona American		0093	Tools and Equipment	New	5,767,790		1,042,361	1,280,021	1,086,615	1,136,891	1,136,891	1,239,902			
Arizona American		0094	Process Plant - Replacement	New	1,374,524		489,895	352,920	489,895	140,583	155,246	235,880			
Arizona American		0095	Treatment Media Replacement and Process Rehabilitation (capitalized)	New	219,280		184,280					35,000			
Arizona American		0096	Tank Rehabilitation / Painting (capitalized)	New	1,029,818		161,246	315,078	175,950	239,990	149,760	149,040			
Arizona American		0097	Comprehensive Planning Studies	New											
			TOTAL RECURRING PROJECTS		189,479,515		37,177,684	42,922,407	30,129,340	27,789,887	34,428,846	34,510,035			
Arizona Am	23010401	2301	STEP	23,010,401	450,335		1,100,000	1,530,000	3,162,000	1,545,000	832,000	648,000			Fred Schmeiter
Arizona Am	23010503	2301	Phoenix Office Remodel	23,010,503	1,802,964		290,900								Amy Yates
Arizona Am	23020003	2302	8,000' of 12" Main in Inverton/Jackrabbit Rts.	23,020,003	375,544		800,530								Justin Rundie
Arizona Am	23020101	2302	PV-Small Main Replacement Prgm	23,020,101	1,347,147		18,722	10,331,965	9,972,872						Joe Gross
Arizona Am	23020203	2302	Arsenic Removal Facilities, PV	23,020,203	514,080		1,531,871	514,080							Ed Rawanski
Arizona Am	23020503	2302	Fire Flow Improv-Ph 2	23,020,501	299,880		299,880	2,450,040	176,716						Brian Vandanson
Arizona Am	23020505	2302	Replace Well 12	23,020,505	18,836		142,290								Dale Conover
Arizona Am	23020506	2302	Fire Flow Improv-Ph 3	23,020,506	2,749,920		2,749,920	2,446,654	2,446,654						Brian Vandanson
Arizona Am	23020507	2302	Fire Flow Improv-Ph 4	23,020,507	4,217,664		2,998,880	2,450,040	2,474,020						Brian Vandanson
Arizona Am	23020508	2302	Fire Flow Improv-Ph 5	23,020,508	500,021		500,021	1,443,764	50,007						Brian Vandanson
Arizona Am	23020509	2302	Fire Flow Improv-Ph 6	23,020,509	748,500		748,500	244,800	504,700						Brian Vandanson
Arizona Am	23460201	2346	Sun City Office Security & Rehab.	23,460,201	25,612		25,612	244,800	249,904						Brian Blaesmeier
Arizona Am	23460503	2346	WWTP Expansion Ph 2	23,460,201	247,573		247,573	247,573							Justin Rundie
Arizona Am	23460504	2346	WWTP Rehabilitation	23,460,201	250,000		250,000	247,573							Justin Rundie
Arizona Am	23460505	2346	WWTP Ph 1	23,460,201	1,750,000		1,750,000	247,573							Justin Rundie
Arizona Am	23460506	2346	WWTP Expansion Ph 3	23,460,201	3,005		3,005								Justin Rundie
Arizona Am	23610203	2361	AGUA-Cleanair Farms Booster St	23,610,203	4,534,316		4,534,316								Joe Gross
Arizona Am	23610204	2361	White Tanks WTP - Phase 1 (13.5 MGD)	23,610,204	4,422,863		1,072,048								Keith Larson
Arizona Am	23610205	2361	Aqua Fire Surface Water Trunk Main Ph 1	23,610,205	2,097,033		7,223,155								Justin Rundie
Arizona Am	23610301	2361	AF WP - Arsenic Treatment	23,610,301	484,126		2,446,036	846,234							Ed Rawanski
Arizona Am	23610302	2361	Misc Trans & Distr oversizing	23,610,302	846,234		40,902								Joe Gross
Arizona Am	23610501	2361	Verrado Zone 3S Reservoir Expansion	23,610,501	1,686,080		61,876	1,561,820	124,440						Brad Finke
Arizona Am	23610502	2361	AF WP 11 (Verrado Zone 3N BPS)	23,610,502	1,500,000		1,500,000								Brad Finke
Arizona Am	23610503	2361	AF WP 5 - Arsenic Treatment	23,610,503	440,403		440,403	440,403							Ed Rawanski
Arizona Am	23610504	2361	AF WP 9 - Arsenic Treatment	23,610,504	447,664		2,032,447	447,664							Ed Rawanski
Arizona Am	23610505	2361	AF WP 5 - Arsenic Removal	23,610,505	153,000		1,854,000	153,000							Brad Finke
Arizona Am	23610506	2361	Aqua Fire Well T.3 (Cone Bella Well 3)	23,610,506	1,672,980		90,000								Dale Conover
Arizona Am	23610512	2361	AF WP 9 Additional Pumps	23,610,512	1,616,736		163,200								Brad Finke
Arizona Am	23610513	2361	AF WP 9 Expansion	23,610,513	2,000,000		900,000								Joe Gross
Arizona Am	23610515	2361	Sierra Montana Plant Expansion	23,610,515	2,000,000		500,000								Joe Gross
Arizona Am	23610516	2361	Cone Bella Plant Expansion	23,610,516	2,499,999		500,000								Joe Gross
Arizona Am	23610517	2361	Verrado Z3N Reservoir/24 Booster Station	23,610,517	2,499,999		500,000								Brad Finke

Loaded with STEP

Units = \$

Company/State Arizona American
Revision Date Oct 10, 2005
Status Approved Budget

Company	District	Project Code	Brief Description of Proposed Expenditures	Stage (P.N.I. PCA, Nsh)	Business Plan 5-year total	Prior	Total 2005	Plan Total 2006	Plan Total 2007	Plan Total 2008	Plan Total 2009	Plan Total 2010	Post 2010	Project Total	Project Manager
Arizona Am	23620202	2362	SUNC-Well Study/Minor Repairs	23 620,202	175,000	199,280								199,280	Joe Gross
Arizona Am	23620401	2362	Replace Well SC 8.2	23 620,204	175,000					175,000				175,000	Dale Conover
Arizona Am	23620402	2362	Replace Well SC 8.2	23 620,401	175,000		1,690	175,000		175,000				175,000	Dale Conover
Arizona Am	23620403	2362	Replace Well SC 3.1	23 620,403	175,000									175,000	Dale Conover
Arizona Am	23620405	2362	Replace Well SC 1.1	23 620,405	175,000				175,000					175,000	Dale Conover
Arizona Am	23620406	2362	Replace Well SC 8.4 (SC 4B)	23 620,406	174,999	8,437		174,999						174,999	Dale Conover
Arizona Am	23620502	2362	Fire Flow Improv Ph 1	23 620,502	800,000			800,000						800,000	Joe Gross
Arizona Am	23620504	2362	Replace Well SC 2.4	23 620,504									540,000	540,000	Brian Biesemeyer
Arizona Am	23620505	2362	Portable Generator 900KW	23 630,201	2,248,560	1,635,277	7,000	167,280		2,248,560				1,642,277	Justin Rundle
Arizona Am	23630201	2363	98th Ave Interceptor Rehab Ph 1	23 630,201	18,360		1,098,560							1,098,560	Erman Fisher
Arizona Am	23630501	2363	98th Ave Interceptor Rehab Ph 2	23 630,503	167,280		7,000							178,030	Erman Fisher
Arizona Am	23630503	2363	Rebuild 11th Ave LS	23 640,201	171,030		5,481,913	3,413,852						9,690,071	Ed Rawanski
Arizona Am	23640201	2364	Youngtown Lift Station Force Main Replacement	23 640,301	794,305									1,200,000	Dale Conover
Arizona Am	23640301	2364	SUNW-Well Study/Minor Repairs	23 640,301	176,699		1,200,000			176,699				1,76,699	Dale Conover
Arizona Am	23640401	2364	SUNW-WP 1 Arsenic Treatment	23 640,401	175,000			175,000						175,000	Dale Conover
Arizona Am	23640402	2364	Replace Well SCW 1.4	23 640,402	777,299		2,567,226	777,299						3,344,526	Brad Finkle
Arizona Am	23640404	2364	Replace Well SCW 1.3 (SCW28A)	23 640,404			50,000							50,000	Brad Finkle
Arizona Am	23650201	2365	SCW WP 2 Arsenic Treatment	23 650,201	253,840	3,146,381					203,840			253,840	Erman Fisher
Arizona Am	23650501	2365	Sun City West WRF Expansion to 5.0 mgd	23 710,502	49,979		20,000	49,979						49,979	Erman Fisher
Arizona Am	23650502	2365	NWV Lift Station #1 Expansion	23 710,502	74,271		74,271	74,271						74,271	Brian Vandenson
Arizona Am	23710404	2371	Bell Rd FM Sloe Lining	23 710,404	774,694			599,760						774,694	Joe Gross
Arizona Am	23710409	2371	Sea Fair Main Replacement	23 720,402	1,799,083			1,690,048					1,160,320	1,799,083	Joe Gross
Arizona Am	23710501	2371	1MG Reservoir at 24-1 Service Area	23 730,301	789,879			109,035						789,879	Joe Gross
Arizona Am	23720402	2372	WWTP Expansion .25 (Wishing Well) Ph 1	23 730,301	219,251	157,121	1,855,624	219,251						2,231,996	Ed Rawanski
Arizona Am	23720502	2372	WWTP Expansion .25 (Wishing Well) Ph 2	23 730,401	153,000			153,000						153,000	Ed Rawanski
Arizona Am	23730301	2373	Arsenic Removal Facilities-Havasu Water	23 820,201	1,388,550	3,235,703	-300,000	255,000						1,53,000	Brian Vandenson
Arizona Am	23730401	2373	Main Replacement, Williams Drive	23 820,201	8,208,122		44,157	3,948,440						2,835,703	Brian Vandenson
Arizona Am	23820201	2382	TRTCWW-Anthem WW Facilities	23 820,201	942,500			3,948,440						1,923,550	Richard Moore
Arizona Am	23830301	2383	Membrane Replacement	23 840,201	5,096,940									8,252,278	Joe Gross
Arizona Am	23840201	2384	DISTWV-SCW WRF Expansion	23 840,201	500,000									500,000	Richard Moore
Arizona Am	23840301	2384	Membrane Replacement	23 840,201	622,000									622,000	Richard Moore
Arizona Am	23850401	2385	Verrado WRF Phase II Expansion	23 850,401	56,650			416,000						56,650	Brad Finkle
Arizona Am	23850501	2385	Verrado WRF Phase III	23 850,401	777,000			309,000						777,000	Brad Finkle
Arizona Am	23850502	2385	Verrado WRF - New Admin Building	23 850,505	2,040		308,480	2,040						310,520	Brad Finkle
Arizona Am	23850503	2385	Verrado WRF - Replace IPS Pumps	23 890,301	350,000	211,354	200,000	350,000						761,354	Justin Rundle
Arizona Am	23850504	2385	Verrado WRF - Grit Removal, Disinfection, and Belt Filter Press Improvements	23 890,301	999,604			119,952						999,604	Justin Rundle
Arizona Am	23890501	2389	Replace Well 4	23 890,301	69,979,076		45,586,956	29,909,743	12,814,219	12,218,079	8,638,943	6,388,092	9,700,320	156,566,607	Dale Conover
TOTAL INVESTMENT PROJECTS															

Transfer to UPIS
Cumulative CWIP

AFUDC -DRM @3.06%
AFUDC Equity @5.68%

TOTAL INVESTMENT PROJECTS

25032207.97	20857022.43	15037035.3	16098412.5	168266927.1
136542	53185	38344	41051	429081
253451	98723	71175	76189	796463
13204211.58	8790851.04	6507611.26	6817570.24	158782150.8

B



Arizona-American Water Company

PROMISSORY NOTE FOR LONG-TERM BORROWING

Interest Rate - 4.92%; Maturity – September 30, 2014

\$25,000,000.00

September 30, 2004

FOR VALUE RECEIVED, Arizona – American Water Company, an Arizona corporation (herein “Borrower”) hereby promises to pay to the order of American Water Capital Corp., a Delaware corporation (“Lender”), in same day funds at its offices at Voorhees, NJ or such other place as Lender may from time to time designate, the principal sum of Twenty-Five Million dollars (\$25,000,000.00), together with interest thereon from the date hereof until paid in full. Interest shall be charged on the unpaid outstanding principal balance hereof at a rate per annum equal to the rate paid and to be paid by Lender with respect to the borrowings it made in order to provide funds to Borrower hereunder. Interest on borrowings shall be due and payable in immediately available funds on the same business day on which the Lender must pay interest on the borrowings it made in order to provide funds to the Borrower hereunder. The principal amount hereof shall be due and payable hereunder at such times and in such amounts and in such installments hereunder as the Lender must pay with respect to the borrowings it made in order to provide funds to the Borrower hereunder. Lender has provided Borrower with a copy of the documentation evidencing the borrowings made by Lender in order to provide funds to Borrower hereunder. In the absence of manifest error, such documentation and the records maintained by Lender of the amount and term, if any, of borrowings hereunder shall be deemed conclusive.

The occurrence of one or more of any of the following shall constitute an event of default hereunder:

(a) Borrower shall fail to make any payment of principal and/or interest due hereunder or under any other promissory note between Lender and Borrower within five business days after the same shall become due and payable, whether at maturity or by acceleration or otherwise;

(b) Borrower shall apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, admit in writing its inability to pay its debts as they mature, make a general assignment for the benefit of creditors, be adjudicated a bankrupt or insolvent or file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation of law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law, or if action shall be taken by Borrower for the purposes of effecting any of the foregoing; or

(c) Any order, judgment or decree shall be entered by any court of competent jurisdiction, approving a petition seeking reorganization of Borrower or all or a substantial part of the assets of Borrower, or appointing a receiver, trustee or liquidator of Borrower or any of its property, and such order, judgment or decree shall continue unstayed and in effect for any period of sixty (60) days.





Upon the occurrence of any event of default, the entire unpaid principal sum hereunder plus all interest accrued thereon plus all other sums due and payable to Lender hereunder shall, at the option of Lender, become due and payable immediately. In addition to the foregoing, upon the occurrence of any event of default, Lender may forthwith exercise singly, concurrently, successively or otherwise any and all rights and remedies available to Lender by law, equity, statute or otherwise.

Borrower hereby waives presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor in connection with any default in the payment of, or any enforcement of the payment of, all amounts due hereunder. To the extent permitted by law, Borrower waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect.

Following the occurrence of any event of default, Borrower will pay upon demand all costs and expenses (including all amounts paid to attorneys, accountants, and other advisors employed by Lender), incurred by Lender in the exercise of any of its rights, remedies or powers hereunder with respect to such event of default, and any amount thereof not paid promptly following demand therefore shall be added to the principal sum hereunder and will bear interest at the contract rate set forth herein from the date of such demand until paid in full. In connection with and as part of the foregoing, in the event that this Note is placed in the hands of an attorney for the collection of any sum payable hereunder, Borrower agrees to pay reasonable attorneys' fees for the collection of the amount being claimed hereunder, as well as all costs, disbursements and allowances provided by law.

If for any reason one or more of the provisions of this Note or their application to any entity or circumstances shall be held to be invalid, illegal or unenforceable in any respect or to any extent, such provisions shall nevertheless remain valid, legal and enforceable in all such other respects and to such extent as may be permissible. In addition, any such invalidity, illegality or unenforceability shall not affect any other provisions of this Note, but this Note shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

This Note inures to the benefit of Lender and binds Borrower and Lender's and Borrower's respective successors and assigns, and the words "Lender" and "Borrower" whenever occurring herein shall be deemed and construed to include such respective successors and assigns.

This Promissory Note is one of the promissory notes referred to in the Financial Services Agreement dated as of June 15, 2000 between Borrower and Lender to which reference is made for a statement of additional rights and obligations of Lender and Borrower.





IN WITNESS WHEREOF, Borrower has executed this Promissory Note the day and year first written above.

Arizona – American Water Company

By: RFLOWN . ROBERT D. BLOOR
Name and Title: V.P. FINANCE



C

Arizona American Water Company
Pro Forma Balance Sheet

	2005	Debt Maturities	Goodwill Write-off	Equity Infusion and Debt Financing	Pro Forma 2005
ASSETS					
Utility Plant	521,206,065			46,000,000	567,206,065
Construction work in progress	53,657,402				53,657,402
Accumulated depreciation	(106,107,261)				(106,107,261)
Utility plant acquisition adjustment	30,318,303				30,318,303
Other utility plant adjustments	-				-
Sub-total Utility Plant	499,074,509	-	-	46,000,000	545,074,509
Non-Utility property	111,151				111,151
Other investments	37,286,237		(33,413,033)		3,873,204
Current Assets					
Cash and cash equivalents	1,932,319				1,932,319
Temporary investments	-				-
Customer accounts receivable	3,838,527				3,838,527
Allowance for uncollectible accounts	(97,466)				(97,466)
Unbilled revenues	3,985,400				3,985,400
FIT refund due from assoc. companies	4,554,302				4,554,302
Miscellaneous receivables	4,642,640				4,642,640
Materials and supplies	247,594				247,594
Other	404,310				404,310
Sub-total	19,507,626	-	-	-	19,507,626
Deferred debits					
Debt and preferred stock	431,476				431,476
Expense of rate proceeding	468,459				468,459
Prelim survey & invest charges	207,055				207,055
Reg Asset-income tax recovery	1,546,335				1,546,335
Other	15,005,173				15,005,173
Sub-total	17,658,498	-	-	-	17,658,498
Total Assets	573,638,021	-	(33,413,033)	46,000,000	586,224,988
CAPITAL AND LIABILITIES					
Common Stock	522,880				522,880
Paid in capital	114,468,228			35,000,000	149,468,228
Retained Earnings	1,258,631		(24,364,784)		(23,106,153)
Total common equity	116,249,739	-	(24,364,784)	35,000,000	126,884,955
Preferred stock	-				-
Tolleson obligation	8,560,000				8,560,000
Long term debt	198,757,395	(158,448,119)		165,488,119	205,797,395
Total capitalization	323,567,134	(158,448,119)	(24,364,784)	200,488,119	341,242,350
Current liabilities					
Bank debt	30,003,138			3,960,000	33,963,138
Current portion of LTD	16,050				16,050
Accounts Payable	15,251,593				15,251,593
Taxes accrued	2,348,023		(9,048,249)		(6,700,226)
Interest accrued	1,265,593				1,265,593
Customer deposits	67,683				67,683
Dividends declared	-				-
Other	5,773,831				5,773,831
Sub-total	54,725,911	-	(9,048,249)	3,960,000	49,637,662
Deferred credits					
Customer adv. for construction	160,474,919				160,474,919
Deferred income taxes	6,840,208				6,840,208
Deferred investment tax credits	67,546				67,546
Reg.liab-inc.tax.refund thru rates	241,674				241,674
Other	7,260,755				7,260,755
Sub-total	174,885,102	-	-	-	174,885,102
Contributions in aid of construction	20,459,874				20,459,874
Total capital and liabilities	573,638,021	(158,448,119)	(33,413,033)	204,448,119	586,224,988

D

Arizona American Water Company
Income Statement
Pro Forma 2005

	2005	Debt Financings	Pro Forma 2005
OPERATING REVENUES			
Water	37,508,706		37,508,706
Sewer	13,101,146		13,101,146
Other	5,084,269		5,084,269
Management	-		-
Total Revenue	55,694,121	-	55,694,121
OPERATIONS & MAINTENANCE EXPENSE			
Labor	5,397,770		5,397,770
Purchased Water	2,306,858		2,306,858
Fuel & Power	5,641,612		5,641,612
Chemicals	452,422		452,422
Waste Disposal	2,310,381		2,310,381
Management Fees	8,286,010		8,286,010
Group Insurance	931,924		931,924
Pensions	139,600		139,600
Regulatory Expense	187,926		187,926
Insurance Other Than Group	920,259		920,259
Customer Accounting	919,071		919,071
Rents	316,016		316,016
General Office Expense	1,655,114		1,655,114
Miscellaneous	2,994,867		2,994,867
Other Maintenance	1,167,679		1,167,679
Total Maintenance & Operations Expense	33,627,509	-	33,627,509
Depreciation	14,394,948		14,394,948
Amortization	300,354		300,354
General Taxes	2,363,298		2,363,298
State Income Taxes	(377,412)		(377,412)
Federal Income Taxes	(1,520,906)	(801,625)	(2,322,531)
Tax Savings Acquisition Adjustment	-		-
Total Operating Expenses	48,787,791	(801,625)	47,986,166
Utility Operating Income	6,906,330	801,625	7,707,955
OTHER INCOME & DEDUCTIONS			
Non-Operating Rental Income	-		-
Dividend Income-Common	-		-
Dividend Income-Preferred	-		-
Interest Income	8,592		8,592
AFUDC Equity	1,923,424		1,923,424
M & J Miscellaneous Income	186,735		186,735
Gain(Loss)on Disposition	2,541,849		2,541,849
Total Other Income	4,660,600	-	4,660,600
Miscellaneous Amortization	-		-
Tax Savings Acquisition Adjustment	-		-
Misc. Other Deductions	3,224		3,224
General Taxes	-		-
State Income Taxes	190,502		190,502
Federal Income Taxes	956,883		956,883
Total Other Deductions	1,150,609	-	1,150,609
Total Other Income	3,509,991	-	3,509,991
Income Before Interest Charges	10,416,321	801,625	11,217,946
INTEREST CHARGES			
Interest on Long-Term Debt	9,856,003	2,960,211	12,816,214
Amortization and Debt Expense	45,333		45,333
Interest-Short Term Bank Debt	447,461		447,461
Other Interest Expense	(42,562)		(42,562)
AFUDC-Debt	(729,298)		(729,298)
Total Interest Charges	9,576,937	2,960,211	12,537,148
Net Income	839,384	(2,158,586)	(1,319,202)

Arizona American Water Company
Pro Forma Debt Service Coverage
and Times Interest Earned

	<u>2005</u>	<u>Pro Forma 2005</u>
Debt Service Coverage		
Income before Interest & Taxes	10,881,301	10,881,301
Depreciation	14,394,948	14,394,948
Amortization	300,354	300,354
Sub total	(A) <u>25,576,603</u>	<u>25,576,603</u>
Interest Charges	9,576,937	12,537,148
Principial repayments	14,857	14,857
Sub Total	(B) <u>9,591,794</u>	<u>12,552,005</u>
Debt Service Coverage A ÷ B	2.67	2.04
Times Interest Earned		
Income before Interest & Taxes	(C) 10,881,301	10,881,301
Interest Charges	(D) 9,576,937	12,537,148
Times Interest Earned C ÷ D	1.14	0.87

E

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR AUTHORITY TO IMPLEMENT ARSENIC COST RECOVERY MECHANISMS FOR ITS AGUA FRIA WATER, SUN CITY WEST WATER, HAVASU WATER, AND TUBAC WATER DISTRICTS

DOCKET NO. W-1303A-05-0280

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS SUN CITY WEST WATER AND WASTEWATER DISTRICTS.

DOCKET NO. WS-01303A-02-0867

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS MOHAVE WATER DISTRICT AND ITS HAVASU WATER DISTRICT.

DOCKET NO. W-1303A-02-0869

**ARIZONA-AMERICAN WATER
COMPANY'S COMPLIANCE
FILING OF EQUITY PLAN**

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER DISTRICT, ITS AGUA FRIA WATER DISTRICT, AND ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT.

DOCKET NO. WS-01303A-02-0870

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**ARIZONA-AMERICAN WATER COMPANY'S
COMPLIANCE FILING OF
EQUITY PLAN**

Commission Decision No. 68310 in the above-captioned dockets ordered Arizona-American Water Company ("Arizona-American" or the "Company") to "file a plan with Docket Control by December 31, 2005, that describes how Arizona-American expects to attain and maintain a capital structure (equity, long-term debt and short-term debt) with equity representing between 40 and 60 percent of total capital." This filing is submitted in compliance with that Decision.

The Company shares the Commission's goal of attaining and maintaining at least a 40% equity ratio and, hence the Commission's and Arizona-American's interests are largely aligned on this issue.

The Company's specific target is to reach and maintain an equity ratio of 40% (or somewhat higher) before the end of Arizona-American's current business planning period, December 31, 2010. The Company will likely temporarily reach 40% prior to 2010, but it will have difficulty maintaining that ratio until 2009, given known upcoming capital expenses, customer refunds, and regulatory lag associated with timing of capital expenses and rate cases.

1 The Company will be unable to reach an equity ratio of 50% or higher during this period
2 and is unlikely to exceed 45%.

3 As of November 30, 2005, the Company's capital structure was 34.1% equity (\$115.3
4 million), 57.5% long-term debt (\$194.3 million) and 8.4% short-term debt (\$28.3 million).

