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Transcript Exhibit(s)

Docket #(s): SW-02361A-08-0609

Exhibit # : A1-A15, Doelle1-Doelle3, BHOA1-BHOA5, Carefree1, R1-R5

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To: Docket Control / ATTN: Michelle
Via facsimile 602-364-0644
**All original exhibits detailed below were filed with Docket Control today.

Date: November 30, 2009 PAGE 1 of 2

Re: Black Mountain Sewer / Rates
SW-02361A-08-0609
Volumes I through IV, Concluded
November 18 through 25, 2009

STATUS OF ORIGINAL EXHIBITS

FILED WITH DOCKET CONTROL

Black Mountain Sewer (A Exhibits)

1 through 15

Dennis Doelle (Doelle Exhibits)

1 through 3

Boulders HOA (BHOA Exhibits)

1 through 5

Town of Carefree (Carefree Exhibits)

1

Residential Utility Consumer Office (RUCO Exhibits)

1 through 8

Staff (S Exhibits)

1 through 9

Copy to:

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Mr. Kevin O. Torrey, Staff
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-_____

DIRECT TESTIMONY OF

GREG SORENSEN

December 19, 2008

EXHIBIT
A-1
ADMITTED

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I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Greg Sorensen. My business address is 12725 W. Indian School Road, Suite D-101, Avondale, AZ 85392.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. On behalf of the Applicant Black Mountain Sewer Corporation ("BMSC" or "Company").

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Algonquin Water Services ("AWS") as Director of Operations for the Western Group. AWS is an affiliate, through common ownership, of BMSC and BMSC's parent, Algonquin Water Resources of America, which is ultimately owned by the Algonquin Power Income Fund.

Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES IN THESE POSITIONS?

A. I oversee the operations and business management functions for AWRA's utility holdings in Arizona. AWS manages and operates 17 utilities in Arizona, Texas, Missouri, and Illinois and operates several others. I have the responsibility for the daily operations of all the Arizona utilities, for the financial operating results for each utility, for capital and operating cost budgeting, for rate case planning and oversight and rate setting policies and procedures as they relate to the operations under my responsibility.

Q. WHAT IS YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND BEFORE GOING TO WORK FOR AWS?

A. I received a Bachelor's degree in Accounting from Wake Forest University in 1993. I worked for Arthur Andersen as a staff and senior auditor for 5 years, after which I was a Director of Financial Reporting & Analysis, Controller, and VP

Finance for Excel Agent Services, an international call center company. I am a Certified Public Accountant in the State of Georgia (license # CPA017709). I have worked for AWS since November 2005 in the capacity of Controller and Director of Operations.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE COMMISSION?

A. Yes, I have testified in Commission proceedings involving Litchfield Park Service Company (LPSCO), Gold Canyon Sewer Company, and Northern Sunrise and Southern Sunrise water companies. These aforementioned entities are all affiliates of BMSC.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. To support BMSC's application for rate relief. Specifically, I will provide background on the Company and its operations. I will also discuss the recent improvements to BMSC's wastewater treatment facilities. Finally, I will address certain aspects of the relief being requested in this case.

II. SUMMARY OF SIGNIFICANT SYSTEM IMPROVEMENTS SINCE THE LAST TEST YEAR.

Q. WHAT IMPROVEMENTS HAS BMSC MADE SINCE ITS LAST TEST YEAR ENDED ON DECEMBER 31, 2004?

A. In our last rate case, the Commission ordered BMSC to undertake remedial measures to address odors and odor complaints within the service territory. Decision No. 69164 (December 5, 2006) at 42-43. Two specific remedial projects were discussed in the Commission Order—the CIE Lift Station and odor control measures for one or more collection mains in the Boulders community. *Id.* As reflected in BMSC's numerous compliance filings, we have achieved compliance with these orders.

Q. HOW DID BMSC ADDRESS THESE ODOR CONCERNS AND WHAT IMPROVEMENTS WERE MADE IN COMPLIANCE WITH DECISION NO. 69164?

A. In Decision No. 69164, we were ordered to remove the CIE lift station. This removal was completed on or around May 31, 2007. The project eliminated the odors in that area that were the source of many customer complaints over the years. However, the removal of this lift station necessitated other related projects to allow the continued collection and transmission of sewage to the wastewater treatment plant. First, a bypass of new sewer lines had to be constructed to convey the sewage. Since a new subdivision was being developed to the west of the Carefree Inn Estates subdivision, the Company was able to work with that developer and accelerate his construction timing so our new lines could tie into his. This effort allowed the Company to only lay an additional 440 feet of line as a bypass, instead of the approximate 1,400 feet it would have otherwise taken to go around his development. This saved the Company and its ratepayers an estimated $80,000.

Also, the system was originally designed to have the sewage pumped from the Commercial Lift Station to the CIE Lift Station, and then to the high point in the collection system at Boulders Drive. However, in removing the CIE Lift Station, the Commercial Lift Station had to be upgraded to safely and adequately pump the flow to Boulders Drive. This necessitated higher pressure pumps, modifications to the electrical service, and a new standby generator so that the Commercial Lift Station would be in compliance with current Maricopa County Code for electrical redundancy. During much of this work and over the course of four months, temporary pumps were utilized to allow continuous pumping of sewage.

Q. WHAT ABOUT THE ODOR CONTROL MEASURES THAT WERE ORDERED?

A. Decision No. 69164 required BMSC to follow one of two of the Town of Carefree's recommendations to mitigate the odor problems that existed in the Boulders community. We referred to this as the Boulders Drive odor issue, as this street was the primary area of odor complaints by our customers and in testimony before the Commission. The Town's two recommended courses of action were to either replace the gravity flow lines with force mains, or install fans and carbon filters to create a negative pressure filtration system within the sewer lines. The Company's consultants concluded that neither of these two recommendations was practical. The first would have required a total reconstruction of the sewer system under Boulders Drive, including equipping each and every connection with its own pump and force main to feed into the main pressure line. Additionally, our consultants concluded that during periods of light flow, septic conditions could likely occur within the lines causing additional odors and defeating the purpose of the entire project.

The second proposed solution was determined to not be practical. While correctly assuming that creating negative pressure in the collection system would help contain odors, it was concluded that a single fan and carbon filter station would be ineffective. The concept would instead require fans and filters to be installed at four separate locations. This would have resulted in significant capital and ongoing operations and maintenance costs.

Q. SO WHAT DID BMSC DO?

A. Our consultants' alternative recommendation, which was unanimously accepted by all the parties, was to install air-jumper pipelines between the manholes up and downstream of the surcharging locations. This pipeline allows the air to flow with

the sewage and stop it from being pushed into the atmosphere. These air-jumper pipelines were installed between manholes at four locations along Boulders Drive, thus directing the odorous air to flow to the plant, where it was treated.

Then, while performing the Boulders Drive project, it was brought to the Company's attention that neighboring Quartz Valley Court homes were also experiencing odor issues emanating from our collection system. BMSC fully investigated the complaints and found them to be valid. BMSC commissioned a topographical survey that revealed that the sewer lines along Quartz Valley Court had a negative slope, draining back toward the homes. Further investigation showed that when the sewer system was built the line was not put as deep as required at that location. Additionally, Quartz Valley Court's sewer lines were routed to a junction manhole that also intercepted flow from all of Boulders Drive causing that junction manhole and Quartz Valley Court lines to be continuously surcharged, except perhaps during periods of very low flows. That junction manhole was found to be the source of the odors about which the residents were complaining.

Q. HOW WAS THIS REMEDIED?

A. A new sewer line and grinder pump station were constructed to permit sewage from Quartz Valley Court to flow freely. The depth and location of the new grinder pump station were determined based on a seismic refractive survey that determined the depth and hardness of the subsurface rock, significantly reducing construction costs.

Q. HAS BMSC BEEN SUCCESSFUL IN MINIMIZING ODORS AND NOISE FROM ITS OPERATIONS?

A. Overall, I believe the odor reduction projects have been a success. This CIE Lift Station removal and sewer line re-routing project went very well. I do not recall a

single odor or noise complaint from the surrounding neighbors since this project was completed in 2007, following some minor commissioning issues. The Boulders Drive, and resulting Quartz Valley Court, sewer line projects have had a very positive reduction on the odors detected in the areas leading to the sewer plant within the Boulders subdivision.

BMSC undertook several projects in an effort to further reduce fugitive odor emissions from the treatment plant itself. We purchased, reconditioned and installed an odor scrubber from an affiliate, LPSCO, which draws air from the influent lift station and scrubs it prior to discharge. The process has been a very successful and cost efficient solution. Additionally, we have placed heavy rubber mats over grate openings which cover the treatment basins, and installed air louvers to seal off the headworks, both of which reduce fugitive odors escaping from these locations. Additionally, at the request of the Boulders HOA, and after discussions with neighbors in the immediate area of the plant, we commissioned a noise study aimed at determining the source of certain noises that were alleged to be emanating from the plant during evenings and early morning hours. Based on this third party study, several projects aimed at reducing plant generated noise were implemented and all resulted in positive results.

Q. BUT THE ODORS HAVE NOT BEEN FULLY ELIMINATED?

A. While there has been significant progress in reducing fugitive odors and noise both at the plant and throughout the collection system, the plant and collection system are fairly old, and there continue to be occasional minor odors events. The Company continues to meet regularly with Town of Carefree officials and representatives from the Boulders HOA and other local community representatives in an effort to maintain effective communications and timely address concerns. BMSC responds quickly to all reports of odors. We have worked with the Town of

Carefree and City of Scottsdale to enforce commercial grease trap cleaning requirements and to implement a fats, oils, and grease disposal program to reduce sewer dumping of these wastes. These have greatly reduced the amount of odor-causing grease buildup within the collection system.

Additionally, we have investigated and tested the addition of various chemical additives into our collection system aimed at reducing odors in the sewer lines. We tested and had some initial success with Thioguard. We have now moved to injecting CBA (calcium hypochlorite) at our lift stations, also with very positive results. While still not perfect, we have a much better plant, collection system, and community relationships than we did just a few years ago. I believe all stakeholders will attest to that.

Q. IS BMSC MONITORING FOR ODORS?

A. Yes. The Company installed four Odor Loggers at the plant in May 2008 to detect, measure and record hydrogen sulfide (H2S) levels. H2S is the primary cause of offensive odors and is also an easily detected and measured indicator that signals the possible presence of other odiferous gases. Since installation of the devices, there have only been two notable odor events recorded, both of which were concurrent with maintenance work on the plant's aeration system. Each of these lasted for only a short period of time. Finally, since the conclusion of the Company's last rate case in December 2006, BMSC has had only one inspection by MCESD, as these are usually triggered by complaints. That inspection noted only one minor deficiency and indicated no NOVs. The noted minor deficiency was a signage issue where the requirement to show the owner's emergency contact information was deemed inadequate. This was promptly corrected.

Q. HAVE THERE BEEN OTHER SIGNIFICANT IMPROVEMENTS TO THE SYSTEM?

A. Yes. We acquired an additional 81,049 gallons per day (gpd) of treatment capacity from the City of Scottsdale at a cost of $486,294.

Q. WHY DID BMSC NEED ADDITIONAL TREATMENT CAPACITY?

A. In January, February, and March of 2005, we experienced high flow levels in our collection system, which were in turn directed to the City of Scottsdale. Average daily flows directed to the City of Scottsdale for treatment during those months were approximately 382,000, 678,000, and 433,000 gpd, respectively. As of that time, we had purchased only 318,951 gpd of treatment capacity from the City. The City of Scottsdale, per our agreement with them, had the right to require us to purchase additional capacity to cover the higher flows. The City demanded that we purchase an additional 181,049 gpd at a cost of approximately $1.1 million.

Q. THAT IS A LOT MORE THAN WHAT BMSC PAID FOR ADDITIONAL CAPACITY. WHAT HAPPENED?

A. We performed a collection system infiltration analysis to determine sources of believed significant infiltration. As a result of this analysis, approximately 3,100 feet of slip-lining of particularly bad portions of our collection system was performed. We also repaired some cracks in manholes, which reduced H2S emissions from the collection system. The combined cost of the analysis and resulting project was approximately $135,000. After discussing this with the City of Scottsdale, they agreed to reduce the additional capacity amount by 100,000 gpd, thus saving the Company, and in turn our ratepayers, $600,000. We now have 400,000 gpd of purchased capacity, which is in my opinion used and useful in the provision of service to our existing customers.

Q. HAVE THERE BEEN ANY OTHER SIGNIFICANT PROJECTS SINCE THE LAST TEST YEAR?

A. Yes. In the late summer of 2007, we experienced an electrical system failure at our Indian Rock Lift Station, which in turn caused failure of the pumping equipment. To improve the reliability of the facility, (1) new submersible Flygt pumps were installed on stainless steel guide rails to permit rapid removal and eliminate confined space entry issues, (2) the electrical system was brought up to current standards including replacement of the electrical panel, (3) a digital auto-dialer alarm was installed to alert operators of developing problems, and (4) new discharge valves and piping were installed. This improved the overall reliability and maintainability of the lift station. During this rehabilitation process, sewage had to be intercepted and bypassed so contractors could safely work within the lift station. This project's total cost was approximately $195,000 and was completed in the spring of 2008.

Q. ARE THERE INCREASED OPERATING EXPENSES ASSOCIATED WITH THESE PLANT IMPROVEMENTS?

A. We don't know yet. There is certainly maintenance of the new generator required at the Commercial Lift Station, which was necessitated by the CIE project ordered by the Commission. There will be costs associated with replacing the carbon in the odor scrubber obtained from LPSCO in June 2008, which aren't reflected in the test year since a carbon change-out didn't occur in that time period. For now, to the best of my knowledge, all other material operating expenses incurred in relation to these plant improvements are reflected in the Company's test year operating expenses.

Q. HOW MUCH OF THE RATE INCREASE SOUGHT IN THIS APPLICATION RESULTS FROM THESE SIGNIFICANT PLANT IMPROVEMENTS?

A. The CIE project and Boulders Drive projects, as ordered by the Commission, cost $686,000 and $319,000, respectively and result in an approximate 21.7% increase, or $9.90 per month for a residential customer. The Quartz Drive Odor project cost $220,000 and results in an approximate 4.8% increase, or $2.18 per month for a residential customer. The additional capacity required to be purchased from the City of Scottsdale and the infiltration/slip lining project (to reduce the amount of capacity purchased) cost $486,000 and $135,000, respectively, and result in an approximate 13.5% increase, or $6.15 per month for a residential customer. Finally, the Indian Rock Lift Station rehabilitation and upgrade cost $195,000 and results in an approximate 4.3% increase, or $1.95 per month for a residential customer. In aggregate, the above projects cost $2,041,000 and will increase a residential customer's monthly bill by 44.3%, or $20.18.

III. MISCELLANEOUS ISSUES.

Q. YOU MENTIONED IMPROVED RELATIONS WITH CUSTOMERS AND THE TOWN. PLEASE EXPLAIN FURTHER.

A. During the process of the last rate case, it became very apparent to Bob Dodds and me that we, as a Company, had failed to achieve a proper level of communication with our customers, neighbors, and the community as a whole. Since that time, I believe we have become a much more responsive service provider. We have a better understanding of our customers' needs and concerns, as a result of their heightened awareness of odor and noise issues. We now hold meetings at least every other month with members of the Boulders HOA, and Town of Carefree officials including the Mayor, Town Administrator, and sometimes, a member of

the Town Council. Bob Dodds or I attend these meetings, along with Charlie Hernandez, Dan Schanaman, and usually at least one of our operators.

These meetings are an opportunity for the parties to express concerns, address questions, provide feedback, and offer suggestions for improvement. We have an opportunity at these meetings to communicate upcoming projects which may affect the Town or our customers, or we can communicate what we are doing to reduce odor or noise within our system. So, the level of communication has increased greatly over the past couple of years, and I believe the Company is well on its way to being a good community member and a partner with its customers and the Town.

Q. WHAT IS BMSC'S COMPLIANCE STATUS?

A. To the best of our knowledge, we are currently in total compliance with the requirements of the Commission, ADEQ and Maricopa County. Since the last rate case, we had one incident of note.

On November 13, 2007, we had a spill at our Commercial Lift Station. This spill was caused initially by an APS power failure, losing one phase on the three phase system. The phasing caused the main pump motor to burn out, which in turn led to the lift station and manhole overflowing. The wetwell overflowed into the dry well, flooding the electrical panel and controls, so the secondary pump would not come on as programmed. The call-out alarm did not work as the phone signals had been changed from analog to digital without notification, but the device was analog.

The next day, the lead operator discovered the situation and began control, notification, and clean-up efforts immediately. We notified both ADEQ and MCESD as required. We also notified Commission Staff as a courtesy. A spill report was issued to ADEQ and MCESD, who are the authoritative entities on this

matter. No Notice of Violation (NOV) was issued as the incident was properly handled. Representatives from the ACC and MCESD also inspected the situation, and issued no report. Regrettably, however, during our internal investigation of the matter, it was discovered that an operator should have done his inspection rounds on the day of the initial incident, but didn't inspect the lift station. While this may not have prevented the spill, it would have detected the spill earlier. This employee was terminated.

Q. CAN MORE INCIDENTS LIKE THIS BE EXPECTED?

A. While the Company has made great strides in improving the collection system, the treatment plant, and its community relationships, this is an active sewer system and occasionally, as with any active sewer system, there are upsets in the process. But we will continue to make every reasonable effort to minimize the impact of our system on the community it serves.

Q. ARE THERE ANY OTHER MATTERS YOU WOULD LIKE TO DISCUSS?

A. Yes. Currently, the Company does not have a Pretreatment tariff. These tariffs better allow the Company to regulate and maintain the quality of influent within its CC&N. The tariff, as proposed, would greatly assist us in our fats, oils and grease (FOG) program, which in turn reduces sewer line plugs and odors, which benefits the community. Additionally, improving the quality of influent could reduce the BOD of the sewage which we bypass to the City of Scottsdale for treatment. One component of the price the City of Scottsdale charges is based on BOD levels in the influent. A reduction in influent BOD could lead to reduced costs to the Company, and in turn the ratepayers. The Company is requesting a Pretreatment Tariff be authorized in this case, in a similar form to the one recently proposed for LPSCO, and a copy of this proposed tariff is attached to my testimony as Exhibit 1.

Additionally, the Company is also requesting approval for a new hook-up fee or HUF tariff.

Q. ARE THERE ANY OTHER PROPOSED ADJUSTMENTS TO YOUR TARIFF?

A. Yes. During the Company's last rate case, it was decided that the Company did not need a Hook-up Fee (HUF). Since that time, the Company has become very aware of the Commission's desire that "growth pay for growth," and realized that the reinstatement of a HUF would be proper to help further that goal and reduce the burden upon our existing customers. Future treatment capacity requirements must be either purchased from the City of Scottsdale, or a new plant will need to be constructed before 2016 when our current capacity agreement with the City expires. This capacity could be very expensive, and we believe a portion of that burden should be borne by new development. Mr. Bourassa will address the details of the proposed HUF in his direct testimony.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

Black Mountain Sewer Corporation Application

Direct Testimony Of Greg Sorensen

Exhibit 1

BLACK MOUNTAIN SEWER CORPORATION

PRETREATMENT STANDARDS TARIFF

EXECUTIVE SUMMARY

Black Mountain Sewer Corporation ("BMSC" or "Company") hereby declares that the following Code of Practice has been prepared and adopted to provide for pretreatment standards in the maintenance and operation of wastewater treatment at the Company's Palm Valley Wastewater Treatment Facility ("WWTF"). This Code of Practice shall be filed with the Arizona Corporation Commission and made part of BMSC's Wastewater Service Tariff, Part Four, Section I.B [Waste Limitations].

BMSC hereby expressly reserves the right to make any lawful addition and/or revisions in this Code of Practice when and as they may become advisable to properly manage the WWTF and to promote the peace, health, safety and welfare of the customers that will be served. This Code of Practice is supplementary to, and are not to be construed as, any abridgement of any lawful rights of the Company as outlined in the Arizona Revised Statutes governing Public Utilities (Title 40) and the Arizona Administrative Corporation Commission Rules on Sewer (Title 14, Article 6), including the right to disconnect or to refuse permission to connect a customer to the Company's wastewater system for violation of this Code of Practice or any other applicable law of the State of Arizona.

This Code of Practice incorporates pretreatment standards per 40 CFR 403, A.A.C. Title 12, Article 4, and A.A.C. Title 18, Articles 9 and 11. This Code of Practice is enforceable per the authority granted to wastewater utilities established under Title 14, Chapter 2, Article 6 of the Arizona Administrative Code.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 1 - DEFINITIONS

A. PROHIBITED WASTE

Prohibited waste means:

1. Air Contaminant Waste

Any waste other than sanitary waste which, by itself or in combination with another substance, is capable of creating, causing or introducing an air contaminant outside any sewer or sewage facility or is capable of creating, causing or introducing an air contaminant within any sewer or sewage facility which would prevent safe entry by authorized personnel.

2. Flammable or Explosive Waste

Any waste, which by itself or in combination with another substance, is capable of causing or contributing to an explosion or supporting combustion in any sewer or sewage facility including, but not limited to gasoline, naphtha, propane, diesel, fuel oil, kerosene or alcohol.

3. Obstructive Waste

Any waste which by itself or in combination with another substance, is capable of obstructing the flow of, or interfering with, the operation or performance of any sewer or sewage facility including, but not limited to: earth, sand, sweepings, gardening or agricultural waste, ash, chemicals, paint, metal, glass, sharps, rags, cloth, tar, asphalt, cement-based products, plastic, wood, waste portions of animals, fish or fowl and solidified fat.

4. Corrosive Waste

Any waste with corrosive properties which, by itself or in combination with any other substance, may cause damage to any sewer or sewage facility or which may prevent safe entry by authorized personnel.

5. High Temperature Waste

Any waste which, by itself or in combination with another substance, will create heat in amounts which will interfere with the operation and maintenance of a sewer or sewage facility or with the treatment of waste in a sewage facility;

Any waste which will raise the temperature of waste entering any sewage facility to 40 degrees Celsius (104 degrees Fahrenheit) or more; or any non-domestic waste with a temperature of 65 degrees Celsius (150 degrees Fahrenheit) or more.

6. Biomedical Waste

Any of the following categories of biomedical waste: human anatomical waste, animal waste, untreated microbiological waste, waste sharps, medical products, and untreated human blood and body fluids known to contain viruses and agents.

7. Miscellaneous Wastes

Any waste, other than sanitary waste, which by itself or in combination with another substance:

a. constitutes or may constitute a significant health or safety hazard to any person;
b. may interfere with any sewer or sewage treatment process;

c. may cause a discharge from a sewage facility to contravene any requirements by or under any ADEQ or NPDES discharge permit or any other act, approved Liquid Waste Management Plan, or any other law or regulation governing the quality of the discharge, or may cause the discharge to result in a hazard to people, animals, property or vegetation;

d. may cause biosolid to fail criteria for beneficial land application.

B. RESTRICTED WASTE

Restricted waste means:

1. Specified Waste

Any waste which, at the point of discharge into a sewer, contains any contaminant at a concentration in excess of the limits set out below. All concentrations are expressed as total concentrations which includes all forms of the contaminant, whether dissolved or un-dissolved. The concentration limits apply to both grab and composite samples. Contaminant definitions and methods of analysis are outlined in standard methods.

CONVENTIONAL CONTAMINANTS [mg/L]	
Biochemical Oxygen Demand (BOD)	350
Chemical Oxygen Demand (COD)	1000
Oil and Grease'	100
Suspended Solids	350

Total oil and grease includes oil and grease (hydrocarbons) (see table (b))

ORGANIC CONTAMINANTS [mg/L]	
Benzene	0.1
Ethyl Benzene	0.2
Toluene	0.2
Xylenes	0.2
Polynuclear Aromatic Hydrocarbons (PAH)[2]	0.05
Phenols	N/A
Oil and Grease (hydrocarbons)	15

INORGANIC CONTAMINANTS [mg/L]	
Arsenic (As)	0.20
Cadmium (Cd)	0.047
Chloride (CI)	1500
Chromium (Cr)	3.0

2 Note: Polynuclear Aromatic Hydrocarbons (PAH) include:

a. naphthalene benzo(a)anthracene
b. acenaphthylene chrysene
c. acenapthene benzo(k)fluoranthene
d. fluorene benzo(k)fluoranthene
e. phenanthrene benzo(a)pyrene
f. anthracene dibenzo(a,h)anthracene
g. fluoranthene indeno(I,2,3-cd)pyrene
h. pyrene benzo(g,h,i)perylene

Approved:_____

Responsible Agent: Operations

Cobalt (Co)	5
Copper (Cu)	1.5
Cyanide (CN)	1
Iron (Fe)	50
Lead (Pb)	0.41
Manganese (Mn)	5
Mercury (Hg)	0.023 mg/L
Molybdenum (Mo)	5
Nickel (Ni)	3
Selenium (Se)	0.10
Silver (Ag)	1.2
Sulfide (S)	10
Zinc (Zn)	3.5

2. Food Waste

Any non-domestic waste from cooking and handling of food that, at the point of discharge into a sewer, contains particles larger than 0.5 centimeters in any dimension.

3. Radioactive Waste

Any waste containing radioactive materials that, at the point of discharge into a sewer, exceeds radioactivity limitations as established by NRC for sewer discharges (Unity equation and other related standards).

4. pH Waste

Any non-domestic waste which, at the point of discharge into a sewer, has a pH lower than 6.0 or higher than 9.0 , or a pH less than 5.0 for discharges from Industrial customers into the Company's wastewater system, as determined by either a grab or a composite sample.

5. Dyes and Coloring Material

Dyes or coloring materials which may pass through a sewage facility and discolor the effluent from a sewage facility except where the dye is used by the Sewer Company, or one or more of its agents, as a tracer.

6. Miscellaneous Restricted Wastes

Any of the following wastes:

a. seawater
b. PCBs
c. chlorinated phenols[1]
d. pesticides
e. herbicides
f. tetrachloroethylene

[1] include:

- chlorophenol (ortho, meta, para)
- dichlorophenol (2,3, 2,4-, 2,5-, 2,6-, 3,4-, 3,5-)
- trichlorophenol (2,3,4-, 2,3,5-, 2,3,6-, 2,4,5-, 2,4,6-, 3,4,5-)
- tetrachlorophenol (2,3,4,5-, 2,3,4,6-, 2,3,5,6-)
- pentachlorophenol

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE-BMSC-CP-01-004

SECTION 2 - DENTAL OPERATIONS

I. APPLICATION

This code of practice for dental operations defines mandatory requirements for managing non-domestic waste discharged directly or indirectly into a sewer connected to a sewage facility.

This code of practice applies to dental operations.

II. DISCHARGE REGULATIONS

An operator of a dental operation must not discharge waste which, at the point of discharge into a sewer, contains:

a. prohibited waste, special waste, or storm water ; or
b. restricted waste with the exception of mercury measured at the point of discharge from a certified amalgam separator.

An operator of a dental operation that produces liquid waste from photographic imaging containing silver shall comply with the requirements of BMSC-CP-01-004.

An operator of a dental operation that produces wastewater containing dental amalgam must either:

a. collect and transport the wastewater from the dental operation for off-site waste management; or
b. treat the wastewater at the dental operation site prior to discharge to the sewer using a certified amalgam separator.

An operator of a dental operation must install and maintain the amalgam separator according to the manufacturer's or supplier's recommendations in order that the amalgam separator functions correctly. Such separator must be certified for use by the manufacturer under the provisions of ISO 11 143.

An operator of a dental operation who installs an amalgam separator must ensure that:

a. all dental operation wastewater that contains dental amalgam is treated using the amalgam separator;
b. a monitoring point is installed at the outlet of the amalgam separator or downstream of the amalgam separator at a location upstream of any discharge of other waste;
c. the monitoring point must be installed in such a manner that the total flow from the amalgam separator may be intercepted and sampled; and
d. the monitoring point shall be readily and easily accessible at all times for inspection.

If the amalgam separator is located downstream of a wet vacuum system, an operator of a dental operation must ensure that:

a. the wet vacuum system is fitted with an internal flow control fitting; or
b. a flow control fitting is installed on the water supply line to the wet vacuum system.

The flow control fitting must be sized to limit the flow to a rate that is no more than the maximum inlet flow rate of the amalgam separator as stated by the manufacturer of the amalgam separator.

An operator of a dental operation must locate an amalgam separator in such a manner that an accidental spill, leak or collecting container failure will not result in waste containing amalgam entering any sewer. If a location is not available, an operator of a dental operation must do one of the following:

(a) install spill containment to contain spills or leaks from the amalgam separator; or
(b) cap all floor drains into which liquid spilled from the amalgam separator would normally flow.

An operator of a dental operation must replace the amalgam separator's collecting container when any one of the following occurs:

(a) the manufacturer's or supplier's recommended expiry date, as shown on the amalgam separator, has been reached; or
(b) the warning level specified in the ISO Standard has been reached; or
(c) analytical data obtained using a method of analysis outlined in standard methods, or an alternative method of analysis approved by the manager, having a method detection limit of 0.1 mg/L or lower, indicates that the total concentration of mercury in the discharge from the amalgam separator is greater than, or equal to, 2 mg/L.

An operator of a dental operation shall not dispose of dental amalgam collected in an amalgam separator, a collecting container, or any other device, to a sewer.

III. RECORD KEEPING AND RETENTION

An operator of a dental operation that uses an amalgam separator must keep, at the site of installation of the amalgam separator, an operation and maintenance manual containing instructions for installation, use, maintenance and service of the amalgam separator installed.

An operator of a dental operation that uses an amalgam separator must post, at the site of installation of the amalgam separator, a copy of the ISO Standard test report pertaining to the amalgam separator installed.

An operator of a dental operation that uses an amalgam separator must keep a record book at the dental operation site that includes the following information pertaining to the amalgam separator installed:

a. date of installation of the amalgam separator and name of the installation service provider;
b. serial number and expiry date of the amalgam separator and/or its components;
c. maximum recommended flow rate through the amalgam separator, where applicable;
d. dates of inspection, maintenance, cleaning and replacement of any amalgam separation equipment or components;
e. dates and descriptions of all operational problems, spills, leaks or collecting container failures associated with the amalgam separator and remedial actions taken;
f. name, address and telephone number of any person or company who performs any maintenance or disposal services related to the operation of the amalgam separator; and
g. dates of pick-up of the collecting container for off-site disposal, volume of waste disposed and the location of disposal.

The records must be retained for a period of two years and must be available on request by an sewer company employee.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 3 - DRY CLEANING OPERATIONS

I. APPLICATION

This code of practice for Dry Cleaning operations defines the requirements for managing waste discharged directly or indirectly into a sewer connected to a sewage facility from dry cleaning businesses, or other facilities employing solvent or chemical cleaning routines.

Definitions are included in BMSC-CP-01-DEF.

II. DISCHARGE REGULATIONS

An operator of a dry cleaning operation must not discharge waste, which at the point of discharge into a sewer contains:

(a) Tetrachloroethylene and Perchlomethyene is prohibited.;
(b) Petroleum solvent in a concentration that is in excess of 15 milligrams per liter as analyzed in a grab sample; and
(c) Prohibited waste, restricted waste, special waste, storm water, or uncontaminated water.

An operator of a dry cleaning operation that generates wastewater containing tetrachloroethylene or petroleum solvent shall either:

(a) Collect and transport the wastewater from the dry cleaning operation for off site waste management; or
(b) Install and maintain a solvent/water separator and holding tank in accordance with this code of practice.

All dry cleaning operations in business that generate wastewater containing tetrachloroethylene or petroleum solvent, but do not have a solvent/water separator and holding tank shall install and maintain a solvent/water separator and holding tank when any of the following occur:

(a) The dry cleaning operation is renovated, to modify the plumbing or dry cleaning equipment;
(b) New equipment, designed specifically for dry cleaning, is added to the dry cleaning operation; or
(c) The discharge from the dry cleaning operation exceeds the discharge limits specified above or any of the restricted waste criteria specified in BMSC-CP-0I-DEF.

Solvent Water Separators and Holding Tanks

Solvent/water separator and holding tank installations must conform to the requirements of this code of practice.

An operator of a dry cleaning operation shall not directly discharge wastewater from the solvent/water separator to a sewage facility

An operator of a dry cleaning operation must:

(a) Collect the wastewater discharged from a solvent/water separator into a transparent, solvent-compatible, holding tank with a containment capacity 25% larger than the total volume of the solvent/water separator; and
(b) Allow the wastewater to stand undisturbed for a period of not less than 12 hours following each operating date.

An operator of a dry cleaning operation must check the contents of the holding tank after the specified period of time has elapsed to determine whether the wastewater contains any visible residual solvent. If there is no visible residual solvent in the holding tank, the contents may be discharged to the sewer.

If the holding tank contains any visible tetrachloroethylene or petroleum solvent after the specified period of time, then the tetrachloroethylene or petroleum solvent must be separated and returned to the solvent recovery system. After the removal of all visible solvent, the wastewater may be discharged to the sanitary sewer.

Visual Inspections

An operator of a dry cleaning operation must:

(a) Visually inspect the solvent/water separator on a daily basis and
(b) Clean the solvent/water separator at least once every seven (7) days to manufacturer's standards.

Spills and Leaks

An operator of a dry cleaning operation must install spill containment facilities in all chemical storage areas and around all dry cleaning machines.

An operator of a dry cleaning operation must block off all sewer drains within the containment area for chemical storage and dry cleaning equipment to prevent any accidental discharge of solvent to a sewer.

An operator of a dry cleaning operation must inspect all dry cleaning equipment for liquid leaks at least once per day.

An operator of a dry cleaning operation must keep all equipment clean to ensure that leaks are visible. The following areas and items are to be checked for leaks:

(i) hose connections, unions, couplings and valves
(ii) machine door gasket and seating
(iii) filter head gasket and seating
(iv) pumps
(v) base tanks and storage
(vi) solvent/water separators
(vii) filter sludge recovery
(viii) distillation unit
(ix) diverter valves
(x) saturated lint in lint baskets
(xi) holding tanks
(xii) cartridge filters

An operator of a dry cleaning operation who detects any liquid leak from dry cleaning equipment or chemical storage must repair the leak within 72 hours and must immediately prevent any discharge of contaminants to a sewer.

III. RECORD KEEPING AND RETENTION

Every dry cleaning operation must keep a record book on site for inspection with records from the previous two years.

The following information shall be recorded in the record book:

(i) record of all inspections done by the operator, employees or other hired personnel;
(ii) record of any liquid leaks detected and remedial action taken;
(iii) record of solvent/water separator cleaning;
(iv) record of holding tank cleaning and solvent transfer; and
(v) record of all other equipment maintenance and repair.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 4 - FOOD SERVICE OPERATIONS

I. APPLICATION

This code of practice for Food Service operations defines the requirements for managing waste discharged directly or indirectly into a sewer connected to a sewage facility from restaurants, or other facilities employing food service as a primary or secondary business operation.

This code of practice applies to:

(a) operators of a food services operation that adds kitchen equipment that discharges oil and grease;
(b) operators of a food services operation that discharges non-domestic waste to sewer that exceeds any of the restricted waste criteria specified in BMSC-CP-O1-DEF; or
(c) any food service operation, as determined by BMSC's wastewater operations group.

Definitions are included in BMSC-CP-01-DEF.

II. DISCHARGE REGULATIONS

An operator of a Food Service Operation must not discharge waste, which at the point of discharge into a sewer, contains:

1. oil and grease in a concentration that is in excess of 100 milligrams per liter as analyzed in a grab sample;
2. suspended solids in a concentration that is in excess of 350 milligrams per liter as analyzed in a grab sample;
3. 5-day biochemical oxygen demand (BOD_5) in a concentration that is in excess of 350 milligrams per liter in a grab sample;
4. prohibited waste, restricted waste, special waste, storm water, or uncontaminated water.

III. GREASE INTERCEPTORS

Grease interceptors are required to be installed and maintained by the Owner of food service operations within the collection system of BMSC facilities. Grease interceptor installations shall conform to the requirements of this code of practice.

Design

The rated flow capacity of each grease interceptor installed in food services establishments shall not be less than the maximum discharge flow from all plumbing fixtures connected to the grease interceptor that will discharge simultaneously.

The rated flow capacity of each grease interceptor must be established using the Uniform Plumbing Code (UPC) 2001 test as approved by the BMSC operations group.

Each grease interceptor must have either:

1. an internal flow control fitting, or
2. a flow control fitting installed on the inlet line.[2]

All grease interceptors must be labeled with information containing the rated flow capacity of the unit. The label shall be permanently affixed and visible following installation. Where a permanently affixed and visible label is not possible or practical, manufacturer and installation drawings of the grease interceptor shall be maintained at the site and shall be available for inspection by an officer, on request.

Flow Rates

The operator of a food services operation must calculate the maximum discharge flow rate to a grease interceptor by adding together the flow rates from each fixture that will discharge simultaneously using the following method to estimate the flow rate from each fixture:

(a) for sinks, calculate the total volume of each sink and assign a drain time of one minute.
(b) for exhaust hoods with an automatic cleaning cycle, measure the discharge flow rate or use the manufacturers estimate of peak discharge flow rate during the automatic wash cycle.
(c) for floor drains, estimate the flow rate using the following table:

Floor Drain Diameter		Drain Rate		
Millimetres	Inches	L/s	Imperial gpm	US gpm
51	2	1.4	18.3	22
76	3	2.36	31.2	37.5
102	4	2.84	37.5	45

(d) for drains on other equipment, use the table in Section (c) or if the drain size is less than 2 inches in diameter either:

1. measure the discharge flow rate, or
2. refer to manufacturers estimated peak discharge flow rate, or
3. use a minimum of 1.4L/s.

(e) for automatic dishwashers, measure the discharge flow rate or use the maximum discharge flow rate specified by the dishwasher manufacturer.

Where the rated flow capacity of a grease interceptor is exceeded by the maximum discharge flow rate from all plumbing fixtures that will be discharged simultaneously to the grease interceptor, the operator of a food services operation must:

1. Install a grease interceptor that has a rated flow capacity equal to or greater than the maximum discharge flow rate from all plumbing fixtures connected to the grease interceptor that will discharge simultaneously; or
2. Install additional grease interceptors so that the maximum discharge flow rate from fixtures connected to each grease interceptor that will discharge simultaneously does not exceed the rated flow capacity of the grease interceptor; or

[2] The flow control fitting must be sized to limit the flow to a rate that is no more than the rated flow capacity of the grease interceptor.

3. Have a plan approved by the manager showing how the discharge of waste will be managed.

Installation

A grease interceptor must be located so that it is readily and easily accessible for inspection and maintenance. A sampling point shall be installed as follows:

1. a sampling tee shall be located either at the outlet of the grease interceptor or downstream of the grease interceptor at a location upstream of any discharge of other waste;
2. the sampling tee shall be not less than 10.2 cm (4 inches) in diameter, and shall be installed so that it opens in a direction at right angles to and vertically above the flow of the sewer pipe; and
3. the sampling tee shall be readily and easily accessible at all times for inspection.

Maintenance

An operator of a food services operation shall maintain all grease interceptors installed in connection with the food services operation in accordance with the manufacturer's recommendations so that the grease interceptors function properly.

An operator of a food services operation must not permit oil and grease to accumulate in a grease interceptor in excess of the lesser of six inches or 25% of the wetted height of the grease interceptor.

An operator of a food services operation shall not dispose of oil and grease from a grease interceptor to a sewer. All cleaning or grease removal shall be accomplished by employing vactor trucks or other means to preclude any grease from entering the collection system.

An operator of a food services operation must not use or permit the use of chemical agents, enzymes, bacteria, solvents, hot water or other agents to facilitate the passage of oil and grease through a grease interceptor without the express written consent of BMSC.

Connections to Grease Interceptors

An operator of a food services operation shall have the following fixtures connected to the grease intercept system:

(a) sinks used for washing pots, pans, dishes, cutlery and kitchen utensils;
(b) drains serving self-cleaning exhaust hoods installed over commercial cooking equipment;
(c) drains serving commercial cooking equipment that discharges oil and grease;
(d) drains serving a garbage compactor used to compact waste that may contain, or be contaminated with, food waste; or
(e) other fixtures that discharge wastewater containing oil and grease.

The following fixtures shall not be connected to a grease interceptor:

(a) garburators, potato peelers and similar equipment discharging solids;
(b) toilets, urinals and hand sinks;
(c) automatic dishwashers[3]

Outdoor Garbage Compactors

An owner of an outdoor garbage compactor installation connected to a sewer must install works as necessary to prevent rainwater from entering the drain connected to the sewer.

[3] An automatic dishwasher may be connected to a grease interceptor provided that there are no other fixtures connected to the grease interceptor and the grease interceptor is sized to accept the maximum discharge flow rate specified by the dishwasher manufacturer.

IV. RECORD KEEPING AND RETENTION

An operator of a food services operation must keep a record at the food services operation of all grease interceptor inspection and maintenance activities including:

(a) the date of inspection or maintenance;
(b) the maintenance conducted;
(c) the type and quantity of material removed from the grease interceptor; and
(d) the location of disposal of the material removed from the grease interceptor.

The records shall be retained for a period of two years, and shall be available on request by an officer.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 5 - PHOTOGRAPHIC IMAGING OPERATIONS

I. APPLICATION

This code of practice for photographic imaging operations defines mandatory requirements for managing non-domestic waste discharged directly or indirectly into a sewer connected to a sewage facility.

This code of practice applies to photographic imaging operations. Definitions are included in BMSC-CP-01-DEP.

II. DISCHARGE REGULATIONS

An operator of a photographic imaging operation must not discharge waste which, at the point of discharge into a sewer, contains:

(a) silver in a concentration that is in excess of 5 milligrams per liter (mg/L) as analyzed in a grab sample; or,

(b) prohibited waste, restricted waste, special waste, storm water, or uncontaminated water as defined in BMSC-CP-01-DEF, other than the following restricted wastes: BOD, COD, chloride, iron and sulfate.

An operator of a photographic imaging operation that produces liquid waste containing silver must either:

(a) collect and transport the waste from the photographic imaging operation for off-site waste management; or

(b) treat the waste at the photographic imaging operation site prior to discharge to the sewer using one of the following silver recovery technologies:

  (i) two chemical recovery cartridges connected in a series;

  (ii) an electrolytic recovery unit followed by two chemical recovery cartridges connected in series; or

  (iii) any other silver recovery technology, or combination of technologies, capable of reducing the concentration of silver in the waste to 5 mg/L or less where valid analytical test data has been submitted to, and accepted by, the BMSC wastewater group.

An operator of a photographic imaging operation must install and maintain silver recovery technology according to the manufacturer's or supplier's recommendations.

An operator of a photographic imaging operation must collect all liquid waste containing silver in a holding tank and must deliver this waste to the chemical recovery cartridges using a metering pump.

An operator of a photographic imaging operation must calibrate the metering pump at least once per year.

Spill/Leak Prevention

An operator of a photographic imaging operation must locate the silver recovery system in such a manner that an accidental spill, leak or container failure will not result in liquid waste containing silver in concentrations greater than 5 mg/L entering any sewer.

If a location referred to above is not available, an operator of a photographic imaging operation must do one of the following:

(a) install spill containment to contain spills or leaks from the silver recovery system; or

(b) cap all floor drains into which liquid spilled from the silver recovery system would normally flow.

Testing

When using two separate chemical recovery cartridges, an operator of a photographic imaging operation must test the discharge from the first cartridge for silver content at least once per month using either silver test paper or a portable silver test kit.

When the discharge from the first chemical recovery cartridge referred to above cannot be sampled, an operator of a photographic imaging operation must:

(a) install a cumulative flow meter on the silver recovery system; and
(b) test the discharge from the second chemical recovery cartridge once per week using silver test paper or a silver test kit.

Cartridge Replacement

An operator of a photographic imaging operation must replace the chemical recovery cartridges when any one of the following occurs:[4]

(a) the manufacturer's or supplier's recommended expiry date, as shown on each cartridge, has been reached;
(b) eighty percent (80%) of the manufacturer's or supplier's maximum recommended capacity, or total cumulative flow, for each cartridge has been reached;
(c) test data, using silver test paper or a silver test kit, indicates that the discharge from the first cartridge is greater than 1000 mg/L; or
(d) analytical data using a method of analysis outlined in standard methods, or an alternative method of analysis approved by the manager, having a method detection limit of 0.5 mg/L silver or lower, indicates that the concentration of silver in the discharge from the silver recovery system is greater than, or equal to, 5 mg/L.

III. RECORD KEEPING AND RETENTION

An operator of a photographic imaging operation that uses a silver recovery system must keep, at the photographic imaging operation site, an operation and maintenance manual pertaining to all equipment used in the silver recovery system.

An operator of a photographic imaging operation that uses two chemical recovery cartridges connected in series must keep a record book at the photographic imaging operation site which includes the following information recorded for the previous two years:

(a) serial number of each chemical recovery cartridge used;
(b) installation date of each chemical recovery cartridge used;
(c) expiry date of each chemical recovery cartridge used (where provided by manufacturers or suppliers);
(d) maximum recommended capacity, or total cumulative flow, of each chemical recovery cartridge used;
(e) dates of all metering pump calibrations;

[4] If treatment of liquid waste with two chemical recovery cartridges connected in series is the only silver recovery technology being used, then the owner of the photographic imaging operation must replace both chemical recovery cartridges when one of the events referred to occurs.

If treatment of liquid waste with two chemical recovery cartridges connected in series is used following treatment by an electrolytic recovery unit, the second cartridge may replace the used first cartridge and a new second cartridge may be installed when one of the events referred to occurs.

Both chemical recovery cartridges used following an electrolytic recovery unit must be replaced by the operator of the photographic imaging operation when one of the events referred to above occurs if this is recommended by the manufacturer or supplier of the cartridges.

(f) monthly silver test results on the discharge from the first chemical recovery cartridge; or where the discharge from the first cartridge cannot be sampled, weekly silver test results on the discharge from the second chemical recovery cartridge and weekly cumulative flows through the silver recovery system; and

(g) dates and descriptions of all operational problems associated with the chemical recovery cartridges and remedial actions taken.

An operator of a photographic imaging operation that uses an electrolytic recovery unit in addition to two chemical recovery cartridges connected in series must keep a record book at the photographic imaging operation site which includes the following information recorded for the previous two years:

(a) all information specified above;

(b) date of each removal of silver from the electrolytic recovery unit;

(c) date of each maintenance check on the electrolytic recovery unit;

(d) dates and descriptions of all operational problems associated with the electrolytic recovery unit anti remedial actions taken.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 6 - RV PARK OPERATIONS

I. APPLICATION

This code of practice for RV park operations defines the requirements for managing waste discharged directly or indirectly into a sewer connected to a sewage facility from RVs, mobile homes, trailers, watercraft and other sources which employ storage, chemical disinfection/stabilization and discharge as a waste disposal mechanism.

This code of practice applies to all RV park operations. Definitions are included in BMSC-CP-01-DEF.

II. DISCHARGE REGULATIONS

An operator of an RV park operation must not discharge waste, which at the point of discharge into a sewer, contains:

1. oil and grease in a concentration that is in excess of 100 milligrams per liter as analyzed in a grab sample;
2. suspended solids in a concentration that is in excess of 350 milligrams per liter as analyzed in a grab sample;
3. 5-day biochemical oxygen demand (BOD_5) in a concentration that is in excess of 350 milligrams per liter in a grab sample;
4. prohibited waste, restricted waste, special waste, storm water, or uncontaminated water.

if the RV park operation accepts RV customers with the intention of providing sewerage hook-ups, that practice is only acceptable if one of the following conditions is met:

1. If the RV park operation has a dedicated pre-treatment facility, that facility must be used for the disposal of the first discharge of wastewater from any entering RVs. The facility must be maintained as per manufacturer's or engineer's operating instructions. Discharge from that facility which is directed to a sewer connected to a sewerage facility shall be metered such that large slugs of waste are not introduced to the sewer instantaneously. Discharges from such facilities to sewers are limited to 10% of the ADWF (in USGPM) experienced in the sewer.
2. In the absence of a dedicated pre-treatment facility, the RV park operation shall require incoming RVs to certify that, prior to connection to a sewer, that the holding tanks of the RV have been discharged at an approved facility.

III. RECORD KEEPING AND RETENTION

An operator of an RV park operation must keep a record at the RV park operation of:

1. all disposals of RV waste into a dedicated pre-treatment facility;
2. Pre-treatment facility inspection and maintenance activities including:
   a. the date of inspection or maintenance;
   b. the maintenance conducted; and
   c. the type and quantity of material removed from the facility;
3. Certifications of waste disposal prior to hook up of RVs to sewer services.

The records shall be retained for a period of two years, and shall be available on request by an sewer company employee.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 7 – PRETREATMENT/INDUSTRIAL WASTE CONTROL

I APPLICATION

This Section is adopted by the Company in accordance with the authority conferred in the Clean Water Act, and any regulations implementing the Clean Water Act, including, but not limited to, 40 CFR 403.8, applicable Arizona Revised Statutes, including but not limited to 49 A.R.S. 2, applicable Arizona Administrative Code, including but not limited to 18 A.A.C. 9 and 18. A.A.C. 11, and with all the powers thereof which are specifically granted to the Company, or are necessary or incidental to or implied from power specifically granted therein for carrying out the objectives and purposes of the Company and this Section.

II. COMPLIANCE

The Pretreatment/Industrial Waste Control Program is designed to enable the Company to comply with all conditions of any applicable National Pollutant Discharge Elimination System (AZPDES) Permit, Federal Pretreatment Regulations, Arizona Pretreatment Regulations, and any applicable sludge disposal regulations, and to meet the following objectives:

(a) To prevent the introduction of pollutants into the Company's Facilities which will interfere with the operation of the wastewater systems or contaminate the sludge.

(b) To prevent the introduction of pollutants into the wastewater system which will pass through the wastewater system, inadequately treated, into the receiving waters or the atmosphere.

(c) To prevent the introduction of pollutants into the wastewater system which might constitute a hazard to humans or to animals.

(d) To assure the Company's ability to recycle and reclaim wastewater and sludge.

(e) To protect human health and welfare, the environment, property and the Company's wastewater system.

II. DISCHARGE REGULATIONS

A. General Discharge Limitations

No customer shall contribute or cause to be contributed, directly or indirectly, any pollutant or wastewater which will interfere with the operation or performance of the Company's wastewater system. These general prohibitions apply to all customers of the Company whether or not the customer is subject to National Categorical Pretreatment Standards or any other national, State, Company, or local pretreatment standards or requirements.

B. Specific Discharge Limitations

No User shall discharge into the Company wastewater system or into any connected sewer system at any time or over any period of time, wastewater containing any of the following materials and substances in excess of the

limitations provided herein. These limitations may also be imposed directly on process wastewaters prior to dilution by domestic and other wastewaters discharged by a customer:

	Contaminant	Limit in mg/L
1.	Arsenic	0.45
2.	Cadmium	0.047
3.	Chromium	3.6
4.	Copper	1.5
5.	Lead	0.41
6.	Mercury	0.002
7.	Molybdenum	0.71
8.	Nickel	3.0
9.	Selenium	0.10
10.	Silver	1.2
11.	Zinc	3.5

Once promulgated, National Categorical Pretreatment Standards for a particular industrial subcategory, if more stringent, shall supersede all conflicting discharge limitations contained in this Section 7, as they apply to that industrial subcategory.

State requirements and limitations on discharges shall apply in any case where they are more stringent than federal requirements and limitations or those contained elsewhere in this Code.

C. Prohibited Discharges

None of the following described sewage, water, substances, materials, or wastes shall be discharged into the Company's wastewater system or into the sewer system by any customer, and each governing body of any applicable Service Provider shall prohibit and shall prevent such discharges by any BMSC customer, either directly or indirectly, into its sewer system:

(a) Any liquids, solids or gases which by reason of their nature or quantity are, or may be, sufficient either alone or by interaction with other substances to cause fire or explosion or be injurious in any other way to the Company's wastewater system, the sewer system of a Service Provider or any of its connectors, or to the operation of the Company. At no time shall any reading on an explosion hazard meter, at the point of discharge into the Company's wastewater system or the sewer system of a Service Provider or any of its customers (or at any point in the wastewater systems), or at any monitoring location designated by the Company in a wastewater contribution permit, be more than ten percent (10%) of the Lower Explosive Limit (LEL) of the meter. Prohibited materials include, but are not limited to, gasoline, kerosene, naphtha, benzene, toluene, xylene, ethers, alcohols, ketones, aldehydes, peroxides, chlorates, perchlorates, tetrachloroethylene, perchloroethylene, bromates, carbides, hydrides, and sulfides.

(b) Any solid or viscous material which could cause an obstruction to flow in the

sewers or in any way could interfere with the treatment process, including as examples of such materials but without limiting the generality of the foregoing, significant proportions of ashes, wax, paraffin, cinders, sand, mud, straw, shavings, metal, glass, rags, lint, feathers, tars, plastics, wood and sawdust, paunch manure, hair and fleshings, entrails, lime slurries, beer and distillery slops, grain processing wastes, grinding compounds, acetylene generation sludge, chemical residues, acid residues, food processing bulk solids, snow, ice, and all other solid objects, material, refuse, and debris not normally contained in sanitary sewage.

(c) Any wastewater having a pH less than 5.0 for discharges from Industrial Customers into the Company's wastewater system or the sewer system of a Service Provider or that of any of its Customers, or less than 6.0 or greater than 9.0 for other discharges into the Company's wastewater system, or wastewater having any other corrosive property capable of causing damage or hazard to any part of the Company's wastewater system or the sewer system of a Service Provider or any of its Customers, or to personnel.

(d) Any wastewater having a temperature which will inhibit biological activity at the Company's treatment plant, but in no case wastewater containing heat in such amounts that the temperature at the introduction into the Company's wastewater treatment exceeds 40°C (104°F).

(e) Any pollutants, including oxygen demanding pollutants (BOD, COD, etc.) released at a flow rate and/or pollutant concentration which cause Upset. In no case shall a slug load have a flow rate or contain concentrations or qualities of pollutants that exceed for any time period longer than fifteen (15) minutes more than five (5) times the average twenty-four (24) hour concentration, quantities, or flow during normal operation.

(f) Any water or wastes containing a toxic substance (such as Chlorine, etc.) in sufficient quantity, either singly or by interaction with other substances, to injure or interfere with any sewage treatment process, to constitute a hazard to humans or to animals, or to create any hazard or toxic effect in the waters which receive the treated or untreated sewage.

(g) Petroleum oil, non-biodegradable cutting oil, or products of mineral oil origin, each in amounts that will cause interference.

(h) Pollutants which result in the presence of toxic gases, vapors, or fumes within the system in a quantity that may cause acute worker health and safety problems.

(i) Any trucked or hauled pollutants except at discharge points designated by the Company.

(j) Any water or wastes containing pollutant quantities or concentrations exceeding the limitations in Section 7 of this Code of Practice, or the limitations in any applicable Categorical Standards.

III. HAZARDOUS WASTE DISCHARGE NOTICE

Any customer disposing of industrial waste shall notify the Company, the EPA Regional Waste Management Division Director, and the state hazardous waste authorities in writing of any discharge into the Company's wastewater system of any substance which, if otherwise disposed of, would be considered a hazardous waste under 40 CFR Part 261. The specific information required to be reported and the time frames in which it is to be reported are found at 40 CFR §403.12(p).

IV. REPORTING REQUIREMENTS FOR SIGNIFICANT INDUSTRIAL USERS

[RESERVED]

V. MONITORING BMSC FACILITIES

The Company may require to be provided and operated, at the customer's own expense, monitoring facilities to allow inspection, sampling, and flow measurement of any discharges as necessary to determine compliance with the provisions of this Code.

There shall be ample room in or near such sampling manhole or facility to allow accurate sampling and preparation of samples for analysis. The facility, sampling, and measuring equipment shall be maintained at all times in a safe and proper operating condition at the expense of the customer.

The sampling and monitoring facilities shall be provided in accordance with the Company's requirements and all applicable local construction standards and specifications. Construction shall be completed within such a time frame as the Company shall specify by written notification.

BLACK MOUNTAIN SEWER CORPORATION

CODE OF PRACTICE

SECTION 8 – NONCOMPLIANCE / ENFORCEMENT

I. NOTICE OF VIOLATIONS

Whenever the Company determines that any customer has violated or is violating any provision of this Code, federal, state or local ordinance, the Company may serve upon such customer a written notice stating the nature of the violation(s). Where directed to do so by the notice, a plan for the satisfactory correction of the violation(s) shall be submitted to the Company by the customer, within a time frame as specified in the notice.

Whenever the Company determines that any customer has violated or is violating any provision of this Code, or any directives, orders, or permits issued or approved to which the Company is bound, the Company may serve upon such customer a written notice stating the nature of the violations(s), and requiring that the customer correct the violation(s) within a specified period of time; perform such tasks as the Company determines are necessary for the customer to correct the violations; or perform such tasks and submit such information as is necessary for the Company to evaluate the extent of noncompliance or to determine appropriate enforcement actions to be taken in conjunction with the applicable regulatory agencies.

II. SUSPENSION OF SERVICE

The Company may suspend the wastewater treatment service, in accordance with A.A.C. R14-2-609, when such suspension is necessary, in the opinion of the Company, in order to stop an actual or threatened discharge which presents or may present an imminent or substantial endangerment to the health or welfare of persons, to the environment, causes pass through or interference or causes the Company to violate any condition of its aquifer protection permit or AZPDES permit.

Any customer notified of a suspension of the wastewater treatment service shall immediately stop or eliminate the discharge. In the event of a failure of the customer to comply voluntarily with the cease and desist request, the Company shall take such steps as deemed necessary, including immediate severance of the sewer connection, to prevent or minimize damage to the company's wastewater system or endangerment to any individuals or the environment. Any reconnection shall be in accordance with the Company's Tariff.

2145261.2

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REBUTTAL TESTIMONY OF

GREGORY S. SORENSEN

October 20, 2009

EXHIBIT
A-2
ADMITTED

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I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Greg Sorensen. My business address is 12725 W. Indian School Road, Suite D-101, Avondale, AZ 85392.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Liberty Water, formerly known as Algonquin Water Services ("AWS") as Director of Operations for the Western Group. For purposes of this rebuttal testimony and this rate case, AWS and Liberty Water can essentially be used interchangeably.

Q. DID YOU PREVIOUSLY PROVIDE TESTIMONY ON BEHALF OF THE COMPANY IN THIS CASE?

A. Yes, my direct testimony was filed on December 19, 2008, with the Company's application.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. To further support BMSC's application for rate relief by responding to certain aspects of the direct testimony of Utilities Division Staff ("Staff"), and the Intervenors, RUCO, Boulders Home Owners Association ("BHOA"), Town of Carefree ("Town"), and Dennis E. Doelle, D.D.S. ("Doelle").

Q. HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?

A. I have provided a section in rebuttal to each of the other parties' direct filings. The Company's accounting witness, Tom Bourassa, will also be filing rebuttal and he will also address many of the issues in dispute between the parties.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY?

A. My testimony addresses certain aspects of the other parties' direct filings. First, I respond to the Town's testimony regarding giving a refund to 33 homeowners in the Carefree Estates HOA. Next, I respond to Doelle's request for a new rate

design for BMSC and BHOA's testimony concerning the settlement agreement between BMSC and BHOA. Then, I address RUCO's direct testimony relating to cost of capital from an operations and investment perspective and also respond to RUCO's testimony regarding non-recurring expense and wastewater treatment expense. Finally, I discuss Staff's recommendation concerning return on equity and the hook up tariff, as well as Staff's adjustments for testing expenses, truck lease and labor expenses.

II. REBUTTAL TO TOWN

Q. HAVE YOU REVIEWED THE TESTIMONY OF BRIAN KINCAID ON BEHALF OF THE TOWN?

A. Yes, and I am familiar with the issue he has raised.

Q. HOW DOES THE COMPANY RESPOND?

A. The same way we have for the past three years after the issue was first brought up – if there is a remedy that is neutral to BMSC, we support it.

Q. IS THERE SUCH A REMEDY?

A. Yes, the same one the Town, RUCO and BMSC proposed – give a refund to the 33 homeowners in the Carefree Estates HOA, and debit the accounts of the remaining customers.

Q. HOW MUCH WOULD THE OTHER CUSTOMERS BE DEBITED?

A. That depends on the number of customers that have their bills debited. Unfortunately, it has been three years since the last rate case decision was issued and some customers have come and some have gone. We don't think we can debit new customers that never got a refund. But, at the time of the prior proposal, the per bill impact would have been relatively minor – a one-time charge of approximately $6.62.[1] The refund was more than $400.

[1] *See* Kincaid Dt. at 5-7.

Q. WHY WAS THIS MISTAKE MADE IN THE FIRST PLACE?

A. There was no mistake. The refund in the last rate case was calculated by all parties by dividing the total dollars to be refunded by the number of customers we bill. For these 33 locations, BMSC only bills one customer – the HOA.

Q. WHY IS THAT, MR. SORENSEN?

A, I have no idea. There does not appear to be anyone affiliated with this utility or its past ratemaking that can explain why the HOA is billed as one customer.

Q. IS IT FAIR FOR 33 HOMES TO PAY THE SAME AS A SINGLE FAMILY HOME FOR SEWER SERVICE?

A. No, and that's not happening. The HOA is billed on the basis of having 33 individual units.

Q. THEN WHY DIDN'T THE CAREFREE ESTATES HOA GET 33 SEPARATE REFUNDS?

A. Because they were treated as one customer, no matter how large, how small, or how much flow they generate. Commercial customers got the same refund as residential customers. This is how everyone that calculated the refund did it, and the Town never spoke up in complaint. No party to the last rate case did. It is just one of those things no one considered until the Town brought it up after the last decision was issued.

Q. BUT DIDN'T BMSC BENEFIT BY MAKING 32 LESS REFUNDS THAN IT ALLEGEDLY SHOULD HAVE?

A. No, we refunded every dollar we were ordered to refund. This is not about how much we should have refunded, but about who gets the refunds. And, therefore, if the Commission wants to correct it, it just has to take some money from those they believe were overpaid and give it to those they believe were underpaid. But the

money for the refunds should not come from BMSC because the Company has already done exactly what the Commission ordered.

Q. DO WE KNOW HOW MANY CUSTOMERS ARE STILL ON THE SYSTEM THAT RECEIVED A REFUND?

A. We figure there are 1,671 current customers that received the refund, including the Carefree Estate HOA, and would in turn need to receive the debit if the Commission chooses to direct a refund to the 33 CIE HOA customers. As I said, I don't think we should debit someone that did not get a refund. Nor can we obtain a refund from customers that have departed the system. All of which means that to issue 33 refunds of $404.64, we need to debit the 1,671 accounts by $7.51 each. I note that the refund amount, $404.64, is less than the $412.15 we refunded, by the amount of the debit. In other words, every one getting a refund would get the same amount.

Q. GOING-FORWARD, WOULD THE COMPANY OPPOSE ALL 33 HOMEOWNERS BEING MADE CUSTOMERS OF BMSC AND ELIMINATING THE HOA?

A. If that is what the customers want, and what the Commission believes should happen, and there is no harm to BMSC, I do not see why we would oppose that.

Q. DO YOU HAVE ANY OTHER COMMENT ON THE ISSUE RAISED BY THE TESTIMONY OF THE TOWN?

A. Just that we work closely with the Town on many issues, and had tried to resolve this one sometime ago. I am not pointing any fingers, rather, just making sure it is clear that BMSC and Liberty Water have done nothing wrong here, and we have tried at their own expense to resolve the issue. Therefore, any resolution should be neutral to BMSC.

III. REBUTTAL TO DR. DOELLE

Q. HAVE YOU REVIEWED DR. DOELLE'S DIRECT TESTIMONY?

A. Yes.

Q. WHAT RELIEF DOES DR. DOELLE SEEK IN THIS PROCEEDING?

A. Well, I am not entirely sure but I think he wants the Commission to approve a new rate design for BMSC.

Q. DOES DR. DOELLE OFFER AN ALTERNATIVE RATE DESIGN?

A. Not really, he says that the rates need a "more rational basis" and says that basing rates on water usage would be more rational.

Q. DO YOU AGREE?

A. Yes, although even basing sewer rates on water use has its draw-backs. For instance, water used for irrigation does not affect the amount of sewage a commercial customer conveys to the Company, but would be included as part of the water usage that the customer would be billed upon.

Q. THEN WHY DOESN'T BMSC BASE ITS SEWER RATES ON WATER USAGE?

A. Because we are not the water provider, and there are multiple water providers in the area of our CCN. Even assuming that these providers would all share the information on water usage with us in a timely matter to avoid billing delays, it would be very difficult, and likely costly, to coordinate water usage billing for a sewer company that shares a service area with multiple water providers.

Q. ON WHAT BASIS DOES BMSC BILL ITS CUSTOMERS?

A. Residential customers are billed on a flat rate per month. I do not believe there is anything unusual about that. Commercial customers are billed based on estimated flows from ADEQ Engineering Bulletin No. 12, with certain specifically

enumerated exceptions – "Special Customers". The Company has sought to eliminate these special billing rates in this proceeding.

Q. WHAT WOULD BE THE IMPACT ON DR. DOELLE?

A. He would be treated like every other commercial customer – estimated flows would be determined by Bulletin No. 12.

Q. WHY DOES BMSC USE ADEQ BULLETIN NO. 12 IN THIS WAY?

A. Because the Commission ordered us to in at least the last two rate cases.[2] I don't know where the idea originated, but we have to have some proxy of sorts for determining billing to commercial customers, unless we were to go to flat rates for all commercial customers.

Q. WHY HASN'T BMSC RECOMMENDED AN ALTERNATIVE RATE DESIGN IN THIS RATE CASE?

A. Because it isn't an issue for us, and other than Dr. Doelle, who also brought a complaint years ago to the Commission and had his rate lowered then, no one is complaining. It is never our goal to add issues and complexity to Commission proceedings.

Q. BUT WHAT ABOUT DR. DOELLE?

A. As I testified, we have asked for the elimination of all "special" rates for commercial customers. But if the Commission feels that some special relief should be afforded Dr. Doelle, BMSC is not opposed to it so long as it does not negatively impact the revenue requirement or the Company's opportunity to earn its authorized rate of return.

[2] Decision No. 69164 (December 5, 2006); Decision No. 59944 (December 26, 1996).

IV. REBUTTAL TO BHOA TESTIMONY

Q. HAVE YOU REVIEWED THE TESTIMONY BY LES PETERSON ON BEHALF OF THE BHOA?

A. Yes, I have.

Q. THE BHOA SEEKS COMMISSION APPROVAL OF A SETTLEMENT AGREEMENT ENTERED INTO BETWEEN BMSC AND THE BHOA. DID BMSC ENTER INTO THIS AGREEMENT WITH THE BHOA?

A. Yes, that is my signature on behalf of BMSC on the signature page.

Q. WHY DID BMSC ENTER INTO THIS SETTLEMENT AGREEMENT?

A. Because a large group of our customers, supported by the Town, wants our wastewater treatment plant closed. Rather than fight with them, we thought coming up with a means to satisfy their concerns would be welcomed by the Commission.

Q. SO BMSC SUPPORTS BHOA IN SEEKING APPROVAL OF THE SETTLEMENT AGREEMENT?

A. Yes, although we do not necessarily think the Commission must formally approve the agreement itself. But there is certain relief necessary before BMSC will undertake the plant closure, and only the Commission can grant that relief.[3]

Q. CAN YOU EXPLAIN FURTHER?

A. I think the language of the agreement speaks very well for itself –

> VI. Approval of Cost Recovery for Plant Closure. ACC must approve a cost recovery mechanism that permits BMSC to recover a return on and of the capital costs of closure, which costs include, without limitation, the costs of procuring additional capacity from the City of Scottsdale, the costs of engineering and other analyses necessary to complete the closure, any system upgrades required as a result of the closure and/or the delivery of the flows previously treated at the Plant to the City of Scottsdale. BMSC must also be authorized recovery of any reasonable costs of reaching agreement with the BHOA, the City of Scottsdale and the Resort as

[3] Settlement Agreement at paragraph 2.a.vi.

required to fulfill the terms of this Agreement, including, without limitation, the costs of obtaining all necessary approval from the ACC, including rate case expense. BMSC shall have no obligation under this Agreement if the ACC does not approve such cost recovery mechanism as acceptable to BMSC in its sole discretion.[4]

Put simply, BMSC will agree to take the steps necessary, including funding, to close the plant, reroute flows and obtain alternative capacity. But we want assurance from the Commission, ahead of time, that if we do so we will not have to wait for a return on and of that investment, or be second guessed as to why we spent more than a million dollars closing the plant.

Q. DO YOU KNOW HOW MUCH THE PLANT CLOSURE WILL COST?

A. No. But we do know that we can buy replacement capacity from the City of Scottsdale for $6 per gallon, or $720,000, to replace the capacity at the plant. We are working on the remaining engineering from which further cost estimates can be refined. At this time, we estimate that the plant closure project will cost in excess of $1.5 million.

Q. HOW DO YOU ENVISION RATE RECOVERY WORKING?

A. Ultimately, the Commission will have to approve some sort of mechanism that will allow the Company's rates to be increased once the project is complete. Whether that requires a surcharge or some other sort of adjuster, I will leave to the Commission and the various ratemaking experts.[5] As I have testified above, we will undertake to close the plant as the BHOA wants, so long as we obtain the necessary cost recovery.

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[4] *Id.*
[5] Bourassa Rb. at 29-30.

Q. BUT MR. SORENSEN, ISN'T THAT ESSENTIALLY ASKING THE COMMISSION TO GIVE BMSC A BLANK CHECK?

A. Absolutely not. The costs incurred will be readily verifiable as related to the plant closure project. To assist in verifying costs, we could provide Staff with an opportunity to review invoices related to the plant closure project prior to recovery. We do not expect recovery through rates until after the costs are incurred and the project is complete. We are simply seeking to avoid the costs, in both time and money, of regulatory lag and rate relief, and to eliminate the risk of being second-guessed.

V. REBUTTAL TO RUCO

Q. HAVE YOU REVIEWED THE DIRECT FILING MADE BY RUCO?

A. I have read Mr. Moore's testimony, and I am familiar with the critical components of Mr. Rigsby's direct testimony. Specifically, I am aware that RUCO is recommending a hypothetical capital structure of 60 percent common equity at a cost of 8.22 percent and 40 percent debt at a cost of 6.26 percent.

Q. HOW DOES BMSC RESPOND TO RUCO'S COST OF CAPITAL RECOMMENDATIONS?

A. Mr. Bourassa will address Mr. Rigsby's testimony from the ratemaking and cost of capital perspective. From an operations and investment perspective, RUCO's recommendation is very disconcerting.

Q. WHY IS THAT MR. SORENSEN?

A. Well, for starters, Mr. Rigsby is recommending a hypothetical capital structure, the same thing the Commission specifically concluded was "results-oriented" for this Company in the last rate case.[6] This is even more troubling as BMSC actually has

[6] Decision No. 69164 at 20.

debt, authorized by the Commission, on its books. This debt is at 9.4%, which is much higher than his recommended cost of equity and cost of debt in this case. The debt on the Company's books is given different treatment for ratemaking purposes, consistent with prior Commission orders, but the debt does exist in the Company's actual capital structure, and the risk associated with that debt is indistinguishable from debt that is treated as supporting plant in rate base. Mr. Rigsby seems to ignore that fact.

Additionally, and most importantly, from an investment perspective, the adoption of the low rates recommended by Mr. Rigsby and the use of hypothetical capital structures like his strongly discourage continued investment in the State of Arizona. Simply put, an 8.22% ROE will not attract investment into BMSC or any other utility in this State. When this anemic ROE is coupled with the hypothetical capital structure, the Company's investors would essentially be granted the opportunity to earn a 7.43% return on their invested capital.[7] And, that is without factoring in the interest synchronization – a.k.a., RUCO's fictitious income tax deduction which would be inflicted upon the Company and prevent any opportunity to earn that 7.43% return. In general, an investor will choose to invest their money where risk is lower and returns are higher. Of course, there is a balance, but Mr. Rigsby just does not seem to recognize that there are 49 other states in which investors can invest their money in water and wastewater utilities, not to mention many other investment choices. A phantom opportunity to earn a 7.43% return would be wholly unacceptable to any rational investor in utilities.

[7] Bourassa COC Rb. at 4-5.

Q. MR. SORENSEN, ISN'T THAT WHAT ANY UTILITY WOULD CLAIM IN THE FACE OF A LOWER RECOMMENDED RETURN AS A SCARE TACTIC?

A. I can only testify as to Liberty Water and its affiliates in Arizona. I have to compete internally within the Liberty Water family of companies for capital, which is not unlimited. Liberty Water has utility investments in Texas. It is my understanding that in two recently filed cases in Texas, their regulatory body has had no issue with a requested 12% return on equity for utilities with 100% equity capital structures. Additionally, rates, whether interim or permanent, are usually implemented within 3 to 6 months after filing of the rate application. So, Liberty Water can invest in Texas utilities and receive a much greater return, more quickly, than can be received in Arizona. This is reality, not ratemaking theory. If Mr. Rigsby really wants to testify about investor expectations, he should start taking into account real world facts that are, in fact, making Arizona an unattractive state for investing capital in the utility industry. Others have recognized this problem, which makes it very difficult, if not impossible, to attract capital investment to the utilities I manage in the State of Arizona.[8]

Q. DO YOU HAVE ANYTHING TO SAY IN RESPONSE TO RUCO'S POSITIONS ON RATE BASE, REVENUES OR EXPENSES?

A. Again, Mr. Bourassa will address Mr. Moore's testimony on behalf of BMSC. However, I do want to briefly address Mr. Moore's testimony relating to non-recurring expense and wastewater treatment expense.

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[8] *See* November 7, 2008 Standard and Poor's Ratings Direct Report, "Assessing U.S. Regulatory Environments", rating Arizona as one of the 6 least credit supportive States in which to do business, attached as Sorensen RB Attachment 1. While that report was generated from the perspective of granting credit to utilities in the various 50 States, it would seem that one could draw a reasonable corollary from this report to equity investment, which has even more risk than debt.

Q. MR. MOORE TESTIFIED ON BEHALF OF RUCO THAT BMSC USED AN INCORRECT RATE FOR WASTEWATER TREATMENT EXPENSE. IS HE CORRECT?

A. Yes, he is, but unfortunately, Mr. Moore is also using an out of date number. The Company had originally used a base rate of $2.59 per thousand gallons, plus an environmental surcharge of 18.953% from the City of Scottsdale and City tax of 1.65% on the sum of those amounts. This was done to approximate the rate that would be in effect today. Mr. Moore used $2.53 per thousand gallons, plus the environmental surcharge and city tax, which was the rate in effect until June 30, 2009. Beginning July 1, 2009, the base rate increased to $2.61 per thousand gallons, plus the environmental surcharge of 18.953% or $.49 per thousand gallons, for a subtotal of $3.10 per thousand gallons, plus city tax of 1.65% of $.05 per thousand gallons, yielding a total rate of $3.15 per thousand gallons for treatment of sewage conveyed to the City of Scottsdale under our agreement.

Q. HOW DID THE COMPANY RECEIVE WORD OF THE COST INCREASE?

A. I received an email from a representative of the City confirming these rates. A copy of this email is being provided to the parties as part of our rebuttal work papers. Mr. Bourassa has made this adjustment in his rebuttal schedules.

Q. WHAT ADJUSTMENT DID MR. MOORE MAKE FOR NON-RECURRING EXPENSES?

A. As part of Mr. Moore's Operating Income Adjustment No. 5, he eliminated the cost of a clean-up that occurred during the test year. The cost he eliminated was $39,870 per his Schedule RLM-12. We certainly strive never to have a spill in our system, however, all systems have such incidents from time to time. Ms. Brown recognized this fact in her testimony and schedules by recommending that one-

third of the spill clean-up cost, or $13,290, be included in test-year operating expense.[9] I believe in this instance her position is a fair compromise and urge RUCO to adopt it to eliminate an issue in dispute.

VI. REBUTTAL TO STAFF

Q. HAVE YOU REVIEWED THE DIRECT TESTIMONIES FILED BY COMMISSION STAFF IN THIS RATE CASE?

A. I have read the testimony by Ms. Brown and the Engineering Report by Ms. Hains. I am also familiar with the recommendations made by Mr. Manrique.

Q. STAFF RECOMMENDS A RETURN ON EQUITY OF 9.6 PERCENT. DO YOU BELIEVE THAT IS REASONABLE?

A. I will leave the detailed model and theory based testimony to Mr. Bourassa. Staff's ROE recommendation certainly moves closer to a reasonable solution than RUCO's recommended ROE of 8.22%, with an effective phantom rate of 7.44%, which won't attract capital. Still, I believe Staff's ROE is too low to attract capital to Arizona when other more profitable, less risky investments are readily available to our investors in other states. I also believe Staff's recommended 70 basis point financial risk adjustment is too high considering we do have debt on the Company's books, as I explained above in response to Mr. Rigsby's recommendations.

Q. THANK YOU, MR. SORENSEN. TURNING TO MS. HAINS' ENGINEERING REPORT, WERE YOU SURPRISED THAT STAFF RECOMMENDED DENIAL OF THE HOOK UP FEE?

A. Yes, and we immediately contacted Staff to discuss this issue with them. I understand from those discussions that Staff now supports the Company's

[9] Brown Dt. at Operating Adjustment No. 4, Schedule CSB-15.

proposed hook up fee tariff and will reflect this in its surrebuttal filing. If I am mistaken, I will address this issue further at the rejoinder stage of this matter.

Q. OKAY. ARE THERE ANY OTHER ASPECTS OF MS. HAINS' REPORT AND RECOMMENDATIONS THAT YOU WISH TO ADDRESS AT THIS TIME?

A. Yes. In her Staff Report, Section H, Tables 5 and 6, I found what I believe to be two separate math errors, which we hope Staff will correct. First, in Table 5, Ms. Hains recommended quarterly Cadmium samples at $15 each (4 per year), but the total in her table was $40, not $60 as is appropriate. Second, in Table 6, she recommended seven quarterly BOD samples, or 28 during the year, at the rate of $36 each. Her total cost for the year was $168, but the total should have been $1,008. The net impact of these two math errors would increase her recommendation for annual testing expense from $14,362 (included as Ms. Brown's Operating Income Adjustment No. 8), to $15,222. BMSC would accept this figure as adjusted test year testing expense, before any adjustment for known and measurable changes, which I will also discuss.

Q. PLEASE DO.

A. Since Staff's testimony was filed, we have been notified by the City of Scottsdale that our testing requirements will increase. This testing is now going to be required in addition to the testing we currently do at the wastewater treatment plant as the required sample point is different, and certain tests, like for Total Suspended Solids (TSS), will increase from that which we currently do for the City. These increased requirements will cost the Company an additional $13,360 in annual testing costs. The letter and cost calculation will be provided to the parties to this case as part of the workpapers. Meanwhile, we feel this cost increase is known and measurable, and hope it will increase Staff's Adjustment No. 8 to increase test year testing

expense by $11,627 ($15,222 + 13,360 - $16,955) above the testing cost of $16,955 as filed. This would eliminate an issue in dispute in this rate case.

Q. DO YOU HAVE ANY TESTIMONY TO PROVIDE IN RESPONSE TO MS. BROWN'S DIRECT TESTIMONY?

A. I do, although I note from the outset that Mr. Bourassa addresses the Company's response to the rate base and income statement adjustments recommended by Staff. For my part, I will provide additional testimony regarding Ms. Brown's adjustments to the truck lease, Operating Income Adjustment No. 7. In addition, I will address the additional $42,200 of labor expenses that RUCO included in its testimony related to RLM Operating Income Adjustment No. 5 which the Company will adopt and adjust for in its Rebuttal schedules.

Q. OKAY, PLEASE START WITH THE TRUCK LEASE?

A. Ms. Brown correctly states in her testimony that the truck lease in Operating Income Adjustment No. 7 was in fact signed by Gold Canyon Sewer Company ("GCSC"), an affiliate of BMSC. The reason for this was that GCSC had a master lease with the vendor and it was easier to add a truck under that existing agreement than to create a new one. However, the truck has been used exclusively for the business of BMSC. It is not shared with GCSC on a 50% basis as Ms. Brown indicates. The truck in question, a 2007 Chevy Silverado, was designated originally as truck #109 for internal purposes. Later, it was reassigned #156 (*see* the Environmental Health & Safety mapping in my workpapers for the internal number assignment change). As proof of the truck's assignment to BMSC, included in the workpapers are Vehicle Inspection reports from 2007 for truck #109, signed by Ryan Kennedy, the BMSC Supervisor during the time, which note that truck 109 is for BMSC. As further evidence of this truck being a BMSC truck, Environmental Health and Safety weekly reports from the test year, which note

truck 109 being a BMSC truck, are being provided in the workpapers. Finally, I am also providing as part of the workpapers the GE Fleet invoices for June 2008 through October 2009. These invoices demonstrate that truck 109/156 is in the Algonquin Water Resources of America fleet, and the assigned company for the vehicle is Black Mountain Sewer Company. This truck was, during and subsequent to the test year, a BMSC truck.

Q. AND THE LABOR EXPENSE ISSUE?

A. During the course of the Company responding to Staff data request CSB 10.5, it was discovered that the charges from a temporary labor/services company, Aerotek, for certain of their temporary operators, were mistakenly charged to LPSCO, an affiliate of BMSC, instead of to BMSC. The invoices and the contractor's timecards were provided to Staff and RUCO as part of our response. There were no further questions, so we believed that what we provided was sufficient proof. In his Direct Testimony, Mr. Moore recommended, as part of RUCO Operating Income Adjustment No. 5, that the $42,200 of Aerotek labor costs be included as costs of the Company incurred during the test year. The Company agrees with Mr. Moore's position. Ms. Brown did not address the issue in her Direct Testimony.

Then, in response to a Company data request, Ms. Brown responded that "[s]ince the invoices in question do not specify the utility wherein the contract employees worked and Algonquin Water has several utilities in Arizona, there is no evidence on the invoices to justify moving the expense from Litchfield Park to Black Mountain." I agree with Ms. Brown that on the invoice's surface, it was not possible to tell whether Santiago Parra and Bret Hurd, the Aerotek employees assigned to BMSC, were actually assigned to BMSC. However, their timesheets were all signed by Ryan Kennedy, the wastewater supervisor at BMSC and their

supervisor during their time working for the Algonquin family of companies. Had Ms. Brown made us aware of her concerns over the assignment of Mr. Parra and Mr. Hurd, we would have pointed out that fact. We also could have provided her (and I now include in my workpapers) with weekly Tail Gate Session (Safety Meeting) participation sheets for BMSC, signed by Ryan Kennedy and the Aerotek contractors in question for the periods they were assigned to BMSC (1/23/08 – 6/30/08 for Mr. Parra and 3/11/08 – 5/17-08 for Mr. Hurd), as well as various training session sign-in sheets. I believe this is more than sufficient evidence and hope with this clarification and additional information that Ms. Brown will join RUCO and the Company in adjusting operating expenses by this $42,200, as it was a necessary expense incurred for the provision of proper service, incurred during the test year. This would eliminate another issue in dispute.

Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, although I wish to note that my silence on any issue does not necessarily signal the Company's agreement.

SORENSEN
RB ATTACHMENT 1

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November 7, 2008

Assessing U.S. Utility Regulatory Environments

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Assessing U.S. Utility Regulatory Environments

The assessment of regulatory risk is perhaps the most important factor in Standard & Poor's Ratings Services' analysis of a U.S. regulated, investor-owned utility's business risk. Each of the other four factors we examine--markets, operations, competitiveness, and management--can affect the quality of the regulation a utility experiences, but we believe the fundamental regulatory environment in the jurisdictions in which a utility operates often influences credit quality the most. In our credit analysis, we evaluate regulatory risk on a company-specific basis. A utility management's skill in managing regulatory risk can in many cases overcome a difficult regulatory environment. Conversely, other companies can experience greater regulatory risk even with supportive regulatory regimes if management fails to devote the necessary time and resources to the important task of managing regulatory risk. Operating in a state with a regulatory structure that is conducive to maintaining credit quality will improve the chances for a utility to successfully negotiate the regulatory maze.

This commentary discusses our views on what constitutes a favorable regulatory climate. We then use those factors to create assessments of the regulatory environments in states that regulate the electric and gas utilities that we rate. (See the table at the end of this article.) Our intention is to provide a common base for our own analysis of regulatory risk and to better communicate to investors, issuers, and regulators how various elements of regulation can affect credit quality. The exercise is also expected to enhance our ability to evaluate management by highlighting instances where our opinion of a company's regulatory risk diverges significantly from the fundamental quality of the regulatory jurisdictions where it operates.

The assessments of relevant jurisdictions are based on quantitative and qualitative factors. Importantly, we make our assessments from a credit perspective. We plan to update them annually or when significant events occur that have an important impact on the regulatory climate in a particular jurisdiction. The new regulatory assessment information augments the methodology applied to regulated utilities today.

Our introduction of these regulatory assessments coincides with what we view as the increasing influence of regulatory matters on the rated utilities' risk profiles and greater credit market awareness of the importance of understanding the regulatory process. Our goal in explaining our views on regulatory practices and policies and their effect on Standard & Poor's analysis of the credit quality of utilities is to provide additional transparency to the market.

Background

State utility regulation is almost as old as credit ratings. Standard & Poor's predecessor, Standard Statistics Bureau, was formed in 1906, and the first state utility commissions, as we know them today, appeared in 1907. Regulation has always been a factor in Standard & Poor's analysis of utility ratings, but its importance to our analysis has shifted with industry trends over time.

Before the 1970s, regulators presided for the most part over stable or decreasing rates as economic growth, rising consumption, and economies of scale drove costs down. The advent of inflation, rising and volatile fuel costs, and nuclear power missteps led to higher rates and, in our view, greater regulatory influence on credit quality during the 1980s. Restructuring in the natural gas and then the electric industries marked the 1990s and the first years of the new millennium, and the importance of regulatory issues in our analysis again started to subside. In our view, we are

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now in another era of increasing and unstable costs and some semblance of a return to traditional utility regulation. Consequently, the quality of regulation is at the forefront of our analysis of utility creditworthiness.

We have historically focused on regulatory risk on a company-specific basis. Nothing in what follows will change that approach. Utility commissions regulate diverse industries and adopt different approaches to different types of businesses. Treatment of utilities within the same industry can vary significantly in the same jurisdiction. The quality of the regulation experienced by a company is often the product of the company's management and business strategy as much as its regulators. The regulatory climate assessments only serve as a baseline of our opinion on the fundamental attitude of a jurisdiction toward the credit quality of the utilities in that state, and they are the starting point for Standard & Poor's analysis of the regulatory risk of each rated utility. Our goal is to achieve greater consistency and continuity in utility ratings.

Assessing Regulatory Jurisdictions

We assess jurisdictions on one basic attribute--the fundamental approach to controlling utility rates--and then in three major categories. The resulting assessments are based primarily on various measures of regulatory risk that are discussed briefly below. With respect to qualitative factors, we look for long-term, historical characteristics of the jurisdiction, as well as transient regulatory and political developments.

The foundation of our opinion of the regulation in a jurisdiction is the degree to which competitive market forces are allowed to influence rates. In order of credit-friendliness, a state will rely either on full cost-based regulation for all components of the utility bill, market-based mechanisms for generation, and (more rarely) retail markets, or a hybrid of the two to control the amount charged and the terms on which that service is offered. It may surprise some to learn that we consider a hybrid setup, which in most cases exists because the transition to some sort of competition has stalled, to harbor more risk for bondholders than a system that is committed to letting market prices set a major part of the customer's bill.

The risk inherent in the market-based model is straightforward: the price for electricity can be more volatile when based on a market than when it is based on embedded costs, and regulators are apt to resist full and timely recovery when changes in generation costs are abrupt and substantial (and perhaps misunderstood). The risks in a hybrid or transitional model are less apparent, but, in our opinion, potentially more significant. First, we consider the uncertainty of the timing of reaching the end state--and what that end state will look like--to be a negative factor from a credit perspective. Second, in some cases, the hybrid model may result in a "lower-of-cost-or-market" approach that allows generation rates to reflect one or the other at different times depending on which one suits ratepayers best. A utility and its bondholders may then face a prolonged period of potential exposure to market risk (the downside) with little or no opportunity to participate in the benefits of competition (the upside of greater returns).

After identifying the fundamental regulatory paradigm, our analysis turns to factors that influence the utility's business risk climate in the jurisdiction. The factors fall into three broad categories: ratemaking, political environment, and financial stability. Broadly speaking, the ratemaking and financial stability factors influence our assessments more than the paradigm and political factors.

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Ratemaking Practices And Procedures

The main, and often the most contentious, task of a regulator is to set the rates a utility may charge its customers. We analyze specific rate decisions as part of the surveillance of each utility. Our regulatory assessments focus on the jurisdiction's overall approach to setting rates and the process it uses to conduct and manage base rate filings. Practices pertaining to separate tariff clauses for large expense items are examined in the third category of the analysis (see below). In this part of the assessment, we concentrate on whether established base rates fairly reflect the cost structure of a utility and allow management an opportunity to earn a compensatory return that provides bondholders with a financial cushion that promotes credit quality.

Notably, the analysis does not revolve around "authorized" returns, but rather on actual earned returns. We note the many examples of utilities with healthy authorized returns that, we believe, have no meaningful expectation of actually earning that return because of rate case lag, expense disallowances, etc. Although, in general, the absolute level of financial returns is less important to our analysis than how that return is earned, we recognize that, all else being equal, higher earned returns translate into better credit metrics and a more comfortable equity cushion for bondholders. A regulatory approach that allows utilities the opportunity to consistently earn a reasonable return is a positive factor in our view of credit quality.

The rates of return and capital structures used to generate the revenue requirement in rate proceedings may not be the primary focus of the assessment, but those and other decisions made in the ratemaking process are still noted. We consider those decisions to be potential signals from regulators on their attitude toward credit quality. We believe that the capital structure in particular is a handy and direct indication from the regulator as to whether or not creditworthiness is an important consideration in its deliberations when setting rates. Obviously, any pronouncements from a regulator that explicitly address credit ratings or ratemaking practices that incorporate credit-minded adjustments (e.g., the use of double-leveraged capital structures or off-balance-sheet debt-like obligations) are considered in the Standard & Poor's assessment.

We analyze the issue of "regulatory lag" in a comprehensive manner and not just as a matter of the efficiency of the regulator in completing rate cases. As part of this analysis, we evaluate the timeliness of rate decisions, coupled with an evaluation of the test year. In addition, we take into account the timing of interim rates, and other practices that affect the appropriateness of rates periodically established by the regulator. We do not view the issue of regulatory lag as an intermittent concern, consequential only during times of acute inflation or rising capital spending, but as a consistent part of our credit analysis. Accordingly, in our regulatory assessments we focus on whether the regulator efficiently prosecutes rate requests and bases its decisions with respect to rate setting on the most current information.

In our view, the prevalence of rate case settlements is not necessarily an important credit consideration. Although the common assumption among market participants seems to be that a settlement must be in the best interest of a utility, we believe this assumption disregards the possibility that management will sometimes make decisions based on its effect on earnings at the expense of cash flow considerations. This does not mean we dismiss the ability of stipulations to reach a fair resolution of difficult matters that help regulators issue timely and constructive rate decisions. It just means that frequent settlements do not, in our view, directly lead to a conclusion that the regulatory environment in a state enhances credit quality.

An important policy-related issue outside of individual rate cases that falls under this part of the assessment is the

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regulatory oversight of large capital projects with long lead times that carry out-sized risks to a utility and its bondholders. In our opinion, practices such as legislative or regulatory recognition of the need for pre-approval of such endeavors, periodic reviews that substantively involve the regulator in the progress of the project, and rolling prudence determinations during construction can reduce the general level of risk associated with a utility committing substantial capital well in advance of the rate proceeding that results in the project being placed into rate base. Before committing to such projects, a resource-procurement process that uses objective guidelines to evaluate competing proposals to meet load obligations and keeps the regulator informed and involved in the decisions can, in our view, help to reduce the risk of subsequent disallowances. If the jurisdiction has an Integrated Resource Plan or similar mechanism that includes the participation of many parties and is used to definitively establish the need for new generation, we consider credit risk to be further diminished.

One more factor that we examine in this part of the analysis is whether a jurisdiction employs nontraditional ratemaking practices. Examples of what we may view to be potentially credit-enhancing regulatory mechanisms include weather normalization and incentive ratemaking. We believe that the beneficial effect on credit quality of a tariff clause that smooths out cash flows that can vary with outside influences like weather is self evident. The benefits of incentives incorporated into the regulatory regime may be less clear. Well-designed incentives can be at least credit neutral. A moderate amount of incentives can be credit supportive. We generally view incentive provisions (whether tied to cost control, reliability, or operational performance) as being beneficial for credit quality if they are linked to fair and objective benchmarks. Incentives that lack some or all of those features, such as a plain, long-term rate freeze, can be, in our opinion, detrimental to credit quality.

Political Insulation

The role of politics in utility regulation is often misunderstood. In most jurisdictions, legislatures created regulatory commissions and invested them with the power to set and enforce utility rates and service standards. Regardless of how a regulatory commission is statutorily organized, its function is to set and regulate rates and service standards with due regard not only for the interests of those who advance the capital needed to provide safe and reliable utility service but for other constituents as well. In this regard, bondholders should recognize that the setting of utility rates invariably reflects political as well as economic factors. Therefore, the potential for political considerations to affect utility regulation can be a key determinant when we assess a regulatory jurisdiction.

A primary factor in this part of our assessment is the method of selecting utility commissioners. In some jurisdictions, the governors appoint regulatory commissioners. In others, the same voters who pay utility bills directly elect commissioners. The regulatory risk associated with that model can sometimes be managed, but there is an inherent level of risk in elected regulatory bodies that we reflect in the assessment. Standard & Poor's also analyzes the track record of the involvement of the executive branch or the legislature in utility matters, and the relative visibility of utility issues in the political arena.

The ability of a regulator to deliver sound, fair, and timely rate decisions and set prudent regulatory policies that assist utility managers in managing business and financial risk can be affected by the overall atmosphere that it operates in. The tone can be set by the governor or legislature, the history and tradition of independence accorded to the regulatory body, and the behavior of important constituent groups that intervene in utility proceedings.

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Cash Flow Support And Stability

The final set of factors in our assessment of regulatory environments is arguably the most important. The phrase "cash is king" can be overused, but it does highlight an essential part of the credit analysis. A regulatory jurisdiction that recognizes the significance of cash flow in its decision making is one that will appeal to bondholders. Generating cash is a function of the actions of utility management, but the regulator can supply (or withhold) the tools that can affect the company's essential ability to actually realize the intended level of cash flow.

The most prominent factor in this part of the analysis is the application of separate tariff provisions for major expenses such as fuel and purchased power. The timely adjustment of rates in response to changing commodity prices and other expenses that are largely out of the control of utility management is a key component of a credit-enhancing regulatory jurisdiction. We analyze the quality of special tariff mechanisms to determine their effectiveness in producing the cash flow stability they are designed to achieve. The frequency of rate adjustments, the ability to quickly react to unusual market volatility, and the control of opportunities to engage in hindsight disallowances of costs could affect the analysis almost as much as whether the tariff provisions exist at all. The record of disallowances plays a part in the regulatory assessment.

The commission's policies and oversight covering hedging activities may also be a factor in this part of the review if a utility has sought regulatory approval. For utilities that attempt to manage commodity risks, we look for a clearly-stated hedging policy and a track record of activity that conforms to that policy. The responsibility for communicating the policy and demonstrating the prudence of the hedging activity rests with the utility, but the initial response to a hedging program and the history of the regulator's treatment of the results of the program could influence our assessment.

Regulators can employ other ratemaking techniques that promote stable cash flows. We consider a commission's decisions on rate design in assessing its attitude on credit quality. For example, we take into account the relative size of the typical monthly customer charge, a decoupling mechanism that severs the direct relationship between revenues and customer usage, or other rate design features that bolster credit quality.

Especially during upswings in the capital expenditure cycle, such as we are experiencing now, a jurisdiction's willingness to support large capital projects with cash during the construction phase is an important aspect of our analysis. This is especially true for ventures with big budgets and long lead times, such as baseload coal-fired or nuclear power plants and high-voltage transmission lines that are susceptible to construction delays. Allowance of a cash return on construction work-in-progress or similar ratemaking methods historically were considered extraordinary measures for use in unusual circumstances, but in today's environment of rising construction costs and possible inflationary pressures, cash flow support could be crucial in maintaining credit quality through the spending program.

Jurisdictional Assessments

The table below shows Standard & Poor's assessments of regulatory jurisdictions. The category titles are designed to communicate one other important point regarding utility regulation and its effect on ratings. All categories are denoted as "credit-supportive". To one degree or another, all U.S. utility regulation sustains credit quality when compared with the rest of corporate ratings at Standard & Poor's. The presence of regulators, no matter where in

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the spectrum of our assessments, reduces business risk and generally supports all U.S. utility ratings.

Regulatory Jurisdictions For Utilities Among U.S. States

Most credit supportive	More credit supportive	Credit supportive	Less credit supportive	Least credit supportive
	Alabama	Arkansas	Louisiana	Arizona
	California	Colorado	Maine	Delaware
	Florida	Connecticut	Missouri	Dist. of Columbia
	Georgia	Hawaii	Montana	Illinois
	Indiana	Idaho	New York	Maryland
	Iowa	Kansas	Oklahoma	New Mexico
	South Carolina	Kentucky	Rhode Island	
	Wisconsin	Massachusetts	Texas	
		Michigan	Utah	
		Minnesota	Vermont	
		Mississippi	Washington	
		Nevada	West Virginia	
		New Hampshire	Wyoming	
		New Jersey		
		North Carolina		
		North Dakota		
		Ohio		
		Oregon		
		Pennsylvania		
		South Dakota		
		Virginia		

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REJOINDER TESTIMONY OF

GREGORY S. SORENSEN

November 16, 2009

EXHIBIT
A-3
ADMITTED

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I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Greg Sorensen. My business address is 12725 W. Indian School Road, Suite D-101, Avondale, AZ 85392.

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

A. Yes, my direct and rebuttal testimony were submitted in support of the initial application and the rebuttal filing in this docket by Black Mountain Sewer Corporation ("BMSC" or "Company").

Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY?

A. To further support BMSC's application for rate relief by responding to certain aspects of the surrebuttal testimony of Utilities Division Staff ("Staff"), and the Intervenors, RUCO, Dr. Doelle and Boulders Home Owners Association ("BHOA").

Q. PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY?

A. First, I will address the BHOA testimony of Mr. Peterson, including the gain share on the future sale of land and the rate impact on customers. Second, I will address Dr. Doelle's testimony his requested "special rate." Additionally, I will discuss RUCO's choice to exclude properly incurred costs related to a regrettable spill, and I will further address RUCO's position on the BHOA proposed plant closure. Finally, I will address Staff's positions on the HUF, wastewater testing costs, and a few of Ms. Brown's positions, including those on the transfer of an odor scrubber from an affiliate, incentive compensation, transportation expense, and the Company's shared services model and the related costs thereof.

II. REJOINDER TO BHOA TESTIMONY

Q. HAVE YOU REVIEWED THE TESTIMONY BY LES PETERSON ON BEHALF OF THE BHOA?

A. Yes, I have.

Q. DO YOU AGREE WITH MR. PETERSON'S TESTIMONY REGARDING THE SHARING OF THE GAIN ON THE SALE OF THE LAND WHERE THE PLANT IS LOCATED?

A. Yes, Mr. Peterson has accurately described our agreement concerning selling the land and how it would be treated.[1] Like Mr. Peterson, BMSC hopes that we can sell the parcel at the highest possible price, and that such sale would eventually reduce the rate impacts of the plant closure project. However, we do not know when we can complete such a sale, nor do we know the final sales price.

Q. WOULDN'T IT REDUCE THE RATE IMPACT FURTHER IF BMSC ALLOWED ALL OF THE GAIN TO INURE TO THE BENEFIT OF THE RATEPAYERS?

A. Yes, but why would BMSC agree to sell its property solely for the benefit of third-parties? It wouldn't, which is why the agreement between BMSC and the BHOA provides that the parties' parcels will be joined together, sold, and the profit from the proceeds shared. This seems very fair to us.

Q. THANK YOU MR. SORENSEN. WHAT ABOUT MR. PETERSON'S TESTIMONY THAT THE RATE IMPACT WOULD BE LOWER IF BMSC EXPERIENCES CUSTOMER GROWTH?

A. Mr. Peterson is right. But, the rate impact could be higher too, if we experience a loss of customers. Which is really our central point – we do not know what this

[1] Surrebuttal Testimony of Les Peterson at 3:4-16.

project is going to cost for certain, and we do not know the rate impact. We can identify factors that will affect the final rate impact on our ratepayers, and we can estimate the costs, as we have done. In the end though, it will cost what it costs and the rate impact will follow directly from that cost, and that is the investment we expect to earn a return on in accordance with our agreement.

Q. SO BMSC REALLY CAN SPEND WHATEVER IT WANTS AND IT WILL AUTOMATICALLY GET A RETURN?

A. Of course not. As I testified in my rebuttal, we are not asking for a blank check, and we do not intend to spend a dollar more than we need to spend to complete the project and maintain service to all of our ratepayers. But, we are asking for a recovery mechanism that allows us to obtain a return on and of our reasonable and prudent investment without the usual ratemaking lag. We fully expect to have to justify that what we spent was in fact reasonable and prudent if Staff, RUCO and/or the BHOA, or the Commission, believe otherwise.

III. REJOINDER TO DR. DOELLE

Q. HAVE YOU REVIEWED DR. DOELLE'S TESTIMONY DATED NOVEMBER 9, 2009?

A. Yes.

Q. DR. DOELLE TESTIFIED THAT YOU APPEAR TO AGREE WITH HIM THAT THE RATE HE IS PAYING IS "UNREASONABLE AND NEEDS TO BE RECONSIDERED."[2] IS THAT ACCURATE?

A. No, BMSC in no way believes that the rates Dr. Doelle is paying for service to his business are unreasonable. The Commission sets the rates and we charge them. My only point is that it is up to the Commission, not BMSC, to decide whether Dr.

[2] Dr. Doelle Testimony (November 9, 2009) at 1.

Doelle deserves special treatment, and then how to provide it to him without adversely impacting our ability to earn our revenue requirement.

Q. BUT ISN'T BMSC ASKING THE COMMISSION TO ELIMINATE THE SPECIAL RATES IT HAS FOR CERTAIN COMMERCIAL CUSTOMERS?

A. Yes, because the other customers on the system are subsidizing these "special rate" customers and we have no idea how they originated. Additionally, these different commercial rates are harder to administer, and if 14 customers have special rates, then there is always a 15th customer that also wants special treatment.

Q. THEN WHY NOT JUST OPPOSE DR. DOELLE'S REQUEST TO BE A SPECIAL RATE CUSTOMER?

A. Dr. Doelle is a customer and he pays his bill every month. He has taken the time to intervene in this case and have his concerns heard. Also, we are not in a position to respond to the Doctor's discussion of modern dental technology, and I surely was not going add to the rate case expense by hiring an expert. As such, we left it to the Commission to decide whether Dr. Doelle deserves special treatment.

Q. BUT THE COMPANY STILL ASKS THAT THE COMMISSION ELIMINATE THE EXISTING SPECIAL RATES?

A. Absolutely. There is no evidence in the record to support continuation of these special rates therefore, as I explain in further detail below in rejoinder to Ms. Brown, they should be eliminated.

Q. DO YOU HAVE ANY OTHER REJOINDER TO DR. DOELLE?

A. Yes. Dr. Doelle continues to advocate sewer rates based on water usage.[3] But this position ignores my testimony that we have multiple water providers in our service

[3] *Id.* at 2-3.

area and we do not have any access to water usage information.[4] We simply cannot bill Dr. Doelle or any other customer based on water usage.

IV. REJOINDER TO RUCO

Q. HAVE YOU REVIEWED THE SURREBUTTAL TESTIMONY FILED BY RUCO?

A. I have reviewed Mr. Rigsby's testimony on cost of capital but will let Mr. Bourassa respond. All I can say, again, is that adoption of Mr. Rigsby's recommended cost of capital will reduce the amount of capital we have available for investment in Arizona.[5] I have also reviewed Mr. Rigsby's testimony in response to the BHOA and I will address that here.

Q. WHAT ABOUT MR. MOORE'S SURREBUTTAL TESTIMONY?

A. I have reviewed his testimony and I will respond to his rejoinder testimony regarding "unnecessary and non-recurring" expenses. I also want to express our gratitude to Mr. Moore. In our rebuttal, we went a long way to provide additional information and explanation regarding several of the other parties' adjustments, and we invited the other parties to use that information to reduce the number of issues in dispute. Mr. Moore did that and we commend him for his cooperative efforts. It shows that the parties can work together to reduce disputes, which benefits all of the stakeholders in a rate case.

Q. THANK YOU MR. SORENSEN. WOULD YOU PLEASE RESPOND TO MR. MOORE'S SURREBUTTAL TESTIMONY THAT $39,870 OF CLEAN-UP COSTS WERE "UNNECESSARY"?

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[4] Rebuttal Testimony of Gregory S. Sorensen ("Sorensen Rb.") at 5:15-21.

[5] Sorensen Rb. at 9-11.

A. Yes. I assume Mr. Moore is not suggesting that the clean-up of an unexpected discharge of wastewater was unnecessary, but rather that the spill was unnecessary. But I don't think "unnecessary" properly characterizes the circumstances. Of course, unexpected wastewater discharges are not necessary or desirable. They are also unfortunate and regrettable, but they are part of operating any wastewater collection and treatment system. Agencies such as ADEQ and MCESD recognize the fact that unexpected wastewater discharges do occur. They evaluate the cause of the spill and the clean-up effort. In our case, as a result of our prompt and thorough remediation, we were not issued an NOV for the aforementioned spill.

In other words, discharges happen, and what is necessary and proper is immediate response and remediation. We did that, and now RUCO wants BMSC to eat all costs of clean-up as just a cost of doing business for the shareholders. In contrast, Staff's recommended expense levels recognize these costs as a cost of BMSC's normal operations, which is why we support the adjustment by Ms. Brown to Contractual Services expense.

Q. YOU TESTIFIED THAT YOU ALSO WISH TO RESPOND TO MR. RIGSBY'S TESTIMONY REGARDING THE AGREEMENT WITH THE BHOA?

A. Yes. For starters, Mr. Rigsby does not seem to understand the process to close the plant.

Q. WHY DO YOU SAY THAT?

A. Because RUCO's recommendation is that "the Commission allow BMSC to retire the treatment facility and require the Company to file a general rate case application twelve months after the retirement."[6] Retiring plant is a bookkeeping

[6] Surrebuttal Testimony of William A. Rigsby ("Rigsby Sb.") at 9:6-8.

entry. In order to close the plant, we need to remove infrastructure and comply with all of the closure requirements under law. We also need to reroute flows by making modifications to our collection and transmission system and we need to buy $720,000 of additional capacity from Scottsdale. This is not simply about writing the plant off the books and then seeing what happens.

Q. MR. RIGSBY TESTIFIES THAT RUCO IS CONCERNED THAT THE PLANT CLOSURE WON'T SOLVE THE ODOR PROBLEM. HOW DO YOU RESPOND?

A. That Mr. Rigsby does not know what he is talking about. He has not conducted any discovery, visited the plant, nor talked to our engineers or the members of the BHOA, to my knowledge. All Mr. Rigsby bases his testimony on is alleged correspondence with parties' lawyers.[7] Clearly, Mr. Rigsby does not have sufficient evidence to support his belief that closing the plant will not eliminate odor emissions.

Q. BUT HOW CAN BMSC BE SURE THAT REMOVAL OF THE PLANT WILL ADDRESS THE ODOR PROBLEM THE BHOA MEMBERS ARE COMPLAINING ABOUT?

A. The current plant operates within all regulatory requirements. However, as with any operating wastewater plant, it does emit odors from time to time. The odors are emitted as part of the treatment process. This treatment process is what the plant does. If the plant is eliminated, there will be no more treatment process on the site. Also, the lift station on the plant site will be eliminated. Currently, this lift station "lifts" sewage from the collection lines to the plant for treatment. If the plant is eliminated, some additional pipes will be placed underground connecting

[7] Rigsby Sb. at 4.

and essentially bypassing the plant site (lines will be along the current roadway in front of plant site). These pipes will be underground, with little chance for odors to escape. All that would remain is a collection system.

Q. BUT MR. SORENSEN, WASN'T THE COMPANY HAVING TROUBLE WITH ODORS FROM THE COLLECTION SYSTEM IN THE LAST RATE CASE?

A. Yes, and we have resolved those concerns. But it is appropriate to qualify my testimony because in any collection system, odors are emitted periodically from manholes (which we try to keep sealed) and occasionally a lift station will have a mechanical failure that can result in odor emission. Those types of odors won't be eliminated by removal of the plant, but with the plant gone and collection lines on that property buried, there would not be odors coming from that location.

Q. MR. RIGSBY ALSO EXPRESSES CONCERN OVER "THE BROADER RATEMAKING IMPACTS AND PRECEDENTS" OF THE RATE RATEMAKING RELIEF CALLED FOR IN THE SETTLEMENT AGREEMENT. HOW DO YOU RESPOND?

A. That I doubt that the approvals sought by BMSC and the BHOA will have a detrimental impact on all of Arizona's ratepayers.[8] This is an extraordinary circumstance and it calls for extraordinary measures. In this case, our residential utility consumers are asking for something, and are willing to pay for it. The Company has agreed to oblige the request if certain conditions are met. I view this as an overall "positive" example of a utility company and its customers working together. Perhaps that is the precedent we should be trying to set.

[8] *See* Rigsby Sb. at 4-7.

Q. WHY DO YOU BELIEVE THIS IS AN EXTRAORDINARY CIRCUMSTANCE?

A. Our customers have intervened in this rate case because they want a part of our system to be removed. The plant is currently used and necessary for service, but the Company would prefer to work with its customers to meet their desires where possible. Ironically, the perception that we were not listening to our customers lead to substantial criticism by the Commission in the last rate case. Since then we have worked very hard to be a part of the community we serve. The agreement with the BHOA is a significant step, and all the ratepayers and Company need is Commission approval of the ratemaking provisions of the settlement agreement.

Q. CAN THE COMMISSION GRANT THE NECESSARY APPROVALS?

A. I am not a lawyer, but I am aware that the Commission has authorized adjuster mechanisms and surcharges in other cases. Mr. Rigsby recognizes this too, and he does not assert that the Commission cannot grant the needed relief. He testifies that the Commission shouldn't because such relief is reserved for extraordinary circumstances.[9] As I testified, these are extraordinary circumstances, and it is simply unfortunate that RUCO doesn't see that based on the concerns expressed by its constituents in this case.

V. <u>REJOINDER TO STAFF</u>

Q. HAVE YOU REVIEWED THE SURREBUTTAL TESTIMONIES FILED BY COMMISSION STAFF IN THIS RATE CASE?

A. I have read the testimonies of Ms. Brown and Ms. Hains. I am also familiar with the positions expressed by Mr. Manrique in his surrebuttal. As with Mr. Rigsby's cost of capital recommendations, I will let Mr. Bourassa provide the Company's

[9] *See* Rigsby Sb. at 7-8.

specific responses. For my part, while Mr. Manrique's recommended ROE is certainly preferable to Mr. Rigsby's, the returns BMSC would realize if Staff's ROE were approved still do not compare favorably with the returns on other assets by APIF. This means that we will have a very difficult time competing for capital beyond the smallest amount needed to maintain the bare minimum level of service.

Q. BUT MR. SORENSEN, HASN'T BMSC COMMITTED TO SPEND AN ESTIMATED $1.5 MILLION TO $2 MILLION ON THE PLANT CLOSURE PROJECT?

A. Yes, but the shareholder's willingness to supply the necessary capital is contingent on the recovery mechanism. If the shareholder isn't assured that it will earn a return on and of its investment, there is no way I am going to get that kind of money to take a used and useful asset out of service. This mindset is the direct result of the regulatory lag inherent in Arizona's ratemaking process, the low rates of return that are being authorized by the Commission, and decisions by this Commission, like the recent decision for BMSC's affiliate Gold Canyon Sewer, that make investing capital here a poor investment decision.

Q. DOES STAFF ADDRESS THE BHOA-BMSC AGREEMENT?

A. No.

Q. THEN WHAT RESPONSE DO YOU HAVE TO MS. HAINS' SURREBUTTAL?

A. Ms. Hains again addresses Staff's recommended reduction in testing costs and Staff's recommended denial of the requested hook-up fee or HUF tariff in her surrebuttal. I will address both of these issues.

Q. DIDN'T YOU TESTIFY IN YOUR REBUTTAL THAT STAFF SUPPORTED THE COMPANY'S PROPOSED HUF DESPITE THE OPPOSITION EXPRESSED IN MS. HAINS' DIRECT?

A. Yes, I did because that is what Staff told the Company its position was shortly after we contacted them about Ms. Hains' direct testimony and explained that we do not already have 1 million gallons of treatment capacity from Scottsdale. This was Ms. Hains' reasoning for recommending denial of the HUF tariff in her direct testimony.[10] I was pretty surprised when I read Ms. Hains' surrebuttal testimony and saw that Staff's position had changed again.

Q. WHAT REASON DOES MS. HAINS GIVE NOW FOR DENIAL OF THE HUF TARIFF?

A. As best I can tell, Ms. Hains thinks our proposed HUF level is too high.[11] To be honest, I can't really follow Ms. Hains' calculation, but I do not agree that our proposed HUF tariff amount is too high. However, Ms. Hains has also submitted an alternative recommendation with different HUF amounts than our proposed HUF tariff. We are willing to accept Staff's recommended HUF amounts, and we will agree to use the HUF form of tariff Mr. Scott recently recommended in the rate case for BMSC's affiliate, LPSCO.[12] However, in the LPSCO case (or others) we may still address concerns with that form of tariff, including perhaps reworking the language in Section IV so as to ensure HUF funds can be used to purchase capacity.

Q. THANK YOU MR. SORENSEN. WOULD YOU PLEASE ADDRESS MS. HAINS' POSITION ON TESTING COSTS?

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[10] Direct Testimony of Dorothy Hains ("Hains Dt.") at Engineering Report Section H.

[11] Surrebuttal Testimony of Dorothy Hains ("Hains Sb.") at 1-2.

[12] Attached as **Sorensen Rejoinder Exhibit 1** is a form of HUF tariff identical to that proposed by Staff in the recent filing it made in the LPSCO rate case, Docket No. SW-01428A-09-0103, but with Ms. Hains' alternative recommended HUF amounts.

A. Yes, although Ms. Hains has corrected some mistakes in her costs, she still recommends a reduction in testing costs because she does not believe that the additional testing that we have been conducting is "required."[13]

Q. DO YOU AGREE?

A. No. Although we do not yet have a new agreement with the City of Scottsdale codifying the City's new sampling plant, the City has made it clear that it wants us to follow this testing plan today. According to Ms. Hains though, we should just refuse the City's certain request because it is not yet written into an agreement as a requirement. We trust the Commission will not be so cavalier with the City's wishes to protect the public health.

Q. WHAT ABOUT MS. BROWN'S SURREBUTTAL. WHAT ISSUES DO YOU WISH TO ADDRESS?

A. I will provide rejoinder to Ms. Brown's surrebuttal testimony on (1) the inclusion of BMSC's odor control unit in rate base; (2) on the reduction of operating expenses to remove "bonuses"; and (3) transportation expense. Additionally, I will address Ms. Brown's adjustments to contractual services in conjunction with Mr. Bourassa's rejoinder on this issue.

Q. WHAT IS YOUR CONCERN WITH STAFF'S POSITION ON THE ODOR CONTROL UNIT?

A. My concern is that while Ms. Brown claims she does not have sufficient information to place the unit in rate base, her colleague removed the plant from LPSCO's rate base because it was transferred to BMSC.[14] This kind of

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[13] Hains Dt. at 4.

[14] *Compare* Surrebuttal Testimony of Crystal S. Brown ("Brown Sb.") at 3 *with* Direct Testimony of Jeffrey M. Michlik (wastewater) (Docket No. SW-01428A-09-0103) at 8-9.

inconsistency makes it hard for us to transfer assets between affiliates when it is very evident that such transfer is a benefit to the receiving utility.

Q. WHY IS THIS BENEFIT "VERY EVIDENT" MR. SORENSEN?

A. We took something one of our affiliates didn't need any more and moved it to another system where it was needed, and obtained a substantial savings. Now, the lesson we will take from Staff's two different adjustments is next time we will just buy new odor control equipment for BMSC at several times the cost. This harms the customers by increasing rates when not otherwise necessary because of Staff's inconsistent treatment of these types of transfers.

Q. BUT WHAT ABOUT MS. BROWN'S CONCERN THAT SHE CANNOT VERIFY THE PLANT ITEM?

A. Staff did not have any problem verifying it for removal from LPSCO's rate base, so I fail to see the problem here. Moreover, what Ms. Brown asks for is extremely difficult to produce. The odor control unit was purchased as part of a major plant upgrade project at LPSCO. While we have tried very hard with the vendor to produce the requested documentation, what Ms. Brown has asked the Company to do is similar to asking a car dealership to give a customer a separate invoice for tires when it purchases a car. It simply does not happen. The tires can be transferred between cars and have standalone value, but were purchased as part of a car. And again, the evidence was sufficient in another rate case. It should be here as well.

Q. YOU ALSO MENTIONED STAFF'S REMOVAL OF THE COST OF BONUSES.

A. Yes, to begin with, Ms. Brown is absolutely wrong in asserting that bonuses harm our ratepayers because the costs are not needed in the provision of service.[15] With

[15] Brown Sb. at 24:15-20.

all due respect, Ms. Brown does not seem to understand much about performance based compensation and how it works in a real business.

Q. WHY DO YOU SAY THAT, MR. SORENSEN?

A. Whether we pay an employee $42,000 a year base salary with a $3,000 bonus for performance, or we pay him/her $45,000 a year base salary, the impact on operating expenses is the same. However, we have found that by paying part of the salary as an incentive or "bonus" that can be taken away for inadequate performance, overall employee productivity increases. This is a benefit, not a detriment to customers, and it shows that Staff's adjustment is based on form, not substance.

Q. WHY DO YOU SAY THAT?

A. Because it seems that Ms. Brown is offended by the word "bonus." The $3,000 in the above example could be recharacterized as "pay at risk" if that is more palatable. We strive to pay our employees at "market rates." In the above example, the employee's TOTAL compensation would be compared to comparable jobs in the local/national job market to ensure the total amount paid is fair. Then, the amount of bonus, or pay at risk, is determined and is broken out from the market rate, with the remainder being paid as the base wage. Again, the ratepayer is not harmed because at worst, if the employee's performance is good, the customer is paying for the market rate. If the performance isn't up to par, the employee is paid less. Essentially, the customer is getting what they paid for in terms of employee performance.

Q. WOULD YOU PLEASE ADDRESS MS. BROWN'S ADJUSTMENT FOR TRANSPORTATION EXPENSE?

A. Yes, like the odor control unit transferred from LPSCO to BMSC, this issue seems to be another lesson in no good deed goes unpunished.

Q. PLEASE EXPLAIN WHAT YOU MEAN?

A. Ms. Brown is of the belief that because BMSC's truck was leased in the name of an affiliate, Gold Canyon, the truck could be used for another utility.[16] Ms. Brown is not following the facts. The vehicle was leased in Gold Canyon's name because Liberty Water has an open account with a lessor in that affiliate's name. This made the purchase easier and ensured we got the best deal possible. That is the extent of Gold Canyon's involvement. The truck is BMSC's, it is used exclusively for BMSC and no other utility, and the expense belongs 100 percent in BMSC's operating expenses.

Q. HAS THE COMPANY PROVIDED STAFF WITH EVIDENCE TO SUPPORT ITS POSITION?

A. Yes. We have provided Ms. Brown with evidence including health/safety and vehicle inspection logs which show that this is a BMSC vehicle.

Q. WHAT ABOUT MS. BROWN'S CONCERN THAT THE TRUCK COULD BE SHARED WITH GOLD CANYON?

A. There is no evidence that the truck is shared. The fact that the truck was leased in Gold Canyon's name does not make it any more likely that the truck would be shared with Gold Canyon any more so than that it would be shared with LPSCO, or Rio Rico Utilities in far southern, Arizona. Gold Canyon and BMSC are 40 miles apart, they don't routinely share trucks no matter whose name was on the original title. In fact, our BMSC operators were unaware of the fact that the truck was in the name of the affiliate until it was brought to their attention as a result of Ms. Brown's inquiries in this case. Again, this revelation was due to the fact that they had used the truck, since lease inception, exclusively for service at BMSC.

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[16] Brown Sb. at 32-33.

Q. YOU ALSO SAID YOU HAVE REJOINDER TESTIMONY ON CONTRACTUAL SERVICES EXPENSE. WHAT DO YOU WISH TO SAY?

A. In the last rate case for BMSC, the Company and Algonquin heard "loud and clear" that this Commission preferred a shared-service model in which the utility did not use a "market based rates" approach that includes a profit. According to the Commission, it was a no-no for an unregulated affiliate to earn a profit providing services to another regulated affiliate.

After Decision No. 69164, and then the same ratemaking treatment in Gold Canyon Sewer's 2007 rate decision, we restructured our shared services model to a true cost-based approach. This was consistent with the testimony in opposition to our prior shared services model voiced by Ms. Brown in both cases, and consistent we believed with similar models employed with approval by other holding companies regulated by the Commission.

Now, with this rate case, and five other Liberty Water utility providers in for rates, rather than welcoming our efforts to follow Staff's recommendations and the Commission's directive by redesigning our model, it appears Staff is looking for even more costs to strip out.

Q. THAT MAY BE TRUE MR. SORENSEN, BUT MS. BROWN DOES ASSERT THAT THESE ALLOCATED COSTS SIMPLY DO NOT BENEFIT RATEPAYERS.

A. Well, that is her testimony, but she is focused primarily on where the costs originate.[17] As Mr. Bourassa explains, the fact that APIF pursues a profit is

[17] Brown Sb. at 27.

immaterial,[18] as well as obviously not in dispute. As a result, Ms. Brown is not looking at the actual benefits from these costs, or their applicability to the utility.

Q. OKAY, LET'S START WITH WHY LIBERTY WATER USES A SHARED SERVICES MODEL?

A. Because a shared services approach centralizes common costs and spreads them across many companies. This is similar to how growth in a utility's customers can lower the per customer impact, and almost always yields a lower-cost result compared to a stand-alone. Staff agrees with the shared services model. In fact, Ms. Brown's opinion in the last rate case was that it would not be reasonable and prudent to operate each of our utilities on a stand alone basis.[19] In other words, I think everyone agrees that economies of scale are achieved.

Q. SO WHAT IS THE PROBLEM?

A. I think Ms. Brown views a shared services model as providing the same services as a stand-alone utility requires. Unfortunately, Ms. Brown does not see that the shared services model allows BMSC, and all of Liberty Water's affiliates in Arizona, to obtain more and better services than they ever could on a stand alone basis. For instance, the shared services model provides smaller companies, like BMSC, access to higher level personnel and expertise that it otherwise wouldn't be able to access easily. These personnel, at the Liberty Water and APIF level, include billing clerks, telephone operators, plant operators, engineers, environmental experts, accountants, tax experts, and strategic management professionals. Because the costs of all of these people's expertise are shared, every

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[18] Rejoinder Testimony of Thomas J. Bourassa – Rate Base, Income Statement and Rate Design ("Bourassa Rj.") at 23-24.

[19] Transcript from June 20, 2006 hearing at 778-779, *Black Mountain Sewer Corporation*, Docket No. SW-02361A-05-0657.

utility and every utility's ratepayers benefit. This is as much a part of a shared services model as saving money on paper and paper clips.

Q. WHAT ABOUT THE SPECIFIC COSTS MS. BROWN RECOMMENDS FOR DISALLOWANCE IN THIS CASE?

A. The starting point is a pool of roughly $4 million dollars allocated from APIF to all its facilities. The amount allocated to BMSC is 0.66% of this amount. This cost pool was supported to Staff by an itemized list of every item and providing invoices for all items over $5,000. We agree with Staff that approximately $190,000 of these costs likely should be excluded.[20] The rest of these costs, roughly $3.8 million, are beneficial in the provision of service to the ratepayers of BMSC and to the rest of the APIF facilities that share in these costs and benefits.

For example, many of the costs Staff proposes to exclude are related to the parent company's costs of being a publicly traded company. However, those costs also represent costs incurred to raise capital, including the capital that is raised for projects at BMSC. When the Commission ordered us in the last rate case to remove the CIE Lift Station and fix the odor issues on Boulders Drive, these projects cost well over $1 million. The BHOA is requesting that we undertake a $2 million project to close the sewer plant. Funds have to be raised somehow. And the costs Ms. Brown is excluding are, in large part, related to raising funds for projects necessary for this utility. If you take away the costs to raise funding for the utility, you will take away the Company's access to much needed investment capital.

[20] These costs include what can be loosely described as corporate perks, things like hockey tickets, and other gifts. While these things are clearly part of any large business expenses, we have no intention of arguing these costs should be passed down to the ratepayers.

The APIF cost component of the shared services model also provides the benefits of ensuring proper corporate governance and strategic planning. Mr. Bourassa also addresses the benefits of audits and tax professionals in his rejoinder.[21] All of these benefits inure to the ratepayers, but at a fraction of the cost if they were obtained by BMSC on a stand alone basis, if they could be obtained at all.

Q. MR. SORENSEN, WITH ALL THIS BENEFIT, COULDN'T THE ABSENCE OF SUCH A SHARED SERVICE MODEL LEAVE A UTILITY LESS HEALTHY?

A. Absolutely, and this is also part of the big picture that Ms. Brown's narrow view misses. That smaller, standalone "mom and pop" utilities don't enjoy these benefits is a good reason to encourage utility consolidation. Companies like the former McLain systems would never have had access to much needed capital to repair those systems and bring them back to acceptable operating utilities; not the third-world systems we initially acquired. They also lacked the management and oversight Liberty Water brings to its assets in Arizona, and APIF requires of all the utilities it owns. And I won't hesitate to point out that it was our shared services model that saved these assets and their ratepayers from a desperate situation. If our shared services model is going to be attacked again, and this time the consequence will be the inability to reimburse APIF for the costs of the benefits it provides, we are going to lose those benefits. This just makes a bad situation worse.

Q. THANK YOU MR. SORENSEN, DO YOU HAVE ANY OTHER COMMENTS ON THE DISPUTE OVER ALLOCATION OF CENTRAL OFFICE COSTS?

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[21] Bourassa Rj. at 25.

A. As a final note, while these costs are incurred in a non-regulated entity, that should be seen as further benefit. While I have never bought into the argument that regulated utilities do not control their costs because they have captive ratepayers, especially before this Commission, non-regulated entities are constantly trying to cut their costs as each dollar cut falls to the bottom line as profit. This has never been more true than during the recent economic downturn. So, it is in APIF's interest to keep a close eye on its costs, including those in this shared services model, as those costs are allocated to other non-regulated facilities as well. Again, BMSC and its ratepayers get the most possible benefit at the lowest possible cost. That Staff does not see this is unfortunate, but it would be far more unfortunate to gut our shared services model. Unlike last time, there will be no way to restructure and retain all of the benefits.

Q. DOES THAT CONCLUDE YOUR REJOINDER TESTIMONY?

A. Yes.

SORENSEN REJOINDER EXHIBIT 1

TARIFF SCHEDULE

UTILITY: Black Mountain Sewer Corporation
DOCKET NO. SW-02361A-08-0609

DECISION NO. _____
EFFECTIVE DATE:. __

OFF-SITE FACILITIES HOOK-UP FEE (WASTEWATER)

I. Purpose and Availability

The purpose of the off-site facilities hook-up fees payable to **Black Mountain Sewer Corporation** ("the Company") pursuant to this tariff is to equitably apportion the costs of constructing additional off-site facilities to provide wastewater treatment and disposal facilities among all new service laterals. These charges are applicable to all new service laterals undertaken via Collection Main Extension Agreements, or requests for service not requiring a Collection Main Extension Agreement, entered into after the effective date of this tariff. The charges are one-time charges and are payable as a condition to Company's establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-601 of the Arizona Corporation Commission's ("Commission") rules and regulations governing sewer utilities shall apply interpreting this tariff schedule.

"Applicant" means any party entering into an agreement with Company for the installation of wastewater facilities to serve new service laterals, and may include Developers and/or Builders of new residential subdivisions, and industrial or commercial properties.

"Company" means Black Mountain Sewer Corporation.

"Collection Main Extension Agreement" means an agreement whereby an Applicant, Developer and/or Builder agrees to advance the costs of the installation of wastewater facilities necessary to serve new service laterals, or install wastewater facilities to serve new service laterals and transfer ownership of such wastewater facilities to the Company, which agreement does not require the approval of the Commission pursuant to A.A.C. R-14-2-606, and shall have the same meaning as "Wastewater Facilities Agreement."

"Off-Site Facilities" means the wastewater treatment plant, sludge disposal facilities, effluent disposal facilities and related appurtenances necessary for proper operation, including engineering and design costs. Off-site facilities may also include lift stations, force mains, transportation mains and related appurtenances necessary for proper operation if these facilities are not for the exclusive use of the Applicant and benefit the entire wastewater system.

"Service Lateral" means and includes all service laterals for single-family residential, commercial, industrial or other uses.

III. Wastewater Hook-up Fee

For each new service lateral, the Company shall collect an off-site facilities hook-up fee as listed in the following table:

TREATMENT PLANT HOOK-UP FEE TARIFF TABLE		
Service Lateral Size	Factor	Fee
4-inch	1	$1,734
6-inch	2.25	$3,901
8-inch	4	$6,936
10-inch	6.25	$10,837

IV. Terms and Conditions

(A) Assessment of One Time Off-Site Facilities Hook-up Fee: The off-site facilities hook-up fee may be assessed only once per parcel, service lateral, or lot within a subdivision (similar to a service lateral installation charge).

(B) Use of Off-Site Facilities Hook-up Fee: Off-site facilities hook-up fees may only be used to pay for capital items of off-site facilities, or for repayment of loans obtained to fund the cost of installation of off-site facilities. Off-site hook-up fees shall not be used to cover repairs, maintenance, or operational costs.

(C) Time of Payment:

(1) In the event that the person or entity that will be constructing improvements ("Applicant," "Developer," or "Builder") is otherwise required to enter into a Collection Main Extension Agreement, payment of the fees required hereunder shall be made by the Applicant, Developer or Builder when operational acceptance is issued for the on-site wastewater facilities constructed to serve the improvement.

(2) In the event that the Applicant, Developer or Builder for service is not required to enter into a Collection Main Extension Agreement, the hook-up fee charges hereunder shall be due and payable at the time wastewater service is requested for the property.

(D) Off-Site Facilities Construction by Developer: Company and Applicant, Developer, or Builder may agree to construction of off-site facilities necessary to serve a particular development by Applicant, Developer or Builder, which facilities are then conveyed to Company. In that event, Company shall credit the total cost of such off-site facilities as an offset to off-site hook-up fees due under this Tariff. If the total cost of the

off-site facilities constructed by Applicant, Developer or Builder and conveyed to Company is less than the applicable off-site hook-up fees under this Tariff, Applicant, Developer or Builder shall pay the remaining amount of off-site hook-up fees owed hereunder. If the total cost of the off-site facilities contributed by Applicant, Developer or Builder and conveyed to Company is more than the applicable off-site hook-up fees under this Tariff, Developer or Builder shall be the difference upon acceptance of the off-site facilities by the Company.

(E) Failure to Pay Charges; Delinquent Payments: The Company will not be obligated to make an advance commitment to provide or actually provide wastewater service to any Developer, Builder or other applicant for service in the event that the Developer, Builder or other applicant for service has not paid in full all charges hereunder. Under no circumstances will the Company connect service or otherwise allow service to be established if the entire amount of any payment has not been paid.

(F) Off-Site Hook-Up Fees Non-refundable: The amounts collected by the Company pursuant to the off-site hook-up fee tariff shall be non-refundable contributions in aid of construction.

(G) Use of Off-Site Hook-Up Fees Received: All funds collected by the Company as off-site facilities hook-up fees shall be deposited into a separate account and bear interest and shall be used solely for the purposes of paying for the costs of installation of off-site facilities, including repayment of loans previously obtained for the installation of off-site facilities.

(H) Off-Site Facilities Hook-Up Fee in Addition to On-site Facilities: The off-site facilities hook-up fee shall be in addition to any costs associated with the construction of on-site facilities under a Collection Main Extension Agreement.

(I) Disposition of Excess Funds: After all necessary and desirable off-site facilities are constructed utilizing funds collected pursuant to the off-site facilities hook-up fees, or if the off-site facilities hook-up fee has been terminated by order of the Arizona Corporation Commission, any funds remaining in the trust account shall be refunded. The manner of the refund shall be determined by the Commission at the time a refund becomes necessary.

(J) Status Reporting Requirements to the Commission: The Company shall submit a calendar year Off-Site Facilities Hook-Up Fee status report each January to Docket Control for the prior twelve (12) month period, beginning January 2011, until the hook-up fee tariff is no longer in effect. This status report shall contain a list of all customers that have paid the hook-up fee tariff, the amount each has paid, the physical location/address of the property in respect of which such fee was paid, the amount of money spent from the account, the amount of interest earned on the funds within the tariff account, and an itemization of all facilities that have been installed using the tariff funds during the 12 month period.

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-_____

Revised H-3 p2 inserted

DIRECT TESTIMONY OF

THOMAS J. BOURASSA

(RATE BASE, INCOME STATEMENT AND RATE DESIGN)

December 19, 2008

EXHIBIT
A-4
ADMITTED

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I. INTRODUCTION AND QUALIFICATIONS.

Q. PLEASE STATE YOUR NAME AND ADDRESS.

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

Q. WHAT IS YOUR PROFESSION AND BACKGROUND?

A. I am a Certified Public Accountant and am self-employed, providing consulting services to utility companies as well as general accounting services. I have a B.S. in Chemistry and Accounting from Northern Arizona University (1980) and an M.B.A. with an emphasis in Finance from the University of Phoenix (1991).

Q. COULD YOU BRIEFLY SUMMARIZE YOUR PRIOR WORK AND REGULATORY EXPERIENCE?

A. Yes. Prior to becoming a private consultant, I was employed by High-Tech Institute, Inc., and served as controller and chief financial officer. Prior to working for High-Tech Institute, I worked as a division controller for the Apollo Group, Inc. Before joining the Apollo Group, I was employed at Kozoman & Kermode, CPAs. In that position, I prepared compilations and other write-up work for water and wastewater utilities, as well as tax returns.

In my private practice, I have prepared and/or assisted in the preparation of several water and wastewater utility rate applications before the Arizona Corporation Commission ("Commission").

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying in this proceeding on behalf of the applicant, Black Mountain Sewer Corporation ("BMSC" or "the Company"). BMSC is seeking increases in its rates and charges for sewer utility service in its certificated service area, which is located in portions of Scottsdale and Carefree, in Maricopa County, Arizona. BMSC was previously named Boulders Carefree Sewer Corporation. I also

testified in BMSC's last rate case filed in September, 2005 based on a 2004 test year. That rate case resulted in Decision No. 69164 (December 5, 2006).

II. OVERVIEW OF THE COMPANY'S REQUEST FOR RATE RELIEF.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. I will testify in support of the Company's proposed adjustments to its rates and charges for sewer utility service. I am sponsoring the direct schedules, which are filed concurrently herewith in support of the Company's application. I was responsible for the preparation of these schedules based on my investigation and review of BMSC's relevant books and records.

For the convenience of the Commission and the parties, the two portions of my direct testimony, each with the relevant schedules attached, are being filed separately in this case. In this volume of my direct testimony, I address the Company's rate base, its income statement (revenue and operating expenses), its required increase in revenue, and its rate design and proposed rates and charges for service. Schedules A through C, E-F and H are attached to this portion of my direct testimony. The Company has not prepared a cost of service study, so the G Schedules are omitted.

In the second volume of my direct testimony, to which the D schedules are attached, I address cost of capital. BMSC is requesting a return on common equity of 12.8 percent. As shown on Schedule D-1, the Company's capital structure for ratemaking purposes consists of 100 percent equity, however, the company does have over $1 million of debt on its books, which debt was converted to an operating lease by the Commission. The weighted cost of capital is 12.8 percent.

Q. PLEASE SUMMARIZE THE COMPANY'S APPLICATION.

A. The test year used by BMSC is the 12-month period ending June 30, 2008. The Company is requesting a 12.8 percent return on its fair value rate base ("FVRB").

The Company has also proposed certain pro forma adjustments to take into account known and measurable changes to rate base, expenses and revenues. These pro forma adjustments are consistent with normal ratemaking and are contemplated by the Commission's rules and regulations governing rate applications. *See* R14-2-103. These adjustments are necessary to obtain a normal or realistic relationship between revenues, expenses and rate base on a going-forward basis.

The Company's fair value rate base is $3,723,245. The increase in revenues to provide for recovery of operating expenses and a 12.8 percent return on rate base is approximately $913,762, an increase of approximately 57.83 percent over the adjusted and annualized test year revenues.

Q. WHY IS THE COMPANY FILING FOR RATE INCREASES AT THIS TIME?

A. Since the prior decision was decided in December 2006, BMSC has made investments in plant, including plant improvements that were ordered by the Commission, and acquired additional required wastewater treatment capacity from the City of Scottsdale. Various operating expenses have also increased. As a consequence, the Company's current rate of return, based on the adjusted test year data, is a negative 2.27 percent. Consequently, rate increases are necessary to ensure that BMSC recovers its reasonable operating expenses and has an adequate opportunity to earn a reasonable return on the fair value of its utility plant and property devoted to public service.

III. SUMMARY OF A, E AND F SCHEDULES.

Q. MR. BOURASSA, LET'S TURN TO THE COMPANY'S SCHEDULES. PLEASE DESCRIBE THE SCHEDULES LABELED AS A, E, AND F.

A. The A-1 Schedule is a summary of the rate base, operating income, current

operating margin, required operating margin, operating income deficiency, and the increase in gross revenue. A 12.8 percent return on FVRB is requested. The increase in the revenue requirement is $913,762. Revenues at present and proposed and customer classifications are also shown on this schedule.

The A-2 Schedule is a summary of results of operations for the test year, prior years, and a projected year at present rates and proposed rates.

Schedule A-3 contains the Company's capital structure for the test year and the two prior years.

Schedule A-4 contains the plant construction, and plant in service for the test year and prior years. The projected plant additions are also shown on this schedule.

Schedule A-5 is the summary of the Company's changes in financial position (cash flow) for the prior two years, the test year at present rates, and a projected year at present and proposed rates.

The E Schedules are based on the Company's actual operating results, as reported by the Company in annual reports filed with the Commission. The E-1 Schedule contains the comparative balance sheet data the years 2006, 2007, and 2006, ending on June 30.

Schedule E-2, page 1, contains the income statement for the years 2006, 2007, and 2008, ending on June 30.

Schedule E-3 contains the statements of changes in the Company's financial position for the test year and the two prior years.

Schedule E-4 provides the changes in membership equity.

Schedule E-5 contains the Company's plant in service at the end of the test year, and one year prior to the end of the test year.

Schedule E-7 contains operating statistics for the years ended 2006, 2007,

and 2008, ending on June 30.

Schedule E-8 contains the taxes charged to operations.

The accountant's notes to the financial statements and the financial assumptions used in preparing the rate filing schedules are shown on Schedules E-9 and F-4, respectively, in accordance with the Commission's standard filing requirements. The Company does not prepare audited financial statements.

Schedule F-1 contains the results of operations at the present rates (actual and adjusted), and at proposed rates.

Schedule F-2 contains the summary of changes in financial position (cash flow) for the prior two years, the test year at present rates, and a projected year at present and proposed rates.

Schedule F-3 shows the Company's projected construction requirements for 2009, 2010, and 2011.

Schedule F-4 contains the assumptions used in developing the adjustments and projections contained in the rate filing.

IV. RATE BASE (B SCHEDULES).

Q. WOULD YOU EXPLAIN THE RATE BASE SCHEDULES, WHICH ARE LABELED AS THE B SCHEDULES?

A. Yes. I will start with Schedule B-5, which is the working capital allowance. Because BMSC is a small sewer utility, I used the "formula method" of computing the working capital allowance to reduce costs. The Company is not requesting a working capital allowance.

Q. PLEASE CONTINUE.

A. The Company did not file Schedules B-3 and B-4. To limit issues in dispute and reduce rate case expense, BMSC is requesting that its original cost rate base ("OCRB") be used as its FVRB.

Q. HAVE YOU PREPARED SCHEDULES SHOWING ADJUSTMENTS TO THE ORIGINAL COST RATE BASE?

A. Yes. Schedule B-2 shows adjustments to the OCRB cost rate base proposed by the Company. Schedule B-2, pages 2 through 6, provide the supporting information. These adjustments are, in summary:

Adjustment number 1, as shown on Schedule B-2, page 3, adjusts plant-in-service to reflect the unrecorded plant adjustments from the prior case (Decision No. 69164), to remove capitalized affiliate profits recorded since the end of the last test year, and to remove the costs of the CIE lift station retired since the end of the last test year but not yet recorded on the books. Also included is a small adjustment to reconcile the Company's book balance to the Company's fixed asset ledger.

Adjustment number 2, as shown on Schedule B-2, page 4, adjusts accumulated depreciation to reflect the recomputed amounts per the Company's B-2 plant schedule.

Q. DO THE PLANT AND ACCUMULATED DEPRECIATION SHOWN ON THE B-2 SCHEDULE REFLECT THE LAST RATE ORDER?

A. Yes. The plant shown on Schedule B-2 started with the Commission-determined plant from the last rate case. Reconciliation to the starting balances for plant-in-service and accumulated depreciation are shown on Schedule B-2, pages 3.6 and 3.7. Plant additions and retirements since the test year in that case have been added to and deducted from total plant shown on Schedule B-2, pages 3.1 to 3.4. As mentioned above, capitalized affiliate profit recorded in the plant additions for each year have been deducted from the plant. Pages 3.1 to 3.5 of the schedule show the details for the accumulated depreciation through the end of the test year using the half-year convention for depreciation.

Q. THANK YOU. PLEASE CONTINUE.

A. Adjustment number 3 increases deferred regulatory assets for the unamortized portion of additional Scottsdale treatment capacity of 81,049 gpd acquired by the Company since December 31, 2004, the end of the last test year.

Q. IS THIS THE SAME RATEMAKING TREATMENT GIVEN TO SCOTTSDALE TREATMENT CAPACITY COSTS IN THE LAST CASE?

A. No. Under the approach adopted by the Commission in Decision No. 59944 (December 26, 1996) and Decision No. 60240 (June 12, 1997), then reaffirmed in the last case (Decision No. 69164), the debt service on the debt used to fund the acquisition of Scottsdale capacity of 318,951 gpd is treated as an operating lease and included in operating expenses as lease expense. There was no rate base treatment associated with the Scottsdale capacity under the approach ordered by the Commission for the previously acquired treatment capacity. In contrast, the additional 81,049 gpd of treatment capacity purchased by the Company since the last rate case has been funded with equity, not debt. BMSC believes that this new capacity should be afforded rate base treatment and amortization included in operating expenses.

