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BEFORE THE ARIZONA CORPORATION COMMISSION

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KRISTIN K. MAYES
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GARY PIERCE
Commissioner

AZ CORP COMMISSION
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Commissioner

SANDRA D. KENNEDY
Commissioner

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Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY,)
AN ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON)
FOR UTILITY SERVICE BY ITS ANTHEM)
WATER DISTRICT AND ITS SUN CITY)
WATER DISTRICT.

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY,)
AN ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON)
FOR UTILITY SERVICE BY ITS)
ANTHEM/AGUA FRIA WASTEWATER)
DISTRICT, ITS SUN CITY WASTEWATER)
DISTRICT AND ITS SUN CITY WEST)
WASTEWATER DISTRICT.

DOCKET NO. SW-01303A-09-0343

Arizona Corporation Commission
DOCKETED

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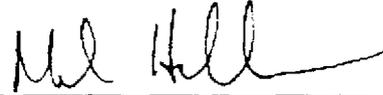
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NOTICE OF FILING TESTIMONY

Attached is the Rebuttal Testimony of Paul Townsley, Thomas M. Broderick,
Joseph E. Gross, P.E., Sandra L. Murrey, Miles H. Kiger, Linda J. Gutowski and Bente Villadsen
filed on behalf of Arizona-American Water Company.

1 RESPECTFULLY SUBMITTED this 22nd day of March, 2010.

2 LEWIS AND ROCA LLP

3 

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8 Phoenix, AZ 85004

9 Attorneys for Arizona-American Water Company

10 ORIGINAL and thirteen (13) copies
11 of the foregoing filed this 22nd day
12 of March, 2010, with:

13 The Arizona Corporation Commission
14 Utilities Division – Docket Control
15 1200 W. Washington Street
16 Phoenix, Arizona 85007

17 Copy of the foregoing hand-delivered
18 this 22nd day of March, 2010, to:

19 Steve Olea
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21 Arizona Corporation Commission
22 1200 W. Washington Street
23 Phoenix, Arizona 85007

24 Teena Wolfe, Administrative Law Judge
25 Hearing Division
26 Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

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this 22nd day of March, 2010, to:

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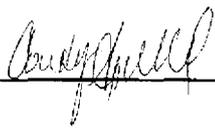
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER AND SUN CITY WATER DISTRICTS

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM /
AGUA FRIA WASTEWATER, SUN CITY
WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICTS

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2010**

**REBUTTAL TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2009**

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REBUTTAL EXHIBIT TMB-1 – Summary of Schedule A-1s, B-1s, C-1s and D-1s

1 **EXECUTIVE SUMMARY**

2
3 Thomas M. Broderick testifies in rebuttal that:

4
5 The total **revised** requested annual revenue increase is \$16,583,067 or a 44.8% increase. The
6 **original** requested annual revenue increase was \$20,628,634. The primary reason for the
7 requested revenue reduction is the Company is accepting Staff's cost of capital which alone
8 reduces the original annual revenue requirement by \$3.6 million.

District	Anthem Water	Sun City Water	Anthem / Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Revenue Increase	\$5,962,687	\$2,026,980	\$5,308,386	\$1,858,070	\$1,426,944

9
10 The Company accepts Staff's 7.2% cost of capital and each of the components comprising that
11 overall amount including the 10.7% return on equity.

12 Mr. Broderick also discusses rate case expense, part of the working capital adjustment, Sun City
13 Well 5.1, tank maintenance reserve and deferral, pension expense, wastewater hook-up tariffs,
14 and Sun City's low income program.

1 **I INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE**
3 **NUMBER.**

4 A. My name is Thomas M. Broderick. My business address is 2355 W. Pinnacle Peak Road,
5 Suite 300, Phoenix, Arizona 85027, and my business phone is 623-445-2420.

6 **Q. ARE YOU THE SAME THOMAS M. BRODERICK THAT SUBMITTED**
7 **DIRECT TESTIMONY ON BEHALF OF THE COMPANY IN THIS CASE ON**
8 **July 2, 2009?**

9 A. Yes.

10 **II PURPOSE OF TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

12 A. Please see the executive summary of my direct testimony.

13 **III SUMMARY OF REVISED REVENUE REQUIREMENT (ALL DISTRICTS IN**
14 **THIS CASE)**

15 **Q. WHAT IS ARIZONA-AMERICAN'S REVISED REQUESTED REVENUE**
16 **REQUIREMENT INCREASE IN THIS CASE?**

17 A. Arizona-American's revised requested revenue increase, rate base and operating expense
18 are summarized on Rebuttal Exhibit TMB-1 Summary of Schedule A-1s, B-1s, C-1s and
19 D-1s. The Company's requested revenue requirement is revised as a result of accepting a
20 number of the positions recommended by Commission Staff and RUCO as well as due to
21 correcting some minor errors uncovered in the discovery process. Also, a few new
22 issues, such as unanticipated expenses under the 1985 City of Glendale Agreement, have
23 arisen in the Sun City wastewater district. The total **revised** requested annual revenue
24 increase is \$16,583,067 or a 44.8% increase. The **original** requested annual revenue

1 increase was \$20,628,634. The primary reason for the requested revenue reduction is the
2 Company is accepting Staff's cost of capital which alone reduces the original annual
3 revenue requirement by \$3.6 million.

4 **Q. HOW DOES THE COMPANY'S REVISED REVENUE REQUIREMENT –**
5 **WHICH RESULTS FROM ACCEPTING MANY OF STAFF'S AND RUCO'S**
6 **POSITIONS – COMPARE TO STAFF'S AND RUCO'S POSITIONS**
7 **SUBMITTED ON MARCH 8, 2010?**

8 A. Staff recommends the Company be authorized approximately 80% of its originally
9 requested overall revenue requirement and RUCO recommends the Company be
10 authorized approximately 66%. The Company has reviewed each of their
11 recommendations and has endeavored to accept as many of Staff's and RUCO's
12 recommendations as we can in order to reduce the remaining open issues. This case
13 requests a large increase in revenue in order to restore Arizona-American to a minimal
14 level of financial performance. Arizona-American has experienced net income losses
15 thru December 31, 2008 totaling \$30.2 million since the acquisition from Citizens of all
16 of its Arizona water and wastewater properties in 2002. This past year - 2009 - was again
17 a difficult year financially. Although the Company had a positive \$0.3 million net
18 income, it was entirely attributable to AFUDC related non-cash income on the White
19 Tanks project. AFUDC is booked based on the standard regulatory promise to include
20 that project in rates in the future.

21 **Q. WHAT OTHER REBUTTAL TESTIMONY WITNESSES ARE SUPPORTING**
22 **ARIZONA-AMERICAN'S REVISED REVENUE REQUIREMENT?**

23 A. The following persons are also providing rebuttal testimony to support Arizona-
24 American's revised revenue requirement. Their primary rebuttal topics are indicated in
25 parentheses:

1 **Mr. Paul G. Townsley** (The proposed infrastructure surcharge for Sun City, the annual
2 achievement incentive plan, imputed water loss penalties, and Anthem Community
3 Council's proposal to defer Anthem plant associated with the most recent (\$20.2 million)
4 Pulte refund from rate base)

5 **Mr. Joseph E. Gross** (Sun City Well 5.1 and Verrado WWTP)

6 **Ms. Linda J. Gutowski** (Rebuttal Schedule B-2 test year adjusted rate base results and
7 various rate base pro forma adjustments, allocation of North West Valley Treatment Plant
8 ("NWVTP"), the Sun City tank maintenance reserve, and water testing costs)

9 **Mr. Miles H. Kiger** (A new cost deferral request for the Glendale Agreement, rebuttal
10 Schedule C-2 test year adjusted operating income results and various expense pro forma
11 adjustments including pension expense)

12 **Ms. Sandra L. Murrey** (Accepts various rate base pro forma adjustments including
13 Verrado WWTP)

14 **Dr. Bente Villadsen** (Rebuttal of RUCO's recommended return on equity)

15 **Q. DOES REBUTTAL EXHIBIT TMB-1 PROVIDE BY DISTRICT THE**
16 **COMPANY'S REVISED REVENUE REQUIREMENT, RATE BASE AND**
17 **EXPENSE?**

18 **A.** Yes, it is a revision of Exhibit TMB-1 which was part of my Direct Testimony and is in
19 the format of Schedules A-1, B-1, C-1 and D-1.

20 **Q. WHAT DOES REVISED SCHEDULE A-1 SHOW AS THE DISTRICT LEVEL**
21 **REVENUE REQUIRMENT INCREASE?**

1 A. Schedule A-1 titled "Computation of Increase in Gross Revenue Requirements" shows
2 the revised calculation of the increase in gross revenue requested by Arizona-American
3 for each district in this proceeding:

District	Anthem Water	Sun City Water	Anthem / Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Revenue Increase	\$5,962,687	\$2,026,980	\$5,308,386	\$1,858,070	\$1,426,944

5
6 **IV REBUTTAL OF RUCO AND STAFF DIRECT TESTIMONIES**

7 **COST OF CAPITAL**

8 **Q. WHY DO YOU RECOMMEND THE COMMISSION REJECT RUCO'S**
9 **PROPOSED 6.77% COST OF CAPITAL IN FAVOR OF STAFF'S PROPOSED**
10 **7.20%?**

11 A. Staff's recommendation is more appropriate for this case. I accept Staff's proposed 7.2%
12 cost of capital as the *lowest* acceptable cost (See Section V below) and disagree with
13 RUCO.

14 **Q. WHAT IS THE SOURCE OF THE DIFFERENCE BETWEEN RUCO'S AND**
15 **STAFF'S RECOMMENDED COST OF CAPITAL?**

16 A. RUCO recommends a return on equity of 9.5% and Staff recommends a return on equity
17 of 10.7%. The Company accepts Staff's recommended return on equity. RUCO and
18 Staff have no other significant differences in their recommended cost of debt or the
19 capital structure. The rebuttal testimony of Ms. Bente Villadsen on behalf of the
20 Company presents the reasons why the RUCO return on equity recommendation is too
21 low and should be rejected in favor of Staff's recommendation.

1 **RATE CASE EXPENSE**

2 **Q. WHY DO YOU DISAGREE WITH RUCO'S RECOMMENDATION TO ALLOW**
3 **ONLY \$460,000 IN TOTAL RATE CASE EXPENSE FOR COSTS ASSOCIATED**
4 **WITH THIS CASE?**

5 A. I disagree with RUCO's method of calculating rate case expense on a per district average
6 basis using authorized rate case expense in prior cases. Each case is different from the
7 last and there is no reason to use past case information when current case assumptions
8 and actual expenses to-date are readily available.

9 **Q. WHAT DATA ARE READILY AVAILABLE FOR THIS CASE?**

10 A. Although Staff accepts the amount the Company originally requested for rate case
11 expense of \$678,425; alternatively, I am willing to provide actual rate case expense to-
12 date plus a remaining cost estimate to completion of this case at the appropriate time(s).
13 Updates can be provided at hearing, in the Company's post hearing exhibits or even later
14 in the Company's post hearing brief. In New Mexico, for example, the NMPRC prefers
15 to receive the actual rate case expense to-date plus an estimate for the remainder of the
16 case for their review and acceptance at the hearing.

17 **Q. DOES THE COMPANY TRY TO KEEP RATE CASE EXPENSE AS LOW AS**
18 **POSSIBLE?**

19 A. Yes, it is one of my major priorities. After each rate case is over, the Company
20 immediately writes off to expense any actual deferred rate case expense in excess of the
21 total Commission authorized amount. It is not pleasant to inform my management that –
22 while new revenues will soon come in – that the first action is to write-off excess rate
23 case expense and reduce income.

1 As part of fulfilling my job duties, I spend a significant amount of time keeping rate case
2 expense low in Arizona (and elsewhere). We typically do not use our external law firm
3 for routine filings or the copying of rate case materials or the logistical handling of
4 responses to data request. And typically, either I or a member of my team attends
5 Commission open meetings so that my external counsel – if needed for the meeting – is
6 not waiting for hours in the hearing room at my customers' expense for my agenda item
7 to be called.

8 If procedural calendar time permits, we always prefer to issue a required public notice as
9 a bill insert to save postage. The stamp is the most costly component of a public notice.
10 Bill text messages cost even less and are used for post case notices of rate increases. A
11 bill text message appears on customers' bills in the section immediately following the
12 billing information. We know many customers see these notices because recently we
13 omitted a post case bill text message for one district and the Company (and the
14 Commission) received a higher than expected number of customer inquiries from this
15 district (even though the increase was not as large as for several other districts).

16 As of March 11, 2010, the Company had incurred \$226,339 in rate case expense for this
17 case. In a procedural order dated March 18, 2010, the ALJ required a Company-wide all
18 customer notice regarding rate consolidation. That notice will be sent as a first class
19 letter at a total cost of approximately, \$55,000. The majority of external legal costs for
20 the case are still ahead.

21 **WORKING CAPITAL ADJUSTMENT**

22 **Q. RUCO'S WITNESS MR. RALPH SMITH IMPLIES THAT ARIZONA-**
23 **AMERICAN CAN CHOOSE WHETHER OR NOT TO PRE-PAY AFFILIATE-**
24 **PROVIDED SERVICES (PAGE 27, LINE 1). IS THAT TRUE?**

1 A. No. All 20 utility affiliates, including Arizona-American, pre-pay the monthly "Service
2 Company Bill." We paid, for example, the January 2008 monthly bill on January 7,
3 2008. Contrary to Mr. Smith's assertion, Arizona-American does not have the discretion
4 to pay its monthly Service Company bill on a timetable different from the other affiliates.
5 This bill is paid automatically.

6 **Q. DID ARIZONA-AMERICAN MAKE ERRORS IN ITS INITIAL FILING**
7 **CONCERNING THE LEAD / LAG DATA FOR THE SERVICE COMPANY**
8 **BILL?**

9 A. Yes. The Company requested a payment *lag* of 14.7715 days in its initial filing. That is
10 being corrected in the rebuttal testimony of Company witness Ms. Linda Gutowski.

11 **Q. DID THE WEST VIRGINIA COMMISSION NOT RECOGNIZE A PRE-**
12 **PAYMENT OF THE SERVICE COMPANY BILL (SMITH DIRECT, PAGE 29,**
13 **LINES 23-24) IN SPITE OF WEST VIRGINIA AMERICAN REQUESTING A**
14 **PRE-PAYMENT LEAD?**

15 A. Yes, but West Virginia is the only exception among the 20 utility affiliates, unless, of
16 course, this Commission later finds similarly.

17 **Q. WHY SHOULD THE ARIZONA COMMISSION ALIGN WITH ALL THE**
18 **OTHER COMMISSIONS AND DISAGREE WITH WEST VIRGINIA?**

19 A. If the Commission aligns with all the other commissions, then Service Company interest
20 costs will not consequentially increase. If Arizona-American no longer pre-pays the
21 Service Company bill, then the Service Company would have to borrow funds to meet its
22 own cash requirements and would pass the associated higher interest costs on to the
23 affiliates (including Arizona-American) in a larger monthly Service Company bill.

1 In recent Decision No. 71410, the Commission accepted the Company's proposed pre-
2 payment lead of 3.88 days. Even this pre-payment lead, understated the actual pre-
3 payment lead, which is correctly calculated at 11.25 pre-payment lead days for the 2008
4 test year in the rebuttal testimony of Company witness Ms. Linda Gutowski. She rebuts
5 this and a number of other working capital issues in her testimony.

6 **SUN CITY WELL 5.1**

7 **Q. CAN ARIZONA-AMERICAN DEMONSTRATE SPECIAL CIRCUMSTANCES**
8 **TO JUSTIFY INCLUSION OF SUN CITY WELL 5.1 IN RATE BASE AS A POST**
9 **TEST YEAR ADDITION (RUCO'S MR. SMITH, PAGE 15, LINES 10-11)?**

10 A. If need be, yes. Staff, however, allows this addition in its revenue requirement because
11 Staff's engineer, Ms. Hains, indicated Well 5.1 was in-service at the time of her
12 inspection.

13 **Q. WOULD ARIZONA-AMERICAN'S FINANCIAL HEALTH BE IN JEOPARDY**
14 **FROM FAILURE TO INCLUDE WELL 5.1 IN RATE BASE?**

15 A. Yes. The replacement of Sun City Well 5.1 – at a cost of \$1.587 million – represents 5.6
16 percent of the Company's requested rate base for the Sun City water district in its direct
17 case presentation. The Company's application requested a 27.74% rate increase for Sun
18 City water district and RUCO recommends an increase of only 7.81%. The annual
19 revenue requirement associated with Well 5.1's addition is \$224,394. In 2009, Arizona-
20 American – for the first time in many years – had a positive net income of \$316,000.
21 Therefore, the revenue from this project alone represents a significant portion of Arizona-
22 American's current income. The reason net income was positive in 2009 was because
23 non-cash AFUDC was recorded on the Company's largest ever construction project –

1 White Tanks. So, in other words, \$224,394 is material on a total Arizona-American level
2 at this juncture in the Company's struggle to return to financial health.

3 **Q. IS THE REPLACEMENT OF SUN CITY WELL 5.1 REVENUE NEUTRAL?**

4 A. Yes. As Company witness Mr. Gross explains, this investment is not related to customer
5 growth.

6 **TANK MAINTENANCE**

7 **Q. DID STAFF ACCEPT THE COMPANY'S PROPOSAL FOR A SUN CITY TANK**
8 **MAINTENANCE RESERVE, BUT RUCO DID NOT?**

9 A. Yes. Staff accepted the Company's proposed \$445,000 annual reserve addition. The
10 rebuttal testimony of Company witness Ms. Linda Gutowski addresses RUCO's position.

11 **Q. IS THE MINIMAL TANK MAINTENANCE SPENDING CITED BY RUCO'S**
12 **MR. SMITH IN SUN CITY WATER DISTRICT INDICATIVE OF THE NEXT**
13 **TEN YEARS SPENDING NEEDED?**

14 A. No, to the contrary it means the Company has spent very little on tank painting in Sun
15 City water district for many years and now such maintenance is already overdue.
16 RUCO's Mr. Smith (Page 64, Lines 3-5) chastises the Company for not providing the
17 requested ten-year history, but there has been virtually no tank painting in Sun City in
18 recent years.

19 **Q. IS THERE AN EXISTING DEFERRAL IN SUN CITY FOR TANK PAINTING?**

20 A. Yes. This deferral was approved many years ago back when Citizens owned the property
21 in that district and it has remained in effect.

1 **Q. SHOULD A TANK PAINTING & INSPECTIONS DEFERRAL NOW BE**
2 **APPROVED FOR ANTHEM WATER DISTRICT AS WAS MUCH EARLIER**
3 **APPROVED FOR SUN CITY WATER DISTRICT?**

4 A. Yes, the Company makes this new request. Although Anthem water district's tank
5 maintenance needs are minimal today and for the near future, it would be prudent to
6 approve a deferral for Anthem district now that is identical to the much earlier approved
7 deferral for the Sun City water district.

8 **PENSION EXPENSE – FAS 87 versus ERISA**

9 **Q. RUCO'S MR. SMITH (Pages 48-59) RAISES TWO ISSUES WITH RESPECT TO**
10 **PENSION EXPENSE: 1) NORMALIZATION AND 2) FAS 87 VERSUS ERISA.**
11 **WHAT IS THE COMPANY'S POSITION?**

12 A. RUCO substitutes the Company's requested 2009 ERISA pension expense for a lower
13 FAS 87 average of 2007 and 2008. The rebuttal testimony of Company witness Miles H.
14 Kiger discusses why it is more appropriate to rely upon 2009 ERISA or an average of
15 2009 and 2010 ERISA instead. The normalizing period is an issue separate from FAS 87
16 versus ERISA which was cleverly co-mingled with normalization by RUCO when it used
17 FAS 87 pension expense for 2007 and 2008 instead of ERISA pension expense. The
18 Company is very strongly opposed to RUCO's co-mingling of these two distinct issues
19 and recommends the Commission reject RUCO's recommendation. The Company
20 believes Mr. Smith has greatly exaggerated the "management discretion" associated with
21 ERISA expense. The Company follows the law.

1 **Q. RUCO'S MR. SMITH APPEARS TO BELIEVE THAT FAS 87 (ACCRUAL) IS**
2 **GENERALLY PREFERRABLE TO ERISA (CASH FUNDED) PENSION**
3 **EXPENSE. DOES THE COMPANY AGREE?**

4 A. This is an important policy question and one for which I am confident the Commission
5 would want a well developed evidentiary record before taking such an important step
6 with long-ranging impacts. A number of American Water's utility affiliates are already
7 on FAS 87 for ratemaking purposes and under the right circumstances and with the
8 proper rate treatment Arizona-American could likewise follow. However, when the
9 Company prepared and filed this rate case in July 2009, we concluded that the issues
10 were already very numerous and that since not all of the Company's districts were in this
11 case, it would be premature to request approval of FAS 87 for rate-making purposes.
12 Recent conversations with Commission Staff have confirmed my earlier conclusion that
13 this case already had many issues that are occupying Staff's resources.

14 We deferred the FAS 87 versus ERISA topic until a future rate case. While it would be
15 more appropriate to transition the whole Company at one time, rather than in waves of
16 different districts, an initial partial transition is not a deal breaker. I note that the next
17 rate case may be state-wide.

18 **Q. WHAT GIVES RISE TO THE DIFFERENCE BETWEEN FAS 87 AND ERISA**
19 **BASED PENSION EXPENSE THAT CREATES TRANSITION ISSUES?**

20 A. While I am not a pension accountant by training, it is my understanding that ERISA
21 pension expense equals annual funding which is the on-going actual payments to retirees
22 plus the change in the value of the plan's assets from period to period as compared to the
23 plan's required value. FAS 87 is accrual based pension expense based on the difference
24 between the actual value of the plan and the required value of the plan. Ultimately, FAS

1 87 and ERISA pension expense are equal over time, but there are significant annual
2 expense timing differences. In some periods, ERISA exceeds FAS 87 and vice versa in
3 other periods. This is due to the differences inherent in each method's quantification of
4 the current funding obligation using different assumptions. An actuarial study performed
5 by an independent third party is required to determine the results of both methods. FAS
6 87 looks at the future pension obligation as the employee earns it while ERISA looks at
7 the pension obligation that is payable currently. Other factors such as earnings on plan
8 assets also enter the calculations.

9 I understand that GAAP requires that FAS 87 obligations be booked to the Company's
10 balance sheet. But, since the Company expenses on ERISA and because FAS 87 has
11 historically generally exceeded ERISA, the Company has regulatory assets on its balance
12 sheet for the accumulated amounts by which FAS 87 has exceeded ERISA.

13 On the Company's balance sheet are two FAS 87 related regulatory assets - one for
14 Deferred Service Company Pension Cost and another for Deferred Pension Cost for
15 everyone else (i.e., Arizona-American employees). At February 28, 2010, the balances
16 are \$746,347 and \$1,050,173, respectively, in account #186408 and #186422. RUCO
17 ignores these regulatory assets in its recommendation. These cannot be ignored.

18 **Q. DID THE COMPANY EARLIER HIGHLIGHT FOR THE COMMISSION THAT**
19 **PENSION EXENSE (UNDER EITHER ERISA OR FAS 87) WAS INCREASING**
20 **WELL ABOVE AMOUNTS IN RATES DUE TO MARKET TURMOIL IN 2008.**

1 A. Yes. On May 15, 2009, the Company filed a request (Docket # 09-0241) for approval to
2 defer current ERISA pension expense in excess of amounts in existing rates. The
3 Company requested that \$1.723 million in 2009 pension expense be allowed to be
4 deferred. The Company requested the deferral be allowed to continue through December
5 31, 2013. The Company acknowledged that as rate cases completed and increased
6 pension expense was included in rates, the amount deferred would be less. The Company
7 acknowledged that future expense (e.g., 2012 or 2013) might eventually be less than the
8 amount then in rates and so the Company offered a balancing account feature so that the
9 Company would only recover its exact pension expense.
10 The Commission has not acted on that application and no time clock rules apply. I think
11 the Company's intentions were clear that it is only seeking to recover its exact pension
12 expense in a difficult situation.

13 **Q. IF THE COMMISSION DECIDES TO APPROVE FAS 87 BASED PENSION**
14 **EXPENSE IN THIS CASE INSTEAD OF THE ERISA BASED REQUEST IN THE**
15 **ORIGINAL APPLICATION WHAT DOES IT NEED TO DO?**

16 A. The Commission needs to state clearly in a final order that it approves FAS 87 based
17 pension expense. Next, it needs to determine and identify the adjusted (perhaps,
18 normalized) test year amount of FAS 87 based pension expense for rate-making. Next, it
19 needs to recognize the amount of the accumulated difference between FAS 87 and
20 ERISA and establish an annual amortization of that difference authorized for recovery in
21 rates for the districts in this case. Lastly, it needs to indicate that the accumulated
22 difference allocated to districts not in this case would likewise be recoverable with an
23 identical or similar amortization period.

24 **Q. WHAT IS THE APPROPRIATE AMOUNT OF THE ACCUMULATED**
25 **DIFFERENCE BETWEEN FAS 87 AND ERISA?**

1 A. Since the Company's accountants have continued to record the on-going difference
2 between FAS 87 and ERISA on the Company's balance sheet it is appropriate to use the
3 most recent available balances in accounts #186408 and #186422 as the basis for the
4 amortization of \$746,347 and \$1,050,173 as of February 28, 2010. These balances can
5 be updated as the case progresses.

6 **Q. WHAT AMORTIZATION PERIOD DOES THE COMPANY RECOMMEND TO**
7 **RECOVER THESE AMOUNTS IN RATES?**

8 A. Five years is appropriate. Any longer and it would be necessary to put the unamortized
9 amount in rate base so as to compensate for the lost time value of money.

10 **Q. WHAT WOULD HAPPEN IF THE COMMISSION APPROVED THE**
11 **ADJUSTED TEAT YEAR PENSION EXPENSE BASED ON FAS 87 IN THIS**
12 **CASE BUT FAILED TO APPROVE THESE AMORTIZATIONS IN RATES?**

13 A. That would be very unfair as we would be forced to write-off these regulatory assets to
14 expense and reduce income. The Company's auditors would conclude that the eventual
15 recovery of these balances is apparently not probable. This would be contrary to the
16 method used by other commissions – including this Commission.

17 **Q. PLEASE SUMMARIZE THE COMPANY'S POSITION ON PENSION EXPENSE**
18 **FOR THIS CASE?**

19 A. In its original application, the Company proposed 2009 ERISA based pension and it
20 continues to support that request with additional information in the testimony of Miles H.
21 Kiger. If the Commission decides a different or average period is more appropriate, then
22 it is critical that this normalization be appropriate and use ERISA pension expense.
23 Alternatively, if it is the preference of the Commission to approve FAS 87 now, the
24 Company can accept FAS 87 pension expense if the allocated historical difference

1 between FAS 87 and ERISA for the districts in this case is approved for recovery over a
2 five-year or less amortization period. A similar recovery can occur for the balance of the
3 Company's other districts in their next rate case. The Company *strongly opposes*
4 approval of FAS 87 *if the transition issues are ignored*. The Company will be carefully
5 reviewing the April 15, 2010 surrebuttal testimony on this topic, especially that of
6 RUCO, and we may ask American Water's internal corporate pension expert and / or our
7 actuarial, Towers Perrin, to provide rejoinder testimony on pension expense.

