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1 BEFORE THE ARIZONA CORPORATION COMMISSION

2 IN THE MATTER OF THE APPLICATION)
3 OF ARIZONA-AMERICAN WATER COMPANY,)
4 AN ARIZONA CORPORATION FOR A)
5 DETERMINATION OF THE CURRENT FAIR)
6 VALUE OF ITS UTILITY PLANT AND)
7 PROPERTY AND FOR INCREASES IN ITS)
8 RATES AND CHARGES BASED THEREON)
9 FOR UTILITY SERVICE BY ITS AGUA)
10 FRIA WATER DISTRICT, HAVASU WATER,)
11 DISTRICT, MOHAVE WATER DISTRICT,)
12 PARADISE VALLEY WATER DISTRICT,)
13 SUN CITY WEST WATER DISTRICT AND)
14 TUBAC WATER DISTRICT.)

DOCKET NO.
W-01303A-08-0227

Arizona Corporation Commission
DOCKETED

APR 15 2009

DOCKETED BY

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11 AN ARIZONA CORPORATION, FOR A)
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13 VALUE OF ITS UTILITY PLANT AND)
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15 RATES AND CHARGES BASED THEREON)
16 FOR UTILITY SERVICE BY ITS MOHAVE)
17 WASTEWATER DISTRICT.)

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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Hearing Room 1 of said
4 Commission, 1200 West Washington Street, Phoenix, Arizona,
5 commencing at 9:00 a.m., on the 23rd day of March, 2009.

6

7

8 BEFORE: KRISTIN MAYES, Chairman
9 GARY PIERCE, Commissioner
TEENA WOLFE, Administrative Law Judge

10

11 APPEARANCES:

12 For the Arizona Corporation Commission Staff:

13 Ms. Robin Mitchell, Ms. Nancy Scott, and
14 Ms. Ayesha Vohra
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1 ALJ WOLFE: Okay. Since it's been a while, I
2 think I will take appearances for the attorneys here
3 today.

4 For the company?

5 MR. MARKS: Happy Monday. Good morning, Your
6 Honor. Craig Marks on behalf of Arizona-American Water
7 Company.

8 ALJ WOLFE: Okay. Good morning.

9 MS. McHALE-HUBBS: Good morning, Your Honor.
10 Carol McHale-Hubbs on behalf of PORA.

11 ALJ WOLFE: Thank you.

12 MR. METLI: Thank you, Your Honor. Robert Metli
13 from the law firm of Snell & Wilmer on behalf of the
14 Sanctuary on Camelback Mountain and the Camelback Inn.

15 ALJ WOLFE: Thank you.

16 MR. POZEFSKY: Good morning, Your Honor.
17 Daniel Pozefsky on behalf of RUCO.

18 ALJ WOLFE: Thank you.

19 MS. MITCHELL: Good morning, Your Honor.
20 Robin Mitchell, Ayesha Vohra and Nancy Scott on behalf of
21 the Commission Staff.

22 ALJ WOLFE: Thank you.

23 Are there any other attorneys present here
24 representing any other parties?

25 (No response.)

1 ALJ WOLFE: Any other parties without attorneys?

2 (No response.)

3 ALJ WOLFE: Let the record reflect there was no
4 response.

5 Okay. Mr. Marks, do you have any procedural
6 issues you would like to cover before we start with
7 witnesses?

8 MR. MARKS: I don't, Your Honor. Thank you.

9 ALJ WOLFE: Would you like to call your witness?

10 MR. MARKS: I would. Arizona-American Water
11 Company calls Dr. Bente Villadsen to the stand.

12

13

BENTE VILLADSEN,

14 called as a witness herein, on behalf of the Company,
15 having been first duly sworn, was examined and testified
16 as follows:

17

18

DIRECT EXAMINATION

19

20 BY MR. MARKS:

21 Q. Good morning, Dr. Villadsen.

22 A. Good morning.

23 Q. For the record would you state your name and
24 business address?

25 A. My first name is Bente, B-e-n-t-e; last name is

1 Villadsen, V-i-l-l-a-d-s-e-n. My business address is
2 44 Brattle Street, Cambridge, Massachusetts 02138.

3 Q. And by whom are you employed and in what
4 capacity?

5 A. I'm employed at the Brattle Group, and I'm
6 principal at that entity.

7 Q. Okay. And who are you representing in this
8 matter?

9 A. Arizona-American.

10 Q. Now, you should have before you three documents
11 that have been marked as Exhibits A-13, A-14 and A-15.

12 Do you have those with you?

13 A. I do.

14 Q. Can you take just a moment to look those over. I
15 will ask you some questions about each one in turn.

16 A. I have checked those, yes.

17 Q. The first one I want to ask you about is what has
18 been marked as A-13, and that is a document titled
19 "Revised Direct Testimony of Bente Villadsen on behalf of
20 Arizona-American Water Company dated June 20th, 2008?

21 A. Yes, it is.

22 Q. And was this document prepared by you or under
23 your direction and supervision?

24 A. Yes, it was.

25 Q. Do you have any additions, corrections or other

1 modifications to make to that testimony at this time?

2 A. Yes, on page 7 in footnote 3.

3 Q. Let's give everybody a chance to get there.

4 A. The last part of that statement says 30 percent
5 of revenue. That should read three times earnings.

6 Q. So we will strike 30 percent of revenue and
7 substitute three times earnings; is that correct?

8 A. Yes. That's correct.

9 Q. Have you made that change to what has been marked
10 as Exhibit A-13?

11 A. Yes, I have.

12 Q. Any other corrections or other modifications to
13 A-13?

14 A. Only one comment. The document that I have does
15 not have tables and work papers.

16 Q. Excuse me just one second.

17 Does that have Appendix A attached to it?

18 A. Yes, it does.

19 Q. And is that where it ends at this point?

20 A. No. It has Appendix A, B, C, and D.

21 Q. Does it have E?

22 A. Yes, it does.

23 Q. Well, I believe that is all of your direct
24 testimony at this point. Work papers have been provided
25 to the parties, but we won't be admitting those as

1 exhibits at this time.

2 A. That's fine.

3 Q. If I were to ask you the same questions today
4 under oath as contained in Exhibit A-13, would your
5 answers be the same?

6 A. Yes.

7 Q. I would like you to turn to what has been marked
8 as Exhibit A-14. This is a document titled "Rebuttal
9 Testimony of Bente Villadsen on Behalf of Arizona-American
10 Company" dated February 10th, 2009?

11 A. Yes, it is.

12 Q. And was this document prepared by you or under
13 your direction and supervision?

14 A. Yes, it was.

15 Q. If I were to ask you today the same questions
16 under oath that are contained in Exhibit A-14, would your
17 answers be the same?

18 A. Yes, they would.

19 Q. Finally I would like to turn to what has been
20 marked as Exhibit A-15.

21 Is that a document titled "Rejoinder Testimony of
22 Bente Villadsen on Behalf of Arizona-American Company"
23 dated March 10th, 2009?

24 A. Yes, it is.

25 Q. And was this document prepared by you or under

1 your direction and supervision?

2 A. Yes, it was.

3 Q. If I were to ask you today the same questions
4 under oath that are contained in Exhibit A-15, would your
5 answers be the same?

6 A. Yes, they would.

7 Q. Thank you, Dr. Villadsen.

8 MR. MARKS: At this time Arizona-American Water
9 Company tenders Dr. Villadsen for cross-examination and
10 moves for the admission of Exhibits A-13, A-14 and A-15.

11 ALJ WOLFE: A-13, A-14, and A-15 are admitted.

12 (Exhibits A-13, A-14, and A-15 were admitted.)

13 MS. MITCHELL: Your Honor, if I could note one
14 small correction. In A-14, at least the copy I have, in
15 the headers of every page it says "Direct Testimony" and I
16 believe it's the rebuttal testimony.

17 ALJ WOLFE: I noted that. That is a
18 typographical error.

19 MR. MARKS: Yes, that is a typographical error.
20 But it is the rebuttal testimony, and is the document with
21 the cover page rebuttal testimony.

22 I think that may have happened with one or two
23 other witness where the headers were changed. So thank
24 you for calling that to our attention. If you see that
25 any more, let me know.

1 MS. MITCHELL: I just noticed this today. It's
2 strange. You look at this stuff over and over again, and
3 then something jumps out.

4 MR. MARKS: I think Dan showed me one last week,
5 if I remember right, too.

6 ALJ WOLFE: Okay. Thank you.

7 Ms. McHale-Hubbs?

8 MS. McHALE-HUBBS: No questions.

9 ALJ WOLFE: Mr. Metli?

10 MR. METLI: No questions, Your Honor.

11 ALJ WOLFE: Mr. Pozefsky?

12 MR. POZEFSKY: Just a few, Your Honor.

13

14

CROSS-EXAMINATION

15

16 BY MR. POZEFSKY:

17 Q Dr. Villadsen, how are you?

18 A Good. Good morning.

19 Q Dr. Villadsen, you are a principal of the Brattle
20 Group; is that correct?

21 A That's correct. Yes.

22 Q And the Brattle Group through its principals
23 testifies on cost of capital throughout the country; is
24 that correct?

25 A That's correct. Yes.

1 Q And I think the last time I talked to you about
2 this you told me that it was -- Missouri and Pennsylvania
3 were the two jurisdictions that the PUCs have accepted
4 your methodology; is that correct? Is my recollection
5 correct?

6 A That's correct. Last time, yes.

7 Q Are there any other jurisdictions since then
8 where your methodology -- your cost of capital methodology
9 has been adopted?

10 A Yes. The National Energy Board of Canada has
11 adopted it, yes. The National Energy Board of Canada has
12 adopted the ATWACC method of setting cost of capital.

13 Q And the methodology that you're proposing here is
14 the same methodology that the company proposed in the
15 Paradise Valley case; is that correct?

16 A It's similar to that, yes.

17 Q And it's similar to the methodology that the
18 company proposed in the Anthem case?

19 A It's similar to that, yes.

20 Q And both those cases this methodology was
21 rejected by the Commission?

22 A No. Both cases the Commission did not accept. I
23 don't think they specifically -- in both of these cases
24 the Commission did not accept the methodology nor did they
25 specifically reject it.

1 Q. Dr. Villadsen, you are recommending a
2 11.75 percent return on equity; is that correct?

3 A. That's the midpoint, yes.

4 Q. Are you aware of any case before this Commission
5 where the Commission has granted a cost of equity of
6 11.75 percent?

7 A. Before this Commission?

8 Q. Yes.

9 A. Not in recent times. I don't recall anyone, no.

10 MR. POZEFSKY: Okay. Thank you.

11 ALJ WOLFE: Ms. Mitchell.

12

13 CROSS-EXAMINATION

14

15 BY MS. MITCHELL:

16 Q. Good morning.

17 A. Good morning.

18 Q. Is it correct to say that your primary cost of
19 equity recommendation of 11.75 percent is applicable to a
20 capital structure containing 46.9 percent common equity?

21 A. That would be applicable to that, yes.

22 Q. And would it be correct to say that the
23 46.9 percent common equity ratio does include short-term
24 debt in the capital structure?

25 A. That's correct.

1 Q Now, I want to turn to your direct testimony. On
2 page 4 you indicate that the use of capital structure with
3 4.6 common equity increases the cost of common equity by
4 100 to 150 basis points.

5 Is that an accurate rendition of what you said on
6 that page?

7 A That's correct. I should also say that I gave a
8 range for the cost of equity in my recommendation.

9 Q And would the midpoint of this adjustment range
10 be 13 percent if you added the 100 to the 150 point basis
11 point adjustment?

12 A No. If I look at my work papers, the midpoint
13 would be probably closer to 12.75, in that range.

14 Q All right. And you previously testified before
15 this Commission; is that correct?

16 A I have, yes.

17 Q And I think Mr. Pozefsky may have mentioned a
18 couple of the cases. I believe it was on behalf
19 Arizona-American in Anthem?

20 A I testified in that case, yes.

21 Q And Paradise Valley; is that correct?

22 A No, I did not.

23 Q Okay. And in the Anthem case what was your
24 return on equity recommendation, if you can recall?

25 A I don't recall.

1 Q And do you know what the Commission awarded in
2 that case?

3 A I can't recall exactly that specific case. I
4 know that in one case award 10.7 and one case award
5 another number. I can't recall what.

6 Q Thank you. I can't recall what I did this
7 morning.

8 I believe in response to a Staff data request
9 that you indicated that you testified in five previous --
10 you have given cost of capital testimony in five previous
11 cases since 2000.

12 A That sounds right, yes.

13 Q Okay. And if you can recall, what was the lowest
14 cost of equity that you recommended during that time
15 period?

16 A I recommended 10.75 in one matter for an electric
17 utility, with a significantly larger amount of equity than
18 this.

19 Q Did you say it had a larger amount?

20 A It was a larger equity percentage than
21 Arizona-American.

22 Q Okay. And your direct testimony in this case was
23 prepared in April of 2008; is that correct?

24 A It was, yes.

25 Q And when you were preparing your direct

1 testimony, were you aware of the decline in the economy in
2 the Arizona-American service area?

3 A. I was aware that it was not increasing as much as
4 it had been. It obviously had not reached the portion
5 that it could because in terms of decline of employment
6 and financial turmoil it is now.

7 Q. And are you aware that in this docket the
8 customers of Arizona-American have submitted voluminous
9 public comments concerning the depressed economic
10 conditions that they face in Arizona?

11 A. I'm aware that there has been numerous comments.
12 I haven't read any of them specifically.

13 Q. And your rebuttal testimony was prepared in
14 February of 2009?

15 A. That's correct.

16 Q. And I think you just mentioned that between the
17 filing of the direct and the filing of the rebuttal, the
18 economic conditions declined even more significantly.

19 Is that kind of an accurate --

20 A. That's correct. There has been significant
21 turmoil since September of last year.

22 Q. Now, it's not the company's position that it
23 should ignore the economic conditions of its service area
24 in making its recommendations on cost of capital?

25 A. That is for the company to respond to. I only

1 estimate what it should be from a financial economic
2 perspective.

3 Q. And do you agree that the regulatory body, like
4 the Commission here, is charged with both balancing the
5 interest of the ratepayers and the interest of the
6 company?

7 A. Yes, and I am aware they are to award a return on
8 overall -- overall return that is consistent with what the
9 guiding legal principles are, yes.

10 Q. I want to turn now to some comments that you have
11 concerning the Staff witness testimony on cost of capital
12 in this case.

13 Mr. Parcell has made some statements regarding --
14 strike that.

15 Let me ask you some question about some risk
16 positioning adjustments that you make some comments on in
17 your testimony.

18 Have you previously proposed any type of risk
19 adjustments in testimony before this Commission?

20 A. Financial risk, yes.

21 Q. Yes?

22 A. Yes.

23 Q. And has the Commission ever adopted your risk
24 positioning adjustments?

25 A. The Commission has not adopted exactly the

1 methodology I have used. They have however adopted a form
2 of risk adjustments for financial risk, yes.

3 Q And is it your understanding that the Commission
4 is not bound to accept any one specific methodology when
5 determining cost of capital?

6 A I don't know exactly what the rules are here, but
7 I believe they should -- they need -- they are -- under
8 most restrictions they listen to all of the evidence on
9 the record and then make a decision.

10 Q In the preparation of your initial testimony,
11 your direct testimony in this case, did you consult or
12 discuss with any Arizona-American Company management about
13 the company's statements to the investment community?

14 A Not specifically, no.

15 Q And in preparing to testify today did you consult
16 with the company management about the company's statements
17 to the investment community?

18 A No, I did not.

19 Q And are you familiar at all with the company's
20 earnings call of February 26, 2009?

21 MR. MARKS: Could I get an objection here? This
22 is the third time that we have heard the phrase "the
23 company."

24 What company is counsel referring to here?

25 MS. MITCHELL: Arizona-American. I should be

1 more clear.

2 MR. MARKS: Does Arizona-American -- I'm sorry.

3 MS. MITCHELL: I mean, Arizona-American -- I
4 mean, your parent company, American Water Works.

5 MR. MARKS: American Water Works?

6 MS. MITCHELL: Yes.

7 MR. MARKS: Thank you.

8 MS. MITCHELL: I'm sorry. I wasn't real clear on
9 that.

10 ALJ WOLFE: Could you repeat the question?

11 MS. MITCHELL: Yes.

12 Q BY MS. MITCHELL: Were you familiar with the
13 earnings conference call of American Water Works that was
14 February 26th of 2009?

15 A No, I have not read that. No.

16 Q And so you wouldn't be familiar with the
17 statement made by American Water Works' CFO that their
18 allowed rate of equity for rate cases finalizing during
19 2008 were generally above 10 percent with the range being
20 from 8.8 percent to 10.8 percent?

21 A No, I'm not familiar with that statement.

22 I do know that rate cases around the country have
23 been awarded different amounts.

24 Q Are you aware that American -- I would say maybe
25 the financing arm of American Water Works -- and I get all

1 the names confused -- issued \$75 million in debt in
2 February of 2009?

3 A Yes, in February sometime. I don't recall the
4 exact date. Yes, they issued -- yes.

5 Q And are you aware that the rate on that debt was
6 8.25 percent?

7 A The coupon on that was 8.25. The yield was a bit
8 higher than that.

9 Q I'm sorry. The yield was?

10 A The yield was a little higher than that.

11 MS. MITCHELL: Thank you. I don't have any more
12 questions.

13 ALJ WOLFE: Mr. Marks, do you have redirect?

14 MR. MARKS: Just a little bit, Your Honor. Thank
15 you.

16

17 REDIRECT EXAMINATION

18

19 BY MR. MARKS:

20 Q Dr. Villadsen, you were asked some questions
21 about financial and economic conditions.

22 In the market for equity, is that a local market,
23 a national market or an international market?

24 A For American Arizona-American is a national or
25 possibly even an international market.

1 Q And when you're determining your recommendation
2 for the cost of equity in this case, are you looking at
3 national and international financial and economic
4 conditions?

5 A Yes, I am.

6 Q And you were also asked a question about a recent
7 debt issuance by American Water Capital Corporation.

8 Do you remember that question?

9 A Yes, I do.

10 Q You stated that the actual yield was higher than
11 the coupon rate.

12 Do you know what the yield actually was?

13 A It would varied by state, but the current yield
14 was about 8.5 or 8.6, in that range, but it varies day by
15 day.

16 Q Do you know the rating on that debt?

17 A I do not. I know Arizona-American is generally a
18 BBB rating, but I don't know the rating on that specific
19 issue.

20 Q You were asked a question about an earnings call
21 by American Water in February.

22 Do you remember that question?

23 A I remember that question, yes.

24 Q And you were asked a question about -- in the
25 statement that was read to you it mentioned a range of

1 allowed returns of equity from 8.8 to 10.8 percent.

2 Do you remember that?

3 A. Yes, I remember that.

4 Q. So 8.8 would be lowest return allowed?

5 A. That would be the lowest and that would be
6 unusual.

7 MR. MARKS: Okay. That is all I have. Thank
8 you.

9 ALJ WOLFE: Is there any recross on those issues?

10 MS. MITCHELL: No, Your Honor.

11 ALJ WOLFE: Okay. Thank you.

12 Thank you for your testimony, Dr. Villadsen. You
13 are excused as a witness. I hope you can enjoy your day
14 in Arizona.

15 THE WITNESS: I will. Thank you.

16 ALJ WOLFE: Mr. Pozefsky, are you ready to call
17 your witness?

18 MR. POZEFSKY: I am. RUCO would call
19 William Rigsby.

20

21 WILLIAM A. RIGSBY,

22 called as a witness herein, on behalf of RUCO, having been
23 first duly sworn, was examined and testified as follows:

24

25

1 DIRECT EXAMINATION

2

3 BY MR. POZEFSKY:

4 Q Good morning, Mr. Rigsby. Would you please state
5 your name for the record.

6 A William A. Rigsby.

7 Q Where do you currently work and in what capacity?

8 A I am employed by the Residential Utility Consumer
9 Office as a Public Utilities Analyst V.10 Q And you prepared testimony in this case,
11 Mr. Rigsby?

12 A Yes, I did.

13 Q And before you should be what's marked RUCO
14 Exhibit No. 1; is that correct?

15 A Yes.

16 Q And that should be a copy of your revised -- or
17 your direct testimony in this case?

18 A Yes.

19 Q And that was prepared by you or under your
20 direction?

21 A Yes.

22 Q And also before you should be RUCO's Exhibit
23 No. 2, which should be a copy of your surrebuttal
24 testimony; is that correct?

25 A Yes.

1 Q And that was prepared by you or under your
2 direction?

3 A Yes.

4 Q Do you have any additions or corrections to make
5 to that testimony?

6 A No, I don't.

7 MR. POZEFSKY: Your Honor, at this time I would
8 move for the admission of RUCO 1 and RUCO 2.

9 ALJ WOLFE: RUCO 1 and RUCO 2 are admitted.

10 (Exhibits R-1 and R-2 were admitted.)

11 MR. POZEFSKY: Your Honor, I typically ask at
12 this time the witness to give us a summary. I know
13 Mr. Marks didn't do that with his witnesses.

14 Is there a preference from the bench either way?

15 ALJ WOLFE: As long as it's a short summary, it's
16 okay.

17 Q BY MR. POZEFSKY: Mr. Rigsby, would you please
18 provide us a short summary of your testimony?

19 A Sure, and I will keep it as brief as possible.

20 If anyone is interested, I'm just referring to
21 some numbers that are exhibited in my surrebuttal
22 testimony, pages 3 through 5.

23 In record to capital structure, RUCO is presently
24 recommending a capital structure comprised of 55.2 percent
25 long-term debt and 44.8 percent common equity. The

1 capital structure that I'm recommending was based on
2 information that was obtained from ACC Staff data request
3 PNC 15.1 dated October the 10th of 2008.

4 In regards to my recommended cost of debt I'm
5 recommending a cost of debt of 5.46 percent. That is the
6 weighted cost of the various debt instruments of the
7 company.

8 My cost of equity capital is 8.88 percent. That
9 was the same figure that I recommended in my direct
10 testimony, and I'm making no changes to that.

11 And my overall weighted average cost of capital
12 is 7 percent. And that is the weighted cost of both my
13 recommended cost of long-term debt and weighted cost of
14 common equity.

15 Q. Okay. Thank you, Mr. Rigsby.

16 MR. POZEFSKY: At this time I would tender
17 Mr. Rigsby for cross-examination.

18 ALJ WOLFE: Thank you.

19 Ms. McHale-Hubbs?

20 MS. McHALE-HUBBS: No question.

21 ALJ WOLFE: Mr. Metli?

22 MR. METLI: No questions, Your Honor.

23 ALJ WOLFE: Ms. Mitchell?

24

25

1 CROSS-EXAMINATION

2

3 BY MS. MITCHELL:

4 Q. Good morning, Mr. Rigsby. How are you?

5 A. I'm fine. Good morning.

6 Q. In your proxy group do you include other
7 companies besides water companies?

8 A. Yes. I actually have two separate proxy groups.
9 One is comprised of regulated publicly-traded water
10 utilities. The other group is comprised of national gas
11 local distribution companies that are also publicly
12 traded.

13 Q. And you were the RUCO cost of capital witness in
14 Chaparral City Water Company?

15 A. Yes, I was.

16 Q. And they objected to the use of those gas
17 companies; is that correct?

18 A. Yes, they did.

19 Q. But in this case -- in Arizona-American, they
20 accepted use of gas companies as a proxy?

21 A. Yes. And typically Dr. Villadsen includes gas,
22 local gas distribution companies in her testimony too, in
23 her proxy groups.

24 MS. MITCHELL: All right. That is all I have.

25 Thank you.

1 THE WITNESS: Sure.

2 ALJ WOLFE: Mr. Marks?

3 MR. MARKS: Thank you, Your Honor.

4

5

CROSS-EXAMINATION

6

7 BY MR. MARKS:

8 Q. Good morning, Mr. Rigsby.

9 A. Good morning.

10 Q. Mr. Rigsby, you have previously provided cost of
11 capital testimony for RUCO in Arizona-American cases; is
12 that correct?

13 A. Yes.

14 Q. I went back and looked, and I found five previous
15 times that you provided testimony in Arizona-American rate
16 cases.

17 Does that sound about right?

18 A. I will take your word about that.

19 Q. And I will give you these. I realize you don't
20 have these in front of you, so I will ask you to accept
21 these subject to check --

22 A. Yes.

23 Q. -- for reasonableness.

24 In the case that became -- it was a multi -- I
25 think it was all of the cases, the decision number

1 ultimately was 67093 in 2004 -- your recommendation in
2 that case was for a 9.11 percent return on equity plus 50
3 basis points for 9.61 percent.

4 Does that sound right?

5 A. I will accept that subject to check.

6 Q. And then later in the -- we talked already about
7 the Paradise Valley rate case, what became decision 68858
8 in, I believe it was, 2007, I believe you recommended
9 9.5 percent return on equity plus 50 basis points for a
10 total recommendation of 10.0 percent.

11 Does that sound right?

12 A. Again, I will accept that figure subject to
13 check.

14 Q. Then the next one that I have is a Mohave Water
15 and Wastewater case, which became Decision 69440. And in
16 that case, I believe you recommended 8.6 percent plus
17 50 basis points and the use of a hypothetical capital
18 structure 40 percent equity and 60 percent debt.

19 Does that sound right?

20 A. Again, I will accept that subject to check.

21 Q. Then in 2008, I believe, the decision came out in
22 Sun City Water and Sun City Wastewater. It was Decision
23 70209. According to my look at the docket you recommended
24 9.53 percent plus 50 basis points for a total
25 recommendation of 10.03 percent, and again you used a

1 hypothetical capital structure of 40 percent equity and
2 60 percent debt.

3 Does that sound about right?

4 A. Yes. Again, I will accept that figure subject to
5 check.

6 Q. And then finally in the Anthem case, which became
7 Decision 70372 -- I believe it was actually filed before
8 the Sun City water cases but came out afterwards -- and
9 your final recommendation in that case, again subject to
10 check, was 9.51 percent plus 50 basis points for 10.01,
11 again based on a hypothetical capital structure of
12 40 percent equity and 60 percent debt.

13 Does that sound right?

14 A. Yes. I again will accept that subject to check.

15 Q. Now, in this case you are recommending -- you are
16 not recommending a hypothetical capital structure; is that
17 correct?

18 A. That's correct.

19 Q. And you are not recommending any adjustments for
20 the increased -- or the increased amount of debt in
21 Arizona-American's capital structure related to the
22 utilities in your sample group; is that correct?

23 A. That's correct.

24 Q. And your overall recommendation is 8.88 percent;
25 is that correct?

1 A. Yes.

2 Q. So that's the lowest you have ever recommended
3 for Arizona-American; is that correct?

4 A. Based on the figures you just quoted, yes.

5 Q. How does Arizona-American Water get its debt
6 financing?

7 A. It's my understanding that the parent company has
8 a lending subsidiary, which issues debt for its various
9 subsidiaries.

10 Q. American Water Capital Company, does that sound
11 right?

12 A. Yes.

13 Q. And how does American Water Capital Company get
14 its debt?

15 A. By going to the capital markets -- floating bond
16 issues and so forth in the capital markets in order to
17 obtain buyers for the bonds and so forth. And, of course,
18 the proceeds would go to whatever subsidiary the debt is
19 being issued for.

20 Q. Do you know the current debt rating for American
21 Water Works or American Water Capital Corporation?

22 A. Offhand, no. Dr. Villadsen just testified that
23 it was BBB. I will take her word on that.

24 Q. Are you familiar with what current debt rates are
25 for BBB-rated corporate debt?

1 A. I don't have the numbers for BBB. I do have the
2 most recent Value Line numbers for A-rated -- oh, excuse
3 me. No, I do have it for BBB.

4 I have the most recent Value Line numbers, which
5 came out this morning, for A-rated and BAA- and BBB-rated
6 utility bonds. As of the 18th of March A-rated utility
7 bonds had a yield of 5.9 percent. BAA-, BBB-rated utility
8 bonds carried a yield of 7.15 percent.

9 I also obtained some information from the Federal
10 Reserve Statistical Release, which was dated March 16th of
11 this year. They don't have a -- they don't specifically
12 list the yields on utility bonds, but they do have yields
13 for corporate bonds, maybe seasoned. AAA for -- let's
14 see, it would have been the week ended March 13th, looks
15 like -- let me make sure I have this.

16 It looks like AAA had a yield of 5.49 and BAA had
17 a yield of 8.4 during that week. Again, that is for
18 13th -- the week ended 13th March.

19 And that would -- that's the most current
20 information I have on bond -- corporate and utility bond
21 yields.

22 Q. Thank you. And I do appreciate it. I know I had
23 asked you on Friday to take a look at those. I appreciate
24 you bringing that information.