5 **Financial Variables.** Four financial variables directly influence Arizona-American's
6 equity ratio:

- 7 1. **Debt Financings.** (Issuing debt decreases the equity ratio.) Arizona-American must
8 obtain new debt to support its significant capital plan and borrowed \$25 million in late
9 2004 to fund its new arsenic facilities. The Company has approximately \$159 million in
10 outstanding debt maturing November 2006 that it must refinance. The Company may
11 also have other refinancing in 2006 as well as \$15 million in new debt associated with
12 new capital expenses.
- 13 2. **Earnings.** (Greater earnings support an increased equity ratio.) However, as discussed
14 below, there are a number of constraints on Arizona-American's ability to generate
15 earnings – resolution of which is at the core of the Company's plan.
- 16 3. **Dividends versus Retaining Earnings.** (Paying dividends decreases retained earnings and
17 reduces the equity ratio.) Arizona-American has not paid a dividend since 2003 and does
18 not expect to pay a dividend until it reaches / maintains a 40% equity ratio. Commission
19 conditions earlier placed upon the Company require cessation of dividends upon a 35%
20 equity ratio and an equity infusion upon a 30% equity ratio.
- 21 4. **Equity Infusions.** (Infusing equity raises the equity ratio). Company management is
22 seeking approval in December 2005 from the Arizona American Water and American
23 Water Works Boards of Directors for an equity infusion of up to \$35 million in 2006.

1 Since approval of both Boards is necessary, the Company does not fully control the
2 outcome of this request. Please note that Arizona-American faces significant competition
3 with regulated affiliates in other jurisdictions whose rate-setting methodologies are
4 presently more favorable. Arizona-American's allowed return on equity is currently the
5 lowest among the 23 states in which American Water and its regulated affiliates operate.
6 If approved, the Company expects to use this equity infusion to retire short-term debt.
7 The Company does not believe that Commission approval for an equity infusion is
8 required. Therefore, unless the Company learns otherwise, it will not be seeking
9 Commission approval for the 2006 equity infusion.

10 **Earnings Constraints.** There are several constraints on Arizona-American's ability to
11 increase earnings and improve its equity ratio:

- 12 • Enormous capital expenses required to serve our customers over the five-year planning
13 horizon relative to existing rate base;
- 14 • Regulatory lag, which often delays Arizona-American's ability to earn on sunk capital;
- 15 • Legacy issues resulting from Arizona-American's acquisition of Citizens Utilities' water
16 districts;
- 17 • Present rates set too low for Arizona-American to earn its authorized return during the
18 period rates were / are in effect; and
- 19 • An existing three-year rate filing moratorium (expires January 2006), which constrained
20 Arizona-American's ability to rectify under-earnings during the moratorium period.

21 For these and other reasons, Arizona-American can only make slow and uneven progress
22 towards reaching and maintaining at least a 40% equity ratio. The first step is for Arizona-
23 American to halt the immediate decline in its equity ratio.

1 **EQUITY PLAN.**

2 Given these factors, Arizona-American's proposed equity plan follows:

3 1. **ACRM and Fire Flow Implementation.** To prevent equity erosion, Arizona
4 American must timely implement ACRM surcharges, hook-up fees, and fire-flow surcharges,
5 and their subsequent Step rate increases in Sun City West, Agua Fria, Havasu, and Paradise
6 Valley water districts.

7 2. **New Rate Cases.** To improve earnings and increase the equity ratio Arizona-
8 American plans to file a series of new rate cases starting on or after January 12, 2006 (as the
9 existing 3-year rate moratorium expires on January 11, 2006). Arizona-American has tentatively
10 scheduled filing the following rates cases:

11 District	11 Filing Date:
12 Mohave - Water and Wastewater	12 January 2006
13 Anthem - Water	13 April 2006
14 Sun City - Wastewater	14 April 2006
15 Sun City West - Wastewater	15 April 2006
16 Agua Fria - Water	16 April 2007
17 Sun City - Water	17 April 2007
18 Sun City West - Water	18 April 2007
19 Tubac - Water	19 April 2007
20 Havasu - Water	20 April 2007
21 Anthem / Agua Fria - Wastewater	21 April 2007
22	22
23	23

24 With the exception of Paradise Valley, for which pending requests include both ACRM
25 and public safety surcharges, virtually all these districts should repeat this filing cycle two years
26 later (April 2008 and April 2009) due to planned capital expenses. This schedule is dynamic and
27 will be updated periodically as events emerge and conditions dictate.

28 Arizona American will continue to hire qualified Rate Department personnel when it can
29 to both support this currently-planned magnitude of rate case filings, and manage regulatory

1 expenses. We will periodically present to Commission Staff Arizona-American's five-year
2 capital-expenditure plan for informational and planning purposes.

3 3. **Hypothetical Capital Structures.** To help improve equity ratios, each of these
4 upcoming rate cases will be based on a hypothetical capital structure, which assumes a 40% or
5 greater equity ratio, even though the actual equity ratio will be less. The Commission has
6 previously approved hypothetical capital structures for Southwest Gas and Tucson Electric
7 Power, for the explicit purpose of improving actual equity ratios over time.

8 4. **Improved Returns on Equity.** As mentioned above, a significant challenge to
9 attracting equity investment for Arizona-American is that the Commission's allowed returns on
10 equity are the lowest allowed by any Commission in the 23 states where Arizona-American and
11 its regulated affiliates operate. Arizona-American intends to continue to press the case for higher
12 equity returns in every available forum.

13 5. **Rate Base for Citizens Plant.** Consistent with Decision No. 63584, in future rate
14 cases for all former Citizens districts, rate base will be increased based on earlier approved rate
15 treatment of advances in aid of construction and contributions in aid of construction retained by
16 Citizens. Any acceleration of the amortization of these advances and contributions would
17 contribute to the Company's equity plan. In the upcoming Mohave rate cases, consistent with
18 Decision No. 63584, the Company will request amortization through the period January 2007,
19 the date new rates are proposed to be in effect.

20 6. **Recovery of Citizens Acquisition Premium.** Arizona-American will request
21 recovery in future rate cases of portions of the Citizens acquisition premium in those districts
22 where it can demonstrate it meets the Commission's threshold net benefits standard.

1 7. Reduced Capital Investment and Improved Operating Efficiency. Arizona-
2 American will continue its increased emphasis on reducing future capital expenses and on
3 improving efficiency. As an initial step, any project categorized as “discretionary” has been
4 removed from the capital plan unless accompanied by an explicit and viable regulatory-recovery
5 plan. For example, the Paradise Valley fire flow-improvements remain in the plan as Arizona-
6 American believes its pending request for a Public Safety surcharge is viable as evidenced by
7 express community support and the Commission’s recent approval (Decision No. 68303) of a
8 deferral of depreciation and post in-service AFUDC on nearly \$3 million of fire-flow investment
9 now in service in Paradise Valley. By contrast, the Sun City fire flow project has been removed
10 from the Company’s capital plan because of the lack of community support for recovery of the
11 costs of this project.

12 Arizona-American’s total net capital expense plan, approved November 2005, for the
13 period 2006 through 2010 is still substantial - \$206 million. The Company will continue to
14 examine the criteria for each project in the plan with an eye towards further reductions.

15 8. Approval of White Tanks Water Capital Lease. As part of capital expense
16 reviews, Arizona-American learned it could not obtain corporate financing for the proposed
17 White Tanks Regional Treatment Plant to be located in its Agua Fria district. As a result,
18 Arizona-American has filed a request at the Commission for a series of approvals supporting a
19 capital lease with Maricopa Water District for a regional facility that MWD will build and own.
20 Commission approval of this request will support improvement in the Company’s equity ratio by
21 reducing regulatory lag.

22 9. Reducing Advanced Plant and Associated Depreciation Expense. Large
23 portions of utility plant are funded by developer advances. Initially, this plant is considered to be

1 an advance in aid of construction, with no return on the advanced investment, but subject to
2 depreciation. Over time, a portion of the cost of this plant is refunded to developers, at which
3 time the plant is added to rate base. Any portion of a plant not refunded is transferred to a
4 contribution account. At that time, the depreciation expense ceases on transferred balances and
5 the previous cumulative depreciation is reversed.

6 In a rapidly growing area like Arizona-American's Agua Fria District, the annual
7 depreciation expense on plant that will ultimately be classified as contributed plant significantly
8 depresses reported earnings under GAAP. The Company estimates that between 50% to 75% of
9 all advanced plant eventually becomes contributed plant. We propose to jointly evaluate this
10 issue with Staff and determine whether an accounting order could help reduce depreciation
11 expense (and the rates needed to recover this expense) and boost earnings.

12 10. **Treatment of Anthem Refunds.** Arizona-American forecasts refunding over
13 \$30 million in advances to Del Webb in its Anthem water and waste water districts in July 2007.
14 The rate case the Company will file for the water district in April 2006 will provide the
15 Commission creative and well supported proposals to proactively address this issue. Given the
16 large magnitude of these future refunds, the Company's equity ratio will likely decline
17 temporarily upon making them.

18 11. **Tubac Arsenic Remediation.** Arizona-American will endeavor to timely resolve
19 the Tubac arsenic issue in a manner acceptable to the community and consistent with the revised
20 compliance deadline of December 2007. However, to date the Company has invested \$300,000
21 for vessels to support a central arsenic treatment facility. This prudent investment must be
22 recovered to prevent further equity erosion. Arizona-American is open to creative solutions to
23 minimize rate shock in Tubac in upcoming filings.

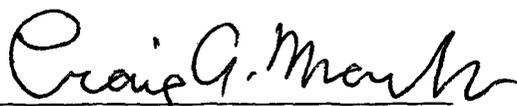
1 Conclusion

2 Arizona-American's plan is to reach and maintain, and perhaps somewhat exceed a 40%
3 equity ratio by December 31, 2010. Arizona-American believes that it can ultimately achieve
4 and maintain this 40% equity ratio. This will require Commission support, although we will not
5 be asking for anything inconsistent with Commission precedent. To that end, the Company will
6 be asking the Commission for a number of specific approvals that are needed to reach our shared
7 goal of at least a 40% equity ratio.

8 As the above discussion illustrates, Arizona-American's first priority is to halt the
9 existing erosion of equity caused by poor earnings by successfully implementing the ACRM and
10 Paradise Valley rate increases and by filing new rate cases.

11 Progress towards maintaining a 40% equity ratio in 2006 through 2008 will be difficult
12 because of known upcoming events, such as the \$30 million advance refund in Anthem. Hence,
13 while Arizona-American may temporarily reach a 40% equity ratio in 2006, it will be
14 challenging to maintain that ratio in 2007 and 2008.

15
16 RESPECTFULLY SUBMITTED on November 30, 2005.

17 

18 Craig A. Marks
19 Corporate Counsel
20 Arizona-American Water Company
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23 Phoenix, Arizona 85024
24 (623) 445-2442
25 Craig.Marks@amwater.com
26
27

1 Original and 19 copies filed
2 on November 30, 2005, with:
3
4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007
8
9 Copies of the foregoing
10 mailed on November 30, 2005, to:
11
12 Dwight Nodes
13 Assistant Chief Administrative Law Judge
14 Arizona Corporation Commission
15 1200 West Washington St.
16 Phoenix, Arizona 85007
17
18 Legal Division
19 Arizona Corporation Commission
20 1200 West Washington St.
21 Phoenix, Arizona 85007
22
23 Daniel Pozefsky
24 Counsel
25 Residential Utility Consumer Office
26 1110 West Washington Street
27 Suite 220
28 Phoenix, Arizona 85007
29
30 Walter W. Meek
31 Arizona Utilities Investors Association
32 P.O. Box 34805
33 Phoenix, Arizona 85067-4805
34

35
36
37 By: *Courtney Appelans*
38 Courtney Appelans
39
40

F

**CERTIFICATE OF RESOLUTION
ARIZONA-AMERICAN WATER COMPANY**

Patricia A. Lyman, Secretary of Arizona-American Water Company, hereby certifies that the following is a true and correct copy of a resolution duly adopted by the Board of Directors at their meeting held on April 13, 2006, in accordance with law and the Bylaws of said Corporation, that said resolution has not been amended and that it is still in full force and effect:

RESOLVED, that the borrowing of up to One-hundred-seventy-four Million Dollars (\$174,000,000) from American Water Capital Corporation ("AWCC") to pay off \$158.4 million in maturing debt and to fund up to \$15.6 million in new capital projects is hereby authorized and approved and deemed advisable and in the best interests of the Company and its stockholders; and

RESOLVED, that the President and Treasurer of the Company are authorized to execute and enter into the Note to borrow One-hundred-seventy-four Million Dollars (\$174,000,000) on terms and conditions deemed acceptable by such Officers;

RESOLVED FURTHER, that the Officers of the Company are hereby authorized and empowered to apply for and obtain any approvals required for said borrowing from the Arizona Corporation Commission or any other regulatory authority and are further authorized to retain the services of outside legal counsel as required to advise in the negotiation, consummation, or regulatory approval of the borrowing.

RESOLVED FURTHER, that the Officers of the Company be, and each of them hereby is, authorized and directed to do and perform, or cause to be done and performed, all such acts, deeds and things and to make, execute and deliver or cause to be made, executed and delivered all such agreements or documents in the name and on behalf of the Company or otherwise as each such officer may deem necessary or advisable to effectuate or carry out fully the purpose and intent of the foregoing resolutions, without further authority or approval by

the Board of Directors of the Company, the taking of any such actions and the execution and delivery of such agreements and documents to be conclusive evidence of the authority therefore.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the corporate seal of Arizona-American Water Company this 24th day of April, 2006.


Patricia A. Lyman
Secretary

G

NEW ISSUE-BOOK ENTRY ONLY

In the opinion of Bond Counsel, under existing laws, regulations, rulings and judicial decisions, and assuming continuing compliance with certain restrictions, conditions and requirements by the City of Tolleson Municipal Finance Corporation and the City of Tolleson as mentioned under "TAX MATTERS" herein, interest income on the Bonds (i) will be excluded from gross income for federal income tax purposes, except for the interest on any Bond for any period during which such Bond is held by a "substantial user" of any facility financed with the proceeds of the Bonds or a "related person" as such terms are used in Section 147(a) of the Internal Revenue Code of 1986 and (ii) will be exempt from Arizona income taxes. Interest income on the Bonds is not an item of preference to be included in alternative minimum taxable income of individuals and corporations for federal income tax purposes. See "TAX MATTERS" herein.

\$8,560,000

WEEKLY RATE BONDS

City of Tolleson Municipal Finance Corporation Revenue Refunding Bonds Series of 1998

Dated: Date of Issuance

Price: 100%

Due: May 1, 2015

The Bonds will be payable solely from moneys pledged therefor under the Refunding Indenture of Trust (the "Indenture") between the City of Tolleson Municipal Finance Corporation (the "Issuer") and Bank One, Arizona, NA (the "Trustee") including moneys derived from the sale by the Issuer to the City of Tolleson, Arizona (the "City") of certain sewage disposal facilities (the "Improvements") pursuant to a Facilities Sales Agreement (the "Facilities Sales Agreement") between the Issuer, as seller, and the City, as buyer. Payments of the purchase price of the Improvements by the City under the Facilities Sales Agreement are payable solely from certain revenues ("Rate Component One") received by the City pursuant to a Sewage Treatment and Transportation Services Agreement (the "Services Agreement") between the City and Sun City Sewer Company (the "Company"). Payments of Rate Component One, consisting of rates and charges calculated to be sufficient to pay the principal of, and interest on, the Bonds by the Company pursuant to the Services Agreement will be guaranteed by

CITIZENS UTILITIES COMPANY

Neither the Bonds, the Facilities Sales Agreement, the obligation of the City to make payments under the Facilities Sales Agreement, nor any of the agreements or obligations of the Issuer or the City shall be construed to constitute a debt or pledge of the full faith and credit of the City or the State of Arizona or any political subdivisions thereof within the meaning of any constitutional or statutory provision whatsoever. The Bonds are special limited obligations of the Issuer, payable only from the revenues received by the Issuer pursuant to the Facilities Sales Agreement, and the Bonds will not constitute an indebtedness or obligation to which the full faith and credit of the Issuer, the City or the State of Arizona is pledged and shall never constitute nor give rise to a pecuniary liability of the Issuer, the City or the State of Arizona or a charge against the general credit or taxing powers of the City or the State of Arizona or the general credit of the Issuer. The Issuer has no taxing power.

The Weekly Rate Bonds are issuable as fully registered bonds without coupons and, when issued, will be registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company ("DTC"). DTC will act as a securities depository for the Bonds. Individual purchases and sales of the Bonds may be made in book-entry form only in denominations of \$100,000 and integral multiples thereof (\$160,000 in the case of one Weekly Rate Bond), and, except under the limited circumstances described herein, beneficial owners of interests in the Bonds will not receive certificates representing their interest in the Weekly Rate Bonds. The principal of, premium, if any, interest on and purchase price of the Bonds will be paid through DTC and its Participants, and disbursements of such payments to beneficial owners will be the responsibility of such Participants (see "THE BONDS—Book-Entry-Only System" herein).

THE BONDS SHALL NOT BE DEEMED TO CONSTITUTE A DEBT OR LIABILITY OF THE ISSUER, THE CITY, THE STATE OF ARIZONA OR ANY POLITICAL SUBDIVISION THEREOF OR A PLEDGE OF THE FULL FAITH AND CREDIT OR TAXING POWER OF THE ISSUER, THE CITY, THE STATE OF ARIZONA OR ANY POLITICAL SUBDIVISION THEREOF. THE ISSUANCE OF THE BONDS SHALL NOT, DIRECTLY, INDIRECTLY OR CONTINGENTLY, OBLIGATE THE ISSUER, THE CITY OR THE STATE OF ARIZONA. THE ISSUER HAS NO TAXING POWER. THE BONDS ARE SPECIAL LIMITED OBLIGATIONS OF THE ISSUER.

This cover page, including the reverse hereof, contains certain information for quick reference only. It is not intended to be a summary of all factors relating to an investment in the Bonds. Investors should review the entire Official Statement before making any investment decision.

The Bonds are offered, subject to prior sale, when, as and if issued by the Issuer and accepted by the Underwriter, subject to certain conditions and the approval of legality. It is expected that delivery of the Bonds will be made on or about May 7, 1998, at The Depository Trust Company, New York, New York against payment therefor.

Lehman Brothers

Dated: May 4, 1998

Trustee and Paying Agent:
Bank One, Arizona, NA
201 N. Central Avenue, 25th Floor
Corporate Trust Division A-804
Phoenix, Arizona 85004
(602) 221-1196

Depository:
Bank One, Arizona, NA
c/o Bank One Trust Company, NA
Corporate Trust Operations OH1-0184
235 West Schrock Road
Westerville, Ohio 43081-0184
ATTN: Tender Unit
(614) 248-4856

Remarketing Agent:
Lehman Brothers Inc.
Public Finance Department
3 World Financial Center
200 Vesey Street, 9th Floor
New York, New York 10285-0900
(212) 528-1022

For each Weekly Rate Period following the date of issuance, the Interest Rate for the Bonds will be the rate of interest established for such Weekly Rate Period by the Remarketing Agent no later than 12:00 noon (New York City time) on each Wednesday, or if Wednesday is not a Business Day, the next succeeding Business Day, as being the minimum rate of interest necessary, in the best professional judgment of the Remarketing Agent taking into account prevailing market conditions, to enable the Remarketing Agent to sell all of the Weekly Rate Bonds in the secondary market at a price equal to the principal amount thereof, plus accrued interest to the date of settlement.

Under certain circumstances, Holders of the Bonds have the option to tender the Bonds for purchase at a purchase price equal to the principal amount thereof plus accrued interest, if any. The purchase price of Bonds is payable solely from amounts paid by the Company or from the proceeds from a remarketing of the Bonds. Obligations to purchase Bonds are solely obligations of the Company and are in no way to be construed to be obligations of the City or the Issuer. Neither the City nor the Issuer shall have any obligation to purchase tendered Bonds.

The method for establishing the Interest Rate borne by the Bonds is subject to Conversion to a different method, in the absence of a default, at the option of the Company, upon 10 days' notice to the Holders thereof. The Bonds are also subject to mandatory Conversion under certain circumstances, described herein, when such Conversion can be expected to result in a lower overall interest cost to the City. See, "**THE BONDS—Conversion Provisions; and —Mandatory Conversion**" herein. In the event the Bonds are converted, they shall be subject to mandatory purchase by Company on the Conversion Date at a purchase price equal to the principal amount thereof plus accrued interest, if any, unless Bondholders receive, at the Company's discretion, the option to waive such mandatory purchase as further described herein, and exercise that option (see, "**THE BONDS—Mandatory Purchases—Mandatory Purchase Upon Conversion**"). Such holders will accept the Interest Rate and other terms of the Bonds established pursuant to such conversion.

The information set forth herein has been obtained from Citizens Utilities Company ("Citizens") and other sources that are believed to be reliable, but it is not guaranteed as to accuracy and completeness and is not to be construed as a representation by the Underwriter or by the Issuer (except for information with respect to the Issuer under the headings, "**THE ISSUER**" and "**LITIGATION**") or by the City (except for information with respect to the City set forth under the heading "**THE CITY**"). The information and expression of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create the implication that there has been no change in the affairs of the Issuer, the City, the Company or Citizens or in any of the information set forth herein since the date hereof.

IN CONNECTION WITH THE OFFERING, THE UNDERWRITER MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SECURITIES OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

No person has been authorized to give any information or to make any representations other than those contained in this Official Statement in connection with the offers made hereby, and, if given or made, such information or representations must not be relied upon as having been authorized by the Issuer, the City, Citizens, the Company or the Underwriter. The information and expression of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer, the City, the Company or Citizens or in any of the information set forth herein since the date hereof. The Issuer has furnished only the information herein concerning it under the captions "**THE ISSUER—City of Tolleson Municipal Finance Corporation**" and "**LITIGATION**" and the City has furnished only the information herein concerning it set forth under the heading "**THE CITY**." Neither the Issuer nor the City has furnished or verified any other information contained in this Official Statement. Other information contained herein has been obtained from Citizens and other sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the Underwriter, the City or the Issuer.

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OFFICIAL STATEMENT

\$8,560,000

WEEKLY RATE BONDS

**City of Tolleson Municipal Finance Corporation
Revenue Refunding Bonds Series of 1998**

INTRODUCTORY STATEMENT

This Official Statement is provided to furnish certain information in connection with the issuance of \$8,560,000 aggregate principal amount of City of Tolleson Municipal Finance Corporation Revenue Refunding Bonds, Series of 1998 (the "Bonds"). The proceeds of the Bonds will be applied to the defeasance and redemption of the Bonds Being Refunded (as hereinafter defined). The Bonds will be secured by the Facilities Sales Agreement dated as of August 1, 1985 between the City of Tolleson Municipal Finance Corporation (the "Issuer") and the City of Tolleson, Arizona (the "City"), as amended by the Refinancing Supplement to the Facilities Sales Agreement dated as of May 1, 1998 (collectively, the "Facilities Sales Agreement"), pursuant to which the City has previously agreed to purchase the Facilities from the Issuer and to pay therefor a purchase price which includes the cost of paying Debt Service on the Bonds Being Refunded. To provide the funds for payment of Debt Service and other costs with respect to the Facilities, and, upon the issuance of the Bonds, the Debt Service on the Bonds, the City entered into a Sewage Treatment and Transportation Services Agreement with Sun City Sewer Company, an Arizona corporation (the "Company"), dated June 21, 1985, as amended by the Refinancing Supplement to the Sewage Treatment and Transportation Services Agreement dated as of May 1, 1998 (collectively, the "Services Agreement"), pursuant to which the Company has agreed to pay rates and charges in exchange for the City using the Facilities together with other sewer treatment facilities to provide sewer treatment and transportation services to the Company, including a charge sufficient to pay principal of, interest on, and costs relating to the Bonds ("Rate Component One"). To further secure the payments of the amounts due from the Company to the City pursuant to the Services Agreement, the parent corporation of the Company, Citizens Utilities Company, a Delaware corporation ("Citizens"), has executed and delivered to the City its Refinancing Guaranty dated May 1, 1998 (the "Guaranty"), by which Citizens has irrevocably, unconditionally and absolutely guaranteed the payment of the obligation of the Company to timely pay Rate Component One pursuant to the Services Agreement if not timely paid by the Company.

General

Brief descriptions of the Issuer, the City, the Facilities, the Bonds, and the Underwriter, all as defined herein, are included in this Official Statement. Descriptions of Citizens, the Company, the Indenture, the Facilities Sales Agreement, the Services Agreement and the Guaranty are set forth in Appendices attached hereto. Such descriptions do not purport to be comprehensive or definitive. All references herein to the Indenture, the Facilities Sales Agreement, and the Services Agreement, hereinafter described, are qualified in their entirety by reference to such documents, and references herein to the Bonds are qualified in their entirety by reference to the forms thereof included in the Indenture and the information with respect thereto included in the aforementioned documents, copies of all of which are available for inspection in the principal corporate trust office of the Trustee. During the period of the offering of the Bonds,

copies of such documents will also be available at the principal office of the investment banking firm listed on the cover page of this Official Statement (the "Underwriter"). Capitalized terms used in this Official Statement and not otherwise defined herein shall have the meanings attributed to them in "APPENDIX A—DEFINITIONS" attached hereto.