8 **V ACCEPTED POSITIONS OF STAFF AND RUCO**
9 **STOCK BASED COMPENSATION LABOR EXPENSE**

10 **Q. RUCO'S MR. SMITH RECOMMENDS DENIAL OF THE TEST YEAR STOCK**
11 **BASED COMPENSATION EXPENSE (Page 44, line 8 thru page 48, line 8). DOES**
12 **THE COMPANY AGREE?**

13 A. Yes, with the exception of a minor partial double counting error Mr. Smith made which
14 is corrected by Company witness Miles H. Kiger. In the past, such compensation has
15 been minor and there is no stock based compensation budgeted for 2010. The 2008 test
16 year was high because American Water's IPO was underway and a one-time grant of
17 restricted stock was provided to **all** non-union employees. In order to vest, employees
18 needed to remain working at American Water for at least three months following the
19 IPO. Even though we accept Mr. Smith's adjustment as corrected, we felt it important to
20 clarify that the 2008 stock compensation – unlike the other companies Mr. Smith cited -
21 was not executive and officer targeted.

22 **COST OF CAPITAL**

23 **Q. DO YOU ACCEPT STAFF'S PROPOSED 7.2% COST OF CAPITAL?**

1 A. Yes and we accept Staff's 10.7% cost of equity, their cost of long and short term debt and
2 their capital structure as expressed in Staff witness Juan Manrique's Schedule JCM-1
3 (which has been incorporated in Company revised Schedule D-1). I note that Staff's
4 recommendation of 7.2% is lower than the cost of capital the Commission recently
5 approved in Decision No. 71410 on December 8, 2009 of 7.33%.

6 Although we believe Staff's overall 7.2% cost of capital recommendation is too low, it
7 seems unlikely the Commission will accept a return on equity in excess of Staff's
8 recommendation or exclude short term debt from the capital structure. The testimony of
9 Ms. Bente Villadsen, on behalf of the Company focuses on why RUCO's
10 recommendation of 9.5% return on equity is too low and should be rejected.

11 **CAPITAL STRUCTURE**

12 Staff again included short term debt in the capital structure. The Company accepts, but
13 still is of the opinion that short term debt funds CWIP and should not be included in the
14 capital structure for ratemaking purposes. We have made and lost this argument in recent
15 cases. In this case, RUCO gave up supporting the Company and now also proposes to
16 include short term debt in the capital structure.

1 Staff proposes a capital structure of 38.9% equity and 61.1% debt. The reason Staff's
2 calculated equity ratio is so low is because of the aforementioned inclusion of \$66.1
3 million of short term debt outstanding as of December 31, 2009 in the capital structure.
4 Under Staff's calculation, short term debt represents 16.6% of the capital structure. The
5 reason the Company has so much short term debt outstanding now is that late last year it
6 finished construction of the White Tanks surface water treatment plant located in the
7 Agua Fria district at a completed cost approximately equal to the amount of short term
8 debt now outstanding. Previously, Staff preferred the Company's equity ratio to be at
9 least 45%, but Staff has not criticized the Company on this point - I believe - for the
10 temporal reason cited.

11 **LONG-TERM DEBT**

12 The Company has pending an application to refinance \$10.635 million in existing short-
13 term debt in Docket # WS-01303A-09-0407 which is on the Commission's March 31,
14 2010 open meeting agenda. Staff has recommended approval at an interest rate not to
15 exceed 6.75% for the new long-term debt that will be issued in the second quarter of this
16 year. The Company anticipates filing soon a new application for \$35 million in long-
17 term debt to pay down more short term debt later in 2010. The incremental interest
18 expense for these new long-term debt issuances was not included in the Company's
19 revised revenue requirement.

20 For these and other reasons, the Commission should not approve a cost of capital lower
21 than 7.2%.

22 **RATE CASE EXPENSE**

1 **Q. WHY IS THE COMPANY ACCEPTING STAFF'S AND RUCO'S**
2 **RECOMMENDATIONS TO DENY RECOVERY OF \$149,119 IN COMMISSION**
3 **APPROVED BUT UNAMORTIZED RATE CASE EXPENSE FROM PRIOR**
4 **RATE CASES INVOLVING THE DISTRICTS IN THIS CASE?**

5 A. These prior case costs were included in this case to highlight that the Commission
6 routinely approves rate case recovery periods that are too long to actually recover the
7 authorized costs. Upon conclusion of this case, the Company will have to write-off these
8 approved but unamortized prior rate case expenses. Prior cases for the districts in this
9 case concluded in the second quarter of 2008. In Anthem, for example, all parties to the
10 prior Anthem case knew the Company would immediately file another Anthem rate case,
11 yet the Commission authorized a three-year recovery period which does not end until
12 summer 2011. Staff opined in its March 8, 2010 report that rate case expense is a cost
13 normalized not amortized. A normalization process can consider circumstances such as a
14 new case following quickly on the heels of a prior case. The rebuttal testimony of
15 Company witness Miles H. Kiger provides the details at the district level.

16 **VI WASTEWATER HOOK-UP FEE TARIFFS**

17 **Q. DOES THE COMPANY ACCEPT THE OFF-SITE WASTEWATER FACILITIES**
18 **HOOK-UP FEE TARIFF REVISIONS PROPOSED BY STAFF'S MS. HAINS?**

19 A. Yes. Ms. Hains added fees for the larger service lateral sizes and recommended
20 additional compliance for Anthem / Agua Fria wastewater district both of which are
21 acceptable to the Company.

1 **VII SUN CITY LOW-INCOME PROGRAM UPDATE**

2 **Q. IN YOUR DIRECT TESTIMONY, YOU INDICATED THAT AS OF MAY 31,**
3 **2009 THE SUN CITY LOW INCOME PROGRAM HAD ONLY 115 ENROLLEES**
4 **OF A MAXIMUM 1,000. HOW MANY ARE THERE NOW?**

5 A. As of February 2010, there were 293 Sun City water residential customers in the program
6 out of a maximum authorized 1,000. As a result, the program is presently over collected
7 by \$61,706 because an additional \$0.047 per kgal is collected on the high block of water
8 consumption in order to fund a \$4 per month discount for program enrollees. The
9 Company has promoted the program recently and is at a loss to explain why there are
10 now not more low income participants.

11 The Commission could either reduce the over collection by temporarily reducing /
12 eliminating the rate on the high block or ordering a one-time refund of the over collection
13 or doing nothing until the next rate case.

14 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY IN THIS CASE?**

15 A. Yes.

REBUTTAL EXHIBIT TMB-1 – Summary of Schedule A-1s, B-1s, C-1s AND D-1s

Line No.	Item of Capital	End of Test Year				End of Projected Year			
		Dollar Amount	Percent of Total	Cost Rate	Weighted Cost	Dollar Amount	Percent of Total	Cost Rate	Weighted Cost
1	Long-Term Debt	\$ 26,181,119	54.85%	5.47%	3.00%	\$ 26,181,119	54.85%	5.47%	3.00%
2									
1									
2	Stockholder's Equity	\$ 21,554,614	45.15%	12.25%	5.53%	\$ 21,554,614	45.15%	12.25%	5.53%
3									
4	Totals	<u>\$ 47,735,732</u>	<u>100.00%</u>		<u>8.53%</u>	<u>\$ 47,735,732</u>	<u>100.00%</u>		<u>8.53%</u>

Line No.	Item of Capital	End of Test Year				End of Projected Year			
		Dollar Amount	Percent of Total	Cost Rate	Weighted Cost	Dollar Amount	Percent of Total	Cost Rate	Weighted Cost
13	Long-Term Debt	\$ 25,581,679	44.55%	5.47%	2.4%	\$ 25,581,679	44.55%	5.47%	2.4%
15	Short Term Debt	\$ 9,526,376	16.59%	3.41%	0.6%	\$ 9,526,376	16.59%	3.41%	0.6%
17									
18	Stockholder's Equity	\$ 22,314,344	38.86%	10.70%	4.2%	\$ 22,314,344	38.86%	10.70%	4.2%
19									
20	Totals	\$ 57,422,400	100.00%		7.2%	\$ 57,422,400	100.00%		7.2%

Supporting Schedules:

Recap Schedules:

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER AND SUN CITY WATER DISTRICTS

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS
ANTHEM/AGUA FRIA WASTEWATER, SUN
CITY WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICTS

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
PAUL G. TOWNSLEY
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
March 22, 2010**

**DIRECT TESTIMONY
OF
PAUL G. TOWNSLEY
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
March 22, 2010**

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EXECUTIVE SUMMARY

Paul G. Townsley testifies that:

The Infrastructure System Replacement Surcharge for the Sun City Water District benefits customers by providing for the systematic replacement of aged infrastructure in a manner which does not lead to the type of rate shock that would be encountered under traditional ratemaking.

Arizona-American has made progress in reducing non-account water levels in the Sun City Water District and the Staff proposed reduction in power and chemical expenses for that District should be rejected.

The Annual Incentive Plan costs for Arizona-American employees should be included in rates with only a 30% reduction from total Annual Incentive Plan costs to reflect the financial component of the Plan. Likewise, Annual Incentive Plan costs for employees of the Service Company should be included in rates to the same extent as the Annual Incentive Plan costs for employees of Arizona-American are included in rates. The RUCO proposed adjustment should be rejected.

The 2008 Anthem refund payment to Pulte should be included in ratebase because it was paid before the end of the Test Year and the proposal for a phase-in of this payment into ratebase should not be adopted. The Anthem Community Council proposed adjustment should be rejected.

1 **I** **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Paul G. Townsley. My business address is 2355 West Pinnacle Peak Road,
4 Phoenix, AZ 85027.

5 **Q. ARE YOU THE SAME PAUL G. TOWNSLEY WHO PROVIDED DIRECT**
6 **TESTIMONY IN THIS CASE?**

7 A. Yes.

8
9 **II** **PURPOSE OF TESTIMONY**

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

11 A. Please see the executive summary of my rebuttal testimony.

12
13 **III** **INFRASTRUCTURE SYSTEM REPLACEMENT SURCHARGE**

14 **Q. ARE YOU ADOPTING THE DIRECT TESTIMONY OF CHRISTOPHER C.**
15 **BULS IN REGARDS TO A REQUEST TO IMPLEMENT AN**
16 **INFRASTRUCTURE SYSTEM REPLACEMENT SURCHARGE?**

17 A. Yes.

18 **Q. DID ANY OTHER PARTIES TO THIS CASE RESPOND TO ARIZONA-**
19 **AMERICAN'S PROPOSAL?**

20 A. Only Mr. William A. Rigsby on behalf of RUCO who recommends that the Arizona
21 Corporation Commission ("Commission") reject Arizona-American's proposal.

22 **Q. DO YOU AGREE WITH MR. RIGSBY'S POSITION?**

23 A. No I do not.

1 **Q. PLEASE EXPLAIN WHY YOU DISAGREE.**

2 A. The Sun City Water District has some of the oldest infrastructure of any of Arizona-
3 American's service areas. Because of its age, the infrastructure in this District is at a
4 point in the asset life cycle where significant levels of replacement capital will need to be
5 invested and Arizona-American is planning for capital investments to address this. An
6 Infrastructure System Replacement Surcharge ("ISRS") is an important tool to better
7 smooth out rate increases related to infrastructure replacement and to minimize rate shock
8 to Sun City water customers. This type of surcharge has also successfully facilitated
9 necessary infrastructure replacement in other states. The ISRS has important safeguards
10 as detailed in Mr. Bul's testimony to protect ratepayers and similar surcharges have been
11 approved by a number of other state Public Utility Commissions. This Commission
12 should approve an ISRS in order to facilitate the orderly reinvestment in facilities in Sun
13 City.

14 **Q. MR. RIGSBY CHARACTERIZES THE ASSETS CONSTRUCTED UNDER AN**
15 **ISRS PROGRAM AS BEING FINANCED BY NON-INVESTOR SUPPLIED**
16 **FUNDS. DO YOU AGREE?**

17 A. No I do not. Under Arizona-American's proposal, the Company will supply the debt and
18 equity funds to construct the replacement facilities, and the ISRS would be applied only
19 after the facilities are constructed, in service, and approved by the Commission similar to
20 the Arsenic Cost Recovery Mechanisms (ACRMs) . As described in Mr. Bul's testimony,
21 the ISRS would be calculated based on Arizona-American's ROE, cost of debt,
22 depreciation rates, capital structure and revenue gross-up factors authorized in this
23 proceeding.

24 **Q. WHAT RATEPAYER BENEFITS DOES THIS PROGRAM PROVIDE?**

1 A. In an older service area such as Sun City, infrastructure is reaching the end of its useful
2 life. Absent a program such as Arizona-American proposes in this case, larger levels of
3 capital investment in Sun City, coupled with the regulatory lag associated with historic
4 test years will result in larger step increases in rates at the time new rates are approved by
5 the Commission. Using this program, once reinvestments are made in qualifying
6 infrastructure, rates would be raised gradually and in smaller steps.

7 In the past three years, Arizona-American has replaced two wells and rehabilitated
8 another well, at a total investment of \$3.5 million which is included in this rate case.
9 Breaks in transmission mains last year required over \$200,000 in emergency
10 replacements, which are also in this case. A comprehensive study of the infrastructure in
11 the Sun City Water District has identified a number of wells in urgent need of
12 replacement because of a high risk of failure, amounting to planned capital expenditures
13 of approximately \$2 million per year for the foreseeable future. These planned capital
14 investments do not include any emergency replacements of other wells and transmission
15 mains during the same period due to failure.

16 An ISRS program facilitates necessary capital investment in older service areas such as
17 Sun City which would help insure that that needed reinvestment is not deferred and that
18 facilities are continuing to work properly. Over time this will improve service quality and
19 reliability for customers and help prevent some of the types of infrastructure crises that
20 are beginning to be experienced in older water and wastewater systems in other parts of
21 the United States.

22 Simply put, this program will provide for the systematic replacement of aged
23 infrastructure in a manner which does not lead to the type of rate shock that would be
24 encountered under traditional ratemaking procedures.

1 **Q. IF THE COMMISSION ORDERS TO CONSOLIDATE ARIZONA-AMERICAN'S**
2 **DISTRICTS, WOULD YOU RECOMMEND THAT THE ISRS PROGRAM BE**
3 **EXPANDED TO ALL CONSOLIDATED DISTRICTS?**

4 A. Yes. An ISRS program implemented state-wide across all of Arizona-American's
5 districts on a consolidated basis would enable the systematic replacement of aged
6 infrastructure in those locations where the need is greatest, and yield an even lower rate
7 impact upon the consolidated customer base due to the gradual and smaller-step nature of
8 an ISRS program, and the larger number of customers involved.

9
10 **IV NON-ACCOUNT WATER COST REDUCTION**

11 **Q. HAVE YOU READ THE DIRECT TESTIMONY OF GERALD BECKER OF THE**
12 **COMMISSION STAFF?**

13 A. Yes I have.

14 **Q. DO YOU AGREE WITH HIS SUN CITY WATER LOSS EXPENSE**
15 **ADJUSTMENT NO 2: FUEL AND POWER CHEMICALS EXPENSE?**

16 A. No I do not.

17 **Q. PLEASE EXPLAIN WHY YOU DISAGREE.**

18 A. Mr. Becker proposes to reduce Arizona-American's allowable operating expenses for the
19 Sun City Water District because the system's non-account water loss was 11.1% at the
20 end of the Test Year. I believe that his proposal oversteps the Commission's direction,
21 hurts the Company, and does not recognize the significant efforts that Arizona-American
22 is undertaking to reduce non-account water in its districts.

1 The Commission, in the last Sun City Water District rate case Opinion and Order
2 (Decision 70351) encouraged Arizona-American to take further steps to reduce water
3 loss in its Sun City Water District.:

4 *"IT IS FURTHER ORDERED that if water loss for Arizona-American Water Company's*
5 *Sun City Water District at any time before the next rate case is greater than 10 percent,*
6 *the Arizona-American Water Company shall devise a plan to reduce water loss to less*
7 *than 10 percent, or prepare a report containing a detailed analysis and explanation*
8 *demonstrating why a water loss reduction to 10 percent or less is not feasible or cost*
9 *effective." (Decision 70351, pg 44)*

10 The Commission, in its most recent Opinion and Order (Decision 71410) reiterated this
11 approach in certain other of Arizona-American's service areas:

12 *"IT IS FURTHER ORDERED that Arizona-American Water Company shall, for its*
13 *Mohave Water district and Havasu Water district, reduce its water loss to below 10*
14 *percent by June 30, 2010 or before it files its next rate increase application and/or*
15 *CC&N application and/or financing application, whichever comes first, and shall begin*
16 *water loss monitoring and take action to ensure water loss remains less than 10 percent*
17 *immediately. If the water loss for the twelve month period ending June 30, 2010, is*
18 *greater than 10 percent, the Company shall formulate a plan to reduce water loss to less*
19 *than 10 percent, or prepare a report containing a detailed analysis and explanation*
20 *demonstrating why water loss reduction to 10 percent or less is not feasible or cost*
21 *effective, and shall docket in this case, no later than July 31, 2010, either the plan, the*
22 *report, or notification that its water loss has been reduced below 10 percent." (Decision*
23 *71410, pp 80-81)*

1 My reading of the Commission's Opinion and Orders does not lead me to conclude that
2 for those districts in which water loss exceeds 10%, a reduction of expenses will be
3 imputed. Rather, my reading leads me to conclude that the Company should undertake
4 steps to reduce water loss and/or to prepare a report demonstrating why water loss
5 reduction to 10% or less is not feasible or cost effective. In the case of the Sun City
6 Water District, Arizona-American is taking a number of steps to reduce unaccounted-for
7 water. *These include annual testing and calibration of production meters, change-out of*
8 *customer meters on a 15 year cycle, annual testing of large customer meters, systematic*
9 *roll-out of automatic meter reading devices, leak detection, and other steps.* As of the end
10 of 2009, the unaccounted-for water for the Sun City District has been reduced to 8.85%
11 which demonstrates Arizona-American's commitment to this program. Mr. Becker's
12 proposed imputation of cost reductions in this case is neither helpful nor necessary and
13 should not be adopted by the Commission.

14
15 **V ANNUAL INCENTIVE PLAN FOR ARIZONA-AMERICAN EMPLOYEES AND**
16 **SERVICE COMPANY EMPLOYEES**

17 **Q. HAVE YOU READ THE DIRECT TESTIMONY OF RALPH C. SMITH ON**
18 **BEHALF OF THE RESIDENTIAL UTILITY CONSUMER OFFICE?**

19 **A.** Yes I have.

20 **Q. DO YOU AGREE WITH MR. SMITH'S SUGGESTION AT PAGE 43 OF HIS**
21 **DIRECT TESTIMONY THAT A 50% REDUCTION IN INCENTIVE**
22 **COMPENSATION EXPENSE MIGHT BE APPROPRIATE?**

23 **A.** No, and ultimately, neither does Mr. Smith. In his Direct Testimony, Mr. Smith
24 ultimately suggests a 30% reduction, which is consistent with prior Commission

1 decisions. As I noted in my Direct Testimony, Annual Incentive Plan (AIP) compensation
2 is a part of "total compensation" offered to employees. This amount of total
3 compensation is competitive with other companies and is a combination of key items
4 including base salary, incentive pay, pension, 401k, group insurance and some other
5 lesser benefit items. Adjusting any one of these components would require an offsetting
6 adjustment in another component to maintain the value of the total compensation offered
7 to our employees. This type of incentive compensation would need to be discontinued if
8 the Commission were to deny additional amounts, which would ultimately result in a
9 greater offsetting increase for employee base pay with no performance contingency.

10 **Q. DO YOU AGREE WITH HIS ADJUSTMENT C-11 WHICH RECOMMENDS**
11 **REMOVAL OF AFFILIATE INCENTIVE COMPENSATION EXPENSE?**

12 A. No I do not.

13 **Q. PLEASE EXPLAIN WHY YOU DISAGREE.**

14 A. Mr. Smith provides no justification or even explanation as to why he recommends that
15 the Commission should remove these Annual Incentive Plan (AIP) costs from Arizona-
16 American's expenses. He likewise provides no justification of why 70% of AIP for
17 Arizona-American employees should be allowed in rates; whereas he recommends 0%
18 for Service Company employees participating in the same plan. The Commission has
19 historically included 70% or the non-financial portion of these expenses in rates. Most
20 recently in the Commission's Decision Number 71410, dated December 8, 2009 it stated:

21 *"D. Achievement Incentive Pay (all districts). RUCO proposes disallowance of 30*
22 *percent, or \$5,555, of the Company's \$18,517 Arizona Corporate allocated annual*
23 *incentive pay ("AIP") management fees expenses for the districts in this proceeding. The*
24 *Company states that while it disagrees with the premise that shareholders are the*

1 *primary beneficiaries of additional profit the Company achieves as the result of Arizona-*
2 *American meeting its financial targets, it will not oppose RUCO's proposed adjustment*
3 *in this proceeding. Staff is in agreement with RUCO and the Company that the*
4 *adjustment should be made... The adjustments proposed by RUCO and agreed to by the*
5 *Company and Staff, as set forth above are reasonable and will be adopted." (Decision*
6 *71410 p 35)*

7 Arizona-American is supported by employees who are direct employees of Arizona-
8 American and by other employees who are employees of American Water Works Service
9 Company ("Service Company"). Through the Service Company, Arizona-American is
10 able to take advantage of the economies of scale and degree of expertise housed within
11 the Service Company, both locally and in other locations. For instance, a number of
12 Arizona-based individuals in finance, human resources, legal, rates, engineering, and
13 administration are employees of the Service Company. The Service Company concept
14 has been in place for many years and has been reviewed in previous rate cases at this
15 Commission. The Commission should not treat AIP costs for Service Company
16 employees differently simply because these employees are in a different organizational
17 structure. Interestingly, while Mr. Smith cites an Order of the West Virginia PSC on page
18 29 of his testimony on lead-lag issues, he does not cite from that same Order that the
19 West Virginia Public Service Commission approved the inclusion of AIP costs for
20 Service Company employees:

21 *"The [West Virginia Public Service] Commission determined in the 2003 Rate Case that*
22 *both stockholders and ratepayers benefit from increased productivity and operating*
23 *efficiencies, and allowed recovery of expenses related to the incentive program at*
24 *issue...The Commission rejects the CAD arguments and will allow the inclusion of the*

1 *costs of the AIP in the revenue requirement in this case.” (PSC of West Virginia, Case*
2 *No. 08-0900-W-42T, March 25, 2009, pg 51)*

3 *“Mr. Rubin proposed an adjustment to disallow the annual incentive plan (“AIP”) costs*
4 *applicable to the AWWSC [American Water Works Service Company] ...Mr. Miller stated*
5 *that (i) the same AIP benefits described in the 2003 Rate Case Order apply to the*
6 *compensation of AWWSC employees and (ii) the Commission has never excluded*
7 *AWWSC AIP costs from the Company revenue requirement...The Commission will apply*
8 *the same decision that it made with regard to the AIP for the Company direct employees*
9 *to this issue.” (emphasis added) (PSC of West Virginia, Case No. 08-0900-W-42T, March*
10 *25, 2009, pg 46)*

11 In summary I request that this Commission reject Mr. Smith’s proposal and instead apply
12 the same 70% factor for inclusion of AIP costs for Service Company employees that it
13 has done for direct employees of Arizona-American in previous cases.

14
15 **VI ANTHEM REFUND PAYMENTS**

16 **Q. HAVE YOU READ THE DIRECT TESTIMONY OF DAN L. NEIDLINGER ON**
17 **BEHALF OF THE ANTHEM COMMUNITY COUNCIL?**

18 **A.** Yes I have.

19 **Q. DO YOU AGREE WITH HIS ALTERNATIVE RATEMAKING**
20 **RECOMMENDATION THAT THE COMMISSION PHASE IN THE ANTHEM**
21 **REFUND PAYMENT OVER FIVE YEARS?**

22 **A.** No I do not. Neither Staff nor RUCO made any such proposals.

23 **Q. PLEASE EXPLAIN WHY YOU DISAGREE.**

1 A. As described in my Direct Testimony, the Fourth Amendment to the Agreement for
2 Anthem Water/Wastewater Infrastructure ("Fourth Amendment"), entered into by
3 Arizona-American and Pulte Homes, Inc. ("Pulte"), already provided and continues to
4 provide rate relief for Arizona-American's Anthem customers by permanently reducing
5 the amount of Advances in Aid of Construction ("AIAC") eligible for refund by \$1.5
6 million and deferring the remaining amount of the Pulte AIAC refunds into two interest-
7 free, installment payments - 75% of the refund was due on March 31, 2008, and the
8 remaining 25% is due on March 31, 2010. These rate relief benefits for Anthem
9 customers were achieved after extensive negotiation between Arizona-American and
10 Pulte. One consequence of the Fourth Amendment was that Arizona-American paid Pulte
11 \$20,226,122 in refunds on March 31, 2008 which was well before the end of the Test
12 Year in this case. The Commission regularly recognizes that refunds of AIAC paid within
13 the Test Year be included in ratebase and included in the revenue requirement of the
14 utility. Arizona-American is seeking this treatment in this case. Since March 31, 2008,
15 Arizona-American's shareholder has not received a return on this investment and will not
16 begin to receive a return on the investment until new rates are ordered by the
17 Commission in this case - expected to be in the third quarter of 2010. Shareholders will
18 have foregone a return on a \$20.2 million investment for approximately two-and-one-half
19 years, even under traditional ratemaking practices used by the Commission. Under Mr.
20 Neidlinger's proposal, Arizona-American's shareholder will not receive a full return on
21 its investment until 2015 which is approximately seven years after the investment was
22 made. This is grossly unfair to the shareholder which made the investment and is wholly
23 out of step with the Commission's own traditional ratemaking approach regarding this
24 issue.

25 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY IN THIS CASE?

1 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER AND SUN CITY WATER DISTRICTS

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM / AGUA FRIA WASTEWATER, SUN CITY WASTEWATER AND SUN CITY WEST WASTEWATER DISTRICTS

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
JOSEPH E. GROSS, P.E.
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
March 22, 2010**

**DIRECT TESTIMONY
OF
JOSEPH E. GROSS, P.E.
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2010**

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EXECUTIVE SUMMARY

The Rebuttal testimony of Joseph E. Gross:

- 1) Rebutts RUCO's recommendation to exclude from rate base the replacement of Sun City Well 5.1 which Staff accepted; and
- 2) Accepts Staff's recommendation to exclude a portion of the Verrado WWTP from rate base even though the portion excluded improves reliability.

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I INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE NUMBER.

A. My name is Joseph E. Gross, my business address is 2355 West Pinnacle Peak Road, suite 300, Phoenix, Arizona 85027 and my telephone number is 623-445-2401.

