ORIGINAL

0000053981

FENNEMORE CRAIG
Norman D. James (No. 006901)
Jay L. Shapiro (No. 014650)
3003 N. Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Arizona-American
Water Company, Inc.

2003 DEC -2 P 3: 13

AZ CORP COMMISSION
DOCUMENT CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 SUN CITY WATER AND WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0868**
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 AND HAVASU WATER DISTRICTS.	**DOCKET NO. W-01303A-02-0869** **ARIZONA-AMERICAN WATER'S WITNESS SUMMARIES**

Arizona Corporation Commission
DOCKETED
DEC - 2 2003
DOCKETED BY

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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, AGUA FRIA WATER AND ANTHEM/AGUA FRIA WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0870**
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 TUBAC WATER DISTRICT.	**DOCKET NO. W-01303A-02-0908**

Arizona-American Water Company ("Arizona-American"), the Applicant in the above-entitled consolidated rate proceedings, hereby submits the written summaries of the pre-filed testimony of each of its witnesses, as follows:

David P. Stephenson	Tab A
Thomas J. Bourassa	Tab B
Blaine Akine	Tab C
William M. Stout	Tab D
B. Kent Turner	Tab E
Ray L. Jones	Tab F
Fredrick K. Schneider	Tab G
Dr. Thomas M. Zepp	Tab H
Ronald L. Kozoman	Tab I

In addition, attached at Tab J is a copy of a summary schedule setting forth the

revenue increase (or decrease) by specific district as recommended by Arizona-American, the Utilities Division and the Residential Utility Consumer Office, as well as copies of the A-1 Schedules for each district summarizing the development of the revenue requirement and showing the revenues generated by meter size and customer class under Arizona-American's recommendations.

RESPECTFULLY SUBMITTED this 2nd day of December, 2003.

FENNEMORE CRAIG

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

An original and 21 copies of the foregoing and attachments were delivered this 2nd day of December, 2003, to:

Docketing Supervisor
Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing and attachments werehand-delivered this 2nd day of December, 2003, to:

Chairman Marc Spitzer
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Commissioner William Mundell
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Commissioner Mike Gleason
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Commissioner Jeff Hatch-Miller
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Commissioner Kristin Mayes
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Paul Walker, Aide to Chairman Spitzer
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Hercules Dellas, Aide to Commissioner Mundell
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Jodi Jerich, Esq., Aide to Commissioner Gleason
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Dean Miller, Aide to Commissioner Hatch-Miller
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Jerry Hays, II, Aide to Commissioner Mayes
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Teena Wolfe
Administrative Law Judge
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ

Timothy Sabo, Esq.
Gary Horton, Esq.
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ

Darron Carlson
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ

Daniel Pozefsky
Residential Utilities Consumer Office
1110 W. Washington, Suite 220
Phoenix, AZ 85007

And a copy mailed this 2nd day of December, 2003 to:

Carlton G. Young
3203 W. Steinbeck Dr.
Anthem, AZ 85086

Frank J. Grimmelmann
42441 N. Cross Timbers Court
Anthem, AZ 85086

Raymond E. Dare
Sun City Taxpayers' Association
12611 N. 103rd Ave., Suite D
Sun City, AZ 85351-3467

William P. Sullivan
Paul R. Michaud
Martinez & Curtis
2712 N. 7th St.
Phoenix, AZ 85006
Attorneys for the Town of Youngtown

Walter Meek
Arizona Utility Investors Association
2100 N. Central Ave.
Phoenix, AZ 85004

John Buric, Esq.
Warner Angle Hallam Jackson & Formanek
3550 N. Central Ave., Suite 1500
Phoenix, AZ 85012
Attorneys for Fiesta RV Resort

Kenneth C. Sundlof, Jr., Esq.
Robert Taylor, Esq.
The Collier Center, 11th Floor
201 E. Washington St.
Phoenix, AZ 85004-2385
Attorneys for Sun Health Corporation

By: Mary L House

1487512.1/73244.034

A

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NOS. WS-01303A-02-0867, ET AL.

SUMMARY OF DAVID P. STEPHENSON'S PRE-FILED TESTIMONY

Mr. Stephenson is employed by American Water Works Service Company, Inc. ("Service Company") as the Director of Rates and Planning for American Water Works Company, Inc.'s ("AWW") Western Region. The Western Region includes AWW's water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including the applicant in these consolidated cases, Arizona-American Water Company ("Arizona-American" or "Company"). Mr. Stephenson also serves as an Assistant Treasurer for Arizona-American.

Mr. Stephenson has been employed by the American Water System since 1978, and has extensive experience in rate proceedings and other regulatory matters, including proceedings before the Arizona Corporation Commission ("Commission") for Arizona-American. Among other things, he has served on the Accounting Committee of the California Water Association and has been an instructor at the NARUC bi-annual Utility Rate Seminar on eight occasions. In his position as Director of Rates and Planning for the operating utilities in the Western Region, Mr. Stephenson has been responsible for the preparation and prosecution of the rate applications in these dockets. He prepared direct, rebuttal and rejoinder testimony in support of the Company's applications.

A. Overview of the Company's Applications.

In his direct testimony, Mr. Stephenson provides an overview of the five rate applications that were originally filed by Arizona-American in late 2002. The applications cover a total of 10 water and wastewater districts, and seek rate adjustments based on the "fair value" rate bases and operating results in those districts utilizing a 12-month test period ending December 31, 2001, with appropriate pro forma adjustments to annualize and normalize rate base, revenues and expenses on a going-forward basis. These specific water and wastewater districts and the revenue increase (decrease) sought by Arizona-American are as follows:

District	Revenue Increase*	Percent Change*
Agua Fria Water	$62,372	1.01%

* Based on the Company's modified requests, set forth in its rejoinder filing. See Rejoinder Testimony of Thomas J. Bourassa, Rejoinder Schedules A-1.

Anthem Water	($11,688)	-0.32%
Anthem/Agua Fria Wastewater	$311,419	16.71%
Sun City Water	$4,453,775	71.92%
Sun City Wastewater	$260,879	5.13%
Sun City West Water	$1,156,931	34.22%
Sun City West Wastewater	$1,565,307	44.27%
Mohave Water	$142,344	3.24%
Havasu Water	$124,760	28.11%
Tubac Water	$181,931	71.49%

Mr. Stephenson explains in his direct testimony that these districts were previously owned and operated by Citizens Communications Company, and were acquired by Arizona-American on January 15, 2002.[1] The Commission approved the sale and transfer of the Citizens' water and wastewater utility plant, property and assets in Arizona, including the transfer of Citizens certificates of convenience and necessity, to Arizona-American in Decision No. 63584 (April 24, 2001). A copy of this decision is attached to Mr. Stephenson's Direct Testimony as Exhibit 1.

Later in 2001, the Commission authorized Arizona-American's debt financing for the purchase of Citizens' water and wastewater assets in Decision No. 64002 (Aug. 30, 2001). The Commission authorized Arizona-American to issue promissory notes and other evidence of indebtedness in an amount not to exceed $180 million and to issue a promissory note reflecting the obligation associated with assuming certain industrial development revenue bonds issued by Citizens in the amount of $10,635,000. The balance of the purchase price was financed by an infusion of paid-in equity capital from AWW.[2]

The ultimate purchase price paid by Arizona-American was approximately $276,500,000. As explained by Mr. Stephenson, the terms and conditions relating to the

[1] A small wastewater district located in Mohave County was also acquired by Arizona-American. This wastewater district is not involved in the rate applications, nor is the Paradise Valley Water District, which has been owned and operated by Arizona-American since the late 1960s.

[2] In Decision No. 64002, the Commission ordered Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition debt in order to maintain a reasonably balanced capital structure. Thus, the acquisition was financed by a mixture of debt and equity.

purchase price and the terms of the transaction generally were the result of arms-length negotiation between two independent and sophisticated utilities, Citizens and AWW.

None of the former Citizens' districts have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company's last rate order was issued in May 1997 based on test periods ending March 31, 1995. Decision No. 60172 (May 7, 1997).[3] Citizens Mohave Water Division last received rate increases in February 1990, based on a test period ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test period ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992). As Mr. Stephenson explains, it appears that once Citizens decided to sell its water and wastewater assets in 1999, it elected not to seek rate increases and, in some cases, to accept operating losses. Mr. Stephenson states that a delay in obtaining rate increases and correcting the districts' anemic earnings would be harmful to the Company and, ultimately, to its customers.[4]

B. Summary of Mr. Stephenson's Direct Testimony.

In addition to providing an overview of the Company's applications and background on its acquisition of Citizens' water and wastewater systems and assets, in his direct testimony Mr. Stephenson addressed the following issues:

(1) The reclassification of the payment made to the City of Tolleson for the installation of a new trickling filter (Sun City Wastewater District only);

(2) Capitalization of payments made for the implementation of ORCOM billing software and the appropriate period for the recovery of this investment (all districts);

(3) The transfer of charges related to the closing of the Citizens acquisition, as well as charges for the development of base accounting procedures (all districts) from expenses to organizational costs;

---

[3] In this decision, Sun City Water Company and Sun City West Utilities' rates for water service were actually reduced.

[4] In addition, Arizona-American was required to file for rate review for the Anthem water and wastewater districts by 2004 or, if earlier, when the number of equivalent residential units in Anthem reached 3,500. Decision No. 60975 (June 19, 1998). Also, in Decision No. 63584 (Dec. 12, 2002), the Commission imposed a 3-year moratorium on rate applications by Arizona-American in the absence of an emergency. The instant rate applications were filed before the 3-year moratorium went into effect.

(4) The rationale for the removal of the Citizens' management costs (all districts);

(5) Estimates of Service Company fees (all districts);

(6) Estimates of rate case expense (all districts);

(7) Estimates of direct charges made to these districts made by AWW (all districts);

(8) The components of the Company's capital structure, except for the cost of equity (addressed by Dr. Thomas M. Zepp);

(9) A discussion of the specific requirements established by the Commission in Decision 63584 (April 24, 2001), which, as discussed above, authorized Arizona-American to purchase the Citizens' water and wastewater systems and assets in Arizona.

Mr. Stephenson, in summary, addressed these issues and recommended the following:

(1) The period ending December 31, 2001, should be used as the test period for these rate filings. This period closely is aligned with the purchase of Citizens' water and wastewater systems by Arizona-American, which transaction closed on January 15, 2002.

(2) The period for pro forma adjustments should extend through the end of 2002 to ensure that rate base, revenues and expenses are normalized on a going-forward basis.

(3) Pro forma plant adjustments should be included in rate base. The adjustments consist of non-revenue generating plant additions (i.e., additions serving existing, rather than new, customers) that will be completed and placed in service by the end of 2002.

(4) Pro forma adjustments for operating expenses should be made, based on known and measurable changes that have or will occur up until the time the rate application is filed. This is consistent with A.A.C. R14-2-103(i).

(5) The $500,000 payment to the City of Tolleson for the trickling filter should be recorded as a limited term asset.

(6) The ORCOM billing system start-up costs of $607,723 should be capitalized and included in rate base.

(7) Corporate costs of $906,532 should be transferred to the acquisition adjustment

as part of the costs of the Citizens acquisition.

(8) All of Citizens' management fees should be removed from test period expenses because these expenses pertain to Citizens' management of the Citizens' systems in Arizona, and are not expenses that will be incurred under the ownership and management of Arizona-American.

(9) The Citizens' management fees should be replaced by the Service Company's annualized charges and Corporate direct charges.

(10) Arizona-American should be allowed to recover total estimated rate case expense of $715,000, amortized over 3 years, based on the size and complexity of the consolidated cases.

(11) The Commission should adopt a capital structure comprised of 60 percent debt and 40 percent equity, based on the actual debt and equity used to finance the acquisition of Citizens' systems and assets.

(12) The difference between the purchase price and the book value of the assets purchased should be recorded as the acquisition adjustment and be amortized over 40 years on a mortgage-style basis.

(13) The deferred taxes, excess deferred taxes and investment tax credits that were on the books and records of Citizens at the time of the closing of the Citizens acquisition should not be considered for ratemaking purposes. These taxes and credits belong to and benefited Citizens, not Arizona-American, and will be considered in determining the amount of Citizens' gain from the transaction.

C. Summary of Mr. Stephenson's Rebuttal Testimony.

In his rebuttal testimony, Mr. Stephenson addressed the following issues:

(1) Arizona-American's overall filing, the test period and the timing of the filing;

(2) Treatment of the acquisition adjustment;

(3) Inclusion of Service Company charges in the test period;

(4) Rate case expense;

(5) Issues related to capital structure and cost of debt; and

(6) Issues related to the financial integrity of the Company resulting from Staff's recommendations.

Mr. Stephenson, in summary, addressed these issues and recommended the following:

(1) Arizona-American determined that, for ease of presentation, the period ending December 31, 2001, is the appropriate test period for this case as it is closely aligned with the purchase of Citizens' water and wastewater systems by Arizona-American.

(2) Arizona-American used an appropriate test period under the circumstances in this case, and the data in the Company's presentation is not "stale."

(3) Arizona-American is basing its request for the rate relief on accepted ratemaking principles, including using pro forma adjustments to normalize for known and measurable changes as required under the Commission's rules.

(4) Further, no other test period is appropriate due to the conditions imposed by the Commission Decision No. 65384, including a 3-year moratorium on new rate applications.

(5) Arizona-American did mistakenly include the recovery of the acquisition premium through amortization as part of depreciation expense. This was inappropriate due to the fact that the Company is <u>not</u> requesting that the revenue requirement in these applications be based on the inclusion of a return on the premium.

(6) Arizona-American is requesting that its revenue requirement be determined by calculating a fair rate of return on its Fair Value Rate Base, and that the Fair Value Rate Base be the same as its RCN Rate Base in order to more closely approximate the current or "fair" value of its utility plant and property.

(7) Arizona-American has included an acquisition adjustment in the recorded historical original cost plant schedules because it is required under any acceptable regulatory accounting methodology. However, Arizona-American has not requested that the revenue requirement be based on its original cost rate base.

(8) Arizona-American's overheads are not higher than Citizen's historical amounts

(9) Benefits of Arizona-American's purchase of the Citizens' assets area being realized by customers. For example, Arizona-American's capital structure contains 60 percent debt at a cost of only 4.86 percent, while Citizens' historic

capital structure contained 49 percent debt at a cost of approximately 7 percent.

(10) The Commission should approve Arizona-American's request for an accounting (not ratemaking) treatment of the acquisition adjustment in this proceeding.

(11) The allocation of the acquisition adjustment for accounting purposes should be based on gross plant value at the time of the acquisition.

(12) The actual AWW Service Company and Corporate overheads should be used in the determination of the revenue requirement to properly normalize these expenses on a going-forward basis, rather than using Citizens' 2001 overheads, as Staff proposes. For the same reason, Arizona-American's actual 2002 salaries should be used in the determination of the revenue requirement.

(13) Arizona-American's requested rate case expense of $715,000, amortized over 3 years, is reasonable. Although Staff agrees with this request, it is opposed by the Residential Utility Consumer Office ("RUCO"). Mr. Stephenson explains why RUCO's arguments are erroneous given the magnitude and complexity of this proceeding, which involves 10 separate districts serving over 100,000 customers.

(14) The City of Tolleson's bonds should not be considered part of the capital structure of Arizona-American, because those bonds were issued by Tolleson and are not Company debt. However, the existing PILOR agreements, which financed the construction of plant for the Paradise Valley Water District, should be considered part of the capital structure of Arizona-American if the Company's entire capital structure is used, as proposed by Staff.

(15) Further, all current bond rates should be used in the determination of the Company's weighted average cost of debt.

(16) The current amount of short-term debt of the Company at December 31, 2002 should be used in the capital structure determination at current long-term debt rates.

