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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER COMPANY, AN ARIZONA CORPORATION, FOR APPROVAL OF INTERIM RATES AND CHARGES.	DOCKET NO: WS-03478A-08-0608 **NOTICE OF FILING REBUTTAL TESTIMONY**

Far West Water & Sewer Company hereby submits this Notice of Filing Rebuttal Testimony in the above-referenced matter. Specifically filed herewith is Far West's rebuttal filing, which includes the following testimonies, along with supporting schedules and/or exhibits:

1. Rebuttal Testimony of Thomas J. Bourassa; and
2. Rebuttal Testimony of Andrew J. Capestro.

DATED this 31st day of March, 2009.

FENNEMORE CRAIG, P.C.

By: Norman D. James

Norman D. James
Jay L. Shapiro
Attorneys for Far West Water & Sewer Company

Arizona Corporation Commission
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FAR WEST WATER & SEWER COMPANY
DOCKET NO: WS-03478A-08-0608

THOMAS J. BOURASSA REBUTTAL TESTIMONY

March 31, 2009

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER COMPANY, AN ARIZONA CORPORATION, FOR APPROVAL OF INTERIM RATES AND CHARGES.	DOCKET NO: WS-03478A-08-0608

REBUTTAL TESTIMONY

OF

THOMAS J. BOURASSA

March 31, 2009

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2180450.2

FENNEMORE CRAIG
PROFESSIONAL CORPORATION
PHOENIX

I. INTRODUCTION, PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas J. Bourassa and my business address is 139 W. Wood Drive, Phoenix, AZ 85029.

Q. HAVE YOU PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THE INSTANT CASE?

A. Yes, my direct testimony was submitted in support of the Far West Water and Sewer Company ("Far West" or the "Company") Emergency Application for Interim Rates and Charges for its sewer division filed on December 19, 2008. I am also the finance, rates and accounting witness in the Far West Sewer's pending but now stayed permanent rate case, Docket No. WS-03478A-08-0454. I also testified in the Company's last rate case for the sewer division, and assisted with its financing application, which was approved by the Commission in Decision No. 69950 (October 30, 2007). I am very familiar with the Company's current financial picture.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. I will provide rebuttal testimony in response to the direct filings by the Residential Utilities Consumer Office ("RUCO") and the Arizona Corporation Commission Utilities Division Staff ("Staff"). In doing so, I will provide further information for the ALJ and Commission on the Company's current financial picture, and I will try to convey the seriousness of the issues before the Commission in this emergency rate case.

Q. HOW WILL YOUR TESTIMONY BE ORGANIZED?

A. First, I will summarize the positions of the parties at this stage of the proceeding. Second, I address the Company current financial situation as well as the expected financial picture if the Company does not receive interim rate relief for its sewer division. Third, I will respond to the direct testimony of RUCO's witness William A. Rigsby.[1] Fourth and finally, I will respond to Staff's recommendations in this docket.[2]

II. SUMMARY OF THE POSITIONS OF THE PARTIES.

Q. PLEASE SUMMARIZE THE POSITIONS OF THE PARTIES.

A. The Company continues to recommend an interim increase of $2,161,788 over adjusted test year revenues, a 101.95 percent, for its sewer division. The Company's request is less than half of the rate increase of $4,595,748, or 214.76 percent, requested in its permanent rate application currently pending before the Commission.[3] This means the Company is asking for less than it actually needs to recover its cost of service and is seeking no return whatsoever of or on its investment.

RUCO recommends that the Commission deny all interim rate relief.[4] RUCO also recommends that the Commission continue the suspension of the time clock on the Company's pending but now stayed permanent rate application until a full 12-month period after all the wastewater improvements ordered by ADEQ are placed into service.[5] Thereafter, RUCO recommends that the Company be forced to update its permanent rate application using a more current test year before being allowed to continue with its permanent rate case.[6] This would leave the Company

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[1] Direct Testimony of William A. Rigsby ("Rigsby Dt.").

[2] *See* Staff Report dated March 24, 2009 ("Staff Report")

[3] The Company has proposed a 3 year phase-in of the requested rate increase in its permanent rate application. The Company's proposed Phase One revenue increase is $2,807,676 over adjusted test year revenues, or 131.2 percent. The Phase Two revenue increase is $3,685,023 over adjusted test year revenues, or 172.2 percent. The Phase Three increase is $4,595,748 over adjusted test year revenues, or 214.76 percent.

[4] Rigsby Dt. at 5.

[5] *Id.* at 6.

[6] *Id.*

without rate relief for another two years or more, assuming Far West can bring the plant on line immediately. Mr. Capestro discusses the impact of RUCO's recommended delay in the permanent rate case in his rebuttal testimony.

Staff also recommends that the Company's request for an interim rate increase be denied.[7] However, if the Commission decides an interim rate increase is warranted, Staff recommends an interim rate increase of $972,150, or 46.3 percent. Staff's indecisive position would leave the Company's problems unresolved.

III. FAR WEST'S CURRENT FINANCIAL CONDITION

Q. PLEASE DESCRIBE FAR WEST'S CURRENT FINANCIAL PICTURE.

A. The Company finds itself unable to cash flow operating expenses, pay current obligations, and complete required sewer system improvements. This was the reason why the Company filed for interim rates last December, 2008.[8] However, the situation has become critical, and the Company's ability to serve both its approximately 15,000 water customers and approximately 7,000 sewers customers is in jeopardy.

Q. WHAT CAUSED THE COMPANY'S CURRENT FINANCIAL CONDITION TO DETERIORATE?

A. Put simply, the Company's current revenues are inadequate to cover the sewer division's operating expenses. On top of that, the Company has been paying debt service on the $25 million of bonds since December 2007, which were issued to finance the improvements mandated by ADEQ. Then, the Company ran into higher than anticipated costs to complete the sewer system improvements. This

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[7] Staff Report at 4.

[8] *See* Direct Testimony of Thomas J. Bourassa in Support of Interim Rates ("Bourassa Dt.") at 2-3.

includes not only increased capital costs, but more than $500,000 a year of effluent removal costs that are necessary while the sewer improvements are in progress.[9] As a result, the Company cannot complete the plant needed to comply with the ADEQ orders.

Q. WHY CAN'T THE COMPANY PAY THE REST OF THE COSTS OF THE PLANT UPGRADE ORDERED BY ADEQ?

A. The Company has utilized all of the available unrestricted cash from the IDA bond proceeds for the wastewater system improvements and has virtually no construction and operating cash reserves. At the end of 2008, the Company had amassed over $3.46 million in accounts payable – most of which is directly related to construction of the sewer system improvements. Its operating cash balance was approximately $14,000 and its construction cash balance was less than $240,000.[10] Adding to the cash flow crunch is the fact that the Company needs to expend about $2.3 million to complete the sewer system improvements. Finally, the Company must pay annual debt service of $1.9 million. Together, these short-term obligations generate a cash need of $7.66 million. However, based on the 2008 financial statement for the Company, the cash flow provided by operations in 2009 will be less than $2.9 million.[11] Ultimately, there is an immediate cash need for at least $4.76 million for the Company to complete its sewer system improvements and pay its current obligations when they come due.

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[9] Rebuttal Testimony of Andrew J. Capestro ("Capestro Rb.") at 5-6.

[10] The Company also had approximately $1.6 million of bond debt reserve funds at the end of 2008. This is addressed later in this section of this testimony.

[11] Based on the 2008 financial statements, the cash flow from operations is operating income of $1,441,403 plus depreciation of $1,423,338 plus income taxes of $0. The $2.9 million does not include temporary effluent removal costs of over $500,000 (included below the line in extraordinary deductions) expected to be incurred in 2009. As such, the actual cash flow from operations is closer to $2.4 million.

Q. THE COMPANY IS REQUESTING AN INTERIM RATE INCREASE OF APPROXIMATELY $2.16 MILLION, LESS THAN HALF OF THE $4.76 MILLION CASH SHORT-FALL. WOULD THE COMPANY'S INTERIM RATE INCREASE SOLVE THE COMPANY'S PROBLEM?

A. Not by itself. The Company will need to seek some additional short-term financing.

Q. DOES THE COMPANY CURRENTLY HAVE THE ABILITY TO OBTAIN SHORT-TERM FINANCING TO MAKE UP THIS DIFFERENCE?

A. Not without meaningful interim rate relief. The Company's inability to borrow, even in the short-term, is exacerbated by the fact that the Company already has over 85 percent debt in its capital structure. But it has no other choice if it wishes to fund the remaining plant improvements.[12]

Q. SO, WHAT YOU ARE SAYING IS THAT THE COMPANY HAS A NEED FOR AN ADDITIONAL $4.76 MILLION OF CASH WITHIN THE NEXT 12 MONTHS?

A. Actually, sooner than that. When we go to hearing in April, we will be into the fourth month of 2009, and the obligations mentioned above will all come due well before the end of 2009. The accounts payable balance of $3.46 million is a very short-term obligation.[13] The additional $2.3 million is needed well before the end of 2009. Plus, the debt service of $1.9 million has to be paid in 2009.

Q. COULDN'T THE COMPANY POSTPONE THE REMAINING SEWER SYSTEM IMPROVEMENTS TO CONSERVE CASH?

A. Unfortunately, the Company cannot postpone the sewer system improvements to eliminate the need for additional cash in the short-term. The sewer system

[12] Capestro Rb. at 7.

[13] Accounts payable typically has 30 day terms.

improvements are the result of two consent orders the Company entered into with ADEQ, and are required to bring much of the plant that has already been constructed on line.[14] But, even if it could, it still has to address the $3.46 million of short-term payables and pay its annual debt service of over $1.9 million. Together, these obligations require $5.36 million of cash in the short-term, which is still $2.46 million above the operating cash flow of $2.9 million. This does not take into account the $500,000 of effluent removal expenses the Company must incur until the plant improvements are brought on line.

Q. DOES THIS SITUATION AFFECT THE COMPANY AS A WHOLE, OR JUST THE SEWER DIVISION?

A. It affects the entire Company, including its water utility customers. The cash needs described above ignore the fact that the water division needs to make roughly $19 million of capital improvements to adequately serve its water customers.[15]

Q. THEN WHY IS THE COMPANY'S INTERIM RATE REQUEST FOCUSED SOLELY ON THE NEEDS OF THE SEWER DIVISION?

A. The sewer division is the primary cause of the current financial dilemma the Company finds itself in. Approximately $21 million of the $25.2 million of long-term debt is directly attributed to the sewer division (about 83 percent of the total debt incurred). The portion of the debt service attributable to the sewer division is nearly $1.6 million.[16] Over $3.1 million of the $3.4 million of accounts payable is directly attributable to the sewer division.[17] Plus, as I have testified, the Company needs to expend more than $2 million to finish the sewer plant improvements. In

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[14] *See* Direct Testimony of Gary M. Lee ("Lee Dt.").

[15] Capestro Rb. at 9-10.

[16] 83 percent of $1.9 million.

[17] Over $2.8 million of the $3.1 sewer division accounts payable is comprised of construction payables for sewer plant improvements.

total, the sewer division alone needs at least $7 million of cash within the next 12 months. Yet, based on 2008 sewer division results, the expected sewer division operating cash flow for 2009 is a negative $67,000.[18]

Q. DID YOU PREPARE A 2009 PROJECTED CASH FLOW FOR THE ENTIRE COMPANY?

A. Yes. A 2009 projected cash flow for the Company was prepared and provided in response to Staff data request GWB 4.2 and is attached hereto as Rebuttal Exhibit 2. As the projected cash flow statement shows, the projected cash flows from operations are actually a negative $2.5 million rather than the positive $2.9 million mentioned above.

Q. WHY IS THIS DIFFERENT THAN THE $2.9 MILLION YOU MENTIONED EARLIER?

A. Because the projected statement of cash flows is a more comprehensive analysis of cash flows and uses the net income of the Company as a starting point rather than operating income, which is the correct methodology in performing a cash flow analysis. It also contemplates paying down the $3.46 million of short-term payables, which is ignored by a simple operating cash analysis that merely adds together operating income, depreciation and amortization, and income taxes. The simplified operating cash flow analysis masks the true cash flow problem. The projected cash flow statement shows the Company's projected operating cash flow to be a negative $2.5 million in 2009. After consideration of the principle payment of debt and additional construction expenditures, the Company is projected to have

[18] Unaudited financial statements for the Company are attached hereto as Rebuttal Exhibit 1. These schedules have been previously provided to Staff and RUCO. Based on the 2008 financial information for the sewer division, the cash flows from operations is equal to ($67,527), based on operating income of ($666,299) plus depreciation and amortization of $598,772 and income taxes of $0.

a negative cash flow of over $6.4 million in 2009. In my opinion, there is no way any business the size of Far West can continue to operate in the face of such negative cash flow without the entity compromising its ability to perform its business functions, in this case water and sewer utility service.

Q. WHAT ABOUT THE OVER $1.6 MILLION IN BOND DEBT RESERVE FUNDS ON THE 2008 BALANCE SHEET AT THE END OF 2008? COULD THE BOND DEBT RESERVE FUNDS BE USED TO HELP SOLVE THE COMPANY'S LIQUIDITY PROBLEM?

A. No. This fund must be used solely for the payment of the principal of and interest on the bonds when (whether at maturity, upon a redemption date or any interest payment date) other funds available for such purposes are insufficient. However, if the Debt Service Reserve Fund should ever contain less than the total Required Reserve, monthly deposits in amounts equal to not less than one-sixth (1/6) of the deficiency in the then Required Reserve must be made to the Debt Service Reserve Fund on or before the 25th day of each month until the Required Reserve has been fully restored. In other words, the fund must be restored within a six month period if it is used. Consequently, this fund cannot be used for debt service for any extended period, unless the Company wants to risk what appears to me (admittedly a non-attorney) to be a default under the bonds. Besides, even if the bond reserve funds could be used to help solve the liquidity problem, the Company would still be short by $4.8 million.

Q. DOES A DEBT SERVICE COVERAGE RATIO COMPUTATION INDICATE THE COMPANY CAN CASH FLOW ITS DEBT SERVICE?

A. Ironically, yes.[19] Based on the 2008 financial results, the debt service coverage

[19] *See* Rebuttal Exhibit 2 (cash flow schedule).

ratio ("DSC") as typically computed by Staff is 1.49.[20] By this measure, it appears that the Company can cash flow the debt service on the IDA bonds. However, the DSC is misleading, at least in the short-term. In terms of liquidity, the current financial picture is bleak. The "current ratio,"[21] a measure of liquidity, based on the 2008 financial results is 0.71.[22] A more stringent measure of liquidity is the "acid-test ratio"[23] which at the end of 2008 was a mere 0.06.[24] The liquidity ratios and the inability of the Company to raise cash in the short-term without rate relief tell the real current financial picture of this Company. If this does not constitute an emergency, I do not know what does.

Q. WHAT DO YOU UNDERSTAND THE CRITERIA TO BE FOR AN EMERGENCY MR. BOURASSA?

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[20] The calculation is 2008 cash flow from operations of $2,864,741 divided by debt service of $1,916,250. In this way, DSCR is an indicator of the amount of cash flow available to meet annual interest and principal payments on debt, including sinking fund payments. It is computed by dividing the earnings before interest, taxes, depreciation and amortization ("EBITDA") or operating income by the annual debt service. A DSCR of greater than 1.0 indicates that there is enough operating cash flow to cover the debt service and, conversely, a DSCR of less than 1.0 indicates that there is insufficient cash flow to service debt. Typically, loan covenants requirement minimum debt service coverage ratios of 1.2 to 1.25 to provide a margin of safety.

[21] The **current ratio** is a measure of liquidity and measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares a company's current assets to its current liabilities. The higher the current ratio, the more capable the company is of paying its obligations. A ratio under 1.0 suggests that the company would be unable to pay off its obligations when they become due. While this shows the company is not in good financial health, it does not necessarily mean that it will go bankrupt if the company has access to financing - but it is definitely not a good sign. However, Far West does not have any means to additional financing – short-term or long-term.

[22] Current assets of $3,165,836 divided by current liabilities of $4,445,590.

[23] The **acid test ratio** is another measure of liquidity but is a more stringent test than the current ratio. The acid test ratio indicates whether a firm has enough short-term assets to cover its immediate liabilities. It compares cash, receivables, and short-term investments with current liabilities. An acid test ratio of less than 1.0 indicates the company cannot pay its short-term obligations. Obviously, it is vital that a company have enough cash on hand to meet accounts payable, property and income taxes, interest, and other bills when they become due.

[24] Cash and cash equivalents of $251,546 divided by current liabilities of $4,445,590. Bond debt reserve funds of $1.6 million are ignored because this fund must be replenished within 6 months.

A. Staff has proposed three factors: (1) sudden change that causes hardship, (2) insolvency, and (3) doubt over whether service can be maintained pending the completion of a permanent case.[25] If any one of these conditions is met, there is an emergency.[26] It seems to me that condition 1 is clearly met. As far as the second condition, I am not sure what Staff's definition of "insolvent" is but I do know that Far West is unable to pay all of its bills when they become due and has $3.4 million of accounts payable. And condition 3 also seems to be met, given the impact that the Company's finances will have on its ability to provide reliable service over the next 12 months. I don't believe the Commission has to wait until a utility has gone under to grant relief. By then it is too late. Is delayed rate relief really a sufficient reason for risking water and sewer service to thousands of customers?

Q. DIDN'T THE COMMISSION STAFF AND THE COMMISSION ITSELF RECOGNIZE THAT THE SEWER SYSTEM IMPROVEMENTS THAT WERE NEEDED WOULD HAVE AN IMPACT ON RATES?

A. Yes. In the Company's prior case, it was recognized that the sewer division's plant needed substantial improvement. As Mr. Capestro explains, none of this should come as a surprise.[27] I further agree with him that this should really be viewed as the first step of a four phase rate increase to cover the costs of more than $20 million of improvements ordered by the State of Arizona.[28]

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[25] Staff Report at 2.