25 A. Not a problem.

1 Q. On a stand-alone basis, do you have an opinion as
2 to what Arizona-American Water's debt rating would be?

3 A. On a stand-alone basis, no, I wouldn't.
4 Typically when we look at either Moody's or Standard &
5 Poor's rating, we generally rely on what is available
6 generally on a parent company basis. There are some
7 cases, like with some of your larger energy companies, APS
8 in particular, they issue a rating for the parent company,
9 Pinnacle West, and they also issue another rating for APS
10 themselves -- APS itself. But in the case of water,
11 generally what I have found is that the ratings are
12 generally based on creditworthiness of the parent company.

13 Q. If Arizona-American Water were to issue debt at
14 the Arizona-American level, do you think the rating would
15 be higher or lower than that debt issued by its parent?

16 A. I'm not sure if I can answer that question to the
17 degree of accuracy that I would like to. I think the
18 reason for -- and the reason for that is because I have
19 never done an analysis on the parent company's capital
20 structure. When I say that I'm referring to the levels of
21 debt and equity that all of their subsidiaries would have.

22 I'm aware of what the capital structure of
23 Arizona-American is, but I'm not familiar with what the
24 overall capital structure of American Water is.

25 Q. Why is that capital structure relevant in your

1 thinking?

2 A. Well, I would think that when the rating agencies
3 look at American Water, they would want to see what the
4 total amount of outstanding debt is in making their rating
5 evaluation.

6 Q. The debt as percent of total capitalization?

7 A. Yes.

8 Q. And what would they like to see -- let me put it
9 another way.

10 How does that percentage affect their rating?

11 A. Well, nationally the more leverage the company
12 has, that would have an impact on it; in other words, the
13 more debt they have, that would have an impact on that
14 rating.

15 What would also have an impact is their overall
16 ability to be able to service the debt. And so as long as
17 they have -- as long as the company has adequate cash
18 flows to be able to service the debt with no problem, why,
19 then I'm sure that that would result in a more favorable
20 rating.

21 They use -- different bond rating agencies use
22 different methodologies. They are pretty secretive about
23 their methods. I think Standard & Poor's relies a lot on
24 its FFO to debt ratio, that we have heard a lot about in
25 the recent APS case that is before the Commission right

1 now.

2 Q All things being equal, a larger company, a
3 parent company, would have more revenue and would likely
4 get a higher return rating than a subsidiary that was
5 relying strictly on its local revenue?

6 A Possibly, but then again you would have to take
7 into consideration the fact that Arizona-American alone,
8 okay, is part of this larger organization. Okay? So you
9 also have -- the company would have that going for it. In
10 other words, they wouldn't just be a separate stand-alone.
11 They would have the financial strength of the parent
12 company also to rely upon.

13 So I would think that any analysis would also
14 take that into consideration too.

15 Q So then you would agree then that the customers
16 of Arizona-American Water would benefit from having -- in
17 terms of their debt cost -- by having that corporate
18 parent behind them?

19 A Well, I don't think it's any secret that their
20 customers do benefit from the fact that the company has in
21 the past been able to obtain low-cost debt financing, and
22 that, of course, results in a lower overall weighted cost
23 of capital, which in turn results in lower rates.

24 Q Now, from a financial theory standpoint, you
25 would agree that an investment in a company's bonds is

1 less risky than an investment in a company's equity; is
2 that correct?

3 A. Yes. Assuming that, you know, the company does
4 have the adequate cash flows, that I mentioned, to be able
5 to service its debt obligations, then typically, yes, debt
6 has a lower cost to it -- or excuse me -- yeah, has a
7 lower cost and cost of common stock, which is regarded as
8 being somewhat more risky because -- mainly because of the
9 hierarchy that exists as to who has a claim on the
10 company's assets in the event that there's a bankruptcy or
11 liquidation.

12 Q. Can you explain?

13 A. Yes. Bond holders, typically they are higher up
14 in the hierarchy. Let's say a company files for
15 bankruptcy and there is a bankruptcy proceeding and the
16 company's assets are sold off and then there is a
17 distribution of the funds that are obtained as a result of
18 selling off these assets, well, bond holders, there is a
19 hierarchy where you have bond holders that have claims on
20 the company's actual assets; they would probably be first
21 in line. Then you have unsecured creditors who don't have
22 any direct claim on the company's assets; so they would be
23 next.

24 Then you get your -- you work your way down to
25 the very bottom and then you have residual claimants, and

1 those will be your common equity -- the common
2 stockholders; and they get typically whatever is left.

3 So as a result of that, historically stocks have
4 been perceived as being riskier investments, but not as
5 risky as other investment vehicles out there like
6 commodities or futures or other types of derivatives.

7 Q. Well, we are not pricing derivatives or those
8 type of things in this case, are we?

9 A. No. You get into an exotic area there.

10 Q. That nobody has done very well with lately?

11 A. Not lately.

12 Q. I would like you, if would you, please,
13 Mr. Rigsby, to turn to page 52 of your direct testimony.

14 Are you there, Mr. Rigsby?

15 A. Yes.

16 Q. At the bottom of the page you make a statement
17 starting at line 15, "As I noted earlier, the Hope
18 decision determined that a utility is entitled to earn a
19 rate of return that is commensurate with the returns it
20 would make on other investments with comparable risk."

21 Did I read that correctly?

22 A. Yes.

23 Q. And is that still your testimony?

24 A. Yes.

25 Q. What is the Hope decision?

1 A. That is a Supreme Court decision that came out in
2 the early part of the 20th Century. It was Hope Natural
3 Gas Company versus Federal Power Commission.

4 Q. And where you say a utility is entitled to earn a
5 rate of return commensurate with returns one could make on
6 other investments with comparable risks, would that be on
7 its utility's debt investments then would be entitled to
8 rate of return commensurate with returns on debt
9 investments of similar risk or comparable risk? Would
10 that be fair to say?

11 A. I think the interpretation of that -- and by the
12 way, I said Hope. I probably should have mentioned
13 Bluefield too. Those are the two Supreme Court decisions
14 that we rely on as a standard for making cost of capital
15 recommendations.

16 But to answer your question, typically the way I
17 have looked at it, and I think most other analysts have
18 also, is that you look at -- when you say investments with
19 comparable risks, we are typically looking at other
20 utility companies that are engaged in either the same type
21 of activity as the company that we are trying to find the
22 cost of capital figure for or the companies that have
23 very, very similar operating characteristics.

24 That is what I have done here in my analysis. As
25 Ms. Mitchell was asking me, I have used two different

1 proxy groups, one comprised of publicly-traded water
2 utilities, and the other comprised of publicly-traded
3 LDCs, which I think have similar operating characteristics
4 to water utilities.

5 So typically what I have done in the past, I have
6 looked at the companies themselves, and I do take into
7 consideration their capital structures and so forth. But
8 we work on the assumption that these are companies that
9 have similar risks that in this case Arizona-American
10 would have. And so we calculate a cost of equity using
11 these companies as a proxy group, and that is how we try
12 to meet the standards that were set forth in the Hope and
13 Bluefield decisions.

14 Q Mr. Rigsby, do you know the concept beta?

15 A Yes.

16 Q Can you explain that, please.

17 A Beta is a measurement of risk. It's the central
18 component to the capital asset pricing model, which is one
19 of the stock valuation models that I used in my analysis.

20 Let me just give you my footnoted definition of
21 it. It's probably a little more accurate than what I
22 would give you off the top of my head.

23 Q That's fine.

24 A Looking at the footnote No. 9 on page 28 of my
25 direct testimony where I say here, "Beta is defined as an

1 index of volatility, or risk, in the return of an asset
2 relative to the return of a market portfolio of assets.
3 It is a measure of systematic or non-diversifiable risk.
4 The returns on a stock with a beta of 1.0 will mirror the
5 returns of the overall stock market. The returns on
6 stocks with betas with greater than 1.0 are more volatile
7 or riskier than those of the overall stock market; and if
8 a stock's beta is less than 1.0, its returns are less
9 volatile or riskier than the overall stock market."

10 Beta is just one method of measuring risk. There
11 are other ways of looking at it, too. Some of the
12 information is provided in Value Line, such as their
13 safety ranking and their timeliness rating is also being
14 used.

15 I think one -- of course, CAPM is one of the more
16 controversial models. There is a whole industry out there
17 of academics who have been criticized over the years.
18 They have been able to publish academic articles on it,
19 but at the end of the day the fellow who developed it
20 wound up winning the Nobel Prize for economics, so take it
21 for what it's worth.

22 I typically put more emphasis on the DCL model.

23 Q As far as beta goes, though, you don't dispute
24 what you read in your footnote, that it is a measure of
25 the risk or volatility of a particular asset compared to

1 the market?

2 A. Relative to the market.

3 Q. And if you know the answer to this -- well, let
4 me back up.

5 How long have you been doing cost of equity
6 estimates here at the Commission?

7 A. I first started providing testimony on cost of
8 capital, I want to say, in 1998. I think the first time I
9 did it was in a case that involved Pima Utilities in Sun
10 Lakes.

11 Q. Focusing on water companies first, what has been
12 the trend on betas since the first water case that you
13 did?

14 A. Well, there is no doubt that betas for water
15 companies have gone up. Okay? But again, as I say, you
16 can't look at that in isolation. You know, I think you
17 have to consider, you know, why is that? In other words,
18 what it's saying is that the beta is increased, and I
19 think some of the -- I'm not sure. I think my water
20 company average was 1.05, if I'm not mistaken. I would
21 have to go back and check. All it means is that there has
22 been some price volatility as a result of trading and what
23 has been going out there in the market. And that just
24 means that there has been a lot of activity on water
25 company stocks and so forth.

1 I think what you have to look at -- and is that
2 what I'm doing in this case, as I do in every other
3 case -- is, you know, well, yeah, it's true; you got a
4 beta that is measuring risk. But you also want to look at
5 the company itself. You know, you want to look at it from
6 a fundamental perspective and you want to see what type
7 of -- what it's actually engaged in.

8 I guess what I do is I kind of take a
9 Peter Lynch-type approach to these things. I like to look
10 at what the company does, you know, what kind of products
11 it makes and so forth. And at the end of day, even though
12 I will admit, yeah, it has a beta that would indicate that
13 it's riskier, you know, relative to other companies out
14 there, even in this case the LBCs, you still have to step
15 back and take a look at that company and say, well, what
16 do they do?

17 And in this case we are looking at a regulated
18 utility that has a monopoly control over a specified
19 service territory. Its rates are regulated by the Arizona
20 Corporation Commission. They have relatively stable
21 streams of revenue and so forth.

22 And so I tend to weigh that with the information
23 that one would derive from what the company -- what the
24 beta coefficients are for similar companies.

25 Q. I asked you about water utility betas. All the

1 water utilities are regulated by one commission or other,
2 and they are all monopolies; is that correct?

3 A. I don't think any of the utilities in my example
4 are pure play companies. They all have some unregulated
5 subsidiaries in them, which, of course, would also have an
6 influence on their stock prices and so forth, and, of
7 course, that would be reflected in beta.

8 Q. Do you know what American Water's beta is?

9 A. I don't have the Value Line update on American
10 Water. If you have it, I will --

11 Q. Accept subject to check it's around 1.0.

12 A. It's what?

13 Q. Right around 1.0.

14 A. If it's at 1.0, then that would be equivalent to
15 the market overall.

16 Q. As of 2009 what do water utility betas look like
17 compared -- let's say compare January 2009 to January of
18 2008, what is the difference in water utility betas over
19 that time period, if you know?

20 A. I don't have that here in front of me. I do know
21 that -- I actually have the betas that were recent as of
22 October of last year, and those were included in my
23 analysis.

24 Q. That was your 1.05 or whatever?

25 A. Yeah, I can give it to you right here.

1 Okay. I was relying on Value Line data that was
2 published in October -- let me make sure about this.

3 Okay. I was relying on Value Line data that was
4 published on the water utility industry on 10/24/2008. At
5 that time American States Water had a beta of 0.95.
6 California Water Services had a beta of 1.1. Southwest
7 Water Company had a beta of 1.0. And Aqua America had a
8 beta of 1.0.

9 So my average beta in this particular filing
10 was 1.01 for the water companies. The natural gas
11 utilities -- I won't go through for each individual one --
12 but I came up with an average of 0.7.

13 *Q.* Now, that is a change, isn't it, from historical
14 relationships between gas and water companies? Isn't it?

15 *A.* Typically utilities have betas that fall in the
16 range of, I want to say about 0.6 to 0.7.

17 *Q.* But I'm asking you about the relationship between
18 gas and water.

19 Didn't water utility betas used to be lower than
20 gas utility betas?

21 *A.* Let me think about that.

22 I believe so, yes. But, again, you have to go --
23 you know, you have to ask yourself, well, what is the
24 reason why the beta has increased? If it has to do with
25 the bidding of stock prices, you know, you have made a

1 good argument that, because of economic conditions people
2 out there view water utilities as a relatively safe
3 investment, and therefore there is a demand -- a greater
4 demand for water utility stocks. And that, of course, is
5 going to have an impact on the daily closing prices of
6 those stocks. And, of course, that volatility in price is
7 going to be reflective in the betas.

8 So that is why I don't think you can look at beta
9 in isolation.

10 Q. Do you know what the trend has been in water
11 utility stocks since last summer compared to the trend in
12 the overall market?

13 A. Again, I'm going to concentrate just on the
14 information that I provided in my testimony. And let me
15 just take a look at the exact information here.

16 I'm just looking at -- what I'm looking at here
17 is my Attachment C of my direct testimony. And I have an
18 individual page for each one -- individual data sheets for
19 each one of my water utility stocks. Information is put
20 out by Zachs Investment Research.

21 And you can see there, the very first page is on
22 American States Water Company, which owns Chaparral City
23 Water Company here in Fountain Hills. It's a large
24 publicly-traded holding company based in California.

25 You can see there on the graft, some of the

1 closing price volatilities that I was talking about
2 between December of '08 and the -- beginning of December
3 of 2008 and the end of December of 2008. And what you are
4 looking at there is just price -- closing price volatility
5 that occurred over that 30-day closing period.

6 You can also look at the Value Line information
7 that I have. That might be a little bit better piece of
8 information to look at if you want to see it over multiple
9 periods. If you look at my Attachment A of my direct
10 testimony, and again in Attachment A I have the Value Line
11 updates dated October 24, 2008, and that is for each of
12 the companies in my proxy.

13 If you look there in the upper portion of the
14 page, you can see there -- you can actually track the
15 closing -- the stock prices adjusted for stock splits and
16 so forth for each one of those companies.

17 And I just want to see here. It looks like on
18 American States the overall trend line was going up.
19 California Water is going up slightly, kind of relatively
20 flat. Southwest Water definite up trend. And did I
21 mention --

22 Q. Aqua America?

23 A. I'm sorry?

24 Q. Aqua America?

25 A. Yeah. I'm looking for Aqua America's here. I

1 don't see it. Maybe it didn't get -- it should have been
2 included in here. I don't think the page copy -- I
3 apologize.

4 MR. MARKS: Could I approach, Your Honor?

5 ALJ WOLFE: Yes.

6 THE WITNESS: Do you have it?

7 Q. BY MR. MARKS: Yes.

8 A. Oh, I'm sorry. Yeah, there it is. Thank you.

9 Okay. Aqua American -- you know, we are looking
10 at the same update, October 24th -- yeah, up slightly.
11 Overall trend is upward, yeah.

12 Of course, what that does -- you have to remember
13 that water utilities, for the most part, have fairly
14 stable dividends. There are some growth in dividends, but
15 for the most part they are fairly stable.

16 And, of course, what happens in terms of dividend
17 yield, what happens is as the price goes up, the dividend
18 yield becomes lower. Okay? Because the price -- you
19 basically are dividing the price of the stock into the
20 dividend. And so if your stock price is going up, of
21 course, that is going to result in a lower dividend yield.
22 And, of course, that would tend to make sense because what
23 it's saying is there is greater demand for the stock, and
24 it has the effect of driving the effective yield down, a
25 similar situation that you have with bond yields.

1 Q. Back to my original question to you, now that you
2 have looked at the data, would you agree that stock prices
3 for water utilities have been more stable over the last
4 year than for the overall market?

5 A. Well, as I said, there is some upward movement,
6 but I think for the most part looking at that I didn't see
7 an awful lot of volatility.

8 Q. The overall market is down close to 40 percent in
9 the last year or so; is that correct?

10 A. That is my understanding.

11 Q. And we haven't seen that kind of trend with water
12 utility stocks, have we?

13 A. No, not according to the graft, which means they
14 are relatively -- apparently the public perceives them as
15 relatively safe investments. I know I state that in my
16 surrebuttal testimony, that Value Line certainly seems to
17 be bullish on the company stocks right now. They seem to
18 see them as basically a safe haven.

19 I think that is one argument why I don't believe
20 that they have to have this high -- that they need to have
21 a high return on equity. Given the fact that there would
22 be demand right now for safe havens, people right now are
23 going to put their money into US Treasury instruments that
24 are yielding virtually next to nothing.

25 Last time -- as a matter of fact, I have it right

1 here. If you look at the current yield on US Treasury
2 rates, a 91-day Treasury bill is only yielding
3 0.2 percent, not even one full percent. If you look at
4 the 30-year yield, we are only looking at 3.53 percent.

5 And again, a lot of that has to do with the fact
6 that the investment community out there views US Treasury
7 instruments as a safe haven. Utilities traditionally have
8 been viewed as safe investments also. And in the case of
9 water utilities, I don't see why there should be any
10 change or any reason not to view them in the same way.

11 Q So if an investment in a water utility -- in
12 water utilities were viewed as speculative as opposed to
13 safe havens, then you might be recommending a higher
14 return on equity?

15 A Might in the case of American Water. The stock
16 hasn't been traded for a long period of time. When their
17 parent company, RWE, spun them off, there was an initial
18 public offering. And unlike some of the other water
19 utilities that are in my sample, they don't have as long
20 of a history for investors to rely on. And I think that
21 was noted in the Value Line opinions that I placed in my
22 surrebuttal testimony.

23 But at the end of the day also you have to think
24 about what this company does, and what this company does
25 is not that much different than what Aqua America or

1 American States Water or Southwest Water Company or
2 California Water Services do. For the most part they
3 operate regulated utilities, whose rates are regulated by
4 public utility commissions. Just as I stated earlier,
5 they have captive ratepayers, they have monopoly service
6 territories. That in itself exhibits relatively safe
7 investment.

8 Q So you wouldn't call it a speculative investment?

9 A I would not call a water utility a speculative
10 investment. It's simply a matter of -- if I were an
11 investor, I would certainly read their annual report. I
12 would, you know, look at the information that is published
13 on it by Value Line and other investment services.

14 But given the fact that, you know, the majority
15 of its operations or a majority of its revenues come from
16 regulated, stable monopoly territories, I think that in
17 itself says that we are looking at a relatively low-risk
18 investment.

19 Q I wonder if you could turn to page 7 in your
20 rebuttal testimony.

21 A Surrebuttal?

22 Q Surrebuttal. I'm sorry.

23 A Okay. I'm there.

24 Q You quote a Value Line analyst in here fairly
25 extensively by the name of Andre Costanza?

1 A. Yes.

2 Q. And at the bottom of the page Mr. Costanza is
3 quoted as saying -- and this continues on to the next page
4 starting on line 27 -- "American Water Works continues to
5 intrigue us too, but its short trading history makes it a
6 speculative play."

7 A. Right, and that is what I was referring to
8 earlier when I was talking about the history that we have
9 on it since the initial public offering and that I think
10 that is why he is simply making that statement there.

11 Now, you can refer to it as speculative play, but
12 again, as I say, if you sit down and you do your research
13 and you do your due diligence on the company, you look at
14 what they do, okay, it -- at the end of the day what you
15 have got is largely a regulated utility.

16 Q. And you stated just a minute ago that one of the
17 things you would look at in doing your due diligence was
18 the opinion of Value Line?

19 A. Uh-huh.

20 Q. Value Line states that American Water Works is a
21 speculative play.

22 So you would just disregard that?

23 A. No. I'm not disregarding it. I even said it
24 down here, "Despite the fact that Arizona-American's
25 parent, American Water Works, is viewed as speculative, it

1 is still one of several utilities that Mr. Costanza
2 considers to be a good choice for investor's portfolio in
3 uncertain economic times."

4 And that being the case -- of course, I went on
5 to say, "Based on this information I would say that no
6 upward adjustment of my cost of equity figure is needed
7 considering that water utility stocks are currently in
8 demand."

9 What I'm simply saying there is that he,
10 Mr. Costanza, has viewed the companies that Value Line has
11 followed, the water companies that they followed, and he
12 considers them to be relatively -- what I consider to be
13 relatively safe investments given the uncertain economic
14 times.

15 And, again, the only reason that I think he
16 states that they are somewhat speculative is only because
17 of the short trading period that we have right now.

18 But then again, you have to know a little bit
19 about this company too. You know, you asked me not too
20 long ago, when was the first time that I filed cost of
21 capital testimony, and I think I said it was in 1998. If
22 you go back to 1998, this was a publicly-traded company at
23 that time. It wasn't until several years later that RWE
24 acquired them and they were no longer publicly traded here
25 in the US; they were part of RWE. Okay?

1 But at the end of the day we are looking at a
2 company that has been around for a number of years, much,
3 much, much longer than the time since the initial public
4 offering.

5 Typically you associate an initial public
6 offering with a start-up company, you know, one that has
7 very little history or track record to go on. That is not
8 the case here. This was a company that was publicly
9 traded for a number of years, and RWE, a very large
10 European energy firm, liked it enough to snap it up in its
11 portfolio of companies.

12 Q And then they disliked it enough to try to sell
13 it?

14 A I think that the reason for that, it wasn't that
15 they disliked it, it was simply, I think, that when they
16 acquired it, they just didn't do their due diligence on US
17 regulation.

18 Q So they speculated and they lost?

19 A Well, maybe you might say that, but the fact
20 is -- and again, as I said before, at the end of the day,
21 when you look at this company, it's a largely regulated
22 utility with a monopoly service territory and relatively
23 stable revenue streams.

24 Q I would like to move on to page 9 of your
25 testimony. And before I refer you to a specific line in

1 here, you would agree generally that ratepayers benefit
2 from a low equity ratio, wouldn't you?

3 A. Are you referring to capital structure?

4 Q. Yes. Overall cost of capital is lower for
5 customers?

6 A. Well, typically equity financing has a higher
7 cost than what debt financing does.

8 And so in this particular case the customer
9 benefits because for the most part Arizona-American's
10 weighted cost of debt is fairly low. And they also have,
11 in this particular case too, a higher percentage of debt
12 in the capital structure.

13 So in this particular case, yes, that is true.
14 It has the effect of lowing the overall weighted cost of
15 capital. That would depend on the company, whether or not
16 their cost of debt is as low as Arizona-American's, you
17 know. But in this particular case, I think it's fair to
18 say that the customers are benefiting from the fact that
19 they have a low cost of debt.

20 By the way, I just want to make sure, you are
21 referring to page 9.

22 Was that my direct?

23 Q. Surrebuttal.

24 A. Okay.

25 Q. Which switched back.

1 Let's go back to your surrebuttal, and let's look
2 at page 9, line 25 after the comma. You state,
3 "Ratepayers should not have to subsidize utilities through
4 equity risk adjustments for hypothetical capital
5 structures."

6 How are ratepayers subsidizing utility through an
7 equity risk adjustment?

8 A. They could be subsidizing it by virtue of the
9 fact that they are being provided with a return on common
10 equity that is higher than what is regarded as an average
11 in the industry.

12 Q. I'm sorry. Go ahead.

13 A. Yeah, probably the other factor -- this is
14 probably the one that has more weight or is the one that
15 I'm more concerned with -- is that when you provide a
16 company with additional equity, it has the effect of
17 lowering the amount of interest deduction that they get on
18 their income tax expense.

19 The way this works is when we calculate rates, we
20 do what is known as an interest synchronization
21 calculation. And what we do is we calculate the amount
22 of interest expense that should be deducted from income
23 tax expense by taking the weighted cost of that debt times
24 the company's rate base.

25 Now, if you use a hypothetical capital structure

1 or you make some upward adjustment to the originally
2 estimated cost of equity, what you do is you come up with
3 a lower weighted cost of debt. And so as a result of that
4 you have a lower interest deduction, and as a result of
5 that you have a higher level of income tax expense.

6 So what happens is you are collecting technically
7 more in income taxes through rates than what the company
8 would actually be paying by virtue of the fact that they
9 have an even higher interest deduction and a lower income
10 tax liability.

11 So that is one way that they would be subsidizing
12 the company. And, of course, the other is by simply
13 increasing the amount of equity in the capital structure,
14 which typically is a higher cost than debt. It just
15 simply results in a higher level of operating income.

16 *Q.* But here weren't you referring to an equity risk
17 adjustment like you previously recommended, your 50 basis
18 point adjustment?

19 *A.* In the past we have gone ahead and we have made a
20 50 basis point risk adjustment. In every case that I have
21 been involved in where I have done that, I always have
22 been criticized for not giving the company more than the
23 50 basis points. I have also been criticized because I
24 did not rely on any type of standardized methodology for
25 calculating that risk adjustment.

1 Staff in the past has used the methodology known
2 as the Hamada methodology. I have been very hesitant to
3 use that methodology because it relies solely on the
4 capital asset pricing model, which I stated earlier here
5 on the stand, I don't put as much weight on that
6 methodology as I do for the discounted cash flow
7 methodology.

8 So I have been hesitant to rely on the Hamada
9 methodology to calculate a risk adjustment to my original
10 estimated cost of common equity.

11 Now, in the last Arizona-American rate case
12 filing that I know Dr. Villadsen had testified in -- I
13 believe I sat here in this same chair -- I made some
14 statements to the effect that I could make a very strong
15 argument as to why I think that there is no need for such
16 an adjustment.

17 And the main reason that I stated that was
18 because when we are looking at regulated utilities, they
19 have the advantage of being able to apply for rate relief
20 when they think it's necessary, unlike other companies out
21 there that operate in a competitive environment that may
22 have absolutely no choice but to possibly file for
23 bankruptcy if they can't compete. That is not the case
24 with regulated utilities. They have that ability to be
25 able to come in and seek rate relief when they are not

1 earning their authorized rates of return.

2 So that is, as I see it, a huge advantage. And
3 for that reason alone I think you can make a very strong
4 argument that there is no need to make a risk adjustment.
5 And that is one of the reasons I haven't made one here.

6 Q I'm going to have an exhibit marked here, please.

7 Please take a moment to look that over, please.

8 Have you had a chance to look this over,

9 Mr. Rigsby, A-16?

10 A Yes.

11 Q And this is an excerpt from direct testimony you
12 filed, I believe, in the Sun City Water and Wastewater
13 case --

14 A Uh-huh.

15 Q -- on October 15th, 2007.

16 A Yes.

17 Q Is there anywhere in here that you are aware of
18 that you characterize the risk adjustment as a subsidy?

19 A No, I did not in this particular case.

20 And again, as I stated, the reasons why I decided
21 not to continue to make such an adjustment is for the
22 reasons that I have just provided you with. I had done
23 this in the past. Largely one of the reasons I had done
24 this in the past is because the Staff has done this in the
25 past, which may or may not have been a good reason to do

1 it.

2 Q If the Staff told to you jump off a cliff, would
3 you?

4 A No, I would not.

5 But I recall the first time I made such an
6 adjustment, I looked at it and weighted the pros and cons
7 of it and decided to give the company a 50 basis point
8 adjustment, and I have done so in every case afterwards.

9 And I'm simply saying that over the years that I
10 have been involved with Arizona-American and I have made
11 this adjustment, as I said, I have been criticized by your
12 company for not coming up with some sort of methodology
13 for arriving at the 50 basis point adjustment.

14 And so given the reasons that I just stated to
15 you on the stand today, I have made the decision that I
16 don't believe that there is a need to make such an
17 adjustment.

18 Q Now, in 2007 -- I would like you to turn to the
19 third page of this document, which is marked as page 37
20 below -- at time that you made this filing you stated,
21 "Because Arizona-American's capital structure has a higher
22 percentage of debt, the company faces a higher level of
23 financial risk, i.e., the risk of not being able to meet
24 debt service obligations than the companies in my proxy."

25 That is true today also, isn't it?

1 A. Yes; however, I would say it's -- they have
2 slightly more debt. I think if you look on the last page
3 of my direct testimony, the water companies in the sample
4 had about 50.2 percent debt and the remainder of it was
5 common equity and preferred stock. So it is about a 50/50
6 split. Same with -- the natural gas companies have a lot
7 more equity, roughly about 54 percent common equity,
8 46 percent --

9 Q. And Arizona-American?

10 A. I'm sorry?

11 Q. And Arizona-American?

12 A. And Arizona-American in this case, as I said, I
13 did it off of the company's updated capital structure,
14 which was 55.2 percent debt, 44.8 percent equity.

15 So they have a little more debt.

16 Q. And that didn't include short-term debt in your
17 recommendation -- or the company's recommendation; is that
18 correct?

