EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION 2002 OCT 25 A 11: 59

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WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
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MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC., AN ARIZONA CORPORATION TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES AND TARIFFS DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. W-02465A-01-0776 **EXCEPTIONS TO RECOMMENDED OPINION AND ORDER**

Bella Vista Water Co., Inc. ("Bella Vista" or "Company") commends Administrative Law Judge Rodda ("ALJ Rodda") for the thorough and balanced evaluation contained in her recommendation in this matter. Bella Vista supports the vast majority of the Recommendation, but files these objections and respectfully requests the Commission to:

1. Reject the recommended rate of return of 8.1% and adopt a fair and reasonable return for Bella Vista;

2. Reject the mandatory requirement of a lead-lag study in Bella Vista's next rate filing;

3. Supplement the Recommendation by adopting the miscellaneous charges, including the increases requested by Bella Vista; and

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4. Supplement the Recommendation by granting the Company leave to apply to establish a more reasonable interest rate on customer deposits, without requiring another rate case.

I. INTRODUCTION/OFFER OF COMPROMISE

This case is about fairness and equity. It is about avoiding regulatory lag and the adverse impact of retroactively imposing regulatory policies on an ad hoc basis. It is about providing sufficient returns, in the face of rapidly deteriorating stock markets, to provide incentives, not penalties, to continue to invest in plant and its upkeep. The Recommendation goes a long way in addressing these issues by including Bella Vista's $1,797,279 of post-test year plant in rate base, financed through a Commission approved $2.1 million low interest loan from the Water Infrastructure Finance Authority ("WIFA"). "No party argues that the post-test year plant in questions was not necessary or was not used and useful at the time of hearing." Recommendation Order ("RO"), p. 11, ll. 5-6. The Recommended Order does not reflect the fact that the Company commenced repaying the WIFA loan on July 1, 2001 (16 months ago).[1] The Commission should now complete the task by providing a fair and reasonable return to Bella Vista.

To limit the areas of dispute and to accelerate and simplify this case, Bella Vista accepted almost all income statement and rate base adjustments recommended by Staff prior to hearing. RO, p. 3, ll. 405. In keeping with this goal, the Company is foregoing its right to file exception to the disallowance of the Professional and Consulting Fees prudently incurred in connection with conducting environmental studies on all of its wellsites or in performing a due diligence investigation associated with the potential

1 The annual payment of principal, interest and reserve is $221,209.

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acquisition of three water companies for their production capabilities. Further, it offers to compromise and accept a rate of return of 8.7%, in lieu of the 9.5% supported by the evidence. These positions are offered with the understanding that the remainder of the Recommendation will be unaltered, except as specified in these Exceptions or as expressly agreed to by Bella Vista. Further, Bella Vista makes this offer without waiving its right to assert its original claims in any Request for Rehearing in the event its offer is not accepted.

II. AN 8.08% RATE OF RETURN IS NOT FAIR AND REASONABLE

Three years ago, this Commission by Decision No. 61730, authorized Bella Vista to earn a 10.75% return on a Fair Value Rate Base ("FVRB") of $5,547,964, which equated to $596,406 in operating income. The Company never earned the authorized return. RO, p. 3, ll. 1-2.[2] The Recommended Order now proposes an 8.08% return on a FVRB of $7,488,816, whereas Bella Vista requested and provided substantial evidence supporting a 9.5% return on its FVRB. Despite the reasonableness of a 9.5% return, by these Exceptions, Bella Vista is offering, as a compromise, to accept a return of 8.7% on a FVRB of $7,488,816.

A. THE RECOMMENDED ORDER IMPROPERLY RELIES SOLELY ON THE COST OF CAPITAL TO ESTABLISH A RETURN FOR BELLA VISTA

"It is elementary that a public utility subject to regulation and fixing of rates is entitled to realize a fair and reasonable profit from its operation in the service of the public." Simms v. Round Valley Light & Power Company, 85 Ariz. 145, 149, 294 P.2d

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2 In fact, the Recommended Order finds the adjusted test year operating income was $468,972 (RO, p. 26, Finding 13), $127,434 less than authorized by Decision No. 61730 and the return of only 6.3%. Id.