[26] *See* Attorney General Opinion 71-17.

[27] Capestro Rb. at 7-8.

[28] *Id.* at 23.

IV. REBUTTAL TO THE TESTIMONY OF RUCO WITNESS WILLIAM A RIGSBY

Q. PLEASE COMMENT ON MR. RIGSBY'S TESTIMONY THAT THE FINANCIAL ANALYSIS OF THE COMPANY'S INTERIM RATE REQUEST BE DONE ON A COMPANY-WIDE BASIS.

A. I don't necessarily disagree. But a "company-wide" picture must not be allowed to mask the real problems Far West and its customers face right now. Whether an analysis is performed on a company-wide basis or for the sewer division alone, the conclusion is the same: Far West has a very serious cash flow problem that qualifies as an emergency. The only available remedy is interim rate relief for the sewer division.

Q. WHY CAN'T THE WATER DIVISION CONTINUE TO SUBSIDIZE THE SEWER DIVISION AS RUCO PROPOSES?

A. Because the water division has been carrying the sewer division financially, water system improvements are being delayed. Put simply, the water division is now on the same troubled ship as the sewer division. This is why one customer group should not subsidize the costs of service to another group of customers. Both groups face the prospect of inadequate and deteriorating service. Given that about half of Far West's water customers do <u>not</u> receive sewer service, this is a risk that those water customers should not have to shoulder.

It is ironic that Mr. Rigsby's has no problem with the water division subsidizing the sewer division. In the past, RUCO has argued that cross-subsidization is unfair to rate payers.[29] In the Arizona Water Company case (Decision No. 64282), for example, RUCO argued that cross-subsidization would

[29] *E.g. Arizona Water Company*, Decision No. 66400 (October 14, 2003) and *Arizona Water Company* Decision No. 64282 (December 28, 2001).

result in inequities between customer groups.[30] RUCO also opposed rate consolidation in a later Arizona Water Company case (Decision No. 64440), arguing that rate consolidation would cause customers on one system to subsidize customers served by another system.[31] In that case, RUCO witness, Marylee Diaz-Cortez, testified that one system was the biggest "cost causer" of arsenic treatment costs, and customers on that system should not be subsidized by customers on another system.[32]

Yet in this case, RUCO has no problem having the water division customers subsidize the sewer division customers. I wonder whether the more than 7,500 or so residential water customers who do not receive sewer service from Far West agree with RUCO's position.

Q. BUT WASN'T RUCO'S POSITION ON CROSS-SUBSIDIZATION BASED ON CONSOLIDATED RATES ACROSS MULTIPLE DIVISIONS?

A. Yes, but the underlying rationale for RUCO's opposition is unaffected. As Ms. Diaz-Cortez argued, the "cost causer" should not be subsidized by customers on another system. Clearly, the water and sewer customers of the Company are served by separate systems, they have separate rate bases, and they are not even the same customer groups. As stated, about half of Far West's water customers do not receive sewer service. RUCO's reasoning and argument applies equally to the situation in the Arizona Water Company cases and to the current situation for the Company and its two divisions.

Q. PLEASE RESPOND TO MR. RIGSBY'S COMMENTS THAT ALL OF THE SEWER IMPROVEMENTS HAVE NOT YET BEEN COMPLETED.

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[30] Decision No. 84282 at 20.

[31] Decision No. 64440 at 12.

[32] *Id.*

A. While a significant portion of the sewer system improvements have been completed, the Company's interim rate request is not based on whether the plant has been completed. Rather, it is based on the Company's inability to currently cash flow its obligations, which jeopardizes its ability to maintain service to both its water and sewer customers until permanent rate relief is granted. Thus, RUCO's argument on whether all of the sewer system improvements are completed muddles the real issue at hand. Again, the real issue is the Company's inability to pay its bills, complete the sewer improvements, and continue to maintain adequate service to its water and sewer customers.

Q. **PLEASE COMMENT ON MR. RIGSBY'S FINANCIAL ANALYSIS OF THE COMPANY FINANCIAL SITUATION.**

A. Mr. Rigsby's financial analysis does not recognize the serious liquidity problem the Company finds itself in today. The metrics that should be used to evaluate the real problem facing the Company are the current ratio, the acid test ratio, and a comprehensive analysis of the cash flow needs of the Company over the next 12 months. I will not repeat the financial picture revealed by those metrics, as I have illustrated it in great detail above. But any person taking an unbiased view of the facts here could not legitimately dispute that the Company needs additional cash flow immediately.

Q. **DO YOU DISPUTE THE DSC RATIOS COMPUTED BY MR. RIGSBY?**

A. Yes, largely because Mr. Rigsby computes several ratios which are based upon erroneous assumptions. I will address his computations, but let me first emphasize that a discussion and analysis strictly based on a simple DSC itself does not provide an accurate picture. A DSC does not analyze the true nature of the problem facing the Company - inadequate actual cash flow. A computed DSC of 1.0 or above does not measure the Company's ability to pay its obligations as they become due. A current ratio, acid test ratio and a comprehensive cash flow analysis do.

Putting that error aside, Mr. Rigsby computed DSC ratios based on the Company's 2007 and 2008 financial statements using an analysis similar to what the Commission Staff performed in the Company's financing proceeding in 2007.[33] He computed DSC ratios for 2007 and 2008 of 1.49 and 1.35, respectively.[34] I computed the similar ratios earlier in my testimony. Thus, I do not dispute Mr. Rigsby's computed ratios based on the 2007 and 2008 financial statements.

Next, in response to the Company pointing out that a simple DSC does not consider extraordinary expenses like effluent removal costs, Mr. Rigsby computed a modified DSC of 0.99.[35] Mr. Rigsby acknowledges a DSC of 0.99 is problematic.[36] This is because it shows the Company does <u>not</u> have sufficient cash flows from operations to cash flow debt service. But, Mr. Rigsby's then dismisses this DSC result by claiming the Company has $635,231 of interest income as an alternative source of cash.[37] He then erroneously adds this income back to get a DSC of 1.47.[38]

Q. WHAT IS THE PROBLEM WITH THIS ANALYSIS?

A. First, the interest income from 2007 should not be considered <u>because it no longer exists and will not exist in the future</u>.[39] In fact, for 2008, interest income dropped to less than $163,000. All of bond proceeds have been expended and are no longer

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[33] Rigsby Dt. at 14.

[34] *Id.* at 15.

[35] *Id.* at 16.

[36] *Id.*

[37] *Id.* at 17.

[38] *Id.* at 17.

[39] Capestro Rb. at 13-14; Staff Report at 2-3.

available to generate interest.[40] Mr. Rigsby admits the interest income was earned on unexpended bond proceeds which will not exist when these funds are expended.[41] At the same time, the level of extraordinary expenses (effluent and legal) experienced in 2007 continued into 2008, and is expected to continue through at least though 2009. So, Mr. Rigsby's DSC of 0.99 for 2008 is much closer to reality right now than his DSC of 1.47 computed with phantom interest income.

Q. DOESN'T MR. RIGSBY QUESTION WHETHER THERE ARE COST OVERRUNS ON THE SEWER SYSTEM IMPROVEMENTS AS WELL AS THE NEED FOR IMMEDIATE CAPITAL IMPROVEMENTS FOR THE WATER DIVISION?

A. Remarkably, yes. But I see no evidence for this testimony, and the statement is wrong.[42] Just as important, and another critical aspect of the Company's cash flow problem, is the $3.46 million of short-term accounts payable at the end of 2008 that I have mentioned several times. Mr. Rigsby completely ignores this fact. These payables are very real and require real cash to pay them. As I testified earlier, even if you dismiss the additional costs to complete the sewer system improvements, there still is insufficient cash over the next 12 months to pay down these payables.

Mr. Rigsby has analyzed the wrong problem using the DSC and has ignored or dismissed critical aspects of a comprehensive cash flow analysis. As a result, he completely misses the mark on the Company's current financial predicament. In his world, as long as the DSC is over 1.0, all is well, regardless of the business' current needs.

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[40] Capestro Rb. At 13-14; *See also* Rebuttal Exhibit 1.

[41] Rigsby Dt. at 18.

[42] Capestro Rb. explained at 12-13.

Q. PLEASE COMMENT ON MR. RIGSBY'S TESTIMONY THAT THE COMPANY HAS NOT DEMONSTRATED THAT AN EMERGENCY EXITS.

A. Mr. Rigsby first cites the criteria set forth by the Attorney General concerning when the Commission can approve interim rates.[43] One of those criteria is that an emergency exits. As quoted by Mr. Rigsby and according to the Attorney General, "an emergency exits when sudden change brings sudden hardship to a company, when a company is insolvent, or when the condition of the company is such that its ability to maintain service pending a pending formal rate determination is in serious doubt."[44] These are the same three conditions listed on page 2 of the Staff Report. As I testified earlier, conditions one and three are satisfied, and if the Company is not yet insolvent, I don't believe it good public policy to drive utilities into insolvency by delaying rate relief. By then, it is too late to proactively address the problem.

Q. WASN'T THE COMPANY GRANTED INTERIM RATE RELIEF FOR ITS WATER DIVISION IN A PRIOR CASE?

A. Yes. In Decision No. 61833 (July 20, 1999) (copy attached as Rebuttal Exhibit 3), the Commission granted the Company's water division interim rates to provide adequate cash flow to obtain financing for the construction of approximately $6 million of new water treatment facilities. In that case the Company requested interim rate relief at roughly half of the amount it was seeking in its permanent rate filing (about $2.5 million). The interim rate increase was sought because changes in operating expenses and anticipated debt service requirements from new debt would have prevent it from obtaining debt financing. In that case, as here, Far

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[43] Rigsby Dt. at 20.

[44] *Id.*

West was constructing the water treatment plant, but required additional financing to complete the facilities. After interim rates were approved, the Company was able to borrow funds from WIFA and complete the plant prior to the hearing on the permanent rate case.

Q. DOESN'T THAT SOUND A LOT LIKE THE FACTS OF THIS CASE, MR. BOURASSA?

A. Yes. While the Company has already obtained long-term debt financing in the instant case, which is different than the prior case, increased operating expenses and higher costs of construction have resulted in the Company's inability to cash flow debt service and to pay its operating costs and other current obligations, which are similar to the prior case. But I believe the situation in this case is far more serious. Because they cannot borrow any more money, Far West is trying to pay for the improvements from cash flow, which limits the use of such funds to pay other expenses.

In the prior case, the water treatment facilities were not mandatory. The Company had a serious problem with high levels of total dissolved solids ("TDS") affecting the taste and causing scale deposits on plumbing fixtures and filters and problems with appliances.[45] But the Company's water met all federal and state water quality standards. Customers just demanded better quality water. In this case, the Company sewer system improvements are mandatory, and they cannot be completed because the Company's cash flow is so poor.[46]

Q. DID RUCO TESTIFY THAT THERE WAS AN EMERGENCY IN THE COMPANY'S PRIOR CASE?

A. Yes. RUCO supported the Company recommendation for interim rates, albeit at a

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[45] Decision No. 61833 at 2.

[46] Capestro Rb. at 6.

lower amount, and based its recommendation on the Attorney General's criteria for authorizing interim rates.[47] In fact, in support of its recommendation to approve interim rates in Decision No. 61833, RUCO cited a 1984 APS interim rate decision[48] that involved similar circumstances. Both cases involved extensive construction projects, large debt issuances, and a cash flow problem associated with the debt issuances during the construction period.

In this case, as a result the construction of the new wastewater treatment facilities, Far West's rate base for its sewer division will be about 15 times greater than the rate base approved in the sewer division's last rate case, which was decided just two years ago. And, as I have shown earlier in my testimony, there is a serious cash flow problem related to debt service associated with this construction project, which is not only preventing the completion of construction, but preventing the Company from paying its operating expenses and its short-term payables in the normal course of business.

Q. IS THE COMPANY ATTEMPTING TO REDEFINE THE REGULATORY PARADIGM IN ARIZONA BY ITS INTERIM RATE REQUEST?

A. With all due respect, this is nonsense given Far West's circumstances. Interim rate relief is an important aspect of regulation, as the interim rate increases granted to APS last year illustrates. APS received interim rates to shore up its credit rating, which in the long-run will lower financing costs and save rate payers money. But, because Mr. Rigsby believes Far West's circumstances do not rise to the level of an emergency, he obfuscates the issue at hand by making assertions about the Company (and other utilities) attempting to circumvent the rate making process at the expense of rate payers. This is misleading and should be rejected as bad policy.

[47] Decision No. 61833 at 5.

[48] *Id.* at 5 (discussing Decision No. 53909 (Jan. 30, 1984)).

V. <u>REBUTTAL TO THE STAFF REPORT</u>

Q. PLEASE COMMENT ON STAFF'S CONCLUSION THAT NEGATIVE NET INCOME DOES NOT NECESSARILY REPRESENT AN EMERGENCY?

A. I agree with Staff on this point.[49] It is true that the Company (combined water and sewer divisions) lost over $809,000 in 2008, over $630,000 in 2007, and $1.2 million in 2006, respectively.[50] While this is certainly not good for the Company's financial health, those loses by themselves do not constitute an emergency. But they are indicative of a lack of revenues sufficient to meet operating expenses, which situation is not sustainable. At some point, these losses impact cash flows, especially when the utility is forced to undertake a major construction project and needs additional funds to support that project (e.g., debt service) in addition to meeting ordinary expense requirements. In other words, although past and continuing negative net income is not why there is an emergency, those losses effectively set the stage for the Company's current cash flow problems. As I have testified, this cash flow problem has been primarily caused by borrowing $25.2 million and the related debt service, and by construction cost overruns that require additional funding.

Like RUCO, Staff offers no way of that dilemma. Postponing rate relief is obviously not the answer. It will simply exacerbate the Company's losses, delay completion of the plant and ultimately require larger increases to maintain the Company's solvency and allow it to continue to operate. As I previously discussed, this is the same situation that Far West faced in 1999, when it was

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[49] Staff Report at 3.

[50] The sewer division losses for 2008, 2007, and 2006 were approximately $2.58 million, $2.8 million and $1.2 million, respectively.

converting from groundwater to Colorado River water, and needed interim rate relief to obtain permanent debt financing from WIFA and to complete the new surface water treatment facilities.

Q. WHAT POSITION DID STAFF TAKE ON THE COMPANY'S 1999 REQUEST FOR INTERIM RATE INCREASES?

A. In contrast to RUCO, Staff opposed interim rate relief. Staff's position was essentially the same as in this case. Staff argued that the Company's income statements and cash flow projections failed to show that the Company was unable to provide service to its customers and remain solvent.[51] The Commission rejected Staff's argument, recognizing that:

> The construction project is very large in proportion to the Company's current rate base, and the substantial debt required to finance the construction of the project, along with the increased operating expenses associated with the river water treatment will have a severe negative impact on cash flow. This will damage the Company's credit worthiness and cause the Company hardship until permanent rates can be put into place. Based on the foregoing, we find Far West is facing an emergency under the criteria established in Attorney general Opinion 71-17.[52]

Q. WHAT ABOUT THE FACT THAT IN THE RECENT FINANCING APPLICATION, DECISION NO. 69550, THE COMPANY ASSERTED AND STAFF CONCLUDED THAT THE COMPANY'S REVENUES WERE ADEQUATE TO SUPPORT THE REQUESTED INDEBTEDNESS?

A. As a preliminary matter, it is again worth noting that Far West faced similar circumstances in its 1999 interim rate proceeding. In that case, Staff recommended, and the Commission authorized Far West to borrow $6 million in Decision No. 61713 (May 13, 1999), even though, according to Staff, the principal

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[51] Decision No. 61833 at 6-7.

[52] *Id.* at 7-8.

and interest payments on the additional debt would result in a DSC of 0.3 and a TIER of -0.29. The Commission recognized that the Company's rate base would increase dramatically and that rates would likely have to increase, but also recognized that it was in the public interest to provide funding for the project. The issue facing the Company in this case is even more serious, given that the upgrades to the Company's wastewater facilities have been mandated by another state agency. It would be improper in my view to approve debt financing for the project, and then argue, as Staff is doing, that because the debt was approved, the Company should be able to service it as well come up with funding to finish the project without needing any rate increases.

During the finance proceeding in 2007, Staff computed a DSC of 1.15 and a TIER of 0.50. This is not in dispute.[53] In its report filed in that docket, Staff stated that a TIER of less than 1.0 was not sustainable.[54] This is because a TIER of less than 1.0 indicates the Company does not have operating income sufficient to cover interest expense.[55] In other words, the Company is experiencing net losses. That being said, I also do not dispute that, using Staff's approach, the DSC ratios for 2007 and 2008 suggest that the Company can support its long-term debt. However, as I have testified, this is the wrong metric and obscures the real cash flow predicament the Company currently finds itself in.

Q. DOES THE FACT THAT STAFF DID NOT RECOMMEND A RATE INCREASE IN ITS REPORT ON THE COMPANY'S FINANCING APPLICATION HAVE ANY RELEVANCE?

A. No. Again, referring to Far West's 1999 financing application, Staff didn't

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[53] *Id.*

[54] Staff Report in Docket WS-0378A-07-0442 at 3.

[55] *Id.*

recommend rate increases despite the magnitude of the financing and the weak DSC and TIER ratios Staff computed.[56] In its decision, the Commission stated that the "substantial increase in rate base as a result of the new plant and added expense of purchasing water from the District may have a significant impact on rates, although the ultimate effect won't be known until the Company's next rate case."[57] In my experience, this is normally what is done when financing application are approved – no position is taken on whether rate increases will be needed and to what extent.

In this case, I believe that rate increases were expected. It was just a matter of when and how much. Anytime a Company borrows and spends over $20 million for plant improvements and the rate base increases by some 15 times, a rate increase is likely to be needed to maintain the utility's financial condition and provide for a fair return on rate base. Again, this happened in Far West's water division rate case in 1999. In this case, the Commission specifically ordered the Company to file a rate case for its sewer division in 2008, presumably because it anticipated that rate relief would be needed because of the major plant construction needed to comply with ADEQ's requirements. Unfortunately, the Company's financial condition has deteriorated such that an interim rate increase is now needed in advance of the permanent rate increases.