Q. ARE YOU THE SAME JOSEPH E. GROSS THAT SUBMITTED DIRECT TESTIMONY ON BEHALF OF THE COMPANY ON JULY 2, 2009?

A. Yes.

II PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

A. Please refer to the Executive Summary, which precedes my testimony.

III MAJOR UTILITY PROJECTS

Q. HAVE YOU READ MR. RALPH SMITH'S DIRECT TESTIMONY FOR RUCO REGARDING SUN CITY WELL 5.1?

A. Yes.

Q. WHY DID YOU INCLUDE THIS POST TEST YEAR PROJECT IN THIS CASE?

A. Post test year projects have previously been allowed in rate case applications prior to 2009, when they were completed in time for staff to inspect and conclude that the project was in service and used and useful.

Q. WHY DIDN'T YOU COMPLETE THE PROJECT WITHIN THE TEST YEAR?

A. The water infrastructure in Sun City is deteriorating rapidly, since most of the wells and transmission mains are 30 – 50 years old and near the end of their useful lives. A number

1 of the 20 wells in Sun City are normally out of service for repairs; and the Company has
2 serious concerns about the adequacy of water supply for our customers. Therefore, the
3 company has examined the condition of each well and embarked on a replacement
4 program for those wells no longer capable of adequate production. This rate case
5 includes three such wells. The company has programmed replacement or rehabilitation
6 of one well per year in its current five-year capital plan. Although it would be preferable
7 to improve the water supply at an accelerated rate, we are restricted by available
8 resources and the desire to avoid an even higher level of rate increases for our customers.

9 **Q WAS SUN CITY WELL 5.1 COMPLETED IN TIME FOR STAFF INSPECTION?**

10 **A.** Yes. It was completed in May 2009, which allowed Staff's Ms. Dorothy Hains adequate
11 time to inspect the well and determine that it was in service and used and useful – which
12 she did.

13 **Q. DOES THIS PROJECT MEET THE CRITERIA FOR WARRANTING RATE**
14 **BASE RECOGNITION OF POST-TEST YEAR PLANT, AS OUTLINED IN MR.**
15 **SMITH'S TESTIMONY?**

16 **A.** Absolutely. Sun City Well 5.1 meets each of the more restrictive conditions stated by
17 Mr. Ralph Smith as being reflected in Commission Decision No. 71410:

18 a. The project cost of \$1.587 million is significant and substantial and represents
19 5.6% of Sun City's rate base.

20 b. This project is revenue neutral.

21 c. This project was prudent and necessary to provide adequate water supply to our
22 customers during the summer peak demand period in 2009; and reflected
23 appropriate, efficient, effective, and timely decision-making.

1 Q. ARE YOU FAMILIAR WITH STAFF'S RECOMMENDATIONS CONCERNING
2 THE VERRADO WASTEWATER TREATMENT PLANT EXPANSION
3 PROJECT?

4 A. Yes.

5 Q. DO YOU CONCUR WITH STAFF'S RECOMMENDATIONS CONCERNING
6 THAT PROJECT?

7 A. I accept Staff's judgment on this project. However, I would like to state that the second
8 clarifier for this plant was installed to provide reliable wastewater treatment capability,
9 should the initial clarifier be out of service for maintenance or repairs.

10 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

11 A. Yes.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA -AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER DISTRICT, AND SUN CITY WATER DISTRICT

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM / AGUA FRIA WASTEWATER DISTRICT, SUN CITY WASTEWATER DISTRICT, AND SUN CITY WEST WASTEWATER DISTRICT

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
LINDA J. GUTOWSKI
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DATED MARCH 22, 2010**

**REBUTTAL TESTIMONY
OF
LINDA J. GUTOWSKI
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DATED MARCH 22, 2010**

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1 **EXECUTIVE SUMMARY**

2
3 Linda J. Gutowski responds to Staff and RUCO testimony concerning certain rate-base issues
4 and then discusses revenue, some operating and maintenance expenses, depreciation expense,
5 and conforming changes for Property Taxes, Interest Synchronization, and Income Taxes.

6 **RATE BASE – UTILITY PLANT IN SERVICE**

7 The Company rejects RUCO's position to not include Well 5.1 in the Sun City Water District in
8 rate.

9 The Company accepts Staff's revision to the allocation of the North West Valley Treatment
10 Plant ("NWVTP") from 32% down to 28% for Anthem / Agua Fria Wastewater District and
11 from 68% up to 72% for Sun City West Wastewater District.

12 **RATE BASE – CASH WORKING CAPITAL**

13
14 The Company accepts Staff's adjustment to leave out Chemical Expense for a downward
15 adjustment for the combined districts of \$71,339. The Company accepts Staff's adjustment to
16 remove Bad Debt Expense from Customer Accounting Expense for a downward adjustment for
17 the combined districts of \$26,048.

18
19 After accepting some Staff adjustments, the Company corrects the payment lag for Management
20 Fees from 14.77 days to a lead of 11.25 days.

21
22 The Company rejects RUCO's Cash Working Capital positions.

23 **RATE BASE – DEFERRED INCOME TAXES**

24
25 The Company accepts Staff's downward adjustment for the combined districts of \$173,965 to
26 agree with audited financials.

27 **REVENUE**

28
29 The Company makes several very minor adjustments due to errors found in linking files.

30 **OPERATING EXPENSES - CUSTOMER ACCOUNTING**

31
32 The Company accepts Staff's reduction to Bad Debt Expense but changes the amount to a
33 decrease of \$3,827 for the combined districts by comparing Net Charge Offs in the test year to
34 Staff's revised Net Charge Offs.

35 **OPERATING EXPENSE – MISCELLANEOUS – WATER TESTING**

36
37 The Company accepts Staff's adjustments for Water Testing Expenses.
38

39 **OPERATING EXPENSE – MAINTENANCE – TANK MAINTENANCE**

40
41 The Company rejects RUCO's disallowance of a Tank Maintenance Reserve.
42

1 **OPERATING EXPENSE – DEPRECIATION**

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3 The Company disagrees with Staff for the Corporate Division depreciation rates. New
4 Corporate Division depreciation rates were effective December 1, 2009 as per Decision No.
5 71410.
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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, ADDRESS, AND TELEPHONE NUMBER.

A. My name is Linda J. Gutowski. My business address is 2355 W. Pinnacle Peak Road, Suite 300, Phoenix, AZ 85027, and my telephone number is 623-445-2496.

Q. ARE YOU THE SAME LINDA J. GUTOWSKI WHO PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THIS DOCKET ON JULY 2, 2009?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will respond to Staff and RUCO testimony concerning adjustments to the Company's proposed rate-base. Please note that I have organized my rebuttal testimony to address each of the rate base topics separately by district (Sections II-V). Then, I discuss revenue (Section VI), a few selected operations expenses (Sections VII-IX), and depreciation expense (Section X).

II. RATE BASE – UTILITY PLANT IN SERVICE

A. ANTHEM WATER DISTRICT

Q. DO THE PARTIES AGREE ON ANTHEM WATER'S RATE BASE?

A. Yes. Staff, RUCO, and the Company all agree on the value of Anthem Water District's Utility Plant in Service at \$90,684,602.

B. SUN CITY WATER DISTRICT

Q. ARE THERE ANY PLANT-IN-SERVICE ISSUES FOR THE SUN CITY WATER DISTRICT?

A. Yes. There are two issues addressed in the rebuttal testimony of Company witnesses, Mr. Broderick, Mr. Gross and Ms. Murrey. Ms. Murrey discusses Staff's removal of

1 \$149,498 from Plant in Service for the value of "Youngtown Plant". Mr. Broderick and
2 Mr. Gross discuss RUCO's recommendation to disallow Well 5.1 in Sun City Water
3 district.

4 **Q. WHAT IS THE REQUEST STAFF'S MR. BECKER MAKES ON PAGE 38 OF**
5 **HIS DIRECT TESTIMONY?**

6 A. Mr. Becker asks that the Company address the addition of Plant 9 and Wells 9.2 and 9.3
7 in the Tierra Del Rio section of Sun City Water. At December 2008, a Journal Entry put
8 the plant on the books since it went operational that month. For Plant 9, plant accounts
9 304100-Structures & Improvements-Source of Supply and 311200-Pump Equipment
10 Electric were each debited for \$3,038,258.32 and an off-setting entry was made to
11 Contributions for \$6,076,516.60. For Well 9.2, plant account 307000-Wells & Springs
12 was debited for \$1,303,213.11 and an off-setting entry was made to Contributions for the
13 same amount. For Well 9.3, plant account 307000-Wells & Springs was debited for
14 \$1,409,416.57 with an off-setting entry to Contributions for the same amount.

15 **Q. WERE THERE ADDITIONAL COSTS RECORDED AFTER DECEMBER 31,**
16 **2008?**

17 A. Yes. The costs for Company-related labor, overheads, and expenses for Materials and
18 Supplies have been included. Since the additional costs are all Company-related there is
19 not a corresponding entry to contributions. The engineering "As Built" which
20 summarizes the accounting by NARUC plant account number (300 accounts) has been
21 completed. The journal entry that was recorded in December 2008 was an estimate of the
22 charges to the individual account numbers. The "As Built" adjusts the estimate recorded
23 to actual and is the final distribution of all charges to a project work order. I am
24 attaching Rebuttal Exhibit LJG-1R which details the segregation of the final costs to the
25 300 accounts. The difference between the estimate and actual for Plant 9 is an additional

1 \$256,402. For Well 9.2 the final distribution adds \$87,106 and for Well 9.3 results in
2 additional costs of \$22,070. These additions have not been included in the Company's
3 rebuttal schedules.

4 **Q. WHAT IS THE VALUE OF SUN CITY WATER DISTRICT'S UTILITY PLANT**
5 **IN SERVICE?**

6 A. The Company's rebuttal amount is \$63,466,921.

7 **C. ANTHEM / AGUA FRIA WASTEWATER DISTRICT**

8 **Q. HAVE YOU REVIEWED STAFF'S ADJUSTMENT GTM-4 RELATING TO THE**
9 **ALLOCATION OF THE NORTHWEST VALLEY TREATMENT PLANT**
10 **("NWVTP") TO ANTHEM / AGUA FRIA WASTEWATER DISTRICT?**

11 A. Yes, I have.

12 **Q. WHAT IS THE COMPANY'S RESPONSE TO STAFF'S RECOMMENDATION**
13 **TO REVISE THE ALLOCATION OF THIS PLANT BETWEEN ANTHEM /**
14 **AGUA FRIA WASTEWATER DISTRICT AND SUN CITY WEST**
15 **WASTEWATER DISTRICT?**

16 A. The Company accepts Staff's proposed allocation of the NWVTP reflected in adjustment
17 GTM-4 NWVTF ADJ #1. This adjustment changes the capital allocation between
18 Anthem / Agua Fria Wastewater and Sun City West Wastewater by decreasing the
19 Anthem / Agua Fria Wastewater district's allocation percentage of plant from 32% to
20 28%. The effect of Staff's adjustment accepted by the Company is a decrease to Utility
21 Plant in Service of \$1,039,823.

22 **Q. WHAT IS THE REVISED ANTHEM / AGUA FRIA WASTEWATER UTILITY**
23 **PLANT IN SERVICE?**

1 A. The Anthem / Agua Fria Wastewater district's Utility Plant in Service incorporating all
2 adjustments is \$128,430,090.

3 **D. SUN CITY WEST WASTEWATER DISTRICT**

4 **Q. HAVE YOU REVIEWED STAFF'S ADJUSTMENT GTM-4 RELATING TO THE**
5 **ALLOCATION OF THE NORTHWEST VALLEY TREATMENT PLANT**
6 **("NWVTP") TO SUN CITY WEST WASTEWATER DISTRICT?**

7 A. Yes, I have.

8 **Q. WHAT IS THE COMPANY'S RESPONSE TO STAFF'S RECOMMENDATION**
9 **TO REVISE THE ALLOCATION OF THIS PLANT BETWEEN SUN CITY**
10 **WEST WASTEWATER DISTRICT AND ANTHEM / AGUA FRIA**
11 **WASTEWATER DISTRICT?**

12 A. As discussed above, the Company accepts Staff's proposed allocation of the NWVTP
13 reflected in adjustment GTM-4 ADJ #1 for the Anthem / Agua Fria Wastewater district
14 and Sun City West Wastewater district. Rate Base Adjustment LJG-1R reflects this
15 reallocation of the NWVTP which increases the allocation percentage to Sun City West
16 Wastewater District from 68% to 72%. This effect of the change is an increase of
17 \$1,039,823 to Utility Plant in Service.

18
19 **Q. WHAT IS THE COMPANY'S REVISED UTILITY PLANT IN SERVICE FOR**
20 **SUN CITY WEST WASTEWATER?**

21 A. The Company's revised Utility Plant in Service for the Sun City West Wastewater district
22 incorporating the Rate Base adjustment LJG-1R and an adjustment proposed by Ms.
23 Sandra Murrey is \$36,983,761.

1 **E. SUN CITY WASTEWATER DISTRICT**

2 **Q. DO YOU HAVE ANY CHANGES TO SUN CITY WASTEWATER DISTRICT**
3 **UTILITY PLANT IN SERVICE?**

4 A. No, however, Company witness Ms. Sandra Murrey is proposing an adjustment. The
5 Company's revised Utility Plant in Service for the Sun City Wastewater district is
6 \$24,457,095 which agrees with Staff's recommendation shown on Staff Schedule GTM-
7 4.

8 **III. RATE BASE – ACCUMULATED DEPRECIATION**

9 **A. ANTHEM WATER DISTRICT**

10 **Q. DOES ACCUMULATED DEPRECIATION IN THE ANTHEM WATER**
11 **DISTRICT NEED ANY ADJUSTMENT?**

12 A. No. All parties agree on \$12,789,099.

13 **B. SUN CITY WATER DISTRICT**

14 **Q. WHAT ADJUSTMENT DID STAFF MAKE TO THE ACCUMULATED**
15 **DEPRECIATION RESERVE FOR SUN CITY WATER DISTRICT?**

16 A. Ms. Murrey will discuss Mr. Becker's GWB-5 Rate Base Adjustment #1 which decreases
17 the accumulated depreciation by \$22,008 related to the Youngtown Plant.

18 **Q. WHAT ABOUT RUCO'S DOWNWARD ADJUSTMENT OF \$463,964 TO NOT**
19 **RETIRE WELL 5.1?**

20 A. The Company disagrees with RUCO's adjustment on Schedule B (SC) in RCS-2 as it
21 reverses the retirement of Well 5.1 and is related to RUCO's adjustment to exclude the
22 post test year replacement of Well 5.1 from rate base. The old Well 5.1 was taken out of
23 service and the new Well 5.1 was built on the same site. This adjustment should be
24 rejected.

1 **Q. WHAT IS THE TOTAL SUN CITY WATER DISTRICT'S ACCUMULATED**
2 **DEPRECIATION?**

3 A. The total accumulated depreciation for Sun City Water district is \$18,951,889 which
4 agrees with the Staff's recommended value.

5 **C. ANTHEM / AGUA FRIA WASTEWATER DISTRICT**

6 **Q. WHAT ADJUSTMENTS ARE YOU ACCEPTING FOR ANTHEM / AGUA FRIA**
7 **WASTEWATER DISTRICT?**

8 A. Rate Base Adjustment LJG-4R accepts Staff's downward adjustment of \$630,244 for the
9 decrease in the NWVTP percentage for Anthem / Agua Fria, from 32% to 28%
10 summarized on Staff's GTM-4, Adjustment #6.

11 **Q. WHAT IS THE REVISED ANTHEM / AGUA FRIA WASTEWATER DISTRICT**
12 **ACCUMULATED DEPRECIATION?**

13 A. The revised total is \$22,154,486, including LJG-4R and Sandra Murrey's adjustments.

14 **D. SUN CITY WEST WASTEWATER DISTRICT**

15 **Q. HAS ARIZONA-AMERICAN MADE ANY ADJUSTMENTS TO**
16 **ACCUMULATED DEPRECIATION FOR SUN CITY WEST WASTEWATER**
17 **DISTRICT?**

18 A. Yes. LJG-4R makes the conforming change to Accumulated Depreciation shown on
19 GTM-4 Adjustment #5 for the change in the capital allocation percentage for the
20 NWVTP. The allocation percentage increased from 68% to 72% under Staff's proposal
21 and results in an adjustment that increases accumulated depreciation by \$630,244.

22 **Q. WHAT IS THE TOTAL ACCUMULATED DEPRECIATION FOR SUN CITY**
23 **WEST WASTEWATER DISTRICT?**

24 A. The total is \$19,813,983, which agrees to Staff.

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E. SUN CITY WASTEWATER DISTRICT

Q. DOES ACCUMULATED DEPRECIATION IN THE SUN CITY WASTEWATER DISTRICT NEED ANY ADJUSTMENT?

A. No. All parties agree on \$10,761,769.

IV. RATE BASE – DEFERRED INCOME TAXES

A. ALL DISTRICTS

Q. STAFF MAKES ADJUSTMENTS IN EACH DISTRICT TO DECREASE DEFERRED INCOME TAXES FOR A TOTAL OF \$173,965. DO YOU AGREE?

A. Yes. The Company agrees with the Staff Adjustments GWB-8 RB No. 3 for Anthem Water district of a downward adjustment of \$18,580 as accepted in LJG-2R; GWB-6 RB No. 2 for Sun City Water district of a downward adjustment of \$49,151 as accepted in LJG-1R; GTM-8 RB No. 4 for Anthem / Agua Fria Wastewater district of a downward adjustment of \$27,084 as accepted in LJG-3R; GTM-7 RB No. 3 for Sun City Wastewater district of a downward adjustment of \$47,073 as accepted in LJG-2R; and GTM-7 RB No. 3 for Sun City West Wastewater district of a downward adjustment of \$32,077 as accepted in LJG-3R. These adjustments are on each district's Schedule B-2 Rebuttal.

V. RATE BASE – CASH WORKING CAPITAL

A. ALL DISTRICTS

Q. WHAT ADJUSTMENTS DID STAFF MAKE TO CASH WORKING CAPITAL?

A. Staff made 3 main adjustments in every district. First, Staff removed Chemical Expense from the calculation of cash working capital. The Company agrees with this adjustment as Chemical Inventory is included in the 13 month average of Materials and Supplies Inventories in the calculation of the Working Capital Allowance on Schedule B-5.

1 Next, Staff removed Bad Debt expense in every district. This results in an adjustment to
2 the expense lag days for Customer Accounting expense from 10.09 to 20.31. The
3 Company agrees with this adjustment for the expense side of the Cash Working Capital
4 calculation.

5 Third, Staff adjusted the expenses in their cash working capital calculation to be
6 consistent with their recommendations for adjusted test year expense levels. RUCO
7 made the same adjustments to the Company's direct case to reflect their recommended
8 expense levels in their cash working capital calculation. The Company agrees with the
9 use of the recommended adjusted test year expense levels and used the same procedure in
10 our direct case and this rebuttal case presentation. We are making the conforming
11 changes to Cash Working Capital that agrees to our rebuttal positions on expenses.

12 **Q. WHAT FURTHER ADJUSTMENTS DID RUCO MAKE TO CASH WORKING**
13 **CAPITAL?**

14 A. First, RUCO suggested that the Collection Lag portion of the Revenue Lag be changed
15 from actual to a theoretical 20 days and that the Revenue Lag should be a theoretical 39
16 days as that is what it is for other electric and gas utilities. The Company disagrees. The
17 Commission has accepted the Company's calculation of Revenue Lag in several prior
18 rate cases without question. In our most recent case, in which 7 other Arizona-American
19 water and wastewater districts were examined, the calculation of the Revenue Lag
20 resulted in a range from 46 to 50 days and a Collection Lag of 28.3 days. As shown on
21 the work papers submitted in this case and in response to a RUCO data request seeking
22 billing and collection data for 2009, the number of charge offs for these 5 districts has
23 changed from 1,312 for 2006 to 1,446 for 2007 to 1,623 for 2008 to 1,830 for 2009. This
24 is almost a 40% increase during the 4 year period which is largely due to the economic
25 climate in Arizona. I do not believe that Arizona is through the foreclosure problem so I

1 don't see the number of charge offs coming down. These charge offs have a definite
2 effect on the revenue the Company can collect to use for cash working capital. To reduce
3 the collection lag in the current situation would be wrong.

4 **Q. HOW IS THE COMPANY'S COLLECTION LAG CALCULATED?**

5 A. The Company's collection lag is calculated the same way it always has been. Accounts
6 Receivable Balances every day divided by 365 days to calculate Average Daily Accounts
7 Receivable. This is divided by the calculation of Average Daily Revenue equal to Total
8 Company Revenue divided by 365 days. This is the standard calculation and ours comes
9 to 26.1 Collection Lag Days.

10 The Company has a late payment charge of 1-1/2% which takes at least some of the
11 burden of delinquency off the customers who pay in a timely fashion. But the late
12 payment penalty was never designed to be a money maker, or to compensate the
13 Company for the delayed receipt of revenue. To pretend that it replaces a substantial
14 portion of our cash working capital requirements serves only to understate the
15 Company's true cost of service.

16 **Q. WHAT DOES RUCO SAY ABOUT THE COMPANY'S BILLING LAG DAYS?**

17 A. Again, RUCO wishes to use someone else's Billing Lags. Our calculation is based on
18 looking at each route for each month in every district in the case. We use the actual
19 billing date minus the current read date to derive the Billing Lag days. To say that we
20 "ought" to have a lower billing lag because there are computers has no basis. The Billing
21 Lag the Company uses is calculated the same way it always has been – bill date minus
22 read date.

23 **Q. PLEASE TALK ABOUT YOUR REBUTTAL POSITION FOR LAG DAYS FOR**
24 **MANAGEMENT FEES.**

1 A. In date request number RUCO 2-75, RUCO requested information pertaining to the
2 payment of Management Fees. In responding to that data request, I discovered that the
3 majority of the payment was, in fact, in advance of the services to be used that month. In
4 addition, there is a monthly true-up that compares actual expenses for the prior month to
5 the payment (estimated) made the prior month. The true-up portion can be positive or
6 negative depending on the Advance from the beginning of the month and the actual as
7 billed for the month. Incorporating this new information provided in response to data
8 request number RUCO 2-75 in the cash working capital calculation changes the lag days
9 from 14.77 to lead days of 11.25 since the majority of the Service Company bill is paid in
10 Advance.

11 **Q. WHY DO ALL THE OPERATING COMPANIES PAY THE SERVICE**
12 **COMPANY BILL IN ADVANCE?**

13 A. All the operating companies signed a Service Company Agreement in 1989. Article IV.
14 BILLING PROCEDURES, Section 4.1 states "As soon as practicable after the last day of
15 each month, Service Company shall render a bill to Water Company for all amounts due
16 from Water Company for services and expenses for such month *plus an amount equal to*
17 *the estimated cost of such services and expenses for the current month* . . . All amounts
18 so billed shall reflect the credit for payments made on the estimated portion of the prior
19 bill and shall be paid by Water Company within a reasonable time after receipt of the bill
20 therefore." (emphasis added) The Service Company has no water or sewer customers. It
21 is also an at cost affiliate. Therefore, implementation of the practical effect of Mr.
22 Smith's theoretical payment lag would decrease Arizona American's working capital and
23 increase the Service Company's cost of working capital. Those additional costs would
24 then be passed back through the Service Company bill to Arizona American in the form
25 of higher Service Company costs. Given the unique nature of the business relationship

1 between Arizona American and the Service Company, the terms of the agreement are
2 reasonable.

3 **Q. SHOULD THE ACTUAL PAYMENT METHOD BE USED IN THIS CASE?**

4 A. Yes. It is Arizona American's actual lead days for payment of Management Fees, not a
5 theoretical number of days that matches our payment of electric bills, for instance. This
6 is the same kind of lead days used in the 2008 Working Capital calculation that was
7 approved as part of Decision 71410.

8 **Q. HOW MUCH OF A CHANGE TO CASH WORKING CAPITAL DOES YOUR
9 CHANGE TO USING ACTUAL DAYS MAKE?**

10 A. It adds \$421,977 to the calculation. Multiplying that by 7.2% return and by 1.65 Gross
11 Revenue Conversion Factor equates to an increase of approximately \$50,000 on Revenue
12 of \$50,000,000, or 0.1%.

13 **VI. OPERATING REVENUES**

14 **A. ANTHEM WATER DISTRICT**

15 **Q. WHAT IS THE ONLY DIFFERENCE AMONG THE PARTIES FOR TEST
16 YEAR ADJUSTED REVENUES?**

17 A. RUCO made an adjustment to the Anthem Water District for an electronic error in the
18 calculation of Customer Annualization. Links were broken and the Commercial class
19 Basic Service Charges is missing from my calculation. The Company accepts this
20 correction and will increase the Customer Annualization pro forma adjustment by \$9,458
21 in Income Statement adjustment LJG-1R.

22 **Q. DOES THIS AGREE TO THE RUCO ADJUSTMENT?**

23 A. No. RUCO decreased the Customer Annualization pro forma by \$9,458 instead of
24 increasing the test year revenue by that amount.

1 **Q. DO YOU HAVE SOME VERY MINOR ADJUSTMENTS TO MAKE TO OTHER**
2 **DISTRICTS?**

3 A. Yes.

4 **B. ANTHEM / AGUA FRIA WASTEWATER DISTRICT**

5 **Q. WHAT MINOR ADJUSTMENT NEEDS TO BE MADE?**

6 A. In Income Statement Adjustment LJG-4R for Schedule C-2 Rebuttal, I have changed the
7 "Remove Billings for Other Districts" amount for a broken link. The change decreases
8 Test Year Revenue by \$121.

9 **C. SUN CITY WASTEWATER DISTRICT**

10 **Q. WHAT MINOR ADJUSTMENT NEEDS TO BE MADE?**

11 A. In Income Statement Adjustment LJG-1R for Schedule C-2 Rebuttal, I have changed the
12 Annualized Rate Increase Adjustments for Rate Schedule A2S1N from (\$2,997.34) to
13 (\$3,642.70), a decrease to Test Year Revenue of \$645.

14 **VII. OPERATING EXPENSES – CUSTOMER ACCOUNTING**

15 **A. ALL DISTRICTS**

16 **Q. HAS STAFF MADE A SIMILAR ADJUSTMENT TO BAD DEBT EXPENSE**
17 **WITHIN CUSTOMER ACCOUNTING EXPENSE IN EVERY DISTRICT?**

18 A. Yes. They have taken Test Year Revenues times a 3 year average percentage of Net
19 Charge Offs of a percent of Revenue in each individual district.

20 **Q. WHAT DID THE COMPANY DO?**

21 A. The Uncollectible Provision is applied to the Company as a whole. Because it goes into
22 the Corporate Uncollectible expense account, the charge offs go against it in the same
23 Corporate account, even though one can query the billing system to see the amount of net
24 charge offs in each district. This total Corporate Uncollectible expense is spread to the

1 districts in the case based on the 4-Factor allocation methodology. Therefore, the offset
2 to the provision as well as the actual charge offs are in a corporate account and are spread
3 to the districts using the 4-Factor allocation methodology.

