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COMMISSIONERS

KRISTIAN K. MAYES, Chairman  
GARY PIERCE  
PAUL NEWMAN  
SANDRA D. KENNEDY  
BOB STUMP

IN THE MATTER OF THE APPLICATION OF  
H2O, INC. FOR A DETERMINATION OF THE  
CURRENT FAIR VALUE OF ITS UTILITY  
PROPERTY AND FOR AN INCREASE IN ITS  
WATER RATES AND CHARGES FOR UTILITY  
SERVICES.

DOCKET NO. W-02234A-07-0557

**NOTICE OF FILING  
STAFF'S DIRECT TESTIMONY  
AND EXHIBITS**

Staff of the Arizona Corporation Commission hereby files the Direct Testimony of  
Brendan C. Aladi and Katrin Stukov, in the above-referenced matters.

RESPECTFULLY submitted this 23<sup>rd</sup> day of January, 2009.

  
Charles H. Haing, Attorney  
Legal Division  
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Phoenix, Arizona 85007  
(602) 542-3402

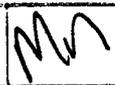
Original and thirteen (13) copies  
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23<sup>rd</sup> day of January, 2009 with:

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Phoenix, Arizona 85007

Arizona Corporation Commission

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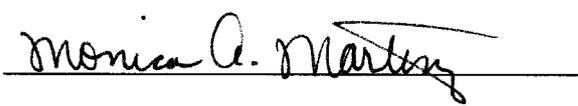
Copy of the foregoing mailed  
this 23<sup>rd</sup> day of January, 2009 to:

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Attorneys for H2O, Inc.

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**DIRECT**

**TESTIMONY**

**OF**

**BRENDAN C. ALADI**

**KATRIN STUKOV**

**DOCKET NO. W-02234A-07-0557**

**IN THE MATTER OF THE APPLICATION OF  
H2O, INC. FOR A DETERMINATION  
OF THE CURRENT FAIR VALUE  
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AND CHARGES FOR UTILITY SERVICES**

**JANUARY 23, 2009**

**BEFORE THE ARIZONA CORPORATION COMMISSION**

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
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WATER RATES AND CHARGES FOR )  
UTILITY SERVICES )  
\_\_\_\_\_ )

DOCKET NO. W-02234A-07-0557

DIRECT

TESTIMONY

OF

BRENDAN C. ALADI

PUBLIC UTILITIES ANALYST III

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JANUARY 23, 2009

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**EXECUTIVE SUMMARY**  
**H2O, INC.**  
**DOCKET NO. W-02234A-07-0557**

H2O, Inc. is an Arizona for profit Class B public service corporation providing water to approximately 6,300 customers in the vicinity of Queen Creek, in portions of Pinal and Maricopa Counties in Arizona. In compliance with Decision No. 69413, on October 1, 2007, H2O, Inc. ("H2O" or "Company") filed its initial rate application with the Arizona Corporation Commission ("ACC" or "Commission"). On May 13, 2008, H2O filed an amended application which it subsequently revised on December 22, 2008. The application shows that for the test year ended December 31, 2006, the Company produced adjusted operating revenues of \$3,379,767 and an operating income of \$296,353, for a 15.24 percent rate of return on a fair value rate base (same as original cost) of \$1,944,185. H2O requests a \$154,861 revenue decrease to provide a \$199,823 operating income representing a 10.28 percent rate of return.

The testimony of Mr. Brendan Aladi presents Staff's recommendation in the areas of rate base, operating income, revenue requirement and rate design. Staff recommends operating revenue of \$3,218,705, a decrease of \$159,937, or 4.73 percent, less than the adjusted test year revenue of \$3,378,642, to produce a \$321,871 operating income and a 10.0 percent operating margin. Staff calculated a negative \$500,901 rate base for which no meaningful rate of return can be calculated. Staff's primary rate base adjustments are a \$2,859,339 increase to contributions-in-aid-of-construction ("CIAC") and a \$34,405 increase to advances-in-aid-of-construction ("AIAC"), and the primary adjustment to operating income is a \$210,061 decrease to depreciation expense.

The present rate design has minimum monthly charges of \$15, \$18, \$37, \$75 and \$120 for 5/8-inch, 3/4-inch, 1-inch, 1.5-inch and 2-inch meter sizes, respectively. Customers with meters of each size receive the first 1,000 gallons of water each month as part of the minimum monthly charge and pay a commodity rate of \$1.78 per 1,000 gallons for the next 19,000 gallons and \$2.11 per 1,000 gallons for all gallons over 20,000.

The Company's proposed rate design has a three-tier rate structure for 5/8-inch and 3/4-inch customer classes with break-over points at 4,000 gallons, and at 10,000 gallons. The Company also proposes a two-tier rate structure for 1-inch meter sizes and larger with break-over points that vary incrementally by meter size. The Company proposes to begin charging a minimum monthly charge for 3-inch, 4-inch, 6-inch, 8-inch and 10-inch meters for the first time. The typical 5/8-inch meter bill with median use of 2,500 gallons would decrease by \$5.11, or 26.3 percent, from \$19.45 to \$14.35.

Staff recommends a three-tier inverted block rate structure for the 5/8-inch and 3/4-inch customer classes with break-over points at 3,000 gallons and at 10,000 gallons. Staff recommends a two-tier inverted block rate structure for the meter sizes 1-inch and larger with break-over points that increase by meter size. Staff recommends monthly minimum charges that increase proportionally to the volumetric capacity of the meter sizes. Staff's recommended rate design would generate Staff's recommended water revenue requirement of \$3,218,705, including

\$3,011,133 from metered water sales. The typical 5/8-inch meter bill with median use of 2,500 gallons would decrease by \$5.47, or 28.1 percent, from \$19.45 to \$13.98.

The Company proposes a Central Arizona Project ("CAP) surcharge. Staff will address this issue in Supplemental Testimony because Staff does not have sufficient information to make a recommendation at this time.

1 **I. INTRODUCTION**

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

3 A. My name is Brendan Aladi. I am a Public Utilities Analyst employed by the Arizona  
4 Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff").  
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6  
7 **Q. Please describe your educational background and professional experience.**

8 A. I received a Bachelor of Science degree in Accounting from Central State University, in  
9 Wilberforce, Ohio, and a Masters of Arts degree in Accounting from the University of  
10 Illinois at Springfield.

11  
12 My prior work experience includes approximately 18 years of auditing (both internal and  
13 external). Prior to joining the Commission, I was employed by the Office of Audit and  
14 Analysis for the Arizona Department of Transportation as an external auditor.

15  
16 In 2007, I began employment at the Commission as a Public Utilities Analyst III in the  
17 Finance and Regulatory Analysis Section. Since coming to the Commission, I have  
18 participated in a number of rate cases and other regulatory proceedings involving water  
19 and gas utilities. I have also attended various seminars and classes on general regulatory  
20 and business issues, including the National Association of Regulatory Utility  
21 Commissioners ("NARUC") Utility Rate School.

22  
23 **Q. Briefly describe your responsibilities as a Public Utilities Analyst III.**

24 A. I am responsible for the examination and verification of financial and statistical  
25 information included in assigned utility rate applications. I develop revenue requirements,

1 design rates, and prepare written reports, testimony and schedules to present Staff's  
2 recommendations to the Commission.

3  
4 **Q. What is the purpose of your testimony in this case?**

5 A. The purpose of my testimony is to present Staff's analysis and recommendations  
6 regarding the H2O application for a permanent rate decrease. I will present  
7 recommendations in the areas of rate base, operating income, revenue requirement and  
8 rate design. Staff witness Katrin Stukov will present the engineering analysis and  
9 recommendations.

10  
11 **Q. What is the basis of your recommendations?**

12 A. I performed a regulatory audit of the Company's records to determine whether sufficient,  
13 relevant and reliable evidence exists to support the proposals in the H2O rate application.  
14 My regulatory audit consisted of the following: (1) examining and testing the Company's  
15 accounting ledgers, reports and supporting documents; (2) checking the accumulation of  
16 amounts in the records; (3) tracing recorded amounts to source documents; and (4)  
17 verifying that the Company applied accounting principles that were in accordance with the  
18 NARUC Uniform System of Accounts ("USOA").

19  
20 **Q. How is your testimony organized?**

21 A. My testimony is presented in eleven sections. Section I is this introduction. Section II  
22 provides a background of the Company. Section III is a summary of consumer service  
23 issues. Section IV is a summary of proposed revenues. Section V is a summary of Staff's  
24 rate base and operating income adjustments. Section VI presents Staff's rate base  
25 recommendations. Section VII presents Staff's operating income recommendations.  
26 Section VIII discusses rate design. Section IX discusses the Off-site Capacity Reservation

1 Charge (Hoop-up Fee). Section X pertains to the Company's proposed Central Arizona  
2 Project ("CAP") surcharge. Section XI discusses the Company's compliance with  
3 Decision No. 69413.

4  
5 **II. BACKGROUND**

6 **Q. Would you please review the pertinent background information associated with the**  
7 **Company's application for a permanent rate decrease?**

8 A. Yes. H2O is a class B for-profit public service corporation providing water service to  
9 approximately 6,300 customers in the vicinity of Queen Creek, in portions of Maricopa  
10 and Pinal Counties, Arizona. The Company's present rates were approved in Decision No.  
11 58641 (May 27, 1994). Decision No. 69413 (April 16, 2007), pertaining to a Company  
12 request for a tariff revision, ordered the Company to file a rate case by September 31,  
13 2007, using a test year of 2006 or later.

14  
15 **Q. What test year did H2O use in its filing?**

16 A. H2O's rate filing is based on the twelve months ended December 31, 2006.

17  
18 **III. CONSUMER SERVICE**

19 **Q. Please provide a brief summary of customer comments received by the Commission**  
20 **regarding H2O.**

21 A. Staff reviewed the Commission's records and found nine complaints for the period  
22 January 1, 2005 through January 22, 2009, all of which have been resolved.

23  
24 **IV. SUMMARY OF PROPOSED REVENUES**

25 **Q. What revenue requirement is H2O proposing?**

26 A. H2O proposes total annual operating revenue of \$3,224,906, a \$154,861 (4.6 percent)  
27 decrease from its adjusted test year revenues of \$3,379,767.

1 **Q. What is Staff's revenue requirement recommendation?**

2 A. Staff's recommended revenue requirement is \$3,218,705, a \$159,937 (4.7 percent)  
3 decrease from Staff's adjusted test year revenues of \$3,378,642.

4  
5 **V. SUMMARY OF STAFF'S RATE BASE AND OPERATING INCOME**  
6 **ADJUSTMENTS**

7 **Q. Please summarize Staff's rate base and operating income adjustments.**

8 A. Rate Base:

9  
10 Reclassification of Miscellaneous Expense to Plant – This adjustment increases plant in  
11 service by \$6,646 to reflect plant that the Company misclassified as an expense.

12  
13 Reclassification of Repairs and Maintenance Expense – This adjustment increases plant in  
14 service by \$2,424 to reflect plant that the Company misclassified as an expense.

15  
16 Accumulated Depreciation – This adjustment increases accumulated depreciation by  
17 \$6,283 to reflect Staff's calculation based on Staff's recommended plant.

18  
19 Contribution in Aid of Construction ("CIAC") – This adjustment increases the CIAC  
20 balance by \$2,859,339 to properly reflect all CIAC paid by customers.

21  
22 Advance in Aid of Construction ("AIAC") – This adjustment increases the AIAC balance  
23 by \$34,405 to properly reflect all AIAC paid by customers.

24  
25 Accumulated Deferred Income Taxes – This adjustment increases rate base by \$445,872  
26 and reflects corrected inputs to the Company's calculation.

27 B. Operating Income:

28  
29 Reclassification of Repairs and Maintenance Expense – This adjustment decreases  
30 operating expenses by \$2,424 to remove costs misclassified as an expense.

31  
32 Reclassification of Miscellaneous Expense to Purchased Power – This adjustment  
33 reclassifies \$7,455 from miscellaneous expense to purchased power expense.

34  
35 Sales Tax – This adjustment decreases operating revenues by \$1,125 to remove a  
36 misclassified sales tax credit for Other Operating Revenues.

37  
38 Miscellaneous Expenses – This adjustment decreases operating expenses by \$5,023 to  
39 remove a late tax filing penalty.  
40

1           Reclassification of Miscellaneous Expense to Plant – This adjustment decreases operating  
2 expenses by \$6,646 to remove costs misclassified as an expense.

3  
4           Depreciation Expense – This adjustment decreases operating expenses by \$210,061. This  
5 adjustment reflects Staff's calculation of depreciation expense based upon Staff's  
6 recommended plant balances and the amortization of Staff's CIAC balance.

7  
8           Unnecessary Expenses – This adjustment decreases operating expenses by \$3,948 to  
9 remove the cost of food service offered for sale to employees with no corresponding  
10 recognition of the revenues generated.

11  
12           Water Testing – This adjustment increases operating expenses by \$11,687 to reflect  
13 Staff's annual water testing costs (see the testimony of Staff witness, Katrin Stukov).

14  
15           Property Tax Expense – This adjustment increases test year operating expense by \$1,980  
16 to reflect Staff's calculation of the Company's property tax expense.

17  
18           Income Tax Expense – This adjustment increases test year operating expense by \$91,525  
19 to reflect application of the statutory State and Federal tax rates to Staff's taxable income.

20

21   **VI.    RATE BASE**

22   **Fair Value Rate Base**

23   **Q.    Does H2O's application include schedules with elements of a Reconstruction Cost**  
24       **New Rate Base ("RCN")?**

25   **A.    No. The Company's filing treats the OCRB the same as the fair value rate base.**

26

27   **Rate Base Summary**

28   **Q.    Please summarize Staff's rate base recommendation.**

29   **A.    Staff's adjustments to H2O's rate base resulted in a net decrease of \$2,445,085, from**  
30       **\$1,944,185 to a negative \$500,901. Staff's recommendation results from the six rate base**  
31       **adjustments described below.**

1 **Rate Base Adjustment Nos. 1 and 2 – Reclassification of Expensed Amount to Plant**

2 **Q. What guidance should water utilities use to determine whether a cost should be**  
3 **capitalized by recording it in a plant account or treated as an operating expense?**

4 A. The Arizona Administrative Code R14-2-411 D.2 requires water companies to maintain  
5 their accounting records in accordance with the NARUC USOA. It states that “Each  
6 utility shall maintain its books and records in conformity with the Uniform System of  
7 Accounts for Class A, B, C and D Water Utilities.”

8  
9 The NARUC USOA provides a listing of plant accounts and the types of costs that should  
10 be recorded in each account. Utilities should use the plant account listing and Accounting  
11 Instruction No. 14 “Utility Plant – Components of Construction Costs” to determine what  
12 costs should be recorded as plant.

13  
14 **Q. Did H2O expense costs that, according to the NARUC USOA, should be recorded in**  
15 **plant accounts?**

16 A. Yes, the Company expensed plant costs incurred for distribution reservoirs and standpipes,  
17 and transmission and distribution main as shown on Schedules BCA-5 and BCA-6.

18  
19 **Q. What is the effect of expensing plant with life extending beyond the current period?**

20 A. The effect of expensing plant beyond the current period will be inconsistent with the  
21 matching principle. The NARUC USOA requires utilities to follow accrual accounting.  
22 The matching principle is the underlying basis of accrual accounting. The matching  
23 principle requires that revenues in an accounting period be matched to the expenses  
24 incurred during that same accounting period.

1           The practice of expensing plant is inconsistent with the matching principle because the  
2           entire cost of the asset is matched to only one accounting period even though the asset will  
3           benefit many accounting periods. Adherence to the matching principle and the NARUC  
4           USOA requires that the cost of an asset that benefits more than one accounting period be  
5           capitalized (by recording it in a plant account) and depreciated over the asset's useful life.