(17) The pre-tax interest coverage provided under Staff's recommendation is approximately 1.0 – an indication of financial distress. Even under the Company's recommendation, its pre-tax interest coverage would be approximately 1.7. (Stephenson Rebuttal Exhibit 4.) By contrast, according to Staff, the median interest coverage ratio for an A-rated utility is 3.4.

D. Summary of Mr. Stephenson's Rejoinder Testimony.

The rejoinder testimony of Mr. Stephenson addressed the following issues:

(1) Arizona-American's overall filing;

(2) The ratemaking implications of the Town of Youngtown's request that the Commission require Arizona-American to perform a study and construct fire flow improvements for the benefit of Youngtown residents;

(3) Rate case expense;

(4) The acquisition premium;

(5) Inclusion of overheads and Service Company charges in the test period; and

(6) Fair value rate base issues.

Mr. Stephenson, in summary, addressed these issues and recommended the following:

(1) Arizona-American continues to recommend that the appropriate test period for this case is based on a test period of 2001, with pro forma adjustments through December 31, 2002, to recognize known and measurable changes on a going-forward basis.

(2) Arizona-American has supported its application with testimony and evidence on every aspect of its request, defended every proposed adjustment, made necessary and appropriate corrections as recommended by other parties, and provided updated schedules reflecting its proposed revenue requirement and rates.

(3) The Town of Youngtown's request that the Company be ordered to proceed with a study of fire flow improvements and make such improvements over 5 years should be denied.

(4) Arizona-American's rate case expense estimate of $715,000 is fully supported and should be approved with a three-year amortization period.

(5) Arizona-American has requested that it be allowed to amortize the full amount of the acquisition adjustment based on a 40-year period using the mortgage style amortization method. The Company is not requesting, at this time, that any portion of the acquisition adjustment be included in the cost of service.

(6) The Town of Youngtown's recommendation that the acquisition adjustment be allocated based on net book value should be denied.

(7) The Staff's recommendation that the determination of the accounting treatment of the acquisition adjustment be delayed until Arizona-American seeks rate recovery thereon should be denied.

(8) Staff's recommendation that the cost of service include Citizens' 2001 overheads, rather than the Company's actual 2002 overheads, should be denied.

(9) The positions of Staff, RUCO and the Town of Youngtown are inconsistent and, moreover, would result in rates being based solely on an Original Cost Rate Base, without regard to the current "fair value" of Arizona-American's utility plant and property.

(10) The Company's recommended capital structure, consisting of 60 percent debt and 40 percent equity should be adopted, as well as the Company's 4.86% cost of debt.

(11) Staff's contention that the Company's calculation of the interest coverage provided under Staff's recommendation is erroneous because it uses "accounting data" is nonsensical, as is Staff's suggestion that Arizona-American "overpaid" for Citizens plant and assets. Pre-tax interest coverage, and other formulas used to determine the ability of a firm to repay its debt, are based on actual debt service requirements (i.e., "accounting data"). Further, the Commission reviewed and approved the acquisition of Citizens' water and wastewater assets, as well as Arizona-American's financing for the acquisition, in Decision Nos. 63584 and 64002.

1486556.1/73244.034

B

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. WS-01303A-02-0867 ET. AL.

SUMMARY OF THOMAS J. BOURASSA'S PRE-FILED TESTIMONY

Mr. Bourassa is a Certified Public Accountant who provides various accounting and consulting services to regulated businesses, including utilities. He has prepared or has assisted in the preparation of rate applications for a number of Arizona water and wastewater utilities. In rate proceeding, Mr. Bourassa was responsible for preparing, and is sponsoring, Schedules A through F of the standard filing requirements for Class A water and wastewater utilities, as set forth in A.A.C. R14-2-103, and for the overall development of the revenue requirement for each Arizona-American Water Company ("Arizona-American" or "Company") water and wastewater district in this case. (Issues related to the cost of capital and return on equity are addressed by David P. Stephenson and Dr. Thomas M. Zepp.)

Mr. Bourassa filed direct, rebuttal and rejoinder testimony, which generally addresses the following aspects of Arizona-American's rate applications:

(1) Revenue Requirement

(2) Rate Base (original cost, reconstruction cost and fair value)

(3) Revenues and Expenses (including depreciation and taxes)

(4) The amended Tolleson agreement (Sun City Wastewater District only)

I. REVENUE REQUIREMENT

A. Direct Testimony.

In his direct testimony, filed in November 2002, Mr. Bourassa presented the recommended revenue increases for each of the 10 water and wastewater districts involved in this consolidated proceeding. He noted the Company recommended a 7.75 percent return on its fair value rate base ("FVRB"), based on its capital structure financing its FVRB.

B. Rebuttal Testimony.

In his rebuttal testimony, Mr. Bourassa testified that the Company has revised its recommended fair value return from 7.75 percent to 7.52 percent. He also testified on the rebuttal recommend revenue increases for each district. Mr. Bourassa explained that the

Company's recommended revenue increases are lower because the Company accepted a number of Staff and RUCO adjustments, which impact the Company's operating income, plant-in-service and FVRB, as well as proposing some of its own adjustments in response to positions taken by the other parties.

C. Rejoinder Testimony.

In his rejoinder testimony, Mr. Bourassa testified that the Company continued to recommend a return of 7.52 percent on FVRB. He testified to the rejoinder recommend revenue increases by district. Mr. Bourassa noted the recommended revenue increases are somewhat lower due to corrections made to expenses and because the Company accepted an additional plant adjustment proposed by Staff.

II. RATE BASE

A. Direct Testimony.

Mr. Bourassa testified on the development of the Company's Original Cost Rate Base ("OCRB") and Reconstruction Cost Rate Base ("RCRB").

Several adjustments were made to the OCRB, including additional plant at closing, post-test year plant, ORCOM billing system costs, additional contributions-in-aid of construction ("CIAC") and advances-in-aid of construction ("AIAC") at closing, acquisition premium, the Tolleson trickling filter (Sun City Wastewater District only), and removal of double-booked Citizens advances (Agua Fria Water District only). The Company included in rate base Citizens CIAC and AIAC imputed to Arizona-American for ratemaking purposes per Decision No. 63584 (April 24, 2001), and the Company's settlement agreement with Staff, approved by the Commission in that decision, which substantially reduced the Company's rate base.

Post-test year plant adjustments were based on Arizona-American capital budgets at the time of filing. Further, no working capital allowance was included in OCRB.

Mr. Bourassa testified on the preparation of the Company's trended RCN plant-in-service study. Mr. Bourassa employed national Handy-Whitman indexes to determine the trended plant values. Land and other intangible plant were also trended to estimate their current value.

The adjustments made to the OCRB were also made to the RCRB, including additional plant at closing, post-test year plant, ORCOM billing system costs, additional CIAC and AIAC at closing and the Tolleson trickling filter (Sun City Wastewater District only), and to remove double-booked Citizens advances (Agua Fria Water District only). Accumulated depreciation, CIAC and AIAC were also trended and restated, and deducted

from RCRB, in accordance with applicable Commission rules. Again, no working capital allowance was included.

The Company recommended that its RCRB be used as the FVRB. Mr. Bourassa testified that the valuation approach used is relatively conservative. The methodology reflects the current costs to construct plant while taking into corresponding increases in accumulated depreciation and the CIAC and AIAC balances (a significant portion of which were imputed to Arizona-American from Citizens). Further, the proposed FVRB is significantly less than the amount paid for the Citizens systems by Arizona-American, which was approximately $276,500,000. Mr. Bourassa testified that the purchase price paid for the Citizens systems is additional evidence of value that should be considered.

B. Rebuttal Testimony.

Mr. Bourassa testified on the development of the Company's rebuttal Original Cost Rate Base ("OCRB") and rebuttal Reconstruction Cost Rate Base ("RCRB"). The Company accepted Staff's adjustments to original cost plant-in-service, including adjustments for post-test year plant, unidentified plant, plant not used and useful, and reversal of 3/95 AFUDC adjustment. Post-test year plant was adjusted to reflect actual 2002 expenditures. The 3/95 AFUDC adjustment was found to have been already booked by Citizens. The Company employed the common plant allocation methodology for all common plant adjustments.

Mr. Bourassa testified that Staff failed to allocate its adjustments using the common plant allocation methodology employed by the Company in its direct filing. Thus, while the Company and Staff's adjustments agree in total, resulting plant-in-service for the individual districts is different. The Company did not agree with certain Staff adjustments to accumulated depreciation for unidentified plant and not used and useful plant. Staff proposed to adjust accumulated depreciation for the balance at 12/31/2001 for each of its plant adjustments. The Company proposed that, for plant given prior rate base treatment, accumulated depreciation should be adjusted for the full cost of the plant as in a retirement. For plant not afforded prior rate base treatment, accumulated depreciation should be adjusted by the balance at 12/31/2001.

The Company did not agree with RUCO's recalculation of accumulated depreciation. Mr. Bourassa explained that RUCO failed to properly account for the accumulated depreciation associated with Citizens plant adjustments (not retirements). Mr. Bourassa also explained that the Company does not did not agree with the convention RUCO used (half-month vs. half-year) and does not agree with additional depreciation on post-test year plant adjustments.

Mr. Bourassa also testified on the preparation of the Company's rebuttal trended RCN plant-in-service study. Mr. Bourassa revised the study to address Staff's concerns

based on the recommendations of William Stout, a profession engineer and utility valuation expert retained by the Company to review the parties' RCN studies. (See Rebuttal Testimony of William M. Stout, P.E.). Mr. Bourassa employed account specific regional Handy-Whitman indexes as well as the Consumer Price Index to determine the trended plant values. Land and other intangible plant were not trended. Adjustments made to the OCRB were also made to the RCRB at their trended amounts and included adjustments for post-test year plant, unidentified plant, plant not used and useful, and reversal of 3/95 AFUDC adjustment. The Company employed the common plant allocation methodology for common plant adjustments. The Company's rebuttal RCRB was lower than its direct RCRB by approximately $12,000,000. The Company recommended its RCRB, as revised in response to Staff's concerns, be used as the FVRB.

C. Rejoinder Testimony

In his rejoinder testimony, Mr. Bourassa testified on the Company's Original Cost Rate Base ("OCRB") and rejoinder Reconstruction Cost Rate Base (RCRB). With respect to the OCRB, the Company accepted an adjustment for additional post-test year plant proposed by Staff. This adjustment was for Mohave Water District only. The Company's RCRB was also adjusted to reflect Staff's additional plant adjustment. The Mohave Water District RCRB changed, while all the other districts remained the same.

Mr. Bourassa explained that Staff revised most of its common plant adjustments to the individual districts to conform to the Company's common plant methodology. However, Staff still failed to account for all common plant adjustments. Staff revised approximately $592,000 out of approximately $624,000 of adjustments for the Maricopa districts (Anthem, Agua Fria, Sun City and Sun City West) and $0 out of approximately $37,000 for the Mohave districts (Mohave and Havasu).

Most importantly as Mr. Bourassa explained, Staff accepted the Company's revised trended RCN plant-in-service study. Staff did not prepare RCRB schedules. Instead, it used a short-cut method by calculating its RCRB by multiplying Staff's OCRB by the ratio of the Company's RCRB to the Company's OCRB.

The Company's rejoinder RCRB was slightly lower than its rebuttal RCRB. Mr. Bourassa testified that the RCRB, as revised and accepted by Staff, provides a superior estimate of the current or "fair" value of the Company's utility plant and property. He noted that the amount paid by Arizona-American for Citizens' utility plant and assets further supports use of the RCRB as the Company's FVRB, rather than historic or original cost.

Mr. Bourassa testified that Staff's FVRB increased by approximately $22,000,000, but Staff's revenue requirement somehow decreased by over $130,000. Analysis of this

anomaly showed that Staff's recommendation was based on its OCRB determination, rather than the Company's FVRB, which would render RCRB meaningless.

III. REVENUES AND EXPENSES

A. Direct Testimony.

In his direct testimony, Mr. Bourassa described the Company's proposed adjustments to the test year in order to normalize revenues and expenses and to take into account known and measurable changes. These adjustments include:

(1) Replacing Citizens' salaries and wages expense and payroll tax expense with Arizona-American's salaries and wages and payroll taxes;

(2) Replacing Citizens' corporate overhead expense with Arizona-American's service company charges and other corporate overhead expenses;

(3) Adjusting depreciation to reflect adjusted plant-in-service as well as amortization of CIAC (including Citizens' imputed CIAC) and amortization of the acquisition premium;

(4) Adjusting property tax expense to synchronize property tax with proposed revenues;

(5) Adjusting interest expense to synchronize interest expense with rate base;

(6) Revenue annualization adjustments for customers at year-end;

(7) Removing purchased water expense covered by adjuster mechanisms (Sun City Water District and Sun City West Water District only);

(8) Adjusting purchased water expense to reflect projected costs (Anthem Water District and Agua Fria Water District only);

(9) Removing other revenues and expenses to eliminate income tax effects;

(10) Purchased power annualization adjustments;

(11) Adjusting rate case expense to reflect amortization of the rate case expense for the instant case;

(12) Eliminating inter-company revenues and expenses (Anthem Water District and Anthem/Agua Fria Wastewater District only);

(13) Removing the Tolleson trickling filter costs from operating expenses (Sun City Wastewater District only); and

(14) Increasing revenues based on Del Webb payments expected to commence in 2004 (Anthem Water District and Anthem/Agua Fria Wastewater District only).

Mr. Bourassa testified the replacement of Citizens' expenses with Arizona-American expenses for salaries and wages, payroll taxes, American Water Works Service Company ("Service Company") charges, and other corporate overhead was proposed because the Citizens' 2001 expenses do not reflect the expenses on a going-forward basis.

B. Rebuttal Testimony.

Mr. Bourassa described the Company's proposed rebuttal adjustments to the adjusted test year revenues and expenses in its direct filing, including:

(1) Adjusting salaries and wages and payroll taxes to reflect Arizona-American's actual 2002 costs;

(2) Adjusting Service Company and other corporate overhead expenses to reflecting Arizona-American's actual 2002 costs;

(3) Adjusting depreciation expense to reflect the rebuttal adjusted plant-in-service and to remove amortization of the acquisition premium;

(4) Adjusting property taxes to reflect adopting Staff's proposed revenue components and to reflect the Company's rebuttal changes to revenues; and

(5) Adjusting purchased water to reflect the annualized 2001 water quantity ordered rather than the 2002 quantity (Anthem Water District only).

Mr. Bourassa noted that Staff did not accept the Company's proposed adjustments to salaries and wages, payroll tax expense, Service Company charges, and other corporate expenses. Staff asserted a mismatch between revenues and expenses and that the

Company's proposed adjustments are not known and measurable. In response, Mr. Bourassa showed that test year expenses were not normal by comparing Citizens expenses for 1999, 2000 and 2001 (the test year). Citizens' expenses were shown to be higher in prior years. Mr. Bourassa explained that Citizens expenses were lower in the test year because Citizens was reducing its expenses in anticipation of the pending sale of its water and wastewater systems to Arizona-American. Mr. Bourassa also pointed out that the change in ownership is a known and measurable event and that Citizens' expenses no longer exist and will not exist when new rates are established.

Mr. Bourassa also noted that RUCO agreed with the Company on using Arizona-American's expenses instead of Citizens' expenses. However, Mr. Bourassa testified that the Company did not agree with the salaries and wages amounts used by RUCO. In particular, Mr. Bourassa noted that RUCO did not account for all the salaries and wages, and that RUCO used an estimated capitalization rate rather than the actual rate. He also disagreed with the amount of Service Company charges RUCO proposed.

Mr. Bourassa testified the Company and Staff agree on the revenue components to be used in the property tax calculations (two times the adjusted test year revenues plus revenues at proposed rates), while RUCO advocated using only historical years to lower property tax expense. Mr. Bourassa explained that RUCO's backward-looking approach is inappropriate.