Q. DO YOU BELIEVE THAT STAFF'S ALTERNATIVE INTERIM RATE OPTION FOR AN INCREASE OF $972,150 TO BE SUFFICIENT?

A. No. It is less than half of the Company request of $2,161,788, which I have already testified will not completely solve the Company's financial problems. The Company will still need to raise additional short-term funds. While an interim rate

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[56] Decision No. 61713 at 3.

[57] *Id.*

increase of $972,150 is certainly better than no interim rate increase at all, the ability of the Company to raise additional short-term funds will be severely diminished by Staff's alternative recommendation compared to the Company's recommendation of $2,161,788. Staff's recommendation is also flawed because of its increase in the rate for effluent.

Q. WHY IS THAT, MR. BOURASSA?

A. Because the Company cannot dispose of all of its effluent now, and an increase in the rate for effluent will leave it, not with more revenues, but with increased operating expenses for effluent disposal.[58] This is why we did not propose any increase in the effluent rate on an interim basis.[59] It is also why we have proposed a decrease in the effluent rate in the permanent rate case.[60] So, in addition to Staff's schedule erroneously showing an increase of 143 percent for all classes (Staff Report at GWB-2), Staff's recommended increase in the rate for effluent is a terrible idea at this time.

Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, except I do wish to note that my silence on any position taken by Staff or RUCO, or with respect to any public comment, does not signal agreement.

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[58] Capestro Rb. at 24.

[59] Bourassa Dt. at 7-8.

[60] Direct Testimony of Thomas J. Bourassa (Rate Base, Income Statement, Rate Design), *Far West Water and Sewer Company,* Docket No. WS-03478A-08-0454, at pp. 17-20.

FAR WEST WATER & SEWER COMPANY
DOCKET NO: WS-03478A-08-0608

THOMAS J. BOURASSA
REBUTTAL TESTIMONY
March 31, 2009

EXHIBIT 1

Far West Water & Sewer, Inc.

Financial Statements

December 31, 2008

Far West Water & Sewer, Inc.
Financial Statements
For the year ended December 31, 2008

Contents

Lloyd H. Sunderman, CPA, P.C.

Accountant's Report on Financial Statements

I have compiled the accompanying balance sheet of Far West Water & Sewer, Inc. as of December 31, 2008 and the related statement of operations and changes in retained earnings, and statement of cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. I have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

I am not independent with regard to Far West Water & Sewer, Inc.

Lloyd H. Sunderman

February 18, 2009

1409 South Fifth Avenue • Yuma, Arizona 85364 • (928) 782-5786 • Fax: (928) 783-8251

Far West Water & Sewer, Inc.
Balance Sheet
December 31, 2008

ASSETS

Utility Plant:	
Land and land rights	$ 1,229,388
Depreciable plant and equipment	47,354,849
Construction work in progress	16,466,494
Total utility plant	65,050,731
Less accumulated depreciation and amortization	14,892,718
Net utility plant	50,158,013
Current Assets:	
Cash and cash equivalents, unrestricted	13,058
Restricted cash, construction accounts	238,488
Restricted cash, reserve accounts	1,632,432
Customer receivables	927,048
Accounts receivable, associated companies	253,172
Prepaid expenses	94,208
Other current assets	7,430
Total current assets	3,165,836
Other assets:	
Unamortized debt discount and expense	1,138,335
Miscellaneous deferred debits	574,047
Deferred rate case expense	217,594
Total other assets	1,929,976
Total assets	$ 55,253,825

See Accompanying Notes to Financial Statements

Far West Water & Sewer, Inc.
Balance Sheet
December 31, 2008

CAPITALIZATION AND LIABILITIES

Capitalization:	
Common stock	$ 1,000,000
Additional paid-in-capital	6,233,279
Retained deficit	(3,617,691)
Total Stockholder's equity	3,615,588
Current liabilities:	
Current maturities of long-term debt	315,000
Accounts payable	3,455,336
Customer deposits and pre-payments	165,802
Accrued wages	25,165
Accrued sales taxes	31,874
Accrued property taxes	318,282
Accrued payroll taxes	694
Accrued interest	133,437
Total current liabilities	4,445,590
Other liabilities:	
Bonds payable	25,045,000
Advances for construction	15,445,966
Contributions in aid of construction	5,689,758
Judgment payable	1,208,665
Unamortized premium on debt	118,258
Less current maturities	(315,000)
Total other liabilities	47,192,647
Total capitalization and liabilities	$ 55,253,825

See Accompanying Notes to Financial Statements

Far West Water & Sewer, Inc.
Statement of Operations and Changes in Retained Earnings
For the year ended December 31, 2008

Operating Revenue	$	7,857,117
Operating Expenses:		
Salaries & wages		1,142,948
Payroll overhead		293,663
Automotive		124,832
Chemicals		435,709
Depreciation and amortization		1,423,338
Electricity		664,325
Insurance		77,691
Miscellaneous		61,317
Office		87,263
Contract services		360,669
Regulatory commission		138,371
Rent - buildings		27,034
Rent - equipment		190,550
Repairs and maintenance		254,929
Sludge removal		102,507
Supplies		78,929
Taxes - other		3,994
Taxes - property		318,282
Water purchased		629,363
Total operating expenses		6,415,714
Net operating income		1,441,403
Other income and expenses:		
Interest income		162,379
Interest expense		(1,698,978)
Amortization of premium on debt		4,078
Amortization of debt discount, expenses		(59,045)
Restitution		(5,533)
Fines and penalties		(9,800)
Prior period income and expenses		(9,282)
Extraordinary deductions		(633,410)
Miscellaneous non-utility expenses		(1,676)
Net other income and expenses		(2,251,267)
Net loss		(809,864)
Retained deficit, December 31, 2007		(2,807,827)
Retained deficit, December 31, 2008	$	(3,617,691)

See Accompanying Notes to Financial Statements

Far West Water & Sewer, Inc.
Statement of Cash Flows
For the year ended December 31, 2008

Operating Activities:	
Net loss	$ (809,864)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	1,423,338
Depreciation (prior year)	(18,596)
Changes in operating assets and liabilities	
Restricted cash	8,674,486
Receivables	223,284
Receivables, associated companies	(197,730)
Prepaid expenses	(3,850)
Income tax refunds receivable	12,430
Other current assets	(7,430)
Deferred rate case expense	47,671
Accounts payable	3,031,100
Accounts payable, associated companies	(918,871)
Customer deposits and pre-payments	14,126
Other current liabilities	189,375
Net cash provided by operating activities	11,659,469
Investing activities:	
Proceeds from retirement of assets	1,392
Utility plant expenditures	(1,001,411)
Construction in progress	(10,836,510)
Net cash used in investing activities	(11,836,529)

Far West Water & Sewer, Inc.
Statement of Cash Flows
For the year ended December 31, 2008
(Continued)

Financing activities:		
Net decrease in long-term borrowings		(716,244)
Unamortized debt discount and expenses		(140,183)
Unamortized premium on debt		118,258
Refundable security deposits		577,150
Advances for construction		(203,862)
Contributions in aid of construction		383,586
Net cash provided by financing activities		18,705
Change in cash and cash equivalents		(158,355)
Cash and cash equivalents at beginning of year		171,413
Cash and cash equivalents at end of year	$	13,058
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$	1,650,812
Income taxes		45

See Accompanying Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Nature of Operations Far West Water & Sewer, Inc. is an Arizona Corporation providing water and sewer services to customers in the Foothills area of Yuma county. The Company was originally organized and began water utility operations in 1965 as a subsidiary of H&S Developers, Inc. Sewer operations began in 1994. The Company was reorganized and began operating as a separate corporation in 1998.

Water Supply The Company obtains its water from the Colorado River and from the Yuma area aquifer. The long-term availability of water supplies is dependent upon, among other factors, drought conditions, increases in population, water quality standards, and legislation that may potentially reduce water supplies. Various California water systems north of Yuma also draw water from the Colorado River.

Public Utility Regulation The Company is subject to regulation for rates and other matters by the Arizona Corporation Commission and follows accounting policies prescribed by the ACC. The Company prepares its financial statements in accordance with generally accepted accounting principles in the United States of America, which includes the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." SFAS 71 requires cost-based, rate-regulated enterprises to reflect the impact of regulatory decisions in their financial statements. The balance sheet includes regulatory assets and liabilities as appropriate.

Business Risks Although the Company has a diversified base of residential, industrial and other customers, risks arise from weather conditions, adequacy and quality of water supplies, regulatory decisions, pronouncements and laws, litigation, and general business conditions.

Note 1. Summary of Significant Accounting Policies (Continued)

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Revenue consists of monthly cycle customer billings for regulated water and sewer services. Revenue includes estimated unbilled amounts based on the last billing to the end of the accounting period. The Company considers accounts receivable to be fully collectable; accordingly, no provision for doubtful accounts is provided for. When accounts become uncollectible, they are charged to operations.

Property and Equipment Depreciation is computed on a straight-line basis at various rates as approved by the Arizona Corporation Commission.

Cash and Cash Equivalents Cash and cash equivalents consist of highly liquid instruments with original maturities at the time of purchase of three months or less. The carrying amount approximates fair value.

Restricted Cash Restricted cash consists of money market cash funds held by banks. The cash is released from restriction as continuing infrastructure improvements are approved for funding.

Concentration of Credit Risk The Company maintains accounts at a bank which is also a related party. Account balances are insured by the Federal Deposit Insurance Corporation up to $ 250,000 per bank. On occasion the Company has deposits at the bank in excess of the FDIC insured amount.

Note 1. Summary of Significant Accounting Policies (Continued)

Utility Plant Utility plant is stated at the original cost of such property when first placed in service. Utility plant accounts are charged with the cost of improvements and replacements. Retired or disposed of depreciable plant is charged to accumulated depreciation and credited to the asset account together with any costs applicable to retirement, less any salvage received. Maintenance of utility plant is charged to expense.

Customers' Advances for Construction and Contribution in Aid of Construction
Under the terms of construction contracts with real estate developers, including a related-party developer, and others, the Company periodically receives either advances for the costs of new main installations or title to the main after it is constructed and financed by the developer. Refunds are made, without interest, as services are connected to the main. Payments are made over a period of ten years for water contracts and twenty years for sewer contracts, and not in excess of the original advance. Unrefunded balances at the end of the contract period are credited to contributions in aid of construction (CIAC) and are no longer refundable.

Income Taxes The Company is a "C" corporation for income tax purposes. Accelerated depreciation methods are used for tax purposes, and those methods have the potential to create a deferred income tax liability to the extent that cumulative accelerated depreciation deductions exceed cumulative straight-line depreciation for financial accounting purposes and taxable income results from operations. However, cumulative tax and financial accounting losses at December 31, 2008 are such that neither a current nor a deferred income tax liability exists.

Note 1. Summary of Significant Accounting Policies (Continued)

Advances in Aid of Construction Advances for construction of collection and distribution lines and related equipment that have been paid by developers, including related-party developers, are reimbursable in part to those developers as a factor of revenue generated through the use of that infrastructure. No interest is payable on those advances.

Unamortized Debt Discount and Expense Fees paid to obtain the interim short-term financing and long-term financing have been capitalized, and are amortized over the life of the loans.

Note 2. Related Party Transactions

In addition to maintaining its checking account at a related party bank, the Company has transactions and balances with other related parties, including a land development company with which Far West Water & Sewer, Inc. works closely in developing water infrastructure in new subdivisions. Balances at December 31, 2008 were:

Accounts receivable - associated companies	$ 253,172

Note 3. Bonds Payable

Industrial Development Authority of Yuma County, Arizona:
(1) Water & Sewer $ 24,820,000 Sewer Exempt Facility Refunding Revenue Bonds (Far West Water & Sewer, Inc. Project) Series 2007A, and
(2) $370,000 Taxable Sewer Exempt Facility Refunding Revenue Bonds (Far West Water & Sewer, Inc. Project) Series 2007B bonds were issued for the purpose of the financing and refinancing of the acquisition, construction, and installation of capital improvements and equipment.

For the years ending December 31:	Principal	Interest
2009	315,000	1,601,250
2010	335,000	1,580,775
2011	360,000	1,559,000
2012	380,000	1,535,600
2013	405,000	1,510,900
2014-2037	23,250,000	22,770,963
Total	$ 25,045,000	$ 30,558,488

Note 4. Judgment Payable

As a result of an accident in 2001, the Yuma County Superior Court in 2006 imposed fines and penalties against the Company and its former President. The liability for those fines and penalties was recorded as current expense and as a contingent liability as of December 31, 2006. The fine is recorded net of discounted imputed interest of 8.25%, since payment of the fine is over several years at $17,500 per month and no interest is included in the stated amount. The case is under appeal, and management and legal counsel anticipate that a decision will be reached during 2009. If payments were to begin in January 2010, following unsuccessful appeals, the future principal and imputed interest payments would be as follows:

For the years ending December 31:	Principal	Interest
2010	$ 114,552	$ 95,448
2011	124,369	85,631
2012	135,026	74,974
2013	146,597	63,403
2014-2017	688,121	116,879
Total	$ 1,208,665	$ 436,335

Note 5. Extraordinary Deductions

Expenses that management has classified as non-operating and non-recurring are as follows:

Professional services	$ 132,047
Emergency services at the Palm Shadows wastewater treatment plant	501,363
	$ 633,410

Note 6. Pension and Other Employee Benefits

The Company maintains a profit sharing contributory 401 (k) plan that covers substantially all employees. Employees who have completed twelve consecutive months of service, have been employed at least 1,000 hours and have attained the age of 21 are eligible to participate in the plan. The Company matches 50% of each employee's contribution up to 8% of gross compensation.

The Company provides health insurance for all full-time employees upon their completion of six months of service. Dependents may be covered at the employees' expense.

Note 7. Pending Litigation

The Arizona Department of Environmental Quality and Far West Water and Sewer, Inc. have executed two consent orders, in March 2006 and again in October 2006, which required Far West to upgrade three of its wastewater facilities and close three others.

In September 2008, the Director of that department filed a complaint in the Superior Court of Arizona, County of Maricopa, primarily based upon the matters contained in the Consent Orders and other alleged reporting violations. Far West has filed an answer to that complaint. No date has been set for any hearing in this matter.

Far West Water & Sewer, Inc.
Balance Sheet - Sewer Division
As of December 31, 2008 and 2007

	Dec 31, 08	Dec 31, 07	$ Change
ASSETS			
Current Assets			
Checking/Savings			
Cash in Bank, Construction Accounts	238,488.11	9,529,797.90	-9,291,309.79
Cash In Bank, Reserve Accounts	1,632,431.57	1,015,607.65	616,823.92
Total Checking/Savings	1,870,919.68	10,545,405.55	-8,674,485.87
Accounts Receivable			
Accounts Receivable, Customers	285,558.02	389,603.60	-104,045.58
Accounts Receivable, Other	0.00	2,604.00	-2,604.00
Accounts Receivable, Associated Companies	192,271.20	0.00	192,271.20
Total Accounts Receivable	477,829.22	392,207.60	85,621.62
Other Current Assets			
Employee Advances	1,450.00	0.00	1,450.00
Prepaid Expenses	37,050.00	52,281.72	-15,231.72
Refundable Security Deposits	0.00	340,287.64	-340,287.64
Total Other Current Assets	38,500.00	392,569.36	-354,069.36
Total Current Assets	2,387,248.90	11,330,182.51	-8,942,933.61
Fixed Assets			
Utility Plant	19,939,570.69	19,357,809.58	581,761.11
Less Accumulated Depreciation	-4,069,473.00	-3,352,988.00	-716,485.00
Construction Work In Progress	15,110,931.27	5,035,435.13	10,075,496.14
Total Fixed Assets	30,981,028.96	21,040,256.71	9,940,772.25
Other Assets			
Unamortized Debt Discount	933,076.33	866,697.41	66,378.92
Miscellaneous Deferred Debits	505,202.87	460,600.11	44,602.76
Deferred Rate Case Expense	217,594.09	265,264.82	-47,670.73
Total Other Assets	1,655,873.29	1,592,562.34	63,310.95
TOTAL ASSETS	35,024,151.15	33,963,001.56	1,061,149.59
LIABILITIES & EQUITY			
Liabilities			
Current Liabilities			
Accounts Payable			
Accounts Payable, Trade	3,146,284.93	224,823.97	2,921,460.96
Accounts Payable, Associated Companies	0.00	905,757.33	-905,757.33
Total Accounts Payable	3,146,284.93	1,130,581.30	2,015,703.63
Other Current Liabilities			
Current Portion of Long-Term Debt	254,016.00	0.00	254,016.00
Customer Deposits	19,909.00	15,406.00	4,503.00
Accrued Interest	107,604.00	68,762.56	38,841.44
Accrued Property Taxes	78,255.46	0.00	78,255.46
Accrued Wages	10,708.31	10,055.77	652.54
Total Other Current Liabilities	470,492.77	94,224.33	376,268.44
Total Current Liabilities	3,616,777.70	1,224,805.63	2,391,972.07
Long Term Liabilities			
Bonds Payable	20,195,959.71	20,312,887.71	-116,928.00
Loans Payable, Associated Companies	0.00	571,244.00	-571,244.00
Unamortized Premium on Debt	95,268.80	0.00	95,268.80
Less Current Maturities	-254,016.00	0.00	-254,016.00
Fines Payable	1,208,665.38	1,208,665.38	0.00
Advances in Aid of Construction	10,030,933.26	10,086,388.61	-55,455.35
Contributions in Aid of Construction	1,490,381.45	1,608,094.45	-117,713.00
Total Long Term Liabilities	32,767,192.60	33,787,280.15	-1,020,087.55
Total Liabilities	36,383,970.30	35,012,085.78	1,371,884.52
Equity			
Retained Earnings	-11,328,178.86	-8,751,511.60	-2,576,667.26
Other Paid-In Capital	9,968,359.71	7,702,427.38	2,265,932.33
Total Equity	-1,359,819.15	-1,049,084.22	-310,734.93
TOTAL LIABILITIES & EQUITY	35,024,151.15	33,963,001.56	1,061,149.59