Q. WHY DOES THE COMPANY BELIEVE THIS CAPACITY PURCHASE SHOULD BE TREATED DIFFERENTLY?

A. The reason for this is two-fold. First, the traditional ratemaking treatment for acquired contractual rights with a limited benefit period is to treat these rights as a regulatory asset and to amortize the asset through operating expenses. Second, this capacity is funded by equity, not debt, and has no associated annual debt service (or interest expense). To treat this treatment capacity similar to the treatment capacity BMSC purchased from Scottsdale more than a decade ago, one would have to assume an interest rate equal to the cost of equity and assume a repayment

period of 10 years. But since there is no interest deduction associated with this debt, the impact on the revenue requirement would be greater under an operating lease approach.

Q. WHY WOULD A 10-YEAR REPAYMENT PERIOD BE ASSUMED?

A. The agreement with the City of Scottsdale expires in 2016. Since the Company acquired the additional capacity in 2006, a 10-year repayment period would have to be assumed.

Q. IF YOU WERE TO ASSUME THAT THE ADDITIONAL 81,049 GPD OF CAPACITY WERE FUNDED BY DEBT WITH AN INTEREST COST EQUAL TO THE COST OF EQUITY OF 12.8 PERCENT AND TREATED SIMILAR TO TREATMENT CAPACITY PREVIOUSLY ACQUIRED FROM SCOTTSDALE, WHAT WOULD BE THE IMPACT ON THE REVENUE REQUIREMENT?

A. The revenue requirement would be higher by at least $16,600.

Q. WHY WOULD THE REVENUE REQUIREMENT BE HIGHER UNDER AN OPERATING LEASE APPROACH?

A. Again, in the instant case, BMSC is proposing rate base treatment for the amortized portion of the cost of the additional capacity of 81,049 gpd recently acquired, or $389,035. The impact of the return and income taxes is $129,727 ($389,035 times 12.8% cost of equity times 1.6286 tax factor plus $48,629 of amortization). Under an operating lease approach, the impact on the revenue requirement would be $146,418 ($89,904 annual "debt service" times 1.6286 tax factor[1]). The difference in revenue requirements is $16,691.

[1] There is no interest expense associated with equity, and thus no interest expense deduction for income tax purposes. There is also no evidence that BMSC could have acquired debt to purchase the capacity, and even if it could, no basis to assume the cost of such debt.

Q. WHY HASN'T THE COMPANY PROPOSED THAT THE PREVIOUSLY ACQUIRED 318,951 GPD OF CAPACITY BE RATE BASED AND AMORTIZED IN THE INSTANT CASE?

A. Because it would be unfair and arbitrary to switch ratemaking treatment on this capacity after the Company was ordered to treat the acquisition costs of this capacity as an operating lease in the past. *See* Decision No. 69164 at 8-9.

Q. PLEASE CONTINUE WITH YOUR TESTIMONY REGARDING THE RATE BASE SCHEDULES.

A. Adjustment number 4, labeled as 4a and 4b, adjusts contributions in aid of construction ("CIAC") and amortization based on additional CIAC recorded since the since the prior rate case.

Adjustment number 5 increases deferred income taxes. The Company's computation is based on the adjusted plant-in-service, accumulated depreciation, and CIAC in the instant case and the tax basis of its assets using the tax rate found on Schedule C-3.

Q. HOW WAS THE PROPOSED "FAIR VALUE" RATE BASE SHOWN ON A-1 DETERMINED?

A. As stated, the FVRB shown on Schedule A-1 is based on OCRB, with no adjustment for the current values of the Company's plant and property.

V. <u>INCOME STATEMENT (C SCHEDULES)</u>.

Q. PLEASE EXPLAIN THE ADJUSTMENTS YOU ARE PROPOSING TO THE INCOME STATEMENT AS SHOWN ON SCHEDULES C-1 AND C-2.

A. The following is a summary of adjustments shown on Schedule C-1:

Adjustment 1 annualizes depreciation expense. The proposed depreciation rate for each component of utility plant is shown on Schedule C-2, page 2. The

depreciation rates approved in the Company's last rate case were account specific rates.

Adjustment 2 increases the property taxes based on proposed revenues. The Company has recognized the reduction in the assessment ratio contained in A.R.S. § 42-15001, entitled "Assessed Valuation of Class One Property"). By law, the assessment ratio will be reduced through tax year 2011 to 20 percent. The Company has proposed a two-year reduction in the assessment ratio or a reduction from the 23 percent employed for the 2008 property tax year to 21 percent for 2010 property tax year.

Q. HOW DID YOU COMPUTE THE PROPERTY TAXES AT PROPOSED RATES?

A. To determine full cash value, I used the method employed by the Arizona Department of Revenue - Centrally Valued Properties ("ADOR" or "the Department"). This method determines full cash value by using twice the average of three years of revenue, plus an addition for CWIP and a deduction for the book value of transportation equipment. In the instant case, I used two times the adjusted revenues for the year end June 30, 2008, and one year of revenues at proposed rates. The assessed value (21 percent of full cash value) was then multiplied by the property tax rate to determine adjusted property tax expense.

Q. IS THIS CONSISTENT WITH PRIOR COMMISSION DECISIONS?

A. Yes. *E.g.*, *Chaparral City Water Company*, Decision No. 68176 at 13, *Rio Rico Utilities*, Decision No. 67279 at 8; *Arizona Water Company*, Decision No. 64282 at 12-13; *Bella Vista Water Company*, Decision No. 65350 at 16; *Arizona-American Water Company*, Decision No. 67093 at 9-10. It is also consistent with the methodology adopted in the prior case. *See* Decision No. 69164 at 10-11.

Q. IS THIS SYNCHRONIZATION OF PROPERTY TAX EXPENSE WITH REVENUES PROPER RATE MAKING?

A. Yes. Like income taxes, property taxes must be adjusted to ensure that the new rates are sufficient to produce the authorized return on rate base. For this reason, the Commission has repeatedly approved the use of proposed revenues to determine an appropriate level of property tax expense to be recovered through rates.

To eliminate issues, I used the methodology approved by the Commission in Arizona-American Water Company's rate case, Decision No. 67093 (June 30, 2004), where two years of adjusted test year revenues and one year of proposed revenues were used to determine full cash value. In that decision, the Commission concluded: "Staff calculated property taxes using its proposed adjusted test year revenues twice and its recommended revenues once to calculate a three year average of revenues. We agree with Staff that using only historical revenues to calculate property taxes to include in the cost of service fails to capture the effects of future revenue from new rates, and can result in an understatement or overstatement of property tax expense." Decision No. 67093 at 9-10.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF THE INCOME STATEMENT ADJUSTMENTS.

A. Adjustment number 3 adjusts operating expenses for "lease" costs associated with the Scottsdale treatment capacity of 318,951 gpd. These costs reflect the annual debt service on the long-term debt the Company incurred to finance the acquisition of wastewater treatment capacity from Scottsdale.

Q. WHAT AMOUNT OF LONG-TERM DEBT IS FINANCING THE 318,951 GPD OF SCOTTSDALE TREATMENT CAPACITY?

A. The Commission granted approval of long-term debt in the amount $960,000 in

Decision No. 59944 (December 26, 1996) to acquire wastewater treatment capacity from Scottsdale. The Company paid a total of $1,260,000 for the right to utilize 210,000 gallons of treatment capacity, of which $960,000 was financed by debt and $300,000 was financed by CIAC. Another $500,000 of long-term debt was approved in Decision No. 60240 (June, 1997). The Company used those funds to acquire an additional 108,951 gallons of treatment capacity from Scottsdale for $653,706, of which $500,000 was financed by long-term debt and $153,706 was financed by CIAC. Both loans have a 9.4% interest rate and a term of 20 years.

The principle balance of the long-term debt at June 30, 2008 and financing Scottsdale treatment capacity was $1,010,649 (approximately $659,546 for the loan approved in Decision No. 59944 and $351,103 for the loan approved in Decision No. 60240).

Q. DOES THE ANNUAL "LEASE" EXPENSE INCLUDE A GROSS UP FOR INCOME TAXES?

A. No. Instead, I have excluded the annual lease costs in the computation of taxable income resulting in higher income taxes. This is the same methodology approved in the prior decision. *See* Decision No. 69164 at 9.

Q. PLEASE CONTINUE.

A. Adjustment 4 shows the rate case expense. The Company estimates rate case expense of $180,000 to be recovered over three years because it believes a three-year cycle for future rate cases is reasonable given this utility's circumstances.

Q. WHAT WAS THE AMOUNT APPROVED IN THE LAST CASE?

A. $150,000. *Id.* at 12.

Q. DO YOU BELIEVE $180,000 IS A REASONABLE AMOUNT OF RATE CASE EXPENSE GIVEN THE REQUESTED INCREASE IN REVENUE?

A. Yes. BMSC expended well over $225,000 in the last case. Considering inflation, the Company expects to expend at least that much in this case. The request of $180,000 is significantly less than the amount likely to be incurred and is a reasonable estimate at this time.

Q. IS THIS THE REASON YOU REFERRED TO THE RATE CASE EXPENSE AS AN "ESTIMATE"?

A. Yes, it is an estimate based on my experience because, at this time, I can only consider the foreseeable. If things turn out more complicated than anticipated, the Company will modify its request to account for that increased expense. Conversely, if the case proceeds and rate case expense is lower than expected, BMSC would make an appropriate adjustment downward.

Q. SHOULDN'T THE COMPANY'S SHAREHOLDERS BEAR SOME OF THE BURDEN OF RATE CASE EXPENSE?

A. As a practical matter, the utility always does. My estimate of $180,000 assumes BMSC will actually incur a higher amount of total rate case expense. I would also agree that if the utility does something improper, or advances positions in bad-faith, it should shoulder the burden of such actions. But, as I testified, the Commission dictates the process, not the utility, and absent such circumstances, the utility should be allowed to recover its reasonably incurred rate case expense.

Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF THE INCOME STATEMENT ADJUSTMENTS?

A. Adjustment 5 annualizes revenues to the year-end number of customers. The annualization was based on the number of customers at the end of the test year, compared to the actual number of customers during each month of the test year.

Average revenues by month were computed for the test year. The average revenues were then multiplied by the increase (or decrease) in number of customers for each month of the test year.

Adjustment 6 reflects the increase in the annual purchased wastewater treatment costs for the City of Scottsdale. The increase is the result of a known and measurable change that occurred on July 1, 2008.

Adjustment 7 annualizes purchased wastewater treatment for additional gallons treated from annualizing revenues to year-end number of customers.

Adjustment 8 increases chemicals expense for increases in costs for chemicals used for odor control.

Adjustment 9 annualizes chemicals expense based on the additional gallons treated from annualizing revenues to the year-end number of customers.

Adjustment 10 annualizes purchased power expense based on the additional gallons treated from annualizing revenues to the year-end number of customers.

Adjustment 11 increases contractual services costs for known and measurable changes to the allocated portions of operations, accounting and billing, and corporate overhead costs since the end of the test year.

Q. DO THE CONTRACTUAL COSTS THE COMPANY HAS RECORDED IN EXPENSE FOR THE TEST YEAR EXCLUDE AFFILIATE PROFIT?

A. Yes, the test year costs reflect actual costs. Since the last rate case, the Company's parent has developed methodologies consistent with rate making practices to allocate and record shared costs used by similarly situated holding companies where the parent company owns more than one subsidiary utility. For example, under the allocation methodology, operation labor costs are directly allocated based on operator time, accounting and billing costs are allocated based on a customer allocation factor, and corporate overhead is allocated based upon a 4-factor

methodology. BMSC's parent has compared the amounts recorded in expense on the books of BMSC and the allocated cost based on its methodology and has determined that the amounts recorded in expense for the test year are, in fact, slightly less than cost.

Q. THANK YOU. PLEASE CONTINUE.

A. Adjustment 12 reflects the annual amortization of the cost of additional Scottsdale treatment capacity of 81,049 gpd acquired since the last test year, as discussed previously.

Adjustment number 13 synchronizes interest expense with rate base. While there is no debt in the capital structure for rate making, this adjustment is necessary to match the interest portion of the annual "lease" costs included in operating expenses.

Adjustment number 14 reflects the income taxes at proposed rates.

There are no further adjustments to the Income Statement at this time.

VI. RATE DESIGN (H SCHEDULES).

Q. WHAT ARE THE COMPANY'S PRESENT RATES?

A. The Company's present rates are:

Residential Charge:	$45.64
Commercial – Std. Rate (Per gallon)[2]:	$0.18298
Commercial – Special Rate (Per gallon)[3]:	
B-H Enterprises (7518 Elbow Bend West)	$0.14034

[2] Per prior Commission order, commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin No. 12, Table 1, published by the Arizona Department of Environmental Quality (June 1989).

[3] Per prior Commission order, wastewater flows are based on Engineering Bulletin No. 12, Table 1. A one-bedroom dwelling is assumed to generate 200 gallons per day, each additional bedroom is assumed to generate an additional 100 gallons per day.

B-H Enterprises (7518 Elbow Bend East)	$0.14034
Barb's Pet Grooming	$0.14034
Boulders Resort	$0.14223
Carefree Dental	$0.14034
Ridgecrest Realty	$0.14193
Desert Forest	$0.16344
Desert Hills Pharmacy	$0.17061
El Pedegral	$0.14034
Lemon Tree	$0.13691
Body Shop	$0.17467
Spanish Village	$0.14034
Boulders Club	$0.14034
Anthony Vuitaggio	$0.15597

In addition, the price for reclaimed (non-potable) water is $122.00 per acre-foot or $0.37440 per 1,000 gallons.

Q. WHAT ARE THE PROPOSED RATES?

A. The proposed rates are:

Residential Charge:	$71.08
Commercial – Std. Rate (Per gallon)[4]:	$0.28499
Commercial – Special Rate (Per gallon)[5]:	
B-H Enterprises (7518 Elbow Bend West)	N/A

[4] Per prior Commission order, commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin No. 12, Table 1, published by the Arizona Department of Environmental Quality (June 1989).

[5] Per prior Commission order, wastewater flows are based on Engineering Bulletin No. 12, Table 1. A one-bedroom dwelling is assumed to generate 200 gallons per day, each additional bedroom is assumed to generate an additional 100 gallons per day.

B-H Enterprises (7518 Elbow Bend East)	N/A
Barb's Pet Grooming	N/A
Boulders Resort	$0.28499
Carefree Dental	N/A
Ridgecrest Realty	N/A
Desert Forest	$0.28499
Desert Hills Pharmacy	N/A
El Pedegral	$0.28499
Lemon Tree	N/A
Body Shop	N/A
Spanish Village	$0.28499
Boulders Club	$0.28499
Anthony Vuitaggio	N/A

In addition, the proposed charge for reclaimed (non-potable) water is $150 per acre-foot.

Q. WHY ARE THERE NO PROPOSED COMMERCIAL SPECIAL RATES FOR SOME OF THE CUSTOMERS LISTED ABOVE?

A. Because these customers no longer exist.

Q. THE SPECIAL COMMERCIAL RATES APPEAR TO BE THE SAME AS THE STANDARD COMMERCIAL RATE. DOES THIS MEAN THAT BMSC IS PROPOSING THAT THE SPECIAL COMMERCIAL RATE BE ELIMINATED?

A. Yes. There are only a small handful (4 or 5) remaining commercial customers that have a special rate. The Company believes that the special rate is no longer justified.

Q. WHY IS THE COMPANY PROPOSING THE EFFLUENT RATE INCREASE LESS THAN THE RESIDENTIAL AND COMMERCIAL RATES?

A. For two reasons. First, the proposed charge is to encourage continued use of effluent by the Boulders Resort. The Company has a contractual arrangement with the Boulders Resort which requires Boulders Resort to accept up to 150,000 gpd of effluent. Per that agreement, if the effluent rate increases more than 25 percent in a given year, the Boulders Resort could terminate the agreement thereby forcing the Company to find other effluent disposal alternatives. Second, the alternatives available to the Company for disposing of effluent are much more costly. If the Company cannot dispose of effluent generated by its own facilities by selling it, it must divert more sewage flow to the City of Scottsdale. The cost of treatment by the City of Scottsdale is now over $3.00 per 1,000 gallons. Diverting flow for treatment would effectively mean a cost of disposal of more than $970 per acre foot of generated effluent ($3.00 times 325.851 thousand gallons per acre foot). Further, diverting more sewage flow to the City of Scottsdale would require the purchase of additional capacity at a cost of $6 per gallon per day.

Q. IS THE COMPANY PROPOSING AN ADJUSTER MECHANISM FOR PURCHASED WASTEWATER TREATMENT?

A. Yes. The reason for this is that increases in purchased wastewater treatment costs are beyond the control of the Company and are expected to increase at an annual rate of over 6 percent in the future. Further, purchased wastewater treatment costs comprise a significant portion of the Company's operating expenses. In fact, over 20 percent of operating expenses (excluding income taxes). A six percent increase represents nearly $20,000 annually in increased costs and would have a significant

detrimental impact on the Company's earnings and its ability to earn its authorized return.

Q. HOW WILL THE ADJUSTER MECHANISM WORK?

A. Based on the Company's application and the proposed level of purchased wastewater treatment costs included in the revenue requirement, the baseline cost per 1,000 gallons of treated sewage would be $3.13 (baseline rate) which includes all applicable taxes and fees. For each year, the Company would compute a total amount to be recovered through the adjuster and then determine a monthly charge for each customer based on the customer's rated gpd relative to the total rated gpd of all customers. For example, based on ADEQ Engineering bulletin 12, a typical residential unit is rated at 320 gpd of sewage flow. The commercial customers' rated gpd, and also based on ADEQ Engineering Bulletin 12, varies based on the type of commercial business. For the test year and based upon the rated gallons for all customers, residential customers comprised 73 percent of all rated gallons.

The amount to be collected through the adjuster would be equal to the total cost difference computed by taking the current year's gallons treated (in 1,000's) times the current rate for treatment and the baseline rate. For example, if the gallons treated were 100,000 thousand gallons and the current rate is $3.30, the computed amount would be $17,000 ($3.30 minus $3.13 times 100,000 thousand gallons). Based on the test year, the amount to be collected from residential customers would be $12,410 ($17,000 times 73 percent) and the amount to be collected from the commercial customers would be $4,590 ($17,000 minus $12,410). Since each residential customer has an equivalent gpd rating, based on the test year end number of residential customers, each residential customer would pay a monthly adjuster charge of $0.524 ($12,410 divided by 1,972 residential customers divided by 12). Each commercial customer would have an adjuster

based on their gpd rating relative to the total commercial rated gallons. For simplicity, and assuming all commercial customers are rated equally, the commercial customer monthly adjuster based on the test year end number of commercial customers would be $2.94 ($4,590 divided by 130 commercial customers divided by 12).

Q. WOULD THE COMPANY BE COLLECTING THE DIFFERENCE IN COST IN THE YEAR FOLLOWING WHEN THE INCREASE IN COST OCCURRED?

A. Yes.

Q. WOULD THE COMPANY PERFORM AN ANNUAL TRUE-UP TO ENSURE THE COMPANY DOES NOT OVER (OR UNDER) COLLECT THE COST DIFFERENCE?

A. Yes.

Q. IS THE COMPANY PROPOSING AN OFF-SITE FACILITIES HOOK-UP FEE FOR NEW SERVICE CONNECTIONS?

A. Yes. The Company is proposing a hook-up fee ("HUF") for new connections of $8.00 per gpd per day. An equivalent residential unit, rated at 320 gpd, would pay a HUF of $2,560 (320 gpd times $8.00).

Q. WHAT IS THE PURPOSE OF THE HOOK-UP FEE?

A. To generate funds for the purpose of either constructing and/or purchasing wastewater treatment capacity. The funds will be recorded as contributions-in-aid of construction ("CIAC"), which will help to offset increases in rates in the future.

The Company's request for a HUF is based on the fact that the City of Scottsdale wastewater treatment agreement will expire in 2016. Before that occurs the Company will be faced with renewing its contract (assuming the City of Scottsdale is willing) or constructing additional facilities of its own to provide

adequate treatment capacity for existing customers as well as future customer growth. The Company expects that if it is able to renew its contract with the City of Scottsdale, the costs to purchase treatment capacity will be greater than the $6.00 per gallon per day set forth in the current agreement. Alternatively, the Company could construct new treatment facilities. Under either scenario, the proposed HUF will cover only a fraction of the anticipated costs but is nevertheless anticipated to help minimize future rate increases.

Q. ARE THERE ANY PROPOSED CHANGES TO THE COMPANY'S MISCELLANEOUS SERVICE CHARGES?

A. No.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Rate Base, Income Statement And Rate Design)

Schedules

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
Schedule A-1
Page 1
Witness: Bourassa

Line No.			
1	Fair Value Rate Base	$	3,723,245
2			
3	Adjusted Operating Income		(84,485)
4			
5	Current Rate of Return		-2.27%
6			
7	Required Operating Income	$	476,575
8			
9	Required Rate of Return on Fair Value Rate Base		12.80%
10			
11	Operating Income Deficiency	$	561,060
12			
13	Gross Revenue Conversion Factor		1.6286
14			
15	Increase in Gross Revenue Revenue Requirement	$	913,762
16			
17	Test Year Revenues	$	1,580,170
18	Increase in Gross Revenue Revenue Requirement	$	913,762
19	Proposed Revenue Requirement	$	2,493,932
20	% Increase		57.83%
21			

22	Customer	Present	Proposed	Dollar	Percent
23	**Classification**	**Rates**	**Rates**	**Increase**	**Increase**
24					
25					
26	Residential	$ 1,077,880	$ 1,678,696	$ 600,816	55.74%
27	Commercial (Standard Rate)	378,678	589,788	211,110	55.75%
28	Commercial (Special Rate)	98,964	195,675	96,711	97.72%
29	Effluent Sales	15,917	19,578	3,661	23.00%
30					
31	Annualization	2,145	3,341	1,196	55.74%
32				-	0.00%
33	**Subtotal**	$ 1,573,584	$ 2,487,078	$ 913,495	58.05%
34					
35	Other Wastewater Revenues	6,915	6,915	-	0.00%
36	Reconciling Amount H-1 to C-1	(329)	(62)	267	-81.16%
37					
38	**Total of Water Revenues**	$ 1,580,499	$ 2,493,993	$ 913,762	57.81%
39					
40					
41					

42 SUPPORTING SCHEDULES:
43 B-1
44 C-1
45 C-3
46 H-1
47

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Results of Operations

Exhibit
Schedule A-2
Page 1
Witness: Bourassa

Line No.	Description	Prior Years Ended 6/30/2006	Prior Years Ended 6/30/2007	Test Year Actual 6/30/2008	Test Year Adjusted 6/30/2008	Projected Year Present Rates 6/30/2009	Projected Year Proposed Rates 6/30/2009
1	Gross Revenues	$ 1,286,374	$ 1,446,140	$ 1,578,025	$ 1,580,170	$ 1,580,170	$ 2,493,932
2							
3	Revenue Deductions and	955,296	1,234,217	1,424,405	1,664,655	1,664,655	2,017,356
4	Operating Expenses						
5							
6	Operating Income	$ 331,078	$ 211,923	$ 153,620	$ (84,485)	$ (84,485)	$ 476,575
7							
8	Other Income and	-	-	-	-	-	-
9	Deductions						
10							
11	Interest Expense	(109,872)	(103,962)	(98,285)	(67,693)	(67,693)	(67,693)
12							
13	Net Income	$ 221,206	$ 107,961	$ 55,335	$ (152,178)	$ (152,178)	$ 408,882
14							
15	Earned Per Average						
16	Common Share	0.48	0.23	0.12	(0.33)	(0.33)	0.89
17							
18	Dividends Per						
19	Common Share	-	-	-	-	-	-
20							
21	Payout Ratio	-	-	-	-	-	-
22							
23	Return on Average						
24	Invested Capital	3.21%	1.52%	0.73%	-2.19%	-2.16%	5.80%
25							
26	Return on Year End						
27	Capital	3.05%	1.55%	0.68%	-2.19%	-2.14%	5.74%
28							
29	Return on Average						
30	Common Equity	14.59%	4.39%	1.62%	-5.08%	-4.12%	10.28%
31							
32	Return on Year End						
33	Common Equity	11.96%	3.51%	1.47%	-5.21%	-4.20%	9.78%
34							
35	Times Bond Interest Earned						
36	Before Income Taxes	3.92	3.08	2.84	(0.67)	(0.67)	7.35
37							
38	Times Total Interest and						
39	Preferred Dividends Earned						
40	After Income Taxes	3.01	2.04	1.56	1.35	1.35	4.19
41							
42							
43	SUPPORTING SCHEDULES						
44	C-1						
45	E-2						
46	F-1						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Capital Structure

Exhibit
Schedule A-3
Page 1
Witness: Bourassa

Line No.	Description:	Prior Years Ended 6/30/2006	Prior Years Ended 6/30/2007	Test Year 6/30/2008	Projected Year 6/30/2009
1					
2					
3	Long-Term Debt	1,329,161	1,258,423	1,010,649	940,875
4					
5	Total Debt	$ 1,329,161	$ 1,258,423	$ 1,010,649	$ 940,875
6					
7					
8	Preferred Stock	-	-	-	-
9					
10	Common Equity	1,850,199	3,072,632	3,772,970	4,181,852
11					
12					
13	Total Capital & Debt	$ 3,179,360	$ 4,331,055	$ 4,783,619	$ 5,122,727
14					
15					
16	Capitalization Ratios:				
17					
18	Long-Term Debt	41.81%	29.06%	21.13%	18.37%
19					
20	Total Debt	41.81%	29.06%	21.13%	18.37%
21					
22					
23	Preferred Stock	-	-	-	-
24					
25	Common Equity	58.19%	70.94%	78.87%	81.63%
26					
27					
28	Total Capital	100.00%	100.00%	100.00%	100.00%
29					
30					
31	Weighted Cost of				
32	Senior Capital	9.40%	9.40%	9.40%	9.40%
33					
34					
35					
36					
37					
38					
39	SUPPORTING SCHEDULES:				
40	E-1				
41	D-1				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Construction Expenditures
and Gross Utility Plant in Service

Exhibit
Schedule A-4
Page 1
Witness: Bourassa

Line No.		Construction Expenditures	Net Plant Placed in Service	Gross Utility Plant in Service
1				
2	Prior Year Ended 06/30/2006	974,274	303,012	9,119,420
3				
4	Prior Year Ended 06/30/2007	575,114	103,815	9,223,235
5				
6	Test Year Ended 06/30/2008	1,696,153	2,118,972	11,342,207
7				
8	Projected Year Ended 06/30/2009	232,450	232,450	11,574,657
9				
10				
11				
12				
13	SUPPORTING SCHEDULES:			
14	B-2			
15	E-5			
16	F-3			
17				
18				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary Statements of Cash Flows

Exhibit
Schedule A-5
Page 1
Witness: Bourassa

Line No.		Prior Year Ended 6/30/2006	Prior Year Ended 6/30/2007	Test Year Ended 6/30/2008	Projected Year Present Rates 6/30/2009	Projected Year Proposed Rates 6/30/2009
5	Cash Flows from Operating Activities					
6	Net Income	$ 226,556	$ 111,934	$ 55,335	$ (152,178)	$ 408,882
7	Adjustments to reconcile net income to net cash					
8	provided by operating activities:					
9	Depreciation and Amortization	115,358	115,358	181,931	224,818	224,818
10	Adjustments to Depreciation/Amortization	-	40,607	2,473		
11	Other	-	-	-		
12	Changes in Certain Assets and Liabilities:	-	-	-		
13	Accounts Receivable	14,052	(2,335)	5,346		
14	Unbilled Revenues	(1,375)	(1,957)	29		
15	Materials and Supplies Inventory	-	-	-		
16	Prepaid Expenses	(3,391)	1,369	(9,251)		
17	Deferred Charges	(2,434)	361,365	-		
18	Accounts Payable	(64,452)	(8,881)	9,953		
19	Intercompany payable	421,220	(439,623)	653,251	(500,000)	(500,000)
20	Customer Deposits	13,096	32,832	(11,621)		
21	Intercompany taxes receivable and taxes payable	(116,017)	623	(8,417)		
22	Other assets and liabilities	(143,688)	(42,437)	209,869		
23						
24	Net Cash Flow provided by Operating Activities	$ 458,925	$ 168,855	$ 1,088,898	$ (427,360)	$ 133,700
25	Cash Flow From Investing Activities:					
26	Capital Expenditures	(974,274)	(575,114)	(1,696,153)	(232,450)	(232,450)
27	Plant Held for Future Use	-	-	-		
28	Changes in debt reserve fund	-	-	-		
29	Net Cash Flows from Investing Activities	$ (974,274)	$ (575,114)	$ (1,696,153)	$ (232,450)	$ (232,450)
30	Cash Flow From Financing Activities					
31	Change in Restricted Cash	-	-	-		
32	Change in net amounts due to parent and affiliates	-	-	-		
33	Receipt of advances for and contributions in aid of construction	170,817	(735,724)	32,150	-	-
34	Refunds for advances for construction	(56,002)	-	-	-	-
35	Repayments of Long-Term Debt	(69,680)	(57,858)	(63,539)	(69,774)	(69,774)
36	Dividends Paid	-	-	-	-	-
37	Deferred Financing Costs	-	-	-		
38	Paid in Capital	442,480	1,110,499	645,003	230,000	230,000
39	Net Cash Flows Provided by Financing Activities	$ 487,615	$ 316,917	$ 613,614	$ 160,226	$ 160,226
40	Increase(decrease) in Cash and Cash Equivalents	(27,734)	(89,342)	6,359	(499,584)	61,476
41	Cash and Cash Equivalents at Beginning of Year	144,513	116,779	27,437	33,796	33,796
42	Cash and Cash Equivalents at End of Year	$ 116,779	$ 27,437	$ 33,796	$ (465,788)	$ 95,272
43	SUPPORTING SCHEDULES:					
44	E-3					
45	F-2					
46						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Rate Base

Exhibit
Schedule B-1
Page 1
Witness: Bourassa

Line No.		Original Cost Rate base	Fair Value Rate Base
1			
2	Gross Utility Plant in Service	$ 11,357,735	$ 11,357,735
3	Less: Accumulated Depreciation	5,625,025	5,625,025
4			
5	Net Utility Plant in Service	$ 5,732,710	$ 5,732,710
6			
7	Less:		
8	Advances in Aid of		
9	Construction	1,457,009	1,457,009
10	Contributions in Aid of		
11	Construction	5,232,139	5,232,139
12	Accumulated Amortization of CIAC	(4,214,384)	(4,214,384)
13			
14	Customer Meter Deposits	94,290	94,290
15	Deferred Income Taxes & Credits	(170,554)	(170,554)
16		-	-
17			
18			
19	Plus:		
20	Unamortized Finance		
21	Charges	-	-
22	Deferred Regulatory Assets	389,035	389,035
23	Allowance for Working Capital	-	-
24			
25			
26	Total Rate Base	$ 3,723,245	$ 3,723,245
27			
28			
29			
30	SUPPORTING SCHEDULES:		
31	B-2		
32	B-3		
33	B-5		
34	E-1		
35			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Schedule B-2
Page 1
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments Amount	Adjusted at end of Test Year
1	Gross Utility			
2	Plant in Service	$ 11,342,207	15,528	$ 11,357,735
3				
4	**Less:**			
5	Accumulated			
6	Depreciation	5,947,887	(322,862)	5,625,025
7				
8				
9	Net Utility Plant			
10	in Service	$ 5,394,320		$ 5,732,710
11				
12	**Less:**			
13	Advances in Aid of			
14	Construction	1,457,009	-	1,457,009
15				
16	Contributions in Aid of			
17	Construction (CIAC)	5,341,461	(109,322)	5,232,139
18				
19	Accumulated Amortization of CIAC	(4,485,415)	271,031	(4,214,384)
20				
21	Customer Meter Deposits	94,290	-	94,290
22	Deferred Income Taxes	-	(170,554)	(170,554)
23				
24				
25	**Plus:**			
26	Unamortized Finance			
27	Charges	-	-	-
28	Deferred Regulatory Assets	-	389,035	389,035
29	Allowance for Working Capital	-	-	-
30				
31	Total	$ 2,986,975		$ 3,723,245
32				
33				
34				
35	SUPPORTING SCHEDULES:		RECAP SCHEDULES:	
36	B-2, pages 1-7		B-1	
37	E-1			
38				
39				
40				
41				
42				
43				
44				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Schedule B-2
Page 2
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments 1 Plant Adjustments	2 Accum. Depr.	3 Scottsdale Treatment	4 CIAC	5 Deferred Income Taxes	Adjusted at end of Test Year
1	Gross Utility							
2	Plant in Service	$ 11,342,207	15,528					$ 11,357,735
3								
4	**Less:**							
5	Accumulated							
6	Depreciation	5,947,887		(322,862)				5,625,025
7								
8								
9	Net Utility Plant							
10	in Service	$ 5,394,320	$ 15,528	$ 322,862		$ -	$ -	$ 5,732,710
11								
12	**Less:**							
13	Advances in Aid of							
14	Construction	1,457,009						1,457,009
15								
16	Contributions in Aid of							
17	Construction (CIAC)	5,341,461				(109,322)		5,232,139
18								
19	Accumulated Amort of CIAC	(4,485,415)				271,031		(4,214,384)
20								
21	Customer Meter Deposits	94,290						94,290
22	Deferred Income Taxes	-					(170,554)	(170,554)
23								
24								
25	**Plus:**							
26	Unamortized Finance							
27	Charges	-						-
28	Deferred Reg. Assets	-			389,035			389,035
29	Allowance for Working Capital	-						-
30								
31	Total	$ 2,986,975	$ 15,528	$ 322,862	$ 389,035	$ (161,709)	$ 170,554	$ 3,723,245
32								
33								
34								
35	SUPPORTING SCHEDULES:						RECAP SCHEDULES:	
36	B-2, pages 3-6						B-1	
37	E-1							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 1

Exhibit
Schedule B-2
Page 3
Witness: Bourassa

Line No.	Acct. No.	Description	Per Books Orginal Cost	A Decision 69164 Capitalized Profits	B Decision 69164 Capitalized Expenses	C Decision 69164 Plant AIAC/CIAC	D Decision 69164 Retire Chlorinator	E Decision 69164 Allocated Computer Equip	F Removal of Affiliate Profit Since Last Test Year	G CIE Lift Station Retirement	H Difference to Computed Balance[1]	Adjusted Original Cost
				Adjustments								
1	Plant-in-Service											
5	351	Organization							-			-
6	352	Franchises							-			-
7	353	Land and Land Rights	461,446	(146)					-		-	461,300
8	354	Structures and Improvements	2,597,197	(5,387)					(33,966)		76	2,557,920
9	355	Power Generation Equipment							-		-	-
10	360	Collection Sewers - Force	371,470	(205)		339,833			(7,868)		3,062	706,292
11	361	Collection Sewers - Gravity	4,353,824	(1,361)	7,286				(81,243)		6,442	4,284,948
12	362	Special Collecting Structures							-		-	-
13	363	Services to Customers	200,306	(1,584)					-		1	198,723
14	364	Flow Measuring Devices	39,878	(49)					(8,317)		-	31,512
15	365	Flow Measuring Installations	181,502	(2,154)					(156)		430	179,622
16	370	Receiving Wells	699,191	(369)					(311)	(7,883)	(0)	690,628
17	371	Effluent Pumping Equipment	661,125	(360)	2,213				(8,134)		(0)	654,844
18	380	Treatment and Disposal Equip.	152,796						(9,218)		(0)	143,578
19	381	Plant Sewers	121,651	(1,152)	2,790				-		-	123,289
20	382	Outfall Sewer Lines							-		-	-
21	389	Other Plant and Misc. Equipment	970,499	(5,185)	5,059		(19,539)		(12,085)		683	939,432
22	390	Office Furniture and Equipment	369,739	(2,920)				(142,232)	-		0	224,587
23	391	Transportation Equipment	107,368						-		(1)	107,367
24	393	Tools, Shop and Garage Equip.	6,276						-		(522)	5,754
25	394	Laboratory Equipment	7,488						-		0	7,488
26	395	Power Operated Equipment							-		-	-
27	396	Communication Equipment	40,451						-		0	40,451
28	398	Other Tangible Plant	-						-		-	-
29												-
30		TOTALS	$ 11,342,207	$ (20,872)	$ 17,348	$ 339,833	$ (19,539)	$ (142,232)	$ (161,298)	$ (7,883)	$ 10,171	$ 11,357,735
31												
32	Plant-in-Service per Books											$ 11,342,207
33												
34	Increase (decrease) in Plant-in-Service											$ 15,528
35												
36	Adjustment to Plant-in-Service											$ 15,528
37												
38	SUPPORTING SCHEDULES											
39	B-2, pages 3.1-3.4											
40												

[1] Computed Balance as shown on B-2, page 3.4.

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Schedule B-2
Page 3.1

Account No.	Description	Deprec. Rate Before Dec-05	Deprec. Rate After Dec-05	Per Decision 69164 Plant At 12/31/2004	2004 Accum. Depr.	2005 Plant Additions	2005 Plant Adjustments[1]	2005 Adjusted Plant Additions	2005 Plant Retirements	2005 Plant Balance	2005 Deprec.
351	Organization	0.0000%	0.00%	-	-			-		-	-
352	Franchises	0.0000%	0.00%	-	-			-		-	-
353	Land and Land Rights	0.0000%	0.00%	461,300	-			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,239,905	888,015	56,562	(1,917)	54,645		1,294,549	61,598
355	Power Generation Equipment	5.0000%	5.00%	-	706			-		-	(706)
360	Collection Sewers - Force	5.0000%	2.00%	568,413	154,483	94,624	(5,062)	89,562		657,976	29,127
361	Collection Sewers - Gravity	5.0000%	2.00%	3,614,544	2,488,740	297,571	(21,880)	275,691		3,890,235	178,238
362	Special Collecting Structures	5.0000%	2.00%	-	-			-		-	-
363	Services to Customers	5.0000%	2.00%	157,218	128,612	19,337		19,337		176,555	7,927
364	Flow Measuring Devices	5.0000%	10.00%	39,829	23,004		(8,135)	(8,135)		31,694	1,937
365	Flow Measuring Installations	5.0000%	10.00%	156,204	3,959	19,404		19,404		175,608	8,987
370	Receiving Wells	5.0000%	3.33%	696,137	199,051			-		696,137	33,838
371	Effluent Pumping Equipment	5.0000%	12.50%	453,558	244,706	11,119		11,119		464,677	25,825
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	-	6,288		6,288		6,288	157
381	Plant Sewers	5.0000%	5.00%	123,289	84,017			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%	-	-			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	719,140	80,678	99,447	(7,527)	91,920		811,059	39,320
390	Office Furniture and Equipment	5.0000%	6.67%	220,360	27,165	1,465		1,465		221,825	11,362
391	Transportation Equipment	5.0000%	20.00%	87,811	7,642			-		87,811	5,488
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-			-		-	-
394	Laboratory Equipment	5.0000%	10.00%	7,279	352	209		209		7,488	400
395	Power Operated Equipment	5.0000%	5.00%	-	-			-		-	-
396	Communication Equipment	5.0000%	10.00%	-	-			-		-	-
398	Other TangiblePlant	5.0000%	10.00%	-	-			-		-	-
								-		-	-
	Plant Held for Future Use										
	TOTAL WATER PLANT			8,544,987	4,331,129	606,025	(44,521)	561,504	-	9,106,490	409,663

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Schedule B-2
Page 3.2

Account No.	Description	Deprec. Rate Before Dec-05	Deprec. Rate After Dec-05	2006 Plant Additions	2006 Plant Adjustments[1]	2006 Adjusted Plant Additions	2006 Plant Retirements	2006 Plant Balance	2006 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	3,625		3,625		1,298,175	43,169
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	3,592		3,592		661,568	13,195
361	Collection Sewers - Gravity	5.0000%	2.00%	112,559	(22,710)	89,849		3,980,083	78,703
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%	10,429		10,429		186,983	3,635
364	Flow Measuring Devices	5.0000%	10.00%		(182)	(182)		31,512	3,160
365	Flow Measuring Installations	5.0000%	10.00%	3,740		3,740		179,348	17,748
370	Receiving Wells	5.0000%	3.33%	2,141		2,141		698,278	23,217
371	Effluent Pumping Equipment	5.0000%	12.50%	44,676		44,676		509,353	60,877
380	Treatment and Disposal Equipment	5.0000%	5.00%	12,184		12,184		18,472	619
381	Plant Sewers	5.0000%	5.00%			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	53,055	(740)	52,315		863,374	55,842
390	Office Furniture and Equipment	5.0000%	6.67%			-		221,825	14,796
391	Transportation Equipment	5.0000%	20.00%			-		87,811	17,562
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%			-		-	-
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	749
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%			-		-	-
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
						-		-	-
	Plant Held for Future Use								
	TOTAL WATER PLANT			246,000	(23,632)	222,368	-	9,328,859	339,437

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Schedule B-2
Page 3.3

Account No.	Description	Deprec. Rate Before Dec-05	Deprec. Rate After Dec-05	2007 Plant Additions	2007 Plant Adjustments[1]	2007 Adjusted Plant Additions	2007 Plant Retirements	2007 Plant Balance	2007 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,539	(20,391)	(18,852)		1,279,322	42,915
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	34,935	(2,469)	32,466		694,034	13,556
361	Collection Sewers - Gravity	5.0000%	2.00%	211,268	(32,273)	178,995		4,159,078	81,392
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%			-		186,983	3,740
364	Flow Measuring Devices	5.0000%	10.00%			-		31,512	3,151
365	Flow Measuring Installations	5.0000%	10.00%			-		179,348	17,935
370	Receiving Wells	5.0000%	3.33%			-		698,278	23,253
371	Effluent Pumping Equipment	5.0000%	12.50%	74,764	(5,336)	69,428		578,780	68,008
380	Treatment and Disposal Equipment	5.0000%	5.00%	4,387		4,387		22,859	1,033
381	Plant Sewers	5.0000%	5.00%			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	784	(942)	(158)		863,216	57,582
390	Office Furniture and Equipment	5.0000%	6.67%	2,763		2,763		224,587	14,888
391	Transportation Equipment	5.0000%	20.00%	19,556		19,556		107,367	19,518
393	Tools, Shop and Garage Equipment	5.0000%	5.00%	3,493		3,493		3,493	87
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	749
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%			-		-	-
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
						-		-	
	Plant Held for Future Use								
	TOTAL WATER PLANT			353,488	(61,411)	292,077	-	9,620,936	353,971

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Schedule B-2
Page 3.4

Account No.	Description	Deprec. Rate Before Dec-05	Deprec. Rate After Dec-05	Jun.-Jun. 2008 Plant Additions	Jun.-Jun. 2008 Plant Adjustments[1]	Jun.-Jun. 2008 Adjusted Plant Additions	Jun.-Jun. 2008 Plant Retirements	June 30 2008 Plant Balance	Jun.-Jun. 2008 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,290,255	(11,658)	1,278,597		2,557,920	31,945
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	12,595	(337)	12,258		706,292	7,002
361	Collection Sewers - Gravity	5.0000%	2.00%	130,250	(4,380)	125,870		4,284,948	42,220
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%	11,739		11,739		198,723	1,929
364	Flow Measuring Devices	5.0000%	10.00%			-		31,512	1,576
365	Flow Measuring Installations	5.0000%	10.00%	430	(156)	274		179,622	8,974
370	Receiving Wells	5.0000%	3.33%	544	(311)	233	(7,883)	690,628	11,563
371	Effluent Pumping Equipment	5.0000%	12.50%	78,862	(2,798)	76,064		654,844	38,551
380	Treatment and Disposal Equipment	5.0000%	5.00%	129,937	(9,218)	120,719		143,578	2,080
381	Plant Sewers	5.0000%	5.00%			-		123,289	3,082
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	79,092	(2,876)	76,216		939,432	30,059
390	Office Furniture and Equipment	5.0000%	6.67%			-		224,587	7,490
391	Transportation Equipment	5.0000%	20.00%			-		107,367	10,737
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	2,262		2,262		5,754	116
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	374
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%	40,451		40,451		40,451	1,011
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
						-		-	-
	Plant Held for Future Use								
	TOTAL WATER PLANT			1,776,417	(31,734)	1,744,683	(7,883)	11,357,735	198,708

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Schedule B-2
Page 3.5

Account No.	Description	Deprec. Rate Before Dec-05	Deprec. Rate After Dec-05	Year End Accumulated Depreciation by Account 2004	2005	2006	2007	2008
351	Organization	0.0000%	0.00%	-	-	-	-	-
352	Franchises	0.0000%	0.00%	-	-	-	-	-
353	Land and Land Rights	0.0000%	0.00%	-	-	-	-	-
354	Structures and Improvements	5.0000%	3.33%	888,015	949,612	992,781	1,035,697	1,067,642
355	Power Generation Equipment	5.0000%	5.00%	706	-	-	-	-
360	Collection Sewers - Force	5.0000%	2.00%	154,483	183,610	196,805	210,361	217,363
361	Collection Sewers - Gravity	5.0000%	2.00%	2,488,740	2,666,978	2,745,682	2,827,073	2,869,293
362	Special Collecting Structures	5.0000%	2.00%	-	-	-	-	-
363	Services to Customers	5.0000%	2.00%	128,612	136,539	140,175	143,914	145,843
364	Flow Measuring Devices	5.0000%	10.00%	23,004	24,941	28,101	31,252	32,828
365	Flow Measuring Installations	5.0000%	10.00%	3,959	12,946	30,693	48,628	57,602
370	Receiving Wells	5.0000%	3.33%	199,051	232,889	256,106	279,359	283,038
371	Effluent Pumping Equipment	5.0000%	12.50%	244,706	270,532	331,408	399,417	437,968
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	157	776	1,810	3,890
381	Plant Sewers	5.0000%	5.00%	84,017	90,181	96,346	102,510	105,592
382	Outfall Sewer Lines	5.0000%	3.33%	-	-	-	-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	80,678	119,998	175,840	233,422	263,481
390	Office Furniture and Equipment	5.0000%	6.67%	27,165	38,527	53,323	68,210	75,700
391	Transportation Equipment	5.0000%	20.00%	7,642	13,130	30,692	50,210	60,947
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-	-	87	203
394	Laboratory Equipment	5.0000%	10.00%	352	752	1,500	2,249	2,624
395	Power Operated Equipment	5.0000%	5.00%	-	-	-	-	-
396	Communication Equipment	5.0000%	10.00%	-	-	-	-	1,011
398	Other TangiblePlant	5.0000%	10.00%	-	-	-	-	-
				-	-	-	-	-
	Plant Held for Future Use			-				
	TOTAL WATER PLANT			4,331,129	4,740,792	5,080,229	5,434,200	5,625,025

Black Mountain Sewer Corporation
Plant Reconciliation to Prior Rate Case

Exhibit
Schedule B-2
Page 3.6

Line No.	Account No.	Description	Balance Per Company Per 2004 Filing Before Adj.	PTY Plant	Capitalized Profits	Adjustments per Decision 69164 Capitalized Expenses	Plant AIAC/CIAC	Retire Chlorinator	Allocated Computer Equip	Plant per Decision 69164	Remove PTY Plant	Initial Balance
6	351	Organization	-							-		-
7	352	Franchises	-							-		-
8	353	Land and Land Rights	461,446		(146)					461,300		461,300
9	354	Structures and Improvements	1,245,292		(5,387)					1,239,905		1,239,905
10	355	Power Generation Equipment	-							-		-
11	360	Collection Sewers - Force	228,785		(205)		339,833			568,413		568,413
12	361	Collection Sewers - Gravity	3,608,619		(1,361)	7,286				3,614,544		3,614,544
13	362	Special Collecting Structures	-							-		-
14	363	Services to Customers	158,802		(1,584)					157,218		157,218
15	364	Flow Measuring Devices	39,878		(49)					39,829		39,829
16	365	Flow Measuring Installations	158,358		(2,154)					156,204		156,204
17	370	Receiving Wells	696,506		(369)					696,137		696,137
18	371	Effluent Pumping Equipment	451,705		(360)	2,213				453,558		453,558
19	380	Treatment and Disposal Equipment	-							-		-
20	381	Plant Sewers	121,651		(1,152)	2,790				123,289		123,289
21	382	Outfall Sewer Lines	-							-		-
22	389	Other Plant and Misc. Equipment	738,804	85,699	(5,185)	5,059		(19,539)		804,839	(85,699)	719,140
23	390	Office Furniture and Equipment	365,512		(2,920)				(142,232)	220,360		220,360
24	391	Transportation Equipment	87,811							87,811		87,811
25	393	Tools, Shop and Garage Equipment.	-							-		-
26	394	Laboratory Equipment	7,279							7,279		7,279
27	395	Power Operated Equipment	-							-		-
28	398	Other TangiblePlant	-							-		-
29										-		-
30										-		-
31												
32		TOTAL	8,370,448	85,699	(20,872)	17,348	339,833	(19,539)	(142,232)	8,630,686	(85,699)	8,544,987
33												

Black Mountain Sewer Corporation
A/D Reconciliation to Prior Rate Case

Exhibit
Schedule B-2
Page 3.7

Line No.	Account No.	Description	Balance Per Company Per 2004 Filing Before Adj.	Adjustments per Decision 69164 Affiliate A/D	Retire Chlorinator	Blank	A/D per Decision 69164	PTY A/D	Initial Balance
1									
2									
3									
4									
5	351	Organization	-				-		-
6	352	Franchises	-				-		-
7	353	Land and Land Rights	-				-		-
8	354	Structures and Improvements	888,015				888,015		888,015
9	355	Power Generation Equipment	706				706		706
10	360	Collection Sewers - Force	154,483				154,483		154,483
11	361	Collection Sewers - Gravity	2,488,740				2,488,740		2,488,740
12	362	Special Collecting Structures	-				-		-
13	363	Services to Customers	128,612				128,612		128,612
14	364	Flow Measuring Devices	23,004				23,004		23,004
15	365	Flow Measuring Installations	3,959				3,959		3,959
16	370	Receiving Wells	199,051				199,051		199,051
17	371	Effluent Pumping Equipment	244,706				244,706		244,706
18	380	Treatment and Disposal Equipment	-				-		-
19	381	Plant Sewers	84,017				84,017		84,017
20	382	Outfall Sewer Lines	-				-		-
21	389	Other Plant and Misc. Equipment	100,217		(19,539)		80,678		80,678
22	390	Office Furniture and Equipment	42,876	(15,711)			27,165		27,165
23	391	Transportation Equipment	7,642				7,642		7,642
24	393	Tools, Shop and Garage Equipment.	-				-		-
25	394	Laboratory Equipment	352				352		352
26	395	Power Operated Equipment	-				-		-
27	398	Other TangiblePlant	-				-		-
28							-		-
29							-		-
30									
31		TOTAL	4,366,379	(15,711)	(19,539)	-	4,331,129	-	4,331,129
32									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 2

Exhibit
Schedule B-2
Page 4
Witness: Bourassa

Line No.				A	B	
1	Plant-in-Service					
2			Per Books	Difference to	Intentionally	Adjusted
3	Acct.		Accum.	Computed	Left	Accum.
4	No.	Description	Depr.	Balance	Blank	Depr.
5	351	Organization		-		-
6	352	Franchises		-		-
7	353	Land and Land Rights		-		-
8	354	Structures and Improvements	1,058,089	9,553		1,067,642
9	355	Power Generation Equipment		-		-
10	360	Collection Sewers - Force	229,394	(12,031)		217,363
11	361	Collection Sewers - Gravity	2,983,703	(114,410)		2,869,293
12	362	Special Collecting Structures		-		-
13	363	Services to Customers	150,275	(4,432)		145,843
14	364	Flow Measuring Devices	32,400	428		32,828
15	365	Flow Measuring Installations	51,006	6,596		57,602
16	370	Receiving Wells	644,672	(361,634)		283,038
17	371	Effluent Pumping Equipment	208,700	229,268		437,968
18	380	Treatment and Disposal Equipment	2,327	1,563		3,890
19	381	Plant Sewers	89,972	15,620		105,592
20	382	Outfall Sewer Lines		-		-
21	389	Other Plant and Misc. Equipment	360,624	(97,143)		263,481
22	390	Office Furniture and Equipment	108,920	(33,220)		75,700
23	391	Transportation Equipment	24,147	36,800		60,947
24	393	Tools, Shop and Garage Equipment.	135	68		203
25	394	Laboratory Equipment	3,523	(899)		2,624
26	395	Power Operated Equipment		-		-
27	396	Communication Equipment	-	1,011		1,011
28	398	Other TangiblePlant	-	-		-
29						-
30		TOTALS	$ 5,947,887	$ (322,862)	$ -	$ 5,625,025
31						
32	Accumulated Deprecaition per Books					$ 5,947,887
33						
34	Increase (decrease) in Plant-in-Service					$ (322,862)
35						
36	Adjustment to Plant-in-Service					$ (322,862)
37						
38	SUPPORTING SCHEDULES					
39	B-2, pages 3.5					
40						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment 3

Exhibit
Schedule B-2
Page 5
Witness: Bourassa

Line No.				
1	Additional Scottsdale Treatment Capacity			
2				
3				
4	Cost of Additonal Scottsdale Treatment Capacity			$ 486,294
5	(acquired in June 2006)			
6				
7	Amortization period (years)		10	
8				
9	Annual amortization	$	48,629	
10				
11	Number of years to Jume 2008		2	
12				
13	Less: Amortization through June 2008			$ 97,259
14				
15	Unamortized balance			$ 389,035
16				
17				
18	Adjustment to deferred regulatory assets			$ 389,035
19				
20				
21				
22				
23				
24				
25				
26				
27				
28				
29				
30				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment 4

Exhibit
Schedule B-2
Page 6
Witness: Bourassa

Line No.	CIAC and Accumulated Amortization		CIAC	Rate	Amortization	Accumulated Amortization
1						
2						
3	Balance at 12/31/2004	$	4,857,632			3,256,134
4	(per Decision 69164)					3,256,134
5	Jan-Dec Amortization			5.00%	242,882	3,499,016
6	2005 Additions		301,511	2.50%	7,538	3,506,553
7						3,506,553
8	Balance at 12/31/2005	$	5,159,143			3,506,553
9	Jan-Dec Amortization			5.00%	257,957	3,764,511
10	2006 Additions		70,523	2.50%	1,763	3,766,274
11						3,766,274
12	Balance at 12/31/2006	$	5,229,666			3,766,274
13	Jan-Nov Amortization			5.00%	239,693	4,005,967
14	Dec Amortization			3.64%	15,857	4,021,824
15	2007 Additions		2,473	2.50%	57	4,021,880
16				1.82%	4	4,021,884
17	Balance at 12/31/2007	$	5,232,139			4,021,884
18	Jan-Dec Amortization			3.68%	192,499	4,214,384
19	2008 Additions		-	1.84%	-	4,214,384
20						4,214,384
21	Balance at 6/30/2008	$	**5,232,139**			**4,214,384**
22						
23						
24						
25	Computed balance at 6/30/2008	$	5,232,139			$ 4,214,384
26						
27	Book balance at 6/30/2008	$	5,341,461			$ 4,485,415
28						
29	Increase (decrease)	$	(109,322)			$ (271,031)
30						
31						
32	Adjustment to CIAC	$	(109,322)			$ 271,031
33	Label		4a			4b
34						
35						
36						
37						
38						
39						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment 5

Exhibit
Schedule B-2
Page 7
Witness: Bourassa

Line No.										
1	**Deferred Income Tax as of June 30, 2008**									
2				Probability	Deductible TD					
3				of Realization	(Taxable TD)					
4		Adjusted		of Future	Expected to	Tax	Future Tax Asset		Future Tax Liability	
5		Book Value[1]	Tax Value	Tax Benefit	be Realized	Rate	Current	Non Current	Current	Non Current
6	Plant-in-Service	$ 11,357,735								
7	Accum. Deprec.	(5,625,025)								
8	CIAC	(1,017,755)								
9	Fixed Assets	$ 4,714,955	$ 3,699,796	100.0%	$ (1,015,159)	38.6%				$ (391,851)
10	AIAC	$ (1,457,009)	-	100.0%	$ 1,457,009	38.6%		$ 562,405		
11										
12							$ -	$ 562,405	$ -	$ (391,851)
13										
14					Net Asset (Liability)		$ 170,554			
15										
16					Adjustment to DIT		$ (170,554)			
17										
18	[1] Adjusted per B-2									
19										
20										
21										
22										
23										
24										

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Working Capital

Exhibit
Schedule B-5
Page 1
Witness: Bourassa

Line No.			
1	Cash Working Capital (1/8 of Allowance		
2	Operation and Maintenance Expense)	$	153,565
3	Pumping Power (1/24 of Pumping Power)		29
4	Purchased Water (1/24 of Purchased Water)		13,969
5	Prepaids		17,326
6	Materials & Supplies		-
7			
8			
9	Total Working Capital Allowance	$	184,889
10			
11			
12	Working Capital Requested	$	-
13			
14			
15	SUPPORTING SCHEDULES:	RECAP SCHEDULES:	
16	E-1	B-1	
17			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Schedule C-1
Page 1
Witness: Bourassa

Line No.		Test Year Book Results	Label	Adjustment	Test Year Adjusted Results	Proposed Rate Increase	Adjusted with Rate Increase
1	**Revenues**						
2	Flat Rate Revenues	$ 1,555,192	5	$ 2,145	$ 1,557,337	$ 913,762	$ 2,471,099
3	Measured Revenues	15,917			15,917		15,917
4	Other Wastewater Revenues	6,916			6,916		6,916
5		$ 1,578,025		$ 2,145	$ 1,580,170	$ 913,762	$ 2,493,932
6	**Operating Expenses**						
7	Salaries and Wages	$ -			$ -		$ -
8	Purchased Wastewater Treatment	300,408	6/7	34,847	335,255		335,255
9	Sludge Removal Expense	706			706		706
10	Purchased Power	54,522	10	168	54,690		54,690
11	Fuel for Power Production	928			928		928
12	Chemicals	34,152	'8/9	3,337	37,489		37,489
13	Materials and Supplies	11,224			11,224		11,224
14	Contractual Services	9,362			9,362		9,362
15	Contractual Services- Testing	16,955			16,955		16,955
16	Contractual Services - Other	502,741	11	50,302	553,043		553,043
17	Equipment Rental	1,863			1,863		1,863
18	Rents - Building	19,830			19,830		19,830
19	Transportation Expenses	34,445			34,445		34,445
20	Insurance - General Liability	18,704			18,704		18,704
21	Insurance - Other	990			990		990
22	Regulatory Commission Expense	59,884	4	116	60,000		60,000
23	Miscellaneous Expense	20,845			20,845		20,845
24	Bad Debt Expense	11,962			11,962		11,962
25	Scottsdale Capacity (Operating Lease)	-	3	164,522	164,522		164,522
26	Amort. of Additional Scottsdale Cap.	-	12	48,629	48,629		48,629
27	Depreciation and Amortization	181,931	1	42,887	224,818		224,818
28	Taxes Other Than Income	(1,780)			(1,780)		(1,780)
29	Property Taxes	19,302	2	13,112	32,414		32,414
30	Income Tax	125,431	14	(117,671)	7,760	352,702	360,462
31					-		-
32	**Total Operating Expenses**	$ 1,424,405		$ 240,250	$ 1,664,655	$ 352,702	$ 2,017,356
33	**Operating Income**	$ 153,620		$ (238,105)	$ (84,485)	$ 561,060	$ 476,575
34	**Other Income (Expense)**						
35	Interest Income	-			-		-
36	Other income	-			-		-
37	Interest Expense	(98,285)	13	30,592	(67,693)		(67,693)
38	Other Expense	-			-		-
39							
40	**Total Other Income (Expense)**	$ (98,285)		$ 30,592	$ (67,693)	$ -	$ (67,693)
41	**Net Profit (Loss)**	$ 55,335		$ (207,513)	$ (152,178)	$ 561,060	$ 408,882
42							
43	SUPPORTING SCHEDULES:					RECAP SCHEDULES:	
44	C-2					A-1	
45	E-2						
46							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses

Exhibit
Schedule C-2
Page 1
Witness: Bourassa

Adjustments to Revenues and Expenses

Line No.		1 Depreciation Expense	2 Property Taxes	3 Scottsdale Treatment Capacity	4 Rate Case Expense	5 Revenue Annualization	6 Purchased WW Treatment	Subtotal
3	Revenues					2,145		2,145
5	Expenses	42,887	13,112	164,522	116		33,845	254,482
8	Operating Income	(42,887)	(13,112)	(164,522)	(116)	2,145	(33,845)	(252,337)
10	Interest							-
11	Expense							-
12	Other							
13	Income /							-
14	Expense							
16	Net Income	(42,887)	(13,112)	(164,522)	(116)	2,145	(33,845)	(252,337)

Adjustments to Revenues and Expenses

Line No.		7 Annualization WW Treatment	8 Increase in Chemicals Exp.	9 Annualization of Chemicals Exp.	10 Annualization Purchased Power	11 Contractual Services	12 Amortization Trmnt Cap.	Subtotal
22	Revenues							2,145
24	Expenses	1,002	2,943	394	168	50,302	48,629	357,921
27	Operating Income	(1,002)	(2,943)	(394)	(168)	(50,302)	(48,629)	(355,776)
29	Interest							
30	Expense							-
31	Other							
32	Income /							-
33	Expense							
35	Net Income	(1,002)	(2,943)	(394)	(168)	(50,302)	(48,629)	(355,776)

Adjustments to Revenues and Expenses

Line No.		13 Interest Synchronization	14 Income Taxes	15	16	17	18	Total
41	Revenues							2,145
43	Expenses		(117,671)					240,250
46	Operating Income	-	117,671	-	-	-	-	(238,105)
48	Interest							
49	Expense	30,592						30,592
50	Other							
51	Income /							-
52	Expense							
54	Net Income	30,592	117,671	-	-	-	-	(207,513)

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses
Adjustment Number 1

Exhibit
Schedule C-2
Page 2
Witness: Bourassa

Line No.					
1	Depreciation Expense				
2					
3	Acct.		Adjusted Original	Proposed	Depreciation
4	No.	Description	Cost	Rates	Expense
5	351	Organization	-	0.00%	-
6	352	Franchises	-	0.00%	-
7	353	Land and Land Rights	461,300	0.00%	-
8	354	Structures and Improvements	2,557,920	3.33%	85,179
9	355	Power Generation Equipment	-	5.00%	-
10	360	Collection Sewers - Force	706,292	2.00%	14,126
11	361	Collection Sewers - Gravity	4,284,948	2.00%	85,699
12	362	Special Collecting Structures	-	2.00%	-
13	363	Services to Customers	198,723	2.00%	3,974
14	364	Flow Measuring Devices	31,512	10.00%	3,151
15	365	Flow Measuring Installations	179,622	10.00%	17,962
16	370	Receiving Wells	690,628	3.33%	22,998
17	371	Effluent Pumping Equipment	654,844	12.50%	81,855
18	380	Treatment and Disposal Equipment	143,578	5.00%	7,179
19	381	Plant Sewers	123,289	5.00%	6,164
20	382	Outfall Sewer Lines	-	3.33%	-
21	389	Other Plant and Misc. Equipment	939,432	6.67%	62,660
22	390	Office Furniture and Equipment	224,587	6.67%	14,980
23	391	Transportation Equipment	107,367	20.00%	21,473
24	393	Tools, Shop and Garage Equipment.	5,754	5.00%	288
25	394	Laboratory Equipment	7,488	10.00%	749
26	395	Power Operated Equipment	-	5.00%	-
27	396	Communication Equipment	40,451	10.00%	4,045
28	398	Other TangiblePlant	-	10.00%	-
29		TOTALS	$ 11,357,735		$ 432,483
30					
31	Less: Amortization of Contributions		$ 5,232,139	3.9690%	$ (207,665)
32					
33	Total Depreciation Expense				$ 224,818
34					
35	Test Year Depreciation Expense				181,931
36					
37	Increase (decrease) in Depreciation Expense				42,887
38					
39	Adjustment to Revenues and/or Expenses				$ 42,887
40					
41	SUPPORTING SCHEDULE				
42	B-2, page 3				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 2

Exhibit
Schedule C-2
Page 3
Witness: Bourassa

Line No.			
1	Adjust Property Taxes to Reflect Proposed Revenues:		
2			
3	Adjusted Revenues in year ended 06/30/2008	$	1,580,170
4	Adjusted Revenues in year ended 06/30/2008		1,580,170
5	Proposed Revenues		2,493,932
6	Average of three year's of revenue	$	1,884,757
7	Average of three year's of revenue, times 2	$	3,769,515
8	Add:		
9	Construction Work in Progess at 10%	$	14,202
10	Deduct:		
11	Book Value of Transportation Equipment		46,420
12			
13	Full Cash Value	$	3,723,094
14	Assessment Ratio		21%
15	Assessed Value		781,850
16	Property Tax Rate		4.1459%
17			
18	Property Tax		32,414
19	Tax on Parcels		0
20			
21	Total Property Tax at Proposed Rates	$	32,414
22	Property taxes in the test year		19,302
23	Change in property taxes	$	13,112
24			
25			
26	Adjustment to Revenues and/or Expenses	$	13,112
27			
28			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 3

Exhibit
Schedule C-2
Page 4
Witness: Bourassa

Line No.					
1	Calculation of Lease Costs on Scottsdale Treatment Capacity				
2					
3	Treatment Capacity Costs per Decision 59944	$	1,260,000		
4	Less Amount Funded by CIAC		(300,000)		
5	Net Amount Funded by Debt	$	960,000		
6					
7	Annual debt service				
8	Interest Rate		9.40%		
9	Term (years)		20.00		
10	Annual Debt Service	$	108,179		
11	Annual 'Lease Expense'			$	108,179
12					
13					
14	Additional Scottsdale Capacity per Decision 60240	$	653,706		
15	Less Amount Funded by CIAC		(153,706)		
16	Net Amount Funded by Debt	$	500,000		
17					
18	Annual debt service				
19	Interest Rate		9.40%		
20	Term (years)		20.00		
21	Annual Debt Service	$	56,343		
22	Annual 'Lease Expense'			$	56,343
23					
24	Total Annual 'Lease Expense'			$	164,522
25					
26					
27					
28					
29	Adjustment to Revenues and/or Expense			$	164,522
30					
31					
32					
33					
34					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 4

Exhibit
Schedule C-2
Page 5
Witness: Bourassa

Line No.			
1	Rate Case Expense		
2			
3	Estimated Rate Case Expense	$	180,000
4			
5	Estimated Amortization Period in Years		3
6			
7	Annual Rate Case Expense	$	60,000
8			
9	Test Year Rate Case Expense	$	59,884
10			
11	Increase(decrease) Rate Case Expense	$	116
12			
13	Adjustment to Revenue and/or Expense	$	116
14			
15			
16			
17			
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 5

Exhibit
Schedule C-2
Page 6
Witness: Bourassa

Line No.			
1	Revenue Annualization		
2			
3			
4	Revenue Annualization	$	2,145
5			
6			
7			
8	Total Revenue from Annualization	$	2,145
9			
10			
11	Adjustment to Revenue and/or Expense	$	2,145
12			
13	SUPPORTING SCHEDULES		
14	C-2 pages 6.1		
15	H-1		
16			
17			
18			
19			
20			

Black Mountain Sewer Corporation
Revenue Anualization to Year-end Number of Customers
Residential

Exhibit
Schedule C-2
Page 6.1
Witness: Bourassa

Line No.		Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
1	Year End Number of Customers	1,972	1,972	1,972	1,972	1,972	1,972
2	Actual Customers	1,964	1,960	1,955	1,959	1,961	1,967
3	Increase in Number of Customers/Bills	8	12	17	13	11	5
4	Average Revenue / Present Rates	$ 45.64	$ 45.64	$ 45.64	$ 45.64	$ 45.64	$ 45.64
5	Revenue Annualization / Present Rates	$ 365	$ 548	$ 776	$ 593	$ 502	$ 228
6							
7	Increase in Number of Customers	8	12	17	13	11	5
8	Average Revenue / Proposed Rates	$ 71.08	$ 71.08	$ 71.08	$ 71.08	$ 71.08	$ 71.08
9	Revenue Annualization / Proposed Rates	$ 569	$ 853	$ 1,208	$ 924	$ 782	$ 355
10							
11							
12							Total
13		Month					Year
14		Jan-08	Feb-08	Mar-08	Apr-08	May-08	
15	Year End Number of Customers	1,972	1,972	1,972	1,972	1,972	
16	Actual Customers	1,975	1,968	1,975	1,978	1,983	
17	Increase in Number of Customers/Bills	(3)	4	(3)	(6)	(11)	47
18	Average Revenue / Present Rates	$ 45.64	$ 45.64	$ 45.64	$ 45.64	$ 45.64	
19	Revenue Annualization / Present Rates	$ (137)	$ 183	$ (137)	$ (274)	$ (502)	$ 2,145
20							
21	Increase in Number of Customers	(3)	4	(3)	(6)	(11)	
22	Average Revenue / Proposed Rates	$ 71.08	$ 71.08	$ 71.08	$ 71.08	$ 71.08	
23	Revenue Annualization / Proposed Rates	$ (213)	$ 284	$ (213)	$ (426)	$ (782)	$ 3,341
24							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 6

Exhibit
Schedule C-2
Page 7
Witness: Bourassa

Line No.

1 City of Scottsdale Purchased Wastewater Treatment

3 Computation of Test Year Billings

Month	Year	Read Date	Sewage Flow (in gals)	Cost per 1,000 gal	Raw Billing	Environmental 18.953%	Subject to Sales tax	Sales tax 1.65%	Scottsdale Billing
July	2007	1-Aug-07	6,126,317	$ 2.39	$ 14,641.90	$ 2,775.08	$ 17,416.98	$ 287.38	$ 17,704.36
Aug	2007	1-Sep-07	7,000,000	$ 2.39	$ 16,730.00	$ 3,170.84	$ 19,900.84	$ 328.36	$ 20,229.20
Sept	2007	1-Oct-07	8,507,019	$ 2.39	$ 20,331.78	$ 3,853.48	$ 24,185.26	$ 399.06	$ 24,584.31
Oct	2007	1-Nov-07	8,800,000	$ 2.39	$ 21,032.00	$ 3,986.19	$ 25,018.19	$ 412.80	$ 25,431.00
Nov	2007	1-Dec-07	8,703,535	$ 2.39	$ 20,801.45	$ 3,942.50	$ 24,743.95	$ 408.28	$ 25,152.22
Dec	2007	1-Jan-08	8,936,845	$ 2.39	$ 21,359.06	$ 4,048.18	$ 25,407.24	$ 419.22	$ 25,826.46
Jan	2008	1-Feb-08	9,500,000	$ 2.26	$ 21,470.00	$ 4,069.21	$ 25,539.21	$ 421.40	$ 25,960.61
Feb	2008	1-Mar-08	11,347,179	$ 2.26	$ 25,644.62	$ 4,860.43	$ 30,505.05	$ 503.33	$ 31,008.38
Mar	2008	1-Apr-08	11,644,059	$ 2.26	$ 26,315.57	$ 4,987.59	$ 31,303.16	$ 516.50	$ 31,819.67
April	2008	1-May-08	9,597,371	$ 2.26	$ 21,690.06	$ 4,110.92	$ 25,800.98	$ 425.72	$ 26,226.69
May	2008	1-Jun-08	7,261,758	$ 2.26	$ 16,411.57	$ 3,110.49	$ 19,522.06	$ 322.11	$ 19,844.17
June	2008	1-Jul-08	6,333,090	$ 2.26	$ 14,312.78	$ 2,712.70	$ 17,025.49	$ 280.92	$ 17,306.41
Test Year Totals			103,757,173		$ 240,740.79	$ 45,627.60	$ 286,368.40	$ 4,725.08	$ 291,093.48

23 Computation of Billings under rate change effecive (7/1/2008)

25 City of Scottsdale billing with new rate	103,757,173	$ 2.59	$ 268,731.08	$ 50,932.60	$ 319,663.68	$ 5,274.45	$ 324,938.13

27 Increase(decrease) in City of Scottsdale purchased wastewater treatment $ 33,844.65

29 Adjustment to Revenues and/or Expenses $ 33,845

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 7

Exhibit
Schedule C-2
Page 8
Witness: Bourassa

Line No.			
1	Annualize Purchased Wastewater Treatment		
2			
3	Adjusted Year Purchased Wastewater Treatment (Scottsdale)	$	324,938
4	Gallons Treated By Scottsdale (in 1000's)		103,757
5	Cost per 1,000 gallons	$	3.13
6			
7	Additional Wasterwater gallons (in 1,000's) from revenue annualization		451
8	Percent diverted to Scottsdale		70.94%
9	Additonal gallons treated by Scottsdale (in 1,000's)		320
10			
11	Increase (decrease) in Purchased Wastewater Treatment	$	1,002
12			
13			
14			
15			
16	Adjustment to Revenue and/or Expense	$	1,002
17			
18			
19			
20	SUPPORTING SCHEDULE		
21	C-2, page 7		
22			
23			
24			
25			

Black Mountain Sewer Corporation
Test Year Ended December 31, 2001
Adjustment to Revenues and/or Expenses
Adjustment Number 8

Exhibit
Schedule C-2
Page 9
Witness: Bourassa

Line No.					
1					
2	Chemicals Expense[1]				
3					
4	Thoigard used from July to November 2007			$	8,169
5	Sodium Hydroxide (ordor control chemical)				
6	Gallons used during test year (approx. 7 months)		6,547		
7	Cost per Gallons	$	1.65		
8	Cost of Sodium Hydroxide			$	10,803
9	Delivery costs (14 deliveries at $35 per)				490
10	Total Cost			$	19,461
11					
12					
13	Sodium Hydroxide (ordor control chemical)				
14	Prjected gallons (test year gallons annualized to 12 months)		11,223		
15	Cost per Gallons	$	1.90		
16	Total Cost			$	21,325
17	Delivery costs (24 deliveries at $45 per)				1,080
18	Total Cost			$	22,405
19					
20					
21	Increase (decrease) in Ordor Control Checmical Expense			$	2,943
22					
23					
24					
25					
26					
27					
28	[1]Company switched from Thiogard to Alkali (Sodicaum Hydroxide) in Nov. 2007. For first 7 months the				
29	Company used 6,547 gallons. The annualized gallons is 11,223.				
30					
31					
32					

Black Mountain Sewer Corporation
Test Year Ended December 31, 2001
Adjustment to Revenues and/or Expenses
Adjustment Number 9

Exhibit
Schedule C-2
Page 10
Witness: Bourassa

Line No.			
1			
2	Annualize Chemicals Expense		
3			
4	Test Year Chemicals plus Adjustment #8	$	37,095
5	Gallons Treated By BMSC (in 1000's)		42,510
6	Cost per 1,000 gallons	$	0.87
7			
8	Additonal Wasterwater gallons (in 1,000's) from revenue annualization		451
9			
10	Additonal cost based on revenue annualization	$	394
11			
12	Increase (decrease) in Chemicals Expense	$	394
13			
14			
15			
16			
17	Adjustment to Revenue and/or Expense	$	394
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 10

Exhibit
Schedule C-2
Page 11
Witness: Bourassa

Line No.			
1			
2	Annualize Purchased Power		
3			
4	Test Year Purchased Power	$	54,522
5	Total Flow Gallons (in 1000's)		146,267
6	Cost per 1,000 gallons	$	0.37
7			
8	Additonal Wasterwater gallons (in 1,000's) from revenue annualization		451
9			
10	Additonal cost based on revenue annualization	$	168
11			
12	Increase (decrease) in Purchased Power	$	168
13			
14			
15			
16			
17	Adjustment to Revenue and/or Expense	$	168
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 11

Exhibit
Schedule C-2
Page 12
Witness: Bourassa

Line No.			
1			
2	Contractual Services		
3			
4	Increase in direct allocated Operations costs		$ 3,474
5			
6	Increase in allocated Accounting/Billing costs	$ 360,981	
7	Allocation Factor based on Year-end Customers	3.18%	
8			$ 11,492
9	Increase in allocated Overhead costs	781,239	
10	Allocation Factor based on 4-factor allocation	4.52%	
11			$ 35,336
12			
13	Total increase (decrease) in Contractual Services		$ 50,302
14			
15			
16			
17	Adjustment to Revenue and/or Expense		$ 50,302
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 12

Exhibit
Schedule C-2
Page 13
Witness: Bourassa

Line No.					
1					
2	Amortization of Additional Scottsdale Treatment Capacity				
3					
4	Additional Scottsdale Treatment Capacity	$	486,294		
5					
6	Amortization period (years)		10		
7					
8	Annual Amortization			$	48,629
9					
10					
11					
12	Adjustment to Revenue and/or Expense			$	48,629
13					
14					
15					
16					
17					
18					
19					
20					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 13

Exhibit
Schedule C-2
Page 14
Witness: Bourassa

Line No.			
1	Interest Synchronization		
2			
3			
4	Fair Value Rate Base	$3,723,245	
5	Weighted Cost of Debt	1.82%	
6	Interest Expense		$ 67,693
7			
8	Test Year Interest Expense		$ 98,285
9			
10	Increase (decrease) in Interest Expense		(30,592)
11			
12			
13			
14	Adjustment to Revenue and/or Expense		$ 30,592
15			
16			
17	Weighted Cost of Debt Computation		

18						Weighted
19			Amount	Percent	Cost	Cost
20	Debt	$	1,010,649	19.34%	9.40%	1.82%
21	Equity	$	4,214,556	80.66%	12.80%	10.32%
22	Total	$	5,225,205	100.00%		12.14%
23						
24						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 14

Exhibit
Schedule C-2
Page 15
Witness: Bourassa

Line No.			Test Year Book Results		Test Year Adjusted Results		Adjusted with Rate Increase	
1	Income Tax Computation							
2								
3								
4								
5								
6								
7	Taxable Income before Scottsdale Operating		$ 180,766		$ (144,418)		$ 769,344	
8	Plus: Scottsdale Operating Lease		-		164,522		164,522	
9	Taxable Income		$ 180,766		$ 20,104		$ 933,866	
10								
11								
12								
13	Income Before Taxes		$ 180,766		$ 20,104		$ 933,866	
14								
15	Arizona Income Before Taxes		$ 180,766		$ 20,104		$ 933,866	
16								
17	Less Arizona Income Tax		$ 12,596		$ 1,401		$ 65,072	
18	Rate =	6.97%						
19	Arizona Taxable Income		$ 168,170		$ 18,703		$ 868,794	
20								
21	Arizona Income Taxes		$ 12,596		$ 1,401		$ 65,072	
22								
23	Federal Income Before Taxes		$ 180,766		$ 20,104		$ 933,866	
24								
25	Less Arizona Income Taxes		$ 12,596		$ 1,401		$ 65,072	
26								
27	Federal Taxable Income		$ 168,170		$ 18,703		$ 868,794	
28								
29								
30								
31	FEDERAL INCOME TAXES:							
32	15% BRACKET		$ 7,500		$ 2,805		$ 7,500	
33	25% BRACKET		$ 6,250		$ -		$ 6,250	
34	34% BRACKET		$ 8,500	Federal	$ -	Federal	$ 8,500	Federal
35	39% BRACKET		$ 26,586	Effective	$ -	Effective	$ 91,650	Effective
36	34% BRACKET		$ -	Tax	$ -	Tax	$ 181,490	Tax
37				Rate		Rate		Rate
38	Federal Income Taxes		$ 48,836	27.02%	$ 2,805	13.95%	$ 295,390	31.63%
39								
40								
41	Total Income Tax		$ 61,432		$ 4,206		$ 360,462	
42								
43	Overall Tax Rate		33.98%		20.92%		38.60%	
44								
45	Income Tax at Proposed Rates Effective Rate →				$ 7,760			
46								

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Gross Revenue Conversion Factor

Exhibit
Schedule C-3
Page 1
Witness: Bourassa

Line No.	Description	Percentage of Incremental Gross Revenues
1	Federal Income Taxes	31.63%
2		
3	State Income Taxes	6.97%
4		
5	Other Taxes and Expenses	0.00%
6		
7		
8	Total Tax Percentage	38.60%
9		
10	Operating Income % = 100% - Tax Percentage	61.40%
11		
12		
13		
14		
15	1 = Gross Revenue Conversion Factor	
16	Operating Income %	1.6286
17		
18	SUPPORTING SCHEDULES:	RECAP SCHEDULES:
19		A-1
20		

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Comparative Balance Sheets

Exhibit
Schedule E-1
Page 1
Witness: Bourassa

Line No.		Test Year Ended 6/30/2008	Year Ended 6/30/2007	Year Ended 6/30/2006
1	**ASSETS**			
2	Plant In Service	$ 11,342,207	$ 9,223,235	$ 9,119,420
3	Non-Utility Plant	-	-	-
4	Scottsdale Treatment Capacity	2,400,000	2,400,000	2,400,000
5	Construction Work in Progress	142,018	564,837	93,538
6	Less: Accumulated Depreciation	(5,947,887)	(5,498,929)	(5,062,263)
7	Net Plant	$ 7,936,338	$ 6,689,143	$ 6,550,695
8				
9	Debt Reserve Fund	$ -	$ -	$ -
10				
11	CURRENT ASSETS			
12	Cash and Equivalents	$ 33,796	$ 27,437	$ 116,779
13	Restricted Cash	(4,953)	(4,953)	356,412
14	Accounts Receivable, Net	30,351	35,697	33,362
15	Accounts Receivable -Other	12,080	12,109	10,152
16	Materials and Supplies	-	-	-
17	Prepayments	17,326	8,075	9,444
18	Other Current Assets	163,791	180,474	176,876
19	Total Current Assets	$ 252,391	$ 258,839	$ 703,025
20				
21	Deferred Debits	$ -	$ -	$ -
22				
23	Other Investments & Special Funds	$ -	$ -	$ -
24				
25	TOTAL ASSETS	$ 8,188,729	$ 6,947,982	$ 7,253,720
26				
27				
28	**LIABILITIES AND STOCKHOLDERS' EQUITY**			
29				
30	Common Equity	$ 3,772,970	$ 3,072,632	$ 1,850,199
31				
32	Long-Term Debt	$ 1,010,649	$ 1,074,188	$ 1,132,046
33				
34	CURRENT LIABILITIES			
35	Accounts Payable	$ 16,146	$ 6,193	$ 15,074
36	Current Portion of Long-Term Debt	-	-	-
37	Payables to Associated Companies	748,526	95,275	534,898
38	Customer Meter Deposits, Current	-	-	-
39	Accrued Taxes	10,393	18,810	18,187
40	Accrued Interest	-	-	-
41	Other Current Liabilities	222,700	29,514	68,353
42	Total Current Liabilities	$ 997,765	$ 149,792	$ 636,512
43	DEFERRED CREDITS			
44	Customer Meter Deposits, less current	$ 94,290	$ 105,911	$ 73,079
45	Advances in Aid of Construction	1,457,009	1,424,859	1,371,859
46	Accumulated Deferred Income Taxes	-	-	-
47	Contributions In Aid of Construction, Net	5,341,461	5,338,988	6,127,712
48	Accumulated Amortization of CIAC	(4,485,415)	(4,218,388)	(3,937,687)
49	Asset Retirement Obligations	-	-	-
50	Total Deferred Credits	$ 2,407,345	$ 2,651,370	$ 3,634,963
51				
52	Total Liabilities & Common Equity	$ 8,188,729	$ 6,947,982	$ 7,253,720
53				
54	SUPPORTING SCHEDULES:			
55	E-5			
56				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Comparative Income Statements

Exhibit
Schedule E-2
Page 1
Witness: Bourassa
Revised

Line No.		Test Year Ended 6/30/2008	Prior Year Ended 6/30/2007	Prior Year Ended 6/30/2006
1	**Revenues**			
2	Flat Rate Revenues	$ 1,555,192	$ 1,420,175	$ 1,251,398
3	Measured Revenues	15,917	16,019	14,692
4	Other Wastewater Revenues	6,916	9,946	20,284
5	**Total Revenues**	$ 1,578,025	$ 1,446,140	$ 1,286,374
6	**Operating Expenses**			
7	Salaries and Wages	$ -	$ -	$ -
8	Purchased Wastewater Treatment	300,408	250,264	209,919
9	Sludge Removal Expense	706	737	1,212
10	Purchased Power	54,522	54,232	44,702
11	Fuel for Power Production	928	-	-
12	Chemicals	34,152	69,037	62,384
13	Materials and Supplies	11,224	10,086	16,903
14	Contractual Services	9,362	4,639	5,503
15	Contractual Services- Testing	16,955	27,041	10,789
16	Contractual Services - Other	502,741	392,538	295,686
17	Equipment Rental	1,863	769	1,047
18	Rents - Building	19,830	2,321	2,786
19	Transportation Expenses	34,445	16,591	5,299
20	Insurance - General Liability	18,704	20,160	12,055
21	Insurance - Other	990	2,139	4,633
22	Regulatory Commission Expense	59,884	51,852	14,048
23	Miscellaneous Expense	20,845	26,868	29,766
24	Bad Debt Expense	11,962	(206)	(10,657)
25	Depreciation and Amortization	181,931	155,965	115,358
26	Taxes Other Than Income	(1,780)	4,715	-
27	Property Taxes	19,302	35,789	34,096
28	Income Tax	125,431	108,680	99,767
29				
30	**Total Operating Expenses**	$ 1,424,405	$ 1,234,217	$ 955,296
31	**Operating Income**	$ 153,620	$ 211,923	$ 331,078
32	**Other Income (Expense)**			
33	Interest Income	$ -	$ 3,973	$ 5,350
34	Other income	-	-	-
35	Interest Expense	(98,285)	(103,962)	(109,872)
36	Other Expense	-	-	-
37		-	-	-
38	**Total Other Income (Expense)**	$ (98,285)	$ (99,989)	$ (104,522)
39	**Net Profit (Loss)**	$ 55,335	$ 111,934	$ 226,556
40				
41				
42				
43	SUPPORTING SCHEDULES:		RECAP SCHEDULES:	
44			A-2	
45				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Comparative Statements of Cash Flows

Exhibit
Schedule E-3
Page 1
Witness: Bourassa

Line No.		Test Year Ended 6/30/2008	Prior Year Ended 6/30/2007	Prior Year Ended 6/30/2006
1				
2				
3	Cash Flows from Operating Activities			
4	Net Income	$ 55,335	$ 111,934	$ 226,556
5	Adjustments to reconcile net income to net cash			
6	provided by operating activities:			
7	Depreciation and Amortization	181,931	115,358	115,358
8	Adjustments to Depreciation/Amortization	2,473	40,607	
9	Other			
10	Changes in Certain Assets and Liabilities:			
11	Accounts Receivable	5,346	(2,335)	14,052
12	Accounts Receivable, Other	29	(1,957)	(1,375)
13	Materials and Supplies Inventory			
14	Prepaid Expenses	(9,251)	1,369	(3,391)
15	Restricted Cash		361,365	(2,434)
16	Accounts Payable	9,953	(8,881)	(64,452)
17	Intercompany payable	653,251	(439,623)	421,220
18	Customer Deposits	(11,621)	32,832	13,096
19	Intercompany taxes receivable and taxes payable	(8,417)	623	(116,017)
20	Other assets and liabilities	209,869	(42,437)	(143,688)
21				
22	Net Cash Flow provided by Operating Activities	$ 1,088,898	$ 168,855	$ 458,925
23	Cash Flow From Investing Activities:			
24	Capital Expenditures	(1,696,153)	(575,114)	(974,274)
25	Plant Held for Future Use			
26	Changes in debt reserve fund			
27	Net Cash Flows from Investing Activities	$ (1,696,153)	$ (575,114)	$ (974,274)
28	Cash Flow From Financing Activities			
29	Change in Restricted Cash			
30	Change in net amounts due to parent and affiliates			
31	Receipt of advances for and contributions in aid of construction	32,150	(735,724)	170,817
32	Refunds for advances for construction			(56,002)
33	Repayments of Long-Term Debt	(63,539)	(57,858)	(69,680)
34	Dividends Paid			
35	Deferred Financing Costs			
36	Paid in Capital	645,003	1,110,499	442,480
37	Net Cash Flows Provided by Financing Activities	$ 613,614	$ 316,917	$ 487,615
38	Increase(decrease) in Cash and Cash Equivalents	6,359	(89,342)	(27,734)
39	Cash and Cash Equivalents at Beginning of Year	27,437	116,779	144,513
40	Cash and Cash Equivalents at End of Year	$ 33,796	$ 27,437	$ 116,779
41				
42				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Statement of Changes in Stockholder's Equity

Exhibit
Schedule E-4
Page 1
Witness: Bourassa

Line No.		Common Stock	Additional Paid-In-Capital	Retained Earnings	Total
1					
2					
3					
4	Balance, June 30, 2005	$ 1,000	$ 1,301,007	$ (120,844)	$ 1,181,163
5	Addnl Paid In Capital		-	442,480	442,480
6	Dividends				-
7	Net Income			226,556	226,556
8					
9	Balance, June 30, 2006	$ 1,000	$ 1,301,007	$ 548,192	$ 1,850,199
10	Addnl Paid In Capital			1,110,499	1,110,499
11	Dividends				-
12	Net Income			111,934	111,934
13					
14	Balance, June 30, 2007	$ 1,000	$ 1,301,007	$ 1,770,625	$ 3,072,632
15	Addnl Paid In Capital			645,003	645,003
16	Dividends				-
17	Net Income			55,335	55,335
18					
19	Balance, June 30, 2008	$ 1,000	$ 1,301,007	$ 2,470,963	$ 3,772,970
20					
21					
22					
23					
24					
25					
26	SUPPORTING SCHEDULES:			RECAP SCHEDULES:	

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Detail of Plant in Service

Exhibit
Schedule E-5
Page 1
Witness: Bourassa

Line No.	Acct. No.	Plant Description	Plant Balance at 12/31/2007	Plant Additions, Reclass-ications or or Retirements	Plant Balance at 6/30/2008
1					
2	351	Organization	$ -	$ -	$ -
3	352	Franchises	-	-	-
4	353	Land and Land Rights	461,300	-	461,300
5	354	Structures and Improvements	1,279,322	1,278,597	2,557,920
6	355	Power Generation Equipment	-	-	-
7	360	Collection Sewers - Force	694,034	12,258	706,292
8	361	Collection Sewers - Gravity	4,159,078	125,870	4,284,948
9	362	Special Collecting Structures	-	-	-
10	363	Services to Customers	186,983	11,739	198,723
11	364	Flow Measuring Devices	31,512	-	31,512
12	365	Flow Measuring Installations	179,348	274	179,622
13	370	Receiving Wells	698,278	(7,650)	690,628
14	371	Effluent Pumping Equipment	578,780	76,064	654,844
15	380	Treatment and Disposal Equipment	22,859	120,719	143,578
16	381	Plant Sewers	123,289	-	123,289
17	382	Outfall Sewer Lines	-	-	-
18	389	Other Plant and Misc. Equipment	863,216	76,216	939,432
19	390	Office Furniture and Equipment	224,587	-	224,587
20	391	Transportation Equipment	107,367	-	107,367
21	393	Tools, Shop and Garage Equipment.	3,493	2,262	5,754
22	394	Laboratory Equipment	7,488	-	7,488
23	395	Power Operated Equipment	-	-	-
24	396	Communication Equipment	-	40,451	40,451
25	398	Other TangiblePlant	-	-	-
26					
27					
28					
29					
30					
31					
32		TOTAL WATER PLANT	$ 9,620,936	$ 1,736,800	$ 11,357,735
33					
34		SUPPORTING SCHEDULES		RECAP SCHEDULES:	
35				A-4	
36				E-1	
37					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Operating Statistics

Exhibit
Schedule E-7
Page 1
Witness: Bouras

Line No.		Test Year Ended 6/30/2008	Prior Year Ended 6/30/2007	Prior Year Ended 6/30/2006
1	WASTEWATER STATISTICS:			
2				
3				
4				
5	Sewer Revenues from Customer:	$ 1,578,025	$ 1,446,140	$ 1,286,374
6				
7				
8				
9				
10	Year End Number of Customers	2,102	2,027	2,019
11				
12				
13				
14	Annual Revenue per Year End Customer	$ 750.73	$ 713.44	$ 637.13
15				
16				
17				
18				
19				
20				
21				
22				
23				
24				
25				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Taxes Charged to Operations

Exhibit
Schedule E-8
Page 1
Witness: Bourassa

Line No.	Description	Test Year Ended 6/30/2008	Prior Year Ended 6/30/2007	Prior Year Ended 6/30/2006
1	Description			
2				
3	Federal Income Taxes*	$ 57,575	$ 93,303	$ 77,022
4	State Income Taxes*	3,857	15,377	22,745
5	Payroll Taxes	-	-	-
6	Property Taxes	19,302	35,789	34,096
7				
8	Totals	$ 80,734	$ 144,469	$ 133,863
9				
10				
11	*Computed			
12				
13				
14				

The Company does not have outside auditors

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Projected Income Statements - Present & Proposed Rates

Exhibit
Schedule F-1
Page 1
Witness: Bourassa

Line No.		Test Year Actual Results	At Present Rates Year Ended 6/30/2009	At Proposed Rates Year Ended 6/30/2009
1	**Revenues**			
2	Flat Rate Revenues	$ 1,555,192	$ 1,557,337	$ 2,471,099
3	Measured Revenues	15,917	15,917	15,917
4	Other Wastewater Revenues	6,916	6,916	6,916
5		$ 1,578,025	$ 1,580,170	$ 2,493,932
6	**Operating Expenses**			
7	Salaries and Wages	$ -	$ -	$ -
8	Purchased Wastewater Treatment	300,408	335,255	335,255
9	Sludge Removal Expense	706	706	706
10	Purchased Power	54,522	54,690	54,690
11	Fuel for Power Production	928	928	928
12	Chemicals	34,152	37,489	37,489
13	Materials and Supplies	11,224	11,224	11,224
14	Contractual Services - Professional	9,362	9,362	9,362
15	Contractual Services - Testing	16,955	16,955	16,955
16	Contractual Services - Other	1,863	1,863	1,863
17	Rents	19,830	19,830	19,830
18	Transportation Expenses	34,445	34,445	34,445
19	Insurance - General Liability	18,704	18,704	18,704
20	Regulatory Commission Expense	59,884	60,000	60,000
21	Miscellaneous Expense	20,845	20,845	20,845
		-	164,522	164,522
22	Depreciation	181,931	224,818	224,818
23	Taxes Other Than Income	(1,780)	(1,780)	(1,780)
24	Property Taxes	19,302	32,414	32,414
25	Income Tax	125,431	7,760	360,462
26				
27	**Total Operating Expenses**	$ 908,712	$ 1,050,031	$ 1,402,733
28	**Operating Income**	$ 669,313	$ 530,139	$ 1,091,199
29	**Other Income (Expense)**			
30	Interest Income	-	-	-
31	Other income	-	-	-
32	Interest Expense	(98,285)	(67,693)	(67,693)
33	Other Expense	-	-	-
34	Gain/Loss Sale of Fixed Assets	-	-	-
35	**Total Other Income (Expense)**	$ (98,285)	$ (67,693)	$ (67,693)
36	**Net Profit (Loss)**	$ 571,028	$ 462,446	$ 1,023,506
37				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Projected Statements of Changes in Financial Position
Present and Proposed Rates

Exhibit
Schedule F-2
Page 1
Witness: Bourassa

Line No.		Test Year Ended 6/30/2008	At Present Rates Year Ended 6/30/2009	At Proposed Rates Year Ended 6/30/2009
5	Cash Flows from Operating Activities			
6	Net Income	$ 55,335	$ (152,178)	$ 408,882
7	Adjustments to reconcile net income to net cash			
8	provided by operating activities:			
9	Depreciation and Amortization	181,931	224,818	224,818
10	Deferred Income Taxes	2,473		
11	Other	-		
12	Changes in Certain Assets and Liabilities:	-		
13	Accounts Receivable	5,346		
14	Unbilled Revenues	29		
15	Materials and Supplies Inventory	-		
16	Prepaid Expenses	(9,251)		
17	Deferred Charges	-		
18	Accounts Payable	9,953		
19	Intercompany payable	653,251	(500,000)	(500,000)
20	Customer Deposits	(11,621)		
21	Intercompany taxes receivable and taxes payable	(8,417)		
22	Other assets and liabilities	209,869		
23				
24	Net Cash Flow provided by Operating Activities	$ 1,088,898	$ (427,360)	$ 133,700
25	Cash Flow From Investing Activities:			
26	*Capital Expenditures*	(1,696,153)	(232,450)	(232,450)
27	Plant Held for Future Use	-		
28	Changes in debt reserve fund	-		
29	Net Cash Flows from Investing Activities	$ (1,696,153)	$ (232,450)	$ (232,450)
30	Cash Flow From Financing Activities			
31	Change in Restricted Cash	-	-	-
32	Change in net amounts due to parent and affiliates	-	-	-
33	Receipt of advances for and contributions in aid of construction	32,150	-	-
34	Refunds for advances for construction	-	-	-
35	Repayments of Long-Term Debt	(63,539)	(69,774)	(69,774)
36	Dividends Paid	-	-	-
37	Deferred Financing Costs	-	-	-
38	Paid in Capital	645,003	230,000	230,000
39	Net Cash Flows Provided by Financing Activities	$ 613,614	$ 160,226	$ 160,226
40	Increase(decrease) in Cash and Cash Equivalents	6,359	(499,584)	61,476
41	Cash and Cash Equivalents at Beginning of Year	27,437	33,796	33,796
42	Cash and Cash Equivalents at End of Year	$ 33,796	$ (465,788)	$ 95,272
43	F-3			
44				
45				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Projected Construction Requirements

Exhibit
Schedule F-3
Page 1
Witness: Bourassa

Line No.	Account Number	Plant Asset:	2009	2010	2011
1					
2					
3					
4	352	Franchises	$ -	$ -	$ -
5	353	Land and Land Rights			
6	354	Structures and Improvements			
7	355	Power Generation Equipment			
8	360	Collection Sewers - Force			
9	361	Collection Sewers - Gravity	140,000	90,000	30,000
10	362	Special Collecting Structures			
11	363	Services to Customers			
12	364	Flow Measuring Devices			
13	365	Flow Measuring Installations			
14	370	Receiving Wells	30,000	220,000	20,000
15	371	Effluent Pumping Equipment	32,500	20,000	20,000
16	380	Treatment and Disposal Equipment	5,500	3,500	303,500
17	381	Plant Sewers			
18	382	Outfall Sewer Lines			
19	389	Other Plant and Misc. Equipment			
20	390	*Office Furniture and Equipment*	375	500	500
21	391	Transportation Equipment		30,000	
22	393	Tools, Shop and Garage Equipment.	4,075	2,000	2,000
23	394	Laboratory Equipment			
24	395	Power Operated Equipment			
25	398	Other TangiblePlant	20,000	50,000	180,000
26					
27					
28					
29					
30	Total		$ 232,450	$ 416,000	$ 556,000
31					
32					
33					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Assumptions Used in Rate Filing

Exhibit
Schedule F-4
Page 1
Witness: Bourassa

Line No.	
1	Property Taxes were computed using the method used by the Arizona Department
2	of Revenue
3	
4	Projected construction expenditures are shown on Schedule A-4.
5	
6	Expense adjustments are shown on Schedule C2, and are explained in the testimony.
7	
8	Accumulated depreciation was computed using depreciation rates authorized
9	in prior Commission decision.
10	
11	Income taxes were computed using statutory state and federal income tax rates.
12	
13	
14	
15	

Black Mountain Sewer Corporation
Revenue Summary
With Annualized Revenues to Year End Number of Customers
Test Year Ended June 30, 2008

Exhibit
Schedule H-1
Witness: Bourassa

Line No.	Customer Classification	Present Revenues	Proposed Revenues	Dollar Change	Percent Change	Percent of Present Sewer Revenues	Percent of Proposed Sewer Revenues
1	Residential	1,077,880	1,678,696	600,816	55.74%	68.59%	67.59%
2	Commercial (Standard Rate)	378,678	589,788	211,110	55.75%	24.10%	23.75%
3	Commercial (Special Rate)						
4	Boulders Resort	50,085	100,356	50,272	100.37%	3.19%	4.04%
5	Desert Forest	13,729	23,939	10,210	74.37%	0.87%	0.96%
6	El Pedegral	26,587	53,990	27,403	103.07%	1.69%	2.17%
7	Boulders Club	168	342	174	103.07%	0.01%	0.01%
8	Spanish Village	8,395	17,048	8,653	103.07%	0.53%	0.69%
9	Effluent Sales	15,917	19,578	3,661	23.00%	1.01%	0.79%
10	Subtotal	1,571,439	2,483,738	912,299	58.06%	100.00%	100.00%
11							
12	Revenue Annualization						
13	Residential	2,145	3,341	1,196	55.74%	0.14%	0.13%
14							
15	Misc Service Revenues						
16	Misc Revenues	6,915	6,915	-	0.00%	0.44%	0.28%
17	Reconciling Amount to C-1	(329)	(62)	267	-81.16%	-0.02%	0.00%
18	Totals	1,580,170	2,493,931	913,762	57.83%	99.98%	100.00%
19							
20							
21							
22							
23							
24							
25							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Analysis of Revenue by Detailed Class
Special Rate Commercial Customers Pay Standard Commerical Rate

Schedule H-2
Page 1
Witness: Bourassa

Line No.	Customer Classification	Average Number of Customers at 6/30/2008	Average Effluent	Average Bill Present Rates	Average Bill Proposed Rates	Proposed Increase Dollar Amount	Proposed Increase Percent Amount
1	Residential	1,972	N/A	$ 45.64	$ 71.08	$ 25.44	55.741%
2	Commercial (Standard Rate)	124	N/A	103.41	161.06	57.65	55.749%
3	Commercial (Special Rate)						
4	B-H Enterprises (West)	-	N/A	$ -	N/A		
5	B-H Enterprises (East)	1	N/A	-	N/A		
6	Barb's Per Grooming	-	N/A	-	N/A		
7	Boulders Resort	1	N/A	4,173.74	8,363.03	4,189.29	100.373%
8	Carefree Dental	-	N/A	-	N/A		
9	Ridgecrest Realty	1	N/A	-	N/A		
10	Desert Forest	1	N/A	1,144.08	1,994.93	850.85	74.370%
11	Desert Hills Pharmacy	1	N/A	-	N/A		
12	El Pedregal	1	N/A	2,215.55	4,499.14	2,283.59	103.071%
13	Lemon Tree	1	N/A	-	N/A		
14	Body Shop	1	N/A	-	N/A		
15	Spanish Village	-	N/A	-	0.28499		
16	Boulders Club	-	N/A	168.41	341.99	173.58	103.071%
17	Anthony Vuitaggio	1	N/A	-	N/A		
18							
19	Effluent	1	3,542,780	$ 1,326.42	$ 1,631.49	305.08	23.000%
20							
21	Total	2,106					
22							
23							
24							
25							

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Schedule H-3
Page 1
Witness: Bourassa

Line No.	Customer Classification		Present Rates	Present Rates	Proposed Rates	Proposed Rates	Percent Change
1							
2							
3							
4	**Monthly Charge for:**						
5	Residential			$ 45.64		$ 71.08	55.74%
6	Commercial (Standard Rate), per gallon per day[1]			0.18298		0.28499	55.75%
7			per acre foot		per acre foot		
8	Effluent Sales (per 1,000 gallons)		$ 122.00	0.37440	$ 150.00	0.46051	23.00%
9							
10	Commercial (Special Rate), per gallon per day[1]						
11		Gallons	Monthly	Rate per	Monthly	Rate per	Percent
12	Customer[2]	Per Day[1]	Billing	Gallon	Billing	Gallon [2]	Change
13	B-H Enterprises	2,525	$ 354.36	0.14034	N/A	N/A	
14	B-H Enterprises	1,400	$ 196.48	0.14034	N/A	N/A	
15	Barb's Per Grooming	250	$ 35.09	0.14034	N/A	N/A	
16	Boulders Resort	29,345	$ 4,173.74	0.14223	$ 8,363.03	0.28499	100.37%
17	Carefree Dental	1,625	$ 228.05	0.14034	N/A	N/A	
18	Ridgecrest Realty	450	$ 63.87	0.14193	N/A	N/A	
19	Desert Forest	7,000	$ 1,144.08	0.16344	$ 1,994.93	0.28499	74.37%
20	Desert Hills Pharmacy	800	$ 136.49	0.17061	N/A	N/A	
21	El Pedregal	15,787	$ 2,215.55	0.14034	$ 4,499.14	0.28499	103.07%
22	Lemon Tree	300	$ 41.07	0.13691	N/A	N/A	
23	Body Shop	1,000	$ 176.47	0.17647	N/A	N/A	
24	Spanish Village	4,985	$ 699.59	0.14034	$ 1,420.68	0.28499	103.07%
25	Boulders Club	1,200	$ 168.41	0.14034	$ 341.99	0.28499	103.07%
26	Anthony Vuitaggio	300	$ 46.79	0.15597	N/A	N/A	
27							
28							

29 [1] Commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin 12, Table 1
30 published by the Arizona Department of Environmental Quality
31 [2] Company is proposing to set the special rate commercial customers at the same rate ase the standard commerical rate
32 customers.

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Schedule H-3
Page 2
Witness: Bourassa
REVISED

Line No.	Other Service Charges	Present Rates	Proposed Rates
1	Establishment	$ 25.00	$ 25.00
2	Re-Establishment	$ 25.00	$ 25.00
3	Reconnection	no charge	[5]
4	After hours service	N/A	$ 25.00
5	Min Deposit Requirement (Residential)	[1]	[1]
6	Min Deposit Requirement (Non-Residential)	[1]	[1]
7	NSF Check	10.00	10.00
8	Deferred Payment finance charge, Per Month	1.50%	1.50%
9	Late Payment Charge, Per Month	1.50%	1.50%
10	Main Extension Tariff [2]	Cost	Cost
11	Purchased Wastewater Surcharge	NT	[3]
12	Hook-Up Fee for New Service Connections (per Gallon per Day)[4]	NT	$ 8.00
13			
14	[1] Per A.C.C. R14-2-603B Residential - two times the average bill. Non-residential - two and one-half times the average bill.		
15			
16	[2] Per A.C.C. R14-2-606(B)		
17			
18	[3] For increases in wastewater treatment costs from City of Scottsdale. See Testimony of Thomas J. Bourassa.		
19			
20	[4] Commercial wastewater flows are based on the average daily flows set forth in *Engineering Bulletin* 12, Table 1		
21	published by the Arizona Department of Environmental Quality. For wastewater treatment capacity constructed or		
22	purchased. See tariff for details.		
23			
24	[5] Actual cost of physical disconnection and reconnection (if same customer) and there shall be no charge if there		
25	is no physical work performed.		
26			
27	IN ADDITION TO THE COLLECTION OF REGULAR RATES, THE UTILITY WILL COLLECT FROM		
28	ITS CUSTOMERS A PROPORTIONATE SHARE OF ANY PRIVILEGE, SALES, USE, AND FRANCHISE		
29	TAX. PER COMMISSION RULE (14-2-608.D 5).		
30	ALL ADVANCES AND/OR CONTRIBUTIONS ARE TO INCLUDE LABOR, MATERIALS, OVERHEADS,		
31	AND ALL APPLICABLE TAXES, INCLUDING ALL GROSS-UP TAXES FOR INCOME TAXES.		
32	COST TO INCLUDE LABOR, MATERIALS AND PARTS, OVERHEADS AND ALL APPLICABLE TAXES.		
33			

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Residential

Exhibit
Schedule H4
Page 1
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 45.64	$ 71.08	$ 25.44	55.74%

Present Rates:
Monthly Charge: $ 45.64

Proposed Rates:
Monthly Charge: $ 71.08

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Commercial

Exhibit
Schedule H4
Page 2
Witness: Bourassa

Flow GPD	Present Bill	Proposed Bill	Dollar Increase	Percent Increase
-	$ -	$ -	$ -	0.00%
60	10.98	17.10	6.12	55.75%
110	20.13	31.35	11.22	55.75%
160	29.28	45.60	16.32	55.75%
210	38.43	59.85	21.42	55.75%
260	47.57	74.10	26.52	55.75%
310	56.72	88.35	31.62	55.75%
360	65.87	102.60	36.72	55.75%
410	75.02	116.85	41.82	55.75%
1,000	182.98	284.99	102.01	55.75%
2,000	365.96	569.98	204.02	55.75%
3,000	548.94	854.97	306.03	55.75%
4,000	731.92	1,139.96	408.04	55.75%
5,000	914.90	1,424.95	510.05	55.75%
10,000	1,829.80	2,849.90	1,020.10	55.75%
20,000	3,659.60	5,699.80	2,040.20	55.75%
30,000	5,489.40	8,549.70	3,060.30	55.75%
40,000	7,319.20	11,399.60	4,080.40	55.75%
50,000	9,149.00	14,249.50	5,100.50	55.75%
Average Flow				
565	103.41	161.06	$ 57.65	55.75%
Median Flow				
105	19.21	29.92	$ 10.71	55.75%

Present Rates:
Charge Per Gallon $0.182980

Proposed Rates:
Charge Per Gallon $0.284990

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Special Tariff - Boulders Resort

Exhibit
Schedule H4
Page 3
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 4,173.74	$ 8,363.03	$ 4,189.29	100.37%

Present Rates:
Monthly Charge: $4,173.74

Proposed Rates:
Monthly Charge: $8,363.03

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Special Tariff - Desert Forest

Exhibit
Schedule H4
Page 4
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 1,144.08	$ 1,994.93	$ 850.85	74.37%

Present Rates:
Monthly Charge: $ 1,144.08

Proposed Rates:
Monthly Charge: $ 1,994.93

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Special Tariff - El Pedregal

Exhibit
Schedule H4
Page 5
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 2,215.55	$ 4,499.14	$ 2,283.59	103.07%

Present Rates:
Monthly Charge: $ 2,215.55

Proposed Rates:
Monthly Charge: $ 4,499.14

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Special Tariff - Boulders Club

Exhibit
Schedule H4
Page 6
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 168.41	$ 341.99	$ 173.58	103.07%

Present Rates:
Monthly Charge: $ 168.41

Proposed Rates:
Monthly Charge: $ 341.99

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Special Tariff - Spanish Village

Exhibit
Schedule H4
Page 7
Witness: Bourassa

Present Bill	Proposed Bill	Dollar Increase	Percent Increase
$ 699.59	$ 1,420.68	$ 721.08	103.07%

Present Rates:
Monthly Charge: $ 699.59

Proposed Rates:
Monthly Charge: $ 1,420.68

Black Mountain Sewer Corporation
Bill Comparison
Customer Classification
Effluent Sales

Exhibit
Schedule H4
Page 8
Witness: Bourassa

MidPoint Usage	Present Bill	Proposed Bill	Dollar Increase	Percent Increase
1,000	0.37	0.46	0	23.00%
2,000	0.75	0.92	0	23.00%
3,000	1.12	1.38	0	23.00%
4,000	1.50	1.84	0	23.00%
5,000	1.87	2.30	0	23.00%
6,000	2.25	2.76	1	23.00%
7,000	2.62	3.22	1	23.00%
8,000	3.00	3.68	1	23.00%
9,000	3.37	4.14	1	23.00%
10,000	3.74	4.61	1	23.00%
12,000	4.49	5.53	1	23.00%
14,000	5.24	6.45	1	23.00%
16,000	5.99	7.37	1	23.00%
18,000	6.74	8.29	2	23.00%
20,000	7.49	9.21	2	23.00%
25,000	9.36	11.51	2	23.00%
30,000	11.23	13.82	3	23.00%
35,000	13.10	16.12	3	23.00%
40,000	14.98	18.42	3	23.00%
45,000	16.85	20.72	4	23.00%
50,000	18.72	23.03	4	23.00%
60,000	22.46	27.63	5	23.00%
70,000	26.21	32.24	6	23.00%
80,000	29.95	36.84	7	23.00%
90,000	33.70	41.45	8	23.00%
100,000	37.44	46.05	9	23.00%
Average Usage				
3,542,780	$ 1,326.42	$ 1,631.49	$ 305.08	23.00%
Median Usage				
3,542,780	$ 1,326.42	$ 1,631.49	$ 305.08	23.00%

Present Rates:

Minimum	$	-
Gallons in Min.		-
Charge Per 1,000 Gallons	$	0.37440

Proposed Rates:

Minimum	$	-
Gallons in Min.		-
Charge Per 1,000 Gallons	$	0.46051

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Residential

Exhibit
Schedule H5
Page 1
Witness: Bourassa

Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
1,964	1,960	1,955	1,959	1,961	1,967	1,975	1,968	1,975	1,978	1,983	1,972	23,617	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
												-	23,617
1,964	1,960	1,955	1,959	1,961	1,967	1,975	1,968	1,975	1,978	1,983	1,972	23,617	

Average Flow	N/A
Median Flow	N/A
Average # Customers	1,968

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Commercial

Exhibit
Schedule H5
Page 2
Witness: Bourassa

Usage From:	Flow GPD	Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year
50	50	10	10	10	10	10	11	10	10	10	10	10	10	121
60	60	2	2	2	2	2	2	2	2	2	2	2	2	24
66	66	2	2	2	2	2	2	2	2	2	2	2	2	24
75	75	2	2	2	2	3	2	2	2	2	2	2	2	25
100	100	6	6	6	6	6	6	5	6	6	7	5	5	70
105	105	5	5	5	5	5	6	6	5	5	5	5	5	62
125	125	2	2	2	2	2	2	2	2	2	2	3	2	25
140	140	2	2	2	2	2	2	2	2	2	2	2	2	24
150	150	6	6	6	6	6	6	6	6	6	6	6	6	72
166	170	2	2	2	2	2	2	2	2	2	2	2	2	24
200	200	10	10	10	10	10	10	10	10	10	10	10	10	120
250	250	6	6	6	6	6	6	6	6	6	6	6	6	72
256	275	2	2	2	2	2	2	2	2	2	2	2	2	24
307	310	3	3	3	3	4	4	4	4	4	4	4	4	44
350	350	1	1	1	1	1	1	1	1	1	1	1	1	12
400	400	2	2	2	2	2	2	2	2	2	2	2	2	24
450	450	1	1	1	1	1	1	1	1	1	1	1	1	12
479	480	3	3	3	3	3	3	3	4	4	4	4	4	41
500	500	7	7	7	7	7	7	7	5	5	5	5	5	74
506	506	1	1	1	1	1	1	1	1	1	1	1	1	12
533	533	-	-	-	-	-	-	-	1	1	1	1	1	5
600	600	3	3	3	3	3	3	3	3	3	3	3	3	36
660	660	-	-	-	-	-	1	1	1	1	1	1	1	7
675	675	1	1	1	1	1	1	1	1	1	1	1	1	12
700	700	1	1	1	1	1	1	2	1	1	1	1	1	13
750	750	2	2	2	2	2	2	2	2	2	2	2	2	24
800	800	2	2	2	2	2	2	2	2	2	2	2	2	24
842	845	1	1	1	1	1	1	1	1	1	1	1	1	12
900	900	3	3	3	3	3	3	3	2	2	2	2	2	31
955	955	1	1	1	1	1	1	1	-	1	1	1	1	11
1,000	1,000	1	1	1	1	1	1	1	1	1	1	1	1	12
1,074	1,074	1	1	1	1	1	1	1	1	1	1	1	1	12
1,140	1,140	2	2	2	2	2	2	2	2	2	2	2	2	24
1,158	1,158	-	-	-	-	-	1	1	1	1	1	1	1	7

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Commercial

Exhibit
Schedule H5
Page 2
Witness: Bourassa

Usage From:	Flow GPD	Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year
1,347	1,347	1	1	1	1	1	1	1	1	1	1	1	1	12
1,423	1,423	1	1	1	1	1	1	1	1	1	1	1	1	12
1,425	1,425	1	1	1	1	1	1	1	1	1	1	1	1	12
1,500	1,500	2	2	2	2	2	2	2	2	2	2	2	2	24
1,527	1,527	3	3	3	3	3	3	3	3	3	3	3	3	36
1,560	1,560	2	2	2	2	2	2	2	2	2	2	2	2	24
1,620	1,620	1	1	1	1	1	1	1	1	1	1	1	1	12
1,750	1,750	1	1	1	1	1	1	1	1	1	1	1	1	12
1,800	1,800	1	1	1	1	1	1	1	1	1	1	1	1	12
1,830	1,830	1	1	1	1	1	1	1	1	1	1	1	1	12
1,850	1,850	1	1	1	1	1	1	1	1	1	1	1	1	12
2,000	2,000	3	3	3	3	3	3	3	3	3	3	3	3	36
2,025	2,025	1	1	1	1	1	1	1	1	1	1	1	1	12
2,288	2,288	1	1	1	1	1	1	1	1	1	1	1	1	12
2,600	2,600	1	1	1	1	1	1	1	1	1	1	1	1	12
3,000	3,000	1	1	1	1	1	1	1	1	1	1	1	1	12
3,011	3,011	-	-	-	-	1	-	-	-	-	-	-	-	1
4,000	4,000	1	1	1	1	1	1	1	1	1	1	1	1	12
4,500	4,500	1	1	1	1	1	1	1	1	1	1	1	1	12
5,000	5,000	1	1	1	1	1	1	1	1	1	1	1	1	12
6,950	6,950	1	1	1	1	1	1	1	1	1	1	1	1	12
7,530	7,530	1	1	1	1	1	1	1	1	1	1	1	1	12
8,851	8,851	1	1	1	1	1	1	1	1	1	1	1	1	12
11,589	11,589	-	-	-	-	-	1	-	-	-	-	-	-	1
17,025	17,025	2	1	1	1	1	1	1	1	1	1	1	1	13
44,490	44,490	1	1	1	1	1	1	1	1	1	1	1	1	12
	-													-
	-													-
	-													-
Totals		124	123	123	123	126	129	127	124	125	126	125	124	1,499

Average Flow	565
Median Flow	105
Average # Customers	125

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Special Tariff - Boulders Resort

Exhibit
Schedule H5
Page 3
Witness: Bourassa

Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
1	1	1	1	1	1	1	1	1	1	1	1	12	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	N/A
Median Usage	N/A
Average # Customers	1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Special Tariff - Desert Forest

Exhibit
Schedule H5
Page 4
Witness: Bourassa

Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
1	1	1	1	1	1	1	1	1	1	1	1	12	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	N/A
Median Usage	N/A
Average # Customers	1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Special Tariff - El Pedregal

Exhibit
Schedule H5
Page 5
Witness: Bourassa

Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
1	1	1	1	1	1	1	1	1	1	1	1	12	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	N/A
Median Usage	N/A
Average # Customers	1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Special Tariff - Boulders Club

Exhibit
Schedule H5
Page 6
Witness: Bourassa

Month	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
	1	1	1	1	1	1	1	1	1	1	1	1	12	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
													-	12
	1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	N/A
Median Usage	N/A
Average # Customers	1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Special Tariff - Spanish Village

Exhibit
Schedule H5
Page 7
Witness: Bourassa

Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
1	1	1	1	1	1	1	1	1	1	1	1	12	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
												-	12
1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	N/A
Median Usage	N/A
Average # Customers	1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Customer Classification
Effluent Sales

Exhibit
Schedule H5
Page 8
Witness: Bourassa

Usage From:	Usage To:	Month Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Total Year	Cumul-ative Billing
Over 50,000 gallons															
3,542,780	3,542,780	1	1	1	1	1	1	1	1	1	1	1	1	12	12
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
	-													-	-
Totals		1	1	1	1	1	1	1	1	1	1	1	1	12	

Average Usage	3,542,780
Median Usage	3,542,780
Average # Customers	1

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-_____

DIRECT TESTIMONY OF

THOMAS J. BOURASSA

(COST OF CAPITAL)

December 19, 2008

EXHIBIT
A-5
ADMITTED

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2138075.4

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME AND ADDRESS.

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

Q. ARE YOU THE SAME THOMAS J. BOURASSA THAT FILED DIRECT TESTIMONY ON RATE BASE, INCOME STATEMENT, REVENUE REQUIREMENT AND RATE DESIGN IN THIS DOCKET?

A. Yes, and all of my background information and testimony regarding my qualifications is contained in that portion of my direct testimony.

II. SUMMARY OF TESTIMONY AND THE PROPOSED COST OF CAPITAL FOR THE COMPANY.

Q. WHAT IS THE PURPOSE OF THIS PORTION OF YOUR DIRECT TESTIMONY?

A. This portion of my direct testimony will focus on cost of capital issues. I will testify in support of the Black Mountain Sewer Corporation's ("BMSC" or "the Company") proposed rate of return on its fair value rate base. I am sponsoring the Company's D Schedules, which are attached to this testimony. Also attached to this testimony are Exhibits 1 through 7, which are discussed below. As noted above, I am also sponsoring direct testimony that addresses the Company's rate base, income statement (revenue and operating expenses), required increase in revenue, and its rate design and proposed rates and charges for service. For the convenience of the Commission and the parties, that testimony and my related schedules are being filed separately in this case.

Q. PLEASE SUMMARIZE YOUR COST OF CAPITAL TESTIMONY.

A. There are two basic components: capital structure and return on rate base. I will address capital structure first. The Company's test year capital structure consisted

of approximately 19.3 percent debt and 80.7 percent common equity. At the end of the test year, June 30, 2008, BMSC had adjusted total capital of $5,225,205, consisting of $1,010,649 long-term debt and $4,214,556 common equity. However, because the debt service for the Company's long-term debt (used for the purchase of Scottsdale wastewater treatment capacity) was treated by the Commission as an operating "lease" expense to keep rates down, the long-term debt is excluded from the capital structure for ratemaking purposes, leaving a 100% equity capital structure for ratemaking purposes.

Q. IS THERE A RELATIONSHIP BETWEEN A UTILITY'S CAPITAL STRUCTURE AND ITS COST OF CAPITAL?

A. Yes, both in the real business world and for ratemaking purposes. The latter relationship has been a significant issue in recent rate cases, but I will address the real world first.

Generally, when a firm engages in debt financing, it exposes itself to greater risk. Once debt becomes significant relative to the total capital structure, the risk increases in a geometric fashion compared to the linear percentage increase in the debt ratio itself. This risk is illustrated by considering the effect of leverage on net earnings. For example, as leverage increases, the equity ratio falls. This creates two adverse effects on the investor. First, equity earnings decline rapidly and may even disappear. Second, the "cushion" of equity protection for debt falls. A decline in the protection afforded debt holders, or the possibility of a serious decline in debt protection, will act to increase the cost of debt financing. Therefore, one may conclude that each new financing, whether through debt or equity, impacts the marginal cost of future financing by any alternative method. For a firm already perceived as being over-leveraged, this additional borrowing would cause the marginal cost of both equity and debt to increase. On the other

hand, if the same firm instead employed equity funding, this could actually reduce the real marginal cost of additional borrowing, even if the particular equity issuance occurred at a higher unit cost than an equivalent amount of debt.

Q. DOES THE COMPANY HAVE AN APPROPRIATE CAPITAL STRUCTURE GIVEN ITS SIZE AND OTHER CHARACTERISTICS?

A. Appropriate yes. Ideal, no. More debt would be preferable, but relatively small utilities like BMSC cannot support the same percentage of debt in their capital structure as a large publicly traded utility. A theoretically "balanced" capital structure is one that provides debt with adequate protection, yet contains enough leverage to produce equity earnings sufficient to attract new equity capital (but not so large a degree of leverage as to introduce earnings instability and render equity investment speculative). For small utilities, financial leverage can be hard to obtain, costly and often has detrimental impacts.

Q. BUT ISN'T BMSC OWNED BY A LARGE INCOME FUND WITH MULTI-NATIONAL HOLDINGS AND ACCESS TO CAPITAL?

A. Yes, but so what? The issue is the investment, BMSC, not the investor, Algonquin. If Algonquin is forced to loan money to or secure financing for its subsidiaries on terms favorable to the utility, this is no different than forcing Algonquin to invest capital at some discounted rate of return. BMSC's access to and cost of debt should be based on BMSC, not its parent.

Q. ARE YOU TESTIFYING THAT BMSC DOES NOT HAVE ANY ACCESS TO DEBT FINANCING?

A. No, not specifically. In fact, in light of recent rate decisions, BMSC should be looking to fund any future projects with some debt to move towards a more balanced capital structure. But the Commission will have to recognize the true costs of that debt for ratemaking if it is reasonable given BMSC's situation.

Q. WHAT IS THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND RATE MAKING?

A. The capital structure is used to weight the debt and equity returns to derive a cost of capital. In the case of BMSC, the Commission determined that the Company's debt would not be used for this ratemaking purpose. Instead, the Commission directed that the debt incurred to acquire treatment capacity should be treated as a lease and run through the income statement. *See* Decision No. 59944 at 6; Decision No. 69146 at 8-9. This results in a weighted average cost of capital of 100% equity for ratemaking purposes and BMSC still facing the financial risk of a capital structure with the 20% debt.

Q. WHY DID THE COMMISSION TREAT DEBT SUPPORTING RATE BASE AS AN EXPENSE?

A. It was a fiction recommended by Staff and adopted by the Commission that resulted in lower rates to customers at that time. *See* Rebuttal Testimony of Thomas J. Bourassa in Docket SW-02361A-05-0657 at 26.

Q. THANK YOU, LET'S CONTINUE WITH THE SUMMARY OF YOUR COST OF CAPITAL TESTIMONY. WHAT IS YOUR RECOMMENDED RETURN ON RATE BASE?

A. I am recommending a return on equity ("ROE") of 12.8 percent. My recommendation is based on (i) cost of equity estimates using constant growth and multi-stage growth discounted cash flow ("DCF") models and the capital asset pricing model ("CAPM") for the sample group of publicly traded utilities, (ii) my review of the economic conditions expected to prevail during the period in which new rates will be in effect, (iii) my judgments about the risks associated with small utilities like BMSC not captured by the market data, and (iv) the financial risk associated with the debt in BMSC's capital structure. The weighted cost of capital

is 12.8 percent, as shown on Schedule D-1. The weighted cost of capital is applied to the Company's fair value rate base to compute the Company's required operating income.

Q. PLEASE SUMMARIZE THE APPROACH YOU USED TO ESTIMATE THE COST OF EQUITY FOR THE COMPANY.

A. The cost of equity for BMSC cannot be estimated directly because BMSC's common stock is not publicly traded and there is no market data for BMSC. Consequently, I applied the DCF and CAPM models using data from a sample of water utilities selected from the Value Line Investment Survey. There are six water utilities in my sample: American States Water, Aqua America, California Water, Connecticut Water, Middlesex Water, and SJW Corp. I selected these particular utilities because the Commission's Utilities Division ("Staff") has relied on data for these water utilities in a number of recent water and sewer utility rate cases. Computations of common equity returns using DCF and CAPM approaches are shown on Schedules D-4.9 through D-4.10 and Schedule D-4.13.

Using Staff's typical sample group, the DCF analyses indicate that a ROE in the range of 9.9 percent to 13.5 percent is appropriate. The CAPM analysis, again using the same sample group, indicates that a ROE in the range of 9.9 percent to 19.4 percent is appropriate.

An ROE of 12.8 percent is higher than that of the range of the averages of the results produced by both types of equity cost estimates. Of course, neither of the models accounts for the Company's high risk for which there is no truly comparable market data. As a result my final recommendation is largely impacted by the result of my judgment about the high degree of financial and other risk associated with BMSC and other small Arizona water and sewer providers. The higher return recommendation for BMSC also takes into consideration BMSC's

small size relative to the six water utilities in Staff's sample group and other business risks not captured by the market data including the higher business risk as the result of Arizona regulation.

Q. WHY DO YOU BELIEVE THAT THE COMPANY HAS HIGH RISK?

A. Arizona is a hard place for small water and sewer providers to conduct business due to the regulatory climate. Shipman, T.A. (2008, November 7). Assessing U.S. Utility Regulatory Environments. *Standard & Poor's RatingsDigest.* Attached hereto as Exhibit 7. Unfortunately, this problem is now getting national attention. I can try to illustrate with two recent examples of regulation impacting a utility's opportunity to earn a return on rate base.

In Chaparral City's pending rate case (Docket No. W-02113A-07-0551), the evidence shows that this utility earned a return hundreds of basis points below its authorized return the first year its current rates were in effect, and less every year since. Meanwhile, its rate case, filed two years ago based on a 2006 test year, finally held Phase One hearings in December 2008. I have every reason to believe that by the time rates go into effect sometime in Spring 2009, Chaparral City will again be earning significantly less than its authorized rate of return.

The Company's affiliate, Gold Canyon Sewer Company, recently had its lawfully adopted revenue requirement chopped by several hundred thousand dollars. This was accomplished through use of fictitious ratemaking, and the disallowance of plant built consistent with all regulatory requirements and found "prudent" under the Commission's own regulation. This was admittedly done to reduce the magnitude of rate increases.

It is hard to envision a more risky financial environment than that presented by these two examples. Rates are delayed by the time the process takes, interim rates are strongly discouraged, and prudently built plant is disallowed, all in the

name of lower rates. These utilities are not being given an opportunity to earn their return on rate base. No disrespect, but I wouldn't make a loan to an Arizona water or sewer company, and if had to I make an equity investment, I would expect returns in the 15%-20% range given the risk.

III. OVERVIEW OF THE RELATIONSHIP BETWEEN RISK AND THE EXPECTED RETURN ON AN INVESTMENT.

Q. HOW IS THE COST OF EQUITY TYPICALLY ANALYZED?

A. The cost of equity is the rate of return that equity investors expect to receive on their investment. Investors can choose to invest in many types of assets, not simply publicly traded stock. Each investment will have varying degrees of risk, ranging from relatively low risk assets such as Treasury securities to somewhat higher risk corporate bonds to even higher risk common stocks. As the level of risk increases, investors require higher returns on their investment. Finance models that are used to estimate the cost of equity often rely on this basic concept.

Q. CAN YOU ILLUSTRATE THE CAPITAL MARKET RISK-RETURN CONCEPT?

A. Yes. The following graph depicts the risk-return relationship that has become widely known as the Capital Market Line ("CML"). The CML illustrates in a general way the risk-return relationship.

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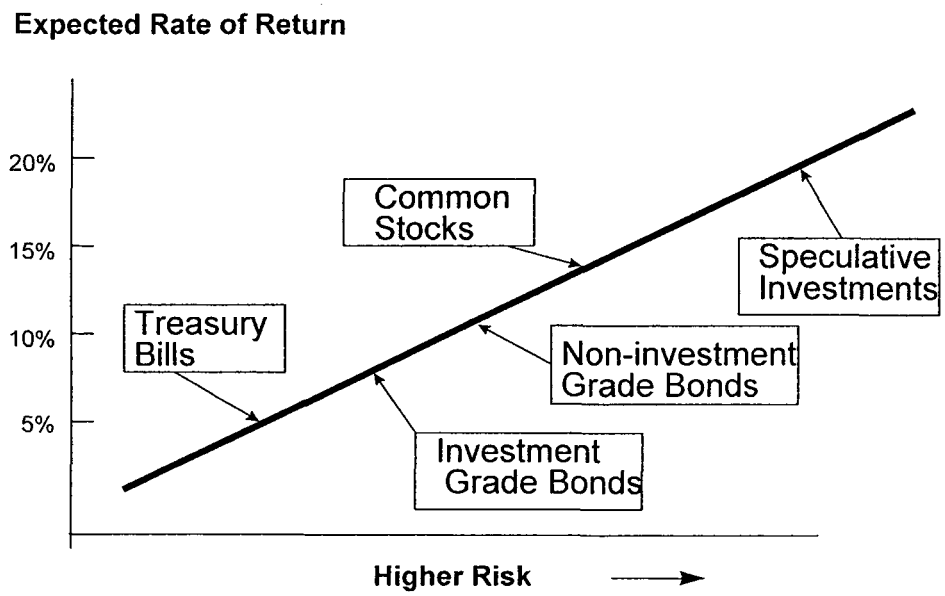
The Capital Market Line (CML)



The CML can be viewed as a continuum of the available investment opportunities for investors. Investment risk increases moving upward and to the right along the CML. Again, the expected return increases with the risk.

Q. HOW DOES THE RISK-RETURN TRADE-OFF CONCEPT WORK IN THE CAPITAL MARKET?

A. As already suggested by the CML, the allocation of capital in a free market economy is based upon the relative risk of, and expected return from, an investment. In general, investors rank investment opportunities in the order of their relative risks. Investment alternatives in which the expected return is commensurate with the perceived risk become viable investment options. If all other factors remain equal, the greater the risk, the higher the rate of return

investors will require to compensate investors for the possibility of loss of either the principal amount invested or the expected annual income from such investment.

Short-term Treasury bills provide a high degree of certainty and in nominal terms (after considering inflation) are considered virtually risk free. Long-term bonds and preferred stocks, having priority claims to assets and fixed income payments, are relatively low risk, but are not risk free. The market values of long-term bonds often fluctuate when government policies or other factors cause interest rates to change. Common stocks are higher and to the right on the CML continuum because they are exposed to more risk. Common stock risk includes the nature of the underlying business and financial strength of the issuing corporation as well as market-wide factors, such as general changes in capital costs.

The capital markets reflect investor expectations and requirements each day through market prices. Prices for stocks and bonds change to reflect investor expectations and the relative attractiveness of one investment versus another. While the example provided above seems straightforward, returns on common stocks are not directly observable in advance, in contrast to debt or preferred stocks with fixed payment terms. This means that these returns must be estimated from market data. Estimating the cost of equity capital is a matter of informed judgment about the relative risk of the company in question and the expected rate of return characteristics of other alternative investments.

Q. HOW IS THE COST OF EQUITY FOR A PARTICULAR UTILITY DETERMINED?

A. The estimation of a utility's cost of equity is complex. It requires an analysis of the factors influencing the cost of various types of capital, such as interest on long-term debt, dividends on preferred stock, and earnings on common equity. The data for such an analysis comes from highly competitive capital markets, where the firm

raises funds by issuing common stock, selling bonds, and by borrowing (both long- and short-term) from banks and other financial institutions. In the capital markets, the cost of capital, whether the capital is in the form of debt or equity, is determined by two important factors:

1) The pure or real rate of interest, often called the risk-free rate of interest; and,

2) The uncertainty or risk premium (the compensation the investor requires over and above the real or pure rate of interest for subjecting his capital to additional risk).

Q. PLEASE DISCUSS THESE FACTORS IN GREATER DETAIL.

A. The pure rate of interest essentially reflects both the time preference for, and the productivity of, capital. From the standpoint of the individual, it is the rate of interest required to induce the individual to forego present consumption and offer the funds thus saved to others for a specified length of time. Moreover, the pure rate of interest concept is based on the assumption that no uncertainty affects the investment undertaken by the individual, i.e., there is no doubt that the periodic interest payments will be made and the principal returned at the end of the time period. In reality, investments without risk do not exist. Every commitment of funds involves some degree of uncertainty.

Turning to the second factor affecting the cost of capital, it is generally accepted that the higher the degree of uncertainty, the higher the cost of capital. Investors are regarded as risk adverse and require that the rate of return increase as the risk (uncertainty) associated with an investment increase.

Q. CAN YOU PROVIDE SOME PERSPECTIVE ON YOUR PREVIOUS DISCUSSION WITH RESPECT TO RETURNS ON COMMON STOCKS?

A. Yes. Conceptually,

[1] Required Return for Common Stocks = Return on a risk-free asset + Risk Premium

where the risk premium investors require for common stocks will be higher than the risk premium they require for investment grade bonds. This relationship is depicted in the graph of the CML, above. As I will discuss later in this testimony, this concept is the basis of risk premium methods, such as the CAPM, that are used to estimate the cost of equity.

Q. WHAT HAS BEEN THE RECENT EXPERIENCE IN THE U.S. CAPITAL MARKETS?

A. In the past 10 years, inflation and capital market costs have generally declined. Interest rates have been lower than in previous decades. Past inflation, as measured by the Consumer Price Index, has been at relatively low levels in the past 10 years.

The roughly 6 year span of economic expansion after the 2001 recession began to wane in 2007. Year-over-year GDP growth for 2004, 2005, and 2006 was 3.6 percent, 2.9 percent, and 2.8 percent, respectively. GDP growth was, in part, spurred on by low interest rates during this period. The Federal Reserve, having lowered the target Federal Funds rate to 1.0 percent by the end of 2003, began raising interest rates in 2004 to help keep the economy from overheating and to help keep inflation in check. By mid-2006, the Federal Reserve had raised the target Federal Funds rate to 5.25 percent.

The economic expansion was broad, taking in the major consumer and industrial sectors for much of its span. However, the economic expansion also brought excesses, particularly in the areas of housing, lending practices, and the financial markets.

Economic growth slowed in 2007. For 2007, the year-over-year GDP growth had dropped to 2.0 percent with the last quarter of 2007 at a negative 0.3 percent. The slow economic growth combined with the excesses during the economic expansion of the previous 6 years has created turmoil in the credit, financial, and housing markets. This turmoil continues to have a significant drag on the economy. Federal Reserve Chairman Ben Bernanke noted in recent Congressional testimony that financial markets are currently under considerable stress and that broader retrenchment in the willingness of investors to bear risk, troubles in the credit markets and a weaker outlook of economic growth have added to the stresses on economic growth.

In order to address the weakening economy, the Federal Reserve, starting in September 2007, has taken a series of rate cut actions (425 basis points). The reductions in interest rates by the Federal Open Market Committee were taken in order to promote economic growth and to mitigate risks to economic activity. The target Federal Funds rate stands at 1.0 percent and is expected to be lowered to 0.5 percent in the coming months.

GDP growth for the first three quarters of 2008 was 0.9 percent, 2.8 percent, and negative 0.3 percent, respectively. It appears that the U.S. economy is now in recession.[1] The Blue Chip Financial Forecast ("Blue Chip") consensus forecasts (December 2008) of real GDP growth for the 4th quarter of 2008 is a negative rate of 3.4 percent and growth for the first and second quarters of 2009 are a negative 1.6 and 0.1 percent, respectively. While economic growth is expected to turn positive by second half of 2009, recovery is expected to be slow as there are risks to the U.S. economy from a far more serious worldwide recession, the failure of the housing market to stabilize in the year ahead, continued weakness in business and

[1] A Recession is defined as two or more consecutive quarters of falling GDP.

consumer spending, and a setback to the war on terror.

One of the biggest risks to the economy stems from the conditions in the credit markets. Without increased access and more affordable credit for consumers and businesses, the prospects for a meaningful economic recovery are dim. The stock market has had the worst year since 1931 and 1926 and has produced a massive safe haven bid for Treasury debt. Recently, the three month Treasury bill yields dropped to near zero, and yields on the two, five, ten and thirty year yield treasuries fell to the lowest levels since the Treasury began regular sales of the securities.

Q. IS THERE A RELATIONSHIP BETWEEN THE COST OF EQUITY AND INTEREST RATES?

A. Yes. All things being equal, the cost of equity moves in the same direction as interest rates. Lower interest rates on U.S Treasuries ("risk-free" rate) imply lower equity returns and visa versa. However, as indicated by Equation 1 above, the risk premium required to compensate investors also impacts the cost of equity. Higher risk premiums required by investors imply higher equity costs and visa versa. Risk premiums are impacted by uncertainty in future interest rates, business and economic conditions, expected inflation, and other risk factors including interest rate risk, business risk, regulatory risk, financial risk, construction risk, and liquidity risk.

Q. HOW DOES ALL THE SOUR ECONOMIC NEWS IMPACT INVESTORS?

A. Like the Fed Chairman said—It makes investors want to hold on to their money and put it in low risk investments.

Q. IS BMSC AFFECTED BY THESE SAME MARKET UNCERTAINTIES AND CONCERNS?

A. Yes, in general, all investors are impacted by bad economic news, and the

Company's investors not immune to uncertainty and inflation. In fact, these smaller utilities generally feel the impact worse because they are small, with a small customer base and an inability to attract capital.

Q. WHAT ARE THE RECENT DEVELOPMENTS IN THE WATER UTILITY INDUSTRY AFFECTING UTILITY INVESTMENTS AND THE MARKET?

A. I have already spoken in my summary of recent trends towards lower rates at later and later dates in Arizona. On the whole, the water utility industry is expected to continue to confront increasing infrastructure demand. According to the *Value Line Investment Survey*, many utilities have infrastructures that are decades old and in need of significant maintenance and, in some cases, massive renovation and replacement. In addition, the EPA and state and local regulators continue to impose more stringent environmental quality and operational standards, such as new maximum contaminant levels for public drinking water systems. Additional operational requirements have also been imposed to address the threat of bio-terrorism on U.S. water systems. As infrastructure costs continue to climb, many smaller companies are at a serious disadvantage. Without sufficient resources to fund improvements to meet new and more stringent requirements, many smaller companies are being forced to sell to larger utilities, which have greater operational flexibility and resources, as well as access to capital. With the backdrop of increasing infrastructure costs, merger and acquisition activity is expected to continue at a feverish pace.

Q. WOULD YOU PLEASE DISCUSS IN MORE DETAIL THE IMPACT OF RISK ON CAPITAL COSTS?

A. With reference to specific utilities, risk is often discussed as consisting of two separate types of risk: business risk and financial risk.

Business risk, the basic risk associated with any business undertaking, is the

uncertainty associated with the enterprise's day-to-day operations. In essence, it is a function of the normal day-to-day business environment, both locally and nationally. Business risks include the condition of the economy and capital markets, the state of labor markets, regional stability, government regulation, technological obsolescence, and other similar factors that may impact demand for the business product and its cost of production. For utilities, business risk also includes the volatility of revenues due to abnormal weather conditions, degree of operational leverage, regulation, and regulatory climate. Regulation, for example, can compound the business risk if it is unpredictable in reacting to cost increases both in terms of the time lag and magnitude. Regulatory lag makes it difficult to earn a reasonable return particularly in an inflationary environment and/or when there is significant lag between the timing of investment in capital projects and its recognition in rates. Put simply, the greater the degree of uncertainty regarding the various factors affecting a company's business, the greater the risk of an investment in a company and the greater the compensation required by the investor.

Financial risk, on the other hand, concerns the distribution of business risk to the various capital investors in the utility. As I discussed earlier, permanent capital is normally divided into three categories: long-term debt, preferred stock, and common equity. Because common equity owners have only a residual claim on earnings after debt and preferred stockholders are paid, financial risk tends to be concentrated in this element of the firm's capital. Thus, a decision by management to raise additional capital by issuing additional debt concentrates even more of the financial risk of the utility in the common equity owners.

An important component of financial risk is construction risk. Construction risk refers to the magnitude of a company's capital budget. If a company has a

large construction budget relative to internally generated cash flows it will require external financing. It is important that companies have access to capital funds on reasonable terms and conditions. Utilities are more susceptible to construction risk for two reasons. First, utilities generally have high capital requirements to build plant to serve customers. Second, utilities have a mandated obligation to serve, leaving less flexibility both in the timing and discretion of scheduling capital projects. This is compounded by the limited ability of a utility to wait for more favorable market conditions to raise the capital necessary to fund the capital projects.

Although often discussed separately, the two types of risks (business and financial) are actually interrelated. Specifically, a common equity investor may seek to offset exposure to high financial risk by investing in a firm perceived to have a low degree of business risk. In other words, the total risk to an investor would be high if the enterprise was characterized as a high business risk with a large portion of its permanent capital financed with senior debt. To attract capital under these circumstances, the firm would have to offer higher rates of return to its common equity investors. I would also note, while the water utilities in the sample have recently encountered a more favorable regulatory environment in many states, such as California, this has not been the case in Arizona. As a result, utilities in Arizona are finding it increasingly difficult to attract capital.