C. Rejoinder Testimony.

In his rebuttal testimony, Mr. Bourassa described the Company's proposed rejoinder adjustments to the rebuttal adjusted test year revenues and expenses, including:

(1) Corrections to errors made in rebuttal for the 2002 Arizona-American salaries and wages, payroll taxes, Service Company charges, and other corporate overhead;

(2) Adjustments to property taxes to reflect rejoinder proposed revenues;

(3) Adjustment to depreciation expense to reflect an additional plant adjustment proposed by Staff.

Mr. Bourassa explained that Staff continued to disagree with the Company on the replacement of Citizens' 2001 expenses with Arizona-American's 2002 expenses. Mr. Bourassa testified the Company has shown the Arizona-American's expenses are the best measure of these expenses on a going-forward basis, when new rates will be in effect. Citizens' expenses no longer exist, have no relationship to the period that rates will be in

effect, and are not appropriate.

Mr. Bourassa noted that RUCO corrected the salaries and wages amounts in its surrebuttal, but continued to utilize a 27 percent capitalization rate. He testified the Company recommended using Arizona-American's actual payroll capitalization rates by district. The actual capitalization rates under Arizona-American's ownership are the best measure of payroll capitalization, not an estimate. The reason for the difference in Service Company charges between the Company and RUCO are the corrections Mr. Bourassa made to the January and February 2002 charges. Charges in the months of January and February were found to be abnormally low, and, accordingly, these months were corrected to capture a full year of normal expenses.

Mr. Bourassa also noted that RUCO recommended using only historical years (1999, 2000, and 2001) as the revenue components for calculating property taxes. Mr. Bourassa explained that for ratemaking purposes, property taxes must be synchronized with prospective revenues to insure property taxes are recovered on a going-forward basis. The synchronization of property taxes to revenues is analogous to computing income taxes based on adjusted revenues and expenses for ratemaking.

IV. TOLLESON WASTEWATER TREATMENT COSTS

A. Direct Testimony.

In his direct testimony, Mr. Bourassa testified that the Sun City Wastewater District was completing an amendment to its agreement for wastewater treatment services with the City of Tolleson, and that the Company was seeking rate relief in the form of an adjuster mechanism to recover increased costs.[1] The new Tolleson agreement amends "Rate Component Three" and creates a new "Rate Component Four." Rate Component Three (reserve for contingencies) increased from $1,500 a month with an aggregate cap of $90,000 to $20,000 per month with an aggregate cap of $200,000. Rate Component Four consists of the Company's prorata share of the $8 million that Tolleson is spending on treatment plant improvements.

Costs under Rate Component Three, Mr. Bourassa testified, would be recovered in the year following payment under the Company proposal. With respect to Rate Component Four, the Company proposes to recover the amortized portion of the actual payments plus the annual carrying cost of any associated debt. The amortization period of the payments would be equal to the remaining life of the agreement. Mr. Bourassa testified that, under these circumstances, a cost adjuster mechanism is appropriate because while these costs are certain to be incurred for the benefit of ratepayers, they are

[1] In Sun City, the Company does not own or operate any wastewater treatment plant. Instead, wastewater is transported to, and treated by, the City of Tolleson at the city's wastewater treatment plant.

not fixed in amount or date of payment. The adjuster mechanism ensures the Company will recover only the actual costs incurred in a timely manner.

B. Rebuttal Testimony.

In his rebuttal testimony, Mr. Bourassa noted that Staff recommended that the Commission defer rate recovery until a future rate case. Staff also suggested it was premature to recommend treatment until the Commission renders a decision on the accounting treatment, which was pending before the Commission. However, the Commission has issued an accounting order that Staff, RUCO, Youngtown, and Arizona-American collectively recommended. Decision No. 66386 (October 6, 2003).

Mr. Bourassa explained that RUCO also recommended that the Commission defer rate recovery until a future rate case. RUCO asserted that because the charges are not known and measurable, ratemaking treatment should be deferred. However, as Mr. Bourassa explained the Company is seeking recovery of the actual costs, not estimates, that the Company pays under its treatment services agreement with Tolleson.

Mr. Bourassa emphasized that none of the parties have challenged the prudency and benefit to ratepayers of the costs the Company will incur, nor have the contended the Company should own and operate its own treatment plant in Sun City. The alternative of siting, designing and building a new wastewater treatment plant would be far costlier than contracting for treatment services from Tolleson.

C. Rejoinder Testimony

In his rejoinder testimony, Mr. Bourassa noted that both Staff and RUCO continued to recommend deferral of the amended Tolleson agreement costs until a future rate proceeding, depriving the Company of its ability to recover these necessary costs. Mr. Bourassa testified that Staff proposed to treat these costs as if the Company owned the plant, rather than Tolleson, and that RUCO appeared to do the same. Both parties refer to the Tolleson costs as "investments," as opposed to payments to Tolleson under the Company's treatment services agreement. Both Staff and RUCO ignore the fact that the Company has no control over the Tolleson plant and its operations beyond the ability to verify the costs. The Company also believes that both Staff and RUCO have not fully considered the implications of placing the Company in the position of "owning" the treatment plant and the ultimate cost to ratepayers. Finally, RUCO considers the Tolleson costs as inappropriate for an adjuster mechanism, claiming that only volatile expenses are candidates for adjusters. Mr. Bourassa testified that this is not true in all circumstances. Adjusters are also appropriate for significant expenses beyond the control of the utility, which is the case here.

C

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NOS. WS-01303A-02-0867, ET AL.

SUMMARY OF BLAINE AKINE
PRE-FILED TESTIMONY

Mr. Akine is employed by Arizona-American Water Company ("Arizona-American" or "Company") as Engineering Director. Mr. Akine's current duties and responsibilities include oversight and management of all engineering, design, construction and developer activities for the Company's Arizona operations. Mr. Akine has been with Arizona-American since its acquisition of the water and wastewater assets of Citizens Communications, Inc. and before the acquisition was employed by Citizens Water Resources. Mr. Akine prepared direct testimony in support of the Company's applications.

Summary of Mr. Akine's Direct Testimony.

Mr. Akine's direct testimony addressed certain plant additions and other capital improvements that were anticipated to be completed in the various water and wastewater districts subject to the Company's rate filing during calendar year 2002. Mr. Akine's direct testimony supported the Company's request to include these post test year plant additions in rate base for ratemaking purposes. Mr. Akine's direct testimony began by describing the yearly budgeting process that the Company goes through to identify all proposed construction projects and to determine which projects need to be included in the Company's capital plan. Once it is determined that a Company funded project will be included in the capital plan, the Company goes through a budgeting process to obtain detailed estimates for each approved project.

Next, in his direct testimony, Mr. Akine identified each of the post test year projects Arizona-American sought to be included in rate base for each of the water and wastewater districts subject to the Company's rate filing. As Mr. Akine explained, in all instances, these were revenue neutral plant additions generally necessary for repair and replacement of existing plant facilities serving existing customers within the water and wastewater districts subject to the Company's rate filing. Capital projects in support of new customer growth were excluded from the Company's rate filing.

Mr. Akine also provided the then current estimated amounts for post test year plant additions to be completed and placed in service on or before December 31, 2002.[1] As Mr. Akine explained in his direct testimony, this cutoff date was selected as a

[1] In the Company's rebuttal filing Mr. Akine's estimates were replaced with the actual costs of the post test year plant as recommended by Staff. See Rebuttal Testimony of Thomas J. Bourassa at 6; Rebuttal Schedule B-2.

reasonable period based on the timing of the Company's applications and to allow Staff and any other party ample opportunity to inspect the plant. Finally, Mr. Akine also explained that the cutoff date was consistent with the Commission's Decision No. 61831 (July 20, 1999) wherein the Commission ordered the Company to limit adjustments to post test year plant to include only plant used and useful and in service within 90 days of the date the rate application was deemed sufficient.

1487268.1/73244.034

D

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. WS-01303A-02-0867 ET. AL.

SUMMARY OF REBUTTAL TESTIMONY OF WILLIAM M. STOUT, P.E.

Mr. Stout is the President of the Valuation and Rate Division of Gannett Fleming, Inc., in Camp Hill, Pennsylvania. He is a registered professional engineer, and is a member of a number of professional societies, including the American Water Works Association, the National Association of Water Companies, and the Society of Depreciation Professionals, of which he served as president. He has been employed in Gannett Fleming's Valuation Division for 30 years, and has performed numerous cost of service and valuation studies. He has also testified before numerous utility regulatory commissions in the United States and Canada.

Mr. Stout's rebuttal testimony responds to the testimony of the Staff engineering witnesses Carlson, Hains, Chelus, Hammon, and Scott (collectively "Staff"). His testimony is related to the Reproduction Cost New (RCN) studies conducted by Staff as well as the study conducted by Mr. Bourassa on behalf of Arizona American Water Company ("Company"). Because the Company submitted revised RCN studies in its rebuttal filing (sponsored by Mr. Bourassa) that were accepted by Staff (see Surrebuttal Testimony of Marlin Scott, Jr.), Mr. Stout did not submit rejoinder testimony.

Both Staff and Mr. Bourassa conducted trended original cost studies as a means of determining RCN. Mr. Stout testified that this is a cost-effective and reasonable approach that valuation experts have used for many years.

Mr. Stout explained that there are several elements of Mr. Bourassa's initial study, such as his use of a single cost index and inclusion of not used and useful property, that warrant adjustment, consistent with Staff's recommended approach. Mr. Bourassa made such adjustments as shown in the exhibits attached to his rebuttal testimony. As a result, the RCN values are now $380.6 million as set forth by Mr. Bourassa and $379.4 million per Staff, a variance of only 0.3 percent. The result is a reasonable determination of the Company's RCN plant values based on generally accepted valuation techniques.

Mr. Stout also explained that Staff's remaining concerns regarding the RCN studies are not warranted and do not preclude their use in this proceeding. Utilization of the assets recorded in the continuing property record in conjunction with periodic inspections is appropriate. A complete physical inventory is not necessary. Contributed plant has appropriately been excluded, contrary to Staff's contention. The misclassification of several minor items does not distort the study results. The use of trended original costs for organization, franchises and consents, and land recognizes that such assets could not be obtained today at their original costs. Finally, the Company's overheads should be

included in the determination of RCN. Such costs are a part of the cost of constructing assets and have been allocated to project in a systematic manner.

E

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NOS. WS-01303A-02-0867, ET AL.

SUMMARY OF KENT TURNER'S PRE-FILED TESTIMONY

Mr. Turner is employed by American Water Works Service Company, Inc. ("Service Company") as Vice President-Finance and Chief Financial Officer of the Western Region. The Western Region includes American Water Works Company, Inc.'s ("AWW") water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including the applicant in these consolidated cases, Arizona-American Water Company ("Arizona-American" or "Company"). Mr. Turner has been employed by the American Water System since 1999 and also serves as the Company's Vice President and Treasurer. Mr. Turner has extensive experience in ratemaking proceedings before regulatory bodies and has previously testified before the Arizona Corporation Commission ("Commission") for Arizona-American. Mr. Turner prepared direct testimony in support of the Company's application.

In his direct testimony, Mr. Turner provided background testimony regarding Arizona-American, AWW and the Service Company. As Mr. Turner explained, Arizona-American, previously known as Paradise Valley Water Company, has been a wholly owned subsidiary of AWW since the late 1960s. AWW is a Delaware corporation headquartered in Voorhees, New Jersey with a business presence in 28 states and 3 Canadian provinces. AWW has operating utility subsidiaries that provide water and/or wastewater services to more than 12 million people in 23 states, including Arizona-American. Mr. Turner also explained the relationship between AWW and a number of subsidiaries that are engaged in non-regulated business activities, including the Service Company, whose business focuses on providing contract operating and management services to subsidiary, municipal, industrial and military clients and American Water Capital Corp., which provides debt capital and treasury management services, at cost, to AWW and its utility subsidiaries.

Mr. Turner's also testified concerning the specific services provided by AWW and other affiliates to Arizona-American. As a part of the American Water System, Arizona-American benefits from the system's depth of knowledge and economies of scale, whether in connection with routine day-to-day operations or design and construction of complex water and wastewater treatment facilities. Some of the specific benefits Mr. Turner identified in his direct testimony include the Shared Services Center, an operations center providing consolidated accounting, treasury and many financial analysis and reporting functions to create a consistent accounting platform across the American Water System. Parallel to the Shared Services Center, Mr. Turner also identified the benefits of the Customer Call Center in Alton, Illinois. This call center

functions as a centralized office for the handling of all customer inquiries, accounting and other service related issues. The American Water System has also instituted a common billing platform, known as ORCOM, at a single location in Hershey, Pennsylvania to provide greater efficiency and consistency in the billing process across the many American Water System utility operations. Finally, in his direct testimony Mr. Turner discussed additional benefits provided by the Service Company to Arizona-American. These benefits include financial, water quality, capital deployment and project management services. These services are provided by the Service Company in a manner that both reflects consolidated economies of scale as well as the breadth and depth of knowledge found throughout the American Water System.

1487232.1/73244.034

F

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NOS. WS-01303A-02-0867, ET AL.

SUMMARY OF RAY JONES' PRE-FILED TESTIMONY

Mr. Jones is employed by Arizona-American Water Company ("Arizona-American" or "Company") as President. Mr. Jones has been employed by Arizona-American since it acquired the water and wastewater assets of Citizens' Communications, Inc. ("Citizens") in January 2001. Previously, Mr. Jones had worked with Citizens since 1985 and he testified before the Arizona Corporation Commission on numerous occasions while employed by Citizens. Mr. Jones prepared rejoinder testimony in support of the Company's applications.

Summary of Mr. Jones' Rejoinder Testimony.

Mr. Jones' rejoinder testimony was submitted to address a very narrow issue originating with Staff's claim that the Company has failed to present evidence that Citizens' test year corporate overhead costs bear little relationship to Arizona-American's cost during the time rates approved in this proceeding will be in effect. See Surrebuttal Testimony of Alexander Ibhade Igwe at 3. As Mr. Jones explains in his rejoinder testimony, Staff has simply chosen to ignore the evidence supporting the Company's pro forma adjustment to Citizens' test year corporate overhead costs, which adjustment raises the revenue requirement. There is, in fact, substantial evidence that Citizens' test year corporate overhead costs have no bearing on the setting of rates in this proceeding.

To begin with, Mr. Jones pointed out that several other Company witnesses had previously explained the basis for the Company's proposed pro forma adjustment to administrative and general overhead costs including, Messrs. Bourassa and Stephenson. In addition, Mr. Jones testified that that each of the Company's direct filing contained the direct testimony of the Company's then Manager, Rob Kuta, whose testimony has since been adopted by the Company's current manager, Fred Schneider. In that testimony Mr. Kuta explained how Citizens, in anticipation of selling its water and wastewater systems had failed to maintain adequate staffing levels, failed to make necessary administrative and operational changes and failed to plan for expanding office needs. In addition, Mr. Jones provides additional testimony regarding the wind-down of Citizens' operations that both preceded and continued during the test year at issue in this proceeding and how this wind-down impacted the test year level of Citizens' corporate overhead costs. From his perspective as Vice-President and General Manager of Citizens Arizona operations from 1998 until the Arizona-American acquisition, Mr. Jones has particular knowledge regarding the decision-making by Citizens leading up to the acquisition.