Far West Water & Sewer, Inc.
Balance Sheet - Sewer Division
As of December 31, 2008

	Dec 31, 08
ASSETS	
Current Assets	
Checking/Savings	
Cash In Bank, Construction Accounts	238,488.11
Cash In Bank, Reserve Accounts	1,632,431.57
Total Checking/Savings	1,870,919.68
Accounts Receivable	
Accounts Receivable, Customers	285,558.02
Accounts Receivable, Associated Companies	192,271.20
Total Accounts Receivable	477,829.22
Other Current Assets	
Employee Advances	1,450.00
Prepaid Expenses	37,050.00
Total Other Current Assets	38,500.00
Total Current Assets	2,387,248.90
Fixed Assets	
Utility Plant	19,939,570.69
Less Accumulated Depreciation	-4,069,473.00
Construction Work In Progress	15,110,931.27
Total Fixed Assets	30,981,028.96
Other Assets	
Unamortized Debt Discount	933,076.33
Miscellaneous Deferred Debits	505,202.87
Deferred Rate Case Expense	217,594.09
Total Other Assets	1,655,873.29
TOTAL ASSETS	**35,024,151.15**
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Accounts Payable	
Accounts Payable, Trade	3,146,284.93
Total Accounts Payable	3,146,284.93
Other Current Liabilities	
Current Portion of Long-Term Debt	254,016.00
Customer Deposits	19,909.00
Accrued Interest	107,604.00
Accrued Property Taxes	78,255.46
Accrued Wages	10,708.31
Total Other Current Liabilities	470,492.77
Total Current Liabilities	3,616,777.70
Long Term Liabilities	
Bonds Payable	20,195,959.71
Unamortized Premium on Debt	95,268.80
Less Current Maturities	-254,016.00
Fines Payable	1,208,665.38
Advances In Aid of Construction	10,030,933.26
Contributions in Aid of Construction	1,490,381.45
Total Long Term Liabilities	32,767,192.60
Total Liabilities	36,383,970.30
Equity	
Retained Earnings	-11,328,178.86
Other Paid-In Capital	9,968,359.71
Total Equity	-1,359,819.15
TOTAL LIABILITIES & EQUITY	**35,024,151.15**

Far West Water & Sewer, Inc.
Profit & Loss - Sewer Division
January through December 2008

	TOTAL
Ordinary Income/Expense	
Income	
Revenues	2,098,425.73
Total Income	2,098,425.73
Gross Profit	2,098,425.73
Expense	
Salaries and Wages	466,264.68
Payroll Taxes	39,100.19
Employee Pension & Benefits	79,075.21
Advertising	184.52
Bad Debt Expense	4,382.27
Chemicals	272,923.70
Contract Services	272,942.35
Depreciation and Amortization	598,772.00
Education Expenses	6,297.42
Insurance	29,734.03
Materials and Supplies	29,820.73
Office Expense and Supplies	22,027.22
Purchased Power	245,610.41
Regulatory Comm. Exp. - Amort. Rate ...	122,429.76
Regulatory Comm. Expense-Other	3,880.84
Rental of Buildings, Real Property	5,689.00
Rental of Equipment	187,004.45
Repairs and Maintenance	106,509.95
Safety Equipment, Supplies	6,194.09
Sludge Removal	102,506.72
Small Tools	185.61
Taxes - Property	78,255.46
Taxes - Other	3,302.61
Telephone Expense	13,352.25
Transportation Expense	68,279.42
Total Expense	2,764,724.89
Net Ordinary Income	-666,299.16
Other Income/Expense	
Other Income	
Interest and Dividend Income	133,364.33
Miscellaneous Income	18.26
Total Other Income	133,382.59
Other Expense	
Non-Utility Expenses	664.91
Non-Recurring Expenses	609,666.23
Restitution	5,533.00
Fines and Penalties	4,900.00
Interest Expense	1,373,797.71
Amortization of Debt Discount and Expe...	49,592.88
Amortization of Premium on Debt	-3,285.24
Prior Period Expenses	2,881.20
Total Other Expense	2,043,750.69
Net Other Income	-1,910,368.10
Net Income	**-2,576,667.26**

Far West Water & Sewer, Inc.
Balance Sheet - Combined
As of December 31, 2008

	Dec 31, 08
ASSETS	
Current Assets	
Checking/Savings	
Cash on Hand & in Bank	13,058.20
Cash In Bank, Construction Accounts	238,488.11
Cash In Bank, Reserve Accounts	1,632,431.57
Total Checking/Savings	1,883,977.88
Accounts Receivable	
Accounts Receivable, Customers	926,832.74
Accounts Receivable, Associated Companies	253,172.53
Total Accounts Receivable	1,180,005.27
Other Current Assets	
Returned Checks	215.22
Employee Advances	5,450.00
Plant Materials & Supplies	1,979.94
Prepaid Expenses	94,207.63
Total Other Current Assets	101,852.79
Total Current Assets	3,165,835.94
Fixed Assets	
Utility Plant	48,584,238.02
Less Accumulated Depreciation	-14,892,718.17
Construction Work In Progress	16,466,493.72
Total Fixed Assets	50,158,013.57
Other Assets	
Unamortized Debt Discount	1,138,334.72
Miscellaneous Deferred Debits	574,046.55
Deferred Rate Case Expense	217,594.09
Total Other Assets	1,929,975.36
TOTAL ASSETS	55,253,824.87
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Accounts Payable	
Accounts Payable, Trade	3,487,209.06
Total Accounts Payable	3,487,209.06
Other Current Liabilities	
Current Portion of Long-Term Debt	315,000.00
Customer Deposits	69,922.50
Customer Prepayments	95,879.77
Accrued Interest	133,437.50
Accrued Property Taxes	318,282.16
Accrued Wages	25,164.61
Payroll Liabilities	693.54
Total Other Current Liabilities	958,380.08
Total Current Liabilities	4,445,589.14
Long Term Liabilities	
Bonds Payable	25,045,000.00
Unamortized Premium on Debt	118,258.12
Less Current Maturities	-315,000.00
Fines Payable	1,208,665.38
Advances In Aid of Construction	15,445,965.60
Contributions in Aid of Construction	5,689,758.29
Total Long Term Liabilities	47,192,647.39
Total Liabilities	51,638,236.53
Equity	
Retained Earnings	-3,630,490.94
Retained Earnings, Current year profit (loss)	809,863.95
Common Stock Issued	1,000,000.00
Other Paid-In Capital	14,320,523.85
Investment In Associated Company	-8,074,444.57
Net Income	-809,863.95
Total Equity	3,615,588.34
TOTAL LIABILITIES & EQUITY	55,253,824.87

Far West Water & Sewer, Inc.
Profit & Loss-Combined
January through December 2008

	Jan - Dec 08
Ordinary Income/Expense	
Income	
Revenues	7,857,117.28
Total Income	7,857,117.28
Gross Profit	7,857,117.28
Expense	
Salaries and Wages	1,133,265.13
Leased Employees	9,682.95
Payroll Taxes	96,151.72
Employee Pension & Benefits	197,511.47
Advertising	8,333.44
Bad Debt Expense	4,382.27
Chemicals	435,709.47
Contract Services	360,668.89
Depreciation and Amortization	1,423,338.00
Education Expenses	15,669.23
Income Taxes-State	45.00
Insurance	77,691.36
Materials and Supplies	63,566.61
Miscellaneous Expense	-0.02
Office Expense and Supplies	87,262.68
Purchased Power	664,325.15
Purchased Water	629,362.74
Regulatory Comm. Exp. - Amort. Rate ...	122,429.76
Regulatory Comm. Expense-Other	15,941.24
Rental of Buildings, Real Property	27,034.33
Rental of Equipment	190,549.63
Repairs and Maintenance	254,929.34
Safety Equipment, Supplies	9,590.42
Sludge Removal	102,506.72
Small Tools	5,771.59
Taxes - Property	318,282.16
Taxes - Other	3,948.67
Telephone Expense	32,931.94
Transportation Expense	124,831.69
Total Expense	6,415,713.58
Net Ordinary Income	1,441,403.70
Other Income/Expense	
Other Income	
Interest and Dividend Income	162,284.99
Miscellaneous Income	93.85
Total Other Income	162,378.84
Other Expense	
Non-Utility Expenses	1,676.46
Non-Recurring Expenses	633,410.30
Restitution	5,533.00
Fines and Penalties	9,800.00
Interest Expense	1,698,978.24
Amortization of Debt Discount and Expe...	59,044.80
Amortization of Premium on Debt	-4,078.08
Prior Period Expenses	9,281.77
Total Other Expense	2,413,646.49
Net Other Income	-2251267.65
Net Income	-809,863.95

Far West Water & Sewer, Inc.
Balance Sheet - Water Division
As of December 31, 2008

	Dec 31, 08
ASSETS	
Current Assets	
Checking/Savings	
Cash on Hand & in Bank	13,058.20
Total Checking/Savings	13,058.20
Accounts Receivable	
Accounts Receivable, Customers	641,274.72
Accounts Receivable, Associated Companies	60,901.33
Total Accounts Receivable	702,176.05
Other Current Assets	
Returned Checks	215.22
Employee Advances	4,000.00
Plant Materials & Supplies	1,979.94
Prepaid Expenses	57,157.63
Total Other Current Assets	63,352.79
Total Current Assets	778,587.04
Fixed Assets	
Utility Plant	28,644,667.33
Less Accumulated Depreciation	-10,823,245.17
Construction Work In Progress	1,355,562.45
Total Fixed Assets	19,176,984.61
Other Assets	
Unamortized Debt Discount	205,258.39
Miscellaneous Deferred Debits	68,843.68
Total Other Assets	274,102.07
TOTAL ASSETS	20,229,673.72
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Accounts Payable	
Accounts Payable, Trade	340,924.13
Total Accounts Payable	340,924.13
Other Current Liabilities	
Current Portion of Long-Term Debt	60,984.00
Customer Deposits	50,013.50
Customer Prepayments	95,879.77
Accrued Interest	25,833.50
Accrued Property Taxes	240,026.70
Accrued Wages	14,456.30
Payroll Liabilities	693.54
Total Other Current Liabilities	487,887.31
Total Current Liabilities	828,811.44
Long Term Liabilities	
Bonds Payable	4,849,040.29
Unamortized Premium on Debt	22,989.32
Less Current Maturities	-60,984.00
Advances in Aid of Construction	5,415,032.34
Contributions in Aid of Construction	4,199,376.84
Total Long Term Liabilities	14,425,454.79
Total Liabilities	15,254,266.23
Equity	
Retained Earnings	7,697,687.92
Common Stock Issued	1,000,000.00
Other Paid-in Capital	4,352,164.14
Investment in Associated Company	-8,074,444.57
Total Equity	4,975,407.49
TOTAL LIABILITIES & EQUITY	20,229,673.72

10:13 PM
03/02/09
Accrual Basis

Far West Water & Sewer, Inc.
Profit & Loss - Water Division
Year ended December 31, 2008

	Jan - Dec 08
Ordinary Income/Expense	
Income	
Revenues	5,758,691.55
Total Income	5,758,691.55
Gross Profit	5,758,691.55
Expense	
Salaries and Wages	667,000.45
Leased Employees	9,682.95
Payroll Taxes	57,051.53
Employee Pension & Benefits	118,436.26
Advertising	8,148.92
Chemicals	162,785.77
Contract Services	87,726.54
Depreciation and Amortization	824,566.00
Education Expenses	9,371.81
Income Taxes-State	45.00
Insurance	47,957.33
Materials and Supplies	33,745.88
Miscellaneous Expense	-0.02
Office Expense and Supplies	65,235.46
Purchased Power	418,714.74
Purchased Water	629,362.74
Regulatory Comm. Expense-Other	12,060.40
Rental of Buildings, Real Property	21,345.33
Rental of Equipment	3,545.18
Repairs and Maintenance	148,419.39
Safety Equipment, Supplies	3,396.33
Small Tools	5,585.98
Taxes - Property	240,026.70
Taxes - Other	646.06
Telephone Expense	19,579.69
Transportation Expense	56,552.27
Total Expense	3,650,988.69
Net Ordinary Income	2,107,702.86
Other Income/Expense	
Other Income	
Interest and Dividend Income	28,920.66
Miscellaneous Income	75.59
Total Other Income	28,996.25
Other Expense	
Non-Utility Expenses	1,011.55
Non-Recurring Expenses	23,744.07
Fines and Penalties	4,900.00
Interest Expense	325,180.53
Amortization of Debt Discount and Expe...	9,451.92
Amortization of Premium on Debt	-792.84
Prior Period Expenses	6,400.57
Total Other Expense	369,895.80
Net Other Income	-340,899.55
Net Income	**1,766,803.31**

FAR WEST WATER & SEWER COMPANY
DOCKET NO: WS-03478A-08-0608

THOMAS J. BOURASSA
REBUTTAL TESTIMONY
March 31, 2009

EXHIBIT 2

Far West Water and Sewer Company

Actual and Projected Statements of Cash Flows

Exhibit
Response to 4.2(f)

Line No.		Actual Year Ended 12/31/2007	Actual Year Ended 12/31/2008	Projected Year Ended 12/31/2009	
1					
2					
3	Cash Flows from Operating Activities				
4	Net Income	$ (632,134)	$ (809,864)	$ (1,074,183)	[1]
5	Adjustments to reconcile net income to net cash				
6	*provided by operating activities:*				
7	Depreciation and Amortization	1,358,380	1,423,338	1,687,657	[2]
8	Adjustments to Accumulated Depreciation/A.A.	-	(18,596)	-	
9	Other	-	-	-	
10	Changes in Certain Assets and Liabilities:				
11	Restricted Cash	456,072	8,674,486	(49,080)	[3]
12	Receivables	(55,111)	223,284		
13	Receivables - assoc. companies	-	(197,730)	253,172	[4]
14	Prepaid Expenses	(10,541)	(3,850)		
15	Income tax refunds receivable	87,650	12,430		
16	Other current assets		(7,430)		
17	Deferred rate case expense	66,998	47,671	47,671	
18	Accounts payable	(145,615)	3,031,100	(3,400,000)	[5]
19	Accounts payable associated companies	(1,462,684)	(918,871)	-	
20	Customer deposits and prepayments	(87,892)	14,126		
21	Other Current Liabilities	(86,198)	189,375		
22					
23					
24	Net Cash Flow provided by Operating Activities	$ (511,075)	$ 11,659,469	$ (2,534,763)	
25	Cash Flow From Investing Activities:				
26	Capital Expenditures	(3,094,728)	(1,001,411)	(3,266,000)	[6]
27	Construction-in-progress	(818,658)	(10,836,510)	-	
28	Asset retirements		1,392		
29	Net Cash Flows from Investing Activities	$ (3,913,386)	$ (11,836,529)	$ (3,266,000)	
30	Cash Flow From Financing Activities				
31	Net Increase (decrease) in short-term borrowings	(17,735,000)	(716,244)	-	
32	Net increase (decrease) in long-term borrowings	21,074,778	-	(315,000)	[7,8]
33	Unamortized debt discounts	(1,203,889)	(140,183)	(140,183)	
34	Unamortized debt premium		118,258	118,258	
35	WIFA debt service reserve	508,073	-	-	
36	Refundable security deposits	(577,150)	577,150	-	
37	Advances for construction	880,959	(203,862)	(300,000)	[9]
38	Contibutions-in-aid of construction	1,286,033	383,586		
39	Stock issued			-	[7]
40					
41	Net Cash Flows Provided by Financing Activities	$ 4,233,804	$ 18,705	$ (636,925)	
42	Increase(decrease) in Cash and Cash Equivalents	(190,657)	(158,355)	(6,437,688)	
43	Cash and Cash Equivalents at Beginning of Year	362,070	171,413	13,058	
44	Cash and Cash Equivalents at End of Year	$ 171,413	$ 13,058	$ (6,424,630)	
45					
46	[1] Assumes only change in net income will be due to depreciation. Assumes Composite rate of 3.5% on new plant and half-year conv..				
47	Growth in revenues on the system is expected to be minimal in 2009 as little customer growth expected. Expenses are assumed to				
48	continue at the same level as 2008.				
49	[2] Estimated based in plant installed in 2008 and 2009.				
50	[3] Restricted cash reserve balance must contain a full year on interest and principle totaling $1,920,000 by end of 2009. Current balance is $1,632,432.				
51	This will consume approximately $287,568 of cash flow. On the other hand there was $238,488 of restricted cash for construction funds at the end				
52	of 2008 which is assumed to be used for construction projects. The net increase (decrease) in restricted cash is $(49,080).				
53	[4] Assume associated co. receivable at end of 2008 is collected.				
54	[5] Pay down of trade payables primarily the result of ww system improvements. Payable balance at end of 2008 was over $3.4 million.				
55	[6] Estimated 2009 cost to complete wastewater system improvements is $2,266,000.				
56	Estimated required 2009 costs for water system improvements is $1,000,000.				
57	[7] It is still unclear how Company will fund capital requirements and cash shortfalls.				
58	[8] Principle payment on Yuma Bonds for 2009 is $315,000.				
59	[9] Refunds of advances are over $300,000 annually.				

FAR WEST WATER & SEWER COMPANY
DOCKET NO: WS-03478A-08-0608

THOMAS J. BOURASSA
REBUTTAL TESTIMONY
March 31, 2009

EXHIBIT 3

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

JUL 20 1999

DOCKETED BY	MY

N. JAMES

JUL 26 1999

ACTION________

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER, INC., FOR A RATE INCREASE.