The Issuer has furnished only the information herein concerning it under the captions "THE ISSUER" and "LITIGATION." The City has furnished only the information herein concerning it as set forth under the heading "THE CITY," and neither the Issuer nor the City has furnished or verified any other information contained in this Official Statement. Other information contained herein has been obtained from Citizens and other sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness, and is not to be construed as a representation, by the Underwriter, the City or the Issuer.

Introduction to Interest Rates and Interest Periods

The Interest Rate and Interest Period for the Bonds will be determined by the designation of the particular Bond. There are seven designations: Daily Rate, Weekly Rate, Money Market (also referred to as Money Market Municipals), Demand Purchase, Adjustable Rate, Auction Rate and Fixed Rate, each of which bears interest at a specified rate during each of their respective Interest Periods.

Daily Rate Bonds and Weekly Rate Bonds. The Interest Rate for Daily Rate Bonds is fixed on each Business Day, and the Interest Rate for Weekly Rate Bonds is fixed at one-week intervals. Interest on both Daily Rate Bonds and Weekly Rate Bonds is payable monthly. The Holder of a Daily Rate Bond may require the purchase of such Bond on any Business Day by giving notice to the Depository by 10:00 a.m. (New York City time) on such Business Day. The Holder of a Weekly Rate Bond may require the purchase of such Bond on any Business Day by giving no less than seven days' telephonic notice to Bank One, Arizona, NA (the "Depository") prior to the Purchase Date, confirmed by written notice to the Depository not later than the third Business Day prior to the Purchase Date.

Money Market Bonds. The Interest Rate on Money Market Bonds is fixed for any given Money Market Period. A Money Market Period shall be from one to 270 days in duration and shall not extend beyond a Conversion Date or any date set for redemption. The Remarketing Agent will determine the Interest Rate and the duration of each Money Market Period on or before the first day of such Money Market Period. The first day next succeeding each Money Market Period shall be a Business Day. Interest on Money Market Bonds is payable on the first Business Day following the last day of each Money Market Period.

Demand Purchase Bonds. Demand Purchase Bonds bear interest for Demand Purchase Periods of at least 15 months and, generally, absent any election or determination by the Remarketing Agent to the contrary, roll over into a new Demand Purchase Period of a different duration (determined at or before the beginning of such succeeding Demand Purchase Period) and which, in general, must be at least 15 months in length or any integral multiple of three months in excess of 15 months at the same Interest Rate. The Demand Purchase Period for Demand Purchase Bonds will be established by the City pursuant to a City Direction. All Demand Purchase Bonds will be purchased on each Purchase Date, which will be the day after the end of each Demand Purchase Period (unless the Bondholder exercises the option, if any, to

waive purchase as hereinafter described). Interest on Demand Purchase Bonds is payable on May 1 and November 1 of each year.

Adjustable Rate Bonds. Adjustable Rate Bonds bear interest for Adjustable Rate Periods of at least 15 months. Absent any election or determination to the contrary by the Remarketing Agent or the City pursuant to a City Direction, Adjustable Rate Bonds will bear interest at a new Interest Rate for a succeeding Adjustable Rate Period of the same duration as the preceding Adjustable Rate Period. The Interest Rate for the Adjustable Rate Period will be established on or before the beginning of the new Adjustable Rate Period by the Remarketing Agent, taking into account prevailing market conditions. All Adjustable Rate Bonds shall be purchased at the principal amount thereof on each Purchase Date, which is also the day after the end of each Adjustable Rate Period (unless the Bondholder exercises the option, if any, to waive purchase as hereinafter described). Interest on Adjustable Rate Bonds is payable on May 1 and November 1 of each year.

Auction Rate Bonds. Auction Rate Bonds bear a designated Interest Rate during each Auction Period, and interest is payable (i) at the end of each Auction Period in the case of Short-Term Auction Rate Bonds and (ii) in the case of Long-Term Auction Rate Bonds, on each May 1 and November 1 during the Auction Period and at the end of each Auction Period. The Initial Auction Period will begin on the date of Conversion of the Bonds to an Auction Rate and will end on the day of the week specified by the City, pursuant to City Direction. After the Initial Auction Period, each subsequent Auction Period shall be of a designated duration established by the Market Agent or the City pursuant to a City Direction so as to be of a duration that will be beneficial to the City based upon prevailing market conditions. The Interest Rate for each Auction Period will be determined by implementing certain auction procedures provided for in the Indenture. See "THE BONDS—Auction Rate Bonds—Auction Procedures" herein.

Fixed Rate Bonds. Fixed Rate Bonds bear a fixed rate of interest (established by the Remarketing Agent) until stated maturity payable on May 1 and November 1 of each year.

Conversion. Bonds (other than Fixed Rate Bonds) will be subject to Conversion into any other mode of Bonds at any time when they are subject to purchase or optional redemption.

The foregoing is intended only as an introductory guide to differentiating the methods of determining Interest Rates and Interest Periods of the Bonds.

THE ISSUER

The City of Tolleson Municipal Finance Corporation (the "Issuer") is an Arizona non-profit corporation formed in 1984 for the purpose of financing the construction and acquisition of additions to and expansion of the City's municipal sewer system. In furtherance of this objective, the Issuer has the power to issue the Bonds and to enter into and consummate the transactions contemplated by the Indenture, the Facilities Sales Agreement, and the Services Agreement. The Issuer has no taxing power.

Pursuant to both its Articles of Incorporation and the Indenture, the Issuer is restricted from incurring indebtedness of any kind except for the indebtedness evidenced by the Bonds or any indebtedness issued to refund or refinance the Bonds, or indebtedness which is to be paid out of available proceeds from the sale of other bonds issued under the Indenture, or indebtedness

which the City is required to pay under the terms of the Facilities Sales Agreement, or additional indebtedness issued to obtain funds needed to complete the acquisition and construction of the Facilities.

The Bonds will be special limited obligations of the Issuer.

THE CITY

The City of Tolleson was founded in 1912 by W. G. Tolleson. Located in the southwest portion of Maricopa County, the City was incorporated as a town in 1929 and became a city under the laws of the State of Arizona in 1956. The City, which encompasses approximately six square miles, is situated about 10 miles west of the downtown business district of the City of Phoenix, Arizona. The City is part of the greater Phoenix Metropolitan area, which is the principal economic, political, and population center in Arizona. The City's 1997 estimated population of 4,505 has remained very stable over the last ten years and has shown slight growth over the past 30 years.

THE FACILITIES

The Facilities originally financed with the proceeds of the Bonds Being Refunded are described in the Facilities Sales Agreement and include various systems and facilities to expand the Sewage Treatment and Transportation Facilities of the City.

USE OF PROCEEDS

The principal amount of the Bonds Being Refunded, which were issued to finance the Facilities, was \$13,810,000, of which amount \$8,860,000 remains outstanding, and will be paid, together with any interest accrued thereon, from the proceeds of the Bonds plus certain monies on deposit in the revenue fund created and held under the indenture pursuant to which the Bonds Being Refunded were issued. The proceeds of the Bonds, together with other funds, are expected to be used to defease the Bonds Being Refunded, to pay certain underwriting costs and to pay legal, printing and other issuance and administrative expenses.

THE BONDS

Dating, Maturity and Authorized Denominations

The Bonds initially will be dated as of their original date of issuance. The Bonds will mature, subject to prior redemption, on May 1, 2015.

The Bonds will be fully registered bonds without coupons and will be issuable in the following authorized denominations: (i) Variable Rate Bonds (as hereinafter defined) in minimum denominations of \$100,000 (\$160,000 in the case of one Variable Rate Bond), and integral multiples thereof (ii) Adjustable Rate Bonds, Demand Purchase Bonds and Fixed Rate Bonds in minimum denominations of \$5,000 and integral multiples thereof, and (iii) Auction Rate Bonds in minimum denominations of \$100,000 (\$160,000 in the case of one Auction Rate Bond), and integral multiples thereof.

Interest Mode and Designation of Bonds at Time of Sale

The Bonds will initially be offered as Weekly Rate Bonds and will bear interest as provided herein. See "THE BONDS—Weekly Rate Bonds—*Determination of Interest Rate.*" The Bonds will be subject, from time to time, to Conversion of the method for establishing the Interest Rate and the related Interest Periods, Purchase Dates and Interest Payment Dates to another method permitted under the Indenture. See "THE BONDS—*Conversion Provisions.*" The Bonds (other than Fixed Rate Bonds) will be subject to Conversion to Daily Rate Bonds, Weekly Rate Bonds, Money Market Bonds, Demand Purchase Bonds, Long-Term Auction Rate Bonds, Short-Term Auction Rate Bonds, Adjustable Rate Bonds, and Fixed Rate Bonds, as described herein.

Place and Manner of Payments on Bonds

If the Bonds are not in book-entry form, the purchase price of the Bonds shall be payable at the principal office of the Depository. The principal of and premium, if any, on the Bonds at the stated Maturity Date will be paid upon presentation and surrender of the Bonds at the principal office of the Paying Agent or at the principal office of any co-paying agent. Payments of purchase price of Variable Rate Bonds shall be in immediately available funds. Payments of purchase price of Adjustable Rate and Demand Purchase Bonds and of principal of the Bonds shall be in clearinghouse funds. Interest on Variable Rate Bonds is payable to the registered owner by wire transfer in immediately available funds if (i) the owner thereof owns at least \$1,000,000 in aggregate principal amount of the Bonds and (ii) the owner has provided the Paying Agent with a wire address. Interest on all other Bonds shall be paid by check mailed to the registered owner.

If the Bonds are in book-entry form, payment of the principal of the Bonds at the stated Maturity Date shall be made upon the presentation and surrender of the Bond or Bonds at the principal office of the Paying Agent or any co-paying agent. All payments of interest and premium, if any, on, and of principal upon redemption of, the Bonds shall be paid through the securities depository (together with any successor securities depository, the "Securities Depository") in accordance with its normal procedures, which now provide for payment by the Securities Depository to its participants and members in same-day funds.

Securities Depository

Unless a successor Securities Depository is designated pursuant to the Indenture, The Depository Trust Company ("DTC") will act as the Securities Depository for its members and participants (the "Agent Members") with respect to the Bonds. On the date of delivery of the Bonds offered hereby, the Bonds will be issued in a single global Bond in the denomination equal to the aggregate principal amount of the Bonds. It is anticipated that the Bonds will be registered in the name of Cede & Co., as nominee of DTC, and "immobilized" in the custody of the Trustee pursuant to the Fast Automated Securities Transfer System of DTC. Stop-transfer instructions will be issued to the Registrar and Paying Agent. The Securities Depository or its nominee will be the holder of record of all issued and outstanding Bonds, and beneficial owners of Bonds may not obtain physical possession of Bonds unless the Securities Depository resigns and no successor is appointed. In such event, beneficial owners may obtain physical possession of the Bonds beneficially owned by them.

DTC, a New York-chartered limited purpose trust company, performs services for its participants (including the Agent Members), some of whom (and/or their representatives) own DTC. DTC maintains lists of its participants and will maintain the positions (ownership interests) held by each Agent Member in the Bonds, whether for its own account or as a nominee. Each beneficial owner of Bonds must make arrangements with its Agent Member to receive notices and payments with respect to the Bonds. None of the Trustee, the Registrar and Paying Agent, the Company, the City, Citizens or the Issuer shall have any responsibility with respect to the accuracy of the records of the Securities Depository or any Agent Member as to the beneficial ownership of Bonds or the delivery of either notices or payment to any party other than the Securities Depository or its nominee as registered owner of the Bonds. See "THE BONDS—Book-Entry-Only System.").

Trustee; Registrar; Paying Agent; Depository; Principal Corporate Offices

Bank One, Arizona, NA, is Trustee under the Indenture. Bank One, Arizona, NA, has also been appointed Registrar and Paying Agent under the Indenture in respect of the Bonds. The principal corporate trust office of the Bank One, Arizona, NA, is 201 N. Central Avenue, 25th Floor, Phoenix, Arizona 85004. Bank One, Arizona, NA, is also Depository under the Indenture in respect of the Bonds. The designated corporate trust office of Bank One, Arizona, NA, in its capacity as Depository is c/o Bank One Trust Company, NA, Corporate Trust Operations, OH1-0184, 235 West Schrock Road, Westerville, Ohio 43081-0184, Attention: Tender Unit, (614) 248-4856. If, for any reason, the Bonds are no longer held by DTC, an alternate New York depository will be designated. One or more co-paying agents may be appointed by the City, and the Registrar, the Paying Agent and any Co-Paying Agent shall be removed or replaced at any time by the City by a written instrument filed with the Registrar, the Paying Agent or such Co-Paying Agent, as the case may be, the Trustee.

Remarketing Agent; Market Agent

Lehman Brothers Inc. has been appointed the Remarketing Agent of the Bonds (the "Remarketing Agent") and also as Market Agent (the "Market Agent"). At any time that the Bonds bear interest at an Auction Rate, the Remarketing Agent is referred to as the Market Agent. Its principal office is at 3 World Financial Center, 200 Vesey Street, 9th Floor, New York, New York, 10285-0900, Attention: Short-Term Municipal Department. The Remarketing Agent may be removed by the City, pursuant to a City Direction, in accordance with the Indenture, upon written notice signed by the City and filed with the Remarketing Agent, the Issuer and the Trustee, and the Remarketing Agent may resign as hereinafter described. The City reserves the right to appoint Co-Remarketing Agents pursuant to a City Direction. See "THE BONDS—Remarketing of Bonds in Event of Repurchase or Conversion."

Auction Agent

The Auction Agent shall be (a) a bank or trust company duly organized under the laws of the United States of America or any state or territory thereof having a combined capital stock, surplus and undivided profits of at least \$20,000,000 or (b) a member of the National Association of Securities Dealers, Inc. having a capitalization of at least \$20,000,000 and, in either case, authorized by law to perform all the duties imposed upon it by the Indenture. The Auction Agent may at any time resign and be discharged of the duties and obligations created by the Indenture by giving at least 90 days' notice to, among others, the Issuer, the Trustee, the City,

the Paying Agent and the Market Agent. The Auction Agent may be removed by the Issuer, at the direction of the City, pursuant to a City Direction, in accordance with the Indenture, upon written notice signed by the Issuer and filed with the Auction Agent, Trustee, the Issuer, Paying Agent and Market Agent. The Auction Agent will be appointed upon a Conversion to Auction Rate Bonds.

In the event of the resignation or removal of the Auction Agent, the Auction Agent shall deliver any Bonds held by it in such capacity to its successor or, if there be no successor, to the Trustee.

Interest Rates and Interest Periods

Interest Payable After Conversion. The Bonds will initially bear interest as Weekly Rate Bonds, as described below. Thereafter, upon Conversion, if any, the Bonds will bear interest as Auction Rate Bonds, Daily Rate Bonds, Money Market Bonds, Demand Purchase Bonds, Adjustable Rate Bonds or as Fixed Rate Bonds pursuant to a City Direction as described below. Interest payable on the Bonds (other than Auction Rate Bonds) will never exceed a rate equal to the lesser of 15% per annum or the maximum rate permitted by applicable state law as the same may be modified by United States law applicable to the Bonds or any other applicable law. Interest payable on Auction Rate Bonds shall never exceed the Maximum Auction Rate as defined in the Indenture.

Interest Payments on Variable Rate Bonds; Computation of Interest on All Bonds. Interest on Variable Rate Bonds or Bonds bearing a Short-Term Auction Rate will be paid in arrears for each preceding Interest Period or Auction Period on each Interest Payment Date and will be computed on the basis of a year of 365 or 366 days, as appropriate, and paid for the actual number of days elapsed. Interest on Adjustable Rate Bonds, Demand Purchase Bonds, Fixed Rate Bonds or Bonds bearing a Long-Term Auction Rate will be paid in arrears for each Interest Period and on each Interest Payment Date and will be computed on the basis of a 360-day year of twelve 30-day months.

Promptly after each Interest Payment Date for the Auction Rate Bonds, and in any event at least seven days prior to the next Interest Payment Date for the Auction Rate Bonds following such Interest Payment Date (unless a shorter period is consented to by the Auction Agent), the Trustee will advise the Auction Agent, so long as no Event of Default has occurred, of such next Interest Payment Date for the Auction Rate Bonds.

Weekly Rate Bonds

Determination of Interest Rate. The Remarketing Agent will set the Interest Rate for Weekly Rate Bonds at or before 12:00 noon (New York City time) on the first day of each Weekly Rate Period for such Weekly Rate Bonds which will be the minimum rate of interest necessary, in the best professional judgment of the Remarketing Agent taking into account prevailing market conditions, to sell all of the Weekly Rate Bonds in the secondary market at a price equal to the principal amount thereof plus accrued interest to the date of settlement.

If for any reason the Remarketing Agent fails to determine an Interest Rate for any Weekly Rate Bonds for one Weekly Rate Period, or for any reason such determination is held to be invalid or unenforceable by a court of law, the Interest Rate on Weekly Rate Bonds for such

Weekly Rate Period will be the Interest Rate on such Bonds during the next preceding Weekly Rate Period. If there is no such preceding Weekly Rate Period or if the Remarketing Agent fails to set an Interest Rate for a period of two or more consecutive Weekly Rate Periods, the Interest Rate for each such Weekly Rate Period will equal 65% of the 30-day dealer taxable commercial paper rate as most recently published by the Federal Reserve Bank of New York before such Weekly Rate Period, to be effective as of the first day of such Weekly Rate Period.

Interest Rate and Demand Purchase Period for Bonds Converted Into Demand Purchase Mode; Determination of Interest Rate if Remarketing Agent Fails To Set Rate. If Demand Purchase Bonds have been converted from Variable Rate Bonds, Auction Rate Bonds, or Adjustable Rate Bonds or from Demand Purchase Bonds bearing a different Demand Purchase Rate, the Interest Rate for the initial Demand Purchase Period following such Conversion shall be that annual rate of interest established by the Remarketing Agent on or before the Conversion Date (which is the first day of such Demand Purchase Period) as being the minimum rate necessary, in the best professional judgment of the Remarketing Agent taking into account prevailing market conditions, to enable Demand Purchase Bonds to be sold in a secondary market transaction on the Conversion Date at a price equal to the principal amount thereof. For Purchase Dates after such a conversion, the Interest Rate in effect before each Purchase Date shall be the Interest Rate for the next Demand Purchase Period, except as described below.

If the Remarketing Agent no longer determines, or fails to determine when required, an Interest Rate as prescribed in the Indenture, or if for any reason such manner of determination is held to be invalid or unenforceable by a court of law, the rate of interest for Demand Purchase Bonds for the next succeeding Demand Purchase Period will be equal to 75% of the rate listed in the table most recently circulated by the United States Treasury Department known as "Table [applicable dates shown on the most recent table], Maximum Interest Rates Payable On United States Treasury Certificates of Indebtedness, Notes and Bonds—State and Local Government Series Subscribed for During Period [applicable dates shown on the most recent table]" or any subsequent and substantially equivalent table circulated by the United States Treasury Department for the maturity most closely approximating the duration of the Demand Purchase Period.

Determination of Demand Purchase Period. The first Demand Purchase Period shall be such period designated upon Conversion of the Bonds to Demand Purchase Bonds. (I) For Demand Purchase Bonds which have been converted from Variable Rate Bonds, Auction Rate Bonds, Adjustable Rate Bonds or from Demand Purchase Bonds bearing a different Demand Purchase Rate, the initial Demand Purchase Period and related Purchase Date, and (II) for all other Demand Purchase Bonds, each next succeeding Purchase Date and related Demand Purchase Period, shall be established by the City, pursuant to a City Direction, on or within 90 days prior to the first day of such Demand Purchase Period, except as is otherwise provided in the following paragraph, provided that each such Demand Purchase Period shall (1) be 15 months in length (the "Minimum Demand Purchase Period") or any integral multiple of three months in excess of 15 months (except that if the first Demand Purchase Period following a Conversion commences on a Conversion Date other than a February 1, May 1, August 1 or November 1, such first Demand Purchase Period shall be of a duration as close as possible to the duration of the specified Demand Purchase Period), (2) terminate on the day prior to the May 1 or November 1 of the year in which the Demand Purchase Period ends, (3) terminate no later than April 30, 2015, and (4) be of such length as would produce, if the Bonds were to be

remarketed on the day of such Demand Purchase Period at (x) the Demand Purchase Rate established by the Remarketing Agent in the case of Bonds specified in clause (I) above or (y) the Interest Rate for the preceding Demand Purchase Period in the case of Bonds specified in clause (II) above, a price equal to the principal amount thereof. The City, pursuant to a City Direction, shall notify the Trustee and the Remarketing Agent in writing of the length of each new Demand Purchase Period on or before the first day of such period. Within five Business Days of its receipt of such notification, the Trustee shall notify all Holders by mail of such new Purchase Date and Demand Purchase Period.

Adjustment for Successive Period if Demand Purchase Rate for Previous Period Is Higher or Lower Than Market Conditions for Maximum or Minimum Periods; Final Demand Purchase Period; Minimum Demand Purchase Period. If, on or within 90 days prior to any Purchase Date, in the best professional judgment of the Remarketing Agent taking into account prevailing market conditions, the Demand Purchase Rate is greater than the market rate of interest for the Final Demand Purchase Period or such Demand Purchase Rate is lower than the market rate of interest for a Minimum Demand Purchase Period, the Remarketing Agent shall establish as the Demand Purchase Rate for such Final Demand Purchase Period or Minimum Demand Purchase Period, as the case may be, the lowest annual rate of interest which, in the best professional judgment of the Remarketing Agent, will enable the Demand Purchase Bonds to be sold in a secondary market transaction at the principal amount thereof. The Remarketing Agent shall notify the Company, the Guarantor, the City and the Trustee in writing of the new Demand Purchase Rate within five Business Days of the establishment thereof. The Trustee shall provide the Holders with written notice of the new Demand Purchase Rate and Demand Purchase Period applicable to Demand Purchase Bonds within five Business Days of the Trustee's receipt of the aforesaid notice from the Remarketing Agent. See "THE BONDS—Optional Redemption—Optional Redemption With Premium for Demand Purchase Bonds."

If more than 90% of Demand Purchase Bonds are retained by the Holders thereof if permitted by the City in accordance with the Indenture, and if the City, pursuant to a City Direction, so directs, the Remarketing Agent shall remarket such Demand Purchase Bonds not so retained at the price necessary, in the best professional judgment of the Remarketing Agent, having due regard for prevailing market conditions, to sell all of the Bonds promptly in a secondary market transaction at a rate of interest equal to the Demand Purchase Rate then in effect.

Money Market Bonds

Determination of Interest Rate; Money Market Period. The Remarketing Agent will set an annual rate of interest for each Money Market Bond on or prior to the first day of each Money Market Period. The Interest Rate for Money Market Bonds will be the Interest Rate necessary, in the best professional judgment of the Remarketing Agent, to enable such Money Market Bonds to be sold in a secondary market transaction on the first day of each Money Market Period at a price equal to the principal amount thereof.

In the event the Remarketing Agent no longer determines, or fails to determine when so required, or for any reason such manner of determination is held to be invalid or unenforceable by a court of law, the Interest Rate for Money Market Bonds will be equal to 60% of the Interest Rate applicable to 90-day United States Treasury Bills based on the average per annum discount rate at which such Treasury Bills sold at the most recent Treasury auction within the preceding

30 days. If there has not been such an auction, or if the Trustee shall fail or refuse to determine such Interest Rate, the Interest Rate for a Money Market Bond shall be equal to the Interest Rate borne by such Bond during the next preceding Interest Period for such Bond.

Determination of Money Market Period; Mandatory Purchase of Money Market Bonds; Purchase Date. A Money Market Period shall be from one to 270 days in duration and shall not extend beyond a Conversion Date or any date set for redemption. The first day next succeeding each Money Market Period must be a Business Day. Generally, the Money Market Periods will be selected as described below under "THE BONDS—Mandatory Purchases—Mandatory Purchase of Money Market Bonds." The Remarketing Agent will determine each next succeeding Purchase Date and the related Money Market Period for each Money Market Bond on or before the first day of such Money Market Period. The Purchase Date and Money Market Period will be selected, in the best professional judgment of the Remarketing Agent and taking into account prevailing market conditions, to produce the lowest overall interest cost until the maturity of the Bonds. If the Remarketing Agent fails to set a Money Market Period for a Money Market Bond, such Money Market Period and succeeding Money Market Periods for such Bond shall be that Money Market Period which results in each succeeding Purchase Date for such Bond being the first Business Day of the next calendar month until the Remarketing Agent again establishes a Money Market Period for such Bond.

Auction Rate Bonds

General. The Indenture provides that the Bonds may be converted to Auction Rate Bonds. Auction Rate Bonds are sold to investors with the Interest Rate thereon established for a specified Auction Period. The Interest Rate is subject to reset at the end of each Auction Period, and, at the end of each Auction Period, the Bonds may be offered for sale through the auction procedures described in the Indenture and briefly outlined below under the subcaption "*Auction Procedures.*"

Short-Term Auction Rate Bonds. A Short-Term Auction Rate Bond is any Auction Rate Bond having an Auction Period of 270 days or less, provided that each Short-Term Auction Period (i) shall not extend beyond a Conversion Date, a date set for redemption of such Bonds, or the Maturity Date of such Bonds, (ii) shall be subject to adjustment pursuant to the Indenture, and (iii) shall not be less than seven days without the consent of the Auction Agent.