Mr. Jones' testimony further illustrates that the Citizens' test year overhead expenses bear no relationship to Arizona-American's expenses during the time the rates in this proceeding will be in effect. Citizens had made the decision to sell its electric, gas, water and wastewater businesses and assets in 1999 and the sale to Arizona-American of the water and wastewater assets in Arizona was announced in October of that year. From that point on, Citizens began to implement changes in its management practices, its processes and its personnel intended to reduce operating costs generally and overhead costs specifically in a phased manner as the divestiture of these assets approached. For example, Citizens discontinued the use of consultants and suspended non-critical employee travel. The public services sector of Citizens' operations implemented a hiring freeze that eliminated new positions on a going-forward basis. The use of Company credit cards was reduced and departments were required to eliminate personnel wherever possible. The entire procurement department was eliminated and numerous cuts were made in accounting, legal, regulatory, finance and IT support functions. Memberships in national organizations were not renewed, employee recognition programs were eliminated. By 2001, the impact of all of these cost saving measures was being realized and Citizens' 2001 corporate overhead costs reflect the cost savings. In fact, Mr. Jones testified that by 2001, corporate support to the Arizona operations was at a minimum and Citizens was performing no long-term planning or budgeting and had become inadequately staffed to meet the needs of an ongoing business with management, legal, regulatory and accounting resources being focused almost exclusively on the sale. This is not to say, as Mr. Jones explains in his rejoinder testimony, that Citizens failed to provide adequate service to customers during the test year. Rather, the cost savings focused almost primarily on overhead and support functions which, ultimately, would have had an impact on service had Citizens' cost cutting measures continued and Arizona-American not acquired the water and wastewater assets. Of course, Arizona-American did complete its acquisition of the Citizens' water and wastewater assets, which then became part of the American Water System.

As a result Mr. Jones testifies, a pro forma adjustment is appropriate to recognize the costs being incurred by Arizona-American for Service Company charges and corporate overheads as it these amounts that are actually being incurred in connection with the provision of service to the Company's customers. Moreover, while Mr. Jones expressly disagreed with Staff's testimony that every pro forma adjustment must have a corresponding benefit to ratepayers, Mr. Jones explains how Arizona-American's ratepayers are now realizing the benefit of a fully staffed organization taking all of the necessary steps to ensure safe and reliable water and wastewater utility service now and well into the future. As a consequence, Mr. Jones testifies that Staff's adherence to Citizens' 2001 overhead costs, costs that bear no relationship to the costs Arizona-American is and will incur, is inappropriate. There is evidence supporting the Company's pro forma adjustment and such evidence demonstrates the propriety of the Company's proposed pro forma adjustment to replace Citizens' 2001 test year overhead

costs with the actual 2002 Service Company and corporate cost allocations incurred by Arizona-American.

1487241.1/73244.034

G

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NOS. WS-01303A-02-0867, ET AL.

SUMMARY OF FREDRICK K. SCHNEIDER
PRE-FILED TESTIMONY

Mr. Schneider is employed by Arizona-American Water Company ("Arizona-American" or "Company"). Mr. Schneider has been with Arizona-American since it acquired the water and wastewater assets of Citizens Communications, Inc. and had previously been employed by Citizens since July 1998. Mr. Schneider recently was promoted to the position of Manager for Arizona-American's operations replacing Mr. Robert J. Kuta, who previously held that position and previously filed direct testimony in support of the Company's applications. Mr. Schneider has adopted all of Mr. Kuta's direct testimony as his own and has also prepared rebuttal and rejoinder testimony in support of the Company's applications.

A. Summary of Mr. Kuta's Direct and Supplemental Direct Testimony Adopted by Mr. Schneider.

In support of each of the Company's five applications, Mr. Kuta's direct testimony begins with an overview of each water or wastewater district including the location in which the district operates, the date service was first established, the date and Commission decision authorizing the current rates and, for each water district, the water resources. Following this general background testimony, Mr. Kuta testifies to certain changes that occurred following Arizona-American's acquisition of Citizens' water and wastewater assets, including changes in office location for the Company's Mohave County and Maricopa County operations. As Mr. Kuta explained, these changes had the effect of consolidating the Company's operations into improved office locations. Finally, Mr. Kuta described changes in staffing occurring after the Citizens' acquisition, including an immediate increase in staffing following the close of the transaction earlier this year in order for Arizona-American to meet increased customer numbers and expanding regulatory requirements. Mr. Kuta testified that, prior to the acquisition, Citizens was operating with insufficient staffing in light of its decision to sell all of its water and wastewater assets in Arizona.

In addition, for the Sun City wastewater district, Mr. Kuta's direct testimony addresses the Company's Sewage Treatment and Transportation Services Agreement with the City of Tolleson ("Tolleson Agreement"). Under this agreement, Arizona-American delivers wastewater flows to the wastewater treatment plant located in and operated by the City of Tolleson. Tolleson also provides wastewater treatment services for the citizens of Tolleson, the City of Peoria and the Sunland Beef processing plant.

Arizona-American has no other means of treating wastewater flows from customers in the Sun City wastewater district.

Pursuant to the Tolleson Agreement, Arizona-American made three separate types of payments during the test year. Rate Component 1 is a fixed charge relating to bond financing by the City to pay for the original plant additions Tolleson made to treat wastewater flows from Sun City. Rate Component 2 is a monthly O&M charge based on the Company's proportionate share of Tolleson's actual costs. Rate Component 3 was a $1,500 per month payment for a replacement and contingencies reserve. However, the Company proposed a pro forma adjustment to allow it to recover cost increases occurring after the test year. As Mr. Kuta explained, at the time the Company's application was filed, Tolleson and Arizona-American were in the process of completing an amendment to the Tolleson Agreement to increase the monthly payment under Rate Component 3 and to create a new rate component, Rate Component 4, to provide a vehicle for the Company to fund a proportionate share of major plant improvements necessary for the Tolleson wastewater treatment plant to continue operating. According to a study prepared for Tolleson by Brown and Caldwell, Tolleson expects to spend $40 million for capital improvements to its wastewater treatment plant between 2003 and 2008. Although the Company's pro rata share (on a capacity basis) of such costs would be substantial, then estimated at $8 million, Mr. Kuta testified that continuing to provide wastewater flows from the Sun City wastewater district to the Tolleson plant under the Tolleson Agreement was preferable to the Company versus attempting to build its own wastewater treatment facility in the Sun City area.

In a supplement to his direct testimony, Mr. Kuta testified that Tolleson and Arizona-American had concluded negotiations and executed the Third Amendment to the Sewage Treatment and Transportation Agreement ("Third Amendment"). Upon execution of the Third Amendment, the Company became obligated to pay an increase in Rate Component 3, the replacement and contingency reserves, from $1,500 per month to $20,000 per month. In addition, as anticipated at the time of Mr. Kuta's direct testimony, the Third Amendment created a new Rate Component 4. At the time of Mr. Kuta's supplemental testimony, it was estimated that Arizona-American's share of Tolleson's capital improvement program to be billed under Rate Component 4 would be approximately $10 million between 2003 and 2008. The Company anticipated financing its share of the capital improvements necessary for Tolleson to continue to operate its wastewater treatment facility in a manner that would provide adequate wastewater treatment services to the Company's Sun City wastewater district through the issuance of certain debt instruments and/or equity and proposed to recover such costs through the proposed surcharge adjustor mechanism outlined in Mr. Bourassa's direct testimony.

B. Summary of Schneider Rebuttal Testimony.

As indicated above, in between the filing the Company's direct testimony and its rebuttal filing, Mr. Kuta left his position as Manager of Arizona-American and Mr.

Schneider was promoted to that position. As a result, in the Company's rebuttal filing, Mr. Schneider adopted Mr. Kuta's direct and supplemental direct testimonies and provided rebuttal testimony focusing on two issues, the Third Amendment, and Youngtown's request that the Commission order Arizona-American to institute a program to study and improve fire flow facilities within the Youngtown portion of the Company's Sun City water district.

Specifically, Mr. Schneider provided an update regarding the Company's Tolleson Agreement in response to the recommendations by Staff and RUCO that the Commission defer rate recovery for the increased costs imposed by the Third Amendment. In his rebuttal testimony, Mr. Schneider describes the process being undertaken by Tolleson to select a contractor to build the necessary improvements and confirms that the Company's pro rata share of Tolleson's major wastewater treatment plant improvement program was estimated at $10 million. Mr. Schneider also testified that Tolleson had already begun billing the Company for increased amounts under Rate Component 3 pursuant to the Third Amendment.

Next, Mr. Schneider addressed the testimony of consultants testifying on behalf of Youngtown concerning fire flow facilities within the Town. By way of background, Mr. Schneider testified that the water and wastewater systems serving Youngtown were constructed between the 1960s through the 1980s. Mr. Schneider further indicated that Arizona-American's predecessor, Citizens, had acquired Youngtown's water and wastewater systems in 1996 and that a number of improvements were made by Citizens, including the installation of additional fire hydrants, interconnection of the water supply system with the existing system serving the Sun City water district as well as replacement of older mains in various portions of the Town. According to Mr. Schneider's rebuttal testimony, these improvements increased flow capacity and reliability for this portion of the Sun City water system.

Mr. Schneider also pointed out that much of the Youngtown's concern over whether the system was adequate to provide proper fire flow arose out of the Town's its adoption of the 1997 Uniform Fire Code which applied only to new construction. Moreover, Mr. Schneider testified that the Company is not required to provide fireflow service under Commission regulation because the Commission's rules, A.A.C. R14-2-407.E, require only that Arizona-American to maintain a minimum standard delivery pressure of 20 pounds per square inch at the customer's meter or point of delivery. As a consequence of the Company meeting all applicable requirements, Mr. Schneider voiced the Company's concern with Youngtown's use of this ratemaking forum to address fire flow and hydrant issues, particularly given Youngtown's lack of commitment towards funding the study and improvements sought. Instead, Mr. Schneider testified it would be more appropriate for the Town and the Company to work in cooperation and in recognition of the Company's need to engage in routine planning for all of its water and

wastewater districts serving more than 115,000 customers in Arizona as opposed to looking for a Commission order prioritizing the needs of a small group of customers.

C. Summary of Mr. Schneider's Rejoinder Testimony.

In his rejoinder testimony, Mr. Schneider again addressed Youngtown's request for fireflow improvements and the Third Amendment to the Tolleson Agreement. In addition, Mr. Schneider provided testimony in relation to certain water quality issues raised before the Commission by customers during the Public Comment Session in Anthem.

Regarding Youngtown's request for an order of the Commission requiring the Company to study and undertake fireflow improvements, Mr. Schneider responded to the testimony of the Town's Public Works Director, Jess Mendez, who testified for the first time in Youngtown's surrebuttal filing. To begin with, Mr. Schneider acknowledged his discovery, since the time of his rebuttal testimony, that Youngtown had previously voiced concerns regarding the adequacy of fire hydrants in the Town to Mr. Schneider's predecessor, Mr. Kuta. However, Mr. Schneider testified that he was unable to locate any follow-up correspondence or other documentation indicating that Youngtown sought priority treatment. Mr. Schneider also testified in response to Youngtown's claim that the water lines the Company used to serve Youngtown were sub-standard. Among other things, Mr. Schneider testified again that the Company was not required to provide enhanced fireflow service in excess of the Commission's minimum standard requirements and that Youngtown had not claimed that the Company was falling short of applicable regulatory requirements.

Mr. Schneider's rejoinder testimony also voices the Company's disagreement with Mr. Mendez' claim that the Company was not acting as a "good corporate citizen." As Mr. Schneider testified, the Company was concerned about Youngtown's desire to utilize the Commission's ratemaking process to "cherry-pick" priority treatment without any willingness to fund the special treatment being requested. According to Mr. Schneider, the Town was ignoring the Company's obligation to address issues impacting more than 115,000 customers across the State as well as the fact that the utility system serving the Town was no longer a stand-alone system. For this reason, Mr. Schneider expressed the Company's frustration with the Town's desire to accomplish its goals through the regulatory process rather than through a process of cooperation between the Company, the Town, fire officials, and perhaps most importantly, the residential and business customers in the Town who would ultimately be responsible for paying for the enhanced facilities and services Youngtown demanded. As Mr. Schneider further explained, based on the Company's recent experience with the Paradise Valley water district, a cooperative effort free from additional regulatory red tape is the preferred manner of addressing the types of concerns raised by Youngtown. Mr. Schneider reiterated Arizona-American's commitment to work outside the scope of a ratemaking proceeding to consider Youngtown's concerns consistent with the Company's commitment to make

reasonable and prudent investment and operational decisions intended to ensure adequate and reliable service to all of its customers.

Mr. Schneider's rejoinder testimony also provide further response to the positions of Staff and RUCO concerning postponing recovery of increased costs being incurred by Arizona-American under the Third Amendment. At the time of Mr. Schneider's rejoinder testimony, the Company had already been invoiced $120,000 under the new Rate Component 3, real costs being incurred by the Company to provide wastewater treatment today. In addition, Mr. Schneider provided a further update on Tolleson's efforts to commence construction of the major improvements identified in the Third Amendment indicating that Tolleson had now selected the contractor and was in the final stages of negotiations. Finally, Mr. Schneider questioned testimony by Staff and RUCO seemingly indicating that the Company's share of Tolleson's capital improvements should be treated as the Company's plant investment. Instead, Mr. Schneider's testimony analogizes the costs being incurred by Arizona-American under Rate Component 4 of the Third Amendment as similar to an O&M Agreement because Arizona-American will not own any of these facilities.

Lastly, regarding water quality and service issues raised during the Commission's recent Public Comment Session in Anthem, Mr. Schneider's rejoinder testimony describes a recent incident resulting in discolored water being provided to customers within the Anthem water system. As Mr. Schneider described the problem, in September of this year, there was a change in water quality from the Central Arizona Project canal and from Lake Pleasant impacting the Company's water supplies. In short, the water supply contained higher than normal levels of manganese because the water was coming from lower levels in the lake where oxygen levels were nearly non-existent. When water with increased levels of manganese was treated with chlorine as part of the Company's water treatment process, it resulted in a discoloration. However, as Mr. Schneider explains in his rejoinder testimony, within a few days of this problem first appearing, additional chemical treatment was undertaken and approximately one week from the time when the problem first appeared, amounts of discolored water in the system were at non-detectable levels. Perhaps most importantly, Mr. Schneider testifies to the fact that the discolored water had no impact on the safety of the water supply for consumption. This was merely a cosmetic or aesthetic effect, similar to incidents recently experienced by Scottsdale and Glendale. Nevertheless, the Company undertook additional sampling to ensure that the water supply met all applicable safety and health requirements, contacted both the Maricopa County Environmental Services Department and the Arizona Department of Environmental Quality and provided public notification of the problem to its customers through a variety of media outlets.

1487295.1/73244.034

H

ARIZONA-AMERICAN WATER COMPANY

DOCKETS NOS. WS-01303A-02-0867, ET. AL.

SUMMARY OF DR. THOMAS M. ZEPP'S PRE-FILED TESTIMONY

Dr. Zepp is an economist and Vice President of Utility Resources, Inc., a consulting firm in Salem, Oregon. He holds a PhD in Economics. Prior to becoming a consultant, Dr. Zepp was a senior economist on the staff of the Oregon Public Utility Commission. Dr. Zepp's testimony deals with the appropriate rate of return on Arizona-American's common equity and the type of rate base to which such a return should be applied to determine revenue requirements.

Dr. Zepp prepared direct, rebuttal and rejoinder testimony on three primary issues, the cost of equity for publicly-traded water utilities, the rate base the Arizona Constitution requires to be used when setting rates and the magnitude of the risk premium Arizona-American requires to compensate the Company for its above-average financial risk. Dr. Zepp also restated the equity cost estimates of Mr. Reiker and Mr. Rigsby with more reasonable assumptions and responded to their criticisms of his analyses.

A. Overview of Dr. Zepp's Pre-Filed Testimony.

In his direct testimony, filed in November 2002, Dr. Zepp testified that Arizona-American had an equity cost that fell in the range of 11.5% to 12.1% and recommended Arizona-American be authorized a return on equity ("ROE") of no less than 11.5%. His recommendation included 60 basis points to compensate the Company for its above-average financial risk due to its capital structure containing 60% debt and 40% equity. Mr. Reiker of the Staff of the Arizona Corporation Commission ("the Commission") estimated Arizona-American requires only 50 basis points to compensate the Company for above-average leverage.

In his September 2003 rebuttal testimony, Dr. Zepp adopted Mr. Reiker's 50 basis point adder, updated his testimony with current information, and found Arizona-American's cost of equity now falls in a range of 10.5% to 11.7%.