6

7           **Q.     What is Staff recommending?**

8           A.     Staff recommends increasing plant in service by \$9,070 (\$6,646 + \$2,424) to reclassify  
9           capital expenditures that the Company incorrectly recorded as operating expenses as  
10          shown on Schedules BCA-5 and BCA-6.

11

12          **Rate Base Adjustment No. 3 – Accumulated Depreciation**

13          **Q.     Did H2O record transactions correctly and maintain adequate records to support its**  
14          **proposed accumulated depreciation balance of \$1,491,666?**

15          A.     No. In the past, the Company recorded costs for work-in-progress directly to plant  
16          accounts and then at year end, identified the recorded costs for incomplete projects and  
17          reported those costs as construction work in progress ("CWIP"). In the calendar year  
18          2001, the Company removed CWIP transactions totaling \$632,332 that was recorded as  
19          plant (Account #311) by allocating the amount to Account Nos. 311, 330 and 331 based  
20          on the following factors 32 percent, 34 percent and 35 percent, respectively. The  
21          Company's method of recording CWIP directly to plant is not in accordance with NARUC  
22          USOA, and it has not reduced plant (Account 311) by the CWIP amount of \$632,332.

23

24          **Q.     How did staff calculate its recommended Accumulated Depreciation?**

25          A.     Staff calculated its accumulated depreciation balance by beginning with the plant balances  
26          authorized in Decision No. 58641. Staff applied the authorized composite depreciation

1 rate of 3.6 percent to the Staff recommended balances for the intervening years, and  
2 removed non-depreciable plant, documented retirements, CWIP recorded as plant and  
3 added depreciation accumulated on all documented additions in the intervening years.

4

5 **Q. What is Staff recommending?**

6 A. Staff recommends an accumulated depreciation balance of \$1,497,786, a \$6,120 increase  
7 over the Company's proposed balance of \$1,491,666 as shown on Schedule BCA-7.

8

9 **Rate base Adjustment No. 4 – Contributions in Aid of Construction (“CIAC”),**  
10 **Amortization of CIAC**

11 **Q. Did H2O include all of its CIAC in rate base?**

12 A. No. H2O excluded \$2,360,596 of its CIAC from rate base because it had not expended  
13 that amount. H2O also excluded \$498,743 of CIAC from rate base that it has expended  
14 for CWIP.

15

16 **Q. Did H2O also exclude from rate base the accumulated amortization attributable to**  
17 **the \$2,859,339 of CIAC it excluded from rate base?**

18 A. No. The Company excluded the CIAC but not the Accumulated Amortization of the  
19 CIAC pertaining to unexpended and CWIP CIAC funds. This unbalanced treatment  
20 unfairly overstates the rate base.

21

22 **Q. Should CIAC or the related Accumulated Amortization be excluded from rate base?**

23 A. No. The Commission usually recognizes CIAC in its entirety. Recognizing all CIAC and  
24 related accumulated amortizations is appropriate because the Company has the use of  
25 these funds regardless of whether it has expended the funds for plant. Recognition of  
26 CIAC in CWIP is also necessary since the NARUC USOA provides for the Company to

1           apply an allowance for funds used during construction (“AFUDC”) to CWIP balances.  
2           Excluding either the unexpended or CWIP portion of CIAC from rate base effectively  
3           allows a utility to earn a return twice on CIAC funds.

4

5       **Q.     What did Staff calculate for the CIAC and Amortization of CIAC balances?**

6       A.     Staff calculated \$9,309,115 and \$683,565 for the gross CIAC and Accumulated  
7           Amortization of CIAC balances, respectively. These amounts are consistent with the  
8           Company’s calculated amounts.

9

10      **Q.     What is Staff recommending?**

11     A.     Staff recommends increasing the CIAC balance by \$2,859,339 as shown on Schedule  
12           BCA-8.

13

14      **Rate base Adjustment No. 5 – Advances in Aid of Construction (“AIAC”)**

15      **Q.     Did H2O include all of its AIAC in the rate base?**

16     A.     No. H2O excluded \$34,405 of its AIAC from rate base because it had not expended that  
17           amount.

18

19      **Q.     Should unexpended AIAC be excluded from rate base?**

20     A.     No. As discussed previously regarding CIAC, recognizing all AIAC is appropriate  
21           because the Company has the use of these funds regardless of whether it has expended the  
22           funds for plant. Excluding unexpended AIAC from rate base effectively allows a utility to  
23           earn on funds not provided by investors. AIAC represents capital provided from  
24           customers, developers or other sources other than owners. Thus, AIAC is appropriately a  
25           deduction in the calculation of rate base.

1 **Q. What amount of AIAC did the Company include in its rate base?**

2 A. The Company's application includes AIAC of \$3,031,454, or \$34,405 less than the  
3 \$3,065,859 recorded in its balance sheet at the end of the test year.

4  
5 **Q. What is Staff recommending?**

6 A. Staff recommends increasing the AIAC in rate base by \$34,405 to add back the  
7 unexpended AIAC funds removed by the Company to reflect the actual AIAC balance at  
8 the end of the test year as shown on Schedules BCA-3 and BCA-9.

9  
10 **Rate Base Adjustment No. 6 – Accumulated Deferred Income Taxes**

11 **Q. What are deferred income taxes?**

12 A. Deferred income taxes are the computed tax difference between income taxes calculated  
13 for rate-making purposes and the actual income taxes that a Company pays to the United  
14 States Treasury and the State of Arizona. Typically, the primary cause of the income tax  
15 difference is the straight line depreciation method used for ratemaking purposes and  
16 accelerated depreciation method used for federal and state income tax reporting purposes.

17  
18 **Q. When should deferred income taxes be recorded in the financial statements?**

19 A. Statement of Financial Accounting Standards ("SFAS") No. 109, Accounting for Income  
20 Taxes, requires companies to use deferred tax accounting to recognize income tax timing  
21 differences when they occur. Also, the Internal Revenue Service requires that timing  
22 differences related to using straight line and accelerated depreciation methods be  
23 normalized by recording deferred income taxes.

1 **Q. Does H2O have an income tax timing difference that would result in deferred income**  
2 **taxes?**

3 A. Yes. Schedule B-2, page 5, of the Company's December 22, 2008, revisions to its  
4 application show it proposes accumulated deferred income tax ("ADIT") for inclusion in  
5 rate base. The Company claims a \$1,616,691 Deferred Tax Asset and a \$769,764  
6 Deferred Tax Liability for a net ADIT debit balance of \$846,927. The Deferred Tax Asset  
7 pertains to a difference in net book value for tax and book basis, and the Deferred Tax  
8 Liability pertains to AIAC.

9  
10 **Q. Does Staff agree with the Company's general method for calculating ADIT?**

11 A. Yes. Staff agrees in concept with the Company's method for estimating its ADIT.  
12 However, the Company's calculation uses a book balance of \$1,180,340 for Accumulated  
13 Depreciation that differs from the amount (\$1,491,666) in its filing. Staff has recalculated  
14 ADIT using Staff's recommended Plant and Accumulated Depreciation balances of  
15 \$12,996,414 and \$1,497,949, respectively, as shown in Schedule BCA-9.1. Staff  
16 calculated a \$1,628,648 Accumulated Deferred Income Tax Debit and a \$335,849  
17 Accumulated Deferred Income Tax Credit for a net ADIT debit balance of \$1,292,799  
18 using its inputs for Plant and Accumulated Depreciation with the Company's method for  
19 estimating ADIT. A net debit ADIT balance increases rate base.

20  
21 **Q. Why is a net debit ADIT balance an increase to rate base?**

22 A. A net debit ADIT balance shows that the Company's income taxes payable have exceeded  
23 the income taxes included in rates due to timing differences requiring investors to provide  
24 capital to fund the taxes payable until those taxes are recovered in the future. The primary  
25 reason for the net debit ADIT balance is the tax liability on AIAC related to customer  
26 connections, i.e., service line and meter installation charges.

1 **Q. What is Staff recommending?**

2 A. Staff recommends increasing the net debit ADIT by \$445,872 from \$846,927 to  
3 \$1,292,799 as shown in Schedules BCA-4 and BCA-9.1.

4

5 **VII. OPERATING INCOME**

6 **Operating Income Summary**

7 **Q. What are the results of Staff's analysis of test year operating revenues, expenses and**  
8 **income?**

9 A. As shown on Schedules BCA-10 and BCA-11 Staff's analysis resulted in test year  
10 operating revenues of \$3,378,642, expenses of \$2,960,503 and income of \$418,139.  
11 Staff's results reflect the ten adjustments described below.

12

13 **Operating Income Adjustment No. 1 – Sales Tax**

14 **Q. Did H2O include any sales taxes in its test year operating revenue?**

15 A. Yes. H2O included \$1,125 of sales taxes in its test year operating revenue.

16

17 **Q. What is the normal regulatory treatment of sales taxes?**

18 A. Normally, sales taxes are treated as a pass-through item, i.e., they are neither recognized in  
19 operating revenues or operating expenses. Pass-through treatment is preferable as it allows  
20 for revising charges to ratepayers as statutory tax rates change.

21

22 **Q. What is Staff recommending?**

23 A. Staff recommends removing \$1,125 from operating revenues as shown on Schedule  
24 BCA-12.

1 **Operating Income Adjustment Nos. 2 and 3 – Reclassification of Expenses to Plant**

2 **Q. Did H2O record transactions as operating expenses costs that should have been**  
3 **capitalized?**

4 A. Yes, as Staff discussed in Rate Base Adjustment Nos. 1 (\$6,646) and 2 (\$2,424), H2O  
5 recorded as operating expenses that according to the NARUC USOA and the matching  
6 principle, should be capitalized.

7  
8 **Q. What treatment does Staff recommend for the Company's expensed plant costs?**

9 A. Staff recommends that the costs be treated consistent with the NARUC USOA and the  
10 matching principle. Staff recommends reclassifying these costs to exclude them from Test  
11 Year operating expenses and to include them in plant.

12  
13 **Q. What is Staff recommending?**

14 A. Staff recommends decreasing operating expenses by \$9,070 (\$6,646 for Adjustment No. 2  
15 and \$2,424 for Adjustment No. 3) as shown in Schedules BCA-13 and BCA-14 to  
16 recognize a reclassification of these amounts to plant

17  
18 **Operating Income Adjustment No. 4 – Reclassification of Miscellaneous expense to**  
19 **Purchased Power**

20 **Q. Did H2O record certain purchased power costs as miscellaneous expenses?**

21 A. Yes. Staff's examination revealed that H2O misclassified the recording of \$7,455  
22 purchased power expenses as in miscellaneous expenses according to the NARUC USOA.

23  
24 **Q. What is Staff recommending?**

25 A. Staff recommends decreasing miscellaneous expense by \$7,455 and increasing purchased  
26 power by the same amount as shown in Schedules BCA-11 and BCA-15.

1 **Operating Income Adjustment No. 5 – Tax Penalty**

2 **Q. How does H2O propose to treat a late tax filing penalty?**

3 A. H2O included a late tax filing penalty of \$5,023 in operating expenses.

4

5 **Q. What is the normal regulatory treatment of late tax filing penalty?**

6 A. Penalties for delinquent tax filings are avoidable and they are not necessary for the  
7 provision of utility service. Accordingly, these penalties should be excluded from  
8 operating expenses.

9

10 **Q. What is Staff recommending?**

11 A. Staff recommends removing \$5,023 from operating expenses as shown in Schedules  
12 BCA-11 and BCA-16.

13

14 **Operating Income Adjustment No. 6 – Food Service Expense**

15 **Q. Does H2O's proposed test year operating expenses include costs for food items?**

16 A. Yes. H2O included \$3,948 for food service offered for sale to employees.

17

18 **Q. What is Staff recommending?**

19 A. Staff recommends decreasing operating expense by \$3,948 as shown in Schedules BCA  
20 11 and BCA-17.

21

22 **Operating Income Adjustment No. 7 – Depreciation Expense**

23 **Q. What is the Company proposing for Depreciation expense?**

24 A. The Company is proposing \$471,243 for depreciation expense. The Company's  
25 calculation applies component rates to its proposed plant balances by account and offsets  
26 the aggregate of those results by amortization of CIAC using its proposed CIAC balance.

1 **Q. Does Staff calculate Depreciation expense in the same manner as the Company?**

2 A. Yes. Staff also calculates Depreciation expense by applying its recommended component  
3 depreciation rates by account to its recommended plant balances, and in accordance with  
4 the NARUC USOA, offsets the aggregate of those results by the amortization of CIAC  
5 using Staff's recommended CIAC balance. Staff's calculation of depreciation expense is  
6 \$261,182 as shown in Schedule BCA-18. Staff uses the same component rates as the  
7 Company. Staff's depreciation expense is difference from the Company's primarily due  
8 to a difference in the CIAC balance amortized and to a lesser extent the plant balances.

9  
10 **Q. What is Staff recommending?**

11 A. Staff recommends \$261,182 for Depreciation expense, a \$210,061 reduction from the  
12 Company's proposed amount as shown in Schedules BCA-11 and BCA-18.

13  
14 **Operating Income Adjustment No. 8 – Water Testing Expense**

15 **Q. What is the Company proposing for water testing expense?**

16 A. The Company is proposing its recorded test year amount of \$12,289 for water testing  
17 expense.

18  
19 **Q. What is Staff recommending?**

20 A. Staff recommends \$23, 976 for water testing expense, an \$11,687 increase over the  
21 Company's proposed amount. Details of Staff recommended amount are presented in the  
22 testimony of Staff witness Katrin Stukov. Staff's adjustment is shown on Schedules  
23 BCA-11 and BCA-19.

1 **Operating Income Adjustment No. 9 – Property Taxes**

2 **Q. What is H2O proposing for Test Year Property Taxes?**

3 A. H2O is proposing \$197,405 for Test Year property taxes or \$122,411 more than the  
4 \$74,994 recorded in the test year. The Company’s proposed property taxes are calculated  
5 on the modified Arizona Department of Revenue (“ADOR”) methodology typically  
6 adopted by the Commission for water and wastewater utilities. The results from using this  
7 methodology are primarily dependent upon the test year and proposed revenues. Using  
8 the modified ADOR method, the amount for property tax is specific for each revenue  
9 requirement just as each operating income has its own income tax expense. Therefore, the  
10 test year property tax is not equal to the anticipated on-going property tax if the authorized  
11 operating revenue differs from the test year operating revenue. The Company has  
12 calculated test year property taxes based on its proposed revenues instead of the test year  
13 amount. The Company’s method of calculating property taxes does not vary with the  
14 authorized revenue, accordingly, it provides the correct on-going property tax only at its  
15 proposed revenues. Therefore, if the Commission adopts any revenue requirement other  
16 than that proposed by the Company, the Company’s proposed test year property tax would  
17 not correspond with the adopted revenues.

18  
19 **Q. Can the Modified ADOR method for calculating Property Tax expense be used in a  
20 flexible manner that provides an appropriate value for Property Tax expense that  
21 recognizes the dependent relationship between Property Tax expense and revenues?**

22 A. Yes. Including a factor for property taxes in the Gross Revenue Conversion Factor  
23 (“GRCF”) (See Schedule BCA-2) automatically adjusts the revenue requirement for  
24 changes in revenue in the same way that income taxes are adjusted for changes in  
25 operating income. This flexible method will accurately reflect the appropriate level for  
26 Property Tax Expense for any level of authorized revenue. Staff has included a factor for

1 property taxes in its GRCF to allow an appropriate calculation for Property Tax expense  
2 based on test year revenue while also providing full recovery of Property Tax expense at  
3 any authorized revenue.

4  
5 **Q. What did Staff calculate for Test Year Property Tax expense?**

6 A. Staff calculated \$199,385 for test year Property Tax expense as shown in Schedules BCA-  
7 20.<sup>1</sup>

8 **Q. What is Staff recommending?**

9 A. Staff recommends increasing property tax expense by \$1,980 as shown on Schedules  
10 BCA-11 and BCA-20.

11  
12 **Operating Income Adjustment No. 10 – Income Taxes**

13 **Q. What is the Company proposing for test year Income Tax expense?**

14 A. The Company is proposing \$171,332 for Test Year Income Tax Expense as shown on  
15 Schedule BCA-23.

16  
17 **Q. How did Staff calculate test year income tax expense?**

18 A. Staff calculated test year income tax expense by applying the statutory state and federal  
19 income tax rates to Staff's adjusted test year taxable income as shown on Schedule  
20 BCA-2.