Long-Term Auction Rate Bonds. A Long-Term Auction Rate Bond is any Auction Rate Bond having an Auction Period of more than 270 days, provided that each Long-Term Auction Period (i) shall not extend beyond a Conversion Date, a date set for redemption of such Bonds, or the Maturity Date of such Bonds and (ii) shall be subject to adjustment pursuant to the Indenture.

Auction Periods. Upon a Conversion to the Auction Rate, the City will designate, pursuant to a City Direction, the Initial Auction Period and the number of weeks to be in each subsequent Auction Period. The Initial Auction Rate for the first Auction Period subsequent to a Conversion Date will be established by the Market Agent, and the Auction Rate for each succeeding Auction Period will be reset on the last day of the Auction Period through the implementation of the Auction Procedures set forth below under "*Auction Procedures.*" The Initial Auction Rate for the Initial Auction Period will be that Interest Rate established by the Market Agent as being the Minimum Rate necessary, in the best professional judgement of the

Market Agent taking into account prevailing market conditions, for the Auction Rate Bonds to be sold in a secondary market transaction on the Conversion Date at a price equal to the principal amount thereof. The Market Agent will inform the Auction Agent of the applicable Auction Rate Index on each Auction Date.

The Market Agent may thereafter adjust a Short-Term Auction Period to another Short-Term Auction Period of different duration if, in the best professional judgment of the Market Agent, taking into account prevailing market conditions, such adjustment would be beneficial to the City by mailing notice to the Trustee, City, the Company, and Auction Agent at least 10 days before the end of the current Auction Period.

The Auction Rate Bonds may, at the option of the City pursuant to a City Direction, be converted from Short-Term Auction Rate Bonds to Long-Term Auction Rate Bonds, from Long-Term Auction Rate Bonds to Short-Term Auction Rate Bonds or from Long-Term Auction Rate Bonds to Long-Term Auction Rate Bonds of a different duration in accordance with the provisions set forth below under **"THE BONDS—Conversion Provisions."**

Notwithstanding the foregoing, each Auction Period shall end on the day of the week originally specified by the Market Agent or the City, pursuant to a City Direction as applicable, unless a different day of the week shall be established by the Market Agent or the City pursuant to a City Direction, as applicable, and, if any Auction Period upon application of the Period selected would end on a day other than such day (unless such day is the day preceding the final payment of the Bonds), the Auction Period shall be adjusted to end on the first day of the week originally specified by the Market Agent or the City pursuant to a City Direction, as applicable, preceding such day, provided that the end of the Auction Period shall be adjusted in the same manner as specified in the Indenture.

Auction Procedures. On or prior to the Submission Deadline on each Auction Date, owners of Auction Rate Bonds may submit to the Broker-Dealer (1) an election to hold such Bonds without regard to the new Auction Rate for the Auction Rate Bonds for the next succeeding Auction Period; (2) an offer to sell such Bonds if the new Auction Rate for the Auction Rate Bonds for the next succeeding Auction Period is lower than a rate specified by the owner; or (3) an offer to sell such Bonds without regard to the new rate for the Auction Rate Bonds for the next succeeding Auction Period (collectively, the "Orders"). Subject to certain provisions in the Indenture, orders submitted to the Broker-Dealers are irrevocable.

Each Broker-Dealer shall submit in writing to the Auction Agent prior to the submission deadline on each Auction Date for Auction Rate Bonds all Orders obtained by such Broker-Dealer for Auction Rate Bonds.

On each Auction Date all Auction Rate Bonds which are offered for sale will be auctioned and, if sufficient bids are received which are at or below the Maximum Auction Rate, will be sold on the basis of the best bids submitted. The bidding will be determined on the basis of Interest Rates, and the bids accepted will be those with the lowest Interest Rates in amounts sufficient to purchase all offered Bonds. The ability of owners to sell Auction Rate Bonds on such date will depend on the availability of sufficient qualifying bids.

Termination of Auction Procedures. If the Interest Rate on the Auction Rate Bonds is to be converted to another Interest Rate pursuant to the Conversion provisions in the Indenture, the

Auction Procedures shall be terminated on the Conversion Date. If an Event of Default shall have occurred, the Auction Procedures shall be terminated upon the Trustee's or the Auction Agent's receipt of notice of such Event of Default. Upon any termination of the Auction Procedures, and if the Bonds shall no longer be held in book-entry form by the Securities Depository, the Bonds shall, after such termination, be registered by the Registrar in such names as the Holders shall direct.

Interest Rates and Payment Dates. On each Auction Date, the Interest Rate on all Auction Rate Bonds will be reset as follows: (i) if sufficient Clearing Bids exist, the Auction Rate for the next succeeding Auction Period shall be equal to the Winning Bid Rate determined pursuant to the Indenture; (ii) if sufficient Clearing Bids do not exist (subject to certain exceptions), then (a) the Auction Rate for Short-Term Auction Rate Bonds for the next succeeding Auction Period (which shall be the shortest Auction Period then permissible) shall be equal to the Maximum Auction Rate, or (b) for Long-Term Auction Rate Bonds, the Long-Term Auction Period shall automatically be adjusted to a Short-Term Auction Period consisting of the shortest period then permissible under the Indenture, and the Auction Rate for the next succeeding Auction Period shall be equal to the Maximum Auction Rate, and thereafter each succeeding Auction Period shall remain at the shortest period then permissible subject to the Indenture; or (iii) if all owners of Auction Rate Bonds elect to retain their Bonds regardless of the new Auction Rate, the new Auction Rate shall be the Minimum Auction Rate designated at the time of conversion to the Auction Rate.

Interest on Short-Term Auction Rate Bonds will be paid on the day following the end of each Auction Period. Interest on Long-Term Auction Rate Bonds will be paid on May 1 and November 1.

Redemptions of Auction Rate Bonds. Auction Rate Bonds which are Short-Term Auction Rate Bonds are subject to optional redemption, in whole or in part, at the option of the City, pursuant to a City Direction, on any Interest Payment Date for such Bonds at a price equal to 100% of the principal amount thereof plus interest due thereon, upon 30 days' notice.

Auction Rate Bonds which are Long-Term Auction Rate Bonds may be redeemed in whole at any time or in part on any Interest Payment Date at the written direction of the City, pursuant to a City Direction, upon 30 days' notice, for such Bonds, except that such Bonds shall not be redeemable during a no-call period as set forth in the Indenture. Long-Term Auction Rate Bonds shall be redeemed at the prices established at the time of Conversion.

Daily Rate Bonds

Determination of Interest Rate. The Remarketing Agent will set the Interest Rate on Daily Rate Bonds on each Business Day at or before 12:00 noon (New York City time). Such Interest Rate will be the minimum rate of interest necessary, in the best professional judgment of the Remarketing Agent taking into account prevailing market conditions, to sell all of the Daily Rate Bonds on such Business Day in a secondary market transaction at a price equal to the principal amount thereof plus accrued interest thereon. For any day which is not a Business Day, Daily Rate Bonds will bear interest at the rate in effect for such Bonds during the next preceding Business Day.

If for any reason the Remarketing Agent fails to set a rate of interest for any Daily Rate Bonds, or for any reason such determination is held to be invalid or unenforceable by a court of law, such Daily Rate Bonds will bear interest at the rate last determined by the Remarketing Agent. If such failure continues for five Business Days, on the sixth Business Day and each day thereafter and until the Remarketing Agent resumes determination of the Interest Rates for such Daily Rate Bonds, the Interest Rate on each Business Day will be equal to 60% of the 30-day dealer taxable commercial paper rate announced on such Business Day for the next preceding Business Day by the Federal Reserve Bank of New York.

Adjustable Rate Bonds

Determination of Interest Rate. The Remarketing Agent shall set the annual Interest Rate for Adjustable Rate Bonds on or before the first day of each Adjustable Rate Period. The Interest Rate for each Adjustable Rate Period will be the minimum rate necessary, in the best professional judgment of the Remarketing Agent and taking into account prevailing market conditions, to sell the Adjustable Rate Bonds in a secondary market transaction on such first day at a price equal to the principal amount thereof. If the Remarketing Agent no longer determines, or fails to determine when so required, an Interest Rate, or if a court holds the Interest Rate set to be invalid or unenforceable, the rate of interest for Adjustable Rate Bonds will be equal to 75% of the rate listed in the table most recently circulated by the United States Treasury Department known as "Table [applicable dates shown on the most recent table], Maximum Interest Rates Payable on United States Treasury Certificates of Indebtedness, Notes and Bonds—State and Local Government Series Subscribed for During Period [applicable dates shown on the most recent table]" or any subsequent and substantially equivalent table circulated by the United States Treasury Department for the maturity most closely approximating the duration of the Adjustable Rate Period.

Determination of Adjustable Rate Period. The Purchase Date and related Adjustable Rate Period for any Adjustable Rate Bond will be set by the City pursuant to a City Direction. Each Adjustable Rate Period shall (1) be 15 months in duration or any integral multiple of three months in excess of 15 months (subject to any adjustments required by parts (3) and (4) of this sentence), and provided further that if the first Adjustable Rate Period commences on a Conversion Date other than a February 1, May 1, August 1 or November 1, such first Adjustable Rate Period shall be of a duration as close as possible to the duration for the specified Adjustable Rate Period, (2) commence on each Purchase Date for such Bonds, (3) end on the day prior to the May 1 and November 1 of the year in which the Adjustable Rate Period ends, and (4) terminate no later than April 30, 2015. Unless a new Purchase Date and Adjustable Rate Period are set by the City, pursuant to a City Direction, or until the occurrence of a Conversion Date, each successive Purchase Date and related Adjustable Rate Period will be substantially the same as those last set by the City. The City, pursuant to a City Direction, may establish a new Purchase Date and related Adjustable Rate Period effective on and after the next pending Purchase Date by providing at least 15 days' notice (or at least 10 days notice upon waiver by the Trustee) prior to the next succeeding Purchase Date for the Bonds of the impending change to the Issuer, the Trustee, the Depository, and the Remarketing Agent. Each Adjustable Rate Bond will be subject to mandatory purchase on each next succeeding Purchase Date, unless the Holders receive and exercise the option to waive such purchases as described under "THE BONDS—Mandatory Purchases—Mandatory Purchase Upon Conversion." On or before such Purchase Date, the City pursuant to a City Direction shall give notice (the "Second Notice") to the Trustee of the new Purchase Date and the related Adjustable Rate Period and shall also

deliver an opinion of Bond Counsel addressed to the Issuer, the Trustee, the Company, the Depository and the Remarketing Agent from nationally recognized Bond Counsel in accordance with the Indenture. If the City shall fail to deliver such opinion of bond counsel, the Bonds shall bear interest as described under **"THE BONDS—Mandatory Conversion—Conversion to Fixed Rate Bonds, Adjustable Rate Bonds or Demand Purchase Bonds."**

Fixed Rate Bonds

Determination of Interest Rate. The Remarketing Agent will set the Interest Rate for Fixed Rate Bonds converted from Variable Rate Bonds, Adjustable Rate Bonds, Auction Rate Bonds or Demand Purchase Bonds on or within 90 days prior to the first day on which such Bonds bear the Fixed Interest Rate. The Interest Rate for Fixed Rate Bonds will be the minimum fixed rate of interest necessary, in the best professional judgment of the Remarketing Agent and taking into account prevailing market conditions, to sell all of the Fixed Rate Bonds in a secondary market transaction at a price equal to the principal amount thereof.

If the Remarketing Agent no longer determines or fails to determine when so required, an Interest Rate for Fixed Rate Bonds, or a court holds such rate to be invalid or unenforceable, the rate of interest will equal 75% of the rate listed in the table most recently circulated by the United States Treasury Department known as "Table [applicable dates shown on the most recent Table], Maximum Interest Rates Payable on United States Treasury Certificates of Indebtedness, Notes and Bonds—State and Local Government Series Subscribed for During Period [applicable dates shown on the most recent Table]" or any subsequent and substantially equivalent Table circulated by the United States Treasury Department for the maturity most closely approximating the duration of the period remaining until the maturity of the Fixed Rate Bonds.

Conversion Provisions

The Bonds (other than Fixed Rate Bonds) are subject to Conversion at the option of the City, pursuant to a City Direction, in whole but not in part upon at least 15 days' notice to the Trustee, the Issuer, the Depository, and the Remarketing Agent or Market Agent, as applicable, prior to the Conversion Date, and upon not less than 10 days' notice to the Holders thereof, when accompanied by a preliminary opinion of Bond Counsel stating that such conversion is authorized by the Indenture, the Services Agreement, the Facilities Sales Agreement, and applicable state law, and that such Conversion is in accordance with the Indenture, the Services Agreement and the Facilities Sales Agreement and will not adversely affect the exclusion of the interest on any of the Bonds from gross income for federal income tax purposes. The Conversion Date shall be, for Bonds other than Auction Rate Bonds, a Purchase Date or any Business Day on which such Bonds are subject to optional redemption. The Conversion Date for Auction Rate Bonds shall be an Interest Payment Date and, with respect to Long-Term Auction Rate Bonds, a date on which such Bonds are also subject to optional redemption. (See **"THE BONDS—Optional Redemption."**) Any Money Market Period then in effect will be terminated as of the Conversion Date. On the Conversion Date, the Bonds so converted will be subject to mandatory purchase on the Conversion Date at a price equal to the principal amount thereof, accrued interest, if any, to the date of purchase and, in the case of Adjustable Rate Bonds and Demand Purchase Bonds, any applicable premium. Holders may receive, at the Company's discretion, the option to waive such purchase and retain their Bonds. If a Holder exercises such option by providing a waiver notice to the Depository in accordance with the requirements set forth in the Indenture, such Holder will accept the Interest Rate and related Interest Period on the

Bonds established pursuant to such Conversion. (See "THE BONDS—Mandatory Purchases—Mandatory Purchase Upon Conversion" and "THE BONDS—Optional Redemption.")

Demand Purchase Bonds which have been converted to Variable Rate Bonds, Adjustable Rate Bonds or Auction Rate Bonds are subject to Conversion back to Demand Purchase Bonds in accordance with the above procedures. In each case, the City must deliver an opinion of nationally recognized bond counsel in accordance with the Indenture.

Any Conversion from or to Auction Rate Bonds from or to another Interest Rate mode or any Conversion from Short-Term Auction Rate Bonds to Long-Term Auction Rate Bonds or from Long-Term Auction Rate Bonds to Short-Term Auction Rate Bonds, or from Long-Term Auction Rate Bonds having Long-Term Auction Periods of different durations, shall, in addition to the conditions set forth above, be subject to the following:

- (i) At least 10 days prior to the intended Conversion Date the Remarketing Agent or the Market Agent, as the case may be, shall, at the request of the City, the Company, pursuant to a City Direction, deliver to, among others, the Issuer, the City, the Trustee, the Paying Agent and the Auction Agent a firm commitment from one or more investment banking firms or institutional investors to purchase, at a purchase price equal to the principal amount thereof (and, with respect to Long-Term Auction Rate Bonds, an amount equal to the premium that would be payable upon an optional redemption of such Bonds at such time), all Bonds which are to be purchased on such Conversion Date;
- (ii) On such Conversion Date, there shall have been delivered to the Paying Agent by such purchaser or purchasers moneys, in same-day funds, in the amount of such purchase price;
- (iii) Prior to a Conversion to an Auction Rate from any other Interest Rate, each potential Holder of an Auction Rate Bond must complete a Purchaser's Letter. Failure of a purchaser to deliver such letter shall render null and void any purchase waiver submitted by such Holder; and
- (iv) The notice of Conversion delivered pursuant to a City Direction shall state the duration of the new Auction Period.

If any of the conditions to a Conversion from an Auction Rate to another Interest Rate or to Long-Term Auction Rate Bonds from Short-Term Auction Rate Bonds or vice versa or from Long-Term Auction Rate Bonds to Long-Term Auction Rate Bonds having Long-Term Auction Periods of different durations are not satisfied, then the proposed Conversion shall not occur and the duration of the Auction Period for such Auction Rate Bonds will become the shortest Auction Period then permissible and the Auction Rate will be equal to the Maximum Auction Rate until the next Auction Date.

Mandatory Conversion

Conversion to Fixed Rate Bonds, Adjustable Rate Bonds or Demand Purchase Bonds. The Bonds will be subject to mandatory Conversion to Fixed Rate Bonds or Adjustable Rate Bonds if (i) the Bonds are then subject to optional redemption at the principal amount thereof,

(ii) the City is then unable to obtain an opinion of nationally recognized bond counsel with respect to optional Conversion as contemplated by the Indenture, (iii) each of the Remarketing Agent and a financial advisor to be designated by the City pursuant to a City Direction, as independent financial advisors, shall provide, following receipt and review of the indices referred to below, favorable opinions to the Trustee, the Company and the City that the Bonds can then be remarketed at a Fixed Interest Rate or an Adjustable Interest Rate, as the case may be, on the secondary market and that such Conversion can be expected to result in a lower overall interest cost to the City over (A) the then remaining term of the Bonds or, if shorter than the then remaining term of the Bonds, (B) 10 years (and such opinion shall state which term shall be most advantageous to the City), and (iv) on the Conversion Date, the Trustee, the Company and the Issuer shall receive (A) an opinion of nationally recognized bond counsel to the effect that such mandatory conversion is in accordance with the Indenture and will not adversely affect the exclusion of the interest on any of the Bonds from gross income for federal income tax purposes and (B) an opinion of the Remarketing Agent that the Bonds can then be remarketed at the Fixed Interest Rate or the Adjustable Interest Rate, as the case may be, on the secondary market.

At the request of the City, pursuant to a City Direction, but only if so requested, the Remarketing Agent will determine and make available in writing to the City, the Issuer, the Company and the Trustee a Short-Term Index and a Fixed Rate Index on or before the tenth Business Day after such request or on such other date as may be specified in such request which is acceptable to the Remarketing Agent.

In the event that the City is unable to obtain the opinion of nationally recognized bond counsel that the interest on Adjustable Rate Bonds would be excluded from gross income for federal income tax purposes upon a change in the Adjustable Interest Rate or the Adjustable Rate Period, the Bonds shall be subject to mandatory Conversion from Adjustable Rate Bonds to Demand Purchase Bonds bearing interest at a rate equal to the rate most recently applicable to Adjustable Rate Bonds, with such initial and succeeding Demand Purchase Periods as, in the best professional judgment of the Remarketing Agent, shall enable the Demand Purchase Bonds to be sold in a secondary market transaction at the principal amount thereof. Such Conversion shall be in accordance with the notice and procedures otherwise applicable to Conversions.

In the event that the City is unable to obtain the opinion of nationally recognized bond counsel that the interest on Demand Purchase Bonds would be excluded from gross income for federal income tax purposes upon a new determination of the applicable Demand Purchase Period, the Bonds shall be subject to mandatory Conversion from Demand Purchase Bonds to Adjustable Rate Bonds with an Adjustable Rate Period equal to the most recent Demand Purchase Period, with such initial and succeeding Adjustable Interest Rates as, in the best professional judgment of the Remarketing Agent, are the lowest rates which shall enable the Adjustable Rate Bonds to be sold in a secondary market transaction at the principal amount thereof. Such Conversion shall be in accordance with the notice and procedures otherwise applicable to Conversions.

In the event that the City is unable to obtain the opinion of nationally recognized bond counsel that the interest on Adjustable Rate Bonds or Demand Purchase Bonds, as the case may be, would be excluded from gross income for federal income tax purposes notwithstanding the mandatory Conversion from Adjustable Rate Bonds to Demand Purchase Bonds or the mandatory Conversion from Demand Purchase Bonds to Adjustable Rate Bonds, as the case may

be, the Bonds shall not be subject to such mandatory Conversion, but shall continue bearing interest at the rate and for the same period as most recently in effect.

The Short-Term Index shall mean *The Bond Buyer* 30-Day Tax-Exempt Prime Commercial Paper Yield Index or, if such index is not then published, any successor commercial paper index published by *The Bond Buyer* or any other comparable short-term tax-exempt index or, if such successor index is not then published, the Short-Term Index will be 65% of the Interest Rate applicable to 13-week United States Treasury bills determined on the basis of the average per annum discount rate at which such 13-week Treasury bills shall have been sold at the most recent Treasury auction.

The Fixed Rate Index shall mean *The Bond Buyer* Revenue Bond Index, or, if *The Bond Buyer* Revenue Bond Index is not then published, any successor municipal index published by *The Bond Buyer*, or, if such successor municipal index is not then published, the Fixed Rate Index shall be the average yield (on the basis of full coupon securities of like maturity or terms for mandatory redemption, trading at par) of not fewer than five debt securities issues selected by the Remarketing Agent, the interest on which is exempt from federal income taxation, which issues (i) in the event that the Bonds are rated by Moody's or S&P, shall have the same long-term debt rating as the rating of the Bonds or shall have a long-term debt rating which is immediately proximate to the rating of the Bonds (without regard to any rating refinement or gradation by numerical modifier or otherwise), or (ii) in the event that the Bonds are not rated by Moody's or S&P, shall have a long-term debt rating which, in the judgment of the Remarketing Agent, is substantially equivalent to the credit quality of the Bonds. The securities selected by the Remarketing Agent in computing the Fixed Rate Index may be changed from time to time by the Remarketing Agent in its discretion.

If (i) the Short-Term Index is at least 200 (for the period ending November 1, 1998, and thereafter 100) basis points above or below the Short-Term Base Level or (ii) the Fixed Rate Index is at least 200 (for the period ending November 1, 1998 and, thereafter, 100) basis points below the Long-Term Base Level on the date of any computation thereof, the Remarketing Agent shall promptly notify in writing the City, the Company and the Trustee, and the Remarketing Agent shall determine and make available to the City, the Company and the Trustee the Short-Term Index and the Fixed Rate Index on the first Business Day of the next succeeding calendar month. If the Short-Term Index or the Fixed Rate Index is at least 200 (for the period ending November 1, 1998 and, thereafter, 100) basis points above or below the Short-Term Base Level or below the Long-Term Base Level, respectively, on such second computation, all Demand Purchase Bonds, Variable Rate Bonds, Auction Rate Bonds and Adjustable Rate Bonds will automatically be converted to Fixed Rate Bonds if the term referred to in the opinion required by clause (iii) of the first paragraph under "Mandatory Conversion" as most advantageous to the City is the remaining term of the Bonds and otherwise to Adjustable Rate Bonds having an Adjustable Rate Period equal to that period referred to in such opinion as being most advantageous to the City. In either case, such conversion shall occur on the first Business Day next succeeding the applicable notice period required by the Indenture. The Short-Term Base Level and the Long-Term Base Level shall mean, respectively, the Short-Term Index and the Fixed Rate Index in effect on the delivery date of the Bonds, as evidenced by a certificate of the Remarketing Agent delivered on such date.

Conversion of Variable Rate Bonds. If the Remarketing Agent certifies that a Conversion from one type of Variable Rate Bonds to another type of Variable Rate Bonds would

achieve a lower overall cost for the City and subject to certain other conditions under the Indenture, all such Variable Rate Bonds of one type shall be converted to Variable Rate Bonds of such other type on the first Business Day after such certification which qualifies as a Conversion Date in accordance with the notice and procedures set forth below.

Conversion Procedure; Form of Notice. The Trustee will notify by mail the Holders of the Bonds (and, in the case of a Conversion from an Auction Rate, all Broker-Dealers) not less than 10 days before the Conversion Date (or Purchase Date, in the case of an adjustment of the Adjustable Rate Period). Such notice will state substantially the following, subject to any necessary modification: (i) that such Bonds are being converted, as set forth in the notice from the City, in the case of an optional Conversion, or pursuant to the mandatory provisions of the Indenture, as the case may be; (ii) whether the City, pursuant to a City Direction, has directed that Holders receive the option to waive the purchase of their Bonds by delivery of a written notice to the Depository not later than 12:00 noon, New York City time, on the fifth day before the Conversion Date, and that all Outstanding Bonds subject to the Conversion (except for Bonds as to which the Holder has waived purchase) shall be purchased by the Depository on or prior to the Conversion Date; (iii) the Conversion Date and the purchase price the City will pay for the Bonds on such Conversion Date, and that after Conversion no interest shall accrue to the benefit of such Holders; (iv) the date and method by which the Interest Rate will be determined and the procedure, which may include the furnishing of a telephone number which Holders can call, for informing such Holders of the Bonds whether the conditions for Conversion under the Indenture have been met and, if so, the applicable Interest Rate and, if not, that such Conversion shall not be effective; (v) the Interest Payment Dates and the Purchase Dates, if any, after the Conversion Date; (vi) the proposed revised optional redemption provisions, if any, applicable to Adjustable Rate Bonds, Demand Purchase Bonds, Auction Rate Bonds or Fixed Rate Bonds; (vii) that, in the case of Conversion to Fixed Rate Bonds, the Bonds so converted will no longer be subject to purchase on demand of the Holder; (viii) that every Bond subject to Conversion (with an appropriate transfer of registration executed in blank) will be delivered to the Depository (at its Principal Office) not later than the Business Day next preceding the Conversion Date (except for Bonds as to which the Holder has waived purchase), that all Bonds shall be accompanied by an appropriate transfer of registration executed in blank in form satisfactory to the Depository and will be deemed to have been delivered and purchased, whether or not such delivery occurs; (ix) that, in the case of a Conversion from Money Market Bonds (if the Bonds will be Book-Entry Bonds), the Bonds will be registered in the name of the Securities Depository or its nominee, if not already so registered, and ownership thereof shall be maintained in book-entry form by the Securities Depository for the account of its participants and, conversely, in the case of a Conversion to Money Market Bonds, the Bonds will no longer be registered in book-entry form; (x) that, in the case of Conversion to Auction Rate Bonds, the Bonds as converted will no longer be subject to purchase on demand by the Holder thereof and will instead be subject to the Auction Procedures; (xi) that, in the case of a Conversion to Auction Rate Bonds, any Holder or potential Holder of an Auction Rate Bond shall have signed and delivered a Purchaser's Letter to the Auction Agent at least 10 days prior to the Conversion Date, and that a Purchaser's Letter is required to be completed with respect to Auction Rate Bonds; (xii) that, in the case of a Conversion from Auction Rate Bonds, the Auction conducted on a specified date will be the last Auction and no further Auctions will be conducted; and (xiii) the rating expected to be applicable to the Bonds after Conversion.