19 A. I didn't include it and neither did the company.

20 Q. Thank you.

21 A. I think ACC Staff is recommending the short-term
22 debt be included in the capital structure.

23 Q. If short-term debt were included in capital
24 structure, that would make the percentage of debt -- of
25 Arizona-American's percentage of debt even -- the spread

1 between that and your proxy company even greater, wouldn't
2 it?

3 A. Well, yeah. I mean, they are looking at total
4 debt would be around, about 42 percent equity and then the
5 remainder would be debt, combined short-term and
6 long-term.

7 Q. I would like you to turn to page 10 of your
8 testimony, and we will be able to wrap this up.

9 Actually, I'm sorry. Starting at the bottom of
10 page 9 you make a statement there. It says, "In short, if
11 Arizona-American wants higher rates of return, it should
12 start trying to improve the level of equity in its capital
13 structure by issuing less debt.

14 Would you explain to me how providing a lower
15 rate of return would encourage the company to issue less
16 debt and inject more equity?

17 A. Well, I don't think it's a question of what
18 they're awarded. I think it's a question of whether or
19 not the company wants to improve its equity ratio.

20 And the way it would do that is try to retain
21 more of its internally-generated funds and try to make an
22 effort not to issue as much debt.

23 Q. But you don't state -- you state "if
24 Arizona-American wants higher rates of return"; what do
25 you mean by that?

1 A. Well, if they want higher rates of return, what
2 they want to do is improve their equity position.

3 In other words, when I am referring to a higher
4 rate of return, I'm referring to the overall weighted
5 average cost of capital.

6 So if the company could increase its equity
7 position, okay -- and again, we are working under the
8 assumption that typically equity -- cost of equity is
9 higher than the cost of debt, then the company, by
10 improving its equity position, by increasing its equity
11 position with a higher weighted average cost of capital,
12 which in turn is a higher return on investment.

13 Q. So the overall cost of capital that the customers
14 paid, as a result of a rate case, would go up then; is
15 that correct?

16 A. If the company elected to improve its equity
17 position, yes, that would be the case.

18 That is one of the reasons -- that is another
19 reason why in this case I decided not to use a
20 hypothetical capital structure, and that is because of
21 some of the signals that I have gotten here in some of the
22 other cases that have gone before the Commission where the
23 Commission has -- essentially they are kind of sending a
24 message out to the company that look, we are not going to
25 continue to give you hypothetical capital structures to

1 help you out. You know, if you are not going to take
2 efforts to improve your equity position, then we are not
3 going to do that for you.

4 Q And, in fact, the company has injected a
5 significant amount of equity since, say, the first case
6 where you recommended a hypothetical capital structure?

7 A I won't deny that. I'm just simply saying that I
8 think maybe in looking at the numbers -- I mean, 55 --
9 just a little over 55 percent debt, I don't think it's --
10 I don't think that's unreasonable to expect the company to
11 try to improve its equity position if it has the desire to
12 do so.

13 Q And if you remember back to the Paradise Valley
14 Water case, at that time wasn't the equity ratio below
15 40 percent at that time? Isn't that one of the reasons
16 you represented a hypothetical capital structure?

17 A I may have at that time, but, again, I would have
18 to go back and look at the testimony and so forth.

19 But I may well have at that time, but, again, I'm
20 looking at this based on what their most recent capital
21 structure numbers are, and so I have just made a decision
22 that I just don't think that the hypothetical capital
23 structure is warranted at this time.

24 Q And no one in this case is recommending a
25 hypothetical capital structure, are they?

1 A. Not in this case, no.

2 MR. MARKS: Thank you, Your Honor. That is all I
3 have.

4 Thank you, Mr. Rigsby.

5 ALJ WOLFE: Mr. Pozefsky, do you have any
6 redirect?

7 MR. POZEFSKY: I do, but not much, Your Honor, I
8 will try to be quick with it.

9

10 REDIRECT EXAMINATION

11

12 BY MR. POZEFSKY:

13 Q. Mr. Rigsby, I would like to cover a few quick
14 points.

15 You stated that the company here -- or in your
16 testimony you stated that the company here has a higher
17 level of debt than most of the companies in your proxy; is
18 that correct?

19 A. Yes.

20 Q. And in all of the cases, or most of the cases,
21 the five cases that Mr. Craigs pointed out to you in the
22 past, it's been RUCO's recommendation for a 50 basis point
23 upper adjustment here; correct?

24 A. Yes.

25 Q. But here we are not making that same

1 recommendation; correct?

2 A. Yes.

3 Q. And wouldn't it be indicative of a company that
4 has more debt than the other companies in the proxy,
5 wouldn't that usually make that company more risky
6 financially?

7 A. If they have a higher -- if they are leveraged
8 and they typically have a higher percentage of debt in
9 their capital structure, you can make an argument that,
10 you know, it would be somewhat more riskier. Again, you
11 know, that is pure theory.

12 You know, if you were looking from the standpoint
13 -- from a cash flow standpoint, if they have adequate cash
14 flows to handle it and so forth, then certainly there is
15 no problem. If the credit rating is such to raise the
16 investment grade, then that would indicate that they are
17 not -- that there is no problem either.

18 And again, as I said, you know, I have been
19 involved in other cases where the Commission has been sort
20 of sending a message to companies that, you know, if they
21 want their equity positions to improve, then they need to
22 start working on it themselves as opposed to relying on us
23 to provide them with higher returns on investment as a
24 result of using hypothetical capital structures or upward
25 adjustments to calculate cost of equity estimates.

1 Q. Mr. Rigsby, in your opinion has the company
2 issued too much debt in the past?

3 A. Well, yeah. Typically they have had leveraged
4 capital structures. I don't deny that. That, as I have
5 also stated, tends to work in the favor of ratepayers.
6 Okay?

7 I'm just simply saying here that if the company
8 isn't happy with the rates of return that it's being
9 awarded, then one of the ways to improve that situation is
10 to increase its equity position.

11 Q. Okay. So what I'm gathering and what you
12 testified to pretty much is, the focus, at least from the
13 Commission's standpoint and in your opinion, should really
14 be on the capital structure and making sure that the
15 company increases its equity ratio?

16 A. Well, yeah, as opposed to, you know, either
17 awarding -- or either basing its return on investment
18 through the use of either a hypothetical capital structure
19 or a making an adjustment to the cost of equity.

20 Q. Okay. And is that -- sort of the way you arrived
21 at that is, look, we have given this company adjustments
22 in the past and that doesn't seem to be working; it's time
23 now to refocus the concentration, if you will?

24 A. Yeah, that had a lot to do with my decision.
25 That and the fact that I think there is no good way of

1 making the kind of risk adjustment that the company would
2 have liked to see me make in this particular case.

3 And so over the years I've just tried to give
4 this a lot of thought, and, as I stated -- I think the
5 last time I testified here on the stand I stated that I
6 thought there were good reasons why maybe we shouldn't do
7 that. And I'm simply just following through on that in
8 this particular case.

9 *Q.* So one more question on that, Mr. Rigsby.

10 So an upward adjustment in this case, at this
11 time, wouldn't be beneficial, in your opinion, to either
12 the ratepayers or the shareholders?

13 *A.* Well, it would certainly favor the shareholders.
14 You know, it would be -- if we made an upward adjustment,
15 then they would have a higher operating income, and
16 certainly that benefits the shareholders in this case more
17 so than it would the ratepayers.

18 *Q.* But it would get them no further ahead in
19 increasing their equity situation?

20 *A.* No. And, as I say, that is a decision that the
21 company -- that is a commitment that, I guess, the company
22 has to make on its own, that it makes the decision that we
23 want to try to improve our equity.

24 *Q.* Mr. Rigsby, would you turn to Attachment A of
25 your direct testimony. You were asked a bunch of

1 questions by Mr. Marks on this exhibit, and I want to ask
2 you a few follow-ups.

3 Are you there?

4 A. Yeah.

5 Q. Let's go to that first page of that attachment,
6 the composite for the water utility industry.

7 This is Value Line; is that correct?

8 A. Yes.

9 Q. If you go down to the composite statistics of
10 water utility industry, under the row entitled Return on
11 Common Equity, for the industry, the composite, could you
12 read 2008, 2009 and 11 through 13?

13 A. Sure, of course, these are return on book equity.
14 2008 composite water utility industry had a
15 return on common equity of 6 percent.

16 2009 -- and they are projecting -- well, let's
17 see. This will come out in October. These are
18 projections, okay, just so we are clear on this, because
19 this update was dated October 24, 2008. So what you are
20 seeing here is Value Line's projections for that
21 particular year even though, see, the year wasn't
22 completely over with.

23 So for 2008 their analyst were projecting a
24 return on book common equity of 6 percent.

25 In 2009 they were projecting a return of

1 7 percent.

2 And then over the 2011 through 2013 period they
3 are projecting a return of 7.5 percent.

4 Q Now, I know this is book equity, but at least
5 based on the industry, your recommendation of 8.8 percent
6 is not too far out of line in the --

7 A Well, it's actually higher than this. It's
8 higher than this. And again, I'm calculating the cost of
9 equity, not a return on book common equity.

10 Q Okay.

11 A Which is what these projections are.

12 Q Another point that you covered with Mr. Marks had
13 to do with beta.

14 Just so we are clear, beta is a component of the
15 CAPM model; correct?

16 A It's central to the model.

17 Q And although there are different opinions as to
18 the usefulness of CAPM, RUCO uses a CAPM usually as a
19 check to its DCF analysis; correct?

20 A Well, typically in the past we did, and what was
21 happening was the Commission typically would adopt a cost
22 of capital figure that was a mean average of the DCF and
23 CAPM results. And I would always do that calculation in
24 my surrebuttal testimony so that the Commission would have
25 a comparison of what I was -- of what my numbers would

1 result in if I did it the same way that the Staff did.

2 And so over time I just decided, well, you know,
3 since this is how the Commission has been -- you know,
4 this is how the Commission has been adopting -- or this is
5 the method that the Commission has pretty much adopted in
6 awarding rates of return, I just decided to go ahead and
7 use the same methodology.

8 Q Well, the Hamada method is pretty much based on
9 the CAPM; correct?

10 A I'm sorry?

11 Q The Hamada method, which the Commission has
12 relied on in the past, is also based on the CAPM?

13 A Well, yes. The Hamada methodology, it makes an
14 adjustment to the basis coefficient, is what it does.
15 It's called releveraging. You know, you have to go
16 through this method of deleveraging the beta and then
17 releveraging it for the amount of debt and equity in the
18 company's capital structure.

19 Q And, Mr. Rigsby, the beta is a measure of risk;
20 correct?

21 A Yeah, right. It's the measurement of volatility
22 of a given security in relation to the overall market.

23 Q And I believe you and Mr. Marks in your exchange
24 established that beta for this company is 1.0; correct?

25 A We may have.

1 Q Subject to check?

2 A I know the average in my proxy group was 1.01, if
3 I remember.

4 Q And did you state that the average of 1.01 is
5 basically the industry average?

6 A Well, it's the average of the water utilities
7 that are followed by Value Line, okay. So when we speak
8 of the industry -- the water utility industry, I'm
9 speaking of those water companies -- publicly-traded water
10 companies that are followed by Value Line.

11 Q One more question on this chart -- actually, not
12 on this chart but to this exhibit.

13 There is a sentence above, about midway down that
14 starts with "Indeed." I will read it to you quickly, and
15 then I will ask you a question.

16 It states, "Indeed, because of the steady stream
17 of income these stocks generate and the necessity for
18 water itself, the group provides shelter for investors
19 looking to get out of the treacherous economic waters that
20 have been pulling many under without having to take too
21 conservative a stance."

22 Does the same hold true to the appeal that this
23 company would have to investors?

24 A Well, as I say, an investor would have to look at
25 each company on an individual basis. But, you know, when

1 you -- you would want to weigh this information. I mean,
2 what they are saying here is essentially what I was saying
3 in my surrebuttal testimony, only I was citing a later
4 rendition of this.

5 But, yeah, you know, I think this statement is
6 just as true now as it was when it was published, not -- I
7 don't think anything has really changed. You've got to
8 remember that, you know, really water, of all the
9 utilities that this Commission regulates or any utilities
10 out there, I mean, that the various state PUCs regulate,
11 water is essentially the last pure monopoly.

12 Q. And then one more area which sort of follows this
13 area.

14 Mr. Marks talked with you about an answer that
15 you responded to on page 52 of your direct testimony --

16 A. Uh-huh.

17 Q. -- which basically asked how you arrived or
18 whether the 8.8 percent recommendation that you are making
19 is reasonable. He read the second part, but I want to
20 talk to you a little bit about the first sentence in that
21 answer that you gave. And that is, you talked about the
22 current slowdown in growth in new housing construction and
23 the Fed's ability to keep inflation in check are all taken
24 into consideration.

25 A. Uh-huh.

1 Q. Can you just briefly describe how in your
2 analysis the current economic situation is actually taken
3 into consideration?

4 A. Well, as far as the slowdown in the housing
5 industry, utilities typically try to make an argument that
6 growth is actually a risk that has to be considered
7 because they have to keep up with growth. In other words,
8 they have to continue to put infrastructure into the
9 ground as a result of new growth. Okay?

10 Even Value Lines and most analysts out there can
11 kind of view growth as a double-edged sword. I'm not so
12 sure that growth is all that bad. I think, you know, you
13 probably want to invest in a company that has growth
14 potential as opposed to one that has none.

15 But, be what it may, I'm simply trying to make
16 the point here that if there is -- you know, I don't think
17 there is any question that we are experiencing a slowdown
18 in housing, and certainly here in Arizona, so if that is
19 the case, then, you know, this is probably providing
20 utilities, obviously not just water companies, but
21 probably all utilities in this state, for that matter,
22 with sort of a chance to catch their breath. In other
23 words, you know, because of the slowdown in growth, they
24 don't necessarily have to keep putting infrastructure into
25 the ground at the rate that they have been in the past.

1 Q. And are these factors another reason that
2 contribute to the recommendation that you are making being
3 historically lower than what you have recommended in the
4 past?

5 A. Yeah, I'm sure that I weighed that along with
6 some of the other things that I mentioned today. You
7 know, you would have to take that into consideration. The
8 lower -- I mean, I already mentioned the lower interest
9 rates that currently exist right now.

10 For that matter, you know, again, this is a
11 question for the commissioners to decide. At the end of
12 the day they have to separate whether rates are just and
13 reasonable. And I am sure they would want to take into
14 consideration the current economic climate, where we have
15 some fairly high unemployment numbers right now, and the
16 question is, do you want to have a large increase in
17 utilities rates, if you want to put that on people that
18 are currently struggling out there right now.

19 Q. Which leads me to my last question, Mr. Rigsby.

20 All things being equal, given the current
21 economic environment, should the Commission be turning
22 towards lower returns on equity for utilities?

23 A. Well, as I have said, I would hope that they
24 would take the current economic environment into
25 consideration when setting the final rates. Ultimately

1 that is their decision.

2 I just -- I have done my analysis. I am putting
3 out there the number that I think they should adopt, the
4 one that I would like for them to adopt. But what the
5 commissioners decide to do is their decision.

6 MR. POZEFSKY: Thank you, sir.

7 That is all I have.

8 ALJ WOLFE: Is there any recross of the redirect?

9 MS. McHALE-HUBBS: Yes, Your Honor, if I may.

10 ALJ WOLFE: On those answers to the questions?

11 MS. McHALE-HUBBS: No. I'm sorry.

12 ALJ WOLFE: Well, Ms. McHale-Hubbs, I did ask you
13 before if you had questions for this witness, and normally
14 we go in that order. But since this is your first time
15 appearing here, I will let you, but first we need to take
16 a break and let our court reporter have a break. So we
17 will come back here at 10 after 11:00.

18 (Whereupon, a recess was taken from 10:53 a.m.
19 until deduction 11:13 a.m.)

20 ALJ WOLFE: Okay. Let's go back on the record.

21 As I said, Ms. McHale-Hubbs, we usually have an
22 order of cross-examination of the witnesses, and we are
23 going out of order at this time. And we won't do it
24 again, but we will do it one more time.

25 MS. McHALE-HUBBS: I will not do it again, Your

1 Honor.

2 ALJ WOLFE: Go ahead.

3

4 CROSS-EXAMINATION

5

6 BY MS. MCHALE-HUBBS:

7 Q. Good morning, Mr. Rigsby.

8 A. Good morning.

9 Q. I just have a couple yes or no questions.

10 A. Sure.

11 Q. Okay. Do you believe that a regulated utility's
12 stock price is governed somewhat by its return?

13 A. Yes.

14 Q. Yes? Okay. Thank you.

15 In this economy would you say that the stock that
16 is traded at 88 percent or more of its recent IPO, which
17 is 2008, is indicative of a healthy company?

18 A. Well, I would say that obviously the investors
19 out there see something in that stock that would cause the
20 price to go up. Obviously, yeah.

21 Q. Okay. Thank you.

22 Are you aware that the American Water Works
23 stocks, the parent company, is trading at or above
24 88 percent of their IPO?

25 A. Let me see something here. I will check real

1 quick.

2 I don't have it. I can't -- as much as I would
3 like to answer that question for you, I don't have the
4 numbers here in front of me.

5 Q I should have provided the sheet for you. My
6 apologies.

7 A Yeah. It's something I could get. You know, we
8 would have to go back and look at the closing -- well, I
9 would have to look and see what it traded at at the point
10 in time when the IPO occurred versus what it's trading at
11 now, and I just don't have those figures in front of me.

12 Q I appreciate that. Thank you.

13 A Sure.

14 ALJ WOLFE: Mr. Marks, do you want to ask any
15 questions on that issue?

16 MR. MARKS: Thank you, Your Honor. I do not.

17 I don't believe that I moved for the admission of
18 Exhibit A-16.

19 ALJ WOLFE: Is there any objection to Exhibit
20 A-16?

21 MR. POZEFSKY: None.

22 ALJ WOLFE: Admitted.

23 (Exhibit A-16 was admitted.)

24 ALJ WOLFE: Was there any recross on redirect?

25 MR. POZEFSKY: No.

1 ALJ WOLFE: Okay. Thank you for your testimony,
2 Mr. Rigsby.

3 THE WITNESS: Thank you, Your Honor.

4 ALJ WOLFE: Ms. Mitchell, would you like to call
5 your witness?

6 MS. MITCHELL: Yes, Your Honor. Staff would call
7 David Parcell.

8

9 DAVID C. PARCELL,
10 called as a witness herein, on behalf of Staff, having
11 been first duly sworn, was examined and testified as
12 follows:

13

14 DIRECT EXAMINATION

15

16 BY MS. MITCHELL:

17 Q. You all comfortable?

18 A. Indeed.

19 Q. If you could, please state your name and business
20 address for the record.

21 A. Yes. My name is David C. Parcell, P-a-r-c-e-l-l.
22 I'm president of Technical Associates, Incorporated. My
23 address is 1051 East Cary, C-a-r-y, Street, Suite 601,
24 Richmond, Virginia 23219.

25 Q. And were you retained by Staff to provide the

1 Staff position on the cost of capital and to assess the
2 company's application with respect to cost of capital?

3 A. Yes.

4 Q. And you prepared testimony in the course of
5 processing this case; is that correct?

6 A. Yes.

7 Q. I believe you have there with you our exhibits
8 that have been marked S-10 and S-11 for identification.

9 Can you please identify those for the record?

10 A. Yes. Exhibit S-10 is my direct testimony, which
11 was filed on January the 12th of this year. And S-11 is
12 my surrebuttal testimony filed on March 3rd of this year.

13 Q. And do you have any additions, corrections or
14 modifications to make to either S-10 or S-11?

15 A. I have a few typos that I want to fix on S-10,
16 please. What I will do is do them verbally and at the
17 same time I will mark the original.

18 Q. Okay. Thank you.

19 A. These will all be on S-10, my direct testimony.

20 The first is on page 1, line 26. Page 1 line 26,
21 the third word is Schedule 14. It should be Schedule 12.
22 So change the 14 to 12.

23 And then on page 3, again that is on S-10, in the
24 middle of the page on lines 10 through 12 are the return
25 equity ranges of my various methodologies. I have to

1 correct two of those. The numbers that are here do not
2 match the rest of my testimony.

3 Beside discounting cash flow it reads 9.0 -- I'm
4 sorry -- it reads currently 9.5 and 10.5. Strike that,
5 make it 9.0 to 10.0 percent. And again, that matches what
6 is said elsewhere in the testimony.

7 And the one below it, capital S and pricing
8 model, strike 10.2 to 10.5 and make that 9.8 to
9 10.4 percent.

10 Those typos don't change my recommendation. It
11 matches what is said elsewhere in the testimony.

12 My next correction, which I believe is my last
13 one, is on page 13. On page 13, line 10, a reference is
14 made to 19 states. It's really 19 state subsidiaries. So
15 just strike the "s" on states and add the word
16 subsidiaries.

17 And that concludes my corrections.

18 Q. All right. Thank you. And with those
19 corrections, do you adopt S-10 and S-11 as your sworn
20 testimony here today?

21 A. Yes.

22 MS. MITCHELL: Your Honor, at this time I would
23 like to move for the admission of Staff Exhibits S-10 and
24 S-11.

25 ALJ WOLFE: S-10 and S-11 are admitted.

1 (Exhibits S-10 and S-11 were admitted.)

2 MS. MITCHELL: And with that we would tender

3 Mr. Parcell for cross-examination. Thank you.

4 ALJ WOLFE: Thank you.

5 Ms. McHale-Hubbs, do you have questions for this

6 witness?

7 MS. MCHALE-HUBBS: Oh, no, Your Honor. I'm

8 sorry.

9 ALJ WOLFE: Mr. Miller, I don't think you have

10 entered an appearance. You have been sitting here for

11 quite a while.

12 MR. MILLER: No questions.

13 ALJ WOLFE: Mr. Metli?

14 MR. METLI: No questions, Your Honor.

15 ALJ WOLFE: Mr. Pozefski?

16 MR. POZEFSKY: No questions. Thank you.

17 ALJ WOLFE: Mr. Marks?

18 BY MR. MARKS: Wouldn't you love it if I said "No

19 questions"?

20 ALJ WOLFE: We could have an early lunch.

21 THE WITNESS: I have traveled too far for that.

22 MR. MARKS: I would like to have an exhibit

23 marked please. And for the record this has been marked as

24 Exhibit A-17.

25

1

CROSS-EXAMINATION

2

3 BY MR. MARKS:

4 Q Mr. Parcell, do you have what has been marked as
5 exhibit S-17 in front of you?

6 A Yes, sir.

7 Q And is this a document titled "Surrebuttal
8 Testimony of David C. Parcell, Technical Associates, Inc.,
9 December 3, 2008" that was filed, it looks like, in the
10 Chaparral City Water rate case?

11 A It is.

12 Q And was this a document prepared by you or under
13 your direction or supervision?

14 A It was.

15 Q If you would please turn in this document to page
16 12.

17 A 12 you said?

18 Q Yes, sir.

19 A Sure. I'm there.

20 Q What was the overall cost of capital that you
21 recommended in that case for Chaparral City Water?

22 A 8.8 percent.

23 Q And that was based on imbedded cost of debt of
24 5 percent and cost of equity of 10 percent; is that
25 correct?

1 A. That's correct.

2 Q. And what are you recommending for
3 Arizona-American Water Company in this case for its
4 overall cost of capital?

5 A. That is shown on page 2 of my testimony. It's
6 7.34 percent.

7 Q. Now, that is significantly lower than the
8 8.8 percent that you recommended for Chaparral City Water;
9 is that correct?

10 A. The overall cost of capital is the same because
11 the -- the overall cost of capital is different. The cost
12 of equity happens to be the same.

13 Q. And my question is, it's significantly different?
14 I calculated 146 basis points lower; is that correct?

15 A. For total cost of capital that would follow, yes.

16 Q. I would like you to turn to the next page of your
17 testimony that you filed in the Chaparral City Water case.

18 A. Page 13?

19 Q. Yes, sir.

20 A. Sure.

21 Q. You make a statement at page 5, "I note that a
22 case could be made that the proper capital structure for
23 Chaparral should be that of its consolidated parent, which
24 contains about a 50 percent equity ratio."

25 What did you mean by that?

1 A. Well, as you are probably aware, in the Chaparral
2 City case, which is Docket No. WW-02113A-07-0051, in my
3 surrebuttal testimony I adopted part and did not adopt
4 part of a previously filed direct testimony by Staff. And
5 as I state on lines 2 through 5 of page 13, the Staff had
6 taken the position that you could use the equity ratio of
7 Chaparral.

8 So in my adoption process, I accepted that, but I
9 did indicate that a case could be made that the parent
10 could be used, especially since the parent and the
11 subsidiary was so much different.

12 Q. And if you were to have used the 50 equity ratio,
13 how would that have affected the overall cost of capital?

14 A. If I had accepted the 50 percent equity ratio and
15 used the same cost of equity, that would have brought the
16 cost of capital down. I haven't calculated the amount. I
17 would have to calculate it to give you a precise answer.

18 Q. It would have been a pretty significant change,
19 would it not?

20 A. At least 25 basis points, yes.

21 Q. And if I wanted to make that calculation -- I'm
22 not going to ask you to do this on the stand -- but I
23 would -- I could take your common equity number of
24 10 percent on the previous page, your imbedded cost of
25 debt number, 5 percent, and weigh each by 50 percent; is

1 that correct?

2 A. That's right. That is the mechanics of it.

3 Q. And would you accept subject to check that that
4 comes out to about 7.5 percent?

5 A. That would be because the cost of debt was 5 and
6 the cost of equity was 10, that would be 7.5; that's
7 correct.

8 Q. I told you I wouldn't make you do any math here,
9 but if you volunteer, I will let you do it.

10 A. It's very simple when you have 50/50 and one is 5
11 and one is 10.

12 Q. I'm trying to make it easy for you.

13 A. Thank you. Appreciate that.

14 Q. You go on in page 13, line 17 --

15 A. Still in the Chaparral case?

16 Q. Still in the Chaparral case, yes.

17 A. Page 13?

18 Q. Page 13, yes.

19 A. I'm with you.

20 Q. I would like you to read into the record line --
21 the sentence beginning on line 17 concluding on line 20.

22 A. Sure. "This significant difference in common
23 equity ratios" -- I'm referring to 75 versus 50 -- "This
24 significant difference in common equity ratios is
25 reflective of the risk differential between Chaparral and

1 proxy group, a risk differential that should be recognized
2 in the cost of equity for the company."

3 I also note that Chaparral's parent company,
4 American States Water, has a common equity ratio that's
5 similar to the proxy group, i.e., about 50 percent equity
6 and is much less equity than is the case for Chaparral.

7 Q. What did you mean -- first of all, let's just
8 qualify some of these phrases or try to quantify them, I
9 should say.

10 Significant difference in common equity ratios,
11 that is the difference between the 75 percent and
12 50 percent in your proxy?

13 A. Yes. And again, it has me thinking in the
14 context of the fact that its parent, which is American
15 States, had a common equity ratio very similar to the
16 proxy group, but the subject company did not.

17 Q. And --

18 A. I mean, it was 50 percent higher, 75 versus 50.

19 Q. And I can follow that math.

20 A. Great.

21 Q. And what is -- you said it's reflected in the
22 risk differential between Chaparral and the proxy group.

23 What do you mean by a risk differential?

24 A. Again, it's between Chaparral, American States,
25 and the proxy group.

1 Here we have American States Water, which is one
2 company in the proxy group that has an equity ratio
3 similar to the proxy group; yet, it's subsidiary, which is
4 the subject company, in its jurisdiction has an equity
5 ratio much higher. So that created a fairly substantial
6 or significant difference between the proxy group and the
7 subject company, again, in the context of the parent whose
8 equity ratio is similar to the proxy group.

9 Q. What is the risk differential? What do you mean
10 by risk differential?

11 A. Sure. I will try to keep this short.

12 When you have any company -- let's just focus on
13 a utility -- there are basically two kind of risks
14 involved. You have business risk and you have financial
15 risk. Business risks are things that impact the stability
16 and growth of revenues. Financial risk relates to
17 leverage.

18 Now, if you had a company like American States
19 Water, which is a company in the proxy group which
20 probably has similar business risks to the proxy group and
21 similar financial risk, then you can have a comparatively
22 equal risk situation.

23 In contrast, if you have a company like American
24 Water Works, which is by far the biggest water company or
25 publicly-traded water company in United States that

1 operates in, I think, 23 states and 19 subsidiaries, its
2 business risk is substantially less, in all likelihood, to
3 the proxy group. In contrast it has a lower equity ratio,
4 so it has a little more financial risk. But on balance
5 they probably equate out because American Water Works has
6 less business risk and more financial risk.

7 So that is the context of how you focus on the
8 financial risk in the context of total risk, which
9 includes business risk.

10 *Q.* Now, to financial risk again and the statement
11 here, you state that the risk differential should be
12 recognized in the cost of equity for the company.

13 Now, are you referring there to the Chaparral
14 City Water Company?

15 *A.* That's correct. Again, its parent company was a
16 member of the proxy group and it appears to have similar
17 total risk to the proxy group, unlike American Water Works
18 and Arizona-American Water Company.