IV. THE MEANING OF "JUST AND REASONABLE" RATE OF RETURN.

Q. HAVE THE COURTS SET FORTH ANY CRITERIA THAT GOVERN THE RATE OF RETURN THAT A UTILITY'S RATES SHOULD PRODUCE?

A. Yes. In 1923, the U.S. Supreme Court set forth the following criteria for determining whether a rate of return is reasonable in *Bluefield Water Works and*

Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 692-93 (1923):

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments on other business undertaking which are attended by corresponding risks and uncertainties .... The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.

In summary, under *Bluefield Water Works*:

(1) The rate of return should be similar to the return in businesses with similar or comparable risks;

(2) The return should be sufficient to ensure the confidence in the financial integrity of the utility; and

(3) The return should be sufficient to maintain and support the utility's credit.

In addition to being widely followed by courts and regulatory commissions, the Court's discussion of the criteria that should be used to determine a reasonable rate of return is important because *Bluefield Water Works* involved the application of the "fair value" standard, which is embodied in the Arizona Constitution. Thus, in discussing the criteria for determining a fair rate of return, the Court applied the rate of return, judged according these criteria, to the current or "fair" value of the utility's plant and property devoted to public service.

Q. HOW HAVE THESE CRITERIA BEEN APPLIED IN REGULATORY PROCEEDINGS?

A. Yes, but the application of the "reasonableness" criteria laid down by the Supreme

Court has resulted in controversy. The typical method of computing the overall cost of capital is quite straightforward: it is the composite, weighted cost of the various classes of capital (debt, preferred stock, and common equity), used by the utility. The weighting is done by calculating the proportion that each class of capital bears to total capital. However, there is no consensus regarding the best method of estimating the cost of equity capital. The increasing regulatory emphasis on objectivity in determining the rate of return has resulted in a proliferation of market-based finance models that are used in equity return determination. As will be discussed more fully below, however, none of these models are universally accepted as the "correct" means of estimating the ROE.

V. THE ESTIMATED COST OF EQUITY FOR THE COMPANY.

A. The Publicly Traded Utilities That Comprise the Sample Group Used to Estimate the Company's Cost of Equity.

Q. PLEASE BRIEFLY DESCRIBE THE APPROACH YOU FOLLOWED IN YOUR COST OF CAPITAL ANALYSIS FOR BMSC.

A. As I have stated, estimating the cost of equity is a matter of informed judgment. The development of an appropriate rate of return for a regulated enterprise involves the determination the level of risk associated with that enterprise and the determination of an appropriate return for that risk level. Practitioners employ various techniques that provide a link to actual capital market data and assist in defining the various relationships that underlie the equity cost estimation process.

Since BMSC is not publicly traded, the information required to directly estimate BMSC's cost of equity is not available. Accordingly, I used a sample group of water utilities as a starting point to develop an appropriate cost of equity for BMSC. There are six water utilities included in the sample group: American States Water, Aqua America, California Water, Connecticut Water, Middlesex

Water, and SJW Corp. All these companies are followed by the *Value Line Investment Survey*, and, as explained previously, these particular utilities have consistently been used by the Staff to estimate the cost of equity in a number of recent water and sewer utility rate cases.

Q. ARE THE WATER UTILITIES IN YOUR SAMPLE DIRECTLY COMPARABLE TO BMSC?

A. No, but they are utilities for which market data is available. All of them are regulated, they primarily provide water service, although some provide both water and wastewater services, and their primary source of revenues is from regulated services. Therefore, they provide a useful starting point for developing a cost of equity for BMSC. I emphasized "starting point" because BMSC is not publicly traded, there is no market data available for smaller utilities, like BMSC, that can be used to develop cost of equity estimates.

Q. DOES THE MARKET DATA PROVIDED BY THE WATER UTILITY SAMPLE CAPTURE ALL OF THE MARKET RISKS THAT BMSC MIGHT FACE IF IT WERE PUBLICLY TRADED?

A. In my opinion, no. First, as I stated, there is no comparable market data for utility companies the size of BMSC. The average revenue of the water utility sample companies is nearly 174 times that of BMSC and the average net plant of the water utility sample companies is nearly 149 times that of BMSC. Even the smallest company in the sample, Connecticut Water, has nearly 42 times the net plant of BMSC, and nearly 39 times the revenues.

Second, market data for the sample water utilities do not include data for water and sewer utilities primarily serving the Arizona market and thus primarily subject to Arizona rate regulation. The Commission requires the use of historical test years with limited out-of-period adjustments. Moreover, current Commission

policy strongly disfavors adjustment mechanisms that allow for prompt recovery of increases in the cost of purchased water and power, in contrast to other jurisdictions. In short, the Commission's current policies make it difficult for water or sewer utilities to earn their authorized rates of return.

Q. HOW DOES THIS IMPACT BMSC?

A. BMSC faces the risk that changes in costs, both unexpected and expected, during the period in which new rates will be in effect will not be recovered without another costly and lengthy general rate case. The water sample is heavily weighted with utilities doing business in California. American States, California Water, and SJW Corp. are based in California and receive the bulk of revenues from utility service in that state. These utilities face less regulatory risk because the California Public Utilities Commission allows the use of future test years and balancing accounts for expenses such as purchased water and power. Aqua America, the largest water utility in the group, has operations in more than 12 states. As a result, Aqua America's systems are regulated by different state commissions and are less affected by unfavorable decisions and policies of a particular regulatory commission.

Q. PLEASE PROVIDE A GENERAL DESCRIPTION OF THE WATER UTILITIES IN YOUR SAMPLE.

A. Schedule D-4.1 lists the operating revenues and net plant for the six water utilities as reported by AUS Utility Reports (formerly C.A. Turner Utility Reports) and BMSC. In addition, below is a general description of each of the companies:

(1) American States Water (AWR) primarily serves the California market through Southern California Water Company, which provides water services to over 254,000 customers and electric utility service to over 23,000 customers within 75 communities in 10 counties in

the State of California, primarily in Los Angeles, San Bernardino, and Orange counties. It has one subsidiary serving the Arizona market with approximately 13,000 customers in Fountain Hills and Scottsdale. Approximately 91 percent of American States revenues were derived commercial and residential water customers. Revenues for American States were over $301 million in 2007 and net plant was over $677 million at the end of 2007.

(2) Aqua America (WTR) owns regulated utilities in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Florida, Indiana, Virginia, Maine, Missouri, New York, and South Carolina, serving over 950,000 customers at the end of 2007. The Company's utility base is diversified among residential water, commercial water, fire protection, industrial water, other water, and wastewater customers. Residential customers make up over 69 percent of its water revenues. Total revenues for Aqua America were over $602 million in 2007 and net plant was over $2.4 billion at the end of 2007.

(3) California Water Service Group (CWT) owns subsidiaries in California, New Mexico, Washington, and Hawaii serving over 490,000 customers. The California operations account for over 95 percent of customers and over 96 percent of operating revenues. Revenues for California Water were over $367 million in 2007 and net plant was over $890 million at the end of 2007.

(4) Connecticut Water Services (CTWS) owns subsidiaries in Connecticut and Massachusetts serving over 84,000 customers. Revenues for Connecticut Water Service were over $59 million in 2007 and net plant was over $229 million at the end of 2007.

(5) Middlesex Water (MSEX) owns subsidiaries in New Jersey and Delaware serving over 90,000 customers and provides water service under contract to municipalities in central New Jersey to a population of over 267,000. Revenues for Middlesex Water were over $86 million in 2007 and net plant was over $297 million at the end of 2007.

(6) SJW Corp. (SJW) owns San Jose Water, which provides water service in a 138 square mile area in San Jose, California, and surrounding communities. Revenues for SJW Corp were over $206 million in 2007 and net plant was over $460 million at year-end.

Q. HOW DOES BMSC COMPARE TO THE SAMPLE WATER UTILITIES?

A. It is much smaller. At the end of the test year, BMSC had approximately 2,100 wastewater customers. Its wastewater revenues totaled a little under $1.6 million, and its wastewater net plant-in-service was approximately $5.7 million. BMSC is not geographically diversified. It has a very small service territory in Northeast Maricopa County compared to the sample companies, and no alternative sources of revenue.

Q. IT DOESN'T APPEAR THAT BMSC IS ACTUALLY COMPARABLE TO THE SAMPLE WATER UTILITIES.

A. For the reasons I have stated, a good argument could be made that BMSC is not comparable to the six publicly traded water utilities in the same group. Unfortunately, as I testified, the approaches commonly used to estimate a utility's cost of equity require market data, which is not available for smaller companies, like BMSC. As a result, much larger, public companies must be used as proxies. The emphasis on proxy is important. The criteria established by the Supreme Court in decisions such as *Bluefield Water Works* require the use of comparable

companies, i.e., companies that would be viewed by investors as having similar risks. A rational investor would not regard BMSC has having the same level of risk as Aqua America or even Connecticut Water. Consequently, the results produced by the DCF and CAPM methodologies, utilizing data for the sample utilities, often understates the appropriate return on equity for an Arizona-regulated water or sewer provided.

Q. YOU PREVIOUSLY DISCUSSED FINANCIAL RISK, WHICH IS RELATED TO A FIRM'S CAPITAL STRUCTURE. HOW DO THE CAPITAL STRUCTURES OF THE SAMPLE WATER UTILITIES COMPARE TO BMSC?

A. Schedule D-4.2 shows the capital structure of BMSC contains 19.3 percent debt and 81.7 percent equity compared to the average of the water utility sample of 48.5 percent debt and 51.5 percent equity. Having less debt in its capital structure implies less financial risk than the water utility sample, which may offset the other factors that make BMSC more risky than the sample group.

B. <u>Current Stocks Prices and Their Effect on Estimating the Cost of Equity.</u>

Q. DO YOU HAVE ANY GENERAL CONCERNS WITH THE DATA AVAILABLE TO MAKE COST OF EQUITY ESTIMATES FOR THE WATER UTILITIES?

A. Yes. Schedule D-4.3 shows that common stock prices have increased significantly during the past five years, and those increases have exceeded the average annual increases in dividends per share ("DPS"), earnings per share ("EPS") and book value per share. As a result, the current market-to-book ratio for the sample water utilities is approximately 2.0.

Value Line (January 2004) has suggested that, in part, the reason for

increases in the stock prices is consolidation in the water utility industry. In January 2004, *Value Line* advised investors to expect stock prices from an acquisition to be as much as four times book value. *Value Line* (October 2008) continues to advise investors to expect mergers and acquisitions.

Irrespective of investor merger and acquisition expectations or other current market conditions, stock price growth has exceeded book growth and both stock price growth, and book growth have all exceeded dividends and earnings growth. Schedule D-4.4 shows that common stock prices have had annual price increases during the past 10 years that have exceeded the annual increases in dividends per share, earnings per share, and book value per share. The market-to-book ratios of most publicly traded utilities, including the sample utilities, have been well above 1.0 for a number of years, and there is no reason to expect those ratios to significantly change in the future, given continuing the conditions in the stock market and overall economic conditions.

Q. WHAT IMPLICATIONS DOES THIS HAVE FOR ESTIMATING THE COST OF EQUITY USING THE SAMPLE WATER UTILITIES?

A. If investors have bid up prices for utility stocks in anticipation of a merger or acquisition, the stock prices will reflect the investor's expected premium at acquisition. This distorts the results produced by the DCF model by underestimating dividend yield, lowering the indicated equity cost.

Alternatively, investors may have bid up the prices for the water utility stocks because they expect increases in earnings and dividends in the future. In other words, investors expect the water utilities to be authorized, and to actually earn higher returns on equity. *Value Line* (April 2007), for example, has advised investors that the extremely consumer-conscious regulatory environments of the past several years and the corresponding delayed rate relief and unfavorable

decisions appear to be at an end, especially in California. The recognition of increasing favorable regulatory environment continues to provide share-price strength. Value Line (October 2008) suggests that utility stocks, with some perceived safety compared to the broader market, will likely outpace the broader market averages during the next year due to seemingly unending volatility of the stock market in the past 6 to 12 months.

There is no doubt investor expectations are influenced by more favorable regulation and the current high volatility of the broader market. We can only hope that Arizona's regulators understand that lower rates means less capital investment and a lower quality of service. Shareholders won't keep chasing bad investment with more capital, nor will they continue to subsidize the provision of service waiting for the regulatory system to fix itself.

C. <u>Overview of the DCF and CAPM Methodologies.</u>

Q. PLEASE EXPLAIN THE GENERAL APPROACHES TO ESTIMATING THE COST OF CAPITAL.

A. There two broad approaches:

1) identify comparable-risk sample companies and estimate the cost of capital directly, and,

2) find the location of the CML and estimate the relative risk of the company that jointly determines the cost of capital.

The DCF model is an example of a method falling into the first general approach. It is a direct method, but uses only a subset of the total capital market evidence. The DCF model rests on the premise that the fundamental value of an asset (stock) is its ability to generate future cash flows to the owner of that asset (stock). I will explain the DCF model in more detail later. For now, the DCF is simply the sum of a stock's expected dividend yield and the expected long-term

growth rate. Dividend yields are readily available, but long-term growth estimates are more difficult to obtain.

The CAPM is an example of a method falling into the second general approach. It uses information on all securities rather than a small subset. I will explain the CAPM in more detail later. For now, the CAPM is a risk-return relationship, often depicted graphically as the CML. The CAPM is the sum of a risk-free return and a risk premium.

Each of these two methods has their own way of measuring investor expectations. In the final analysis, ROE estimates are subjective and should be based on sound, informed judgment. I have applied several versions of the DCF, and two versions of the CAPM to "bracket" the fair cost of equity capital for BMSC, but without taking into account the additional risks that BMSC possesses.

D. <u>Explanation of the DCF Model and Its Inputs.</u>

Q. PLEASE EXPLAIN THE DCF METHOD OF ESTIMATING THE COST OF EQUITY.

A. The DCF model is based on the concept that the current price of a share of stock is equal to the present value of future cash flows from the purchase of the stock. In other words, the DCF model is an attempt to replicate the market valuation process that sets the price investors are willing to pay for a share of a company's stock. It rests on the assumption that investors rely on the expected returns (i.e., cash flow they expect to receive) to set the price of a security. The DCF model in its most general form is:

$$(2) \qquad P_0 = CF_1/(1+k) + CF_2/(1+k)^2 + \ldots + CF_n/(1+k)^n$$

where k is the cost of equity; n is a very large number; P_0 is the current stock price; and, CF_1, CF_2,...CF_n are all the expected future cash flows expected to be received in periods 1, 2, ... n.

Equation (2) can be written to show that the current price (P_0) is also equal to

(3) $P_0 = CF_1/(1+k) + CF_2/(1+k)^2 + \ldots + P_t/(1+k)^t$

where P_t is the price expected to be received at the end of the period t. If the future price (P_t) included a premium (an expected increase in the stock price or capital gain), the price the investor would pay today in anticipation of receiving that premium would increase. In other words, by estimating the cash flows from the purchase of a stock in the form of dividends and capital gains, we can calculate the investor's required rate of return, i.e., the rate of return an investor presumptively used in bidding the current price to the stock (P_0) to its current level.

Equation (3) is a Market Price version of the DCF model. As with the general form of the DCF model in equation (2), in the Market Price approach the current stock price (P_0) is the present value of the expected cash inflows. The cash flows are comprised of dividends and the final selling price of the stock. The estimated cost of equity (k) is the rate of return investors expect if they bought the stock at today's price, held the stock and received dividends through the transition period, and then sold it for price (P_t).

Q. CAN YOU PROVIDE AN EXAMPLE TO ILLUSTRATE THE MARKET PRICE VERSION OF THE DCF MODEL?

A. Yes. Assume an investor buys a share of common stock for $40. If the expected dividend during the coming year is $2.00, then the expected dividend yield is 5 percent ($2.00/$40 = 5.0 percent). If the stock price is also expected to increase to $43.00 after one year, this $3.00 expected gain adds an additional 7.5 percent to the expected total rate of return ($3.00/$40 = 7.5 percent). Thus, the investor buying the stock at $40 per share, expects a total return of 12.5 percent (5 percent dividend yield plus 7.5 percent price appreciation). The total return of 12.5 percent is the

appropriate measure of the cost of capital because this is the rate of return that caused the investor to commit $40 of his capital by purchasing the stock.

I have provided a Market Price DCF model in Exhibit 1 to illustrate the Market Price DCF model approach further. The model computes the implied rate of return from a stream of cash flows. The first cash flow is negative and is the purchase price of the stock. I used the spot price at November 21, 2008, as reported by Value Line as the initial purchase price. The next series of cash flows are the expected dividends for the next four years. The final cash flow is the dividend in year 5 plus the expected selling price of the stock. The selling price of the stock is based on the historical 5-year average annual price growth for each of the stocks. The average implied rate of return is over 15 percent.

Q. HOW DOES THE RESULT OF YOUR MARKET PRICE DCF COMPARE TO THE HISTORICAL COMPOUND ANNUAL MARKET RETURNS FOR THE WATER UTILITY SAMPLE?

A. As shown in Exhibit 2, the average 5-year historical compound annual total market return for the water utility sample is over 15 percent. I cannot compare total market returns for AZ water and wastewater utilities because there is no market data. Despite the fact that the historical 5-year total market returns as well as the market price DCF indicate returns in the range of 15 percent, I do not rely on this method. I have instead used it to evaluate the reasonableness of the results produced by the other versions of my DCF model.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF THE DCF MODEL.

A. Under the assumption that future cash flows are expected to grow at a constant rate ("g"), equation (1) can be solved for k and rearranged into the simple form:

(4) $k = CF_1/P_0 + g$

where CF_1/P_0 is the expected dividend yield and g is the expected long term dividend (price) growth rate ("g"). The expected dividend yield is computed as the ratio of next period's expected dividend ("CF_1") divided by the current stock price ("P_0"). This form of the DCF model is known as the constant growth DCF model and recognizes that investors expect to receive a portion of their total return in the form of current dividends and the remainder through future dividends and capital (price) appreciation. A key assumption of this form of the model is that investors expect that same rate of return (k) every year and that market price grows at the same rate as dividends. This has not been historically true for the water utility sample, as shown by the data shown in Schedules D-4.3 and D-4.4. As a result, estimates of long-term growth rates (g) should take this into account.

Q. HOW IS THE FORMULA FOR THE MULTI-STAGE DCF MODEL DERIVED?

A. Under the multi-stage growth DCF model, equation (1) is expanded to incorporate two or more growth rate periods and is written as:

$$(5)\ P_0 = CF_0(1+g_1)/(1+k) + \ldots + CF_0(1+g_2)^n/(1+k)^n + CF_0(1+g_t)^{(t+1)}/k-g_t)$$

where g_1, g_2, etc., represent growth rates for periods 1, 2, etc., and g_t represents the growth rate from period t to infinity. This version of the DCF model assumes that cash flow growth will occur at different rates for one or more periods and ultimately reach a terminal growth stage that continues indefinitely.

Q. ARE THERE ANY GENERAL CONCERNS ABOUT APPLYING THE DCF MODEL TO UTILITY STOCKS?

A. There are a number of reasons why caution must be used when applying the DCF model to utility stocks. First, as I have already discussed, the stock price and dividend yield component may be unduly influenced by structural changes in the industry, such as mergers and acquisitions, which influence investor expectations.

Second, the DCF model is based on a number of assumptions which may not be realistic given the current capital market environment. The traditional DCF model assumes that the stock price, book value, dividends, and earnings all grow at the same rate. This has not been historically true for the sample water utility companies. Third, the application of the DCF model produces estimates of the cost of equity that are consistent with investor expectations only when the market price of a stock and the stock's book value are approximately the same. The DCF model will understate the cost of equity when the market-to-book ratio exceeds 1.0 and conversely will overstate the cost of equity when the market-to-book ratio is less than 1.0. The reason for this is that the market-derived return produced by the DCF is often applied to book value rate base by regulators. Fourth, the assumption of a constant growth rate may be unrealistic, and there may be difficulty in finding an adequate proxy for the growth rate. Historical growth rates can be downward biased as a result of the impact of acquisitions, mergers, unfavorable regulatory decisions, and even abnormal weather patterns.

Q. LET'S TURN TO THE SPECIFIC INPUTS USED IN YOUR DCF MODELS. WHAT DATA HAVE YOU USED TO COMPUTE THE DIVIDEND YIELD (CF_1/P_0) IN YOUR MODELS?

A. I used the spot price for each of stocks of the water utilities in the sample group on November 21, 2008 as reported by Value Line. The dividend is the expected dividend for the next year.

Q. EARLIER YOU TESTIFIED THAT STOCK PRICES HAVE BEEN INCREASING DUE TO STRUCTURAL CHANGES--HOW DO SUCH CHANGES IMPACT THE DIVIDEND YIELD?

A. The DCF model results will be negatively biased because the dividend yield (CF_1/P_0) is reduced by virtue of having a larger denominator, the stock price (P_0).

This impact is not by itself problematic because the DCF model is intended to take into account changes in the stock price (upward or downward). Investors may have bid up the price of the stocks of the water utilities in the sample group because they expect increased growth in earnings and, as a result, increased dividend growth and appreciation in the price of the stock. However, if stock prices have been bid up in anticipation of a merger or an acquisition, then the DCF model estimate will not reflect true market conditions and understate the cost of equity.

Q. WHAT MEASURES OF GROWTH ("g") HAVE YOU USED?

A. I have used earnings growth forecasts, where available, from three different, widely-followed sources: *Zack's Investment Research*, *Standard & Poor Earnings Guide*, and *Value Line Investment Survey*. Schedule D-4.6 reflects estimates of earnings growth. The currently available estimates from these three sources provide at least two estimates for each of the sample water utility companies. There are three estimates for the majority of the companies.

I have also used forecasts of book returns, retention ratios, and growth in the number of common shares from *Value Line* to determine sustainable growth estimates, which I describe in more detail below. Schedules D-4.7 and D-4.8 show my calculations of sustainable growth.

For the multi-stage DCF, I employed a two-stage model with short-term and long-term growth rates. I used analysts' forecasts of EPS growth for the near term and average long-term GDP growth for the long-term.

Q. DID YOU USE THE ARITHMETIC MEAN OR THE GEOMETRIC MEAN FOR GDP GROWTH?

A. The arithmetic mean. It is well established that if the cost of capital is estimated from historical data, an arithmetic average should be used. Dr. Morin, in his text on regulatory finance, provides a detailed explanation of why this is the case, citing

various authorities, including Professors Brealey, Myers and Allen, authors of the leading graduate textbook on corporate finance.[2]

Q. WHY DID YOU USE FORECASTED GROWTH RATES IN YOUR MODELS?

A. The DCF model requires estimates of growth that investors expect in the future. Accordingly, I used analysts' forecasts of growth. Logically, in estimating future growth, financial institutions and analysts have taken into account all relevant historical information on a company as well as other more recent information.[3] To the extent that past results provide useful indications of future growth prospects, analysts' forecasts would already incorporate that information. In addition, a stock's current price reflects known historic information on that company, including its past earnings history. Any further recognition of the past will double count what has already occurred. Therefore, forward-looking growth rates should be used.

Q. HAVE YOU COMPARED THE ANALYSTS' ESTIMATES OF GROWTH WITH HISTORICAL DATA?

A. Yes. As shown in Exhibit 3, the average 5-year historical compound annual capital (price) appreciation is 12.27 percent. The average 10-year historical compound annual capital (price) appreciation is 11.28 percent. This is significantly higher than the average of the analysts' estimates of growth of 9.03 percent as shown on Schedule D-4.5. While historical returns do not necessarily reflect what will occur in the future, the analysts' estimates of EPS growth are significantly less than the historical capital appreciation and the historical total returns. Thus, I believe using

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[2] Roger A. Morin, *New Regulatory Finance* (2006) 133-43.

[3] David A. Gordon, Myron J. Gordon and Lawrence I Gould, "Choice Among Methods of Estimating Share Yield," *Journal of Portfolio Management* (Spring 1989) 50-55.

the analysts' estimates of EPS growth for the growth rate in the DCF model is conservative.

Q. WHY DIDN'T YOU USE FORECASTS OF DIVIDEND GROWTH?

A. Primarily because of the limited availability of analyst estimates of dividend growth for the utility sample companies. Forecasts are available for only three of the six sample companies. A second reason is that of the three DCF estimates that can be made two are less than the current cost of investment grade bonds - one produces an indicated cost of equity of only 3.9 percent.

Q. HAVE YOU PREPARED CONSTANT GROWTH DCF ESTIMATES USING ANALYSTS' ESTIMATES OF DPS GROWTH?

A. Yes. Exhibit 4, attached hereto, reflect constant growth DCF results using analysts' estimates of DPS growth. The average result is 7.2 percent well below the current cost of investment grade bonds at 9.0 percent.

Q. HAVE YOU PREPARED CONSTANT GROWTH DCF MODELS USING HISTORICAL DPS AND EPS GROWTH RATES?

A. Yes. Exhibit 5, attached hereto, reflects constant growth DCF results using five-year historical annual growth rates for DPS. The DCF results using five-year historical annual growth rates using historical DPS growth is 7.2 percent – below the current cost of investment grade bonds. Five of the six estimates are significantly below the cost of debt, with the lowest being only 3.6 percent.

Exhibit 6, attached hereto, reflects constant growth DCF results using five-year historical annual growth rates for EPS. The range of cost of equity estimates using historical EPS growth are 7.1 percent to 11.4 percent with the average of the estimates being 9.2 percent. Two of the six estimates are well below the cost of debt with one as low as 7.1 percent. If these two estimates are removed, the average result is 10.1 percent.

Q. WHY HAVEN'T YOU INCLUDED ANALYSTS' FORECASTS OF DPS GROWTH AND HISTORICAL DPS GROWTH IN YOUR DCF ESTIMATE OF GROWTH?

A. Using analysts' forecasts of DPS growth and historical DPS growth results in returns that are unrealistic. It is important to keep in mind that there is a great deal of empirical evidence demonstrating that, on average, stocks are riskier than bonds and achieve higher returns. Morningstar (formerly Ibbotson Associates), for example, annually publishes its comprehensive study of historical returns on stocks and bonds.[4]

Putting aside the potential distortions to the result produced by the DCF model caused by structural changes to the industry and abnormal weather conditions, it does not make sense to employ grow rates that result in indicated equity returns less than the cost of debt, especially when those results fly in the face of a large body of empirical evidence. Investors would not bid up the price of a utility stock if the expected return is equivalent to returns on bonds and other debt investments. As the CML depicted previously illustrates, common stocks are higher and to the right of investment grade bonds on the CML continuum because they are riskier investments. Again, the empirical evidence supports this conclusion. The results using the analysts' expectations of DPS growth and historical DPS growth are unreasonable.

Q. YOU MENTIONED SUSTAINABLE GROWTH EARLIER. PLEASE EXPLAIN WHAT SUSTAINABLE GROWTH IS?

A. Sustainable growth is derived by combining the expected growth from future retained earnings and expected future growth from sales of common stock. The growth rate (g) becomes:

[4] Morningstar, *SBBI Valuation Edition 2006 Yearbook.*

(6) $g = br + sv$

where b is the expected retention ratio; r is the expected return on common equity; s is the funds raised from the sale of stock as a fraction of existing common equity; and v is the fraction of funds raised from the sale of stock that accrues to shareholders.

Q. HOW DID YOU ESTIMATE "br" GROWTH?

A. I used projected rates of return, dividends per share, and earnings per share reported in *Value Line* to estimate "br" growth.

Q. HOW DID YOU ESTIMATE "sv" GROWTH?

A. I used *Value Line*'s projections of new issues of common stock to estimate "s" and reported books values and the spot price to estimate "v". All of the water utility stocks used in my sample are currently selling at prices above book value and thus have "sv" growth.

Q. HOW DO YOUR ESTIMATES FOR SUSTAINABLE GROWTH COMPARE TO THE HISTORICAL COMPOUND ANNUAL CAPITAL APPRECIATION RETURN?

A. The average sustainable growth for the utility sample as shown in Schedule D-4.7 is 7.26 percent, which is lower than the average 5-year and 10-year historical compound annual capital appreciation return of 12.27 percent and 11.28 percent, respectively.

E. <u>Explanation of the CAPM and Its Inputs.</u>

Q. PLEASE EXPLAIN THE CAPM METHODOLOGY FOR ESTIMATING THE COST OF EQUITY.

A. As I already indicated, the CAPM is a type of risk premium methodology that is often depicted graphically in a form identical to the CML. Put simply, the CAPM formula is the sum of a risk-free rate plus a risk premium. It quantifies the

additional return required by investors for bearing incremental risk. The risk-free rate is the reward for postponing consumption by investing in the market. The risk premium is the additional return compensation for assuming risk.

The CAPM formula provides a formal risk-return relationship premised on the idea that only market risk matters, as measure by beta. The CAPM formula is:

$$(7) \quad k = R_f + \beta(R_m - R_f)$$

where k is the expected return, R_f is the risk-free rate, R_m is the market return, $(R_f - R_m)$ is the market risk premium, and β is beta.

The difficulty with the CAPM is that it is a prospective or forward-looking model while most of the capital market data required to match the input variables above is historical.

Q. WHAT IS THE RISK-FREE RATE?

A. It is the return on an investment with no risk. U.S. Treasury rates serve as the basis for the risk-free rate because the yields are directly observable in the market and are backed by the U.S. government. Practically speaking, short-term rates are volatile, fluctuate widely and are subject to more random disturbances than long-term rates. In short, long-term Treasury rates are preferred for these reasons and because long-term rates are more appropriately matched to securities with an indefinite life or long-term investment horizon.

Q. WHAT IS BETA AND WHAT DOES IT MEASURE?

A. Beta is measure of the relative risk of a security and the market. In other words, it is a measure of the sensitivity of a security to the market as a whole. This sensitivity is also known as systematic risk. It is estimated by regressing a security's excess returns against a market portfolio's excess returns. The slope of the regression line is the beta.

Beta for the market is 1.0. A security with a beta greater than 1.0 is

considered riskier than the market. A security with a beta less than 1.0 is considered less risky than the market.

There are computational problems surrounding beta. It depends on the return data, the time period used, its duration, the choice of the market index, and whether annual, monthly, or weekly return figures are used. Betas are estimated with error. Based on empirical evidence, high betas will tend to have a positive error (risk is overestimated) and low betas will have a negative error (risk is underestimated).[5]

Q. WHAT DID YOU USE AS THE PROXY OF THE BETA FOR BMSC?

A. I used the average beta of the sample water utility companies. Betas were obtained from *Value Line Investment Analyzer* (November 21, 2008). *Value Line* is the source for estimated betas that Staff has used in a number of recent rate cases. The average beta as shown on Schedule D-4.12 is 0.98. In the past few years, beta for the sample water utility companies has increased significantly, indicating an upward trend. For example, in the average beta for the water utility sample in January 2006 was 0.74. The average beta increased to 0.85 by January 2007. I should note that because BMSC is not publicly traded, BMSC has no beta. I believe that BMSC, if it were publicly traded, would have a higher beta than the sample water utility companies.

Q. PLEASE EXPLAIN THE MARKET RISK PREMIUM?

A. The market-risk premium (R_m-R_f) is the return an investor expects to receive as compensation for market risk. It is the expected market return minus the risk-free rate. Approaches for estimating the market risk premium can be historical or prospective.

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[5] Eugene F. Fama and Kenneth R. French, "The Capital Asset Pricing Model: Theory and Evidence," *Journal of Economic Perspectives* (Summer 2004) 25-46.

Since expected returns are not directly observable, historical realized returns are often used as a proxy for expected returns on the basis that the historical market risk premium follows what is known in statistics as a "random walk." If the historical risk premium does follow the random walk, then one should expect the risk premium to remain at its historical mean. Based on this argument, the best estimate of the future market risk premium is the historical mean. Morningstar's *SBBI Valuation Edition 2008 Yearbook* provides historical market returns for various asset classes from 1926 to 2007. This publication also provides market risk premiums over U.S. Treasury bonds, which make it an excellent source for historical market risk premiums.

Prospective market risk premium estimation approach necessarily examining the returns expected from common equities and bonds. They can be extremely volatile, especially when examining very short periods of time. When such methods are shown to be volatile, they should be avoided. One method employs applying the DCF model to a representative market index such as the S&P 500 index or the *Value Line* Composite Index. The expected return from the DCF is measured for a number of periods of time, and then subtracted from the prevailing risk-free rate for each period to arrive at market risk premium for each period. The market risk premium subsequently employed in the CAPM is the average market risk premium of the overall period.

Q. HOW MANY MARKET RISK PREMIUM ESTIMATES DID YOU PREPARE IN CONNECTION WITH YOUR ASSIGNMENT FOR BMSC?

A. I prepared two market risk premium estimates: An historical market risk premium and a current market risk premium.

Q. HOW DID YOU ESTIMATE THE HISTORICAL MARKET RISK PREMIUM?

A. I used the Morningstar's *SBBI Valuation Edition 2008 Yearbook* measure of the average premium of the market over intermediate-term treasury securities from 1926 through 2007. The average historical market risk premium over intermediate-term treasury securities is 7.5 percent.

Q. HOW DID YOU ESTIMATE THE CURRENT MARKET RISK PREMIUM?

A. I derived a market risk premium by, first, using the DCF model to compute an expected market return for each of the past 12 months using *Value Line's* projections of the average dividend yield and average price appreciation (growth) on the *Value Line* Composite Index. I then subtracted the average 30-year Treasury yield for each month from the expected market returns to arrive at the expected market risk premiums. Finally, I averaged the computed market risk premiums to determine the current market risk premium. The data and computations are shown on Schedule D-4.12. The average market risk premium is 16.04 percent.

Q. WHY DID YOU USE A FULL 12 MONTHS OF DATA TO ESTIMATE THE EXPECTED MARKET RISK PREMIUM?

A. Staff typically computes a market risk premium based on a single point in time, which makes estimates extremely volatile, so much so that the expected market risk premium estimate can change by as much as 300 basis points (or more) each time it is estimated. The accuracy of the expected risk premium in greatly enhanced by increasing the number of periods used to estimate it. It is analogous to flipping a coin. One cannot predict with any degree of accuracy the result of a single flip of a balanced coin, or even a few. But the more coin flips, the greater degree of confidence one has in predicting the outcome.

Q. WHY DID YOU USE THE 30-YEAR TREASURY AS OPPOSED TO THE 5, 7, OR EVEN 10 YEAR TREASURIES IN COMPUTING YOUR EXPECTED MARKET RISK PREMIUMS?

A. To properly match the risk-free rate (based the 30-year Treasury rate) with the expected market risk premium I used in the current market risk premium CAPM.

F. <u>The Results of the DCF and CAPM Models, and Recommended ROE.</u>

Q. PLEASE DISCUSS YOUR ANALYSIS OF THE COST OF EQUITY FOR BMSC.

A. In the first part of my analysis, I applied two versions of the constant growth DCF and a two-stage DCF models to the six water utilities in the sample group. The DCF analyses appear on Schedules D-4.9, D-4.10, and D-4.11. The DCF models produce an indicated equity cost in the range of 9.9 percent to 13.5 percent.

In the second part of my analysis, I applied two versions of the CAPM – an historical risk premium CAPM and a current market risk premium CAPM. The CAPM analyses appear on Schedule D-4.13 and produce an indicated cost of equity in the range of 9.8 percent to 19.4 percent.

Q. PLEASE SUMMARIZE YOUR DCF AND CAPM RESULTS.

A. The following table summarizes the results of the models I have used:

	Range	Midpoint
DCF Constant Growth (earnings growth)	10.7% - 14.9%	12.8%
DCF Constant Growth (sustainable growth)	8.6% - 12.3%	10.4%
Two-Stage Growth Model	10.3% - 13.2%	11.7%
DCF Average Results	**9.9% - 13.5%**	**11.7%**
CAPM Historical MRP		9.8%
CAPM Current MRP		19.4%
Average CAPM Results	**9.8%-19.4%**	**14.6%**

Average Overall Results	**9.8%-16.5%**	**13.2%**

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 1

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Market Price

Exhibit 1
Witness: Bourassa

Line No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
							EXPECTED CASH FLOWS						
	Company	Projected Div	5 Year Historical Average Div. Growth	Recent Price	5 Year Historical Annual Compound Price Growth	Year 5 Price	Recent Price	Year 1 Div	Year 2 Div	Year 3 Div	Year 4 Div	Year 5 Div + Price	**Implied ROE =** Internal Rate of Return (Cols 7-12)
7	1. American States	$ 0.98	2.02%	$ 31.32	13.68%	$ 59.46	$ (31.32)	$ 0.98	$ 1.00	$ 1.02	$ 1.04	$ 60.52	16.2%
8	2. Aqua America	0.52	8.80%	20.57	13.72%	39.12	(20.57)	0.52	0.57	0.62	0.67	39.85	16.0%
9	3. California Water	1.17	0.71%	40.47	12.76%	73.78	(40.47)	1.17	1.27	1.39	1.51	75.30	15.4%
10	4. Connecticut Water	0.89	1.51%	20.60	1.91%	22.65	(20.60)	0.89	0.97	1.05	1.15	23.81	6.8%
11	5. Middlesex	0.71	1.94%	14.32	6.86%	19.95	(14.32)	0.71	0.77	0.84	0.91	20.88	11.9%
12	6. SJW Corp.	0.66	7.43%	23.93	24.69%	72.12	(23.93)	0.66	0.72	0.78	0.85	73.04	26.8%
15	GROUP AVERAGE		3.74%		12.27%								15.5%
16	GROUP MEDIAN		1.98%		13.22%								15.7%

Sources:
Value Line Data
Yahoo Finance November 21, 2008

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 2

Black Mountain Sewer Corporation
Historical Compound Annual Total Market Returns

Exhibit 2
Witness: Bourassa

Line No.	Company	3 Yr.** Return	5 Yr.** Return	10 Yr.*** Return
1				
2				
3				
4				
5				
6				
7	1. American States	19.08%	16.30%	19.95%
8	2. Aqua America	9.00%	15.84%	15.62%
9	3. California Water	5.58%	16.07%	9.20%
10	4. Connecticut Water	3.15%	5.38%	12.18%
11	5. Middlesex	6.97%	10.43%	13.15%
12	6. SJW Corp.	28.62%	26.51%	17.90%
13				
14	Average	12.07%	15.09%	14.67%
15				
16				
17				
18				
19				
20	* 2005-2007			
21	** 2003-2007			
22	*** 1998-2007			
23				
24	Sources:			
25	Value Line Data			
26	Yahoo Finance			
27				
28				
29				
30				

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 3

Black Mountain Sewer Corporation
Historical Compound Annual Capital Appreciation Returns

Exhibit 3
Witness: Bourassa

Line No.	Company	3 Yr.* Return	5 Yr.** Return	10 Yr.*** Return
8	1. American States	16.28%	13.68%	12.35%
9	2. Aqua America	6.81%	13.72%	13.87%
10	3. California Water	2.47%	12.76%	6.33%
11	4. Connecticut Water	-0.40%	1.91%	8.84%
12	5. Middlesex	3.35%	6.86%	9.88%
13	6. SJW Corp.	26.63%	24.69%	16.43%
17	Average	9.19%	12.27%	11.28%

* 2005-2007
** 2003-2007
*** 1998-2007

Sources:
Value Line Data
Yahoo Finance

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 4

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model
Using Analyst Estimates of DPS Growth

Exhibit 4
Witness: Bourassa

Line No.	Company	(1) Spot Price (Po)	(2) Next Year's Div (D1)	(3) Dividend Yield	(4) Div. Growth	(5) Indicated Equity Cost k=Div Yld + G (Cols 1+4)	[6] Indicated Equity Cost k=Div Yld + G (Cols 1+4)
1	1. American States	31.32	1.00	3.19%	4.50%	7.7%	*
2	2. Aqua America	20.57	0.50	2.43%	7.50%	9.9%	9.9%
3	3. California Water	40.47	1.17	2.89%	1.00%	3.9%	*
4	4. Connecticut Water	20.60	0.89	4.30%	Not Available		
5	5. Middlesex	14.32	0.71	4.93%	Not Available		
6	6. SJW Corp.	23.93	0.66	2.74%	Not Available		
7	GROUP AVERAGE					7.2%	9.9%
8	GROUP MEDIAN					7.7%	9.9%
9	Current Baa interest rate (November 20, 2008)					9.0%	
10	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Top 10					8.0%	
11	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Bottom 10					6.8%	
12	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Consensus					7.3%	

* Indicated equity cost below current cost of debt (Baa) or negative growth.

Sources:
Value Line Analyzer Data September 2008
Yahoo Finance November 21, 2008
Federal Reserve October 16, 2008
Blue Chip Financial Forecast June 2008

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 5

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Historical
Using 5 Year Historical Dividend Growth

Exhibit 5
Witness: Bourassa

Line No.	Company	(1) Spot Price (Po)	(2) Next Year's Div (D1)	(3) Dividend Yield	(4) Historical Div. Growth	(5) Indicated Equity Cost k=Div Yld + G (Cols 1+4)	[6] Indicated Equity Cost k=Div Yld + G (Cols 1+4)
7	1. American States	31.32	1.00	3.19%	2.02%	5.2%	*
8	2. Aqua America	20.57	0.50	2.43%	8.80%	11.2%	11.2%
9	3. California Water	40.47	1.17	2.89%	0.71%	3.6%	*
10	4. Connecticut Water	20.60	0.89	4.30%	1.51%	5.8%	*
11	5. Middlesex	14.32	0.71	4.93%	1.94%	6.9%	*
12	6. SJW Corp.	23.93	0.66	2.74%	7.43%	10.2%	10.2%
15	GROUP AVERAGE				3.7%	7.2%	10.7%
16	GROUP MEDIAN				4.1%	6.3%	10.7%
18	Current Baa interest rate (November 20, 2008)					9.0%	
20	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Top 10					8.0%	
21	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Bottom 10					6.8%	
22	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Consensus					7.3%	

24 * Indicated equity cost below current cost of debt (Baa) or negative growth.

26 Sources:
27 Value Line Analyzer Data September 2008
28 Yahoo Finance November 21, 2008
29 Federal Reserve October 16, 2008
30 Blue Chip Financial Forecast June 2008

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 6

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Historical
Using 5 Year Historical EPS Growth

Exhibit 6
Witness: Bourassa

Line No.	Company	(1) Spot Price (Po)	(2) Next Year's Div (D1)	(3) Dividend Yield	(4) Historical EPS Growth	(5) Indicated Equity Cost k=Div Yld + G (Cols 1+4)	[6] Indicated Equity Cost k=Div Yld + G (Cols 1+4)
7	1. American States	31.32	1.00	3.19%	8.22%	11.4%	11.4%
8	2. Aqua America	20.57	0.50	2.43%	5.76%	8.2%	*
9	3. California Water	40.47	1.17	2.89%	4.25%	7.1%	*
10	4. Connecticut Water	20.60	0.89	4.30%	Negative	NM	NM
11	5. Middlesex	14.32	0.71	4.93%	4.42%	9.4%	9.4%
12	6. SJW Corp.	23.93	0.66	2.74%	6.93%	9.7%	9.7%
15	GROUP AVERAGE				5.9%	9.2%	10.1%
16	GROUP MEDIAN				5.8%	9.4%	9.7%
18	Current Baa interest rate (November 20, 2008)					9.0%	
20	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Top 10					8.0%	
21	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Bottom 10					6.8%	
22	Blue Chip Forecast Baa Corporate Bond Interest Rate 2011 Consensus					7.3%	

* Indicated equity cost below current cost of debt (Baa) or negative growth.

Sources:
- Value Line Analyzer Data September 2008
- Yahoo Finance November 21, 2008
- Federal Reserve October 16, 2008
- Blue Chip Financial Forecast June 2008

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Exhibit 7

STANDARD
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RATINGSDIRECT®

November 7, 2008

Assessing U.S. Utility Regulatory Environments

Primary Credit Analyst:
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Background

Assessing Regulatory Jurisdictions

Ratemaking Practices And Procedures

Political Insulation

Cash Flow Support And Stability

Jurisdictional Assessments

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Assessing U.S. Utility Regulatory Environments

The assessment of regulatory risk is perhaps the most important factor in Standard & Poor's Ratings Services' analysis of a U.S. regulated, investor-owned utility's business risk. Each of the other four factors we examine--markets, operations, competitiveness, and management--can affect the quality of the regulation a utility experiences, but we believe the fundamental regulatory environment in the jurisdictions in which a utility operates often influences credit quality the most. In our credit analysis, we evaluate regulatory risk on a company-specific basis. A utility management's skill in managing regulatory risk can in many cases overcome a difficult regulatory environment. Conversely, other companies can experience greater regulatory risk even with supportive regulatory regimes if management fails to devote the necessary time and resources to the important task of managing regulatory risk. Operating in a state with a regulatory structure that is conducive to maintaining credit quality will improve the chances for a utility to successfully negotiate the regulatory maze.

This commentary discusses our views on what constitutes a favorable regulatory climate. We then use those factors to create assessments of the regulatory environments in states that regulate the electric and gas utilities that we rate. (See the table at the end of this article.) Our intention is to provide a common base for our own analysis of regulatory risk and to better communicate to investors, issuers, and regulators how various elements of regulation can affect credit quality. The exercise is also expected to enhance our ability to evaluate management by highlighting instances where our opinion of a company's regulatory risk diverges significantly from the fundamental quality of the regulatory jurisdictions where it operates.

The assessments of relevant jurisdictions are based on quantitative and qualitative factors. Importantly, we make our assessments from a credit perspective. We plan to update them annually or when significant events occur that have an important impact on the regulatory climate in a particular jurisdiction. The new regulatory assessment information augments the methodology applied to regulated utilities today.

Our introduction of these regulatory assessments coincides with what we view as the increasing influence of regulatory matters on the rated utilities' risk profiles and greater credit market awareness of the importance of understanding the regulatory process. Our goal in explaining our views on regulatory practices and policies and their effect on Standard & Poor's analysis of the credit quality of utilities is to provide additional transparency to the market.

Background

State utility regulation is almost as old as credit ratings. Standard & Poor's predecessor, Standard Statistics Bureau, was formed in 1906, and the first state utility commissions, as we know them today, appeared in 1907. Regulation has always been a factor in Standard & Poor's analysis of utility ratings, but its importance to our analysis has shifted with industry trends over time.

Before the 1970s, regulators presided for the most part over stable or decreasing rates as economic growth, rising consumption, and economies of scale drove costs down. The advent of inflation, rising and volatile fuel costs, and nuclear power missteps led to higher rates and, in our view, greater regulatory influence on credit quality during the 1980s. Restructuring in the natural gas and then the electric industries marked the 1990s and the first years of the new millennium, and the importance of regulatory issues in our analysis again started to subside. In our view, we are

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now in another era of increasing and unstable costs and some semblance of a return to traditional utility regulation. Consequently, the quality of regulation is at the forefront of our analysis of utility creditworthiness.

We have historically focused on regulatory risk on a company-specific basis. Nothing in what follows will change that approach. Utility commissions regulate diverse industries and adopt different approaches to different types of businesses. Treatment of utilities within the same industry can vary significantly in the same jurisdiction. The quality of the regulation experienced by a company is often the product of the company's management and business strategy as much as its regulators. The regulatory climate assessments only serve as a baseline of our opinion on the fundamental attitude of a jurisdiction toward the credit quality of the utilities in that state, and they are the starting point for Standard & Poor's analysis of the regulatory risk of each rated utility. Our goal is to achieve greater consistency and continuity in utility ratings.

Assessing Regulatory Jurisdictions

We assess jurisdictions on one basic attribute--the fundamental approach to controlling utility rates--and then in three major categories. The resulting assessments are based primarily on various measures of regulatory risk that are discussed briefly below. With respect to qualitative factors, we look for long-term, historical characteristics of the jurisdiction, as well as transient regulatory and political developments.

The foundation of our opinion of the regulation in a jurisdiction is the degree to which competitive market forces are allowed to influence rates. In order of credit-friendliness, a state will rely either on full cost-based regulation for all components of the utility bill, market-based mechanisms for generation, and (more rarely) retail markets, or a hybrid of the two to control the amount charged and the terms on which that service is offered. It may surprise some to learn that we consider a hybrid setup, which in most cases exists because the transition to some sort of competition has stalled, to harbor more risk for bondholders than a system that is committed to letting market prices set a major part of the customer's bill.

The risk inherent in the market-based model is straightforward: the price for electricity can be more volatile when based on a market than when it is based on embedded costs, and regulators are apt to resist full and timely recovery when changes in generation costs are abrupt and substantial (and perhaps misunderstood). The risks in a hybrid or transitional model are less apparent, but, in our opinion, potentially more significant. First, we consider the uncertainty of the timing of reaching the end state--and what that end state will look like--to be a negative factor from a credit perspective. Second, in some cases, the hybrid model may result in a "lower-of-cost-or-market" approach that allows generation rates to reflect one or the other at different times depending on which one suits ratepayers best. A utility and its bondholders may then face a prolonged period of potential exposure to market risk (the downside) with little or no opportunity to participate in the benefits of competition (the upside of greater returns).

After identifying the fundamental regulatory paradigm, our analysis turns to factors that influence the utility's business risk climate in the jurisdiction. The factors fall into three broad categories: ratemaking, political environment, and financial stability. Broadly speaking, the ratemaking and financial stability factors influence our assessments more than the paradigm and political factors.

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Ratemaking Practices And Procedures

The main, and often the most contentious, task of a regulator is to set the rates a utility may charge its customers. We analyze specific rate decisions as part of the surveillance of each utility. Our regulatory assessments focus on the jurisdiction's overall approach to setting rates and the process it uses to conduct and manage base rate filings. Practices pertaining to separate tariff clauses for large expense items are examined in the third category of the analysis (see below). In this part of the assessment, we concentrate on whether established base rates fairly reflect the cost structure of a utility and allow management an opportunity to earn a compensatory return that provides bondholders with a financial cushion that promotes credit quality.

Notably, the analysis does not revolve around "authorized" returns, but rather on actual earned returns. We note the many examples of utilities with healthy authorized returns that, we believe, have no meaningful expectation of actually earning that return because of rate case lag, expense disallowances, etc. Although, in general, the absolute level of financial returns is less important to our analysis than how that return is earned, we recognize that, all else being equal, higher earned returns translate into better credit metrics and a more comfortable equity cushion for bondholders. A regulatory approach that allows utilities the opportunity to consistently earn a reasonable return is a positive factor in our view of credit quality.

The rates of return and capital structures used to generate the revenue requirement in rate proceedings may not be the primary focus of the assessment, but those and other decisions made in the ratemaking process are still noted. We consider those decisions to be potential signals from regulators on their attitude toward credit quality. We believe that the capital structure in particular is a handy and direct indication from the regulator as to whether or not creditworthiness is an important consideration in its deliberations when setting rates. Obviously, any pronouncements from a regulator that explicitly address credit ratings or ratemaking practices that incorporate credit-minded adjustments (e.g., the use of double-leveraged capital structures or off-balance-sheet debt-like obligations) are considered in the Standard & Poor's assessment.

We analyze the issue of "regulatory lag" in a comprehensive manner and not just as a matter of the efficiency of the regulator in completing rate cases. As part of this analysis, we evaluate the timeliness of rate decisions, coupled with an evaluation of the test year. In addition, we take into account the timing of interim rates, and other practices that affect the appropriateness of rates periodically established by the regulator. We do not view the issue of regulatory lag as an intermittent concern, consequential only during times of acute inflation or rising capital spending, but as a consistent part of our credit analysis. Accordingly, in our regulatory assessments we focus on whether the regulator efficiently prosecutes rate requests and bases its decisions with respect to rate setting on the most current information.

In our view, the prevalence of rate case settlements is not necessarily an important credit consideration. Although the common assumption among market participants seems to be that a settlement must be in the best interest of a utility, we believe this assumption disregards the possibility that management will sometimes make decisions based on its effect on earnings at the expense of cash flow considerations. This does not mean we dismiss the ability of stipulations to reach a fair resolution of difficult matters that help regulators issue timely and constructive rate decisions. It just means that frequent settlements do not, in our view, directly lead to a conclusion that the regulatory environment in a state enhances credit quality.

An important policy-related issue outside of individual rate cases that falls under this part of the assessment is the

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regulatory oversight of large capital projects with long lead times that carry out-sized risks to a utility and its bondholders. In our opinion, practices such as legislative or regulatory recognition of the need for pre-approval of such endeavors, periodic reviews that substantively involve the regulator in the progress of the project, and rolling prudence determinations during construction can reduce the general level of risk associated with a utility committing substantial capital well in advance of the rate proceeding that results in the project being placed into rate base. Before committing to such projects, a resource-procurement process that uses objective guidelines to evaluate competing proposals to meet load obligations and keeps the regulator informed and involved in the decisions can, in our view, help to reduce the risk of subsequent disallowances. If the jurisdiction has an Integrated Resource Plan or similar mechanism that includes the participation of many parties and is used to definitively establish the need for new generation, we consider credit risk to be further diminished.

One more factor that we examine in this part of the analysis is whether a jurisdiction employs nontraditional ratemaking practices. Examples of what we may view to be potentially credit-enhancing regulatory mechanisms include weather normalization and incentive ratemaking. We believe that the beneficial effect on credit quality of a tariff clause that smooths out cash flows that can vary with outside influences like weather is self evident. The benefits of incentives incorporated into the regulatory regime may be less clear. Well-designed incentives can be at least credit neutral. A moderate amount of incentives can be credit supportive. We generally view incentive provisions (whether tied to cost control, reliability, or operational performance) as being beneficial for credit quality if they are linked to fair and objective benchmarks. Incentives that lack some or all of those features, such as a plain, long-term rate freeze, can be, in our opinion, detrimental to credit quality.

Political Insulation

The role of politics in utility regulation is often misunderstood. In most jurisdictions, legislatures created regulatory commissions and invested them with the power to set and enforce utility rates and service standards. Regardless of how a regulatory commission is statutorily organized, its function is to set and regulate rates and service standards with due regard not only for the interests of those who advance the capital needed to provide safe and reliable utility service but for other constituents as well. In this regard, bondholders should recognize that the setting of utility rates invariably reflects political as well as economic factors. Therefore, the potential for political considerations to affect utility regulation can be a key determinant when we assess a regulatory jurisdiction.

A primary factor in this part of our assessment is the method of selecting utility commissioners. In some jurisdictions, the governors appoint regulatory commissioners. In others, the same voters who pay utility bills directly elect commissioners. The regulatory risk associated with that model can sometimes be managed, but there is an inherent level of risk in elected regulatory bodies that we reflect in the assessment. Standard & Poor's also analyzes the track record of the involvement of the executive branch or the legislature in utility matters, and the relative visibility of utility issues in the political arena.

The ability of a regulator to deliver sound, fair, and timely rate decisions and set prudent regulatory policies that assist utility managers in managing business and financial risk can be affected by the overall atmosphere that it operates in. The tone can be set by the governor or legislature, the history and tradition of independence accorded to the regulatory body, and the behavior of important constituent groups that intervene in utility proceedings.

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Cash Flow Support And Stability

The final set of factors in our assessment of regulatory environments is arguably the most important. The phrase "cash is king" can be overused, but it does highlight an essential part of the credit analysis. A regulatory jurisdiction that recognizes the significance of cash flow in its decision making is one that will appeal to bondholders. Generating cash is a function of the actions of utility management, but the regulator can supply (or withhold) the tools that can affect the company's essential ability to actually realize the intended level of cash flow.

The most prominent factor in this part of the analysis is the application of separate tariff provisions for major expenses such as fuel and purchased power. The timely adjustment of rates in response to changing commodity prices and other expenses that are largely out of the control of utility management is a key component of a credit-enhancing regulatory jurisdiction. We analyze the quality of special tariff mechanisms to determine their effectiveness in producing the cash flow stability they are designed to achieve. The frequency of rate adjustments, the ability to quickly react to unusual market volatility, and the control of opportunities to engage in hindsight disallowances of costs could affect the analysis almost as much as whether the tariff provisions exist at all. The record of disallowances plays a part in the regulatory assessment.

The commission's policies and oversight covering hedging activities may also be a factor in this part of the review if a utility has sought regulatory approval. For utilities that attempt to manage commodity risks, we look for a clearly-stated hedging policy and a track record of activity that conforms to that policy. The responsibility for communicating the policy and demonstrating the prudence of the hedging activity rests with the utility, but the initial response to a hedging program and the history of the regulator's treatment of the results of the program could influence our assessment.

Regulators can employ other ratemaking techniques that promote stable cash flows. We consider a commission's decisions on rate design in assessing its attitude on credit quality. For example, we take into account the relative size of the typical monthly customer charge, a decoupling mechanism that severs the direct relationship between revenues and customer usage, or other rate design features that bolster credit quality.

Especially during upswings in the capital expenditure cycle, such as we are experiencing now, a jurisdiction's willingness to support large capital projects with cash during the construction phase is an important aspect of our analysis. This is especially true for ventures with big budgets and long lead times, such as baseload coal-fired or nuclear power plants and high-voltage transmission lines that are susceptible to construction delays. Allowance of a cash return on construction work-in-progress or similar ratemaking methods historically were considered extraordinary measures for use in unusual circumstances, but in today's environment of rising construction costs and possible inflationary pressures, cash flow support could be crucial in maintaining credit quality through the spending program.

Jurisdictional Assessments

The table below shows Standard & Poor's assessments of regulatory jurisdictions. The category titles are designed to communicate one other important point regarding utility regulation and its effect on ratings. All categories are denoted as "credit-supportive". To one degree or another, all U.S. utility regulation sustains credit quality when compared with the rest of corporate ratings at Standard & Poor's. The presence of regulators, no matter where in

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the spectrum of our assessments, reduces business risk and generally supports all U.S. utility ratings.

Regulatory Jurisdictions For Utilities Among U.S. States

Most credit supportive	More credit supportive	Credit supportive	Less credit supportive	Least credit supportive
	Alabama	Arkansas	Louisiana	Arizona
	California	Colorado	Maine	Delaware
	Florida	Connecticut	Missouri	Dist. of Columbia
	Georgia	Hawaii	Montana	Illinois
	Indiana	Idaho	New York	Maryland
	Iowa	Kansas	Oklahoma	New Mexico
	South Carolina	Kentucky	Rhode Island	
	Wisconsin	Massachusetts	Texas	
		Michigan	Utah	
		Minnesota	Vermont	
		Mississippi	Washington	
		Nevada	West Virginia	
		New Hampshire	Wyoming	
		New Jersey		
		North Carolina		
		North Dakota		
		Ohio		
		Oregon		
		Pennsylvania		
		South Dakota		
		Virginia		

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The McGraw-Hill Companies

Black Mountain Sewer Corporation Application

Direct Testimony Of Thomas J. Bourassa
(Cost of Capital)

Schedules

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Bourassa

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
6	Long-Term Debt[1]	-	0.00%	9.40%	0.00%	-	0.00%	9.40%	0.00%
8	Stockholder's Equity[2]	4,214,556	100.00%	12.80%	12.80%	4,623,438	100.00%	12.80%	12.80%
10	Totals	$ 4,214,556	100.00%		12.80%	$ 4,623,438	100.00%		12.80%

[1] **Excluded long-term debt for Scottsdale Treatment Capacity $ 1,010,649 .**
[2] **Adjusted for correction to accummulated depreciation of $ 271,031 . See B-2 Page 2**
[3] **Adjusted for deferred income taxes $ 170,554 . See B-2 Page 6**

SUPPORTING SCHEDULES:
D-1
D-3
D-4
E-1

RECAP SCHEDULES:
A-3

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Bourassa

Line No.	Description of Debt	End of Test Year Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost	End of Projected Year Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost
1	Loan for Scottsdale Treatment Capacity	659,546	74,518	9.40%	6.13%	613,181	71,388	9.40%	6.13%
2	Loan for Scottsdale Treatment Capacity	351,103	39,325	9.40%	3.27%	327,694	36,010	9.40%	3.27%
3			-		0.00%	-	-	0.00%	0.00%
4			-		0.00%	-	-	0.00%	0.00%
5									
6									
7									
8									
9									
10									
11									
12									
13	Totals	$ 1,010,649	$ 113,843		9.40%	$ 940,875	$ 107,398		9.40%
14									
15	Supporting Schdules:								
16	E-2								
17									
18									
19									
20									
21									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Preferred Stock

Exhibit
Schedule D-3
Page 1
Witness: Bourassa

Line No.	Description of Issue	End of Test Year Shares Outstanding	End of Test Year Amount	End of Test Year Dividend Requirement	End of Projected Year Shares Outstanding	End of Projected Year Amount	End of Projected Year Dividend Requirement
1							
2							
3	NOT APPLICABLE, NO PREFERRED STOCK ISSUED OR OUTSTANDING						
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17	SUPPORTING SCHEDULES:			RECAP SCHEDULES:			
18	E-1			D-1			
19							
20							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Common Equity

Exhibit
Schedule D-4
Page 1
Witness: Bourassa

Line No.	
1	
2	The Company is proposing a cost of common equity of 12.8%.
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	SUPPORTING SCHEDULES:
18	E-1
19	D-4.0 to D-4.13
20	

RECAP SCHEDULES:
D-1

Black Mountain Sewer Corporation
Summary of Results

Exhibit
Schedule D-4.0
Witness: Bourassa

Line No.	Method	Low	High	Midpoint
1				
2				
3				
4	Method	Low	High	Midpoint
5	DCF Constant Growth	10.7%	14.9%	12.8%
6	DCF Sustainable Growth	8.6%	12.3%	10.4%
7	DCF Two-Stage	10.3%	13.2%	11.8%
8				
9	Average DCF Results	9.9%	13.5%	11.7%
10				
11	CAPM	9.9%	19.4%	14.7%
12				
13	Average DCF and CAPM Results	9.9%	16.5%	13.2%
14				
15				
16				
17				
18				
19				
20				
21				
22				
23				
24				
25				
26				
27				
28				

Black Mountain Sewer Corporation
Selected Characteristics of Water Utilities

Exhibit
Schedule D-4.1
Witness: Bourassa

Line No.	Company	% Water Revenues	Operating Revenues (millions)	Net Plant (millions)	S&P Bond Rating	Moody's Bond Rating
1						
2						
3	Company					
4	1. American States	82%	$ 299.1	$ 701.8	NR	A2
5	2. Aqua America	87%	$ 604.6	$ 2,466.5	AA-	NR
6	3. California Water	97%	$ 378.2	$ 929.5	NR	NR
7	4. Connecticut Water	85%	$ 61.3	$ 239.2	AAA	NR
8	5. Middlesex	90%	$ 89.3	$ 307.2	A	NR
9	6. SJW Corp.	95%	$ 213.8	$ 476.8	NR	NR
10						
11	Average	89%	$ 274.4	$ 853.5		
12						
13	Black Mountain Sewer Corporation	0%	$ 1.6	$ 5.7	NR	NR
14						
15	Source: AUS Utility Reports (November 2008)					
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						

Black Mountain Sewer Corporation
Capital Structures of Water Utilities

Exhibit
Schedule D-4.2
Witness: Bourassa

No.	Company	Book Value Long-Term Debt	Book Value Common Equity	Market Value Long-Term Debt	Market Value Common Equity
1	American States	47.0%	53.0%	33.2%	66.8%
2	Aqua America	55.4%	44.6%	30.7%	69.3%
3	California Water	43.0%	57.0%	25.6%	74.4%
4	Connecticut Water	47.9%	52.1%	34.7%	65.3%
5	Middlesex	49.8%	50.2%	40.5%	59.5%
6	SJW Corp.	47.7%	52.3%	33.0%	67.0%
	Average	48.5%	51.5%	32.9%	67.1%
	Black Mountain Sewer Corporation	19.3%	80.7%	N/A	N/A

Source: Value Line Analyzer Data (November 21, 2008)

Black Mountain Sewer Corporation
Comparisons of Past and Future Estimates of Growth

Exhibit
Schedule D-4.3
Page 1
Witness: Bourassa

Line No.	Company	Five-year historical compound annual changes: Price	Book Value	DPS	EPS	Average Future Growth[1]
7	1. American States	13.68%	4.53%	1.99%	6.53%	8.50%
8	2. Aqua America	13.72%	9.84%	8.45%	5.63%	8.00%
9	3. California Water	12.76%	7.11%	0.70%	3.71%	8.67%
10	4. Connecticut Water	1.91%	3.50%	1.51%	Negative	9.03%
11	5. Middlesex	6.86%	6.34%	1.93%	3.57%	8.00%
12	6. SJW Corp.	24.69%	8.96%	7.24%	5.92%	12.00%
15	GROUP AVERAGE	12.27%	6.71%	3.64%	5.07%	9.03%
16	GROUP MEDIAN	13.22%	6.73%	1.96%	5.63%	8.58%

[1] See Schedule D-4.5

Sources:
Value Line Data
Yahoo Finance

Black Mountain Sewer Corporation
Comparisons of Past and Future Estimates of Growth

Exhibit
Schedule D-4.4
Page 1
Witness: Bourassa

Line No.	Company	Ten-year historical compound annual changes: Price	Book Value	DPS	EPS	Average Future Growth[1]
1	1. American States	12.35%	4.54%	1.47%	4.53%	8.50%
2	2. Aqua America	13.87%	9.39%	7.18%	7.64%	8.00%
3	3. California Water	6.33%	3.59%	0.91%	Negative	8.67%
4	4. Connecticut Water	8.84%	3.76%	1.26%	1.08%	9.03%
5	5. Middlesex	9.88%	3.98%	1.98%	2.65%	8.00%
6	6. SJW Corp.	16.43%	4.85%	5.13%	2.66%	12.00%
7						
8						
9	GROUP AVERAGE	11.28%	5.02%	2.99%	3.71%	9.03%
10	GROUP MEDIAN	11.12%	4.26%	1.72%	2.66%	8.58%

[1] See Schedule D-4.5

Sources:
Value Line Data
Yahoo Finance

Black Mountain Sewer Corporation
Analysts Forecasts of Earnings Per Share Growth

Exhibit
Schedule D-4.5
Witness: Bourassa

Line No.		(1)	(2)		(3)	(4)
		EPS GROWTH				Average
	Company	Zacks	Morningstar	Yahoo	Value Line	Growth (G) (Cols 1-3)
1	1. American States	12.00%	7.00%	4.00%	11.00%	8.50%
2	2. Aqua America	9.00%	7.50%	8.00%	7.50%	8.00%
3	3. California Water	9.00%	8.00%	7.67%	10.00%	8.67%
4	4. Connecticut Water					9.03%
5	5. Middlesex	8.00%		8.00%	8.00%	8.00%
6	6. SJW Corp.	10.00%	18.00%	10.00%	10.00%	12.00%
7						
8	GROUP AVERAGE	9.60%	10.13%	7.53%	9.30%	9.03%
9	GROUP MEDIAN					8.58%

Sources:
Value Line Investment Analyzer Data November 21, 2008
Zacks Investment Research Site November 21, 2008
Morningstar Website November 21, 2008
Yahoo Finance November 21, 2008

Black Mountain Sewer Corporation
Estimates of Sustainable Growth

Exhibit
Schedule D-4.6
Witness: Bourassa

Line No.	Company	(1) Retention Ratio	(2) Rate of Return	(3) br Growth	(4) sv Growth	(5) Average Sustainable Growth (Cols 3+4)
7	1. American States	0.52	13.50%	7.02%	0.89%	7.91%
8	2. Aqua America	0.43	12.00%	5.20%	0.67%	5.87%
9	3. California Water	0.49	11.00%	5.34%	2.66%	7.99%
10	4. Connecticut Water					
11	5. Middlesex					
12	6. SJW Corp.					
15	GROUP AVERAGE	0.48	12.17%	5.85%	1.40%	7.26%
16	GROUP MEDIAN	0.49	12.00%	5.34%	0.89%	7.91%

Sources:
Value Line Data

Black Mountain Sewer Corporation
Estimates of sv Growth

Exhibit
Schedule D-4.7
Witness: Bourassa

Line No.	Company	(1) Stock Financing Rate	(2) Current Market to Book Ratio	(3) v	(4) sv Growth
7	1. American States	2.03%	1.78	0.44	0.89%
8	2. Aqua America	1.03%	2.81	0.64	0.67%
9	3. California Water	4.87%	2.20	0.55	2.66%
10	4. Connecticut Water				na
11	5. Middlesex				na
12	6. SJW Corp.				na
15	GROUP AVERAGE	2.65%	2.26	0.54	1.40%
16	GROUP MEDIAN	2.03%	2.20	0.55	0.89%

Sources:
Value Line Data

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model
Using Projected EPS Growth

Exhibit
Schedule D-4.8
Witness: Bourassa

Line No.		(1)	(2)	(3)	(4)	(5)
1						Indicated
2						Cost of
3			Next			Equity
4		Spot	Year's	Dividend		k=Div Yld + g
5	Company	Price (Po)	Div (D1)	Yield	Growth (g)[1]	(Cols 3+4)
6	1. American States	31.32	1.08	3.45%	8.50%	11.9%
7	2. Aqua America	20.57	0.56	2.72%	8.00%	10.7%
8	3. California Water	40.47	1.18	2.92%	8.67%	11.6%
9	4. Connecticut Water	20.60	0.90	4.37%	9.03%	13.4%
10	5. Middlesex	14.32	0.72	5.03%	8.00%	13.0%
11	6. SJW Corp.	23.93	0.70	2.94%	12.00%	14.9%
12						
13						
14	GROUP AVERAGE			3.57%	9.03%	12.6%
15	GROUP MEDIAN					12.5%
16						
17	[1] See Schedules D-4.5					
18						
19	Sources:					
20	Value Line Investment Analyzer Data November 21, 2008					
21	Yahoo Finance November 21, 2008					
22						
23						

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Sustainable Growth

Exhibit
Schedule D-4.9
Witness: Bourassa

Line No.		(1)	(2)	(3)	(4)	(5)	(6)	(7)
1								Indicated
2								Cost of
3			Next		Sustainable Growth[1]			Equity
4		Spot	Year's	Dividend			br+sv	k=Div Yld + g
5	Company	Price (Po)	Div (D1)	Yield	br	vs	Growth (g)	(Cols 3+6)
6	1. American States	31.32	1.08	3.45%	7.02%	0.89%	7.91%	11.4%
7	2. Aqua America	20.57	0.56	2.72%	5.20%	0.67%	5.87%	8.6%
8	3. California Water	40.47	1.18	2.92%	5.34%	2.66%	7.99%	10.9%
9	4. Connecticut Water	20.60	0.90	4.37%			7.26%	11.6%
10	5. Middlesex	14.32	0.72	5.03%			7.26%	12.3%
11	6. SJW Corp.	23.93	0.70	2.94%			7.26%	10.2%
12								
13								
14	GROUP AVERAGE			3.57%			7.26%	10.8%
15	GROUP MEDIAN							11.1%
16								
17								
18	1 See Schedule D-4.6 and D-4.7							
19								
20								
21	Sources:							
22	Value Line Investment Analyzer Data November 21, 2008							
23	Yahoo Finance November 21, 2008							
24								

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Two-Stage Growth - Projected

Exhibit
Schedule D-4.10
Witness: Bourassa

Line No.		(1)	(2)	(3)	(4)	(5)	(6)	(7)
					Projected Growth Rates			
	Company	Spot Price(P_0)	Next Year's Div (D_1)	Yield (D_1/P_0)	Near Term[1]	Long Term (GDP)	Average[2]	Indicated Cost of Equity
7	1. American States	31.32	1.08	3.45%	8.50%	6.80%	7.94%	11.4%
8	2. Aqua America	20.57	0.56	2.72%	8.00%	6.80%	7.60%	10.3%
9	3. California Water	40.47	1.18	2.92%	8.67%	6.80%	8.05%	11.0%
10	4. Connecticut Water	20.60	0.90	4.37%	9.03%	6.80%	8.30%	12.7%
11	5. Middlesex	14.32	0.72	5.03%	8.00%	6.80%	7.60%	12.6%
12	6. SJW Corp.	23.93	0.70	2.94%	12.00%	6.80%	10.28%	13.2%
15	GROUP AVERAGE			3.57%			8.30%	11.9%
16	GROUP MEDIAN							12.0%

1 See Schedule D-4.5
[2] Near term growth given weighting of .67

Black Mountain Sewer Corporation
Market Betas

Exhibit
Schedule D-4.11
Witness: Bourassa

Line No.		Company	
1			
2	1.	American States	0.95
3	2.	Aqua America	1.00
4	3.	California Water	1.10
5	4.	Connecticut Water	0.80
6	5.	Middlesex	0.90
7	6.	SJW Corp.	1.15
8		Average	**0.98**
9			
10	Source:		
11	Value Line Investment Analyzer Data November 21, 2008		
12			
13			
14			
15			
16			

Black Mountain Sewer Corporation
Computation of Current Market Risk Premium

Exhibit
Schedule D-4.12
Witness: Bourassa

Line No.	Month	Dividend Yield	+	Growth	=	Expected Market Return	-	Monthly Average 30 Year Treasury Rate	=	Market Risk Premium
1										
2										
3	**Month**	Yield	+	Growth	=	Return	-	Treasury Rate	=	Premium
4										
5	Jun	2.17%	+	9.71%	=	11.88%	-	5.20%	=	6.68%
6	Jul	2.27%	+	10.91%	=	13.18%	-	5.11%	=	8.07%
7	Aug	2.37%	+	11.92%	=	14.29%	-	4.93%	=	9.36%
8	Sept	2.31%	+	11.16%	=	13.47%	-	4.79%	=	8.68%
9	Oct	2.45%	+	11.90%	=	14.35%	-	4.77%	=	9.58%
10	Nov	2.60%	+	13.41%	=	16.01%	-	4.52%	=	11.49%
11	Dec 2007	2.61%	+	13.51%	=	16.12%	-	4.52%	=	11.60%
12	Jan 2008	2.67%	+	15.19%	=	17.86%	-	4.33%	=	13.53%
13	Feb	2.74%	+	16.47%	=	19.21%	-	4.52%	=	14.69%
14	March	2.85%	+	17.64%	=	20.49%	-	4.39%	=	16.10%
15	April	2.69%	+	15.73%	=	18.42%	-	4.44%	=	13.98%
16	May	2.73%	+	15.51%	=	18.24%	-	4.60%	=	13.64%
17	Jun	3.13%	+	18.51%	=	21.64%	-	4.69%	=	16.95%
18	Jul	3.15%	+	18.61%	=	21.76%	-	4.57%	=	17.19%
19	Aug	3.06%	+	17.08%	=	20.14%	-	4.50%	=	15.64%
20	Sept	3.07%	+	19.30%	=	22.37%	-	4.27%	=	18.10%
21	Oct	4.31%	+	29.40%	=	33.71%	-	4.17%	=	29.54%
22										
23	Recent 12 Mon Avg	2.97%	+	17.53%	=	20.50%	-	4.46%	=	16.04%
27										
28	Short-term Trends									
29	Recent Nine Months Avg	3.08%	+	18.69%	=	21.78%	-	4.46%	=	17.31%
30	Recent Six Months Avg	3.24%	+	19.74%	=	22.98%	-	4.47%	=	18.51%
31	Recent Three Months Avg	3.48%	+	21.93%	=	25.41%	-	4.31%	=	21.09%
32										
33	Sources									
34	Value Line Investment Analyzer Software Data									
35	Federal Reserve									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Capital Asset Pricing Model (CAPM)

Exhibit
Schedule D-4.13
Witness: Bourassa

Line No.		Rf	+	beta[3]	x	Rp	=	k
1								
2								
3	Historical Market Risk Premium CAPM[1]	2.6%	+	0.98	x	7.5% [4]	=	9.9%
4								
5	Current Market Risk Premium CAPM[2]	3.7%	+	0.98	x	16.0% [5]	=	19.4%
6								
7								
8	Average							14.7%
9								
10								
11								

12 [1] Federal Reserve November 21, 2008 average of 5, 7 and 10 year Treasury rates (Rf)
13 [2] Federal Reserve November 21, 2008 30 year Treasury rate (Rf)
14 [3] Value Line Investment Analyzer data. See Schedule D-4.11
15 [4] Historical Market Risk Premium from (Rp) MoriningStar SBBI 2008 Yearbook Table A-2 Intermediate-Horizon ERP 1926-2007
16 [5] Computed using DCF constant growth method to determine current market return on Value Line 1700 stocks
17 and CAPM with beta of 1.0 to compute Current Market Risk Premium (Rp). See Schedule D-4.12.
18
19
20

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REBUTTAL TESTIMONY OF

THOMAS J. BOURASSA

(Rate Base, Income Statement And Rate Design)

October 20, 2009

EXHIBIT
A-6
ADMITTED

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I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. On behalf of the applicant, Black Mountain Sewer Corporation ("BMSC" or the "Company").

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

A. Yes, my direct testimony was submitted in support of the initial application in this docket. There were two volumes, one addressing rate base, income statement and rate design, and the other addressing cost of capital.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. I will provide rebuttal testimony in response to the direct filings by Staff and RUCO. More specifically, this first volume of my rebuttal testimony relates to rate base, income statement and rate design for BMSC. I will also address the testimony by the Boulders Home Owners Association ("BHOA") in the rate design section of this volume of my rebuttal testimony. In a second, separate volume of my testimony, I will also present an update to the Company's requested cost of capital as well as provide responses to Staff and RUCO on the cost of capital and rate of return applied to the fair value rate base, and the determination of operating income.

II. SUMMARY OF BMSC'S REBUTTAL POSITION.

Q. WHAT IS THE REVENUE INCREASE THAT THE COMPANY IS PROPOSING IN THIS REBUTTAL TESTIMONY?

A. The Company is proposing a total revenue requirement of $2,541,508, which constitutes an increase in revenues of $961,338, or 60.84% over adjusted test year revenues.

Q. HOW DOES THIS COMPARE WITH THE COMPANY'S DIRECT FILING?

A. In the direct filing, the Company requested a total revenue requirement of $2,493,932, which required an increase in revenues of $913,762, or 57.83%.

Q. WHY IS THE REQUESTED REVENUE INCREASE HIGHER IN BMSC'S REBUTTAL FILING?

A. In its rebuttal filing, BMSC has adopted a number of adjustments recommended by Staff and/or RUCO, as well as proposed a number of adjustments of its own based on known and measurable changes to the test year. The net result of these adjustments is: (1) the Company's proposed operating expenses have increased by $44,936, from $1,664,665 in the direct filing to $1,709,590; and a net decrease of $6,596 in rate base from the direct filing of $3,723,645 to $3,317,649.

Q. PLEASE SUMMARIZE THE REASON FOR THE DECREASE IN RATE BASE?

A. The Company has proposed a number of rebuttal adjustments to rate base which has resulted in a net decrease in rate base. Included among these proposed adjustments are an adjustment to increase plant-in-service ("PIS") for unrecorded plant; an adjustment to increase advances-in-aid of construction ("AIAC") associated with the unrecorded plant; an adjustment to increase plant-in-service for plant transferred from an affiliate, Litchfield Park Service Company ("LPSCO"), and an adjustment to reflect a plant retirement that was not recorded at the end of the test year. The net increase to PIS is $288,809 and the net increase to AIAC is $254,251. The net rate base impact of these two adjustments is $34,558.

In addition to the above mentioned adjustments, the Company is proposing an adjustment to accumulated depreciation for the PIS adjustments it recommends. The Company has also corrected an error in its accumulated depreciation computation, which correction is reflected in its proposed accumulated depreciation adjustment. The net adjustment to accumulated depreciation is $97,641. The net rate base impact is ($97,641).

The Company is also proposing an increase to the Company's deferred income taxes ("DIT") of $24,344 based on its proposed adjustments to PIS and accumulated depreciation. Finally, the Company is proposing an adjustment to working capital of $32,142. The net rate base impact on these two adjustments is $52,556. Combined, the Company rebuttal proposed adjustments reduce rate base by $6,596 ($34,558 minus $97,641 plus $54,556).

Q. WHAT ARE THE PROPOSED REVENUE REQUIREMENTS AND RATE INCREASES FOR THE COMPANY, STAFF, AND RUCO AT THIS STAGE OF THE PROCEEDING?

A. The proposed revenue requirements and proposed rate increases are as follows:

	Revenue Requirement	Revenue Incr.	% Increase
Company-Direct	$2,493,932	$ 913,762	57.83%
Staff	$2,063,310	$ 483,140	30.58%
RUCO	$2,069,774	$ 489,604	30.98%
Company Rebuttal	$2,541,508	$ 961,338	60.84%

III. RATE BASE

Q. WOULD YOU PLEASE IDENTIFY THE PARTIES' RESPECTIVE RATE BASE RECOMMENDATIONS?

A. Yes, the rate bases proposed by the parties proposing rate base in the case, the Company, Staff and RUCO, are as follows:

	OCRB	FVRB
Company-Direct	$ 3,723,245	$ 3,723,245
Staff	$ 3,602,336	$ 3,602,336
RUCO	$ 3,745,364	$ 3,745,364
Company Rebuttal	$ 3,716,649	$ 3,716,649

Although there are three other parties, none of them has made any proposals regarding rate base, revenues or expenses.

A. Plant-in-service.

Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROPOSED ORIGINAL COST RATE BASE, AND IDENTIFY ANY ADJUSTMENTS YOU HAVE ACCEPTED FROM STAFF AND/OR RUCO?

A. The Company's rebuttal rate base adjustments to OCRB are detailed on rebuttal schedules B-2, pages 3 through 6. Rebuttal Schedule B-2, pages 1 and 2, summarize the Company's proposed adjustments and the rebuttal OCRB.

Rebuttal B-2 adjustment 1, as summarized on Rebuttal Schedule B-2, page 2, consists of three adjustments labeled as "A", "B", "C" and "D" on Rebuttal Schedule B-2, page 3.

Adjustment A reflects an increase to PIS for unrecorded plant totaling $254,251. This plant is for the New Trade Lift Station project. Both Staff and RUCO have made similar adjustments, although both Staff and RUCO increased PIS by $276,985.[1]

[1] *See* Moore Dt. at 8; Brown Dt. at 8-9.

Q. WHY ARE STAFF AND RUCO'S PIS ADJUSTMENTS FOR THE NEW TRADE LIFT STATION HIGHER THAN THE COMPANY'S ADJUSTMENT?

A. The Company had previously provided cost estimates to Staff and RUCO in a data request. However, since that time, the Company has received and tabulated invoices totaling $254,251. As this is now a known and measurable cost, it is likely Staff and RUCO will revise their adjustments, thus eliminating this as an issue in dispute.

Q. PLEASE CONTINUE.

A. Adjustment B, of rebuttal B-2 adjustment 1, reflects a decrease to PIS of $13,208 for a plant retirement. The retirement is for the Old Trade Center Lift Station. Both Staff and RUCO propose the same adjustment to PIS.[2]

Adjustment C, of rebuttal B-2 adjustment 1, reflects an increase to PIS of $9,141 for capitalized expenses. This adjustment reflects an adoption of Staff's proposed PIS adjustment for $9,141.[3] RUCO has not proposed an adjustment to PIS for capitalized expenses.

Adjustment D, of rebuttal B-2 adjustment 1, reflects an increase to PIS of $38,625 for an odor control unit transferred from LPSCO. RUCO proposes this adjustment.[4] However, Staff does not propose this adjustment.

Q. IS THIS THE ODOR CONTROL UNIT IN SERVICE?

A. Yes, and it has been since June 27, 2008.

---

[2] Moore Dt. at 8; Brown Dt. at 8-9.

[3] Brown Dt. at 10.

[4] Moore Dt. at 9.

B. Accumulated Depreciation.

Q. PLEASE EXPLAIN YOUR ADJUSTMENTS TO ACCUMULATED DEPRECIATION.

A. Rebuttal B-2 adjustment 2, as summarized on Rebuttal Schedule B-2, page 2, consists of three adjustments labeled as "A", "B", "C" and "D" on Rebuttal Schedule B-2, page 4.

Adjustment A reflects an increase to accumulated depreciation for unrecorded plant totaling $4,233.

Adjustment B, of rebuttal B-2 adjustment 2, reflects a decrease to accumulated depreciation of $13,208 for a plant retirement. The retirement is for the Old Trade Center Lift Station as discussed previously. The same amount has been removed from both PIS and accumulated depreciation, making this retirement a rate base neutral adjustment.

Adjustment C, of rebuttal B-2 adjustment 2, reflects an increase to accumulated depreciation of $280 for capitalized expenses. This adjustment reflects an adoption of Staff's proposed PIS adjustment for $9,141 for capitalized expenses as discussed previously.

Adjustment D, of rebuttal B-2 adjustment 2, reflects an increase to accumulated depreciation of $10,183[5] for prior year accumulated depreciation (from 2002 to December 2007) for an odor control unit transferred from LPSCO as discussed previously.

Adjustment E, of rebuttal B-2 adjustment 2, reflects an increase to accumulated depreciation of $97,641, primarily for the correction of an error in the

[5] There is additional depreciation totaling $965 for the odor control unit for the January through June 2008 period which is included in rebuttal B-2 adjustment E. The total accumulated depreciation through the end of June 2008 is $11,148.

Company's direct re-computation of accumulated depreciation from the end of the last test year to the end of the test year in the instant case. In direct, the prior authorized depreciation rates were assumed to have changed in December 2005. However, the date of the last decision (Decision No. 69164) was December 5, 2006. The prior depreciation rates should have been used until the date of the last decision. For purposes of my re-computation, I assume that plant was depreciated at the prior authorized depreciation rates for eleven months during 2006 and depreciated one month during 2006 at the depreciation rates approved in Decision No. 69164. Neither Staff nor RUCO discovered this error and have not proposed an adjustment for this error at this stage of the proceeding.

Q. WHEN DID YOU DISCOVER THIS ERROR?

A. During the preparation of my rebuttal testimony.

C. <u>Advances-in-aid of Construction ("AIAC").</u>

Q. PLEASE DISCUSS THE COMPANY'S ADJUSTMENT TO ADVANCES-IN-AID OF CONSTRUCTION?

A. The Company proposes an increase to AIAC of $254,251 to reflect the funding of the New Trade Center Lift Station. This adjustment corresponds to the proposed PIS adjustment of $254,251 for the New Trade Center Lift Station as I discussed previously. Both Staff and RUCO propose an increase to AIAC of $278,985, which corresponds to their respective proposed PIS adjustment for the New Trade Center Lift Station. As I discussed above, the difference in our numbers reflects use of estimates before and actual costs now.

D. **Deferred Income Taxes ("DITs").**

Q. HAS THE COMPANY PROPOSED A REBUTTAL ADJUSTMENT TO DEFERRED INCOME TAXES?

A. Yes. In rebuttal B-2 adjustment 3, as shown on Schedule B-2, page 2, the Company's deferred income tax asset is increased by $24,344. The increase reflects the Company's rebuttal proposed changes to PIS, accumulated depreciation, and AIAC. The details of the Company's rebuttal proposed DIT adjustment is shown on Schedule B-2, page 6.

Q. HAVE STAFF OR RUCO PROPOSED CHANGES TO THE COMPANY'S DEFERRED INCOME TAXES?

A. No. Neither Staff nor RUCO propose changes to DIT based on their proposed adjustments to PIS, accumulated depreciation, and AIAC. And, neither Staff nor RUCO have explained why. It is necessary to reflect changes to DIT based on changes to PIS, accumulated depreciation, AIAC (and CIAC) in order to properly match rate base and revenues and expenses.

E. **Working Capital.**

Q. HOW DOES THE COMPANY REBUT STAFF'S RECOMMENDED WORKING CAPITAL?

A. The Company rebuts Staff's recommendation by recommending a working capital allowance based on an adequate lead-lag study that I had to prepare to rebut Staff's recommendation of a negative working capital allowance.

Q. WHY DIDN'T YOU DO A LEAD-LAG STUDY IN THE DIRECT FILING?

A. Lead-lag studies are costly to prepare and often subject to dispute. I had hoped by showing the results of a formula method analysis and seeking no working capital allowance that any dispute on this issue could be avoided. That didn't happen, and as a result, in response to Staff's proposed rate base reduction of $127,713, the

Company asked me to prepare a lead-lag study for the determination of a cash working capital allowance component of working capital. Based on my lead-lag study for cash working capital and including materials and supplies and prepayments in my computation of a working capital allowance, the Company is proposing a working capital allowance of $32,142. The details of the working capital allowance computation are shown on Schedule B-5, page 1. The details of the cash working capital (lead-lag study) are shown on Schedule B-5, page 2.

Q. DID STAFF PREPARE A LEAD-LAG STUDY FOR BMSC?

A. No. Staff estimated leads and lags for BMSC using generalized estimates similar to the approach adopted by the Commission in the last rate case.[6] However, even if one accepts the cash working capital computation of a negative $127,713, Staff failed to include materials and supplies inventory and prepayments in its working capital allowance.[7] As a result of Staff's failure to include these other components of the working capital allowance, Staff's proposed working capital allowance is overstated by $17,326 and should be ($110,387), not ($127,713). But, Staff's computation as shown on Staff Schedule CSB-9 is really just the determination of a cash working capital component, and now that Staff has taken a position that necessitated BMSC preparing a lead-lag study, it should be utilized to determine working capital.

Q. DID RUCO PROPOSE WORKING CAPITAL?

A. No. RUCO proposes a zero working capital allowance consistent with the Company's initial position.

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[6] *See* Decision No. 69164 at 6-7; Brown Dt. at 11.

[7] Per R14-2-103, Appendix A, the working capital allowance (Schedule B-5) includes cash working capital, materials and supplies and prepayments.

F. **Miscellaneous.**

Q. DO THE PARTIES AGREE ON THE BALANCE OF CONTRIBUTIONS-IN-AID OF CONSTRUCTION AND ACCUMULATED AMORTIZATION IN RATE BASE?

A. Yes. Neither Staff nor RUCO propose an adjustment to contributions-in-aid of construction ("CIAC") or accumulated amortization of CIAC.

Q. DO THE PARTIES AGREE ON THE BALANCE OF DEFERRED REGULATORY ASSETS IN RATE BASE?

A. Yes. Again, the Company's proposed deferred regulatory asset consists of the amortized balance of the additional Scottsdale wastewater treatment capacity the Company purchased in 2006.[8]

IV. INCOME STATEMENT

Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROPOSED REBUTTAL ADJUSTMENTS TO REVENUES AND EXPENSES AND IDENTIFY ANY ADJUSTMENTS YOU HAVE ACCEPTED FROM STAFF AND/OR RUCO?

A. The Company's proposed rebuttal adjustments are detailed on Rebuttal Schedule C-2, pages 1-20. The rebuttal income statement with adjustments is summarized on Rebuttal Schedule C-1, page 1-2.

Rebuttal adjustment 1 increases depreciation expense. Depreciation expense is higher due to the impacts of the Company proposed rebuttal adjustments to plant-in-service.

Rebuttal adjustment number 2 increases property tax expense and reflects the rebuttal proposed revenues. All the parties are in agreement on the method of

[8] *See* Bourassa Dt. at 7-8.

computing property taxes, but each computes the property taxes based on their proposed revenues. I did that, and then used the property tax rate and assessment ratio that was used in the direct filing.

Q. ARE THERE DIFFERENCES IN THE PROPOSED TAX ASSESSMENT RATIO USED IN THE COMPUTATION OF PROPERTY TAXES?

A. Yes. While the Company and RUCO propose an assessment ratio of 21 percent, Staff proposes an assessment ratio of 23 percent.[9] All other things being equal, a higher assessment ratio results in higher property taxes.

Q. HAS STAFF EXPLAINED WHY IT USES THE HIGHER ASSESSMENT RATIO?

A. No, but Staff is using the 2008 assessment ratio, while the Company proposed a 21 percent rate - the assessment ratio for 2010. Since this is the time new rates will be in effect, and it is known and measurable, I maintain this is the appropriate assessment ratio to use in this case.[10]

Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF THE INCOME STATEMENT?

A. Rebuttal adjustment number 3 removes capitalized expenses from Contractual Services and Contractual Services – Other. The adjustment reflects the Company's acceptance of Staff's proposed adjustment for capitalized expenses.[11] RUCO does not propose an adjustment for capitalized expenses.

Rebuttal adjustment number 4 increases purchased wastewater treatment expense based on the most current City of Scottsdale treatment rate of $2.61 per 1,000 gallons (excluding environmental fees and sales tax). RUCO proposes a

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[9] *See* RUCO Schedule RLM-9 and Staff Schedule CSB-23.

[10] Bourassa Dt. at 10.

[11] Brown Dt. at 19.

downward adjustment to purchased wastewater treatment expense.[12] However, RUCO's downward adjustment is based on an incorrect rate of $2.53 per 1,000 gallons (excluding environmental fees and sales taxes). Staff appears to have accepted the Company's purchased wastewater treatment expense adjustment from its direct filing using a rate of $2.59 per 1,000 gallons (excluding environmental fees and sales taxes).

Q. IS THE RATE OF $2.61 PER 1,000 GALLONS A KNOWN AND MEASURABLE CHANGE?

A. Yes. Mr. Sorensen discusses the most current rate from the City of Scottsdale in his rebuttal testimony.[13]

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 5 annualizes purchased wastewater treatment expense based on the current rate from the City of Scottsdale, as discussed previously. The annualization of purchased wastewater expense is intended to match the Company's revenue annualization adjustment that was proposed in the Company direct filing.

Q. DID RUCO PROPOSE AN ANNUALIZATION ADJUSTMENT USING ITS PROPOSED RATE OF $2.53 PER 1,000 GALLONS?

A. Yes, so other than the number, we should be in agreement. Then, hopefully, Staff and RUCO will recognize that Scottsdale has made a change, and the change is both known and measurable and beyond BMSC's control, and they will adjust their schedules accordingly, eliminating an issue from dispute.

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[12] Moore Dt. at 12.

[13] Sorensen Rb. at 11-12.

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 6 increases chemicals expense for a known and measurable change to the cost of chemicals. This adjustment is similar to the adjustment RUCO proposes, except the Company computes an amount of $3,191 while RUCO computes an amount of $3,185. Staff does not propose an adjustment to chemicals expense.

Rebuttal adjustment 7 annualizes chemicals expense for a known and measurable change to the cost of chemicals. The annualization of chemicals expense is intended to match the Company's revenue annualization adjustment that was proposed in the Company direct filing.[14] RUCO does not propose an annualization adjustment for chemicals expense as it did with purchased wastewater treatment.

Rebuttal adjustment 8 increases testing expense reflecting known and measurable changes to this expense. As explained by Mr. Sorensen in his rebuttal testimony, the City of Scottsdale is requiring additional testing in order to comply with its requirements to accept wastewater for treatment.[15] The Company proposed level of testing expense reflects the Staff proposed level plus the incremental costs of complying with the City of Scottsdale requirements.

Rebuttal adjustment 9 increases rent expense to reflect a full 12 months of rental costs for its operation office in Carefree. The Company adjustment matches RUCO's proposed adjustment of $18,432.[16] Staff proposes a similar adjustment totaling $17,034.[17] However, Staff's adjustment is flawed in that it eliminates the

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[14] Bourassa Dt. at 14.

[15] Sorensen Rb. at 14.

[16] Moore Dt. at 14.

[17] Brown Dt. at 21.

rental costs of storage space. Staff's proposed level of rental expense is understated by $1,328.

Rebuttal adjustment 10 reflects the adoption of Staff's normalization of Contractual Services (legal and engineering) and Contractual Services – Other, contained in Staff's operating income adjustment number 4 on Staff Schedule CSB-15. However, the Company has identified an error in Staff's computation and my proposed normalization reflects the correction.

Q. PLEASE EXPLAIN.

A. First, Staff normalizes Contractual Services – Other by dividing clean up costs of $39,870 by 3 for an annual cost of $13,290.[18] The Company does not disagree with this approach for normalizing these costs under the circumstances, nor does it disagree with the amount computed.[19]

Q. DOES RUCO NORMALIZE THE CLEAN UP COSTS?

A. No. RUCO recommends removal of all the clean up costs. But it is unrealistic to assume that the Company will not incur similar costs in the future. Wastewater utilities work diligently to avoid events that require clean up costs, and BMSC is no exception. However, all wastewater systems have spill or overflow events from time to time that require clean up. Therefore, the costs are a normal and recurring expense for wastewater utilities and it is appropriate to include some level of expense for sewer spills in the cost of service.

Q. PLEASE CONTINUE.

A. Second, for Contractual Services (legal and engineering), Staff computes an historical 3 year average and then reduces the test year expense down to the

[18] *See* Staff Schedule CSB-15, lines 1-16.

[19] Sorensen Rb. at 12.

historical average expense.[20] However, when computing the downward adjustment to bring the test year expense down to the 3 year average expense level, Staff fails to first remove capitalized expenses that Staff proposes in another Staff adjustment and overstates its adjustment by $1,500 as a result.

Q. PLEASE EXPLAIN.

A. Staff computes a three year historical average of $6,001 on lines 23 through 28 using the actual expense for the years ended June 30, 2006 of $5,503 and June 30, 2007 of $4,639, as well as an adjusted test year expense for the year ended June 30, 2008 of $7,862 ($9,362 actual test year expense less $1,500 of Staff proposed capitalized expenses). Yet, when computing the downward adjustment on lines 30 through 32, Staff uses the actual test year level of expense of $9,362. Staff should have used the adjusted expense level of $7,862 on line 31 instead of $9,362. By using the adjusted test year expense of $7,362, Staff would have computed an adjustment of $1,861 rather than $3,361 as shown. The $1,500 difference is the $1,500 Staff already proposes to remove through its capitalized expense adjustment as discussed previously.

Q. DO YOU AGREE WITH AVERAGING AS A MEANS OF NORMALIZING AN EXPENSE?

A. No. In general, I believe this normalization approach should be avoided. Surrounding facts and circumstances may justify their use, but substantial evidence must justify a deviation from the test year. Here, in the interest of eliminating issues between the parties, the Company has agreed to accept Staff's adjustment to Contractual Services, with a correction as noted previously above.

[20] *See* Staff Schedule CSB-15, lines 20 through 32.

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 11 reflects Staff's proposed adjustment to decrease bad debt expense by $4,067 for write-offs related to prior year revenue (2006 and 2007), and BMSC's proposal to increase bad debt expense by $6,479 for additional write-offs related to test year revenues that occurred after the end of the test year.

Staff determined that "since this expense was not within the test year, Staff removed it".[21] Obviously, the expense was recorded in the test year and included in test year expense. Arguably, it is related to prior year revenues. This shouldn't matter, but if we are to follow Staff's logic that only bad debt expense relating to test year revenues should be reflected in bad debt expense for the test year, then it is appropriate to reflect the known and measurable write-offs in bad debt expense that are related to test year revenues which occurred after the end of the test year. The Company's adjustment increases bad debt expense by $2,412 ($6,479 minus $4,067).

Rebuttal adjustment 12 removes costs for meals, beverages, and charitable contributions and reflects adjustments for meals of $526, beverages of $907, and charitable contributions of $52 contained in Staff's adjustment number 9.[22] The Company does not agree to the removal of bonuses of $13,460 also contained in Staff's adjustment. Bonuses and incentives are a useful tool in promoting efficiencies in operations and in motivating employees. The ratepayer ultimately benefits from efficient operations, reduced cost of service, and better customer service. As long as the bonuses and incentive payments are reasonable, designed to help achieve operational efficiencies and cost reductions, improve customer service, and the total compensation (including bonuses) to the employee is within

[21] Brown Dt. at 20.

[22] *See* Staff Schedule CSB-20. *See also* Brown Dt. at 23.

the range of comparable compensation for positions with similar required experience, skill, educational requirements, and responsibility levels, the cost should be allowed.

Q. DOES RUCO PROPOSE REMOVAL OF MEALS, BEVERAGES, AND CHARITABLE CONTRIBUTIONS?

A. Yes. Contained within RUCO operating income adjustment number 5 on RUCO Schedule RLM-12 are adjustments for beverages of $908 and charitable contributions of $52.

Q. DOES RUCO PROPOSE THE REMOVAL OF BONUSES?

A. No.

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 13 increases Contractual Services by $42,200 for costs related to work performed by Aerotek Environmental for BMSC that were incorrectly booked to LPSCO expense. RUCO makes a similar adjustment in its operating income adjustment number 5.[23]

Q. DOES STAFF RECOGNIZE THIS ADDITIONAL COST?

A. No. Mr. Sorensen discusses this issue in more detail in his rebuttal testimony.[24]

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 14 reflects the agreement with both Staff and RUCO to remove a negative expense of $1,780 from test year expenses.[25]

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[23] *See* RUCO Schedule RLM-12. *See also* Moore Dt. at 13.

[24] Sorensen Rb. at 15-16.

[25] *See* Staff Operating Income Adjustment 11 on Schedule CSB-22 and RUCO Operating Income Adjustment 7 on Schedule RLM-7.

Rebuttal adjustment 15 reflects an increase to the allocated affiliate central office cost by $1,490 to $33,778. The Company's adjustment is detailed on Rebuttal Schedule C-2, page 16.

Q. PLEASE EXPLAIN THE AFFILIATE CENTRAL OFFICE COST ALLOCATION AND THE COMPANY'S REBUTTAL ADJUSTMENT?

A. The rebuttal allocated affiliate central office cost is based on adjusted actual test year central office cost pool of $3,936,352 US dollars or "USD" which includes Staff's proposed reduction for disallowed costs of $182,693 USD ($191,828 shown on Staff Schedule CSB-12 divided by Canadian dollar to US dollar conversion factor). The central office cost pool is then allocated between the two operating groups of companies within the parent company (Algonquin Power Income Fund or APIF) – the Power Generation Infrastructure Group and the Utility Infrastructure Group. Based on the number of companies within each group relative to the total number of companies, the Utilities Infrastructure Group is allocated 26.98 percent or $1,062,190 USD of the central office cost pool. The Utilities Infrastructure Group cost pool is then allocated to each individual utility with the group based on the number of customers relative to the total number of customers for the group. For BMSC, the rate is 3.18 percent. The total central office costs included in BMSC's cost of service is $33,778 USD. This is approximately 0.086 percent (less than one tenth of one percent) of the adjusted total central office cost pool of $3,936,352.

Q. STAFF STATES THAT THE CENTRAL OFFICE COST POOL WAS $3.95 MILLION, BUT YOU ARE USING A FIGURE OF $4.25 MILLION IN YOUR CENTRAL OFFICE COST ALLOCATION SHOWN ON C-2, PAGE 16. PLEASE EXPLAIN.

A. The $3.95 million (Canadian dollars or CAD) was a budgeted cost for 2008 which Ms. Brown refers to on page 15 of her testimony. The Company provided the 2008 budget information in the Company Response to Staff data request MEM 4.1. During the course of this case, the Company provided to Staff invoices and other supporting documentation (Response to Staff Data Request JMM 9.1) totaling $4.235 million CAD - the actual incurred central office costs during the test year. It is the $4.235 million CAD that the Company is using as the starting basis for its rebuttal adjustment for allocated central office costs as shown on Rebuttal Schedule C-2, page 16.

Q. PLEASE COMMENT ON STAFF'S ADJUSTMENT FOR ALLOCATED CENTRAL OFFICE COSTS?

A. Staff is recommending an expense level of $1,452 based on an adjusted central office allocation pool of $113,224 and an allocation factor of 1.28 percent based on the number of companies in the APIF.[26] Staff's allocation method and analysis of the benefits to BMSC is flawed. Staff eliminates 97 percent of the central office cost allocation pool before allocating the remaining 3 percent to BMSC. However, APIF incurs the central office cost for the benefit of its subsidiary businesses. APIF provides management, audit, tax and legal resources for all of its subsidiary businesses that would otherwise be incurred if they were a stand-alone business. In other words, but for the subsidiary business, APIF would not have central office costs, nor would it need to provide these benefits to its subsidiaries, including BMSC, at a cost that reflects the economies of scale associated with this sort of shared service model.

[26] *See* Staff Schedule CSB-12.

For example, under the allocation method proposed by the Company, BMSC is allocated about $1,925 USD ($2,022 CAD divided by 1.05) for tax services (Federal and state income tax return preparation tax returns and tax advisory services). This is far below the comparable tax services fees which would be incurred by BMSC if it were to engage such services on a stand-alone basis. By way of comparison, for a company the size of BMSC, the tax services costs would be in the range of $5,000 to $10,000 annually. Under the APIF model, a savings of $3,000 to $8,000 annually is achieved for BMSC.

Q. WHAT DOES STAFF'S RECOMMENDATION PROVIDE FOR IN TERMS OF COST FOR TAX SERVICES?

A. $339.[27] This woefully understates the cost of such services. I couldn't go to H&R Block and have my personal tax returns prepared for that amount.

Q. ARE THERE OTHER EXAMPLES YOU CAN PROVIDE?

A. Yes. BMSC is allocated $7,688 USD ($8,072 CAD divided by 1.05) for audit services under the Company's allocation method. By way of comparison, an independent audit for a similarly sized company such as BMSC would be in the range of $20,000 to $30,000. Under the APIF model, a savings of $12,000 to $22,000 annually is achieved for BMSC.

Q. WHAT ARE THE BENEFITS OF AN AUDIT?

A. The benefits of an audit are numerous. Audits can improve a company's efficiency and profitability by helping the management to better understand their own working and financial systems. Audits insure the financial integrity of a company, and help to identify and investigate possible frauds or irregularities. Audits help an enterprise to develop effective and strong financial internal controls. Audits

[27] *See* Staff Schedule CSB-12, line 15, column K.

help recognize business strength and opportunities for improvement of efficiency and effectiveness in operations. Audits help to pinpoint deviations from management's standards and expectations, and verify compliance with laws and regulations. Auditors can gain a unique, broad perspective which they apply to deliver effective analyses and relevant information to the company. Management can then use this information to evaluate the company and implement measures necessary to meet their objectives. Ultimately, management, shareholders, suppliers and financers, and ratepayers are assured that the risks in the organization are well-studied, and effective systems are in place to handle them. Further, audits demonstrate to regulators that a company (in this instance, BMSC) has followed appropriate methods to record its affairs on its books, thus reducing the effort required by Staff and Intervenors to ensure that records are accurate.

Q. UNDER STAFF'S ALLOCATION, WHAT AMOUNT IS PROVIDED FOR AUDIT SERVICES?

A. $650.[28] This is less than four percent of the low end of the range of the cost of an audit engagement to BMSC and is unrealistic.

Q. WOULD THE COMPANY HAVE AN AUDIT PERFORMED IF IT WERE STAND ALONE?

A. If BMSC were able to afford audits I am sure it would. Clearly, audits provide a number of benefits to an organization. On the other hand, most small utilities do not have audits performed because they cannot afford the cost. In the instant case, BMSC is able to benefit by an audit because of the significant cost savings achieved by the APIF business model.

[28] *See* Staff Schedule CSB-12, line 14, column K.

Q. WHAT ARE OTHER EXAMPLES OF COSTS FOR SERVICES THAT ARE ALLOCATED TO BMSC THROUGH THE COMPANY PROPOSED ALLOCATION?

A. The Company is allocated a cost for Other Professional Services, Management Fees, Unit Holder Communications, and Trustee Fees. Professional Services primarily relate to maintenance on the APIF Enterprise Reporting System ("ERP"), payroll system, 401k services, and Health and Benefit services. BMSC benefits because it utilizes the ERP system for proper record keeping, and the payroll system to pay the operators and others who do work on BMSC's behalf. Under BMSC's proposed allocation method BMSC is allocated a cost of only $1,525 for these services.[29] Under Staff's proposal - $0 is allocated for ERP.[30]

I can go on. Management Fees include the costs for management services such as strategic advice and consultation concerning business planning, support, guidance, and policy making and general services. These expenses are critical to ensure the on-going health and sustainability of APIF, and thus, each of its subsidiaries, including BMSC. Under the Company's proposed allocation method, BMSC is allocated a cost of only $5,404 for these services.[31] Compare this to Staff's allocated cost of $0.[32]

Unit Holder Communication costs are incurred because APIF is a publicly traded entity on the Toronto Stock Exchange. APIF is obligated under securities law to report regularly on APIF'S financial condition to its unit holders. Communication costs are associated with the issuance of the quarterly and annual

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[29] *See* Rebuttal Schedule C-2, page 16, line 10.

[30] *See* Staff Schedule CSB-12, line 17.

[31] *See* Rebuttal Schedule C-2, page 16, line 11.

[32] *See* Staff Schedule CSB-12, line 18.

reporting, as well as the annual information form, the management discussion and analysis, and press releases. As a publicly traded entity these costs are essential in order for APIF to have access to the capital markets. BMSC benefits from this because it ensures that capital is available for its ongoing capital needs. Under the Company's proposed allocation method, BMSC is allocated a cost of only $1,686.[33] Staff's allocated cost is $0.[34]

Finally, Trustee Fees are incurred for the Board of Trustees who represent the Unit Holders. Ultimately, the Unit Holders are the investors in BMSC. The Board approves the strategic direction of APIF, approves financial statements, provides corporate governance, comprises part of the audit committee, and oversees the strategic direction and health of the APIF on behalf of all of its Unit Holders. Ratepayers ultimately benefit from good corporate governance. Under the Company's proposed allocation method, BMSC is allocated a cost of only $1,931.[35] Staff's allocated cost is $0.[36]

Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF THE OPERATING INCOME ADJUSTMENTS.

A. Rebuttal adjustment 16 reduces Contractual Services – Other by $6,284 and reflects a revision to the Company proposed direct filing adjustment 11 for known and measurable changes to allocated direct operations costs, accounting/billing costs and overhead costs. The Company originally proposed an adjustment for the increase in this expense in direct.[37]

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[33] *See* Rebuttal Schedule C-2, page 16, line 12.

[34] *See* Staff Schedule CSB-12, line 19.

[35] *See* Rebuttal Schedule C-2, page 16, line 13.

[36] *See* Staff Schedule CSB-12, line 20.

[37] Bourassa Dt. at 14.

Q. PLEASE COMMENT ON STAFF'S DISALLOWANCE OF THE INCREASES IN THE ALLOCATED DIRECT OPERATIONS, ACCOUNTING/BILLING AND OVERHEAD COSTS.

A. Staff rejects the Company's adjustment to the known and measurable increases to affiliate allocated accounting/billing and overhead expenses asserting that the increases were "not justified".[38] This does not tell us much about Staff's reasoning, but the information provided to Staff clearly shows that the direct operations costs, accounting and billing costs, and overhead costs proposed by the Company reflect known and measurable changes to the test year level of expenses related to payroll. The payroll expense changes include additional labor costs from annualization of salaries and wages to a full 12 months, additional labor costs from annualization of pay increases that occurred during the test year, and the cost of additional employees hired after the end of the test year for vacant positions during the test year. The annualization of salaries and wages is necessary because the test year included less than a full 12 months of wages for several employees. The pay increases are necessary because they reflect payroll costs of employees on a going forward basis. The additional employee costs include the wages for a Manager of Safety and Regulatory Matters, a Customer Service Representative, a Budget Analyst, and a Business and Strategic Planning Analyst. Arguably, these additional positions are necessary for the provision of safe and reliable service to rate payers.

Q. DID RUCO AGREE TO THE COMPANY'S DIRECT ADJUSTMENT FOR KNOWN AND MEASURABLE INCREASES TO ALLOCATED OPERATIONS, ACCOUNTING/BILLING, AND OVERHEAD COSTS.

[38] Brown Dt. at 18.

A. Yes, RUCO adopted the Company's proposed direct adjustment. RUCO has not had a chance to review the Company's rebuttal adjustment, but will have an opportunity to do so in its surrebuttal testimony.

Q. PLEASE CONTINUE.

A. Rebuttal adjustment 17 increases rate case expense by $50,000, or $16,667 annually. The proposed increase to rate case expense reflects the additional costs that have already been incurred negotiating the settlement agreement with the BHOA and the costs that have been and will be incurred in taking the steps necessary to support BMSC's request for relief. These costs were not considered in the initial estimate of rate case expense and, for now, $50,000 is a reasonable additional cost. This amount, like the total rate case expense, will be further revisited before rejoinder and the hearings in this docket. Of course, we hope that the various opportunities to minimize disputes set forth throughout BMSC's rebuttal filing are adopted, as these measures would go a long way to reducing the costs of the hearing and briefing.

Q. THANK YOU. PLEASE CONTINUE WITH YOUR DISCUSSION OF THE INCOME STATEMENT.

A. Rebuttal adjustment 18 reflects the synchronization of interest expense with the Company's proposed rate base.

Rebuttal adjustment 19 reflects income taxes at Company's proposed rates.

Q. DID STAFF AND RUCO COMPUTE INCOME TAXES ACCORDING TO THE METHOD APPROVED IN THE LAST CASE?

A. No. Neither Staff nor RUCO excluded the Scottsdale Lease operating expense from the determination of taxable income. In the last case, the Company proposed a gross-up for income taxes on the Scottsdale capacity operating lease expense and

proposed to include it in operating expenses.[39] Staff's proposed alternative was to exclude the Scottsdale capacity operating lease expense from operating expenses in the determination of taxable income, thereby providing higher income tax expense. The Commission adopted this method.[40] As a result of the failure to follow the method approved in the last case, Staff and RUCO have understated income tax expense.

Q. PLEASE COMMENT ON STAFF'S ADJUSTMENT TO REDUCE TRANSPORTATION EXPENSE.

A. The Company disagrees with Staff's adjustment to remove $5,375 of transportation expense related to a truck lease.[41] Staff believes the truck is shared between an affiliate, Gold Canyon Sewer Company, and BMSC. However, this truck is used exclusively by BMSC and Staff's adjustment is inappropriate.[42] This is discussed in more depth in Mr. Sorensen's Rebuttal Testimony.[43]

Q. PLEASE COMMENT ON STAFF'S RECOMMENDATION TO DISALLOW BMSC'S PROPOSED PURCHASED WASTEWATER TREATMENT ADJUSTMENT MECHANISM.

A. Staff has recommended that the Commission not approve BMSC's request for a Purchased Wastewater Adjustment Mechanism ("PWWAM").[44] The purpose of the adjusters like the PWWAM is to allow the Company's rates to reflect changes in certain operating expenses that fluctuate unpredictably outside of the Company's control, thereby more accurately reflecting the current cost of service and allowing

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[39] Decision No. 69164 at 9.

[40] *Id.* at 9.

[41] Brown Dt. at 22.

[42] Sorensen Rb. at 14-15.

[43] Sorensen Rb. at 14-15.

[44] Brown Dt. at 26.

the Company a more realistic opportunity to achieve its authorized rate of return. These mechanisms are well-established ratemaking tools that work to keep the utility's revenue stable without the need for numerous costly and time-consuming rate case proceedings.

Staff does not believe that the $20,000 which BMSC estimated as an annual increase is significant enough to warrant an adjuster.[45] But consider that purchased wastewater treatment expense is one of the largest operating expenses of the Company (about 20 percent of operating expenses), and an increase of $20,000 annually represents over 5 percent of the Company net earnings. Further, assuming the Company files a rate case every three years, the unrecovered expense amounts to an estimated $60,000 or more. Given the significance of this expense and the fact that the City of Scottsdale has historically increased the wastewater treatment rate annually, the Company will immediately suffer earnings attrition when new rates are put into effect in the instant case unless the PWWAM is approved.

V. RATE DESIGN

Q. WHAT ARE THE PROPOSED RATES?

A. The proposed rates are:

Residential Charge:	$72.45
Commercial – Std. Rate (Per gallon)[46]:	$0.29048
Commercial – Special Rate (Per gallon)[47]:	
B-H Enterprises (7518 Elbow Bend West)	N/A

[45] Brown Dt. at 26.

[46] Per prior Commission order, commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin No. 12, Table 1, published by the Arizona Department of Environmental Quality (June 1989).

[47] Per prior Commission order, wastewater flows are based on Engineering Bulletin No. 12, Table 1. A one-bedroom dwelling is assumed to generate 200 gallons per day, each additional bedroom is assumed to generate an additional 100 gallons per day.

B-H Enterprises (7518 Elbow Bend East)	N/A
Barb's Pet Grooming	N/A
Boulders Resort	$0.29048
Carefree Dental	N/A
Ridgecrest Realty	N/A
Desert Forest	$0.29048
Desert Hills Pharmacy	N/A
El Pedegral	$0.29048
Lemon Tree	N/A
Body Shop	N/A
Spanish Village	$0.29048
Boulders Club	$0.29048
Anthony Vuitaggio	N/A

In addition, the proposed charge for reclaimed (non-potable) water is $150 per acre-foot.

Q. PLEASE COMMENT ON THE PROPOSED RATE DESIGNS OF STAFF AND RUCO.

A. Staff and RUCO recommend the same rate designs for residential and commercial customers – a flat rate for residential customers and a per gallon rate for commercial customers. In addition, all parties apply their respective increases evenly across all classes of customers.[48] Both BMSC and RUCO propose to charge the existing special rate commercial customers the same rate as standard commercial customers, while Staff continues to propose different rates for the special rate commercial customers. Staff's direct filing does not explain why it maintains separate rates for special rate customers. The Company continues to

[48] Moore Dt. at 17, Brown Dt. at 28.

believe that a special rate is no longer justified for the reasons articulated in the direct filing.[49]

Q. WHAT ABOUT EFFLUENT RATES?

A. Both BMSC and RUCO propose an effluent rate of $150.00 per acre foot or $0.46051 per 1,000 gallons. Staff proposes an effluent rate of $159.84 per acre foot or $0.490538 per 1,000 gallons. Staff increases the effluent rate by over 30 percent, which is in conflict with the effluent delivery agreement with the Boulder's Resort, which limits any increase to no more than 25 percent in a given year.[50] The Company's believes Staff's increase to the effluent rate would jeopardize the Company's ability to dispose of effluent causing it to choose more costly alternatives as long as it continues to produce effluent.

Q. PLEASE COMMENT ON THE COMPANY'S PROPOSED HOOK-UP FEE AND THE POSITIONS TAKEN BY STAFF AND/OR RUCO AT THIS STAGE OF THE PROCEEDING?

A. BMSC continues to propose its HUF tariff, and Mr. Sorensen states in his rebuttal that the Company understands that Staff now supports this tariff as proposed.[51]

Q. HAVE YOU ALSO REVIEWED DR. DOELLE'S TESTIMONY AND REQUEST FOR A "MORE RATIONALE RATE DESIGN"?

A. Yes, and I really hope not to have to engage in a "battle of experts" with Dr. Doelle given that Mr. Sorensen has addressed in his rebuttal testimony the Company's response to Dr. Doelle.[52]

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[49] Bourassa Dt. at 17.

[50] Bourassa Dt. at 8.

[51] Sorensen Dt. at 13.

[52] Sorensen Rb. at 4-6.

Q. MR. PETERSON, ON BEHALF OF THE BHOA, TESTIFIES THAT THE COMPANY WILL ADDRESS THE RATEMAKING RELATED TO THE SETTLEMENT AGREEMENT. CAN YOU DO THAT PLEASE?

A. I think what Mr. Peterson refers to is the proposed ratemaking mechanism for BMSC to recover a return on and of its investment. I would envision a surcharge, not unlike the arsenic recovery mechanisms the Commission has approved, but the name is not so important. The point is that a surcharge can be designed to accomplish the "rate relief" goals of the settlement agreement.

Q. WHAT ARE THOSE GOALS, MR. BOURASSA?

A. The specific language of the agreement as it relates to necessary rate relief is set forth in Mr. Sorensen's rebuttal testimony, along with the Company's general response to the BHOA's filing.[53] Again, it is not all that difficult to calculate a surcharge that would allow the Company to begin recovering a return on and of its investment in the plant closure at the time the project is complete, the cost is known and measurable. After a reasonable period for verification by Staff, such a surcharge would essentially be added to the existing rates, and then, in the next rate case, it would be rolled into the revenue requirement.

Q. ARE YOU PROPOSING A SPECIFIC SURCHARGE OR SURCHARGE MECHANISM AT THIS TIME?

A. No, nor do I think we need to. For one thing, once Staff and RUCO's rate analysts have a chance to respond to the BHOA's filing, more light might be shed on the best sort of mechanism to utilize, and I can address this issue further in rejoinder and at the hearings if appropriate.

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[53] Sorensen Rb. at 7.

Q. BUT DOESN'T THE COMMISSION NEED TO KNOW THE RATE IMPACT IN ORDER TO APPROVE THE RELIEF BHOA WANTS?

A. No, no more so than it did when approving the ACRMs or other similar relief that has been afforded electric utilities in extraordinary circumstances. We can't know the rate impact precisely until we know the final costs to close the plant as contemplated in the parties' agreement. But, with the current estimated cost of at least $1.5 million, I can estimate a rate increase of approximately $15 per customer per month through a surcharge mechanism. This includes the original cost of $1.5 million multiplied by the weighted cost of capital of 12.4 percent grossed up for income taxes using a factor of 1.6286 plus depreciation expense of $75,000 on the added plant divided by the test-year end of 2,100 divided by 12.

Q. WHAT ABOUT CHANGES IN OPERATING EXPENSES?

A. With the exception of the increases in the monthly cost for wastewater treatment by Scottsdale, which increase is covered by the Company's proposed PWWAM, changes in operating expenses are unlikely to be known and measurable at the time a surcharge goes into effect, and therefore they would not be appropriate for recovery in this manner.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

BOURASSA
RATE BASE, INCOME STATEMENT
& RATE DESIGN SCHEDULES

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
Rebuttal Schedule A-1
Page 1
Witness: Bourassa

Line No.			
1	Fair Value Rate Base	$	3,716,649
2			
3	Adjusted Operating Income		(129,420)
4			
5	Current Rate of Return		-3.48%
6			
7	Required Operating Income	$	460,864
8			
9	Required Rate of Return on Fair Value Rate Base		12.40%
10			
11	Operating Income Deficiency	$	590,285
12			
13	Gross Revenue Conversion Factor		1.6286
14			
15	Increase in Gross Revenue Revenue Requirement	$	961,338
16			
17	Test Year Revenues	$	1,580,170
18	Increase in Gross Revenue Revenue Requirement	$	961,338
19	Proposed Revenue Requirement	$	2,541,508
20	% Increase		60.84%
21			

22	Customer	Present	Proposed	Dollar	Percent
23	**Classification**	**Rates**	**Rates**	**Increase**	**Increase**
24					
25					
26	Residential	$ 1,077,880	$ 1,711,052	$ 633,172	58.74%
27	Commercial (Standard Rate)	378,678	601,150	222,472	58.75%
28	Commercial (Special Rate)	98,964	199,445	100,481	101.53%
29	Effluent Sales	15,917	19,578	3,661	23.00%
30					
31	Annualization	2,145	3,405	1,260	58.74%
32				-	0.00%
33	**Subtotal**	$ 1,573,584	$ 2,534,629	$ 961,045	61.07%
34					
35	Other Wastewater Revenues	6,915	6,915	-	0.00%
36	Reconciling Amount H-1 to C-1	(329)	(36)	293	-89.06%
37					
38	**Total of Water Revenues**	$ 1,580,499	$ 2,541,544	$ 961,338	60.82%
39					

40
41
42 SUPPORTING SCHEDULES:
43 Rebuttal B-1
44 Rebuttal C-1
45 Rebuttal C-3
46 Rebuttal H-1
47
48

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Rate Base

Exhibit
Rebuttal Schedule B-1
Page 1
Witness: Bourassa

Line No.		Original Cost Rate base	Fair Value Rate Base
1			
2	Gross Utility Plant in Service	$ 11,646,544	$ 11,646,544
3	Less: Accumulated Depreciation	5,722,666	5,722,666
4			
5	Net Utility Plant in Service	$ 5,923,878	$ 5,923,878
6			
7	Less:		
8	Advances in Aid of		
9	Construction	1,711,260	1,711,260
10	Contributions in Aid of		
11	Construction	5,232,139	5,232,139
12	Accumulated Amortization of CIAC	(4,214,384)	(4,214,384)
13			
14	Customer Meter Deposits	94,290	94,290
15	Deferred Income Taxes & Credits	(194,898)	(194,898)
16		-	-
17			
18			
19	Plus:		
20	Unamortized Finance		
21	Charges	-	-
22	Deferred Regulatory Assets	389,035	389,035
23	Allowance for Working Capital	32,142	32,142
24			
25			
26	Total Rate Base	$ 3,716,649	$ 3,716,649
27			
28			
29			
30	SUPPORTING SCHEDULES:		RECAP SCHEDULES:
31	Rebuttal B-2		A-1
32			
33			
34			
35			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Rebuttal Schedule B-2
Page 1
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments Amount	Adjusted at end of Test Year
1	Gross Utility			
2	Plant in Service	$ 11,357,735	288,809	$ 11,646,544
3				
4	**Less:**			
5	Accumulated			
6	Depreciation	5,625,025	97,641	5,722,666
7				
8				
9	Net Utility Plant			
10	in Service	$ 5,732,710		$ 5,923,878
11				
12	**Less:**			
13	Advances in Aid of			
14	Construction	$ 1,457,009	254,251	$ 1,711,260
15				
16	Contributions in Aid of			
17	Construction (CIAC)	5,232,139	-	5,232,139
18				
19	Accumulated Amortization of CIAC	(4,214,384)	-	(4,214,384)
20				
21	Customer Meter Deposits	94,290	-	94,290
22	Deferred Income Taxes	(170,554)	(24,344)	(194,898)
23				
24				
25	**Plus:**			
26	Unamortized Finance			
27	Charges	-	-	-
28	Deferred Regulatory Assets	389,035	-	389,035
29	Allowance for Working Capital	-	32,142	32,142
30				
31	Total	$ 3,723,245		$ 3,716,649
32				
33				
34				
35	SUPPORTING SCHEDULES:			RECAP SCHEDULES:
36	Rebuttal B-2, pages 1-6			Rebuttal B-1
37				
38				
39				
40				
41				
42				
43				
44				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Rebuttal Schedule B-2
Page 2
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments 1 Plant in Service	2 Accum. Depr.	3 AIAC	4 Deferred Income Taxes	5 Working Capital	Rebuttal Adjusted at end of Test Year
1	Gross Utility							
2	Plant in Service	$ 11,357,735	288,809					$ 11,646,544
3								
4	**Less:**							
5	Accumulated							
6	Depreciation	5,625,025		97,641				5,722,666
7								
8								
9	Net Utility Plant							
10	in Service	$ 5,732,710	$ 288,809	$ (97,641)		$ -	$ -	$ 5,923,878
11								
12	**Less:**							
13	Advances in Aid of							
14	Construction	1,457,009			254,251			1,711,260
15								
16	Contributions in Aid of							
17	Construction (CIAC)	5,232,139						5,232,139
18								
19	Accumulated Amort of CIAC	(4,214,384)						(4,214,384)
20								
21	Customer Meter Deposits	94,290						94,290
22	Deferred Income Taxes	(170,554)				(24,344)		(194,898)
23								
24								
25	**Plus:**							
26	Unamortized Finance							
27	Charges	-						-
28	Deferred Reg. Assets	389,035						389,035
29	Allowance for Working Capital	-					$ 32,142	32,142
30								
31	Total	$ 3,723,245	$ 288,809	$ (97,641)	$ (254,251)	$ 24,344	$ 32,142	$ 3,716,649
32								
33								
34								
35	SUPPORTING SCHEDULES:						RECAP SCHEDULES:	
36	Rebuttal B-2, pages 3-6						Rebuttal B-1	
37	Rebuttal B-5							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 1

Exhibit
Schedule B-2
Page 3
Witness: Bourassa

Line No.	Acct. No.	Description	Adjusted Orginal Cost	A Unrecorded Plant Addition	B Unrecorded Plant Retirement	C Capitalized Expenses	D Odor Control Unit	E	F	Rebuttal Adjusted Original Cost
1		Plant-in-Service								
5	351	Organization	-							-
6	352	Franchises	-							-
7	353	Land and Land Rights	461,300							461,300
8	354	Structures and Improvements	2,557,920			2,300				2,560,220
9	355	Power Generation Equipment	-							-
10	360	Collection Sewers - Force	706,292			1,600				707,892
11	361	Collection Sewers - Gravity	4,284,948							4,284,948
12	362	Special Collecting Structures	-							-
13	363	Services to Customers	198,723							198,723
14	364	Flow Measuring Devices	31,512							31,512
15	365	Flow Measuring Installations	179,622							179,622
16	370	Receiving Wells	690,628	254,251	(13,208)	1,200				932,871
17	371	Effluent Pumping Equipment	654,844			2,803				657,647
18	380	Treatment and Disposal Equip.	143,578				38,625			182,203
19	381	Plant Sewers	123,289			1,238				124,527
20	382	Outfall Sewer Lines	-							-
21	389	Other Plant and Misc. Equipment	939,432							939,432
22	390	Office Furniture and Equipment	224,587							224,587
23	391	Transportation Equipment	107,367							107,367
24	393	Tools, Shop and Garage Equip.	5,754							5,754
25	394	Laboratory Equipment	7,488							7,488
26	395	Power Operated Equipment	-							-
27	396	Communication Equipment	40,451							40,451
28	398	Other Tangible Plant	-							-
29			-							-
30		TOTALS	$ 11,357,735	$ 254,251	$ (13,208)	$ 9,141	$ 38,625	$ -	$ -	$ 11,646,544
31										
32		Adjusted Plant-in-Service per Direct								$ 11,357,735
33										
34		Increase (decrease) in Plant-in-Service								$ 288,809
35										
36		Adjustment to Plant-in-Service								$ 288,809
37										
38		SUPPORTING SCHEDULES								
39		Rebuttal B-2, pages 3.1-3.4								
40										
41										
42										

ADJUSTMENTS
Adj. A - Staff Adj. #1 New Trade Center Lift Sta.
Adj. B - Staff Adj. #1 Old Trade Center Lift Sta.
Adj. C - Staff Adj. #2 Capitalized Expenses
Adj. D - Ordor Control Unit RUCO - see Schedule RLM-4

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rebuttal Schedule B-2
Page 3.1

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Per Decision 69164 Plant At 12/31/2004	2004 Accum. Depr.	2005 Plant Additions	2005 Plant Adjustments[1]	2005 Adjusted Plant Additions	2005 Plant Retirements	2005 Plant Balance	2005 Deprec.
351	Organization	0.0000%	0.00%	-	-			-		-	-
352	Franchises	0.0000%	0.00%	-	-			-		-	-
353	Land and Land Rights	0.0000%	0.00%	461,300	-			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,239,905	888,015	56,562	(1,917)	54,645		1,294,549	63,361
355	Power Generation Equipment	5.0000%	5.00%	-	706			-		-	(706)
360	Collection Sewers - Force	5.0000%	2.00%	568,413	154,483	94,624	(5,062)	89,562		657,976	30,660
361	Collection Sewers - Gravity	5.0000%	2.00%	3,614,544	2,488,740	297,571	(21,880)	275,691		3,890,235	187,619
362	Special Collecting Structures	5.0000%	2.00%	-	-			-		-	-
363	Services to Customers	5.0000%	2.00%	157,218	128,612	19,337		19,337		176,555	8,344
364	Flow Measuring Devices	5.0000%	10.00%	39,829	23,004		(8,135)	(8,135)		31,694	1,788
365	Flow Measuring Installations	5.0000%	10.00%	156,204	3,959	19,404		19,404		175,608	8,295
370	Receiving Wells	5.0000%	3.33%	696,137	199,051			-		696,137	34,807
371	Effluent Pumping Equipment	5.0000%	12.50%	453,558	244,706	11,119		11,119		464,677	22,956
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	-	6,288		6,288		6,288	157
381	Plant Sewers	5.0000%	5.00%	123,289	84,017			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%	-	-			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	719,140	80,678	99,447	(7,527)	91,920		811,059	38,255
390	Office Furniture and Equipment	5.0000%	6.67%	220,360	27,165	1,465		1,465		221,825	11,055
391	Transportation Equipment	5.0000%	20.00%	87,811	7,642			-		87,811	4,391
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-			-		-	-
394	Laboratory Equipment	5.0000%	10.00%	7,279	352	209		209		7,488	369
395	Power Operated Equipment	5.0000%	5.00%	-	-			-		-	-
396	Communication Equipment	5.0000%	10.00%	-	-			-		-	-
398	Other TangiblePlant	5.0000%	10.00%	-	-			-		-	-
								-		-	-
	Plant Held for Future Use										
	TOTAL WATER PLANT			8,544,987	4,331,129	606,025	(44,521)	561,504	-	9,106,490	417,516

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rebuttal Schedule B-2
Page 3.2

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	2006 Plant Additions	2006 Plant Adjustments[1]	2006 Adjusted Plant Additions	2006 Plant Retirements	2006 Plant Balance	2006 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	3,625		3,625		1,298,175	63,014
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	3,592		3,592		661,568	31,339
361	Collection Sewers - Gravity	5.0000%	2.00%	112,559	(22,710)	89,849		3,980,083	186,920
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%	10,429		10,429		186,983	8,634
364	Flow Measuring Devices	5.0000%	10.00%		(182)	(182)		31,512	1,712
365	Flow Measuring Installations	5.0000%	10.00%	3,740		3,740		179,348	9,613
370	Receiving Wells	5.0000%	3.33%	2,141		2,141		698,278	33,890
371	Effluent Pumping Equipment	5.0000%	12.50%	44,676		44,676		509,353	27,395
380	Treatment and Disposal Equipment	5.0000%	5.00%	12,184		12,184		18,472	619
381	Plant Sewers	5.0000%	5.00%			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	53,055	(740)	52,315		863,374	43,026
390	Office Furniture and Equipment	5.0000%	6.67%			-		221,825	11,400
391	Transportation Equipment	5.0000%	20.00%			-		87,811	5,488
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%			-		-	-
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	406
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%			-		-	-
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
	Plant Held for Future Use					-		-	-
	TOTAL WATER PLANT			246,000	(23,632)	222,368	-	9,328,859	429,620

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rebuttal Schedule B-2
Page 3.3

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	2007 Plant Additions	2007 Plant Adjustments[1]	2007 Adjusted Plant Additions	2007 Plant Retirements	2007 Plant Balance	2007 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,539	(20,391)	(18,852)		1,279,322	42,915
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	34,935	(2,469)	32,466		694,034	13,556
361	Collection Sewers - Gravity	5.0000%	2.00%	211,268	(32,273)	178,995		4,159,078	81,392
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%			-		186,983	3,740
364	Flow Measuring Devices	5.0000%	10.00%			-		31,512	3,151
365	Flow Measuring Installations	5.0000%	10.00%			-		179,348	17,935
370	Receiving Wells	5.0000%	3.33%			-		698,278	23,253
371	Effluent Pumping Equipment	5.0000%	12.50%	74,764	(5,336)	69,428		578,780	68,008
380	Treatment and Disposal Equipment	5.0000%	5.00%	4,387		4,387		22,859	1,033
381	Plant Sewers	5.0000%	5.00%			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	784	(942)	(158)		863,216	57,582
390	Office Furniture and Equipment	5.0000%	6.67%	2,763		2,763		224,587	14,888
391	Transportation Equipment	5.0000%	20.00%	19,556		19,556		107,367	19,518
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	3,493		3,493		3,493	87
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	749
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%			-		-	-
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
						-		-	
	Plant Held for Future Use								
	TOTAL WATER PLANT			353,488	(61,411)	292,077	-	9,620,936	353,971

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rebuttal Schedule B-2
Page 3.4

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Jun.-Jun. 2008 Plant Additions	Jun.-Jun. 2008 Plant Adjustments[1]	Staff Jun.-Jun. 2008 Plant Adjustments	Jun.-Jun. 2008 Adjusted Plant Additions	Jun.-Jun. 2008 Plant Retirements	Staff Jun.-Jun. 2008 Plant Retirements	2002 to Dec. 2007 A/D Adjustment	June 30 2008 Plant Balance	Jun.-Jun. 2008 Deprec.
351	Organization	0.0000%	0.00%				-				-	-
352	Franchises	0.0000%	0.00%				-				-	-
353	Land and Land Rights	0.0000%	0.00%				-				461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,290,255	(11,658)	2,300	1,280,897				2,560,220	31,964
355	Power Generation Equipment	5.0000%	5.00%				-				-	-
360	Collection Sewers - Force	5.0000%	2.00%	12,595	(337)	1,600	13,858				707,892	7,010
361	Collection Sewers - Gravity	5.0000%	2.00%	130,250	(4,380)		125,870				4,284,948	42,220
362	Special Collecting Structures	5.0000%	2.00%				-				-	-
363	Services to Customers	5.0000%	2.00%	11,739			11,739				198,723	1,929
364	Flow Measuring Devices	5.0000%	10.00%				-				31,512	1,576
365	Flow Measuring Installations	5.0000%	10.00%	430	(156)		274				179,622	8,974
370	Receiving Wells	5.0000%	3.33%	544	(311)	255,451	255,684	(7,883)	(13,208)		946,079	13,579
371	Effluent Pumping Equipment	5.0000%	12.50%	78,862	(2,798)	2,803	78,867				657,647	38,638
380	Treatment and Disposal Equipment	5.0000%	5.00%	129,937	(9,218)	38,625	159,344			10,183	182,203	2,563
381	Plant Sewers	5.0000%	5.00%			1,238	1,238				124,527	3,098
382	Outfall Sewer Lines	5.0000%	3.33%				-				-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	79,092	(2,876)		76,216				939,432	30,059
390	Office Furniture and Equipment	5.0000%	6.67%				-				224,587	7,490
391	Transportation Equipment	5.0000%	20.00%				-				107,367	10,737
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	2,262			2,262				5,754	116
394	Laboratory Equipment	5.0000%	10.00%				-				7,488	374
395	Power Operated Equipment	5.0000%	5.00%				-				-	-
396	Communication Equipment	5.0000%	10.00%	40,451			40,451				40,451	1,011
398	Other TangiblePlant	5.0000%	10.00%				-				-	-
							-				-	-
	Plant Held for Future Use											
	TOTAL WATER PLANT			1,776,417	(31,734)	302,017	2,046,700	(7,883)	(13,208)	10,183	11,659,752	201,338

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rebuttal Schedule B-2
Page 3.5

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Year End Accumulated Depreciation by Account 2004	2005	2006	2007	2008
351	Organization	0.0000%	0.00%	-	-	-	-	-
352	Franchises	0.0000%	0.00%	-	-	-	-	-
353	Land and Land Rights	0.0000%	0.00%	-	-	-	-	-
354	Structures and Improvements	5.0000%	3.33%	888,015	951,376	1,014,390	1,057,305	1,089,269
355	Power Generation Equipment	5.0000%	5.00%	706	-	-	-	-
360	Collection Sewers - Force	5.0000%	2.00%	154,483	185,143	216,482	230,038	237,047
361	Collection Sewers - Gravity	5.0000%	2.00%	2,488,740	2,676,359	2,863,279	2,944,671	2,986,891
362	Special Collecting Structures	5.0000%	2.00%	-	-	-	-	-
363	Services to Customers	5.0000%	2.00%	128,612	136,957	145,591	149,330	151,259
364	Flow Measuring Devices	5.0000%	10.00%	23,004	24,792	26,504	29,655	31,230
365	Flow Measuring Installations	5.0000%	10.00%	3,959	12,254	21,868	39,802	48,777
370	Receiving Wells	5.0000%	3.33%	199,051	233,858	267,748	291,001	283,489
371	Effluent Pumping Equipment	5.0000%	12.50%	244,706	267,662	295,057	363,065	401,703
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	157	776	1,810	14,556
381	Plant Sewers	5.0000%	5.00%	84,017	90,181	96,346	102,510	105,608
382	Outfall Sewer Lines	5.0000%	3.33%	-	-	-	-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	80,678	118,933	161,959	219,541	249,600
390	Office Furniture and Equipment	5.0000%	6.67%	27,165	38,219	49,619	64,507	71,997
391	Transportation Equipment	5.0000%	20.00%	7,642	12,032	17,521	37,038	47,775
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-	-	87	203
394	Laboratory Equipment	5.0000%	10.00%	352	721	1,126	1,875	2,250
395	Power Operated Equipment	5.0000%	5.00%	-	-	-	-	-
396	Communication Equipment	5.0000%	10.00%	-	-	-	-	1,011
398	Other TangiblePlant	5.0000%	10.00%	-	-	-	-	-
				-	-	-	-	-
	Plant Held for Future Use			-				
	TOTAL WATER PLANT			4,331,129	4,748,645	5,178,265	5,532,236	5,722,666

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 2

Exhibit
Schedule B-2
Page 4
Witness: Bourassa

Line No.				A	B	C	D	B	
1	Plant-in-Service								
2			Adjusted	Unrecorded		Ordor	Ordor	Difference	Rebuttal
3	Acct.		Accum.	Plant	Plant	Control	Control	To	Adjusted
4	No.	Description	Depr.	Addition	Retirement	Unit	Unit	Computed Amount	Accum. Depr.
5	351	Organization	-					-	-
6	352	Franchises	-					-	-
7	353	Land and Land Rights	-					-	-
8	354	Structures and Improvements	1,067,642			38		21,590	1,089,269
9	355	Power Generation Equipment	-					-	-
10	360	Collection Sewers - Force	217,363			16		19,669	237,047
11	361	Collection Sewers - Gravity	2,869,293					117,598	2,986,891
12	362	*Special Collecting Structures*	-					-	-
13	363	Services to Customers	145,843					5,416	151,259
14	364	Flow Measuring Devices	32,828					(1,597)	31,230
15	365	Flow Measuring Installations	57,602					(8,826)	48,777
16	370	Receiving Wells	283,038	4,233	(13,208)	20		9,405	283,489
17	371	Effluent Pumping Equipment	437,968			175		(36,439)	401,703
18	380	Treatment and Disposal Equipment	3,890				10,183	483	14,556
19	381	Plant Sewers	105,592			31		(15)	105,608
20	382	Outfall Sewer Lines	-					-	-
21	389	Other Plant and Misc. Equipment	263,481					(13,881)	249,600
22	390	Office Furniture and Equipment	75,700					(3,703)	71,997
23	391	Transportation Equipment	60,947					(13,172)	47,775
24	393	Tools, Shop and Garage Equipment.	203					-	203
25	394	Laboratory Equipment	2,624					(374)	2,250
26	395	*Power Operated Equipment*	-					-	-
27	396	Communication Equipment	1,011					-	1,011
28	398	Other TangiblePlant	-					-	-
29			-						-
30		TOTALS	$ 5,625,025	$ 4,233	$ (13,208)	$ 280	$ 10,183	$ 96,152	$ 5,722,666
31									
32	Adjusted Accumulated Depreciation per Direct								$ 5,625,025
33									
34	Increase (decrease) in Plant-in-Service								$ 97,641
35									
36	Adjustment to Plant-in-Service								$ 97,641
37									
38	SUPPORTING SCHEDULES								
39	Rebuttal B-2, pages 3.5								
40									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 3

Exhibit
Rebuttal Schedule B-2
Page 5
Witness: Bourassa

Line No.