DOCKET NO. WS-03478A-99-0144

DECISION NO. 61833

OPINION AND ORDER
(Interim Rates)

DATE OF HEARING: June 9, 1999

PLACE OF HEARING: Tucson, Arizona

PRESIDING OFFICER: Jane L. Rodda

APPEARANCES: Mr. Norman D. James, Fennemore Craig, on behalf of Applicant;

Mr. Kevin D. Quigley, Streich Lang, P.A., on behalf of Yuma Park Associates, Ltd., Intervenor;

Mr. Scott Wakefield, Chief Counsel, on behalf of Residential Utility Consumer Office, Intervenor; and

Mr. Robert Metli, Staff Attorney, Commission Legal Division, on behalf of the Utilities Division Staff.

BY THE COMMISSION:

On February 10, 1999, Far West Water & Sewer, Inc. ("Far West" "Applicant" or "Company") filed with the Arizona Corporation Commission ("Commission") an application to increase its water rates. On April 9, 1999, Far West filed an application for interim rates to provide Far West with adequate cash flow to obtain financing for the construction of a water treatment plant and related facilities to permit the use of Colorado River water. By Procedural Order dated April 16, 1999, a hearing on the interim increase was set for June 9, 1999, in Tucson, Arizona.[1]

Pursuant to Procedural Orders dated April 13, 1999, May 26, 1999 and May 28, 1999, the Commission granted intervention to the Residential Utility Consumer Office ("RUCO"), to Yuma

[1] The hearing on Far West's permanent rate case is set to commence on December 9, 1999, in Yuma, Arizona.

Park Associates, Ltd. ("Yuma Park"), a commercial customer of Far West's, and to George T. Broucek, President of the Mesa Del Sol Property Owners Association. In conformance with the Procedural Orders dated May 17, 1999 and May 19, 1999, the Commission's Utilities Division Staff ("Staff") and RUCO filed direct testimony regarding the interim rate increase on May 28, 1999, and Far West filed rebuttal testimony on June 4, 1999. A hearing on the interim rate increase was held on June 9, 1999 in Tucson, Arizona.

DISCUSSION

Background

Far West provides water service to more than 9,000 customers in an area immediately east of the City of Yuma, Arizona. Historically, Far West's sole source of water has been groundwater from wells within its certificated area. During Far West's last rate case (Decision No. 60437, September 29, 1997), a large number of Far West customers complained about the Company's service quality and the quality of its water. The Company's groundwater contains a high level of total dissolved solids ("TDS"), which, although within federal and state water quality standards, affected the taste and caused scale deposits on plumbing fixtures and filters and problems with appliances. In Decision No. 60437, the Commission ordered Far West to perform a study of its water quality problems, addressing in particular, ways to efficiently and cost-effectively meet customer expectations for safe and potable water.

The Company filed a report with the Commission's Utilities Division, as required in Decision No. 60437, in which the Company's engineers and consultants discussed various alternatives. The Company concluded that its best alternative to alleviate the TDS problem is to acquire a source of Colorado River water and construct water treatment and delivery facilities. Consequently, to address the TDS problem and to ensure a long-term supply, Far West initiated a program to substitute Colorado River water for groundwater.

In June 1998, Far West entered into a contract with the Yuma Mesa Irrigation and Drainage District ("District") under which Far West will purchase 5,000 acre-feet of Colorado River water annually. The contract price for Colorado River water is $75.00 per acre-foot, or $375,000 annually. This quantity of water will satisfy about 70 percent of Far West's current customer demand. Far

West intends to contract with the District for additional acre-feet in the next several years.

In conjunction with a finance request by Far West to finance the construction of the treatment plant and delivery system, Commission Engineering Staff reviewed the Company's report and agreed that the treatment plant and related facilities as proposed by the Company were its most reasonable option for addressing the TDS problem. Staff recommended that the Company's finance request be granted.

<u>Construction Project</u>

Far West has estimated that the new plant will cost $6.0 million. The construction project will nearly double the Company's gross utility plant in service. In Far West's last rate case, the Commission determined that the Company had gross plant in service of $6.4 million and an original cost rate base ("OCRB") of $2.9 million.

Far West commenced constructing the facilities in 1998, and by the time of the interim rate hearing, a substantial portion of the facilities had already been completed, including a 3.0 million gallon storage tank, 20-inch raw water transmission main, the raw water pump station and the finished water pump station. Construction on the treatment plant itself had commenced and the Company's president testified that Far West had already committed $4.0 million to this project. Far West expected the treatment facilities to be completed and in operation by October 1999.

In Decision No. 61713 (May 13, 1999), the Commission authorized Far West to borrow up to $5 .0 million on a short-term basis as an interim loan from H&S Developers, an affiliate of Far West, and $6.0 million on a long-term basis to construct the Colorado River water treatment plant and delivery system. The short-term debt bears an interest rate of prime plus 1.5 percent, or 9.25 percent at the time of the hearing. Far West initially intended to obtain long-term financing from a conventional lender, but also sought assistance from the Water Infrastructure Finance Authority of Arizona ("WIFA"). In March 1999, WIFA adopted a resolution authorizing a binding commitment to assist Far West with its construction project. At the time of the hearing, the precise form of WIFA's financial assistance was unclear. WIFA will either make a direct loan in the amount of $6.0 million or provide financial assistance in the form of a "linked deposit guarantee," under which funds will be deposited with a conventional lender in order to reduce the interest rate that would otherwise be payable by Far West. In either case, the interest rate for the long-term debt will be reduced to approximately 75 percent of the prime lending. WIFA has conditioned its financial assistance on the approval of rates and charges for services that are "sufficient to make principal repayments and interest payments and generate net revenues coverage."

Requested Revenue Increase

In Far West's permanent rate application, the Company sought an increase of $2.5 million, or 140 percent, over test year revenues. In its interim application, Far West is seeking a revenue increase of $1,258,630 (on an annualized basis). Based on its projected changes in operating expenses associated with the new plant and the anticipated debt service requirements resulting from the long-term debt, Far West projected negative net income of $948,612, negative operating income of $520,941 and a negative cash flow of $547,194 for the period June 1999 through May 2000, if interim rates are not granted. The Company contended that the lack of operating income and positive cash flow would result in debt service coverage of only 0.06, negative interest coverage of (1.22) and a negative return on rate base of (4.8) percent. Far West argued that without interim rates, the negative coverage ratios would prevent the Company from obtaining long-term debt financing and Far West would have to either halt construction of the facilities or finance those facilities with equity which would substantially increase the Company's cost of capital, and increase the accrual of a substantial allowance for funds used during construction ("AFUDC") which would inflate Far West's rate base in future.

Far West assumed that the interim rates would go into effect in August 1999 and remain in effect until May 2000 when it is expected the permanent rates would go into effect. The actual revenue increase produced by Far West's proposed interim rates would be $1,015,213 over the ten month period. Far West calculated this revenue increase would result in a debt service coverage of 1.78, an interest coverage of 1.12 and a positive net income of $51,000, and a return on common equity of approximately 1.0 percent.

Far West recognized that the magnitude of its interim request is substantial, nearly a 70 percent increase. Far West argued, however, that its existing rates are very low compared with other water utilities. Far West noted that under its proposed interim rates the average monthly bill for a

5/8" x 3/4" meter would increase from $12.73 to $21.47. In addition to the Colorado River project, Far West has made capital improvements of approximately $2.0 million since its last rate case.

Criteria For Interim Rates

RUCO supported the Company's interim rate request, although it recommended lower interim rates than those sought by the Company. RUCO based its recommendation on the criteria established in Arizona Attorney General Opinion No. 71-17 (May 25, 1971) regarding when the Commission can set interim rates. Attorney General Opinion No. 71-17 found that the Commission has jurisdiction to grant interim rates to be effective until the Commission establishes permanent rates without having to make a finding of fair value if the need for interim rates qualifies as an "emergency." Specifically, the Attorney General's Opinion found an emergency exists "when sudden change brings hardship to a company, when the company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt."

In formulating its recommendation, RUCO noted the precedent set in Arizona Public Service Company ("APS") Decision No. 53909 (January 30, 1984) when the Commission issued emergency rates for APS because of severe cash flow restraints associated with extensive construction projects. At that time APS was engaged in an extensive construction program to build the Palo Verde nuclear plants. Due to the large investment requirements for the nuclear plants and resultant debt issuances, APS had negative cash flow indicators. Absent interim rate relief, APS's commercial paper rating was in danger of being downgraded which would have increased its cost of debt and further eroded APS's cash flow ratios. In Decision No. 53909, the Commission recognized the severe drain that a massive construction project has on cash flow, and the resulting adverse effects on the financial viability of the utility. Accordingly, the Commission found these conditions to constitute an emergency that qualified for interim rates.

RUCO believed that the situation faced by APS in the 1984 Decision and by Far West currently are similar in that they both involve proportionately large construction projects, large debt issuances to finance the projects and a cash flow problem associated with the debt issuance during the construction period. Consequently, RUCO concluded that Far West's situation meets the criteria for emergency interim rates as set forth in Attorney General Opinion No. 71-17 and Decision No. 53909.

RUCO believed Far West's situation qualified as an "emergency" because the construction project is very large relative to the current rate base; the debt necessary to finance the construction has a severe impact on cash flow, and ultimately on the Company's continued viability; and the Company is unable to service the debt with current rates. RUCO disagreed with Far West that the timing differences that arise as a result of the lag between the plant construction period and the time when the plant enters service and is included in rates constitutes an "emergency" justifying interim rates. RUCO believed such "timing differences" were faced by all regulated utilities and alone do not constitute an emergency.

RUCO also disagreed with the amount of the interim rate increase Far West requested because in RUCO's opinion, the increase exceeded the amount necessary to address the emergency. RUCO argued that under Attorney General Opinion 71-17, interim rates are reserved for emergencies and are not used to compensate a utility for a mere inability to generate profits or pay dividends, and consequently, the magnitude of Far West's request, which included a small profit margin, was more than needed to address the emergency situation. RUCO calculated that an increase of $837,817 (on an annual basis) is necessary to address the emergency. This is the amount, RUCO argued, that the Company would require to service the new debt and provide for increased operating costs associated with the new treatment plant. To provide a margin of safety, RUCO's recommendation provided a debt service coverage ratio of 1.5. Far West calculated that under RUCO's recommendation, the Company would experience a net loss of $215,828 during the expected interim period ending May 31, 2000.

Staff and Yuma Park opposed the interim rate increase because in their opinions, Far West was not facing an "emergency" under the criteria of the Attorney General's Opinion. Staff testified that historically Staff recommends interim rate increases in cases where an operating change has or will create a hardship for the company, the company is insolvent, or it is doubtful that the company can maintain service pending a rate determination. After review of the submitted income statements, Staff determined that Far West's request for interim rates did not meet the criteria Staff historically applies. Staff did not believe that the cash flow of the Company as of September 30, 1998, the test year used in the permanent rate case, indicated an insolvent entity or an entity unable to provide service to its customers. Even utilizing the Company's cash flow projections Staff did not believe Far West was unable to provide service to its customers and remain solvent. Yuma Park did not present witnesses of its own, but participated in the questioning of witnesses and agreed with Staff that the current request did not meet the "emergency" criteria established in the Attorney General Opinion as the Company was not insolvent or unable to continue providing service.

Analysis

Under the unique circumstances presented by this case, we concur with RUCO and the Company that Far West is facing an "emergency" caused by severe cash flow shortfalls associated with the financing of a substantial construction project. The Company's move to utilize Colorado River water for a large portion of its supply needs represents a significant operating change. The additional plant associated with the project will almost double the Company's gross utility plant in service (based on its last rate case). Without the interim increase, Far West will not be able to obtain debt financing for the project until permanent rates are in place. It is uncertain whether Far West would be able to finance the project with equity in the event it cannot obtain debt financing, but we note that even if it could command an equity infusion of such magnitude, equity funding will substantially increase the Company's cost of capital and affect the ultimate rates customers will be required to bear at some point in the future.

The Company has determined that acquiring a source of Colorado River water is necessary for it to address water quality issues that have plagued the Company. We concurred with that determination in Decision No. 61713. Consequently, the Company has engaged in a relatively large project to acquire Colorado River water and to construct the facilities necessary to deliver the treated water to its customers. Absent sufficient rates to cover debt service, including interest, principal and reserve requirements, neither WIFA nor conventional financing will be available for the Colorado River water project. Far West's current rates are not sufficient to meet WIFA's or a conventional lender's lending requirements, and Far West has not been able to make interest or principal payments on its existing short-term loan. The construction project is very large in proportion to the Company's current rate base, and the substantial debt required to finance the construction of the project, along with the increased operating expenses associated with the river water treatment will have a severe negative impact on cash flow. This will damage the Company's credit worthiness and cause the Company hardship until permanent rates can be put in place. Based on the foregoing, we find Far West is facing an "emergency" under the criteria established in Attorney General Opinion 71-17. The interim rates we approve herein shall be subject to refund in the event they are not justified in the final determination of the permanent rate case.

We agree with RUCO that the interim rates should be designed to address the "emergency" situation. In this case, interim rates should provide sufficient cash flow to enable the Company to meet debt service requirements of WIFA and/or a conventional lender and should not provide a return on equity during the interim period. We accept RUCO's recommended revenue level and rate design because we agree with RUCO that in calculating cash flow requirements the same time period must be utilized for determining revenues and expected expenses. RUCO utilized a twelve month period in analyzing both sources and uses of cash. The Company appears to have utilized a ten month period for calculating revenue and a twelve month period for calculating debt service costs.

In general, we agree with the Company that an AFUDC component in rate base is reasonable. In balancing the Company's entitlement to recover costs during construction with the effect of the emergency rate increase on customers, we find that it is reasonable in this case to require that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On February 10, 1999, Far West filed with the Commission an application to increase its water rates. The hearing on Far West's application for permanent rates is set to commence on December 9, 1999, in Yuma, Arizona.

2. On April 9, 1999, Far West filed an application for the implementation of interim rates to provide the Company with adequate cash flow to obtain financing for the construction of a water treatment plant and related facilities to permit the use of Colorado River water to improve water

quality and to provide a long-term source of supply.

3. By Procedural Order dated April 16, 1999, a hearing on the interim increase was set for June 9, 1999, in Tucson, Arizona.

4. Pursuant to Procedural Orders dated April 13, 1999, May 26, 1999 and May 28, 1999, respectively, the Commission granted intervention to RUCO, to Yuma Park, a commercial customer of Far West's and to George T. Broucek, President of the Mesa Del Sol Property Owners Association.

5. In conformance with the Procedural Orders dated May 17, 1999 and May 19, 1999, Staff and RUCO filed direct testimony regarding the interim rate increase on May 28, 1999, and Far West filed rebuttal testimony on June 4, 1999.

6. A hearing on the interim rate increase was held on June 9, 1999, in Tucson, Arizona.

7. Far West, Staff and RUCO presented witnesses at the hearing and Yuma Park participated in the examination of witnesses.

8. Following the hearing, Far West and RUCO filed a joint submission for the purpose of explaining a dispute that developed during the hearing concerning the computation of Far West's debt service coverage.

9. Far West provides water utility service to over 9,000 customers, many of whom are seasonal.

10. Historically, groundwater has been Far West's sole source of water and has been characterized by high concentrations of TDS. Far West's groundwater supply meets or exceeds federal and state drinking water quality standards, but the high levels of TDS caused deposits of scale on plumbing fixtures and filters, undesirable taste, and in certain cases, damage to plumbing and appliances.

11. Far West's current rates and charges for water utility service were approved in Decision No. 60437, as modified in Decision No. 60826 (April 13, 1998).

12. During Far West's last rate case, many customers complained about the appearance, odor and taste of Far West's water and its corrosive effect on appliances.

13. In Decision No. 60826, the Commission ordered Far West to perform a study of its

water quality problems, addressing in particular, ways to efficiently and cost-effectively meet customer expectations for safe and potable water.

14. The Company filed a report with the Commission's Utilities Division as required in Decision No. 60437. The Company concluded that its best alternative to alleviate the TDS problem is to acquire a source of Colorado River water.

15. Far West has entered into a contract with the District to purchase up to 5,000 acre-feet of Colorado River water annually at a cost of $75.00 per acre-foot (an annual cost of $375,000).

16. In order to utilize the Colorado River water, Far West is constructing a water treatment plant with a capacity of 4.0 million gallons per day, together with a 3.0 million gallon storage reservoir, a six mile 20-inch raw water transmission main, raw water pumping station, finished water pumping station and other transmission mains and improvements.

17. Far West estimates a cost of $6.0 million for constructing the water treatment plant and other facilities required to use Colorado River water.

18. In November 1998, Far West filed an application requesting authority to incur long-term debt in the amount of $6.0 million and to incur a short-term bridge loan in the amount of $5.0 million to finance the construction of the facilities needed to utilize Colorado River water. Staff investigated Far West's proposal to use Colorado River water in connection with analyzing the Company's financing application, and concurred with the Company that the use of Colorado River water is the best and most cost-effective option currently available for improving water quality.

19. In Decision No. 61713 the Commission approved Far West's request for authority to incur long-term debt in the amount of $6.0 million, at an interest rate not to exceed 8.0 percent per annum, and to incur short-term debt in the amount of $5.0 million in connection with constructing the Colorado River water treatment plant and related facilities.

20. Far West commenced construction of the facilities in 1998, and as of the date of the hearing, had completed a significant portion of the facilities, including the 20-inch raw water transmission main, 3.0 million gallon storage tank, raw water pump station and turn-out on the District canal, and finished water pump station. As of the date of the hearing, Far West had already expended, or had committed to spend, approximately $4.0 million in connection with the purchase of

materials, labor, engineering and design services and other activities related to the construction of the facilities.

21. Far West anticipates completing the treatment plant and related facilities by early October 1999.

22. Far West has applied for and obtained a binding commitment for financial assistance from WIFA, under which WIFA will either loan funds directly to Far West or provide a "linked deposit guarantee" to a conventional lender in order to reduce the interest rate for the loan.