19 *Q.* Okay. How would you recognize that risk
20 differential in the cost of equity?

21 *A.* In which case?

22 *Q.* In the case of Chaparral City here, if you had
23 done that?

24 *A.* Well, I did not, as we just established, because
25 I was adopting part and not adopting part of Staff's

1 testimony, so I focused on what I could adopt and then I
2 gave my own logic and recommendations for the part I did
3 not adopt.

4 Q But your statement is that a risk differential
5 should be recognized in the cost of equity, how would you
6 go about doing that?

7 A Well, again, the first step is to compare
8 Chaparral's equity ratio to the parent, American States,
9 and then compare that to the proxy group and take also
10 into consideration the business risks of those.

11 So that's the process by which it would be and
12 should be done.

13 Q I don't think you are -- maybe we are not
14 communicating here.

15 Your statement is that the risk differential
16 should be recognized in the cost of equity for the
17 company.

18 How would you recognize that risk differential in
19 the cost of equity? Would you lower the cost of equity to
20 account for lower risk?

21 A If I had chosen to make an adjustment, which I
22 did not, there are two ways to do it. One would be to
23 modify the cost of equity, and the second would be to
24 alter the equity ratio or use the parent's or a
25 hypothetical capital structure.

1 For example, in Southwest Gas and historic --
2 well, not history -- but in a past decision by this
3 Commission, when their equity ratio was down in the low
4 30 percent range, the Commission over a period of several
5 years in several cases used a hypothetical capital
6 structure as an incentive to the company to get its equity
7 ratio up, which apparently has happened.

8 CHMN. MAYES: Mr. Marks, could I?

9 MR. MARKS: Certainly.

10 CHMN. MAYES: And by the same token, Mr. Parcell,
11 the Commission has also used a hypothetical capital
12 structure to lower the equity ratio when we thought the
13 company's equity ratio was so high that it was burdensome
14 to its consumers. In other words, equity is more
15 expensive than debt, and when a company -- sometimes we
16 have seen companies come in here with 100 percent equity
17 structures, especially most recently, which we found to
18 be, you know, totally unacceptable for the consumers of
19 that company, who then have to pay higher rates to
20 accommodate that 100 percent equity ratio.

21 Would that be accurate?

22 THE WITNESS: Yes, that is my understanding. And
23 that's in the context of an efficient versus an
24 inefficient capital structure ratio. If it's inefficient,
25 it should not be used -- ratepayers should not pay rates

1 based upon inefficient capital structure.

2 CHMN. MAYES: Can you elaborate on that? What do
3 you mean by that? What level do you find inefficiency?

4 THE WITNESS: Well, the basis for it has an
5 economic basis and a semi-legal basis. The legal basis
6 would be the Bluefield/Hope cases where reference was made
7 to economic management.

8 What that means is that when you set rates for a
9 utility, you assume that the utility is operating
10 efficiently. If it's not, that burden should rest with
11 the company shareholders and not its ratepayers.
12 Ratepayers have a right to expect an efficiently-operated
13 utility. And if it's not efficient, they should not pay
14 for any costs to exceed.

15 And that really follows -- I give you the legal
16 aspect of it, even though I'm not a lawyer. But the
17 financial/economic aspect is the same. An unregulated
18 firm, the markets drive the attitude to operate in an
19 efficient fashion. And if you are not, it will cut at
20 your price and you run out of business.

21 So you expect a competitive firm to be efficient
22 and the ratepayers -- and regulation is a substitute or
23 surrogate to competition.

24 CHMN. MAYES: And in that sense, when a company
25 chooses -- I mean, a company in the marketplace might find

1 it difficult to set prices based on a 100 percent equity
2 structure, and that is when the Commission -- a public
3 utilities commission or a regulatory body comes in and
4 says, no, that is not an efficient capital structure.

5 THE WITNESS: That's correct, because it's -- for
6 a company whose rates substantially are based upon capital
7 costs -- plant in the ground -- whether it's a water
8 company or a gas utility or an electric utility -- a lot
9 of the infrastructure, if you will, to generate these
10 utility services comes from plant equipment, i.e., the
11 rate base. And rate base is created for the long term.

12 So it would make sense that you should finance on
13 a long-term basis, 30-year debt, for example.

14 And at some point in time you have an efficient
15 capital structure, I would just say that from a broad
16 range, an equity ratio stops becoming efficient if it's
17 less than 40 percent. I'm not saying it's the cutoff
18 point, but it stops becoming efficient.

19 And probably on an upper end it stops becoming
20 efficient when it's maybe 55 percent equity. Maybe 60 --
21 55 to 60 percent, but somewhere in that range is what I
22 regard as an efficient capital structure. That is also
23 the capital structures we have tended to see over time
24 with healthy utilities. Oftentimes companies have
25 substantial write-offs and Tucson Electric is the case for

1 an example. Their equity ratio was in the 20s at one
2 time. Again, they didn't start there. Their write-offs
3 put them there.

4 But healthy companies tend to have equity ratios
5 in the 40 to 55 percent range.

6 CHMN. MAYES: Thank you.

7 ALJ WOLFE: Thank you.

8 Mr. Marks.

9 Please let the record reflect that
10 Commissioner Pierce is on the bench as well.

11 MR. MARKS: Thank you, Chairman Mayes. You
12 actually asked a question I was going to next.

13 I believe you were referring to the Gold Canyon
14 Sewer case.

15 Q. BY MR. MARKS: Are you familiar with that case,
16 Mr. Parcell?

17 A. Not specifically, no.

18 MR. MARKS: If I could, could I have Your Honor
19 take -- I don't know if we need to or not -- I would like
20 to be able to cite that case in our brief. I don't have
21 the decision number for it.

22 ALJ WOLFE: You certainly can. If you are making
23 legal argument in regard to any Commission decision, you
24 can cite it in your brief.

25 MR. MARKS: Thank you. Then I won't ask you to

1 take administrative notice of it.

2 Q BY MR. MARKS: Mr. Parcell, you have provided a
3 significant amount of testimony, it sounds like, here in
4 Arizona on cost of capital; is that correct?

5 A I have been in several cases over the last three
6 or four years, yes.

7 Q Are you aware of any utility in Arizona with a
8 lower overall cost of capital than you are recommending
9 for Arizona-American Water?

10 A The cases I have been in in recent years -- and
11 I'm trying to be responsive to you here -- I was in a UNS
12 Gas case. The return of equity was 10.0. The overall
13 cost of capital was 8.3.

14 I was in a UNS Electric case. Cost of equity was
15 10.0 and overall rate of return authorized was 9.02.

16 Q Did you mean APS, Arizona Public Service?

17 A What did I say? I said UNS Electric. That is
18 what I am reading from here, UNS Electric.

19 Q You mean UNS?

20 A Yes, UNS. I'm sorry.

21 Q I'm sorry. What were those numbers again?

22 A UNS Electric was 10.0 equity cost of return on
23 equity total -- I'm sorry -- total rate of return was
24 9.02 percent.

25 Southwest Gas -- I know Southwest Gas return on

1 equity was 10.0, but I don't have rate of return here.

2 So as you can see from what I gave you, the cost
3 of equity has been in a range of 10.0. The reason that
4 the cost of capital is less than I am recommending for
5 Arizona-American is that the company has a lower cost of
6 debt because its parent company has been able to sell some
7 debt -- tax-free debt, and its the lower cost of debt
8 which brings down the cost of capital.

9 Q. And also the cost of capital structure itself
10 having a higher percentage of debt brings down the
11 weighted cost of capital; is that correct?

12 A. To some extent, but bear in mind the capital
13 structure of Southwest Gas was about 43 percent, I
14 believe. And I'm recommending over 42 for this company.
15 The capital structure for UNS Electric was about
16 44 percent. So the equity ratios are just a couple
17 percentage points different. These companies have a
18 higher cost of debt because they did not have significant
19 or substantial access to the cost-free debt that
20 Arizona-American has.

21 Q. Do you know if Arizona-American has any cost-free
22 debt?

23 A. Having read its application where it shows its
24 cost of debt, these schedules, I see some interest rates
25 of less than 4 percent here and some low 5s. That

1 would -- it was -- it appears, yes. It would appear they
2 do.

3 Q. Zero cost of debt or --

4 A. No. I didn't say zero. I said zero tax-free
5 debt.

6 Q. Tax-free.

7 A. Tax-free. I didn't mean to say zero cost.

8 Q. I may have misheard you.

9 A. Tax-free debt, which is arranged through local
10 governments or state governments.

11 Q. And the percentage of that debt is in the capital
12 structure?

13 A. I don't have that percentage. I have a list of
14 their debt issues at the end of the test period. It does
15 not break them down in the way you are asking so I cannot
16 answer that specifically.

17 Q. I would like you to turn to page 12 in your
18 direct testimony, if you would.

19 A. Sure, 12.

20 We are back to my direct testimony, are we not?

21 Q. Yes, sir.

22 A. Okay.

23 Q. And you discuss there something called --

24 A. I'm sorry. Page 12?

25 Q. Page 12, top of the page.

1 A. I'm trying to keep organized.

2 Q. That's all right.

3 A. I'm sorry for the delay. I'm there.

4 Q. You talk about something you call "flight to
5 quality," which I think is a phrase I have heard
6 elsewhere.

7 Can you explain what you mean by that?

8 A. Certainly. I have been doing this cost of
9 capital testimony long enough that I have seen three
10 instances of flight to quality. The first occurred in the
11 middle of the 1970s when we had the combination of the
12 Arab oil embargo and Con Ed eliminated its dividend, which
13 bumped interest rates very high and people stayed away
14 from lower-rate securities.

15 The second one occurred in the late 1970s, early
16 '80s when we had double-digit inflation and people --
17 investors did not want to go along on debt because they
18 were concerned with the inflation; they didn't want to tie
19 up their money for a long period of time.

20 And the third, and by far the worst, which has
21 occurred in the past six months, it looked like a fall in
22 the industry. Whether you are a portfolio manager or
23 someone who is trying to manage your own 401(k)K, or at
24 least what used to be a 401(k), or an IRA and you see the
25 stock market dropping, we are hearing 40 percent levels

1 for the last year, people/investors are hesitant to keep
2 money in stocks because they are risky right now. They
3 are hesitant to keep money in corporate bonds because
4 there is concern about corporate profits and liability as
5 stockholders of Wachovia and Bear Stearns found out. So
6 what they can do right now is put the their money in safe
7 havens, like United States Treasury securities. That is
8 called a flight to quality. So money has gone into -- or
9 investing dollars has gone into these very safe treasury
10 securities.

11 Now, as a side, on a longer-term basis that is
12 very risky because if you were 30 years old right now you
13 probably would be pulling 401(k) money into 30-year
14 treasury bonds. And when we turn to more normal times,
15 you would expect treasury yields to go up and the value of
16 your investment to go down. So even that is a short-term
17 flight to quality.

18 But it's a little interpretation. It's the
19 flight of money into the most low-risk quality securities.
20 And while that is going on, the money is not going into
21 the stock market, at least it hasn't recently. And as the
22 money goes back to the stock market a little bit, a little
23 bit more goes into corporate bonds, then the yields of
24 treasuries crept back down.

25 The yields on BBB utility bonds were up above

1 9 percent back in October and November.

2 Q I was going to ask you, you have a schedule, I
3 think it's attached to your direct testimony, as
4 historical bond yields.

5 A Right, but that is actually a month old now
6 because that Schedule 2 just goes through, I believe,
7 January.

8 Q Just for the record before you basically update
9 it, where would I find -- I saw it this morning. I can't
10 find it now -- your historical yields on bonds?

11 A Yes, it's Schedule 2, page 4 of 6.

12 And I should also say Schedule 2, page 4 of 6 of
13 S-11, which is my surrebuttal testimony. That is where
14 the most current versions that I had at that time.

15 But let me indicate to you now that the BBB
16 utility bonds in November of 2008, for the month, was
17 almost 9 percent -- 8.9 percent. Four months earlier they
18 had been 6.9. That is 200 basis points in two months.
19 That is flight to quality.

20 And in February, which is not on my schedule
21 because it was not available at that time, the BBB
22 yields -- I thought I had it. January it was 7.9. So
23 it's dropped 100 basis points in two months since
24 November. So the -- rates are still high. They are still
25 a flight to quality, but not to quite the extent as was

1 the case in November and October.

2 Q So the record is clear, you are referring to BBB
3 utility bonds. Your column at the top says Baa. And
4 this, just the difference between Baa, is a Moody's rating
5 and the BBB is a Standard & Poor's rating; is that
6 equivalent?

7 A That's correct. Baa is the Moody's equivalent of
8 BBB. Standard & Poor's just call it BBB, all in caps. So
9 they are all in the context of BBB, yes.

10 Q And I asked Mr. Rigsby about this earlier today.
11 He wasn't sure.

12 Do you know what the current bond rating is for
13 American Water?

14 A Yes. If you look in the prospectus that went
15 with the November 2008 note issue of American Water
16 Capital, the Moody's rating is Baa2, which is middle B;
17 Standard & Poor's is BBB plus.

18 So it's mid to high BBB.

19 Q Okay. Thank you.

20 And you would agree that equity investors require
21 a premium over debt investors, wouldn't you?

22 A Almost all the time they do, yes.

23 Q Who owns Arizona-American Water's equity?

24 A American Water Works.

25 Q And who issues Arizona-American Water's debt?

1 A. It depends. And again, this goes back to the
2 prospectus associated with the November 2008 note issue.

3 If it's what is referred to as a corporate debt,
4 it's issued by American Water Capital, which is the
5 financing arm. On the other hand, the prospectus also
6 points out that when possible the local water utilities
7 take advantage of the tax exempt debt in issue to local
8 agencies. So it's a combination of those two. Again,
9 that is why the actual debt cost of Arizona-American is
10 only 5 percent.

11 MR. MARKS: Just one moment, please.

12 ALJ WOLFE: Certainly.

13 MR. MARKS: That is all I have for you,
14 Mr. Parcell.

15 And at this time I would move for the admission
16 of Exhibit A-17.

17 ALJ WOLFE: Is there any objection to A-17?

18 MS. MITCHELL: No, Your Honor.

19 MR. POZEFSKY: No.

20 ALJ WOLFE: A-17 is admitted.

21 (Exhibit A-17 was admitted.)

22 ALJ WOLFE: Do you have redirect for this
23 witness?

24 MS. MITCHELL: No, Your Honor, I don't. Thank
25 you.

1 ALJ WOLFE: Thank you for your testimony. You
2 are excused as a witness, and I hope you enjoy Arizona
3 weather today, too.

4 THE WITNESS: Absolutely.

5 ALJ WOLFE: This is a good time for us to break
6 for lunch. We will come back here at 1:15.

7 (Whereupon, a recess was taken from 11:54 a.m.
8 until 1:18 p.m.)

9 ALJ WOLFE: Let's go back on the record.

10 Mr. Marks, would you like to call your next
11 witness?

12 MR. MARKS: I would, Your Honor. I just have a
13 procedural question before we start, if that is all right.

14 ALJ WOLFE: Yes.

15 MR. MARKS: I wanted to be clear that we were to
16 be doing things in the hearing, I think, in the way we
17 have done it in previous hearing that I have had the
18 privilege of being before you, and that has to do with the
19 company's schedules.

20 I don't normally mark those and put those into
21 evidence separately, particularly when we are a moving
22 target and we have the direct schedules, the rebuttal
23 schedules and rejoinder schedules and then we do
24 post-hearing schedules, which are the ones that really
25 count.

1 And I know they have always been scheduled to be
2 filed in the docket, but I don't normally move them
3 separately as an exhibit.

4 Is that what you would prefer? Or if not, I can
5 get sets and we can put them all in as exhibits.

6 ALJ WOLFE: Sometimes they are attached to the
7 testimony.

8 You are talking about when they are not, when
9 they have been docketed separately?

10 MR. MARKS: Well, I mean, for example, when we
11 did our application, we had four binders about -- roughly
12 five inches thick, each one of them. We have filed -- we
13 did the original and 15 copies of all of those, but we
14 have not been -- I don't intend to mark separately the
15 three binders of exhibits.

16 ALJ WOLFE: That is appreciated. I think the
17 final schedules are the ones that are the most important.
18 But if there is something that one of the parties needs to
19 use in order to cross-examine a witness, then --

20 MR. MARKS: Then we would go through them at that
21 point, of course, yes.

22 ALJ WOLFE: -- that would be fine. That would be
23 acceptable. Thank you for bringing that up.

24 MR. MARKS: Thank you.

25 At this time then, Your Honor, Arizona-American

1 Water Company would call Mr. Paul G. Townsley.

2

3 PAUL G. TOWNSLEY,

4 called as a witness herein, on behalf of the Applicant,

5 having been first duly sworn, was examined and testified

6 as follows:

7

8 DIRECT EXAMINATION

9

10 BY MR. MARKS:

11 Q. Good afternoon, Mr. Townsley.

12 A. Good afternoon.

13 Q. State your name and business address for the
14 record.

15 A. My name is Paul Townsley. My business address is
16 19820 North 7th Street, Suite 201, Phoenix, Arizona.

17 Q. And you are the president of Arizona-American
18 Water Company?

19 A. Yes, I am.

20 Q. Mr. Townsley, do you have before you two
21 documents, one of them which has been marked as Exhibit
22 A-18 and the other as Exhibit A-19?

23 A. I have those.

24 Q. I will go through exhibit A-18 first, if you
25 could take a quick peek at that.

1 A. I have.

2 Q. Was Exhibit A-18 prepared by you or under your
3 direction and supervision?

4 A. Yes, it was.

5 Q. And do you have at this time any additions,
6 corrections or other modifications to make to what has
7 been marked as Exhibit A-18?

8 A. Yes, I have one.

9 Q. Okay. Go ahead, please.

10 A. On page 18, line 18, the number 349,612 should be
11 revised to reflect 427,519.

12 Q. And have you made that change to the exhibit
13 copy?

14 A. Yes, I have.

15 Q. Thank you.

16 With that change, if I were to ask you today
17 under oath the same questions that are contained in
18 Exhibit A-18, would your answers be the same?

19 A. Yes, they would.

20 Q. Turning now to Exhibit A-19, could you take a
21 quick look at that, please.

22 A. I have.

23 Q. And that is a document titled Rebuttal Testimony
24 of Paul J Townsley on behalf of Arizona-American Water
25 Company dated February 11, 2009?

1 A. That's correct.

2 Q. And was this document prepared by you or under
3 your direction and supervision?

4 A. Yes, it was.

5 Q. Do you have any additions, corrections or other
6 modifications to make to Exhibit A-19 at this time?

7 A. I do have one.

8 Q. Go ahead.

9 A. On page 4, line 1, the number 189 should be
10 replaced with the number 89.

11 Q. Anything else?

12 A. No, that is all.

13 Q. And have you made that change also to the exhibit
14 copy?

15 A. Yes, I have.

16 Q. Thank you. With that change if I were to ask you
17 the same questions today under oath that are contained in
18 exhibit A-19, would your answers be the same?

19 A. Yes, they would.

20 MR. MARKS: Your Honor, at this time I would move
21 for the admission of Exhibits A-18 and A-19 and tender
22 Mr. Townsley for cross-examination.

23 ALJ WOLFE: A-18 and A-19 are admitted.

24 (Exhibits A-18 and A-19 were admitted.)

25 ALJ WOLFE: Ms. McHale-Hubbs?

1 MS. McHALE-HUBBS: I do, Your Honor.

2

3

CROSS-EXAMINATION

4

5 BY MS. McHALE-HUBBS:

6 Q. Good afternoon, Mr. Townsley.

7 A. Good morning.

8 Q. Excuse me. I'm a little hoarse today.

9 The residents of Sun City West Water District are
10 concerned or perplexed about Olympic groundwater stating
11 they want to continue to charge the users for many years.
12 About ten years ago we signed a contract for CAP water.
13 The CAP water has never, due to any number of
14 circumstances, made its way to Sun City West or that area
15 and has never been used by the residents in that area, and
16 yet we still continue to pay this monthly charge.

17 Now, we understand that you do sell the CAP water
18 to Maricopa Water District.

19 So why are we still paying for charges on water
20 that we never received and not using and there are no
21 plans in the future for the water district to use CAP
22 water?

23 MR. MARKS: Is this --

24 Mr. Townsley, if you are not the correct person
25 to answer that --

1 Q. BY MS. MCHALE-HUBBS: I'm sorry I did not ask
2 that. I may need to ask someone else.

3 A. Yes. I can provide, perhaps, part of your answer
4 and Mr. Lenderking, Jake Lenderking, who is our water
5 resources witness, later, either today or tomorrow, would
6 probably be able to provide a more complete answer.

7 Q. Okay.

8 A. What I can tell you is that we have all worked
9 very hard to try to deliver CAP water to both our Sun City
10 and our Sun City West communities, and, in fact, have
11 worked on that project together for, I believe, over a
12 decade.

13 Q. Yes, we have.

14 A. And it has been discouraging for all of us that
15 the costs of that project have continued to increase
16 foiling our collective attempt to bring water to the
17 communities.

18 Nevertheless, we do have an obligation to pay the
19 Central Arizona Project fee, a payment, an annual payment,
20 for the lease of that CAP water. And the Arizona
21 Corporation Commission has allowed that payment to be
22 included in rates, and it is currently included in rates.

23 We have been able to provide some of that CAP
24 water to MWD in lieu of their groundwater pumping, which
25 benefits all of the communities because that is more

1 groundwater then to remain in the system.

2 And for that exchange they are provided some
3 funds back, which have helped to offset the costs, the
4 sharing costs for our customers of the groundwater saving
5 fee.

6 So it has been a good solution for us, not as
7 good as, obviously, delivering the water directly to the
8 system, but it has provided some benefit to our customers
9 in an effort to try to reuse the cost of that CAP water.

10 That is about the extent that I can provide the
11 answer. To give a more detailed answer on that, I think
12 Mr. Lenderking can probably help you with that.

13 Q. Thank you, Mr. Townsley.

14 Mr. Townsley, in your rebuttal testimony of
15 February 11, 2009 you stated that in addition to Sabrosa
16 Water near Arizona-American's Anthem Water District, many
17 other troubled water systems exist in the state that would
18 be prime candidates for acquisitions if the cost of
19 upgrading them and properly equipping them to be shared by
20 larger districts through rate consolidation.

21 Isn't this the same as saying these are not good
22 investment opportunities for Arizona-American Water but if
23 somebody else will pay for the necessary improvements we
24 are ready to acquire them?

25 MR. MARKS: Could counsel provide a reference to

1 the testimony of where that is, please?

2 Q BY MS. McHALE-HUBBS: That is his rebuttal
3 testimony.

4 A If you will give me a moment, I will find where
5 you're referencing.

6 Q Sure.

7 MR. MARKS: Page and line, please.

8 MS. McHALE-HUBBS: Sure.

9 THE WITNESS: I do find a reference in my
10 rebuttal testimony on page 14 beginning on line 23, and
11 because I was trying to find it as you were asking me the
12 question, I wonder if you wouldn't mind asking me the
13 question again.

14 Q BY MS. McHALE-HUBBS: Okay. In this rebuttal
15 testimony you stated that in addition to Sabrosa Water
16 near the Anthem Water District many other troubled water
17 systems exist there and in the state that would be prime
18 candidates for a position if the cost of upgrading them
19 and properly equipping them could be shared by larger
20 districts by rate consolidation.

21 I'm asking, isn't this the same as saying that
22 these are not good investment opportunities for
23 Arizona-American, but if somebody else pays the cost, then
24 would you acquire them?

25 A Well, I think you are taking a very narrow view

1 of that particular issue.

2 Q. Okay.

3 A. I will say that there are a number of troubled
4 water systems in this state, and many of them require a
5 lot of upgrade to their systems because their systems are
6 antiquated and in some ways don't meet State and Federal
7 requirements.

8 It was purely a business decision. I would not
9 be inclined to make those investments; however, if there
10 are other guided policies, State policies that would
11 encourage that, then that may change the particular
12 situation.

13 Q. So that, in fact, if we did future studies
14 throughout the area, then would you take a look at it?

15 A. I'm sorry. Ask me that again.

16 Q. I said if over the years we all cooperated and
17 did studies on these various troubled areas, the company
18 would then take another look at it? Is that what you are
19 saying?

20 A. We would definitely take a look at it, and I
21 think we need to, as a state, need to confront this issue.
22 I can't confront it on my own.

23 Q. That's fine. Thank you.

24 Do you believe that the users of the present
25 water and sewer districts of Arizona-American Water have

1 an obligation to rescue the troubled water systems in the
2 county by paying for their required improvements? And I
3 guess that is just another way of saying, do you believe
4 that all of the residents should be involved, all the
5 ratepayers?

6 A. Are you talking in the context of small troubled
7 water systems like your previous question?

8 Q. Yes, and most are in critical water areas, which
9 are in the Phoenix area.

10 A. I would answer your question this way. I cannot
11 make those decisions on my own. There needs to be a
12 broader coalition and a State involvement in that to make
13 those kind of decisions, that I would expect that we would
14 all be part of that discussion.

15 Q. Thank you. You stated that better.

16 To what extent has Arizona-American studied rate
17 consolidation for water and sewer districts in Arizona or
18 are we just on the threshold?

19 A. Arizona-American Water has not done a tremendous
20 amount of analysis on rate consolidation here in Arizona.
21 As you are aware we have 13 districts, and just the
22 different combinations of those 13 districts, in terms of
23 rate consolidation, is a large undertaking. And frankly,
24 we have been busy with this rate case.

25 But I will say that other states have made much

1 further progress than Arizona has in terms of rate
2 consolidation. And we have, as part of this particular
3 case, Mr. Broderick has developed a tool that would allow
4 all of the parties to evaluate different scenarios under
5 rate consolidation.

6 So that is the extent of the work that we have
7 done.

8 Q Okay. Thank you.

9 Do you agree that large differentials exist
10 between the needs and investment requirements of districts
11 that will continue development until a favorable economy
12 exists, and those, such as Sun City and Sun City West,
13 which are built out and static?

14 A I really apologize, but you will have to ask me
15 that question, one more time, please.

16 Q I'm sorry. Do you agree that large differentials
17 exist between the needs and investment requirements of
18 districts that will continue to develop when we have a
19 favorable economy, and those, such as Sun City and
20 Sun City West, which are built out and static, just the
21 differential between the static communities versus the
22 ones that are beginning to grow?

23 A I will agree that there are differentials in
24 needs and requirements among different districts, not just
25 between those that are growing and those that are static

1 or those that are large and those that are small. There
2 are differentials that exist inheritably, but even static
3 systems, systems that are built out, like in
4 Sun City West, also require investment and have
5 significant needs over time to replace infrastructure.

6 So I would be careful to not draw a conclusion
7 that is the only differentials between a growing system
8 and a non-growing system. There are more elements at play
9 than that.

10 Q. I understand that. Thank you very much.

11 Do you agree that Sun City and Sun City West
12 Water and Sewer Districts are unique in the fact that they
13 will no longer expand -- we are just talking expansion
14 here -- and will not require continuously developing new
15 facilities and these water and sewer districts have a
16 large percentage of users on fixed incomes and should have
17 an option to not be included in a consolidated rate design
18 in Arizona? In other words, could they have the option of
19 opting out?

20 A. You love those compound questions.

21 Q. I know.

22 A. Let me see if I can keep this all straight.

23 Q. It's my committee behind me.

24 A. I will recognize that Sun City and Sun City West
25 do have a large portion of customers on fixed incomes. I

1 can answer that part.

2 I will agree that Sun City and Sun City West do
3 not require the kind of investment for new growth-related
4 infrastructure, even though recently we were just talking
5 about the Groundwater Savings Project, which, in fact, is
6 new infrastructure.

7 But I would also say that all systems, regardless
8 of whether they are growing or non-growing, new or old,
9 will eventually require replacement of existing
10 infrastructure, and that should not be overlooked.

11 And then to your last part of your question about
12 the involvement of Sun City and Sun City West, I really
13 would like to see a broader effort to understand and to
14 develop criteria for where and when and how should we
15 consolidate. So it's not just myself making those
16 decision but it's a broader effort from all the parties.
17 And I think this case has helped to start us down that
18 path, to start the journey about consolidation and the
19 discussions about consolidation and the choices that we
20 need to make and the consequences of those choices.

21 So I think this has been a very good beginning of
22 this journey that we are on together.

23 Q. It sounds very interesting. Thank you.

24 And I have no further questions.

25 ALJ WOLFE: Mr. Metli?

1 MR. METLI: No questions.

2 ALJ WOLFE: Mr. Pozefsky?

3 MR. POZEFSKY: Thank you.

4

5

CROSS-EXAMINATION

6

7 BY MR. POZEFSKY:

8 Q. Good morning, Mr. Townsley.

9 A. Good morning.

10 Q. You are the president of Arizona-American;
11 correct?

12 A. Yes.

13 Q. I want to ask you some general question about
14 budget, Mr. Townsley.

15 Last Thursday APS announced \$26 million in budget
16 cuts. These cuts included: advertising, lobbying,
17 maintenance and pay raises.