With respect to Conversion to Auction Rate Bonds, any Holder who delivers the required notice shall, simultaneously with the delivery thereof, deliver (or shall have previously delivered)

a signed Purchaser's Letter to the Auction Agent, and failure to deliver or have in effect such Purchaser's Letter shall cause the submitted notice delivered to be deemed ineffective.

Purchase of Bonds at Option of Holder

Generally. The Bonds shall be purchased upon demand of the Holders thereof when they are Daily Rate Bonds or Weekly Rate Bonds, as described below; provided, however, that the Bondholders shall not have the right to have such Bonds purchased during the existence of an Event of Default described in clause (a), (b) or (c) under "APPENDIX B—THE INDENTURE—Defaults" or if any event has occurred which with the lapse of time would constitute such an Event of Default. The obligation to purchase Bonds is solely from amounts paid by the Company or proceeds from a remarketing of the Bonds. Obligations to purchase Bonds are solely obligations of the Company and are in no way to be construed to be obligations of the City or the Issuer. Neither the City nor the Issuer shall have any obligation to purchase tendered Bonds.

Demand Purchase Option for Daily Rate Bonds. Any Daily Rate Bond shall be purchased, or deemed purchased, on the demand of the Holder thereof, on any Business Day at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the date of purchase upon written notice or irrevocable telephonic notice (promptly confirmed in writing) to the Depository (at its Principal Office) no later than 10:00 a.m. (New York City time) on such Business Day of such Holder's demand for purchase, which notice (A) states the number and principal amount (or portion thereof in an authorized denomination) of such Bond to be purchased, (B) states the Purchase Date on which such Bond shall be purchased and (C) irrevocably requests such purchase.

Demand Purchase Option for Weekly Rate Bonds. Any Weekly Rate Bond shall be purchased, or deemed purchased, on the demand of the Holder thereof, on any Business Day at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date, upon telephonic notice to the Depository, at its Principal Office on a Business Day not later than seven days prior to the Purchase Date, confirmed by written notice to the Depository (at its Principal Office) not later than the third Business Day prior to the Purchase Date, which (A) states the number and principal amount (or portion thereof in an Authorized Denomination) of such Bond to be purchased, (B) states the Purchase Date on which such Bond shall be purchased and (C) irrevocably requests such purchase.

Delivery of Bonds. Any Bond with regard to which demand is made as set forth above shall be deemed to have been tendered for purchase on the Purchase Date, regardless of whether such Bond is, in fact, so tendered. Delivery of such Bond (with an appropriate transfer of registration executed in blank in form satisfactory to the Depository) at the Principal Office of the Depository at or prior to 12:00 noon (New York City time) on the date specified in the aforesaid notice shall be required for payment on such day in immediately available funds of the purchase price due on such Purchase Date. No Holder shall be entitled to payment of the purchase price due on such Purchase Date except upon surrender of such Bond or additional bonds as set forth herein.

Mandatory Purchases

Upon the occurrence of the events set forth below, the Bonds shall be purchased or deemed purchased as described below. The purchase price of Bonds is payable solely from amounts paid by the Company or proceeds from a remarketing of the Bonds. Obligations to purchase Bonds are solely obligations of the Company and are in no way to be construed to be obligations of the City or the Issuer. Neither the City nor the Issuer shall have any obligation to purchase tendered Bonds.

Mandatory Purchase of Money Market Bonds. Every Money Market Bond shall be purchased, or deemed purchased, on its Purchase Date at a purchase price equal to the principal amount thereof unless the Holder thereof shall deliver to the Depository (at its Principal Office) prior to 10:00 a.m. (New York City time) on the Purchase Date an irrevocable written or telephonic notice (promptly confirmed in writing) which shall (i) identify by number the Bond or Bonds affected and the principal amount thereof, (ii) state that the Holder elects not to have such Bond or Bonds purchased and (iii) state the new Money Market Period requested by such Holder, which notice shall be confirmed in writing to such Holder by the Depository (with a copy to the Remarketing Agent), provided that a Holder of a Money Market Bond which is an Investment Company at its option may at any time prior to the Purchase Date for such Bond deliver to the Depository or the Trustee irrevocable written notice of such Holder's election to have such Bond purchased on such Purchase Date. Delivery of such Bonds (with an appropriate transfer of registration executed in blank in form satisfactory to the Depository) at the Principal Office of the Depository at or prior to 12:00 noon (New York City time) on the Purchase Date shall be required for payment in immediately available funds of the Purchase Price on such Purchase Date. Except for Bonds with respect to which the first aforesaid notice has been received by the Depository, and for which the newly requested Money Market Period, (or an alternate Money Market Period acceptable to the Holders) is available, all Money Market Bonds shall be deemed to have been tendered for purchase on the Purchase Date. No Holder shall be entitled to payment of the Purchase Price for any Bond except upon surrender of such Bond or Bonds as set forth herein.

Mandatory Purchase of Adjustable Rate Bonds and Demand Purchase Bonds. Every Adjustable Rate Bond and Demand Purchase Bond shall be purchased, or deemed purchased, on each Purchase Date at a purchase price equal to the principal amount thereof, unless Bondholders waive such mandatory purchase as described by the second succeeding paragraph hereof. Delivery of such Bond (with an appropriate transfer of registration executed in blank in form satisfactory to Depository) at the Principal Office of the Depository at or prior to 3:00 p.m. (New York City time) on the date specified in the Trustee's Notice to Holders referred to in the Indenture shall be required for payment on such day of the purchase price due. Payment of such purchase price shall be in clearinghouse funds. No Holder shall be entitled to payment of the purchase price due on such Purchase Date except upon surrender of such Bonds as set forth herein.

Not less than 10 days prior to each Purchase Date for the Adjustable Rate Bonds or Demand Purchase Bonds, the Trustee shall notify by mail the Holders of such Bonds of the impending Purchase Date and that their Bonds shall be subject to mandatory purchase by the Depository on such Purchase Date at a price equal to the principal amount thereof (the "Notice to Holders").

The City, pursuant to a City Direction, and upon 15 days' or more notice (10 days if 15 days' notice is waived by the Trustee) to the Trustee in advance of a Purchase Date for Adjustable Rate Bonds or Demand Purchase Bonds, may direct that the Notice to Holders referred to in the preceding paragraph provide such Holders with the option to waive the mandatory purchase of some or all of their Adjustable Rate Bonds or Demand Purchase Bonds on such Purchase Date by providing the Depository not later than noon (New York City time) on or before the fifth day before such Purchase Date with a waiver notice in the form to be provided to such Holders by the Trustee.

Mandatory Purchase Upon Conversion. Whenever the Bonds are converted or, with respect to Adjustable Rate Bonds, the Adjustable Rate Period is changed, such Bonds shall be subject to mandatory purchase by the Issuer on the Conversion Date (or the date of change in the Adjustable Rate Period, as the case may be) at a price equal to the principal amount thereof and premium, if any, plus accrued interest, if any, to the date of purchase, unless Bondholders waive such mandatory purchase as described by the second succeeding paragraph.

Delivery of such Bonds subject to mandatory purchase (with an appropriate transfer of registration executed in blank) at the Principal Office of the Depository on or before the day next preceding the Purchase Date shall be required for payment on such Purchase Date.

The City, pursuant to a City Direction, and upon 15 days' or more notice (10 days if 15 days' notice is waived by the Trustee) to the Trustee in advance of a Purchase Date upon a Conversion or change in the Adjustable Rate Period, may direct that the Notice to Holders described under "THE BONDS—Mandatory Conversion—*Conversion Procedure; Form of Notice*" provide such Holders with the option to waive the mandatory purchase of some or all of their Bonds on such Purchase Date by providing the Depository not later than 12:00 noon (New York City time) on or before the fifth day before such Purchase Date with a waiver notice in the form to be provided to such Holders by the Trustee.

Bonds Undelivered on Purchase Date or Conversion Date Cease to Bear Interest

Any Bond as to which a notice of optional demand for purchase has been given or which is subject to mandatory purchase for the payment of the purchase price of which moneys have been deposited with the Depository and which is not delivered to the Depository shall nevertheless be deemed purchased. Thereafter, the Holder of such Bond shall be entitled only to the purchase price of such Bond held by the Depository and the Trustee may authenticate and deliver a Bond to a subsequent Holder in lieu of such undelivered Bond. Payment of the purchase price of any Bond which is deemed purchased shall be made only on surrender of such Bond to the Depository.

Remarketing of Bonds in Event of Repurchase or Conversion

Pursuant to the Remarketing Agreement between the Company and the Remarketing Agent, in the event that the Trustee receives notice from a Bondholder demanding purchase of the Bonds held by such Bondholder or notice from the City, pursuant to a City Direction, of the Conversion of any Bonds or of an impending Demand Purchase Bond Purchase Date, the

Remarketing Agent will use its best efforts to solicit purchases of the Bonds at a price not less than par plus accrued interest, if any.

To the extent the Remarketing Agent is successful in remarketing any such Bonds, the aggregate purchase price therefor will be deposited in the Bond Purchase Fund maintained with the Depository under the Depository Agreement. If the Remarketing Agent fails to remarket all of such Bonds, the Company will deposit into the appropriate Bond Purchase Fund an amount of funds equal to the deficiency. Funds deposited in the Bond Purchase Fund will be used to pay principal of, premium, if any, and accrued interest on the Bonds which are to be purchased on the dates specified in the notice from a Bondholder who has made a demand for the purchase of such Bonds or in the notice from the City pursuant to a City Direction of the Conversion of such Bonds or on the Demand Purchase Bond Purchase Date. The Remarketing Agreement may be cancelled by the Remarketing Agent upon appropriate notice or upon the occurrence of certain events and by the Company upon appropriate notice.

Any such remarketing shall be conditioned on compliance by the Company, the Issuer, the Trustee, the City and the Remarketing Agent with the Rule, if applicable to such remarketing.

Optional Redemption

Optional Redemption of Variable Rate Bonds and Short-Term Auction Rate Bonds. The Weekly Rate Bonds, the Daily Rate Bonds, the Money Market Bonds and the Short-Term Auction Rate Bonds are subject to optional redemption by Trustee, on behalf of Issuer, in whole or in part, pursuant to a City Direction, at a redemption price equal to the principal amount of such Bonds to be redeemed, plus payment of the interest due thereon on such redemption date, as follows: (A) in the case of Daily Rate Bonds, Weekly Rate Bonds and Short-Term Auction Rate Bonds, on any Interest Payment Date, upon 30 days' notice, as set forth herein below; and (B) in the case of Money Market Bonds, on any Interest Payment Date, upon 10 days' notice, or on any Business Day upon 30 days' notice, as set forth in the Indenture.

Optional Redemption With Premium for Adjustable Rate Bonds, Demand Purchase Bonds, Fixed Rate Bonds and Long-Term Auction Rate Bonds. Upon Conversion, the Adjustable Rate Bonds, the Demand Purchase Bonds, the Fixed Rate Bonds, and the Long-Term Auction Rate Bonds are subject to redemption at the option of the Issuer, in whole at any time or in part on any Interest Payment Date, pursuant to a City Direction, upon not less than 30 days' notice; provided, however, that such Bonds shall not be redeemable during the No-Call Period shown below which shall begin on the first day of the Adjustable Rate Period, the Demand Purchase Period, the Fixed Rate Period or the Long-Term Auction Period, as the case may be. On and after the no-call period, such Bonds shall be redeemable at the percentage of their principal amount shown in the Initial Premium column plus interest accrued to the redemption date. The premium shall decline by the percentage shown in the Premium Amortization column for the first four entries on each anniversary of the date on which such Bonds are first callable, and, for the final four entries, each semi-anniversary and anniversary of such date, until they shall be redeemable without premium.

**Adjustable Rate Period,
Demand Purchase Period, Fixed
Rate Period or Long-Term
Auction Period**

<u>Equal to or Greater Than</u>	<u>But Less Than</u>	<u>No-Call Period</u>	<u>Initial Premium</u>	<u>Premium Amortization</u>
15 years	N/A	10 years	101.5	0.750
12 years	15 years	8 years	101.0	0.500
8 years	12 years	6 years	101.0	0.500
5 years	8 years	4 years	100.5	0.250
4 years	5 years	3 years	100.5	0.250
3 years	4 years	2 years	100.5	0.250
2 years	3 years	1 year	100.25	0.125
0 years	2 years	1 month	100.125	0.125

If (i) the Bonds are converted to an Adjustable Interest Rate, Demand Purchase Rate, Fixed Interest Rate or Long-Term Auction Rate at the option of the City, pursuant to a City Direction, and (ii) the Remarketing Agent certifies to the Trustee, the Company and the City in writing that the foregoing schedule is not consistent with then prevailing market conditions, the foregoing premiums and No-Call Periods may be revised in accordance with the best professional judgment of the Remarketing Agent to reflect the then prevailing market conditions, provided that such revision shall not be effective if, because of such revision, nationally recognized bond counsel cannot deliver its unqualified confirming opinion on the Conversion Date.

Extraordinary Optional Redemption

The Bonds are subject to Extraordinary Optional Redemption by Trustee, on behalf of Issuer, in whole or in part, pursuant to a City Direction, on any Business day, at a redemption price equal to the principal amount of such Bonds to be redeemed, plus payment of the interest due thereon on such redemption date, upon 30 days' notice given within 180 days of the occurrence of any of the following events:

- (i) All or a portion of the wastewater collection and treatment system of which the Facilities are a part (the "System") shall have been damaged or destroyed (a) to such extent that such System (or portion thereof) cannot be reasonably restored to the condition thereof immediately preceding such damage or destruction, (b) to such extent that such System is thereby prevented from carrying on its normal operation with respect to the Company as determined in a City Direction for a period of 6 months or more, or (c) to such extent that the cost of restoration thereof would exceed the proceeds of the insurance carried thereon;

(ii) Title to, or the temporary use for a period of six months or more of, all or a portion of the System shall have been taken, or is reasonably expected to be taken (based upon the opinion of Independent Counsel), under the exercise of the power or eminent domain by any governmental body or by any person, firm or corporation acting under governmental authority (including such a taking or takings as results in the System being thereby prevented from carrying on its normal operations with respect to the Company) or such System or portion thereof is sold in reasonable expectation thereof (based on the opinion of Independent Counsel);

(iii) Changes which City and Company cannot reasonably control or overcome in the economic availability of materials, supplies, labor, equipment and other properties and things necessary for the efficient operation of the System for the purpose contemplated by the Facilities Sales Agreement shall have occurred, or technological or other changes shall have occurred which as determined in a City Direction render the continued operation of such System uneconomic for such purposes; or

(iv) As a result of any changes in the Constitution of the State or the Constitution of the United States of America or of legislative or administrative action (whether state or federal) or by final decree, judgment or order of any court or administrative body (whether state or federal) entered after the contest thereof by Company in good faith, the Indenture, the Services Agreement, the Facilities Sales Agreement or any other agreement or contract necessary for the performance of the foregoing shall have become void or unenforceable or impossible of performance in accordance with the intent and purposes of the parties as expressed in the Indenture, or unreasonable burdens or excessive liabilities shall have been imposed on Company, as determined in a City Direction, in respect to the System, including, without limitation, federal, state or other ad valorem, property, income or other taxes not being imposed as of May 1, 1998;

provided that such redemption shall not exceed an amount (a) in excess of the fair value of the property damaged or destroyed as set forth in (i) above (as such fair value is determined by a qualified professional engineer who is not a full-time employee of Company, Guarantor, City or Issuer) or (b) in excess of the amount of a condemnation award or sale price resulting from the circumstances set forth in (ii) above, or (c) in excess of the higher of the cost or fair value of the portion of the Facilities adversely affected in the case of (iii) or (iv) above (as determined by a qualified professional engineer who is not a full-time employee of Company or Issuer) and in no event may such redemption occur if the fair value or cost of such damaged, destroyed, condemned, sold or adversely affected property, as the case may be, is less than \$100,000.

Procedure for and Notice of Redemption

Notice of the call for any redemption of the Bonds pursuant to the Indenture (i) identifying the Bonds or portions of Bonds to be redeemed, specifying the redemption date, the redemption price, the place or places of payment where amounts due upon such redemption will be payable (which shall be the principal office of the Paying Agent or any Co-Paying Agent) and, if less than all of the Bonds are to be redeemed, the numbers of the Bonds and the portions of the Bonds so to be redeemed, (ii) stating any condition to such redemption and (iii) stating that, on the redemption date, and upon satisfaction of any such condition, the Bonds to be redeemed shall cease to bear interest, will be given to the Bondholders by first-class mail at least

the number of days prior to redemption as described under "THE BONDS—Optional Redemption."

If fewer than all the Bonds are called for redemption, the Trustee shall select, in such manner as it may deem proper, the Bonds or portions of Bonds to be redeemed in the principal amount designated to the Trustee by the City pursuant to a City Direction or otherwise as required by the Indenture; provided, however, that, if the City has offered to purchase all the Bonds then outstanding and less than all such Bonds have been tendered, the Trustee, pursuant to a City Direction, shall select for redemption all Bonds not tendered. Upon surrender of any Bond redeemed in part, the Trustee will authenticate a new Bond or Bonds equal in principal amount to the unredeemed portion of the Bond.

Conditions to Redemption

With respect to any notice of optional redemption of Bonds, unless, upon the giving of such notice, such Bonds shall be deemed to have been paid within the meaning of the Indenture, such notice may state that such redemption shall be conditioned upon the receipt by the Trustee on or prior to the date fixed for such redemption of moneys sufficient to pay the principal of, premium, if any, and interest on such Bonds to be redeemed, and that if such moneys shall not have been so received said notice shall be of no force and effect and the Trustee, on behalf of the Issuer, shall not be required to redeem such Bonds. In the event that such notice of redemption contains such a condition and such moneys are not so received, the redemption shall not be made and the Trustee shall within a reasonable time thereafter give notice, in the manner in which the notice of redemption was given, that such moneys were not so received.

If any Event of Default described in "APPENDIX B—THE INDENTURE" herein shall have occurred and is continuing, there shall be no redemption of less than all of the Bonds then outstanding.

Additional Bonds

So long as the Facilities Sales Agreement, the Services Agreement and the Guaranty are in effect and there is no event of default existing under such Facilities Sales Agreement, Services Agreement, Guaranty or the Indenture, one or more series of Additional Bonds on a parity with the Bonds may be issued for the purposes provided in the Facilities Sales Agreement. Such Additional Bonds shall be payable solely from the amounts payable under the Facilities Sales Agreement (except to the extent paid out of moneys attributable to the proceeds derived from the sale of the Additional Bonds as to income from the temporary investment thereof and, under certain circumstances, to proceeds from insurance and condemnation awards). The Additional Bonds shall be delivered by the Trustee only upon the filing of certain documents with the Trustee, including *inter alia*:

- (i) a supplemental indenture and an amendment of the Facilities Sales Agreement, the Services Agreement, and the Guaranty expressly providing that, for all purposes of the Indenture, the Facilities Sales Agreement, the Services Agreement and the Guaranty, the Facilities shall include any facilities being financed by the Additional Bonds, and that the amounts payable under the Facilities Sales Agreement, the Services Agreement and the Guaranty shall include sufficient moneys to pay when due the principal of, premium, if any, and

interest on all Bonds Outstanding upon the issuance and delivery of the Additional Bonds;

(ii) a written opinion of nationally recognized bond counsel to the effect that the issuance of Additional Bonds and the execution thereof have been duly authorized, all conditions precedent to the delivery thereof have been fulfilled, that the Additional Bonds are legal, valid and binding special, limited obligations of the Issuer and that the exclusion from gross income for federal income tax purposes of the interest on the Bonds and any Additional Bonds theretofore issued will not be affected by the issuance of any such Additional Bonds; and

(iii) a written order to the Trustee from the Issuer to authenticate and deliver the Additional Bonds.

Each series of Additional Bonds shall be equally and ratably secured under the Indenture with the Bonds and all other series of Additional Bonds, without preference, priority or distinction of any Bonds over any other. Interest payable on Additional Bonds may be at fixed or floating rates and such rates will not necessarily be the same as the rate or rates payable with respect to the Bonds.

Book-Entry-Only System

DTC will act as securities depository for the Bonds. The Bonds will be issued initially in the form of a single fully registered global bond certificate for each separate issue of Bonds, each in the aggregate principal amount of such issue, and will be registered in the name of Cede & Co., as nominee for DTC. Unless and until the Bonds are qualified for DTC's Municipal Commercial Paper-Variable Rate Demand Obligation bond program, DTC will not at present act as securities depository for the Bonds when the Bonds are Money Market Bonds.

DTC is a limited-purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC was created to hold securities of its participants (the "DTC Participants") and to facilitate the clearance and settlement of securities transactions among DTC Participants in such securities through electronic book-entry changes in accounts of the DTC Participants, thereby eliminating the need of physical movement of securities certificates. DTC Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations, some of whom (and/or their representatives) own DTC. Access to the DTC system is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly.

Ownership interests in the Bonds may be purchased by or through DTC Participants. Such DTC Participants and the persons for whom they acquire interests in the Bonds as nominees will not receive certificated Bonds, but each DTC Participant will receive a credit balance in the records of DTC in the amount of the DTC Participant's interest in the Bonds, which will be confirmed to such DTC Participant in accordance with DTC's standard procedures. Each such person for which a DTC Participant acquires an interest in the Bonds, as nominee, may desire to make arrangements with such DTC Participant to receive a credit balance in the records of such DTC Participant and may desire to make arrangements with such

DTC Participant to have all notices of redemption or other communications to DTC which may affect such persons forwarded in writing by such DTC Participant and to have notification made of all interest payments. NEITHER THE ISSUER NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO SUCH DTC PARTICIPANTS OR THE PERSONS FOR WHICH THEY ACT AS NOMINEES WITH RESPECT TO THE BONDS. In this Official Statement, the term "Beneficial Owner" or "beneficial owner" shall mean the person for whom the DTC Participant acquires an interest in the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, as nominee for DTC, references herein to the Bondholders, registered owners or holders of the Bonds shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the Bonds.

DTC will receive payments from the Trustee to be remitted to the DTC Participants, who will in turn remit such payments to the Beneficial Owners. The ownership interest of each Beneficial Owner in the Bonds will be recorded on the records of the DTC Participants, whose ownership interest will in turn be recorded on a computerized book-entry system operated by DTC. When notices are given, they shall be sent by the Trustee to DTC only. DTC must receive notice of any mandatory purchase of Bonds upon a Conversion or otherwise not later than the close of business two Business Days before the date which is 15 days before the earlier of the Purchase Date or the expiration date of the Bondholder option, if any, to waive the Bond purchase.

Transfers of ownership interests in the Bonds will be accomplished by book entries made by DTC and, in turn, by the DTC Participants who act on behalf of the Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except as specifically provided in the Indenture in the event the book-entry system is discontinued. For every transfer or exchange of the Bonds, or interest therein, the Beneficial Owner may be charged a sum sufficient to cover any tax or other governmental charge that may be imposed relating thereto.