4 **Q. DO YOU ACCEPT THE METHOD STAFF USED TO DEVELOP A TEST YEAR**
5 **“NORMALIZED” BAD DEBT EXPENSE?**

6 A. Yes, but Staff compared the 3 year average of net charge offs to the total expense of the
7 provision netted with the charge offs. This is comparing apples and oranges. If one
8 compared Staff's 3 year average to what was spread to the water and wastewater districts
9 in this proceeding using the 4-Factor for net charge offs only, the amounts would be as
10 follows.

District	4-Factor %	Original Company Amount	Revised Pro Forma Amount	Company Adj #	Adjustment
Anthem W	9.36%	\$18,927	\$33,904	LJG-3R	(\$14,977)
Sun City W	12.2%	\$24,670	\$13,830	LJG-1R	\$10,840
A / AF WW	12.35%	\$24,974	\$43,651	LJG-4R	(\$18,677)
Sun City WW	7.54%	\$15,247	\$7,558	LJG-3R	\$7,689
Sun City West WW	6.38%	\$12,901	\$1,602	LJG-2R	\$11,299
Total		\$96,719	\$100,546		\$3,827

11 This is the amount I make in various adjustments on Schedule C-2 Rebuttal rather than
12 accepting Staff's combined adjustment of (\$259,309).

13 **VIII. OPERATING EXPENSES – MISCELLANEOUS – WATER TESTING**

14 **A. ANTHEM WATER DISTRICT**

15 **Q. WHAT IS THE AMOUNT THAT THE COMPANY, ACCOUNTING STAFF, AND**
16 **ENGINEERING STAFF HAVE AS THE PRO FORMA AMOUNT OF WATER**
17 **TESTING IN ANTHEM WATER?**

18 A. We all agree on \$4,469. Test Year Expense was \$12,173 and the pro forma decrease is
19 \$7,704. No adjustment is needed.

1 **B. SUN CITY WATER DISTRICT**

2 **Q. WHAT IS THE AMOUNT FOR SUN CITY WATER DISTRICT FOR WATER**
3 **TESTING?**

4 A. The Company requested a pro forma amount of \$29,167 over the booked amount of
5 \$15,865. In response to Staff Data Request, the Company revised their estimate to
6 \$6,172. Staff Engineering determined the pro forma amount should be \$7,479. Staff
7 Accounting on Schedule GWB-15, Adjustment #4 used \$3,787 and subtracted the
8 Anthem Water booked amount of \$12,173 in error for a downward pro forma adjustment
9 of \$8,386.

10 **Q. IN YOUR OPINION, WHAT ARE THE CORRECT AMOUNTS FOR SUN CITY**
11 **WATER DISTRICT WATER TESTING EXPENSE?**

12 A. The Company will accept Staff's revision to Data Request 12.1 as explained on Hains'
13 Table 5, page 7 with a cost of \$7,479. The Company pro forma amount as filed was
14 \$29,167. A downward adjustment is needed in the amount of \$21,688 as shown on LJC-
15 2R.

16 **C. ANTHEM / AGUA FRIA WASTEWATER DISTRICT**

17 **Q. WHAT ARE THE AMOUNTS FOR ANTHEM / AGUA FRIA WASTEWATER**
18 **DISTRICT'S WATER TESTING COSTS?**

19 A. Staff shows a total of \$80,596 which represents \$62,642 for Anthem Wastewater and
20 \$17,954 for Agua Fria Wastewater Verrado and Russell Ranch plants. What is missing is
21 28% of the NWVTP's water testing costs, which is equal to \$3,695 for a combined total
22 of \$84,291. The adjustment needed is an increase in Water Testing Expense from what
23 the Company originally filed of \$21,478 as shown on Adjustment LJC-3R.

24 **D. SUN CITY WASTEWATER DISTRICT**

1 **Q. ARE THERE ANY TESTING COSTS IN A DISTRICT WITHOUT A**
2 **TREATMENT PLANT?**

3 A. No. The Company has the correct amount and Staff accepted it. Pro forma amount of \$0
4 less the spread of Corporate of \$9,808 gives a downward adjustment of \$9,808.

5 **E. SUN CITY WEST WASTEWATER DISTRICT**

6 **Q. WHAT SHOULD THE COST FOR TESTING BE IN SUN CITY WEST**
7 **WASTEWATER?**

8 A. After the spread of 68% of the NWVTP, the Company showed booked amount of \$8,300
9 and a pro forma amount of \$10,222. In response to Staff Data Request 9.6, the revised
10 amount for the NWVTP is \$13,196. GTM-15 Adjustment #4 shows \$13,196 before
11 splitting NWVTP. The Company accepts the Staff amount but reduces it to 72%, or
12 \$9,501. I made a downward adjustment, LIG-3R, of \$721.

1 **IX. TANK MAINTENANCE**

2 **A. SUN CITY WATER DISTRICT**

3 **Q. PLEASE DISCUSS THE COMPANY'S REQUEST FOR TANK MAINTENANCE**
4 **COSTS AND WHAT IS THE CURRENT SITUATION?**

5 A. Currently, we are allowed to defer tank maintenance costs for Sun City Water district in a
6 Regulatory Asset account. In each rate case for Sun City Water district, we request
7 amortization of the balance in the account. Effective April of 2008, we were allowed to
8 amortize the authorized balance of \$109,338 over 4 years. In this case, the Company has
9 requested a Tank Maintenance Reserve based on painting the 14 older tanks in Sun City
10 over a 14 year period. The estimated costs are over \$5 million dollars and would require
11 an additional \$445,000 in operating expenses each year.

12 **Q. WHAT ARE THE POSITIONS OF THE PARTIES?**

13 A. Staff was silent in its testimony but did not reverse the Company's \$445,000 pro forma in
14 its revenue requirement. RUCO recommended denial of the Reserve. The Company
15 continues to believe that the most effective way to cause timely tank maintenance is for
16 the Commission to approve the tank reserve. Otherwise, necessary Sun City tank
17 maintenance competes at this time with very scarce capital funds. While the existence of
18 a tank painting deferral gives a slight edge to tank maintenance, the Company still must
19 come up with the necessary funds until the deferred costs can be included in rates. As
20 Mr. Broderick explains, the Company's short-term debt is already too high.

21 **X. DEPRECIATION EXPENSE**

22 **Q. WHY IS THE ACCURACY AND CONSISTENCY OF DEPRECIATION RATES**
23 **MORE IMPORTANT TO THE COMPANY NOW?**

24 A. Since the Company became publicly traded on the New York Stock Exchange, there are
25 certain Sarbanes-Oxley Requirements ("SOX"). One of those requirements is a quarterly

1 review of depreciation rates in the accounting system compared to those allowed by the
2 Commission. Another requirement is to submit a depreciation rate for any utility plant
3 account (NARUC 300 accounts) with a balance but no depreciation rate (i.e. 0%). This
4 prevents new accounts from sitting on the books with no depreciation expense until we
5 can get authorization for new rates. If we don't approve the rates quarterly, or if we let
6 plant balances go without depreciating them, we fail an internal SOX control.

7 **A. ANTHEM WATER DISTRICT**

8 **Q. WHAT CHANGES TO DEPRECIATION RATES DOES THE STAFF SUGGEST**
9 **FOR ANTHEM WATER DISTRICT?**

10 A. Staff suggests, and the Company accepts, a change to account 304600-Structures &
11 Improvements Offices to 1.67%; a new rate for account 308000-Infiltration Galleries &
12 Tunnels of 2%; a change for account 331001-Transmission Distribution Mains Not
13 Classified by Size to 1.53% (to match the rate for other Mains accounts); and a change
14 for account 341300-Transportation Equipment Autos to 20%.

15 **B. SUN CITY WATER DISTRICT**

16 **Q. WHAT CHANGES TO DEPRECIATION RATES DOES THE STAFF SUGGEST**
17 **FOR SUN CITY WATER DISTRICT?**

18 A. Staff's changes depreciation rates for account 303300-Land & Land Rights Pumping,
19 303500-Land & Land Rights Transmission Distribution, and 303600-Land & Land
20 Rights Administrative General which are all for Land and Land Rights as shown on Staff
21 Schedule GWB-16. These accounts are not usually depreciable. The Staff Engineering
22 report shows the Staff recommendation at 0%, and the Company agrees with the Staff
23 Engineer's recommendations.

24 **C. ANTHEM / AGUA FRIA WASTEWATER DISTRICT**

1 **Q. WHAT CHANGES TO DEPRECIATION RATES DOES THE STAFF SUGGEST**
2 **FOR ANTHEM / AGUA FRIA WASTEWATER DISTRICT?**

3 A. The Company accepts Staff's changes to depreciation rates for accounts 354500-
4 Structures & Improvements General Plant to 1.67%, account 355500-Power Generation
5 Equipment to 4.42%, and account 370000-Receiving Wells to 3.3%. We disagree with
6 Staff Engineer changing the depreciation rates for accounts 380625-TD Equipment
7 General Treatment and 380650-TD Equipment Influent Lift Station from 8.4% which
8 was approved in Decision 70372 as of June 1, 2008, the middle of the test year,
9 downward to 5%. In general, we oppose changing rates back and forth with no study
10 performed. We accept Staff's new depreciation rate for account 398000-Other Tangible
11 Plant of 10.3%.

12 **D. SUN CITY WASTEWATER DISTRICT**

13 **Q. WHAT CORRECTION WOULD YOU MAKE TO STAFF'S SCHEDULE GTM-**
14 **14?**

15 A. The Company would correct the schedule GTM-14 for account 354500-Structures &
16 Improvements General Plant from the depreciation rate of 1.67% to 2%, which is used in
17 the Staff Engineering report.

18 **E. SUN CITY WEST WASTEWATER DISTRICT**

19 **Q. WHAT CHANGES TO DEPRECIATION RATES DOES THE STAFF SUGGEST**
20 **FOR SUN CITY WEST WASTEWATER DISTRICT?**

21 A. The Company accepts Staff's depreciation rate for account 389100 of 4.98%. Now all
22 the sewer districts will have the same rate for Other Plant and Miscellaneous Equipment.
23 We reject Staff Engineer's change for accounts 390000 Office Furniture and Equipment
24 from 4.59% to 4.98% for Sun City West Wastewater only. The other sewer districts use
25 4.59% and Sun City Water and Sun City Wastewater use 4.59% for this account. I

1 realize this is a small change, but the Company is trying to get the depreciation rates for
2 similar type accounts to be the same in each district, unless there is some distinguishing
3 reason to be different.

4 **F. NORTHWEST VALLEY TREATMENT PLANT (NWVTP)**

5 **Q. ARE THERE CHANGES TO BE ACCEPTED FOR NWVTP DEPRECIATION**
6 **RATES?**

7 A. Yes. The Company would like to thank Staff for making the rates in the NWVTP agree
8 to the rates in the Sun City West Wastewater District, where the plant is physically
9 located. It requires a lot of coordination, and we appreciate the effort. The Company
10 agrees to the Staff's changes in depreciation rates for account 371100-Pumping
11 Equipment Electric to 10%, account 390000-Office Furniture & Equipment to 4.59%,
12 account 390200-Computers & Peripheral to 25%, and to 391000-Transportation
13 Equipment to 20%. We believe there is a typographical error on Staff's schedule GTM-
14 16 for account 393000-Tools Shop & Garage Equipment. The rate should be 4.47%
15 rather than 4.74% to agree to Staff Engineer's recommendations.

16 **G CORPORATE DIVISION**

17 **Q. WHAT IS THE COMPANY'S OBJECTION TO THE CORPORATE**
18 **DEPRECIATION RATES AS USED BY STAFF ACCOUNTING WITNESSES?**

19 A. The Company disagrees with Staff's rates for the Corporate Division whose depreciation
20 expense is spread to the 5 districts in this case. Those rates were changed in Decision
21 71410, effective December 1, 2009, a mere 4 months ago. They were effective for the
22 other 7 districts. The Company cannot depreciate the same desk, or computer, at one rate
23 for 7 districts and at a different rate for 5 districts. Rate Base Adjustment SLM-2 in
24 every district spreads the depreciation expense to each of the 5 districts using the same

1 rates approved 4 months ago. The Company maintains its position to retain its original
2 rates in this case and rejects Staff's return to old rates.

3 **XI. PROPERTY TAXES**

4 **Q. HAS THE COMPANY MADE CONFORMING CHANGES TO THE PROPERTY**
5 **TAX CALCULATION?**

6 **A.** Yes. Each District has an adjustment to property taxes for the changes to proposed
7 revenue.

1 **XII. INTEREST SYNCHRONIZATION**

2 **Q. HAS THE COMPANY MADE CONFORMING CHANGES TO THE INTEREST**
3 **SYNCHRONIZATION CALCULATION?**

4 A. Yes. Each District has an adjustment to interest synchronization based on two factors.
5 Mr. Broderick has accepted Staff's Cost of Capital with a 3% Weighted Cost of Debt
6 which was the same as the Company used in the original filing. And the conforming
7 change is to reflect any and all updates to Rate Base.

8 **XIII. INCOME TAXES**

9 **Q. HAS THE COMPANY MADE CONFORMING CHANGES TO THE STATE AND**
10 **FEDERAL INCOME TAX CALCULATIONS?**

11 A. Each District has an adjustment to income taxes that reflects any and all revised revenues
12 and expenses.

13 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

14 A. Yes.

EXHIBIT LJG-1R

Sun City Water Project

**Plant #9
Well #9.2
Well #9.3**

Exhibit LJG-1R

Sun City Water
Tierra Del Rio Projects

NARUC Acct #	Acct Description	Item Description	Plant # 9	Well # 9.2	Well # 9.3	Total
303	Land & Land Rights	Land & Land Rights	\$88,715			\$88,715
		Subtotal	\$88,715	\$0	\$0	\$88,715
304 Structures & Improvements						
304100		Earth Work, Fencing		\$291,194	\$227,492	\$518,686
		Paving		\$34,179	\$21,688	\$55,867
		Catch Basin (Drywell)		\$34,230	\$33,279	\$67,509
304200		Earth Work, Fencing	\$736,677			\$736,677
		Paving	\$13,066			\$13,066
		Buildings	\$678,916			\$678,916
		HVAC Unit	\$143,119			\$143,119
		8" Piping for HVAC Unit	\$9,882			\$9,882
		Fire Supression Eqpt	\$46,780			\$46,780
		Manhole/Catch Basin	\$24,094			\$24,094
		Electric Gate Opener	\$25,890			\$25,890
		Subtotal	\$1,678,424	\$359,603	\$282,459	\$2,320,486
307 Wells & Springs						
		Drilling, design, installation, initial water quality testing		\$417,840	\$374,105	\$791,945
		Subtotal	\$0	\$417,840	\$374,105	\$791,945
309 Supply Mains						
		Pipe & Fittings		\$40,980	\$110,411	\$151,391
		Valves		\$74,049	\$60,948	\$134,997
		Subtotal	\$0	\$115,029	\$171,359	\$286,388
310 Power Generator						
		1 - 750 kW / 938 kVA generator	\$228,632			\$228,632
		Subtotal	\$228,632	\$0	\$0	\$228,632
311 Pump Equipment						
311200		3 - 60 hp Pumps	\$207,973			\$207,973
		3 - 100 hp booster pumps	\$255,832			\$255,832
		Electrical; Control Panel	\$564,901			\$564,901
		Compressor for Hydropneumatic Tank	\$41,367			\$41,367
		Pressure Measurement Device	\$16,651			\$16,651
		Ultrasonic Level Measurement Device	\$3,528			\$3,528
		Chlorine Analytical Water Monitoring Instrument	\$3,280			\$3,280
		Well Pump		\$105,562	\$121,764	\$227,326
		Electrical; Control Panel		\$343,838	\$436,240	\$780,078
		Measurement Device Gage		\$3,444	\$2,314	\$5,758
		Subtotal	\$1,093,532	\$452,844	\$560,318	\$2,106,694
320.1 Water Treat Eqpt						
320100		Magnetic Meters	\$15,760			\$15,760
		Subtotal	\$15,760	\$0	\$0	\$15,760
320.2 Solution Chemical Feeders						
320200		On-site Sodium Hyprchlorite Generator	\$120,791			\$120,791
		Subtotal	\$120,791	\$0	\$0	\$120,791

330.1 Storage Tank							
	330100 1.5 MG Storage Tank	\$2,078,210					\$2,078,210
	Subtotal	<u>\$2,078,210</u>	\$0	\$0			<u>\$2,078,210</u>
330.2 Pressure Tank							
	330200 1,500 Gal Hydro Pneumatic Tank	\$74,268					\$74,268
	Yard Hydrant/Sampling Station		\$3,651	\$3,433			\$7,084
	Subtotal	<u>\$74,268</u>	<u>\$3,651</u>	<u>\$3,433</u>			<u>\$81,352</u>
331 Mains							
	331100 Mains 4" & Less	\$55,204					\$55,204
	331200 Mains 6" to 8"	\$48,870					\$48,870
	331300 Mains 10" to 16"	\$517,858					\$517,858
	331300 Valves	\$89,130					\$89,130
	331400 Mains 18" & Greater	\$76,118					\$76,118
	Subtotal	<u>\$787,180</u>	\$0	\$0			<u>\$787,180</u>
334 Meters							
	334000 2 - 6" Well meters		\$34,441	\$33,636			\$68,077
	Subtotal	\$0	<u>\$34,441</u>	<u>\$33,636</u>			<u>\$68,077</u>
336 Backflow Preventor							
	336000 Backflow Preventors	\$2,139	\$2,583	\$2,314			\$7,036
	Subtotal	<u>\$2,139</u>	<u>\$2,583</u>	<u>\$2,314</u>			<u>\$7,036</u>
346 Communication Equipment							
	346190 SCADA	\$164,204	\$4,305	\$3,857			\$172,366
	Subtotal	<u>\$164,204</u>	<u>\$4,305</u>	<u>\$3,857</u>			<u>\$172,366</u>
347 Misc Equipment							
	347000 Eye Wash / Drench	\$1,069					\$1,069
	Subtotal	<u>\$1,069</u>	\$0	\$0			<u>\$1,069</u>
TOTAL PROJECT COSTS		\$6,332,924	\$1,390,296	\$1,431,481			\$9,154,701
BOOKS AT TEST YEAR END							
	304100 Structures & Improvements	\$3,038,258					\$3,038,258
	307000 Wells		\$1,303,213	\$1,409,393			\$2,712,606
	311200 Pumping Equipments	\$3,038,258					\$3,038,258
		<u>\$6,076,516</u>	<u>\$1,303,213</u>	<u>\$1,409,393</u>			<u>\$8,789,122</u>
	271160 Contributions	(\$6,076,516)	(\$1,303,213)	(\$1,409,393)			(\$8,789,122)
INCREASE IN UTILITY PLANT IN SERVICE		\$256,408	\$87,083	\$22,088			\$365,579

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER DISTRICT AND ITS SUN CITY WATER DISTRICT.

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT, ITS SUN CITY WASTEWATER DISTRICT AND ITS SUN CITY WEST WASTEWATER DISTRICT.

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
MILES H. KIGER
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2009**

**REBUTTAL TESTIMONY
OF
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ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2009**

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Exhibit MHK-1R - City of Glendale Sewage Transportation Agreement

Exhibit MHK-2R - City of Glendale Replacement Cost Invoice

Exhibit MHK-3R - 99th Avenue Interceptor Ongoing O&M Cost Estimate

Exhibit MHK-4R - Company Revised Response RUCO 6-3, Stock

1 **EXECUTIVE SUMMARY**

2
3 Miles H. Kiger testifies as follows:

4
5 **New Request for an Accounting Deferral**

6
7 Arizona-American Water Company ("Arizona-American" or "the Company") seeks Arizona
8 Corporation Commission ("the Commission") authority to defer replacement costs paid to the
9 City of Glendale in association with the 99th Avenue Interceptor, pursuant to the City of
10 Glendale Sewage Transportation Agreement ("Glendale Agreement").
11

12 **Adjusted Operating Income**

13 Arizona-American's rebuttal position for Adjusted Operating Income is:

14

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Adjusted TY Operating Income	\$519,034	\$769,886	\$88,927	(\$66,402)	\$441,997

15
16
17 **Operating Expense**

18 Arizona-American's rebuttal position for Operating Expense is:

19

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Adjusted TY Operating Expenses	\$6,973,710	\$8,513,215	\$8,548,075	\$6,027,429	\$5,219,712

20
21
22 **Operating Income Adjustments**

23
24 Mr. Kiger sponsors the following rebuttal adjustments to operating income:

- 25
26
27
28
29
- Adjustment MHK-1R – Accept RUCO C-3, 30% Disallowance of AIP
 - Adjustment MHK-2R – Accept RUCO C-4, Removal of Stock Based Compensation
 - Adjustment MHK-3R – Accept Staff Fuel & Power Expense Adjustment
 - Adjustment MHK-4R – Sun City WW – Glendale Waste Disposal Expense Adjustment

- 1 • Adjustment MHK-5R – Adjust Mgmt. Fees for 30% Disallowance of AIP
- 2 • Adjustment MHK-6R – Accept RUCO C-9, Mgmt. Fees Other Expenses Adjustment
- 3 • Adjustment MHK-7R – Accept RUCO C-14, Mgmt. Fees Business Development Adj
- 4 • Adjustment MHK-8R – Accept RUCO C-7, Mgmt. Fees Dues & Donations Adjustment
- 5 • Adjustment MHK-9R – Annualize Pension Expense
- 6 • Adjustment MHK-10R – Accept Staff Rate Case Expense Adjustment

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE**
3 **NUMBER.**

4 A. My name is Miles H. Kiger and my business address is 2355 W. Pinnacle Peak Road,
5 Suite 300, Phoenix, AZ 85027. My office phone number is 623-445-2492.

6 **Q. ARE YOU THE SAME MILES H. KIGER THAT SUBMITTED DIRECT**
7 **TESTIMONY ON BEHALF OF THE COMPANY IN THIS CASE ON JULY 2,**
8 **2009?**

9 A. Yes.

10 **II. PURPOSE OF TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
12 **CASE?**

13 A. The purpose of my rebuttal testimony is set forth in my Executive Summary.

14 **Q. HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?**

15 A. First, I list my rebuttal schedules and then discuss a new request for an accounting order
16 for capital costs associated with the 1985 City of Glendale Sewage Transportation
17 Agreement ("Glendale Agreement"). Next, I describe the Company's revised Operating
18 Income Adjustments (MHK-1R thru MHK-10R) in response to the positions
19 recommended by Staff and RUCO in their March 8, 2010 testimonies regarding those
20 Operating Income Adjustments.

21 **III. REBUTTAL SCHEDULES AND EXHIBITS (ALL DISTRICTS)**

22 **Q. PLEASE IDENTIFY YOUR REBUTTAL SCHEDULES.**

1 A. I prepared the following rebuttal schedules for each district in this case:

- 2 • Schedule C-2 Rebuttal – Arizona-American Income Statement Pro Forma
- 3 Adjustments
- 4 • Schedule C-3 Rebuttal – Arizona-American Gross Revenue Conversion Factor

5
6 **IV. DEFERRAL OF CITY OF GLENDALE CAPITAL COSTS – SUN CITY**
7 **WASTEWATER DISTRICT**

8 **Q. WHY IS ARIZONA-AMERICAN REQUESTING AN ACCOUNTING ORDER**
9 **FOR CERTAIN CAPITAL COSTS RELATED TO THE 1985 CITY OF**
10 **GLENDALE SEWAGE TRANSPORTATION AGREEMENT AT THIS TIME?**

11 A. As part of the City of Glendale Sewage Transportation Agreement (“Glendale
12 Agreement”), which initially established the terms and conditions by which Arizona-
13 American acquired service rights to the 99th Avenue Interceptor, Arizona-American
14 (formerly the Sun City Sewer Company) is obligated to pay the City of Glendale (or the
15 City of Phoenix) its proportionate share of replacement costs associated with the 99th
16 Avenue Interceptor, in addition to operation and maintenance costs. The original
17 Glendale Agreement between Arizona-American (formerly Sun City Sewer Company)
18 and the City of Glendale, signed and dated May 14, 1985, is attached to my rebuttal
19 testimony and includes Amendment No. 1, signed and dated May 7, 1991 (Exhibit MHK-
20 1R).

21 Arizona-American was recently billed by the City of Glendale \$917,906 in replacement
22 costs previously incurred, which the Company anticipates paying soon (Exhibit MHK-2R
23 - City of Glendale Replacement Cost Invoice). Because these replacement costs are
24 considered capital investments (much like Rate Components 3 and 4 of the Tolleson

1 Agreement, approved for deferral in Commission Decision No. 66386 and subsequently
2 re-granted rate recovery in Decision No. 70209, dated March 20, 2008), Arizona-
3 American requests that the Commission authorize an accounting order in the decision in
4 this case to defer these costs, as well as future similar costs, for consideration of rate
5 recovery in a future rate case.

6 **Q. WHY HASN'T ARIZONA-AMERICAN INCLUDED THE \$917,906 AMOUNT**
7 **DUE IN ITS REVISED REVENUE REQUIREMENT FOR ITS SUN CITY**
8 **WASTEWATER DISTRICT?**

9 A. The Company has not yet paid the invoice and, therefore, alternatively requests an
10 accounting order granting it authority to defer related capital costs – including the
11 aforementioned payment now due - as they are incurred, for consideration in a future rate
12 case. The amount the Company ultimately pays may differ from the invoiced amount as
13 discussions continue between the Company and the City of Glendale.

14 **Q. IS THE INVOICE FOR \$917,906 THE FIRST TIME ARIZONA-AMERICAN**
15 **HAS BEEN BILLED FOR REPLACEMENT CAPITAL COSTS UNDER THE**
16 **1985 GLENDALE AGREEMENT?**

17 A. Yes.

18 **Q. WHAT TIME PERIODS DOES THIS INVOICE SPAN?**

19 A. The aforementioned replacements occurred from December, 2005 to April, 2009. The
20 City of Glendale failed to timely invoice the Company and only very recently presented
21 this invoice. That is the reason why the Company did not make this request earlier.

22 **Q. WHY WAS ARIZONA-AMERICAN NOT BILLED SOONER, AND IN**
23 **SMALLER INCREMENTS, BY THE CITY OF GLENDALE FOR THE**
24 **REPLACEMENT COSTS?**

1 A. We do not know. However, the Company is currently pursuing negotiations with the
2 City of Glendale to address this concern.

3 **Q. DOES THE COMPANY ANTICIPATE ADDITIONAL CAPITAL**
4 **REPLACEMENT COSTS OWED TO THE CITY OF GLENDALE?**

5 A. Yes. Arizona-American has already received an estimate from the City of Glendale for
6 its share of the 2010 capital replacement costs associated with the 99th Avenue
7 Interceptor in the amount of \$120,360. In the future, as replacement and rehabilitation
8 work is needed on the 99th Avenue Interceptor, the Company must pay its share of those
9 replacement costs. An expense such as this is recorded as an O&M waste disposal
10 expense even though it relates to capital improvements of the Interceptor. The amount of
11 \$120,360 in O&M waste disposal expense has not been included in the adjusted test year
12 waste disposal expense in this case, so a deferral is necessary.