18 Has this company made any similar cuts in its
19 budget over the last two years?

20 A. Yes, we have, and as a matter of fact, if you
21 look at my rebuttal testimony beginning on page 2,
22 beginning on line 8, I actually catalog a number of those.

23 If you want, I can walk you through them or refer
24 you to my testimony.

25 Q. No. I'm familiar with your testimony, but while

1 we are here, why don't you.

2 A Well, first of all, one of the things that
3 Arizona-American has done that APS has not done is we have
4 suspended dividend payments, and we continue our dividend
5 payment suspension today. And that is a huge cost
6 savings, if you will, because those are fees that we do
7 not pay to our parent.

8 In addition to that we have reduced our capital
9 budget by almost 50 percent prospectively beginning in
10 2008. I have removed about 92 and a half million dollars'
11 worth of capital investment projects and another 2- to \$3
12 million in what I call recurring projects. So that is a
13 huge step that we have taken.

14 We have also identified number of cost savings
15 areas that we have undertaken. We are -- we have
16 eliminated 25 positions that we were proposing to put in
17 our plan. That is about a \$1.1 million savings. That is
18 just based on savings. That doesn't include overtime or
19 other kinds of pay.

20 We have reduced a number of expenses:
21 maintenance expenses, which is one that you mentioned
22 earlier; general office expenses; travel expenses;
23 training expenses. We have done a lot of things to really
24 try to, you know, tighten that belt as much as we can.

25 And frankly, we continue to look for a number of

1 opportunities like that.

2 Q Are there any more budget cuts that you
3 anticipate making over the course of the next year?

4 A I don't have anything particularly in the plan.
5 You know, I'm always looking for opportunities, but I
6 don't have, you know, a list in my back pocket of things
7 that I'm looking to do.

8 You know, know what I really try to do when I
9 look at our cost savings is try to identify those areas of
10 cost savings that don't adversely affect our customers or
11 employees. And, you know, those are the ones that are the
12 last that I want to do you, but I try to find other things
13 that we can do, and those are the ones I'm always looking
14 for.

15 And not only am I looking at those, but I have to
16 give credit to my staff. My staff has come up with all
17 kinds of ideas and opportunities for us to save costs, and
18 we have implemented a number of those. So it's a team
19 effort.

20 Q You also provided some testimony on the company's
21 achievement incentive pay.

22 That achievement incentive pay, that is offered
23 companywide; is that correct.

24 A The annual incentive program, I talk about that
25 beginning on page 16 of my direct testimony.

1 Q. Right.

2 A. That is offered to all employees who do not earn
3 overtime, so all non-overtime-eligible employees. So it
4 includes people like myself, my executive staff,
5 professional staff, engineers, information technology,
6 technicians, human resource professionals, supervisors,
7 managers. About 40 percent of our workforce are covered
8 under that annual incentive program.

9 Q. Can you briefly describe how that works?

10 A. I would be happy to, and it's also shown in my
11 direct testimony beginning on page 16 line 11. But let me
12 just walk you through it.

13 Our annual incentive program is a component of
14 our total compensation, and we really attempt to have a
15 program like this because we believe that it incents our
16 employees to perform more, perform better. And it also
17 incents our employees to align their efforts with the
18 efforts of the company, to make us a better provider of
19 water and wastewater service to our customers.

20 The program is really designed around three
21 components. The three components of our annual incentive
22 plan are financial success, the company's financial
23 success. The second component is operational success.
24 And the third component is, I'll call it, individual
25 success. Let me just walk you through those.

1 We have -- every year we have a business plan
2 target for operating income. So our performance against
3 that operating income target, obviously, is one of the
4 components and one of the measurements that is used. We
5 also have targets for environmental compliance, for health
6 and safety statistics, and for customer service. And we
7 have measurable metrics for each of those. And those are
8 established in our business plan, and it is against those
9 that we work towards.

10 And then finally on the individual piece, all of
11 us have our own individual performance targets. And how
12 well we achieve those individual performance targets make
13 up the third part. And the individual pieces, as you
14 would expect, it's individual, so someone else may have
15 different targets than I may have.

16 And if you take those together, those three
17 components and bundle them up into a group, that is our
18 annual incentive plan. And if you achieve success against
19 the targets, then you are eligible for an annual incentive
20 plan payment. And if you don't achieve it, then you are
21 not eligible for annual incentive plan payment. And if
22 you achieve some of the target but not the others, you get
23 a diminished payout.

24 So that is how it works. It's probably not that
25 dissimilar from other types of programs.

1 Q. Okay. And the benefits of the annual incentive
2 plan ultimately derive or can be seen by the ratepayers;
3 is that correct?

4 A. Absolutely. Let me give you some examples, if
5 you would like.

6 Q. Well, no, that's okay. Maybe counsel can ask you
7 for further.

8 But let me ask you this: Would you also agree
9 that the benefits are also shared by the shareholders?

10 A. I think that all parties gain from effective
11 accomplishment of targets. I think our ratepayers, our
12 customers benefit. I think our employees benefit. And I
13 think our shareholders benefit.

14 And so a well-designed, well-implemented annual
15 incentive plan will benefit all of those and even beyond
16 that, our communities.

17 Q. And is the company requesting to recover the cost
18 associated with the annual incentive plan entirely from
19 the ratepayers?

20 A. We are asking that this component of compensation
21 be included in rates because it is a component of
22 compensation.

23 Q. Okay. Is there an additional or separate plan or
24 bonus plan for management or senior management?

25 A. We have one annual incentive program that covers

1 all of us in the program. There is a long-term incentive
2 program that does cover certain senior executives, and
3 there are only a few people in Arizona, if even that many,
4 I think, that are even eligible for that program.

5 Q. Who in your company is eligible for that plan?

6 A. The way that that plan is rolled out is it has to
7 do with the grade levels, salary grade levels. So I'm
8 eligible for that plan. I may have one or two people in
9 the organization that are at that grade level.

10 Q. Okay. And are there costs associated with that
11 plan that are being sought in this rate case?

12 A. Yes, there are.

13 Q. And do you recall how much?

14 A. Do you have the number there with you?

15 Q. I don't.

16 A. I believe that we initially requested inclusion
17 of some of those costs in the rate case. And I believe
18 that subsequent to our initial submission adjustments were
19 made, in perhaps our rebuttal testimony, that took out
20 most or if not all of those funds.

21 Q. Okay. And again, would you agree with me that
22 the benefits achieved by that program would be shared by
23 both the ratepayers and the shareholders?

24 A. I believe that that program, like the annual
25 incentive program, would benefit all parties, so perhaps

1 we should bring those costs back into the case.

2 Q. What about pay raises for management and senior
3 management? How does that work, Mr. Townsley?

4 A. The salary adjustments are the same for all
5 employees. We have an annual salary adjustment program, a
6 merit program based on employee's performance. We have a
7 budget, and we go through an annual merit review process
8 and adjust people's salaries as appropriate.

9 Q. And do you know collectively how much in pay
10 raises were paid out in 2008?

11 A. You mean after the test year?

12 Q. Yes.

13 A. I don't. I can tell you that I got nothing, if
14 that helps.

15 CHMN. MAYES: Could we get an answer from
16 Mr. Broderick when he is on the stand, Mr. Townsley, on
17 that issue?

18 THE WITNESS: Yes.

19 CHMN. MAYES: Okay.

20 MR. MARKS: Mr. Broderick has already testified.
21 What was the question? I don't mind putting him
22 back on.

23 Ms. Hubbard would have the answer.

24 CHMN. MAYES: Okay. Great.

25 Q. BY MR. POZEFSKY: Has there been any change in

1 the process or the way that the company awards pay raises
2 for the coming year, Mr. Townsley?

3 A. Not to my knowledge.

4 Q. And it is the same as it was a during the test
5 year?

6 A. It is the same. It is always based on employee's
7 performance, and then there is a merit program, which
8 means an employee could receive a merit increase or could
9 receive no merit increase.

10 Q. Okay. Are there any areas, Mr. Townsley, that
11 the company could target or could consider additional
12 adjustments and still have the company remain healthy?

13 A. There is no silver bullet. There are a number of
14 areas that we are looking at, and I speak about the
15 request for an O & M deferral in the White Tanks as an
16 example of that. But I can't find in my managing this
17 company a single thing that we could do that would resolve
18 our financial situation.

19 One of the reasons we are here today is obviously
20 to put more of our plant in rates, which helps us in that
21 direction, but there are a number of things that we need
22 to continue to work on.

23 CHMN. MAYES: Mr. Pozefsky, could I interject?

24 MR. POZEFSKY: Please.

25 CHMN. MAYES: Thank you.

1 Well, while there is no one -- there may be no
2 silver bullet, Mr. Townsley -- and I certainly appreciate
3 the fact that your company, unlike APS, on its own
4 volition made cuts. The APS cuts that Mr. Pozefsky
5 referred to were ordered by this Commission, and
6 specifically by an amendment I gave to them last rate
7 case, otherwise I'm pretty sure they wouldn't have made
8 \$26 million in cuts, including finally at long last the
9 cuts to their advertising and lobbying budgets. Not to
10 get too far into the details of that case, but they were
11 spending \$2.5 million a year on advertising -- on
12 lobbying.

13 Anyway, I think the question is, given the fact
14 that the company, your company is asking for a very large
15 rate increase, very large under the Staff proposal, very
16 large under almost all of the proposals in this case, is
17 there anything more that you could do to show some
18 sacrifice on the part of the shareholders at a time when
19 you are asking your ratepayers to show sacrifice?

20 THE WITNESS: If I may respond to that, we, as
21 you stated just a few moments ago, have been very
22 proactive and have been working at this issue for a number
23 of years partly because we understand the impact on
24 customers and are very sensitive to that, partly because
25 we find ourselves in a situation that we are making no

1 money and paying no dividends to our parent. So there is
2 a lot of incentive among my staff and myself to find other
3 things to do.

4 As I said earlier, I'm trying to find ways to
5 reduce costs that don't adversely affect customers or
6 employees. So those are, while they are always out there,
7 are ones that I try to avoid.

8 We have, as an example, every vacancy that occurs
9 in our company, whether it's a meter reader, a supervisor,
10 an engineer, every one of those has to come across my desk
11 for approval, and every one of those I push very hard on.

12 CHMN. MAYES: So you have a de facto hiring
13 freeze at the company or a soft hiring freeze?

14 THE WITNESS: I would describe it as a soft
15 hiring freeze.

16 If I have, for instance, a meter reader that
17 leaves the company and if I don't have technology to
18 backfill that, I really do need to fill that position or a
19 pump operator.

20 But as I described earlier there are 25 -- more
21 than 25 positions that I have on hold in this company
22 right now, and for a company the size of us -- about 200
23 employees -- you know, that is a sizeable holdback.

24 CHMN. MAYES: Does Arizona-American have a
25 lobbying budget in Arizona?

1 THE WITNESS: I think I have a retainer for, I
2 think it's \$2,000 a month.

3 CHMN. MAYES: With a lobbying firm?

4 THE WITNESS: Right -- well, it's really more for
5 monitoring the bills through the legislature.

6 But I do have a very small amount. I don't even
7 believe that is included in the case. I think those are
8 expenses that are not included.

9 CHMN. MAYES: You did not ask for recovery of any
10 of that?

11 THE WITNESS: I can't answer that question
12 directly.

13 CHMN. MAYES: Okay.

14 THE WITNESS: But this is test year 2007. 2007 I
15 don't believe I even had that. I think this is something I
16 started subsequent to that, and it's very small.

17 CHMN. MAYES: Do you have an advertising budget
18 of any kind that is not safety related or reliability
19 related?

20 THE WITNESS: Or conservation related.

21 CHMN. MAYES: Or conservation related, yeah.

22 THE WITNESS: No, I do not. I did run some ads
23 last year that were paid for as shareholder expense having
24 to do with a threat of condemnation. That is the only one
25 I can think of.

1 CHMN. MAYES: Okay. Okay.

2 Q. BY MR. POZEFSKY: Mr. Townsley, in response to my
3 questions towards the end there, you talked there about
4 the reason why you are seeking the recovery of O & M
5 expenses, deferrals related to the White Tanks. You talk
6 about it in your direct -- I believe it's your rebuttal
7 testimony on page 5.

8 A. That's correct, my rebuttal testimony.

9 Q. There is a Q & A there that you address, and I
10 wanted to talk to you about that Q & A.

11 In that Q & A you talk about the detriment that
12 would be caused to the company should the Commission adopt
13 RUCO and Staff's recommendations on that, and it looks
14 like you try to quantify what that detriment would be in
15 financial or in dollar terms. And in doing that you used
16 a bunch of assumptions, and I would like to go over those
17 assumptions with you. That is again on page 5 starting on
18 line 24. You can go over them one by one.

19 Using a following assumption, one, the plant goes
20 into the service November 1, 2009.

21 So just so we are clear, the plant is not in
22 service totally at this point; correct?

23 A. That's correct. Our latest projections are that
24 it will go into service sometime during the month of
25 November of 2009.

1 Q Okay. Then No. 2 is annual operating costs are
2 \$1.1 million per year.

3 Again, that is a projection of what the actual
4 operating costs would be; correct?

5 A Well, first of all, I do list these as
6 assumptions, so we can use any assumptions, but these were
7 my best assumptions.

8 The \$1.1 million is our estimate of the net
9 operating costs. The actual operating costs of the plant
10 would be more on the order of \$1.9 million per year, and
11 that is primarily chemical costs and electricity costs.

12 But if we are running the White Tanks plant and
13 providing water from that, there are wells that we won't
14 have to run or won't run as much. So we project that
15 there is about an \$800,000 saving, primarily electricity
16 costs for the wells.

17 So the net of the 1.9 less the 0.8 gives me the
18 1.1 that was my second assumption there.

19 Q Okay. And then your third assumption is
20 Arizona-American's next Aqua Fria Water District test year
21 ending December 31, 2009 and the Commission order rates
22 effective August 31, 2001; correct?

23 A That was the assumption I used there.

24 Q December 31, 2009, that is two years after the
25 test year end -- the end of the test year in this case,

1 2007; correct?

2 A. Yes, December 2009 is two years after
3 December 2007.

4 Q. Okay. And using that assumption, at that point
5 we would have -- assuming the plant goes into service
6 November 1, 2009, we would have at that point only two
7 months of actual or known operating and maintenance costs;
8 correct?

9 A. Yes, using that assumption.

10 Q. Okay. And then based on all of those assumptions
11 you come up with a conclusion that the total loss would be
12 over \$2 million; correct?

13 A. That's correct. And that is precisely why I have
14 asked in this case for the Commission to grant us an O & M
15 deferral. I recognize what I'm asking for is not
16 traditional ratemaking, but the size of those operating
17 costs and the size of the White Tanks plant overall, I
18 think really warrants a change in the approach for
19 ratemaking for this project because the project does
20 provide significant benefit.

21 But last year I lost \$1.8 million as
22 Arizona-American. And a \$2 million incremental cost on
23 the company, it's just a very large number for this
24 company. And it's precisely that reason that I'm asking
25 that the Commission consider this idea of allowing us to

1 defer these costs and then in our next case, you know, if
2 you believe my assumption, August 31st, 2011, then we
3 could begin to roll those costs into rates.

4 Q But another option, of course, would be to finish
5 the plant, and then in the next rate case to come in and
6 ask for costs recovery; correct?

7 A You mean prospectively or retroactively?

8 Q Well, retroactively. What I mean is, if you are
9 going to use a 2009 test year and complete the plant and
10 you continue to defer those costs and when you come in for
11 the -- when you come in for your next rate case using that
12 as the test year, you could ask for those costs at that
13 time?

14 A I could, and the challenge that I would have is
15 that by the time that the Commission made a decision --
16 again, using my assumptions here -- sometime late in 2011,
17 I would have been operating that plant for about
18 22 months, paying for power, paying for chemical,
19 providing service water to our customers. And if you use
20 my assumptions -- and I think they are fairly accurate --
21 I think that would be about \$2 million that I don't think
22 I would ever be able to recover. And it's for that reason
23 that I have been -- that I'm asking for a slightly
24 different approach in the context of this case.

25 Q And if the Commission were not to grant you that

1 approach, I think -- I know you have not testified to it,
2 but I am sure you are aware -- the intention would be to
3 mothball the project?

4 A. Well, I do testify to that in my testimony. And
5 your characterization is not correct.

6 I have said in my testimony -- and I will show it
7 to you -- it's on page 8, line 4 -- that we would have to
8 take very hard look.

9 Commissioner Mayes -- Chairman Mayes, you were
10 asking me earlier about what are the things that the
11 company is doing to control costs. A \$1.1 million cost
12 for operating White Tanks is obviously a very large cost
13 to us, and I simply don't think I can find enough other
14 offsetting costs in other parts of my business to really
15 fully compensate me for that.

16 I want to be very clear, no decision has been
17 made on whether to mothball this plant or not. It's
18 premature today to make that decision. But as a prudent
19 manager I really do need to look at all of my options, and
20 if I have an avoided \$1.1 million a year of operating
21 costs that I defer until later when I need to start up the
22 plant, I need to seriously think about that.

23 But I don't want you to characterize that I have
24 made that decision, because that is not true. And if some
25 other member of my staff has said that in their testimony,

1 then I trump their testimony.

2 Q. Okay. I wanted to clear that up. I didn't come
3 up with that word, mothball. I think it was Mr. Buls that
4 referred to it. But I wanted to understand what the
5 company's position is on that.

6 A. You know, I would very much like to avoid that,
7 going to that place. I don't take the idea of mothballing
8 this plant lightly. I am a proponent of this plant
9 because it allows us to use renewable water in an area
10 that has dwindling groundwater supplies.

11 It also allows us to provide -- to not have to
12 use some of the arsenic treatment like some of the other
13 facilities out there, and it helps the West Valley.

14 So I really don't go there lightly. But I'm
15 evaluating it, as I should be. And I even mention, you
16 know, a potential sale of the plant. I have not made any
17 decision on that, and I don't go there lightly either. We
18 have been working on this project since, I believe, the
19 mid 1990s. I'm a water provider. I like to operate water
20 plants. But I also need to make sure I'm looking out for
21 making sure that we are investing our money wisely and are
22 conserving our costs where we can.

23 That is what I intended to cover in my testimony,
24 and if it wasn't clear, I apologize for that.

25 Q. Okay. I just have one more quick area, and it's

1 really just a point of clarification, Mr. Townsley, more
2 than anything else. And it's just following the testimony
3 you had on page 6 where you discuss RUCO's position
4 regarding the company's request for an accounting order.

5 It appears to be its previous request. And just
6 so we are clear, RUCO, as you state, and I think correctly
7 state in the last case where we were discussing this
8 issue, did object to an accounting order, correct, which
9 would allow for the deferral?

10 MR. MARKS: Mr. Pozefsky, could you provide a
11 reference so the record is clear here?

12 MR. POZEFSKY: Sure. It's page 6 of
13 Mr. Townsley's testimony. I'm just summing up what he
14 stated there.

15 MR. MARKS: This is the rebuttal testimony or
16 direct testimony?

17 MR. POZEFSKY: Rebuttal testimony starting on
18 line 5.

19 MR. MARKS: Thank you.

20 MR. POZEFSKY: Page 6.

21 THE WITNESS: And I'm not an attorney, so maybe I
22 misread what RUCO intended.

23 But when I read the RUCO reply brief in the White
24 Tanks case, which was Docket W-01303A-05-0718, on page 3
25 of your reply brief, line 14 to 18, that was my

1 impression, was that you supported our request for an
2 O & M deferral or an accounting order.

3 Q. BY MR. POZEFSKY: But what the company is
4 requesting in this case is an arm-like mechanism that
5 would allow the company to recover these O & M costs
6 through a surcharge prior to the Commission actually
7 putting them into rates; correct?

8 A. No, that is not what I'm requesting.

9 What I'm requesting, and maybe this -- you know,
10 one of the challenges with testimony is sometimes it's
11 hard to get a whole point across.

12 What I'm asking the Commission to allow us to do
13 is to capture these costs on our balance sheet as a
14 regulatory asset so at the time of the next case, our next
15 Agua Fria Water case, the disposition of those costs could
16 be appropriately dealt with, whether it's through a ACRM
17 surcharge or whether it's through other mechanisms.

18 So I'm not asking -- and maybe my attorney or my
19 accountants will disagree with me -- I'm not asking for a
20 definitive decision today as to how those costs get
21 recovered through customer rates. I'm seeking today the
22 ability to book those costs so that I have the opportunity
23 it my next case to recover those costs.

24 Q. And you are not making any declaration as to what
25 RUCO's position is on that, what you are doing in this

1 case; correct?

2 A. No, I'm not make any declarations on behalf of
3 RUCO.

4 MR. POZEFSKY: Okay. Thank you, Mr. Townsley.
5 That is all I have.

6 ALJ WOLFE: Chairman.

7 CHMN. MAYES: Thank you, Your Honor.

8

9

EXAMINATION

10

11 BY CHMN. MAYES:

12 Q. So, Mr. Townsley, in terms of the reg asset, the
13 company -- the company wants the reg asset, and it would
14 book that asset and seek to recover it, I presume from
15 your answer, either in the form of a surcharge or simply
16 in the form of rates in the next rate case. I mean, would
17 that be one possible avenue? I mean, what mechanism do
18 you envision or intend to seek recovery through?

19 A. Chairman Mayes, I haven't made that decision yet
20 because I haven't really put together that case.

21 I think they -- what I was seeking in this case
22 was the opportunity to book these cost as reg asset. I
23 think as I get together with my regulatory staff and
24 Mr. Broderick, we can decide what is the best way to do
25 that.

1 A surcharge clearly comes to mind as one possible
2 avenue. It could be amortizing them in rates over a
3 period of time. I really haven't gotten to that point.

4 Q Well, I mean, it's plant, so why would you
5 recover that through a surcharge? I mean, I understand
6 why that is preferable to the company, but it's not
7 necessarily preferable to consumers, it seems to me.

8 A These are the operating costs that I'm talking
9 about.

10 Q Okay. Operating costs, which also could be
11 recovered through rates though, couldn't they?

12 A Prospectively they can be recovered through
13 rates. The challenge I have here is that we will begin to
14 incur these costs this fall, and we will go almost
15 two years before the Commission would likely rule on the
16 operating costs of this plant going forward.

17 By allowing me to book these as a reg asset in
18 this case would allow me then to capture those costs, not
19 have it seen as out-of-period expenses, and then in our
20 next case we will provide proposals to the Commission and
21 to the parties as to what is the best way to recover those
22 costs?

23 CHMN. MAYES: Thank you.

24

25

1

EXAMINATION

2

3 BY ALJ WOLFE:

4 Q Mr. Townsley, it's my understanding that to have
5 an accounting order granted there has to be a strong
6 likelihood of recovering of the deferral; is that correct?

7 A Well, luckily for all of us, Mr. Buls follows me
8 and he can better answer that question for me.

9 Obviously I'm not asking for an accounting order
10 just so we can then turn around and throw the costs away
11 in two years. I am looking for support for a cost
12 recovery and under some mechanism in the next case.

13 ALJ WOLFE: Ms. Mitchell.

14 MS. MITCHELL: You were looking at me. It must
15 be my turn.

16

17

CROSS-EXAMINATION

18

19 BY MS. MITCHELL:

20 Q Good afternoon, Mr. Townsley.

21 A Good afternoon, Ms. Mitchell.

22 Q You mentioned a previous docket, and I'm just
23 going to refer to it just generically as the White Tanks
24 docket. I believe it was where the company had requested
25 a number of things, one being an increase in the hook-up

1 fees for Aqua Fria; is that correct? Did you -- you
2 referred to that decision?

3 A. Yes.

4 Q. I want to ask a couple questions about that.

5 When your company came in to request an increase
6 in hook-up fees, what was the purpose for the increase --
7 the request for the increase in the hook-up fees?

8 A. May I take a step back before I answer that
9 question?

10 Q. I guess, it depends where you are stepping back
11 to.

12 A. In the White Tanks case that was voted on by the
13 Commission in I believe September of 2007, that culminated
14 a very long process that this been going on for years up
15 to that point. And one of the decisions that the
16 Commission made in that order was to allow us to increase
17 our hook-up fees in our Aqua Fria District in part to pay
18 for this White Tanks surface water treatment plant.

19 In essence we felt -- collectively we, I think
20 all the parties agreed -- that this was a financing
21 vehicle for this surface water treatment plant that would
22 allow us to pay for an important treatment plant on future
23 growth, even though everyone recognized in that case, and
24 today, that the White Tanks treatment plant provides
25 benefits for current customers as well as future

1 customers. It really is a plant that benefits all
2 customers.

3 But we thought in that case that we found a
4 vehicle, hook-up fees, to finance this plant so we would
5 not have to, at that point, seek to have any of the costs
6 of that plant, the capital portion of those costs, in
7 current rates.

8 Q. So could it be that the company -- and I won't
9 use the term that I used with Mr. Broderick, gamble -- but
10 could it be that the company took a chance on growth in
11 the West Valley and lost?

12 A. I was hoping you would ask me the gamble question
13 because I was all ready for that.

14 Q. I could rephrase, if you would like.

15 A. Well, let me -- whether we use the words take a
16 chance or gamble, I strongly disagree with that
17 characterization.

18 We are not a gambling company. You know, water
19 companies are very conservative. We are very
20 conservative. Actually as a customer of a water company,
21 I would want to make sure that my water company was not a
22 gambler. If I am drinking their product, I want to be
23 sure they are very, very conservative.

24 In the case of the White Tanks plant, we took a
25 lot of steps that ultimately culminated in the decision of

1 2007, to try to reduce the risk of that project, the
2 financial risk of that project.

3 I mentioned earlier that the project first kind
4 of came to light in about the mid 1990s. And we are the
5 largest water provider out there, and yet it wasn't until
6 the fall of 2007 that we actually committed to proceed
7 with the project.

8 So the first step we did to reduce the risk was I
9 delayed that project as long as I possibly could because I
10 was trying to find other ways to finance it. And I think
11 if you ask some of my operating and engineering guys, they
12 were becoming very, very uncomfortable that the reserve
13 margin of capacity that we had out there was getting ever
14 smaller and they wanted me to commit to building this
15 plant. And I kept say, no, we have to look and make sure
16 that this is not a gamble.

17 We also -- and for those that were involved in
18 the 2007 case, remember Maricopa Water District was a big
19 player in all of that. We actually sought out Maricopa
20 Water District to try to get them to invest in the
21 project, and at one time had them build the project,
22 again, as a way to reduce a financial risk to our
23 customers and to the company.

24 We also did a number of improvements in our Aqua
25 Fria District, capital improvements to try to further

1 optimize our system, again to push this off.

2 Unfortunately, if I had been able to push it off
3 another year, maybe we wouldn't be having this discussion
4 today. But I finally ran out of room, and I had to make a
5 commitment. Because, if you are a gambler, that means you
6 have a choice. You can place the bet or not place the
7 bet. We have an obligation to serve, and we can't wait
8 until we run out of water to then decide to build the next
9 plant.

10 So there was a lead time into there, and I pushed
11 us as far back as I possibly could. But eventually, given
12 the information we had at that time, we had to proceed
13 with building this plant. It is a two-year construction
14 cycle, so we did.

15 Now, unfortunately things are very different
16 today in the West Valley than they were in '96 and -- 2006
17 and 2007, but I still believe we were very prudent and
18 very conservative in our approach of that project. And
19 given the information that I had back then, if I had that
20 information again today, I still would make that same
21 decision.

22 ALJ WOLFE: Commissioner Mayes.

23 CHMN. MAYES: Thank you, Your Honor.

24 Mr. Townsley, you said something interesting.

25 You said "We have an obligation to serve," and I agree

1 with you. And under the normal regulatory model, don't
2 companies, recognizing that obligation to serve, build
3 plant and then seek cost recovery afterwards? Do you
4 agree with that?

5 THE WITNESS: I agree that that is the
6 traditional model.

7 CHMN. MAYES: Okay. And so under the normal
8 regulatory scheme you would have had to build this plant
9 anyway, presumably, to build this growing area, and the
10 Commission blessed off on a hook-up fee to help you build
11 that plant, which itself is something of a departure from
12 the normal model, although it is one that certainly this
13 Commission from a policy standpoint approves of in order
14 to make growth pay for itself.

15 So why shouldn't that -- you know, we can
16 disagree on how much risk you took or didn't take, but why
17 shouldn't the downside of that fall to your shareholders
18 for a two-year period? Assuming a future Commission
19 allows cost recovery of prudently-incurred plant and
20 costs, and assuming that period is for two or three years,
21 why shouldn't your shareholders bear the downside risk of
22 that two-year period?

23 THE WITNESS: Let me answer your questions in
24 bits and pieces, if I may.

25 First of all, our shareholders are paying for

1 that right now and have been paying for that since the
2 fall of 2007 when we started construction, so they have
3 already got a lot of skin in the game.