23. WIFA's financial assistance is expected to reduce the interest rate that Far West must pay in connection with the long-term debt to approximately 75 percent of the prime interest rate, or about 6.0 percent.

24. WIFA has informed Far West that to obtain WIFA assistance, Far West must obtain approval of rates and charges sufficient to make interest payments, principal repayments and satisfy other requirements of WIFA and any conventional lender.

25. Far West's current rates and charges are not sufficient to generate sufficient cash flow to make debt service payments on either its existing short-term note or its anticipated long-term financing.

26. Far West requested approval of interim rates that would produce, on an annualized basis, additional revenue of $1,258,630, to become effective on August 1, 1999, and remain in effect until the effective date of the rates established in the permanent rate case.

27. For the period June 1999 through May 2000, Far West projects that it will have a negative cash flow of $547,194 and negative operating income of $520,941 without the interim rate increase.

28. Without an interim rate increase, Far West's debt service coverage, interest coverage and other negative financial indicators will undermine Far West's credit-worthiness and prevent Far West from obtaining long-term debt financing for its Colorado River project on reasonable terms prior to the establishment of permanent rates.

29. Far West had not been able to make interest or principal payments on its short-term bridge loan from its affiliate H & S Developers. Interest continues to accrue on the short-term debt at

the rate of 9.25 percent.

30. The long-term debt financing will allow Far West to achieve a balanced capital structure of approximately 50 percent equity and 50 percent debt, which will reduce the Company's cost of capital.

31. RUCO testified that the proportionately large construction project, the large debt financing required to fund the project and the resulting severe negative impact on Far West's cash flow constituted an "emergency" under Arizona Attorney General Opinion 71-17. RUCO recommended that the Commission grant Far West interim rates that would generate additional revenue of $837,817 on an annual basis.

32. Staff and intervenor Yuma Park did not believe that Far West's financial position constituted an emergency and recommended against the Company's request for interim rates.

33. The proportionately large capital improvement project, the large amount of financing required to fund the project and the severe cash flow shortfalls caused by the debt service and increased operating costs will cause a hardship on Far West that will negatively impact its credit worthiness and ability to provide quality water utility service until permanent rates can be put in place, thus constituting an "emergency" under Arizona Attorney General Opinion 71-17.

34. It is reasonable to set interim rates at a level that will allow Far West to make interest and principal payments and meet reserve requirements on the proposed long-term debt. Interim rate relief should not include any sums to generate a positive operating income.

35. An interim increase in water revenues of $837,817 (on an annual basis) is sufficient to insure adequate cash flow, debt service and interest coverage to alleviate the emergency and to allow Far West to proceed with its long-term financing and complete construction of the treatment plant and other facilities needed to use Colorado River water.

CONCLUSIONS OF LAW

1. Far West is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. sections 40-250 and 40-251.

2. The Commission has jurisdiction over Far West and of the subject matter of the application.

3. Notice of the application was provided in the manner prescribed by law

4. Far West is facing an "emergency" within the definition set forth in Arizona Attorney General Opinion No. 71-17.

5. The emergency rates approved herein and set forth in Exhibit A, attached hereto, and incorporated by reference, are just and reasonable on an interim basis and should be granted.

6. It is reasonable to require that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase approved herein.

ORDER

IT IS THEREFORE ORDERED that Far West Water & Sewer, Inc. shall file on or before July 30, 1999, a schedule of interim rates reflecting the monthly minimum changes and commodity rate set forth in Exhibit A hereto.

IT IS FURTHER ORDERED that the rates approved herein shall be interim and subject to refund pending the resolution of a permanent rate case.

IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service provided on and after August 1, 1999.

IT IS FURTHER ORDERED that Far West Water & Sewer, Inc. shall notify its customers of the interim rates and charges authorized herein and the effective date of same as well as the fact such rates are subject to refund in the event they are not justified in the permanent rate case, by means of an insert in its next regular monthly billing.

IT IS FURTHER ORDERED that in the event of any refund, interest is to be paid at the legal rate.

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IT IS FURTHER ORDERED that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase approved herein.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 20th day of July, 1999.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT ________________

JR:bbs

SERVICE LIST FOR: FAR WEST WATER & SEWER, INC.

DOCKET NO. WS-03478A-99-0144

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EXHIBIT A

LINE NO.	METER SIZE	
	MONTHLY MINIMUMS	
1	5/8 x ¾ INCH	9.50
2	¾ INCH	14.25
3	1 INCH	23.75
4	1.5 INCH	47.50
5	2 INCH	76.00
6	3 INCH	152.00
7	4 INCH	237.50
8	6 INCH	475.00
9	FIRE HYDRANTS (CONSTRUCTION)	152.00
10	GALLONS INCLUDED IN MINIMUM	1,000
11	COMMODITY RATES – 1,000 GALS	$1.042

FAR WEST WATER & SEWER COMPANY
DOCKET NO: WS-03478A-08-0608

ANDREW J. CAPESTRO
REBUTTAL TESTIMONY
March 31, 2009

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER COMPANY, AN ARIZONA CORPORATION, FOR APPROVAL OF INTERIM RATES AND CHARGES.	DOCKET NO: WS-03478A-08-0608

REBUTTAL TESTIMONY

OF

ANDREW J. CAPESTRO

March 31, 2009

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2142973

I. INTRODUCTION, PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Andrew J. Capestro, 12486 Foothills Blvd., Yuma, Arizona 85367.

Q. WHAT IS YOUR OCCUPATION?

A. I am an attorney.

Q. WHAT IS YOUR AFFILIATION WITH FAR WEST WATER AND SEWER COMPANY?

A. I am affiliated with Far West Water and Sewer Company ("Far West" or the "Company") because my wife, Paula Capestro, and my sister-in-law, Sandra Braden, are the officers of the Company and its sole stockholders. Until the beginning of 2006, I assisted Far West primarily with legal matters as they arose. For example, I was lead counsel for Company in the criminal complaint brought by the State of Arizona against the Company. However, I still am not on the Company's payroll, and I bill Far West for legal services rendered.

Q. WHAT ARE YOU DOING FOR THE COMPANY AT THIS TIME?

A. Following the conclusion of the criminal matter, I started to take a more active role in Far West's day-to-day operations, in addition to my legal counsel role. At that time, the Company had a director of operations, Dusty Thomas, and a field manager, Mark Kaveney. By the end of 2006, both Mr. Thomas and Mr. Kaveney were gone. Since that time, I have essentially been acting as a *de facto* director of operations, although I still have no official title. In that role, I sign all checks issued by the Company, I approve most purchase orders and work orders, I negotiate contracts and I work on the budget. I am also in direct communication with the vendors and contractors supplying equipment for and constructing the wastewater treatment plant improvements. I approve the hiring, promotion and discharge of personnel. I review safety standards with the Company's safety officer, and I assist in resolving customer complaints. I oversee regulatory matters including the recent financing application approved by the Commission and I am directly responsible for overseeing the prosecution of the Company's emergency and permanent rate cases. I also work with county and city officials, and I am in the field almost every day. Paula Capestro and Sandra Braden are also in the field most days, meet with the Company's personnel, and review and approve action I have either taken or recommended.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE COMMISSION?

A. No.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY AND HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?

A. The purpose of my testimony is two-fold. First, I will respond to certain issues raised in the filings by Staff and RUCO on the Company's request for emergency rate relief. I will begin by discussing the Company's rapidly deteriorating financial condition. Then, I will address RUCO's position that there is no emergency and no basis for interim rate relief. In doing so, I will discuss the impact of Far West's changed and changing circumstances, and the severe hardship the Company and all of our over 15,000 water and our over 7,000 sewer customers will suffer if RUCO's recommendations were adopted. Thereafter, I will respond to Staff's filing and discuss Staff's alternative recommendations. Staff's recommendation that the Commission deny any interim rate relief suffers from many of the same flaws as RUCO's recommendation, and its alternative recommendation of an interim increase of 46 percent is insufficient to address the Company's problems.

Second, I will address some of the concerns that were expressed by customers at the Commission's recent public comment session, and that have been expressed in the numerous customer inquiries and informal complaints we have received from Commission Staff since our pending, permanent rate case for the sewer division was filed last summer. *Far West Water and Sewer Company,* Docket No. WS-03478A-08-0454.

Q. WHY DOES THE COMPANY FEEL THAT IT NEEDS TO ADDRESS MATTERS RAISED IN PUBLIC COMMENT OR COMPLAINTS?

A. We understand that these issues are not directly related to the request for interim rate relief. Nevertheless, I attended the public comment session and I was quite disturbed by the number of customers that stated that no one ever responded to complaints, that service was bad and that the Company did not care. Until the rate cases were filed, we were not experiencing a lot of complaints from our customers, and since I have been involved with the daily operations of the Company, our staff has tried to resolve every complaint received in a timely manner. Far West's personnel try hard to put the customer first, and everyone was devastated following the Commission's public comment session. Of course, any legitimate customers complaints about service are justified and must be addressed and rectified.

II. <u>OVERVIEW OF THE COMPANY'S CURRENT FINANCIAL PICTURE.</u>

Q. MR. CAPESTRO, WHY DID FAR WEST SEEK EMERGENCY RATE RELIEF?

A. To ensure that the Company does not become insolvent and will be able to provide adequate and reliable water and wastewater service. That is what our application for interim rate relief filed last December says on the first page.

Q. IS THE COMPANY INSOLVENT TODAY?

A. I really don't know. I do know that the Company cannot pay its bills when they become due. For instance, Far West owes $318,281 for property taxes which it cannot pay. The Company also has an outstanding bill with Yuma Mesa Irrigation District ("YMID") for over $100,000 for last year which has not been paid, and it has another bill from YMID for $100,000 for water used between December 2008 and February 2009 that must be paid.

Q. **HAS YMID TAKEN STEPS TO COLLECT THESE OUTSTANDING AMOUNTS DUE?**

A. Not since I went to a YMID board meeting, and pled my case. They agreed to accept payments of $10,000 per month, plus interest of 1.5% per month for unused water, but they are requiring that all present use be paid when due.

Q. **THANK YOU. YOU WERE DISCUSSING BILLS THE COMPANY COULD NOT PAY. PLEASE CONTINUE.**

A. The Company owes $2,932,734 for unpaid sewer plant invoices for equipment delivered and services rendered through March 25, 2009. This does not include an additional $557,996 for equipment yet to be delivered, or services yet to be billed, for completing the improvements at the Section 14 and the Del Oro treatment plants. In addition, $533,045 will be needed to complete the Seasons WWTP, and $440,045 will be needed to construct the Paula Street lift station. We cannot pay for any of these remaining plant upgrades, and as a result, we cannot bring the system into compliance with the two ADEQ Consent Orders that required these system improvements.

Q. **WHAT BILLS ARE BEING PAID, MR. CAPESTRO?**

A. The ones that have to be paid to keep operating. We have to pay for power because we cannot provide water or wastewater service if we do not have electricity. Salaries and wages have to be paid, or there will be no one to operate the plants to treat wastewater and deliver treated water for potable use. We also have to pay for chemicals, testing, and materials and supplies, or we wouldn't be able to operate properly. We have to make our monthly payments on the IDA bonds, including funding the debt reserve, or else we will be in default. We have to pay the City of

Yuma to take the effluent from Palm Shadows or else the Company's ability to dispose of that effluent will be in danger. We have to pay for the fuel and repairs of the trucks and tanker trailers that transport that effluent. And we are making payments from cash flow to pay the subcontractors working on the ADEQ-ordered plant improvements so that they can make their own payroll.

Q. WEREN'T ALL THESE EXPENSES BEING INCURRED BY THE COMPANY DURING FAR WEST'S 2007 TEST YEAR?

A. No. The first payment made by the Company on the IDA bond issue was in January 2008. The monthly interest and principal payment, including funding the debt service reserve, is $201,096.61. In addition, in 2007 the Company did not pay the City of Yuma for the effluent removal. That began in 2008 when we had to find another source for removing effluent.

Q. WHY IS FAR WEST PAYING THE CITY TO REMOVE EFFLUENT?

A. I need to provide a little history here. Under a temporary permit issued by ADEQ, the effluent from our Palm Shadows plant was used for dust control. When that permit expired and could not be renewed, Far West transported the effluent from that plant to other treatment plants owned by the Company. When it became clear that those couldn't handle the extra volume, the City of Yuma agreed to take up to 100,000 gallons a day of effluent. Later, the City agreed to take 200,000 gallons a day. Permits are now being issued by the City, in thirty day increments, to allow for the transportation of the Palm Shadows effluent to a sewer manhole designated by the City. Hauling to the City began in the middle of February, 2008, and during 2008, the Company paid the City of Yuma $192,375 to take its effluent.

Q. WAS THAT THE TOTAL COST TO THE COMPANY FOR EFFLUENT REMOVAL?

A. No. The total cost to the Company to remove this influent, including hauling, came to $501,363 and will continue to cost over $40,000 each month until the Section 14 plant is finished.

Q. ARE THERE ANY OTHER EXPENSES THE COMPANY IS PAYING TODAY THAT ARE OUTSIDE THE 2007 TEST YEAR?

A. In addition to those expenses I have already discussed, on the water side, the Company now must pay YMID for an additional 2,500 acre feet of surface water. In 2007, the commitment to take or pay was for 5,000 acre feet, but beginning in 2008 the commitment to take or pay increased to 7,500. Our contract with YMID calls for payment of $100 for each acre foot not used. Far West barely uses 5,000 acre feet . The additional charge should be $250,000, however, when I met with the District and pled my case, YMID agreed to accept $50 an unused acre foot ($125,000) for a short period of time. This is less than it could have been, but still a new drain on cash flows.

Q. BUT FAR WEST IS CURRENTLY UNABLE TO COMPLETE THE IMPROVEMENTS REQUIRED BY THE TWO CONSENT ORDERS WITH ADEQ?

A. That is correct. The improvements required by ADEQ cost more than expected, and Far West has spent all the funds from the IDA bond financing. Without rate relief, the improvements may never be completed. Far West will be stuck in regulatory limbo, with substantially completed plants that cannot be placed in service.

Q. WHY CAN'T FAR WEST BORROW MORE MONEY TO FINISH THE NECESSARY IMPROVEMENTS?

A. For two reasons. First, capital markets are extremely tight, and conventional lenders are unwilling to lend funds except at very high interest rates, if at all. Second, Far West has been unable to pay its current obligations, as previously explained. The Company is having great difficulty securing even more debt given its current cash flow problem. Let me put it this way – would you lend Far West say $2 million based on its current financial situation?

Q. WHY DON'T THE SHAREHOLDERS FINANCE THE BALANCE OF THE TREATMENT PLANT CONSTRUCTION COSTS WITH PAID IN CAPITAL?

A. This economy has hit the shareholders as hard as anybody else. The shareholders do not have the money to invest in the Company, let alone several million needed to finish the project. The shareholders have found the extremely tight credit market to be just as daunting as has the Company. As shareholders, they receive no dividends. As officers on the Company, Paula Capestro and Sandra Braden receive a salary for their work, but earn no return on their investment in Far West.

Q. SO THE ONLY SOURCE OF FUNDS AVAILABLE TO FINISH FUNDING PLANT IMPROVEMENTS AND PAY EXISTING EXPENSES AND DEBT SERVICE ARE YOUR CURRENT REVENUES?

A. Yes, and those revenues are inadequate. Rebuttal Testimony of Thomas J. Bourassa ("Bourassa Rb.") at 3-4. That is why we need rate increases, now, and then again in the permanent rate case. Hopefully, if we can get the additional cash flows we need to service the IDA debt from interim rate relief, we can pay for some of these other extraordinary expenses, and obtain the funding to finish the necessary sewer improvements and bring everything on line.

Q. HOW DID THINGS GET THIS WAY?

A. There are a number of reasons, including the inadequate revenues we were authorized in our last rate case. But the straw that broke the camel's back was the two ADEQ's Consent Orders. These orders forced us to make major upgrades to our wastewater system in a very short period of time. Far West went from being a small sewer utility operating several small, package-type treatment plants to serve fewer than 1,000 customers in the late 1990s to needing more than $20 million in additional plant to satisfy regulatory requirements today.

Q. ARE YOU SUGGESTING THAT THIS IS SOMEHOW ADEQ'S FAULT?

A. No. While we have disagreements with ADEQ, we have accepted responsibility for our problems. We are doing what ADEQ has required to ensure safe and reliable wastewater treatment, which is what Far West promised the Commission it would do in its last rate case. Frankly, none of this should come as a surprise to the Commission, Staff or RUCO.

Q. WHAT DO YOU MEAN, MR. CAPESTRO?

A. Our last rate increase two years ago was conditioned on entering into the Consent Orders with ADEQ. The Commission was aware that the Company would be undertaking a substantial construction project to upgrade and expand its wastewater treatment facilities to comply with those Consent Orders. Moreover, the rates approved in that case were based on a now very distant 2004 test year. *See* Decision No. 69335 (Feb. 26, 2007). Putting aside the cost of construction needed to comply with the ADEQ Consent Orders, the Company's rate base and operating expenses have increased since 2004.

In Decision No. 69335, the Commission ordered Far West to file another rate case for its sewer division by April 30, 2008. Presumably, the problems that led to the ADEQ Consent Orders and the investment needed to address those problems are what led the Commission to order us to file our pending, permanent rate case. And we told the Commission in the prior rate case, roughly a year before we actually issued the IDA bonds, that the rates being approved were inadequate and that we would likely have to file for emergency rate relief to support the capital investment needed to comply with the ADEQ Consent Orders.

In addition, the Commission authorized Far West to borrow $25 million later in 2007 in Decision No. 69950 (October 30, 2007). By contrast, the original cost rate base approved in the sewer division's last rate case was $1,549,650. No one that understands anything about business would seriously contend that Far West could borrow $25 million and make payments of principal and interest for several years without having to seek rate increases to be able to meet debt service requirements and have sufficient funds to operate the business.