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378, 380 (1956); Smyth v. Ames, 169 U.S. 466, 18 S. Ct. 818, 42 L. Ed. 819 (1898) ("rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment." Blue Field Waterworks & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690, 43 S. Ct. 675, 678 (1923); Arizona Corporation Commission v. Arizona Public Service Company, 113 Ariz. 368, 370, 555 P.2d 326, 328 (1976)).

The 1923 Blue Field Waterworks decision set two overriding legal standards for a fair rate of return. First, the rate of return must be adequate to maintain a utility's financial soundness (e.g., supporting existing credit and the ability to attract new capital) and second, it must be the same as that being currently earned by other companies with similar business risks. § 9.02[1], Hahne & Aliff, Accounting for Public Utilities (2001). While the Commission has significant discretion in setting a return, it is precluded from utilizing what it believes is a fair rate of return on common equity as the sole basis of establishing rates. Simms, 85 Ariz. at 155, 294 P.2d at 385 (holding "the standard for establishing a rate base must be the fair value of the property and not what the Commission might believe was a fair rate of return on common equity"); Arizona Community Action Association v. Arizona Corporation Commission, 123 Ariz. 228, 599 P.2d 184 (1979) (invalidating a Commission order authorizing step rate increases for APS based solely on the return earned on common stock equity).

The Recommended Order has improperly set Bella Vista's rate of return based solely on Bella Vista's cost of capital. RO, p. 23, ll. 6-27. The Commission must

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also consider all evidence bearing on the rate of return, including such things as: the financial condition of the Company, its historical ability to achieve any authorized return, its capital improvement needs, as well as any specific risks faced by the Company that are not adequately reflected by the systematic risk encompassed within the Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses. While no party contends the cost of capital can be ignored, it represents only a starting point for determining a reasonable rate of return. Hearing Transcript ("HT") Vol. II, p. 361, ll. 19-25. However, the 8.08% weighted cost of capital contained in the Recommended Order, a cost below the level recommended by every party to this proceeding, is not a proper starting point.

B. THE COMMISSION SHOULD REJECT THE RECOMMENDATION'S WEIGHTED COST OF CAPITAL OF 8.1% AND RETURN OF 8.08%

1. The Capital Structure

The sole issue with regard to capital structure was whether the WIFA debt should be included in the capital structure. This issue was resolved by inclusion of the disputed plant.[3] All parties agree that when the post-test year plant is included in rate base, it is appropriate to include the WIFA debt in the capital structure, resulting in 31.9% of long-term debt and 68.1% of common equity. Both Staff and Bella Vista agree the cost of long-term debt, including the WIFA loan, is 5.94%.

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3 Inclusion of the $2.1 million WIFA debt in Bella Vista's capital structure, while excluding the plant financed by the WIFA loan (as proposed by Staff) creates a significant mismatch between rate base and capital structure. RO, p. 20, ll. 11-4.

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2. <u>The Cost of Equity and Rate of Return</u>

Bella Vista vigorously takes exception to the Recommendation's adoption of 9.1% as the cost of equity and an authorized return of 8.08%. The Company presented evidence, through Mr. Kozoman, that comparable water utilities followed by <u>Value Line</u> are projected to earn an 11.5% accounting rate of return on equity for the period 2004 through 2006. RO, p. 19. ll. 18-20. Mr. Kozoman, on behalf of the Company, also presented evidence that the water companies followed by <u>C.A. Turner</u> are currently earning returns on equity of 10.85% (or 10.72% if Southwest Water is excluded due to its ratio of water revenues to total revenues). He also testified that the projection for returns on equity for 2003 for these companies is 10.5%. In fact, this Commission authorized an 11% cost of equity for Southwest Gas in November 2001, and a 10.25% cost of equity for Arizona Water Company in December 2001 (Decision No. 64282), both of which have much lower risks than Bella Vista.