21  
22 **Q. What is Staff recommending?**

23 A. Staff recommends a test year income tax expense of \$262,857 as shown on Schedules  
24 BCA-2 and BCA-21.

---

<sup>1</sup> Schedule BCA-20 also shows calculations for Property Tax expense for Staff's recommended revenue.

1 **VIII. RATE DESIGN**

2 **Rate Design Schedules**

3 **Q Did Staff prepare a schedule showing the present, Company proposed, and Staff**  
4 **recommended monthly minimums and commodity rates for each rate class?**

5 A. Yes. Staff's Schedule BCA-22 shows the present monthly minimum charges and  
6 commodity rates, the Company's proposed monthly minimum charges and commodity  
7 rates and Staff's recommended monthly minimum charges and commodity rates.  
8 Schedule BCA-22 also shows the service charges.

9 **Q. Did Staff prepare a schedule showing the average and median monthly bill under**  
10 **present rates, the Company's proposed rates, and Staff's recommended rates?**

11 A. Yes. Staff's Schedule BCA-23 presents the average and median monthly bill using  
12 present rates, the Company's proposed rates and Staff's recommended rates.

13  
14 **Present Rate Design**

15 **Q. Please provide an overview of the Company's present rates.**

16 A. The following is a general description of the present rate design. The present rate design  
17 contains minimum monthly charges only for the following meter sizes: 5/8-inch, \$15.00;  
18 3/4-inch, \$18.00; 1-inch, \$37.00; 1.5-inch, \$75.00 and 2-inch, \$120.00. Customers with  
19 meters of each size receive the first 1,000 gallons of water each month as part of the  
20 minimum monthly charge and pay a commodity rate of \$1.78 per 1,000 gallons for the  
21 next 19,000 gallons and \$2.11 for all gallons over 20,000. As discussed above, the present  
22 rate design is presented in Schedule BCA-22.

1 **The Company's Proposed Water Rate Design**

2 **Q. Please provide an overview of the Company's proposed rate structure.**

3 A. The Company's proposed rate design has a three-tier commodity rate structure for 5/8-  
4 inch and 3/4-inch customer classes with break-over points at 4,000 gallons, and 10,000  
5 gallons. The Company proposes a two-tier rate structure for 1-inch meter sizes and larger  
6 with break-over points for residential, commercial and industrial customers that vary  
7 incrementally by meter size. The Company proposes a one-tier rate structure for 2-inch  
8 and 3-inch meter construction customers. The Company proposes to begin charging a  
9 minimum charge for 3-inch, 4-inch, and 6-inch meters for the first time. As discussed  
10 above, the Company's proposed rate design is shown in Schedule BCA-22.

11 **Q. What is the impact of the Company's proposed rates on the typical 5/8-inch meter  
12 residential customer with median usage of 2,500 gallons?**

13 A. The Company's proposed rates would decrease the typical 5/8-inch meter residential bill  
14 with median usage of 2,500 gallons from \$19.45 to \$14.35 for a decrease of \$5.11 or 26.3  
15 percent as shown in Schedule BCA-23, page 2.

16  
17 **Q. Does the Company propose any changes to its water system service charges?**

18 A. Yes. The Company proposes to replace the 12 percent per annum deferred payment  
19 charge with 1.5 percent per month, and it proposes to introduce a charge for moving a  
20 customer meter and a separate charge for moving a meter after hours which it requests in  
21 the unspecific language "refer to above charges."

22  
23 **Q. Does the Company propose any changes to its meter and service line installation  
24 charges?**

25 A. Yes. The Company proposed meter and service line installation charges based on a now  
26 out of date Staff memorandum suggesting typical meter and service line charges. Staff is

1 recommending meter and service line charges consistent with its current meter and service  
2 line guidance. Staff's recommended amounts are the same or higher than the Company's  
3 proposed amounts as shown in Schedule BCA-22.

4

5 **Staff's Recommended Water Rate Design**

6 **Q. In addition to maintaining non-discriminatory rates that provide Staff's**  
7 **recommended revenue and other issues such as gradualism, revenue stability, and**  
8 **customer affordability, what policy objectives are reflected in Staff's recommended**  
9 **rates?**

10 A. Staff's rate design recognizes the growing importance of managing water as a finite  
11 resource and its increasing cost. The quantity of water resources available to Arizona and  
12 in H2O service territories does not grow with population and customer base, and the cost  
13 of developing, treating, and delivering water increases with diminishing supply and  
14 increased health and safety regulations. Staff recommends a rate design that encourages  
15 efficient use of water.

16

17 **Q. Please provide a description of Staff's recommended rate structure for the water**  
18 **system.**

19 A. Staff recommends a three-tier inverted block rate structure for the 5/8-inch and 3/4-inch  
20 customer classes with break-over points at 3,000 gallons and at 10,000 gallons. Staff  
21 recommends a two-tier inverted block rate structure for the 1-inch meters and larger, and  
22 one-tier rate structure for the 2-inch and 3-inch construction customers. The  
23 recommended break-over points increase with meter size as shown in Schedule BCA-22.  
24 Under the recommended rate design, the monthly bill at any usage level is higher for a  
25 larger meter than for a smaller meter. Staff's recommendation eliminates any free gallons  
26 included in the minimum monthly charge. This will serve to eliminate the implication that

1 any water is free and to send an appropriate economic signal to customers for all  
2 consumption. Staff's rate design also includes recommendations for other meter sizes for  
3 which there are presently no customers. This will serve to provide a rate structure should  
4 the Company offer service through different sized meters in the future.

5  
6 **Q. Please describe the basis for Staff's recommended monthly minimum charges and**  
7 **commodity rates.**

8 A. The monthly minimum charges and commodity rates recommended by Staff in this case  
9 are based on a methodology regularly used by Staff in water rate cases. This rate structure  
10 has been regularly adopted by the Commission. Staff's methodology for determination of  
11 monthly minimum charges is based on the volumetric capacity of each meter size and  
12 increases proportionally to the volumetric capacity of the meter size.

13  
14 Staff's rate design is conservation oriented because the second tier rate for 5/8-inch meter  
15 customers is greater than the rate that would be required to recover the revenue  
16 requirement using a uniform commodity rate. As a result, customers experience a greater  
17 incremental cost for all use exceeding 3,000 gallons for this size meter. The concept for  
18 5/8-inch meters is extended to customers with larger meters where the break-over points  
19 graduate in correlation with meter size. As discussed above, Staff's recommended rate  
20 design is presented in Schedule BCA-22.

21  
22 **Q. What is the impact of Staff's recommended rates on the typical 5/8-inch meter**  
23 **residential customer with median usage of 2,500 gallons?**

24 A. The typical 5/8-inch meter bill with median use of 2,500 gallons would decrease by \$5.47,  
25 or 28.1 percent, from \$19.45 to \$13.98 as shown in Schedule BCA-23, page 3.

1 **Q. What water system service charges does Staff recommend?**

2 A. Staff recommends the amounts shown in Schedule BCA-22. Staff's recommendations are  
3 different from the Company's for the following service charges:

- 4
- 5 1. Charge of moving customer meter after hours – The Company proposes to charge  
6 “referred to above charges” for moving a customer meter after hours. This  
7 language is not sufficiently specific. Staff recommends establishing “cost” as the  
8 charge for moving a customer meter after hours.
- 9
- 10 2. Damaged by customer for:
- 11 a. Company locks
- 12 b. Mains
- 13

14 The Company proposes a charge for customer damage in accordance with A.A.C. R14-2-  
15 407.B. This rule makes the customer responsible for payment for any equipment damaged  
16 from unauthorized breaking of seals, interfering, tampering or bypassing the utility meter.  
17 Staff is not opposed to the tariff, but it is redundant and unnecessary.

18

19 **Q. Will Staff's recommended rate design generate Staff's recommended revenue**  
20 **requirement?**

21 A. Staff's recommended rate design would generate Staff's recommended water revenue  
22 requirement of \$3,218,705, including \$3,011,133 from metered water sales and \$207,572  
23 from other operating revenue.

24

25 **IX. OFF-SITE CAPACITY RESERVATION CHARGE (HOOK-UP FEE)**

26 **Q. Has the Commission authorized an off-site capacity reservation charge for the**  
27 **Company?**

28 A. Yes. Decision No. 63259, dated December 14, 2000, authorize the Company's request for  
29 a hook-up fee. The currently authorized rates for each meter size are shown in Schedule  
30 BCA-22.

1 **Q. Is H2O requesting to change its authorized hook-up fees in this proceeding?**

2 A. No. The Company is requesting to continue charging its currently authorized hook-up  
3 fees.

4

5 **Q. Is Staff recommending any change from the currently authorized hook-up fees at  
6 this time?**

7 A. No, however, Staff reserves the right to modify its position in supplemental or surrebuttal  
8 testimony.

9

10 **X. CAP SURCHARGE**

11 **Q. Does the Company propose a Central Arizona Project ("CAP") surcharge for its  
12 CAP water?**

13 A. Yes. The Company proposes the following:

14

15 "The CAP surcharge is in addition to all other commodity charges and will be  
16 adjusted annually to recover the acquisition and purchased water costs of the  
17 company associated with the right to receive 147 acre feet of Central Arizona  
18 Project Water each year for delivery to customers. The surcharge will include a  
19 10 year amortization of the acquisition cost plus the projected annual fixed costs  
20 of the contract and the delivery costs. Surcharge will be computed annually  
21 based on gallons sold and trued-up at the end of each year with any over and  
22 under recovery of actual costs during the year included in the next years  
23 surcharge computation."

24

25 **Q. What is Staff's recommendation regarding the CAP surcharge proposed by the  
26 Company?**

27 A. Staff recommends denial of the CAP surcharge pending its receipt and analysis of  
28 responses to data requests.

1 **XI. COMPLIANCE WITH DECISION NO. 69413**

2 **Q. Has the Company made refunds in compliance with the requirements of Decision No.**  
3 **69413?**

4 A. Decision No. 69413 required H2O to refund to ratepayers the revenues it collected on 3-  
5 inch meter customers for which it had no authorized tariff. Decision No. 69413 does not  
6 specify the method for calculating the refundable amount. The Company refunded to  
7 customers the amount it collected for the monthly minimum charge in excess of the  
8 authorized monthly minimum charge for a 2-inch meter. Thus, collections equal to the 2-  
9 inch monthly minimum charge were not refunded, and no collections of commodity  
10 charges were refunded. Staff presents this factual information revealed in the processing  
11 of this case. It is for the Commission to interpret whether the Company's refunding  
12 method complied with its order.

13

14 **Q. Does this conclude your direct testimony?**

15 A. Yes, it does.

H2O, Inc.  
Docket No. W-02234A-07-0557  
Test Year December 31, 2006

DIRECT TESTIMONY OF BRENDAN C. ALADI

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REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) COMPANY FAIR VALUE	(C) STAFF ORIGINAL COST	(D) STAFF FAIR VALUE
1	Adjusted Rate Base - Fair Value equals Original Cost	\$ 1,944,185	\$ 1,944,185	\$ (500,901)	\$ (500,901)
2	Adjusted Operating Income (Loss)	\$ 296,354	\$ 296,354	\$ 418,139	\$ 418,139
3	Current Rate of Return (L2 / L1)	15.24%	15.24%	NMF	NMF
4	Required Rate of Return	10.28%	10.28%	NMF	NMF
5	Required Operating Income: Col. A & B (L1 * L4); Col. C & D 10% Operating Margin	\$ 199,823	\$ 199,823	\$ 321,871	\$ 321,871
6	Operating Income Deficiency/(Excess) (L5 - L2)	\$ (96,531)	\$ (96,531)	\$ (96,269)	\$ (96,269)
7	Gross Revenue Conversion Factor	1.6043	1.6043	1.6614	1.6614
8	Required Revenue Increase/(Decrease) (L7 * L6)	\$ (154,861)	\$ (154,861)	<b>\$ (159,937)</b>	<b>\$ (159,937)</b>
9	Adjusted Test Year Revenue	\$ 3,379,767	\$ 3,379,767	\$ 3,378,642	\$ 3,378,642
10	Proposed Annual Revenue (L8 + L9)	\$ 3,224,906	\$ 3,224,906	\$ 3,218,705	\$ 3,218,705
11	Required Increase/(Decrease) in Revenue (%)	-4.58%	-4.58%	-4.73%	-4.73%
12	Rate of Return on Equity (%)	10.75%	10.75%	NMF	NMF

References:

Columns [A] and [B]: Company Schedules A-1, A-2, & D-1  
Columns [C] and [D]: STAFF Schedules BCA-2, BCA-3 and BCA-11

NMF - Not Meaningful

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)	(E)	(F)
<i>Calculation of Gross Revenue Conversion Factor:</i>							
1	Revenue	100.0000%					
2	Uncollectible Factor (Line 11)	0.0000%					
3	Revenues (L1 - L2)	100.0000%					
4	Combined Federal and State Income Tax and Property Tax Rate (Line 23)	39.8084%					
5	Subtotal (L3 - L4)	60.1916%					
6	Revenue Conversion Factor (L1 / L5)	1.661361					
<i>Calculation of Uncollectible Factor:</i>							
7	Unity	100.0000%					
8	Combined Federal and State Tax Rate (Line 23)	38.5989%					
9	One Minus Combined Income Tax Rate (L7 - L8)	61.4011%					
10	Uncollectible Rate	0.0000%					
11	Uncollectible Factor (L9 * L10)	0.0000%					
<i>Calculation of Effective Tax Rate:</i>							
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%					
13	Arizona State Income Tax Rate	6.9680%					
14	Federal Taxable Income (L12 - L13)	93.0320%					
15	Applicable Federal Income Tax Rate (Line 55)	34.0000%					
16	Effective Federal Income Tax Rate (L14 x L15)	31.6309%					
17	Combined Federal and State Income Tax Rate (L13 +L16)		38.5989%				
<i>Calculation of Effective Property Tax Factor</i>							
18	Unity	100.0000%					
19	Combined Federal and State Income Tax Rate (L17)	38.5989%					
20	One Minus Combined Income Tax Rate (L18-L19)	61.4011%					
21	Property Tax Factor (BCA-16, L21)	1.9698%					
22	Effective Property Tax Factor (L20*L21)		1.2095%				
23	Combined Federal and State Income Tax and Property Tax Rate (L17+L22)			39.8084%			
24	Required Operating Income (Schedule BCA-1, Line 5)	\$	321,871				
25	Adjusted Test Year Operating Income (Loss) (Schedule BCA-11, Line 28)		418,139				
26	Required Increase in Operating Income (L24 - L25)			\$	(96,269)		
27	Income Taxes on Recommended Revenue (Col. [E], L52)	\$	202,339				
28	Income Taxes on Test Year Revenue (Col. [B], L52)		262,857				
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)				(60,518)		
30	Recommended Revenue Requirement (Schedule BCA-1, Line 10)	\$	3,218,705				
31	Uncollectible Rate (Line 10)		0.0000%				
32	Uncollectible Expense on Recommended Revenue (L30*L31)	\$	-				
33	Adjusted Test Year Uncollectible Expense	\$	-				
34	Required Increase in Revenue to Provide for Uncollectible Exp. (L32-L33)						
35	Property Tax with Recommended Revenue (BCA-20, Col B, L16)	\$	196,234				
36	Property Tax on Test Year Revenue (BCA-16, Col A, L16)		199,385				
37	Increase in Property Tax Due to Increase in Revenue (L35-L36)				(3,150)		
38	Total Required Increase in Revenue (L26 + L29 + L34 + L37)				\$	(159,937)	