4 Second, in our proposal to put a portion of the
5 CWIP in rate base, we are not asking to put all the CWIP
6 in rate base, so there is still a substantial portion of
7 CWIP, that even if the Commission were able to grant my
8 request to place \$25 million of CWIP into rate base, there
9 still is about another \$35 million of plant that would not
10 go into rates as CWIP and our shareholders would continue
11 to carry that cost going forward.

12 But those are a couple of answers to your
13 question.

14 CHMN. MAYES: Well, I don't know if it was a full
15 answer to my question, but let me ask you this: Would the
16 company be satisfied with and avoid having to take any of
17 the dire measures that Mr. Marks outlined in his opening
18 statement, including mothballing or selling the plant, if
19 the Commission did not allow CWIP in rate base but did
20 allow a reg asset?

21 THE WITNESS: Well, I guess a half a loaf is
22 better than a whole loaf.

23 CHMN. MAYES: That is a standard utility
24 response. Okay. Well, I mean it is certainly from your
25 standpoint is something?

1 THE WITNESS: It is something, and I believe that
2 we acted prudently throughout this whole process. I
3 believe that we did everything we could to minimize the
4 costs. And I believe that we have a plant here that
5 benefits both current and future customers.

6 So people who have characterized this as just a
7 growth project are missing an important part of the story.
8 But if the Commission were to give me the half a loaf
9 instead of a whole loaf, that is better than what I have
10 today.

11 CHMN. MAYES: Okay. Thank you, Your Honor.

12 ALJ WOLFE: Thank you.

13 Ms. Mitchell, go ahead.

14 MS. MITCHELL: Can I go ahead?

15 ALJ WOLFE: Yes.

16 Q. BY MS. MITCHELL: Isn't it the company's
17 responsibility, Mr. Townsley, to provide sufficient
18 capital to fund this capital improvement project, and if
19 one source of funds becomes unavailable, then is it not
20 the company's obligation to find that money and make that
21 up?

22 A. Would you be a little bit more specific? Are you
23 talking hypothetically or are you talking in terms of the
24 White Tanks plant?

25 Q. Well, in terms of the White Tanks and just in

1 terms of capital projects in general, shouldn't the
2 company fund that or provide the funds to do capital
3 improvement projects?

4 CHMN. MAYES: Could I ask it a different way?

5 MS. MITCHELL: Certainly.

6 CHMN. MAYES: What makes this different from any
7 other capital expenditure projects that the company would
8 then undertake in any of its service territories in
9 Arizona?

10 THE WITNESS: The primary difference is size and
11 cost. This project is, I believe, at \$62.5 million. It's
12 the largest single capital project this company has ever
13 undertaken and is likely to undertake for any time while
14 I'm in charge.

15 So the size is what is the big issue for us.
16 This is not a million dollar well or a \$500,000 pipeline.
17 It truly is extraordinary for us, and that is why I'm
18 seeking a different approach in this particular case.

19 If you put it in context, this plant, \$60 million
20 maybe for APS or TEP may not sound like a whole lot of
21 money, but I think our total ratepayer is somewhere in the
22 order of 2- to \$300 million. I forget. The numbers keep
23 moving around. So under those measurements, it is a very
24 large piece.

25 Q. BY MS. MITCHELL: You mentioned earlier about a

1 relationship that the company had at one time with
2 Maricopa Water District.

3 What is the status of that relationship now?

4 A. A little silent. There was at one point in which
5 Maricopa Water District was going to build this plant and
6 we were simply going to be a wholesale customer, and that
7 is a real low-risk type of situation for us.

8 Subsequent to that, I think we have gone through
9 four generations of relationships with them. The last one
10 that was memorialized in the joint development agreement
11 that we executed back in, I think it was early '08,
12 contemplated them taking an ownership interest of about a
13 third of the plant and in that way contributing a third of
14 the capital, sharing in the operating costs, and then
15 being able to market their portion of the plant to people
16 outside our service area.

17 I think the same issues that have affected us all
18 have affected them, and so they haven't been calling
19 lately. So I really don't have any update. I know they
20 are still interested. I know that they may still be out
21 there talking to other municipalities, but the option that
22 they had -- and I described it in my rebuttal testimony --
23 expired in January of '09. So there is no contractual
24 relationship that we have with them any more.

25 Now, if they were to knock on my door with a bag

1 full of money and want to buy capacity of the plant, if
2 the terms of the deal were right for us and our customers,
3 I would welcome them into the living room, but they
4 haven't knocked.

5 Q. And with respect to the Wishing Well plant that
6 is in the Mohave Wastewater District, is there anything
7 that would preclude the company from waiting until its
8 next rate case to seek recovery for that plant?

9 A. Well, I can't think of anything that would
10 preclude it because the plant is operational. It's used
11 and useful. It's providing service to customers. I can't
12 mothball that one because it's -- really it was a
13 refurbishing of an existing plant, so I really don't have
14 a whole a lot of choice in that one.

15 You are taking Commission Mayes' half loaf and
16 slicing a couple more slices off the end of that.

17 I would obviously much prefer to have it in rates
18 and it's used and useful, because it's operating today and
19 has been since some period of time ago. I lose track of
20 dates.

21 But if the Commission ultimately denied that as
22 including that in rates, I would have no alternative but
23 to come back and seek it in my next case.

24 Q. And you mentioned earlier in your testimony that
25 Arizona-American has suspended dividend payment to its

1 parent.

2 They don't keep track of that and won't be
3 looking for all of the suspended dividend payments
4 somewhere down the road, will they?

5 A. I have a lot of masters that I report to. They
6 are one of them. They have -- I'm sure that once we start
7 earning a fair return on investments, they will be wanting
8 to resume dividend payments, but I don't think they can go
9 back and, you know, get money from me from the old days.

10 MS. MITCHELL: All right. I don't have any other
11 questions, Mr. Townsley. Thank you.

12 ALJ WOLFE: Commissioner Mayes?

13 CHMN. MAYES: I needed you to stall a little
14 more.

15 ALJ WOLFE: We could take a break if you'd like,
16 and then we could have the rest of cross-examination after
17 the break.

18 CHMN. MAYES: That would be wonderful.

19 (Whereupon, a recess was taken from 2:28 p.m.
20 until 2:48 p.m.)

21 ALJ WOLFE: Let's go back on the record.

22 Commissioner Mayes.

23 CHMN. MAYES: Thank you, Your Honor. I
24 appreciate the forbearance in allowing me to take that
25 meeting.

1 FURTHER EXAMINATION

2

3 BY CHMN. MAYES:

4 Q. Mr. Townsley, I just wanted to ask you a few
5 questions.

6 Let's go back to the issue of consolidation,
7 which you know I am very interested in. I may upset some
8 people by asking some of these questions and I may upset
9 some people by generically supporting the notion of
10 consolidation, although, I want to make it clear that I
11 have not made up my mind about that in this case.

12 I think generically consolidation holds a lot of
13 promise for water companies, and I want to ask you some
14 questions about what would have happened if consolidation
15 had already been in place at this company and some of your
16 water systems.

17 First, how many of your water systems have or had
18 an arsenic problem, in other words, had it put in plant to
19 meet Federal -- the new Federal EPA standard for arsenic?

20 A. We have, I believe, it's four systems -- Agua
21 Fria, Sun City West, Tubac, and Havasu, and Paradise
22 Valley -- five systems that have arsenic treatment
23 requirements, and some, as the case with Agua Fria, we
24 have multiple arsenic removal facilities.

25 Q. Okay. Can you say them again?

1 A. Agua Fria, Paradise Valley, Sun City West, Tubac
2 and Havasu Water.

3 Q. Okay. And in some of those instances, Tubac --
4 well, Tubac in particular, but probably, am I correct in
5 believing, in all of those instances, because there was
6 only a certain number of customers across which to spread
7 the cost of that arsenic compliance, there was or could be
8 what might approach rate shock in those service
9 territories -- or let's just not use that word because it
10 can be insinuary -- but it was very hard for the consumers
11 of Paradise Valley and Tubac, and frankly in all of those
12 places, to absorb the spike in their water bills that
13 resulted from those costs being incurred -- being forced
14 on those customers by the federal government?

15 A. It was a classic unfunded mandate from the
16 federal government. And I hear from customers in every
17 one of those systems, and none of them are happy with the
18 significant cost increase for arsenic treatment.

19 Q. Okay. And if your system was -- let's set --
20 let's just set the issue aside, although I want to get to
21 it, of Sun City or Sun City West or both being separated
22 out for various reasons from the whole idea of
23 consolidation, but if your system had been consolidated
24 when that arsenic mandate was implemented, how would that
25 have impacted the impact of the arsenic rate increases; in

1 other words, what would it have looked like for those
2 customers had your system been consolidated in the first
3 place?

4 A. Well, I presume you are just talking about our
5 water systems.

6 Q. Yes.

7 A. If we were to consolidate, we would have a
8 consolidated water district and we would have a
9 consolidated wastewater district.

10 I sure can't give you numbers, Chairman, about
11 what it would have looked like, but there is no doubt in
12 my mind that had the costs that were required to remove
13 arsenic been spread out over a much larger customer base,
14 the impact on customer's bills would have been far less
15 than what we have seen, and especially in some of those
16 smaller systems, dramatically less than either what we
17 have seen or expect to see.

18 Q. And is it possible -- and I know we have had
19 customers come in here and say -- you know, we had the
20 Tubac customers come and say we are for consolidation. We
21 have had people come from Paradise Valley and from
22 Sun City say we are against it. But if there were -- is
23 it -- isn't it conceivable that there could be an
24 unexpected crisis in Sun City involving your water
25 company, the need for a new well, a new EPA mandate on

1 some other element that would have to be removed from the
2 water, some other unexpected event that would cause cost
3 increases in Paradise Valley and Sun City and
4 Sun City West; that if the company were consolidated it
5 would benefit those water districts to have had that
6 consolidation take place?

7 A. First of all, I don't believe that Paradise
8 Valley opposed the consolidation. They simple said, if I
9 remember their statements, that they were not in a
10 position to really make a proposal one way or another.

11 Q. I thought I heard a couple individuals say they
12 were opposed to it, but I'm not sure. I would have to go
13 back an reread that.

14 A. But to answer your question directly, there are
15 both unknown and known impacts to different systems in the
16 state that had they been consolidated and spread across a
17 larger base would impact the effect of it. Let me give
18 you an example that I have been using in some of my
19 meetings.

20 Sun City, which is not a party to this case, has
21 among the oldest infrastructure of our systems in the
22 state. It started construction in the '60s, and some of
23 the wells even go back to the '50s.

24 At some point that infrastructure needs to be
25 replaced. And if Sun City is to remain a stand-alone

1 system, there will be, obviously, much greater costs borne
2 by those particular customers.

3 I will come right out and say I am a supporter of
4 consolidation. Philosophically I think consolidation
5 makes as much sense in the water business as it does in
6 the energy business, and because of all the reasons that I
7 have laid out in my testimony.

8 But one thing that we do know is that the cost of
9 infrastructure in water systems in the state of Arizona
10 are only going to go up, and the EPA has a requirement
11 every few years to review all of their different possible
12 contaminants, develop new rules. Arsenic came out of that
13 process.

14 Q. What are they looking at now? They are looking
15 at something in particular, aren't they? It's -- I'm
16 sorry to put you on the spot, but I recall seeing
17 something new that they are looking at mandating that the
18 states deal with.

19 A. The reason I'm drawing a blank is because I have
20 read so many those things; I can't recall which ones they
21 are looking at now.

22 And the challenge is, that when these new
23 regulations come out from the EPA, they will almost
24 inevitably have disproportionate impacts in different
25 states and in different systems.

1 Let's use Sun City and Sun City West as an
2 example again. Sun City West, as a result of the arsenic
3 treatment rule, was required to have arsenic treatment.
4 On the other side of the river in Sun City, wells in
5 Sun City did not require it. So there was a
6 disproportionate impact to the residents of Sun City West.

7 I know that as the EPA continues its process and
8 it identifies potential contaminants, that it will have a
9 disproportionate impact. That is why consolidation helps
10 to ameliorate some of those.

11 Q. Right. And I fully recognize that there is not
12 consensus in Sun City and Sun City West. It looks like
13 both areas for consolidation. But my argument would be,
14 why is it fair to subject the people of Sun City to those
15 disproportionate impacts when they didn't have any choice
16 in the matter? I mean, people moved to Sun City a long
17 time ago -- a lot of folks moved to Sun City a long time
18 ago and didn't choose the Federal EPA to impose these
19 costs on them. Whereas you point out that just across the
20 river -- or on either side of them costs are not being
21 imposed on them.

22 Let me go to the issue that was raised earlier by
23 one of the intervenors.

24 If the Commission were to deal with consolidation
25 in this case, could Sun City be or Sun City West --

1 although, I understand Sun City -- let me rephrase.

2 Could Sun City and/or Sun City West be segregated
3 out of any consolidation proposal in this case and dealt
4 with separately in perpetuity, even if that is to their
5 harm, from your other rate cases? Because I believe in
6 the future it would be to the detriment to both of those
7 communities eventually if they were not included in a
8 consolidation proposal. But there is clearly no consensus
9 in those communities.

10 So can they be segregated out and be treated on a
11 stand-alone basis for better and for worse from here on
12 forward?

13 A. First of all, using your example, I think because
14 Sun City is not even in this case, it would be
15 inappropriate to --

16 Q. To include them?

17 A. -- to include them.

18 The Commission Staff proposal was to in the
19 future do a statewide case and to contemplate that at that
20 point. I think that makes a lot of sense.

21 But even if there was a statewide case in which
22 all of the water and all wastewater districts were brought
23 in and consolidation were considered at that point, that
24 doesn't mean that everyone needs to be considered. And if
25 the Commission decided that Sun City Water should stay out

1 or Sun City Sewer should stay out or Sun City West Water
2 or any other district should stay out, that is clearly
3 within the purview of the Commission.

4 I think frankly there is a lot more discussion
5 and education that we all need before we are ready to make
6 that leap. I described it earlier that we have taken the
7 first step in the journey. I would think we would want to
8 have community meetings and discuss this issue in each of
9 our different districts and try to resolve a lot of the
10 questions and the education outside of the context of a
11 rate case, which is always very difficult to do.

12 So perhaps that's the right process for you here.

13 Q. Okay. Well, I want to follow up on that because
14 one of my questions was, where do we go from here and how
15 do we make sure that this doesn't wither on the vine and
16 that the issue gets resolved? Because this is something
17 that I believe needs to be addressed. I asked for it to
18 be addressed in this case, and I want to ask you about the
19 concrete steps that need to be taken and when it would be
20 proposed, if it's proposed.

21 And I don't have it in front of me, but I guess
22 it's Mr. Broderick's exhibit. It's the one, the chart
23 showing the impacts to the various systems.

24 What exhibit is that?

25 ALJ WOLFE: I believe it's in Mr. Broderick's

1 rebuttal testimony.

2 It's Exhibit A-12. It should be in Exhibit A-12.

3 We will go off the record until we find it.

4 (Discussion off the record.)

5 ALJ WOLFE: Back on the record.

6 Q BY CHMN. MAYES: Okay. Mr. Townsley, how many of
7 Arizona-American's systems as presented in A-12 in
8 Mr. Broderick's testimony would benefit from
9 consolidation?

10 A I don't have a copy of the exhibit in front of
11 me.

12 Q I will give this back to you.

13 CHMN. MAYES: Do you have one, Mr. Marks?

14 MR. MARKS: Yes.

15 THE WITNESS: Well, under Mr. Broderick's
16 exhibits -- and this exhibit, just to make sure we are
17 all -- the record is clear, only includes the water
18 districts.

19 Q BY CHMN. MAYES: Right.

20 A It does not include any wastewater districts --

21 Q Okay.

22 A -- and just provides certain underlying
23 assumptions.

24 But using those assumptions and based on this
25 exhibit, it appears that one, two, three, four, five,

1 six -- six of the eight districts will see a decrease in
2 rates and two of the districts will see an increase in
3 rates based on these inputs.

4 Q Okay. And, you know, obviously unfortunately one
5 of those districts that would see an increase would be Sun
6 City, and that is probably something that has attracted
7 the attention of the folks in Sun City for obvious
8 reasons.

9 I would note that in Mohave, though, the increase
10 is not -- well, the increase is not as large as the
11 decrease in a lot of the other systems; although, it is
12 sort of across the board. I mean, there is a huge
13 decrease for Havasu, a very significant decrease for
14 Anthem, a very significant decrease for Tubac; Paradise
15 Valley has a small decrease, about \$3.32 in their rates.

16 Okay. So six out of the eight systems would
17 actually benefit from consolidation?

18 A Yes. Again, in this scenario that is true.

19 And as you were asking me a little earlier about
20 unforeseen changes in the future, these scenarios only
21 reflect what we know today. If five years from now new
22 treatment technologies or new capital requirements are
23 required in some of this, that could change that. So this
24 is a very static view, but as we know, things are always
25 changing.

1 Q. Okay. And so they also don't reflect in any of
2 these districts the impact of those districts not having
3 to shoulder the burden of specific infrastructure
4 improvements in the future; correct?

5 A. Yes. That's correct.

6 Q. So, for instance, Sun City, whose infrastructure
7 is getting older by the year, would benefit from, in that
8 sense, from having those infrastructure costs spread
9 across the larger rate base or a larger number of
10 ratepayers?

11 A. That's correct.

12 Q. Now, I want to ask you about the -- this issue of
13 sort of consolidation conceptually.

14 I think it was a public commenter who stood up
15 and said, well, you know, it doesn't make sense to
16 consolidate water companies because they are not
17 physically interconnected like electric companies are.
18 And my view on that is, well, first of all, that is not
19 true about electric companies. Even electric companies
20 aren't entirely physically interconnected.

21 For instance, I don't believe that -- I believe
22 that there are certain portions of, for instance, the
23 Navajo and Hopi reservations that are very, very
24 unconnected from the rest of APS's system, and yet we
25 don't -- this Commission doesn't say to the Hopis, oh,

1 sorry; you will have to cover all of the cost of serving
2 your remote territory. Those costs are essentially
3 socialized across the entire rate base because we believe
4 it's in the public interest to serve the Hopis and to
5 serve the Navajos and to serve the people in my home town
6 of Prescott. Even though it's tougher to serve in
7 Prescott and to serve the people down in Nogales or
8 Bisbee, even though it's tougher to serve, we spread those
9 across the entire rate base and handle it in one rate
10 case.

11 And so I guess my question to you from a policy
12 standpoint or a conceptual standpoint is why -- you know,
13 who is right? Is the public commenter right or am I right
14 in my thinking about this?

15 A. I could sure refer you to my testimony because I
16 share many of your thoughts, Chairman Mayes.

17 First of all, I believe we are interconnected.
18 If you think of the aquifer that we are drawing water
19 from, whether it's in Tubac or here in Maricopa County or
20 in points north, the aquifer is a unified element of all
21 of that, very similar to what power plant or transmission
22 lines may be to electric companies.

23 So just because the local distribution systems of
24 different parts of our system are not interconnected does
25 not mean, in my mind, philosophically that they are

1 separate systems.

2 I also think that, again philosophically
3 speaking, that in a state such as Arizona, if we don't
4 address this issue of consolidation, given the increase in
5 capital costs, given the increasing water quality
6 requirements, and given how widespread out we are in this
7 state, this issue is only going to get worse. And my view
8 is that we need to address it and we need to find a way to
9 get there.

10 Now, the difficult part, and this is what we
11 heard from public commenters, is not necessarily whether
12 we should be consolidating or not consolidating; it's the
13 transition to get us there, how do we do that with causing
14 as little damage as possible. And that is the challenge
15 that we have in front of us.

16 Q. Okay. Let me ask you about the status. You
17 mentioned something about consolidation proceeding at a
18 faster pace in other states.

19 Well, what did you mean by that, and how many of
20 the other states that you serve in have some form of
21 consolidation -- that Arizona-American serves in that has
22 some form of consolidation? I'm familiar with the
23 Pennsylvania situation, but I'm curious about your other
24 states.

25 A. I think Pennsylvania American Water, which is the

1 sister company of Arizona-American Water, is the best
2 example of consolidated rates because, I believe, to the
3 best of my knowledge, all of the customers -- and they
4 serve about a half million customers -- are on one group
5 of rates.

6 It's my understanding that in New Jersey,
7 American Water, they are also close to consolidated rates.

8 In West Virginia, American Water, they are also
9 close to or at consolidated rates.

10 I believe that in most of Missouri they are
11 consolidated.

12 There is no state in the American system, that
13 I'm familiar with, that has more districts and more
14 separate rates than we have here in Arizona. So we are
15 kind of at one extreme. We don't necessarily need to get
16 all the way to the other extreme in one step, but I think
17 we should be making progress in that way.

18 And you asked me about concrete steps, if I
19 could, I do have some thoughts.

20 First of all, this is obviously from the public
21 comments, an issue that is causing a lot of people a lot
22 of concern. And as a result of that I don't think that we
23 should rush into this and end up making -- either making
24 mistakes or not having enough public involvement in the
25 process. I think that, again, the Commission Staff's

1 approach is a good one, and the first concrete step that I
2 would suggest would be that the Commission lay out a
3 policy, guidelines that help all of the parties, not just
4 here in Arizona-American Water, but other water companies,
5 to understand what are the criteria for considering
6 consolidation.

7 And a Staff witness laid out some criteria, and I
8 think that is a good starting point. I obviously have my
9 thoughts of criteria, but if the Commission were to lay
10 out, either in this case or in some other way, that it
11 encourages consolidation, that it supports consolidation
12 and here are criteria to help move it forward, that would
13 be very helpful.

14 The second concrete step I would suggest is that
15 we will engage the parties. We will engage our customers.
16 We have had a number of community meetings as a result of
17 this rate case in preparation for this rate case. We will
18 do more of those types of meetings with our customers so
19 they understand what their issues are. We will meet with
20 Staff and with RUCO and with other interested parties.

21 I believe that a rate case setting is not really
22 the right place for us to try to design consolidation
23 because there are always so many different issues that are
24 on the table at the same time that are competing for
25 attention and competing for resources.

1 So if we were to do that spade work and then in
2 some future case, a statewide case, come in, if not with
3 agreement on how to consolidate, at least having done a
4 number of steps, I think we would be more successful in
5 getting it done.

6 That is my view.

7 Q. All right. And I think that, you know, that is
8 something that the Commission should consider.

9 When you say in some future case, that gives me
10 pause because that is very vague. And that just sort
11 of -- it seems to indicate --

12 You know, what I'm concerned about is that the
13 Commission not kick the can down the road yet again. You
14 know, I have been talking about this for six years. I
15 have been talking about it since I got here, talking about
16 it till I'm blue in the face. In the meantime, in the
17 last six years all I have seen is one ratepayer after
18 another get hurt. And I'm sick of it.

19 I have to tell you, I am absolutely sick to
20 death. Anthem, Paradise Valley, Sun City West, Tubac, you
21 know, one service territory after another getting hammered
22 by costs that never -- that would never happen in a
23 natural gas rate case, in an electric rate case. It's not
24 just your company; it's every water company -- you know,
25 the 350 water companies in the state of Arizona.

1 And so I just don't want to see this issue get
2 punted because the people in this room don't have, you
3 know, the political will to address the issue. And, you
4 know, I will tell you that I do have the political will to
5 address the issue. Unfortunately I will only be here for
6 22 more months -- not that I'm counting -- but I think we
7 all have to really -- we have to saddle up here and do
8 what is right for the people of Arizona even if it might
9 be unpopular in some quarters, while at the same time
10 being sensitive to those issues.

11 If it means cutting Sun City out, I'm willing to
12 look at that. But if you have six out of the eight of
13 your districts that would be helped by this policy, I
14 frankly am unsure why we are punting it.

15 A. Chairman Mayes, please don't think that I am
16 proposing to punt this system. I have spoken very
17 passionately about consolidation for many years.

18 There are downsides, but there are a lot of
19 upsides. At the same time, I don't want us to rush into
20 something and create a consolidation road map, because
21 that is what we talking about here, that has unintended
22 consequences.

23 So what I am suggesting is not kicking the can
24 down the street, but not embracing it today. I am sure
25 there is a path there that will work.

1 Q Okay. Well, and I appreciate that.

2 Just moving, I guess, to another topic, is the
3 company proposing anything in the way of a new
4 conservation program or the adoption of best management
5 practices in this case?

6 A If you don't mind, I would like to punt that one.

7 Q Okay. Which witness?

8 A Jake Lenderking should be following Chris Buls
9 today, so hopefully if we get through, you will be able to
10 ask him that question. I know he has done a lot of work
11 and a lot of thinking in that area.

12 Q Okay. And in case I'm not here for that, if you
13 could make sure that your witness does address the BMP
14 issue, what has been adopted in the case, what needs to be
15 adopted.

16 For those of you who don't know, BMPs is the best
17 management practices. It's conservation programs that we
18 are adopting at water companies in the state of Arizona.

19 I just want to make sure that that and the
20 conservation issue generally is addressed by one of your
21 witnesses.

22 And in terms of the White Tanks plant, are there
23 any other arrangements that you have looked at besides
24 mothballing or selling the plant to try to address some of
25 the costs recovery, i.e., partnership of some kind? You

1 sort of alluded to this with the Metro Water District, a
2 partnership that, I guess, kind of evaporated. Is there
3 anything that is on your radar screen that might address
4 some of these costs?

5 A. I think you have captured them. You know,
6 operating the plant and taking the loss, which is very
7 painful for me, not operating the plant and letting it sit
8 idle until we need it is a second option. Selling the
9 plant, if I can find someone that was interested in buying
10 it, would be a third option and presumably being a
11 wholesale customer to that.

12 A Staff witness -- the Staff attorney was asking
13 me about Maricopa Water District, and I think they are
14 interested in being a partner. I know they are interested
15 in being a partner, but they need a client. They need
16 someone to buy their water treatment services, and I think
17 the housing turndown has affected that.

18 But I maintain an open door to the Maricopa Water
19 District and have told them if they can find a way forward
20 and want to be involved in this project, I would be very
21 interested in talking to them.

22 I don't really have any other ideas beyond those
23 that I just laid out.

24 Q. Okay. Mr. Townsley, as you know, not as
25 certainly part of this case, but because I saw the great

1 possible benefit associated with the Federal Stimulus
2 Package for Arizona water companies, but more specifically
3 for their consumers, I called you and as many water
4 company executives as I could after I learned of the
5 Federal Stimulus Package provision that allows for about,
6 I think, \$31 million for water company improvements and
7 asked you all to think about your water system and which
8 ones would benefit from that money.

9 Tubac obviously came to mind -- it's pretty much
10 a no-brainer -- to try to deal with that through some of
11 the federal stimulus money.

12 Can you update the Commission about your efforts,
13 what projects you put in for at WIFA -- Water
14 Infrastructure Financing Authority -- which is essentially
15 disbursing that money to water systems, both municipal and
16 private, and what you know about your prospects of getting
17 some of that for you water companies, including Tubac?

18 A. I would be happy to. And before I even do that,
19 Chairman Mayes, I would like to thank you for your support
20 in ensuring that regulated water companies in the state of
21 Arizona do get access to those funds. I frankly believe
22 that had you not been as active in that area as you have
23 been, that we would not be in nearly as good a position to
24 be able to get some of those funds that will benefit our
25 customers.

1 Having said that, we have put two proposals in
2 front of the Water Infrastructure Financing Authority of
3 Arizona, WIFA. One is for the arsenic treatment facility
4 in Tubac, and that project is beyond shovel ready. We are
5 poised to go. And the other project is a well
6 rehabilitation project in Sun City that is not as far
7 along the development timeline as the Tubac project, but
8 still would be ready to go if we were to obtain some
9 favorable WIFA financing.

10 In the case of the Tubac one -- I will focus on
11 that because we have actually made more progress on that.
12 We have bids in hand. We have some materials already
13 available, and the issue that is -- there are two issues
14 that are standing between us, I think, and being able to
15 proceed beyond simply getting the funds from WIFA, which
16 of course is important.

17 One is that we need Commission approval for a
18 financing application. And my understanding as I left the
19 office on Friday is that we had staff that was working on
20 that and that the application for financing approval will
21 be filed with the Commission here shortly. That is for
22 both projects. And once we obtain Commission approval on
23 that, we will be able to demonstrate to WIFA that we have
24 the authority we need to proceed.

25 The other issue that is standing in front of us

1 in the Tubac project is Santa Cruz County permitting
2 approval. And I don't believe that to be an
3 insurmountable issue. We have been working very closely
4 with a number of residents in Tubac on that area -- in
5 that area, and I believe that will be addressed in due
6 time.

7 Q. Okay. Can you just -- for the record, what is
8 the amount of both of those grants that you are seeking
9 or, I guess, it's no interest -- well, it's basically a
10 grant, as I understand it.

11 A. The amount of the Tubac application is, I
12 believe, \$2.4 million. And in the case of the Sun City
13 well project, I think it's about \$2 million.