Regulators have been utilizing comparable earnings as an appropriate measure of a fair return for more than 100 years. *See*, <u>Smyth v. Ames</u>, 169 U.S. 466, 18 S. Ct. 418 (1898). As explained in Roger Morin's <u>Utilities Cost of Capital</u>, (Public Utilities Reports), 1984 at page 229:

> "The comparable earnings standard is easy to calculate, and the amount of <u>subjective judgment required is minimal</u>. The method avoids several of the subjective factors involved in other cost of capital methodologies. For example, the DCF approach requires the determination of the growth rate contemplated by investors, which is a subjective factor.... The CAPM requires the specification of several expectational variables, such as market return and beta. In contrast, the comparable earnings approach makes use of simple readily available accounting data...."

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"The method is easily understood, and is firmly anchored in regulatory tradition. The method is not influenced by the regulatory process to the same extent as market-based methods such as the DCF and CAPM." (Emphasis added.)

Mr. Kozoman did not ignore the CAPM or the DCF methodology. In fact, he conducted his own DCF and CAPM analyses as a check on his conclusions reached under the comparative earnings approach. However, Mr. Kozoman concluded that the result of the DCF method should be rejected because cash has been depleted due to recent stock buybacks, payouts of large portions of earnings in the form of dividends, and heavy investment in plant to meet new regulatory mandates. Ex. A-1 (Kozoman, Direct) p. 15, ll. 20-26. Mr. Kozoman examined both the Value Line water company data together with small cap and mid-cap risk premiums. He concluded that when small cap and mid-cap premiums are used, the CAPM yields an expected return of 10.83%. Id., p. 18, ll. 12-17. Mr. Kozoman's testimony supports the following weighted cost of capital.

	Weight	**Cost**	**Weighted Cost**
Long-Term Debt	31.9%	5.94	1.89%
Common Equity	68.1%	10.5	7.15%
Totals	100%		9.04%

However, calculating the weighted cost of capital does not end the analysis required to establish a just and reasonable rate of return. The Commission must also consider the specific risks faced by Bella Vista:

1. The slim likelihood of actually achieving the authorized return. The evidence demonstrates that Bella Vista is not, and has not historically achieved its authorized rate of return. In fact, despite currently being authorized to earn a

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10.75% rate of return, it is earning a mere 6.3%, just three years after it was authorized. RO, p. 26, ll. 24-26.

2. The relatively small size of Bella Vista. The companies followed by Value Line are much larger (e.g., the smallest, Middlesex Water, has over $5 million in net income in the year 2000, with the largest, American Waterworks having over $157 million in net income, while Bella Vista had test year operating income (i.e., prior to paying interest expenses) of less than $500,000. RO, p. 26, ll. 24-26).

3. The Company's stunted rate of growth. Bella Vista is growing at less than 1.25% per year.

4. The impacts of drought conditions. The production of Bella Vista's wells in its southern system are severely limited due to drought.

5. The impacts created due to proximity to the San Pedro River, the San Pedro River National Conservation Area and Fort Huachuca. This happenstance of location presents unique and significant risk to Bella Vista's water supply. Bella Vista relies exclusively on groundwater. Recent decisions by the Arizona Supreme Court create a real potential that at some future time, Bella Vista's withdrawals of groundwater will be deemed to affect the surface water rights associated with the San Pedro River and thus subject Bella Vista's pumping to injunctive relief. See, In re General Adjudication of Gila River, 195 Ariz. 411, 989 P.2d 739 (1999) (defining the scope of federal reserved water rights); In re General Adjudication of Gila River, 198 Ariz. 330, p P.3d 1069 (2000) (defining the relationship between wells pumping groundwater when they intercept surface water). Further, the San Pedro River National Conservation Area is being utilized to foster repopulation of endangered and threatened animal and plant

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species. Protections for these species are significantly elevated creating another level of risk to the Company's water supply. The greater number of endangered and threatened species in a locality, the greater the threat to long-term growth in the area.

Each of these risks warrant granting a return above the mere cost of Bella Vista's capital.

The Commission should also consider the fact that Bella Vista is a well-managed water company. It has few service complaints and has been able to provide water service at modest rates. Although never achieving its authorized rate of return, the Company has willing pursued an aggressive capital improvement program to increase service reliability, especially with regard to water production, which is especially critical in these times of drought. At this same time, the Company has been able to maintain its high level of service with a lesser investment per customer in net plant than the national average ($1,290 per customer versus the national average of $1,888 per customer) and a lower expense per customer than the national average ($260 per customer versus the national average of $402 per customer). Exhibit A-1 (Kozoman Direct), p. 22, ll. 13-26. The Company has maintained this above average level of performance even though it has operated with two employee positions unfilled for over a year.