13 **Q. ARE THERE PREVIOUS O&M EXPENSES ASSOCIATED WITH THE**
14 **GLENDALE AGREEMENT?**

15 A. Yes. O&M waste disposal expenses under the Glendale Agreement were approximately
16 \$55,800 in the 2008 test year and they were included in the prior rate case for Sun City
17 Wastewater District in the amount of \$111,600. That is the amount of O&M expense
18 presently in customers' rates related to the Glendale Agreement.

19 **Q. HOW MUCH O&M EXPENSE HAS ARIZONA-AMERICAN BEEN PAYING**
20 **THE CITY OF GLENDALE PER THE GLENDALE AGREEMENT?**

21 A. Arizona-American has been paying the City of Glendale \$111,600 annually for 20 years,
22 beginning in July, 1989 and ending in June, 2009 (which is why the annual O&M
23 expense of \$55,800 included in the test year is just half of \$111,600). This includes an
24 annual principal and interest payment of \$110,600, plus an annual license fee \$1,000.

1 Exhibit A of Amendment No. 1 of the Glendale Agreement (Exhibit MHK-1R), details
2 the calculation of the annual principal and interest payment, and the license fee is
3 referenced in Section 5.2, on page 4, of the Glendale Agreement.

4 **Q. NOW THAT THE FIRST 20 YEAR TERM OF THE GLENDALE AGREEMENT**
5 **HAS TERMINATED WHAT DOES THE AGREEMENT STIPULATE GOING**
6 **FORWARD?**

7 A. With respect to Arizona-American, the Glendale Agreement stipulates two automatic 10
8 year renewals (beginning July, 2009) of the Company's license to the 99th Avenue
9 Interceptor capacity rights, with the license fee increasing to \$5,000 annually. Not later
10 than June, 2026, both Arizona-American and the City of Glendale are to commence
11 negotiations on the renewal of the Glendale Agreement.

12 **Q. IS ARIZONA-AMERICAN STILL OBLIGATED FOR ITS PROPORTIONATE**
13 **SHARE OF THE ONGOING CAPITAL REPLACEMENT AND O&M COSTS**
14 **GOING FORWARD?**

15 A. Yes.

16 **Q. DOES THE COMPANY ANTICIPATE ADDITIONAL CAPITAL**
17 **REPLACEMENT AND O&M COSTS OWED TO THE CITY OF GLENDALE?**

18 A. Yes. As mentioned above in my rebuttal testimony, Arizona-American has already
19 received an estimate from the City of Glendale for its share of the 2010 capital
20 replacement costs associated with the 99th Avenue Interceptor in the amount of \$120,360.

21
22 **Q. HAS ARIZONA-AMERICAN RECEIVED A 2010 ESTIMATE FOR ITS SHARE**
23 **OF O&M COSTS UNDER THE GLENDALE AGREEMENT?**

24 A. Yes, it has. Arizona-American recently received a 2010 cost estimate of \$129,339 from
25 the City of Glendale for its share of 2010 odor control expenses related to the 99th

1 Avenue Interceptor.¹ The amount is an increase of \$73,539 over the 2008 test year
2 expense. As Arizona-American's O&M cost estimate is derived from a calculation
3 involving capacity ownership rights of the 99th Avenue Interceptor and flows (see
4 footnote 1), Arizona-American anticipates future changes in the O&M cost calculation.²
5 The Company revised its Sun City Wastewater waste disposal expense for this known
6 and measureable change in its operating expenses (see Waste Disposal section of my
7 rebuttal testimony).

8 **Q. WHY ARE O&M EXPENSES FOR THE GLENDALE AGREEMENT**
9 **INCREASING?**

10 A. O&M expenses are increasing due to an odor problem related to the 99th Avenue
11 Interceptor. The odor control expenses are associated with an odor mitigation program
12 undertaken by the City of Phoenix, the entity who operates the 99th Avenue Interceptor.
13 Arizona-American is obligated under the Glendale Agreement to pay for its share of the
14 99th Avenue Interceptor O&M expenses.

15 **V. ADJUSTED OPERATING INCOME (ALL DISTRICTS)**

16 **Q. WHAT IS ARIZONA-AMERICAN'S ADJUSTED OPERATING INCOME BY**
17 **DISTRICT IN THIS PROCEEDING?**

18 A. The following table summarizes Arizona-American's revised Adjusted Operating Income
19 for the districts in this case.

¹ The \$129,339 figure is derived by taking the City of Glendale's portion (based on ownership capacity of 69.8% of 99th Ave. Interceptor) of the total odor control cost of \$545,000, and then taking Arizona-American's portion of Glendale's cost (based on average sewer flows of 34%): $\$545,000 \times 69.8\% = \$380,410 \times 34\% = \$129,339$. See Exhibit MIHK-3R - 99th Avenue Interceptor Ongoing O&M Cost Estimate, which was furnished to Arizona-American by the City of Glendale.

² Per an email from City of Glendale Utilities Director Roger Bailey, Glendale anticipates its share of O&M expense (which would in turn affect Arizona-American's share) to change due to the City of Peoria no longer discharging flows to the 99th Avenue Interceptor. Glendale's share (currently 69.8%) is expected to increase to 91.24%, thereby increasing Arizona-American's share, subject to the Company's actual discharge levels.

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Table 1. Adjusted Operating Income

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Adjusted TY Operating Income	\$519,034	\$769,886	\$88,927	(\$66,402)	\$441,997

4

A OPERATING EXPENSES

5

Q. WHAT ARE ARIZONA-AMERICAN'S REQUESTED TOTAL OPERATING EXPENSES BY DISTRICT?

6

7

A. Revised adjusted test year operating expenses for each district are:

8

Table 2 – Operating Expenses

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Adjusted TY Operating Expenses	\$6,973,710	\$8,513,215	\$8,548,075	\$6,027,429	\$5,219,712

9

10

B LABOR

1 **Q. WHY DID RUCO WITNESS MR. SMITH DOUBLE COUNT A PORTION OF**
2 **THE STOCK BASED COMPENSATION LABOR EXPENSE IN HIS**
3 **ADJUSTMENT TO REMOVE IT FROM OPERATING EXPENSE?**

4 A. A portion of the test year stock based compensation was inadvertently booked to an
5 Arizona-American district not part of this case, instead of the Company's Corporate
6 account, as disclosed in data response RUCO 6-3 (Exhibit MHK-4R). Because this
7 portion of stock based compensation was not included in the Company's original case as
8 filed, RUCO's adjustment removing all stock based compensation over-adjusts by an
9 amount equal to each Arizona-American district's 4-Factor allocation of the incremental
10 stock based compensation inadvertently booked to the wrong business unit (a total of
11 \$40,740 for the five districts in this case). To correct this, test year labor needs to be
12 increased by \$40,740 prior to a reversing adjustment. Therefore, when Company witness
13 Mr. Broderick states the Company agrees to remove stock based compensation, he means
14 the amount included in its original filing request. Hence, the Company has removed all
15 of the test year stock based compensation in Adjustment MHK-2R – Accept RUCO's
16 Removal of Stock Based Compensation.

17 **Q. DID RUCO WITNESS MR. SMITH ALSO INCORRECTLY REMOVE SERVICE**
18 **COMPANY STOCK BASED COMPENSATION FROM ARIZONA LABOR**
19 **EXPENSE?**

20 A. Yes. As shown on RUCO schedules "RCS-2, Schedule C.1" and "RCS-3, Schedule C.1"
21 RUCO witness Mr. Smith removes stock based compensation as an adjustment to the
22 Arizona labor line, but only a portion of the Company's stock based compensation relates
23 to Arizona labor. Some of the stock based compensation relates to the American Water
24 Works Service Company ("Service Company") and should be adjusted out the
25 Management Fee line. Exhibit MHK-4R - "Company Response RUCO 6-3, Stock"

1 shows the stock based compensation amounts as they pertain to the Service Company and
2 Arizona labor. Accordingly, Arizona-American has reflected properly the adjustment in
3 both the Labor and Management Fee lines in Company Adjustment MHK- R – Accept
4 RUCO’s Removal of Stock Based Compensation.

5 **Q. HAVE YOU INCORPORATED MR. SMITH’S PROPOSED ARIZONA LABOR**
6 **ADJUSTMENT DISALLOWING 30% OF ACHIEVEMENT INCENTIVE PAY?**

7 A. Yes. Company witness Mr. Paul Townsley discusses this topic. Company Adjustment
8 MHK-1R – Accept RUCO’s 30% Disallowance of AIP demonstrates this. A summary of
9 the combined Arizona labor adjustments is shown in Table 3 below.

10 **Table 3. Summary of Rebuttal Labor Pro Forma Adjustments**

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Labor Pro Forma Adjustment	(\$14,417)	(\$31,378)	(\$25,483)	(\$18,616)	(\$21,078)

11
12 **C FUEL & POWER**

13 **Q. DOES THE COMPANY ACCEPT THE FUEL & POWER EXPENSE**
14 **ADJUSTMENT PROPOSED BY STAFF WITNESSES MR. BECKER AND MR.**
15 **MCMURRY?**

16 A. Yes. Arizona-American accepts Staff’s proposed Fuel & Power Expense adjustment,
17 which reflects the final rate increase approved in the recent Arizona Public Service
18 (“APS”) rate case. A summary of the Fuel & Power Expense Adjustments is shown in
19 Table 4 below.

Table 4. Summary of Rebuttal Fuel & Power Pro Forma Adjustments

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Fuel & Power Pro Forma Adjustment	\$83,883	\$228,562	(\$58,356)	\$2,746	\$265,325

D WASTE DISPOSAL

Q. WHAT IS THE COMPANY'S REVISION TO ITS TEST YEAR ADJUSTED WASTE DISPOSAL EXPENSE FOR ITS SUN CITY WASTEWATER DISTRICT, AS PER YOUR EARLIER DISCUSSION OF THE GLENDALE AGREEMENT?

A. Arizona-American recently received a cost estimate of \$129,339 from the City of Glendale for its share of 2010 odor control expenses related to the 99th Avenue Interceptor. The amount is an increase of \$73,539 over the 2008 test year actual. The Company revised its Sun City Wastewater waste disposal expense for this change in its revised operating expenses.

E MANAGEMENT FEES

Q. HAVE YOU REVIEWED THE SIX PROPOSED ADJUSTMENTS TO MANAGEMENT FEES BY RUCO WITNESS MR. SMITH?

A. Yes. RUCO witness Mr. Smith makes seven adjustments to Management Fees, displayed on his Attachment RCS-2. I list the adjustments below and then address each of them separately. The first, Schedule C-7, removes charges related to dues and donations paid by the Company. The second, Schedule C-9, removes a *pro forma* adjustment to Service Company Other expenses. The third, Schedule C-10, removes a *pro forma* adjustment to

1 Service Company employee benefits. The fourth, Schedule C-11, removes all Service
2 Company AIP compensation. The fifth, Schedule C-12, adjusts Service Company
3 pension expense. The sixth, Schedule C-13, adjusts Service Company OPEB expense.
4 The seventh, Schedule C-14, removes Service Company business development expense.

5 **Q. DOES THE COMPANY ACCEPT SOME OF MR. SMITH'S ADJUSTMENTS TO**
6 **MANAGEMENT FEES?**

7 A. Yes, but not all. Arizona-American accepts RUCO's proposed Dues & Donations
8 adjustment to Management Fees, shown on RUCO Schedule C-7. Company Adjustment
9 MHK-8R – Accept RUCO's Mgmt. Fees Business Dues & Donations Adjustment
10 summarizes this (\$16,612) adjustment. The Company accepts RUCO's proposed
11 Management Fees Other Expense adjustment, shown on RUCO Schedule C-9, which
12 removes a 4% *pro forma* increase to the Other Expense portion of Management Fees.
13 The Company accepts RUCO C-9 because it's too difficult and time-consuming to justify
14 and explain inflation for the myriad of items comprising Other Expense. The Company
15 Adjustment MHK-6R – Accept RUCO's Mgmt. Fees Other Expenses Adjustment
16 summarizes this (\$81,530) adjustment. Arizona-American also accepts RUCO's
17 proposed Management Fees – Remove Business Development Expense adjustment,
18 shown on RUCO Schedule C-14, which removes business development expenses from
19 Management Fees. The Company accepts because the Business Development function
20 has been scaled back on account of the difficult economy and limited growth
21 opportunities. The Company Adjustment MHK-7R – Accept RUCO's Mgmt. Fees
22 Business Development Adjustment summarizes this (\$48,232) adjustment.

1 **Q. HAVE YOU REVIEWED MR. SMITH'S EMPLOYEE BENEFITS**
2 **ADJUSTMENT TO MANAGEMENT FEES?**

3 A. Yes, I have. Mr. Smith proposes to adjust the employee benefits portion of Management
4 Fees by removing a known and measureable 22% *pro forma* increase to the test year
5 employee benefits level.

6 **Q. DO YOU AGREE WITH THE EMPLOYEE BENEFITS ADJUSTMENT TO**
7 **MANAGEMENT FEES AS PROPOSED BY MR. SMITH?**

8 A. No, I do not. The larger-than-typical 22% *pro forma* increase I applied to the test year
9 level of employee benefits expense was driven by the increase in the known and
10 measureable pension funding obligation under ERISA requirements for 2009. Arizona-
11 American's pension and OPEB costs are determined by Towers Perrin, a nationally
12 recognized actuary. Towers Perrin determined the Service Company's 2009 pension
13 funding obligation during 2008 (a portion of which is then allocated to Arizona-
14 American), which is why the percentage increase in Service Company pension expense
15 from 2008 to 2009 was included as a *pro forma* adjustment to the test year Service
16 Company employee benefits expense. Arizona-American must recover all of its known
17 and measureable pension expense, especially pension expense related to the Service
18 Company, in order for it to recover its cost of service.

19 **Q. HAVE YOU MADE ANY CHANGES TO THE ADJUSTED TEST YEAR LEVEL**
20 **OF THE EMPLOYEE BENEFITS COMPONENT OF MANAGEMENT FEES AS**
21 **ORIGINALLY FILED BY THE COMPANY?**

22 A. No.

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Q. HAVE YOU REVIEWED MR. SMITH'S ACHIEVEMENT INCENTIVE PAY ("AIP") ADJUSTMENT TO MANAGEMENT FEES?

A. Yes, I have. Mr. Smith proposes to adjust Management Fees by removing the AIP portion of Service Company compensation.

Q. DOES THE COMPANY AGREE WITH MR. SMITH'S AIP ADJUSTMENT TO MANAGEMENT FEES?

A. No. Company witness Mr. Paul Townsley addresses this topic in his rebuttal testimony and notes Mr. Smith is inconsistent with respect to rate treatment of AIP. For Arizona employees, Mr. Smith recommended a 30 percent disallowance of AIP compensation as an adjustment to test year labor expense but for Service Company AIP compensation, as shown in RUCO Schedule C-11, Mr. Smith recommends a complete 100 percent disallowance.

Q. HAVE YOU MADE ANY CHANGES TO THE ADJUSTED TEST YEAR LEVEL OF THE AIP COMPENSATION COMPONENT OF MANAGEMENT FEES AS ORIGINALLY FILED BY THE COMPANY?

A. Yes, to be consistent with Arizona-American's acceptance of Mr. Smith's 30 percent disallowance of Arizona AIP compensation, per Mr. Townsley's rebuttal testimony, I removed 30 percent of the AIP component of Management Fees. Company Adjustment MHK-5R – Adjust Mgmt. Fees for 30% Disallowance of AIP summarizes this adjustment.

1 **Q. HAVE YOU REVIEWED MR. SMITH'S ADJUSTMENT OF THE TEST YEAR**
2 **PENSION AND OPEB EXPENSE COMPONENTS OF MANAGEMENT FEES?**

3 A. Yes, I have. Mr. Smith proposes to adjust Management Fees by taking a two-year
4 average (2007-2008) of pension and OPEB expense. These adjustments are shown on
5 RUCO Schedules C-12 and C-13, respectively.

6 **Q. DO YOU AGREE WITH MR. SMITH'S ADJUSTMENT OF THE TEST YEAR**
7 **PENSION AND OPEB EXPENSE COMPONENTS OF MANAGEMENT FEES?**

8 A. No, I do not. As discussed in my rebuttal of Mr. Smith's proposed adjustment to the
9 employee benefits piece of Management Fees, in order for Arizona-American to recover
10 its cost of service, it is essential that the Company recover its actual pension and OPEB
11 expense. Adjusting the Company's test year pension and OPEB expense would only
12 serve to exacerbate Mr. Smith's understatement of the Company's actual pension and
13 OPEB expense.

14 **Q. HAVE YOU MADE ANY CHANGES TO THE ADJUSTED TEST YEAR LEVEL**
15 **OF THE PENSION AND OPEB EXPENSE COMPONENTS OF MANAGEMENT**
16 **FEES AS ORIGINALLY FILED BY THE COMPANY?**

17 A. No.

18 **Q. IF THE COMMISSION WERE INCLINED TO PREFER AN AVERAGING**
19 **METHOD TO DETERMINE ARIZONA-AMERICAN'S ADJUSTED TEST YEAR**
20 **PENSION AND OPEB EXPENSE UNDER ERISA, WHICH YEARS WOULD BE**
21 **MOST REFLECTIVE OF ARIZONA-AMERICAN'S NORMAL PENSION**
22 **COST?**

23 A. 2009 and 2010.

1 **Q. WHAT IS ARIZONA-AMERICAN'S 2009 AND 2010 ERISA PENSION COST,**
 2 **NOT INCLUDING ITS SHARE OF THE SERVICE COMPANY'S PENSION**
 3 **COST?**

4 A. For 2009, the ERISA cost was \$2,090,643 and for 2010 it is \$2,062,641.

5 **Q. WHAT WOULD ARIZONA-AMERICAN'S PENSION COST FOR 2009 AND**
 6 **2010 BE IF IT WERE A FAS 87 COMPANY?**

7 A. Under FAS 87, for 2009 it would have been \$2,143,740 and for 2010 it would be
 8 \$1,587,097.

9 **Q. IS THE PENSION ACCOUNTING TOPIC OF FAS 87 VERSUS ERISA**
 10 **DISCUSSED ELSEWHERE IN ARIONZA-AMERICAN'S REBUTTAL**
 11 **TESTIMONY?**

12 A. Yes. Please see the rebuttal testimony of Mr. Thomas M. Broderick.

13 **Q. WHERE ARE YOUR REBUTTAL MANAGEMENT FEE ADJUSTMENTS**
 14 **SUMMARIZED?**

15 A. A summary of rebuttal Management Fees adjustments is shown below in Table 5. The
 16 Management Fee adjustments MHK-5R – MHK-8R are also filed in conjunction with the
 17 Company's schedule C-2 Rebuttal – Arizona-American Income Statement Pro Forma
 18 Adjustments.

19 **Table 5. Summary of Rebuttal Management Fees *Pro Forma* Adjustments**

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Mgmt Fees <i>Pro Forma</i> Adjustment	(\$43,721)	(\$65,472)	(\$62,936)	(\$40,478)	(\$34,252)

1 **F PENSION EXPENSE**

2 **Q. DOES THE COMPANY NEED TO CORRECT AN ERROR IN ITS ADJUSTED**
3 **PENSION EXPENSE IN ITS REBUTTAL FILING?**

4 A. Yes. In its original filing Arizona-American erred and excluded the test year actual
5 amount recorded to adjust Service Company pension expense from FAS 87 to ERISA.
6 Since 2007, the Service Company has charged the Company FAS 87 pension expense
7 through the monthly Management Fees and the Company records an adjustment to
8 pension expense to recognize the ERISA level of expense. Although Arizona-American
9 uses ERISA pension accounting for ratemaking, it is liable for its amount charged from
10 the Service Company. The Company is including an additional \$72,296 in pension
11 expense for the 5 districts in this case.

12
13 **Table 6. Summary of Rebuttal Pension Expense *Pro Forma* Adjustments**

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Pension Expense <i>Pro Forma</i> Adjustment	\$14,147	\$18,438	\$18,666	\$11,399	\$9,646

1 **G RATE CASE EXPENSE**

2 **Q. HAVE YOU INCORPORATED THE ADJUSTMENTS TO PRIOR RATE CASE**
3 **EXPENSE PROPOSED BY STAFF WITNESSES MR. BECKER AND MR.**
4 **MCMURRY, AND RUCO WITNESS MR. SMITH?**

5 **A.** Yes. Staff witness Mr. Becker and Mr. McMurry and RUCO witness Mr. Smith propose
6 removing any amortizations of remaining balances of *prior*-approved rate case expenses
7 incorporated into the ongoing annual amortization of the pending case's level of rate case
8 expense. As discussed by Company witness Mr. Broderick, Arizona-American accepts
9 Staff's and RUCO's removal of prior-approved rate case expenses in the calculation of
10 ongoing annual rate case expense amortization. Company Adjustment MHK-10R –
11 Accept Staff's Rate Case Expense Adjustment and Table 7 below shows the Company's
12 revised position regarding rate case expense.

13 **Table 7. Summary of Rebuttal Rate Case Expense Amortization Pro Forma Adjustments**

District	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
RC Expense Amortization <i>Pro Forma</i> Adjustment	(\$12,500)	(\$5,891)	(\$12,500)	(\$9,406)	(\$9,406)

14
15 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY IN THIS CASE?**

16 **A.** Yes.
17

**REBUTTAL EXHIBIT MHK-1R - City of Glendale Sewage Transportation
Agreement**

**SEWAGE TRANSPORTATION SERVICE AGREEMENT BETWEEN
THE CITY OF GLENDALE, MARICOPA COUNTY, ARIZONA
AND SUN CITY SEWER COMPANY**

THIS AGREEMENT, made and entered into this 14th day of ~~May 1980~~ and executed in duplicate originals (each executed copy constituting an original) by the CITY OF GLENDALE, a municipal corporation of the State of Arizona (hereinafter referred to as "Glendale") and SUN CITY SEWER COMPANY, an Arizona corporation (hereinafter referred to as "SCSC");

W I T N E S S E T H;

WHEREAS, SCSC owns and operates a public utility sewer system and furnishes sewer service to the public located in and in the vicinity of Sun City, Maricopa County, Arizona, for residential, commercial, industrial and corporate purposes, pursuant to Certificates of Convenience and Necessity granted by the Arizona Corporation Commission; and

WHEREAS, SCSC currently obtains sewage transportation and sewage treatment services from Glendale pursuant to the Agreement, dated April 10, 1979, as extended from time to time; and

WHEREAS, SCSC has been advised by Glendale that Glendale desires to have the City of Tolleson (hereinafter referred to as "Tolleson") contract directly with SCSC for sewage treatment services; and

WHEREAS, Tolleson plans on expanding the sewage treatment capacity of its Wastewater Treatment Plant; and

WHEREAS, the Tolleson, Peoria, Phoenix, Glendale Joint Sewerage Treatment Plant Agreement for the Construction, Operation and Maintenance of the Jointly Used Sewerage Transportation

Facilities, dated August 21, 1979, (hereinafter referred to as "Agreement No. 22749") provides, inter alia, Glendale with capacity ownership in the interceptor running southerly along 99th Avenue from the intersection of Olive Avenue and 99th Avenue to the southern terminus of the 42-inch interceptor immediately south of Van Buren Street (hereinafter referred to as the "99th Avenue Interceptor"); and

WHEREAS, Agreement No. 22749 provides inter alia, for the City of Phoenix (hereinafter referred to as "Phoenix") to provide operation, maintenance and replacement services on the 99th Avenue Interceptor and bill for said services;

WHEREAS, pursuant to Agreement No. 22749, the 99th Avenue Interceptor was planned to accommodate a peak hourly flow for interceptor sizing of 7.06 mgd for flows from SCSC's service area; and

WHEREAS, the actual "as built" capacity of the 99th Avenue Interceptor exceeds the planned capacity contemplated in Agreement No. 22749; and

WHEREAS, SCSC desires to increase its sewage transportation capability in the 99th Avenue Interceptor to a peak hourly flow for interceptor sizing of 10.4 mgd (equivalent to a maximum monthly average daily flow of 5.2 mgd); and

WHEREAS, Glendale has rights to sufficient excess capacity in the 99th Avenue Interceptor to enter into an agreement with SCSC for SCSC's flows from Point 1 to Point A, as more

particularly described in the revised Exhibit A, dated December 7, 1982, to Agreement No. 22749.

NOW, THEREFORE, for and in consideration of the foregoing and of the mutual covenants and agreements herein contained, the parties hereby agree as follows:

1. SCSC will contract with Tolleson for sewage treatment services for its present and estimated future flow requirements.

2. SCSC will contract with Tolleson to finance, engineer, construct and install or cause to be financed, engineered, constructed and installed sewage transportation facilities, (and lift station if necessary), hereinafter referred to as the "Tie-line", from either Point 18 or Point A on the 99th Avenue Interceptor, as more particularly described in the revised Exhibit A, dated December 7, 1982, to Agreement No. 22749, to the Tolleson Wastewater Treatment Plant. The precise location of the Tie-line is subject to the engineering review of SCSC and Tolleson, and approval by Glendale. Such approval by Glendale shall not be unreasonably withheld.

3. Glendale hereby grants a license to SCSC in the capacity rights in the 99th Avenue Interceptor from Point 1 to the Tie-line for a total peak hourly flow of 10.4 mgd.

4. The initial term of this license shall be for twenty (20) years, commencing on the date on which the wastewater transportation and treatment services herein above described are first provided by Tolleson. This license will be automatically renewed

for two successive periods of ten (10) years each, so long as SCSC is not in default in any of its obligations herein. Not later than the first day of June, 2026, both Glendale and SCSC shall commence negotiations for construction, extension or renewal of this Agreement.

5. As full and final compensation for the services provided to SCSC pursuant to Paragraph 3, herein, SCSC shall pay Glendale as follows:

(1) Capital recovery in the amount of \$942,664.39, payable in annual installments which shall be calculated by amortizing said \$942,664.39 over a 20-year period at a 10.6% rate of interest, as set forth on Exhibit A attached hereto and incorporated herein by reference for all purposes.

(2) A pipeline license fee for administrative purposes, in the amount of \$1,000 per year shall be paid annually for the initial 20-year term of this Agreement. Said pipeline license fee shall increase to \$5,000 per year during the two successive ten year periods of automatic renewal of this Agreement. The annual pipeline license fee beyond the 40th year shall be negotiated.

Said annual payments will commence one year subsequent to wastewater treatment services first being provided to SCSC by Tolleson. The capital recovery payments shall cease when the full amount as herein computed is fully amortized.

6. Annually, commencing one year subsequent to wastewater treatment services first being provided to SCSC by Tolleson,

Glendale shall invoice SCSC pursuant to Paragraph 5 for the services provided under this Agreement. SCSC shall remit payment within 30 days of receipt of said invoice. The payments due and payable hereunder shall not be withheld as a remedy under this Agreement. In the event the payments are not received by Glendale within 30 days of the due date, interest shall accrue at one percent (1%) per month on the unpaid balance.