Q. WHAT OTHER PROBLEMS DOES THE COMPANY FACE AS A RESULT OF ITS PRESENT FINANCIAL CONDITION?

A. On the sewer side, if and when we get the rest of the new treatment facilities in operation, we will immediately face increases in certain operating expenses relating to the operation of the plants. DR 4.2, Rigsby Attachment E. Reduced sludge removal costs will offset some of these additional expenses, but we still anticipate that operating expenses will increase.

In addition, the construction of the facilities for sewer division has caused us to postpone capital improvements for the water division. For example, we need to expand our surface water treatment plant to allow us to utilize additional Colorado River water. The current plant is operating at capacity, forcing us to use increasing quantities of lower quality groundwater. We also need to make upgrades to wells and water storage facilities. In effect, we have been forced to neglect upgrades and improvements for the water division to keep the sewer division operational. We can't continue to ignore the water division in this manner.

Q. HOW WILL THESE WATER UTILITY PROJECTS BE FINANCED?

A. I have no idea. The budgeted cost for the planned well improvements totals $3,000,000. The budgeted cost for storage tank improvements is $1,000,000. The budgeted cost to expand the water treatment plant is $16,928,016. The total of these water projects is $19,928,016. As I discussed, there is no way for us to raise another $20 million of capital given our current financial picture, especially in today's economy. Not when we can't even secure financing to finish the sewer projects ordered by ADEQ.

Q. DOES THE COMPANY UNDERSTAND THAT INTERIM RATES ARE TEMPORARY?

A. Yes, we only expect these rates to be in effect until the decision is issued in the pending rate case, at which time we expect permanent rates based on a higher revenue requirement than the interim revenue requirement

Q. WHY DO YOU BELIEVE THAT TO BE THE CASE MR. CAPESTRO?

A. Because the interim rate increase we are seeking will only pay 83% of the Company's annual debt service. Application at 2; Bourassa Rb. at 6-7. As a practical matter, that means we will not be recovering increases in operating expenses since our last rate case, or any sort of return on any of our additional, post-2004 rate base. When all those things factor in, I believe additional increases will be necessary above what we have asked for on an interim basis.

III. RESPONSE TO RUCO.

Q. HAVE YOU REVIEWED RUCO'S FILING IN RESPONSE TO THE COMPANY'S REQUEST FOR INTERIM RATE RELIEF?

A. Yes, I have read Mr. Rigsby's testimony. I was really disappointed.

Q. WHY IS THAT, MR. CAPESTRO?

A. We are working very hard to keep Far West up and running, while also trying to finish the construction of more than $20 million of sewer improvements. We are also responding to dozens of customer inquiries and "informal" Commission complaints per week since the rate cases were filed. We worked very hard to provide RUCO and Staff all of the information they requested. It took some time, but I believe that information supports everything I have said about our current financial crisis.

And I personally spent a day with Mr. Rigsby showing him everything we have done and are doing to improve our wastewater treatment system. Mr. Rigsby saw the significant changes in our sewer operations, and he seemed to appreciate that more than $20 million of sewer improvements don't just appear overnight for free. Perhaps he should have spent a month with us so he could witness our inability to pay debts when they fall due. It is very disappointing that RUCO is ignoring the serious threat faced right now by the Company and all of its water and sewer customers.

Q. WOULD YOU LIKE TO RESPOND TO MR. RIGSBY'S DIRECT TESTIMONY?

A. Yes. I would like to make four points in response:

First, RUCO's two-fold recommendation that: interim rates are denied <u>and</u> the permanent rate case be stayed, is truly terrifying. It will leave the Company in regulatory limbo, unable to resolve its cash flow problem and unable able to pay our bills.

Second, Far West sewer division is clearly insolvent, and the Company as a whole is unable to pay its bills as they fall due and its ability to continue providing water and wastewater service is seriously in doubt.

Third, Mr. Rigsby's financial analysis is contrary to reality.

Fourth, our circumstances and the relief sought to address them are consistent with past Commission precedent involving Far West.

Q. WHAT IS IT ABOUT RUCO'S RECOMMENDATION THAT FRIGHTENS YOU MR. CAPESTRO?

A. RUCO's recommendation that the Commission not even consider rate relief until we have operated more than $20 million of new sewer utility facilities for at least one full year. Rigsby Dt. at 6. We started this project in 2006. We began making debt service payments on over $25 million dollars of IDA bonds in January 2008. Even if we could finish all of the ADEQ-mandated sewer plant improvements tomorrow, under RUCO's approach, we would not be able to continue our rate case until sometime in mid-2010, and there would be no rate relief before sometime in 2011, under the best of all possible scenarios.

Q. WHAT DO YOU MEAN "EVEN IF YOU COULD FINISH" ALL OF THE PLANT IMPROVEMENTS?

A. As I testified above, we cannot finish the plant improvements required by ADEQ and bring the remaining plant on line.

Q. WHY NOT?

A. As I previously explained, we do not have the $4,463,820 to finish the plant improvements and finish bringing Section 14, Del Oro and the Palm Shadows force main on line. We already owe $2,932,734 at present, and there is another $557,996 still to be billed for the Section 14 WWTP and the Del Oro WWTP. Plus, we still need $533,045 to complete the Seasons WWTP and $440,045 to construct the Paula Street lift station.

Q. DOESN'T MR. RIGSBY TESTIFY (AT 18) THAT THE CLAIMED COST OVERRUNS ARE "QUESTIONABLE"?

A. Yes, but he does not provide any evidence to support his opinion, and with all due respect, he has no idea what he is talking about. The original budget was based upon engineers estimates, and some suppliers purchase orders, issued before ADEQ issued approved permits. My rebuttal testimony contains the most current updated numbers based upon issued contracts complying with the requirements of the permits. In reality, RUCO would have us caught in an endless regulatory

Catch-22. We cannot increase our rates because we cannot bring the plant on line. We cannot bring the plant on line because we have no money. We cannot get more money because we cannot get our plants on line. It is the regulatory equivalent of your worst nightmare.

Q. WHY DOESN'T RUCO AGREE THAT THE COMPANY'S CIRCUMSTANCES ARISE TO AN EMERGENCY?

A. Because, according to Mr. Rigsby, we are not yet insolvent, and "there is no question that the Company can continue to maintain service." Rigsby Dt. at 22, 23.

Q. DO YOU AGREE WITH MR. RIGSBY THAT THERE IS NO EMERGENCY BECAUSE THERE IS NO QUESTION THAT YOU CAN CONTINUE TO MAINTAIN SERVICE?

A. No, and Mr. Rigsby is not qualified to render such an opinion. He has spent his entire working career at RUCO, the Commission and the Department of Revenue. He is not an engineer or a utility plant operator, and he has no real world business experience of any kind. He has based his opinion almost entirely on his view of our financial data, and he is wrong. A utility that cannot pay its bills when they fall due in the usual course of business is in clear jeopardy of having its ability to serve compromised.

Q. WHY DO YOU BELIEVE THAT MR. RIGSBY'S FINANCIAL ANALYSIS IS CONTRARY TO REALITY?

A. Mr. Bourassa addresses RUCO's numbers in his rebuttal testimony, including Mr. Rigsby's debt service coverage calculations. Mr. Bourassa testifies that we do not have adequate cash flows and we are on the verge of a financial collapse. Bourassa Rb. at 11.

Q. CAN YOU PROVIDE A SPECIFIC EXAMPLE OF WHERE MR. RIGSBY'S ANALYSIS DIVERGES FROM REALITY?

A. Sure, that's an easy one. Mr. Rigsby's reliance on Interest Income of $635,000. Rigsby Dt. at 16-19. When we first borrowed the IDA funds in late 2007, we put roughly $8.5 million in the bank, (the remainder was used to pay off the short term financing used for engineering and for down payments on equipment) until we could obtain certain approvals from ADEQ. While we waited, the funds earned interest and kept doing so until the funds were fully expended. Mr. Rigsby saw the plant we built with those funds and he knows that these funds are gone. Rigsby Dt., Attachment E. There is no current source of interest income to subsidize operations.

Q. ANY OTHER EXAMPLES?

A. Mr. Rigsby also ignores the real and continued impact of sludge removal costs, which are nearly $500,000 a year. Rigsby Dt. at 19. Yes, once the plant is on line, these costs will go down, but we are paying about $40,000 each month to haul off sludge right now as I testified in detail above. When we have to pay an extraordinary cost of more than $40,000 a month, something else isn't going to be paid. This is the real world, and it is really that simple.

Q. ISN'T RUCO REALLY JUST SUGGESTING THAT YOU KEEP YOURSELF AFLOAT WITH REVENUES FROM WATER SALES?

A. Yes. In his rebuttal Mr. Bourassa discusses how convenient this argument seems given past testimony by RUCO. Bourassa Rb. at 11-12. But in general, I agree with Mr. Rigsby that the Commission should consider things on a Company-wide basis. Particular attention should be given to the 8,000 customers that pay their water bills every month but do <u>not</u> receive sewer service from us. Those folks are on the same ship which is headed for disaster unless relief is given.

Q. WELL MR. CAPESTRO, IF THAT'S TRUE, DIDN'T THE COMPANY PLACE ITS CUSTOMERS IN PERIL?

A. The Company's President in our last rate case accepted responsibility for not keeping up with the explosive growth that took place in our service area. We grew from less than 500 customers in 1998 to approximately 7,000 customers in 2006, and neither the Company, its management nor its plant kept up. We accepted that. Transcript from July 18, 2006 Hearing at 21, Docket No. WS-03478A-05-0801. And we accepted responsibility to fix it. As I testified earlier, the Commission would not approve our last rate increase if we did not enter into the Consent Orders with ADEQ.

Bottom line, the Company could spend a lot of time assessing blame and defending itself from accusations. But I urge Judge Rodda and the Commission not to make this emergency rate case about finger pointing. Why ADEQ ordered us to do what we were told to do, and whether we did it as we were ordered can be addressed in our pending, permanent rate case.

Q. ARE THERE ANY PROBLEMS SPECIFIC TO THE WATER DIVISION YOU WOULD LIKE TO DISCUSS?

A. Yes, I would like to respond to Mr. Rigsby's testimony (Dt. at 18) that it is "questionable" that any water utility improvements are needed. Again, as with his claims regarding cost overruns, Mr. Rigsby has no basis to make this claim, and he is wrong. As we told RUCO and Staff in discovery, we are going to have to make an estimated $20 million worth of water system improvements if we are going to continue to provide potable water utility service to our over 15,000 water customers. Rigsby Dt., Attachment E. We have already delayed these projects, and we cannot do so indefinitely, as Mr. Rigsby believes.

Q. THEN WHY DOESN'T THE COMPANY GET STARTED ON THE IMPROVEMENTS TO THE WATER UTILITY SYSTEM?

A. Because we do not have another $20 million to invest, and we cannot borrow any more money. Because we are currently unable to finance the remaining costs of the sewer plant improvements ADEQ has ordered us to construct. We can only hope that Judge Rodda and the Commission see that our water customers are already at risk of deteriorating service due to the financial crisis.

Q. WHAT ABOUT MR. RIGSBY'S CONCERNS THAT THE COMPANY IS SEEKING TO SET RATES BASED ON PLANT THAT IS STILL BEING BUILT?

A. I will leave it to Mr. Bourassa to discuss ratemaking concepts, but I found this testimony to be a bit misleading. Bourassa Rb. at 12-13. For one thing, the Company's rate base increased by nearly $4 million dollars between the last test year, 2004, and the test year in the Company's pending rate case before consideration of the IDA Bond funded improvements totaling nearly $19 million that the Company proposed as post test year plant. Also, some of the improvements built with the IDA funds are currently in service. These include a Zenon plant installed at Del Oro with a total cost of $1,715,216, Somat dewatering units at Marwood, Section and Del Oro for a total cost of $348,752, Trojan Ultraviolet at Palm Shadows with a cost of $71,924, Lift Station 16 with a cost of $56,703, a Nitrogen removal system with a cost of $42,116 and the installation of the odor control project with a cost of $16,123. The Del Oro temporary plant is in service, which is bought and paid for, and will be ultimately used at Seasons. Finally, as Mr. Rigsby recognizes, we are not seeking to recover a return on rate base on an emergency basis. Rigsby Dt. at 13.

In fact, as I testified above, granting the full interim rate increase we seek won't cover the full debt service requirement and generate positive operational income for the sewer division. Water customers will still have to subsidize sewer customers. Bourassa Rb. at 11-12.

Q. THEN WHY SHOULD THE COMMISSION BOTHER GRANTING INTERIM RATE RELIEF?

A. If we can increase our cash flows, we can pay our creditors faster, and we can try to borrow the money that we need to finish the sewer improvements ADEQ requires. Then we can finish our permanent rate case and hopefully have rates set that allows a fair return to be earned on our investment in plant. Then, hopefully, we can raise funds to upgrade and expand the water system. I understand that the Commission needs to go through certain processes before making ratepayers pay for utility service. But we need more revenue now on an interim basis or the issue of permanent rates will be moot.

Q. WHAT ABOUT MR. RIGSBY'S TESTIMONY (Dt. at 24) THAT YOU ARE SOMEHOW TRYING TO "REDEFINE THE REGULATORY PARADIGM IN ARIZONA"?

A. I had to go to Webster's on that one. Far West does not know what the "paradigm" or "outstandingly clear or typical example or archetype" regulated utility is in Arizona. We don't have the luxury of considering the circumstances of other utility providers right now. The only thing the Company is trying to do is complete the improvements to its sewer utility system, as ADEQ ordered. Emergency rate relief is appropriate to address "severe cash flow shortfalls associated with the financing of a substantial construction project." *See Far West Water and Sewer Company,* Decision No. 61833 (July 20, 1999) at 7, copy of which is attached to Bourassa Rb.

Q. ARE THE CIRCUMSTANCES THE COMPANY FACES TODAY SIMILAR TO THE CIRCUMSTANCES PRESENTED IN DECISION NO. 61833?

A. Yes, they are remarkably similar. The sewer plant improvements ordered by ADEQ constitute a "substantial construction project" and "represent a significant operating change" just like the Company's shift to Colorado River water supplies in the late 1990s. *Id.* Like that transition, it has been determined (in this case by ADEQ) that the improvements are necessary to address problems that have "plagued" the Company. In that case, the cost of the water system improvements more than doubled gross plant in service. *Id.* In this case, the costs will increase the Company's existing plant in service more than 15 times from the rate base approved in our rate case decided just two years ago. That is, when/if the improvements are finally completed. As in that case, without interim rate relief the Company will not be able to complete the necessary improvements because it cannot obtain the necessary financing. *Id.*

Q. ISN'T IT FAIR TO SAY THEN, MR. CAPESTRO, THAT FAR WEST HAS FAILED TO LEARN FROM ITS MISTAKES?

A. I do not believe so. The reasons for the improvements to our water system a decade ago were different. At that time, numerous customers complained about our poor quality groundwater, and we promised the Commission that we would investigate how to address that problem. The most cost-effective solution was to convert to surface water and use groundwater as a back-up supply. Here, we have already admitted that we failed to keep up with growth. In contrast, in the 1990s, our customers had grown tired of poor quality groundwater and demanded that the Commission make the Company do something about water quality. Then, as now, we accepted responsibility to fix a problem. We also expected to recover the costs, and then, like now, we needed help with cash flow along the way due to the size of the project. The Commission saw that need and awarded interim rate relief, subject to refund, to provide that help.

Ironically, in that case, RUCO never suggested that the Company should use sewer revenues to keep the water division afloat. Actually, in that case, RUCO supported interim rate relief to keep the Company going as long as there was no profit being earned. *Id.* at 5-6. We are asking for the same relief. It appears to me that the only thing that has changed is RUCO's view of what constitutes an emergency and its concern for the welfare of our customers.

IV. <u>RESPONSE TO STAFF</u>

Q. HAVE YOU REVIEWED COMMISSION STAFF'S FILING IN RESPONSE TO FAR WEST'S REQUEST FOR EMERGENCY RATE RELIEF?

A. Yes, I have reviewed the Staff Report dated March 24, 2009. Staff's recommendation is flawed for many of the same reasons as RUCO's. Namely, Staff misses the point. Our interim rate application is about increasing cash flow pending the establishment of permanent rates so that we can pay our bills <u>and</u> complete the new treatment plants. Like RUCO, Staff ignores the serious threats faced by the Company and its customers due to our current cash flow problem.

Q. BUT MR. CAPESTRO, ISN'T IT JUST THAT STAFF DISAGREES THAT THE COMPANY LACKS SUFFICIENT CASH FLOW?

A. Yes, and for the reasons I have stated, this is erroneous. Again, how can we have sufficient cash flow when we can't pay our bills? Moreover, Staff still recognizes that the Company's sewer division suffered a net loss (including interest payments) of more than $2.7 million in 2008. No one that understands business would suggest that this cash is "sufficient to cover [Far West's] operating expenses and interest expenses while providing a reasonable amount of funds for unexpected events/contingencies." Staff Report at 5. This is particularly the case when, according to the Staff Report, interim rates will be in effect for 12 months, i.e., Far West won't receive permanent rate increases until mid-2010, at the earliest.

Q. WHAT ABOUT STAFF'S ALTERNATIVE RECOMMENDATION FOR AN INTERIM INCREASE OF NEARLY $1 MILLION?

A. It tells me that Staff knows we need interim rate relief but doesn't want to say so. But, the amount recommended by Staff, $972,000, is insufficient. But, the amount recommended by Staff, $972,000, is insufficient. Bourassa Rb. at 22-23. It is premised on the water division continuing to heavily subsidize the sewer division, as the Staff Report shows. Staff Report at Schedule GWB-1.