Furthermore, the Commission should consider the reality that Arizona water companies, including Bella Vista, cannot attract capital on the same basis as comparable water companies followed by Value Line. No one can seriously believe that Bella Vista would be able to attract an infusion of new equity with a 9.1% cost of equity. Instead, Bella Vista has used its access to WIFA to secure low interest loans, thereby significantly reducing its overall weighted cost of capital. The relatively low cost of

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Bella Vista's debt should also be considered in evaluating the use of Bella Vista' weighted cost of capital.

The Commission is respectfully requested to set a return high enough to recognize the unique risks faced by Bella Vista, to encourage the Company's management to maintain its record of excellence and to attract new equity capital. These factors warrant setting Bella Vista's rate of return at 9.5%.

C. STAFF'S RATE OF RETURN ANALYSIS SHOULD BE REJECTED

Staff's DCF analysis is the only one that uses a spot price method (i.e., stock prices at closing on a single day). Both RUCO and Bella Vista used average stock prices in their DCF analysis, but over varying time periods. Staff's methodology results in wide swings, depending on the day chosen. This is evidenced Exhibit A-9, a copy of which is attached hereto as Exhibit A. Utilizing Staff's constant growth DCF methodology, the Exhibit demonstrates how Staff's 9.1% cost of capital using the March 26, 2002 prices increases to 9.46% using July 15, 2002 prices and then to 9.69% eight days later utilizing July 23, 2002 prices. Similarly, Staff's multi-stage DCF started at 9.3% based on March 26, 2002 closing prices increased to 9.64% using July 15, 2002 stock prices and then increased to 9.86% with July 23, 2002 closing prices. Such wide swings over an eight-day period should cause the Commission to reject Staff's entire analysis. At a minimum it justifies adopting a cost of equity much higher than proposed by Staff.

D. BELLA VISTA'S OFFER OF COMPROMISE ON RATE OF RETURN

Bella Vista recognizes that the setting of a rate of return, and especially the determining of the cost of equity represents the epitome of subjectivity, albeit wrapped in

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a century of legalese and technical jargon giving it the appearance of objectivity. Therefore, without waiving its rights in any future proceeding to advocate a 9.5% rate of return, the Company requests that the Commission adopt a compromise rate of return of 8.7%. This level represents more of a concession by the Company, than an increase by Staff (which the Recommended Order adopted). Based upon the general methodology reflected at page 24 of the Recommended Order[4], an 8.7% return would result in Required Operating Income of $650,979 and an Operating Income Deficiency of $165,101. Multiplying the Deficiency by the Gross Revenue Conversion Factor[5] results in a Required Revenue Increase of $274,679 and Approved Annual Revenues of $3,182,454 (or a 9.45% increase), thereby providing revenues to assist Bella Vista in meeting its $221,209 annual payment for principal, interest and reserves under the WIFA loan; a repayment obligation that commenced July 1, 2001.[6]

III. A LEAD-LAG STUDY SHOULD NOT BE REQUIRED IN THE NEXT RATE CASE

The Recommended Order recognizes the formula method is a widely accepted method of computing cash working capital. RO, p. 12, ll. 3-5. The Recommended Order correctly notes there is no evidence on the record to rebut the accuracy of the formula's result in this proceeding. RO, p. 12, ll. 26-28. However, the

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4 The Recommended Order at page 18, does not appear to reflect $16,906 in tax savings associated with the changes made to Staff's position, which would increase Test Year Operating Income to $485,878. Theses corrections are reflected in the Company's calculation.

5 The Company notes that no party testified to a 1.7538 Gross Revenue Conversion Factor. Staff's Gross Revenue Conversion Factor of 1.6637 is the highest conversion factor supported by the record and is used in the Company's calculation.

6 This offer assumes, and is expressly contingent upon, the Commission accepting all other components of the Recommendation, including a determination of a fair value rate base of $7,488,816.