7. In the event the Tie-line interconnects with the 99th Avenue Interceptor north of Point A, the allocation of costs to SCSC as contained on Exhibit A to this Agreement shall be adjusted and the annual payment under Paragraph 5 shall be reduced accordingly.

8. Glendale and SCSC hereby agree that the terms and conditions set forth in the April 10, 1979 Agreement, as extended from time to time, will remain in full force and effect until the date sewage treatment services of the Tolleson WWTP and sewage transportation services through the Tie-line are first provided to SCSC by Tolleson, at which time this Agreement for 10.4 mgd peak hourly flow in the 99th Avenue Interceptor shall become operative.

9. This Sewage Transportation Service Agreement is expressly conditioned upon the following:

(a) The approval of this Sewage Transportation Service Agreement by the Arizona Corporation Commission.

(b) Execution of the agreement with Tolleson and satisfaction of all conditions precedent contained therein,

provided for in Paragraphs 1 and 2 hereinabove. An executed copy of said agreement is attached hereto as Exhibit B and incorporated herein by reference for all purposes.

10. SCSC will obtain any and all necessary permits or approvals required to carry out the intention of this Agreement. Glendale agrees to cooperate with and assist SCSC in obtaining those permits or approvals. Any cost or expense associated with obtaining such permits or approvals shall be paid by SCSC.

11. SCSC agrees to pay ~~Glendale or~~ if billed directly by Phoenix, Phoenix for its proportionate share for operation, maintenance and replacement costs assessed pursuant to Paragraphs 9.1 and 9.2 of Agreement No. 22749, said replacement costs being limited to those defined in Paragraph 5.9 of said Agreement.

12. In the event the U.S. Environmental Protection Agency (EPA) grant funding for Glendale's capacity used to provide the subject service to SCSC via the 99th Avenue Interceptor is challenged or withdrawn, SCSC shall have the right to participate in the defense of that action. Glendale hereby agrees to support SCSC's right to the services provided for under this Agreement in that action. If such defense is unsuccessful, SCSC will purchase its proportionate share hereunder of the Interceptor upon obtaining full legal right and title (fee ownership) to utilize its share of the facilities. If said fee ownership is not provided, SCSC shall have the option to withdraw from the use of the 99th Avenue Interceptor. In the event SCSC purchases its proportionate share of the facilities or withdraws from the use

of the 99th Avenue Interceptor, then, and in that event, Glendale shall provide at no cost to SCSC, an easement within public rights of way suitable for wastewater transportation facilities comparable to the facilities used to provide the service under this Agreement. Upon withdrawal, SCSC shall be relieved of all obligations and from further payments under this Agreement. SCSC further agrees to indemnify Glendale against any liability, loss or damage arising out of the EPA action referenced herein or third party claims regarding SCSC's use of the facilities.

13. SCSC, throughout the term of this agreement, shall maintain an industrial waste pretreatment monitoring and control standard, if SCSC has any applicable industrial customers. Said standards shall comply in every respect with the industrial waste discharge monitoring and control requirements imposed upon entities party to joint operation of the 91st Avenue Wastewater Treatment Plant in Phoenix, or to similar requirements imposed upon users of the Tolleson Wastewater Treatment Plant if the latter are more stringent. The industrial waste pretreatment and control standard established by SCSC shall be at least equal to that established by Glendale, and shall be subject to inspection and approval by Glendale at intervals not exceeding one year, or more often if deemed appropriate by Glendale. Such approval by Glendale shall not be unreasonably withheld.

14. All notices or communications pertaining to this Agreement shall be sent to Glendale, addressed as follows:

City of Glendale
Attn: Martin Vanacour, City Manager
5850 West Glendale Avenue
Glendale, Arizona 85301

or to such other address as Glendale may advise SCSC in writing,
and to SCSC at:

Sun City Sewer Company
Attn: William J. Raymo, Manager
(15626 North Del Webb Boulevard)
P. O. Box 1687
Sun City, Arizona 85372

with copy to:

Sun City Sewer Company
Attn: David E. Chardavoyne
Assistant Vice President
High Ridge Park
Stamford, Connecticut 06905

or to such other addresses as SCSC may advise Glendale in writing.

15. This Sewage Transportation Service Agreement shall inure to the benefit of and be binding upon the parties hereto, their heirs, executors, administrators, successors and assigns, provided, however, that any assignment shall be approved by the other party, which approval shall not be unreasonably withheld. This Agreement shall be governed by and construed in accordance with the laws of the State of Arizona. This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matter hereof and expressly supersedes and revokes all other prior or contemporaneous promises, representations and assurances of any nature whatsoever with respect to the subject matter hereof except as stated in Paragraph 8. The remedies provided in this Agreement in favor of SCSC shall not be deemed its exclusive remedies but shall be in addition to all other remedies available at law or in equity. In the event any provision of this Agreement is for any reason adjudicated deficient, unenforceable, irregular and/or invalid, the parties hereto

and each of them, will promptly take such action or proceedings as may be necessary to correct such deficiency or otherwise validate that provision. If any provision of this Agreement is declared void or unenforceable, such provision shall be deemed severed from this Agreement, which shall otherwise remain in full force and effect.

IN WITNESS WHEREOF, the CITY OF GLENDALE and SUN CITY SEWER COMPANY have caused this Agreement to be signed by its respective Officer and attested by its respective City Clerk and Assistant Secretary and their seals affixed hereto, all as of the day and date first hereinabove set forth.

APPROVED AS TO FORM:

Peter VanHaren
City Attorney

SEAL

ATTEST:

Jawergns Behm

CITY OF GLENDALE, a municipal corporation

By [Signature]
Mayor

SUN CITY SEWER COMPANY, an Arizona corporation

By David E. Chardavoyne
Its Assistant Vice President

SEAL

ATTEST:

Greg M. Stt
Assistant Secretary

EXHIBIT A

COST ALLOCATION FOR SCSC USE
OF 10.4 MGD IN THE 99TH AVENUE INTERCEPTOR

<u>Line No.</u>	<u>Item</u>	<u>Costs Allocated to SCSC for 10.4 mgd Peak Hourly Flow</u>
<u>Reach 1 through 18</u>		
1.	Construction	\$466,031.18
2.	Engineering	<u>31,591.58</u>
3.	Subtotal	\$497,622.76
4.	Interest ^{1/}	<u>406,687.18^{2/}</u>
5.	Subtotal	\$904,309.94 <i>110,602.44 - 4</i>
<u>Reach 18 through A</u>		
6.	Construction	\$ 19,842.02
7.	Engineering	<u>1,263.63</u>
8.	Subtotal	\$ 21,105.65
9.	Interest ^{1/}	<u>17,248.80^{3/}</u>
10.	Subtotal	\$ 38,354.45
<u>All Reaches</u>		
11.	TOTAL	<u>\$942,664.39</u>
12.	Annual Amortization of Amount on Line No. 11 ^{4/}	<u>\$115,293.42</u>

^{1/} At a simple interest rate of 10.6% per annum for the period of October, 1980 (midpoint of 99th Avenue Interceptor Construction) to July 1, 1988 (scheduled date for completion of treatment facilities at the Tolleson WWTP for use by SCSC).

^{2/} $7.71 \text{ years} \times 10.6\% \times \$497,622.76$

^{3/} $7.71 \text{ years} \times 10.6\% \times \$21,105.65$

^{4/} Calculated using 10.6 percentage interest with twenty (20) equal annual payments at year end.

files

AMENDMENT NO. 1 TO SEWAGE TRANSPORTATION
SERVICE AGREEMENT BETWEEN THE CITY OF
GLENDALE, MARICOPA COUNTY, ARIZONA AND
SUN CITY SEWER COMPANY

RECEIVED

MAY 21 1991

Citizens Utilities Co.

THIS AMENDMENT NO. 1 to that certain Sewage Transportation Service Agreement Between the City of Glendale, Maricopa County, Arizona and Sun City Sewer Company, dated May 14, 1985 (hereinafter referred to as the "Service Agreement") is executed in duplicate originals (each executed copy constituting an original) by the CITY OF GLENDALE, a municipal corporation (hereinafter referred to as "Glendale") and SUN CITY SEWER COMPANY, an Arizona corporation (hereinafter referred to as "SCSC") to be effective the 7th day of May, 1991.

WHEREAS, the "Tie-line", as defined in Section 2 of the Service Agreement, has been completed, commencing at Point 18 and terminating at the Tolleson Wastewater Treatment Plant; and

WHEREAS, Glendale and SCSC desire to modify certain terms of the Service Agreement based on the location of the Tie-line.

NOW THEREFORE, the parties agree as follows:

1. Section 2 of the Service Agreement is hereby deleted in its entirety and the following is hereby added to the Service Agreement as revised Section 2:

2. SCSC will contract with Tolleson to finance, engineer, construct and install or cause to be financed, engineered, constructed or installed sewage transportation facilities (and lift station if necessary), hereinafter referred to as the "Tie-line", from Point 18 on the 99th Avenue Interceptor, as more particularly described in the revised Exhibit A, dated December 7, 1982, to Agreement No. 22749, to the Tolleson Wastewater Treatment Plant.

2. Section 5(1) of the Service Agreement is hereby deleted in its entirety and the following is hereby added to the Service Agreement as revised Section 5(1):

(1) Capital recovery in the amount of \$904,309.94, payable in annual installments which shall be calculated by amortizing said \$904,309.94 over a 20-year period at a 10.6% rate of interest, as set forth in revised Exhibit A to the Service Agreement, which revised Exhibit is attached hereto as Exhibit A.

3. Section 7 of the Service Agreement is hereby deleted in its entirety.

4. Exhibit A attached to the Service Agreement is hereby deleted in its entirety and Exhibit A attached hereto is hereby added to the Service Agreement as revised Exhibit A.

5. All terms and conditions contained in the Service Agreement which are not expressly modified in this Amendment No. 1 are hereby confirmed.

IN WITNESS WHEREOF, Glendale and SCSC have caused this Amendment No. 1 to the Service Agreement to be executed by their duly authorized respective officers.

APPROVED AS TO FORM:

Peter Voffe
City Attorney

CITY OF GLENDALE, a municipal corporation

By Martin Gonzalez
City Manager

ATTEST:

Julienne Selim
City Clerk (Seal)

SUN CITY SEWER COMPANY, an Arizona corporation

By [Signature]
Its cut up

ATTEST:

[Signature]
[Signature] (Seal)

REBUTTAL EXHIBIT MHK-2R - City of Glendale Replacement Cost Invoice

City of Glendale



Utilities Department
6210 W. Myrtle Avenue, Suite 112
Glendale, AZ 85301
623.930.2700 fax 623.915.3094

DATE: November 6, 2009
INVOICE # 101
FOR: 99th Avenue
Interceptor Repair

Bill To:
Arizona American Water
15626 N. Del Webb Boulevard
Sun City, AZ 85351

DESCRIPTION	AMOUNT
99th Avenue Interceptor Repair Costs	\$ 917,906.09
TOTAL	\$ 917,906.09

Make all checks payable to **City of Glendale**
If you have any questions concerning this invoice, contact Deborah Lewis, 623.930.2705, dlewis@glendaleaz.com

THANK YOU FOR YOUR BUSINESS!

City of Glendale

Summary of Repair Costs associated with 99th Ave Interceptor

	Invoice #	Date	Amount	Sun City %	Sun City Cost
#WS90160074					
99 Ave Siphon Elimination, North of Van Buren #WS90160074					
September 2006-February 2007	400424626	3/13/2007	\$ 30,482.73	32.83%	\$ 10,007.48
March 2007 - May 2008	400512781	5/22/2008	200,952.53	33.00%	\$ 66,314.33
May 2008 - April 2009	400576643	5/1/2009	5,029.17	32.38%	\$ 1,628.45
			<u>\$ 236,464.43</u>		
#WS90160075					
99 Avenue Rehab - Olive to Broadway #WS90160075					
Inception through June 2007	400455209	7/31/2007	\$ 76,954.79	33.18%	\$ 25,533.60
July 2007 - June 2008	400516231	6/5/2008	870,008.23	32.46%	\$ 282,404.67
May 2008 - April 2009	400576643	5/31/2009	390,528.44	32.38%	\$ 126,453.11
			<u>\$ 1,337,491.46</u>		
#WS90160076					
99 Ave Siphon Structure repairs, North I-10 #WS90160076					
September 2006-February 2007	400425429	3/19/2007	\$ 33,132.96	32.83%	\$ 10,877.55
March 2007 -May 2008	400515189	5/27/2008	103,678.65	33.00%	\$ 34,213.95
May 2008 - April 2009	400576643	5/31/2009	1,111,719.50	32.38%	\$ 359,974.77
			<u>\$ 1,248,531.11</u>		
#WS90160062-1					
99 Ave Siphon Structure repairs, Lined Sewer Assessment					
December 2005 - February 2006	400358660	9/6/2006	\$ 1,915.29	26.01%	\$ 498.17
			<u>\$ 1,915.29</u>		
TOTAL			\$ 2,824,402.29		\$ 917,906.09

Month	Net Glendale Flow (MGD)	SC01 Flow (MGD)	Total Glendale and Sun City Flow (MGD)	Sun City %		9/06-2/07	3/07-6/07	7/07-9/07	10/07-12/07
Jul 06	9.30	3.27	12.57	26.01%		32.83%	33.70%	29.34%	31.44%
Aug 06	9.77	3.34	13.11	25.48%					
Sep 06	9.22	3.49	12.71	27.46%					
Oct 06	8.39	3.60	11.99	30.03%		1/08-3/08	4/08-6/08	7/08-3/09	4/09-6/09
Nov 06	8.07	3.93	12.00	32.75%		37.55%	31.50%	32.32%	34.06%
Dec 06	8.25	3.94	12.19	32.32%					
Jan 07	7.74	4.09	11.83	34.57%					
Feb 07	6.17	4.09	10.26	39.86%					
Mar 07	5.92	4.18	10.10	41.39%					
Apr 07	7.64	3.95	11.59	34.08%					
May 07	8.69	3.55	12.24	29.00%					
Jun 07	7.77	3.38	11.15	30.31%					
Jul 07	8.35	3.42	11.77	29.06%					
Aug 07	8.29	3.52	11.81	29.81%					
Sep 07	8.82	3.63	12.45	29.16%					
Oct 07	9.40	3.75	13.15	28.52%					
Nov 07	8.09	4.03	12.12	33.25%					
Dec 07	8.41	4.06	12.47	32.56%					
Jan 08	8.31	4.10	12.41	33.04%					
Feb 08	6.37	4.17	10.54	39.56%					
Mar 08	6.12	4.09	10.21	40.06%					
Apr 08	6.90	3.71	10.61	34.97%					
May 08	7.68	3.34	11.02	30.31%					
Jun 08	7.58	3.13	10.71	29.23%					
Jul 08	7.13	3.15	10.28	30.64%					
Aug 08	8.35	3.17	11.52	27.52%					
Sep 08	8.83	3.15	11.98	26.29%					
Oct 08	9.40	3.38	12.78	26.45%					
Nov 08	6.97	3.63	10.60	34.25%					
Dec 08	6.84	3.60	10.44	34.48%					
Jan 09	7.81	3.76	11.57	32.50%					
Feb 09	5.95	3.93	9.88	39.78%					
Mar 09	6.08	3.88	9.96	38.96%					
Apr 09	5.81	3.59	9.40	38.19%					
May 09	6.74	3.21	9.95	32.26%					
Jun 09	6.52	3.03	9.55	31.73%					
Jul 09	6.78	2.96	9.74	30.39%					
Aug 09	6.92	3.04	9.96	30.52%					

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CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295



Invoice	
Number/Date	400424626 03/14/2007
Due Date: 04/13/2007	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Malcolm Pirnie, Inc	1	24,852.40	1 EA	\$ 24,852.40
2	Wastewater - Misc revenue City of Phoenix Project Costs Costs for 99th Ave Siphon Elimination North of Van Buren Project #200160074 Project Costs from September 2006 thru February 2007 This invoice is based on capacity ownership in the 99th Ave Interceptor. TGA representatives may determine to reconcile costs with average daily flow (ADF) data if/when available in the future.	1	5,630.33	1 EA	5,630.33
Items total					\$ 30,482.73
Taxes					\$ 30,482.73
Total amount due.....					\$ 30,482.73

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

Make check or money order payable to City of Phoenix
Include your name and Customer No. on check or money order
Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.

Check or Money Order _____
Credit Card _____
VISA MC AMEX DISCOVER OTHER _____
Credit Card Account Number: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400424626	03/14/2007	04/13/2007	\$30,482.73

0100084600535040084246262000000000304827312



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

Invoice	
Number/Date	400512781 05/22/2008
Due Date: 06/21/2008	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue <i>Project Engineering Consultants Ltd.</i>	1	\$ 184,996.22	1 EA	\$ 184,996.22
2	Wastewater - Misc revenue <i>City of Phx/Misc Project Costs</i> <i>Costs for 99th Ave Siphon Elimination North Van Buren Project #WS90160074 Project costs from March 2007 thru May 2008 This invoice is based on capacity ownership in the 99th Ave Interceptor. IGA representatives may determine to reconcile costs with average daily flow (ADF) data if/when available in the future.</i>	1	15,956.31	1 EA	15,956.31
Items total					\$ 200,952.53
Taxes					
Total amount due.....					\$ 200,952.53

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CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

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Include your name and Customer No. on check or money order
Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.*

Check or Money Order
Credit Card
VISA MC AMEXP DISCOVER OTHER _____
Credit Card Account Number: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400512781	05/22/2008	06/21/2008	\$200,952.53

010008460053504005127818000000002009525395



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

Invoice	
Number/Date	400576643 05/01/2009
Due Date: 05/31/2009	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
MICHAEL WEBER
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Units	Amount
1	Wastewater - Misc revenue Project Engineering Consultants Ltd	1	1,301.56	1 EA	1,301.56
2	Wastewater - Misc revenue City of Phx/Misc Project Costs Costs for 99th Ave Siphon Elimination North Van Buren Project #WS0160074 Project costs from May 2008 through April 2009. This invoice is based on capacity ownership in the 99th Ave Interceptor. ICA representatives may determine to reconcile costs with average daily flow (ADF) data if/ when available in the future.	1	3,727.61	1 EA	3,727.61
3	Wastewater - Misc revenue Quest Civil Constructors, Inc.	1	1,077,800.39	1 EA	1,077,800.39
4	Wastewater - Misc revenue City of Phx/Misc Project Costs Costs for 99th Ave Siphon Structure Penalties	1	33,919.11	1 EA	33,919.11

5029.17

CO
5-11-09
3420-63003-551200

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

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Include your name and Customer No. on check or money order
Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.

Check or Money Order
Credit Card
VISA MC AMEX DISCOVER OTHER _____
Credit Card Account Number: _____ Zip Code: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400576643	05/01/2009	05/31/2009	\$1,507,277.11

010008460053504005766433000000015072771177



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

Invoice	
Number/Date	400455209 07/31/2007
Due Date: 08/30/2007	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue <i>CITY OF PHOENIX COSES</i>	1	76,954.79	EA	\$ 76,954.79
	Costs for 99th Ave Rehab-Olive to Broadway Project #590160075				
	Project Costs From Contract Inception Through June 2007				
	Items total				\$ 76,954.79
	Taxes				
	Total amount due.....				\$ 76,954.79

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

*Make check or money order payable to City of Phoenix
Include your name and Customer No. on check or money order
Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 334-5500.*

Check or Money Order
Credit Card
VISA MC AMEX DISCOVER OTHER _____
Credit Card Account Number: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400455209	07/31/2007	08/30/2007	\$76,954.79

010008460053504004552099000000000769547916

CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295



Invoice	
Number/Date	400516231 06/05/2008
Due Date: 07/05/2008	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
 CITY OF GLENDALE
 CHRIS OCHS
 6210 W MYRTLE AVE STE 112
 GLENDALE AZ 85301-1700

SOLD TO:
 CITY OF GLENDALE
 6210 W MYRTLE AVE STE 112
 GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Achen Gardner CM e-Risk	1	806,345.75	1 EA	806,345.75
2	Wastewater - Misc revenue City of Phx/Misc. Project Costs Costs for 49th Ave Rehab-Olive to Broadway Project WS901R0075 Project costs from July 2007 through June 2008	1	63,662.48	1 EA	63,662.48
Items total					\$ 870,008.23
Taxes					
Total amount due.....					\$ 870,008.23

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
 P.O. Box 78815
 Phoenix, AZ 85062-8815

*Make check or money order payable to City of Phoenix
 Include your name and Customer No. on check or money order
 Payments can be made in person at 251 W. Washington St., Third
 Floor. This statement is available in alternative formats upon request.
 TTY number is (602) 534-5500.*

Check or Money Order
 Credit Card
 VISA MC AMEX DISCOVER OTHER _____
 Credit Card Account Number: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400516231	06/05/2008	07/05/2008	\$870,008.23

010008460053504005162310000000008700082320



CITY OF PHOENIX
 251 West Washington Street
 Phoenix, Arizona 85003-2295

INVOICE	
Number/Date	400576643 05/01/2009
Due Date: 05/31/2009	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
 CITY OF GLENDALE
 MICHAEL WEBER
 6210 W MYRTLE AVE STE 112
 GLENDALE AZ 85301-1700

SOLD TO:
 CITY OF GLENDALE
 6210 W MYRTLE AVE STE 112
 GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
	Replacement Project #NS90160076 Project costs from May 2008 through April 2009				
5	Wastewater - Misc revenue ACQUA GARDEN LN & MIST	1	383,251.50	1 EA	383,251.50
6	Wastewater - Misc revenue City of Phx/Misc Project Costs Costs for Park Ave Rehab-Olive to Broadway Project #NS90160076 Project costs from May 2008 to April 2009	1	7,276.94	1 EA	7,276.94
Items total					\$ 1,507,277.11
Taxes					
Total amount due.....					\$ 1,507,277.11

39057



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

Invoice

Number/Date
400425429 03/19/2007

Due Date: 04/18/2007

Customer Number: 8460053
Contact/Phone
Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Malcolm Pirnie, Inc	1	21,349.33	EA	\$ 21,349.33
2	Wastewater - Misc revenue City of Phoenix Project Costs Costs for 99th Ave Siphon Structure Repairs & Replacement Project #WS90160076 Project costs thru February 2007	1	11,783.63	EA	\$ 11,783.63
Items total					\$ 33,132.96
Taxes					
Total amount due.....					\$ 33,132.96

2420-63003-551200

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

Make check or money order payable to City of Phoenix
Include your name and Customer No. on check or money order
Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.

Check or Money Order
Credit Card
VISA MC AMEXP DISCOVER OTHER _____
Credit Card Account Number: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400425429	03/19/2007	04/18/2007	\$33,132.96

010008460053504004254290000000000331329605

CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295



Invoice	
Number/Date	400515189 05/27/2008
Due Date: 06/26/2008	
Customer Number:	8460053
Contact/Phone	Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Quest Civil Contractors, Inc.	1	\$ 83,438.09	1 EA	\$ 83,438.09
2	Wastewater - Misc revenue City of Phx/Misc. Project Costs Coate Id. 2211 Ave Fibron STRUCTURE Repairs & Replacement Project #MS90160076 Project costs from March 2007 thru May 2008	1	20,240.56	1 EA	20,240.56
Items total					\$ 103,678.65
Taxes					
Total amount due.....					\$ 103,678.65
2420-63003 -551200					

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P.O. Box 78815
Phoenix, AZ 85062-8815

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TTY number is (602) 534-5500.*

Check or Money Order _____
Credit Card _____
VISA MC AMEX DISCOVER OTHER _____
Credit Card Account Number: _____

Expiration Date: ____ / ____ / ____

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400515189	05/27/2008	06/26/2008	\$103,678.65

010008460053504005151891000000001036786524



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

INVOICE

Number/Date
400576643 05/01/2009

Due Date: 05/31/2009

Customer Number: 8460053
Contact/Phone
Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
MICHAEL WEBER
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Project Engineering Consultants Ltd.	1	1,301.56	EA	1,301.56
2	Wastewater - Misc revenue City of Phx/Misc. Project Costs Costs for 95th Ave Siphon Elimination North Van Buren Project #W590160074 Project costs from May 2008 through April 2009 This invoice is based on capacity ownership in the 95th Ave Interceptor. IGA representatives may determine to reconcile costs with average daily flow (ADF) data if/ when available in the future.	1	3,727.61	EA	3,727.61
3	Wastewater - Misc revenue Quest Civil Contractors, Inc.	1	1,077,800.39	EA	1,077,800.39
4	Wastewater - Misc revenue City of Phx/Misc. Project Costs Costs for 95th Ave Siphon Structure Repairs	1	33,919.11	EA	33,919.11

CO
5-11-09
3420-63003-551200

10071

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CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

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Payments can be made in person at 251 W. Washington St., Third
Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.

Check or Money Order _____
Credit Card _____
VISA MC AMEXP DISCOVER OTHER _____
Credit Card Account Number: _____ Zip Code: _____

Expiration Date: ___ / ___ / ___

Signature: _____
(Credit Card Only)

Enter Amount Paid

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400576643	05/01/2009	05/31/2009	\$1,507,277.11

010008460053504005766433000000015072771177



CITY OF PHOENIX

251 West Washington Street
Phoenix, Arizona 85003-2295

Invoice

Number/Date
400358660 03/07/2006

Due Date: 04/06/2006

Customer Number: 8460053

Contact/Phone

Finance Util. (602) 256-5640

BILL TO:
CITY OF GLENDALE
CHRIS OCHS
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

SOLD TO:
CITY OF GLENDALE
6210 W MYRTLE AVE STE 112
GLENDALE AZ 85301-1700

Item	Description	Qty	Rate	Unit	Amount
1	Wastewater - Misc revenue Odor Control Costs for 99th Avenue Interceptor December 2005 - February 2006 This invoice is based on a billing schedule acceptable by partner cities. IGA No. 22747	1	38,084.87	1 EA	38,084.87
2	wastewater - Misc revenue City of Phoenix Cost Cost for Lined Sewer Condition Assessment 99th Ave Siphon Structure Inspect & Air Lifter Feasibility Study - Project # WS90160062-1 Project Costs from December 2005 - February 2006 This invoice is based on capacity ownership in the 99th Ave Interceptor. IGA representatives may determine to reconcile costs with average daily flow	1	1,915.29	1 EA	1,915.29

PLEASE DETACH AND RETURN THIS PORTION WITH YOUR PAYMENT



CITY OF PHOENIX
P.O. Box 78815
Phoenix, AZ 85062-8815

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Payments can be made in person at 251 W. Washington St., Third Floor. This statement is available in alternative formats upon request.
TTY number is (602) 534-5500.

Check or Money Order

Credit Card

VISA MC AMEXP DISCOVER OTHER

Credit Card Account Number: _____

Expiration Date: ____ / ____ / ____

Signature: _____

(Credit Card Only)

CLASS ACCOUNT PAID

Customer Number	Invoice Number	Invoice Date	Payment Due Date	Amount Due
8460053	400358660	03/07/2006	04/06/2006	\$100,000.16

010008460053504003586601000000001000001655

REBUTTAL EXHIBIT MHK-3R - 99th Avenue Interceptor Ongoing O&M Cost

Estimate

99th Avenue Interceptor Proposed Budget FY 09/10 through FY 16/17

Item	Item Description	Estimated Cost by Fiscal Year													
		09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	GRAND TOTAL					
1	Interceptor Condition Re-assessment and Rehabilitation				\$930,000	\$1,000,000	\$3,000,000	\$3,000,000							
2	Sewer Cleaning				\$66,000										\$75,000
3	Odor Control	\$545,000	\$545,000	\$545,000	\$575,000	\$575,000	\$575,000	\$575,000	\$600,000	\$600,000					\$600,000
GRAND TOTAL		\$545,000	\$545,000	\$545,000	\$1,571,000	\$1,575,000	\$3,575,000	\$3,600,000	\$675,000						

NOTE: Costs in red not currently funded in the City of Phoenix CIP.
Revision Date: 12/15/2009

99th Avenue Interceptor Proposed Billing Schedule for Assessment, Cleaning, and Odor Control ¹

City	Percent ²
Glendale	69.80%
Peoria ³	21.44%
Phoenix	8.70%
Tolleson	0.06%

NOTES:

- 1) Billing Schedule(s) for rehabilitation could vary, can't determine this until project scope / location is developed.
- 2) Based on Weighted Overall Capacity Ownership in the Interceptor.
- 3) Assume Peoria's portion to be picked up by whomever ends up owning their Capacity.

REBUTTAL EXHIBIT MHK-4R - Company Revised Response RUCO 6-3, Stock

Revised Response to Data Request No. RUCO 6-3

(a) (b) (c) (d) (e)

Account	Description	Service Co. Portion ¹	AAWC Non-Affiliate Portion ²	AAWC Non-Affiliate Portion ³
501716	Com - Stock Options	\$ 36,693	\$ -	\$ 41,909
501717	Comp - Restricted Stock	\$ 28,834	\$ 103,974	\$ -
501718	Comp - Restricted Stock Units	\$ 4,046	\$ -	\$ 43,232
		\$ 69,573	\$ 103,974	\$ 85,141

4-Factor Allocation to Districts:

9.363% Anthem Water	\$ 6,514	\$ 9,735	\$ 7,972
12.203% Sun City Water	\$ 8,490	\$ 12,688	\$ 10,390
12.354% Anthem / Agua Fria Wastewater	\$ 8,595	\$ 12,845	\$ 10,519
7.545% Sun City Wastewater	\$ 5,249	\$ 7,845	\$ 6,424
6.384% Sun City West Wastewater	\$ 4,442	\$ 6,638	\$ 5,436
47.850%	\$ 33,291	\$ 49,752	\$ 40,740
	Included in P13 - MGT Fees	Included in P08 - Labor	Excluded from P08 - Labor in error

¹ Included in Management Fees (Line 12 of Schedule C-2) and allocated to the districts in this case using the 4-Factor allocation methodology.
² Included in Labor (Line 7 of Schedule C-2) and allocated to the districts in this case using the 4-Factor allocation methodology.
³ Not included in Case - Charges were recorded in Labor for Paradise Valley in error and as such were not allocated to any districts in this case.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
ARIZONA -AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER AND SUN CITY WATER DISTRICTS

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM/
AGUA FRIA WASTEWATER, SUN CITY
WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICTS

DOCKET NO. SW-01303A-09-0343

**REBUTTAL TESTIMONY
OF
SANDRA L. MURREY
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DATED MARCH 22, 2010**

**REBUTTAL TESTIMONY
OF
SANDRA L. MURREY
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DATED MARCH 22, 2010**

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1
2 **EXECUTIVE SUMMARY**

3 Sandra L. Murrey responds to Staff and RUCO testimony concerning certain rate base issues.
4

5 **RATE BASE – UTILITY PLANT IN SERVICE & ACCUMULATED DEPRECIATION**

6 A. ANTHEM WATER

7 The Company accepts Staff's transfer of plant \$22,289 between NARUC accounts.

8 B. SUN CITY WATER

9 The Company accepts Staff's downward adjustment of \$149,497 for the Youngtown Plant and
10 \$22,008 of accumulated depreciation.

11 C. ANTHEM/AGUA FRIA WASTEWATER

12 The Company accepts Staff's revision for the downward adjustment of \$1,838,637 for the
13 Verrado Wastewater Plant.

14 The Company accepts Staff's transfer of generator costs of \$487,000 between NARUC accounts.

15 The Company accepts RUCO's inclusion of the retirement of 2 – 75 hp pumps at the Verrado
16 Wastewater Treatment Facility for a downward adjustment of \$52,636 offset by identical
17 accumulated depreciation.

18 D. SUN CITY WASTEWATER

19 The Company accepts Staff's transfer of force main study for Sun City West Wastewater for a
20 downward adjustment of \$12,242. Please see offsetting adjustment in Sun City West
21 Wastewater.

22 E. SUN CITY WEST WATER DISTRICT

23 The Company accepts Staff's transfer of force main study for Sun City Wastewater for an
24 upward adjustment of \$12,242. Please see offsetting adjustment in Sun City Wastewater.
25

26 **RATE BASE – CONTRIBUTIONS ASSOCIATED WITH CWIP**

27 The Company accepts RUCO's and Staff's adjustments for all districts as immaterial.
28

29 **OTHER**

30 The Company notes that no party disagreed with the Company's proposed Tolleson Rate
31 Component costs for Sun City Wastewater District.

1 **I INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, ADDRESS, AND TELEPHONE NUMBER.**

3 A. My name is Sandra L. Murrey. My business address is 2355 W. Pinnacle Peak Rd., Suite
4 300, Phoenix, Arizona 85027, and my telephone number is 623-445-2490.

5 **Q. ARE YOU THE SAME SANDRA L. MURREY WHO PREVIOUSLY**
6 **SUBMITTED DIRECT TESTIMONY IN THIS DOCKET?**

7 A. Yes.

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

9 A. On behalf of the Company, I accept a number of the recommendations in Staff and
10 RUCO testimony concerning various rate base issues. Please note that the rebuttal
11 testimony of Company witness Ms. Linda J. Gutowski also addresses other rate base
12 issues not covered in my rebuttal testimony.

13 **II RATE BASE – UTILITY PLANT IN SERVICE**

14 **A. ANTHEM WATER DISTRICT**

15 **Q. STAFF RATE BASE ADJUSTMENT NO. 1 RECOMMENDS A TRANSFER OF**
16 **\$22,289 FROM ACCOUNT 304300 TO 320100, AS SHOWN ON ANTHEM**
17 **WATER SCHEDULES GWB-4 AND GWB-5. DOES THE COMPANY ACCEPT**
18 **THIS ADJUSTMENT?**

19 A. Yes, this reclass was resolved during discovery. This amount is for chemical feed and
20 water quality monitoring equipment that will be reclassified to account 320100 – Water
21 Treatment Equipment Non-Media. Company adjustment, SLM-1R, is shown on
22 Schedule B-2 Rebuttal for the Anthem Water District.

23

24

1 **B. SUN CITY WATER DISTRICT**

2 **Q. STAFF RATE BASE ADJUSTMENT NO. 1 RECOMMENDS A DECREASE OF**
3 **\$149,497 FOR COSTS RELATING TO THE YOUNGTOWN PLANT, AS SHOWN**
4 **ON SUN CITY WATER SCHEDULES GWB-4 AND GWB-5. DOES THE**
5 **COMPANY ACCEPT THIS ADJUSTMENT?**

6 A. Yes, Company adjustment, SLM-1R, is shown on Schedule B-2 Rebuttal for the Sun City
7 Water District. This unspecified plant item was included on the Company's work papers
8 in this case as a Staff reconciling item from the previous case. (Please see conforming
9 adjustment for accumulated depreciation.) The reason the Company again included it in
10 its original application is that Staff's earlier adjustment did not identify specific plant.
11 The Company may further research and support this amount in a future rate case.

12 **C. ANTHEM/AGUA FRIA WASTEWATER DISTRICT**

13 **Q. STAFF RATE BASE ADJUSTMENT NO. 2 RECOMMENDS AN ADJUSTMENT**
14 **OF (\$1,838,637) FOR COSTS RELATING TO THE VERRADO WWTF, AS**
15 **SHOWN ON ANTHEM/AGUA FRIA WASTEWATER SCHEDULES GTM-4**
16 **AND GTM-6. DOES THE COMPANY ACCEPT THIS ADJUSTMENT?**

17 A. Yes, Company adjustment, SLM-1R, is shown on Schedule B-2 Rebuttal for the
18 Anthem/Agua Fria Wastewater District. The Company accepts this adjustment as a
19 reasonable outcome in this case. Staff witness Ms. Dorothy Hains stated that this
20 adjustment is due to her finding of excess Verrado WWTF plant capacity that should be
21 excluded from rate base as it is not used at this time. I request that the Commission in its
22 decision in this case conclude that this determination is temporary and also find that it is
23 appropriate to include the amount of \$1,838,637 in Property Held for Future Use
24 (Account # 103000). The disallowance is temporary until a future rate case finds the
25 disallowed portion of the plant is used by customers. Please note that Anthem/Agua Fria
26 Wastewater district Schedule B-2, Adjustment LJG-5 reduces rate base \$1,415,610 for a

1 future payment (expected April 2011) from Pulte for Tesoto Hills for the Verrado
2 WWTP. For further information on the Verrado WWTF, please refer to the Direct
3 testimony of Mr. Joseph Gross who provided the engineering background on this project.

4 **Q. STAFF RATE BASE ADJUSTMENT NO. 7 RECOMMENDS A TRANSFER OF**
5 **\$487,000 FROM ACCOUNT 354400 TO 355500 FOR A POWER GENERATOR,**
6 **AS SHOWN ON ANTHEM/AGUA FRIA WASTEWATER SCHEDULES GTM-4**
7 **AND GTM-9C. DOES THE COMPANY ACCEPT THIS ADJUSTMENT?**

8 A. Yes, this reclass was resolved during discovery. The Company will transfer the costs of
9 the generator to account 355500 – WW Power Gen Equip RWTP. Company adjustment,
10 SLM-3R, is shown on Schedule B-2 Rebuttal for the Anthem/Agua Fria Wastewater
11 District.

12 **Q. RUCO RATE BASE ADJUSTMENT NO. B-2 RECOMMENDS A DECREASE IN**
13 **PLANT OF \$52,636 FOR THE RETIREMENT OF TWO EFFLUENT PUMPS, AS**
14 **SHOWN ON RUCO'S SCHEDULE B.1 (AAF). DOES THE COMPANY ACCEPT**
15 **THIS ADJUSTMENT?**

16 A. Yes, this was resolved in discovery. Company adjustment, SLM-4R, is shown on
17 Schedule B-2 Rebuttal for the Anthem/ Agua Fria Wastewater District. Please note the
18 corresponding accumulated depreciation adjustment in the section below.

19 **D. SUN CITY WASTEWATER DISTRICT**

20 **Q. STAFF RATE BASE ADJUSTMENT NO. 1 WOULD DECREASE PLANT BY**
21 **\$12,242 FOR PLANNING STUDY COSTS AS SHOWN ON SUN CITY**
22 **WASTEWATER SCHEDULES GTM-4 AND GTM-5. DOES THE COMPANY**
23 **AGREE?**

24 A. Yes. The comprehensive planning study was performed for the Sun City West
25 Wastewater District and should be transferred to that district. Company adjustment,

1 SLM-1R, is shown on Schedule B-2 Rebuttal for the Sun City Wastewater District.

2 Please note the offsetting adjustment in Sun City West Wastewater.

3 **E. SUN CITY WEST WASTEWATER DISTRICT**

4 **Q. STAFF RATE BASE ADJUSTMENT NO. 4 WOULD INCREASE PLANT BY**
5 **\$12,242 FOR PLANNING STUDY COST AS SHOWN ON SUN CITY WEST**
6 **WASTEWATER SCHEDULES GTM-4 AND GTM-5. DOES THE COMPANY**
7 **AGREE?**

8 **A.** Yes. Company adjustment, SLM-1R, is shown on Schedule B-2 Rebuttal for the Sun
9 City West Wastewater District. Please note the offsetting adjustment in Sun City
10 Wastewater.

11 **III RATE BASE – ACCUMULATED DEPRECIATION**

12 **A. SUN CITY WATER DISTRICT**

13 **Q. STAFF RATE BASE ADJUSTMENT NO. 1 RECCOMENDS A DECREASE TO**
14 **ACCUMULATED DEPRECIATION IN THE AMOUNT OF \$22,008 RELATING**
15 **TO THE YOUNGTOWN PLANT, AS SHOWN ON SUN CITY WATER**
16 **SCHEDULES GWB-4 AND GWB-5. DOES THE COMPANY ACCEPT THIS**
17 **ADJUSTMENT?**

18 **A.** Yes, this was addressed above in the section on plant. Company adjustment, SLM-1R, is
19 shown on Schedule B-2 Rebuttal for the Sun City Water District and adjusts for both the
20 plant and accumulated depreciation for Youngtown.

21 **B. ANTHEM/AGUA FRIA WASTEWATER DISTRICT**

22 **Q. RUCO RATE BASE ADJUSTMENT NO. B-2 RECOMMENDS A DECREASE IN**
23 **ACCUMULATED DEPRECIATION OF \$52,636 FOR THE RETIREMENT OF**
24 **TWO EFFLUENT PUMPS, AS SHOWN ON RUCO'S SCHEDULE B (AAF).**
25 **DOES THE COMPANY ACCEPT THIS ADJUSTMENT?**

1 A. Yes. Please note corresponding utility plant in service adjustment in the section above.
2 Company adjustment, SLM-4R, is shown on Schedule B-2 Rebuttal for the Anthem
3 Agua/Fria Wastewater District and adjusts for both the plant and accumulated
4 depreciation associated with the pumps.

5 **IV RATE BASE – CONTRIBUTIONS ASSOCIATED WITH CWIP**

6 **A. ANTHEM WATER DISTRICT**

7 **Q. RUCO (Adjustment No. B-3) AND STAFF (Adjustment No. 4) RATE BASE**
8 **ADJUSTMENTS RECOMMEND AN ADJUSTMENT OF \$30,271 FROM**
9 **CONTRIBUTIONS. DOES THE COMPANY ACCEPT THIS ADJUSTMENT?**

10 A. Yes. The Company accepts their adjustments in this case because the amounts are
11 immaterial and the Company has improved its accounting for developer projects to
12 eliminate this inconsistency in the future. In the prior case, CIAC associated with CWIP
13 was very material and the Company did not prevail on this topic after extensive
14 discussion in the case. As explained in that case, the Company recorded CIAC on
15 developer projects at the time of operational acceptance, but the plant remained in CWIP
16 a few months longer until final acceptance of the developer project. The Company has
17 since improved its developer accounting policies and has eliminated the internal practice
18 of operational acceptance and, since 2009, only has the category of final acceptance of
19 developer projects. Company adjustment, SLM-2R, is shown on Schedule B-2 Rebuttal
20 for the Anthem Water District.

21 **B. SUN CITY WATER DISTRICT**

22 **Q. RUCO (Adjustment No. B-3) AND STAFF (Adjustment No. 4) RATE BASE**
23 **ADJUSTMENTS RECOMMEND AN ADJUSTMENT OF \$38,991 FROM**
24 **CONTRIBUTIONS. DOES THE COMPANY ACCEPT THIS ADJUSTMENT?**

1 A. Yes. Please see response to Anthem Water District for Company's position on this
2 adjustment category. Company adjustment, SLM-2R, is shown on Schedule B-2 Rebuttal
3 for the Sun City Water District.

4 **C. ANTHEM/AGUA FRIA WASTEWATER DISTRICT**

5 **Q. RUCO RATE BASE ADJUSTMENT NO. B-3 RECOMMENDS AN**
6 **ADJUSTMENT OF \$65,490 FROM CONTRIBUTIONS. DOES THE COMPANY**
7 **ACCEPT THIS ADJUSTMENT?**

8 A. Yes, the Company accepts RUCO's adjustment. Please see the response to Anthem
9 Water District for Company's position on this adjustment category. Also, note that Staff
10 made an adjustment for this category as well, however, in the amount of \$988,900 –
11 which we believe to be in error as it does not match our books. The Company has
12 requested further detail from Staff in discovery but at this time Company can not validate
13 Staff's amount and, therefore, rejects Staff's adjustment. Company adjustment, SLM-2R,
14 is shown on Schedule B-2 Rebuttal for the Anthem/Agua Fria Wastewater District.

15 **D. SUN CITY WASTEWATER DISTRICT**

16 **Q. RUCO RATE BASE ADJUSTMENT NO. B-3 RECOMMENDS AN**
17 **ADJUSTMENT OF \$3,743 FROM CONTRIBUTIONS. DOES THE COMPANY**
18 **ACCEPT THIS ADJUSTMENT?**

19 A. Yes, the Company accepts RUCO's adjustment. Please see the response to Anthem
20 Water District for Company's position on this adjustment category. Also, note that Staff
21 made an adjustment for this category as well, however, in the amount of \$6,593 – which
22 we believe to be in error as it does not match our books. The Company has requested
23 further detail from Staff in discovery but at this time Company can not validate Staff's

1 amount and therefore rejects Staff's adjustment. Company adjustment, SLM-2R, is
2 shown on Schedule B-2 Rebuttal for the Sun City Wastewater District

3 **V OTHER**

4 **Q. THE DIRECT TESTIMONY OF MS. SHERYL L. HUBBARD SUPPORTS**
5 **ADJUSTMENT SLH-7 – ANNUALIZE WATER DISPOSAL EXPENSE. THIS**
6 **PRO FORMA ADJUSTMENT ADDRESSES COSTS CONTRACTED WITH THE**
7 **CITY OF TOLLESON. DID THE PARTIES MAKE ANY REVISIONS TO THE**
8 **TOLLESON RELATED COSTS OR ITS RATE COMPONENTS?**

9 A. No, the parties did not. The Company maintains its original pro forma adjustment
10 amount and highlights the other parties' silence on this topic as implying their agreement
11 with the Company on this important contract for Sun City Wastewater District.

12 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

13 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER AND SUN CITY WATER DISTRICTS

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM /
AGUA FRIA WASTEWATER, SUN CITY
WASTEWATER AND SUN CITY WEST
WASTEWATER DISTRICTS

DOCKET NO. SW-01303A-0343

**REBUTTAL TESTIMONY
OF
BENTE VILLADSEN
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MARCH 22, 2010**

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1 **EXECUTIVE SUMMARY**

2
3
4 Dr. Bente Villadsen, a Principal at *The Brattle Group*, filed direct testimony on the cost
5 of capital for Arizona-American's Anthem and Sun City water districts as well as for its
6 Anthem / Agua Fria, Sun City, and Sun City West waste water districts (collectively,
7 "Arizona-American Water") in July 2009, and is now filing rebuttal testimony in
8 response to the testimony submitted by Mr. William A. Rigsby on behalf of the
9 Residential Utility Consumer Office ("RUCO"). As Arizona-American Water has
10 accepted Staff's recommended cost of equity, Dr. Villadsen is not responding to the
11 Direct Testimony of Staff Witness Juan C. Manrique.

12 Mr. Rigsby's recommended 9.5% return on equity on 39.15% equity is too low to be
13 reasonable. It does not afford Arizona-American Water the opportunity to earn a
14 reasonable return on its assets and to successfully raise equity capital. The main reasons,
15 Mr. Rigsby finds such a low cost of equity is that he (i) fails to take Arizona-American's
16 financial risk into account, (ii) relies on an unconventional adjustment in his DCF
17 analysis, and (iii) includes cost of equity estimates below the cost of debt plus a minimum
18 equity risk premium of 100 basis points in his Capital Asset Pricing Model. Simple
19 modifications to Mr. Rigsby's cost of equity estimation methodology increases the
20 calculated cost of equity by at least 100 basis points.

21

1 **I. INTRODUCTION**

2 **Q1. PLEASE STATE YOUR NAME AND ADDRESS FOR THE RECORD.**

3 A1. My name is Bente Villadsen. My business address is *The Brattle Group*, 44 Brattle
4 Street, Cambridge, MA 02138.

5 **Q2. ARE YOU THE SAME BENITE VILLADSEN WHO FILED DIRECT**
6 **TESTIMONY IN THIS PROCEEDING?**

7 A2. Yes I am.

8 **Q3. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
9 **PROCEEDING?**

10 A3. I have been asked by Arizona-American Water Company ("Arizona-American Water" or
11 the "Company") to review and comment on the Direct Testimony of William C. Rigsby
12 ("Rigsby Testimony") on behalf of RUCO and to review the Direct Testimony of Juan C.
13 Manrique ("Manrique Testimony") on behalf of the Arizona Corporation Commission
14 ("Commission") Staff in this proceeding.

15 **Q4. PLEASE SUMMARIZE THE RECOMMENDATIONS OF MR. MANRIQUE AND**
16 **MR. RIGSBY.**

17 A4. The Manrique Testimony recommends that Arizona-American Water Company be
18 allowed a return on equity of 10.7% and a weighted average cost of capital of 7.2% while
19 the Rigsby Testimony recommends the an allowed return on equity of 9.5% and a
20 weighted average cost of capital of 6.77%.¹

21 **Q5. DO YOU BELIEVE A RETURN ON EQUITY OF 9.5% REFLECTS**
22 **ACCURATELY THE COST OF EQUITY FOR ARIZONA-AMERICAN WATER**
23 **COMPANY?**

24 A5. No. First and foremost, I believe investors require a return that is higher than 9.50% and
25 that is especially true because financial markets remain turbulent. Second, the Rigsby
26 Testimony arrives at its recommendation using methods and procedures that are

¹ Manrique Testimony, Executive Summary and Rigsby Testimony p. 7.

1 unreasonable and unconventional such as relying on cost of equity estimates below the
2 cost of investment grade debt.

3 **Q6. HOW IS THE REMAINDER OF YOUR REBUTTAL TESTIMONY**
4 **ORGANIZED?**

5 A6. Section III discusses the reasonableness of the return on equity Mr. Rigsby recommends.
6 Section IV discusses specifics of the Rigsby Testimony and re-calculates its cost-of-
7 equity estimates using more reasonable assumptions. Section V concludes.

8 **II. A RETURN ON EQUITY OF 9.5% IS NOT REASONABLE**

9 **Q7. HOW DOES THE RIGSBY TESTIMONY ARRIVE AT ITS RECOMMENDED**
10 **9.5% RETURN ON EQUITY?**

11 A7. The Rigsby Testimony applies several cost of equity estimation techniques to a sample of
12 4 water utilities and to a sample of 10 gas LDC companies resulting in a range of
13 estimates from 5.24 to 9.75 percent.² First, combining historical and forward looking
14 growth rates, the Rigsby Testimony uses a sustainable growth DCF model to determine a
15 cost of equity figure for its water sample and for its gas LDC sample. The Rigsby
16 Testimony averages these two estimates to come up with a DCF-based cost of equity of
17 9.65%. Second, the Rigsby Testimony uses two versions of the Capital Asset Pricing
18 Model ("CAPM") to determine two cost of equity estimates for each of the two samples.
19 As for the DCF method, the Rigsby Testimony averages the four CAPM-based cost of
20 equity estimates and finds an average CAPM-based cost of equity of 6.28%.³ The
21 average of Mr. Rigsby's DCF and CAPM estimates is 7.96%, which the Rigsby
22 Testimony increases by approximately 150 basis points to get a recommendation of
23 9.50%, which "falls within the range of results that I obtained."⁴

24 **Q8. CAN YOU ELABORATE ON WHY YOU THINK THE RIGSBY TESTIMONY'S**
25 **RECOMMENDATION IS TOO LOW?**

² Rigsby Testimony p. 9.

³ Rigsby Testimony, Schedule WAR-1.

⁴ Rigsby Testimony p. 6.

1 A8. There are several reasons why I believe the recommendation is too low. First, the
2 financial crisis of 2008-09 has eased but financial markets remain volatile and, as
3 explained in my Direct Testimony, volatility increases the risk premium investors require
4 to hold equity. Second, if I make simple and conservative adjustments to cost-of-equity
5 estimates provided in the Rigsby Testimony, I find a much more reasonable estimate.
6 Specifically, (i) discarding cost-of-equity estimates below the cost of investment grade
7 debt, (ii) taking Arizona-American Water Company's higher leverage into account, (iii)
8 eliminating the market-to-book adjustment in Mr. Rigsby's DCF estimates, lead to cost of
9 equity estimates in the range of 10.5 to 11.2 percent. This range is consistent with Staff's
10 recommended cost of equity, which Arizona-American Water Company has accepted.

11 **Q9. DO YOU HAVE A VIEW ON THE APPROPRIATENESS OF STAFF'S**
12 **RECOMMENDED ROE?**

13 A9. Yes. The ROE level recommended by Staff is consistent with the ROE allowed by other
14 jurisdictions and within the range of what credit rating agencies consider appropriate for
15 a utility such as Arizona-American Water. For example, in Q4 2009, the average allowed
16 ROE for natural gas distribution companies was 10.4% and those companies had on
17 average higher equity and thus less financial risk than Arizona-American Water.⁵

18 **Q10. PLEASE COMMENT ON THE IMPACT OF THE FINANCIAL CRISIS ON THE**
19 **COST OF CAPITAL AND SPECIFICALLY ON THE DISCUSSION IN THE**
20 **TESTIMONY OF MR. RIGSBY.**

21 A10. As acknowledged in the Rigsby Testimony (pp. 49-51), the second half of 2008 and all of
22 2009 were turbulent times in financial markets with substantial government action.
23 Among the consequences of the financial turbulence were a very large increase in the
24 spread between utility and government bond yields, highly volatile stock prices, and
25 limited access to liquidity for many companies. While financial markets certainly have
26 improved, they have yet to fully recover. For example, Figure R-1, which is an updated
27 version of Figure 7 from my Direct Testimony shows that the spread between utility

⁵ Regulatory Research Associates, Major Rate Case Decisions – January 2009-December 2009, issued January 8, 2010. According to this publication, the average equity percentage for the gas utilities was 49.4%. I do not know of public data that summarize allowed rates of return for water and wastewater utilities.

1 borrowing rates and risk-free rates remains higher than in the recent past. The Figure is
2 attached to this testimony.

3 Because the borrowing rate for a utility is related to the yield on utility bonds,
4 information about utility bonds is, in my view, an important consideration, when
5 determining the cost of capital for a utility.

6 **Q11. MORE BROADLY WHAT HAPPENS TO INVESTOR EXPECTATIONS**
7 **DURING TIMES OF FINANCIAL TURMOIL?**

8 A11. The facts that financial markets are in turmoil and stock market volatility has increased
9 dramatically mean that equity investors face increased uncertainty. Increased uncertainty
10 leads them to seek lower risk investments or to demand a higher expected rate of return
11 before they are willing to invest their money. In part, this is an explanation of why
12 market prices have fallen. The financial market distress means that the current market
13 risk premium ("MRP") is higher than it would otherwise be. Dimson, Marsh, and
14 Staunton (2008) appear to agree as they note:

- 15 • Although credit spreads widened, credit fundamentals as measured by low default
16 rates remained at historically strong levels. This may indicate higher defaults to
17 come, an increase in risk aversion, a bigger premium for liquidity, or all three.⁶
- 18 • As investors' risk aversion also increases during times of financial distress, there
19 can be little doubt that the MRP is currently higher than in the recent past.