1
2 Advances in aid of construction

	Test Year Adjusted Balance	Adjustment	Rebuttal Test Year Adjusted Balance
8	$ 1,457,009	254,251 [1]	$ 1,711,260

16 [1] Line Extension Agreement for New Trade Lift Station

20 SUPPORTING SCHEDULE
21 See Testimony

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment 5

Exhibit
Rebuttal Schedule B-2
Page 6
Witness: Bourassa

Deferred Income Tax as of June 30, 2008

Line No.		Adjusted Book Value[1]	Tax Value	Probability of Realization of Future Tax Benefit	Deductible TD (Taxable TD) Expected to be Realized	Tax Rate	Future Tax Asset Current	Future Tax Asset Non Current	Future Tax Liability Current	Future Tax Liability Non Current
6	Plant-in-Service	$ 11,646,544								
7	Accum. Deprec.	(5,722,666)								
8	CIAC	(1,017,755)								
9	Fixed Assets	$ 4,906,123	$ 3,699,796	100.0%	$ (1,206,327)	38.6%				$ (465,629)
10	AIAC	$ (1,711,260)	-	100.0%	$ 1,711,260	38.6%		$ 660,527		
12							$ -	$ 660,527	$ -	$ (465,629)

14	Net Asset (Liability)	$ 194,898
16	DIT Asset per Direct	$ 170,554
18	Adjustment to DIT	$ (24,344)

[1] Adjusted per Rebuttal B-2

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Working Capital

Exhibit
Schedule B-5
Page 1
Witness: Bourassa

Line No.			
1			
2	Cash Working Capital - Lead-Lag Study	$	14,816
3	Prepayments		17,326
4	Materials & Supplies		-
5			
6			
7			
8			
9	Total Working Capital Allowance	$	32,142
10			
11			
12	Working Capital Requested	$	32,142
13			
14			
15	SUPPORTING SCHEDULES:	RECAP SCHEDULES:	
16	Rebuttal B-5, page 2	Rebuttal B-1	
17			

Black Mountain Sewer Corporation
Lead/Lag Study
Cash Working Capital

Exhibit
Rebuttal Schedule B-5
Page 2
Witness: Bourassa

Line No.	Description (A)	A Proforma TY Expense (B)	B Revenue Lag Days[1] (C)	C Expense Lag Days (D)	D Net Lag Days (E)	E Lead/Lag Factor (Col. E/365) (F)	F Cash Working Capital Required (Col. B x Col. F) (G)
10	Salaries and Wages						
11	Net Pay	-	NA	NA	NA	NA	-
12	Income Taxes Withheld	-	NA	NA	NA	NA	-
13	Payroll taxes Withheld	-	NA	NA	NA	NA	-
15	Pensions and Benefits	-	NA	NA	NA	NA	-
17	Purchased Power[2]	54,690	11.40	39.79	(28.39)	-0.07778	(4,254)
19	Purchased Wastewater Treatment[3]	338,381	11.40	38.01	(26.61)	-0.07290	(24,668)
21	Rents- Building[4]	38,262	11.40	(15.00)	26.40	0.07233	2,767
23	Scottsdale Capacity Lease[5]	164,522	11.40	(15.00)	26.40	0.07233	11,900
25	Contractual Services - Allocated Expense[6]	514,028	11.40	15.00	(3.60)	-0.00986	(5,068)
27	Regulatory Commission Expense[7]	76,667	11.40	(360.00)	371.40	1.01753	78,011
29	Insurance[8]	18,704	11.40	(270.00)	281.40	0.77096	14,420
31	Other Operating Expenses[9]	201,953	11.40	45.00	(33.60)	-0.09205	(18,590)
33	Taxes						
34	Employer's Payroll Taxes	-	NA	NA	NA	NA	-
35	Property Taxes[10]	32,700	11.40	182.00	(170.60)	-0.46740	(15,284)
36	Income Taxes[11]	348,134	11.40	37.00	(25.60)	-0.07014	(24,418)
38	Total Cash Working Capital						$ 14,816

[1] Revenue lag days equals -15 day service lag plus 4.65 day billing lag plus 21.75 day average customer payment lag.
[2] Power bill expense lag days equals 15 days to mid-point of service period plus 24.79 days from billing date to the paid date.
[3] Wastewater treatment expense lag days equals 15 days to mid-point of service period plus 23.01 days from billing date to the due date.
[4] Rents - building payment due 1st of month of serivce period. Expense lag days equals -15 days to mid point of service period.
[5] Scottsdale lease (debt) payment due 1st of month following service period. Expense lag days equals 15 days to mid point of service period.
[6] Contractual Services allocation lag days equals 15 days to mid-point of service period.
[7] Rate case expense lag days is paid before new rates are put into effect. Weighted average expense lag days is -360 days
[8] Insurance is paid once annually. Expense lag days equals weighted average expense lag days is -270 days.
[9] Other operating expenses (excludes depreciation, amortization, purchased power, ww treatment, Scottsdale capcity lease, property taxes, rent - buliding, insurance, allocated contractual services, and income taxes. Lag days equals 15 days to mid-point of service period plus average 30 days to due date of bill.
[10] Property tax expense lag days equals the weighted average lag days for payment of property taxes due on Oct 1 of current year and May 1 of following year.

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Schedule C-1
Page 1
Witness: Bourassa

Line No.		Test Year Book Results	Adjustment	Test Year Adjusted Results	Proposed Rate Increase	Adjusted with Rate Increase
1	**Revenues**					
2	Flat Rate Revenues	$ 1,557,337	$ -	$ 1,557,337	$ 961,338	$ 2,518,675
3	Measured Revenues	15,917	-	15,917	-	15,917
4	Other Wastewater Revenues	6,916	-	6,916	-	6,916
5		$ 1,580,170	$ -	$ 1,580,170	$ 961,338	$ 2,541,508
6	**Operating Expenses**					
7	Salaries and Wages	$ -	-	$ -	-	$ -
8	Purchased Wastewater Treatment	335,255	3,126	338,381	-	338,381
9	Sludge Removal Expense	706	-	706	-	706
10	Purchased Power	54,690	-	54,690	-	54,690
11	Fuel for Power Production	928	-	928	-	928
12	Chemicals	37,489	3,324	40,813	-	40,813
13	Materials and Supplies	11,224	-	11,224	-	11,224
14	Contractual Services	9,362	37,354	46,716	-	46,716
15	Contractual Services- Testing	16,955	12,094	29,049	-	29,049
16	Contractual Services - Other	553,043	(39,015)	514,028	-	514,028
17	Equipment Rental	1,863	-	1,863	-	1,863
18	Rents - Building	19,830	18,432	38,262	-	38,262
19	Transportation Expenses	34,445	-	34,445	-	34,445
20	Insurance - General Liability	18,704	-	18,704	-	18,704
21	Insurance - Other	990	-	990	-	990
22	Regulatory Commission Expense	60,000	16,667	76,667	-	76,667
23	Miscellaneous Expense	20,845	-	20,845	-	20,845
24	Bad Debt Expense	11,962	2,412	14,374	-	14,374
25	Scottsdale Capacity (Operating Lease)	164,522	-	164,522	-	164,522
26	Amort. of Additional Scottsdale Cap.	48,629	-	48,629	-	48,629
27	Depreciation and Amortization	224,818	19,168	243,986	-	243,986
28	Taxes Other Than Income	(1,780)	1,780	-	-	-
29	Property Taxes	32,414	285	32,700	-	32,700
30	Income Tax	7,760	(30,692)	(22,932)	371,066	348,134
31				-		-
32	**Total Operating Expenses**	$ 1,664,655	$ 44,936	$ 1,709,590	$ 371,066	$ 2,080,656
33	**Operating Income**	$ (84,485)	$ (44,936)	$ (129,420)	$ 590,272	$ 460,852
34	**Other Income (Expense)**					
35	Interest Income	-	-	-	-	-
36	Other income	-	-	-	-	-
37	Interest Expense	(67,693)	(3,887)	(71,580)	-	(71,580)
38	Other Expense	-	-	-	-	-
39						
40	**Total Other Income (Expense)**	$ (67,693)	$ (3,887)	$ (71,580)	$ -	$ (71,580)
41	**Net Profit (Loss)**	$ (152,178)	$ (48,823)	$ (201,001)	$ 590,272	$ 389,271
42						
43	SUPPORTING SCHEDULES:				RECAP SCHEDULES:	
44	Rebuttal C-1, page 2				Rebuttal A-1	
45						
46						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Rebuttal Schedule C-1
Page 2.1
Witness: Bourassa

Continued on Page 2.2

Line No.		Direct Adjusted Test Year Book Results	1 Depreciation	2 Property Taxes	3 Expensed Plant	4 Scottsdale Treatment	5 Annualize WW Treatment	6 Chemicals Expense	7 Annualize Chemicals Expense	8 Testing Expense	9 Rent Expense	10 Normalize Contractual Services	11 Bad Debt Expense
1	**Revenues**												
2	Flat Rate Revenues	$ 1,557,337											
3	Measured Revenues	15,917											
4	Other Wastewater Revenues	6,916											
5		$ 1,580,170	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Salaries and Wages	$ -											
8	Purchased Wastewater Treatment	335,255				2,509	616						
9	Sludge Removal Expense	706											
10	Purchased Power	54,690											
11	Fuel for Power Production	928											
12	Chemicals	37,489						3,191	133				
13	Materials and Supplies	11,224											
14	Contractual Services	9,362			(1,500)							(1,861)	
15	Contractual Services- Testing	16,955								12,094			
16	Contractual Services - Other	553,043			(7,641)							(26,580)	
17	Equipment Rental	1,863											
18	Rents - Building	19,830									18,432		
19	Transportation Expenses	34,445											
20	Insurance - General Liability	18,704											
21	Insurance - Other	990											
22	Regulatory Commission Expense	60,000											
23	Miscellaneous Expense	20,845											
24	Bad Debt Expense	11,962											2,412
25	Scottsdale Capacity (Operating Lease)	164,522											
26	Amort. of Additional Scottsdale Cap.	48,629											
27	Depreciation and Amortization	224,818	19,168										
28	Taxes Other Than Income	(1,780)											
29	Property Taxes	32,414		285									
30	Income Tax	7,760											
31													
32	**Total Operating Expenses**	$ 1,664,655	$ 19,168	$ 285	$ (9,141)	$ 2,509	$ 616	$ 3,191	$ 133	$ 12,094	$ 18,432	$ (28,441)	$ 2,412
33	**Operating Income**	$ (84,485)	$ (19,168)	$ (285)	$ 9,141	$ (2,509)	$ (616)	$ (3,191)	$ (133)	$ (12,094)	$ (18,432)	$ 28,441	$ (2,412)
34	**Other Income (Expense)**												
35	Interest Income	-											
36	Other Income	-											
37	Interest Expense	(67,693)											
38	Other Expense	-											
39													
40	**Total Other Income (Expense)**	$ (67,693)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
41	**Net Profit (Loss)**	$ (152,178)	$ (19,168)	$ (285)	$ 9,141	$ (2,509)	$ (616)	$ (3,191)	$ (133)	$ (12,094)	$ (18,432)	$ 28,441	$ (2,412)
42													
43	SUPPORTING SCHEDULES:												
44	Rebuttal C-2												
45													
46													

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Rebuttal Schedule C-1
Page 2.2
Witness: Bourassa

Line No.		Direct Adjusted Test Year Book Results	Continued From Page 2.1 12 Meals Beverages Contributions	13 Contractual Services	14 Taxes Other Than Income	15 Expense Allocation	16 Contractual Services	17 Rate Case Expense	18 Interest Synch.	19 Income Tax	Rebuttal Test Year Adjusted Results	Rebuttal Proposed Rate Increase	Rebuttal Adjusted with Rate Increase
1	**Revenues**												
2	Flat Rate Revenues	$ 1,557,337									$ 1,557,337	$ 961,338	$ 2,518,675
3	Measured Revenues	15,917									15,917		15,917
4	Other Wastewater Revenues	6,916									6,916		6,916
5		$ 1,580,170	$ -	$ -	$ -	$ -	$ -		$ -	$ -	$ 1,580,170	$ 961,338	$ 2,541,508
6	**Operating Expenses**												
7	Salaries and Wages	$ -									$ -		$ -
8	Purchased Wastewater Treatment	335,255									338,381		338,381
9	Sludge Removal Expense	706									706		706
10	Purchased Power	54,690									54,690		54,690
11	Fuel for Power Production	928									928		928
12	Chemicals	37,489									40,813		40,813
13	Materials and Supplies	11,224									11,224		11,224
14	Contractual Services	9,362	(1,485)	42,200							46,716		46,716
15	Contractual Services- Testing	16,955									29,049		29,049
16	Contractual Services - Other	553,043				1,490	(6,284)				514,028		514,028
17	Equipment Rental	1,863									1,863		1,863
18	Rents - Building	19,830									38,262		38,262
19	Transportation Expenses	34,445									34,445		34,445
20	Insurance - General Liability	18,704									18,704		18,704
21	Insurance - Other	990									990		990
22	Regulatory Commission Expense	60,000						16,667			76,667		76,667
23	Miscellaneous Expense	20,845									20,845		20,845
24	Bad Debt Expense	11,962									14,374		14,374
25	Scottsdale Capacity (Operating Lease)	164,522									164,522		164,522
26	Amort. of Additional Scottsdale Cap.	48,629									48,629		48,629
27	Depreciation and Amortization	224,818									243,986		243,986
28	Taxes Other Than Income	(1,780)			1,780						-		-
29	Property Taxes	32,414									32,700		32,700
30	Income Tax	7,760								(30,692)	(22,932)	371,066	348,134
31													-
32	**Total Operating Expenses**	$ 1,664,655	$ (1,485)	$ 42,200	$ 1,780	$ 1,490	$ (6,284)	$ 16,667	$ -	$ (30,692)	$ 1,709,590	$ 371,066	$ 2,080,656
33	**Operating Income**	$ (84,485)	$ 1,485	$ (42,200)	$ (1,780)	$ (1,490)	$ 6,284	$ (16,667)	$ -	$ 30,692	$ (129,420)	$ 590,272	$ 460,852
34	**Other Income (Expense)**												
35	Interest Income	-									-		-
36	Other income	-									-		-
37	Interest Expense	(67,693)							(3,887)		(71,580)		(71,580)
38	Other Expense	-									-		-
39													
40	**Total Other Income (Expense)**	$ (67,693)	$ -	$ -	$ -	$ -	$ -	$ -	$ (3,887)	$ -	$ (71,580)	$ -	$ (71,580)
41	**Net Profit (Loss)**	$ (152,178)	$ 1,485	$ (42,200)	$ (1,780)	$ (1,490)	$ 6,284	$ (16,667)	$ (3,887)	$ 30,692	$ (201,001)	$ 590,272	$ 389,271
42													
43	SUPPORTING SCHEDULES:											RECAP SCHEDULES:	
44	Rebuttal C-2											Rebuttal A-1	
45													
46													

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses

Exhibit
Schedule C-2
Page 1
Witness: Bourassa

Adjustments to Revenues and Expenses

Line No.		1 Depreciation Expense	2 Property Taxes	3 Expensed Plant	4 Scottsdale Treatment	5 Annualize WW Treatment	6 Chemicals Expense	Subtotal
1								
2								
3								
4								
5								
6	Revenues							-
7								
8	Expenses	19,168	285	(9,141)	2,509	616	3,191	16,629
9								
10	Operating							
11	Income	(19,168)	(285)	9,141	(2,509)	(616)	(3,191)	(16,629)
12								
13	Interest							-
14	Expense							-
15	Other							
16	Income /							-
17	Expense							
18								
19	Net Income	(19,168)	(285)	9,141	(2,509)	(616)	(3,191)	(16,629)

Adjustments to Revenues and Expenses

Line No.		7 Ann. Chemicals Expense	8 Testing Expense	9 Rent Expense	10 Contractual Services	11 Bad Debt Expense	12 Meals, Beverages, Contributions	Subtotal
20								
21								
22								
23								
24								
25	Revenues							-
26								
27	Expenses	133	12,094	18,432	(28,441)	2,412	(1,485)	19,774
28								
29	Operating							
30	Income	(133)	(12,094)	(18,432)	28,441	(2,412)	1,485	(19,774)
31								
32	Interest							
33	Expense							-
34	Other							
35	Income /							-
36	Expense							
37								
38	Net Income	(133)	(12,094)	(18,432)	28,441	(2,412)	1,485	(19,774)

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses

Exhibit
Schedule C-2
Page 1 (Continued)
Witness: Bourassa

Line No.		Adjustments to Revenues and Expenses						
		13 Contractual Services	14 Taxes Other Tan Income	15 Expense Allocation	16 Contractual Services	17 Rate Case Exp.	18 Interest Synch.	Total
1								
2								
3								
4								
5								
6	Revenues							-
7								
8	Expenses	42,200	1,780	1,490	(6,284)	16,667		75,627
9								
10	Operating							
11	Income	(42,200)	(1,780)	(1,490)	6,284	(16,667)	-	(75,627)
12								
13	Interest							
14	Expense						(3,887)	(3,887)
15	Other							
16	Income /							-
17	Expense							
18								
19	Net Income	(42,200)	(1,780)	(1,490)	6,284	(16,667)	(3,887)	(79,514)
20								
21		Adjustments to Revenues and Expenses						
22		19	20	21	22	23	24	Subtotal
23		Income						
24		Tax	Blank	Blank	Blank	Blank	Blank	
25	Revenues							-
26								
27	Expenses	(30,692)						44,936
28								
29	Operating							
30	Income	30,692	-	-	-	-	-	(44,936)
31								
32	Interest							
33	Expense							(3,887)
34	Other							
35	Income /							-
36	Expense							
37								
38	Net Income	30,692	-	-	-	-	-	(48,823)

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses
Adjustment Number 1

Exhibit
Rebuttal Schedule C-2
Page 2
Witness: Bourassa

Line No.					Proforma Adjustments					
1	Depreciation Expense									
2			Adjusted	1	2	3	4	Rebuttal Adjusted		
3	Acct.		Original	Unrecorded	Plant	Expensed	Odor Control	Original	Proposed	Depreciation
4	No.	Description	Cost	Plant	Retirement	Plant	Unit	Cost	Rates	Expense
5	351	Organization	-	-	-	-	-	-	0.00%	-
6	352	Franchises	-	-	-	-	-	-	0.00%	-
7	353	Land and Land Rights	461,300	-	-	-	-	461,300	0.00%	-
8	354	Structures and Improvements	2,557,920	-	-	2,300	-	2,560,220	3.33%	85,255
9	355	Power Generation Equipment	-	-	-	-	-	-	5.00%	-
10	360	Collection Sewers - Force	706,292	-	-	1,600	-	707,892	2.00%	14,158
11	361	Collection Sewers - Gravity	4,284,948	-	-	-	-	4,284,948	2.00%	85,699
12	362	Special Collecting Structures	-	-	-	-	-	-	2.00%	-
13	363	Services to Customers	198,723	-	-	-	-	198,723	2.00%	3,974
14	364	Flow Measuring Devices	31,512	-	-	-	-	31,512	10.00%	3,151
15	365	Flow Measuring Installations	179,622	-	-	-	-	179,622	10.00%	17,962
16	370	Receiving Wells	690,628	254,251	(13,208)	1,200	-	932,871	3.33%	31,065
17	371	Effluent Pumping Equipment	654,844	-	-	2,803	-	657,647	12.50%	82,206
18	380	Treatment and Disposal Equipment	143,578	-	-	-	38,625	182,203	5.00%	9,110
19	381	Plant Sewers	123,289	-	-	1,238	-	124,527	5.00%	6,226
20	382	Outfall Sewer Lines	-	-	-	-	-	-	3.33%	-
21	389	Other Plant and Misc. Equipment	939,432	-	-	-	-	939,432	6.67%	62,660
22	390	Office Furniture and Equipment	224,587	-	-	-	-	224,587	6.67%	14,980
23	391	Transportation Equipment	107,367	-	-	-	-	107,367	20.00%	21,473
24	393	Tools, Shop and Garage Equipment.	5,754	-	-	-	-	5,754	5.00%	288
25	394	Laboratory Equipment	7,488	-	-	-	-	7,488	10.00%	749
26	395	Power Operated Equipment	-	-	-	-	-	-	5.00%	-
27	396	Communication Equipment	40,451	-	-	-	-	40,451	10.00%	4,045
28	398	Other TangiblePlant	-	-	-	-	-	-	10.00%	-
29		TOTALS	$ 11,357,735	$ 254,251	$ (13,208)	$ 9,141	$ 38,625	$ 11,646,544		$ 443,002
30										
31	Less: Amortization of Contributions		$ 5,232,139					$ 5,232,139	3.8037%	$ (199,016)
32										
33	Total Depreciation Expense									$ 243,986
34										
35	Test Year Depreciation Expense									224,818
36										
37	Increase (decrease) in Depreciation Expense									19,168
38										
39	Adjustment to Revenues and/or Expenses									$ 19,168
40										
41	SUPPORTING SCHEDULE									
42	Rebuttal B-2, page 3									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 2

Exhibit
Rebuttal Schedule C-2
Page 3
Witness: Bourassa

Line No.			As Adjusted With Rate Incr.
1	Adjust Property Taxes to Reflect Proposed Revenues:		
2			
3	Adjusted Revenues in year ended 06/30/2008	$	1,580,170
4	Adjusted Revenues in year ended 06/30/2008		1,580,170
5	Proposed Revenues		2,541,508
6	Average of three year's of revenue	$	1,900,616
7	Average of three year's of revenue, times 2	$	3,801,232
8	Add:		
9	Construction Work in Progess at 10%	$	14,202
10	Deduct:		
11	Book Value of Transportation Equipment		59,592
12			
13	Full Cash Value	$	3,755,842
14	Assessment Ratio		21%
15	Assessed Value		788,727
16	Property Tax Rate		4.1459%
17			
18	Computed Property Tax		32,700
19	Tax on Parcels		0
20			
21	Total Property Tax at Proposed Rates	$	32,700
22	Property Taxes (Adjusted Direct and Adjusted Rebuttal)		32,414
23	Change in property taxes	$	285
24			
25			
26	Adjustment to Revenues and/or Expenses	$	285
27			
28			
29			
30			
31			
32			
33			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 3

Exhibit
Rebuttal Schedule C-2
Page 4
Witness: Bourassa

Line No.				Label
1	Expensed Plant			
2				
3	Contractual Services - Legal and Engineering	$	(1,500)	3a
4				
5	Contractual Services - Other	$	(7,641)	3b
6				
7				
8				
9				
10				
11				
12	Adjustment to Revenues and/or Expenses	$	(9,141)	
13				
14				
15				
16				
17	SUPPORTING SCHEDULES			
18	Staff Adj. #3 Schedule CSB-14			
19				
20				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 4

Exhibit
Rebuttal Schedule C-2
Page 5
Witness: Bourassa

Line No.

1 City of Scottsdale Purchased Wastewater Treatment

2

3 Computation of Test Year Billings

Line	Month	Year	Read Date	Sewage Flow (in gals)	Cost per 1,000 gal	Raw Billing	Environmental 18.953%	Subject to Sales tax	Sales tax 1.65%	Scottsdale Billing
7	July	2007	1-Aug-07	6,126,317	$ 2.39	$ 14,641.90	$ 2,775.08	$ 17,416.98	$ 287.38	$ 17,704.36
8	Aug	2007	1-Sep-07	7,000,000	$ 2.39	$ 16,730.00	$ 3,170.84	$ 19,900.84	$ 328.36	$ 20,229.20
9	Sept	2007	1-Oct-07	8,507,019	$ 2.39	$ 20,331.78	$ 3,853.48	$ 24,185.26	$ 399.06	$ 24,584.31
10	Oct	2007	1-Nov-07	8,800,000	$ 2.39	$ 21,032.00	$ 3,986.19	$ 25,018.19	$ 412.80	$ 25,431.00
11	Nov	2007	1-Dec-07	8,703,535	$ 2.39	$ 20,801.45	$ 3,942.50	$ 24,743.95	$ 408.28	$ 25,152.22
12	Dec	2007	1-Jan-08	8,936,845	$ 2.39	$ 21,359.06	$ 4,048.18	$ 25,407.24	$ 419.22	$ 25,826.46
13	Jan	2008	1-Feb-08	9,500,000	$ 2.26	$ 21,470.00	$ 4,069.21	$ 25,539.21	$ 421.40	$ 25,960.61
14	Feb	2008	1-Mar-08	11,347,179	$ 2.26	$ 25,644.62	$ 4,860.43	$ 30,505.05	$ 503.33	$ 31,008.38
15	Mar	2008	1-Apr-08	11,644,059	$ 2.26	$ 26,315.57	$ 4,987.59	$ 31,303.16	$ 516.50	$ 31,819.67
16	April	2008	1-May-08	9,597,371	$ 2.26	$ 21,690.06	$ 4,110.92	$ 25,800.98	$ 425.72	$ 26,226.69
17	May	2008	1-Jun-08	7,261,758	$ 2.26	$ 16,411.57	$ 3,110.49	$ 19,522.06	$ 322.11	$ 19,844.17
18	June	2008	1-Jul-08	6,333,090	$ 2.26	$ 14,312.78	$ 2,712.70	$ 17,025.49	$ 280.92	$ 17,306.41
20	Test Year Totals			103,757,173		$ 240,740.79	$ 45,627.60	$ 286,368.40	$ 4,725.08	$ 291,093.48

21

22

23 Computation of Billings under rate change effecive (7/1/2009)

24

Line										
25	City of Scottsdale billing with new rate			103,757,173	$ 2.61	$ 270,806.22	$ 51,325.90	$ 322,132.12	$ 5,315.18	$ 327,447.30

26

27 Adjusted Test Year Wastewater Treatment Expenses (before annualization) $ 324,938.13

28

29 Increase(decrease) in City of Scottsdale purchased wastewater treatment $ 2,509.17

30

31 Adjustment to Revenues and/or Expenses $ 2,509

32

33

34 SUPPORTING SCHEDULES

35 Direct Schedule C-2, page 7

36

37

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 5

Exhibit
Rebuttal Schedule C-2
Page 6
Witness: Bourassa

Line No.			
1	Annualize Purchased Wastewater Treatment		
2			
3	Adjusted Year Purchased Wastewater Treatment (Scottsdale)	$	327,447
4	Gallons Treated By Scottsdale (in 1000's)		103,757
5	Cost per 1,000 gallons	$	3.1559
6			
7	Additional Wasterwater gallons (in 1,000's) from revenue annualization		451
8	Percent diverted to Scottsdale		70.94%
9	Additonal gallons treated by Scottsdale (in 1,000's)		320
10			
11	Annualization of Purchased WW Treatment per Rebuttal	$	1,010
12			
13	WW Treatment Annualization per Direct	$	394
14			
15	Increase (decrease) in annualization	$	616
16			
17			
18	Adjustment to Revenue and/or Expense	$	616
19			
20			
21			
22	SUPPORTING SCHEDULE		
23	Rebuttal C-2, page 5		
24	Direct C-2, page 8		
25			
26			
27			

Black Mountain Sewer Corporation
Test Year Ended December 31, 2001
Adjustment to Revenues and/or Expenses
Adjustment Number 6

Exhibit
Rebuttal Schedule C-2
Page 7
Witness: Bourassa

Line No.					
1					
2	Chemicals Expense				
3					
4	Thoigard used from July to November 2007			$	8,169
5	Sodium Hydroxide (ordor control chemical)				
6	Gallons used during test year (approx. 7 months)		6,997		
7	Cost per Gallons	$	1.65		
8	Cost of Sodium Hydroxide			$	11,545
9	Delivery costs (14 deliveries at $45 per)				630
10	Sales tax at 8.5%				1,035
11	Total Cost			$	21,378
12					
13					
14	Sodium Hydroxide (ordor control chemical)				
15	Projected gallons (test year gallons annualized to 12 months)		11,995		
16	Cost per Gallons	$	2.05		
17	Total Cost			$	24,590
18	Delivery costs (24 deliveries at $32 per)				768
19	Sales tax at 8.5%				2,155
20	Total Cost			$	27,513
21					
22					
23	Increase (decrease) in Chemicals Expense per Rebuttal			$	6,135
24					
25	Increase (decrease) in Chemicals Expense per Direct			$	2,943
26					
27	Rebuttal Increase (decrease) in Chemicals Expenses			$	3,191
28					
29					
30	Adjustment to Revenue and/or Expense			$	3,191
31					
32					
33					
34					
35					
36	SUPPORTING SCHEDULE				
37	RUCO Adj. #8 SCHEDULE RLM-13				
38					
39					

Black Mountain Sewer Corporation
Test Year Ended December 31, 2001
Adjustment to Revenues and/or Expenses
Adjustment Number 7

Exhibit
Rebuttal Schedule C-2
Page 8
Witness: Bourassa

Line No.			
1			
2	Annualize Chemicals Expense		
3			
4	Test Year Chemicals plus Adjustment #6	$	49,584
5	Gallons Treated By BMSC (in 1000's)		42,510
6	Cost per 1,000 gallons	$	1.17
7			
8	Additonal Wasterwater gallons (in 1,000's) from revenue annualization		451
9			
10	Additonal cost based on revenue annualization per Rebuttal	$	526
11			
12	Additonal cost based on revenue annualization per Direct	$	394
13			
14			
15	Rebuttal Increase (decrease) in Chemicals Expense	$	133
16			
17			
18			
19			
20	Adjustment to Revenue and/or Expense	$	133
21			
22			
23			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 8

Exhibit
Rebuttal Schedule C-2
Page 9
Witness: Bourassa

Line No.			
1			
2	Testing Expense		
3			
4	Revised Test Year Test Year	$	15,689
5			
6	Incremental Costs Required By City of Scottsdale	$	13,360
7			
8	Total Proposed testing cost per Rebuttal	$	29,049
9			
10	Testing Costs per Direct	$	16,955
11			
12	Increase (decrease) in Testing Costs	$	12,094
13			
14	Adjustment to Revenue and/or Expense	$	12,094
15			
16			
17			
18	SUPPORTING SCHEDULES		
19	Rebuttal C-2, page 9.1		
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment Number 8

Exhibit
Rebuttal Schedule C-2
Page 9.1

Line No.	Testing Costs	Test Year Costs			City of Scottsdale Incremental	Co. Recommended Costs			Staff Recommended
5	Test name or number	Tests/yr	Price/test	Yearly Total	Tests	Tests/yr	Price/test	Yearly Total	Cost
7	515- chemical water test	2	$ 175	$ 350		2	$ 175	$ 350	$ 350
8	525- chemical water test	2	$ 290	$ 580		2	$ 290	$ 580	$ 580
9	624- chemical water test	3	$ 160	$ 480		2	$ 160	$ 320	$ 320
10	Antimony, GFAA	3	$ 15	$ 44		4	$ 15	$ 58	$ -
11	Antimony, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ 67
12	Arsenic, GFAA	3	$ 15	$ 44	16	20	$ 15	$ 290	$ -
13	Arsenic, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ 67
14	Barium, total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
15	Barium, total	2	$ 10	$ 19		4	$ 10	$ 38	$ -
16	Beryllium, total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
17	Beryllium, total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
18	BOD	59	$ 36	$ 2,124	0	52	$ 36	$ 1,872	$ 1,008
19	Cadmium GFAA	2	$ 14	$ 29	16	20	$ 14	$ 288	$ -
20	Cadmium GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
21	Cadmium Total	1	$ 17	$ 17		4	$ 17	$ 66	$ -
22	Chromium, Total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
23	Chromium, Total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
24	Cyanide,	4	$ 56	$ 224		4	$ 56	$ 224	$ 224
25	Cyanide, Total	4	$ 44	$ 176	16	20	$ 44	$ 880	$ -
26	Fecal Coliforms	259	$ 15	$ 3,885		255	$ 15	$ 3,825	$ 5,475
27	Fecal Coliforms, Soil/Sludge	10	$ 68	$ 680		10	$ 68	$ 680	$ -
28	Mercury	4	$ 32	$ 128	16	20	$ 32	$ 640	$ 128
29	Nickel, Total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
30	Nickel, Total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
31	Nitrogen 2	12	$ 64	$ 768		12	$ 64	$ 768	$ -
32	Nitrogen 3	12	$ 52	$ 624		12	$ 52	$ 624	$ 624
33	Nitrogen, NO3NO2	24	$ 20	$ 480	28	52	$ 20	$ 1,040	$ -
34	Nitrogen, Nitrite	2	$ 12	$ 24		2	$ 12	$ 24	$ -
35	Nitrogen, Total Kjeldahl	24	$ 32	$ 768	28	52	$ 32	$ 1,664	$ -
36	Oil and Grease	35	$ 88	$ 3,080		28	$ 88	$ 2,464	$ -
37	Flouride	4	$ 16	$ 64	16	20	$ 16	$ 320	$ 64
38	ICP Digestion	4	$ 16	$ 64		4	$ 16	$ 64	$ 16
39	ICP-MS Digestion	1	$ 16	$ 16		1	$ 16	$ 16	$ 15
40	Lead GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
41	Lead GFAA	2	$ 14	$ 29	16	20	$ 14	$ 288	$ -
42	Lead, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
43	Ph	24	$ 12	$ 288		24	$ 12	$ 288	$ -
44	Selenium GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
45	Selenium GFAA	1	$ 14	$ 14	16	20	$ 14	$ 288	$ -
46	Selenium Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
47	Selenium- Subcontract	1	$ 24	$ 24		1	$ 24	$ 24	$ -
48	Thallium GFAA	2	$ 14	$ 29		4	$ 14	$ 58	$ -
49	Thallium GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
50	Thallium Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
51	Boron				16	16	$ 9	$ 144	
52	COD				84	84	$ 38	$ 3,192	
53	Copper				16	16	$ 9	$ 144	
54	VOC GC/MS 624				2	2	$ 320	$ 640	
55	VOC GC/MS 625				2	2	$ 312	$ 624	
56	VOC GC/MS 608				2	2	$ 160	$ 320	
57	Molybdenum				16	16	$ 9	$ 144	
58	Silver				16	16	$ 14	$ 224	
59	Nitrate - N				28	28	$ 32	$ 896	
60	Nitrite - N				28	28	$ 32	$ 896	
61	TDS				84	84	$ 12	$ 1,008	
62	Zinc				16	16	$ 9	$ 144	
63	Total Suspended Solids	46	$ 12	$ 552	56	84	$ 12	$ 1,008	$ -
64	Total Suspended Solids	13	$ 13	$ 169		24	$ 13	$ 312	$ 364
65	Enteric Virus monthly					0	$ 460	$ -	$ 5,520
66	Unknown Cost								
67				Company				Company	Staff
68	Total	588		$ 16,053	582	1201		$ 29,049	15,222 [1]
69									
70	Total Recommended							$ 29,049	
71	Original Filing test year costs							$ 16,955	
72	Increase (decrease) in Test Year Testing Costs							$ 12,094	
73									
74	Reconciliation								
75	*Testing Costs Per Direct*							$ 16,955	
76	Less: Costs outside test year							$ (1,266)	
77	Adjusted Test Year Costs							$ 15,689	
78	Incremental COS tests required by City of Scottsdale							$ 13,360	
79	Rebuttal Testing Costs							$ 29,049	
80									

81 1 Staff Schedule contains a math error of $860.

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 9

Exhibit
Rebuttal Schedule C-2
Page 10
Witness: Bourassa

Line No.			
1			
2	Rent Expense		
3			
4	Additional Test Year Rent Expense	$	18,432
5			
6			
7			
8			
9	Adjustment to Revenue and/or Expense	$	18,432
10			
11			
12			
13			
14			
15			
16	SUPPORTING SCHEDULE		
17	RUCO Adj. # 6 Schedule RLM-12		
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 10

Exhibit
Rebuttal Schedule C-2
Page 11
Witness: Bourassa

Line No.				Label
1				
2	Normalization of Maintenance, Legal and Engineering			
3				
4				
5	Contractual Services - Other	$	(26,580)	10a
6				
7	Contractual Services - Legal and Engineering		(1,861)	10b
8				
9	Total	$	(28,441)	
10				
11				
12	Adjustment to Revenue and/or Expense	$	(28,441)	
13				
14				
15				
16				
17	SUPPORTING SCHEDULE			
18	Staff Adj. # 4 Schedule CSB-15 (corrected for errors - see testimony)			
19				
20				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 11

Exhibit
Rebuttal Schedule C-2
Page 12
Witness: Bourassa

Line No.			
1			
2	Bad Debt Expense		
3			
4			
5	Remove Write-offs from prior year revenues (per Staff Adj. #5)	$	(4,067)
6			
7	Write-offs for test year revenues occuring post test year		6,479
8			
9	Total	$	2,412
10			
11			
12	Adjustment to Revenue and/or Expense	$	2,412
13			
14			
15			
16			
17	SUPPORTING SCHEDULE		
18	Staff Adj. # 5 Schedule CSB-16		
19	Testimony		
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 12

Exhibit
Rebuttal Schedule C-2
Page 13
Witness: Bourassa

Line No.			
1			
2	Remove Meals, Beverages, Charitable Contributions		
3			
4			
5	Meals (per Staff Adj. # 9 Schedule CSB-20)	$	(526)
6			
7	Beverages (per Staff Adj. # 9 Schedule CSB-20)		(907)
8			
9	Charitable Contributions(per Staff Adj. # 9 Schedule CSB-20)		(52)
10			
11	Total Adjustment to Contractual Services - Other	$	(1,485)
12			
13			
14	Adjustment to Revenue and/or Expense	$	(1,485)
15			
16			
17			
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 13

Exhibit
Rebuttal Schedule C-2
Page 14
Witness: Bourassa

Line No.			
1			
2	Contractual Services		
3			
4			
5	Contractual Services Costs[1] (per RUCO Adj. #5 Schedule RLM-12)	$	42,200
6			
7			
8			
9			
10			
11			
12	Adjustment to Revenue and/or Expense	$	42,200
13			
14			
15			
16			
17			
18	[1]BMSC cost incorrectly recorded on books of LPSCo. See testimony.		
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 14

Exhibit
Rebuttal Schedule C-2
Page 15
Witness: Bourassa

Line No.			
1			
2	Taxes Other Than Income		
3			
4			
5	Remove negative expense	$	1,780
6			
7			
8			
9			
10			
11			
12	Adjustment to Revenue and/or Expense	$	1,780
13			
14			
15			
16			
17	SUPPORTING SCHEDULES		
18	Staff Adj. #11 Schedule CSB-22		
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 15

Exhibit
Rebuttal Schedule C-2
Page 16
Witness: Bourassa

Cental Office Costs - Infrastructure Allocation

Line No.		Actual Total Cost Pool[1]	Adjustments	Rebuttal Total Cost Pool	Utility Infrastructure Group Allocation %	Utility Infrastructure Group Allocated Cost Pool	BMSC Allocation by Customer Count	Rebuttal BMSC Allocation
7	Audit	$ 940,719		$ 940,719	26.98%	$ 253,845	3.18%	8,072
8	Tax Services	235,582		$ 235,582	26.98%	63,570	3.18%	2,022
9	Legal	485,980		$ 485,980	26.98%	131,138	3.18%	4,170
10	Other Professional Services	177,762		$ 177,762	26.98%	47,968	3.18%	1,525
11	Management Fee - Total	629,738		$ 629,738	26.98%	169,929	3.18%	5,404
12	Unit Holder Communications	196,509		$ 196,509	26.98%	53,026	3.18%	1,686
13	Trustee Fees	225,052		$ 225,052	26.98%	60,728	3.18%	1,931
14	Escrow & Transfer Agent Fees	61,115		$ 61,115	26.98%	16,491	3.18%	524
15	Rent	295,881		$ 295,881	26.98%	79,841	3.18%	2,539
16	Licenses/Fees & Permits	131,619	(128,380) [1]	$ 3,239	26.98%	874	3.18%	28
17	Office Expenses	726,427	(63,448) [1]	$ 662,979	26.98%	178,899	3.18%	5,689
18	Depreciation	218,613		$ 218,613	26.98%	58,991	3.18%	1,876
20	**Total (Candadian dollars CAD)**	**$ 4,324,998**	**$ (191,828)**	**$ 4,133,170**		**$ 1,115,300**		**$ 35,467**
21	Factor	1.05	1.05	1.05		1.05		1.05
22	**Total (US dollars USD**	$ 4,119,045	$ (182,693)	$ 3,936,352		$ 1,062,190		$ 33,778
24	Infrastructure Cost Allocation per Direct (USD)[2]							$ 32,287
26	Increase (decrease) in Infrastructure Allocated Costs (USD)							$ 1,490
29	Adjustment to Revenues and/or Expenses							$ 1,490

[1] Per Response to CSB 9.1 (in Canadian dollars)
[2] $3,950,800 budgeted allocation pool times 26.98% times 3.18% divided by 1.05

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 16

Exhibit
Rebuttal Schedule C-2
Page 17
Witness: Bourassa

Line No.				
1				
2				
3	Contractual Services			
4				
5	Increase in direct allocated Operations costs		$	3,474
6				
7	Increase in allocated Accounting/Billing costs	$ 254,381		
8	Allocation Factor based on Year-end Customers	3.18%		
9			$	8,098
10	Increase in allocated Overhead costs	717,339		
11	Allocation Factor based on 4-factor allocation	4.52%		
12			$	32,446
13				
14	Increase (decrease) in Contractual Services per Rebuttal		$	44,018
15				
16	Increase (decrease) in Contractual Services per Direct			50,302
17				
18	Increase (decrease) in Contractual Services		$	(6,284)
19				
20				
21	Adjustment to Revenue and/or Expense		$	(6,284)
22				
23				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 17

Exhibit
Rebuttal Schedule C-2
Page 18
Witness: Bourassa

Line No.			
1			
2	Rate Case Expense		
3			
4	Rate Case Expense Request per Direct	$	180,000
5			
6	Additional Rate Case Expense		50,000
7			
8	Rate Case Expense Request per Rebuttal	$	230,000
9			
10			
11	Amortization Period (years)		3.00
12			
13			
14	Rate Case Expense to be included in Expense	$	76,667
15			
16	Rate Case Expense per Direct	$	60,000
17			
18	Increase (decrease) in Rate Case Expense	$	16,667
19			
20			
21	Adjustment to Revenue and/or Expense	$	16,667

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 18

Exhibit
Rebuttal Schedule C-2
Page 19
Witness: Bourassa

Line No.			
1	Interest Synchronization		
2			
3			
4	Fair Value Rate Base	$3,716,649	
5	Weighted Cost of Debt	1.93%	
6	Interest Expense		$ 71,580
7			
8	Test Year Interest Expense		$ 67,693
9			
10	Increase (decrease) in Interest Expense		3,887
11			
12			
13			
14	Adjustment to Revenue and/or Expense		$ (3,887)
15			
16			
17	Weighted Cost of Debt Computation		

18						Weighted
19			Amount	Percent	Cost	Cost
20	Debt	$	1,010,649	20.49%	9.40%	1.93%
21	Equity	$	3,922,058	79.51%	12.40%	9.86%
22	Total	$	4,932,707	100.00%		11.79%

23
24

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 19

Exhibit
Rebuttal Schedule C-2
Page 20
Witness: Bourassa

Line No.			Test Year Adjusted Results	Adjusted with Rate Increase	
1	Income Tax Computation				
2					
3					
4					
5					
6					
7	Taxable Income before Scottsdale Operating Lease		$ (223,932)	$ 737,405	
8	Plus: Scottsdale Operating Lease		164,522	164,522	
9	Taxable Income		$ (59,410)	$ 901,927	
10					
11	Income Before Taxes			$ 901,927	
12					
13	Arizona Income Before Taxes			$ 901,927	
14					
15	Less Arizona Income Tax			$ 62,846	
16	Rate =	6.968%			
17	Arizona Taxable Income			$ 839,081	
18					
19	Arizona Income Taxes			$ 62,846	
20					
21	Federal Income Before Taxes			$ 901,927	
22					
23	Less Arizona Income Taxes			$ 62,846	
24					
25	Federal Taxable Income			$ 839,081	
26					
27					
28					
29	FEDERAL INCOME TAXES:				
30	15% BRACKET			$ 7,500	
31	25% BRACKET			$ 6,250	
32	34% BRACKET			$ 8,500	Federal
33	39% BRACKET			$ 91,650	Effective
34	34% BRACKET			$ 171,388	Tax
35					Rate
36	Federal Income Taxes			$ 285,288	31.63%
37					
38	State Income Tax Rate at Proposed Rates		6.9680%		
39	Federal Effective Tax Rate at Proposed Rates		31.6309%		
40	Total Federal and State Income Tax Effective Rate		38.5989%	$ 348,134	
41					
42	Taxable Income		$ (59,410)		
43	State and Federal Income Taxes at Effective Rate		$ (22,932)		
44	Adjusted Test Year Income Tax per Direct		$ 7,760		
45	Adjusted Test Year Income Tax per Rebuttal			(22,932)	
46	Increase (decrease) in Income Taxes	→	$ (30,692)	371,066	
47					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Gross Revenue Conversion Factor

Exhibit
Rebuttal Schedule C-3
Page 1
Witness: Bourassa

Line No.	Description	Percentage of Incremental Gross Revenues
1	Federal Income Tax Factor	31.6309%
2		
3	State Income Tax Factor	6.9680%
4		
5	Other Tax Factor	0.0000%
6		
7		
8	Total Tax Percentage	38.5989%
9		
10	Operating Income % = 100% - Tax Percentage	61.4011%
11		
12		
13		
14		
15	1 = Gross Revenue Conversion Factor	
16	Operating Income %	1.6286
17		
18	SUPPORTING SCHEDULES:	RECAP SCHEDULES:
19		Rebuttal A-1
20		

Black Mountain Sewer Corporation
Revenue Summary
With Annualized Revenues to Year End Number of Customers
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-1
Witness: Bourassa

Line No.	Customer Classification	Present Revenues	Proposed Revenues	Dollar Change	Percent Change	Percent of Present Sewer Revenues	Percent of Proposed Sewer Revenues
1	Residential	1,077,880	1,711,052	633,172	58.74%	68.59%	67.60%
2	Commercial (Standard Rate)	378,678	601,150	222,472	58.75%	24.10%	23.75%
3	Commercial (Special Rate)						
4	Boulders Resort	50,085	102,290	52,205	104.23%	3.19%	4.04%
5	Desert Forest	13,729	24,400	10,671	77.73%	0.87%	0.96%
6	El Pedegral	26,587	55,030	28,443	106.98%	1.69%	2.17%
7	Boulders Club	168	349	180	106.98%	0.01%	0.01%
8	Spanish Village	8,395	17,377	8,981	106.98%	0.53%	0.69%
9	Effluent Sales	15,917	19,578	3,661	23.00%	1.01%	0.77%
10	Subtotal	1,571,439	2,531,224	959,785	61.08%	100.00%	100.00%
11							
12	Revenue Annualization						
13	Residential	2,145	3,405	1,260	58.74%	0.14%	0.13%
14							
15	Misc Service Revenues						
16	Misc Revenues	6,915	6,915	-	0.00%	0.44%	0.27%
17	Reconciling Amount to C-1	(329)	(36)	293	-89.06%	-0.02%	0.00%
18	Totals	1,580,170	2,541,508	961,338	60.84%	99.98%	100.00%
19							
20							
21							
22							
23							
24							
25							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Analysis of Revenue by Detailed Class
Special Rate Commercial Customers Pay Standard Commerical Rate

Rebuttal Schedule H-2
Page 1
Witness: Bourassa

Line No.	Customer Classification	Average Number of Customers at 6/30/2008	Average Effluent	Average Bill Present Rates	Average Bill Proposed Rates	Proposed Increase Dollar Amount	Proposed Increase Percent Amount
1	Residential	1,972	N/A	$ 45.64	$ 72.45	$ 26.81	58.742%
2	Commercial (Standard Rate)	124	N/A	103.41	164.16	60.75	58.750%
3	Commercial (Special Rate)						
4	B-H Enterprises (West)	-	N/A	$ -	N/A		
5	B-H Enterprises (East)	1	N/A	-	N/A		
6	Barb's Per Grooming	-	N/A	-	N/A		
7	Boulders Resort	1	N/A	4,173.74	8,524.14	4,350.40	104.233%
8	Carefree Dental	-	N/A	-	N/A		
9	Ridgecrest Realty	1	N/A	-	N/A		
10	Desert Forest	1	N/A	1,144.08	2,033.36	889.28	77.729%
11	Desert Hills Pharmacy	1	N/A	-	N/A		
12	El Pedregal	1	N/A	2,215.55	4,585.81	2,370.26	106.983%
13	Lemon Tree	1	N/A	-	N/A		
14	Body Shop	1	N/A	-	N/A		
15	Spanish Village	-	N/A	-	0.29048		
16	Boulders Club	-	N/A	168.41	348.58	180.17	106.983%
17	Anthony Vuitaggio	1	N/A	-	N/A		
18							
19	Effluent	1	3,542,780	$ 1,326.42	$ 1,631.49	305.08	23.000%
20							
21	Total	2,106					
22							
23							
24							
25							

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-3
Page 1
Witness: Bourassa

Line No.	Customer Classification		Present Rates	Present Rates	Proposed Rates	Proposed Rates	Percent Change
1							
2							
3							
4	**Monthly Charge for:**						
5	Residential			$ 45.64		$ 72.45	58.74%
6	Commercial (Standard Rate), per gallon per day[1]			0.18298		0.29048	58.75%
7			per acre foot		per acre foot		
8	Effluent Sales (per 1,000 gallons)		$ 122.00	0.37440	$ 150.00	0.46051	23.00%
9							
10	Commercial (Special Rate), per gallon per day[1]						
11		Gallons	Monthly	Rate per	Monthly	Rate per	Percent
12	Customer[2]	Per Day[1]	Billing	Gallon	Billing	Gallon [2]	Change
13	B-H Enterprises	2,525	$ 354.36	0.14034	N/A	N/A	
14	B-H Enterprises	1,400	$ 196.48	0.14034	N/A	N/A	
15	Barb's Per Grooming	250	$ 35.09	0.14034	N/A	N/A	
16	Boulders Resort	29,345	$ 4,173.74	0.14223	$ 8,524.14	0.29048	104.23%
17	Carefree Dental	1,625	$ 228.05	0.14034	N/A	N/A	
18	Ridgecrest Realty	450	$ 63.87	0.14193	N/A	N/A	
19	Desert Forest	7,000	$ 1,144.08	0.16344	$ 2,033.36	0.29048	77.73%
20	Desert Hills Pharmacy	800	$ 136.49	0.17061	N/A	N/A	
21	El Pedregal	15,787	$ 2,215.55	0.14034	$ 4,585.81	0.29048	106.98%
22	Lemon Tree	300	$ 41.07	0.13691	N/A	N/A	
23	Body Shop	1,000	$ 176.47	0.17647	N/A	N/A	
24	Spanish Village	4,985	$ 699.59	0.14034	$ 1,448.04	0.29048	106.98%
25	Boulders Club	1,200	$ 168.41	0.14034	$ 348.58	0.29048	106.98%
26	Anthony Vuitaggio	300	$ 46.79	0.15597	N/A	N/A	
27							
28							

29 [1] Commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin 12, Table 1
30 published by the Arizona Department of Environmental Quality
31 [2] Company is proposing to set the special rate commercial customers at the same rate ase the standard commerical rate
32 customers.

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-3
Page 2
Witness: Bourassa

Line No.	Other Service Charges	Present Rates	Proposed Rates
1	Establishment	$ 25.00	$ 25.00
2	Re-Establishment	$ 25.00	$ 25.00
3	Reconnection	no charge	[5]
4	After hours service	N/A	$ 25.00
5	Min Deposit Requirement (Residential)	[1]	[1]
6	Min Deposit Requirement (Non-Residential)	[1]	[1]
7	NSF Check	10.00	10.00
8	Deferred Payment finance charge, Per Month	1.50%	1.50%
9	Late Payment Charge, Per Month	1.50%	1.50%
10	Main Extension Tariff [2]	Cost	Cost
11	Purchased Wastewater Surcharge	NT	[3]
12	Hook-Up Fee for New Service Connections (per Gallon per Day)[4]	NT	$ 8.00
13			
14	[1] Per A.C.C. R14-2-603B Residential - two times the average bill. Non-residential - two and one-half times the average bill.		
15			
16	[2] Per A.C.C. R14-2-606(B)		
17			
18	[3] For increases in wastewater treatment costs from City of Scottsdale. See Testimony of Thomas J. Bourassa.		
19			
20	[4] Commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin 12, Table 1		
21	published by the Arizona Department of Environmental Quality. For wastewater treatment capacity constructed or		
22	purchased. See tariff for details.		
23			
24	[5] Actual cost of physical disconnection and reconnection (if same customer) and there shall be no charge if there		
25	is no physical work performed.		
26			
27	IN ADDITION TO THE COLLECTION OF REGULAR RATES, THE UTILITY WILL COLLECT FROM		
28	ITS CUSTOMERS A PROPORTIONATE SHARE OF ANY PRIVILEGE, SALES, USE, AND FRANCHISE		
29	TAX. PER COMMISSION RULE (14-2-608.D 5).		
30	ALL ADVANCES AND/OR CONTRIBUTIONS ARE TO INCLUDE LABOR, MATERIALS, OVERHEADS,		
31	AND ALL APPLICABLE TAXES, INCLUDING ALL GROSS-UP TAXES FOR INCOME TAXES.		
32	COST TO INCLUDE LABOR, MATERIALS AND PARTS, OVERHEADS AND ALL APPLICABLE TAXES.		
33			

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REBUTTAL TESTIMONY OF

THOMAS J. BOURASSA

(Cost of Capital)

October 20, 2009

EXHIBIT
A-7
ADMITTED

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2239523/16040.035

I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. On behalf of the applicant, Black Mountain Sewer Corporation ("BMSC" or the "Company").

Q. ARE YOU THE SAME THOMAS J. BOURASSA THAT FILED DIRECT AND REBUTTAL TESTIMONY ON RATE BASE, INCOME STATEMENT, REVENUE REQUIREMENT AND RATE DESIGN IN THIS CASE?

A. Yes. My background and qualifications are discussed in my direct testimony on those aspects of the case.

Q. DID YOU ALSO PREPARE DIRECT TESTIMONY ON THE COST OF CAPITAL ON BEHALF OF BMSC IN THIS CASE?

A. Yes, I also provided direct testimony on the cost of capital, including the cost of equity, in this case.

II. SUMMARY OF REBUTTAL TESTIMONY AND THE PROPOSED COST OF CAPITAL FOR THE COMPANY.

A. Summary of Company's Rebuttal Recommendation.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. In this portion of my rebuttal testimony I will provide updates of my cost of capital analysis and recommended rate of return using more recent financial data. I also will respond as appropriate to the direct testimonies of Mr. Manrique on behalf of Staff and the direct testimony of Mr. William A. Rigsby on behalf of RUCO.

Q. PLEASE SUMMARIZE YOUR UPDATED COST OF CAPITAL ANALYSIS.

A. Since the Company's direct filing, the cost of equity has increased substantially, as indicated by the Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM"). The table below summarizes the results of my updated analysis using those models:

	Range	Midpoint
DCF Constant Growth (earnings growth)	10.0% - 15.3%	12.6%
DCF Constant Growth (sustainable growth)	9.5% - 11.8%	10.7%
Two-Stage Growth Model	9.9% - 13.8%	11.9%
DCF Average Results	**9.8% - 13.6%**	**11.7%**
CAPM Historical Market Risk Premium		8.5%
CAPM Current Market Risk Premium		17.8%
Average CAPM Results	**8.5%-17.8%**	**13.2%**
Average Overall Results	**9.2%-15.7%**	**12.4%**

The schedules containing my updated cost of capital analysis are included with my rebuttal schedules, attached to my other rebuttal testimony. Attached to this testimony are four attachments, which are discussed below.

I also prepared rebuttal testimony that addresses the Company's rebuttal rate base, its income statement (revenue and operating expenses), its required increase in revenue, and its rate design and proposed rates and charges for service. For the convenience of the Commission and the parties, that volume of my testimony has been filed separately in this case.

Q. PLEASE SUMMARIZE YOUR RECOMMENDED REBUTTAL COST OF DEBT AND EQUITY, AND YOUR RECOMMENDED REBUTTAL RATE OF RETURN ON RATE BASE.

A. The Company's recommended capital structure consists of 0 percent debt and 100 percent common equity as shown on Rebuttal Schedule D-1. While the Company

has long-term debt, the debt service is being treated as an operating lease and is therefore excluded from the capital structure for purposes of computing a weighted average cost of capital ("WACC").[1] Based on my updated cost of capital analysis, I am recommending a cost of equity of 12.4 percent.

Based on my 12.4 percent recommended cost of equity, the Company's weighted cost of capital ("WACC") is 12.4 percent, as shown on Rebuttal Schedule D-1.

B. <u>Comments on Updates to Direct Testimony.</u>

Q. WHY IS YOUR COST OF EQUITY RECOMMENDATION LOWER IN YOU REBUTTAL THAN IN YOUR DIRECT TESTIMONY?

A. When I prepared my direct testimony in early December 2008, the economy was in the midst of a severe recession and a crisis was occurring in the financial markets. The Dow Jones average had fallen by 38 percent and the S&P 500 dropped by 40 percent in just a couple of months. During this period, there was a "flight to quality" that led to the traditional spread between required returns on Treasury securities and other assets increasing as investors turned away from common stocks and corporate bonds in favor of treasuries. During the past several months, both the economy and the financial markets have improved. Economists now believe the recession has ended, but also see a long sluggish recovery. As Value Line states "the evolving business upturn may be a checkered affair, with a succession of peaks and valleys along the way...Should [the] uneven recovery unfold, the stock market might remain quite volatile."[2]

There are several key factors that could cap the strength of economic recovery over the next few years. These include an unusually slow improvement in

[1] *See* Bourassa Dt. at 2.

[2] Value Line Selection and Opinion, October 16, 2009.

labor market conditions,[3] only modest gains in consumer spending, tight credit and a desire by households to pare debt, a slow recovery in residential investment due to still rising home foreclosures and persistently high inventories of unsold existing homes, a further pull-back in commercial construction, limited improvement in capital spending resulting from excess capacity that exists in many sectors, and still lack of capital available to small and mid-sized businesses.[4]

Q. SO HOW EXACTLY HAS THE COST OF EQUITY DROPPED SINCE YOU PREPARED YOUR DIRECT TESTIMONY?

A. My updated analysis indicates cost of equity is 12.4 percent, which is lower than the 13.2 percent indicated cost of equity in my direct testimony. My cost of equity estimates based on the discounted cash flow ("DCF") and the capital asset pricing model ("CAPM") ranged from 9.9 percent to 16.5 percent with a mid-point of 13.2 percent. Despite a 13.2 percent indicated cost of equity in my direct cost of equity analysis, my recommendation for the cost of equity was 12.8 percent.

C. <u>Summary of the Recommendations of Staff and RUCO.</u>

Q. PLEASE SUMMARIZE THE COST OF DEBT AND EQUITY RECOMMENDED BY STAFF AND RUCO, AND THEIR RESPECTIVE RECOMMENDATIONS FOR THE RATE OF RETURN ON FAIR VALUE RATE BASE.

A. Staff determined a cost of equity of 9.6 percent based on the average cost of equity produced by its DCF and CAPM models (10.3 percent) and a 70 basis point downward adjustment for BMSC's lower financial risk as compared to the publicly traded water utilities in Staff's sample group.[5] Staff did not consider any of

[3] The unemployment rate recently jumped to 9.8%, which is higher than the unemployment rate during the 2001 recession.

[4] Blue Chip Financial Forecasts, Vol. 28, No. 10, October 1, 2009.

[5] *See* Direct testimony of Juan C. Manrique ("Manrique Dt.") at 32 and 33.

BMSC's firm-specific risks other than financial risk. Like the Company, Staff is recommending a capital structure consisting of 100 percent equity.[6] Based on a capital structure of 0 percent debt and 100 percent equity, Staff determined the WACC for BMSC to be 9.6 percent.[7]

RUCO determined its recommended cost of equity, 8.22 percent, based on the average cost of equity of its DCF and CAPM results.[8] RUCO is also recommending a hypothetical capital structure of 40 percent debt and 60 percent equity.[9] RUCO's recommended cost of debt is 6.26 percent, based the average cost of debt for seven publicly traded water companies followed by Value Line.[10] Based on a hypothetical capital structure of 40 percent debt and 60 percent equity, RUCO computed a WACC of 7.43 percent, which is RUCO's recommended rate of return on FVRB.[11] RUCO also did not consider firm-specific risks other than financial risk.

III. RESPONSE TO STAFF'S COST OF CAPITAL ANALYSIS

A. Staff's Financial Risk Adjustment

Q. DID STAFF RECOMMEND A FINANCIAL RISK ADJUSTMENT?

A. Yes, and my primary criticism of Staff's financial risk adjustment is that a beta for BMSC is required to make this adjustment, yet BMSC does not have a beta because it is not publicly traded. Staff assumes the beta of the large publicly traded utility companies is the beta for BMSC. I believe that BMSC, if it were publicly

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[6] *Id.* at 34.

[7] *Id.*

[8] *See* Rigsby Dt. at 7.

[9] *Id.*

[10] *Id.*

[11] *Id.* at 8.

traded, would have a higher beta than the sample water utility companies.[12] In Chapter 7 of Morningstar's *Ibbotson SBBI 2009 Valuation Yearbook*, for example, Ibbotson reports that when betas are properly estimated, betas are larger for smaller companies than for larger companies. A higher beta for BMSC would result in a much lower financial risk adjustment using the Hamada method Staff employs.

A secondary criticism is that Staff ignores the higher risk of BMSC due to its small size. If Staff is going to make a financial risk adjustment for differences in the capital structures between Staff's water proxy group and BMSC, it should also consider a small firm risk premium to account for firm size differences. Ibbotson finds that even after accounting for differences in beta risk, small firms require an additional risk premium over and above the added risk premium indicated by differences in beta risk.[13] Another reviewer also reported evidence that the stocks of small water utilities, like BMSC, are more risky than the stocks of larger water utilities, such as those in the water utilities sample.[14] Even the California PUC conducted a study that showed smaller water utilities are more risky than larger ones.[15] Frankly, it seems to me indisputable that investors require higher returns on small company stocks as compared to large company stocks.

As a consequence of smaller firms having higher risks (after accounting for differences in beta risk), an additional small firm risk premium should be considered. In the end, differences in financial risk can be more than offset by the required small firm risk premium.

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[12] Bourassa Dt. at 37.

[13] *Ibbotson SBBI 2009 Valuation Yearbook* Chapter. 7 (Morningstar).

[14] Thomas M. Zepp, *Utility Stocks and the Size Effect – Revisited*, The Quarterly Review Economics and Finance, Vol. 43, Issue 3, 578-582 (Autumn 2003).

[15] Staff Report on Issues Related to Small Water Utilities, June 10, 1991 and CPUC Decision 92-03-093.

Q. HAVE YOU PREPARED AN ATTACHMENT SUMMARIZING YOUR ASSESSMENT OF THE ADDITIONAL RISK PREMIUMS REQUIRED FOR SMALLER FIRMS LIKE BMSC?

A. Yes. I have included at COC-RB Attachment 1 the results of an *Ibbotson* study using annual data reporting the size premium based upon firm size and return data provided in Morningstar *Ibbotson SBBI 2009 Valuation Yearbook* and information contained in a published work by Dr. Thomas M. Zepp. I have estimated that a small company risk premium in the range of 99 to 181 basis points is appropriate. To be conservative, I would estimate a small company risk premium of no less than 100 basis points is warranted for BMSC. Putting aside the fact that Staff's financial risk adjustment is too high because the beta for BMSC would be higher than the average beta of Staff's water proxy group, the upward 100 basis point small firm risk premium would more than offset the downward 70 basis point financial risk adjustment recommended by Staff.

Q. DO INVESTORS CONSIDER THESE RISKS?

A. Of course. Contrary to Mr. Manrique's assertion that the risks due to small size and risks associated with the Arizona regulatory requirements use of historic test years and limited out of period adjustments are "unique" risks,[16] the market risk for small utilities and small utilities doing business in Arizona, like BMSC, is important to investors, and these risks are not captured by the market data of the water utility proxy group Staff uses to estimate the cost of equity for BMSC. Again, none of the utilities in Staff's water proxy group are of comparable size to BMSC.[17] In fact, BMSC is but a small fraction of the size of the water utilities in Staff's water proxy group. Neither are any of the water utilities in Staff's water

[16] Manrique Dt. at 40.

[17] Bourassa Dt. at 19.

proxy group subject exclusively to Arizona regulation.[18] Had Mr. Manrique used a proxy group consisting of utilities of similar size to BMSC and primarily subject to Arizona regulation I would have no argument. But, sadly there is no such market data available.

In summary, as I testified, the criteria established by the Supreme Court in decisions such as *Bluefield Water Works* require the use of comparable companies, i.e., companies that would be viewed by investors as having similar risks. A rational investor would not regard BMSC has having the same level of risk as Aqua America or even Connecticut Water just because they all sell water under state regulation.[19]

Q. ARE YOU PERSUADED BY MR. MANRIQUE'S TESTIMONY ON PAGE 41, WHERE HE REFERENCES PRIOR COMMISSION DECISIONS THAT THE DID NOT FIND A FIRM SIZE PHENOMENON FOR REGULATED UTILITIES?

A. No. Frankly, failure to recognize a small firm risk existence despite an abundance of empirical financial evidence suggesting otherwise is another reason why it is more risky for smaller utilities to do business in Arizona. Investors do recognize the unfavorable regulatory environment here in Arizona. Standard and Poor's, for example, issued a report in November 2008 which ranked Arizona among the least credit supportive regulatory environments.[20] Arizona's regulatory environment may drive investors to invest in utilities in states with more favorable regulatory environments, such as California.[21] Three of the six utilities in the Staff's water

[18] *Id.* at 20-23.

[19] *Id.*

[20] *Assessing U.S. Utility Regulatory Environments*, Rating Directs, Standard and Poor's (November 7, 2008); *see also* Sorensen Rb. at 11.

[21] Bourassa COC Dt. at 15-16; *see also* Sorensen Rb. at 11.

proxy group are located in California, which offers a more favorable regulatory environment by using future test years and adjustor/balancing accounts in its rate-setting process. As a result, utilities in Arizona are finding it increasingly difficult to attract capital as investors invest their funds in less-risky regulatory environments.

B. <u>Response to Staff' Criticisms of BMSC Cost of Capital Analysis</u>

Q. PLEASE RESPOND TO MR. MANRIQUE'S TESTIMONY ON THE ARTICLE, "CHOICE AMONG METHODS OF ESTIMATING SHARE YIELD", BY GORDON, GORDON, AND GOULD, WHICH ARTICLE YOU REFERENCED AS SUPPORTING ESTIMATING THE DCF GROWTH RATE.

A. Mr. Manrique characterizes the article as merely an "article that describes more generally the methods exclusively using analysts' forecasts [as] 'popular and attractive models'; but the article does not support the conclusion that analyst forecasts should be used alone."[22] However, the article reported on a formal study conducted by the authors which concluded:

> We have compared the accuracy of four methods for estimating the growth component of the discounted cash flow yield on a share: pats growth in earnings (KEGR), past growth in dividends (KDGR, past retention growth rate (KBRG), and forecasts of growth by security analysts (KFRG)..... For our sample of utility shares, KFRG performed well, with KBRG, KDGR, and KEGR following in that order, and with KEGR a distant fourth....
>
> Before closing, we have three observations to make. First, the superior performance by KFRG should come as no surprise. All four estimates of growth rely upon past data, but in the case of KFRG a larger body of past data is used, filtered through a group of security analysts who adjust for

[22] Manrique Dt. at 36.

abnormalities that are not considered relevant for future growth...[23]

As I testified, to the extent that past results provide useful indications of future growth prospects, analysts' forecasts or growth would already incorporate that information.[24] In addition, a stock's current price reflects known historic information on that company, including its past earnings history.[25] If investors rely on such analysts' growth rate forecasts those are the forecasts of relevance to the determination of equity costs.

Q. PLEASE COMMENT ON MR. MANRIQUE'S TESTIMONY ON PAGE 36-37 REFERENCING PROFESSOR GORDON'S REMARKS AT THE 30TH ANNUAL FORUM OF THE SOCIETY OF UTILITY AND REGULATORY FINANCIAL ANALYSTS.

A. First, let me state that I do not know the context upon which Professor Gordon made his remarks. Further, in the quoted remarks Professor Gordon does not say anything about past growth rates. There is no reference in the quotation as to which past growth rates (EPS, DPS, book value) should be used, if any, or what weighting past growth rates should be given when estimating the growth rate for the DCF model.[26] Having said that, Mr. Manrique confirms "Professor Gordon would temper the typically higher analysts' growth rates with the typically lower GNP growth rate."[27] I am sure Mr. Manrique would agree that I have done this in

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[23] David A. Gordon, Myron J. Gordon and Lawrence I Gould, *Choice Among Methods of Estimating Share Yield*, Journal of Portfolio Management 50-55 (Spring 1989).

[24] Bourassa Dt. at 32.

[25] *Id.*

[26] Staff has not provided Professor Gordon's complete remarks in their work papers.

[27] Manrique Dt. at 37.

my two-stage DCF model.[28] The result of my two-stage DCF model indicates a cost of equity of 11.7 percent. Compare that to Staff's overall DCF results of 9.8 percent. So, having tempered the analysts' growth rates I employ with a lower GNP, my estimate is still significantly greater than Staff's. This is the result of Staff's models being heavily weighted on low historical growth rates.

Q. DOES MR. MANRIQUE STATE THAT INVESTORS RELY ON ANALYST ESTIMATES?

A. Yes.[29] He also states that investors rely "to some extent on past growth as well." However, he does not provide support as to what extent investors rely on past growth rates, only that they are considered. Staff's approach to estimating the growth rate gives 50 percent weight to historic growth rates. If analyst estimates already consider past growth, then Staff vastly overstates the impact of past growth rates in its growth rates. And, by utilizing past growth rates that produce extremely low results, Staff biases its DCF results downward.

Q. PLEASE EXPLAIN.

A. I have prepared two exhibits that demonstrate the unrealistically low results produced by Staff's historical growth rates. COC-RB Attachment 2 and COC-RB Attachment 3 show the DCF results produced by Staff's historical DPS and EPS growth rates. For example, as shown in COC-RB Attachment 2, Staff's historical DPS growth rates produce indicated costs of equity *below* the cost of debt for 3 of the 6 publicly traded water utilities in Staff's water proxy group – one as low as 3.9 percent. The average indicated cost of equity is 6.6 percent, which is nearly at the current cost of Baa investment grade bonds at 6.5 percent and well below the expected Baa investment grade bond cost of 7.5 percent during the period of time

[28] Rebuttal Schedule D.4-10.

[29] Manrique Dt. at 37.

new rates will be in effect. As shown in COC-RB Attachment 3, Staff's historical EPS growth rate produces indicated costs of equity *below* the cost of debt for 3 of the 6 publicly traded water utilities in Staff's water proxy group – one as low as 4.9 percent. Again, the average indicated cost of equity is only 6.8 percent, not much above the current cost of Baa investment grade bonds and well below the expected cost of Baa investment grade bonds during the period of time new rates will be in effect. Thus, while Mr. Manrique criticizes my use of analyst estimates, he does not explain why growth rates which produce indicated costs of equity below the cost of debt are reasonable and should be given 50 percent weight in his DCF growth estimate computation or even why they should be considered in this case.

Q. DO YOU HAVE OTHER COMMENTS IN RESPONSE TO MR. MANRIQUE'S TESTIMONY ON ANALYST ESTIMATES?

A. Yes. Mr. Manrique's reliance on the study by David Dreman is puzzling.[30] Even though Mr. Dreman has criticized analysts' growth rates as being too optimistic, Mr. Dreman also says *investors rely on those forecasts*.

> We have also seen that in spite of high error rates being recognized for decades, neither analysts nor investors who religiously depend on them have altered their methods in any way.[31]

If investors rely on analysts' growth rate forecasts, those forecasts should be used to determine the cost of equity. Those growth rates influence the prices investors will pay for stocks and thus impact the dividend yields. The dividend yields change until the sum of the dividend yield plus the growth rate equals investors' perceived cost of equity. Had the growth forecasts been lower – as Mr.

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[30] Manrique Dt. at 37.

[31] David Dreman, *Contrarian Investment Strategies: The Next Generation* 115-116 (Simon & Schuster 1998).

Manrique suggests they should be – the stock prices would be lower and dividend yields would be higher, but there would not necessarily be any difference in the ultimate estimate of the cost of equity.

Mr. Manrique's reliance on the quote from Jeremy Siegel that dividends and not earnings are meaningful is also puzzling.[32] The DCF model assumes, among other things, that a firm will have a stable dividend payout policy and a stable earned return on book value. Thus, the stock price, book value, dividends, and earnings all grow at the same rate. While it is appropriate to make such assumptions for forecasting purposes, these assumptions are frequently violated when examining historical data. As it turns out, the historical growth in the stock price, book value, dividends, and earnings for the water have not been the same.[33] As a result, estimates of long-term growth rates should take this into account.

IV. RESPONSE TO RUCO'S COST OF CAPITAL ANALYSIS

A. Use of Gas Utilities to Develop Cost of Equity

Q. HOW DOES THE SAMPLE OF WATER UTILITIES MR. RIGSBY USED TO ESTIMATE THE COST OF EQUITY COMPARE TO THE UTILITIES USED BY THE COMPANY AND STAFF?

A. Mr. Rigsby used three publicly traded water utilities. He used the three largest water utilities out of the six water utilities that I have used and Staff typical uses when performing its cost of capital analysis.

Q. DOES MR. RIGSBY ALSO USE SAMPLE GAS COMPANIES TO DEVELOP HIS ESTIMATE OF THE COST OF EQUITY? HOW DO THEY COMPARE TO THE SAMPLE WATER COMPANIES?

A. Yes. He uses ten natural gas companies. However, the sample gas utilities are less

[32] Manrique Dt. at 39.

[33] *See* Rebuttal Schedule D.4-3 and Rebuttal Schedule D.4-4.

risky and therefore are not comparable to water utilities. His sample water companies, for example, have an average beta of 0.75, while his sample gas companies have an average beta of just 0.67.[34] That means that the equity cost for the water utility should be greater than the gas companies, based on their relative riskiness.

The water utility sample has more systematic risk than the gas utility sample. Mr. Rigsby erroneously assumes that the gas utilities and water utility have the same systematic risk and are directly comparable, when they are not.

Q. CAN THE GAS UTILITIES BE USED TO ESTIMATE BMSC'S COST OF EQUITY?

A. Yes, if the results produced by the DCF and CAPM models are adjusted upward to reflect the water utilities' additional risk. Mr. Rigsby, however, has made no adjustment to account for the water utilities' additional risk.

Q. HAS THIS ISSUE EVER COME UP BEFORE?

A. Yes. In several prior cases, water utilities presented evidence of the cost of equity using financial data for a similar group of publicly traded gas companies, which at that time had a higher average beta than the water utility sample. In rejecting this evidence, the Commission adopted Staff's argument that because the water utility sample had a lower average beta than the gas utility sample, the cost of equity for the water utility should be lower. For example, in Arizona Water Company's Eastern Group rate case, the water utility sample had an average beta of 0.59, while the gas utility sample had an average beta of 0.69. Staff estimated that based on

[34] *See* RUCO Schedule WAR-7, page 1 of 2.

the difference in the two groups' betas, the sample gas companies has an equity cost that is 100 basis points higher than the water utilities.[35]

Q. WHAT IS THE IMPACT OF RUCO'S USE OF THE GAS UTILITIES TO ESTIMATE THE COST OF EQUITY IN THIS CASE?

A. By averaging the results of his equity cost estimate for the water utility sample with his equity cost estimate for the gas utility sample, Mr. Rigsby has depressed the cost of equity estimates. For example, the average of Mr. Rigsby's CAPM estimates for the water companies and gas companies are 6.37 percent and 5.93 percent, respectively. This is a 44 basis point difference.

Q. HOW WOULD AN APPROPRIATE RISK ADJUSTMENT BE CALCULATED?

A. By using the CAPM. As I explained above, the difference between the results produced by Mr. Rigsby's CAPM model is 44 basis points. Because of the method used by Mr. Rigsby to implement the CAPM, however, 44 basis points understates the required adjustment to properly reflect the gas utilities' lower investment risk. If my method and inputs are used instead, similar to the method used in the aforementioned Arizona Water Eastern Group case, the result is 160 basis points, calculated as follows:

	Rf		Beta		Rp		K
Historic MRP	3.0%	+	0.67	X	6.9%	=	7.6%
Current MRP	4.3%	+	0.67	X	16.9%	=	15.6%
Average Gas Utility Sample							11.6%
Average Water Utility Sample[36]							13.2%
Difference/Risk Adjustment							**1.6%**

[35] Decision No. 66849 at 21 (March 19, 2004); *see also Arizona-American Water Company* Decision No. 67093 at 27 (June 30, 2004).

[36] *See* Rebuttal Schedule D-4.13.

Given this difference, it is clearly inappropriate to simply average the gas utilities' equity cost with the water utilities' equity cost, as Mr. Rigsby has done. This error assumes that a typical gas utility has the same investment risk as a typical water utility, which is simply not the case at the present time. As a result, Mr. Rigsby's use of gas utilities depresses the cost of equity for BMSC.

B. <u>Criticisms of RUCO's Implementation of the CAPM</u>

Q. WHAT OTHER CONCERNS DO YOU HAVE WITH RESPECT TO MR. RIGBY'S CAPM ANALYSIS?

A. I have four other concerns with respect to Mr. Rigsby's CAPM analysis. First, Mr. Rigsby employs a geometric average in calculating the market risk premium in his CAPM. His choice to use geometric average depresses his cost of equity estimate downward. An arithmetic average is the correct approach to use in estimating the cost of capital, as various experts have explained.[37] In fact, the CAPM was developed on the premise of expected returns being averages and risk being measured with the standard deviation. As Dr. Morin states,

> Since the latter **[standard deviation]** is estimated around the arithmetic average, and not the geometric average, it is logical to stay with arithmetic averages to estimate the market risk premium. In fact, annual returns are uncorrelated over time, and the objective is to estimate the market risk premium for the next year, the arithmetic average is the best unbiased estimate of the premium.[38]

Attached as COC-RB Attachment 4 is an excerpt from Dr. Roger Morin's textbook on regulatory finance, which provides a detailed discussion of this issue.[39]

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[37] Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance* 156-157 (7th ed. 2003); Roger A. Morin, *New Regulatory Finance* 156-157 (Public Utility Reports, Inc. 2006) ("*Morin*"); *Ibbotson SBBI 2008 Valuation Yearbook* 77-78 (Morningstar).

[38] *Morin, supra,* at 157-157.

[39] *Morin* at 133-43.

Second, Mr. Rigsby uses the U. S. Treasury total returns in his computation when he should have used U.S. Treasury income returns. As I explained in my direct testimony, the market risk premium is calculated by subtracting the risk-free rate from the market return.[40] Mr. Rigsby erroneously used the average total return on a Treasury security rather than the average income return. As shown on Schedule WAR-7, at page 2, attached to Mr. Rigsby's direct testimony, the total return used to calculate the market risk premium was 5.6 percent. This was the average total return on an intermediate-term Treasury (1926-2008) as published in the *2009 Ibbotson SBBI Valuation Edition Yearbook* (Table 2-1). By contrast, the average income return for an intermediate-term Treasury security was 4.7 percent.

The reason that an average income return must be used, rather than the average total return, is quite straightforward. The CAPM is a risk premium methodology that is based on the premise that an investor expects to earn a return equal to the return on a risk-free investment plus a premium for assuming additional risk that is proportional to the security's market risk (i.e., its beta). U.S. Treasuries are commonly used as a proxy for the risk-free rate because they are backed by the United States government, effectively eliminating default risk. The income return is the portion of the total return that results from the bond's periodic cash flow, i.e., the interest payments. The income return provides an unbiased estimate of the riskless rate of return because an investor can hold the Treasury security to maturity and receive fixed interest payments with no capital loss or capital gain. If the total return on a Treasury security is used instead, additional risk is injected into the CAPM estimate, which is inconsistent with treating the security as a riskless asset. As explained by *Ibbotson*:

[40] Bourassa Dt. at 37.

> Another point to keep in mind when calculating the equity risk premium is that the income return on the appropriate-horizon Treasury security, rather than the total return, is used in the calculation. The total return is comprised of three return components: the income return, the capital appreciation return, and the reinvestment return. The income return is defined as the portion of the total return that results from a periodic cash flow or, in this case, the bond coupon payment. The capital appreciation return results from the price change of a bond over a specific period. Bond prices generally change in reaction to unexpected fluctuations in yields. Reinvestment return is the return on a given month's investment income when reinvested into the same asset class in the subsequent months of the year. The income return is thus used in the estimation of the equity risk premium because it represents the truly riskless portion of the return.[41]

As a consequence of incorrectly using U.S. Treasury total returns and well as geometric means, RUCO's CAPM estimate dramatically understates the cost of equity for the water utility sample. If an intermediate-term Treasury security is used as the proxy for the risk-free rate of return, the market risk premium would increase to 6.9 percent from 6.1 percent using the conceptually correct arithmetic averages. If that market risk premium is substituted for the 6.1 percent market risk premium used by Mr. Rigsby, the arithmetic mean CAPM cost of equity for his water utility sample would increase from 7.08 percent to 7.69 percent – an increase of 61 basis points.

Third, Mr. Rigsby has ignored current market risk. This Commission has consistently approved the use of a current market risk premium in implementing the CAPM in water and wastewater utility rate cases. In the Chaparral City case,[42] for example, the Commission adopted cost of capital used an historic market risk

[41] *Ibbotson* at 75-76.

[42] *Chaparral City Water Company*, Decision No. 68176 (September 30, 2005).

premium and a current market risk premium in its CAPM estimates.[43] RUCO, however, has ignored current market risk in its CAPM estimates and has relied instead on incorrectly calculated historic market risk premiums.

Changes in the current market risk premium have been a significant factor in the cost of equity authorized by the Commission for water and wastewater utilities. In Arizona Water Company's Eastern Group case, filed in 2002, Staff computed a current market risk premium of 13.1 percent in its CAPM estimate, and relied on that market risk premium in estimating a cost of equity of 9.2 percent, using the same six sample water utilities.[44] At that time, the country was in the midst of a recession, and, according to Staff, interest rates had fallen to the lowest levels since the 1950s.[45] Moreover, the average beta of Staff's water utility sample group was only 0.59 at that time, indicating that investment risk for the water utility industry was low relative to the market.[46]

Two years later, Arizona Water Company filed a rate case for its Western Group systems. Interest rates had increased from the levels in 2003, and the average beta of the Staff's sample utilities had increased as well, indicating greater investment risk. However, Staff's cost of equity estimate was virtually identical to the Eastern Group case, 9.1 percent.[47] The primary reason was that Staff's current

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[43] *See* Direct Testimony of Alejandro Ramirez, Docket No. W-02113A-04-0616 (March 22, 2005); Surrebuttal Testimony of Alejandro Ramirez, Docket No. W-02113A-04-0616 (May 5, 2005).

[44] Decision No. 66849 at 21 (March 19, 2004); *see also* Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-0619, 24-25 (July 8, 2003).

[45] Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-0619, 5 (July 8, 2003).

[46] Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-0619, 23 (July 8, 2003); *see also* Decision No. 66849 at 20.

[47] Surrebuttal Testimony of Alejandro Ramirez, Docket No. W-01445A-04-0650, Sch. AXR-8 (May 25, 2005).

market risk premium had dropped from 13.1 percent to 7.8 percent.[48] The Commission, in adopting Staff's CAPM estimate, relied on this change, explaining that "while interest rates have gone up, the cost of equity for the market as a whole has decreased, while the cost of equity for utilities has remained relatively stable."[49]

Even more recently, in Black Mountain Sewer Corporation's rate case, the Commission relied on a further decline in the current market risk premium to support Staff's recommended 9.6 percent cost of equity.[50] In that case, interest rates and the average beta of the sample group were even higher than 2003 levels, and while the result produced by Staff's models was higher, the increase was not as large as would be expected.[51] The reason was that the current market risk premium had decreased to only 5.7 percent, reducing the result produced by the CAPM. Thus, while interest rates increased and the investment risk of the water utility sample had increased, Staff explained that those increases were offset by a further decline in the current market risk premium, indicating that the overall risk of the market had declined.[52]

As these decisions show, not only has the Commission consistently considered the current market risk premium, but changes in the current market risk premium have had a major impact on the cost of equity, offsetting changes in

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[48] *Id.*

[49] *Arizona Water Co. (Western Group)*, Decision No. 68302 at 38 (Nov. 14, 2005).

[50] *Black Mountain Sewer Corp.*, Decision No. 69164 (Dec. 5, 2006).

[51] In the Black Mountain case, the intermediate-term Treasury used by Staff in its CAPM was 4.8 percent, while the average beta of Staff's sample group was 0.74. Surrebuttal Testimony of Pedro M. Chaves, Docket No. SW-02361A-05-0657, Sch. PMC-2 (May 4, 2006). In Arizona Water's Eastern Group case, in contrast, the intermediate-term Treasury used by Staff in its CAPM was 3.3 percent, while the average beta of Staff's sample group was 0.59. Direct Testimony of Joel M. Reiker, Docket No. W-01445A-02-0619, Sch. JMR-7 (July 8, 2003).

[52] *Black Mountain Sewer Corp.*, Decision No. 69164 at 25-26 (Dec. 5, 2006).

interest rates and water utility betas in recent cases. Further, RUCO's witness has acknowledged the importance of considering current market conditions in determining the cost of equity:

> Consideration of the economic environment is necessary because trends in interest rates, present and projected levels of inflation, and the overall state of the U.S. economy determine the rate of return that investors earn on their invested funds. Each of these factors represent potential risks that must be weighed when estimating the cost of equity capital for a regulated utility and are, most often, the same factors considered by individuals who are also investing in non-regulated entities.[53]

In light of the current volatility in the financial markets, the failure to consider current market risk would grossly distort the CAPM result. Consequently, RUCO's use of two historic market risk premiums (one of which is conceptually wrong for the reasons given previously) without considering the impact of current market risk on investor expectations invalidates RUCO's cost of equity estimate.

Finally, and perhaps most importantly of all, three of the four of Mr. Rigsby's CAPM estimates (one for water and two for the gas utilities), as well as his overall CAPM result, are at or below the current cost of Baa investment grade bonds. The current cost of investment grade bonds in 6.5 percent. The following are the results of Mr. Rigsby's CAPM as shown on WAR-1, page 3 of 3:

Geometric mean CAPM estimate - water companies	5.66%
Arithmetic mean CAPM estimate - water companies	7.08%
Geometric mean CAPM estimate - gas companies	5.30%
Arithmetic mean CAPM estimate - gas companies	6.56%
Overall CAPM result	6.15%

[53] Rigsby Dt. at 38-39.

A simple reality check should have caused Mr. Rigsby to question his inputs to the CAPM. This clearly demonstrates that RUCO's methods are not only biased downward, but should not be used.

C. <u>Criticisms of RUCO's Use of Hypothetical Capital Structure</u>

Q. WHY DOES MR. RIGSBY PROPOSE THE USE OF A HYPOTHETICAL CAPITAL STRUCTURE?

A. Mr. Rigsby explains that his hypothetical capital structure is to account for the lower financial risk of BMSC when compared to his sample of publicly traded water companies.[54] His sample publicly traded water utilities had approximately 50.4 percent debt and 49.6 percent equity.[55] He advocates use of a 40 percent debt and 60 percent equity rather than a 50.4 percent debt and 49.6 percent equity because he believes that the higher level of equity in his hypothetical capital structure will compensate the Company's shareholder for any perceived higher levels of company specific risk.[56]

Q. HOW MUCH ADDITIONAL RETURN FOR COMPANY SPECIFIC RISK IS IMPLIED BY USING A 40 PERCENT DEBT AND 60 PERCENT EQUITY AS OPPOSED TO A 50.4 PERCENT DEBT AND 49.6 PERCENT EQUITY USING RUCO'S MODELS?

A. Less than 20 basis points. But this is an illusion. By recommending a hypothetical capital structure that assumes a higher amount of debt for rate making than actually exists, Mr. Rigsby effectively reclassifies investor equity investment to debt and then provides a return on that equity investment equal to Mr. Rigsby's proposed hypothetical debt cost of 6.26 percent. Mr. Rigsby concludes that the cost of

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[54] *Id.* at 55.

[55] *Id.* at 54.

[56] *Id.* at 55.

equity is 8.22 percent. But, by virtue of the hypothetical capital structure, RUCO provides an equity return of 6.26 percent on 40 percent of the shareholder's equity investment – 196 basis points below what even Mr. Rigsby would agree is the required return for equity (8.22 percent less 6.26 percent).

To make matters worse, RUCO witness, Mr. Moore, imputes hypothetical interest expense through interest synchronization in BMSC's income tax computation, which artificially lowers the Company's income taxes and revenue requirement. Together, the lower return provided to investors on equity capital and the lower revenue requirement due to lower income taxes result in a net negative equity risk premium of well over 200 basis points.

Q. WOULD AN ADDITIONAL 20 BASIS POINTS, IF IT WERE REAL, ADEQUATELY COMPENSATE BMSC FOR THE ADDITIONAL RISKS BMSC FACES COMPARED TO THE LARGE PUBLICLY TRADED UTILITIES?

A. No. As I discussed earlier in my testimony, I believe a risk premium above the estimated cost of equity is warranted for BMSC on the order of 100 basis points.

Q. HAS FINANCIAL RISK BEEN ACCOUNTED FOR USING A HYPOTHETICAL CAPITAL STRUCTURE IN PRIOR WATER AND WASTEWATER RATE CASES?

A. Only in Gold Canyon, which I mentioned above and which is on appeal. In the last BMSC case, the Commission rejected the exact position advanced by RUCO in this case as "results oriented."[57] Instead, the "typical" method, as RUCO recognized in this case, is by a direct financial risk adjustment to the cost of equity. Downward financial risk adjustments adopted by the Commission have typically been based upon the Hamada method as described previously.

[57] Decision No. 69164 at 20.

Q. ARE DOWNWARD ADJUSTMENTS TO THE COST OF EQUITY FOR FINANCIAL RISK BY THIS COMMISSION COMMON?

A. No. Downward adjustments to the cost of equity for financial risk are not adopted as often as one would think. The downward adjustment often depends on whether a reasonable return on equity is afforded to the utility based on consideration of all of the evidence in the case. In some cases, even though the Hamada indicates a higher downward adjustment, the cost of equity is adjusted downward less than what may be indicated by the Hamada adjustment. In the Bella Vista Water Company case,[58] for example, the Hamada adjustment indicated an 89 basis point reduction to the cost of equity which would have resulted in an 8.4 percent return on equity. However, Staff did not recommend an 8.4 percent cost of equity, but rather recommended the low end of its cost of equity range of 9.1 percent to 9.5 percent.[59] The Commission ultimately adopted Staff's recommended 9.1 percent.[60] In the prior BMSC rate case,[61] Staff's cost of equity analysis produced an indicated cost of equity of 9.60 percent (before adjusting for financial risk). Staff's calculated financial risk adjustment using the Hamada methodology was 50 basis points but Staff did not recommend a downward adjustment in that case.[62] Ultimately, the Commission, based on the evidence in that case, adopted a 9.6 percent return on equity.[63]

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[58] Decision No. 65350 (November 1, 2002).

[59] *See* Direct Testimony of William S. Reiker, Docket No. W-02465A-01-0776. 26-27 (April 29, 2002).

[60] Decision No. 65350 at 23.

[61] Decision No. 69164 (December 5, 2006).

[62] *See* Surrebuttal Testimony of Pedro M. Chaves, Docket SW-02361A-05-0657, Sch. PMC-2 (May 4, 2006).

[63] Decision No. 69164 at 27.

The bottom line is that downward adjustments for financial risk must be used cautiously. Final consideration must always be given to whether the result is fair and reasonable under the circumstances. One reason for this is that basis for the cost of capital analyses are often based on large publicly traded water companies, which are not directly comparable to the relatively small water and sewer utilities in Arizona.[64] There are also considerations as to the requirements set forth in the *Hope* and *Bluefield* cases.

Q. IF MR. RIGSBY HAD COMPUTED A FINANCIAL RISK ADJUSTMENT USING THE HAMADA METHOD WHAT WOULD IT HAVE BEEN?

A. If Mr. Rigsby had performed a Hamada type financial risk adjustment, his financial risk adjustment would have been about 30 basis points. Subtracting this from his overall cost of equity result of 8.22 percent would have put his final estimate at 7.92 percent. This is approximately 50 basis points higher than his WACC of 7.43 percent.

D. <u>Criticisms of RUCO's Cost of Debt</u>

Q. PLEASE COMMENT ON MR. RIGSBY'S HYPOTHETICAL COST OF DEBT.

A. As already mentioned, Mr. Rigsby's proposed cost of debt on his proposed 40 percent hypothetical debt is 6.26 percent. He bases this debt cost on the average weighted cost of debt for the water utilities in his water proxy group. But, these are

[64] Black Mountain Sewer has more zero cost capital in its capitalization than the large publicly traded water utilities. All things being equal, this results in a lower capital cost per dollar of plant-in service. But, the higher proportions of zero cost capital do not come without risk to the Company. CIAC funded plant receives no recovery of depreciation in rates. This plant will have to eventually be replaced. Further, earnings are lower which means a lower earnings cushion to pay debt holders, absorb increases in operating expenses as well as lower cash flows available to make plant replacements.

large publicly traded utilities, most of which have bond ratings. Mr. Rigsby assumes that BMSC could raise debt capital at this cost. I seriously doubt it could.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

BOURASSA
COST OF CAPITAL
SCHEDULES

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Cost of Capital

Exhibit
Rebuttal Schedule D-1
Page 1
Witness: Bourassa

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
6	Long-Term Debt[1]	-	0.00%	9.40%	0.00%	-	0.00%	9.40%	0.00%
8	Stockholder's Equity[2]	3,922,058	100.00%	12.40%	12.40%	4,311,330	100.00%	12.40%	12.40%
10	Totals	$ 3,922,058	100.00%		12.40%	$ 4,311,330	100.00%		12.40%

12	[1] Excluded long-term debt for Scottsdale Treatment Capacity	$ 1,010,649	. See D-2
13	[2] Adjusted for correction to accummulated depreciation of	$ 322,862	. See Direct B-2 Page 2
14	[3] Adjusted for correction to accummulated depreciation of	$ (97,641)	. See Rebuttal B-2, page 2
15	[4] Adjusted for correction to accummulated amortization	$ (271,031)	. See Direct B-2 Page 2
16	[5] Adjusted for deferred income taxes	$ 170,554	. See Direct B-2 Page 6
17	[7] Adjusted for deferred income taxes	$ 24,344	. See Rebuttal B-2, page 6

20 SUPPORTING SCHEDULES:
21 Rebuttal D-2
22 Rebuttal D-3
23 Rebuttal D-4

RECAP SCHEDULES:

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Long Term Debt

Exhibit
Rebuttal Schedule D-2
Page 1
Witness: Bourassa

Line No.	Description of Debt	End of Test Year Amount Outstanding	End of Test Year Annual Interest	End of Test Year Interest Rate	End of Test Year Weighted Cost	End of Projected Year Amount Outstanding	End of Projected Year Annual Interest	End of Projected Year Interest Rate	End of Projected Year Weighted Cost
1	Loan for Scottsdale Treatment Capacity	659,546	74,518	9.40%	6.13%	613,181	71,388	9.40%	6.13%
2	Loan for Scottsdale Treatment Capacity	351,103	39,325	9.40%	3.27%	327,694	36,010	9.40%	3.27%
3			-		0.00%	-	-	0.00%	0.00%
4			-		0.00%	-	-	0.00%	0.00%
5									
6									
7									
8									
9									
10									
11									
12									
13	Totals	$ 1,010,649	$ 113,843		9.40%	$ 940,875	$ 107,398		9.40%
14									
15	Supporting Schdules:								
16	E-2								
17									
18									
19									
20									
21									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Preferred Stock

Exhibit
Rebuttal Schedule D-3
Page 1
Witness: Bourassa

Line No.	Description of Issue	End of Test Year Shares Outstanding	End of Test Year Amount	End of Test Year Dividend Requirement	End of Projected Year Shares Outstanding	End of Projected Year Amount	End of Projected Year Dividend Requirement
1							
2							
3	NOT APPLICABLE, NO PREFERRED STOCK ISSUED OR OUTSTANDING						
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17	SUPPORTING SCHEDULES:			RECAP SCHEDULES:			
18				Rebuttal D-1			
19							
20							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Common Equity

Exhibit
Rebuttal Schedule D-4
Page 1
Witness: Bourassa

Line No.	
1	
2	The Company is proposing a cost of common equity of 12.4%.
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	SUPPORTING SCHEDULES: RECAP SCHEDULES:
18	Rebuttal D-4.0 to D-4.13 Rebuttal D-1
19	
20	

Black Mountain Sewer Corporation
Summary of Results

Exhibit
Rebuttal Schedule D-4.0
Witness: Bourassa

Line No.	Method	Low	High	Midpoint
1				
2				
3				
4	Method	Low	High	Midpoint
5	DCF Constant Growth	10.0%	15.3%	12.6%
6	DCF Sustainable Growth	9.5%	11.8%	10.7%
7	DCF Two-Stage	9.9%	13.8%	11.9%
8				
9	Average DCF Results	9.8%	13.6%	11.7%
10				
11	CAPM	8.5%	17.8%	13.2%
12				
13	Average DCF and CAPM Results	9.2%	15.7%	12.4%
14				
15				
16	Recommended cost of equity			12.4%
17				
18				
19				
20				
21				
22				
23				
24				
25				
26				
27				
28				

Black Mountain Sewer Corporation
Selected Characteristics of Water Utilities

Exhibit
Rebuttal Schedule D-4.1
Witness: Bourassa

Line No.	Company	% Water Revenues	Operating Revenues (millions)	Net Plant (millions)	S&P Bond Rating	Moody's Bond Rating
1						
2						
3	Company					
4	1. American States	82%	$ 299.1	$ 701.8	A	A2
5	2. Aqua America	87%	$ 604.6	$ 2,466.5	AA-	NR
6	3. California Water	97%	$ 378.2	$ 929.5	NR	NR
7	4. Connecticut Water	85%	$ 61.3	$ 239.2	AAA	NR
8	5. Middlesex	90%	$ 89.3	$ 307.2	A	NR
9	6. SJW Corp.	95%	$ 213.8	$ 476.8	NR	NR
10						
11	Average	89%	$ 274.4	$ 853.5		
12						
13	Black Mountain Sewer Corporation	0%	$ 1.6	$ 5.9	NR	NR
14						
15						
16						
17						
18						
19	Source:					
20	AUS Utility Reports (October 2009)					
21						
22						
23						
24						
25						
26						
27						
28						

Black Mountain Sewer Corporation
Capital Structures of Water Utilities

Exhibit
Rebuttal Schedule D-4.2
Witness: Bourassa

No.	Company	Book Value Long-Term Debt	Book Value Common Equity	Market Value Long-Term Debt	Market Value Common Equity
1					
2					
3					
4	1. American States	47.0%	53.0%	33.2%	66.8%
5	2. Aqua America	55.4%	44.6%	30.7%	69.3%
6	3. California Water	43.0%	57.0%	25.6%	74.4%
7	4. Connecticut Water	47.9%	52.1%	34.7%	65.3%
8	5. Middlesex	49.8%	50.2%	40.5%	59.5%
9	6. SJW Corp.	47.7%	52.3%	33.0%	67.0%
10					
11	Average	48.5%	51.5%	32.9%	67.1%
12					
13	Black Mountain Sewer Corporation	19.3%	80.7%	N/A	N/A
14					
15					
16	Source:				
17	Value Line Analyzer Data (October 16, 2009)				
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					

Black Mountain Sewer Corporation
Comparisons of Past and Future Estimates of Growth

Exhibit
Rebuttal Schedule D-4.3
Page 1
Witness: Bourassa

Line No.	Company	Five-year historical compound annual changes: Price	Book Value	DPS	EPS	Average Future Growth[1]
7	1. American States	8.84%	4.66%	1.99%	14.72%	6.88%
8	2. Aqua America	6.73%	9.84%	8.45%	5.07%	8.90%
9	3. California Water	14.51%	7.30%	0.70%	9.44%	7.90%
10	4. Connecticut Water	0.29%	3.50%	1.44%	0.45%	11.00%
11	5. Middlesex	Negative	6.34%	1.84%	7.85%	7.67%
12	6. SJW Corp.	17.82%	8.96%	5.81%	3.48%	10.00%
15	GROUP AVERAGE	9.64%	6.77%	3.37%	6.84%	8.72%
16	GROUP MEDIAN	8.84%	6.82%	1.91%	6.46%	8.40%

[1] See Rebuttal Schedule D-4.5

Sources:
Value Line Data
Yahoo Finance

Black Mountain Sewer Corporation
Comparisons of Past and Future Estimates of Growth

Exhibit
Rebuttal Schedule D-4.4
Page 1
Witness: Bourassa

Line No.	Company	Ten-year historical compound annual changes: Price	Book Value	DPS	EPS	Average Future Growth[1]
7	1. American States	9.72%	4.61%	1.47%	3.68%	6.88%
8	2. Aqua America	9.75%	9.39%	7.18%	6.20%	8.90%
9	3. California Water	8.42%	3.68%	0.91%	2.74%	7.90%
10	4. Connecticut Water	6.28%	3.76%	1.23%	1.45%	11.00%
11	5. Middlesex	7.37%	3.98%	1.93%	2.29%	7.67%
12	6. SJW Corp.	14.89%	4.85%	5.13%	3.64%	10.00%
15	GROUP AVERAGE	9.40%	5.05%	2.97%	3.33%	8.72%
16	GROUP MEDIAN	9.07%	4.30%	1.70%	3.19%	8.40%

[1] See Rebuttal Schedule D-4.5

Sources:
Value Line Data
Yahoo Finance

Black Mountain Sewer Corporation
Analysts Forecasts of Earnings Per Share Growth

Exhibit
Rebuttal Schedule D-4.5
Witness: Bourassa

Line No.	Company	(1) Zacks	(2) Morningstar	Yahoo	(3) Value Line	(4) Average Growth (G) (Cols 1-3)
		EPS GROWTH				
7	1. American States	7.00%	7.00%	4.00%	9.50%	6.88%
8	2. Aqua America	8.00%	8.80%	8.80%	10.00%	8.90%
9	3. California Water	8.00%	7.30%	7.30%	9.00%	7.90%
10	4. Connecticut Water	9.00%		15.00%	9.00%	11.00%
11	5. Middlesex	8.00%		8.00%	7.00%	7.67%
12	6. SJW Corp.	10.00%	10.00%	10.00%	10.00%	10.00%
15	GROUP AVERAGE	8.33%	8.28%	8.85%	9.08%	8.72%
16	GROUP MEDIAN					8.40%

Sources:
Value Line Investment Analyzer Data October 16, 2009
Zacks Investment Research Site October 16, 2009
Morningstar Website October 16, 2009
Yahoo Finance October 16, 2009

Black Mountain Sewer Corporation
Estimates of Sustainable Growth

Exhibit
Rebuttal Schedule D-4.6
Witness: Bourassa

Line No.		(1)	(2)	(3)	(4)	(5)
1						
2						
3						Average
4						Sustainable
5		Retention	Rate	br	sv	Growth
6	Company	Ratio	of Return	Growth	Growth	(Cols 3+4)
7	1. American States	0.51	12.00%	6.09%	1.62%	7.71%
8	2. Aqua America	0.50	11.50%	5.80%	0.31%	6.11%
9	3. California Water	0.49	12.00%	5.93%	1.14%	7.07%
10	4. Connecticut Water					
11	5. Middlesex					
12	6. SJW Corp.					
13						
14						
15	GROUP AVERAGE	0.50	11.83%	5.94%	1.02%	6.96%
16	GROUP MEDIAN	0.50	12.00%	5.93%	1.14%	7.07%
17						
18	Sources:					
19	Value Line Data					
20						
21						
22						
23						

Black Mountain Sewer Corporation
Estimates of sv Growth

Exhibit
Rebuttal Schedule D-4.7
Witness: Bourassa

Line No.		(1)	(2)	(3)	(4)
1					
2					
3					
4		Stock	Current		
5		Financing	Market to Book		sv
6	Company	Rate	Ratio	v	Growth
7	1. American States	3.69%	1.78	0.44	1.62%
8	2. Aqua America	0.48%	2.81	0.64	0.31%
9	3. California Water	2.08%	2.20	0.55	1.14%
10	4. Connecticut Water				na
11	5. Middlesex				na
12	6. SJW Corp.				na
13					
14					
15	GROUP AVERAGE	2.09%	2.26	0.54	1.02%
16	GROUP MEDIAN	2.08%	2.20	0.55	1.14%
17					
18	Sources:				
19	Value Line Data				
20					
21					

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model
Using Projected EPS Growth

Exhibit
Rebuttal Schedule D-4.8
Witness: Bourassa

Line No.	Company	(1) Spot Price (P_0)	(2) Current Dividend (D_0)	(3) Current Dividend Yield (D_0/P_0)	(4) Expected Dividend Yield (D_1/P_0)[1]	(5) Growth (g)[2]	(6) Indicated Cost of Equity k=Div Yld + g (Cols 3+4)
7	1. American States	36.08	1.04	2.88%	3.08%	6.88%	10.0%
8	2. Aqua America	16.65	0.54	3.24%	3.53%	8.90%	12.4%
9	3. California Water	39.56	1.18	2.98%	3.22%	7.90%	11.1%
10	4. Connecticut Water	22.80	0.88	3.86%	4.28%	11.00%	15.3%
11	5. Middlesex	15.44	0.70	4.53%	4.88%	7.67%	12.5%
12	6. SJW Corp.	22.66	0.65	2.87%	3.16%	10.00%	13.2%
15	GROUP AVERAGE			3.40%	3.69%	8.72%	12.4%
16	GROUP MEDIAN						12.5%

Sources:
Value Line Investment Analyzer Data October 16, 2009

[1] Expected Dividend Yield = $D_1/P_0 = D_0/P_0 * (1+g)$.
[2] See Rebuttal Schedules D-4.5

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Sustainable Growth

Exhibit
Rebuttal Schedule D-4.9
Witness: Bourassa

Line No.		(1)	(2)		(3)	(4)	(5)	(6)	(7)
1									
2									Indicated
3				Current	Expected				Cost of
4		Spot	Current	Dividend	Dividend	Sustainable Growth[2]			Equity
5		Price	Dividend	Yield	Yield			br+sv	k=Div Yld + g
6	Company	(P_0)	(D_0)	(D_0/P_0)	(D_1/P_0)[1]	br	vs	Growth (g)	(Cols 3+6)
7	1. American States	36.08	1.04	2.88%	3.10%	6.09%	1.62%	7.71%	10.8%
8	2. Aqua America	16.65	0.54	3.24%	3.44%	5.80%	0.31%	6.11%	9.5%
9	3. California Water	39.56	1.18	2.98%	3.19%	5.93%	1.14%	7.07%	10.3%
10	4. Connecticut Water	22.80	0.88	3.86%	4.13%			6.96%	11.1%
11	5. Middlesex	15.44	0.70	4.53%	4.85%			6.96%	11.8%
12	6. SJW Corp.	22.66	0.65	2.87%	3.07%			6.96%	10.0%
13									
14									
15	GROUP AVERAGE				3.63%			6.96%	10.6%
16	GROUP MEDIAN								10.5%
17									
18									
19	Sources:								
20	Value Line Investment Analyzer Data October 16, 2009								
21									
22	[1] Expected Dividend Yield = $D_1/P_0 = D_0/P_0 * (1+g)$.								
23	[2] See Rebuttal Schedules D-4.6 and 4.7								
24									

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Two-Stage Growth - Projected

Exhibit
Rebuttal Schedule D-4.10
Witness: Bourassa

Line No.		(1)	(2)		(3)	(4)	(5)	(6)	(7)
						Projected Growth Rates			
	Company	Spot Price (P_0)	Current Dividend (D_0)	Current Dividend Yield (D_0/P_0)	Expected Dividend Yield (D_1/P_0)[1]	Near Term[1]	Long Term (GDP)2	Average[3]	Indicated Cost of Equity
7	1. American States	36.08	1.04	2.88%	3.08%	6.88%	6.70%	6.82%	9.9%
8	2. Aqua America	16.65	0.54	3.24%	3.51%	8.90%	6.70%	8.17%	11.7%
9	3. California Water	39.56	1.18	2.98%	3.21%	7.90%	6.70%	7.50%	10.7%
10	4. Connecticut Water	22.80	0.88	3.86%	4.23%	11.00%	6.70%	9.58%	13.8%
11	5. Middlesex	15.44	0.70	4.53%	4.87%	7.67%	6.70%	7.35%	12.2%
12	6. SJW Corp.	22.66	0.65	2.87%	3.12%	10.00%	6.70%	8.91%	12.0%
15	GROUP AVERAGE				3.67%			8.06%	11.7%
16	GROUP MEDIAN								11.9%

[1] Expected Dividend Yield = $D_1/P_0 = D_0/P_0 * (1+g)$.
[2] Growth in GDP from 1938 to 2008.
[3] Near term growth given weighting of .67

Black Mountain Sewer Corporation
Market Betas

Exhibit
Rebuttal Schedule D-4.11
Witness: Bourassa

Line No.		Company	
1		Company	
2	1.	American States	0.80
3	2.	Aqua America	0.65
4	3.	California Water	0.75
5	4.	Connecticut Water	0.85
6	5.	Middlesex	0.80
7	6.	SJW Corp.	0.95
8		Average	**0.80**
9			
10	Source:		
11	Value Line Investment Analyzer Data October 16, 2009		
12			
13			
14			
15			
16			

Black Mountain Sewer Corporation
Computation of Current Market Risk Premium

Exhibit
Rebuttal Schedule D-4.12
Witness: Bourassa

Line No.	Month	Dividend Yield (D_0/P_0)[1]	Expected Dividend Yield (D_1/P_0)[2]	+	Growth (g)[3]	=	Expected Market Return (k)	-	Monthly Average 30 Year Treasury Rate[4]	=	Market Risk Premium (MRP)
4	Aug 2006	2.20%	2.20%	+	11.69%	=	13.89%	-	5.00%	=	8.89%
5	Jul	2.27%	2.27%	+	10.91%	=	13.18%	-	5.11%	=	8.07%
6	Aug	2.37%	2.37%	+	11.92%	=	14.29%	-	4.93%	=	9.36%
7	Sept	2.31%	2.31%	+	11.16%	=	13.47%	-	4.79%	=	8.68%
8	Oct	2.45%	2.45%	+	11.90%	=	14.35%	-	4.77%	=	9.58%
9	Nov	2.60%	2.60%	+	13.41%	=	16.01%	-	4.52%	=	11.49%
10	Dec 2007	2.61%	2.61%	+	13.51%	=	16.12%	-	4.52%	=	11.60%
11	Jan 2008	2.67%	2.67%	+	15.19%	=	17.86%	-	4.33%	=	13.53%
12	Feb	2.74%	3.19%	+	16.47%	=	19.66%	-	4.52%	=	15.14%
13	Mar	2.85%	3.35%	+	17.64%	=	20.99%	-	4.39%	=	16.60%
14	April	2.69%	3.11%	+	15.73%	=	18.84%	-	4.44%	=	14.40%
15	May	2.73%	3.15%	+	15.51%	=	18.66%	-	4.60%	=	14.06%
16	Jun	3.13%	3.71%	+	18.51%	=	22.22%	-	4.69%	=	17.53%
17	Jul	3.15%	3.74%	+	18.61%	=	22.35%	-	4.57%	=	17.78%
18	Aug	3.06%	3.59%	+	17.08%	=	20.67%	-	4.50%	=	16.17%
19	Sept	3.07%	3.66%	+	19.30%	=	22.96%	-	4.27%	=	18.69%
20	Oct	4.31%	5.63%	+	30.53%	=	36.16%	-	4.17%	=	31.99%
21	Nov	4.97%	6.71%	+	35.02%	=	41.73%	-	4.00%	=	37.73%
22	Dec 2008	4.44%	5.76%	+	29.62%	=	35.38%	-	2.87%	=	32.51%
23	Jan 2009	4.86%	6.32%	+	30.02%	=	36.34%	-	3.13%	=	33.21%
24	Feb	5.50%	7.43%	+	35.13%	=	42.56%	-	3.59%	=	38.97%
25	Mar	4.21%	5.36%	+	27.33%	=	32.69%	-	3.64%	=	29.05%
26	April	3.66%	4.47%	+	22.05%	=	26.52%	-	3.76%	=	22.76%
27	May	3.46%	4.14%	+	19.67%	=	23.81%	-	4.23%	=	19.58%
28	Jun	3.25%	3.87%	+	19.16%	=	23.03%	-	4.52%	=	18.51%
29	Jul	2.90%	3.37%	+	16.31%	=	19.68%	-	4.41%	=	15.27%
30	Aug	2.82%	3.22%	+	14.21%	=	17.43%	-	4.37%	=	13.06%
31	Sept	2.71%	3.06%	+	13.09%	=	16.15%	-	4.19%	=	11.96%
32											
33	Recent 24 Months Avg	3.37%	4.05%		20.21%	=	24.26%		4.21%	=	20.05%
34	Recent 12 Months Avg	3.92%	4.95%	+	24.35%	=	29.29%	-	3.91%	=	25.38%
35	Recent 9 Months Avg	3.71%	4.58%	+	21.89%	=	26.47%	-	3.98%	=	22.49%
36	Recent 6 Months Avg	3.13%	3.69%	+	17.42%	=	21.10%	-	4.25%	=	16.86%
37	Recent 3 Months Avg	2.81%	3.22%	+	14.54%	=	17.76%	-	4.32%	=	13.43%
38											
39	Recommended Market Risk Premium										**16.86%**
40											

41 [1] Average Current Dividend Yield (D_0/P_0) of dividend paying stocks. Data from Value Line Investment Analyzer Software Data - Value Line 1700 Stocks

42 [2] Expected Dividend Yield (D_1/P_0) equals average current dividend yield (D0/P0) times one plus growth rate(g).

43 [3] Average 3-5 year price appreciation (annualized). Data from Value Line Investment Analyzer Software Data - Value Line 1700 Stocks

44 [4] Montly average 30 year U.S. Treasury. Federal Reserve.

Black Mountain Sewer Corporation
Capital Asset Pricing Model (CAPM)

Exhibit
Rebuttal Schedule D-4.13
Witness: Bourassa

Line No.		Rf	+	beta[3]	x	Rp	=	k
1								
2								
3	Historical Market Risk Premium CAPM[1]	3.0%	+	0.80	x	6.9% [4]	=	8.5%
4								
5	Current Market Risk Premium CAPM[2]	4.3%	+	0.80	x	16.9% [5]	=	17.8%
6								
7								
8	Average							13.2%
9								
10								
11								

12 [1] Average of 5/7 and 10 Year Treasuries Federal Reserve October 15, 2009 (Rf)
13 [2] Federal Reserve October 15, 2009 30 year Treasury rate (Rf)
14 [3] Value Line Investment Analyzer data. See Rebuttal Schedule D-4.11
15 [4] Historical Market Risk Premium from (Rp) MoriningStar SBBI 2009 Yearbook Table A-2 Intermediate-Horizon ERP 1926-2008
16 [5] Computed using DCF constant growth method to determine current market return on Value Line 1700 stocks
17 and CAPM with beta of 1.0 to compute Current Market Risk Premium (Rp). See Rebuttal Schedule D-4.12.
18
19
20

COC-RB ATTACHMENT 1

Black Mountain Sewer Corporation
Size Premium[1]

Attachment 1

Line No.		Beta(β)	Size Premium	Risk Premium for Small Water Utilities[7]
6	Mid-Cap Companies[2]	1.12	0.90%	
8	Low-Cap Companies[3]	1.25	1.56%	
10	Micro-Cap Companies[4]	1.50	2.83%	
12	Decile 10[5]	1.62	4.43%	1.81%

		Risk Premium for Small Water Utilities
20	Estimated Risk Premium for small water utilities[6]	0.99%

[1] Data from Table 7-11 of Morningstar, *Ibbotson SBBI 2009 Valuation Yearbook.*
[2] Mid-Cap companies includes companies with market capitalization between $1,850 million and $7,360 million.
[3] Low-Cap companies includes companies with market capitalization between $454 million and $1,849 million.
[4] Micro-Cap companies includes companies with market capitalization less than $453 million.
[5] Decile 10 includes companies with market capitalization between $1.6 million and $219 million.
[6] From Table 2, Thomas M. Zepp, "Utility Stocks and the Size Effect Revisited," *The Quarterly Review of Economics and Finance*, 43 (2003), 578-582.
[7] Computed as the weighted differences between the Decile 10 risk premium and the inidicated risk premiums for the sample water utlities as shown below. Excludes risk due to differences in beta.

		Market Cap. (Millions)	Class	Size Premium	Difference to Decile 10	Weight	Weighted Size Premium
1.	American States	$ 587	Low-Cap	1.56%	2.87%	0.166667	0.48%
2.	Aqua America	$ 2,365	Mid-Cap	0.90%	3.53%	0.166667	0.59%
3.	California Water	$ 794	Low-Cap	1.56%	2.87%	0.166667	0.48%
4.	Connecticut Water	$ 193	Decile 10	4.43%	0.00%	0.166667	0.00%
5.	Middlesex	$ 205	Decile 10	4.43%	0.00%	0.166667	0.00%
6.	SJW Corp.	$ 408	Micro-Cap	2.83%	1.60%	0.166667	0.27%
	Weighted Size Premium for small companies						1.81%

COC-RB ATTACHMENT 2

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Historical
Using Compound 10 Year Historical Dividend Growth

Attachment 2

Line No.	Company	[1] Current Dividend Yield (D_0/P_0)[1]	[2] Expected Dividend Yield (D_1/P_0)[2]	[3] Staff Historical Div. Growth (g)[3]	[4] Indicated Equity Cost k=Div Yld + G (Cols 2+3)	[5] Indicated Equity Cost k=Div Yld + G (Cols 2+3)
7	1. American States	2.88%	2.93%	1.76%	4.7%	*
8	2. Aqua America	3.24%	3.47%	6.97%	10.4%	10.4%
9	3. California Water	2.98%	3.01%	0.90%	3.9%	*
10	4. Connecticut Water	3.86%	3.91%	1.34%	5.3%	*
11	5. Middlesex	4.53%	4.63%	2.08%	6.7%	6.7%
12	6. SJW Corp.	2.87%	3.03%	5.51%	8.5%	8.5%
15	GROUP AVERAGE			3.1%	6.6%	8.6%
16	GROUP MEDIAN			3.4%	6.0%	8.5%
18	Current Baa interest rate (October 16, 2009)[4]				6.5%	
20	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012Top 10[5]				8.5%	
21	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012 Bottom 10[5]				6.7%	
22	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012 Consensus[5]				7.5%	

* Indicated equity cost below current cost of debt (Baa) or negative growth.

[1] Spot Dividend Yield = D_0/P_0. See Scehdule D.4-8
[2] Expected Dividend Yield = $D_1/P_0 = D_0/P_0 * (1+g)$.
[3] Growth rate (g). From Staff work papers.
[4] Federal Reserve. Baa investment grade bonds.
[5] Blue Chip Financial Forecast (June 2009)

COC-RB ATTACHMENT 3

Black Mountain Sewer Corporation
Discounted Cash Flow Analysis (Water)
Constant Growth DCF Model - Historical
Using Compound 10 Year Historical EPS Growth

Attachment 3

Line No.	Company	(1) Current Dividend Yield (D_0/P_0)[1]	[2] Expected Dividend Yield (D_1/P_0)[2]	[3] Staff Historical EPS Growth (g)[3]	[4] Indicated Equity Cost k=Div Yld + G (Cols 2+3)	[5] Indicated Equity Cost k=Div Yld + G (Cols 2+3)
7	1. American States	2.88%	2.99%	3.68%	6.7%	6.7%
8	2. Aqua America	3.24%	3.44%	6.20%	9.6%	9.6%
9	3. California Water	2.98%	3.06%	2.74%	5.8%	*
10	4. Connecticut Water	3.86%	3.90%	1.05%	4.9%	*
11	5. Middlesex	4.53%	4.66%	2.88%	7.5%	7.5%
12	6. SJW Corp.	2.87%	2.96%	3.05%	6.0%	*
15	GROUP AVERAGE		3.5%	3.3%	6.8%	8.0%
16	GROUP MEDIAN		3.3%	3.0%	6.3%	7.5%
18	Current Baa interest rate (Ocotber 16, 2009)[4]				6.5%	
20	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012 Top 10[5]				8.5%	
21	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012 Bottom 10[5]				6.7%	
22	Blue Chip Forecast Baa Corporate Bond Interest Rate 2012 Consensus[5]				7.5%	

* Indicated equity cost below current cost of debt (Baa) or negative growth.

[1] Spot Dividend Yield = D_0/P_0. See Scehdule D.4-8
[2] Expected Dividend Yield = $D_1/P_0 = D_0/P_0 * (1+g)$.
[3] Growth rate (g). Staff work papers.
[4] Federal Reserve. Baa investment grade bonds.
[5] Blue Chip Financial Forecast (June 2009)

COC-RB ATTACHMENT 4

NEW
REGULATORY
FINANCE

Roger A. Morin, PhD

2006
PUBLIC UTILITIES REPORTS, INC.
Vienna, Virginia

Appendix 4-A
Arithmetic versus Geometric Means in Estimating the Cost of Capital

The use of the arithmetic mean appears counter-intuitive at first glance, because we commonly use the geometric mean return to measure the average annual achieved return over some time period. For example, the long-term performance of a portfolio is frequently assessed using the geometric mean return.

But performance appraisal is one thing, and cost of capital estimation is another matter entirely. In estimating the cost of capital, the goal is to obtain the rate of return that investors expect, that is, a target rate of return. On average, investors expect to achieve their target return. This target expected return is in effect an arithmetic average. The achieved or retrospective return is the geometric average. In statistical parlance, the arithmetic average is the unbiased measure of the expected value of repeated observations of a random variable, not the geometric mean. This appendix formally illustrates that only arithmetic averages can be used as estimates of cost of capital, and that the geometric mean is not an appropriate measure of cost of capital.

The geometric mean answers the question of what constant return you would have had to achieve in each year to have your investment growth match the return achieved by the stock market. The arithmetic mean answers the question of what growth rate is the best estimate of the future amount of money that will be produced by continually reinvesting in the stock market. It is the rate of return which, compounded over multiple periods, gives the mean of the probability distribution of ending wealth.

While the geometric mean is the best estimate of performance over a long period of time, this does not contradict the statement that the arithmetic mean compounded over the number of years that an investment is held provides the best estimate of the ending wealth value of the investment. The reason is that an investment with uncertain returns will have a higher ending wealth value than an investment which simply earns (with certainty) its compound or geometric rate of return every year. In other words, more money, or terminal wealth, is gained by the occurrence of higher than expected returns than is lost by lower than expected returns.

In capital markets, where returns are a probability distribution, the answer that takes account of uncertainty, the arithmetic mean, is the correct one for estimating discount rates and the cost of capital.

While the geometric mean is appropriate when measuring performance over a long time period, it is incorrect when estimating a risk premium to compute the cost of capital.

TABLE 4A-1
GEOMETRIC VS. ARITHMETIC RETURNS

	Stock A	Stock B
1996	50.0%	11.61%
1997	−54.7%	11.61%
1998	98.5%	11.61%
1999	42.2%	11.61%
2000	−32.3%	11.61%
2001	−39.2%	11.61%
2002	153.2%	11.61%
2003	−10.0%	11.61%
2004	38.9%	11.61%
2005	20.0%	11.61%
Standard Deviation	64.9%	0.0%
Arithmetic Mean	26.7%	11.6%
Geometric Mean	11.6%	11.6%

Theory

The geometric mean measures the magnitude of the returns, as the investor starts with one portfolio and ends with another. It does not measure the variability of the journey, as does the arithmetic mean. The geometric mean is backward looking. There is no difference in the geometric mean of two stocks or portfolios, one of which is highly volatile and the other of which is absolutely stable. The arithmetic mean, on the other hand, is forward-looking in that it does impound the volatility of the stocks.

To illustrate, Table 4A-1 shows the historical returns of two stocks, the first one is highly volatile with a standard deviation of returns of 65% while the second one has a zero standard deviation. It makes no sense intuitively that the geometric mean is the correct measure of return, one that implies that both stocks are equally risky since they have the same geometric mean. No rational investor would consider the first stock equally as risky as the second stock. Every financial model to calculate the cost of capital recognizes that investors are risk-averse and avoid risk unless they are adequately compensated for undertaking it. It is more consistent to use the mean that fully impounds risk (arithmetic mean) than the one from which risk has been removed (geometric mean). In short, the arithmetic mean recognizes the uncertainty in the stock market while the geometric mean removes the uncertainty by smoothing over annual differences.

Empirical Evidence

If both the geometric and arithmetic mean returns over the 1926–2004 data are regressed against the standard deviation of returns for the firms in the

deciles, the arithmetic mean outperforms the geometric mean in this statistical regression. Moreover, the constant of arithmetic mean regression matches the average Treasury bond rate and therefore makes economic sense while the constant for the geometric mean matches nothing in particular. This is simply because the geometric mean is stripped of volatility information and, as a result, does a poor job of forecasting returns based on volatility.

The following illustration is frequently invoked in defense of the geometric mean. Suppose that a stock's performance over a two-year period is representative of the probability distribution, doubling in one year ($r_1 = 100\%$) and halving in the next ($r_2 = -50\%$). The stock's price ends up exactly where it started, and the geometric average annual return over the two-year period, r_g, is zero:

$$
\begin{aligned}
1 + r_g &= [(1 + r_1)(1 + r_2)]^{1/2} \\
&= [(1 + 1)(1 - .50)]^{1/2} = 1 \\
r_g &= 0
\end{aligned}
$$

confirming that a zero year-by-year return would have replicated the total return earned on the stock. The expected annual future rate of return on the stock is not zero, however. It is the arithmetic average of 100% and −50%, $(100 - 50)/2 = 25\%$. There are two equally likely outcomes per dollar invested: either a gain of \$1 when $r = 100\%$ or a loss of \$0.50 when $r = -50\%$. The expected profit is $(\$1 - \$.50)/2 = \$.25$ for a 25% expected rate of return. The profit in the good year more than offsets the loss in the bad year, despite the fact that the geometric return is zero. The arithmetic average return thus provides the best guide to expected future returns.

What Academics Have to Say

Bodie, Kane, and Marcus (2005) cite:

> Which is the superior measure of investment performance, the arithmetic average or the geometric average? The geometric average has considerable appeal because it represents the constant rate of return we would have needed to earn in each year to match actual performance over some past investment period. It is an excellent measure of *past* performance. However, if our focus is on future performance, then the arithmetic average is the statistic of interest because it is an unbiased estimate of the portfolio's expected future return (assuming, of course, that the expected return does not change over time). In contrast, because the geometric return over a sample period is always less than the arithmetic mean,

> it constitutes a downward-biased estimator of the stock's expected return in any future year.
>
> Again, the arithmetic average is the better guide to future performance.

Another way of stating the Bodie, Kane, Marcus argument in favor of the arithmetic mean is that it is the best estimate of the future value of the return distribution because it represents the expected value of the distribution. It is most useful for determining the central tendency of a distribution at a particular time, that is, for cross-sectional analysis. The geometric mean, on the other hand, is best suited for measuring an investment's compound rate of return over time, that is, for time-series analysis. This is the same argument made by Ibbotson Associates (2005) where it is shown, using probability theory, that future terminal wealth is given by compounding the arithmetic mean, and not the geometric mean. In other words, if we accept the past as prologue, the best estimate of a future year's return based on a random distribution of the prior years' returns is the arithmetic average. Statistically, it is our best guess for the holding-period return in a given year.

Brigham and Ehrhardt (2005) in their widely used corporate finance text point out that the arithmetic average is more consistent with CAPM theory, as one of its key underpinning assumptions is that investors are supposed to focus, in their portfolio decisions, upon returns in the next period and the standard deviation of this return. To the extent that this next period is one year, the preference for the arithmetic mean, which derives from a set of single one year period returns, follows. It is also noteworthy that one of the crucial assumptions inherent in the CAPM is that investors are single-period expected utility of terminal wealth maximizers who choose among alternative portfolios on the basis of each portfolio's expected return and standard deviation.

Brealey, Myers, and Allen (2006) in their leading graduate textbook in corporate finance opt strongly for the arithmetic mean. The authors illustrate the distinction between arithmetic and geometric averages and conclude that arithmetic averages are appropriate when estimating the cost of capital:

> The proper uses of arithmetic and compound rates of return from past investments are often misunderstood. Therefore, we call a brief time-out for a clarifying example.
>
> Suppose that the price of Big Oil's common stock is \$100. There is an equal chance that at the end of the year the stock will be worth \$90, \$110, or \$130. Therefore, the return could be -10 percent, $+10$ percent or $+30$ percent (we assume that Big Oil does not pay a dividend). The expected return is $1/3(-10+10+30) = +10$ percent.

If we run the process in reverse and discount the expected cash flow by the expected rate of return, we obtain the value of Big Oil's stock:

$$PV = \frac{110}{1.10} = \$100$$

The expected return of 10 percent is therefore the correct rate at which to discount the expected cash flow from Big Oil's stock. It is also the opportunity cost of capital for investments which have the same degree of risk as Big Oil.

Now suppose that we observe the returns on Big Oil stock over a large number of years. If the odds are unchanged, the return will be −10 percent in a third of the years, +10 percent in a further third, and +30 percent in the remaining years. The arithmetic average of these yearly returns is

$$\frac{-10 + 10 + 30}{3} = +10\%$$

Thus the arithmetic average of the returns correctly measures the opportunity cost of capital for investments of similar risk to Big Oil stock.

The average compound annual return on Big Oil stock would be

$$(.9 \times 1.1 \times 1.3)^{1/3} - 1 = .088, \text{ or } 8.8\%$$

less than the opportunity cost of capital. Investors would not be willing to invest in a project that offered an 8.8 percent expected return if they could get an expected return of 10 percent in the capital markets. The net present value of such a project would be

$$NPV = -100 + \frac{108.8}{1.1} = -1.1$$

Moral: If the cost of capital is estimated from historical returns or risk premiums, use arithmetic averages, not compound annual rates of return (geometric averages).

(Richard A. Brealey, Stewart C. Myers, and Paul Allen, *Principles of Corporate Finance*, 8th Edition, Irwin McGraw-Hill, 2006, page 156–7.)

The widely cited Ibbotson Associates publication also contains a detailed and rigorous discussion of the impropriety of using geometric averages in estimating the cost of capital.[12]

[12] Ibbotson Associates, *Stocks, Bonds, Bills, and Inflation, 2005 Yearbook, Valuation Edition*, page 75.

> The arithmetic average equity risk premium can be demonstrated to be most appropriate when discounting future cash flows. For use as the expected equity risk premium in either the CAPM or the building block approach, the arithmetic mean or the simple difference of the arithmetic means of stock market returns and riskless rates is the relevant number. This is because both the CAPM and the building block approach are additive models, in which the cost of capital is the sum of its parts. The geometric average is more appropriate for reporting past performance, since it represents the compound average return.
>
> The argument for using the arithmetic average is quite straightforward. In looking at projected cash flows, the equity risk premium that should be employed is the equity risk premium that is expected to actually be incurred over the future time periods.
>
> The best estimate of the expected value of a variable that has behaved randomly in the past is the average (or arithmetic mean) of its past values.

In their widely publicized research on the market risk premium, Dimson, Marsh and Staunton (2002) state

> The arithmetic mean of a sequence of different returns is always larger than the geometric mean. To see this, consider equally likely returns of +25 and −20 percent. Their arithmetic mean is 2½ percent, since (25 − 20)/2 = 2½. Their geometric mean is zero, since (1 + 25/100) × (1 − 20/100) − 1 = 0. But which mean is the right one for discounting risky expected future cash flows? For forward-looking decisions, the arithmetic mean is the appropriate measure.
>
> To verify that the arithmetic mean is the correct choice, we can use the 2½ percent required return to value the investment we just described. A $1 stake would offer equal probabilities of receiving back $1.25 or $0.80. To value this, we discount the cash flows at the arithmetic mean rate of 2½ percent. The present values are respectively $1.25/1.015 = $1.22 and $0.80/1.025 = $0.78, each with equal probability, so the value is $1.22 × ½ + $0.80 × ½ = $1.00. If there were a sequence of equally likely returns of +25 and −20 percent, the geometric mean return will eventually converge on zero. The 2½ percent forward-looking arithmetic mean is required to compensate for the year-to-year volatility of returns.

Lastly, on the practical side, Bruner, Eades, Harris, and Higgins (1998) found that 71% of the texts and tradebooks in their extensive survey of practice supported use of an arithmetic mean for estimation of the cost of equity.

Mean Reversion Argument

Some academics have argued that if stock returns were expected to revert to a trend, this would suggest the use of a geometric mean since the geometric mean is, by definition, an estimate of a smoothed long-run trend increment. These same academics have argued that the historical estimate of the market risk premium ("MRP") is upward-biased by the buoyant performance of the stock market prior to 2002, and because of the extraordinary and unusually high realized MRPs in those years, investors expect a return to lower MRPs in the future, bringing the average MPR to a more "normal" level.

The presence or absence of mean reversion is an empirical issue. The empirical findings are weak and highly contradictory; the empirical evidence is inconclusive and unconvincing, certainly not enough to support the "mean reversion" hypothesis. The weight of the empirical evidence on this issue is that the more sophisticated tests of mean reversion in the MRP demonstrate that the realized MRP over the last 75 years or so was almost perfectly free of mean reversion, and had no statistically identifiable time trend. It is also noteworthy that most of these studies were performed prior to the stock market's debacle in 2000–2002, years of extraordinary and unusually low realized MRPs. The stock market's dismal performance of 2000–2002 has certainly taken the wind out of the mean reversion school's sails.

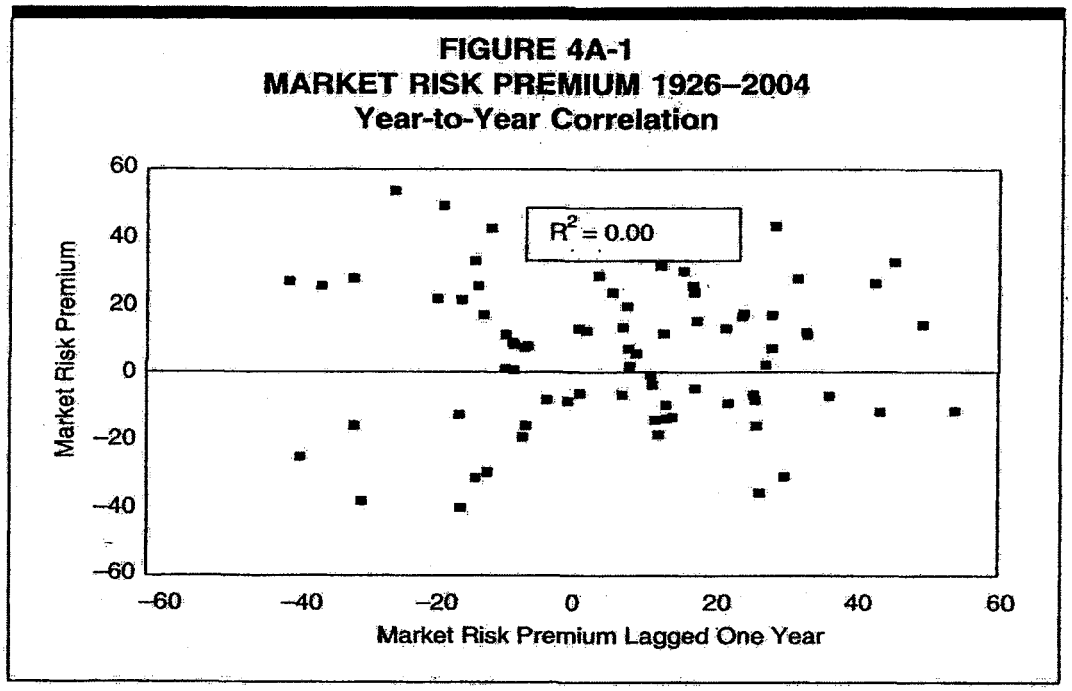
An examination of historical MRPs reveals that the MRP is random with no observable pattern. To the extent that the estimated historical equity risk premium follows what is known in statistics as a random walk, one should expect the equity risk premium to remain at its historical mean. Therefore, the best estimate of the future risk premium is the historical mean.

Ibbotson Associates (2005) find no evidence that the market price of risk or the amount of risk in common stocks has changed over time:

> Our own empirical evidence suggests that the yearly difference between the stock market total return and the U.S. Treasury bond income return in any particular year is random . . . there is no discernable pattern in the realized equity risk premium. (Ibbotson Associates, *Stocks, Bonds, Bills, and Inflation, 2005 Yearbook, Valuation Edition,* pages 74–75)

In statistical parlance, there is no significant serial correlation in successive annual market risk premiums, that is, no trend. Ibbotson Associates go on to state that it is reasonable to assume that these quantities will remain stable in the future (*Id.*):

> The best estimate of the expected value of a variable that has behaved randomly in the past is the average (or arithmetic mean)



of its past values. (Ibbotson Associates, *Stocks, Bonds, Bills, and Inflation, 2004 Yearbook, Valuation Edition*, page 75)

Nowhere is it suggested by Ibbotson Associates that the market risk premium has declined over time.

Because there is little evidence that the MRP has changed over time, it is reasonable to assume that these quantities will remain stable in the future. Figure 4A-1 shows the relationship, or the lack of relationship, between year-to-year MRPs reported in the Ibbotson Associates Valuation Yearbook, 2005 edition, for the 1926–2004 period. The relationship is virtually absent, as indicated by the low R^2 of zero between successive MRPs. In other words, there is no history in successive MRPs as indicated by the zero serial correlation coefficient.

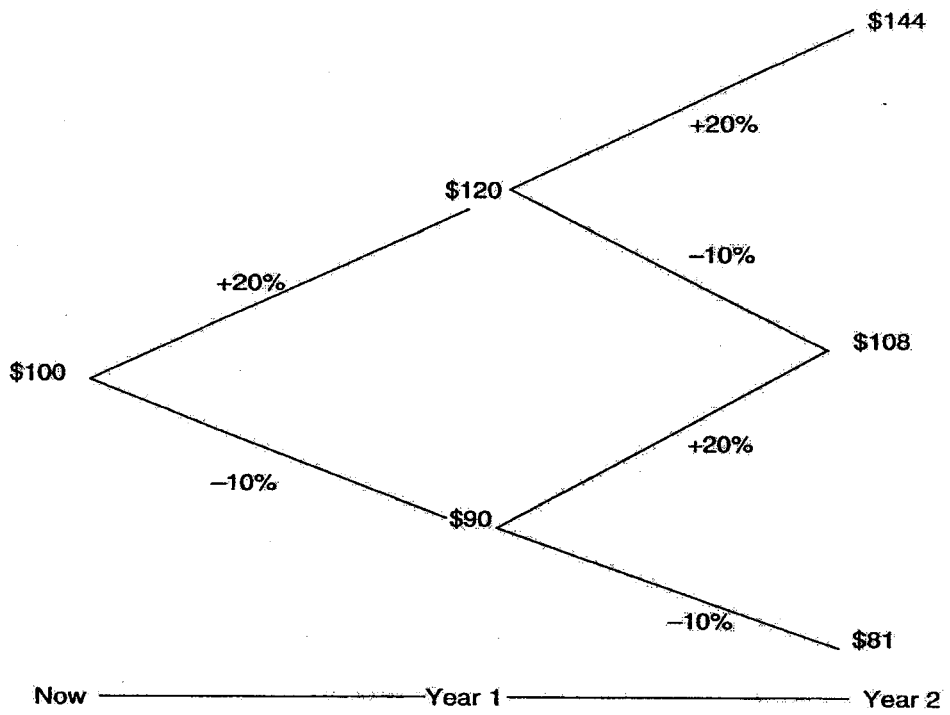
In short, the determination of the cost of capital with the CAPM requires an unbiased estimate of the expected annual return. The expected arithmetic return provides the appropriate measure for this purpose.

Formal Demonstration

This section shows why arithmetic rather than geometric means should be used for forecasting, discounting, and estimating the cost of capital.[13] By

[13] This section is adapted from a similar treatments and demonstration in Brealey, Myers, and Allen (2006) and Ibbotson Associates (2005).

FIGURE 4A-2
POSSIBLE STOCK PRICES



definition, the cost of equity capital is the annual discount rate that equates the discounted value of expected future cash flows (from dividends and the sale of the stock at the end of the investor's investment horizon) to the current market price of a share in the firm. The discount rate that equates the discounted value of future expected dividends and the end of period expected stock price to the current stock price is a prospective arithmetic, rather than a prospective geometric, mean rate of return. Since future dividends and stock prices cannot be predicted with certainty, the "expected" annual rate of return that investors require is an average "target" percentage rate around which the actual, year-by-year returns will vary. This target rate is, in effect, an arithmetic average.

A numerical illustration will clarify this important point. Consider a non-dividend paying stock trading for $100 which has, in every year, an equal chance of appreciating by 20% or declining by 10%. Thus, after one year, there is an equal chance that the stock's price will be $120 and an equal chance the price will be $90. Figure 4A-2 presents all possible eventualities after two periods have elapsed (the rates of return are presented at the end of the lines in the diagram).

The possible stock prices are shown in the following table.

TABLE 4A-2
STOCK PRICES AFTER TWO PERIODS

Price	Chance
$144	1 chance in 4
$108	2 chances in 4
$ 81	1 chance in 4

The expected future stock price after two periods is then:

$$1/4\ (\$144) + 2/4\ (\$108) + 1/4\ (\$81) = \$110.25$$

The cost of equity capital is calculated as the discount rate that equates the present value of the future expected cash flows to the current stock price. In the present simple example, the only cash flow is the gain from selling the stock after two periods have elapsed. Thus, using the expected stock price of $110.25 calculated above, the expected rate of return is that r, which solves the following equation:

$$\text{Current Stock Price} = \frac{\text{Expected Stock Price}}{(1 + r)^2}$$

The factor $(1 + r)^2$ discounts the expected stock price to the present. Substituting the numerical values, we have:

$$\$100 = \frac{\$110.25}{(1+r)^2}$$

$$r = 5\%$$

Thus, the cost of equity capital is 5%. This 5% cost of equity capital is equal to the prospective arithmetic mean rate of return, which is the probability-weighted average single period rate of return on equity. Since in every period there is an equal chance that the stock's return will be 20% or −10%, the probability-weighted average is:

$$1/2\ (20\%) + 1/2\ (-10\%) = 5\%$$

However, the 5% cost of equity capital is not equal to the prospective geometric mean rate of return, which is a probability-weighted average of the possible compounded rates of return over the two periods. Now consider the prospective geometric mean rate of return. Table 4A-3 shows the possible compounded rates of return over two periods, and the probability of each.

Thus, the prospective geometric mean rate of return is:

$$1/4\ (20\%) + 2/4\ (3.92\%) + 1/4\ (-10\%) = 4.46\%$$

TABLE 4A-3
STOCK PRICES AND RETURNS AFTER TWO PERIODS

Price	Chance	Compounded Return
$144	1 chance in 4	20.00%
$108	2 chances in 4	3.92%
$ 81	1 chance in 4	−10.00%

This return is not equal to the 5% cost of equity capital.

The example can easily be extended to include the case of a dividend-paying company and will reach the same conclusion: the implied discount rate calculated in the DCF model is an expected arithmetic rather than an expected geometric mean rate of return.

The foregoing analysis shows that it is erroneous to use a prospective multi-year geometric mean rate of return as a "target" rate of return for each year of the period. If, for example, investors currently require an expected future rate of return on an investment of 13% each year, then 13% is the appropriate annual rate of return on equity for ratemaking purposes. Consequently, in using a risk premium approach for the purposes of rate of return regulation, the single-year annual required rate of return should be estimated using arithmetic mean risk premiums.