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Recommendation orders Bella Vista to submit a lead-lag study in its next rate filing if it wishes to recover cash working capital as a part of rate base. RO, p. 13, ll. 1-3. The Recommendation concludes that a lead-lag study would more accurately determine the need for a cash working capital allowance and finds that any extra burden on the Company from performing such a study is not unreasonable and is outweighed by the benefits of a more accurate method of determining cash working capital. The evidence indicates that a lead-lag study would cost the Company between $10,000 and $14,000. Such cost would be recoverable as rate case expense. At the Company's proposed return of 8.7% the working capital allowance permitted in this case of $137,550 increases the revenue requirement $11,967 (or approximately the cost of simply conducting the lead-lag study). Requiring lead-lag studies will also increase the Staff's audit time, as well as the time of rate proceedings. Although the Recommended Order finds that the requirement of a lead-lag study is consistent with past decisions effecting Class B utilities, the Utilities' Staff testified in this matter that they have never conducted a lead-lag study on a Class B water utility and that only one Class B water utility has ever submitted a lead-lag study to support cash working capital. HT, V. II, pp. 439-41. Lead-lag studies are fraught with controversy and significantly increase the time and expense for relatively little gain. Class B companies are still small enough that lead-lag studies should be the exception, not the rule.

It is respectfully suggested that if the Commission intends to require lead-lag studies for Class B water companies, it first conduct workshops with the affected utilities and agree upon a uniform methodology for conducting a lead-lag study. In this manner, the cost of a lead-lag study can be substantially reduced. Until such a uniform

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methodology is adopted, it is respectfully suggested that the Commission should continue to accept the formula method for any company proposing cash working capital of not less than $200,000.

IV. MISCELLANEOUS CHARGES WERE NOT ADDRESSED BY THE RECOMMENDED ORDER

As part of its Application, the Company requested increases in various of its miscellaneous charges. Because of the more significant dollar value of other issues, the issue of miscellaneous charges was not explored at hearing, or in any of the Closing Briefs filed by the parties. As a result, the Recommended Order inadvertently failed to address them.

The Company requests an increase in five miscellaneous charges: Reconnection Fee – from $30 to $40; Reconnection Fee (after hours) – from $45 to $55; NSF Check Charge – from $15 to $25; Late Payment Charge – from a $5 minimum to a $10, minimum; and damage to the Company's meters, meter locks, valves or seals – from cost only to $40, plus costs.

In all instances, the Company is seeking to recover costs associated with customer actions that can be avoided by customer vigilance. Reconnection fees are only incurred where there has been a termination of service for non-payment or other violation of Company rules and regulations. NSF check charges and late payment charges are only incurred when the customer has not performed its duty of paying the Company in a timely manner. Finally, a customer who protects the Company's equipment located on their property can avoid the incurrence of a damage fee. The Company seeks to increase the level of these costs to better allocate the responsibility to the cost causer. Staff, without explanation, rejected these increased fees. RUCO, without explanation, adopted

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them. These increases in Bella Vista's miscellaneous charges will generate approximately $40,363 of additional revenues annually. By collecting these revenues through miscellaneous costs, the level of increase collected through Bella Vista's standard rate is reduced.

V. THE COMPANY SEEKS LEAVE TO FILE, AT ITS DISCRETION, A REQUEST TO ADJUST THE INTEREST RATE PAID ON DEPOSITS

The Company respectfully requests the Recommended Order be amended to grant it leave to file, at its discretion, a request to lower the interest rate on deposits that it holds for customers. The interest expense paid to customers is a below the line expense; however, it can slightly impact the level of income taxes. The Company has not fully evaluated whether to request a change in the level of interest it pays on customer deposits, or what level to request. To avoid any concern that such a request can only be considered as part of a full rate case under the Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (App. 1978) line of cases, the Company requests recognition, in any Decision issued in this matter, that it may make such an application in the future without filing another rate case.

VI. SPECIFIC AMENDMENTS TO THE RECOMMEND ORDER

Attached hereto as Exhibit B is a proposed form of amendment incorporating the changes suggested by these exceptions. Because of the thoroughness of the current Recommended Order, relatively minor changes (although numerous) are necessary to implement the changes requested by the Company.