14 Q. Okay.

15 A. And my understanding is that what WIFA is
16 considering or contemplating right now is a financing that
17 would be -- a portion of it would be a loan and a portion
18 of it would be -- let me try this again.

19 That WIFA is contemplating a loan in which a
20 portion of the principal would be forgiven.

21 Q. Okay.

22 A. So it's a hybrid, grant and loan combination.

23 Q. Okay. And for the relief from that grant
24 portion, that is money that ratepayers then are flat out
25 not going to have to pay for; correct?

1 A. That is absolutely correct. That would be an
2 offset to rate base, so that cost -- the value of the
3 grant, as you call it, ratepayers would not pay for.

4 Q. So it's a dollar-for-dollar bang for their buck?

5 A. Absolutely dollar-for-dollar.

6 Q. And then the, what I believe to be a very low
7 interest loan portion of it is good also, because again,
8 the ratepayers aren't having to pay for the higher
9 financing cost associated with that; is that correct?

10 A. That's correct. I haven't seen what the loan
11 rate is, but there is no doubt in my mind that the package
12 together, the loan component and the grant component,
13 would have tremendous ratepayer benefit in the case of the
14 Tubac community for that project and in the case of the
15 Sun City community for that project.

16 Now, neither of these have been approved by WIFA,
17 so our applications are in front of WIFA, and they need to
18 make a decision. I understand that they have a board
19 meeting on April 15th in which they will make these
20 decisions.

21 Q. Okay. That was my next question, is when will we
22 learn -- so April 15th. Okay. And I know the
23 Commission -- all the commissioners are doing everything
24 we can to advocate for our water companies in that
25 process. And I do appreciate the fact that you applied,

1 and I hope that both Sun City and Tubac are awarded that
2 grant money.

3 CHMN. MAYES: Okay. Your Honor, I think that is
4 all I had for now. I appreciate it.

5 ALJ WOLFE: Okay.

6

7

FURTHER EXAMINATION

8

9 BY ALJ WOLFE:

10 Q. Good afternoon again, Mr. Townsley.

11 A. Good afternoon.

12 Q. I had a question to follow up on some questions
13 about discrepancies in data about water bought and water
14 sold.

15 It's my understanding that there are two data
16 systems, and they don't communicate with each other, and
17 that is why there was a discrepancy in the data reported
18 to the Commission Staff.

19 Is that correct?

20 A. While all utilities have data system, computer
21 systems that don't communicate as well as they should, I
22 think the issue is -- my understanding is a little bit
23 more fundamental than that.

24 Historically we have always measured our water
25 loss on a district level. So we measure all the gallons

1 that are produced and we measure all the gallons that go
2 through customer meters and whatever the difference is, in
3 essence, is our unaccounted-for water.

4 In this particular case we were asked to measure
5 unaccounted water, not on a district level, but on a
6 smaller subset of a district level, which is what is
7 called a PSID level. So within a particular district you
8 could have one or two or three or four PSIDs.

9 We never measured water losses at a PSID level.
10 And as an example, some of our meter reading routes -- to
11 give you probably the biggest reason why we had some of
12 these discrepancies -- follow the streets but don't
13 necessarily follow the PSID boundaries.

14 So when the water that was sold to a customer's
15 meter as measured by a meter route may have been
16 inadvertently assigned to one PSID when it should have
17 been assigned to the other PSID. So that's an example of
18 the kinds of issues that came up when we were preparing
19 for this case.

20 We also had numerous employees entering the
21 system and entering data into the system. And so while I
22 think there may have been an element of incompatible
23 computer systems, I think the bigger part of the answer is
24 that we changed our processes on how we measured water in
25 and water out, and our historic process just didn't really

1 support that. And it took us a little bit of time to get
2 ready for this case to get it all sorted out, to make sure
3 that the meters on this part of a meter route were
4 assigned to this PSID and other meters on a meter route
5 were assigned to that PSID. And I know it was confusing
6 for Commission and Commission Staff. I apologize for
7 that. It was a lot of work for a lot of us, and I know we
8 even had a big summit done here with Commission Staff to
9 sort it all out.

10 So I think we have put processes in place to make
11 sure that we have better data integrity. We make sure
12 that the people that are entering the data know the
13 importance of getting it right and getting it assigned to
14 the right PSID.

15 And then we are always working on making sure
16 that our systems are working better -- in this case, I
17 think it was some spreadsheets -- to make sure we are
18 capturing it and recording it better.

19 So I don't want to leave you with the impression
20 that a new computer system would solve this problem. I
21 think it was more people entering the data the right way
22 that we have now addressed and continue to address, not
23 only in the districts in this case, but in our other water
24 districts as well.

25 Q. My concern was a little broader than the one

1 issue that came up in this case.

2 A. Okay.

3 Q. This isn't the first time -- I have been the
4 assigned ALJ on several Arizona-American Water cases, and
5 it seems to me -- I can't give you a list -- but it seems
6 to me that this issue has come up repeatedly, that there
7 are, I think I heard two, computer systems that are not
8 compatible and that it causes a lot of problems, not only
9 with water pumped and water sold issues.

10 So I want to ask you about that on a broader
11 level.

12 A. Thank you, and I would be happy to address that
13 as well.

14 We have older systems. These are older computer
15 systems that are used not only here in Arizona-American
16 but across the company. I think our financial reporting
17 system is early 1990 vintage, and I think our customer
18 information billing system may be earlier than that. I
19 think there are still some green screen computer systems
20 out there.

21 We do have a project that is ongoing -- it's in
22 its early days -- to upgrade both of those systems, along
23 with some other systems. And it would ensure that they
24 are contemporary in design, and, in fact, if you have a
25 bill from a customer, that revenue flows straight through

1 your financial system without having someone have to
2 manually enter it because they don't talk through it.

3 Those kind of projects are very expensive, and
4 they take some time to undertake. But we have actually
5 been having meetings this year with a design team as they
6 have come to Arizona and gone to other states to talk
7 about what our requirements are and make sure that when
8 these new systems are put in place that they will -- that
9 they will work well.

10 I will also say that as we became a
11 publicly-traded company again, the parent of
12 Arizona-American, American Water, that process has caused
13 us to relook at a lot of the way we do things and to
14 tighten them up and to ensure that they are repeatable
15 from state to state and from district to district. And
16 while that has not been a computer change, the improvement
17 in those processes, in order to become Sarbanes-Oxley
18 compliant, has also improved a lot of our reliability of
19 data.

20 So we are going down a path. We have improved
21 processes. We have documented them. And the stage we are
22 in now is to put new systems in place to support those
23 processes and we are starting that.

24 Q. And do you see that as ultimately being more cost
25 effective than struggling with systems that aren't

1 optimal?

2 A. I believe that it will be more cost effective in
3 the long run. In the short run there are always costs in
4 changing out one system to another system. But over the
5 long run it should be more cost effective, and more
6 importantly, some of the old systems we have, they aren't
7 being supported anymore. So at some point you just don't
8 have the capability to maintain the system that we have
9 in place today. So that is another reason why we are
10 starting that process.

11 Q. I have some questions that Commissioner Kennedy
12 asked me to ask the company, and I was referred to you.

13 She wanted to know what the company is paying
14 their executives. And I can follow up on that if you can
15 tell me what the answer is that you think that should be
16 forthcoming as far as the definition of executives. I
17 don't know exactly what she meant by that.

18 A. Well, I believe a lot of that data is in our
19 application already. It's in the hands of all the
20 parties.

21 What I would be very willing to do, if it works
22 for you, is to summarize that and provide that as an
23 exhibit to all the parties, you know, here shortly, I
24 mean, here within the next few days, if that would address
25 her question.

1 Q. Okay. We can try that. I did ask -- I let your
2 counsel know that I would be asking that question.

3 A. And I knew you would be asking that question. I
4 just thought, just from a privacy perspective, rather than
5 broadcasting names and numbers, it may be would be more
6 effective, and meet Commissioner Kennedy's needs, to
7 provide that as an exhibit.

8 But I will defer to your judgment on that.

9 Q. Okay. And I can check with her as well.

10 CHMN. MAYES: Your Honor, and I can't speak for
11 Commissioner Kennedy, but I think it would probably be a
12 valuable exercise if you could put that into an exhibit,
13 and if, at the very least, categorize that by position,
14 even if you don't put names next to it. But in previous
15 rate cases we have had, I know I have asked for that kind
16 of information in previous rate cases, and I think what is
17 usually done is, you know, it's listed by position and
18 then salaries are attached to those positions. But it
19 seems like something that the commissioners would like to
20 have.

21 ALJ WOLFE: Thank you.

22 Q. BY ALJ WOLFE: And the other question is related
23 to, what is the company practice or policy on bonuses for
24 executives and staff? I know that is covered in your
25 testimony too, but I would like to have the response on

1 the record while you are here.

2 A. Our -- I'm sorry. It was what is our --

3 Q. Company practice or policy on bonuses for
4 executives and the staff.

5 A. Well, I think I spent quite some time talking to
6 Mr. Pozefsky -- the RUCO attorney on that issue.

7 Our policy, in essence, is that here in
8 Arizona-American -- and I'm speaking for
9 Arizona-American -- we have an annual incentive plan that
10 affects all non-overtime eligible employees. It is a
11 consistent program for everybody. The percentage of the
12 target amount may change by category of job. But it's the
13 same practice that we have for -- it covers about
14 40 percent of our workforce, everyone who is not eligible
15 for overtime.

16 And I have also -- beginning on page 16 of my
17 direct testimony I go into great detail on it.

18 So is that responsive to the question?

19 Q. I believe that it is. Thank you.

20 ALJ WOLFE: Those are all the questions I have
21 for you today.

22 Commissioner Mayes?

23 CHMN. MAYES: Thank you, Your Honor.

24

25

1

FURTHER EXAMINATION

2

3 BY CHMN. MAYES:

4 Q One of the Judge's questions triggered a question
5 that I meant to ask you.

6 When I was at the same meeting where I learned
7 about the federal stimulus funds being available for water
8 companies, it was the National Association of Regulatory
9 Utility Commissioners in Washington about, I don't know,
10 maybe a month ago or three weeks ago, and one of
11 Arizona-American's other companies in another state -- and
12 I can't remember which one it was, perhaps Pennsylvania,
13 but I'm not sure -- mentioned that in that system the
14 company is deploying a leak detection system -- an
15 advanced leak detection system of some sort.

16 Do you know what I'm talking about? And has
17 Arizona-American considered that, or is it planning the
18 same leak detection system for its water systems in
19 Arizona?

20 A Chairman Mayes, I'm very familiar with that
21 system, and it comprises of acoustic devices that you
22 attach to your pipes and they can actually hear leaks over
23 time.

24 And I'm sure that it was Pennsylvania that is
25 deploying that within American Water because

1 Pennsylvania-American Water, along with many of Eastern
2 utilities, have water losses that approach or exceed
3 30 percent.

4 Q Which is very large?

5 A Very large. Our average unaccounted-for water
6 here is 10 or less than 10.

7 So while I have evaluated that and am very
8 interested in that system, it has not yet made
9 cost-effective sense for us here.

10 What we're instead attempting to do at this stage
11 of our water loss management program is to better evaluate
12 the amount of water that comes into the system and the
13 amount of water that comes out of the system. Because
14 what I find is that usually we don't have a lot of water
15 loss or leakage. Usually what we have are inaccurate
16 meters that lead to an apparent increase in water loss or
17 we have a lot of processed water that is being used at a
18 treatment plant or is being used for construction purposes
19 that is not being adequately metered.

20 So our process today and over the past couple
21 years has been to really make sure that all of our meters
22 are accurate and that all of the places that water comes
23 into the system or goes out of the system has a meter.

24 And you will remember that when times were --
25 there was a lot of construction going on in the Valley, we

1 had a lot of -- not a lot -- yes, we had a lot of tanker
2 trucks that would come up and connect themselves to our
3 hydrants and take water and fill up their tanker trucks
4 for dust control. Well, that shows up as unaccounted-for
5 water, but it's really not a leak in a pipe.

6 Q. Someone is stealing your water or your customers'
7 water actually?

8 A. And it has been those type of steps that we have
9 been focusing on. And if we get to a point where we think
10 we have exhausted all of that and we still have systems
11 with a higher amount of water loss than we think we
12 should, then we will deploy some of these devices or other
13 devices like that.

14 Q. You mean like the acoustic leak detection?

15 A. Correct.

16 Q. What is the highest water loss of any of your
17 systems; do you know?

18 A. I believe it's Mohave Water.

19 Q. Okay. Do you know what that is?

20 A. I'm not the right witness for that,
21 unfortunately.

22 Q. Who would that be? Do you know who would be the
23 best?

24 A. Troy Day, but he has already come and gone,
25 unless the Judge wants him recalled on that issue.

1 Q Okay.

2 A I believe all that data is in the record anyway.

3 Q Is it?

4 A Because that was a requirement of Staff, to
5 report on all of that.

6 Q Okay. Well, I'm interested in this.

7 When you say it's not cost effective, what do you
8 mean by that?

9 A What I mean by that is that there are more
10 effective ways for us to reduce our unaccountable water
11 than installing these devices. I don't remember if they
12 were \$200 apiece or \$500 apiece. But in order to use
13 them, you have to deploy an army of them across your
14 system so they are all listening to different parts of
15 your system.

16 So today, where we are today, given the condition
17 of our system, the amount of unaccounted-for water that we
18 have, we find that there are more effective ways to do
19 that.

20 But I think it's a great system. I really like
21 it, and I look forward to the day that we are going to be
22 deploying that system here.

23 Q Okay.

24 A And it won't be statewide. It would be in
25 specific locations where we think we have leakage.

1 Q You know, I would be interested in having the
2 company provide in this docket a letter or a late-filed
3 exhibit, either one, either a letter to the Commissioners
4 or a letter to the docket, describing, you know, which
5 systems you think it might be cost effective to deploy
6 acoustic leak detection, what steps you have taken to
7 examine that issue, and then a more fulsome description of
8 the metering reforms that you are undertaking and where,
9 and if possible, also, a description of the acoustic leak
10 detection that is being deployed by American Water in
11 other states.

12 It strikes me that it may be cost effective in
13 some systems, and aside from that, it's always been my
14 view that a 10 percent water loss is itself not a good
15 thing, especially in the desert. For losing 10 percent of
16 our water, it's just flat out not a good thing, and that
17 we ought to be striving for ways to drive that down and
18 looking for ways to drive down that water loss as we
19 continue to grapple with the drought that we are in and
20 the water supply issues.

21 A We will provide you that.

22 Q Thank you. I appreciate that.

23 CHMN. MAYES: Thank you.

24 ALJ WOLFE: Do have you redirect for this
25 witness, Mr. Marks?

1 MR. MARKS: I have just a little bit, Your Honor.
2 Thank you.

3

4

REDIRECT EXAMINATION

5

6 BY MR. MARKS:

7 Q Mr. Townsley, you had asked Mr. Pozefsky if you
8 could provide examples of benefits to ratepayers of the
9 annual incentive program, and I believe his response was
10 no. So I will now give you that opportunity to provide
11 those examples, if you would like.

12 A I appreciate that opportunity.

13 The annual incentive plan, as I described
14 earlier, I do believe, does provide benefits to all
15 parties: to the employees, to customers, and to
16 ratepayers. And let's just take the components one by
17 one.

18 The easiest one, I think, is the operational
19 component. I described it as environmental compliance,
20 customer service, and safety. I mean, obviously if we
21 improve our environmental compliance, we improve our
22 safety, we improve your customer service, that's a direct
23 correlation to customer benefit.

24 The individual component, which typically
25 includes individual goals developed for people -- that

1 people develop, also oftentimes are tied directly to
2 specific elements that benefit customers, whether it's
3 reducing the number of estimated meter reads or it is
4 reducing overtime or it's being -- meeting appointments
5 with customers.

6 Those are some of the examples of some of those
7 targets that would be on an individual level. And even
8 the financial targets, which some people may claim have no
9 benefits for customers, I would disagree. Because if a
10 company is stronger financially, it's going to be able,
11 like we would like to, to be able to attract capital and
12 to be able to have a parent that wants to invest in the
13 state. So the financial component, though not as direct
14 as the other two, I believe provides customer benefits as
15 well as the others.

16 Q Thank you. Mr. Pozefsky also asked you about
17 whether there had been any changes in the annual incentive
18 plan over the last several years, and I understand that
19 you wanted to expand on your previous answer.

20 A It wasn't so much on the annual incentive pay
21 system, but on merit pay.

22 Q Thank you for their clarification.

23 A I did recall a couple elements that I did not
24 cover in my cross-examination.

25 One is that a change this year has been that all

1 senior executives, myself included, have no merit increase
2 this year. So we have -- we have eliminated that because
3 of the financial conditions across the country. So all of
4 us who are at a certain salary grade or higher, our
5 salaries have been frozen.

6 And the other thing that we have done, which is a
7 change that I didn't remember when I was being
8 cross-examined, is that we used to have in the business
9 car allowances for certain individuals, and those have all
10 been taken away as well.

11 So there are a couple of changes. They don't go
12 across the whole company, but, you know, as I stated
13 earlier, we are tightening our belts and we are tightening
14 our belts in a number of ways. And those are a couple.

15 Q. Thank you.

16 You were asked some questions, I believe, by
17 Ms. Mitchell about the decision to invest in the White
18 Tanks plant.

19 Were there other options available to the company
20 besides investing in the White Tanks plant?

21 A. There were two. One was we would run out of
22 water, and I don't think that is -- and I probably won't
23 be sitting here today if that would happen.

24 The other option is that we could continue to
25 drill wells. We have a number of wells in Agua Fria. The

1 wells have become much more problematic. The wells are
2 being drilled deeper. A lot of them are coming up dry,
3 which means the investment in the well is lost. And we
4 are also seeing a lot more contaminants. We are seeing --
5 I describe it in my testimony -- but a number of
6 contaminants that are showing up in wells out there --
7 arsenic only being one of them -- that all require
8 treatment.

9 So we really believed -- and I still believe --
10 that the White Tanks treatment plant, for the reasons of
11 renewable source of supply and because the wells
12 themselves have become much more difficult to put in
13 service, really is a much more better holistic solution.
14 And so that is why we did that.

15 And in the long run, I think we clearly
16 established in the last White Tanks case, that in the long
17 run it's a better alternative.

18 Q. Mr. Townsley, you were asked a couple of times, I
19 think by Mr. Pozefsky, but it's about the phrase or word
20 called mothball, and I believe I used it in my opening
21 statement and it's been used in other testimony as well.

22 What do you mean -- what is your understanding of
23 what the term mothball means?

24 A. Well, a mothball could be a variety of things
25 from suspending construction right now with an uncompleted

1 plant to taking it to completion and having the plant
2 ready for service but then putting it on hold.

3 And I apologize if I was a little imprecise in my
4 description.

5 We are today probably 85 percent complete with
6 this project. We expect it to be ready for testing in
7 November or October of this year. So to me if we were to
8 not put it in service, it makes most sense for us to
9 complete the construction portion, because there is not a
10 whole a lot of money left to complete construction and
11 then to place it on standby.

12 That is really what I have intended in my
13 thinking, but as I said earlier, I just want to make sure
14 that I can evaluate all options that I have got in front
15 of me and make the decision that is most appropriate when
16 we get there.

17 Q. One last question, Mr. Townsley.

18 You and Chairman Mayes were discussing the
19 consolidation exhibit that Mr. Broderick prepared.

20 Do you remember that?

21 A. Yes.

22 Q. And was that exhibit -- I know you characterize
23 it as a scenario and that has qualifiers in it.

24 Does that apply to all customers or was that just
25 residential customers, that particular scenario? If you

1 need to refer to it again, please do.

2 A. It only applied to residential customers.

3 MR. MARKS: Thank you. That is all I have.

4 ALJ WOLFE: Thank you.

5 Is there any recross on this redirect issue?

6 Mr. Pozefsky?

7 MR. POZEFSKY: Yes.

8

9

REXCROSS-EXAMINATION

10

11 BY MR. POZEFSKY:

12 Q. Mr. Townsley, if the annual incentive program
13 provides benefits to ratepayers and shareholders alike,
14 why shouldn't the shareholders share in the costs?

15 A. I think the shareholders do share in the costs.
16 I know this Commission in the past has disallowed a
17 portion of the AIP with that intention on it and has
18 allowed a portion of the AIP to be included in rates.

19 Q. So is that what the company's position is then,
20 that the Commission should continue to disallow that
21 portion in rates?

22 A. No. My position is that we should include it all
23 in rates. But you asked me whether shareholders should
24 pay for it, and I have given you an example of what the
25 Commission has done in the past.

1 MR. POZEFSKY: Okay. Thank you.

2 ALJ WOLFE: Staff?

3 MS. MITCHELL: No, thank you.

4 ALJ WOLFE: Okay. Thank you for your testimony
5 today. We appreciate it. Mr. Townsley, you are excused
6 as a witness.

7 Mr. Marks, in your estimation, do we have time
8 for Mr. Buls, who is on the list as the next witness for
9 today? Have you got any impression from the parties as to
10 how much cross-examination there would be?

11 MR. MARKS: Yes. Your Honor, I think that won't
12 be up to me as to whether we will get through Mr. Buls
13 this afternoon; that will be up to the other parties.

14 And we had a request also to take up
15 Mr. Lenderking today, if possible. We would be willing,
16 if the schedule accommodates that today. I have already
17 checked with other counsel, and they don't have any
18 objection to it, to take Mr. Lenderking after Mr. Buls if
19 we have time today. But I have no strong feelings about
20 it one way or another. I'm just making that offer, to
21 take him out of order, if we have time today.

22 ALJ WOLFE: Would it be possible for us to have
23 Mr. Lenderking put on today and then Mr. Buls tomorrow?

24 MR. MARKS: Can you give me just a moment to
25 check?

1 ALJ WOLFE: Yes.

2 (Discussion off the record.)

3 MR. MARKS: Thank you, Your Honor. If we
4 could -- if I could beg your indulgence for a five-minute
5 break, we could take Mr. Lenderking after break, and then
6 move on with Mr. Buls either this afternoon or tomorrow
7 morning.

8 ALJ WOLFE: We will come back at 4:10.

9 (Whereupon, a recess was taken from 3:58 p.m.
10 until 4:11 p.m.)

11 ALJ WOLFE: Let's go back on the record and see
12 if we can finish up these two witnesses today.

13 MR. MARKS: Your Honor, at this time
14 Arizona-American Water Company calls Mr. Jake Lenderking
15 to the stand.

16

17 JOHN C. LENDERKING,
18 called as a witness herein, on behalf of the Applicant,
19 having been first duly sworn, was examined and testified
20 as follows:

21

22 MR. MARKS: And before I do the direct exam of
23 Mr. Lenderking, I will note that I have passed out to the
24 parties what has been marked as Exhibit A-21. It's
25 slightly different than the direct testimony that I

1 provided previously. It contains actually the changes
2 that he will be making on the stand. It's already put in
3 there for everybody. There was enough of them that I
4 thought it would be useful to hand them out to everybody.

5 So go ahead, once we are done today, and discard
6 the previous version of this, and I will have
7 Mr. Lenderking describe it on the stand.

8 Is there anyone who did not get a copy? I have
9 one extra.

10 CHMN. MAYES: Oh, I've got it.

11

12

DIRECT EXAMINATION

13

14 BY MR. MARKS:

15 Q. Good afternoon, Mr. Lenderking.

16 A. Good afternoon, Mr. Marks.

17 Q. State your name and business address for the
18 record.

19 A. My name is John C. Lenderking, although I am
20 known as Jake, at 19820 North 7th Street, Suite 201,
21 Phoenix, Arizona 85024.

22 Q. And who is your employer in this case?

23 A. Arizona-American Water Company.

24 Q. And what are your duties with Arizona-American
25 Water?

1 A. I'm water the resources manager. I oversee rules
2 and rights of our water supply in addition to water
3 conservation.

4 Q. And, Mr. Lenderking, do you have before you what
5 has been marked as Exhibit A-21, a document titled Direct
6 Testimony of John C. (Jake) Lenderking on behalf of
7 Arizona-American Water Company dated April 30, 2008?

8 A. Yes, I do.

9 Q. And was this document prepared by you or under
10 your direction and supervision?

11 A. Yes, it is.

12 Q. And I understand that you have -- that this is
13 slightly different than what was originally filed in the
14 docket, and you had a few changes that you wanted to walk
15 through with everybody to make sure that we were all on
16 the same page.

17 A. Yes, I do.

18 Q. Could you go ahead and identify the first change
19 from what was originally filed.

20 A. On page -- I believe page 5, I struck a few
21 words. Beginning on page 5, line 18, I struck the word
22 "more," on line 19, "than the first tier."

23 Q. That would be line 19?

24 A. Yes, line 19.

25 Following on page 6.

1 Q I'm sorry. There appear to be more on the bottom
2 of line 23.

3 A I'm sorry. Thank you.

4 On line 23, page 5, I also struck the word "more"
5 and the words "than the first tier."

6 Q Page 6.

7 A Page 6, starting at line 4, I struck the word
8 "additional"; the last word in the line, "compared"; line
9 5, "to the first tier."

10 Q And just so it's clear, the last clause of the
11 sentence after the comma just says, "which requires five
12 conservation measures."

13 Is that correct?

14 A Correct.

15 Q Go ahead, please.

16 A Following on line 11, again a similar change, I
17 struck the word "more" and then "than the first tier." So
18 the sentence then reads, "This tier requires ten
19 conservation measures."

20 Q Thank you.

21 A Following on line 14 I struck the word
22 "additional."

23 On line 16 I struck the word "additional" as
24 well.

25 And I believe that is all the changes to this

1 document.

2 Q And those changes are all marked in the record
3 copy of exhibit A-21, the one with the yellow sticker in
4 front of you?

5 A Correct.

6 Q And with those changes, if I were to ask you the
7 same questions today under oath that are contained in
8 Exhibit 21, would your answers be the same?

9 A Yes.

10 Q I would like you to turn to what is mark as A-22,
11 a document titled "Rejoinder Testimony of John C. (Jake)
12 Lenderking on behalf of Arizona-American Water Company
13 dated March 11 of 2009."

14 Do you have that in front of you?

15 A Yes, I do.

16 Q And was this document prepared by you or under
17 your direction and supervision?

18 A Yes, it was.

19 Q Do you have any additions, corrections or other
20 modifications to make to this document at this time?

21 A No, I don't.

22 Q And if I were to ask you the same questions today
23 that are contained in Exhibit A-22, would your answers be
24 the same?

25 A Yes.

1 MR. MARKS: With that, Your Honor,
2 Arizona-American Water Company tenders Mr. Lenderking for
3 cross-examination and moves for the admission of Exhibits
4 A-21 and A-22.

5 ALJ WOLFE: Is there any objection to A-21 with
6 the modifications?

7 (No response.)

8 ALJ WOLFE: A-21 and A-22 are admitted.

9 (Exhibits A-21 and A-22 were admitted.)

10 MR. MARKS: And just a slight housekeeping, Your
11 Honor, we are slightly out of sequence with the exhibits.
12 A-20 was reserved for Mr. Buls testimony and has been
13 already been marked for that.

14 ALJ WOLFE: Thank you. Sorry to have thrown you
15 off like that.

16 MR. MARKS: It's all right.

17 ALJ WOLFE: Mr. Miller, do you have
18 cross-examination of this witness?

19 MR. MILLER: Yes, I do have cross-examination for
20 this witness.

21

22 CROSS-EXAMINATION

23

24 BY MR. MILLER:

25 Q. Mr. Lenderking, thank you for the clarification

1 of your direct testimony that instead of five more
2 measures for each of the different tiers, it's basically
3 five measures total; is that correct?

4 A. Correct.

5 Q. And these tiers that we are talking about, these
6 are tiers of conservation measures now required by the
7 Arizona Department of Water Resources?

8 A. Correct.

9 Q. And the program that is being put forth in this,
10 would that be called the modified non-per capita
11 conservation program?

12 A. Yes, it is.

13 Q. And have you already implemented this program in
14 any of your other rate districts?

15 A. No, we have not. Our plan is to enter this new
16 program within the -- we must submit a provider profile by
17 the end of this year, and we are looking more towards the
18 end of the month, to provide a profile for each and every
19 district.

20 Q. Okay. And given the customer level number for
21 the different districts, do you know which tier the Town
22 of Paradise Valley -- the Paradise Valley rate district
23 would currently fall into?

24 A. Yes. It would be in the first tier.

25 Q. First tier.

1 And based upon your testimony, did it appear that
2 the Sun City and Sun City West districts would be in the
3 second tier?

4 A. Yes.

5 Q. And then Agua Fria is kind of on the borderline,
6 that it might be in the third tier?

7 A. Yes. It's over 30,000 connections and in the
8 third tier.

9 Q. Okay. And you projected 30,000, I believe, in
10 your direct testimony; correct?

11 A. Yes.

12 Q. And in your direct testimony you noted that
13 currently Arizona-American spends approximately \$40,000
14 per year for its Save H2O program in all three of the --
15 Sun City, Sun City West and Agua Fria -- districts?