20 **Q12. WHAT BEARING DOES THIS HAVE ON WATER UTILITIES, WHICH**
21 **HISTORICALLY HAVE BEEN VIEWED AS RELATIVELY LOW RISK?**

22 A12. Debra G. Coy, a senior research analyst at the investment firm Janney Montgomery
23 specializing in the water industry, noted, in testimony before the California PUC,

24 Water utilities have historically been viewed as low-risk,
25 predictable, regulated monopolies, and they have attracted equity

⁶ Elroy Dimson, Paul Marsh, and Mike Staunton, 2008, *Global Investment Returns Yearbook 2008*, p. 25.

1 investors who appreciated those characteristics. Now, investors are
2 more wary
3 and

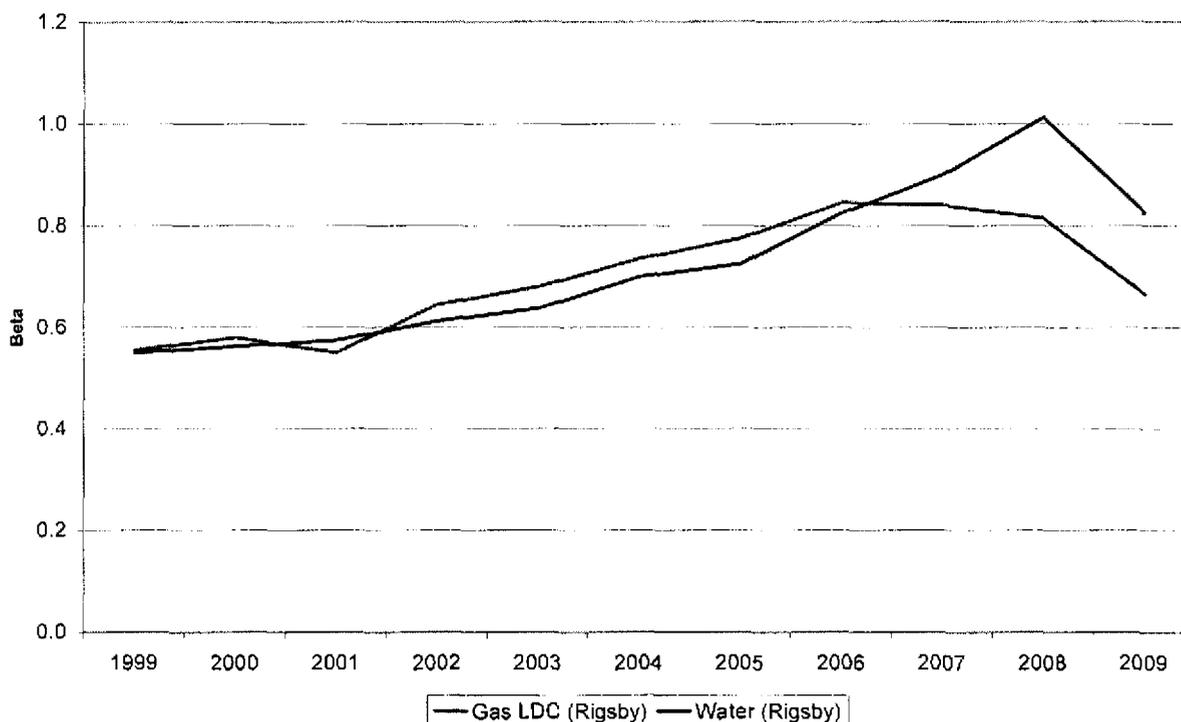
4 [i]nvestors have come to understand that 'low risk' water utilities in
5 fact carry a variety of potential risks, the largest of which is their
6 raising need to repair and replace aging infrastructure, resulting in
7 high capex requirements, low depreciation rates, and negative free
8 cash flow, along with the negative effects of regulatory lag on
9 earnings.⁷

10 *Value Line* documents this increase in systematic risk as the betas *Value Line* estimates
11 for the utility companies in the water sample have increased over time and are now
12 higher than those of, for example, gas LDC companies. Figure R-2 below also
13 demonstrates that water utility betas have not declined to the degree that has, for example
14 those of gas LDCs. Further, the water companies' beta did not decline until well into the
15 financial crisis. This indicate that water utility stock are moving in co-step with the
16 market - - when the market declines, so does utility stock. Put simply, investors in water
17 utility stock can expect to be exposed to substantial systematic risk (i.e., water utility
18 stock is not a safe haven based on this measure).

19
20
21

⁷ Debra G. Coy, "A Capital Markets View of Water Utilities," submitted to the California Public Utilities Commission at the request of the CPUC Staff, January 30, 2009 ("Coy Testimony") p. 7.

Figure R-2: Value Line Betas



Source: Value Line; based on Rigsby Samples.

Q13. ARE VALUE LINE BETAS A RELIABLE MEASURE OF THE WATER INDUSTRY'S SYSTEMATIC RISK?

A13. Yes. While the stocks of some publicly traded water companies trade relatively infrequently, the impact hereof on estimated betas do not change significantly over time, so the trend illustrated in Figure R-2 reflects an increase in the water industry's systematic risk albeit the financial crisis impacted the trend. At the same time, there are other indications that the overall risk of the industry is increasing. For example, the industry has a significant need for infrastructure investment⁸ and faces unique water supply risks in some jurisdictions. At the same time, the regulatory requirements

⁸ A recent discussion of this is found in the *New York Times*, "Saving U.S. Water and Sewer Systems Would be Costly," March 14, 2010. See also, *American Society of Civil Engineers' Infrastructure Report Card* at www.infrastructurereportcard.org

1 imposed on the water industry are evolving. Hence the water industry is experiencing a
2 transition period which adds to the risk of the industry. As there is a positive relationship
3 between risk and return, the cost of equity necessarily has increased in the last couple of
4 years.

5 **III. REASONABLE ADJUSTMENTS TO THE RECOMMENDED ROE IN THE**
6 **RIGSBY TESTIMONY**

7 **Q14. PLEASE EXPLAIN THE REASONABLE ADJUSTMENTS YOU MAKE TO MR.**
8 **RIGSBY'S CALCULATIONS.**

9 A14. First, I note that Mr. Rigsby fails to take Arizona-American Water Company's higher
10 financial risk into account. I illustrate the impact of this using the Staff's book value
11 based approach as well as an implementation based on market values. Second, the
12 Rigsby Testimony makes an unconventional adjustment to the DCF model and fails to
13 take the fact that the cost of equity necessarily is higher than the cost of debt plus a risk
14 premium into account. The risk premium simply compensates equity holders for the fact
15 that equity carries more risk than debt.

16 **Q15. PLEASE EXPLAIN THE FIRST ADJUSTMENTS YOU MENTIONED ABOVE.**

17 A15. The Rigsby Testimony fails to consider the additional risk Arizona-American Water
18 faces because it has more debt than comparable companies. It is common to take this
19 feature into account and, in this case, Staff Witness Manrique has taken the difference in
20 Arizona-American Water Company's and the sample companies' book value capital
21 structure into account. I implemented the same procedure as relied upon by staff using
22 Mr. Rigsby's data and found that an upward adjustment of 55 to 60 basis points are
23 warranted using book value capital structures whereas an adjustment of 80 to 120 basis
24 points is warranted using the theoretically more correct market value capital structure

1 relied upon in the estimation phase.⁹ The calculation of this adjustment is presented in
2 Schedules R-1, Panels A and B attached to this testimony.

3 **Q16. PLEASE EXPLAIN HOW THE RIGSBY TESTIMONY DETERMINES ITS DCF**
4 **RESULTS.**

5 A16. The Rigsby Testimony relies on a constant growth DCF model with a sustainable growth
6 rate where the standard sustainable growth model states that

7
$$g = b \times r + s \times v \quad (1)$$

8 where b is the earnings retention ratio

9 r is the return on common equity

10 s is the growth in shares

11
$$v = [(\text{Market Value per Share}) / (\text{Book Value per Share}) - 1] \quad (2-a)$$

12 Rigsby calculates the five-year historical and forecasted retention ratio, book return on
13 equity, book value per share, and growth in shares. Based on five-year historical
14 averages and forecasted growth rates, Rigsby decides on an internal growth rate.¹⁰ He
15 also estimates the share growth. However, the Rigsby Testimony relies on a model
16 where v is replaced by¹¹

17
$$v^* = \{[(\text{Market Value per Share}) / (\text{Book Value per Share}) + 1] / 2 - 1\} \quad (2-b)$$

18 As v^* is less than v whenever the stock price per share is higher than the book value per
19 share, the formula in (2-b) results in a lower growth rate than the standard formula for
20 companies with a market-to-book (or price to book value per share) above one. The
21 simplest way to see the difference between (2-a) and (2-b) is to slightly rewrite the
22 formula. Let M denote the market value per share and B denote the book value per share.
23 Simple algebraic manipulations show that

24
$$v = s \times (M - B) / B \quad (3-a)$$

⁹ The figures are not necessarily consistent with those obtained by Staff because the Rigsby Testimony relied on a different sample.

¹⁰ See Rigsby Direct p. 27 and Schedules WAR-4, WAR-5, and WAR-6.

¹¹ Rigsby Direct, Schedule WAR-4, page 2.

1 while (2-b) becomes

2
3
$$v^* = s \times (M - B) / 2B$$
 (3-b)
4

5 Equation (3-a) is the standard version of the sustainable growth model that textbooks
6 present. It simply calculates growth in equity that shareholders contribute in excess of
7 book value from external financing. In contrast, the version presented in the Rigsby
8 Testimony (versions (2-a) and (2-b)) do not have a straightforward interpretation.
9 Instead, it arbitrarily reduces the growth contribution by equity holders as it assumes that
10 the market value will drop to approach the book value and do so in a manner that cuts the
11 long-term external growth in half. There is no theory that justifies this formula and the
12 Rigsby Testimony did not cite a textbook or scholarly article that demonstrates the
13 empirical validity of the assumption. Instead Mr. Rigsby cited testimony by another
14 ROE witness.¹² Because Mr. Rigsby's adjustment to the standard sustainable growth has
15 no theoretical support and Mr. Rigsby has not provided empirical evidence that it is an
16 accurate description of real world phenomena, I find the adjustment unsupported and
17 modified the Rigsby Testimony's results using the textbook formula for the sustainable
18 growth.

19 **Q17. WHAT ARE THE CONSEQUENCES OF THE RIGSBY TESTIMONY'S**

20 **MODIFICATION OF THE SUSTAINABLE GROWTH METHOD?**

21 A17. In essence, the adjustment lowers (increases) the sustainable growth rate when the
22 market-to-book ratio is higher (lower) than one. Table R-2 attached to this testimony
23 reports the results from using the data in the Rigsby Testimony's Schedules WAR-3 and
24 WAR-4 page 2, but removing the adjustment factor. For the water companies the cost-
25 of-equity estimate increases by about 80 basis points while the cost-of-equity estimate for
26 the gas LDC sample increases by about 35 basis points for an average increase of about
27 60 basis points in the DCF cost-of-equity estimate.

¹² Rigsby Testimony p. 18.

1 As can be seen from R-2, the impact of this one adjustment is significant and biases the
2 DCF estimates obtained in the Rigsby Testimony downward.

3 **Q18. WHAT IS YOUR POINT THAT THE COST OF EQUITY NEEDS TO BE**
4 **HIGHER THAN THE COST OF DEBT PLUS A RISK PREMIUM?**

5 A18. First, I note that a cost of equity estimate that is below the cost of debt plus an amount is
6 unreasonable. At the Federal Energy Regulatory Commission ("FERC"), it is common to
7 exclude ROE estimates that are lower than the yield on utility bonds of the same rating as
8 the target company plus 100 basis points.¹³ FERC's rationale for this is that equity is
9 riskier than debt and therefore ROE estimates below the cost of debt plus a risk premium
10 are not meaningful.¹⁴ Following FERC's approach of excluding estimates of the cost of
11 equity that are lower than the yield on Baa-rated utility bonds, only two CAPM estimate
12 meets that criteria as the Baa utility bond yield averaged 6.23% for the first 15 days in
13 March.¹⁵ Using this approach to the CAPM, the Rigsby Testimony's results are
14 modified by eliminating all company-specific ROE results that are less than the cost of
15 debt plus 100 basis points. Specifically, I used the average yield on Baa-rated utility
16 bonds for the first 15 days in March. The results of this analysis is presented in Schedule
17 R-3 attached to this testimony and shows that failing to consider that equity is riskier than
18 debt downward biases the ROE estimates by approximately 60 basis points. In this
19 analysis I relied on Mr. Rigsby's analysis using his arithmetic risk premium.

20 **Q19. DO YOU HAVE ANY PRELIMINARY COMMENTS ABOUT THE CAPM**
21 **RESULTS OBTAINED BY THE RIGSBY TESTIMONY?(I WOULD MOVE THIS**
22 **POINT TO LATER IN YOUR TESTIMONY-I NOTE IT LATER ON PAGE 9)**

23 A19. Yes. Two of CAPM estimates presented in Schedule WAR-1 are lower than the current
24 yield on Baa-rated utility bonds, which simply makes no sense. The cost of equity is
25 higher than the cost of investment grade debt. Further, the average CAPM-based cost of
26 equity estimate is essentially equal to the current yield on Baa-rated utility bonds, which
27 simply indicate that the estimate is flawed. As of March 15, 2010, the yield on Moody's

¹³ FERC has not ordered a specific number of basis points but used 100 bps in several orders.

¹⁴ See, for example, FERC Order 445, 92 FERC ¶61,007.

¹⁵ See Rigsby Schedule WAR-7.

1 Baa-rated utility bonds was approximately 6.2% or 8 basis points below the average
2 CAPM estimate provided in the Rigsby Testimony.¹⁶ Even though the Rigsby Testimony
3 recommends a return on equity in the high end of its estimated range, it is too low to
4 reflect the return investors currently require.

5 **Q20. DID YOU FIND ANY OTHER PROBLEMS WITH MR. RIGSBY'S CAPM?**

6 A20. Yes. In addition to relying on cost of equity estimates that are below the cost of debt, the
7 Rigsby Testimony relies on a medium term government bond in its estimation of the
8 CAPM. While the theoretical CAPM was developed using short-term risk-free rates,
9 most practitioners rely on long-term risk-free rates because long-term risk-free rates are
10 less influenced by current monetary policy. It is uncommon to see intermediate risk-free
11 rates relied upon. At the moment, all shorter term government instruments have a very
12 low yield, this downward biases the results. Also, the Rigsby Testimony presents two
13 versions of the CAPM of which one relies on geometric measures of the market risk
14 premium. While the magnitude of the market risk premium currently is the subject of
15 scrutiny in the academic literature,¹⁷ there is little doubt among academics that the
16 geometric market risk premium does not apply to cost-of-capital estimation. For
17 example, Ibbotson Associates state

18 The equity risk premium data presented in this book are arithmetic
19 average risk premia as opposed to geometric average risk premia. The
20 arithmetic average equity risk premium can be demonstrated to be most
21 appropriate when discounting future cash flows. For use as the expected
22 equity risk premium in either the CAPM or the building block approach,
23 the arithmetic mean or the simple difference of the arithmetic means of
24 stock market returns and riskless rates is the relevant number. This is
25 because both the CAPM and the building block approach are additive
26 models, in which the cost of capital is the sum of its parts. The geometric
27 average is more appropriate for the reporting past performance, since it
28 represents the compound average return.¹⁸

29 Similarly, the *New Regulatory Finance* text by Roger A. Morin (2006) argues that

¹⁶ Bloomberg as of March 17, 2010.

¹⁷ See Villadsen Appendix C for a detailed discussion.

¹⁸ Morningstar Ibbotson SBBi 2009 Valuation Yearbook, p. 59.

1 Only arithmetic means are correct for forecasting purposes and for
2 estimating the cost of capital. There is no theoretical or empirical
3 justification for the use of geometric mean rates of returns as a measure of
4 the appropriate discount rate in computing the cost of capital or in
5 computing present values. There is no dispute in academic circles as to
6 whether the arithmetic or geometric average should be used for purposes
7 of computing the cost of capital.¹⁹
8

9 Finally, the text by Bode, Kane, and Marcus (2005) states:

10 [I]f our focus is on future performance, then the arithmetic average is the
11 statistic of interest because it is an unbiased estimate of the portfolio's
12 expected return (assuming, of course, that the expected return does not
13 change over time). In contrast, because the geometric return over a
14 sample period is always less than the arithmetic mean, it constitutes a
15 downward-biased estimator of the stock's expected return in any future
16 year.²⁰

17 For these reasons and because all estimated figures are below the cost of debt plus 100
18 basis points, this analysis should be ignored.

19 **Q21. PLEASE SUMMARIZE YOUR MODIFICATIONS TO THE RIGSBY**
20 **TESTIMONY'S CALCULATIONS.**

21 A21. Table 1 below summarizes the impact of the three adjustments discussed above.

¹⁹ Roger A. Morin (2006), *New Regulatory Finance*, Public Utilities Reports, Inc., ("Morin (2006)"), pp. 116-117.

²⁰ Zvi Bode, Alex Kane, and Alan J. Marcus (2005), *Investments*, 6'th Edition, McGraw-Hill, p. 865.

Table 1: Rigsby Modified Analysis

	Water	Gas LDC
Rigsby DCF	9.75%	9.55%
Reversing M/B Adjustment	0.80%	0.36%
Revised DCF	10.56%	9.91%
Rigsby Arithmetic CAPM	7.46%	6.52%
Eliminating Estimates below CoD + 1%	0.76%	nmf
Revised CAPM	8.23%	nmf
Median	9.91%	
Adjustment for financial Risk - book value	0.56%	0.56%
Adjustment for financial Risk - market value	1.28%	0.79%
Median Range after Adjustment	10.47%	to 11.19%

1
2 I note that all three adjustments are warranted. Because the modification to the CAPM
3 model leaves only two companies available for the estimation process, of which one has
4 recently restated its financials, I believe the median is more representative of the results
5 than the average, which would assign a very large weight to those two companies. The
6 median result of the modified Rigsby analysis result in a ROE range of 10.5 to 11.2%, so
7 that Staff's recommendation falls within that range.

8 **IV. CONCLUDING REMARKS**

9 **Q22. DO YOU HAVE ANY OTHER COMMENTS ON THE TESTIMONY OF MR.**
10 **RIGSBY?**

11 A22. Yes. On pages 37-39, the Rigsby Testimony cites recent improvements in capital
12 markets as one reason why an ROE of 9.5% is appropriate for Arizona-American Water.
13 While I certainly agree that financial markets have improved substantially over the last
14 year, I believe investors remain cautious about investing because of the recent experience
15 and because the economy faces many risks going forward with a record level federal
16 debt, a continual troubled real estate market, etc. Therefore, the necessity to ensure that
17 Arizona-American Water Company earns a return that enables it to maintain access to

1 financial markets to finance infrastructure and operating needs continues to be a critical
2 factor.

3 **Q23. YOU DID NOT ADDRESS STAFF'S APPROACH TO COST OF EQUITY**
4 **ESTIMATION. DOES THAT MEAN YOU AGREE WITH THE**
5 **METHODOLGY?**

6 A23. Not necessarily. Because the Company has accepted Staff's recommendation, I did not
7 include a rebuttal of Staff's Testimony.

8 **Q24. YOU DO NOT ADDRESS ALL ISSUES OR FINDINGS DISCUSSED IN THE**
9 **RIGSBY TESTIMONY. DOES THAT IMPLY THAT YOU ACCEPT THEIR**
10 **POSITIONS OR FINDINGS?**

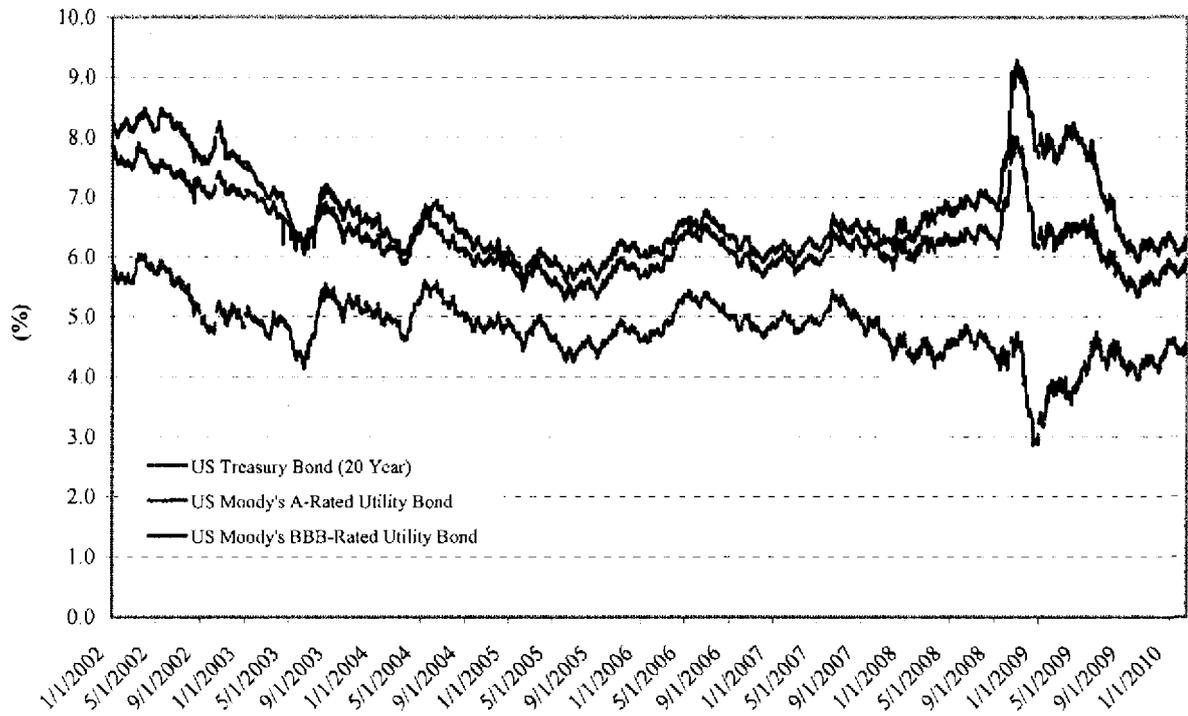
11 A24. No, not necessarily.

12 **Q25. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

13 A25. Yes.

SUPPORTING FIGURES AND SCHEDULES

Figure R-1: US Bond Yields from January 2002 to February 2010



Source: Bloomberg as of February, 2010.

**Schedule R-1, Panel A: Adjusting for Financial Risk
 (book value capital structure)**

	Water Utilities	Gas LDC
Value Line Beta	0.83	0.67
Raw Beta	0.71	0.48
Average Book Equity	49%	53%
Tax Rate	34%	34%
Unlevered Beta	0.42	0.30
Company Book Equity	39.15%	39.15%
Relevered Beta	0.85	0.61
Relevered Adj. Beta	0.92	0.76
Risk Free Rate	2.43%	2.43%
Market Risk Premium	6.10%	6.10%
CoE with Relevered Beta	8.02%	7.07%
Original CoE	7.46%	6.52%
Leverage Adjustment	0.56%	0.56%

Sources: Rigsby WAR-7 and WAR-9
 Staff Workpapers provide methodology

**Schedule R-1, Panel B: Adjusting for Financial Risk
(market value capital structure)**

	Water Utilities	Gas LDC
Value Line Beta	0.83	0.67
Raw Beta	0.71	0.48
Average Book Equity	62%	60%
Tax Rate	34%	34%
Unlevered Beta	0.50	0.33
Company Book Equity	39.15%	39.15%
Relevered Beta	1.02	0.67
Relevered Adj. Beta	1.04	0.80
Risk Free Rate	2.43%	2.43%
Market Risk Premium	6.10%	6.10%
CoE with Relevered Beta	8.74%	7.31%
Original CoE	7.46%	6.52%
Leverage Adjustment	1.28%	0.79%

Sources: Rigsby WAR-7 and WAR-9
Staff Workpapers provide methodology
Villadsen Direct Testimony Table BV-4 and BV-16

Schedule R-2: Recalculating Rigsby Sustainable Growth

Revisiting Rigsby DCF	Dividend Yield [1]	Internal Growth [2]	Share Growth [3]	Market to Book [4]	External Growth [5]	Sustainable Growth [6]	Estimated Cost of Equity Capital [7]
Water Utilities							
AMERICAN STATES WATER CO.	2.99%	6.25%	5.00%	1.78	3.88%	10.13%	13.12%
CALIFORNIA WATER SERVICE GROUP	3.19%	6.00%	1.75%	1.85	1.48%	7.48%	10.68%
SOUTHWEST WATER COMPANY	3.29%	5.75%	1.10%	1.35	0.39%	6.14%	9.43%
AQUA AMERICA, INC.	3.34%	5.00%	0.55%	2.20	0.66%	5.66%	9.00%
AVERAGE							10.56%
Gas LDC							
AGL RESOURCES, INC.	4.72%	5.50%	1.00%	1.62	0.62%	6.12%	10.64%
ATMOS ENERGY CORP.	4.62%	4.10%	3.75%	1.23	0.86%	4.96%	9.59%
LACLEDE GROUP, INC.	4.62%	4.50%	3.25%	1.41	1.34%	5.84%	10.45%
NEW JERSEY RESOURCES CORPORATION	3.66%	5.25%	1.25%	2.27	1.59%	6.84%	10.49%
NICOR, INC.	4.45%	4.50%	0.25%	1.87	0.22%	4.72%	9.17%
NORTHWEST NATURAL GAS CO.	3.74%	4.25%	1.00%	1.78	0.78%	5.03%	8.78%
PIEDMONT NATURAL GAS COMPANY	4.14%	5.75%	0.01%	2.07	0.01%	5.76%	9.90%
SOUTH JERSEY INDUSTIES, INC.	4.27%	7.00%	1.50%	2.05	1.57%	8.57%	12.84%
SOUTHWEST GAS CORPORATION	3.33%	4.50%	2.50%	1.10	0.25%	4.75%	8.08%
WGL HOLDINGS, INC.	4.51%	4.40%	0.10%	1.49	0.05%	4.45%	8.96%
AVERAGE							9.91%
Average of Water and Gas LDC							10.23%

[1] Rigsby WAR-3.
 [2] Rigsby WAR-4, page 1
 [3]-[4] Rigsby WAR-4 page 2.
 [5] = [3] x ([4] - 1)
 [6] = [2] + [5]
 [7] = [1] + [6]

Schedule R-3: Modifying Rigsby's CAPM

	As Filed [1]	Modified [2]
Water Using Geometric MRP	5.90%	nmf
Gas LDC Using Geometric MRP	5.24%	nmf
Water Using Arithmetic MRP	7.46%	8.23%
Gas LDC Using Aritmetic MRP	6.52%	nmf

[1]: Rigsby Schedule WAR-7

[2]: Eliminating all results below cost of debt plus 100 bps