*Calculation of Income Tax:*

39	Revenue (Schedule BCA-10, Col. [C], Line 4 & Sch. BCA-1, Col. [D] Line 10)	\$	-	\$	3,378,642	\$	-	\$	-
40	Operating Expenses Excluding Income Taxes	\$	-	\$	2,697,646	\$	-	\$	-
41	Synchronized Interest (L56)	\$	-	\$	-	\$	-	\$	-
42	Arizona Taxable Income (L39 - L40 - L41)	\$	-	\$	680,996	\$	-	\$	-
43	Arizona State Income Tax Rate		6.9680%		6.9680%		6.9680%		6.9680%
44	Arizona Income Tax (L42 x L43)	\$	-	\$	47,452	\$	-	\$	-
45	Federal Taxable Income (L42 - L44)	\$	-	\$	633,545	\$	-	\$	-
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$	-	\$	7,500	\$	-	\$	-
47	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$	-	\$	6,250	\$	-	\$	-
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$	-	\$	8,500	\$	-	\$	-
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$	-	\$	91,650	\$	-	\$	-
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$	-	\$	101,505	\$	-	\$	-
51	Total Federal Income Tax	\$	-	\$	215,405	\$	-	\$	-
52	Combined Federal and State Income Tax (L44 + L51)	\$	-	\$	262,857	\$	-	\$	-

Test Year			
\$	-	\$	3,378,642
\$	-	\$	2,697,646
\$	-	\$	-
\$	-	\$	680,996
	6.9680%		6.9680%
\$	-	\$	47,452
\$	-	\$	633,545
\$	-	\$	7,500
\$	-	\$	6,250
\$	-	\$	8,500
\$	-	\$	91,650
\$	-	\$	101,505
\$	-	\$	215,405
\$	-	\$	262,857

Staff Recommended			
\$	-	\$	3,218,705
\$	-	\$	2,694,495
\$	-	\$	-
\$	-	\$	524,210
	6.9680%		6.9680%
\$	-	\$	36,527
\$	-	\$	487,683
\$	-	\$	7,500
\$	-	\$	6,250
\$	-	\$	8,500
\$	-	\$	91,650
\$	-	\$	51,912
\$	-	\$	165,812
\$	-	\$	202,339

53 Applicable Federal Income Tax Rate [Col. [E], L51 - Col. [B], L51] / [Col. [E], L45 - Col. [B], L45]  
55  
56

34.0000%

*Calculation of Interest Synchronization: Not Applicable In This Docket*  
57 Rate Base (Schedule BCA-3, Col. (C), Line 17  
58 Weighted Average Cost of Debt (Schedule DRR-17, Col. [F], L1 + L2)  
59 Synchronized Interest (L45 X L46)

Water  
\$ (500,901)  
0.0000%  
NMF

**RATE BASE - ORIGINAL COST**

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS	(C) STAFF AS ADJUSTED
1	\$ 12,987,344	\$ 9,070	\$ 12,996,414
2	1,491,666	6,283	1,497,949
3	<u>\$ 11,495,678</u>	<u>\$ 2,787</u>	<u>\$ 11,498,465</u>
<b>LESS:</b>			
4	\$ 6,449,776	\$ 2,859,339	\$ 9,309,115
5	683,565	-	683,565
6	<u>5,766,211</u>	<u>2,859,339</u>	<u>8,625,550</u>
7	3,031,454	34,405	3,065,859
8	1,600,755	-	1,600,755
9	-	-	-
<b>ADD:</b>			
10	-	-	-
11	846,927	445,872	1,292,799
12	-	-	-
13	-	-	-
17	<u>\$ 1,944,185</u>	<u>\$ (2,445,085)</u>	<u>\$ (500,901)</u>

References:

Column [A], Company Schedule B-1  
Column [B]: Column [C] - Column [A]  
Column [C]: Schedule BCA-4 Column [H].

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	[A] COMPANY AS FILED Revised Schedule B-2	[B] ADJ #1	[C] ADJ #2	[D] ADJ #3	[E] ADJ #4	[F] ADJ #5	[G] ADJ #6	[H] ADJ #7	[H] STAFF ADJUSTED
<b>PLANT IN SERVICE:</b>											
1		Intangible Plant									
2	301.00	Organization	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
3	302.00	Franchises	131,452	-	-	-	-	-	-	-	131,452
4	303.00	Land & Land Rights	7,954	-	-	-	-	-	-	-	7,954
5		Subtotal Intangible	139,406	-	-	-	-	-	-	-	139,406
6											
7		Source of Supply									
8	304.00	Structures & Improvements	\$ 538,179	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 538,179
9	305.00	Collecting and Impounding Res.	-	-	-	-	-	-	-	-	-
10	306.00	Lake River and Other Intakes	-	-	-	-	-	-	-	-	-
11	307.00	Wells and Springs	255,856	-	-	-	-	-	-	-	255,856
12	308.00	Infiltration Galleries and Tunnels	-	-	-	-	-	-	-	-	-
13	309.00	Supply Mains	-	-	-	-	-	-	-	-	-
14	310.00	Power Generating Equipment	-	-	-	-	-	-	-	-	-
15	311.00	Electric Pumping Equipment	4,437,582	-	-	-	-	-	-	-	4,437,582
16	312.00	Collecting & Impounding Reservoirs	-	-	-	-	-	-	-	-	-
17	313.00	Lakes, Rivers, Other Intakes	-	-	-	-	-	-	-	-	-
18		Subtotal Source of Supply	\$ 5,231,617	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,231,617
19											
20		Water Treatment									
21	320.00	Water Treatment Equipment	\$ 51,404	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 51,404
22	321.00	Structures & Improvements	-	-	-	-	-	-	-	-	-
23	323.00	Other Power Production	-	-	-	-	-	-	-	-	-
24	325.00	Electric Pumping Equipment	-	-	-	-	-	-	-	-	-
25	325.00	Diesel Pumping Equipment	-	-	-	-	-	-	-	-	-
26	328.10	Gas Engine Pumping Equipment	-	-	-	-	-	-	-	-	-
27		Subtotal Water Treatment	51,404	-	-	-	-	-	-	-	51,404
28											
29		Transmission & Distribution									
30	330.00	Distribution Reservoirs & Standpipe	\$ 2,706,417	\$ 6,646	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,713,063
31	331.00	Transmission and Distribution Mains	1,647,121	-	2,424	-	-	-	-	-	1,649,545
32	332.00	Services	207,500	-	-	-	-	-	-	-	207,500
33	334.00	Meters	2,290,426	-	-	-	-	-	-	-	2,290,426
34	335.00	Hydrants	45,343	-	-	-	-	-	-	-	45,343
35	336.00	Backflow Prevention Devices	-	-	-	-	-	-	-	-	-
36	339.00	Other Plant and Miscellaneous Equipment	-	-	-	-	-	-	-	-	-
37		Subtotal Transmission & Distribution	6,896,807	6,646	2,424	-	-	-	-	-	6,905,877
38											
39		General Plant									
40	340.00	Office Furniture and Equipment	\$ 90,771	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 90,771
41	340.10	Computer and Software	-	-	-	-	-	-	-	-	-
42	341.00	Transportation Equipment	121,240	-	-	-	-	-	-	-	121,240
43	342.00	Stores Equipment	-	-	-	-	-	-	-	-	-
44	343.00	Tools and Work Equipment	52,816	-	-	-	-	-	-	-	52,816
45	344.00	Laboratory Equipment	-	-	-	-	-	-	-	-	-
46	345.00	Power Operated Equipment	29,569	-	-	-	-	-	-	-	29,569
47	346.00	Communications Equipment	224,500	-	-	-	-	-	-	-	224,500
48	347.00	Miscellaneous Equipment	-	-	-	-	-	-	-	-	-
49	349.00	Other Tangible Plant	149,414	-	-	-	-	-	-	-	149,414
50		Plant Held for Future Use	-	-	-	-	-	-	-	-	-
51		Subtotal General Plant	668,110	-	-	-	-	-	-	-	668,110
52											
53		Total	12,987,344	6,646	2,424	-	-	-	-	-	12,996,414
54	Add:										
55											
56											
57	Less:										
58											
59											
60		Total Plant in Service	\$ 12,987,344	\$ 6,646	\$ 2,424	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 12,996,414
61		Less: Accumulated Depreciation	1,491,666	-	-	6,283	-	-	-	-	1,497,949
62		Net Plant in Service (L59 - L 60)	\$ 11,495,678	\$ 6,646	\$ 2,424	\$ (6,283)	\$ -	\$ -	\$ -	\$ -	\$ 11,498,465
63											
64		LESS:									
65		Contributions in Aid of Construction (CIAC)	\$ 6,448,776	\$ -	\$ -	\$ -	\$ 2,859,339	\$ -	\$ -	\$ -	\$ 9,308,115
66		Less: Accumulated Amortization	683,565	-	-	-	-	-	-	-	683,565
67		Net CIAC (L25 - L26)	\$ 5,766,211	\$ -	\$ -	\$ -	\$ 2,859,339	\$ -	\$ -	\$ -	\$ 8,625,550
68		Advances in Aid of Construction (AIAC)	3,031,454	-	-	-	-	34,405	-	-	3,065,859
71		Customer Deposits	1,600,755	-	-	-	-	-	-	-	1,600,755
72		Deferred Income Tax Credits	-	-	-	-	-	-	-	-	-
75		ADD:									
76		Unamortized Finance Charges	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
77		Deferred Income Tax Debits	846,927	-	-	-	-	-	445,872	-	1,292,799
78		Working Capital	-	-	-	-	-	-	-	-	-
79		Intentionally Left Blank	-	-	-	-	-	-	-	-	-
80		Original Cost Rate Base	\$ 1,944,185	\$ 6,646	\$ 2,424	\$ (6,283)	\$ (2,859,339)	\$ (34,405)	\$ 445,872	\$ -	\$ (500,901)

ADJ #	References:
1	Schedule BCA-5
2	Schedule BCA-6
3	Schedule BCA-7
4	Schedule BCA-8
5	Schedule BCA-9
6	Schedule BCA-9.1

**RATE BASE ADJUSTMENT #1 - RECLASSIFICATION OF MISCELLANEOUS EXPENSE TO PLANT**

LINE NO.	Acct. No.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	330	Distribution Reservoirs and Standpipes	\$ 2,706,417	\$ 6,646	\$ 2,713,063

References:

Col [A]: Company Schedule C-1

Col [B]: Col [C] - Col [A]

Col [C]: BCA Testimony

**RATE BASE ADJUSTMENT #2 - RECLASSIFICATION OF REPAIRS AND MAINTENANCE EXPENSE TO PLANT**

<u>LINE</u> <u>NO.</u>	<u>Acct.</u> <u>No.</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>PROPOSED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1	331	Transmission and Distribution Mains	<u>\$ 1,647,121</u>	<u>\$ 2,424</u>	<u>\$ 1,649,545</u>

References:

- Col [A]: Company Schedule C-1
- Col [B]: Col [C] - Col [A]
- Col [C]: BCA Testimony

**RATE BASE ADJUSTMENT #3 - ACCUMULATED DEPRECIATION**

<u>Line No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Accumulated Depreciation	<u>\$ 1,491,666</u>	<u>\$ 6,283</u>	<u>\$ 1,497,949</u>

References:

- Col [A]: Company Schedule C-1
- Col [B]: Col [C] - Col [A]
- Col [C]: BCA Testimony

**RATE BASE ADJUSTMENT #4 - CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION**

<u>Line No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Beginning Balance Contribution in aid of Construction	<u>\$ 6,449,776</u>	<u>\$ 2,859,339</u>	<u>\$ 9,309,115</u>
	<u>CIAC Adjustment Schedules</u>			
	Add:			
	CIAC - Cash in various bank accounts		\$ 2,360,596	
	Expended CIAC included in CWIP		498,743	
			<u>\$ 2,859,339</u>	

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
[C] = BCA Testimony

**RATE BASE ADJUSTMENT #5 - ADVANCES-IN-AID-OF-CONSTRUCTION**

<u>LINE</u> <u>NO.</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>AS</u> <u>FILED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1	Advance in Aid of Construction	\$ 3,031,454	\$ 34,405	\$ 3,065,859

References

- [A]: Assets per the Company's rate application
- [B]: Col [C] - Col [A] Assets that were validated during audit.
- [C]: BCA Testimony

**RATE BASE ADJUSTMENT #6 - DEFERRED INCOME TAXES**

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
	Accumulated Deferred Income tax	\$ 846,927	\$ 445,872	\$ 1,292,799
1	AIAC End of Year (Tax Basis)		\$ 4,666,614	
2	AIAC End of Year (Accounting Basis)		-	
3	Timing Difference		4,666,614	
4	Tax rate		34.90%	
5	Accumulated Defered Income Tax Debit			\$1,628,648
6	Accounting basis at end of year (Note 1)		\$ 2,872,915	
7	Tax basis of capital assets at end of year (Note 1)		3,835,234	
8	Timing Difference		\$ 962,319	
9	Tax rate		34.90%	
10	Accumulated Defered Income Tax Credit			\$ 335,849
11	Net Deferred Income Tax (L5 - L10)			\$1,292,799

Note 1 - Calculation of Plant Book and Tax Basis

	<u>Tax</u>	<u>Book</u>
Plant in Service (from BCA-3)		\$ 12,996,414
CIAC (from BCA-3)		(9,309,115)
Amort. on CIAC (From BCA-3)		683,565
Asset Cost	\$ 4,933,687	\$ 4,370,864
Accum. Depr. (from BCA-3)	(1,098,453)	(1,497,949)
Net Book Value	\$ 3,835,234	\$ 2,872,915

References

- [A]: Accumulated DIT per the Company's rate application
- [B]: Col [C] - Col [A]
- [C]: BCA Testimony

**OPERATING INCOME STATEMENT - TEST YEAR AND STAFF RECOMMENDED**

LINE NO.	DESCRIPTION	[A] COMPANY TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
<b>REVENUES:</b>						
1	Metered Water Sales	\$ 3,171,070	\$ -	\$ 3,171,070	\$ (159,937)	\$ 3,011,133
2	Water Sales - Unmetered	-	-	-	-	-
3	Other Operating Revenue	208,697	(1,125)	207,572	-	207,572
4	<b>Total Operating Revenues</b>	<b>\$ 3,379,767</b>	<b>\$ (1,125)</b>	<b>\$ 3,378,642</b>	<b>\$ (159,937)</b>	<b>\$ 3,218,705</b>
<b>OPERATING EXPENSES:</b>						
7	Salaries and Wages	\$ 790,693	-	\$ 790,693	\$ -	\$ 790,693
8	Purchased Water	77,793	-	77,793	-	77,793
9	Purchased Power	253,894	7,455	261,349	-	261,349
10	Chemicals	4,229	-	4,229	-	4,229
11	Repairs and Maintenance	169,792	(2,424)	167,368	-	167,368
12	Office Supplies and Expense	75,119	(3,948)	71,171	-	71,171
13	Outside Services	66,331	-	66,331	-	66,331
14	Water Testing	12,289	11,687	23,976	-	23,976
15	Rents	175,063	-	175,063	-	175,063
16	Transportation Expenses	214,459	-	214,459	-	214,459
17	Insurance - General Liability	52,245	-	52,245	-	52,245
18	Insurance - Health and Life	61,213	-	61,213	-	61,213
19	Reg. Comm. Exp.- Rate Case	40,000	-	40,000	-	40,000
20	Miscellaneous Expenses	187,311	(19,124)	168,187	-	168,187
21	Depreciation Expense	471,243	(210,061)	261,182	-	261,182
22	Taxes Other than Income	63,002	-	63,002	-	63,002
23	Property Taxes	197,405	1,980	199,385	(3,150)	196,234
24	Income Taxes	171,332	91,525	262,857	(60,518)	202,339
25	Intentionally Left blank(Rounding)	-	-	-	-	-
27	<b>Total Operating Expenses</b>	<b>3,083,413</b>	<b>(122,910)</b>	<b>2,960,503</b>	<b>(63,668)</b>	<b>2,896,834</b>
28	<b>Operating Income (Loss)</b>	<b>\$ 296,354</b>	<b>\$ 121,785</b>	<b>\$ 418,139</b>	<b>\$ (96,269)</b>	<b>\$ 321,871</b>