16 A. Yes.

17 MR. MARKS: Could you provide a reference,
18 Counsel?

19 Q. BY MR. MILLER: Yes. I had it marked in the
20 summary, and I thought I noted it in the --

21 Here it is. I'm sorry. It would be in your
22 direct testimony page 5, lines 21 and 22.

23 A. Yes.

24 The question was, is Sun City West in the second
25 tier?

1 Q. No. The question is, is the amount of money that
2 is currently spent towards conservation in the three rate
3 districts, does that come to an approximately \$40,000
4 number?

5 A. Yes.

6 Q. And that \$40,000 a year would allow two of those
7 districts to meet the current tier-two requirements.

8 Is that consistent with your testimony?

9 A. Yes.

10 Q. And based upon the numbers that you have
11 projected in your testimony for customer accounts, do you
12 have an idea of what a per-customer cost is to do the
13 tier-two level programs for the districts?

14 A. No, I don't have those calculations here with me.

15 Q. If I said you had indicated in your testimony on
16 pages, I'll say, 5 or 6, that the Sun City Water Company
17 has 23,000 connections, Sun City has 15,500 -- I'm on page
18 6, line 1 right now -- and page 6 line 5, Agua Fria 30,000
19 connections, would you say that is approximately correct?

20 A. Correct.

21 Q. And if my math is correct, that is about 68,500
22 connections?

23 A. Yes.

24 Q. And if the program currently being run, which is
25 a two-tier level program or meets two-tier standards,

1 costs \$40,000 per year, then the cost for each customer
2 account would be less than \$1 per year?

3 A. Correct.

4 Q. Okay.

5 A. I did take a moment to make some calculations,
6 not based on all the customers and all the districts, but
7 I believe it comes out to be around 60 or 70 cents per
8 connection.

9 Q. Yes. That is my ballpark math as well.

10 And you also indicated on page 5 of your
11 testimony, line 5, that the Paradise Valley Water District
12 has about 4800 -- 4,800 connections?

13 A. Yes.

14 Q. Based upon that and the cost that you -- that the
15 company currently incurs in the other districts, you give
16 an estimate of what it would cost the company to implement
17 a tier-two level of modified non-per capita cost
18 participation for the Paradise Valley rate district?

19 A. Yes. I worked through a low-cost estimate that
20 brings it probably around \$1,000; although, that wouldn't
21 give it the same comparable program as our Sun City. They
22 do implement a little more or different conservation, not
23 necessarily the lowest cost, but an appropriate cost. And
24 I think to have a similar program along with the Sun
25 Cities, it would be approximately \$4,000.

1 Q. \$4,000? Okay. Thank you.

2 How is the Save H2O program paid for in the
3 Sun City/Sun City West and Agua Fria districts?

4 A. I believe it's built into the rate base.

5 Q. In rate base.

6 If Arizona-American were to implement the same
7 Save H2O program in the Paradise Valley district, do you
8 see that being the same method being used in the Paradise
9 Valley district as well?

10 A. Yes.

11 MR. MILLER: No further questions.

12 ALJ WOLFE: Thank you.

13 Mr. Pozefsky?

14 MR. POZEFSKY: I just have a few questions.

15

16 CROSS-EXAMINATION

17

18 BY MR. POZEFSKY:

19 Q. Good afternoon, Mr. Lenderking.

20 A. Good afternoon.

21 Q. I just want to clear up some of the confusion
22 that I had when I was reading your testimony with regard
23 to the contaminated water in Paradise Valley.

24 A. Okay.

25 Q. Just for some background, what had happened was

1 that one of the wells had some contamination, and it
2 required the company to seek an alternative water source
3 or to do something to secure a capital outlet.

4 Is that correct? Is that what the company did?

5 A. I'm not quite following you.

6 Q. Well, what I'm reading or referring to is on
7 page -- starting on page 6 of your testimony, your revised
8 direct testimony.

9 A. Okay.

10 Q. Under the CAP surcharge modification.

11 A. Okay.

12 Q. Are you there?

13 A. Go ahead.

14 Q. Okay. What I'm wanting to know is, the company
15 secured an allotment of CAP water for the benefit of the
16 Paradise Valley customers; correct?

17 A. Correct.

18 Q. And that was necessary because the PCX-1 well
19 that was owned by SRP became contaminated with TC;
20 correct?

21 A. No, we didn't secure the CAP water allocation
22 prior to that. That was -- when we first put it to
23 beneficial use was through an exchange with SRP to use
24 that well.

25 Q. Well, all right.

1 So that is actually how the allotment is being
2 used at this point? It's being used because there was a
3 contamination in one of the wells, and there needed to be
4 another water source. And what was done was it was an
5 exchange; is that correct? I'm trying to get the
6 background of it.

7 A. I think you have it close to correct.

8 We did exchange the water for groundwater from
9 the PTX-1 well. In January of last year we discontinued
10 the exchange and discontinued taking water from the PTX-1
11 well.

12 Q. And really what I'm trying to get at,
13 Mr. Lenderking, and I'll cut right to the chase: Is it
14 costing and will it cost -- if the company is able to
15 recover its cost, will it cost the Paradise Valley
16 ratepayers more for the CAP water than it will for the SRP
17 water, what it was before? Is there going to be an
18 additional cost involved?

19 MR. MARKS: I will object to the question. I
20 think what Mr. Lenderking has said is that they have been
21 using CAP water in Paradise Valley for some time.

22 MR. POZEFSKY: Okay.

23 MR. MARKS: So I don't think that question
24 accurately characterizes what Mr. Lenderking has said so
25 far.

1 Q BY MR. POZEFSKY: And that is fair because I'm
2 really trying to understand what the transaction was, and
3 where I am going to is -- let me give you the -- on page 7
4 of 9 on the bottom, maybe you can just expand on your
5 answer there and what the question and answer there
6 actually means so I understand it.

7 A I'm sorry. Page 7, line 10, that question?

8 Q Right, how did the company recover the costs
9 associated with its CAP water from SRP's PCX-1 well?

10 A I believe originally when we put that CAP water
11 to use through the exchange; we had an authorized
12 surcharge. I'm not sure which number it is now, but I
13 think it's been revised in time. It incorporates the cost
14 of the capital M & I charges, which is the water charges
15 each year; the capital charges that CAWCD charges us to
16 hold CAP water; and it also includes the charges that SRP
17 would charge us to make that exchange happen.

18 They had two charges, both an administrative
19 charge and a water charge. Those charges totaled -- I
20 believe I had in my testimony, and I wasn't able to
21 reference it right off -- but somewhere around \$20. I'm
22 sorry. I'm not able to find it right now.

23 I'm sorry. On page 9, line 7, the SRP cost was
24 22.62. So what we had been paying was the SRP charge of
25 22.26; that included the administrative charge and a water

1 charge. And in addition to the capital charges for the
2 CAP water, the M & I charges for the CAP water; that was
3 the total charge to use the CAP water.

4 Today our charges are the capital charges for the
5 CAP water, the M & I charges for the CAP water and an \$8
6 storage charge for the CAP water, not the 22.62 that SRP
7 charges.

8 Q That's what I needed to do know.

9 A Okay.

10 Q Thank you, sir.

11 MR. POZEFSKY: That is all I have.

12 ALJ WOLFE: Does Staff have questions for this
13 witness?

14 MS. VOHRA: Yes, we do. Thank you.

15

16 CROSS-EXAMINATION

17

18 BY MS. VOHRA:

19 Q Hello, Mr. Lenderking.

20 A Hello.

21 Q In your revised direct testimony, and I believe
22 it's the same page with the new one, beginning on page 2,
23 you briefly discuss the Arizona-American Save H2O
24 conservation program. One of the items or one of the
25 components of the program is a water conservation kit.

1 Can you please expand on what that is?

2 A. The water conservation kit has evolved over time.
3 Right now it's become two different kits, but historically
4 it's been things that help customers save water, things
5 such as leak detection tablets for toilets, bags that can
6 capture water from the fixture to measure how much water
7 is coming out of that fixture; low-flow shower heads;
8 low-flow aerators; and low flow -- I'm sorry -- hose
9 nozzle that have auto shutoff; some instruction on
10 conservation and various conservation literature.

11 Q. Okay. And in what water systems are these kits
12 provided?

13 A. They have primarily been provided in the
14 Sun City/Sun City West and Agua Fria districts because
15 those are districts that we have had --

16 Q. Okay. And can you explain how a home water audit
17 is initiated? Is it initiated from the customer or by the
18 company?

19 A. That's generally initiated by the customer. We
20 have a Save H2O web site that is a free-standing web site
21 for our conservation program where they can request it.
22 They can request it directly by phone or by e-mail.

23 Oftentimes the individual homeowner audits are
24 requested through one-on-one contact with people at an
25 event or anytime where our conservation staff is in

1 attendance.

2 A lot of the times there is a discussion about a
3 particular problem a customer is having, and this idea is
4 thrown out there and the customer takes us up on it.

5 Q Okay. Can you describe the Rinse Smart Program
6 as well?

7 A Yes. The Rinse Smart Program was a partnership
8 with the City of Surprise and ADWR in replacing spray
9 heads, the prewash spray heads for restaurants.
10 Restaurants often use the -- spray off all their dishes
11 before they put them into a dishwasher, and there is a lot
12 of food and debris. This is a more efficient spray head
13 nozzle.

14 Q Okay. And I asked this question about the water
15 conservation kits, but are all the elements of the Save
16 H2O program available in all the water systems or just in
17 Sun City, Sun City West and Agua Fria, I believe you said?

18 A We have a hard time limiting such valuable
19 information to only those districts; although, we have
20 mainly marketed them towards those districts.

21 Q Okay. So if the customer wanted, from another
22 water system, they could request a water conservation kit,
23 for example?

24 A Yes.

25 Q Okay.

1 A. We get requests from all over the state. It's
2 the unfortunate circumstance of having our web site being
3 free-standing. It doesn't tie us into an individual city,
4 so sometimes people from Avondale give us a call, and we
5 have to break the news to them. It's very hard.

6

7

EXAMINATION

8

9 BY CHMN. MAYES:

10 Q. You have to break the news to them what? That
11 they are not -- oh, that in Avondale that they aren't a
12 customer of yours?

13 But if they're a customer in Mohave County or in
14 your Mohave District, could get this.

15 A. Correct.

16 Q. But you don't market -- you don't let them know
17 proactively that they are eligible for it?

18 A. No. Today we haven't marketed this much. We
19 have in one time -- let me step back.

20 In December we published a bill insert to all
21 service areas to see how it would work in all our service
22 areas, and we had a very big response. And we did send
23 them out to all service areas in that instance.

24 Q. That is interesting.

25 If I could, because I had some of these same

1 questions, and I don't mean to interpret, but why
2 shouldn't we require this in all service territories? I
3 mean, I look at what is going on, for instance, in
4 Paradise Valley, and I think it's, frankly, willfully
5 inadequate. Paradise Valley is one of your biggest
6 water-using communities. It seems to me what you are
7 doing out there now is nothing compared to what needs to
8 happen.

9 So why shouldn't the Commission order this
10 program be adopted in every single one of your service
11 territories and aggressively marketed to all of your
12 consumers so they could benefit from it, especially since
13 apparently you got a pretty good reaction to the one time
14 you did market it?

15 A. Well, we did that part in anticipation of the
16 Commission may have such an order. We have seen similar
17 orders of water companies of late.

18 Q. From us recently?

19 A. Yes.

20 Q. You knew that we weren't going to let you just do
21 what you have in your direct testimony?

22 A. Correct.

23 Q. You knew that we don't think that DWR's rule are
24 particular -- well, we think that the company should go
25 beyond DWR's rules?

1 A. Yes. It's been my understand that you have seen
2 that ADWR has a limit in their scope to AMAs and you may
3 be reaching for additional conservation outside the AMAs
4 and anticipated planning for it.

5 Q. So you did the outreach in anticipation of maybe
6 getting this request in this case?

7 A. Correct.

8 Q. Okay. That is interesting.

9 But you didn't like propose it in this case?

10 A. No. At that point my testimony was already
11 written and submitted. We submitted quite a while back,
12 and in the last two months I have noticed.

13 Q. Well, it's a good to know that there is a reason
14 for me being here, that I'm still relevant, as one
15 politician once said.

16 So that is good. So the company wouldn't have a
17 problem with seeing this adopted in other service
18 territories?

19 A. Yes. Yes, we would like to adopt more
20 conservation around the state. We agree and yet disagree
21 with what you say about the department and their -- about
22 ADWR and their conservation program. They are limited in
23 scope, and I do agree with you that we could implement
24 some of these conservation measures outside of AMAs.

25 Although, I do disagree that, as seen by some of your past

1 decisions, to expand heavily on what DWR's elements are, I
2 believe their program is well put together with a large
3 group the stakeholders, water users, conservation experts,
4 and compliance experts and try to work through the
5 appropriate number of tiers or BMPs for each district.

6 So such that if we were to expand this
7 conservation program, we would expand it within the rules
8 of ADWR.

9 Q Well --

10 A Outside of the AMAs. I'm sorry.

11 Q Okay. I'm trying to understand what that means.
12 You mean in terms of --

13 A For instance, if Mohave was to enter the program,
14 it would be -- if it was in an AMA, it would be under the
15 regulation of DWR to implement five additional
16 conservation measures. I believe that would be
17 appropriate for the size and scope of that system.

18 Q Well, DWR doesn't require them to do -- I think
19 they are only required outside of an AMA to do one, if
20 any; correct? They are at 0.10 or 1 something; right?

21 A Correct. Their conservation program is different
22 outside of the AMAs.

23 Q It's like nil outside of AMAs?

24 A Yes. The non-per capita conservation program
25 doesn't apply outside the AMAs at all, but if we were to

1 take that program and apply it outside of the AMAs --

2 Q. Then it would be five for Mohave?

3 A. Yeah.

4 Q. So what you're arguing is -- what you are saying
5 is if the Commission were to do, in these cases, what we
6 have been doing, which is going beyond DWR's requirement,
7 at least, in terms of inside and outside AMAs, you would
8 like it to still be five?

9 A. Correct.

10 Q. And this water conservation kit and the home
11 water audits and the Rinse Smart Program, are those -- are
12 these -- is it your view that the Save H2O program would
13 meet one of the BMPs or would it meet -- or would the
14 individual elements within it meet the ten and up to the
15 BMPs?

16 So, for instance, the kits would be 1 BMP. The
17 home water audits would be 1 BMPs or is the whole program
18 a BMP?

19 A. The program would be ten and up, the multiple
20 BMPs.

21 Q. Okay. And it strikes me that elements within
22 this program are precisely what we want to see happen, and
23 why we have gone beyond DWR's requirements on some of
24 these, for some of these systems because some of the
25 requirements simply would allow, you know, a company to

1 send out a leaflet and say, hey, it's a good idea to
2 serve. But the Save H2O Program to me seems to have
3 actual physical conservation measures.

4 Would you agree with that?

5 A. Correct.

6 Q. Would you agree with that?

7 A. Yes, I do.

8 Q. Okay. And then the home water audits, you say
9 those are initiated by the customers.

10 Wouldn't it be a better idea to have the company
11 initiate those?

12 A. We offer those through the web page. We don't
13 knock on doors, I guess. We put it out there that they
14 can request them.

15 Q. What would be wrong on knocking on doors? I ask
16 that question because in terms -- there are some states
17 now that are doing precisely that in the area of energy
18 efficiency. I mean, California utilities are going door
19 to door and offering energy efficiency services to their
20 consumers.

21 A. We are exploring the possibility of doing
22 something similar to that actually. We currently have a
23 program where if a customer calls about a high bill, we
24 can go out and read their meter. If we observe that their
25 water usage, through an algorithm, is higher than it

1 should be for their customer class -- or I'm not entirely
2 sure of the mechanism -- but we will go and reread the
3 meter and see if we had a mistake.

4 We are currently looking at how much staff time
5 and how much money it would take to add more conservation
6 elements to that.

7 Yes, we came out -- here is an example. If we
8 went out and read someone's meter and we did discover it
9 was high and they did use a lot of water, we will take our
10 responsibility maybe past that meter. As a water company
11 our responsibility is up to the meter. We know they use
12 this much water, and now we may go past that meter and
13 say, we observed that you use a lot of water and it's
14 really unusual this month. Maybe you have a leak. Here
15 are some conservation information. Here is a contact
16 person that can come out and perform a home audit, if you
17 would like.

18 I think that is where we would actually be
19 knocking on doors, on individuals that fit certain
20 criteria.

21 Q. So you are looking at that right now?

22 A. Yeah, trying to explore the cost and the staff
23 time that it may take. I think we will have to set
24 benchmarks for how many and what range of customers we can
25 offer this to because it could prove to be very

1 burdensome.

2 I believe it's something we are going to
3 implement, but we are in the designing phase of that
4 program.

5 Q For all of your systems or are you looking at
6 specific systems?

7 A I think we could participate in that for all of
8 our systems.

9 Q Okay. Do you know what or when you believe the
10 company will have those estimates? What is the ETA on
11 that?

12 A I'm not certain. I would like to know by the end
13 of the month myself for entering into the municipal
14 program with DWR for our systems that are within the AMAs,
15 but there are certainly programs and programming reports
16 and algorithms to pull that data out of our database so
17 that we can appropriately target the customer. I'm not
18 sure of the time frame for the development of those.

19 Q Okay. And just while I'm at it, would the
20 company oppose the Commission if it decided to go to
21 require the company to go beyond the DWR MMP, CCP or
22 otherwise known as Best Management Practices program in
23 terms of the number of BMPs that are required both inside
24 and outside of an active management area?

25 A My short answer to that is yes and no. The

1 districts, like Paradise Valley, which are on the edge and
2 have the need for attention, I think implementing five
3 BMPs there instead of one would be appropriate.

4 In other districts, such as Mohave or Tubac or
5 Havasu, where they are very small systems, implementing
6 additional conservation may prove to be very burdensome
7 and very much more costly where we don't have a lot of
8 staff. Particularly Tubac, we could do some more outreach
9 through mail and other things, but we don't have a lot of
10 staff there, and travel time to get there is difficult.

11 Q. Okay. In terms of Paradise Valley, you say
12 implementing five BMPs instead of one would be
13 appropriate.

14 Under DWR's rules right now they would only have
15 to do one?

16 A. Correct. The tier breakdown is up to 5,000
17 connections it's one BMP. Paradise Valley has just under
18 5,000 connections. It's a hard line.

19 Q. I mean, that is crazy. One BMP for this system
20 in Paradise Valley is just crazy.

21 A. I think when the program was being evaluated and
22 developed, it wasn't looking at a water system that was
23 being operated by a large utility, such as
24 Arizona-American. It was the one small company out in
25 Western Arizona that might have 3,000 connections and has

1 four employees.

2 Q It didn't envision a water system that is being
3 managed by essentially a national corporation?

4 A Or the more modest Arizona-American.

5 Q Which has a parent company that is national.

6 Okay. But I think you also say in your testimony
7 that you don't have to do any more in Paradise Valley than
8 you are already doing; is that correct?

9 A Correct.

10 Q Then why shouldn't we asked you to go beyond five
11 BMPs?

12 A Moving up to five we would be implementing a
13 little bit more conservation.

14 Q A little more conservation?

15 A A little more conservation in Paradise Valley.
16 We would be moving into the --

17 Q Don't you think we should be doing a lot more
18 conservation in Paradise Valley? This Commission -- we
19 already backtracked from the high block surcharge, and we
20 already backtracked in Paradise Valley because we were
21 asked to by the consumers and the Town, which originally
22 wanted it, all of this stuff. And now you are saying only
23 a little bit more conservation is needed in Paradise
24 Valley, where we persistently hear of tens of thousands of
25 gallons of water being used per month by some customers,

1 which give all the customers a bad name, quite frankly.

2 A. I believe that moving into having five BMPs would
3 have us provide a little bit more conservation. I'm not
4 speaking to the need of more or less conservation.

5 Q. But I want you to speak to the need. Am I right?

6 Who uses more water, the Sun City customer or your
7 Paradise Valley customers?

8 A. I believe our Paradise Valley customers.

9 Q. By how much?

10 A. A significant amount.

11 Q. Like what?

12 A. I'm not able to quantify that, but it's
13 significant.

14 Q. And yet Sun City has a more robust conservation
15 program than Paradise Valley?

16 A. There are different elements to conservation and
17 different philosophies on it.

18 A few of them would be cost benefit, what does it
19 cost to provide the conservation services versus the
20 benefit to the system or the overall ratepayers.

21 There is a few others, and that is the individual
22 customer's desire for conservation. The cost benefit --
23 I'm trying to find a good way to go about this.

24 I'll use an example, if I could.

25 A lot of the time real robust conservation

1 programs are built around declining water supplies or
2 problems with the water supply. If you take the Southern
3 Nevada Water Authority, for example, if you are at all
4 familiar with their conservation program, it would be in
5 one word described as robust. Their conservation program
6 pays, I believe, millions of dollars out to customers in
7 rebates and other things, but they are also faced with a
8 future of inevitable chronic water shortages.

9 Q You don't think Arizona-America is?

10 A We have a different set of rules that have
11 allowed us to progress differently. Most of our new
12 subdivisions --

13 Q Do you think we are in a drought? Do you think
14 Arizona has a long-term water supply issue?

15 A We are in a drought, and we do have a long-term
16 water supply issue. Although, we have a lot of able water
17 supply managers, water resource managers, and conservation
18 experts, which has really helped us in our state, but we
19 haven't had to take heavy-handed and expensive measures.

20 A lot of the conservation that you see where it
21 does have a cost benefit, where you're basically buying
22 the water back from the customer, you are buying that at a
23 very, very expensive rate through rebates.

24 Q Let's go back real quickly, and I will turn it
25 back over to Staff.

1 But in term of cost benefit, wouldn't the
2 Paradise Valley customers have a higher cost estimate
3 associated with water conservation if the water use is
4 higher there than it is in Sun City?

5 I mean, couldn't -- I'm trying -- this is all
6 again -- again, this is stuff that benefits consumers.
7 They are the ones that have to pay these rates. And, of
8 course, it benefits the company. But the consumers are
9 the ones who benefit the most for water conservation
10 measures.

11 A. I believe our conservation program needs to try
12 to strike a balance between what the individual consumers
13 get and what we will end up expending through the
14 conservation program. We can, and most likely will be,
15 implementing more conservation through the new BMP
16 program. Through DWR it will be easier to implement more
17 through more districts, such as bringing PV to the fifth
18 tier.

19 But going a lot further than that, if our costs
20 start to go up dramatically, we may not see the benefit
21 for all the customers, only the ones that are
22 participating in the program.

23 Q. Okay. So everybody is on notice, I don't think
24 five is enough for Paradise Valley, and I'm not sure it's
25 enough in the other districts as well. But that has

1 been -- that is pretty par for the course for me, and I
2 think you will probably see, if it's not in the order, in
3 an amendment from me, when the recommended opinion comes
4 out.

5 But thank you, and I will turn it back over.

6 ALJ WOLFE: Mr. Vohra.

7 MS. VOHRA: Yes. You covered a bit of my
8 questions, Chairman.

9

10 CROSS-EXAMINATION CONTINUED

11

12 BY MS. VOHRA:

13 Q Just one question relating to the Chairman's line
14 of questions, and she may have asked it and I missed the
15 answer.

16 What conservation measures is Arizona-American
17 taking in the Paradise Valley district?

18 A We have been offering home water audits there.
19 We did offer the home water kits -- the water conservation
20 kit. And we are looking into doing additional thinking
21 there as well, such as school assembly programs and
22 participating in other water forums, such as Water, Use it
23 Wisely.

24 Q And has Arizona-American met with the Town of
25 Paradise Valley to discuss any further conservation

1 measures?

2 A. Yes, we have.

3 Q. Okay. And what's the result of that meeting?

4 A. We met several times. Initially we met
5 discussing a new kind of tariff, which was originally
6 proposed in Mr. Tom Broderick's testimony. And there
7 were -- it was really early on, and it was a lot more
8 development to do that. There were some issues with that,
9 and we are not sure that will work.

10 But in subsequent meetings, I believe, we have
11 come down to the general concept that additional
12 conservation education would benefit the citizens of
13 Paradise Valley.

14 Q. And moving on to the active management area
15 designation, although Mohave and Havasu systems aren't
16 located in the Arizona Department of Water Resources AMA,
17 does Arizona-American implement any of the Save H2O
18 conservation programs in any of those systems?

19 A. Yes, we have always offered and had everything on
20 the web site. Recent times we did implement the bill
21 insert to all customers, which offer the home water -- the
22 conservation kit to everybody, and they participated in
23 that.

24 Q. Okay. And in your revised direct testimony you
25 discuss, beginning on page 6, I believe, that -- you

1 discussed that Paradise Valley CAP surcharge modification
2 and the current storage solution that Arizona-American has
3 found at the Tonopah Desert Recharge Project, I believe.

4 Is Arizona-American any closer to finding a
5 specific alternate storage location for its CAP
6 allocation?

7 A. Yes. We have identified several different places
8 that we could store or possibly otherwise use our CAP
9 water. Two of the close storage places are the SRP GSI
10 and the SRP groundwater -- Granite Reef underground
11 storage project, both of which would be unavailable this
12 year because of other water supply issues, should we have
13 already been able to store water.

14 In other words, both of those projects, because
15 of the robust supplies on the Salt and Verde Rivers this
16 year, are unavailable. Those storage projects aren't
17 actually storing water this year.

18 Q. I see.

19 I just have one final question. This is
20 regarding your rejoinder testimony, in which you responded
21 to Mr. Magruder's testimony regarding A.R.S. 45-454 and
22 the Assure Water Supply designation.

23 You explain that Arizona-American's Tubac Water
24 District does not have such a designation. And you also
25 state that ADWR is in the process of developing new

1 assured water supply rules.

2 Once those rules are published, will
3 Arizona-American be seeking an assured water supply
4 distinction for its Tubac Water District?

5 A. It is something we will definitely further the
6 exploring.

7 Because of the nature of the rules and the
8 complexity of that basin, the Santa Cruz AMA, there are
9 likely obstacles and costs that may make it not effective
10 or able for us to become designated there, but we will
11 definitely pursue it.

12 MS. VOHRA: Thank you, Your Honor. I have no
13 further questions.

14 ALJ WOLFE: Thank you.

15 And I believe that you answered Commissioner
16 Kennedy's questions in the course of answering
17 Commissioner Mayes' questions and the Staff questions.

18 Do you have redirect for this witness, Mr. Marks?

19 MR. MARKS: I have no redirect, Your Honor.
20 Thank you.

21 ALJ WOLFE: Thank you very much for your
22 testimony today, Mr. Lenderking. You are excused as a
23 witness.

24 And I don't think we will have any more witnesses
25 today. Tomorrow we were scheduled to meet in Room 100.

1 There is really not very much room in there, and because
2 we have moved through our witnesses so quickly, we are
3 just going to not meet tomorrow. We will meet on
4 Wednesday the 25th, and we will begin with -- well, it's
5 your choice, Mr. Marks, whether you want to begin with
6 Mr. Herbert or Mr. Buls.

7 MR. MARKS: I think if Mr. Herbert can hang -- I
8 don't know what his airline requirements are. Assuming he
9 can stay for a little while, we will start with Mr. Buls
10 and then take Mr. Herbert.

11 ALJ WOLFE: Okay. And then go ahead with
12 Ms. Gutowski after that and Ms. Hubbard?

13 MR. MARKS: Yes.

14 ALJ WOLFE: And that will be all your witnesses,
15 unless you want to bring any back for rebuttal; correct?

16 MR. MARKS: Correct.

17 ALJ WOLFE: And then we would also have the rate
18 design witnesses for RUCO and Staff. We will try to get
19 to those on Wednesday as well. Okay?

20 Is there anything, any procedural matters anyone
21 wants to cover today?

22 (No response.)

23 ALJ WOLFE: We will see you at 9:00 a.m. on
24 Wednesday in this room. Thank you.

25 (TIME NOTED: 4:56 p.m.)

1 STATE OF ARIZONA.)
) ss.
 2 COUNTY OF MARICOPA)

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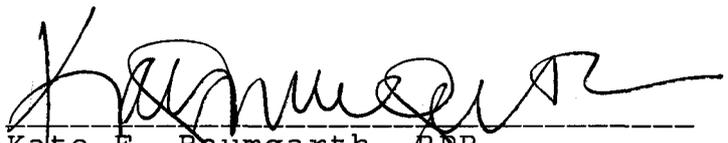
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I, KATE E. BAUMGARTH, RPR, Certified Reporter
 No. 50582, for the State of Arizona, do hereby certify
 that the foregoing printed pages constitute a full, and
 accurate transcript of the proceedings had in the
 foregoing matter, all done to the best of my skill and
 ability.

WITNESS my hand this 7th day of April, 2009.


 Kate E. Baumgarth, RPR
 Certified Reporter, No. 50582