It should be pointed out that the use of the arithmetic mean does not imply an investment holding period of one year. Rather, it is premised on the uncertainty with respect to each year's return during the holding period, however many years that may be. When computing the arithmetic average of historic annual returns in order to calculate the average return (expected value of the return), every achieved return outcome is one possible future outcome for each year the security will be held. Each historic return has an equal probability of occurring during each year of the holding period. The resulting expected value of the risk premium is the arithmetic average of all of the past premiums considered, regardless of the length of the expected holding period.

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REJOINDER TESTIMONY OF

THOMAS J. BOURASSA

(Rate Base, Income Statement And Rate Design)

November 16, 2009

EXHIBIT
A-8
ADMITTED

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1 I. **INTRODUCTION AND PURPOSE OF TESTIMONY.**

2 Q. **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Thomas J. Bourassa. My business address is 139 W. Wood Drive,
4 Phoenix, Arizona 85029.

5 Q. **ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?**

6 A. On behalf of the applicant, Black Mountain Sewer Corporation ("BMSC" or the
7 "Company").

8 Q. **HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THE INSTANT**
9 **CASE?**

10 A. Yes, my direct testimony was submitted in support of the initial application in this
11 docket. There were two volumes, one addressing rate base, income statement and
12 rate design, and the other addressing cost of capital. My rebuttal testimony was
13 also submitted in two separate volumes.

14 Q. **WHAT IS THE PURPOSE OF THIS REJOINDER TESTIMONY?**

15 A. I will provide rejoinder testimony in response to the surrebuttal filings by Staff and
16 RUCO. More specifically, this first volume of my rejoinder testimony relates to
17 rate base, income statement and rate design for BMSC. I will also address the
18 testimony by the Boulders Home Owners Association ("BHOA"). In a second,
19 separate volume of my testimony, I will also provide responses to Staff and RUCO
20 on the cost of capital and rate of return applied to the fair value rate base, and the
21 determination of operating income.

22 II. **SUMMARY OF BMSC'S REJOINDER POSITION.**

23 Q. **WHAT IS THE REVENUE INCREASE THAT THE COMPANY IS**
24 **PROPOSING IN THIS REJOINDER TESTIMONY?**

25 A. The Company is proposing a total revenue requirement of $2,533,172, which
26 constitutes an increase in revenues of $953,002, or 60.31% over test year revenues.

Q. PLEASE SUMMARIZE THE PROPOSED REVENUE REQUIREMENTS AND RATE INCREASES FOR THE COMPANY, STAFF, AND RUCO AT THIS STAGE OF THE PROCEEDING?

A. The proposed revenue requirements and proposed rate increases are as follows:

	Revenue Requirement	Revenue Incr.	% Increase
Company - Rebuttal	$2,541,508	$961,338	60.84%
Staff - Surrebuttal	$2,124,105	$543,935	34.42%
RUCO - Surrebuttal	$2,071,997	$491,827	31.12%
Company Rejoinder	$2,533,172	$953,002	60.31%

There are several other interveners but none of them have submitted evidence on the revenue requirement.

Q. WHY IS THE COMPANY'S REJOINDER PROPOSED REVENUE AND RATE INCREASE LOWER THAN IN ITS REBUTTAL FILING?

A. As with the rebuttal filing, the Company continues to accept adjustments offered by Staff and RUCO where reasonable to do so. The reduction in the revenue requirement at rejoinder is primarily due to the Company's acceptance of RUCO's proposal for zero working capital. I will discuss the Company's position on working capital later in my rejoinder testimony.

III. RATE BASE

Q. WOULD YOU PLEASE IDENTIFY THE PARTIES' RESPECTIVE RATE BASE RECOMMENDATIONS AT THIS STAGE OF THE PROCEEDING?

A. The rate bases proposed by all parties in the case are as follows:

	OCRB/FVRB[1]
Company-Rebuttal	$ 3,716,649
Staff – Surrebuttal	$ 3,365,416
RUCO - Surrebuttal	$ 3,680,911
Company Rejoinder	$ 3,682,905

Q. WHY IS THE COMPANY'S REJOINDER PROPOSED RATE BASE LOWER THAN ITS REBUTTAL PROPOSED RATE BASE?

A. Again, the reduction in the rate base is primarily due to the Company's acceptance of RUCO's proposal for zero working capital.

Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S REJOINDER PROPOSED ORIGINAL COST RATE BASE, AND IDENTIFY ANY REMAINING DISAGREEMENTS BETWEEN THE PARTIES?

A. The Company's rate base adjustments to OCRB are detailed on rejoinder schedules B-2, pages 3 through 6. Rejoinder Schedule B-2, page 1 and 2, summarize the Company's proposed adjustments and the rejoinder OCRB. BMSC's adjustments to its direct OCRB have been explained in detail in my rebuttal testimony. Further adjustments to OCRB or revisions of prior adjustments are explained below.

A. <u>Plant in Service.</u>

Q. STARTING WITH PLANT-IN-SERVICE, PLEASE DISCUSS THE COMPANY'S REJOINDER PROPOSED UTILITY PLANT-IN-SERVICE ADJUSTMENTS TO ORIGINAL COST RATE BASE.

A. BMSC and RUCO are in agreement on a plant-in-service balance of $11,646,544. Staff recommends a slightly lower plant-in-service balance of $11,607,919. The difference is the Company's proposed inclusion of an odor control unit costing

[1] The parties agree to use OCRB and FVRB in this rate case.

$38,625 that was transferred from Litchfield Park Service Company ("LPSCO"). Staff recommends disallowing this cost because it has not verified the cost as of its surrebuttal filing.[2]

Q. HAS STAFF RECOMMENDED REMOVING THE COST OF THE ODOR CONTROL UNIT FROM PLANT-IN-SERVICE IN THE PENDING LPSCO RATE CASE?

A. Yes, because the unit was transferred to BMSC.[3] The positions of two Staff auditors on the same piece of plant are contradictory.[4]

B. <u>Accumulated Depreciation.</u>

Q. HAS THE COMPANY MADE ANY ADDITIONAL ADJUSTMENTS TO ACCUMULATED DEPRECIATION?

A. Yes. I have made a small correction to accumulated depreciation of $482 related to the odor control unit discussed above. I have also made a small correction to accumulated depreciation of $2,127 for the New Trade Center Lift Station in order to match RUCO's proposed additional deprecation. These changes are reflected in the Company's B-2 adjustment 2 – D on Rejoinder Schedule B-2, page 3.

Q. PLEASE IDENTIFY THE PARTIES' RESPECTIVE PROPOSED ACCUMULATED DEPRECIATION BALANCES AND IDENTIFY THE DIFFERENCES BETWEEN THE PARTIES?

A. The Company recommends an accumulated depreciation balance of $5,725,275, Staff recommends an accumulated depreciation balance of $5,714,143, and RUCO recommends an accumulated depreciation balance of $5,726,261. The roughly $11,000 difference in the accumulated depreciation balances between Staff and the

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[2] *See* Surrebuttal Testimony of Crystal S. Brown ("Brown Sb.") at 3.

[3] *See* Direct Testimony of Jeffrey M. Michlik in Docket SW-01428A-09-0103 at 8.

[4] *See also* Rejoinder Testimony of Gregory S. Sorensen ("Sorensen Rj.") at 12-13.

Company arises for three reasons. First, Staff includes post test year plant from the prior rate case totaling $85,699 in the starting plant balance of plant-in-service when re-computing accumulated depreciation.[5] This error causes additional accumulated depreciation of $2,142.

Q. WHY DO YOU BELIEVE THIS IS AN ERROR?

A. Because the post test year plant is placed into service in the year following the test year and therefore it is not included in the starting balance of plant, but rather as an addition in the following year. The first year that plant is placed into service there should be only one half the depreciation (using half-year convention). But, by virtue of including this plant in Staff's starting balance, Staff computes a full year of depreciation on the first year this plant was placed into service. In the prior rate case neither Staff nor the Company proposed to include any additional depreciation related to post test year plant in accumulated depreciation, and the Commission approved accumulated depreciation balance in the last case did not include depreciation on post test year plant.[6] If the Commission intended to treat this plant as having been placed into service during the last test year, it would have included a half year of depreciation in the accumulated depreciation balance that was approved. As a consequence, Staff's accumulated depreciation balance is over stated by $2,142.

Q. THANK YOU. WHAT ABOUT THE SECOND AND THIRD FACTORS CAUSING THE DIFFERENCE IN ACCUMULATED DEPRECIATION BETWEEN THE COMPANY AND STAFF?

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[5] Brown Sb. at 5.

[6] *See* BMSC Final Schedule B-2, page 3 and Staff Final CSB-0b in Docket SW-02361A-05-0657. The only accumulated depreciation adjustment for post test year plant was for the retirement of a chlorinator that was replaced by a new chlorinator included in post test year plant. There was no accumulated depreciation added for the new chlorinator.

A. The second item is accumulated depreciation related to the odor control unit that was transferred from LPSCO to BMSC and discussed previously. Staff's accumulated depreciation balance does not reflect $11,148 of accumulated depreciation because Ms. Brown refuses to include this plant in rate base.

The third item is the additional depreciation of $2,127 the Company includes in the accumulated depreciation related to the New Trade Center Lift Station.

Q. WHAT MAKES UP THE SLIGHT DIFFERENCE BETWEEN THE COMPANY AND RUCO WITH RESPECT TO ACCUMULATED DEPRECIATION?

A. The difference between the accumulated depreciation balances is $986 and appears to be related to additional depreciation on the odor control unit transferred from LPSCO that is contained in RUCO's computation. RUCO has already accounted for the $11,148 of accumulated depreciation at the end of the test year and should not have added more. The remaining $20 difference is unidentified at this time.

C. <u>Deferred Income Taxes.</u>

Q. HAS THE COMPANY MADE ANY ADDITIONAL ADJUSTMENTS TO DEFERRED INCOME TAXES?

A. Yes. The Company has increased the deferred income tax ("DIT") balance slightly, from $194,898 to $195,906 or approximately $1,008. This is due to the change in the Company's proposed accumulated depreciation balance as discussed above. This change is reflected in Company B-2 adjustment 5 as shown on Rejoinder Schedule B-2, page 6.

Q. ARE RUCO AND THE COMPANY IN AGREEMENT ON THE DEFERRED INCOME TAX BALANCE?

A. We are in material agreement. RUCO proposes a DIT balance that is approximately $795 lower at $194,898.[7] However, in its surrebuttal filing, RUCO agreed to the Company's rebuttal proposed DIT and revised its recommended DIT to match BMSC's rebuttal amount. RUCO has not yet had a chance to review the Company rejoinder proposal.

Q. DOES STAFF CONTINUE TO PROPOSE A DIT BALANCE?

A. No. Staff has reduced its recommended DIT balance to zero.[8]

Q. WHY?

A. Because Ms. Brown erroneously asserts that because the net DIT balance in the instant case is an asset rather than a liability, that there is either an error in the computation or that there is some unusual treatment of depreciation expense by the Commission or the IRS.[9]

Q. DOES MS. BROWN OFFER ANY EVIDENCE TO SUPPORT HER CONCLUSION?

A. None, she simply assumes an erroneous result because a mathematical calculation produced a particular result. Ironically, a similar argument was made by RUCO in the Company's prior rate case and rejected by this Commission.[10] RUCO asserted that utilities "unfailingly create net deferred tax liabilities."[11] However, as I explained in the prior rate case, "when a significant amount of plant has been financed with CIAC and AIAC, or when there are net operating losses, DIT assets

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[7] *See* RUCO Surrebuttal Schedule RLM-2.

[8] Brown Sb. at 9.

[9] *Id.* at 8.

[10] *See* Decision No. 69164 at 6.

[11] *Id.*

are common."[12] Amazingly, in that case, Ms. Brown agreed with my calculation of a deferred tax asset.[13]

Q. ARE YOU USING THE SAME METHOD TO COMPUTING DITS AS YOU USED IN THE PRIOR RATE CASE?

A. Yes, except that it is updated to the end of the test year in the instant case. This is not "art," it is math. I simply follow the requirements of the Statement of Financial Accounting Standards No. 109 – Accounting for Income Taxes ("FAS 109"). And, as in the last case, the computation shows a net DIT asset – the $195,906 discussed earlier. This is not surprising since BMSC assets are still significantly funded with CIAC and AIAC.

Q. WAS STAFF PROVIDED RELEVANT TAX DOCUMENTATION TO VERIFY THE COMPANY'S TAX BASIS OF BMSC'S ASSETS?

A. Yes. Staff was provided the tax depreciation report from the 2007 tax return and was provided information to bring the tax basis of assets to end of the test year. It appears that Ms. Brown chose to ignore this information and assume facts that are not in evidence and adopt an argument that was rejected already by the Commission.

Q. BUT MS. BROWN CLAIMS THERE WAS AN ERROR IN THE COMPANY'S DIT COMPUTATION?

A. Yes, she asserts that because the Commission does not recognize AIAC as revenue, that only AIAC recognized for tax purposes as revenue should be included in the

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[12] *Id.*

[13] *Id.*

Company's DIT computation.[14] This view that only AIAC recognized as income for tax purposes creates a book-tax timing difference is simply wrong.[15]

Q. WHY IS THIS VIEW WRONG?

A. Because the book-tax timing difference is not created because of the recognition or non-recognition of AIAC as revenues by the IRS. The book-tax timing difference exists because depreciation on AIAC funded plant is recognized for book purposes, but not recognized for tax purposes. In other words, for book purposes, a lower taxable income is recognized because of the depreciation expense on AIAC funded plant. But because the Company cannot recognize a depreciation deduction for tax purposes, it pays higher income taxes as a result. Thus, a deferred tax asset is created by this book-tax timing difference.

Q. WHY IS AIAC NOT RECOGNIZED FOR INCOME TAX PURPOSES BY THE IRS?

A. The Company has no tax basis in the plant because it did not fund the plant with its own money. This plant was funded by contributed capital from others. The Company will receive recognition of AIAC funded plant for tax purposes when it makes refunds and can begin to take a tax depreciation deduction. CIAC funded plant also has no tax basis for the same reasons. The difference between AIAC and CIAC funded plant is that for both book and tax purposes there is no depreciation recognized for CIAC funded plant. Therefore, there is no book-tax timing difference created for CIAC funded plant.

Q. WHEN AIAC IS TREATED AS REVENUE FOR INCOME TAX PURPOSES IS THE PLANT FUNDED WITH THIS AIAC RECOGNIZED FOR INCOME TAX PURPOSES?

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[14] Brown Sb. at 9.

[15] *Id.*

A. Yes. Accordingly, AIAC recognized for income tax purposes as revenue should be excluded from the AIAC component in the Company's DIT computation as this plant will be recognized in both the book and tax basis plant components of the Company's DIT computation. This is the exact opposite of the argument Staff makes.

Q. DID STAFF PERFORM A DIT COMPUTATION OF ITS OWN?

A. No. Staff could have prepared its own computation from the information it was provided. Instead, Staff simply reduced the DIT to zero.

Q. DOES THE COMPANY HAVE AIAC RELATED TO SERVICE LINE CONNECTION FEES THAT HAS BEEN TREATED AS REVENUE FOR INCOME TAX PURPOSES?

A. No. BMSC, like most wastewater utilities, does not have service line connection fees. Service line connection fees are typically found with water utilities.

Q. WHAT IS THE NET IMPACT OF MS. BROWN'S RECOMMENDATION FOR DEFERRED INCOME TAXES ON THE REVENUE REQUIREMENT?

A. Approximately $40,000. As it did last time, the Commission should simply reject the position that deferred tax assets do not exist.

D. <u>Working Capital.</u>

Q. HAS THE COMPANY MADE ANY ADDITIONAL ADJUSTMENTS TO WORKING CAPITAL?

A. Yes. In order to help eliminate issues between the parties, the Company is reducing its working capital request to zero. Both the Company and RUCO are now in agreement on working capital.

Q. BUT MR. BOURASSA, ISN'T THIS ANOTHER CHANGE IN BMSC'S POSITION ON WORKING CAPITAL?

A. Not really. I recommended zero working capital in my direct. Then in rebuttal, in direct response to what were serious flaws in Ms. Brown's position on working capital, I did a lead-lag analysis that showed a small, positive amount of working capital. Given the additional and significant errors in Ms. Brown's position on working capital, I remain of the view that a zero working capital allowance is appropriate in this rate case.

Q. HAS STAFF MODIFIED ITS RECOMMENDED WORKING CAPITAL AMOUNT?

A. Yes. Staff has increased its recommended working capital amount from a negative $127,713 in its direct filing to a negative $101,242 in its surrebuttal filing.[16]

Q. DID STAFF PREPARE A LEAD-LAG STUDY OF ITS OWN?

A. No. Ms. Brown used my rebuttal lead-lag study and modified the expense components as well as the revenue and expense lag day components based on her own views. However, Staff's modifications to the lead-lag study contain at least 4 significant errors. These errors include: 1) use of a materially understated revenue lag day, 2) the double counting of interest expense, 3) failure to reflect actual timing of payment of expenses based on the practices of the Company in its expense lags, and 4) failure to include rate case expense.

Q. PLEASE DISCUSS STAFF'S ERROR IN THE COMPUTATION OF THE REVENUE LAG DAYS.

A. Staff computes a revenue lag of 9.6 days by averaging the revenue lag days from the last rate case of 7.83 days with the 11.4 days the Company proposes.[17] There are three problems with this. First, the revenue lag from the last rate case is outdated and cannot be used unless it is shown to still be applicable. Ms. Brown

[16] *See* Direct testimony of Crystal S. Brown ("Brown Dt.") at 11; Brown Sb. at 17.

[17] Brown Sb. at 15.

made no attempt to reconcile nearly 5-year old customer data. Second, the revenue lag in the last case was computed using a sample of 10 customer bills, which is hardly a representative sample. In the instant case, the revenue lag was computed using thousands of customer billing records from 2008 and 2009. Third, Staff has the customer data to compute revenue lag and should have computed a revenue lag according to according to the method it prefers. As I will discuss later, had Staff used the method employed in the last rate case, the revenue lag would have been significantly higher than the 9.6 days Staff computed.

Q. HOW DO YOU RESPOND TO MS. BROWN'S CRITICISM THAT YOU DID MEASURE THE REVENUE LAG FROM THE MIDPOINT OF THE SERVICE PERIOD?

A. My approach does measure the revenue lag from the midpoint of the service period by including a service lag component in my revenue lag computation.

Q. WHAT IS REVENUE LAG AND HOW IS IT COMPUTED?

A. Revenue lag is a term used to describe the measured period from the point of service to customer payment. Revenue lag days consist of 3 components – a service lag, a billing lag, and a payment lag. The service lag for a water utility is measured from the mid-point of the service period to the point in time the customer meter is read. For a wastewater company, the service lag is measured from the midpoint of the service period to the end of the service period. Assuming a 30 day service period, the midpoint would be 15 days. Thus, there is a 15 day service lag. When a wastewater company bills in advance of service, like BMSC, the service lag is negative. Thus, the service lag component for BMSC is a negative 15 days.

The billing lag component is measured from the end of the service period to the billing date. It is positive for BMSC because it bills customers after the beginning of the month of service. The dollar weighted average billing lag

determined from the customer billing data is 4.65 days. The payment lag is measured from the customer bill date to the customer payment date. It is nearly always positive because customers generally do not prepay their bills. The weighted average payment lag days determined from BMSC's customer billing data is 21.75 days. Combined, the revenue lag is 11.40 days (-15 days service lag plus 4.65 days billing lag and 21.75 days payment lag).

Q. IS THE 11.4 DAY REVENUE LAG CONSISTENT WITH STAFF'S TESTIMONY ON THE TYPICAL PAYMENT PATTERN OF UTILITY CUSTOMERS?

A. Yes. Ms. Brown testifies that customers typically pay their bills 4 to 5 days before the end of the service period.[18] If the midpoint of the service period is the 15th of the month and the revenue lag days is 11.4 days, the expected payment of the customer bill is around the 26th or 27th of the month (15 plus 11.4 equals 26.4). This is within 4 to 5 days of the end of the month.

Q. IS STAFF'S REVENUE LAG CONSISTENT WITH ITS TESTIMONY THAT CUSTOMERS TYPICALLY PAY THEIR BILLS 4 TO 5 DAYS BEFORE THE END OF THE MONTH?

A. No. A revenue lag of 9.6 days implies the customer bills are paid on the 24th or 25th of the month. Using the illustration previously, if the midpoint of the service period is the 15th of the month and the revenue lag days is 9.6 days, the expected payment of the customer bill is around the 24th or 25th of the month (15 plus 9.6 equals 24.6). This is 6 to 7 days before the end of the month.

[18] *Id.* at 12.

Q. RATHER THAN DETERMINING THE INDIVIDUAL COMPONENTS OF REVENUE LAG, IS THERE ANOTHER METHOD FOR DETERMINING REVENUE LAG?

A. Yes. One can simply measure the period from the midpoint of service to the customer payment date. For example, assuming a June 2008 billing, one would assume a June 15, 2008 midpoint of service date. If the customer pays the bill on June 27, 2008, the revenue lag is 12 days. This was the method employed by RUCO in the last case.

Q. HAVE YOU COMPUTED THE REVENUE LAG USING THE METHOD USED IN THE LAST CASE?

A. Yes, using the data from the instant case. The result is 12.78 days. This is significantly higher than Staff's 9.6 days.

Q. LET'S MOVE ON TO THE SECOND ERROR IN STAFF'S LEAD-LAG COMPUTATION. PLEASE EXPLAIN.

A. The second error in Staff's lead-lag computation is that Staff double counts interest expense. Ms. Brown added an interest expense component for synchronized interest.[19] However, the Scottsdale capacity lease payment already reflects the interest on debt. As you will recall, the Scottsdale capacity was financed, in part, by long-term debt. In an earlier rate case, the debt service (principle and interest payments) were treated as lease payments and included in operating expenses for rate making purposes. By adding an additional interest expense component in its computation, Ms. Brown is double counting interest expense.

Q. IS THE LONG-TERM DEBT USED TO FINANCE THE SCOTTSDALE CAPACITY THE ONLY LONG-TERM DEBT FOR THE COMPANY?

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[19] *Id.* at 17.

A. Yes. So, there is no other source of interest expense to serve as the basis for the addition of an interest expense component.

Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT STAFF'S INTEREST EXPENSE COMPONENT?

A. Yes. Putting aside Staff's double counting of interest expense, Ms. Brown assumes 4 quarterly payments for interest. Debt payments (interest and principle) are made monthly, not quarterly. There is no basis to assume quarterly interest payments.

Q. SO YOU BELIEVE STAFF'S COMPUTATION OF 91.25 EXPENSE LAG DAYS FOR QUARTERLY INTEREST PAYMENTS IS WRONG?

A. Yes, because Ms. Brown does not measure expense lag from the midpoint of the service period. The correct number of expense lag days is 46.50, not 91.25 as suggested by Ms. Brown.[20]

Q. PLEASE EXPLAIN.

A. To compute the expense lag that assumes 4 quarterly payments over a year, you begin with a service period of 12 months (January 1 to December 31). The midpoint of the service period is June 30. The first payment is made on March 31. Measuring the lag from the midpoint of June 30 to March 31, the expense lag is a negative 92.5 days. The second payment is made on June 30. Measuring the lag from the midpoint of June 30 to June 30, the expense lag is a negative 0.5 days. The third payment is made on September 30. Measuring the lag from September 30 to the midpoint of June 30, the expense lag is a positive 93.5 days. Finally, the fourth payment is made on December 31. Measuring the lag from December 31 to the midpoint of June 30, the expense lag is a positive 185.5 days.

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[20] *Id.*

Using the data above, the weighted average expense lag for quarterly payments is computed as follows:

Interest Payment Date	Percent Of Liability	(Lead) Lag Days	Weighted Days
March 31	25%	-92.5	(23.13)
June 30	25%	-0.5	(0.13)
September 30	25%	93.5	23.38
December 31	25%	185.5	46.38
			46.50

Q. LET'S MOVE ON TO THE THIRD ERROR IN STAFF'S LEAD-LAG COMPUTATION. PLEASE EXPLAIN.

A. The third error in Staff computation is that Ms. Brown ignores the payment practices of the Company to determine expense lags and instead contrives her own. There are several examples. First, she asserts that because the debt payments for Scottsdale capacity are treated as an operating expense, the expense lag days should be increased to 45 because the Company proposes a 45 day expense lag for "other operating expenses."[21] However, the Scottsdale Capacity lease payments are more similar to the allocated contractual services costs than to other operating expenses. The expense lag for allocated contractual services is 15 days.

Q. WHY ARE THE SCOTTSDALE LEASE PAYMENTS MORE SIMILAR TO THE ALLOCATED CONTRACTUAL SERVICES EXPENSE?

[21] *Id.* at 15.

A. Because the debt financing for the Scottsdale Capacity is paid to the parent company. The debt payments are due on the 1st of the month following the service period. Since the allocation occurs at the end of the month, it is similar in terms of timing.

Q. IF BMSC INCURRED THE COSTS INCLUDED IN THE ALLOCATED EXPENSES AS A STAND ALONE COMPANY, WOULD THE EXPENSE LAG BE MUCH DIFFERENT THAN 15 DAYS.

A. No, it would likely be less because the allocated expense consists primarily of payroll related costs that are paid by Liberty Water and its parent during the service period[22] and not at the end of the service period (end of month) as is assumed in the 15 day expense lag. Using a 15 day expense lag is conservative.

Q. PLEASE CONTINUE.

A. Second, Staff used 212 days for the payment of property taxes based on an amount used in another rate case.[23] I do not know the circumstances under which a 212 day expense lag was used, but strictly based on the due dates for property taxes, I find that the weighted average expense lag days is 170 days.

Q. PLEASE EXPLAIN.

A. To compute the expense lag that assumes 2 property tax payments over a year, you begin with a service period of 12 months (January 1 to December 31). The midpoint of the service period is June 30. The first property tax payment is due on October 1. Measuring the lag from October 1 to the midpoint of June 30, the expense lag is a positive 94.5 days. The second property tax payment is due on March 1 of the following year. Measuring the lag from March 1 of the following year to the midpoint of June 30, the expense lag is a negative 245.5 days.

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[22] Bi-weekly net pay lag is typically 13 days.

[23] *Id.* at 16.

Using the data above, the weighted average expense lag for property taxes is computed as follows:

Payment Date	Percent Of Liability	(Lead) Lag Days	Weighted Days
October 1	50%	94.5	47.25
March 1 following year	50%	245.5	122.75
			170.00

Q. WAIT A MINUTE, MR. BOURASSA, ISN'T THE 2ND HALF PROPERTY TAX DUE ON MAY 1 OF THE FOLLOWING YEAR?

A. No. May 1 is the delinquent date. The due date is March 1. I inadvertently put the delinquent date of May 1 in my footnote in my rebuttal lead-lag study (Rebuttal Schedule B-5, page 2), but it is really March 1.

Q. WHEN DID THE COMPANY ACTUALLY PAY ITS 2008 PROPERTY TAX BILLS?

A. I have found that the Company paid its 2008 property taxes well in advance of the due dates. For example, the 1st half property tax payment for 2008 that was due on October 1, 2008 was paid on September 12, 2008. The 2nd half property tax payment for 2008 that was due on March 1, 2009 was paid on February 17, 2009. The weighted average expense lag is 154.5 days.

Q. WHY DIDN'T YOU USE 154.5 DAYS AS YOUR EXPENSE LAG FOR PROPERTY TAXES?

A. To be conservative.

Q. PLEASE CONTINUE.

A. Another example of Staff ignoring the Company's current payment practices is for general insurance. The Company pays its insurance annually. It records the

insurance payment as a prepaid and then expenses 1/12 of the total amount monthly. Nevertheless, Ms. Brown set the insurance expense lag to a negative 15 days which assumes that insurance is paid monthly. This is contrary to reality.

Q. LET'S MOVE ON TO THE FOURTH ERROR IN STAFF'S LEAD-LAG COMPUTATION. PLEASE EXPLAIN.

A. The fourth error in Staff's lead-lag computation is the failure to include rate case expense. This expense, like insurance, is paid up-front before the service period. In fact, rate case expense is paid well in advance of service because it is recovered over several years. In the instant case, the proposal is for a 3 year recovery. Rate case expense is a cash outlay requiring working cash capital and should not be ignored in a lead-lag study.

Q. WHY DOES STAFF EXCLUDE RATE CASE EXPENSE?

A. Staff removed rate case expense so that customers would not be required to pay a rate of return on any portion of rate case expense.[24] This is not a valid reason. The cash outlays for rate case expense tie up cash until recovered. Accordingly, it should be included in a cash working capital computation.

IV. INCOME STATEMENT

Q. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROPOSED ADJUSTMENTS TO REVENUES AND EXPENSES AND IDENTIFY ANY ADJUSTMENTS YOU HAVE ACCEPTED FROM STAFF AND/OR RUCO?

A. The Company's rejoinder adjustments are detailed on Rejoinder Schedule C-2, pages 1-20. The rejoinder income statement with adjustments is summarized on Rejoinder Schedule C-1, page 1-2. The Company's revenue and expense adjustments to the direct filing adjusted test year results have been explained in

[24] Brown Sb. at 11.

detail in my rebuttal testimony. Further adjustments to revenue and expenses or revisions of prior adjustments are explained below.

A. Depreciation Expense

Q. HAS THE COMPANY PROPOSED ANY CHANGES TO DEPRECIATION EXPENSE?

A. No. The Company continues to propose depreciation expense of $243,986.[25]

Q. HOW DO THE PROPOSED LEVELS OF DEPRECIATION EXPENSE DIFFER BETWEEN THE PARTIES?

A. All the parties use account specific depreciation rates. Both the Company and RUCO agree on the level of depreciation expense of $243,986. Staff proposes a lower level of depreciation expense of $234,035. Staff's depreciation expense is lower for two reasons. First, Staff does not include the costs of the odor control unit, as discussed earlier. Second, Staff uses an overstated composite rate for computing amortization of CIAC. Staff computes the composite rate using only depreciable plant.[26] But the composite rate should reflect all plant, not just depreciable plant. Non-depreciable assets, such as land, can be funded with CIAC and so land costs should be included. Under the concept of using a composite rate for amortization of CIAC, a key assumption is that CIAC is used to fund all plant, not just depreciable plant.

B. Property Taxes

Q. IS STAFF NOW IN AGREEMENT WITH THE COMPANY ON THE PROPERTY TAX ASSESSMENT RATIO?

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[25] *See* Rejoinder Schedule C-2, page 1.

[26] *See* Staff Surrebuttal Schedule CSB-26.

A. Yes. Staff has adopted the Company proposed assessment ratio of 21%.[27] Each parties' recommended expense level is different due to different revenue requirements, but there is no dispute over the methodology and inputs to determine property taxes.

C. **Purchased Wastewater Treatment**

Q. HAS THE COMPANY PROPOSED A CHANGE TO PURCHASED WASTEWATER TREATMENT IN ITS REJOINDER FILING?

A. Yes. The Company is proposing two corrections to purchased wastewater treatment. The first correction is to reduce the Scottsdale treatment cost from $2.61 per 1,000 gallons to $2.60 per 1,000 gallons. This change is reflected in adjustment number 4 as shown on Rejoinder Schedule C-2, page 5. The second correction is to the annualization of purchased wastewater treatment. This change is reflected in adjustment number 5 on Rejoinder Schedule C-2, page 6.

Q. PLEASE IDENTIFY STAFF AND RUCO'S POSITION ON THE SCOTTSDALE TREATMENT COST AND THE LEVEL OF PURCHASED WASTEWATER TREATMENT?

A. RUCO and the Company propose wastewater treatment expense that is within $1 of each other at $335,513 and $336,514, respectively. Staff proposes $338,380 for purchased wastewater treatment expense. This is because Ms. Brown adopted the Company's rate of $2.61 per 1,000 gallons from the Company's rebuttal filing.[28] This was the rate that was provided to the Company by the City of Scottsdale at the time. After further inquiry with the City of Scottsdale, it turns out the rate was 1 cent too high and should be $2.60 per 1,000 gallons.

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[27] Brown Sb. at 33.

[28] Brown Sb. at 20.

D. **Testing Expense**

Q. PLEASE DISCUSS THE DIFFERENCE BETWEEN THE PARTIES WITH RESPECT TO TESTING EXPENSE?

A. Both RUCO and the Company are in agreement on the level of testing expense.[29] Staff rejects the Company's additional testing expense that is necessary to comply with the City of Scottsdale's requirements.[30] Mr. Sorensen addresses this issue in greater detail in his rejoinder testimony.[31]

E. **Bad Debt Expense**

Q. PLEASE DISCUSS THE DIFFERENCE BETWEEN THE PARTIES WITH RESPECT TO BAD DEBT EXPENSE?

A. The Company proposes bad debt expense of $14,374. Staff's proposed level of bad debt expense at this stage of the proceeding is $7,895. While Staff has not adopted the Company's adjustment to bad debt expense in its surrebuttal filing, Ms. Brown is seeking additional documentation, and therefore may change her position.[32]

Q. DOES STAFF AGREE THAT BAD DEBT SHOULD INCLUDE TEST YEAR RELATED WRITE-OFFS?

A. Yes.[33]

Q. WHAT IS RUCO'S POSITION ON BAD DEBT EXPENSE?

A. Thus far, RUCO has not proposed to adjust the test year bad debt expense.[34] RUCO's proposed level of bad debt expense is $11,962.

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[29] *See* Surrebuttal Testimony of Rodney L. Moore ("Moore Sb.") at 16.

[30] *See* Surrebuttal Testimony of Dorothy Hains ("Hains Sb.") at 4; Brown Sb. at 21

[31] Sorensen Rj. at 11-12.

[32] Brown Sb. at 23.

[33] *Id.*

[34] Moore Sb. at 5.

F. **Rent Expense**

Q. DOES STAFF NOW AGREE WITH THE COMPANY ON THE LEVEL OF RENT EXPENSE?

A. Yes.[35] All of the parties now agree on a rent expense of $38,362.[36]

G. **Chemical Expense**

Q. DOES STAFF NOW AGREE ON THE LEVEL OF CHEMICAL EXPENSE PROPOSED BY THE COMPANY?

A. Yes.[37] All the parties now agree on chemicals expense of $40,813.[38]

H. **Contractual Services- Bonuses**

Q. DOES STAFF CONTINUE TO DENY RECOVERY OF BONUSES PAID DURING THE TEST YEAR?

A. Yes.[39] But this is really an operations issue now, so BMSC's position is addressed by Mr. Sorensen in his rejoinder testimony.[40]

I. **Contractual Services- Central Office Costs**

Q. PLEASE COMMENT ON STAFF'S SURREBUTTAL TESTIMONY CONCERNING CENTRAL OFFICE COSTS?

A. Ms. Brown claims that the central office costs allocated to BMSC exist solely to benefit investors because APIF is a for-profit enterprise.[41] This is an extreme and distorted view of the role of APIF.

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[35] Brown Sb. at 21-22.

[36] *Id.*; Moore Sb. at 13.

[37] Brown Sb. at 21.

[38] *Id.*; Moore Sb. at 14.

[39] Brown Sb. at 24-25.

[40] Sorensen Rj. at 13-14.

[41] Brown Sb. at 27.

Q. YOU BETTER EXPLAIN THAT TESTIMONY MR. BOURASSA.

A. APIF now owns and operates some 71 different assets in North America. APIF oversees these subsidiary companies in a manner intended to ensure proper and cost efficient management of these assets, individually and collectively. And yes, it seeks a profit. So what? But for that pursuit of a profit through the efficient operation of utility subsidiaries like BMSC and others, APIF would not need to exist.[42] Under Ms. Brown's view, a for-profit enterprise would not spend money to make its business operate efficiently and cost effectively. This is not how businesses in the real world operate. And the fact of a profit-motive does not mean ratepayers are not benefiting.

Q. IS IT MORE REASONABLE TO USE A SHARED SERVICES MODEL UNDER THE OWNERSHIP OF A PARENT COMPANY WITH MORE THAN ONE SUBSIDIARY THAN TO HAVE EACH SUBSIDIARY INCUR COSTS ON A STAND ALONE BASIS?

A. Yes. The reason should be clear. When costs are shared, no individual entity incurs the full cost of the shared service while at the same time achieving the same or higher level of benefit as would be achieved by the individual entity alone. I believe Ms. Brown will also agree that, where possible, a shared services model is more reasonable and cost effective than a stand-alone model.[43]

Q. CAN YOU PROVIDE AN EXAMPLE?

A. I believe I already have. In my rebuttal testimony, I pointed out that the allocated cost for audit services to BMSC was less than $7,700.[44] On a stand-alone basis this

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[42] *See also* Rebuttal Testimony of Thomas J. Bourassa – Rate Base, Income Statement and Rate Design ("Bourassa Rb.") at 18-23 (discussing the nature and benefits of the management of APIF to both BMSC and its rate papers).

[43] Transcript from June 20, 2006 hearing at 778-779, *Black Mountain Sewer Corporation*, Docket No. SW-02361A-05-0657.

[44] Bourassa Rb. at 21.

cost would be at least $20,000.[45] Also in my rebuttal testimony, I pointed out that the allocated cost to BMSC for tax services is less than $2,000.[46] On a stand-alone basis this cost would be at least $5,000.[47] These are just ready examples, because these services have been criticized by Ms. Brown, but there are others as well.

Q. BUT MS. BROWN SAYS BMSC IS NOT REQUIRED TO HAVE AN AUDIT?

A. BMSC would likely be required to have an audit if it were to raise capital on its own. The terms of debt or equity issuances would likely require it. So although it doesn't need one today, if it were standalone and needed capital it probably would need one. Putting that aside, BMSC wasn't "required" to work with its various customer groups to become a better corporate citizen in its community either, nor is it strictly required by its contract to conduct additional testing. But this does not mean these things are not reasonable and appropriate. Stand-alone small utilities often cannot afford things like audits or the services of qualified tax professionals, but this does not mean that they would not benefit. In fact Staff and RUCO benefit when these professionals improve the utility's record-keeping. In other words, just because a stand-alone utility cannot afford something also does not mean if it could it does provide a benefit.

In short, a well run utility is a benefit to ratepayers, and the costs allocated by APIF to its subsidiaries are the costs needed to operate a well-run utility. They should not be excluded just because they were incurred by a for-profit shareholder as part of a shared services model. And that is Ms. Brown's only real reason for removing more than $25,000 from the Company's operating expenses.

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[45] *Id.*

[46] *Id.* at 20.

[47] *Id.*

Q. ARE THE COSTS RELATED TO THE APIF CENTRAL OFFICE SIMILAR IN NATURE TO CORPORATE COSTS ALLOCATED TO OTHER UTILITIES IN ARIZONA WHO ARE OWNED AND OPERATED BY PARENT COMPANIES?

A. Yes. Chaparral City Water Company ("CCWC"), for example, is allocated similar costs in the corporate allocation from American States Water Company ("American States") through Golden State Water Company. In the recent CCWC rate case (Decision), the corporate allocation pool was over $34 million of which CCWC was allocated approximately $1.3 million (approximately 4%). Among the costs in the allocation pool used in the CCWC case were costs for corporate office rent, office expense, management, accounting and financial services (tax and audit).

Q. DID STAFF RECOMMEND DISALLOWANCE OF THESE CORPORATE COSTS ALLOCATED TO CCWC BECAUSE AMERICAN STATES IS A FOR-PROFIT ENTERPRISE?

A. No.

Q. DO YOU HAVE ANY FURTHER COMMENTS?

A. Yes. Smaller utilities are more likely to run into operational and financial problems. These problems were recognized in the 1999 Water Task Force Report.[48] In fact, this Commission recognized the problems of small utilities and the benefits of consolidation within the water industry (Decision No. 62993). The McLain Systems matter[49] is a perfect example of a small mom and pop utility that ran into significant financial and operational problems.

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[48] *See* Interim Report of the Arizona Corporation Commission's Water Task Force, Docket W-00000C-98-0153, October 28, 1999, at 4; Decision No. 62993, November 3, 2000.

[49] Decision No. 68826 (June 29, 2006).

The benefits to consolidation are numerous and the shared services models employed by the parent company of Arizona utilities such as Liberty Water, CCWC, Arizona-American Water, and Arizona Water, should not be discouraged by this Commission through the disallowance of prudent, necessary, and beneficial costs under such arrangements. The shared service model used by Liberty Water promotes efficiency, cost control, access to capital, high quality water and wastewater services, value-added customer service, and the long-term financial health and stability of its utilities.

J. <u>Contractual Services- Sewer Clean-Up Costs</u>

Q. PLEASE COMMENT ON RUCO'S RECOMMENDATION TO DENY RECOVERY OF SEWER SPILL CLEAN-UP COSTS?

A. RUCO continues to recommend that the Company not be allowed to recover costs arising from the clean up of unintended discharges of wastewater.[50] Both Staff and the Company agree to include these costs in operating expenses.[51] Inclusion of the clean-up costs in operating expenses recognizes that these costs are a necessary and recurring expense related to the provision of wastewater service. Mr. Sorensen addresses this expense in more detail in his rejoinder testimony.[52]

K. <u>Contractual Services- Legal and Survey Costs</u>

Q. PLEASE COMMENT ON RUCO'S RECOMMENDATION TO REMOVE LEGAL AND SURVEY COSTS FROM TEST YEAR EXPENSES.

A. RUCO recommends removing legal and survey costs related to an easement dispute totaling $4,723 from operating expenses.[53] The Company disagrees. Legal

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[50] Moore Sb. at 11.

[51] Bourassa Rb. at 14.

[52] Sorensen Rj. at 5-6.

[53] Moore Sb. at 11.

expenses are incurred every year, although by nature, the cost of any particular specific legal matter may or may not reoccur. The Company believes the test year level of expense represents the costs it expects to incur on a going-forward basis for legal needs.

L. **Contractual Services- Aerotek**

Q. DO STAFF AND THE COMPANY CONTINUE TO DISAGREE ON THE INCLUSION OF $42,200 OF CONTRACTUAL SERVICES EXPENSE FROM AEROTEK IN OPERATING EXPENSE?

A. Yes. Staff continues to recommend the disallowance of the $42,200 of expense because it is included in the operating expenses of pending rate case for LPSCO.[54]

Q. DO YOU KNOW WHETHER LPSCO OR THE COMPANY WAS AWARE OF THE BOOKKEEPING ERROR THAT OCCURRED WHEN LPSCO FILED ITS RATE CASE?

A. I know that the bookkeeping error was only discovered after the LPSCO rate case filing, so LPSCO could not make an adjustment to operating expenses.

Q. IS IT THE INTENTION OF LPSCO TO EXCLUDE THIS EXPENSE FROM ITS OPERATING EXPENSES IN LPSCO'S PENDING RATE CASE?

A. Yes. The LPSCO rate case is at the rebuttal stage, and I will be filing my rebuttal testimony early next month. I will make the adjustment at that time.

Q. DOES STAFF ARGUE THAT THE EXPENSE IS NOT LEGITIMATE?

A. No, so there is no valid reason at this point to deny BMSC recovery of a legitimate operating expense.

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[54] Brown Sb. at 25.

Q. DOES RUCO CONTINUE TO PROPOSE THE INCLUSION OF THE $42,200 IN THE COMPANY'S OPERATING EXPENSES?

A. Yes.[55]

M. <u>Contractual Services - Normalization</u>

Q. DOES STAFF'S NORMALIZATION OF CONTRACTUAL SERVICES EXPENSE STILL CONTAIN AN ERROR?

A. Yes. I pointed out that Ms. Brown erroneously includes $1,500 of capitalized expense in her normalization adjustment computation.[56] Now, Ms. Brown appears to misunderstand the Company's testimony and believes that it did remove the $1,500 before computing its adjustment.[57] However, Staff continues to make the error.

I will try to explain further. I agree with Staff that the $1,500 was removed before computing its 3 year average for Contractual Services – Legal and Engineering of $7,862. However, Staff did not remove the $1,500 before computing its net adjustment. Staff first removed the $1,500 of capitalized expense from Contractual Service – Legal and Engineering in its capitalized expenses adjustment number 7 on Staff Surrebuttal Schedule CSB-19, line 1. The expense was adjusted from the test year amount of $9,362 to $7,862. Subsequently, in Staff's normalization adjustment number 8 on Staff Surrebuttal Schedule CSB-20 Staff used the $9,362 (line 31) to compute its adjustment rather than the adjusted amount of $7,862. Hopefully, Staff will correct this error, and I apologize if my prior testimony on this subject wasn't clear enough.

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[55] Moore Sb. at 12.

[56] Bourassa Rb. at 15.

[57] Brown Sb. at 22.

N. **Transportation Expense**

Q. DOES STAFF CONTINUE TO DISAGREE WITH THE COMPANY ON THE TRUCK LEASE COSTS?

A. Yes.[58]

Q. WHAT REASONS DOES STAFF PROVIDE?

A. Staff states several reasons.[59] First, Staff asserts that because of some bookkeeping errors made by the Company on its general ledger (e.g. failure to record odor control unit transfer, error in recording the Aerotek invoice) that the truck lease costs should be disallowed. Second, Staff asserts that the truck could be subsequently transferred to another utility, like Gold Canyon Sewer Company ("GCSC"), who then files a rate case to get double recovery. Third, the Company did not maintain mileage logs.

Q. LET'S START WITH STAFF'S FIRST REASON. ARE BOOKKEEPING ERRORS FOUND DURING THE COURSE OF A RATE CASE?

A. In my experience, yes. Bookkeeping errors are not uncommon. One of the elements of any rate case is a thorough examination of the books and records. Inevitably mistakes are found. That is good because one of the goals of the rate case process is to identify legitimate expenses that are included in the cost of service and rates. In other words, errors occur and this is the best time to find them and fix them. But a readily correctible bookkeeping error should not be the basis for the exclusion of a legitimate expense. Mr. Sorensen addresses Staff's second reason in his rejoinder testimony.[60]

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[58] Brown Sb. at 32.

[59] *Id.* at 32-33.

[60] Sorensen Rj. at 14-15.

Q. CAN YOU ADDRESS STAFF'S THIRD REASON PLEASE?

A. The IRS does not require mileage logs to be kept unless the vehicle is used for personal and business. The function of a mileage log for IRS purposes is to help establish business use percentage. The State of Arizona is required to keep mileage logs on its vehicles because the vehicles are part on an interagency vehicle pool. Without the logs, the State would not know how to allocate vehicle expense among its agencies. The evidence in the instant case is that the truck is used exclusively by BMSC, so there is no need to maintain mileage logs. There is simply no reason to exclude this expense.

O. <u>Income Taxes</u>

Q. PLEASE DISCUSS THE POSITIONS OF THE PARTIES WITH RESPECT TO THE COMPUTATION OF INCOME TAXES?

A. Staff has now excluded the Scottsdale Capacity lease costs from expense when computing its income taxes. This treatment is now consistent with the Company and the prior decision.[61] RUCO, on the other hand, has not computed income taxes consistent with the prior decision.[62] Indeed, RUCO expressly rejects the Commission's prior ratemaking treatment.[63]

Q. ON WHAT BASIS?

A. RUCO asserts that the Scottsdale Capacity lease costs are like any other operating expense and do not require further treatment for tax purposes.[64]

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[61] Decision No. 69164 at 9.

[62] Moore Sb. at 17.

[63] *Id.*

[64] *Id.*

Q. PLEASE RESPOND.

A. The Scottsdale Capacity leases costs are not like other operating expenses because they are in reality debt payments and RUCO knows this to be the case from the last rate cases for the Company. Mr. Moore should also know that only the interest portion of the debt payment is tax deductable. The income tax treatment provided in the prior case insures the Company will be provided with the full debt service payment after tax.

RUCO's position on income tax treatment should be rejected by the Commission, just as RUCO's position of eliminating the Scottsdale Capacity costs from operating expense was rejected in the prior decision.[65] Even before the last rate order,[66] the Commission concluded that the debt service on the debt financing for the Scottsdale Capacity should be treated as an operating expense. RUCO sought to change this treatment in the last rate case and its recommendation was rejected.[67] What RUCO is doing now is seeking a second bite at the apple in order to reduce the revenue requirement for BMSC. This effort should again be rejected.

V. <u>RATE DESIGN</u>

Q. WHAT ARE THE COMPANY'S REJOINDER PROPOSED RATES?

A. The proposed rates are:

Residential Charge:	$72.23
Commercial – Std. Rate (Per gallon)[68]:	$0.28957
Commercial – Special Rate (Per gallon)[69]:	

[65] *See* Decision No. 69164 at 8.

[66] *See* Decision No. 59944, January 4, 1997.

[67] *Id.*

[68] Per prior Commission order, commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin No. 12, Table 1, published by the Arizona Department of Environmental Quality (June 1989).

B-H Enterprises (7518 Elbow Bend West)	N/A
B-H Enterprises (7518 Elbow Bend East)	N/A
Barb's Pet Grooming	N/A
Boulders Resort	$0.28957
Carefree Dental	N/A
Ridgecrest Realty	N/A
Desert Forest	$0.28957
Desert Hills Pharmacy	N/A
El Pedegral	$0.28957
Lemon Tree	N/A
Body Shop	N/A
Spanish Village	$0.28957
Boulders Club	$0.28957
Anthony Vuitaggio	N/A

In addition, the proposed charge for reclaimed (non-potable) water is $150 per acre-foot.

Q. DOES STAFF CONTINUE TO RECOMMEND SPECIAL RATES?

A. Yes.[70] Mr. Sorensen addresses this issue in his rejoinder testimony.[71]

[69] Per prior Commission order, wastewater flows are based on Engineering Bulletin No. 12, Table 1. A one-bedroom dwelling is assumed to generate 200 gallons per day, each additional bedroom is assumed to generate an additional 100 gallons per day.

[70] Brown Sb. at 35.

[71] Sorensen Rj. at 3-4.

Q. HAS STAFF REVISED ITS RECOMMENDATION FOR THE EFFLUENT RATE?

A. Yes. Staff agrees with the Company to set the effluent rate to $150 per acre foot or $0.46051 per thousand gallons.[72] All the parties are now in agreement on the proposed effluent rate.

Q. DOES STAFF RECOMMEND THE APPROVAL OF A HOOK-UP FEE?

A. No.[73] However, Staff has proposed an alternative in case the Commission disagrees with Staff.[74]

Q. HAS THE COMPANY MODIFIED ITS PROPOSAL FOR HOOK-UP FEES?

A. Yes. The Company has revised its proposed HUF fees to match Staff's schedule of fees in Exhibit 1 of Ms. Hains' surrebuttal testimony. Mr. Sorensen addresses the Company's position in more detail in his rejoinder testimony.[75]

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

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[72] Brown Sb. at 36.

[73] Hains Sb. at 1.

[74] *Id.* at 2.

[75] Sorensen Rj at 10-11.

BOURASSA
RATE BASE, INCOME STATEMENT
& RATE DESIGN SCHEDULES

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Increase in Gross Revenue
Requirements As Adjusted

Exhibit
Rejoinder Schedule A-1
Page 1
Witness: Bourassa

Line No.			
1	Fair Value Rate Base	$	3,682,905
2			
3	Adjusted Operating Income		(128,486)
4			
5	Current Rate of Return		-3.49%
6			
7	Required Operating Income	$	456,680
8			
9	Required Rate of Return on Fair Value Rate Base		12.40%
10			
11	Operating Income Deficiency	$	585,166
12			
13	Gross Revenue Conversion Factor		1.6286
14			
15	Increase in Gross Revenue Revenue Requirement	$	953,002
16			
17	Test Year Revenues	$	1,580,170
18	Increase in Gross Revenue Revenue Requirement	$	953,002
19	Proposed Revenue Requirement	$	2,533,172
20	% Increase		60.31%
21			

22	**Customer**	**Present**	**Proposed**	**Dollar**	**Percent**
23	**Classification**	**Rates**	**Rates**	**Increase**	**Increase**
24					
25					
26	Residential	$ 1,077,880	$ 1,705,856	$ 627,976	58.26%
27	Commercial (Standard Rate)	378,678	599,266	220,588	58.25%
28	Commercial (Special Rate)	98,964	198,820	99,856	100.90%
29	Effluent Sales	15,917	19,578	3,661	23.00%
30					
31	Annualization	2,145	3,395	1,250	58.26%
32				-	0.00%
33	**Subtotal**	$ 1,573,584	$ 2,526,915	$ 953,331	60.58%
34					
35	Other Wastewater Revenues	6,915	6,915	-	0.00%
36	Reconciling Amount H-1 to C-1	(329)	(658)	(329)	100.00%
37					
38	**Total of Water Revenues**	$ 1,580,499	$ 2,533,830	$ 953,002	60.30%
39					
40					
41					

42 SUPPORTING SCHEDULES:
43 Rejoinder B-1
44 Rejoinder C-1
45 Rejoinder C-3
46 Rejoinder H-1
47
48

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Rate Base

Exhibit
Rejoinder Schedule B-1
Page 1
Witness: Bourassa

Line No.		Original Cost Rate base	Fair Value Rate Base
1			
2	Gross Utility Plant in Service	$ 11,646,544	$ 11,646,544
3	Less: Accumulated Depreciation	5,725,275	5,725,275
4			
5	Net Utility Plant in Service	$ 5,921,269	$ 5,921,269
6			
7	Less:		
8	Advances in Aid of		
9	Construction	1,711,260	1,711,260
10	Contributions in Aid of		
11	Construction	5,232,139	5,232,139
12	Accumulated Amortization of CIAC	(4,214,384)	(4,214,384)
13			
14	Customer Meter Deposits	94,290	94,290
15	Deferred Income Taxes & Credits	(195,906)	(195,906)
16		-	-
17			
18			
19	Plus:		
20	Unamortized Finance		
21	Charges	-	-
22	Deferred Regulatory Assets	389,035	389,035
23	Allowance for Working Capital	-	-
24			
25			
26	Total Rate Base	$ 3,682,905	$ 3,682,905
27			
28			
29			
30	SUPPORTING SCHEDULES:		RECAP SCHEDULES:
31	Rejoinder B-2		A-1
32			
33			
34			
35			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Rejoinder Schedule B-2
Page 1
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments Amount	Adjusted at end of Test Year
1	Gross Utility			
2	Plant in Service	$ 11,357,735	288,809	$ 11,646,544
3				
4	**Less:**			
5	Accumulated			
6	Depreciation	5,625,025	100,250	5,725,275
7				
8				
9	Net Utility Plant			
10	in Service	$ 5,732,710		$ 5,921,269
11				
12	**Less:**			
13	Advances in Aid of			
14	Construction	$ 1,457,009	254,251	$ 1,711,260
15				
16	Contributions in Aid of			
17	Construction (CIAC)	5,232,139	-	5,232,139
18				
19	Accumulated Amortization of CIAC	(4,214,384)	-	(4,214,384)
20				
21	Customer Deposits	94,290	-	94,290
22	Deferred Income Taxes	(170,554)	(25,351)	(195,906)
23				
24				
25	**Plus:**			
26	Unamortized Finance			
27	Charges	-	-	-
28	Deferred Regulatory Assets	389,035	-	389,035
29	Allowance for Working Capital	-	-	-
30				
31	Total	$ 3,723,245		$ 3,682,905
32				
33				
34				
35	SUPPORTING SCHEDULES:			RECAP SCHEDULES:
36	Rejoinder B-2, pages 1-6			Rejoinder B-1
37				
38				
39				
40				
41				
42				
43				
44				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments

Exhibit
Rejoinder Schedule B-2
Page 2
Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustments 1 Plant in Service	2 Accum. Depr.	3 AIAC	4 Deferred Income Taxes	5 Working Capital	Rejoinder Adjusted at end of Test Year
1	Gross Utility							
2	Plant in Service	$ 11,357,735	288,809					$ 11,646,544
3								
4	**Less:**							
5	Accumulated							
6	Depreciation	5,625,025		100,250				5,725,275
7								
8								
9	Net Utility Plant							
10	in Service	$ 5,732,710	$ 288,809	$ (100,250)		$ -	$ -	$ 5,921,269
11								
12	**Less:**							
13	Advances in Aid of							
14	Construction	1,457,009			254,251			1,711,260
15								
16	Contributions in Aid of							
17	Construction (CIAC)	5,232,139						5,232,139
18								
19	Accumulated Amort of CIAC	(4,214,384)						(4,214,384)
20								
21	Customer Deposits	94,290						94,290
22	Deferred Income Taxes	(170,554)				(25,351)		(195,906)
23								
24								
25	**Plus:**							
26	Unamortized Finance							
27	Charges	-						-
28	Deferred Reg. Assets	389,035						389,035
29	Allowance for Working Capital	-					$ -	-
30								
31	Total	$ 3,723,245	$ 288,809	$ (100,250)	$ (254,251)	$ 25,351	$ -	$ 3,682,905
32								
33								
34								
35	SUPPORTING SCHEDULES:						RECAP SCHEDULES:	
36	Rejoinder B-2, pages 3-6						Rejoinder B-1	
37	Rejoinder B-5							
38								
39								
40								

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 1

Exhibit
Schedule B-2
Page 3
Witness: Bourassa

Line No.	Acct. No.	Description	Adjusted Orginal Cost	A New Trade Center Lift Sta. Plant Addition	B Old Trade Center Lift Sta. Plant Retirement	C Capitalized Expenses	D 2002 Odor Control Unit	E	F	Rejoinder Adjusted Original Cost
1		Plant-in-Service								
5	351	Organization	-							-
6	352	Franchises	-							-
7	353	Land and Land Rights	461,300							461,300
8	354	Structures and Improvements	2,557,920			2,300				2,560,220
9	355	Power Generation Equipment	-							-
10	360	Collection Sewers - Force	706,292			1,600				707,892
11	361	Collection Sewers - Gravity	4,284,948							4,284,948
12	362	Special Collecting Structures	-							-
13	363	Services to Customers	198,723							198,723
14	364	Flow Measuring Devices	31,512							31,512
15	365	Flow Measuring Installations	179,622							179,622
16	370	Receiving Wells	690,628	254,251	(13,208)	1,200				932,871
17	371	Effluent Pumping Equipment	654,844			2,803				657,647
18	380	Treatment and Disposal Equip.	143,578				38,625			182,203
19	381	Plant Sewers	123,289			1,238				124,527
20	382	Outfall Sewer Lines	-							-
21	389	Other Plant and Misc. Equipment	939,432							939,432
22	390	Office Furniture and Equipment	224,587							224,587
23	391	Transportation Equipment	107,367							107,367
24	393	Tools, Shop and Garage Equip.	5,754							5,754
25	394	Laboratory Equipment	7,488							7,488
26	395	Power Operated Equipment	-							-
27	396	Communication Equipment	40,451							40,451
28	398	Other Tangible Plant	-							-
29			-							-
30		TOTALS	$ 11,357,735	$ 254,251	$ (13,208)	$ 9,141	$ 38,625	$ -	$ -	$ 11,646,544
31										
32		Adjusted Plant-in-Service per Direct								$ 11,357,735
33										
34		Increase (decrease) in Plant-in-Service								$ 288,809
35										
36		Adjustment to Plant-in-Service								$ 288,809
37										
38		SUPPORTING SCHEDULES		ADJUSTMENTS						
39		Rejoinder B-2, pages 3.1-3.4		Adj. A - Staff Adj. #1 New Trade Center Lift Sta.				Adj. D - Ordor Control Unit RUCO - see Schedule RLM-4		
40				Adj. B - Staff Adj. #1 Old Trade Center Lift Sta.						
41				Adj. C - Staff Adj. #2 Capitalized Expenses						
42										

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rejoinder Schedule B-2
Page 3.1

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Per Decision 69164 Plant At 12/31/2004	2004 Accum. Depr.	2005 Plant Additions	2005 Plant Adjustments[1]	2005 Adjusted Plant Additions	2005 Plant Retirements	2005 Plant Balance	2005 Deprec.
351	Organization	0.0000%	0.00%	-	-			-		-	-
352	Franchises	0.0000%	0.00%	-	-			-		-	-
353	Land and Land Rights	0.0000%	0.00%	461,300	-			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,239,905	888,015	56,562	(1,917)	54,645		1,294,549	63,361
355	Power Generation Equipment	5.0000%	5.00%	-	706			-		-	(706)
360	Collection Sewers - Force	5.0000%	2.00%	568,413	154,483	94,624	(5,062)	89,562		657,976	30,660
361	Collection Sewers - Gravity	5.0000%	2.00%	3,614,544	2,488,740	297,571	(21,880)	275,691		3,890,235	187,619
362	Special Collecting Structures	5.0000%	2.00%	-	-			-		-	-
363	Services to Customers	5.0000%	2.00%	157,218	128,612	19,337		19,337		176,555	8,344
364	Flow Measuring Devices	5.0000%	10.00%	39,829	23,004		(8,135)	(8,135)		31,694	1,788
365	Flow Measuring Installations	5.0000%	10.00%	156,204	3,959	19,404		19,404		175,608	8,295
370	Receiving Wells	5.0000%	3.33%	696,137	199,051			-		696,137	34,807
371	Effluent Pumping Equipment	5.0000%	12.50%	453,558	244,706	11,119		11,119		464,677	22,956
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	-	6,288		6,288		6,288	157
381	Plant Sewers	5.0000%	5.00%	123,289	84,017			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%	-	-			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	719,140	80,678	99,447	(7,527)	91,920		811,059	38,255
390	Office Furniture and Equipment	5.0000%	6.67%	220,360	27,165	1,465		1,465		221,825	11,055
391	Transportation Equipment	5.0000%	20.00%	87,811	7,642			-		87,811	4,391
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-			-		-	-
394	Laboratory Equipment	5.0000%	10.00%	7,279	352	209		209		7,488	369
395	Power Operated Equipment	5.0000%	5.00%	-	-			-		-	-
396	Communication Equipment	5.0000%	10.00%	-	-			-		-	-
398	Other TangiblePlant	5.0000%	10.00%	-	-			-		-	-
								-		-	-
	Plant Held for Future Use										
	TOTAL WATER PLANT			8,544,987	4,331,129	606,025	(44,521)	561,504	-	9,106,490	417,516

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rejoinder Schedule B-2
Page 3.2

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	2006 Plant Additions	2006 Plant Adjustments[1]	2006 Plant Adjustments	2006 Adjusted Plant Additions	2006 Plant Retirements	2006 Plant Balance	2006 Deprec.
351	Organization	0.0000%	0.00%				-		-	-
352	Franchises	0.0000%	0.00%				-		-	-
353	Land and Land Rights	0.0000%	0.00%				-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	3,625			3,625		1,298,175	63,014
355	Power Generation Equipment	5.0000%	5.00%				-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	3,592			3,592		661,568	31,339
361	Collection Sewers - Gravity	5.0000%	2.00%	112,559	(22,710)		89,849		3,980,083	186,920
362	Special Collecting Structures	5.0000%	2.00%				-		-	-
363	Services to Customers	5.0000%	2.00%	10,429			10,429		186,983	8,634
364	Flow Measuring Devices	5.0000%	10.00%		(182)		(182)		31,512	1,712
365	Flow Measuring Installations	5.0000%	10.00%	3,740			3,740		179,348	9,613
370	Receiving Wells	5.0000%	3.33%	2,141			2,141		698,278	33,890
371	Effluent Pumping Equipment	5.0000%	12.50%	44,676			44,676		509,353	27,395
380	Treatment and Disposal Equipment	5.0000%	5.00%	12,184			12,184		18,472	619
381	Plant Sewers	5.0000%	5.00%				-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%				-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	53,055	(740)		52,315		863,374	43,026
390	Office Furniture and Equipment	5.0000%	6.67%				-		221,825	11,400
391	Transportation Equipment	5.0000%	20.00%				-		87,811	5,488
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%				-		-	-
394	Laboratory Equipment	5.0000%	10.00%				-		7,488	406
395	Power Operated Equipment	5.0000%	5.00%				-		-	-
396	Communication Equipment	5.0000%	10.00%				-		-	-
398	Other TangiblePlant	5.0000%	10.00%				-		-	-
							-		-	-
	Plant Held for Future Use									
	TOTAL WATER PLANT			246,000	(23,632)		222,368	-	9,328,859	429,620

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rejoinder Schedule B-2
Page 3.3

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	2007 Plant Additions	2007 Plant Adjustments[1]	2007 Adjusted Plant Additions	2007 Plant Retirements	2007 Plant Balance	2007 Deprec.
351	Organization	0.0000%	0.00%			-		-	-
352	Franchises	0.0000%	0.00%			-		-	-
353	Land and Land Rights	0.0000%	0.00%			-		461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,539	(20,391)	(18,852)		1,279,322	42,915
355	Power Generation Equipment	5.0000%	5.00%			-		-	-
360	Collection Sewers - Force	5.0000%	2.00%	34,935	(2,469)	32,466		694,034	13,556
361	Collection Sewers - Gravity	5.0000%	2.00%	211,268	(32,273)	178,995		4,159,078	81,392
362	Special Collecting Structures	5.0000%	2.00%			-		-	-
363	Services to Customers	5.0000%	2.00%			-		186,983	3,740
364	Flow Measuring Devices	5.0000%	10.00%			-		31,512	3,151
365	Flow Measuring Installations	5.0000%	10.00%			-		179,348	17,935
370	Receiving Wells	5.0000%	3.33%			-		698,278	23,253
371	Effluent Pumping Equipment	5.0000%	12.50%	74,764	(5,336)	69,428		578,780	68,008
380	Treatment and Disposal Equipment	5.0000%	5.00%	4,387		4,387		22,859	1,033
381	Plant Sewers	5.0000%	5.00%			-		123,289	6,164
382	Outfall Sewer Lines	5.0000%	3.33%			-		-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	784	(942)	(158)		863,216	57,582
390	Office Furniture and Equipment	5.0000%	6.67%	2,763		2,763		224,587	14,888
391	Transportation Equipment	5.0000%	20.00%	19,556		19,556		107,367	19,518
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	3,493		3,493		3,493	87
394	Laboratory Equipment	5.0000%	10.00%			-		7,488	749
395	Power Operated Equipment	5.0000%	5.00%			-		-	-
396	Communication Equipment	5.0000%	10.00%			-		-	-
398	Other TangiblePlant	5.0000%	10.00%			-		-	-
						-		-	
	Plant Held for Future Use								
	TOTAL WATER PLANT			353,488	(61,411)	292,077	-	9,620,936	353,971

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rejoinder Schedule B-2
Page 3.4

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Jun.-Jun. 2008 Plant Additions	Jun.-Jun. 2008 Plant Adjustments[1]	Staff Jun.-Jun. 2008 Plant Adjustments	Jun.-Jun. 2008 Adjusted Plant Additions	2002 Odor Control Unit	Jun.-Jun. 2008 Plant Retirements	Staff Jun.-Jun. 2008 Plant Retirements	2002 to Dec. 2007 A/D Adjustment	June 30 2008 Plant Balance	Jun.-Jun. 2008 Deprec.
351	Organization	0.0000%	0.00%				-					-	-
352	Franchises	0.0000%	0.00%				-					-	-
353	Land and Land Rights	0.0000%	0.00%				-					461,300	-
354	Structures and Improvements	5.0000%	3.33%	1,290,255	(11,658)	2,300	1,280,897					2,560,220	31,964
355	Power Generation Equipment	5.0000%	5.00%				-					-	-
360	Collection Sewers - Force	5.0000%	2.00%	12,595	(337)	1,600	13,858					707,892	7,010
361	Collection Sewers - Gravity	5.0000%	2.00%	130,250	(4,380)		125,870					4,284,948	42,220
362	Special Collecting Structures	5.0000%	2.00%				-					-	-
363	Services to Customers	5.0000%	2.00%	11,739			11,739					198,723	1,929
364	Flow Measuring Devices	5.0000%	10.00%				-					31,512	1,576
365	Flow Measuring Installations	5.0000%	10.00%	430	(156)		274					179,622	8,974
370	Receiving Wells	5.0000%	3.33%	544	(311)	255,451	255,684		(7,883)	(13,208)		932,871	15,706
371	*Effluent Pumping Equipment*	5.0000%	12.50%	78,862	(2,798)	2,803	78,867					657,647	38,638
380	Treatment and Disposal Equipment	5.0000%	5.00%	129,937	(9,218)		120,719	38,625			11,148	182,203	2,080
381	Plant Sewers	5.0000%	5.00%			1,238	1,238					124,527	3,098
382	Outfall Sewer Lines	5.0000%	3.33%				-					-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	79,092	(2,876)		76,216					939,432	30,059
390	Office Furniture and Equipment	5.0000%	6.67%				-					224,587	7,490
391	Transportation Equipment	5.0000%	20.00%				-					107,367	10,737
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	2,262			2,262					5,754	116
394	Laboratory Equipment	5.0000%	10.00%				-					7,488	374
395	Power Operated Equipment	5.0000%	5.00%				-					-	-
396	Communication Equipment	5.0000%	10.00%	40,451			40,451					40,451	1,011
398	Other TangiblePlant	5.0000%	10.00%				-					-	-
							-					-	-
	Plant Held for Future Use												
	TOTAL WATER PLANT			1,776,417	(31,734)	263,392	2,008,075		(7,883)	(13,208)	11,148	11,646,544	202,982

[1] Affiliate Profit

Black Mountain Sewer Corporation
Plant Additions and Retirements

Exhibit
Rejoinder Schedule B-2
Page 3.5

Account No.	Description	Deprec. Rate Before Dec-06	Deprec. Rate After Dec-06	Year End Accumulated Depreciation by Account 2004	2005	2006	2007	2008
351	Organization	0.0000%	0.00%	-	-	-	-	-
352	Franchises	0.0000%	0.00%	-	-	-	-	-
353	Land and Land Rights	0.0000%	0.00%	-	-	-	-	-
354	Structures and Improvements	5.0000%	3.33%	888,015	951,376	1,014,390	1,057,305	1,089,269
355	Power Generation Equipment	5.0000%	5.00%	706	-	-	-	-
360	Collection Sewers - Force	5.0000%	2.00%	154,483	185,143	216,482	230,038	237,047
361	Collection Sewers - Gravity	5.0000%	2.00%	2,488,740	2,676,359	2,863,279	2,944,671	2,986,891
362	Special Collecting Structures	5.0000%	2.00%	-	-	-	-	-
363	Services to Customers	5.0000%	2.00%	128,612	136,957	145,591	149,330	151,259
364	Flow Measuring Devices	5.0000%	10.00%	23,004	24,792	26,504	29,655	31,230
365	Flow Measuring Installations	5.0000%	10.00%	3,959	12,254	21,868	39,802	48,777
370	Receiving Wells	5.0000%	3.33%	199,051	233,858	267,748	291,001	285,616
371	Effluent Pumping Equipment	5.0000%	12.50%	244,706	267,662	295,057	363,065	401,703
380	Treatment and Disposal Equipment	5.0000%	5.00%	-	157	776	1,810	15,038
381	Plant Sewers	5.0000%	5.00%	84,017	90,181	96,346	102,510	105,608
382	Outfall Sewer Lines	5.0000%	3.33%	-	-	-	-	-
389	Other Plant and Misc. Equipment	5.0000%	6.67%	80,678	118,933	161,959	219,541	249,600
390	Office Furniture and Equipment	5.0000%	6.67%	27,165	38,219	49,619	64,507	71,997
391	Transportation Equipment	5.0000%	20.00%	7,642	12,032	17,521	37,038	47,775
393	Tools, Shop and Garage Equipment.	5.0000%	5.00%	-	-	-	87	203
394	Laboratory Equipment	5.0000%	10.00%	352	721	1,126	1,875	2,250
395	Power Operated Equipment	5.0000%	5.00%	-	-	-	-	-
396	Communication Equipment	5.0000%	10.00%	-	-	-	-	1,011
398	Other TangiblePlant	5.0000%	10.00%	-	-	-	-	-
				-	-	-	-	-
	Plant Held for Future Use			-				
	TOTAL WATER PLANT			4,331,129	4,748,645	5,178,265	5,532,236	5,725,275

Black Mountain Sewer Corporation
Plant Reconciliation to Prior Rate Case

Exhibit
Rejoinder Schedule B-2
Page 3.6

Line No.	Account No.	Description	Balance Per Company Per 2004 Filing Before Adj.	PTY Plant	Capitalized Profits	Adjustments per Decision 69164 Capitalized Expenses	Plant AIAC/CIAC	Retire Chlorinator	Allocated Computer Equip	Plant per Decision 69164	Remove PTY Plant	Initial Balance
6	351	Organization	-							-		-
7	352	Franchises	-							-		-
8	353	Land and Land Rights	461,446		(146)					461,300		461,300
9	354	Structures and Improvements	1,245,292		(5,387)					1,239,905		1,239,905
10	355	Power Generation Equipment	-							-		-
11	360	Collection Sewers - Force	228,785		(205)		339,833			568,413		568,413
12	361	Collection Sewers - Gravity	3,608,619		(1,361)	7,286				3,614,544		3,614,544
13	362	Special Collecting Structures	-							-		-
14	363	Services to Customers	158,802		(1,584)					157,218		157,218
15	364	Flow Measuring Devices	39,878		(49)					39,829		39,829
16	365	Flow Measuring Installations	158,358		(2,154)					156,204		156,204
17	370	Receiving Wells	696,506		(369)					696,137		696,137
18	371	Effluent Pumping Equipment	451,705		(360)	2,213				453,558		453,558
19	380	Treatment and Disposal Equipment	-							-		-
20	381	Plant Sewers	121,651		(1,152)	2,790				123,289		123,289
21	382	Outfall Sewer Lines	-							-		-
22	389	Other Plant and Misc. Equipment	738,804	85,699	(5,185)	5,059		(19,539)		804,839	(85,699)	719,140
23	390	Office Furniture and Equipment	365,512		(2,920)				(142,232)	220,360		220,360
24	391	Transportation Equipment	87,811							87,811		87,811
25	393	Tools, Shop and Garage Equipment.	-							-		-
26	394	Laboratory Equipment	7,279							7,279		7,279
27	395	Power Operated Equipment	-							-		-
28	398	Other TangiblePlant	-							-		-
29										-		-
30										-		-
32		TOTAL	8,370,448	85,699	(20,872)	17,348	339,833	(19,539)	(142,232)	8,630,686	(85,699)	8,544,987

Black Mountain Sewer Corporation
A/D Reconciliation to Prior Rate Case

Exhibit
Rejoinder Schedule B-2
Page 3.7

Line No.	Account No.	Description	Balance Per Company Per 2004 Filing Before Adj.	Adjustments per Decision 69164 Affiliate A/D	Retire Chlorinator	Blank	A/D per Decision 69164	PTY A/D	Initial Balance
5	351	Organization	-				-		-
6	352	Franchises	-				-		-
7	353	Land and Land Rights	-				-		-
8	354	Structures and Improvements	888,015				888,015		888,015
9	355	Power Generation Equipment	706				706		706
10	360	Collection Sewers - Force	154,483				154,483		154,483
11	361	Collection Sewers - Gravity	2,488,740				2,488,740		2,488,740
12	362	Special Collecting Structures	-				-		-
13	363	Services to Customers	128,612				128,612		128,612
14	364	Flow Measuring Devices	23,004				23,004		23,004
15	365	Flow Measuring Installations	3,959				3,959		3,959
16	370	Receiving Wells	199,051				199,051		199,051
17	371	Effluent Pumping Equipment	244,706				244,706		244,706
18	380	Treatment and Disposal Equipment	-				-		-
19	381	Plant Sewers	84,017				84,017		84,017
20	382	Outfall Sewer Lines	-				-		-
21	389	Other Plant and Misc. Equipment	100,217		(19,539)		80,678		80,678
22	390	Office Furniture and Equipment	42,876	(15,711)			27,165		27,165
23	391	Transportation Equipment	7,642				7,642		7,642
24	393	Tools, Shop and Garage Equipment.	-				-		-
25	394	Laboratory Equipment	352				352		352
26	395	Power Operated Equipment	-				-		-
27	398	Other TangiblePlant	-				-		-
28							-		-
29							-		-
31		TOTAL	4,366,379	(15,711)	(19,539)	-	4,331,129	-	4,331,129

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 2

Exhibit
Schedule B-2
Page 4
Witness: Bourassa

Line No.	Acct. No.	Description	Direct Adjusted Accum. Depr.	A New Trade Center Lift Sta. Plant Addition	B Old Trade Center Lift Sta. Plant Retirement	C Capitalized Expense Additional Test Year Depr	D Transfer A/D 2002 Odor Control Unit	F Difference To Computed Amount	Rejoinder Adjusted Accum. Depr.
1	Accumulated Depreciation								
5	351	Organization	-					-	-
6	352	Franchises	-					-	-
7	353	Land and Land Rights	-					-	-
8	354	Structures and Improvements	1,067,642			38		21,590	1,089,269
9	355	Power Generation Equipment	-					-	-
10	360	Collection Sewers - Force	217,363			16		19,669	237,047
11	361	Collection Sewers - Gravity	2,869,293					117,598	2,986,891
12	362	Special Collecting Structures	-					-	-
13	363	Services to Customers	145,843					5,416	151,259
14	364	Flow Measuring Devices	32,828					(1,597)	31,230
15	365	Flow Measuring Installations	57,602					(8,826)	48,777
16	370	Receiving Wells	283,038	4,233	(13,208)	20		11,532	285,616
17	371	Effluent Pumping Equipment	437,968			175		(36,439)	401,703
18	380	Treatment and Disposal Equipment	3,890				11,148	-	15,038
19	381	Plant Sewers	105,592			31		(15)	105,608
20	382	Outfall Sewer Lines	-					-	-
21	389	Other Plant and Misc. Equipment	263,481					(13,881)	249,600
22	390	Office Furniture and Equipment	75,700					(3,703)	71,997
23	391	Transportation Equipment	60,947					(13,172)	47,775
24	393	Tools, Shop and Garage Equipment	203					-	203
25	394	Laboratory Equipment	2,624					(374)	2,250
26	395	Power Operated Equipment	-					-	-
27	396	Communication Equipment	1,011					-	1,011
28	398	Other TangiblePlant	-					-	-
29			-						-
30		TOTALS	$ 5,625,025	$ 4,233	$ (13,208)	$ 280	$ 11,148	$ 97,796	$ 5,725,275
31									
32	Adjusted Accumulated Depreciation per Direct								$ 5,625,025
33									
34	Increase (decrease) in Plant-in-Service								$ 100,250
35									
36	Adjustment to Plant-in-Service								$ 100,250
37									
38	SUPPORTING SCHEDULES								
39	Rejoinder B-2, pages 3.5								
40									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment Number 3

Exhibit
Rejoinder Schedule B-2
Page 5
Witness: Bourassa

Line No.

Advances in aid of construction

Test Year Adjusted Balance	Adjustment	Rejoinder Test Year Adjusted Balance
$ 1,457,009	254,251 [1]	$ 1,711,260

[1] Line Extension Agreement for New Trade Lift Station

SUPPORTING SCHEDULE
See Testimony

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Original Cost Rate Base Proforma Adjustments
Adjustment 5

Exhibit
Rejoinder Schedule B-2
Page 6
Witness: Bourassa

Line No.										
1	**Deferred Income Tax as of June 30, 2008**									
2										
3				**Probability of Realization**	**Deductible TD (Taxable TD)**					
4		**Adjusted**		**of Future**	**Expected to**	**Tax**	**Future Tax Asset**		**Future Tax Liability**	
5		**Book Value[1]**	**Tax Value**	**Tax Benefit**	**be Realized**	**Rate**	**Current**	**Non Current**	**Current**	**Non Current**
6	Plant-in-Service	$ 11,646,544								
7	Accum. Deprec.	(5,725,275)								
8	CIAC	(1,017,755)								
9	Fixed Assets	$ 4,903,514	$ 3,699,796	100.0%	$ (1,203,718)	38.6%				$ (464,622)
10	AIAC	$ (1,711,260)	-	100.0%	$ 1,711,260	38.6%		$ 660,527		
11										
12							$ -	$ 660,527	$ -	$ (464,622)
13										
14					Net Asset (Liability)		$ 195,906			
15										
16					DIT Asset per Direct		$ 170,554			
17										
18					Adjustment to DIT		$ (25,351)			
19										
20										
21										
22										
23	1 Adjusted per Rejoinder B-2									
24										
25										
26										

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Working Capital

Exhibit
Rejoinder Schedule B-5
Page 1
Witness: Bourassa

Line No.			
1			
2	Cash Working Capital - Lead-Lag Study	$	5,252
3	Prepayments (Excluding Prepaid Insurance)		8,292
4	Materials & Supplies		-
5			
6			
7			
8			
9	Total Working Capital Allowance	$	13,544
10			
11			
12	Working Capital Requested	$	-
13			
14			
15	SUPPORTING SCHEDULES:	RECAP SCHEDULES:	
16	Rejoinder B-5, page 2	Rejoinder B-1	
17			

Black Mountain Sewer Corporation
Lead/Lag Study
Cash Working Capital

Exhibit
Rejoinder Schedule B-5
Page 2
Witness: Bourassa

Line No.	Description (A)	A Proforma TY Expense (B)	B Revenue Lag Days[1] (C)	C Expense Lag Days (D)	D Net Lag Days (E)	E Lead/Lag Factor (Col. E/365) (F)	F Cash Working Capital Required (Col. B x Col. F) (G)
10	Salaries and Wages						
11	Net Pay	-	NA	NA	NA	NA	-
12	Income Taxes Withheld	-	NA	NA	NA	NA	-
13	Payroll taxes Withheld	-	NA	NA	NA	NA	-
15	Pensions and Benefits	-	NA	NA	NA	NA	-
17	Purchased Power[2]	54,690	12.87	39.79	(26.92)	-0.07375	(4,033)
19	Purchased Wastewater Treatment[3]	336,514	12.87	38.01	(25.14)	-0.06887	(23,176)
21	Rents- Building[4]	38,262	12.87	(15.00)	27.87	0.07636	2,922
23	Scottsdale Capacity Lease[5]	164,522	12.87	15.00	(2.13)	-0.00584	(961)
25	Contractual Services - Allocated Expense[6]	514,028	12.87	15.00	(2.13)	-0.00584	(3,002)
27	Regulatory Commission Expense[7]	76,667	12.87	(360.00)	372.87	1.02156	78,320
29	Insurance[8]	18,704	12.87	(180.00)	192.87	0.52841	9,883
31	Other Operating Expenses[9]	201,953	12.87	45.00	(32.13)	-0.08803	(17,778)
33	Taxes						
34	Employer's Payroll Taxes	-	NA	NA	NA	NA	-
35	Property Taxes[10]	32,651	12.87	170.00	(157.13)	-0.43049	(14,056)
36	Income Taxes[11]	345,898	12.87	37.00	(24.13)	-0.06611	(22,867)
38	Total Cash Working Capital						$ 5,252

[1] Computed from customer billing data. Measured from midpoint of service period to customer payment date. See testimony
[2] Power bill expense lag days equals 15 days to mid-point of service period plus 24.79 days from billing date to the paid date.
[3] Wastewater treatment expense lag days equals 15 days to mid-point of service period plus 23.01 days from billing date to the due date.
[4] Rents - building payment due 1st of month of serivce period. Expense lag days equals -15 days to mid point of service period.
[5] Scottsdale lease (debt) payment due 1st of month following service period. Expense lag days equals 15 days to mid point of service period.
[6] Contractual Services allocation lag days equals 15 days to mid-point of service period.
[7] Rate case expense lag days is paid before new rates are put into effect and recovered over 3 years. Weighted average expense lag days is -36(
[8] Insurance is paid once annually. Expense lag days equals weighted average expense lag days is -270 days.
[9] Other operating expenses (excludes depreciation, amortization, purchased power, ww treatment, Scottsdale capcity lease, property taxes, rent - buliding, insurance, allocated contractual services, and income taxes. Lag days equals 15 days to mid-point of service period plus average 30 days to due date of bill.
[10] Property tax expense lag days equals the weighted average lag days for payment of property taxes due on Oct 1 of current year and March 1 of following year. See testimony.

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Rejoinder Schedule C-1
Page 1
Witness: Bourassa

Line No.		Test Year Book Results	Adjustment	Test Year Adjusted Results	Proposed Rate Increase	Adjusted with Rate Increase
1	**Revenues**					
2	Flat Rate Revenues	$ 1,557,337	$ -	$ 1,557,337	$ 953,002	$ 2,510,339
3	Measured Revenues	15,917	-	15,917	-	15,917
4	Other Wastewater Revenues	6,916	-	6,916	-	6,916
5		$ 1,580,170	$ -	$ 1,580,170	$ 953,002	$ 2,533,172
6	**Operating Expenses**					
7	Salaries and Wages	$ -	-	$ -	-	$ -
8	Purchased Wastewater Treatment	335,255	1,259	336,514	-	336,514
9	Sludge Removal Expense	706	-	706	-	706
10	Purchased Power	54,690	-	54,690	-	54,690
11	Fuel for Power Production	928	-	928	-	928
12	Chemicals	37,489	3,324	40,813	-	40,813
13	Materials and Supplies	11,224	-	11,224	-	11,224
14	Contractual Services	9,362	37,354	46,716	-	46,716
15	Contractual Services- Testing	16,955	12,094	29,049	-	29,049
16	Contractual Services - Other	553,043	(39,015)	514,028	-	514,028
17	Equipment Rental	1,863	-	1,863	-	1,863
18	Rents - Building	19,830	18,432	38,262	-	38,262
19	Transportation Expenses	34,445	-	34,445	-	34,445
20	Insurance - General Liability	18,704	-	18,704	-	18,704
21	Insurance - Other	990	-	990	-	990
22	Regulatory Commission Expense	60,000	16,667	76,667	-	76,667
23	Miscellaneous Expense	20,845	-	20,845	-	20,845
24	Bad Debt Expense	11,962	2,412	14,374	-	14,374
25	Scottsdale Capacity (Operating Lease)	164,522	-	164,522	-	164,522
26	Amort. of Additional Scottsdale Cap.	48,629	-	48,629	-	48,629
27	Depreciation and Amortization	224,818	19,168	243,986	-	243,986
28	Taxes Other Than Income	(1,780)	1,780	-	-	-
29	Property Taxes	32,414	237	32,651	-	32,651
30	Income Tax	7,760	(29,710)	(21,951)	367,848	345,898
31				-		-
32	**Total Operating Expenses**	$ 1,664,655	$ 44,002	$ 1,708,656	$ 367,848	$ 2,076,504
33	**Operating Income**	$ (84,485)	$ (44,002)	$ (128,486)	$ 585,154	$ 456,668
34	**Other Income (Expense)**					
35	Interest Income	-	-	-	-	-
36	Other income	-	-	-	-	-
37	Interest Expense	(67,693)	(3,260)	(70,954)	-	(70,954)
38	Other Expense	-	-	-	-	-
39						
40	**Total Other Income (Expense)**	$ (67,693)	$ (3,260)	$ (70,954)	$ -	$ (70,954)
41	**Net Profit (Loss)**	$ (152,178)	$ (47,262)	$ (199,440)	$ 585,154	$ 385,714
42						
43	SUPPORTING SCHEDULES:				RECAP SCHEDULES:	
44	Rejoinder C-1, page 2				Rejoinder A-1	
45						
46						

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Rejoinder Schedule C-1
Page 2.1
Witness: Bourassa

Continued on Page 2.2

Line No.		Direct Adjusted Test Year Book Results	1 Depreciation	2 Property Taxes	3 Expensed Plant	4 Scottsdale Treatment	5 Annualize WW Treatment	6 Chemicals Expense	7 Annualize Chemicals Expense	8 Testing Expense	9 Rent Expense	10 Normalize Contractual Services	11 Bad Debt Expense
1	**Revenues**												
2	Flat Rate Revenues	$ 1,557,337											
3	Measured Revenues	15,917											
4	Other Wastewater Revenues	6,916											
5		$ 1,580,170	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Salaries and Wages	$ -											
8	Purchased Wastewater Treatment	335,255				1,255	4						
9	Sludge Removal Expense	706											
10	Purchased Power	54,690											
11	Fuel for Power Production	928											
12	Chemicals	37,489						3,191	133				
13	Materials and Supplies	11,224											
14	Contractual Services	9,362			(1,500)							(1,861)	
15	Contractual Services- Testing	16,955								12,094			
16	Contractual Services - Other	553,043			(7,641)							(26,580)	
17	Equipment Rental	1,863											
18	Rents - Building	19,830									18,432		
19	Transportation Expenses	34,445											
20	Insurance - General Liability	18,704											
21	Insurance - Other	990											
22	Regulatory Commission Expense	60,000											
23	Miscellaneous Expense	20,845											
24	Bad Debt Expense	11,962											2,412
25	Scottsdale Capacity (Operating Lease)	164,522											
26	Amort. of Additional Scottsdale Cap.	48,629											
27	Depreciation and Amortization	224,818	19,168										
28	Taxes Other Than Income	(1,780)											
29	Property Taxes	32,414		237									
30	Income Tax	7,760											
31													
32	**Total Operating Expenses**	$ 1,664,655	$ 19,168	$ 237	$ (9,141)	$ 1,255	$ 4	$ 3,191	$ 133	$ 12,094	$ 18,432	$ (28,441)	$ 2,412
33	**Operating Income**	$ (84,485)	$ (19,168)	$ (237)	$ 9,141	$ (1,255)	$ (4)	$ (3,191)	$ (133)	$ (12,094)	$ (18,432)	$ 28,441	$ (2,412)
34	**Other Income (Expense)**												
35	Interest Income	-											
36	Other income	-											
37	Interest Expense	(67,693)											
38	Other Expense	-											
39													
40	**Total Other Income (Expense)**	$ (67,693)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
41	**Net Profit (Loss)**	$ (152,178)	$ (19,168)	$ (237)	$ 9,141	$ (1,255)	$ (4)	$ (3,191)	$ (133)	$ (12,094)	$ (18,432)	$ 28,441	$ (2,412)
42													
43	SUPPORTING SCHEDULES:												
44	Rejoinder C-2												
45													
46													

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Income Statement

Exhibit
Rejoinder Schedule C-1
Page 2.2
Witness: Bourassa

Line No.		Direct Adjusted Test Year Book Results	Continued From Page 2.1 12 Meals Beverages Contributions	13 Contractual Services	14 Taxes Other Than Income	15 Expense Allocation	16 Contractual Services	17 Rate Case Expense	18 Interest Synch.	19 Income Tax	Rejoinder Test Year Adjusted Results	Rejoinder Proposed Rate Increase	Rejoinder Adjusted with Rate Increase
1	**Revenues**												
2	Flat Rate Revenues	$ 1,557,337									$ 1,557,337	$ 953,002	$ 2,510,339
3	Measured Revenues	15,917									15,917		15,917
4	Other Wastewater Revenues	6,916									6,916		6,916
5		$ 1,580,170	$ -	$ -	$ -	$ -	$ -		$ -	$ -	$ 1,580,170	$ 953,002	$ 2,533,172
6	**Operating Expenses**												
7	Salaries and Wages	$ -									$ -		$ -
8	Purchased Wastewater Treatment	335,255									336,514		336,514
9	Sludge Removal Expense	706									706		706
10	Purchased Power	54,690									54,690		54,690
11	Fuel for Power Production	928									928		928
12	Chemicals	37,489									40,813		40,813
13	Materials and Supplies	11,224									11,224		11,224
14	Contractual Services	9,362	(1,485)	42,200							46,716		46,716
15	Contractual Services- Testing	16,955									29,049		29,049
16	Contractual Services - Other	553,043				1,490	(6,284)				514,028		514,028
17	Equipment Rental	1,863									1,863		1,863
18	Rents - Building	19,830									38,262		38,262
19	Transportation Expenses	34,445									34,445		34,445
20	Insurance - General Liability	18,704									18,704		18,704
21	Insurance - Other	990									990		990
22	Regulatory Commission Expense	60,000						16,667			76,667		76,667
23	Miscellaneous Expense	20,845									20,845		20,845
24	Bad Debt Expense	11,962									14,374		14,374
25	Scottsdale Capacity (Operating Lease)	164,522									164,522		164,522
26	Amort. of Additional Scottsdale Cap.	48,629									48,629		48,629
27	Depreciation and Amortization	224,818									243,986		243,986
28	Taxes Other Than Income	(1,780)			1,780						-		-
29	Property Taxes	32,414									32,651		32,651
30	Income Tax	7,760								(29,710)	(21,951)	367,848	345,898
31													-
32	**Total Operating Expenses**	$ 1,664,655	$ (1,485)	$ 42,200	$ 1,780	$ 1,490	$ (6,284)	$ 16,667	$ -	$ (29,710)	$ 1,708,656	$ 367,848	$ 2,076,504
33	**Operating Income**	$ (84,485)	$ 1,485	$ (42,200)	$ (1,780)	$ (1,490)	$ 6,284	$ (16,667)	$ -	$ 29,710	$ (128,486)	$ 585,154	$ 456,668
34	**Other Income (Expense)**												
35	Interest Income	-									-		-
36	Other income	-									-		-
37	Interest Expense	(67,693)							(3,260)		(70,954)		(70,954)
38	Other Expense	-									-		-
39													
40	**Total Other Income (Expense)**	$ (67,693)	$ -	$ -	$ -	$ -	$ -	$ -	$ (3,260)	$ -	$ (70,954)	$ -	$ (70,954)
41	**Net Profit (Loss)**	$ (152,178)	$ 1,485	$ (42,200)	$ (1,780)	$ (1,490)	$ 6,284	$ (16,667)	$ (3,260)	$ 29,710	$ (199,440)	$ 585,154	$ 385,714
42													
43	SUPPORTING SCHEDULES:												
44	Rejoinder C-2												
45													
46													

RECAP SCHEDULES:
Rejoinder A-1

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses

Exhibit
Schedule C-2
Page 1
Witness: Bourassa

Adjustments to Revenues and Expenses

Line No.		1 Depreciation Expense	2 Property Taxes	3 Expensed Plant	4 Scottsdale Treatment	5 Annualize WW Treatment	6 Chemicals Expense	Subtotal
6	Revenues							-
8	Expenses	19,168	237	(9,141)	1,255	4	3,191	14,714
10	Operating							
11	Income	(19,168)	(237)	9,141	(1,255)	(4)	(3,191)	(14,714)
13	Interest							-
14	Expense							-
15	Other							
16	Income /							-
17	Expense							
19	Net Income	(19,168)	(237)	9,141	(1,255)	(4)	(3,191)	(14,714)

Adjustments to Revenues and Expenses

Line No.		7 Ann. Chemicals Expense	8 Testing Expense	9 Rent Expense	10 Contractual Services	11 Bad Debt Expense	12 Meals, Beverages, Contributions	Subtotal
25	Revenues							-
27	Expenses	133	12,094	18,432	(28,441)	2,412	(1,485)	17,859
29	Operating							
30	Income	(133)	(12,094)	(18,432)	28,441	(2,412)	1,485	(17,859)
32	Interest							
33	Expense							-
34	Other							
35	Income /							-
36	Expense							
38	Net Income	(133)	(12,094)	(18,432)	28,441	(2,412)	1,485	(17,859)

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses

Exhibit
Schedule C-2
Page 1 (Continued)
Witness: Bourassa

Line No.		Adjustments to Revenues and Expenses						
		13 Contractual Services	14 Taxes Other Tan Income	15 Expense Allocation	16 Contractual Services	17 Rate Case Exp.	18 Interest Synch.	Total
1								
2								
3								
4								
5								
6	Revenues							-
7								
8	Expenses	42,200	1,780	1,490	(6,284)	16,667		73,712
9								
10	Operating							
11	Income	(42,200)	(1,780)	(1,490)	6,284	(16,667)	-	(73,712)
12								
13	Interest							
14	Expense						(3,260)	(3,260)
15	Other							
16	Income /							-
17	Expense							
18								
19	Net Income	(42,200)	(1,780)	(1,490)	6,284	(16,667)	(3,260)	(76,972)
20								
21		Adjustments to Revenues and Expenses						
22		19	20	21	22	23	24	Subtotal
23		Income						
24		Tax	Blank	Blank	Blank	Blank	Blank	
25	Revenues							-
26								
27	Expenses	(29,710)						44,002
28								
29	Operating							
30	Income	29,710	-	-	-	-	-	(44,002)
31								
32	Interest							
33	Expense							(3,260)
34	Other							
35	Income /							-
36	Expense							
37								
38	Net Income	29,710	-	-	-	-	-	(47,262)

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustments to Revenues and Expenses
Adjustment Number 1

Exhibit
Rejoinder Schedule C-2
Page 2
Witness: Bourassa

Line No.					Proforma Adjustments					
1	Depreciation Expense							Rejoinder		
2			Adjusted	1	2	3	4	Adjusted		
3	Acct.		Original	Unrecorded	Plant	Expensed	Odor Control	Original	Proposed	Depreciation
4	No.	Description	Cost	Plant	Retirement	Plant	Unit	Cost	Rates	Expense
5	351	Organization	-	-	-	-	-	-	0.00%	-
6	352	Franchises	-	-	-	-	-	-	0.00%	-
7	353	Land and Land Rights	461,300	-	-	-	-	461,300	0.00%	-
8	354	Structures and Improvements	2,557,920	-	-	2,300	-	2,560,220	3.33%	85,255
9	355	Power Generation Equipment	-	-	-	-	-	-	5.00%	-
10	360	Collection Sewers - Force	706,292	-	-	1,600	-	707,892	2.00%	14,158
11	361	Collection Sewers - Gravity	4,284,948	-	-	-	-	4,284,948	2.00%	85,699
12	362	Special Collecting Structures	-	-	-	-	-	-	2.00%	-
13	363	Services to Customers	198,723	-	-	-	-	198,723	2.00%	3,974
14	364	Flow Measuring Devices	31,512	-	-	-	-	31,512	10.00%	3,151
15	365	Flow Measuring Installations	179,622	-	-	-	-	179,622	10.00%	17,962
16	370	Receiving Wells	690,628	254,251	(13,208)	1,200	-	932,871	3.33%	31,065
17	371	Effluent Pumping Equipment	654,844	-	-	2,803	-	657,647	12.50%	82,206
18	380	Treatment and Disposal Equipment	143,578	-	-	-	38,625	182,203	5.00%	9,110
19	381	Plant Sewers	123,289	-	-	1,238	-	124,527	5.00%	6,226
20	382	Outfall Sewer Lines	-	-	-	-	-	-	3.33%	-
21	389	Other Plant and Misc. Equipment	939,432	-	-	-	-	939,432	6.67%	62,660
22	390	Office Furniture and Equipment	224,587	-	-	-	-	224,587	6.67%	14,980
23	391	Transportation Equipment	107,367	-	-	-	-	107,367	20.00%	21,473
24	393	Tools, Shop and Garage Equipment.	5,754	-	-	-	-	5,754	5.00%	288
25	394	Laboratory Equipment	7,488	-	-	-	-	7,488	10.00%	749
26	395	Power Operated Equipment	-	-	-	-	-	-	5.00%	-
27	396	Communication Equipment	40,451	-	-	-	-	40,451	10.00%	4,045
28	398	Other TangiblePlant	-	-	-	-	-	-	10.00%	-
29		TOTALS	$ 11,357,735	$ 254,251	$ (13,208)	$ 9,141	$ 38,625	$ 11,646,544		$ 443,002
30										
31	Less: Amortization of Contributions		$ 5,232,139					$ 5,232,139	3.8037%	$ (199,016)
32										
33	Total Depreciation Expense									$ 243,986
34										
35	Test Year Depreciation Expense									224,818
36										
37	Increase (decrease) in Depreciation Expense									19,168
38										
39	Adjustment to Revenues and/or Expenses									$ 19,168
40										
41	SUPPORTING SCHEDULE									
42	Rejoinder B-2, page 3									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 2

Exhibit
Rejoinder Schedule C-2
Page 3
Witness: Bourassa

Line No.			As Adjusted With Rate Incr.
1	Adjust Property Taxes to Reflect Proposed Revenues:		
2			
3	Adjusted Revenues in year ended 06/30/2008	$	1,580,170
4	Adjusted Revenues in year ended 06/30/2008		1,580,170
5	Proposed Revenues		2,533,172
6	Average of three year's of revenue	$	1,897,837
7	Average of three year's of revenue, times 2	$	3,795,675
8	Add:		
9	Construction Work in Progess at 10%	$	14,202
10	Deduct:		
11	Book Value of Transportation Equipment		59,592
12			
13	Full Cash Value	$	3,750,285
14	Assessment Ratio		21%
15	Assessed Value		787,560
16	Property Tax Rate		4.1459%
17			
18	Computed Property Tax		32,651
19	Tax on Parcels		0
20			
21	Total Property Tax at Proposed Rates	$	32,651
22	Property Taxes (Adjusted Direct and Adjusted Rejoinder)		32,414
23	Change in property taxes	$	237
24			
25			
26	Adjustment to Revenues and/or Expenses	$	237
27			
28			
29			
30			
31			
32			
33			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 3

Exhibit
Rejoinder Schedule C-2
Page 4
Witness: Bourassa

Line No.				Label
1	Expensed Plant			
2				
3	Contractual Services - Legal and Engineering	$	(1,500)	3a
4				
5	Contractual Services - Other	$	(7,641)	3b
6				
7				
8				
9				
10				
11				
12	Adjustment to Revenues and/or Expenses	$	(9,141)	
13				
14				
15				
16				
17	SUPPORTING SCHEDULES			
18	Staff Adj. #3 Schedule CSB-14			
19				
20				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 4

Exhibit
Rejoinder Schedule C-2
Page 5
Witness: Bourassa

Line No.

1 City of Scottsdale Purchased Wastewater Treatment

3 Computation of Test Year Billings

Month	Year	Read Date	Sewage Flow (in gals)	Cost per 1,000 gal	Raw Billing	Environmental 18.953%	Subject to Sales tax	Sales tax 1.65%	Scottsdale Billing
July	2007	1-Aug-07	6,126,317	$ 2.39	$ 14,641.90	$ 2,775.08	$ 17,416.98	$ 287.38	$ 17,704.36
Aug	2007	1-Sep-07	7,000,000	$ 2.39	$ 16,730.00	$ 3,170.84	$ 19,900.84	$ 328.36	$ 20,229.20
Sept	2007	1-Oct-07	8,507,019	$ 2.39	$ 20,331.78	$ 3,853.48	$ 24,185.26	$ 399.06	$ 24,584.31
Oct	2007	1-Nov-07	8,800,000	$ 2.39	$ 21,032.00	$ 3,986.19	$ 25,018.19	$ 412.80	$ 25,431.00
Nov	2007	1-Dec-07	8,703,535	$ 2.39	$ 20,801.45	$ 3,942.50	$ 24,743.95	$ 408.28	$ 25,152.22
Dec	2007	1-Jan-08	8,936,845	$ 2.39	$ 21,359.06	$ 4,048.18	$ 25,407.24	$ 419.22	$ 25,826.46
Jan	2008	1-Feb-08	9,500,000	$ 2.26	$ 21,470.00	$ 4,069.21	$ 25,539.21	$ 421.40	$ 25,960.61
Feb	2008	1-Mar-08	11,347,179	$ 2.26	$ 25,644.62	$ 4,860.43	$ 30,505.05	$ 503.33	$ 31,008.38
Mar	2008	1-Apr-08	11,644,059	$ 2.26	$ 26,315.57	$ 4,987.59	$ 31,303.16	$ 516.50	$ 31,819.67
April	2008	1-May-08	9,597,371	$ 2.26	$ 21,690.06	$ 4,110.92	$ 25,800.98	$ 425.72	$ 26,226.69
May	2008	1-Jun-08	7,261,758	$ 2.26	$ 16,411.57	$ 3,110.49	$ 19,522.06	$ 322.11	$ 19,844.17
June	2008	1-Jul-08	6,333,090	$ 2.26	$ 14,312.78	$ 2,712.70	$ 17,025.49	$ 280.92	$ 17,306.41
Test Year Totals			103,757,173		$ 240,740.79	$ 45,627.60	$ 286,368.40	$ 4,725.08	$ 291,093.48

23 Computation of Billings under rate change effecive (7/1/2009)

City of Scottsdale billing with new rate	103,757,173	$ 2.60	$ 269,768.65	$ 51,129.25	$ 320,897.90	$ 5,294.82	$ 326,192.72

27 Adjusted Test Year Wastewater Treatment Expenses (before annualization) $ 324,938.13

29 Increase(decrease) in City of Scottsdale purchased wastewater treatment $ 1,254.59

31 Adjustment to Revenues and/or Expenses $ 1,255

34 SUPPORTING SCHEDULES
35 Direct Schedule C-2, page 7

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 5

Exhibit
Rejoinder Schedule C-2
Page 6
Witness: Bourassa

Line No.			
1	Annualize Purchased Wastewater Treatment		
2			
3	Adjusted Year Purchased Wastewater Treatment (Scottsdale)	$	326,193
4	Gallons Treated By Scottsdale (in 1000's)		103,757
5	Cost per 1,000 gallons	$	3.1438
6			
7	Additional Wasterwater gallons (in 1,000's) from revenue annualization		451
8	Percent diverted to Scottsdale		70.94%
9	Additonal gallons treated by Scottsdale (in 1,000's)		320
10			
11	Annualization of Purchased WW Treatment per Rejoinder	$	1,006
12			
13	WW Treatment Annualization per Direct	$	1,002
14			
15	Increase (decrease) in annualization	$	4
16			
17			
18	Adjustment to Revenue and/or Expense	$	4
19			
20			
21			
22	SUPPORTING SCHEDULE		
23	Rejoinder C-2, page 5		
24	Direct C-2, page 8		
25			
26			
27			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 6

Exhibit
Rejoinder Schedule C-2
Page 7
Witness: Bourassa

Line No.					
1					
2	Chemicals Expense				
3					
4	Thoigard used from July to November 2007			$	8,169
5	Sodium Hydroxide (ordor control chemical)				
6	Gallons used during test year (approx. 7 months)		6,997		
7	Cost per Gallons	$	1.65		
8	Cost of Sodium Hydroxide			$	11,545
9	Delivery costs (14 deliveries at $45 per)				630
10	Sales tax at 8.5%				1,035
11	Total Cost			$	21,378
12					
13					
14	Sodium Hydroxide (ordor control chemical)				
15	Projected gallons (test year gallons annualized to 12 months)		11,995		
16	Cost per Gallons	$	2.05		
17	Total Cost			$	24,590
18	Delivery costs (24 deliveries at $32 per)				768
19	Sales tax at 8.5%				2,155
20	Total Cost			$	27,513
21					
22					
23	Increase (decrease) in Chemicals Expense per Rejoinder			$	6,135
24					
25	Increase (decrease) in Chemicals Expense per Direct			$	2,943
26					
27	Rejoinder Increase (decrease) in Chemicals Expenses			$	3,191
28					
29					
30	Adjustment to Revenue and/or Expense			$	3,191
31					
32					
33					
34					
35					
36	SUPPORTING SCHEDULE				
37	RUCO Adj. #8 SCHEDULE RLM-13				
38					
39					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 7

Exhibit
Rejoinder Schedule C-2
Page 8
Witness: Bourassa

Line No.			
1			
2	Annualize Chemicals Expense		
3			
4	Test Year Chemicals plus Adjustment #6	$	49,584
5	Gallons Treated By BMSC (in 1000's)		42,510
6	Cost per 1,000 gallons	$	1.17
7			
8	Additonal Wasterwater gallons (in 1,000's) from revenue annualization		451
9			
10	Additonal cost based on revenue annualization per Rejoinder	$	526
11			
12	Additonal cost based on revenue annualization per Direct	$	394
13			
14			
15	Rejoinder Increase (decrease) in Chemicals Expense	$	133
16			
17			
18			
19			
20	Adjustment to Revenue and/or Expense	$	133
21			
22			
23			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 8

Exhibit
Rejoinder Schedule C-2
Page 9
Witness: Bourassa

Line No.			
1			
2	Testing Expense		
3			
4	Revised Test Year Test Year	$	15,689
5			
6	Incremental Costs Required By City of Scottsdale	$	13,360
7			
8	Total Proposed testing cost per Rejoinder	$	29,049
9			
10	Testing Costs per Direct	$	16,955
11			
12	Increase (decrease) in Testing Costs	$	12,094
13			
14	Adjustment to Revenue and/or Expense	$	12,094
15			
16			
17			
18	SUPPORTING SCHEDULES		
19	Rejoinder C-2, page 9.1		
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment Number 8

Exhibit
Rejoinder Schedule C-2
Page 9.1

Testing Costs

Line No.	Test name or number	Test Year Costs Tests/yr	Test Year Costs Price/test	Test Year Costs Yearly Total	City of Scottsdale Incremental Tests	Co. Recommended Costs Tests/yr	Co. Recommended Costs Price/test	Co. Recommended Costs Yearly Total	Staff Recommended Cost
7	515- chemical water test	2	$ 175	$ 350		2	$ 175	$ 350	$ 350
8	525- chemical water test	2	$ 290	$ 580		2	$ 290	$ 580	$ 580
9	624- chemical water test	3	$ 160	$ 480		2	$ 160	$ 320	$ 320
10	Antimony, GFAA	3	$ 15	$ 44		4	$ 15	$ 58	$ -
11	Antimony, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ 67
12	Arsenic, GFAA	3	$ 15	$ 44	16	20	$ 15	$ 290	$ -
13	Arsenic, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ 67
14	Barium, total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
15	Barium, total	2	$ 10	$ 19		4	$ 10	$ 38	$ -
16	Beryllium, total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
17	Beryllium, total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
18	BOD	59	$ 36	$ 2,124	0	52	$ 36	$ 1,872	$ 1,008
19	Cadmium GFAA	2	$ 14	$ 29	16	20	$ 14	$ 288	$ -
20	Cadmium GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
21	Cadmium Total	1	$ 17	$ 17		4	$ 17	$ 66	$ -
22	Chromium, Total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
23	Chromium, Total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
24	Cyanide,	4	$ 56	$ 224		4	$ 56	$ 224	$ 224
25	Cyanide, Total	4	$ 44	$ 176	16	20	$ 44	$ 880	$ -
26	Fecal Coliforms	259	$ 15	$ 3,885		255	$ 15	$ 3,825	$ 5,475
27	Fecal Coliforms, Soil/Sludge	10	$ 68	$ 680		10	$ 68	$ 680	$ -
28	Mercury	4	$ 32	$ 128	16	20	$ 32	$ 640	$ 128
29	Nickel, Total	2	$ 10	$ 19	16	20	$ 10	$ 192	$ -
30	Nickel, Total	2	$ 10	$ 20		4	$ 10	$ 40	$ 40
31	Nitrogen 2	12	$ 64	$ 768		12	$ 64	$ 768	$ -
32	Nitrogen 3	12	$ 52	$ 624		12	$ 52	$ 624	$ 624
33	Nitrogen, NO3NO2	24	$ 20	$ 480	28	52	$ 20	$ 1,040	$ -
34	Nitrogen, Nitrite	2	$ 12	$ 24		2	$ 12	$ 24	$ -
35	Nitrogen, Total Kjeldahl	24	$ 32	$ 768	28	52	$ 32	$ 1,664	$ -
36	Oil and Grease	35	$ 88	$ 3,080		28	$ 88	$ 2,464	$ -
37	Flouride	4	$ 16	$ 64	16	20	$ 16	$ 320	$ 64
38	ICP Digestion	4	$ 16	$ 64		4	$ 16	$ 64	$ 16
39	ICP-MS Digestion	1	$ 16	$ 16		1	$ 16	$ 16	$ 15
40	Lead GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
41	Lead GFAA	2	$ 14	$ 29	16	20	$ 14	$ 288	$ -
42	Lead, Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
43	Ph	24	$ 12	$ 288		24	$ 12	$ 288	$ -
44	*Selenium* GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
45	Selenium GFAA	1	$ 14	$ 14	16	20	$ 14	$ 288	$ -
46	Selenium Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
47	Selenium- Subcontract	1	$ 24	$ 24		1	$ 24	$ 24	$ -
48	Thallium GFAA	2	$ 14	$ 29		4	$ 14	$ 58	$ -
49	Thallium GFAA	1	$ 15	$ 15		4	$ 15	$ 60	$ 60
50	Thallium Total	1	$ 17	$ 17		4	$ 17	$ 67	$ -
51	Boron				16	16	$ 9	$ 144	
52	COD				84	84	$ 38	$ 3,192	
53	Copper				16	16	$ 9	$ 144	
54	VOC GC/MS 624				2	2	$ 320	$ 640	
55	VOC GC/MS 625				2	2	$ 312	$ 624	
56	VOC GC/MS 608				2	2	$ 160	$ 320	
57	Molybdenum				16	16	$ 9	$ 144	
58	Silver				16	16	$ 14	$ 224	
59	Nitrate - N				28	28	$ 32	$ 896	
60	Nitrite - N				28	28	$ 32	$ 896	
61	TDS				84	84	$ 12	$ 1,008	
62	Zinc				16	16	$ 9	$ 144	
63	Total Suspended Solids	46	$ 12	$ 552	56	84	$ 12	$ 1,008	$ -
64	Total Suspended Solids	13	$ 13	$ 169		24	$ 13	$ 312	$ 364
65	Enteric Virus monthly					0	$ 460	$ -	$ 5,520
66	Unknown Cost								
67				Company				Company	Staff
68	Total	588		$ 16,053	582	1201		$ 29,049	15,222 [1]
69									
70	Total Recommended							$ 29,049	
71	Original Filing test year costs							$ 16,955	
72	Increase (decrease) in Test Year Testing Costs							$ 12,094	
73									
74	Reconciliation								
75	Testing Costs Per Direct							$ 16,955	
76	Less: Costs outside test year							$ (1,266)	
77	Adjusted Test Year Costs							$ 15,689	
78	Incremental COS tests required by City of Scottsdale							$ 13,360	
79	Rejoinder Testing Costs							$ 29,049	
80									

81 1 Staff Schedule contains a math error of $860.

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 9

Exhibit
Rejoinder Schedule C-2
Page 10
Witness: Bourassa

Line No.			
1			
2	Rent Expense		
3			
4	Additional Test Year Rent Expense	$	18,432
5			
6			
7			
8			
9	Adjustment to Revenue and/or Expense	$	18,432
10			
11			
12			
13			
14			
15			
16	SUPPORTING SCHEDULE		
17	RUCO Adj. # 6 Schedule RLM-12		
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 10

Exhibit
Rejoinder Schedule C-2
Page 11
Witness: Bourassa

Line No.				Label
1				
2	Normalization of Maintenance, Legal and Engineering			
3				
4				
5	Contractual Services - Other	$	(26,580)	10a
6				
7	Contractual Services - Legal and Engineering		(1,861)	10b
8				
9	Total	$	(28,441)	
10				
11				
12	Adjustment to Revenue and/or Expense	$	(28,441)	
13				
14				
15				
16				
17	SUPPORTING SCHEDULE			
18	Staff Adj. # 4 Schedule CSB-15 (corrected for errors - see testimony)			
19				
20				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 11

Exhibit
Rejoinder Schedule C-2
Page 12
Witness: Bourassa

Line No.			
1			
2	Bad Debt Expense		
3			
4			
5	Remove Write-offs from prior year revenues (per Staff Adj. #5)	$	(4,067)
6			
7	Write-offs for test year revenues occuring post test year		6,479
8			
9	Total	$	2,412
10			
11			
12	Adjustment to Revenue and/or Expense	$	2,412
13			
14			
15			
16			
17	SUPPORTING SCHEDULE		
18	Staff Adj. # 5 Schedule CSB-16		
19	Testimony		
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 12

Exhibit
Rejoinder Schedule C-2
Page 13
Witness: Bourassa

Line No.			
1			
2	Remove Meals, Beverages, Charitable Contributions		
3			
4			
5	Meals (per Staff Adj. # 9 Schedule CSB-20)	$	(526)
6			
7	Beverages (per Staff Adj. # 9 Schedule CSB-20)		(907)
8			
9	Charitable Contributions(per Staff Adj. # 9 Schedule CSB-20)		(52)
10			
11	Total Adjustment to Contractual Services - Other	$	(1,485)
12			
13			
14	Adjustment to Revenue and/or Expense	$	(1,485)
15			
16			
17			
18			
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 13

Exhibit
Rejoinder Schedule C-2
Page 14
Witness: Bourassa

Line No.			
1			
2	Contractual Services		
3			
4			
5	Contractual Services Costs[1] (per RUCO Adj. #5 Schedule RLM-12)	$	42,200
6			
7			
8			
9			
10			
11			
12	Adjustment to Revenue and/or Expense	$	42,200
13			
14			
15			
16			
17			
18	[1]BMSC cost incorrectly recorded on books of LPSCo. See testimony.		
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 14

Exhibit
Rejoinder Schedule C-2
Page 15
Witness: Bourassa

Line No.			
1			
2	Taxes Other Than Income		
3			
4			
5	Remove negative expense	$	1,780
6			
7			
8			
9			
10			
11			
12	Adjustment to Revenue and/or Expense	$	1,780
13			
14			
15			
16			
17	SUPPORTING SCHEDULES		
18	Staff Adj. #11 Schedule CSB-22		
19			
20			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 15

Exhibit
Rejoinder Schedule C-2
Page 16
Witness: Bourassa

Cental Office Costs - Infrastructure Allocation

Line No.		Actual Total Cost Pool[1]	Adjustments	Rejoinder Total Cost Pool	Utility Infrastructure Group Allocation %	Utility Infrastructure Group Allocated Cost Pool	BMSC Allocation by Customer Count	Rejoinder BMSC Allocation
7	Audit	$ 940,719		$ 940,719	26.98%	$ 253,845	3.18%	8,072
8	Tax Services	235,582		$ 235,582	26.98%	63,570	3.18%	2,022
9	Legal	485,980		$ 485,980	26.98%	131,138	3.18%	4,170
10	Other Professional Services	177,762		$ 177,762	26.98%	47,968	3.18%	1,525
11	Management Fee - Total	629,738		$ 629,738	26.98%	169,929	3.18%	5,404
12	Unit Holder Communications	196,509		$ 196,509	26.98%	53,026	3.18%	1,686
13	Trustee Fees	225,052		$ 225,052	26.98%	60,728	3.18%	1,931
14	Escrow & Transfer Agent Fees	61,115		$ 61,115	26.98%	16,491	3.18%	524
15	Rent	295,881		$ 295,881	26.98%	79,841	3.18%	2,539
16	Licenses/Fees & Permits	131,619	(128,380) [1]	$ 3,239	26.98%	874	3.18%	28
17	Office Expenses	726,427	(63,448) [1]	$ 662,979	26.98%	178,899	3.18%	5,689
18	Depreciation	218,613		$ 218,613	26.98%	58,991	3.18%	1,876
20	**Total (Candadian dollars CAD)**	**$ 4,324,998**	**$ (191,828)**	**$ 4,133,170**		**$ 1,115,300**		**$ 35,467**
21	Factor	1.05	1.05	1.05		1.05		1.05
22	**Total (US dollars USD**	$ 4,119,045	$ (182,693)	$ 3,936,352		$ 1,062,190		$ 33,778
24	Infrastructure Cost Allocation per Direct (USD)[2]							$ 32,287
26	Increase (decrease) in Infrastructure Allocated Costs (USD)							$ 1,490
29	*Adjustment to Revenues and/or Expenses*							$ 1,490

[1] Per Response to CSB 9.1 (in Canadian dollars)
[2] $3,950,800 budgeted allocation pool times 26.98% times 3.18% divided by 1.05

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 16

Exhibit
Rejoinder Schedule C-2
Page 17
Witness: Bourassa

Line No.				
1				
2				
3	Contractual Services			
4				
5	Increase in direct allocated Operations costs		$	3,474
6				
7	Increase in allocated Accounting/Billing costs	$ 254,381		
8	Allocation Factor based on Year-end Customers	3.18%		
9			$	8,098
10	Increase in allocated Overhead costs	717,339		
11	Allocation Factor based on 4-factor allocation	4.52%		
12			$	32,446
13				
14	Increase (decrease) in Contractual Services per Rejoinder		$	44,018
15				
16	Increase (decrease) in Contractual Services per Direct			50,302
17				
18	Increase (decrease) in Contractual Services		$	(6,284)
19				
20				
21	Adjustment to Revenue and/or Expense		$	(6,284)
22				
23				

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 17

Exhibit
Rejoinder Schedule C-2
Page 18
Witness: Bourassa

Line No.			
1			
2	Rate Case Expense		
3			
4	Rate Case Expense Request per Direct	$	180,000
5			
6	Additional Rate Case Expense		50,000
7			
8	Rate Case Expense Request per Rejoinder	$	230,000
9			
10			
11	Amortization Period (years)		3.00
12			
13			
14	Rate Case Expense to be included in Expense	$	76,667
15			
16	Rate Case Expense per Direct	$	60,000
17			
18	Increase (decrease) in Rate Case Expense	$	16,667
19			
20			
21	Adjustment to Revenue and/or Expense	$	16,667

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and Expenses
Adjustment Number 18

Exhibit
Rejoinder Schedule C-2
Page 19
Witness: Bourassa

Line No.			
1	Interest Synchronization		
2			
3			
4	Fair Value Rate Base	$3,682,905	
5	Weighted Cost of Debt	1.93%	
6	Interest Expense		$ 70,954
7			
8	Test Year Interest Expense		$ 67,693
9			
10	Increase (decrease) in Interest Expense		3,260
11			
12			
13			
14	Adjustment to Revenue and/or Expense		$ (3,260)
15			
16			
17	Weighted Cost of Debt Computation		

		Amount	Percent	Cost	Weighted Cost
Debt	$	1,010,649	20.50%	9.40%	1.93%
Equity	$	3,920,456	79.50%	12.40%	9.86%
Total	$	4,931,105	100.00%		11.79%

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Adjustment to Revenues and/or Expenses
Adjustment Number 19

Exhibit
Rejoinder Schedule C-2
Page 20
Witness: Bourassa

Line No.			Test Year Adjusted Results	Adjusted with Rate Increase	
1	Income Tax Computation				
2					
3					
4					
5					
6					
7	Taxable Income before Scottsdale Operating Lease		$ (221,390)	$ 731,612	
8	Plus: Scottsdale Operating Lease		164,522	164,522	
9	Taxable Income		$ (56,868)	$ 896,134	
10					
11	Income Before Taxes			$ 896,134	
12					
13	Arizona Income Before Taxes			$ 896,134	
14					
15	Less Arizona Income Tax			$ 62,443	
16	Rate =	6.968%			
17	Arizona Taxable Income			$ 833,691	
18					
19	Arizona Income Taxes			$ 62,443	
20					
21	Federal Income Before Taxes			$ 896,134	
22					
23	Less Arizona Income Taxes			$ 62,443	
24					
25	Federal Taxable Income			$ 833,691	
26					
27					
28					
29	FEDERAL INCOME TAXES:				
30	15% BRACKET			$ 7,500	
31	25% BRACKET			$ 6,250	
32	34% BRACKET			$ 8,500	Federal
33	39% BRACKET			$ 91,650	Effective
34	34% BRACKET			$ 169,555	Tax
35					Rate
36	Federal Income Taxes			$ 283,455	31.63%
37					
38	State Income Tax Rate at Proposed Rates		6.9680%		
39	Federal Effective Tax Rate at Proposed Rates		31.6309%		
40	Total Federal and State Income Tax Effective Rate		38.5989%	$ 345,898	
41					
42	Taxable Income		$ (56,868)		
43	State and Federal Income Taxes at Effective Rate		$ (21,951)		
44	Adjusted Test Year Income Tax per Direct		$ 7,760		
45	Adjusted Test Year Income Tax per Rejoinder			(21,951)	
46	Increase (decrease) in Income Taxes	→	$ (29,710)	367,848	
47					

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Computation of Gross Revenue Conversion Factor

Exhibit
Rejoinder Schedule C-3
Page 1
Witness: Bourassa

Line No.	Description	Percentage of Incremental Gross Revenues
1	Federal Income Tax Factor	31.6309%
2		
3	State Income Tax Factor	6.9680%
4		
5	Other Tax Factor	0.0000%
6		
7		
8	Total Tax Percentage	38.5989%
9		
10	Operating Income % = 100% - Tax Percentage	61.4011%
11		
12		
13		
14		
15	1 = Gross Revenue Conversion Factor	
16	Operating Income %	1.6286
17		
18	SUPPORTING SCHEDULES:	RECAP SCHEDULES:
19		Rejoinder A-1
20		

Black Mountain Sewer Corporation
Revenue Summary
With Annualized Revenues to Year End Number of Customers
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-1
Witness: Bourassa

Line No.	Customer Classification	Present Revenues	Proposed Revenues	Dollar Change	Percent Change	Percent of Present Sewer Revenues	Percent of Proposed Sewer Revenues
1	Residential	1,077,880	1,705,856	627,976	58.26%	68.59%	67.60%
2	Commercial (Standard Rate)	378,678	599,266	220,588	58.25%	24.10%	23.75%
3	Commercial (Special Rate)						
4	Boulders Resort	50,085	101,969	51,884	103.59%	3.19%	4.04%
5	Desert Forest	13,729	24,324	10,595	77.17%	0.87%	0.96%
6	El Pedegral	26,587	54,857	28,271	106.33%	1.69%	2.17%
7	Boulders Club	168	347	179	106.33%	0.01%	0.01%
8	Spanish Village	8,395	17,322	8,927	106.33%	0.53%	0.69%
9	Effluent Sales	15,917	19,578	3,661	23.00%	1.01%	0.78%
10	Subtotal	1,571,439	2,523,520	952,081	60.59%	100.00%	100.00%
11							
12	Revenue Annualization						
13	Residential	2,145	3,395	1,250	58.26%	0.14%	0.13%
14							
15	Misc Service Revenues						
16	Misc Revenues	6,915	6,915	-	0.00%	0.44%	0.27%
17	Reconciling Amount to C-1	(329)	(658)	(329)	100.00%	-0.02%	-0.03%
18	Totals	1,580,170	2,533,172	953,002	60.31%	99.98%	99.97%
19							
20							
21							
22							
23							
24							
25							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Analysis of Revenue by Detailed Class
Special Rate Commercial Customers Pay Standard Commerical Rate

Rebuttal Schedule H-2
Page 1
Witness: Bourassa

Line No.	Customer Classification	Average Number of Customers at 6/30/2008	Average Effluent	Average Bill Present Rates	Average Bill Proposed Rates	Proposed Increase Dollar Amount	Proposed Increase Percent Amount
1	Residential	1,972	N/A	$ 45.64	$ 72.23	$ 26.59	58.260%
2	Commercial (Standard Rate)	124	N/A	103.41	163.64	60.24	58.252%
3	Commercial (Special Rate)						
4	B-H Enterprises (West)	-	N/A	$ -	N/A		
5	B-H Enterprises (East)	1	N/A	-	N/A		
6	Barb's Per Grooming	-	N/A	-	N/A		
7	Boulders Resort	1	N/A	4,173.74	8,497.43	4,323.69	103.593%
8	Carefree Dental	-	N/A	-	N/A		
9	Ridgecrest Realty	1	N/A	-	N/A		
10	Desert Forest	1	N/A	1,144.08	2,026.99	882.91	77.172%
11	Desert Hills Pharmacy	1	N/A	-	N/A		
12	El Pedregal	1	N/A	2,215.55	4,571.44	2,355.89	106.335%
13	Lemon Tree	1	N/A	-	N/A		
14	Body Shop	1	N/A	-	N/A		
15	Spanish Village	-	N/A	-	0.28957		
16	Boulders Club	-	N/A	168.41	347.48	179.08	106.335%
17	Anthony Vuitaggio	1	N/A	-	N/A		
18							
19	Effluent	1	3,542,780	$ 1,326.42	$ 1,631.49	305.08	23.000%
20							
21	Total	2,106					
22							
23							
24							
25							

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-3
Page 1
Witness: Bourassa

Line No.	Customer Classification	Present Rates	Present Rates	Proposed Rates	Proposed Rates	Percent Change
4	**Monthly Charge for:**					
5	Residential		$ 45.64		$ 72.23	58.26%
7	Commercial (Standard Rate), per gallon per day[1]		0.18298		0.28957	58.25%
9		per acre foot		per acre foot		
10	Effluent Sales (per 1,000 gallons)	$ 122.00	0.37440	$ 150.00	0.46051	23.00%
12	Commercial (Special Rate), per gallon per day[1]					

Customer[2]	Gallons Per Day[1]	Monthly Billing	Rate per Gallon	Monthly Billing	Rate per Gallon [2]	Percent Change
B-H Enterprises	2,525	$ 354.36	0.14034	N/A	N/A	
B-H Enterprises	1,400	$ 196.48	0.14034	N/A	N/A	
Barb's Per Grooming	250	$ 35.09	0.14034	N/A	N/A	
Boulders Resort	29,345	$ 4,173.74	0.14223	$ 8,497.43	0.28957	103.59%
Carefree Dental	1,625	$ 228.05	0.14034	N/A	N/A	
Ridgecrest Realty	450	$ 63.87	0.14193	N/A	N/A	
Desert Forest	7,000	$ 1,144.08	0.16344	$ 2,026.99	0.28957	77.17%
Desert Hills Pharmacy	800	$ 136.49	0.17061	N/A	N/A	
El Pedregal	15,787	$ 2,215.55	0.14034	$ 4,571.44	0.28957	106.33%
Lemon Tree	300	$ 41.07	0.13691	N/A	N/A	
Body Shop	1,000	$ 176.47	0.17647	N/A	N/A	
Spanish Village	4,985	$ 699.59	0.14034	$ 1,443.51	0.28957	106.33%
Boulders Club	1,200	$ 168.41	0.14034	$ 347.48	0.28957	106.33%
Anthony Vuitaggio	300	$ 46.79	0.15597	N/A	N/A	

[1] Commercial wastewater flows are based on the average daily flows set forth in Engineering Bulletin 12, Table 1 published by the Arizona Department of Environmental Quality

[2] Company is proposing to set the special rate commercial customers at the same rate ase the standard commerical rate customers.

Black Mountain Sewer Corporation
Present and Proposed Rates
Test Year Ended June 30, 2008

Exhibit
Rebuttal Schedule H-3
Page 2
Witness: Bourassa

Line No.	Other Service Charges	Present Rates	Proposed Rates
1	Establishment	$ 25.00	$ 25.00
2	Re-Establishment	$ 25.00	$ 25.00
3	Reconnection	no charge	[4]
4	After hours service	N/A	$ 25.00
5	Min Deposit Requirement (Residential)	[1]	[1]
6	Min Deposit Requirement (Non-Residential)	[1]	[1]
7	NSF Check	10.00	10.00
8	Deferred Payment finance charge, Per Month	1.50%	1.50%
9	Late Payment Charge, Per Month	1.50%	1.50%
10	Main Extension Tariff [2]	Cost	Cost
11	Purchased Wastewater Surcharge	NT	[3]
12			
13			
14	[1] Per A.C.C. R14-2-603B Residential - two times the average bill. Non-residential - two and one-half times the average bill.		
15			
16	[2] Per A.C.C. R14-2-606(B)		
17			
18	[3] For increases in wastewater treatment costs from City of Scottsdale. See Testimony of Thomas J. Bourassa.		
19			
20	[4] Actual cost of physical disconnection and reconnection (if same customer) and there shall be no charge if there		
21	is no physical work performed.		
22			
23			
24			
25			
26			
27	IN ADDITION TO THE COLLECTION OF REGULAR RATES, THE UTILITY WILL COLLECT FROM		
28	ITS CUSTOMERS A PROPORTIONATE SHARE OF ANY PRIVILEGE, SALES, USE, AND FRANCHISE		
29	TAX. PER COMMISSION RULE (14-2-608.D 5).		
30	ALL ADVANCES AND/OR CONTRIBUTIONS ARE TO INCLUDE LABOR, MATERIALS, OVERHEADS,		
31	AND ALL APPLICABLE TAXES, INCLUDING ALL GROSS-UP TAXES FOR INCOME TAXES.		
32	COST TO INCLUDE LABOR, MATERIALS AND PARTS, OVERHEADS AND ALL APPLICABLE TAXES.		
33			

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Capacity Reservation Charges

Exhibit
Rejoinder Schedule H-3
Page 3
Witness: Bourassa

Line No.

1
2 **Off-site Capacity Reservation Charge (Hook-up Fee)**
3
4

Lateral Service Size	Present	Proposed
4 Inch	NT	$ 1,734.00
6 Inch and larger	NT	$ 3,901.00
8 Inch	NT	$ 6,936.00
10 Inch	NT	$ 10,837.00

5
6
7
8
9
10
11
12
13
14
15
16
17
18 N/T = No Tariff
19
20

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02361A-08-0609

REJOINDER TESTIMONY OF

THOMAS J. BOURASSA

(Cost of Capital)

November 16, 2009

EXHIBIT
A-9
ADMITTED

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I. INTRODUCTION AND PURPOSE OF TESTIMONY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. On behalf of the applicant, Black Mountain Sewer Corporation ("BMSC" or the "Company").

Q. ARE YOU THE SAME THOMAS J. BOURASSA THAT FILED DIRECT AND REBUTTAL TESTIMONY ON RATE BASE, INCOME STATEMENT, REVENUE REQUIREMENT AND RATE DESIGN IN THIS CASE?

A. Yes. My background and qualifications are discussed in my direct testimony on those aspects of the case.

Q. DID YOU ALSO PREPARE DIRECT AND REBUTTAL TESTIMONY ON COST OF CAPITAL ON BEHALF OF BMSC IN THIS CASE?

A. Yes, I also provided direct and rebuttal testimony on the cost of capital in this case.

II. SUMMARY OF REJOINDER TESTIMONY AND THE PROPOSED COST OF CAPITAL FOR THE COMPANY.

A. Summary of Company's Rejoinder Recommendation.

Q. WHAT IS THE PURPOSE OF THIS REJOINDER TESTIMONY?

A. I will respond as appropriate to the surrebuttal testimonies of Mr. Manrique on behalf of Staff and Mr. Rigsby on behalf of RUCO.

Q. HAVE YOU UPDATED YOUR COST OF CAPITAL ANALYSIS.

A. No. I updated my cost of capital analysis on my rebuttal testimony filed on October 20, 2009. I updated my cost of capital in my rebuttal testimony because for the significant period of time between the Company's direct filing and its

rebuttal filing, I did not feel the need to provide an additional update at this time as my rebuttal update is less than 1 month old.

Q. PLEASE SUMMARIZE YOUR RECOMMENDED REJOINDER COST OF DEBT AND EQUITY, AND YOUR RECOMMENDED REJOINDER RATE OF RETURN ON RATE BASE.

A. I continue to recommend a cost of equity of 12.4% based on my most recent cost of capital analysis. The results of my cost of capital analysis can be found in my rebuttal testimony.[1] The Company's recommended capital structure consists of 100 percent common equity as shown on Rejoinder Schedule D-1. While the Company has long-term debt, the debt service is being treated as an operating lease and is therefore excluded from the capital structure for purposes of computing a weighted average cost of capital ("WACC").[2] This debt does, of course, confers risk on the Company, however, it is risk that cannot be eliminated by creative accounting. Based on my 12.4 percent recommended cost of equity, the Company's weighted cost of capital ("WACC") is 12.4 percent, as shown on Rejoinder Schedule D-1.

B. <u>Summary of the Recommendations of Staff and RUCO.</u>

Q. PLEASE SUMMARIZE THE COST OF DEBT AND EQUITY RECOMMENDED BY STAFF AND RUCO, AND THEIR RESPECTIVE RECOMMENDATIONS FOR THE RATE OF RETURN ON FAIR VALUE RATE BASE.

A. Staff has updated its cost of capital analysis in its surrebuttal testimony and has determined a cost of equity of 9.4 percent based on the average cost of equity

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[1] *See* Rebuttal Testimony of Thomas J. Bourassa - Cost of Capital ("Bourassa Rb.") at 2.

[2] *See* Direct Testimony of Thomas J. Bourassa Bourassa – Rate Base, Income Statement and Rate Design at 2.

produced by its DCF and CAPM models (10.2 percent) and an 80 basis point downward adjustment for BMSC's lower financial risk as compared to the publicly traded water utilities in Staff's sample group.[3] Staff continues to ignore BMSC's firm-specific risks, focusing solely on financial risk. Like the Company, Staff continues to recommend a capital structure consisting of 100 percent equity.[4] Based on a capital structure of 0 percent debt and 100 percent equity, Staff determined the WACC for BMSC to be 9.4 percent.[5]

RUCO has not updated its cost of capital analysis and continues to recommend a cost of equity of 8.22 percent, based on the average cost of equity of its DCF and CAPM results.[6] RUCO also continues to recommend a hypothetical capital structure of 40 percent debt and 60 percent equity.[7] RUCO's recommended cost of debt is 6.26 percent, based the average cost of debt for seven publicly traded water companies followed by Value Line.[8] Based on a hypothetical capital structure of 40 percent debt and 60 percent equity, RUCO computed a WACC of 7.43 percent, which is RUCO's recommended rate of return on FVRB.[9] RUCO also continues to ignore firm-specific risks other than financial risk.

III. RESPONSE TO STAFF'S COST OF CAPITAL ANALYSIS

A. Staff's Financial Risk Adjustment

Q. DOES STAFF CONTINUE TO RECOMMEND A FINANCIAL RISK ADJUSTMENT BASED ON THE HAMADA METHOD?

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[3] *See* Surrebuttal Testimony of Juan C. Manrique ("Manrique Sb.") at 2.

[4] *Id.*

[5] *Id.*

[6] *See* Surrebuttal Testimony of William A. Rigsby ("Rigsby Sb.") at 12.

[7] *Id.* at 10.

[8] *Id.*

[9] *Id.* at 11.

A. Yes.[10] Staff's financial risk adjustment increased from 70 basis points in its direct testimony to 80 basis points in its surrebuttal testimony.

Q. DID STAFF RESPOND TO YOUR TESTIMONY CRITICIZING STAFF'S FINANCIAL RISK ADJUSTMENT?

A. No. I pointed out Staff uses the average beta of the publicly traded water utility companies as the beta for BMSC because the Company has no beta.[11] If it did have a beta, empirical financial data would indicate that BMSC's beta would be much higher than the average beta of a bunch of huge utility companies. This would lower the indicated financial risk adjustment substantially. But Mr. Manrique ignored my testimony entirely, and as a result Staff financial risk adjustment of 80 basis points is even more overstated than the 70 point reduction to the ROE Staff recommended in direct.

Q. SO THERE ARE OTHER REASONS WHY STAFF'S FINANCIAL RISK ADJUSTMENT IS TOO HIGH?

A. Yes. Putting aside BMSC's beta would be higher if it were publicly traded, Staff uses book values in its Hamada method. This results in an overstatement of the financial risk adjustment. The Hamada method should be based on market values rather than book values.

Q. PLEASE EXPLAIN.

A. Professor Hamada developed his methodology using market values of the firm. Market values are relevant.[12] Other authorities in the subject of finance recognize that market values of the firm are relevant when it comes to leverage and financial

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[10] Manrique Sb. at 2.

[11] Bourassa Rb. at 5-6.

[12] "Effects of the Firm's Capital structure on Systematic Risk of Common Stock," *Journal of Finance*, Vol. 27 No. 2 (May 1972) 435-453.

risk.[13] This is logical given that Professor Hamada's formula is an extension of the CAPM, which is a market-based model that does not consider book or accounting data.

Q. HAS STAFF PROVIDED ANY SUPPORT FOR USING BOOK DEBT AND EQUITY?

A. No. Staff's discussion on the subject other than their financial risk adjustment is sparse.[14] It is difficult to address this subject adequately at this time without knowing Staff's rationale and authoritative support for the use of book values. I have been unable to find any authority for using book value in the Hamada formula.

Q. WHAT FINANCIAL RISK ADJUSTMENT HAVE YOU COMPUTED USING STAFF'S MODELS AND MARKET VALUES?

A. I computed a downward financial risk adjustment of 40 basis points. I used the market value of equity for the publicly traded water utilities, which I computed using their market-to-book ratios as set forth in Staff's testimony. For debt, I used the book value of debt as the market value. According to Dr. Morin, this is an appropriate assumption.[15] To compute the market value of BMSC's equity, I used the market value of BMSC's equity using the average market-to-book ratio of the sample publicly traded utility companies.

Q. SO STAFF'S HAMADA ADJUSTMENT IS OVERSTATED BY AT LEAST 40 BASIS POINTS?

---

[13] Shannon, P. Pratt, *Cost of Capital – Estimations and Applications*, John Wiley & Sons 83-85, Roger A. Morin. *New Regulatory Finance* (2006) 221-25.

[14] Manrique Dt. at 33-34.

[15] Morin, *supra* at 224.

A. Yes, but that still does not account for the problem with using the average betas as I discussed above. BMSC's small size compared to those sample companies taints the use of the beta in the first place, then Staff has overstated it in the second place. Under these circumstances I simply do not believe the evidence supports a financial risk adjustment in the range of 40-80 basis points.

Q. IS THE IMPACT ON THE REVENUE REQUIREMENT OF BMSC'S 100% EQUITY CAPITAL STRUCTURE HIGHER THAN THAT OF THE PUBLICLY TRADED WATER UTILITIES WITH APPROXIMATELY 50% DEBT AND 50% EQUITY?

A. No. It is lower. Despite BMSC's higher equity ratio and lower debt ratio compared to my sample of publicly traded water utilities, the impact on the revenue requirement (the cost to ratepayers) is still less than my sample of publicly traded water utilities. This is because BMSC has a much higher ratio of zero cost capital funding its plant-in-service. A utility's total capitalization consists of AIAC, CIAC, debt and equity. AIAC and CIAC funded plant receives no recognition in rate base and thus there is no rate of return dollar component for this plant "investment" in the revenue requirement. By virtue of BMSC's reliance on a high proportion of zero cost capital to fund plant, the ultimate impact on rate payers per $100 of plant-in-service "investment" recognized in rate base is far less on average than the water utility companies in my sample group.

I have illustrated this in a schedule attached hereto at **Rejoinder Attachment 1**. To make things simpler, I assumed the same debt costs and equity costs for BMSC and for my sample water utilities. As shown, the weighted cost of capital from a total capitalization perspective is 8.23% for my sample water utilities and 7.31% for BMSC. As one would expect, the impact on the revenue

requirement per $100 of plant investment for my sample water utilities is $13.41 while that for BMSC is $11.91.

Q. DOES THE FACT THAT STAFF IS APPLYING A FINANCIAL RISK ADJUSTMENT TO A RATE OF RETURN THAT IS BEING APPLIED TO A BOOK VALUE CAPITAL STRUCTURE PROVIDE A BASIS FOR USING BOOK VALUES IN THE HAMADA METHOD?

A. No. Again, putting aside the fact that the Hamada method is supposed to use market returns, a market based return should not be adjusted using a financial risk adjustment measured by book values. Staff is mixing apples and oranges.

B. <u>Response to Staff' Criticisms of BMSC'S Cost of Capital Analysis</u>

Q. PLEASE RESPOND TO MR. MANRIQUE'S TESTIMONY THAT THE IBBOTSON DATA INDICATING HIGHER BETAS FOR SMALLER COMPANIES IS NOT UTILITY INDUSTRY SPECIFIC.

A. Mr. Manrique asserts that because the Ibbotson data is market wide it is not useful for determining utility industry specific risk premia.[16] This is not true. In fact, the Ibbotson data contains industry specific risk premia data used as a component to the buildup method of estimating the cost of equity. The Ibbotson industry risk premium in conjunction with the Ibbotson small company risk premium can be used to estimate the premium over and above the Ibbotson market risk premium on large stocks.

Let me explain. One of the methods for determining cost of equity is the buildup method.[17] In fact, according to Ibbotson, it is one of the most commonly used and effective methods to estimate the cost of equity.[18] Put simply, the buildup

[16] Manrique Sb. at 3.