**References:**

- Column (A): Company Schedule C-1
- Column (B): Schedule BCA-11
- Column (C): Column (A) + Column (B)
- Column (D): Schedules BCA-1 and BCA-2
- Column (E): Column (C) + Column (D)

H2O, Inc.  
Docket No. W-02234A-07-0557  
Test Year December 31, 2006

SUMMARY OF OPERATING INCOME ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) ADJ.#1	(C) ADJ.#2	(D) ADJ.#3	(E) ADJ.#4	(F) ADJ.#5	(G) ADJ.#6	(H) ADJ.#7	(I) ADJ.#8	(J) ADJ.#9	(K) ADJ.#10	(L) ADJ.#11	(M) STAFF ADJUSTED
1	REVENUES:													
2	Metered Water Sales	\$ 3,171,070	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,171,070
3	Water Sales - Unmetered	208,697	(1,125)	-	-	-	-	-	-	-	-	-	-	207,572
4	Other Operating Revenue													
5	Total Operating Revenues	\$ 3,379,767	\$ (1,125)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,378,642
6	OPERATING EXPENSES:													
7	Salaries and Wages	\$ 790,693	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 790,693
8	Purchased Water	77,793	-	-	-	7,455	-	-	-	-	-	-	-	77,793
9	Purchased Power	253,894	-	-	-	-	-	-	-	-	-	-	-	261,349
10	Chemicals	4,229	-	-	(2,424)	-	-	-	-	-	-	-	-	4,229
11	Repairs and Maintenance	169,792	-	-	-	-	-	(3,948)	-	-	-	-	-	167,368
12	Office Supplies and Expense	75,119	-	-	-	-	-	-	-	-	-	-	-	66,331
13	Outside Services	66,331	-	-	-	-	-	-	-	-	-	-	-	23,976
14	Water Testing	12,289	-	-	-	-	-	-	-	11,687	-	-	-	175,063
15	Rents	175,063	-	-	-	-	-	-	-	-	-	-	-	214,459
16	Transportation Expenses	214,459	-	-	-	-	-	-	-	-	-	-	-	52,245
17	Insurance - General Liability	52,245	-	-	-	-	-	-	-	-	-	-	-	61,213
18	Insurance - Health and Life	61,213	-	-	-	-	-	-	-	-	-	-	-	40,000
19	Reg. Comm. Exp.- Rate Case	40,000	-	-	-	-	-	-	-	-	-	-	-	168,187
20	Miscellaneous Expenses	187,311	-	(6,646)	-	-	(5,023)	-	-	-	-	-	-	261,182
21	Depreciation Expense	471,243	-	-	-	(7,455)	-	-	(210,061)	-	-	-	-	63,002
22	Taxes Other than Income	63,002	-	-	-	-	-	-	-	-	-	-	-	189,385
23	Property Taxes	197,405	-	-	-	-	-	-	-	-	1,980	-	-	262,857
24	Income Taxes	171,352	-	-	-	-	-	-	-	-	-	91,525	-	-
25	Intentionally Left blank(Rounding)													
26	Total Operating Expenses	\$ 3,083,413	\$ -	\$ (6,646)	\$ (2,424)	\$ -	\$ (5,023)	\$ (3,948)	\$ (210,061)	\$ 11,687	\$ 1,980	\$ 91,525	\$ -	\$ 2,960,503
27	Operating Income (Loss)	\$ 296,354	\$ (1,125)	\$ 6,646	\$ 2,424	\$ -	\$ 5,023	\$ 3,948	\$ 210,061	\$ (11,687)	\$ (1,980)	\$ (91,525)	\$ -	\$ 418,139

ADJ.#	References
1	Schedule BCA-12
2	Schedule BCA-13
3	Schedule BCA-14
4	Schedule BCA-15
5	Schedule BCA-16
6	Schedule BCA-17
7	Schedule BCA-18
8	Schedule BCA-19
9	Schedule BCA-20
10	Schedule BCA-21

**OPERATING INCOME ADJUSTMENT #1 - REMOVAL OF SALES TAX FROM OTHER WATER REVENUES**

<u>LINE NO.</u>	<u>Acct. No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Other Water Revenue	<u>\$ 208,697</u>	<u>\$ (1,125)</u>	<u>\$ 207,572</u>

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: BCA Testimony

Remove sales tax from other water revenues to treat it as a pass-through item.

**OPERATING INCOME ADJUSTMENT #2 - RECLASSIFICATION OF MISC. EXPENSES TO PLANT ACCOUNT**

LINE NO.	Acct. No.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	675	Miscellaneous Expense	<u>\$ 174,833</u>	<u>\$ (6,646)</u>	<u>\$ 168,187</u>

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: Testimony BCA

Reclassify \$6,646 from miscellaneous expenses to  
Distribution Reservoirs and Standpipes

OPERATING INCOME ADJUSTMENT #3 - RECLASSIFICATION OF REPAIRS AND MAINTENANCE EXPENSE TO PLANT ACCOUNT

<u>Line No.</u>	<u>Acct. #</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>	
1	620	Repairs and Maintenance Expense	\$ 169,792	\$ (2,424)	\$ 167,368	\$ (2,424)

References:  
Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: BCA Testimony

**OPERATING INCOME ADJUSTMENT #4 - RECLASSIFICATION OF MISC. EXPENSE TO PURCHASED POWER EXPENSE**

<u>LINE NO.</u>	<u>Acct. No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Miscellaneous Expense	\$ 187,311	\$ (7,455)	\$ 179,856
2		Purchased Power	\$ 253,894	7,455	\$ 261,349
3		Total	<u>\$ 441,205</u>	<u>\$ -</u>	<u>441,205</u>

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: BCA Testimony

The Company erroneously posted purchased power expense to miscellaneous expense.

**OPERATING INCOME ADJUSTMENT #5 - REMOVAL OF LATE TAX FILING PENALTY FROM MISC. EXPENSE**

<u>LINE NO.</u>	<u>Acct. No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1		Miscellaneous Expense	<u>\$ 179,856</u>	<u>\$ (5,023)</u>	<u>\$ 174,833</u>

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: BCA Testimony

Remove late tax filing penalty from miscellaneous expense.

**OPERATING INCOME ADJUSTMENT #6 - REMOVAL OF UNNECESSARY EXPENSE**

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Office Supplies Expense	<u>\$ 75,119</u>	<u>\$ (3,948)</u>	<u>\$ 71,171</u>

References:

Col [A]: Company Schedule C-1

Col [B]: Col [C] - Col [A]

Col [C]: BCA Testimony

**OPERATING INCOME ADJUSTMENT #7 - DEPRECIATION EXPENSE**

Line No.	ACCT NO.	DESCRIPTION	[A] AMOUNT	[B] PROJECTED RATE	[C] DEPRECIATION EXPENSE
<b>Plant In Service</b>					
1	301	Organization	\$ -	0.00%	\$ -
2	302	Franchises	131,452	0.00%	\$ -
3	303	Land and Land Rights	7,954	0.00%	\$ -
4	304	Structures & Improvements	538,179	3.33%	\$ 17,921
5	305	Collecting & Impounding Reservoirs	-	2.50%	\$ -
6	306	Lakes, Rivers, Other Intakes	-	2.50%	\$ -
7	307	Wells and Springs	255,856	3.33%	\$ 8,520
8	308	Infiltration Galleries and Tunnels	-	6.67%	\$ -
9	309	Supply Mains	-	2.00%	\$ -
10	310	Power Generation Equipment	-	5.00%	\$ -
11	311	Electric Pumping Equipment	4,437,582	12.50%	\$ 554,698
12	320	Water Treatment Equipment	51,404	3.33%	\$ 1,712
13	330	Distribution Reservoirs & Standpipes	2,713,063	2.22%	\$ 60,230
14	331	Transmission & Distribution Mains	1,649,545	2.00%	\$ 32,991
15	333	Services	207,500	3.33%	\$ 6,910
16	334	Meters & Meter Installation	2,290,426	8.33%	\$ 190,792
17	335	Hydrants	45,343	2.00%	\$ 907
18	336	Backflow Prevention Devices	-	6.67%	\$ -
19	339	Other Plant & Misc. Equipment	-	6.67%	\$ -
20	340	Office Furniture & Equipment	90,771	6.67%	\$ 6,054
21	341	Transportation Equipment	121,240	20.00%	\$ 24,248
22	342	Stores Equipment	-	4.00%	\$ -
23	343	Tools, Ship & Garage Equipment	52,616	5.00%	\$ 2,631
24	344	Laboratory Equipment	-	10.00%	\$ -
25	345	Power Operated Equipment	29,569	5.00%	\$ 1,478
26	346	Communication Equipment	224,500	10.00%	\$ 22,450
27	347	Miscellaneous Equipment	-	10.00%	\$ -
28	348	Other Tangible Plant	149,414	10.00%	\$ 14,941
29					
30		Subtotal General	\$ 12,996,414		\$ 946,484
31		Less: Non- depreciable Account(s) (L2 + L3)	139,406		
32		Depreciable Plant (L29-L30)	\$ 12,857,008		
33					
34		Contributions-in-Aid-of-Construction (CIAC)	\$ 9,309,115		
35		Composite Depreciation/Amortization Rate	7.36%		
36		Less: Amortization of CIAC (L34 x L35)			\$ 685,302
37		<b>Depreciation Expense - STAFF [Col. (C), L30 - L36]</b>			<b>\$ 261,182</b>

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
38	Depreciation Expense	\$ 471,243	\$ (210,061)	\$ 261,182

**OPERATING INCOME ADJUSTMENT #8 - WATER TESTING**

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Water Testing Expense	<u>\$ 12,289</u>	<u>\$ 11,687</u>	<u>\$ 23,976</u>

References:

Col [A]: Company Schedule C-1

Col [B]: Col [C] - Col [A]

Col [C]: BCA Testimony

**OPERATING INCOME ADJUSTMENT #9 - PROPERTY TAX EXPENSE**

LINE NO.	DESCRIPTION	[A]	[B]
		STAFF AS ADJUSTED	STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2006	\$ 3,378,642	\$ 3,378,642
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	\$ 6,757,284	\$ 6,757,284
4	Staff Recommended Revenue	3,378,642	\$ 3,218,705
5	Subtotal (Line 4 + Line 5)	\$ 10,135,926	\$ 9,975,989
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	\$ 3,378,642	\$ 3,325,330
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	\$ 6,757,284	\$ 6,650,659
10	Plus: 10% of CWIP	-	-
11	Less: Net Book Value of Licensed Vehicles	9,321	9,321
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$ 6,747,963	\$ 6,641,338
13	Assessment Ratio	23.00%	23.00%
14	Assessment Value (Line 12 * Line 13)	\$ 1,552,031	\$ 1,527,508
15	Composite Property Tax Rate - Obtained from ADOR	12.8467%	12.8467%
16	Staff Test Year Adjusted Property Tax Expense (Line 14 * Line 15)	\$ 199,385	
17	Company Proposed Property Tax	197,405	
18	Staff Test Year Adjustment (Line 16 - Line 17)	\$ 1,980	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)		\$ 196,234
20	Staff Test Year Adjusted Property Tax Expense (Line 16)		\$ 199,385
21	Increase (Decrease) in Property Tax Due to Increase in Revenue Requirement		\$ (3,150)
22	Increase (Decrease) in Property Tax Due to Increase in Revenue Requirement (Line 21)		\$ (3,150)
23	Increase (Decrease) in Revenue Requirement		\$ (159,937)
24	Increase in Property Tax Per Dollar Increase in Revenue (Line 22 / Line 23)		1.96983%

**REFERENCES:**

- Line 15: Composite Tax Rate obtained from Arizona Department of Revenue
- Line 17: Company Schedule C-1 Page 2
- Line 21: Line 19 - Line 20
- Line 23: Schedule BCA-1

**OPERATING INCOME ADJUSTMENT #10- INCOME TAXES**

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Income Tax Expense	<u>\$ 171,332</u>	<u>\$ 91,525</u>	<u>\$ 262,857</u>

References:

Col [A]: Company Schedule C-1  
Col [B]: Col [C] - Col [A]  
Col [C]: Schedule BCA-2, Line 52

H2O, Inc.  
Docket No. W-02234A-07-0557  
Test Year December 31, 2006

RATE DESIGN

Monthly Usage Charge  
Residential, Commercial  
Irrigation and Construction  
Gallons in the minimum  
5/8" x 3/4" Meter  
3/4" Meter  
1" Meter  
1.5" Meter  
2" Meter  
3" Meter  
4" Meter  
6" Meter  
Irrigation 3/4"  
Irrigation 1"  
Irrigation 1.5"  
Irrigation 2"  
Construction 2"  
Construction 3"

Present Rates	Company Proposed	Staff Recommended
1,000	-	-
\$ 15.00	\$ 11.70	\$ 10.40
18.00	17.55	15.60
37.00	29.25	25.90
75.00	58.50	51.90
120.00	93.60	83.00
N/T	187.20	166.10
N/T	292.50	259.50
N/T	585.00	519.00
18.00	17.55	15.60
37.00	29.25	25.90
75.00	58.50	51.90
120.00	93.60	83.00
120.00	93.60	-
N/T	187.20	-

Commodity Charges  
No Gallons included in any Minimum

Excess of Minimum - per 1,000 Gallons  
5/8" x 3/4" Meter  
3/4" Meter  
1" Meter  
1.5" Meter  
2" Meter  
3" Meter  
4" Meter  
6" Meter  
Irrigation 3/4"  
Irrigation 1"  
Irrigation 1.5"  
Irrigation 2"  
Construction 2"  
Construction 3"

Present	Company Proposed			Staff Recommended		
	1st Tier	2nd Tier	3rd Tier	1st Tier	2nd Tier	3rd Tier
\$ 1.78	\$ 2.11	\$ 1.20	\$ 1.60	\$ 1.43	\$ 2.15	\$ 2.58
20,000	Infinite	4,000	10,000	Infinite	3,000	10,000
20,000	Infinite	4,000	10,000	Infinite	3,000	10,000
20,000	Infinite		25,000	Infinite		25,000
20,000	Infinite		50,000	Infinite		50,000
20,000	Infinite		80,000	Infinite		80,000
N/T	N/T		160,000	Infinite		160,000
N/T	N/T		290,000	Infinite		250,000
N/T	N/T		500,000	Infinite		500,000
20,000	Infinite	\$ 4,000	10,000	Infinite	3,000	10,000
20,000	Infinite		25,000	Infinite		25,000
20,000	Infinite		50,000	Infinite		50,000
20,000	Infinite		80,000	Infinite		80,000
20,000	Infinite			Infinite		Infinite
N/T	N/T			Infinite		Infinite

Service Line and Meter Installation Charges

5/8" x 3/4" Meter  
3/4" Meter  
1" Meter  
1.5" Meter  
2" Meter  
2" Turbine Meter  
2" Compound Meter  
3" Meter  
3" Turbine Meter  
3" Compound Meter  
4" Meter  
4" Turbine Meter  
4" Compound Meter  
6" Meter  
6" Turbine Meter  
6" Compound Meter  
8" Meter and Larger