As part of his rebuttal testimony and, in his November 2003 rejoinder testimony, Dr. Zepp restated the equity costs made by Mr. Rigsby and Mr. Reiker with assumptions that are consistent with the approaches they chose to use. Using their models with more reasonable assumptions, he found the cost of equity for Arizona-American fell in a range of 10.1% to 11.8% based on data presented in their direct testimonies and 10.3% to 11.4% based on data they relied upon in their surrebuttal testimonies. Those estimates also included 50 basis points to compensate Arizona-American for its above-average financial risk.

In his direct, rebuttal and surrebuttal testimonies, Dr. Zepp recommended his equity cost should be combined with the Company's 60% debt / 40% equity capital structure, and applied to the Company's fair value rate base. His testimonies explain the basis for his recommendation and responses to Staff and RUCO regarding the proper use of fair value rate base to determine revenue requirements.

B. All Parties Agree Arizona-American Requires a 50 Basis Point Adder for Leverage.

In his direct testimony, Dr. Zepp presented a standard financial theory that shows Arizona-American requires a higher ROE because it is more leveraged. Based on that theory, he estimated the equity cost adder required by Arizona-American is 80 to 90 basis points, but, to be conservative, adopted a value of 60 basis points to determine the Company's cost of equity. In direct testimony, Mr. Reiker presented a different method to determine the equity cost adder and found that method supported a value of only 50 basis points. To avoid an issue and be conservative, Dr. Zepp adopted Mr. Reiker's estimate. In direct testimony, Mr. Rigsby, the RUCO cost of capital witness, did not propose such an adjustment. But after reading Mr. Reiker's and Mr. Stephenson's testimonies, in his surrebuttal testimony Mr. Rigsby agreed that the 50 basis point adder to the cost of equity for less leveraged water utilities was appropriate. All parties now agree that the adder should be no less than 50 basis points.

C. Cost of Equity for Publicly Traded Water Utilities.

Dr. Zepp used the discounted cash flow ("DCF") model and three risk premium models to estimate benchmark equity costs with data for publicly traded water and gas utilities in his direct testimony. He also presented estimates based on the capital asset pricing model ("CAPM") because RUCO and Staff have relied upon that model in the past, but gave those estimates no weight. Based on the data Dr. Zepp examined in 2002 and 2003, gas utilities require equity costs that are no greater than 50 basis points higher than the required returns for publicly traded water utilities. In using the data for the gas utilities to determine proxy estimates of equity costs for the benchmark water utilities, he reduced equity cost estimates for the gas utilities by 50 basis points.

1. DCF Model Estimates.

Using the DCF model and an average of two forward-looking measures of growth, Dr. Zepp updated his DCF costs of equity in September 2003. He found the current equity cost for the benchmark water utilities fell in a range of 10.0% to 10.5%. Dr. Zepp also restated Mr. Reiker's DCF estimates based on the constant growth model, noting that the worst measure of average future growth for that DCF model is dividends per share ("DPS") when earnings per share ("EPS") are growing more rapidly. Dr. Zepp presented evidence that reliance on DPS growth in the constant growth DCF model produces results

that are nonsense. (Zepp Rebuttal, pages 46-47; Zepp Rejoinder, page 11.) Restating Mr. Reiker's constant growth DCF estimates without DPS growth in the average, Mr. Reiker's equity cost with the constant growth DCF model was found to fall in range of 9.6% to 9.9% based on data in his direct testimony and 9.6% to 9.8% in his surrebuttal.

Dr. Zepp also restated Mr. Reiker's multi-stage DCF model by including a second stage that reflects investors' expectations that future growth will be higher than current DPS growth when DPS are growing more slowly than EPS. Dr. Zepp presented an e-mail from Myron Gordon, an authority on the DCF model, which supported the inclusion of this second stage. (Zepp Rejoinder Exhibit TMZ-RJ2.) With this restatement of Mr. Reiker's multi-stage DCF model, the equity cost for the benchmark water utilities was found to be 10.1% at the time Mr. Reiker prepared his direct testimony and 10.0% to 10.1% at the time he prepared his surrebuttal testimony.

Dr. Zepp also restated Mr. Rigsby's DCF results by basing Mr. Rigsby's estimate of VS (external) growth on a more realistic forecast of the growth in the number of shares of common stock expected to be issued by water utilities. Dr. Zepp showed that past growth in shares had averaged 4.5% and forecasted growth in shares averaged 2.8%, but Mr. Rigsby used a paltry 1.0% growth rate. Dr. Zepp also restated Mr. Rigsby's DCF model results using estimates of future BR (sustainable) growth and VS growth presented by Mr. Reiker. With these two separate restatements of Mr. Rigsby's DCF model, Mr. Rigsby's DCF estimate for the benchmark water utilities fell in a range of 10.1% to 10.9%. The restatements of Mr. Reiker's and Mr. Rigsby's DCF models indicate the cost of equity for the benchmark water utilities falls in a range of 9.6% to 10.9%, a range that overlaps Dr. Zepp's updated range of 10.0% to 10.5%.

2. Risk Premium Estimates.

Dr. Zepp presented three different risk premium models that indicate the updated cost of equity for publicly traded water utilities currently falls in a range of 10.3% to 11.2%. Mr. Rigsby and Mr. Reiker presented CAPM equity costs but did not present separate risk premium estimates. Dr. Zepp explained that the versions of the CAPM that Mr. Rigsby and Mr. Reiker relied upon were special cases of the more general risk premium approach.

Mr. Rigsby and Mr. Reiker presented versions of the CAPM that are variations of the original CAPM developed by Sharpe and Lintner. William Sharpe, the same person as the Sharpe who developed the original CAPM model, has indicated tests of his model show low beta stocks (like water utilities) require higher returns and high beta stocks (like airline stocks) require lower returns than the versions of CAPM Mr. Reiker and Mr. Rigsby used. Sharpe also stated that professionals who use the CAPM in their work use a version of the model that reflects those test results. Dr. Zepp took a conservative CAPM approach and used forecasted values for long-term Treasury bonds to restate Mr. Reiker's

and Mr. Rigsby's CAPM results. Ibbotson Associates and Dr. Roger Morin also implement the CAPM with the model adopted by Dr. Zepp. (Zepp Rejoinder, page 6.) With this restatement, Dr. Zepp found the cost of equity for the benchmark water utilities fell in a range of 9.8% to 11.3% at the time Mr. Reiker prepared direct testimony, and 9.8% to 10% when Mr. Reiker updated his CAPM estimates.

Mr. Reiker took issue with the use of forecasted interest rates to make equity cost estimates. Dr. Zepp explained that (1) data underlying Mr. Reiker's Chart 4 show forecasted interest rates are not biased against ratepayer interests (Zepp Rebuttal, page 19) and (2) the use of current interest rates instead of forecasted rates will understate the cost of money in 2004 and beyond when the new tariffs will be authorized (Zepp Rebuttal pp. 20-21). Forecasted interest rates relied upon by Dr. Zepp are consistent with the 50 to 60 basis point increases in intermediate-term Treasury rates that has occurred since the time Mr. Reiker and Mr. Rigsby prepared direct testimony. (Zepp Rejoinder Table 6.) Mr. Reiker updated his CAPM estimates with September data, but his updates are still 30 basis points below rates in November (Zepp Rejoinder Table 6). Dr. Zepp explained that Mr. Rigsby's reliance on current 91-day Treasury bill rates cannot reflect the cost of equity in 2004, the period when new tariffs for Arizona-American will be authorized, and thus, an update of his analysis was not made. Dr. Zepp noted that based on current Treasury rates, even Mr. Reiker should agree his CAPM estimates are too low by 30 basis points.

3. Other Evidence of the Cost of Equity.

Dr. Zepp pointed out four other facts that supported his conclusion that the cost of equity for Arizona-American falls in a range of 10.5% to 11.7% at this time. First, equity costs for publicly traded water utilities are higher today than when Staff and RUCO prepared their direct testimonies. Interest rates have increased by 50 to 60 basis points and DCF estimates are the same or higher. The only evidence Staff relied upon to reduce its equity cost recommendation is a mechanical update of one of two CAPM approaches relied upon by Mr. Reiker. Second, authorized, realized and forecasted ROEs for the benchmark water utilities fall in a range of 10.6% to 10.9% and support an equity cost range for Arizona-American of 11.1% to 11.4%. Those ROEs provide useful evidence on the cost of equity because current and expected interest rates fall in a range of interest rates prevailing at the time those ROEs were established, earned and forecasted. Third, appropriate restatements of Mr. Reiker's and Mr. Rigsby's DCF and CAPM approaches support an equity cost range of 10.3% to 11.4% (Rejoinder Table 4) for Arizona-American. Finally, if forecasted interest rates had been relied upon by Mr. Reiker and Mr. Rigsby, their equity cost estimates – even if not restated – would be higher.

D. The Arizona Constitution Requires Application of an Unadjusted ROE to the Fair Value Rate Base.

Dr. Zepp presented his interpretation, as an economist, of what rate of return the Arizona Constitution and Arizona court decisions require to be applied to the Fair Value Rate Base ("FVRB"). (Zepp Direct, pages 5 to 12.) He concluded that a rate of return that included his unadjusted cost of equity should be applied to the FVRB. He noted his equity cost estimates do not depend upon the type of rate base being used (Zepp Direct, page 9) and that application of a current cost of equity to a FVRB will not necessarily lead to rate increases (Zepp Direct, page 10-11). He further noted that if the rate of return was restated in such a way that the ROR applied to the FVRB produced the same earnings as it would when the FVRB was higher (lower) than the original cost rate base ("OCRB"), that such a restatement would be a sham. (Zepp Rebuttal, page 29)

In his rebuttal testimony, Dr. Zepp responded to Staff. Mr. Carlson stated that often utilities stipulate to OCRB being the FVRB, it was not the normal practice to apply a current cost of capital to the FVRB, and that such a practice would overstate the utility's revenue requirements. Mr. Reiker also argued the practice could either lead to windfall gains or devastating losses not envisioned by investors. Dr. Zepp responded that Staff's comments made no attempt to address his reading of the Arizona Constitution and his economic interpretation of decisions of the Arizona courts. The fact that some utilities have chosen to avoid the cost of paying someone to determine the fair values of their rate base, does not mean a true FVRB should not be used, if requested by a utility. And, the fact that the Commission has not followed the procedure Dr. Zepp recommends does not invalidate his conclusion that it should be followed if a utility has requested it. Finally, with respect to Mr. Carlson's and Mr. Reiker's comment that it could lead to either an overstatement or understatement of the company's revenue requirement, Dr. Zepp explained that such a statement assumes the revenue requirement should be based on an OCRB, when the Arizona Supreme Court has clearly stated it should be based on the value of assets "at the time of inquiry." An investor in an Arizona utility should be aware of those Arizona decisions. (Zepp Rebuttal, page 29-32.)

In his rebuttal testimony, Dr. Zepp also responded to RUCO. RUCO has agreed that the FVRB must be used to set rates in Arizona, but Ms. Diaz Cortez argued Dr. Zepp's procedure "double-counts" inflation and that the ROR must be adjusted to maintain the same earnings as would occur if an OCRB were used to set rates. Dr. Zepp showed the fallacy in this argument by providing an example in which the value of the FVRB decreased (negative inflation), but, to the extent that investors demand a ROE that includes expected future inflation, the cost of money would include positive inflation. There is no double-counting. The measures of inflation have nothing to do with each other. (Zepp Rebuttal, page 32.) Dr. Zepp also pointed out that it is the U. S. Supreme Court's *Bluefield Water Works* decision that is relevant in Arizona because the Arizona Supreme Court has stated that the *Hope* decision does not apply in Arizona. Ms. Diaz ignored the fact that rates of return found reasonable to determine prices charged by regulated companies in the *Bluefield* decision were being applied to FVRB, not OCRB. Mr. Rigsby expressed concern that if an unadjusted rate of return multiplied by a FVRB

were adopted to set tariffs, it could lead to larger rate increases than would be the case if the current Commission procedures are followed. Mr. Rigsby does not, however, offer any reason to reject such a cost of service if the cost of service required by the Arizona Constitution is different than it would be if Arizona were an original cost state. (Zepp Rebuttal, page 33.)

1486607.1/73244.034

I

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. WS-01303A-02-0867 ET. AL.

SUMMARY OF RONALD L. KOZOMAN'S PRE-FILED TESTIMONY

Mr. Kozoman is a Certified Public Accountant and provides consulting services to utility companies and other regulated businesses. He has been employed by both the Illinois Commerce Commission and the Arizona Corporation Commission ("Commission"), and served as the Commission's Chief Rate Analyst. He has testified on numerous occasions on behalf of utilities, utility consumers and regulatory agencies. He has also been an instructor on various public utility accounting and regulatory topics for the National Association of Regulatory Utility Commissioners in its Annual Regulatory Studies Program held at Michigan State University, including cost of service studies and rate design.

Mr. Kozoman has filed direct, rebuttal and rejoinder testimony in support of Arizona-American Water Company's ("Arizona-American" or "Company") consolidated applications for rate adjustments. Mr. Kozoman's pre-filed testimony deals with rate design and cost of service issues.

A. Direct Testimony.

In Mr. Kozoman's direct testimony for Arizona-American, he recommended that the proposed rate increases be uniformly spread across the monthly minimum charges and commodity rates, retaining the existing rate design. When a rate increase resulted in more that a 40% increase for a particular district, he proposed that the rate increase be phased in over a two year period. The rates charged customers would increase by 40% in the first year, and the remainder of the rate increase would become effective in the second year. Although a phase-in of this nature is not required, Mr. Kozoman explained that the Company is willing to do so if a rate increase is greater than 40% to ameliorate the impact on customers.

He also proposed new meter and service line charges, including the income tax on these charges. Any resulting income taxes would be refunded along with the meter and service line charges over a 10-year period.

B. Rebuttal Testimony.

This phase of Mr. Kozoman's testimony provided rebuttal to the recommendations for water rate design to the Staff of the Arizona Corporation Commission ("ACC") and the Residential Utility Consumers Office ("RUCO"). Additionally, Mr. Kozoman

addressed the request by the Town of Youngtown for an irrigation rate for service to its parks.

Staff proposed a three-tier commodity rate design that included a discounted rate for the first 4,000 gallons for all residential and commercial customers, and a higher rate block for all customers using over 100,000 gallons in a month, regardless of their customer class and meter size. However, no cost of service study was prepared by Staff to evaluate the effect of this radical change in rate design. Accordingly, Mr. Kozoman prepared a cost of service study, using the commodity-demand method, for the districts providing water service. The revenues, expenses, plant, cost of debt and equity used in the study are based on Staff's proposed amounts taken from Staff's direct filing. The study allocated the most of the demand charges to the monthly minimums. Approximately 10% of the demand charges were allocated to the commodity rates, along with expenses and plant normally allocated to the commodity function.

The cost of service study showed that Staff's proposed rates resulted in customers on larger meter sizes paying substantially more than Staff's recommended rate of return, while customers on small meters would be paying substantially less than Staff's recommended rate of return, i.e., larger meters would be subsidizing the smaller meters.

The cost of service study showed that (1) Staff's proposed monthly minimums did not recover expenses, return on rate base, and income taxes and (2) the commodity rates proposed by Staff did recover expenses, return, and income taxes. However, at average usage for customers on 5/8 inch meters, Staff's proposed rates did not recover expenses, return on rate base, and income taxes. In all districts, residential customers would have to use substantially higher quantities of water than the average usage before the expenses, return on rate base, and income taxes would be recovered. Because Arizona-American's customer base consists of approximately 88% to 92% residential customers, depending on the water district, Mr. Kozoman strongly opposed Staff's proposed rates. Mr. Kozoman computed the allocation factors that would be required to derive Staff's proposed monthly minimums. In some cases, the allocation factors for commodity function had to exceed 100%, while the demand function allocations would have to be negative. These allocations are not logical, and are not supported by a cost of service study.