[17] *See* Morningstar *Ibbotson SBBI 2009 Valuation Yearbook* ("Ibbotson") at 29.

[18] *Id.*

method is an additive model in which the return on an asset is estimated as the sum of a risk-free rate and one or more risk premia. The equation for the buildup method is as follows:[19]

Riskless Rate
+ Equity Risk Premium (large stocks)
+ Industry Risk Premium
+ Size Premium
= Cost of Equity Estimate

The Industry Risk Premium and the Size Premium data are published by Ibbotson[20] and can be combined to estimate the additional risk premium for small water utility company stocks over large company stocks. For example, Ibbotson identifies a market risk premium for the water supply industry as a negative 3.64% percent. The Ibbotson small company risk premium for the Decile 10 stocks[21] is 5.81%. Based in this data, the additional indicated risk premium required over and above large company stocks risk premium for small utilities, like BMSC, is 217 basis points (5.84% minus 3.64%).

Q. THE 217 BASIS POINT SMALL UTILITY RISK PREMIUM IS OVER LARGE COMPANY STOCKS, BUT ARE THE PUBLICLY TRADED WATER UTILITY COMPANIES IN THE SAMPLE USED IN YOUR COST OF EQUITY ANALYSIS CONSIDERED LARGE COMPANY STOCKS BY IBBOTSON?

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[19] *Ibbotson* at 33.

[20] Industry risk premium can be found in Table 3-5 of *Ibbotson*. Small company risk premium for Decile 10 can be found in Appendix C of *Ibbotson*.

[21] BMSC would be considered in the smallest.

A. No. My cost of equity analysis is based on a sample of publicly traded water utilities of different market capitalizations (from Decile 10 for Middlesex Water and Connecticut Water to Mid-cap for Aqua America). Recognizing this, a small utility risk premium can be further refined to identify the additional risk premium over and above the cost of equity for the sample water utilities. If we assume the water industry risk premium is the same for all the sample water utilities as well as BMSC, then the additional risk premium is only related to the relative size of each utility to BMSC. This is exactly what I have done in my size premium study present in my rebuttal testimony.[22] The study indicates a risk premium over and above the returns of the publicly traded utility companies of 1.81%.

Q. THIS SIZE RISK PREMIUM IS NOT RELATED TO FINANCIAL RISK?

A. Correct. Measures on financial risk are contained within the beta estimate. The 1.81% risk premium is based upon a beta adjusted size premium.[23] In other words, the additional risk premium for size is the risk premium not explained by beta. Ibbotson devotes an entire chapter on firm size and return.[24]

Q. THE 181 BASIS POINT INDICATED RISK PREMIUM FOR BMSC WOULD MORE THAN OFFSET STAFF'S 80 BASIS POINT FINANCIAL RISK ADJUSTMENT. CORRECT?

A. Yes. And, Staff's indicated cost of equity would be 11.21% (10.2% minus 0.8% plus 1.81%). As I have suggested, Staff's financial risk is overstated so Staff's indicated cost of equity would be much higher.

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[22] *See* Rebuttal Attachment 1.

[23] Beta adjusted size premium

[24] Ibbotson Chapter 7 – Firm Size and Return.

Q. DOES THE "JANUARY EFFECT" DISPROVE THE NOTION THAT THERE IS NO RISK PREMIUM ON SMALL COMPANY STOCKS OVER LARGE COMPANY STOCKS?

A. No. Mr. Manrique presents this as an argument against any size premium.[25] However, while Ibbotson acknowledges the "January effect" in discussing size premia, Ibbotson states that "... simply demonstrating that the size premium is largely produced by the January effect does nothing to refute the existence of such a premium."[26]

Ibbotson specifically concludes:[27]

> Most criticisms of the use of a size premia do not address the underlying reason for the existence of size premia. Small capitalization stocks are still considered riskier investments that large company stocks. Investors require an additional reward, in the form of an additional return, to take on the added risk of an investment in small-capitalization stock. It is unlikely that future investors will require no compensation for taking on this additional risk.....
>
> ... Most criticisms presented to date...have not provided sufficient evidence to disprove the existence of a size premia.

Q. DOES THE ANNIE WONG STUDY CITED BY MR. MANRIQUE DISPROVE THE EXISTENCE OF A SIZE PREMIUM FOR SMALL UTILITY STOCKS?

A. No. As Dr. Zepp concluded in his review of Ms. Wong's study, "[her] weak evidence provides little support for a small firm effect existing or not existing in either the industrial or utility sector.[28] As I testified in my rebuttal testimony, even

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[25] Manrique Sb. at 3.

[26] *Ibbotson* at 101.

[27] *Id.* at 105.

[28] Thomas M. Zepp, "Utility Stocks and the Size Effect – Revisited", The Quarterly Review Economics and Finance, Vol. 43, Issue 3, Autumn 2003, 578-582.

the California PUC conducted a study that showed smaller water utilities are more risky than larger ones.[29]

IV. RESPONSE TO RUCO'S COST OF CAPITAL ANALYSIS

Q. PLEASE RESPOND TO MR. RIGSBY'S TESTIMONY THAT AN 8.22 PERCENT RETURN ON EQUITY IS ATTRACTIVE TO INVESTORS CONSIDERING THE VALUE LINE PROJECTED RETURNS FOR THE WATER UTILITY INDUSTRY OF 7.5 PERCENT?

A. There are several problems contained in this testimony. First, we have unrefuted, real world evidence in this case that BMSC's shareholder is not going to be attracted to Mr. Rigsby's recommended returns because it can earn higher returns every where else it does business. Until Mr. Rigsby's fictitious investors buy BMSC, the evidence is that his ROE is not going to attract capital from the only investor that matters.

Second, in a lovely piece of irony, Mr. Rigsby appears to justify his recommended cost of equity using a Comparable Earnings approach. This is an approach I have advocated in the past before this Commission, unsuccessfully.[30] If a Comparable Earnings approach is now considered appropriate by this Commission, the comparison certainly can't be the Value Line ("VL") projected book return of 7.5%. The VL Water Industry includes companies that have not (and should not) be used in a cost of capital analysis, like Southwest Water, which even Mr. Rigsby has stopped including Southwest Water (SWWC) in his analysis because it is financially distressed and less than 50 percent of its revenues are from regulated business. American Water Works (AWK) is also a financially distressed

[29] Bourassa Rb. at 6.

[30] Decision No. 69164. Mr. Bourassa used comparable earnings on book equity and authorized equity returns. In addition, Mr. Bourassa used a bond risk premium analysis using book equity returns and authorized equity returns.

utility as VL reports that a large shareholder (RWE) is liquidating its stake from just over 45% to 25%. VL further reports that AWK "has been trading for little over a year and lacks a track record to accurately track trading habits." Pennichuck Water (PNNW) is the focus of a condemnation proceeding and has been for several years. Sun Hydraulics (SHNY) is not a regulated utility. It designs, manufactures and sells cartridge valves and manifolds used in hydraulic systems. In short, Mr. Rigsby's comparable companies are anything but comparable to BMSC.

Third, Mr. Rigsby's recommended cost of equity does not square with the VL projected book returns on the sample companies he uses in his cost of equity analysis. In fact, Mr. Risgby's recommended cost of equity in the instant case of 8.22% is 300 to 380 basis points below the projected book returns on the sample companies he includes in his analysis. As shown below, the average VL projected book return for his water utility sample group and his gas utility sample group are 11.8% and 11.2%, respectively.

RUCO Water Utility Sample Group

Stock Symbol	Company	Value Line Projected Book Return on Equity[31]
AWR	American States Water Co.	12.0
WTR	Aqua America	11.5
CWT	California Water Services Group	12.0
	Average	11.8

[31] Value Line Investment Survey October 23, 2009.

RUCO Gas Utility Sample Group

Stock Symbol	Company	Value Line Projected Book Return on Equity[32]
AGL	AGL Resources, Inc.	14.0
ATO	Atmos Energy Corp.	9.5
LG	Laclede Group, Inc.	11.0
NJR	New Jersey Resources Corp.	10.0
GAS	Nicor, Inc.	12.0
NWN	Northwest Natural Gas	11.0
PNY	Piedmont Natural Gas Company	12.5
SJI	South Jersey Industry	13.5
SWX	Southwest Gas Corp.	8.0
WGL	WGL Holdings, Inc.	10.5
	Average	11.2

Again, if Mr. Rigsby is going to do a comparable analysis, he shouldn't ignore the lack of comparison between his comparables and his subject when it comes to the ROE.

Q. WHAT WILL BE THE RETURN ON EQUITY ON THE ACTUAL EQUITY BALANCE IN THE COMPANY'S CAPITAL STRUCTURE UNDER RUCO'S RECOMMENDATION?

A. 5.5 percent.[33] This is the appropriate number to compare to projected book returns because the projected book returns by VL are on the balances of equity and not on

[32] Value Line Investment Survey October 23, 2009.

[33] RUCO required operating income is $307,492 per RUCO Surrebuttal Schedule RLM-1, page 1 of 1, less synchronized interest of $92,023 per RUCO Surrebuttal Schedule RLM-1, page 2 of 2 divided by adjusted book equity of $3,920,456 per Company Rejoinder Schedule D-1.

rate base. In the instant case, the Company has over $3.9 million of equity capital but the rate base is only about $3.6 million. This is far below the 7.5% Mr. Rigsby professes to be a comparable return on book equity and even farther below the projected book returns of the utility companies Mr. Rigsby uses to estimate the cost of equity.

Q. BASED ON THE COMPANY'S RECOMMENDATIONS, WHAT IS THE COMPANY'S RETURN ON EQUITY on THE ACTUAL EQUITY CAPITAL IN THE COMPANY'S CAPITAL STRUCTURE?

A. 9.84%.[34] Even the Company's book equity return is far below the projected book returns of VL of the utility companies is Mr. Rigsby water and gas samples of 11.8 percent and 11.2 percent, respectively. If a Comparable Earnings approach is now acceptable, then it is the 9.83% return that should be used as a measure of reasonableness. By this measure, the Company's recommendations on the cost of capital in the instant case are more than reasonable.

A. <u>Criticisms of RUCO's Cost of Debt</u>

Q. PLEASE RESPOND TO MR. RIGSBY'S TESTIMONY THAT THERE IS NO REASON WHY BMSC COULD NOT OBTAIN DEBT AT A COST OF 6.21 PERCENT.

A. There are two significant problems with Mr. Rigsby's assertion that BMSC could borrow at a cost of 6.21%. The first is that the cost of borrowing is based on the credit risk of BMSC and not its parent company, Algonquin. Small utility companies, like BMSC, have a higher credit risk compared to a large publicly traded utilities company. This is because small utilities typically do not have the

[34] Company required operating income is $456,680 per Rejoinder Schedule A-1 less synchronized interest of $70,954 per Rejoinder Schedule C-1, page 2 of 2 divided by adjusted book equity of $3,920,456 per Company Rejoinder Schedule D-1.

earnings and cash flow cushion to help address unexpected changes in operating expenses and to help fund capital expenditures. Second, Algonquin's current cost of borrowing is currently much higher than 6.21%. Recently Algonquin Power and Utilities Corp. announced that it will issue convertible debentures at a cost of 7.0 percent. *See* **Rejoinder Attachment 2**. I have also been provided information which indicates Algonquin intends to borrow approximately $63 million. The debt issuance costs will be approximately $3 million which will mean that the effective interest rate will be 7.7%. *See* **Rejoinder Attachment 3**.

Q. HAS MR. RIGSBY RESPONDED TO YOUR TESTIMONY THAT HIS CAPM ESTIMATES PRODUCE INDICATED RETURNS BELOW THE COST OF DEBT?

A. No. As you will recall, I showed that Mr. Rigsby's CAPM estimates produced indicated returns less than the cost of Baa investment grade bonds as well as BBB utility bonds.[35] Mr. Rigsby CAPM estimates range from 5.3% to 7.08% with an over-all average of 6.15%.[36] The current cost of Baa investment grade bonds is 6.4 percent.[37] The information on Algonquin's current borrowing cost (7.7%) as discussed previously makes his CAPM results even more suspect.

B. <u>Criticisms of RUCO's Hypothetical Capital Structure</u>

Q. DO YOU HAVE ANY FURTHER COMMENTS ON RUCO'S HYPOTHETICAL CAPITAL STRUCTURE?

A. Yes. RUCO's use of a hypothetical capital structure results in a WACC of 7.43%. This is below the 7.7 percent current cost of debt discussed earlier. And, despite RUCO recommended equity return of 8.22%, RUCO's effective return on equity is

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[35] Bourassa Rb. at 21.

[36] *Id.*

[37] Federal Reserve, November 12, 2009.

well below its WACC of 7.43%. This is because RUCO imputes additional hypothetical interest expense which lowers the income taxes. RUCO's approach not only utilizes hypothetical debt and hypothetical cost of debt but further imputes hypothetical interest expense. This parade of hypotheticals is all fiction and should be rejected by this Commission as results oriented. So, in other words, the Company would not even have the opportunity to earn its authorized ROE if RUCO's recommendation is accepted.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

REJOINDER ATTACHMENT 1

Black Mountain Sewer Company
Comparison of Total Capitalization and Return $ Impact on Revenue Requirement

Total Capitalization	Sample Group Average Percentage	Cost	Weighted Cost	BMSC	Cost	Weighted Cost
Refundable Advances for Construction (AIAC)	10.53%	0.0%	0.0%	25.74%	0.0%	0.0%
Contributions-in-aid of Construction (CIAC)	14.41%	0.0%	0.0%	15.31%	0.0%	0.0%
Debt	35.95%	9.4%	3.4%	0.00%	9.4%	0.0%
Equity (Common and Preferred)	39.11%	12.4%	4.8%	58.96%	12.4%	7.3%
Totals	100.00%		8.23%	100.00%		7.31%

Capital Structure	Sample Group Average Percentage	Cost	Weighted Cost	BMSC	Cost	Weighted Cost
Debt	47.7%	9.4%	4.5%	0.0%	9.4%	0.0%
Equity (Common and Preferred)	52.3%	12.4%	6.5%	100.0%	12.4%	12.4%
Totals	100.0%		11.0%	100.0%		12.4%

Rate Base		
Net Plant-in-service	$ 100.00	$ 100.00
AIAC	(10.53)	(25.74)
CIAC	(14.41)	(15.31)
Implied Rate Base (per $100)[1]	$ 75.06	$ 58.96
WACC	11.0%	12.4%
Required Return (per $100)	$ 8.23	$ 7.31
Income Tax Factor[2]	1.6287	1.6287
Impact on Revenue Requirement (per $100)	$ 13.41	$ 11.91

[1] Assumes plant is funded with AIAC, CIAC, debt and equity and only debt and equity funded plant receive recognition in rate base.
[2] Assumes 38.6 percent tax rate. Income tax factor is equal to 1/(1-tax rate)

REJOINDER ATTACHMENT 2

The following news about Algonquin was issued today. / Les informations suivantes sur Algonquin ont été diffusées aujourd'hui.

ALGONQUIN POWER & UTILITIES CORP. ANNOUNCES ACQUISITION OF HYDROELECTRIC GENERATION ASSETS

Acquisition Expected to Grow Renewable Energy Business by more than 10%

TORONTO, ONTARIO – November 10, 2009 – Algonquin Power & Utilities Corp. (TSX: AQN) is pleased to announce that it and its affiliates ("Algonquin") have entered into definitive agreements (the "Purchase Agreements") with Integrys Energy Services Inc. and its subsidiaries to purchase certain electrical generating facility assets, most notably 36.8MW of hydroelectric generating capacity located in New Brunswick and Maine.

Pursuant to the Purchase Agreements, Algonquin has agreed to acquire, through the purchase of shares and assets, three hydroelectric generating stations including the 34.5MW Tinker Hydroelectric station located on the Aroostook River near the Town of Perth-Andover, New Brunswick. Additionally, Algonquin will acquire five legacy thermal generating stations (together with the hydroelectric plants, the "Hydro Plants") and certain regulated NB ISO transmission lines located in proximity to the generating facilities. Closing of the acquisition is subject to satisfaction of certain conditions including regulatory approval, and is anticipated to occur within approximately 60 days. For additional information on the acquired assets, please refer to the fact sheet posted on Algonquin's website.

The Hydro Plants are interconnected to access the northeastern electricity markets of Northern Maine, New Brunswick, and New England. Historically, the primary market for the energy and capacity produced by the Hydro Plants has been New Brunswick and Northern Maine and the Hydro Plants are under firm energy and capacity sale contracts continuing through February 2011, with several future contract opportunities available beyond the existing contract expiries. The transaction also builds on the previously announced strategic partnership with Emera Inc. through an energy marketing alliance with Emera Energy Services Inc. for off-take management and marketing services.

Due to confidentiality provisions with the seller, the purchase price was not disclosed. The acquisition will be financed with $20 million of new equity and the balance with long term convertible debentures, consistent with Algonquin's objective of achieving superior returns within a moderate risk profile and balanced capital structure.

"The earnings and cash flow accretion generated by these long lived, utility grade hydroelectric generating facilities supports Algonquin's commitment to providing total shareholder return through a combination of predictable and growing earnings and dividends together with capital appreciation" commented Ian Robertson, a senior officer with Algonquin. "The addition of these assets is expected to deliver growth of more than 10% in our renewable energy business, reinforcing Algonquin's strategic focus on the renewable energy sector", he continued.

Algonquin Power & Utilities Corp. Announces $75 Million Offering of Common Shares and Convertible Debentures

[illegible]

About Algonquin Power & Utilities Corp.

Through its distinct operating subsidiaries, Algonquin owns and operates a diversified approximately $1 billion North American portfolio of clean renewable electric generation and sustainable utility distribution businesses. Algonquin's electric generation subsidiary includes 42 renewable energy facilities and 11 high efficiency thermal energy facilities representing more than 400 MW of installed capacity. Through its wholly owned subsidiary, Liberty Water Co., Algonquin provides regulated utility services to more than 70,000 customers with a portfolio of 18 water distribution and wastewater treatment utility systems. Pursuant to a previously announced agreement, Algonquin is committed to acquiring the California based regulated utility electric distribution and generation assets of NV Energy which serve approximately 47,000 retail electricity distribution customers. Algonquin and its operating subsidiaries deliver continuing growth through an expanding pipeline of greenfield and expansion renewable power and clean energy projects, organic growth within its regulated utilities and the aggressive pursuit of accretive acquisition opportunities. Algonquin's common shares and convertible debentures are traded on the Toronto Stock Exchange under the symbols AQN, AQN.DB and AQN.DB.A. Visit Algonquin Power & Utilities Corp. on the web at www.AlgonquinPower.com.

For Further Information contact:

Kelly Castledine

Telephone: (905) 465-4500

Algonquin Power & Utilities Corp.

Forward Looking Information

Certain statements in this news release, other than statements of historical fact, are forward-looking statements based on certain assumptions and reflect Algonquin's and its subsidiaries' current expectations. Forward-looking statements are provided for the purpose of presenting information about management's current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. These statements may include, without limitation, statements regarding the operations, business, financial condition, priorities, ongoing objectives, strategies and outlook of Algonquin and its subsidiaries' for the current fiscal year and subsequent periods. Forward-looking statements include statements that are predictive in nature, depend upon or refer to future events or conditions, or include words such as "will" and "may". This information is based upon certain material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking statements, including the perception of historical trends, current conditions and expected future developments, as well as other factors that are believed to be appropriate in the circumstances. Although these forward-looking statements are based upon management's current reasonable expectations and assumptions, they are subject to numerous risks and uncertainties, including those set out in the management's discussion and analysis section of Algonquin's 2008 annual report, Algonquin's Annual Information Form dated March 31, 2009, Algonquin's Management Information Circular dated March 20, 2009. Algonquin's actual results could differ materially from those expressed in, or implied by, these forward looking statements and, accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or what benefits, including the amount of dividends, Algonquin and shareholders will derive therefrom.

The forward-looking statements contained in this news release are made as of the date hereof for the purpose of providing readers with Algonquin's expectations for the coming year. The forward-looking statements may not be appropriate for other purposes. Other than as specifically required by law, Algonquin undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events, whether as a result of new information, future events or results, or otherwise.

REJOINDER ATTACHMENT 3

Algonquin Power
Series 3 - Effective Interest Rate
New - October 27, 2009

Facts

Issue Date	10-Nov-09
Series I Debt	$63,250,000
Add: Premium	$0
Total Series 3 Debt	$63,250,000
Less: Unamortized Issue Costs	
Add: Issue Costs	**-$2,530,000**
Add: Additional Issue Costs	**-$366,505**
New Equity portion	
Less: Premium on Series I	$0
Book Value	$60,353,495
Coupon Rate	7.00%
Frequency of coupon	Semi Annual
Term (Maturity)	Bond maturing June 30, 2017
Effective Interest rate	7.6796%

BOURASSA
COST OF CAPITAL SCHEDULES

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Summary of Cost of Capital

Exhibit
Rejoinder Schedule D-1
Page 1
Witness: Bourassa

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
6	Long-Term Debt[1]	-	0.00%	9.40%	0.00%	-	0.00%	9.40%	0.00%
8	Stockholder's Equity[2]	3,920,456	100.00%	12.40%	12.40%	4,306,170	100.00%	12.40%	12.40%
10	Totals	$ 3,920,456	100.00%		12.40%	$ 4,306,170	100.00%		12.40%

12	[1] Excluded long-term debt for Scottsdale Treatment Capacity	$ 1,010,649	. See D-2
13	[2] Adjusted for correction to accummulated depreciation of	$ 322,862	. See Direct B-2 Page 2
14	[3] Adjusted for correction to accummulated depreciation of	$ (100,250)	. See Rejoinder B-2, page 2
15	[4] Adjusted for correction to accummulated amortization	$ (271,031)	. See Direct B-2 Page 2
16	[5] Adjusted for deferred income taxes	$ 170,554	. See Direct B-2 Page 6
17	[7] Adjusted for deferred income taxes	$ 25,351	. See Rejoinder B-2, page 6

20 SUPPORTING SCHEDULES:
21 Rejoinder D-2
22 Rejoinder D-3
23 Rejoinder D-4

RECAP SCHEDULES:

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Long Term Debt

Exhibit
Rejoinder Schedule D-2
Page 1
Witness: Bourassa

Line No.	Description of Debt	End of Test Year Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost	End of Projected Year Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost
1	Loan for Scottsdale Treatment Capacity	659,546	74,518	9.40%	6.13%	613,181	71,388	9.40%	6.13%
2	Loan for Scottsdale Treatment Capacity	351,103	39,325	9.40%	3.27%	327,694	36,010	9.40%	3.27%
3			-		0.00%	-	-	0.00%	0.00%
4			-		0.00%	-	-	0.00%	0.00%
5									
6									
7									
8									
9									
10									
11									
12									
13	Totals	$ 1,010,649	$ 113,843		9.40%	$ 940,875	$ 107,398		9.40%
14									
15	Supporting Schdules:								
16	E-2								
17									
18									
19									
20									
21									

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Preferred Stock

Exhibit
Rejoinder Schedule D-3
Page 1
Witness: Bourassa

Line No.	Description of Issue	End of Test Year Shares Outstanding	End of Test Year Amount	End of Test Year Dividend Requirement	End of Projected Year Shares Outstanding	End of Projected Year Amount	End of Projected Year Dividend Requirement
1							
2							
3	NOT APPLICABLE, NO PREFERRED STOCK ISSUED OR OUTSTANDING						
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17	SUPPORTING SCHEDULES:			RECAP SCHEDULES:			
18				Rejoinder D-1			
19							
20							

Black Mountain Sewer Corporation
Test Year Ended June 30, 2008
Cost of Common Equity

Exhibit
Rejoinder Schedule D-4
Page 1
Witness: Bourassa

Line No.	
1	
2	The Company is proposing a cost of common equity of 12.4%.
3	
4	
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17	SUPPORTING SCHEDULES:
18	Rebuttal D-4.0 to D-4.13
19	
20	

RECAP SCHEDULES:
Rejoinder D-1

Black Mountain Sewer Company
Test Year Ended June 30, 2008
Summary of Disputed Rate Base Items

Line No.	Description	Amounts in Dispute: Original Cost	Amounts in Dispute: Accumulated Depreciation (A/D)	Amounts in Dispute: CIAC/AIAC	Net Rate Base Impact	Company Position	Staff Position
1	Plant-in-service - Odor Control Unit (transferred from LPSCo)	$ 38,625		$ -	$ 38,625	Included in rate base	Disallowed in rate base
2	Accumulated Depreciation - Odor Control Unit (transferred from LPSCo)		$ 11,149		$ (11,149)	Included in rate base	Staff does not include odor control unit and therefore does include related A/D.
3	Accumulated Depreciation (prior case PTY plant)		$ 2,149		$ (2,149)	Excluded from rate base	Staff includes an additional 1/2 yr of accumulated depreciation from post test year plant in the last rate case.
4	Accumulated Depreciation (New trade center lift station)		$ 2,127		$ (2,127)	Included in rate base	Staff excludes from A/D.
5	Deferred Income Taxes	$195,000 deferred income tax asset	N/A	N/A	$ 195,000	Included in rate base	Zero DIT.
6	Working Capital	$ (75,980)	N/A	N/A	$ (75,980)	Company recommends zero working capital. Company lead-lag study indicates positive cash working capital of $5,252 plus $8,292 of prepayments totaling $13,544.	Staff recommends negative 83,132 of cash working capital plus $7,152 of prepayments for toal working capital of a negative $75,980.

EXHIBIT
A-10
ADMITTED

Black Mountain Sewer Company
Test Year Ended June 30, 2008
Summary of Disputed Revenue/Expense Items

Line No.	Description	Amount of Expense in Dispute	Net Impact on Revenue Requirement	Company Position	Staff Position
1	Testing Expense	$ 13,807	$ 13,807	Company includes additional testing requested by City of Scottdale. Total testing expense of $29,049.	Staff disallows inclusion of additional testing requested by City of Scottsdale. Total testing expense of $15,222.
2	Contractual Services - Performance Incentives	$ 13,460	$ 13,460	Company includes in expense.	Staff disallows inclusion in expense.
3	Contractual Services - Central Office Costs	$ 32,327	$ 32,327	Company includes $33,778 of allocated Central Office costs in expense.	Staff includes $1,451 of Central Office cost in expense.
4	Contractual Services - Increases in allocated costs	$ 44,018	$ 44,018	Company includes known and measureable increases in expense due to annualization of wages and salaries totaling $44,018.	Staff disallows inclusion increases in allocated expense.
5	Contractual Services - Aerotek	$ 42,200	$ 42,200	Company includes cost in expense that was inadverantly booked to LPSCo.	Staff disallows inclusion in expense.
6	Contractual Services - Legal and Engineering	$ 1,500	$ 1,500	Company agrees with Staff normalization but Staff computation contains an error.	Staff does not include $1,500 of expense due to an error in computation.
7	Transportation Expense (1/2 of annual truck lease)	$ 5,375	$ 5,375	Company includes entire annaul cost of truck lease in expense.	Staff disallows 1/2 year of cost in expense. Shares cost with Gold Canyon Sewer Company.
8	Depreciation Expense	$ 8,019	$ 8,019	Company computes composite rate for CIAC on all plant. Company excludes $8,019 of CIAC amortization (depreciation expense is higher by $8,019)	Staff computes composite rate for CIAC on only depreciable plant. Depreciation expense is lower by $8,019.

Black Mountain Sewer Company
Cost Recovery Surcharge Computation
for Decommissioning of WW Treatment Plant

Hearing Exhibit
Page 1

Example Computation of Cost Recovery Surcharge

Wastewater Treatment Decommissioning Costs		$ 1,841,666
Less:		
Gain on Sale of Land (assume land not sold at time of implementation)	$ -	
Share %	50%	
		-
Net Wastewater Treatment Decommissioning Costs		$ 1,841,666
Cost of Capital		10.00%

Step 1 Compute the Annual Amortization

Total Cost	$ 1,841,666
(*) Amortization rate (assuming 20 years)	5%
(=) Equals Annual Amortization	$ 92,083

Step 2 Compute the Annual Return on Investment

Total Cost	$ 1,841,666
(*) Cost of Capital	10.0%
(=) Equals Annual Return on Investment	$ 184,167

Step 3 Compute the Gross Revenue Conversion Factor (GRCF)

GRCF (assuming 38.6% effective Federal and State tax rate) $= \frac{1}{1 - 0.386} = 1.6287$

Step 4 Find the Incremental Income Tax Factor

Incremental Income Tax Factor = GRCF - 1

= 1.6129 - 1

= 0.6287

Step 5 Find the Annual Income Tax Component of the Cost Recovery Surcharge Revenue

Incremental Income Tax Conversion	0.6287
(*) Times Annual Return on Investment	$ 184,167
(=) Equals Annual Income Tax Component of Annual Cost Recovery Surcharge	$ 115,786

Step 6 Find the Amortization and Return on Investment of the Annual Surcharge Revenue (before Income Taxes)

Annual Return on Investment (from Step 2)	$ 184,167
(+) Plus Annual Amortization (from Step 1)	$ 92,083
(=) Equals Annual Cost Recovery Surcharge Revenue before income taxes	$ 276,250

Step 7 Find the Total Annual Cost Recovery Surcharge Revenue Requirement (with Income Taxes)

Annual Income Tax Component of the Surcharge Revenue (from Step 6)	$ 115,786
(+) Plus Annual Amortization and Return on Investment Component of the Surcharge Revenue (from Step 6)	$ 276,250
(=) Equals the Total Annual Surcharge Revenue Requirement	$ 392,035

Step 8 Find the Monthly Surcharge per Customer

Total Annual Cost Recovery Surcharge Revenue Requirement (from Step 7)	$ 392,035
(/) Divided by 12	12
(=) Equals Total Monthly Surcharge Revenue Requirement	$ 32,670
(/) Divided by Number of Customers at time of filing (assumes test year end nuber of customers)	2,100
(=) Equals the Monthly Surcharge per Customer	**$ 15.56**

Black Mountain Sewer Company
Cost Recovery Surcharge Computation
for Decommissioning of WW Treatment Plant

Example Computation of Cost Recovery Surcharge

Wastewater Treatment Decommissioning Costs		$ 1,841,666
Less:		
Gain on Sale of Land	$ 500,000	
Share %	50%	
		(250,000)
Net Wastewater Treatment Decommissioning Costs		$ 1,591,666
Cost of Capital		10.00%

Step 1 Compute the Annual Amortization

Total Cost	$ 1,591,666
(*) Amortization rate (assuming 20 years)	5%
(=) Equals Annual Amortization	$ 79,583

Step 2 Compute the Annual Return on Investment

Total Cost	$ 1,591,666
(*) Cost of Capital	10.0%
(=) Equals Annual Return on Investment	$ 159,167

Step 3 Compute the Gross Revenue Conversion Factor (GRCF)

GRCF (assuming 38.6% effective Federal and State tax rate) $= \frac{1}{1 - 0.386} = 1.6287$

Step 4 Find the Incremental Income Tax Factor

Incremental Income Tax Factor = GRCF - 1

= 1.6129 - 1

= 0.6287

Step 5 Find the Annual Income Tax Component of the Cost Recovery Surcharge Revenue

Incremental Income Tax Conversion	0.6287
(*) Times Annual Return on Investment	$ 159,167
(=) Equals Annual Income Tax Component of Annual Cost Recovery Surcharge	$ 100,068

Step 6 Find the Amortization and Return on Investment of the Annual Surcharge Revenue (before Income Taxes)

Annual Return on Investment (from Step 2)	$ 159,167
(+) Plus Annual Amortization (from Step 1)	$ 79,583
(=) Equals Annual Cost Recovery Surcharge Revenue before income taxes	$ 238,750

Step 7 Find the Total Annual Cost Recovery Surcharge Revenue Requirement (with Income Taxes)

Annual Income Tax Component of the Surcharge Revenue (from Step 6)	$ 100,068
(+) Plus Annual Amortization and Return on Investment Component of the Surcharge Revenue (from Step 6)	$ 238,750
(=) Equals the Total Annual Surcharge Revenue Requirement	$ 338,818

Step 8 Find the Monthly Surcharge per Customer

Total Annual Cost Recovery Surcharge Revenue Requirement (from Step 7)	$ 338,818
(/) Divided by 12	12
(=) Equals Total Monthly Surcharge Revenue Requirement	$ 28,235
(/) Divided by Number of Customers at time of filing (assumes test year end nuber of customers)	2,100
(=) Equals the Monthly Surcharge per Customer	**$ 13.45**

BLACK MOUNTAIN SEWER CORPORATION
DOCKET NO: SW-02361A-08-0609
RESPONSE TO STAFF'S NINTH SET OF DATA REQUESTS

July 7, 2009

Response provided by: Gerald Tremblay

Title: Director of Finance

Company Name: Algonquin Power Income Fund

Address: 2845 Bristol Circle
Oakville, Ontario Canada L6H 7H7

Company Response Number: CSB 9-1

Q. Central Office Fixed Overhead Allocations – This is a follow-up question to data request MEM 4.1. Your response indicates that Algonquin Power Trust incurs $3,950,000 in corporate costs and allocates a portion of those costs to its 17 utility companies as follows:

Description	Total Cost	Allocation %	Infrastructure Allocated Costs
Rent	$ 430,739	26.98%	$ 116,231
Audit	$ 507,000	26.98%	$ 136,810
Tax Services	$ 265,000	26.98%	$ 74,508
Legal – General	$ 300,000	26.98%	$ 80,952
Other Professional Services	$ 455,000	26.98%	$ 122,778
Management Fee – Salaries	$ 636,619	26.98%	$ 171,786
Unit Holder Communications	$ 314,100	26.98%	$ 84,757
Trustee Fees	$ 204,000	26.98%	$ 55,048
Office Costs	$ 254,100	26.98%	$ 68,567
Licenses/Fees and Permits	$ 305,000	26.98%	$ 82,302
Escrow and Transfer Fees	$ 75,000	26.98%	$ 20,238
Depreciation Expense	$ 204,242	26.98%	$ 55,113
Total	**$3,950,800**		**$1,066,089**

Please provide the following information:

a. Rent – Please provide underlying invoices and any other cost documentation to support the $430,739 amount. Also, please state what the item(s) being rented are

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ADMITTED

used for. Also state how each expense is used in the provision of service for Black Mountain's ratepayers.

b. Audit - Please provide underlying invoices and any other cost documentation to support the $507,000 amount. Please state the type of audit performed.

c. Tax Services - Please provide underlying invoices and any other cost documentation to support the $265,000 amount.

d. Legal, General - Please provide or make available for inspection the underlying invoices and any other cost documentation to support the $300,000 amount.

e. Other Professional Services – Please provide underlying invoices and any other cost documentation to support the $455,000 amount. Please provide a schedule listing each component of the amount. Also state how each expense is used in the provision of service for Black Mountain's ratepayers.

f. Management Fee, Salaries - Please provide underlying invoices and any other cost documentation to support the $636,619 amount. Please provide a schedule listing each employee, his/her annual salary, and the primary job duties. Also state how the expense for each employee is used in the provision of service for Black Mountain's ratepayers.

g. Unit Holder Communications - Please provide underlying invoices and any other cost documentation to support the $314,100 amount. Please provide an explanation of the expense, such as but not limited to, what was communicated, how the communications were made, etc. Also state how the expense is used in the provision of service for Black Mountain's ratepayers.

h. Trustee Fees - Please provide underlying invoices and any other cost documentation to support the $204,000 amount. Additionally, please provide a schedule listing each trustee, his/her annual fee, and a description of his/her primary job duties.

i. Office Costs - Please provide underlying invoices and any other cost documentation to support the $254,100 amount. Please provide a schedule listing each component of the amount. Also state how each expense is used in the provision of service for Black Mountain's ratepayers.

j. Licenses/Fees and Permits - Please provide underlying invoices and any other cost documentation to support the $305,000 amount. Please provide a schedule listing each component of the amount. Also state how each expense is used in the provision of service for Black Mountain's ratepayers.

k. Escrow and Transfer Fees - Please provide underlying invoices and any other cost documentation to support the $75,000 amount. Please provide a schedule listing each component of the amount. Also state how each expense is used in the provision of service for Black Mountain's ratepayers.

l. Depreciation Expense – Please provide underlying invoices and any other cost documentation to support the $204,242 amount. Please provide a detailed listing of each depreciated asset, and depreciation rate and depreciation method used. Please state the make, model, and cost of all vehicles. Please provide a detailed description of items in the "miscellaneous" or "other" asset accounts. Please identify the original cost and accumulated depreciation of any boats or aircraft.

m. 26.98% Allocation Factor – Please provide all studies and underlying invoices and any other cost documentation to support the 26.98 percent allocation factor.

OBJECTION: BMSC objects to this data request because it is overly burdensome. The Company believes it has submitted more than adequate information to support its allocation of a pro rata share of actual costs. The information requested by this data request would require BMSC to produce thousands of pages of additional documentation from one or more third-parties. As a result, BMSC proposes to provide invoices above $5000 for the build up of the corporate costs and a detailed GL listing of the total build up. If, thereafter, Staff would like to see any specific invoices under $5000, Staff may request those specific invoices and the Company will make reasonable effort to promptly provide them.

RESPONSE: Notwithstanding its objection, BMSC responds below. The Company would like to clarify that the costs set forth in data request CSB 9-1 are the *budgeted* costs for the year 2008. The costs allocated to BMSC are based on these *budgeted* costs. Attached is a schedule of *actual* costs for all of 2008, along with the actual costs for the test year, 7/1/07 to 6/30/08 (*see* the excel file labeled "Corporate Cost Build Up July 2007 to June 2008"). The GL detail, along with supporting documentation, is based on actual costs for the test year. The actual costs for the period 7/1/07 to 6/30/08 were above the budgeted costs by approximately $374,000. This would amount to an approximate $2,400 annual expense increase to BMSC (*see* the summary tab of the Corporate Cost Build Up July 2007 to June 2008 excel file).

a) Rent – Please see the attached documents labeled "Rent Invoices." The rent is for the use of office space at 2845 Bristol Circle, Oakville, Ontario, Canada, for corporate personnel. All executive and corporate decision making is based out of this office.

b) Audit – Please see the attached documents labeled "Audit Expense Invoices." The types of services performed are quarterly reviews, yearly audits, and control documentation and testing for the entire Income Fund.

c) Tax Services – Please see the attached documents labeled "Tax Services Expense Invoices."

d) Legal, General – Legal invoices are not being provided because they contain information that is subject to the attorney-client privilege. However, Staff may arrange to review the invoices by contacting Company's legal counsel, Attn: Whitney Birk at 602-916-5720. The proposed manner of review of legal invoices is the same as used by Staff and Fennemore Craig in other rate cases. The Company reserves, and in no way intends to waive the attorney-client privilege with respect to the production of these documents, which are being made available for review to allow Staff to verify amounts incurred by the Company on matters that may be included in rate case expense and/or the Company's operating expenses.

e) Other Professional Services – Please see the attached documents labeled "Other Professional Fees Expense Invoices." For a schedule of amounts, please refer to the excel file labeled "Corporate Cost Build Up July 2007 to June 2008." These services mainly relate to maintenance of the ERP system, payroll system, 401k services, and health and benefit services. The allocated cost to BMSC is essential because BMSC must utilize the ERP system for proper record keeping, as well as an upgraded payroll system to pay the operators.

f) Management Fee, Salaries – Please see the attached documents labeled "Management Fee Expense Invoices." The management fee represents the fee from the management executive group: Chris Jarratt, David Kerr, and Ian Robertson. The management executive group provides management services, including strategic advice and consultation concerning business planning, support, guidance and policy making and general services. These expenses are critical to ensure the ongoing health and sustainability of the Income Fund and thus BMSC.

For a schedule listing, please refer to the Corporate Cost Build Up July 2007 to June 2008 excel file (tab labeled "Expenses," cell K 201).

g) Unit Holder Communications – Please see the attached documents labeled "Unit Holder Communication Expense Invoices." The Income Fund is a publicly traded entity on the Toronto Stock Exchange, and is obligated under securities law to report regularly on the Fund's financial condition to the unit holders. Communication costs are associated with the issuance of the quarterly and annual reporting, as well as the annual information form, the management discussion and analysis, and press releases. APIF is a publicly traded entity, and these costs are essential in order for the Income Fund to have access to the capital markets. BMSC benefits from this because it ensures that capital is available for its ongoing capital needs.

h) Trustee Fees – Please see the attached documents labeled "Trustee Fee Expense Invoices." The Income Fund has three trustees: Christopher Ball, George Steeves, and Ken Moore. The primary role of the trustees is to oversee the strategic direction and health of the Income Fund on behalf of all unit holders.

i) Office Costs – Please see the attached documents labeled "Office Cost Expense Invoices." For a schedule of amounts, please refer to the excel file labeled "Corporate Cost Build Up July 2007 to June 2008." These costs are associated with the day to day operating activities such as maintenance, development, and purchasing for computer systems, stationary materials, property maintenance, service awards, and other ad hoc costs. BMSC requires the use of APIF's systems and support from its corporate office.

j) License/Fees and Permits – Please see the attached documents labeled "Licenses and Fees Expense Invoices." For a schedule of amounts, please refer to the excel file labeled "Corporate Cost Build Up July 2007 to June 2008." Some of these costs are related to donations and as a good corporate citizen, it is the Company's policy to give back to the community.

k) Escrow and Transfer fees – Please see the attached documents labeled "Escrow Expense Invoices." For a schedule of amounts, please refer to the excel file labeled "Corporate Cost Build Up July 2007 to June 2008." CIBC Trust Company is the agent which performs distributions to the unit holders and convertible debenture holders. A publicly traded entity, APIF must incur such a cost in order to have access to the capital markets. As noted above, BMSC benefits from the Income Fund's having access to the capital markets.

l) Depreciation Expense – Please refer to the "Dep Detail" tab of the Corporate Cost Build Up July 2007 to June 2008 excel file.

m) 26.98% Allocation Factor – There are no underlying invoices or any other cost documentation to support the 26.98 percent allocation factor. This allocation factor is simply based on the number of utilities within the utility division relative to the total number of facilities within the Income Fund. Please refer to BMSC's responses to Staff data requests MEM 1.28 and DH 4.1 for further detail.

Black Mountain Sewer Company
Test Year Ended June 30, 2008
Summary of Disputed Rate Base Items

Line No.	Description	Amounts in Dispute: Original Cost	Amounts in Dispute: Accumulated Depreciation (A/D)	Amounts in Dispute: CIAC/AIAC	Net Rate Base Impact	Company Position	Staff Position
1	Plant-in-service - Odor Control Unit (transferred from LPSCo)	$ 38,625		$ -	$ 38,625	Included in rate base	Disallowed in rate base
2	Accumulated Depreciation - Odor Control Unit (transferred from LPSCo)		$ 11,149		$ (11,149)	Included in rate base	Staff does not include odor control unit and therefore does not include related A/D.
3	Accumulated Depreciation (prior case PTY plant)		$ 2,149		$ (2,149)	Excluded from rate base	Staff includes an additional 1/2 yr of accumulated depreciation from post test year plant in the last rate case.
4	Accumulated Depreciation (New trade center lift station)		$ 2,127		$ (2,127)	Included in rate base	Staff excludes from A/D.
5	Deferred Income Taxes	$195,000 deferred income tax asset	N/A	N/A	$ 195,000	Included in rate base	Zero DIT.
6	Working Capital	$ (75,980)	N/A	N/A	$ (75,980)	Company recommends zero working capital. Company lead-lag study indicates positive cash working capital of $5,252 plus $8,292 of prepayments totaling $13,544.	Staff recommends negative 83,132 of cash working capital plus $7,152 of prepayments for toal working capital of a negative $75,980.

EXHIBIT
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ADMITTED

Black Mountain Sewer Company
Test Year Ended June 30, 2008
Summary of Disputed Revenue/Expense Items

Line No.	Description	Amount of Expense in Dispute	Net Impact on Revenue Requirement	Company Position	Staff Position
1	Testing Expense	$ 13,807	$ 13,807	Company includes additional testing requested by City of Scottdale. Total testing expense of $29,049.	Staff disallows inclusion of additional testing requested by City of Scottsdale. Total testing expense of $15,222.
2	Contractual Services - Performance Incentives	$ 13,460	$ 13,460	Company includes in expense.	Staff disallows inclusion in expense.
3	Contractual Services - Central Office Costs	$ 32,327	$ 32,327	Company includes $33,778 of allocated Central Office costs in expense.	Staff includes $1,451 of Central Office cost in expense.
4	Contractual Services - Increases in allocated costs	$ 44,018	$ 44,018	Company includes known and measureable increases in expense due to annualization of wages and salaries totaling $44,018.	Staff disallows inclusion increases in allocated expense.
5	Contractual Services - Aerotek	$ 42,200	$ 42,200	Company includes cost in expense that was inadverantly booked to LPSCo.	Staff disallows inclusion in expense.
6	Contractual Services - Legal and Engineering	$ 1,500	$ 1,500	Company agrees with Staff normalization but Staff computation contains an error.	Staff does not include $1,500 of expense due to an error in computation.
7	Transportation Expense (1/2 of annual truck lease)	$ 5,375	$ 5,375	Company includes entire annaul cost of truck lease in expense.	Staff disallows 1/2 year of cost in expense. Shares cost with Gold Canyon Sewer Company.
8	Depreciation Expense	$ 8,019	$ 8,019	Company computes composite rate for CIAC on all plant. Company excludes $8,019 of CIAC amortization (depreciation expense is higher by $8,019)	Staff computes composite rate for CIAC on only depreciable plant. Depreciation expense is lower by $8,019.
9	Rate Case Expense	$ 40,000	$ 40,000	Company's revised rate case estimate if $220,000	Staff recommends $180,000 of rate case expense.

BLACK MOUNTAIN SEWER CORPORATION
DOCKET NO: SW-02361A-08-0609
RESPONSE TO STAFF'S ELEVENTH SET OF DATA REQUESTS

November 3, 2009

Response provided by: Thomas J. Bourassa, CPA

Title: Rate Consultant

Company Name: Thomas J. Bourassa, CPA

Address: 139 W. Wood Drive
Phoenix, Arizona 85029

Company Response Number: CSB 11-4

Q. Accumulated Deferred Taxes, $3,699,796 Amount – Please provide all calculations and other documentation to support the $170,554 amount shown on Schedule B-2, Page 6, line 9.

RESPONSE:

The computation of the $3,699,796 tax value as shown on Schedule B-2, page 6, is as follows:

Black Mountain Sewer Co. Tax Values	[A] Actual BMSC Plant	[B] Actual BMSC Scottsdale Capacity	[C] 2008-adds BMSC-Addition Bonus	[D] 2008-adds BMSC Additions	[E] Total	
UCC at end of prior year	2,409,789*	830,195	176,434	1,230,487	4,646,905	
Annual amortization for 2008 (estimate)	(48,196)	(48,864)	(44,109)	(24,610)	(165,778)	1/2 year
Totals	$ 2,361,593	$ 781,331	$ 132,326	$1,205,877	$ 4,481,127	
Computed Tax Value	$ 2,361,593	Excluded not in Rate Base	$ 132,326	$ 1,205,877	**$ 3,699,796** Sum of [A],[C], [D]	

* See 2007 tax depreciation report

EXHIBIT
A-14
ADMITTED

BLACK MOUNTAIN SEWER COMPANY.

2007 Depreciation

Description of Property

GENERAL DEPRECIATION AND AMORTIZATION

Asset description	Date placed in service	Unadjusted cost or basis	Bus. %	179 exp. reduc. in basis	Basis Reduction	Basis for depreciation	Beginning Accumulated Depreciation	Ending Accumulated Depreciation	Method	Convention	Life	ACRS class	MACRS class	Current-yr 179 expense	Current-year depreciation
WATER PLANT EQUIP	01/01/1984	73,000.	100.			73,000.	73,000.	73,000.	S/L	S/L	20.000				
WATER PLANT EQUIP	01/01/1984	16,241.	100.			16,241.	16,241.	16,241.	S/L	S/L	20.000				
WATER PLANT EQUIP	01/01/1984	116,577.	100.			116,577.	105,532.	116,577.	S/L	S/L	25.000				11,045.
WATER PLANT EQUIP	01/01/1984	18,121.	100.			18,121.	16,392.	18,121.	S/L	S/L	25.000				1,729.
WATER PLANT EQUIP	01/01/1984	629.	100.			629.	629.	629.	S/L	S/L	5.000				
WATER PLANT EQUIP	07/01/1983	153,867.	100.			153,867.	153,867.	153,867.	S/L	S/L	5.000				
WATER PLANT EQUIP	07/01/1984	10,416.	100.			10,416.	10,416.	10,416.	S/L	S/L	5.000				
WATER PLANT EQUIP	07/01/1986	36,357.	100.			36,357.	36,357.	36,357.	S/L	S/L	5.000				
WATER PLANT EQUIP	07/01/1988	224,978.	100.			224,978.	196,389.	215,448.	S/L	HY			20		19,059.
WATER PLANT EQUIP	07/01/1989	12,536.	100.			12,536.	12,536.	12,536.	S/L	S/L	7.000				
WATER PLANT EQUIP	07/01/1989	108,982.	100.			108,982.	94,449.	100,262.	S/L	HY			20		5,813.
WATER PLANT EQUIP	07/01/1990	122,259.	100.			122,259.	99,845.	106,249.	S/L	HY			20		6,404.
WATER PLANT EQUIP	07/01/1990	130,610.	100.			130,610.	106,671.	113,511.	S/L	HY			20		6,840.
WATER PLANT EQUIP	07/01/1991	579,366.	100.			579,366.	444,176.	474,218.	S/L	HY			20		30,042.
WATER PLANT EQUIP	07/01/1991	346,840.	100.			346,840.	265,911.	283,895.	S/L	HY			20		17,984.
WATER PLANT EQUIP	07/01/1991	31,569.	100.			31,569.	24,267.	25,890.	S/L	HY			20		1,623.
WATER PLANT EQUIP	07/01/1991	330,833.	100.			330,833.	330,833.	330,833.	150 DB	HY			20		
WATER PLANT EQUIP	09/01/1992	254,303.	100.			254,303.	180,129.	193,615.	S/L	HY			20		13,486.
WATER PLANT EQUIP	07/01/1993	82,452.	100.			82,452.	54,974.	59,201.	S/L	HY			20		4,227.
WATER PLANT EQUIP	07/01/1994	1,223.	100.			1,223.	753.	816.	S/L	HY			20		63.
WATER PLANT EQUIP	07/01/1995	27,555.	100.			27,555.	15,617.	17,021.	S/L	HY			20		1,404.
WATER PLANT EQUIP	06/01/1996	3,611.	100.			3,611.	1,870.	2,053.	S/L	HY			20		183.
WATER PLANT EQUIP	07/01/1996	4,894.	100.			4,894.	2,311.	2,583.	S/L	HY			20		272.
WATER PLANT EQUIP	07/01/1997	89,592.	100.			89,592.	38,677.	43,526.	S/L	HY			20		4,849.
FURNITURE & FIXTURES	07/01/1999	2,200.	100.			2,200.	2,135.	2,200.	S/L	HY			7		65.
WATER PLANT EQUIP	08/01/2001	18,222.	100.			18,222.	3,847.	4,838.	S/L	HY			25		991.
WATER PLANT EQUIP	08/01/2001	2,736.	100.			2,736.	575.	724.	S/L	HY			25		149.
WATER PLANT EQUIP	08/01/2001	18,734.	100.			18,734.	3,953.	4,972.	S/L	HY			25		1,019.
WATER PLANT EQUIP	08/01/2001	612.	100.			612.	127.	160.	S/L	HY			25		33.
WATER PLANT EQUIP	08/01/2001	5,281.	100.			5,281.	1,114.	1,401.	S/L	HY			25		287.
FURNITURE & FIXTURES	08/01/2001	84,073.	100.			84,073.	70,810.	79,652.	S/L	HY			7		8,842.
WATER PLANT EQUIP	02/15/2002	420.	100.		126.	294.	59.	75.	S/L	MQ			25		16.
WATER PLANT EQUIP	03/15/2002	2,340.	100.		702.	1,638.	319.	406.	S/L	MQ			25		87.
WATER PLANT EQUIP	03/15/2002	315.	100.		95.	220.	43.	55.	S/L	MQ			25		12.
WATER PLANT EQUIP	04/15/2002	108.	100.		32.	76.	14.	17.	S/L	MQ			25		3.
WATER PLANT EQUIP	05/15/2002	85.	100.		26.	59.	10.	12.	S/L	MQ			25		2.
Less: Retired Assets															
TOTALS															

*Assets Retired

JSA
7C9027 1.000

EXHIBIT
A-15
ADMITTED

BLACK MOUNTAIN SEWER COMPANY.

2007 Depreciation

Description of Property

GENERAL DEPRECIATION AND AMORTIZATION

Asset description	Date placed in service	Unadjusted cost or basis	Bus. %	179 exp. reduc. in basis	Basis Reduction	Basis for depreciation	Beginning Accumulated Depreciation	Ending Accumulated Depreciation	Method	Convention	Life	ACRS class	MACRS class	Current-yr 179 expense	Current-year depreciation
WATER PLANT EQUIP	05/15/2002	74.	100.		22.	52.	9.	11.	S/L	MQ			25		2.
WATER PLANT EQUIP	06/15/2002	500.	100.		150.	350.	64.	83.	S/L	MQ			25		19.
WATER PLANT EQUIP	07/15/2002	3,545.	100.		1,064.	2,481.	446.	576.	S/L	MQ			25		130.
WATER PLANT EQUIP	08/15/2002	1,372.	100.		412.	960.	168.	219.	S/L	MQ			25		51.
WATER PLANT EQUIP	09/15/2002	3,330.	100.		999.	2,331.	403.	526.	S/L	MQ			25		123.
WATER PLANT EQUIP	10/15/2002	105.	100.		32.	73.	13.	16.	S/L	MQ			25		3.
WATER PLANT EQUIP	10/15/2002	18,350.	100.			18,350.	8,349.	8,979.	S/L	MQ			25		630.
WATER PLANT EQUIP	11/15/2002	2,625.	100.		788.	1,837.	304.	401.	S/L	MQ			25		97.
WATER PLANT EQUIP	12/15/2002	2,390.	100.		717.	1,673.	274.	362.	S/L	MQ			25		88.
TRUCKS	07/15/2002	21,120.	100.		6,336.	14,784.	13,742.	14,784.	S/L	MQ			5		1,042.
COMPUTER SOFTWARE	01/15/2002	613.	100.		184.	429.	429.	429.	200 DB	MQ			3		
COMPUTER SOFTWARE	10/15/2002	14,202.	100.		4,261.	9,941.	9,941.	9,941.	200 DB	MQ			3		
COMPUTER SOFTWARE	11/15/2002	60,370.	100.		18,111.	42,259.	42,258.	42,258.	200 DB	MQ			3		
COMPUTER SOFTWARE	12/15/2002	40,443.	100.		12,133.	28,310.	28,310.	28,310.	200 DB	MQ			3		
WATER PLANT EQUIP	03/01/2003	6,161.	100.		1,848.	4,313.	663.	884.	S/L	HY			25		221.
WATER PLANT EQUIP	09/01/2003	30,745.	100.		15,373.	15,372.	2,050.	2,857.	S/L	HY			25		807.
WATER PLANT EQUIP	03/01/2003	10,271.	100.		3,081.	7,190.	1,104.	1,473.	S/L	HY			25		369.
WATER PLANT EQUIP	09/01/2003	28,542.	100.		14,271.	14,271.	1,903.	2,653.	S/L	HY			25		750.
TRUCKS	03/01/2003	49,239.	100.		14,772.	34,467.	28,511.	32,482.	S/L	HY			5		3,971.
TRUCKS	09/01/2003	17,453.	100.		8,727.	8,726.	7,217.	8,223.	S/L	HY			5		1,006.
WATER PLANT EQUIP	03/01/2003	20,052.	100.		6,016.	14,036.	2,151.	2,871.	S/L	HY			25		720.
WATER PLANT EQUIP	09/01/2003	50,551.	100.		25,276.	25,275.	3,370.	4,698.	S/L	HY			25		1,328.
WATER PLANT EQUIP	03/01/2003	6,131.	100.		1,839.	4,292.	659.	879.	S/L	HY			25		220.
WATER PLANT EQUIP	09/01/2003	1,797.	100.		899.	898.	120.	167.	S/L	HY			25		47.
WATER PLANT EQUIP	03/01/2003	24,440.	100.		7,332.	17,108.	2,622.	3,500.	S/L	HY			25		878.
WATER PLANT EQUIP	09/01/2003	96,438.	100.		48,219.	48,219.	6,430.	8,963.	S/L	HY			25		2,533.
WATER PLANT EQUIP	09/01/2003	6,658.	100.		3,329.	3,329.	443.	618.	S/L	HY			25		175.
WATER PLANT EQUIP	03/01/2003	780.	100.		234.	546.	84.	112.	S/L	HY			25		28.
WATER PLANT EQUIP	09/01/2003	2,386.	100.		1,193.	1,193.	160.	223.	S/L	HY			25		63.
WATER PLANT EQUIP	09/01/2003	3,759.	100.		1,880.	1,879.	250.	349.	S/L	HY			25		99.
WATER PLANT EQUIP	09/01/2003	465.	100.		233.	232.	30.	42.	S/L	HY			25		12.
WATER PLANT EQUIP	03/01/2003	1,740.	100.		522.	1,218.	188.	250.	S/L	HY			25		62.
WATER PLANT EQUIP	09/01/2003	87,338.	100.		43,669.	43,669.	5,823.	8,117.	S/L	HY			25		2,294.
WATER PLANT EQUIP	03/01/2003	539.	100.		162.	377.	58.	77.	S/L	HY			25		19.
WATER PLANT EQUIP	09/01/2003	566.	100.		283.	283.	37.	52.	S/L	HY			25		15.
WATER PLANT EQUIP	09/01/2003	3,168.	100.		1,584.	1,584.	210.	293.	S/L	HY			25		83.
Less: Retired Assets															
TOTALS															

*Assets Retired

JSA
7C9027 1.000

BLACK MOUNTAIN SEWER COMPANY.

2007 Depreciation

Description of Property

GENERAL DEPRECIATION AND AMORTIZATION

Asset description	Date placed in service	Unadjusted cost or basis	Bus. %	179 exp. reduc. in basis	Basis Reduction	Basis for depreciation	Beginning Accumulated Depreciation	Ending Accumulated Depreciation	Method	Convention	Life	ACRS class	MACRS class	Current-yr 179 expense	Current-year depreciation
WATER PLANT EQUIP	09/01/2003	45,536.	100.		22,768.	22,768.	3,037.	4,233.	S/L	HY			25		1,196.
WATER PLANT EQUIP	09/01/2003	1,100.	100.		550.	550.	73.	102.	S/L	HY			25		29.
WATER PLANT EQUIP	03/01/2003	2,053.	100.		616.	1,437.	219.	293.	S/L	HY			25		74.
WATER PLANT EQUIP	09/01/2003	4,339.	100.		2,170.	2,169.	290.	404.	S/L	HY			25		114.
WATER PLANT EQUIP	09/01/2003	10,814.	100.		5,407.	5,407.	720.	1,004.	S/L	HY			25		284.
FURNITURE & FIXTURES	09/01/2003	111,457.	100.		55,729.	55,728.	38,319.	43,293.	200 DB	HY			7		4,974.
WATER PLANT EQUIP	09/01/2003	3,632.	100.		1,816.	1,816.	243.	338.	S/L	HY			25		95.
FURNITURE & FIXTURES	03/01/2003	33,712.	100.		10,114.	23,598.	16,225.	18,332.	200 DB	HY			7		2,107.
WATER PLANT EQUIP	06/30/2003	24,304.	100.			24,304.	3,867.	5,106.	S/L	HY			25		1,239.
WATER PLANT EQUIP	02/01/2004	3,300.	100.		1,650.	1,650.	193.	276.	S/L	HY			25		83.
WATER PLANT EQUIP	03/01/2004	5,378.	100.		2,689.	2,689.	306.	442.	S/L	HY			25		136.
WATER PLANT EQUIP	03/01/2004	743.	100.		372.	371.	42.	61.	S/L	HY			25		19.
FURNITURE & FIXTURES	06/01/2004	5,272.	100.		2,636.	2,636.	1,484.	1,813.	200 DB	HY			7		329.
WATER PLANT EQUIP	06/01/2004	29,161.	100.		14,581.	14,580.	1,506.	2,253.	S/L	HY			25		747.
WATER PLANT EQUIP	12/01/2004	33,250.	100.		16,625.	16,625.	1,385.	2,256.	S/L	HY			25		871.
WATER PLANT EQUIP	07/01/2004	9,987.	100.		4,994.	4,993.	500.	757.	S/L	HY			25		257.
WATER PLANT EQUIP	10/25/2005	209.	100.			209.	9.	19.	S/L	MQ			25		10.
INFORMATION SYSTEMS	03/01/2005	541.	100.			541.	281.	385.	200 DB	HY			5		104.
INFORMATION SYSTEMS	09/30/2005	924.	100.			924.	481.	658.	200 DB	HY			5		177.
WATER PLANT EQUIP	01/27/2005	95.	100.			95.	7.	11.	S/L	MQ			25		4.
WATER PLANT EQUIP	08/10/2005	540.	100.			540.	31.	58.	S/L	MQ			25		27.
WATER PLANT EQUIP	09/09/2005	4,007.	100.			4,007.	213.	417.	S/L	MQ			25		204.
WATER PLANT EQUIP	10/18/2005	4,305.	100.			4,305.	201.	418.	S/L	MQ			25		217.
WATER PLANT EQUIP	11/28/2005	2,172.	100.			2,172.	94.	204.	S/L	MQ			25		110.
WATER PLANT EQUIP	08/31/2005	19,337.	100.			19,337.	1,031.	2,014.	S/L	MQ			25		983.
WATER PLANT EQUIP	06/08/2005	6,288.	100.			6,288.	399.	719.	S/L	MQ			25		320.
WATER PLANT EQUIP	12/05/2005	66,029.	100.			66,029.	2,861.	6,208.	S/L	MQ			25		3,347.
WATER PLANT EQUIP	01/31/2006	2,265.	100.			2,265.	83.	197.	S/L	MQ			25		114.
WATER PLANT EQUIP	02/28/2006	6,288.	100.			6,288.	210.	528.	S/L	MQ			25		318.
WATER PLANT EQUIP	03/31/2006	5,670.	100.			5,670.	170.	458.	S/L	MQ			25		288.
WATER PLANT EQUIP	03/31/2006	1,248.	100.			1,248.	37.	100.	S/L	MQ			25		63.
WATER PLANT EQUIP	04/28/2006	5,761.	100.			5,761.	154.	443.	S/L	MQ			25		289.
WATER PLANT EQUIP	04/30/2006	25,000.	100.			25,000.	667.	1,923.	S/L	MQ			25		1,256.
WATER PLANT EQUIP	05/31/2006	1,045.	100.			1,045.	24.	77.	S/L	MQ			25		53.
WATER PLANT EQUIP	05/31/2006	6,978.	100.			6,978.	163.	515.	S/L	MQ			25		352.
WATER PLANT EQUIP	06/02/2006	260.	100.			260.	6.	19.	S/L	MQ			25		13.
Less: Retired Assets															
TOTALS															

*Assets Retired

JSA
7C9027 1.000

BLACK MOUNTAIN SEWER COMPANY.

2007 Depreciation

Description of Property

GENERAL DEPRECIATION AND AMORTIZATION

Asset description	Date placed in service	Unadjusted cost or basis	Bus. %	179 exp. reduc. in basis	Basis Reduction	Basis for depreciation	Beginning Accumulated Depreciation	Ending Accumulated Depreciation	Method	Convention	Life	ACRS class	MACRS class	Current-yr 179 expense	Current-year depreciation
WATER PLANT EQUIP	07/31/2006	3,029.	100.			3,029.	50.	202.	S/L	MQ			25		152.
WATER PLANT EQUIP	07/31/2006	15,640.	100.			15,640.	261.	1,045.	S/L	MQ			25		784.
WATER PLANT EQUIP	07/31/2006	687.	100.			687.	11.	45.	S/L	MQ			25		34.
WATER PLANT EQUIP	08/16/2006	3,268.	100.			3,268.	44.	208.	S/L	MQ			25		164.
WATER PLANT EQUIP	08/31/2006	4,246.	100.			4,246.	57.	270.	S/L	MQ			25		213.
WATER PLANT EQUIP	08/31/2006	11,498.	100.			11,498.	153.	731.	S/L	MQ			25		578.
WATER PLANT EQUIP	09/15/2006	2,535.	100.			2,535.	34.	161.	S/L	MQ			25		127.
WATER PLANT EQUIP	09/30/2006	7,357.	100.			7,357.	74.	445.	S/L	MQ			25		371.
WATER PLANT EQUIP	09/30/2006	29,000.	100.			29,000.	290.	1,753.	S/L	MQ			25		1,463.
WATER PLANT EQUIP	10/31/2006	2,263.	100.			2,263.	15.	127.	S/L	MQ			25		112.
WATER PLANT EQUIP	10/31/2006	2,902.	100.			2,902.	19.	163.	S/L	MQ			25		144.
WATER PLANT EQUIP	10/31/2006	2,918.	100.			2,918.	19.	164.	S/L	MQ			25		145.
WATER PLANT EQUIP	10/31/2006	3,625.	100.			3,625.	24.	205.	S/L	MQ			25		181.
WATER PLANT EQUIP	11/30/2006	389.	100.			389.	1.	20.	S/L	MQ			25		19.
WATER PLANT EQUIP	11/30/2006	833,367.	100.			833,367.	2,778.	44,569.	S/L	MQ			25		41,791.
WATER PLANT EQUIP	12/31/2006	10,039.	100.			10,039.	1.	506.	S/L	MQ			25		505.
WATER PLANT EQUIP	12/31/2006	155.	100.			155.	1.	9.	S/L	MQ			25		8.
WATER PLANT EQUIP	12/31/2006	2,141.	100.			2,141.	1.	108.	S/L	MQ			25		107.
WATER PLANT EQUIP	06/30/2006	486,294.	100.			486,294.	9,726.	34,323.	S/L	MQ			25		24,597.
WATER PLANT EQUIP	02/28/2007	7,514.	100.			7,514.		329.	S/L	MQ			25		329.
FURNITURE & FIXTURES	02/28/2007	2,763.	100.			2,763.		691.	200 DB	MQ			7		691.
WATER PLANT EQUIP	03/31/2007	90.	100.			90.		4.	S/L	MQ			25		4.
WATER PLANT EQUIP	05/31/2007	488.	100.			488.		15.	S/L	MQ			25		15.
WATER PLANT EQUIP	06/30/2007	94.	100.			94.		3.	S/L	MQ			25		3.
WATER PLANT EQUIP	07/31/2007	131.	100.			131.		2.	S/L	MQ			25		2.
WATER PLANT EQUIP	08/31/2007	563.	100.			563.		11.	S/L	MQ			25		11.
WATER PLANT EQUIP	09/30/2007	38.	100.			38.		1.	S/L	MQ			25		1.
WATER PLANT EQUIP	12/31/2007	225,115.	100.			225,115.		1,407.	S/L	MQ			25		1,407.
Less: Retired Assets															
TOTALS		5,671,344.			389,649.	5,281,695.	2,622,731.	2,871,906.							249,175.

*Assets Retired

JSA
7C9027 1.000

BLACK MOUNTAIN SEWER COMPANY.

2007 Depreciation

Description of Property

GENERAL DEPRECIATION AND AMORTIZATION - GRAND TOTAL PROPERTY DETAIL

Asset description	Date placed in service	Unadjusted cost or basis	Bus. %	179 exp. reduc. in basis	Basis Reduction	Basis for depreciation	Beginning Accumulated Depreciation	Ending Accumulated Depreciation	Method	Convention	Life	ACRS class	MACRS class	Current-yr 179 expense	Current-year depreciation
OTHER THAN LISTED PROPERTY															
GROSS		5,671,344.			389,649.	5,281,695.	2,622,731.	2,871,906.							249,175.
LESS: RETIRED ASSETS															
CURRENT YEAR SPECIAL	DEPRECIATION	ALLOWANCE													
SUB TOTAL:		5,671,344.			389,649.	5,281,695.	2,622,731.	2,871,906.							249,175.
GROSS AMOUNTS		5,671,344.			389,649.	5,281,695.	2,622,731.	2,871,906.							249,175.
Less: Retired Assets															
TOTALS		5,671,344.			389,649.	5,281,695.	2,622,731.	2,871,906.							249,175.

*Assets Retired

JSA
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86-0380053

TAX VALUE @ DEC 31 '07 = 5,281,695 - 2,871,906 = 2,409,789

ORIGINAL

RECEIVED

2009 JUL 20 P 4: 10

AZ CORP COMMISSION
DOCKET CONTROL

EXHIBIT
DOELLE-1
ADMITTED

Dennis E. Doelle, D.D.S
7223 E. Carefree Drive
P. O. Box 2506
Carefree, Arizona 85377

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	)	DOCKET NO: SW-02361A-08-0609 INTERVENOR'S TESTIMONY AND EXHIBITS

Arizona Corporation Commission
DOCKETED
JUL 20 2009
DOCKETED BY

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INTRODUCTION AND QUALIFICATIONS

I am an owner of a commercial office building located at 7223 E. Carefree Drive in Carefree, Arizona. I am a health care provider who has practiced general dentistry at this location for the past 30 years. During that time I have been a customer of the Black Mountain Sewer Corporation ("BMSC" or "the Company") which was previously named Boulders Carefree Sewer Corporation ("the Company").

I am interested in this application for a rate increase because of my experience with the ramifications of a prior rate increase by the Company that significantly impacted my business. After the approval of a rate increase for the Company in 1995, my utility rate increased over 300 percent. I conducted exhaustive research and investigation at that time into the methods used by the Company to classify their customers as a means of determining rates.

I have a genuine concern with the specific methodology proposed in this rate application to determine and calculate new commercial sewer rates.

HISTORICAL PERSPECTIVE AND RESEARCH

In November 1996, I filed a complaint with the Arizona Corporation Commission. This was followed by an amended complaint, as I gathered additional information, in January 1997. These complaints addressed discrimination in classification of customers and the application of rate increases based on inaccuracies in engineering bulletin tables. That complaint resulted in Decision #60258 in 1997 which provided for a reclassification of my business.

Upon researching the basis for determining new commercial rates that became effective in September 1995, I became aware of Engineering Bulletin #12 published by the Arizona Department of Environmental Quality in June 1989. This is the same publication that BMSC is proposing be used to determine new commercial rates in 2009.[1]

I was able, in 1996, to contact the original authors, Prabnat Bhargava and James Walters, who were responsible for drafting that publication. From them I obtained affidavits explaining the intent of the publication and why it would not apply to the specific nature of my business. I also contacted the Arizona Department of Environmental Quality to determine an up to date assessment of the Engineering Bulletin #12. I received correspondence from ADEQ that confirms and supports the opinion of the authors of Engineering Bulletin #12.

Since learning of this new rate increase application by BMSC, I have conducted additional ongoing inquiry into the status of Bulletin #12 and other methods used by waste management companies to determine and calculate rates for their customers.

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[1]Testimony of Thomas J. Bourassa, page 16, footnote #4.

PROBLEMS WITH CLASSIFICATION OF CUSTOMERS USING ARBITRARY TABLES

The BMSC is citing a prior commission order, and proposes, as part of the rate increase application, the classification of commercial customers based on the same document used in the 1995 rate increase, Engineering Bulletin #12. (ADEQ June, 1989). This bulletin provides a breakdown of certain types of commercial establishments.

The problems with using Engineering Bulletin #12 to classify commercial customers are:

- The table in Bulletin #12 does not cover every type of commercial establishment and omits many common establishments. Included in these omissions are banks and brokerage firms, pharmacies, health clubs and spas, coffee shops, health clinics and most professional service providers (physicians, chiropractors, veterinarians, accountants, tax preparers, lawyers, optometrists).
- A classification system for customers based on incomplete tables of establishments has the potential to suggest the appearance of discrimination among customers by not having the majority of the customer base included.
- In the past, if a customer class was not included on Engineering Bulletin #12, the company would create their own new classification with often "special" rates. These "special" rates invite complaints and protests arguing the merits and validity of class distinctions.
- Customers classified by tables such as Engineering Bulletin #12 may not possess the characteristics intended by the original creators of the ADEQ classifications. Technology and water generating systems are constantly being created and improved to significantly conserve the use of water by businesses. There is no better example of this than the evolution of new dental delivery systems that have dramatically decreased water usage.

PROBLEMS WITH DETERMINING SEWER RATES FROM ARBITRARY TABLES OF ESTIMATED WATER USE.

The BMSC, in this application for a rate increase is citing a prior commission order that they imply authorizes them to use ADEQ Bulletin #12 to determine gallons of water used by various classes of commercial customers.

The problems with ADEQ Bulletin #12 to estimate wastewater discharge are:

- The document itself is now 20 years old and contains data compiled from the 1980's.
- ADEQ Bulletin #12 has information that was not adjusted for and has not considered updates in technology and delivery systems. For example, dental offices prior to the 1980's had cuspidors that emitted a constant stream of water into a basin next to the patient chair. Most dental offices as we enter the year 2010 have no cuspidors and use less than 1 gallon of water per chair per day. A more universal example are the many restaurants and coffee houses now organized around take out and drive thru operations. Are the number of seats in those facilities the best measure of water usage?
- ADEQ Bulletin #12 does not take into consideration water conservation efforts and low flow devices that have much more appeal and universal application than they did in the 1980's.
- Using ADEQ Bulletin #12 for estimating wastewater discharge is a mis-application of the original intent of that document. ADEQ Bulletin #12 was not written and was never intended to be used for estimating discharges into a commercial sewer system. The complete title of the Bulletin is Minimum Requirements for the Design and Installation of Septic Tank Disposal Systems. I was informed 13 years ago in correspondence from the Arizona Department of Environmental Quality that "the higher discharge rates that appear in these tables are developed for design purposes

and can not be used for estimating discharge rates from a single facility".[2] The author of that correspondence, Lauren Evans, was involved in a complete revision of Engineering Bulletin #12 at the time of her writing. It was to be replaced by a series of four bulletins, all of which were being developed for the design of on-site septic systems[3]

- Finally, Bulletin #12 omits the most logical, prudent, factual, readily available alternative to estimating water usage by various customers.....**actual water use** data. Small communities throughout the state of Arizona commonly use this methodology. It is not unusual for small communities to be served by separate, independent water and sewer companies. The water company furnishes water use data to the sewer company which uses various formulas to calculate rates.

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[2]Correspondence from Lauren Evans (ADEQ) dated August 30, 1996.
[3]Special Notice to Users of ADEQ Engineering Bulletin #12: Update on Revision of Bulletin #12 by Lauren Evans November 30, 1995.

SUMMARY

1. BMSC and the Arizona Corporation Commission must consider a more rational system and basis for rate determinations than Engineering Bulletin #12.
2. BMSC should base rate determinations on a percentage of actual water use from data obtained from municipal water companies, a recognized standard utility protocol.
3. BMSC should have a rate structure that recognizes and includes efforts of its customers to conserve water. This would be reflected in water use data of businesses that have incorporated water conservation measures.

In 1997, the Commission as a part of the opinion and order for Decision #60258, that was approved by all of the Commissioners, stated "As a result of this case, it is obvious that Engineering Bulletin Number 12 may need to be updated". Perhaps it is time, now in 2009, that the more logical, factual, readily available and customary method for estimating water use be considered.

engineering bulletin no. 12

Minimum Requirements for the Design and Installation of Septic Tank Systems and Alternative On-site Disposal Systems

June 1989

ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY

ACKNOWLEDGEMENTS

This bulletin was prepared primarily through the efforts of Messrs. Prabhat Bhargava and James Walters, environmental engineers on the staff of the Arizona Department of Environmental Quality. Other staff members who assisted in the development of this document were Jerry A. Breckenridge, Kathleen Carson, Debra L. Daniel, David Effert, James A. Maston, Charles E. Ohr, and Gary M. Ullinskey. The concepts, perspectives and approaches described in this document also reflect the views of a select advisory committee which was formed for the purpose of providing guidance and assistance to the Department in its effort to revise Engineering Bulletin No. 12, Guidelines for Installation of Septic Tank Systems. The advisory committee consisted of:

. Mike Block, Hydrologist, Pima Association of Governments
. Richard Broman, City of Apache Junction
. Bob Johnson, Pima County Planning and Development Services
. Fred May, Maricopa Association of Governments
. Richard McComb, City of El Mirage
. Dr. E. L. McFarlane, Keep Sedona Beautiful
. Dick Mettler, Home Builders Association
. Ken Ricker, Soil Specialist, Thomas-Hardig and Associates
. David Shephard, Sanitary Engineer
. Dale Smith, A Septic Tank Manufacturer
. Dr. Paul Trotta, Associate Professor, Northern Arizona University

We would also like to thank all the County Health Departments for their participation in development of this bulletin. Its preparation would have been impossible without their advice.

Finally, we would like to thank Dr. Ronald L. Miller and Lyndon Hammon for reviewing this document, Joe Drosendahl for providing graphics and Diana Kowalski and Cecilia Vela for their expertise in the typescript.

AFFIDAVIT OF JAMES A. WALTERS

STATE OF ARIZONA)
) ss.
County of Maricopa)

Before me, this 26 day of February, 1997, appeared James A. Walters, P.E., who after being duly sworn, deposed and said:

1. I am James A. Walters. I am a licensed professional engineer in the State of Arizona and am currently employed by the Arizona Department of Environmental Quality ("ADEQ") as a Hazardous Waste Permits Engineer. I have been employed by ADEQ continuously since 1987.

2. I earned a Bachelor's Degree in Chemical Engineering from ASU in 1968 and a Master's Degree in Chemical Engineering from ASU in 1969. I earned a Master's Degree in Environmental Engineering from USC in 1973.

3. While employed by ADEQ as an Environmental Engineer, I helped rewrite and revise Engineering Bulletin 12, at that time entitled "Guidelines for Installation of Septic Tank Systems," dated May, 1976 ("Bulletin No. 12, May 1976").

4. The revision of Bulletin No. 12, May 1976, that I participated in preparing was published by ADEQ in 1989 and entitled, "Engineering Bulletin No. 12, Minimum Requirements for the Design and Installation of Septic Tank Systems and Alternative On-Site Disposal Systems," dated June 1989 ("Bulletin No. 12, June 1989"). My name is shown in the page of Acknowledgments at Page "v" as one of the engineers primarily responsible for the rewrite which ADEQ issued as Bulletin No. 12, June 1989.

5. As part of my personal efforts in preparing Bulletin No. 12, June 1989, I helped prepare and review Table 1 on page 8, entitled, "Average Daily Sewage Flow" ("Table 1"), and am familiar with the meanings intended by the drafters of the words used in Table 1.

6. The purpose of Table 1 was to classify various businesses according to the anticipated maximum waste water and sewage flow quantities per day so that septic systems would be designed to handle those flows, called "hydraulic loadings." As one of the drafters, I participated in classifying the businesses shown on Table 1 and am familiar with the basis for those classifications.

7. Table 1 of Bulletin No. 12, June 1989, contained a reference to dental offices: "Dental office (chair)." In drafting Table 1, I understood the term "chair" to refer not to any kind of chair, but only to the patient chairs (like the ones that I had seen in my dentist's office). Those patient chairs had attached basins that provided a continuous stream of water

to wash the basin clean after the patient spit into the basin during the cleaning or repair of his or her teeth. The stream of water in the basin flowed continuously during the workday whether or not a patient was actually in the chair at the time. In drafting Table 1 of Bulletin No. 12, June 1989, my colleagues who participated in the drafting of Table 1 and I approved such a high hydraulic loading for the dental patient chairs (500 gallons per unit per day) because we intended that septic systems be designed with enough capacity to handle the continuous flows of waste water generated by the continuous flows of water in the basins attached to the patient chairs and the sinks and toilets. I believe that these basins are called "cuspidors," but I am not sure as I am not a health care professional. The hydraulic loading of 500 gallons per chair per day represented an effort on the part of the drafters of Bulletin No. 12 to quantify the probable hydraulic loading generated to the septic system by the continuous flows of water from these basins attached to the patient chairs in a dental office.

8. But for my understanding that the basins attached to the patent chairs in dental offices flowed continuously for the entire work day, I would not have approved the incorporation of the classification of dental offices with such a high hydraulic loading in the drafting of Table 1 of Bulletin No. 12, June 1989.

Further affiant saith naught.

James A. Walters

SWORN TO and subscribed before me this 26th day of February, 1997.

Kathleen DuFrain
Notary Public

My Commission Expires: 3-18-99

OFFICIAL SEAL
KATHLEEN DuFRAIN
Notary Public - State of Arizona
MARICOPA COUNTY
My Comm. Expires March 18, 1999

Doc. # 10959

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2009 SEP 18 P 12: 26

AZ CORP COMMISSION
DOCKET CONTROL

Dennis E. Doelle, D.D.S
7223 E. Carefree Drive
P. O. Box 2506
Carefree, Arizona 85377

EXHIBIT
DOELLE-2
ADMITTED

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	)	DOCKET NO: SW-02361A-08-0609 EXPANDED INTERVENOR'S TESTIMONY AND EXHIBITS

DIRECT TESTIMONY OF

DENNIS E. DOELLE, D. D. S.

SEPTEMBER 18, 2009

Arizona Corporation Commission
DOCKETED
SEP 18 2009
DOCKETED BY

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Dennis E. Doelle. My business address is 7223 E. Carefree Drive, Carefree, Arizona 85377.

Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?

A. I am a dentist licensed in the State of Arizona. I own the building in which I have had a practice of General Dentistry for the past 30 years.

Q. WHAT IS YOUR RELATIONSHIP WITH THE BLACK MOUNTAIN SEWER CORPORATION?

A. I have been a commercial customer of the Black Mountain Sewer Company (BMSC), which was previously named Boulders Carefree Sewer Corporation, since 1979.

Q. WHY ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I have concerns regarding the specific methodology proposed to determine rates and classify commercial customers.

Q. WHAT ARE YOUR PARTICULAR CONCERNS ABOUT THE RATE DETERMINATION METHODOLOGY AND CLASSIFICATION OF CUSTOMERS?

A. This proposed application for a rate increase lacks a rational basis for the determination of rates. It also fails to accurately classify all commercial customers and provides outdated, innaccurate data for some of those it does classify.

II. HISTORICAL BASIS FOR TESTIMONY

Q. HAVE YOU PROVIDED PRIOR TESTIMONY RELATED TO THIS OR PREVIOUS RATE INCREASES OF THE BMSC?

A. Yes, on several occasions.

Q. WHEN DID YOU FIRST BECOME INVOLVED WITH BMSC RATE INCREASES AND HOW WERE YOU INVOLVED?

A. In 1996 I filed a formal complaint with the Arizona Corporation Commission (AZCC).

Q. WHAT WAS THE NATURE OF YOUR FORMAL COMPLAINT?

A. My complaint addressed the improper classification of my business and inaccuracies in the bulletin used to determine sewer rates.

Q. WHAT WAS DECIDED AS A RESULT OF YOUR COMPLAINT?

A. A Hearing was eventually scheduled that resulted in AZCC Decision #60258 (March 1997).

Q. WHAT DIFFERENCE, IF ANY, IS THERE BETWEEN YOUR FORMAL COMPLAINT AND YOUR CONCERNS WITH THIS APPLICATION FOR A RATE INCREASE?

A. In 1996 the rate structure and methodology for determining rates had already been approved by the Commission. This application which proposes the same methodology for determining rates, has not been approved by the Commission.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY ON THIS NEW APPLICATION FOR A RATE INCREASE?

A. Yes. On July 20, 2009 I filed preliminary testimony that addressed problems created by using arbitrary tables and specifically Engineering Bulletin #12 to determine rates and classify commercial customers.

Q. HAS BULLETIN #12 BEEN QUESTIONED BY THE COMMISSION IN THE PAST?

A. Yes. As I reviewed in my preliminary testimony, the Commission as a part of the opinion and order of Decision #60258 stated "As a result of this case, it is obvious that Engineering Bulletin #12 may need to be updated."[1]

[1]page 2, line 24

III. BULLETIN #12: AN IRRATIONAL BASIS FOR DETERMINING RATES?

Q. CAN YOU ELABORATE FURTHER ON SPECIFICALLY HOW ENGINEERING BULLETIN #12 CREATES A PROBLEM WHEN IT IS USED AS A MEANS OF CLASSIFYING YOUR BUSINESS?

A. Engineering Bulletin #12 provides an estimate of sewage flow for a "dental office" of 500 gallons per each dental chair per day. My dental office has never possessed the characteristics intended by the original drafters of Bulletin #12. If the estimated sewage flow from Bulletin #12 was accurate for my office, the estimated water delivered to my office and potentially released to the sewer system would easily exceed 60,000 gallons every month.

Q. IS THE WATER DELIVERED TO YOUR OFFICE METERED AND IF SO WHAT AMOUNT OF WATER IS DELIVERED TO YOUR OFFICE ON A MONTHLY BASIS?

A. It varies depending on primarily landscaping demands. My most recent available water usage figure supplied by the Carefree Water Company for the month of August 2009 was 11,650 gallons.

Q. HOW DOES THIS WATER USAGE COMPARE TO OTHER MONTHS?

A. It is somewhat higher because of summer landscaping demands for irrigation.

Q. WHAT PERCENTAGE OF WATER DELIVERED TO YOUR BUILDING DO YOU ESTIMATE TO BE ALLOCATED TO LANDSCAPE IRRIGATION?

A. Approximately 40%.

Q. HOW DO YOU ACCOUNT FOR THE EXTREME DIFFERENCE BETWEEN THE AMOUNT OF NON-LANDSCAPING WATER THAT IS SUPPLIED TO YOUR BUILDING AND THE ESTIMATED WATER USAGE FIGURES IN ENGINEERING BULLETIN #12?

A. This was the basis of my Formal Complaint to the Commission in 1996 in which I argued my office does not have the characteristics that were intended by the engineers that wrote the Bulletin in the 1970's.

Q. ARE THERE ANY DENTAL OFFICES TODAY THAT WOULD POSSESS THE CHARACTERISTICS OF THE "DENTAL OFFICE" CATEGORY INTENDED BY BULLETIN #12?

A. Only if they still had continuously running water cuspidors (sink basins next to dental chairs which were popular prior to 1975.)

IV. TREND TOWARD MORE RATIONAL DETERMINATION OF RATES

Q. WHAT ONGOING RESEARCH HAVE YOU BEEN CONDUCTING SINCE YOU FILED YOUR PRELIMINARY TESTIMONY?

A. I have been contacting other wastewater companies throughout Arizona to assess rate determination methods and trends.

Q. HAVE YOU FOUND ANY COMPANIES THAT ARE STILL USING ENGINEERING BULLETIN #12 (1989) TO CLASSIFY CUSTOMERS AND DETERMINE RATES?

A. No. If there are other companies using the Bulletin #12, I have not found them yet.

Q. WHAT ARE THE RESULTS OF YOUR SURVEY AS OF THIS TIME?

A. The majority of utilities are using actual water usage figures for some or all of their rate computation process. At least one company, the City of Casa Grande, is in the process of proposing conversion of all customers from partial water usage computations to only water usage,[2] now that water usage figures are more readily available. In many cases, smaller water companies, such as the Green Valley Water District, supplies water usage figures to the sewer utility, Pima County Wastewater Department, for computation of wastewater rates.

Q. WHAT IS THE ATTRACTION OF USING ACTUAL WATER USAGE FIGURES?

A. It is the most rational basis for determining rates since there is a correlation between water usage and wastewater discharge.

---

[2]Information from: Diane Archer, finance director, City of Casa Grande Sewer/Trash.

V. SUMMARY

Q. WHAT IS YOUR UNDERSTANDING OF WHY THE BMSC IS PROPOSING THE USE OF ENGINEERING BULLETIN #12 TO CLASSIFY COMMERCIAL CUSTOMERS AND DETERMINE RATE STRUCTURES?

A. Per the direct testimony of Thomas J. Bourassa (December 19, 2008) "Per prior Commission order, wastewater flows are based on Engineering Bulletin No. 12, Table 1." [3] No reference is provided to cite the Commission order that previously requested the use of that publication.

Q. WHAT DIRECTION DO YOU CONSIDER THIS APPLICATION FOR A RATE INCREASE SHOULD MOVE?

A. The same direction that many other utilities are moving, toward a more rational basis for the determination of sewer rates.

---

[3]Direct Testimony of Thomas Bourassa page 15, lines 25, 26

CAREFREE WATER COMPANY
P.O. Box 702
Carefree, Arizona 85377
(480) 488-9100

BILLING DATE	ACCOUNT NUMBER
08/31/2009	3495
PAST DUE DATE	**AMOUNT DUE**
09/23/2009	79.63

AMOUNT PAID _____

DENNIS DOELLE
P.O. BOX 2506
CAREFREE, AZ 85377-

EMAIL ADDRESS _____and/or address/phone update. Thank you.

PLEASE CUT AND INCLUDE THE ABOVE STUB WITH PAYMENT. KEEP THE BOTTOM PORTION FOR YOUR RECORDS.

DESCRIPTION	METER READINGS PRESENT	PREVIOUS	GALLONS USED	AMOUNT
Meter Reading *	1120850	1109200	11650	
Base Charge for WR1				36.05
Tier 1: Usage $2.83 per 1000 first 8000				22.64
Tier 2: Usage $3.86 per 1000 from 8001 to 20000				14.09
Tier 3:				
Tier 4:				
Tier 5:				
Late, Set-up and/or Misc. Fees				
Tax 9.3% (State Water Usage Tax .0065/1000 gals. included in total)				6.85
Previous Unpaid Balance				

Due Upon Receipt - Delinquent After 09/23/2009

TOTAL DUE $ 79.63

CUSTOMER	BILLING PERIOD
DOELLE, DENNIS	07/29/09 - 08/26/09

SERVICE ADDRESS	ACCOUNT NUMBER	BILLING DATE
7223 CAREFREE DR	3495	08/31/2009

ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY

Fife Symington, Governor Russell F. Rhoades, Director

August 30, 1996 DA96:036

Dr. Dennis E. Doelle
P.O. Box 2506
Carefree, AZ 85377

RE: Wastewater Discharge from Dentist's Chairs in Bulletin No. 12.; Estimating Wastewater Discharges from Dentist's Offices

Dear Dr. Doelle:

This letter is to answer your question regarding the average daily discharge of wastewater from a dentist's office based on the number of dentists chairs installed, and how to estimate the discharge from a dentist's office. I will also attempt to answer your question regarding the application of ADEQ's Bulletin No. 12.

First, the only logically and factually correct way to estimate the wastewater flow discharge rates from your dentist's office would be to total the gallons of water delivered to your business as shown on your water bills for the last 12 months and divide that number by 12. This will give you the total maximum average amount of water used per month and also give you the total *maximum* wastewater your office would discharge per month. The actual monthly average would be less if you are using some of you water for landscape irrigation.

In regards to the 500 gallons per day per dentist chair wastewater discharge you referenced in Engineering Bulletin No. 12, *Minimum Requirements for the Design and Installation of Septic Tanks Systems and Alternative On-Site Disposal Systems*, that figure can not be applied to your office discharge for several reasons. I will try to explain below.

The first and the most obvious reason is that Bulletin No. 12 only applies to those households and small businesses that are connected to an on-site wastewater system. Since you discharge to a sewer, Bulletin No. 12 does not apply to you. Applying Bulletin No. 12 to your situation would be a mis-application of the bulletin.

Secondly, some of the discharges and sizing calculations in Bulletin No. 12 have been based on artificially inflated figures and built in safety factors for wastewater discharge amounts in an effort to prevent the failure of on-site systems. When the on-site systems are over designed based on the higher discharge rates, there is less of a chance of the system and drain field failing due to hydraulic overloading. These sizing calculations are not based on average discharge rates, rather they are based on the higher-end producers of

wastewater with the goal of covering about 95% of the population. In other words when dealing with on-site systems, the goal of the regulatory agency developing design standards is to cover as much of the population as possible while balancing the costs of the systems and protecting public health and the environment. This is a valid and justifiable goal because if the discharge rates that appeared in these tables were based on average discharge rates then 50% of the systems would be under designed and a 50% failure rate would be expected. This could never be acceptable based on the potential threat to public health. So as you can see, the higher discharge rates that appear in these tables are developed for design purposes and can not be used for estimating discharge rates from a single facility.

The third reason is that Bulletin No. 12 is being re-written because of some existing technical problems within the document itself. One problem worth noting is that in some areas the increases in wastewater flows and sizing requirements are not realistic because they have become too conservative (too large a factor of safety) resulting in undue expense to the public. Therefore all of these calculations and tables are being re-checked and in some instances being down-sized to a more realistic number.

Whether or not the 500 gallons per day per chair of wastewater is accurate or not is not really relevant to your situation because Bulletin No. 12 does not apply to you. However, one of the reasons that I am re-writing Bulletin No. 12 is that there are problems with the implementation of the bulletin due to the conflicts and inconsistencies it has with local codes, such as the plumbing code. The on-site, private sewage disposal system appendix within the 1994 Plumbing Code ™ does not specifically address the discharge from dentists' offices. The only reference I could find is in Table 7-3. It assigns a fixture unit rate of 1 for dental units or cuspidors. This means that for these units it is assumed that they can discharge up to 7.5 gallons per minute. This is important in regards to sizing the waste piping so that it can handle all of the potential fixtures that could discharge at any one time. It really does not tell me what the total discharge per day is in gallons for a dentist's chair. The discharge amount depends on how long the fixture is left on during a 24-hour period. But if you do not have cuspidors in your dental office then this fixture unit size would not apply.

Another reason that there are problems with the discharge rates within the tables in Bulletin No. 12 is that the figures do not represent the water conservation or low flow devices. This "credit" is usually calculated separately and applied to the facility during the final plan review just prior to approving an on-site wastewater system design. But again I state that these tables would not apply to you since they are to be used when designing on-site wastewater systems.

Again, to determine your wastewater discharge you should assume you can not discharge any more in gallons than the amount of water that is delivered to the office. I suggest that you calculate your wastewater discharge amounts based on you water delivery amounts recorded in your water bills.

I hope I have answered your questions. I could not address the issue of fee rates since I do not understand what the relationship could be between the tables in Bulletin No. 12 and fee rate structures for facilities discharging to sewers. Please feel free to contact me at 602-207-4534 if you have any other questions or if I can be further service.

Sincerely,

Lauren G. Evans

Lauren G. Evans, Hydrologist IV
Water Quality Division

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2009 NOV -9 P 4: 48

AZ CORP COMMISSION
DOCKET CONTROL

Dennis E. Doelle, D.D.S
7223 E. Carefree Drive
P. O. Box 2506
Carefree, Arizona 85377

EXHIBIT
DOELLE-3
ADMITTED

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	)	DOCKET NO: SW-02361A-08-0609 SURREBUTTAL TESTIMONY

DIRECT TESTIMONY OF

DENNIS E. DOELLE, D. D. S.

NOVEMBER 9, 2009

Arizona Corporation Commission
DOCKETED
NOV - 9 2009
DOCKETED BY

Q. HAVE YOU REVIEWED THE REBUTTAL TESTIMONIES OF MR. SORENSEN AND MR. BOURASSA?

A. Yes, I have.

Q. WHAT IS YOUR RESPONSE TO THE RATE DESIGN AND RELIEF YOU ARE SEEKING FROM THIS PROCEEDING?

A. My position on the rate design for commercial customers of the BMSC is the same now as it was in 1996 when I filed a complaint with the Commission. A rate design that uses ADEQ Engineering Bulletin No. 12 presents a significant problem when it is applied to the modern day dental profession.

Q. SPECIFICALLY, WHAT IS THE PROBLEM WITH *BULLETIN* NO. 12?

A. As I have argued in every filing before the Commission for the past 14 years, Bulletin No. 12 is obsolete relative to the modern dental office. Technological advances in my profession have eliminated the extreme potential water flows that were envisioned when the original version of Bulletin No. 12 was written in the 1970's. This argument has been supported in my previous testimonies with affidavits and correspondence from ADEQ Engineers who were involved with drafting and revising Bulletin No. 12.[1]

Q. WHAT TECHNOLOGICAL CHANGES HAVE RESULTED IN A DECREASE IN WATER USAGE IN DENTAL OFFICES?

A. There are many with the greatest impact resulting from the elimination of water circulating dental chair cuspidors. Other contributions include conversion from x-ray processing tanks to digital radiography and hand washing between patients replaced by disposable gloves and waterless sanitizers.

Q. WHY HAVEN'T OTHER DENTISTS COMPLAINED ABOUT *BULLETIN* NO. 12?

A. To my knowledge, there may only be one or possibly two other dentists in the BMSC service area. Both of these dental offices are in leased space with the sewer bills being the responsibility of their landlord. I suspect they are unaware of the impact that Bulletin No. 12 has on their sewer rates.

Q. BASED ON THE TESTIMONY OF MR. SORENSEN, DO YOU THINK THE BMSC UNDERSTANDS THAT BILLING YOUR BUSINESS BASED ON WATER FLOWS FROM BULLETIN NO. 12 IS UNREASONABLE AND NEEDS TO BE RECONSIDERED?

A. The company stops short of addressing that but they seem to imply it when they suggest the Commission may want to consider "some special relief" for my situation.[2]

Q. WHAT IS YOUR UNDERSTANDING OF HOW BMSC INTENDS TO BILL YOU IN THE ABSENCE OF RELIEF FROM THE COMMISSION?

A. They intend to bill me "like every other commercial customer-estimated flows would be determined by Bulletin No. 12."[3]

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[1]Doelle Testimonies, July 20, 2009 and September 18, 2009 (Exhibits)
[2]Sorensen Rebuttal page 6
[3]Sorensen Rebuttal page 6

Q. WHAT WOULD THIS TRANSLATE TO AS FAR AS YOUR FUTURE SEWER BILLS?

A. Water flows exceeding thousands of gallons for every day will be used to determine my rates when I have demonstrated that in actuality my dental chairs are supplied with no more than one gallon per week from a closed bottle water system.[4]

Q. WHAT IS YOUR UNDERSTANDING OF THE OBLIGATION OF THE COMMISSION IN THIS PROCEEDING?

A. It is my understanding that the Arizona Corporation Commission's power to prescribe utility rates is confined to the power to prescribe only such rates as are "just and reasonable." (Arizona Constitution, Article 15, Section 3). I also understand that parties aggrieved by an order of the AZCC involving a public service company related to rate design may appeal directly to the court of appeals to vacate, or remand the ACC's rate. (A.R.S. 40-254.01 (A), *Ariz.-Am Water Co. v. Ariz. Corp. Comm'n,* 209 Ariz. 189, 191, 98 P.2d 624, 626 (App. 2004)).

Q. IS BULLETIN NO. 12 A "JUST AND REASONABLE" RATE DESIGN WHEN APPLIED TO YOUR DENTAL OFFICE?

A. While Engineering Bulletin No. 12 might still be a reasonable basis for determining rates for some commercial customers, it is no longer applicable to a modern dental office. Bulletin No. 12 is not reflective of current dental practices and it is therefore unreasonable to use Bulletin No. 12 to determine my rates.

Q. WHAT ABOUT BMSC SUGGESTION OF AFFORDING SOME FORM OF SPECIAL RELIEF FOR YOU?

A. The BMSC does not oppose a special rate so long as there is not a negative impact on revenue or rate of return. I do not oppose relief from the Commission so long as the special relief is based on a reasonable and rational rate design.

Q. IS IT REASONABLE FOR THE COMMISSION TO PROVIDE SPECIAL RELIEF TO YOU?

A. The Commission is authorized by the constitution to provide "just and reasonable" classifications and should exercise that authority in this case. In the past, the Commission has allowed 14 such special rates for BMSC commercial customers. The rate determined and approved for me as a part of Decision No. 60258 (1997) is but one of those special rates.

Q. WHAT WOULD BE THE IMPACT ON THE REVENUE OR RATE OF RETURN FOR THE COMPANY?

A. It should be minimal since I am the only customer, as previously stated, that has been affected and/or complained about the impact of Bulletin No. 12.

Q. WHAT RATE DESIGN WOULD BE ACCEPTABLE TO YOU?

A. It must have a reasonable and rational basis and not be determined by ambiguities, inaccuracies, or omissions such as are the customer classifications and water flows of Engineering Bulletin No. 12.

---

[4]Decision #60258 (March 14, 1997) pages 2-3

Q. YOU HAVE STATED IN YOUR PREVIOUS DIRECT TESTIMONY THAT THE MOST RATIONAL BASIS FOR A RATE DESIGN WOULD BE TO USE ACTUAL WATER USAGE TO DETERMINE RATES. DO YOU STILL AGREE?

A. Yes.

Q. WHAT ABOUT MR. SORENSEN'S ARGUMENT THAT BASING RATES ON ACTUAL WATER USAGE HAS "ITS DRAWBACKS"?

A. It certainly could present some additional administrative challenges but that doesn't argue against actual water usage as the most rational basis for determination of rates.

Q. WHAT FORM OF RELIEF DO YOU FEEL THE COMMISSION COULD OFFER THAT WOULD PROVIDE A REASONABLE AND RATIONAL RATE DESIGN FOR YOU WITHOUT EXTREME ADMINISTRATIVE CHALLENGES FOR THE COMPANY?

A. I would suggest the most reasonable and rational method that is already used by many wastewater companies in Arizona. In July of each year, my sewer bill would be recalculated based on the average amount of water use in the previous months of December, January and February. Water usage figures for these months could be obtained from the Carefree Water Company, or I would supply them.

Q. WHY ARE THE MONTHS OF DECEMBER, JANUARY AND FEBRUARY USED?

A. These are the months that in Arizona reflect high seasonal activity and low irrigation demands.

Q. WHY ALLOW FOUR MONTHS BEFORE NEW RATES BECOME EFFECTIVE?

A. This is customary to allow for administrative recalculation.

Q. ARE THERE ANY MAJOR DRAWBACKS TO THIS METHOD?

A. If there were an unusual, unanticipated large water or irrigation leak in one of those months, the customer must have to have the right to appeal for a revised rate that would disallow the month when the leak occured.

Q. ARE THERE OTHER FORMS OF RELIEF THAT WOULD BE ACCEPTABLE TO YOU?

A. There could be and as long as they are reasonable, rational and non-discriminatory, I would have no objection.

DOCKET NO. SW-02361A-08-0609

ORIGINAL AND THIRTEEN (13) COPIES
of the foregoing were filed this
9th day of November, 2009, with:

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Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Copies of the foregoing mailed
this 9th day of November, 2009 to:

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By: Rose Turley
Rose Turley
Secretary

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

Arizona Corporation Commission
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IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. SW-02361A-05-0657

DECISION NO. 69164

OPINION AND ORDER

DATE OF HEARING: June 7, 8, 9, and 20, 2006

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes

APPEARANCES: Jay Shapiro, FENNEMORE CRAIG, P.C., on behalf of Black Mountain Sewer Corporation;

Daniel Pozefsky, on behalf of the Residential Utility Consumer Office;

David W. Garbarino, MOHR, HACKETTT, PEDERSON, BLAKLEY & RANDOLPH, P.C., on behalf of Intervenor Town of Carefree;

Robert Williams, on behalf of Intervenor Boulders Homeowners Association; and

Keith Layton, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On September 16, 2005, Black Mountain Sewer Corporation ("BMSC" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for a rate increase. BMSC currently provides wastewater service to approximately 1,957 customers in and around Carefree, Arizona, 1,836 of which are residential customers and 121 are commercial (Ex. A-4, at 3).

BMSC's current rates and charges were authorized in Decision No. 59944 (December 26,

EXHIBIT BHOA-1 ADMITTED

1996) for Boulders Carefree Sewer Corporation ("Boulders Carefree"). In 2001, the common stock of Boulders Carefree was acquired by Algonquin Water Resources of America ("AWRA"), which is a wholly owned subsidiary of Algonquin Power Income Fund ("APIF"). APIF owns energy, water and wastewater, and related assets of approximately $800 million in the United States and Canada. In Arizona, APIF owns seven water and wastewater companies serving approximately 50,000 customers[1]. APIF also owns 10 other water and wastewater utilities in Texas, Illinois, and Missouri (Ex. A-4, at 3; Ex. A-5, at 2-3).

On September 26, 2005, the Residential Utility Consumer Office ("RUCO") filed an Application to Intervene, which was granted by Procedural Order issued October 7, 2005.

On October 14, 2005, the Commission's Utilities Division ("Staff") filed a Deficiency Letter, stating that the application did not meet the sufficiency requirements set forth in A.A.C. R14-2-103 because the Company had failed to include a cost of service study with its application. The Deficiency Letter also stated that Staff would not require a cost of service study if BMSC provided the information attached to the Letter.

On October 28, 2005, a Procedural Order was issued addressing an agreement between the Company and Staff whereby the application would be deemed sufficient, subject to the condition that the information requested by Staff must be submitted within 60 days of a Procedural Order approving the Stipulation, and failure to submit the required information would result in suspension of the applicable time clock. The Procedural Order declined to approve the Stipulation between BMSC and Staff, on the basis that such approval would require an advance determination of the Commission's time clock rule in the absence of a factual justification being presented.

On November 1, 2005, Staff issued a Letter of Sufficiency and classified BMSC as a Class B utility.

On November 2, 2005, a Procedural Order was issued setting a hearing to commence on June 7, 2006, directing the Company to publish and mail notice of the hearing, and establishing other procedural deadlines.

[1] In addition to BMSC, AWRA also controls in Arizona Bella Vista Water Company, Litchfield Park Service Company, and Gold Canyon Sewer Company (Ex. S-13). AWRA added Northern Sunrise Water Company and Southern Sunrise Water Company after the close of the hearing (Decision No. 68826 – June 29, 2006).

On December 30, 2005, BMSC filed a "simplified cost of service study" as requested by Staff.

On January 24, 2006, BMSC filed a Certification of Publication and Proof of Mailing, attesting to compliance with the notice requirements set forth in the November 2, 2005 Procedural Order.

On February 14, 2006, Robert Williams filed a letter requesting intervention on behalf of the Boulders Homeowners Association ("Boulders HOA" or "HOA").

On February 16, 2006, the Town of Carefree ("Town" or "Carefree") filed an Application to Intervene.

On February 21, 2006, M. M. Schirtzinger filed a letter requesting intervention as an individual customer of BMSC.

On March 8, 2006, a Procedural Order was issued granting intervention to the Boulders HOA, Carefree, and M. M. Schirtzinger.

With its application, BMSC filed the Direct Testimony of Michael Weber and Thomas Bourassa.

On March 9, 2006, Staff filed the Direct Testimony of Crystal Brown, Marlin Scott, Jr., and Pedro Chaves; RUCO filed the Direct Testimony of William Rigsby and Marylee Diaz Cortez; and Carefree filed Affidavits of Stan Francom, Jonathon Pearson, and Jason Bethke, as well as several attachments.

On April 6, 2006, BMSC filed the Rebuttal Testimony of Michael Weber, Joel Wade, and Thomas Bourassa.

On May 4, 2006, Staff filed the Surrebuttal Testimony of Marlin Scott, Jr., and Pedro Chaves; RUCO filed the Surrebuttal Testimony of William Rigsby and Marylee Diaz Cortez; and Carefree filed the Surrebuttal Testimony of Stan Francom and Jonathon Pearson.

On May 5, 2006, Staff filed the Surrebuttal Testimony of Crystal Brown.

On May 26, 2006, BMSC filed the Rejoinder Testimony of Joel Wade and Thomas Bourassa.

On June 2, 2006, BMSC filed a Motion to Strike Affidavit of M. M. Schirtzinger, dated May 31, 2006, based on the failure to file the statement within the timeframe established for intervenor

testimony[2].

A prehearing conference was conducted on June 5, 2006.

The hearing commenced on June 7, 2006, and additional hearing days were held on June 8, 9, and 20, 2006.

On June 15, 2006, Staff filed updated Surrebuttal Schedules.

On July 26, 2006, Staff filed Post-Hearing Recommendations based on documentation provided by the Company on June 22, 2006. The adjustments to Staff's recommendations were presented to reflect Staff witness Crystal Brown's testimony during the hearing that Staff would review its position on several items if the Company could support its position with documentation. The adjustments recommended by Staff are reflected in Staff's final schedules attached to its Post-Hearing Brief.

Initial Post-Hearing Briefs were filed on August 18, 2006 by the Boulders HOA, and on August 21, 2006 by BMSC, Staff, RUCO, and Carefree.

Reply Briefs were filed on September 5, 2006 by BMSC, Staff, RUCO, Carefree, and the Boulders HOA.

Rate Application

According to the Company's application, as modified, in the test year ended December 31, 2004 BMSC had adjusted operating income of $11,595 on an adjusted Fair Value Rate Base ("FVRB") and Original Cost Rate Base ("OCRB") of $1,568,502, for a 0.74 percent rate of return. Pursuant to its final schedules, BMSC requests a gross revenue increase of $256,063 (21.54 percent). Staff recommends a gross revenue increase of $250,195 (20.76 percent), and RUCO recommends an increase of $5,470 (0.45 percent). A summary of the parties' final revenue requirement positions follows[3]:

[2] Docket Control records do not reflect that an Affidavit was filed on May 31, 2006, and M. M. Schirtzinger did not appear at the hearing. Mr. Williams, appearing on behalf of intervenor Boulders HOA, did not submit pre-filed testimony but was given the opportunity to present a statement in the public comment portion of the hearing (Tr. 30-44). Mr. Williams also posed cross-examination questions to various witnesses during the hearing.

[3] Intervenors Carefree and the Boulders HOA raised only non-revenue requirement issues (*i.e.*, odor problems) which are discussed below.

	Company Proposed	Staff Proposed	RUCO Proposed
FVRB/OCRB			
Adjusted Rate Base	$1,568,502	$1,550,710	$1,372,834
Rate of Return	11.00%	9.60%	9.45%
Req'd Operating Inc.	172,535	148,868	129,733
Op. Income Available	11,595	4,819	125,730
Operating Inc. Def.	160,940	144,049	4,003
Rev.Conver. Factor	1.5911	1.73688	1.3663
Gross Rev. Increase	256,063	250,195	5,470

REVENUE REQUIREMENT

Rate Base Issues

As indicated above, BMSC proposes an OCRB of $1,568,502; Staff proposes an OCRB of $1,550,710; and RUCO proposes an OCRB of $1,372,834. Each of the disputed issues regarding rate base items is discussed below.

Accumulated Deferred Income Taxes

Accumulated deferred income taxes ("ADIT") reflect the timing difference between when income taxes are calculated for ratemaking purposes and the actual federal and state income taxes paid by the Company. The timing difference is primarily due to the fact that straight line depreciation is used for ratemaking purposes, whereas accelerated depreciation is used for income tax reporting purposes (Ex. S-9, at 19). According to Staff witness Crystal Brown, the Statement of Financial Accounting Standards ("SFAS") No. 109, Accounting for Income Taxes, requires companies to use deferred tax accounting to recognize income tax timing differences.

Ms. Brown stated that although BMSC did not initially reflect an ADIT liability in its application, in response to a RUCO data request the Company stated that it had a deferred income tax credit (liability) of $360,000. However, BMSC's response also indicated that it had a deferred tax asset of $524,000 resulting from the Company's advances in aid of construction ("AIAC") account. According to Staff, the net difference between the $360,000 deferred tax liability and the $524,000 deferred tax asset, is a net deferred tax asset of $164,000, and therefore an increase to the Company's rate base of that amount (*Id.* at 20-21).

RUCO witness Marylee Diaz Cortez disagrees with the Company's and Staff's proposed

ADIT asset and RUCO instead recommends an ADIT liability of $161,250 (reduction to rate base). RUCO's recommendation is based on BMSC's parent company's (APIF's) 2004 Annual Report, which reflects a net tax liability. RUCO developed its proposal in this case by allocating BMSC's portion of the tax liability based on the ratio of the price paid by APIF for BMSC's stock compared to APIF's total assets (RUCO Ex. 12, at 4-7; Tr. 417-418). Ms. Diaz Cortez stated that utility companies "almost unfailingly create net deferred tax liabilities" (RUCO Ex. 12, at 4).

Whether other utilities normally report net deferred tax liabilities is not a controlling factor in determining whether BMSC should have a net asset or liability in this case. BMSC's ultimate parent, APIF, controls myriad companies (*see, e.g.* Ex. S-13) and the fact that its Annual Report reflects a net deferred tax liability is not necessarily indicative of whether its individual subsidiaries have a net liability or asset on their respective books. As Mr. Bourassa explained, "[w]hen a significant amount of plant has been financed by CIAC [contributions in aid of construction] and AIAC, or when there are net operating losses, DIT assets are common" (Ex. A-2, at 4). We agree with the Company and Staff that BMSC properly included $164,000 as a net deferred income tax asset for purposes of setting rates in this case..

Cash Working Capital

Cash working capital represents the amount of cash a company must have on hand to pay its bills when they are due (Tr. 386). All parties agree that using a lead/lag study, which measures the timing of funds received compared to expenses paid, is the most accurate method of determining cash working capital.

In this case, BMSC did not conduct a lead/lag study. In its application, BMSC calculated a positive cash working capital requirement of $130,508, based on the "formula method." The formula method calculates cash working capital based on one-eighth of the Company's operating expenses less depreciation, taxes, purchased water, and purchased pumping power expense, plus one twenty-fourth of purchased water and purchased pumping power expense (Ex. S-9, at 23).

In her direct testimony, Staff witness Crystal Brown stated that use of the formula method is not appropriate for BMSC and is, in general, appropriate only for Class D and E utilities that do not have the resources to conduct a lead/lag study (*Id.*). Ms. Brown indicated that, "[h]ad a lead-lag

study been conducted, it might have shown that Cash Working Capital is a negative component of rate base" (*Id.* at 24). Therefore, Staff recommended removal of BMSC's proposed working capital requirement, in effect resulting in a zero working capital requirement (*Id.*). On rebuttal, Company witness Bourassa accepted Staff's zero working capital recommendation (Ex. A-2, at 11).

RUCO believes that BMSC has a negative cash working capital requirement because the Company "receives its revenues prior to having to pay its expenses" (RUCO Ex. 12, at 8). According to RUCO witness Diaz Cortez, unlike many utilities that bill after service is rendered, BMSC customers are required to pay for service in a given month prior to receiving an entire month of service. Ms. Diaz Cortez testified that the formula method assumes that there exists an average lag of 45 days for operating and maintenance ("O&M") expenses, and an average lag of 15 days for purchased power expenses. Ms. Diaz Cortez stated that RUCO performed a modified lead/lag study in which a sampling of actual customer bills was reviewed showing the service period, bill date, and payment due date (*Id.*). Based on this review, RUCO calculated an average revenue collection lead of 7.83 days (Tr. 382). RUCO also used the formula method's 45 lag days for O&M expenses and 15 lag days for purchased power expenses, which the Company was initially advocating in this case and, based on its analysis proposes a negative cash working capital for BMSC of $87,253 (RUCO Ex. 11, at 14).

We agree with RUCO's negative working capital proposal in this proceeding based on its analysis which, while not as accurate as a full scale lead/lag study, provides a more accurate representation of BMSC's actual cash working capital situation. Although BMSC argues in its brief that "RUCO has not met its burden of proof" on this issue (BMSC Reply Brief at 10), it is the Company which has failed to sustain its burden of presenting evidence to support its zero working capital proposal as a more accurate reflection of BMSC's actual working capital requirement. BMSC is critical of RUCO's acceptance of 45 O&M lag days and 15 purchased power lag days, yet its own witness initially proposed using the formula method, which employs those very estimates (Tr. 126-127). We therefore adopt RUCO's proposal regarding the working capital issue.

Scottsdale Treatment Capacity

In order to serve its approximately 2,000 customers, BMSC currently operates one 120,000

gallon per day ("gpd") wastewater treatment facility located near the Boulders Resort. The remainder of the Company's wastewater flows are diverted into the City of Scottsdale's ("City" or "Scottsdale") wastewater treatment system and ultimately delivered to the City of Phoenix Regional 91st Avenue Wastewater Treatment Plant (Ex. A-4, at 3).

In order to divert wastewater flows into Scottsdale's system, BMSC's predecessor, Boulders Carefree, entered into a 20-year Agreement with Scottsdale in 1996 that allows the Company to deliver up to 1,000,000 gpd to the City (Ex. A-15). According to the Agreement, no "right, title or interest in the other party's utility plant or facilities" is granted to either party (*Id.* at 2).

In the Company's prior rate case, both the Company and RUCO sought to have the amounts paid under the contract treated as plant and included in rate base. However, in Decision No. 59944 (December 26, 1996), the Commission agreed with Staff and treated the debt service on the debt used to fund the Scottsdale treatment capacity as an operating lease, that is included in operating expenses as lease expense (Ex. A-2, at 22). Mr. Bourassa stated that the Commission's treatment of the capacity as a lease expense has resulted in lower rates to customers and lower revenues to the Company compared to a rate base treatment scenario (*Id.* at 25-27). Staff agrees with the Company that the Scottsdale capacity should continue to be treated as a lease expense consistent with the Commission's prior Order (Ex. S-9, at 32-33).

RUCO claims that the operating lease treatment of the Scottsdale capacity costs was a "fallacy" in 1996, and is an even greater fallacy now because of BMSC's acquisition of Boulder Carefree (RUCO Ex. 11, at 3-4). Ms. Diaz Cortez contends that because the original capacity was purchased with a loan from Boulders Carefree's parent, and because BMSC's acquisition was financed with equity from AWRA, there is no basis for continuing to treat the capacity as an operating lease because to do so would not provide a credit to ratepayers for capacity that is already paid for (*Id.* at 7).

We disagree with RUCO's proposed treatment of the Scottsdale treatment capacity. As Mr. Bourassa points out, if rate base treatment of the Scottsdale capacity costs had been approved in the Company's prior rate case, the revenue requirement would have included a return on and of the capacity costs, thereby resulting in significantly higher rates in the interim period since the last case.

In this case, RUCO's proposal to accord rate base treatment to the capacity rights would result in a reduction to the Company's revenue requirement because the original cost of the Scottsdale capacity has been amortized. To switch ratemaking treatment after more than a decade, would be arbitrary and inherently unfair to the Company. We therefore reject RUCO's position on this issue.

Gross-Up Factor for Income Taxes

With respect to the income tax effect for the Scottsdale capacity operating lease, the Company proposed to include $27,801 in operating expenses as a gross-up for income taxes. Under the Company's proposal, income taxes would be included on the principal amount of loan payments for the Scottsdale treatment capacity agreement (Ex. S-9, at 32).

Staff recommended a treatment that does not require a gross-up factor and which Staff believes is a simpler and cleaner method. Under Staff's proposal, the loan payments would not be included in the ratemaking calculation of taxable income, which would result in a higher taxable income and an offsetting, higher income tax expense to be included in rates (*Id.*). Staff argues that the Company's method would understate income tax expense, and adoption of Staff's recommendation would result in a more realistic level of income taxes expense for ratemaking purposes (*Id.* at 33).

The Company did not brief this issue and we assume that it therefore accepts Staff's proposed treatment of this issue. We will adopt Staff's recommendation.

Summary of Rate Base Adjustments

Based on the foregoing discussion, we adopt an adjusted OCRB and FVRB of $1,472,969 for BMSC in this proceeding.

	Commission Approved
OCRB	
Plant in Service	$8,630,686
Less: Accumulated Depreciation	4,331,129
Net Plant in Service	4,299,557
Deductions:	
AIAC	1,311349
CIAC	4,857,632
Less: Accumulated Amortization	3,256,134
Net CIAC	1,601,498
Total AIAC and CIAC	2,912,847

ADIT	164,000
Additions:	
Prepayments	9,512
Working Capital	(87,253)
Total OCRB	$1,472,969

Operating Income Issues

In the test year, the Company's adjusted operating revenues were $1,205,452. In its final schedules, BMSC reported adjusted test year operating expenses of $1,221,973, and test year net operating income of negative $14,233. As set forth in its final schedules, Staff's proposed adjusted test year operating expenses are $1,200,633, resulting in test year operating income of $4,819. RUCO's schedules show proposed adjusted test year total operating expenses of $1,083,477, yielding test year operating income of $129,733. The disputed expense adjustments are discussed below.

Property Tax Expense

The Arizona Department of Revenue ("ADOR") determines the value of utility property for tax purposes using a formula that is based on the utility's historical revenues. BMSC and Staff propose to follow a line of recent Commission decisions to use adjusted test year revenues in the application of the ADOR formula in order to determine the allowable property tax expense in this proceeding (*See, e.g.*, *Chaparral City Water Company*, Decision No. 68176 (September 30, 2005); *Rio Rico Utilities Co.*, Decision No. 67279 (October 5, 2004); *Arizona-American Water Company*, Decision No. 67093 (June 30, 2004); *Bella Vista Water Company*, Decision No. 65350 (November 1, 2002); *Arizona Water Company*, Decision No. 64282 (December 28, 2001)). RUCO continues to disagree with the Commission's use of adjusted test year revenues in the application of the ADOR formula for estimating property tax expense for ratemaking purposes, and argues as it has in a number of prior cases that only historical revenues should be used (RUCO Ex. 13, at 13-17).

RUCO compared the results of its methodology, based on the Company's historical revenues for the test year, and the two years prior, with the results of the Commission's methodology. RUCO contends that since its methodology more accurately predicted the actual 2005 assessment, the Commission should adopt its approach on this issue (*Id.* at 15).

We once again disagree with RUCO's position. Consistent with numerous prior decisions, we do not believe RUCO's backward-looking methodology properly recognizes that, barring

extraordinary circumstances, any increase granted in this case will increase the Company's property taxes. As we stated in the *Chaparral City* case cited above, "RUCO's calculation methodology, which uses only historical revenues, unfairly and unreasonably understates property tax expense, and is therefore inappropriate for ratemaking purposes" (Decision No. 68176, at 14). RUCO has not demonstrated a basis for departure from our prior determinations on this issue and we will therefore adopt the recommendations of the Company and Staff to follow Commission precedent and use adjusted test year revenues in determining property tax expense.

Rate Case Expense

In its direct case, BMSC estimated rate case expense in the amount of $120,000, but indicated that it would true-up costs as the case progressed (Ex. A-1, at 10-12). On rebuttal, Mr. Bourassa adjusted the Company's estimated rate case expense upward, to $150,000, which would be amortized over four years. Mr. Bourassa claimed that the additional rate case expense allowance is justified because the Company has incurred additional expenses due to the intervention of Carefree and the Boulders HOA, as well as more extensive discovery than expected by Staff and RUCO (Ex. A-2, at 31-32). BMSC attached to its Opening Brief an exhibit (Brief Exhibit 3) that purports to show that it had incurred actual rate case expenses of more than $194,000 through the end of July 2006, prior to the filing of briefs in this case.

Staff recommends that the Company be allowed rate case expense of $124,800, amortized over four years. Staff witness Brown stated that the additional $4,800 over the Company's original estimate is sufficient to cover any additional expenses incurred by the Company to address the issues raised by the Town's and Boulders HOA's intervention (Ex. S-10, at 16-18). Ms. Brown testified that the $4,800 figure is based on a $400 hourly rate, multiplied by an additional 24 hours that Staff believes is sufficient to address intervenor issues, less removal of half of the additional amount "to reflect only the amount that customers should pay" (*Id.* at 18).

RUCO witness William Rigsby filed testimony recommending recognition of only the Company's original estimate of $120,000, amortized over four years. Mr. Rigsby stated that RUCO found the original estimate to be reasonable and "decided that the prudent approach would be to wait until a final figure can be accurately calculated and compared to the Company's request" (RUCO Ex.

13, at 17). However, once the Company presented an updated estimate of rate case expenses due primarily to odor issues raised by the intervenors, RUCO continued to propose that only the original $120,000 estimate should be recognized.

We believe the Company has justified recognition of its proposed rate case expense of $150,000 in this proceeding. Mr. Bourassa testified that BMSC had incurred actual rate case expenses of approximately $115,000 through April 2006, more than a month before the evidentiary hearing commenced and several months before post-hearing briefs were prepared (Ex. A-3, at 19). We believe that the Company's $150,000 rate case expense represents a reasonable allowance under the facts and circumstances of this case and is consistent with rate case expense allowances in other proceedings. *See, e.g., Arizona-American Water Company* ($419,000), Decision No. 67093 June 30, 2004); *Arizona Water Company* ($250,000), Decision No. 66849 (March 19, 2004). To hold a company strictly to its original estimate, regardless of intervening events, would create an incentive for over-estimating costs on the front end rather than attempting to provide a good faith estimate subject to reconciliation based on actual events. We do not believe Staff's or RUCO's proposals provide adequate recognition of the additional costs incurred by BMSC in prosecuting its rate case and we will therefore adopt the Company's position on this issue.

Removal of Legal Costs

Staff witness Brown recommended removal from test year expenses of $3,228 in legal costs associated with negotiating an operating agreement with Carefree. She proposed, instead, that the legal costs should be capitalized and amortized over the life of the agreement (Ex. S-9, at 31). The Company did not oppose Staff's recommendation and we will therefore adopt Staff's position.

Affiliate Company Profits

As described above, AWRA [Algonquin Water Resources of America, Inc.] is a wholly owned subsidiary of APIF [Algonquin Power Income Fund]. In Arizona, AWRA owns and operates Black Mountain Sewer Corporation, Bella Vista Water Company, Litchfield Park Service Company, Gold Canyon Sewer Company, Northern Sunrise Water Company and Southern Sunrise Water Company.

AWRA employs an organizational model that is unique in Arizona. AWRA, BMSC's sole

shareholder, has no employees. BMSC, as well as all of the other regulated utility companies listed above, have no employees. Instead, almost all operational services are provided by an allegedly unregulated affiliate called Algonquin Water Services ("AWS") that has between 70 and 90 employees and which, apparently, provides similar services received by the regulated public service corporations owned by Algonquin in Arizona, including BMSC (Tr. 529-530)[4]. The written contract that exists between BMSC and AWS for provision of wastewater services was not negotiated, but was based on a template that is used by the Algonquin Power System to manage its hydroelectric plants in Canada (Tr. 510).

Staff's Position

Based on its analysis, Staff recommends that the Commission disallow $20,871 that the Company is seeking in rate base for capitalized affiliate profit, and $21,761 the Company seeks to recover in operating expenses for affiliate profit (Staff Ex. 9, at 27; Staff Br. Sched. CSB-6)[5]. Staff points out that BMSC has in effect turned over the entirety of its operations and management to an (allegedly) unregulated affiliate, and that the affiliate's shareholders have imposed a contract on BMSC, without negotiation, that provides the affiliate with guaranteed profits at the expense of BMSC's captive ratepayers (Ex. S-10, at 4-5). Ms. Brown stated that BMSC's affiliate is essentially operating as an unregulated monopoly based on the Company's claims that there are no other companies or individuals that could provide comparable services to BMSC[6]. Ms. Brown dismissed the Company's claims that the affiliate arrangement resulted in $222,000 in savings as unsupported assertions but, regardless of savings, Staff contends that it is reasonable for the affiliate to recover only the reasonable actual costs from customers (*Id.* at 7-8). Staff also asserts that there may be additional affiliate profit that it was unable to specifically identify. As an example, Staff cites to a billing rate for a "general manager" of $150 per hour that was charged to BMSC by its affiliate. Ms.

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[4] Staff witness Crystal Brown indicated that, during the test year, the Company was billed $275,460 by AWS, $32,017 by Algonquin Power Trust, and $27,311 by Algonquin Power Systems, for a total of $332,604 in billings by the Company's affiliates (Ex. S-9, at 26).

[5] The capitalized affiliate profit represents 8 percent of project costs billed to BMSC and, for operating expenses the affiliate billings included a 6.5 percent profit (*Id.*; Ex. A-2, at 17).

[6] As evidence of the potentially manipulative effect of affiliate control, Ms. Brown pointed out that the affiliate increased its management fees to BMSC from $7,500 per month in 2003 to $13,062 per month in 2004, the test year (Ex. S-10, at 6).

Brown stated that the $150 hourly rate equates to $312,000 on an annual basis to perform management duties for BMSC (*Id.* at 8).

In support of its recommended disallowance of capitalized and expensed affiliate profits, Staff argues that the record supports piercing the corporate veil and treating all of the Algonquin affiliates as a single entity. Staff cites to a prior case involving *Consolidated Water Utilities, LTD*, Decision No. 57666 (December 19, 1991), wherein the Commission stated: "We do not believe it is appropriate for ratepayers to pay a profit margin for each layer of related companies. Hence we totally agree with Staff that all of the profit margin of CUC should be disallowed as part of the allocation." (*Id.* at 18-19). Staff also cites *Walker v. Southwest Mines Development Co.*, 52 Ariz. 403, 81 P.2d 90 (1938), wherein the Arizona Supreme Court stated:

> [W]hen one corporation so dominates and controls another to make that other a simple instrumentality or adjunct to it, the courts will look beyond the legal fiction of distinct corporate existence, as the interests of justice require; and where stock ownership is resorted to not for the purpose of participating in the affairs of the corporation in the customary and usual manner, but for the purpose of controlling the subsidiary company so that it may be used as a mere agency or instrumentality of the owning company, the court will not permit itself to be blinded by mere corporate form, but will, in a proper case, disregard corporate entity, and treat the two entities as one.[7]

According to Staff, the case of *Deutsche Credit Corp. v. Case Power & Equip. Co.*, 179 Ariz. 155, 876 P.2d 1190 (App. 1994), provides additional support for this view. In that case, the Arizona Court of Appeals quoted *Jabczenski v. Southern Pacific Memorial Hospital, Inc.*, 119 Ariz. 15, 21, 579 P.2d 53, 59 (App. 1978), as follows:

> Two corporations can be regarded as the same if "[e]ither the dominant corporation ... so control[s] and use[s] the other as a mere tool or instrument in carrying out its own plans and purposes that justice requires it be held liable for the results, or, there [is] such a confusion of identities and acts as to work a fraud upon third persons."

Staff further argues that, pursuant to *Gatecliff v. Great Republic Life Insurance Co.*, 170 Ariz. 34, 37, 821 P.2d 725, 728 (1991), the standard for imposing the alter ego theory requires a showing of unity of control and that the corporate form would sanction a fraud or promote injustice.

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[7] *Id.*, 52 Ariz. At 414-415, 81 P.2d at 95, quoting *Platt v. Bradner Co.*, 131 Wash. 573, 230 P. 633 (Wash. 1924).

Staff also cites a decision by the Washington Utilities and Transportation Commission, in *Washington Water Power Co.*, 24 P.U.R. 4th 427 (at page 13) (1978), in which the Washington Commission, citing *Mississippi River Fuel Corp. v. Federal Power Comm'n*, 102 US App 238, 252 F.2d 619 (D.C. Cir. 1957), made the following finding:

> [T]he clearly stated concern appears to be not the level of price at which the transaction is accomplished in comparison with prices in nonaffiliated transactions, but instead a level of earnings by the unregulated arm of the utility at a rate higher than the utility is authorized and would be allowed to achieve if no corporate device were utilized. In effect, the courts approve for rate-making purposes the placement of a 100 percent affiliate in the same position as an integrated [part] of a utility.

Based on these decisions, as well as several others cited in its Brief, Staff claims that the corporate veil should be pierced to avoid an injustice. Staff points to the fact that neither BMSC nor AWRA have any employees and, as a result, the Algonquin affiliates provide virtually all of the services needed to serve the Company's customers; contracts between BMSC and AWC are presented to the Company without negotiation based on a template provided by the ultimate parent, APIF; that AWS was "specifically created" to provide the majority of services to BMSC; and the vice-president and general manager of AWS directs day-to-day management and operations of the water and wastewater systems owned by AWRA (including BMSC) (Ex. A-5, at 1). Staff asserts that the record supports the conclusion that BMSC is merely an agency or instrumentality of the Algonquin affiliates, and the corporate structure created by the Algonquin companies results in an injustice to ratepayers by creating a layer of profit that is inconsistent with Arizona's regulatory ratemaking standards.

Finally, Staff expressed concern with BMSC's suggestion in this case that, if the Commission disallows the Company's requested affiliate profit request, Algonquin will reorganize its corporate structure in a manner that will be more costly to ratepayers. As described in the Company's testimony, "[e]ither operating expenses increase because BMSC will have to hire personnel to perform all of the essential services or many of the services that benefit the Company and ratepayers will not be provided. There really is no other possible outcome because AWS is not going to stay in business if it cannot realize a return on its investment." (Ex. A-5, at 5). Staff requests that the

Commission make a finding in this Decision that it expects AWRA to operate its affiliate companies as efficiently as possible.

BMSC's Position

The Company contends that Staff's recommendation should be disregarded because common ownership alone is not a sufficient reason to pierce the corporate veil of the Company and its affiliates. BMSC claims that Staff failed to meet the burden of proving its proposal because, once Staff raised the issue of affiliate profit disallowance, the Company presented evidence as to the reasonableness of its affiliate costs. According to Mr. Bourassa, the Company is not aware of any local companies that could provide the type of services supplied by the Algonquin affiliates. However, he indicated that the Company attempted to compare its costs with those of a management services firm and estimated that such a firm would charge approximately $10 to $12 per customer per month, compared to $10 to $11 for the BMSC affiliate (Ex. A-2, at 34). Mr. Bourassa testified that Chaparral City Water Company has operational costs of approximately $14 to $16 per customer and he believed some other companies had costs of more than $18 per customer (Tr. 171-172).

The Company argues that, once this evidence was presented, it was incumbent upon Staff to present evidence showing why BMSC's proposed costs are unreasonable. BMSC claims that Staff could have sought to audit the affiliate companies' books and records, but Staff did not do so. The Company contends that the only evidence in the record shows that bids for comparable services were not available and, in any event, there is no evidence of excessive profits.

With respect to Staff's proposal to pierce the Company's corporate veil, BMSC asserts that the cases cited by Staff stand for the proposition that corporate structures will not be ignored unless they were created for essentially fraudulent purposes. BMSC cites *Arizona Public Service Co. v. Arizona Corp. Comm'n*, 155 Ariz. 263, 267, 746 P.2d 4, 8 (App. 1987), wherein the court declined to pierce the corporate veil because the Commission did not show undercapitalization, fraud, misconduct or impropriety in the management of the affiliated companies. The Company also claims the court in *Deutsche Credit, supra,* held that "[t]he concept of a corporation as a separate entity is a legal fact, not a fiction." *Deutsche Credit* at 160. In addition, BMSC cites *Kearns v. Tempe Technical Institute, Inc.*, 993 F.Supp. 714, 723 (D. Ariz. 1997), in which the court stated that

"corporate status will not be lightly disregarded."

With respect to the *Washington Water Power* case cited by Staff, as well as *Central Louisiana Electric Co.*, 373 So.2d 123 (La. 1979), BMSC argues that the central holding of both cases is that the regulatory commission must assure that rates are just and reasonable, and the evidence presented in this proceeding supports a finding that BMSC's affiliate company expenses are reasonable. The Company also contends that the profit on the affiliated transactions is not guaranteed because all costs are subject to intense scrutiny in the ratemaking process and all costs can go up or down during intervening periods between rate cases. BMSC asserts that Staff has not provided evidence to disprove the reasonableness of the affiliate costs, including the requested profits, and thus Staff's recommendation should be rejected.

RUCO's Position

RUCO did not present testimony or take a position on this issue.

Resolution

We agree with Staff that, at a minimum, the profit component of both capitalized costs and expenses by the BMSC affiliate companies should be disallowed. We will not countenance a corporate shell game that allows companies to hide behind corporate structures in order to avoid scrutiny of what would normally be the function of the regulated public service company. BMSC criticizes Staff's failure to present evidence as to the unreasonableness of the subsidiary costs. Although Staff could have pursued discovery of the affiliate companies, given Staff's heavy caseload and the constraints for processing this matter under the time clock rules, it was not unreasonable for Staff to pursue other means of supporting its recommendation to disallow affiliate company profits.

Presumably, the Algonquin companies conducted a due diligence analysis prior to acquiring BMSC and understood the regulatory framework in Arizona. The rate base/rate of return regulatory scheme provides that, in exchange for being granted an exclusive service territory with monopoly status, public service corporations are granted an opportunity to earn an authorized return on investment used and useful, plus reasonable operating expenses. We believe it is inherently unreasonable for an affiliate company that performs all of the operational functions of the utility company, under a non-negotiated contract, to seek an additional profit margin simply because the

affiliate was structured as a separate corporate entity. The question that must be asked is whether an affiliate company under common ownership and control should be permitted to add an additional layer of profit, and to do what a regulated public service corporation is otherwise legally prohibited from doing (*i.e.*, recover an additional profit margin for its services), based solely on the parent company's decision to create a separate affiliate company. Our answer is a resounding no.

We believe our finding is consistent with the line of cases which indicate regulatory commissions have broad authority to scrutinize transactions between a regulated company and its unregulated affiliates, and to disallow excessive costs. *See, e.g., U.S. West Communications, Inc. v. Arizona Corporation Comm'n*, 185 Ariz. 277, 282, 915 P.2d 1232 (App. 1996); *General Telephone Co. of New York v. Public Service Commission of New York*, 17 N.Y.2d 373, 378 (N.Y. 1966) ("[w]hen a utility and its suppliers are both owned and controlled by the same holding company, the safeguards provided by arm's length bargaining are absent, and ever present is the danger that the utility will be charged exorbitant prices which will, by inclusion in its operating costs, become the predicate for excessive rates."). *See also, State of North Carolina v. Morg*an, 177 S.E.2d 405, 416 (Supreme Court of North Carolina, 1970) ("the doctrine of the corporate entity may not be used as a means for defeating the public interest and circumventing public policy. In order to prevent such a result, a parent corporation and its wholly owned subsidiaries may be treated as one." [citations omitted]); *Washington Water Power, supra,* at page 15, quoting the Public Utilities Commission of Ohio's decision in *Columbus Gas & Fuel Co.*, PUR1933A 337 ("[A] company enjoying the immunities of a public utility has no right to impose upon the consumers a heavier burden than that which would be justly borne, and that will produce a proper rate of return, considering the value of the property devoted to this public service and to the risks involved."). Moreover, as this Commission stated in the *Consolidated Water* case, "[w]e do not believe it is appropriate for ratepayers to pay a profit margin for each layer of related companies....[and] all of the profit margin of CUC [the affiliate company] should be disallowed as part of the allocation." (Decision No. 57666, at 18-19).

We also share the concern raised by Staff that there may be additional profit margins built into the affiliate billings that have not been specifically identified. Because we do not have any

specific record evidence of additional inappropriate profits in this case, we will exclude only the "profits" that have been clearly identified by Staff. In doing so, however, we make no finding as to the reasonableness of the Algonquin affiliate structure and, in future cases involving the Algonquin companies, we expect all affiliate salaries, expenses, and billings to be scrutinized to avoid potential abuses.

Net Operating Income

Consistent with the foregoing discussion, we will allow adjusted test year operating expenses of $1,205,533, which based on test year revenues of $1,205,452, results in test year adjusted operating income of negative $81, for no rate of return on FVRB.

COST OF CAPITAL

BMSC recommends that the Commission determine the Company's cost of common equity to be 11.0 percent. Staff recommends a cost of common equity rate of 9.6 percent. Both the Company and Staff recommend a capital structure of 100 percent equity and no debt. RUCO proposes a return on equity of 9.49 percent, with a hypothetical capital structure of 43 percent debt and 57 percent equity, resulting in an 8.92 percent weighted cost of capital (RUCO Ex. 14, at 9-10)[8].

Capital Structure

Company witness Bourassa stated that BMSC's capital structure consists of 100 percent equity because, although the Company has $1,184,732 of long-term debt on its books due to acquisition of the Scottsdale treatment capacity, that debt service is included in operating expenses pursuant to prior Commission Order and there is no other long-term debt (Ex. A-2, at 39). Staff agrees with the Company's proposed 100 percent equity capital structure (Ex. S-4, at 6). RUCO, however, proposes the use of a hypothetical structure of 43 percent debt and 57 percent equity (RUCO Ex. 14, at 9-11).

According to Mr. Rigsby, the Commission should adopt a hypothetical capital structure based on the Algonquin parent company's capital structure. Mr. Rigsby claims that adoption of a

[8] Mr. Rigsby recommended that, if the Commission adopts RUCO's position on the Scottsdale capacity issue, the capital structure should be weighted at 44 percent debt and 56 percent equity, with a 9.45 percent weighted cost of capital (RUCO Ex. 14, at 9; Tr. 539). Since we have adopted the Company's position regarding the Scottsdale capacity issue, RUCO's position is as stated above.

hypothetical capital structure is appropriate in this case because his estimate of a 9.49 percent return on common equity ("ROE") was derived from a sample group of companies that have capital structures that consist of approximately 50 percent debt and 50 percent equity. He therefore proposed using the weighted cost of debt reported in APIF's 2004 Annual Report (Tr. 550-553).

We agree with Staff and the Company that a capital structure comprised of 100 percent equity should be used for calculating BMSC's cost of equity capital in this proceeding. Although RUCO proposes using a hypothetical capital structure based on the 2004 APIF Annual Report, its witness admitted that the APIF capital structure would incorporate the debt and equity of a variety of companies under the Algonquin umbrella, including a Canadian waste reclamation company, a hydroelectric company in New Hampshire, and a sewer company in Texas (Tr. 553-554). In fact, the plant in BMSC's rate base is financed entirely by equity. Although there is some long-term debt on the Company's books associated with the Scottsdale treatment capacity, as explained above that debt has been treated as an operating lease for nearly a decade pursuant to prior Commission Decisions and, therefore, there is no plant in rate base associated with the Scottsdale capacity debt. We believe RUCO's hypothetical capital structure recommendation is results oriented and is not consistent with the Company's actual capital structure. We therefore adopt a 100 percent equity capital structure for BMSC in this case.

Cost of Common Equity

Determining a company's cost of common equity for purposes of setting its overall cost of capital requires an estimation that is both art and science. As evidenced by the competing methodologies employed in this case, and most other rate cases, there is no clear-cut answer as to which formula should be used for reaching the appropriate outcome. Rather, the three expert cost of capital witnesses, Messrs. Bourassa, Chavez, and Rigsby, each rely on various analyses for their recommendations.

BMSC's Position

The Company's expert witness, Mr. Bourassa, based his common equity cost recommendation of 11.00 percent on the results of his discounted cash flow ("DCF") model using six proxy companies (American States Water, Aqua America, California Water, Connecticut Water,

Middlesex Water, and SJW Corp.). Mr. Bourassa employed a risk premium analysis and a comparable earnings analysis as a check on the reasonableness of the DCF results (Ex. A-1, at 13-14; Ex. A-3, at 21-25).

The Company's DCF analysis produced ROE results for the proxy companies ranging from 8.5 to 11.0 percent (Ex. A-3, at 22). Mr. Bourassa's risk premium analysis resulted in an ROE range of 10.2 to 11.0 percent; while the earnings analysis produced results in the 7.8 to 12.7 percent range (*Id.*). He also looked at *Value Line* projections for ROE in the water industry for 2006, 2007, and 2009, and found projected returns of 10.0, 10.5, and 11.5 percent, respectively (*Id.*). BMSC argues that Mr. Bourassa's analysis supports the Company's proposed 11.0 ROE in this case considering BMSC's risks and investor expectations.