VII. CONCLUSION

Administrative Law Judge Rodda did a commendable job weighing the facts and the evidence. The Company's primary objection to the Recommended Order is

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the adoption of Staff's weighted cost of capital, compounded by a failure to adjust the rate of return for: (a) the specific risks facing Bella Vista; (b) to provide an incentive to maintain the above average management of Bella Vista; and (c) to recognize the need to ameliorate the rapid deterioration of the economy.

The Commission should reject the use of the spot market methodology advocated by Staff. Staff's approach unreasonably subjects the utility industry to wide swings in rate of return based upon a rapidly fluctuating stock market. In any event, adoption of the low end of Staff's range of reasonableness is unsupported by this record. Bella Vista has provided substantial evidence to support its requested 9.5% rate of return. Despite this substantial evidence, the Company, as a compromise, has offered to accept an 8.7% rate of return to move this case forward expeditiously.

Finally, the Company asks that the Commission closely examine the full ramifications of requiring Class B utilities to submit lead-lag studies; to approve the miscellaneous charges requested by Bella Vista, but which were inadvertently omitted from the Recommended Order; and to authorize Bella Vista to request the alteration of the interest rates paid on customer deposits outside the context of a full rate case.

Respectfully submitted this 25th day of October, 2002.

MARTINEZ & CURTIS, P.C.

By: ______________________

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PROOF OF
AND CERTIFICATE OF MAILING

I hereby certify that on this 25th day of October, 2002, I caused the foregoing document to be served on the Arizona Corporation Commission by hand-delivering the original and thirteen (13) copies of the above to:

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Phoenix, Arizona 85007

With copies of the foregoing mailed this 25th day of October, 2002 to:

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EXHIBIT A

Bella Vista Water Company
ACC Staff Witness Joel Reiker Cost of Capital Recomputed
with Closing Stock Prices at July 15, and July 23, 2002

Cross Examination
Schedule _______

Rates of Return Using Mr. Reiker's Spot Price Method

Line No.		Per ACC Staff Witness Reiker Page 23 Using 3/26/02 Closing Prices	With July 15, 2002 Closing Stock Prices	With July 23, 2002 Closing Stock Prices
9	Constant Growth DCF	9.1%	9.460%	9.690%
10	Multi-Stage DCF	9.3%	9.640%	9.860%
11	Historical MRP CAPM (a)	9.4%	9.400%	9.400%
12	Current MRP CAPM (a)	9.5%	9.500%	9.500%
13				
14	Simple Average	9.3%	9.500%	9.613%
15	(a) Did not recompute			
16				
17	Range for Rates of Return			
18	Low	9.100%	9.400%	9.400%
19	High	9.500%	9.640%	9.860%

Line No.		Column 1	Column 2	Column 3 (Col. 2 - Col.1)	Column 4	Column 5 (Col. 4 - Col.1)
24-28		March 26, 2002 Closing Prices Per ACC Staff Witness Reiker	July 15, 2002 Closing Prices	Change in Closing Prices 3/26/02 to 7/15/2002	July 23, 2002 Closing Prices	Change in Closing Prices 3/26/02 to 7/23/2002
29	American States Water	$ 34.94	$ 21.60	$ (13.34)	$ 21.01	$ (13.93)
30	American Water Works	43.69	43.20	(0.49)	42.90	(0.79)
31	California Water Service	25.50	23.75	(1.75)	21.60	(3.90)
32	Connecticut Water Service	26.92	28.84	1.92	24.06	(2.86)
33	Middlesex Water	23.40	21.75	(1.65)	20.27	(3.13)
34	Philadelphia Suburban	23.82	17.51	(6.31)	16.48	(7.34)
35	SJW Corp.	80.00	79.25	(0.75)	76.25	(3.75)
36	Southwest Water	14.75	15.15	0.40	13.95	(0.80)
37	Totals	$ 273.02	$ 251.05	$ (21.97)	$ 236.52	$ (36.50)

EXHIBIT B

EXHIBIT B

PROPOSED FORM OF AMENDMENT
INCORPORATING CHANGES SUGGESTED BY BELLA VISTA'S EXCEPTIONS

Page 12, line 26: Insert after the word "allowance":

", but the cost and time associated with conducting and verifying lead-lag studies can be substantial; a cost ultimately reflected in rates."