If at any time DTC notifies the Trustee, the Issuer, the Company and the City that it is unwilling or unable to continue as securities depository with respect to the Bonds or if at any time DTC shall no longer be registered or in good standing under the Securities Exchange Act of 1934, as amended, or other applicable statute or regulation and a successor securities depository is not appointed by the Issuer pursuant to a City Direction, with the consent of the Auction Agent and the Market Agent, if any, within 90 days after the Trustee, the Issuer, the City and the Company receive notice or become aware of such condition, as the case may be, the Bonds no longer shall be maintained in book-entry form, and the Issuer shall execute (but need not prepare) and the Trustee shall authenticate and deliver certificates representing the Bonds as provided below. In addition, the Issuer may, pursuant to a City Direction, determine at any time that Money Market Bonds or, with the consent of the Market Agent in the case of Auction Rate Bonds, that the Bonds shall no longer be represented by global certificates and that the Bonds no longer shall be maintained in book-entry form. In any such event, the Issuer shall execute (but need not prepare) and the Trustee shall authenticate and deliver certificates representing the Bonds as provided below. Certificates for the Bonds issued in exchange for a global certificate shall be registered in such names and authorized denominations as DTC, or its successor as securities depository, pursuant to instructions from the DTC Participants or otherwise, shall instruct the Issuer and the Trustee. The Trustee shall deliver such certificates representing the

Bonds to the persons in whose names such Bonds are so registered on the Business Day immediately preceding the first day of an Interest Period.

Upon the written consent of 100% of the owners of the Bonds, the Trustee shall withdraw the Bonds from DTC, and authenticate and deliver Bond certificates fully registered to the assignees of DTC or its nominee. Such withdrawal, authentication and delivery shall be at the cost and expense (including costs of printing, preparing and delivering such Bonds) of the persons requesting such withdrawal, authentication and delivery.

CANCELLATION OF ARIZONA CONTRACTS

Arizona Revised Statutes Section 38-511, as amended, permits the Issuer to cancel any contract at any time within three years of the date of its execution if any person significantly involved in initiating, negotiating, securing, drafting or creating the contract on behalf of the Issuer is, at any time while the contract or any extension of the contract is in effect, an employee or agent of any other party to the contract in any capacity or consultant to any other party of the contract with respect to the subject matter of the contract. Exercise by the Issuer of its rights under Arizona Revised Statutes Section 38-511 could adversely affect the owners of the Bonds.

UNDERWRITING

The Underwriter has agreed to purchase the Bonds from the Issuer under a Bond Purchase Agreement dated as of the date of this Official Statement. The Bonds will be offered at an aggregate purchase price of 100% of the principal amount thereof, plus accrued interest, if any. The Company has agreed to pay certain expenses of the Underwriter.

The Bond Purchase Agreement provides that the obligations of the Underwriter are subject to certain conditions, including, among other things, that (i) there has been no material change in the condition of Citizens from that set forth in "APPENDIX F—INFORMATION CONCERNING CITIZENS UTILITIES COMPANY," (ii) no event has occurred which impairs or threatens to impair the status of the interest on the Bonds as exempt from federal income taxation and (iii) proceedings relating to obligations of the same general character as the Bonds or relating to the Bonds are not pending or threatened by the Securities and Exchange Commission.

Citizens has agreed to indemnify the Issuer and the Underwriter against certain civil liabilities, including certain liabilities under the federal securities laws.

TAX MATTERS

Gust Rosenfeld P.L.C., Bond Counsel, is of the opinion that under existing laws, regulations, rulings and judicial decisions, interest income on the Bonds (i) is excluded from gross income for the purpose of calculating federal income taxes, except for interest on any Bond during any period while it is held by a "substantial user" of the facilities financed by the Bonds or a "related person" as such terms are used in Section 147(a) of the Code and (ii) is exempt from Arizona income taxes. The form of such opinion is included as Appendix H attached hereto.

The Code imposes various restrictions, conditions and requirements relating to the continued exclusion of interest income on the Bonds from gross income for federal income tax purposes, including a requirement that the Issuer rebate to the federal government certain of the investment earnings with respect to the Bonds. The Issuer, the Company and Citizens have each covenanted to comply with the provisions of the Code relating to such matters. Failure to comply with such restrictions, conditions and requirements could result in the interest income on the Bonds being included as gross income for federal income tax purposes, under some circumstances, from the date of issuance. The opinion of Bond Counsel assumes continuing compliance with such restrictions, conditions and requirements.

The Code also imposes an "alternative minimum tax" ("AMT") upon certain corporations and individuals. The AMT is equal to the excess (if any) of a taxpayer's "tentative minimum tax" for a taxable year over its regular income tax liability for the taxable year. The tentative minimum tax is based upon a taxpayer's "alternative minimum taxable income" ("AMTI"). A taxpayer's AMTI is its taxable income with certain adjustments. Interest income on the Bonds is not an item of tax preference to be included in the AMTI of individuals and corporations.

Notwithstanding the foregoing paragraph, included in the adjustments of AMTI for corporations is an adjustment increasing the corporation's AMTI by seventy-five percent (75%) of the excess (if any) of the corporation's "adjusted current earnings" over the corporation's AMTI for the taxable year (determined without regard to such adjustment for excess adjusted current earnings and the alternative tax net operating loss deduction). A corporation's "adjusted current earnings" includes all tax exempt interest, including the interest on the Bonds.

Although Bond Counsel will render an opinion that, as of the date of delivery of the Bonds, interest income on the Bonds is excluded from gross income for federal income tax purposes, the accrual or receipt of interest on the Bonds may otherwise affect a Bondholder's federal tax liability. Certain taxpayers may experience other tax consequences. Taxpayers purchasing the Bonds, including, without limitation, corporations subject to the branch profits tax, financial institutions, certain insurance companies, certain subchapter S corporations, individuals who receive Social Security or Railroad Retirement Benefits and taxpayers who have or who are deemed to have incurred indebtedness to purchase or carry tax exempt obligations should consult their tax consultants as to the applicability of such tax consequences to the respective Bondholder. The nature and extent of these other tax consequences will depend upon the Bondholder's particular tax status and the bondholder's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

APPROVAL OF LEGAL PROCEEDINGS

Legal matters incident to the authorization, issuance and sale by the Issuer of the Bonds and with regard to the tax-exempt status thereof are subject to the unqualified approving opinion of Gust Rosenfeld P.L.C., Phoenix, Arizona, Bond Counsel. Copies of such opinions will be available at the time of the delivery of the Bonds. Certain legal matters will be passed upon for the Company by Craig Marks, Esq., Phoenix, Arizona and for the Guarantor by Winthrop, Stimson, Putnam & Roberts, New York, New York. Certain legal matters will be passed upon for the Underwriter by Kutak Rock, Phoenix, Arizona.

ONGOING DISCLOSURE

City and Company have agreed to enter into an undertaking to provide ongoing disclosure (the "Undertaking") for the benefit of the Bondholders and beneficial owners of the Bonds pursuant to the Rule, in the event of a Conversion and related remarketing that would subject the Bonds to the continuing disclosure requirements of such Rule. The Undertaking, as and when made, will be assigned by the Issuer to the Trustee under the terms of the Indenture for the benefit of the Bondholders and the beneficial owners of the Bonds. The Undertaking shall be enforceable by any Bondholder.

Citizens is a reporting company under the Securities Exchange Act of 1934, as amended, and files periodic and other reports and information accordingly with the Securities and Exchange Commission. See "APPENDIX F—INFORMATION CONCERNING CITIZENS UTILITIES COMPANY". Citizens has not otherwise obligated itself to provide ongoing or continuous disclosure information.

LITIGATION

Concurrently with the delivery of the Bonds, the Issuer will deliver a certificate stating, among other things, that, to the best of the Issuer's knowledge, there is no litigation pending or threatened directly against the Issuer to restrain or enjoin the issuance or sale of the Bonds or the execution, delivery and performance of the Indenture, the Facilities Sales Agreement or the Bonds, or in any way affecting the authority for or validity of the Bonds, the Indenture, the Facilities Sales Agreement, this Official Statement or the existence or power of the Issuer to use the proceeds from the Bonds to assist in the financing of the costs of the Facilities.

There is no litigation now pending or, to the knowledge of the Company, threatened against the Company which in any way will materially affect the Company's performance under the Services Agreement or the operation or management of the Facilities.

There is no litigation now pending or, to the knowledge of the City, threatened against the City which in any way will materially affect the City's performance under the Facilities Sales Agreement or the Services Agreement or the operation or management of the Facilities.

There is no litigation now pending or, to the knowledge of Citizens, threatened against Citizens or the Company which in any way may materially affect the performance of Citizens under the Guaranty.

MISCELLANEOUS

THE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT HAS BEEN COMPILED OR PREPARED FROM INFORMATION OBTAINED FROM CITIZENS AND OTHER SOURCES DEEMED TO BE RELIABLE AND, WHILE NOT GUARANTEED AS TO COMPLETENESS OR ACCURACY, IS BELIEVED TO BE CORRECT AS OF THIS DATE. THE ISSUER FURNISHED ONLY THE INFORMATION CONTAINED UNDER THE CAPTIONS "THE ISSUER" AND "LITIGATION" (INsofar AS IT RELATES TO THE ISSUER), THE CITY FURNISHED ONLY THE INFORMATION UNDER THE HEADING "THE CITY" AND, EXCEPT FOR SUCH INFORMATION, NEITHER THE ISSUER NOR THE CITY MAKES ANY REPRESENTATION OR WARRANTIES

EXPRESSED OR IMPLIED AS TO (i) THE ADEQUACY, COMPLETENESS OR ACCURACY OF THIS OFFICIAL STATEMENT OR THE INFORMATION CONTAINED HEREIN; (ii) THE VALIDITY OF THE BONDS; OR (iii) THE TAX STATUS OF THE INTEREST ON THE BONDS. ANY STATEMENTS INVOLVING MATTERS OF OPINION, WHETHER OR NOT EXPRESSLY SO STATED, ARE INTENDED AS SUCH AND NOT AS REPRESENTATIONS OF FACT.

Citizens has reviewed the information contained herein relating to Citizens and the summaries herein of all documents, and Citizens has approved this Official Statement, including its distribution.

APPENDIX A

DEFINITIONS

"Additional Bonds" means the Bonds issued by Issuer in addition to, and on a parity with, the Series 1998 Bonds.

"Adjustable Interest Rate" means the Interest Rate determined not more frequently than every three months in accordance with the Indenture.

"Adjustable Rate Bonds" means Bonds bearing the Adjustable Interest Rate. Adjustable Rate Bonds bearing an Adjustable Interest Rate for an Adjustable Rate Period ending upon the maturity of the Bonds may be referred to as "Convertible Fixed Rate Bonds".

"Adjustable Rate Period" means the period during which the Bonds bear a particular Adjustable Interest Rate, determined as provided in the Indenture.

"Administration Expenses" means the reasonable expenses incurred by the Issuer with respect to the Facilities Sales Agreement, the Indenture and any transaction or event contemplated by the Facilities Sales Agreement or the Indenture, which expenses, including, without limitation, the compensation and reimbursement of expenses and advances payable to Trustee, Paying Agent, any Co-Paying Agent, Depository, Registrar, Market Agent, Auction Agent, Remarketing Agent and any other agent or functionary under the Indenture, shall be payable by City.

"Arbitrage Rebate Consultant" means an accounting firm or firm of attorneys or another person or firm with knowledge of or experience in advising bond trustees with respect to the provisions of Section 148(f) of the Code.

"Auction" means each periodic implementation of the Auction Procedures.

"Auction Agent" means such entity in the Borough of Manhattan, the City of New York appointed as such for the Auction Rate Bonds in accordance with and satisfying the requirements of the Indenture.

"Auction Date" means, until an Event of Default has occurred, the last Business Day of an Auction Period.

"Auction Period" means each period established pursuant to the Indenture during which a Bond shall bear a particular fixed rate of interest established pursuant to the Auction Procedures.

"Auction Period Adjustment Date" means the effective date of an adjustment of the Auction Period.

"Auction Procedures" means the procedures for conducting auctions for the Auction Rate Bonds set forth in the Indenture.

"Auction Rate" means the rate per annum that results from implementation of the Auction Procedures (whether a Short-Term Auction Rate or a Long-Term Auction Rate), provided that if

an Event of Default shall have occurred prior to the first day of the Auction Period, the rate of interest for any Auction Period after such Event of Default shall be the Overdue Rate. In no event shall the Auction Rate exceed the Maximum Auction Rate.

"Auction Rate Bonds" means Auction Rate Bonds which bear interest at an Auction Rate, whether Short-Term Auction Rate Bonds or Long-Term Auction Rate Bonds. SAVRS^(TM) is an acronym for Auction Rate Bonds derived from the Lehman Brothers Inc. program known as "Select Auction Variable Rate Securities".

"Authorized Denominations" means the denominations authorized for the Bonds by the Indenture.

"Bond" or *"Bonds"* means the Series 1998 Bonds and any Additional Bonds authorized to be issued under the Indenture.

"Bond Counsel" means any firm of nationally recognized bond counsel selected by City and acceptable to Issuer, Trustee or any other person asked to act or refrain from acting in reliance on the opinion of such counsel.

"Bond Fund" means the fund by that name created in the Indenture.

"Bondholder" or *"Holder"* means the person in whose name any Bond is registered upon the registration book. The City, the Company or the Guarantor may be a Bondholder.

"Bond Year" means the one-year period beginning on the day after expiration of the preceding bond year. The first Bond Year begins on the date of issue of the bonds and ends the day before the first anniversary date of the date of issue.

"Bonds Being Refunded" means the \$8,860,000 of City of Tolleson Municipal Finance Corporation Revenue Bonds, Series of 1985 maturing on or after September 1, 1998.

"Book-Entry Bond" means any Bond registered in the name of Cede & Co., as nominee of DTC.

"Business Day" means a day of the year on which banks located in the City of New York, New York and the City of Phoenix, Arizona (or if the Principal Office of Trustee shall not be in the City of Phoenix, Arizona, then such other city in which is located such Principal Office) are not required or authorized to remain closed and on which The New York Stock Exchange is not closed.

"City" means the City of Tolleson, Maricopa County, Arizona, its successors and assigns.

"City Direction" means a direction, instruction, approval or consent under the Indenture of the City acting at the direction of the Company, which direction is pursuant to, and in accordance with, the terms of the Services Agreement.

"City Representative" means the person or persons at the time designated to act on behalf of City by written certificate furnished to Issuer and Trustee containing the specimen signatures

of such person or persons and signed on behalf of City by its Mayor or Vice Mayor, together with its Clerk. Such certificate may designate an alternate or alternates.

"Co-Authenticating Agent" means the co-authenticating agent appointed in accordance with the Indenture, which Co-Authenticating Agent initially shall be the Depository.

"Code" means the Internal Revenue Code of 1986. Each reference to a section of the code herein shall be deemed to include the United States Treasury Regulations proposed or in effect thereunder and applicable to the Bonds or the use of proceeds thereof, unless the context clearly requires otherwise.

"Company" means Sun City Sewer Company, an Arizona corporation, its successors or assigns.

"Company Representative" means the person or persons at the time designated to act on behalf of Company by written certificate furnished to Issuer and Trustee containing the specimen signatures of such person or persons and signed on behalf of Company by its President or any Vice President, together with its Secretary or any Assistant Secretary or Treasurer or any Assistant Treasurer. Such certificate may designate an alternate or alternates.

"Conversion" means the conversion from time to time in accordance with the terms of the Indenture of the method for establishing the Interest Rate on the Bonds to another method permitted hereunder, including the establishment of the related applicable Interest Periods, Purchase Dates and Auction Periods and, in addition, shall mean (i) conversions from Demand Purchase Bonds bearing one Demand Purchase Rate to Demand Purchase Bonds bearing a different Demand Purchase Rate and (ii) in the case of Auction Rate Bonds, conversions from Short-Term Auction Rate Bonds to Long-Term Auction Rate Bonds or from Long-Term Auction Rate Bonds to Short-Term Auction Rate Bonds or from Long-Term Auction Rate Bonds to Long-Term Auction Rate Bonds having Long-Term Auction Periods of a different duration.

"Conversion Date" means the date of any Conversion.

"Daily Interest Rate" means the Interest Rate determined daily in accordance with provisions contained in the Indenture.

"Daily Rate Bonds" means Bonds bearing the Daily Interest Rate.

"Default" and *"Event of Default"* means any occurrence or event specified as such in the Indenture.

"Demand Purchase Bonds" means Bonds bearing the Demand Purchase Rate.

"Demand Purchase Period". In the event of Conversion to Demand Purchase Bonds, the initial "Demand Purchase Period" means the period beginning on, and including, the Conversion Date, provided that each such initial Demand Purchase Period shall (i) be at least 15 months in length, (ii) terminate on the day prior to the May 1 or November 1 of the year in which the Demand Purchase Period ends, and (iii) terminate no later than April 30, 2015. After the initial Demand Purchase Period following a Conversion to Demand Purchase Bonds, "Demand Purchase Period" means the period determined in accordance with the Indenture.

"Demand Purchase Rate" means the Interest Rate determined in accordance with the Indenture.

"Depository" means Bank One, Arizona, NA, as depository under the Depository Agreement, and its successors and assigns. *"Principal Office"* of Depository means the office of Depository as identified in the Depository Agreement.

"Depository Agreement" means the Depository Agreement, dated as of May 1, 1998, among Trustee, Company, Depository and Remarketing Agent, and any and all modifications, alterations, amendments and supplements thereto.

"DTC" means the Securities Depository, The Depository Trust Company, New York, New York.

"Facilities" means the capital improvement or equipment constituting wastewater collection, treatment or disposal facilities and facilities for the furnishing of water constructed with the proceeds of the Bonds Being Refunded. The Facilities financed with the proceeds of the Bonds Being Refunded are described in Exhibit A to the Facilities Sales Agreement.

"Facilities Sales Agreement" means the Facilities Sales Agreement, dated as of August 1, 1985, between Issuer and City, as supplemented by the Refinancing Supplement to Facilities Sale Agreement dated as of May 1, 1998, and any and all additional modifications, alterations, amendments and supplements thereto.

"Final Demand Purchase Period" means the market rate of interest for a Demand Purchase Period ending on the maturity date of the Bonds.

"Fixed Interest Rate" means a fixed, nonvariable Interest Rate established in accordance with the Indenture.

"Fixed Rate Bonds" means Bonds bearing a Fixed Interest Rate.

"Fixed Rate Period" means the period during which the Bonds bear a Fixed Interest Rate.

"Governmental Obligations" means any of the following which are noncallable and which at the time of investment are legal investments under the laws of the State for the moneys proposed to be invested therein:

- (a) direct general obligations of, or obligations the payment of principal of and interest on which are unconditionally guaranteed by, the United States of America;
- (b) bonds, debentures or notes issued by any of the following federal agencies: Banks for Cooperatives, Federal Land Banks or Federal National Mortgage Association (including participation certificates and Federal Farm Credit Banks Consolidated Systemwide Bonds); or
- (c) Public Housing Bonds, Temporary Notes or Preliminary Loan Notes fully secured by contracts with the United States of America.

"Guarantor" means Citizens Utilities Company, a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns and any surviving, resulting or transferee entity.

"Guarantor Representative" means the person or persons at the time designated to act on behalf of the Guarantor by written certificate furnished to Issuer and Trustee containing the specimen signatures of such person or persons and signed on behalf of the Guarantor by its President or any Vice President, together with its Secretary or Assistant Secretary or Treasurer or any Assistant Treasurer. Such certificate may designate an alternate or alternates.

"Guaranty" means that Refinancing Guaranty dated as of May 1, 1998 by the Guarantor in favor of the City, and any and all additions, modifications, alterations, amendments and supplements thereto.

"Indenture" means the Refunding Indenture of Trust, dated as of May 1, 1998, between Issuer and Trustee, and any and all modifications, alterations, amendments and supplements thereto.

"Independent Counsel" means an attorney duly admitted to practice law before the highest court of any state or the District of Columbia and who is not a full-time employee of Issuer, City, Company or Guarantor, or a director or holder of 5% or more of the shares of Company or Guarantor.

"Interest Payment Date" means (i) in the cases of Daily Rate Bonds and Weekly Rate Bonds, the first Wednesday of each month, commencing the first such Wednesday that occurs at least 30 days after issuance of the Bonds, (ii) in the case of Money Market Bonds, the first Business Day following the last day of the Money Market Period, (iii) in the cases of Fixed Rate Bonds, Adjustable Rate Bonds and Demand Purchase Bonds, each May 1 and November 1, (iv) in the case of Short-Term Auction Rate Bonds, the day next succeeding the end of an Auction Period and, with respect to Long-Term Auction Rate Bonds, each May 1 and November 1 during the Auction Period and on the day following the end of each Auction Period, and (v) the Conversion Date. In any case, if any such Interest Payment Date described in (i), (ii) and (iv) shall not occur on a Business Day, the Interest Payment Date shall be the next succeeding day which is a Business Day. The final Interest Payment Date shall be the maturity date or earlier date of redemption or acceleration of the Bonds.

"Interest Period" means, for all Series 1998 Bonds, the period from and including each Interest Payment Date to and including the day next preceding the then next Interest Payment Date (except that the correlative periods for Auction Rate Bonds shall be called "Auction Periods"). The first Interest Period for Bonds converted from one mode of determining interest to a different mode shall begin on the Conversion Date. The final Interest Period shall end on April 30, 2015, or the earlier date of redemption or acceleration of the Bonds.

"Interest Rate" means the rate of interest borne by the Bond or Bonds identified in the reference thereto, as the time referred to.

"Investment Company" means an open-end diversified management investment company registered under the Investment Company Act of 1940, as amended.

"Investment Securities" means any of the following obligations or securities on which neither Guarantor nor any of its Subsidiaries is the obligor: (a) Governmental Obligations; (b) interest bearing deposit accounts (which may be represented by certificates of deposit) in national or state banks (which may include Trustee, Paying Agent, any Co-Paying Agent, Depository and the Registrar) having a combined capital and surplus of not less than \$10,000,000, or savings and loan associations having total assets of not less than \$40,000,000; (c) bankers' acceptances drawn on and accepted by commercial banks (which may include Trustee, Paying Agent, any Co-Paying Agent, Depository and the Registrar) having a combined capital and surplus of not less than \$10,000,000; (d)(i) direct obligations of, (ii) obligations the principal of and interest on which are unconditionally guaranteed by, and (iii) any other obligations the interest on which is exempt from federal income taxation issued by, any State of the United States of America, the District of Columbia or the Commonwealth of Puerto Rico, or any political subdivision, agency, authority or other instrumentality of any of the foregoing, which, in any case, are rated in any of the three highest rating categories by a nationally recognized rating agency; (e) obligations of any agency or instrumentality of the United States of America; (f) commercial or finance company paper which is rated in any of the three highest rating categories by a nationally recognized rating agency; (g) corporate debt securities issued by corporations having debt securities rated in any of the three highest rating categories by a nationally recognized rating agency; (h) repurchase agreements with banking or financial institutions having a combined capital and surplus of not less than \$10,000,000 (which may include Trustee, Paying Agent, any Co-Paying Agent and the Registrar) with respect to any of the foregoing obligations or securities in which Trustee shall have a perfected security interest and for which Trustee shall hold as collateral the securities purchased; (i) money market fund shares issued by a fund having assets of not less than \$100,000,000; (j) investment contracts guaranteed by life and casualty insurance companies having a combined capital and surplus of not less than \$10,000,000 and for which Trustee shall hold collateral security satisfactory to it; and (i) any other obligations which may lawfully be purchased by Trustee.

"Issuer" means City of Tolleson Municipal Finance Corporation, an Arizona nonprofit corporation incorporated with the approval of City, its successors and its assigns.

"Issuer Representative" means the President, any Vice President, Secretary/Treasurer or Assistant Secretary/Treasurer of Issuer or the person or persons at the time designated to act on behalf of Issuer by written certificate furnished to Company, Guarantor and Trustee containing the specimen signatures of such person or persons and signed on behalf of Issuer by its President or Vice President. Such certificate may designate an alternate or alternates.

"Letter of Representations" means the Letter of Representations dated the date of original issue of the Bonds addressed to DTC with respect to the Book-Entry Bonds by Issuer, Remarketing Agent, Depository, Paying Agent and Trustee, and any and all modifications, alterations, amendments and supplements thereto.

"Long-Term Auction Period" means an Auction Period of more than 270 days determined in the manner provided in the Indenture.

"Long-Term Auction Rate" means the Interest Rate determined for Long-Term Auction Rate Bonds in accordance with the Indenture.

"Money Market Bonds" means Bonds the Interest Rate on which shall be determined from time to time in accordance with the Indenture.

"Money Market Period" means the Interest Period for any Money Market Bond, as determined from time to time in accordance with the Indenture.

"Moody's" means Moody's Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successor or successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized rating agency designated by Issuer pursuant to a City Direction.

"1985 Indenture" means that certain Indenture dated as of August 1, 1985, by and between the Issuer and the 1985 Trustee.

"1985 Trustee" means Bank One, Arizona, NA, formerly known as The Valley National Bank of Arizona, as trustee under the 1985 Indenture.

"Notice by Mail" or *"Notice"* of any action or condition "by Mail" means a written notice meeting the requirements of this Indenture mailed by first-class mail to the Bondholders, at the addresses shown in the registration books maintained pursuant to the Indenture. A notice period specified herein shall consist of the number of consecutive calendar or Business Days specified to, but not including, the date of the event being noticed.