BMSC criticizes the recommendations of both Staff and RUCO (9.6 and 9.49 percent ROE, respectively), because the Company claims that Staff and RUCO blindly followed the results of their models without regard for whether their proxy companies are actually comparable in terms of investment risk. The Company contends that the Staff and RUCO recommendations, compared to ROE proposals in prior cases, have not kept pace with rising interest rates over the past several years, thereby producing skewed results. BMSC asserts that the Staff and RUCO analyses ignore firm-specific risk based on their claim that under modern finance theory all risk is reflected in a stock's "beta" (which estimates risk by comparing a stock's volatility relative to the market in which it is traded). The Company argues that the Staff and RUCO beta assumption ignores factors such as firm size; diversification of the utility; regulatory risk; and liquidity risk (Ex. A-2, at 48). BMSC cites additional alleged defects with the Staff and RUCO methodologies, including: the sample group consists primarily of water utilities; only one of the companies in the group has operations in Arizona; the stock of the sample companies is traded on a national exchange; and all but one of the companies has published credit ratings (Ex. A-1, Sched. D-4.1).

BMSC is critical of Staff's use of a multi-stage DCF model, which assumes that earnings and dividend growth will occur in multiple stages, compared to the constant growth version of the DCF model, which assumes constant growth of earnings and dividends (Ex. A-1, at 31). The Company also claims that while its analysis relies on forward-looking growth, Staff's methodology gives a 50

percent weighting to historical growth (1995 to 2005) which produces unrealistic results and depresses the equity cost estimate. BMSC claims that giving a 50 percent weighting to historical growth effectively double counts what has happened in the past, because historical information is already embedded in the stock prices used to calculate the dividend yield (*Id.*).

With respect to Staff's use of the Capital Asset Pricing Model ("CAPM"), the Company asserts that the CAPM is difficult to implement in practice, especially when applied to a small, closely-held firm (*Id.*). The CAPM is calculated using the subject company's beta (measurement of a security's volatility in relation to the market); the risk free rate (the return an investor expects to earn on a theoretical "riskless" investment); and the average market return (from which the market risk premium is calculated). BMSC claims that the 0.74 beta for Staff's six proxy companies (as calculated by *Value Line*) should not be applied to BMSC because it is not publicly traded and has no estimated beta. With respect to the risk free rate selected by Staff (average yield on 5, 7 and 10-year Treasury securities), the Company claims that because a corporation has an indefinite life, the use of intermediate Treasury securities is inappropriate.

According to BMSC, the inputs Staff used in its CAPM produce results that are contrary to the CAPM theory. The Company claims that, although under the CAPM theory cost of equity moves in the same direction as interest rates and estimated beta, Staff's CAPM estimates move in the opposite direction of both interest rates and beta risk. In addition to the alleged application problems perceived by BMSC, the Company contends that the CAPM has empirical shortcomings that invalidate its use for estimating ROE. BMSC cites to several articles in Economics journals to support its claim the CAPM is flawed. The Company argues that the Risk Premium Model ("RPM") is superior to CAPM because under the RPM the risk premium is directly estimated by comparing authorized and actual returns on equity with the current yield of investment grade bonds or other debt instruments.

BMSC is also critical of the RUCO DCF analysis because the Company claims that Mr. Rigsby substituted his own subjective judgment for market data in its DCF model. The Company claims that RUCO used the sustainable growth method to estimate dividend growth, but substituted its witness' subjective dividend growth rate, thereby understating substantially the Company's cost of

equity. BMSC argues that RUCO's witness ignored the actual and forecasted stock financing rates reported in his own schedules.

RUCO's Position

RUCO witness Rigsby based his ROE recommendation on the results of his DCF and CAPM analyses, which ranged from 8.89 percent to 10.69 percent for his sample group of publicly traded water and gas companies. His 9.49 percent ROE recommendation is the result of the DCF analysis, which utilized a sample of publicly traded water companies (RUCO Ex. 14, at 8).

RUCO contends that Mr. Rigsby's DCF model relied on objective estimates of external growth using *Value Line* analyst projections as a guide (RUCO Ex. 15, at 24). RUCO argues that Mr. Rigsby's growth estimates properly recognize that the market price of a utility's common stock will tend to move towards book value if regulators allow a rate of return that is equal to the cost of capital (*Id.* at 19-20). According to RUCO, the Commission recently adopted the same methodology in determining the cost of common equity for Southwest Gas Company in Decision No. 68487 (February 23, 2006).

RUCO asserts that the Company's criticism of the CAPM employed by RUCO and Staff is unfounded. RUCO claims that the Company's risk premium analysis is simply a variation of the CAPM, but the RPM fails to account for the additional market-based information that is included in the CAPM. RUCO contends that the estimated return produced by either the CAPM or the RPM is one of a number of factors that investors take into consideration when evaluating a company's stock. RUCO also argues that, despite *Value Line* projections of lower ROEs for water utilities, the Company made no comparable downward adjustment to its original 11.0 percent recommendation. RUCO claims that its cost of capital recommendation is reasonable and should be adopted by the Commission.

Staff's Position

In formulating its ROE recommendation in this case, Staff employed a constant growth DCF model, a multi-stage DCF model, and a two-part CAPM analysis. The two CAPM estimates were based on an historical market risk premium and a current market risk premium. Staff's DCF model produced a ROE of 9.6 percent; the average of its two CAPM results was 9.5 percent; and the

average of the DCF and CAPM results was 9.6 percent, which is its recommendation in this proceeding. For purposes of its analysis, Staff selected six publicly traded water companies that derive most of their earnings from regulated operations and which are analyzed by *Value Line* publications (Ex. S-4, at 13)[9].

Staff's cost of capital witness, Pedro Chaves, calculated the growth factor for his DCF model by averaging the results of six growth projection methods[10] (*Id.* at 16). Mr. Chavez explained that the most controversial element of a DCF analysis is the choice of inputs for the growth rate. He stated that Staff's use of both historical and projected EPS, DPS and sustainable growth components provide a balanced outcome that avoids a skewed result which could occur if only historical or projected growth results are analyzed (Ex. S-5, at 4).

In response to BMSC's criticisms, Staff contends that its methodologies reflect a properly balanced analysis compared to the Company's proposal. Staff refutes the Company's claim that it blindly followed the results of its models and argues that Mr. Bourassa used professional judgment inappropriately. According to Staff, its inputs were chosen by identifying available market data, and then analyzing whether investors could be expected to rely on such data prior to inputting the data into its models. Staff argues that the Company's methodology, on the other hand, is results oriented in order to produce the highest ROE result possible. Mr. Chaves testified that Staff selects the dates for its inputs before the date occurs, and attempts to use the most recent dates before its testimony is finalized (Tr. 717-718). Staff also disagrees that its CAPM is subject to manipulation, as suggested by the Company, because it picks dates for the inputs without regard to the end result that will fall out from the analysis.

With respect to the Company's criticism that rising interest rates are not reflected in Staff's cost of capital analysis, Staff contends that three of the CAPM variables do not necessarily move in the same direction at the same time. Although Mr. Chaves conceded that there is a relationship between interest rates and the cost of equity capital, he stated that cost of equity would tend to move

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[9] The six proxy companies chosen by Staff are American States Water, California Water, Aqua America, Connecticut Water, Middlesex Water, and SJW Corp. (*Id.*, Sched. PMC-3).

[10] The six methods involve calculations of historical and projected dividends per share ("DPS"), historical and projected earnings per share ("EPS"), and historical and projected sustainable growth (Ex. S-5, Sched. PMC-7).

in the same direction as interest rates only if all other variables are constant (Tr. 684). According to Mr. Chaves, while interest rates increased between the filing of his direct and surrebuttal testimonies from 3.3 to 4.7 percent, Staff's current MRP declined from 13.1 to 5.7 percent, thereby offsetting the interest rate increase (Tr. 719-722).

Staff asserts that the Commission should reject BMSC's proposed 11.0 percent ROE because it is based on inputs that artificially inflate the required return. Staff points out that the Company's DCF results are identical to Staff's DCF results (*i.e.*, 9.6 percent) (Tr. 144). However, Mr. Bourassa excluded Middlesex Water because its cost of equity was only 40 basis points above the projected cost of Baa investment grade bonds (Ex. A-3, Sched.D-4.9). Mr. Chaves stated that he believed the reason for exclusion of Middlesex was insufficient, and if Middlesex were included in the Company's DCF analysis, the overall results would drop from 9.6 to 9.5 percent (Tr. 712-713; Ex. S-8).

Staff argues that the Company's use of the risk premium and comparable earnings analyses, as well as the Company's size, for purposes of inflating its ROE proposal have been rejected by the Commission in the past. *See, e.g., Southwest Gas Corp.*, Decision No. 68487 (February 23, 2006). Staff claims that BMSC's witness used only forecasted EPS growth estimates, while excluding historical DPS, EPS, and forecasted DPS growth. Staff also points out that although his DCF analysis produced a range of 8.5 to 11.0 percent for the sample group of companies, Mr. Bourassa chose the highest point in that range for his ROE recommendation. Staff therefore recommends that the Commission adopt its 9.6 percent cost of capital recommendation in this proceeding.

Conclusion on Cost of Capital

We believe that Staff's recommended cost of capital achieves an appropriate result that is supported by the evidence in the record. Staff's witness' use of the DCF model as the primary basis for determining the Company's reasonable estimated cost of equity capital is a methodology that has been used for many years by this Commission, as well as other regulatory commissions across the country.

With respect to the methodology employed for calculating the return on common equity, we believe Staff's analysis is appropriate and consistent with prior Commission decisions regarding cost of capital. The companies included in Staff's sample group are appropriate because they have

objective data that is publicly available through *Value Line* and other investor publications. We agree with Staff that the Company's proposal to exclude Middlesex Water, because its cost of equity was perceived by the Company to be too low for inclusion in its DCF analysis, is an artificial means of skewing the end result in the Company's favor.

We are not persuaded by the Company's legal arguments that adoption of Staff's cost of equity recommendation would result in a violation of the Commission's authority under the Arizona Constitution, the case law interpreting that authority, or of the *Hope, Bluefield, and Duquesne* decisions[11]. Article 15, Section 3 of the Arizona Constitution provides in relevant part that the Commission "shall have full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein." In determining just and reasonable rates, the Commission has broad discretion subject to the obligation to ascertain the fair value of the utility's property, and establishing rates that "meet the overall operating costs of the utility and produce a reasonable rate of return." *Scates, et al. v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612 (Ct. App. 1978). Under the Arizona Constitution, a utility company is entitled to a fair rate of return on the fair value of its properties, "no more and no less." *Litchfield Park Service Co. v. Arizona Corp. Comm'n*, 178 Ariz. 431, 434, 874 P.2d 988 (Ct. App. 1994), *citing Arizona Corp. Comm'n v. Citizens Utilities Co.*, 120 Ariz. 184 (Ct. App. 1978). The oft cited *Hope* and *Bluefield* cases provide that the return determined by the Commission must be equal to an investment with similar risks made at generally the same time, and should be sufficient under efficient management to enable the Company to maintain its credit standing and raise funds needed for the proper discharge of its duties.

For the reasons described above, we believe that adoption of Staff's recommendation for a 9.60 cost of equity capital, which is also its overall cost of capital with a 100 percent equity capital structure, complies with these obligations. Staff's expert witness, although primarily relying on the well-established DCF method for calculating his cost of equity capital, also employed two other tests

[11] *Federal Power Commission et al. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, et al.*, 262 U.S. 679 (1923); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

as a check on the reasonableness of his results. Staff pointed out that the Company's witness arbitrarily excluded one of the companies in his proxy group because inclusion of that company resulted in a lower DCF and ROE result, and thus skewed downward the overall results on his analysis. We believe that adoption of Staff's recommendation results in a just and reasonable return for BMSC based on the record of this proceeding.

We therefore adopt a cost of equity of 9.60 percent, which also results in an overall weighted cost of capital of 9.60 percent.

AUTHORIZED INCREASE

Based on our findings herein, we determine that BMSC is entitled to a gross revenue increase of $141,486.

Fair Value Rate Base	$1,472,969
Adjusted Operating Income	(81)
Required Rate of Return	9.60%
Required Operating Income	$141,405
Operating Income Deficiency	141,486
Gross Revenue Conversion Factor	1.74051
Gross Revenue Increase	$246,257

RATE DESIGN ISSUES

The current monthly customer charge for residential customers is $38.00 with no commodity charge. Regular commercial customers currently pay $0.15236 per gallon of sewer flow (based on ADEQ Engineering average daily flows for various types of customers), and no monthly service charge. In addition, there are 14 special commercial customers that pay a monthly customer charge only, that varies by customer, based on an estimate for each customer's sewer volume flow (Ex. S-9, at 35; Sched. CSB-24).

As updated in their final schedules, the Company and Staff recommended percentage increases of 21.42 percent and 20.41 percent, respectively, be applied to all customers under their existing rate structures (Co. Final Sched. H3; Staff Brief Sched. CSB-25). RUCO recommended that its proposed revenue requirement be applied under the Company's current rate design.

In accordance with the revenue requirement determined above, the increase will be applied to all classes equally. Accordingly, the current residential rate of $38.00 per month will increase by

20.1 percent, to $45.64, and the regular commercial customer rate will increase from $0.15236 to $0.18298, also an increase of 20.1 percent. The special commercial customer rates will be increased by the same percentage.

Refund of Hook-Up Fee Funds

In her Direct Testimony, Staff witness Crystal Brown stated that BMSC's predecessor was authorized in the Decision in 1980 granting the original Certificate of Convenience and Necessity ("CC&N") to charge a hook-up fee. Ms. Brown indicated that at the time the Company was relatively small and had little ability to attract capital needed to build infrastructure and to fund growth (Ex. S-9, at 36). Use of hook-up fee funds is generally limited to costs associated with building infrastructure to serve growth in the utility's service area.

Ms. Brown also pointed out that, in the Company's last rate case (Decision No. 59944), the Commission stated that the Company's hook-up fee may be rescinded for reasons including, but not limited to, "failure to track and account for hook-up fees, misuse of hook-up fees, or no need for additional capital" (*Id.* at 10). During its investigation in this proceeding, Staff discovered that the Company had purchased computer equipment totaling approximately $142,232, vehicles totaling approximately $20,000, and land totaling $451,000 from the hook-up fees (Ex. S-9, at 35-38). Ms. Brown recommended that these funds be refunded to customers (*Id.*).

In his Rebuttal Testimony, Mr. Bourassa proposed a reduction to CIAC of $833,367 to account for $452,467 of land purchased with hook-up fee funds, and $380,900 for unexpended hook-up fees. The Company agreed that this amount should be refunded to customers. Although BMSC does not agree that the identified amounts for land purchases were improper, it agreed with Staff's recommendation to avoid litigation of the issue (Ex. A-2, at 18-22). As a result, the Company's parent would be required to provide paid in capital of $452,467 to replace the hook-up fees used for land purchases (*Id.*). Regarding the remaining $380,900, the refunds will come from funds held in a restricted cash account (*Id.* at 19).

In her Surrebuttal Testimony, Ms. Brown agreed with the Company's proposed refund amount, but disagreed with the Company's recommendation as to how the individual refunds are to be calculated. She stated that the refunds should be calculated based upon the amount contributed by

each customer class, and that the Company should "propose an equitable way to calculate the CIAC refunds" (Ex. S-10, at 18). She also indicated that the rates from this case should not go into effect until after the refunds are made.

Mr. Bourassa responded that the proposed refund should be calculated on a per customer basis, irrespective of customer class. He explained that the information regarding contributions by customer class is not available, but since over 92 percent of the customer base is residential and most of the growth is in the residential class, the refund will be made primarily to residential customers (Ex. A-3, at 7-8).

RUCO opposes a refund of any of the hook-up fees. Although RUCO did not file testimony on the issue, at hearing Ms. Diaz Cortez testified that refunding hook-up fees is contrary to the spirit of why the fees were collected in the first place (*i.e.*, to defray costs of future plant) (Tr. 390). RUCO contends that the Company will likely have a need for the accumulated hook-up fees in the future and the Commission should reject the proposal by Staff and the Company to terminate and refund the hook-up fees.

We agree with Staff and the Company that $833,367 should be refunded to customers to account for $452,467 of land purchased with hook-up fee funds, and $380,900 for unexpended hook-up fees. BMSC indicated it does not need the hook-up fee funds to resolve odor problems (see discussion below) because the Company is adequately capitalized to make necessary capital investments for infrastructure (Tr. 470).

We agree with BMSC that the proposed refund should be calculated on a per customer basis, irrespective of customer class. Further, as recommended by Staff, the rates from this case should not go into effect until after the refunds are made.

Withdrawn Staff Alternative Proposal

On the third day of the hearing, Staff witness Marlin Scott, Jr. stated in his direct testimony on the stand that, in response to concerns expressed by the Town and customers, Staff proposed that instead of refunding the hook-up fees, perhaps those funds could be used to fund system improvements needed to alleviate noise and odor problems described at the hearing (see discussion below) (Tr. 617-618). Because Staff developed the alternative recommendation on the morning of

the third day of the hearing, it did not have any specific ideas of how the proposal may be accomplished. The Administrative Law Judge therefore directed Staff to file a written description of its alternative recommendation prior to the close of the hearing (Tr. 624).

Staff decided to withdraw its alternative recommendation and, on the final day of the hearing, a discussion occurred regarding the issue (Tr. 653-674). In general terms, RUCO, the Town and the Boulders HOA were interested in pursuing the Staff alternative. However, the Company objected to Staff's "eleventh hour" proposal and to the attempt by the Town and the HOA to resurrect the issue after it was withdrawn by Staff (*Id.*). The Company also raised the issue of whether the hook-up fee funds could legally be used for the purposes suggested in Staff's alternative. In any event, the Company represented that financial resources to make necessary system improvements are not lacking (Tr. 470).

Given Staff's withdrawal of its alternative recommendation, the hearing concluded without further consideration of the proposal.

OTHER ISSUES

Odor Issues

The most contentious issue in this proceeding involves claims made by a number of the Company's customers, as well as the Town of Carefree and the Boulders HOA, that the BMSC system emits significant odors. For the Town and the HOA, the odor problem was the only issue pursued. In addition to Mr. Williams on behalf of the Boulders HOA, public comment was given at the hearing by seven customers, each of whom described various experiences regarding odors at their properties due to the BMSC wastewater system (Tr. 30-80). In addition, a number of other customers submitted written comments or contacted the Commission's Consumer Services Division to register complaints regarding odors and/or the Company's proposed rate increase.

In response to the odor complaints, the Company initially took the position that any odor problems that may exist were not related to the BMSC system (Ex. A-6, at 2). In its rejoinder testimony, the Company's witness indicated that BMSC does not have an odor problem, "it has an odor complaint problem" (Ex. A-7, at 1). In opening statements, the Company's counsel reiterated BMSC's position that "we don't have a problem with odors; we have a problem with odor

complaints" (Tr. 15). During cross-examination, the Company's position appeared to soften as evidenced by the testimony given by Robert Dodds, APIF's director of operations and president of several of Algonquin's operating companies. Although Mr. Dodds was hesitant to commit unlimited resources to resolve the odor issues, he conceded that "there is an issue [and] obviously customers are smelling odors" (Tr. 482). However, in its initial post-hearing brief the Company appeared to move closer to its pre-hearing position, arguing that it is not possible to set a standard that would satisfy everyone, "[n]or is it possible to eliminate odors from a wastewater collection and treatment system" (BMSC Closing Brief, at 4). In response to arguments by the Town and the HOA that rate relief should be delayed until the odor issues are resolved, or that conditions should be imposed in conjunction with any rate increase granted in this case, the Company argues that the Commission should defer to the Maricopa County Environmental Services Department ("MCESD") which has determined that the Company meets the applicable odor control standards (*Id.* at 5).

Cause of Odors

Based on the public comments received, as well as the sworn testimony presented by various witnesses, there appears to be general agreement that the odor problems reported by customers stem from two separate sources, the CIE Lift Station and the wastewater line that flows under Boulder Drive in the Boulders subdivision.

CIE Lift Station

During prior updates to the wastewater system by BMSC's predecessor, all but one of the older lift stations (CIE lift station) was replaced. Operational problems at the CIE lift station have caused frequent odor issues and have required the Company to pump raw sewage from the site into trucks, which then deposit the sewage into other locations in the system. The Town's witness, Stan Francom stated that the CIE lift station should be replaced or bypassed because of regular breakdowns at the facility, and the inability to continue patching the lift station to keep it operational (Tr. 292, 334). An engineering report commissioned by the Town ("Carter Burgess Report") recommended replacing the CIE Lift Station due to operational problems (Ex. T-3, Ex. A., at 14).

BMSC witness Dodds also recognized the problems associated with the CIE Lift Station and indicated that the Company was studying ways to bypass or eliminate the facility (Tr. 466-467). The

Company attached to its initial Closing Brief an agreement dated August 9, 2006 between Algonquin and an engineering company to eliminate and bypass the CIE Lift Station (BMSC Closing Brief, Ex. 2).

Given the Company's decision to eliminate the CIE Lift Station, that particular source of odors should be eliminated in the near future. The Company should notify the Commission and all other parties, within 30 days of the effective date of this Decision, as to the status of the CIE Lift Station project and projected completion date. The project should be completed within 180 days of the effective date of this Decision unless an extension is granted upon an appropriate timely request.

Boulders Community

The more complicated odor issue involves ongoing complaints by residents in the Boulders subdivision, especially along Boulders Drive where the sewer line flows from the CIE Lift Station to the Boulders wastewater treatment plant ("Boulders WWTP" or "WWTP"). According to Carefree witness Francom, the odors in the Boulders community are attributable to two problems: the long retention time that sewage sits in the Boulders line, thereby allowing the sewage to become septic (Tr. 283-285); and "positive pressure" between the CIE Lift Station and the Boulders WWTP due to the fact that the lines between the lift station and discharge manholes in the Boulders community are pressurized, but are gravity lines from the Boulders manholes to the WWTP (*Id.*). Mr. Francom explained that, once sewage is released suddenly into the Boulders discharge manholes, turbulence is created because the sewage displaces gasses within the system thereby pushing odors out into the community through any gaps, such as unsealed manhole covers or residential vent stacks (Id. at 286).

The Town asserts that Mr. Francom's analysis is confirmed by an engineering study by Lamb Technical Services, Inc. ("LTS Report"), which was commissioned by BMSC (Ex. A-6, Ex. 1, Attach. F). The LTS Report indicated that hydrogen sulfide concentrations are "extremely high" at the locations where the force mains discharge into the gravity lines upstream from the WWTP, and those locations "had positive pressures that tend to drive the odors and hydrogen sulfide concentrations out through the manhole cover pickholes" (*Id.*). The LTS Report noted that the Company's addition of the chemical treatment Thioguard in the Boulders area was partially successful in reducing hydrogen sulfide concentrations. However, LTS indicated that even with

those reductions the odors being driven out of residential vent stacks were still significant, and a redesign at the Boulder/Quartz discharge location "is recommended if turbulence could be reduced" (*Id.* at 5). The LTS Report stated that "[e]ven with reduced concentrations due to less turbulence a fan generating negative pressures will still most likely be needed at the Quartz and Boulder Drive location to prevent odors from being forced out the local vent stacks" (*Id.*).

Mr. Francom testified that there were two possible solutions to the Boulders odor problems: replacement of the gravity flow lines with pressure lines all the way to the Boulders WWTP; or installation of fans and carbon filters to create a negative pressure filtration system within the sewer lines between the discharge manholes and the WWTP (Tr. 334-335). Mr. Francom pointed out that the Town offered to install a temporary fan system to test the effectiveness of that method of odor remediation, but the offer was previously rejected by the Company on the basis that no odor problems existed (Tr. 315-318).

BMSC contends that it takes the odor complaints seriously and has been taking reasonable steps to address those complaints. The Company states that AWRA has invested more than $1.4 million on system improvements, much of which was designed to address odor issues (Ex. A-4, at 4). The Company argues that the standards suggested by the Town and the HOA for resolving the odor issues are too vague, because they would presumably require every customer to be totally satisfied, possibly well in excess of applicable government standards. BMSC argues that the public comment relied upon by the Town and HOA is not evidence in this proceeding, and the Company points out that it has never been found to be in violation of MCESD odor regulations (Tr. 322-323, 354, 620). The Company asserts that it would be unfair for the Commission to impose additional requirements, especially when such requirements may be beyond the Commission's jurisdiction. The Company claims that it has already addressed the odor problems by starting to remove the CIE Lift Station, and that it is willing to commence "yet another engineering study to evaluate allegations of continuing odors from facilities located within Boulders Drive" (BMSC Reply Brief, at 6). However, BMSC argues that ordering the specific steps recommended by the Town and HOA is "not related to ratemaking, and in the absence of any evidence that BMSC's operations violate the governing standards, would constitute improper interference with management of the utility" (*Id.*).

The Town and the Boulders HOA cite to several statutes that they argue give the Commission authority to impose remedial measures in cases such as this. Pursuant to A.R.S. §40-361(B), the intervenors argue that BMSC is obligated to "furnish and maintain such service, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons...." They also contend that, under A.R.S. §40-334(B), BMSC may not "maintain any unreasonable difference as to ... service, facilities or in any other respect, either between localities...." The Town argues that this provision is applicable because customers in different areas of the BMSC service territory are affected by odors disproportionately. The intervenors further claim that Maricopa County regulations prohibit wastewater treatment facilities from producing air pollution that unreasonably interferes with property owners' enjoyment of life or property.

The Town claims that its recommendations are not vague because they propose specific remedies for resolving the odor issues raised in this proceeding. Therefore, Carefree requests that a condition be placed on any rate increase granted to BMSC requiring the Company to either replace the gravity line discussed above with pressure lines and/or install fans and carbon filters to create a negative filtration system between the Boulders discharge manhole and the Boulders WWTP. The HOA also argues that any rate increase granted in this case should be conditioned on BMSC being required to undertake an audit of the Company's sewer system; if the hook-up fee refund plan is rejected, all funds derived from the rate increase should be escrowed and used only for system improvements; an independent audit of BMSC's management structure should be conducted; the $833,000 in hook-up fees should be used to fix the odor problems identified in this case; the Town's grease trap ordinance inspection and compliance reports should be monitored and publicized; and an expedited hearing should be conducted if BMSC fails to comply with the proposed conditions.

Resolution

We believe the evidentiary record in this case amply supports the appropriateness of, and the need for, imposition of odor remediation requirements as a condition of granting the rate relief approved herein. We turn first to the evidentiary standard for dealing with public comment since that issue was raised by the Company in its post-hearing Brief. Although we agree with BMSC that unsworn public comments made by ratepayers are not treated as evidence in a strict sense, we believe

ratepayer input is important to consider as an indication of how customers view the operations of a regulated utility company. For example, it may not be appropriate to rely solely on unsubstantiated claims made in public comments, because such comments are not subject to cross-examination. However, if corroborating sworn testimony or documentary evidence is presented in the course of the hearing, it is entirely appropriate to treat the public comments as an indicator of customer perception and experience in dealing with regulated monopoly utility companies. Indeed, such comments are invaluable for the Commission to understand both positive and negative experiences of customers, especially since those customers have no choice but to take service from the utility holding an exclusive Certificate to provide service.

We disagree with BMSC that the intervenor proposals are impossibly vague and would impose an undue compliance burden on the Company. As the Town points out, at least one of its proposed remedies for reducing odors in the Boulders subdivision was cited in both the Carter Burgess Report and LTS Report. The evidence in the record suggests that, despite the Company's attempts to solve the odor problems in that area through the introduction of Thioguard, there is an ongoing problem that cannot be solved by chemical injections alone. In addition to replacement of the CIE Lift Station, the prior engineering studies appear to have pinpointed not only the remaining cause of the odor problems (*i.e.*, pumping of sewage into the Boulders discharge manhole), but a possible solution (*i.e.*, fans to create negative pressure in the line leading from the Boulders manhole to the WWTP). Mr. Francom indicated that another solution may be the installation of a pressurized line to the WWTP, to replace the existing gravity line. As such, it hardly requires speculation to address the source of, and the solution for, the odor issues in the Boulders community. Rather, there is ample record evidence to support the conclusion that the Company should take action consistent with the prior engineering reports, as well as the credible testimony presented by the Town's witness, in order to remedy the odor problems discussed herein.

We are not persuaded by the Company's arguments that the Commission is without authority to take action to protect the public health and welfare of customers served by utilities under its jurisdiction. With respect to a public service corporation's adequacy of service, A.R.S. §40-321(A) states:

> When the commission finds that the equipment, appliances, facilities or service of any public service corporation, or the methods of manufacture, distribution, transmission, storage or supply employed by it are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine what is just, reasonable, safe, proper, adequate or sufficient, and shall enforce its determination by order or regulation.

As set forth in A.R.S. §40-331(A):

> When the Commission finds that additions or improvements to or changes in the existing plant or physical property of a public service corporation ought reasonably to be made, or that a new structure or structures should be erected, to promote the security or convenience of its employees or the public, the commission shall make and serve an order directing that such changes be made or such structure be erected in the manner and within the time specified in the order. If the commission orders erection of a new structure, it may also fix the site thereof.

In addition, A.R.S. §40-361(B) provides as follows:

> Every public service corporation shall furnish and maintain such service, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient and reasonable.

As these statutes make abundantly clear, the Commission has the authority and the duty to protect the health, safety and welfare of a public service corporation's customers. And, contrary to BMSC's "micromanagement" arguments, the law just as clearly states that in order to protect the security or convenience of the public, the Commission may specify not only the type of facilities that are required, but the timeframe in which the facilities must be constructed.

A.R.S. §40-202(A), provides additional supervisory authority to the Commission for regulation of public service corporations[12]. The authority granted to the Commission under these statutes, as well as the Commission's constitutional powers pursuant to Article 15, §3 of the Arizona Constitution, was discussed in *Arizona Corp. Comm'n v. Palm Springs Utility Co., Inc.*, 24 Ariz. App. 124, 128, 536 P.2d 245, 249 (App. 1975). In that case, the court held that "the regulatory powers of the Commission are not limited to making orders respecting the health and safety, but also

[12] A.R.S. §40-202(A), provides in relevant part: "The commission may supervise and regulate every public service corporation in the state and do all things, whether specifically designated in this title or in addition thereto, necessary and convenient in the exercise of that power and jurisdiction."

include the power to make orders respecting comfort, convenience, adequacy and reasonableness of service...." (*Id.*). Given our determination that our constitutional and statutory powers provide the requisite authority to require actions by the Company to resolve the odor problems cited herein, we need not decide whether the Maricopa County rules and regulations cited by the intervenors are implicated by the facts presented in this case.

Having determined that the record supports a finding that odor problems exist on the BMSC system, and that we have legal authority to craft a remedy for those problems, we turn next to the appropriate directives that should be given to the Company as a condition of our approval of the rate increase discussed hereinabove. We find that the Boulders odor problems should be addressed by the Company's adoption of one of the two solutions suggested by Mr. Francom. As he explained on the record, the odors being experienced by members of that community may be solved by implementing a pressurized line to replace the gravity line that currently exists between the Boulders discharge manhole and the Boulders WWTP, or by installing fans and carbon filters to create a negative pressure filtration system between the Boulders discharge manhole and the Boulders WWTP[13].

The implementation of these remedies should be completed within 180 days of the effective date of this Decision although, for good cause shown and with the agreement of all other parties to this proceeding, the timeline may be extended by the Commission upon timely receipt of a request for extension of time. We also wish to make clear that failure by BMSC to comply with this order, or to otherwise continue to operate its system in a manner that fails to reasonably mitigate odors affecting customer residences and properties, may result in penalties or other action deemed necessary by the Commission to enforce this Decision.

By imposing this requirement, we wish to make clear that we are not attempting to manage the Company's affairs. However, based on the record, we believe action needs to be taken to advance a solution that will enable all customers on the BMSC system to enjoy fully their property without enduring offensive odors.

* * * * * * * * * *

[13] With the mutual agreement of all other parties to this proceeding, an alternative remedy may be employed to accomplish the desired goal of odor remediation in the Boulders community.

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

FINDINGS OF FACT

1. On September 16, 2005, BMSC filed an application with the Commission for an increase in rates.

2. On October 14, 2005, the Commission's Utilities Division Staff filed a Letter of Insufficiency.

3. Following an agreement between the Company and Staff regarding the submission of information, Staff issued a Letter of Sufficiency on November 1, 2005, and classified BMSC as a Class B utility.

4. By Procedural Order issued November 2, 2005, procedural timeframes were established and a hearing was scheduled to commence on June 7, 2006.

5. Intervention was granted to RUCO, the Town of Carefree, the Boulders HOA, and M.M. Schirtzinger.

6. On December 30, 2005, BMSC filed a "simplified cost of service study" as requested by Staff.

7. On January 24, 2006, BMSC filed a Certification of Publication and Proof of Mailing, attesting to compliance with the notice requirements set forth in the November 2, 2005 Procedural Order.

8. With its application, BMSC filed the Direct Testimony of Michael Weber and Thomas Bourassa, and, on March 9, 2006, Staff filed the Direct Testimony of Crystal Brown, Marlin Scott, Jr., and Pedro Chaves; RUCO filed the Direct Testimony of William Rigsby and Marylee Diaz Cortez; and Carefree filed Affidavits of Stan Francom, Jonathon Pearson, and Jason Bethke, as well as several attachments.

9. On April 6, 2006, BMSC filed the Rebuttal Testimony of Michael Weber, Joel Wade, and Thomas Bourassa. On May 4, 2006, Staff filed the Surrebuttal Testimony of Marlin Scott, Jr., and Pedro Chaves; RUCO filed the Surrebuttal Testimony of William Rigsby and Marylee Diaz Cortez; and Carefree filed the Surrebuttal Testimony of Stan Francom and Jonathon Pearson. On

May 5, 2006, Staff filed the Surrebuttal Testimony of Crystal Brown. On May 26, 2006, BMSC filed the Rejoinder Testimony of Joel Wade and Thomas Bourassa.

10. The hearing commenced on June 7, 2006, and additional hearing days were held on June 8, 9, and 20, 2006.

11. On June 15, 2006, Staff filed updated Surrebuttal Schedules. On July 26, 2006, Staff filed Post-Hearing Recommendations based on documentation provided by the Company on June 22, 2006.

12. Initial Post-Hearing Briefs were filed on August 18, 2006 by the Boulders HOA, and on August 21, 2006 by BMSC, Staff, RUCO, and Carefree.

13. Reply Briefs were filed on September 5, 2006 by BMSC, Staff, RUCO, Carefree, and the Boulders HOA.

14. According to the Company's application, as modified, in the test year ending December 31, 2005, BMSC had adjusted operating income of $11,595 on an adjusted FVRB and OCRB of $1,568,502, for a 0.74 percent rate of return.

15. In its application, as modified, the Company requested a gross revenue increase of $256,063 (21.54 percent), based on OCRB of $1,568,502, and a recommended return on common equity of 11.00 percent.

16. Staff recommends a gross revenue increase of $250,195 (20.76 percent), based on OCRB of $1,550,710, and a recommended return on common equity of 9.60 percent.

17. RUCO recommends a gross revenue increase of $5,470 (0.45 percent), based on OCRB of $1,372,834, and a recommended return on common equity of 9.45 percent.

18. For purposes of this proceeding, we determine that BMSC has a FVRB and OCRB of $1,472,969.

19. A rate of return on FVRB of 9.60 percent, based on a capital structure of 100 percent common equity, is reasonable and appropriate.

20. BMSC is entitled to a gross revenue increase of $246,257.

21. The rate design recommended by Staff should be adopted in this proceeding.

22. Staff's recommendation to exclude affiliate profits is adopted, and no finding is made

regarding the reasonableness of the Algonquin affiliate structure. In future cases involving the Algonquin companies, the Commission will scrutinize all affiliate salaries, expenses and billings.

23. The record supports a finding that customers should be refunded $833,367 for hook-up fees that were used to purchase land and that have not been expended. The refunds should be distributed in the manner proposed by the Company, on a per customer basis irrespective of customer class. The rates granted in this Decision should not go into effect until the refunds have been distributed.

24. The record supports a finding that BMSC should, within 30 days, notify the Commission and all other parties as to the status of the CIE Lift Station project and projected completion date.

25. The record supports a finding that odor problems exist on BMSC's system, and that the steps taken by the Company to date have not been sufficient to resolve the problems. BMSC should therefore be required to pursue one of the remedies proposed by the Town of Carefree in order to mitigate the odor problems that currently exist in the Boulders community. The implementation of the remedies should be completed within 180 days from the effective date of this Decision.

CONCLUSIONS OF LAW

1. BMSC is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§40-250, 40-251, 40-367, 40-202, 40-321, 40-331, and 40-361.

2. The Commission has jurisdiction over BMSC and the subject matter contained in the Company's rate application.

3. Pursuant to A.R.S. §§40-202(A), 40-321(A), 40-331(A), 40-361(B), and the authority under Article 15 of the Arizona Constitution, the Commission has jurisdiction to impose requirements for public service corporations to improve and repair facilities necessary to protect the health and safety of the public, and provide for the comfort and convenience of customers.

4. The rates, charges and conditions of service established herein are just and reasonable and in the public interest.

ORDER

IT IS THEREFORE ORDERED that Black Mountain Sewer Corporation is hereby authorized

and directed to file with the Commission, on or before November 30, 2006, revised schedules of rates and charges consistent with the discussion herein, as set forth below.

Residential Service – Per Month	$45.64
Commercial - Regular (c)	$0.18298

Commercial – Special Rates	Gallons Per Day	Rate Per Day	Monthly Charge
Name of Business			
BH Enterprises – West	2,525	$0.14034	$354.35
BH Enterprises – East	1,400	$0.14034	$196.47
Barb's Pet Grooming	250	$0.14034	$35.08
Boulders Resort	29,345	$0.14223	$4,173.87
Carefree Dental	1,625	$0.14034	$228.05
Ridgecrest Realty	450	$0.14193	$63.87
Desert Forest	7,000	$0.16344	$1,144.11
Desert Hills Pharmacy	800	$0.17061	$136.49
El Pedregal	15,787	$0.14034	$2,215.50
Lemon Tree	300	$0.13691	$41.07
Body Shop	1,000	$0.17467	$174.67
Spanish Village	4,985	$0.14034	$699.58
Boulders Club	1,200	$0.14034	$168.40
Anthony Vuitaggio	300	$015597	$46.79

Effluent Sales	
Per thousand gallons	$0.374400
Service Charges	
Establishment	$25.00
Re-establishment	$25.00
Re-connection	No Charge
Minimum Deposit (Residential)	(a)
Minimum Deposit (Non-Residential)	(a)
Deposit Interest	(a)
NSF Check Charge	$10.00
Deferred Payment Finance Charge	1.50%
Late Charge	1.50%
Main Extension Tariff (b)	Cost
Hook-up Fee for New Service	Discontinue

(a) Per A.A.C. R14-2-603B; Residential – two times average bill, Non-residential – two and one-half times average bill;
(b) Per A.A.C. R14-2-406(B);
(c) Per Gallon per Day. Wastewater flows are based on Engineering Bulletin 12, Table 1 for purposes of determining a monthly charge for individual customers on this rate.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after December 1, 2006, subject to the requirement that Black Mountain Sewer Corporation has mailed to each customer prior to that date a refund check for the hook-up fee funds, consistent with and in the manner described hereinabove. The new rates may not go into effect until the Company has provided, to the satisfaction of the Director of the Utilities Division, sufficient information to show that the refunds have been issued in accordance with the discussion set forth herein.

IT IS FURTHER ORDERED that Black Mountain Sewer Corporation shall notify its customers of the revised schedules of rates and charges authorized herein by means of an insert in its next regularly scheduled billing, or by separate mailing, in a form acceptable to Staff.

IT IS FURTHER ORDERED that Black Mountain Sewer Corporation shall, within 30 days of the effective date of this Decision, notify the Commission and all other parties as to the status of the CIE Lift Station project and projected completion date. The project shall be completed within 180 days of the effective date of this Decision unless an extension is granted upon an appropriate timely request.

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IT IS FURTHER ORDERED that Black Mountain Sewer Corporation shall pursue one of the remedies proposed by the Town of Carefree in order to mitigate the odor problems that currently exist in the Boulders community, and notify the Commission and all parties, within 90 days, regarding the option chosen through a filing in this docket. The implementation of the remedies shall be completed within 180 days from the effective date of this Decision unless an extension is granted upon an appropriate request. The Company shall file as a compliance item in this docket, notification of completion of the Boulders community odor mitigation project, within 30 days of completion of the project.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 5th day of Dec., 2006.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

SERVICE LIST FOR: BLACK MOUNTAIN SEWER CORPORATION

DOCKET NO.: SW-02361A-05-0657

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Agreement No. 960058

WASTEWATER TREATMENT AGREEMENT

THIS AGREEMENT is made this 1st day of April, 1996, by and between the CITY OF SCOTTSDALE, an Arizona municipal corporation ("Scottsdale"), and BOULDERS CAREFREE SEWER CORPORATION, an Arizona corporation ("the Sewer Company"), for the purposes and consideration set forth hereinafter.

RECITALS:

A. The Sewer Company is a privately-owned corporation which owns and operates certain wastewater collection, transportation and treatment facilities within portions of the Town of Carefree and the City of Scottsdale pursuant to a certificate of convenience and necessity issued by the Arizona Corporation Commission. At present, the Sewer Company has approximately 850 utility customers, and total revenues of approximately $400,000. Its customers' peak wastewater flows are in excess of 320,000 gallons per day. The Sewer Company's existing wastewater treatment plant has a maximum treatment capacity of 160,000 gallons per day.

B. Scottsdale operates a wastewater collection and treatment system. In 1989, Scottsdale entered into an agreement with the Sewer Company (Agreement No. 880080), under which Scottsdale agreed to accept and treat wastewater delivered by the Sewer Company at a metered connection located in the vicinity of North Scottsdale Road and Westland Road, in the southern portion of the Sewer Company's certificated area. Since 1989, Scottsdale has been accepting deliveries of wastewater from the Sewer Company and charging the Sewer Company for wastewater treatment services as a "large volume, non-uniform discharger" under Scottsdale's rate ordinance.

C. Following the execution and approval of Agreement No. 880080, a dispute developed concerning the extent and nature of the duties and obligations that may be imposed on the Sewer Company as a private utility regulated by the Arizona Corporation Commission and the effectiveness of Agreement No. 880080. As a consequence, certain obligations contained in Agreement No. 880080 have not been fully performed, including the purchase of treatment capacity by the Sewer Company. However, if Scottsdale were to cease treatment of a portion of the Sewer Company's wastewater, the Sewer Company would be unable to furnish sewer utility service to its customers due to its lack of treatment capacity.

D. The Sewer Company and Scottsdale desire to enter into a new agreement setting forth the terms and conditions under which Scottsdale will receive and treat wastewater from the Sewer Company and to clarify each party's rights and obligations.

EXHIBIT
B HOA-2
ADMITTED

16932-1
4/4/96

EXHIBIT
A-1

NOW, THEREFORE, in consideration of the promises and agreements set forth hereinafter, and other valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Scottsdale and the Sewer Company agree as follows:

AGREEMENTS:

1. Definitions.

(a) All terms used in this Agreement that are defined in Chapter 49, Article IV, Division 1 of the Scottsdale Revised Code shall have the same meaning as set forth in the Code unless specified otherwise herein.

(b) "Point of delivery" means the connection existing between the Sewer Company's collection and transmission system and the trunk main which has been constructed pursuant to Agreement No. 880079 within the right-of-way of North Scottsdale Road, in the vicinity of Westland Road. In the event that the portion of the Sewer Company's certificated area lying south of Westland Road is subsequently developed, Scottsdale and the Sewer Company agree to modify the point of delivery as may be necessary to include wastewater flows from this area.

2. General Obligations and Rights.

(a) Scottsdale shall accept deliveries of wastewater from the Sewer Company up to a total maximum of 1,000,000 gallons per day ("gpd") at the point of delivery and shall be responsible for transporting and treating such wastewater.

(b) All wastewater accepted by Scottsdale at the point of delivery shall become the sole property of Scottsdale. Scottsdale shall have the exclusive right to use, sell or exchange such wastewater, and the Sewer Company shall have no right or interest therein.

(c) The Sewer Company shall not be obligated to deliver any minimum quantity of wastewater to Scottsdale. However, the Sewer Company shall not sell, assign or exchange any wastewater to or with a third party; provided, that the Sewer Company shall not be prohibited from selling treated wastewater effluent produced by the operation of its treatment plant.

(d) This Agreement shall not grant Scottsdale or the Sewer Company any right, title or interest in the other party's utility plant or facilities. Each party shall be solely responsible for the operation, maintenance and repair of its system, except as may be otherwise provided herein.

3. Compliance With Scottsdale's Ordinances.

(a) The Sewer Company shall comply with the provisions of the Scottsdale Revised Code, Enforcement Response Plan and Penalty Policy Plan, as they may be amended from time to time, governing wastewater discharges to Scottsdale's sewer system. The current

requirements of the Scottsdale Revised Code are set forth in Chapter 49, Article IV and are attached to this Agreement as Exhibit A. Scottsdale shall provide the Sewer Company with notice of any proposed amendment or modification affecting the Sewer Company. The Sewer Company shall also comply with all applicable requirements of the U.S.E.P.A. and the Arizona Department of Environmental Quality governing the Sewer Company's wastewater discharges to Scottsdale's sewer system. In addition, and without limiting the foregoing, the Sewer Company shall conduct an annual survey of its commercial customers to determine if any require an industrial user permit. Such survey shall be completed by November 1, and the results thereof reported to Scottsdale. In the event the survey indicates that a customer's discharge requires permitting, the Sewer Company shall develop and implement a pretreatment program that satisfies applicable federal and state requirements. The Sewer Company shall confer with Scottsdale with respect to the development of such program.

(b) The failure of the Sewer Company or any of its customers to comply with the requirements described in subsection (a), above, or any interference with Scottsdale's wastewater treatment or transportation system caused by the Sewer Company shall be an act of default under this Agreement.

(c) The Sewer Company shall be liable for any penalties assessed against Scottsdale that are caused by the Sewer Company's deliveries of wastewater to Scottsdale. In such event, Scottsdale shall provide written notice to the Sewer Company specifying the particular penalties which have been assessed against it and describing with reasonable particularity the reasons why the Sewer Company's wastewater deliveries are believed to have caused the assessment of penalties. The Sewer Company acknowledges that the penalties which may be assessed against Scottsdale at present could be as great as $25,000 per day of violation.

4. <u>Purchase of Wastewater Treatment Capacity</u>.

(a) The Sewer Company shall pay to Scottsdale a one-time capital charge for the acquisition of wastewater treatment capacity hereunder. The capacity charge shall be equal to $6.00 per gallon per day ("gpd") of wastewater treatment capacity utilized by the Sewer Company.

(b) The Sewer Company shall purchase 210,000 gpd of wastewater treatment capacity on the effective date of this Agreement, at a total cost of $1,260,000. Such amount shall be paid to Scottsdale as follows:

(i) Not less than $200,000 shall be paid to Scottsdale within thirty (30) days of the effective date of this Agreement; and

(ii) The balance of the total cost, together with any interest accrued thereon (as more particularly described below) shall be paid to Scottsdale on or before two hundred seventy (270) days from the effective date of this Agreement.

(iii) Interest shall accrue on the deferred balance of the total cost for the purchase of wastewater treatment capacity at the rate of six percent (6.00%) per annum, commencing on June 1, 1996, and continuing through the date of payment.

In order to evidence the Sewer Company's obligation for the payment of the deferred balance of the amount due for the initial purchase of treatment capacity, the Sewer Company shall deliver to Scottsdale, concurrently with the payment described in subparagraph (i), above, a promissory note payable to Scottsdale evidencing the balance of the payment and the accrual of interest thereon, which shall be due and payable 270 days from the effective date of this Agreement. Said promissory note shall also provide for the payment of interest at the rate of fifteen percent (15%) per annum on all unpaid amounts in the event of a default.

(c) The Sewer Company shall purchase additional wastewater treatment capacity as necessary to correspond to the Sewer Company's wastewater deliveries to Scottsdale, up to a total maximum capacity of 1,000,000 gpd. Such additional wastewater treatment capacity shall be purchased by the Sewer Company in annual increments, calculated in January each year based on the highest average daily flow per month recorded during the previous calendar year. The Sewer Company's payment for the purchase of additional wastewater treatment capacity shall be due within thirty (30) days of the Sewer Company's receipt of Scottsdale's written notice specifying the amount of additional wastewater treatment capacity which must be purchased hereunder.

(d) Notwithstanding anything contained herein to the contrary, the Sewer Company shall be permitted to deliver quantities of wastewater in excess of the treatment capacity it has purchased in the event of an emergency that would temporarily prevent or restrict the operation of the Sewer Company's wastewater treatment plant. Such emergency must be the result of an unanticipated or unusual event or occurrence beyond the control of the Sewer Company. If any emergency occurs, the Sewer Company shall immediately provide telephonic notice thereof to Scottsdale's Water Resources Operations Division, and thereafter, provide written notice to Scottsdale describing the circumstances of the emergency in reasonable detail. In such event, the wastewater delivered to Scottsdale in excess of the treatment capacity previously purchased shall not be considered in calculating the Sewer Company's average daily flow per month, as provided in the previous subsection. However, no emergency shall exist for a period in excess of seven (7) days (excluding weekends and holidays), and any wastewater deliveries after such seven-day period shall be considered regular wastewater deliveries and be included in the calculation of the average daily flow unless otherwise agreed by Scottsdale.

5. <u>Payment of Monthly User Charges.</u>

(a) The Sewer Company shall pay Scottsdale a monthly user charge for all wastewater delivered to Scottsdale measured at the point of delivery. For the purpose of calculating the monthly user charge, the Sewer Company shall be classified as a non-uniform discharger, as set forth in Chapter 49, Article IV, Division 4 of the Scottsdale Revised Code. User charges shall be calculated and billed on a monthly basis, and be based upon the quantity and quality of wastewater

delivered to Scottsdale in accordance with the applicable provisions of the Code, unless otherwise agreed by the parties. Scottsdale may modify the user charge paid by the Sewer Company to correspond to any modifications made to Scottsdale's charges for the non-uniform discharger classification generally. Scottsdale shall provide the Sewer Company with written notice of any proposed amendment or modification of its monthly user charge.

(b) Scottsdale shall bill the Sewer Company for user charges on a monthly basis in accordance with Scottsdale's regular billing practices. The Sewer Company shall pay the user charges on or before twenty-five (25) days from the Sewer Company's receipt of a billing statement. An interest charge of one percent (1%) per month shall be added to any charges not paid by the due date, and any delinquent charges shall constitute a lien on the Sewer Company's utility plant and facilities for the purpose of securing payment, as specified by the Scottsdale Revised Code.

6. <u>Metering and Water Quality Sampling</u>.

(a) All wastewater delivered to Scottsdale shall be measured at the point of delivery using a flow meter approved by Scottsdale. At the Sewer Company's expense, Scottsdale and the Sewer Company shall jointly test and calibrate the flow meter annually, and maintain and repair the flow meter and the connection at the point of delivery. The accuracy of the flow meter shall be maintained as close to zero error as practical, but in no event shall error exceed three percent (3%). The flow meter shall be read by Scottsdale on a monthly basis in connection with calculating the Sewer Company's monthly user charge.

(b) Facilities sufficient to permit the accurate sampling of the quality of wastewater the Sewer Company delivers to Scottsdale shall also be installed at the point of delivery. The parties acknowledge and agree that the sampling facilities previously installed by the Sewer Company are sufficient for such purpose. The Sewer Company shall, at its expense, maintain and repair the sampling facilities as may be necessary to ensure the accuracy and reliability of wastewater samples.

(c) The Sewer Company shall measure the quality of the wastewater it delivers to Scottsdale on a quarterly basis for the purpose of computing the Sewer Company's monthly user charge as a non-uniform discharger. Each quarter, the Sewer Company shall take twenty-four (24) hour composite samples for a seven-day period during regular business hours. Standard sampling techniques shall be used, as specified in the Scottsdale Revised Code, and all samples shall be promptly delivered to and tested by a testing laboratory acceptable to both parties. Copies of the results of such testing shall be furnished by the laboratory to both the Sewer Company and Scottsdale.

(d) In the event the point of delivery is changed from its current location, the Sewer Company shall be responsible for all costs and expenses related thereto, including the cost of installing a new flow meter (if necessary) and sampling facilities. The design of the new connection and all related facilities shall be subject to approval by Scottsdale.

7. Right of Inspection.

(a) Scottsdale and its authorized agents and representatives shall have the right to:

(i) Inspect the flow meter, sampling facilities and connection to Scottsdale's transmission main at all reasonable hours; and

(ii) Take samples from the Sewer Company's collection mains and facilities for the purpose of verifying and monitoring discharges to the Sewer Company.

All such sampling and inspections shall be undertaken by Scottsdale at its sole risk, and shall not disrupt or interfere with the Sewer Company's regular business activities. The Sewer Company shall cooperate with and assist Scottsdale in such sampling and inspections. The costs of testing samples shall be borne by Scottsdale; provided, however, that if the test results show that a customer of the Sewer Company is discharging an industrial waste which may cause a violation of a water quality standard, interference or pass through, then the Sewer Company shall reimburse Scottsdale.

(b) The Sewer Company shall have the right to be present when Scottsdale takes samples for the Sewer Company's collection mains and facilities. If requested by the Sewer Company, Scottsdale shall provide the Sewer Company with split samples, and shall in any event provide the Sewer Company with complete copies of all laboratory test results. In the event that split samples are taken, the Sewer Company shall likewise provide Scottsdale with complete copies of any laboratory test results that it obtains.

8. Plant Failure or Scheduled Bypass.

(a) The Sewer Company shall immediately provide telephonic notice to Scottsdale's Water Resources Operations Division in the event of the failure of its treatment plant, and shall thereafter provide Scottsdale with written notice stating the reasons for the plant failure in reasonable detail.

(b) Sewer Company shall provide written notice to Scottsdale thirty (30) days prior to any scheduled bypass of its treatment plant to make repairs or modifications.

(c) In the event of a plant failure or scheduled bypass, the Sewer Company shall diligently and with all reasonable speed attempt to complete the repairs or modifications to the treatment plant and resume operation. In no event shall the Sewer Company bypass its treatment plant for more than seven (7) days (exclusive of weekends and holidays) without Scottsdale's written permission, which shall not be unreasonably withheld in the event of an emergency beyond the control of the Sewer Company.

(d) In the event Sewer Company elects to permanently cease operation of its treatment plant, then Scottsdale, in its sole discretion, may elect to terminate this Agreement and Scottsdale shall not be obligated to accept wastewater from the Sewer Company.

9. Service Area and Facility Map.

Following the execution of this Agreement, the Sewer Company shall provide Scottsdale with a map of its service area showing its collection and transmission mains, manholes, lift stations and other plant and facilities. Thereafter, the Sewer Company shall from time to time provide Scottsdale with an updated map of its facilities following any significant additions or improvements to the Sewer Company's system.

10. Liability and Indemnification.

(a) Scottsdale shall not be responsible for the control, transportation, handling, use, disposal, treatment or distribution of any wastewater or any by-products for constituents thereof upstream of the point of delivery.

(b) Sewer Company shall indemnify and hold Scottsdale and its elected and appointed officials, agents and employees harmless from any damage or claim of damage of any nature (including property damage, personal injury of death and any fines and penalties) arising out of or resulting from the wastewater the Sewer Company delivers to Scottsdale, including any failure of the Sewer Company or any of its agents, employees or contractors to comply with any statute, administrative regulation, ordinance or other standard or requirement applicable to the Sewer Company's wastewater collection and treatment system. The foregoing notwithstanding, the Sewer Company shall not be required to indemnify and hold Scottsdale harmless hereunder if the primary cause of the damage or claim of damage is an intentional or negligent act or omission of Scottsdale or any of its agents, employees or contractors.

11. Default and Remedies.

(a) In the event of a default by the Sewer Company, Scottsdale shall have the right to terminate this Agreement by providing to the Sewer Company a written notice specifying the nature of the default not less than thirty (30) days prior to the date of termination. In the event that the Sewer Company cures the default prior to the date of termination, then this Agreement shall not terminate and shall remain in effect.

(b) In the event this Agreement is terminated, the Sewer Company shall promptly disconnect its collection and transmission system from Scottsdale's transmission main at the Sewer Company's expense. In the event that the Sewer Company fails to promptly complete disconnection, Scottsdale may elect to do so, and all reasonable costs and expenses incurred by Scottsdale shall be paid by the Sewer Company.

(c) A defaulting party agrees to pay any penalties, fines and other impositions caused by the default, reasonable attorneys' fees and other reasonable costs and expenses incurred by the non-defaulting party to enforce the performance of the duties and obligations of the defaulting party or to protect the rights and interests of the non-defaulting party hereunder.

(d) Scottsdale shall have the right to take any lawful action against any person, including the Sewer Company, in response to a condition which may present an imminent and substantial endangerment to the public health, welfare or the environment, or which would cause the violation of any law, regulation, permit or other regulatory requirement imposed on Scottsdale.

12. Term of Agreement.

Unless otherwise terminated in accordance with Section 8 or Section 11 of this Agreement, this Agreement shall terminate without further action of the parties on December 31, 2016. The foregoing notwithstanding, this Agreement may be renewed for one or more additional five-year terms upon the mutual agreement of the parties.

13. Notices.

All notices to be given hereunder shall be given to the respective parties at the following addresses:

Scottsdale

General Manager
Water Resources Dept.
City of Scottsdale
9388 East San Salvador Drive
Scottsdale, Arizona 85258

with a copy to:

Scottsdale City Attorney
3939 Civic Center Boulevard
Post Office Box 1000
Scottsdale, Arizona 85252-1000

Sewer Company

President
Boulders Carefree Sewer Company
Post Office Box 5293
Carefree, Arizona 85377

All notices given hereunder shall be deemed given: (i) upon the sooner of actual receipt or five (5) days after such notice has been deposited in the United States Mail, certified--return receipt requested, postage prepaid and properly addressed; (ii) upon personal delivery of such notice; or (iii) one (1) day after the deposit of such notice with a reputable commercial courier service for hand-delivery.

14. Force Majeure.

Notwithstanding anything herein to the contrary, if the Sewer Company is delayed or interrupted in the performance of any of its duties or obligations hereunder by reason of "force majeure," then the Sewer Company shall be temporarily excused from the performance of such duty or obligation for so long as the condition causing the "force majeure" is in existence. "Force majeure" for the purposes of the Agreement shall mean a disability arising from causes beyond the control of the Sewer Company, including acts of God, accidents, fires, floods, damage to facilities, labor troubles, unavailability of materials, supplies or equipment, and any decisions, orders or requirements of courts or other governmental authorities. Upon the occurrence of a condition causing a "force majeure", the Sewer Company shall immediately provide written notice thereof to Scottsdale, describing the condition with reasonable specificity. The Sewer Company shall act in good faith and with all reasonable diligence to correct of eliminate the condition causing the "force majeure" as soon as possible. Notwithstanding anything in this section to the contrary, the occurrence of an event or condition causing a "force majeure" shall not relieve the Sewer Company of its duties and obligations under Section 8 relating to bypass and plant failure.

15. Cancellation of Contracts.

Pursuant to A.R.S. § 38-511, Scottsdale may cancel this Agreement within three (3) years after its execution, without penalty or further obligation, if any person significantly involved in initiating, negotiating, securing, preparing or creating this Agreement on behalf of Scottsdale is, at any time while this Agreement is in effect, an employee or agent of any other party to this Agreement in any capacity or a consultant to any other party to this Agreement with respect to its subject matter. In addition to the right to terminate this Agreement as provided above, Scottsdale may recover any fee or commission paid or due to any person significantly involved in initiating, negotiating, securing, preparing or creating this Agreement on behalf of Scottsdale from any other party to this Agreement arising as a result of this Agreement.

16. Approval by Subregional Operating Group.

This Agreement shall be effective when it is executed and approved by both parties. However, the parties acknowledge that this Agreement is subject to approval by the Subregional Operating Group Committee. Scottsdale covenants and agrees to diligently and in good faith seek approval from the Subregional Operating Group Committee, and to take such other and further action as may be required to secure such approval.

17. Miscellaneous.

(a) This Agreement sets forth the entire agreement between the parties with respect to its subject matter and supersedes all prior and contemporaneous agreements, discussions and representations related thereto, including Agreement No. 880080. No supplement, modification or amendment hereof shall be binding and effective unless in writing and executed and approved by all of the parties.

(b) The obligations in rights created by this Agreement are binding upon and inure to the benefit of the successors and assigns of the parties; provided, however, the Sewer Company may not assign or transfer any of its rights or obligations hereunder without the prior written consent of Scottsdale.

(c) This Agreement is made and entered into in the State of Arizona and the laws of such state shall govern the validity and interpretation hereof and the performance of the parties' respective duties and obligations.

(d) Each party shall cooperate with and provide reasonable assistance to the other party to obtain all required approvals and consents necessary to effectuate and perform this Agreement.

(e) Time is of the essence of this Agreement and each and every agreement, term, condition and obligation set forth herein. Any extension of time granted for the performance of any duty or obligation hereunder shall not be considered an extension of time for the performance of any other duty or obligation hereunder.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers and agents thereunto duly authorized on the date set forth hereinabove.

CITY OF SCOTTSDALE
A Municipal Corporation

By Shirley Bennett - Vice Mayor - for
MAYOR

ATTEST:

Lorrie Robertson
CITY CLERK

APPROVED AS TO FORM:

Margaret Wilson for
CITY ATTORNEY

BOULDERS CAREFREE SEWER CORPORATION, an Arizona corporation

By _____
PRESIDENT

BLACK MOUNTAIN SEWER CORPORATION

EXHIBIT
BHOA-3
ADMITTED

VIA FACSIMILE: 480-488-9623

4 May, 2001

Robert Hanus
President
WET Inc. (Western Environmental Tech.)
P.O. Box 4752,
Cave Creek, Arizona, 85331

RE: Effluent Delivery Agteement

Dear Robert:

As requested, please find attached Effluent Delivery Agreement for the Black Mountain Sewer Corporation as requested. Please read carefully and ensure you understand in detail this agreement and that you govern yourself and your company in accordance with this agreement at all times. If at any time you find that you cannot meet the conditions outlined in this agreement, please ensure that you contact myself or Graham Symmonds immediately or in anticipation of such an event.

Sincerely,

BLACK MOUNTAIN SEWER CORPORATION

Trevor T. Hill P.Eng
President

cc: Graham Symmonds – VP Engineering - BMSC

Document6

One Carefree Place
Box 731
Suite A2, 36800 N. Sidewinder Dr.
Carefree, AZ, 85377

Telephone: 480-488-4152 Facsimile: 480-488-8573

EFFLUENT DELIVERY AGREEMENT

THIS EFFLUENT DELIVERY AGREEMENT (this "Agreement") is made this ____ day of March, 2001 between THE BOULDERS CAREFREE SEWER CORPORATION, an Arizona corporation ("BCSC"), and BOULDERS JOINT VENTURE, an Arizona general partnership ("User"), sometimes referred to herein as a "Party" or collectively as the "Parties," for the purposes and consideration set forth hereinafter.

RECITALS:

A. BCSC owns and operates certain wastewater collection and treatment facilities and holds a certificate of convenience and necessity granted by the Arizona Corporation Commission (the "Commission") authorizing BCSC to provide sewer utility service within portions of the Town of Carefree and the City of Scottsdale, Arizona, including the sale of treated effluent ("Effluent") resulting from the operation of BCSC's treatment facilities.

B. User owns and operates a destination resort in north Scottsdale commonly known as The Boulders Resort and Club ("the Resort"). The Resort includes a hotel, clubhouse, pool, tennis courts, various landscaped areas and two 18-hole championship golf courses (the "Golf Courses"), and is located within BCSC's certificated service territory.

C. At the present time, BCSC operates a single wastewater treatment plant known as the Boulders East Plant. This treatment plant currently has a permitted capacity of 120,000 gallons per day ("gpd"). BCSC intends to seek approval to increase the treatment plant's permitted capacity to 150,000 gpd. The remainder of BCSC's wastewater is delivered to the City of Scottsdale for treatment.

D. BCSC currently delivers all of the Effluent produced by the Boulders East Plant to the Resort, pursuant to that certain Agreement, dated March, 18, 1986, as amended by that certain First Amendment to Agreement, dated March 18, 1996. The Resort utilizes the Effluent for

irrigation and maintenance of the turf, trees, shrubs and other landscaping at the Golf Courses, for the filling and refilling of storage reservoirs at the Golf Courses, and for related exterior uses.

E. The Parties desire to enter into a new agreement in order to modify certain terms and conditions, which shall supersede and replace the existing agreement, as amended.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Parties covenant and agree as follows:

AGREEMENTS:

1. Purchase and Sale of Effluent. BCSC agrees to sell and deliver and User agrees to purchase and accept delivery of all Effluent generated by the Boulders East Plant subject to the terms and conditions set forth hereinafter.

2. Service and Delivery of Effluent. BCSC shall deliver and User shall accept Effluent as follows:

(a) Quantity of Effluent. BCSC shall deliver to the Resort all Effluent generated by the operation of the Boulders East Plant (or a new wastewater treatment facility which may be constructed by BCSC as contemplated herein). In the event the treatment capacity of the Boulders East Plant is increased to a capacity greater than 150,000 gpd, or a new wastewater treatment facility is constructed by BCSC to replace the Boulders East Plant which produces Effluent in a quantity that is greater than 150,000 gpd, BCSC shall enter into good faith negotiations with User for the purchase by User of amounts of Effluent in excess of 150,000 gpd. The foregoing notwithstanding, nothing herein shall require BCSC to deliver Effluent to User in amounts in excess of 150,000 gpd.

(b) Quality of Effluent. The Effluent delivered by BCSC shall meet all applicable Federal, State of Arizona, and local health and safety standards for non-potable water supplied for turf irrigation and other exterior uses contemplated in this Agreement. BCSC makes no

representations or warranties with respect to any characteristic of the Effluent which is not specifically addressed by the applicable standards or the current re-use permit held by the User with respect to the Effluent. BCSC makes no representation or warranty that the Effluent is suitable for any purpose intended by User and use of the Effluent for any purpose is at the sole risk of the User.

(c) Metered Deliveries; Delivery Point. All deliveries of Effluent to User shall be metered. The meter is presently located immediately adjacent to the Boulders East Plant, which shall constitute the point of delivery. BCSC shall be responsible for the maintenance, repair and replacement of all facilities on BCSC's side of the meter as well as the meter, and User shall be responsible for the maintenance, repair and replacement of all facilities on User's side of the meter. The location of the meter may be changed by the mutual agreement of the parties. The User shall pay all costs associated with the maintenance, testing and certification of the meter.

(d) Service Interruptions by BCSC. BCSC shall use its reasonable efforts to provide a continuous level of service to User. In the event service is to be temporarily discontinued, BCSC shall promptly notify User of the particular circumstances and the estimated length of time during which service will be discontinued. BCSC shall make reasonable efforts to resume normal service as quickly as possible.

(e) Service Interruptions by User. In the event User is unable to accept deliveries of Effluent, User shall pay BCSC as if such Effluent had been delivered in accordance herewith and shall further pay BCSC the reasonable costs incurred by BCSC to dispose of such Effluent. In the event of a temporary interruption of the ability of User to accept Effluent, BCSC shall cooperate with User to minimize the amount of Effluent which cannot be accepted by BCSC. User shall make reasonable efforts to resume acceptance of deliveries of effluent as quickly as possible.

3. Charges for Effluent. The charge for all Effluent delivered to User hereunder shall

be determined from time to time by the Commission in connection with a general rate proceeding or similar proceeding in which all of BCSC's rates and charges for sewer utility service are determined in accordance with applicable laws and regulations. BCSC shall promptly notify User of all requests for modification of the charge for Effluent, and shall provide User, at User's cost, with a complete copy of all requests for rate increases or other rate adjustments, including the application, pre-filed testimony and supporting schedules and other exhibits. If the Commission at any time de-tariffs effluent service or ceases to consider such service a regulated service subject to the Commission's jurisdiction, the charge for Effluent delivered to User shall remain the tariffed charge for at least one year, after which time BCSC may modify the charge for Effluent without Commission approval provided that BCSC and User shall negotiate such modification in good faith. All such charges shall be subject to the provisions of Paragraph 12(a), below.

4. Payment for Effluent Service. User shall be billed for and shall pay for Effluent on a quarterly basis based on the metered quantity of Effluent delivered to User during the preceding calendar quarter plus the amount of any Effluent which BCSC made available but User was unable to accept during such calendar quarter. All amounts payable by User to BCSC hereunder shall be due and payable within twenty-five (25) days of receipt of invoice, and any payment not received within such time shall be considered delinquent and be subject to any late payment penalty authorized by the Commission.

5. Changes to Effluent Standards. In the event that material changes are made to the re-use permit held by the User, or to an Aquifer Protection Permit, or to the quality standards applicable to Effluent used for turf irrigation and related purposes, BCSC shall notify User of those modifications to the facility from which the Effluent is provided or to any retainage features which are required to ensure that such new standards are met. At the option of the User, User shall (a) pay the reasonable costs of such modifications which are required to be made to the facility or retainage

feature for the purpose of complying with the new permit requirements or effluent re-use standards, or (b) terminate this agreement in accordance with Paragraph 12.

6. BCSC's Covenants. BCSC covenants and agrees that BCSC will:

(a) Operate the Boulders East Plant and the related pipelines, pumps and facilities so as to allow the production and delivery of Effluent to User;

(b) Maintain in good standing and renew when appropriate all permits and other regulatory approvals necessary for purposes of subparagraph (a);

(c) Make such repairs, upgrades and improvements to the Boulders East Plant as may be necessary in connection with subparagraph (a); and

(d) Not restrict, reduce or otherwise limit the quantity of Effluent produced by the Boulders East Plant or take any action that would reduce the plant's treatment capacity except as otherwise provided for in this Agreement.

The obligations of BCSC under this Paragraph shall terminate if physical conditions at the Boulders East Plant or any laws, regulations, orders or other regulatory requirements prevent or materially limit the operation of the Boulders East Plant or render the operation of such plant uneconomic. If economic considerations, technical requirements or regulatory changes require BCSC to close or relocate the Boulders East Plant, BCSC will attempt, in good faith and to the extent technically feasible, to relocate the Boulders East Plant or construct a new wastewater treatment plant at a site that is a close as reasonably possible (taking into account the economics of such relocation or construction) to the Golf Courses. In the event the Boulders East Plant is relocated or a new facility constructed, User will be responsible for the costs of constructing additional pipelines and other facilities necessary to transport the Effluent from such new location to the Resort's delivery point, which upon request of BCSC shall be considered a contribution in aid of construction. BCSC shall be solely responsible for all costs and expenses resulting from the treatment of such pipelines and

facilities as contributions in aid of construction, including (without limitation) (i) costs relating to any easements for pipelines and facilities; (ii) costs relating to meter relocation; (iii) costs relating to maintenance and repair of the pipelines and facilities; and (iv) any income taxes. In the event the relocated or new facility has a larger capacity than the Boulders East Plant, User shall have the right to purchase a maximum amount of 150,000 gpd of effluent. For the purposes of this provision, the term "uneconomic" means that the costs and expenses relating to the treatment and delivery of Effluent, including applicable overheads, would exceed the market price for effluent used for golf course irrigation and similar purposes in Maricopa County.

7. User's Covenants. User covenants and agrees that User will:

(a) Operate, repair and maintain its storage lakes, pipelines, and other facilities used in connection with the transportation and storage of Effluent provided hereunder in accordance with all applicable laws and regulations; and

(b) Maintain in good standing and renew when appropriate all permits, including but not limited to Aquifer Protection Permits, and other approvals necessary for User to receive delivery of, store and utilize Effluent for turf irrigation, exterior landscape watering and similar uses.

8. Limitations on Effluent Use. User covenants and agrees that all Effluent delivered to User pursuant to this Agreement shall be used by User in connection with the Resort. User shall not make any changes in the nature of the use of the Effluent nor make any application for changes or amendments to the permit governing the use of the Effluent by the User, which changes or amendments may affect BCSC's operations, without the express written consent of BCSC. User shall not transport Effluent to any location outside of BCSC's certificated service territory, nor shall User sell or agree to sell Effluent to any other person or entity.

9. Indemnity.

(a) Indemnification of User. Subject to the limitations set out herein, BCSC shall indemnify, protect, defend (with legal counsel acceptable to User) and hold User harmless from, and upon demand shall pay or reimburse User for, any and all claims, actions, costs, fees, expenses, damages, environmental investigation costs, obligations, penalties, fines and liabilities (including, without limitation, reasonable attorneys' fees and court costs) arising out of any breach or default in the performance of this Agreement by BCSC or caused by any act, neglect, fault or omission of BCSC or its agents, contractors, employees or servants. User shall not seek indemnification from BCSC for any and all claims, actions, costs, fees, expenses, damages, environmental investigation costs, obligations, penalties, fines and liabilities (including, without limitation, reasonable attorneys' fees and court costs) arising out of the use of Effluent by the User or resulting from any characteristic of the Effluent which is not specifically addressed in the standards which are applicable to the Effluent.

(b) Indemnification of BCSC. User shall indemnify, protect, defend (with legal counsel acceptable to BCSC) and hold BCSC harmless from, and upon demand shall pay or reimburse BCSC for, any and all claims, actions, costs, fees, expenses, damages, environmental investigation costs, obligations, penalties, fines and liabilities (including, without limitation, reasonable attorneys' fees and court costs) arising out of any breach or default in the performance of this Agreement by User or caused by any act, neglect, fault or omission of User or its agents, contractors, employees or servants.

10. Force Majeure. Neither Party to this Agreement shall be liable to the other for failure, default or delay in performing any of its obligations hereunder, other than for the payment of money obligations specified herein, when such failure, default or delay is caused by strikes or other labor problems, by forces of nature, unavoidable accident, fire, acts of the public enemy,

interference by civil authorities, passage of laws, orders of the court, delays in receipt of materials, or any other cause, where such cause is not within the control of the Party affected and which, by the exercise of due diligence, such Party is unable to prevent. Should any of the foregoing occur, the Parties hereto agree to proceed with diligence to do what is reasonable and necessary so that each Party may perform its obligations under this Agreement.

11. Term. This Agreement shall remain in effect for a period of twenty (20) years from the date on page one of this Agreement, unless earlier terminated as provided under Paragraph 12, below. After the expiration of the initial twenty (20) year term, this Agreement shall be automatically renewed for successive five (5) year terms unless a Party provides written notice to the other Party of its election to terminate the Agreement, which notice shall be provided no less than one (1) year prior to the renewal of the Agreement.

12. Termination of Agreement.

(a) Rate Increases. In the event that the charge for Effluent delivered to User under this Agreement increases by more than twenty-five percent (25%) above the charge in effect at the time of any increase in the charge for Effluent or, in the alternative, increases by more than fifty percent (50%) within any five-year period, User, in its sole discretion, may terminate this Agreement by providing notice of its intent to terminate to BCSC on or before sixty (60) days from the date on which the increased charge becomes effective. If such notice is given, this Agreement, and all rights and obligations hereunder, shall terminate without further action one hundred twenty (120) days from the date such notice is delivered to BCSC. In the event that User elects not to exercise its right to terminate this Agreement following any increase in the charges for Effluent, User shall not waive its right to terminate based on future increases in charges.

(b) Termination for Breach. Either Party may terminate this Agreement in the event of a breach or anticipated breach of a material term or condition by the other Party. In such

event, the Party contending that a breach has or will occur shall promptly provide notice thereof to the other Party, and shall initiate proceedings in accordance with Paragraph 14, below.

(c) Termination for Effluent Quality Changes. If User elects not to pay for those modifications to the East Boulders Plant necessary to ensure the Effluent continues to meet changes to the quality standards applicable to the Effluent, this Agreement may be terminated by BCSC upon 120 days written notice to User by BCSC.

13. Notices. Any notice required or permitted to be given hereunder shall be in writing and directed to the address set forth below for the Party to whom the notice is given and shall be deemed delivered (i) by personal delivery, on the date of delivery; (ii) by first class United States mail, three (3) business days after being mailed; or (iii) by Federal Express Corporation (or other reputable overnight delivery service), one (1) business day after being deposited into the custody of such service.

If to BCSC to: Trevor Hill
Suite 201, 1962 Canso Road,
Sidney, British Columbia,
Canada V8L 5V5

with a copy to: Algonquin Power Income Fund
c/o Peter Kampian
Algonquin Power Corporation, Inc.
#210, 2085 Hurontario Street
Mississauga, Ontario L5A 4G1

If to User to: Boulders Joint Venture
c/o Wyndham International, Inc.
1950 Stemmons Freeway, Suite 6001
Dallas, Texas 75207
Attention: Legal Department

Any Party may designate another address for notices under this Agreement by giving the other Party not less than thirty (30) days advance notice.

14. Dispute Resolution.

(a) Good Faith Negotiations. For the purpose of dispute resolution, each Party

shall designate an officer or employee to act as its representative (hereinafter, "a Designated Representative"). A Party that believes a dispute exists under this Agreement will first refer the dispute to the Designated Representatives of the Parties for resolution. The Designated Representatives will personally meet and attempt in good faith to resolve the dispute. If the Designated Representatives cannot resolve the dispute within thirty (30) days, a Party that still believes a dispute requires resolution shall avail itself of the provisions of subparagraph (b), below.

(b) Arbitration. If a Party still believes a dispute requires resolution after following the procedures of subparagraph (a), that Party shall provide a detailed written notice of dispute to the other Party setting forth the nature of the dispute and requesting that the dispute be determined by means of arbitration. Immediately following such notice, the dispute shall be submitted for and settled by binding arbitration administered by the American Arbitration Association ("AAA") under its Commercial Arbitration Rules before a single arbitrator. Judgment on the award rendered by the arbitrator may be entered in any court with jurisdiction.

(c) Other Remedies. The preceding subparagraphs are intended to set forth the primary procedure to resolve all disputes under this Agreement. It is expected that all disputes that would traditionally be resolvable by a law court would be resolved under this procedure. However, the Parties recognize that certain business relationships could give rise to the need for one or more of the Parties to seek equitable remedies from a court that were traditionally available from an equity court, such as emergency, provisional or summary relief, and injunctive relief. Immediately following the issuance of any such equitable relief, the Parties will stay any further judicial proceeding pending arbitration of all underlying claims between the Parties. The Parties also recognize that the Commission may have primary jurisdiction over certain issues that may arise between and among the Parties that relate to the provision of public utility service. Accordingly, this paragraph is not intended to prohibit a Party from bringing any such issues to the Commission

for resolution or from taking any position at the Commission that would not be inconsistent with or barred by this Agreement or by collateral estoppel, res judicata or other issue or fact preclusion doctrines.

15. Attorneys' Fees. In the event either Party hereto employs legal counsel or brings a judicial action or any other proceeding against the other Party to enforce any of the terms, covenants or conditions hereof, the prevailing Party in such action or proceeding shall be entitled to recover its reasonable attorneys' fees and costs from the other Party, and in the event any judgment is secured by such prevailing Party, all such attorneys' fees and costs shall be included in such judgment. Any arbitration shall be considered a judicial action for the purposes of this paragraph.

16. Resort Accommodations. From time to time, and subject to availability, User shall make accommodations at the Resort available to visiting representatives of BCSC at the best available corporate rate then offered by the Resort. BCSC's rights under this Paragraph shall be strictly limited to the use of accommodations for business purposes.

17. Amendments and Waiver of Conditions. No waiver by either Party of any breach of this Agreement by the other Party shall be construed as a waiver of any preceding or succeeding breach. This Agreement may be amended only in writing and may not be amended or modified by any part performance, reliance or course of dealing.

18. Additional Acts. The Parties agree to execute promptly any other documents and to perform promptly any other acts as may be reasonably required to effectuate the purposes and intent of this Agreement.

19. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Parties. This Agreement, together with all rights, obligations, duties and privileges arising hereunder, may be assigned by either Party without the consent of the other Party. If either Party assigns its interest hereunder, then such assignment shall

be set forth in a written document executed by the assignor and assignee, which document shall contain an express assumption by the assignee of all obligations of the assignor under this Agreement. The foregoing notwithstanding, the failure of an assignee or other successor in interest to execute and deliver such written document shall not terminate or otherwise limit the rights of the non-assigning Party hereunder.

20. Governing Law; Severability. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of Arizona. If a court or governmental agency with jurisdiction determines that any provision of this Agreement is unenforceable, illegal or contrary to any applicable law, regulation, regulatory order, or tariff, then such provision shall be severed from this Agreement. In such case, the remainder of this Agreement shall remain in effect if both Parties can legally, practicably, and commercially continue without the severed provision.

21. Construction. The terms and provisions of this Agreement represent the results of negotiations between BCSC and User, neither of which have acted under any duress or compulsion, whether legal, economic or otherwise. Each Party has had the full opportunity to review and understand the legal consequences of this Agreement. Consequently, the terms and provisions of this Agreement should be interpreted and construed in accordance with their usual and customary meaning, and BCSC and User each waive the application of any rule of law providing that ambiguous or conflicting terms or provisions are to be interpreted or construed against the Party whose attorney prepared this Agreement.

22. Integration. The terms of this Agreement supersede all prior and contemporaneous oral or written agreements and understandings of BCSC and User with respect to its subject matter, all of which will be deemed to be merged into this Agreement. This Agreement is a final and complete integration of the understandings of BCSC and User with respect to the subject matter hereof. If there is any specific and direct conflict between, or any ambiguity resulting from, the

ms and provisions of this Agreement and the terms and provisions of any document, instrument, or other agreement executed in connection with or furtherance of this Agreement, the term, sion, document, instrument, letter or other agreement will be interpreted in a manner consistent the general purpose and intent of this Agreement.

22. Headings and Captions. The headings and captions of this Agreement are for ce only and are not intended to limit or define the meaning of any provision of this ment.

23. Counterparts. This Agreement may be executed in any number of counterparts, each when executed and delivered, shall be deemed an original, but all of which when taken would constitute one binding contract and instrument.

IN WITNESS WHEREOF, BOULDERS CAREFREE SEWER COMPANY and ERS JOINT VENTURE, have caused this Agreement to be executed on their behalf by uthorized representatives as of the day and year first above written.

BOULDERS CAREFREE SEWER
CORPORATION, an Arizona corporation

By: _____
TREVOR T. HILL
Its: PRESIDENT

BOULDERS JOINT VENTURE,
an Arizona general partnership

By: PAH GP, INC.
A Delaware corporation
Its: general partner

By: _____
~~Fred J. Kleisner, President~~
John R. Bohlmann, Vice President

Ridenour, Hienton & Lewis, P.L.L.C.
Scott S. Wakefield, State Bar No. 013442
201 N. Central Avenue, Suite 3300
Phoenix, Arizona 85004-1052
602-254-9900
sswakefield@rhkl-law.com

EXHIBIT
BHOA-4
ADMITTED
PENGAD 800-631-6989

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	NO. DOCKET NO. SW-02361A-08-0609

DIRECT TESTIMONY OF

LES PETERSON

Boulders Homeowners' Association

September 18, 2009

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INTRODUCTION AND PURPOSE OF TESTIMONY

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Les Peterson. I live at 2045 Smoketree Drive, Carefree AZ. My home is located within the north (Carefree) portion of The Boulders subdivision.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of the Boulders Homeowners' Association ("BHOA"), which is an association of 332 home and property owners in the northern portion of the Boulders community in Black Mountain Sewer Corporation's ("BMSC" or the "Company") service area. The residents of the south portion of the Boulders community (which is located in the limits of the City of Scottsdale) have a separate homeowners association, the Owners' Association of Boulders Scottsdale ("OABS"). The OABS fully supports the position of the BHOA in this matter.

Q. WHAT IS YOUR AFFILIATION WITH BOULDERS HOMEOWNERS' ASSOCIATION?

A. I am President of the BHOA.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. Arizona State University; BA, 1965, MA, 1967

Teacher; Scottsdale, AZ School District, 1967

Marketing; Procter & Gamble, 1968-1971

Promotion Manager; The Pillsbury Company, 1971-1973

Executive Vice President; Glendinning Companies, 1973 – 1979

Founder and President; Connecticut Consulting Group, 1979-1991

Executive Vice President; Clarion Division of Darcy Masius Benton & Bowles, 1991 – 2000

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am testifying to provide the Commission information about the wastewater treatment plant (the "Boulders Wastewater Plant" of the "Plant") located within the Boulders community, and an agreement the BHOA has reached with BMSC, to finally and completely address the noise and odor issues associated with the Plant.

BACKGROUND ON ODOR ISSUES

Q. PLEASE PROVIDE SOME HISTORICAL BACKGROUND ON THE ISSUE.

A. The Boulders Wastewater Plant was originally constructed in about 1971. It was initially constructed to serve homes within the Boulders. Even before the Company received a certificate of convenience and necessity ("CC&N) from the Commission, problems with a sewer system in nearby Carefree led to the absorption of that system by the Company.[1]

In 1980 the Commission issued the original certificate of convenience and necessity ("CC&N") to Boulders Carefree Sewer Corporation ("Boulders Carefree"), BMSC's predecessor. Boulders Carefree's CC&N application sought approval to move the site for treatment of wastewater from the site of the Plant to another site.[2] The Commission did not approve use of a substitute site for

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[1] Decision No. 53300 at 2 (1982). Until the Company acquired the Carefree system, it was not required to hold a CC&N.

[2] *See* Decision No. 50544 at Finding of Fact No. 2 (attached as Exhibit A).

treatment of the Company's wastewater at that time because the request was "too indefinite as to time and can be submitted for approval" at a later time.[3] Nearly thirty years later, the Boulders Wastewater Plant still operates in the center of our neighborhood.

Over time, however, the Boulders Wastewater Plant came to service approximately 50% of all of the homes - and all of the commercial establishments - in the Town of Carefree (the "Town"), and it became the sole wastewater treatment plant for the entire Town. Residences were built around and in relatively close proximity to the Boulders Wastewater Treatment Plant prior to the time its use and service area were dramatically expanded. The "sudden and unexpected expansion" of the Company's service territory created severe financing difficulties for the Company, which were addressed by plant capacity charges[4], an interim rate increase in 1981[5] and permanent rate increase in 1982[6] and 1985.[7]

As a result of the unexpected rapid expansion of the service territory, the Company required an alternative source to treat its wastewater flows that exceeded the capacity of the Boulders Wastewater Plant and began sending excess flows to by treated by the City of Scottsdale as early as 1989.[8] Currently, only about 20 percent of BMSC's total annual raw sewage is treated at the Boulders Wastewater Plant. The Plant has a permitted treatment capacity of 120,000 gallons per day, and flows of raw sewage to the Plant are slightly more than this 120,000 gallon per day in the summer months, and approximately 400,000

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[3] *Id.* at pg. 10.
[4] Decision No. 50544.
[5] Decision No. 52585.
[6] Decision No. 53300.
[7] Decision No. 54537.
[8] Decision No. 59944 at 2.

gallons/day in the winter months. All raw sewage in excess of 120,000 gallons daily flows directly into the City of Scottsdale's ("Scottsdale" or the "City") sewer system and is treated at the City's Water Campus treatment plant ("Scottsdale Treatment Plant").

The Boulders Wastewater Plant is located very close to several homes. Three homes are within less than 100 feet from the Plant, and 10 homes are within approximately 300 feet of the Plant. Within approximately 500 feet of the Wastewater Plant there are 17 homes, and within approximately 1,000 feet there are between approximately 200 to 300 homes plus primary dining and conference facilities of the Boulders Resort (the "Resort").

Over the years, particularly on occasions during the colder weather and heavier BMSC system usage during the winter months, strong odors have permeated throughout the Boulders. Given the strength of the odors, it was difficult to specifically tell if the odors originated from the Wastewater Treatment Plant or the raw sewage collection system from throughout Carefree or from both.

At the time of BMSC's last rate case in 2005, the odor issues (I use the term "odor" to include the strong and nauseating smells, system noises and health concerns resulting from raw sewage flowing out of the man-hole covers, lift stations and broken collection system pipes during rains and into the streets and washes) were so frequent and so pervasive that the BHOA intervened in the case to bring the problem to the Commission's attention and seek its assistance in getting the "odor" issues resolved. The Town also intervened in the case to raise its concerns about the "odor" issues and a lift station in a commercial area.

The Commission's Decision in that case allocated nearly eight pages to discussion of the "odor" issues, which it described as "[t]he most contentious

issue of [the] proceeding."[9] The Commission ordered the Company to adopt either one of the two solutions that had been proposed at the hearing by the Town's witness or some alternate remedy with the agreement of all of the parties. The Company then hired a consultant who proposed an alternative remedy focusing upon the collection system as the primary source of the "odor" problem, to which the other parties acquiesced based upon the consultant's expertise. Among other proposed solutions, the consultant's recommended remedy involved installing air jumpers between manholes along Boulder Drive. The Company also corrected the slope of the collection system line on Quartz Valley Drive. The Company installed the air jumpers and corrected Quartz Valley Drive line slope by June 2007.

Q. ARE THERE STILL ODOR AND NOISE ISSUES?

A. Odors from the Boulders Wastewater Plant continue to be very noticeable by and objectionable to Boulders residents, though at a lesser frequency than before the air jumpers were installed and the line slope was corrected. In addition, the noises of the operation of the Boulders Wastewater Plant are very noticeable from nearby homes and homes as far away as an estimated 400 feet, and there is ongoing traffic (service vehicles, pumper trucks, sub-contractor vehicle parking, dumpsters, etc.) associated with the Wastewater Plant operations in our quiet community. The BHOA has had open dialogue with Company about these ongoing issues and the Company assures us that it takes our concerns seriously. Since the last rate case, the Company's behavior generally has been consistent with those assurances. However, it is our understanding that it is impossible to

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[9] Decision No. 69164 at pg. 30.

completely eliminate the significant remaining odors and noise from any wastewater treatment plant, let alone one that is nearly 40 years old. The Company has described the fact that Plant is located very close to residences as "a problem of geography." The Company has also informed us that they understand, pursuant to current requirements, a facility such as the Boulders Wastewater Plant would currently have required set backs of at least 1,000 feet from the nearest property line of an adjacent dwelling.[10]

BENEFITS OF CLOSING OF THE PLANT

Q. WHAT IS BHOA HOPING TO ACCOMPLISH BY PARTICIPATING IN THIS PROCEEDING?

A. BHOA intervened in this rate case in an attempt to get BMSC to shut down the Boulders Wastewater Plant as soon as possible, either voluntarily or pursuant to a Commission order. After all, it was the Company's intention as early as 1980 that the Plant site in the middle of a neighborhood would be replaced and the Company's wastewater would be treated at a different, and less objectionable, location. Portions of the Company's wastewater in fact has been treated at a different location for the past 20 years, and it is time to finally shutter the plant that was thirty years ago considered a temporary treatment plant location.

Fortunately, BMSC and other interested stakeholders have been cooperative in our discussions with them to achieve that result. As a result, BMSC and the BHOA have been able to reach an agreement (the "Settlement Agreement") under which BMSC would cease operations of the Wastewater Plant within 15 months of the Commission's Order in this case approving the agreement.

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[10] A.A.C. R18-9-B201(I).

Q. ARE THERE ANY IMPEDIMENTS TO CLOSING THE BOULDERS WASTEWATER PLANT THAT THE COMPANY NEEDED RESOLVED PRIOR TO AGREEING TO SHUT IT DOWN?

A. Yes, there are several. First, BMSC needs an alternative plant to treat the wastewater that is currently being treated at the Boulders Wastewater Plant. Second, BMSC has an agreement obligating it to provide the treated effluent from the Boulders Wastewater Plant to the Resort for irrigating the golf course in the Boulders community. That agreement is effective until 2021. Therefore, BMSC would need to get the Resort's agreement to close the Wastewater Plant. The Resort needs to secure an alternative source of effluent in order to agree to termination of its agreement with BMSC.

Q. HAS THE COMPANY IDENTIFIED AN ALTERNATIVE SOURCE TO TREAT THE WASTEWATER THAT IS CURRENTLY TREATED AT THE PLANT?

A. Yes. The City is willing to treat those wastewater flows at the Scottsdale Treatment Plant. This is the same plant that currently treats the other 80 percent of BMSC's wastewater that is not treated at the Boulders Wastewater Plant. The Scottsdale Treatment Plant has sufficient excess capacity to treat these additional wastewater flows. Representatives of the City have indicated their willingness to treat these additional flows from BMSC. BMSC's existing wastewater collection system is already connected to the Scottsdale Treatment Plant. Upon closure of the Boulders Wastewater Plant, Scottsdale would be treating all of BMSC's wastewater. The Company may need to upgrade some of its collection system to

deliver the additional wastewater flows to the Scottsdale Treatment Plant, but it expects it could perform any necessary upgrades within a year.

Q. HAS THE RESORT AGREED TO TERMINATE ITS CONTRACT WITH BMSC FOR THE EFFLUENT FROM THE WASTEWATER PLANT?

A. Representatives of BMSC, the Town, the OABS and the BHOA met with the Resort to discuss that, and the Resort expressed its' agreement to this change provided that an alternative source of effluent could be identified and contracted at an acceptable price. As a matter of background, the Resort currently purchases 70% of its required effluent from the Scottsdale Treatment Plant in addition to the effluent it purchases from BMSC. Additional effluent produced by the Scottsdale Treatment Plant is available to the Boulders Resort in sufficient quantities to replace the effluent from the Boulders Wastewater Plant. Currently, the Desert Mountain Golf Club ("Desert Mountain") contracts for (and is required to pay for) effluent from the Scottsdale Treatment Plant well in excess of what Desert Mountain requires to irrigate its turf. The Resort could purchase a portion of this excess Desert Mountain effluent, which could be delivered directly to the Resort through the existing lines that already deliver effluent from the Scottsdale Treatment Plant to the Resort's golf courses.

The effluent from the Scottsdale Treatment Plant is of a higher quality (less salt and brine) than the effluent produced by the Boulders Wastewater Plant. Therefore, the Resort could achieve a level of cost savings by using more of the higher-quality effluent from the Scottsdale Treatment Plant in lieu of the effluent from the Boulders Wastewater Plant.

SETTLEMENT AGREEMENT TO ACCOMPLISH PLANT CLOSURE

Q. PLEASE DESCRIBE THE MAJOR TERMS OF THE SETTLEMENT AGREEMENT.

A. The Settlement Agreement is attached as Exhibit B. It provides for BMSC to shut down the Boulders Wastewater Plant within 15 months of certain conditions being satisfied. Those conditions include (1) modifying its agreement with the City of Scottsdale to confirm that the Company will have continued access to capacity at the Scottsdale Treatment Plant after closure of the Boulders Wastewater Plant and beyond the term of its current agreement with the City; (2) modifying BMSC's collection system to accommodate sending the additional flows to the Scottsdale Treatment Plant; (3) the Resort agreeing to termination of its agreement with BMSC for the effluent from the Boulders Wastewater Plant; and (4) the Commission approving a cost recovery mechanism for the costs associated with the closure of the Boulders Wastewater Plant. Once operations of the Boulders Wastewater Plant have ceased, the Company will remove the structures and equipment from the site, perform any necessary hazardous substance remediation, and restore the site so that residential structure(s) may be constructed on the site. The Company will sell the site for residential use, and share the gain on the property equally with its customers.

Q. IN ADDITION TO ELIMINATING THE ODORS ASSOCIATED WITH THE PLANT, ARE THERE OTHER BENEFITS OF THE SETTLEMENT AGREEMENT?

A. Yes. BHOA understands that BMSC has an existing agreement with the City of Scottsdale under which BMSC can buy additional processing capacity at the Scottsdale Treatment Plant at very favorable rates through 2016. BMSC has

requested a 25 year extension of its existing contract with the City at these attractive rates. I understand that the City is agreeable to extend the contract through 2041. The Settlement Agreement will result in BMSC entering into an agreement with Scottsdale for both an additional 25 years of BMSC having access to additional capacity at Scottsdale's treatment plant, and at rates that are about 1/3 of what the current market rate is for treatment capacity. ($6.00/gallon under the Scottsdale Agreement, versus, for example, what I understand is approximately $18.00/gallon at the new Cave Creek Wastewater Treatment Plant.)

Q. DO YOU KNOW WHAT THE FUTURE RATE IMPACTS WOULD BE FROM CLOSING THE BOULDERS WASTEWATER PLANT AND SENDING ALL OF THE WASTEWATER TO THE SCOTTSDALE TREATMENT PLANT?

A. BMSC will be addressing the possible rate impacts of closing the Plant when it files its rebuttal testimony.

Q. HAVE YOU DISCUSSED THE TERMS OF THE SETTLEMENT AGREEMENT WITH ANY OTHER PARTIES TO THIS PROCEEDING AND OTHER CUSTOMER REPRESENTATIVES?

A. Yes, we have. Throughout our negotiations, we have discussed the matter with representatives of the Town of Carefree, which have expressed its support for closing the Boulders Wastewater Plant, and the OABS, which is also supportive of the Settlement Agreement. We also met with the Commission's Staff and the Residential Utility Consumer Office to brief them on the settlement deveopments.

Q. WHAT SPECIFICALLY ARE YOU REQUESTING FROM THE COMMISSION AT THIS TIME?

A. BHOA is requesting that the Commission approve the Settlement Agreement.

CONCLUSION

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS?

A. Yes. Nearly thirty years ago, when BMSC's predecessor first came to this Commission for authorization to provide wastewater service, it indicated its expectation that the Boulders Wastewater Plant would be replaced as the area grew and more customers required treatment of their sewage. The Commission indicated at that time that the utility could seek specific approval for such replacement at the time a more definite treatment alternative was identified. Though it has been 20 years since the Company first identified the City of Scottsdale as a specific alternative source of treatment, the Plant that sits less than 100 feet from homes remains in operation. The time has come to retire the Boulders Wastewater Plant, as the Company has intended to do since it first came to the Commission for a CC&N. The two homeowners associations that together represent 732 residential customers, and the Town of Carefree, support the Settlement Agreement and the closure of the Boulders Wastewater Plant.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

308889;ssw;22938-0001

EXHIBIT A

Arizona Corporation Commission
DOCKETED
JAN - 3 1980
DOCKETED BY

BUD TIMS
Chairman
JIM WEEKS
Commissioner
JOHN AHEARN
Commissioner

IN THE MATTER OF THE APPLICATION OF THE BOULDERS CAREFREE SEWER CORPORATION FOR CERTIFICATE OF CONVENIENCE AND NECESSITY FOR SEWAGE TREATMENT SYSTEM.

DOCKET NO. U-2361

DECISION NO. 50544

OPINION AND ORDER

DATE OF HEARING: November 13, 1979

PLACE OF HEARING: Phoenix, Arizona

HEARING OFFICER: Wm. R. Giese

APPEARANCES: Barney Paulsen, Assistant Director, Utilities Division, on behalf of the Arizona Corporation Commission

Richard Hoffarth, Engineer, Utilities Division, on behalf of the Arizona Corporation Commission

Brown & Bain, by Cary D. Jones, on behalf of the Applicant

FINDINGS OF FACT

1. The applicant, Boulders Carefree Sewer Corporation, is a wholly owned subsidiary of Boulders Carefree Corporation, both Arizona corporations, having the same officers and directors. Boulders Properties, Inc. hereinafter referred to has the same officers, directors, and shareholders as Boulders Carefree Corporation.

2. The applicant has applied for a Certificate of Convenience and Necessity to construct, maintain and operate a sewage treatment plant and system consisting of lines, connections, manholes and all necessary equipment in the area more particularly described herein lying in Maricopa County, Arizona. In addition, the applicant requested approval of; (a) proposed rates to be charged users for sewer service, (b) a contract with Desert Foothills Sanitary District to process the sewage originating within the District, (c) an effluent contract proposed between applicant and Boulders Carefree Corporation for the sale of effluent from the applicant's sewage treatment

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Arizona Corporation Commission
DOCKETED
JAN - 3 1980
DOCKETED BY: mlp

BUD TIMS
Chairman
JIM WEEKS
Commissioner
JOHN AHEARN
Commissioner

IN THE MATTER OF THE APPLICATION OF THE BOULDERS CAREFREE SEWER CORPORATION FOR CERTIFICATE OF CONVENIENCE AND NECESSITY FOR SEWAGE TREATMENT SYSTEM.

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facilities, and (d) for future movement of the present site of applicant's sewage treatment plant to another site in the area. By amendment to its original application, the applicant requested approval for construction of an additional interim sewage treatment plant in the approximate amount of $258,738 and approval of financing for the additional interim sewage plant. By the amendment, the applicant also requested higher rates for sewer service than proposed in its original application. At the hearing, the applicant also amended its original application to include the Carefree Drive Improvement District within its certificated area and for the transfer of the assets and Certificate of Convenience and Necessity of Carefree Water Company, Inc. for sewer services in said area as provided in Arizona Corporation Commission Decision No. 34518, to Boulders Carefree Sewer Corporation.

3. The Maricopa County Board of Supervisors on August 6, 1979 granted a franchise to Boulders Carefree Sewer Corporation for the right to construct, maintain and operate a sewage treatment plant and system for the proposed certificated area. The applicant has also received the approval of the Arizona State Land Department and the Maricopa County Health Department to the granting of the certificate of convenience and necessity.

4. The Boulders Carefree Corporation is the developer of a real estate development called "Boulders Carefree" Units 1 through 5 to date, in the Carefree area consisting presently of an aggregate total of 249 lots, a golf course and club house. At the present time, approximately 143 residential units are constructed and occupied at "Boulders Carefree." Boulders Properties, Inc., an affiliate of Boulders Carefree Corporation, is the owner of a private sewage treatment plant and system. This sewage treatment plant and system was originally built to serve only the residents and golf course in Boulders Carefree development, but is now processing all the treated sewage in Carefree. The sewage treatment plant is presently serving approximately 200 users including 15 commercial users. The present sewage treatment plant is operating to capacity and construction of

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an additional treatment plant is necessary to process sewage for additional users anticipated during the next 3 to 5 years. The existing sewage treatment plant (Defiance package plant) has a capacity of approximately 120,000 gallons per day and the additional plant (Smith & Loveless package plant) will have a capacity of about 60,000 gallons per day. The new Smith & Loveless package treatment plant has already been contracted for and is expected to be on the line in service by March 1980, according to the applicant. Testimony was presented indicating long-term future growth potential of 1,000 to 1,200 more hookups in the Boulders development and an unknown number in other parts of the proposed certificate area. It was indicated that when this occurred in approximately 10 years, more or less, the peak load would run 750,000 to a million gallon per day requiring construction of an entirely new sewage treatment plant. The applicant anticipates that all other future treatment plant construction would be at a different site than the present location of the two package plants and has requested approval of site change when and if this occurs.

5. The applicant proposes the construction at this time of an additional sewage treatment plant to increase the present capacity of 120,000 gallons per day to 180,000 gallons per day. This construction would occur at the present site of the Boulders Properties, Inc. sewage treatment plant and the initial cost to the applicant of constructing this Smith & Loveless package plant and related equipment including sewer lines, would be approximately $258,738. It is anticipated that the financing for the additional treatment plant would be provided by a refundable advance in aid of construction from Boulders Carefree Corporation in an amount sufficient to construct the required mains and lines estimated to be approximately $140,638 and a short-term loan from Boulders Carefree Corporation to the applicant in the approximate sum of $118,100. The proposed loan would bear interest at the rate of interest which Boulders Carefree Corporation has to pay for the advance funds, estimated initially at 2%

greater than the prime rate of interest. A portion of the funds necessary to construct the interim plant and to repay the foregoing debt would be provided by hookup fees, in the form of a contribution in aid of construction charge to existing users not within the Boulders development and all future users regardless of their location within the certificated area.

6. According to the applicant, the Boulders Carefree Corporation will make a contribution of capital to the applicant of $250,000. This contribution to capital will consist of the existing sewage treatment facility (Defiance package plant) with an estimated replacement cost of $225,000 and $25,000 cash for working capital. Upon certificate approval, Boulders Properties, Inc. will merge into Boulders Carefree Corporation and the present package plant will be transferred to Boulders Carefree Corporation and then to the applicant. The real estate upon which the present Defiance package plant and new Smith & Loveless package plant is located is leased from another party. The present lease fee is $2,000 per year.

7. Mr. Edward F. Everett, President of Carefree Water Company, Inc., testified at the hearing that the Board of Directors and stockholders of Carefree Water Company, Inc. had approved of the transfer of its certificate for sewer services only and its sewer assets to the applicant. The Carefree Water Company has no sewer plant and presently all its sewage is treated by Boulders Properties, Inc. at its plant without charge. The certificated area of Carefree Water Company, Inc. includes portions of the area known as Carefree Drive Improvement District. The assets of Carefree Water Company consist of a collection system, a force main and two leach fields. The personal property assets of Carefree Water, Inc. used in its sewer operation and its certificate would be transferred to the applicant upon Commission approval without cost. The real property owned by Carefree Water Company, Inc. used in its sewer service would be sold to the applicant at the appraised value. Mr. Everett further testified that Carefree

Water Company, Inc. has no line extension agreements or refundable deposits due its users. Mr. Everett is presently the certified operator and manager of the Boulders Properties, Inc. plant and the Carefree Water Company, Inc. collection system and it is contemplated that he will continue in that capacity for the applicant. Mr. Harry R. Keller, Assistant Maricopa County Engineer and Deputy Superintendent of Streets, testified that his department consented to the granting of the certificate to the applicant, including the area known as the Carefree Drive Improvement District. He also testified that the Carefree Drive Improvement District would not be dissolved until its bonded indebtedness is paid in full by approximately 1988. This bonded indebtedness appears to have been incurred by the Carefree Drive Improvement District when it constructed a force main to assist Carefree Water Company to get the district sewage to the Boulders Properties, Inc. treatment plant. At the present time, a loose accounting system appears to exist for the users of the Boulders treatment plant in that Carefree Water Company bills all users the monthly fee and then takes operating expenses out of monies collected.

8. The Desert Foothills Sanitary District and Desert Foothills Improvement District both have the same boundaries and are not included in the proposed certificated area. These districts have no sewer service at present and are served by septic systems. Eventually, the applicant intends to process the sewage originating within these districts and has submitted a proposed contract (Exhibit 11) with the districts for Commission approval. The agreement appears to be in proper form except a commencement date should be provided therein.

9. The applicant proposes to enter into a contract with the Boulders Carefree Corporation for the sale of its effluent and a copy of the proposed contract (Exhibit 12) is submitted for approval. As a result of the hearing, the applicant has now submitted an amendment to Exhibit 12, making certain revisions in the original proposed contract as to commencement date, sale price of effluent, and billing

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cycle. The contract as amended provides for an initial sale price of the effluent of $12 for each acre foot, subject to review and revision every two years. The purchaser of the effluent, Boulders Carefree Corporation, intends to use the effluent for irrigation purposes on one or more of its golf courses.

10. The present rates and the proposed rates of the applicant are as set forth in Amended Exhibit 10 attached hereto and incorporated herein as part of these Findings of Fact.

CONCLUSIONS OF LAW

1. The Arizona Revised Statutes give the Arizona Corporation Commission the power to regulate and supervise public service corporations, determine and prescribe the rates and require said corporations to obtain a certificate of convenience and necessity.

2. There is a present and continuous need for a sewage treatment plant and system to serve the population in the proposed certificated area.

3. The Boulders Carefree Sewer Corporation is a fit and proper entity to receive a certificate of convenience and necessity for the operation of a sewage treatment plant and system consisting of lines, connections, manholes and all necessary equipment.

4. Interim rates may be granted where there exists an immediate and urgent need therefore.

5. The interim rates and charges established herein are just and reasonable.

ORDER

WHEREFORE, IT IS ORDERED: That Boulders Carefree Sewer Corporation be granted a certificate of convenience and necessity to construct, maintain and operate a sewage treatment plant and system consisting of lines, connections, manholes and all necessary equipment in an area in Maricopa County, Arizona, more particularly described as follows:

1. Section 35, Township 6 North, Range 4 East, Gila and Salt River Base and Meridian.

2. Section 36, Township 6 North, Range 4 East, Gila and Salt River Base and Meridian, except that part of Section 36 situated south of Cave Creek Road in the Southeast Quarter (SE 1/4) of said Section 36.

3. Southeast Quarter (SE 1/4) of the Northeast Quarter (NE 1/4) of Section 34, Township 6 North, Range 4 East, Gila and Salt River Base and Meridian.

4. East half (E 1/2) of Southeast Quarter (SE 1/4) of Section 34, Township 6 North, Range 4 East, Gila and Salt River Base and Meridian.

5. Section 2, Township 5 North, Range 4 East, Gila and Salt River Base and Meridian.

6. Section 11, Township 5 North, Range 4 East, Gila and Salt River Base and Meridian.

7. East half (E 1/2) of Section 3, Township 5 North, Range 4 East, Gila and Salt River Base and Meridian.

8. Except that portion of the Area described in paragraphs 1 through 8 hereof that is currently situated within the boundaries of the Desert Foothills Sanitary District and the Desert Foothills Improvement District, described as follows:

<u>Desert Foothills Sanitary District and Desert Foothills Improvement District (Both Districts Have the Same Boundaries)</u>.

Beginning at the intersection of the monument line of Cave Creek Road and the north-south midsection line of Section 35, Township 6 North, Range 4 East, Gila and Salt River Base and Meridian; thence northerly along said midsection line to the North Quarter (N 1/4) corner of said Section 35, thence westerly along the north line of said Section 35 to the northwest corner of said Section 35; thence southerly along the west line of said Section 35 to the southwest corner of the Northwest Quarter (NW 1/4) of the Northwest Quarter (NW 1/4) of said Section 35; thence continue southerly along the west line of Lots 268, 269, 270 and 271 of Carefree, Arizona, as recorded in Book 80 of Maps, Page 27, Maricopa County Recorder, to the southwest corner of said Lot 268; thence continue southeasterly along the southwesterly line of said Lot 268 to the west right-of-way line of Scottsdale Road; thence continue southerly along said right-of-way line to the southeast corner of Lot 263 in said Carefree,

Arizona; thence southeasterly to the intersection of the monument lines of Scottsdale Road and Bloody Basin Road; thence northeasterly along the monument line of Bloody Basin Road to a point of intersection with the east line extended of Lot 66 of said Carefree, Arizona; thence northwesterly along said east lot line extended a distance of 166.75 feet beyond the southeast corner of said Lot 66; thence South 67°01'40" West 141.91 feet; thence North 46°00'00" West 215.00 feet; thence South 52°00'00" West 144.00 feet to the northeasterly right-of-way line of Sidewinder Road; thence continue South 52°00'00" West to the monument line of Sidewinder Road; thence northwesterly along the monument line of Sidewinder Road to the monument line of Elbow Road; thence westerly along the monument line of Sidewinder Road to the monument line of Carefree Drive; thence southwesterly along the monument line of Carefree Drive to the monument line of Scottsdale Road; thence northerly along the monument line of Scottsdale Road to the monument line of Cave Creek Road; thence southeasterly along the monument line of Cave Creek Road to the north-south midsection line of said Section 35, the point of beginning.

IT IS FURTHER ORDERED: That Carefree Water Company, Inc. is authorized to transfer to Boulders Carefree Sewer Corporation its assets and certificate of convenience and necessity for sewer service as provided in Arizona Corporation Commission Decision No. 34518.

IT IS FURTHER ORDERED: That the applicant be authorized to establish interim rates for its sewer service as follows:

Service	Rate
Residential	$10.00/month
Non-Restaurant Commercial	$25.00/month plus $.75 per 1,000 gallons of water used
Restaurants	$34.00/month plus $1.00 per 1,000 gallons of water used
Carefree Inn	$1,100.00/month
Golf Course Effluent	Sale Price $12.00/acre foot

MTP

IT IS FURTHER ORDERED: That non-refundable plant capacity charges in contribution of construction to be charged existing sewer users are hereby approved as follows:*

Existing Commercial Users	$900.00 to $3,600.00/per installation**
Existing Residential "Non-Boulders" Users	$475.00/per installation
Carefree Inn	$65,500.00

** The charge will be made consistent with the manner in which the Carefree Drive Improvement District (the District in which these commercial users are located) has historically assessed commercial users for sewer improvements. The total, aggregate amount to be charged to these users will be approximately $47,450.

IT IS FURTHER ORDERED: That non-refundable plant capacity charges in contribution of construction to be charged new sewer users are hereby approved as follows:*

Residential: An amount equal to $18.00 times the square root of the area in square feet of the structure, which area shall be computed in accordance with the standards of the Building Owners and Managers Association.

Commercial: $1,000.00, plus an amount equal to $18.00 times the square root of the area in square feet of the structure, which area shall be computed in accordance with the standards of the Building Owners and Managers Association.

Restaurant: $2,000.00, plus an amount equal to $18.00 times the square root of the area in square feet of the structure, which area shall be computed in accordance with the standards of the Building Owners and Managers Association.

IT IS FURTHER ORDERED: That at the time of hearing on the application for a permanent rate increase further evidence shall be presented on a plant capacity charge for all classifications of new users, for review by the Commission.

IT IS FURTHER ORDERED: That the interim rates authorized herein shall be effective as of January 1980 usage and that the applicant shall advise each of its customers by mail of the interim rates authorized herein prior to January 1980 usage.

* The plant capacity charge shall be a one time charge for sewage treatment facilities provided by Boulders Carefree Sewer Corporation.

MTP

IT IS FURTHER ORDERED: That monies collected on the foregoing interim rates shall be subject to refund to customers in the event the permanent rate when established is less than the aforesaid interim rate and the interim rate shall remain in effect until permanent rates are established for Boulders Carefree Sewer Corporation.

IT IS FURTHER ORDERED: That Boulders Carefree Sewer Corporation shall make formal application for permanent rate relief to this Commission on or before March 1, 1981, based on a test year ending December 31, 1980.

IT IS FURTHER ORDERED: That the proposed contract with Desert Foothills Sanitary District (Exhibit 11) be approved with the addition of a commencement date of said contract.

IT IS FURTHER ORDERED: That the proposed effluent contract (Exhibit 12) as amended between Boulders Carefree Sewer Corporation and Boulders Carefree Corporation for the sale of effluent from the applicant's sewage treatment facilities, be approved.

IT IS FURTHER ORDERED: That approval of a new site for future plant construction be denied as the request is too indefinite as to time and can be submitted for approval prior to or simultaneous with other approvals which will be necessary when definite plans are made.

IT IS FURTHER ORDERED: That the construction of an additional sewage treatment plant (Smith & Loveless package plant) and the financing therefore as proposed by the applicant be approved.

IT IS FURTHER ORDERED: That Boulders Carefree Sewer Corporation shall keep adequate financial records of its operations in accordance with established accounting procedures and the rules and regulations of the Arizona Corporation Commission.

IT IS FURTHER ORDERED: That the request for a permanent rate increase as proposed by applicant be, and hereby is denied.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER COMMISSIONER

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EXHIBIT B

WASTEWATER TREATMENT PLANT CLOSURE AGREEMENT

This WASTEWATER TREATMENT PLANT CLOSURE AGREEMENT (this "Agreement") is made this 17th day of September, 2009, by and between the BOULDERS HOME OWNERS ASSOCIATION, a non-profit Arizona corporation ("BHOA") and BLACK MOUNTAIN SEWER CORPORATION, an Arizona public service corporation ("BMSC") (individually, a "Party" and collectively, "Parties"), for the purposes and consideration set forth hereinafter.

RECITALS

A. BMSC is a public service corporation as defined in Article 15, Section 2 of the Arizona Constitution. BMSC owns and operates certain wastewater collection, transmission and treatment facilities and holds a certificate of convenience and necessity granted by the Arizona Corporation Commission (the "ACC") authorizing BMSC to provide sewer utility service within portions of the Town of Carefree and the City of Scottsdale.

B. BHOA is an association of 332 home and property owners in the northern portion of the area known as the Boulders community in North Scottsdale and Carefree, Arizona. A map depicting the general location of the Boulders community is attached hereto as Exhibit A to this Agreement. The Boulders community also includes the Boulders Resort and Club (the "Resort"). The Resort is located in north Scottsdale and includes a hotel, clubhouse, pool, tennis courts, various landscaped areas, two 18-hole championship golf courses, and numerous residential units. BHOA owns and controls the common areas and BHOA and its members are customers of BMSC, as the entire Boulders community is located within BMSC's certificated service territory.

D. At the present time, BMSC operates a single wastewater treatment plant known as the Boulders East Plant (the "Plant") within the Resort. The Plant currently has a permitted capacity of 120,000 gallons per day ("gpd") and a maximum treatment capacity of 160,000 gpd. BMSC currently treats an average 120,000 gpd of wastewater and delivers all effluent from the Plant to the Resort pursuant to an Effluent Delivery Agreement, dated March 2001. The remainder of BMSC's wastewater is delivered to the City of Scottsdale for treatment, pursuant to a Wastewater Treatment Agreement, dated April 1, 1996 ("Scottsdale Agreement").

E. As required by ACC Decision No. 69164 (December 5, 2006), BMSC has made substantial improvements to its wastewater collection systems. These improvements have been successful in addressing odors from the Company's collection system. However, fugitive odors continue to be a problem at the Plant, as do intermittent noises and traffic from an assortment of trucks and related vehicles servicing the Plant due primarily to its location within the BHOA and in the immediate proximity of residential properties. Because these odors and noises remain largely within the Plant's normal operating parameters, the parties believe that the only viable remedy to remove all odors and noises/truck traffic from the surrounding community is closure of the Plant. This is true, despite the parties' agreement that the Plant is being operated by

BSS

BMSC in compliance with all applicable law and regulation, and that such utility property is a used and necessary asset of BMSC.

F. BHOA represents that the closure of the Plant is supported by the Boulders community, the Town of Carefree, and the City of Scottsdale, all of whom, in addition to BMSC's customers, have an interest in the closure of the Plant. Therefore, in order to pursue closure of the Plant, the Parties desire to enter into an agreement setting forth the terms and conditions under which BMSC will close the Plant and clarify each Party's rights and obligations with respect to that closure and the associated regulatory and ratemaking approvals.

NOW, THEREFORE, for good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the Parties covenant and hereby agree as follows:

AGREEMENT

1. Incorporation of Recitals. Each of the recitals set forth above are hereby incorporated into this Agreement by this reference as if fully set forth herein.

2. Closure of the Plant. BMSC agrees to close the Plant subject to the terms and conditions set forth hereinafter. As used herein, the terms "closure" and "close" in reference to the Plant shall mean the termination of the wastewater treatment operations at the Plant, removal of the physical structure of the Plant and the associated equipment that is not necessary for the continued operation of the wastewater collection and transportation systems and remediation and restoration of the Plant's associated property as required by applicable law and regulation.

a. Conditions Precedent to Plant Closure. BMSC agrees to commence the closure of the Plant if the following conditions are satisfied:

i. Downstream Collection System Line Capacity. The downstream collection system line from the Plant to the City of Scottsdale must have sufficient capacity to support an additional 120,000 gpd flow of wastewater. If engineering evaluations conducted by BMSC or its agents determine that the downstream collection system line lacks sufficient capacity to support the extra flow, BMSC agrees to upgrade the system to provide sufficient capacity for additional flow if it determines, in its discretion and in consultation with BHOA, such an upgrade is not prohibitively expensive for BMSC and is in the best interests for BMSC and its ratepayers.

ii. Flow-through to the City of Scottsdale. Engineering evaluations conducted by BMSC or its agents must demonstrate that the Plant's intake and outflow lines can be connected to permit flow-through of wastewater to the City of Scottsdale's wastewater treatment system in the same or similar manner as BMSC currently delivers flows from its customers to the City of Scottsdale system under the Scottsdale Agreement. BMSC agrees to modify the Plant's system to permit such flow-through if it determines, in its discretion and in consultation with BHOA, such an upgrade is not prohibitively expensive for BMSC and is in the best interests for BMSC and its ratepayers.

iii. Wastewater Treatment Agreement with the City of Scottsdale. BMSC must successfully negotiate the purchase of 120,000 gpd of additional wastewater treatment capacity to treat the flows currently being treated at that Plant. In addition, BMSC must sign an amendment to the Scottsdale Agreement that (1) extends BMSC's right to purchase additional capacity beyond December 21, 2016; (2) states that BMSC's right to capacity shall survive the termination of the Scottsdale Agreement; (3) states that the City of Scottsdale cannot terminate the Scottsdale Agreement if BMSC closes the Plant; and (4) provides BMSC the long-term right to purchase additional capacity at market rates.

iv. Effluent Agreement with the Resort. BMSC currently has an agreement with the Resort which requires BMSC to deliver all effluent generated at the Plant to the Resort through March 2021. In the agreement, BMSC covenanted to continue to operate the Plant and to not reduce the amount of effluent produced by the Plant. BMSC must sign an agreement with the Resort whereby the Resort agrees to allow the termination of the Effluent Agreement at no or limited cost to BMSC.

v. Approval of Plant Closure. BMSC must seek and obtain all the necessary local, county, state, and/or federal approvals for the closure of the Plant.

vi. ACC Approval of Cost Recovery for Plant Closure. ACC must approve a cost recovery mechanism that permits BMSC to recover a return on and of the capital costs of closure, which costs include, without limitation, the costs of procuring additional capacity from the City of Scottsdale, the costs of engineering and other analyses necessary to complete the closure, any system upgrades required as a result of the closure and/or the delivery of the flows previously treated at the Plant to the City of Scottsdale. BMSC must also be authorized recovery of any reasonable costs of reaching agreement with the BHOA, the City of Scottsdale and the Resort as required to fulfill the terms of this Agreement, including, without limitation, the costs of obtaining all necessary approval from the ACC, including rate case expense. BMSC shall have no obligation under this Agreement if the ACC does not approve such cost recovery mechanism as acceptable to BMSC in its sole discretion.

b. Termination of Operations at the Plant. BMSC agrees to use all commercially reasonable efforts to complete termination of its operation of the Plant within 15 months of the satisfaction of conditions listed in Sections 2(a) (i) – (vi), subject to government approvals and the terms and conditions set forth hereinafter.

c. Removal of Plant Structure and Associated Equipment. After terminating its operations, BMSC agrees to remove the Plant's physical structure from the Plant Property. The "Plant Property" includes the 1.03 acres of the current Plant site. BMSC agrees to remove any associated equipment or structures from the property that are not necessary for the continued operation of its wastewater collection or transportation systems.

d. Remediation of the Plant Property. BMSC agrees to be responsible for the proper management, handling, transportation, storage and disposal of any hazardous substances generated by BMSC's activities on the Plant Property. BMSC is responsible for remediating the hazardous substances directly generated by its activities on the Plant Property to the level required by applicable laws, if such remediation is required by an applicable law. The term

"Hazardous Substances" shall mean any substance, material, pollutant, contaminant, or waste, whether solid, gaseous or liquid, that is infectious, toxic, hazardous, explosive, corrosive, flammable or radioactive, and that is regulated, defined, listed or included in any Applicable Laws, including, without limitation, asbestos, petroleum, petroleum or fuel additives, polychlorinated biphenyls, urea formaldehyde, or waste tires.

e. Restoration of the Plant Property. BMSC agrees to restore the surface and subsurface of the Plant Property to a safe and stable condition. Further, upon completing closure of the Plant structure, BMSC and its agents shall remove from the Plant Property all tools, excavated material, personal property, rubbish, waste and surplus materials in connection with the closure and/or previous operation of the Plant and leave the Plant property free and clear from all obstructions and hindrances until such time that residential structures may be constructed on the site.

3. Ownership of Plant Property. BMSC will have full and complete ownership of the Plant Property after the completion of the closure, remediation and restoration. Within 60 days of BMSC completing removal of the Plant's physical structure from the Plant Property, BHOA agrees to contribute or work with BMSC to enable transfer of the 0.2+ acres of land adjacent to the Plant to BMSC to enable development of the Plant Property. Thereafter, BMSC will determine, in its discretion, the best time to market the residential property so as to maximize its value, subject to local laws and rules applicable to development within the BHOA. BMSC further agrees to seek ratemaking treatment of such gain that would result in an equal sharing of the gain between BMSC's shareholders and ratepayers, and BHOA agrees to provide support for such ratemaking treatment of any gain of the Plant Property. Gain on sale shall be that amount over and above BMSC's basis in the Plant Property. The gain on sale shall exclude the proceeds from the 0.2+ acres "contributed" by BHOA. All proceeds from the sale of the 0.2 acres "contributed" by BHOA shall be allocated towards reducing the rate base and costs of the closure of the Plant

4. Costs of the Closure of the Plant. BMSC will be responsible for all costs related to the closure of the Plant, notwithstanding BHOA's contribution discussed in Paragraph 3.

5. Covenants.

a. BMSC covenants and agrees to negotiate in good faith and with promptness the modifications to the agreements contemplated in Sections 2(a)(iii) and 2(a)(iv) above.

b. BHOA covenants and agrees to lend assistance and support as requested by BMSC in relation to BMSC's efforts to close the Plant, including assisting and supporting BMSC as requested in relations to BMSC's efforts with the City of Scottsdale and the Resort. BHOA specifically covenants to assist and support BMSC, publicly and privately, in its efforts before the ACC to obtain recovery of its costs incurred under this Agreement, including rate case expense, as contemplated in Section 2.a.iv above. BHOA agrees and acknowledges that recovery of a return on and of the capital investments and the expenses incurred by BMSC and/or its parent company in reaching and

obtaining the necessary approvals of the Agreement and thereafter closing the Plant will likely result in the need for higher utility rates by BMSC.

c. Both Parties covenant and agree to not interfere with or cause an unreasonable delay in the removal of the Plant.

6. Risk and Indemnification. Subject to the limitations set out herein, BMSC hereby assumes any and all risks associated with the Plant's closure or other actions to be conducted by BMSC pursuant to this Agreement. BHOA shall not seek indemnification from BMSC for any and all claims, actions, costs, fees, expenses, damages, environmental investigation costs, obligations, penalties, fines, liabilities or other losses arising out of any breach or default in the performance of this Agreement by BHOA.

7. Force Majeure. Neither Party to this Agreement shall be liable to the other for failure, default or delay in performing any of its obligations hereunder, other than for the payment of money obligations specified herein, in case such failure, default or delay is caused by strikes or other labor problems, by forces of nature, unavoidable accident, fire, floods, acts of the public enemy, interference by civil authorities, passage of laws, orders of the court, unavailability of or delays in receipt of materials, supplies or equipment, or any other cause, whether of similar nature, not within the control of the Party affected and which, by the exercise of due diligence, such Party is unable to prevent. Should any of the foregoing occur, the Parties hereto agree to proceed with reasonable diligence to correct or eliminate the condition causing the force majeure and do what is reasonable and necessary so that each Party may perform its obligations under this Agreement.

8. Term of Agreement. This Agreement shall terminate when the Parties have performed all of their obligations under this Agreement, but no earlier than the time BMSC has obtained favorable ratemaking for the costs of the closure.

9. Termination of Agreement.

a. Termination for Breach. Either Party may initiate proceedings for termination of this Agreement in the event of a breach or anticipated breach of a material term or condition by the other Party. In such event, the Party contending that a breach has or will occur shall promptly provide notice thereof to the other Party, and shall initiate proceedings in accordance with Paragraph 12, below.

b. Failure of Conditions to Plant Closure. If any of the conditions listed in Paragraphs 2(a) (i) – (vi) are not satisfied, either Party may initiate proceedings for termination of this Agreement. In such event, the Party contending that a failure of a condition has or will occur shall promptly provide notice thereof to the other Party, and shall initiate proceedings in accordance with Paragraph 11, below.

10. Notices. Any notice required or permitted to be given hereunder shall be in writing and directed to the address set forth below for the Party to whom the notice is given and shall be deemed delivered (i) by personal delivery, on the date of delivery; (ii) by first class United States mail, three (3) business days after being mailed; or (iii) by Federal Express

Corporation (or other reputable overnight delivery service), one (1) business day after being deposited into the custody of such service.

If to BMSC to: Greg Sorensen
Black Mountain Sewer Corporation dba Liberty Water
12725 W. Indian School Road, Suite D-101
Avondale, AZ 85392

With a copy to: Jay L. Shapiro
Fennemore Craig, P.C.
3003 N. Central Avenue, Suite 2600
Phoenix, AZ 85012

If to BHOA to: Ted Wojtasik
Rossmar & Graham
9362 E. Raintree Drive
Scottsdale, AZ 85260

With a copy to: Scott Wakefield
Ridenour, Hienton & Lewis
201 N. Central Avenue, Suite 3300
Phoenix, AZ 85004

Any Party may designate another address for notices under this Agreement by giving the other Party not less than thirty (30) days advance notice.

11. Dispute Resolution. The Parties agree to use good faith efforts to resolve, through negotiation, disputes arising under this Agreement. If the Parties are unable to resolve the dispute within sixty (60) days, a Party that still believes the dispute requires resolution may pursue mediation or arbitration or commence litigation in a court or other tribunal of appropriate jurisdiction.

12. Attorneys' Fees. In the event either Party hereto finds it necessary to employ legal counsel or to bring an action at law or any other proceeding against the other Party to enforce any of the terms, covenants or conditions hereof, the prevailing Party in such action or proceeding shall be paid its reasonable attorneys' fees and costs, and in the event any judgment is secured by such prevailing Party, all such attorneys' fees and costs shall be included in such judgment. Any arbitration shall be considered a proceeding for the purposes of this paragraph.

13. Amendments and Waiver of Conditions. No waiver by either Party of any breach of this Agreement by the other Party shall be construed as a waiver of any preceding or succeeding breach. This Agreement may be amended only in writing and may not be amended or modified by any part performance, reliance or course of dealing.

14. Additional Acts. The Parties agree to execute promptly any other documents and to perform promptly any other acts as may be reasonably required to effectuate the purposes and intent of this Agreement. Each Party shall cooperate with and provide reasonable assistance to the other party to obtain all required approvals and consents necessary to effectuate and perform this Agreement.

15. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Parties. This Agreement, together with all rights, obligations, duties and privileges arising hereunder, may be assigned by either Party without the consent of the other Party. If either Party assigns its interest hereunder, then such assignment shall be set forth in a written document executed by the assignor and assignee, which document shall contain an express assumption by the assignee of all obligations of the assignor under this Agreement. The foregoing notwithstanding, the failure of an assignee or other successor in interest to execute and deliver such written document shall not terminate or otherwise limit the rights of the non-assigning Party hereunder.

16. Governing Law. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of Arizona.

17. Construction. The terms and provisions of this Agreement represent the results of negotiations between BMSC and BHOA, neither of which have acted under any duress or compulsion, whether legal, economic or otherwise. Each Party has had the full opportunity to review and understand the legal consequences of this Agreement. Consequently, the terms and provisions of this Agreement should be interpreted and construed in accordance with their usual and customary meaning, and BMSC and BHOA each waive the application of any rule of law providing that ambiguous or conflicting terms or provisions are to be interpreted or construed against the Party whose attorney prepared this Agreement. This Agreement represents the Parties' mutual desire to compromise and settle disputed issues. The acceptance by any Party of a specific element of this Agreement shall not be considered precedent for acceptance of that element in any other context. Nothing in this Agreement shall be construed as an admission by any Party as to the reasonableness or unreasonableness or lawfulness or unlawfulness of any position previously taken by any other Party. No Party is bound by any position asserted in negotiations, except as expressly stated in this Agreement. No Party shall offer evidence of conduct or statements made in the course of negotiating this Agreement before the Commission, any other regulatory agency, or any court. The invalidity of any provision of this Agreement shall in no way affect any other provision hereof.

18. Interpretation. The terms of this Agreement supersede all prior and contemporaneous oral or written agreements and understandings of BMSC and BHOA with respect to its subject matter, all of which will be deemed to be merged into this Agreement. This Agreement is a final and complete integration of the understandings of BMSC and BHOA and sets forth the entire agreement between the parties with respect to the subject matter hereof. If there is any specific and direct conflict between, or any ambiguity resulting from, the terms and provisions of this Agreement and the terms and provisions of any document, instrument, letter or other agreement executed in connection with or furtherance of this Agreement, the term, provision, document, instrument, letter or other agreement will be interpreted in a manner consistent with the general purpose and intent of this Agreement.

19. Counterparts. This Agreement may be executed in two or more original or facsimile counterparts, each of which shall be deemed an original and all of which together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, BMSC and BHOA have executed this Wastewater Treatment Plant Closure Agreement as of the date and year first written above.

BLACK MOUNTAIN SEWER CORPORATION
An Arizona corporation.

By _____
Its Director of Operations

BOULDERS HOME OWNERS ASSOCIATION
A non-profit Arizona corporation

By _____
Its _____

19. Counterparts. This Agreement may be executed in two or more original or facsimile counterparts, each of which shall be deemed an original and all of which together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, BMSC and BHOA have executed this Wastewater Treatment Plant Closure Agreement as of the date and year first written above.

BLACK MOUNTAIN SEWER CORPORATION
An Arizona corporation.

By_____
Its _____

BOULDERS HOME OWNERS ASSOCIATION
A non-profit Arizona corporation

By_____
Its President

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Ridenour, Hienton & Lewis, P.L.L.C.
Scott S. Wakefield, State Bar No. 013442
201 N. Central Avenue, Suite 3300
Phoenix, Arizona 85004-1052
602-254-9900
sswakefield@rhkl-law.com

EXHIBIT
BHOA-5
ADMITTED
PENGAD 800-631-6989

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	NO. DOCKET NO. SW-02361A-08-0609

SURREBUTTAL TESTIMONY OF

LES PETERSON

Boulders Homeowners' Association

November 9, 2009

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I. INTRODUCTION AND PURPOSE OF TESTIMONY 1

II. SURREBUTTAL TO BMSC 1

INTRODUCTION AND PURPOSE OF TESTIMONY

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Les Peterson. I live at 2045 Smoketree Drive, Carefree AZ. My home is located within the north (Carefree) portion of The Boulders subdivision.

Q. ARE YOU THE SAME LES PETERSON WHO PROVIDED DIRECT TESTIMONY IN THIS PROCEEDING ON SEPTEMBER 18, 2009?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. My surrebuttal testimony further supports the Settlement Agreement referred to in my direct testimony, and responds to certain aspects of the rebuttal testimony of Black Mountain Sewer Corporation ("BMSC").

Q. CAN YOU DESCRIBE THE EXHIBIT A ATTACHED TO THIS TESTIMONY?

A. Yes. Exhibit A is a map demonstrating point I discussed in my direct testimony, which should have been included there. In my direct testimony, I described the proximity of the Boulders Wastewater Plant to homes in the community (at page 4), and that the Company had communicated to me that current setback requirements for the plant would be a minimum of 1,000 feet from adjacent homes (at page 6). Exhibit A is a map of the Boulders, showing the location of the Boulders Wastewater Plant in the center of the two circles, which represent 500 and 1,000 feet from the Plant.

SURREBUTTAL TO BMSC

Q. HAVE YOU REVIEWED THE REBUTTAL TESTIMONY FILED BY BMSC?

A. Yes. I have reviewed the rebuttal testimony filed by Gregory S. Sorensen, and the rate base, income statement and rate design testimony filed by Thomas J. Bourassa.

Q. MR. BOURRASSA ESTIMATED THAT A SURCHARGE MECHANIM COULD RESULT IN A RATE INCREASE OF APPROXIMATELY $15 PER CUSTOMER PER MONTH. DO YOU HAVE ANY RESPONSE TO THAT?

A. Yes. For several reasons, I believe the estimate overstates the amount the surcharge is likely to be. First, the calculation is based on the Company's requested weighted average cost of capital of 12.4 percent. Staff and RUCO have proposed significantly lower weighted average costs of capital in this proceeding (Staff proposed 9.6 percent and RUCO proposed 7.43 percent). While I am not taking any position on what cost of capital the Commission should adopt, I would like to note that if the Commission adopts a different cost of capital than the Company proposes, the computation of the surcharge could change substantially. For example, estimating the surcharge based on Staff's middle of the pack cost of capital proposal, the surcharge would be $12.12.

Second, the estimate is based on a customer count of 2,100, which is in the range of the customer count at the end of the test year (2,106). Staff's engineering report indicates that by the end of the calendar year 2008, there were 2,130 customers, and Staff projected there will be approximately 2,194 customers by the end of 2010. By the time the surcharge is put into effect (about a year and a half after the decision in this case), the customer count would likely be in the range of

2,200. Using the Company's proposed cost of capital, but substituting a customer count of 2,200, the surcharge estimate falls to $14.13. Using Staff's cost of capital and a 2,200 customer count, the estimate would be $11.72.

Finally, I would like to point out that the estimate of the surcharge does not include the impact of the sharing of the gain on the sale of the parcel of land on which the Boulders Treatment Plant is located (along with the additional small parcels the BHOA has agreed to contribute). While the lot is not likely to be sold by the time the surcharge would be put into effect, the Commission should not overlook this valuable benefit of the Settlement Agreement to customers. The Settlement Agreement provides that the gain on the sale of that lot would be shared evenly between customers and the Company. In total, we believe, after consultation with the Town of Carefree, the BMSC would be able to divide this combined 1.1 acre parcel into at least two building lots. For comparison of the recent approximate value of a building lot in the Boulders, the most recent sale of an undeveloped building lot in the Boulders was in January of 2009, and the transaction price was $350,000.

Q. DO YOU HAVE ANY OTHER COMMENTS IN RESPONSE TO THE COMPANY'S TESTIMONY?

A. Yes. Though there will be costs to close the Boulders Wastewater Plant pursuant to the Settlement Agreement, those costs are much lower than they would be if closure were delayed several years. If the Company does not secure capacity in the Scottsdale Plant to treat the wastewater currently being treated at the Boulders Wastewater Plant before the Company's contract with Scottsdale expires in 2016, it won't have access to that capacity at the very favorable $6.00 per gallon rate specified in the existing contract. Today's rates for similar capacity from other

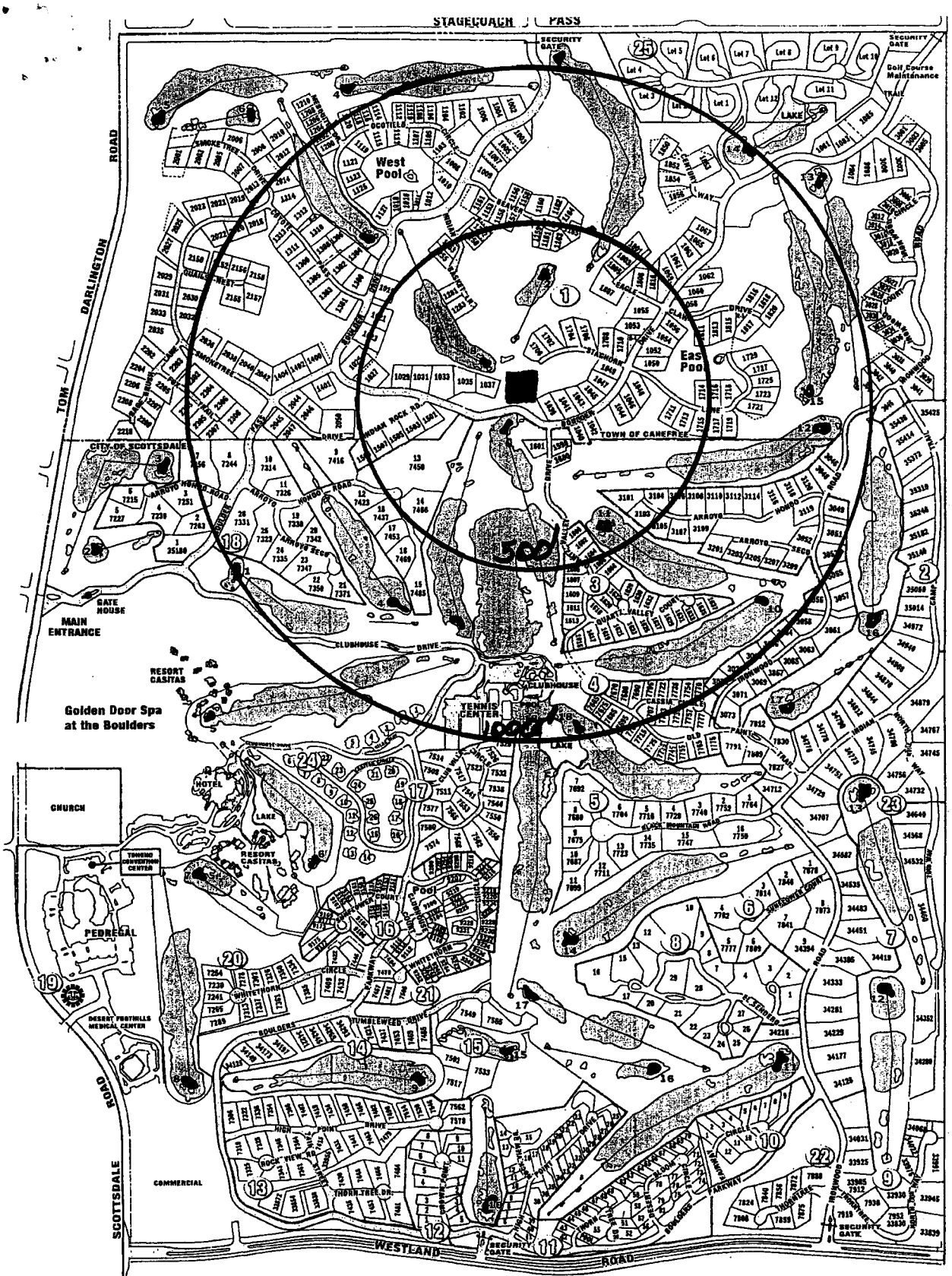
plants in the general area are more than three times the rate under the Company's current agreement with Scottsdale. Thus, the best possible time to begin shuttering the Boulders Plant is now, while the Company has a very favorably-priced alternative source of treatment available.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

311969;ssw;22938-0001

EXHIBIT "A"



1. NORTH COMMUNITY
2. PALO BREA I
3. VILLAS
4. DESERT RIDGE
5. THE RESERVE
6. EL DESEO
7. PALO BREA II
8. ADOBES DE LA TIERRA
9. ACACIA
10. 5th GREEN II
11. 5th GREEN I
12. 5th GREEN II
13. GREYTHORN I
14. GREYTHORN II
15. ALTURA
16. PUEBLO EN LAS ROCAS
17. CLUB VILLAS
18. BOULDER ESTATES
19. RUSS LYON REALTY
20. ENCHANTRA
21. PUEBLO EN LAS ROCAS II
22. IRONWOOD
23. CROSSING
24. CACHET HOMES
25. LA ULTIMA PIEDRA

THE BOULDERS COMMUNITY

Map provided courtesy of Russ Lyon Realty Company. For Boulders information: (480) 488-2400

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ORIGINAL

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Attorneys for the Town of Carefree

RECEIVED
2009 SEP 18 A 10: 56
AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	No. SW-02361A-08-0609 INTERVENOR TOWN OF CAREFREE'S NOTICE OF FILING DIRECT TESTIMONY

Intervenor Town of Carefree hereby files the Direct Testimony of Brian Kincaid of the Carefree Estates Homeowners Association in the above-referenced matter.

RESPECTFULLY SUBMITTED THIS 18 day of September, 2009.

SHERMAN & HOWARD L.L.C.