Page 13, line 3: Insert after the word "capital": "of $200,000 or more".

Page 13, lines 5-6: Delete the sentence staring with "We note".

Page 18, starting with line 21½: Insert the following: "Income Taxes ($16,906)".

Page 18, line 22: Delete "$2,438,803" and Insert "$2,421,897".

Page 18, line 23: Delete "$468,972" and Insert "$485,878".

Page 18, line 24: Delete "6.3" and Insert "6.49".

Page 18, line 25: Insert after the word "Capital": "and Rate of Return".

Page 20, line 15: Insert after the period:

"Using Staff's methodology, the cost of equity increased from 9.640% using July 15, 2002 closing stock prices to 9.860% eight days later using July 23, 2002 closing stock prices."

Page 23, lines 11-14: Delete everything following the sentence ending with "equity." and combine with next paragraph starting with "RUCO's".

Page 23, line 19½: Insert:

"The Commission has also used, and under Blue Field Waterworks & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690, 43 S. Ct. 675, 678 (1923); and Simms v. Round Valley Light & Power Company, 85 Ariz. 145, 149, 294 P.2d 378, 380 (1956), we must consider the accounting returns by seven comparable, but much larger and nationally traded water companies. The evidence reflects that these companies are currently earning accounting returns on equity of 10.85% and are projected to earn returns on equity of 10.5% in 2003 and 11.5% for the period 2004 and 2005. Furthermore, the Commission provided Arizona Water Company, a much larger utility, a 10.25% cost of equity less than a year ago. (Decision No. 64282.)

EXHIBIT B

PROPOSED FORM OF AMENDMENT INCORPORATING CHANGES SUGGESTED BY BELLA VISTA'S EXCEPTIONS

"While contending the evidence supports a 10.5% return on equity and a 9.5% return for Bella Vista, the Company has expressed a willingness to accept an 8.7% rate of return in this case. We find an 8.7% rate of return to be fair and reasonable for Bella Vista and will adopt it for this proceeding."

Page 23, lines 20-26:	Delete everything.
Page 24, line 2:	Delete "8.08" and Insert "8.7".
Page 24, line 3:	Delete "$604,588" and Insert $650,979".
Page 24, line 3:	Delete "$135,616" and Insert "$165,101".
Page 24, line 4:	Delete "our" and Insert "Staff's".
Page 24, line 4:	Delete "1.7538" and Insert "1.6637".
Page 24, line 4:	Delete $237,837 and Insert "$274,679".
Page 24, line 5:	Delete "8.18" and Insert "9.45".
Page 24, line 7:	Delete "$468,972" and Insert "$485,878".
Page 24, line 8:	Delete "6.3%" and Insert "6.49%".
Page 24, line 9:	Delete "8.08%" and insert "8.7%".
Page 24, line 10:	Delete "$604,588" and Insert "$650,979".
Page 24, line 11:	Delete "$135,616" and Insert "$165,101".
Page 24, line 12:	Delete "1.7538" and Insert "1.6637".
Page 24, line 13:	Delete "$237,837" and Insert "$274,679".
Page 24, line 15:	Delete "$3,145,612" and Insert $3,182,454".
Page 24, line 16:	Delete "8.18%" and Insert "8.7%".
Page 25, line 22:	Delete "$3,145,612" and Insert "$3,182,454".