"Outstanding" or *"Bonds Outstanding"* means all Bonds which have been authenticated and delivered under the Indenture, except:

- (a) Bonds cancelled after purchase in the open market or because of payment or redemption prior to maturity;
- (b) Bonds for the payment or redemption of which cash funds or Governmental Obligations shall have been theretofore deposited with Trustee (whether upon or prior to the maturity or redemption date of any such Bonds), provided that, if such Bonds are to be redeemed prior to the maturity thereof, notice of such redemption shall have been given or arrangements satisfactory to Trustee shall have been made therefor, or waiver of such notice satisfactory in form to Trustee shall have been filed with Trustee; and
- (c) Bonds in lieu of which others have been authenticated under the Indenture.

"Overdue Rate" means, subject to limitations set forth in the Indenture, 265% of the Auction Rate Index or such other rate as the Remarketing Agent may establish in accordance with then market conditions.

"Payments" means the payments required to be made by City pursuant to the Facilities Sales Agreement.

"Paying Agent" or *"Co-Paying Agent"* means such financial institutions as are appointed the paying agent and any co-paying agent, which institutions initially shall be Trustee and

Depository, respectively. "Principal Office" of Paying Agent or any Co-Paying Agent shall mean the office thereof designated in writing to Issuer and Trustee.

"Person" means any individual, group of individuals, corporation, partnership, limited partnership, limited liability company, joint venture, association, joint-stock company, syndicate, trust, unincorporated organization or any other form of entity or government or any agency or political subdivision thereof.

"Purchase Date" means (i) in the case of Money Market Bonds, the Interest Payment Date, (ii) in the cases of Daily Rate Bonds and Weekly Rate Bonds, any Business Day as set forth in the Indenture, and (iii) in the case of Demand Purchase Bonds or Adjustable Rate Bonds, the final Interest Payment Date of a Demand Purchase Period or an Adjustable Rate Period, respectively.

"Receipts and Revenues of Issuer from the Facilities Sales Agreement" means all moneys paid or payable to Trustee for the account of Issuer in respect of the payments of the purchase price pursuant to Article VIII of the Facilities Sales Agreement and all receipts of Trustee credited under the provisions of the Indenture against such payments.

"Record Date" means, in the case of Variable Rate Bonds or Auction Rate Bonds, the fifth Business Day next preceding such Interest Payment Date and, in the cases of Adjustable Rate Bonds, Demand Purchase Bonds and Fixed Rate Bonds, the April 15 or October 15, as the case may be, next preceding each Interest Payment Date.

"Registrar" means the Registrar appointed in accordance with the Indenture, which Registrar initially shall be Trustee. "Principal Office" of the Registrar means the office thereof designated in writing to Issuer and Trustee.

"Remarketing Agent" or "Market Agent" means the Remarketing Agent or, with respect to Auction Rate Bonds, the Market Agent appointed in accordance with the Indenture, which institutions both initially shall be Lehman Brothers Inc. "Principal Office" of Remarketing Agent means the office thereof designated in writing to Issuer and Trustee.

"Remarketing Agreement" means the Remarketing Agreement to be entered into between Company and Remarketing Agent and any and all modifications, alterations, amendments and supplements thereto.

The "Rule" means Securities and Exchange Commission Rule 15c2-12 under the Securities Exchange Act of 1934, as amended (17 C.F.R. §240.15c2-12).

"Securities Depository" means The Depository Trust Company, New York, New York, or its successor or assigns or substitute depository for the Bonds.

"Series 1998 Bonds" means the \$8,560,000 aggregate principal amount of City of Tolleson Municipal Finance Corporation Revenue Refunding Bonds Series of 1998 issued by Issuer pursuant to this Indenture.

"Services Agreement" means that Sewage Treatment and Transportation Services Agreement between the City of Tolleson, Maricopa County, Arizona and Sun City Sewer

Company dated as of June 21, 1985, as amended by that Refinancing Supplement to Sewage Treatment and Services Agreement dated as of May 1, 1998, and any and all modifications, alterations, amendments and supplements thereto.

"Short-Term Auction Index" means an interest index determined in accordance with the Indenture.

"Short-Term Auction Period" means any Auction Period consisting of from one (1) to 270 days as determined in the manner provided in the Indenture.

"Short-Term Auction Rate" means the Interest Rate determined for Short-Term Auction Rate Bonds in accordance with the Indenture.

"Short-Term Auction Rate Bond" means any Auction Rate Bond having a Short-Term Auction Period.

"S&P" means Standard & Poor's Ratings Service, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successor or successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized rating agency designated by Issuer pursuant to a City Direction.

"Supplemental Indenture" means any indenture of Issuer modifying, altering, amending, supplementing or confirming the Indenture for any purpose, in accordance with the terms hereof.

"Trustee" means Bank One, Arizona, NA, a national banking association organized and existing under the laws of the United States of America, as trustee under this Indenture, its successors in trust and its assigns. "Principal Office" of Trustee means the designated corporate trust office of Trustee, which office at the date of acceptance by Trustee of the duties and obligations imposed on Trustee by the Indenture is located at 201 N. Central Avenue, 25th Floor, Phoenix, Arizona 85004.

"Trust Estate" means the property conveyed to Trustee pursuant to the Granting Clauses of the Indenture.

"Variable Rate Debt" or *"Variable Rate Bonds"* means, collectively, all Weekly Rate Bonds, all Money Market Bonds and all Daily Rate Bonds issued hereunder.

"Weekly Rate Bonds" means Bonds having an interest rate which shall be determined weekly in accordance with the Indenture.

"Weekly Rate Period" means the period beginning on, and including, any Wednesday (or, if not a Business Day, on the next succeeding Business Day) and ending on, and including, the then next Tuesday (or the day immediately preceding the first day of the next Weekly Rate Period for Weekly Rate Bonds), except that in the event of Conversion to Weekly Rate Bonds, the first "Weekly Rate Period" means the period beginning on, and including the Conversion Date and ending on, and including the second succeeding Tuesday (or the day immediately preceding the first day of the next weekly Rate Period for Weekly Rate Bonds).

APPENDIX B

THE INDENTURE

The following is a summary of the Indenture. Such summary does not purport to be comprehensive or definitive. The terms of the summary contained herein are qualified in their entirety by reference to the Indenture.

Revenues and Funds

The Indenture creates "City of Tolleson Municipal Finance Corporation Revenue Refunding Bonds Series of 1998 Bond Fund (1998)".

Bond Fund

On the Bond Issuance Date the Trustee shall deposit into the Bond Fund all accrued interest received, if any, at the time of the issuance, sale and delivery of the Bonds. In addition, there shall be deposited into the Bond Fund, as and when received, all payments of principal, premium, if any, and interest, together with Administration Expenses, as provided in the Facilities Sales Agreement which are required or which are accompanied by directions that such moneys are to be paid into the Bond Fund.

Except as provided in the succeeding two paragraphs and as otherwise excepted in the Indenture, moneys in the Bond Fund shall be used solely for the payment of the principal of, premium, if any, and interest on the Bonds and for the redemption of the Bonds prior to maturity.

Moneys deposited into the Bond Fund pursuant to the Indenture and any income or other gain from the investment thereof, shall be applied by Trustee (a) in whole or in part in any manner directed by City, pursuant to a City Direction, which, as indicated in an opinion of Bond Counsel furnished by City to Issuer, Company and Trustee, will not impair the validity of the Bonds or the exclusion from gross income for federal income tax purposes of the interest thereon, or, if a Default, to pay fees, costs, debt service or, in the absence of any such application on or prior to the twenty-fifth day prior to the redemption date determined pursuant to the Indenture, or (b) to the payment of principal upon the redemption, from time to time, of Bonds pursuant to the Indenture, any moneys which are not so applied to be retained in the Bond Fund and applied by Trustee to the payment of principal of Bonds either at maturity or upon the redemption of all or any portion of the Bonds, whichever occurs first.

Moneys in the Bond Fund shall also be expended by Trustee to pay Administration Expenses pursuant to City Directions.

Tax Covenants

The Issuer covenants that, if and to the extent such moneys are under Issuer's control, the proceeds of the Bonds, directly or indirectly, any moneys derived from the use or investment thereof, and any other moneys on deposit in any fund or account maintained in respect of the Bonds (whether such moneys were derived from the proceeds of the sale of the Bonds or from other sources) will not be knowingly used by Issuer in a manner that would cause the Bonds to be treated as "arbitrage bonds" within the meaning of Section 148 of the Code, and the Treasury

Regulations proposed or adopted thereunder as the same may be in effect from time to time and to the extent the same are applicable to the Bonds. Issuer further covenants within the aforesaid limitations that it will comply with all necessary restrictions of the Code so as not to cause the interest on the Bonds (excluding any periods of time when the Bonds are held by a "substantial user" or "related person" (within the meaning of Section 147(a) of the Code)) to be subject to federal income taxation other than any applicable minimum tax.

Defaults

If any one or more of the following events occur, it is hereby defined as and declared to be and to constitute an "Event of Default" under the Indenture:

- (a) default in the due and punctual payment of any interest on any Bond, and, in the case of Adjustable Rate Bonds, Demand Purchase Bonds, Fixed Rate Bonds and Long-Term Auction Rate Bonds, the failure to pay for a period of five days after such payment has become due and payable;
- (b) default in the due and punctual payment of the principal of or redemption premium, if any, on any Bond, whether at the stated maturity or accelerated maturity thereof, or upon proceedings for redemption thereof;
- (c) default in the due and punctual payment of an amount due pursuant to provisions of the Indenture for purchase upon tender or deemed tender of Bonds and, in the case of Adjustable Rate Bonds or Demand Purchase Bonds, failure to so pay for a period of five days after such payment has become due and payable;
- (d) default in the performance or observance of any other of the covenants, agreements or conditions on the part of Issuer or City in the Indenture or in the Bonds contained and failure to remedy the same after notice thereof pursuant to the Indenture; or
- (e) default in the payment of any portion of the purchase price when due under the Facilities Sales Agreement or the breach of any other covenant or obligation of the City thereunder not cured within 30 days of written notice from Trustee to Issuer, City, Company and Guarantor.

Acceleration

During the continuation of an Event of Default described in clause (a), (b), or (c) described above under the caption **Defaults**, caused by the failure of the Company to pay when due Rate Component One under the Services Agreement or amounts due under the Depository Agreement or the Remarketing Agreement or by failure of the Guarantor to pay amounts due under the Guaranty, Trustee may, and upon the written request of the Bondholders of not less than 33-1/3% in aggregate principal amount of Outstanding Bonds shall, upon notice in writing delivered to Issuer, City, Company and Guarantor declare the principal of all Outstanding Bonds and the interest accrued thereon immediately due and payable, and such principal and interest shall thereupon become and be immediately due and payable. Upon any declaration of acceleration under the Indenture, Trustee shall immediately declare an amount equal to all amounts then due and payable on the Bonds to be immediately due and payable as liquidated

damages. If the Event of Default is not due to the failure of the Company to pay when due Rate Component One under the Services Agreement or amounts due under the Depository Agreement or the Remarketing Agreement or to the failure of the Guarantor to pay amounts due under the Guaranty, any Outstanding Bonds shall not be declared immediately due and payable and Trustee will have only those remedies otherwise described further in the Indenture.

Under certain circumstances provided in the Indenture, the Trustee may annul the declaration of acceleration.

Application of Moneys

Upon an Event of Default, all moneys received by Trustee pursuant to any right or remedy given or action taken under the Indenture shall, after payment of the reasonable costs and expenses of the proceedings resulting in the collection of such moneys and of the expenses, liabilities and advances incurred or made by Trustee, be deposited in the Bond Fund to be applied as follows:

(a) Unless the principal of all the Bonds shall have become or shall have been declared due and payable, all such moneys shall be applied: FIRST-to the payment to the persons entitled thereto of all installments of interest then due on the Bonds, in the order of the maturity of the installments of such interest and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or privilege; SECOND-to the payment to the persons entitled thereto of the unpaid principal of and premium, if any, on any of the Bonds which shall have become due (other than Bonds matured or called for redemption for the payment of which moneys are held pursuant to the provisions of the Indenture), with interest on such Bonds from the respective dates upon which they became due and, if the amount available shall not be sufficient to pay in full Bonds due on any particular date, together with such interest, then to the payment ratably, according to the amount of principal due on such date, to the persons entitled thereto without any discrimination or privilege; and THIRD-to be held for the payment to the persons entitled thereto as the same shall become due of the principal of and premium, if any, and interest on the Bonds which may thereafter become due either at maturity or upon call for redemption prior to maturity and, if the amount available shall not be sufficient to pay in full Bonds due on any particular date, together with interest then due and owing thereon, payment shall be made ratably according to the amount of principal due on such date to the persons entitled thereto without any discrimination or privilege.

(b) If the principal of all the Bonds shall have become due or shall have been declared due and payable, all such moneys shall be applied to the payment of the principal and interest then due and unpaid upon the Bonds, without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, ratably, according to the amounts due, respectively, for principal and interest, to the persons entitled thereto without any discrimination or privilege.

(c) If the principal of all the Bonds shall have been declared due and payable, and if such declaration shall thereafter have been rescinded and annulled under the Indenture then, in the event that the principal of all the Bonds shall later become due or be declared due and payable, the moneys shall be applied in accordance with the Indenture.

Supplemental Indentures Not Requiring Consent of Bondholders

The Issuer and the Trustee may from time to time, without the consent of any of the Bondholders, enter into a Supplemental Indenture or Supplemental Indentures for one of the following purposes: (a) to cure any ambiguity or formal defect or omission in the Indenture; (b) to provide for modifications of the DTC book-entry system or adoption of additional or alternative systems of Book-Entry Bonds; (c) to grant to or confer upon Trustee for the benefit of the Bondholders any additional rights, remedies, powers or authorities that may lawfully be granted to or conferred upon the Bondholders or Trustee; (d) to subject to the Indenture additional revenues, collateral or credit enhancement; (e) to modify, amend or supplement this Indenture or any indenture supplemental hereto in such manner as (i) to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar federal statute in effect, (ii) to permit the qualification of the Bonds for sale under the securities laws of any of the states of the United States of America or (iii) to comply with the requirements of any applicable federal securities law, including, without limitation, the Rule, for the primary or secondary market sales of the Bonds; (f) to provide for the issuance of Additional Bonds pursuant to the provisions of the Indenture hereof; (g) to evidence the appointment of a separate or Co-Trustee, the succession of a new Trustee or the appointment of a new Remarketing Agent or Co-Remarketing Agent; (h) to change the method for determining any Interest Rate, Money Market Period, Demand Purchase Period, Adjustable Rate Period, Short-Term Auction Rate or Short-Term Auction Period or to add provisions for a new interest rate or interest period determination method; (i) to change the optional redemption prices and dates relating to Adjustable Rate Bonds, Demand Purchase Bonds, Long-Term Auction Rate Bonds and Fixed Rate Bonds upon Conversion to such types of Bond; (j) to change the Conversion notice periods, related purchase procedures or other Conversion procedures in a manner which, in the judgment of Trustee based on the advice of investment bankers or other knowledgeable professionals, is not to the prejudice of Trustee or the Bondholders; (k) to provide for a bond insurance policy, surety bond, letter of credit or other credit support facility; (l) to make any change to the Auction Procedures set forth herein which does not adversely affect the rights of Existing Holders; (m) to preserve the exemption of the interest income borne on the Bonds from federal or State of Arizona income taxes and preserve the power of Issuer to continue to issue bonds or other obligations (specifically not limited to the Bonds authorized hereby), the interest income on which is likewise exempt from federal and State of Arizona income taxes; or (n) to make any other change in the Indenture which is not to the prejudice of Trustee or the Bondholders.

Supplemental Indenture Requiring Consent of Bondholders

The Bondholders of not less than 60% in aggregate principal amount of the Outstanding Bonds which would be adversely affected thereby shall have the right, from time to time, to consent to and approve the execution by Issuer and Trustee of such other supplemental indenture as shall be deemed necessary and desirable by Issuer for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Indenture or in any Supplemental Indenture; provided, however, that nothing in the Indenture

permits, or is to be construed as permitting, without the consent of the Holders of all Bonds Outstanding, (a) an extension of the maturity of the principal of, or the interest on, any Bond issued thereunder, or (b) a reduction in the principal amount of, or redemption premium on, any Bond or the rate of interest thereon, or a change in the terms of redemption of the Bonds, or (c) a privilege or priority of any Bond or Bonds over any other Bond or Bonds, or (d) a reduction in the aggregate principal amount of the Bonds required for consent to such Supplemental Indentures or any modification or waiver of the provisions of the Facilities Sales Agreement, or (e) the creation of any lien ranking prior to or on a parity with the lien of the Indenture on the Trust Estate or any part thereof, except as hereinbefore expressly permitted or (f) the deprivation of the Bondholder of any Outstanding Bond of the lien thereby created on the Trust Estate.

Amendments to Facilities Sales Agreement or Services Agreement Not Requiring Consent of Bondholders

The Issuer and the Trustee shall, without the consent of or notice to the Bondholders, consent to any amendment, change or modification of the Facilities Sales Agreement or Services Agreement as may be required (i) by the provisions of such documents and the Indenture, (ii) for the purpose of curing any ambiguity or formal defect or omission in such documents, (iii) so as to more precisely identify the Facilities or to add additional rights or interests in property acquired in accordance therewith, (iv) to enter into an indenture or indentures supplemental to the Indenture, (v) to provide for the issuance of Additional Bonds in accordance with the Indenture, (vi) to preserve the exemption of the interest income borne on the Bonds from federal or State of Arizona income taxes and preserve the power of Issuer to continue to issue bonds or other obligations (specifically not limited to the Bonds authorized hereby), the interest income on which is likewise exempt from federal and State of Arizona income taxes or (vii) in connection with any other change therein which is not to the prejudice of Trustee or the Bondholders. A revision of any Exhibit to the Facilities Sales Agreement or Services Agreement pursuant to the Indenture will not be deemed to be a modification, alteration, amendment or supplement thereto.

Amendments to Facilities Sales Agreement or Services Agreement Requiring Consent of Bondholders

Except as described in the immediately preceding paragraph, neither Issuer nor Trustee shall consent to any amendment, change or modification of the Facilities Sales Agreement or Services Agreement without the written approval or consent of the Bondholders of not less than 60% in aggregate principal amount of the Bonds at the time Outstanding which would be adversely affected thereby; provided that the consent of the Bondholders of all Bonds Outstanding is required for any amendment, change or modification of the Facilities Sales Agreement or Services Agreement that would permit the termination or cancellation of the Facilities Sales Agreement or Services Agreement or a reduction in or postponement of the payments under the Facilities Sales Agreement or Services Agreement or any change in the provisions relating to the payment thereunder.

Discharge of the Indenture

If Issuer shall cause to be paid, or there shall otherwise be paid or provision for payment made, to the Holders of the Bonds, the principal of, premium, if any, and interest due or to become due thereon at the times and in the manner stipulated therein, and if Issuer shall not then be in Default in any of the other covenants and promises in the Bonds and in the Indenture

expressed as to be kept, performed and observed by it or on its part, and if Issuer shall cause to be paid to Trustee, Paying Agents or Co-Paying Agents, Registrar, Depository and Remarketing Agent all sums of money due or to become due according to the provisions of the Indenture, then the Trust Estate and rights granted by the Indenture shall cease, determine and be void, whereupon Trustee, upon receipt of a written request of Issuer and of an opinion of Bond Counsel addressed to Issuer and Trustee that all conditions precedent to the satisfaction and discharge of the Indenture have been complied with, shall cancel and discharge the Indenture, and execute and deliver to Issuer such instruments in writing as shall be requisite to release the Indenture, and reconvey, release, assign and deliver unto Issuer any and all of the Trust Estate, right, title and interest in and to any and all rights conveyed, assigned or pledged to Trustee or otherwise subject to the Indenture, except amounts held in the Bond Fund required to be paid to Company under the Indenture and except cash held by Trustee for payment of the principal of, premium, if any, and interest on the Bonds.

Deemed Payment

After Conversion to the Adjustable Interest Rate (but only during an Adjustable Rate Period), the Demand Purchase Rate (but only during a Demand Purchase Period), the Fixed Interest Rate or the Auction Rate, any Bond shall be deemed to be paid pursuant to the Indenture when (a) payment of the principal of, the redemption premium (if any) and the interest on such Bond to the due date thereof (whether such due date is by reason of maturity or upon redemption) either (i) shall have been made or caused to be made in accordance with the terms of the Indenture or (ii) shall have been provided for by irrevocably depositing in the Bond Fund (1) moneys sufficient to make such payment and/or (2) Government Obligations maturing as to principal and interest in such amount and at such time as will insure the availability of sufficient moneys to make such payment, and (b) all necessary and proper fees, compensation and expenses of Trustee, Remarketing Agent, Registrar, Paying Agent and any Co-Paying Agent and Depository pertaining to the Bonds with respect to which such deposit is made shall have been paid or the payment thereof provided for to the satisfaction of Trustee. At such times as a Bond shall be deemed to be paid under the Indenture, as aforesaid, such Bond shall no longer be secured by or entitled to the benefits of the Indenture, except for the purposes of any such payment from such moneys or Government Obligations.

APPENDIX C

THE FACILITIES SALES AGREEMENT

The following is a summary of the Facilities Sales Agreement. Such summary does not purport to be comprehensive or definitive. The terms of the summary contained herein are qualified in their entirety by reference to the Facilities Sales Agreement itself.

Construction and Acquisition of the Improvements

The Issuer originally issued bonds in 1985 to finance the costs and expenses relating to the financing, engineering, acquisition and construction of certain improvements (the "Improvements") to an already existing sewage treatment facility, including the fee for the usufructuary interest to be paid by the Company to the City pursuant to that Facilities Sales Agreement dated as of August 1, 1985 (the "1985 Facilities Sales Agreement"), subsequently amended by the Refinancing Supplement to Facilities Sales Agreement, dated as of May 1, 1998 (the "1998 Facilities Sales Agreement", together with the 1985 Facilities Sales Agreement, the "Facilities Sales Agreement") (see "APPENDIX D—SERVICES AGREEMENT—Usufructuary Interest"). The Issuer subsequently constructed or caused to be constructed the Improvements, in accordance with plans and specifications prepared for the City.

Sale of the Improvements to the City

The Issuer sold to the City, and the City purchased from the Issuer, the Improvements which were constructed by the Issuer pursuant to the 1985 Facilities Sales Agreement. Payments with respect to the Bonds, along with costs related thereto are payable by the City, pursuant to the Facilities Sales Agreement, in installments to the Trustee for the account of the Issuer, at such time and in sufficient amounts to permit the Issuer to make timely payments of the debt service on the Bonds and the periodic fees of the Trustee, the Registrar and the Paying Agent. In addition to paying all amounts necessary to meet the Issuer's requirements under the Indenture, the City is required to pay (i) reasonable fees and expenses of the Trustee, Registrar and Paying Agent under the Indenture to the extent, if any, that such fees and expenses are not met by the regular purchase payments, (ii) the reasonable expenses of the Issuer, approved by the City and the Company and not otherwise required to be paid by the City under the Facilities Sales Agreement, (iii) fees for maintaining the Issuer's corporate existence and, at a time mutually agreed by the Issuer and the City, fees and expenses for terminating the Issuer's corporate existence, and (iv) all other expenses of the Issuer incurred at the written request of the City or the Trustee and approved by the Company.

The purchase price payments, as well as any other amounts required to be paid by the City pursuant to the provisions of the Facilities Sales Agreement, are payable solely from (i) proceeds of the Bonds deposited with the Trustee, together with certain investment earnings thereon, and (ii) payments of Rate Component One received by the City from the Company pursuant to the Services Agreement or, in the event the Company fails to make timely payment of Rate Component One, from payments to be made by Citizens Utilities Company pursuant to the Guaranty. Pursuant to the Facilities Sales Agreement, the City has pledged and assigned to the Issuer such payments of Rate Component One and payments by Citizens Utilities Company under the Guaranty for the payment of the purchase price of the Improvements. Under no circumstances shall the obligations of the City under the Facilities Sales Agreement constitute a

general obligation of the City or be payable from proceeds of ad valorem taxes or other general or special funds of the City.

Taxes, Utilities and Other Charges

The City shall pay, as additional purchase price, all property taxes, income taxes, gross receipt taxes, business and occupation taxes, occupational license taxes, water charges, sewer charges, assessments and all governmental taxes and charge of every kind which shall be due and payable by the Issuer or the City relating to the Improvements, the Facilities Sales Agreement, or the transaction contemplated thereby.

Assignments, Subletting and Mortgaging

The City may not sell or assign its interest in the Facilities Sales Agreement or to any portion of the Improvements if (i) the sale or assignment, (ii) the use of the proceeds thereof, or (iii) the subsequent intended use of the Improvements will, in the opinion of nationally recognized bond counsel selected by the Issuer and approved by the Company, cause the Bonds to be arbitrage bonds under the Code, or will otherwise cause the interest paid on the Bonds to be subject to income tax.

Pursuant to the Indenture, the Issuer's right, title and interest in, to and under the Facilities Sales Agreement (except for certain rights to the payment of its expenses and indemnification) are pledged and assigned to the Trustee as security for the Bonds. The rights of the Trustee under the Facilities Sales Agreement, including but not limited to the right to receive payments of purchase price thereunder, are not subject to any defense, setoff, counterclaim or recoupment whatsoever, whether arising out of any breach of any obligation of the Issuer thereunder or by reason of any other indebtedness or liability at any time owing by the Issuer to the City.