Present Rates	Company Proposed			Staff Recommended		
	Total	Service Line	Meter Install.	Total	Service Line	Meter Install.
285.00	385.00	135.00	520.00	415.00	105.00	520.00
320.00	385.00	215.00	600.00	415.00	205.00	620.00
360.00	435.00	255.00	690.00	465.00	265.00	730.00
545.00	470.00	465.00	935.00	520.00	475.00	995.00
915.00	N/T	N/T	N/T	N/T	N/T	N/T
N/T	630.00	965.00	1,595.00	800.00	995.00	1,795.00
N/T	630.00	1,690.00	2,320.00	800.00	1,840.00	2,640.00
1,150.00	N/T	1,470.00	2,275.00	1,015.00	1,620.00	2,635.00
N/T	805.00	2,265.00	3,110.00	1,135.00	2,485.00	3,630.00
N/T	845.00					
1,885.00	N/T	1,170.00	2,350.00	1,430.00	2,570.00	4,000.00
N/T	1,230.00	3,245.00	4,475.00	1,610.00	3,545.00	5,155.00
3,780.00	N/T	1,730.00	4,545.00	2,150.00	4,925.00	7,075.00
N/T	1,770.00	6,280.00	8,050.00	2,270.00	6,820.00	9,090.00
N/T	N/T	At Cost	At Cost	At Cost	At Cost	At Cost

Service Charges

Establishment  
Establishment (After Hours)  
Reconnection (Delinquent)  
Reconnection (Delinquent)- After Hours  
Meter Test (If Correct)  
Deposit - Residential Note 1  
Deposit - Non - Residential Note 2  
Deposit Interest - Note 3  
Re-Establishment (Within 12 Months)- Note 4  
Re-Establishment (After Hours)- Note 4  
NSF Check  
Deferred Payment, per Month  
Meter Re-Read (If Correct)  
Late Charge per Month  
Company Locks Damaged by Customer- Note 5  
Mains Damaged by Customer- Note 5  
Charge of Moving Customer Meters -  
Per Customer Request  
After hours service charge

	Present	Company Proposed	Staff Recommended
	15.00	15.00	15.00
25.00	25.00	25.00	
15.00	15.00	15.00	
N/A	15.00	15.00	
25.00	25.00	25.00	
(1)	(1)	(1)	
(2)	(2)	(2)	
(3)	(3)	(3)	
(4)	(4)	(4)	
(4)	(4)	(4)	
15.00	25.00	25.00	
12%	1.50%	1.50%	
10.00	10.00	10.00	
N/T	1.50%	1.50%	
N/T	(5)	(5)	
N/T	(5)	(5)	
N/T	Cost	Cost	
N/T	Refer to above charges	Cost	

- Note 1 Per Commission Rules (R14-2-403.B) Two times the average bill.
- Note 2 Per Commission Rules (R14-2-403.B) Two and one-half times the average bill
- Note 3 Per Commission Rules (R14-2-403.B)
- Note 4 Months off system times the minimum (R14-2-403.D)
- Note 5 Per Commission Rules (R14-2-407.B)

CAP Surcharge

Currently there is no authorized CAP surcharge. The Company proposes the following CAP surcharge in addition to all other commodity charges and will be adjusted annually to recover the acquisition and purchased water costs of the Company associated with the right to receive 147 acre feet of Central Arizona Project water each year for delivery to customers. The surcharge will include a 10 year amortization of the acquisition cost plus the projected annual fixed costs of the contract and the delivery costs. Surcharge will be computed annually based on gallons sold and true-up at the end of each year with any over and under recovery of actual costs during the year included in the next years surcharge computation. Staff will present a recommendation on the CAP surcharge in supplemental testimony.

Off-Site Capacity Reservation Charge (Hook-up Fee)

- Note 6  
5/8" x 3/4" Meter  
3/4" Meter  
1" Meter  
1 1/2" Meter  
2" Meter  
3" Meter  
4" Meter  
6" Meter

Present Rates	Company Proposed	Staff Recommended
875.00	875.00	875.00
1,050.00	1,050.00	1,050.00
1,750.00	1,750.00	1,750.00
3,500.00	3,500.00	3,500.00
5,600.00	5,600.00	5,600.00
10,500.00	10,500.00	10,500.00
17,500.00	17,500.00	17,500.00
35,000.00	35,000.00	35,000.00

Note 6 New Water installations. May be assessed only once per parcel, service connection, or lot within a subdivision. Purpose is to equitably apportion the costs of constructing additional off-site facilities to provide water production, delivery, storage, and pressure among all new service connections.

NT = No Tariff

TYPICAL BILL ANALYSIS AVERAGE AND MEDIAN USAGE - CURRENT RATES

LINE NO.	CUSTOMER CLASS	CURRENT			
		AVERAGE		MEDIAN	
		USAGE	DOLLARS	USAGE	DOLLARS
1	Residential 5/8"	3,553	\$ 21.32	2,500	\$ 19.45
2	Residential 3/4"	8,333	\$ 32.83	6,500	\$ 29.57
3	Residential 1"	25,908	\$ 85.07	17,500	\$ 68.15
4	Residential 1.5"	47,726	\$ 169.10	34,500	\$ 141.20
5	Residential 2"	44,800	\$ 207.93	46,500	\$ 211.52
6	Residential 3"	NOT USED			
7	Residential 4"	NOT USED			
8	Residential 6"	NOT USED			
9	Residential 8"	NOT USED			
12	Commerical 5/8"	17,617	\$ 46.36	1,500	\$ 17.67
13	Commerical 3/4"	23,309	\$ 60.58	11,500	\$ 38.47
14	Commerical 1"	20,642	\$ 73.95	8,500	\$ 52.13
15	Commerical 1.5"	38,917	\$ 150.51	34,000	\$ 140.14
16	Commerical 2"	176,813	\$ 486.48	46,500	\$ 211.52
17	Commerical 3"	NOT USED			
18	Commerical 4"	NOT USED			
19	Commerical 6"	NOT USED			
20	Commerical 8"	NOT USED			
23	Irrigation 3/4"	10,282	\$ 36.30	6,500	\$ 29.57
24	Irrigation 1"	97,197	\$ 235.48	43,000	\$ 121.13
25	Irrigation 1.5"	139,711	\$ 363.19	76,000	\$ 228.76
26	Irrigation 2"	326,818	\$ 802.99	219,128	\$ 575.76
27	Construction 2"	341,750	\$ 834.49	1,500	\$ 122.67
28	Construction 3"	NOT USED			
29	Intentionally Left Blank	NOT USED			
30	Intentionally Left Blank	NOT USED			
31	Intentionally Left Blank	NOT USED			

TYPICAL BILL ANALYSIS AVERAGE AND MEDIAN USAGE - COMPANY PROPOSED

LINE NO.	CUSTOMER CLASS	COMPANY PROPOSED							
		AVERAGE	INCREASE	PERCENT	MEDIAN	INCREASE	PERCENT		
32	Residential 5/8"	\$ 15.61	\$ (5.71)	-26.79%	\$ 14.35	\$ (5.11)	-26.25%		
33	Residential 3/4"	\$ 28.76	\$ (4.07)	-12.40%	\$ 25.82	\$ (3.75)	-12.67%		
34	Residential 1"	\$ 70.27	\$ (14.80)	-17.40%	\$ 56.39	\$ (11.77)	-17.26%		
35	Residential 1.5"	\$ 133.16	\$ (35.94)	-21.25%	\$ 111.97	\$ (29.23)	-20.70%		
36	Residential 2"	\$ 162.41	\$ (45.52)	-21.89%	\$ 165.21	\$ (46.30)	-21.89%		
37	Residential 3"	NOT USED							
38	Residential 4"	NOT USED							
39	Residential 6"	NOT USED							
40	Residential 8"	NOT USED							
43	Commercial 5/8"	\$ 41.38	\$ (4.97)	-10.73%	\$ 13.14	\$ (4.53)	-25.62%		
44	Commercial 3/4"	\$ 58.75	\$ (1.84)	-3.03%	\$ 34.51	\$ (3.96)	-10.30%		
45	Commercial 1"	\$ 61.42	\$ (12.53)	-16.95%	\$ 41.97	\$ (10.16)	-19.50%		
46	Commercial 1.5"	\$ 119.05	\$ (31.47)	-20.91%	\$ 111.17	\$ (28.97)	-20.67%		
47	Commercial 2"	\$ 417.52	\$ (68.96)	-14.17%	\$ 165.21	\$ (46.30)	-21.89%		
48	Commercial 3"	NOT USED							
49	Commercial 4"	NOT USED							
50	Commercial 6"	NOT USED							
51	Commercial 8"	NOT USED							
54	Irrigation 3/4"	\$ 32.01	\$ (4.29)	-11.82%	\$ 25.82	\$ (3.75)	-12.67%		
55	Irrigation 1"	\$ 216.55	\$ (18.94)	-8.04%	\$ 105.34	\$ (15.79)	-13.04%		
56	Irrigation 1.5"	\$ 320.88	\$ (42.31)	-11.65%	\$ 190.15	\$ (38.61)	-16.88%		
57	Irrigation 2"	\$ 614.32	\$ (188.66)	-23.50%	\$ 504.37	\$ (71.39)	-12.40%		
58	Construction 2"	\$ 791.33	\$ (43.16)	-5.17%	\$ 93.80	\$ (28.88)	-23.54%		
59	Construction 3"	NOT USED							
60	Intentionally Left Blank	NOT USED							
61	Intentionally Left Blank	NOT USED							
62	Intentionally Left Blank	NOT USED							

TYPICAL BILL ANALYSIS AVERAGE AND MEDIAN USAGE - STAFF RECOMMENDED

LINE NO.	CUSTOMER CLASS	STAFF RECOMMENDED							
		AVERAGE	INCREASE	PERCENT	MEDIAN	INCREASE	PERCENT	PERCENT	
63	Residential 5/8"	\$ 15.89	\$ (5.44)	-25.49%	\$ 13.98	\$ (5.47)	-28.11%		
64	Residential 3/4"	\$ 31.37	\$ (1.47)	-4.47%	\$ 25.27	\$ (4.30)	-14.53%		
65	Residential 1"	\$ 81.99	\$ (3.07)	-3.61%	\$ 63.53	\$ (4.63)	-6.79%		
66	Residential 1.5"	\$ 155	\$ (14.59)	-8.63%	\$ 126.08	\$ (15.12)	-10.71%		
67	Residential 2"	\$ 179	\$ (28.61)	-13.76%	\$ 182.98	\$ (28.54)	-13.49%		
68	Residential 3"	NOT USED							
69	Residential 4"	NOT USED							
70	Residential 6"	NOT USED							
71	Residential 8"	NOT USED							
74	Commerical 5/8"	\$ 49.40	\$ 3.04	6.56%	\$ 12.55	\$ (5.12)	-28.98%		
75	Commerical 3/4"	\$ 68.49	\$ 7.91	13.05%	\$ 39.25	\$ 0.78	2.02%		
76	Commerical 1"	\$ 70.28	\$ (3.67)	-4.97%	\$ 44.18	\$ (7.96)	-15.26%		
77	Commerical 1.5"	\$ 135.57	\$ (14.94)	-9.93%	\$ 125.00	\$ (15.14)	-10.80%		
78	Commerical 2"	\$ 504.68	\$ 18.20	3.74%	\$ 182.98	\$ (28.54)	-13.49%		
79	Commerical 3"	NOT USED							
80	Commerical 4"	NOT USED							
81	Commerical 6"	NOT USED							
82	Commerical 8"	NOT USED							
85	Irrigation 3/4"	\$ 35.56	\$ (0.75)	-2.06%	\$ 28.50	\$ (1.07)	-3.62%		
86	Irrigation 1"	\$ 265.85	\$ 30.36	12.89%	\$ 126.07	\$ 4.94	4.08%		
87	Irrigation 1.5"	\$ 390.76	\$ 27.57	7.59%	\$ 226.45	\$ (2.31)	-1.01%		
88	Irrigation 2"	\$ 892.01	\$ 89.03	11.09%	\$ 613.48	\$ 37.72	6.55%		
89	Construction 2"	\$ 881.72	\$ 47.22	5.66%	\$ 3.87	\$ (118.80)	-96.85%		
90	Construction 3"	NOT USED							
91	Intentially Left Blank								
92	Intentially Left Blank								
93	Intentially Left Blank								

**BEFORE THE ARIZONA CORPORATION COMMISSION**

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
H2O, INC., AN ARIZONA CORPORATION, FOR )  
A DETERMINATION OF THE CURRENT FAIR )  
VALUE OF ITS UTILITY PLANT AND )  
PROPERTY AND FOR INCREASE IN ITS )  
WATER RATES AND CHARGES FOR UTILITY )  
SERVICES )  
\_\_\_\_\_ )

DOCKET NO. W-02234A-07-0557

DIRECT

TESTIMONY

OF

KATRIN STUKOV

UTILITIES ENGINEER

ARIZONA CORPORATION COMMISSION

UTILITIES DIVISION

JANUARY 23, 2009

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**EXHIBIT**

Engineering Report ..... Exhibit KS

1   **INTRODUCTION**

2   **Q.    Please state your name, place of employment and job title.**

3    A.    My name is Katrin Stukov. My place of employment is the Arizona Corporation  
4           Commission (“Commission”), Utilities Division, 1200 West Washington Street, Phoenix,  
5           Arizona 85007. My job title is Utilities Engineer.

6  
7   **Q.    How long have you been employed by the Commission?**

8    A.    I have been employed by the Commission since June 2006.

9  
10   **Q.    Please list your duties and responsibilities.**

11   A.    As a Utilities Engineer, specializing in water and wastewater engineering, I inspect,  
12           investigate, and evaluate water and wastewater systems; obtain data, prepare investigative  
13           reports; suggest corrective action and provide technical recommendations on water and  
14           wastewater system deficiencies; and provide written and oral testimony on rate and other  
15           cases before the Commission.

16  
17   **Q.    How many cases have you analyzed for the Utilities Division?**

18   A.    I have analyzed approximately 35 cases covering various responsibilities for the Utilities  
19           Division.

20  
21   **Q.    What is your educational background?**

22   A.    I graduated from the Moscow University of Civil Engineering with a Bachelor of Science  
23           degree in Civil Engineering with a concentration in water and wastewater systems.

1 **Q. Briefly describe your pertinent work experience.**

2 A. Prior to my employment with the Commission, I was a design review environmental  
3 engineer with the Arizona Department of Environmental Quality ("ADEQ") for twenty  
4 years. My responsibilities with ADEQ included review of projects for the construction of  
5 water and wastewater facilities. Prior to that, I worked as a civil engineer in several  
6 engineering and consulting firms, including Bechtel, Inc. and Brown & Root, Inc., in  
7 Houston, Texas.

8  
9 **PURPOSE OF TESTIMONY**

10 **Q. Were you assigned to provide the Utilities Division Staff's ("Staff") engineering**  
11 **analysis and recommendation for the H20, Inc. ("H20" or "Company") in this**  
12 **proceeding?**

13 A. Yes. I reviewed the Company's application and responses to data requests, and I visited  
14 the water system on September 12, 2008. This testimony and its attachment present  
15 Staff's engineering evaluation.

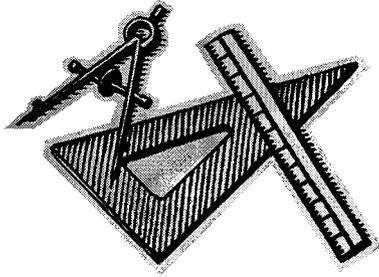
16  
17 **ENGINEERING REPORT**

18 **Q. Please describe the attached Engineering Report, Exhibit KS.**

19 A. Exhibit KS presents H20 water system's details and Staff's analysis and findings, and is  
20 attached to this direct testimony. Exhibit KS contains the following major topics: (1) a  
21 description and analysis of the water system, (2) water use, (3) growth, (4) compliance  
22 with the rules of the ADEQ, Arizona Department of Water Resources, and the Arizona  
23 Corporation Commission, (5) depreciation rates and Staff's conclusions and  
24 recommendations.