EXHIBIT B

PROPOSED FORM OF AMENDMENT INCORPORATING CHANGES SUGGESTED BY BELLA VISTA'S EXCEPTIONS

Page 25, line 24½: Insert the following:

"Miscellaneous Charges

The Company has requested approval of the following miscellaneous charges:

Charge	Present Rates	Proposed Rates
Establishment	$ 30.00	$ 30.00
Establishment (After Hours)	$ 45.00	$ 45.00
Reconnection (Delinquent)	$ 30.00	$ 40.00
Reconnection (After Hours)	$ 45.00	$ 55.00
Meter Test	$ 30.00	$ 30.00
Deposit	**	**
Deposit Interest	**	**
Re-Establishment (within 12 Months)	***	***
NSF Check	$ 15.00	$ 25.00
Deferred Payment, Per Month (b)	1.50%	1.50%
Meter Re-Read	$ 15.00	$ 15.00
Charge of Moving Customer Meter - Customer Requested	Cost	Cost
Late Payment Charge, greater of 1.50% or	$ 5.00	$ 10.00 (1)
Damages to Meter Locks, Valves, Seals	Cost	$ 40.00 (2)
Sprinklers	(a)	(a)

(1) Greater of 1.50% or $5.00 Present Rates of 1.5% or $10.00 Proposed Rates.

(2) $40.00 plus actual cost of making repairs.

** PER COMMISSION RULES (R14-2-403.B).

*** MONTHS OFF SYSTEM TIMES MINIMUM (R14-2-403.D).

IN ADDITION TO THE COLLECTION OF REGULAR RATES, THE UTILITY WILL COLLECT FROM ITS CUSTOMERS A PROPORTIONATE SHARE OF ANY PRIVILEGE, SALES, USE AND FRANCHISE TAX. PER COMMISSION RULE (R14-2-409.D.5).

ALL ADVANCES AND/OR CONTRIBUTIONS ARE TO INCLUDE LABOR, MATERIALS, OVERHEADS, AND ALL APPLICABLE TAXES, INCLUDING ALL GROSS-UP TAXES FOR INCOME TAXES.

(a) 1.00% of the monthly minimum for a comparable sized meter connection, but no less than $5.00 per month.

EXHIBIT B

PROPOSED FORM OF AMENDMENT
INCORPORATING CHANGES SUGGESTED BY BELLA VISTA'S EXCEPTIONS

Meter Size	Present Charges	Proposed Charges
5/8 x 3/4	$ 350	$ 350
3/4 Inch	$ 350	$ 350
1 Inch	$ 400	$ 400
1 1/2 Inch	$ 500	$ 500
2 Inch	$ 675	$ 675
3 Inch	$1,500	$1,500
4 Inch	$2,500	$2,500
6 Inch	$4,400	$4,400
8 Inch		Cost

Plus Actual Cost of Road Crossing Costs

The Company contends that the charges for which it is requesting increases are all items charged generally when the customer fails to perform its responsibilities to the Company in a proper manner (e.g., reconnect charge is incurred when the account is delinquent, NSF check charge is incurred when the customer has insufficient funds to cover the check, late payment charges are incurred when timely payments are not made and the damage charges is incurred when the customer has not adequately protected the Company's equipment located on the customers property). We agree with the Company that the costs incurred for these types of actions should be charged to the cost causer and approve the Company's miscellaneous charges.

Interest of Customer Deposits

The Company is evaluating whether it is appropriate to lower the interest rate paid on customer deposits, but has not made a request for a specific adjustment at this time. The Company contends such an adjustment will have no significant impact on the rate of return it is earning and should be permitted outside the scope of a general rate proceeding. We agree with the Company that a change in the interest paid on customer deposits can be considered outside the context of a general rate application and recognize the Company's authority to file such a tariff change at its discretion. The merits of the request will be determined when and if it is filed by the Company."

EXHIBIT B

PROPOSED FORM OF AMENDMENT
INCORPORATING CHANGES SUGGESTED BY BELLA VISTA'S EXCEPTIONS

Page 26, line 25:	Delete "$2,438,803" and Insert "$2,421,897"; Delete "$468,972" and Insert "$485,878"; and Delete "6.3" and Insert "6.49".
Page 27, line 3:	Delete Finding 15 and Insert the following: "15. A return of 8.7% on the Company's FVRB is fair and reasonable."
Page 27, line 5:	Delete "$604,588" and Insert "$650,979"; and Delete "$135,616" and Insert "$165,101".
Page 27, line 6:	Delete "1.7538" and Insert "1.6637".
Page 27, line 7:	Delete "$237,837" and Insert "$274,679".
Page 27, line 9:	Delete "$3,145,612" and Insert "$3,182,454".