By _____
Thomas K. Chenal
David W. Garbarino
7047 East Greenway Parkway, Suite 155
Scottsdale, AZ 85254-8110
Attorneys for Town of Carefree

Arizona Corporation Commission
DOCKETED
SEP 18 2009
DOCKETED BY

///

EXHIBIT
Carefree -
ADMITTED

ORIGINAL AND 13 COPIES of
the foregoing filed September 18, 2009
with:

ARIZONA CORPORATION COMMISSION
Docket Control
1200 W. Washington St.
Phoenix, AZ 85007

COPIES of the foregoing mailed this
same date to:

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Phoenix, Arizona 85004-1481

Roger Strassburg
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Scottsdale, Arizona 85255

M.M. Schirtzinger
34773 N. Indian Camp Trail
Scottsdale, Arizona 85262

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Attorneys for the Town of Carefree

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	No. SW-02361A-08-0609

DIRECT TESTIMONY OF

BRIAN KINCAID

TABLE OF CONTENTS

I. INTRODUCTION.....1

II. BACKGROUND.....2

III. RELIEF SOUGHT/CONCLUSION.....5

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. Brian Kincaid.

Q. WHERE DO YOU LIVE?

A. I live in the development known as the Carefree Estates, formerly known as the Carefree Inn Estates (the "Carefree Estates Development"), located within the Town of Carefree (the "Town"), Arizona. My address is 7801 E. Carefree Dr, Carefree, Arizona 85377.

Q. HOW MANY RESIDENCES ARE LOCATED WITHIN THE CAREFREE ESTATES DEVELOPMENT?

A. There are thirty-three residences located within the Carefree Estates Development.

Q. IS THERE A HOMEOWNERS' ASSOCIATION RELATED TO THE CAREFREE ESTATES DEVELOPMENT?

A. Yes, the Carefree Estates Homeowners Association (the "Association") is a homeowners' association created through a Declaration of Covenants, Conditions and Restrictions and Grant of Easements recorded in 1978 (the "Declaration"). Each owner of a residence located within the Carefree Estates Development is a member of the Association.

Q. WHAT IS YOUR RELATIONSHIP WITH THE ASSOCIATION?

A. I am a member of the Association by virtue of my ownership of a residence

located within the Carefree Estates Development, and I am the President of the Association.

Q. HOW LONG HAVE YOU HELD THE POSITION OF PRESIDENT OF THE ASSOCIATION?

A. Since January 2009.

II. BACKGROUND

Q. WHAT IS THE RELATIONSHIP BETWEEN BLACK MOUNTAIN SEWER CORPORATION ("BLACK MOUNTAIN") AND THE ASSOCIATION?

A. Black Mountain considers the Association to be a "customer" of Black Mountain. In fact, however, the Association itself receives no sewer services from Black Mountain. Instead, the residences of the Carefree Estates Development, i.e. the members of the Association, receive sewer services directly from Black Mountain.

Q. IF THE RESIDENTS OF THE CAREFREE ESTATES DEVELOPMENT ACTUALLY RECEIVE THE SEWER SERVICES FROM BLACK MOUNTAIN, WHY IS THE ASSOCIATION CONSIDERED BLACK MOUNTAIN'S CUSTOMER WHEN IT RECEIVES NO SERVICES FROM BLACK MOUNTAIN?

A. I do not have an answer to that question.

Q. WHO DOES BLACK MOUNTAIN BILL FOR THE SERVICES PROVIDED TO THE THIRTY-THREE RESIDENCES OF THE CAREFREE ESTATES DEVELOPMENT?

A. Black Mountain bills the Association, and the Association pays Black Mountain directly for the sewer services provided to the thirty-three residents of the Carefree

Estates Development.

Q. IS THE BILL RECEIVED BY THE ASSOCIATION FROM BLACK MOUNTAIN BROKEN OUT BY RESIDENCE?

A. The bill the Association receives from Black Mountain for its sewer services provided to the residences of the Carefree Estates Development charges the Association for thirty-three units.

Q. HOW DOES THE ASSOCIATION HAVE THE MONEY TO PAY BLACK MOUNTAIN?

A. The Association assesses its members for the amounts it pays to Black Mountain. In other words, the thirty-three residents of the Carefree Estates Development pay for the sewer services they receive from Black Mountain through assessments paid to the Association.

Q. CAN YOU EXPLAIN WHY YOUR DIRECT TESTIMONY IS BEING OFFERED BY THE TOWN IN THIS MATTER?

A. Sure. In the decision of the Arizona Corporation Commission (the "Commission") in the previous rate proceeding of Black Mountain, Decision No. 69164 in Docket No. SW-02361A-05-0657, the Commission ordered Black Mountain to refund $833,367.00 to its customers related to hook-up fees charged to customers in the past. Black Mountain refunded $412.15 to each of its customers, including the Association. Because Black Mountain recognized the Association as only one customer, and did not recognize the individual thirty-three residents within the Carefree Estates Development as customers, Black Mountain only refunded the Association

$412.15. Not one of the residents of the Carefree Estates Development, however, received a refund from Black Mountain even though Black Mountain serves the thirty-three customers within the Carefree Estates.

After Black Mountain refunded $412.15 to each of its customers, the Town, at the request of then President of the Association, Thomas Van Dyke, sought to compel Black Mountain to issue refunds with respect to each residence of the Carefree Estates. Black Mountain stipulated to make refunds to the thirty-three residents of Carefree Estates as long as it could also assess its other customers to equalize the amount of the refunds to each of Black Mountain's customers. A stipulation and proposed order between the Town, Black Mountain, and the Residential Utility Consumer Office was filed with Administrative Law Judge Dwight D. Nodes on December 7, 2007 (the "Stipulation"). The parties learned through informal means that Judge Nodes did not believe he had the authority to enter the proposed order stipulated to by the parties, and that the Stipulation and proposed order should be filed with the Commission.

The Town then requested the parties to agree that the Stipulation and related proposed order could be submitted to the Commission, but Black Mountain would no longer agree to the Stipulation given its upcoming rate proceeding, i.e. this rate proceeding, and instead suggested that the matter be raised in this proceeding.

Accordingly, it is my understanding that the Town has intervened in this matter, in part, to assist the Association with respect to the refund issue. Through my testimony contained herein, the Association simply requests that the Commission enter an order in conformity with the Stipulation previously submitted to Judge Nodes in the prior rate

proceeding.

III. RELIEF SOUGHT/CONCLUSION

Q. SO, IN OTHER WORDS, ALL YOU ARE ASKING FOR IS THAT THE COMMISSION ENTER THE ORDER PREVIOUSLY SUBMITTED TO JUDGE NODES IN THE PRIOR RATE PROCEEDING?

A. Yes.

Q. IS EXHIBIT 1 ATTACHED HERETO A TRUE AND CORRECT COPY OF THE STIPULATION AND PROPOSED ORDER SUBMITTED BY THE TOWN, BLACK MOUNTAIN, AND RUCO?

A. Yes, which provides as follows:

> On or about October 1, 2007, the Town filed with the Arizona Corporation Commission (the "Commission") a Combined Motion for Clarification and Application for Amendment of Order Pursuant to A.R.S. $ 40-252 (the "Motion") regarding the issue of whether thirty-three individuals owning real property within the Carefree Inn Estates subdivision ("Carefree Inn Estates") were entitled to receive a refund of hook-up fees from Black Mountain in connection with Decision No. 69164 (Opinion and Order in Docket No. SW-02361A-05-0657) (the "Decision"). The Decision concluded in part as follows:
>
> > The record supports a finding that customers should be refunded $833,367 for hook-up fees that were used to purchase land and that have not been expended. The refunds should be distributed in the manner proposed by the Company, on a per customer basis irrespective of customer class. The rates granted in this Decision should not go into effect until the refunds have been distributed.
>
> Decision No. 69164 at 42. The Decision ordered Black Mountain as follows:

> IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after December 1, 2006, subject to the requirement that Black Mountain Sewer Corporation has mailed to each customer prior to that date a refund check for the hook-up fee funds, consistent with and in the manner described hereinabove. The new rates may not go into effect until the Company has provided, to the satisfaction of the Director of the Utilities Division, sufficient information to show that the refunds have been issued in accordance with the discussion set forth herein.

Decision No. 69164 at 40. Black Mountain made refunds of $412.15 to 2,022 customers.

The Motion requested the Commission to clarify or amend the Decision to provide that thirty-three additional refunds were appropriate for parcels of real property located within the Carefree Inn Estates subdivision, owners of which had not individually received a refund of $412.15, but have and continue to receive sewer service from Black Mountain. Instead, the Carefree Inn Estates Homeowners' Association received one check in the sum of $412.15 on behalf of the thirty-three individual parcels of real property located with the Carefree Inn Estates because Black Mountains bills only the Homeowners Association and view only the Homeowners Association as a customer.

Without admitting or conceding any position on the relief requested by the Town, the Town, Black Mountain and the Residential Utility Consumer Office ("RUCO") have agreed that an appropriate and revenue neutral means of resolving the issue would be for Black Mountain to (1) refund $405.73 with respect to each of the thirty-three parcels of real property within Carefree Inn Estates; (2) debit its other customers' accounts for $6.62. The debit to the other customers' accounts allows Black Mountain to make the thirty-three additional refunds without paying more than originally ordered by the Commission (i.e. $833,367.00 to 2,055 individuals instead of 2,022 individuals). The parties hereto further stipulate that no finding that the individual homeowners within Carefree Inn Estates are "customers" of Black Mountain is being requested of or should

be made by the Commission except for the limited purposes of distribution of refunds as stipulated herein.

Q. DO YOU HAVE ANY THING ELSE TO ADD?

A. Not at this time.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

EXHIBIT 1

ORIGINAL

LAW OFFICES
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2800 NORTH CENTRAL AVENUE, SUITE 1100
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Attorneys for the Town of Carefree

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Arizona Corporation Commission
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DEC -7 2007
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICES BASED THEREON.	No. SW-02361A-05-0657 **JOINT STIPULATION REGARDING HOOK-UP FEE REFUND AND CAREFREE ESTATES**

On or about October 1, 2007, the Town filed with the Arizona Corporation Commission (the "Commission") a Combined Motion for Clarification and Application for Amendment of Order Pursuant to A.R.S. § 40-252 (the "Motion") regarding the issue of whether thirty-three individuals owning real property within the Carefree Inn Estates subdivision ("Carefree Inn Estates") were entitled to receive a refund of hook-up fees from Black Mountain in connection with Decision No. 69164 (Opinion and Order in Docket No. SW-02361A-05-0657) (the "Decision"). The Decision concluded in part as follows:

> The record supports a finding that customers should be refunded $833,367 for hook-up fees that were used to purchase land and that have not been expended. The refunds should be distributed in the manner proposed by the

> Company, on a per customer basis irrespective of customer class. The rates granted in this Decision should not go into effect until the refunds have been distributed.

Decision No. 69164 at 42. The Decision ordered Black Mountain as follows:

> IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after December 1, 2006, subject to the requirement that Black Mountain Sewer Corporation has mailed to each customer prior to that date a refund check for the hook-up fee funds, consistent with and in the manner described hereinabove. The new rates may not go into effect until the Company has provided, to the satisfaction of the Director of the Utilities Division, sufficient information to show that the refunds have been issued in accordance with the discussion set forth herein.

Decision No. 69164 at 40. Black Mountain made refunds of $412.15 to 2,022 customers.

The Motion requested the Commission to clarify or amend the Decision to provide that thirty-three additional refunds were appropriate for parcels of real property located within the Carefree Inn Estates subdivision, owners of which had not individually received a refund of $412.15, but have and continue to receive sewer service from Black Mountain. Instead, the Carefree Inn Estates Homeowners' Association received one check in the sum of $412.15 on behalf of the thirty-three individual parcels of real property located with the Carefree Inn Estates because Black Mountains bills only the Homeowners Association and view only the Homeowners Association as a customer.

Without admitting or conceding any position on the relief requested by the Town, the Town, Black Mountain and the Residential Utility Consumer Office

("RUCO") have agreed that an appropriate and revenue neutral means of resolving the issue would be for Black Mountain to (1) refund $405.73 with respect to each of the thirty-three parcels of real property within Carefree Inn Estates; (2) debit its other customers' accounts for $6.62. The debit to the other customers' accounts allows Black Mountain to make the thirty-three additional refunds without paying more than originally ordered by the Commission (i.e. $833,367.00 to 2,055 individuals instead of 2,022 individuals). The parties hereto further stipulate that no finding that the individual homeowners within Carefree Inn Estates are "customers" of Black Mountain is being requested of or should be made by the Commission except for the limited purposes of distribution of refunds as stipulated herein.

The order attached hereto as Exhibit A reflects the stipulated position of the Town, Black Mountain and RUCO. Commission Staff has taken no position on this issue.

RESPECTFULLY SUBMITTED: December 5, 2007.

MOHR, HACKETT, PEDERSON, BLAKLEY
& RANDOLPH, P.C.

By _____
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David W. Garbarino
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Scottsdale, Arizona 85254
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By _____
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Attorneys for Black Mountain Sewer Company

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By _____
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Attorney for Residential Utility Consumer Office

ORIGINAL and 13 COPIES
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2007 with:

Arizona Corporation Commission
Docket Control
1200 Washington Street
Phoenix, AZ 85007

COPIES of the foregoing hand-delivered
December 7, 2007 to:

The Honorable Dwight D. Nodes
Administrative Law Judge
Hearing Division
Arizona Corporation Commission
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Phoenix, AZ 85007

Keith Layton
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Brian Bozzo
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December 7, 2007 to:

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Carefree, AZ 85377
M.M. Shirtzinger
34773 N. Indian Camp Trail
Scottsdale, AZ 85262

Ernestine Gamble

EXHIBIT A

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
JEFF HATCH-MILLER
Commissioner
WILLIAM A. MUNDELL
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF BLACK MOUNTAIN SEWER CORPORATION, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICES BASED THEREON.	No. SW-02361A-05-0657 **JOINT STIPULATION REGARDING HOOK-UP FEE REFUND AND CAREFREE ESTATES**

BY THE COMMISSION:

On September 16, 2005, Black Mountain Sewer Corporation ("Black Mountain") filed an application with the Arizona Corporation Commission (the "Commission") for a rate increase.

In Decision No. 69164 (December 5, 2006) (the "Decision") arising from the rate proceeding, the Commission concluded as follows:

> The record supports a finding that customers should be refunded $833,367 for hook-up fees that were used to purchase land and that have not been expended. The refunds should be distributed in the manner proposed by the Company, on a per customer basis irrespective of customer class. The rates granted in this Decision should not go into effect until the refunds have been distributed.

Decision No. 69164 at 40. The Decision ordered Black Mountain as follows:

> IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after December 1, 2006, subject to the requirement that Black Mountain Sewer Corporation has mailed to each customer prior to that date a refund check for the hook-up fee funds, consistent with and in the manner described hereinabove. The new rates may not go into effect until the Company has provided, to the satisfaction of the Director of the Utilities Division, sufficient information to show that the refunds have been issued in accordance with the discussion set forth herein.

Decision No. 69164 at 42. Black Mountain made refunds of $412.15 to 2,022 customers, including a single check in the sum of $412.15 to the Carefree Inn Estates Homeowners' Association, but no refunds to the thirty-three individual real property owners within Carefree Inn Estates.

The Town of Carefree (the "Town"), an intervening party, filed a Combined Motion for Clarification and Application for Amendment of Order Pursuant to A.R.S. § 40-252 (the "Motion"), that requested the Commission to clarify or amend the Decision to address the issue of refunds for the thirty-three parcels of real property within the Carefree Inn Estates subdivision that receive sewer services from Black Mountain, but owners of which did not receive a refund.

To resolve the issue raised by the Motion, the Town, Black Mountain, the Residential Utility Consumer Office, stipulated as follows:

1. Black Mountain will refund $405.73 for each of the thirty-three parcels of real property located within Carefree Inn Estates; and

2. Black Mountain will debit Black Mountains' other customers' accounts $6.62.

Commission Staff has taken no position on this matter.

IT IS THEREFORE ORDERED that Black Mountain Sewer Corporation shall refund $405.73 for each of the thirty-three parcels of real property located within Carefree Inn Estates.

IT IS FURTHER ORDERED that Black Mountain Sewer Corporation shall debit each of its customer's accounts $6.62.

IT IS FURTHER ORDERED that in all other respects, Decision No. 69164 shall remain in full force and effect.

IT IS FURTHER ORDERED that the Administrative Law Judge may rescind, alter, amend, or waive any portion of this Procedural Order either by subsequent Procedural Order.

Dated this ____ day of _____, 2007.

_____
DWIGHT D. NODES
ASSISTANT CHIEF ADMINISTRATIVE LAW JUDGE

///

///

///

///

///

COPIES of the foregoing
mailed this ___ day of
_____ to:

Thomas K. Chenal David W. Garbarino Suite 155 7047 East Greenway Parkway Scottsdale, Arizona 85254 Attorneys for the Town of Carefree	Jay Shapiro Patrick J. Black 3003 North Central Avenue, Suite 2600 Phoenix, AZ 85012 Attorneys for Black Mountain Sewer Company
Daniel W. Pozefsky 1110 West Washington Street Suite 220 Phoenix, AZ 85007 Attorney for Residential Utility Consumer Office	Brian Bozzo Utilities Division Arizona Corporation Commission 1200 W. Washington St. Phoenix, AZ 85007
Keith Layton Staff Counsel Legal Division Arizona Corporation Commission 1200 Washington Street Phoenix, AZ 85007	Boulders Homeowners Association Marilyn H. Courier, Secretary P.O. Box 2956 Carefree, AZ 85377
M.M. Shirtzinger 34773 N. Indian Camp Trail Scottsdale, AZ 85262	

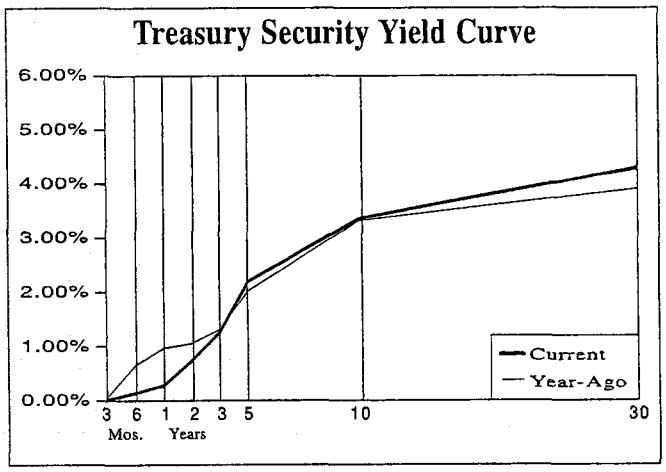
_____

Selected Yields

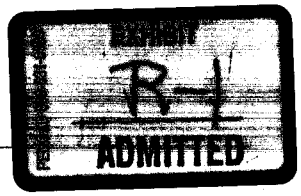
R-1

	Recent (11/18/09)	3 Months Ago (8/19/09)	Year Ago (11/19/08)
TAXABLE			
Market Rates			
Discount Rate	0.50	0.50	1.25
Federal Funds	0.00-0.25	0.00-0.25	1.00
Prime Rate	3.25	3.25	4.00
30-day CP (A1/P1)	0.14	0.23	2.60
3-month LIBOR	0.27	0.42	2.17
Bank CDs			
6-month	0.34	0.48	1.59
1-year	0.58	0.72	1.95
5-year	2.23	1.90	3.32
U.S. Treasury Securities			
3-month	0.02	0.16	0.06
6-month	0.14	0.25	0.65
1-year	0.28	0.39	0.97
5-year	2.19	2.41	2.02
10-year	3.36	3.45	3.32
10-year (inflation-protected)	1.15	1.69	3.51
30-year	4.30	4.29	3.91
30-year Zero	4.47	4.42	3.92

	Recent (11/18/09)	3 Months Ago (8/19/09)	Year Ago (11/19/08)
Mortgage-Backed Securities			
GNMA 6.5%	3.03	3.85	5.82
FHLMC 6.5% (Gold)	2.03	2.95	5.73
FNMA 6.5%	1.99	2.73	5.67
FNMA ARM	2.42	2.75	3.90
Corporate Bonds			
Financial (10-year) A	5.21	6.23	8.73
Industrial (25/30-year) A	5.52	5.60	7.23
Utility (25/30-year) A	5.51	5.64	7.34
Utility (25/30-year) Baa/BBB	6.24	6.23	8.20
Foreign Bonds (10-Year)			
Canada	3.41	3.40	3.51
Germany	3.29	3.25	3.54
Japan	1.31	1.35	1.48
United Kingdom	3.68	3.59	4.04
Preferred Stocks			
Utility A	5.68	6.02	7.10
Financial A	7.14	7.10	7.94
Financial Adjustable A	5.52	5.52	5.52



	Recent (11/18/09)	3 Months Ago (8/19/09)	Year Ago (11/19/08)
TAX-EXEMPT			
Bond Buyer Indexes			
20-Bond Index (GOs)	4.40	4.65	5.14
25-Bond Index (Revs)	5.02	5.66	5.98
General Obligation Bonds (GOs)			
1-year Aaa	0.42	0.40	1.10
1-year A	1.38	0.90	1.20
5-year Aaa	1.82	1.73	2.84
5-year A	3.00	2.17	2.94
10-year Aaa	3.27	2.94	3.83
10-year A	4.18	3.30	4.03
25/30-year Aaa	4.49	4.54	5.20
25/30-year A	5.48	5.00	5.60
Revenue Bonds (Revs) (25/30-Year)			
Education AA	4.78	5.50	5.85
Electric AA	4.79	5.60	5.90
Housing AA	5.72	5.75	6.00
Hospital AA	5.19	5.85	6.10
Toll Road Aaa	4.91	5.55	5.95



Federal Reserve Data

BANK RESERVES
(Two-Week Period; in Millions, Seasonally Adjusted)

	Recent Levels 11/4/09	10/21/09	Change	Average Levels Over the Last... 12 Wks.	26 Wks.	52 Wks.
Excess Reserves	1059253	986798	72455	877903	827902	766778
Borrowed Reserves	248364	265229	-16865	299705	375407	492904
Net Free/Borrowed Reserves	810889	721569	89320	578198	452495	273875

MONEY SUPPLY
(One-Week Period; in Billions, Seasonally Adjusted)

	Recent Levels 11/2/09	10/26/09	Change	Growth Rates Over the Last... 3 Mos.	6 Mos.	12 Mos.
M1 (Currency+demand deposits)	1695.9	1668.0	27.9	4.2%	11.1%	11.2%
M2 (M1+savings+small time deposits)	8387.3	8393.8	-6.5	2.6%	1.7%	5.7%

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EXHIBIT
R-2
ADMITTED

There has not been much change in the Water Utility Industry since our last review in July. Providers continued to reap the benefits of an increasingly favorable regulatory backing, with most in the group posting solid top- and bottom-line growth in the second quarter (September results were not out as of the date this issue was published).

However, the industry has fallen well into the bottom half of our *Survey* for Timeliness, as share-price gains paled in comparison to those enjoyed by the seemingly revitalized broader market. We suspect that water utility stocks will continue to lose some of their shine in the months ahead for similar reasons, as hopes of economic stability prompt many to look outside this relative safe-haven in hopes of securing wider gains. Making matter worse, earnings growth is likely to slow in the second half of the year and remain weak thereafter, due to tougher comparisons and burgeoning operating costs.

Longer-term growth prospects are not much better either. Despite the brighter regulatory landscape, infrastructure costs are expected to continue ramping up due to aging water systems, geographic expansion, and increasingly stringent EPA regulations. These, along with the subsequent financing expenses, will offset most of the aforementioned help, and thus limit appreciation potential going forward. As a result, most of the stocks in this segment offer minimal 3-to 5-year appeal.

Bright Demand Picture

These utilities have the ultimate job security. Water is a necessity, a fact that cannot be changed no matter what. Recognizing that a community's well being is closely tied to a providers health, many state regulatory bodies that were once antagonists, have changed their tune and taken on a more business approach. These authorities, which were put in place to help maintain a balance of power between customers and providers and to ensure fair business practices, are now handing down more favorable rulings. Responsible for reviewing and ruling on general rate requests made by utilities to help recover costs, they hold tremendous power and can potentially make or break a company. The recent about face in demeanor creates a far more favorable climate

INDUSTRY TIMELINESS: 72 (of 98)

and augurs well for providers.

Alarming Costs

That said, the water utility industry has some issues to contend with. Infrastructures are getting older and becoming inadequate in many cases. Some will require heavy investment in order to make the necessary repairs, while EPA standards get tougher due to the potential threat of bioterrorism. In all, infrastructure costs are estimated to amount to hundreds of millions of dollars over the next decade. Unfortunately, most operating in this space are laden with debt and strapped for cash. They will be forced to seek outside financing in order to meet the growing capital outlays, with the higher interest rate costs and greater share counts thwarting shareholder returns. Note, however, that, as a result of the industry's capital intensive nature, consolidation is white hot. Those with the flexibility to meet its commitments have ample opportunity to make deals and grow their customer base.

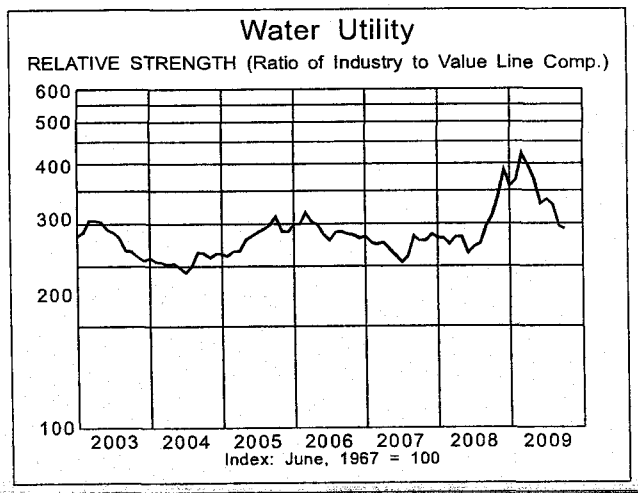
Conclusion

This industry is a good place for cautious investors looking to park themselves until a sustained market recovery is evident. Water utility stocks are historically more recession proof than the broader market, with their steady dividend growth reducing turbulence in share price and padding returns. However, those with a penchant for growth will probably want to take a pass, opting for an area with more upside. There are a couple of issues here that stand out for 3- to 5-year appreciation potential, namely *Aqua America* and *Southwest Water Company*, but the latter's Below Average (4) Safety rank and poor Financial Strength rating may evoke some apprehension. Meanwhile, *Aqua*'s dependence on an aggressive acquisition tendency to drive gains may well need to be tempered if finances continue to deteriorate. *American Water Works* is another interesting option, but its short trading history and lack of performance indicators should scare off most. As always, we advise potential investors to read the individual reports of each stock before making a financial commitment.

Andre J. Costanza

Composite Statistics: Water Utility Industry

2005	2006	2007	2008	2009	2010		12-14
1256.9	3454.1	3702.5	3913.8	*4180*	*4475*	Revenues ($mill)	*5425*
148.2	d5.8	d183.0	352.7	*425*	*485*	Net Profit ($mill)	*625*
40.5%	NMF	NMF	37.0%	*38.0%*	*39.0%*	Income Tax Rate	*40.0%*
1.1%	NMF	NMF	6.5%	*8.0%*	*10.0%*	AFUDC % to Net Profit	*15.0%*
50.4%	54.0%	51.0%	52.6%	*54.0%*	*52.5%*	Long-Term Debt Ratio	*50.0%*
49.5%	45.9%	49.0%	47.4%	*46.0%*	*47.5%*	Common Equity Ratio	*50.0%*
3053.8	12113.9	12985.9	12629.1	*13600*	*14125*	Total Capital ($mill)	*16250*
4200.7	13308.3	14315.2	15356.1	*16180*	*16950*	Net Plant ($mill)	*19375*
6.3%	1.6%	.2%	4.3%	*5.0%*	*5.0%*	Return on Total Cap'l	*6.0%*
9.8%	NMF	NMF	5.9%	*7.0%*	*7.0%*	Return on Shr. Equity	*7.5%*
9.8%	NMF	NMF	5.9%	*7.0%*	*7.0%*	Return on Com Equity	*7.5%*
3.7%	NMF	NMF	2.9%	*3.0%*	*3.5%*	Retained to Com Eq	*4.5%*
62%	NMF	NMF	51%	*65%*	*62%*	All Div'ds to Net Prof	*60%*
29.4	NMF	NMF		*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	*22.0*
1.57	NMF	NMF				Relative P/E Ratio	*1.45*
2.1%	2.0%	2.3%				Avg Ann'l Div'd Yield	*2.5%*



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R-3

BLACK MOUNTAIN SEWER CORPORATION

DOCKET NO. SW-02361A-08-0609

DIRECT TESTIMONY

OF

RODNEY L. MOORE

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

SEPTEMBER 18, 2009

EXHIBIT
R-3
ADMITTED
PENGAD 800-631-6989

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INTRODUCTION

Q. Please state your name, position, employer and address.

A. My name is Rodney L. Moore. I am a Public Utilities Analyst V with the Residential Utility Consumer Office ("RUCO"), located at 1110 West Washington Street, Suite 220, Phoenix, Arizona 85007.

Q. Please state your educational background and qualifications in the utility regulation field.

A. Appendix 1, which is attached to this testimony, describes my educational background and includes a list of the rate case and regulatory matters in which I have participated.

Q. Please state the purpose of your testimony.

A. The purpose of my testimony is to present RUCO's recommendations regarding Black Mountain Sewer Corporation's ("BMSC" or "Company") application for an increase in its wastewater rates. The test year utilized by the Company in connection with the preparation of this application is the 12-month period that ended June 30, 2008 ("Test Year").

BACKGROUND

Q. Please describe your work effort on this project.

A. I obtained and reviewed data and performed analytical procedures necessary to understand the Company's filing as it relates to the rate base, operating income and revenue requirements. My recommendations are based on these analyses. Procedures performed include the in-house formulation and analysis of two sets of data requests, and the review and analysis of Company responses to Commission Staff data requests and other intervenors.

Q. When were the Company's present rates and charges established?

A. The Company's present rates and charges were established by the Commission in Decision No. 69164, dated December 5, 2006.

Q. What areas will you address in your testimony?

A. I will address issues related to revenue requirement, rate base, operating income and rate design. RUCO's witness William A. Rigsby will provide an analysis of the cost of capital as presented on Schedule RLM-15.

Q. Please identify the exhibits you are sponsoring.

A. I am sponsoring a separate set of Schedules numbered RLM-1 through RLM-16.

SUMMARY OF ADJUSTMENTS

Q. Please summarize the adjustments to rate base, operating income and revenue requirement addressed in your testimony.

A. My testimony addresses the following issues:

Rate Base

Gross Plant-In-Service and Accumulated Depreciation – This is a conforming adjustment to reflect the Company's responses to Staff data requests.

Advances In Aid Of Construction ("AIAC") – This also is a conforming adjustment to reflect the Company's responses to Staff data requests.

Operating Income

Test Year Depreciation Expense – This adjustment increases test year operating expenses to reflect computations based on RUCO's recommended gross plant-in-service.

Property Tax Expense - This adjustment reflects property tax expense based on RUCO's calculation of adjusted and proposed operating revenues.

City of Scottsdale Wastewater Treatment Expense – This adjustment corrects a Company calculation error by inserting the appropriate rate into the formula.

Unnecessary and/or Non-Recurring Operating Expenses – These adjustments remove unnecessary operating expenses not required for the provisioning of wastewater service and/or remove test year expenses deemed atypical and non-recurring.

Normalization of Rent Expense –This is a conforming adjustment to increase rent expense based on the Company's response to Staff data request "MEM 1.55".

Normalization of Taxes Other Than Income – This is a conforming adjustment to decrease taxes other than income based on the Company's response to Staff data request "MEM 1.58".

Income Tax Expense – This adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses.

Rate Design and Proof of Recommended Revenue

I am recommending a rate design that is generally consistent with the Company's present rate design, but reflects RUCO's recommended revenue requirement and provides proof that the design will produce the appropriate revenue requirement.

REVENUE REQUIREMENTS

Q. Please summarize the results of RUCO's analysis of the Company's filing and state RUCO's recommended revenue requirement.

A. As outlined in Schedule RLM-1, RUCO is recommending that the Company's revenue requirement not exceed the following levels:

BMSC	RUCO	DIFFERENCE
$2,493,933	$2,069,774	($424,159)

RUCO's recommended increase in Fair Value Rate Base ("FVRB") is based on the Company's Original Cost Rate Base ("OCRB") and is summarized on Schedule RLM-1:

BMSC	RUCO	DIFFERENCE
$3,723,245	$3,745,364	$22,119

RUCO's recommended required operating income is shown on Schedule RLM-1 as:

BMSC	RUCO	DIFFERENCE
$476,575	$278,281	($198,294)

RUCO's recommended revenue requirement percentage increase versus the Company's proposal is as follows:

BMSC	RUCO	DIFFERENCE
57.83 %	30.98 %	-26.85 %

Schedule RLM-1 presents the calculation of RUCO's recommended revenue requirement.

RATE BASE

Rate Base Adjustment Summary

Q. Is RUCO recommending any changes to the Company's proposed rate base?

A. Yes. My adjustments to rate base are exhibited on Schedule RLM-3, columns A through G. Based on my analysis I made two adjustments to the rate base as filed by the Company.

Q. Does RUCO accept BMSC's request to use the Company's OCRB as the FVRB?

A. Yes. RUCO accepts the Company's request that the OCRB be used as the fair value rate base ("FVRB").

Q. Please describe your rate base adjustments.

A. My review, analysis and adjustments are explained below.

Rate Base Adjustment No. 1 – Gross Plant-In-Service and Accumulated Depreciation

Q. Please explain the basis for your adjustment to the gross plant-in-service and the accumulated depreciation.

A. My plant-in-service analysis from the prior rate case to the end of the Test Year mirrored the Company's filing; however, the Company acknowledged in its responses to Staff data requests DH 2.4, DH 2.5, DH 2.7 and DH 2.17 there were plant additions and retirements omitted from the original filing. RUCO reviewed BMSC's responses and made several appropriate adjustments.

Q. Please explain your adjustments to gross plant-in-service and accumulated depreciation.

A. First, the Company had failed to record the replacement of a sewer lift station. This lift station was constructed under a line extension agreement ("LXA") and financed by advances in aid of construction ("AIAC"). Because the Company was unable to provide documentation to substantiate the actual costs I recorded the estimated values provided by BMSC. The estimated value recorded was $276,985.

Second, the Company had failed to record the retirement of the replaced sewer lift station. Because the Company was unable to provide documentation to substantiate the original costs I recorded the values

calculated by BMSC using the Handy Whitman index for structures. The calculated retirement value recorded was ($13,208).

Third, the Company had failed to record the transfer of an odor control unit from Litchfield Park Sewer Company ("LPSCO"), an affiliated Company. The value transferred from LPSCO to BMSC was $38,625.

Next, I calculated the associated accumulated depreciation for replacement/retirement of the sewer lift station using authorized depreciation rates and the half-year convention. The accumulated depreciation recorded for the replacement of the lift station was $4,392 and ($13,208) for the retired lift station, amounting to a total decrease of $8,816.

Finally, the associated accumulated depreciation for the transferred odor control unit was obtained through the Company's response to RUCO data request 2.01 in the amount of $11,148.

Q. Please explain the total effect of your Adjustment No. 1 on the rate base.

A. As shown on Schedule RLM-3, column (B), and with supporting Schedule RLM-4, these adjustments increase adjusted test year rate base by $299,104.

Rate Base Adjustment No. 2 – Advances In Aid Of Construction ("AIAC")

Q. Please explain the basis for your adjustment to AIAC.

A. This is a companion adjustment to the sewer lift station replacement discussed above. Since a developer paid for all the costs associated with the installation of the new lift station, these costs were appropriately recorded in the AIAC account, but were not reflected in the Company's application.

As shown on Schedule RLM-3, column (C), this adjustment decreased adjusted test year rate base by $276,985.

OPERATING INCOME

Operating Income Adjustment Summary

Q. Is RUCO recommending any changes to the Company's proposed operating expenses?

A. Yes. Based on my analysis of the Company's adjustments to its historical test year operating income, I have made nine adjustments to the Company-proposed level of operating income. The adjustments are exhibited on Schedule RLM-7, columns A through K.

Operating Income Adjustment No. 1 – Test Year Depreciation Expense

Q. Please explain your adjustment to the test year depreciation expense.

A. As shown on Schedule RLM-8, adjustment No. 1 reflects RUCO's end of test year gross plant-in-service and calculates the depreciation expense based on depreciation rates proposed by the Company and accepted by RUCO.

As shown on Schedule RLM-7, column (B), with supporting documentation on Schedule RLM-8, this adjustment increased the adjusted test year operating expenses by $10,715.

Operating Income Adjustment No. 2 – Property Tax Computation

Q. Did RUCO use the same methodology used by BMSC to calculate property tax expenses?

A. Yes.

Q. Did RUCO make an adjustment to the Company-proposed level of property tax expense?

A. Yes. RUCO made adjustments to the property tax expense based on its calculation of adjusted and proposed operating revenues.

As shown on Schedule RLM-7, column (C), with supporting documentation on Schedule RLM-9 this adjustment decreased the adjusted test year operating expenses by $2,203.

Operating Income Adjustments Nos. 3 & 4 – City of Scottsdale Wastewater Treatment Expense

Q. Please explain your adjustment to the test year revenue.

A. This adjustment recalculated the Company's expected charges from the City of Scottsdale for the treatment of BMSC wastewater to accurately reflect the new rate schedule ($2.53 per thousand gallons). The Company had used an incorrect rate ($2.59 per thousand gallons) when computing this expense.

First, I made an adjustment to reflect RUCO's recalculation of the test year charges from the City of Scottsdale for treatment of the test year wastewater gallons.

As shown on Schedule RLM-10 this adjustment decreased the adjusted test year operating revenues by $7,528.

Secondly, I made an adjustment to reflect RUCO's recalculation of the charges expected from the City of Scottsdale for treatment of the additional annualized wastewater gallons on a going-forward basis.

RUCO's computation used the correct rate of a $2.53 base plus the environmental surcharge and city sales tax to determine the proper level of this expense.

As shown on Schedule RLM-11 this adjustment decreased adjusted test year expenses by $24.

Therefore, in total and as shown on Schedule RLM-7, column (D), with supporting documentation on Schedules RLM-11 and RLM-12, this adjustment decreased test year expenses by $7,551.

Operating Income Adjustment No. 5 – Unnecessary and/or Non-Recurring

Q. Please explain your adjustments based on information obtained from the Company's response to Staff data requests MEM 1.46 and MEM 1.55.

A After an analysis of the Company's responses to Staff data requests MEM 1.46 and MEM 1.55, I determined there were test year expenditures not required for the provision of wastewater service or were abnormal and atypical for considerations as a reasonable recurring test year expense. Therefore, I disallowed their inclusion as acceptable test year operating expenses.

My adjustment removed unnecessary expenditures for charitable donations and bottled water. I also removed costs associated with an easement boundary dispute and costs to clean up a sewer spill, which are incidents that are unlikely to occur on a regular basis.

As shown on Schedule RLM-7, column (E), with supporting documentation on Schedule RLM-12, this adjustment decreased test year expenses by $834.

Operating Income Adjustment No. 6 – Normalization of Rent Expense

Q. Please explain your adjustment to the test year rent expense.

A. This is a conforming adjustment to reflect the Company's response to Staff data request MEM 1.55. The adjustment addresses an incorrect charge for annual rent for the operations office in Carefree. The instant filing inadvertently included only six months rent. Thus an additional six months rent was allowed for inclusion as a fair, reasonable and recurring test year expense. My adjustment normalized the level of rent expense that will be incurred by the Company on a going-forward basis.

As shown on Schedule RLM-7, column (F), this adjustment increased the adjusted test year expenses by $3,072 X 6 = $18,432.

Operating Income Adjustment No. 7 – Normalization of Taxes Other Than Income

Q. Please explain your adjustment to test year taxes other than income expense.

A. This is a conforming adjustment to reflect the Company's response to Staff data request MEM 1.58. This adjustment reflects an over accrual of $1,780 related to fees assessed in 2006 and corrected in 2007. RUCO agreed with the Company that this expense should be $0 and excluded from test year operating expenses.

As shown on Schedule RLM-7, column (G), this adjustment increased the adjusted test year expenses by $1,780.

Operating Income Adjustment No. 8 – Normalization of Chemical Expenses

Q. Please explain your adjustment to normalize chemical expenses.

A. This is a conforming adjustment to reflect the Company's response to RUCO data request 2.03. The adjustment recalculated the test year level of chemical expenses to include the sale tax omitted in the Company's original filing. RUCO also made an additional adjustment to reflect the known and measurable post test year increase in the "cost per gallon" charge identified by the Company in the response.

As shown on Schedule RLM-7, column (H), with supporting documentation on Schedule RLM-13, this adjustment increased the adjusted test year expenses by $3,185.

RUCO Operating Income Adjustment No. 9 – Income Taxes

Q. Please explain RUCO's adjustment to the income tax expenses.

A. This adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses.

Q. Does RUCO's recommended level of income tax expense reflect an interest deduction using a synchronized interest calculation?

A. Yes.

As shown on Schedules RLM-7, column (K) and supporting Schedule RLM-14, this adjustment decreased the adjusted test year expenses by $81,261.

COST OF CAPITAL

Q. Has RUCO conducted a cost of capital analysis for BMSC?

A. Yes. RUCO witness William A. Rigsby has filed testimony on the cost of capital issues associated with the case. His recommended capital structure and weighted average cost of capital is exhibited on Schedule RLM-15.

RATE DESIGN AND PROOF OF RECOMMENDED REVENUE

Q. Have you prepared a Schedule presenting your recommended rate designs?

A. Yes, as shown on Schedule RLM-16, I am recommending a rate design that is consistent with RUCO's recommended revenue allocations and requirement.

Q. Please describe your recommended rate designs for the Company's wastewater operation.

A. RUCO recommends a $58.88 flat rate residential monthly charge, which is a $13.24 or 29 percent increase over the present rate of $45.64.

RUCO also recommends a $0.23608 per gallon per day commodity usage rate for commercial customers, which is a $0.0531 or 29 percent increase over the present rate of $0.18298.

The rate design provides for a 23 percent increase equally across the residential and standard commercial classes of service, which is a decrease of 33 percent over the Company's requested 56 percent increase.

Q. Have you prepared a Schedule presenting proof of your recommended revenue?

A. Yes, I have. Proof that my recommended rate designs will produce the recommended required revenue as illustrated, is presented also on Schedule RLM-16.

Q. Does this conclude your direct testimony?

A. Yes, it does.

APPENDIX 1

Qualifications of Rodney Lane Moore

EDUCATION: Athabasca University
Bachelor's Degree in Business Administration - 1993

EXPERIENCE: Public Utilities Analyst V
Residential Utility Consumer Office
Phoenix, Arizona 85007
May 2001 - Present

My duties include review and analysis of financial records and other documents of regulated utilities for accuracy, completeness, and reasonableness. I am also responsible for the preparation of work papers and Schedules resulting in testimony and/or reports regarding utility applications for increase in rates, financings, and other matters. Extensive use of Microsoft Excel and Word, spreadsheet modeling and financial statement analysis.

Auditor
Arizona Corporation Commission
Phoenix, Arizona 85007
October 1999 - May 2001

My duties include review and analysis of financial records and other documents of regulated utilities for accuracy, completeness, and reasonableness. I am also responsible for the preparation of work papers and Schedules resulting in testimony and/or reports regarding utility applications for increase in rates, financings, and other matters. Extensive use of Microsoft Excel and Word, spreadsheet modeling and financial statement analysis.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

Utility Company	Docket No.
Rio Verde Utilities, Inc	WS-02156A-00-0321
Black Mountain Gas Company	G-03703A-01-0283
Green Valley Water Company	W-02025A-01-0559
New River Utility Company	W-01737A-01-0662

Utility Company	Docket No.
Dragoon Water Company	W-01917A-01-0851
Roosevelt Lake Resort, Inc.	W-01958A-02-0283
Southwest Gas Company	G-01551A-02-0425
Arizona-American Water Company	W-01303A-02-0867 et al.
Rio Rico Utilities, Inc.	WS-02676A-03-0434
Qwest Corporation	T-01051B-03-0454
Chaparral City Water Company	W-02113A-04-0616
Southwest Gas Company	G-01551A-04-0876
Arizona-American Water Company	W-01303A-05-0405
Far West Water and Sewer Company	WS-03478A-05-0801
Gold Canyon Sewer Company	SW-02519A-06-0015
Arizona-American Water Company	WS-01303A-06-0403
UNS Gas, Inc.	G-04204A-06-0463 et al.
UNS Electric, Inc.	E-04204A-06-0783
Tucson Electric Power Company	E-01933A-07-0402
Southwest Gas Company	G-01551A-07-0504
Arizona-American Water Company	W-01303A-08-0227 et al.
Arizona Water Company	W-01445A-08-0440

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

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RLM-4	1	RATE BASE ADJUSTMENT NO. 1 - RUCO ADJUSTMENT TO GROSS PLANT AND ACCUMULATED DEPRECIATION
TESTIMONY		RATE BASE ADJUSTMENT NO. 2 - RUCO ADJUSTMENT TO ADVANCES IN AID OF CONSTRUCTION
RLM-5	1	INTENTIONALLY LEFT BLANK
RLM-6	1	OPERATING INCOME
RLM-7	1	SUMMARY OF OPERATING INCOME ADJUSTMENTS
RLM-8	1	OPERATING INCOME ADJUSTMENT NO. 1 - TEST YEAR DEPRECIATION EXPENSE
RLM-9	1	OPERATING INCOME ADJUSTMENT NO. 2 - PROPERTY TAX COMPUTATION
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RLM-11		OPERATING INCOME ADJUSTMENT NO. 4 - ANNUALIZED WASTEWATER TREATMENT EXPENSE
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RLM-13		OPERATING INCOME ADJUSTMENT NO. 8 - NORMALIZATION OF CHEMICAL EXPENSE
RLM-14		OPERATING INCOME ADJUSTMENT NO. 9 - INCOME TAX EXPENSE
RLM-15	1	COST OF CAPITAL
RLM-16	1	RATE DESIGN AND PROOF OF RECOMMENDED REVENUE

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY OCRB/FVRB COST	(B) RUCO OCRB/FVRB COST
1	Fair Value Rate Base	$ 3,723,245	$ 3,745,364
2	Adjusted Operating Income (Loss)	$ (84,485)	$ (27,286)
3	Current Rate Of Return (L2 / L1)	-2.27%	-0.73%
4	Required Operating Income (L5 X L1)	$ 476,575	$ 278,281
5	Required Rate Of Return On Fair Value Rate Base	12.80%	7.43%
6	Operating Income Deficiency (L4 - L2)	$ 561,060	$ 305,567
7	Gross Revenue Conversion Factor (RLM-1, Pg 2)	1.6286	1.6023
8	Increase In Gross Revenue Requirement (L7 X L6)	$ 913,763	$ 489,604
9	Adjusted Test Year Revenue	$ 1,580,170	$ 1,580,170
10	Proposed Annual Revenue (L8 + L9)	$ 2,493,933	$ 2,069,774
11	Required Percentage Increase In Revenue (L8 / L9)	57.83%	30.98%
12	Rate Of Return On Common Equity	12.80%	8.22%

References:

Column (A): Company Schedules A-1 and C-1
Column (B): RUCO Schedule RLM-2, RLM-6, And RLM-15

REVENUE REQUIREMENT - CONT'D
GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
	CALCULATION OF GROSS REVENUE CONVERSION FACTOR:				
1	Revenue	1.0000			
2	Combined Federal And State Tax Rate (L10)	(0.3759)			
3	Subtotal (L1 + L2)	0.6241			
4	**Revenue Conversion Factor** (L1 / L3)	**1.6023**			
	CALCULATION OF EFFECTIVE TAX RATE:				
5	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
6	Arizona State Income Tax Rate	6.9680%			
7	Federal Taxable Income (L5 - L6)	93.0320%			
8	Applicable Federal Income Tax Rate (Col. (D), L34)	32.9144%			
9	Effective Federal Income Tax Rate (L7 X L8)	30.6209%			
10	Combined Federal And State Income Tax Rate (L6 + L9)	37.5889%			
11	Required Operating Income (Sch. RLM-1, Col. (B), L4)	$ 278,281			
12	Adj'd T.Y. Oper'g Inc. (Loss) (Sch. RLM-1, Col. (B), L2)	(27,286)			
13	Required Increase In Operating Income (L11 - L12)		$ 305,567		
14	Income Taxes On Recommended Revenue (Col. (D), L31)	$ 111,209			
15	Income Taxes On Test Year Revenue (Col. (D), L32)	(72,828)			
16	Required Increase In Revenue To Provide For Income Taxes (L14 - L15)		$ 184,037		
17	Total Required Increase In Revenue (L13 + L16)		$ 489,604		
	CALCULATION OF INCOME TAX:			RUCO Recommended	
18	Revenue (Sch. RLM-1, Col. (B), L10)			$ 2,069,774	
19	Operating Expense Excluding Income Tax (RLM-5, Col. (E), L25 - L24)			(1,680,284)	
20	Synchronized Interest (Col. (C), L37)			(93,634)	
21	Arizona Taxable Income (L18 + L19 + L20)			$ 295,855	
22	Arizona State Income Tax Rate			6.9680%	
23	Arizona Income Tax (L21 X L22)				$ 20,615
24	Fed. Taxable Income (L21 - L23)			$ 275,240	
25	Fed. Tax On 1st Inc. Bracket ($1 - $50,000) @ 15%			$ 7,500	
26	Fed. Tax On 2nd Inc. Bracket ($50,001 - $75,000) @ 25%			6,250	
27	Fed. Tax On 3rd Inc. Bracket ($75,001 - $100,000) @ 34%			8,500	
28	Fed. Tax On 4th Inc. Bracket ($100,001 - $335,000) @ 39%			68,344	
29	Fed. Tax On 5th Inc. Bracket ($335,001 - $10M) @ 34%			-	
30	Total Federal Income Tax (L25 + L26 + L27 + L28 + L29)				$ 90,594
31	Combined Federal And State Income Tax (L23 + L30)				$ 111,209
32	Test Year Combined Income Tax, RUCO As Adjusted (RLM-6, Col. (C), L24)				$ (72,828)
33	RUCO Adjustment (L31 - L32) (See RLM-6, Col. (D), L24)				$ 184,037
34	Applicable Federal Income Tax Rate (Col. (D), L30 / Col. (C), L24)				32.91%
	CALCULATION OF INTEREST SYNCHRONIZATION:				
35	Rate Base (Sch. RLM-2, Col. (H), L15)			$ 3,745,364	
36	Weighted Avg. Cost Of Debt (Sch. RLM-15, Col. (F), L1)			2.50%	
37	Synchronized Interest (L35 X L36)			$ 93,634	

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED OCRB/FVRB	(B) RUCO ADJUSTMENTS	(C) RUCO AS ADJUSTED OCRB/FVRB
1	Gross Utility Plant In Service	$ 11,357,735	$ 302,402	$ 11,660,137
2	Accumulated Depreciation	(5,625,025)	(3,298)	(5,628,323)
3	Net Utility Plant In Service (L1 + L2)	$ 5,732,710	$ 299,104	$ 6,031,814
4	Advances In Aid Of Const.	$ (1,457,009)	$ (276,985)	$ (1,733,994)
5	Contribution In Aid Of Const.	$ (5,232,139)	$ -	$ (5,232,139)
6	Accumulated Amortization Of CIAC	4,214,384	-	4,214,384
7	NET CIAC (L5 + L6)	$ (1,017,755)	$ -	$ (1,017,755)
8	Customer Meter Deposits	$ (94,290)	$ -	$ (94,290)
9	Deferred Income Taxes & Credits	$ 170,554	$ -	$ 170,554
10	Unamortized Finance Charges	$ -	$ -	$ -
11	Deferred Regulatory Assets	$ 389,035	$ -	$ 389,035
12	Allowance For Working Capital	$ -	$ -	$ -
13	TOTAL RATE BASE (Sum L's 3, 4, 7, 8 Thru 12)	$ 3,723,245	$ 22,119	$ 3,745,364

References:
Column (A): Company Schedule B-2, Page 1 And Workpapers Schedule E-1
Column (B): RLM-3, Columns (B) Thru (G)
Column (C): Column (A) + Column (B)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED OCRB/FVRB	(B) ADJ # 1 GROSS PLT & ACC DEP	(C) ADJ # 2 AIAC	(D) INTENT'NLY LEFT BLANK	(E) INTENT'NLY LEFT BLANK	(F) INTENT'NLY LEFT BLANK	(G) INTENT'NLY LEFT BLANK	(H) RUCO ADJ'TED OCRB/FVRB
1	Gross Utility Plant In Service	$ 11,357,735	$ 302,402	$ -	$ -	$ -	$ -	$ -	$ 11,660,137
2	Accumulated Depreciation	(5,625,025)	(3,298)	-	-	-	-	-	(5,628,323)
3	Net Utility Plant In Service (L1 + L2)	$ 5,732,710	$ 299,104	$ -	$ -	$ -	$ -	$ -	$ 6,031,814
4	Advances In Aid Of Const.	$ (1,457,009)	$ -	$ (276,985)	$ -	$ -	$ -	$ -	$ (1,733,994)
5	Contribution In Aid Of Const.	$ (5,232,139)	$ -	$ -	$ -	$ -	$ -	$ -	$ (5,232,139)
6	Accumulated Amortization Of CIAC	4,214,384	-	-	-	-	-	-	4,214,384
7	NET CIAC (L5 + L6)	$ (1,017,755)	$ -	$ -	$ -	$ -	$ -	$ -	$ (1,017,755)
8	Customer Meter Deposits	$ (94,290)	$ -	$ -	$ -	$ -	$ -	$ -	$ (94,290)
9	Deferred Income Taxes & Credits	$ 170,554	$ -	$ -	$ -	$ -	$ -	$ -	$ 170,554
10	Unamortized Finance Charges	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
11	Deferred Regulatory Assets	$ 389,035	$ -	$ -	$ -	$ -	$ -	$ -	$ 389,035
12	Allowance For Working Capital	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
13	TOTAL RATE BASE (Sum L's 3, 4, 7, 8 Thru 12	$ 3,723,245	$ 299,104	$ (276,985)	$ -	$ -	$ -	$ -	$ 3,745,364

References:

Column (A): Company Schedule B-2, Page 1 And Workpapers Schedule E-1
Column (B): Adjustment No. 1 - RUCO Adjustment To GPIS And Acc. Dep. (See Testimony and Schedule RLM-4)
Column (C): Adjustment No. 2 - RUCO Adjustment To AIAC (See Testimony)
Column (D): Intentionally Left Blank
Column (E): Intentionally Left Blank
Column (F): Intentionally Left Blank
Column (G): Intentionally Left Blank
Column (H): Sum Of Columns (A), (B), (C), (D), (E) & (F)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

TEST YEAR PLANT SCHEDULE
YEAR ENDED JUNE 30, 2008

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) COMPANY T/Y PLANT AS FILED	(B) RUCO TEST-YEAR ADJUSTMENTS PLANT ADDITIONS	(C) PLANT RETIRMENTS	(D) DEPRECIATION EXPENSE	(E) TOTAL PLANT VALUE	(F) ACCUMULATED DEPRECIATION	(G) NET PLANT VALUE
1	351	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	352	Franchises	-	-	-	-	-	-	-
3	353	Land and Land Rights	461,300	-	-	-	461,300	-	461,300
4	354	Structures And Improvements	2,557,920	-	-	-	2,557,920	(1,067,642)	1,490,278
5	355	Power Generation Equipment	-	-	-	-	-	-	-
6	360	Collection Sewers - Force	706,291	-	-	-	706,291	(217,363)	488,928
7	361	Collection Sewers - Gravity	4,284,949	-	-	-	4,284,949	(2,869,293)	1,415,656
8	362	Special Collecting Structures	-	-	-	-	-	-	-
9	363	Services To Customers	198,723	-	-	-	198,723	(145,843)	52,880
10	364	Flow Measuring Devices	31,512	-	-	-	31,512	(32,828)	(1,316)
11	365	Flow Measuring Installations	179,622	-	-	-	179,622	(57,602)	122,020
12	370	Receiving Wells	690,628	276,985	(13,208)	(4,392)	954,405	(274,222)	680,183
13	371	Effluent Pumping Equipment	654,845	-	-	-	654,845	(437,967)	216,878
14	380	Treatment And Disposal Equip	143,578	38,625	-	(966)	182,203	(16,004)	166,199
15	381	Plant Sewers	123,289	-	-	-	123,289	(105,593)	17,696
16	382	Outfall Sewer Lines	-	-	-	-	-	-	-
17	389	Other Plant And Misc Equip	939,433	-	-	-	939,433	(263,481)	675,952
18	390	Office Furniture And Equipment	224,588	-	-	-	224,588	(75,701)	148,887
19	391	Transportation Equipment	107,367	-	-	-	107,367	(60,947)	46,420
20	393	Tools, Shop And Garage Equip	5,755	-	-	-	5,755	(203)	5,552
21	394	Laboratory Equipment	7,488	-	-	-	7,488	(2,624)	4,864
22	395	Power Operated Equipment	-	-	-	-	-	-	-
23	396	Communication Equipment	40,451	-	-	-	40,451	(1,011)	39,440
24	398	Other Tangible Plant	-	-	-	-	-	-	-
			(4)				(4)	2	
25	TOTAL WASTEWATER PLANT		$ 11,357,735	$ 315,610	$ (13,208)	$ (5,358)	$ 11,660,137	$ (5,628,323)	$ 6,031,816
26	Company As Filed						$ 11,357,735	$ (5,625,025)	
27	Difference						$ 302,402	$ (3,298)	
28	RUCO Adjustment (Line 27) (See RLM-3, Column (B))						$ 302,402	$ (3,298)	

References:

Column (A): RUCO Workpapers "WP RLM-4(5)"
Columns (B) (C): Testimony, RLM
Column (D): [(Col. (A) + Col. (B) + Col. (C)) X WP RLM-4, Page 1, Col. (A) X 1/2 yr. conv.]

Column (E): Column (A) + Column (B) + Column (C)
Column (F): WP RLM-4, Page 5, Col. (E) + (Col. (C) + Col. (D) - $11,148.46 (See Testimony, Pg 9)
Column (G): (Column (E) + Column (F)

RUCO MADE NO POST TEST-YEAR PLANT ADJUSTMENTS

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

OPERATING INCOME

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) RUCO TEST YEAR ADJM'TS	(C) RUCO TEST YEAR AS ADJ'TED	(D) RUCO PROP'D CHANGES	(E) RUCO AS RECOMM'D
	Revenues:					
1	Flat Rate Revenues	$ 1,557,337	$ -	$ 1,557,337	$ 485,943	$ 2,043,280
2	Misc. Service Revenues	15,917	-	15,917	3,661	19,578
3	Other WW Revenues	6,916	-	6,916	-	6,916
4	TOTAL OPERATING REVENUE	$ 1,580,170	$ -	$ 1,580,170	$ 489,603	$ 2,069,773
	Operating Expenses:					
5	Salaries And Wages	$ -	-	$ -	$ -	$ -
6	Purchased WW Treatment	335,255	(7,551)	327,704	-	327,704
7	Sludge Removal Expense	706	-	706	-	706
8	Purchased Power	54,690	-	54,690	-	54,690
9	Fuel For Power Production	928	-	928	-	928
10	Chemicals	37,489	3,185	40,674	-	40,674
11	Materials And Supplies	11,224	-	11,224	-	11,224
12	Contractual Services	9,362	(4,723)	4,639	-	4,639
13	Contractual Services - Testing	16,955	-	16,955	-	16,955
14	Contractual Services - Other	553,043	3,942	556,984	-	556,984
15	Equipment Rentals	1,863	-	1,863	-	1,863
16	Rents	19,830	18,432	38,262	-	38,262
17	Transportation Expenses	34,445	-	34,445	-	34,445
18	Insurance - General Liability	18,704	-	18,704	-	18,704
19	Insurance - Other	990	-	990	-	990
20	Regulatory Comm. Expense	60,000	-	60,000	-	60,000
21	Miscellaneous Expense	20,845	(52)	20,793	-	20,793
22	Bad Debt Expense	11,962	-	11,962	-	11,962
23	Scottsdale Cap. (Oper'g Lease)	164,522	-	164,522	-	164,522
24	Amort. Scottsdale Cap.	48,629	-	48,629	-	48,629
25	Depreciation Expense	224,818	10,715	235,533	-	235,533
26	Taxes Other Than Income	(1,780)	1,780	-	-	-
27	Property Taxes	32,414	(2,338)	30,077	-	30,077
28	Income Tax	7,760	(80,588)	(72,828)	184,037	111,209
29	TOTAL OPERATING EXPENSES	$ 1,664,655	$ (57,198)	$ 1,607,456	$ 184,037	$ 1,791,493
30	OPERATING INCOME (LOSS)	$ (84,485)		$ (27,286)		$ 278,280

References:

Column (A): Company Schedule C-1
Column (B): RLM-7, Columns (B) Thru (K)
Column (C): Column (A) + Column (B)
Column (D): Revenue From RLM-1, Column (B), Line 8 And Income Tax From RLM-1, Column (B), Line 8 - Line 6
Column (E): Column (C) + Column (D)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SUMMARY OF OPERATING INCOME ADJUSTMENTS
TEST YEAR AS FILED AND ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) ADJ # 1 DEP. EXPENSE	(C) ADJ # 2 PROPERTY TAX	(D) ADJ # 3 & 4 SC'SDALE TREATM'T	(E) ADJ # 5 UNNES'RY EXPENSES	(F) ADJ # 6 NORM'LIZE RENT	(G) ADJ # 7 NORM'LIZE OTH'R TAX	(H) ADJ # 8 NORM'LIZE CHEMICAL	(I) INTENT'LY LEFT BLANK	(J) INTENT'LY LEFT BLANK	(K) ADJ # 9 INCOME TAX	(L) RUCO AS ADJT'D
	Revenues:												
1	Flat Rate Revenues	$ 1,557,337	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,557,337
2	Misc. Service Revenues	15,917	-	-	-	-	-	-	-	-	-	-	15,917
3	Other WW Revenues	6,916	-	-	-	-	-	-	-	-	-	-	6,916
4	TOTAL OPR'G REV.	$ 1,580,170	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,580,170
	Operating Expenses:												
5	Salaries And Wages	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	Purchased WW Treatment	335,255	-	-	(7,551)	-	-	-	-	-	-	-	327,704
7	Sludge Removal Expense	706	-	-	-	-	-	-	-	-	-	-	706
8	Purchased Power	54,690	-	-	-	-	-	-	-	-	-	-	54,690
9	Fuel For Power Production	928	-	-	-	-	-	-	-	-	-	-	928
10	Chemicals	37,489	-	-	-	-	-	-	3,185	-	-	-	40,674
11	Materials And Supplies	11,224	-	-	-	-	-	-	-	-	-	-	11,224
12	Contractual Services	9,362	-	-	-	(4,723)	-	-	-	-	-	-	4,639
13	Contractual Services - Testing	16,955	-	-	-	-	-	-	-	-	-	-	16,955
14	Contractual Services - Other	553,043	-	-	-	3,942	-	-	-	-	-	-	556,984
15	Equipment Rentals	1,863	-	-	-	-	-	-	-	-	-	-	1,863
16	Rents	19,830	-	-	-	-	18,432	-	-	-	-	-	38,262
17	Transportation Expenses	34,445	-	-	-	-	-	-	-	-	-	-	34,445
18	Insurance - General Liability	18,704	-	-	-	-	-	-	-	-	-	-	18,704
19	Insurance - Other	990	-	-	-	-	-	-	-	-	-	-	990
20	Regulatory Comm. Expense	60,000	-	-	-	-	-	-	-	-	-	-	60,000
21	Miscellaneous Expense	20,845	-	-	-	(52)	-	-	-	-	-	-	20,793
22	Bad Debt Expense	11,962	-	-	-	-	-	-	-	-	-	-	11,962
23	Scottsdale Cap. (Oper'g Lease)	164,522	-	-	-	-	-	-	-	-	-	-	164,522
24	Amort. Scottsdale Cap.	48,629	-	-	-	-	-	-	-	-	-	-	48,629
25	Depreciation Expense	224,818	10,715	-	-	-	-	-	-	-	-	-	235,533
26	Taxes Other Than Income	(1,780)	-	-	-	-	-	1,780	-	-	-	-	-
27	Property Taxes	32,414	-	(2,338)	-	-	-	-	-	-	-	-	30,077
28	Income Tax	7,760	-	-	-	-	-	-	-	-	-	(80,588)	(72,828)
29	TOTAL OPR'G EXP.	$ 1,664,655	$ 10,715	$ (2,338)	$ (7,551)	$ (834)	$ 18,432	$ 1,780	$ 3,185	$ -	$ -	$ (80,588)	$ 1,607,456
30	OPR'G INC. (LOSS)	$ (84,485)											$ (27,286)

References:

Column (A): Company Schedule C-1
Column (B): Testimony, RLM And Schedule RLM-8
Column (C): Testimony, RLM And Schedule RLM-9
Column (D): Testimony, RLM And Schedule RLM-10
Column (E): Testimony, RLM And Schedule RLM-11
Column (F): Testimony, RLM And Schedule RLM-12
Column (G): Testimony, RLM
Column (H): Testimony, RLM
Column (I): Testimony, RLM And Schedule RLM-13
Column (J): Intentionally Left Blank
Column (K: Testimony, RLM And Schedule RLM-14
Column (L): Sum Of Columns (A) Thru (K)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 1
TEST YEAR DEPRECIATION EXPENSE

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) TOTAL PLANT VALUE	(B) APR'D DEP. RATE	(C) TEST YEAR DEPREC'N EXPENSE
1	351	Organization	$ -	0.00%	$ -
2	352	Franchises	-	0.00%	-
3	353	Land and Land Rights	461,300	0.00%	-
4	354	Structures And Improvements	2,557,920	3.33%	85,179
5	355	Power Generation Equipment	-	5.00%	-
6	360	Collection Sewers - Force	706,291	2.00%	14,126
7	361	Collection Sewers - Gravity	4,284,949	2.00%	85,699
8	362	Special Collecting Structures	-	2.00%	-
9	363	Services To Customers	198,723	2.00%	3,974
10	364	Flow Measuring Devices	31,512	10.00%	3,151
11	365	Flow Measuring Installations	179,622	10.00%	17,962
12	370	Receiving Wells	954,405	3.33%	31,782
13	371	Effluent Pumping Equipment	654,845	12.50%	81,856
14	380	Treatment And Disposal Equip	182,203	5.00%	9,110
15	381	Plant Sewers	123,289	5.00%	6,164
16	382	Outfall Sewer Lines	-	3.33%	-
17	389	Other Plant And Misc Equip	939,433	6.67%	62,660
18	390	Office Furniture And Equipment	224,588	6.67%	14,980
19	391	Transportation Equipment	107,367	20.00%	21,473
20	393	Tools, Shop And Garage Equip	5,755	5.00%	288
21	394	Laboratory Equipment	7,488	10.00%	749
22	395	Power Operated Equipment	-	5.00%	-
23	396	Communication Equipment	40,451	10.00%	4,045
24	398	Other Tangible Plant	-	10.00%	-
					(1)
25		TOTALS	$ 11,660,141		$ 443,198
		Less:			
26		Amortizations Of CIAC (RLM-2, Col. (C), Line 5)	$ (5,232,139)	3.9690%	(207,665)
27		TOTAL DEPRECIATION EXPENSE (Line 25 + Line 26)			$ 235,533
28		Test Year Depreciation Expense As Filed (Co. Sch. C-1)			224,818
29		Decrease Of Depreciation Expense (Line 27 - Line 28)			$ 10,715
30		RUCO Adjustment (Line 29) (See RLM-7, Column (B), Line 25)			$ 10,715

References:

Column (A): RLM-4, Column (E)
Column (B): Company Schedule C-2, Page 2
Column (C): Column (A) X Column (B)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 2
PROPERTY TAX COMPUTATION

LINE NO.	DESCRIPTION	REFERENCE	(A)	(B)
	Calculation Of The Company's Full Cash Value:			
	Annual Operating Revenues:			
1	Adjusted Revenues In Year Ended December 2007	Sch. RLM-6, Col (C), Ln 4	$ 1,580,170	
2	Adjusted Revenues In Year Ended December 2007	Sch. RLM-6, Col (C), Ln 4	1,580,170	
3	Proposed Revenues	Sch. RLM-6, Col (E), Ln 4	2,069,773	
4	Total Three Year Operating Revenues	Sum Of Lines 1, 2 & 3	$ 5,230,113	
5	Average Annual Operating Revenues	Line 4 / 3	1,743,371	
6	Two Times Three Year Average Operating Revenues	Line 5 X 2		$ 3,486,742
	ADD:			
	10% Of Construction Work In Progress ("CWIP"):			
7	Test Year CWIP	Co. Sch. E-1	$ 142,018	
8	10% Of CWIP	Line 7 X 10%		$ 14,202
	SUBTRACT:			
	Transportation At Book Value:			
9	Original Cost Of Transportation Equipment	RLM-4, Col. (B), Ln 19	$ 107,367	
10	Acc. Dep. Of Transportation Equipment	RLM-4, Col. (C), Ln 19	(60,947)	
11	Book Value Of Transportation Equipment	Line 9 + Line 10		$ (46,420)
12	Company's Full Cash Value ("FCV")	Sum Of Lines 6, 8 & 11		$ 3,454,524
	Calculation Of The Company's Tax Liability:			
	MULTIPLY:			
	FCV X Valuation Assessment Ratio X Property Tax Rates:			
13	Assessment Ratio	House Bill 2779	21.0%	
14	Assessed Value	Line 12 X Line 13	$ 725,450	
	Property Tax Rates:			
15	Primary Tax Rate - 2005 Tax Notice	RUCO Data Req. 1.12	4.1459%	
16	Secondary Tax Rate - 2005 Tax Notice	RUCO Data Req. 1.12	0.0000%	
17	Estimated Tax Rate Liability	Line 15 + Line 16	4.15%	
18	Company's Total Tax Liability - Based On Full Cash Value	Line 14 X Line 17		$ 30,076
19	Test Year Adjusted Property Tax Expense As Filing	Co. Sch. C-1, Line 25		32,414
20	Decrease In Property Tax Expense	Line 18 - Line 19		$ (2,338)
21	RUCO Adjustment (See RLM-7, Column (C), Line 27)	Line 20		$ (2,338)

Black Mountain Sewer Corporation
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Test Year Ended June 30, 2008

EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 3
PURCHASED WASTEWATER TREATMENT FROM THE CITY OF SCOTTSDALE

LINE NO.	DESCRIPTION	(A) SEWAGE FLOW (Gallon)	(B) COST PER 1,000 GAL.	(C) RAW BILLING	(D) ENVIRO TAX 18.953%	(E) SUBJECT TO SALES TAX	(F) SALES TAX 1.65%	(G) SCOTTSDALE BILLING
	COMPANY CALCULATION							
1	Co.'s Computation Of Test-Year Billings (Co. Sch C-2, Pg 7)	103,757,173		$ 240,741	$ 45,628	$ 286,368	$ 4,725	$ 291,093
2	Company's Computation Under New Rate (Co. Sch C-2, Pg 7)	103,757,173	$ 2.59	$ 268,731	$ 50,933	$ 319,664	$ 5,274	$ 324,938
3	Company's Adjustment Number 6 (Line 2 - Line 1)							$ 33,845
	RUCO CALCULATION							
4	RUCO's Computation Under Actual New Rate Per Co. WP's	103,757,173	$ 2.53	$ 262,506	$ 49,753	$ 312,258	$ 5,152	$ 317,411
5	Actual Increase In Purchased Wastewater Treatment (Line 4 - Line 1)							$ 26,317
6	Difference Between Calculations Using Actual new Rate (Line 5 - Line 3)							$ (7,528)
7	RUCO Adjustment (Line 6) (See RLM-7, Column (D), Line 6)							$ (7,528)

References:
- Column (A): Company Workpapers
- Column (B): Correction To New Rate (Company filed Rate Incorrect As $2.59 / Actual Rate Is $2.53 Per Response To RUCO DR 2.02)
- Column (C): Column (A) X Column (B)
- Column (D): Column (C) X 18.953% Evironment Tax
- Column (E): Column (C) + Column (D)
- Column (F): Column (E) X 1.65% Sales Tax
- Column (G): Column (E) + Column (F)

Black Mountain Sewer Corporation
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EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 4
ANNUALIZATION PURCHASED WASTEWATER TREATMENT

LINE NO.	DESCRIPTION	REFERENCE	(A) AMOUNT
1	Adjusted Year Purchased Wastewater Treatment (Scottsdale)	RLM-10, Column (G), Line 4	$ 317,411
2	Gallons Treated By Scottsdale (In 1000's)	RLM-10, Column (A), Line 1	103,757
3	Cost Per 1,000 gallons (Per Co. Response To Staff DR MEM 5.2)	Line 1 / Line 2	$ 3.06
4	Additional Wasterwater Gallons (In 1,000's) From Rev. Annualization	Company's Workpapers	451
5	Percent Diverted To Scottsdale	Company's Workpapers	70.94%
6	Additonal Gallons Treated By Scottsdale (In 1,000's)	Line 4 X Line 5	320
7	Increase (Decrease) In Purchased Wastewater Treatment	Line 3 X Line 6	$ 979
8	Company's Calculation Of Annualized Purchased WW Treatment	Company Schedule C-2, Page 8	$ 1,002
9	Difference	Line 8 - Line 7	$ (24)
10	RUCO Adjustment (See RLM-7, Column (E), Line 6)	Line 9	$ (24)

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EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 5
DISALLOWANCE OF UNNECESSARY AND/OR NON-RECURRING OPERATING EXPENSES

LINE NO.	DESCRIPTION	REFERENCE	(B) TOTAL
	Disallowed Contractual Services Expenses	Co. Response To Staff D. R. MEM 1.55	
1	Legal & Survey Costs To Clarify BMSC Easement Dispute		$ (4,723)
	Disallowed Contractual Services Expenses - Other	Co. Response To Staff D. R. MEM 1.55	
2	Clean-Up Costs For A Sewer Spill		(39,870)
3	Sparkletts (13 Journal Entries) (Bottled Water)		(908)
	Increased Contractual Services Expenses - Other		
4	Transfer Costs From LPSCO - Aerotek Environmental	Co. Response To Staff D. R. CSB 10.5	42,200
	Increased Contractual Services Expenses - Other		
5	Revised Central Office Fixed Overhead Costs	Co. Responses To D. R. CSB 10.8 & 10.14	2,519
	Disallowed Miscellaneous Expenses	Co. Response To Staff D. R.t MEM 1.46	
6	Charitable Donations Allocated To BMSC		(52)
7	RUCO Adjustment To Unnecessary/Non-Recurring Expenses	Sum Of Lines 1 Thru 17	$ (834)
8	RUCO Adjustment (See RLM-7, Column (F))	Line 18	$ (834)

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EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 8
NORMALIZATION OF CHEMICAL EXPENSES

LINE NO.	DESCRIPTION	REFERENCE	(A) AMOUNT	(B) AMOUNT
	CALCULATION OF TEST-YEAR CHEMICAL EXPENSES			
1	Thoigard Used From July To November 2007	Company Worpapers		$ 8,169
2	Sodium Hydroxide (Ordor Control Chemical)			
3	Gallons Used During Test Year (7 Months)	Company Response To RUCO DR 2.03	6,997	
4	Cost Per Gallons	Company Response To RUCO DR 2.03	$ 1.65	
5	Sub-Total Of Sodium Hydroxide	Line 2 X Line 3	$ 11,545.05	
6	Delivery costs (14 deliveries at $45 per)	Company Response To RUCO DR 2.03	630.00	
7	Sales Tax Of 8.5%	Sum Of Lines 5 & 6 X 8.5%	1,040.70	
8	Total Cost Of Sodium Hydroxide	Sum Of Lines 5, 6 & 7		13,216
9	Total Cost Of Test-Year Chemical Expenses	Sum Of Lines 1 & 8		$ 21,385
	NORMALIZATION OF TEST-YEAR CHEMICAL EXPENSES			
	Sodium Hydroxide			
10	Projected Gallons Used During A Full Test Yeai	Line 3 / 7 Months X 12 Months	11,995	
11	Cost Per Gallons Effective January 2009	Company Response To RUCO DR 2.03	$ 2.05	
12	Sub-Total Of Sodium Hydroxide		$ 24,589.46	
13	Delivery costs (24 deliveries at $32 per)	Company Response To RUCO DR 2.03	768.00	
14	Sales Tax Of 8.5%	Sum Of Lines 12 & 13 X 8.5%	2,155.38	
15	Total Normalization Of Test-Year Chemical Exp	Sum Of Lines 12,13 & 14		$ 27,513
16	Calculated Additional Costs To Chemcial Exp	Line 15 - Line 9		$ 6,128
17	Company Adjustment	Schedule C-2, Adjusmtent 8		$ 2,943
18	Difference	Line 16 - Line 17		$ 3,185
19	RUCO Adjustment (See RLM-7, Column (I))	Line 18		$ 3,185

Black Mountain Sewer Corporation
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EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 9
INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) REFERENCE	(B) AMOUNT
	FEDERAL INCOME TAXES:		
1	Operating Income Before Taxes	Sch. RLM-5, Column (C), L26 + L24	$ (100,114)
	LESS:		
2	Arizona State Tax	Line 11	13,500
3	Interest Expense	Note (A) Line 20	(93,634)
4	Federal Taxable Income	Line 1 - Line 2 - Line 3	$ (180,248)
5	Federal Tax Rate	Sch. RLM-1, Pg 2, Col. (D), L34	32.91%
6	Federal Income Tax Expense	Line 4 X line 5	$ (59,328)
	STATE INCOME TAXES:		
7	Operating Income Before Taxes	Line 1	$ (100,114)
	LESS:		
8	Interest Expense	Note (A) Line 20	(93,634)
9	State Taxable Income	Line 7 - Line 8	$ (193,748)
10	State Tax Rate	Tax Rate	6.97%
11	State Income Tax Expense	Line 9 X Line 10	$ (13,500)
	TOTAL INCOME TAX EXPENSE:		
12	Federal Income Tax Expense	Line 6	$ (59,328)
13	State Income Tax Expense	Line 11	(13,500)
14	Total Income Tax Expense Per RUCO	Line12 + Line 13	$ (72,828)
15	Total Income Tax Expense Per Company (Per Company Sch. C-1)		7,760
16	Total Income Tax Adjustment	Line 14 - Line 15	$ (80,588)
17	RUCO Adjustment (See Sch. RLM-7, Column (I), L28)	Line16	$ (80,588)

NOTE (A):
Interest Synchronization:

18	Adjusted Rate Base (Sch. RLM-2, Col. (E), L15)	$	3,745,364
19	Weighted Cost Of Debt (Sch. RLM-15, Col. (F), L1)		2.50%
20	Interest Expense (L17 X L18)	$	93,634

Black Mountain Sewer Corporation
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COST OF CAPITAL

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D) CAPITAL RATIO	(E) COST	(F) WEIGHTED COST RATE
1	Long-Term Debt				40.00%	6.26%	2.50%
2	Stockholder's Equity				60.00%	8.22%	4.93%
3	TOTAL CAPITAL				100.00%		
4	COST OF CAPITAL						7.43%

References:

Column (A): Intentionally Left Blank
Column (B): Intentionally Left Blank
Column (C): Intentionally Left Blank
Column (D): Hypothetical Capital Structure
Column (E): Testimony, WAR
Column (F): Column (D) X Column (E)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

RATE DESIGN AND PROOF OF RECOMMENDED REVENUE
PROPOSED REVENUE

LINE NO.	CUSTOMER CLASSIFICATION	(A) BILL DETERMINENTS	(B) MONTHLY RATES & CHARGES	(C) REVENUE
	Residential			
1	Customers	1,972	$ 58.88	$ 1,393,338
	Commercial (Standard Rate)			
2	Customers	125	$ -	$ -
3	Commodity Usage (Per Thousand Gallons)	2,069,505	$ 0.23608	488,559
4	Sub-Total			$ 488,559
	Commercial (Special Rate)			
5	Boulders Resort	1	$ 6,927.63	$ 83,131.57
6	Desert Forest	1	$ 1,652.53	$ 19,830.33
7	El Pedegral	1	$ 3,726.92	$ 44,723.06
8	Boulders Club	1	$ 283.29	$ 3,399.48
9	Spanish Village	1	$ 1,176.84	$ 14,122.03
10	Sub-Total			$ 165,206.47
11	Effluent Sales (Per Thousand Gallons)	42,513	$ 0.46051	$ 19,578
12	TOTAL REVENUE PER BILL DETERMINENTS			$ 2,066,682
13	Flat Rate Revenues			$ 2,047,104
14	Miscellaneous Service Revenues			19,578
15	Other Wastewater Revenues			6,916
16	Reconcillation With Book Value			(3,824)
17	TOTAL PROPOSED REVENUE			$ 2,069,773
18	RUCO RECOMMENDED REVENUE REQUIREMENT			$ 2,069,774
19	DIFFERENCE			$ (0)

EXHIBIT
R-4
ADMITTED
PENGAD 800-631-6989

BLACK MOUNTAIN SEWER CORPORATION

DOCKET NO. SW-02361A-08-0609

SURREBUTTAL TESTIMONY

OF

RODNEY L. MOORE

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

NOVEMBER 9, 2009

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INTRODUCTION

Q. Please state your name for the record.

A. My name is Rodney Lane Moore.

Q. Have you previously filed testimony regarding this docket?

A. Yes, I have. I filed direct testimony in this docket on September 18, 2009.

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony will address Company's rebuttal comments pertaining to adjustments I sponsored in my direct testimony.

SUMMARY OF ADJUSTMENTS

Q. After analyzing the Company's rebuttal testimony, did RUCO find positions of agreement?

A. Yes. RUCO is now in substantial agreement with several of the Company's rebuttal adjustments identified by BMSC as:

Rate Base

1. Unrecorded Plant Additions (RUCO Adjustment No. 1);
2. Unrecorded Plant Retirements (RUCO Adjustment No. 1);
3. Capitalized Expenses (RUCO Adjustment No.1); and
4. Odor Control Unit (RUCO Adjustment No.1).

Operating Income

1. Depreciation (RUCO Adjustment No. 1);
2. Expensed Plant (RUCO Surrebuttal Adjustment No. 9);
3. Scottsdale WW Treatment (RUCO Adjustments No. 3 and 4);

4. Annualized WW Treatment (RUCO Adjustments No. 3 and 4);
5. Chemical Expenses (RUCO Adjustment No. 8);
6. Annualize Chemical Expenses (RUCO Surrebuttal Adjustment No. 10);
7. Testing Expense (RUCO Surrebuttal Adjustment No. 11);
8. Rent Expense (RUCO Adjustment No. 6);
9. Meals/Beverages/Contributions (RUCO Adjustment No. 5);
10. Contractual Services (RUCO Adjustment No. 5);
11. Taxes Other Than Income (RUCO Adjustment No. 7);
12. Expense Allocation (RUCO Adjustment No. 5);
13. Contractual Services (RUCO Surrebuttal Adjustment No. 12);

Q. What areas will you address in your surrebuttal testimony?

A. My surrebuttal testimony will address the following RUCO proposed adjustments:

Rate Base

Gross Plant-In-Service and Accumulated Depreciation – This is a revision to my direct testimony adjustment, which reflects updated information provided by the Company's rebuttal testimony. RUCO is now in substantial agreement with the Company.

Advances In Aid Of Construction ("AIAC") – This is a revision to my direct testimony adjustment, which reflects updated information provided by the Company's rebuttal testimony. RUCO is now in substantial agreement with the Company.

Deferred Income Taxes – This is a revision to my direct testimony adjustment, which reflects updated information provided by the

Company's rebuttal testimony. RUCO is now in substantial agreement with the Company.

Working Capital – RUCO has not changed the recommendation of a zero allowance for working capital.

Operating Income

Test Year Depreciation Expense – This is a revision to my direct testimony adjustment, which reflects updated information provided by the Company's rebuttal testimony. RUCO is now in substantial agreement with the Company.

Property Tax Expense - This adjustment reflects property tax expense based on RUCO's calculation of adjusted and proposed operating revenues.

City of Scottsdale Wastewater Treatment Expense – RUCO is now in substantial agreement with the Company. However, the Company has a computation error to be corrected in rejoinder testimony.

Unnecessary and/or Non-Recurring Operating Expenses – This adjustment has several components, although RUCO is now in substantial agreement with the Company in five out of the seven components, RUCO has to recommend additional adjustments in surrebuttal testimony on the two areas of disagreement.

Normalization of Chemical Expenses – RUCO is now in substantial agreement with the Company. However, RUCO has a $6.00 computation error to be corrected in surrebuttal testimony.

Capitalization of Expenses - RUCO is now in substantial agreement with the Company over plant items incorrectly recorded as operating expenses. Thus, RUCO has to recommend an additional adjustment in surrebuttal testimony.

Annualization of Chemical Expenses - RUCO is now in substantial agreement with the Company. Thus, RUCO has to recommend an additional adjustment in surrebuttal testimony.

Bad Debt Expense - RUCO has not altered its position and does not recommend an adjustment for bad debt expense.

Rate Case Expense - RUCO will provide a final recommended level of rate case expense when it files final schedules after the evidentiary hearing on the instant case is concluded.

Income Tax Expense – This adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses.

To support the adjustments in my surrebuttal testimony, I prepared seventeen Surrebuttal Schedules, which are filed concurrently in my surrebuttal testimony.

RATE BASE

Rate Base Adjustment No. 1 – Gross Plant-In-Service and Accumulated Depreciation

Q. Please explain the basis for your adjustment to the gross plant-in-service and the accumulated depreciation.

A. RUCO and the Company are now in substantial agreement with the level of gross plant-in-service and accumulated depreciation as adjusted in my surrebuttal schedules. This adjustment consists of five elements.

First, the Company finally provided the documentation requested during discovery, which verified the actual cost to replace a sewer lift station. RUCO had originally relied on the estimated cost of $276,985; however, BMSC's documentation records the actual cost at $254,251, a reduction of $22,734.

Second, RUCO agrees with Staff and the Company to capitalize plant, which was previously expensed; therefore, $9,181 was removed from operating expenses in operating income adjustment No. 9 (discussed below) and added to plant-in-service through this adjustment.

Third, the Company accepts RUCO adjustment to remove the retired lift station from rate base; therefore, the Company rate base adjustment B decreases BMSC's plant-in-service by $13,208.

Fourth, these three adjustments to plant-in-service result in a reduction in the associated accumulated depreciation.

Fifth, the Company identified, and RUCO accepted, a correction to reflect the actual date of implementation of the authorized depreciation rates from the prior rate case. Originally, parties had inadvertently used the date of December 5, 2005 instead of the actual Decision's docketed date of December 5, 2006, one year later.

In conclusion, as shown Schedule SURR RLM-3, column B, and with supporting Schedule SURR RLM-4, RUCO and the Company recommend an aggregate increase to the rate base of $187,573.

Rate Base Adjustment No. 2 – Advances In Aid Of Construction ("AIAC")

Q. Please explain the basis for your adjustment to AIAC.

A. RUCO and the Company are now in substantial agreement with the level of AIAC. This is a conforming adjustment to correct the level of AIAC associated with the revisions to the plant-in-service to reflect the actual replacement cost of a sewer lift station (versus the estimated value relied on in direct testimony), as outlined in the Company's rebuttal testimony and explained in the first element of rate base adjustment No. 1 above.

Therefore, as shown on Schedule SURR RLM-3, column C, I revised my direct testimony to reflect the correct level of AIAC, $1,711,260, with an adjustment to decrease the rate base by $254,251.

Rate Base Adjustment No. 3 – Deferred Income Taxes ("DITs")

Q. Please explain the basis for your adjustment to DITs.

A. RUCO and the Company are now in substantial agreement with the level of DITs. This is a conforming adjustment to correct the level of DITs associated changes to rate base, as explained in the rate base adjustments Nos. 1 and 2 above, and outlined in the Company's rebuttal testimony.

Therefore, as shown on Schedule SURR RLM-3, column D, I revised my direct testimony to reflect the correct level of DITs with an adjustment to increase the rate base by $24,344.

Rate Base Adjustment No. 4 – Allowance For Working Capital

Q. Please explain the basis for RUCO's position on the allowance for working capital.

A. RUCO accepted the Company's original position on the allowance for working capital, because working capital calculations and lead/lag studies are time-consuming and expensive.

The Company did not include a request for an allowance for working capital to avoid disputes and eliminate rate case expense associated with this issue.

Therefore, as shown on Schedule SURR RLM-3, column D, RUCO, in the instant case, will avoid the time-consuming analysis of a lead/lag study and continue to recommend a zero working capital allowance.

OPERATING INCOME

Operating Income Adjustment No. 1 – Test Year Depreciation Expense

Q. Please explain your adjustment to the test year depreciation expense.

A. RUCO and the Company are now in substantial agreement with the level of test year depreciation expense. This adjustment reflects RUCO's end of test year gross plant-in-service. The adjustment is driven by the revisions to plant additions and retirements as explained previously in my testimony.

As shown on Schedule SURR RLM-7, column B and supporting Schedule SURR RLM-8, this adjustment increases adjusted test-year operating expenses by $19,169.

Operating Income Adjustment No. 2 – Property Tax Computation

Q. Did RUCO and the Company use the same methodology to calculate property tax expenses?

A. Yes. This adjustment varies from the Company's recommendation only to reflect RUCO's proposed annual revenue.

As shown on Schedule SURR RLM-7, column C and supporting Schedule SURR RLM-9, this adjustment decreases adjusted test-year operating expenses by $2,440.

Operating Income Adjustments Nos. 3 & 4 – City of Scottsdale Wastewater Treatment Expense

Q. Please explain your adjustment to the City of Scottsdale Wastewater treatment expense.

A. RUCO and the Company are now in substantial agreement with the level of City of Scottsdale wastewater treatment expense. This adjustment reflects the most recent known and measurable fee structure between the City of Scottsdale and the Company. Documentation provided by the Company in its rebuttal filing indicates the cost to treat wastewater at the City of Scottsdale facility is $2.60 per thousand gallons (excluding environmental fees and sales tax), effective July 2009. This adjustment has also been increased to recognize the annualization component of the expense.

As shown on Schedule SURR RLM-7, column D and supporting Schedules SURR RLM-10 and SURR RLM-11, this adjustment increases adjusted test-year operating expenses by $1,258.

Operating Income Adjustment No. 5 – Unnecessary and/or Non-Recurring Expenses

Q. Please explain the basis for your adjustment to the unnecessary and/or non-recurring expenses

A. RUCO and the Company are now in substantial agreement with five out of seven components of this adjustment. The seven components of this adjustment are listed below.

First, RUCO maintains the legal and survey costs associated with an easement dispute is an unique and non-recurring expense and atypical for consideration as an appropriate historical test year operating expense. Therefore, RUCO disallowed $4,723 of contractual services expense.

Second, RUCO maintains the clean-up costs associated with a sewer spill are not the financial responsibility of the ratepayers. The Company has a duty to provide safe conduct and handling of the sewage from the customer's point of collection. Thus, the cost to clean up improperly discharged sewage is not an appropriate historical test year operating expense.

Therefore, RUCO disallowed $39,870 of contractual services expense.

Third, RUCO and the Company are now in substantial agreement with the removal of $908 for bottled water.

Fourth, RUCO and the Company are now in substantial agreement with the additional expense of $42,200 to correctly account for contractual services previously recorded improperly under an affiliate – Litchfield Park Service Company.

Fifth, RUCO and the Company are now in substantial agreement with the removal of $52 for charitable donations.

Sixth, RUCO and the Company are now in substantial agreement with the removal of $526 for additional meals.

Seventh, RUCO and the Company are now in substantial agreement with the removal of $1,490 for unallowable expenses identified by Staff on Schedule CSB-12, page 2.

In conclusion, as shown on Schedule SURR RLM-7, column E and supporting Schedule SURR RLM-12, this adjustment aggregately decreases adjusted test-year operating expenses by $5,369.

Operating Income Adjustment No. 6 – Normalization of Rent Expense

Q. Please explain your adjustment to the test year rent expense.

A. RUCO and the Company are now in substantial agreement with the appropriate level of rent expense. The Company accepts RUCO's adjustment to reflect a full twelve months of rental costs.

As shown on Schedule SURR RLM-7, column F, this adjustment increases adjusted test-year operating expenses by $18,432.

Operating Income Adjustment No. 7 – Normalization of Taxes Other Than Income

Q. Please explain your adjustment to test year taxes other than income expense.

A. RUCO and the Company are now in substantial agreement with the appropriate level of taxes other than income expense. RUCO accepted the Company's original adjustment to reflect a zero balance in this account.

As shown on Schedule SURR RLM-7, column G, this adjustment increases adjusted test-year operating expenses by $1,780.

Operating Income Adjustment No. 8 – Normalization of Chemical Expenses

Q. Please explain your adjustment to normalization chemical expenses.

A. RUCO and the Company are now in substantial agreement with the appropriate test year level of the chemical expenses. RUCO accepts the Company's adjustment for a known and measurable change to the cost of chemicals. The Company provided documentation to reflect January 2009 chemical costs. Therefore, the test year level of chemical expenses was adjusted for the known and measurable January 2009 chemical costs.

As shown on Schedule SURR RLM-7, column H, and supporting Schedule SURR RLM-13, this adjustment increases adjusted test-year operating expenses by $3,191.

Operating Income Adjustment No. 9 – Capitalized Expenses

Q. Please explain your adjustment to capitalize expenses.

A. RUCO and the Company are now in substantial agreement to capitalize certain expenses. This is a companion adjustment to RUCO's rate base adjustment No. 1 (the second element) discussed above. RUCO accepts the Company and Staff's adjustment to appropriately record plant items in the plant-in-service accounts and remove those plant items from operating expense accounts.

As shown on Schedule SURR RLM-7, column I, and supporting Schedule SURR RLM-4, this adjustment decreases adjusted test-year operating expenses by $9,141.

Operating Income Adjustment No. 10 – Annualization of Chemical Expenses

Q. Please explain your adjustment to annualization chemical expenses.

A. RUCO and the Company are now in substantial agreement with the appropriate level of the chemical expenses on a going forward basis. RUCO accepts the Company's adjustment for a known and measurable change to the cost of chemicals. The Company provided documentation to reflect January 2009 chemical costs. Test year chemical usage was annualized to reflect the calculated increase in the quantity of chemicals required due to changes directly related to the annualization of the number of customers, which creates an incremental increase in wastewater to be treated. Therefore, the annualized level of chemical expenses was adjusted for the known and measurable January 2009 chemical costs.

As shown on Schedule SURR RLM-7, column J, this adjustment increases adjusted test-year operating expenses by $133.

Operating Income Adjustment No. 11 – Testing Expenses

Q. Please explain your adjustment to effluent testing expenses.

A. RUCO and the Company are now in substantial agreement with the appropriate level of the effluent testing expenses on a going forward basis. RUCO accepts the Company's adjustment for a known and measurable change to the cost of testing the effluent to be treated by the City of Scottsdale. The Company provided documentation to reflect July 2009 testing requirements and frequencies now imposed by the City of Scottsdale for effluent received for treatment. Therefore, the level of effluent testing expenses was adjusted for the known and measurable July 2009 testing costs.

As shown on Schedule SURR RLM-7, column K, this adjustment increases adjusted test-year operating expenses by $12,094.

Operating Income Adjustment No. 12 – Contract Services Expense

Q. Please explain your adjustment to contract services expense.

A. RUCO and the Company are now in substantial agreement with the appropriate level of the contract services expense. RUCO accepts the Company's adjustment for a known and measurable change to allocated direct operations costs, accounting/billing costs and overhead costs. The Company provided documentation to reflect the actual test year costs (versus the estimated/budgeted value originally used) allocated and

record as shared services. Therefore, the level of contractual services expense was adjusted for the known and measurable changes.

As shown on Schedule SURR RLM-7, column L, this adjustment decreases adjusted test-year operating expenses by $6,284.

RUCO Operating Income Adjustment No. 13 – Income Taxes

Q. Please explain RUCO's adjustment to the income tax expenses.

A. This adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses. RUCO rejects the Company's proposal to adopt the Commission approved exclusion of the Scottsdale capacity operating lease expense from operating expenses in determination of taxable income as authorized in the prior Decision. RUCO disagrees with the Company and the prior Decision's taxation treatment of the Scottsdale capacity operating lease expense. RUCO recommends that for ratemaking purposes the costs associated with the Scottsdale capacity operating lease be treated as an operating expense and therefore, similar to other allowable expenses requires no further recognition in the determination of the income tax expense.

As shown on Schedule SURR RLM-7, column M, this adjustment decreases adjusted test-year operating expenses by $83,795.

COST OF CAPITAL

Q. Is RUCO proposing any surrebuttal adjustments to the Company proposed cost of capital?

A. No. This adjustment is fully explained in the testimony of RUCO witness William A. Rigsby.

RATE DESIGN AND PROOF OF RECOMMENDED REVENUE

Q. Have you revised your Schedule presenting your recommended rate designs?

A. Yes, as shown on Schedule SURR RLM-16, I am recommending a rate design that is consistent with RUCO's recommended revenue allocations and requirement as revised in my surrebuttal testimony.

Q. Please describe your recommended rate designs for the Company's wastewater operation.

A. RUCO recommends a $58.98 flat rate residential monthly charge, which is a $13.34 or 29 percent increase over the present rate of $45.64.

RUCO also recommends a $0.23649 per gallon per day commodity usage rate for commercial customers, which is a $0.0551 or 29 percent increase over the present rate of $0.18298.

The rate design provides for a 23 percent increase equally across the residential and standard commercial classes of service, which is a decrease of 36 percent over the Company's rebuttal requested 59 percent increase.

Q. Have you prepared a Schedule presenting proof of your recommended revenue?

A. Yes, I have. Proof that my recommended rate designs will produce the recommended required revenue as illustrated, is presented also on Schedule RLM-16.

COMPARISON OF THE IMPACT ON A TYPICAL BILL

Q. Have you presented a comparison of the impact on a typical bill based on RUCO and the Company's recommendations?

A. Yes, as shown on Schedule SURR RLM-17, I compare the present impact on a typical bill with the Company's original filing and the Company's rebuttal position to RUCO's direct filing and RUCO's surrebuttal position.

A residential customer currently pays $45.64 per month. The Company's rebuttal position increases the residential customer's bill to $72.45, a 58.74 percent increase. RUCO's surrebuttal position increases the residential customer's bill to $58.94, a 29.14 percent increase.

Q. Does this conclude your direct testimony?

A. Yes, it does.

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SCH. NO.	PAGE NO.	TITLE
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SURR RLM-4	1	RATE BASE ADJUSTMENT NO. 1 - RUCO ADJUSTMENT TO GROSS PLANT AND ACCUMULATED DEPRECIATION
TESTIMONY		RATE BASE ADJUSTMENT NO. 2 - RUCO ADJUSTMENT TO ADVANCES IN AID OF CONSTRUCTION
RLM-5	1	INTENTIONALLY LEFT BLANK
SURR RLM-6	1	OPERATING INCOME
SURR RLM-7	1	SUMMARY OF OPERATING INCOME ADJUSTMENTS
SURR RLM-8	1	OPERATING INCOME ADJUSTMENT NO. 1 - TEST YEAR DEPRECIATION EXPENSE
SURR RLM-9	1	OPERATING INCOME ADJUSTMENT NO. 2 - PROPERTY TAX COMPUTATION
SURR RLM-10	1	OPERATING INCOME ADJUSTMENT NO. 3 - SCOTTSDALE WASTEWATER TREATMEN EXPENSET
SURR RLM-11	1	OPERATING INCOME ADJUSTMENT NO. 4 - ANNUALIZED WASTEWATER TREATMENT EXPENSE
SURR RLM-12	1	OPERATING INCOME ADJUSTMENT NO. 5 - UNNECESSARY AND/OR NON-RECURRING EXPENSES
TESTIMONY		OPERATING INCOME ADJUSTMENT NO. 6 - NORMALIZATION OF RENT EXPENSE
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SURR RLM-13	1	OPERATING INCOME ADJUSTMENT NO. 8 - NORMALIZATION OF CHEMICAL EXPENSE
SURR RLM-14	1	OPERATING INCOME ADJUSTMENT NO. 9 - INCOME TAX EXPENSE
SURR RLM-15	1	COST OF CAPITAL
SURR RLM-16	1	RATE DESIGN AND PROOF OF RECOMMENDED REVENUE
SURR RLM-17	1	COMPARISON OF THE IMPACT ON A TYPICAL BILL

Black Mountain Sewer Corporation
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SURREBUTTAL
REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY OCRB/FVRB COST	(B) RUCO OCRB/FVRB COST
1	Fair Value Rate Base	$ 3,723,245	$ 3,680,911
2	Adjusted Operating Income (Loss)	$ (84,485)	$ (34,000)
3	Current Rate Of Return (L2 / L1)	-2.27%	-0.92%
4	Required Operating Income (L5 X L1)	$ 476,575	$ 273,492
5	Required Rate Of Return On Fair Value Rate Base	12.80%	7.43%
6	Operating Income Deficiency (L4 - L2)	$ 561,060	$ 307,492
7	Gross Revenue Conversion Factor (RLM-1, Pg 2)	1.6286	1.5995
8	Increase In Gross Revenue Requirement (L7 X L6)	$ 913,763	$ 491,827
9	Adjusted Test Year Revenue	$ 1,580,170	$ 1,580,170
10	Proposed Annual Revenue (L8 + L9)	$ 2,493,933	$ 2,071,997
11	Required Percentage Increase In Revenue (L8 / L9)	57.83%	31.12%
12	Rate Of Return On Common Equity	12.80%	8.22%

References:
Column (A): Company Schedules A-1 and C-1
Column (B): RUCO Schedule SURR RLM-2, SURR RLM-6, And SURR RLM-15

Black Mountain Sewer Corporation
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SURREBUTTAL
REVENUE REQUIREMENT - CONT'D
GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
	CALCULATION OF GROSS REVENUE CONVERSION FACTOR:				
1	Revenue	1.0000			
2	Combined Federal And State Tax Rate (L10)	(0.3748)			
3	Subtotal (L1 + L2)	0.6252			
4	**Revenue Conversion Factor**(L1 / L3)	**1.5995**			
	CALCULATION OF EFFECTIVE TAX RATE:				
5	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
6	Arizona State Income Tax Rate	6.9680%			
7	Federal Taxable Income (L5 - L6)	93.0320%			
8	Applicable Federal Income Tax Rate (Col. (D), L34)	32.7970%			
9	Effective Federal Income Tax Rate (L7 X L8)	30.5117%			
10	Combined Federal And State Income Tax Rate (L6 + L9)	37.4797%			
11	Required Operating Income (SURR RLM-1, Col. (B), L4)	$ 273,492			
12	Adj'd T.Y. Oper'g Inc. (Loss) (SURR RLM-1, Col. (B), L2)	(34,000)			
13	Required Increase In Operating Income (L11 - L12)		$ 307,492		
14	Income Taxes On Recommended Revenue (Col. (D), L31)	$ 108,787			
15	Income Taxes On Test Year Revenue (Col. (D), L32)	(75,548)			
16	Required Increase In Revenue To Provide For Income Taxes (L14 - L15)		$ 184,335		
17	Total Required Increase In Revenue (L13 + L16)		$ 491,827		
	CALCULATION OF INCOME TAX			RUCO Recommended	
18	Revenue (Sch. SURR RLM-1, Col. (B), L10)			$ 2,071,997	
19	Operating Expense Excluding Income Tax (SURR RLM-6, Col. (E), L25 - L24)			(1,689,719)	
20	Synchronized Interest (Col. (C), L37)			(92,023)	
21	Arizona Taxable Income (L18 + L19 + L20)			$ 290,256	
22	Arizona State Income Tax Rate			6.9680%	
23	Arizona Income Tax (L21 X L22)				$ 20,225
24	Fed. Taxable Income (L21 - L23)			$ 270,031	
25	Fed. Tax On 1st Inc. Bracket ($1 - $50,000) @ 15%			$ 7,500	
26	Fed. Tax On 2nd Inc. Bracket ($50,001 - $75,000) @ 25%			6,250	
27	Fed. Tax On 3rd Inc. Bracket ($75,001 - $100,000) @ 34%			8,500	
28	Fed. Tax On 4th Inc. Bracket ($100,001 - $335,000) @ 39%			66,312	
29	Fed. Tax On 5th Inc. Bracket ($335,001 - $10M) @ 34%			-	
30	Total Federal Income Tax (L25 + L26 + L27 + L28 + L29)				$ 88,562
31	Combined Federal And State Income Tax (L23 + L30)				$ 108,787
32	Test Year Combined Income Tax, RUCO As Adjusted (SURR RLM-6, Col. (C), L24)				$ (75,548)
33	RUCO Adjustment (L31 - L32) (See SURR RLM-6, Col. (D), L24)				$ 184,335
34	Applicable Federal Income Tax Rate (Col. (D), L30 / Col. (C), L24)				32.80%
	CALCULATION OF INTEREST SYNCHRONIZATION:				
35	Rate Base (SURR RLM-2, Col. (H), L15)			$ 3,680,911	
36	Weighted Avg. Cost Of Debt (SURR RLM-15, Col. (F), L1)			2.50%	
37	Synchronized Interest (L35 X L36)			$ 92,023	

Black Mountain Sewer Corporation
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SURREBUTTAL
SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED OCRB/FVRB	(B) RUCO ADJUSTMENTS	(C) RUCO AS ADJUSTED OCRB/FVRB
1	Gross Utility Plant In Service	$ 11,357,735	$ 288,809	$ 11,646,544
2	Accumulated Depreciation	(5,625,025)	(101,236)	(5,726,261)
3	Net Utility Plant In Service (L1 + L2)	$ 5,732,710	$ 187,573	$ 5,920,283
4	Advances In Aid Of Const.	$ (1,457,009)	$ (254,251)	$ (1,711,260)
5	Contribution In Aid Of Const.	$ (5,232,139)	$ -	$ (5,232,139)
6	Accumulated Amortization Of CIAC	4,214,384	-	4,214,384
7	NET CIAC (L5 + L6)	$ (1,017,755)	$ -	$ (1,017,755)
8	Customer Meter Deposits	$ (94,290)	$ -	$ (94,290)
9	Deferred Income Taxes & Credits	$ 170,554	$ 24,344	$ 194,898
10	Unamortized Finance Charges	$ -	$ -	$ -
11	Deferred Regulatory Assets	$ 389,035	$ -	$ 389,035
12	Allowance For Working Capital	$ -	$ -	$ -
13	TOTAL RATE BASE (Sum L's 3, 4, 7, 8 Thru 12)	$ 3,723,245	$ (42,334)	$ 3,680,911

References:
Column (A): Company Schedule B-2, Page 1 And Workpapers Schedule E-1
Column (B): SURR RLM-3, Columns (B) Thru (G)
Column (C): Column (A) + Column (B)

Black Mountain Sewer Corporation
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SURREBUTTAL
SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED OCRB/FVRB	(B) ADJ # 1 GROSS PLT & ACC DEP	(C) ADJ # 2 AIAC	(D) ADJ # 3 DEFERRED INC TAXES	(E) ADJ # 4 WORKING CAPITAL	(F) INTENT'NLY LEFT BLANK	(G) INTENT'NLY LEFT BLANK	(H) RUCO ADJ'TED OCRB/FVRB
1	Gross Utility Plant In Service	$ 11,357,735	$ 288,809	$ -	$ -	$ -	$ -	$ -	$ 11,646,544
2	Accumulated Depreciation	(5,625,025)	(101,236)	-	-	-	-	-	(5,726,261)
3	Net Utility Plant In Service (L1 + L2)	$ 5,732,710	$ 187,573	$ -	$ -	$ -	$ -	$ -	$ 5,920,283
4	Advances In Aid Of Const.	$ (1,457,009)	$ -	$ (254,251)	$ -	$ -	$ -	$ -	$ (1,711,260)
5	Contribution In Aid Of Const.	$ (5,232,139)	$ -	$ -	$ -	$ -	$ -	$ -	$ (5,232,139)
6	Accumulated Amortization Of CIAC	4,214,384	-	-	-	-	-	-	4,214,384
7	NET CIAC (L5 + L6)	$ (1,017,755)	$ -	$ -	$ -	$ -	$ -	$ -	$ (1,017,755)
8	Customer Meter Deposits	$ (94,290)	$ -	$ -	$ -	$ -	$ -	$ -	$ (94,290)
9	Deferred Income Taxes & Credits	$ 170,554	$ -	$ -	$ 24,344	$ -	$ -	$ -	$ 194,898
10	Unamortized Finance Charges	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
11	Deferred Regulatory Assets	$ 389,035	$ -	$ -	$ -	$ -	$ -	$ -	$ 389,035
12	Allowance For Working Capital	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
13	TOTAL RATE BASE (Sum L's 3, 4, 7, 8 Thru 12	$ 3,723,245	$ 187,573	$ (254,251)	$ 24,344	$ -	$ -	$ -	$ 3,680,911

References:

Column (A): Company Schedule B-2, Page 1 And Workpapers Schedule E-1
Column (B): Adjustment No. 1 - RUCO Adjustment To GPIS And Acc. Dep. (See Testimony and Schedule SURR RLM-4)
Column (C): Adjustment No. 2 - RUCO Adjustment To AIAC (See Testimony)
Column (D): Adjustment No. 3 - RUCO Adjustment To DITs (See Testimony)
Column (E): Adjustment No. 4 - RUCO Adjustment To The Allowance For Working Capital (See Testimony)
Column (F): Intentionally Left Blank
Column (G): Intentionally Left Blank
Column (H): Sum Of Columns (A), (B), (C), (D), (E) & (F)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SURREBUTTAL
TEST YEAR PLANT SCHEDULE
YEAR ENDED JUNE 30, 2008

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) COMPANY T/Y PLANT AS FILED	(B) RUCO TEST-YEAR ADJUSTMENTS PLANT ADDITIONS	(C) PLANT RETIRMENTS	(D) DEPRECIATION EXPENSE	(E) TOTAL PLANT VALUE	(F) ACCUMULATED DEPRECIATION	(G) NET PLANT VALUE
1	351	Organization	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	352	Franchises	-	-	-	-	-	-	-
3	353	Land and Land Rights	461,300	-	-	-	461,300	-	461,300
4	354	Structures And Improvements	2,557,920	2,300	-	(38)	2,560,220	(1,089,289)	1,470,931
5	355	Power Generation Equipment	-	-	-	-	-	-	-
6	360	Collection Sewers - Force	706,291	1,600	-	(16)	707,891	(237,055)	470,836
7	361	Collection Sewers - Gravity	4,284,949	-	-	-	4,284,949	(2,986,891)	1,298,058
8	362	Special Collecting Structures	-	-	-	-	-	-	-
9	363	Services To Customers	198,723	-	-	-	198,723	(151,259)	47,464
10	364	Flow Measuring Devices	31,512	-	-	-	31,512	(31,231)	281
11	365	Flow Measuring Installations	179,622	-	-	-	179,622	(48,777)	130,845
12	370	Receiving Wells	690,628	255,451	(13,208)	(4,033)	932,871	(285,506)	647,365
13	371	Effluent Pumping Equipment	654,845	2,803	-	(175)	657,648	(401,791)	255,857
14	380	Treatment And Disposal Equip	143,578	38,625	-	(966)	182,203	(16,004)	166,199
15	381	Plant Sewers	123,289	1,238	-	(31)	124,527	(105,624)	18,903
16	382	Outfall Sewer Lines	-	-	-	-	-	-	-
17	389	Other Plant And Misc Equip	939,433	-	-	-	939,433	(249,600)	689,833
18	390	Office Furniture And Equipment	224,588	-	-	-	224,588	(71,997)	152,591
19	391	Transportation Equipment	107,367	-	-	-	107,367	(47,775)	59,592
20	393	Tools, Shop And Garage Equip	5,755	-	-	-	5,755	(203)	5,552
21	394	Laboratory Equipment	7,488	-	-	-	7,488	(2,250)	5,238
22	395	Power Operated Equipment	-	-	-	-	-	-	-
23	396	Communication Equipment	40,451	-	-	-	40,451	(1,011)	39,440
24	398	Other Tangible Plant	-	-	-	-	-	-	-
			(4)				(4)	2	
25		TOTAL WASTEWATER PLANT	$ 11,357,735	$ 302,017	$ (13,208)	$ (5,259)	$ 11,646,544	$ (5,726,261)	$ 5,920,285
26		Company As Filed	New Lift Station	$ 254,251			$ 11,357,735	$ (5,625,025)	
27		Difference	Odor Control	38,625			$ 288,809	$ (101,236)	
			Capitalized Plant	9,141					
28		RUCO Adjustment (Line 27) (See SURR RLM-3, Column (B))		$ 302,017			$ 288,809	$ (101,236)	$ 187,573

References:

Column (A): RUCO Workpapers "WP RLM-4(5)"
Columns (B) (C): Testimony, RLM
Column (D): [(Col. (A) + Col. (B) + Col. (C)) X WP RLM-4, Page 1, Col. (A) X 1/2 yr. conv.]
Column (E): Column (A) + Column (B) + Column (C)
Column (F): WP RLM-4, Page 5, Col. (E) + (Col. (C) + Col. (D) - $11,148.46 (See Testimony, Pg 9)
Column (G): (Column (E) + Column (F)

SURREBUTTAL
RUCO MADE NO POST TEST-YEAR PLANT ADJUSTMENTS

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SURREBUTTAL
OPERATING INCOME

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) RUCO TEST YEAR ADJM'TS	(C) RUCO TEST YEAR AS ADJ'TED	(D) RUCO PROP'D CHANGES	(E) RUCO AS RECOMM'D
	Revenues:					
1	Flat Rate Revenues	$ 1,557,337	$ -	$ 1,557,337	$ 488,166	$ 2,045,503
2	Misc. Service Revenues	15,917	-	15,917	3,661	19,578
3	Other WW Revenues	6,916	-	6,916	-	6,916
4	TOTAL OPERATING REVENUE	$ 1,580,170	$ -	$ 1,580,170	$ 491,827	$ 2,071,997
	Operating Expenses:					
5	Salaries And Wages	$ -	-	$ -	$ -	$ -
6	Purchased WW Treatment	335,255	1,258	336,513	-	336,513
7	Sludge Removal Expense	706	-	706	-	706
8	Purchased Power	54,690	-	54,690	-	54,690
9	Fuel For Power Production	928	-	928	-	928
10	Chemicals	37,489	3,324	40,813	-	40,813
11	Materials And Supplies	11,224	(526)	10,698	-	10,698
12	Contractual Services	9,362	(6,223)	3,139	-	3,139
13	Contractual Services - Testing	16,955	12,094	29,049	-	29,049
14	Contractual Services - Other	553,043	(13,992)	539,050	-	539,050
15	Equipment Rentals	1,863	-	1,863	-	1,863
16	Rents	19,830	18,432	38,262	-	38,262
17	Transportation Expenses	34,445	-	34,445	-	34,445
18	Insurance - General Liability	18,704	-	18,704	-	18,704
19	Insurance - Other	990	-	990	-	990
20	Regulatory Comm. Expense	60,000	-	60,000	-	60,000
21	Miscellaneous Expense	20,845	(52)	20,793	-	20,793
22	Bad Debt Expense	11,962	-	11,962	-	11,962
23	Scottsdale Cap. (Oper'g Lease)	164,522	-	164,522	-	164,522
24	Amort. Scottsdale Cap.	48,629	-	48,629	-	48,629
25	Depreciation Expense	224,818	19,169	243,987	-	243,987
26	Taxes Other Than Income	(1,780)	1,780	-	-	-
27	Property Taxes	32,414	(2,440)	29,975	-	29,975
28	Income Tax	7,760	(83,308)	(75,548)	184,335	108,787
29	TOTAL OPERATING EXPENSES	$ 1,664,655	$ (50,484)	$ 1,614,170	$ 184,335	$ 1,798,506
30	OPERATING INCOME (LOSS)	$ (84,485)		$ (34,000)		$ 273,492

References:
- Column (A): Company Schedule C-1
- Column (B): SURR RLM-7, Columns (B) Thru (K)
- Column (C): Column (A) + Column (B)
- Column (D): Revenue From SURR RLM-1, Column (B), Line 8 And Income Tax From SURR RLM-1, Column (B), Line 8 - Line 6
- Column (E): Column (C) + Column (D)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SURREBUTTAL
SUMMARY OF OPERATING INCOME ADJUSTMENTS
TEST YEAR AS FILED AND ADJUSTMENTS

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED	(B) ADJ # 1 DEP. EXPENSE	(C) ADJ # 2 PROPERTY TAX	(D) ADJ # 3 & 4 SC'SDALE TREATM'T	(E) ADJ # 5 UNNES'RY EXPENSES	(F) ADJ # 6 NORM'LIZE RENT	(G) ADJ # 7 NORM'LIZE OTH'R TAX	(H) ADJ # 8 NORM'LIZE CHEMICAL	(I) ADJ # 9 CAPITAL'D PLANT	(J) ADJ # 10 ANN'LIZE CHEMICAL	(K) ADJ # 11 TESTING EXPENSES	(L) ADJ # 12 CONTRACT SERVICES	(M) ADJ # 13 INCOME TAX	(N) RUCO AS ADJT'D
	Revenues:														
1	Flat Rate Revenues	$ 1,557,337	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,557,337
2	Misc. Service Revenues	15,917	-	-	-	-	-	-	-	-	-	-	-	-	15,917
3	Other WW Revenues	6,916	-	-	-	-	-	-	-	-	-	-	-	-	6,916
4	TOTAL OPR'G REV.	$ 1,580,170	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,580,170
	Operating Expenses:														
5	Salaries And Wages	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	Purchased WW Treatment	335,255	-	-	1,258	-	-	-	-	-	-	-	-	-	336,513
7	Sludge Removal Expense	706	-	-	-	-	-	-	-	-	-	-	-	-	706
8	Purchased Power	54,690	-	-	-	-	-	-	-	-	-	-	-	-	54,690
9	Fuel For Power Production	928	-	-	-	-	-	-	-	-	-	-	-	-	928
10	Chemicals	37,489	-	-	-	-	-	-	3,191	-	133	-	-	-	40,813
11	Materials And Supplies	11,224	-	-	-	(526)	-	-	-	-	-	-	-	-	10,698
12	Contractual Services	9,362	-	-	-	(4,723)	-	-	-	(1,500)	-	-	-	-	3,139
13	Contractual Services - Testing	16,955	-	-	-	-	-	-	-	-	-	12,094	-	-	29,049
14	Contractual Services - Other	553,043	-	-	-	(67)	-	-	-	(7,641)	-	-	(6,284)	-	539,050
15	Equipment Rentals	1,863	-	-	-	-	-	-	-	-	-	-	-	-	1,863
16	Rents	19,830	-	-	-	-	18,432	-	-	-	-	-	-	-	38,262
17	Transportation Expenses	34,445	-	-	-	-	-	-	-	-	-	-	-	-	34,445
18	Insurance - General Liability	18,704	-	-	-	-	-	-	-	-	-	-	-	-	18,704
19	Insurance - Other	990	-	-	-	-	-	-	-	-	-	-	-	-	990
20	Regulatory Comm. Expense	60,000	-	-	-	-	-	-	-	-	-	-	-	-	60,000
21	Miscellaneous Expense	20,845	-	-	-	(52)	-	-	-	-	-	-	-	-	20,793
22	Bad Debt Expense	11,962	-	-	-	-	-	-	-	-	-	-	-	-	11,962
23	Scottsdale Cap. (Oper'g Lease)	164,522	-	-	-	-	-	-	-	-	-	-	-	-	164,522
24	Amort. Scottsdale Cap.	48,629	-	-	-	-	-	-	-	-	-	-	-	-	48,629
25	Depreciation Expense	224,818	19,169	-	-	-	-	-	-	-	-	-	-	-	243,987
26	Taxes Other Than Income	(1,780)	-	-	-	-	-	1,780	-	-	-	-	-	-	-
27	Property Taxes	32,414	-	(2,440)	-	-	-	-	-	-	-	-	-	-	29,975
28	Income Tax	7,760	-	-	-	-	-	-	-	-	-	-	-	(83,308)	(75,548)
29	TOTAL OPR'G EXP.	$ 1,664,655	$ 19,169	$ (2,440)	$ 1,258	$ (5,369)	$ 18,432	$ 1,780	$ 3,191	$ (9,141)	$ 133	$ 12,094	$ (6,284)	$ (83,308)	$ 1,614,170
30	OPR'G INC. (LOSS)	$ (84,485)													$ (34,000)

References:
- Column (A): Company Schedule C-1
- Column (B): SURR Testimony, RLM And Schedule SURR RLM-8
- Column (C): SURR Testimony, RLM And Schedule SURR RLM-9
- Column (D): SURR Testimony, RLM And Schedules SURR RLM-10 & SURR RLM-11
- Column (E): SURR Testimony, RLM And Schedule SURR RLM-12
- Column (F): SURR Testimony, RLM
- Column (G): SURR Testimony, RLM
- Column (H): SURR Testimony, RLM
- Column (I): SURR Testimony, RLM And Schedule SURR RLM-13
- Column (J): Intentionally Left Blank
- Column (K: SURR Testimony, RLM And Schedule SURR RLM-14
- Column (L): Sum Of Columns (A) Thru (K)

Black Mountain Sewer Corporation
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Test Year Ended June 30, 2008

SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 1
TEST YEAR DEPRECIATION EXPENSE

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) TOTAL PLANT VALUE	(B) APR'D DEP. RATE	(C) TEST YEAR DEPREC'N EXPENSE
1	351	Organization	$ -	0.00%	$ -
2	352	Franchises	-	0.00%	-
3	353	Land and Land Rights	461,300	0.00%	-
4	354	Structures And Improvements	2,560,220	3.33%	85,255
5	355	Power Generation Equipment	-	5.00%	-
6	360	Collection Sewers - Force	707,891	2.00%	14,158
7	361	Collection Sewers - Gravity	4,284,949	2.00%	85,699
8	362	Special Collecting Structures	-	2.00%	-
9	363	Services To Customers	198,723	2.00%	3,974
10	364	Flow Measuring Devices	31,512	10.00%	3,151
11	365	Flow Measuring Installations	179,622	10.00%	17,962
12	370	Receiving Wells	932,871	3.33%	31,065
13	371	Effluent Pumping Equipment	657,648	12.50%	82,206
14	380	Treatment And Disposal Equip	182,203	5.00%	9,110
15	381	Plant Sewers	124,527	5.00%	6,226
16	382	Outfall Sewer Lines	-	3.33%	-
17	389	Other Plant And Misc Equip	939,433	6.67%	62,660
18	390	Office Furniture And Equipment	224,588	6.67%	14,980
19	391	Transportation Equipment	107,367	20.00%	21,473
20	393	Tools, Shop And Garage Equip	5,755	5.00%	288
21	394	Laboratory Equipment	7,488	10.00%	749
22	395	Power Operated Equipment	-	5.00%	-
23	396	Communication Equipment	40,451	10.00%	4,045
24	398	Other Tangible Plant	-	10.00%	-
					(1)
25		TOTALS	$ 11,646,548		$ 443,001
		Less:			
26		Amortize Of CIAC (SURR RLM-2, Col. (C), Ln 5)	$ (5,232,139)	3.8037%	(199,015)
27		TOTAL DEPRECIATION EXPENSE (Line 25 + Line 26)			$ 243,986
28		Test Year Depreciation Expense As Filed (Co. Sch. C-1)			224,818
29		Decrease Of Depreciation Expense (Line 27 - Line 28)			$ 19,169
30		RUCO Adjustment (Line 29) (See SURR RLM-7, Column (B), Line 25)			$ 19,169

References:
Column (A): SURR RLM-4, Column (E)
Column (B): Company Schedule C-2, Page 2
Column (C): Column (A) X Column (B)

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SURREBUTTAL

EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 2

PROPERTY TAX COMPUTATION

LINE NO.	DESCRIPTION	REFERENCE	(A)	(B)
	Calculation Of The Company's Full Cash Value:			
	Annual Operating Revenues:			
1	Adjusted Revenues In Year Ended December 2007	SURR RLM-6, Col (C), Ln 4	$ 1,580,170	
2	Adjusted Revenues In Year Ended December 2007	SURR RLM-6, Col (C), Ln 4	1,580,170	
3	Proposed Revenues	SUR RLM-6, Col (E), Ln 4	2,071,997	
4	Total Three Year Operating Revenues	Sum Of Lines 1, 2 & 3	$ 5,232,337	
5	Average Annual Operating Revenues	Line 4 / 3	1,744,112	
6	Two Times Three Year Average Operating Revenues	Line 5 X 2		$ 3,488,225
	ADD:			
	10% Of Construction Work In Progress ("CWIP"):			
7	Test Year CWIP	Co. Sch. E-1	$ 142,018	
8	10% Of CWIP	Line 7 X 10%		$ 14,202
	SUBTRACT:			
	Transportation At Book Value:			
9	Original Cost Of Transportation Equipment	SURR RLM-4, Col. (B), Ln 19	$ 107,367	
10	Acc. Dep. Of Transportation Equipment	SURR RLM-4, Col. (C), Ln 19	(47,775)	
11	Book Value Of Transportation Equipment	Line 9 + Line 10		$ (59,592)
12	Company's Full Cash Value ("FCV")	Sum Of Lines 6, 8 & 11		$ 3,442,835
	Calculation Of The Company's Tax Liability:			
	MULTIPLY:			
	FCV X Valuation Assessment Ratio X Property Tax Rates:			
13	Assessment Ratio	House Bill 2779	21.0%	
14	Assessed Value	Line 12 X Line 13	$ 722,995	
	Property Tax Rates:			
15	Primary Tax Rate - 2005 Tax Notice	RUCO Data Req. 1.12	4.1459%	
16	Secondary Tax Rate - 2005 Tax Notice	RUCO Data Req. 1.12	0.0000%	
17	Estimated Tax Rate Liability	Line 15 + Line 16	4.15%	
18	Company's Total Tax Liability - Based On Full Cash Value	Line 14 X Line 17		$ 29,974
19	Test Year Adjusted Property Tax Expense As Filing	Co. Sch. C-1, Line 25		32,414
20	Decrease In Property Tax Expense	Line 18 - Line 19		$ (2,440)
21	RUCO Adjustment (See SURR RLM-7, Column (C), Line 27)	Line 20		$ (2,440)

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SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 3
PURCHASED WASTEWATER TREATMENT FROM THE CITY OF SCOTTSDALE

LINE NO.	DESCRIPTION	(A) SEWAGE FLOW (Gallon)	(B) COST PER 1,000 GAL.	(C) RAW BILLING	(D) ENVIRO TAX 18.953%	(E) SUBJECT TO SALES TAX	(F) SALES TAX 1.65%	(G) SCOTTSDALE BILLING
	COMPANY CALCULATION							
1	Co.'s Computation Of Test-Year Billings (Co. Sch C-2, Pg 7)	103,757,173		$ 240,741	$ 45,628	$ 286,368	$ 4,725	$ 291,093
2	Company's Computation Under New Rate (Co. Sch C-2, Pg 7)	103,757,173	$ 2.59	$ 268,731	$ 50,933	$ 319,664	$ 5,274	$ 324,938
3	Company's Adjustment Number 6 (Line 2 - Line 1)							$ 33,845
	RUCO CALCULATION							
4	RUCO's Computation Under Actual New Rate Per Co. WP's	103,757,173	$ 2.60	$ 269,769	$ 51,129	$ 320,898	$ 5,295	$ 326,193
5	Actual Increase In Purchased Wastewater Treatment (Line 4 - Line 1)							$ 35,099
6	*Difference Between Calculations Using Actual new Rate* (Line 5 - Line 3)							$ 1,255
7	RUCO Adjustment (Line 6) (See SURR RLM-7, Column (D), Line 6)							$ 1,255

References:
- Column (A): Company Workpapers
- Column (B): Correction To New Rate (Company filed Rate Incorrect As $2.59 / Actual Rate Is $2.60 Per Company's Rebuttal Response)
- Column (C): Column (A) X Column (B)
- Column (D): Column (C) X 18.953% Evironment Tax
- Column (E): Column (C) + Column (D)
- Column (F): Column (E) X 1.65% Sales Tax
- Column (G): Column (E) + Column (F)

Black Mountain Sewer Corporation
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SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 4
ANNUALIZATION PURCHASED WASTEWATER TREATMENT

LINE NO.	DESCRIPTION	REFERENCE	(A) AMOUNT
1	Adjusted Year Purchased Wastewater Treatment (Scottsdale)	SURR RLM-10, Column (G), Line 4	$ 326,193
2	Gallons Treated By Scottsdale (In 1000's)	SURR RLM-10, Column (A), Line 1	103,757
3	Cost Per 1,000 gallons (Per Co. Response To Staff DR MEM 5.2)	Line 1 / Line 2	$ 3.14
4	Additional Wasterwater Gallons (In 1,000's) From Rev. Annualization	Company's Workpapers	451
5	Percent Diverted To Scottsdale	Company's Workpapers	70.94%
6	Additonal Gallons Treated By Scottsdale (In 1,000's)	Line 4 X Line 5	320
7	Increase (Decrease) In Purchased Wastewater Treatment	Line 3 X Line 6	$ 1,006
8	Company's Calculation Of Annualized Purchased WW Treatment	Company Schedule C-2, Page 8	$ 1,002
9	Difference	Line 8 - Line 7	$ 3
10	RUCO Adjustment (See SURR RLM-7, Column (E), Line 6)	Line 9	$ 3

Black Mountain Sewer Corporation
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SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 5
DISALLOWANCE OF UNNECESSARY AND/OR NON-RECURRING OPERATING EXPENSES

LINE NO.	DESCRIPTION	REFERENCE	(B) TOTAL
	Disallowed Contractual Services Expenses		
1	Legal & Survey Costs To Clarify BMSC Easement Dispute	Co. Response To Staff D. R. MEM 1.55	$ (4,723)
	Disallowed Contractual Services Expenses - Other		
2	Clean-Up Costs For A Sewer Spill	Co. Response To Staff D. R. MEM 1.55	(39,870)
3	Sparkletts (13 Journal Entries) (Bottled Water)	Bourassa Rebuttal Schedule C-2, Page 13	(908)
	Increased Contractual Services Expenses - Other		
4	Transfer Costs From LPSCO - Aerotek Environmental	Bourassa Rebuttal Schedule C-2, Page 14	42,200
	Disallowed Miscellaneous Expenses		
5	Charitable Donations Allocated To BMSC	Bourassa Rebuttal Schedule C-2, Page 13	(52)
	SURREBUTTAL ADJUSTMENTS		
6	Company's Rebuttal Testimony To Remove Additional Meal Costs	Bourassa Rebuttal Schedule C-2, Page 13	(526)
7	Company's Rebuttal Testimony To Remove Additional Central Office Costs	Bourassa Rebuttal Schedule C-2, Page 16	$ (1,490)
8	RUCO Adjustment To Unnecessary/Non-Recurring Expenses	Sum Of Lines 1 Thru 17	$ (5,369)
9	RUCO Adjustment (See SURR RLM-7, Column (F))	Line 18	$ (5,369)

Black Mountain Sewer Corporation
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SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 8
NORMALIZATION OF CHEMICAL EXPENSES

LINE NO.	DESCRIPTION	REFERENCE	(A) AMOUNT	(B) AMOUNT
	CALCULATION OF TEST-YEAR CHEMICAL EXPENSES			
1	Thoigard Used From July To November 2007	Company Worpapers		$ 8,169
2	*Sodium Hydroxide (Ordor Control Chemical)*			
3	Gallons Used During Test Year (7 Months)	Company Response To RUCO DR 2.03	6,997	
4	Cost Per Gallons	Company Response To RUCO DR 2.03	$ 1.65	
5	Sub-Total Of Sodium Hydroxide	Line 2 X Line 3	$ 11,545.05	
6	Delivery costs (14 deliveries at $45 per)	Company Response To RUCO DR 2.03	630.00	
7	Sales Tax Of 8.5%	Sum Of Lines 5 & 6 X 8.5%	1,034.88	
8	Total Cost Of Sodium Hydroxide	Sum Of Lines 5, 6 & 7		13,210
9	Total Cost Of Test-Year Chemical Expenses	Sum Of Lines 1 & 8		$ 21,379
	NORMALIZATION OF TEST-YEAR CHEMICAL EXPENSES			
	Sodium Hydroxide			
10	Projected Gallons Used During A Full Test Yeai	Line 3 / 7 Months X 12 Months	11,995	
11	Cost Per Gallons Effective January 2009	Company Response To RUCO DR 2.03	$ 2.05	
12	Sub-Total Of Sodium Hydroxide		$ 24,589.46	
13	Delivery costs (24 deliveries at $32 per)	Company Response To RUCO DR 2.03	768.00	
14	Sales Tax Of 8.5%	Sum Of Lines 12 & 13 X 8.5%	2,155.38	
15	Total Normalization Of Test-Year Chemical Exp	Sum Of Lines 12,13 & 14		$ 27,513
16	Calculated Additional Costs To Chemcial Exp	Line 15 - Line 9		$ 6,134
17	Company Adjustment	Schedule C-2, Adjusmtent 8		$ 2,943
18	Difference	Line 16 - Line 17		$ 3,191
19	RUCO Adjustment (See SURR RLM-7, Column (	Line 18		$ 3,191

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SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 9
INCOME TAX EXPENSE

LINE NO.	DESCRIPTION	(A) REFERENCE	(B) AMOUNT
	FEDERAL INCOME TAXES:		
1	Operating Income Before Taxes	SURR RLM-5, Column (C), L26 + L24	$ (109,549)
	LESS:		
2	Arizona State Tax	Line 11	14,045
3	Interest Expense	Note (A) Line 20	(92,023)
4	Federal Taxable Income	Line 1 - Line 2 - Line 3	$ (187,526)
5	Federal Tax Rate	SURR RLM-1, Pg 2, Col. (D), L34	32.80%
6	Federal Income Tax Expense	Line 4 X line 5	$ (61,503)
	STATE INCOME TAXES:		
7	Operating Income Before Taxes	Line 1	$ (109,549)
	LESS:		
8	Interest Expense	Note (A) Line 20	(92,023)
9	State Taxable Income	Line 7 - Line 8	$ (201,571)
10	State Tax Rate	Tax Rate	6.97%
11	State Income Tax Expense	Line 9 X Line 10	$ (14,045)
	TOTAL INCOME TAX EXPENSE:		
12	Federal Income Tax Expense	Line 6	$ (61,503)
13	State Income Tax Expense	Line 11	(14,045)
14	Total Income Tax Expense Per RUCO	Line12 + Line 13	$ (75,548)
15	Total Income Tax Expense Per Company (Per Company Sch. C-1)		7,760
16	Total Income Tax Adjustment	Line 14 - Line 15	$ (83,308)
17	RUCO Adjustment (See SURR RLM-7, Column (I), L28)	Line16	$ (83,308)

NOTE (A):
Interest Synchronization:

18	Adjusted Rate Base (Sch. RLM-2, Col. (E), L15)	$	3,680,911
19	Weighted Cost Of Debt (Sch. RLM-15, Col. (F), L1)		2.50%
20	Interest Expense (L17 X L18)	$	92,023

Black Mountain Sewer Corporation
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Test Year Ended June 30, 2008

SURREBUTTAL
COST OF CAPITAL

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D) CAPITAL RATIO	(E) COST	(F) WEIGHTED COST RATE
1	Long-Term Debt				40.00%	6.26%	2.50%
2	Stockholder's Equity				60.00%	8.22%	4.93%
3	TOTAL CAPITAL				100.00%		
4	COST OF CAPITAL						7.43%

References:

Column (A): Intentionally Left Blank
Column (B): Intentionally Left Blank
Column (C): Intentionally Left Blank
Column (D): Hypothetical Capital Structure
Column (E): Testimony, WAR
Column (F): Column (D) X Column (E)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

SURREBUTTAL
RATE DESIGN AND PROOF OF RECOMMENDED REVENUE
PROPOSED REVENUE

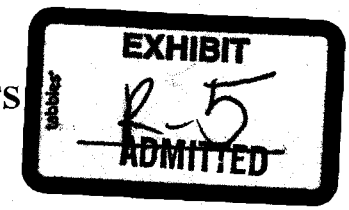
LINE NO.	CUSTOMER CLASSIFICATION	(A) BILL DETERMINENTS	(B) MONTHLY RATES & CHARGES	(C) REVENUE
	Residential			
1	Customers	1,972	$ 58.94	$ 1,394,852
	Commercial (Standard Rate)			
2	Customers	125	$ -	$ -
3	Commodity Usage (Per Thousand Gallons)	2,069,505	$ 0.23633	489,090
4	Sub-Total			$ 489,090
	Commercial (Special Rate)			
5	Boulders Resort	1	$ 6,935.16	$ 83,221.88
6	Desert Forest	1	$ 1,654.32	$ 19,851.87
7	El Pedegral	1	$ 3,730.97	$ 44,771.64
8	Boulders Club	1	$ 283.60	$ 3,403.18
9	Spanish Village	1	$ 1,178.11	$ 14,137.37
10	Sub-Total			$ 165,385.94
11	Effluent Sales (Per Thousand Gallons)	42,513	$ 0.46051	$ 19,578
12	TOTAL REVENUE PER BILL DETERMINENTS			$ 2,068,905
13	Flat Rate Revenues			$ 2,049,328
14	Miscellaneous Service Revenues			19,578
15	Other Wastewater Revenues			6,916
16	Reconcillation With Book Value			(3,824)
17	TOTAL PROPOSED REVENUE			$ 2,071,997
18	RUCO RECOMMENDED REVENUE REQUIREMENT			$ 2,071,997
19	DIFFERENCE			$ (0)

Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609
Test Year Ended June 30, 2008

COMPARISON OF TYPICAL BILLS

LINE NO.	CUSTOMER CLASSIFICATION	(A) PRESENT RATES	(B) COMPANY ORIGINAL RATES	(C) COMPANY REBUTTAL RATES	(D) RUCO DIRECT RATES	(E) RUCO SURREBUTTAL RATES
	Residential					
1	Customers	$ 45.64	$ 71.08	$ 72.45	$ 58.88	$ 58.94
	Commercial (Standard Rate)					
2	Customers				$ -	
3	Commodity Usage (Per 1000 Gallons)	$ 0.18298	$ 0.28499	$ 0.29048	$ 0.23608	$ 0.23633
4	Sub-Total					
	Commercial (Special Rate)					
5	Boulders Resort	$ 4,173.74	$ 8,363.03	$ 8,524.14	$ 6,927.63	$ 6,935.16
6	Desert Forest	$ 1,144.08	$ 1,994.93	$ 2,033.36	$ 1,652.53	$ 1,654.32
7	El Pedegral	$ 2,215.55	$ 4,499.14	$ 4,584.81	$ 3,726.92	$ 3,730.97
8	Boulders Club	$ 168.41	$ 341.99	$ 348.58	$ 283.29	$ 283.60
9	Spanish Village	$ 699.59	$ 1,420.68	$ 1,448.04	$ 1,176.84	$ 1,178.11
10	Sub-Total					
11	Effluent Sales (Per Thousand Gallons)	$ 0.37440	$ 0.46051	$ 0.46051	$ 0.46051	$ 0.46051

BLACK MOUNTAIN SEWER CORPORATION
DOCKET NO: SW-02361A-08-0609
RESPONSE TO STAFF'S FIRST SET OF DATA REQUESTS



February 10, 2009

Response provided by: Greg Sorensen

Title: Director of Operations

Company Name: Algonquin Water Services

Address: 12725 W. Indian School Rd Ste D-101
Avondale, AZ 85392

Company Response Number: MEM 1.55

Q. Please provide a detailed listing of expenditures, copies of invoices and other supporting documents for the following test year BSWC expenses balances per Exhibit Schedule E-2:

Contractual Services Expense	$ 9,632
Contractual Services Expense – Testing	16,955
Contractual Services Expense – Other	$502,741
Rents – Building	19,830
Transportation	$ 34,445

Please explain the increase, or decrease, from the previous year ending 6/30/2007.

A. Please see the attached files containing the detailed listing of test year expenditures and supporting invoices. Additionally, below are the variance explanations for test year differences from those account figures for the 12 months ended June 30, 2007:

Contractual Services Expense –This account increased from $4,639 for the 12 months ended June 30, 2007 to $9,362 for the test year, an increase of $4,723. These costs are primarily legal in nature, although the test year includes $1,500 for surveying the property along the boundary of a company easement and a customer's property. This was necessary to clarify boundaries and the boundary markers were missing.

The remainder of the increase is related to the general need for legal work at the utility, which occurs as a normal part of business, and the general increase in

billing rates charged by the law firm Fennemore Craig for legal services performed. Please note that legal invoices are not being provided; however, Staff may arrange to review an unredacted statement of fees and costs by contacting Whitney Birk at 602-916-5720. The proposed manner of review of legal invoices is the same as used by Staff and Fennemore Craig in other pending rate cases.

Contractual Services Expense – Testing – This account decreased from $27,041 for the 12 months ended June 30, 2007 to $16,955 for the test year, a decrease of $10,086. This decrease is the result of $15,163 of line cleaning charges from December 2006 (included in 12 months ended June 2007), which should have been included in Contractual Services – Other, account # 8100-2-0200-50-5200-0100.

Contractual Services Expense – Other – Contractual Services Other increased from $392,536 for the 12 months ended June 30, 2007 to $502,740 during the test year, an increase of $110,204. The increase can be attributed to increases in two accounts: the operating/administration costs from AWS ($60k increase), and other contracted services from third parties ($51k). The third party contracted services mainly increased due to clean-up costs of approximately $40k related to the clean-up of a sewer spill at the Commercial Lift Station in December 2007, which was reported to ADEQ, Maricopa County, and voluntarily to the ACC.

The fees charged by AWS to BMSC increased from $18k/month to $19k/month in April 2007, and from $19k/month to $25k/month in January 2008. These fee increases were caused by cost increases at AWS to provide the operations, billing, accounting, and administration services for BMSC. Please note that AWS billings to BMSC during the test year were on a fee per month basis. However, an analysis was performed to ensure that the total of these billings for the test year represented the cost of these services, and that no "affiliate profit" was included in the test year operating costs of BMSC. In addition, AWS services for the period July 2006 to June 2007 were provided to BMSC for a loss of approximately $16,000. See the Company's response to data request MEM 1.28 for additional information regarding affiliated costs and allocation methodology. Moreover, the 12 months ended June 2007 included credits related to the first 6 months of 2006, which accounts for $19k of the $60k variance (i.e. the 12 months ended 6/30/07 was artificially $19k low due to those credits for a prior period).

Rents – Building – During 2007, the rent for the operations office in Carefree was incorrectly charged to AWS, rather than being charged directly to the BMSC utility. During 2007, the only charges to this BMSC account were for a small storage facility for records and a refuse dumpster. However, beginning in 2008, the $3,072 for office rent began to be charged to this account. As this is an ongoing expense, but only 6 months' charges were included in the test year, it is

proper to adjust test year expense by increasing it by $18,432 for rent for the period July-December 2007.

Transportation – Transportation expense increased from $16,592 during the 12 months ended June 30, 2007 to $34,446 during the test year, an increase of $17,854. This increase was driven by two primary factors: the increase in fuel prices during the test year, and the addition of a leased truck in June 2007. The additional truck was needed as employees were being reimbursed for their own mileage, which was costly, and their vehicles were not a proper fit for the job, which included hauling and use of a trailer for a portable generator (a health and safety concern). The annual lease cost is approximately $10,750.