1 **Q. Does this conclude your direct testimony?**

2 **A. Yes, it does.**



**Engineering Report For**  
H2O, Inc.  
Docket No. W-02234A-07-0557 (RATES)  
By: Katrin Stukov  
Utilities Engineer  
September 24, 2008

**SUMMARY**

**CONCLUSIONS**

1. The Arizona Department of Environmental Quality (“ADEQ”) has reported that the H2O’s Public Water System (“PWS”) #11-060 is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
2. The Maricopa County Environmental Services Department (“MCESD”), as a formally delegated agent of the ADEQ, reported that H2O’s PWS# 07-904 is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
3. MCESD has reported that the Town of Queen Creek’s PWS# 07-033, which supplies water to H2O PWS # 07-904, is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
4. The H2O’s water system PWS# 11-060 has a water loss of 10.1 percent, which is just above the recommended threshold amount of 10 percent.
5. The H2O water system’s current well and storage capacities are adequate to serve the present customer base and a reasonable level of growth.
6. The Company is located in the Phoenix Active Management Area (“AMA”) and is in compliance with Arizona Department of Water Resources (“ADWR”) reporting requirements, and upon completion of its review of the Company’s System Water Plan, which includes a Water Supply Plan, Drought Preparedness Plan and Water Conservation Plan, ADWR will issue the documentation stating whether or not the System Water Plan filed meets ADWR requirements.
7. The Company has no outstanding Arizona Corporation Commission (“ACC”) compliance issues.
8. The Company has an approved curtailment plan and a backflow prevention tariffs.

**RECOMMENDATIONS**

1. The Company's water system PWS# 11-060 has water loss of 10.1 percent. Staff recommends that the Company evaluate this water system and prepare a report for corrective measures demonstrating how the Company will reduce its water loss to less than 10 percent. Water loss shall be reduced to less than 10 percent by December 31, 2009. If the Company finds that reduction of water loss to less than 10 percent is not cost-effective, the Company shall submit a detailed cost analysis and explanation demonstrating why water loss reduction to less than 10 percent is not cost effective. The Company shall file such report with Docket Control, as a compliance item in this docket, within six month of the effective date of the decision in this case.
2. Staff recommends that the Company file as a compliance item in this docket no later than December 31, 2009, a copy of the documentation issued by ADWR indicating that the Company's System Water Plan met ADWR requirements.
3. Staff recommends its annual water testing expense estimate of \$23,976 be used for this proceeding.
4. Staff recommends that the Company adopt the depreciation rates delineated in Table C on a going forward basis.
5. Staff recommends approval of its service line and meter installation charges labeled "Staff's Recommendation" in Table D.

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**A. INTRODUCTION AND LOCATION OF COMPANY**

On October 1, 2007, H2O, Inc. Water Company ("H2O" or "Company") filed its initial rate application with the Arizona Corporation Commission ("ACC" or "Commission"), and on May 13, 2008, H2O filed an amended rate application.

H2O's service area is located in the vicinity of Queen Creek, in portions of Pinal and Maricopa Counties. H2O served over 6,300 customers in 2006.

The H2O's water plant facilities are located in both Pinal and Maricopa Counties, subsequently, ADEQ regulates facilities within Pinal County under PWS #11-060 and MCESD regulates H2O'S facilities within Maricopa County under PWS # 07-904 (this system is a consecutive water system to the Town of Queen Creek ("Town") water system PWS #07-033).

The Company is temporarily purchasing water from the Town's water system, formally owned by Queen Creek Water Company<sup>1</sup>, in order to serve approximately 77 customers, within H2O's service area, located west of the railroad/Rittenhouse Road ("railroad") in Maricopa County. H2O indicated that it is planning to install a water line extension sometime in the future in order to interconnect both distribution systems (PWS #11-060 and PWS # 07-904) east and west of the railroad, which when installed will eliminate any need to purchase water from the Town.

Figure 1 shows the location of the Company within Pinal and Maricopa Counties and delineates the approximate 11,640 acres of H2O's existing certificated area.

**B. DESCRIPTION OF THE WATER SYSTEM**

The H2O water systems were visited on September 12, 2008, by Katrin Stukov, Staff Utilities Engineer, in the accompaniment of Donald Schnepf, the Company President and Craig Thiesenhusen, the water system operator.

The Company reported that in 2006 its plant consisted of four active wells, eight storage tanks, gas chlorination units, pressure tanks, booster pumps and two separate distribution systems serving 6,382 customers ( the main water system PWS #11-060 had 6,305 connections and the consecutive system PWS# 07-904 had 77 connections).

Table A includes a detailed plant facility listing and a system schematic is shown as Figure 2.

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<sup>1</sup> The application of Queen Creek Water Company to sell its assets to the Town was approved by ACC in Decision No 70204 on March 20, 2008.

Figure 1

Maricopa County

Pinal County

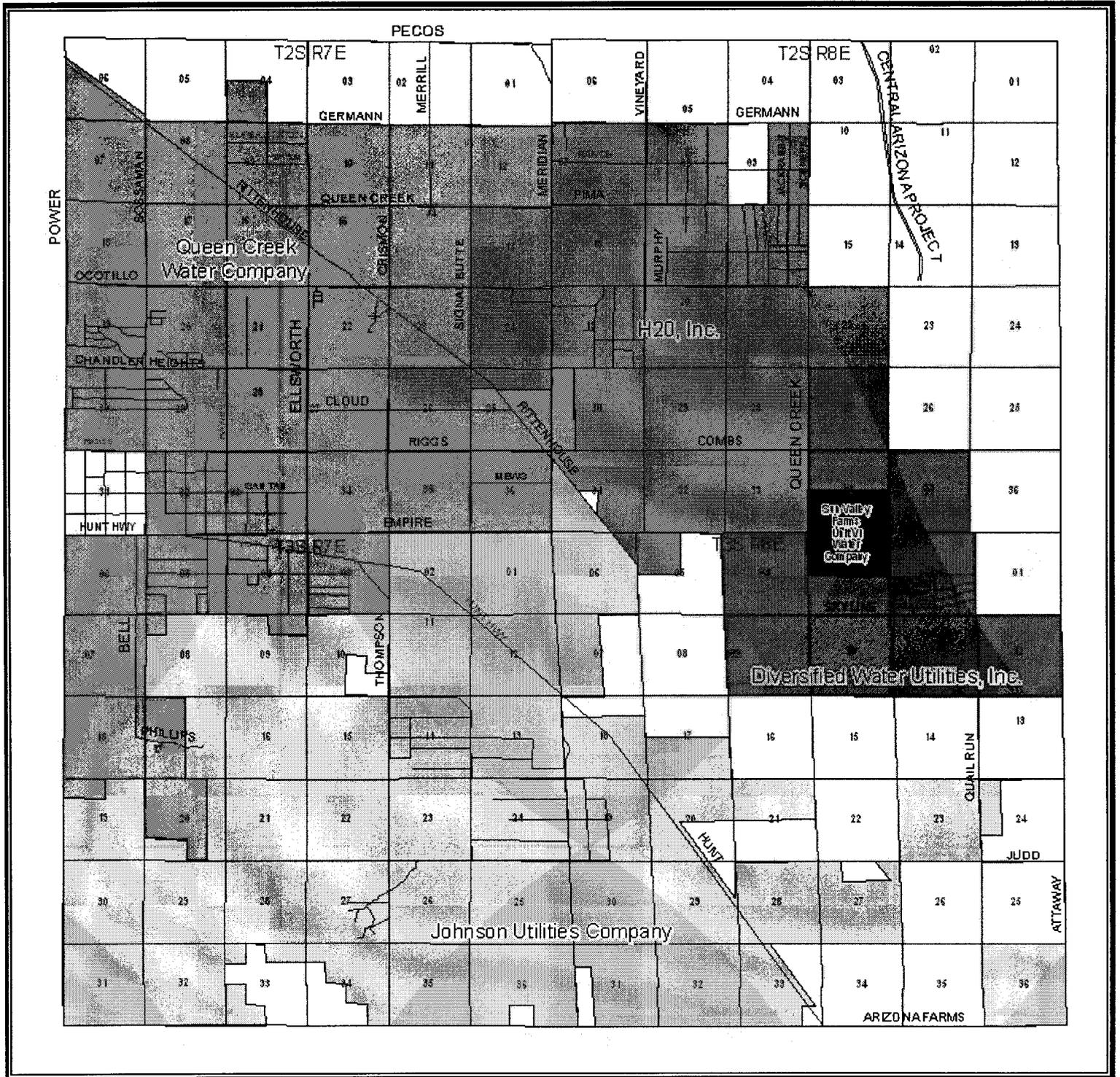


Table A. Plant Facilities Summary<sup>2</sup>

Wells

Plant Name	Well ADWR ID#	Pump horsepower (hp)	Pump Yield (gpm)	Casing Depth (feet)	Casing Diameter (inches)	Meter Size (inches)	Year Drilled	Notes
Main	55-605834	300	1,300	1,200	16/14	10	1966	Primary
	55-605835	200	1,050	1,200	20/16	6	1950	Back-up
	55-605836	n/a	n/a	1,200	20/16	n/a	1950	Not in service
	55-605837	n/a	n/a	1,200	20/16	n/a	1966	Capped
Castlegate	55-625006	300	1,400	940	16	10	1972	
Pecan Creek North	55-809158	300	1,200	878	16	10	1946	

Water Tanks and Components

Plant Name	Storage Tanks		Pressure Tanks		Booster Pumps		Components	Structures
	Size (gallons)	quantity	Size (gallons)	quantity	hp	quantity		
Main	500,000	1	5,000	1	15	4	Chlorinator(2) w/enclosure	Steel shade 8' Block wall
	200,000	1			50	3		
					60	1		
Castlegate	800,000	1	5,000	2	50	6	Chlorinator w/enclosure	Steel shade 8' Block wall
	800,000	1						
Pecan Creek North	800,000	1	5,000	2	50	6	Chlorinator w/enclosure; Backup Generator	Steel shade 8' Block wall
	800,000	1						
Links	700,000	1	5,000	2	15	3	Chlorinator w/enclosure; Backup Generator	Steel shade 8' Block wall
	300,000	1			25	3		
					100	100		

Mains

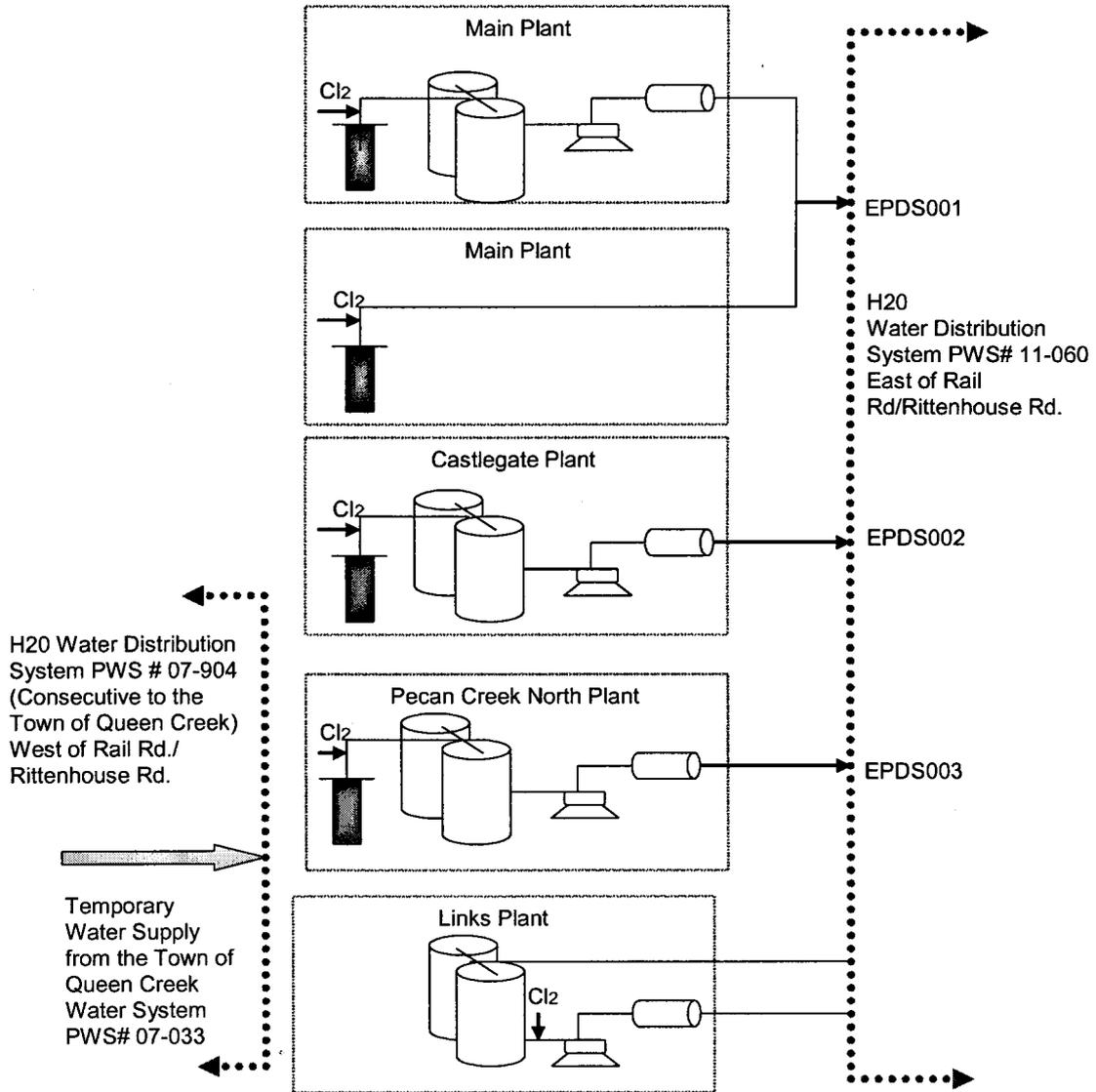
Size(inches)	Material	Length(feet)
4		8,752
6		154,033
8		252,453
10		-
12		224,077

Customer Meters

Size(inches)	Quantity
5/8 X 3/4	236
3/4	6,119
1	212
1 1/2	22
2	79
Total	6,668

<sup>2</sup> Based on the Company's application

Figure 2 System Schematic



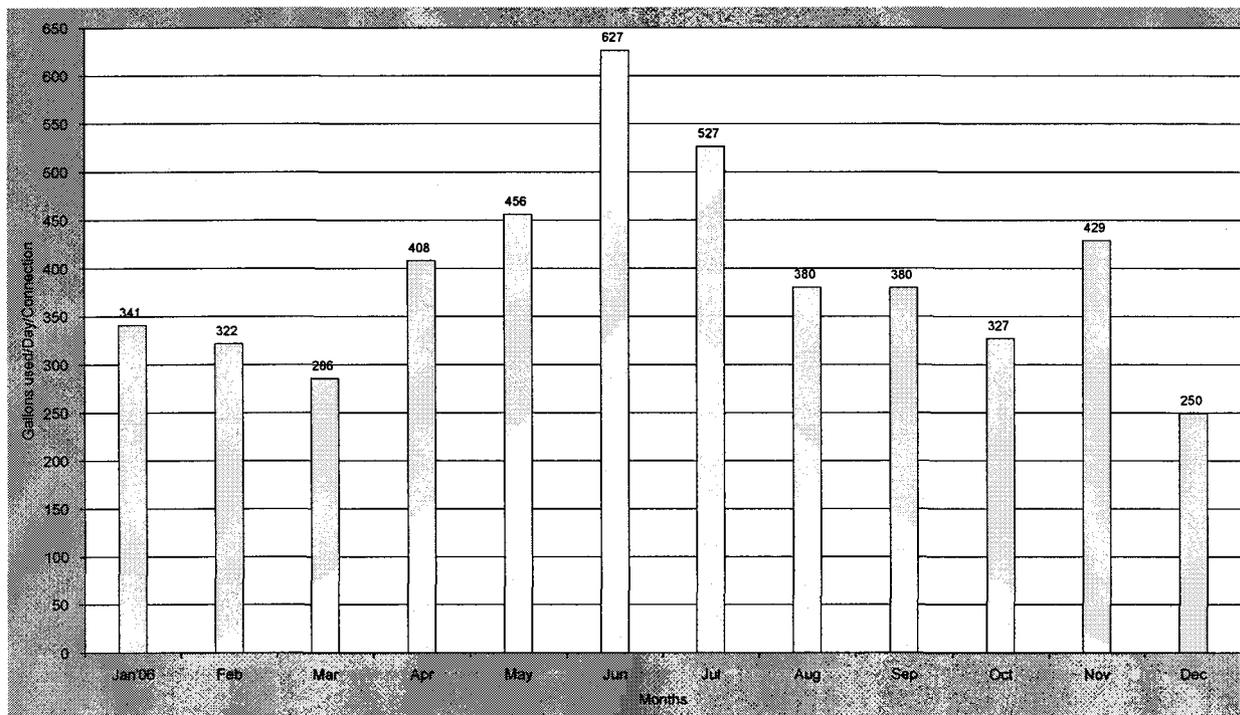
### C. WATER USE

#### 1. Main Water System PWS# 11-060

##### Water Sold

Figure 3 represents the water consumption data for the test year ending December 31, 2006, provided by the Company in its water use data sheet<sup>3</sup>. Customer consumption included a high monthly water use of 627 gallons per day (“GPD”) per connection in June, and the low water use was 250 GPD per connection in December. The average annual use was 394 GPD per connection.