Mr. Kozoman explained that combining a monthly minimum, which did not recover expenses, return on rate base, and income taxes, with a "lifeline" (discounted) commodity rate is not good social or environmental rate design. Pricing water below its cost does not give customers the correct price signal needed for effective conservation, but instead encourages greater water use.

Attached to Mr. Kozoman's rebuttal testimony is a chapter dealing with lifeline and other types of discounted rates from the American Water Works Association

("AWWA") Manual 34, entitled *Alternative Rates.* This manual sets forth three important points on these types of discounted rates. The first is that discounted rates should be offered only to residential customers, and only to residential customers who meet certain income eligibility requirements. Second, discounted rates should not be considered unless the total cost of water service is high relative to other similar water utilities, or where a significant percentage of residential customers are believed to be unable to afford water service. Third, lifeline rate and similar types of discounted rates should not be used in areas where there are water shortages, or when water use is a concern, because water is priced below cost, encouraging greater use.

Mr. Kozoman's rebuttal testimony to RUCO was primarily directed at the proposed rate design for the Sun City and Sun City West Water Districts. The RUCO witness recommended that the monthly minimums not be increased. Instead, the revenue increase would be allocated to the commodity rates. Additionally, RUCO's irrigation rate increase was substantially higher than the overall rate increase recommended for the districts, resulting in substantial rate increases for the irrigation customer class. The result was that RUCO's proposed rate increase would affect customers on larger size meters much more than smaller size meters.

Mr. Kozoman testified that the Company does not oppose the request by the Town of Youngstown for an irrigation rate for its town lake. However, under RUCO's proposal, Youngtown's rate would actually increase if its request were approved.

C. Rejoinder Testimony.

The rejoinder testimony of Mr. Kozoman addresses the points raised by the surrebuttal testimony of Staff relating to Staff's allocation of all demand charges to the commodity rate.

To determine the validity of Staff's argument, Mr. Kozoman revised his cost of service studies to allocate all demand costs to the commodity function. These cost of service studies showed that Staff's monthly minimums for the bulk of the residential customers still did not recover expenses, return on rate base, and income taxes. Additionally, under the change in the methodology proposed by Staff, the larger meters would be priced substantially above the recovery point for expenses, return, and income taxes. The allocation of more plant, expenses, rate of return on rate base, and income taxes to the commodity function resulted in the Staff's proposed first tier rates not recovering expenses, return, and income taxes, creating a subsidy. The revenue collected from Staff's proposed rates for residential customers using the system average was, again, considerably below the cost of service. Mr. Kozoman again emphasized that this sort of discounted pricing scheme, where water is sold below cost, encourages increased water use.

Mr. Kozoman had little rejoinder to RUCO, as it proposed an across-the-board rate increase in its surrebuttal testimony. Mr. Kozoman testified that the proposed RUCO rates for the Havasu and Mohave water districts produced more revenues than recommended by the RUCO witness.

Mr. Kozoman also testified that the proposal by the Town of Youngtown for a phased rate increase for the Sun City Water District was not necessary or appropriate under the recommendation made Youngtown's consultants. Further, Mr. Kozoman emphasized that the Company is willing to phase in its rate increases only if the increase exceeds 40%.

1486588.1/73244.034

J

Arizona-American
Rate Increases By District

Exhibit: #1
Witness: Bourassa
Page 1

Line No.	District	Direct Filing Revenue Increase	Direct Filing % Increase	Company Rebuttal Filing Revenue Increase	Company Rebuttal Filing % Increase	Rejoinder Filing Revenue Increase	Rejoinder Filing % Increase
1							
2	Sun City Water	$ 5,366,367	86.65%	$ 4,364,140	70.47%	$ 4,453,775	71.92%
3							
4	Sun City Wastewater	636,236	12.50%	316,400	6.22%	260,879	5.13%
5							
6	Sun City West Water	1,479,624	43.77%	1,215,842	35.96%	1,156,931	34.22%
7							
8	Sun City West Wastewater	1,963,624	55.54%	1,608,856	45.50%	1,565,307	44.27%
9							
10	Tubac Water	216,034	84.89%	186,106	73.13%	181,931	71.49%
11							
12	Agua Fria Water	417,889	6.76%	119,289	1.93%	62,372	1.01%
13							
14	Anthem Water	299,082	7.46%	18,658	0.47%	(12,809)	-0.32%
15							
16	Anthem/Agua Fria Wastewater	438,989	23.52%	323,599	17.34%	311,419	16.68%
17							
18	Mohave Water	584,010	13.29%	196,561	4.47%	142,344	3.24%
19							
20	Havasu Water	196,984	44.68%	128,301	29.10%	123,933	28.11%
21							
22	Totals	$ 11,598,839		$ 8,477,752		$ 8,246,082	
23							
24							
25							
26							

Arizona-American
Rate Increases By District

Exhibit: #1
Witness: Bourassa
Page 2

Line No.	District	Staff				RUCO			
		Direct Filing		Surrebuttal Filing		Direct Filing		Surrebuttal Filing	
		Revenue Increase	% Increase	Revenue Increase	% Increase	Revenue Increase	% Increase	Revenue Increase	% Increase
1									
2	Sun City Water	$ 1,928,691	31.14%	$ 1,916,522	30.95%	$ 1,963,334	31.70%	$ 1,572,021	25.38%
3									
4	Sun City Wastewater	(807,038)	-15.86%	(844,589)	-16.60%	(894,775)	-17.58%	(856,821)	-16.48%
5									
6	Sun City West Water	388,828	11.50%	348,346	10.30%	479,708	14.19%	545,792	16.14%
7									
8	Sun City West Wastewater	1,128,063	31.91%	1,095,198	30.98%	1,027,392	29.06%	1,027,392	29.06%
9									
10	Tubac Water	88,417	34.74%	85,420	33.57%	40,812	16.04%	50,353	19.79%
11									
12	Agua Fria Water	(872,320)	-14.10%	(822,019)	-13.29%	(613,371)	-9.92%	(241,111)	-3.90%
13									
14	Anthem Water	(588,512)	-14.67%	(588,512)	-14.67%	(424,126)	-10.57%	(305,056)	-7.61%
15									
16	Anthem/Agua Fria Wastewater	(73,484)	-3.94%	(81,922)	-4.39%	74,649	4.00%	159,127	8.53%
17									
18	Mohave Water	(684,727)	-15.58%	(715,595)	-16.28%	(790,139)	-17.98%	(698,249)	-15.89%
19									
20	Havasu Water	(31,197)	-7.08%	(33,100)	-7.51%	2,467	0.56%	25,968	5.89%
21									
22	Totals	$ 476,721		$ 359,749		$ 865,951		$ 1,279,416	
23									
24									
25									
26									

Arizona American - Agua Fria Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.			
1	Fair Value Rate Base	$	18,346,919
2			
3	Adjusted Operating Income		1,340,208
4			
5	Current Rate of Return		7.30%
6			
7	Required Operating Income	$	1,378,954
8			
9	Required Rate of Return on Fair Value Rate Base		7.52%
10			
11	Operating Income Deficiency	$	38,746
12			
13	Gross Revenue Conversion Factor		1.6286
14			
15	Increase in Gross Revenue		
16	Requirement	$	63,103
17			

18	Customer	Present	Proposed	Dollar	Percent
19	Classification	Rates	Rates	Increase	Increase
20	5/8 Inch Residential	$ 3,127,076	$ 3,160,350	$ 33,274	1.06%
21	3/4 Inch Residential	36,220	36,628	407	1.13%
22	1 Inch Residential	399,199	403,825	4,625	1.16%
23	1.5 Inch Residential	78,797	79,800	1,003	1.27%
24	2 Inch Residential	328,284	332,473	4,189	1.28%
25	3 Inch Residential	563	569	6	1.05%
26	5/8 Inch Commercial	4,629	4,679	50	1.08%
27	3/4 Inch Commercial	4,437	4,491	54	1.21%
28	1 Inch Commercial	31,984	32,367	383	1.20%
29	1.5 Inch Commercial	91,467	92,624	1,156	1.26%
30	2 Inch Commercial	359,785	364,305	4,520	1.26%
31	3 Inch Commercial	359,249	363,719	4,470	1.24%
32	6 Inch Commercial	147,370	149,298	1,928	1.31%
33	2 Inch Public Interruptible	-	-	-	0%
34	3 Inch Public Interruptible	4,838	4,838	-	0.00%
35	6 Inch Public Interruptible	282,872	282,872	-	0.00%
36	8 Inch Public Interruptible	71,829	71,829	-	0.00%
37	10 Inch Public Interruptible	7,554	7,554	-	0.00%
38	4 Inch Prison	248,933	251,398	2,465	0.99%
39	4 Inch Private Fire	2,520	2,545	25	1.00%
40	6 Inch Private Fire	10,890	10,999	109	1.00%
41	8 Inch Private Fire	4,020	4,060	40	1.00%
42	Miscellaneous Revenues	339,961	339,961	-	0.00%
43	Subtotal Water Revenues	$ 5,942,478	$ 6,054,661	$ 112,183	1.89%

Arizona American - Agua Fria Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
Schedule A-1
Page 2
Witness: Bourassa

Line No.	Customer Classification	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
1	**Revenue Annualizations**				
2	5/8 Inch Residential	$ 202,538	$ 204,614	$ 2,075	1.02%
3	3/4 Inch Residential	1,584	1,602	17	1.10%
4	1 Inch Residential	10,260	10,377	117	1.14%
5	1.5 Inch Residential	5,170	5,236	66	1.27%
6	2 Inch Residential	44,120	44,679	559	1.27%
7	3 Inch Residential	(563)	(569)	(6)	1.05%
8	5/8 Inch Commercial	201	203	2	0.98%
9	3/4 Inch Commercial	(492)	(498)	(6)	1.19%
10	1 Inch Commercial	2,266	2,293	26	1.17%
11	1.5 Inch Commercial	14,983	15,172	188	1.26%
12	2 Inch Commercial	31,582	31,976	394	1.25%
13	3 Inch Commercial	(1,330)	(1,347)	(17)	1.30%
14	6 Inch Commercial	16,136	16,348	212	1.31%
15	6 Inch Public Interruptible	(81,903)	(81,903)	-	0.00%
16	10 Inch Public Interruptible	(7,554)	(7,554)	-	0.00%
17	4 Inch Private Fire	1,440	1,454	14	1.00%
18	6 Inch Private Fire	1,530	1,545	15	1.00%
19	8 Inch Private Fire	1,020	1,030	10	1.00%
20	Totals	240,990	244,657	3,667	1.52%
21	Total Revenues	$ 6,183,467	$ 6,245,839	$ 62,372	1.01%
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39	SUPPORTING SCHEDULES:				
40	Rejoinder B-1				
41	Rejoinder C-1				
42	Rebuttal D-1				
43	Rejoinder H-1				
44					

Arizona American - Anthem Water
Test Year Ending December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 9,627,995
2		
3	Adjusted Operating Income	731,486
4		
5	Current Rate of Return	7.60%
6		
7	Required Operating Income	$ 723,640
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ (7,846)
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ (12,779)
17		

18	Customer		Present	Proposed	Dollar	Percent
19	Classification		Rates	Rates	Increase	Increase
20	5/8 Inch	Residential	$ 3,606	$ 3,576	$ (30)	-0.84%
21	3/4 Inch	Residential	620,738	615,713	(5,025)	-0.81%
22	1 Inch	Residential	650,122	646,251	(3,871)	-0.60%
23	1.5 Inch	Residential	2,834	2,822	(13)	-0.44%
24	2 Inch	Residential	65,116	64,551	(565)	-0.87%
25	3 Inch	Residential	-	-	-	0.00%
26	4 Inch	Residential	-	-	-	0.00%
27	3/4 Inch	Commercial	2,064	2,049	(15)	-0.74%
28	1 Inch	Commercial	50,820	50,353	(467)	-0.92%
29	1.5 Inch	Commercial	19,528	19,347	(181)	-0.93%
30	2 Inch	Commercial	100,690	99,846	(844)	-0.84%
31	3 Inch	Commercial	63,160	62,640	(520)	-0.82%
32	2 Inch	Wholesale	-	-	-	0.00%
33	3 Inch	Wholesale	11,915	11,915	-	0.00%
34	6 Inch	Wholesale	56	56	-	0.00%
35	10 Inch	Wholesale	18,457	18,457	-	0.00%
36	4 Inch	Fire Protection	3,330	3,321	(9)	-0.28%
37	6 Inch	Fire Protection	19,845	19,698	(147)	-0.74%
38	Miscellaneous Revenues		1,950,387	1,950,387	-	0.00%
39	Citizens Water Resouces (Treatco)		226,872	226,872	-	0.00%
40	Subtotal Water Revenues		$ 3,809,540	$ 3,797,852	$ (11,688)	-0.31%
41						

Arizona American - Anthem Water
Test Year Ending December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 2
Witness: Bourassa

Line No.						
1	**Revenue Annualization**					
2	Citizens Water Resouces (Treatco)		$ (18,289)	$ (18,289)	$ -	0.00%
3	3/4 Inch	Residential	67,152	66,618	(533)	-0.79%
4	1 Inch	Residential	98,822	98,254	(568)	-0.57%
5	2 Inch	Residential	(3,894)	(3,861)	32	-0.83%
6	3/4 Inch	Commercial	1,642	1,630	(12)	-0.75%
7	1 Inch	Commercial	2,646	2,631	(15)	-0.55%
8	1.5 Inch	Commercial	12,807	12,690	(116)	-0.91%
9	2 Inch	Commercial	13,560	13,446	(114)	-0.84%
10	3 Inch	Commercial	(24,131)	(23,929)	201	-0.83%
11	3 Inch	Wholesale	45,275	45,275	-	0.00%
12	6 Inch	Wholesale	5	5	-	0.00%
13	10 Inch	Wholesale	1,678	1,678	-	0.00%
14	6 Inch	Fire Protection	(405)	(402)	3	-0.74%
15	Total Revenues Annualziations		196,868	195,747	(1,121)	-0.57%
16	Total Water Revenues with		0	0	0	0
17	Revenue Annualizaiton		$ 4,006,408	$ 3,993,599	$ (12,809)	-0.32%
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32						
33						
34						
35	SUPPORTING SCHEDULES:					
36	Rejoinder B-1					
37	Rejoinder C-1					
38	Rebuttal D-1					
39	Rejoinder H-1					
40						
41						
42						

Arizona American - Anthem/Agua Fria Wastewater
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 2,789,661
2		
3	Adjusted Operating Income	18,444
4		
5	Current Rate of Return	0.66%
6		
7	Required Operating Income	$ 209,671
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 191,227
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 311,438

	Customer Classification	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
18					
19					
20	Residential	$ 650,824	$ 888,618	$ 237,795	36.54%
21	Small Commercial 5/8 Inch Meter	1,501	2,050	549	36.55%
22	Small Commercial 3/4 Inch Meter	-	-	-	0.00%
23	Small Commercial 1 Inch Meter	-	-	-	0.00%
24	Large Commercial	29,477	40,227	10,750	36.47%
25	Revenues from Treatco excluding Annualization	11,231	11,231	-	0.00%
26	Miscellaneous Revenues	986,072	986,072	-	0.00%
27	Subtotal of Revenues	$ 1,679,105	$ 1,928,198	$ 249,093	14.83%
28					
29	**Revenue Annualization**				
30	Treatco Revenue Annualization	13,480	13,480	-	0.00%
31	Residential	167,515	228,715	61,200	36.53%
32	Small Commercial 5/8 Inch Meter	(841)	(1,148)	(307)	36.54%
33	Small Commercial 3/4 Inch Meter	-	-	-	0.00%
34	Small Commercial 1 Inch Meter	-	-	-	0.00%
35	Large Commercial	3,930	5,363	1,433	36.47%
36	Total Revenue Annualization	184,083	246,409	62,326	33.86%
37	Total Revenues with Revenue Annualization	1,863,188	2,174,607	311,419	16.71%
38					