Q. DO YOU DISAGREE WITH STAFF THAT REVENUES FROM WATER SALES SHOULD BE CONSIDERED?

A. As I testified above, the water division should be considered because it is already being harmed by our financial difficulties. But Staff is using a Company-wide approach to mask the magnitude of our current cash flow problem. That won't help the water division or the Company as a whole.

Q. WHY NOT, MR. CAPESTRO?

A. The most important thing is to get this Company financially healthy as soon as possible. That requires improving our cash flow, which can only occur by increasing our revenue. Bourassa Rb. at 19-20. Staff believes that the sewer division is losing $2.7 million annually. Even with the $972,000 revenue proposed by Staff, the water division is providing a subsidy of $1.7 million. Who is going to provide financing under this scenario? And if we can't obtain additional financing, we cannot finish the sewer projects we have been ordered to construct. If we can't finish the new plant, we can never get permanent rates. Finally, we won't be able to construct the improvements to the water system, which have already been delayed because water revenues are needed to subsidize the sewer division. The bottom line is Staff put its head in the sand.

Q. ACCORDING TO STAFF, FAR WEST HAS 7,237 SEWER CUSTOMERS AND 8,286 WATER CUSTOMERS. ARE THOSE FIGURES ACCURATE?

A. No. The number of sewer customers is about right, but we have over 15,000 water customers at present. It appears that Staff relied on an error in our application. In any event, about half of our water customers do not receive sewer service. This is because they live in older subdivisions that were constructed before sewer service was mandated by Yuma County. Those customers have individual septic systems, and do not pay for sewer service. But they are being asked to continue to subsidize our sewer customers, while facing the risk of deteriorating water service due to the postponement of water system improvements.

Q. HOW DO YOU RESPOND TO STAFF'S ASSERTION THAT THE CONDITIONS FOR EMERGENCY RATE RELIEF ARE NOT PRESENT?

A. Staff is wrong. I believe that all three conditions cited on page 2 of the Staff Report are present: a sudden change has caused hardship, Far West's sewer division is obviously insolvent, and the Company's ability to maintain service pending a full rate case is in serious doubt.

Q. WHAT SUDDEN CHANGE HAS CAUSED HARDSHIP?

A. It should be obvious. As a result of having to upgrade our treatment plants to meet ADEQ requirements under the Consent Orders, the sewer division's rate base has increased by more than $20 million since our current rates were set in Decision No. 69335, issued in February 2007. By comparison Far West's sewer division rate base was set at $1.5 million in that case, which used a 2004 test year. What if APS or Southwest Gas had to increase its plant by 1500 percent over a period of several years? Would that be a sudden change causing financial hardship? I certainly believe it would be.

Q. DOES STAFF BELIEVE FAR WEST IS CURRENTLY SOLVENT?

A. That is what they say. The sewer division cannot pay its debts when they fall due in the usual course while also having insufficient funds to complete the new plant. Instead, the sewer division is being subsidized by the water division. That would seem to meet the test.

Q. HOW DO YOU RESPOND TO STAFF'S ARGUMENT THAT FAR WEST'S ABILITY TO MAINTAIN SERVICE IS NOT SERIOUSLY IN DOUBT?

A. The fact that we cannot finish the ADEQ-mandated plant improvements for our sewer division indicates that our ability to maintain service is in jeopardy. The delay in making needed water system improvements is further evidence that there is a serious problem that must be addressed now. If we have to wait another year (or longer) to obtain rate relief, the Company and its customers will be exposed to serious service-related issues. Consequently, I believe this qualifies as an emergency.

Q. WHY DO YOU THINK THAT STAFF AND RUCO ARE OPPOSING INTERIM RATE INCREASES, GIVEN THE CIRCUMSTANCES YOU HAVE DESCRIBED?

A. I am frankly very confused by their positions. Perhaps they are simply opposed to interim rates under any circumstances. But I can speak to the result their recommendations are likely to produce. First, as I discussed, service is going to erode. As the memo attached to the conclusion of the Staff Report shows, in 2007 we had three complaints filed, while in 2008 we had only one complaint filed. We have been able to maintain high quality service while completing the bulk of the wastewater treatment plant improvements. But if we are forced to operate with negative operating income for another year, and use a substantial portion of our water revenues to subsidize our sewer system, our service will erode.

Moreover, denying interim rate relief will simply delay substantial increases in our rates. If the price of that delay is compromised service, or worse, I do not think the public interest would be well served. And if anyone thinks our customers are upset now, wait until service is actually compromised. I see no good reason to take the risk simply to delay rate relief.

Q. YOU DO REALIZE THAT THIS IS NOT AN EASY TIME TO RAISE RATES GIVEN THE PREVAILING ECONOMIC CONDITIONS?

A. Of course, we feel it too. And this is a large part of the reason we have volunteered to phase in new rates for the sewer division without carrying costs in our permanent rate case. And now, we have risked that case, which has been stayed for an unknown time, to obtain emergency rate relief. That is how important interim rate relief is to the Company. The bottom line is that the interim rate increase is just the first of what can be viewed as a four-phase rate increase. Unfortunately, without the interim phase, we may not get to the permanent rate case. As I stated, we will be stuck in regulatory limbo, or worse.

Q. CAN THE COMPANY POST STAFF'S RECOMMENDED $300,000 BOND IF THE COMMISSION APPROVES INTERIM RATES?

A. I honestly don't know. Even if we can get some party to post a bond in the amount of $300,000, we will have to put up some amount in cash, and there is very little of that to go around. Given the probability of permanent increases, we hope the ALJ and Commission will not require a bond in an amount that would unreasonable given our current financial condition.

Q. DO YOU HAVE ANY OTHER CONCERNS WITH STAFF'S RECOMMENDATIONS IN THIS CASE?

A. Yes, Staff's recommended rate design is problematic because Staff recommends an increase in the rate for effluent. Staff Report at Schedule GWB-2. We specifically recommended that the price for effluent not be increased on an interim basis because we cannot sell all of our effluent now due to its high cost. *See* Bourassa Dt. at 7-8. Golf courses are already choosing to pump more water and not buy our effluent because it is too costly to buy our effluent. Thus, while this will likely be an issue in the permanent rate case, the last thing we need now is a rate design that not only will result in phantom revenues because we won't sell as much effluent, but also increased operating expenses as the cost to dispose of effluent will increase.

V. <u>CUSTOMER CONCERNS AND PUBLIC COMMENT.</u>

Q. MR. CAPESTRO, DID YOU ATTEND THE COMMISSION'S PUBLIC COMMENT SESSION ON MARCH 5, 2009?

A. Yes. Additionally, we have also received approximately twenty-one informal complaints from the Commission's Consumer Services Division. These complaints were all filed sometime after the notice of the filing of the permanent rate case went to the Company's sewer customers. Where those complaints raise specific customer service concerns, such as odors, we have provided a written response.

Q. WHAT HAS THE COMPANY DONE SINCE THE PUBLIC COMMENT SESSION?

A. The day after the public comment session I met with both the customer relations staff and the field personnel. As mentioned, everyone was quite shook-up, and some of our staff were reduced to tears. Everyone, both inside personnel and outside field staff, felt that they had been responding to customer complaints as quickly as was possible, and that no one was ever ignored.

Q. BUT SOME OF YOUR STAFF IS RATHER NEW TO FAR WEST, CORRECT?

A. Yes. Roxanne Fiddes became office and customer service manager less than two years ago, along with Jeff Bigsby and Isaac Yocupicio, the field supervisors for all the wastewater treatment plants and collections systems. However, all of Far West's lead personnel are highly qualified.

Isaac Yocupicio has a grade four, the highest grade awarded in the State of Arizona, across the board, in wastewater collection, wastewater treatment, water treatment and water distribution, as do Sean Duvall and Maria Arreaga. Jeff Bigsby has grade threes in wastewater treatment and wastewater collections, and grade twos in water treatment and water distribution. Vern Garrison has grade fours in water treatment and water distribution, and grade threes in wastewater treatment and wastewater collections. The rest of the crew are all certified, grade one or higher. Even Roxanne Fiddes, the office manager, has a grade one in water distribution.

My point is that to be told that we were "simply" incompetent came as quite a shock to each of them that have tried so hard to please customers. But perhaps our customers simply don't want to be pleased. I cannot help but note that the onslaught of customer complaints came after the notice of our rate filings.

Q. WAS THE COMPANY RECEIVING A LARGE NUMBER OF COMPLAINTS BEFORE THE RATE FILINGS WERE MADE?

A. No. The Company had a large number of complaints in early 2006 before the odor control program became effective in May 2006 and the Zenon temporary plant was installed at Del Oro in June 2006. After that, few complaints were received, and most of those concerned billing questions. This is consistent with the Consumer Service Section's Memorandum at the end of the Staff Report.

Q. WHAT OTHER STEPS DID THE COMPANY AND ITS STAFF TAKE FOLLOWING THE PUBLIC COMMENT SESSION?

A. We reviewed the action taken when a customer complaint is received. I confirmed that the procedures that were put in place nearly two years ago had been followed. Those procedures included resolution of a problem upon first contact if possible.

More specifically, if the complaint concerns billing, office staff try to arrange a face-to-face meeting with the customer to determine how to resolve the customers concerns. If the complaint concerns sewer management, including odor complaints, or water management, including meter problems, a supervisor is to be dispatched to the customer's residence to make personal contact. If there is an odor complaint, the supervisor is instructed to try to determine the cause of the odor and to take corrective action. Far West will flush all sewer lines near the customer's residence with water and chlorine whether or not this has been determined to be the cause. If the cause is from a lift station or plant, once again corrective action will be taken, including addition of chemicals, and US Filter will be contacted. Staff and service crew have been instructed to respond the same day the complaint is received if possible. If not possible, response must be made within 24 hours. Personal contact with the customer is preferred. If the customer is not home, staff must follow up with a phone call. In some instances, written communication is warranted. All complaints must be logged in to the customer's file, a work order issued and resolution noted to the customers file. After reviewing these issues with staff, and reviewing customer files, I believe that these procedures have been followed.

Q. HAS THE COMPANY INVESTIGATED THE SPECIFIC CUSTOMER COMPLAINTS THAT WERE RAISED AT THE PUBLIC COMMENT SESSION EARLIER THIS MONTH?

A. Yes, and we have either responded and addressed the concern to the customer, or determined that the complaint was baseless.

Q. HAVE THERE BEEN A LARGE NUMBER OF ODOR COMPLAINTS SINCE THE RATE CASES WERE FILED?

A. The Company has received six written complaints about odor since the rate cases were filed, plus as I mentioned above, we have gone through the transcript of the public comment session to investigate whether or not appropriate action was taken. We received one odor complaint since the public comment session.

Q. HAS THE COMPANY ADDRESSED ODORS AS PART OF ITS PLANT IMPROVEMENTS?

A. Yes, in fact, the Company implemented a formal odor control program in May 2006. This program is used throughout the areas serviced by the Company. Pursuant to this program, Midas Carbon Scrubbers were installed at strategic locations for wet well odor control. In addition, Bioxide is injected to eliminate odors at set locations. The program is managed by US Filter (Siemens), which inspects the equipment every two weeks to make sure that the scrubbers are working properly. Also, pursuant to the contract, US Filter is obligated to investigate any odor problem that may arise. Since instituting this program, the Company has spent $502,418 for the equipment and chemicals.

Q. MR. CAPESTRO, DO YOU BELIEVE THAT THE COMPANY CURRENTLY HAS AN ODOR PROBLEM?

A. No. There are always going to be some fugitive odors from a wastewater collection, treatment and disposal system. The goal is to eliminate those you can, and minimize those odors you cannot eliminate. The odor control program instituted in May of 2006 has greatly reduced or eliminated any odor coming from the Del Oro, Marwood, Section 14, Seasons, Del Rey and Royale plants. It has reduced the odors coming from the Palm Shadows plant, but has not eliminated them. The Palm Shadows plant is set to be closed when the Section 14 plant becomes operational. The Company, in addition to extra chemicals injected into the system to control odors, has drained the primary pond thought to cause those odors, used its equipment to remove any sludge that might be emitting odors and constantly monitors air flow in the underground tanks to reduce smell. The action seems to be working as the odor has diminished greatly, but has not been totally eliminated.

Also, a large portion of the collection system is gravity flow. Sewage can collect and stagnate when the flows are insufficient. This is especially true when the winter visitors leave. The Company has implemented a year round program of flushing the gravity collection lines, jetting them with water and chlorine from the Company's vac truck. This should eliminate the odors coming from manholes along the gravity collection. This program is increased during the summer months. It is also used when a complaint is received about odors emanating for a location close to a manhole.

Finally, sometimes the problem arises from one or more of the approximately 8,000 septic tanks in the area we serve. These septic tanks also emit sewer odor on occasion, but the Company cannot take any action to address those odor sources because they are privately owned.

Q. SOME CUSTOMERS HAVE ALSO COMPLAINED THAT THE COMPANY IS BUILDING PLANT THAT SHOULD BE PAID FOR BY DEVELOPERS. HOW DO YOU RESPOND TO SUCH CLAIMS?

A. Actually, it was largely the other way around as much of the old plant was paid for by developers. That is why the Company's rate base was so low in the last rate case decided two years ago. The Del Oro, Del Rey and Villa Royale plants that are being replaced were originally built by the Mesa del Sol Company which paid for the original plant. Far West did not acquire those plants until 2001 at which time they had already been is service for a number of years. The original Seasons plant was paid for by the Development Group. The original Marwood plant was paid for by H&S Developers, Inc. All of the plant improvements we are building today are what the State of Arizona has told we are required to have to serve our sewer CCN.

Q. DOES THE COMPANY HAVE A HOOK-UP FEE FOR THE SEWER DIVISION?

A. No, and none was proposed or approved in the last rate case decided in February 2007, despite the fact that it was known that all of these improvements were being mandated by ADEQ. Moreover, many of the unfinished or not yet connected lots in our CCN are in existing developments with no current developer involvement.

Q. WHAT ABOUT NEW DEVELOPMENTS? DOES THE COMPANY REQUIRE THAT DEVELOPERS PROVIDE FUNDING FOR BACKBONE INFRASTRUCTURE?

A. Yes, to the extent that treatment capacity is not available, and it has not been for some time, as our issues with ADEQ and the County's moratorium on new connections illustrates. Currently, we are including a pro rata share of the costs of off-site treatment capacity in all of our line extension agreements. This funding for off-site facilities is in addition to the usual requirements for on-site facilities.

Q. YOU MENTIONED A MORATORIUM ON NEW HOUSING IN YOUR SERVICE TERRITORY. WOULD YOU PLEASE WHO IMPOSED A MORATORIUM AND WHY?

A. The moratorium was imposed by ADEQ in one of the two Consent Orders, the one dated October 31, 2006, but it was not system wide. For Palm Shadows, the order stated that unless approved by ADEQ, Far West shall not construct any new connections to the existing Palm Shadows collections system. For Seasons, the order restricted the maximum flow to 70,000 gpd. Seasons has reached that capacity, however there are few new homes ready for hookup which would be served by that plant. For Del Oro, the restriction read "prior to adding new connections to the Del Oro System, Far West shall submit a written request to ADEQ for connection approval." Since the temporary plant was installed in June 2006, ADEQ has granted all written requests we have made for connections to the Del Oro collections system. No restrictions were placed upon the Section 14 or Marwood plants for additional hookups.

Q. SO FAR WEST REALLY IS BUILDING MORE THAN $20 MILLION WORTH OF SEWER IMPROVEMENTS SO THE MORATORIUM WILL BE LIFTED AND YOU CAN SERVE NEW DEVELOPMENTS?

A. No. The plants are being built so that the Company can comply with the environmental requirements of the State of Arizona and the EPA. The Company signed Consent Orders almost three years ago, vowing to meet those standards and it was given strict guidelines to follow by the wording of those orders. To say that Far West signed a Consent Order, obligating itself to become indebted for more than $20,000,000, and agreeing to severe sanctions if it did not comply, just so that the Company can serve new developments is ridiculous. Really, there are few new developments of substance being built right now in our CCN, and this all has very little to do with any moratorium. There is no moratorium for Marwood or the Section 14 plants, and the restriction for Del Oro has been alleviated by the temporary plant installed almost three years ago which can handle 300,000 gpd. However, the temporary Del Oro plant cannot consistently meet ADEQ standards and the permanent plant is necessary to achieve the goal set by ADEQ.

Q. SOME CUSTOMERS HAVE ALSO RAISED CONCERNS OVER TRANSACTIONS WITH AFFILIATES. WOULD YOU LIKE TO ADDRESS THIS ISSUE MR. CAPESTRO?

A. Yes. H&S Developers, Inc. is an affiliate of Far West. Because of the nature of the new plants, the involvement of H&S Developers has been minimal. Outside contractors have been hired directly by Far West, after competitive bid, to do the electrical, mechanical and plumbing. All equipment was purchased directly by Far West. H&S Developers expertise is in underground wet utilities, and was awarded the contract to put in the force main from Palm Shadows to the Section 14 plant. The contract was awarded after competitive bids were taken. H&S Developers also built one building at Del Oro and two at Section 14.

Q. ARE AFFILIATED ENTITIES BEING REQUIRED TO ENTER INTO LINE EXTENSION AGREEMENTS AND PAY A PRO RATA SHARE OF THE COST OF OFF-SITE TREATMENT CAPACITY?

A. Yes.

Q. THANK YOU MR. CAPESTRO, DO YOU HAVE ANYTHING ELSE TO ADD AT THIS TIME?

A. I would just reiterate that we understand customers are upset, and that the interim and permanent rate increases we are seeking are large. But our sewer plant has increased more than 1500% in just two years. This is causing serious financial hardship, our ability to serve is being impacted because we cannot finish the improvements we need. Far West needs rate relief now, not a year from this summer. I fear we simply won't be able to keep it up much longer unless the Commission acts favorably on our emergency request. It does not seem to be in the public interest to wait until it is too late given the facts we have presented.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, except I do wish to note that the Company's silence on any position taken by Staff or RUCO, or with respect to any public comment, does not signal agreement.