Figure 3 Water Use



##### Non-account Water

Non-account water should be 10 percent or less. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a company to identify water and revenue losses due to leakage, theft and flushing.

<sup>3</sup> Per Company’s response dated September 8, 2008.

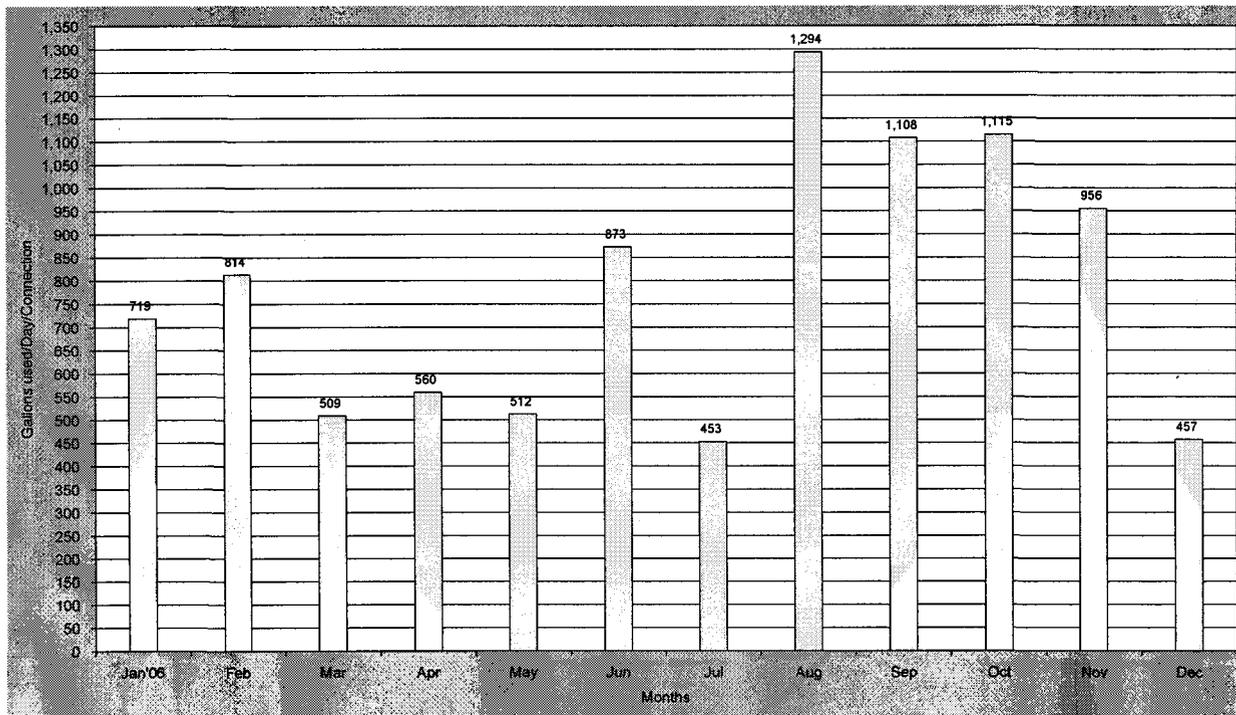
The Company reported 922,090,000 gallons pumped, 825,049,000 gallons sold and 3,537,947 gallons of metered non-revenue uses<sup>4</sup> for the test year, resulting in a water loss of 10.1 percent, which is just above the recommended threshold amount of 10 percent.

2. Consecutive Water System PWS# 07-904

Water Sold

Figure 4 represents the water consumption data for the test year ending December 31, 2006, provided by the Company in its water use data sheet<sup>5</sup>. Customer consumption included a high monthly water use of 1,294 GPD per connection in August, and the low water use was 457 GPD per connection in December. The average annual use was 781 GPD per connection.

Figure 4 Water Use



Non-account Water

The Company reported 21,240,000 gallons purchased and 21,240,000 gallons sold for the test year, resulting in a water loss of 0.00 percent, because during the test year customers were directly metered by the Town.

<sup>4</sup> Per Company's response dated September 16, 2008.

<sup>5</sup> Per Company's response dated September 8, 2008.

**D. SYSTEM ANALYSIS**

Based on the data provided by the Company for the Test Year, Staff concludes that the Company's current system has adequate production and storage capacities to serve its customer base and reasonable growth.

**E. GROWTH**

Based on customer data obtained from the Company's Annual Reports, it is projected that the Company could have over 12,000 customers by 2011. Figure 5 depicts actual growth from 2004 to 2006 and projects an estimated growth in the service area for the next five years using linear regression analysis.

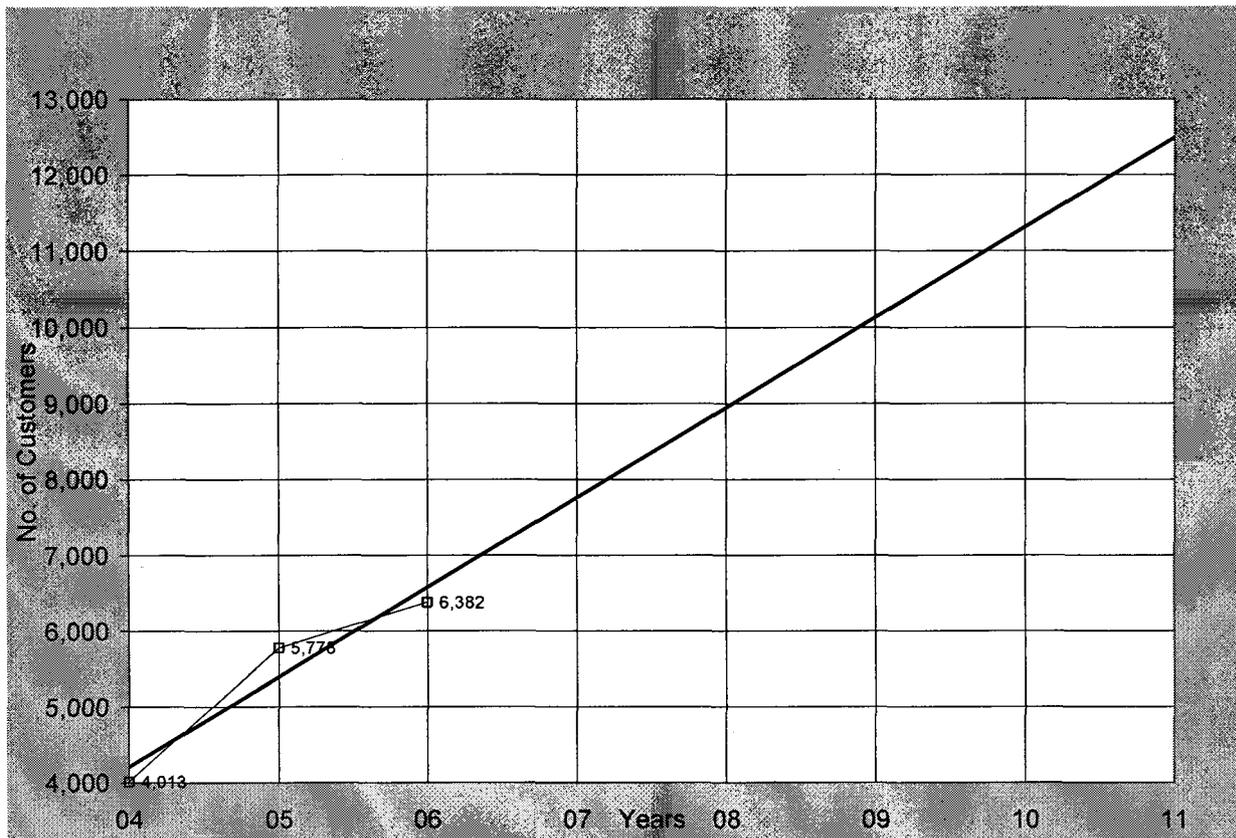


Figure 5 Growth Projection

## F. ADWR COMPLIANCE

The Company is located in the Phoenix Active Management Area (“AMA”). According to an ADWR Compliance Status Report, dated July 25, 2008, the Company’s water system is in compliance with the reporting requirements. Upon completion of its review of the Company’s System Water Plan, which includes a Water Supply Plan, Drought Preparedness Plan and Water Conservation Plan, per *Arizona Revised Statutes* § 45-341-343, ADWR will issue the documentation stating whether or not the System Water Plan filed meets ADWR requirements.

## G. ADEQ COMPLIANCE

### Compliance Status

Based on ADEQ Compliance Status Report of September 7, 2007, and Compliance Inspection Report of July 14, 2008, H2O PWS # 11-060 has no deficiencies and ADEQ has determined that this system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, and Chapter 4.

Based on MCESD Compliance Status Report, dated August 29, 2008, H2O PWS # 07-904 has no deficiencies and MCESD has determined that this system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, and Chapter 4.

Based on MCESD Compliance Status Report, dated September 2, 2008, the Town PWS #07-033, which supplies water to H2O PWS # 07-904, has no deficiencies and MCESD has determined that this system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, and Chapter 4.

### Water Testing Expense

The Company reported its water testing expense at \$13,900<sup>6</sup> for the 2006 test year and at \$22,185<sup>7</sup> for 2008. Staff has reviewed the Company’s testing expense and has recalculated testing costs based on the current Sample Schedules provided by ADEQ and the costs provided by the Aquatic Consulting & Testing Laboratory.

Table B shows Staff’s annual water monitoring expense estimate of \$23,976.

---

<sup>6</sup> Per Company’s response dated May 13, 2008.

<sup>7</sup> Per Company’s response dated September 8, 2008.

Table B. Water Testing Cost

Monitoring	Sample Frequency					Average number of tests per year	Cost per test	Average Annual Cost
	#07-094	#11-060 (3 EPDS <sup>8</sup> )						
	DS <sup>9</sup>	DS	EPDS001	EPDS002	EPDS003			
Total coliform	2 / MN	20 / MN				264	\$25	\$6,600
TTHM	1 / yr	4 / QT				17	\$150	\$2,550
HAA5	1 / yr	4 / QT				17	\$200	\$3,400
Lead & Copper	10 / 3 yr	30 / 3 yr				13	\$30	\$400
IOCs			1 / 9 yr	1 / 3 yr	1 / 3 yr	0.77	\$300	\$233
VOCs			1 / 6 yr	4 / 1 yr	4 / 1 yr	8.16	\$225	\$1,836
SOCs			2 / 9 yr	4 / 3 yr	4 / 3 yr	2.88	\$2,075	\$5,994
RADs			1 / 9 yr	4 / 1 yr	4 / 1 yr	8.11	\$350	\$2,838
Asbestos			1 / 9 yr	1 / 9 yr	1 / 9 yr	0.33	\$175	\$58
Nitrate			1 / 1yr	1 / 1yr	1 / 1yr	3	\$20	\$60
Nitrite			1 / 9 yr	1 / 9 yr	1 / 9 yr	0.33	\$20	\$7
Total								<b>\$23,976</b>

## H. ACC COMPLIANCE

A check with Utilities Division Compliance Section showed that there are currently no delinquent compliance items for the Company<sup>10</sup>.

## I. DEPRECIATION RATES

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Table C. The depreciation rate table submitted by the Company with this application deviates from Staff's typical and customary water depreciation rate table (For example, the Company has not classified its plant-in-service in to the sub-accounts: NARUC Accounts No. 320.1, 320.2, 330.1, 330.2 and 340.1). Staff recommends that the Company adopt Staff's typical and customary depreciation rates in the accounts listed in Table C on a going forward basis.

<sup>8</sup> Entry Point into the Distribution System ("EPDS")

<sup>9</sup> Distribution System ("DS")

<sup>10</sup> Per ACC Compliance status check dated August 28, 2008

TABLE C  
TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

## NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

**J. OTHER ISSUES****1. Service Line and Meter Installation Charges**

The Company has requested changes in its service line and meter installation charges. Service line and meter installation charges are refundable advances. The Company has submitted a prior listing of Staff's customary range of charges for the service line and meter installation charges. However, Staff will recommend its updated version at its the lower end of its customary range of charges as shown in Table D. Staff believes its updated charges, which are slightly higher than the charges proposed by the Company, are more reflective of current costs. The Company also has requested charges for the installation of 8-inch and larger service line and meter be charged on an individual customer basis "At Cost". Staff concurs with using this approach for larger size meters. Therefore, Staff recommends that the charges labeled "Staff's Recommendation" in Table D be adopted.

Table D. Service Line and Meter Installation Charges

Meter Size	Company's Current Charges	Company's Requested Charges			Staff's Recommendation		
		Service Line Charges	Meter Charges	Total Charges	Service Line Charges	Meter Charges	Total Charges
5/8"x 3/4"	\$285	\$385	\$135	\$520	\$415	\$105	\$520
3/4"	\$320	\$385	\$215	\$600	\$415	\$205	\$620
1"	\$360	\$435	\$255	\$690	\$465	\$265	\$730
1-1/2"	\$545	\$470	\$465	\$935	\$520	\$475	\$995
2"	\$915	N/A	N/A	N/A	N/A	N/A	N/A
2"- Turbine	N/T	\$630	\$965	\$1,595	\$800	\$995	\$1,795
2"- Compound	N/T	\$630	\$1,690	\$2,320	\$800	\$1,840	\$2,640
3"	\$1,150	N/A	N/A	N/A	N/A	N/A	N/A
3"- Turbine	N/T	\$805	\$1,470	\$2,275	\$1,015	\$1,620	\$2,635
3"- Compound	N/T	\$845	\$2,265	\$3,110	\$1,135	\$2,495	\$3,630
4"	\$1,885	N/A	N/A	N/A	N/A	N/A	N/A
4"- Turbine	N/T	\$1,170	\$2,350	\$3,520	\$1,430	\$2,570	\$4,000
4"- Compound	N/T	\$1,230	\$3,245	\$4,475	\$1,610	\$3,545	\$5,155
6"	\$3,780	N/A	N/A	N/A	N/A	N/A	N/A
6"-Turbine	N/T	\$1,730	\$4,545	\$6,275	\$2,150	\$4,925	\$7,075
6"-Compound	N/T	\$1,770	\$6,280	\$8,050	\$2,270	\$6,820	\$9,090
8" & larger	N/T	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost

Note: "N/T"- No Tariff  
"N/A"- Not Applicable

2. Off-site Capacity Reservation Charges (Hook-up Fee)

The Company has approved Off-site Capacity Reservation Charges.

3. Curtailment Plan Tariff

The Company has an approved curtailment plan tariff.

4. Backflow Prevention Tariff

The Company has an approved backflow prevention tariff.