39 SUPPORTING SCHEDULES:
40 Rejoinder B-1
41 Rejoinder C-1
42 Rebuttal D-1
43 Rejoinder H-1

Arizona American - Anthem/Agua Fria Wastewater
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 2,789,661
2		
3	Adjusted Operating Income	18,444
4		
5	Current Rate of Return	0.66%
6		
7	Required Operating Income	$ 209,671
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 191,227
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 311,438
17		

18	Customer	Present	Proposed	Dollar	Percent
19	Classification	Rates	Rates	Increase	Increase
20	Residential	$ 650,824	$ 888,618	$ 237,795	36.54%
21	Small Commercial 5/8 Inch Meter	1,501	2,050	549	36.55%
22	Small Commercial 3/4 Inch Meter	-	-	-	0.00%
23	Small Commercial 1 Inch Meter	-	-	-	0.00%
24	Large Commercial	29,477	40,227	10,750	36.47%
25	Revenues from Treatco excluding Annualization	11,231	11,231	-	0.00%
26	Miscellaneous Revenues	986,072	986,072	-	0.00%
27	Subtotal of Revenues	$ 1,679,105	$ 1,928,198	$ 249,093	14.83%
28					
29	**Revenue Annualization**				
30	Treatco Revenue Annualization	13,480	13,480	-	0.00%
31	Residential	167,515	228,715	61,200	36.53%
32	Small Commercial 5/8 Inch Meter	(841)	(1,148)	(307)	36.54%
33	Small Commercial 3/4 Inch Meter	-	-	-	0.00%
34	Small Commercial 1 Inch Meter	-	-	-	0.00%
35	Large Commercial	3,930	5,363	1,433	36.47%
36	Total Revenue Annualization	184,083	246,409	62,326	33.86%
37	Total Revenues with Revenue Annualization	1,863,188	2,174,607	311,419	16.71%
38					

39 SUPPORTING SCHEDULES:
40 Rejoinder B-1
41 Rejoinder C-1
42 Rebuttal D-1
43 Rejoinder H-1

Arizona American - Mohave Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.					
1	Fair Value Rate Base			$ 13,350,302	
2					
3	Adjusted Operating Income			915,999	
4					
5	Current Rate of Return			6.86%	
6					
7	Required Operating Income			$ 1,003,409	
8					
9	Required Rate of Returnon Fair Value Rate base			7.52%	
10					
11	Operating Income Deficiency			$ 87,410	
12					
13	Gross Revenue Conversion Factor			1.6286	
14					
15	Increase in Gross Revenue				
16	Requirement			$ 142,359	
17					
18	Customer	Present	Proposed	Dollar	Percent
19	Classification	Rates	Rates	Increase	Increase
20	Residential 5/8 Inch	$ 2,648,370	$ 2,736,091	$ 87,721	3.31%
21	Residential 1 Inch	15,626	16,151	526	3.36%
22	Residential 1.5 Inch	-	-	-	0.00%
23	Residential 2 Inch	14,500	14,991	491	3.38%
24					
25	Residential Muti-family 5/8 Inch	94,231	97,330	3,099	3.29%
26	Residential Muti-family 1 Inch	44,888	46,366	1,478	3.29%
27	Residential Muti-family 1.5 Inch	16,223	16,752	529	3.26%
28	Residential Muti-family 2 Inch	248,296	256,444	8,148	3.28%
29	Residential Muti-family 4 Inch	17,645	18,226	580	3.29%
30	Residential Muti-family 6 Inch	162,922	168,254	5,332	3.27%
31					
32	Rio Water Residential 5/8 Inch	80,529	83,272	2,743	3.41%
33	Rio Water Residential 1 Inch	26	27	1	3.41%
34	Rio Water Residential 2 Inch	74	77	3	3.41%
35					
36	Commercial 5/8 Inch	125,418	129,600	4,182	3.33%
37	Commercial 1 Inch	90,568	93,617	3,049	3.37%
38	Commercial 1.5 Inch	28,828	29,799	971	3.37%
39	Commercial 2 Inch	355,657	367,686	12,028	3.38%
40	Commercial 3 Inch	51,990	53,740	1,750	3.37%

Arizona American - Mohave Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 2
Witness: Bourassa

Line No.		Present Rates	Proposed Rates	Dollar Increase	Percent Increase
1					
2	Commercial Multi-Unit 5/8 Inch	16,427	16,970	542	3.30%
3	Commercial Multi-Unit 1 Inch	3,014	3,113	99	3.27%
4	Commercial Multi-Unit 1.5 Inch	2,619	2,707	88	3.35%
5	Commercial Multi-Unit 2 Inch	9,383	9,695	312	3.32%
6					
7	Public Authority 58 Inch	4,450	4,596	146	3.29%
8	Public Authority 1 Inch	5,109	5,281	172	3.37%
9	Public Authority 1.5 Inch	3,877	4,007	130	3.36%
10	Public Authority 2 Inch	61,130	63,199	2,068	3.38%
11	Public Authority 3 Inch	15,446	15,967	521	3.38%
12	Public Authority 4 Inch	19,712	20,377	665	3.38%
13	Public Authority 6 Inch	33,295	34,419	1,124	3.37%
14		-	-	-	0.00%
15	Private Fire 2 Inch	264	273	9	3.33%
16	Private Fire 4 Inch	4,554	4,706	152	3.33%
17	Private Fire 6 Inch	1,539	1,590	51	3.33%
18	Private Fire 8 Inch	588	608	20	3.33%
19	Private Fire 10 Inch	180	186	6	3.33%
20	Private Fire Hydrant	14,489	14,963	474	3.27%
21	Miscellaneous Revenues	108,705	108,705	-	0.00%
22	Difference Between Bill Count Rev. & G/L Rev.	48,141	49,741	1,600	3.32%
23	Subtotal of Water Revenues	$ 4,348,715	$ 4,489,522	$ 140,807	3.24%
24	**Revenue Annualization**				
25	Residential 5/8 Inch	$ 49,762	$ 51,411	$ 1,649	3.31%
26	Residential 1 Inch	1,073	1,109	36	3.36%
27	Residential 1.5 Inch	-	-	-	0.00%
28	Residential 2 Inch	(1,244)	(1,286)	(42)	3.38%
29		0	0	0	0
30	Residential Muti-family 5/8 Inch	(1,693)	(1,749)	(57)	3.34%
31	Residential Muti-family 1 Inch	57	59	2	3.31%
32	Residential Muti-family 1.5 Inch	(277)	(286)	(9)	3.24%
33	Residential Muti-family 2 Inch	(13,893)	(14,345)	(452)	3.26%
34	Residential Muti-family 4 Inch	-	-	-	0.00%
35	Residential Muti-family 6 Inch	(10,652)	(10,994)	(343)	3.22%
36					0
37	Rio Water Residential 5/8 Inch	2,721	2,813	93	3.41%
38	Rio Water Residential 1 Inch	287	297	10	3.41%
39	Rio Water Residential 2 Inch	212	219	7	3.40%
40					0.03407
41	Commercial 5/8 Inch	2,096	2,166	70	3.33%
42	Commercial 1 Inch	3,184	3,291	107	3.37%
43	Commercial 1.5 Inch	-	-	-	0
44	Commercial 2 Inch	10,608	10,967	359	3.38%
45	Commercial 3 Inch	2,711	2,802	91	3.36%

Arizona American - Mohave Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 3
Witness: Bourassa

Line No.		Present Rates	Proposed Rates	Dollar Increase	Percent Increase
1					
2	Commercial Multi-Unit 5/8 Inch	3,966	4,098	133	3.35%
3	Commercial Multi-Unit 1 Inch	42	43	1	3.26%
4	Commercial Multi-Unit 1.5 Inch	0	0	0	0
5	Commercial Multi-Unit 2 Inch	(2,842)	(2,936)	(93)	3.28%
6		0	0	0	0
7	Public Authority 58 Inch	0	0	0	0
8	Public Authority 1 Inch	45	46	2	3.36%
9	Public Authority 1.5 Inch	0	0	0	0
10	Public Authority 2 Inch	(977)	(1,010)	(33)	3.38%
11	Public Authority 3 Inch	0	0	0	0
12	Public Authority 4 Inch	(18)	(19)	(1)	3.33%
13	Public Authority 6 Inch	0	0	0	0
14		0	0	0	0
15	Private Fire 2 Inch	132	136	4	3.33%
16	Private Fire 4 Inch	0	0	0	0
17	Private Fire 6 Inch	81	84	3	3.33%
18	Private Fire 8 Inch	132	136	4	3.33%
19	Private Fire 10 Inch	-	-	-	0.00%
20	Private Fire Hydrant	(95)	(98)	(3)	3.27%
21	Total Revenue Annualization	$ 45,417	$ 46,955	$ 1,538	3.39%
22	Revenues from Page 1	$ 4,348,715	$ 4,489,522	$ 140,807	3.24%
23	Totals	$ 4,394,133	$ 4,536,477	$ 142,344	3.24%
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39					
40					
41					
42					
43					
44	SUPPORTING SCHEDULES:				
45	Rejoinder B-1				
46	Rejoinder C-1				
47	Rebuttal D-1				
48	Rejoinder H-1				
49					

Arizona American - Havasu Water Company
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 1,216,964
2		
3	Adjusted Operating Income	12,310
4		
5	Current Rate of Return	1.01%
6		
7	Required Operating Income	$ 91,467
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 79,157
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 128,917
17		

	Customer Classification		Present Rates	Proposed Rates	Dollar Increase	Percent Increase
18						
19						
20	5/8 Inch Residential		$ 249,903	$ 322,282	$ 72,379	28.96%
21	1 Inch Residential		3,296	4,248	952	28.88%
22	1.5 Inch Residential		0	0	0	0
23	2 Inch Residential		1,580	2,037	457	28.92%
24	3 Inch Residential		0	0	0	0
25	4 Inch Residential		3,730	4,807	1,078	28.90%
26	6 Inch Residential		0	0	0	0
27	5/8 Inch Commercial		15,714	20,262	4,549	28.95%
28	1 Inch Commercial		7,007	9,036	2,028	28.95%
29	2 Inch Commercial		3,958	5,104	1,146	28.96%
30	3 Inch Commercial		30,088	38,793	8,706	28.93%
31	4 Inch Commercial		3,820	4,926	1,106	28.95%
32	6 inch Commercial		0	0	0	0
33	Multi-Family 44	1"	7,203	9,291	2,087	28.98%
34	Multi-Family 56	2"	7,741	9,985	2,244	28.99%
35	Multi-Family 64	4"	10,065	12,982	2,917	28.98%
36	Multi-Family 65	2"	9,406	12,132	2,726	28.98%
37	Multi-Family 67	4"	11,990	15,464	3,474	28.97%
38	Multi-Family 89	1"	13,438	16,576	3,137	23.35%
39	Multi-Family 102	2"	12,850	16,576	3,726	29.00%
40	Multi-Family 129	4"	16,174	20,882	4,708	29.11%
41	Multi-Family 153	4"	18,998	24,507	5,509	29.00%
42	Miscellaneous Revenues		10,532	10,532	-	0.00%
43	Difference between Bill Count Revenues		-	-	-	0.00%
44	and General Ledger Revenues		6,311	8,141	1,830	29.00%
45	**Subtotal Revenues**		$ 443,802	$ 568,563	$ 124,760	28.11%

Arizona American - Havasu Water Company
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

RejoinderSchedule A-1
Page 2
Witness: Bourassa

Line No.		Present Revenues	Proposed Revenues	Dollar Change	Percent Change
1	***Revenue Annualization***				
2	0				
3	0				
4	5/8 Inch Residential	11,725	15,121	3,395	28.96%
5	1 Inch Residential	(3,296)	(4,248)	(952)	28.88%
6	2 Inch Residential	(1,428)	(1,840)	(413)	28.91%
7	4 Inch Residential	(4,464)	(5,755)	(1,291)	28.92%
8	5/8 Inch Commercial	783	1,009	226	28.94%
9	1 Inch Commercial	(541)	(698)	(157)	29.01%
10	2 Inch Commercial	$ (764)	$ (985)	$ (221)	29.00%
11	3 Inch Commercial	$ (4,894)	$ (6,309)	$ (1,415)	28.92%
12	Total Revenue Annualizations	(2,878)	(3,706)	(827)	28.74%
13	**Total Revenues**	440,924	564,857	123,933	28.11%
14					
15					
16					
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39					
40					
41					
42					
43					
44	SUPPORTING SCHEDULES:				
45	Rejoinder B-1				
46	Rejoinder C-1				
47	Rebuttal D-1				
48	Rejoinder H-1				
49					

Arizona American - Sun City Water Company
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 44,279,756
2		
3	Adjusted Operating Income	581,339
4		
5	Current Rate of Return	1.31%
6		
7	Required Operating Income	$ 3,328,066
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 2,746,728
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 4,473,416
17		

18	Customer		Present	Proposed	Dollar	Percent
19	Classification		Rates	Rates	Increase	Increase
20	5/8 Inch	Residential	$ 2,662,562	$ 4,624,450	$ 1,961,888	73.68%
21	3/4 Inch	Residential	1,817	3,150	1,333	73.39%
22	1 Inch	Residential	66,498	115,187	48,689	73.22%
23	1.5 Inch	Residential	1,485,121	2,571,799	1,086,678	73.17%
24	2 Inch	Residential	632,378	1,095,144	462,765	73.18%
25	3 Inch	Residential	13,103	22,671	9,568	73.02%
26	6 Inch	Residential	6,383	11,065	4,681	73.33%
27	5/8 Inch	Commercial	25,941	45,004	19,064	73.49%
28	3/4 Inch	Commercial	3,226	5,594	2,368	73.40%
29	1 Inch	Commercial	48,884	84,743	35,860	73.36%
30	1.5 Inch	Commercial	150,893	261,448	110,556	73.27%
31	2 Inch	Commercial	280,522	485,631	205,108	73.12%
32	3 Inch	Commercial	71,578	123,900	52,322	73.10%
33	4 Inch	Commercial	71,802	124,152	52,351	72.91%
34	6 Inch	Commercial	203,846	352,413	148,567	72.88%
35	1 Inch	Irrigation	339	590	250	73.77%
36	1.5 Inch	Irrigation	98,009	170,347	72,338	73.81%
37	2 Inch	Irrigation	6,157	10,703	4,546	73.84%
38	3 Inch	Irrigation	1,142	1,984	842	73.76%
39	6 Inch	Irrigation	114,183	198,501	84,318	73.84%
40	3 Inch	Public Interruptible	3,193	5,555	2,362	74.00%
41	8 Inch	Public Interruptible	19	33	14	74.00%
42	3 Inch	Fire Protection	72	125	53	73.67%
43	4 Inch	Fire Protection	5,814	10,103	4,289	73.78%
44	6 Inch	Fire Protection	7,150	12,424	5,274	73.76%
45	8 Inch	Fire Protection	2,480	4,309	1,829	73.75%
46	Standby		2,646	4,596	1,950	73.71%
47	Miscellaneous Revenues		113,419	113,419	-	0.00%
48	Subtotal of Water Revenues		$ 6,079,178	$ 10,459,042	$ 4,379,864	72.05%

Arizona American - Sun City Water Company
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 2
Witness: Bourassa

Line No.						
1	Revenue Annualization					
2	5/8 Inch	Residential	$ 10,636	$ 18,492	$ 7,856	73.86%
3	1 Inch	Residential	404	700	296	73.25%
4	1.5 Inch	Residential	1,046	1,810	764	73.11%
5	2 Inch	Residential	5,905	10,226	4,322	73.19%
6	5/8 Inch	Commercial	421	732	311	73.88%
7	3/4 Inch	Commercial	(70)	(122)	(52)	73.80%
8	1 Inch	Commercial	(343)	(595)	(252)	73.43%
9	1.5 Inch	Commercial	863	1,496	633	73.35%
10	2 Inch	Commercial	5,008	8,668	3,661	73.11%
11	3 Inch	Commercial	(3,159)	(5,470)	(2,311)	73.16%
12	1.5 Inch	Irrigation	(4)	(6)	(3)	73.85%
13	2 Inch	Irrigation	(594)	(1,033)	(439)	73.83%
14	3 Inch	Irrigation	(97)	(169)	(72)	73.77%
15	6 Inch	Irrigation	83,116	144,493	61,377	73.84%
16	3 Inch	Public Interruptible	(3,193)	(5,555)	(2,362)	74.00%
17	4 Inch	Fire Protection	126	219	93	73.78%
18	6 Inch	Fire Protection	200	348	148	73.76%
19	8 Inch	Fire Protection	(80)	(139)	(59)	73.75%
20	Total Water Annualization		$ 100,185	$ 174,097	$ 73,911	73.77%
21	Total Water Revenues with Annualization		$ 6,179,363	$ 10,633,139	$ 4,453,775	72.07%
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32						
33						
34						
35						
36						
37						
38						
39						
40						
41						
42						
43						
44						
45	SUPPORTING SCHEDULES:					
46	Rejoinder B-1					
47	Rejoinder C-1					
48	Rebuttal D-1					
49	Rejoinder H-1					
50						

Arizona American - Sun City Wastewater
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 17,192,669
2		
3	Adjusted Operating Income	1,130,307
4		
5	Current Rate of Return	6.57%
6		
7	Required Operating Income	$ 1,292,201
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 161,894
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 263,666
17		

18	Customer	Present	Proposed	Dollar	Percent
19	Classification	Rates	Rates	Increase	Increase
20	Residential Units (SSR)	$ 2,920,525	$ 3,070,295	$ 149,771	5.13%
21	Commercial/Residential Units (SSR)	116	122	6	5.13%
22	Commercial (SSC)	104,865	110,292	5,426	5.17%
23	Commercial Large User (SS6)	64,965	68,114	3,149	4.85%
24	Multi-family Residential Units (AC SSR)	1,793,100	1,885,054	91,954	5.13%
25	Commercial additional toilets (SS1)	133,438	140,498	7,060	5.29%
26	Commercial per dishwasher (SS2)	26,568	27,947	1,379	5.19%
27	Commercial per wash machine (SS3)	5,457	5,743	286	5.24%
28	Commercial per wash rack (SS4)	2,736	2,879	143	5.21%
29	Miscellaneous Revenues	2,859	2,859	-	0.00%
30	Subtotal of Revenues	$ 5,054,629	$ 5,313,802	$ 259,173	5.13%
31					
32	Revenue Annualization				
33	Residential Units (SSR)	$ 12,754	$ 13,408	$ 654	5.13%
34	Commercial/Residential Units (SSR)	(116)	(122)	(6)	5.13%
35	Commercial (SSC)	1,809	1,902	94	5.17%
36	Commercial Large User (SS6)	-	-	-	0.00%
37	Multi-family Residential Units (AC SSR)	17,709	18,617	908	5.13%
38	Commercial additional toilets (SS1)	329	346	17	5.29%
39	Commercial per dishwasher (SS2)	669	704	35	5.19%
40	Commercial per wash machine (SS3)	49	52	3	5.24%
41	Commercial per wash rack (SS4)	29	30	2	5.21%
42	Total Revenue Annualization	$ 33,233	$ 34,939	$ 1,706	5.13%
43		0	0	0	0
44	Total of Revenues	$ 5,087,862	$ 5,348,741	$ 260,879	5.13%

45

46 SUPPORTING SCHEDULES:
47 Rejoinder B-1
48 Rejoinder C-1
49 Rebuttal D-1
50 Rejoinder H-1
51

Arizona American - Sun City Wastewater
Test Year Ended December 31, 2001
Summary of Fair Value Rate Base

Exhibit
Rejoinder Schedule B-1
Page 1
Witness: Bourassa

Line No.		Original Cost Rate base	RCND Rate base	Fair Value Rate base (RCND Only)
1				
2	Gross Utility Plant in Service	$ 19,900,934	$ 43,537,027	$ 43,537,027
3	Less: Accumulated Depreciation	7,195,117	17,008,200	17,008,200
4				
5	Net Utility Plant in Service	$ 12,705,816	$ 26,528,827	$ 26,528,827
6				
7	Less:			
8	Advances in Aid of			
9	Construction	3,309,005	7,239,070	7,239,070
10	Contributions in Aid of			
11	Construction - Net of amortization	1,187,139	2,597,089	2,597,089
12	Customer Meter Deposits	-	-	-
13	Deferred Income Taxes & Credits	-	-	-
14	Investment tax Credits	-	-	-
15	Plus:			
16	Tolleson Trickling			
17	Filter	500,000	500,000	500,000
18	Deferred Tax Assets	-	-	-
19	Allowance for Working Capital	-	-	-
20	Citizens Acquisition Adjustment	5,224,179	-	-
21				
22	Total Rate Base	$ 13,933,851	$ 17,192,669	$ 17,192,669
23				
24				
25				
26	SUPPORTING SCHEDULES:			RECAP SCHEDULES:
27	Rejoinder B-2			Rejoinder A-1
28	Rejoinder B-3			
29				
30				
31				

Arizona American - Sun City West Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.			
1	Fair Value Rate Base	$	15,432,917
2			
3	Adjusted Operating Income		447,938
4			
5	Current Rate of Return		2.90%
6			
7	Required Operating Income	$	1,159,938
8			
9	Required Rate of Return on Fair Value Rate Base		7.52%
10			
11	Operating Income Deficiency	$	712,000
12			
13	Gross Revenue Conversion Factor		1.6286
14			
15	Increase in Gross Revenue		
16	Requirement	$	1,159,587
17			

	Customer Classification		Present Rates	Proposed Rates	Dollar Increase	Percent Increase
20	5/8 Inch	Residential	$ 2,075,364	$ 2,795,821	$ 720,458	34.71%
21	3/4 Inch	Residential	409	551	142	34.76%
22	1 Inch	Residential	40,107	54,071	13,964	34.82%
23	1.5 Inch	Residential	511,059	689,126	178,067	34.84%
24	2 Inch	Residential	162,940	219,749	56,808	34.86%
25	3 Inch	Residential	-	-	-	0.00%
26	4 Inch	Residential	117,032	157,787	40,754	34.82%
27	5/8 Inch	Commercial	9,572	12,904	3,332	34.81%
28	3/4 Inch	Commercial	-	-	-	0.00%
29	1 Inch	Commercial	34,155	46,046	11,892	34.82%
30	1.5 Inch	Commercial	74,345	100,252	25,907	34.85%
31	2 Inch	Commercial	208,910	281,722	72,812	34.85%
32	3 Inch	Commercial	51,125	68,947	17,822	34.86%
33	4 Inch	Commercial	11,618	15,666	4,047	34.84%
34	6 Inch	Commercial	4,923	6,640	1,717	34.88%
35	4 Inch	Fire Protection	4,140	5,589	1,449	35.00%
36	6 Inch	Fire Protection	11,745	15,856	4,111	35.00%
37	8 Inch	Fire Protection	5,040	6,804	1,764	35.00%
38	Miscellaneous Revenues		37,640	37,640	-	0.00%
39	Subtotal Water Revenues		$ 3,360,124	$ 4,515,170	$ 1,155,046	34.38%

Arizona American - Sun City West Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 2
Witness: Bourassa

Line No.	Customer Classification		Present Rates	Proposed Rates	Dollar Increase	Percent Increase
1	**Revenue Annualization**					
2	5/8 Inch	Residential	$ 3,500	$ 4,713	$ 1,213	34.65%
3	3/4 Inch	Residential	-	-	-	0.00%
4	1.5 Inch	Residential	278	375	97	34.84%
5	2 Inch	Residential	(901)	(1,215)	(314)	34.86%
6	3 Inch	Residential	-	-	-	0.00%
7	4 Inch	Residential	-	-	-	0.00%
8	5/8 Inch	Commercial	(246)	(332)	(86)	34.70%
9	3/4 Inch	Commercial	-	-	-	0.00%
10	1 Inch	Commercial	(440)	(593)	(153)	34.80%
11	1.5 Inch	Commercial	1,014	1,368	353	34.84%
12	2 Inch	Commercial	5,600	7,552	1,952	34.85%
13	3 Inch	Commercial	(4,055)	(5,469)	(1,414)	34.86%
14	4 Inch	Commercial	-	-	-	0
15	6 Inch	Commercial	-	-	-	0
16	4 Inch	Fire Protection	540	729	189	35.00%
17	6 Inch	Fire Protection	135	182	47	35.00%
18	8 Inch	Fire Protection	0	0.00	0	0.00%
19	Total Revenue Annualization		$ 5,424	$ 7,309	$ 1,885	34.74%
20	Total Revenues		$ 3,365,549	$ 4,522,479	$ 1,156,931	34.38%
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32						
33						
34						
35						
36						
37	SUPPORTING SCHEDULES:					
38	Rejoinder B-1					
39	Rejoinder C-1					
40	Rebuttal D-1					
41	Rejoinder H-1					
42						

Arizona American - Sun City West Wastewater
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
RejoinderSchedule A-1
Page 1
Witness: Bourassa

Line No.		
1	Fair Value Rate Base	$ 12,221,084
2		
3	Adjusted Operating Income	(42,627)
4		
5	Current Rate of Return	-0.35%
6		
7	Required Operating Income	$ 918,537
8		
9	Required Rate of Return on Fair Value Rate Base	7.52%
10		
11	Operating Income Deficiency	$ 961,164
12		
13	Gross Revenue Conversion Factor	1.6286
14		
15	Increase in Gross Revenue	
16	Requirement	$ 1,565,385
17		

	Customer Classification	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
18					
19					
20	Residential Units (WSR)	$ 2,789,886	$ 4,026,781	$ 1,236,895	44.33%
21	Commercial Units (SSC)	$76,035	$109,756	$ 33,720	44.35%
22	Commercial Large User (WS6)	12,683	18,363	5,680	44.78%
23	Muti-family Residential Units (AC WSRE)	553,264	798,554	245,290	44.33%
24		-	-	-	0.00%
25		-	-	-	0.00%
26	Commercial additional toilets (WS1)	70,575	101,867	31,293	44.34%
27	Commercial per dishwasher (WS2)	11,241	16,225	4,984	44.34%
28	Commercial per wash machine (WS3)	3,247	4,686	1,439	44.31%
29	Commercial per wash rack (WS4)	2,497	3,605	1,108	44.35%
30	Miscellaneous Revenues	1,002	1,002	-	0.00%
31	Subtotal of Revenues	3,520,431	5,080,839	1,560,408	44.32%
32					
33					
34	Revenue Annualization				
35	Residential Units (WSR)	$ 3,134	$ 4,524	$ 1,390	44.33%
36	Commercial Units (SSC)	7,089	10,232	3,144	44.35%
37	Commercial Large User (WS6)	681	983	302	44.34%
38	Muti-family Residential Units (AC WSRE)	-	-	-	0.00%
39	Commercial additional toilets (WS1)	(424)	(612)	(188)	44.34%
40	Commercial per dishwasher (WS2)	-	-	-	0.00%
41	Commercial per wash machine (WS3)	566	817	251	44.31%
42	Commercial per wash rack (WS4)	-	-	-	0.00%
43	Total Revenue Annualization	$ 11,046	$ 15,944	$ 4,898	44.34%
44		0	0	0	0.00%
45	Total Revenues	$ 3,531,477	$ 5,096,784	$ 1,565,307	44.32%
46					
47	SUPPORTING SCHEDULES:				
48	Rejoinder B-1				
49	Rejoinder C-1				
50	Rebuttal D-1				
51	Rejoinder H-1				
52					
53					

Arizona American - Sun City West Wastewater
Test Year Ended December 31, 2001
Summary of Fair Value Rate Base

Exhibit
Rejoinder Schedule B-1
Page 1
Witness: Bourassa

Line No.		Original Cost Rate base	RCND Rate base	Fair Value Rate base (RCND Only)
1				
2	Gross Utility Plant in Service	$ 39,022,368	$ 54,170,595	$ 54,170,595
3	Less: Accumulated Depreciation	14,145,184	19,791,126	19,791,126
4				
5	Net Utility Plant in Service	$ 24,877,183	$ 34,379,469	$ 34,379,469
6				
7	Less:			
8	Advances in Aid of			
9	Construction	14,502,979	20,132,941	20,132,941
10	Contributions in Aid of			
11	Construction - Net of amortization	1,458,672	2,024,919	2,024,919
12	Customer Meter Deposits	525	525	525
13	Deferred Income Taxes & Credits	-	-	-
14	Investment tax Credits	-	-	-
15	Plus:			
16	Deferred Finance			
17	Charges	-	-	-
18	Deferred Tax Assets	-	-	-
19	Allowance for Working Capital	-	-	-
20	Citizens Acquisition Adjustment	10,321,436	-	-
21				
22	Total Rate Base	$ 19,236,443	$ 12,221,084	$ 12,221,084
23				
24				
25				
26	SUPPORTING SCHEDULES:			RECAP SCHEDULES:
27	Rejoinder B-2			Rejoinder A-1
28	Rejoinder B-3			
29				
30				
31				

Arizona American - Tubac Water
Test Year Ended December 31, 2001
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
Rebuttal Schedule A-1
Page
Witness: Bourassa

Line No.						
1	Fair Value Rate base				$ 1,732,373	
2						
3	Adjusted Operating Income				18,486	
4						
5	Current Rate of Return				1.07%	
6						
7	Required Operating Income				$ 130,205	
8						
9	Required Rate of Return on Fair Value Rate Base				7.52%	
10						
11	Operating Income Deficiency				$ 111,719	
12						
13	Gross Revenue Conversion Factor				1.6286	
14						
15	Increase in Gross Revenue					
16	Requirement				$ 181,950	
17						
18	Customer		Present	Proposed	Dollar	Percent
19	Classification		Rates	Rates	Increase	Increase
20	5/8 Inch	Residential	$ 192,378	$ 331,745	$ 139,366	72.44%
21	1 Inch	Residential	11,339	19,554	8,215	72.44%
22	1.5 Inch	Residential	1,501	2,589	1,088	72.49%
23	2 Inch	Residential	1,671	2,882	1,211	72.48%
24	3 Inch	Residential	1,255	2,164	909	72.45%
25			-	-	-	0.00%
26	5/8 Inch	Commercial	20,444	35,253	14,809	72.44%
27	1 Inch	Commercial	6,953	11,991	5,038	72.46%
28	1.5 Inch	Commercial	2,753	4,748	1,995	72.48%
29	2 Inch	Commercial	9,544	16,465	6,922	72.52%
30	3 Inch	Commercial	807	1,392	585	72.47%
31	Miscellaneous Revenues		2,691	2,691	-	0.00%
32			0	0	0	0
33	Subtotal of Water Revenues		$ 251,336	$ 431,475	$ 180,138	71.67%
34						
35						
36	Revenue Annualization					
37	5/8 Inch	Residential	$ 738	$ 1,271	$ 534	72.40%
38	1 Inch	Residential	370	638	268	72.40%
39	5/8 Inch	Commercial	350	603	253	72.38%
40	1 Inch	Commercial	218	375	158	72.44%
41	3 Inch	Commercial	801	1,382	581	72.46%
42	Total Revenue Annualization		2,476	4,269	1,793	72.42%
43	Total Water Revenues with		-	-	-	0.00%
44	Revenue Annualization		$ 253,812	$ 435,744	$ 181,931	71.68%
45						
46	SUPPORTING SCHEDULES:					
47	Rejoinder B-1					
48	Rejoinder C-1					
49	Rebuttal D-1					
50	Rejoinder H-1					
51						
52						