Default

In the event the City fails to pay any part of the purchase price of the Improvements or violates any other provision of the Facilities Sales Agreement, the Issuer may bring an action for the recovery of the purchase price due and unpaid or for damages for the breach of the Facilities Sales Agreement, and the Issuer may pursue any other remedy available at law or in equity, including the remedy of specific performance. Notwithstanding any default by the City, the only remedy of the Issuer against the Company shall be the enforcement of payment of Rate Component One pursuant to the Services Agreement, and the only remedy of the Issuer against Citizens Utilities Company shall be the enforcement of the Guaranty. The Issuer shall not be permitted to accelerate payments of Rate Component One so long as the Company is making timely payments of Rate Component One or Citizens Utilities Company has made timely response to a proper demand for payment under the Guaranty and there has been no default in respect of any payment due on the Bonds.

The Issuer shall not be deemed to be in default under the Facilities Sales Agreement unless it shall have failed to perform any obligations thereunder within 30 days after receiving notice of such default. In any event, so long as any Bonds are outstanding, the City shall have no right to abate or offset payments of purchase price to be made by it under the Facilities Sales Agreement as a result of any default by the Issuer.

The Facilities Sales Agreement shall not terminate or be affected in any manner by reason of the condemnation, destruction or damage, or by reason of the unusability, of the Improvements, and the purchase price payable by the City shall be paid in accordance with the terms, covenants and conditions of the Facilities Sales Agreement without abatement, diminution or reduction.

Redeeming or Purchasing Bonds

The City or its designee shall have the right to pay purchase price payments in advance and may specify that such prepayments be placed in the Principal Fund under the Indenture. In such case, the Issuer shall, at the City's request, cause such prepaid amount to be used on any redemption date authorized in the Indenture to redeem outstanding Bonds pursuant to the Indenture or to be used to purchase Bonds for the purpose of cancellation.

APPENDIX D

THE SERVICES AGREEMENT

The following is a summary of the Services Agreement. Such summary does not purport to be comprehensive or definitive. The terms of the summary contained herein are qualified in their entirety by reference to the Services Agreement itself.

In 1985, the City owned and operated a sewage treatment facility with a maximum monthly average day capacity of 8.3 million gallons per day (mgd), which capacity was fully utilized. The Company furnishes sewer service to the public in Sun City, Arizona and at that time obtained sewage treatment and transportation services from another municipality in the area. Such other municipality advised the Company that it desired to have the Company obtain sewage treatment and transportation services directly from the City. In order to provide such sewage treatment and transportation services to the Company, the City had to construct and acquire the Improvements to expand the capacity of the City's sewage treatment facility.

Sewage Treatment and Transportation Services

Pursuant to the Sewage Treatment and Transportation Services Agreement dated as of June 21, 1985 (the "1985 Services Agreement"), as amended by the Refinancing Supplement to Sewage Treatment and Transportation Services dated as of May 1, 1998 (the "1998 Services Agreement", and, together with the 1985 Services Agreement, the "Services Agreement"), the City shall, at all times following completion of the Improvements, provide sewage treatment and transportation services for the Company of up to 5.2 mgd. The Company agreed to continue to obtain sewage treatment and transportation services from the municipality providing such services to the Company in 1985 until the completion of the Improvements, which completion occurred in 1988. The term of the Services Agreement extends to June 30, 2028, and the City and the Company have agreed to commence negotiations, not later than June 30, 2026, for continuation, extension or renewal of the Services Agreement.

Construction and Acquisition of the Improvements

The City financed, engineered, constructed and installed all sewage treatment and transportation facilities necessary to enable the City to treat and transport wastewater flows of 5.2 mgd for the Company pursuant to the 1985 Services Agreement.

Usufructuary Interest

The treatment and transportation of sewage by the City for the Company requires not only the use of the Improvements but also of the sewage treatment and transportation facilities of the City existing in 1985. Pursuant to the 1985 Services Agreement, the City granted the Company a usufructuary interest in the City's existing sewage treatment and transportation facilities, giving the Company the right to enjoy the use of such facilities without, however, altering or impairing the substance of such facilities. Such usufructuary interest did not give the Company legal title to or any ownership interest in the improvements or the City's existing facilities. Legal title to the existing facilities remained in the City, and legal title to the Improvements was transferred to the Company pursuant to the Indenture.

Execution of Additional Agreements by the Company or the City

The Services Agreement does not prohibit the Company or the City from entering into additional sewage treatment agreements with other parties, so long as the Company fulfills its minimum financial obligations under the Services Agreement and so long as the City provides sewage treatment and transportation services to the Company under the Services Agreement. No such additional agreement entered into by the City shall contain terms and conditions more favorable to the other party than the terms and conditions granted to the Company under the Services Agreement, and no such additional agreement by the City shall operate to increase amounts payable by the Company under the Services Agreement.

Payments by the Company

In consideration for the sewage treatment and transportation services to be provided by the City under the Services Agreement, the Company shall make payments to the City in three separate components, as follows:

Rate Component One – User Fees for the Company’s Service Facilities.

Rate Component One shall be payable at such times and in such amounts as may be necessary to provide the Trustee with funds sufficient to pay when due all amounts due on the Refunding bonds and reasonable fees of the Trustee, Paying Agent, any Co-Paying Agent, Depositary, Registrar, Market Agent, Auction Agent, Remarketing Agent and any other agent or functionary under the Indenture. More particularly Rate Component One shall include:

1. Principal on the Bonds - payable by 12:00 Noon New York City time on each day in which principal is due on the Bonds, whether at maturity, or upon redemption or acceleration, in an amount equal to the amount of principal due on the Bonds on such day.
2. Interest on the Bonds – payable by 12:00 Noon New York City time on each day interest is due on the Bonds in an amount equal to the amount of interest due on the Bonds on such date.
3. Reasonable fees and costs of the Trustee, Paying Agent, any Co-Paying Agent, Depositary, Registrar, Market Agent, Auction Agent, Remarketing Agent and any other agent or functionary under the Indenture, including amounts due to the foregoing under any provisions for indemnity under the Indenture, the Remarketing Agreement, or the Depositary Agreement.

In the event a failure by the Company to pay any installment of Rate Component One on a timely basis results in the acceleration of payments of principal, premium, if any, and interest on the Bonds, all remaining payments of Rate Component One shall become immediately due and payable, to the extent necessary to pay the accelerated payments of principal, premium, if

any, and interest on the Bonds and costs payable by the Issuer under the Indenture. Except as set forth in the immediately preceding sentence, no other defaults by the Company under the Services Agreement and no other default by the City or the Issuer under the Facilities Sales Agreement or the Indenture can result in an acceleration of the payments of Rate Component One by the Company. Payment of Rate Component One by the Company shall be guaranteed by Citizens Utilities Company pursuant to the Guaranty (See "EXHIBIT E—THE GUARANTY").

Payments of Rate Component One have been pledged and assigned by the City to the Issuer to secure payment of the purchase price under the Facilities Sales Agreement and, in turn, assigned by the Issuer to the Trustee under the Indenture to secure payment of principal of, premium, if any, and interest on the Bonds. the Company and Citizens Utilities Company do not in any way guarantee the Issuer's obligations on the Bonds and shall have no direct liability to the holders of the Bonds, but are responsible only for payment of Rate Component One pursuant to the Services Agreement and the Guaranty.

Installments of Rate Component One are absolutely and unconditionally due and payable by the Company, irrespective of whether there is any interruption in the treatment of wastewater by the City for the Company, and irrespective of any other contingency.

Rate Component Two consists of the Company's pro rata share of the operation and maintenance expenses for treatment of the sewage delivered to the City by the Company.

Rate Component Three consists of the Company's pro rata share of the replacement and contingencies reserve for the City's sewage treatment facilities.

In the event the average daily flows of wastewater sent by the Company to the City for treatment exceed the maximum amount which the City has agreed to treat, the Company will pay the City additional consideration based upon the amount by which actual flows exceed the maximum allowable flow.

Payments by the Company of Rate Component Two, Rate Component Three and any consideration for excess flows have not been assigned by the City to the Issuer or to the Trustee and will not be available to the Trustee for the payment of debt service on the bonds.

Defaults

No adverse ruling by the Internal Revenue Service as to the tax-exempt status of the Bonds, no default by the City under the Facilities Sales Agreement, and no default by the Issuer under the Indenture, including any acceleration of payments that may result from any such default, shall cause any additional liability or obligation on the part of the Company or Citizens Utilities company so long as the Company otherwise performs its obligations under the Services Agreement; provided, however, that in the event a default or acceleration under Facilities Sales Agreement, the Indenture or the bonds is due to the failure of the Company and Citizens Utilities Company to make timely payment of Rate Component One, all remaining installments of Rate Component One may be declared to be immediately due and payable.

APPENDIX E

THE GUARANTY

The following is a summary of the Guaranty. Such summary does not purport to be comprehensive or definitive. The terms of the summary contained herein are qualified in their entirety by reference to the Guaranty itself.

Pursuant to the Guaranty, Citizens, as the parent corporation of the Company, in order to induce the City to enter into the Services Agreement, has unconditionally guaranteed to the City the due and punctual payment of Rate Component One under the Services Agreement, including any acceleration of payments of Rate Component One pursuant to the Services Agreement. If any installment of Rate Component One is not timely paid by the Company, Citizens will irrevocably, unconditionally and absolutely pay or cause to be paid such installment of Rate Component One regardless of any defense, offset or counterclaim which the Company or Citizens may have or assert. No other payment or performance under the Services Agreement, other than payment of Rate Component One as it becomes due under the Services Agreement, is guaranteed by Citizens.

The obligations of Citizens under the Guaranty shall not be affected by any bankruptcy, insolvency, reorganization, liquidation, receivership, or other proceedings to which the Company is a party, voluntarily or involuntarily, pursuant to (a) the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, as the same may be amended from time to time, or (b) any other state or federal law, rule or regulation. The obligations of Citizens under the Guaranty shall likewise not be affected by any amendment, modification, extension or renewal of the Services Agreement or any waiver of any default thereunder or any departure from the provisions thereof; provided, however, that no such waiver, extension, modification or amendment shall, without the consent of Citizens, increase the payment obligation of Rate Component One under the Services Agreement or extend the duration of those payments.

APPENDIX F

INFORMATION CONCERNING CITIZENS UTILITIES COMPANY

GENERAL

Citizens Utilities Company ("Citizens") provides, either directly or through subsidiaries, communications services, competitive local exchange carrier services ("CLEC") and public services including electric distribution, natural gas transmission and distribution, water distribution and wastewater treatment services to primarily rural and suburban customers throughout the United States. Subsidiaries of Citizens provide communications and CLEC services and divisions of Citizens provide electric distribution and natural gas transmission and distribution services, purchasing most of the electric power needed and all gas supplies, except for the production of synthetic natural gas in Hawaii. Water distribution and wastewater services are provided either by divisions of Citizens or by its subsidiaries. Citizens Communications operates an integrated distribution network over which it provides local network service, network access services, long distance service, directory advertising, centrex, custom calling and caller ID services, paging, cellular, Internet access, voice mail and conference calling. Citizens also has investments in Centennial Cellular Corp., a cellular telephone company, and Electric Lightwave, Inc., a leading competitive provider of telecommunications services for business and long distance carriers in the western United States.

Citizens, with administrative offices at High Ridge Park, Stamford, Connecticut 06905 (telephone (203) 614-5600), was incorporated in Delaware in 1935 to acquire the assets and business of a predecessor corporation. Since then, Citizens has grown as a result of investment in owned communications and public services and from numerous acquisitions of additional communications, CLEC and public services operations.

As a result of its diversification, Citizens is not dependent upon any single geographic area for its revenues. Citizens' operations are conducted primarily in small and medium size towns and communities. No material part of Citizens' business is dependent upon a single customer or a small group of customers for its revenues. The loss of any single customer or a small group of customers would not have a materially adverse effect upon Citizens. Citizens' customer connections have increased from 26,150 in 1945, to 225,389 in 1965, to 610,585 in 1985, and to over 1,700,000 as of December 31, 1997.

Citizens continually considers and is carrying out expansion through internal investments, acquisitions and joint ventures in the rapidly evolving telecommunications industry and in traditional public services and related fields.

RECENT DEVELOPMENTS

In March 1998, a lawsuit was filed in the United States District Court for the District of Connecticut against the Company and three of its officers, one of whom is also a director, on behalf of all purchasers of the Company's common stock between May 6, 1996 and August 7, 1997 inclusive. The complaint alleges that Citizens and the individual defendants, during such period, violated the Securities Exchange Act of 1934 by making materially false and misleading public statements concerning the Company's relationship with a purported affiliate and by failing

to disclose material information necessary to render prior statements not misleading. The plaintiff seeks to recover unspecified compensatory damages. The Company and the individual defendants intend to file a motion to dismiss.

AVAILABLE INFORMATION

Citizens is subject to the informational requirements of the Securities Exchange Act of 1934 (the "1934 Act") and in accordance therewith files reports, proxy and information statements and other information with the Securities and Exchange Commission (the "SEC"). Such reports, proxy and information statements and other information can be inspected and copied at the public reference facilities maintained by the SEC at 450 Fifth Street, N.W., Washington, D.C., 20549 and at its regional offices at Citicorp Center, Suite 1400, 500 West Madison Street, Chicago, Illinois 60661 and Suite 1300, 7 World Trade Center, New York, New York 10048. Copies of such material can also be obtained from the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The SEC also maintains a web site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding Citizens. Certain securities of Citizens are listed on the New York Stock Exchange, 20 Broad Street, New York, New York 10005 and reports, proxy material and other information concerning Citizens may be inspected at the office of that Exchange.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The following documents heretofore filed by Citizens with the SEC are incorporated herein by reference:

Citizens' Annual Report on Form 10-K for the year ended December 31, 1997.

Citizens' Current Reports on Form 8-K filed on March 12, and April 7, 1998.

All documents subsequently filed by Citizens pursuant to Sections 13(a), 13(c), 14 or 15(d) of the 1934 Act prior to the termination of the offering of the securities made by this Official Statement shall be deemed to be incorporated by reference in this "INFORMATION CONCERNING CITIZENS UTILITIES COMPANY" in this Official Statement and to be a part hereof from the date of filing of such documents.

Citizens hereby undertakes to provide without charge to each person to whom a copy of this Official Statement is delivered, upon written or oral request of such person, a copy of any or all of the documents referred to above which have been or may be incorporated by reference in this Official Statement, other than exhibits to such documents not specifically incorporated by reference herein. Requests for such copies should be directed to Office of the Treasurer, Citizens Utilities Company, High Ridge Park, P.O. Box 3801, Stamford, Connecticut 06905 (telephone (203) 614-5600).

FINANCIAL INFORMATION

The following financial information is qualified in its entirety by, and should be read in conjunction with, the information appearing elsewhere herein and the documents and financial statements incorporated by reference herein.

Consolidated Summary Financial Information (In millions, except percentages, ratios and per-share amounts)

INCOME STATEMENT DATA	Year Ended December 31,		
	1997 ⁽¹⁾	1996	1995
Revenues	\$1,394	\$1,307	\$1,069
Net Income	\$10	\$179	\$160
Earnings Per Share of Common Stock ⁽²⁾	\$.04	\$.70	\$.66
Ratio of Earnings to Fixed Charges ⁽³⁾	1.2	3.7	3.4
CAPITALIZATION DATA	As at December 31,		
	1997	1996	1995
Long-Term Debt	\$1,707	\$1,510	\$1,187
Equity ⁽⁴⁾	\$1,880	\$1,879	\$1,560
Long-Term Debt to Long-Term Debt and Equity Ratio	48%	45%	43%
OTHER FINANCIAL DATA			
Estimated 1998 Construction Expenditures	\$594		

- (1) As discussed in Citizens' Form 10-K for the year ended December 31, 1997 and incorporated by reference herein, Citizens recorded approximately \$197 million of pre-tax charges to earnings in the second quarter of 1997. The pre-tax charges primarily relate to telecommunication information systems and software costs no longer deemed recoverable in the current regulatory environment, benefit plan curtailments and related regulatory assets no longer deemed recoverable in the current regulatory environment, a curtailment of certain telecommunications long distance service operations and regulatory commission orders issued in the second quarter of 1997. In addition, on November 25, 1997, Electric Lightwave, Inc. ("ELI"), a subsidiary of Citizens, completed an initial public offering of 8 million shares of its Class A Common Stock for gross proceeds of \$128 million. Citizens recorded a pre-tax non-operating gain of approximately \$79 million resulting from this transaction. Citizens retained 97.97% of the voting interest and 82.83% of the economic ownership in ELI. Excluding such pre-tax charges and non-operating gain, Citizens' Income Statement Data is as follows:

	Year Ended December 31, 1997
Revenues	\$1,414
Net Income	\$94
Earnings Per Share of Common Stock	\$.37
Ratio of Earnings to Fixed Charges ⁽³⁾	2.2

- (2) Common Stock, per share amounts, including the one-for-one conversion of all Series A shares into Series B shares effective August 25, 1997, have been adjusted retroactively for subsequent stock dividends through December 31, 1997. No adjustment has been made for the Citizens .75% 1998 1st quarter stock dividend, as this adjustment is immaterial.
- (3) "Earnings" consist of income before income taxes plus fixed charges. "Fixed Charges" consist of interest charges and an amount representing the interest factor included in rentals.
- (4) Includes shareholders' equity and Company Obligated Mandatorily Redeemable Convertible Preferred Securities.

FINANCIAL STATEMENTS

The consolidated financial statements of Citizens and its subsidiaries as of December 31, 1997, 1996 and 1995, and for each of the years then ended, incorporated by reference in this Official Statement from Citizens' Annual Report on Form 10-K, have been audited by KPMG Peat Marwick LLP, independent certified public accountants, as stated in their report appearing therein.

SUMMARY INFORMATION

The information contained in this "INFORMATION CONCERNING CITIZENS UTILITIES COMPANY" is furnished solely to provide limited introductory information regarding Citizens and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the documents and financial statements incorporated by reference herein. This Official Statement contains a forward-looking statement relating to capital expenditures. This statement may differ from actual future results due to, but not limited to, changes in the local and overall economy, the nature and pace of technological changes, the number and effectiveness of competitors in Citizens' markets, success in overall strategy, weather conditions, changes in legal and regulatory policy, Citizens' ability to identify future markets and successfully expand existing ones and the mix of products and services offered in Citizens' target markets. Readers should consider these important factors in evaluating any statements contained herein. Citizens has no obligation to update and revise these forward-looking statements to reflect the occurrence of future events or circumstances.

APPENDIX G

GENERAL INFORMATION REGARDING THE COMPANY

Sun City Sewer Company (the "Company") was incorporated in 1962 under the laws of Arizona and is a wholly-owned subsidiary of Citizens Utilities Company. The Company is a Public Service Corporation regulated by the Arizona Corporation Commission and authorized to provide wastewater utility service within and in the vicinity of Sun City, Maricopa County, Arizona. The Company owns and operates a public utility sewer collection system and furnishes service to approximately 29,300 customers located in and around the vicinity of Sun City. All treatment services are obtained through long-term agreements with municipalities in the proximity of the service area. The Company renders service for residential, commercial, industrial, and corporate purposes, pursuant to certificates of convenience and necessity granted by the Arizona Corporation Commission.

The Company maintains an operating office at 15626 North Del Webb Blvd., Sun City, Arizona 85372, telephone (602) 974-2521. The principal executive offices of the Company are located at High Ridge Park, Stamford, Connecticut 06905. The telephone number is (203) 614-5600.

APPENDIX H

FORM OF BOND COUNSEL OPINION

City of Tolleson Municipal Finance
Corporation

Re: \$8,560,000 Revenue Refunding
Bonds, Series of 1998

We have examined the transcript of proceedings relating to the issuance by the City of Tolleson Municipal Finance Corporation (the "Corporation") of its \$8,560,000 Revenue Refunding Bonds, Series of 1998 (the "Bonds"), issued pursuant to a Refunding Indenture of Trust dated as of May 1, 1998 (the "Indenture"), between the Corporation and Bank One, Arizona, NA, as trustee (the "Trustee").

We have examined the law and such documents and matters as we have deemed necessary to render this opinion, including, without limitation, originals or copies identified to our satisfaction as being true copies of:

- (i) The Indenture;
- (ii) The Facilities Sales Agreement dated as of August 1, 1985 (the "1985 Facilities Sales Agreement"), between the Corporation and the City of Tolleson, Arizona (the "City");
- (iii) The Refinancing Supplement to Facilities Sales Agreement dated as of May 1, 1998 between the Corporation and the City (the 1985 Facilities Sales Agreement, as so supplemented, is referred to herein as the "Facilities Sales Agreement");
- (iv) The Sewage Treatment and Transportation Services Agreement dated June 21, 1985 (the "1985 Services Agreement"), between the City and Sun City Sewer Company ("SCSC"), an Arizona corporation and a wholly-owned subsidiary of Citizens Utilities Company ("Citizens"), a Delaware corporation;
- (v) The Refinancing Supplement to Sewage Treatment and Transportation Services Agreement dated as of May 1, 1998 between the City and SCSC (the 1985 Services Agreement, as so supplemented, is referred to herein as the "Services Agreement"); and
- (vi) The Refinancing Guaranty dated as of May 1, 1998 (the "Guaranty"), from Citizens in favor of the City, of certain payments to be made by SCSC under the Services Agreement for payment of debt service on, and costs associated with, the Bonds;

As to questions of fact material to our opinion, we have relied upon, and have assumed due and continuing compliance with the provisions of, the proceedings and other documents, and have relied upon certifications and representations furnished to us without undertaking to verify the same by independent investigation, including, without limitation, the use to be made of the proceeds of the Bonds and property refinanced thereby. Reference is made to certifications of and opinions of counsel to parties other than the Corporation with respect to the existence and power of such parties to enter into and perform the instruments referred to, the authorization, execution and delivery of such instruments by such parties and such instruments being binding upon and enforceable against such parties, including the opinion of counsel to SCSC with respect to the Services Agreement, and the opinion of counsel to Citizens with respect to the Guaranty. We have not undertaken to express an opinion upon those matters.

Based upon the foregoing, it is our opinion, under law existing on this date, which is the date of initial delivery of the Bonds against payment therefor, that:

1. The Indenture and the Facilities Sales Agreement have been duly authorized, executed and delivered by the Corporation and are valid and binding upon and enforceable against the Corporation.

2. The Bonds have been duly authorized, issued and delivered by the Corporation and are valid, binding and enforceable limited obligations of the Corporation payable solely from the revenues and other property pledged and assigned for such payment as provided in the Indenture. The Bonds are not secured by an obligation or pledge of any taxing power or moneys raised thereby and are not a debt of and do not constitute a pledge of the faith and credit of the State of Arizona or any political subdivision thereof. The Corporation has no taxing power.

3. Under existing laws, regulations, rulings and judicial decisions, the interest on the Bonds is excluded from gross income for the purpose of calculating federal income taxes and is exempt from Arizona income taxes. Interest on the Bonds is not an item of tax preference to be included in computing alternative minimum tax of individuals or corporations; such interest, however, must be taken into account for federal income tax purposes as an adjustment to alternative minimum taxable income for certain corporations which income is subject to the federal alternative minimum tax. We express no opinion regarding other federal tax consequences arising with respect to the Bonds.

The Code imposes various restrictions, conditions and requirements relating to the continued exclusion of interest income on the Bonds from gross income for federal income tax purposes, including a requirement that the Corporation rebate to the federal government certain of the investment earnings with respect to the Bonds. Failure to comply with such restrictions, conditions and requirements could result in the interest income on the Bonds being included as gross income for federal income tax purposes from the date of issuance of the Bonds. The Corporation and the City have covenanted to comply with the restrictions, conditions and requirements of the Code necessary to preserve the tax-exempt status of the interest income on the

Bonds. For purposes of this opinion, we have assumed continuing compliance by the Corporation and the City with such restrictions, conditions and requirements.

The rights of the owners of the Bonds and others under the documents referred to and the enforceability of those rights may be subject to bankruptcy, insolvency, reorganization, moratorium and similar laws affecting creditors' rights and enforcement of those rights may be subject to the exercise of judicial discretion in accordance with general principles of equity.

GUST ROSENFELD P.L.C.

By

Keith C. Hoskins
Bond Counsel

H

PUBLIC NOTICE
OF AN APPLICATION FOR AN ORDER
AUTHORIZING THE ISSUANCE OF UP TO \$174 MILLION IN LONG-TERM DEBT
BY ARIZONA-AMERICAN WATER COMPANY

Arizona-American Water Company filed an Application with the Arizona Corporation Commission (Commission) for an order authorizing Applicant to issue up to \$174 million of long-term debt. The application is available for inspection during regular business hours at the office of the Commission at 1200 W. Washington, Phoenix, Arizona 85007, and the Company's offices in 19820 N. 7th Street, Suite 201, Phoenix, Arizona 85024.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

1. The name, address, and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice.