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Transcript Exhibit(s)

Docket #(s): WS-01303A-02-0867
WS-01303A-02-0868
WS-01303A-02-0869
WS-01303A-02-0870
W-01303A-02-0908

Exhibit # : A45 - A80, A82 - A102, A104
H1, H2

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WS-01303A-02-0867
WS-01303A-02-0868
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WS-01303A-02-0870
W-01303A-02-0908

Ms. Teena Wolfe
Administrative Law Judge
ACC – HEARING DIVISION
1200 West Washington, 1st Floor
Phoenix, AZ 85007

Arizona Corporation Commission
DOCKETED
JAN - 9 2004
DOCKETED BY

Case: Arizona-American Water Co.
Number: WS-01303A-02-0867, etc.
Dates: December 4, 5, 8 through 12, 22, and 23, 2003

Dear ALJ Wolfe:

With copy of this letter the original exhibits in this matter have been distributed, as follows:

Docket Control	A-1 through A-80, A-82 through A-102, and A-104
	H-1 and H-2
	RUCO-1 through RUCO-8, and RUCO-10 through RUCO-12
	S-1, S-2, S-4 through S-8, and S-11 through S-48
	SH-1
	Y-1 through Y-6
Returned to Applicant	A-81 and A-103
Returned to Staff	S-3, S-9 and S-10

Exhibits Nos. A-81, A-103, and S-3 are being returned to the Applicant and Staff, respectively, because they were withdrawn.

Exhibits Nos. S-9 and S-10 are being returned to Staff because they were not moved for admission on the record either inadvertently or by design.

We did not check out the Docket File.

Please let us know if you have any questions or if we may be of any further assistance.

Very truly yours,

Marta T. Hetzer
Administrator/Owner

Enclosure

Copy to: Arizona-American Water
AUIA
Docket Control
Frank Grimmelmann, Intervenor
RUCO
Staff
Sun City Taxpayers' Assoc.
Sun Health Corp.
Town of Youngtown

COPY FOR YOUR INFORMATION

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Water Company

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SUN CITY WEST WATER AND SUN CITY WEST WASTEWATER DISTRICTS.	DOCKET NO. W-01303A-02-_____ SW-01303A-02-_____

DIRECT TESTIMONY

OF

DAVID P. STEPHENSON

EXHIBIT
A-65
Admitted

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I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is David P. Stephenson. My business address is 303 H Street, Suite 250, Chula Vista, California 91910. My telephone number is (619) 409-7700.

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

A. I am employed by American Water Works Service Company, Inc. ("Service Company"), as the Director of Rates and Planning for American Water Works Company, Inc.'s ("AWW") Western Region. The Western Region includes AWW's water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including Arizona-American Water Company ("Arizona-American" or "Company"). I am also an Assistant Treasurer for Arizona American.

Q. PLEASE BRIEFLY OUTLINE YOUR RESPONSIBILITIES AS THE DIRECTOR OF RATES AND PLANNING.

A. I am responsible for directing preparation of all rate applications and various other matters related to rates and charges for utility service with the public utility commissions that regulate AWW's operating utilities in Arizona, California, Hawaii, New Mexico and Texas. I am also responsible for overseeing other rate related proceedings before these commissions such as acquisition and financing applications.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science in Business Administration, with emphasis in Accounting, from San Diego State University in 1977.

Q. HAVE YOU HAD ANY OTHER FORMAL TRAINING?

A. Yes, I have attended many seminars on various aspects of the water industry and

rate applications, including the National Association of Regulatory Utility Commissioners (NARUC) biannual Utility Rate Seminar.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have been employed by the American Water System since 1978. The various positions I have held within the American Water System are: Accountant - 1978; Accounting Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for the operating utilities in the Western Region - 1983; Assistant Director of Rates and Revenues for the operating utilities in the Western Region - 1984; Director of Rates and Revenues for the operating utilities in the Western Region - 1986, and Director of Rates and Planning for the operating utilities in the Western Region since 2001.

Q. HAVE YOU HAD ANY OTHER PROFESSIONAL EXPERIENCES?

A. Yes, I served on the Accounting Committee of the California Water Association and have been an instructor at the NARUC biannual Utility Rate Seminar on eight occasions.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE UTILITY REGULATORY COMMISSIONS?

A. Yes, I have testified before the Arizona Corporation Commission ("Commission") in rate and acquisition proceedings for Arizona-American; before the California Public Utilities Commission on many occasions for all of the California-American Water Company systems; and before the New Mexico Public Regulation Commission in many types of proceedings on behalf of New Mexico-American Water Company.

II. <u>PURPOSE OF TESTIMONY, SUMMARY AND CONCLUSIONS</u>

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

A. The purposes of my testimony are to: (1) identify and explain the Company's rate filing; (2) provide background concerning the purchase of the former Citizens Communications' water and wastewater utility assets in Arizona ("Citizens' Assets") by Arizona-American (the Citizens' Acquisition); (3) explain and support various adjustments made to the test period actual results; (4) explain and support all components of the capital structure except for cost of equity; and (5) to discuss the specific requirements set forth in Decision 63584 (April 24, 2001), which authorized Arizona-American to purchase the Citizens' Assets ("Acquisition Decision").

Q. WHAT DO YOU MEAN THE "COMPANY'S RATE FILING"?

A. I mean the five (5) separate applications for rate relief being filed with the Commission in 2002. This filing follows our efforts to determine the best approach to file rate applications for a substantial number of systems in a manner that would make the most sense for both public presentation and ease of handling for the Commission's Utilities Division Staff ("Staff").

Q. YOU ALSO USED THE TERM "SYSTEM." ARE YOU REFERRING TO "SYSTEM" IN A LEGAL OR OTHER SPECIFIC SENSE?

A. No, I am using the term "system" in a more general sense. By way of background, as I mentioned earlier, Arizona-American acquired all of the water and wastewater assets of Citizens in Arizona in a transaction that closed earlier this year. Previously, Citizens' Assets were under a different ownership structure with a number of separate corporate entities, such as Sun City Water Company, Sun City West Utilities Company or the Agua Fria Water Division of Citizens Communications Company, for example. However, Arizona-American acquired only the assets – not the stock. Therefore, the assets were removed from separate ownership and now all fall under the ownership umbrella of Arizona-American.

Q. HOW DOES ARIZONA-AMERICAN REFER TO THESE SEPARATE GROUPS OF ASSETS INTERNALLY?

A. Generally we use the term "district" to refer to a separate area within Arizona-American where, for accounting purposes, we individually account for revenues and expenses, and maintain separate balance sheets. These areas generally coincide with areas where the same tariffs apply and in that sense, a district could be identified as a "tariffed area." Of course, reference to the "Tubac water tariffed area" or the "Sun City West water tariffed area" would be awkward, and for purposes of the Company's rate filing, we basically use the terms "district" or "system" interchangeably and neither is intended to denote the actual name of any particular corporate entity or to designate an operational or other system as such term is used by ADEQ or any other regulatory agency to identify water or wastewater systems in Arizona.

Q. THANK YOU MR. STEPHENSON. WOULD YOU PLEASE CONTINUE WITH YOUR DISCUSSION OF HOW THE COMPANY ULTIMATELY DECIDED THE BEST WAY TO ORGANIZE THE COMPANY'S RATE FILING?

A. Certainly, again from a public perspective, it was determined that it made sense to file separate applications for the Sun City and Sun City West districts. These four districts, two water and two wastewater systems, are relatively large in size and have certain unique characteristics and circumstances that distinguish them from the other Arizona systems. The third application consists of two water systems in Mohave County, the Mohave water district, which provides water service in the vicinity of Bullhead City, and the Havasu water district, which provides service near Lake Havasu City. These systems are close together and operated by essentially the same Company personnel. The fourth application being filed is the

combination of Agua Fria water district and the water and wastewater systems serving the Anthem development in Maricopa County. These utility systems primarily serve recent developments and have very similar operating procedures. The final application is for the small Class C water system known as the Tubac water district in Santa Cruz County. This system is distinctive based on its small size, limited revenues and location. Again, for convenience, I will sometimes refer to the five applications as the Company's rate filing. And, again, I want to emphasize that the terms "system" and "district" should be considered synonymous throughout the Company's rate filing.

Q. ALL OF THESE DISTRICTS OR SYSTEMS ARE PART OF THE CITIZENS' ACQUISITION, CORRECT?

A. That is correct. I should also note that none of the former Citizens' systems have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company last rate order was issued in May 1997 based on test years ending March 31, 1995. Decision No. 60172 (May 7, 1997).[1] Citizens Mohave Water and Wastewater Divisions last received rate increases in February 1990, based on test years ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test year ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992). It appears that once Citizens decided to sell its water and wastewater systems in 1999, it elected not to seek rate increases and, in some cases, to accept operating losses. This situation has caused Arizona-American to seek rate

[1] In Decision No. 60172, rates for Sun City Water Company and Sun City West Utilities' rates for water service were actually reduced. I also understand the Sun City West Utilities' rates for both water and wastewater service were reduced in the prior rate proceeding, as were Sun City Water Company's rates. Decision No. 55488 (March 17, 1987).

increases more quickly than it anticipated. However, a delay in obtaining rate increases and correcting these systems' anemic earnings would be harmful to the Company and, ultimately, to its customers.

Q. WHAT ARE YOUR OVERALL RESPONSIBILITIES IN THIS CASE?

A. I have been responsible for the coordination and supervision of all of the rate case applications discussed including, among other things, selecting the test period and the pro-forma time period for various adjustments, and determining what adjustments need to included in the filing.

Q. WHAT TEST PERIOD DID YOU DETERMINE WAS APPROPRIATE IN THIS CASE?

A. I determined, for ease of presentation, that the period ending December 31, 2001, should be used as the test period for the Company's rate filing. This period closely is aligned with the purchase of the Citizens' Assets by Arizona-American, which transaction closed on January 15, 2002.

Q. DID ARIZONA-AMERICAN OWN THE CITIZENS' ASSETS, OR HAVE ANY RESPONSIBILITY FOR THE OPERATING EXPENSES OR THE PROVISION OF SERVICE DURING THE TEST PERIOD FOR THE SYSTEMS THAT ARE THE SUBJECT OF THE COMPANY'S RATE FILING?

A. No. As I stated, the purchase of the Citizens' Assets was not completed until January 15, 2002, on which date Arizona-American assumed operational control and responsibility for the Citizens' Assets.

Q. SINCE ARIZONA-AMERICAN DID NOT OWN AND OPERATE THE CITIZENS' ASSETS AND DID NOT HAVE ANY OPERATING RESPONSIBILITY FOR THE WATER AND WASTEWATER UTILITY OPERATIONS IN 2001, HOW DOES THE COMPANY JUSTIFY FILING A

RATE APPLICATION WITH A TEST PERIOD ENDING PRIOR TO THE COMPLETION OF THE PURCHASE?

A. The recorded operating expenses directly incurred by each district basically remain unchanged following the acquisition. Further, the Commission ordered Citizens to maintain its books and records for a period of 5 years following the closing. It is relatively simple to remove the management and services costs allocated to each of the operating systems by Citizens from the normally-incurred direct operating expenses of these systems. Likewise, it is relatively simple to add in the expected Service Company charges from AWW applicable to Arizona-American.

Q. WHAT PRO FORMA TIME PERIOD HAVE YOU USED FOR EXPENSE AND PLANT ESTIMATIONS IN THIS CASE?

A. I am recommending that such adjustments, all of which will be detailed further in the various witnesses' direct testimonies, go no further into the future than end of year 2002. This will provide ample time for Staff to review and analyze these adjustments prior to providing their recommendations in Staff's direct filing.

Q. ARE THERE PRO FORMA ADJUSTMENTS FOR PLANT ADDITIONS?

A. Yes, we have estimated the non-revenue generating plant additions that will be completed and placed in service by the end of 2002, and have included pro forma adjustments that include those additions in utility plant in service. This is consistent with Commission Decision No. 61831 (July 20, 1999) related to the Paradise Valley water district, wherein the Commission ordered the Company to limit pro forma plant additions to those plant items that are used and useful and in service 90 days after the application is deemed sufficient. The December 31, 2002 cut-off date proposed by Arizona-American in this case is well within the 90-day deadline established by the Commission.

Q. HOW ARE PRO FORMA ADJUSTMENTS DETERMINED FOR

OPERATING EXPENSES?

A. Pro forma adjustments for operating expenses are based on known and measurable changes that have or will occur up until the time each rate application is filed to develop a normal 12-month period of operations. This is consistent with A.A.C. R14-2-103(i).

III. ACQUISITION OF THE WATER AND WASTEWATER ASSETS OF CITIZENS UTILITIES OF ARIZONA

Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE CITIZENS' ACQUISITION?

A. By way of background, Arizona-American has owned and operated a water utility system in Arizona, which was formerly known as Paradise Valley Water Company, since the late 1960s. The Paradise Valley water district is relatively small, and currently furnishes service to approximately 5,000 customers. Sometime in 1998 or 1999, Citizens Communications Company (formerly Citizens Utility Company) decided to focus its business activities in the telecommunications area, and elected to sell its water and wastewater assets, which were located in six states including Arizona. Arizona-American's parent company, AWW, which is the largest privately-owned water utility system in the United States and whose business activities focus on water and wastewater, entered into negotiations with Citizens. Ultimately, on October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American agreed to purchase the Citizens' Assets, which included all of the water and wastewater systems and assets in Arizona.

Citizens and its various Arizona water and wastewater subsidiaries, along with Arizona-American, filed an application on March 24, 2000, seeking approval of the transfer of the Citizens' Assets to Arizona-American in Docket Nos. W-

01032A-00-0192, et. seq. Later that same year, Arizona-American filed a separate application in Docket No. W-01303A-00-0929 seeking authority to issue certain promissory notes and other evidence of indebtedness and to assume certain industrial development revenue bonds in connection with financing the purchase of the Citizens' Assets. Following notice and a public hearing, the Commission ultimately approved the transfer of the Citizens' Assets in the Acquisition Decision. Attached to the Acquisition Decision and incorporated therein in the second ordering paragraph, was a settlement agreement setting forth specific terms and conditions agreed to by Staff and the Company. These terms and conditions settled one ratemaking issue and set forth deadlines, procedures and filing requirements that Arizona-American is to follow in future rate proceedings. The terms and conditions are as follows:

1. The ratemaking treatment of the of the acquisition adjustment, deferred taxes, excess deferred taxes and the investment tax credit will be deferred until a future rate case proceeding.
2. The decision to allow recovery of the acquisition adjustment must be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred
3. The Company must file a report 13 months after the closing of the transaction, comparing the number of complaints received by the Commission prior to and after the transaction.
4. The adjusted AIAC balance not transferred to Arizona-American as part of the transaction will be imputed ratably into rate base over a 6.5 year period. The balance will be ratably reduced over the 6.5 years utilizing a levelized monthly below the line amortization.

A copy of the Acquisition Decision is attached hereto as Stephenson Dir. Exh. 1.

Later in 2001, the Commission issued Decision No. 64002 (Aug. 30, 2001) authorizing the debt financing for the purchase of the Citizens' Assets. In summary, the Commission authorized Arizona-American to issue promissory notes and other evidence of indebtedness in an amount not to exceed $180 million and to issue a promissory note reflecting the obligation associated with assuming Citizens' industrial development revenue bonds in the amount of $10,635,000. The balance of the purchase price was financed by an infusion of additional paid in equity capital from AWW. In Decision No. 64002, the Commission ordered Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition in order to maintain a reasonably balanced capital structure.

Q. WHEN DID ARIZONA-AMERICAN FINALIZE THE PURCHASE OF THE CITIZENS' ASSETS?

A. The transaction was finalized on January 15, 2002, the date title to all of the Citizens' Assets was transferred to Arizona-American. All of the service provision responsibilities were also transferred to Arizona-American on that date. The final Citizens' Asset purchase price was approximately $276,500,000, and included an initial book acquisition adjustment of approximately $71,100,000. As Explained in the Direct Testimony of Mr. Joseph Hartnett, appended as Exhibit C to the Joint Application for Authority to Transfer Assets and Related Approvals in Docket Nos. W-01032A-00-0192, et seq., the purchase for the Citizens' Assets was determined by an arms-length negotiation based on the advice of each companies financial advisors. This open market negotiated purchase price then establishes AWW's reasonable investment in the Citizens' Assets. This reasonable investment in the Citizens' Assets was funded by a combination of debt and equity as shown on at the top of the closing journal entry to record the transaction, which is

attached hereto as Stephenson Dir. Exh. 2.

IV. POST TEST PERIOD ADJUSTMENTS

Q. WHAT PRO FORMA ADJUSTMENTS ARE YOU RESPONSIBLE FOR SUPPORTING?

A. I am responsible for supporting six adjustments that impact all of the Company's rate filings. The specific adjustments are as follows: 1) capitalization of payments made for the implementation of ORCOM billing software from operating expense and the determination period for the recovery of this expense; 2) the transfer of charges related to the completion of the Citizens' Acquisition, as well as charges for the development of base accounting procedures from expenses to organizational costs; 3) the rationale for the removal of the Citizens' management costs, 4) estimates of Service Company charges; 5) estimates of rate case expense and 6) estimates of direct charges to the systems made by AWW.

Q. WHY HAVE PAYMENTS BEEN MADE FOR THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Payments made for the development of the ORCOM billing software have been made in connection with converting all of the Citizens' customers over to the AWW billing system. The payments should be considered as organizational costs or start-up costs. I will refer to these as "start-up costs" for the remainder of this discussion. These start-up costs were for such items as consultants' fees, billing programs modifications and related expenses of AWW associates to assist in the development of the billing system. The billing system had to come on line exactly at the time of closing. Since the acquisition was an asset sale, there was no arrangement between Citizens and AWW for Citizens to continue billing any utility customers after the transaction closed. The ORCOM system had to be up and running, and running properly, at the closing. To the benefit of these

customers, AWW has been developing this same system for its own use at all of its present properties, including the Paradise Valley district. This made the time and expense of converting the Citizens' customers to the ORCOM system less burdensome.

Q. WHY WERE THESE COSTS EXPENSED?

A. Over the past few years accounting requirements regarding the booking of these types of start-up costs have changed. Start-up costs historically have been capitalized along with the purchase or development of new assets. This is no longer the case. The Financial Accounting Standards Board has deteremined that too many expenses were being capitalized and companies' balance sheets were being overstated. However, for a regulated utility, the books and records of a company are maintained in acordance with Commission regulations and policy. These start-up costs have always been treated as a capitalized asset, and there is no valid reason to stray from that policy. These start-up costs are incurrred for the development of programs to serve new customers. The addition of the new customers lowers the overall fixed costs per customer. This produces a net cost savings. Therefore, all present and future customers should share in both the development costs as well as the savings. Common regulatory practice is to spread the development costs of a cost saving measure over the customer base receiving known and measurable savings.

Q. DOES THIS COMMISSION HAVE JURISDICTION TO OVERIDE ACCOUNTING POLICY AND AUTHORIZE THESE COSTS TO BE CLASSIFIED AS A CAPITALIZED START-UP OR ORGANIZATION COST?

A. Yes. As has been the common practice under Financial Accounting Standard Board Policy FAS 71, the Commission can establish different accounting

proceedures for various items so long as the proceedure establishes a set methodolgy and time period for the recovery of the item.

Q. WHAT ARE THE ACTUAL COSTS RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Attached as Stephenson Dir. Exh. 3 is an analysis showing the actual costs of this project and other relationships. Page 1 of the Exhibit shows that the total one-time costs for this project is $607,723. The amount included in the rate base for Sun City West water and wastewater districts is $78,774 and $78,774, respectively.

Q. DID ARIZONA-AMERICAN PURCHASE ANY BILLING SYSTEM ASSETS FROM CITIZENS AS PART OF THE ASSET PURCHASE?

A. No. As page 2 of Stephenson Dir. Exh. 3 shows, the billing system used by Citizens to bill its water and wastewater customers (the Banner System) was retained by Citizens. Therefore, as I testified earlier, Arizona-American had to have its own billing system set up and fully functional at the time the Citizens' Acquisition closed.

Q. WHAT IS THE EFFECT ON THE RATE BASES FOR THE ARIZONA DISTRICTS INCLUDED IN THE COMPANY'S RATE FILING RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. As shown, the net book value of the Banner billing system at the time the Citizens' Acquisition was completed was $2,620,054. Of that amount $982,488 was allocated to the Citizens' water and wastewater systems in Arizona. The difference between the development costs of the ORCOM system ($607,723) and the allocated net book value of the Banner system not purchased ($982,488) is $374,766. Thus, there was a net benefit to the customers in Arizona through the development of the ORCOM billing system as opposed to purchasing the Banner billing system from Citizens at the net book value allocated to Arizona. The net

effect on the rate base of Sun City West water and wastewater districts is $48,577 and $48,577, respectively.

Q. WHY HAVE YOU MADE AN ADJUSTMENT OF $906,531 FOR CORPORATE COSTS TO TRANSFER VARIOUS ITEMS RELATED TO THE CITIZENS' ACQUISITION TO THE ACQUISITION ADJUSTMENT?

A. I have made this adjustment for the same reasons that I recommend the transfer of the one-time start-up costs from expenses. These costs were incurred to complete the purchase of the Citizens' Assets and to establish books and records for the Citizens' Assets and systems. The costs are related to title reviews, legal interpetations of contract clauses, legal representation to transfer existing contracts and for accounting assistance. These costs were necessary to secure and protect Arizona-American's legal rights to all the transferred assets and to obtain transfers of all existing contracts and agreements. These are normal "organizational" expenses to ensure full and proper title to transferred assets and to set up the books and records in an appropriate manner.

Q. CAN YOU PLEASE FURTHER DESCRIBE THE ITEMS WHICH YOU ARE PROPOSING TO RECLASSIFY TO THE ACQUISITION ADJUSTMENT?

A. Certainly. The total amount of $906,531 is comprised of charges from two separate sources: charges incurred by AWW in connection with the purchase; and charges from our accounting contractor in Arizona (Ronald L. Kozoman, CPA) to develop satisfactory records for regulatory purposes. The total of the charges from AWW is $784,784 and the total of the charges from Mr. Kozoman is $121,747. The details of all of these charges is attached hereto as Stephenson Dir. Exh. 4. This full amount is included in the Acquisition Adjustment.

Q. PLEASE EXPLAIN THE JUSTIFICATION FOR REMOVING ALL OF

CITIZENS' MANAGEMENT FEES FROM THE TEST PERIOD EXPENSES.

A. I have removed all of Citizens' management fees from the test period expenses because these expenses pertain to Citizens' management of the Citizens' Assets in Arizona, not expenses that will be incurred under the ownership and management of Arizona-American. These expenses must be removed and replaced by current annualizations of Service Company charges to Arizona-American in order to provide an accurate presentation of known and measureable expenses that are occuring now and will occur on a going-forward basis in the future.

Q. HOW DID YOU DETERMINE WHICH EXPENSES TO REMOVE RELATED TO CITIZENS' MANAGEMENT AND WHICH EXPENSES RELATED TO THE SERVICE COMPANY TO INCLUDE?

A. The explanation of the proceedure to determine what expenses were removed will be discussed by Mr. Tom Bourassa in his direct testimony. I have annualized the amount of expense to be included in the pro forma test period based on actual recorded costs from April through July 2002. Attached as Stephenson Dir. Exh. 5 is a spreadsheet showing the recorded costs from January through the end of July. I have not included the months of January through March in my annualization because these months were either not full months due to the finalization of the acquisition (January) or the months were not accurately reflect normal cost allocations from the Service Company (February and March). Viewing Exhibit 5, it is obvious that January and February have very low recorded expenses in comparison to the other months. The month of March is more in line with future months, but is still questionable due in part to the obvious omission of a credit for the call center amortization (this amortization relates only to the Paradise Valley system). Furthermore, March is a quarter-ending month, and as such expenses in

that month tend to contain more quarterly adjustments, thereby causing distortion of the annualization without including the other months of the quarter.

Q. WHAT IS THE AVERAGE MONTHLY CHARGE FOR THE SERVICE COMPANY FOR THE MONTHS OF APRIL THROUGH JULY 2002?

A. As shown on Stephenson Dir. Exh. 5, the average monthly amount of Service Company charges for the period April through July 2002 is $429,476. Annualizing this amount yields a total of $5,153,711 for 2002.

Q. DID YOU SPREAD THE ANNUALIZED TOTAL TO EACH OF THE SYSTEMS IN ARIZONA?

A. Yes, I spread the annualized expense to each of the systems on a four-factor basis. The four-factor analysis considers many factors all of which produce the benefits Arizona-American receives from the Service Company. The four-factor spreadsheet is attached hereto as Stephenson Dir. Exh. 6. The allocation to Sun City West water and wastewater districts is $515,886 and $552,478, respectively, based on the four-factor allocation methodology.

Q. PLEASE EXPLAIN YOUR ESTIMATE OF RATE CASE COSTS INCLUDED IN THE COMPANY'S RATE FILING.

A. The estimate of rate case expense has been developed with estimates provided by all outside consultants and costs estimated for in-house items. Attached as Stephenson Dir. Exh. 7 is an estimate of the rate case costs necessary to prosecute these applications. . The total estimated costs of consultants and legal counsel is $608,000. This amount is comprised of $275,000 for ouside accounting and rate assistance, $51,000 for the outside rate of return consultant and $282,000 for legal counsel. The total estimate of in-house costs is $98,000 and is comprised of $18,000 for employee expenses and $80,000 for expenses related to mailings, notices, printing and supplies. I have allocated the total estimated rate case costs to

each system based on adjusted test period revenues and have spread those totals over a three-year recovery period. The total amount allocated to Sun City West water and wastewater districts is $66,939 and $70,006, respectively.

Q. ARE THE ESTIMATED COSTS TO PROSECUTE THE RATE FILINGS CONSISTENT WITH PRIOR COSTS INCURRED TO PROSECUTE RATE APPLICATIONS IN ARIZONA?

A. Yes, in fact the estimated cost to prosecute this case is lower on a per customer basis than the amount the Commission has previously allowed for the Paradise Valley water district in its past two rate cases. The average rate case cost per customer in the last two Paradise Valley rate proceedings was approximately $13.25. In these applications we have estimated the rate case cost per customer to be approximately $6.50 per customer, or only $2.17 per customer annually.

Q. WHAT ARE THE ADJUSTED DIRECT CHARGES COMPRISED OF?

A. The direct charges are comprised mostly of employee benefits, customer accounting charges (bill forms, postage, inserts, collection agency fees, etc.), insurance fees, dues and memberships, employee travel and directors and trustee fees. Attached as Stephenson Dir. Exh. 8 is an itemization of the charges.

Q. HOW DID YOU ESTIMATE THE ANNUAL COSTS FOR THESE ITEMS?

A. I based the annualized cost for these items on the actual recorded costs for March through July of 2002.

Q. WHAT IS THE TOTAL OF THE ANNUALIZED DIRECT CHARGES AND HOW WERE THEY ALLOCATED TO VARIOUS TEST PERIOD EXPENSE CATAGORIES?

A. The annual total for these direct expenses is $3,161,915. The charges were related to four different expense catagories: salary and wages ($1,586,293); miscellaneous expenses ($23,058); general office expenses ($1,293,829) and insurance fees

($258,736).

Q. HOW WERE THESE DIRECT CHARGES ALLOCATED TO EACH OF THE ARIZONA-AMERICAN SYSTEMS?

A. These charges were allocated to each of the systems based on four different factors. The system charges for salaries and wages were allocated to each system based on expensed test period salaries; the allocation of miscellaneous expense was spread to each system based on customer count and pro forma plant; the allocation of general office expense was allocated to each system based on customer count, pro forma plant and adjusted test period rate base; and the allocation of insurance fees to each of the sysetms was based on adjusted test period rate base.

Q. WHY DID YOU USE THE MARCH THROUGH JULY TIME PERIOD?

A. As stated earlier, I chose the time period that best represents the normalized expenditures. I had to eliminate January and February from consideration due to the fact that Arizona-American did not own the Citizens' Assets until January 15, 2002, and February 2002 was the first full month of operation by Arizona-American and not all charges were recorded properly.

Q. DID YOU REMOVE ALL OF THE RECORDED TEST PERIOD EXPENSES RELATED TO THESE SYSTEM SPECIFIC ALLOCATIONS?

A. Yes, all of the test period expenses for these items were removed from the test period along with the Citizens' management fees.

Q. WHAT WAS THE AMOUNT ALLOCATED TO EACH OF THE EXPENSE CATAGORIES FOR THE SUN CITY WEST WATER AND WASTEWATER DISTRICTS?

A. The allocations to each of the expense catagories for Sun City West water and wastewater districts is : $108,156 and $162,234, respectively, for salaries and

wages; $1,099 and $920, respectively, for miscellaneous; $162,863 and $146,102, respectively, for general office; and $23,821 and $19,536, respectively, for insurance.

V. CAPITAL STRUCTURE AND COST OF DEBT

Q. WHAT IS THE CAPITAL STRUCTURE THAT ARIZONA-AMERICAN PROPOSES TO UTILIZE IN THESE APPLICATIONS?

A. The Company proposes a capital structure comprised of 60 percent debt and 40 percent equity.

Q. HOW WAS THIS CAPITAL STRUCTURE DETERMINED?

A. It was determined based on the actual financing of the acquisition of the Citizens' Assets by Arizona-American. At the very top of the first page of Stephenson Dir. Exh. 1 is the entry to record the purchase of the Citizens' Assets by Arizona-American. This entry shows Common Stock in the amount of $110,888,158 (40 percent), Bonds – Inside of $154,948,119 (56 percent) and Bonds – Outside of $10,635,000 (4 percent). These are the actual amounts for each of these components as recorded on the books of Arizona-American at the time of purchase of the Citizens' Assets. AWW strives to have its subsidiaries maintain the most efficient capital structure. Typically, the most efficient capital structure for AWW utility subsidiaries is comprised of approximately 60 percent debt. AWW has maintained its high debt rating (A-) and secured very efficient rates for bonds and notes by maintaining a 60 percent debt component in the capital structure. The greater the leverage of the capital structure while still maintaining a high bond rating, the lower the cost of capital to the Company and its customers.

Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN "BONDS-INSIDE" AND "BONDS-OUTSIDE."

A. The "Bonds-Inside" comprise the debt financing provided by American Water

Works Capital Corp. ("AWCC") in the form of a short-term note. This is a five-year unsecured note with an interest rate of 4.92%. The "Bonds–Outside" is debt financing reflecting the assumption of Citizens' industrial development revenue bonds I mentioned previously, which have an interest rate of 7.30%.

VI. ACQUISITION ADJUSTMENT

Q. EARLIER, YOU DISCUSSED THE ACQUISTION. HOW WILL ARIZONA-AMERICAN ACCOUNT FOR THE DIFFERENCE BETWEEN THE PURCHASE PRICE AND THE ACQUIRED ASSET BALANCE FOR REGULATORY PURPOSES?

A. The difference will be recorded as an Acquisition Adjustment in accordance with the NARUC Uniform System of Accounts.

Q. WHAT IS THE AMORTIZATION PERIOD THAT ARIZONA-AMERICAN PROPOSES TO USE?

A. Forty years.

Q. WHAT METHOD OF AMORTIZATION IS ARIZONA-AMERICAN PROPOSING TO USE?

A. Arizona-American proposes to follow a mortgage amortization method, which incorporates the same amortization principle as home mortgages. Under this method, Arizona-American would recover only a small portion of the Acquisition Adjustment in the initial years and recover increasingly greater amounts in the later years. The annual amortization increases each year. The proposed amortization of the Acquisition Adjustment balance is attached hereto as Stephenson Dir. Exh. 9. The amount of the amortization included in the cost of service for the Sun City West water and wastewater districts in these applications is $21,800 and $21,800, respectively, based on amortization of the Acquisition Adjustment in 2003, as shown on Exhibit 9.

Q. WHAT IS THE NORMAL METHOD OF RECOVERY FOR UTILITY ASSETS?

A. The normal method, known as a straight-line method of recovery, involves equal or level recovery in each year of the asset's life.

Q. WHY ARE YOU PROPOSING THE MORTGAGE METHOD RATHER THAN THE STRAIGHT-LINE METHOD?

A. Although there are several reasons for this proposal, there is one significant reason: the mortgage method provides a much better matching of the recovery of the acquisition adjustment to the benefits the customers will receive as a result of this transaction.

Q. DOES USING THE MORTGAGE AMORTIZATION METHOD BETTER ILLUSTRATE THE CUSTOMER BENEFITS OF THIS TRANSACTION?

A. Yes. As stated previously, the savings generated from this transaction will grow as time passes. Allocating the recovery of the Acquisition Adjustment on an increasing basis over the recovery period, instead of leveling the recovery of the Acquisition Adjustment as is normal under the straight-line method of recovery, provides a superior opportunity for all current and future ratepayers to realize the benefits of the transaction.

Q. ARE THERE ANY OTHER FACTORS THAT SUPPORT YOUR SELECTION OF THIS METHODOLOGY?

A. Yes. The effects of inflation should also be considered. If a straight-line amortization method is used, the highest net-present value amounts are charged initially, and lower amounts are charged toward the end of the amortization. Given the effects of inflation, the differential between initial and final charges are substantial in terms of constant dollars. The mortgage-style amortization works with the effects of inflation to create a more level, constant dollar charge.

Q. WHAT SHOULD THE COMMISSION AUTHORIZE IN THIS PROCEEDING WITH RESPECT TO AN ACQUISITION ADJUSTMENT?

A. Arizona-American requests that the Commission authorize a 40-year amortization period and use of a mortgage amortization method, with the recovery of the acquisition adjustment as a component of the cost of service, as discussed previously.

VII. DISCUSSION OF THE REQUIREMENTS OF THE ACQUISITION DECISION

Q. HAVE YOU ADDRESSED COMPLIANCE WITH ALL OF THE COMMISSION'S DIRECTIVES IN THE ACQUISITION DECISION?

A. No. I have only covered the requested treatment of the Acquisition Adjustment. The Acquisition Decision also calls for the determination of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American; and the determination of the ratemaking treatment of deferred taxes, excess deferred taxes and investment tax credits that were on the books and records of Citizens at the time of the closing of the purchase transaction, yet were not transferred to Arizona-American. It is my recommendation to delay the demonstration of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American until a later date, after which time Arizona-American will have greater operating experience and be better able to demonstrate the tremendous net ratepayer benefits that result from this transaction. However, by recommending this delay, Arizona-American does not waive its right to, at some point in time in the future, request recovery of and on the Acquisition Adjustment, if it so desires to do so. It is my recommendation is that the deferred taxes, excess deferred taxes and the investment tax credit not be considered for any ratemaking

purpose.

Q. WHAT IS THE BASIS FOR THIS RECOMMENDATION AS IT RELATES TO THE DEFERRED TAXES, EXCESS DEFERRED TAXES AND THE INVESTMENT TAX CREDIT?

A. All of these items were established on the books and records of Citizens due to timing differences between book and tax recognition of an allowance to record the event causing the tax difference in the income stream. For deferred taxes, it is the tax effect of the difference between depreciation methods of assets for book and tax purposes. For tax purposes, many assets were once allowed to be depreciated at an accelerated rate, meaning that the assets were depreciated at a higher early period rate, and over a shorter time period, than for book purposes. For investment tax credits, in the past the Internal Revenue Code allowed a percentage tax deduction for the investment in various assets. The investment tax credit was never considered for book purposes.

In short, these are taxes and credits that belong to Citizens, not Arizona-American. Arizona-American purchased the water and wastewater assets of Citizens in Arizona; it did not assume any of the liabilities, except for the one series of industrial development revenue bonds. The deferred taxes and investment tax credits will be reconciled from the books and records of Citizens when Citizens files its 2002 tax return and applies these items against the gain or loss realize upon the sale of the water and wastewater assets to Arizona-American.

Q. WHAT WERE THE BALANCES OF THE DEFERRED TAXES AND INVESTMENT TAX CREDITS ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME OF CLOSING OF THE ASSET PURCHASE BY AWW OF THE ARIZONA ASSETS?

A. Stephenson Dir. Exh. 10 is a copy of the Arizona Property Detail supplied by

Citizens at the time of closing. This Exhibit shows that the balance for the deferred taxes was $4,674,819 and the balance of the investment tax credits was $1,910,600. There were no excess deferred taxes shown on the books and records of Citizens for Arizona at the time of closing.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THAT THE DEFERRED TAXES ON THE BOOKS OF CITIZENS FOR ARIZONA AT THE TIME OF CLOSING SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. Deferred taxes that were on the books and records of Citizens at the time of closing are not an item that should be considered as a "carryover" item in an asset purchase agreement. Deferred taxes result from items being treated differently for tax and book purposes. These differences are primarily created by Citizens' ability to delay actual tax payments due to accelerated asset value depreciation or amortization for tax purposes over the straight-line depreciation or amortization used for book and regulatory purposes. These tax-differences are recorded as deferred taxes. These deferred taxes will be taken into consideration when calculating a tax gain or loss as a result of the sale of the Citizens' Assets. Upon the sale of such assets, these deferred taxes will be paid and the deferred tax balances zeroed out.

When deferred taxes have been allowed as a component of cost of service in utility ratemaking, their accumulated balance (ADIT) is typically deducted from rate base as a source of non-investor capital. This is because deferred taxes are collected in rates prior to the time they must be remitted to the respective taxing authorities. In the interim, they represent a source of funds available to the utility for plant investment or other corporate purposes. During that period it is entirely appropriate to deduct the ADIT from rate base. When the tax liabilities underlying

previously deferred taxes are paid, however, the related ADIT balances are eliminated and the rate base deductions are no longer available.

With respect to Citizens' ADIT existing at the time the sale of its water and wastewater assets to AWW, the related income taxes will become due. At that time, the ADIT's will be paid and there will be no balance available to deduct from rate base. On-going compensation to customers is not warranted. When non-investor funds have been satisfied they no longer exist, and no further rate base deduction is appropriate. ADIT's may be viewed as a temporary loan to the utility by the taxing authority. By deferring the date upon which taxes are ultimately paid, a source of funds is created. Once the "loan" is repaid, the source of funds ceases to exist. There is no entitlement inuring to the utility's customers, since they pay taxes applicable to the utility service they receive.

Q. WHAT IS THE EFFECT ON ARIZONA-AMERICAN IF THE COMMISSION ELECTED TO USE CITIZENS' RECORDED DEFERRED TAXES IN FUTURE RATEMAKING.

A. The Internal Revenue Service has, on a number of occasions, declared that any deferred income tax reserves or unauthorized income tax credits relating to assets that have been sold, transferred, or removed from regulation may not continue to be considered in the subsequent ratemaking determinations. To attempt to do otherwise will result in the utility losing the ability to take accelerated depreciation on its Federal income tax return.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THE INVESTMENT TAX CREDITS THAT WERE ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME THE PURCHASE WAS COMPLETED BY ARIZONA-AMERICAN SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. The reasons are exactly the same as for deferred taxes. The investment tax credits will be considered in calculating Citizens' gain or loss as a result of the sale of the assets, and therefore will be eliminated. The investment tax credits were a "temporary" source of non-investor funds, once appropriately deducted from rate base, but now that they have been "paid", they are no available as a rate base deduction. This deduction no longer exists and as such cannot be used for ratemaking.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes it does.

STEPHENSON DIR. EXH. 1

N. JAMES

MAY 30 2001

ACTION

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

APR 24 2001

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00-0192 W-01032B-00-0192 W-01032C-00-0192 S-02276A-00-0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00-0192 W-01595A-00-0192 W-01303A-00-0192 DECISION NO. 63584 **OPINION AND ORDER**

DATE OF HEARING:	September 27, 2000
PLACE OF HEARING:	Phoenix, Arizona
PRESIDING ADMINISTRATIVE LAW JUDGE:	Karen E. Nally[1]
IN ATTENDANCE:	Chairman William A. Mundell and Commissioner Jim Irvin
APPEARANCES:	Mr. Michael M. Grant, GALLAGHER & KENNEDY, and Mr. Craig Marks, Associate General Counsel, on behalf of Citizens Communications Company;

[1] This Recommended Opinion and Order was prepared by Administrative Law Judge Marc E. Stern upon review of the testimony and exhibits admitted into evidence in the proceeding.

Mr. Norman D. James, FENNEMORE CRAIG, on behalf of Arizona-American Water Company;

Mr. Daniel W. Pozefsky, Staff Attorney, on behalf of Residential Utility Consumer Office;

Mr. Bill Meek on behalf of the Arizona Utility Investors Association; and

Ms. Teena Wolfe, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On March 24, 2000, Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively "Citizens"), and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a Joint Application to Transfer Assets and Related Approvals ("Application") of Citizens' water and wastewater utility assets in Arizona including Citizens' Certificates of Convenience and Necessity ("Certificates") held by Citizens to Arizona-American.

On May 17, 2000 and on June 1, 2000, the Residential Utility Consumer Office ("RUCO") and the Arizona Utility Investors Association ("AUIA") filed applications for leave to intervene. Subsequently, intervention was granted to RUCO and to AUIA.[2]

On May 30, 2000, by Procedural Order, a hearing was scheduled on the above-captioned matter for September ~~27~~, 2000. Citizens and Arizona-American caused public notice of the Application and hearing thereon to be published in various newspapers throughout Arizona. In

[2] On April 10, 2000, Mr. Marvin Lustiger filed an application to intervene in the above-captioned matter. However, by subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone service in Mohave County, and therefore, Mr. Lustiger's request to intervene was deemed to have been withdrawn.

addition. Citizens notified all its customers of the Application by means of a written bill insert.

On September 14, 2000, a formal public comment session was held in Sun City.

On September 26, 2000, the Commission's Utilities Division ("Staff") filed a Settlement Agreement ("Agreement") marked Exhibit A which is incorporated by reference and attached hereto.

On September 27, 2000, a full public hearing took place at the offices of the Commission in Phoenix, Arizona. Citizens, Arizona-American, RUCO, AUIA and Staff were present with counsel. Following the presentation of evidence, Citizens and RUCO submitted written briefs on the issue of whether Citizens should be required to pay a portion of the gain resulting from the sale of its utility assets to Citizens' customers. The matter was then taken under advisement pending submission of a recommended Opinion and Order to the Commission.

DISCUSSION

Parties to the Transaction

Citizens, through its various divisions and subsidiaries, provides water, wastewater, electric, natural gas and telecommunications services to approximately 1.8 million customers in 22 states, including in excess of 100,000 customers in Arizona. Citizens' current business strategy is to focus on the provision of telecommunications services and the expansion of those operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas, as was the case in the recently approved transfer of rural wire centers by Qwest Corporation to Citizens Utilities Rural Company, Inc.

In connection with this business strategy, Citizens intends to sell its water, wastewater, electric, and natural gas utilities and to apply the proceeds to finance acquisitions and other business activities in the telecommunications area. In April 2000, Citizens also announced the sale of its Louisiana natural gas operations for $375 million.

The Commission granted Arizona-American a Certificate of Convenience and Necessity to provide water service to approximately 4,600 customers in portions of the Town of Paradise

Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW") which is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states, and with a reported consolidated net plant of $5.1 billion and operating revenues of $1.26 billion. AWW's December 31, 1999, balance sheet reflected a capital structure of 58.4 percent long-term debt, 2.3 percent preferred stock and 39.3 percent common equity.

In 1999, AWW's subsidiaries invested $467 million in improving and upgrading their facilities, and for the past several years, AWW has made similar expenditures averaging nearly $400 million per year. According to AWW witnesses, AWW's acquisition policy is motivated, at least in part, by anticipated capital expenditures resulting from new regulatory requirements and programs and the need to replace or upgrade aged infrastructure to maintain high quality service. With the additional water and wastewater systems, AWW and its subsidiaries hope to obtain economies of scale and to strengthen their financial capability by expanding their customer base.

The Transaction

On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American is to acquire the water and wastewater assets and the Certificates held by Citizens in Arizona ("the Acquired Assets") for approximately $231 million, subject to adjustment at the time of closing. The purchase price will be increased based on utility plant added by Citizens after June 30, 1999, and will be reduced based on plant retirements occurring after such date. The Acquired Assets include all utility plant, property and interests relating to Citizens' water and wastewater operations in Arizona, with certain exceptions, including assets commonly used by Citizens in connection with other utility operations, cash and cash equivalents, and assets related to benefit plans. Citizens will also retain certain liabilities, including obligations for taxes payable, obligations relating to employee compensation and

benefits, and refunds of certain advances in aid of construction. Arizona-American will assume and be liable for all contracts and permits assigned at closing, certain Industrial Development Revenue Bonds ("IDRBs"), and unperformed obligations.

Arizona-American will finance the purchase of the Acquired Assets by a combination of debt and equity. AWW has recently formed a new subsidiary, American Water Capital Corporation ("AWCC"), that will provide loans and other financial services to AWW subsidiaries. Initially, Arizona-American will borrow funds from AWCC on a short-term basis, and receive additional funds in the form of common equity directly from AWW. Within 12 months, the short-term debt will be converted to long-term debt with a planned capital structure which will contain 55 to 60 percent debt and 45 to 40 percent common equity, including Arizona-American's existing debt and equity capital and the Citizens' IDRBs that will be assumed.[3]

The Position of Staff and the Staff Settlement Agreement

Staff generally supported the application, and recommended that the transfer of the Acquired Assets to Arizona-American be approved, subject to several conditions.

First, Staff recommended that the Commission defer any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes, and investment tax credits until a future rate proceeding.

Second, Staff recommended that the decision to allow recovery of an acquisition adjustment be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred.

Third, Staff recommended that Arizona-American should be ordered to file, 13 months

[3] Arizona-American has filed an application for authority to issue short-term and long-term debt in connection with financing the purchase of the Acquired Assets, which is pending in Docket No. W-01303A-00-0929.

after the closing of the transaction, a report comparing the number of complaints received by the Commission prior to and after the transaction. The report should provide an explanation of any significant changes in the number and importance of the complaints. Staff would then review this report and, if necessary, make a recommendation to the Commission of any further action to be taken.

Fourth, Staff recommended that an imputation of the benefits related to advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") received by Arizona-American be made in subsequent rate proceedings for each former Citizens' system. The purpose of the imputation would be to recognize those portions of the Acquired Assets that were financed by AIAC and CIAC which Arizona-American will not be assuming. Staff also recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC would be amortized below the line in the same manner as would have otherwise occurred.

Fifth, Staff recommended that Arizona-American be required to seek Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' Central Arizona Project ("CAP") water subcontracts.

Finally, Staff recommended that the Commission order Arizona-American to charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

In its rebuttal filing, Arizona-American indicated that it would stipulate to the conditions recommended by Staff, including the deferral of a decision concerning the recognition of an acquisition adjustment and the conditions under which an acquisition adjustment would be recognized, and would adopt and utilize the rates and charges for service, and all other service tariffs currently in effect in each of the affected Citizens service territories. However, Arizona-American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.

Subsequently, Staff and Arizona-American entered into the Agreement, which resolved all areas of disagreement relating to the terms and conditions under which the Acquired Assets would be transferred to Arizona-American.

Pursuant to the terms of the Agreement, Citizens' AIAC and CIAC will be imputed to Arizona-American for ratemaking purposes. This adjustment will reduce rate base. The amount of the AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer of the Acquired Assets, adjusted as follows: an amount equal to 5 percent of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place. The adjusted amount of CIAC will be amortized above the line (i.e., as a reduction to depreciation expense that would otherwise be recoverable in rates) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place. The imputation of AIAC and CIAC to Arizona-American is solely for ratemaking purposes, and not for financial accounting or any other purpose.

In addition to agreeing to the imputation of AIAC and CIAC, Arizona-American agreed that the Commission may adopt Staff's remaining conditions concerning the sale and transfer of the Acquired Assets. Staff and Arizona-American also agreed that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

Based on these agreements by Arizona-American, Staff is recommending that the Commission should approve the transfer of the Acquired Assets to Arizona-American and should not impose any additional terms, conditions or requirements on Arizona-American.

During the hearing, Staff and Arizona-American voiced their support of the Agreement, believing that its terms are reasonable and in the public interest. AUIA also expressed its support for the Agreement. However, the remaining party to the proceeding, RUCO, objects to the approval of the Agreement and to the transaction generally, as discussed below.

Position of RUCO

RUCO maintains the proposed transaction believing that it is not in the public interest and should not be approved unless it is restructured. RUCO argued that the transaction could possibly, in the future, impact on ratepayers. While RUCO did not disagree that consideration of an acquisition adjustment should be deferred until a future ratecase, RUCO argued that the gain resulting from the sale of the Acquired Assets received by Citizens, i.e., the difference between the net book value of the Acquired Assets and the purchase price being paid by Arizona-American, should be shared equally between Citizens stockholders and the ratepayers. RUCO further argued that the Commission should adopt a set of criteria to determine what, if any, acquisition adjustment should be allowed in a future rate proceeding. RUCO also suggested that to make this transaction in the public interest, among other things, the transaction should be contingent upon Arizona-American's Board of Director's approving a letter pledging to invest no less than 15 percent of the purchase price in acquisitions and capital improvements of "resources stressed" water and/or wasterwater utilities in Arizona no later than 72 months after the date the Commission authorizes the transaction.

Analysis of Disposition of Gain Issue

RUCO contended that fundamental principles of fairness support sharing the gain in this case. RUCO maintained that ratepayers have shared in the risk associated with the operation of the utility assets and that it necessarily follows that ratepayers should share in the gain realized from the sale of those assets. According to RUCO, this risk sharing results from the accounting treatment provided in the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts when an asset is retired prematurely, i.e., before a

utility fully recovers its original cost via depreciation. RUCO also stated that prior Commission decisions support gain sharing.

In response, Citizens argued that ratepayers have assumed no risk in connection with the operation of Citizens' water and wastewater utility business. Investors have provided the utility's capital and bear the financial risks associated with its operations. Therefore, the investors should be entitled to receive any gain resulting from the transaction. As to prior Commission decisions, Citizens cited three analogous cases involving a sale of an entire line of utility business in which the Commission did not order gain sharing.[4] Citizens also cited Decision No. 60167 (April 17, 1997) in which a utility's natural gas business was sold at a loss. In that case, the Commission did not order the customers to share in the loss.[5]

This proceeding is similar to the three cases cited earlier by Citizens since it is selling its entire business and will have no further water and wastewater operations in Arizona. The Commission has never required gain sharing under these circumstances. In the Contel of the West matter, in which Citizens was authorized to acquire all of Contel's telephone properties in Arizona, Staff urged that the gain resulting from the sale be shared equally with ratepayers. However, the Commission rejected gain sharing in that case.

We also do not believe that ratepayers bear a substantial risk by virtue of receiving utility service in this case. The particular accounting treatment for depreciable plant provided under the Uniform System of Accounts does not shift risk to customers, but rather prescribes particular accounting adjustments to properly reflect rate base before and after the retirement of a plant item. The utility's owners, i.e., its shareholders, ultimately bear the risks associated with the utility's business. While regulation may reduce those risks relative to most non-regulated

[4] Citizens/Southern Union, Decision No. 57647 (December 2, 1991); Contel/Citizens, Decision No. 58819, (October 17, 1994); and GTE/Citizens, Decision No. 62648 (June 13, 2000).

[5] Ajo Improvement Company/Southwest Gas, Decision No. 60167 (April 17, 1997).

businesses, regulation does not shift that risk to ratepayers, who are entitled to receive utility service at rates set by the Commission.

Accordingly, we do not find it appropriate under the circumstances in this case to require Citizens to share with ratepayers any part of the gain it receives from the sale of the Acquired Assets to Arizona-American. However, this will not preclude the Commission from protecting the ratepayers in the future. In any claim for an acquisition adjustment in a future rate case, the Commission can strictly scrutinize the foundation of the claim and determine what amount, if any, should be approved.

Analysis of Remaining RUCO Recommendations

RUCO's other recommendations pertained to the structure of the transaction and RUCO's concerns that this structure could lead to rate increases in the future. RUCO's concern primarily relates to the fact that Arizona-American will not be assuming all of Citizens' liabilities associated with AIAC and CIAC, which totaled approximately $80.8 million and $4.7 million, respectively, at December 31, 1999. According to RUCO, the structure of the transaction will result in the elimination of AIAC and CIAC as reductions from rate base, which will in turn result in an increase in rate base and, eventually, to rate increases.

We believe that the Agreement appropriately deals with this issue. Citizens' AIAC and CIAC will be recognized for ratemaking purposes by Arizona-American, even though Arizona-American is not assuming those liabilities. By virtue of this imputation, the impact of the structure of the transaction will be ameliorated. Based on the evidence and the testimony, the approach utilized in the Agreement is reasonable.

Further, the evidence indicates that the transaction between Citizens, Arizona-American and AWW was the product of arms-length negotiations that occurred after Citizens had adopted its current business strategy of focusing on telecommunications services and divesting itself of its water and wastewater systems, as well as its electric and natural gas systems throughout the

country. This is not a transaction between affiliated companies. The payment by Arizona-American will constitute an investment in the Acquired Assets.

RUCO also expressed concern regarding the impact of the transaction on Citizens' accumulated deferred income taxes ("ADITs"), which totaled approximately $5.2 million as of December 31, 1999, and Citizens' investment tax credits ("ITCs"), which totaled approximately $2.2 million as of the same date. Under the Agreement, any decision on the treatment of ADITs and ITCs will be deferred until Arizona-American seeks new rates in a future proceeding. Staff's recommendation is appropriate under the circumstances herein.

Next, RUCO questioned the approach proposed by Arizona-American and Staff, as adopted in the Agreement, for dealing with the possible future recognition of an acquisition adjustment in rates. RUCO agreed with Arizona-American and Staff that it is appropriate to defer consideration of any acquisition adjustment resulting from the transaction until a future rate proceeding, in order to afford Arizona-American an opportunity to demonstrate that the acquisition has provided a net benefit to ratepayers by virtue of improved operating efficiencies, economies of scale and other synergies. However, RUCO's witnesses also contended that the Commission should adopt a set formula that would be used in connection with any future determination of the amount of the acquisition adjustment.

We have concerns about the adoption of a set, mechanical formula to quantify a future acquisition adjustment. We believe that such a determination should be made at the time all the facts and circumstances are known. Staff's recommendation concerning the basis on which the Commission will allow the recovery of an acquisition adjustment is reasonable and in the public interest. Arizona-American is cautioned that the Commission will require Arizona-American to demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission will consider recovery of any acquisition adjustment in a future rate proceeding.

RUCO was also critical of Arizona-American's failure to assume all of Citizens' IDRBs. As stated, Arizona-American will assume certain IDRBs, which total approximately $10.6 million. The IDRBs that will be assumed constitute low-cost capital. The average cost of the IDRBs that will be assumed by Arizona-American was 3.55 percent per annum during 1999. RUCO believes that there may be three additional Citizens bond issues, representing low-cost capital, that will not be assumed in connection with the transaction.

Arizona-American, in its testimony, has acknowledged that other bonds have been issued by Citizens. The evidence indicates, however, that in contrast to the IDRBs that will be assumed, the other bonds would require unanimous consent from all bond holders in order to be assumed, which would be administratively difficult, if not impossible, to accomplish within the time frame of the transaction. The additional costs to Arizona-American to replace these low-cost IDRBs with alternative forms of financing was not ascertained.

We find that it would not be feasible for Arizona-American to assume the remaining bonds and it would not be reasonable to impute these bonds to Arizona-American's capital structure. The remaining bonds will continue to be an obligation of Citizens and will continue to be included in Citizens' capital structure in its ongoing telecommunications business.

Finally, RUCO recommends that authorization of the transaction be made contingent on Arizona-American pledging to invest not less than 15 percent of the purchase price for the Acquired Assets, or approximately $35 million, in acquisitions and capital improvements of "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and capital improvements would have to be made within 72 months from the date on which the Commission approves the transaction.

The Commission recognizes that there are small water and wastewater utilities in Arizona that may need technical and financial assistance. Indeed, the Commission has provided such assistance to small water and wastewater utilities through workshops and the development of policies aimed at improving their financial viability. However, it is not reasonable to compel a

private utility to spend in excess of $35 million to solve these problems, nor is it clear that the Commission has the authority to do so.

Arizona-American has indicated its willingness to work with the Commission in developing solutions to service problems being experienced by small, troubled utilities. By virtue of acquiring Citizens' systems in Arizona, Arizona-American will be in closer proximity to a number of these systems, and the Commission would expect Arizona-American, as circumstances warrant, to seriously consider acquiring these systems or otherwise provide technical or financial assistance. For these reasons, we do not believe it is appropriate to impose such a mandate on Arizona-American.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Pursuant to authority granted by the Commission, Citizens provides public water, wastewater, electric, natural gas and telecommunications services in various parts of Arizona.

2. Pursuant to authority by the Commission, Arizona-American, a wholly owned subsidiary of AWW, provides public water service to approximately 4,600 customers in the Town of Paradise Valley, the City of Scottsdale and in certain unincorporated portions of Maricopa County, Arizona. Arizona-American is presently classified as a Class B water utility.

3. On March 24, 2000, Citizens and Arizona-American filed an Application requesting approval of the sale and transfer of Citizens' water and wastewater utility assets in Arizona together with the transfer of Citizens' Certificates to Arizona-American.

4. RUCO and the AUIA were granted intervention in this Docket.

5. Public notice of the Application and hearing thereon was published in various newspapers throughout Arizona within and in the vicinity of Citizens' and Arizona-American's certificated service areas.

6. Customers of Citizens were also notified of the Application by means of a written bill insert.

7. Citizens' current business strategy is to focus on the provision of telecommunication services and to expand its telecommunications subsidiaries' operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas.

8. In the furtherance of this business strategy, Citizens is selling its water, wastewater, electric and natural gas utilities and applying the proceeds to finance acquisitions and other business activities in the telecommunications industry.

9. AWW and its subsidiaries, including Arizona-American, are the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately three million customers in 23 states.

10. AWW is financially sound, and has the experience, expertise and resources to assume and perform Citizens' public service obligations.

11. On October 15, 1999, Citizens, Arizona-American and AWW entered into an asset purchase agreement under which Arizona-American will acquire all of the water and wastewater utility assets together with the requisite Certificates held by Citizens in Arizona.

12. Arizona-American will pay a purchase price of approximately $231 million which includes the assumption of approximately $10.6 million of existing debt in the form of outstanding IDRBs. The purchase price is subject to adjustment either higher or lower based on plant additions and retirements occurring after June 30, 1999.

13. Arizona-American will finance the transaction through a combination of debt and equity, resulting in Arizona-American having a capital structure of 55 to 60 percent debt and 45 to 40 percent common equity. This debt to equity ratio is comparable to the capital structures of most large, publicly-traded water utilities.

14. Staff is recommending that the Application be approved for the sale and transfer of Citizens' water and wastewater utility assets including the Certificates to Arizona-American subject to the following conditions:

- that any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes and investment tax credits be deferred until a future rate proceeding;
- that if recovery of any acquisition adjustment is authorized in the future it should be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers in the affected areas, which would not have been realized had the transaction not occurred;
- that Arizona-American file, 30 days after the first anniversary of the transaction, a report which compares the number of complaints received by the Commission under Citizens' ownership and under Arizona-American's ownership and provide an explanation of any significant changes in the number and importance of the complaints received. Staff should review the data and, if necessary, make a recommendation to the Commission of any further action to be taken;
- that an imputation of the benefits related to AIAC and CIAC received by Arizona-American should be made in subsequent rate proceedings for each former Citizens system as recommended by Staff in its direct testimony;
- that Arizona-American shall be required to secure prior Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' CAP water subcontracts; and
- that Arizona-American shall charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

15. On September 26, 2000, Staff filed the Agreement that is marked Exhibit A. The Agreement resolves all issues relating to the terms and conditions under which the Acquired Assets may be sold and transferred to Arizona-American.

16. In the Agreement, Arizona-American acknowledged that it will follow Staff's recommendations if they are adopted by the Commission.

17. While RUCO did not oppose the treatment of the acquisition adjustment in a future rate proceeding, it neither joined in signing the Agreement nor suggested a workable

alternative approach to that agreed upon by Arizona-American and Staff in the Agreement in this instance based on our prior treatment of similar transactions.

18. Arizona-American is a fit and proper entity to acquire Citizens' utility assets and Certificates and to assume Citizens' public service obligations for the operation of the utility systems in Arizona.

19. Staff and Arizona-American believe that the approval of the Agreement attached hereto as Exhibit A is in the public interest.

20. Based on our review of the evidence, Staff's recommendations in Findings of Fact No. 14 and the Agreement are reasonable and in the public interest. Therefore, the transfer of Citizens' water and wastewater utility assets and Certificates to Arizona-American should be approved.

CONCLUSIONS OF LAW

1. Citizens and Arizona-American are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282 and 40-285.

2. The Commission has jurisdiction over Citizens and Arizona-American and over the subject matter of the Application.

3. Citizens and Arizona-American provided notice of this proceeding in accordance with the law.

4. There is a continuing need for public water and wastewater service in the certificated service areas of Citizens.

5. Arizona-American is a fit and proper entity to receive the Certificates of Citizens.

6. The Application of Citizens and Arizona-American, the Agreement and the conditions recommended by Staff in Findings of Fact No. 14 should be approved.

ORDER

IT IS THEREFORE ORDERED that the Joint Application for Approval to Transfer the Assets and Certificates of Convenience and Necessity of Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company, to Arizona-American Water Company be, and is hereby, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company shall comply with the terms, conditions and requirements as set forth in the Staff Settlement Agreement, attached hereto as Exhibit A, and with Staff's recommendations in Findings of Fact No. 14 hereinabove.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 30 days from the date on which the acquisition has been completed, with the Director of the Commission's Utilities Division, appropriate documentation evidencing its acquisition of the Citizens Utilities Company now known as Citizens Communications Company's Arizona water and wastewater utility assets.

IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its customers of the effective date of the transfer of the utility assets and of its assumption of the obligation to provide water and wastewater utility services at the existing rates by means of an insert in its first regular monthly billing or by other appropriate means immediately following the date it files the documentation with the Director of the Utilities Division.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 15 days of the date it files the documentation with the Director of the Utilities Division, a copy of the notice it provides its customers.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to charge the existing rates and charges of the transferred utility companies until further Order by the Commission.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to file all periodic reports, and comply with all outstanding compliance matters previously required of Citizens Utilities Company, now known as Citizens Communications Company relative to the acquired water and wastewater operations.

IT IS FURTHER ORDERED that Citizens Utilities Company shall maintain its books and records for the transferred utility companies for a period of 5 years from the effective date of this Decision.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24TH day of April, 2001

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT_____

SERVICE LIST FOR: CITIZENS COMMUNICATIONS COMPANY ET AL.

DOCKET NOS.: W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192; S-02276A-00-0192; WS-02334A-00-0192; WS-03454A-00-0192; WS-03455A-00-0192; W-02013A-00-0192; W-01595A-00-0192; and W-01303A-00-0192

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

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00- 0192 W-01032B-00- 0192 W-01032C-00- 0192 S-02276A-00- 0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00- 0192 W-01595A-00- 0192 W-01303A-00- 0192 SETTLEMENT AGREEMENT BETWEEN ARIZONA CORPORATION COMMISSION STAFF AND ARIZONA-AMERICAN WATER COMPANY

On March 24, 2000, Citizens Utilities Company (now known as Citizens Communications Company), its Agua Fria Water Division, its Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively, "Citizens") and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a joint application for the approval of the sale and transfer of Citizens water and wastewater utility plant, property and assets in Arizona, including transfer of Citizens' certificates of convenience and necessity

EXHIBIT A

("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

The Commission's Utilities Division Staff ("Staff") has investigated the application and has recommended that the application be approved by the Commission, subject, however, to certain conditions and requirements, which are set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has indicated that it is willing to accept the Staff Recommendations, with the exception of the recommendation that Citizens' advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") be imputed to Arizona-American.

Representatives of Staff and Arizona-American have had discussions concerning the matters in dispute with respect to the application and have reached a settlement. The purpose of this Settlement Agreement is to memorialize the agreement that has been made by and among Staff and Arizona-American, which resolves all areas of disagreement relating to the terms and conditions under which Citizens' Arizona water and wastewater assets and Citizens' Certificates may be transferred to Arizona-American.

1. AIAC Imputation; Amortization. As of December 31,1999, Citizens' AIAC balance was $80,818,669. Citizens' AIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American becomes responsible for the provision of water and wastewater services will be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of AIAC imputed will be adjusted as more particularly provided below. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place.

2. CIAC Imputation; Amortization. As of December 31, 1999, Citizens' CIAC balance was $4,734,430. Citizens' CIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American become responsible for the provision of water and wastewater services will also be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of CIAC to be imputed to Arizona-American will also be adjusted as provided below. The adjusted CIAC balance imputed to Arizona-American will be amortized above the line (i.e., as a reduction to depreciation expense) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place.

3. Adjustment to Recorded AIAC and CIAC Balances. The amounts of AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer, adjusted as follows: An amount equal to five percent (5%) of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance in computing the amounts to be imputed to Arizona-American for ratemaking purposes hereunder.

4. Adoption of Remaining Staff Recommendations. Arizona-American agrees that the Commission may adopt the remaining Staff Recommendations, as set forth in the Direct Testimony of Linda A. Jaress.

5. Deferral of Determination of Amortization Method. The parties agree that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

6. Transfer in the Public Interest. Based on the foregoing agreements

and understandings, Staff agrees that Arizona-American is a fit and proper entity to acquire the Certificates and that the Commission should authorize and approve the transfer of Citizens' Arizona water and wastewater assets to Arizona-American on the terms set forth herein. No additional terms, conditions or requirements are necessary or appropriate.

7. Support and Defend. This Settlement Agreement will be introduced as an exhibit during the hearing on the application, presently set for September 27, 2000. Arizona-American and Staff will jointly request that the Settlement Agreement be received into evidence, and agree to support and defend this Settlement Agreement and the transfer of Citizens' water and wastewater assets and the Certificates to Arizona-American on the terms set forth herein as just, reasonable and appropriate based on the particular circumstances presented in this application.

8. Compromise; No Precedent. This Settlement Agreement represents a compromise in the positions of the parties hereto. By entering into this Settlement Agreement, neither Staff nor Arizona-American acknowledges the validity or invalidity of any particular method, theory or principle of regulation, or agrees that any method, theory or principle of regulation employed in reaching a settlement is appropriate for resolving any issue in any other proceeding, including (without limitation) any issues that are deferred to a subsequent rate proceeding. Except as specifically agreed upon in this Settlement Agreement, nothing contained herein will constitute a settled regulatory practice or other precedent.

9. Privileged and Confidential Negotiations. All negotiations and other communications relating to this Settlement Agreement are privileged and confidential, and no party is bound by any position asserted during the negotiations, except to the extent expressly stated in this Settlement Agreement.

As such, evidence of statements that were made or other conduct occurring during the course of the negotiation of this Settlement Agreement is not admissible in any proceeding before the Commission or a court.

10. Complete Agreement. This Settlement Agreement represents the complete agreement of the parties with respect to its subject matter. There are no understandings or commitments other than those expressly set forth herein.

DATED this 26 day of September, 2000.

ARIZONA CORPORATION COMMISSION STAFF

By: _____
Steven M. Olea
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

ARIZONA-AMERICAN WATER COMPANY

By: _____
Norman D. James
FENNEMORE CRAIG
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Arizona-American Water Company

An original and 10 copies of the foregoing was delivered this ___ day of September, 2000, to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing was delivered this ___ day of September, 2000, to:

Karen E. Nally
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing
was telecopied/delivered and mailed this ___
day of September, 2000, to:

Daniel W. Pozefsky
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Craig A. Marks
Associate General Counsel
Citizens Communications Company
2901 N. Central, Suite 1660
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(602) 265-3415

By: _____

STEPHENSON DIR. EXH. 2

AMERICAN WATER WORKS - SHARED SERVICES CENTER
CITIZENS ACQUISITION
Final Acquisition Journal Entry - Arizona

F:\RATES\Arizona Citizens Rate Case\[AZ Czn Entries Fina

1. RECORD UTILITY PLANT PURCHASED (Booked in Jan Based on Nov Info) JE2301, reclass debt JE231

230105.104000	Utility Plant Purchased/Sold	276,471,277		
230105.201200	Common Stock		110,888,158	
230105.221120	Bonds Inside		154,948,119	
230105.221100	Bonds Outside		10,635,000	

2. RECORD ACQUISITION - NET ASSETS

CZN record net assets	JE#			
230105.10400	Utility Plant Purchased/Sold		276,471,277	
230105.134100	Petty Cash	3,371		
230105.146100.001	A/R Other Manual (Notes Rec)	500,000		R
230105.141000	Accounts Receivable	1,723,245		R
230105.141000	Accounts Receivable-unexplained difference		71,151	
230105.144000	Unbilled Revenue	825,523		
230105.143000	Allowance for Doubtful Accounts		47,496	R
239902.241249.002	Collection for Others (agua fria)	27,730		
239902.241249.001	Collection for Others (agua fria)		27,730	
239903.241249.002	Collection for Others (Sun City)	9,027		
239903.241249.001	Collection for Others (Sun City)		9,027	
239901.241249.002	Collection for Others (Surprise)	382,751		
239901.241249.001	Collection for Others (Surprise)		382,751	
239905.241249.002	Collection for Others (Sabrosa)	4,952		
239905.241249.001	Collection for Others (Sabrosa)		4,952	
230105.146100.001	Misc A/R - Manual	581,849		R
230105.146100.001	Misc A/R - Manual	99,208		
230105.153000	Materials & Supplies-Stk E	30,557		
230105.165500	Prepaid Postage	896		R
230105.165500	Prepayments - Transition services	24,374		
230105.165500	Prepayments CAP Legal Services		2,500	
230105.105110.1 CZN X	Capital Exp. Invoices paid by Citizens	1,057,874		Exb I
238305.146100.001	Sabrosa Water Well Project	9,672		
236206.675000.2135	Sun City Main Repairs	5,654		
236406.675000.2135	Sun City West Main Repairs	195		
230105.101099	Utility Plant	272,822,609		
230105.101099	Utility Plant CBSC Assets	19,974		
230105.105110.1 CZN X	CWIP	6,110,694		
230105.108105	Accumulated Depreciation		55,775,969	
230105.108105	Accumulated Depreciation CBSC Assets		9,253	
230105.183000	Preliminary Survey & Investigation	663,525		R
230105.238010	Customer Deposits		143,867	R
238905.186898.DD230001 s	Ground Water Withdraw Fee	418		
236205.186898.DD230001 s	Ground Water Withdraw Fee		97,658	
236205.186898	DDA -Other	201,088		
236205.186898	DDA -Other	497,393		
236405.186898.DD230001 s	Ground Water Withdraw Fee		48,222	
236405.186898	DDA -Other		96,961	
236405.186898	DDA -Other	294,013		
236105.186898.DD230001 s	Ground Water Withdraw Fee		28,554	
236105.186898	DDA -Other	22,458		
236105.186898	DDA -Other		44,971	
236105.186898	DDA -Other	2,929,500		
230105.186898	DDN Other (regulatory assets)	1,392,615		R
230105.181110	Unamortized Debt Expense - outside	387,690		

230105.181110	Unamortized Debt Expense - outside	22,990	
230105.241998	Other Current Liability - analyzed		1,972,236.00
230105.236151	Accrued Property Taxes		886,624 sch
230105.252120	Advances for Const		23,364,564 sch
230105.262411	DCN - Advance Payments and Deposits Other		284,879 sch
230105.840000	Interest Exp Other	30,921	
230105.234300	A/P Misc. -Net Cash Payable		2,030,554
230105.114100	UPAA**	71,118,430	
		361,801,197	361,801,197

UPAA DETAIL

	Initial UPAA	
	Initial Cash Payment (line 5)	266,618,443
	Less: Net Assets Purchased	195,489,291
	Initial UPAA	71,129,152
	Difference	10,722
	CBSC Assets not on Citizen's AZ Balance sheet but should be according to the schedule	10,722 Part of IL workpapers

3. RECORD UTILITY PLANT DETAIL

GARY TO RECORD

230105.101099	Utility Plant (incl CBSC Assets)		272,842,583
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	

4. WRITE-OFF INVENTORY TO EXPENSE (CREDITED EXP WHEN LOADED)

CZN W/O Inventory #4		JE#	
230105.575000.16	Misc Oper Exp AG	30,557	
230105.153000	Material & Supplies		30,557

5. EXPENSE PREPAID POSTAGE

CZN - w/o prepaids#5		JE#	
230105.575000.16	Misc Expense	896	
230105.165500	Prepayments		896

6. EXPENSE PREPAID MOTOR VEHICLE TAXES AND CAP Legal

CZN - w/o prepaids#6		JE#	
230105.575000.16	Misc Exp	21,874	
230105.165500	Prepayments	2,500	
230105.165500	Prepayments		24,374

7. TO WRITE OFF UNBILLED REV.

CZN - w/o unbilled #7		JE#
236105.401120	Aqua Fria Res	120,069
236105.401220	Aqua Fria Comm	29,652
236105.401520	Aqua Fria OPA	24,609
236205.401120	Sun City Water - Res	211,176
236205.401220	Sun City Water - Comm	36,464
236405.401120	Sun City West - Res	107,910
236405.401220	Sun City West - Comm	22,191
237105.401120	Mohave - Res	115,155
237105.401220	Mohave - Comm	32,575
237105.401520	Mohave - OPA	4,601
237305.401120	Havasu Res	17,944
237305.401220	Havasu Comm	5,827
238305.401120	Distco Res	71,303

238305.401220	Distco Comm	9,753	
238905.401120	Tubac Res	13,783	
238905.401220	Tubac Comm	2,510	
230105.144000	Unbilled Revenue		825,523

8. CAPITAL INVOICES PAID BY CITIZENS NEED TASK ORDER NUMBERS

NO ENTRY NEEDED

Task Order	Anthem Valve Vaults Task Order 5	15,366	
Task Order	Anthem Water Treatment Plant Ph 3	51,093	
Task Order	Anthem Solids Handling Facility	344,109	
Task Order	Sun City West Reclaim Facilty	70,913	
Task Order	Sun Village Well #5	18,900	
Task Order	Sun Village Water Plant Mods	11,129	
Task Order	Sun Village SCADA	2,240	
Task Order	Sun City Grand Water Plant #1.	7,990	
Task Order	Anthem Project Mana Phase 4	76,444	
Task Order	Anthem Water Campus WTP 4MGD	310,975	
Task Order	Anthem Water Campus Tank #2	3,757	
Task Order	AT/AF Interconnect	1,147	
Task Order	Oakmont Dr. Water Replace	1,965	
Task Order	Anthem Remote Vault Float Valve	7,410	
Task Order	Anthem Valve Replacement	5,124	
Task Order	Sun City West Service Replacements	5,916	
Task Order	Sun City Sewer Flo Mtr SCADA RTU	11,266	
Task Order	Water test Agua Fira	88	
Task Order	Water Test Sun City	70	
Task Order	Water Test Anthem	640	
Task Order	Sun City/Sun City West Grdwtr Svgs	3,016	
Task Order	Sun City/Sun City Wst Well Study	25,415	
Task Order	Whitestone Water Reclaim Fac	5,846	
Task Order	Anthem Finished Water Res.#2	47,735	
Task Order	Sun City Grand SCADA	1,560	
Task Order	99th & Olive Flow Meter	1,318	
Task Order	Sun Village Booster Station	3,494	
Task Order	Surprise Main Replace	1,520	
Task Order	Anthem Phase 2	1,851	
	SUB - TOTAL	1,038,299	
Need Task Order	Sun Valley Water Treatment Plant	19,575	Not On D. Baka's sheets
	Was on the PA line of Exhibit I should be AZ		
	TOTAL	1,057,874	

STEPHENSON DIR. EXH. 3

[09101] - Journal Entries

Functions Tools Help

Model (Y)

Reverse or Void (R/V)

Document Type JE

Document Number/Co 24545 00023 Explanation RECLASS CITIZENS ORCOM CHARGES

G/L Date 12/31/01 Batch Number 23054064 Home BU

Remaining Ref 1

Skip to Line

Account No.	Subl/WO#	T	Amount	Explanation 2
230205.760715			607,722.55	
2302000E.105150.1	23002001	W	607,722.55-	

F5=Make New Model F6=% JE F15=Model JE's F13=Acct Master F24=More Keys MW

Citizens Business Services Company (CBSC)
Net Book Value of Assets - Banner System & Non Banner Items
At January 15, 2002

Category	Description	Capitalized Cost	Accumulated Depreciation	Est. Net Book Value	Allocated by State Illinois	Allocated by State Arizona
	Furniture & fixtures:					
5	Office furniture	2,497	1,157	1,340	1,340	0
6	Work tables, files & storage cabinets	3,582	1,662	1,920	1,920	0
7	Copier	1,565	728	837	837	0
8	Facsimile machine	2,465	1,141	1,324	1,324	0
9	File server & software - Sun City, Az	19,974	9,253	10,721	0	10,721
9	File server & software - Harvey, LA	99,870	46,263	53,607	53,607	0
9	File server & software - Woodridge, IL	79,895	37,011	42,884	42,884	0
10	PCs and software	53,085	24,595	28,490	28,490	0
11	Misc.	2,465	1,141	1,324	1,324	0
12	PC credit services	7,056	3,271	3,785	3,785	0
	Total Furniture & Fixtures	272,454	126,222	146,232	135,511	10,721
	Data Center Implementation:					
13	HAVC System (50%)	58,276	27,000	31,276	31,276	0
14	UPS unit	81,342	37,677	43,665	43,665	0
15	Generator	99,337	46,018	53,319	53,319	0
16	Fire suppression system	44,442	20,589	23,853	23,853	0
17	Raised flooring	10,212	4,726	5,486	5,486	0
18	Equipment racks / workstations	33,989	15,748	18,241	18,241	0
19	Telephone / data wiring	22,144	10,256	11,888	11,888	0
	Total Data Center Implementation	349,742	162,014	187,728	187,728	0
20	Computer hardware HP 9000 & HP-UX	705,391	326,768	378,623	378,623	0
	Mailing Center Implementation:					
28	HVAC system (50%)	36,260	16,797	19,463	19,463	0
29	Ceiling tile	1,514	705	809	809	0
30	Carpet padding	404	184	220	220	0
31	Canape	3,082	1,425	1,657	1,657	0
	Total Mailing Center Implementation	41,260	19,111	22,149	22,149	0
32	Automated mailing system	316,328	146,541	169,787	169,787	0
33	Billing printer	202,150	93,647	108,503	108,503	0
						0
34	Postage meter	7,046	3,263	3,783	3,783	0
	Total Allocated Assets	1,894,371	877,566	1,016,805	1,006,084	10,721
	Assets Expected to Retain					
	Banner System	2,956,710	1,369,691	1,587,019		
	Other Unallocated Assets	138,601	64,194	74,407		
	Software License cost transferred from LGS 12/00	1,223,780	265,152	958,628		
	Total Retained Assets	4,319,091	1,699,037	2,620,054		
	Total CBSC Assets	6,213,462	2,576,603	3,636,859		

ARIZONA-AMERICAN WATER COMPANY
SPREAD OF ORCOM COSTS

Water / Wastewater	4 Factor Percentage	% of 4 Factor Percentage	Banner	Arizona	ORCOM
Mohave Water	1.791	4.34%	$113,730	$113,730	$70,348
Havasu Water	0.215	0.52%	$13,653	$13,653	$8,445
Tubac Water	0.143	0.35%	$9,081	$9,081	$5,617
Sun City Water	3.295	7.99%	$209,236	$209,236	$129,424
Sun City Sewer	2.579	6.25%	$163,769	$163,769	$101,300
Sun City West Water/Wstwtr	4.011	9.72%	$254,703	$254,703	$157,548
Aqua Fria	1.862	4.51%	$118,239	$118,239	$73,137
California Water	7.450	18.06%	$473,083		$0
Home Water	1.862	4.51%	$118,239		$0
CU Water of Penn	1.361	3.30%	$86,425		$0
Lake Heritage	0.143	0.35%	$9,081		$0
Blue Mountain	1.289	3.12%	$81,853		$0
Glen Alsace	1.003	2.43%	$63,692		$0
CUC Illinois	10.316	25.00%	$655,077		$0
Flowing Wells	0.143	0.35%	$9,081		$0
Ohio Utilities	2.221	5.38%	$141,036		$0
Citizens Water Resources Co. of AZ	0.931	2.26%	$59,119	$59,119	$36,568
Citizens Water Services Co. of AZ	0.645	1.56%	$40,958	$40,958	$25,335
	41.26	100.00%			
Total Banner Net Assets Retained			$2,620,054	$982,488	$607,722
Total ORCOM Costs					$607,722

STEPHENSON DIR. EXH. 4

Arizona-American Water Co.
Citizens Acqusition - Phase 3 Costs
As of September 30,2002

	2000	2001	2002		Total
Service Company Charges	165,778	235,692	217,655	$	619,125
Intergration Services (Consultants)			157,932	$	157,932
Miscellaneous (*data lines, office trailer rental)*		1,497	450	$	1,947
Notices to Customers		375	5,407	$	5,782
	167,778	239,564	383,445	$	784,784

F:\RATES\Arizona Citizens Rate Case\[Phase 3 Acquisition Costs.xls]Phase 3

09200P

Account Ledger Print

Date - 9/25/02
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From Date/Per 01/01/00
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	20608	02/29/00	Reclass 2/00 Service Co. Chrgs	14124		2,011.32		P
				Batch Date 03/08/00				User ID BBEINLIC
JE	405	03/31/00	Service Company Charges	15043		27,296.79		P
				Batch Date 04/05/00				User ID MPATACSI
JE	405	04/30/00	Service Company Charges A#106,113,268,273	16469		35,842.17		P
				Batch Date 05/02/00				User ID MPATACSI
JE	20866	04/30/00	Reclass Mar.,00 Serv Co Chrgs	16469		822.51		P
				Batch Date 05/02/00				User ID MPATACSI
JE	405	05/31/00	Service Company Charges A#106,113,268,273	18080		12,907.91		P
				Batch Date 06/05/00				User ID ARIVERA
JE	405	06/30/00	Service Company Charges A#106,113,268,273	20131		54,847.50		P
				Batch Date 07/06/00				User ID MPATACSI
JE	405	07/31/00	Service Company Charges July 0 A#106,113,268,273	22002			4,038.25-	P
				Batch Date 08/03/00				User ID BBEINLIC
JE	405	08/31/00	Service Company Charges A#106,113,268,273	23686		12,287.88		P
				Batch Date 09/06/00				User ID MPATACSI
JE	405	09/30/00	Service Company Charges A#106,113,268,273	25338		6,022.32		P
				Batch Date 10/07/00				User ID DBAKA
JE	405	10/31/00	Service Company Charges A#106,113,268,273	27022		5,786.27		P
				Batch Date 11/06/00				User ID DBAKA
JE	405	11/30/00	Service Company Charges A#106,113,268,273	28379		3,944.81		P
				Batch Date 12/05/00				User ID DBAKA
JE	405	12/31/00	Service Company Charges A#106,113,268,273	30020		8,046.96		P
				Batch Date 01/04/01				User ID DBAKA
						169,816.44	4,038.25-	

---- Account Balances ----

Ledger Total	165,778.19
Unposted	
Year-to-Date	165,778.19
Cumulative	165,778.19

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Account Ledger Print

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From Date/Per 01/01/01
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Ledger Type. AA
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Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	405	01/31/01	Service Company Charges A#106,113,268,273	32855 Batch Date 02/07/01		13,980.82		P User ID DBAKA
JE	405	02/28/01	Service Company Charges A#106,113,268,273	34637 Batch Date 03/06/01		8,400.76		P User ID DBAKA
JE	405	03/31/01	Service Company Charges A#106,113,268,273	36299 Batch Date 04/04/01		7,732.01		P User ID DBAKA
JE	405	04/30/01	Service Company Charges	38086 Batch Date 05/02/01		8,353.84		P User ID MPATACSI
JE	405	05/31/01	Service Company Charges	40082 Batch Date 06/05/01		1,224.37		P User ID DBAKA
JE	405	06/30/01	Service Company Charges	42149 Batch Date 07/05/01		609.09		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		895.92		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		3,535.69		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			471.88-	P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			1.18-	P User ID DBAKA
JE	405	08/31/01	Service Company Charges	46074 Batch Date 09/06/01		19,930.36		P User ID DBAKA
JE	405	09/30/01	Service Company Charges	47791 Batch Date 10/04/01		29,575.23		P User ID DBAKA
CC	46250	10/31/01	JAMES M CAMPBELL SERIOUS SIGNS	49402 Batch Date 11/02/01		86.08		P User ID DBAKA
JE	405	10/31/01	Service Company Charges	49657 Batch Date 11/06/01		48,506.95		P User ID DBAKA
PV	5501	11/15/01	WOODENSHIP BILLING CHG PSTCRD: SURPSE AZ	50586 Batch Date 11/15/01		375.00		P User ID DBAKA Invoice 200233
PV	5563	11/28/01	QWEST - POB 2348 (CITIZENS) PREWIRE @ 11102 W ROSE GARDEN	50917 Batch Date 11/28/01		90.36		P User ID DBAKA Invoice A682306
JE	405	11/30/01	Service Company Charges	51279 Batch Date 12/04/01		36,592.11		P User ID DBAKA
PV	5689	12/14/01	UNITED RENTALS (formerly Woude OFFICE TRAILER RENTAL	52310 Batch Date 12/14/01		426.63		P User ID DBAKA Invoice 21818444-001
PV	5690	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		225.86		P User ID DBAKA
PV	5693	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		270.04		P User ID DBAKA
PV	5739	12/26/01	QWEST - POB 29060 (480...636B, CITIZENS SERVICE: 11/28-12/27	52624 Batch Date 12/26/01		120.90		P User ID DBAKA Invoice 6235727003564B
JE	395	12/31/01	Special Accounts Payable AT&T - Citizens	53086 Batch Date 01/04/02		27,256.97		P User ID DBAKA
JE	405	12/31/01	Service Company Charges	52958 Batch Date 01/03/02		29,570.56		P User ID DBAKA
JE	24545	12/31/01	RECLASS CITIZENS ORCOM CHARGES	54064 Batch Date 01/10/02		607,722.55		P User ID DBAKA
PV	5778	12/31/01	UNITED RENTALS (formerly Woude	52935		276.63		P

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Currency Code
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User ID DBAKA
Invoice 21919444-002

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit
			RENT: 16 FT OFFICE TRAILER	Batch Date 01/03/02			
						845,758.73	473.06-

---- Account Balances ----

Ledger Total	845,285.67
Unposted	
Year-to-Date	845,285.67
Cumulative	845,285.67

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Account Ledger Print

Date - 9/25/02
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 230105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO# .	Debit	Credit	
PV	40068645	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,509.28		P User ID SCHAFFCE
PV	40068654	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,897.51		Invoice CAWW00602 P User ID SCHAFFCE
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		149,699.60		Invoice CAWW00302 P User ID TUMANEW
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		8,231.91		P User ID TUMANEW
JE	2312	09/30/02	Reclass Citizens Phase 3	2169053 Batch Date 09/17/02		217,333.01		P User ID TUMANEW
						380,671.31		

---- Account Balances ----

Ledger Total	380,671.31
Unposted	
Year-to-Date	380,671.31
Cumulative	380,671.31

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Account Ledger Print

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From Date/Per 01/01/02
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code
P
-
P
User ID RUSSOTL
P
User ID RUSSOTL

Account 230205.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit
JE	66	01/31/02	record awws bill	478862 Batch Date 02/06/02		321.69	
JE	66	02/28/02	record awws bill	665000 Batch Date 03/05/02			
						321.69	

---- Account Balances ----

Ledger Total	321.69
Unposted	
Year-to-Date	321.69
Cumulative	321.69

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Account Ledger Print

Date - 9/25/02
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From Date/Per 01/01/02
Thru Date/Per 12/31/02
Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 236105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
PV	40043671	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2447
PV	40043684	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2446
PV	40043686	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELL	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2445
						450.00		

---- Account Balances ----

Ledger Total	450.00
Unposted	
Year-to-Date	450.00
Cumulative	450.00

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 5

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$	5,153,711		
2					
3				4 Factor Formula	
4					
5	**Location**			**Factor**	**Management Fee Allocation**
6					
7	Mohave Water, Havasu Water			0.1157	$ 596,284
8	Mohave Sewer			0.0070	36,076
9	Sun City Water			0.1797	926,122
10	Sun City Sewer			0.1014	522,586
11	Sun City West Water			0.1001	515,886
12	Sun City West WasteWater			0.1072	552,478
13	Agua Fria, CWS, CWR Water			0.2300	1,185,353
14	CWS, CWR Sewer			0.0558	287,577
15	Tubac Valley			0.0075	38,653
16					
17					
18	TOTAL CUSTOMER COUNT			0.9044	$ 4,661,016
19					
20					
21					

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$	5,153,711		
2					
3				4 Factor Formula	
4					
5	**Location**			**Factor**	**Management Fee Allocation**
6					
7	Mohave Water			0.1011	$ 521,040
8	Havasu Water			0.0146	75,244
9	Mohave Sewer			0.0070	36,076
10	Sun City Water			0.1797	926,122
11	Sun City Sewer			0.1014	522,586
12	Sun City West Water			0.1001	515,886
13	Sun City West WasteWater			0.1072	552,478
14	Agua Fria			0.1384	713,274
15	CWS/CWR Water			0.0916	472,080
16					-
17	CWS/CWR Sewer			0.0558	287,577
18					-
19	Tubac Valley			0.0075	38,653
20					
21					
22	TOTAL CUSTOMER COUNT			0.9044	$ 4,661,016
23					
24					
25					

Management Fees
per168 Line 13

		Actual								Forecast		
		January	February	March	April	May	June	July	ytd	Apr-July	2002 YE Forecast	Annual Est
Arizona		22,441	215,344	396,649	429,178	471,821	396,921	451,837	2,384,191	437,439	4,571,387	5,249,271
per Dbaka amnt includes Amort OneTime Costs	Call Ctr				(4,295)	(4,295)	(6,681)	(6,681)	(21,951)			
	SSC			(5,881)	(1,960)	(2,312)	(2,815)	(2,815)	(15,784)			
per168 Line 13 less Amort One Time Costs		22,441	215,344	390,768	422,923	465,214	387,425	442,341	2,346,456	429,476	4,493,836	5,163,711

Customers

	Current
AZ Total Water	74,325
AZ Total Sewer	40,198
Total Customers	114,523

Customers

Per JDE STAT Report	Total	Residential	Commercial	Industrial	Fire	OPA	Resale
Paradise Valley	4,669	4,350	239	-	55	6	19
WhiteStone Water	-						
WhiteStone WasteWater	-						
Agua Fria - Water	13,566	13,271	246	-	44	1	4
Sun City Water	22,068	21,118	713	-	113	123	1
Sun City WasteWater	21,144	20,696	448				
Sun City West Water	15,303	14,925	337	-	41	-	-
Sun City West WasteWater	14,889	14,697	192				
Treatco Water	46	1	5	-	-	40	
Treatco WasteWater	7	1	4	-	-	2	
Distco Water	3,307	3,208	83	-	16		
Distco WasteWater	3,593	3,557	36				
Tusayan	-						
Surprise Water	23	15	8				
Cave Creek	-						
Tubac Water	488	426	62				
Mohave Water	13,623	12,741	696	-	98	88	-
Sorenson WasteWater	565	558	5	-	-	2	
Havasu Water	1,232	1,184	48				
Havasu WasteWater	-						
Check total	114,523						

Agua Fria (2361) Count	9	400,368
Cave Creek (2388) Count	1	44,485
Corporate (2301) Count	15	667,280
Distco (2383) Count	4	177,941
Distco Waste Water(2384) Count	2	88,971
Havasu (2373) Count	3	133,456
Mohave (2371) Count	16	711,766
Paradise Valley (2302) Count	10	444,853
Sun City (2362) Count	42	1,868,385
Sun City West (2364) Count	6	266,912
Sun City West Waste (2365) Count	9	400,368
Tubac (2389) Count	1	44,485
Grand Count	118	5,249,270

STEPHENSON DIR. EXH. 6

ARIZONA-AMERICAN WATER COMPANY
FOUR FACTOR ALLOCATION

DISTRICT/CO.	PLANT IN SERVICE	GENERAL METERED CUSTOMERS	SALARIES & WAGES	DIRECT O&M EXPENSES (EXCLUDE PR)	4 Factor Allocation %
SUN CITY SEWER DISTRICT/CO.	12,612,288 5.1853%	21,144 18.4614%	170,492 2.8744%	2,110,347 14.0583%	10.14%
SUN CITY WEST WASTE WATER DISTRICT/CO.	24,836,561 10.2111%	14,889 13.0000%	656,756 11.0727%	1,291,160 8.6012%	10.72%
MOHAVE (SORENSON) DISTRICT/CO.	1,742,120 0.7162%	565 0.4933%	66,444 1.1202%	71,876 0.4788%	0.70%
DISTCO/TREATCO SEWER DISTRICT/CO.	21,774,316 8.9521%	3,600 3.1433%	341,267 5.7537%	673,393 4.4859%	5.58%
SUN CITY WATER DISTRICT/CO.	28,533,245 11.7309%	22,068 19.2681%	1,248,678 21.0523%	2,973,822 19.8104%	17.97%
SUN CITY WEST WATER DISTRICT/CO.	24,724,945 10.1652%	15,303 13.3614%	494,526 8.3376%	1,226,276 8.1690%	10.01%
TUBAC VALLEY DISTRICT/CO.	1,450,789 0.5965%	488 0.4261%	84,319 1.4216%	85,010 0.5663%	0.75%
MOHAVE WATER DISTRICT/CO.	15,573,103 6.4026%	13,623 11.8946%	907,831 15.3057%	1,024,583 6.8254%	10.11%
HAVASU DISTRICT/CO.	1,447,094 0.5949%	1,232 1.0757%	184,457 3.1099%	157,357 1.0482%	1.46%
AGUA FRIA DISTRICT/CO.	49,451,561 20.3311%	13,589 11.8649%	688,562 11.6089%	1,731,272 11.5330%	13.84%
DISTCO/TREATCO WATER DISTRICT/CO.	39,161,570 16.1005%	3,353 2.9276%	626,309 10.5594%	1,059,889 7.0605%	9.16%
PARADISE VALLEY DISTRICT/CO.	21,923,699 9.0135%	4,677 4.0836%	461,666 7.7835%	2,606,438 17.3630%	9.56%
ARIZONA TOTAL	243,231,291	114,531	5,931,307	15,011,423	100.00%

STEPHENSON DIR. EXH. 7

ARIZONA-AMERICAN WATER COMPANY
2002 General Rate Case Application
Rate Case Expense

Estimated Rate Case Expense for Current Rate Case Application:

Consultants			
(see detail)			$608,000
Employee Cost per Day			
Hotel	$	105	
Airfare	$	50	
Food	$	30	
Miscellaneous	$	15	
Cost/Day	$	200	

AWWS Co. Employees		Cost/Day	Days	# Emps		Total $$	
Filing	$	200	1	1	$	200	
System Tour	$	200	3	3	$	1,800	
Stipulation Meeting	$	200	1	2	$	400	
Hearings	$	200	10	5	$	10,000	
Commission Conference	$	200	2	2	$	800	
Public Meetings (1)	$	200	4	2	$	1,600	
Public Meetings (2)	$	200	4	4	$	3,200	
Total							$ 18,000

Mailings, Printings, Supplies & Miscellaneous	$80,000
Total Estimated Rate Case Expense	$706,000
Amortization Period (In Years)	3
Normalized Annual Rate Case Expense	$235,333
Recorded Rate Case Expense Per General Ledger	
Rate Case Expense Adjustment	$235,333

Arizona / American
Rate Case Expense

Preparation of Rate Case Hourly Rate			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 8

per168 Actual (no Svc Co Expenses included)

Arizona	January	February	March	April	May	June	July	YTD	Forecast *avg other than Mar-July Mar-July Monthly Avg	YE Forecast	Annual Est				
Directors Fees			-	-	1,250	-	1,250	2,500	500	5,000	6,000	CC	MISC	6,000	
Bank Svc Charges CA	-	1,390	5,794	1,304	796	3,389	925	13,599	2,442	25,807	29,799	CC	OFFICE		
Bill Inserts -CA	-		440		-	925	-	1,364	341	3,070	4,095	CC	OFFICE		
Collection Agencies						-	145	145	73	508	870	CC	OFFICE		
Bank Svc Chg AG	-	306	-	-	-	235	-	541	47	776	564	CC	OFFICE		
Forms			1,295	365	3,524	172	1,758	7,114	1,423	14,228	17,074	CC	OFFICE		
Required Notifications		100	8,160	-	78,781	3,193	5,819	96,053	19,191	192,006	230,267	CC	OFFICE		
Bill Inserts AG			-	-	10,600	-	70	10,670	2,134	21,340	25,608	CC	OFFICE		
Brochures and Handouts			834	-	-	-		834	209	1,877	2,502	CC	OFFICE		
Community Relations			76	1,786	699	-	660	3,220	644	6,441	7,730	CC	OFFICE		
Postage CA			31	199	90,401	18,939	27,910	137,481	27,496	274,961	329,952	CC	OFFICE	647,981	
Incentive Plan	1,290	1,290	16,863	20,280	14,196	17,256	25,830	97,004	18,885	191,429	228,620	EE	S&W		
Group Insurance	32,598	30,669	60,198	83,721	24,043	47,051	44,214	322,495	51,845	581,722	622,145	EE	S&W		
PBOP	5,295	3,826	104,922	32,363	25,950	28,133	27,388	227,879	28,459	370,172	341,502	EE	S&W		
Wrks Comp	880	484	(196)	3,749	(7,845)	(1,317)	(2,333)	(6,578)	(1,586)	(14,520)	(19,061)	EE	S&W		
Dues/Memberships Deduct		697	973	362	170	(170)	170	2,202	301	3,707	3,612	EE	S&W		
Dues/Memberships NonDeduct		40	147	53	546	(389)	770	1,167	225	2,294	2,706	EE	S&W		
Employee Exp		175	3,716	11,498	32,963	(10,476)	10,313	48,189	9,603	96,203	115,234	EE	S&W		
Employee Exp Conf/Registration			1,067	770	1,373	2,294	4,744	10,249	2,050	20,497	24,595	EE	S&W		
Meal/Travel		239	1,773	4,478	10,818	(3,693)	3,190	16,805	3,313	33,371	39,766	EE	S&W		
Other Welfare			120	472	799	559	335	2,285	541	4,991	6,495	EE	S&W		
Employee Awards					42	-		42	21	147	252	EE	S&W		
Employee Physicals			270	205	79	60		614	154	1,382	1,842	EE	S&W		
Tuition			1,620	2,430	5,906	(3,396)	5,738	12,298	2,460	24,596	29,515	EE	S&W		
Training			530	170	2,263	(1,846)	9,224	10,341	2,068	20,682	24,818	EE	S&W		
401K	297	5,732	5,898	8,674	5,876	5,217	5,377	37,070	6,208	68,112	74,501	EE	S&W		
ESOP	2,045	7,491	7,522	10,724	6,834	6,703	6,450	47,769	7,647	86,002	91,759	EE	S&W	1,586,293	1,586,293
Trustee Fees		1,600	1,243	1,243	1,610	1,233	1,600	8,528	1,422	15,636	17,066	PFP	MISC	17,058	23,058
Credit Line Fees	101	103	1,094	369	215	1,166	634	3,683	696	7,161	8,347	PFP	OFFICE	8,347	1,293,829
General Liab Insurance, Property	2,509	2,509	3,169	2,509	2,674	5,608	3,263	22,241	3,445	39,464	41,335	RB	INS	41,335	258,736
Security Svc CA				1,005	460	458	449	2,372	593	5,337	7,116	RB	OFFICE		
Security Svc		15,516	44,104	52,184	90,296	32,047	44,029	278,177	52,532	540,837	630,384	RB	OFFICE	637,500	
Insurance Other, Gen. Liability	1,911	2,311	1,911	14,511	23,509	20,036	14,411	69,597	16,117	160,181	217,401	RB	INS	217,401	
Co Dues/Memberships Deduct		190	2,500	2,020	-	(1,990)	4,211	6,931	1,348	13,672	16,178				
Co Dues/Memberships NonDeduct			495	8,501	340	2,700		12,036	3,009	27,081	36,108				
Co Dues/Memberships AWWA Deduct			30	108	-	156		294	74	662	882				
Co Dues/Memberships AWWA NonDeduct			443	152	-	54		649	162	1,460	1,947				
Charitable Contributions Deduct				450	533	(108)		875	292	2,333	3,500				
Charitable Contributions NonDeduct				100	100	-		200	67	533	800				
Property Taxes	23,403	23,403	23,403	24,553	773,403	174,471	174,471	1,217,107	174,471	2,089,462	2,093,652		TOTAL	3,161,915	3,161,915

STEPHENSON DIR. EXH. 9

Acquisition Adjustment Analysis

CITIZENS

	BOY	Amortization	EOY	Tax Dep	Def Tax	Acc Def Tax	AVERAGE	Revenue Requirement	Total Revenue Requirement
BOY Balance	71,631,081								
0									
1	71,631,081	$141,500	71489581	4775405	1807223	1807223	70660000	7555000	$7,555,000
2	71489581	$156,400	71333181	4775405	1801412	3608635	68700000	7364000	$7,364,000
3	71333181	$172,800	71160381	4775405	1795016	5403651	66740000	7175000	$7,175,000
4	71160381	$190,900	70969481	4775405	1787957	7191608	64770000	6986000	$6,986,000
5	70969481	$211,000	70758481	4775405	1780118	8971726	62780000	6798000	$6,798,000
6	70758481	$233,100	70525381	4775405	1771499	10743225	60780000	6610000	$6,610,000
7	70525381	$257,600	70267781	4775405	1761944	12505169	58770000	6423000	$6,423,000
8	70267781	$284,600	69983181	4775405	1751414	14256583	56740000	6237000	$6,237,000
9	69983181	$314,400	69668781	4775405	1739792	15996375	54700000	6053000	$6,053,000
10	69668781	$347,400	69321381	4775405	1726922	17723297	52640000	5870000	$5,870,000
11	69321381	$383,900	68937481	4775405	1712687	19435984	50550000	5687000	$5,687,000
12	68937481	$424,100	68513381	4775405	1697009	21132993	48440000	5506000	$5,506,000
13	68513381	$468,600	68044781	4775405	1679654	22812647	46310000	5327000	$5,327,000
14	68044781	$517,800	67526981	4775405	1660466	24473113	44140000	5149000	$5,149,000
15	67526981	$572,100	66954881	4775405	1639289	26112402	41950000	4973000	$4,973,000
16	66954881	$632,200	66322681	0	-246558	25865844	40650000	4897000	$4,897,000
17	66322681	$698,500	65624181	0	-272415	25593429	40240000	4920000	$4,920,000
18	65624181	$771,800	64852381	0	-301002	25292427	39800000	4947000	$4,947,000
19	64852381	$852,700	63999681	0	-332553	24959874	39300000	4976000	$4,976,000
20	63999681	$942,200	63057481	0	-367458	24592416	38750000	5008000	$5,008,000
21	63057481	$1,041,000	62016481	0	-405990	24186426	38150000	5043000	$5,043,000
22	62016481	$1,150,300	60866181	0	-448617	23737809	37480000	5082000	$5,082,000
23	60866181	$1,270,900	59595281	0	-495651	23242158	36740000	5125000	$5,125,000
24	59595281	$1,404,300	58190981	0	-547677	22694481	35920000	5173000	$5,173,000
25	58190981	$1,551,600	56639381	0	-605124	22089357	35020000	5226000	$5,226,000
26	56639381	$1,714,400	54924981	0	-668616	21420741	34030000	5285000	$5,285,000
27	54924981	$1,894,300	53030681	0	-738777	20681964	32930000	5349000	$5,349,000
28	53030681	$2,093,000	50937681	0	-816270	19865694	31710000	5420000	$5,420,000
29	50937681	$2,312,600	48625081	0	-901914	18963780	30370000	5499000	$5,499,000
30	48625081	$2,555,200	46069881	0	-996528	17967252	28880000	5585000	$5,585,000
31	46069881	$2,823,300	43246581	0	-1101087	16866165	27240000	5681000	$5,681,000
32	43246581	$3,119,500	40127081	0	-1216605	15649560	25430000	5787000	$5,787,000
33	40127081	$3,446,800	36680281	0	-1344252	14305308	23430000	5905000	$5,905,000
34	36680281	$3,808,400	32871881	0	-1485276	12820032	21210000	6034000	$6,034,000
35	32871881	$4,207,900	28663981	0	-1641081	11178951	18770000	6177000	$6,177,000
36	28663981	$4,649,400	24014581	0	-1813266	9365685	16070000	6335000	$6,335,000
37	24014581	$5,137,200	18877381	0	-2003508	7362177	13080000	6509000	$6,509,000
38	18877381	$5,676,100	13201281	0	-2213679	5148498	9780000	6702000	$6,702,000
39	13201281	$6,271,700	6929581	0	-2445963	2702535	6140000	6916000	$6,916,000
40	6929581	$6,929,600	-19	0	-2702544	-9	2110000	7151000	$7,151,000
		71631100	2164820740	71631075			1551900000	234445000	$234,445,000

Cost of Debt	4.9200%	Tax Life	15
Cost of Equity	11.5000%	Tax Rate	39.00%
Debt Percent	60.0000%		
Equity Percent	40.0000%		
Weighted Cost of Debt	2.9520%		
Weighted Cost of Equity	4.6000%		
Tax Gross Up	1.639		
TOTAL REVENUE GROSS UP	10.4914%		

Premium Defined

Allocated Purchase Price	276471277
Total Value of Assets	205246727
Gross Premium	71224550
Capitalized Expenses	500000
Corporate Costs	906531
Net Premium	71631081

STEPHENSON DIR. EXH. 10

Exhibit A

Estimated Net Asset Adjustment
Arizona Water Property Detail
As of 11/01

	Mohave	Havasu	Sun City Water	SunCity Sewer	Tubac Valley	Agua Fria	Sun City West	TrestCo	Distco	Citizens Public Works of AZ	Citizens Cons. Serv.- Mohave	Citizen Wtr Resc Mgt Sv C	Citizens Business Services (CBSC)	Total Az. Water by Property	EXCL. CBSC Total Az. Water by Property
Petty Cash	$ 1,321	$ -	$ 2,050	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,371	$ 3,371
Notes Receivable	-	-	-	-	-	500,000	-	-	-	-	-	-	-	500,000	500,000
Accounts Receivable	467,298	45,069	787,008	297,124	26,611	674,508	572,212	54,229	336,635	-	3,951	-	-	3,264,645	3,264,645
Accounts Receivable - Other	-	-	10,417	217	-	334,011	-	63,617	150,533	485,586	-	-	-	1,044,381	1,044,381
Reserve for Doubtful Accounts	(25,168)	(1,257)	(2,975)	-	(85)	(6,438)	(375)	(433)	(10,992)	-	-	-	-	(47,723)	(47,723)
Material & Supplies	-	-	-	-	-	-	-	-	-	26,354	-	-	-	26,354	26,354
Special Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Prepayments	1,000	2,415	91,730	-	1,254	99,049	50,998	5,930	-	-	-	-	3,751	256,127	252,376
Other Current Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Current Assets	444,451	46,227	888,230	297,341	27,780	1,601,130	622,835	123,343	476,176	511,940	3,951	-	3,751	5,047,155	5,043,404
Property Plant and Equipment	24,069,880	1,977,535	39,037,505	17,299,171	1,963,983	52,850,104	69,366,422	42,805,257	11,416,286	-	-	-	8,213,462	266,999,805	260,786,143
Construction Work in Progress	837,185	19,312	379,860	797,889	22,860	1,412,832	320,279	13,270,295	318,324	3,332	-	-	-	17,382,168	17,382,168
Accumulated Depreciation	(7,507,773)	(510,030)	(13,822,745)	(6,697,853)	(564,559)	(4,402,369)	(19,271,951)	(1,994,695)	(245,397)	-	-	-	(2,426,277)	(57,443,649)	(55,017,372)
Net Fixed Assets	17,399,292	1,486,817	25,594,620	11,399,207	1,422,284	49,860,567	50,414,750	54,080,857	11,489,213	3,332	-	-	3,787,185	226,938,124	223,150,939
Preliminary Survey & Investigation	-	-	385,769	-	-	-	268,836	-	-	-	-	-	-	654,605	654,605
Other Deferred Debits	-	-	585,268	-	533	2,921,537	139,137	-	100	-	-	-	-	3,646,595	3,646,595
Regulatory Assets	234,640	24,786	655,877	145,771	4,596	109,279	217,666	-	-	-	-	-	-	1,392,615	1,392,615
Unamortized Debt Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Non-Current	234,640	24,786	1,626,934	145,771	5,129	3,030,816	625,639	-	100	-	-	-	-	5,693,815	5,693,815
	$ 18,078,383	$ 1,557,830	$ 28,109,784	$ 11,842,319	$ 1,455,193	$ 54,492,513	$ 51,663,224	$ 54,204,200	$ 11,965,489	$ 515,272	$ 3,951	$ -	$ 3,790,936	$ 237,679,094	$ 233,886,158
Accounts Excluded:															
Cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
InterCompany Receivables	(9,633,765)	(681,563)	10,223,590	17,790,427	(405,108)	(18,008,861)	8,245,593	(32,066,952)	(1,999,397)	992,666	(1,357,696)	(650,696)	(3,874,841)	(31,426,583)	(27,551,742)
Clearing Accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment in Associate Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	(59,014)	(353)	(75,877)	(144,389)	(239)	(54,982)	(189,807)	(368,679)	(36,039)	(5,178)	-	-	(17,161)	(951,718)	(934,557)
Customers' Deposits	(106,858)	(10,905)	(1,575)	-	(410)	(18,059)	(1,750)	(1,600)	(2,736)	-	-	-	-	(143,893)	(143,893)
Income Taxes Accrued	(489,872)	(50,695)	(142,492)	(319,665)	(13,456)	(840,837)	(5,944)	(265,783)	170,736	(260,115)	187,588	-	-	(2,030,535)	(2,030,535)
Other Taxes Accrued	(225,880)	(17,857)	(183,547)	(82,173)	(13,087)	(289,104)	(176,866)	(61,998)	(20,240)	(1,651)	-	-	(373)	(1,072,776)	(1,072,403)
Interest Accrued	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Current & Accrued Liabilities	-	-	(11,662)	(1,932,421)	-	(308,402)	-	-	-	(422,125)	-	-	-	(2,674,630)	(2,674,630)
Subordinate Investment Note	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Customer Advances for Construction	(4,302,830)	(440,351)	(2,443,976)	(3,468,190)	(180,250)	(31,985,339)	(29,648,102)	(19,215,739)	(10,682,471)	-	-	-	-	(102,367,248)	(102,367,248)
Deferred Income Taxes	486,537	111,894	(1,794,889)	(356,822)	19,763	(978,964)	(2,162,338)	-	-	-	-	-	-	(4,674,819)	(4,674,819)
Regulatory Liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment Tax Credit	(84,565)	-	(386,710)	(179,806)	(16,477)	(94,636)	(1,148,406)	-	-	-	-	-	-	(1,910,600)	(1,910,600)
Other Deferred Credits	-	(12,327)	-	-	-	-	-	-	-	-	-	-	-	(12,327)	(12,327)
Contributions in Aid of Construction	(2,962,599)	(259,451)	(1,020,713)	(1,021,182)	(135,527)	(692,359)	(1,040,772)	-	-	-	-	-	-	(7,132,603)	(7,132,603)
Equity	(699,537)	(196,222)	(32,271,913)	(22,128,098)	(710,402)	(1,220,970)	(25,534,832)	(2,223,449)	604,858	(818,889)	1,166,157	650,696	101,439	(83,281,362)	(83,382,801)
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 MOHAVE WATER DISTRICT AND ITS HAVASU WATER DISTRICT	DOCKET NO. W-01303A-02-_____

DIRECT TESTIMONY

OF

DAVID P. STEPHENSON

EXHIBIT
A-66
Admitted

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I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is David P. Stephenson. My business address is 303 H Street, Suite 250, Chula Vista, California 91910. My telephone number is (619) 409-7700.

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

A. I am employed by American Water Works Service Company, Inc. ("Service Company"), as the Director of Rates and Planning for American Water Works Company, Inc.'s ("AWW") Western Region. The Western Region includes AWW's water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including Arizona-American Water Company ("Arizona-American" or "Company"). I am also an Assistant Treasurer for Arizona American.

Q. PLEASE BRIEFLY OUTLINE YOUR RESPONSIBILITIES AS THE DIRECTOR OF RATES AND PLANNING.

A. I am responsible for directing preparation of all rate applications and various other matters related to rates and charges for utility service with the public utility commissions that regulate AWW's operating utilities in Arizona, California, Hawaii, New Mexico and Texas. I am also responsible for overseeing other rate related proceedings before these commissions such as acquisition and financing applications.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science in Business Administration, with emphasis in Accounting, from San Diego State University in 1977.

Q. HAVE YOU HAD ANY OTHER FORMAL TRAINING?

A. Yes, I have attended many seminars on various aspects of the water industry and

rate applications, including the National Association of Regulatory Utility Commissioners (NARUC) biannual Utility Rate Seminar.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have been employed by the American Water System since 1978. The various positions I have held within the American Water System are: Accountant - 1978; Accounting Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for the operating utilities in the Western Region - 1983; Assistant Director of Rates and Revenues for the operating utilities in the Western Region - 1984; Director of Rates and Revenues for the operating utilities in the Western Region - 1986, and Director of Rates and Planning for the operating utilities in the Western Region since 2001.

Q. HAVE YOU HAD ANY OTHER PROFESSIONAL EXPERIENCES?

A. Yes, I served on the Accounting Committee of the California Water Association and have been an instructor at the NARUC biannual Utility Rate Seminar on eight occasions.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE UTILITY REGULATORY COMMISSIONS?

A. Yes, I have testified before the Arizona Corporation Commission ("Commission") in rate and acquisition proceedings for Arizona-American; before the California Public Utilities Commission on many occasions for all of the California-American Water Company systems; and before the New Mexico Public Regulation Commission in many types of proceedings on behalf of New Mexico-American Water Company.

II. <u>PURPOSE OF TESTIMONY, SUMMARY AND CONCLUSIONS</u>

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

A. The purposes of my testimony are to: (1) identify and explain the Company's rate filing; (2) provide background concerning the purchase of the former Citizens Communications' water and wastewater utility assets in Arizona ("Citizens' Assets") by Arizona-American (the Citizens' Acquisition); (3) explain and support various adjustments made to the test period actual results; (4) explain and support all components of the capital structure except for cost of equity; and (5) to discuss the specific requirements set forth in Decision 63584 (April 24, 2001), which authorized Arizona-American to purchase the Citizens' Assets ("Acquisition Decision").

Q. WHAT DO YOU MEAN THE "COMPANY'S RATE FILING"?

A. I mean the five (5) separate applications for rate relief being filed with the Commission in 2002. This filing follows our efforts to determine the best approach to file rate applications for a substantial number of systems in a manner that would make the most sense for both public presentation and ease of handling for the Commission's Utilities Division Staff ("Staff").

Q. YOU ALSO USED THE TERM "SYSTEM." ARE YOU REFERRING TO "SYSTEM" IN A LEGAL OR OTHER SPECIFIC SENSE?

A. No, I am using the term "system" in a more general sense. By way of background, as I mentioned earlier, Arizona-American acquired all of the water and wastewater assets of Citizens in Arizona in a transaction that closed earlier this year. Previously, Citizens' Assets were under a different ownership structure with a number of separate corporate entities, such as Sun City Water Company, Sun City West Utilities Company or the Agua Fria Water Division of Citizens Communications Company, for example. However, Arizona-American acquired only the assets – not the stock. Therefore, the assets were removed from separate ownership and now all fall under the ownership umbrella of Arizona-American.

Q. HOW DOES ARIZONA-AMERICAN REFER TO THESE SEPARATE GROUPS OF ASSETS INTERNALLY?

A. Generally we use the term "district" to refer to a separate area within Arizona-American where, for accounting purposes, we individually account for revenues and expenses, and maintain separate balance sheets. These areas generally coincide with areas where the same tariffs apply and in that sense, a district could be identified as a "tariffed area." Of course, reference to the "Tubac water tariffed area" or the "Sun City West water tariffed area" would be awkward, and for purposes of the Company's rate filing, we basically use the terms "district" or "system" interchangeably and neither is intended to denote the actual name of any particular corporate entity or to designate an operational or other system as such term is used by ADEQ or any other regulatory agency to identify water or wastewater systems in Arizona.

Q. THANK YOU MR. STEPHENSON. WOULD YOU PLEASE CONTINUE WITH YOUR DISCUSSION OF HOW THE COMPANY ULTIMATELY DECIDED THE BEST WAY TO ORGANIZE THE COMPANY'S RATE FILING?

A. Certainly, again from a public perspective, it was determined that it made sense to file separate applications for the Sun City and Sun City West districts. These four districts, two water and two wastewater systems, are relatively large in size and have certain unique characteristics and circumstances that distinguish them from the other Arizona systems. The third application consists of two water systems in Mohave County, the Mohave water district, which provides water service in the vicinity of Bullhead City, and the Havasu water district, which provides service near Lake Havasu City. These systems are close together and operated by essentially the same Company personnel. The fourth application being filed is the

combination of Agua Fria water district and the water and wastewater systems serving the Anthem development in Maricopa County. These utility systems primarily serve recent developments and have very similar operating procedures. The final application is for the small Class C water system known as the Tubac water district in Santa Cruz County. This system is distinctive based on its small size, limited revenues and location. Again, for convenience, I will sometimes refer to the five applications as the Company's rate filing. And, again, I want to emphasize that the terms "system" and "district" should be considered synonymous throughout the Company's rate filing.

Q. ALL OF THESE DISTRICTS OR SYSTEMS ARE PART OF THE CITIZENS' ACQUISITION, CORRECT?

A. That is correct. I should also note that none of the former Citizens' systems have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company last rate order was issued in May 1997 based on test years ending March 31, 1995. Decision No. 60172 (May 7, 1997).[1] Citizens Mohave Water and Wastewater Divisions last received rate increases in February 1990, based on test years ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test year ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992). It appears that once Citizens decided to sell its water and wastewater systems in 1999, it elected not to seek rate increases and, in some cases, to accept operating losses. This situation has caused Arizona-American to seek rate

[1] In Decision No. 60172, rates for Sun City Water Company and Sun City West Utilities' rates for water service were actually reduced. I also understand the Sun City West Utilities' rates for both water and wastewater service were reduced in the prior rate proceeding, as were Sun City Water Company's rates. Decision No. 55488 (March 17, 1987).

increases more quickly than it anticipated. However, a delay in obtaining rate increases and correcting these systems' anemic earnings would be harmful to the Company and, ultimately, to its customers.

Q. WHAT ARE YOUR OVERALL RESPONSIBILITIES IN THIS CASE?

A. I have been responsible for the coordination and supervision of all of the rate case applications discussed including, among other things, selecting the test period and the pro-forma time period for various adjustments, and determining what adjustments need to included in the filing.

Q. WHAT TEST PERIOD DID YOU DETERMINE WAS APPROPRIATE IN THIS CASE?

A. I determined, for ease of presentation, that the period ending December 31, 2001, should be used as the test period for the Company's rate filing. This period closely is aligned with the purchase of the Citizens' Assets by Arizona-American, which transaction closed on January 15, 2002.

Q. DID ARIZONA-AMERICAN OWN THE CITIZENS' ASSETS, OR HAVE ANY RESPONSIBILITY FOR THE OPERATING EXPENSES OR THE PROVISION OF SERVICE DURING THE TEST PERIOD FOR THE SYSTEMS THAT ARE THE SUBJECT OF THE COMPANY'S RATE FILING?

A. No. As I stated, the purchase of the Citizens' Assets was not completed until January 15, 2002, on which date Arizona-American assumed operational control and responsibility for the Citizens' Assets.

Q. SINCE ARIZONA-AMERICAN DID NOT OWN AND OPERATE THE CITIZENS' ASSETS AND DID NOT HAVE ANY OPERATING RESPONSIBILITY FOR THE WATER AND WASTEWATER UTILITY OPERATIONS IN 2001, HOW DOES THE COMPANY JUSTIFY FILING A

RATE APPLICATION WITH A TEST PERIOD ENDING PRIOR TO THE COMPLETION OF THE PURCHASE?

A. The recorded operating expenses directly incurred by each district basically remain unchanged following the acquisition. Further, the Commission ordered Citizens to maintain its books and records for a period of 5 years following the closing. It is relatively simple to remove the management and services costs allocated to each of the operating systems by Citizens from the normally-incurred direct operating expenses of these systems. Likewise, it is relatively simple to add in the expected Service Company charges from AWW applicable to Arizona-American.

Q. WHAT PRO FORMA TIME PERIOD HAVE YOU USED FOR EXPENSE AND PLANT ESTIMATIONS IN THIS CASE?

A. I am recommending that such adjustments, all of which will be detailed further in the various witnesses' direct testimonies, go no further into the future than end of year 2002. This will provide ample time for Staff to review and analyze these adjustments prior to providing their recommendations in Staff's direct filing.

Q. ARE THERE PRO FORMA ADJUSTMENTS FOR PLANT ADDITIONS?

A. Yes, we have estimated the non-revenue generating plant additions that will be completed and placed in service by the end of 2002, and have included pro forma adjustments that include those additions in utility plant in service. This is consistent with Commission Decision No. 61831 (July 20, 1999) related to the Paradise Valley water district, wherein the Commission ordered the Company to limit pro forma plant additions to those plant items that are used and useful and in service 90 days after the application is deemed sufficient. The December 31, 2002 cut-off date proposed by Arizona-American in this case is well within the 90-day deadline established by the Commission.

Q. HOW ARE PRO FORMA ADJUSTMENTS DETERMINED FOR

OPERATING EXPENSES?

A. Pro forma adjustments for operating expenses are based on known and measurable changes that have or will occur up until the time each rate application is filed to develop a normal 12-month period of operations. This is consistent with A.A.C. R14-2-103(i).

III. ACQUISITION OF THE WATER AND WASTEWATER ASSETS OF CITIZENS UTILITIES OF ARIZONA

Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE CITIZENS' ACQUISITION?

A. By way of background, Arizona-American has owned and operated a water utility system in Arizona, which was formerly known as Paradise Valley Water Company, since the late 1960s. The Paradise Valley water district is relatively small, and currently furnishes service to approximately 5,000 customers. Sometime in 1998 or 1999, Citizens Communications Company (formerly Citizens Utility Company) decided to focus its business activities in the telecommunications area, and elected to sell its water and wastewater assets, which were located in six states including Arizona. Arizona-American's parent company, AWW, which is the largest privately-owned water utility system in the United States and whose business activities focus on water and wastewater, entered into negotiations with Citizens. Ultimately, on October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American agreed to purchase the Citizens' Assets, which included all of the water and wastewater systems and assets in Arizona.

Citizens and its various Arizona water and wastewater subsidiaries, along with Arizona-American, filed an application on March 24, 2000, seeking approval of the transfer of the Citizens' Assets to Arizona-American in Docket Nos. W-

01032A-00-0192, et. seq. Later that same year, Arizona-American filed a separate application in Docket No. W-01303A-00-0929 seeking authority to issue certain promissory notes and other evidence of indebtedness and to assume certain industrial development revenue bonds in connection with financing the purchase of the Citizens' Assets. Following notice and a public hearing, the Commission ultimately approved the transfer of the Citizens' Assets in the Acquisition Decision. Attached to the Acquisition Decision and incorporated therein in the second ordering paragraph, was a settlement agreement setting forth specific terms and conditions agreed to by Staff and the Company. These terms and conditions settled one ratemaking issue and set forth deadlines, procedures and filing requirements that Arizona-American is to follow in future rate proceedings. The terms and conditions are as follows:

1. The ratemaking treatment of the of the acquisition adjustment, deferred taxes, excess deferred taxes and the investment tax credit will be deferred until a future rate case proceeding.
2. The decision to allow recovery of the acquisition adjustment must be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred
3. The Company must file a report 13 months after the closing of the transaction, comparing the number of complaints received by the Commission prior to and after the transaction.
4. The adjusted AIAC balance not transferred to Arizona-American as part of the transaction will be imputed ratably into rate base over a 6.5 year period. The balance will be ratably reduced over the 6.5 years utilizing a levelized monthly below the line amortization.

A copy of the Acquisition Decision is attached hereto as Stephenson Dir. Exh. 1.

Later in 2001, the Commission issued Decision No. 64002 (Aug. 30, 2001) authorizing the debt financing for the purchase of the Citizens' Assets. In summary, the Commission authorized Arizona-American to issue promissory notes and other evidence of indebtedness in an amount not to exceed $180 million and to issue a promissory note reflecting the obligation associated with assuming Citizens' industrial development revenue bonds in the amount of $10,635,000. The balance of the purchase price was financed by an infusion of additional paid in equity capital from AWW. In Decision No. 64002, the Commission ordered Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition in order to maintain a reasonably balanced capital structure.

Q. WHEN DID ARIZONA-AMERICAN FINALIZE THE PURCHASE OF THE CITIZENS' ASSETS?

A. The transaction was finalized on January 15, 2002, the date title to all of the Citizens' Assets was transferred to Arizona-American. All of the service provision responsibilities were also transferred to Arizona-American on that date. The final Citizens' Asset purchase price was approximately $276,500,000, and included an initial book acquisition adjustment of approximately $71,100,000. As Explained in the Direct Testimony of Mr. Joseph Hartnett, appended as Exhibit C to the Joint Application for Authority to Transfer Assets and Related Approvals in Docket Nos. W-01032A-00-0192, et seq., the purchase for the Citizens' Assets was determined by an arms-length negotiation based on the advice of each companies financial advisors. This open market negotiated purchase price then establishes AWW's reasonable investment in the Citizens' Assets. This reasonable investment in the Citizens' Assets was funded by a combination of debt and equity as shown on at the top of the closing journal entry to record the transaction, which is

attached hereto as Stephenson Dir. Exh. 2.

IV. POST TEST PERIOD ADJUSTMENTS

Q. WHAT PRO FORMA ADJUSTMENTS ARE YOU RESPONSIBLE FOR SUPPORTING?

A. I am responsible for supporting six adjustments that impact all of the Company's rate filings. The specific adjustments are as follows: 1) capitalization of payments made for the implementation of ORCOM billing software from operating expense and the determination period for the recovery of this expense; 2) the transfer of charges related to the completion of the Citizens' Acquisition, as well as charges for the development of base accounting procedures from expenses to organizational costs; 3) the rationale for the removal of the Citizens' management costs, 4) estimates of Service Company charges; 5) estimates of rate case expense and 6) estimates of direct charges to the systems made by AWW.

Q. WHY HAVE PAYMENTS BEEN MADE FOR THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Payments made for the development of the ORCOM billing software have been made in connection with converting all of the Citizens' customers over to the AWW billing system. The payments should be considered as organizational costs or start-up costs. I will refer to these as "start-up costs" for the remainder of this discussion. These start-up costs were for such items as consultants' fees, billing programs modifications and related expenses of AWW associates to assist in the development of the billing system. The billing system had to come on line exactly at the time of closing. Since the acquisition was an asset sale, there was no arrangement between Citizens and AWW for Citizens to continue billing any utility customers after the transaction closed. The ORCOM system had to be up and running, and running properly, at the closing. To the benefit of these

customers, AWW has been developing this same system for its own use at all of its present properties, including the Paradise Valley district. This made the time and expense of converting the Citizens' customers to the ORCOM system less burdensome.

Q. WHY WERE THESE COSTS EXPENSED?

A. Over the past few years accounting requirements regarding the booking of these types of start-up costs have changed. Start-up costs historically have been capitalized along with the purchase or development of new assets. This is no longer the case. The Financial Accounting Standards Board has deteremined that too many expenses were being capitalized and companies' balance sheets were being overstated. However, for a regulated utility, the books and records of a company are maintained in acordance with Commission regulations and policy. These start-up costs have always been treated as a capitalized asset, and there is no valid reason to stray from that policy. These start-up costs are incurrred for the development of programs to serve new customers. The addition of the new customers lowers the overall fixed costs per customer. This produces a net cost savings. Therefore, all present and future customers should share in both the development costs as well as the savings. Common regulatory practice is to spread the development costs of a cost saving measure over the customer base receiving known and measurable savings.

Q. DOES THIS COMMISSION HAVE JURISDICTION TO OVERIDE ACCOUNTING POLICY AND AUTHORIZE THESE COSTS TO BE CLASSIFIED AS A CAPITALIZED START-UP OR ORGANIZATION COST?

A. Yes. As has been the common practice under Financial Accounting Standard Board Policy FAS 71, the Commission can establish different accounting

proceedures for various items so long as the proceedure establishes a set methodolgy and time period for the recovery of the item.

Q. WHAT ARE THE ACTUAL COSTS RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Attached as Stephenson Dir. Exh. 3 is an analysis showing the actual costs of this project and other relationships. Page 1 of the Exhibit shows that the total one-time costs for this project is $607,723. The amount included in the rate bases for the Mohave water and Havasu water districts is $70,348 and $8,445, respectively.

Q. DID ARIZONA-AMERICAN PURCHASE ANY BILLING SYSTEM ASSETS FROM CITIZENS AS PART OF THE ASSET PURCHASE?

A. No. As page 2 of Stephenson Dir. Exh. 3 shows, the billing system used by Citizens to bill its water and wastewater customers (the Banner System) was retained by Citizens. Therefore, as I testified earlier, Arizona-American had to have its own billing system set up and fully functional at the time the Citizens' Acquisition closed.

Q. WHAT IS THE EFFECT ON THE RATE BASES FOR THE ARIZONA DISTRICTS INCLUDED IN THE COMPANY'S RATE FILING RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. As shown, the net book value of the Banner billing system at the time the Citizens' Acquisition was completed was $2,620,054. Of that amount $982,488 was allocated to the Citizens' water and wastewater systems in Arizona. The difference between the development costs of the ORCOM system ($607,723) and the allocated net book value of the Banner system not purchased ($982,488) is $374,766. Thus, there was a net benefit to the customers in Arizona through the development of the ORCOM billing system as opposed to purchasing the Banner billing system from Citizens at the net book value allocated to Arizona. The net

effect on the rate bases of the Mohave water and Havasu water districts is $43,382 and $5,208, respectively.

Q. WHY HAVE YOU MADE AN ADJUSTMENT OF $906,531 FOR CORPORATE COSTS TO TRANSFER VARIOUS ITEMS RELATED TO THE CITIZENS' ACQUISITION TO THE ACQUISITION ADJUSTMENT?

A. I have made this adjustment for the same reasons that I recommend the transfer of the one-time start-up costs from expenses. These costs were incurred to complete the purchase of the Citizens' Assets and to establish books and records for the Citizens' Assets and systems. The costs are related to title reviews, legal interpetations of contract clauses, legal representation to transfer existing contracts and for accounting assistance. These costs were necessary to secure and protect Arizona-American's legal rights to all the transferred assets and to obtain transfers of all existing contracts and agreements. These are normal "organizational" expenses to ensure full and proper title to transferred assets and to set up the books and records in an appropriate manner.

Q. CAN YOU PLEASE FURTHER DESCRIBE THE ITEMS WHICH YOU ARE PROPOSING TO RECLASSIFY TO THE ACQUISITION ADJUSTMENT?

A. Certainly. The total amount of $906,531 is comprised of charges from two separate sources: charges incurred by AWW in connection with the purchase; and charges from our accounting contractor in Arizona (Ronald L. Kozoman, CPA) to develop satisfactory records for regulatory purposes. The total of the charges from AWW is $784,784 and the total of the charges from Mr. Kozoman is $121,747. The details of all of these charges is attached hereto as Stephenson Dir. Exh. 4. This full amount is included in the Acquisition Adjustment.

Q. PLEASE EXPLAIN THE JUSTIFICATION FOR REMOVING ALL OF

CITIZENS' MANAGEMENT FEES FROM THE TEST PERIOD EXPENSES.

A. I have removed all of Citizens' management fees from the test period expenses because these expenses pertain to Citizens' management of the Citizens' Assets in Arizona, not expenses that will be incurred under the ownership and management of Arizona-American. These expenses must be removed and replaced by current annualizations of Service Company charges to Arizona-American in order to provide an accurate presentation of known and measureable expenses that are occuring now and will occur on a going-forward basis in the future.

Q. HOW DID YOU DETERMINE WHICH EXPENSES TO REMOVE RELATED TO CITIZENS' MANAGEMENT AND WHICH EXPENSES RELATED TO THE SERVICE COMPANY TO INCLUDE?

A. The explanation of the proceedure to determine what expenses were removed will be discussed by Mr. Tom Bourassa in his direct testimony. I have annualized the amount of expense to be included in the pro forma test period based on actual recorded costs from April through July 2002. Attached as Stephenson Dir. Exh. 5 is a spreadsheet showing the recorded costs from January through the end of July. I have not included the months of January through March in my annualization because these months were either not full months due to the finalization of the acquisition (January) or the months were not accurately reflect normal cost allocations from the Service Company (February and March). Viewing Exhibit 5, it is obvious that January and February have very low recorded expenses in comparison to the other months. The month of March is more in line with future months, but is still questionable due in part to the obvious omission of a credit for the call center amortization (this amortization relates only to the Paradise Valley system). Furthermore, March is a quarter-ending month, and as such expenses in

that month tend to contain more quarterly adjustments, thereby causing distortion of the annualization without including the other months of the quarter.

Q. WHAT IS THE AVERAGE MONTHLY CHARGE FOR THE SERVICE COMPANY FOR THE MONTHS OF APRIL THROUGH JULY 2002?

A. As shown on Stephenson Dir. Exh. 5, the average monthly amount of Service Company charges for the period April through July 2002 is $429,476. Annualizing this amount yields a total of $5,153,711 for 2002.

Q. DID YOU SPREAD THE ANNUALIZED TOTAL TO EACH OF THE SYSTEMS IN ARIZONA?

A. Yes, I spread the annualized expense to each of the systems on a four-factor basis. The four-factor analysis considers many factors all of which produce the benefits Arizona-American receives from the Service Company. The four-factor spreadsheet is attached hereto as Stephenson Dir. Exh. 6. The allocation to the Mohave water and Havasu water districts is $521,040 and $75,244, respectively, based on the four-factor allocation methodology.

Q. PLEASE EXPLAIN YOUR ESTIMATE OF RATE CASE COSTS INCLUDED IN THE COMPANY'S RATE FILING.

A. The estimate of rate case expense has been developed with estimates provided by all outside consultants and costs estimated for in-house items. Attached as Stephenson Dir. Exh. 7 is an estimate of the rate case costs necessary to prosecute these applications. . The total estimated costs of consultants and legal counsel is $608,000. This amount is comprised of $275,000 for ouside accounting and rate assistance, $51,000 for the outside rate of return consultant and $282,000 for legal counsel. The total estimate of in-house costs is $98,000 and is comprised of $18,000 for employee expenses and $80,000 for expenses related to mailings, notices, printing and supplies. I have allocated the total estimated rate case costs to

each system based on adjusted test period revenues and have spread those totals over a three-year recovery period. The total amount allocated to the Mohave water and Havasu water districts is $87,016 and $8,730, respectively.

Q. ARE THE ESTIMATED COSTS TO PROSECUTE THE RATE FILINGS CONSISTENT WITH PRIOR COSTS INCURRED TO PROSECUTE RATE APPLICATIONS IN ARIZONA?

A. Yes, in fact the estimated cost to prosecute this case is lower on a per customer basis than the amount the Commission has previously allowed for the Paradise Valley water district in its past two rate cases. The average rate case cost per customer in the last two Paradise Valley rate proceedings was approximately $13.25. In these applications we have estimated the rate case cost per customer to be approximately $6.50 per customer, or only $2.17 per customer annually.

Q. WHAT ARE THE ADJUSTED DIRECT CHARGES COMPRISED OF?

A. The direct charges are comprised mostly of employee benefits, customer accounting charges (bill forms, postage, inserts, collection agency fees, etc.), insurance fees, dues and memberships, employee travel and directors and trustee fees. Attached as Stephenson Dir. Exh. 8 is an itemization of the charges.

Q. HOW DID YOU ESTIMATE THE ANNUAL COSTS FOR THESE ITEMS?

A. I based the annualized cost for these items on the actual recorded costs for March through July of 2002.

Q. WHAT IS THE TOTAL OF THE ANNUALIZED DIRECT CHARGES AND HOW WERE THEY ALLOCATED TO VARIOUS TEST PERIOD EXPENSE CATAGORIES?

A. The annual total for these direct expenses is $3,161,915. The charges were related to four different expense catagories: salary and wages ($1,586,293); miscellaneous expenses ($23,058); general office expenses ($1,293,829) and insurance fees

($258,736).

Q. HOW WERE THESE DIRECT CHARGES ALLOCATED TO EACH OF THE ARIZONA-AMERICAN SYSTEMS?

A. These charges were allocated to each of the systems based on four different factors. The system charges for salaries and wages were allocated to each system based on expensed test period salaries; the allocation of miscellaneous expense was spread to each system based on customer count and pro forma plant; the allocation of general office expense was allocated to each system based on customer count, pro forma plant and adjusted test period rate base; and the allocation of insurance fees to each of the sysetms was based on adjusted test period rate base.

Q. WHY DID YOU USE THE MARCH THROUGH JULY TIME PERIOD?

A. As stated earlier, I chose the time period that best represents the normalized expenditures. I had to eliminate January and February from consideration due to the fact that Arizona-American did not own the Citizens' Assets until January 15, 2002, and February 2002 was the first full month of operation by Arizona-American and not all charges were recorded properly.

Q. DID YOU REMOVE ALL OF THE RECORDED TEST PERIOD EXPENSES RELATED TO THESE SYSTEM SPECIFIC ALLOCATIONS?

A. Yes, all of the test period expenses for these items were removed from the test period along with the Citizens' management fees.

Q. WHAT WAS THE AMOUNT ALLOCATED TO EACH OF THE EXPENSE CATAGORIES FOR THE MOHAVE WATER AND HAVASU WATER DISTRICTS?

A. The allocations to each of the expense catagories for the Mohave water and Havasu water districts is: $270,391 and $54,078, respectively, for salaries and

wages; $1,418 and $1,043, respectively, for miscellaneous; $147,339 and $13,395, respectively, for general office; and $22,086 and $1,988, respectively, for insurance.

V. CAPITAL STRUCTURE AND COST OF DEBT

Q. WHAT IS THE CAPITAL STRUCTURE THAT ARIZONA-AMERICAN PROPOSES TO UTILIZE IN THESE APPLICATIONS?

A. The Company proposes a capital structure comprised of 60 percent debt and 40 percent equity.

Q. HOW WAS THIS CAPITAL STRUCTURE DETERMINED?

A. It was determined based on the actual financing of the acquisition of the Citizens' Assets by Arizona-American. At the very top of the first page of Stephenson Dir. Exh. 1 is the entry to record the purchase of the Citizens' Assets by Arizona-American. This entry shows Common Stock in the amount of $110,888,158 (40 percent), Bonds – Inside of $154,948,119 (56 percent) and Bonds – Outside of $10,635,000 (4 percent). These are the actual amounts for each of these components as recorded on the books of Arizona-American at the time of purchase of the Citizens' Assets. AWW strives to have its subsidiaries maintain the most efficient capital structure. Typically, the most efficient capital structure for AWW utility subsidiaries is comprised of approximately 60 percent debt. AWW has maintained its high debt rating (A-) and secured very efficient rates for bonds and notes by maintaining a 60 percent debt component in the capital structure. The greater the leverage of the capital structure while still maintaining a high bond rating, the lower the cost of capital to the Company and its customers.

Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN "BONDS-INSIDE" AND "BONDS-OUTSIDE."

A. The "Bonds-Inside" comprise the debt financing provided by American Water

Works Capital Corp. ("AWCC") in the form of a short-term note. This is a five-year unsecured note with an interest rate of 4.92%. The "Bonds–Outside" is debt financing reflecting the assumption of Citizens' industrial development revenue bonds I mentioned previously, which have an interest rate of 7.30%.

VI. ACQUISITION ADJUSTMENT

Q. EARLIER, YOU DISCUSSED THE ACQUISTION. HOW WILL ARIZONA-AMERICAN ACCOUNT FOR THE DIFFERENCE BETWEEN THE PURCHASE PRICE AND THE ACQUIRED ASSET BALANCE FOR REGULATORY PURPOSES?

A. The difference will be recorded as an Acquisition Adjustment in accordance with the NARUC Uniform System of Accounts.

Q. WHAT IS THE AMORTIZATION PERIOD THAT ARIZONA-AMERICAN PROPOSES TO USE?

A. Forty years.

Q. WHAT METHOD OF AMORTIZATION IS ARIZONA-AMERICAN PROPOSING TO USE?

A. Arizona-American proposes to follow a mortgage amortization method, which incorporates the same amortization principle as home mortgages. Under this method, Arizona-American would recover only a small portion of the Acquisition Adjustment in the initial years and recover increasingly greater amounts in the later years. The annual amortization increases each year. The proposed amortization of the Acquisition Adjustment balance is attached hereto as Stephenson Dir. Exh. 9. The amount of the amortization included in the cost of service for the Mohave water and Havasu water districts in these applications is $12,900 and $1,100, respectively, based on amortization of the Acquisition Adjustment in 2003, as shown on Exhibit 9.

Q. WHAT IS THE NORMAL METHOD OF RECOVERY FOR UTILITY ASSETS?

A. The normal method, known as a straight-line method of recovery, involves equal or level recovery in each year of the asset's life.

Q. WHY ARE YOU PROPOSING THE MORTGAGE METHOD RATHER THAN THE STRAIGHT-LINE METHOD?

A. Although there are several reasons for this proposal, there is one significant reason: the mortgage method provides a much better matching of the recovery of the acquisition adjustment to the benefits the customers will receive as a result of this transaction.

Q. DOES USING THE MORTGAGE AMORTIZATION METHOD BETTER ILLUSTRATE THE CUSTOMER BENEFITS OF THIS TRANSACTION?

A. Yes. As stated previously, the savings generated from this transaction will grow as time passes. Allocating the recovery of the Acquisition Adjustment on an increasing basis over the recovery period, instead of leveling the recovery of the Acquisition Adjustment as is normal under the straight-line method of recovery, provides a superior opportunity for all current and future ratepayers to realize the benefits of the transaction.

Q. ARE THERE ANY OTHER FACTORS THAT SUPPORT YOUR SELECTION OF THIS METHODOLOGY?

A. Yes. The effects of inflation should also be considered. If a straight-line amortization method is used, the highest net-present value amounts are charged initially, and lower amounts are charged toward the end of the amortization. Given the effects of inflation, the differential between initial and final charges are substantial in terms of constant dollars. The mortgage-style amortization works with the effects of inflation to create a more level, constant dollar charge.

Q. WHAT SHOULD THE COMMISSION AUTHORIZE IN THIS PROCEEDING WITH RESPECT TO AN ACQUISITION ADJUSTMENT?

A. Arizona-American requests that the Commission authorize a 40-year amortization period and use of a mortgage amortization method, with the recovery of the acquisition adjustment as a component of the cost of service, as discussed previously.

VII. DISCUSSION OF THE REQUIREMENTS OF THE ACQUISITION DECISION

Q. HAVE YOU ADDRESSED COMPLIANCE WITH ALL OF THE COMMISSION'S DIRECTIVES IN THE ACQUISITION DECISION?

A. No. I have only covered the requested treatment of the Acquisition Adjustment. The Acquisition Decision also calls for the determination of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American; and the determination of the ratemaking treatment of deferred taxes, excess deferred taxes and investment tax credits that were on the books and records of Citizens at the time of the closing of the purchase transaction, yet were not transferred to Arizona-American. It is my recommendation to delay the demonstration of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American until a later date, after which time Arizona-American will have greater operating experience and be better able to demonstrate the tremendous net ratepayer benefits that result from this transaction. However, by recommending this delay, Arizona-American does not waive its right to, at some point in time in the future, request recovery of and on the Acquisition Adjustment, if it so desires to do so. It is my recommendation is that the deferred taxes, excess deferred taxes and the investment tax credit not be considered for any ratemaking

purpose.

Q. WHAT IS THE BASIS FOR THIS RECOMMENDATION AS IT RELATES TO THE DEFERRED TAXES, EXCESS DEFERRED TAXES AND THE INVESTMENT TAX CREDIT?

A. All of these items were established on the books and records of Citizens due to timing differences between book and tax recognition of an allowance to record the event causing the tax difference in the income stream. For deferred taxes, it is the tax effect of the difference between depreciation methods of assets for book and tax purposes. For tax purposes, many assets were once allowed to be depreciated at an accelerated rate, meaning that the assets were depreciated at a higher early period rate, and over a shorter time period, than for book purposes. For investment tax credits, in the past the Internal Revenue Code allowed a percentage tax deduction for the investment in various assets. The investment tax credit was never considered for book purposes.

In short, these are taxes and credits that belong to Citizens, not Arizona-American. Arizona-American purchased the water and wastewater assets of Citizens in Arizona; it did not assume any of the liabilities, except for the one series of industrial development revenue bonds. The deferred taxes and investment tax credits will be reconciled from the books and records of Citizens when Citizens files its 2002 tax return and applies these items against the gain or loss realize upon the sale of the water and wastewater assets to Arizona-American.

Q. WHAT WERE THE BALANCES OF THE DEFERRED TAXES AND INVESTMENT TAX CREDITS ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME OF CLOSING OF THE ASSET PURCHASE BY AWW OF THE ARIZONA ASSETS?

A. Stephenson Dir. Exh. 10 is a copy of the Arizona Property Detail supplied by

Citizens at the time of closing. This Exhibit shows that the balance for the deferred taxes was $4,674,819 and the balance of the investment tax credits was $1,910,600. There were no excess deferred taxes shown on the books and records of Citizens for Arizona at the time of closing.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THAT THE DEFERRED TAXES ON THE BOOKS OF CITIZENS FOR ARIZONA AT THE TIME OF CLOSING SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. Deferred taxes that were on the books and records of Citizens at the time of closing are not an item that should be considered as a "carryover" item in an asset purchase agreement. Deferred taxes result from items being treated differently for tax and book purposes. These differences are primarily created by Citizens' ability to delay actual tax payments due to accelerated asset value depreciation or amortization for tax purposes over the straight-line depreciation or amortization used for book and regulatory purposes. These tax-differences are recorded as deferred taxes. These deferred taxes will be taken into consideration when calculating a tax gain or loss as a result of the sale of the Citizens' Assets. Upon the sale of such assets, these deferred taxes will be paid and the deferred tax balances zeroed out.

When deferred taxes have been allowed as a component of cost of service in utility ratemaking, their accumulated balance (ADIT) is typically deducted from rate base as a source of non-investor capital. This is because deferred taxes are collected in rates prior to the time they must be remitted to the respective taxing authorities. In the interim, they represent a source of funds available to the utility for plant investment or other corporate purposes. During that period it is entirely appropriate to deduct the ADIT from rate base. When the tax liabilities underlying

previously deferred taxes are paid, however, the related ADIT balances are eliminated and the rate base deductions are no longer available.

With respect to Citizens' ADIT existing at the time the sale of its water and wastewater assets to AWW, the related income taxes will become due. At that time, the ADIT's will be paid and there will be no balance available to deduct from rate base. On-going compensation to customers is not warranted. When non-investor funds have been satisfied they no longer exist, and no further rate base deduction is appropriate. ADIT's may be viewed as a temporary loan to the utility by the taxing authority. By deferring the date upon which taxes are ultimately paid, a source of funds is created. Once the "loan" is repaid, the source of funds ceases to exist. There is no entitlement inuring to the utility's customers, since they pay taxes applicable to the utility service they receive.

Q. WHAT IS THE EFFECT ON ARIZONA-AMERICAN IF THE COMMISSION ELECTED TO USE CITIZENS' RECORDED DEFERRED TAXES IN FUTURE RATEMAKING.

A. The Internal Revenue Service has, on a number of occasions, declared that any deferred income tax reserves or unauthorized income tax credits relating to assets that have been sold, transferred, or removed from regulation may not continue to be considered in the subsequent ratemaking determinations. To attempt to do otherwise will result in the utility losing the ability to take accelerated depreciation on its Federal income tax return.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THE INVESTMENT TAX CREDITS THAT WERE ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME THE PURCHASE WAS COMPLETED BY ARIZONA-AMERICAN SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. The reasons are exactly the same as for deferred taxes. The investment tax credits will be considered in calculating Citizens' gain or loss as a result of the sale of the assets, and therefore will be eliminated. The investment tax credits were a "temporary" source of non-investor funds, once appropriately deducted from rate base, but now that they have been "paid", they are no available as a rate base deduction. This deduction no longer exists and as such cannot be used for ratemaking.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes it does.

STEPHENSON DIR. EXH. 1

N. JAMES

MAY 10 2001

ACTION _____

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

APR 24 2001

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00-0192 W-01032B-00-0192 W-01032C-00-0192 S-02276A-00-0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00-0192 W-01595A-00-0192 W-01303A-00-0192 DECISION NO. 63584 **OPINION AND ORDER**

DATE OF HEARING:	September 27, 2000
PLACE OF HEARING:	Phoenix, Arizona
PRESIDING ADMINISTRATIVE LAW JUDGE:	Karen E. Nally[1]
IN ATTENDANCE:	Chairman William A. Mundell and Commissioner Jim Irvin
APPEARANCES:	Mr. Michael M. Grant, GALLAGHER & KENNEDY, and Mr. Craig Marks, Associate General Counsel, on behalf of Citizens Communications Company;

[1] This Recommended Opinion and Order was prepared by Administrative Law Judge Marc E. Stern upon review of the testimony and exhibits admitted into evidence in the proceeding.

Mr. Norman D. James, FENNEMORE CRAIG, on behalf of Arizona-American Water Company;

Mr. Daniel W. Pozefsky, Staff Attorney, on behalf of Residential Utility Consumer Office;

Mr. Bill Meek on behalf of the Arizona Utility Investors Association; and

Ms. Teena Wolfe, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On March 24, 2000, Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively "Citizens"), and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a Joint Application to Transfer Assets and Related Approvals ("Application") of Citizens' water and wastewater utility assets in Arizona including Citizens' Certificates of Convenience and Necessity ("Certificates") held by Citizens to Arizona-American.

On May 17, 2000 and on June 1, 2000, the Residential Utility Consumer Office ("RUCO") and the Arizona Utility Investors Association ("AUIA") filed applications for leave to intervene. Subsequently, intervention was granted to RUCO and to AUIA.[2]

On May 30, 2000, by Procedural Order, a hearing was scheduled on the above-captioned matter for September ~~27~~, 2000. Citizens and Arizona-American caused public notice of the Application and hearing thereon to be published in various newspapers throughout Arizona. In

[2] On April 10, 2000, Mr. Marvin Lustiger filed an application to intervene in the above-captioned matter. However, by subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone service in Mohave County, and therefore, Mr. Lustiger's request to intervene was deemed to have been withdrawn.

addition. Citizens notified all its customers of the Application by means of a written bill insert.

On September 14, 2000, a formal public comment session was held in Sun City.

On September 26, 2000, the Commission's Utilities Division ("Staff") filed a Settlement Agreement ("Agreement") marked Exhibit A which is incorporated by reference and attached hereto.

On September 27, 2000, a full public hearing took place at the offices of the Commission in Phoenix, Arizona. Citizens, Arizona-American, RUCO, AUIA and Staff were present with counsel. Following the presentation of evidence, Citizens and RUCO submitted written briefs on the issue of whether Citizens should be required to pay a portion of the gain resulting from the sale of its utility assets to Citizens' customers. The matter was then taken under advisement pending submission of a recommended Opinion and Order to the Commission.

DISCUSSION

Parties to the Transaction

Citizens, through its various divisions and subsidiaries, provides water, wastewater, electric, natural gas and telecommunications services to approximately 1.8 million customers in 22 states, including in excess of 100,000 customers in Arizona. Citizens' current business strategy is to focus on the provision of telecommunications services and the expansion of those operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas, as was the case in the recently approved transfer of rural wire centers by Qwest Corporation to Citizens Utilities Rural Company, Inc.

In connection with this business strategy, Citizens intends to sell its water, wastewater, electric, and natural gas utilities and to apply the proceeds to finance acquisitions and other business activities in the telecommunications area. In April 2000, Citizens also announced the sale of its Louisiana natural gas operations for $375 million.

The Commission granted Arizona-American a Certificate of Convenience and Necessity to provide water service to approximately 4,600 customers in portions of the Town of Paradise

Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW") which is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states, and with a reported consolidated net plant of $5.1 billion and operating revenues of $1.26 billion. AWW's December 31, 1999, balance sheet reflected a capital structure of 58.4 percent long-term debt, 2.3 percent preferred stock and 39.3 percent common equity.

In 1999, AWW's subsidiaries invested $467 million in improving and upgrading their facilities, and for the past several years, AWW has made similar expenditures averaging nearly $400 million per year. According to AWW witnesses, AWW's acquisition policy is motivated, at least in part, by anticipated capital expenditures resulting from new regulatory requirements and programs and the need to replace or upgrade aged infrastructure to maintain high quality service. With the additional water and wastewater systems, AWW and its subsidiaries hope to obtain economies of scale and to strengthen their financial capability by expanding their customer base.

The Transaction

On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American is to acquire the water and wastewater assets and the Certificates held by Citizens in Arizona ("the Acquired Assets") for approximately $231 million, subject to adjustment at the time of closing. The purchase price will be increased based on utility plant added by Citizens after June 30, 1999, and will be reduced based on plant retirements occurring after such date. The Acquired Assets include all utility plant, property and interests relating to Citizens' water and wastewater operations in Arizona, with certain exceptions, including assets commonly used by Citizens in connection with other utility operations, cash and cash equivalents, and assets related to benefit plans. Citizens will also retain certain liabilities, including obligations for taxes payable, obligations relating to employee compensation and

benefits, and refunds of certain advances in aid of construction. Arizona-American will assume and be liable for all contracts and permits assigned at closing, certain Industrial Development Revenue Bonds ("IDRBs"), and unperformed obligations.

Arizona-American will finance the purchase of the Acquired Assets by a combination of debt and equity. AWW has recently formed a new subsidiary, American Water Capital Corporation ("AWCC"), that will provide loans and other financial services to AWW subsidiaries. Initially, Arizona-American will borrow funds from AWCC on a short-term basis, and receive additional funds in the form of common equity directly from AWW. Within 12 months, the short-term debt will be converted to long-term debt with a planned capital structure which will contain 55 to 60 percent debt and 45 to 40 percent common equity, including Arizona-American's existing debt and equity capital and the Citizens' IDRBs that will be assumed.[3]

The Position of Staff and the Staff Settlement Agreement

Staff generally supported the application, and recommended that the transfer of the Acquired Assets to Arizona-American be approved, subject to several conditions.

First, Staff recommended that the Commission defer any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes, and investment tax credits until a future rate proceeding.

Second, Staff recommended that the decision to allow recovery of an acquisition adjustment be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred.

Third, Staff recommended that Arizona-American should be ordered to file, 13 months

[3] Arizona-American has filed an application for authority to issue short-term and long-term debt in connection with financing the purchase of the Acquired Assets, which is pending in Docket No. W-01303A-00-0929.

after the closing of the transaction, a report comparing the number of complaints received by the Commission prior to and after the transaction. The report should provide an explanation of any significant changes in the number and importance of the complaints. Staff would then review this report and, if necessary, make a recommendation to the Commission of any further action to be taken.

Fourth, Staff recommended that an imputation of the benefits related to advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") received by Arizona-American be made in subsequent rate proceedings for each former Citizens' system. The purpose of the imputation would be to recognize those portions of the Acquired Assets that were financed by AIAC and CIAC which Arizona-American will not be assuming. Staff also recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC would be amortized below the line in the same manner as would have otherwise occurred.

Fifth, Staff recommended that Arizona-American be required to seek Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' Central Arizona Project ("CAP") water subcontracts.

Finally, Staff recommended that the Commission order Arizona-American to charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

In its rebuttal filing, Arizona-American indicated that it would stipulate to the conditions recommended by Staff, including the deferral of a decision concerning the recognition of an acquisition adjustment and the conditions under which an acquisition adjustment would be recognized, and would adopt and utilize the rates and charges for service, and all other service tariffs currently in effect in each of the affected Citizens service territories. However, Arizona-American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.

Subsequently, Staff and Arizona-American entered into the Agreement, which resolved all areas of disagreement relating to the terms and conditions under which the Acquired Assets would be transferred to Arizona-American.

Pursuant to the terms of the Agreement, Citizens' AIAC and CIAC will be imputed to Arizona-American for ratemaking purposes. This adjustment will reduce rate base. The amount of the AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer of the Acquired Assets, adjusted as follows: an amount equal to 5 percent of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place. The adjusted amount of CIAC will be amortized above the line (i.e., as a reduction to depreciation expense that would otherwise be recoverable in rates) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place. The imputation of AIAC and CIAC to Arizona-American is solely for ratemaking purposes, and not for financial accounting or any other purpose.

In addition to agreeing to the imputation of AIAC and CIAC, Arizona-American agreed that the Commission may adopt Staff's remaining conditions concerning the sale and transfer of the Acquired Assets. Staff and Arizona-American also agreed that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

Based on these agreements by Arizona-American, Staff is recommending that the Commission should approve the transfer of the Acquired Assets to Arizona-American and should not impose any additional terms, conditions or requirements on Arizona-American.

During the hearing, Staff and Arizona-American voiced their support of the Agreement, believing that its terms are reasonable and in the public interest. AUIA also expressed its support for the Agreement. However, the remaining party to the proceeding, RUCO, objects to the approval of the Agreement and to the transaction generally, as discussed below.

Position of RUCO

RUCO maintains the proposed transaction believing that it is not in the public interest and should not be approved unless it is restructured. RUCO argued that the transaction could possibly, in the future, impact on ratepayers. While RUCO did not disagree that consideration of an acquisition adjustment should be deferred until a future ratecase, RUCO argued that the gain resulting from the sale of the Acquired Assets received by Citizens, i.e., the difference between the net book value of the Acquired Assets and the purchase price being paid by Arizona-American, should be shared equally between Citizens stockholders and the ratepayers. RUCO further argued that the Commission should adopt a set of criteria to determine what, if any, acquisition adjustment should be allowed in a future rate proceeding. RUCO also suggested that to make this transaction in the public interest, among other things, the transaction should be contingent upon Arizona-American's Board of Director's approving a letter pledging to invest no less than 15 percent of the purchase price in acquisitions and capital improvements of "resources stressed" water and/or wasterwater utilities in Arizona no later than 72 months after the date the Commission authorizes the transaction.

Analysis of Disposition of Gain Issue

RUCO contended that fundamental principles of fairness support sharing the gain in this case. RUCO maintained that ratepayers have shared in the risk associated with the operation of the utility assets and that it necessarily follows that ratepayers should share in the gain realized from the sale of those assets. According to RUCO, this risk sharing results from the accounting treatment provided in the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts when an asset is retired prematurely, i.e., before a

utility fully recovers its original cost via depreciation. RUCO also stated that prior Commission decisions support gain sharing.

In response, Citizens argued that ratepayers have assumed no risk in connection with the operation of Citizens' water and wastewater utility business. Investors have provided the utility's capital and bear the financial risks associated with its operations. Therefore, the investors should be entitled to receive any gain resulting from the transaction. As to prior Commission decisions, Citizens cited three analogous cases involving a sale of an entire line of utility business in which the Commission did not order gain sharing.[4] Citizens also cited Decision No. 60167 (April 17, 1997) in which a utility's natural gas business was sold at a loss. In that case, the Commission did not order the customers to share in the loss.[5]

This proceeding is similar to the three cases cited earlier by Citizens since it is selling its entire business and will have no further water and wastewater operations in Arizona. The Commission has never required gain sharing under these circumstances. In the Contel of the West matter, in which Citizens was authorized to acquire all of Contel's telephone properties in Arizona, Staff urged that the gain resulting from the sale be shared equally with ratepayers. However, the Commission rejected gain sharing in that case.

We also do not believe that ratepayers bear a substantial risk by virtue of receiving utility service in this case. The particular accounting treatment for depreciable plant provided under the Uniform System of Accounts does not shift risk to customers, but rather prescribes particular accounting adjustments to properly reflect rate base before and after the retirement of a plant item. The utility's owners, i.e., its shareholders, ultimately bear the risks associated with the utility's business. While regulation may reduce those risks relative to most non-regulated

[4] Citizens/Southern Union, Decision No. 57647 (December 2, 1991); Contel/Citizens, Decision No. 58819, (October 17, 1994); and GTE/Citizens, Decision No. 62648 (June 13, 2000).

[5] Ajo Improvement Company/Southwest Gas, Decision No. 60167 (April 17, 1997).

businesses, regulation does not shift that risk to ratepayers, who are entitled to receive utility service at rates set by the Commission.

Accordingly, we do not find it appropriate under the circumstances in this case to require Citizens to share with ratepayers any part of the gain it receives from the sale of the Acquired Assets to Arizona-American. However, this will not preclude the Commission from protecting the ratepayers in the future. In any claim for an acquisition adjustment in a future rate case, the Commission can strictly scrutinize the foundation of the claim and determine what amount, if any, should be approved.

Analysis of Remaining RUCO Recommendations

RUCO's other recommendations pertained to the structure of the transaction and RUCO's concerns that this structure could lead to rate increases in the future. RUCO's concern primarily relates to the fact that Arizona-American will not be assuming all of Citizens' liabilities associated with AIAC and CIAC, which totaled approximately $80.8 million and $4.7 million, respectively, at December 31, 1999. According to RUCO, the structure of the transaction will result in the elimination of AIAC and CIAC as reductions from rate base, which will in turn result in an increase in rate base and, eventually, to rate increases.

We believe that the Agreement appropriately deals with this issue. Citizens' AIAC and CIAC will be recognized for ratemaking purposes by Arizona-American, even though Arizona-American is not assuming those liabilities. By virtue of this imputation, the impact of the structure of the transaction will be ameliorated. Based on the evidence and the testimony, the approach utilized in the Agreement is reasonable.

Further, the evidence indicates that the transaction between Citizens, Arizona-American and AWW was the product of arms-length negotiations that occurred after Citizens had adopted its current business strategy of focusing on telecommunications services and divesting itself of its water and wastewater systems, as well as its electric and natural gas systems throughout the

country. This is not a transaction between affiliated companies. The payment by Arizona-American will constitute an investment in the Acquired Assets.

RUCO also expressed concern regarding the impact of the transaction on Citizens' accumulated deferred income taxes ("ADITs"), which totaled approximately $5.2 million as of December 31, 1999, and Citizens' investment tax credits ("ITCs"), which totaled approximately $2.2 million as of the same date. Under the Agreement, any decision on the treatment of ADITs and ITCs will be deferred until Arizona-American seeks new rates in a future proceeding. Staff's recommendation is appropriate under the circumstances herein.

Next, RUCO questioned the approach proposed by Arizona-American and Staff, as adopted in the Agreement, for dealing with the possible future recognition of an acquisition adjustment in rates. RUCO agreed with Arizona-American and Staff that it is appropriate to defer consideration of any acquisition adjustment resulting from the transaction until a future rate proceeding, in order to afford Arizona-American an opportunity to demonstrate that the acquisition has provided a net benefit to ratepayers by virtue of improved operating efficiencies, economies of scale and other synergies. However, RUCO's witnesses also contended that the Commission should adopt a set formula that would be used in connection with any future determination of the amount of the acquisition adjustment.

We have concerns about the adoption of a set, mechanical formula to quantify a future acquisition adjustment. We believe that such a determination should be made at the time all the facts and circumstances are known. Staff's recommendation concerning the basis on which the Commission will allow the recovery of an acquisition adjustment is reasonable and in the public interest. Arizona-American is cautioned that the Commission will require Arizona-American to demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission will consider recovery of any acquisition adjustment in a future rate proceeding.

RUCO was also critical of Arizona-American's failure to assume all of Citizens' IDRBs. As stated, Arizona-American will assume certain IDRBs, which total approximately $10.6 million. The IDRBs that will be assumed constitute low-cost capital. The average cost of the IDRBs that will be assumed by Arizona-American was 3.55 percent per annum during 1999. RUCO believes that there may be three additional Citizens bond issues, representing low-cost capital, that will not be assumed in connection with the transaction.

Arizona-American, in its testimony, has acknowledged that other bonds have been issued by Citizens. The evidence indicates, however, that in contrast to the IDRBs that will be assumed, the other bonds would require unanimous consent from all bond holders in order to be assumed, which would be administratively difficult, if not impossible, to accomplish within the time frame of the transaction. The additional costs to Arizona-American to replace these low-cost IDRBs with alternative forms of financing was not ascertained.

We find that it would not be feasible for Arizona-American to assume the remaining bonds and it would not be reasonable to impute these bonds to Arizona-American's capital structure. The remaining bonds will continue to be an obligation of Citizens and will continue to be included in Citizens' capital structure in its ongoing telecommunications business.

Finally, RUCO recommends that authorization of the transaction be made contingent on Arizona-American pledging to invest not less than 15 percent of the purchase price for the Acquired Assets, or approximately $35 million, in acquisitions and capital improvements of "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and capital improvements would have to be made within 72 months from the date on which the Commission approves the transaction.

The Commission recognizes that there are small water and wastewater utilities in Arizona that may need technical and financial assistance. Indeed, the Commission has provided such assistance to small water and wastewater utilities through workshops and the development of policies aimed at improving their financial viability. However, it is not reasonable to compel a

private utility to spend in excess of $35 million to solve these problems, nor is it clear that the Commission has the authority to do so.

Arizona-American has indicated its willingness to work with the Commission in developing solutions to service problems being experienced by small, troubled utilities. By virtue of acquiring Citizens' systems in Arizona, Arizona-American will be in closer proximity to a number of these systems, and the Commission would expect Arizona-American, as circumstances warrant, to seriously consider acquiring these systems or otherwise provide technical or financial assistance. For these reasons, we do not believe it is appropriate to impose such a mandate on Arizona-American.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Pursuant to authority granted by the Commission, Citizens provides public water, wastewater, electric, natural gas and telecommunications services in various parts of Arizona.

2. Pursuant to authority by the Commission, Arizona-American, a wholly owned subsidiary of AWW, provides public water service to approximately 4,600 customers in the Town of Paradise Valley, the City of Scottsdale and in certain unincorporated portions of Maricopa County, Arizona. Arizona-American is presently classified as a Class B water utility.

3. On March 24, 2000, Citizens and Arizona-American filed an Application requesting approval of the sale and transfer of Citizens' water and wastewater utility assets in Arizona together with the transfer of Citizens' Certificates to Arizona-American.

4. RUCO and the AUIA were granted intervention in this Docket.

5. Public notice of the Application and hearing thereon was published in various newspapers throughout Arizona within and in the vicinity of Citizens' and Arizona-American's certificated service areas.

6. Customers of Citizens were also notified of the Application by means of a written bill insert.

7. Citizens' current business strategy is to focus on the provision of telecommunication services and to expand its telecommunications subsidiaries' operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas.

8. In the furtherance of this business strategy, Citizens is selling its water, wastewater, electric and natural gas utilities and applying the proceeds to finance acquisitions and other business activities in the telecommunications industry.

9. AWW and its subsidiaries, including Arizona-American, are the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately three million customers in 23 states.

10. AWW is financially sound, and has the experience, expertise and resources to assume and perform Citizens' public service obligations.

11. On October 15, 1999, Citizens, Arizona-American and AWW entered into an asset purchase agreement under which Arizona-American will acquire all of the water and wastewater utility assets together with the requisite Certificates held by Citizens in Arizona.

12. Arizona-American will pay a purchase price of approximately $231 million which includes the assumption of approximately $10.6 million of existing debt in the form of outstanding IDRBs. The purchase price is subject to adjustment either higher or lower based on plant additions and retirements occurring after June 30, 1999.

13. Arizona-American will finance the transaction through a combination of debt and equity, resulting in Arizona-American having a capital structure of 55 to 60 percent debt and 45 to 40 percent common equity. This debt to equity ratio is comparable to the capital structures of most large, publicly-traded water utilities.

14. Staff is recommending that the Application be approved for the sale and transfer of Citizens' water and wastewater utility assets including the Certificates to Arizona-American subject to the following conditions:

- that any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes and investment tax credits be deferred until a future rate proceeding;
- that if recovery of any acquisition adjustment is authorized in the future it should be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers in the affected areas, which would not have been realized had the transaction not occurred;
- that Arizona-American file, 30 days after the first anniversary of the transaction, a report which compares the number of complaints received by the Commission under Citizens' ownership and under Arizona-American's ownership and provide an explanation of any significant changes in the number and importance of the complaints received. Staff should review the data and, if necessary, make a recommendation to the Commission of any further action to be taken;
- that an imputation of the benefits related to AIAC and CIAC received by Arizona-American should be made in subsequent rate proceedings for each former Citizens system as recommended by Staff in its direct testimony;
- that Arizona-American shall be required to secure prior Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' CAP water subcontracts; and
- that Arizona-American shall charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

15. On September 26, 2000, Staff filed the Agreement that is marked Exhibit A. The Agreement resolves all issues relating to the terms and conditions under which the Acquired Assets may be sold and transferred to Arizona-American.

16. In the Agreement, Arizona-American acknowledged that it will follow Staff's recommendations if they are adopted by the Commission.

17. While RUCO did not oppose the treatment of the acquisition adjustment in a future rate proceeding, it neither joined in signing the Agreement nor suggested a workable

alternative approach to that agreed upon by Arizona-American and Staff in the Agreement in this instance based on our prior treatment of similar transactions.

18. Arizona-American is a fit and proper entity to acquire Citizens' utility assets and Certificates and to assume Citizens' public service obligations for the operation of the utility systems in Arizona.

19. Staff and Arizona-American believe that the approval of the Agreement attached hereto as Exhibit A is in the public interest.

20 Based on our review of the evidence, Staff's recommendations in Findings of Fact No. 14 and the Agreement are reasonable and in the public interest. Therefore, the transfer of Citizens' water and wastewater utility assets and Certificates to Arizona-American should be approved.

CONCLUSIONS OF LAW

1. Citizens and Arizona-American are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282 and 40-285.

2. The Commission has jurisdiction over Citizens and Arizona-American and over the subject matter of the Application.

3. Citizens and Arizona-American provided notice of this proceeding in accordance with the law.

4. There is a continuing need for public water and wastewater service in the certificated service areas of Citizens.

5. Arizona-American is a fit and proper entity to receive the Certificates of Citizens.

6. The Application of Citizens and Arizona-American, the Agreement and the conditions recommended by Staff in Findings of Fact No. 14 should be approved.

ORDER

IT IS THEREFORE ORDERED that the Joint Application for Approval to Transfer the Assets and Certificates of Convenience and Necessity of Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company, to Arizona-American Water Company be, and is hereby, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company shall comply with the terms, conditions and requirements as set forth in the Staff Settlement Agreement, attached hereto as Exhibit A, and with Staff's recommendations in Findings of Fact No. 14 hereinabove.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 30 days from the date on which the acquisition has been completed, with the Director of the Commission's Utilities Division, appropriate documentation evidencing its acquisition of the Citizens Utilities Company now known as Citizens Communications Company's Arizona water and wastewater utility assets.

IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its customers of the effective date of the transfer of the utility assets and of its assumption of the obligation to provide water and wastewater utility services at the existing rates by means of an insert in its first regular monthly billing or by other appropriate means immediately following the date it files the documentation with the Director of the Utilities Division.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 15 days of the date it files the documentation with the Director of the Utilities Division, a copy of the notice it provides its customers.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to charge the existing rates and charges of the transferred utility companies until further Order by the Commission.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to file all periodic reports, and comply with all outstanding compliance matters previously required of Citizens Utilities Company, now known as Citizens Communications Company relative to the acquired water and wastewater operations.

IT IS FURTHER ORDERED that Citizens Utilities Company shall maintain its books and records for the transferred utility companies for a period of 5 years from the effective date of this Decision.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24TH day of April, 2001

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT_____

SERVICE LIST FOR: CITIZENS COMMUNICATIONS COMPANY ET AL.

DOCKET NOS.: W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192; S-02276A-00-0192; WS-02334A-00-0192; WS-03454A-00-0192; WS-03455A-00-0192; W-02013A-00-0192; W-01595A-00-0192; and W-01303A-00-0192

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3099-0035/898296

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

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00- 0192 W-01032B-00- 0192 W-01032C-00- 0192 S-02276A-00- 0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00- 0192 W-01595A-00- 0192 W-01303A-00- 0192 SETTLEMENT AGREEMENT BETWEEN ARIZONA CORPORATION COMMISSION STAFF AND ARIZONA-AMERICAN WATER COMPANY

On March 24, 2000, Citizens Utilities Company (now known as Citizens Communications Company), its Agua Fria Water Division, its Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively, "Citizens") and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a joint application for the approval of the sale and transfer of Citizens water and wastewater utility plant, property and assets in Arizona, including transfer of Citizens' certificates of convenience and necessity

EXHIBIT A

("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

The Commission's Utilities Division Staff ("Staff") has investigated the application and has recommended that the application be approved by the Commission, subject, however, to certain conditions and requirements, which are set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has indicated that it is willing to accept the Staff Recommendations, with the exception of the recommendation that Citizens' advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") be imputed to Arizona-American.

Representatives of Staff and Arizona-American have had discussions concerning the matters in dispute with respect to the application and have reached a settlement. The purpose of this Settlement Agreement is to memorialize the agreement that has been made by and among Staff and Arizona-American, which resolves all areas of disagreement relating to the terms and conditions under which Citizens' Arizona water and wastewater assets and Citizens' Certificates may be transferred to Arizona-American.

1. AIAC Imputation; Amortization. As of December 31,1999, Citizens' AIAC balance was $80,818,669. Citizens' AIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American becomes responsible for the provision of water and wastewater services will be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of AIAC imputed will be adjusted as more particularly provided below. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place.

2. CIAC Imputation; Amortization. As of December 31, 1999, Citizens' CIAC balance was $4,734,430. Citizens' CIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American become responsible for the provision of water and wastewater services will also be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of CIAC to be imputed to Arizona-American will also be adjusted as provided below. The adjusted CIAC balance imputed to Arizona-American will be amortized above the line (i.e., as a reduction to depreciation expense) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place.

3. Adjustment to Recorded AIAC and CIAC Balances. The amounts of AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer, adjusted as follows: An amount equal to five percent (5%) of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance in computing the amounts to be imputed to Arizona-American for ratemaking purposes hereunder.

4. Adoption of Remaining Staff Recommendations. Arizona-American agrees that the Commission may adopt the remaining Staff Recommendations, as set forth in the Direct Testimony of Linda A. Jaress.

5. Deferral of Determination of Amortization Method. The parties agree that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

6. Transfer in the Public Interest. Based on the foregoing agreements

and understandings, Staff agrees that Arizona-American is a fit and proper entity to acquire the Certificates and that the Commission should authorize and approve the transfer of Citizens' Arizona water and wastewater assets to Arizona-American on the terms set forth herein. No additional terms, conditions or requirements are necessary or appropriate.

7. Support and Defend. This Settlement Agreement will be introduced as an exhibit during the hearing on the application, presently set for September 27, 2000. Arizona-American and Staff will jointly request that the Settlement Agreement be received into evidence, and agree to support and defend this Settlement Agreement and the transfer of Citizens' water and wastewater assets and the Certificates to Arizona-American on the terms set forth herein as just, reasonable and appropriate based on the particular circumstances presented in this application.

8. Compromise; No Precedent. This Settlement Agreement represents a compromise in the positions of the parties hereto. By entering into this Settlement Agreement, neither Staff nor Arizona-American acknowledges the validity or invalidity of any particular method, theory or principle of regulation, or agrees that any method, theory or principle of regulation employed in reaching a settlement is appropriate for resolving any issue in any other proceeding, including (without limitation) any issues that are deferred to a subsequent rate proceeding. Except as specifically agreed upon in this Settlement Agreement, nothing contained herein will constitute a settled regulatory practice or other precedent.

9. Privileged and Confidential Negotiations. All negotiations and other communications relating to this Settlement Agreement are privileged and confidential, and no party is bound by any position asserted during the negotiations, except to the extent expressly stated in this Settlement Agreement.

As such, evidence of statements that were made or other conduct occurring during the course of the negotiation of this Settlement Agreement is not admissible in any proceeding before the Commission or a court.

10. Complete Agreement. This Settlement Agreement represents the complete agreement of the parties with respect to its subject matter. There are no understandings or commitments other than those expressly set forth herein.

DATED this 26 day of September, 2000.

ARIZONA CORPORATION COMMISSION STAFF

By: _____
Steven M. Olea
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

ARIZONA-AMERICAN WATER COMPANY

By: Norman D. James
Norman D. James
FENNEMORE CRAIG
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Arizona-American Water Company

An original and 10 copies of the foregoing was delivered this ___ day of September, 2000, to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing was delivered this ___ day of September, 2000, to:

Karen E. Nally
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing
was telecopied/delivered and mailed this ___
day of September, 2000, to:

Daniel W. Pozefsky
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Associate General Counsel
Citizens Communications Company
2901 N. Central, Suite 1660
Phoenix, AZ 85012
(602) 265-3415

By: _____

STEPHENSON DIR. EXH. 2

AMERICAN WATER WORKS - SHARED SERVICES CENTER
CITIZENS ACQUISITION
Final Acquisition Journal Entry - Arizona

F:\RATES\Arizona Citizens Rate Case\[AZ Czn Entries Fina

1. RECORD UTILITY PLANT PURCHASED (Booked in Jan Based on Nov Info)

JE2301, reclass debt JE231

230105.104000	Utility Plant Purchased/Sold	276,471,277		
230105.201200	Common Stock		110,888,158	
230105.221120	Bonds Inside		154,948,119	
230105.221100	Bonds Outside		10,635,000	

2. RECORD ACQUISITION - NET ASSETS

CZN record net assets	JE#			
230105.10400	Utility Plant Purchased/Sold		276,471,277	
230105.134100	Petty Cash	3,371		
230105.146100.001	A/R Other Manual (Notes Rec)	500,000		R
230105.141000	Accounts Receivable	1,723,245		R
230105.141000	Accounts Receivable-unexplained difference		71,151	
230105.144000	Unbilled Revenue	825,523		
230105.143000	Allowance for Doubtful Accounts		47,496	R
239902.241249.002	Collection for Others (agua fria)	27,730		
239902.241249.001	Collection for Others (agua fria)		27,730	
239903.241249.002	Collection for Others (Sun City)	9,027		
239903.241249.001	Collection for Others (Sun City)		9,027	
239901.241249.002	Collection for Others (Surprise)	382,751		
239901.241249.001	Collection for Others (Surprise)		382,751	
239905.241249.002	Collection for Others (Sabrosa)	4,952		
239905.241249.001	Collection for Others (Sabrosa)		4,952	
230105.146100.001	Misc A/R - Manual	581,849		R
230105.146100.001	Misc A/R - Manual	99,208		
230105.153000	Materials & Supplies-Stk E	30,557		
230105.165500	Prepaid Postage	896		R
230105.165500	Prepayments - Transition services	24,374		
230105.165500	Prepayments CAP Legal Services		2,500	
230105.105110.1 CZN X	Capital Exp. Invoices paid by Citizens	1,057,874		Exb I
238305.146100.001	Sabrosa Water Well Project	9,672		
236206.675000.2135	Sun City Main Repairs	5,654		
236406.675000.2135	Sun City West Main Repairs	195		
230105.101099	Utility Plant	272,822,609		
230105.101099	Utility Plant CBSC Assets	19,974		
230105.105110.1 CZN X	CWIP	6,110,694		
230105.108105	Accumulated Depreciation		55,775,969	
230105.108105	Accumulated Depreciation CBSC Assets		9,253	
230105.183000	Preliminary Survey & Investigation	663,525		R
230105.238010	Customer Deposits		143,867	R
238905.186898.DD230001 s	Ground Water Withdraw Fee	418		
236205.186898.DD230001 s	Ground Water Withdraw Fee		97,658	
236205.186898	DDA -Other	201,088		
236205.186898	DDA -Other	497,393		
236405.186898.DD230001 s	Ground Water Withdraw Fee		48,222	
236405.186898	DDA -Other		96,961	
236405.186898	DDA -Other	294,013		
236105.186898.DD230001 s	Ground Water Withdraw Fee		28,554	
236105.186898	DDA -Other	22,458		
236105.186898	DDA -Other		44,971	
236105.186898	DDA -Other	2,929,500		
230105.186898	DDN Other (regulatory assets)	1,392,615		R
230105.181110	Unamortized Debt Expense - outside	387,690		

230105.181110	Unamortized Debt Expense - outside	22,990	
230105.241998	Other Current Liability - analyzed		1,972,236.00
230105.236151	Accrued Property Taxes		886,624 sch
230105.252120	Advances for Const		23,364,564 sch
230105.262411	DCN - Advance Payments and Deposits Other		284,879 sch
230105.840000	Interest Exp Other	30,921	
230105.234300	A/P Misc. -Net Cash Payable		2,030,554
230105.114100	UPAA**	71,118,430	
		361,801,197	361,801,197

UPAA DETAIL

	Initial UPAA	
	Initial Cash Payment (line 5)	266,618,443
	Less: Net Assets Purchased	195,489,291
	Initial UPAA	71,129,152
	Difference	10,722
	CBSC Assets not on Citizen's AZ Balance sheet but should be according to the schedule	10,722 Part of IL workpapers

3. RECORD UTILITY PLANT DETAIL

GARY TO RECORD

230105.101099	Utility Plant (incl CBSC Assets)		272,842,583
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	

4. WRITE-OFF INVENTORY TO EXPENSE (CREDITED EXP WHEN LOADED)

CZN W/O Inventory #4		JE#		
230105.575000.16	Misc Oper Exp AG		30,557	
230105.153000	Material & Supplies			30,557

5. EXPENSE PREPAID POSTAGE

CZN - w/o prepaids#5		JE#		
230105.575000.16	Misc Expense		896	
230105.165500	Prepayments			896

6. EXPENSE PREPAID MOTOR VEHICLE TAXES AND CAP Legal

CZN - w/o prepaids#6		JE#		
230105.575000.16	Misc Exp		21,874	
230105.165500	Prepayments		2,500	
230105.165500	Prepayments			24,374

7. TO WRITE OFF UNBILLED REV.

CZN - w/o unbilled #7		JE#	
236105.401120	Aqua Fria Res	120,069	
236105.401220	Aqua Fria Comm	29,652	
236105.401520	Aqua Fria OPA	24,609	
236205.401120	Sun City Water - Res	211,176	
236205.401220	Sun City Water - Comm	36,464	
236405.401120	Sun City West - Res	107,910	
236405.401220	Sun City West - Comm	22,191	
237105.401120	Mohave - Res	115,155	
237105.401220	Mohave - Comm	32,575	
237105.401520	Mohave - OPA	4,601	
237305.401120	Havasu Res	17,944	
237305.401220	Havasu Comm	5,827	
238305.401120	Distco Res	71,303	

238305.401220	Distco Comm	9,753	
238905.401120	Tubac Res	13,783	
238905.401220	Tubac Comm	2,510	
230105.144000	Unbilled Revenue		825,523

8. CAPITAL INVOICES PAID BY CITIZENS NEED TASK ORDER NUMBERS

NO ENTRY NEEDED

Task Order	Anthem Valve Vaults Task Order 5	15,366	
Task Order	Anthem Water Treatment Plant Ph 3	51,093	
Task Order	Anthem Solids Handling Facility	344,109	
Task Order	Sun City West Reclaim Facilty	70,913	
Task Order	Sun Village Well #5	18,900	
Task Order	Sun Village Water Plant Mods	11,129	
Task Order	Sun Village SCADA	2,240	
Task Order	Sun City Grand Water Plant #1	7,990	
Task Order	Anthem Project Mana Phase 4	76,444	
Task Order	Anthem Water Campus WTP 4MGD	310,975	
Task Order	Anthem Water Campus Tank #2	3,757	
Task Order	AT/AF Interconnect	1,147	
Task Order	Oakmont Dr. Water Replace	1,965	
Task Order	Anthem Remote Vault Float Valve	7,410	
Task Order	Anthem Valve Replacement	5,124	
Task Order	Sun City West Service Replacements	5,916	
Task Order	Sun City Sewer Flo Mtr SCADA RTU	11,266	
Task Order	Water test Agua Fira	88	
Task Order	Water Test Sun City	70	
Task Order	Water Test Anthem	640	
Task Order	Sun City/Sun City West Grdwtr Svgs	3,016	
Task Order	Sun City/Sun City Wst Well Study	25,415	
Task Order	Whitestone Water Reclaim Fac	5,846	
Task Order	Anthem Finished Water Res.#2	47,735	
Task Order	Sun City Grand SCADA	1,560	
Task Order	99th & Olive Flow Meter	1,318	
Task Order	Sun Village Booster Station	3,494	
Task Order	Surprise Main Replace	1,520	
Task Order	Anthem Phase 2	1,851	
	SUB - TOTAL	1,038,299	
Need Task Order	Sun Valley Water Treatment Plant	19,575	Not On D. Baka's sheets
	Was on the PA line of Exhibit I should be AZ		
	TOTAL	**1,057,874**	

STEPHENSON DIR. EXH. 3

[09101] - Journal Entries

Functions Tools Help

Model (Y)

Reverse or Void (R/V)

Document Type: JE

Document Number/Co: 24545 00023 Explanation: RECLASS CITIZENS ORCOM CHARGES

G/L Date: 12/31/01 Batch Number 23054064 Home BU

Remaining Ref. 1

Skip to Line

Account No.	Subl/WO#	T	Amount	Explanation 2
230205.760715			607,722.55	
2302000E.105150.1	23002001	W	607,722.55-	

F5=Make New Model F6=% JE F15=Model JE's F13=Acct Master F24=More Keys MW

Citizens Business Services Company (CBSC)
Net Book Value of Assets - Banner System & Non Banner Items
At January 15, 2002

Category	Description	Capitalized Cost	Accumulated Depreciation	Est. Net Book Value	Allocated by State Illinois	Allocated by State Arizona
	Furniture & fixtures:					
5	Office furniture	2,497	1,157	1,340	1,340	0
6	Work tables, files & storage cabinets	3,582	1,662	1,920	1,920	0
7	Copier	1,565	728	837	837	0
8	Facsimile machine	2,465	1,141	1,324	1,324	0
9	File server & software - Sun City, Az	19,974	9,253	10,721	0	10,721
9	File server & software - Harvey, LA	99,870	46,263	53,607	53,607	0
9	File server & software - Woodridge, IL	79,895	37,011	42,884	42,884	0
10	PCs and software	53,085	24,595	28,490	28,490	0
11	Misc.	2,465	1,141	1,324	1,324	0
12	PC credit services	7,056	3,271	3,785	3,785	0
	Total Furniture & Fixtures	272,454	126,222	146,232	135,511	10,721
	Data Center Implementation:					
13	HAVC System (50%)	58,276	27,000	31,276	31,276	0
14	UPS unit	81,342	37,677	43,665	43,665	0
15	Generator	99,337	46,018	53,319	53,319	0
16	Fire suppression system	44,442	20,589	23,853	23,853	0
17	Raised flooring	10,212	4,726	5,486	5,486	0
18	Equipment racks / workstations	33,989	15,748	18,241	18,241	0
19	Telephone / data wiring	22,144	10,256	11,888	11,888	0
	Total Data Center Implementation	349,742	162,014	187,728	187,728	0
20	Computer hardware HP 9000 & HP-UX	705,391	326,768	378,623	378,623	0
	Mailing Center Implementation:					
28	HVAC system (50%)	36,260	16,797	19,463	19,463	0
29	Ceiling tile	1,514	705	809	809	0
30	Carpet padding	404	184	220	220	0
31	Canape	3,082	1,425	1,657	1,657	0
	Total Mailing Center Implementation	41,260	19,111	22,149	22,149	0
32	Automated mailing system	316,328	146,541	169,787	169,787	0
33	Billing printer	202,150	93,647	108,503	108,503	0
						0
34	Postage meter	7,046	3,263	3,783	3,783	0
	Total Allocated Assets	1,894,371	877,566	1,016,805	1,006,084	10,721
	Assets Expected to Retain					
	Banner System	2,956,710	1,369,691	1,587,019		
	Other Unallocated Assets	138,601	64,194	74,407		
	Software License cost transferred from LGS 12/00	1,223,780	265,152	958,628		
	Total Retained Assets	4,319,091	1,699,037	2,620,054		
	Total CBSC Assets	6,213,462	2,576,603	3,636,859		

ARIZONA-AMERICAN WATER COMPANY
SPREAD OF ORCOM COSTS

Water / Wastewater	4 Factor Percentage	% of 4 Factor Percentage	Banner	Arizona	ORCOM
Mohave Water	1.791	4.34%	$113,730	$113,730	$70,348
Havasu Water	0.215	0.52%	$13,653	$13,653	$8,445
Tubac Water	0.143	0.35%	$9,081	$9,081	$5,617
Sun City Water	3.295	7.99%	$209,236	$209,236	$129,424
Sun City Sewer	2.579	6.25%	$163,769	$163,769	$101,300
Sun City West Water/Wstwtr	4.011	9.72%	$254,703	$254,703	$157,548
Aqua Fria	1.862	4.51%	$118,239	$118,239	$73,137
California Water	7.450	18.06%	$473,083		$0
Home Water	1.862	4.51%	$118,239		$0
CU Water of Penn	1.361	3.30%	$86,425		$0
Lake Heritage	0.143	0.35%	$9,081		$0
Blue Mountain	1.289	3.12%	$81,853		$0
Glen Alsace	1.003	2.43%	$63,692		$0
CUC Illinois	10.316	25.00%	$655,077		$0
Flowing Wells	0.143	0.35%	$9,081		$0
Ohio Utilities	2.221	5.38%	$141,036		$0
Citizens Water Resources Co. of AZ	0.931	2.26%	$59,119	$59,119	$36,568
Citizens Water Services Co. of AZ	0.645	1.56%	$40,958	$40,958	$25,335
	41.26	100.00%			
Total Banner Net Assets Retained			$2,620,054	$982,488	$607,722
Total ORCOM Costs					$607,722

STEPHENSON DIR. EXH. 4

Arizona-American Water Co.
Citizens Acqusition - Phase 3 Costs
As of September 30,2002

	2000	2001	2002		Total
Service Company Charges	165,778	235,692	217,655	$	619,125
Intergration Services (Consultants)			157,932	$	157,932
Miscellaneous *(data lines, office trailer rental)*		1,497	450	$	1,947
Notices to Customers		375	5,407	$	5,782
	167,778	239,564	383,445	$	784,784

F:\RATES\Arizona Citizens Rate Case\[Phase 3 Acquisition Costs.xls]Phase 3

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Account Ledger Print

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From Date/Per 01/01/00
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	20608	02/29/00	Reclass 2/00 Service Co. Chrgs	14124		2,011.32		P
				Batch Date 03/08/00				P
JE	405	03/31/00	Service Company Charges	15043		27,296.79		User ID BBEINLIC
				Batch Date 04/05/00				P
JE	405	04/30/00	Service Company Charges	16469		35,842.17		User ID MPATACSI
			A#106,113,268,273	Batch Date 05/02/00				P
JE	20866	04/30/00	Reclass Mar.,00 Serv Co Chrgs	16469		822.51		User ID MPATACSI
				Batch Date 05/02/00				P
JE	405	05/31/00	Service Company Charges	18080		12,907.91		User ID MPATACSI
			A#106,113,268,273	Batch Date 06/05/00				P
JE	405	06/30/00	Service Company Charges	20131		54,847.50		User ID ARIVERA
			A#106,113,268,273	Batch Date 07/06/00				P
JE	405	07/31/00	Service Company Charges July 0	22002			4,038.25-	User ID MPATACSI
			A#106,113,268,273	Batch Date 08/03/00				P
JE	405	08/31/00	Service Company Charges	23686		12,287.88		User ID BBEINLIC
			A#106,113,268,273	Batch Date 09/06/00				P
JE	405	09/30/00	Service Company Charges	25338		6,022.32		User ID MPATACSI
			A#106,113,268,273	Batch Date 10/07/00				P
JE	405	10/31/00	Service Company Charges	27022		5,786.27		User ID DBAKA
			A#106,113,268,273	Batch Date 11/06/00				P
JE	405	11/30/00	Service Company Charges	28379		3,944.81		User ID DBAKA
			A#106,113,268,273	Batch Date 12/05/00				P
JE	405	12/31/00	Service Company Charges	30020		8,046.96		User ID DBAKA
			A#106,113,268,273	Batch Date 01/04/01				P
						169,816.44	4,038.25-	User ID DBAKA

---- Account Balances ----

Ledger Total	165,778.19
Unposted	
Year-to-Date	165,778.19
Cumulative	165,778.19

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Ledger Type. AA
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Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	405	01/31/01	Service Company Charges A#106,113,268,273	32855 Batch Date 02/07/01		13,980.82		P - User ID DBAKA
JE	405	02/28/01	Service Company Charges A#106,113,268,273	34637 Batch Date 03/06/01		8,400.76		P User ID DBAKA
JE	405	03/31/01	Service Company Charges A#106,113,268,273	36299 Batch Date 04/04/01		7,732.01		P User ID DBAKA
JE	405	04/30/01	Service Company Charges	38086 Batch Date 05/02/01		8,353.84		P User ID MPATACSI
JE	405	05/31/01	Service Company Charges	40082 Batch Date 06/05/01		1,224.37		P User ID DBAKA
JE	405	06/30/01	Service Company Charges	42149 Batch Date 07/05/01		609.09		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		895.92		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		3,535.69		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			471.88-	P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			1.18-	P User ID DBAKA
JE	405	08/31/01	Service Company Charges	46074 Batch Date 09/06/01		19,930.36		P User ID DBAKA
JE	405	09/30/01	Service Company Charges	47791 Batch Date 10/04/01		29,575.23		P User ID DBAKA
CC	46250	10/31/01	JAMES M CAMPBELL SERIOUS SIGNS	49402 Batch Date 11/02/01		86.08		P User ID DBAKA
JE	405	10/31/01	Service Company Charges	49657 Batch Date 11/06/01		48,506.95		P User ID DBAKA
PV	5501	11/15/01	WOODENSHIP BILLING CHG PSTCRD: SURPSE AZ	50586 Batch Date 11/15/01		375.00		P User ID DBAKA Invoice 200233
PV	5563	11/28/01	QWEST - POB 2348 (CITIZENS) PREWIRE @ 11102 W ROSE GARDEN	50917 Batch Date 11/28/01		90.36		P User ID DBAKA Invoice A682306
JE	405	11/30/01	Service Company Charges	51279 Batch Date 12/04/01		36,592.11		P User ID DBAKA
PV	5689	12/14/01	UNITED RENTALS (formerly Woude OFFICE TRAILER RENTAL	52310 Batch Date 12/14/01		426.63		P User ID DBAKA Invoice 21818444-001
PV	5690	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		225.86		P User ID DBAKA
PV	5693	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		270.04		P User ID DBAKA
PV	5739	12/26/01	QWEST - POB 29060 (480...636B, CITIZENS SERVICE: 11/28-12/27	52624 Batch Date 12/26/01		120.90		P User ID DBAKA Invoice 6235727003564B
JE	395	12/31/01	Special Accounts Payable AT&T - Citizens	53086 Batch Date 01/04/02		27,256.97		P User ID DBAKA
JE	405	12/31/01	Service Company Charges	52958 Batch Date 01/03/02		29,570.56		P User ID DBAKA
JE	24545	12/31/01	RECLASS CITIZENS ORCOM CHARGES	54064 Batch Date 01/10/02		607,722.55		P User ID DBAKA
PV	5778	12/31/01	UNITED RENTALS (formerly Woude	52935		276.63		P

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-
User ID DBAKA
Invoice 21919444-002

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit
			RENT: 16 FT OFFICE TRAILER	Batch Date 01/03/02			
						845,758.73	473.06-

---- Account Balances ----

Ledger Total	845,285.67
Unposted	
Year-to-Date	845,285.67
Cumulative	845,285.67

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Currency Code

Account 230105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO# .	Debit	Credit	
PV	40068645	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,509.28		P - P User ID SCHAFFCE Invoice CAWW00602
PV	40068654	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,897.51		P User ID SCHAFFCE Invoice CAWW00302
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		149,699.60		P User ID TUMANEW
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		8,231.91		P User ID TUMANEW
JE	2312	09/30/02	Reclass Citizens Phase 3	2169053 Batch Date 09/17/02		217,333.01		P User ID TUMANEW
						380,671.31		

---- Account Balances ----

Ledger Total	380,671.31
Unposted	
Year-to-Date	380,671.31
Cumulative	380,671.31

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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 230205.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
JE	66	01/31/02	record awws bill	478862		321.69		P -
				Batch Date 02/06/02				P
JE	66	02/28/02	record awws bill	665000				User ID RUSSOTL P
				Batch Date 03/05/02				User ID RUSSOTL
						321.69		

---- Account Balances ----

Ledger Total	321.69
Unposted	
Year-to-Date	321.69
Cumulative	321.69

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Account Ledger Print

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From Date/Per 01/01/02
Thru Date/Per 12/31/02
Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 236105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
PV	40043671	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2447
PV	40043684	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2446
PV	40043686	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELL	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2445
						450.00		

---- Account Balances ----

Ledger Total	450.00
Unposted	
Year-to-Date	450.00
Cumulative	450.00

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 5

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$	5,153,711		
2					
3					
4				4 Factor Formula	
5	**Location**			**Factor**	**Management Fee Allocation**
6					
7	Mohave Water, Havasu Water			0.1157	$ 596,284
8	Mohave Sewer			0.0070	36,076
9	Sun City Water			0.1797	926,122
10	Sun City Sewer			0.1014	522,586
11	Sun City West Water			0.1001	515,886
12	Sun City West WasteWater			0.1072	552,478
13	Agua Fria, CWS, CWR Water			0.2300	1,185,353
14	CWS, CWR Sewer			0.0558	287,577
15	Tubac Valley			0.0075	38,653
16					
17					
18	TOTAL CUSTOMER COUNT			0.9044	$ 4,661,016
19					
20					
21					

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$	5,153,711		
2					
3					
4				4 Factor Formula	
5	**Location**			**Factor**	**Management Fee Allocation**
6					
7	Mohave Water			0.1011	$ 521,040
8	Havasu Water			0.0146	75,244
9	Mohave Sewer			0.0070	36,076
10	Sun City Water			0.1797	926,122
11	Sun City Sewer			0.1014	522,586
12	Sun City West Water			0.1001	515,886
13	Sun City West WasteWater			0.1072	552,478
14	Agua Fria			0.1384	713,274
15	CWS/CWR Water			0.0916	472,080
16					-
17	CWS/CWR Sewer			0.0558	287,577
18					-
19	Tubac Valley			0.0075	38,653
20					
21					
22	TOTAL CUSTOMER COUNT			0.9044	$ 4,661,016
23					
24					
25					

Management Fees
per168 Line 13

		Actual								Forecast		
		January	February	March	April	May	June	July	ytd	Apr-July	2002 YE Forecast	Annual Est
Arizona		22,441	215,344	396,649	429,178	471,821	396,921	451,837	2,384,191	437,439	4,571,387	5,249,271
per Dbaka amnt includes Amort OneTime Costs	Call Ctr				(4,295)	(4,295)	(6,681)	(6,681)	(21,951)			
	SSC			(5,881)	(1,960)	(2,312)	(2,815)	(2,815)	(15,784)			
per168 Line 13 less Amort One Time Costs		22,441	215,344	390,768	422,923	465,214	387,425	442,341	2,346,456	429,476	4,493,836	5,163,711

Customers	Current
AZ Total Water	74,325
AZ Total Sewer	40,198
Total Customers	114,523

Customers

Per JDE STAT Report	Total	Residential	Commercial	Industrial	Fire	OPA	Resale
Paradise Valley	4,669	4,350	239	-	55	6	19
WhiteStone Water	-						
WhiteStone WasteWater	-						
Agua Fria - Water	13,566	13,271	246	-	44	1	4
Sun City Water	22,068	21,118	713	-	113	123	1
Sun City WasteWater	21,144	20,696	448				
Sun City West Water	15,303	14,925	337	-	41	-	-
Sun City West WasteWater	14,889	14,697	192				
Treatco Water	46	1	5	-	-	40	
Treatco WasteWater	7	1	4	-	-	2	
Distco Water	3,307	3,208	83	-	16		
Distco WasteWater	3,593	3,557	36				
Tusayan	-						
Surprise Water	23	15	8				
Cave Creek	-						
Tubac Water	488	426	62				
Mohave Water	13,623	12,741	696	-	98	88	-
Sorenson WasteWater	565	558	5	-	-	2	
Havasu Water	1,232	1,184	48				
Havasu WasteWater	-						
Check total	114,523						

Agua Fria (2361) Count	9	400,368
Cave Creek (2388) Count	1	44,485
Corporate (2301) Count	15	667,280
Distco (2383) Count	4	177,941
Distco Waste Water(2384) Count	2	88,971
Havasu (2373) Count	3	133,456
Mohave (2371) Count	16	711,766
Paradise Valley (2302) Count	10	444,853
Sun City (2362) Count	42	1,868,385
Sun City West (2364) Count	6	266,912
Sun City West Waste (2365) Count	9	400,368
Tubac (2389) Count	1	44,485
Grand Count	118	5,249,270

STEPHENSON DIR. EXH. 6

ARIZONA-AMERICAN WATER COMPANY
FOUR FACTOR ALLOCATION

DISTRICT/CO.	PLANT IN SERVICE	GENERAL METERED CUSTOMERS	SALARIES & WAGES	DIRECT O&M EXPENSES (EXCLUDE PR)	4 Factor Allocation %
SUN CITY SEWER DISTRICT/CO.	12,612,288 5.1853%	21,144 18.4614%	170,492 2.8744%	2,110,347 14.0583%	10.14%
SUN CITY WEST WASTE WATER DISTRICT/CO.	24,836,561 10.2111%	14,889 13.0000%	656,756 11.0727%	1,291,160 8.6012%	10.72%
MOHAVE (SORENSON) DISTRICT/CO.	1,742,120 0.7162%	565 0.4933%	66,444 1.1202%	71,876 0.4788%	0.70%
DISTCO/TREATCO SEWER DISTRICT/CO.	21,774,316 8.9521%	3,600 3.1433%	341,267 5.7537%	673,393 4.4859%	5.58%
SUN CITY WATER DISTRICT/CO.	28,533,245 11.7309%	22,068 19.2681%	1,248,678 21.0523%	2,973,822 19.8104%	17.97%
SUN CITY WEST WATER DISTRICT/CO.	24,724,945 10.1652%	15,303 13.3614%	494,526 8.3376%	1,226,276 8.1690%	10.01%
TUBAC VALLEY DISTRICT/CO.	1,450,789 0.5965%	488 0.4261%	84,319 1.4216%	85,010 0.5663%	0.75%
MOHAVE WATER DISTRICT/CO.	15,573,103 6.4026%	13,623 11.8946%	907,831 15.3057%	1,024,583 6.8254%	10.11%
HAVASU DISTRICT/CO.	1,447,094 0.5949%	1,232 1.0757%	184,457 3.1099%	157,357 1.0482%	1.46%
AGUA FRIA DISTRICT/CO.	49,451,561 20.3311%	13,589 11.8649%	688,562 11.6089%	1,731,272 11.5330%	13.84%
DISTCO/TREATCO WATER DISTRICT/CO.	39,161,570 16.1005%	3,353 2.9276%	626,309 10.5594%	1,059,889 7.0605%	9.16%
PARADISE VALLEY DISTRICT/CO.	21,923,699 9.0135%	4,677 4.0836%	461,666 7.7835%	2,606,438 17.3630%	9.56%
ARIZONA TOTAL	243,231,291	114,531	5,931,307	15,011,423	100.00%

STEPHENSON DIR. EXH. 7

ARIZONA-AMERICAN WATER COMPANY
2002 General Rate Case Application
Rate Case Expense

Estimated Rate Case Expense for Current Rate Case Application:

Consultants			
(see detail)			$608,000
Employee Cost per Day			
Hotel	$	105	
Airfare	$	50	
Food	$	30	
Miscellaneous	$	15	
Cost/Day	$	200	

AWWS Co. Employees		Cost/Day	Days	# Emps		Total $$
Filing	$	200	1	1	$	200
System Tour	$	200	3	3	$	1,800
Stipulation Meeting	$	200	1	2	$	400
Hearings	$	200	10	5	$	10,000
Commission Conference	$	200	2	2	$	800
Public Meetings (1)	$	200	4	2	$	1,600
Public Meetings (2)	$	200	4	4	$	3,200
Total						$ 18,000

Mailings, Printings, Supplies & Miscellaneous	$80,000
Total Estimated Rate Case Expense	$706,000
Amortization Period (In Years)	3
Normalized Annual Rate Case Expense	$235,333
Recorded Rate Case Expense Per General Ledger	
Rate Case Expense Adjustment	$235,333

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 8

per168 Actual (no Svc Co Expenses included)	Actual							YTD	Forecast		Annual Est				
									avg other than Mar-July						
	January	February	March	April	May	June	July		Mar-July Monthly Avg	YE Forecast					
Arizona															
Directors Fees			-	-	1,250	-	1,250	2,500	500	5,000	6,000	CC	MISC	6,000	
Bank Svc Charges CA	-	1,390	5,794	1,304	796	3,389	925	13,599	2,442	25,807	29,299	CC	OFFICE		
Bill Inserts -CA	-		440		-	925	-	1,364	341	3,070	4,095	CC	OFFICE		
Collection Agencies						-	145	145	73	508	870	CC	OFFICE		
Bank Svc Chg AG	-	306	-	-	-	235	-	541	47	776	564	CC	OFFICE		
Forms			1,295	365	3,524	172	1,758	7,114	1,423	14,228	17,074	CC	OFFICE		
Required Notifications		100	8,160	-	78,781	3,193	5,819	96,053	19,191	192,006	230,287	CC	OFFICE		
Bill Inserts AG			-	-	10,600	-	70	10,670	2,134	21,340	25,608	CC	OFFICE		
Brochures and Handouts			834	-	-	-		834	209	1,877	2,502	CC	OFFICE		
Community Relations			76	1,786	699	-	660	3,220	644	6,441	7,730	CC	OFFICE		
Postage CA			31	199	90,401	18,939	27,910	137,481	27,496	274,961	329,952	CC	OFFICE	647,981	
Incentive Plan	1,290	1,290	16,863	20,280	14,196	17,256	25,830	97,004	18,885	191,429	226,620	EE	S&W		
Group Insurance	32,598	30,669	60,198	83,721	24,043	47,051	44,214	322,495	51,845	561,722	622,145	EE	S&W		
PBOP	5,295	3,826	104,922	32,363	25,950	28,133	27,388	227,879	28,459	370,172	341,502	EE	S&W		
Wrks Comp	880	484	(196)	3,749	(7,845)	(1,317)	(2,333)	(6,578)	(1,586)	(14,520)	(19,061)	EE	S&W		
Dues/Memberships Deduct		697	973	362	170	(170)	170	2,202	301	3,707	3,612	EE	S&W		
Dues/Memberships NonDeduct		40	147	53	546	(389)	770	1,167	225	2,294	2,706	EE	S&W		
Employee Exp		175	3,716	11,498	32,963	(10,476)	10,313	48,189	9,603	96,206	115,234	EE	S&W		
Employee Exp Conf/Registration			1,067	770	1,373	2,294	4,744	10,249	2,050	20,497	24,595	EE	S&W		
Meal/Travel		239	1,773	4,478	10,818	(3,693)	3,190	16,805	3,313	33,371	39,766	EE	S&W		
Other Welfare			120	472	799	559	335	2,285	541	4,991	6,495	EE	S&W		
Employee Awards					42	-		42	21	147	252	EE	S&W		
Employee Physicals			270	205	79	60		614	154	1,382	1,642	EE	S&W		
Tuition			1,620	2,430	5,906	(3,396)	5,738	12,298	2,460	24,596	29,515	EE	S&W		
Training			530	170	2,263	(1,846)	9,224	10,341	2,068	20,682	24,819	EE	S&W		
401K	297	5,732	5,898	8,674	5,876	5,217	5,377	37,070	6,208	68,112	74,501	EE	S&W		
ESOP	2,045	7,491	7,522	10,724	6,834	6,703	6,450	47,769	7,647	86,002	91,759	EE	S&W	1,586,293	1,586,293
Trustee Fees		1,600	1,243	1,243	1,610	1,233	1,600	8,528	1,422	15,636	17,068	PFP	MISC	17,058	23,058
Credit Line Fees	101	103	1,094	369	215	1,166	634	3,683	696	7,161	8,347	PFP	OFFICE	8,347	1,293,829
General Liab Insurance, Property	2,509	2,509	3,169	2,509	2,674	5,608	3,263	22,241	3,445	39,464	41,335	RB	INS	41,335	258,736
Security Svc CA				1,005	460	458	449	2,372	593	5,337	7,116	RB	OFFICE		
Security Svc		15,516	44,104	52,184	90,296	32,047	44,029	278,177	52,532	540,637	630,384	RB	OFFICE	637,500	
Insurance Other, Gen. Liability	1,911	2,311	1,911	14,511	23,509	20,036	14,411	69,597	18,117	160,181	217,401	RB	INS	217,401	
Co Dues/Memberships Deduct		190	2,500	2,020	-	(1,990)	4,211	6,931	1,348	13,672	16,176				
Co Dues/Memberships NonDeduct			495	8,501	340	2,700		12,036	3,009	27,081	36,108				
Co Dues/Memberships AWWA Deduct			30	108	-	156		294	74	662	882				
Co Dues/Memberships AWWA NonDeduct			443	152	-	54		649	162	1,460	1,947				
Charitable Contributions Deduct				450	533	(108)		875	292	2,333	3,500				
Charitable Contributions NonDeduct				100	100	-		200	67	533	800				
Property Taxes	23,403	23,403	23,403	24,553	773,403	174,471	174,471	1,217,107	174,471	2,089,462	2,093,652		**TOTAL**	**3,161,915**	**3,161,915**

STEPHENSON DIR. EXH. 9

Acquisition Adjustment Analysis

CITIZENS

	BOY	Amortization	EOY	Tax Dep	Def Tax	Acc Def Tax	AVERAGE	Revenue Requirement	Total Revenue Requirement
BOY Balance	71,631,081								
0									
1	71,631,081	$141,500	71489581	4775405	1807223	1807223	70660000	7555000	$7,555,000
2	71489581	$156,400	71333181	4775405	1801412	3608635	68700000	7364000	$7,364,000
3	71333181	$172,800	71160381	4775405	1795016	5403651	66740000	7175000	$7,175,000
4	71160381	$190,900	70969481	4775405	1787957	7191608	64770000	6986000	$6,986,000
5	70969481	$211,000	70758481	4775405	1780118	8971726	62780000	6798000	$6,798,000
6	70758481	$233,100	70525381	4775405	1771499	10743225	60780000	6610000	$6,610,000
7	70525381	$257,600	70267781	4775405	1761944	12505169	58770000	6423000	$6,423,000
8	70267781	$284,600	69983181	4775405	1751414	14256583	56740000	6237000	$6,237,000
9	69983181	$314,400	69668781	4775405	1739792	15996375	54700000	6053000	$6,053,000
10	69668781	$347,400	69321381	4775405	1726922	17723297	52640000	5870000	$5,870,000
11	69321381	$383,900	68937481	4775405	1712687	19435984	50550000	5687000	$5,687,000
12	68937481	$424,100	68513381	4775405	1697009	21132993	48440000	5506000	$5,506,000
13	68513381	$468,600	68044781	4775405	1679654	22812647	46310000	5327000	$5,327,000
14	68044781	$517,800	67526981	4775405	1660466	24473113	44140000	5149000	$5,149,000
15	67526981	$572,100	66954881	4775405	1639289	26112402	41950000	4973000	$4,973,000
16	66954881	$632,200	66322681	0	-246558	25865844	40650000	4897000	$4,897,000
17	66322681	$698,500	65624181	0	-272415	25593429	40240000	4920000	$4,920,000
18	65624181	$771,800	64852381	0	-301002	25292427	39800000	4947000	$4,947,000
19	64852381	$852,700	63999681	0	-332553	24959874	39300000	4976000	$4,976,000
20	63999681	$942,200	63057481	0	-367458	24592416	38750000	5008000	$5,008,000
21	63057481	$1,041,000	62016481	0	-405990	24186426	38150000	5043000	$5,043,000
22	62016481	$1,150,300	60866181	0	-448617	23737809	37480000	5082000	$5,082,000
23	60866181	$1,270,900	59595281	0	-495651	23242158	36740000	5125000	$5,125,000
24	59595281	$1,404,300	58190981	0	-547677	22694481	35920000	5173000	$5,173,000
25	58190981	$1,551,600	56639381	0	-605124	22089357	35020000	5226000	$5,226,000
26	56639381	$1,714,400	54924981	0	-668616	21420741	34030000	5285000	$5,285,000
27	54924981	$1,894,300	53030681	0	-738777	20681964	32930000	5349000	$5,349,000
28	53030681	$2,093,000	50937681	0	-816270	19865694	31710000	5420000	$5,420,000
29	50937681	$2,312,600	48625081	0	-901914	18963780	30370000	5499000	$5,499,000
30	48625081	$2,555,200	46069881	0	-996528	17967252	28880000	5585000	$5,585,000
31	46069881	$2,823,300	43246581	0	-1101087	16866165	27240000	5681000	$5,681,000
32	43246581	$3,119,500	40127081	0	-1216605	15649560	25430000	5787000	$5,787,000
33	40127081	$3,446,800	36680281	0	-1344252	14305308	23430000	5905000	$5,905,000
34	36680281	$3,808,400	32871881	0	-1485276	12820032	21210000	6034000	$6,034,000
35	32871881	$4,207,900	28663981	0	-1641081	11178951	18770000	6177000	$6,177,000
36	28663981	$4,649,400	24014581	0	-1813266	9365685	16070000	6335000	$6,335,000
37	24014581	$5,137,200	18877381	0	-2003508	7362177	13080000	6509000	$6,509,000
38	18877381	$5,676,100	13201281	0	-2213679	5148498	9780000	6702000	$6,702,000
39	13201281	$6,271,700	6929581	0	-2445963	2702535	6140000	6916000	$6,916,000
40	6929581	$6,929,600	-19	0	-2702544	-9	2110000	7151000	$7,151,000
		71631100	2164820740	71631075			1551900000	234445000	$234,445,000

Cost of Debt	4.9200%	Tax Life	15
Cost of Equity	11.5000%	Tax Rate	39.00%
Debt Percent	60.0000%		
Equity Percent	40.0000%		
Weighted Cost of Debt	2.9520%		
Weighted Cost of Equity	4.6000%		
Tax Gross Up	1.639		
TOTAL REVENUE GROSS UP	10.4914%		

Premium Defined

Allocated Purchase Price	276471277
Total Value of Assets	205246727
Gross Premium	71224550
Capitalized Expenses	500000
Corporate Costs	906531
Net Premium	71631081

STEPHENSON DIR. EXH. 10

Exhibit A

Estimated Net Asset Adjustment
Arizona Water Property Detail
As of 11/01

	Mohave	Havasu	Sun City Water	SunCity Sewer	Tubac Valley	Agua Fria	Sun City West	TreatCo	Distco	Citizens Public Works of AZ	Citizens Cdna Serv.- Mohave	Citizen Wtr Resc Mgt Sv C	Citizens Business Services (CBSC)	Total Az. Water by Property	EXCL. CBSC Total Az. Water by Property
Petty Cash	$ 1,321	$ -	$ 2,050	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,371	$ 3,371
Notes Receivable	-	-	-	-	-	500,000	-	-	-	-	-	-	-	500,000	500,000
Accounts Receivable	467,298	45,069	787,008	297,124	26,611	674,508	572,212	54,229	336,635	-	3,951	-	-	3,264,645	3,264,645
Accounts Receivable - Other	-	-	10,417	217	-	334,011	-	63,617	150,533	485,586	-	-	-	1,044,381	1,044,381
Reserve for Doubtful Accounts	(25,168)	(1,257)	(2,975)	-	(85)	(6,438)	(375)	(433)	(10,992)	-	-	-	-	(47,723)	(47,723)
Material & Supplies	-	-	-	-	-	-	-	-	-	26,354	-	-	-	26,354	26,354
Special Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Prepayments	1,000	2,415	91,730	-	1,254	99,049	50,998	5,930	-	-	-	-	3,751	256,127	252,376
Other Current Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Current Assets	444,451	46,227	888,230	297,341	27,780	1,601,130	622,835	123,343	476,176	511,940	3,951	-	3,751	5,047,155	5,043,404
Property Plant and Equipment	24,069,880	1,977,535	39,037,505	17,299,171	1,963,983	52,850,104	69,366,422	42,805,257	11,416,266	-	-	-	6,213,462	266,999,605	260,786,143
Construction Work in Progress	837,185	19,312	379,860	797,889	22,860	1,412,832	320,279	13,270,295	318,324	3,332	-	-	-	17,382,168	17,382,168
Accumulated Depreciation	(7,507,773)	(510,030)	(13,822,745)	(6,697,853)	(564,559)	(4,402,369)	(19,271,951)	(1,994,695)	(245,397)	-	-	-	(2,426,277)	(57,443,649)	(55,017,372)
Net Fixed Assets	17,399,292	1,486,817	25,594,620	11,399,207	1,422,284	49,860,567	50,414,750	54,080,857	11,489,213	3,332	-	-	3,787,185	226,938,124	223,150,939
Preliminary Survey & Investigation	-	-	385,769	-	-	-	268,836	-	-	-	-	-	-	654,605	654,605
Other Deferred Debits	-	-	585,288	-	533	2,921,537	139,137	-	100	-	-	-	-	3,646,595	3,646,595
Regulatory Assets	234,640	24,786	655,877	145,771	4,596	109,279	217,666	-	-	-	-	-	-	1,392,615	1,392,615
Unamortized Debt Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Non-Current	234,640	24,786	1,626,934	145,771	5,129	3,030,816	625,639	-	100	-	-	-	-	5,693,815	5,693,815
	$ 18,078,383	$ 1,557,830	$ 28,109,784	$ 11,842,319	$ 1,455,193	$ 54,492,513	$ 51,663,224	$ 54,204,200	$ 11,965,489	$ 515,272	$ 3,951	$ -	$ 3,790,936	$ 237,679,094	$ 233,888,158
Accounts Excluded:															
Cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
InterCompany Receivables	(9,633,765)	(681,563)	10,223,590	17,790,427	(405,108)	(18,008,861)	8,245,593	(32,066,952)	(1,999,397)	992,686	(1,357,696)	(650,696)	(3,874,841)	(31,426,583)	(27,551,742)
Clearing Accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment in Associate Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	(59,014)	(353)	(75,877)	(144,389)	(239)	(54,982)	(189,807)	(368,679)	(36,039)	(5,178)	-	-	(17,161)	(951,718)	(934,557)
Customers' Deposits	(106,858)	(10,905)	(1,575)	-	(410)	(18,059)	(1,750)	(1,600)	(2,736)	-	-	-	-	(143,893)	(143,893)
Income Taxes Accrued	(489,872)	(50,695)	(142,492)	(319,665)	(13,456)	(840,837)	(5,944)	(265,783)	170,736	(260,115)	187,588	-	-	(2,030,535)	(2,030,535)
Other Taxes Accrued	(225,880)	(17,857)	(183,547)	(82,173)	(13,087)	(289,104)	(176,866)	(61,998)	(20,240)	(1,651)	-	-	(373)	(1,072,776)	(1,072,403)
Interest Accrued	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Current & Accrued Liabilities	-	-	(11,682)	(1,932,421)	-	(308,402)	-	-	-	(422,125)	-	-	-	(2,674,630)	(2,674,630)
Subordinate Investment Note	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Customer Advances for Construction	(4,302,830)	(440,351)	(2,443,976)	(3,468,190)	(180,250)	(31,985,339)	(29,648,102)	(19,215,739)	(10,682,471)	-	-	-	-	(102,367,248)	(102,367,248)
Deferred Income Taxes	486,537	111,894	(1,794,889)	(356,822)	19,783	(978,964)	(2,162,338)	-	-	-	-	-	-	(4,674,819)	(4,674,819)
Regulatory Liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment Tax Credit	(84,565)	-	(386,710)	(179,806)	(16,477)	(94,636)	(1,148,406)	-	-	-	-	-	-	(1,910,600)	(1,910,600)
Other Deferred Credits	-	(12,327)	-	-	-	-	-	-	-	-	-	-	-	(12,327)	(12,327)
Contributions in Aid of Construction	(2,962,599)	(259,451)	(1,020,713)	(1,021,182)	(135,527)	(692,359)	(1,040,772)	-	-	-	-	-	-	(7,132,603)	(7,132,603)
Equity	(699,537)	(196,222)	(32,271,913)	(22,128,098)	(710,402)	(1,220,970)	(25,534,832)	(2,223,449)	604,658	(618,889)	1,166,157	650,696	101,439	(83,281,362)	(83,382,801)
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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Water Company

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AGUA FRIA WATER DISTRICT, ITS ANTHEM WATER DISTRICT AND ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT.	DOCKET NO. W-01303A-02-_____ SW-01303A-02-_____

DIRECT TESTIMONY

OF

DAVID P. STEPHENSON

EXHIBIT
A-67
Admitted

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I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is David P. Stephenson. My business address is 303 H Street, Suite 250, Chula Vista, California 91910. My telephone number is (619) 409-7700.

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

A. I am employed by American Water Works Service Company, Inc. ("Service Company"), as the Director of Rates and Planning for American Water Works Company, Inc.'s ("AWW") Western Region. The Western Region includes AWW's water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including Arizona-American Water Company ("Arizona-American" or "Company"). I am also an Assistant Treasurer for Arizona American.

Q. PLEASE BRIEFLY OUTLINE YOUR RESPONSIBILITIES AS THE DIRECTOR OF RATES AND PLANNING.

A. I am responsible for directing preparation of all rate applications and various other matters related to rates and charges for utility service with the public utility commissions that regulate AWW's operating utilities in Arizona, California, Hawaii, New Mexico and Texas. I am also responsible for overseeing other rate related proceedings before these commissions such as acquisition and financing applications.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science in Business Administration, with emphasis in Accounting, from San Diego State University in 1977.

Q. HAVE YOU HAD ANY OTHER FORMAL TRAINING?

A. Yes, I have attended many seminars on various aspects of the water industry and

rate applications, including the National Association of Regulatory Utility Commissioners (NARUC) biannual Utility Rate Seminar.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have been employed by the American Water System since 1978. The various positions I have held within the American Water System are: Accountant - 1978; Accounting Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for the operating utilities in the Western Region - 1983; Assistant Director of Rates and Revenues for the operating utilities in the Western Region - 1984; Director of Rates and Revenues for the operating utilities in the Western Region - 1986, and Director of Rates and Planning for the operating utilities in the Western Region since 2001.

Q. HAVE YOU HAD ANY OTHER PROFESSIONAL EXPERIENCES?

A. Yes, I served on the Accounting Committee of the California Water Association and have been an instructor at the NARUC biannual Utility Rate Seminar on eight occasions.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE UTILITY REGULATORY COMMISSIONS?

A. Yes, I have testified before the Arizona Corporation Commission ("Commission") in rate and acquisition proceedings for Arizona-American; before the California Public Utilities Commission on many occasions for all of the California-American Water Company systems; and before the New Mexico Public Regulation Commission in many types of proceedings on behalf of New Mexico-American Water Company.

II. <u>PURPOSE OF TESTIMONY, SUMMARY AND CONCLUSIONS</u>

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

A. The purposes of my testimony are to: (1) identify and explain the Company's rate filing; (2) provide background concerning the purchase of the former Citizens Communications' water and wastewater utility assets in Arizona ("Citizens' Assets") by Arizona-American (the Citizens' Acquisition); (3) explain and support various adjustments made to the test period actual results; (4) explain and support all components of the capital structure except for cost of equity; and (5) to discuss the specific requirements set forth in Decision 63584 (April 24, 2001), which authorized Arizona-American to purchase the Citizens' Assets ("Acquisition Decision").

Q. WHAT DO YOU MEAN THE "COMPANY'S RATE FILING"?

A. I mean the five (5) separate applications for rate relief being filed with the Commission in 2002. This filing follows our efforts to determine the best approach to file rate applications for a substantial number of systems in a manner that would make the most sense for both public presentation and ease of handling for the Commission's Utilities Division Staff ("Staff").

Q. YOU ALSO USED THE TERM "SYSTEM." ARE YOU REFERRING TO "SYSTEM" IN A LEGAL OR OTHER SPECIFIC SENSE?

A. No, I am using the term "system" in a more general sense. By way of background, as I mentioned earlier, Arizona-American acquired all of the water and wastewater assets of Citizens in Arizona in a transaction that closed earlier this year. Previously, Citizens' Assets were under a different ownership structure with a number of separate corporate entities, such as Sun City Water Company, Sun City West Utilities Company or the Agua Fria Water Division of Citizens Communications Company, for example. However, Arizona-American acquired only the assets – not the stock. Therefore, the assets were removed from separate ownership and now all fall under the ownership umbrella of Arizona-American.

Q. HOW DOES ARIZONA-AMERICAN REFER TO THESE SEPARATE GROUPS OF ASSETS INTERNALLY?

A. Generally we use the term "district" to refer to a separate area within Arizona-American where, for accounting purposes, we individually account for revenues and expenses, and maintain separate balance sheets. These areas generally coincide with areas where the same tariffs apply and in that sense, a district could be identified as a "tariffed area." Of course, reference to the "Tubac water tariffed area" or the "Sun City West water tariffed area" would be awkward, and for purposes of the Company's rate filing, we basically use the terms "district" or "system" interchangeably and neither is intended to denote the actual name of any particular corporate entity or to designate an operational or other system as such term is used by ADEQ or any other regulatory agency to identify water or wastewater systems in Arizona.

Q. THANK YOU MR. STEPHENSON. WOULD YOU PLEASE CONTINUE WITH YOUR DISCUSSION OF HOW THE COMPANY ULTIMATELY DECIDED THE BEST WAY TO ORGANIZE THE COMPANY'S RATE FILING?

A. Certainly, again from a public perspective, it was determined that it made sense to file separate applications for the Sun City and Sun City West districts. These four districts, two water and two wastewater systems, are relatively large in size and have certain unique characteristics and circumstances that distinguish them from the other Arizona systems. The third application consists of two water systems in Mohave County, the Mohave water district, which provides water service in the vicinity of Bullhead City, and the Havasu water district, which provides service near Lake Havasu City. These systems are close together and operated by essentially the same Company personnel. The fourth application being filed is the

combination of Agua Fria water district and the water and wastewater systems serving the Anthem development in Maricopa County. These utility systems primarily serve recent developments and have very similar operating procedures. The final application is for the small Class C water system known as the Tubac water district in Santa Cruz County. This system is distinctive based on its small size, limited revenues and location. Again, for convenience, I will sometimes refer to the five applications as the Company's rate filing. And, again, I want to emphasize that the terms "system" and "district" should be considered synonymous throughout the Company's rate filing.

Q. ALL OF THESE DISTRICTS OR SYSTEMS ARE PART OF THE CITIZENS' ACQUISITION, CORRECT?

A. That is correct. I should also note that none of the former Citizens' systems have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company last rate order was issued in May 1997 based on test years ending March 31, 1995. Decision No. 60172 (May 7, 1997).[1] Citizens Mohave Water and Wastewater Divisions last received rate increases in February 1990, based on test years ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test year ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992). It appears that once Citizens decided to sell its water and wastewater systems in 1999, it elected not to seek rate increases and, in some cases, to accept operating losses. This situation has caused Arizona-American to seek rate

[1] In Decision No. 60172, rates for Sun City Water Company and Sun City West Utilities' rates for water service were actually reduced. I also understand the Sun City West Utilities' rates for both water and wastewater service were reduced in the prior rate proceeding, as were Sun City Water Company's rates. Decision No. 55488 (March 17, 1987).

increases more quickly than it anticipated. However, a delay in obtaining rate increases and correcting these systems' anemic earnings would be harmful to the Company and, ultimately, to its customers.

Q. WHAT ARE YOUR OVERALL RESPONSIBILITIES IN THIS CASE?

A. I have been responsible for the coordination and supervision of all of the rate case applications discussed including, among other things, selecting the test period and the pro-forma time period for various adjustments, and determining what adjustments need to included in the filing.

Q. WHAT TEST PERIOD DID YOU DETERMINE WAS APPROPRIATE IN THIS CASE?

A. I determined, for ease of presentation, that the period ending December 31, 2001, should be used as the test period for the Company's rate filing. This period closely is aligned with the purchase of the Citizens' Assets by Arizona-American, which transaction closed on January 15, 2002.

Q. DID ARIZONA-AMERICAN OWN THE CITIZENS' ASSETS, OR HAVE ANY RESPONSIBILITY FOR THE OPERATING EXPENSES OR THE PROVISION OF SERVICE DURING THE TEST PERIOD FOR THE SYSTEMS THAT ARE THE SUBJECT OF THE COMPANY'S RATE FILING?

A. No. As I stated, the purchase of the Citizens' Assets was not completed until January 15, 2002, on which date Arizona-American assumed operational control and responsibility for the Citizens' Assets.

Q. SINCE ARIZONA-AMERICAN DID NOT OWN AND OPERATE THE CITIZENS' ASSETS AND DID NOT HAVE ANY OPERATING RESPONSIBILITY FOR THE WATER AND WASTEWATER UTILITY OPERATIONS IN 2001, HOW DOES THE COMPANY JUSTIFY FILING A

RATE APPLICATION WITH A TEST PERIOD ENDING PRIOR TO THE COMPLETION OF THE PURCHASE?

A. The recorded operating expenses directly incurred by each district basically remain unchanged following the acquisition. Further, the Commission ordered Citizens to maintain its books and records for a period of 5 years following the closing. It is relatively simple to remove the management and services costs allocated to each of the operating systems by Citizens from the normally-incurred direct operating expenses of these systems. Likewise, it is relatively simple to add in the expected Service Company charges from AWW applicable to Arizona-American.

Q. WHAT PRO FORMA TIME PERIOD HAVE YOU USED FOR EXPENSE AND PLANT ESTIMATIONS IN THIS CASE?

A. I am recommending that such adjustments, all of which will be detailed further in the various witnesses' direct testimonies, go no further into the future than end of year 2002. This will provide ample time for Staff to review and analyze these adjustments prior to providing their recommendations in Staff's direct filing.

Q. ARE THERE PRO FORMA ADJUSTMENTS FOR PLANT ADDITIONS?

A. Yes, we have estimated the non-revenue generating plant additions that will be completed and placed in service by the end of 2002, and have included pro forma adjustments that include those additions in utility plant in service. This is consistent with Commission Decision No. 61831 (July 20, 1999) related to the Paradise Valley water district, wherein the Commission ordered the Company to limit pro forma plant additions to those plant items that are used and useful and in service 90 days after the application is deemed sufficient. The December 31, 2002 cut-off date proposed by Arizona-American in this case is well within the 90-day deadline established by the Commission.

Q. HOW ARE PRO FORMA ADJUSTMENTS DETERMINED FOR

OPERATING EXPENSES?

A. Pro forma adjustments for operating expenses are based on known and measurable changes that have or will occur up until the time each rate application is filed to develop a normal 12-month period of operations. This is consistent with A.A.C. R14-2-103(i).

III. ACQUISITION OF THE WATER AND WASTEWATER ASSETS OF CITIZENS UTILITIES OF ARIZONA

Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE CITIZENS' ACQUISITION?

A. By way of background, Arizona-American has owned and operated a water utility system in Arizona, which was formerly known as Paradise Valley Water Company, since the late 1960s. The Paradise Valley water district is relatively small, and currently furnishes service to approximately 5,000 customers. Sometime in 1998 or 1999, Citizens Communications Company (formerly Citizens Utility Company) decided to focus its business activities in the telecommunications area, and elected to sell its water and wastewater assets, which were located in six states including Arizona. Arizona-American's parent company, AWW, which is the largest privately-owned water utility system in the United States and whose business activities focus on water and wastewater, entered into negotiations with Citizens. Ultimately, on October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American agreed to purchase the Citizens' Assets, which included all of the water and wastewater systems and assets in Arizona.

Citizens and its various Arizona water and wastewater subsidiaries, along with Arizona-American, filed an application on March 24, 2000, seeking approval of the transfer of the Citizens' Assets to Arizona-American in Docket Nos. W-

01032A-00-0192, et. seq. Later that same year, Arizona-American filed a separate application in Docket No. W-01303A-00-0929 seeking authority to issue certain promissory notes and other evidence of indebtedness and to assume certain industrial development revenue bonds in connection with financing the purchase of the Citizens' Assets. Following notice and a public hearing, the Commission ultimately approved the transfer of the Citizens' Assets in the Acquisition Decision. Attached to the Acquisition Decision and incorporated therein in the second ordering paragraph, was a settlement agreement setting forth specific terms and conditions agreed to by Staff and the Company. These terms and conditions settled one ratemaking issue and set forth deadlines, procedures and filing requirements that Arizona-American is to follow in future rate proceedings. The terms and conditions are as follows:

1. The ratemaking treatment of the of the acquisition adjustment, deferred taxes, excess deferred taxes and the investment tax credit will be deferred until a future rate case proceeding.
2. The decision to allow recovery of the acquisition adjustment must be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred
3. The Company must file a report 13 months after the closing of the transaction, comparing the number of complaints received by the Commission prior to and after the transaction.
4. The adjusted AIAC balance not transferred to Arizona-American as part of the transaction will be imputed ratably into rate base over a 6.5 year period. The balance will be ratably reduced over the 6.5 years utilizing a levelized monthly below the line amortization.

A copy of the Acquisition Decision is attached hereto as Stephenson Dir. Exh. 1.

Later in 2001, the Commission issued Decision No. 64002 (Aug. 30, 2001) authorizing the debt financing for the purchase of the Citizens' Assets. In summary, the Commission authorized Arizona-American to issue promissory notes and other evidence of indebtedness in an amount not to exceed $180 million and to issue a promissory note reflecting the obligation associated with assuming Citizens' industrial development revenue bonds in the amount of $10,635,000. The balance of the purchase price was financed by an infusion of additional paid in equity capital from AWW. In Decision No. 64002, the Commission ordered Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition in order to maintain a reasonably balanced capital structure.

Q. WHEN DID ARIZONA-AMERICAN FINALIZE THE PURCHASE OF THE CITIZENS' ASSETS?

A. The transaction was finalized on January 15, 2002, the date title to all of the Citizens' Assets was transferred to Arizona-American. All of the service provision responsibilities were also transferred to Arizona-American on that date. The final Citizens' Asset purchase price was approximately $276,500,000, and included an initial book acquisition adjustment of approximately $71,100,000. As Explained in the Direct Testimony of Mr. Joseph Hartnett, appended as Exhibit C to the Joint Application for Authority to Transfer Assets and Related Approvals in Docket Nos. W-01032A-00-0192, et seq., the purchase for the Citizens' Assets was determined by an arms-length negotiation based on the advice of each companies financial advisors. This open market negotiated purchase price then establishes AWW's reasonable investment in the Citizens' Assets. This reasonable investment in the Citizens' Assets was funded by a combination of debt and equity as shown on at the top of the closing journal entry to record the transaction, which is

attached hereto as Stephenson Dir. Exh. 2.

IV. POST TEST PERIOD ADJUSTMENTS

Q. WHAT PRO FORMA ADJUSTMENTS ARE YOU RESPONSIBLE FOR SUPPORTING?

A. I am responsible for supporting six adjustments that impact all of the Company's rate filings. The specific adjustments are as follows: 1) capitalization of payments made for the implementation of ORCOM billing software from operating expense and the determination period for the recovery of this expense; 2) the transfer of charges related to the completion of the Citizens' Acquisition, as well as charges for the development of base accounting procedures from expenses to organizational costs; 3) the rationale for the removal of the Citizens' management costs, 4) estimates of Service Company charges; 5) estimates of rate case expense and 6) estimates of direct charges to the systems made by AWW.

Q. WHY HAVE PAYMENTS BEEN MADE FOR THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Payments made for the development of the ORCOM billing software have been made in connection with converting all of the Citizens' customers over to the AWW billing system. The payments should be considered as organizational costs or start-up costs. I will refer to these as "start-up costs" for the remainder of this discussion. These start-up costs were for such items as consultants' fees, billing programs modifications and related expenses of AWW associates to assist in the development of the billing system. The billing system had to come on line exactly at the time of closing. Since the acquisition was an asset sale, there was no arrangement between Citizens and AWW for Citizens to continue billing any utility customers after the transaction closed. The ORCOM system had to be up and running, and running properly, at the closing. To the benefit of these

customers, AWW has been developing this same system for its own use at all of its present properties, including the Paradise Valley district. This made the time and expense of converting the Citizens' customers to the ORCOM system less burdensome.

Q. WHY WERE THESE COSTS EXPENSED?

A. Over the past few years accounting requirements regarding the booking of these types of start-up costs have changed. Start-up costs historically have been capitalized along with the purchase or development of new assets. This is no longer the case. The Financial Accounting Standards Board has deteremined that too many expenses were being capitalized and companies' balance sheets were being overstated. However, for a regulated utility, the books and records of a company are maintained in acordance with Commission regulations and policy. These start-up costs have always been treated as a capitalized asset, and there is no valid reason to stray from that policy. These start-up costs are incurrred for the development of programs to serve new customers. The addition of the new customers lowers the overall fixed costs per customer. This produces a net cost savings. Therefore, all present and future customers should share in both the development costs as well as the savings. Common regulatory practice is to spread the development costs of a cost saving measure over the customer base receiving known and measurable savings.

Q. DOES THIS COMMISSION HAVE JURISDICTION TO OVERIDE ACCOUNTING POLICY AND AUTHORIZE THESE COSTS TO BE CLASSIFIED AS A CAPITALIZED START-UP OR ORGANIZATION COST?

A. Yes. As has been the common practice under Financial Accounting Standard Board Policy FAS 71, the Commission can establish different accounting

proceedures for various items so long as the proceedure establishes a set methodolgy and time period for the recovery of the item.

Q. WHAT ARE THE ACTUAL COSTS RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Attached as Stephenson Dir. Exh. 3 is an analysis showing the actual costs of this project and other relationships. Page 1 of the Exhibit shows that the total one-time costs for this project is $607,723. The amount included in the rate bases for the Agua Fria water, Anthem water and Anthem/Agua Fria wastewater districts is $73,137, $30,952 and $30,952, respectively.

Q. DID ARIZONA-AMERICAN PURCHASE ANY BILLING SYSTEM ASSETS FROM CITIZENS AS PART OF THE ASSET PURCHASE?

A. No. As page 2 of Stephenson Dir. Exh. 3 shows, the billing system used by Citizens to bill its water and wastewater customers (the Banner System) was retained by Citizens. Therefore, as I testified earlier, Arizona-American had to have its own billing system set up and fully functional at the time the Citizens' Acquisition closed.

Q. WHAT IS THE EFFECT ON THE RATE BASES FOR THE ARIZONA DISTRICTS INCLUDED IN THE COMPANY'S RATE FILING RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. As shown, the net book value of the Banner billing system at the time the Citizens' Acquisition was completed was $2,620,054. Of that amount $982,488 was allocated to the Citizens' water and wastewater systems in Arizona. The difference between the development costs of the ORCOM system ($607,723) and the allocated net book value of the Banner system not purchased ($982,488) is $374,766. Thus, there was a net benefit to the customers in Arizona through the development of the ORCOM billing system as opposed to purchasing the Banner

billing system from Citizens at the net book value allocated to Arizona. The net effect on the rate bases of the Agua Fria water, Anthem water and Anthem/Agua Fria wastewater districts is $45,102, $19,087 and $19,087, respectively.

Q. WHY HAVE YOU MADE AN ADJUSTMENT OF $906,531 FOR CORPORATE COSTS TO TRANSFER VARIOUS ITEMS RELATED TO THE CITIZENS' ACQUISITION TO THE ACQUISITION ADJUSTMENT?

A. I have made this adjustment for the same reasons that I recommend the transfer of the one-time start-up costs from expenses. These costs were incurred to complete the purchase of the Citizens' Assets and to establish books and records for the Citizens' Assets and systems. The costs are related to title reviews, legal interpetations of contract clauses, legal representation to transfer existing contracts and for accounting assistance. These costs were necessary to secure and protect Arizona-American's legal rights to all the transferred assets and to obtain transfers of all existing contracts and agreements. These are normal "organizational" expenses to ensure full and proper title to transferred assets and to set up the books and records in an appropriate manner.

Q. CAN YOU PLEASE FURTHER DESCRIBE THE ITEMS WHICH YOU ARE PROPOSING TO RECLASSIFY TO THE ACQUISITION ADJUSTMENT?

A. Certainly. The total amount of $906,531 is comprised of charges from two separate sources: charges incurred by AWW in connection with the purchase; and charges from our accounting contractor in Arizona (Ronald L. Kozoman, CPA) to develop satisfactory records for regulatory purposes. The total of the charges from AWW is $784,784 and the total of the charges from Mr. Kozoman is $121,747. The details of all of these charges is attached hereto as Stephenson Dir. Exh. 4. This full amount is included in the Acquisition Adjustment.

Q. PLEASE EXPLAIN THE JUSTIFICATION FOR REMOVING ALL OF CITIZENS' MANAGEMENT FEES FROM THE TEST PERIOD EXPENSES.

A. I have removed all of Citizens' management fees from the test period expenses because these expenses pertain to Citizens' management of the Citizens' Assets in Arizona, not expenses that will be incurred under the ownership and management of Arizona-American. These expenses must be removed and replaced by current annualizations of Service Company charges to Arizona-American in order to provide an accurate presentation of known and measureable expenses that are occuring now and will occur on a going-forward basis in the future.

Q. HOW DID YOU DETERMINE WHICH EXPENSES TO REMOVE RELATED TO CITIZENS' MANAGEMENT AND WHICH EXPENSES RELATED TO THE SERVICE COMPANY TO INCLUDE?

A. The explanation of the proceedure to determine what expenses were removed will be discussed by Mr. Tom Bourassa in his direct testimony. I have annualized the amount of expense to be included in the pro forma test period based on actual recorded costs from April through July 2002. Attached as Stephenson Dir. Exh. 5 is a spreadsheet showing the recorded costs from January through the end of July. I have not included the months of January through March in my annualization because these months were either not full months due to the finalization of the acquisition (January) or the months were not accurately reflect normal cost allocations from the Service Company (February and March). Viewing Exhibit 5, it is obvious that January and February have very low recorded expenses in comparison to the other months. The month of March is more in line with future months, but is still questionable due in part to the obvious omission of a credit for the call center amortization (this amortization relates only to the Paradise Valley

system). Furthermore, March is a quarter-ending month, and as such expenses in that month tend to contain more quarterly adjustments, thereby causing distortion of the annualization without including the other months of the quarter.

Q. WHAT IS THE AVERAGE MONTHLY CHARGE FOR THE SERVICE COMPANY FOR THE MONTHS OF APRIL THROUGH JULY 2002?

A. As shown on Stephenson Dir. Exh. 5, the average monthly amount of Service Company charges for the period April through July 2002 is $429,476. Annualizing this amount yields a total of $5,153,711 for 2002.

Q. DID YOU SPREAD THE ANNUALIZED TOTAL TO EACH OF THE SYSTEMS IN ARIZONA?

A. Yes, I spread the annualized expense to each of the systems on a four-factor basis. The four-factor analysis considers many factors all of which produce the benefits Arizona-American receives from the Service Company. The four-factor spreadsheet is attached hereto as Stephenson Dir. Exh. 6. The allocation to the Agua Fria water, Anthem water and Anthem/Agua Fria wastewater districts is $713,274,$472,080 and $287,577, respectively, based on the four-factor allocation methodology.

Q. PLEASE EXPLAIN YOUR ESTIMATE OF RATE CASE COSTS INCLUDED IN THE COMPANY'S RATE FILING.

A. The estimate of rate case expense has been developed with estimates provided by all outside consultants and costs estimated for in-house items. Attached as Stephenson Dir. Exh. 7 is an estimate of the rate case costs necessary to prosecute these applications. . The total estimated costs of consultants and legal counsel is $608,000. This amount is comprised of $275,000 for ouside accounting and rate assistance, $51,000 for the outside rate of return consultant and $282,000 for legal counsel. The total estimate of in-house costs is $98,000 and is comprised of

$18,000 for employee expenses and $80,000 for expenses related to mailings, notices, printing and supplies. I have allocated the total estimated rate case costs to each system based on adjusted test period revenues and have spread those totals over a three-year recovery period. The total amount allocated to the Agua Fria water, Anthem water and Anthem/Agua Fria wastewater districts is $122,482, $79,413 and $36,958, respectively.

Q. ARE THE ESTIMATED COSTS TO PROSECUTE THE RATE FILINGS CONSISTENT WITH PRIOR COSTS INCURRED TO PROSECUTE RATE APPLICATIONS IN ARIZONA?

A. Yes, in fact the estimated cost to prosecute this case is lower on a per customer basis than the amount the Commission has previously allowed for the Paradise Valley water district in its past two rate cases. The average rate case cost per customer in the last two Paradise Valley rate proceedings was approximately $13.25. In these applications we have estimated the rate case cost per customer to be approximately $6.50 per customer, or only $2.17 per customer annually.

Q. WHAT ARE THE ADJUSTED DIRECT CHARGES COMPRISED OF?

A. The direct charges are comprised mostly of employee benefits, customer accounting charges (bill forms, postage, inserts, collection agency fees, etc.), insurance fees, dues and memberships, employee travel and directors and trustee fees. Attached as Stephenson Dir. Exh. 8 is an itemization of the charges.

Q. HOW DID YOU ESTIMATE THE ANNUAL COSTS FOR THESE ITEMS?

A. I based the annualized cost for these items on the actual recorded costs for March through July of 2002.

Q. WHAT IS THE TOTAL OF THE ANNUALIZED DIRECT CHARGES AND HOW WERE THEY ALLOCATED TO VARIOUS TEST PERIOD EXPENSE CATAGORIES?

A. The annual total for these direct expenses is $3,161,915. The charges were related to four different expense catagories: salary and wages ($1,586,293); miscellaneous expenses ($23,058); general office expenses ($1,293,829) and insurance fees ($258,736).

Q. HOW WERE THESE DIRECT CHARGES ALLOCATED TO EACH OF THE ARIZONA-AMERICAN SYSTEMS?

A. These charges were allocated to each of the systems based on four different factors. The system charges for salaries and wages were allocated to each system based on expensed test period salaries; the allocation of miscellaneous expense was spread to each system based on customer count and pro forma plant; the allocation of general office expense was allocated to each system based on customer count, pro forma plant and adjusted test period rate base; and the allocation of insurance fees to each of the sysetms was based on adjusted test period rate base.

Q. WHY DID YOU USE THE MARCH THROUGH JULY TIME PERIOD?

A. As stated earlier, I chose the time period that best represents the normalized expenditures. I had to eliminate January and February from consideration due to the fact that Arizona-American did not own the Citizens' Assets until January 15, 2002, and February 2002 was the first full month of operation by Arizona-American and not all charges were recorded properly.

Q. DID YOU REMOVE ALL OF THE RECORDED TEST PERIOD EXPENSES RELATED TO THESE SYSTEM SPECIFIC ALLOCATIONS?

A. Yes, all of the test period expenses for these items were removed from the test period along with the Citizens' management fees.

Q. WHAT WAS THE AMOUNT ALLOCATED TO EACH OF THE EXPENSE CATAGORIES FOR THE AGUA FRIA WATER, ANTHEM WATER AND

ANTHEM/AGUA FRIA WASTEATER DISTRICTS?

A. The allocations to each of the expense catagories for the Agua Fria water, Anthm water and Anthem/Agua Fria wastewater districts is: $126,182, $216,313 and $108,156, respectively, for salaries and wages; $4,997, $4,299 and $4,175, respectively, for miscellaneous; $160,596 , $63,385 and $29,291, respectively, for general office; and $5,250 , $2,715 and $788, respectively, for insurance.

V. CAPITAL STRUCTURE AND COST OF DEBT

Q. WHAT IS THE CAPITAL STRUCTURE THAT ARIZONA-AMERICAN PROPOSES TO UTILIZE IN THESE APPLICATIONS?

A. The Company proposes a capital structure comprised of 60 percent debt and 40 percent equity.

Q. HOW WAS THIS CAPITAL STRUCTURE DETERMINED?

A. It was determined based on the actual financing of the acquisition of the Citizens' Assets by Arizona-American. At the very top of the first page of Stephenson Dir. Exh. 1 is the entry to record the purchase of the Citizens' Assets by Arizona-American. This entry shows Common Stock in the amount of $110,888,158 (40 percent), Bonds – Inside of $154,948,119 (56 percent) and Bonds – Outside of $10,635,000 (4 percent). These are the actual amounts for each of these components as recorded on the books of Arizona-American at the time of purchase of the Citizens' Assets. AWW strives to have its subsidiaries maintain the most efficient capital structure. Typically, the most efficient capital structure for AWW utility subsidiaries is comprised of approximately 60 percent debt. AWW has maintained its high debt rating (A-) and secured very efficient rates for bonds and notes by maintaining a 60 percent debt component in the capital structure. The greater the leverage of the capital structure while still maintaining a high bond rating, the lower the cost of capital to the Company and its customers.

Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN "BONDS-INSIDE" AND "BONDS-OUTSIDE."

A. The "Bonds-Inside" comprise the debt financing provided by American Water Works Capital Corp. ("AWCC") in the form of a short-term note. This is a five-year unsecured note with an interest rate of 4.92%. The "Bonds–Outside" is debt financing reflecting the assumption of Citizens' industrial development revenue bonds I mentioned previously, which have an interest rate of 7.30%.

VI. ACQUISITION ADJUSTMENT

Q. EARLIER, YOU DISCUSSED THE ACQUISTION. HOW WILL ARIZONA-AMERICAN ACCOUNT FOR THE DIFFERENCE BETWEEN THE PURCHASE PRICE AND THE ACQUIRED ASSET BALANCE FOR REGULATORY PURPOSES?

A. The difference will be recorded as an Acquisition Adjustment in accordance with the NARUC Uniform System of Accounts.

Q. WHAT IS THE AMORTIZATION PERIOD THAT ARIZONA-AMERICAN PROPOSES TO USE?

A. Forty years.

Q. WHAT METHOD OF AMORTIZATION IS ARIZONA-AMERICAN PROPOSING TO USE?

A. Arizona-American proposes to follow a mortgage amortization method, which incorporates the same amortization principle as home mortgages. Under this method, Arizona-American would recover only a small portion of the Acquisition Adjustment in the initial years and recover increasingly greater amounts in the later years. The annual amortization increases each year. The proposed amortization of the Acquisition Adjustment balance is attached hereto as Stephenson Dir. Exh. 9. The amount of the amortization included in the cost of service for the Agua Fria

water, Anthem water and Anthem/Agua Fria wastewater districts in these applications is $27,900, $23,200 and $12,900, respectively, based on amortization of the Acquisition Adjustment in 2003, as shown on Exhibit 9.

Q. WHAT IS THE NORMAL METHOD OF RECOVERY FOR UTILITY ASSETS?

A. The normal method, known as a straight-line method of recovery, involves equal or level recovery in each year of the asset's life.

Q. WHY ARE YOU PROPOSING THE MORTGAGE METHOD RATHER THAN THE STRAIGHT-LINE METHOD?

A. Although there are several reasons for this proposal, there is one significant reason: the mortgage method provides a much better matching of the recovery of the acquisition adjustment to the benefits the customers will receive as a result of this transaction.

Q. DOES USING THE MORTGAGE AMORTIZATION METHOD BETTER ILLUSTRATE THE CUSTOMER BENEFITS OF THIS TRANSACTION?

A. Yes. As stated previously, the savings generated from this transaction will grow as time passes. Allocating the recovery of the Acquisition Adjustment on an increasing basis over the recovery period, instead of leveling the recovery of the Acquisition Adjustment as is normal under the straight-line method of recovery, provides a superior opportunity for all current and future ratepayers to realize the benefits of the transaction.

Q. ARE THERE ANY OTHER FACTORS THAT SUPPORT YOUR SELECTION OF THIS METHODOLOGY?

A. Yes. The effects of inflation should also be considered. If a straight-line amortization method is used, the highest net-present value amounts are charged initially, and lower amounts are charged toward the end of the amortization. Given

the effects of inflation, the differential between initial and final charges are substantial in terms of constant dollars. The mortgage-style amortization works with the effects of inflation to create a more level, constant dollar charge.

Q. WHAT SHOULD THE COMMISSION AUTHORIZE IN THIS PROCEEDING WITH RESPECT TO AN ACQUISITION ADJUSTMENT?

A. Arizona-American requests that the Commission authorize a 40-year amortization period and use of a mortgage amortization method, with the recovery of the acquisition adjustment as a component of the cost of service, as discussed previously.

VII. DISCUSSION OF THE REQUIREMENTS OF THE ACQUISITION DECISION

Q. HAVE YOU ADDRESSED COMPLIANCE WITH ALL OF THE COMMISSION'S DIRECTIVES IN THE ACQUISITION DECISION?

A. No. I have only covered the requested treatment of the Acquisition Adjustment. The Acquisition Decision also calls for the determination of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American; and the determination of the ratemaking treatment of deferred taxes, excess deferred taxes and investment tax credits that were on the books and records of Citizens at the time of the closing of the purchase transaction, yet were not transferred to Arizona-American. It is my recommendation to delay the demonstration of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American until a later date, after which time Arizona-American will have greater operating experience and be better able to demonstrate the tremendous net ratepayer benefits that result from this transaction. However, by recommending this delay, Arizona-American does not waive its right to, at some

point in time in the future, request recovery of and on the Acquisition Adjustment, if it so desires to do so. It is my recommendation is that the deferred taxes, excess deferred taxes and the investment tax credit not be considered for any ratemaking purpose.

Q. WHAT IS THE BASIS FOR THIS RECOMMENDATION AS IT RELATES TO THE DEFERRED TAXES, EXCESS DEFERRED TAXES AND THE INVESTMENT TAX CREDIT?

A. All of these items were established on the books and records of Citizens due to timing differences between book and tax recognition of an allowance to record the event causing the tax difference in the income stream. For deferred taxes, it is the tax effect of the difference between depreciation methods of assets for book and tax purposes. For tax purposes, many assets were once allowed to be depreciated at an accelerated rate, meaning that the assets were depreciated at a higher early period rate, and over a shorter time period, than for book purposes. For investment tax credits, in the past the Internal Revenue Code allowed a percentage tax deduction for the investment in various assets. The investment tax credit was never considered for book purposes.

In short, these are taxes and credits that belong to Citizens, not Arizona-American. Arizona-American purchased the water and wastewater assets of Citizens in Arizona; it did not assume any of the liabilities, except for the one series of industrial development revenue bonds. The deferred taxes and investment tax credits will be reconciled from the books and records of Citizens when Citizens files its 2002 tax return and applies these items against the gain or loss realize upon the sale of the water and wastewater assets to Arizona-American.

Q. WHAT WERE THE BALANCES OF THE DEFERRED TAXES AND INVESTMENT TAX CREDITS ON THE BOOKS AND RECORDS OF

CITIZENS AT THE TIME OF CLOSING OF THE ASSET PURCHASE BY AWW OF THE ARIZONA ASSETS?

A. Stephenson Dir. Exh. 10 is a copy of the Arizona Property Detail supplied by Citizens at the time of closing. This Exhibit shows that the balance for the deferred taxes was $4,674,819 and the balance of the investment tax credits was $1,910,600. There were no excess deferred taxes shown on the books and records of Citizens for Arizona at the time of closing.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THAT THE DEFERRED TAXES ON THE BOOKS OF CITIZENS FOR ARIZONA AT THE TIME OF CLOSING SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. Deferred taxes that were on the books and records of Citizens at the time of closing are not an item that should be considered as a "carryover" item in an asset purchase agreement. Deferred taxes result from items being treated differently for tax and book purposes. These differences are primarily created by Citizens' ability to delay actual tax payments due to accelerated asset value depreciation or amortization for tax purposes over the straight-line depreciation or amortization used for book and regulatory purposes. These tax-differences are recorded as deferred taxes. These deferred taxes will be taken into consideration when calculating a tax gain or loss as a result of the sale of the Citizens' Assets. Upon the sale of such assets, these deferred taxes will be paid and the deferred tax balances zeroed out.

When deferred taxes have been allowed as a component of cost of service in utility ratemaking, their accumulated balance (ADIT) is typically deducted from rate base as a source of non-investor capital. This is because deferred taxes are collected in rates prior to the time they must be remitted to the respective taxing

authorities. In the interim, they represent a source of funds available to the utility for plant investment or other corporate purposes. During that period it is entirely appropriate to deduct the ADIT from rate base. When the tax liabilities underlying previously deferred taxes are paid, however, the related ADIT balances are eliminated and the rate base deductions are no longer available.

With respect to Citizens' ADIT existing at the time the sale of its water and wastewater assets to AWW, the related income taxes will become due. At that time, the ADIT's will be paid and there will be no balance available to deduct from rate base. On-going compensation to customers is not warranted. When non-investor funds have been satisfied they no longer exist, and no further rate base deduction is appropriate. ADIT's may be viewed as a temporary loan to the utility by the taxing authority. By deferring the date upon which taxes are ultimately paid, a source of funds is created. Once the "loan" is repaid, the source of funds ceases to exist. There is no entitlement inuring to the utility's customers, since they pay taxes applicable to the utility service they receive.

Q. WHAT IS THE EFFECT ON ARIZONA-AMERICAN IF THE COMMISSION ELECTED TO USE CITIZENS' RECORDED DEFERRED TAXES IN FUTURE RATEMAKING.

A. The Internal Revenue Service has, on a number of occasions, declared that any deferred income tax reserves or unauthorized income tax credits relating to assets that have been sold, transferred, or removed from regulation may not continue to be considered in the subsequent ratemaking determinations. To attempt to do otherwise will result in the utility losing the ability to take accelerated depreciation on its Federal income tax return.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THE INVESTMENT TAX CREDITS THAT WERE ON THE BOOKS AND RECORDS OF

CITIZENS AT THE TIME THE PURCHASE WAS COMPLETED BY ARIZONA-AMERICAN SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. The reasons are exactly the same as for deferred taxes. The investment tax credits will be considered in calculating Citizens' gain or loss as a result of the sale of the assets, and therefore will be eliminated. The investment tax credits were a "temporary" source of non-investor funds, once appropriately deducted from rate base, but now that they have been "paid", they are no available as a rate base deduction. This deduction no longer exists and as such cannot be used for ratemaking.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes it does.

STEPHENSON DIR. EXH. 1

N. JAMES

MAY 1 0 2001

ACTION

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

APR 2 4 2001

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00-0192 W-01032B-00-0192 W-01032C-00-0192 S-02276A-00-0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00-0192 W-01595A-00-0192 W-01303A-00-0192 DECISION NO. 63584 **OPINION AND ORDER**

DATE OF HEARING:	September 27, 2000
PLACE OF HEARING:	Phoenix, Arizona
PRESIDING ADMINISTRATIVE LAW JUDGE:	Karen E. Nally[1]
IN ATTENDANCE:	Chairman William A. Mundell and Commissioner Jim Irvin
APPEARANCES:	Mr. Michael M. Grant, GALLAGHER & KENNEDY, and Mr. Craig Marks, Associate General Counsel, on behalf of Citizens Communications Company;

[1] This Recommended Opinion and Order was prepared by Administrative Law Judge Marc E. Stern upon review of the testimony and exhibits admitted into evidence in the proceeding.

Mr. Norman D. James, FENNEMORE CRAIG, on behalf of Arizona-American Water Company;

Mr. Daniel W. Pozefsky, Staff Attorney, on behalf of Residential Utility Consumer Office;

Mr. Bill Meek on behalf of the Arizona Utility Investors Association; and

Ms. Teena Wolfe, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On March 24, 2000, Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively "Citizens"), and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a Joint Application to Transfer Assets and Related Approvals ("Application") of Citizens' water and wastewater utility assets in Arizona including Citizens' Certificates of Convenience and Necessity ("Certificates") held by Citizens to Arizona-American.

On May 17, 2000 and on June 1, 2000, the Residential Utility Consumer Office ("RUCO") and the Arizona Utility Investors Association ("AUIA") filed applications for leave to intervene. Subsequently, intervention was granted to RUCO and to AUIA.[2]

On May 30, 2000, by Procedural Order, a hearing was scheduled on the above-captioned matter for September ~~27~~, 2000. Citizens and Arizona-American caused public notice of the Application and hearing thereon to be published in various newspapers throughout Arizona. In

[2] On April 10, 2000, Mr. Marvin Lustiger filed an application to intervene in the above-captioned matter. However, by subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone service in Mohave County, and therefore, Mr. Lustiger's request to intervene was deemed to have been withdrawn.

addition. Citizens notified all its customers of the Application by means of a written bill insert.

On September 14, 2000, a formal public comment session was held in Sun City.

On September 26, 2000, the Commission's Utilities Division ("Staff") filed a Settlement Agreement ("Agreement") marked Exhibit A which is incorporated by reference and attached hereto.

On September 27, 2000, a full public hearing took place at the offices of the Commission in Phoenix, Arizona. Citizens, Arizona-American, RUCO, AUIA and Staff were present with counsel. Following the presentation of evidence, Citizens and RUCO submitted written briefs on the issue of whether Citizens should be required to pay a portion of the gain resulting from the sale of its utility assets to Citizens' customers. The matter was then taken under advisement pending submission of a recommended Opinion and Order to the Commission.

DISCUSSION

Parties to the Transaction

Citizens, through its various divisions and subsidiaries, provides water, wastewater, electric, natural gas and telecommunications services to approximately 1.8 million customers in 22 states, including in excess of 100,000 customers in Arizona. Citizens' current business strategy is to focus on the provision of telecommunications services and the expansion of those operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas, as was the case in the recently approved transfer of rural wire centers by Qwest Corporation to Citizens Utilities Rural Company, Inc.

In connection with this business strategy, Citizens intends to sell its water, wastewater, electric, and natural gas utilities and to apply the proceeds to finance acquisitions and other business activities in the telecommunications area. In April 2000, Citizens also announced the sale of its Louisiana natural gas operations for $375 million.

The Commission granted Arizona-American a Certificate of Convenience and Necessity to provide water service to approximately 4,600 customers in portions of the Town of Paradise

Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW") which is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states, and with a reported consolidated net plant of $5.1 billion and operating revenues of $1.26 billion. AWW's December 31, 1999, balance sheet reflected a capital structure of 58.4 percent long-term debt, 2.3 percent preferred stock and 39.3 percent common equity.

In 1999, AWW's subsidiaries invested $467 million in improving and upgrading their facilities, and for the past several years, AWW has made similar expenditures averaging nearly $400 million per year. According to AWW witnesses, AWW's acquisition policy is motivated, at least in part, by anticipated capital expenditures resulting from new regulatory requirements and programs and the need to replace or upgrade aged infrastructure to maintain high quality service. With the additional water and wastewater systems, AWW and its subsidiaries hope to obtain economies of scale and to strengthen their financial capability by expanding their customer base.

The Transaction

On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American is to acquire the water and wastewater assets and the Certificates held by Citizens in Arizona ("the Acquired Assets") for approximately $231 million, subject to adjustment at the time of closing. The purchase price will be increased based on utility plant added by Citizens after June 30, 1999, and will be reduced based on plant retirements occurring after such date. The Acquired Assets include all utility plant, property and interests relating to Citizens' water and wastewater operations in Arizona, with certain exceptions, including assets commonly used by Citizens in connection with other utility operations, cash and cash equivalents, and assets related to benefit plans. Citizens will also retain certain liabilities, including obligations for taxes payable, obligations relating to employee compensation and

benefits, and refunds of certain advances in aid of construction. Arizona-American will assume and be liable for all contracts and permits assigned at closing, certain Industrial Development Revenue Bonds ("IDRBs"), and unperformed obligations.

Arizona-American will finance the purchase of the Acquired Assets by a combination of debt and equity. AWW has recently formed a new subsidiary, American Water Capital Corporation ("AWCC"), that will provide loans and other financial services to AWW subsidiaries. Initially, Arizona-American will borrow funds from AWCC on a short-term basis, and receive additional funds in the form of common equity directly from AWW. Within 12 months, the short-term debt will be converted to long-term debt with a planned capital structure which will contain 55 to 60 percent debt and 45 to 40 percent common equity, including Arizona-American's existing debt and equity capital and the Citizens' IDRBs that will be assumed.[3]

The Position of Staff and the Staff Settlement Agreement

Staff generally supported the application, and recommended that the transfer of the Acquired Assets to Arizona-American be approved, subject to several conditions.

First, Staff recommended that the Commission defer any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes, and investment tax credits until a future rate proceeding.

Second, Staff recommended that the decision to allow recovery of an acquisition adjustment be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred.

Third, Staff recommended that Arizona-American should be ordered to file, 13 months

[3] Arizona-American has filed an application for authority to issue short-term and long-term debt in connection with financing the purchase of the Acquired Assets, which is pending in Docket No. W-01303A-00-0929.

after the closing of the transaction, a report comparing the number of complaints received by the Commission prior to and after the transaction. The report should provide an explanation of any significant changes in the number and importance of the complaints. Staff would then review this report and, if necessary, make a recommendation to the Commission of any further action to be taken.

Fourth, Staff recommended that an imputation of the benefits related to advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") received by Arizona-American be made in subsequent rate proceedings for each former Citizens' system. The purpose of the imputation would be to recognize those portions of the Acquired Assets that were financed by AIAC and CIAC which Arizona-American will not be assuming. Staff also recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC would be amortized below the line in the same manner as would have otherwise occurred.

Fifth, Staff recommended that Arizona-American be required to seek Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' Central Arizona Project ("CAP") water subcontracts.

Finally, Staff recommended that the Commission order Arizona-American to charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

In its rebuttal filing, Arizona-American indicated that it would stipulate to the conditions recommended by Staff, including the deferral of a decision concerning the recognition of an acquisition adjustment and the conditions under which an acquisition adjustment would be recognized, and would adopt and utilize the rates and charges for service, and all other service tariffs currently in effect in each of the affected Citizens service territories. However, Arizona-American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.

Subsequently, Staff and Arizona-American entered into the Agreement, which resolved all areas of disagreement relating to the terms and conditions under which the Acquired Assets would be transferred to Arizona-American.

Pursuant to the terms of the Agreement, Citizens' AIAC and CIAC will be imputed to Arizona-American for ratemaking purposes. This adjustment will reduce rate base. The amount of the AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer of the Acquired Assets, adjusted as follows: an amount equal to 5 percent of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place. The adjusted amount of CIAC will be amortized above the line (i.e., as a reduction to depreciation expense that would otherwise be recoverable in rates) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place. The imputation of AIAC and CIAC to Arizona-American is solely for ratemaking purposes, and not for financial accounting or any other purpose.

In addition to agreeing to the imputation of AIAC and CIAC, Arizona-American agreed that the Commission may adopt Staff's remaining conditions concerning the sale and transfer of the Acquired Assets. Staff and Arizona-American also agreed that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

Based on these agreements by Arizona-American, Staff is recommending that the Commission should approve the transfer of the Acquired Assets to Arizona-American and should not impose any additional terms, conditions or requirements on Arizona-American.

During the hearing, Staff and Arizona-American voiced their support of the Agreement, believing that its terms are reasonable and in the public interest. AUIA also expressed its support for the Agreement. However, the remaining party to the proceeding, RUCO, objects to the approval of the Agreement and to the transaction generally, as discussed below.

Position of RUCO

RUCO maintains the proposed transaction believing that it is not in the public interest and should not be approved unless it is restructured. RUCO argued that the transaction could possibly, in the future, impact on ratepayers. While RUCO did not disagree that consideration of an acquisition adjustment should be deferred until a future ratecase, RUCO argued that the gain resulting from the sale of the Acquired Assets received by Citizens, i.e., the difference between the net book value of the Acquired Assets and the purchase price being paid by Arizona-American, should be shared equally between Citizens stockholders and the ratepayers. RUCO further argued that the Commission should adopt a set of criteria to determine what, if any, acquisition adjustment should be allowed in a future rate proceeding. RUCO also suggested that to make this transaction in the public interest, among other things, the transaction should be contingent upon Arizona-American's Board of Director's approving a letter pledging to invest no less than 15 percent of the purchase price in acquisitions and capital improvements of "resources stressed" water and/or wasterwater utilities in Arizona no later than 72 months after the date the Commission authorizes the transaction.

Analysis of Disposition of Gain Issue

RUCO contended that fundamental principles of fairness support sharing the gain in this case. RUCO maintained that ratepayers have shared in the risk associated with the operation of the utility assets and that it necessarily follows that ratepayers should share in the gain realized from the sale of those assets. According to RUCO, this risk sharing results from the accounting treatment provided in the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts when an asset is retired prematurely, i.e., before a

utility fully recovers its original cost via depreciation. RUCO also stated that prior Commission decisions support gain sharing.

In response, Citizens argued that ratepayers have assumed no risk in connection with the operation of Citizens' water and wastewater utility business. Investors have provided the utility's capital and bear the financial risks associated with its operations. Therefore, the investors should be entitled to receive any gain resulting from the transaction. As to prior Commission decisions, Citizens cited three analogous cases involving a sale of an entire line of utility business in which the Commission did not order gain sharing.[4] Citizens also cited Decision No. 60167 (April 17, 1997) in which a utility's natural gas business was sold at a loss. In that case, the Commission did not order the customers to share in the loss.[5]

This proceeding is similar to the three cases cited earlier by Citizens since it is selling its entire business and will have no further water and wastewater operations in Arizona. The Commission has never required gain sharing under these circumstances. In the Contel of the West matter, in which Citizens was authorized to acquire all of Contel's telephone properties in Arizona, Staff urged that the gain resulting from the sale be shared equally with ratepayers. However, the Commission rejected gain sharing in that case.

We also do not believe that ratepayers bear a substantial risk by virtue of receiving utility service in this case. The particular accounting treatment for depreciable plant provided under the Uniform System of Accounts does not shift risk to customers, but rather prescribes particular accounting adjustments to properly reflect rate base before and after the retirement of a plant item. The utility's owners, i.e., its shareholders, ultimately bear the risks associated with the utility's business. While regulation may reduce those risks relative to most non-regulated

[4] Citizens/Southern Union, Decision No. 57647 (December 2, 1991); Contel/Citizens, Decision No. 58819, (October 17, 1994); and GTE/Citizens, Decision No. 62648 (June 13, 2000).

[5] Ajo Improvement Company/Southwest Gas, Decision No. 60167 (April 17, 1997).

businesses, regulation does not shift that risk to ratepayers, who are entitled to receive utility service at rates set by the Commission.

Accordingly, we do not find it appropriate under the circumstances in this case to require Citizens to share with ratepayers any part of the gain it receives from the sale of the Acquired Assets to Arizona-American. However, this will not preclude the Commission from protecting the ratepayers in the future. In any claim for an acquisition adjustment in a future rate case, the Commission can strictly scrutinize the foundation of the claim and determine what amount, if any, should be approved.

Analysis of Remaining RUCO Recommendations

RUCO's other recommendations pertained to the structure of the transaction and RUCO's concerns that this structure could lead to rate increases in the future. RUCO's concern primarily relates to the fact that Arizona-American will not be assuming all of Citizens' liabilities associated with AIAC and CIAC, which totaled approximately $80.8 million and $4.7 million, respectively, at December 31, 1999. According to RUCO, the structure of the transaction will result in the elimination of AIAC and CIAC as reductions from rate base, which will in turn result in an increase in rate base and, eventually, to rate increases.

We believe that the Agreement appropriately deals with this issue. Citizens' AIAC and CIAC will be recognized for ratemaking purposes by Arizona-American, even though Arizona-American is not assuming those liabilities. By virtue of this imputation, the impact of the structure of the transaction will be ameliorated. Based on the evidence and the testimony, the approach utilized in the Agreement is reasonable.

Further, the evidence indicates that the transaction between Citizens, Arizona-American and AWW was the product of arms-length negotiations that occurred after Citizens had adopted its current business strategy of focusing on telecommunications services and divesting itself of its water and wastewater systems, as well as its electric and natural gas systems throughout the

country. This is not a transaction between affiliated companies. The payment by Arizona-American will constitute an investment in the Acquired Assets.

RUCO also expressed concern regarding the impact of the transaction on Citizens' accumulated deferred income taxes ("ADITs"), which totaled approximately $5.2 million as of December 31, 1999, and Citizens' investment tax credits ("ITCs"), which totaled approximately $2.2 million as of the same date. Under the Agreement, any decision on the treatment of ADITs and ITCs will be deferred until Arizona-American seeks new rates in a future proceeding. Staff's recommendation is appropriate under the circumstances herein.

Next, RUCO questioned the approach proposed by Arizona-American and Staff, as adopted in the Agreement, for dealing with the possible future recognition of an acquisition adjustment in rates. RUCO agreed with Arizona-American and Staff that it is appropriate to defer consideration of any acquisition adjustment resulting from the transaction until a future rate proceeding, in order to afford Arizona-American an opportunity to demonstrate that the acquisition has provided a net benefit to ratepayers by virtue of improved operating efficiencies, economies of scale and other synergies. However, RUCO's witnesses also contended that the Commission should adopt a set formula that would be used in connection with any future determination of the amount of the acquisition adjustment.

We have concerns about the adoption of a set, mechanical formula to quantify a future acquisition adjustment. We believe that such a determination should be made at the time all the facts and circumstances are known. Staff's recommendation concerning the basis on which the Commission will allow the recovery of an acquisition adjustment is reasonable and in the public interest. Arizona-American is cautioned that the Commission will require Arizona-American to demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission will consider recovery of any acquisition adjustment in a future rate proceeding.

RUCO was also critical of Arizona-American's failure to assume all of Citizens' IDRBs. As stated, Arizona-American will assume certain IDRBs, which total approximately $10.6 million. The IDRBs that will be assumed constitute low-cost capital. The average cost of the IDRBs that will be assumed by Arizona-American was 3.55 percent per annum during 1999. RUCO believes that there may be three additional Citizens bond issues, representing low-cost capital, that will not be assumed in connection with the transaction.

Arizona-American, in its testimony, has acknowledged that other bonds have been issued by Citizens. The evidence indicates, however, that in contrast to the IDRBs that will be assumed, the other bonds would require unanimous consent from all bond holders in order to be assumed, which would be administratively difficult, if not impossible, to accomplish within the time frame of the transaction. The additional costs to Arizona-American to replace these low-cost IDRBs with alternative forms of financing was not ascertained.

We find that it would not be feasible for Arizona-American to assume the remaining bonds and it would not be reasonable to impute these bonds to Arizona-American's capital structure. The remaining bonds will continue to be an obligation of Citizens and will continue to be included in Citizens' capital structure in its ongoing telecommunications business.

Finally, RUCO recommends that authorization of the transaction be made contingent on Arizona-American pledging to invest not less than 15 percent of the purchase price for the Acquired Assets, or approximately $35 million, in acquisitions and capital improvements of "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and capital improvements would have to be made within 72 months from the date on which the Commission approves the transaction.

The Commission recognizes that there are small water and wastewater utilities in Arizona that may need technical and financial assistance. Indeed, the Commission has provided such assistance to small water and wastewater utilities through workshops and the development of policies aimed at improving their financial viability. However, it is not reasonable to compel a

private utility to spend in excess of $35 million to solve these problems, nor is it clear that the Commission has the authority to do so.

Arizona-American has indicated its willingness to work with the Commission in developing solutions to service problems being experienced by small, troubled utilities. By virtue of acquiring Citizens' systems in Arizona, Arizona-American will be in closer proximity to a number of these systems, and the Commission would expect Arizona-American, as circumstances warrant, to seriously consider acquiring these systems or otherwise provide technical or financial assistance. For these reasons, we do not believe it is appropriate to impose such a mandate on Arizona-American.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Pursuant to authority granted by the Commission, Citizens provides public water, wastewater, electric, natural gas and telecommunications services in various parts of Arizona.

2. Pursuant to authority by the Commission, Arizona-American, a wholly owned subsidiary of AWW, provides public water service to approximately 4,600 customers in the Town of Paradise Valley, the City of Scottsdale and in certain unincorporated portions of Maricopa County, Arizona. Arizona-American is presently classified as a Class B water utility.

3. On March 24, 2000, Citizens and Arizona-American filed an Application requesting approval of the sale and transfer of Citizens' water and wastewater utility assets in Arizona together with the transfer of Citizens' Certificates to Arizona-American.

4. RUCO and the AUIA were granted intervention in this Docket.

5. Public notice of the Application and hearing thereon was published in various newspapers throughout Arizona within and in the vicinity of Citizens' and Arizona-American's certificated service areas.

6. Customers of Citizens were also notified of the Application by means of a written bill insert.

7. Citizens' current business strategy is to focus on the provision of telecommunication services and to expand its telecommunications subsidiaries' operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas.

8. In the furtherance of this business strategy, Citizens is selling its water, wastewater, electric and natural gas utilities and applying the proceeds to finance acquisitions and other business activities in the telecommunications industry.

9. AWW and its subsidiaries, including Arizona-American, are the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately three million customers in 23 states.

10. AWW is financially sound, and has the experience, expertise and resources to assume and perform Citizens' public service obligations.

11. On October 15, 1999, Citizens, Arizona-American and AWW entered into an asset purchase agreement under which Arizona-American will acquire all of the water and wastewater utility assets together with the requisite Certificates held by Citizens in Arizona.

12. Arizona-American will pay a purchase price of approximately $231 million which includes the assumption of approximately $10.6 million of existing debt in the form of outstanding IDRBs. The purchase price is subject to adjustment either higher or lower based on plant additions and retirements occurring after June 30, 1999.

13. Arizona-American will finance the transaction through a combination of debt and equity, resulting in Arizona-American having a capital structure of 55 to 60 percent debt and 45 to 40 percent common equity. This debt to equity ratio is comparable to the capital structures of most large, publicly-traded water utilities.

14. Staff is recommending that the Application be approved for the sale and transfer of Citizens' water and wastewater utility assets including the Certificates to Arizona-American subject to the following conditions:

- that any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes and investment tax credits be deferred until a future rate proceeding;
- that if recovery of any acquisition adjustment is authorized in the future it should be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers in the affected areas, which would not have been realized had the transaction not occurred;
- that Arizona-American file, 30 days after the first anniversary of the transaction, a report which compares the number of complaints received by the Commission under Citizens' ownership and under Arizona-American's ownership and provide an explanation of any significant changes in the number and importance of the complaints received. Staff should review the data and, if necessary, make a recommendation to the Commission of any further action to be taken;
- that an imputation of the benefits related to AIAC and CIAC received by Arizona-American should be made in subsequent rate proceedings for each former Citizens system as recommended by Staff in its direct testimony;
- that Arizona-American shall be required to secure prior Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' CAP water subcontracts; and
- that Arizona-American shall charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

15. On September 26, 2000, Staff filed the Agreement that is marked Exhibit A. The Agreement resolves all issues relating to the terms and conditions under which the Acquired Assets may be sold and transferred to Arizona-American.

16. In the Agreement, Arizona-American acknowledged that it will follow Staff's recommendations if they are adopted by the Commission.

17. While RUCO did not oppose the treatment of the acquisition adjustment in a future rate proceeding, it neither joined in signing the Agreement nor suggested a workable

alternative approach to that agreed upon by Arizona-American and Staff in the Agreement in this instance based on our prior treatment of similar transactions.

18. Arizona-American is a fit and proper entity to acquire Citizens' utility assets and Certificates and to assume Citizens' public service obligations for the operation of the utility systems in Arizona.

19. Staff and Arizona-American believe that the approval of the Agreement attached hereto as Exhibit A is in the public interest.

20 Based on our review of the evidence, Staff's recommendations in Findings of Fact No. 14 and the Agreement are reasonable and in the public interest. Therefore, the transfer of Citizens' water and wastewater utility assets and Certificates to Arizona-American should be approved.

CONCLUSIONS OF LAW

1. Citizens and Arizona-American are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282 and 40-285.

2. The Commission has jurisdiction over Citizens and Arizona-American and over the subject matter of the Application.

3. Citizens and Arizona-American provided notice of this proceeding in accordance with the law.

4. There is a continuing need for public water and wastewater service in the certificated service areas of Citizens.

5. Arizona-American is a fit and proper entity to receive the Certificates of Citizens.

6. The Application of Citizens and Arizona-American, the Agreement and the conditions recommended by Staff in Findings of Fact No. 14 should be approved.

ORDER

IT IS THEREFORE ORDERED that the Joint Application for Approval to Transfer the Assets and Certificates of Convenience and Necessity of Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company, to Arizona-American Water Company be, and is hereby, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company shall comply with the terms, conditions and requirements as set forth in the Staff Settlement Agreement, attached hereto as Exhibit A, and with Staff's recommendations in Findings of Fact No. 14 hereinabove.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 30 days from the date on which the acquisition has been completed, with the Director of the Commission's Utilities Division, appropriate documentation evidencing its acquisition of the Citizens Utilities Company now known as Citizens Communications Company's Arizona water and wastewater utility assets.

IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its customers of the effective date of the transfer of the utility assets and of its assumption of the obligation to provide water and wastewater utility services at the existing rates by means of an insert in its first regular monthly billing or by other appropriate means immediately following the date it files the documentation with the Director of the Utilities Division.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 15 days of the date it files the documentation with the Director of the Utilities Division, a copy of the notice it provides its customers.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to charge the existing rates and charges of the transferred utility companies until further Order by the Commission.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to file all periodic reports, and comply with all outstanding compliance matters previously required of Citizens Utilities Company, now known as Citizens Communications Company relative to the acquired water and wastewater operations.

IT IS FURTHER ORDERED that Citizens Utilities Company shall maintain its books and records for the transferred utility companies for a period of 5 years from the effective date of this Decision.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24TH day of April, 2001

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT_____

SERVICE LIST FOR: CITIZENS COMMUNICATIONS COMPANY ET AL.

DOCKET NOS.: W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192; S-02276A-00-0192; WS-02334A-00-0192; WS-03454A-00-0192; WS-03455A-00-0192; W-02013A-00-0192; W-01595A-00-0192; and W-01303A-00-0192

Michael M. Grant
GALLAGHER & KENNEDY
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3099-0035/898296

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

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00- 0192 W-01032B-00- 0192 W-01032C-00- 0192 S-02276A-00- 0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00- 0192 W-01595A-00- 0192 W-01303A-00- 0192 SETTLEMENT AGREEMENT BETWEEN ARIZONA CORPORATION COMMISSION STAFF AND ARIZONA-AMERICAN WATER COMPANY

On March 24, 2000, Citizens Utilities Company (now known as Citizens Communications Company), its Agua Fria Water Division, its Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively, "Citizens") and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a joint application for the approval of the sale and transfer of Citizens water and wastewater utility plant, property and assets in Arizona, including transfer of Citizens' certificates of convenience and necessity

EXHIBIT A

("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

The Commission's Utilities Division Staff ("Staff") has investigated the application and has recommended that the application be approved by the Commission, subject, however, to certain conditions and requirements, which are set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has indicated that it is willing to accept the Staff Recommendations, with the exception of the recommendation that Citizens' advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") be imputed to Arizona-American.

Representatives of Staff and Arizona-American have had discussions concerning the matters in dispute with respect to the application and have reached a settlement. The purpose of this Settlement Agreement is to memorialize the agreement that has been made by and among Staff and Arizona-American, which resolves all areas of disagreement relating to the terms and conditions under which Citizens' Arizona water and wastewater assets and Citizens' Certificates may be transferred to Arizona-American.

1. AIAC Imputation; Amortization. As of December 31,1999, Citizens' AIAC balance was $80,818,669. Citizens' AIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American becomes responsible for the provision of water and wastewater services will be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of AIAC imputed will be adjusted as more particularly provided below. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place.

2. CIAC Imputation; Amortization. As of December 31, 1999, Citizens' CIAC balance was $4,734,430. Citizens' CIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American become responsible for the provision of water and wastewater services will also be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of CIAC to be imputed to Arizona-American will also be adjusted as provided below. The adjusted CIAC balance imputed to Arizona-American will be amortized above the line (i.e., as a reduction to depreciation expense) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place.

3. Adjustment to Recorded AIAC and CIAC Balances. The amounts of AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer, adjusted as follows: An amount equal to five percent (5%) of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance in computing the amounts to be imputed to Arizona-American for ratemaking purposes hereunder.

4. Adoption of Remaining Staff Recommendations. Arizona-American agrees that the Commission may adopt the remaining Staff Recommendations, as set forth in the Direct Testimony of Linda A. Jaress.

5. Deferral of Determination of Amortization Method. The parties agree that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

6. Transfer in the Public Interest. Based on the foregoing agreements

and understandings, Staff agrees that Arizona-American is a fit and proper entity to acquire the Certificates and that the Commission should authorize and approve the transfer of Citizens' Arizona water and wastewater assets to Arizona-American on the terms set forth herein. No additional terms, conditions or requirements are necessary or appropriate.

7. Support and Defend. This Settlement Agreement will be introduced as an exhibit during the hearing on the application, presently set for September 27, 2000. Arizona-American and Staff will jointly request that the Settlement Agreement be received into evidence, and agree to support and defend this Settlement Agreement and the transfer of Citizens' water and wastewater assets and the Certificates to Arizona-American on the terms set forth herein as just, reasonable and appropriate based on the particular circumstances presented in this application.

8. Compromise; No Precedent. This Settlement Agreement represents a compromise in the positions of the parties hereto. By entering into this Settlement Agreement, neither Staff nor Arizona-American acknowledges the validity or invalidity of any particular method, theory or principle of regulation, or agrees that any method, theory or principle of regulation employed in reaching a settlement is appropriate for resolving any issue in any other proceeding, including (without limitation) any issues that are deferred to a subsequent rate proceeding. Except as specifically agreed upon in this Settlement Agreement, nothing contained herein will constitute a settled regulatory practice or other precedent.

9. Privileged and Confidential Negotiations. All negotiations and other communications relating to this Settlement Agreement are privileged and confidential, and no party is bound by any position asserted during the negotiations, except to the extent expressly stated in this Settlement Agreement.

As such, evidence of statements that were made or other conduct occurring during the course of the negotiation of this Settlement Agreement is not admissible in any proceeding before the Commission or a court.

10. Complete Agreement. This Settlement Agreement represents the complete agreement of the parties with respect to its subject matter. There are no understandings or commitments other than those expressly set forth herein.

DATED this 26 day of September, 2000.

ARIZONA CORPORATION COMMISSION STAFF

By: _____
Steven M. Olea
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

ARIZONA-AMERICAN WATER COMPANY

By: _____
Norman D. James
FENNEMORE CRAIG
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Arizona-American Water Company

An original and 10 copies of the foregoing was delivered this ___ day of September, 2000, to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing was delivered this ___ day of September, 2000, to:

Karen E. Nally
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing
was telecopied/delivered and mailed this ___
day of September, 2000, to:

Daniel W. Pozefsky
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2828 North Central Avenue
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Craig A. Marks
Associate General Counsel
Citizens Communications Company
2901 N. Central, Suite 1660
Phoenix, AZ 85012
(602) 265-3415

By: _____

STEPHENSON DIR. EXH. 2

AMERICAN WATER WORKS - SHARED SERVICES CENTER
CITIZENS ACQUISITION
Final Acquisition Journal Entry - Arizona

F:\RATES\Arizona Citizens Rate Case\[AZ Czn Entries Fina

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1. RECORD UTILITY PLANT PURCHASED (Booked in Jan Based on Nov Info) JE2301, reclass debt JE231

230105.104000	Utility Plant Purchased/Sold	276,471,277		
230105.201200	Common Stock		110,888,158	
230105.221120	Bonds Inside		154,948,119	
230105.221100	Bonds Outside		10,635,000	

2. RECORD ACQUISITION - NET ASSETS

CZN record net assets	JE#			
230105.10400	Utility Plant Purchased/Sold		276,471,277	
230105.134100	Petty Cash	3,371		
230105.146100.001	A/R Other Manual (Notes Rec)	500,000		R
230105.141000	Accounts Receivable	1,723,245		R
230105.141000	Accounts Receivable-unexplained difference		71,151	
230105.144000	Unbilled Revenue	825,523		
230105.143000	Allowance for Doubtful Accounts		47,496	R
239902.241249.002	Collection for Others (agua fria)	27,730		
239902.241249.001	Collection for Others (agua fria)		27,730	
239903.241249.002	Collection for Others (Sun City)	9,027		
239903.241249.001	Collection for Others (Sun City)		9,027	
239901.241249.002	Collection for Others (Surprise)	382,751		
239901.241249.001	Collection for Others (Surprise)		382,751	
239905.241249.002	Collection for Others (Sabrosa)	4,952		
239905.241249.001	Collection for Others (Sabrosa)		4,952	
230105.146100.001	Misc A/R - Manual	581,849		R
230105.146100.001	Misc A/R - Manual	99,208		
230105.153000	Materials & Supplies-Stk E	30,557		
230105.165500	Prepaid Postage	896		R
230105.165500	Prepayments - Transition services	24,374		
230105.165500	Prepayments CAP Legal Services		2,500	
230105.105110.1 CZN X	Capital Exp. Invoices paid by Citizens	1,057,874		Exb I
238305.146100.001	Sabrosa Water Well Project	9,672		
236206.675000.2135	Sun City Main Repairs	5,654		
236406.675000.2135	Sun City West Main Repairs	195		
230105.101099	Utility Plant	272,822,609		
230105.101099	Utility Plant CBSC Assets	19,974		
230105.105110.1 CZN X	CWIP	6,110,694		
230105.108105	Accumulated Depreciation		55,775,969	
230105.108105	Accumulated Depreciation CBSC Assets		9,253	
230105.183000	Preliminary Survey & Investigation	663,525		R
230105.238010	Customer Deposits		143,867	R
238905.186898.DD230001 s	Ground Water Withdraw Fee	418		
236205.186898.DD230001 s	Ground Water Withdraw Fee		97,658	
236205.186898	DDA -Other	201,088		
236205.186898	DDA -Other	497,393		
236405.186898.DD230001 s	Ground Water Withdraw Fee		48,222	
236405.186898	DDA -Other		96,961	
236405.186898	DDA -Other	294,013		
236105.186898.DD230001 s	Ground Water Withdraw Fee		28,554	
236105.186898	DDA -Other	22,458		
236105.186898	DDA -Other		44,971	
236105.186898	DDA -Other	2,929,500		
230105.186898	DDN Other (regulatory assets)	1,392,615		R
230105.181110	Unamortized Debt Expense - outside	387,690		

230105.181110	Unamortized Debt Expense - outside	22,990	
230105.241998	Other Current Liability - analyzed		1,972,236.00
230105.236151	Accrued Property Taxes		886,624 sch
230105.252120	Advances for Const		23,364,564 sch
230105.262411	DCN - Advance Payments and Deposits Other		284,879 sch
230105.840000	Interest Exp Other	30,921	
230105.234300	A/P Misc. -Net Cash Payable		2,030,554
230105.114100	UPAA**	71,118,430	
		361,801,197	361,801,197

UPAA DETAIL

	Initial UPAA	
	Initial Cash Payment (line 5)	266,618,443
	Less: Net Assets Purchased	195,489,291
	Initial UPAA	71,129,152
	Difference	10,722
	CBSC Assets not on Citizen's AZ Balance sheet but should be according to the schedule	10,722 Part of IL workpapers

3. RECORD UTILITY PLANT DETAIL

GARY TO RECORD

230105.101099	Utility Plant (incl CBSC Assets)		272,842,583
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	

4. WRITE-OFF INVENTORY TO EXPENSE (CREDITED EXP WHEN LOADED)

CZN W/O Inventory #4		JE#	
230105.575000.16	Misc Oper Exp AG	30,557	
230105.153000	Material & Supplies		30,557

5. EXPENSE PREPAID POSTAGE

CZN - w/o prepaids#5		JE#	
230105.575000.16	Misc Expense	896	
230105.165500	Prepayments		896

6. EXPENSE PREPAID MOTOR VEHICLE TAXES AND CAP Legal

CZN - w/o prepaids#6		JE#	
230105.575000.16	Misc Exp	21,874	
230105.165500	Prepayments	2,500	
230105.165500	Prepayments		24,374

7. TO WRITE OFF UNBILLED REV.

CZN - w/o unbilled #7		JE#
236105.401120	Aqua Fria Res	120,069
236105.401220	Aqua Fria Comm	29,652
236105.401520	Aqua Fria OPA	24,609
236205.401120	Sun City Water - Res	211,176
236205.401220	Sun City Water - Comm	36,464
236405.401120	Sun City West - Res	107,910
236405.401220	Sun City West - Comm	22,191
237105.401120	Mohave - Res	115,155
237105.401220	Mohave - Comm	32,575
237105.401520	Mohave - OPA	4,601
237305.401120	Havasu Res	17,944
237305.401220	Havasu Comm	5,827
238305.401120	Distco Res	71,303

238305.401220	Distco Comm	9,753	
238905.401120	Tubac Res	13,783	
238905.401220	Tubac Comm	2,510	
230105.144000	Unbilled Revenue		825,523

8. CAPITAL INVOICES PAID BY CITIZENS NEED TASK ORDER NUMBERS

NO ENTRY NEEDED

Task Order	Anthem Valve Vaults Task Order 5	15,366	
Task Order	Anthem Water Treatment Plant Ph 3	51,093	
Task Order	Anthem Solids Handling Facility	344,109	
Task Order	Sun City West Reclaim Facilty	70,913	
Task Order	Sun Village Well #5	18,900	
Task Order	Sun Village Water Plant Mods	11,129	
Task Order	Sun Village SCADA	2,240	
Task Order	Sun City Grand Water Plant #1	7,990	
Task Order	Anthem Project Mana Phase 4	76,444	
Task Order	Anthem Water Campus WTP 4MGD	310,975	
Task Order	Anthem Water Campus Tank #2	3,757	
Task Order	AT/AF Interconnect	1,147	
Task Order	Oakmont Dr. Water Replace	1,965	
Task Order	Anthem Remote Vault Float Valve	7,410	
Task Order	Anthem Valve Replacement	5,124	
Task Order	Sun City West Service Replacements	5,916	
Task Order	Sun City Sewer Flo Mtr SCADA RTU	11,266	
Task Order	Water test Agua Fira	88	
Task Order	Water Test Sun City	70	
Task Order	Water Test Anthem	640	
Task Order	Sun City/Sun City West Grdwtr Svgs	3,016	
Task Order	Sun City/Sun City Wst Well Study	25,415	
Task Order	Whitestone Water Reclaim Fac	5,846	
Task Order	Anthem Finished Water Res.#2	47,735	
Task Order	Sun City Grand SCADA	1,560	
Task Order	99th & Olive Flow Meter	1,318	
Task Order	Sun Village Booster Station	3,494	
Task Order	Surprise Main Replace	1,520	
Task Order	Anthem Phase 2	1,851	
	SUB - TOTAL	1,038,299	
Need Task Order	Sun Valley Water Treatment Plant	19,575	Not On D. Baka's sheets
	Was on the PA line of Exhibit I should be AZ		
	TOTAL	**1,057,874**	

STEPHENSON DIR. EXH. 3

[09101] - Journal Entries

Functions Tools Help

Model (Y)

Reverse or Void (R/V)

Document Type: JE

Document Number/Co: 24545 00023

Explanation: RECLASS CITIZENS ORCOM CHARGES

G/L Date: 12/31/01

Batch Number 23054064 Home BU

Remaining

Ref 1

Skip to Line

Account No.	Subl/WO#	T	Amount	Explanation 2
230205.760715			607,722.55	
2302000E.105150.1	23002001	W	607,722.55-	

F5=Make New Model F6=% JE F15=Model JE's F13=Acct Master F24=More Keys MW

Citizens Business Services Company (CBSC)
Net Book Value of Assets - Banner System & Non Banner Items
At January 15, 2002

Category	Description	Capitalized Cost	Accumulated Depreciation	Est. Net Book Value	Allocated by State	
					Illinois	Arizona
	Furniture & fixtures:					
5	Office furniture	2,497	1,157	1,340	1,340	0
6	Work tables, files & storage cabinets	3,582	1,662	1,920	1,920	0
7	Copier	1,565	728	837	837	0
8	Facsimile machine	2,465	1,141	1,324	1,324	0
9	File server & software - Sun City, Az	19,974	9,253	10,721	0	10,721
9	File server & software - Harvey, LA	99,870	46,263	53,607	53,607	0
9	File server & software - Woodridge, IL	79,895	37,011	42,884	42,884	0
10	PCs and software	53,085	24,595	28,490	28,490	0
11	Misc.	2,465	1,141	1,324	1,324	0
12	PC credit services	7,056	3,271	3,785	3,785	0
	Total Furniture & Fixtures	272,454	126,222	146,232	135,511	10,721
	Data Center Implementation:					
13	HAVC System (50%)	58,276	27,000	31,276	31,276	0
14	UPS unit	81,342	37,677	43,665	43,665	0
15	Generator	99,337	46,018	53,319	53,319	0
16	Fire suppression system	44,442	20,589	23,853	23,853	0
17	Raised flooring	10,212	4,726	5,486	5,486	0
18	Equipment racks / workstations	33,989	15,748	18,241	18,241	0
19	Telephone / data wiring	22,144	10,256	11,888	11,888	0
	Total Data Center Implementation	349,742	162,014	187,728	187,728	0
20	Computer hardware HP 9000 & HP-UX	705,391	326,768	378,623	378,623	0
	Mailing Center Implementation:					
28	HVAC system (50%)	36,260	16,797	19,463	19,463	0
29	Ceiling tile	1,514	705	809	809	0
30	Carpet padding	404	184	220	220	0
31	Canape	3,082	1,425	1,657	1,657	0
	Total Mailing Center Implementation	41,260	19,111	22,149	22,149	0
32	Automated mailing system	316,328	146,541	169,787	169,787	0
33	Billing printer	202,150	93,647	108,503	108,503	0
						0
34	Postage meter	7,046	3,263	3,783	3,783	0
	Total Allocated Assets	1,894,371	877,566	1,016,805	1,006,084	10,721
	Assets Expected to Retain					
	Banner System	2,956,710	1,369,691	1,587,019		
	Other Unallocated Assets	138,601	64,194	74,407		
	Software License cost transferred from LGS 12/00	1,223,780	265,152	958,628		
	Total Retained Assets	4,319,091	1,699,037	2,620,054		
	Total CBSC Assets	6,213,462	2,576,603	3,636,859		

ARIZONA-AMERICAN WATER COMPANY
SPREAD OF ORCOM COSTS

Water / Wastewater	4 Factor Percentage	% of 4 Factor Percentage	Banner	Arizona	ORCOM
Mohave Water	1.791	4.34%	$113,730	$113,730	$70,348
Havasu Water	0.215	0.52%	$13,653	$13,653	$8,445
Tubac Water	0.143	0.35%	$9,081	$9,081	$5,617
Sun City Water	3.295	7.99%	$209,236	$209,236	$129,424
Sun City Sewer	2.579	6.25%	$163,769	$163,769	$101,300
Sun City West Water/Wstwtr	4.011	9.72%	$254,703	$254,703	$157,548
Aqua Fria	1.862	4.51%	$118,239	$118,239	$73,137
California Water	7.450	18.06%	$473,083		$0
Home Water	1.862	4.51%	$118,239		$0
CU Water of Penn	1.361	3.30%	$86,425		$0
Lake Heritage	0.143	0.35%	$9,081		$0
Blue Mountain	1.289	3.12%	$81,853		$0
Glen Alsace	1.003	2.43%	$63,692		$0
CUC Illinois	10.316	25.00%	$655,077		$0
Flowing Wells	0.143	0.35%	$9,081		$0
Ohio Utilities	2.221	5.38%	$141,036		$0
Citizens Water Resources Co. of AZ	0.931	2.26%	$59,119	$59,119	$36,568
Citizens Water Services Co. of AZ	0.645	1.56%	$40,958	$40,958	$25,335
	41.26	100.00%			
Total Banner Net Assets Retained			$2,620,054	$982,488	$607,722
Total ORCOM Costs					$607,722

STEPHENSON DIR. EXH. 4

Arizona-American Water Co.
Citizens Acqusition - Phase 3 Costs
As of September 30,2002

	2000	2001	2002		Total
Service Company Charges	165,778	235,692	217,655	$	619,125
Intergration Services (Consultants)			157,932	$	157,932
Miscellaneous (*data lines, office trailer rental)*		1,497	450	$	1,947
Notices to Customers		375	5,407	$	5,782
	167,778	239,564	383,445	$	784,784

F:\RATES\Arizona Citizens Rate Case\[Phase 3 Acquisition Costs.xls]Phase 3

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Account Ledger Print

Date - 9/25/02
Page - 1
From Date/Per 01/01/00
Thru Date/Per 12/31/00
Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	20608	02/29/00	Reclass 2/00 Service Co. Chrgs	14124	Batch Date 03/08/00	2,011.32		P User ID BBEINLIC
JE	405	03/31/00	Service Company Charges A#106,113,268,273	15043	Batch Date 04/05/00	27,296.79		P User ID MPATACSI
JE	405	04/30/00	Service Company Charges A#106,113,268,273	16469	Batch Date 05/02/00	35,842.17		P User ID MPATACSI
JE	20866	04/30/00	Reclass Mar.,00 Serv Co Chrgs	16469	Batch Date 05/02/00	822.51		P User ID MPATACSI
JE	405	05/31/00	Service Company Charges A#106,113,268,273	18080	Batch Date 06/05/00	12,907.91		P User ID ARIVERA
JE	405	06/30/00	Service Company Charges A#106,113,268,273	20131	Batch Date 07/06/00	54,847.50		P User ID MPATACSI
JE	405	07/31/00	Service Company Charges July 0 A#106,113,268,273	22002	Batch Date 08/03/00		4,038.25-	P User ID BBEINLIC
JE	405	08/31/00	Service Company Charges A#106,113,268,273	23686	Batch Date 09/06/00	12,287.88		P User ID MPATACSI
JE	405	09/30/00	Service Company Charges A#106,113,268,273	25338	Batch Date 10/07/00	6,022.32		P User ID DBAKA
JE	405	10/31/00	Service Company Charges A#106,113,268,273	27022	Batch Date 11/06/00	5,786.27		P User ID DBAKA
JE	405	11/30/00	Service Company Charges A#106,113,268,273	28379	Batch Date 12/05/00	3,944.81		P User ID DBAKA
JE	405	12/31/00	Service Company Charges A#106,113,268,273	30020	Batch Date 01/04/01	8,046.96		P User ID DBAKA
						169,816.44	4,038.25-	

---- Account Balances ----

Ledger Total	165,778.19
Unposted	
Year-to-Date	165,778.19
Cumulative	165,778.19

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Account Ledger Print

Account 23050.760715 Merger Costs Phase 3

Date - 9/25/02
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From Date/Per 01/01/01
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	405	01/31/01	Service Company Charges A#106,113,268,273	32855 Batch Date 02/07/01		13,980.82		P User ID DBAKA
JE	405	02/28/01	Service Company Charges A#106,113,268,273	34637 Batch Date 03/06/01		8,400.76		P User ID DBAKA
JE	405	03/31/01	Service Company Charges A#106,113,268,273	36299 Batch Date 04/04/01		7,732.01		P User ID DBAKA
JE	405	04/30/01	Service Company Charges	38086 Batch Date 05/02/01		8,353.84		P User ID MPATACSI
JE	405	05/31/01	Service Company Charges	40082 Batch Date 06/05/01		1,224.37		P User ID DBAKA
JE	405	06/30/01	Service Company Charges	42149 Batch Date 07/05/01		609.09		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		895.92		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		3,535.69		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			471.88-	P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			1.18-	P User ID DBAKA
JE	405	08/31/01	Service Company Charges	46074 Batch Date 09/06/01		19,930.36		P User ID DBAKA
JE	405	09/30/01	Service Company Charges	47791 Batch Date 10/04/01		29,575.23		P User ID DBAKA
CC	46250	10/31/01	JAMES M CAMPBELL SERIOUS SIGNS	49402 Batch Date 11/02/01		86.08		P User ID DBAKA
JE	405	10/31/01	Service Company Charges	49657 Batch Date 11/06/01		48,506.95		P User ID DBAKA
PV	5501	11/15/01	WOODENSHIP BILLING CHG PSTCRD: SURPSE AZ	50586 Batch Date 11/15/01		375.00		P User ID DBAKA
PV	5563	11/28/01	QWEST - POB 2348 (CITIZENS) PREWIRE @ 11102 W ROSE GARDEN	50917 Batch Date 11/28/01		90.36		P User ID DBAKA Invoice 200233
JE	405	11/30/01	Service Company Charges	51279 Batch Date 12/04/01		36,592.11		P User ID DBAKA Invoice A682306
PV	5689	12/14/01	UNITED RENTALS (formerly Woude OFFICE TRAILER RENTAL	52310 Batch Date 12/14/01		426.63		P User ID DBAKA
PV	5690	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		225.86		P User ID DBAKA Invoice 21818444-001
PV	5693	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		270.04		P User ID DBAKA
PV	5739	12/26/01	QWEST - POB 29060 (480...636B, CITIZENS SERVICE: 11/28-12/27	52624 Batch Date 12/26/01		120.90		P User ID DBAKA
JE	395	12/31/01	Special Accounts Payable AT&T - Citizens	53086 Batch Date 01/04/02		27,256.97		P User ID DBAKA Invoice 6235727003564B
JE	405	12/31/01	Service Company Charges	52958 Batch Date 01/03/02		29,570.56		P User ID DBAKA
JE	24545	12/31/01	RECLASS CITIZENS ORCOM CHARGES	54064 Batch Date 01/10/02		607,722.55		P User ID DBAKA
PV	5778	12/31/01	UNITED RENTALS (formerly Woude	52935		276.63		P User ID DBAKA

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Account Ledger Print

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P
-
User ID DBAKA
Invoice 21919444-002

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit
			RENT: 16 FT OFFICE TRAILER	Batch Date 01/03/02			
						845,758.73	473.06-

---- Account Balances ----

Ledger Total	845,285.67
Unposted	
Year-to-Date	845,285.67
Cumulative	845,285.67

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Account Ledger Print

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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 230105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO# .	Debit	Credit	
PV	40068645	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,509.28		P - P User ID SCHAFFCE
PV	40068654	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,897.51		Invoice CAWW00602 P User ID SCHAFFCE
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		149,699.60		Invoice CAWW00302 P User ID TUMANEW
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		8,231.91		P User ID TUMANEW
JE	2312	09/30/02	Reclass Citizens Phase 3	2169053 Batch Date 09/17/02		217,333.01		P User ID TUMANEW
						380,671.31		

---- Account Balances ----

Ledger Total	380,671.31
Unposted	
Year-to-Date	380,671.31
Cumulative	380,671.31

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Account Ledger Print

Date - 9/25/02
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From Date/Per 01/01/02
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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 230205.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO# .	Debit	Credit	
JE	66	01/31/02	record awws bill	478862		321.69		P
				Batch Date 02/06/02				-
JE	66	02/28/02	record awws bill	665000				P
				Batch Date 03/05/02				User ID RUSSOTL
								P
								User ID RUSSOTL
						321.69		

---- Account Balances ----

Ledger Total	321.69
Unposted	
Year-to-Date	321.69
Cumulative	321.69

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Account Ledger Print

Date - 9/25/02
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From Date/Per 01/01/02
Thru Date/Per 12/31/02
Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 236105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
PV	40043671	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P - P User ID DIETZMDP Invoice DR2447
PV	40043684	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2446
PV	40043686	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELL	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2445
						450.00		

---- Account Balances ----

Ledger Total	450.00
Unposted	
Year-to-Date	450.00
Cumulative	450.00

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalized.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

These expenses are to be capitalized. These costs were incurred to enable Citizens data to usable for rate case

STEPHENSON DIR. EXH. 5

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$ 5,153,711			
2					
3					
4			4 Factor Formula		Management Fee
5	**Location**		**Factor**		**Allocation**
6					
7	Mohave Water, Havasu Water		0.1157	$	596,284
8	Mohave Sewer		0.0070		36,076
9	Sun City Water		0.1797		926,122
10	Sun City Sewer		0.1014		522,586
11	Sun City West Water		0.1001		515,886
12	Sun City West WasteWater		0.1072		552,478
13	Agua Fria, CWS, CWR Water		0.2300		1,185,353
14	CWS, CWR Sewer		0.0558		287,577
15	Tubac Valley		0.0075		38,653
16					
17					
18	TOTAL CUSTOMER COUNT		0.9044	$	4,661,016
19					
20					
21					

Arizona American - Management Fees Allocations

Line No.					
1	Annual Management Fee	$ 5,153,711			
2					
3					
4			4 Factor Formula		Management Fee
5	**Location**		**Factor**		**Allocation**
6					
7	Mohave Water		0.1011	$	521,040
8	Havasu Water		0.0146		75,244
9	Mohave Sewer		0.0070		36,076
10	Sun City Water		0.1797		926,122
11	Sun City Sewer		0.1014		522,586
12	Sun City West Water		0.1001		515,886
13	Sun City West WasteWater		0.1072		552,478
14	Agua Fria		0.1384		713,274
15	CWS/CWR Water		0.0916		472,080
16					-
17	CWS/CWR Sewer		0.0558		287,577
18					-
19	Tubac Valley		0.0075		38,653
20					
21					
22	TOTAL CUSTOMER COUNT		0.9044	$	4,661,016
23					
24					
25					

Management Fees
per168 Line 13

		Actual								Forecast		
		January	February	March	April	May	June	July	ytd	Apr-July	2002 YE Forecast	Annual Est
Arizona		22,441	215,344	396,649	429,178	471,821	396,921	451,837	2,384,191	437,439	4,571,367	5,249,271
per Dbaka amnt includes Amort OneTime Costs	Call Ctr				(4,295)	(4,295)	(6,681)	(6,681)	(21,951)			
	SSC			(5,881)	(1,960)	(2,312)	(2,815)	(2,815)	(15,784)			
per168 Line 13 less Amort One Time Costs		22,441	215,344	390,768	422,923	465,214	387,425	442,341	2,346,456	429,476	4,493,836	5,163,711

Customers

	Current
AZ Total Water	74,325
AZ Total Sewer	40,198
Total Customers	114,523

Customers

Per JDE STAT Report	Total	Residential	Commercial	Industrial	Fire	OPA	Resale
Paradise Valley	4,669	4,350	239	-	55	6	19
WhiteStone Water	-						
WhiteStone WasteWater	-						
Agua Fria - Water	13,566	13,271	246	-	44	1	4
Sun City Water	22,068	21,118	713	-	113	123	1
Sun City WasteWater	21,144	20,696	448				
Sun City West Water	15,303	14,925	337	-	41	-	-
Sun City West WasteWater	14,889	14,697	192				
Treatco Water	46	1	5	-	-	40	
Treatco WasteWater	7	1	4	-	-	2	
Distco Water	3,307	3,208	83	-	16		
Distco WasteWater	3,593	3,557	36				
Tusayan	-						
Surprise Water	23	15	8				
Cave Creek	-						
Tubac Water	488	426	62				
Mohave Water	13,623	12,741	696	-	98	88	-
Sorenson WasteWater	565	558	5	-	-	2	
Havasu Water	1,232	1,184	48				
Havasu WasteWater	-						
Check total	114,523						

Agua Fria (2361) Count	9	400,368
Cave Creek (2388) Count	1	44,485
Corporate (2301) Count	15	667,280
Distco (2383) Count	4	177,941
Distco Waste Water(2384) Count	2	88,971
Havasu (2373) Count	3	133,456
Mohave (2371) Count	16	711,766
Paradise Valley (2302) Count	10	444,853
Sun City (2362) Count	42	1,868,385
Sun City West (2364) Count	6	266,912
Sun City West Waste (2365) Count	9	400,368
Tubac (2389) Count	1	44,485
Grand Count	118	5,249,270

STEPHENSON DIR. EXH. 6

ARIZONA-AMERICAN WATER COMPANY
FOUR FACTOR ALLOCATION

DISTRICT/CO.	PLANT IN SERVICE	GENERAL METERED CUSTOMERS	SALARIES & WAGES	DIRECT O&M EXPENSES (EXCLUDE PR)	4 Factor Allocation %
SUN CITY SEWER DISTRICT/CO.	12,612,288 5.1853%	21,144 18.4614%	170,492 2.8744%	2,110,347 14.0583%	10.14%
SUN CITY WEST WASTE WATER DISTRICT/CO.	24,836,561 10.2111%	14,889 13.0000%	656,756 11.0727%	1,291,160 8.6012%	10.72%
MOHAVE (SORENSON) DISTRICT/CO.	1,742,120 0.7162%	565 0.4933%	66,444 1.1202%	71,876 0.4788%	0.70%
DISTCO/TREATCO SEWER DISTRICT/CO.	21,774,316 8.9521%	3,600 3.1433%	341,267 5.7537%	673,393 4.4859%	5.58%
SUN CITY WATER DISTRICT/CO.	28,533,245 11.7309%	22,068 19.2681%	1,248,678 21.0523%	2,973,822 19.8104%	17.97%
SUN CITY WEST WATER DISTRICT/CO.	24,724,945 10.1652%	15,303 13.3614%	494,526 8.3376%	1,226,276 8.1690%	10.01%
TUBAC VALLEY DISTRICT/CO.	1,450,789 0.5965%	488 0.4261%	84,319 1.4216%	85,010 0.5663%	0.75%
MOHAVE WATER DISTRICT/CO.	15,573,103 6.4026%	13,623 11.8946%	907,831 15.3057%	1,024,583 6.8254%	10.11%
HAVASU DISTRICT/CO.	1,447,094 0.5949%	1,232 1.0757%	184,457 3.1099%	157,357 1.0482%	1.46%
AGUA FRIA DISTRICT/CO.	49,451,561 20.3311%	13,589 11.8649%	688,562 11.6089%	1,731,272 11.5330%	13.84%
DISTCO/TREATCO WATER DISTRICT/CO.	39,161,570 16.1005%	3,353 2.9276%	626,309 10.5594%	1,059,889 7.0605%	9.16%
PARADISE VALLEY DISTRICT/CO.	21,923,699 9.0135%	4,677 4.0836%	461,666 7.7835%	2,606,438 17.3630%	9.56%
ARIZONA TOTAL	243,231,291	114,531	5,931,307	15,011,423	100.00%

STEPHENSON DIR. EXH. 7

ARIZONA-AMERICAN WATER COMPANY
2002 General Rate Case Application
Rate Case Expense

Estimated Rate Case Expense for Current Rate Case Application:

Consultants			
(see detail)			$608,000
Employee Cost per Day			
Hotel	$	105	
Airfare	$	50	
Food	$	30	
Miscellaneous	$	15	
Cost/Day	$	200	

AWWS Co. Employees		Cost/Day	Days	# Emps		Total $$	
Filing	$	200	1	1	$	200	
System Tour	$	200	3	3	$	1,800	
Stipulation Meeting	$	200	1	2	$	400	
Hearings	$	200	10	5	$	10,000	
Commission Conference	$	200	2	2	$	800	
Public Meetings (1)	$	200	4	2	$	1,600	
Public Meetings (2)	$	200	4	4	$	3,200	
Total							$ 18,000

Mailings, Printings, Supplies & Miscellaneous	$80,000
Total Estimated Rate Case Expense	$706,000
Amortization Period (In Years)	3
Normalized Annual Rate Case Expense	$235,333
Recorded Rate Case Expense Per General Ledger	
Rate Case Expense Adjustment	$235,333

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 8

per168 Actual (no Svc Co Expenses included)

Arizona	January	February	March	April	May	June	July	YTD	Forecast *avg other than Mar-July Mar-July Monthly Avg	YE Forecast	Annual Est				
	Actual														
Directors Fees			-	-	1,250	-	1,250	2,500	500	5,000	6,000	CC	MISC	6,000	
Bank Svc Charges CA	-	1,390	5,794	1,304	796	3,389	925	13,599	2,442	25,807	29,299	CC	OFFICE		
Bill Inserts -CA	-		440		-	925	-	1,364	341	3,070	4,095	CC	OFFICE		
Collection Agencies						-	145	145	73	508	870	CC	OFFICE		
Bank Svc Chg AG	-	306	-	-	-	235	-	541	47	776	564	CC	OFFICE		
Forms			1,295	365	3,524	172	1,758	7,114	1,423	14,228	17,074	CC	OFFICE		
Required Notifications		100	8,160	-	78,781	3,193	5,819	96,053	19,191	192,006	230,287	CC	OFFICE		
Bill Inserts AG			-	-	10,600	-	70	10,670	2,134	21,340	25,608	CC	OFFICE		
Brochures and Handouts			834	-	-	-		834	209	1,877	2,502	CC	OFFICE		
Community Relations			76	1,786	699	-	660	3,220	644	6,441	7,730	CC	OFFICE		
Postage CA			31	199	90,401	18,939	27,910	137,481	27,496	274,961	329,952	CC	OFFICE	647,981	
Incentive Plan	1,290	1,290	16,863	20,280	14,196	17,256	25,830	97,004	18,885	191,429	226,820	EE	S&W		
Group Insurance	32,598	30,669	60,198	83,721	24,043	47,051	44,214	322,495	51,845	581,722	622,145	EE	S&W		
PBOP	5,295	3,826	104,922	32,363	25,950	28,133	27,388	227,879	28,459	370,172	341,502	EE	S&W		
Wrks Comp	880	484	(196)	3,749	(7,845)	(1,317)	(2,333)	(6,578)	(1,588)	(14,520)	(19,061)	EE	S&W		
Dues/Memberships Deduct		697	973	362	170	(170)	170	2,202	301	3,707	3,612	EE	S&W		
Dues/Memberships NonDeduct		40	147	53	546	(389)	770	1,167	225	2,294	2,705	EE	S&W		
Employee Exp		175	3,716	11,498	32,963	(10,476)	10,313	48,189	9,603	96,203	115,234	EE	S&W		
Employee Exp Conf/Registration			1,067	770	1,373	2,294	4,744	10,249	2,050	20,497	24,595	EE	S&W		
Meal/Travel		239	1,773	4,478	10,818	(3,693)	3,190	16,805	3,313	33,371	29,768	EE	S&W		
Other Welfare			120	472	799	559	335	2,285	541	4,991	6,495	EE	S&W		
Employee Awards					42	-		42	21	147	252	EE	S&W		
Employee Physicals			270	205	79	60		614	154	1,382	1,842	EE	S&W		
Tuition			1,620	2,430	5,906	(3,396)	5,738	12,298	2,460	24,598	29,515	EE	S&W		
Training			530	170	2,263	(1,846)	9,224	10,341	2,068	20,682	24,818	EE	S&W		
401K	297	5,732	5,898	8,674	5,876	5,217	5,377	37,070	6,208	68,112	74,501	EE	S&W		
ESOP	2,045	7,491	7,522	10,724	6,834	6,703	6,450	47,769	7,647	86,002	91,759	EE	S&W	1,586,293	1,586,293
Trustee Fees		1,600	1,243	1,243	1,610	1,233	1,600	8,528	1,422	15,636	17,066	PFP	MISC	17,058	23,058
Credit Line Fees	101	103	1,094	369	215	1,166	634	3,683	696	7,161	8,347	PFP	OFFICE	8,347	1,293,829
General Liab Insurance, Property	2,509	2,509	3,169	2,509	2,674	5,608	3,263	22,241	3,445	39,464	41,335	RB	INS	41,335	258,736
Security Svc CA				1,005	460	458	449	2,372	593	5,357	7,116	RB	OFFICE		
Security Svc		15,516	44,104	52,184	90,296	32,047	44,029	278,177	52,532	540,837	630,384	RB	OFFICE	637,500	
Insurance Other, Gen. Liability	1,911	2,311	1,911	14,511	23,509	20,036	14,411	69,597	18,117	160,181	217,401	RB	INS	217,401	
Co Dues/Memberships Deduct		190	2,500	2,020	-	(1,990)	4,211	6,931	1,348	13,672	16,176				
Co Dues/Memberships NonDeduct			495	8,501	340	2,700		12,036	3,009	27,081	36,108				
Co Dues/Memberships AWWA Deduct			30	108	-	156		294	74	662	882				
Co Dues/Memberships AWWA NonDeduct			443	152	-	54		649	162	1,460	1,947				
Charitable Contributions Deduct				450	533	(108)		875	292	2,333	3,500				
Charitable Contributions NonDeduct				100	100	-		200	67	533	800				
Property Taxes	23,403	23,403	23,403	24,553	773,403	174,471	174,471	1,217,107	174,471	2,089,462	2,093,652		**TOTAL**	**3,161,915**	**3,161,915**

STEPHENSON DIR. EXH. 9

Acquisition Adjustment Analysis

CITIZENS

BOY Balance	BOY	Amortization	EOY	Tax Dep	Def Tax	Acc Def Tax	AVERAGE	Revenue Requirement	Total Revenue Requirement
	71,631,081								
0									
1	71,631,081	$141,500	71489581	4775405	1807223	1807223	70660000	7555000	$7,555,000
2	71489581	$156,400	71333181	4775405	1801412	3608635	68700000	7364000	$7,364,000
3	71333181	$172,800	71160381	4775405	1795016	5403651	66740000	7175000	$7,175,000
4	71160381	$190,900	70969481	4775405	1787957	7191608	64770000	6986000	$6,986,000
5	70969481	$211,000	70758481	4775405	1780118	8971726	62780000	6798000	$6,798,000
6	70758481	$233,100	70525381	4775405	1771499	10743225	60780000	6610000	$6,610,000
7	70525381	$257,600	70267781	4775405	1761944	12505169	58770000	6423000	$6,423,000
8	70267781	$284,600	69983181	4775405	1751414	14256583	56740000	6237000	$6,237,000
9	69983181	$314,400	69668781	4775405	1739792	15996375	54700000	6053000	$6,053,000
10	69668781	$347,400	69321381	4775405	1726922	17723297	52640000	5870000	$5,870,000
11	69321381	$383,900	68937481	4775405	1712687	19435984	50550000	5687000	$5,687,000
12	68937481	$424,100	68513381	4775405	1697009	21132993	48440000	5506000	$5,506,000
13	68513381	$468,600	68044781	4775405	1679654	22812647	46310000	5327000	$5,327,000
14	68044781	$517,800	67526981	4775405	1660466	24473113	44140000	5149000	$5,149,000
15	67526981	$572,100	66954881	4775405	1639289	26112402	41950000	4973000	$4,973,000
16	66954881	$632,200	66322681	0	-246558	25865844	40650000	4897000	$4,897,000
17	66322681	$698,500	65624181	0	-272415	25593429	40240000	4920000	$4,920,000
18	65624181	$771,800	64852381	0	-301002	25292427	39800000	4947000	$4,947,000
19	64852381	$852,700	63999681	0	-332553	24959874	39300000	4976000	$4,976,000
20	63999681	$942,200	63057481	0	-367458	24592416	38750000	5008000	$5,008,000
21	63057481	$1,041,000	62016481	0	-405990	24186426	38150000	5043000	$5,043,000
22	62016481	$1,150,300	60866181	0	-448617	23737809	37480000	5082000	$5,082,000
23	60866181	$1,270,900	59595281	0	-495651	23242158	36740000	5125000	$5,125,000
24	59595281	$1,404,300	58190981	0	-547677	22694481	35920000	5173000	$5,173,000
25	58190981	$1,551,600	56639381	0	-605124	22089357	35020000	5226000	$5,226,000
26	56639381	$1,714,400	54924981	0	-668616	21420741	34030000	5285000	$5,285,000
27	54924981	$1,894,300	53030681	0	-738777	20681964	32930000	5349000	$5,349,000
28	53030681	$2,093,000	50937681	0	-816270	19865694	31710000	5420000	$5,420,000
29	50937681	$2,312,600	48625081	0	-901914	18963780	30370000	5499000	$5,499,000
30	48625081	$2,555,200	46069881	0	-996528	17967252	28880000	5585000	$5,585,000
31	46069881	$2,823,300	43246581	0	-1101087	16866165	27240000	5681000	$5,681,000
32	43246581	$3,119,500	40127081	0	-1216605	15649560	25430000	5787000	$5,787,000
33	40127081	$3,446,800	36680281	0	-1344252	14305308	23430000	5905000	$5,905,000
34	36680281	$3,808,400	32871881	0	-1485276	12820032	21210000	6034000	$6,034,000
35	32871881	$4,207,900	28663981	0	-1641081	11178951	18770000	6177000	$6,177,000
36	28663981	$4,649,400	24014581	0	-1813266	9365685	16070000	6335000	$6,335,000
37	24014581	$5,137,200	18877381	0	-2003508	7362177	13080000	6509000	$6,509,000
38	18877381	$5,676,100	13201281	0	-2213679	5148498	9780000	6702000	$6,702,000
39	13201281	$6,271,700	6929581	0	-2445963	2702535	6140000	6916000	$6,916,000
40	6929581	$6,929,600	-19	0	-2702544	-9	2110000	7151000	$7,151,000
		71631100	2164820740	71631075			1551900000	234445000	$234,445,000

Cost of Debt	4.9200%	Tax Life	15
Cost of Equity	11.5000%	Tax Rate	39.00%
Debt Percent	60.0000%		
Equity Percent	40.0000%		
Weighted Cost of Debt	2.9520%		
Weighted Cost of Equity	4.6000%		
Tax Gross Up	1.639		
TOTAL REVENUE GROSS UP	10.4914%		

Premium Defined

Allocated Purchase Price	276471277
Total Value of Assets	205246727
Gross Premium	71224550
Capitalized Expenses	500000
Corporate Costs	906531
Net Premium	71631081

STEPHENSON DIR. EXH. 10

Exhibit A

Estimated Net Asset Adjustment
Arizona Water Property Detail
As of 11/01

	Mohave	Havasu	Sun City Water	SunCity Sewer	Tubac Valley	Agua Fria	Sun City West	TreatCo	Distco	Citizens Public Works of AZ	Citizens Cons Serv.-Mohave	Citizen Wtr Resc Mgt Sv C	Citizens Business Services (CBSC)	Total Az. Water by Property	EXCL. CBSC Total Az. Water by Property
Petty Cash	$ 1,321	$ -	$ 2,050	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,371	$ 3,371
Notes Receivable	-	-	-	-	-	500,000	-	-	-	-	-	-	-	500,000	500,000
Accounts Receivable	467,298	45,069	787,008	297,124	26,611	674,506	572,212	54,229	336,635	-	3,951	-	-	3,264,645	3,264,645
Accounts Receivable - Other	-	-	10,417	217	-	334,011	-	63,617	150,533	485,586	-	-	-	1,044,381	1,044,381
Reserve for Doubtful Accounts	(25,168)	(1,257)	(2,975)	-	(65)	(6,438)	(375)	(433)	(10,992)	-	-	-	-	(47,723)	(47,723)
Material & Supplies	-	-	-	-	-	-	-	-	-	26,354	-	-	-	26,354	26,354
Special Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Prepayments	1,000	2,415	91,730	-	1,254	99,049	50,998	5,930	-	-	-	-	3,751	256,127	252,376
Other Current Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Current Assets	444,451	46,227	888,230	297,341	27,780	1,601,130	622,835	123,343	476,176	511,940	3,951	-	3,751	5,047,155	5,043,404
Property Plant and Equipment	24,069,880	1,977,535	39,037,505	17,299,171	1,963,983	52,850,104	69,366,422	42,805,257	11,416,286	-	-	-	6,213,462	266,999,605	260,786,143
Construction Work in Progress	837,185	19,312	379,860	797,889	22,860	1,412,832	320,279	13,270,295	318,324	3,332	-	-	-	17,382,168	17,382,168
Accumulated Depreciation	(7,507,773)	(510,030)	(13,822,745)	(6,697,853)	(564,559)	(4,402,369)	(19,271,951)	(1,994,695)	(245,397)	-	-	-	(2,426,277)	(57,443,649)	(55,017,372)
Net Fixed Assets	17,399,292	1,486,817	25,594,620	11,399,207	1,422,284	49,860,567	50,414,750	54,080,857	11,489,213	3,332	-	-	3,787,185	226,938,124	223,150,939
Preliminary Survey & Investigation	-	-	385,769	-	-	-	268,836	-	-	-	-	-	-	654,605	654,605
Other Deferred Debits	-	-	585,288	-	533	2,921,537	139,137	-	100	-	-	-	-	3,646,595	3,646,595
Regulatory Assets	234,640	24,786	655,877	145,771	4,596	109,279	217,666	-	-	-	-	-	-	1,392,615	1,392,615
Unamortized Debt Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Non-Current	234,640	24,786	1,626,934	145,771	5,129	3,030,816	625,639	-	100	-	-	-	-	5,693,815	5,693,815
	$ 18,078,383	$ 1,557,830	$ 26,109,784	$ 11,842,319	$ 1,455,193	$ 54,492,513	$ 51,663,224	$ 54,204,200	$ 11,965,489	$ 515,272	$ 3,951	$ -	$ 3,790,936	$ 237,679,094	$ 233,888,158
Accounts Excluded:															
Cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
InterCompany Receivables	(9,633,765)	(681,563)	10,223,590	17,790,427	(405,108)	(18,008,861)	8,245,593	(32,066,952)	(1,999,397)	992,686	(1,357,696)	(650,696)	(3,874,841)	(31,426,583)	(27,551,742)
Clearing Accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment in Associate Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	(59,014)	(353)	(75,877)	(144,389)	(239)	(54,982)	(189,807)	(368,679)	(36,039)	(5,178)	-	-	(17,161)	(951,718)	(934,557)
Customers' Deposits	(106,858)	(10,905)	(1,575)	-	(410)	(18,059)	(1,750)	(1,600)	(2,736)	-	-	-	-	(143,893)	(143,893)
Income Taxes Accrued	(489,872)	(50,695)	(142,492)	(319,665)	(13,456)	(840,837)	(5,944)	(265,783)	170,736	(260,115)	187,588	-	-	(2,030,535)	(2,030,535)
Other Taxes Accrued	(225,880)	(17,857)	(183,547)	(82,173)	(13,087)	(289,104)	(176,866)	(61,998)	(20,240)	(1,651)	-	-	(373)	(1,072,776)	(1,072,403)
Interest Accrued	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Current & Accrued Liabilities	-	-	(11,682)	(1,932,421)	-	(308,402)	-	-	-	(422,125)	-	-	-	(2,674,630)	(2,674,630)
Subordinate Investment Note	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Customer Advances for Construction	(4,302,830)	(440,351)	(2,443,976)	(3,468,190)	(180,250)	(31,985,339)	(29,648,102)	(19,215,739)	(10,682,471)	-	-	-	-	(102,367,248)	(102,367,248)
Deferred Income Taxes	486,537	111,894	(1,794,889)	(356,822)	19,763	(978,964)	(2,162,338)	-	-	-	-	-	-	(4,674,819)	(4,674,819)
Regulatory Liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment Tax Credit	(84,565)	-	(386,710)	(179,806)	(16,477)	(94,636)	(1,148,406)	-	-	-	-	-	-	(1,910,600)	(1,910,600)
Other Deferred Credits	-	(12,327)	-	-	-	-	-	-	-	-	-	-	-	(12,327)	(12,327)
Contributions in Aid of Construction	(2,962,599)	(259,451)	(1,020,713)	(1,021,182)	(135,527)	(692,359)	(1,040,772)	-	-	-	-	-	-	(7,132,603)	(7,132,603)
Equity	(699,537)	(196,222)	(32,271,913)	(22,128,098)	(710,402)	(1,220,970)	(25,534,832)	(2,223,449)	604,658	(818,889)	1,166,157	650,696	101,439	(83,281,362)	(83,382,801)
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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Water Company

BEFORE THE ARIZONA CORPORATION COMMISSION

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 TUBAC WATER DISTRICT.	DOCKET NO. W-01303A-02-_____

DIRECT TESTIMONY

OF

DAVID P. STEPHENSON

EXHIBIT
A-68
Admitted

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rate applications, including the National Association of Regulatory Utility Commissioners (NARUC) biannual Utility Rate Seminar.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have been employed by the American Water System since 1978. The various positions I have held within the American Water System are: Accountant - 1978; Accounting Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for the operating utilities in the Western Region - 1983; Assistant Director of Rates and Revenues for the operating utilities in the Western Region - 1984; Director of Rates and Revenues for the operating utilities in the Western Region - 1986, and Director of Rates and Planning for the operating utilities in the Western Region since 2001.

Q. HAVE YOU HAD ANY OTHER PROFESSIONAL EXPERIENCES?

A. Yes, I served on the Accounting Committee of the California Water Association and have been an instructor at the NARUC biannual Utility Rate Seminar on eight occasions.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE UTILITY REGULATORY COMMISSIONS?

A. Yes, I have testified before the Arizona Corporation Commission ("Commission") in rate and acquisition proceedings for Arizona-American; before the California Public Utilities Commission on many occasions for all of the California-American Water Company systems; and before the New Mexico Public Regulation Commission in many types of proceedings on behalf of New Mexico-American Water Company.

II. <u>PURPOSE OF TESTIMONY, SUMMARY AND CONCLUSIONS</u>

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

A. The purposes of my testimony are to: (1) identify and explain the Company's rate filing; (2) provide background concerning the purchase of the former Citizens Communications' water and wastewater utility assets in Arizona ("Citizens' Assets") by Arizona-American (the Citizens' Acquisition); (3) explain and support various adjustments made to the test period actual results; (4) explain and support all components of the capital structure except for cost of equity; and (5) to discuss the specific requirements set forth in Decision 63584 (April 24, 2001), which authorized Arizona-American to purchase the Citizens' Assets ("Acquisition Decision").

Q. WHAT DO YOU MEAN THE "COMPANY'S RATE FILING"?

A. I mean the five (5) separate applications for rate relief being filed with the Commission in 2002. This filing follows our efforts to determine the best approach to file rate applications for a substantial number of systems in a manner that would make the most sense for both public presentation and ease of handling for the Commission's Utilities Division Staff ("Staff").

Q. YOU ALSO USED THE TERM "SYSTEM." ARE YOU REFERRING TO "SYSTEM" IN A LEGAL OR OTHER SPECIFIC SENSE?

A. No, I am using the term "system" in a more general sense. By way of background, as I mentioned earlier, Arizona-American acquired all of the water and wastewater assets of Citizens in Arizona in a transaction that closed earlier this year. Previously, Citizens' Assets were under a different ownership structure with a number of separate corporate entities, such as Sun City Water Company, Sun City West Utilities Company or the Agua Fria Water Division of Citizens Communications Company, for example. However, Arizona-American acquired only the assets – not the stock. Therefore, the assets were removed from separate ownership and now all fall under the ownership umbrella of Arizona-American.

Q. HOW DOES ARIZONA-AMERICAN REFER TO THESE SEPARATE GROUPS OF ASSETS INTERNALLY?

A. Generally we use the term "district" to refer to a separate area within Arizona-American where, for accounting purposes, we individually account for revenues and expenses, and maintain separate balance sheets. These areas generally coincide with areas where the same tariffs apply and in that sense, a district could be identified as a "tariffed area." Of course, reference to the "Tubac water tariffed area" or the "Sun City West water tariffed area" would be awkward, and for purposes of the Company's rate filing, we basically use the terms "district" or "system" interchangeably and neither is intended to denote the actual name of any particular corporate entity or to designate an operational or other system as such term is used by ADEQ or any other regulatory agency to identify water or wastewater systems in Arizona.

Q. THANK YOU MR. STEPHENSON. WOULD YOU PLEASE CONTINUE WITH YOUR DISCUSSION OF HOW THE COMPANY ULTIMATELY DECIDED THE BEST WAY TO ORGANIZE THE COMPANY'S RATE FILING?

A. Certainly, again from a public perspective, it was determined that it made sense to file separate applications for the Sun City and Sun City West districts. These four districts, two water and two wastewater systems, are relatively large in size and have certain unique characteristics and circumstances that distinguish them from the other Arizona systems. The third application consists of two water systems in Mohave County, the Mohave water district, which provides water service in the vicinity of Bullhead City, and the Havasu water district, which provides service near Lake Havasu City. These systems are close together and operated by essentially the same Company personnel. The fourth application being filed is the

combination of Agua Fria water district and the water and wastewater systems serving the Anthem development in Maricopa County. These utility systems primarily serve recent developments and have very similar operating procedures. The final application is for the small Class C water system known as the Tubac water district in Santa Cruz County. This system is distinctive based on its small size, limited revenues and location. Again, for convenience, I will sometimes refer to the five applications as the Company's rate filing. And, again, I want to emphasize that the terms "system" and "district" should be considered synonymous throughout the Company's rate filing.

Q. ALL OF THESE DISTRICTS OR SYSTEMS ARE PART OF THE CITIZENS' ACQUISITION, CORRECT?

A. That is correct. I should also note that none of the former Citizens' systems have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company last rate order was issued in May 1997 based on test years ending March 31, 1995. Decision No. 60172 (May 7, 1997).[1] Citizens Mohave Water and Wastewater Divisions last received rate increases in February 1990, based on test years ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test year ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992). It appears that once Citizens decided to sell its water and wastewater systems in 1999, it elected not to seek rate increases and, in some cases, to accept operating losses. This situation has caused Arizona-American to seek rate

[1] In Decision No. 60172, rates for Sun City Water Company and Sun City West Utilities' rates for water service were actually reduced. I also understand the Sun City West Utilities' rates for both water and wastewater service were reduced in the prior rate proceeding, as were Sun City Water Company's rates. Decision No. 55488 (March 17, 1987).

increases more quickly than it anticipated. However, a delay in obtaining rate increases and correcting these systems' anemic earnings would be harmful to the Company and, ultimately, to its customers.

Q. WHAT ARE YOUR OVERALL RESPONSIBILITIES IN THIS CASE?

A. I have been responsible for the coordination and supervision of all of the rate case applications discussed including, among other things, selecting the test period and the pro-forma time period for various adjustments, and determining what adjustments need to included in the filing.

Q. WHAT TEST PERIOD DID YOU DETERMINE WAS APPROPRIATE IN THIS CASE?

A. I determined, for ease of presentation, that the period ending December 31, 2001, should be used as the test period for the Company's rate filing. This period closely is aligned with the purchase of the Citizens' Assets by Arizona-American, which transaction closed on January 15, 2002.

Q. DID ARIZONA-AMERICAN OWN THE CITIZENS' ASSETS, OR HAVE ANY RESPONSIBILITY FOR THE OPERATING EXPENSES OR THE PROVISION OF SERVICE DURING THE TEST PERIOD FOR THE SYSTEMS THAT ARE THE SUBJECT OF THE COMPANY'S RATE FILING?

A. No. As I stated, the purchase of the Citizens' Assets was not completed until January 15, 2002, on which date Arizona-American assumed operational control and responsibility for the Citizens' Assets.

Q. SINCE ARIZONA-AMERICAN DID NOT OWN AND OPERATE THE CITIZENS' ASSETS AND DID NOT HAVE ANY OPERATING RESPONSIBILITY FOR THE WATER AND WASTEWATER UTILITY OPERATIONS IN 2001, HOW DOES THE COMPANY JUSTIFY FILING A

RATE APPLICATION WITH A TEST PERIOD ENDING PRIOR TO THE COMPLETION OF THE PURCHASE?

A. The recorded operating expenses directly incurred by each district basically remain unchanged following the acquisition. Further, the Commission ordered Citizens to maintain its books and records for a period of 5 years following the closing. It is relatively simple to remove the management and services costs allocated to each of the operating systems by Citizens from the normally-incurred direct operating expenses of these systems. Likewise, it is relatively simple to add in the expected Service Company charges from AWW applicable to Arizona-American.

Q. WHAT PRO FORMA TIME PERIOD HAVE YOU USED FOR EXPENSE AND PLANT ESTIMATIONS IN THIS CASE?

A. I am recommending that such adjustments, all of which will be detailed further in the various witnesses' direct testimonies, go no further into the future than end of year 2002. This will provide ample time for Staff to review and analyze these adjustments prior to providing their recommendations in Staff's direct filing.

Q. ARE THERE PRO FORMA ADJUSTMENTS FOR PLANT ADDITIONS?

A. Yes, we have estimated the non-revenue generating plant additions that will be completed and placed in service by the end of 2002, and have included pro forma adjustments that include those additions in utility plant in service. This is consistent with Commission Decision No. 61831 (July 20, 1999) related to the Paradise Valley water district, wherein the Commission ordered the Company to limit pro forma plant additions to those plant items that are used and useful and in service 90 days after the application is deemed sufficient. The December 31, 2002 cut-off date proposed by Arizona-American in this case is well within the 90-day deadline established by the Commission.

Q. HOW ARE PRO FORMA ADJUSTMENTS DETERMINED FOR

OPERATING EXPENSES?

A. Pro forma adjustments for operating expenses are based on known and measurable changes that have or will occur up until the time each rate application is filed to develop a normal 12-month period of operations. This is consistent with A.A.C. R14-2-103(i).

III. ACQUISITION OF THE WATER AND WASTEWATER ASSETS OF CITIZENS UTILITIES OF ARIZONA

Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE CITIZENS' ACQUISITION?

A. By way of background, Arizona-American has owned and operated a water utility system in Arizona, which was formerly known as Paradise Valley Water Company, since the late 1960s. The Paradise Valley water district is relatively small, and currently furnishes service to approximately 5,000 customers. Sometime in 1998 or 1999, Citizens Communications Company (formerly Citizens Utility Company) decided to focus its business activities in the telecommunications area, and elected to sell its water and wastewater assets, which were located in six states including Arizona. Arizona-American's parent company, AWW, which is the largest privately-owned water utility system in the United States and whose business activities focus on water and wastewater, entered into negotiations with Citizens. Ultimately, on October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American agreed to purchase the Citizens' Assets, which included all of the water and wastewater systems and assets in Arizona.

Citizens and its various Arizona water and wastewater subsidiaries, along with Arizona-American, filed an application on March 24, 2000, seeking approval of the transfer of the Citizens' Assets to Arizona-American in Docket Nos. W-

01032A-00-0192, et. seq. Later that same year, Arizona-American filed a separate application in Docket No. W-01303A-00-0929 seeking authority to issue certain promissory notes and other evidence of indebtedness and to assume certain industrial development revenue bonds in connection with financing the purchase of the Citizens' Assets. Following notice and a public hearing, the Commission ultimately approved the transfer of the Citizens' Assets in the Acquisition Decision. Attached to the Acquisition Decision and incorporated therein in the second ordering paragraph, was a settlement agreement setting forth specific terms and conditions agreed to by Staff and the Company. These terms and conditions settled one ratemaking issue and set forth deadlines, procedures and filing requirements that Arizona-American is to follow in future rate proceedings. The terms and conditions are as follows:

1. The ratemaking treatment of the of the acquisition adjustment, deferred taxes, excess deferred taxes and the investment tax credit will be deferred until a future rate case proceeding.
2. The decision to allow recovery of the acquisition adjustment must be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred
3. The Company must file a report 13 months after the closing of the transaction, comparing the number of complaints received by the Commission prior to and after the transaction.
4. The adjusted AIAC balance not transferred to Arizona-American as part of the transaction will be imputed ratably into rate base over a 6.5 year period. The balance will be ratably reduced over the 6.5 years utilizing a levelized monthly below the line amortization.

A copy of the Acquisition Decision is attached hereto as Stephenson Dir. Exh. 1.

Later in 2001, the Commission issued Decision No. 64002 (Aug. 30, 2001) authorizing the debt financing for the purchase of the Citizens' Assets. In summary, the Commission authorized Arizona-American to issue promissory notes and other evidence of indebtedness in an amount not to exceed $180 million and to issue a promissory note reflecting the obligation associated with assuming Citizens' industrial development revenue bonds in the amount of $10,635,000. The balance of the purchase price was financed by an infusion of additional paid in equity capital from AWW. In Decision No. 64002, the Commission ordered Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition in order to maintain a reasonably balanced capital structure.

Q. WHEN DID ARIZONA-AMERICAN FINALIZE THE PURCHASE OF THE CITIZENS' ASSETS?

A. The transaction was finalized on January 15, 2002, the date title to all of the Citizens' Assets was transferred to Arizona-American. All of the service provision responsibilities were also transferred to Arizona-American on that date. The final Citizens' Asset purchase price was approximately $276,500,000, and included an initial book acquisition adjustment of approximately $71,100,000. As Explained in the Direct Testimony of Mr. Joseph Hartnett, appended as Exhibit C to the Joint Application for Authority to Transfer Assets and Related Approvals in Docket Nos. W-01032A-00-0192, et seq., the purchase for the Citizens' Assets was determined by an arms-length negotiation based on the advice of each companies financial advisors. This open market negotiated purchase price then establishes AWW's reasonable investment in the Citizens' Assets. This reasonable investment in the Citizens' Assets was funded by a combination of debt and equity as shown on at the top of the closing journal entry to record the transaction, which is

attached hereto as Stephenson Dir. Exh. 2.

IV. POST TEST PERIOD ADJUSTMENTS

Q. WHAT PRO FORMA ADJUSTMENTS ARE YOU RESPONSIBLE FOR SUPPORTING?

A. I am responsible for supporting six adjustments that impact all of the Company's rate filings. The specific adjustments are as follows: 1) capitalization of payments made for the implementation of ORCOM billing software from operating expense and the determination period for the recovery of this expense; 2) the transfer of charges related to the completion of the Citizens' Acquisition, as well as charges for the development of base accounting procedures from expenses to organizational costs; 3) the rationale for the removal of the Citizens' management costs, 4) estimates of Service Company charges; 5) estimates of rate case expense and 6) estimates of direct charges to the systems made by AWW.

Q. WHY HAVE PAYMENTS BEEN MADE FOR THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Payments made for the development of the ORCOM billing software have been made in connection with converting all of the Citizens' customers over to the AWW billing system. The payments should be considered as organizational costs or start-up costs. I will refer to these as "start-up costs" for the remainder of this discussion. These start-up costs were for such items as consultants' fees, billing programs modifications and related expenses of AWW associates to assist in the development of the billing system. The billing system had to come on line exactly at the time of closing. Since the acquisition was an asset sale, there was no arrangement between Citizens and AWW for Citizens to continue billing any utility customers after the transaction closed. The ORCOM system had to be up and running, and running properly, at the closing. To the benefit of these

customers, AWW has been developing this same system for its own use at all of its present properties, including the Paradise Valley district. This made the time and expense of converting the Citizens' customers to the ORCOM system less burdensome.

Q. WHY WERE THESE COSTS EXPENSED?

A. Over the past few years accounting requirements regarding the booking of these types of start-up costs have changed. Start-up costs historically have been capitalized along with the purchase or development of new assets. This is no longer the case. The Financial Accounting Standards Board has deteremined that too many expenses were being capitalized and companies' balance sheets were being overstated. However, for a regulated utility, the books and records of a company are maintained in acordance with Commission regulations and policy. These start-up costs have always been treated as a capitalized asset, and there is no valid reason to stray from that policy. These start-up costs are incurrred for the development of programs to serve new customers. The addition of the new customers lowers the overall fixed costs per customer. This produces a net cost savings. Therefore, all present and future customers should share in both the development costs as well as the savings. Common regulatory practice is to spread the development costs of a cost saving measure over the customer base receiving known and measurable savings.

Q. DOES THIS COMMISSION HAVE JURISDICTION TO OVERIDE ACCOUNTING POLICY AND AUTHORIZE THESE COSTS TO BE CLASSIFIED AS A CAPITALIZED START-UP OR ORGANIZATION COST?

A. Yes. As has been the common practice under Financial Accounting Standard Board Policy FAS 71, the Commission can establish different accounting

proceedures for various items so long as the proceedure establishes a set methodolgy and time period for the recovery of the item.

Q. WHAT ARE THE ACTUAL COSTS RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. Attached as Stephenson Dir. Exh. 3 is an analysis showing the actual costs of this project and other relationships. Page 1 of the Exhibit shows that the total one-time costs for this project is $607,723. The amount included in the rate base for the Tubac water district is $5,617.

Q. DID ARIZONA-AMERICAN PURCHASE ANY BILLING SYSTEM ASSETS FROM CITIZENS AS PART OF THE ASSET PURCHASE?

A. No. As page 2 of Stephenson Dir. Exh. 3 shows, the billing system used by Citizens to bill its water and wastewater customers (the Banner System) was retained by Citizens. Therefore, as I testified earlier, Arizona-American had to have its own billing system set up and fully functional at the time the Citizens' Acquisition closed.

Q. WHAT IS THE EFFECT ON THE RATE BASES FOR THE ARIZONA DISTRICTS INCLUDED IN THE COMPANY'S RATE FILING RELATED TO THE DEVELOPMENT OF THE ORCOM BILLING SOFTWARE?

A. As shown, the net book value of the Banner billing system at the time the Citizens' Acquisition was completed was $2,620,054. Of that amount $982,488 was allocated to the Citizens' water and wastewater systems in Arizona. The difference between the development costs of the ORCOM system ($607,723) and the allocated net book value of the Banner system not purchased ($982,488) is $374,766. Thus, there was a net benefit to the customers in Arizona through the development of the ORCOM billing system as opposed to purchasing the Banner billing system from Citizens at the net book value allocated to Arizona. The net

effect on the rate base of the Tubac water district is $3,464.

Q. WHY HAVE YOU MADE AN ADJUSTMENT OF $906,531 FOR CORPORATE COSTS TO TRANSFER VARIOUS ITEMS RELATED TO THE CITIZENS' ACQUISITION TO THE ACQUISITION ADJUSTMENT?

A. I have made this adjustment for the same reasons that I recommend the transfer of the one-time start-up costs from expenses. These costs were incurred to complete the purchase of the Citizens' Assets and to establish books and records for the Citizens' Assets and systems. The costs are related to title reviews, legal interpetations of contract clauses, legal representation to transfer existing contracts and for accounting assistance. These costs were necessary to secure and protect Arizona-American's legal rights to all the transferred assets and to obtain transfers of all existing contracts and agreements. These are normal "organizational" expenses to ensure full and proper title to transferred assets and to set up the books and records in an appropriate manner.

Q. CAN YOU PLEASE FURTHER DESCRIBE THE ITEMS WHICH YOU ARE PROPOSING TO RECLASSIFY TO THE ACQUISITION ADJUSTMENT?

A. Certainly. The total amount of $906,531 is comprised of charges from two separate sources: charges incurred by AWW in connection with the purchase; and charges from our accounting contractor in Arizona (Ronald L. Kozoman, CPA) to develop satisfactory records for regulatory purposes. The total of the charges from AWW is $784,784 and the total of the charges from Mr. Kozoman is $121,747. The details of all of these charges is attached hereto as Stephenson Dir. Exh. 4. This full amount is included in the Acquisition Adjustment.

Q. PLEASE EXPLAIN THE JUSTIFICATION FOR REMOVING ALL OF CITIZENS' MANAGEMENT FEES FROM THE TEST PERIOD

EXPENSES.

A. I have removed all of Citizens' management fees from the test period expenses because these expenses pertain to Citizens' management of the Citizens' Assets in Arizona, not expenses that will be incurred under the ownership and management of Arizona-American. These expenses must be removed and replaced by current annualizations of Service Company charges to Arizona-American in order to provide an accurate presentation of known and measureable expenses that are occuring now and will occur on a going-forward basis in the future.

Q. HOW DID YOU DETERMINE WHICH EXPENSES TO REMOVE RELATED TO CITIZENS' MANAGEMENT AND WHICH EXPENSES RELATED TO THE SERVICE COMPANY TO INCLUDE?

A. The explanation of the proceedure to determine what expenses were removed will be discussed by Mr. Tom Bourassa in his direct testimony. I have annualized the amount of expense to be included in the pro forma test period based on actual recorded costs from April through July 2002. Attached as Stephenson Dir. Exh. 5 is a spreadsheet showing the recorded costs from January through the end of July. I have not included the months of January through March in my annualization because these months were either not full months due to the finalization of the acquisition (January) or the months were not accurately reflect normal cost allocations from the Service Company (February and March). Viewing Exhibit 5, it is obvious that January and February have very low recorded expenses in comparison to the other months. The month of March is more in line with future months, but is still questionable due in part to the obvious omission of a credit for the call center amortization (this amortization relates only to the Paradise Valley system). Furthermore, March is a quarter-ending month, and as such expenses in that month tend to contain more quarterly adjustments, thereby causing distortion

of the annualization without including the other months of the quarter.

Q. WHAT IS THE AVERAGE MONTHLY CHARGE FOR THE SERVICE COMPANY FOR THE MONTHS OF APRIL THROUGH JULY 2002?

A. As shown on Stephenson Dir. Exh. 5, the average monthly amount of Service Company charges for the period April through July 2002 is $429,476. Annualizing this amount yields a total of $5,153,711 for 2002.

Q. DID YOU SPREAD THE ANNUALIZED TOTAL TO EACH OF THE SYSTEMS IN ARIZONA?

A. Yes, I spread the annualized expense to each of the systems on a four-factor basis. The four-factor analysis considers many factors all of which produce the benefits Arizona-American receives from the Service Company. The four-factor spreadsheet is attached hereto as Stephenson Dir. Exh. 6. The allocation to the Tubac water district is $38,653, based on the four-factor allocation methodology.

Q. PLEASE EXPLAIN YOUR ESTIMATE OF RATE CASE COSTS INCLUDED IN THE COMPANY'S RATE FILING.

A. The estimate of rate case expense has been developed with estimates provided by all outside consultants and costs estimated for in-house items. Attached as Stephenson Dir. Exh. 7 is an estimate of the rate case costs necessary to prosecute these applications. The total estimated costs of consultants and legal counsel is $608,000. This amount is comprised of $275,000 for ouside accounting and rate assistance, $51,000 for the outside rate of return consultant and $282,000 for legal counsel. The total estimate of in-house costs is $98,000 and is comprised of $18,000 for employee expenses and $80,000 for expenses related to mailings, notices, printing and supplies. I have allocated the total estimated rate case costs to each system based on adjusted test period revenues and have spread those totals over a three-year recovery period. The total amount allocated to the Tubac water

district is $5,039.

Q. ARE THE ESTIMATED COSTS TO PROSECUTE THE RATE FILINGS CONSISTENT WITH PRIOR COSTS INCURRED TO PROSECUTE RATE APPLICATIONS IN ARIZONA?

A. Yes, in fact the estimated cost to prosecute this case is lower on a per customer basis than the amount the Commission has previously allowed for the Paradise Valley water district in its past two rate cases. The average rate case cost per customer in the last two Paradise Valley rate proceedings was approximately $13.25. In these applications we have estimated the rate case cost per customer to be approximately $6.50 per customer, or only $2.17 per customer annually.

Q. WHAT ARE THE ADJUSTED DIRECT CHARGES COMPRISED OF?

A. The direct charges are comprised mostly of employee benefits, customer accounting charges (bill forms, postage, inserts, collection agency fees, etc.), insurance fees, dues and memberships, employee travel and directors and trustee fees. Attached as Stephenson Dir. Exh. 8 is an itemization of the charges.

Q. HOW DID YOU ESTIMATE THE ANNUAL COSTS FOR THESE ITEMS?

A. I based the annualized cost for these items on the actual recorded costs for March through July of 2002.

Q. WHAT IS THE TOTAL OF THE ANNUALIZED DIRECT CHARGES AND HOW WERE THEY ALLOCATED TO VARIOUS TEST PERIOD EXPENSE CATAGORIES?

A. The annual total for these direct expenses is $3,161,915. The charges were related to four different expense catagories: salary and wages ($1,586,293); miscellaneous expenses ($23,058); general office expenses ($1,293,829) and insurance fees ($258,736).

Q. HOW WERE THESE DIRECT CHARGES ALLOCATED TO EACH OF

THE ARIZONA-AMERICAN SYSTEMS?

A. These charges were allocated to each of the systems based on four different factors. The system charges for salaries and wages were allocated to each system based on expensed test period salaries; the allocation of miscellaneous expense was spread to each system based on customer count and pro forma plant; the allocation of general office expense was allocated to each system based on customer count, pro forma plant and adjusted test period rate base; and the allocation of insurance fees to each of the sysetms was based on adjusted test period rate base.

Q. WHY DID YOU USE THE MARCH THROUGH JULY TIME PERIOD?

A. As stated earlier, I chose the time period that best represents the normalized expenditures. I had to eliminate January and February from consideration due to the fact that Arizona-American did not own the Citizens' Assets until January 15, 2002, and February 2002 was the first full month of operation by Arizona-American and not all charges were recorded properly.

Q. DID YOU REMOVE ALL OF THE RECORDED TEST PERIOD EXPENSES RELATED TO THESE SYSTEM SPECIFIC ALLOCATIONS?

A. Yes, all of the test period expenses for these items were removed from the test period along with the Citizens' management fees.

Q. WHAT WAS THE AMOUNT ALLOCATED TO EACH OF THE EXPENSE CATAGORIES FOR THE TUBAC WATER DISTRICT?

A. The allocations to each of the expense catagories for the Tubac water district is : $18,026, for salaries and wages; $221 for miscellaneous; $11,446, for general office; and $2,867 for insurance.

V. <u>CAPITAL STRUCTURE AND COST OF DEBT</u>

Q. WHAT IS THE CAPITAL STRUCTURE THAT ARIZONA-AMERICAN

PROPOSES TO UTILIZE IN THESE APPLICATIONS?

A. The Company proposes a capital structure comprised of 60 percent debt and 40 percent equity.

Q. HOW WAS THIS CAPITAL STRUCTURE DETERMINED?

A. It was determined based on the actual financing of the acquisition of the Citizens' Assets by Arizona-American. At the very top of the first page of Stephenson Dir. Exh. 1 is the entry to record the purchase of the Citizens' Assets by Arizona-American. This entry shows Common Stock in the amount of $110,888,158 (40 percent), Bonds – Inside of $154,948,119 (56 percent) and Bonds – Outside of $10,635,000 (4 percent). These are the actual amounts for each of these components as recorded on the books of Arizona-American at the time of purchase of the Citizens' Assets. AWW strives to have its subsidiaries maintain the most efficient capital structure. Typically, the most efficient capital structure for AWW utility subsidiaries is comprised of approximately 60 percent debt. AWW has maintained its high debt rating (A-) and secured very efficient rates for bonds and notes by maintaining a 60 percent debt component in the capital structure. The greater the leverage of the capital structure while still maintaining a high bond rating, the lower the cost of capital to the Company and its customers.

Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN "BONDS-INSIDE" AND "BONDS-OUTSIDE."

A. The "Bonds-Inside" comprise the debt financing provided by American Water Works Capital Corp. ("AWCC") in the form of a short-term note. This is a five-year unsecured note with an interest rate of 4.92%. The "Bonds–Outside" is debt financing reflecting the assumption of Citizens' industrial development revenue bonds I mentioned previously, which have an interest rate of 7.30%.

VI. ACQUISITION ADJUSTMENT

Q. EARLIER, YOU DISCUSSED THE ACQUISTION. HOW WILL ARIZONA-AMERICAN ACCOUNT FOR THE DIFFERENCE BETWEEN THE PURCHASE PRICE AND THE ACQUIRED ASSET BALANCE FOR REGULATORY PURPOSES?

A. The difference will be recorded as an Acquisition Adjustment in accordance with the NARUC Uniform System of Accounts.

Q. WHAT IS THE AMORTIZATION PERIOD THAT ARIZONA-AMERICAN PROPOSES TO USE?

A. Forty years.

Q. WHAT METHOD OF AMORTIZATION IS ARIZONA-AMERICAN PROPOSING TO USE?

A. Arizona-American proposes to follow a mortgage amortization method, which incorporates the same amortization principle as home mortgages. Under this method, Arizona-American would recover only a small portion of the Acquisition Adjustment in the initial years and recover increasingly greater amounts in the later years. The annual amortization increases each year. The proposed amortization of the Acquisition Adjustment balance is attached hereto as Stephenson Dir. Exh. 9. The amount of the amortization included in the cost of service for the Tubac water district in these applications is $1,100, based on amortization of the Acquisition Adjustment in 2003, as shown on Exhibit 9.

Q. WHAT IS THE NORMAL METHOD OF RECOVERY FOR UTILITY ASSETS?

A. The normal method, known as a straight-line method of recovery, involves equal or level recovery in each year of the asset's life.

Q. WHY ARE YOU PROPOSING THE MORTGAGE METHOD RATHER

THAN THE STRAIGHT-LINE METHOD?

A. Although there are several reasons for this proposal, there is one significant reason: the mortgage method provides a much better matching of the recovery of the acquisition adjustment to the benefits the customers will receive as a result of this transaction.

Q. DOES USING THE MORTGAGE AMORTIZATION METHOD BETTER ILLUSTRATE THE CUSTOMER BENEFITS OF THIS TRANSACTION?

A. Yes. As stated previously, the savings generated from this transaction will grow as time passes. Allocating the recovery of the Acquisition Adjustment on an increasing basis over the recovery period, instead of leveling the recovery of the Acquisition Adjustment as is normal under the straight-line method of recovery, provides a superior opportunity for all current and future ratepayers to realize the benefits of the transaction.

Q. ARE THERE ANY OTHER FACTORS THAT SUPPORT YOUR SELECTION OF THIS METHODOLOGY?

A. Yes. The effects of inflation should also be considered. If a straight-line amortization method is used, the highest net-present value amounts are charged initially, and lower amounts are charged toward the end of the amortization. Given the effects of inflation, the differential between initial and final charges are substantial in terms of constant dollars. The mortgage-style amortization works with the effects of inflation to create a more level, constant dollar charge.

Q. WHAT SHOULD THE COMMISSION AUTHORIZE IN THIS PROCEEDING WITH RESPECT TO AN ACQUISITION ADJUSTMENT?

A. Arizona-American requests that the Commission authorize a 40-year amortization period and use of a mortgage amortization method, with the recovery of the acquisition adjustment as a component of the cost of service, as discussed

previously.

VII. DISCUSSION OF THE REQUIREMENTS OF THE ACQUISITION DECISION

Q. HAVE YOU ADDRESSED COMPLIANCE WITH ALL OF THE COMMISSION'S DIRECTIVES IN THE ACQUISITION DECISION?

A. No. I have only covered the requested treatment of the Acquisition Adjustment. The Acquisition Decision also calls for the determination of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American; and the determination of the ratemaking treatment of deferred taxes, excess deferred taxes and investment tax credits that were on the books and records of Citizens at the time of the closing of the purchase transaction, yet were not transferred to Arizona-American. It is my recommendation to delay the demonstration of the clear, quantifiable and substantial net benefits for ratepayers resulting from the purchase of the Citizens' Assets by Arizona-American until a later date, after which time Arizona-American will have greater operating experience and be better able to demonstrate the tremendous net ratepayer benefits that result from this transaction. However, by recommending this delay, Arizona-American does not waive its right to, at some point in time in the future, request recovery of and on the Acquisition Adjustment, if it so desires to do so. It is my recommendation is that the deferred taxes, excess deferred taxes and the investment tax credit not be considered for any ratemaking purpose.

Q. WHAT IS THE BASIS FOR THIS RECOMMENDATION AS IT RELATES TO THE DEFERRED TAXES, EXCESS DEFERRED TAXES AND THE INVESTMENT TAX CREDIT?

A. All of these items were established on the books and records of Citizens due to

timing differences between book and tax recognition of an allowance to record the event causing the tax difference in the income stream. For deferred taxes, it is the tax effect of the difference between depreciation methods of assets for book and tax purposes. For tax purposes, many assets were once allowed to be depreciated at an accelerated rate, meaning that the assets were depreciated at a higher early period rate, and over a shorter time period, than for book purposes. For investment tax credits, in the past the Internal Revenue Code allowed a percentage tax deduction for the investment in various assets. The investment tax credit was never considered for book purposes.

In short, these are taxes and credits that belong to Citizens, not Arizona-American. Arizona-American purchased the water and wastewater assets of Citizens in Arizona; it did not assume any of the liabilities, except for the one series of industrial development revenue bonds. The deferred taxes and investment tax credits will be reconciled from the books and records of Citizens when Citizens files its 2002 tax return and applies these items against the gain or loss realize upon the sale of the water and wastewater assets to Arizona-American.

Q. WHAT WERE THE BALANCES OF THE DEFERRED TAXES AND INVESTMENT TAX CREDITS ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME OF CLOSING OF THE ASSET PURCHASE BY AWW OF THE ARIZONA ASSETS?

A. Stephenson Dir. Exh. 10 is a copy of the Arizona Property Detail supplied by Citizens at the time of closing. This Exhibit shows that the balance for the deferred taxes was $4,674,819 and the balance of the investment tax credits was $1,910,600. There were no excess deferred taxes shown on the books and records of Citizens for Arizona at the time of closing.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THAT THE

DEFERRED TAXES ON THE BOOKS OF CITIZENS FOR ARIZONA AT THE TIME OF CLOSING SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. Deferred taxes that were on the books and records of Citizens at the time of closing are not an item that should be considered as a "carryover" item in an asset purchase agreement. Deferred taxes result from items being treated differently for tax and book purposes. These differences are primarily created by Citizens' ability to delay actual tax payments due to accelerated asset value depreciation or amortization for tax purposes over the straight-line depreciation or amortization used for book and regulatory purposes. These tax-differences are recorded as deferred taxes. These deferred taxes will be taken into consideration when calculating a tax gain or loss as a result of the sale of the Citizens' Assets. Upon the sale of such assets, these deferred taxes will be paid and the deferred tax balances zeroed out.

When deferred taxes have been allowed as a component of cost of service in utility ratemaking, their accumulated balance (ADIT) is typically deducted from rate base as a source of non-investor capital. This is because deferred taxes are collected in rates prior to the time they must be remitted to the respective taxing authorities. In the interim, they represent a source of funds available to the utility for plant investment or other corporate purposes. During that period it is entirely appropriate to deduct the ADIT from rate base. When the tax liabilities underlying previously deferred taxes are paid, however, the related ADIT balances are eliminated and the rate base deductions are no longer available.

With respect to Citizens' ADIT existing at the time the sale of its water and wastewater assets to AWW, the related income taxes will become due. At that time, the ADIT's will be paid and there will be no balance available to deduct from

rate base. On-going compensation to customers is not warranted. When non-investor funds have been satisfied they no longer exist, and no further rate base deduction is appropriate. ADIT's may be viewed as a temporary loan to the utility by the taxing authority. By deferring the date upon which taxes are ultimately paid, a source of funds is created. Once the "loan" is repaid, the source of funds ceases to exist. There is no entitlement inuring to the utility's customers, since they pay taxes applicable to the utility service they receive.

Q. WHAT IS THE EFFECT ON ARIZONA-AMERICAN IF THE COMMISSION ELECTED TO USE CITIZENS' RECORDED DEFERRED TAXES IN FUTURE RATEMAKING.

A. The Internal Revenue Service has, on a number of occasions, declared that any deferred income tax reserves or unauthorized income tax credits relating to assets that have been sold, transferred, or removed from regulation may not continue to be considered in the subsequent ratemaking determinations. To attempt to do otherwise will result in the utility losing the ability to take accelerated depreciation on its Federal income tax return.

Q. PLEASE EXPLAIN FURTHER WHY YOU BELIEVE THE INVESTMENT TAX CREDITS THAT WERE ON THE BOOKS AND RECORDS OF CITIZENS AT THE TIME THE PURCHASE WAS COMPLETED BY ARIZONA-AMERICAN SHOULD NOT BE CONSIDERED FOR RATEMAKING.

A. The reasons are exactly the same as for deferred taxes. The investment tax credits will be considered in calculating Citizens' gain or loss as a result of the sale of the assets, and therefore will be eliminated. The investment tax credits were a "temporary" source of non-investor funds, once appropriately deducted from rate base, but now that they have been "paid", they are no available as a rate base

deduction. This deduction no longer exists and as such cannot be used for ratemaking.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes it does.

STEPHENSON DIR. EXH. 1

N. JAMES

MAY 3 0 2001

ACTION

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

APR 2 4 2001

DOCKETED BY

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00-0192 W-01032B-00-0192 W-01032C-00-0192 S-02276A-00-0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00-0192 W-01595A-00-0192 W-01303A-00-0192 DECISION NO. 63584 OPINION AND ORDER

DATE OF HEARING:	September 27, 2000
PLACE OF HEARING:	Phoenix, Arizona
PRESIDING ADMINISTRATIVE LAW JUDGE:	Karen E. Nally[1]
IN ATTENDANCE:	Chairman William A. Mundell and Commissioner Jim Irvin
APPEARANCES:	Mr. Michael M. Grant, GALLAGHER & KENNEDY. and Mr. Craig Marks, Associate General Counsel, on behalf of Citizens Communications Company;

[1] This Recommended Opinion and Order was prepared by Administrative Law Judge Marc E. Stern upon review of the testimony and exhibits admitted into evidence in the proceeding.

Mr. Norman D. James, FENNEMORE CRAIG, on behalf of Arizona-American Water Company;

Mr. Daniel W. Pozefsky, Staff Attorney, on behalf of Residential Utility Consumer Office;

Mr. Bill Meek on behalf of the Arizona Utility Investors Association; and

Ms. Teena Wolfe, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On March 24, 2000, Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively "Citizens"), and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a Joint Application to Transfer Assets and Related Approvals ("Application") of Citizens' water and wastewater utility assets in Arizona including Citizens' Certificates of Convenience and Necessity ("Certificates") held by Citizens to Arizona-American.

On May 17, 2000 and on June 1, 2000, the Residential Utility Consumer Office ("RUCO") and the Arizona Utility Investors Association ("AUIA") filed applications for leave to intervene. Subsequently, intervention was granted to RUCO and to AUIA.[2]

On May 30, 2000, by Procedural Order, a hearing was scheduled on the above-captioned matter for September ~~27~~, 2000. Citizens and Arizona-American caused public notice of the Application and hearing thereon to be published in various newspapers throughout Arizona. In

[2] On April 10, 2000, Mr. Marvin Lustiger filed an application to intervene in the above-captioned matter. However, by subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone service in Mohave County, and therefore, Mr. Lustiger's request to intervene was deemed to have been withdrawn.

addition. Citizens notified all its customers of the Application by means of a written bill insert.

On September 14, 2000, a formal public comment session was held in Sun City.

On September 26, 2000, the Commission's Utilities Division ("Staff") filed a Settlement Agreement ("Agreement") marked Exhibit A which is incorporated by reference and attached hereto.

On September 27, 2000, a full public hearing took place at the offices of the Commission in Phoenix, Arizona. Citizens, Arizona-American, RUCO, AUIA and Staff were present with counsel. Following the presentation of evidence, Citizens and RUCO submitted written briefs on the issue of whether Citizens should be required to pay a portion of the gain resulting from the sale of its utility assets to Citizens' customers. The matter was then taken under advisement pending submission of a recommended Opinion and Order to the Commission.

DISCUSSION

Parties to the Transaction

Citizens, through its various divisions and subsidiaries, provides water, wastewater, electric, natural gas and telecommunications services to approximately 1.8 million customers in 22 states, including in excess of 100,000 customers in Arizona. Citizens' current business strategy is to focus on the provision of telecommunications services and the expansion of those operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas, as was the case in the recently approved transfer of rural wire centers by Qwest Corporation to Citizens Utilities Rural Company, Inc.

In connection with this business strategy, Citizens intends to sell its water, wastewater, electric, and natural gas utilities and to apply the proceeds to finance acquisitions and other business activities in the telecommunications area. In April 2000, Citizens also announced the sale of its Louisiana natural gas operations for $375 million.

The Commission granted Arizona-American a Certificate of Convenience and Necessity to provide water service to approximately 4,600 customers in portions of the Town of Paradise

Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW") which is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states, and with a reported consolidated net plant of $5.1 billion and operating revenues of $1.26 billion. AWW's December 31, 1999, balance sheet reflected a capital structure of 58.4 percent long-term debt, 2.3 percent preferred stock and 39.3 percent common equity.

In 1999, AWW's subsidiaries invested $467 million in improving and upgrading their facilities, and for the past several years, AWW has made similar expenditures averaging nearly $400 million per year. According to AWW witnesses, AWW's acquisition policy is motivated, at least in part, by anticipated capital expenditures resulting from new regulatory requirements and programs and the need to replace or upgrade aged infrastructure to maintain high quality service. With the additional water and wastewater systems, AWW and its subsidiaries hope to obtain economies of scale and to strengthen their financial capability by expanding their customer base.

The Transaction

On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement under which Arizona-American is to acquire the water and wastewater assets and the Certificates held by Citizens in Arizona ("the Acquired Assets") for approximately $231 million, subject to adjustment at the time of closing. The purchase price will be increased based on utility plant added by Citizens after June 30, 1999, and will be reduced based on plant retirements occurring after such date. The Acquired Assets include all utility plant, property and interests relating to Citizens' water and wastewater operations in Arizona, with certain exceptions, including assets commonly used by Citizens in connection with other utility operations, cash and cash equivalents, and assets related to benefit plans. Citizens will also retain certain liabilities, including obligations for taxes payable, obligations relating to employee compensation and

benefits, and refunds of certain advances in aid of construction. Arizona-American will assume and be liable for all contracts and permits assigned at closing, certain Industrial Development Revenue Bonds ("IDRBs"), and unperformed obligations.

Arizona-American will finance the purchase of the Acquired Assets by a combination of debt and equity. AWW has recently formed a new subsidiary, American Water Capital Corporation ("AWCC"), that will provide loans and other financial services to AWW subsidiaries. Initially, Arizona-American will borrow funds from AWCC on a short-term basis, and receive additional funds in the form of common equity directly from AWW. Within 12 months, the short-term debt will be converted to long-term debt with a planned capital structure which will contain 55 to 60 percent debt and 45 to 40 percent common equity, including Arizona-American's existing debt and equity capital and the Citizens' IDRBs that will be assumed.[3]

The Position of Staff and the Staff Settlement Agreement

Staff generally supported the application, and recommended that the transfer of the Acquired Assets to Arizona-American be approved, subject to several conditions.

First, Staff recommended that the Commission defer any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes, and investment tax credits until a future rate proceeding.

Second, Staff recommended that the decision to allow recovery of an acquisition adjustment be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred.

Third, Staff recommended that Arizona-American should be ordered to file, 13 months

[3] Arizona-American has filed an application for authority to issue short-term and long-term debt in connection with financing the purchase of the Acquired Assets, which is pending in Docket No. W-01303A-00-0929.

after the closing of the transaction, a report comparing the number of complaints received by the Commission prior to and after the transaction. The report should provide an explanation of any significant changes in the number and importance of the complaints. Staff would then review this report and, if necessary, make a recommendation to the Commission of any further action to be taken.

Fourth, Staff recommended that an imputation of the benefits related to advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") received by Arizona-American be made in subsequent rate proceedings for each former Citizens' system. The purpose of the imputation would be to recognize those portions of the Acquired Assets that were financed by AIAC and CIAC which Arizona-American will not be assuming. Staff also recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC would be amortized below the line in the same manner as would have otherwise occurred.

Fifth, Staff recommended that Arizona-American be required to seek Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' Central Arizona Project ("CAP") water subcontracts.

Finally, Staff recommended that the Commission order Arizona-American to charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

In its rebuttal filing, Arizona-American indicated that it would stipulate to the conditions recommended by Staff, including the deferral of a decision concerning the recognition of an acquisition adjustment and the conditions under which an acquisition adjustment would be recognized, and would adopt and utilize the rates and charges for service, and all other service tariffs currently in effect in each of the affected Citizens service territories. However, Arizona-American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.

Subsequently, Staff and Arizona-American entered into the Agreement, which resolved all areas of disagreement relating to the terms and conditions under which the Acquired Assets would be transferred to Arizona-American.

Pursuant to the terms of the Agreement, Citizens' AIAC and CIAC will be imputed to Arizona-American for ratemaking purposes. This adjustment will reduce rate base. The amount of the AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer of the Acquired Assets, adjusted as follows: an amount equal to 5 percent of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place. The adjusted amount of CIAC will be amortized above the line (i.e., as a reduction to depreciation expense that would otherwise be recoverable in rates) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place. The imputation of AIAC and CIAC to Arizona-American is solely for ratemaking purposes, and not for financial accounting or any other purpose.

In addition to agreeing to the imputation of AIAC and CIAC, Arizona-American agreed that the Commission may adopt Staff's remaining conditions concerning the sale and transfer of the Acquired Assets. Staff and Arizona-American also agreed that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

Based on these agreements by Arizona-American, Staff is recommending that the Commission should approve the transfer of the Acquired Assets to Arizona-American and should not impose any additional terms, conditions or requirements on Arizona-American.

During the hearing, Staff and Arizona-American voiced their support of the Agreement, believing that its terms are reasonable and in the public interest. AUIA also expressed its support for the Agreement. However, the remaining party to the proceeding, RUCO, objects to the approval of the Agreement and to the transaction generally, as discussed below.

Position of RUCO

RUCO maintains the proposed transaction believing that it is not in the public interest and should not be approved unless it is restructured. RUCO argued that the transaction could possibly, in the future, impact on ratepayers. While RUCO did not disagree that consideration of an acquisition adjustment should be deferred until a future ratecase, RUCO argued that the gain resulting from the sale of the Acquired Assets received by Citizens, i.e., the difference between the net book value of the Acquired Assets and the purchase price being paid by Arizona-American, should be shared equally between Citizens stockholders and the ratepayers. RUCO further argued that the Commission should adopt a set of criteria to determine what, if any, acquisition adjustment should be allowed in a future rate proceeding. RUCO also suggested that to make this transaction in the public interest, among other things, the transaction should be contingent upon Arizona-American's Board of Director's approving a letter pledging to invest no less than 15 percent of the purchase price in acquisitions and capital improvements of "resources stressed" water and/or wasterwater utilities in Arizona no later than 72 months after the date the Commission authorizes the transaction.

Analysis of Disposition of Gain Issue

RUCO contended that fundamental principles of fairness support sharing the gain in this case. RUCO maintained that ratepayers have shared in the risk associated with the operation of the utility assets and that it necessarily follows that ratepayers should share in the gain realized from the sale of those assets. According to RUCO, this risk sharing results from the accounting treatment provided in the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts when an asset is retired prematurely, i.e., before a

utility fully recovers its original cost via depreciation. RUCO also stated that prior Commission decisions support gain sharing.

In response, Citizens argued that ratepayers have assumed no risk in connection with the operation of Citizens' water and wastewater utility business. Investors have provided the utility's capital and bear the financial risks associated with its operations. Therefore, the investors should be entitled to receive any gain resulting from the transaction. As to prior Commission decisions, Citizens cited three analogous cases involving a sale of an entire line of utility business in which the Commission did not order gain sharing.[4] Citizens also cited Decision No. 60167 (April 17, 1997) in which a utility's natural gas business was sold at a loss. In that case, the Commission did not order the customers to share in the loss.[5]

This proceeding is similar to the three cases cited earlier by Citizens since it is selling its entire business and will have no further water and wastewater operations in Arizona. The Commission has never required gain sharing under these circumstances. In the Contel of the West matter, in which Citizens was authorized to acquire all of Contel's telephone properties in Arizona, Staff urged that the gain resulting from the sale be shared equally with ratepayers. However, the Commission rejected gain sharing in that case.

We also do not believe that ratepayers bear a substantial risk by virtue of receiving utility service in this case. The particular accounting treatment for depreciable plant provided under the Uniform System of Accounts does not shift risk to customers, but rather prescribes particular accounting adjustments to properly reflect rate base before and after the retirement of a plant item. The utility's owners, i.e., its shareholders, ultimately bear the risks associated with the utility's business. While regulation may reduce those risks relative to most non-regulated

[4] Citizens/Southern Union, Decision No. 57647 (December 2, 1991); Contel/Citizens, Decision No. 58819, (October 17, 1994); and GTE/Citizens, Decision No. 62648 (June 13, 2000).

[5] Ajo Improvement Company/Southwest Gas, Decision No. 60167 (April 17, 1997).

businesses, regulation does not shift that risk to ratepayers, who are entitled to receive utility service at rates set by the Commission.

Accordingly, we do not find it appropriate under the circumstances in this case to require Citizens to share with ratepayers any part of the gain it receives from the sale of the Acquired Assets to Arizona-American. However, this will not preclude the Commission from protecting the ratepayers in the future. In any claim for an acquisition adjustment in a future rate case, the Commission can strictly scrutinize the foundation of the claim and determine what amount, if any, should be approved.

Analysis of Remaining RUCO Recommendations

RUCO's other recommendations pertained to the structure of the transaction and RUCO's concerns that this structure could lead to rate increases in the future. RUCO's concern primarily relates to the fact that Arizona-American will not be assuming all of Citizens' liabilities associated with AIAC and CIAC, which totaled approximately $80.8 million and $4.7 million, respectively, at December 31, 1999. According to RUCO, the structure of the transaction will result in the elimination of AIAC and CIAC as reductions from rate base, which will in turn result in an increase in rate base and, eventually, to rate increases.

We believe that the Agreement appropriately deals with this issue. Citizens' AIAC and CIAC will be recognized for ratemaking purposes by Arizona-American, even though Arizona-American is not assuming those liabilities. By virtue of this imputation, the impact of the structure of the transaction will be ameliorated. Based on the evidence and the testimony, the approach utilized in the Agreement is reasonable.

Further, the evidence indicates that the transaction between Citizens, Arizona-American and AWW was the product of arms-length negotiations that occurred after Citizens had adopted its current business strategy of focusing on telecommunications services and divesting itself of its water and wastewater systems, as well as its electric and natural gas systems throughout the

country. This is not a transaction between affiliated companies. The payment by Arizona-American will constitute an investment in the Acquired Assets.

RUCO also expressed concern regarding the impact of the transaction on Citizens' accumulated deferred income taxes ("ADITs"), which totaled approximately $5.2 million as of December 31, 1999, and Citizens' investment tax credits ("ITCs"), which totaled approximately $2.2 million as of the same date. Under the Agreement, any decision on the treatment of ADITs and ITCs will be deferred until Arizona-American seeks new rates in a future proceeding. Staff's recommendation is appropriate under the circumstances herein.

Next, RUCO questioned the approach proposed by Arizona-American and Staff, as adopted in the Agreement, for dealing with the possible future recognition of an acquisition adjustment in rates. RUCO agreed with Arizona-American and Staff that it is appropriate to defer consideration of any acquisition adjustment resulting from the transaction until a future rate proceeding, in order to afford Arizona-American an opportunity to demonstrate that the acquisition has provided a net benefit to ratepayers by virtue of improved operating efficiencies, economies of scale and other synergies. However, RUCO's witnesses also contended that the Commission should adopt a set formula that would be used in connection with any future determination of the amount of the acquisition adjustment.

We have concerns about the adoption of a set, mechanical formula to quantify a future acquisition adjustment. We believe that such a determination should be made at the time all the facts and circumstances are known. Staff's recommendation concerning the basis on which the Commission will allow the recovery of an acquisition adjustment is reasonable and in the public interest. Arizona-American is cautioned that the Commission will require Arizona-American to demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission will consider recovery of any acquisition adjustment in a future rate proceeding.

RUCO was also critical of Arizona-American's failure to assume all of Citizens' IDRBs. As stated, Arizona-American will assume certain IDRBs, which total approximately $10.6 million. The IDRBs that will be assumed constitute low-cost capital. The average cost of the IDRBs that will be assumed by Arizona-American was 3.55 percent per annum during 1999. RUCO believes that there may be three additional Citizens bond issues, representing low-cost capital, that will not be assumed in connection with the transaction.

Arizona-American, in its testimony, has acknowledged that other bonds have been issued by Citizens. The evidence indicates, however, that in contrast to the IDRBs that will be assumed, the other bonds would require unanimous consent from all bond holders in order to be assumed, which would be administratively difficult, if not impossible, to accomplish within the time frame of the transaction. The additional costs to Arizona-American to replace these low-cost IDRBs with alternative forms of financing was not ascertained.

We find that it would not be feasible for Arizona-American to assume the remaining bonds and it would not be reasonable to impute these bonds to Arizona-American's capital structure. The remaining bonds will continue to be an obligation of Citizens and will continue to be included in Citizens' capital structure in its ongoing telecommunications business.

Finally, RUCO recommends that authorization of the transaction be made contingent on Arizona-American pledging to invest not less than 15 percent of the purchase price for the Acquired Assets, or approximately $35 million, in acquisitions and capital improvements of "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and capital improvements would have to be made within 72 months from the date on which the Commission approves the transaction.

The Commission recognizes that there are small water and wastewater utilities in Arizona that may need technical and financial assistance. Indeed, the Commission has provided such assistance to small water and wastewater utilities through workshops and the development of policies aimed at improving their financial viability. However, it is not reasonable to compel a

private utility to spend in excess of $35 million to solve these problems, nor is it clear that the Commission has the authority to do so.

Arizona-American has indicated its willingness to work with the Commission in developing solutions to service problems being experienced by small, troubled utilities. By virtue of acquiring Citizens' systems in Arizona, Arizona-American will be in closer proximity to a number of these systems, and the Commission would expect Arizona-American, as circumstances warrant, to seriously consider acquiring these systems or otherwise provide technical or financial assistance. For these reasons, we do not believe it is appropriate to impose such a mandate on Arizona-American.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Pursuant to authority granted by the Commission, Citizens provides public water, wastewater, electric, natural gas and telecommunications services in various parts of Arizona.

2. Pursuant to authority by the Commission, Arizona-American, a wholly owned subsidiary of AWW, provides public water service to approximately 4,600 customers in the Town of Paradise Valley, the City of Scottsdale and in certain unincorporated portions of Maricopa County, Arizona. Arizona-American is presently classified as a Class B water utility.

3. On March 24, 2000, Citizens and Arizona-American filed an Application requesting approval of the sale and transfer of Citizens' water and wastewater utility assets in Arizona together with the transfer of Citizens' Certificates to Arizona-American.

4. RUCO and the AUIA were granted intervention in this Docket.

5. Public notice of the Application and hearing thereon was published in various newspapers throughout Arizona within and in the vicinity of Citizens' and Arizona-American's certificated service areas.

6. Customers of Citizens were also notified of the Application by means of a written bill insert.

7. Citizens' current business strategy is to focus on the provision of telecommunication services and to expand its telecommunications subsidiaries' operations through the acquisition of wire centers and access lines from other providers, primarily in rural areas.

8. In the furtherance of this business strategy, Citizens is selling its water, wastewater, electric and natural gas utilities and applying the proceeds to finance acquisitions and other business activities in the telecommunications industry.

9. AWW and its subsidiaries, including Arizona-American, are the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately three million customers in 23 states.

10. AWW is financially sound, and has the experience, expertise and resources to assume and perform Citizens' public service obligations.

11. On October 15, 1999, Citizens, Arizona-American and AWW entered into an asset purchase agreement under which Arizona-American will acquire all of the water and wastewater utility assets together with the requisite Certificates held by Citizens in Arizona.

12. Arizona-American will pay a purchase price of approximately $231 million which includes the assumption of approximately $10.6 million of existing debt in the form of outstanding IDRBs. The purchase price is subject to adjustment either higher or lower based on plant additions and retirements occurring after June 30, 1999.

13. Arizona-American will finance the transaction through a combination of debt and equity, resulting in Arizona-American having a capital structure of 55 to 60 percent debt and 45 to 40 percent common equity. This debt to equity ratio is comparable to the capital structures of most large, publicly-traded water utilities.

14. Staff is recommending that the Application be approved for the sale and transfer of Citizens' water and wastewater utility assets including the Certificates to Arizona-American subject to the following conditions:

- that any decision on the ratemaking treatment of an acquisition adjustment, deferred taxes, excess deferred taxes and investment tax credits be deferred until a future rate proceeding;
- that if recovery of any acquisition adjustment is authorized in the future it should be based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers in the affected areas, which would not have been realized had the transaction not occurred;
- that Arizona-American file, 30 days after the first anniversary of the transaction, a report which compares the number of complaints received by the Commission under Citizens' ownership and under Arizona-American's ownership and provide an explanation of any significant changes in the number and importance of the complaints received. Staff should review the data and, if necessary, make a recommendation to the Commission of any further action to be taken;
- that an imputation of the benefits related to AIAC and CIAC received by Arizona-American should be made in subsequent rate proceedings for each former Citizens system as recommended by Staff in its direct testimony;
- that Arizona-American shall be required to secure prior Commission approval of any amendments to, or transfers of agreements relating to the purchase of water, such as Citizens' CAP water subcontracts; and
- that Arizona-American shall charge ratepayers for services based on the rates, charges, and service tariffs in effect at the time of closing in each Citizens service territory, until such time as Arizona-American files general rate proceedings for each service territory.

15. On September 26, 2000, Staff filed the Agreement that is marked Exhibit A. The Agreement resolves all issues relating to the terms and conditions under which the Acquired Assets may be sold and transferred to Arizona-American.

16. In the Agreement, Arizona-American acknowledged that it will follow Staff's recommendations if they are adopted by the Commission.

17. While RUCO did not oppose the treatment of the acquisition adjustment in a future rate proceeding, it neither joined in signing the Agreement nor suggested a workable

alternative approach to that agreed upon by Arizona-American and Staff in the Agreement in this instance based on our prior treatment of similar transactions.

18. Arizona-American is a fit and proper entity to acquire Citizens' utility assets and Certificates and to assume Citizens' public service obligations for the operation of the utility systems in Arizona.

19. Staff and Arizona-American believe that the approval of the Agreement attached hereto as Exhibit A is in the public interest.

20 Based on our review of the evidence, Staff's recommendations in Findings of Fact No. 14 and the Agreement are reasonable and in the public interest. Therefore, the transfer of Citizens' water and wastewater utility assets and Certificates to Arizona-American should be approved.

CONCLUSIONS OF LAW

1. Citizens and Arizona-American are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282 and 40-285.

2. The Commission has jurisdiction over Citizens and Arizona-American and over the subject matter of the Application.

3. Citizens and Arizona-American provided notice of this proceeding in accordance with the law.

4. There is a continuing need for public water and wastewater service in the certificated service areas of Citizens.

5. Arizona-American is a fit and proper entity to receive the Certificates of Citizens.

6. The Application of Citizens and Arizona-American, the Agreement and the conditions recommended by Staff in Findings of Fact No. 14 should be approved.

ORDER

IT IS THEREFORE ORDERED that the Joint Application for Approval to Transfer the Assets and Certificates of Convenience and Necessity of Citizens Utilities Company, now known as Citizens Communications Company, together with its Agua Fria Water Division, Mohave Water Division. Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company, to Arizona-American Water Company be, and is hereby, approved.

IT IS FURTHER ORDERED that Arizona-American Water Company shall comply with the terms, conditions and requirements as set forth in the Staff Settlement Agreement, attached hereto as Exhibit A, and with Staff's recommendations in Findings of Fact No. 14 hereinabove.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 30 days from the date on which the acquisition has been completed, with the Director of the Commission's Utilities Division, appropriate documentation evidencing its acquisition of the Citizens Utilities Company now known as Citizens Communications Company's Arizona water and wastewater utility assets.

IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its customers of the effective date of the transfer of the utility assets and of its assumption of the obligation to provide water and wastewater utility services at the existing rates by means of an insert in its first regular monthly billing or by other appropriate means immediately following the date it files the documentation with the Director of the Utilities Division.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 15 days of the date it files the documentation with the Director of the Utilities Division, a copy of the notice it provides its customers.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to charge the existing rates and charges of the transferred utility companies until further Order by the Commission.

IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to file all periodic reports, and comply with all outstanding compliance matters previously required of Citizens Utilities Company, now known as Citizens Communications Company relative to the acquired water and wastewater operations.

IT IS FURTHER ORDERED that Citizens Utilities Company shall maintain its books and records for the transferred utility companies for a period of 5 years from the effective date of this Decision.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24TH day of April, 2001

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT_____

SERVICE LIST FOR: CITIZENS COMMUNICATIONS COMPANY ET AL.

DOCKET NOS.: W-01032A-00-0192; W-01032B-00-0192; W-01032C-00-0192; S-02276A-00-0192; WS-02334A-00-0192; WS-03454A-00-0192; WS-03455A-00-0192; W-02013A-00-0192; W-01595A-00-0192; and W-01303A-00-0192

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3099-0035/898296

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

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.	DOCKET NOS. W-01032A-00- 0192 W-01032B-00- 0192 W-01032C-00- 0192 S-02276A-00- 0192 WS-02334A-00-0192 WS-03454A-00-0192 WS-03455A-00-0192 W-02013A-00- 0192 W-01595A-00- 0192 W-01303A-00- 0192 SETTLEMENT AGREEMENT BETWEEN ARIZONA CORPORATION COMMISSION STAFF AND ARIZONA-AMERICAN WATER COMPANY

On March 24, 2000, Citizens Utilities Company (now known as Citizens Communications Company), its Agua Fria Water Division, its Mohave Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively, "Citizens") and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation Commission ("Commission") a joint application for the approval of the sale and transfer of Citizens water and wastewater utility plant, property and assets in Arizona, including transfer of Citizens' certificates of convenience and necessity

EXHIBIT A

("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

The Commission's Utilities Division Staff ("Staff") has investigated the application and has recommended that the application be approved by the Commission, subject, however, to certain conditions and requirements, which are set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has indicated that it is willing to accept the Staff Recommendations, with the exception of the recommendation that Citizens' advances in aid of construction ("AIAC") and contributions in aid of construction ("CIAC") be imputed to Arizona-American.

Representatives of Staff and Arizona-American have had discussions concerning the matters in dispute with respect to the application and have reached a settlement. The purpose of this Settlement Agreement is to memorialize the agreement that has been made by and among Staff and Arizona-American, which resolves all areas of disagreement relating to the terms and conditions under which Citizens' Arizona water and wastewater assets and Citizens' Certificates may be transferred to Arizona-American.

1. AIAC Imputation; Amortization. As of December 31,1999, Citizens' AIAC balance was $80,818,669. Citizens' AIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American becomes responsible for the provision of water and wastewater services will be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of AIAC imputed will be adjusted as more particularly provided below. The adjusted amount of AIAC will be amortized below the line (i.e., no impact on expenses) over a period of 6.5 years, with the amortization period beginning on the day on which the transfer takes place.

2. CIAC Imputation; Amortization. As of December 31, 1999, Citizens' CIAC balance was $4,734,430. Citizens' CIAC balance as of the date on which Citizens' water and wastewater assets and Certificates are transferred to Arizona-American and Arizona-American become responsible for the provision of water and wastewater services will also be imputed to Arizona-American. Such imputation shall be solely for ratemaking purposes. The total amount of CIAC to be imputed to Arizona-American will also be adjusted as provided below. The adjusted CIAC balance imputed to Arizona-American will be amortized above the line (i.e., as a reduction to depreciation expense) over a period of 10 years, with the amortization period beginning on the day on which the transfer takes place.

3. Adjustment to Recorded AIAC and CIAC Balances. The amounts of AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be based on the actual balances shown on Citizens' regulatory books as of the date of the transfer, adjusted as follows: An amount equal to five percent (5%) of Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and added to the CIAC balance, and the same amount will be deducted from Citizens' AIAC balance in computing the amounts to be imputed to Arizona-American for ratemaking purposes hereunder.

4. Adoption of Remaining Staff Recommendations. Arizona-American agrees that the Commission may adopt the remaining Staff Recommendations, as set forth in the Direct Testimony of Linda A. Jaress.

5. Deferral of Determination of Amortization Method. The parties agree that Arizona-American's request for an accounting order to establish the amortization method for any acquisition adjustment resulting from the transaction should be deferred until a future rate case.

6. Transfer in the Public Interest. Based on the foregoing agreements

and understandings, Staff agrees that Arizona-American is a fit and proper entity to acquire the Certificates and that the Commission should authorize and approve the transfer of Citizens' Arizona water and wastewater assets to Arizona-American on the terms set forth herein. No additional terms, conditions or requirements are necessary or appropriate.

7. Support and Defend. This Settlement Agreement will be introduced as an exhibit during the hearing on the application, presently set for September 27, 2000. Arizona-American and Staff will jointly request that the Settlement Agreement be received into evidence, and agree to support and defend this Settlement Agreement and the transfer of Citizens' water and wastewater assets and the Certificates to Arizona-American on the terms set forth herein as just, reasonable and appropriate based on the particular circumstances presented in this application.

8. Compromise; No Precedent. This Settlement Agreement represents a compromise in the positions of the parties hereto. By entering into this Settlement Agreement, neither Staff nor Arizona-American acknowledges the validity or invalidity of any particular method, theory or principle of regulation, or agrees that any method, theory or principle of regulation employed in reaching a settlement is appropriate for resolving any issue in any other proceeding, including (without limitation) any issues that are deferred to a subsequent rate proceeding. Except as specifically agreed upon in this Settlement Agreement, nothing contained herein will constitute a settled regulatory practice or other precedent.

9. Privileged and Confidential Negotiations. All negotiations and other communications relating to this Settlement Agreement are privileged and confidential, and no party is bound by any position asserted during the negotiations, except to the extent expressly stated in this Settlement Agreement.

As such, evidence of statements that were made or other conduct occurring during the course of the negotiation of this Settlement Agreement is not admissible in any proceeding before the Commission or a court.

10. Complete Agreement. This Settlement Agreement represents the complete agreement of the parties with respect to its subject matter. There are no understandings or commitments other than those expressly set forth herein.

DATED this 26 day of September, 2000.

ARIZONA CORPORATION COMMISSION STAFF

By: _____
Steven M. Olea
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

ARIZONA-AMERICAN WATER COMPANY

By: _____
Norman D. James
FENNEMORE CRAIG
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Arizona-American Water Company

An original and 10 copies of the foregoing was delivered this ___ day of September, 2000, to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing was delivered this ___ day of September, 2000, to:

Karen E. Nally
Assistant Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing
was telecopied/delivered and mailed this ___
day of September, 2000, to:

Daniel W. Pozefsky
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Citizens Communications Company
2901 N. Central, Suite 1660
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(602) 265-3415

By: _____

STEPHENSON DIR. EXH. 2

AMERICAN WATER WORKS - SHARED SERVICES CENTER
CITIZENS ACQUISITION
Final Acquisition Journal Entry - Arizona

F:\RATES\Arizona Citizens Rate Case\[AZ Czn Entries Fina

1. RECORD UTILITY PLANT PURCHASED (Booked in Jan Based on Nov Info)

JE2301, reclass debt JE231

230105.104000	Utility Plant Purchased/Sold	276,471,277		
230105.201200	Common Stock		110,888,158	
230105.221120	Bonds Inside		154,948,119	
230105.221100	Bonds Outside		10,635,000	

2. RECORD ACQUISITION - NET ASSETS

CZN record net assets	JE#			
230105.10400	Utility Plant Purchased/Sold		276,471,277	
230105.134100	Petty Cash	3,371		
230105.146100.001	A/R Other Manual (Notes Rec)	500,000		R
230105.141000	Accounts Receivable	1,723,245		R
230105.141000	Accounts Receivable-unexplained difference		71,151	
230105.144000	Unbilled Revenue	825,523		
230105.143000	Allowance for Doubtful Accounts		47,496	R
239902.241249.002	Collection for Others (agua fria)	27,730		
239902.241249.001	Collection for Others (agua fria)		27,730	
239903.241249.002	Collection for Others (Sun City)	9,027		
239903.241249.001	Collection for Others (Sun City)		9,027	
239901.241249.002	Collection for Others (Surprise)	382,751		
239901.241249.001	Collection for Others (Surprise)		382,751	
239905.241249.002	Collection for Others (Sabrosa)	4,952		
239905.241249.001	Collection for Others (Sabrosa)		4,952	
230105.146100.001	Misc A/R - Manual	581,849		R
230105.146100.001	Misc A/R - Manual	99,208		
230105.153000	Materials & Supplies-Stk E	30,557		
230105.165500	Prepaid Postage	896		R
230105.165500	Prepayments - Transition services	24,374		
230105.165500	Prepayments CAP Legal Services		2,500	
230105.105110.1 CZN X	Capital Exp. Invoices paid by Citizens	1,057,874		Exb I
238305.146100.001	Sabrosa Water Well Project	9,672		
236206.675000.2135	Sun City Main Repairs	5,654		
236406.675000.2135	Sun City West Main Repairs	195		
230105.101099	Utility Plant	272,822,609		
230105.101099	Utility Plant CBSC Assets	19,974		
230105.105110.1 CZN X	CWIP	6,110,694		
230105.108105	Accumulated Depreciation		55,775,969	
230105.108105	Accumulated Depreciation CBSC Assets		9,253	
230105.183000	Preliminary Survey & Investigation	663,525		R
230105.238010	Customer Deposits		143,867	R
238905.186898.DD230001 s	Ground Water Withdraw Fee	418		
236205.186898.DD230001 s	Ground Water Withdraw Fee		97,658	
236205.186898	DDA -Other	201,088		
236205.186898	DDA -Other	497,393		
236405.186898.DD230001 s	Ground Water Withdraw Fee		48,222	
236405.186898	DDA -Other		96,961	
236405.186898	DDA -Other	294,013		
236105.186898.DD230001 s	Ground Water Withdraw Fee		28,554	
236105.186898	DDA -Other	22,458		
236105.186898	DDA -Other		44,971	
236105.186898	DDA -Other	2,929,500		
230105.186898	DDN Other (regulatory assets)	1,392,615		R
230105.181110	Unamortized Debt Expense - outside	387,690		

230105.181110	Unamortized Debt Expense - outside	22,990	
230105.241998	Other Current Liability - analyzed		1,972,236.00
230105.236151	Accrued Property Taxes		886,624 sch
230105.252120	Advances for Const		23,364,564 sch
230105.262411	DCN - Advance Payments and Deposits Other		284,879 sch
230105.840000	Interest Exp Other	30,921	
230105.234300	A/P Misc. -Net Cash Payable		2,030,554
230105.114100	UPAA**	71,118,430	
		361,801,197	361,801,197

UPAA DETAIL

	Initial UPAA	
	Initial Cash Payment (line 5)	266,618,443
	Less: Net Assets Purchased	195,489,291
	Initial UPAA	71,129,152
	Difference	10,722
	CBSC Assets not on Citizen's AZ Balance sheet but should be according to the schedule	10,722 Part of IL workpapers

3. RECORD UTILITY PLANT DETAIL

GARY TO RECORD

230105.101099	Utility Plant (incl CBSC Assets)		272,842,583
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	
230105.101000.xxxxxx		xxx	

4. WRITE-OFF INVENTORY TO EXPENSE (CREDITED EXP WHEN LOADED)

CZN W/O Inventory #4		JE#	
230105.575000.16	Misc Oper Exp AG	30,557	
230105.153000	Material & Supplies		30,557

5. EXPENSE PREPAID POSTAGE

CZN - w/o prepaids#5		JE#	
230105.575000.16	Misc Expense	896	
230105.165500	Prepayments		896

6. EXPENSE PREPAID MOTOR VEHICLE TAXES AND CAP Legal

CZN - w/o prepaids#6		JE#	
230105.575000.16	Misc Exp	21,874	
230105.165500	Prepayments	2,500	
230105.165500	Prepayments		24,374

7. TO WRITE OFF UNBILLED REV.

CZN - w/o unbilled #7		JE#	
236105.401120	Aqua Fria Res	120,069	
236105.401220	Aqua Fria Comm	29,652	
236105.401520	Aqua Fria OPA	24,609	
236205.401120	Sun City Water - Res	211,176	
236205.401220	Sun City Water - Comm	36,464	
236405.401120	Sun City West - Res	107,910	
236405.401220	Sun City West - Comm	22,191	
237105.401120	Mohave - Res	115,155	
237105.401220	Mohave - Comm	32,575	
237105.401520	Mohave - OPA	4,601	
237305.401120	Havasu Res	17,944	
237305.401220	Havasu Comm	5,827	
238305.401120	Distco Res	71,303	

238305.401220	Distco Comm	9,753	
238905.401120	Tubac Res	13,783	
238905.401220	Tubac Comm	2,510	
230105.144000	Unbilled Revenue		825,523

8. CAPITAL INVOICES PAID BY CITIZENS NEED TASK ORDER NUMBERS

NO ENTRY NEEDED

Task Order	Anthem Valve Vaults Task Order 5	15,366	
Task Order	Anthem Water Treatment Plant Ph 3	51,093	
Task Order	Anthem Solids Handling Facility	344,109	
Task Order	Sun City West Reclaim Facilty	70,913	
Task Order	Sun Village Well #5	18,900	
Task Order	Sun Village Water Plant Mods	11,129	
Task Order	Sun Village SCADA	2,240	
Task Order	Sun City Grand Water Plant #1	7,990	
Task Order	Anthem Project Mana Phase 4	76,444	
Task Order	Anthem Water Campus WTP 4MGD	310,975	
Task Order	Anthem Water Campus Tank #2	3,757	
Task Order	AT/AF Interconnect	1,147	
Task Order	Oakmont Dr. Water Replace	1,965	
Task Order	Anthem Remote Vault Float Valve	7,410	
Task Order	Anthem Valve Replacement	5,124	
Task Order	Sun City West Service Replacements	5,916	
Task Order	Sun City Sewer Flo Mtr SCADA RTU	11,266	
Task Order	Water test Agua Fira	88	
Task Order	Water Test Sun City	70	
Task Order	Water Test Anthem	640	
Task Order	Sun City/Sun City West Grdwtr Svgs	3,016	
Task Order	Sun City/Sun City Wst Well Study	25,415	
Task Order	Whitestone Water Reclaim Fac	5,846	
Task Order	Anthem Finished Water Res.#2	47,735	
Task Order	Sun City Grand SCADA	1,560	
Task Order	99th & Olive Flow Meter	1,318	
Task Order	Sun Village Booster Station	3,494	
Task Order	Surprise Main Replace	1,520	
Task Order	Anthem Phase 2	1,851	
	SUB - TOTAL	1,038,299	
Need Task Order	Sun Valley Water Treatment Plant	19,575	Not On D. Baka's sheets
	Was on the PA line of Exhibit I should be AZ		
	TOTAL	1,057,874	

STEPHENSON DIR. EXH. 3

[09101] - Journal Entries

Functions Tools Help

Model (M)

Reverse or Void (R/V)

Document Type JE

Document Number/Co 24545 00023 Explanation RECLASS CITIZENS ORCOM CHARGES

G/L Date 12/31/01 Batch Number 23054064 Home BU

Remaining Ref 1

Skip to Line

Account No.	Subl/WO#	T	Amount	Explanation 2
230205.760715			607,722.55	
2302000E.105150.1	23002001	W	607,722.55-	

F5=Make New Model F6=% JE F15=Model JE's F13=Acct Master F24=More Keys MW

Citizens Business Services Company (CBSC)
Net Book Value of Assets - Banner System & Non Banner Items
At January 15, 2002

Category	Description	Capitalized Cost	Accumulated Depreciation	Est. Net Book Value	Allocated by State Illinois	Allocated by State Arizona
	Furniture & fixtures:					
5	Office furniture	2,497	1,157	1,340	1,340	0
6	Work tables, files & storage cabinets	3,582	1,662	1,920	1,920	0
7	Copier	1,565	728	837	837	0
8	Facsimile machine	2,465	1,141	1,324	1,324	0
9	File server & software - Sun City, Az	19,974	9,253	10,721	0	10,721
9	File server & software - Harvey, LA	99,870	46,263	53,607	53,607	0
9	File server & software - Woodridge, IL	79,895	37,011	42,884	42,884	0
10	PCs and software	53,085	24,595	28,490	28,490	0
11	Misc.	2,465	1,141	1,324	1,324	0
12	PC credit services	7,056	3,271	3,785	3,785	0
	Total Furniture & Fixtures	272,454	126,222	146,232	135,511	10,721
	Data Center Implementation:					
13	HAVC System (50%)	58,276	27,000	31,276	31,276	0
14	UPS unit	81,342	37,677	43,665	43,665	0
15	Generator	99,337	46,018	53,319	53,319	0
16	Fire suppression system	44,442	20,589	23,853	23,853	0
17	Raised flooring	10,212	4,726	5,486	5,486	0
18	Equipment racks / workstations	33,989	15,748	18,241	18,241	0
19	Telephone / data wiring	22,144	10,256	11,888	11,888	0
	Total Data Center Implementation	349,742	162,014	187,728	187,728	0
20	Computer hardware HP 9000 & HP-UX	705,391	326,768	378,623	378,623	0
	Mailing Center Implementation:					
28	HVAC system (50%)	36,260	16,797	19,463	19,463	0
29	Ceiling tile	1,514	705	809	809	0
30	Carpet padding	404	184	220	220	0
31	Canape	3,082	1,425	1,657	1,657	0
	Total Mailing Center Implementation	41,260	19,111	22,149	22,149	0
32	Automated mailing system	316,328	146,541	169,787	169,787	0
33	Billing printer	202,150	93,647	108,503	108,503	0
						0
34	Postage meter	7,046	3,263	3,783	3,783	0
	Total Allocated Assets	1,894,371	877,566	1,016,805	1,006,084	10,721
	Assets Expected to Retain					
	Banner System	2,956,710	1,369,691	1,587,019		
	Other Unallocated Assets	138,601	64,194	74,407		
	Software License cost transferred from LGS 12/00	1,223,780	265,152	958,628		
	Total Retained Assets	4,319,091	1,699,037	2,620,054		
	Total CBSC Assets	6,213,462	2,576,603	3,636,859		

ARIZONA-AMERICAN WATER COMPANY
SPREAD OF ORCOM COSTS

Water / Wastewater	4 Factor Percentage	% of 4 Factor Percentage	Banner	Arizona	ORCOM
Mohave Water	1.791	4.34%	$113,730	$113,730	$70,348
Havasu Water	0.215	0.52%	$13,653	$13,653	$8,445
Tubac Water	0.143	0.35%	$9,081	$9,081	$5,617
Sun City Water	3.295	7.99%	$209,236	$209,236	$129,424
Sun City Sewer	2.579	6.25%	$163,769	$163,769	$101,300
Sun City West Water/Wstwtr	4.011	9.72%	$254,703	$254,703	$157,548
Aqua Fria	1.862	4.51%	$118,239	$118,239	$73,137
California Water	7.450	18.06%	$473,083		$0
Home Water	1.862	4.51%	$118,239		$0
CU Water of Penn	1.361	3.30%	$86,425		$0
Lake Heritage	0.143	0.35%	$9,081		$0
Blue Mountain	1.289	3.12%	$81,853		$0
Glen Alsace	1.003	2.43%	$63,692		$0
CUC Illinois	10.316	25.00%	$655,077		$0
Flowing Wells	0.143	0.35%	$9,081		$0
Ohio Utilities	2.221	5.38%	$141,036		$0
Citizens Water Resources Co. of AZ	0.931	2.26%	$59,119	$59,119	$36,568
Citizens Water Services Co. of AZ	0.645	1.56%	$40,958	$40,958	$25,335
	41.26	100.00%			
Total Banner Net Assets Retained			$2,620,054	$982,488	$607,722
Total ORCOM Costs					$607,722

STEPHENSON DIR. EXH. 4

Arizona-American Water Co.
Citizens Acqusition - Phase 3 Costs
As of September 30,2002

	2000	2001	2002		Total
Service Company Charges	165,778	235,692	217,655	$	619,125
Intergration Services (Consultants)			157,932	$	157,932
Miscellaneous (*data lines, office trailer rental)*		1,497	450	$	1,947
Notices to Customers		375	5,407	$	5,782
	167,778	239,564	383,445	$	784,784

F:\RATES\Arizona Citizens Rate Case\[Phase 3 Acquisition Costs.xls]Phase 3

09200P

Account Ledger Print

Date - 9/25/02
Page - 1
From Date/Per 01/01/00
Thru Date/Per 12/31/00
Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	20608	02/29/00	Reclass 2/00 Service Co. Chrgs	14124		2,011.32		P
				Batch Date 03/08/00				User ID BBEINLIC
JE	405	03/31/00	Service Company Charges	15043		27,296.79		P
				Batch Date 04/05/00				User ID MPATACSI
JE	405	04/30/00	Service Company Charges	16469		35,842.17		P
			A#106,113,268,273	Batch Date 05/02/00				User ID MPATACSI
JE	20866	04/30/00	Reclass Mar.,00 Serv Co Chrgs	16469		822.51		P
				Batch Date 05/02/00				User ID MPATACSI
JE	405	05/31/00	Service Company Charges	18080		12,907.91		P
			A#106,113,268,273	Batch Date 06/05/00				User ID ARIVERA
JE	405	06/30/00	Service Company Charges	20131		54,847.50		P
			A#106,113,268,273	Batch Date 07/06/00				User ID MPATACSI
JE	405	07/31/00	Service Company Charges July 0	22002			4,038.25-	P
			A#106,113,268,273	Batch Date 08/03/00				User ID BBEINLIC
JE	405	08/31/00	Service Company Charges	23686		12,287.88		P
			A#106,113,268,273	Batch Date 09/06/00				User ID MPATACSI
JE	405	09/30/00	Service Company Charges	25338		6,022.32		P
			A#106,113,268,273	Batch Date 10/07/00				User ID DBAKA
JE	405	10/31/00	Service Company Charges	27022		5,786.27		P
			A#106,113,268,273	Batch Date 11/06/00				User ID DBAKA
JE	405	11/30/00	Service Company Charges	28379		3,944.81		P
			A#106,113,268,273	Batch Date 12/05/00				User ID DBAKA
JE	405	12/31/00	Service Company Charges	30020		8,046.96		P
			A#106,113,268,273	Batch Date 01/04/01				User ID DBAKA
						169,816.44	4,038.25-	

---- Account Balances ----

Ledger Total	165,778.19
Unposted	
Year-to-Date	165,778.19
Cumulative	165,778.19

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Sub Ledger/Ty *
Currency Code

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit	
JE	405	01/31/01	Service Company Charges AN106,113,268,273	32855 Batch Date 02/07/01		13,980.82		P User ID DBAKA
JE	405	02/28/01	Service Company Charges AN106,113,268,273	34637 Batch Date 03/06/01		8,400.76		P User ID DBAKA
JE	405	03/31/01	Service Company Charges AN106,113,268,273	36299 Batch Date 04/04/01		7,732.01		P User ID DBAKA
JE	405	04/30/01	Service Company Charges	38086 Batch Date 05/02/01		8,353.84		P User ID MPATACSI
JE	405	05/31/01	Service Company Charges	40082 Batch Date 06/05/01		1,224.37		P User ID DBAKA
JE	405	06/30/01	Service Company Charges	42149 Batch Date 07/05/01		609.09		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		895.92		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01		3,535.69		P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			471.88-	P User ID DBAKA
JE	405	07/31/01	Service Company Charges	44101 Batch Date 08/02/01			1.18-	P User ID DBAKA
JE	405	08/31/01	Service Company Charges	46074 Batch Date 09/06/01		19,930.36		P User ID DBAKA
JE	405	09/30/01	Service Company Charges	47791 Batch Date 10/04/01		29,575.23		P User ID DBAKA
CC	46250	10/31/01	JAMES M CAMPBELL SERIOUS SIGNS	49402 Batch Date 11/02/01		86.08		P User ID DBAKA
JE	405	10/31/01	Service Company Charges	49657 Batch Date 11/06/01		48,506.95		P User ID DBAKA
PV	5501	11/15/01	WOODENSHIP BILLING CHG PSTCRD: SURPSE AZ	50586 Batch Date 11/15/01		375.00		P User ID DBAKA Invoice 200233
PV	5563	11/28/01	QWEST - POB 2348 (CITIZENS) PREWIRE @ 11102 W ROSE GARDEN	50917 Batch Date 11/28/01		90.36		P User ID DBAKA Invoice A682306
JE	405	11/30/01	Service Company Charges	51279 Batch Date 12/04/01		36,592.11		P User ID DBAKA
PV	5689	12/14/01	UNITED RENTALS (formerly Woude OFFICE TRAILER RENTAL	52310 Batch Date 12/14/01		426.63		P User ID DBAKA Invoice 21818444-001
PV	5690	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		225.86		P User ID DBAKA
PV	5693	12/14/01	QWEST - POB 29060 (480..000M, POTS LINES INSTALLED	52310 Batch Date 12/14/01		270.04		P User ID DBAKA
PV	5739	12/26/01	QWEST - POB 29060 (480...636B, CITIZENS SERVICE: 11/28-12/27	52624 Batch Date 12/26/01		120.90		P User ID DBAKA Invoice 6235727003564B
JE	395	12/31/01	Special Accounts Payable AT&T - Citizens	53086 Batch Date 01/04/02		27,256.97		P User ID DBAKA
JE	405	12/31/01	Service Company Charges	52958 Batch Date 01/03/02		29,570.56		P User ID DBAKA
JE	24545	12/31/01	RECLASS CITIZENS ORCOM CHARGES	54064 Batch Date 01/10/02		607,722.55		P User ID DBAKA
PV	5778	12/31/01	UNITED RENTALS (formerly Woude	52935		276.63		P

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P
*
User ID DBAKA
Invoice 21919444-002

Account 23050.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subledger.	Debit	Credit
			RENT; 16 FT OFFICE TRAILER	Batch Date 01/03/02			
						845,758.73	473.06-

---- Account Balances ----

Ledger Total	845,285.67
Unposted	
Year-to-Date	845,285.67
Cumulative	845,285.67

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Ledger Type. AA
Sub Ledger/Ty *
Currency Code

Account 230105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO# .	Debit	Credit	P
PV	40068645	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,509.28		P User ID SCHAFFCE Invoice CAWW00602
PV	40068654	02/28/02	J L A ADVERTISING (JULIE LOHNE CALIFORNIA AMERICAN WATER CO	619415 Batch Date 03/01/02		2,897.51		P User ID SCHAFFCE Invoice CAWW00302
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		149,699.60		P User ID TUMANEW
JE	2335	05/31/02	Reclass expenses	1494101 Batch Date 06/10/02		8,231.91		P User ID TUMANEW
JE	2312	09/30/02	Reclass Citizens Phase 3	2169053 Batch Date 09/17/02		217,333.01		P User ID TUMANEW
						380,671.31		

---- Account Balances ----

Ledger Total	380,671.31
Unposted	
Year-to-Date	380,671.31
Cumulative	380,671.31

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Ledger Type. AA
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Currency Code

Account 230205.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
JE	66	01/31/02	record awws bill	478862		321.69		P
				Batch Date 02/06/02				User ID RUSSOTL
JE	66	02/28/02	record awws bill	665000				P
				Batch Date 03/05/02				User ID RUSSOTL
						321.69		

---- Account Balances ----

Ledger Total	321.69
Unposted	
Year-to-Date	321.69
Cumulative	321.69

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Currency Code

Account 236105.760715 Merger Costs Phase 3

DT	Document	Date	Explanation	Batch	Subl/WO#	Debit	Credit	
PV	40043671	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2447
PV	40043684	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELLS	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2446
PV	40043686	01/25/02	Arizona Dept of Water Resource CONVEYANCE OF RECOVERY WELL	379996 Batch Date 01/25/02		150.00		P User ID DIETZMDP Invoice DR2445
						450.00		

---- Account Balances ----

Ledger Total	450.00
Unposted	
Year-to-Date	450.00
Cumulative	450.00

Arizona / American
Rate Case Expense

Preparation of Rate Case			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Hourly Rate									
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

These expenses are to be capitalizated. These costs were incurred to enable Citizens data to usable for rate case

STEPHENSON DIR. EXH. 5

Arizona American - Management Fees Allocations

Line No.				
1	Annual Management Fee	$ 5,153,711		
2				
3				
4			4 Factor Formula	
5	**Location**		**Factor**	**Management Fee Allocation**
6				
7	Mohave Water, Havasu Water		0.1157	$ 596,284
8	Mohave Sewer		0.0070	36,076
9	Sun City Water		0.1797	926,122
10	Sun City Sewer		0.1014	522,586
11	Sun City West Water		0.1001	515,886
12	Sun City West WasteWater		0.1072	552,478
13	Agua Fria, CWS, CWR Water		0.2300	1,185,353
14	CWS, CWR Sewer		0.0558	287,577
15	Tubac Valley		0.0075	38,653
16				
17				
18	TOTAL CUSTOMER COUNT		0.9044	$ 4,661,016
19				
20				
21				

Arizona American - Management Fees Allocations

Line No.				
1	Annual Management Fee	$ 5,153,711		
2				
3				
4			4 Factor Formula	
5	**Location**		**Factor**	**Management Fee Allocation**
6				
7	Mohave Water		0.1011	$ 521,040
8	Havasu Water		0.0146	75,244
9	Mohave Sewer		0.0070	36,076
10	Sun City Water		0.1797	926,122
11	Sun City Sewer		0.1014	522,586
12	Sun City West Water		0.1001	515,886
13	Sun City West WasteWater		0.1072	552,478
14	Agua Fria		0.1384	713,274
15	CWS/CWR Water		0.0916	472,080
16				-
17	CWS/CWR Sewer		0.0558	287,577
18				-
19	Tubac Valley		0.0075	38,653
20				
21				
22	TOTAL CUSTOMER COUNT		0.9044	$ 4,661,016
23				
24				
25				

Management Fees
per168 Line 13

		Actual								Forecast		
											2002	
		January	February	March	April	May	June	July	ytd	Apr-July	YE Forecast	Annual Est
Arizona		22,441	215,344	396,649	429,178	471,821	396,921	451,837	2,384,191	437,439	4,571,387	5,249,271
per Dbaka amnt includes Amort OneTime Costs	Call Ctr				(4,295)	(4,295)	(6,681)	(6,681)	(21,951)			
	SSC			(5,881)	(1,960)	(2,312)	(2,815)	(2,815)	(15,784)			
per168 Line 13 less Amort One Time Costs		22,441	215,344	390,768	422,923	465,214	387,425	442,341	2,346,456	429,476	4,493,836	5,163,711

Customers	Current
AZ Total Water	74,325
AZ Total Sewer	40,198
Total Customers	114,523

Customers Per JDE STAT Report	Total	Residential	Commercial	Industrial	Fire	OPA	Resale
Paradise Valley	4,669	4,350	239	-	55	6	19
WhiteStone Water	-						
WhiteStone WasteWater	-						
Agua Fria - Water	13,566	13,271	246	-	44	1	4
Sun City Water	22,068	21,118	713	-	113	123	1
Sun City WasteWater	21,144	20,696	448				
Sun City West Water	15,303	14,925	337	-	41	-	-
Sun City West WasteWater	14,889	14,697	192				
Treatco Water	46	1	5	-	-	40	
Treatco WasteWater	7	1	4	-	-	2	
Distco Water	3,307	3,208	83	-	16		
Distco WasteWater	3,593	3,557	36				
Tusayan	-						
Surprise Water	23	15	8				
Cave Creek	-						
Tubac Water	488	426	62				
Mohave Water	13,623	12,741	696	-	98	88	-
Sorenson WasteWater	565	558	6	-	-	2	
Havasu Water	1,232	1,184	48				
Havasu WasteWater	-						
Check total	114,523						

Agua Fria (2361) Count	9	400,368
Cave Creek (2388) Count	1	44,485
Corporate (2301) Count	15	667,280
Distco (2383) Count	4	177,941
Distco Waste Water(2384) Count	2	88,971
Havasu (2373) Count	3	133,456
Mohave (2371) Count	16	711,766
Paradise Valley (2302) Count	10	444,853
Sun City (2362) Count	42	1,868,385
Sun City West (2364) Count	6	266,912
Sun City West Waste (2365) Count	9	400,368
Tubac (2389) Count	1	44,485
Grand Count	118	5,249,270

STEPHENSON DIR. EXH. 6

ARIZONA-AMERICAN WATER COMPANY
FOUR FACTOR ALLOCATION

DISTRICT/CO.	PLANT IN SERVICE	GENERAL METERED CUSTOMERS	SALARIES & WAGES	DIRECT O&M EXPENSES (EXCLUDE PR)	4 Factor Allocation %
SUN CITY SEWER	12,612,288	21,144	170,492	2,110,347	
DISTRICT/CO.	5.1853%	18.4614%	2.8744%	14.0583%	10.14%
SUN CITY WEST WASTE WATER	24,836,561	14,889	656,756	1,291,160	
DISTRICT/CO.	10.2111%	13.0000%	11.0727%	8.6012%	10.72%
MOHAVE (SORENSON)	1,742,120	565	66,444	71,876	
DISTRICT/CO.	0.7162%	0.4933%	1.1202%	0.4788%	0.70%
DISTCO/TREATCO SEWER	21,774,316	3,600	341,267	673,393	
DISTRICT/CO.	8.9521%	3.1433%	5.7537%	4.4859%	5.58%
SUN CITY WATER	28,533,245	22,068	1,248,678	2,973,822	
DISTRICT/CO.	11.7309%	19.2681%	21.0523%	19.8104%	17.97%
SUN CITY WEST WATER	24,724,945	15,303	494,526	1,226,276	
DISTRICT/CO.	10.1652%	13.3614%	8.3376%	8.1690%	10.01%
TUBAC VALLEY	1,450,789	488	84,319	85,010	
DISTRICT/CO.	0.5965%	0.4261%	1.4216%	0.5663%	0.75%
MOHAVE WATER	15,573,103	13,623	907,831	1,024,583	
DISTRICT/CO.	6.4026%	11.8946%	15.3057%	6.8254%	10.11%
HAVASU	1,447,094	1,232	184,457	157,357	
DISTRICT/CO.	0.5949%	1.0757%	3.1099%	1.0482%	1.46%
AGUA FRIA	49,451,561	13,589	688,562	1,731,272	
DISTRICT/CO.	20.3311%	11.8649%	11.6089%	11.5330%	13.84%
DISTCO/TREATCO WATER	39,161,570	3,353	626,309	1,059,889	
DISTRICT/CO.	16.1005%	2.9276%	10.5594%	7.0605%	9.16%
PARADISE VALLEY	21,923,699	4,677	461,666	2,606,438	
DISTRICT/CO.	9.0135%	4.0836%	7.7835%	17.3630%	9.56%
ARIZONA TOTAL	243,231,291	114,531	5,931,307	15,011,423	100.00%

STEPHENSON DIR. EXH. 7

ARIZONA-AMERICAN WATER COMPANY
2002 General Rate Case Application
Rate Case Expense

Estimated Rate Case Expense for Current Rate Case Application:

Consultants			
(see detail)			$608,000
Employee Cost per Day			
Hotel	$	105	
Airfare	$	50	
Food	$	30	
Miscellaneous	$	15	
Cost/Day	$	200	

AWWS Co. Employees		Cost/Day	Days	# Emps		Total $$
Filing	$	200	1	1	$	200
System Tour	$	200	3	3	$	1,800
Stipulation Meeting	$	200	1	2	$	400
Hearings	$	200	10	5	$	10,000
Commission Conference	$	200	2	2	$	800
Public Meetings (1)	$	200	4	2	$	1,600
Public Meetings (2)	$	200	4	4	$	3,200
Total					$	18,000

Mailings, Printings, Supplies & Miscellaneous	$80,000
Total Estimated Rate Case Expense	$706,000
Amortization Period (In Years)	3
Normalized Annual Rate Case Expense	$235,333
Recorded Rate Case Expense Per General Ledger	
Rate Case Expense Adjustment	$235,333

Arizona / American
Rate Case Expense

Preparation of Rate Case Hourly Rate			Kozoman CPA Bourassa CPA Monthly Charges (a)	Thomas Zep	Fennamore Craig $ 290.00	Expenses	Total Actual Expenses & Estimates	Kozoman & Bourassa Actual & Estimated Hours	Fennamore & Craig Actual & Estimated Hours
Dec. 2001	(1)	These expenses	$ 3,181					23	
Jan-02	(1)	are to be	9,544					68	
Feb.	(1)	capitalizated.	7,635					55	
March	(1)	These costs were	8,104					58	
April	(1)	incurred to enable	5,768					41	
May	(1)	Citizens data to	8,075					58	
June	(1)	usable for rate case	19,898					142	
July	Capitalized Costs	$ 121,747	59,541					425	-
August			81,366				81,366	581	-
Estimated September 2002			23,800	$ 25,000			130,166	170	-
Review Rate Filing Schedules and Testimony, Prepare Application					$ 80,000		210,166		276
Reproduction of Direct, Rebuttal & Rejoinder					10,000		220,166		34
Replies to Data Requests			30,000		20,000		270,166	200	69
Review ACC Staff & Intervenor Direct Rate Case Schedules and Testimony							270,166		
			15,000		10,000		295,166	100	34
Prepare Rebuttal Testimony & Schedules			35,000		30,000		360,166	233	103
Review ACC Staff and Intervenor's Surr.			12,000		10,000		382,166	80	34
Prepare Rejoinder Testimony & Schedules			20,000		15,000		417,166	133	52
Pre-Hearing Conference & Miscellaneous Activities					10,000		427,166		34
Preparation for Hearing				11,250			438,416	-	-
Hearing, estimated at six (6) days			80,000	15,000	80,000		613,416	533	276
Briefs			6,000		15,000		634,416	40	52
Analysis of Proposed Order					5,000		639,416		17
Preparation of exceptions					10,000		649,416		34
Preparation for and attend Open Meeting			2,400		5,000		656,816	16	17
			36,511		30,000		723,327	243	103
Totals			$ 342,077	$ 51,250	$ 330,000	$ -		2,331	1,034
Round Down to							$ 715,000		

STEPHENSON DIR. EXH. 8

per168 Actual (no Svc Co Expenses included)

Arizona	January	February	March	April	May	June	July	YTD	Forecast: Avg other than Mar-July Monthly Avg	Forecast: Mar-July YE Forecast	Annual Est				
Directors Fees			-	-	1,250	-	1,250	2,500	500	5,000	6,000	CC	MISC	6,000	
Bank Svc Charges CA	-	1,390	5,794	1,304	796	3,389	925	13,599	2,442	25,607	29,299	CC	OFFICE		
Bill Inserts -CA	-		440		-	925	-	1,364	341	3,070	4,095	CC	OFFICE		
Collection Agencies						-	145	145	73	508	870	CC	OFFICE		
Bank Svc Chg AG	-	306	-	-	-	235	-	541	47	778	564	CC	OFFICE		
Forms			1,295	365	3,524	172	1,758	7,114	1,423	14,228	17,074	CC	OFFICE		
Required Notifications		100	8,160	-	78,781	3,193	5,819	96,053	19,191	192,006	230,287	CC	OFFICE		
Bill Inserts AG			-	-	10,600	-	70	10,670	2,134	21,340	25,608	CC	OFFICE		
Brochures and Handouts			834	-	-	-		834	209	1,877	2,502	CC	OFFICE		
Community Relations			76	1,786	699	-	660	3,220	644	6,441	7,730	CC	OFFICE		
Postage CA			31	199	90,401	18,939	27,910	137,481	27,496	274,961	329,952	CC	OFFICE	647,981	
Incentive Plan	1,290	1,290	16,863	20,280	14,196	17,256	25,830	97,004	18,885	191,429	228,520	EE	S&W		
Group Insurance	32,598	30,669	60,198	83,721	24,043	47,051	44,214	322,495	51,845	881,722	622,145	EE	S&W		
PBOP	5,295	3,826	104,922	32,363	25,950	28,133	27,388	227,879	28,459	370,172	341,502	EE	S&W		
Wrks Comp	880	484	(196)	3,749	(7,845)	(1,317)	(2,333)	(6,578)	(1,586)	(14,520)	(19,061)	EE	S&W		
Dues/Memberships Deduct		697	973	362	170	(170)	170	2,202	301	3,707	3,612	EE	S&W		
Dues/Memberships NonDeduct		40	147	53	546	(389)	770	1,167	225	2,294	2,700	EE	S&W		
Employee Exp		175	3,716	11,498	32,963	(10,476)	10,313	48,189	9,803	98,208	115,234	EE	S&W		
Employee Exp Conf/Registration			1,067	770	1,373	2,294	4,744	10,249	2,050	20,497	24,595	EE	S&W		
Meal/Travel		239	1,773	4,478	10,816	(3,693)	3,190	18,805	3,313	33,371	39,766	EE	S&W		
Other Welfare			120	472	799	559	335	2,285	541	4,991	6,495	EE	S&W		
Employee Awards					42	-		42	21	147	252	EE	S&W		
Employee Physicals			270	205	79	60		814	154	1,382	1,642	EE	S&W		
Tuition			1,620	2,430	5,906	(3,396)	5,738	12,298	2,460	24,596	29,515	EE	S&W		
Training			530	170	2,263	(1,846)	9,224	10,341	2,068	20,682	24,818	EE	S&W		
401K	297	5,732	5,896	8,674	5,876	5,217	5,377	37,070	6,206	68,112	74,501	EE	S&W		
ESOP	2,045	7,491	7,522	10,724	6,834	6,703	6,450	47,769	7,647	88,002	91,759	EE	S&W	1,586,293	1,586,293
Trustee Fees		1,600	1,243	1,243	1,610	1,233	1,600	8,528	1,422	15,638	17,058	PFP	MISC	17,058	23,058
Credit Line Fees	101	103	1,094	369	215	1,166	634	3,683	696	7,161	8,347	PFP	OFFICE	8,347	1,293,829
General Liab Insurance, Property	2,509	2,509	3,169	2,509	2,674	5,608	3,283	22,241	3,445	36,484	41,335	RB	INS	41,335	258,736
Security Svc CA				1,005	460	458	449	2,372	593	5,337	7,119	RB	OFFICE		
Security Svc		15,516	44,104	52,184	90,296	32,047	44,029	278,177	52,532	540,837	630,384	RB	OFFICE	637,500	
Insurance Other, Gen. Liability	1,911	2,311	1,911	14,511	23,509	20,036	14,411	89,597	16,117	180,181	217,401	RB	INS	217,401	
Co Dues/Memberships Deduct		190	2,500	2,020	-	(1,990)	4,211	8,931	1,348	13,672	14,178				
Co Dues/Memberships NonDeduct			495	8,501	340	2,700		12,036	3,009	27,081	34,108				
Co Dues/Memberships AWWA Deduct			30	108	-	156		294	74	662	882				
Co Dues/Memberships AWWA NonDeduct			443	152	-	54		649	162	1,460	1,847				
Charitable Contributions Deduct				450	533	(108)		875	292	2,333	3,500				
Charitable Contributions NonDeduct				100	100	-		200	67	533	800				
Property Taxes	23,403	23,403	23,403	24,553	773,403	174,471	174,471	1,217,107	174,471	2,089,462	2,093,552		TOTAL	3,161,915	3,161,915

STEPHENSON DIR. EXH. 9

Acquisition Adjustment Analysis

CITIZENS

	BOY	Amortization	EOY	Tax Dep	Def Tax	Acc Def Tax	AVERAGE	Revenue Requirement	Total Revenue Requirement
BOY Balance	71,631,081								
0									
1	71,631,081	$141,500	71489581	4775405	1807223	1807223	70660000	7555000	$7,555,000
2	71489581	$156,400	71333181	4775405	1801412	3608635	68700000	7364000	$7,364,000
3	71333181	$172,800	71160381	4775405	1795016	5403651	66740000	7175000	$7,175,000
4	71160381	$190,900	70969481	4775405	1787957	7191608	64770000	6986000	$6,986,000
5	70969481	$211,000	70758481	4775405	1780118	8971726	62780000	6798000	$6,798,000
6	70758481	$233,100	70525381	4775405	1771499	10743225	60760000	6610000	$6,610,000
7	70525381	$257,600	70267781	4775405	1761944	12505169	58770000	6423000	$6,423,000
8	70267781	$284,600	69983181	4775405	1751414	14256583	56740000	6237000	$6,237,000
9	69983181	$314,400	69668781	4775405	1739792	15996375	54700000	6053000	$6,053,000
10	69668781	$347,400	69321381	4775405	1726922	17723297	52640000	5870000	$5,870,000
11	69321381	$383,900	68937481	4775405	1712687	19435984	50550000	5687000	$5,687,000
12	68937481	$424,100	68513381	4775405	1697009	21132993	48440000	5506000	$5,506,000
13	68513381	$468,600	68044781	4775405	1679654	22812647	46310000	5327000	$5,327,000
14	68044781	$517,800	67526981	4775405	1660466	24473113	44140000	5149000	$5,149,000
15	67526981	$572,100	66954881	4775405	1639289	26112402	41950000	4973000	$4,973,000
16	66954881	$632,200	66322681	0	-246558	25865844	40650000	4897000	$4,897,000
17	66322681	$698,500	65624181	0	-272415	25593429	40240000	4920000	$4,920,000
18	65624181	$771,800	64852381	0	-301002	25292427	39800000	4947000	$4,947,000
19	64852381	$852,700	63999681	0	-332553	24959874	39300000	4976000	$4,976,000
20	63999681	$942,200	63057481	0	-367458	24592416	38750000	5008000	$5,008,000
21	63057481	$1,041,000	62016481	0	-405990	24186426	38150000	5043000	$5,043,000
22	62016481	$1,150,300	60866181	0	-448617	23737809	37480000	5082000	$5,082,000
23	60866181	$1,270,900	59595281	0	-495651	23242158	36740000	5125000	$5,125,000
24	59595281	$1,404,300	58190981	0	-547677	22694481	35920000	5173000	$5,173,000
25	58190981	$1,551,600	56639381	0	-605124	22089357	35020000	5226000	$5,226,000
26	56639381	$1,714,400	54924981	0	-668616	21420741	34030000	5285000	$5,285,000
27	54924981	$1,894,300	53030681	0	-738777	20681964	32930000	5349000	$5,349,000
28	53030681	$2,093,000	50937681	0	-816270	19865694	31710000	5420000	$5,420,000
29	50937681	$2,312,600	48625081	0	-901914	18963780	30370000	5499000	$5,499,000
30	48625081	$2,555,200	46069881	0	-996528	17967252	28880000	5585000	$5,585,000
31	46069881	$2,823,300	43246581	0	-1101087	16866165	27240000	5681000	$5,681,000
32	43246581	$3,119,500	40127081	0	-1216605	15649560	25430000	5787000	$5,787,000
33	40127081	$3,446,800	36680281	0	-1344252	14305308	23430000	5905000	$5,905,000
34	36680281	$3,808,400	32871881	0	-1485276	12820032	21210000	6034000	$6,034,000
35	32871881	$4,207,900	28663981	0	-1641081	11178951	18770000	6177000	$6,177,000
36	28663981	$4,649,400	24014581	0	-1813266	9365685	16070000	6335000	$6,335,000
37	24014581	$5,137,200	18877381	0	-2003508	7362177	13080000	6509000	$6,509,000
38	18877381	$5,676,100	13201281	0	-2213679	5148498	9780000	6702000	$6,702,000
39	13201281	$6,271,700	6929581	0	-2445963	2702535	6140000	6916000	$6,916,000
40	6929581	$6,929,600	-19	0	-2702544	-9	2110000	7151000	$7,151,000
		71631100	2164820740	71631075			1551900000	234445000	$234,445,000

Cost of Debt	4.9200%	Tax Life	15	Premium Defined	
Cost of Equity	11.5000%	Tax Rate	39.00%		
Debt Percent	60.0000%			Allocated Purchase Price	276471277
Equity Percent	40.0000%			Total Value of Assets	205246727
Weighted Cost of Debt	2.9520%			Gross Premium	71224550
Weighted Cost of Equity	4.6000%			Capitalized Expenses	500000
				Corporate Costs	906531
Tax Gross Up	1.639			Net Premium	71631081
TOTAL REVENUE GROSS UP	10.4914%				

STEPHENSON DIR. EXH. 10

Exhibit A

Estimated Net Asset Adjustment
Arizona Water Property Detail
As of 11/01

	Mohave	Havasu	Sun City Water	SunCity Sewer	Tubac Valley	Agua Fria	Sun City West	TrestCo	Distco	Citizens Public Serv (Works of AZ)	Citizens Cons Serv (Mohave)	Citizen Water Resc Mgt Sv Co	Citizens Business Services (CBSC)	Total Az Water by Property	EXCL CBSC Total Az Water by Property
Petty Cash	$ 1,321	$ -	$ 2,050	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,371	$ 3,371
Notes Receivable	-	-	-	-	-	500,000	-	-	-	-	-	-	-	500,000	500,000
Accounts Receivable	467,298	45,069	787,008	297,124	26,611	674,508	572,212	54,229	336,635	-	3,951	-	-	3,264,645	3,264,645
Accounts Receivable - Other	-	-	10,417	217	-	334,011	-	63,617	150,533	485,586	-	-	-	1,044,381	1,044,381
Reserve for Doubtful Accounts	(25,168)	(1,257)	(2,975)	-	(85)	(6,436)	(375)	(433)	(10,992)	-	-	-	-	(47,723)	(47,723)
Material & Supplies	-	-	-	-	-	-	-	-	-	26,354	-	-	-	26,354	26,354
Special Deposits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Prepayments	1,000	2,415	91,730	-	1,254	99,049	50,998	5,930	-	-	-	-	3,751	256,127	252,376
Other Current Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Current Assets	444,451	46,227	886,230	297,341	27,780	1,601,130	622,835	123,343	476,176	511,940	3,951	-	3,751	5,047,155	5,043,404
Property Plant and Equipment	24,069,860	1,977,535	39,037,505	17,299,171	1,963,963	52,850,104	69,368,422	42,805,257	11,416,288	-	-	-	6,213,462	266,999,605	260,786,143
Construction Work in Progress	837,165	19,312	379,860	797,869	22,660	1,412,832	320,279	13,270,295	318,324	3,332	-	-	-	17,382,168	17,382,168
Accumulated Depreciation	(7,507,773)	(510,030)	(13,822,745)	(6,697,853)	(564,559)	(4,402,369)	(19,271,951)	(1,994,695)	(245,397)	-	-	-	(2,426,277)	(57,443,649)	(55,017,372)
Net Fixed Assets	17,399,292	1,486,817	25,594,620	11,399,207	1,422,284	49,860,567	50,414,750	54,080,857	11,489,213	3,332	-	-	3,787,185	226,938,124	223,150,939
Preliminary Survey & Investigation	-	-	385,769	-	-	-	268,836	-	-	-	-	-	-	654,605	654,605
Other Deferred Debits	-	-	585,266	-	533	2,921,537	139,137	-	100	-	-	-	-	3,646,595	3,646,595
Regulatory Assets	234,640	24,786	655,877	145,771	4,596	109,279	217,666	-	-	-	-	-	-	1,392,615	1,392,615
Unamortized Debt Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Non-Current	234,640	24,786	1,626,934	145,771	5,129	3,030,816	625,639	-	100	-	-	-	-	5,693,815	5,693,815
	$ 18,078,383	$ 1,557,830	$ 26,109,784	$ 11,842,319	$ 1,455,193	$ 54,492,513	$ 51,663,224	$ 54,204,200	$ 11,965,489	$ 515,272	$ 3,951	$ -	$ 3,790,936	$ 237,679,094	$ 233,888,158
Accounts Excluded:															
Cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
InterCompany Receivables	(9,633,765)	(661,563)	10,223,590	17,790,427	(405,108)	(18,006,861)	8,245,593	(32,068,952)	(1,999,397)	992,686	(1,357,696)	(650,696)	(3,874,841)	(31,426,583)	(27,551,742)
Clearing Accounts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment in Associate Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	(59,014)	(353)	(75,677)	(144,389)	(239)	(54,982)	(189,807)	(368,679)	(38,039)	(5,178)	-	-	(17,161)	(951,718)	(934,557)
Customers' Deposits	(106,658)	(10,905)	(1,575)	-	(410)	(18,059)	(1,750)	(1,600)	(2,736)	-	-	-	-	(143,893)	(143,893)
Income Taxes Accrued	(489,672)	(50,695)	(142,492)	(319,665)	(13,456)	(640,637)	(5,944)	(265,783)	170,736	(260,115)	187,588	-	-	(2,030,535)	(2,030,535)
Other Taxes Accrued	(225,680)	(17,857)	(183,547)	(82,173)	(13,067)	(289,104)	(176,886)	(61,998)	(20,240)	(1,851)	-	-	(373)	(1,072,776)	(1,072,403)
Interest Accrued	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Current & Accrued Liabilities	-	-	(11,682)	(1,932,421)	-	(308,402)	-	-	-	(422,125)	-	-	-	(2,674,630)	(2,674,630)
Subordinate Investment Note	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Customer Advances for Construction	(4,302,830)	(440,351)	(2,443,978)	(3,466,190)	(180,250)	(31,985,339)	(29,648,102)	(19,215,739)	(10,682,471)	-	-	-	-	(102,367,248)	(102,367,248)
Deferred Income Taxes	486,537	111,694	(1,794,869)	(356,822)	19,763	(978,964)	(2,162,338)	-	-	-	-	-	-	(4,674,819)	(4,674,819)
Regulatory Liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment Tax Credit	(84,565)	-	(386,710)	(179,606)	(16,477)	(94,636)	(1,148,406)	-	-	-	-	-	-	(1,910,600)	(1,910,600)
Other Deferred Credits	-	(12,327)	-	-	-	-	-	-	-	-	-	-	-	(12,327)	(12,327)
Contributions in Aid of Construction	(2,962,599)	(259,451)	(1,020,713)	(1,021,182)	(135,527)	(692,359)	(1,040,772)	-	-	-	-	-	-	(7,132,603)	(7,132,603)
Equity	(699,537)	(196,222)	(32,271,913)	(22,128,096)	(710,402)	(1,220,970)	(25,534,832)	(2,223,449)	804,658	(818,889)	1,166,157	650,696	101,439	(83,261,362)	(83,362,801)
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 SUN CITY WATER AND SUN CITY WASTEWATER DISTRICTS.	DOCKET NO. Ws-01303A-02-0868

SUPPLEMENT TO DIRECT TESTIMONY OF

DAVID P. STEPHENSON

EXHIBIT
A-69
Admitted

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I. INTRODUCTION 1

II. CAUSE OF INSUFFICIENCY: SUN CITY WATER DISTRICT(NO. 4) AND WASTEWATER DISTRICT (NO. 5) 1

1373387.2

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. The purpose of this supplemental testimony is to respond to Staff's List of Items Causing the Filing to be Insufficient dated December 23, 2002 ("Staff Insufficiency Finding"). In addition, the Company is concurrently filing supplements to the direct testimony of Thomas Bourassa and Ronald L. Kozoman in response to the Staff Insufficiency Finding.

Q. HOW WILL YOUR SUPPLEMENTAL TESTIMONY BE ORGANIZED?

A. In this testimony, I address Staff's expressed concerns over the application for the Sun City water and wastewater districts. Specifically, I address Staff's conclusion that Arizona-American's rate filings are insufficient because the Company's D Schedules did not present dollar values. The remaining items listed as causes of the insufficiency determination are addressed by Mr. Bourassa and Mr. Kozoman in the supplements to their direct testimony filed concurrently herewith.

II. CAUSE OF INSUFFICIENCY: SUN CITY WATER DISTRICT(NO. 4) AND WASTEWATER DISTRICT (NO. 5)

Q. IN THE STAFF INSUFFICIENCY FINDING, STAFF INDICATES THAT THE D SCHEDULES DO NOT HAVE DOLLAR VALUES. DO YOU HAVE ANY COMMENT?

A. Yes, Staff correctly notes that the D-1 and D-2 Schedules lack "dollar values," but the Company is not aware that the Commission's rules require that dollar values be included in the D Schedules. The D-1 and D-2 Schedules show the percentages of debt and equity and their respective cost, including their weighted costs. These schedules provide support for the weighted cost of capital. I also do not believe it is Staff's practice to include dollar value in its cost of capital schedules.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S FINDING CONCERNING THE D SCHEDULES?

A. Although Arizona-American disagrees that this is a basis for an insufficiency finding, we have revised the D-1 and D-2 Schedules for the Sun City water and wastewater districts to reflect the amounts of debt and equity in its capital structure. These schedules are attached hereto at Tab A.

Q. PLEASE YOU EXPLAIN THE DOLLAR VALUES YOU PROVIDED.

A. The amounts shown on the D-1 and D-2 Schedules reflect the debt and equity of the former Citizens properties of Arizona-American as a whole, rather than on a district-by-district basis. Because Arizona-American is an Arizona corporation and raises capital (debt and equity) on a company-wide basis, it is necessary to identify its capital structure on a company-wide basis. The debt and equity for the acquisition of the Citizens properties can easily be identified, at this time, and therefore we have done so for this filing. None of the different rate structures established during Citizens' ownership, have individual capital structures, nor can any of the Company's individual districts borrow funds or separately maintain capital accounts. Consequently, Arizona-American is requesting that its capital structure for the acquisition of the former Citizens property be used in determining the cost of capital for each district.

Q. DO ANY OF THESE REVISIONS TO THE D SCHEDULES AFFECT THE COMPANY'S COST OF CAPITAL ANALYSIS OR THE AMOUNT SHOWN ON SCHEDULE A-1?

A. No.

Q. DOES THAT CONCLUDE THE SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. Yes.

A

Arizona American
Test Year Ended December 31, 2001
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Stephenson

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
1	Long-Term Debt	165,583,119	59.89%	(a)	3.04%	177,583,119	60.00%	(a)	3.15%
2									
3	Stockholder's Equity	110,888,158	40.11%	11.50%	4.61%	118,888,158	40.00%	11.50%	4.60%
4									
5	Totals	276,471,277	100.00%		7.65%	296,471,277	100.00%		7.75% (b)
6									
7	(a) See D-2								
8	(b) Used on A-1								
9									
10	SUPPORTING SCHEDULES:								
11	D-1								
12	D-3								
13	D-4								
14	E-1								
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									

Arizona American
Test Year Ended December 31, 2001
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Stephenson

Line No.	Description of Debt	End of Test Year Amount Outstanding	End of Test Year Percent	End of Test Year Interest Rate	End of Test Year Composite Cost	End of Projected Year Amount Outstanding	End of Projected Year Percent	End of Projected Year Interest Rate	End of Projected Year Composite Cost
1									
2	Long-Term Debt	154,948,119	56.04%	4.92%	2.76%	154,948,119	52.26%	4.92%	2.57%
3	Long-Term Debt	10,635,000	3.85%	7.30%	0.28%	10,635,000	3.85%	7.30%	0.28%
4	Long-Term Debt	-	0.00%	0.00%	0.00%	12,000,000	3.89%	7.60%	0.30%
5									
6									
7									
8									
9									
10	Totals	165,583,119	59.89%		3.04%	177,583,119	60.00%		3.15%
11									
12	Supporting Schdules:								
13									
14									
15									
16									
17									
18									

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Norman D. James
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Attorneys for Arizona-American
Water Company

BEFORE THE ARIZONA CORPORATION COMMISSION

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 SUN CITY WEST WATER AND SUN CITY WEST WASTEWATER DISTRICTS.	DOCKET NO. WS-01303A-02-0867

SUPPLEMENT TO DIRECT TESTIMONY OF

DAVID P. STEPHENSON

EXHIBIT
A-70
Admitted

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I.	INTRODUCTION	1
II.	CAUSE OF INSUFFICIENCY: SUN CITY WEST WATER DISTRICT(NO. 5) AND WASTEWATER DISTRICT (NO. 4)	1

1373854.1

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. The purpose of this supplemental testimony is to respond to Staff's List of Items Causing the Filing to be Insufficient dated December 23, 2002 ("Staff Insufficiency Finding"). In addition, the Company is concurrently filing supplements to the direct testimony of Thomas Bourassa and Ronald L. Kozoman in response to the Staff Insufficiency Finding.

Q. HOW WILL YOUR SUPPLEMENTAL TESTIMONY BE ORGANIZED?

A. In this testimony, I address Staff's expressed concerns over the application for the Sun City West water and wastewater districts. Specifically, I address Staff's conclusion that Arizona-American's rate filings are insufficient because the Company's D Schedules did not present dollar values. The remaining items listed as causes of the insufficiency determination are addressed by Mr. Bourassa and Mr. Kozoman in the supplements to their direct testimony filed concurrently herewith.

II. CAUSE OF INSUFFICIENCY: SUN CITY WEST WATER DISTRICT(NO. 5) AND WASTEWATER DISTRICT (NO. 4)

Q. IN THE STAFF INSUFFICIENCY FINDING, STAFF INDICATES THAT THE D SCHEDULES DO NOT HAVE DOLLAR VALUES. DO YOU HAVE ANY COMMENT?

A. Yes, Staff correctly notes that the D-1 and D-2 Schedules lack "dollar values," but the Company is not aware that the Commission's rules require that dollar amounts be included in the D Schedules. The D-1 and D-2 Schedules show the percentages of debt and equity and their respective cost, including their weighted costs. These schedules provide support for the weighted cost of capital. I also do not believe it

is Staff's practice to include dollar value in its cost of capital schedules.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S FINDING CONCERNING THE D SCHEDULES?

A. Although Arizona-American disagrees that this is a basis for an insufficiency finding, we have revised the D-1 and D-2 Schedules for the Sun City West water and wastewater districts to reflect the amounts of debt and equity in its capital structure. These schedules are attached hereto at Tab A.

Q. PLEASE YOU EXPLAIN THE DOLLAR VALUES YOU PROVIDED.

A. The amounts shown on the D-1 and D-2 Schedules reflect the debt and equity of the former Citizens properties of Arizona-American as a whole, rather than on a district-by-district basis. Because Arizona-American is an Arizona corporation and raises capital (debt and equity) on a company-wide basis, it is necessary to identify its capital structure on a company-wide basis. The debt and equity for the acquisition of the Citizens properties can easily be identified, at this time, and therefore we have done so for this filing. None of the different rate structures established during Citizens' ownership, have individual capital structures, nor can any of the Company's individual districts borrow funds or separately maintain capital accounts. Consequently, Arizona-American is requesting that its capital structure for the acquisition of the former Citizens property be used in determining the cost of capital for each district.

Q. DO ANY OF THESE REVISIONS TO THE D SCHEDULES AFFECT THE COMPANY'S COST OF CAPITAL ANALYSIS OR THE AMOUNT SHOWN ON SCHEDULE A-1?

A. No.

Q. DOES THAT CONCLUDE THE SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. Yes.

A

Arizona American
Test Year Ended December 31, 2001
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Stephenson

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
1	Long-Term Debt	165,583,119	59.89%	(a)	3.04%	177,583,119	60.00%	(a)	3.15%
2									
3	Stockholder's Equity	110,888,158	40.11%	11.50%	4.61%	118,888,158	40.00%	11.50%	4.60%
4									
5	Totals	276,471,277	100.00%		7.65%	296,471,277	100.00%		7.75% (b)
6									
7	(a) See D-2								
8	(b) Used on A-1								
9									
10	SUPPORTING SCHEDULES:								
11	D-1								
12	D-3								
13	D-4								
14	E-1								
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Arizona American
Test Year Ended December 31, 2001
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Stephenson

Line No.	Description of Debt	End of Test Year Amount Outstanding	End of Test Year Percent	End of Test Year Interest Rate	End of Test Year Composite Cost	End of Projected Year Amount Outstanding	End of Projected Year Percent	End of Projected Year Interest Rate	End of Projected Year Composite Cost
1									
2	Long-Term Debt	154,948,119	56.04%	4.92%	2.76%	154,948,119	52.26%	4.92%	2.57%
3	Long-Term Debt	10,635,000	3.85%	7.30%	0.28%	10,635,000	3.85%	7.30%	0.28%
4	Long-Term Debt	-	0.00%	0.00%	0.00%	12,000,000	3.89%	7.60%	0.30%
5									
6									
7									
8									
9									
10	Totals	165,583,119	59.89%		3.04%	177,583,119	60.00%		3.15%
11									
12	Supporting Schdules:								
13									
14									
15									
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17									
18									

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 MOHAVE WATER DISTRICT AND ITS HAVASU WATER DISTRICT	DOCKET NO. W-01303A-02-0869

SUPPLEMENT TO DIRECT TESTIMONY OF

DAVID P. STEPHENSON

EXHIBIT
A-71
Admitted

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I. INTRODUCTION 1

II. CAUSE OF INSUFFICIENCY: MOHAVE WATER DISTRICT(NO. 7) AND HAVASU WATER DISTRICT (NO. 7) 1

1373859.1

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. The purpose of this supplemental testimony is to respond to Staff's List of Items Causing the Filing to be Insufficient dated December 23, 2002 ("Staff Insufficiency Finding"). In addition, the Company is concurrently filing supplements to the direct testimony of Thomas Bourassa and Ronald L. Kozoman in response to the Staff Insufficiency Finding.

Q. HOW WILL YOUR SUPPLEMENTAL TESTIMONY BE ORGANIZED?

A. In this testimony, I address Staff's expressed concerns over the application for the Mohave water and Havasu water districts. Specifically, I address Staff's conclusion that Arizona-American's rate filings are insufficient because the Company's D Schedules did not present dollar values. The remaining items listed as causes of the insufficiency determination are addressed by Mr. Bourassa and Mr. Kozoman in the supplements to their direct testimony filed concurrently herewith.

II. CAUSE OF INSUFFICIENCY: MOHAVE WATER DISTRICT(NO. 7) AND HAVASU WATER DISTRICT (NO. 7)

Q. IN THE STAFF INSUFFICIENCY FINDING, STAFF INDICATES THAT THE D SCHEDULES DO NOT HAVE DOLLAR VALUES. DO YOU HAVE ANY COMMENT?

A. Yes, Staff correctly notes that the D-1 and D-2 Schedules lack "dollar values," but the Company is not aware that the Commission's rules require that dollar amounts be included in the D Schedules. The D-1 and D-2 Schedules show the percentages of debt and equity and their respective cost, including their weighted costs. These schedules provide support for the weighted cost of capital. I also do not believe it

is Staff's practice to include dollar value in its cost of capital schedules.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S FINDING CONCERNING THE D SCHEDULES?

A. Although Arizona-American disagrees that this is a basis for an insufficiency finding, we have revised the D-1 and D-2 Schedules for the Mohave water and Havasu water districts to reflect the amounts of debt and equity in its capital structure. These schedules are attached hereto at Tab A.

Q. PLEASE YOU EXPLAIN THE DOLLAR VALUES YOU PROVIDED.

A. The amounts shown on the D-1 and D-2 Schedules reflect the debt and equity of the former Citizens properties of Arizona-American as a whole, rather than on a district-by-district basis. Because Arizona-American is an Arizona corporation and raises capital (debt and equity) on a company-wide basis, it is necessary to identify its capital structure on a company-wide basis. The debt and equity for the acquisition of the Citizens properties can easily be identified, at this time, and therefore we have done so for this filing. None of the different rate structures established during Citizens' ownership, have individual capital structures, nor can any of the Company's individual districts borrow funds or separately maintain capital accounts. Consequently, Arizona-American is requesting that its capital structure for the acquisition of the former Citizens property be used in determining the cost of capital for each district.

Q. DO ANY OF THESE REVISIONS TO THE D SCHEDULES EFFECT THE COMPANY'S COST OF CAPITAL ANALYSIS OR THE AMOUNT SHOWN ON SCHEDULE A-1?

A. No.

Q. DOES THAT CONCLUDE THE SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. Yes.

A

Arizona American
Test Year Ended December 31, 2001
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Stephenson

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
1	Long-Term Debt	165,583,119	59.89%	(a)	3.04%	177,583,119	60.00%	(a)	3.15%
2									
3	Stockholder's Equity	110,888,158	40.11%	11.50%	4.61%	118,888,158	40.00%	11.50%	4.60%
4									
5	Totals	276,471,277	100.00%		7.65%	296,471,277	100.00%		7.75% (b)
6									
7	(a) See D-2								
8	(b) Used on A-1								
9									
10	SUPPORTING SCHEDULES:								
11	D-1								
12	D-3								
13	D-4								
14	E-1								
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Arizona American
Test Year Ended December 31, 2001
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Stephenson

Line No.	Description of Debt	End of Test Year Amount Outstanding	Percent	Interest Rate	Composite Cost	End of Projected Year Amount Outstanding	Percent	Interest Rate	Composite Cost
1									
2	Long-Term Debt	154,948,119	56.04%	4.92%	2.76%	154,948,119	52.26%	4.92%	2.57%
3	Long-Term Debt	10,635,000	3.85%	7.30%	0.28%	10,635,000	3.85%	7.30%	0.28%
4	Long-Term Debt	-	0.00%	0.00%	0.00%	12,000,000	3.89%	7.60%	0.30%
5									
6									
7									
8									
9									
10	Totals	165,583,119	59.89%		3.04%	177,583,119	60.00%		3.15%
11									
12									
13	Supporting Schdules:								
14									
15									
16									
17									
18									

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 AGUA FRIA WATER DISTRICT, ITS ANTHEM WATER DISTRICT AND ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT.	DOCKET NO. WS-01303A-02-0870

SUPPLEMENT TO DIRECT TESTIMONY OF

DAVID P. STEPHENSON

EXHIBIT
A-72
Admitted

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II.	CAUSE OF INSUFFICIENCY: ANTHEM WATER DISTRICT (NO. 5), AGUA FRIA WATER DISTRICT (NO. 4) AND ANTHEM/AGUA FRIA WASTEWATER DISTRICT (NO. 4)	1

1373857.1

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. The purpose of this supplemental testimony is to respond to Staff's List of Items Causing the Filing to be Insufficient dated December 23, 2002 ("Staff Insufficiency Finding"). In addition, the Company is concurrently filing supplements to the direct testimony of Thomas Bourassa and Ronald L. Kozoman in response to the Staff Insufficiency Finding.

Q. HOW WILL YOUR SUPPLEMENTAL TESTIMONY BE ORGANIZED?

A. In this testimony, I address Staff's expressed concerns over the application for the Anthem water, Agua Fria water and Anthem/Agua Fria wastewater districts. Specifically, I address Staff's conclusion that Arizona-American's rate filings are insufficient because the Company's D Schedules did not present dollar values. The remaining items listed as causes of the insufficiency determination are addressed by Mr. Bourassa and Mr. Kozoman in the supplements to their direct testimony filed concurrently herewith.

II. CAUSE OF INSUFFICIENCY: ANTHEM WATER DISTRICT (NO. 5), AGUA FRIA WATER DISTRICT (NO. 4) AND ANTHEM/AGUA FRIA WASTEWATER DISTRICT (NO. 4)

Q. IN THE STAFF INSUFFICIENCY FINDING, STAFF INDICATES THAT THE D SCHEDULES DO NOT HAVE DOLLAR VALUES. DO YOU HAVE ANY COMMENT?

A. Yes, Staff correctly notes that the D-1 and D-2 Schedules lack "dollar values," but the Company is not aware that the Commission's rules require that dollar amounts be included in the D Schedules. The D-1 and D-2 Schedules show the percentages of debt and equity and their respective cost, including the weighted costs. These

schedules provide support for the weighted cost of capital. I also do not believe it is Staff's practice to include dollar value in its cost of capital schedules.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S FINDING CONCERNING THE D SCHEDULES?

A. Although Arizona-American disagrees that this is a basis for an insufficiency finding, we have revised the D-1 and D-2 Schedules for the Anthem water, Agua Fria water and Anthem/Agua Fria wastewater districts to reflect the amount of debt and equity in its capital structure. These schedules are attached hereto at Tab A.

Q. PLEASE YOU EXPLAIN THE DOLLAR VALUES YOU PROVIDED.

A. The amounts shown on the D-1 and D-2 Schedules reflect the debt and equity of the former Citizens properties of Arizona-American as a whole, rather than on a district-by-district basis. Because Arizona-American is an Arizona corporation and raises capital (debt and equity) on a company-wide basis, it is necessary to identify its capital structure on a company-wide basis. The debt and equity for the acquisition of the Citizens properties can easily be identified, at this time, and therefore we have done so for this filing. None of the different rate structures established during Citizens' ownership, have individual capital structures, nor can any of the Company's individual districts borrow funds or separately maintain capital accounts. Consequently, Arizona-American is requesting that its capital structure for the acquisition of the former Citizens property be used in determining the cost of capital for each district.

Q. DO ANY OF THESE REVISIONS TO THE D SCHEDULES EFFECT THE COMPANY'S COST OF CAPITAL ANALYSIS OR THE AMOUNT SHOWN ON SCHEDULE A-1?

A. No.

Q. DOES THAT CONCLUDE THE SUPPLEMENT TO YOUR DIRECT

TESTIMONY?

A. Yes.

A

Arizona American
Test Year Ended December 31, 2001
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Stephenson

Line No.	Item of Capital	End of Test Year Dollar Amount	Percent of Total	Cost Rate	Weighted Cost	End of Projected Year Dollar Amount	Percent of Total	Cost Rate	Weighted Cost
1	Long-Term Debt	165,583,119	59.89%	(a)	3.04%	177,583,119	60.00%	(a)	3.15%
2									
3	Stockholder's Equity	110,888,158	40.11%	11.50%	4.61%	118,888,158	40.00%	11.50%	4.60%
4									
5	Totals	276,471,277	100.00%		7.65%	296,471,277	100.00%		7.75% (b)
6									
7	(a) See D-2								
8	(b) Used on A-1								
9									
10	SUPPORTING SCHEDULES:								
11	D-1								
12	D-3								
13	D-4								
14	E-1								
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28									
29									

Arizona American
Test Year Ended December 31, 2001
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Stephenson

Line No.	Description of Debt	End of Test Year Amount Outstanding	End of Test Year Percent	End of Test Year Interest Rate	End of Test Year Composite Cost	End of Projected Year Amount Outstanding	End of Projected Year Percent	End of Projected Year Interest Rate	End of Projected Year Composite Cost
1									
2	Long-Term Debt	154,948,119	56.04%	4.92%	2.76%	154,948,119	52.26%	4.92%	2.57%
3	Long-Term Debt	10,635,000	3.85%	7.30%	0.28%	10,635,000	3.85%	7.30%	0.28%
4	Long-Term Debt	-	0.00%	0.00%	0.00%	12,000,000	3.89%	7.60%	0.30%
5									
6									
7									
8									
9									
10	Totals	165,583,119	59.89%		3.04%	177,583,119	60.00%		3.15%
11									
12	Supporting Schdules:								
13									
14									
15									
16									
17									
18									

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Water Company, Inc.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 TUBAC WATER DISTRICT.	DOCKET NO. W-01303A-02-0908

SUPPLEMENT TO DIRECT TESTIMONY OF

DAVID P. STEPHENSON

EXHIBIT
A-73
Admitted

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I. INTRODUCTION 1

II. CAUSE OF INSUFFICIENCY: TUBAC WATER DISTRICT NO. 4 1

III. CAUSE OF INSUFFICIENCY: TUBAC WATER DISTRICT NO. 7 3

JSHAPIRO/1381589

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. The purpose of this supplemental testimony is to respond to Staff's List of Items Causing the Filing to be Insufficient dated January 13, 2003 ("Staff Insufficiency Finding"). In addition, the Company is concurrently filing supplements to the direct testimony of Thomas Bourassa and Ronald L. Kozoman in response to the Staff Insufficiency Finding.

Q. HOW WILL YOUR SUPPLEMENTAL TESTIMONY BE ORGANIZED?

A. In this testimony, I address Staff's expressed concerns over the application for the Tubac water district. Specifically, I address Staff's conclusion that Arizona-American's rate filings are insufficient because (1) the Company's D Schedules did not present dollar values and (2) Staff's contention that the Company's rate filing does not include compliance with Commission Decision No. 64002. The remaining items listed as causes of the insufficiency determination are addressed by Mr. Bourassa and Mr. Kozoman in the supplements to their direct testimony filed concurrently herewith.

II. CAUSE OF INSUFFICIENCY: TUBAC WATER DISTRICT NO. 4

Q. IN THE STAFF INSUFFICIENCY FINDING, STAFF INDICATES THAT THE D SCHEDULES DO NOT HAVE DOLLAR VALUES. DO YOU HAVE ANY COMMENT?

A. Yes, Staff correctly notes that the D-1 and D-2 Schedules lack "dollar values," but the Company is not aware that the Commission's rules require that dollar amounts be included in the D Schedules. The D-1 and D-2 Schedules show the percentages of debt and equity and their respective cost, including their weighted costs. These schedules provide support for the weighted cost of capital. I also do not believe it

is Staff's practice to include dollar value in its cost of capital schedules.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S FINDING CONCERNING THE D SCHEDULES?

A. Although Arizona-American disagrees that this is a basis for an insufficiency finding, we have revised the D-1 and D-2 Schedules for the Tubac water district to reflect the amounts of debt and equity in its capital structure. These schedules are attached hereto at Tab A.

Q. PLEASE YOU EXPLAIN THE DOLLAR VALUES YOU PROVIDED.

A. The amounts shown on the D-1 and D-2 Schedules reflect the debt and equity of the former Citizens' properties of Arizona-American as a whole, rather than on a district-by-district basis. Because Arizona-American is an Arizona corporation and raises capital (debt and equity) on a company-wide basis, it is necessary to identify its capital structure on a company-wide basis. The debt and equity for the acquisition of the Citizens' properties can easily be identified, at this time, and therefore we have done so for this filing. None of the different rate structures established during Citizens' ownership, have individual capital structures, nor can any of the Company's individual districts borrow funds or separately maintain capital accounts. Consequently, Arizona-American is requesting that its capital structure for the acquisition of the former Citizens' properties be used in determining the cost of capital for each district.

Q. DO ANY OF THESE REVISIONS TO THE D SCHEDULES AFFECT THE COMPANY'S COST OF CAPITAL ANALYSIS OR THE AMOUNT SHOWN ON SCHEDULE A-1?

A. No.

III. CAUSE OF INSUFFICIENCY: TUBAC WATER DISTRICT NO. 7.

Q. STAFF ALSO CONTENDS THAT THE COMPANY'S RATE FILING FOR THE TUBAC WATER DISTRICT IS INSUFFICIENT BECAUSE THEY FOUND NO FILING IN COMPLIANCE WITH COMMISSION DECISION NO. 64002. HOW DOES ARIZONA-AMERICAN RESPOND?

A. As correctly pointed out in the Staff Insufficiency Finding, in Decision No. 64002, which approved the debt financing for the acquisition of the Citizens' water and wastewater systems, the Commission ordered the Company to "perform an analysis that shows the savings resulting from having [American Water] Capital Corp. provide financing compared to Arizona-American procuring financing from a non-affiliate." Arizona-American filed the analysis required by Decision No. 64002 on January 13, 2003. Therefore, Arizona-American has complied with the decision.

I should also note that we do not believe this is a proper basis for finding a rate filing insufficient in accordance under A.A.C. R14-2-103. Although this filing was to be made at the *time* of Arizona-American's next rate filing, there is no requirement that it be included in the rate application. Indeed, if we had included the analysis in the rate application, the Staff compliance officer would have been unable to verify that the required analysis had in fact been completed and filed. This would make no sense.

Q. DOES THAT CONCLUDE THE SUPPLEMENT TO YOUR DIRECT TESTIMONY?

A. Yes.

A

Arizona American
Test Year Ended December 31, 2001
Summary of Cost of Capital

Exhibit
Schedule D-1
Page 1
Witness: Stephenson

Line No.	Item of Capital	End of Test Year Dollar Amount	End of Test Year Percent of Total	End of Test Year Cost Rate	End of Test Year Weighted Cost	End of Projected Year Dollar Amount	End of Projected Year Percent of Total	End of Projected Year Cost Rate	End of Projected Year Weighted Cost
1	Long-Term Debt	165,583,119	59.89%	(a)	3.04%	177,583,119	60.00%	(a)	3.15%
2									
3	Stockholder's Equity	110,888,158	40.11%	11.50%	4.61%	118,888,158	40.00%	11.50%	4.60%
4									
5	Totals	276,471,277	100.00%		7.65%	296,471,277	100.00%		7.75% (b)
6									
7	(a) See D-2								
8	(b) Used on A-1								
9									
10	SUPPORTING SCHEDULES:								
11	D-1								
12	D-3								
13	D-4								
14	E-1								
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Arizona American
Test Year Ended December 31, 2001
Cost of Long Term Debt

Exhibit
Schedule D-2
Page 1
Witness: Stephenson

Line No.	Description of Debt	End of Test Year Amount Outstanding	End of Test Year Percent	End of Test Year Interest Rate	End of Test Year Composite Cost	End of Projected Year Amount Outstanding	End of Projected Year Percent	End of Projected Year Interest Rate	End of Projected Year Composite Cost
1									
2	Long-Term Debt	154,948,119	56.04%	4.92%	2.76%	154,948,119	52.26%	4.92%	2.57%
3	Long-Term Debt	10,635,000	3.85%	7.30%	0.28%	10,635,000	3.85%	7.30%	0.28%
4	Long-Term Debt	-	0.00%	0.00%	0.00%	12,000,000	3.89%	7.60%	0.30%
5									
6									
7									
8									
9									
10	Totals	165,583,119	59.89%		3.04%	177,583,119	60.00%		3.15%
11									
12	Supporting Schdules:								
13									
14									
15									
16									
17									
18									

Arizona American
Test Year Ended December 31, 2001
Cost of Preferred Stock

Exhibit
Schedule D-3
Page 1
Witness: Stephenson

Line No.	Description of Issue	End of Test Year Shares Outstanding	End of Test Year Amount	End of Test Year Dividend Requirement	End of Projected Year Shares Outstanding	End of Projected Year Amount	End of Projected Year Dividend Requirement
1							
2							
3	NOT APPLICABLE, NO PREFERRED STOCK ISSUED OR OUTSTANDING						
4							
5							
6							
7							
8							
9							
10							
11							
12							
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14							
15							
16							
17	SUPPORTING SCHEDULES:			RECAP SCHEDULES:			
18	(a) E-1			(a) D-1			
19							
20							

Arizona American
Test Year Ended December 31, 2001
Cost of Common Equity

Exhibit
Schedule D-4
Page 1
Witness: Zepp

Line No.	
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3	THE COMPANY IS REQUESTING 11.5% RATE OF RETURN ON COMMON EQUITY.
4	THE REQUEST IS SUPPORTED BY THE TESTIMONY AND EXHIBITS OF
5	DR. THOMAS M. ZEPP INCLUDED IN THE FILING.
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BEFORE THE ARIZONA CORPORATION COMMISSION

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 SUN CITY WEST WATER AND WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0867**
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., 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 SUN CITY WATER AND WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0868**
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 MOHAVE WATER AND HAVASU WATER DISTRICTS.	**DOCKET NO. W-01303A-02-0869**

EXHIBIT
A-74
Admitted

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, AGUA FRIA WATER AND ANTHEM/AGUA FRIA WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0870**
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 TUBAC WATER DISTRICT.	**DOCKET NO. W-01303A-02-0908**

REBUTTAL TESTIMONY OF

DAVID STEPHENSON

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I. INTRODUCTION

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

A. My name is David P. Stephenson. My business address is 303 H Street, Suite 250, Chula Vista, California 91910. My telephone number is (619) 409-7700.

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

A. I am employed by the Service Company, as the Director of Rates and Planning for AWW's water and wastewater utilities located in Arizona, California, Hawaii, New Mexico and Texas, including Arizona-American.[1] These five utilities are commonly referred to as the Western Region. I am also an Assistant Treasurer for Arizona-American.

II. OVERVIEW AND SUMMARY OF REBUTTAL TESTIMONY

Q HAVE YOU READ ALL OF THE DIRECT TESTIMONIES OF THE WITNESSES FOR THE STAFF, RUCO, AND THE TOWN OF YOUNGTOWN?

A. Yes, I have.

Q. DO YOU AGREE WITH ALL OF THE PROPOSED ADJUSTMENTS AND RECOMMENDATIONS BY EACH OF THE PARTIES?

A. No, I do not.

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

A. The purpose of my rebuttal testimony is to respond to various issues raised in the testimony of the witnesses for Staff, RUCO and the Town of Youngtown ("Youngtown"). I will generally be covering issues related to: 1) the Company's

[1] As applicable, I will use the same abbreviations and conventions in this rebuttal testimony as I utilized in my direct testimony for Arizona-American.

overall filing, the test period and the timing of the filing; 2) the acquisition premium; 3) inclusion of Service Company charges in the test period; 4) rate case expense; 5) issues related to capital structure and cost of debt; and 6) issues related to the financial integrity of the Company.

III. SUMMARY OF ARIZONA-AMERICAN'S REQUEST FOR RATE RELIEF

Q. WHY DID ARIZONA-AMERICAN SEEK RATE RELIEF USING A 2001 TEST YEAR?

A. The Company filed for rate relief because the rates being charged in most of the water and wastewater districts acquired from Citizens are inadequate to allow for recovery of operating expenses and a reasonable return on the Company's investment in plant to serve customers. We determined that, for ease of presentation, the period ending December 31, 2001, was the appropriate test period for this case as it is closely aligned with the purchase of the Citizens Assets by Arizona-American.

Q. DO YOU AGREE WITH STAFF AND RUCO THAT THE RATE FILING WAS BASED ON A "STALE TEST YEAR"?

A. No. Staff witness Darron Carlson alludes to his belief that these cases are based on a stale test year. Direct Testimony of Darron W. Carlson ("Carlson DT") at 10-11. However, Mr. Carlson never defines "stale" nor explains why the Company's filings should be considered stale. RUCO witness Rodney Moore uses the word stale along with other unfavorable adjectives to describe information provided by the Company. Direct Testimony of Rodney L. Moore ("Moore DT") at 2, l. 23. Like Mr. Carlson though, Mr. Moore provides no definition or description for this term, and never really claims that the applications were stale, only that certain information should be considered stale.

In response to Company data request 2.15, Staff defined stale as "having

lost freshness" and further stated that the test year chosen by Arizona-American "doesn't appear to be the most recent practical year." See Staff Response to Data Request 2.15, copy attached hereto as Stephenson Rebuttal Exhibit 1. Again, however, Staff provides absolutely no support for Mr. Carlson's contention that Arizona-American did not use the most practical test year, nor does Staff present any evidence as to what would be considered a more practical test year.

Q. WAS THE COMPANY'S FILING BASED ON THE MOST PRACTICAL TIME PERIOD AVAILABLE?

A. Yes, as explained in my direct testimony, Arizona-American had no choice but to use the time period and data that it did to file these cases. To use a 2002 historical year and test year, Arizona-American would have had to wait until well past year-end 2002 to compile and prepare the filing and, by that time, we would have been prohibited from seeking rate relief due to the three-year moratorium imposed in Decision No. 63584 (December 12, 2001). The Company would have incurred severe financial hardship had it not sought rate relief for another three years.

Q. WHY COULDN'T ARIZONA-AMERICAN FILE BASED ON SOME OTHER 12-MONTH PERIOD ENDING AT SOME POINT IN 2002?

A. Quite simply it would have been impossible to file a case based on a partial year of Citizens data and a partial year of Arizona-American data. The two companies use different accounting and customer billing software programs. The output of these programs would have made it impossible to integrate the data successfully.

Q. WHY DID ARIZONA-AMERICAN TELL STAFF THAT IT WOULD FILE FOR RATE RELIEF BASED ON A JUNE 30, 2002 TEST PERIOD?

A. To my knowledge we never made such a representation to Staff, as Mr. Carlson alleges. Carlson DT at 13. It is possible that we said we would cut off plant addition as of June 30, 2002, providing the case was filed in July or August 2002,

but given the fact that we could not use a partial year of Citizens' data and a partial year of Arizona-American data, it was never even a consideration to file on any other period than a test period ended December 31, 2001.

Q. DID THE COMPANY TELL STAFF THAT IT WOULD FILE THE CASE WITH NO POST-TEST YEAR PLANT ADDITIONS?

A. No, although we did indicate that we would not file a case with pro forma plant additions further than three months beyond the filing date. This is consistent with the rate applications we filed in late November 2002, with pro forma plant additions through December 31, 2002. As Staff agrees, this was also consistent with Decision No 61831. Carlson DT at 12.

Q. DID STAFF AGREE WITH THE INCLUSION OF THESE PLANT ADDITIONS THROUGH DECEMBER 31, 2002?

A. Yes, Mr. Carlson explains why Staff accepted the Company's proposal to include non-revenue producing plant additions completed and placed in service by December 31, 2002. Carlson DT at 14-16.

Q. DO YOU AGREE WITH RUCO'S TESTIMONY (MOORE DT AT 2) THAT "A LARGE PERCENTAGE OF THE INFORMATION PROVIDED BY THE COMPANY WAS IRRELEVANT, STALE, INCOMPLETE, NON-VERIFIABLE, POORLY FORMATTED, SUSPECT AND/OR UNTIMELY"?

A. No. Frankly, the RUCO witness, Mr. Moore, is exaggerating the circumstances in these proceedings, and mischaracterizing the information provided by the Company. Mr. Moore states that over 300 questions on 39 sets of data requests, numerous telephone conversations and several face-to-face meeting were held, illustrating that there were problems with the data provided by the Company. Moore DT at 2-3. This is absurd given that such discovery would be expected in a

rate case involving 10 separate operating water and wastewater districts, all of which have not had rate cases filed with test periods on or before 1995. In some districts, there has not been a rate case filed since 1988. I am not sure what Mr. Moore expected.

Q. WOULD THE SITUATION MR. MOORE COMPLAINS OF HAVE BEEN IMPROVED IF ARIZONA-AMERICAN WAITED TO FILE BASED ON A LATER TEST YEAR?

A. No, it would not have been any better had the Company waited to file. In fact, it would have been much worse. All of the information Mr. Moore refers to is plant-related data. All of the historical plant data had to come from Citizens, and the longer the Company waited the more likely that the data would have not been available. The Company had a working arrangement with Citizens for a period of one year after the close of the sale. Citizens bent over backwards to provide all of the data that they had available, however, Citizens is no longer in the water and sewer service business. Some of the historical data had been purged from their systems prior to the Citizens' Acquisition. By way of comparison, in the Paradise Valley rate case filed in 1989, there were over 1200 data requests and sup-parts, even though Paradise Valley is just one operating district serving approximately 4,500 customers.

Q. MR. MOORE ALSO STATES THAT HE SPENT NUMEROUS HOURS TRYING TO RECONCILE THREE DIFFERENT BILL COUNTS. IS THAT INAPPROPRIATE?

A. Not in the least. Again, there are 10 separate operating districts seeking rate relief in this case, many with diverse tariffs, and several of these have not been through rate proceedings in more than a decade. The rates for some of the districts, which the Commission approved, are quite complicated. The Company inherited three

rate structures, and also spent a considerable amount of time dealing with them. The bottom line is, again, that this is a complicated rate case. Consequently, Mr. Moore's complaints have no basis.

Q. DO YOU AGREE THAT MUCH OF THE DATA CONTAINED IN THE FILING WAS NOT RELEVANT BECAUSE ARIZONA-AMERICAN DID NOT OWN THESE DISTRICTS DURING THE TEST PERIOD OF 2001?

A. No, I do not agree. The fact is that operation and maintenance expenses are incurred in each of these districts and are materially similar whether under Citizens' or Arizona-American's ownership. The rate base at the district level also did not materially change with the change in ownership. Further, although administrative and general costs, i.e., overhead from the parent and/or affiliated service providers, will differ depending on how the parent wishes to administer all operations, this merely supports the pro forma adjustments recommended by RUCO and the Company, i.e., use of the 2002 recorded data for Arizona-American's corporate and Service Company charges. Again, I will emphasize that this has no impact on the plant and district level operating expenses of each of the districts.

Q. MS. DIAZ-CORTEZ STATES, HOWEVER, THAT THE ESTIMATES USED BY THE COMPANY TO REPLACE THE CITIZENS' MANAGEMENT FEES WERE CLEARLY SPECULATIVE. DOES RUCO REALLY AGREE WITH THE USE OF THE SERVICE COMPANY FEES IN 2002 TO DETERMINE THE REVENUE REQUIREMENT?

A. Yes. Ms. Diaz-Cortez is correct that the filing contained estimated numbers for the Service Company and corporate charges. This was a timing issue later corrected when the Company, as part of its responses to data requests, provided the actual 2002 charges to all parties requesting such information, including Staff and

RUCO. These actual expenses are obviously not speculative. These recorded 2002 charges would not change and certainly are not reasonably considered speculative. In fact, as provided in an analysis by Mr. Bourassa in his rebuttal testimony, the estimated charges Arizona-American provided in the filing are extremely close to the actuals recorded by Arizona-American for 2002. Therefore, I would suggest that Arizona-American is not basing its request for the rate relief on estimates or speculation, but on accepted ratemaking principles including using pro forma adjustments to normalize for known and measurable changes. See A.A.C. R14-2-103(A)(3)(i).

Q. WHAT ABOUT COMPLAINTS THAT IT WAS TIME CONSUMING TO ANALYZE THE 2002 DATA OF THE SERVICE COMPANY?

A. I would expect that it would be. It should always take time to analyze data to ensure that proper charges were allocated to each district. I applaud RUCO for their analysis and their conclusion that AWW properly allocated costs to Arizona, as must be the fact since they determined that the recorded costs in 2002 for the Service Company were appropriate. Direct Testimony of Marylee Diaz-Cortez ("Diaz-Cortez DT") at 21-22; see also Rebuttal Testimony of Thomas J. Bourassa ("Bourassa RBT") at 20-27 (explaining inappropriate adjustments made by RUCO in their determination of the appropriate level of expense).

Q. DO YOU AGREE WITH MR. MOORE THAT A PROBLEM EXISTED WITH THE COMPANY PROVIDING THE COMMISSION'S APPROVED 1995 PLANT BALANCES?

A. I agree that there was a problem in understanding the prior Commission decision and that the Company may have been unable to provide every possible piece of evidence concerning plant costs. However, as discussed above, the longer the Company waited to file a case, the worse this situation would have been. As

explained earlier, both Citizens and AWW provided all the data they could in the most expeditious manner. If Arizona-American had deferred the rate case, much less data and assistance would have been available from Citizens.

Q. DO YOU AGREE THAT MANY PLANT ENTRIES AND RETIREMENTS HAD TO BE ANALYZED WITHOUT VERIFICATION DUE TO A LACK OF SOURCE DOCUMENTS?

A. Again, there was some source documentation that was not available from Citizens. However, in my view, this comes down to a lack of trust on RUCO's part. The computer documentation that was available was provided. Citizens provided all documentation that was necessary to verify that expenditures were made for plant additions in each and every year. Under any practical auditing methodology, I firmly believe that more than sufficient information was provided to determine appropriate capitalization of assets from the last test period to the current test year for each district.

Q. BUT WOULDN'T THE CLAIMED LACK OF SPECIFIC ALLOCATION FACTORS RUCO DISCUSSED CREATE PROBLEMS IN DETERMINING THE PROPER LEVEL OF EXPENSE CHARGED TO EACH OPERATING DISTRICT?

A. Absolutely not. Arizona-American does not specifically allocate Service Company charges or general corporate charges to each operating district. Instead, Arizona-American has a corporate district to which all of these costs are charged. The Company did explain how it suggested allocating the charges to each of the districts based on very specific factors. This information was provided in the initial filing. All parties have the right to differ on how charges should be allocated, but it is clearly the obligation of each party to do its own analysis if it disagrees with the Company's proposal. If RUCO suggests that it created more

work for them to due their own allocation, RUCO may need to consider their own methodology. This does not mean, however, that the Company's allocation methodology was inadequate or improper.

Q. MR. STEPHENSON, DOES THAT MEAN YOU AGREE WITH RUCO'S CONTENTION THAT (MOORE DT AT 4) "ANY DETERMINATION OF THE RATEMAKING ELEMENTS BASED ON THIS APPLICATION AS FILED WOULD NOT ACCURATELY REPRESENT THE ACTUAL PRESENT VALUE OF RATE BASE, OPERATING INCOME, OPERATING EXPENSES AND/OR REVENUE REQUIREMENT"?

A. Again, absolutely not. RUCO simply wishes to delay rate increases as long as possible. The rate base determination is as accurate as humanly possible given the length of time between filings and the closing of Citizens water and sewer operations. Operating income is no more than the subtraction of revenues and expenses. Operating revenues were verified by all parties as accurate. Operating expenses were the recorded cost of the operating districts for the historical test period. Operating expenses of the Service Company and AWW Corporate Office were the actual costs for 2002, and are reflective of the current operating philosophy of the parent, as RUCO agrees. Diaz-Cortez DT at 21-22.

IV. <u>ACQUISITION ADJUSTMENT</u>

Q. STAFF AND YOUNGTOWN HAVE BOTH SUGGESTED THAT THE COMPANY HAS INAPPROPRIATELY INCLUDED THE "PREMIUM" THAT THE COMPANY'S PARENT, AWW, PAID IN THE CITIZENS' ACQUISITION TO CITIZENS AS PART OF RATE BASE. DO YOU AGREE?

A. Not really. As a preliminary matter, I should note that the "premium" is really not a premium. Instead, it is the difference between the recorded book costs, less

depreciation, of Citizens' utility plant and assets and the purchase price negotiated between Citizens and Arizona-American and its parent, AWW. The purchase price reflected the current value of Citizens' utility plant and assets. For accounting purposes (not valuation purposes), an acquisition adjustment or "premium" is recorded on the books of Arizona-American based on the purchase price paid.

In its direct filing, the Company did mistakenly include the recovery **of** the acquisition premium through amortization as part of depreciation expense. This was inappropriate due to the fact that the Company was not requesting that the revenue requirement in these applications be based on the inclusion of a return **on** the premium. This has been corrected by removal of the return **of** the premium (amortization) in the revenue requirement. The Company **did not** include a return **on** the premium in the revenue requirement. The Company, according to the Arizona Constitution, has requested that its rates be determined based on the "fair value" of its utility plant and property at the time rates are set. The Company has not included any acquisition adjustment or premium in its fair value rate base ("FVRB").

Q. SO YOU AGREE THAT THE COMPANY IS, BY COMMISSION ORDER, "REQUIRED TO DEMONSTRATE THAT CLEAR, QUANTIFIABLE AND SUBSTANTIAL NET BENEFITS TO RATEPAYERS HAVE RESULTED FROM THE CITIZENS' ACQUISITION THAT WOULD NOT HAVE BEEN REALIZED HAD THE TRANSACTION NOT OCCURRED BEFORE THE COMMISSION WILL CONSIDER RECOVERY OF ANY ACQUISITION ADJUSTMENT IN A FUTURE RATE PROCEEDING"?

A. Yes, in accordance with Decision No. 63584, as I clearly discussed in my direct testimony. I further explained that Arizona-American has not attempted to prove

the net benefits at this time. Obviously, we have provided a showing of what net benefits might be expected, and as shown later in this testimony, we do have a reasonable idea of the quantity of some of those benefits, but an acquisition adjustment is not requested in this case.

Q. SO YOU DISAGREE WITH STAFF THAT ARIZONA-AMERICAN IS PROPOSING TO RECOVER THE ACQUISITION ADJUSTMENT BY INCLUDING IT IN THE ORIGINAL COST RATE BASE?

A. I strongly disagree with Staff, which is merely attempting to conceal their rejection of fair value ratemaking. The Company has included an acquisition adjustment in the recorded historical original cost plant because it is required under any acceptable regulatory accounting methodology. This is the recorded plant balance on the books of the Company, and it has to be shown as part of the historical data. However, the Company has not requested that the revenue requirement be based on its original cost rate base as explained throughout our direct filing. Instead, we have requested a revenue requirement based on FVRB, **excluding** the acquisition adjustment.

Q. HOW DOES THE COMPANY RESPOND TO STAFF'S CLAIMS THAT THERE ARE MANY ISSUES TO CONSIDER BEFORE ARIZONA-AMERICAN SHOULD BE ALLOWED TO RECOVER ANY PORTION OF THE ACQUISITION ADJUSTMENT?

A. Staff's comments raise several issues. The first of which was the "gain" Citizens received on the sale. I do not agree that the gain is to be considered in the context of a demonstration of the benefits because the Citizens' "gain" and the acquisition adjustment are two completely different items. The "gain," whatever it may or may not be, belongs to Citizens. If the Commission thought that "gain" should be shared, it would have done so as a condition at the time of approval of the sale;

RUCO argued for such treatment at that time. The Commission has ruled that the "gain," whatever it may be or not be, is to be retained by Citizens. Thus, the acquisition adjustment is all that should be considered. Besides, it is important to keep in mind that to the extent that there was any "gain," **Citizens** obtained the benefits from it – not Arizona-American.

I do agree with Staff that the mere change in ownership is not sufficient justification for increasing rates by providing for the revenue requirement on an acquisition adjustment. However, I disagree that the acquisition harmed ratepayers due to the elimination of accumulated deferred taxes and investment tax credits. In fact, by year four after the transaction, Arizona-American will have greater deferred taxes on its books than would have been recorded on the books and records of Citizens because the acquisition adjustment will be amortized over 40 years for book purposes as compared to 15 years for tax purposes. Based on the Company's requested use of the mortgage style amortization, very little book amortization would be recorded in the initial years. The approximate balance of the deferred taxes in year four, due solely to the acquisition adjustment, will total over $6.5 million. See Stephenson Rebuttal Exhibit 2.

Staff has also testified that the Company's overhead costs are higher than Citizens, another detrimental effect. This is simply not true. When normalized, Arizona-American actually has lower overheads than Citizens. Bourassa RBT at 24-25.

Finally, Staff claims that the benefits derived would not have been obtainable by Citizens. This point is simply speculation. There is no way to know what Citizens would or would not have obtained at some unknown time in the future. However, since the Company has not undertaken any study on that aspect to this point, I do not believe it has any relevance at this time.

Q. ARE THERE ANY OBVIOUS NET BENEFITS FROM THE TRANSACTION THAT HAVE ALREADY BEEN REALIZED BY RATEPAYERS?

A. Yes, all parties to this case have already recognized a substantially lower cost of capital due to the acquisition. In fact, as I will show later in this testimony, this is one example of the Staff picking and choosing the lowest cost of service components, irrespective of their stated position that all components of the test period must match using historical data. See, e.g., Direct Testimony of Joel M. Reiker ("Reiker DT") at 3-4. The Company has proposed in these filings to use the capital structure and the cost of debt after acquisition. The current capital structure is composed of over 60 percent debt, in comparison to Citizens' historical capital structure of only 49 percent debt. Citizens' imbedded cost of debt was approximately 7 percent compared to that recommended by Staff in this case for the Company of 4.59 percent. These two items alone produce a cost of capital for Citizens based on their historical debt/equity ratios and using Staff's suggested 9.7 percent cost of equity of over 8.3 percent. Staff has recommended a rate of return on rate base for the Company of 6.6%. This is 170 basis points lower than that which would have been used by Citizens. Using Staff's recommended, albeit improper, original cost rate base of over $91.5 million and a gross revenue conversion factor of 1.63, the Company has reduced the revenue requirement by over $2.2 million due to the Citizens' acquisition. Staff, and all other parties criticizing Arizona-American, have failed to mention this benefit, despite using this post-acquisition capital structure in the development of their revenue requirement. I will speak further to the cost of capital components later in this testimony.

Q. YOUNGTOWN'S CONSULTANT TESTIFIES (BURTON DT AT 10) THAT THE ACQUISITION ADJUSTMENT "SEEKS" TO ADJUST THE UTILITY'S BOOKS SO THAT THE PLANT'S BOOK VALUE IS CLOSER TO THE AMOUNT PAID BY THE WILLING BUYER. DO YOU AGREE?

A. No, I do not agree. As I explained, the acquisition adjustment <u>is</u> the difference between the purchase price paid and the book value of the assets purchased, period. According to every accounting standard I am aware of, the purchase must be recorded in a manner that reflects the total price paid for the assets. It follows that the acquisition adjustment has to be recorded in the original cost records as the difference between the price paid and the book cost of the assets acquired. It would appear that Youngtown's consultants are mistakenly confusing the book treatment of the acquisition adjustment with the ratemaking treatment. Recording for book purposes is, however, immaterial to ratemaking treatment, as I explained.

Q. YOUNGTOWN'S WITNESS FURTHER TESTIFIES (BURTON DT AT 9) THAT "IF THE FVRB BASED ON RCND CAUSES RATES TO BE HIGHER THAN WHAT THEY WOULD BE UNDER A STRAIGHT OCRB APPROACH AS IN THIS CASE, THEN THE UTILITY MUST DEMONSTRATE A PUBLIC BENEFIT JUSTIFYING THE USE OF RCND IN THE FVRB DETERMINATION." DO YOU HAVE ANY COMMENT ON THIS TESTIMONY?

A. This is an unsupported legal argument. I am not surprised that Youngtown's consultants do not understand Arizona law, however, as they admitted in responses to the Company's data requests they have no experience with rate making in Arizona or, for that matter, anywhere that follows the "fair value" approach. <u>See</u> Stephenson Rebuttal Exhibit 1(Youngtown Response to Data Request 1.1d). I am not a lawyer but I understand that the Arizona Constitution obligates the

Commission to determine the fair value of Arizona-American's property and to use that finding in setting rates. I am not aware that this constitutional mandate applies only if the utility shows "ratepayer benefit" from a fair value finding, as Youngtown's witnesses seem to believe.

It also appears that Youngtown's witnesses may believe that fair value is determined by including the acquisition adjustment in the original cost rate base. The Company did not propose such a determination, nor is it, to my knowledge, required by any applicable statute, law or rule. Therefore, Youngtown's "straw-man" methodology should be rejected.

Q. SHOULD THE COMPANY'S REQUEST FOR ACCOUNTING TREATMENT OF THE ACQUISITION ADJUSTMENT BE DEFERRED?

A. No, Youngtown is wrong in this regard as well. Direct Testimony of Michael G. Burton ("Burton DT") at 12-13. The request for the accounting treatment of the acquisition adjustment is entirely independent of whether or not the Commission will grant the acquisition adjustment in rates, when and if the Company makes such a request. Financial Accounting Board Standard ("FAS") 71 requires that any utility seeking a book treatment different from that required under normal accounting obtain a Commission order allowing the different treatment.

Consistent with FAS 71, and as explained in my direct testimony, the Company is seeking Commission approval to amortize the acquisition adjustment over 40 years using a mortgage style amortization. If the determination is not made in this case, again as I stated in my direct testimony, the Company will have to amortize the acquisition adjustment over 40 years on a straight-line basis leading to a mismatch with the distribution of any of the benefits that could and will be proven.

Q. DOES THE DETERMINATION OF THE ACCOUNTING TREATMENT

HAVE ANY RELATIONSHIP TO THE DETERMINATION OF NET BENEFITS?

A. No, the approval of the recovery period and method pertains specifically to the book treatment, not necessarily ratemaking. As I stated earlier, the Company must have this determination to vary from normal accounting treatment.

Q. IS IT LOGICAL AND APPROPRIATE TO DETERMINE THE DOLLAR VALUE OF THE ACQUISITION ADJUSTMENT BEFORE THE ACCOUNTING TREATMENT?

A. Yes it is. I agree with Youngtown's consultants on this point. However, contrary to the Youngtown consultant's claims, the dollar value of the acquisition adjustment is known and is recorded in the books and records of the Company. I am unaware of any reason that the accounting treatment has to be delayed until a determination of the acquisition adjustment is finalized for ratemaking purposes. As stated above, book treatment and ratemaking treatment are two separate and essentially unrelated matters. Thus, the treatment of the acquisition adjustment for book purposes is appropriate in this case, irrespective of the future ratemaking treatment.

Q. SHOULD THE ACQUISITION ADJUSTMENT BE ALLOCATED TO EACH OF THE COMPANY'S OPERATING DISTRICTS BASED ON NET PLANT?

A. No, this is yet another unsupported assertion of Youngtown's consultants. Direct Testimony of Andrew J. Burnham ("Burnham DT") at 9-10. Arizona-American's parent company, AWW, has allocated the acquisition adjustment to each of the states where assets were purchased from Citizens. The methodology adopted in each of these states called for allocation of the acquisition premium based on gross plant. The methodologies at the parent level and the state level have to be

consistent. To adopt a different method at this point to suit a particular party's ratemaking objectives is inappropriate and unwarranted.

V. AMERICAN WATER WORKS OVERHEADS AND SERVICE COMPANY CHARGES

Q. DO YOU AGREE WITH RUCO THAT SERVICE COMPANY COSTS, GENERAL OFFICE COSTS AND OVERHEADS BASED ON 2002 ACTUALS SHOULD BE USED IN DETERMINING THE REVENUE REQUIREMENT IN THIS CASE?

A. Yes, with adjustments to reflect the normalized actual amounts recorded in 2002. Mr. Bourassa discusses the particular expenses in his rebuttal testimony. Bourassa RBT at 20-27.

Q. THEN YOU DISAGREE WITH THE STAFF RECOMMENDED USE OF CITIZENS' 2001 RECORDED EXPENSES?

A. The Company strenuously disagrees with Staff on this point. Use of Citizens' recorded administrative expenses in 2001 is inappropriate for a number of reasons. First, these Citizens' expenses bear no relation to the administrative and general management expenses the Company will incur during the time the new rates will be in effect. Second, as explained by Mr. Bourassa, the amounts recorded by Citizens during the test year are extraordinary and irregular. See Bourassa RBT at 24. In other words, and consistent with the Commission's rules, and its customary practice, pro forma adjustments are required to obtain a normal or more realistic relationship between revenues, expenses and rate base for the test year. See A.A.C. R14-2-103(A)(3)(i).

Q. WOULD YOU PLEASE SUMMARIZE THE REASONS THAT THE CITIZENS' OVERHEAD AND SERVICES CHARGES IN 2001 ARE NOT REFLECTIVE OF A NORMAL LEVEL OF EXPENSE, EVEN FOR

CITIZENS?

A. As Mr. Bourassa explains, Citizens' charges for these expenses in 1999 and 2000 were significantly higher. In fact, the average of the 1999 and 2000 charges is over $1.3 million higher than the pro forma charges from 2002 the Company proposed to use. The reason for this large disparity in Citizens charges in 2001 is clearly due to the pending sale of their water and sewer assets. Citizens was winding down its operations and eliminated various personnel and expenses as it transitioned toward a telecommunications utility. This included management personnel, benefits and other vital management services.

Again, proper ratemaking calls for adjustments for known and measurable occurrences. This is obviously a known and measurable occurrence, as reflected by the significant decrease in Citizens' expenses from 1999 and 2000 to 2001, when the sale was pending. This casts serious doubt as to whether the extraordinarily low Citizens overheads and other service charges Staff's seeks to utilize for setting rates have any realistic relationship to the charges the Company will incur during the period the rates are in effect.

Q. ARE THERE ANY OTHER REASONS WHY IT IS INAPPROPRIATE TO USE CITIZENS' RECORDED EXPENSES FOR ADMINISTRATIVE AND GENERAL MANAGEMENT UNDER ARIZONA-AMERICAN AND AWW'S OWNERSHIP?

A. Quite simply, Citizens no longer owns and operates any of the water and wastewater operations at issue in this proceeding. The expenses allocated to these districts by Citizens' management have no relationship to the expenses that will incurred by Arizona-American to provide water and wastewater utility service in these districts at the time the rates will be in effect.

Q. BUT, MR. STEPHENSON, HAVEN'T ALL PARTIES CONSISTENTLY

PROPOSED THE USE OF THE RECORDED EXPENSES FOR ALL OTHER EXPENSES?

A. Yes. However, as explained above, the operation and maintenance (O&M) expenses charged directly to each of the Arizona-American districts will not materially change. Thus, the O&M expenses actually recorded in 2001, the test year, are, for the most part, known and measurable expenses, and should be matched with 2001 revenues. The Service Company charges, AWW General Office charges and overheads for 2002 are not dependent on the revenues or other expenses charged directly to each of these districts to supply utility service at the district level and are now known and measurable.

Q. WHAT ABOUT STAFF'S CLAIM THAT THE AWW EXPENSES ARE NOT KNOWN AND MEASURABLE?

A. It appears that Mr. Igwe, the Staff witness who provided this testimony, is basing this view on the Company's original filing, which necessarily used an extrapolated 12 month average for Service Company and AWW overhead charges based on the recorded level of expense from April 2002 through July 2002. I agree that the actual 2002 costs were not precisely known and measurable until year-end 2002. However, following acceptance of the filing by Staff in January 2003, the **actual costs** for the year 2002 were known and were provided to Staff during the discovery and audit process. This same data was provided to RUCO, which, unlike Staff, recognized that the Citizens' data bears no relationship to the Company's expenses on a going-forward basis.

Q. HOW DOES THE COMPANY RESPOND TO MR. IGWE'S SUGGESTION THAT THE GOING FORWARD MANAGEMENT COSTS SHOULD BE REJECTED ABSENT A COMMENSURATE BENEFIT TO RATEPAYERS BECAUSE THERE IS A SIGNIFICANT DIFFERENCE WHEN

COMPARED WITH THE CITIZENS 2001 NUMBERS?

A. First, I know of no regulatory rule or accepted method that requires the demonstration of "benefits" due a known and measurable change in going forward expenses. Staff is also unaware of any authority for Mr. Igwe's testimony. See Stephenson Rebuttal Exhibit 1 (Staff Responses to Data Request 2.32 and 2.33). Indeed, applying Staff's logic, it would be improper to adjust purchased power expense or payroll tax expense based on known changes in these expenses because customers don't "benefit" from them. This is contrary to A.A.C. R14-2-103(A)(3)(i). Further, Staff cannot show how its adjustments provide a commensurate benefit to ratepayers, beyond lower rates. Id. In any event, the Company has the obligation to show the appropriate level of expense and further to demonstrate that the costs are necessary to the provision of service. No party to this case has questioned any of the Company's particular expenses relative to the going-forward administrative costs.

Second, and perhaps more importantly, as explained above, the level of expenses recorded on the books and records of Citizens in 2001 is not commensurate with the normal operation of the districts at issue in this proceeding. In fact, the 2001 expenses do not even correspond to Citizens' actual expenses in 1999 and 2000. Thus, they have no bearing on the determination of rates in this proceeding.

Q. DO YOU AGREE WITH THE STAFF'S PROPOSAL TO USE THE LEVEL OF WAGES, SALARIES AND BENEFITS AS RECORDED ON THE BOOKS AND RECORDS OF CITIZENS IN 2001?

A. No, for the same reason that I disagree with the Staff's proposal to use Citizens' recorded administrative and general recorded costs from 2001. Included in the recorded salaries, wages and benefits are the costs related to employees who no

longer provide any water and wastewater related services to ratepayers in the 10 operating districts at issue in this case. These employees were terminated at the time of the acquisition, or before, as a result of the purchase of the Citizens' assets. The recorded expenses in 2001 do not reflect known and measurable information relative to Arizona-American's costs of providing service following the change in ownership. Nor does the recorded level of expense include annualized levels based on an entire year of operation. Citizens terminated many employees before the closing of the purchase by AWW. These terminated employees' positions and jobs were replaced in the organization by a portion of the increase in administrative fees. Because Staff didn't annualize the recorded level of expense in 2001, they have understated the actual Citizens' expense to manage and operate these systems.

Finally, one other point should be considered. In April 2002, all of Arizona-American's employees were granted their annual salary adjustment, a fact ignored by Staff. This is obviously a known and measurable change typically considered in the determination of the revenue requirement. The Company, therefore, made a pro forma adjustment to annualize wage, salary and benefit levels based on the actual number of employees after the completion of Citizens' acquisition and the known and measurable level of each of these items at the time of filing.

Q. DO YOU HAVE OTHER COMMENTS TO MAKE ABOUT STAFF'S RECOMMENDATION AS IT RELATES TO ADMINISTRATIVE COSTS, SALARIES, WAGES AND BENEFITS?

A. Yes, another point Staff repeatedly makes is that all of the items contained in the revenue requirements have to be matched to the appropriate period. Yet, Staff conveniently ignores this concept when it chooses. For example, Staff claims that

the 2001 recorded salaries, wages and benefits are the only known and measurable amounts. It was obvious that the 2002 amount was known to Staff well before they filed their direct testimony and schedules, just like the pro forma plant additions for 2002 Staff allows because they were known and measurable during the same time period. These plant items were recorded on the same 2002 books and records of the Company as the recorded administrative expenses and salaries and benefits. Moreover, Staff used the December 31, 2002 actual capital structure of the Company (with minor adjustments) in the determination of the cost of capital, and accepted the Company's proposed adjustment to revenues for the Anthem district to include in-lieu revenue payments by Del Webb that will not begin until 2004. The latter adjustment goes well outside the test year.

Q. DO STAFF'S RECOMMENDED POSITIONS HAVE ANY COMMON THREAD?

A. Unfortunately, yes. Frankly, it seems impossible to escape the conclusion that Staff is picking and choosing those expenses that result in the lowest possible revenue requirement. This is the only common thread between all of these otherwise inconsistent positions.

Q. DO YOU HAVE ANY OTHER COMMENTS ON THE ISSUE OF PRO FORMA ADJUSTMENTS?

A. Yes, I have one other item to note. Staff has removed Citizens' customer billing plant from the recommended rate base. However, they have not recommended allowance of any of the AWW administrative costs that contain the billing costs. This basically eliminates any of the costs of the billing assets from consideration in the revenue requirement. Again, this is inconsistent as well as inappropriate.

VI. <u>RATE CASE EXPENSE</u>

Q. DO YOU AGREE WITH ANY OF THE OTHER PARTIES'

RECOMMENDATIONS CONCERNING THE APPROPRIATE LEVEL OF RATE CASE EXPENSE?

A. I agree with Staff that the Company's requested rate case expense is appropriate. The Company requested that it be allowed to include in the revenue requirement $715,000 of rate case expense amortized over 3 years. Staff has recommended approval of this request.

Q. WHAT HAS RUCO RECOMMENDED?

A. RUCO recommends that the level of expense be reduced to $418,941 amortized over 3 years. This recommendation is based on RUCO's comparison of Citizens' authorized level of rate case expense from in their last rate decision, issued in 1997 and inflated to today's costs. However, as noted by RUCO, Citizens only filed applications for six of its districts in the last case, a little over one-half of the districts filed in this case. Obviously, the greater the number of districts involved in the rate case, the greater the expense will be. Additionally, the level of rate case expense is dependent on a multitude of factors, including customer notices, use of outside consultants, intervenors, and other items, such as the number and magnitude of the issues in dispute. RUCO's straight-line comparison, unadjusted for anything but inflation, ignores all of these factors.

Q. WHY SHOULD THE COMMISSION CONSIDER AN INCREASE IN THE LEVEL OF CONSULTANT CHARGES?

A. Because Citizens employed specific individuals who were assigned the task of prosecuting rate applications. All of these charges were included in the management fees charged to the districts. This is not the case for AWW and Arizona-American. All of the salaries of these Citizens' employees were eliminated after the Citizens' Acquisition. The outside consultants, including attorneys, are retained to replace the employees that had previously been used in

Arizona to prosecute rate applications and handle other regulatory matters making RUCO's comparison methodology inappropriate.

Q. CAN I THEREFORE ASSUME THAT YOU DISAGREE WITH RUCO THAT THE COMPANY'S RECOMMENDED LEVEL OF EXPENSE IS EXORBITANT?

A. I strongly disagree. As I demonstrated in my direct testimony, it is lower than the per customer cost that the Company has historically been allowed in its prior two cases. The prior historical allowance was $13.25 and the Company's proposal in this case is $7.39 per customer. Viewed in this light, this is hardly exorbitant, especially when it is considered amortized over three years, or $2.46 per customer annually.

Q. ARE THERE ANY OTHER RELEVANT CONSIDERATIONS WITH RESPECT TO THE APPROPRIATE LEVEL OF RATE CASE EXPENSE?

A. There is one other significant factor that must be considered. It has been at least 7 years between rate filings for most of these districts, and no rate filing has ever been made for Anthem. This alone makes the case more complex and time consuming, as all parties have noted in their testimony. The time between filings requires detailed explanations of all plant expenditures since the time of the previous filing. Additionally, some of the prior applications were based on test periods in the 1980's, requiring even more time.

Q. DO YOU AGREE WITH YOUNGTOWN THAT RATE CASE EXPENSE SHOULD BE AMORTIZED OVER 5 YEARS?

A. No. This recommendation is based on the fact that it has been a long time in between rate filings for these districts. I agree that it has been a long time. However that was the track record of Citizens, not AWW. AWW has a track record of filing rate cases much more often. The Paradise Valley water district of

Arizona-American filed applications for rate increases 5 times in an 8 year period, or one every 1.6 years. Moreover, the new arsenic treatment requirements will require a significant plant investment prior to January 1, 2006, or in less than 3 years, which will likely lead to new rates cases being filed in less than five years. In short, the next rate application will likely be filed at the first possible opportunity.

VII. COST OF DEBT AND CAPITAL STRUCTURE

Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION CONCERNING THE EMBEDDED COST OF DEBT?

A. No, I do not agree with their recommendation for four specific reasons: 1) they should not have included the Tolleson bonds in their analysis; 2) they should have included the most recent cost of the Maricopa IRDB's; 3) they should have included the current amount of the short-term debt at current long-term costs; and 4) they should have included all of the Company's debt, including the PILAR agreements.

Q. PLEASE EXPLAIN WHY THEY SHOULD NOT HAVE INCLUDED THE TOLLESON BONDS.

A. These bonds are not debt of the Company. These are bonds issued by the City of Tolleson for construction of improvements to their own wastewater system. The Company pays for the costs of these improvements through the fees it pays to Tolleson for wastewater services under its contract with Tolleson. These costs are included in current operating expense and as such have no bearing on the capital structure of the Company.

Q. WHY SHOULD THE CURRENT KNOWN COST OF THE MARICOPA BONDS BE INCLUDED IN THE EMBEDDED COST OF LONG-TERM DEBT?

A. The Company should be reimbursed for whatever its current cost is of this debt. In this case, the Staff should have updated the cost of this floating issue through at least July 2003. The rate of this debt at July 31, 2003 was 1.28%. This is the rate that should have been used in the capital structure.

Q. WHY DO YOU BELIEVE THAT THE STAFF SHOULD HAVE INCLUDED THE SHORT-TERM DEBT AS OF DECEMBER 31, 2002 IN THE CAPITAL STRUCTURE AT CURRENT LONG-TERM DEBT RATES?

A. Staff has allowed non-revenue producing plant additions for 2002 to be included in plant in service. The short-term debt was incurred to finance these long-term capital assets. Staff should match the capital structure of the Company to the allowed capital investment. The rates that should be used on this debt are the latest estimates of what the Company will pay at the time of the issuance in November 2003. That rate is estimated to be 6.00%. Additionally, Staff realizes that the Company has a financing application filed with this Commission to refinance the total outstanding short-term debt. That application was filed on August 14, 2003, and is being reviewed by Staff. This has to be considered in the overall capital structure.

Q. WHY SHOULD THE STAFF HAVE INCLUDED THE PILAR AGREEMENTS IN THE CAPITAL STRUCTURE OF THE COMPANY?

A. The Company entered into several "PILAR" agreements with developers under which the developers effectively finance the construction of utility plant for the Paradise Valley water district. As part of these agreements, the Company issued promissory notes to the developers, which constitute long-term debt obligations of the Company. As such, these promissory notes should be included in the Company's long-term debt if the entire Company capital structure is to be used.

Staff states that the capital structure should include the Company-wide cost of debt. Reiker DT at 4. I agree with this, but Staff failed to do so in its calculations.

Q. HAVE YOU RECALCULATED THE WEIGHTED COST OF EMBEDDED DEBT BASED ON YOUR ABOVE RECOMMENDATIONS?

A. Yes, I have. That analysis is attached hereto as Stephenson Rebuttal Exhibit 3, which shows that the Company's weighted cost of embedded debt, based on the Company's total long-term indebtedness at December 31, 2002, should be 4.86%.

Q. DO YOU AGREE WITH RUCO'S PROPOSED APPROACH TO THE EMBEDDED COST OF LONG-TERM DEBT?

A. No, I have the same issues with RUCO's approach as I do with that of Staff. I believe that the embedded cost of long-term debt should be as I have stated above, or 4.86%, if the Company's current capital structure is to be used.

Q. DO YOU AGREE WITH MR. REIKER'S USE OF THE "ACTUAL" CAPITAL STRUCTURE AS OF DECEMBER 31, 2002 FOR ARIZONA-AMERICAN?

A. No. Again, to reemphasize the point made above, Mr. Reiker has not included all of the Company's actual long-term debt and instead has erroneously included short-term debt financing construction projects and the City of Tolleson's bonds, which are not debt of the Company. Moreover, as I have previously testified, it is Arizona-American's intention to retain a capital structure as close to 60% debt and 40% equity as possible. Accordingly, it is more appropriate to use this 60% - 40% ratio of long-term debt to equity in setting rates in this proceeding.

VIII. <u>ARIZONA-AMERICAN'S FINANCIAL INTEGRITY</u>

Q. THE STAFF COST OF CAPITAL WITNESS, MR. REIKER, TESTIFIES THAT HIS RECOMMENDED RATE OF RETURN WILL ALLOW ARIZONA-AMERICAN TO MAINTAIN ITS FINANCIAL INTEGRITY.

DO YOU AGREE WITH MR. REIKER?

A. I do not agree with Mr. Reiker.

Q. ON WHAT BASIS DOES MR. REIKER TESTIFY THAT STAFF'S RECOMMENDATION WILL ALLOW ARIZONA-AMERICAN TO MAINTAIN ITS FINANCIAL INTEGRITY?

A. On pages 30-31 of his direct testimony, Mr. Reiker argues that Staff's recommended rate of return on rate base results in a pre-tax interest coverage ratio of 3.2. Mr. Reiker goes on to explain:

> Interest coverage is one of the determinants of a company's bond rating – a higher ratio of earnings to interest results in a higher bond rating. According to Standard & Poor's ("S&P") 2002 Corporate Ratings Criteria, the median interest coverage ratio for an 'A' rated U.S. electric utility (Staff's most available proxy for a water company) is 3.4.

Reiker DT at 30-31. I agree with Mr. Reiker that interest coverage is an important determinant of a company's bond or credit rating and, more generally, its financial integrity. In addition, although I have not reviewed the particular S&P document cited by Mr. Reiker, I agree with Mr. Reiker that a water utility would be expected to maintain an interest coverage ratio of approximately 3.4 in order to maintain a credit rating of A or higher.

However, I certainly disagree with Mr. Reiker's attempt to show that Staff's recommended rate of return of only 6.6%, which is approximately equal to the current interest rate on an investment-grade utility bond, produces pre-tax interest coverage of 3.2 in this case. In fact, under Staff's recommendation, Arizona-American's interest coverage will be slightly more than 1.0.

Q. WHAT IS A PRE-TAX INTEREST COVERAGE RATIO AND WHY IS IT A GOOD INDICATOR OF A COMPANY'S FINANCIAL INTEGRITY, AS MR. REIKER STATES IN HIS TESTIMONY?

A. A pre-tax interest coverage ratio is the ratio of operating income and income taxes to interest on bonds and other long-term debt in the company's capital structure. This ratio indicates how many times interest charges have been earned by the company on a pre-tax basis. Since the failure to meet interest payments on debt would constitute a default, the interest coverage ratio measures the company's margin of safety. For example, if a utility's operating income before payment of income taxes is equal to $250,000, its income taxes totaled $70,000 and its annual interest payments totaled $100,000, the utility's pre-tax interest coverage ratio would be 3.2 ($320,000 divided by $100,000). In this example, if the utility's revenues decline, its expenses increase, or some other important operating parameter changes, thereby reducing its operating income, the utility should still have sufficient funds available to meet its interest payments and avoid a default. This is clearly important to bond holders and lenders, and to equity investors as well.

Q. WHY DO YOU MAINTAIN THAT MR. REIKER'S CLAIM THAT STAFF'S RECOMMENDED RATE OF RETURN FAILS TO RESULT IN A PRE-TAX INTEREST COVERAGE RATIO OF 3.2?

A. This can easily be demonstrated by referring to Schedule JMR-2, attached to Mr. Reiker's Direct Testimony. Schedule JMR-2, entitled "Cost of Long-term Debt," shows Staff's total long-term debt used in its capital structure. As I testified above, this schedule is not accurate in certain respects. However, it can be used to demonstrate why Mr. Reiker's assertion that his recommended rate of return produces a pre-tax interest coverage ratio of 3.2 is obviously wrong.

The final column in Schedule JMR-2 shows a total annual cost of debt equal to $8,361,302. Using Mr. Reiker's computed annual cost of debt (which he has used in developing his weighted cost of capital and recommended rate of

return), Arizona-American's total operating income and income taxes would have to equal approximately $26,750,000 to obtain an interest coverage ratio of 3.2.

Q. HOW DOES THAT AMOUNT, $26,750,000, COMPARE TO THE TOTAL OPERATING INCOME AND TOTAL INCOME TAX EXPENSE THAT RESULT FROM STAFF'S RECOMMENDATIONS IN THIS CASE?

A. There are 10 water and wastewater districts involved in this rate case. Referring to Staff Schedules All-1 for each of those districts, Arizona-American's total operating income is $6,035,145, and the Company's total income taxes, based on the same Staff schedules, is $2,167,944. Thus, based on Staff's recommendations, the total operating income and income taxes for all 10 districts is $8,203,089. This compares to Mr. Reiker's annual interest expense calculation of $8,361,302, shown on Schedule JMR-2.

Q. WHY DID YOU TESTIFY THAT THE PRE-TAX INTEREST COVERAGE RATIO BASED ON STAFF'S RECOMMENDED RATE OF RETURN WOULD BE GREATER THAN 1.0?

A. Arizona-American has two additional districts that are not involved in this rate case, the Paradise Valley water district and the Mohave wastewater district. To evaluate Arizona-American's pre-tax interest coverage ratio, the operating incomes and income taxes for those districts also have to be included in the calculation. Both of those districts are small, and their inclusion in the calculation will not result in a significant increase in total Company operating income and income taxes. Attached to my testimony as Rebuttal Schedule 4 is a calculation showing the pre-tax interest coverage resulting from Staff's recommendations with the Paradise Valley water and the Mohave wastewater districts included. Using Staff's recommended rate of return and other recommendations in this case, and including operating income and income taxes for the Paradise Valley water and the

Mohave wastewater districts, the pre-tax interest coverage produced by Staff's recommendations is 1.16.

Q. WHAT ELSE DOES YOUR REBUTTAL EXHIBIT 4 CONTAIN, MR. STEPHENSON?

A. Page 1 of my Rebuttal Exhibit 4 contains the pre-tax interest coverage ratio resulting from Staff's recommendations, discussed above. Page 2 of this exhibit shows the return on equity that would actually result from Staff's recommendations in this case. That return is a negative 0.62% based on Mr. Reiker's capital structure. This is why the pre-tax interest coverage ratio based on Staff's recommendations is approximately 1.0.

Pages 3 and 4 of my Rebuttal Schedule 4 contain the same calculations based on the Company's recommendations in this case. As shown on page 3 of the exhibit, the Company's recommendation, if adopted, would result in a pre-tax interest coverage ratio of 1.72. This is certainly better than the ratio resulting from Staff's recommendations, but still well below Staff's 3.4 ratio for the benchmark, A-rated water utilities. The final page of this exhibit, page 4, shows that if the Company's recommendations were adopted, it would earn a return on equity of 2.21%. Once again, this return is better than earning no return, as would be the case under Staff's recommendations, but is still well below the returns currently being earned by publicly traded water utilities, as discussed in Dr. Zepp's rebuttal testimony.

Q. WHAT DO THE PRE-TAX INTEREST COVERAGE RATIOS AND PROJECTED RETURNS ON EQUITY TELL YOU ABOUT STAFF'S RECOMMENDA-TIONS IN THIS CASE?

A. As I stated, Staff's cost of capital witness, who is responsible for Staff's recommended rate of return of 6.6% in this case, has specifically raised the issue

of whether Staff's recommendations will allow Arizona-American to maintain its financial integrity. It is apparent Staff's recommendations will not result in a pre-tax interest coverage ratio anywhere close to the interest coverage ratio S&P requires for an A-rated utility, which is the benchmark cited in Mr. Reiker's testimony. In reality, Staff's recommendations essentially place Arizona-American in a break-even position, i.e., the Company will have sufficient cash flow to meet debt service requirements, but not earn a return on equity. Assuming that Staff is legitimately concerned about this issue, and actually proposes that the Commission take into account the overall financial impact of Staff's recommendations on Arizona-American in setting rates, which the Commission certainly can and should do, then the Company's recommendations should be approved.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes it does.

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STEPHENSON REBUTTAL

EXHIBIT 1

**ARIZONA CORPORATION COMMISSION STAFF
RESPONSES TO ARIZONA-AMERICAN WATER COMPANY'S
SECOND SET OF DATA REQUESTS
(Docket No. WS-01303A-02-0867 et al.)**

September 19, 2003

2.15 Please define the terms "stale test year" as such terms are used in the Direct Testimony of Darron W. Carlson at page 14, l. 10. In responding to this data request, please identify any Commission rule or prior decision, as well as any relevant industry standards or publications that define when a test year is "stale."

Response: Stale means having lost freshness. Staff believes that the Test Year the Company used would not appear to be the most recent practical Test Year.

Response by: Darron W. Carlson

TOWN OF YOUNGTOWN'S RESPONSES TO ARIZONA-AMERICAN WATER COMPANY'S FIRST SET OF DATA REQUESTS (Docket No. WS-01303A-02-0867, et al.)

1.1 **With respect to Youngtown witnesses Michael E. Burton and Andrew J. Burnham, please:**

(a) identify any proceedings before the Arizona Corporation Commission in which testimony was provided and provide a copy of all such testimony;

(b) identify any manuals, papers, articles or presentations made concerning Arizona law and/or ratemaking proceedings for public service corporations regulated by the Commission;

(c) identify any and all circumstances, including the identity of clients, in which analysis of any ratemaking for any Arizona public service corporation was conducted;

(d) identify all proceedings in any other state in which the witness participated in which the state set rates for a water or wastewater utility based on a determination of the utility's fair value rate base.

RESPONSE:

(a) There are no proceedings, aside from the current proceeding before the Arizona Corporation Commission in which testimony was provided by either Mr. Burton or Mr. Burnham.

(b) There are no manuals, papers, articles, or presentations concerning Arizona law and/or ratemaking proceedings for public service corporations regulated by the Arizona Corporation Commission made by either Mr. Burton or Mr. Burnham.

(c) There are no circumstances in which either Mr. Burton or Mr. Burnham conducted analyses of any ratemaking for any Arizona public service corporations on behalf of a client prior to the Arizona-American rate case proceeding.

(d) There are no proceedings in other states in which either Mr. Burton or Mr. Burnham participated where the state set rates for a water or wastewater utility based upon a determination of the utility's fair value rate base.

**ARIZONA CORPORATION COMMISSION STAFF
RESPONSES TO ARIZONA-AMERICAN WATER COMPANY'S
SECOND SET OF DATA REQUESTS
(Docket No. WS-01303A-02-0867 et al.)**

September 19, 2003

2.32 Please identify any Commission decision, or industry standard or publication that requires that pro forma adjustments provide a commensurate benefit to ratepayers.

Response: Staff is not aware of any Commission decision, or industry standard or publication that requires that pro forma adjustments provide a commensurate benefit to ratepayers. Sound rate making principles provide that cost of service include prudent costs reasonably necessary for the provision of service under efficient management.

Response by: Alexander Ibhade Igwe

2.33 Please explain how each and every adjustment made by Staff in connection with Arizona-American request for rate increases provides a commensurate benefit to ratepayers.

Response: Staff's adjustments provide a basis for fair and reasonable rates based on prudent costs reasonably necessary for provision of service under efficient management.

Response by: Alexander Ibhade Igwe

STEPHENSON REBUTTAL

EXHIBIT 2

Acquisition Adjustment Analysis

CITIZENS

	BOY	Amortization	EOY	Tax Dep	Def Tax	Accumulated Deferred Tax	AVERAGE
BOY Balance	71,151,139						
1	71151139	$80,700	71070439	2371705	923275	923275	70650000
2	71070439	$161,400	70909039	4743409	1846550	2769825	69140000
3	70909039	$177,500	70731539	4743409	1840061	4609886	67130000
4	70731539	$195,300	70536239	4743409	1832888	6442774	65110000
5	70536239	$214,800	70321439	4743409	1825029	8267803	63070000
6	70321439	$236,200	70085239	4743409	1816405	10084208	61030000
7	70085239	$259,800	69825439	4743409	1806894	11891102	58970000
8	69825439	$285,700	69539739	4743409	1796457	13687559	56890000
9	69539739	$314,300	69225439	4743409	1784931	15472490	54800000
10	69225439	$345,600	68879839	4743409	1772317	17244807	52690000
11	68879839	$380,100	68499739	4743409	1758414	19003221	50570000

STEPHENSON
Rebuttal Exhibit 2

STEPHENSON REBUTTAL

EXHIBIT 3

ARIZONA-AMERICAN WATER COMPANY
PROPOSED RATE OF RETURN ON LONG-TERM DEBT
($1,000's)

2003		Principal	Net Proceeds	Annual Charges: Interest	Annual Charges: Debt Expense	Annual Charges: Total	Effective Cost of Debt
7.12%	Due 8/08	$4,500.0	$4,459.0	$320.4	$4.1	$324.5	7.28%
4.92%	Due 11/06	$3,500.0	$3,500.0	$172.2	$0.0	$172.2	4.92%
4.92%	Due 11/06	$154,948.0	$154,861.0	$7,623.4	$8.7	$7,632.1	4.93%
1.28%	Due 9/28	$10,635.0	$10,604.0	$136.1	$3.1	$139.2	1.31%
6.26%	Due 9/12	$76.0	$76.0	$4.8	$0.0	$4.8	6.32%
5.76%	Due 8/13	$39.0	$39.0	$2.2	$0.0	$2.2	5.64%
7.18%	Due 8/15	$64.0	$64.0	$4.6	$0.0	$4.6	7.19%
7.18%	Due 8/15	$55.0	$55.0	$3.9	$0.0	$3.9	7.09%
6.00%	Due 11/13	$12,517.0	$12,454.0	$751.0	$6.3	$757.3	6.08%
	TOTAL	186,334.0	186,112.0	9,018.6	22.2	$9,040.8	4.86%

STEPHENSON
Rebuttal Exhibit 3

ARIZONA-AMERICAN WATER COMPANY
PROPOSED RATE OF RETURN
($1,000's)

		Amount	Ratio	Cost	Weighted Avg. Cost
2004					
	Debt	$186,334.0	60.00%	4.86%	2.91%
	Equity	$124,266.0	40.00%	11.50%	4.60%
	Total	$310,600.0	100.00%		7.51%

STEPHENSON
Rebuttal Exhibit 3

STEPHENSON REBUTTAL

EXHIBIT 4

Arizona American
Pre-Tax Interest Coverage under Staff Recommendations
Test Year Ended December 31, 2001

Stephenson Rebuttal Exhibit 4
Page 1

Line No.		Column 1 (a) ACC Staff's Proposed Operating Income	Column 2 (a) Income Taxes	Column 3 (Col. 1 + Col. 2) Total Available for Interest Coverage
1	Agua Fria	$ 1,101,634	$ 395,729	$ 1,497,363
2	Anthem Water	611,179	219,548	830,727
3	Anthem / Agua Fria Wastewater	180,748	64,929	245,676
4	Havasu Water	54,096	19,432	73,528
5	Mohave Water	634,934	228,081	863,015
6	Sun City Water	1,410,332	506,619	1,916,951
7	Sun City Wastewater	581,576	208,914	790,490
8	Sun City West Water	793,779	285,141	1,078,921
9	Sun City West Wastewater	592,474	212,828	805,302
10	Tubac	74,393	26,724	101,116
11	Subtotal (Total Lines 1 to 10)	$ 6,035,145	$ 2,167,944	$ 8,203,089
12				
13				
14				
15				
16		Operating	Income	
17		Income	Taxes	ACC
18	Paradise Valley Water **(b)**	$ 1,395,483	$ (65,560)	1,329,923
19	Mohave Wastewater **(b)**	138,008	0	138,008
20	Total Operating Income and			Interest
21	Income Taxes (Line 11 + 18 + 19)	$ 7,568,636	$ 2,102,384	$ 9,671,020
22				From
23	ACC Staff Interest Expense from JRM-2			8,361,302
24				Schedule JRM-9
25	ACC Staff Actual Interest Coverage (Line 21 divided by Line 23)			**1.1566** **3.2**
26				
27				
28	**(a)** Source of Data: ACC Staff's Direct / Schedule AII-1 for each district.			
29	**(b)** Source of Data: Arizona Corporation Commission Annual Report for 12/31/2001			
30				

Arizona American
Equity Return under Staff Recommendations
Test Year Ended December 31, 2001

Stephenso n Rebuttal
Exhibit 4
Page 2

Line No.		(a) ACC Staff's Proposed Operating Income
1	Agua Fria	$ 1,101,634
2	Anthem Water	611,179
3	Anthem / Agua Fria Wastewater	180,748
4	Havasu Water	54,096
5	Mohave Water	634,934
6	Sun City Water	1,410,332
7	Sun City Wastewater	581,576
8	Sun City West Water	793,779
9	Sun City West Wastewater	592,474
10	Tubac	74,393
11	Subtotal (Sum of Lines 1 through 10)	6,035,145
12		
13		
14		Operating
15		Income
16	Paradise Valley Water **(b)**	$ 1,395,483
17	Mohave Wastewater **(b)**	138,008
18	Total Operating Income (Sum of Lines 11 + 16 + 17)	$ 7,643,029
19		
20	Less:	
21	ACC Staff's Interest Expense From JRM-2	8,361,302
22		
23	Income Available for Common Equity	$ (718,273)
24	(Line 18 minus Line 21)	
25	Divided by Common Equity (Equity Computed below)	$ 115,309,693
26		
27	ACC Staff Equity Return (Line 23 divided by Line 25)	**-0.62%**
28		

		ACC Staff's Proposed Equity Return From Schedule JRM-9
		9.70%

	Column 1	Column 2 Dollar Amount	Column 3 Percent of Total	
29				
30				
31				
32	Debt	181,956,852	61.21%	**(1)**
33	Equity	115,309,693	38.79%	**(3)**
34	Total Capitalization	297,266,545	100.00%	**(2)**
35				

36 **(1)** Debt Dollar Amount from JRM-2. Debt Percentage from JRM-9.
37
38 **(2)** $181,956,852 divided by 61.21% = $297,266,545 Equals Total Capitalization
39 (Line 32, Column 2 divided by Line 32, column 3)
40
41 **(3)** $297,266,545 minus $181,956,852 = $115,309,693
42 (Line 34, Column 2 Minus Line 32, Column 2). Or $297,266,545 multiplied by 38.79%
43
44 **(a)** Source of Data: ACC Staff's Direct / Schedule All-1 for each district.
45 **(b)** Source of Data: Arizona Corporation Commission Annual Report for 12/31/2001
46

Arizona American
Pre-Tax Interest Coverage under Company Recommendations
Test Year Ended December 31, 2001

Line No.		Column 1 (a) Company's Proposed Operating Income	Column 2 (a) Income Taxes	Column 3 (Col. 1 + Col. 2) Total Available for Interest Coverage
1	Agua Fria	$ 1,377,911	$ 529,885	$ 1,907,796
2	Anthem Water	723,305	278,204	1,001,509
3	Anthem / Agua Fria Wastewater	209,480	80,549	290,029
4	Havasu Water	91,089	34,953	126,042
5	Mohave Water	1,008,720	388,068	1,396,788
6	Sun City Water	3,327,708	1,139,720	4,467,428
7	Sun City Wastewater	1,292,150	497,132	1,789,282
8	Sun City West Water	1,159,164	445,790	1,604,954
9	Sun City West Wastewater	917,584	352,801	1,270,385
10	Tubac	130,028	49,984	180,013
11	Subtotal (Total Lines 1 to 10)	$ 10,237,140	$ 3,797,087	$ 14,034,227
12				
13				
14				
15				
16		Operating	Income	
17		Income	Taxes	
18	Paradise Valley Water **(b)**	$ 1,395,483	$ (65,560)	1,329,923
19	Mohave Wastewater **(b)**	138,008	0	138,008
20	Total Operating Income and Income			
21	Taxes (Lines 11 + 18 + 19)	$ 11,770,631	$ 3,731,527	$ 15,502,158
22				
23	Company's Interest Expense **(c)**			9,018,600
24				
25	Company's Proposed Interest Coverage			**1.7189**
26	(Line 21 divided by Line 23)			
27				
28	**(a)** Source of Data: Company's Rebuttal Schedules C-1 for each district.			
29	**(b)** Source of Data: Arizona Corporation Commission Annual Report for 12/31/2001			
30	**(c)** Source of Data: Stephenson Rebuttal Exhibit 3			

Arizona American
Equity Return under Company Recommendations
Test Year Ended December 31, 2001

Stephenson Rebuttal Exhibit 4
Page 4

Line No.		(a) Company's Proposed Operating Income
1	Agua Fria	$ 1,377,911
2	Anthem Water	723,305
3	Anthem / Agua Fria Wastewater	209,480
4	Havasu Water	91,089
5	Mohave Water	1,008,720
6	Sun City Water	3,327,708
7	Sun City Wastewater	1,292,150
8	Sun City West Water	1,159,164
9	Sun City West Wastewater	917,584
10	Tubac	130,028
11	Subtotal (Sum of Lines 1 through 10)	10,237,140
12		
13		
14		
15		Operating
16		Income
17	Paradise Valley Water **(b)**	$ 1,395,483
18	Mohave Wastewater **(b)**	138,008
19	Total Operating Income (Lines 11 + 17 + 18)	$ 11,770,631
20		
21	Less:	
22	Company's Interest **(c)**	9,018,600
23		
24	Income Available for Common Equity	$ 2,752,031
25	(Line 19 minus Line 22)	
26	Common Equity **(c)**	$ 124,266,000
27		
28	Company's Equity Return	**2.21%**
29	(Line 24 divided by Line 26)	
30		
31		
32		
33		
34	**(a)** Source of Data: Company's Rebuttal Schedules C-1 for each district.	
35	**(b)** Source of Data: Arizona Corporation Commission Annual Report for 12/31/2001	
36	**(c)** Source of Data: Stephenson Rebuttal Exhibit 3	

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 SUN CITY WEST WATER AND WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0867**
IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., 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 SUN CITY WATER AND WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0868**
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 MOHAVE WATER AND HAVASU WATER DISTRICTS.	**DOCKET NO. W-01303A-02-0869**

EXHIBIT
A-75
Admitted

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, AGUA FRIA WATER AND ANTHEM/AGUA FRIA WASTEWATER DISTRICTS.	**DOCKET NO. WS-01303A-02-0870**
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 TUBAC WATER DISTRICT.	**DOCKET NO. W-01303A-02-0908**

REJOINDER TESTIMONY OF

DAVID P. STEPHENSON

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I. INTRODUCTION.

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

A. My name is David P. Stephenson. My business address is 303 H Street, Suite 250, Chula Vista, California 91910. My telephone number is (619) 409-7700.

Q. ARE YOU THE SAME DAVID P. STEPHENSON THAT FILED DIRECT AND REBUTTAL TESTIMONY IN THIS MATTER?

A. Yes.

II. OVERVIEW AND SUMMARY OF REJOINDER TESTIMONY.

Q HAVE YOU READ ALL OF THE SURREBUTTAL TESTIMONIES OF THE WITNESSES FOR STAFF, RUCO, THE TOWN OF YOUNGTOWN AND THE OTHER INTERVENERS?

A. Yes, I have.

Q. DO YOU AGREE WITH ALL OF THE PROPOSED ADJUSTMENTS AND RECOMMENDATIONS BY EACH OF THE PARTIES?

A. No, I do not. Most of the Company's disagreements are explained in its rejoinder presentation and I address several of them in this rejoinder testimony. I would also note that, to the extent Arizona-American has not addressed an issue raised or adjustment recommended by Staff, RUCO, Youngtown, or any other party, this does not necessarily mean that we agree with the position taken by those parties.

Q. WHAT ISSUES ARE YOU ADDRESSING IN YOUR REJOINDER TESTIMONY?

A. I will generally be covering issues related to: 1) the Company's overall filing; 2) the ratemaking implications of Youngtown's request for a Commission order requiring Arizona-American to do a study and construct fire flow improvements; 3) rate case expense; 4) the acquisition premium; 5) inclusion of American Water

Works' overheads and American Water Works Service Company charges in the test period; 6) fair value rate base issues; and 7) Arizona-American's capital structure, debt cost and financial integrity (pre-tax interest coverage).

III. SUMMARY OF ARIZONA-AMERICAN'S REQUEST FOR RATE RELIEF.

Q. WHY DID ARIZONA-AMERICAN FILE FOR RATE INCREASES IN EACH OF THE TEN SYSTEMS SUBJECT TO THIS PROCEEDING WHEN IT DID?

A. First, a substantial amount of time has elapsed since the prior rate cases for these systems. It has been at least 6 years between test years for each of the districts and it has been more than 12 years since the last filing in one. This alone made it imperative that rate filings be made. To wait any longer would have compounded some of the problems Staff and the interveners complain about in their testimonies.

Second, had Arizona-American not filed when it did, it would not have been able to file until 2006 as a result of the three-year stay-out imposed by Decision No. 63584 (December 12, 2002). This would have added another four plus years between test years.

Third, Arizona-American was required to file for rate review for the Anthem water and wastewater districts by 2004 or, if earlier, when the number of equivalent residential units in Anthem reached 3,500. Decision No. 60975 (June 19, 1998) at 15. All of these factors combined mandated that the Company file when and how it did.

Q. DO YOU BELIEVE THE COMPANY HAS SUPPORTED ITS APPLICATION WITH SUBSTANTIAL EVIDENCE?

A. Yes. Arizona-American has supported its application with testimony on every aspect of its request, defended every proposed adjustment, made necessary and

appropriate corrections as recommended by other parties and provided updated schedules reflecting its proposed revenue requirement and rates. We have also responded to a tremendous amount of discovery from multiple parties and submitted evidence in support of the Company's position on every significant issue in dispute with Staff and the interveners.

IV. YOUNGTOWN'S REQUEST FOR FIRE FLOW IMPROVEMENTS.

Q. DO YOU AGREE WITH MR. MENDEZ THAT THE COMPANY SHOULD FUND ALL OF THE FIRE FLOW IMPROVEMENTS HE RECOMMENDS FOR THE YOUNGTOWN AREA?

A. No. To begin with, I note that Fredrick Schneider has thoroughly responded to Youngtown's surrebuttal testimony on fire flow matters in his rejoinder testimony. I am merely going to address the narrow ratemaking impacts of Youngtown's request, impacts Youngtown seeks to deflect to the Company and/or other ratepayers.

That said, we take issue with Mr. Mendez' suggestion that Arizona-American fund fire flow improvements and then seek recovery in a future rate case. Prefiled Surrebuttal Testimony of Jesse Mendez at 9. Although the Company can seek recovery for prudently incurred costs to replace and upgrade service within its service areas in a future rate case, but ultimate recovery through rates is not assured. Moreover, the study and the upgrades Youngtown seeks would likely have an impact on rates for all customers in the Sun City water district for the reasons Mr. Schneider explains. Rejoinder Testimony of Fredrick Schneider at 6, 11. It is simply not as easy as Mr. Mendez seems to believe, and absent an urgent need, upgrades to particular systems should be made after careful planning, including addressing ratemaking concerns like subsidization. This is especially in the case of upgrades for fire flow, where the benefit is very isolated,

often requested for self-serving purposes and neither required by policy or rule.

IV. RATE CASE EXPENSE.

Q. DID YOU STATE THE COMPANY'S POSITION ON RATE CASE EXPENSE IN YOUR REBUTTAL TESTIMONY?

A. Yes, on pages 22-25 of that testimony, I discuss the Company's request and respond to RUCO's objection to the level of expense and the recommendation by Youngtown that the amortization period be lengthened.

Q. HAS THE COMPANY CHANGED ITS POSITION IN REGARD TO THE AMORTIZATION PERIOD?

A. No, Mr. Burnham continues to advocate that the proper amortization period should be five years. Surrebuttal Testimony of Andrew Burnham ("Burnham Sb.") at 4-5. However, the only new "evidence" he offers, a literal shred from my rebuttal testimony, is my use of the word "likely" in referring to the fact that the Company will file new cases prior to a five-year period. I can assure this Commission that Arizona-American is nearly certain to file more rate cases no later than July of 2006 due to the substantial number of capital improvements, including arsenic treatment facilities, that are planned during the next few years.

Q. DOES ANY OTHER PARTY CHALLENGE THE COMPANY'S RECOMMENDED THREE-YEAR AMORTIZATION PERIOD?

A. No.

Q. IS RUCO STILL RECOMMENDING THAT THE COMPANY ONLY BE ALLOWED $418,941 OF RATE CASE EXPENSE?

A. Yes, RUCO has not changed its position.

Q. DO YOU AGREE WITH RUCO WITNESS DIAZ CORTEZ THAT RATE CASE EXPENSE IS DRIVEN PRIMARILY BY THE NUMBER OF ISSUES, THE NUMBER OF EXPERTS RETAINED, THE RATES CHARGED BY

EXPERTS AND ATTORNEYS, AND THE NUMBER OF HOURS FOR WHICH THE COMPANY IS WILLING TO RETAIN EXPERTS AND ATTORNEYS?

A. Yes, I do, with the caveat that the Company often has little choice in the number of hours attorneys and outside consultants are required to spend, as those costs are driven by the number of issues and, to a large extent, by the actions of the other parties. In any case, all of these factors Ms. Diaz Cortez identifies support the Company's request for rate case expense in the amount of approximately $715,000, which I should note is several hundred thousand dollars less than the Company's actual expense for this proceeding.

Q. HOW DO YOU RESPOND TO MS. DIAZ-CORTEZ' ASSERTION THAT THE NUMBER OF DISTRICTS DOES NOT SIGNIFICANTLY IMPACT THE LEVEL OF RATE CASE EXPENSE?

A. I disagree with Ms. Diaz Cortez' argument. *See* Surrebuttal Testimony of Marylee Diaz Cortez ("Diaz Cortez Sb.") at 10-11. First, even where there are issues relevant to more than one district, a single issue can create a tremendous amount of work to produce volumes of district-specific books and records. In this case, for example, a great deal of time was spent justifying to Staff that we had "sufficient" proof of plant additions since the last rate decision. This had to be done for each district because Staff required the Company to prove the cost and existence of all plant additions since the last rate case for virtually every plant item. Since it was between 6 and 12 years between test years for these districts, a significant amount of time was needed to produce the evidence Staff wanted, and the fact that this was done in one district produced no costs savings in another district.

Similarly, items such as district account analysis, proof of test period revenues, costs to assemble and produce the filings are not limited because there

are multiple districts. The proof of revenues in each district was arduous and time consuming. It was based on individual proof in each district – solely dependent on the rates and sales in each individual district. The analysis of accounts is not a Company-wide issue; it is a district specific issue and, as such, requires additional time and effort to fulfill, based on the number of districts filed. This means, obviously, that the number of filings will have a significant impact on rate case expense.

Q. ARE THERE OTHER DISTRICT SPECIFIC ITEMS THAT WILL INCREASE RATE CASE EXPENSE?

A. Yes, as has occurred in this proceeding, several of the districts have their own unique and special issues. Sun City has the Tolleson and Town of Youngtown issues. Anthem has its issues with meter charges, current rates and water quality. Sun City Health has intervened in the Sun City West and Sun City areas. There are issues in Mohave concerning meter charges to mobile home parks. There are purchased water issues in Anthem and Agua Fria. Each of these things contributed to the overall rate case expense, and each in its own unique way.

Q. DO YOU AGREE WITH RUCO THAT THE NUMBER OF CUSTOMERS HAS LITTLE BEARING ON RATE CASE EXPENSE?

A. No, Ms. Diaz Cortez claims that rate case expense is not related to and/or directly dependent on the number of customers. Diaz Cortez Sb. at 10-11. Ms. Diaz Cortez' testimony unduly narrows the issue. I can agree that the **number** of customers may not complicate issues or require the retention of "extra" consultants, increase attorney fees or prolong hearings. However, the more customers the utility has, the larger its operations and rate base and the more likely there are going to be multiple issues in dispute in a rate proceeding. Of course, direct customer involvement as interveners, as has also been the case here, will

also have an impact on rate case expense. In addition, 10 separate districts serve our customers, each having its own rates and separate accounting schedules and treatments, as I explained. Ms. Diaz-Cortez's argument suggests that the Company should consider consolidating these districts, which the Company is certainly willing to do.

Q. ARE THERE OTHER SPECIFIC CUSTOMER DRIVEN RATE CASE EXPENSES?

A. Yes, in fact there is one specific item that is driven exclusively by the number of customers, customer notice requirements. Notices can cost up to one dollar per customer. There are usually at least two notices required; one for notice of the filing and one for notice of an approved rate increase. This will result in rate case expense of as much as $80,000.

Q. DO YOU AGREE WITH RUCO THAT THE LEVEL OF RATE CASE EXPENSE THE COMPANY IS REQUESTING IS UNPRECEDENTED FOR A WATER AND/OR SEWER COMPANY?

A. I do not disagree, nor do I believe it is material in any way. Every rate case stands on its own merits, so to speak, and the request for rate case expense must be viewed in the totality of the circumstances of that proceeding. As Ms. Diaz Cortez and I both have testified, there are many factors that have to be considered and I believe consideration of these factors explains why Arizona-American has requested a particular level of expense.

Many of these factors are unique to this case. For example, the Company has requested that it be allowed a reasonable return on the fair value of its rate base in accordance with its interpretation of Arizona law. Staff, RUCO and Youngtown vehemently disagree with Arizona-American's position. This has led to a monumental effort to produce and reconcile up to thirteen years of historical plant

information and "prove" the existence and reasonable cost for these assets as well as analyze the applicable legal authorities supporting the Company's position.

Third, and this is an extremely important factor, the Company does not employ any dedicated rate department staff in Arizona whose salary and wages are continuously charged to all customers. If it did, the Company would have additional operating expenses that are far in excess of the amount of rate case expense it seeks to recover on an annual basis

Q. DID YOU ALSO TESTIFY THAT ARIZONA-AMERICAN WOULD INCUR MORE IN RATE CASE EXPENSE THAN ITS REQUESTED LEVEL OF RECOVERY?

A. Yes, in fact, as of October 31, 2003, we have already expended over $900,000 in rate case expense. Notably, this does not include any costs for analysis of surrebuttal, preparation of rejoinder, costs related to hearings (which we anticipate will take about 10 days), costs to prepare and file post-hearing briefs and costs of final Commission approval of a recommended opinion and order. We have already estimated these remaining costs will exceed $360,000. Thus, we estimate incurring total rate case expense of over $1.25 million, or almost double our request in this case. Therefore, the Company stands by its level requested in the filing as being prudent and fully justified.

Q. ARE ANY OF THE OTHER PARTIES CONTESTING THE LEVEL OF RATE CASE EXPENSE?

A. No.

Q. DO YOU AGREE WITH RUCO THAT ALLOWANCE OF THE COMPANY'S RATE CASE EXPENSE, IN AND BY ITSELF COULD CREATE THE NEED FOR A RATE INCREASE?

A. Ms. Diaz Cortez seems to be testifying that the Company's filings in these cases

were unnecessary and unwarranted, and therefore, even if the Company can justify its request of over $700,000, it should not be considered due to the fact that many of these filings should never have been made. Diaz Cortez Sb. at 11– 12. First of all, we do not agree with Staff, RUCO, Youngtown or any other party recommending rate decreases for some of the water and wastewater districts in this proceeding.

Moreover, as explained above, these cases essentially had to be filed when they were, no matter how large or small the increase requested. For instance, in two of the service areas (Anthem water and Mohave water) that need the smallest percentage increases there we compelling reasons to file. For Anthem water, the Commission ordered a filing, and for Mohave water, the passage of time since its last case, 12 years, dictated that Arizona-American file now, lest information become more stale.

Q. DO YOU AGREE WITH RUCO THAT THE MERE OCCURRENCE OF AN EXPENSE DOES NOT MEAN IT WAS NECESSARY, PRUDENT, OR PROVIDED A BENEFIT TO RATEPAYERS?

A. Yes, I do agree with this statement. This is one reason that we have not changed our request in this case despite much greater expense actually being incurred. We understand that some of the expenditures that we incurred in the processing of this case may have been incurred through no fault of the other parties or ratepayers. However, this was certainly an amount far less than $500,000, the minimum difference between our expected final actual level and that originally projected and requested.

Q. WHAT ABOUT THE SPECIFIC EXAMPLES OF EXCESSIVE EXPENDITURES MS. DIAZ CORTEZ IDENTIFIES?

A. RUCO has pointed to three items as being potentially imprudent: 1) $8,000 for

correction of bill counts, 2) $40,000 for a cost of service study, and 3) $200,000 for legal fees prior to Staff and intervener testimony being filed. Diaz Cortez Sb. at 12-13. None of these examples supports RUCO's position.

Bill counts are required in any filing and as such, should be part of rate case expense. It is not relevant that the Company had to correct the bill count, had it done it that way in the first place it would have taken longer than it did in the first place.

The cost of service study was not filed with the application, but it was done and was submitted in response to the rate design recommendations by Staff. Why should the Company not recover for preparing a study of a type common in Commission ratemaking proceedings that was required to support its position and show that Staff's proposed rate design is not justified based on cost of service principles?

Some legal fees will be encountered prior to the filing of the other parties' direct cases. Attorney fees will be required to assist in preparing the filing and developing rate case strategies on crucial legal and other issues, responding to data requests and representing the Company in preliminary proceedings (such as conferences and motions). This is a substantial series of rate filings. Therefore, these "up-front" costs were substantial.

Q. DO YOU HAVE ANY OTHER FINAL COMMENTS IN REGARDS TO RUCO'S POSITION ON RATE CASE EXPENSE?

A. Yes, I would like to note RUCO's reliance on its position in Arizona Water Company's Eastern Group rate case, Docket, No. W-01445A-02-0619. RUCO's positions are somewhat contradictory. In the Arizona Water case, RUCO has taken a position that the Company's estimate included in their original filing should be adopted. RUCO has not made cost comparisons nor is it willing to

consider the actual incurred and projected costs of Arizona Water, which are over $300,000. In our case, in contrast, RUCO has chosen to ignore our estimate, ignore our current level of expense, only to determine an estimate based on costs from a past case that is over 7 years old. This case should stand on its own, with respect to rate case expense and the Company's requested level of rate case expense has not be shown by RUCO to be unreasonable.

V. <u>ACQUISITION PREMIUM</u>.

Q. DO YOU AGREE WITH THE TOWN OF YOUNGTOWN THAT THE ACQUISITION ADJUSTMENT SHOULD BE ALLOCATED BASED ON THE CURRENT VALUE OF THE ASSETS?

A. Yes, I actually do. The acquisition adjustment could be considered a payment made by a willing buyer to a willing seller of an amount over the current historical book value of the assets based on those assets' current value. In other words, the acquisition adjustment would be based on the difference between what the willing buyer determines to be the current fair value of the assets and the current historical book value. Therefore, in this case, the allocation should then be based on the present reproduction cost new less depreciation ("RCND") values considered in this case, which Staff has now accepted.

Q. IS THIS THE METHOD PROPOSED BY MR. BURNHAM IN HIS DIRECT AND/OR SURREBUTTAL TESTIMONY?

A. No. Mr. Burnham (Sb. at 3) continues to recommend the use of net book value, which bears no relationship to the current value of the assets. In fact, in most cases, net book value is substantially different than current value.

Q. WHAT METHOD OF ALLOCATION DID THE COMPANY RECOMMEND?

A. The Company allocated the acquisition adjustment based on gross plant. The

Company used gross plant as a method of allocation for consistency, even though I consider the current value to be the most appropriate method. The allocation by and between the six acquired former Citizens' state specific entities was based on gross plant. To remain consistent, I proposed the same methodology.

Q. HAS THE COMPANY REQUESTED THAT THE COMMISSION DETERMINE THE ALLOCATION METHODOLOGY IN THIS PROCEEDING?

A. No, the Company allocated the premium to each of the districts solely for purposes of presentation in its filing. The Company presented the allocation in each of the district's original cost rate base ("OCRB"), but that presentation has absolutely no impact on the revenue requirement in this case.

Q. DO YOU AGREE WITH THE TOWN OF YOUNGTOWN THAT THE ALLOCATION OF THE ACQUISITION ADJUSTMENT SHOULD BE BASED ON THE SAME METHODOLOGY FOR BOTH ACCOUNTING AND RATEMAKING PURPOSES.

A. No. In fact, the Company never allocates an acquisition adjustment for accounting purposes. The Company has recorded the acquisition adjustment on its books and records as a Company-wide, not district specific, entry. The only time the Company has to allocate the acquisition adjustment is for ratemaking purposes. Therefore, the Town of Youngtown's recommendation is without merit.

Q. DO YOU AGREE WITH STAFF THAT THE COMPANY HAS BASED ITS RECOMMENDATION TO AMORTIZE THE ACQUISITION ADJUSTMENT OVER 40 YEARS ON ACCOUNTING PRINCIPLE BOARD OPINION 17?

A. No. The Company has made its request based on Financial Accounting Standard ("FAS") 71, which allows a regulated utility to vary from other FAS's as long as

the varied treatment is approved by the appropriate regulatory body. In this case, we are seeking approval of a method for ratemaking that is different from the method prescribed in FAS 141 and 142.

Q. DOES THE COMMISSION HAVE TO ALLOW THE RECOVERY OF THE ACQUISITION ADJUSTMENT IN RATES FOR THEM TO ISSUE A RULING ON THE RECOVERY METHOD, AMOUNT AND PERIOD?

A. No.

Q. IS THE STAFF CORRECT THAT FAS 142 REQUIRES ANY AND ALL AMOUNTS PAID IN EXCESS FOR ASSETS TO BE BOOKED AS GOODWILL IN ACCORDANCE WITH FAS 142.

A. No. FAS 141 and 142 set specific guidelines as to how to record an acquisition. Any acquisition could have goodwill as well as infinite and finite intangible assets, and an acquisition adjustment or UPAA. The acquisition adjustment for the purchase of the Citizens water and wastewater assets was recorded by American Water Works on its books as $34,319,549 of UPAA, $16,200,000 of infinite intangible asset, $4,300,000 of finite intangible asset and $17,117,581 of goodwill. The UPAA and finite intangible assets are currently being amortized in accordance with FAS 142.

Q. WOULD YOU PLEASE SUMMARIZE THE COMPANY'S REQUEST CONCERNING THE ACQUISITION ADJUSTMENT IN THIS MATTER?

A. The Company has requested that it be allowed to amortize the full amount of the acquisition adjustment based on a 40-year period using the mortgage style amortization method. The Company is not requesting, at this time, that any portion of the acquisition adjustment be included in the cost of service.

Q. IS THERE ANY BENEFIT TO RATEPAYERS FROM THE COMPANY'S PROPOSED TREATMENT?

A. I believe that there are two distinct benefits. First, if and when the Company does seek recovery of a portion of the acquisition adjustment in rates, the amount available for recovery in a future rate case will be smaller since the Commission would have previously authorized the Company to amortize the acquisition adjustment. Second, by extinguishing the acquisition adjustment from the books of the Company through amortization, any controversy and confusions over treatment of the amortization should be reduced.

VI. RECOVERY OF OVERHEADS AND SERVICE COMPANY CHARGES.

Q. STAFF WITNESS ALEXANDER IGWE TESTIFIES THAT THE COMPANY HAS NOT PROVIDED ANY EVIDENCE THAT CITIZENS' 1999 AND 2000 CORPORATE OVERHEAD EXPENSES ARE MORE REPRESENTATIVE OF A NORMAL EXPENSE LEVEL THAN CITIZENS' RECORDED TEST YEAR OVERHEAD EXPENSES. DO YOU AGREE?

A. No, as further explained by Mr. Bourassa and the Company's President, Ray Jones, in their rejoinder testimony, Staff has simply chosen to ignore the evidence. Staff asked for and was provided a detailed itemization of Citizens' corporate overheads for 1999 and 2000 as part of their review of the Company's books and records. Staff's review of these books and records surely led to the inescapable conclusion that something was amiss given that the data clearly reflects a continuing decrease in corporate overhead costs reaching its pinnacle in the same year that a final sale of Citizens' assets was pending. *See* Rejoinder Testimony of Ray L. Jones at 3-7. I suspect it is not so much as Staff's auditors missed this evidence, rather they have just decided to ignore it because the irregular test year data leads to a lower revenue requirement. As we have repeatedly explained, however, Citizens' test year corporate overhead expenses bear no relationship to the overhead and Service

Company costs Arizona-American will incur during the period the rates established in this proceeding will be in effect.

Q. SO STAFF NEVER MADE ANY INQUIRIES CONCERNING THE OBVIOUS DECREASE IN THE LEVEL OF CORPORATE OVERHEAD EXPENSE IN 2001 AS COMPARED TO 1999 AND 2000?

A. No, although Staff has already acknowledged that the Company provided information that the 2001 Citizens' overheads were not representative. *See* Attachment to Surrebuttal of Alexander Ibhade Igwe ("Igwe Sb.)(Company's response to Data Request DWC 6-9, explaining that Citizens eliminated 15 full time positions between the time the acquisition agreement was signed and the time the acquisition was closed.).

Q. DID RUCO CONDUCT AN ANALYSIS OF THE COMPANY'S PROPOSED PRO FORMA ADJUSTMENT?

A. Yes, RUCO asked many questions concerning the Company's proposed pro forma adjustment to use Arizona-American's 2002 overheads (from American Water Works) and Service Company (from American Water Works Service Company) expense levels. RUCO accepted the concept of this pro forma adjustment but recommended use of the actual 2002 amounts, which, at the time of the Company's filing were not yet available. We have accepted this recommended change by RUCO and now propose a pro forma adjustment based on Arizona-American's actual 2002 levels of overhead and Service Company charges.

Q. DO YOU HAVE ANY COMMENT ON MR. IGWE'S CLAIM THAT THIS PRO FORMA ADJUSTMENT SHOULD BE REJECTED BECAUSE THERE IS NO CORRESPONDING "BENEFIT" TO RATEPAYERS?

A. Yes, I do. Staff offers this remarkable position in several places in its testimony in this case. *See e.g.,* Igwe Sb. at 4, ls. 15-17. I know of no Commission rule, order,

policy or other document that requires that every pro forma adjustment provide a corresponding benefit to ratepayers. Instead, the Commission's rules call for pro forma adjustments to ensure a more realistic relationship between rate base, revenues and expenses during the period rates will be in effect. A.A.C. R14-2-103(A)(3)(i) (definition of "pro forma adjustment"). There is simply no mention of a "ratepayer benefit" requirement, nor is it always possible to show such a benefit, as Mr. Jones explains in his rejoinder testimony.

Q. IN SUMMARY, MR. STEPHENSON, WHAT IS WRONG WITH STAFF'S POSITION THAT CITIZENS' 2001 TEST YEAR CORPORATE EXPENSE LEVELS SHOULD BE USED?

A. Staff essentially bases its recommended use of 2001 Citizens' corporate overheads on two specific points: 1) that the use of the Company's 2002 overheads and Service Company charges is inconsistent with historical test year premises and creates a mismatch with teat year revenues and customers, and 2) using the 2002 numbers unduly increases overhead expenses by $4,079,823 without any known benefit to ratepayers. Igwe Sb. at 6.

First, overheads have little or nothing to do with revenues, customers or rate base. Overheads are the costs that the general office allocates to an entity to run the business. These overheads are allocated to each of the entities based on prior year-end number of customers. The Company did normalize customers and revenues to the 2001 year-end level – the same level used to allocate general office overheads for the year 2002. Therefore, under any proforma scenario, the overheads and revenues are matched.

Second, Staff is bantering about figures that are totally misleading. Staff wants this Commission to believe that Arizona-American is requesting a level of overheads that is $4 million greater than that of the previous ownership. I agree

that the narrow scope of Service Company overheads may be increasing by over $4 million. However, the total allocated charges, including salaries, per the Company's rebuttal filing is now just over $1.9 million. *See* Stephenson Rejoinder Exhibit 2, attached hereto. This is less than the reduction in Citizens 2001 charges as compared to the average of the 1999 and 2000 Citizens' overheads and less than the reduction provided by the lower cost of capital for American Water Works. Staff should present the whole picture when making comparisons, not just a one-sided view.

Q. HOW DOES STAFF'S POSITION ON THE COMPANY'S RECOMMENDED USE OF 2002 OVERHEADS AND SERVICE COMPANY CHARGES SQUARE WITH STAFF INCLUSION OF THE DEL WEBB PILAR PAYMENTS?

A. These positions are completely inconsistent. These payments do not start until 2004, or three years beyond the test period in this case. Applying Staff's view, this would create an inappropriate mismatch between revenues and expenses. Nevertheless, Staff includes these payments, which lower the revenue requirement.

Q. ARE THESE PAYMENTS KNOWN AND MEASURABLE?

A. No. The agreement has conditions that could alter the amount of the payments.

Q. IF THE AGREEMENT IS BEYOND THE TEST PERIOD, AND THE AMOUNT IS NOT FULLY KNOWN, WHY DID THE COMPANY RECOMMEND THAT THE AMOUNT BE INCLUDED IN THE TEST YEAR PRO FORMA CALCULATIONS?

A. The Company thought it would be best to consider the time period in which new rates would become effective, i.e. 2004. There should be a payment in 2004. Additionally, the Company realized that failing to include the PILAR payments would lead to much higher rate increases in the Anthem districts. In other words,

the Company was trying to be fair to its customers.

Q. HOW DOES THE INCLUSION OF THE DEL WEBB PAYMENT REFLECT ON THE COMPANY'S REQUEST TO INCLUDE THE 2002 OVERHEADS?

A. Simply, the Company was matching known, future changes that should be considered at the time rates would be in effect. Again, this is the purpose of pro forma adjustments.

Q. DO YOU HAVE ANY OTHER COMMENTS TO MAKE ABOUT STAFF'S CONTENTION THAT USING THE AWW 2002 RECORDED OVERHEADS CREATES A MISMATCH?

A. Yes I do. Staff keeps referring to the creation of a mismatch between revenues, expenses and rate base. However, as I noted earlier, Staff has accepted the Company's recommendation to consider the Del Webb 2004 payment in the revenue requirement. Based on Mr. Igwe's definition of mismatch, there is one other very blatant mismatch that Staff recommends. Staff is recommending basing the return on equity for Arizona-American on updated information through September 2003. This updated information was not known and measurable at the end of the test period. In fact, it didn't exist until a month ago. The Company has had little or no opportunity to test or evaluate this updated information. Yet, the Company understands that it is the best information available on which to evaluate a determination of a revenue requirement in this case. The Company does not dispute updating the information, even though it will dispute how the information is used in any determination of a recommendation for a return on equity.

The Company provided all of its overhead recommendations in its filing, which was accepted in January 2003. Staff had ample time to evaluate the prudency of these overheads, but instead chose to ignore them. They are known

and measurable, they are based on the current operations of the Company, and no party to this proceeding has made any claims that any of the amounts are imprudent. I again will state my view that the only reason Staff continues to recommend use of historical overheads of a former owner is an effort to base their recommendations on whatever option leads to the lowest possible revenue requirement, regardless of whether the adjustment is known and measurable.

VII. FAIR VALUE RATE BASE ISSUES.

Q. IN YOUR REBUTTAL TESTIMONY WERE YOU BEING "INFLAMMATORY AND INACCURATE" IN YOU REPRESENTATION OF THE QUALIFICATIONS OF THE TOWN OF YOUNGTOWN WITNESS MR. BURTON?

A. No, I was merely testifying than I believe all of the intervenor witnesses, including Mr. Burton, have failed to adequately and accurately represent what the Company understands is the law in Arizona. The Company believes the Arizona Constitution requires that regulated entities be allowed a fair rate of return on a fair value rate base.

Q. DO YOU AGREE WITH MR. BURTON THAT ALL THREE PARTIES (RUCO, STAFF AND THE TOWN OF YOUNGTOWN) REACH THE SAME OR SIMILAR CONCLUSIONS?

A. No, I think Mr. Burton has jumped the gun here, which further reflects his lack of experience with the way things are done here in Arizona. Prefiled Surrebuttal Testimony of Michael E. Burton ("Burton Sb.") at 4, ls. 17-19. RUCO testified on surrebuttal that the Commission must consider RCND rate base ("RCRB") when evidence of such is presented. Diaz Cortez Sb. at 3. In his surrebuttal testimony, Staff's lead witness, Darren Carlson, states Staff's position that the Company's fair value rate base ("FVRB") be determined using a 50/50 weighting of RCND and

original cost. Surrebuttal of Darron W. Carlson ("Carlson Sb.") at 6, ls. 1-3. Mr. Burton has recommended that FVRB should equal OCRB and that the Commission should disregard the Company's RCRB. Burton Sb. at 6-7. Thus, the positions of these three parties are not consistent. We maintain that adoption of Youngtown's recommended approach would violate Arizona law.

Q. DO YOU AGREE WITH MR. BURTON THAT ALL THREE PARTIES REACH THE APPROXIMATE SAME RECOMMENDATION (FOR A REVENUE REQUIREMENT)?

A. Yes, because despite testifying that the Commission should consider RCRB in determining the FVRB, Staff and RUCO then ignore RCRB in determining the appropriate revenue requirement. This, the Company submits, makes the positions advanced by Staff, RUCO and Youngtown unlawful and confiscatory.

Q. DO YOU AGREE WITH MR. BURTON, THAT HIS DETERMINATION OF FAIR VALUE RATE BASE IN THIS PROCEEDING IS ENTIRELY CONSISTENT WITH PRIOR (COMMISSION) FAIR VALUE DETERMINATIONS?

A. I agree that most fair value determinations have been based on a return based on OCRB to determine a revenue requirement and then the return on FVRB is "backed into," as Mr. Carlson and Ms. Diaz Cortez explain. This does not mean this approach is valid. Past "practices" do not override the law. In this case, we assert that the Commission should follow the law and grant Arizona-American a just and reasonable rate of return on the FVRB.

Q. IS STAFF NOW RECOMMENDING THIS APPROACH?

A. No. Staff has proposed a FVRB determined by a 50/50 weighting of the Company's OCRB and RCRB. Carlson Sb. at 12, 16. However, Staff is not recommending that the Commission provide the Company a just and reasonable

return on that FVRB as reflected in Staff's surrebuttal schedules.

Q. PLEASE EXPLAIN.

A. Yes, looking at Stephenson Rejoinder Exhibit 1, attached hereto, Staff has determined a rate of return on FVRB that differs from district to district. *See, generally*, Staff Surrebuttal Schedules. In fact, the returns recommended by Staff on FVRB vary from a high of 8.76% to a low of 3.97%. A 3.97% rate of return is hardly reasonable. It is less than the cost of most debt instruments. We believe the law mandates that regulated monopolies be provided with an opportunity to earn a reasonable return on the fair value of the plant it devotes to serving customers. I do not believe a 3.97% return would ever be considered reasonable.

Q. HOW DID STAFF REACH THIS RESULT?

A. I think it is quite obvious that the revenue requirements recommended by Staff, on all of the three rate base determinations, are calculated by applying the recommended rate of return exclusively to OCRB. There is no other answer. Staff has simply determined a revenue requirement based on OCRB, and then used that exact same revenue requirement for the other two rate base determinations, RCRB and FVRB. In other words, the returns allowed on the equity portion of the non-OCRB determinations is simply "backed into" as a matter of simple mathematics.

Q. WHAT IS WRONG WITH THIS APPROACH?

A. I believe it is unlawful and confiscatory. If the law of the State is to determine a revenue requirement based on the fair value of the utility's plant and property, then it is only logical that the returns on rate base should be the same, unless the Commission is going to conclude, without any evidence, that the cost of equity capital is vastly different for every one of the 10 districts at issue in this case. Otherwise, the Commission is not setting rates based on fair value.

Q. WHY IS THIS CONFISCATORY?

A. In his surrebuttal testimony, Mr. Carlson testifies that Staff has increased its recommended rate base from $91,647,303 in their direct presentation to $113,569,259 in their surrebuttal presentation. Carlson Sb. at 17. Yet, Staff's surrebuttal presentation contains a lower recommended revenue increase than its direct presentation, from $476,722 to $346,647. *Id.* at 18.

Now, there are a few minor expense adjustments in the testimony of Mr. Igwe, and Staff has lowered its recommended rate of return on equity (from 9.7% to 9.0%). However, Staff has also eliminated the approximately $22 million in plant from rate base. Based on a 40% equity structure and a $91 million rate base, the revenue requirement, based on the change in the recommended return on equity, should be reduced by about $250,000. Thus, Staff's increase in rate base makes absolutely no difference.

Q. SO IS IT YOUR OPINION THAT STAFF, AND OTHER PARTIES, ARE REALLY NOT RECOMMENDING DETERMINATION OF THE REVENUE REQUIREMENT BASED ON ANYTHING EXCEPT OCRB?

A. That is correct. This point is quite evident in all three parties recommendations. The Staff recommends a FVRB, but only recommends a revenue requirement on what they proclaim is a reasonable return on OCRB. *See* Stephenson Rejoinder Exhibit 1; Staff Surrebuttal Schedules. RUCO states that the revenue requirements on all three rate base determinations should be the same and that the returns are no more than a "fall-out". Diaz Cortez Sb. at 3-4. The Town of Youngtown very plainly states that OCRB should equal FVRB, unless the Commission determines that an acquisition premium should be allowed. Burton Sb. at 6-8.

VIII. CAPITAL STRUCTURE AND FINANCIAL INTEGRITY.

Q. THE STAFF COST OF CAPITAL WITNESS, MR. REIKER, TESTIFIES THAT STAFF HAS MODIFIED ITS RECOMMENDATION AS TO THE

COMPANY'S CAPITAL STRUCTURE AND COST OF DEBT. DOES THE COMPANY AGREE WITH STAFF'S SURREBUTTAL POSITION?

A. The Company and Staff are now extremely close. The Company is proposing a capital structure that consists of 60% debt and 40% equity, with a cost of debt of 4.86%. Staff is now recommending a capital structure consisting of 60.1% debt and 39.9% common equity, and a cost of debt of 4.8%. Surrebuttal Testimony of Joel M. Reiker ("Reiker Sb.") at 2 Table 1).

Q. HOW DOES RUCO'S RECOMMENDED CAPITAL STRUCTURE COMPARE TO THE COMPANY'S CAPITAL STRUCTURE?

A. RUCO's recommended capital structure is, once again, very similar to the Company's. Its capital structure contains 59.89% debt and 40.11% common equity. Thus, the recommended capital structures of the three parties are virtually identical, with Staff's capital structure containing the largest percentage of debt and RUCO's capital structure containing the smallest percentage of debt. RUCO has also accepted the Company's debt cost of 4.86%.

Q. HAVE STAFF AND RUCO MODIFIED THEIR RECOMMENDED RETURNS ON EQUITY?

A. Yes, although Staff and RUCO are moving in opposite directions. As I noted, Staff has <u>reduced</u> its recommended return on equity from 9.7% to only 9.0%. Reiker Sb. at 2. RUCO, in contrast, has increased its recommended return on equity from 9.11% to 9.61%, in order to take into account the leverage in the Company's capital structure. Surrebuttal Testimony of William A. Rigsby at 10. Consequently, Staff, RUCO and the Company all agree that 50 basis points should be added to the cost of equity estimates derived from the sample groups of publicly traded water and gas utilities. However, there is still a substantial disagreement regarding those cost of equity estimates, which is the subject of Dr. Zepp's

testimony in this case. The Company is continuing to request an authorized return on equity of 11.5% (which includes the 50 basis point adder, mentioned above), based on Dr. Zepp's recommendations.

Q. ON PAGES 29 AND 30 OF HIS SURREBUTTAL TESTIMONY, MR. REIKER AGAIN RAISES THE ISSUES OF ARIZONA-AMERICAN'S FINANCIAL INTEGRITY. DO YOU HAVE ANY COMMENTS ON THAT TESTIMONY?

A. Yes. Frankly, Mr. Reiker's surrebuttal testimony on the issue of financial integrity makes no sense. As a preliminary matter, I should emphasize that Mr. Reiker raised the issue of financial integrity in his direct testimony on page 30, in which he claimed that Staff's rate of return recommendation results in a pre-tax interest coverage ratio of 3.2, which is comparable to the interest coverage ratio typically required by a major credit rating service for an A-rated electric utility. My rebuttal testimony, at pages 28 through 32, explained why Mr. Reiker's assertion is clearly wrong and that based on Staff's recommendations, the pre-tax interest coverage ratio is approximately 1.0 – an indication of financial distress.

Mr. Reiker has responded to my rebuttal testimony by pointing out that I used accounting data to compute the pre-tax interest coverage ratio based on Staff's recommendations. I am not sure what Mr. Reiker means. Interest coverage and debt service ratios use book (i.e., accounting) data. Staff's updated capital structure consisting of 60.1% debt and 39.9% equity is based on accounting data, as is Staff's updated recommended cost of debt of 4.77%, as shown in Schedule JMR-S17, attached to Mr. Reiker's surrebuttal testimony. Accordingly to Mr. Reiker, the Company's annual debt service cost is $8,295,442 and its annual coupon cost of debt is $8,267,724, as shown in Schedule JMR-S17. Putting aside the extremely small difference between Staff's cost of debt and the Company's

cost of debt, we agree that the annual debt service requirement is approximately $8.2 million. I can't believe that any credit rating service, like Standard & Poor's, or any standard finance textbook, such as the Brealey and Myers text cited in Mr. Reiker's direct testimony on page 30, would recommend the use of anything other than the actual amount of interest that a firm is required to pay on its outstanding debt to determine its interest coverage.

Mr. Reiker also claims that the pre-tax interest coverages that I computed somehow assume that "the Commission is obligated to provides a dollar return on items other than assets devoted to public service." Reiker Sb. at 29. This is also nonsensical. Nowhere in his testimony does Mr. Reiker criticize the formula that I employed, which is very simple and easy to apply. The total available for interest coverage is equal to operating income (i.e., revenue less expenses) plus income taxes. That total is then divided by Mr. Reiker's interest expense taken from his schedule. There are other variations of this formula, such as the times-interest-earned ratio, in which depreciation is included. These are straightforward, widely used formulas that don't assume anything about Commission ratemaking.

I am also very disturbed by Mr. Reiker's suggestion that the Company is asking for a return on assets that are not devoted to public service. I am not aware that the Company's rate base, as adjusted, includes any assets that are not used and useful, and Mr. Reiker fails to identify any of those assets in his testimony. In fact, Staff has now accepted the Company's RCRB. Thus, Mr. Reiker's testimony conflicts with the testimony of other Staff witnesses.

Q. MR. REIKER ALSO PROVIDES A HYPOTHETICAL EXAMPLE ON PAGE 29 OF HIS SURREBUTTAL TESTIMONY THAT PURPORTEDLY SUPPORTS HIS ARGUMENT. IS THAT EXAMPLE VALID?

A. This example is not valid. Mr. Reiker asks himself whether he can "provide an

example of the situation where a utility made substantial investment in assets *not* devoted to public service," which would purportedly support the use of "non-accounting" data to compute the pre-tax interest coverage ratio. In his answer, Mr. Reiker goes on to describe a utility paying a 100% premium in purchasing the assets of another utility "[d]ue to reasons related to management self-interest and not public benefit." Reiker Sb. at 29. There are several obvious problems with this hypothetical example.

First of all, I don't see how it would ever be in the "self-interest" of a utility's management to "overpay" for another utility's assets. Mr. Reiker's basic premise is illogical. Putting that aside, I don't see how this hypothetical is analogous to Arizona-American's acquisition of the water and wastewater utility plant and assets of Citizens Communications Company in Arizona. Under Arizona law, a transaction like the transaction in Mr. Reiker's example would require two different approvals from the Commission: (1) an approval to sell and transfer the assets, and (2) approval of debt financing to purchase the assets. Arizona-American obtained both of those approvals. First, in Decision No. 63584 (April 24, 2001), the Commission authorized Citizens to sell and transfer its water and wastewater utility plant and assets to Arizona-American in accordance with the terms of a settlement agreement we negotiated with Staff, attached to the decision. Among other things, the Commission specifically stated, as findings of fact:

- Arizona-American is a fit and proper entity to acquire Citizens' utility assets and Certificates and to assume Citizens' public service obligations for the operation of the utility systems in Arizona.
- Staff and Arizona-American believe that approval of the Agreement attached hereto as Exhibit A is in the public interest.
- Based on our review of the evidence, Staff's recommendations in findings of fact No. 14 and the Agreement are reasonable and in the public interest. Therefore, transfer of Citizens' water and wastewater utility assets and Certificates to Arizona-American

should be approved.

Decision No. 63584 at 16. In the Settlement Agreement itself, Staff expressly agreed "that Arizona-American is a fit and proper entity to acquire the Certificates and that the Commission should authorize and approve the transfer of Citizens' Arizona water and wastewater assets to Arizona-American on the terms set forth herein. No additional terms, conditions or requirements are necessary or appropriate." Decision No. 63584, Exhibit A at 3-4. There was never any suggestion of "overpayment" or any other improper conduct by Arizona-American made by Staff.

Moreover, in Decision No. 64002 (Aug. 30, 2001), the Commission authorized Arizona-American to issue debt in an aggregate principal amount not to exceed $180 million in order to finance the acquisition of Citizens' water and wastewater utility plant and assets in Arizona. Among other things, Staff specifically examined Arizona-American's ability to repay the proposed debt, and computed times-interest-earned and debt service coverage ratios based on various scenarios. The decision states:

> . . . Staff believes that approval of the application will be compatible with the public interest, with sound financial practices, and with the proper performance by Arizona-American of service as a public service corporation and will not impair its ability to perform that service. We concur with Staff, and believe it is appropriate to approve Arizona-American's application without a hearing, subject to the conditions indicated above.

Decision No. 64002 at 7. Among the conditions recommended by Staff and imposed by the Commission was the requirement that the Company increase its equity by at least $0.69 for each dollar of acquisition debt issued by Arizona-American to ensure that Arizona-American's capital structure remain reasonably balanced. Decision No. 64002 at 9 (Finding of Fact No. 17) and 10-11. The

Company has complied with all of these conditions, including making an infusion of equity capital in conjunction with the acquisition to maintain a reasonably balanced capital structure.

In short, the Company's acquisition of, and financing associated with acquiring Citizens' water and wastewater assets was thoroughly reviewed and considered by Staff and approved by the Commission. Both the Commission and Staff have determined that the acquisition and the financing through the acquisition were in the public interest. Mr. Reiker is implicitly attacking the Commission's prior decisions, which were supported by Staff, in suggesting that the Company grossly overpaid for Citizens' assets or invested in assets that are not devoted to public service through his hypothetical example. This sort of tactic is improper.

IX. REBUTTAL TO MR. GRIMMELMANN.

Q. DID YOU HAVE AN OPPORTUNITY TO REVIEW THE SURREBUTTAL TESTIMONY FILED BY MR. GRIMMELMANN ON BEHALF OF THE ANTHEM COUNTRY CLUB HOMEOWNERS ASSOCIATION?

A. Yes. I should note, however, that the Anthem Country Club Homeowners Association did not serve a copy of Mr. Grimmelmann's testimony on Arizona-American or its counsel. Fortunately, one of the Staff attorneys alerted us that this testimony had been filed, and subsequently provided a copy of the testimony to us. Consequently, I did have an opportunity to review it, albeit rather quickly under the circumstances. Frankly, I am not sure how to respond to this testimony.

Put simply, Mr. Grimmelmann believes that the rates and charges for water and wastewater services in Anthem are too high, and is very critical of what he calls "the inaccurate (or potentially incompetent) initial rate estimates requested by the former Citizens Water Company, and the acceptance of these rates by

[Arizona-American]." Surrebuttal Testimony of Frank J. Grimmelmann at 6. It is true that Anthem's water and wastewater rates are high relative to the rates established for the older districts, such as Sun City and Sun City West. However, Mr. Grimmelmann apparently does not understand that the setting of rates is based on a variety of different district-specific factors, and that rates charged by water and wastewater utilities, as well as non-regulated municipal providers, vary widely based on the number of customers, amount and date of plant, level of accumulated depreciation, operating expenses and many other factors.

I should also note that the initial rates approved for Citizens in Decision No. 60975 (June 19, 1998) are actually lower than the rates initially recommended by Staff in that proceeding. I understand that Citizens (with the assistance of RUCO) were able to convince Staff to accept the lower rates and charges for service that Citizens proposed. In addition, as I indicated above, the Commission was aware that it was setting rates based on estimated customers, rate base, revenue and expenses, and ordered Citizens to file a rate application in 2004 using a 2003 test year, or within six months of the time when 3,500 "equivalent residential units" are being served. Arizona-American, in obtaining approval to acquire Citizens' water and wastewater assets, was specifically ordered to continue to charge the existing rates and charges previously authorized for each of the Citizens districts in Decision No. 63584. Mr. Grimmelmann is probably not aware that Arizona-American could not have requested modifications to the rates and charges for the Anthem districts during the course of that proceeding.

Q. MR. GRIMMELMANN'S TESTIMONY CONTAINS A FAIRLY LENGTHY DISCUSSION ABOUT THE PURCHASE PRICE PAID FOR THE CITIZENS' WATER AND WASTEWATER ASSETS AND THE APPROPRIATE RETURN ON EQUITY. DO YOU HAVE ANY

COMMENTS ON THAT TESTIMONY?

A. Frankly, I have reviewed this testimony, and I am unable to follow Mr. Grimmelmann's arguments. Like some of the other parties, as discussed above, Mr. Grimmelmann appears to be advocating the use of an OCRB rate base, without regard to the current fair value of those assets. I have addressed this issue at length above, and will not repeat that discussion here. I also could not follow the logic of his discussion about the "appropriate theoretical rate of return." Mr. Grimmelmann seems to assume that a return on equity of only 7.95% would allow a utility to double its equity every 10 years. It is not clear to me how this would be possible if his hypothetical company were to meet annual debt service requirements, pay dividends to our shareholder, and finance new plant, in addition to paying operating expenses and taxes. I am sorry, but I simply don't know how to respond to this discussion.

Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?

A. Yes it does.

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STEPHENSON REJOINDER
EXHIBIT 1

Arizona American
ACC Staff Rebuttal Returns
(Source: DWC-1)

District			RCND	OCRB	FVRB
Sun City Water		Required Rate of Return	**3.20%**	**6.50%**	**4.20%**
		Revenue Requirement	1,411,735	1,411,735	1,411,735
		Interest Expense	627,195	627,195	627,195
		Rate Base	43,955,934	21,853,479	32,904,707
	0.601	Debt Rate Base	13,133,941	13,133,941	13,133,941
		Equity Rate Base	30,821,993	8,719,538	19,770,766
		Equity Return	**2.55%**	**9.00%**	**3.97%**
Sun City Wastewater		Required Rate of Return	**3.30%**	**6.50%**	**4.30%**
		Revenue Requirement	562,884	562,884	562,884
		Interest Expense	250,074	250,074	250,074
		Rate Base	17,199,992	8,713,382	12,956,687
	0.601	Debt Rate Base	5,236,743	5,236,743	5,236,743
		Equity Rate Base	11,963,249	3,476,639	7,719,944
		Equity Return	**2.61%**	**9.00%**	**4.05%**
Sun City West Water		Required Rate of Return	**5.00%**	**6.50%**	**5.70%**
		Revenue Requirement	773,345	773,345	773,345
		Interest Expense	343,576	343,576	343,576
		Rate Base	15,314,756	11,971,281	13,643,019
	0.601	Debt Rate Base	7,194,740	7,194,740	7,194,740
		Equity Rate Base	8,120,016	4,776,541	6,448,279
		Equity Return	**5.29%**	**9.00%**	**6.66%**
Sun City West Wastewater		Required Rate of Return	**4.70%**	**6.50%**	**5.40%**
		Revenue Requirement	575,975	575,975	575,975
		Interest Expense	255,890	255,890	255,890
		Rate Base	12,222,469	8,916,017	10,569,243
	0.601	Debt Rate Base	5,358,526	5,358,526	5,358,526
		Equity Rate Base	6,863,943	3,557,491	5,210,717
		Equity Return	**4.66%**	**9.00%**	**6.14%**
Agua Fria		Required Rate of Return	**5.90%**	**6.50%**	**6.20%**
		Revenue Requirement	1,076,571	1,076,571	1,076,571
		Interest Expense	478,291	478,291	478,291
		Rate Base	18,283,746	16,665,182	17,474,464
	0.601	Debt Rate Base	10,015,774	10,015,774	10,015,774
		Equity Rate Base	8,267,972	6,649,408	7,458,690
		Equity Return	**7.24%**	**9.00%**	**8.02%**
Anthem Water		Required Rate of Return	**6.20%**	**6.50%**	**6.30%**
		Revenue Requirement	598,784	598,784	598,784
		Interest Expense	266,023	266,023	266,023
		Rate Base	9,629,285	9,269,095	9,449,190
	0.601	Debt Rate Base	5,570,726	5,570,726	5,570,726
		Equity Rate Base	4,058,559	3,698,369	3,878,464
		Equity Return	**8.20%**	**9.00%**	**8.58%**
Anthem Wastewater		Required Rate of Return	**6.30%**	**6.50%**	**6.40%**
		Revenue Requirement	176,479	176,479	176,479

		Interest Expense	78,405	78,405	78,405
		Rate Base	2,790,224	2,731,868	2,761,046
	0.601	Debt Rate Base	1,641,853	1,641,853	1,641,853
		Equity Rate Base	1,148,371	1,090,015	1,119,193
		Equity Return	**8.54%**	**9.00%**	**8.76%**
Tubac Water		Required Rate of Return	**4.20%**	**6.50%**	**5.10%**
		Revenue Requirement	72,847	72,847	72,847
		Interest Expense	32,364	32,364	32,364
		Rate Base	1,734,478	1,127,661	1,431,070
	0.601	Debt Rate Base	677,724	677,724	677,724
		Equity Rate Base	1,056,754	449,937	753,346
		Equity Return	**3.83%**	**9.00%**	**5.37%**
Havasu Water		Required Rate of Return	**4.60%**	**6.50%**	**5.40%**
		Revenue Requirement	53,109	53,109	53,109
		Interest Expense	23,595	23,595	23,595
		Rate Base	1,142,665	822,117	982,391
	0.601	Debt Rate Base	494,092	494,092	494,092
		Equity Rate Base	648,573	328,025	488,299
		Equity Return	**4.55%**	**9.00%**	**6.04%**
Mohave Water		Required Rate of Return	**4.70%**	**6.50%**	**5.40%**
		Revenue Requirement	618,688	618,688	618,688
		Interest Expense	274,866	274,866	274,866
		Rate Base	13,216,710	9,577,221	11,396,966
	0.601	Debt Rate Base	5,755,910	5,755,910	5,755,910
		Equity Rate Base	7,460,800	3,821,311	5,641,056
		Equity Return	**4.61%**	**9.00%**	**6.09%**

STEPHENSON REJOINDER
EXHIBIT 2

ARIZONA-AMERICAN WATER COMPANY
DOCKET NOS. WS-1303A-02-0867, ET AL
COMPARISON OF OVERALL OVERHEAD ADJUSTMENTS

	STAFF ADJUSTMENT #1	STAFF ADJUSTMENT #2	STAFF ADJUSTMENT #3	STAFF ADJUSTMENT #4	STAFF ADJUSTMENT #5	TOTAL
SSW - Water	$366,251	($515,886)	($300,468)	$396,788	($375,805)	($429,120)
SSW - Wastewater	$448,093	($552,478)	($332,507)	$740,228	($481,323)	($177,987)
SC - Water	$741,540	($926,122)	($860,980)	$948,649	($62,065)	($158,978)
SC - Wastewater	$437,588	($522,586)	($320,555)	$357,570	($96,303)	($144,286)
Havasu	$64,464	($75,244)	($70,882)	$67,795	($127,053)	($140,920)
Mohave	$436,643	($521,040)	($445,434)	$652,224	($621,259)	($498,866)
Agua Fria - Water	$385,897	($324,638)	($713,274)	$459,186	($546,577)	($739,406)
Anthem - Water	$188,806	($472,080)	($300,995)	$450,680	($400,165)	($533,754)
Ant/Agua - Wastewater	$83,978	($287,577)	($146,553)	$152,759	($227,320)	($424,713)
Tubac	$27,929	($38,653)	($33,106)	$86,512	($64,473)	($21,791)
TOTAL PER DIRECT	$3,181,189	($4,236,304)	($3,524,754)	$4,312,391	($3,002,343)	($3,269,821)
COMPANY REBUTTAL ADJUSTMENTS		$1,159,535	$21,282		$182,637	$1,363,454
TOTAL PER REBUTTAL	$3,181,189	($3,076,769)	($3,503,472)	$4,312,391	($2,819,706)	($1,906,367)

RATE BASE ADJUSTMENT #1 - TEST YEAR PLANT & ACCUMULATED DEPRECIATION
YEAR ENDED DECEMBER 31, 1989

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) PLANT ADDIT'NS	(B) PLANT RETIRM'TS	(C) FULL DEP. PL'T	(D) DEP. EXP.	(E) TOTAL PLANT VALUE	(F) ACCUM. DEP.	(G) NET PLANT VALUE
		INTANGIBLE							
1	301.00	Organization	$ 0	$ 0	$ 0	$ 0	$ 21,309	$ 0	$ 21,309
2	302.00	Franchises	-	-	-	-	7,291	-	7,291
3	303.00	Miscellaneous Intangibles	-	-	-	-	0	-	0
4		SUBTOTAL INTANGIBLE	$ 0	$ 0	$ 0	$ 0	$ 28,600	$ 0	$ 28,600
		SOURCE OF SUPPLY							
5	310.00	Land And Land Rights	$ 28,324	$ 0	$ 0	$ 0	$ 230,149	$ 0	$ 230,149
6	311.00	Structures And Improvements	-	-	-	3,379	119,396	5,913	113,483
7	312.00	Collecting And Impounding Res.	2,293	-	-	108	5,412	138	5,274
8	313.00	Lakes, Rivers, Other Intakes	-	-	-	-	0	-	0
9	314.00	Wells And Springs	97,663	-	-	14,336	579,794	23,207	556,588
10		SUBTOTAL SUPPLY	$ 128,280	$ 0	$ 0	$ 17,823	$ 934,751	$ 29,258	$ 905,493
		PUMPING							
11	320.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 2,358	$ 0	$ 2,358
12	321.00	Structures And Improvements	-	-	-	243	10,182	426	9,756
13	323.00	Other Power Production	-	-	-	-	0	-	0
14	325.00	Electric Pumping Equipment	189,316	-	-	47,169	1,015,935	77,915	938,020
15	326.00	Diesel Pumping Equipment	-	-	-	-	0	-	0
16	328.10	Gas Engine Pumping Equipment	-	-	-	-	0	-	0
17		SUBTOTAL PUMPING	$ 189,316	$ 0	$ 0	$ 47,413	$ 1,028,475	$ 78,341	$ 950,135
		WATER TREATMENT							
18	330.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ (0)
19	331.00	Structures And Improvements	-	-	-	379	15,141	662	14,478
20	332.00	Water Treatment Equipment	5,314	-	-	4,266	38,204	7,226	30,979
21		SUBTOTAL TREATMENT	$ 5,314	$ 0	$ 0	$ 4,644	$ 53,345	$ 7,888	$ 45,457
		TRANSMISSION & DISTRIBUTION							
22	340.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 9,600	$ 0	$ 9,600
23	341.00	Structures And Improvements	-	-	-	83	4,578	145	4,433
24	342.00	Distribution, Reservoirs, & ST	6,253	-	-	9,774	543,142	16,569	526,573
25	343.00	Trans. And Dist. Mains	593,132	-	-	165,508	6,637,860	274,676	6,363,184
26	344.00	Fire Mains	-	-	-	-	0	-	0
27	345.00	Services	85,094	-	-	58,067	1,115,868	98,918	1,016,950
28	346.00	Meters	47,629	-	-	65,950	1,033,762	112,385	921,377
29	348.00	Hydrants	-	-	-	-	31,351	-	31,351
30	349.00	Other Trans. And Dist.	-	-	-	-	0	-	0
31		SUBTOTAL TRANS. & DIST.	$ 732,108	$ 0	$ 0	$ 299,381	$ 9,376,160	$ 502,692	$ 8,873,468
		GENERAL							
32	389.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 330	$ 0	$ 330
33	390.00	Structures And Improvements	-	-	-	2,848	140,300	4,984	135,316
34	391.00	Office Furniture And Equipment	3,169	-	-	1,816	45,884	3,124	42,760
35	391.10	Computer Equipment	-	-	-	0	0	0	0
36	392.00	Transportation Equipment	-	-	-	38,499	153,995	67,373	86,622
37	393.00	Stores Equipment	-	-	-	195	4,958	321	4,637
38	394.00	Tools, Shop And Garage	-	-	-	3,170	41,990	5,548	36,442
39	395.00	Laboratory Equipment	-	-	-	143	4,661	250	4,411
40	396.00	Power Operated Equipment	-	-	-	5,245	56,826	9,179	47,647
41	397.00	Communication Equipment	-	-	-	766	18,690	1,340	17,350
42	398.00	Miscellaneous Equipment	393	-	-	814	13,346	1,357	11,989
43		SUBTOTAL GENERAL	$ 3,562	$ 0	$ 0	$ 53,496	$ 480,980	$ 93,475	$ 387,505
44		Acc. Depre. March 31, 1988						$ 1,570,861	
45		Adjustment Due To Rounding	-	-	-	-	-	-	0
46		**TOTAL WATER PLANT**	$ 1,058,580	$ 0	$ 0	$ 422,757	$ 11,902,311	$ 2,282,516	$ 9,619,796

References:
Columns (A) & (B): Company Response To RUCO Data Request No. 1.22
Column (C): Intentionally Left Blank
Column (D): [(Col. (A) + Col. (B)) X TJC-4, Page 2, Col. (A) X 1/2 yr. conv.] + [TJC-4, Page 3, Col. (D) - Col. (C)] X TJC-4, Page 2, Col. (A)
Column (E): Schedule TJC-4, Page 3, Column (D) + Column (A) - Column (B)
Column (F): Schedule TJC-4, Page 3, Column (E) - Column (B) + Column (D)
Column (G): Column (E) - Column (F)

EXHIBIT
A-76
Admitted

RATE BASE ADJUSTMENT #1 - TEST YEAR PLANT & ACCUMULATED DEPRECIATION
YEAR ENDED DECEMBER 31, 1990

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) PLANT ADDIT'NS	(B) PLANT RETIRM'TS	(C) FULL DEP. PL'T	(D) DEP. EXP.	(E) TOTAL PLANT VALUE	(F) ACCUM. DEP.	(G) NET PLANT VALUE
		INTANGIBLE							
1	301.00	Organization	$ 1,421	$ 0	$ 0	$ 0	$ 22,730	$ 0	$ 22,730
2	302.00	Franchises	-	-	-	0	7,291	0	7,291
3	303.00	Miscellaneous Intangibles	-	-	-	0	0	0	0
4		SUBTOTAL INTANGIBLE	$ 1,421	$ 0	$ 0	$ 0	$ 30,021	$ 0	$ 30,021
		SOURCE OF SUPPLY							
5	310.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 230,149	$ 0	$ 230,149
6	311.00	Structures And Improvements	90,091	-	-	4,654	209,487	10,567	198,920
7	312.00	Collecting And Impounding Res.	19,803	-	-	389	25,215	527	24,688
8	313.00	Lakes, Rivers, Other Intakes	-	-	-	0	0	0	0
9	314.00	Wells And Springs	-	(119,565)	-	14,040	460,229	37,247	422,982
10		SUBTOTAL SUPPLY	$ 109,894	$ (119,565)	$ 0	$ 19,083	$ 925,080	$ 48,341	$ 876,739
		PUMPING							
11	320.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 2,358	$ 0	$ 2,358
12	321.00	Structures And Improvements	-	-	-	243	10,182	669	9,513
13	323.00	Other Power Production	-	-	-	0	0	0	0
14	325.00	Electric Pumping Equipment	79,886	(79,105)	-	52,036	1,016,716	129,951	886,765
15	326.00	Diesel Pumping Equipment	-	-	-	0	0	0	0
16	328.10	Gas Engine Pumping Equipment	-	-	-	0	0	0	-
17		SUBTOTAL PUMPING	$ 79,886	$ (79,105)	$ 0	$ 52,279	$ 1,029,256	$ 130,620	$ 898,637
		WATER TREATMENT							
18	330.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
19	331.00	Structures And Improvements	-	-	-	379	15,141	1,041	14,100
20	332.00	Water Treatment Equipment	16,777	-	-	5,591	54,981	12,817	42,164
21		SUBTOTAL TREATMENT	$ 16,777	$ 0	$ 0	$ 5,970	$ 70,122	$ 13,858	$ 56,264
		TRANSMISSION & DISTRIBUTION							
22	340.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 9,600	$ 0	$ 9,600
23	341.00	Structures And Improvements	-	-	-	83	4,578	228	4,350
24	342.00	Distribution, Reservoirs, & ST	-	(68,617)	-	9,210	474,525	25,779	448,746
25	343.00	Trans. And Dist. Mains	238,816	(496,170)	-	169,890	6,380,506	444,566	5,935,941
26	344.00	Fire Mains	-	-	-	0	0	0	0
27	345.00	Services	105,606	-	-	63,225	1,221,474	162,143	1,059,331
28	346.00	Meters	136,348	-	-	71,956	1,170,110	184,341	985,769
29	348.00	Hydrants	1	-	-	0	31,352	0	31,352
30	349.00	Other Trans. And Dist.	-	-	-	0	0	0	0
31		SUBTOTAL TRANS. & DIST.	$ 480,771	$ (564,787)	$ 0	$ 314,364	$ 9,292,144	$ 817,056	$ 8,475,088
		GENERAL							
32	389.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 330	$ 0	$ 330
33	390.00	Structures And Improvements	-	(1,040)	-	2,838	139,260	7,822	131,438
34	391.00	Office Furniture And Equipment	77,274	-	-	3,465	123,158	6,590	116,568
35	391.10	Computer Equipment	277	(277)	-	0	0	0	(0)
36	392.00	Transportation Equipment	50,157	-	-	44,768	204,152	112,141	92,011
37	393.00	Stores Equipment	-	(1,120)	-	173	3,838	494	3,344
38	394.00	Tools, Shop And Garage	13,428	-	-	3,677	55,418	9,225	46,193
39	395.00	Laboratory Equipment	-	-	-	143	4,661	392	4,269
40	396.00	Power Operated Equipment	6,295	-	-	5,536	63,121	14,714	48,407
41	397.00	Communication Equipment	8,855	-	-	948	27,545	2,287	25,258
42	398.00	Miscellaneous Equipment	-	(2,505)	-	749	10,841	2,106	8,735
43		SUBTOTAL GENERAL	$ 156,286	$ (4,942)	$ 0	$ 62,296	$ 632,324	$ 155,771	$ 476,553
44		Acc. Depre. March 31, 1988						$ 1,570,861	
45		Adjustment Due To Rounding	-	-	-	-	-	-	0
46		**TOTAL WATER PLANT**	$ 845,035	$ (768,399)	$ 0	$ 453,992	$ 11,978,947	$ 2,736,508	$ 9,242,440

References:
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Column (F): Schedule TJC-4, Page 4, Column (E) - Column (B) + Column (D)
Column (G): Column (E) - Column (F)

PRIME-ACCT: 301.00 GRID: D01

PLANT-IN-SERVICE SUMMARY

01500400-MOHAVE COUNTY WATER REPORT DATE 04/30/99 RUN DATE 04/30/99 PAGE 34

ACCT	ACCOUNT DESCRIPTION	BEGINNING BALANCE	ADDITIONS	RETIREMENTS	ADJUSTMENTS	NET TRANSFERS	ENDING BALANCE
	ACCOUNT SUMMARY						
301.00	ORGANIZATION	34,003.58	.00	.00	.00	.00	34,003.58
302.00	FRANCHISES	37,060.53	.00	.00	.00	.00	37,060.53
TOTAL	INTANGIBLE	71,064.11	.00	.00	.00	.00	71,064.11
310.00	LAND AND LAND RIGHTS	246,525.58	.00	.00	.00	.00	246,525.58
311.00	STRUCTURES AND IMPROVEM	415,660.22	.00	.00	.00	.00	415,660.22
312.00	COLLECTING AND IMPOUNDI	663,944.26	.00	.00	.00	.00	663,944.26
314.00	WELLS AND SPRINGS	793,778.11	.00	.00	.00	.00	793,778.11
TOTAL	SRC OF SUPPLY	2,117,908.17	.00	.00	.00	.00	2,117,908.17
320.00	LAND AND LAND RIGHTS	2,561.00	.00	.00	.00	.00	2,561.00
321.00	STRUCTURES AND IMPROVEM	7,122.00	.00	.00	.00	.00	7,122.00
325.00	ELECTRIC PUMPING EQUIPM	1,586,726.64	.00	.00	.00	.00	1,586,726.64
TOTAL	PUMPING	1,596,209.64	.00	.00	.00	.00	1,596,209.64
331.00	STRUCTURES AND IMPROVEM	15,157.00	.00	.00	.00	.00	15,157.00
332.00	WATER TREATMENT EQUIPME	60,502.26	.00	.00	.00	.00	60,502.26
TOTAL	WATER TREATMENT	75,659.26	.00	.00	.00	.00	75,659.26
340.00	LAND AND LAND RIGHTS	9,689.15	.00	.00	.00	.00	9,689.15
341.00	STRUCTURES AND IMPROVEM	4,583.00	.00	.00	.00	.00	4,583.00
342.00	DISTR, RESERVOIRS, & ST	1,208,128.65	.00	.00	.00	.00	1,208,128.65
343.00	TRANSMISSION AND DISTR	10,455,726.95	59,536.52	.00	.00	.00	10,495,265.47
345.00	SERVICES	2,533,615.17	18,567.44	.00	.00	.00	2,552,182.61
346.00	METERS	2,039,469.96	2,873.98-	.00	.00	.00	2,036,615.98
348.00	HYDRANTS	88,885.27	.00	.00	.00	.00	88,885.27
TOTAL	TRANS AND DIST	16,318,238.13	75,031.98	.00	.00	.00	16,393,270.11
389.00	LAND AND LAND RIGHTS	330.00	.00	.00	.00	.00	330.00
390.00	STRUCTURES AND IMPROVEM	139,557.00	.00	.00	.00	.00	139,557.00
391.00	OFFICE FURNITURE AND EQ	130,894.68	6,143.61	.00	.00	.00	137,038.21
391.10	COMPUTER EQUIPMENT	257,754.67	11,519.87	.00	.00	.00	269,274.54
392.00	TRANSPORTATION EQUIPMEN	397,154.25	.00	.00	.00	.00	397,154.25
393.00	STORES EQUIPMENT	5,857.66	.00	.00	.00	.00	5,857.66
394.00	TOOLS, SHOP AND GARAGE	121,359.54	.00	.00	.00	.00	121,359.54
395.00	LABORATORY EQUIPMENT	7,660.00	.00	.00	.00	.00	7,660.00
396.00	POWER OPERATED EQUIPMEN	75,031.30	.00	.00	.00	.00	75,031.30
397.00	COMMUNICATION EQUIPMENT	65,303.50	.00	.00	.00	.00	65,303.50
398.00	MISCELLANEOUS EQUIPMENT	12,585.40	.00	.00	.00	.00	12,585.40
TOTAL	GENERAL	1,209,456.00	17,663.48	.00	.00	.00	1,227,119.54
*PLANT-IN-SVC TOTAL		21,588,535.39	92,695.46	.00	.00	.00	21,681,230.85
GROSS PLANT-IN-SERVICE		21,588,535.39	92,695.46	.00	.00	.00	21,681,230.85

EXHIBIT
A-77
Admitted

PRIME-ACCT: GRID: E01

Mohave County Water
Mohave, AZ

Asset Acquisitions
FA DIRECT ADDITIONS

Time 08.17.36 Date 03/31/03
RAZUGA01/JKELLIS Page 1

Report date: 12/31/1999

Asset Acquisitions - 01 PUC/Book

Creation date: 03/31/2003 1

Companycode
4000

Assetclass
TAX1

Main number / DocumentNo	SNo.	Cap.date / PostngDate	Name / TTy	AstValDate	Reference	Quantity	Un	Acquis	O.dep	S.dep
Assetclass		TAX1			TAX ONLY 1	*		0	0	
Assetclass		W32500			ELEC PUMP EQUIP	*		26,867.89	-57.32	
Assetclass		W33200			WATER TREAT EQUIP	*		2,741.16	-41.12	
Assetclass		W34200			DIST RESRV & STNDPIP	*		4,805.20	-3.63	
Assetclass		W34300			TRANS/DISTR	*		654,964.80	-1,807.57	
Assetclass		W34500			SERVICES	*		121,486.83	-776.16	
Assetclass		W34600			METERS	*		61,649.10	-425.87	
Assetclass		W39110			COMPUTER EQUIPMENT	*		169,672.01	-1,281.95	
Assetclass		W39600			PWR OPER EQUIP	*		54,941.60	-959.42	
Companycode		4000			Mohave County Water	**		1,097,128.59	-5,353.04	

RATE BASE ADJUSTMENT #1 - TEST YEAR PLANT & ACCUMULATED DEPRECIATION
YEAR ENDED DECEMBER 31, 1999

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) PLANT ADDIT'NS	(B) PLANT RETIRM'TS	(C) FULL DEP. PL'T	(D) DEP. EXP.	(E) TOTAL PLANT VALUE	(F) ACCUM. DEP.	(G) NET PLANT VALUE
		INTANGIBLE							
1	301.00	Organization	$ 0	$ 0	$ 0	$ 0	$ 38,868	$ 0	$ 38,868
2	302.00	Franchises	-	-	-	-	37,053	0	37,053
3	303.00	Miscellaneous Intangibles	-	-	-	-	0	0	0
4		SUBTOTAL INTANGIBLE	$ 0	$ 0	$ 0	$ 0	$ 75,921	$ 0	$ 75,921
		SOURCE OF SUPPLY							
5	310.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 246,325	$ (10,679)	$ 257,004
6	311.00	Structures And Improvements	-	-	-	11,703	413,540	95,763	317,777
7	312.00	Collecting And Impounding Res.	-	(559)	-	16,857	663,385	46,760	616,625
8	313.00	Lakes, Rivers, Other Intakes	-	-	-	-	0	0	0
9	314.00	Wells And Springs	-	(125)	-	21,419	793,219	175,494	617,724
10		SUBTOTAL SUPPLY	$ 0	$ (685)	$ 0	$ 49,979	$ 2,116,468	$ 307,338	$ 1,809,130
		PUMPING							
11	320.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 2,358	$ 0	$ 2,358
12	321.00	Structures And Improvements	-	-	-	170	7,111	2,676	4,435
13	323.00	Other Power Production	-	-	-	-	0	0	0
14	325.00	Electric Pumping Equipment	26,868	-	-	81,885	1,612,753	585,646	1,027,107
15	326.00	Diesel Pumping Equipment	-	-	-	-	0	0	-
16	328.10	Gas Engine Pumping Equipment	-	-	-	-	0	0	-
17		SUBTOTAL PUMPING	$ 26,868	$ 0	$ 0	$ 82,055	$ 1,622,222	$ 588,322	$ 1,033,901
		WATER TREATMENT							
18	330.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ (0)
19	331.00	Structures And Improvements	-	-	-	379	15,141	4,448	10,693
20	332.00	Water Treatment Equipment	2,741	-	-	7,420	63,208	69,010	(5,802)
21		SUBTOTAL TREATMENT	$ 2,741	$ 0	$ 0	$ 7,799	$ 78,348	$ 73,457	$ 4,891
		TRANSMISSION & DISTRIBUTION							
22	340.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 9,600	$ 0	$ 9,600
23	341.00	Structures And Improvements	-	-	-	83	4,578	974	3,604
24	342.00	Distribution, Reservoirs, & ST	4,805	-	-	21,902	1,212,432	158,397	1,054,035
25	343.00	Trans. And Dist. Mains	654,965	-	-	281,342	11,106,883	2,348,475	8,758,408
26	344.00	Fire Mains	-	-	-	-	0	0	(0)
27	345.00	Services	121,487	-	-	140,454	2,656,943	1,077,433	1,579,510
28	346.00	Meters	61,649	-	-	136,247	2,117,301	833,863	1,283,438
29	348.00	Hydrants	-	-	-	-	88,851	0	88,851
30	349.00	Other Trans. And Dist.	-	-	-	-	0	0	0
31		SUBTOTAL TRANS. & DIST.	$ 842,906	$ 0	$ 0	$ 580,028	$ 17,196,587	$ 4,419,142	$ 12,777,446
		GENERAL							
32	389.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 330	$ 0	$ 330
33	390.00	Structures And Improvements	-	-	-	2,833	139,557	32,139	107,418
34	391.00	Office Furniture And Equipment	-	-	-	5,367	130,894	78,306	52,588
35	391.10	Computer Equipment	169,672	-	-	14,046	427,426	26,283	401,143
36	392.00	Transportation Equipment	-	-	-	99,289	397,155	566,289	(169,134)
37	393.00	Stores Equipment	-	-	-	151	3,838	1,851	1,987
38	394.00	Tools, Shop And Garage	-	-	-	9,163	121,361	68,181	53,180
39	395.00	Laboratory Equipment	-	-	-	234	7,648	2,457	5,191
40	396.00	Power Operated Equipment	54,942	-	-	9,461	129,974	81,608	48,366
41	397.00	Communication Equipment	-	-	-	2,595	63,304	1,104	62,200
42	398.00	Miscellaneous Equipment	-	-	-	779	12,586	6,245	6,341
43		SUBTOTAL GENERAL	$ 224,614	$ 0	$ 0	$ 143,918	$ 1,434,073	$ 864,463	$ 569,609
44		Acc. Depre. March 31, 1988						$ 1,570,861	
45		Adjustment Due To Rounding	-	-	-	-	-	-	0
46		**TOTAL WATER PLANT**	$ 1,097,129	$ (685)	$ 0	$ 863,779	$ 22,523,619	$ 7,823,583	$ 14,700,037

References:
Columns (A) & (B): Company Response To RUCO Data Request No. 1.22
Column (C): Intentionally Left Blank
Column (D): [(Col. (A) + Col. (B)) X TJC-4, Page 2, Col. (A) X 1/2 yr. conv.] + [TJC-4, Page 13, Col. (D) - Col. (C)] X TJC-4, Page 2, Col. (A)
Column (E): Schedule TJC-4, Page 13, Column (D) + Column (A) - Column (B)
Column (F): Schedule TJC-4, Page 13, Column (E) - Column (B) + Column (D)
Column (G): Column (E) - Column (F)

Docket

A-78

Arizona Corporation Commission
DOCKETED

NOV 01 2002

DOCKETED BY

EXHIBIT
A-78
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC. AN ARIZONA CORPORATION TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATE MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES AND TARIFFS DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. W-02465A-01-0776

DECISION NO. 65350

OPINION AND ORDER

DATE OF HEARING: July 25 and 26, 2002
August 16, 2002

PLACE OF HEARING: Tucson, Arizona

ADMINISTRATIVE LAW JUDGE: Jane L. Rodda

APPEARANCES: Mr. William Sullivan, MARTINEZ & CURTIS, P.C., on behalf of Bella Vista Water Company, Inc.;

Mr. Daniel W. Pozefsky, Staff Attorney, on Behalf of the Residential Utility Consumer Office;

Mr. Jason Gellman, Staff Attorney, Legal Divison, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Procedural Background

Bella Vista Water Company, Inc. ("Bella Vista" or "Company") provides water utility services to approximately 6,659 residential and commercial customers in and around the City of Sierra Vista, in Cochise County, Arizona. Bella Vista filed an application to increase its rates with the Arizona Corporation Commission ("Commission") on September 28, 2001. The Company filed an amendment to its application on October 16, 2001. The Company used a test year of December 31, 2000. The Commission authorized Bella Vista's current rates in Decision No. 61730 (June 4,

potential acquisition of three water companies should not be allowed. Staff argues that the environmental review was not related to providing water service and the due diligence review was not the result of its normal cost of doing business. Staff asserts that shareholders rather than ratepayers reaped the benefits of these expenditures. If the Company had not been seeking to sell operations or acquire other companies, it would not have commissioned either study.

Resolution

We concur with Staff. The Company did not incur these expenses for the benefit of ratepayers, and they are not on-going expenses. Consequently, we accept Staff's recommended $39,430 for Professional Fees.

Property Tax Calculation

Company's Position

All parties employ the Arizona Department of Revenue ("ADOR") methodology that utilizes three historic years of revenue to determine property taxes. The Company states that the only issue is what years to include in the formula. The Company states it advocates using 2000, 2001 and the revenues approved by this proceeding as the most accurate forecast of the future property tax expense. Bella Vista states that Staff utilizes 1999 and 2000 with its proposed revenues and RUCO uses years 1998, 1999 and 2000. Bella Vista calculated a Property Tax expense for the test year of $205,787. RUCO recommends $200,400, and Staff recommends $174,243 for the test year. Under its proposed rates, the Company calculates Property Tax Expense of $364,464, Staff calculates $172,311. (Under RUCO's methodology the Property Tax Expense does not change with proposed revenues.)

RUCO's and Staff's Positions

Neither RUCO nor Staff briefed this issue. In testimony, RUCO expressed the belief that the Company is incorrect when it used pro forma revenues as opposed to actual revenues for the 1998 through 2000 operating periods. Staff's witness, Mr. Igwe, states using only historical revenues to calculate property taxes causes a mismatch between the property taxes used in ratemaking and actual bills as the revenues generated by new rates become historical and incorporated into ADOR's calculation. Thus, Staff explains it uses two historic years and Staff's recommended revenues to

calculate the three-year average. Staff states this methodology provides a normalized amount for property taxes over several years. Staff states that the difference between its methodology and that of the Company is that the Company uses test year revenues twice as a substitute for the two historical years.[4]

Resolution

Staff used revenues for 1998, 1999 and 2000 for calculating the Property Tax Expense for the test year. We concur that this is a proper method for calculating property taxes, although using actual Property Taxes paid is reasonable too for the test year under current rates. Under proposed rates, the most logical approach is to use the two most recent historic years' revenues and the projected revenues under the newly approved rates. In this case, we utilize 2000, 2001 and the projected year.

Depreciation Expense

Company's Position

Bella Vista states the only issue is the inclusion of $41,395 associated with the post-test year plant. Our decision to include post test-year plant in rate base results in additional Depreciation Expense of $41,395.

Wages and Salaries

Company's Position

The Company had a vacant field position during the test year. Staff confirmed that it was filled and made the appropriate pro forma adjustment. The Company accepts Staff's adjustments. RUCO did not accept the adjustment and thus, the Company argues, understates wages, employee benefits and payroll taxes.

RUCO's Position

RUCO did not brief this issue. The Company had originally sought $187,636 for field labor. RUCO recommended removing $48,464 because the Company did not provide any analysis or study to support the need for three additional employees and was able to operate in the test year and into 2001 without them.

[4] Later, the Company revised its position and used the test year 2000 and actual 2001 revenues in its calculation.

AR-79

Arizona Corporation Commission
DOCKETED

DEC 28 2001

DOCKETED BY

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

N. JAMES
JAN 0 2002
ACTION

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS NORTHERN GROUP AND FOR CERTAIN RELATED APPROVALS.

DOCKET NO. W-01445A-00-0962

DECISION NO. 64282

OPINION AND ORDER

DATES OF HEARING: August 31 (pre-hearing conference), September 5, 6, and 7, 2001.

PLACE OF HEARING: Phoenix, Arizona

ADMNISTRATIVE LAW JUDGE: Stephen Gibelli[1]

APPEARANCES: Mr. Norman James and Mr. Jay Shapiro, FENNEMORE CRAIG, on behalf of Arizona Water Company;

Mr. Daniel W. Pozefsky, Attorney, on behalf of the Residential Utility Consumer Office; and

Ms. Teena Wolfe, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

EXHIBIT
A-79
Admitted

BY THE COMMISSION:

I. INTRODUCTION

On November 22, 2000, Arizona Water Company ("Arizona Water" or "Company") filed an application for a rate increase for the Company's Northern Group water systems. Arizona Water supplies water to approximately 60,000 customers in eight Arizona counties under 18 separate water systems. The rate application filed in this proceeding involves only the Company's Northern Group, which serves approximately 16,000 customers under five separate water systems (Sedona, Pinewood, Rimrock, Lakeside, and Overgaard). Arizona Water seeks approval in this case to organize these five systems into two divisions with consolidated rate schedules. Under the

[1] Mr. Gibelli conducted the hearing in this matter and the Recommended Opinion and Order was written by Dwight Nodes.

creating new individual depreciation accounts. Indeed, these long-term benefits are the basis for the requirement in our rules that public service corporations with revenues in excess of $250,000 *shall* be required to maintain separate accounts.

However, pursuant to A.A.C. R14-2-102(D), "the Commission may determine that good cause exists for granting a waiver from 1 or more of the requirements of this Section." Although we agree with the premise of Staff's recommendation, given the small difference between the current composite rate and the result of implementing the component structure, we will grant the Company's requested waiver and adopt Arizona Water's proposed 2.59 percent composite depreciation rate in this proceeding.

Although we are granting the Company's requested waiver in this case, in order to give effect to the requirements set forth in our rules we believe it is appropriate for Arizona Water to develop component depreciation rates for all 18 of its systems. Therefore, the Company should file in its next rate case application, a schedule of component depreciation rates for all of its systems. This additional time will allow the Company to develop individual depreciation rates on a uniform basis and eliminate the Company's concerns regarding inconsistencies in how depreciation is recorded between its various systems.

D. <u>Property Tax Expense</u>

In January 2001, the Arizona Department of Revenue ("ADOR") announced that a new formula would be instituted beginning in 2002 for determining the full cash value ("FCV") of water and sewer utilities based solely on revenues. This methodology will replace a relatively complex formula for calculating FCV that is currently used by ADOR. The Company agrees with Staff and RUCO that the new FCV methodology should be used to adjust test year expenses (Ex. A-4, at 34). However, Arizona Water disagrees with the calculations made by Staff and RUCO using the new methodology.

According to the Company, the new ADOR formula requires that the FCV be calculated based on the average of the three previous years of gross revenues multiplied by two, plus CWIP valued at 10 percent of its cost as of December 31 of the most recent calendar year, less the net

book cost of licensed vehicles.[5] The Company claims that Staff erred in its calculation of property taxes under the new ADOR formula by failing to include 10 percent of CWIP, by deducting the net book value of licensed vehicles (which are leased), and by applying an erroneous composite property tax rate that is one-half of the actual rate. The Company contends that RUCO also failed to include the 10 percent CWIP balance and that RUCO used unadjusted revenues for calendar years 1997 through 1999, resulting in property tax amounts that are incorrect.

Staff argues that its methodology properly values the Company's property tax expense under the new ADOR methodology. However, on brief Staff notes that an incorrect rate was used on line 15 of Staff's schedule for each system (Ex. CSB-17). As corrected, Staff maintains that its recommendation should be adopted by the Commission. Staff claims that the Company's methodology contains several errors. Staff argues that the Company's CWIP balance should have been taken at the end of the test year, rather than at the end of 2000; that the net book value of vehicles should be deducted, whether they are purchased or leased; and that a 0.25 assessment ratio should have been applied.

We agree with the Company's property tax calculation methodology. With respect to CWIP, we agree that the end of year 2000 balance is appropriate especially given Staff's proposal to include plant additions in rate base to December 31, 2000. The Company also explained that because its vehicles are leased there is no net book value to deduct for such vehicles. As the Company points out in its brief, it also appears that the Staff witness improperly assessed the value of property by adding the assessed value for the "Primary Property Tax Calculation" to the "Secondary Property Tax Calculation" thereby effectively doubling the assessed value of the property. Based on the record evidence, we agree that Arizona Water's property tax expense calculation should be adopted.

E. <u>Income Tax Expense</u>

Effective January 1, 2001, the state corporate income tax rate was reduced to 6.968 percent. The Company agreed with Staff and RUCO that using this new tax rate is appropriate since it is

[5] The Company points out that it does not deduct the net book cost of licensed vehicles because it leases all of its vehicles (the annual lease expense is included in test year operating expenses) (Ex. A-4, at 35; Ex. A-5, at 26).

SURREBUTTAL
TEST YEAR PLANT SCHEDULES CONT'D
YEAR ENDED DECEMBER 31, 1998

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) PLANT ADDIT'NS	(B) PLANT RETIRM'TS	(C) FULL DEP. PL'T	(D) DEP. EXP.	(E) TOTAL PLANT VALUE	(F) ACCUM. DEP.	(G) NET PLANT VALUE
		INTANGIBLE							
1	301.00	Organization	$ 0	$ 0	$ 0	$ 0	$ 4,078	$ 0	$ 4,078
2	302.00	Franchises	-	-	-	-	1,372	-	1,372
3	303.00	Miscellaneous Intangibles	-	-	-	-	5,184	-	5,184
4		SUBTOTAL INTANGIBLE	$ 0	$ 0	$ 0	$ 0	$ 10,634	$ 0	$ 10,634
		TREATMENT AND DISCHARGE							
5	310.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 342,851	$ 0	$ 342,851
6	311.00	Structures And Improvements	82,151	-	-	127,245	2,585,976	1,053,325	1,532,651
7	312.00	Preliminary Treatment	8,683	-	-	53,704	1,078,425	518,733	559,692
8	313.00	Primary Treatment Equipment	-	21,485	-	53,154	1,052,329	437,247	615,083
9	314.00	Secondary Treatment Equip.	52,335	-	-	222,167	4,469,498	2,403,665	2,065,832
10	315.00	Tertiary Equipment	305,362	-	-	163,714	3,426,952	1,275,990	2,150,962
11	316.00	Disinfection Equipment	4,849	-	-	10,808	218,575	162,549	56,026
12	317.00	Effluent Lift Station E	-	901	-	27,893	331,607	236,849	94,758
13	318.00	Outfall Line	-	-	-	4,569	91,379	45,294	46,085
14	319.00	Sludge, Treatment & Dist.	50,579	-	-	43,355	892,394	446,516	445,878
15	321.00	Influent Lift Station	-	3,675	-	1,615	17,389	5,076	12,312
16	322.00	General Treatment Equipment	22,550	-	-	12,236	256,000	44,233	211,767
17		SUBTOTAL TREAT.& DIS.	$ 526,509	$ 26,061	$ 0	$ 720,459	$ 14,763,375	$ 6,629,478	$ 8,133,897
		COLLECTION AND INFLUENT							
18	340.00	Land And Land Rights	$ 56	$ 0	$ 0	$ 0	$ 20,747	$ 0	$ 20,747
19	341.00	Structures And Improvements	70	-	-	4,733	283,459	(150,516)	433,975
20	342.00	Collection System Lift	857	-	-	109,888	1,308,616	624,168	684,447
21	343.00	Collection Mains	46,719	-	-	188,583	9,267,624	1,400,832	7,866,791
22	344.00	Force Mains	-	-	-	15,042	726,687	109,473	617,214
23	345.00	Discharge Services	551	-	-	52,140	2,556,173	358,802	2,197,371
24	348.00	Manholes	14,204	-	-	62,059	3,064,218	488,573	2,575,644
25		SUBTOTAL COLL. & INFLU.	$ 62,457	$ 0	$ 0	$ 432,446	$ 17,227,524	$ 2,831,334	$ 14,396,190
		GENERAL							
26	389.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
27	390.00	Structures And Improvements	-	-	-	-	-	-	0
28	391.00	Office Furniture & Equipment	110,466	-	-	5,548	144,270	21,442	122,828
29	391.10	Computer Equipment	-	-	-	-	5,168	3,969	1,199
30	392.00	Transportation Equipment	341	-	-	21,219	83,225	206,896	(123,671)
31	393.00	Stores Equipment	58	-	-	154	13,964	3,072	10,892
32	394.00	Tools, Shop And Garage	5,166	-	-	1,212	45,842	15,696	30,146
33	395.00	Laboratory Equipment	-	3,108	-	625	42,009	12,808	29,200
34	396.00	Power Operated Equipment	-	-	-	-	3,984	307	3,677
35	397.00	Communication Equipment	311,693	-	-	16,312	318,806	21,647	297,159
36	398.00	Miscellaneous Equipment	24,547	-	-	2,009	70,251	23,067	47,184
37		SUBTOTAL GENERAL	$ 452,271	$ 3,108	$ 0	$ 47,081	$ 727,518	$ 308,904	$ 418,614
38		AFUDC ADJUSTMENT 3/95	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
39		Adjustment Due To Rounding	-	-	-	-	-	-	0
40		**TOTAL WASTEWATER PLT**	$ 1,041,237	$ 29,169	$ 0	$ 1,199,985	$ 32,729,051	$ 9,769,716	$ 22,959,336

References:
Columns (A) (B): Company Schedule B-2, Page 6b
Column (C): Intentionally Left Blank
Column (D): [(Col. (A) - Col. (B)) X RLM-4, Page 4, Col. (A) X 1/2 yr. conv.] + [RLM-4, Page 7, Col. (D) - Col. (C)] X RLM-4, Page 4, Col. (A)]
Column (E): Schedule RLM-4, Page 7, Column (D) + Column (A) - Column (B)
Column (F): Schedule RLM-4, Page 7, Column (E) - Column (B) + Column (D)
Column (G): Column (E) - Column (F)

EXHIBIT
A-80
Admitted

SURREBUTTAL
TEST YEAR PLANT SCHEDULES CONT'D
YEAR ENDED DECEMBER 31, 1999

LINE NO.	ACCT. NO.	ACCOUNT NAME	(A) PLANT ADDIT'NS	(B) PLANT RETIRM'TS	(C) FULL DEP. PL'T	(D) DEP. EXP.	(E) TOTAL PLANT VALUE	(F) ACCUM. DEP.	(G) NET PLANT VALUE
		INTANGIBLE							
1	301.00	Organization	$ 0	$ 0	$ 0	$ 0	$ 4,078	$ 0	$ 4,078
2	302.00	Franchises	-	-	-	-	1,372	-	1,372
3	303.00	Miscellaneous Intangibles	-	-	-	-	5,184	-	5,184
4		SUBTOTAL INTANGIBLE	$ 0	$ 0	$ 0	$ 0	$ 10,634	$ 0	$ 10,634
		TREATMENT AND DISCHARGE							
5	310.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 342,851	$ 0	$ 342,851
6	311.00	Structures And Improvements	-	-	-	129,299	2,585,976	1,182,624	1,403,352
7	312.00	Preliminary Treatment	-	-	-	55,472	1,078,425	458,586	619,839
8	313.00	Primary Treatment Equipment	-	-	-	49,633	1,052,329	353,316	699,013
9	314.00	Secondary Treatment Equip.	392,870	-	-	225,481	4,862,368	1,969,562	2,892,806
10	315.00	Tertiary Equipment	241,617	-	-	122,720	3,668,569	981,786	2,686,783
11	316.00	Disinfection Equipment	-	-	-	10,621	218,575	141,059	77,516
12	317.00	Effluent Lift Station E	1,118	-	-	26,410	332,725	181,706	151,019
13	318.00	Outfall Line	-	-	-	4,569	91,379	36,156	55,223
14	319.00	Sludge, Treatment & Dist.	13,869	-	-	32,832	906,263	358,295	547,968
15	321.00	Influent Lift Station	1,558	-	-	1,551	18,947	5,787	13,160
16	322.00	General Treatment Equipment	-	-	-	11,285	256,000	20,475	235,525
17		SUBTOTAL TREAT.& DIS.	$ 651,032	$ 0	$ 0	$ 669,873	$ 15,414,407	$ 5,689,352	$ 9,725,055
		COLLECTION AND INFLUENT							
18	340.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 20,747	$ 0	$ 20,747
19	341.00	Structures And Improvements	-	-	-	4,734	283,460	(145,782)	429,242
20	342.00	Collection System Lift	105	-	-	109,928	1,308,720	734,096	574,624
21	343.00	Collection Mains	15,371	-	-	189,216	9,282,994	1,590,049	7,692,946
22	344.00	Force Mains	-	-	-	15,042	726,686	124,515	602,171
23	345.00	Discharge Services	1,451	-	-	52,161	2,557,625	410,963	2,146,662
24	348.00	Manholes	10,365	-	-	62,309	3,074,584	550,882	2,523,702
25		SUBTOTAL COLL. & INFLU.	$ 27,293	$ 0	$ 0	$ 433,390	$ 17,254,816	$ 3,264,724	$ 13,990,092
		GENERAL							
26	389.00	Land And Land Rights	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
27	390.00	Structures And Improvements	250,266	-	-	2,103	250,266	2,103	248,163
28	391.00	Office Furniture & Equipment	1,723	-	-	6,596	145,993	28,038	117,955
29	391.10	Computer Equipment	-	-	-	235	5,168	4,204	964
30	392.00	Transportation Equipment	-	-	-	20,806	83,225	227,702	(144,477)
31	393.00	Stores Equipment	-	-	-	547	13,964	3,619	10,345
32	394.00	Tools, Shop And Garage	14,040	-	-	2,186	59,882	17,881	42,000
33	395.00	Laboratory Equipment	16,704	-	-	1,868	58,712	14,677	44,035
34	396.00	Power Operated Equipment	-	-	-	205	3,984	512	3,472
35	397.00	Communication Equipment	-	-	-	32,766	318,807	54,413	264,394
36	398.00	Miscellaneous Equipment	-	-	-	3,498	70,250	26,565	43,685
37		SUBTOTAL GENERAL	$ 282,732	$ 0	$ 0	$ 70,812	$ 1,010,251	$ 379,716	$ 630,535
38		AFUDC ADJUSTMENT 3/95	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
39		Adjustment Due To Rounding	-	-	-	-	-	-	0
40		**TOTAL WASTEWATER PLT**	$ 961,057	$ 0	$ 0	$ 1,174,075	$ 33,690,108	$ 9,333,792	$ 24,356,316

References:
Columns (A) (B): Company Schedule B-2, Page 6b
Column (C): Intentionally Left Blank
Column (D): [(Col. (A) - Col. (B)) X RLM-4, Page 4, Col. (A) X 1/2 yr. conv.] + [RLM-4, Page 8, Col. (D) - Col. (C)] X RLM-4, Page 4, Col. (A)]
Column (E): Schedule RLM-4, Page 8, Column (D) + Column (A) - Column (B)
Column (F): Schedule RLM-4, Page 8, Column (E) - Column (B) + Column (D)
Column (G): Column (E) - Column (F)

NOVEMBER 2003

C.A. TURNER UTILITY REPORTS

THE INVESTOR'S EDGE

ELECTRIC COMPANIES

NATURAL GAS COMPANIES

TELEPHONE COMPANIES

WATER COMPANIES

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WATER COMPANIES

COMPANY	LATEST 12 MONTHS EARNINGS AVAILABLE	PER SHARE EARNINGS	PER SHARE CURRENT ANNUAL DIVIDEND	DATA ($) BOOK VALUE (1)	DATA ($) STOCK PRICE 10/20	DATA ($) COMMON SHARES O/S MILL	PERCENT (2) DIV PAYOUT	PERCENT (2) DIV YIELD	PERCENT (2) MKT/ BOOK	DIV/ BOOK (2)	PRICE EARN MULT
American States Water Co. (NYSE-AWR)	6/03	1.12	0.88	14.02	24.41	15.2	79	3.6	174	6.3	21.8
Artesian Resources Corp. (NDQ-ARTNA)	6/03	1.18	0.79	13.38	26.39	3.9	67	3.0	197	5.9	22.4
California Water Service Group (NYSE-CWT)	6/03	0.99	1.13	12.81	27.06	15.2	114	4.2	211	8.8	27.5
Connecticut Water Service, Inc. (NDQ-CTWS)	6/03	1.09	0.83	10.11	28.76	8.0	76	2.9	284	8.2	26.4
Middlesex Water Company (NDQ-MSEX)	6/03	0.95	0.86	9.94	24.84	7.9	91	3.5	250	8.7	26.1
Pennichuck Corporation (NDQ-PNNW)	6/03	1.22	0.86	12.56	27.25	2.4	70	3.2	217	6.8	22.3
Philadelphia Suburban Corp. (NYSE-PSC)	6/03	1.19	0.56	7.76	24.44	69.8	47	2.3	315	7.2	20.5
SJW Corporation (ASE-SJW)	6/03	4.98	2.91	53.10	88.07	3.0	58	3.3	166	5.5	17.7
Southwest Water Company (NDQ-SWWC)	6/03	0.51	0.23	7.28	14.84	10.2	45	1.6	204	3.2	29.0
York Water Company (NDQ-YORW)	6/03	0.60	0.54	5.91	17.90	6.4	90	3.0	303	9.1	29.8
AVERAGE							74	3.0	232	7.0	24.4

INTERNATIONAL COMPANIES

COMPANY	LATEST 12 MONTHS EARNINGS AVAILABLE	PER SHARE EARNINGS	PER SHARE CURRENT ANNUAL DIVIDEND	DATA ($) BOOK VALUE (1)	DATA ($) STOCK PRICE 10/20	DATA ($) COMMON SHARES O/S MILL	PERCENT (2) DIV PAYOUT	PERCENT (2) DIV YIELD	PERCENT (2) MKT/ BOOK	DIV/ BOOK (2)	PRICE EARN MULT
BCE, Inc. (NYSE-BCE)	6/03	1.53	0.86	9.31	22.51	919.3	56	3.8	242	9.2	14.7
BT Group PLC (NYSE-BTY)	6/03	2.53	1.40	5.77	31.56	862.3	55	4.4	547	24.3	12.5
Philippine Long Distance Tel. Co. (NYSE-PHI)	6/03	0.04	0.00	9.38	13.51	169.0	0	0.0	144	NM	NM
Telecom Argentina (NYSE-TEO)	6/03	0.49	0.00	3.84	6.71	196.8	0	0.0	175	NM	13.6
Telecom New Zealand (NYSE-NZT)	6/03	0.22	0.93	4.36	24.12	235.9	NM	3.9	553	21.3	NM
AVERAGE							28	2.4	332	18.3	13.6

WATER COMPANIES

COMPANY	OPER REV $ MILL (1)	% WAT REV	NET PLANT $ MILL	NET PLANT PER $ REV (1)	S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE: COMMON EQUITY (4)	% RETURN ON BOOK VALUE: TOTAL CAPITAL	REGULATION: ALLOWED ROE	REGULATION: ORDER DATE
American States Water Co. (NYSE-AWR)	210.4	88	522.3	2.48	A+	A2	43	8.2	7.4	10.00	4Q/99
Artesian Resources Corp. (NDQ-ARTNA)	36.2	97	145.7	4.02	NR	NR	43	9.1	8.0	10.50	04/03
California Water Service Group (NYSE-CWT)	261.7	100	653.4	2.50	A+	A1	37	7.2	6.6	8.90	-
Connecticut Water Service, Inc. (NDQ-CTWS)	46.6	100	186.1	4.00	NR	NR	55	11.4	9.1	12.70	03/91
Middlesex Water Company (NDQ-MSEX)	63.1	100	198.1	3.14	A+	A2	41	9.6	6.9	10.38	-
Pennichuck Corporation (NDQ-PNNW)	20.3	89	61.0	3.01	NR	NR	52	9.9	8.6	10.33	-
Philadelphia Suburban Corp. (NYSE-PSC)	418.1	95	1,377.3	3.29	AA-	NR	43	16.0	11.0	10.15	-
SJW Corporation (ASE-SJW)	145.0	98	286.3	1.97	NR	NR	56	9.7	8.1	9.95	04/01
Southwest Water Company (NDQ-SWWC)	147.5	35	134.1	0.91	NR	NR	49	8.2	7.2	9.84	05/03
York Water Company (NDQ-YORW)	19.8	87	96.2	4.86	NR	NR	51	10.2	9.0	-	08/01
AVERAGE							47	10.0	8.2	10.31	

INTERNATIONAL COMPANIES

COMPANY	OPER REV $ MILL (1)	% TEL REV LOCAL OR CLEC	NET PLANT $ MILL	NET PLANT PER $ REV (1)	S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE: COMMON EQUITY (4)	% RETURN ON BOOK VALUE: TOTAL CAPITAL	REGULATION: ALLOWED ROE	REGULATION: ORDER DATE
BCE, Inc. (NYSE-BCE)	13,086.4	33	15,174.1	1.16	NR	A3	36	20.9	10.4		
BT Group PLC (NYSE-BTY)	30,885.3	64	25,870.1	0.84	NR	Baa1	16	NM	11.1		
Philippine Long Distance Tel. Co. (NYSE-PHI)	1,597.5	58	4,589.6	2.87	NR	Ba3	31	2.3	4.8		
Telecom Argentina (NYSE-TEO)	1,305.9	54	3,117.6	2.39	NR	Ca	19	NM	8.2		
Telecom New Zealand (NYSE-NZT)	3,023.2	21	2,699.4	0.89	NR	A3	27	NM	17.3		
AVERAGE							26	11.6	10.4		

GLOSSARY OF TERMS

Latest 12 Month Earnings Available -
Earnings per share as reported, based upon the latest 12 months ending as of the last day of the month reported in this column.

Earnings -
Earnings per share as reported before extraordinary items for the latest 12 months ending on the date reported.

Current Annual Dividend -
Latest quarterly dividend per share annualized.

Book Value -
Common equity divided by Common Shares Outstanding for the latest end figures available.

Price -
Closing market price per share of common stock on the date cited at the head of the column.

Common Shares Outstanding -
Common shares Outstanding for the latest quarter end figures available.

Dividend Payout -
Annualized Dividend per share divided by the reported Earnings per Share, multiplied by 100.

Dividend Yield -
Annualized Dividend per share divided by the market price per share of of common stock reported, multiplied by 100.

Market/Book Ratio -
Market price per share of common stock reported, divided by the by the reported Book Value per share multiplied by 100.

Dividend/Book Ratio -
Annualized Dividend per share divided by the reported Book Value per share, multiplied by 100

Price-Earnings Multiple Ratio -
Market price per share of common stock reported divided by the reported earnings per share.

Operating Revenue -
Total operating revenues for the latest 12 months as available.

% Electric /Gas /Water /Telephone Revenue -
Percentage of revenues attributable to Electric/Gas/Water/Telecomm. operations relative to total Operating Revenue. Company groupings are based on revenue percentages and SIC classification criteria.

Net Plant -
Total Property, Plant and Equipment less Depreciation and Contributions in Aid of Construction for the latest quarter end figures available.

Net Plant Per Revenue-
Net Plant as reported divided by Operating Revenue as reported.

Standard & Poor's and Moody's Bond Ratings-
Ratings for each company's most senior long term debt security. For holding companies, ratings are based on an average of the bond ratings available for the subsidiaries.

Common Equity Ratio -
Common Equity capital for the latest quarter divided by total capital as reported, multiplied by 100. Total capital is equal to the sum of long-term debt, current maturities, short-term debt, preferred stock and common equity for the latest quarter end figures available.

% Return on Book Value -- Common Equity -
Income Available for Common Equity divided by Average Common Equity, multiplied by 100. Average common equity based upon the most recent beginning and ending moving 12 month period available.

% Return on Book Value --Total Capital -
Income before Interest Charges (inclusive of taxes) divided by Average Total Capitalization, multiplied by 100. Average total capitalization based upon the most recent beginning and ending four quarter values available.

Allowed R O E -
Most recent reported state-level allowed return rate on common equity (ROE). ROE for companies operating in multiple jurisdictions are averages. Various companies have received incentive-base ROE authorizations that are not reported upon in this report

Order Date -
The date of the commission order authorizing reported ROE. For companies operating in multiple jurisdictions, no date is given because because reported ROE is an average derived from multiple commission orders issued at different times.

(NYSE) - New York Stock Exchange.

(ASE) - American Stock Exchange.

(NDQ) - Nasdaq.

NM - Not Meaningful.

NA - Not Available.

Additional Notes -

(1) Balance sheet values are the latest quarter end figures as available Income statement figures are for the latest 12 month available

(2) Based on per share value.

(3) Based on permanent capital. (The sum of long-term debt, current maturities, short term debt, preferred stock and common equity capital.)

(4) In many instances, available information require that Per Share and % Return on Book Value of Common Equity /Total Capital derived from figures that represent financial activity from different 12 month periods.

(5) The following companies do not pay cash dividends. However, they do pay a quarterly stock dividend that is non-taxable upon receipt:

Citizens Utilities Company (NYSE-CZN)
Commonwealth Telephone Enterprises (NDQ-CTCO)
Southern Union Company (NYSE-SUG)

(6) The telephone companies have been divided into three groups: Telephone Companies, Small Telephone Companies and International Telephone Companies. All International Telephone companies included in our reports are located outside the United States and provide local telephone service around the world. We have divided the telephone companies located in the U.S. based upon their annual revenues. If a company generates less than $200 million, it is included in the small company group, otherwise it is considered a large telephone company. Also due to the current changes taking place in the telecommunications industry, we have decided to include some independent telephone companies which offer local telephone service. And, we have decided to include the major Competitive Local Exchange Carriers (CLECs), which have been operating as CLECs for at least 2 years, and which are publicly traded.

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The Water Utility Industry's consolidation continues to gain momentum, as industry leaders look for opportunities to buy out smaller companies that are struggling to keep up with escalating infrastructure costs and heightened regulatory requirements.

Water Utility stocks are unlikely to outperform the broad market for the year ahead. With that said, however, some of these issues offer conservative investors attractive risk-adjusted, total-return potential.

INDUSTRY TIMELINESS: 97 (of 98)

Government Regulations

In order to keep water supplies safe, national purification standards have been established that the water industry is required to meet. Amended in 1996, the Safe Drinking Water Act (SDWA) of 1974 authorizes the Environmental Protection Agency (EPA) to work with state and local governments to periodically test for impurities in drinking water and regulate the levels of contaminants that are acceptable per a specified amount of water. These standards take into account the health effects of chemicals, measurement capabilities, and technical feasibility. One of the most significant contaminants that the industry screens for is arsenic, a naturally occurring substance. However, the EPA is in the process of lowering the tolerated amount of arsenic to 10 parts per billion from 20 parts currently. The change is expected to be in effect by January, 2006. Large chunks of water utilities' annual capital budgets are already spent on infrastructure maintenance and improvements in order to stay in compliance with the SDWA, the Clean Water Act, and numerous state and local laws. This percentage is likely to climb even higher, as fears of terrorism have prompted officials to further tighten regulation requirements.

Rising Infrastructure Costs

Along with the necessity to remain in compliance with increasingly strict water purity standards, water companies are also being pressured to continually upgrade aging facilities. Many of the water/wastewater systems that are presently in use were built over 100 years ago and are growing outdated. The costs associated with replacing these systems are dramatically higher now than when they initially were put in place. The EPA and other industry sources indicate that hundreds of billions of dollars over the next 20 years will be needed to repair the nation's entire water system. The Water Infrastructure Network believes that there will be a $12 billion annual shortfall for wastewater infrastructure over that period, and long-term help from the federal government is needed to solve the problem. Water companies will most likely foot the majority of the bill, though, as budget deficits at state and local levels will limit funds dedicated to the industry.

Industry Consolidation

With the costs of meeting safe drinking water guidelines on the rise, many smaller companies lack the funds to commit to long-term structural improvements. As such, these smaller water companies have been increasingly willing to accept takeover offers from larger suitors with significantly greater capital resources. The larger utilities benefit from economies of scale, which enables them to reduce overhead. In addition, the acquisitions usually enhance geographic diversity, reducing a company's vulnerability to weather fluctuations. Then, too, a multistate territory helps to alleviate a company's exposure to especially onerous regulatory atmospheres. Large foreign utilities have been particularly active in recent years, swallowing up domestic water companies in an effort to gain exposure to the United States' steady population growth.

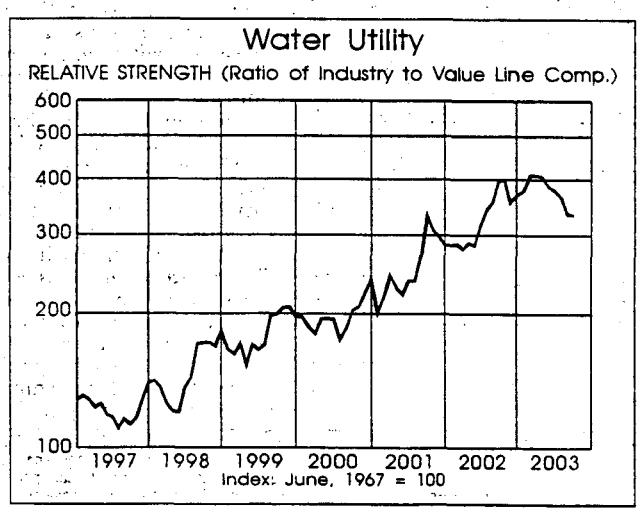
Investment Advice

None of the stocks under review are timely at this juncture, as poor weather conditions have resulted in inconsistent earnings patterns. Although *Philadelphia Suburban, California Water Services Group, and American States Water* all have below-average total-return potential out to 2006-2008, income-oriented investors might may find one of these stocks attractive, given their favorable risk profile. Income-bearing stocks have gained some additional popularity of late, because of the recent federal tax bill that reduced the top rate investors pay on dividend income to 15%. As usual, though, we recommend that potential investors careful review individual reports before making any new commitments.

Andre J. Costanza

Composite Statistics: Water Utility Industry

1999	2000	2001	2002	2003	2004		06-08
637.2	704.3	751.8	794.4	*845*	*950*	Revenues ($mill)	*1185*
72.4	90.9	95.4	106.6	*105*	*130*	Net Profit ($mill)	*190*
40.0%	41.2%	40.2%	38.8%	*39.0%*	*39.5%*	Income Tax Rate	*40.0%*
--	--	--	--	*Nil*	*.5%*	AFUDC % to Net Profit	*.5%*
51.1%	50.3%	52.4%	53.9%	*53.0%*	*51.5%*	Long-Term Debt Ratio	*51.0%*
48.3%	49.3%	47.2%	45.9%	*46.5%*	*48.5%*	Common Equity Ratio	*49.0%*
1444.7	1661.0	1840.7	1973.6	*2250*	*2425*	Total Capital ($mill)	*3050*
2100.3	2342.5	2532.3	2751.1	*3025*	*3225*	Net Plant ($mill)	*3950*
7.4%	7.0%	6.8%	7.0%	*6.5%*	*7.0%*	Return on Total Cap'l	*7.5%*
11.5%	10.7%	10.6%	11.2%	*10.0%*	*10.5%*	Return on Shr. Equity	*12.0%*
11.5%	10.8%	10.7%	11.2%	*10.0%*	*11.0%*	Return on Com Equity	*12.0%*
3.8%	3.6%	3.3%	3.9%	*3.0%*	*4.0%*	Retained to Com Eq	*5.5%*
68%	67%	69%	66%	*75%*	*65%*	All Div'ds to Net Prof	*54%*
19.5	18.6	22.6	21.5	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	*13.5*
1.11	1.21	1.16	1.17			Relative P/E Ratio	*.90*
3.5%	3.6%	3.1%	3.1%			Avg Ann'l Div'd Yield	*3.0%*



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AMER. STATES WATER NYSE-AWR

RECENT PRICE **24.00** | P/E RATIO **21.8** (Trailing: 21.4; Median: 15.0) | RELATIVE P/E RATIO **1.22** | DIV'D YLD **3.8%** | VALUE LINE **1421**

TIMELINESS **5** Lowered 8/8/03
SAFETY **3** New 2/4/00
TECHNICAL **3** Raised 5/16/03
BETA .65 (1.00 = Market)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
High:	13.8	16.3	14.7	14.0	16.1	17.1	19.5	26.5	25.3	28.4	29.0	29.0
Low:	10.7	13.1	10.2	10.5	12.5	13.5	14.1	14.8	16.7	19.0	20.3	21.6

2006-08 PROJECTIONS

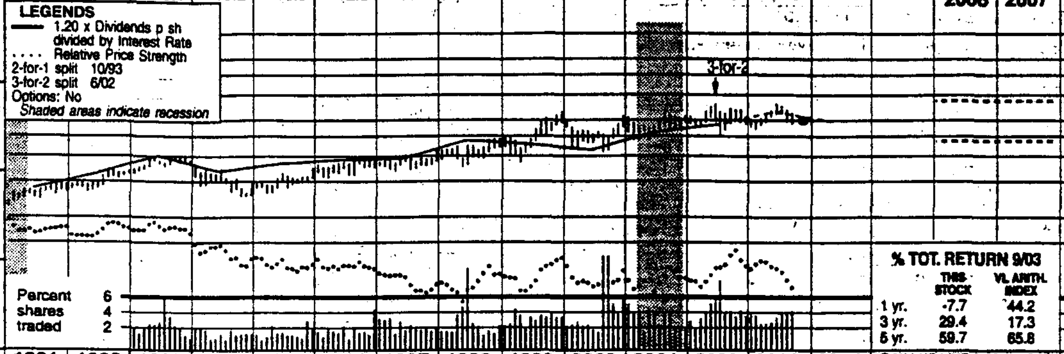
	Price	Gain	Ann'l Total Return
High	30	(+25%)	9%
Low	19	(-20%)	-1%

Insider Decisions

	D	J	F	M	A	M	J	J	A
to Buy	0	1	0	0	0	3	0	0	2
Options	0	0	0	0	0	0	0	0	0
to Sell	0	0	1	0	0	3	0	0	0

Institutional Decisions

	4Q2002	1Q2003	2Q2003
to Buy	36	41	43
to Sell	34	30	29
Hld's(000)	5723	5593	5547



% TOT. RETURN 9/03

	THIS STOCK	VL ARITH. INDEX
1 yr.	-7.7	44.2
3 yr.	29.4	17.3
5 yr.	59.7	65.8

1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	© VALUE LINE PUB., INC.	06-08
8.35	8.58	9.12	9.58	9.15	10.10	9.27	10.43	11.03	11.37	11.44	11.02	12.91	12.17	13.06	13.78	*12.80*	*14.00*	Revenues per sh	*16.20*
1.34	1.13	1.44	1.49	1.78	1.81	1.67	1.68	1.75	1.75	1.85	2.04	2.26	2.20	2.53	2.54	*2.25*	*2.70*	"Cash Flow" per sh	*3.30*
.89	.65	.92	.94	1.19	1.15	1.11	.95	1.03	1.13	1.04	1.08	1.19	1.28	1.35	1.34	*1.05*	*1.45*	Earnings per sh A	*1.85*
.64	.67	.69	.72	.73	.77	.79	.80	.81	.82	.83	.84	.85	.86	.87	.87	*.88*	*.90*	Div'd Decl'd per sh B■	*.96*
2.45	2.39	2.46	2.53	2.77	2.31	1.90	2.43	2.19	2.40	2.58	3.11	4.30	3.03	3.18	2.68	*4.75*	*4.75*	Cap'l Spending per sh	*3.50*
7.11	7.07	7.31	7.54	8.39	8.85	9.95	10.07	10.29	11.01	11.24	11.48	11.82	12.74	13.22	14.05	*14.00*	*14.90*	Book Value per sh	*17.65*
9.31	9.35	9.39	9.43	9.91	9.96	11.71	11.77	11.77	13.33	13.44	13.44	13.44	15.12	15.12	15.18	*16.80*	*16.80*	Common Shs Outst'g C	*17.00*
10.0	14.2	9.7	10.2	8.8	10.6	13.4	12.8	11.6	12.6	14.5	15.5	17.1	15.9	16.7	18.3	*Bold figures are*		Avg Ann'l P/E Ratio	*13.0*
.67	1.18	.73	.76	.56	.64	.79	.84	.78	.79	.84	.81	.97	1.03	.86	1.00	*Value Line*		Relative P/E Ratio	*.85*
7.2%	7.4%	7.7%	7.5%	7.0%	6.3%	5.3%	6.6%	6.7%	5.8%	5.5%	5.0%	4.2%	4.2%	3.9%	3.6%	*estimates*		Avg Ann'l Div'd Yield	*4.1%*

CAPITAL STRUCTURE as of 6/30/03
Total Debt $277.1 mill. Due in 5 Yrs $65.0 mill.
LT Debt $230.8 mill. LT Interest $17.0 mill.
(Total interest coverage: 2.8x) (52% of Cap'l)

Leases, Uncapitalized: None
Pension Assets-12/02 $39.8 mill.
Oblig. $49.1 mill.
Pfd Stock None. **Pfd Div'd** None.

Common Stock 15,196,970 shs.
as of 8/14/03
MARKET CAP: $375 million (Small Cap)

1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004		06-08
108.5	122.7	129.8	151.5	153.8	148.1	173.4	184.0	197.5	209.2	*215*	*235*	Revenues ($mill)	*275*
12.0	11.3	12.2	13.5	14.1	14.6	16.1	18.0	20.4	20.3	*18.0*	*24.5*	Net Profit ($mill)	*31.0*
31.3%	43.9%	41.9%	43.3%	41.1%	40.9%	46.0%	45.7%	43.0%	38.9%	*40.0%*	*40.0%*	Income Tax Rate	*41.0%*
--	--	--	--	--	--	--	--	--	--	*Nil*	*Nil*	AFUDC % to Net Profit	*Nil*
41.5%	43.5%	46.6%	41.9%	43.0%	43.6%	51.0%	47.5%	54.9%	52.0%	*49.0%*	*47.0%*	Long-Term Debt Ratio	*50.0%*
57.4%	55.5%	52.5%	57.3%	56.3%	55.7%	48.4%	51.9%	44.7%	48.0%	*51.0%*	*53.0%*	Common Equity Ratio	*50.0%*
203.0	213.5	230.6	256.0	268.4	277.1	328.2	371.1	447.6	444.4	*480*	*490*	Total Capital ($mill)	*630*
295.0	314.9	335.0	357.8	383.6	414.8	449.6	509.1	539.8	563.3	*600*	*640*	Net Plant ($mill)	*750*
7.8%	7.1%	7.2%	6.9%	6.9%	7.0%	6.6%	6.4%	6.1%	6.5%	*5.5%*	*6.5%*	Return on Total Cap'l	*6.5%*
10.1%	9.4%	9.9%	9.0%	9.2%	9.4%	10.0%	9.2%	10.1%	9.5%	*8.0%*	*9.5%*	Return on Shr. Equity	*10.5%*
10.2%	9.5%	10.0%	9.0%	9.2%	9.4%	10.1%	9.3%	10.1%	9.5%	*8.0%*	*9.5%*	Return on Com Equity	*10.5%*
2.9%	1.6%	2.1%	2.4%	1.8%	2.1%	2.9%	3.0%	3.6%	3.3%	*1.5%*	*3.5%*	Retained to Com Eq	*5.0%*
72%	84%	79%	73%	80%	78%	72%	68%	65%	65%	*80%*	*62%*	All Div'ds to Net Prof	*53%*

CURRENT POSITION ($MILL.)	2001	2002	6/30/03
Cash Assets	30.5	18.4	5.6
Receivables	10.6	10.8	10.5
Inventory (Avg Cst)	1.0	.9	1.4
Other	45.7	21.7	24.4
Current Assets	87.8	51.8	41.9
Accts Payable	13.9	11.6	8.6
Debt Due	20.8	48.3	46.3
Other	28.9	19.6	17.0
Current Liab.	63.6	79.5	71.9
Fix. Chg. Cov.	327%	285%	*208%*

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '00-'02 to '06-'08
Revenues	3.0%	3.0%	*3.5%*
"Cash Flow"	3.5%	6.5%	*5.5%*
Earnings	2.0%	4.5%	*6.0%*
Dividends	1.5%	1.0%	*1.5%*
Book Value	5.0%	4.0%	*5.0%*

Cal-endar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun. 30	Sep. 30	Dec. 31	Full Year
2000	38.7	45.4	55.3	44.6	184.0
2001	40.3	49.9	59.4	47.9	197.5
2002	44.5	52.8	61.6	50.3	209.2
2003	46.7	51.8	*64.0*	*52.5*	*215*
2004	*49.0*	*60.0*	*69.0*	*57.0*	*235*

Cal-endar	EARNINGS PER SHARE A Mar.31	Jun. 30	Sep. 30	Dec. 31	Full Year
2000	.21	.29	.57	.21	1.28
2001	.21	.33	.63	.18	1.35
2002	.25	.36	.50	.23	1.34
2003	.20	.13	*.53*	*.19*	*1.05*
2004	*.25*	*.38*	*.60*	*.22*	*1.45*

Cal-endar	QUARTERLY DIVIDENDS PAID B■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1999	.213	.213	.213	.213	.85
2000	.213	.213	.213	.217	.86
2001	.217	.217	.217	.217	.87
2002	.217	.217	.217	.221	.87
2003	.221	.221	.221		

BUSINESS: American States Water Co. operates as a holding company. Through its principal subsidiary, Southern California Water Company, it supplies water to 75 communities in 10 counties. Service areas include the greater metropolitan areas of Los Angeles and Orange Counties. The company also provides electric utility services to approximately 22,000 customers in the city of Big Bear Lake and in areas of San Bernardino County. Acquired Chaparral City Water of Arizona (10/00); 11,400 customers. Has about 500 employees. Off. & dir. own less than 1% of common stock (4/03 Proxy). Chairman: Lloyd Ross. President & CEO: Floyd Wicks. Incorporated: CA. Add.: 630 East Foothill Boulevard, San Dimas, CA 91773. Tel.: 909-394-3600. Web: www.aswater.com.

American States Water Company reported disappointing second-quarter earnings per share. Share net of $0.13 was dramatically below last year's total of $0.36. The shortfall was largely due to wet weather conditions and continued delays in rate relief decisions by the California Public Utilities Commission (CPUC). Water consumption was 10.6% lower in the three-month period year to year. Contracting margins also contributed to the company's misfortunes, as higher administration and general costs caused operating and maintenance costs to rise about 7%.

We've lowered our full-year 2003 share-net estimate by $0.25 to $1.05. Our revised estimate mostly adjusts for the weak second-quarter results, but we also shaved our second-half outlook slightly to reflect concerns regarding further delays in rate-relief decisions by the CPUC and escalating operating expenses. Historically, the CPUC has shown a propensity to take its time with rulings.

However, our 2004 share-net estimate of $1.45 stands. More normal weather conditions, the rapidly growing population in California, and an increase in rate relief cases should boost revenues moving forward. American has three major base-rate cases in front of the CPUC at this time. We suspect that the pending rate increase surrounding Region 3, which contains about 30% of AWR's customer base, will be resolved by early 2004, adding approximately $26 million to revenues.

American will likely initiate an equity offering. This will allow it to fund some capital expenditures that it had been delaying under its not-so-successful cash-preservation program. However, the investment will not be delayed any further and capital spending is expected to ramp up to $80 million for 2003.

Growth-minded investors are advised to look elsewhere. These shares are ranked to underperform the year-ahead market averages. Moreover, the earnings advances we project out to 2006-2008 appear to already be reflected in the stock's current quotation. The company's dividend payout and the stock's Price Stability rating may appeal to more-conservative investors.

Andre J. Costanza *October 31, 2003*

(A) Primary earnings. Excludes nonrecurring gains: '91, 73¢; '92, 13¢. Next earnings report due late Jan.

(B) Dividends historically paid in early-March, June, September, December.■ Div'd reinvestment plan available.

(C) In millions, adjusted for splits.

Company's Financial Strength	B+
Stock's Price Stability	85
Price Growth Persistence	70
Earnings Predictability	85

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CALIFORNIA WATER NYSE-CWT

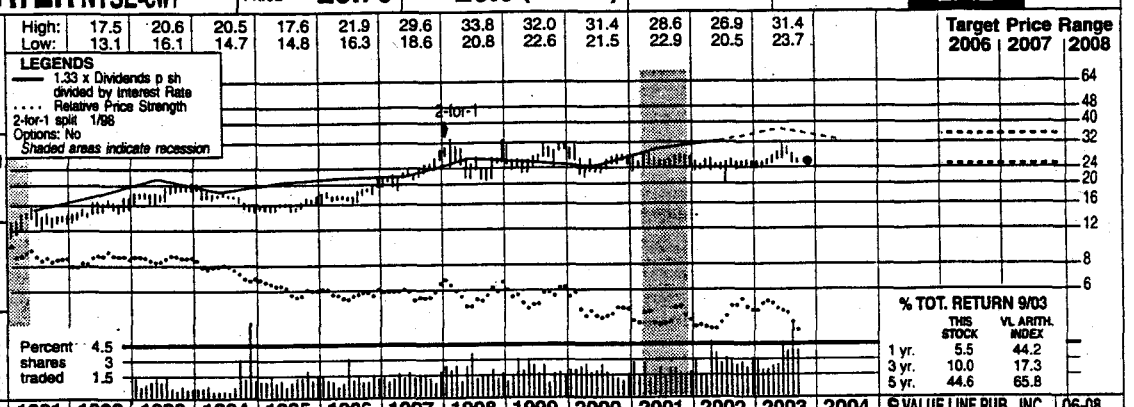
RECENT PRICE	25.75	P/E RATIO	20.6 (Trailing: 27.1 / Median: 16.0)	RELATIVE P/E RATIO	1.15	DIV'D YLD	4.4%	VALUE LINE	1422

TIMELINESS 4 Lowered 8/1/03
SAFETY 2 Lowered 8/11/95
TECHNICAL 3 Lowered 7/18/03
BETA .60 (1.00 = Market)

High:	17.5	20.6	20.5	17.6	21.9	29.6	33.8	32.0	31.4	28.6	26.9	31.4
Low:	13.1	16.1	14.7	14.8	16.3	18.6	20.8	22.6	21.5	22.9	20.5	23.7

Target Price Range 2006 | 2007 | 2008

LEGENDS
— 1.33 x Dividends p sh divided by Interest Rate
.... Relative Price Strength
2-for-1 split 1/98
Options: No
Shaded areas indicate recession



2006-08 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	35	(+35%)	11%
Low	25	(-5%)	4%

Insider Decisions

	D	J	F	M	A	M	J	J	A
to Buy	0	0	0	0	0	0	0	0	0
Options	0	0	0	0	0	0	0	0	0
to Sell	0	0	0	0	0	0	0	0	0

Institutional Decisions

	4Q2002	1Q2003	2Q2003
to Buy	28	24	27
to Sell	10	18	24
Hld's(000)	2901	2803	2879

% TOT. RETURN 9/03

	THIS STOCK	VL ARITH. INDEX
1 yr.	5.5	44.2
3 yr.	10.0	17.3
5 yr.	44.6	65.8

1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	© VALUE LINE PUB., INC.	06-08
10.13	10.03	10.33	10.93	11.18	12.29	13.34	12.59	13.17	14.48	15.48	14.76	15.96	16.16	16.26	17.33	*15.90*	*14.90*	Revenues per sh	*19.15*
1.94	1.87	1.89	1.97	1.98	1.92	2.25	2.02	2.07	2.50	2.92	2.60	2.75	2.52	2.20	2.65	*2.45*	*2.75*	"Cash Flow" per sh	*3.60*
1.32	1.23	1.20	1.25	1.21	1.09	1.35	1.22	1.17	1.51	1.83	1.45	1.53	1.31	.94	1.25	*1.03*	*1.45*	Earnings per sh A	*1.95*
.74	.80	.84	.87	.90	.93	.96	.99	1.02	1.04	1.06	1.07	1.09	1.10	1.12	1.12	*1.12*	*1.13*	Div'd Decl'd per sh B ■	*1.18*
1.75	2.12	2.40	2.36	3.03	3.09	2.53	2.26	2.17	2.83	2.61	2.74	3.44	2.45	4.09	5.82	*4.70*	*4.25*	Cap'l Spending per sh	*5.30*
8.85	9.30	9.66	10.04	10.35	10.51	10.90	11.56	11.72	12.22	13.00	13.38	13.43	12.90	12.95	13.12	*13.90*	*15.75*	Book Value per sh C	*18.45*
11.13	11.34	11.38	11.38	11.38	11.38	11.38	12.49	12.54	12.62	12.62	12.62	12.94	15.15	15.18	15.18	*17.00*	*18.80*	Common Shs Outst'g D	*18.80*
10.5	11.5	10.6	10.4	11.2	14.1	13.6	14.1	13.7	11.9	12.6	17.8	17.8	19.6	27.1	19.8	*Bold figures are*		Avg Ann'l P/E Ratio	*14.5*
.70	.95	.80	.77	.72	.86	.80	.92	.92	.75	.73	.93	1.01	1.27	1.39	1.08	*Value Line*		Relative P/E Ratio	*.95*
5.3%	5.7%	6.6%	6.7%	6.6%	6.1%	5.2%	5.8%	6.4%	5.8%	4.6%	4.2%	4.0%	4.3%	4.4%	4.5%	*estimates*		Avg Ann'l Div'd Yield	*4.2%*
						151.7	157.3	165.1	182.8	195.3	186.3	206.4	244.8	246.8	263.2	*270*	*280*	Revenues ($mill)	*360*
						15.5	14.4	14.7	19.1	23.3	18.4	19.9	20.0	14.4	19.1	*18.0*	*27.5*	Net Profit ($mill)	*37.0*
						40.6%	40.0%	40.1%	38.9%	37.4%	36.4%	37.9%	42.3%	39.4%	39.7%	*42.0%*	*42.0%*	Income Tax Rate	*42.0%*
						--	--	--	--	--	--	--	--	--	--	*Nil*	*Nil*	AFUDC % to Net Profit	*Nil*
						50.4%	46.6%	49.2%	47.4%	45.4%	44.2%	46.9%	48.9%	50.3%	55.3%	*57.0%*	*53.0%*	Long-Term Debt Ratio	*51.5%*
						48.2%	52.2%	49.7%	51.4%	53.5%	54.7%	52.0%	50.2%	48.8%	44.0%	*42.5%*	*46.5%*	Common Equity Ratio	*48.0%*
						257.1	276.9	296.0	299.9	306.7	308.6	333.8	388.8	402.7	453.1	*555*	*635*	Total Capital ($mill)	*725*
						391.7	407.9	422.2	443.6	460.4	478.3	515.4	582.0	624.3	697.0	*780*	*820*	Net Plant ($mill)	*950*
						8.1%	7.1%	6.8%	8.3%	9.4%	7.8%	7.8%	6.8%	5.3%	5.9%	*5.0%*	*6.0%*	Return on Total Cap'l	*6.5%*
						12.2%	9.7%	9.8%	12.1%	13.9%	10.7%	11.2%	10.0%	7.2%	9.4%	*8.0%*	*9.0%*	Return on Shr. Equity	*10.5%*
						12.4%	9.9%	9.9%	12.3%	14.1%	10.8%	11.4%	10.1%	7.2%	9.5%	*8.0%*	*9.0%*	Return on Com Equity	*10.5%*
						3.6%	1.9%	1.2%	3.8%	6.0%	2.8%	3.5%	1.8%	NMF	1.0%	*NMF*	*2.0%*	Retained to Com Eq	*4.0%*
						71%	81%	88%	69%	58%	74%	70%	82%	119%	90%	*102%*	*78%*	All Div'ds to Net Prof	*61%*

CAPITAL STRUCTURE as of 9/30/03
Total Debt $274.3 mill. Due in 5 Yrs $30.0 mill.
LT Debt $270.9 mill. LT Interest $16.5 mill.

(LT interest earned: 2.9x; total int. cov.: 2.7x)

Pension Assets-12/02 $56.3 mill. Oblig. $79.6 mill.

Pfd Stock $3.5 mill. Pfd Div'd $.15 mill.
139,000 shares, 4.4% cumulative ($25 par).

Common Stock 16,932,046 shs.
as of 8/11/03
MARKET CAP: $425 million (Small Cap)

CURRENT POSITION ($MILL.)	2001	2002	9/30/03
Cash Assets	1.0	1.1	12.4
Other	39.4	41.9	50.1
Current Assets	40.4	43.0	62.5
Accts Payable	24.0	23.7	29.0
Debt Due	26.6	24.8	3.4
Other	28.4	43.0	44.1
Current Liab.	79.0	91.5	76.5
Fix. Chg. Cov.	214%	250%	242%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '00-'02 to '06-'08
Revenues	4.0%	3.0%	*2.5%*
"Cash Flow"	2.5%	-.5%	*6.5%*
Earnings	--	-5.0%	*9.0%*
Dividends	2.0%	1.5%	*1.0%*
Book Value	2.5%	1.0%	*7.0%*

Cal-endar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2000	46.6	66.0	76.6	55.6	244.8
2001	47.0	67.0	76.3	56.5	246.8
2002	51.7	69.2	81.4	60.9	263.2
2003	51.3	68.0	88.2	*62.5*	*270*
2004	*55.0*	*73.0*	*85.0*	*67.0*	*280*

Cal-endar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2000	.09	.40	.60	.22	1.31
2001	.01	.34	.39	.20	.94
2002	.12	.43	.50	.20	1.25
2003	d.05	.30	.53	*.25*	*1.03*
2004	*.15*	*.40*	*.62*	*.28*	*1.45*

Cal-endar	QUARTERLY DIVIDENDS PAID B ■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1999	.272	.271	.271	.271	1.09
2000	.275	.275	.275	.275	1.10
2001	.279	.279	.279	.279	1.12
2002	.28	.28	.28	.28	1.12
2003	.281	.281	.281		

BUSINESS: California Water Service Group provides regulated and nonregulated water service to over 2 million people (461,200 customers) in 98 communities in California, Washington, and New Mexico. Main service areas: San Francisco Bay area, Sacramento Valley, Salinas Valley, San Joaquin Valley & parts of Los Angeles. Acquired Dominguez Services Corp. (5/00); Rio Grande Corp. (11/00). Revenue breakdown, '02: residential, 70%; business, 18%; public authorities, 5%; industrial, 4%; other, 3%. '02 reported deprec. rate: 2.1%. Has about 800 employees. Chairman: Robert W. Foy. President & CEO: Peter C. Nelson. Inc.: Delaware. Address: 1720 North First Street, San Jose, California 95112-4598. Telephone: 408-367-8200. Internet: www.calwater.com.

We have reduced our 2003 share-net estimate for California Water Service Group by $0.07, to $1.03, to reflect the weakness of the third quarter. The company posted third-quarter earnings of $0.53, $0.07 lower than our estimate. Revenue growth remained subdued in the period, as cool and wet weather continued to hurt water consumption rates.

The company appears to be gathering some momentum, though. The California Public Utilities Commission (CPUC) recently approved Cal's 2001 rate cases, granting an 8.9% rate of return for 14 of the company's California Districts and approving rate increases that will add $12.8 million to annual revenues. The new rates will be retroactive from September 9th, 2003. In addition, the board ruled that the company was entitled to collect $5 million in surcharges for the period from April 3rd to September 9th, and authorized Cal to apply for step-rate increases of $2.2 million for 2004 and 2005, which if approved, will become effective January 1st of each year. The additional revenue from the rulings should enable Cal to achieve 25% year-over-year earnings growth in the fourth quarter.

Industry consolidation should aid bottom-line growth out to 2006-2008. The Environmental Protection Agency (EPA) and other local regulators have stepped up regulatory requirements considerably in recent years to ensure the safety of the water supply. However, the additional costs to remain in compliance with the higher safety standards will likely be too much for many smaller utilities to endure, resulting in further industry consolidation. Thus, Cal, the second-largest public utility in the nation, should be very active in the acquisition market in the years ahead. We believe that any future activity will follow in the footsteps of Cal's latest purchase of Hawaiian-based Ka'anapali Water to diversify its geographic presence outside of California.

Cal's solid dividend yield makes these high-quality shares a compelling investment for income-minded investors. However, this untimely stock may not appeal to growth-oriented investors because of its modest appreciation potential out to 2006-2008.

Andre J. Costanza *October 31, 2003*

(A) Basic EPS. Excl. nonrecurring gain (loss): '87, 39¢; '00, (7¢); '01, 4¢; Q2'02, 8¢. Next earnings report due late Jan.
(B) Dividends historically paid in mid-Feb., May, Aug., Nov. ■ Div'd reinvestment plan available.
(C) Incl. deferred charges. In '02: $31.4 mill., $2.07/sh.
(D) In millions, adjusted for split.

Company's Financial Strength	B++
Stock's Price Stability	95
Price Growth Persistence	80
Earnings Predictability	75

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PHILA. SUBURBAN NYSE-PSC

RECENT PRICE 19.25 | P/E RATIO 23.2 (Trailing: 25.6 / Median: 18.0) | RELATIVE P/E RATIO 1.30 | DIV'D YLD 2.5% | VALUE LINE 1423

TIMELINESS 3 Lowered 2/1/02
SAFETY 3 Lowered 8/1/03
TECHNICAL 3 Raised 10/24/03
BETA .70 (1.00 = Market)

High:	4.2	5.3	5.0	5.5	7.6	11.4	15.4	15.4	16.0	19.7	20.0	20.1
Low:	3.5	4.0	4.4	4.4	5.2	5.9	9.7	10.1	8.4	12.5	12.8	15.8

Target Price Range 2006 | 2007 | 2008

2006-08 PROJECTIONS

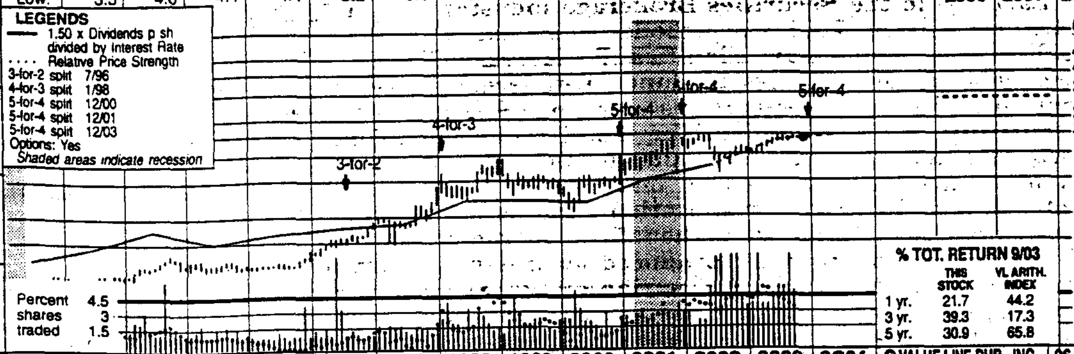
	Price	Gain	Ann'l Total Return
High	30	(+55%)	14%
Low	20	(+5%)	4%

Insider Decisions

	D	J	F	M	A	M	J	J	A
to Buy	0	0	0	0	0	0	0	0	0
Options	0	0	1	1	0	1	0	0	0
to Sell	0	0	0	1	0	0	0	0	0

Institutional Decisions

	4Q2002	1Q2003	2Q2003
to Buy	78	85	83
to Sell	55	55	59
Hld's(000)	29223	28948	29526



% TOT. RETURN 9/03

	THIS STOCK	VL ARITH. INDEX
1 yr.	21.7	44.2
3 yr.	39.3	17.3
5 yr.	30.9	65.8

1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	© VALUE LINE PUB., INC.	06-08
3.68	4.45	4.53	2.70	2.85	2.43	2.27	2.42	2.45	2.48	2.69	2.79	3.21	3.29	3.59	3.79	*4.10*	*4.75*	Revenues per sh	*5.50*
.60	.66	.65	.58	.59	.52	.56	.56	.63	.67	.74	.81	.96	1.01	1.15	1.26	*1.45*	*1.60*	"Cash Flow" per sh	*2.20*
.28	.30	.27	.33	.33	.31	.33	.35	.39	.40	.46	.53	.56	.62	.68	.72	*.80*	*.90*	Earnings per sh A	*1.20*
.24	.24	.24	.26	.26	.27	.27	.28	.29	.30	.32	.34	.36	.38	.40	.43	*.46*	*.49*	Div'd Decl'd per sh B■	*.60*
.74	.88	1.15	1.01	.72	.80	.63	.61	.69	.64	.77	1.09	1.20	1.55	1.45	1.60	*1.70*	*1.85*	Cap'l Spending per sh	*2.25*
2.82	2.88	2.92	2.80	2.76	2.79	3.05	3.21	3.28	3.59	3.79	4.28	4.57	5.13	5.53	5.81	*6.45*	*6.70*	Book Value per sh	*8.15*
28.23	28.27	29.45	30.48	31.06	38.40	44.55	44.83	47.81	49.31	50.60	54.15	80.10	83.87	85.48	84.90	*89.50*	*91.50*	Common Shs Outst'g C	*100.00*
14.0	12.3	12.9	10.2	10.8	12.5	14.4	13.5	12.0	15.6	17.8	22.5	21.2	18.2	23.6	23.6	*Bold figures are*		Avg Ann'l P/E Ratio	*21.0*
.94	1.02	.98	.76	.69	.76	.85	.89	.80	.98	1.03	1.17	1.21	1.18	1.21	1.29	*Value Line*		Relative P/E Ratio	*1.40*
6.0%	6.5%	6.9%	7.7%	7.2%	6.8%	5.9%	6.0%	6.2%	4.9%	3.9%	2.9%	3.0%	3.3%	2.5%	2.5%	*estimates*		Avg Ann'l Div'd Yield	*2.3%*

CAPITAL STRUCTURE as of 6/30/03
Total Debt $715.2 mill. **Due in 5 Yrs** $260.0 mill.
LT Debt $584.1 mill. **LT Interest** $35.0 mill.
(Total interest coverage: 3.5x)

Pension Assets-12/02 $94.4 mill. **Oblig.** $131.1 mill.
Pfd Stock $.2 mill. **Pfd Div'd** $.1 mill.

Common Stock 87,253,365 shares **as of 7/28/03**

MARKET CAP: $1.7 billion (Mid Cap)

1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004		06-08
101.2	108.6	117.0	122.5	136.2	151.0	257.3	275.5	307.3	322.0	*365*	*435*	Revenues ($mill)	*550*
14.7	15.6	19.0	19.8	23.2	28.8	45.0	50.7	58.5	62.7	*70.0*	*80.0*	Net Profit ($mill)	*120*
41.5%	42.5%	40.4%	41.4%	40.6%	40.5%	38.4%	38.9%	39.3%	38.5%	*40.0%*	*40.0%*	Income Tax Rate	*40.0%*
5.5%	.8%	1.6%	--	--	--	--	--	--	--	*Nil*	*1.0%*	AFUDC % to Net Profit	*2.0%*
49.9%	50.2%	51.9%	54.1%	54.4%	52.7%	52.9%	52.0%	52.2%	54.2%	*56.0%*	*56.0%*	Long-Term Debt Ratio	*52.0%*
46.7%	47.4%	46.4%	44.0%	44.8%	46.6%	46.7%	47.8%	47.7%	45.8%	*44.0%*	*44.0%*	Common Equity Ratio	*48.0%*
291.2	303.1	338.0	401.7	427.2	496.6	782.7	901.1	990.4	1076.2	*1230*	*1300*	Total Capital ($mill)	*1700*
366.2	385.7	436.9	502.9	534.5	609.8	1135.4	1251.4	1368.1	1490.8	*1650*	*1760*	Net Plant ($mill)	*2250*
7.1%	7.0%	7.7%	6.8%	7.4%	7.6%	7.6%	7.4%	7.8%	7.6%	*7.5%*	*7.5%*	Return on Total Cap'l	*8.5%*
10.1%	10.4%	11.7%	10.7%	11.9%	12.3%	12.2%	11.7%	12.3%	12.7%	*12.0%*	*13.0%*	Return on Shr. Equity	*14.5%*
10.2%	10.3%	11.7%	11.2%	12.0%	12.4%	12.3%	11.7%	12.4%	12.7%	*12.0%*	*13.0%*	Return on Com Equity	*14.5%*
1.6%	2.1%	3.5%	2.8%	3.6%	4.5%	4.3%	4.7%	5.1%	5.2%	*5.0%*	*6.0%*	Retained to Com Eq D	*7.5%*
85%	81%	71%	75%	70%	64%	65%	60%	59%	59%	*59%*	*56%*	All Div'ds to Net Prof	*50%*

CURRENT POSITION ($MILL.)	2001	2002	6/30/03
Cash Assets	20.8	49.7	42.8
Receivables	56.3	57.7	59.8
Inventory (AvgCst)	4.4	4.6	5.0
Other	8.1	2.7	2.0
Current Assets	89.6	114.7	109.6
Accts Payable	27.7	31.1	20.8
Debt Due	124.6	149.4	131.1
Other	50.3	46.0	45.1
Current Liab.	202.6	226.5	197.0
Fix. Chg. Cov.	335%	347%	345%

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '00-'02 to '06-'08
Revenues	3.0%	7.0%	*7.5%*
"Cash Flow"	7.5%	11.0%	*11.5%*
Earnings	7.5%	10.0%	*10.0%*
Dividends	4.5%	6.0%	*7.0%*
Book Value	7.0%	9.0%	*7.0%*

Cal-endar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2000	64.5	68.5	73.3	69.2	275.5
2001	70.2	77.3	84.7	75.1	307.3
2002	71.7	76.6	91.9	81.8	322.0
2003	80.5	83.4	*106*	*95.1*	*365*
2004	*97.0*	*107*	*120*	*111*	*435*

Cal-endar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2000	.13	.15	.19	.15	.62
2001	.14	.18	.22	.14	.68
2002	.14	.16	.25	.17	.72
2003	.15	.18	*.26*	*.21*	*.80*
2004	*.18*	*.21*	*.30*	*.21*	*.90*

Cal-endar	QUARTERLY DIVIDENDS PAID B ■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
1999	.087	.087	.092	.092	.36
2000	.092	.092	.092	.099	.38
2001	.099	.099	.099	.106	.40
2002	.106	.106	.106	.112	.43
2003	.112	.112	.112		

BUSINESS: Philadelphia Suburban Corp., parent of Philadelphia Suburban Water Co. (PSWC), a regulated utility, provides water to approximately 2.5 million residents in Pennsylvania, Ohio, New Jersey, Illinois, Maine, North Carolina, Texas, Florida, and seven other states. Divested three of four non-water businesses in '91; telemarketing group in '93; and others. Acquired Consumers Water, 4/99; AquaSource, 7/03; and others. Water supply revenues '02: residential, 61%; commercial, 17%; industrial & other, 22%. Officers and directors own 1.6% of the common stock (4/03 Proxy). Chairman & CEO: Nicholas DeBenedictis. Incorporated: Pennsylvania. Address: 762 Lancaster Avenue, Bryn Mawr, Pennsylvania 19010. Telephone: 610-527-8000. Web: www.suburbanwater.com.

Philadelphia Suburban recently completed its acquisition of AquaSource for around $195 million in cash, financed largely with proceeds from the issuance of unsecured debt.

We think the transaction augurs well for the water utility. AquaSource brings roughly 130,000 customer accounts, and an additional 40,000 customers via integrated operating and maintenance contracts. What's more, a considerable number of these customers are in new service territories with fast-growing populations, particularly Florida, Texas, Virginia, and Indiana. Lastly, we estimate that AquaSource will add about a penny to Philadelphia Suburban's share earnings this year, and improvements in operating efficiencies could well lead to even more accretion to the bottom line in 2004 and afterward.

The company has generated solid results of late. This partly reflects additional revenues arising from new contracts and acquisitions. It is also benefiting from higher water rates in Pennsylvania, New Jersey, Ohio, and Maine. At this point in time, we look for share earnings to be $0.80 and $0.90 in 2003 and next year, respectively. *(Note that all per-share information was restated to reflect the five-for-four stock split payable on December 1st.)*

Philadelphia Suburban ought to continue to expand through the purchase of public and private water systems. The cost of maintaining the water industry's infrastructure has been on the rise over the past several years, largely the result of environmental regulations calling for increased purification standards for drinking water. Given this operating environment, a number of smaller water firms have concluded that their interests are better served by selling out to the bigger players, such as Philadelphia Suburban. (Future acquisitions are excluded from our presentation because of timing issues and other uncertainties involved with that strategy.)

These shares offer unexciting 3- to 5-year total-return potential. Too, they're ranked to perform only in line with the broader market averages for the coming six to 12 months.

Frederick L. Harris, III *October 31, 2003*

(A) Primary shares outstanding through '96: diluted thereafter. Excl. nonrec. gains (losses): '90, (38¢); '91, (34¢); '92, (38¢); '99, (11¢); '00, 2¢; '01, 2¢; '02, 5¢. Excl. gain from disc. operations: '96, 2¢. Next earnings report due early Nov. (B) Dividends historically paid in early March, June, Sept. & Dec. ■ Div'd. reinvestment plan available. (C) In millions, adjusted for stock splits. (D) Return on common equity allowed by PA PUC in '91 rate adjustment: 12.0%. Return on avg. common equity in '02, 13.9%.

Company's Financial Strength	B+
Stock's Price Stability	85
Price Growth Persistence	95
Earnings Predictability	100

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CONN. WATER SERVICES NDQ–CTWS

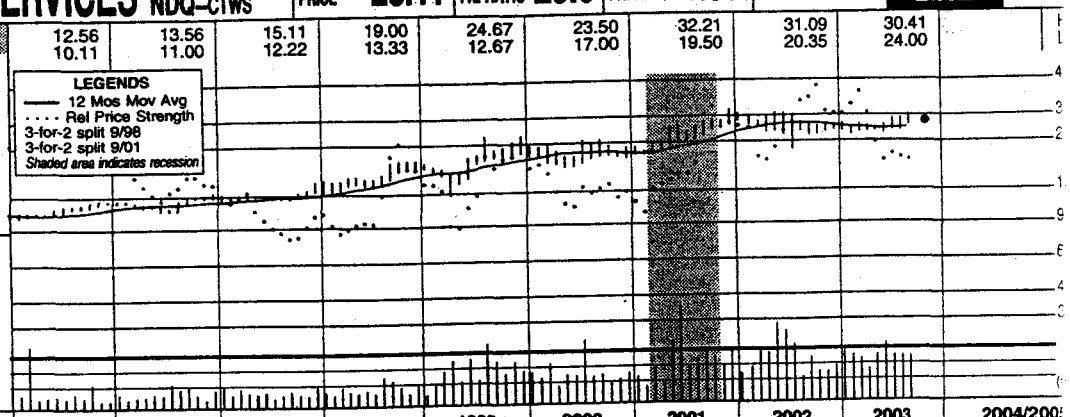
RECENT PRICE	TRAILING P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
28.11	25.6	1.36	3.0%	471

12.56	13.56	15.11	19.00	24.67	23.50	32.21	31.09	30.41
10.11	11.00	12.22	13.33	12.67	17.00	19.50	20.35	24.00

RANKS

PERFORMANCE	4	Below Average
Technical	3	Average
SAFETY	3	Average
BETA .60		(1.00 = Market)

Financial Strength	B++
Price Stability	85
Price Growth Persistence	60
Earnings Predictability	95



© VALUE LINE PUBLISHING, INC.	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004/2005
SALES PER SH	5.88	5.69	5.67	5.58	5.87	5.70	5.93	5.77	--	
"CASH FLOW" PER SH	1.42	1.46	1.51	1.59	1.65	1.73	1.78	1.78	--	
EARNINGS PER SH	.96	.97	1.00	1.02	1.03	1.09	1.13	1.12	NA	NA/NA
DIV'DS DECL'D PER SH	.75	.76	.77	.78	.79	.79	.80	.81	--	
CAP'L SPENDING PER SH	1.38	1.62	1.99	1.12	1.42	1.43	1.86	1.98	--	
BOOK VALUE PER SH	7.74	8.03	8.26	8.52	8.61	8.92	9.25	10.06	--	
COMMON SHS OUTST'G (MILL)	6.69	6.78	6.79	6.80	7.26	7.28	7.65	7.94	--	
AVG ANN'L P/E RATIO	11.7	12.5	12.9	15.5	18.2	18.2	21.5	24.3	NA	NA/NA
RELATIVE P/E RATIO	.78	.78	.74	.81	1.04	1.18	1.10	1.33	--	
AVG ANN'L DIV'D YIELD	6.6%	6.2%	6.0%	4.9%	4.2%	4.0%	3.3%	3.0%	--	
SALES ($MILL)	39.4	38.6	38.5	37.9	42.6	41.5	45.4	45.8	--	
OPERATING MARGIN	60.8%	44.9%	45.5%	46.2%	48.7%	48.8%	56.1%	57.7%	--	
DEPRECIATION ($MILL)	3.2	3.3	3.5	3.9	4.5	4.7	5.0	5.4	--	
NET PROFIT ($MILL)	6.4	6.6	6.8	7.0	7.5	8.0	8.7	8.8	--	
INCOME TAX RATE	43.8%	37.0%	35.1%	34.3%	40.1%	35.7%	36.1%	33.8%	--	
NET PROFIT MARGIN	16.2%	17.1%	17.7%	18.4%	17.6%	19.2%	19.1%	19.2%	--	
WORKING CAP'L ($MILL)	d4.7	d7.9	d10.4	d3.7	d3.8	.3	d3.3	d5.1	--	
LONG-TERM DEBT ($MILL)	54.5	54.4	54.5	62.5	65.4	64.7	64.0	64.8	--	
SHR. EQUITY ($MILL)	52.6	55.2	56.8	58.7	63.3	65.7	71.6	80.7	--	
RETURN ON TOTAL CAP'L	7.8%	7.6%	7.7%	7.3%	7.4%	7.6%	7.9%	7.4%	--	
RETURN ON SHR. EQUITY	12.1%	12.0%	12.0%	11.9%	11.8%	12.1%	12.1%	10.9%	--	
RETAINED TO COM EQ	2.7%	2.7%	2.8%	2.8%	3.1%	3.2%	3.6%	3.1%	--	
ALL DIV'DS TO NET PROF	78%	78%	77%	76%	74%	74%	71%	72%	--	

Bold figures are consensus earnings estimates and, using the recent price, P/E ratios.

Note: No analyst estimates available.

ANNUAL RATES

of change (per share)	5 Yrs.	1 Yr.
Sales	--	-2.5%
"Cash Flow"	4.0%	-0.5%
Earnings	2.5%	-1.0%
Dividends	1.0%	1.0%
Book Value	3.5%	8.5%

Fiscal Year	QUARTERLY SALES ($mill.) 1Q	2Q	3Q	4Q	Full Year
12/31/01	10.2	11.0	13.5	10.7	45.4
12/31/02	10.3	10.7	13.8	11.0	45.8
12/31/03	10.9	10.8			
12/31/04					

Fiscal Year	EARNINGS PER SHARE 1Q	2Q	3Q	4Q	Full Year
12/31/00	.22	.25	.37	.25	1.09
12/31/01	.30	.25	.38	.20	1.13
12/31/02	.19	.24	.50	.19	1.12
12/31/03	.26	.15			
12/31/04					

Cal-endar	QUARTERLY DIVIDENDS PAID 1Q	2Q	3Q	4Q	Full Year
2000	.198	.198	.20	.20	.80
2001	.20	.20	.202	.202	.80
2002	.202	.202	.205	.205	.81
2003	.205	.205	.208		

INSTITUTIONAL DECISIONS

	4Q'02	1Q'03	2Q'03
to Buy	19	13	20
to Sell	7	12	11
Hld's(000)	1189	1157	1123

ASSETS ($mill.)	2001	2002	6/30/03
Cash Assets	.1	.5	.9
Receivables	8.2	8.8	8.1
Inventory (Avg cost)	.9	1.0	.9
Other	.2	.1	.5
Current Assets	9.4	10.4	10.4
Property, Plant & Equip, at cost	283.7	321.5	--
Accum Depreciation	78.0	88.8	--
Net Property	205.7	232.7	233.4
Other	16.6	21.7	21.8
Total Assets	231.7	264.8	265.6
LIABILITIES ($mill.)			
Accts Payable	6.1	6.5	3.5
Debt Due	4.0	7.2	10.3
Other	2.6	1.8	.5
Current Liab	12.7	15.5	14.3

LONG-TERM DEBT AND EQUITY as of 6/30/03

Total Debt $74.9 mill. Due in 5 Yrs. NA
LT Debt $64.6 mill.
Including Cap. Leases NA (44% of Cap'l)

Leases, Uncapitalized Annual rentals NA

Pension Liability None in '02 vs. None in '01

Pfd Stock $.8 mill. Pfd Div'd Paid NMF (1% of Cap'l)

Common Stock 7,960,146 shares (55% of Cap'l)

INDUSTRY: Water Utility

BUSINESS: Connecticut Water Services, Inc. acts as parent company of The Connecticut Water Co. and o subsidiaries, which supply water for residential, comm cial, industrial, and municipal purposes in Connecti Sales and distributions are affected by seasonal weat fluctuations throughout the year. Profitability is depen on numerous factors, such as the quantity of rainfall temperature in a given period of time, industrial dema prevailing rates of interest for short-term and long-t borrowings, energy rates, and compliance with environm tal and water-quality regulations. Connecticut Water o and operates 10 water filtration treatment plants, includ the Guilford Well, Rockville, Westbrook Well, MacKen Hunt Well Field, Stafford Springs, and Reynolds Bri Has 191 employees. Chairman, C.E.O. & President: M shall T. Chiaraluce. Inc.: CT. Address: 93 West Main St Clinton, CT 06413. Tel.: 860 669-8636. Inter http://www.ctwater.com.

October 31, 2003

TOTAL SHAREHOLDER RETURN

Dividends plus appreciation as of 9/30

3 Mos.	6 Mos.	1 Yr.	3 Yrs.	5 Y
6.01%	2.76%	8.17%	37.64%	90.

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MIDDLESEX WATER NDQ-MSEX

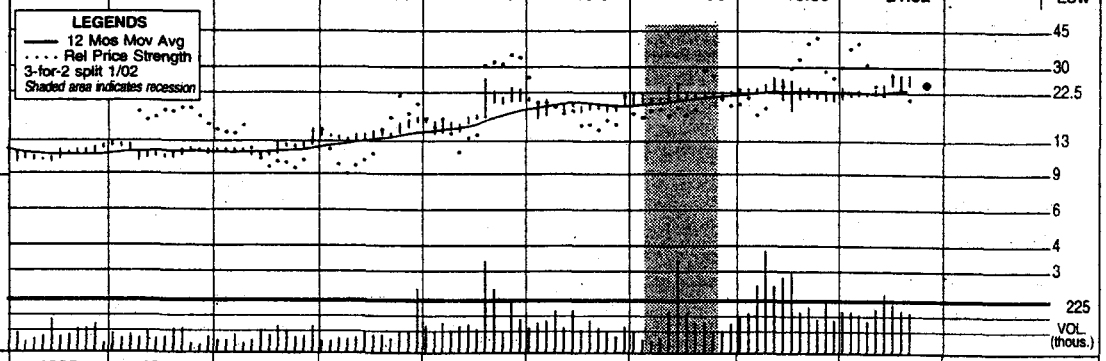
RECENT PRICE	TRAILING P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
24.70	26.3	1.39	3.5%	4714

RANKS

PERFORMANCE	3	Average
Technical	3	Average
SAFETY	2	Above Average
BETA .55		(1.00 = Market)

Financial Strength	B+
Price Stability	95
Price Growth Persistence	55
Earnings Predictability	70

1995	1996	1997	1998	1999	2000	2001	2002	2003	
12.50	12.83	15.00	17.17	26.33	22.63	24.97	26.72	28.30	High
10.17	10.33	10.92	12.83	14.00	16.67	19.58	18.30	21.02	Low



© VALUE LINE PUBLISHING, INC.	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004/2005
SALES PER SH	6.08	6.03	6.29	5.85	7.13	7.18	7.82	7.97	--	
"CASH FLOW" PER SH	1.34	1.26	1.36	1.36	1.58	1.32	1.57	1.61	--	
EARNINGS PER SH	.91	.80	.89	.94	1.01	.67	.88	.97	***1.00*** [A,B]	***1.15*** [C]***/NA***
DIV'DS DECL'D PER SH	.72	.74	.75	.77	.79	.82	.83	.85	--	
CAP'L SPENDING PER SH	1.44	.98	1.60	3.57	3.10	1.76	1.67	2.12	--	
BOOK VALUE PER SH	7.65	7.80	8.00	9.06	9.27	9.31	9.48	9.85	--	
COMMON SHS OUTST'G (MILL)	6.23	6.31	6.40	7.36	7.50	7.59	7.63	7.77	--	
AVG ANN'L P/E RATIO	12.2	14.4	13.4	15.2	17.6	28.7	24.6	23.5	***24.7***	***21.5/NA***
RELATIVE P/E RATIO	.82	.90	.77	.79	1.00	1.87	1.26	1.28	--	
AVG ANN'L DIV'D YIELD	6.5%	6.4%	6.3%	5.4%	4.4%	4.2%	3.8%	3.7%	--	
SALES ($MILL)	37.9	38.0	40.3	43.1	53.5	54.5	59.6	61.9	--	***Bold figures***
OPERATING MARGIN	38.8%	36.0%	37.2%	37.0%	33.9%	32.2%	47.2%	47.1%	--	***are consensus***
DEPRECIATION ($MILL)	2.8	2.9	3.1	3.8	4.3	4.9	5.3	5.0	--	***earnings***
NET PROFIT ($MILL)	5.7	5.2	5.9	6.5	7.9	5.3	7.0	7.8	--	***estimates***
INCOME TAX RATE	34.3%	32.8%	34.9%	31.5%	28.8%	33.1%	34.8%	33.3%	--	***and, using the***
NET PROFIT MARGIN	15.1%	13.6%	14.5%	15.1%	14.7%	9.7%	11.7%	12.5%	--	***recent prices,***
WORKING CAP'L ($MILL)	4.2	2.0	d2.9	14.6	6.8	d2.7	d.9	d9.3	--	***P/E ratios.***
LONG-TERM DEBT ($MILL)	53.0	53.0	52.9	78.0	82.3	81.1	88.1	87.5	--	
SHR. EQUITY ($MILL)	50.3	51.9	56.2	71.7	74.6	74.7	76.4	80.6	--	
RETURN ON TOTAL CAP'L	6.9%	6.4%	6.8%	5.7%	6.4%	4.9%	5.6%	6.0%	--	
RETURN ON SHR. EQUITY	11.3%	10.0%	10.4%	9.1%	10.6%	7.1%	9.1%	9.6%	--	
RETAINED TO COM EQ	2.4%	.8%	1.7%	1.8%	2.5%	NMF	.5%	1.3%	--	
ALL DIV'DS TO NET PROF	80%	92%	85%	81%	78%	121%	94%	87%	--	

[A] *No. of analysts changing earn. est. in last 11 days: 0 up, 0 down, consensus 5-year earnings growth 7.0% per year.* [B] *Based upon 2 analysts' estimates.* [C] *Based upon 2 analysts' estimates.*

ANNUAL RATES

of change (per share)	5 Yrs.	1 Yr.
Sales	4.5%	2.0%
"Cash Flow"	2.5%	2.0%
Earnings	-0.5%	10.0%
Dividends	2.5%	2.0%
Book Value	4.0%	4.0%

Fiscal Year	QUARTERLY SALES ($mill.) 1Q	2Q	3Q	4Q	Full Year
12/31/01	13.1	14.7	16.1	15.7	59.6
12/31/02	14.3	15.5	17.0	15.1	61.9
12/31/03	15.0	16.0			
12/31/04					

Fiscal Year	EARNINGS PER SHARE 1Q	2Q	3Q	4Q	Full Year
12/31/00	.12	.17	.19	.19	.67
12/31/01	.11	.24	.30	.23	.88
12/31/02	.16	.24	.32	.25	.97
12/31/03	.15	.22	***.34***	***.27***	
12/31/04	***.18***				

Cal-endar	QUARTERLY DIVIDENDS PAID 1Q	2Q	3Q	4Q	Full Year
2000	.203	.203	.203	.207	.82
2001	.207	.207	.207	.21	.83
2002	.21	.21	.21	.215	.85
2003	.215	.215	.215		

INSTITUTIONAL DECISIONS

	4Q'02	1Q'03	2Q'03
to Buy	17	15	18
to Sell	7	10	12
Hld's(000)	1206	1216	1250

ASSETS ($mill.)	2001	2002	6/30/03
Cash Assets	4.5	2.9	2.8
Receivables	9.5	9.2	10.2
Inventory (Avg cost)	1.0	1.2	1.4
Other	10.1	7.0	6.6
Current Assets	25.1	20.3	21.0
Property, Plant & Equip, at cost	242.7	259.3	--
Accum Depreciation	43.6	47.9	--
Net Property	199.1	211.4	216.9
Other	12.2	12.9	13.3
Total Assets	236.4	244.6	251.2
LIABILITIES ($mill.)			
Accts Payable	2.4	2.1	3.8
Debt Due	13.6	18.3	10.0
Other	10.0	9.2	10.2
Current Liab	26.0	29.6	24.0

LONG-TERM DEBT AND EQUITY as of 6/30/03

Total Debt $107.6 mill. **Due in 5 Yrs.** NA
LT Debt $97.5 mill.
Including Cap. Leases NA
(55% of Cap'l)

Leases, Uncapitalized Annual rentals NA

Pension Liability $5.3 mill. in '02 vs. $5.3 mill. in '01

Pfd Stock $4.1 mill. **Pfd Div'd Paid** $.3 mill.
(2% of Cap'l)

Common Stock 7,859,926 shares
(43% of Cap'l)

INDUSTRY: Water Utility

BUSINESS: Middlesex Water Company collects, treats, and distributes water for domestic, commercial, industrial, and fire-protection purposes. The company provides water services to retail customers primarily in eastern Middlesex County, NJ, where water services are furnished to approximately 57,000 retail customers, and in Delaware. The retail customers include residential customers, large industrial concerns, and commercial and light industrial facilities. The water utility plant consists of source of supply, pumping, water treatment transmission, distribution, and general facilities. Water is obtained from both surface and groundwater sources. It is also derived from groundwater sources equipped with electric-motor-driven, deep-well, turbine-type pumps. Has 199 employees. C.E.O. & President: Dennis Sullivan. Inc.: NJ. Address: 1500 Ronson Road, Iselin, NJ 08830. Tel.: (732) 634-1500. Internet: http://www.middlesexwater.com.

A.Z.

October 31, 2003

TOTAL SHAREHOLDER RETURN

Dividends plus appreciation as of 9/30/2003

3 Mos.	6 Mos.	1 Yr.	3 Yrs.	5 Yrs.
0.30%	12.85%	13.07%	40.75%	110.17%

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SJW CORP. AMEX–SJW

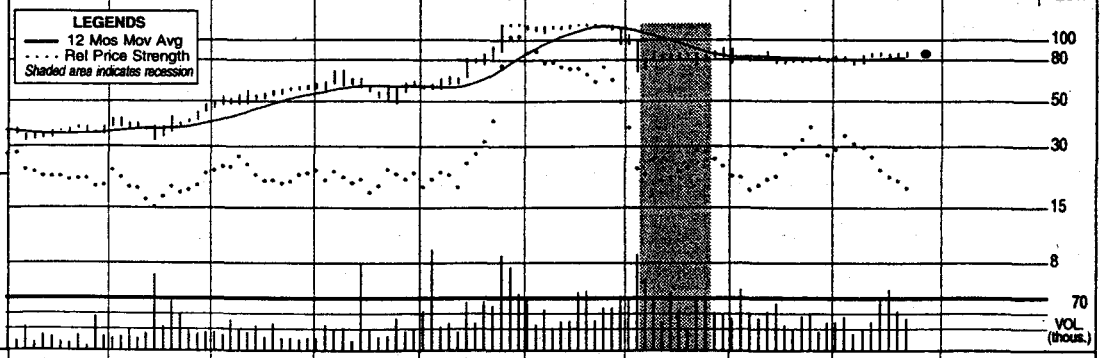
RECENT PRICE	TRAILING P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	VALUE LINE
85.82	14.4	0.76	3.4%	4715

RANKS

PERFORMANCE	3	Average
Technical	3	Average
SAFETY	2	Above Average
BETA .50	(1.00 = Market)	

Financial Strength	B++
Price Stability	100
Price Growth Persistence	65
Earnings Predictability	70

									High
37.88	48.25	60.50	71.50	121.00	122.00	107.00	90.40	88.49	High
31.25	32.00	46.00	48.50	57.25	95.00	69.50	76.00	75.40	Low



© VALUE LINE PUBLISHING, INC.	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004/2005
SALES PER SH	29.96	32.36	34.72	33.47	38.42	40.44	44.69	47.83	--	
"CASH FLOW" PER SH	5.90	8.59	7.59	7.57	8.58	7.39	8.95	9.28	--	
EARNINGS PER SH	3.55	5.75	4.80	4.54	5.20	3.50	4.60	4.67	NA	NA/NA
DIV'DS DECL'D PER SH	2.10	2.22	2.28	2.34	2.40	2.46	2.57	2.76	--	
CAP'L SPENDING PER SH	5.76	6.33	7.60	10.85	10.60	11.31	15.76	12.35	--	
BOOK VALUE PER SH	33.48	37.86	42.12	45.19	47.25	47.40	49.05	50.41	--	
COMMON SHS OUTST'G (MILL)	3.25	3.17	3.17	3.17	3.05	3.05	3.05	3.05	--	
AVG ANN'L P/E RATIO	9.9	6.8	11.2	13.1	15.5	33.1	18.5	17.3	NA	NA/NA
RELATIVE P/E RATIO	.66	.43	.65	.68	.88	2.15	.95	.94	--	
AVG ANN'L DIV'D YIELD	6.0%	5.7%	4.3%	3.9%	3.0%	2.1%	3.0%	3.4%	--	
SALES ($MILL)	97.4	102.6	110.1	106.0	117.0	123.2	136.1	145.7	--	*Bold figures are consensus earnings estimates and, using the recent prices, P/E ratios.*
OPERATING MARGIN	41.1%	34.4%	34.8%	36.0%	33.2%	30.2%	64.4%	63.7%	--	
DEPRECIATION ($MILL)	7.6	8.7	8.9	9.6	10.2	11.9	13.2	14.0	--	
NET PROFIT ($MILL)	11.5	18.6	15.2	14.4	15.9	10.7	14.0	14.2	--	
INCOME TAX RATE	40.2%	32.8%	39.9%	40.2%	35.9%	41.0%	34.5%	40.4%	--	
NET PROFIT MARGIN	11.8%	18.1%	13.8%	13.6%	13.6%	8.7%	10.3%	9.8%	--	
WORKING CAP'L ($MILL)	10.7	11.9	7.0	9.4	d3.0	d11.4	d3.8	d4.9	--	
LONG-TERM DEBT ($MILL)	76.5	75.0	75.0	90.0	90.0	90.0	110.0	110.0	--	
SHR. EQUITY ($MILL)	108.9	120.0	133.6	143.2	143.9	144.3	149.4	153.5	--	
RETURN ON TOTAL CAP'L	7.5%	11.0%	8.7%	7.4%	8.2%	5.9%	6.7%	6.9%	--	
RETURN ON SHR. EQUITY	10.6%	15.5%	11.4%	10.1%	11.0%	7.4%	9.4%	9.3%	--	
RETAINED TO COM EQ	4.2%	9.5%	6.0%	4.9%	5.9%	2.2%	4.1%	3.8%	--	
ALL DIV'DS TO NET PROF	61%	39%	48%	52%	46%	70%	56%	59%	--	

Note: No analyst estimates available.

ANNUAL RATES

of change (per share)	5 Yrs.	1 Yr.
Sales	6.5%	7.0%
"Cash Flow"	3.0%	3.5%
Earnings	-2.0%	1.5%
Dividends	3.5%	7.5%
Book Value	5.5%	3.0%

Fiscal Year	QUARTERLY SALES ($mill.) 1Q	2Q	3Q	4Q	Full Year
12/31/01	24.2	36.4	44.2	31.3	136.1
12/31/02	27.7	38.7	46.2	33.1	145.7
12/31/03	27.8	38.0			
12/31/04					

Fiscal Year	EARNINGS PER SHARE 1Q	2Q	3Q	4Q	Full Year
12/31/00	.44	.89	1.63	.54	3.50
12/31/01	.22	1.37	2.10	.91	4.60
12/31/02	.57	1.31	1.90	.89	4.67
12/31/03	1.73	1.46			
12/31/04					

Cal-endar	QUARTERLY DIVIDENDS PAID 1Q	2Q	3Q	4Q	Full Year
2000	.615	.615	.615	.615	2.46
2001	.615	.652	.652	.652	2.57
2002	.69	.69	.69	.69	2.76
2003	.728	.728	.728		

INSTITUTIONAL DECISIONS

	4Q'02	1Q'03	2Q'03
to Buy	22	19	24
to Sell	8	10	16
Hld's(000)	644	652	688

ASSETS ($mill.)	2001	2002	6/30/03
Cash Assets	5.0	.3	.0
Receivables	13.6	13.9	21.0
Inventory (Avg cost)	.5	.5	.0
Other	1.3	4.0	1.3
Current Assets	20.4	18.7	22.3
Property, Plant & Equip, at cost	517.5	552.4	--
Accum Depreciation	149.7	161.6	--
Net Property	367.8	390.8	420.1
Other	42.8	43.7	50.2
Total Assets	431.0	453.2	492.6
LIABILITIES ($mill.)			
Accts Payable	.4	.4	5.3
Debt Due	11.5	11.5	6.4
Other	12.3	11.7	18.0
Current Liab	24.2	23.6	29.7

LONG-TERM DEBT AND EQUITY as of 6/30/03

Total Debt $126.2 mill. **Due in 5 Yrs.** NA
LT Debt $119.8 mill.
Including Cap. Leases NA (43% of Cap'l)

Leases, Uncapitalized Annual rentals NA

Pension Liability None in '02 vs. None in '01

Pfd Stock None **Pfd Div'd Paid** None

Common Stock 3,045,147 shares (57% of Cap'l)

INDUSTRY: Water Utility

BUSINESS: SJW Corp. operates as a holding company with two wholly owned subsidiaries: San Jose Water Co. and SJW Land Co. San Jose Water Co. is a public utility in the business of providing water service to a population of approximately 988,000 in an area comprising about 138 square miles in the metropolitan San Jose area. SJW Land Co. owns and operates parking facilities adjacent to the company's headquarters and the San Jose Arena. It also owns commercial buildings in San Jose and a 70% limited partnership interest in 444 West Santa Clara Street, L.P. SJW produces, purifies, and distributes water. The company's water supply is obtained from wells, surface run-off, or diversion and by purchases from the Santa Clara Valley Water District. Has 301 employees. Chairman: Drew Gibson. Inc.: CA. Address: 374 West Santa Clara Street, San Jose, CA 95196. Tel.: 408 279-7800. Internet: http://www.sjwater.com.

A.Z.

October 31, 2003

TOTAL SHAREHOLDER RETURN

Dividends plus appreciation as of 9/30/2003

3 Mos.	6 Mos.	1 Yr.	3 Yrs.	5 Yrs.
-0.00%	12.40%	12.18%	-22.34%	69.44%

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ARIZONA-AMERICAN WATER COMPANY
COMPARISON OF DIVIDEND YIELDS USING
RUCO WATER UTILITIES

Company	Book Value	Stock Price	Div. Yield	Div./Book	Difference in Yield
American States Water	14.02	24.41	3.6	6.3	2.7
California Water Services	12.81	27.06	4.2	8.8	4.6
Philadelphia Suburban	7.76	24.44	2.3	7.2	4.9
AVERAGE YIELD			3.37	7.43	4.07

Source: C.A. Turner Utility Reports (November 2003). Stock price at October 20, 2003.

1489537.1/73244.034

EXHIBIT
A-84
Admitted

ARIZONA-AMERICAN WATER COMPANY
RUCO DCF COST OF EQUITY
USING BOOK DIVIDEND YIELD

Company	Book Dividend Yield	Growth Rate	DCF Cost of Equity
American States Water	6.3%	4.70%	11.00%
California Water Services	8.8%	4.31%	13.11%
Philadelphia Suburban	7.2%	8.91%	16.11%
WATER COMPANY AVERAGE			**13.41%**
ADJUSTMENT FOR ADD'L FINANCIAL RISK			**0.50%**
ARIZONA-AMERICAN COST OF EQUITY			**13.91%**

Source: Schedule WAR-3 and book dividend yields from C.A. Turner Utility Reports (November 2003).

1489536.1/73244.034

PLANT-IN-SERVICE LEDGER

01530400-AGUA FRIA WATER REPORT DATE 12/31/97 RUN DATE 01/12/98 PAGE 525

ACCT ACCOUNT DESCRIPTION	E-O	BEGINNING BALANCE	ADDITIONS	RETIREMENTS	ADJUSTMENTS	NET TRANSFERS	ENDING BALANCE
398.00 MISCELLANEOUS EQUIPMENT CONTD.							
*ACNT TOTAL		57,291.35	.00	.00	819.78-	.00	56,471.57
** DISTR TOTAL		10,198,100.23	13,167,558.30	10,500.00	312,151.97-	.00	23,043,006.56
*** SERVICE TOTAL		10,198,100.23	13,167,558.30	10,500.00	312,151.97-	.00	23,043,006.56
**** SUB/DIV TOTAL		10,198,100.23	13,167,558.30	10,500.00	312,151.97-	.00	23,043,006.56
			1	2	3		

1 − 2 + 3 = 12,844,906.33

(NET PLANT ADDITIONS)

EXHIBIT

A-85

Admitted

NATIONAL ASSOCIATION
OF
REGULATORY UTILITY
COMMISSIONERS

1996
Uniform System of Accounts
For
Class A
Water Utilities

EXHIBIT
A-86
Admitted

Pursuant to action by the National Association of Regulatory Utility Commissioners, this System of Accounts is recommended to the Commissions represented in the membership of this Association for consideration and for adoption in their respective jurisdictions with such modifications only as they may deem necessary in the public interest.

110.2 Accumulated Amortization of Utility Plant Leased to Others

A. This account shall be credited with amounts charged to account 413 - Income from Utility Plant Leased to Others, for the current amortization of limited-term or other investments subject to amortization included in account 102 - Utility Plant Leased to Others.

B. When any property to which this account applies is sold, relinquished or otherwise retired from service, this account shall be charged with the amount previously credited in respect to such property. The book cost of the property so retired less the amount chargeable to this account and less the net proceeds realized at retirement shall be included in account 414 - Gains (Losses) from Disposition of Utility Property, unless otherwise authorized or required by the Commission.

C. Records shall be maintained so as to show separately the balance applicable to each class of property which is being amortized.

D. The utility is restricted in its use of the accumulated provision for amortization to the purposes set forth above. It shall not transfer any portion of this account or make any other use thereof without authorization by the Commission.

Note:--See Accounting Instruction 8 and account 439 regarding adjustments for past accrued amortization.

114. Utility Plant Acquisition Adjustments

A. This account shall include the difference between (a) the cost to the accounting utility of utility plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated depreciation, accumulated amortization and contributions in aid of construction with respect to such property.

B. This account shall be subdivided so as to show the amounts included herein for each property acquisition and the amounts applicable to each utility department and to utility plant in service and utility plant leased to others (See Accounting Instruction 21).

C. The amounts recorded in this account with respect to each property acquisition shall be amortized, or otherwise disposed of, as the Commission may approve or direct.

115. Accumulated Amortization of Utility Plant Acquisition Adjustments

This account shall be credited or debited with amounts which are includible in account 406 - Amortization of Utility Plant Acquisition Adjustments, or account 426 - Miscellaneous Nonutility Expenses, for the purpose of providing for the extinguishment of amounts in account 114 - Utility Plant Acquisition Adjustments.

116. Other Utility Plant Adjustments

A. This account shall include the difference between the original cost, estimated if not known, and the book cost of utility plant to the extent that such difference is not properly includible in account 114 - Utility Plant Acquisition Adjustments (See Accounting Instruction 17C).

B. Amounts included in this account shall be classified in such manner as to show the origin of each amount and shall be disposed of as the Commission may approve or direct.

Note:--The provisions of this account shall not be construed as approving or authorizing the recording of appreciation of utility plant.

Other Property and Investments

121. Nonutility Property

A. This account shall include the book cost of land, structures, equipment or other tangible or intangible property owned by the utility, but not used in utility service and not properly includible in account 103 - Property Held for Future Use.

B. This account shall be subdivided so as to show the amount of property used in operations which are nonutility in character but nevertheless constitute a distinct operating activity of the company (such as plant merchandising and repair where such activity is not classed as utility) and the amount of miscellaneous property not used in operations. The records in support of each subaccount shall be maintained so as to show an appropriate classification of the property.

Note:--For transfers from utility plant accounts (see Accounting Instruction 29B).

ARIZONA-AMERICAN WATER COMPANY
2003 GENERAL RATE CASE
DOCKET NOS. WS-01303A-02-0867, 0868, 0869, 0870, and 0908
RESPONSE TO DATA REQUEST NO. AII 39-5

Response provided by: David P. Stephenson

Title: Director of Rates & Planning

Company Name: American Water Works Service Company
Address: 303 H Street, Suite 250
Chula Vista, CA 91910

Company Response Number: AII 39-5

Q. Provide an itemized list of all expense reductions implemented in 1999, 2000, and 2001 with regard to corporate overheads and service company charges. Provide a brief narrative description of each reduction and the amount of each reduction.

A. Qualification of response that follows: Arizona-American is not privy to the books and records of Citizens. Nor is Arizona-American privy to the rationale for the reductions that Citizens instituted during the pendency of the sale of their water and wastewater assets to the Company. However, I can provide the following response based on records that we do have in our possession and some understanding of the operations of Citizens before the finalization of the sale.

Attached hereto and attached to the response to DR AII 39-3 are copies of various overhead cost allocations of Citizens in the years requested. Also attached is a summary of the allocated charges to Arizona (not including labor or local overheads) from Citizens in 1999, 2000 and 2001. The summary provides a very telling story in that all of the 2001 costs from the three main centers (Louisiana Public Services, Stamford Office and Dallas Administrative Office) were reduced. There was an extremely significant reduction in the allocated costs from the Louisiana Public Service office in 2001. The Louisiana Public Service Office provided most of the accounting and billing services. This operation was being dismantled in 2001 since Citizens was selling all of its public utility service assets. There would be no use for the office after 2001. In fact, it is evident that the costs and services were being reduced by viewing the YTD Totals by PSS Company – Charges Allocated from Company 3999 (PSO) 2001 schedule attached to DR AII 39-3. The monthly charges shown on this sheet show that the costs started high in January 2001 ($1,048,758) and were reduced to -$32,984 by December. It is obvious that this center was closing operations. All accounting and billing services were reduced to only computer operations with no internal support by the end of 2001. Other reductions were also evident in the other offices, but not to the same extent.

EXHIBIT
A-87
Admitted

ARIZONA AMERICAN WATER COMPANY
ARIZONA DIVISION
ALLOCATION OF CORPORATE AND SERVICE COMPANY CHARGES
1999 THROUGH 2001

	1999	2000	2001
LA PUBLIC SERVICES	7,785,522	9,009,121	885,568
STAMFORD CORP.	1,737,725	1,407,890	1,298,517
DALLAS ADMIN OFFICE	464,425	232,730	144,104
Total	9,987,672	10,649,741	2,328,189

Overhead - not salaries & wages

1999

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4000* *Mohave Water*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	Ma
	Accounting	9,156	305	8,203	5,940	3,819	6,768	8,725	5,069	3,
	Corporate Admin	2	0	0	6	0	42	77	108	
	EH&S Security	1,222	-1,466	-444	745	2,820	951	1,625	1,484	1,
	Human Resources	9,047	3,107	5,546	16,642	2,323	8,805	5,626	8,749	6,
	Information Systems	9,138	-6,978	5,841	9,871	10,704	18,913	64,607	23,684	7,
	Legal & Regulatory	3,911	1,941	356	840	458	877	1,262	900	
	Marketing	158	199	154	102	26	147	170	552	
	Other Sector groups	2,155	1,135	2,006	1,644	2,155	2,336	2,528	1,504	2,
	Property Admin	80,577	2,588	75,311	75,551	56,733	68,119	81,222	56,107	51,
	Purchasing	697	-375	2,968	1,961	1,922	2,307	1,850	2,094	1,
Totals Company: Mohave Water		116,062	456	99,941	113,302	80,961	109,264	167,691	100,251	75,

$ = 862,928

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4002* *Tubac Valley*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	Ma
	Accounting	1,300	-1,279	936	648	2,660	494	715	725	
	Corporate Admin	0	0	0	0	0	3	6	9	
	EH&S Security	105	-289	-34	102	229	153	130	118	
	Human Resources	558	68	247	496	182	348	307	345	
	Information Systems	1,053	-24	659	769	537	1,358	1,407	2,015	
	Legal & Regulatory	610	-148	235	225	72	105	164	130	
	Marketing	13	16	9	8	2	12	14	-1	
	Other Sector groups	167	35	202	137	134	157	206	130	
	Property Admin	15,511	-1,422	11,862	12,044	8,856	11,557	12,529	12,799	6,
	Purchasing	57	-30	238	159	156	188	150	170	
Totals Company: Tubac Valley		19,374	-3,073	14,353	14,589	12,829	14,376	15,629	16,441	8,

$ = 112,518

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4003* *Sun City Water*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	May
	Accounting	20,863	-4,006	18,154	19,740	16,558	15,202	22,510	18,320	11,
	Corporate Admin	3	0	0	11	0	80	145	203	
	EH&S Security	9,144	-258	2,867	5,216	7,352	3,338	5,654	2,731	5,
	Human Resources	12,927	1,579	5,790	11,456	5,032	8,907	7,900	8,704	6,
	Information Systems	24,328	-570	15,394	18,308	20,006	35,052	32,592	51,095	17,
	Legal & Regulatory	14,056	-11,130	5,388	5,228	1,661	2,426	3,787	2,992	11,
	Marketing	297	373	297	192	49	276	1,439	-25	1,
	Other Sector groups	861	-7,107	17,286	9,317	6,923	3,637	4,752	3,009	9,
	Property Admin	207,115	54,815	222	275,757	2,112	262,234	157,645	229,237	165,
	Purchasing	1,308	-704	5,578	3,683	3,610	4,332	3,474	3,932	2,
Totals Company: Sun City Water		290,903	32,994	70,976	348,906	63,303	335,484	239,897	320,196	230,

$\Sigma = 1,932,659$

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4004* *Sun City Sewer*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	May
	Accounting	16,586	794	14,969	11,100	11,112	9,565	14,672	11,109	9,6
	Corporate Admin	3	0	0	9	0	67	122	171	
	EH&S Security	2,041	-5,628	-706	1,180	4,471	1,508	2,540	2,305	4,0
	Human Resources	9,840	-2,143	4,215	8,787	3,554	6,788	5,984	6,731	5,2
	Information Systems	20,536	-481	12,995	15,455	10,471	25,735	26,938	39,975	13,7
	Legal & Regulatory	11,848	-5,505	4,548	7,425	1,402	2,048	3,197	2,525	2,7
	Marketing	251	315	250	162	42	233	269	-21	1,3
	Other Sector groups	3,264	676	3,835	2,679	2,617	3,070	4,011	2,540	3,3
	Property Admin	144,948	-8,547	199,285	57,055	145,431	202,531	137,011	218,554	40,9
	Purchasing	1,104	-594	4,707	3,109	3,047	3,657	2,932	3,319	1,7
Totals Company: Sun City Sewer		210,421	-21,112	244,100	106,961	182,146	255,203	197,677	287,209	82,8

Σ = 1,545,405

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4005* *Sun City West Water*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	Ma
	Accounting	26,026	756	23,304	17,395	17,438	14,961	22,052	17,670	15,
	Corporate Admin	4	0	0	14	0	105	191	268	
	EH&S Security	3,193	-8,802	-1,103	1,846	6,993	2,359	3,973	3,606	6,
	Human Resources	16,174	-749	7,095	14,405	5,558	10,618	10,109	10,528	8,
	Information Systems	32,121	-752	20,326	24,172	16,378	40,253	42,134	62,525	21,
	Legal & Regulatory	18,588	-4,106	7,113	6,853	2,193	3,203	5,000	3,950	4,
	Marketing	392	493	388	253	65	364	422	-33	2,
	Other Sector groups	5,106	1,057	6,002	4,190	4,094	4,802	6,274	3,972	5,
	Property Admin	221,247	-24,638	92,794	223,694	74,243	267,369	178,267	189,018	333,
	Purchasing	1,727	-929	7,360	4,863	4,766	5,720	4,587	5,192	2,
Totals Company: Sun City West Water		324,577	-37,671	163,280	297,685	131,728	349,753	273,008	296,696	399,

$\Sigma = 2,198,056$

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4006* *Agua Fria*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	Ma
	Accounting	13,501	-1,795	12,030	8,994	9,615	8,390	11,906	8,615	7,
	Corporate Admin	2	0	0	7	0	49	90	126	
	EH&S Security	1,497	-4,127	-517	866	3,278	1,106	1,863	1,691	2,
	Human Resources	7,983	978	3,584	7,092	2,606	4,978	4,438	4,936	3,
	Information Systems	15,060	-353	9,530	11,333	7,679	18,873	19,755	29,315	10,
	Legal & Regulatory	10,486	-1,892	3,335	3,213	1,028	1,502	2,344	1,852	2,
	Marketing	184	231	181	119	31	171	198	-16	1,
	Other Sector groups	2,394	495	2,814	1,965	1,919	2,251	2,942	1,862	2,
	Property Admin	109,707	-13,862	87,564	85,836	26,379	112,136	105,735	187,046	41,
	Purchasing	810	-436	3,451	2,280	2,235	2,682	2,150	2,434	1,
Totals Company: Agua Fria		161,622	-20,760	121,973	121,703	54,770	152,139	151,420	237,861	72,

$\Sigma = 1,052,728$

Citizens Utilities

Billing Model Allocations - PSO Only By Company By Functional Group

Company: *4007* *Havasu Water*

Cost Center	Description	Dec 99	Nov TU	Nov 99	Oct 99	Sept 99	Aug 99	July 99	June 99	Ma
	Accounting	2,330	1,341	2,058	1,383	404	1,251	739	532	
	Corporate Admin	0	0	0	1	0	4	8	11	
	EH&S Security	123	-83	-46	79	298	101	169	154	
	Human Resources	915	-85	543	1,584	218	770	585	723	
	Information Systems	940	-1,131	625	1,043	1,021	1,953	7,303	2,503	
	Legal & Regulatory	340	471	51	89	48	93	133	95	
	Marketing	17	21	14	11	3	16	18	-1	
	Other Sector groups	228	120	216	174	228	247	267	159	
	Property Admin	6,589	-1,450	6,006	7,198	4,507	5,403	7,945	4,192	3,
	Purchasing	74	-40	310	207	203	244	195	221	
Totals Company: Havasu Water		11,556	-835	9,778	11,768	6,929	10,080	17,363	8,589	6,

$\Sigma = 81,228$

Arizona American
Summary Comparison of Corporate Overheads for 1999-2001*

Exhibit: 11
Witness: Bourassa
Page 1

	Citizens 1999*	Citizens 2000*	(A) Citizens Average 1999 and 2000	(B) Citizens 2001*	(B) minus (A) Difference	(C) Direct Proposed AZ-AM Overheads	(C) minus (A) Difference to 1999/2000 Average (Savings)
Agua Fria Water	$ 1,111,180	$ 1,356,653	$ 1,233,916	$ 491,297	$ (742,619)	$ 1,037,912	$ (196,004)
Tubac Water	122,761	156,314	139,537	34,142	(105,395)	71,759	(67,778)
Anthem Water	313,004	758,370	535,687	258,837	(276,850)	773,074	237,387
Anthem/Agua Fria Wastewater	275,516	456,527	366,022	96,252	(269,770)	434,130	68,109
Mohave Water	1,096,367	1,378,323	1,237,345	567,335	(670,011)	966,473	(270,872)
Havasu Water	107,360	146,181	126,770	74,569	(52,201)	146,126	19,356
Sun City West Water	1,013,582	1,457,380	1,235,481	476,262	(759,219)	816,355	(419,126)
Sun City West Wastewater	1,417,759	1,806,325	1,612,042	581,851	(1,030,191)	884,985	(727,057)
Sun City Water	721,584	2,318,280	1,519,932	409,839	(1,110,092)	1,787,102	267,171
Sun City Wastewater	1,190,274	986,865	1,088,570	595,292	(493,277)	824,032	(264,538)
Total	$ 7,369,388	$ 10,821,217	$ 9,095,303	$ 3,585,676	$ (5,509,627)	$ 7,741,949	$ (1,353,353)
				Rebuttal Adjustment		(1,159,535)	
				Net Rebuttal Amounts		$ 6,582,414	$ (2,512,889)

* Includes Salaries and Wages from Affiliates and Depreciation from Affiliates
Excludes purchased power and chemicals.

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Arizona American
Summary Comparison of Salaries and Wages for 1999-2001*

Exhibit: 11
Witness: Bourassa
Page 2

	1999*	2000*	(A) Citizens Average 1999 and 2000	(B) Citizens 2001*	(B) minus (A) Difference	(C) Direct Proposed AZ-AM Overheads	(C) minus (A) Difference to 1999/2000 Average (Savings)
Agua Fria Water	$ 574,805	$ 511,117	$ 542,961	$ 415,526	$ (127,435)	$ 632,324	$ 89,364
Tubac Water	70,569	69,905	70,237	60,230	(10,007)	77,690	7,453
Anthem Water	253,009	390,240	321,624	372,210	50,585	585,309	263,685
Anthem/Agua Fria Wastewater	161,073	182,956	172,014	139,311	(32,704)	317,956	145,942
Mohave Water	800,782	814,072	807,427	601,283	(206,144)	844,087	36,660
Havasu Water	84,809	92,051	88,430	59,845	(28,585)	138,514	50,084
Sun City West Water	628,699	560,033	594,366	392,023	(202,343)	455,889	(138,477)
Sun City West Wastewater	700,885	725,081	712,983	673,038	(39,945)	607,304	(105,678)
Sun City Water	1,193,214	1,068,798	1,131,006	833,976	(297,030)	1,167,073	36,067
Sun City Wastewater	1,508,816	914,583	1,211,700	332,698	(879,001)	160,653	(1,051,046)
Total	$ 5,976,662	$ 5,328,834	$ 5,652,748	$ 3,880,140	$ (1,772,608)	$ 4,986,800	$ (665,948)
				Rebuttal Adjustment		(880,633)	
				Net Rebuttal Amounts		$ 4,106,167	$ (1,546,581)

* Includes Salaries and Wages from Affiliates
Excludes purchased power and chemicals.

ARIZONA-AMERICAN WATER COMPANY
DOCKET NOS. WS-1303A-02-0867, ET AL
COMPARISON OF OVERALL OVERHEAD ADJUSTMENTS

	STAFF ADJUSTMENT #1	STAFF ADJUSTMENT #2	STAFF ADJUSTMENT #3	STAFF ADJUSTMENT #4	STAFF ADJUSTMENT #5	TOTAL
SSW - Water	$366,251	($515,886)	($300,468)	$396,788	($375,805)	($429,120)
SSW - Wastewater	$448,093	($552,478)	($332,507)	$740,228	($481,323)	($177,987)
SC - Water	$741,540	($926,122)	($860,980)	$948,649	($62,065)	($158,978)
SC - Wastewater	$437,588	($522,586)	($320,555)	$357,570	($96,303)	($144,286)
Havasu	$64,464	($75,244)	($70,882)	$67,795	($127,053)	($140,920)
Mohave	$436,643	($521,040)	($445,434)	$652,224	($621,259)	($498,866)
Agua Fria - Water	$385,897	($324,638)	($713,274)	$459,186	($546,577)	($739,406)
Anthem - Water	$188,806	($472,080)	($300,995)	$450,680	($400,165)	($533,754)
Ant/Agua - Wastewater	$83,978	($287,577)	($146,553)	$152,759	($227,320)	($424,713)
Tubac	$27,929	($38,653)	($33,106)	$86,512	($64,473)	($21,791)
TOTAL PER DIRECT	$3,181,189	($4,236,304)	($3,524,754)	$4,312,391	($3,002,343)	($3,269,821)
COMPANY REBUTTAL ADJUSTMENTS		$1,159,535	$21,282		$182,637	$1,363,454
TOTAL PER REBUTTAL	$3,181,189	($3,076,769)	($3,503,472)	$4,312,391	($2,819,706)	($1,906,367)

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Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR WATER UTILITY SERVICE	)	DOCKET NO. W-01445A-02-0619

DIRECT

TESTIMONY

OF

JOHN S. THORNTON, JR.

CHIEF, FINANCIAL & REGULATORY ANALYSIS SECTION

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 8, 2003

EXHIBIT
A-90
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tier is derived for each system depending on the system revenue requirement and rate design considerations. Mr. Ludders addresses revenue requirements and rates for the systems.

THE FIRST TIER – THE LIFELINE RATE

Q. What principle does Staff recommend for developing the first tier for the Eastern Group?

A. Staff recommends a lifeline rate; a rate that has a lower rate than the system's average commodity cost and that covers a minimum amount of gallons. The lifeline rate concept is appropriate for water pricing because it is the only utility commodity that is necessary for life and is actually ingested by consumers. The lifeline rate can provide affordable and available minimum amounts of water to a consumer. Staff recommends that the lifeline rate be set at an approximate twenty (20) percent discount to the second tier rate. Staff recommends that the first tier apply to the first three thousand gallons of consumption per customer.

Q. How did Staff choose the three thousand gallon break for the first tier?

A. Staff considered a number of factors, including the Arizona Department of Environmental Quality engineering standard for the minimum level of consumption: one hundred gallons per day per consumer. The three-thousand gallon break provides a minimum amount of water for one consumer per month given an average of about thirty days in any given month.

MARGINAL COST PRICING, REGULATION, AND ECONOMIC EFFICIENCY

Q. Has marginal cost pricing been used in setting utility rates in the United States?

Chapter 4

Inverted-Block Rates

INTRODUCTION

An inverted-block rate structure, sometimes termed "increasing blocks," "inclining blocks," or "inverted-pyramid" rates, incorporates a unit charge that increases with increasing consumption. This rate alternative requires a multiple blocking structure with the rate per unit of consumption increasing with each successive step.

The primary objective of establishing inverted-block rates is to reduce water use, particularly from the larger-volume customers that are charged the progressively higher rates. For this reason it is often characterized as a conservation rate.

Types of Inverted-Block Rates

While inverted-block rates may be based on one rate schedule applicable to all customers throughout the year, there are several possible variations.

Customer class. It is not uncommon to apply inverted-block rates by customer class. Under this variation, an inverted-block rate schedule is developed for each customer class. Rates under this method can be better designed to encourage large-volume customers within each class to reduce usage. The block(s) within each class can be set to reflect the usage characteristics of that class.

Ratchet variation. Another variation of this alternative involves a ratchet element whereby all usage, not just that falling within one block, is charged at the rate applicable to the highest block of consumption reached by a customer. By including a ratchet element, a stronger incentive to conserve is provided because reductions in consumption that drop total usage into a lower rate block will result in a reduction in the total cost of all water used by the customer, not just that used within the highest rate block.

Seasonal. Inverted-block rates may also be used on a seasonal basis when water reductions are primarily sought during the peak-use season. In this case, the inverted-block rates would apply only during the peak-demand season. Other rate forms are used during other times of the year.

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Reductions in Water Use

While inverted-block rates were once quite rare, many utilities, including some of the country's largest, have adopted such rates during the last decade. Inverted-block rates are most frequently used in the west, southwest, and eastern parts of the United States where water supply shortages are critical.

Three reasons are typically offered for targeting reductions in use by large-volume customers:

- Based on some price elasticity studies, larger-volume customers may have a greater response to price increases than smaller-volume customers. Since large-volume customers have larger total water bills, water reduction measures may be more economical for them.
- In cases where considerable reductions in water use are required, significant reductions by several large customers may meet the desired reduction goals.
- In some cases, larger-volume customers have a greater ability to absorb increased costs for water service. By shifting costs to larger-volume customers, the burden on smaller-volume customers is lessened.

Special Considerations

If an inverted-block rate is substituted for a declining-block rate with little or no increase in overall revenue requirements, the bills to smaller-volume customers may decrease. This could result in an undesired increase in use by smaller-volume customers, offsetting the original purpose of inverted-block rates to reduce overall consumption. The cost impact on all customers should be carefully examined. Determination of the number of blocks, usage break points, and rate differentials also requires careful analysis.

Another factor that must be carefully considered is the level of the rates, particularly the initial (lowest) rate block. In general, no rates should be set below the utility's variable production costs.

There are several factors that should be considered if an inverted-block rate is to be used.

Limited supply. Inverted-block rates are particularly applicable when customer water use exceeds or is approaching the utility's safe yield for water. It should also be determined if water usage by the large-volume customers can or will realistically be reduced. Since the main purpose of this rate alternative is to reduce customer usage, there may be no reason for its use if water supplies are adequate.

Inverted-block rates may or may not affect a utility's peak demands, depending upon the application. They may reduce peak demands if all or a majority of the consumption during the peak period is priced at the higher levels while consumption during the off-peak periods is priced at the lower levels, such as with a seasonal application. On the other hand, if (1) the peak period is of relatively short duration and little consumption during the peak period is priced at the higher levels, and (2) a majority of consumption during the off-peak periods is priced at the higher levels, the utility's peak may not be affected. The utility's ratio of peak to average demand may actually increase in this case since off-peak consumption is more affected.

Alternate sources. The adoption of an inverted-block rate may cause some larger customers to develop their own, less expensive water supplies. Since this will result in a reduction in the utility's overall supply requirements, such action may or may not be consistent with the objectives of this rate alternative, depending on the utility's source of supply.

Targeting discretionary uses. Inverted-block rates may be appropriate for utilities that serve a uniform customer base (essentially one customer class). In this case, higher volume uses may be discretionary uses that could be charged the higher rates under this rate alternative.

Targeting residential use. If the customer base is primarily residential, higher volume uses could typically be associated with extensive lawn watering and filling of swimming pools. In this case, an inverted-block rate would charge these uses at higher rates. Since some of these uses (lawn watering, for example) may also cause higher peak seasonal demands, an inverted-block rate may recover costs in proportion to use more approximately than other rate forms.

Incremental pricing. If the incremental cost of new supplies and/or treatment is higher than the cost of existing facilities, an inverted-block rate structure may be somewhat consistent with the economic theories surrounding marginal-cost rates (see chapter 10 on marginal-cost pricing). If the rate for the final (highest priced) block for all or most customers is set at the marginal or incremental cost of the new water supplies, customers would pay for their last increment of use (marginal use) at the marginal rates. The lower initial rate blocks could be set at levels such that the total revenue requirements of the utility are not exceeded. If smaller-volume users do not use enough to pay the higher (marginal) rate, they will not be sent the correct economic signal.

Discounted rates for low-income customers. Inverted-block rates may also be considered a form of lifeline rates (see chapter 3 on lifeline rates). In some cases, the initial rate block can be set at a level that provides for minimal sanitary water use requirements at a rate below the average cost of water. In this case, use deemed necessary can be provided at a reduced rate with subsequent usage by larger customers established at higher rates to recover the revenue loss that would result from the initial block use.

ADVANTAGES AND DISADVANTAGES

Financial Sufficiency

Inverted-block rates can result in revenue erosion and instability. Since the intent of this rate alternative is to reduce consumption, some change in revenue should be expected. Reductions in revenue and consumption could cause an increase in system average cost. The magnitude of the change can be difficult to predict because of such variables as weather, economic conditions, pricing, and customer response. Changes in customer water use magnify the revenue impacts since the changes take place at the higher rates of the inverted-block rate structure. Sufficient revenues under this alternative tend to be uncertain because the rates frequently do not correspond to the utility's costs.

Equity

A single inverted-block schedule typically will not reflect cost causation patterns, and may therefore be considered inequitable. Since large-volume customers generally are less costly to serve, a single inverted-block rate schedule will typically result in rates that do not correspond directly to costs. In some cases, this disadvantage may be reduced by implementing increasing block rates by customer class.

There may be situations where a single-schedule, inverted-block rate does correspond directly to costs. This would occur when large-volume customers have a relatively high peak-to-average demand ratio and are thus costly to serve. A

residential community with significant variations in customer lawn watering patterns would be another example.

Impact on Customers

The adverse impact of inverted-block rates on large-volume customers is an essential consideration. Depending on the existing rate form, the adoption of inverted-block rates can have substantial negative financial impacts on such customers. The degree of impact should be understood as should possible reactions by those customers. While significant reductions in water use or even withdrawal from the community water system may be desired, the utility should be aware that the lack of economically feasible alternatives for some customers may result in undesired plant closures and the resultant loss of water utility income, community jobs, and tax revenues. Further, the loss of revenues from larger users will generally result in eventual rate increases to remaining users because of an increase in the system average cost.

Depending on the level of rates and how rate blocks are set, the adoption of an inverted-block rate may result in rate decreases to some smaller-volume customers. While this may be politically popular, it sends the wrong economic signal to these customers, and may result in increased usage by these customers.

Simplicity

Since an inverted-block rate is essentially the opposite of a declining-block rate, it is readily understandable by customers.

Implementation

The development and implementation of an inverted-block rate structure requires a full billing analysis and a study of the impacts on various customers. An analysis of possible consumption and revenue impacts should also be undertaken.

Conservation

Inverted-block rates are primarily intended to encourage water use reduction, particularly from large-volume customers or larger-volume customers within a class. If conversion from an existing rate structure results in large water bill reductions for some smaller users, the reduction in use by large-volume users may be somewhat offset by increased usage by small users.

HISTORICAL PERSPECTIVE

The use of inclining-block rates in the water industry was quite uncommon several decades ago. With increased consumer activism and increasing attention to the adequacy of local water supplies, the use of increasing-block water rates is growing. In areas of the country where water supplies have become limited, its use is becoming common. A number of large cities have adopted inverted-block rates in one form or another.

EXAMPLE

An example of one inverted-block rate structure applicable to all customers is presented below. As shown in Table 4-1, the declining-block rate schedule presented in AWWA Manual M1 results in annual retail consumption revenues of $2,114,569.

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METERED WATER RATE SCHEDULE
Effective July 1, 2003

METER SIZE	BASE FEE	MONTHLY WATER USAGE FEE
5/8"	$ 10.92	First 7,500 @ $1.28/1000 gals Over 7,500 @ $2.33/1000 gals
3/4"	$ 15.06	First 8,300 @ $1.28/1000 gals Over 8,300 @ $2.33/1000 gals
1"	$ 22.86	First 12,600 @ $1.28/1000 gals Over 12,600 @ $2.33/1000 gals
1 1/2"	$ 41.99	First 23,100 @ $1.28/1000 gals Over 23,100 @ $2.33/1000 gals
2"	$ 62.44	First 34,300 @ $1.28/1000 gals Over 34,300 @ $2.33/1000 gals
3"	$108.96	First 60,000 @ $1.28/1000 gals Over 60,000 @ $2.33/1000 gals
4"	$167.37	First 92,000 @ $1.28/1000 gals Over 92,000 @ $2.33/1000 gals
6"	$311.42	First 171,000 @ $1.28/1000 gals Over 171,000 @ $2.33/1000 gals
8"	$459.32	First 252,000 @ $1.28/1000 gals Over 252,000 @ $2.33/1000 gals
Water Haulers	$ 6.48	First 3,800 @ $1.28/1000 gals Over 3,800 @ $2.33/1000 gals

Applicable taxes and environmental fees will be added.

RESIDENTIAL WATER SERVICE

WESTERN ZONE - Inside W1.1, Outside W2.1
RWCD ZONE - Inside W1.2, Outside W2.2
EASTERN ZONE - Inside W1.3, Outside W2.3
DESERT SAGE PRESSURE ZONE - Inside W1.4, Outside W2.4
COUNTY LINE PRESSURE ZONE - Inside W1.5, Outside W2.5
APACHE JUNCTION PRESSURE ZONE - Inside W1.6, Outside W2.6
RANGE RIDER PRESSURE ZONE - Inside W1.7, Outside W2.7

APPLICATION

Applicable to all residential water service inside and outside the City limits required for domestic purposes in individually metered dwelling units.

MONTHLY BILL

Rate: In addition to the service charge, the rate for water used shall be $1.77 per 1,000 gallons for the first 12,000 gallons used and $2.65 per 1,000 gallons for all additional use.

Service Charge:

$8.82	-	¾"service
$10.52	-	1"service
$16.83	-	1½"service
$23.73	-	2"service
$52.23	-	3"service
$85.83	-	4"service
$169.23	-	6"service
$253.19	-	8"service
$344.91	-	10"service

Plus: For all water used in the upper pressure zones, the following pumping surcharges will apply:

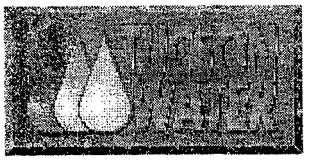
DESERT SAGE PRESSURE ZONE (W1.4, W2.4):	$.05 per 1,000 gallons
COUNTY LINE PRESSURE ZONE (W1.5, W2.5):	$.10 per 1,000 gallons
APACHE JUNCTION PRESSURE ZONE (W1.6, W2.6):	$.15 per 1,000 gallons
RANGE RIDER PRESSURE ZONE (W1.7, W2.7):	$.20 per 1,000 gallons

ADJUSTMENTS

Plus the applicable proportionate part of any taxes or governmental impositions that are assessed on the basis of the gross revenues of the City and/or the price or revenue from the energy or services sold hereunder.

TERMS AND CONDITIONS

See Terms and Conditions for the Sale of Utilities.



Current Water Rates

The current monthly water rates became effective October 14, 2002. Major rate elements are discussed below, followed by a listing of current r

Potable water charges have 1) **a monthly service charge** (based on meter size) whi the customer pays regardless of the amount of water used; 2) **usage charges;** and 3) **CAP charge**.

The **monthly service charge** based on meter size is set to recover the costs of meter maintenance and replacement as well as meter reading and billing costs.

Residential customers are charged for **water usage** via an inclining block rate struc As the usage block increases, the unit price or rate for the block increases.

Other potable customers, with the **exception of multifamily and construction wa customers,** pay a base rate for water usage year round but are subject, in addition, to surcharges in the summer, should their monthly usage exceed their winter monthly u There are two tiers of summer surcharges, and each has a different threshold: the firs applied to any monthly usage exceeding the average winter monthly usage and the se is applied to any monthly usage greater than 145% of average winter monthly usage. summer surcharges are added to the charge resulting from the base rate.

Multifamily and construction water customers are charged a year round rate with summer surcharges. For these customers, a higher year round rate replaces being sub to summer surcharges.

The **CAP charge**, a flat rate assessed on all potable usage, helps pay the cost of Cent Arizona Project (CAP) water which Tucson Water purchases from the Central Arizo Water Conservation District (CAWCD).

Reclaimed water charges have two basic components: **a monthly service charge** (l on meter size) which the customer pays regardless of the amount of water used; and **usage charge.**

POTABLE RATES

Minimum Monthly Charge:

Meter Size	Current Rates
0.75 inch	$5.35
1.00 inch	$6.99
1.50 inch	$10.73
2.00 inch	$15.41
2.50 inch	$21.73
3.00 inch	$28.05
4.00 inch	$45.84
6.00 inch	$90.78
8.00 inch	$135.71
10.00 inch	$205.92
12.00 inch	$338.39

Usage Charges:

Customer Class / Charge Categories	Current Charge per Ccf
Residential Block Rates	
Single Family	
1 – 15 Ccf	$1.03
16 – 30 Ccf	$3.50
31 – 45 Ccf	$4.92
Over 45 Ccf	$6.97
Duplex-Triplex	
1 – 20 Ccf	$1.03
21 – 35 Ccf	$3.50
36 – 50 Ccf	$4.92
Over 50 Ccf	$6.97
Non-Residential Rates – Base Volume Rates	

Multifamily	
All usage	**$1.59**
Mobile Home Parks with Sub-meters	
All usage	**$1.08**
Commercial	
All usage	**$1.48**
Industrial	
All usage	**$1.47**
Construction Water	
All usage	**$1.93**
Non-Residential Summer Surcharges	
Tier 1, per Ccf	**$.95**
Tier 2, per Ccf	**$.25**

Note: 1 Ccf = 748 Gallons

CAP Charge:

Current Charge per Ccf
$0.03

RECLAIMED WATER RATES

Monthly Service Charge:

Meter Size	Current Rates
0.75 inch	**$5.35**
1.00 inch	**$6.99**
1.50 inch	**$10.73**
2.00 inch	**$15.41**
2.50 inch	**$21.73**
3.00 inch	**$28.05**

4.00 inch	$45.84
6.00 inch	$90.78
8.00 inch	$135.71
10.00 inch	$205.92
12.00 inch	$338.39

Usage Charge:

Current Charge per Ccf
$1.31

Source: City of Tucson
Last Revision: Thursday, December 05, 2002

Arizona American
Test Year Ended December 31, 2001
Comparison of Present Rates and Arizona Corporation Commission Staff Direct Proposed Rates on Various Classes of Customers / Data From ACC Staff Schedules DDR-2

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Line No.	Division	Average Usage	Present Rates	ACC Staff Proposed Rates	Increase in Dollars	Increase in Percent	ACC Staff Rate Increase As a Percent
				STAFF RECOMMENDED			
1							
2	Division	Average Usage	Present Rates	ACC Staff Proposed Rates	Increase in Dollars	Increase in Percent	ACC Staff Rate Increase As a Percent
3	**Agua Fria Water**						
4	Residential 5/8"	7,002	$ 22.46	$ 18.72	$ (3.74)	-16.64%	-14.10%
5							
6	Commerical 6"	1,816,455	$ 4,465.18	$ 4,208.79	$ (256.39)	-5.74%	-14.10%
7							
8	**Anthem Water**						
9	Residential 5/8"	10,212	$ 36.42	$ 23.17	$ (13.25)	-36.38%	-14.67%
10							
11	Commerical 3"	201,964	$ 563.93	$ 404.86	$ (159.07)	-28.21%	-14.67%
12							
13	**Havasu Water**						
14	Residential 5/8" Summer Rate	7,659	$ 19.46	$ 16.91	$ (2.55)	-13.12%	-7.08%
15							
16	Residential 5/8" Winter Rate	7,659	$ 18.72	$ 16.91	$ (1.81)	-9.68%	-7.08%
17							
18	Multi-family 153 4" Summer Rate	192,500	$ 1,585.38	$ 1,667.01	$ 81.63	5.15%	-7.08%
19							
20	Multi-family 153 4" Winter Rate	192,000	$ 1,581.09	$ 1,667.01	$ 85.92	5.43%	-7.08%
21							
22	**Mohave Water**						
23	RS BCMI 5/8"						
24	(Residential 5/8 Inch Meter)	8,787	$ 20.18	$ 16.40	$ (3.78)	-18.74%	-15.58%
25	CM B004 2"						
26	(Commercial 2 Inch Meter)	118,000	203.32	$ 176.86	$ (26.46)	-13.01%	-15.58%
27							
28	**Sun City Water**						
29	Residential 5/8"	8,361	$ 11.17	$ 14.82	$ 3.65	32.65%	31.14%
30							
31	Commerical 6"	2,486,155	$ 2,426.74	$ 3,618.16	$ 1,191.42	49.10%	31.14%
32							
33	**Sun City West Water**						
34	Residential 5/8"	7,171	$ 11.67	$ 13.42	$ 1.75	15.03%	11.50%
35							
36	Commerical 4"	773,833	$ 968.17	$ 1,164.97	$ 196.80	20.33%	11.50%
37							
38	**Tubac Water**						
39	Residential 5/8"	13,177	$ 39.19	$ 53.00	$ 13.81	35.24%	34.74%
40							
41	Commerical 2"	159,167	$ 397.66	$ 753.68	$ 356.02	89.53%	34.74%

material recoverable is chargeable to materials and supplies, or other appropriate accounts.

9. "Service life" means the period between the date an asset is first devoted to public service and the date of its retirement from service.

B. All public service corporations shall maintain adequate accounts and records related to depreciation practices, subject to the following:
1. Annual depreciation accruals shall be recorded.
2. A separate reserve for each account or functional account shall be maintained.
3. The cost of depreciable plant adjusted for net salvage shall be distributed in a rational and systemic manner over the estimated service life of such plant.
4. Public service corporations having less than $250,000 in annual revenue shall not be required to maintain depreciation records by separate accounts but shall make annual composite accruals to accumulated depreciation for total depreciable plant.

C. Requests for depreciation rate changes and methods for estimating depreciation rates shall be as follows:
1. If a public service corporation seeks a change in its depreciation rates, it shall submit a request for such as part of a rate application in accordance with the requirements of R14-2-103.
2. A public service corporation may propose any reasonable method for estimating service lives, salvage values, and cost of removal. The method shall be fully described in a request to change depreciation rates.
3. Data and analyses supporting the change shall be submitted, including engineering data and assessment of the impact and appropriateness of the change for ratemaking purposes.
4. Changed depreciation rates shall not become effective until the Commission authorizes such changes.

D. Upon the motion of any party or upon its own motion, the Commission may determine that good cause exists for granting a waiver from one or more of the requirements of this Section.

Historical Note

Former Section R14-2-102 repealed, former Section R14-2-127 renumbered as Section R14-2-102 without change effective March 2, 1982 (Supp. 82-2). Forward to the rule corrected as filed April 13, 1973 (Supp. 89-1). Section R14-2-102 repealed, new Section adopted effective April 9, 1992 (Supp. 92-2).

R14-2-103. Defining Filing Requirements in Support of a Request by a Public Service Corporation Doing Business in Arizona for a Determination of the Value of Property of the Corporation and of the Rate of Return Thereon, or in Support of Proposed Increased Rates or Charges

A. Purpose and definitions
1. Purpose: The purpose of this General Order is to define the specific financial and statistical information required to be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return to be earned thereon, with regard to proposed increased rates or charges. This General Order does not apply to the implementation of previously approved adjustment or escalation clauses.
2. Applicability of rules: These rules shall apply to all electric, gas, telephone, telegraph, water and private fire protection public service corporations under the jurisdiction of the Commission. These rules are applicable both to all filings made after the effective date of this General Order and to any rate proceeding pending on the effective date of this General Order in which the Commission has issued no final decision. These rules are not intended to prohibit utilities from filing additional schedules, exhibits and other documents in which the Commission has issued no final decision. These rules are not intended to prohibit utilities from filing additional schedules, exhibits and other documents which may be material to the rate proceeding, nor are they intended to prohibit the Commission from considering such schedules, exhibits or other documents in making its determination. In pending proceedings, to the extent that the information required by this General Order is not included in the public service corporation's exhibits or is not otherwise in the record, such information shall be supplied as soon as possible unless a waiver is requested and granted pursuant to subsection (B)(5).
3. Definitions: Terminology used in this General Order is defined as follows:
a. "Accounting method" -- the accounting method prescribed or recognized by the Commission.
b. "Commission" -- The Arizona Corporation Commission.
c. "Cost of service" -- The total cost of providing service to a defined segment of customers, as determined by the application of logical and generally accepted cost analysis and allocation techniques.
d. "Department" -- A responsibility center within a combination utility where revenues and costs are accumulated by commodity or service rendered.
e. "Depreciated original cost" -- The cost of property to the person first devoting it to public service, less the depreciation reserve, which shall include accrued depreciation and amortization calculated in accordance with General Order R14-2-102. Depreciated original cost shall not include any goodwill or going concern value, nor shall it include certificate value in excess of payment made or costs incurred in the initial acquisition thereof.
f. "Exhibit" -- One or more schedules which support a rate filing or testimony in a rate proceeding.
g. "Filing" -- An application and required schedules, exhibits or other documents filed by a public service corporation to initiate any proceeding enumerated in subsection (A)(1). For all Class A and B utilities and for Class C electric and gas utilities, the filing shall include direct testimony in support of the application. For Class C water, sewer, and telephone utilities and for all Class D and E utilities, the filing shall include a written description of the components of the application. Nothing in this Section shall be construed to prohibit a public service corporation, prior to making a filing, from giving the Commission informal pre-filing notice of its intent to make a filing. Such pre-filing notice would permit the Commission, on a tentative basis, to assign a hearing date and would permit agreement on an appropriate test year.
h. "Original cost rate base" -- An amount consisting of the depreciated original cost, prudently invested, of the property (exclusive of contributions and/or advances in aid of construction) at the end of the test year, used or useful, plus a proper allowance for working capital and including all applicable pro forma adjustments.

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Admitted

i. "Pro forma adjustments" -- Adjustments to actual test year results and balances to obtain a normal or more realistic relationship between revenues, expenses and rate base.

j. "Projected year" -- The year immediately following the test year.

k. "Projections" -- Estimate of future results of operations based upon known facts or logical assumptions concerning future events.

l. "Prudently invested" -- Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made.

m. "Rate schedule" -- A schedule of rates and conditions for a specific classification of customer or for other specific services.

n. "Reconstructed Cost New (RCND) Rate Base" -- An amount consisting of the depreciated reconstruction cost new of the property (exclusive of contributions and/or advances in aid of construction) at the end of the test year, used and useful, plus a proper allowance for working capital and including all applicable pro forma adjustments. Contributions and advances in aid of construction, if recorded in the accounts of the public service corporation, shall be increased to a reconstruction new basis.

o. "Staff" -- The staff of the Commission or its designated representatives.

p. "Test year" -- The 1-year historical period used in determining rate base, operating income and rate of return. The end of the test year shall be the most recent practical date available prior to the filing.

q. "Utilities" -- For purposes of the Section, utilities are electric, gas, telephone, water, sewer or any other that may be supplying service and/or commodities which in the future may be adjudged a public service corporation and under the jurisdiction of this Commission, are classified as follows:

	Annual Operating Revenue				
	Class A	B	C	D	E
Electric & Gas	Exceeding $5,000,000	$1,000,000 to $5,000,000	$250,000 to $999,000	$50,000 to $249,999	Less than $50,000
Water & Sewer	Exceeding $5,000,000	$1,000,000 to $5,000,000	$250,000 to $999,000	$50,000 to $249,999	Less than $50,000
Telephone	Exceeding $1,000,000	$250,000 to $1,000,000	$100,000 to $249,000	$25,000 to $99,999	Less than $25,000

Annual operating revenues are those gross utility operating revenues derived from jurisdictional operations, including the requested rate relief. A combination utility is a utility which provides more than one of the commodities or services enumerated in this subsection. For combination utilities, the annual operating revenue, including the requested rate relief, for the specific subsidiary, department, or operating division requesting the rate change shall be used for classification purposes.

r. "Working capital" -- A proper allowance for cash, materials and supplies and prepayments.

B. Filing requirements:

1. Information required from Class A, B, C and D utilities except for electric distribution cooperatives whose filing requirements are detailed in subsection (B)(3): The information required to be prepared and submitted by Class A, B, C and D Utilities in conjunction with a filing is presented below. Corresponding schedule formats are contained in the Appendix of this General Order and denoted. These formats are not applicable to Class E utilities. The Appendix schedule formats A-1 through A-5 are a part of this General Order, and the Applicant's schedules should conform to these formats. All other Appendix schedule formats and descriptions are illustrative and the applicant's specific formats may vary from that suggested in the Appendix. The substantive information requested, both on the Appendix schedule and in the body of this General Order, however, must be contained on the applicant's schedules together with the titles and schedule numbers provided in the Appendix. Specific information items requested on the Appendix schedules may be omitted without formal waiver, from the filing where it is evident that said items are not applicable to the applicant's business. The instructions and notes contained on the Appendix schedules shall be followed where applicable. Reconstruction Cost New Depreciated information not filed by the applicant shall be deemed waived.

Information	Filing Required by	Appendix Schedule Reference(s)
A. Summary Information:		
1. A summary of the increase in revenue requirements and the spread of the revenue increase by customer classification.	All classes	A-1
2. A summary of the results of operations for the test year and for the test year and the 2 fiscal years ended prior to the end of the test year, compared with the projected year.	All classes	A-2
3 A summary of the capital structure for the test year and the 2 fiscal years ended prior to the end of the test year, compared with the projected year.	Classes A & B	A-3
4. Construction expenditures and gross utility plant in service for the test year and the 2 fiscal years ended prior to the end of the test year, compared with the projected year.	All classes	A-4

ARIZONA CORPORATION COMMISSION
REGULATION R14-2-103

APPENDIX A.
SUMMARY SCHEDULES

ARIZONA CORPORATION COMMISSION
REGULATION R14-2-103
APPENDIX
ILLUSTRATIVE SCHEDULE FORMAT

Schedule: A-1

Title: Computation of Increase in Gross Revenue Requirements.

Explanation:
Schedule showing computation of increase in gross revenue requirements and spread of revenue increase by customer classification.

Required For:

All Utilities	[x]	Special Reqmt.	[ ]
Class A	[ ]		
Class B	[ ]		
Class C	[ ]		
Class D	[ ]		

	Original Cost	RCND
1. Adjusted Rate Base	$ _____ (a)	$ _____ (a)
2. Adjusted Operating Income	$ _____ (b)	$ _____ (b)
3. Current Rate of Return	_____ %	_____ %
4. Required Operating Income	$ _____	$ _____
5. Required Rate of Return _____ %	_____ %	

6. Operating Income Deficiency (4 - 2)	$_____
7. Gross Revenue Conversion Factor	_____(c)
8. Increase in Gross Revenue Requirements (6 x 7)	$_____

Customer Classification	Projected Revenue Increase Due to Rates	% Dollar Increase
Residential	$	% (d)
	_____	_____
	$_____	_____ %

Note: For combination utilities, the above information should be presented in total and by department.

Supporting Schedules:
(a) B-1 (c) C-3
(b) C-1 (d) H-1

ARIZONA CORPORATION COMMISSION
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APPENDIX B
RATE BASE SCHEDULES

ARIZONA CORPORATION COMMISSION REGULATION R14-2-103 APPENDIX ILLUSTRATIVE SCHEDULE FORMAT	Schedule: B-1 Title: Summary of Original Cost and RCND Base Elements
Explanation: Schedule showing elements of adjusted original cost and RCND rate bases.	Required For: All Utilities [x] Special Reqmt. [ ] Class A [ ] Class B [ ] Class C [ ] Class D [ ]

	Original Cost Rate Base*	RCND Rate Base*
1. Gross Utility Plant in Service	$	
2. Less: Accumulated Depreciation	_____	_____
3. Net Utility Plant in Service	$ (a)	$ (b)
Less:		
4. Customers' Advances for Construction	(c)	(c)
5. Contributions in Aid of Construction	_____(c)_____	(c)
Add:		
6. Allowance for Working Capital	(d)	(d)
	_____	_____
7. Total Rate Base	$ _____(e)	$ _____(e)
* Including pro forma adjustments	_____	_____

Note: For combination utilities, above information should be presented in total and by department.

Supporting Schedules:
(a) B-2
(b) B-3
(c) E-1
(d) B-5
(e)

Recap Schedules:
A-1

ARIZONA CORPORATION COMMISSION
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APPENDIX
ILLUSTRATIVE SCHEDULE FORMAT

Schedule: B-2

Title: Original Cost Rate Base Pro forma Adjustments

Explanation:
Schedule showing pro forma adjustments to gross plant in service and accumulated depreciation for the original cost rate base.

Required For:

All Utilities	[x]	Special Reqmt.	[ ]
Class A	[ ]		
Class B	[ ]		
Class C	[ ]		
Class D	[ ]		

	Actual at End of Test Year (a)	Pro forma Adjustments A	B	Z	Adjusted at End of Test Year (b)
1. Gross Utility Plant in Service	$	$	$	$	$
2. Less: Accumulated Depreciation	_____	_____	_____	_____	_____
3. Net Utility Plant in Service	$ _____	$ _____	$ _____	$ _____	$ _____

All pro forma adjustments should be adequately explained on this schedule or on attachments hereto.

Note: For combination utilities, above information should be presented in total and by department.

Supporting Schedules:
(a) E-1
(b)

Recap Schedules:
B-1

ARIZONA CORPORATION COMMISSION
REGULATION R14-2-103
APPENDIX
ILLUSTRATIVE SCHEDULE FORMAT

Schedule: B-3

Title: RCND Rate Base Pro forma Adjustments

Explanation:
Schedule showing pro forma adjustments to gross plant in service and accumulated depreciation for the RCN rate base.

Required For:

All Utilities	[x]	Special Reqmt.	[ ]
Class A	[ ]		
Class B	[ ]		
Class C	[ ]		
Class D	[ ]		

	Actual at End of Test Year (a)	Pro forma Adjustments A	B	Z	Adjusted at End of Test Year (b)
1. Gross Utility Plant in Service	$	$	$	$	$
2. Less: Accumulated Depreciation	_____	_____	_____	_____	_____
3. Net Utility Plant in Service	$ _____	$ _____	$ _____	$ _____	$ _____

All pro forma adjustments should be adequately explained on this schedule or on attachments hereto.

Note: For combination utilities, above information should be presented in total and by department.

Supporting Schedules:
(a) B-4
(b)

Recap Schedules:
B-1

ARIZONA CORPORATION COMMISSION
REGULATION R14-2-103
APPENDIX
ILLUSTRATIVE SCHEDULE FORMAT

Schedule: B-4

Title: RCND by Major Plant Accounts

Explanation:
Schedule showing the determination of Reproduction Cost New Less Depreciation at end of Test Period.

Required For:

All Utilities	[x]	Special Reqmt.	[ ]
Class A	[ ]		
Class B	[ ]		
Class C	[ ]		
Class D	[ ]		

Plant Account	Description	RCN	Condition Percent	RCND
	Total (a)			

Note: For combination utilities, above information should be presented in total and by department.

Supporting Schedules:
RCND Study

a)

Recap Schedules:
B-3

ARIZONA CORPORATION COMMISSION REGULATION R14-2-103 APPENDIX ILLUSTRATIVE SCHEDULE FORMAT	Schedule: B-5 Title: Computation of Working Capital
Explanation: Schedule showing computation of working capital allowance.	Required For: All Utilities [x] Special Reqmt. [ ] Class A [ ] Class B [ ] Class C [ ] Class D [ ]

		Amount
1.	Cash working capital	$
2.	Materials and Supplies Inventories	(a)
3.	Prepayments	_____(a)
4.	Total Working Capital Allowance	$ _____(b)

NOTES:

1. Adequate detail should be provided to determine the bases for the above computations.
2. Adjusted test year operating expenses should be used in computing cash working capital requirements.
3. Combination utilities should compute working capital allowances for each department.

Supporting Schedules:
(a) E-1
b)

Recap Schedules:
B-1

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

DEC 1 2 2002

DOCKETED BY

EXHIBIT A-95 Admitted

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC. FOR A LIMITED WAIVER OF THE REQUIREMENTS OF A.A.C. R14-2-801, ET SEQ., AND CERTAIN RELATED RELIEF.

DOCKET NO. W-01303A-01-0983

DECISION NO. 65453

OPINION AND ORDER

DATE OF HEARING: August 8, 2002

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

APPEARANCES: Mr. Norman D. James and Mr. Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Applicant Arizona-American Water Company; and

Ms. Janet Wagner, Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On December 17, 2001, Arizona-American Water Company, an Arizona corporation ("Arizona-American"), filed an application with the Arizona Corporation Commission ("Commission") requesting a Commission declaration that the Commission's Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R14-2-801, *et seq.* ("Affiliated Interests Rules") do not apply to the transaction described in the application, or alternatively, requesting a limited waiver of the requirements of the Affiliated Interests Rules, solely with respect to the described transaction ("Application"). The transaction described in the Application consists of the proposed merger of Arizona-American's parent, American Water Works Company, Inc., a Delaware corporation ("American Water Works") with a subsidiary of RWE AG ("RWE"), a company organized under the laws of the Federal Republic of Germany. The described transaction includes the acquisition of American Water Works' outstanding shares of stock.

On January 15, 2002, at the request of the Commission's Utilities Division Staff ("Staff"), the

Commission suspended the Application for a period of 120 days.

On April 22, 2002, Arizona-American filed an amendment to the Application to include a Notice of Intent to Reorganize, pursuant to Section 803(A) of the Affiliated Interests Rules.[1] By its Application and subsequent amendment, Arizona-American requests either: 1) a declaration that the Commission lacks jurisdiction over the transaction; or 2) a waiver from the Affiliated Interests Rules with respect to the proposed transaction pursuant to A.A.C. R14-2-806; or 3) approval of the transaction as a reorganization of a holding company pursuant to A.A.C. R14-2-803.

On May 10, 2002, Staff requested that a hearing be held on this matter. Arizona-American consented to the procedural dates proposed by Staff, and by Procedural Order dated May 14, 2002, this matter was set for hearing.

Arizona-American provided public notice of the hearing as required by the May 14, 2002 Procedural Order. No requests for intervention were received.

A public hearing was held as scheduled on August 8, 2002, before a duly authorized Administrative Law Judge of the Commission. Arizona-American and Staff appeared through counsel and presented evidence. No members of the public appeared to provide public comment. Following the hearing, on September 6, 2002, Arizona-American and Staff submitted closing briefs, and the matter was taken under advisement.

DISCUSSION

A. The Proposed Transaction

The transaction underlying Arizona-American's Application is an agreement by American Water Works with RWE and Thames Water Aqua Holdings GmbH, a wholly-owned subsidiary of RWE ("Thames Holdings"). Pursuant to the agreement, all of American Water Works' issued and outstanding common stock will be acquired by Thames Water Aqua U.S. Holdings, a recently formed Delaware corporation and a wholly-owned subsidiary of Thames Holdings. Thames Water Aqua U.S. Holdings will be an American holding company, serving as a single "umbrella" company under which RWE plans to place all of its American water and wastewater assets. The acquisition of

[1] Arizona-American states that its amendment of the Application to include the Notice of Reorganization should not be construed as a waiver of its right to seek alternative relief, as may be appropriate.

American Water Works' common stock will be accomplished by means of a merger in which Apollo Acquisition Company, also a Delaware corporation controlled by Thames Holdings, will be merged with and into American Water Works, with American Water Works surviving the merger as a wholly owned subsidiary of Thames Water Aqua U.S. Holdings. In conjunction with the merger, Thames Water Aqua U.S. Holdings will purchase all of the issued and outstanding shares of American Water Works' common stock at $46.00 per share. Shareholder approval was obtained at a special meeting on January 17, 2002.

RWE, Germany's fifth largest industrial group, is an international multi-utility service provider with its core businesses in electricity, water, gas, waste management and other utility-related services.[2] Thames Holdings serves as a holding company for the water and wastewater operations under the RWE corporate umbrella. As stated above, Thames Water Aqua U.S. Holdings has been formed as the holding company for all of the water and wastewater operations in the United States. RWE has delegated the management of its various water operations worldwide to Thames Water PLC ("Thames Water"), a corporation organized under the laws of England and Wales and headquartered in London, which will be a sister affiliate of Thames Water Aqua U.S. Holdings. Thames Water is presently the third largest private water company in the world.[3]

Following the completion of the proposed transaction, American Water Works' shares of common stock would no longer be publicly traded, but would be held by Thames Water Aqua U.S. Holdings. American Water Works would remain in existence and become responsible for managing the Americas region (North and South America) of Thames Water, and would continue to be headquartered in Voorhees, New Jersey. Arizona-American would continue to be a wholly-owned subsidiary of American Water Works.

Arizona-American asserts that as a result of the proposed transaction, Arizona-American's local and regional management will not change, there will be no reduction in Arizona-American's

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[2] RWE has a business presence in more than 120 countries on six continents. RWE and its subsidiaries employ some 170,000 people, more than one-third of whom work outside of Germany, including more than 16,000 employees in the United States.

[3] Thames Water provides drinking water and wastewater treatment services to over 43 million people worldwide, including 12 million people in and around the City of London. In the United States, Thames Water has 880 employees staffing operations or offices in Houston, Pittsburgh, Cincinnati, Westfield, New Jersey, and Puerto Rico.

local staffing, there will be no changes in Arizona-American's rates and charges for service, and Arizona-American's capital structure will not change. Arizona-American's witness testified that there will be no request to recover any acquisition premium or any other costs associated with the proposed transaction, and that the proposed transaction will not cause any additional layer of management overhead to be allocated to Arizona-American. In addition, Arizona-American asserts that there will not be any cross-subsidization of any affiliates, and any transactions between Arizona-American and any "affiliate," as such term is defined in A.A.C. R14-2-801, will continue to be subject to the Affiliated Interests Rules and other regulatory requirements of the Commission.

Arizona-American believes that the proposed transaction is likely to generate benefits for Arizona-American and its utility customers. Arizona-American states that in addition to potential reductions in the cost of capital, Thames Water's extensive experience in managing water and wastewater operations throughout the world, when combined with the existing expertise of American Water Works' management, should enhance the quality of service provided to Arizona-American utility customers. Arizona-American states in support of this assertion that Thames Water, which manages water operations on six continents, has considerable experience in operating water systems in regions where security has been a significant concern for decades, and that Thames Water has an outstanding track record in terms of the quality of utility service it provides. Arizona-American claims that American Water Works and its subsidiaries, including Arizona-American, will benefit by becoming a part of an organization with significant expertise, greater access to capital, and greater economies of scale.

B. Conditions Proposed by Staff

Staff has recommended approval of the transaction pursuant to A.A.C. R14-2-803, subject to the following fifteen conditions:

#1 Arizona-American shall not seek recovery of any excess of cost over book value paid pursuant to the reorganization at any time in the future from this Commission.

#2 Arizona-American shall not seek recovery of any costs associated with the reorganization, including internal corporate costs, in any future Arizona rate proceeding.

#3 Arizona-American and its affiliates shall provide their books and records, upon request, in the Phoenix metropolitan area. Arizona-American and its affiliates shall also provide access to their books and records where such documents are maintained.

#4 Arizona-American shall not adjust any existing account amounts as a result of the reorganization. Arizona-American may make normal accounting adjustments that would have occurred absent the reorganization.

#5 In future rate proceedings filed after the effective date of the reorganization, Arizona-American shall have the burden of demonstrating that any cost overhead allocations and direct charges resulting from the reorganization including, but not limited to, the addition of layers of management, are reasonable and provide a net benefit to Arizona-American and/or its customers.

#6 Arizona-American shall not allow the reorganization to diminish local (Arizona) staffing that would result in service degradation.

#7 Arizona-American shall not allow its quality of service to diminish, the number of service complaints should not increase, the response time to service complaints should not increase, and service interruptions should not increase as a result of the reorganization.

#8 Arizona-American shall continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its service.

#9 If Arizona-American ever plans to share with affiliates, or other entities, any information made available to Arizona-American solely by virtue of the company/customer relationship, such as billing information and services received by a customer, it shall notify the Commission at least 180 days in advance. Such notice shall, at a minimum, identify the intended use of the information. Arizona-American shall also, at the time of the filing of the 180-day notice, file a tariff setting forth appropriate customer notification procedures to inform customers about the sharing.

#10 If Arizona-American ever shares any customer information with affiliates, or other entities, it shall maintain accurate records of revenues earned as a result and make those records available to Staff upon request with ten days' notice. For the purposes of this condition and Condition Nine above, customer information that is prohibited from disclosure does not include a customer's name, address or service location, and telephone number.

#11 Arizona-American shall not use any utility plant or other property, that is used or necessary for the provision of utility service, for any unregulated activity unless Arizona-American maintains appropriate books and record of account detailing the nature of such unregulated activity and providing appropriate allocations between

activities relating to Arizona-American's provision of utility service and the unregulated activity. Arizona-American's books and records concerning all unregulated activities shall be subject to the Commission's review and shall be made available in the Phoenix metropolitan area or, at the Commission's request, where the records are maintained, on ten days' notice.

#12 Arizona-American shall maintain a minimum common equity ratio of 35 percent of total capital. Arizona-American's total capital is defined as common equity, preferred equity, and long-term debt. Arizona-American shall not make remittances or pay dividends to American Water Works unless Arizona-American's common equity is at least 35 percent of total capital. If Arizona-American's common equity falls to 30 percent of total capital, American Water Works shall provide a cash infusion of equity sufficient to bring Arizona-American's common equity ratio back to a minimum of 35 percent of total capital. Arizona-American shall not be prohibited from requesting that the foregoing equity percentages be decreased based on changes to capital markets or other conditions that make it prudent to alter Arizona-American's capital structure.

#13 The cost of debt issued after the closing date of the reorganization, for purposes of setting rates in Arizona-American's rate proceedings, filed within ten years from the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baa1 (Moody's) or higher.

#14 Arizona-American and its affiliates agree that in future Commission proceedings, they shall not seek a higher cost of capital than that which Arizona-American would have been authorized as a stand-alone entity. Specifically, no capital financing costs (either debt or equity) should increase by virtue of the reorganization.

#15 Arizona-American shall refrain from filing any non-emergency rate increase requests for one year from the closing date of the reorganization; however, Arizona-American may file rate increase requests prior to the reorganization's closing date, and any such requests shall not be subject to the conditions set forth herein.

C. Conditions in Dispute

Arizona-American and Staff both stated at the hearing that the fifteen conditions recommended by Staff, that are set forth above, are the result of attempts by Arizona-American and Staff to resolve the parties' differences regarding the necessity of conditions on Commission approval of the proposed transaction. The parties are not in complete agreement on the language of Staff's recommended Conditions Five and Eight, and are in substantial disagreement on the substance of Conditions Three and Thirteen. Arizona-American believes that Staff's recommended Conditions Three and Thirteen are unnecessary.

1. Condition Three

In lieu of the Condition Three proposed by Staff, Arizona-American proposes a Condition Three as follows:

(Arizona-American)
Three. Arizona-American and its affiliates will comply with R14-2-801, *et seq.*, pertaining to affiliated interests, or seek Commission authorization for any waivers thereof, including the provisions of R14-2-804 relating to the transaction of business with and access to the books and records of any affiliate, including the production of records at Arizona-American's local business headquarters and elsewhere.

For purposes of comparison, Staff's proposed Condition Three is as follows:

(Staff)
Three. Arizona-American and its affiliates shall provide their books and records, upon request, in the Phoenix metropolitan area. Arizona-American and its affiliates shall also provide access to their books and records where such documents are maintained.

Arizona-American believes that the language Staff proposes for Condition Three goes beyond what is already required under the Affiliated Interests Rules. Arizona-American believes there is no reason to grant Staff *carte blanche* to examine the books and records of all RWE affiliates throughout the world, without regard to whether that affiliate has business dealings with Arizona-American. Arizona-American states that it is already prohibited, by A.A.C. R14-2-804(B), from transacting any business with an affiliate "unless the affiliate agrees to provide the Commission access to the books and records of the affiliate to the degree required to fully audit, examine or otherwise investigate transactions between the public utility and the affiliate." Arizona-American believes that the Commission may only regulate transactions between public utilities and their affiliates.

Staff argues that Arizona-American's proposal is not sufficient because it does not cover the other possible situations in which Staff may need access to the books and records of one of the Company's affiliates. Staff believes that there might be a need to look at the books and records of an affiliate that doesn't do business directly with Arizona-American, because Staff might perceive that the affiliate is causing costs to fall unfairly on Arizona-American's ratepayers.

We believe that, without provision of affiliate books and records to the Commission for

review, upon request, the Commission has no means of verifying whether transactions between a regulated public utility and its affiliate have occurred, and of thereby assessing possible ratemaking effects. The public interest requires that the Commission have access to such information. As Staff points out, Arizona-American's proposed Condition Three fails to recognize that the Commission's ratemaking authority extends beyond the requirements of the Affiliated Interests Rules. The Commission's constitutional ratemaking authority allows it to obtain information about a public service corporation's affiliates in order to be prepared to take action to prevent any negative consequences of intercompany transactions significantly affecting a public service corporation's structure or capitalization. This authority includes requiring access to a utility affiliate's books and records when such access is necessary for effective ratemaking. As a condition of approval of the proposed transaction, Arizona-American should be required to abide by Condition Three as proposed by Staff.

2. Condition Five

Staff proposes Condition Five as follows:

> Five. In future rate proceedings filed after the effective date of the reorganization, Arizona-American shall have the burden of demonstrating that any cost overhead allocations and direct charges resulting from the reorganization including, but not limited to, the addition of layers of management, are reasonable and provide a net benefit to Arizona-American and/or its customers.

Arizona-American has stated that it is willing to accept Condition Five based on its understanding that the term "net" is intended to indicate only that Arizona-American must benefit in some respect from the service being provided, without a quantifiable dollar amount being associated with the benefit. Staff believes, however, that the crucial question is whether the cost of a transaction is reasonable in relation to the benefit to Arizona-American and its customers. Staff believes that the term "net" implies a comparison, though not necessarily a numerical one. Both Arizona-American and Staff agree that a benefit must be shown. We believe that in the future rate proceedings referred to in this condition, in order for Arizona-American to recover any cost overhead allocations and direct charges resulting from the reorganization, Arizona-American should have the burden of demonstrating that such costs are reasonable in relation to the benefits conferred on Arizona-

American and its customers. We find that no change to the language recommended by Staff is required.

3. Condition Eight

Staff proposes Condition Eight as follows:

Eight. Arizona-American shall continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its service.

Arizona-American proposed at the hearing that a second sentence be added to Condition Eight, as follows: "However, Arizona-American is not precluded from making local operational changes in connection with integrating the water and wastewater systems acquired from Citizens Communications and any future acquisitions into Arizona-American's local operations." Staff stated at the hearing that elimination of the second sentence did not affect the meaning of Condition Eight. Arizona-American believes that Staff's testimony at the hearing clarified that the second sentence is not necessary to allow Arizona-American to make operational changes in connection with integrating the water and wastewater systems acquired from Citizens earlier this year, or other operational changes that relate to the provision of local services and are unconnected to the reorganization. Arizona-American states that it can agree to Condition Eight, based on Staff's testimony. We agree that the language of the first sentence does not preclude Arizona-American from making such changes, and will adopt the language of Condition Eight as recommended by Staff.

4. Condition Thirteen

Staff proposes Condition Thirteen as follows:

Thirteen. The cost of debt issued after the closing date of the reorganization, for purposes of setting rates in Arizona-American's rate proceedings, filed within ten years from the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baal (Moody's) or higher.

Arizona-American proposes that Condition Thirteen remain in effect for a period of three years, as opposed to the ten year period proposed by Staff.

Arizona-American objects to this condition because credit ratings involve subjective determinations made by investment services. Arizona-American states that its credit rating may be

affected by changes in regulatory requirements or other factors affecting the water utility industry or the economy generally, regardless of the business activities of RWE or its subsidiaries. Arizona-American therefore believes that Arizona-American should not be required to guarantee a minimum debt cost. In addition, Arizona-American states that Condition 13 could weaken it financially and lead to more frequent rate increase applications to maintain cash flows and debt service coverages. Further, Arizona-American believes that its acceptance of Condition Fourteen eliminates the possibility that an adverse credit rating will cause Arizona-American's cost of debt in a future rate proceeding to exceed the market cost of debt for a business organization comparable to Arizona-American.[4]

Staff states that although Arizona-American has suggested that the proposed transaction may benefit Arizona-American by lowering its cost of capital, such a benefit cannot be quantified and may not materialize, so Staff proposed Condition Thirteen to address the issue. Staff argues that Condition 13 is necessary to protect ratepayers from the potential of increased rates due to any possible downgrading in Arizona-American or its affiliates' bond ratings, and that its proposed ten-year protection period is a relevant time frame that provides better protection to Arizona ratepayers than Arizona-American's proposal of three years.

While we agree with Staff that the ratepayers should be protected from possible rate increase that may result from a possible downgrade of Arizona-American or its affiliates, we also recognize the subjective nature of determinations made by investment services and the possibility that the entire industry may suffer from a poor economy and/or volatile nature of today's capital markets. Further, we also recognize that Arizona-American could be subject to possible credit downgrade absent this merger, and that no protection for ratepayers currently exits to offset this possibility.

Based on the above, we find that Arizona-American's proposal to guarantee its credit rating for three years from the effective date of the reorganization is reasonable and shall adopt it for purposes of Condition 13.

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[4] Staff proposes Condition Fourteen as follows:

> Fourteen. Arizona-American and its affiliates agree that in future Commission proceedings, they shall not seek a higher cost of capital than that which Arizona-American would have been authorized as a stand-alone entity. Specifically, no capital financing costs (either debt or equity) should increase by virtue of the reorganization.

D. Rate Increase Moratorium

Condition 15 proposed by Staff would require Arizona-American to refrain from filing any non-emergency rate increase requests for one year from the closing date of the reorganization. We believe that increasing this moratorium from one year to three years is appropriate, as it would provide increased protection to Arizona-American's ratepayers. We will therefore amend Condition 15 as proposed by Staff to require that Arizona-American refrain from filing any non-emergency rate increase requests for three years from the closing date of the reorganization.

E. Conclusion

Staff and Arizona-American agree that as a result of the proposed transaction, Arizona-American may benefit from the lower cost of capital that RWE enjoys as compared to that of Arizona-American's affiliate, American Water Capital Corp., which currently provides debt capital to Arizona-American through its parent, American Water Works. Because RWE's credit ratings are superior to those of American Water Capital Corp. at the present time, and RWE has a substantially larger market capitalization than that available to Arizona-American through American Water Works and American Water Capital Corp., RWE currently has greater equity and debt financing capability than American Water Works and American Water Capital Corp.

Precise quantification of benefits to Arizona-American resulting from RWE's lower cost of capital is difficult, however, due to factors such as the maturity dates of existing debt, uncertainty concerning future levels of capital expenditures and associated financing requirements, and changes in interest rates and potential future changes in credit ratings. Utility rates can be impacted by holding company structure and capitalization, and we believe that utility ratepayers should not be required to bear the burden of financial risk resulting from holding company diversification. Understanding this, Staff has proposed fifteen conditions that it recommends we place upon our approval of the transaction. Staff believes its proposed conditions will provide Arizona-American's ratepayers with protection from the possible adverse effects of the reorganization. Arizona-American disagrees with certain of those conditions. We believe, however, that the public interest requires that the Commission apply the Affiliated Interests Rules in a manner that will maximize protection to ratepayers, and for the reasons stated above, we believe that approval of the transaction proposed in

the application should be made subject to the conditions as proposed by Staff and as amended herein.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Arizona-American is an Arizona corporation that has provided water utility service in portions of the Town of Paradise Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County for many years.[5]

2. All of Arizona-American's common stock was purchased by American Water Works in the late 1960s. Since that time, Arizona-American has been a wholly-owned subsidiary of American Water Works.

3. American Water Works is a Delaware corporation with headquarters located in Voorhees, New Jersey. American Water Works is a publicly-traded company, whose shares of common stock are traded on the New York Stock Exchange.[6]

4. In January 2002, Arizona-American completed the acquisition of the water and wastewater utility systems and assets of Citizens Communications Company in Arizona. As a result of that transaction, approved by the Commission in Decision No. 63584 (April 4, 2001), Arizona-American currently provides water and wastewater service to approximately 140,000 customers in Arizona. Consequently, Arizona-American is a Class A water utility, and is subject to the Commission's Affiliated Interests Rules.

5. On September 16, 2001, American Water Works entered an agreement with RWE to merge with one of RWE's subsidiaries. On January 17, 2002, at a special meeting, American Water

[5] Arizona-American was originally named Paradise Valley Water Company. The Company's name was changed to Arizona-American Water Company in January 2000.

[6] At present, there are approximately 100 million shares of American Water Works common stock issued and outstanding. American Water Works has more than 60 subsidiaries (both regulated and unregulated), which collectively have a

Works' shareholders approved Thames Water Aqua U.S. Holdings' purchase of all of the issued and outstanding shares of American Water Works' common stock at $46.00 per share, in conjunction with the merger.

6. On December 17, 2001, Arizona-American filed the Application with the Commission.

7. On January 15, 2002, at the request of Staff, the Commission issued Decision No. 64362, which suspended the Application for a period of 120 days.

8. On April 22, 2002, Arizona-American filed an amendment to the Application that contained the information required for a notice of intent to reorganize pursuant to A.A.C. R14-2-803(A). By its Application and the subsequent amendment, Arizona-American requests either: 1) a declaration that the Commission lacks jurisdiction over the transaction; or 2) a waiver from the Affiliated Interests Rules with respect to the proposed transaction pursuant to A.A.C. R14-2-806; or 3) approval of the transaction as a reorganization of a holding company pursuant to A.A.C. R14-2-803.

9. On May 10, 2002, Staff filed a Request for Procedural Order, requesting that deadlines be established for the filing of written testimony, the commencement of the hearing and certain other procedural matters. Arizona-American consented to the dates proposed by Staff.

10. The Commission issued a Procedural Order on May 14, 2002, setting this matter for hearing on August 8, 2002, and establishing the agreed-upon procedural deadlines.

11. On July 11, 2002, Arizona-American caused public notice of the hearing to be published in The Arizona Republic, a newspaper of general circulation within the State of Arizona.

12. The Commission received no intervention requests.

13. A public hearing was held on the Application on August 8, 2002. Arizona-American

business presence in 27 states and 3 Canadian provinces.

and Staff appeared through counsel and presented evidence. No persons appeared to provide public comment at the hearing.

14. Written public comments that advocated a thorough review of the application were filed in the docket on September 3, 2002.

15. The parties filed closing briefs on September 6, 2002.

16. The transaction described in the discussion above would result in a holding company structure that can be summarized as follows:

RWE AG, a company organized under the laws of the Federal Republic of Germany

↓

Thames Water Aqua Holdings GmbH, a holding company organized under the laws of the Federal Republic of Germany (wholly-owned by RWE AG)

↓

Thames Water Aqua U.S. Holdings, a Delaware Corporation (wholly-owned by Thames Water Aqua Holdings GmbH)

↓

American Water Works Company, Inc., a Delaware Corporation (wholly-owned by Thames Water Aqua U.S. Holdings)

↓

Arizona-American Water Company, Inc., an Arizona Corporation (wholly-owned by American Water Works Company, Inc.)

17. American Water Capital Corp. ("AWCC"), another American Water Works subsidiary, currently provides debt capital and financial management services to American Water Works and its utility subsidiaries, including Arizona-American.

18. Both Staff and Arizona-American agree that Arizona-American may benefit from the lower cost of capital that RWE enjoys as compared to AWCC. RWE's credit ratings are superior to those of AWCC at the present time, and RWE has a substantially larger market capitalization than that available to Arizona-American through American Water Works and AWCC. RWE therefore has greater equity and debt financing capability than American Water Works and AWCC. RWE also has access to the European capital market as well as the United States domestic market.

19. Precise quantification of benefits to Arizona-American resulting from RWE's lower cost of capital is difficult, due to factors such as the maturity dates of existing debt, uncertainty concerning future levels of capital expenditures and associated financing requirements, and changes in interest rates and potential future changes in credit ratings.

20. The credit rating of a parent company can positively impact the cost of capital of a utility affiliate, but it can also negatively impact it. If RWE's ratings were to fall in the future, the positive benefits that Arizona-American anticipates could fail to materialize and be replaced by negative ones.

21. Staff recommends that the Commission condition the approval of this transaction upon the following fifteen conditions:

#1 Arizona-American shall not seek recovery of any excess of cost over book value paid pursuant to the reorganization at any time in the future from this Commission.

#2 Arizona-American shall not seek recovery of any costs associated with the reorganization, including internal corporate costs, in any future Arizona rate proceeding.

#3 Arizona-American and its affiliates shall provide their books and records, upon request, in the Phoenix metropolitan area. Arizona-American and its affiliates shall also provide access to their books and records where such documents are maintained.

#4 Arizona-American shall not adjust any existing account amounts as a result of the reorganization. Arizona-American may make normal accounting adjustments that would have occurred absent the reorganization.

#5 In future rate proceedings filed after the effective date of the reorganization, Arizona-American shall have the burden of demonstrating that any cost overhead allocations and direct charges resulting from the reorganization including, but not limited to, the addition of layers of management, are reasonable and provide a net benefit to Arizona-American and/or its customers.

#6 Arizona-American shall not allow the reorganization to diminish local (Arizona) staffing that would result in service degradation.

#7 Arizona-American shall not allow its quality of service to diminish, the number of service complaints should not increase, the response time to service complaints

should not increase, and service interruptions should not increase as a result of the reorganization.

#8 Arizona-American shall continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its service.

#9 If Arizona-American ever plans to share with affiliates, or other entities, any information made available to Arizona-American solely by virtue of the company/customer relationship, such as billing information and services received by a customer, it shall notify the Commission at least 180 days in advance. Such notice shall, at a minimum, identify the intended use of the information. Arizona-American shall also, at the time of the filing of the 180-day notice, file a tariff setting forth appropriate customer notification procedures to inform customers about the sharing.

#10 If Arizona-American ever shares any customer information with affiliates, or other entities, it shall maintain accurate records of revenues earned as a result and make those records available to Staff upon request with ten days' notice. For the purposes of this condition and Condition Nine above, customer information that is prohibited from disclosure does not include a customer's name, address or service location, and telephone number.

#11 Arizona-American shall not use any utility plant or other property, that is used or necessary for the provision of utility service, for any unregulated activity unless Arizona-American maintains appropriate books and record of account detailing the nature of such unregulated activity and providing appropriate allocations between activities relating to Arizona-American's provision of utility service and the unregulated activity. Arizona-American's books and records concerning all unregulated activities shall be subject to the Commission's review and shall be made available in the Phoenix metropolitan area or, at the Commission's request, where the records are maintained, on ten days' notice.

#12 Arizona-American shall maintain a minimum common equity ratio of 35 percent of total capital. Arizona-American's total capital is defined as common equity, preferred equity, and long-term debt. Arizona-American shall not make remittances or pay dividends to American Water Works unless Arizona-American's common equity is at least 35 percent of total capital. If Arizona-American's common equity falls to 30 percent of total capital, American Water Works shall provide a cash infusion of equity sufficient to bring Arizona-American's common equity ratio back to a minimum of 35 percent of total capital. Arizona-American shall not be prohibited from requesting that the foregoing equity percentages be decreased based on changes to capital markets or other conditions that make it prudent to alter Arizona-American's capital structure.

#13 The cost of debt issued after the closing date of the reorganization, for purposes of setting rates in Arizona-American's rate proceedings, filed within ten years from

the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baa1 (Moody's) or higher.

#14 Arizona-American and its affiliates agree that in future Commission proceedings, they shall not seek a higher cost of capital than that which Arizona-American would have been authorized as a stand-alone entity. Specifically, no capital financing costs (either debt or equity) should increase by virtue of the reorganization.

#15 Arizona-American shall refrain from filing any non-emergency rate increase requests for one year from the closing date of the reorganization; however, Arizona-American may file rate increase requests prior to the reorganization's closing date, and any such requests shall not be subject to the conditions set forth herein.

22. Arizona-American proposes that the Commission adopt its version of Condition #3 and Condition # 13 as opposed to Staff's version.

23. In order to provide greater protection to Arizona-American's ratepayers, we will amend Condition 15 as proposed by Staff, to require that Arizona-American refrain from filing any non-emergency rate increase requests for three years from the closing date of the reorganization.

24. We find that Arizona-American's proposal to guarantee that the cost of debt issued after the closing date of the reorganization, for purposes of setting rates in Arizona-American's rate proceedings, filed within three years from the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baa1 (Moody's) or higher is reasonable, and we shall adopt it for purposes of Condition 13.

25. For the reasons set forth herein, it is in the public interest to attach the conditions as proposed by Staff, with the amendments to Conditions 13 and 15 described in Findings of Fact Nos. 23 and 24 above, to Commission approval of the transaction proposed in the Application.

CONCLUSIONS OF LAW

1. Arizona-American is a public service corporation within the meaning of Article 15, Section 3 of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

2. The Commission has jurisdiction over the transaction proposed in the Application pursuant to Article 15, Section 3 of the Arizona Constitution and the Commission's Affiliated Interests Rules, A.A.C. R14-2-801 through -806.

3. It is not in the public interest to grant Arizona-American's request for a waiver from Commission review of the proposed transaction.

4. The public interest requires that the Commission apply the Affiliated Interests Rules in a manner that will maximize protection to ratepayers.

5. Utility rates can be impacted by holding company structure and capitalization.

6. Utility ratepayers should not be required to bear the burden of financial risk resulting from holding company diversification.

7. Approval of the transaction proposed in the Application would serve the public interest only if conditions are imposed to provide adequate protection to ratepayers.

8. The public interest requires that the transaction proposed in the Application be approved, subject to the conditions as recommended by Staff, set forth in Findings of Fact No. 21 above, with the amendments to Conditions 13 and 15 described in Findings of Fact Nos. 23 and 24 above.

ORDER

IT IS THEREFORE ORDERED that Arizona-American Water Company's request for a waiver from Commission review of the transaction proposed in the Application, pursuant to A.A.C. R14-2-806, is hereby denied.

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SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. W-01303A-01-0983

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IT IS FURTHER ORDERED that the transaction proposed by Arizona-American Water Company in the Application is hereby approved, as a reorganization of a holding company pursuant to A.A.C. R14-2-803, subject to the conditions recommended by Staff as set forth in Findings of Fact No. 21 above, with the amendments to Conditions 13 and 15 described in Findings of Fact Nos. 23 and 24 above.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 12th day of December, 2002.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

TW:mlj

Arizona Corporation Commission
DOCKETED

AUG 3 0 2001

DOCKETED BY

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR AUTHORITY TO ISSUE SHORT-TERM AND LONG-TERM DEBT INSTRUMENTS IN CONNECTION WITH FINANCING THE ACQUISITION OF THE WATER AND WASTEWATER UTILITY PLANT AND ASSETS OF CITIZENS COMMUNICATIONS.

DOCKET NO. W-01303A-00-0929

DECISION NO. 64002

ORDER

EXHIBIT
A-96
Admitted

Open Meeting
August 28 and 29, 2001
Phoenix, Arizona

BY THE COMMISSION:

On November 15, 2000, Arizona-American Water Company ("Arizona-American" or "the Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authority to issue short-term and long-term debt in an aggregate principal amount not to exceed $180.0 million and to assume certain industrial development revenue bonds ("IDRBs") in the amount of $10,635,000. The proposed debt will be used to finance the acquisition of the Arizona water and wastewater utility plant and assets of Citizens Communications Company ("Citizens"). The assumption of the revenue bonds would also be accomplished in connection with the acquisition of Citizens' assets.

On December 29, 2000, Arizona-American filed an Affidavit of Publication indicating compliance with the Commission's notice requirements. On May 25, 2001, the Commission's Utilities Division Staff ("Staff") filed its Staff Report in the matter, recommending approval of the application without a hearing.

DISCUSSION

Introduction

Arizona-American (formerly Paradise Valley Water Company) serves approximately 4,700

customers in portions of the Town of Paradise Valley, the City of Scottsdale and certain unincorporated areas in Maricopa County, Arizona. It has been in the utility business since 1950. The parent of Arizona-American, American Water Works Company, Inc. ("AWW"), is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states. Citizens currently serves about 160,000 customers in the state of Arizona.

Purpose of Financing

The short-term and long-term debt requested by Arizona-American will be used for the sole purpose of financing the acquisition of the water and wastewater utility plant and assets of Citizens in the state of Arizona. On March 24, 2000, Citizens and Arizona-American jointly filed an application with the Commission requesting authority to transfer the Arizona water and wastewater assets and the Certificates of Convenience and Necessity of Citizens to Arizona-American. A hearing was held on that application on September 27, 2000, and the Commission approved the transfer in Decision No. 63584 (April 24, 2001).

Citizens' and Arizona-American's compliance with the Arizona Department of Environmental Quality ("ADEQ") requirements was addressed in the sale and transfer application proceeding. Both companies were found to be in compliance with all ADEQ requirements. ADEQ indicated that Arizona-American was in total compliance and delivering water that does not exceed any maximum contaminant level and meets the water quality standards of the Safe Drinking Water Act. All of the Citizens water companies were either in total or substantial compliance and all were delivering water that does not exceed any maximum contaminant level and meets the water quality standards of the Safe Drinking Water Act. The Citizens wastewater treatment plants were in total compliance with ADEQ rules.

The purchase price to be paid by Arizona-American to Citizens is $231,310,000, subject to adjustment at closing. The purchase price includes the assumption of IDRBs in the amount of $10,635,000. Under the purchase agreement between Arizona-American and Citizens, a post-closing adjustment to the purchase price will be made to reflect changes in Citizens' net assets occurring after June 30, 1999. Arizona-American anticipates that the purchase price will increase, based on

increased investment in new plant to support growth occurring in Citizens' service territories. Arizona-American expects to pay approximately $71,000,000 over book value for Citizens' assets.

Although Arizona-American is requesting approval of up to $180,000,000 of long-term debt, all the projections supplied to Staff indicate an initial issuance of $132,000,000. None of the projections though 2005 indicate the issuance of more than a total of $134,900,000 in long-term debt.

Arizona-American currently has a capital structure consisting of approximately 53 percent debt and 47 percent common equity. Arizona-American intends to maintain a capital structure consisting of 60 to 55 percent debt and 40 to 45 percent equity following the completion of the Citizens' acquisition. In order to achieve this capital structure, approximately 40 percent of the purchase price for Citizens' water and wastewater assets will be financed by an infusion of paid-in capital provided by AWW, with the balance of the purchase price financed by a combination of short-term debt and the assumption of the IDRBs. The short-term debt will then be refinanced and converted to long-term debt within 12 months from the date of closing.

At December 31, 2000, AWW's consolidated capital structure consisted of approximately 59 percent debt, 1 percent preferred stock and 40 percent common equity. AWW also reported consolidated net utility plant of $5.20 billion and operating revenues of $1.35 billion as of such date.

American Water Capital Corp.

The debt financing will be provided to Arizona-American by American Water Capital Corp. ("Capital Corp."), which is also a subsidiary of AWW. Capital Corp. serves as the primary funding vehicle for all of AWW's utility subsidiaries. By combining the short and long-term debt requirements of AWW's utility subsidiaries, Capital Corp. is able to issue bonds, commercial paper and other securities in the public markets. This combined borrowing power should result in lower transaction costs and increased borrowing efficiency. Capital Corp. carries strong corporate credit ratings from Standard and Poor's and Moody's rating services of A- and Baa1, respectively.

Arizona-American has previously entered into a Financial Services Agreement with Capital Corp.[1] Under this agreement, Capital Corp. will provide short and long-term loans and cash

[1] See Decision No. 63586 (April 24, 2001) (approving short-term debt to be provided by Capital Corp. for miscellaneous capital projects).

management services to Arizona-American. This agreement requires Arizona-American to reduce the balance of its short-term debt owed to Capital Corp. by the excess of any cash not required to pay daily disbursements.

Terms of the Proposed Debt

Initially, Arizona-American will borrow up to $180.0 million from Capital Corp. on a short-term basis. This debt will be unsecured and will be issued at prevailing interest rates. Arizona-American expects that the short-term debt will carry an interest rate no greater than 50 basis points over the London Interbank Offer Rate ("LIBOR"). LIBOR is the British Banker's Association average of interbank offered rates for dollars deposited in the London market and is based on quotations at 16 major banks. As of May 18, 2001, the one-year LIBOR rate was 4.44 percent, which is nearly equal to the rate on U.S. Treasury bonds maturing in two years.

Within 12 months from the date of the transfer of the assets, Arizona-American will refinance and replace the short-term debt with long-term debt issued through Capital Corp. Although the precise terms of the debt have not yet been determined, Arizona-American has committed in its application to limit the interest rate to a level no greater than 250 basis points over Treasury bonds of similar maturities. Arizona-American expects that the long-term debt will have a maturity between 5 and 30 years, but most likely will be issued with maturities in the 7 to 10-year range. Staff indicated that 7 and 10-year Treasury bonds currently carry interest rates between 5 percent and 5.5 percent. Adding 250 basis points results in a range of 7.5 percent to 8.0 percent.

Assumption of IDRBs

Under the terms of the asset purchase agreement with Citizens, Arizona-American agreed to assume a portion of Citizens' IDRBs in the amount of $10,635,000. Capital Corp. will initially be the assuming entity. Capital Corp. will then enter into a matching loan, containing terms identical to those of the IDRBs, with Arizona-American, at which time the debt will be reflected in the capital structure of Arizona-American.

The IDRBs mature on September 1, 2028. These bonds are floating rate bonds, similar to commercial paper, with the interest rate changing daily with each remarketing of the bonds. Staff indicated that the most recent rate paid by Citizens on the IDRBs was 4.25 percent.

Arizona-American's Ability to Repay the Proposed Debt

Staff utilized pro forma financial information and conducted an analysis of Arizona-American's ability to repay the proposed debt following the acquisition of Citizens' water and wastewater utility assets. Staff's projections and analysis are based upon the assumption that the new short-term debt issued to finance the purchase of Citizens' assets is immediately converted to long-term debt. Another assumption adopted by Staff was Arizona-American's projection that the new debt would not have principal payments until maturity.

Staff's projections show that with the proposed debt, Arizona-American would have a Times Interest Earned Ratio ("TIER") ranging from 1.05 to 0.83 and a Debt Service Coverage ratio ("DSC") ranging from 1.62 to 1.21, depending on the amount of debt actually issued and future ratemaking treatment of the acquisition premium that will be paid for Citizens' assets.[2] Based on the company's financial statements ending December 31, 2000, Arizona-American had a TIER of 2.19 and a DSC of 3.49. As indicated by Staff, while the ratios based on the new debt issuances do not reflect robust financial health, they indicate that Arizona-American should generate sufficient earnings and cash flow to make principal and interest payments on its current and proposed debt.

Impact on Capital Structure and Cost of Capital

In Arizona-American's most recent rate proceeding, the Commission, in Decision No. 61831 (July 20, 1999), used a capital structure consisting of 45.0 percent long-term debt with a cost of 7.3 percent, and 55.0 percent common equity at a cost of 11.0 percent, resulting in a weighted cost of capital of 9.3 percent. Staff evaluated the impact of the proposed debt issuance of approximately $132,000,000 and the assumption of $10,635,000 of Citizens' IDRBs on Arizona-American's capital structure. Staff's pro forma capital structure for Arizona-American consists of 59.4 percent long-term debt at a cost of 7.4 percent, and 40.6 percent common equity at a cost of 11.0 percent, resulting in a weighted cost of capital of 8.9 percent. This pro forma capital structure reflects the assumption that AWW would invest additional paid-in capital (equity) of approximately $92.5 million, which would constitute an increase in equity of approximately $0.70 for every dollar of new debt issued.

[2] If the Company assumes Citizens' IDRBs and issues $132,457,390 of acquisition debt, the projected TIER and DSC are .95 and 1.62, respectively. If the Company is allowed to issue $180,000,000 in long-term debt, the projected TIER and DSC are .83 and 1.21, respectively.

Staff expressed concern that if the entire $180.0 million of debt is issued, the percentage of debt in Arizona-American's capital structure would increase to more than 65 percent, while the percentage of equity in the Company's capital structure would decrease to less than 35 percent. Staff indicates that these ratios would not be comparable to those of healthy, publicly-traded water utilities. Moreover, Staff believes that if the entire $180.0 million of debt is issued without any additional equity infusion, Arizona-American's coverage ratios may not reach 1.0. This capital structure is likely to result in a higher cost of equity as a result of the additional financial risk associated with repayment of interest, thereby requiring a higher return on equity.

Staff's concerns about the capital structure that may result from the issuance of additional debt in connection with acquiring Citizens' assets are legitimate. However, in its application, Arizona-American has stated that it intends to achieve and maintain a capital structure containing between 60 percent and 55 percent debt and between 40 percent and 45 percent equity following the acquisition. In accordance with Arizona-American's application and the recommendations of Staff, this Decision will require Arizona-American to increase its equity by at least $0.69 for each dollar of acquisition debt issued by Arizona-American to ensure that Arizona-American's capital structure remains reasonably balanced.

Additional Staff Recommendations

In the Staff Report, the Staff recommends approval of a total of $180.0 million of new debt for the purpose of financing the acquisition of Citizens' assets. Based on Arizona-American's application, the Company intends to borrow up to $180.0 million on a short-term basis in order to complete the acquisition, and to refinance and replace this short-term debt with long-term debt within 12 months from the closing. Therefore, Arizona-American is seeking authority to borrow a total of $180.0 million (exclusive of the financing relating to assumption of Citizens' IDRBs), and our approval is accordingly limited to that total amount of debt.

Staff also recommends that Arizona-American perform an analysis that shows the savings resulting from having Capital Corp. provide financing compared to Arizona-American procuring financing from a non-affiliate. This analysis would be filed at the time of Arizona-American's next rate case. Because Capital Corp. is an affiliate of Arizona American, and because of the magnitude

of the debt financing and its potential impact on Arizona-American's cost of capital, we concur with this recommendation.

Finally, Staff recommends that any matching loans made by Capital Corp. to Arizona-American relating to the assumption of Citizens' IDRBs carry terms that are no less favorable to Capital Corp. than those presently associated with the IDRBs. We also concur with this recommendation.

Based on the above, Staff believes that approval of the application will be compatible with the public interest, with sound financial practices, and with the proper performance by Arizona-American of service as a public service corporation and will not impair its ability to perform that service. We concur with Staff, and believe that it is appropriate to approve Arizona-American's application without a hearing, subject to the conditions indicated above.

* * * * * * * * * *

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

FINDINGS OF FACT

1. Arizona-American is an Arizona corporation that provides water utility service to approximately 4,700 customers in portions of the Town of Paradise Valley, the City of Scottsdale and other unincorporated areas within Maricopa County, Arizona.

2. On November 15, 2000, Arizona-American filed an application with the Commission requesting authority to issue short-term and long-term debt in an aggregate principal amount not to exceed $180.0 million and to assume certain IDRBs in connection with financing the acquisition of Citizens' Arizona water and wastewater utility plant and assets.

3. On December 29, 2000, Arizona-American filed an Affidavit of Publication indicating compliance with the Commission's notice requirements.

4. On May 25, 2001, Staff filed its Report on Arizona-American's application.

5. The parent of Arizona-American, AWW, is the largest privately-owned water utility system in the United States, providing water, wastewater and other water resource management services to approximately 3 million customers in 23 states.

6. The short-term and long-term debt that will be issued by Arizona-American will be used for the sole purpose of financing the acquisition of Citizens' assets.

7. Citizens and Arizona-American received authorization from the Commission for the transfer of Citizens' water and wastewater assets and Citizens' Certificates of Convenience and Necessity to Arizona-American in Decision No. 63584.

8. The purchase price to be paid by Arizona-American to Citizens is $231,310,000, subject to adjustment at closing to reflect changes in Citizens' net assets occurring after June 30, 1999. The purchase price includes the assumption of IDRBs in the amount of $10,635,000.

9. The debt financing will be provided to Arizona-American by Capital Corp., which serves as the primary funding vehicle for all of AWW's utility subsidiaries.

10. Capital Corp. carries strong corporate credit ratings from Standard and Poor's and Moody's rating services of A- and Baa1, respectively.

11. Initially, Arizona-American will borrow up to $180.0 million from Capital Corp. on a short-term basis. This debt will be unsecured and is expected to have an interest rate no greater than 50 basis points over the LIBOR.

12. Within 12 months of the date of the transfer of the assets, Arizona-American will refinance and replace the short-term debt with long-term debt issued through Capital Corp., which is expected to have an interest rate no greater than 250 basis points over U.S. Treasury bonds of similar maturities.

13. Capital Corp. will initially act as the assuming entity with respect to Citizens' IDRBs. Capital Corp. will enter into a matching loan, containing terms identical to those of the IDRBs, with Arizona-American, at which time the debt will be reflected in Arizona-American's capital structure.

14. Arizona-American currently has a capital structure consisting of approximately 53 percent debt and 47 percent common equity.

15. Arizona-American intends to achieve and maintain a capital structure containing between 60 percent and 55 percent debt and between 40 percent and 45 percent equity following its acquisition of Citizens' assets.

16. Staff's analysis of the effect of the proposed financing indicates that Arizona-

American would have a TIER ranging from 1.05 to 0.83 and a DSC ranging from 1.62 to 1.21, depending on the amount of debt actually issued and future ratemaking treatment of the acquisition premium that will be paid for Citizens' assets.

17. Staff recommends that Arizona-American be required to increase its equity by at least $0.69 for each dollar of acquisition debt issued by Arizona-American to ensure that Arizona-American's capital structure remains reasonably balanced and its coverage ratios remain acceptable.

18. Staff also recommends that this Decision approve a total of up to $180.0 million of new debt for the purpose of financing the purchase of Citizens' assets to ensure that there is no possibility that Arizona-American would issue combined long- and short-term debt exceeding that amount. In its application, Arizona-American has indicated that it understands this limitation.

19. Staff also recommends that Arizona-American be required to perform an analysis that shows the savings resulting from having Capital Corp. provide financing compared to Arizona-American procuring financing from a non-affiliate. This analysis should be filed at the time of Arizona-American's next rate case.

20. Staff also recommends that the terms of any matching loan made by Capital Corp. to Arizona-American relating to the assumption of Citizens' IDRBs carry terms that are no less favorable to Capital Corp. than those presently associated with the IDRBs.

21. Subject to the foregoing conditions, Staff believes that the proposed financing is for lawful purposes, consistent with sound financial practices, and is in the public interest.

22. Staff recommends that the proposed financing be approved without a hearing.

CONCLUSIONS OF LAW

Arizona-American is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281 and 40-282.

2. The Commission has jurisdiction over Arizona-American and the subject matter of this application.

3. Notice of the application was given in accordance with the law.

4. The financing approved herein is for lawful purposes within Arizona-American's corporate powers, is compatible with the public interest, with sound financial practices, and with the

proper performance by Arizona-American of service as a public service corporation. and will not impair Arizona-American's ability to perform that service.

5. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

6. Staff's recommendations in Findings of Fact Nos. 17 through 20 are reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that the application of Arizona-American Water Company for authority to issue promissory notes and other evidence of indebtedness in a total aggregate principal amount not to exceed $180.0 million, exclusive of the financing relating to the assumption of Citizens' IDRBs, on the terms and conditions set forth hereinabove shall be and the same is hereby approved.

IT IS FURTHER ORDERED that Arizona-American Water Company shall secure long-term debt financing within 12 months of obtaining the short-term debt. The long-term debt shall be used to repay the principal and interest owed under the short-term financing, and at such time the authorization for the short term financing contained in this Order shall terminate.

IT IS FURTHER ORDERED that Arizona-American Water Company's request to incur additional long-term indebtedness, and to issue a promissory note payable to American Water Capital Corp. in consideration for American Water Capital Corp.'s assumption of Citizens Communications Company's industrial development revenue bonds totaling $10.635,000 on terms that are no less favorable than the terms of the revenue bonds being assumed, shall be and the same is hereby approved.

IT IS FURTHER ORDERED that Arizona-American Water Company is hereby authorized to issue and deliver promissory notes and other instruments evidencing said short-term and long-term indebtedness consistent with the foregoing approvals and to execute and deliver any additional documents necessary to effectuate the authorization granted hereinabove.

IT IS FURTHER ORDERED that Arizona-American be required to increase its equity by at

least $0.69 for each dollar of acquisition debt issued by Arizona-American to ensure that Arizona-American's capital structure remains reasonably balanced and its coverage ratios remain acceptable.

IT IS FURTHER ORDERED that Arizona-American shall comply with Staff's recommendations as set forth in Findings of Fact Nos. 17 through 20.

IT IS FURTHER ORDERED that the authorization granted hereinabove is expressly contingent upon Arizona-American Water Company's use of the proceeds for the purposes set forth in its application.

IT IS FURTHER ORDERED that approval of the financing set forth above does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file copies of all executed financing documents setting forth the terms and conditions of the financing with the Compliance Section of the Commission's Utilities Division within 30 days of execution of said documents.

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IT IS FURTHER ORDERED that Arizona-American Water Company shall perform an analysis that shows the savings resulting from having American Water Capital Corp. provide the new debt financing, as provided hereinabove, as compared to obtaining financing from a non-affiliated lender, and shall file such analysis in conjunction with Arizona-American Water Company's next general rate proceeding.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 30th day of August, ~~2000.~~ 2001

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____
PJD:dap

SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY

DOCKET NO.: W-1303A-00-0929

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EXHIBIT
A-97
Admitted

CREDIT RATINGS

Standard & Poor		MOODY
AAA		Aaa
AA+		Aa1
AA		Aa2
AA-		Aa3
A+	RWE RWE	A1
A		A2
A-	AWCC	A3
BBB+	AWCC	Baa1
BBB		Baa2
BBB-		Baa3

ARIZONA-AMERICAN WATER COMPANY

CURRENT AND PROJECTED RETURNS ON EQUITY FOR WATER UTILITIES

Company	Current ROE	Projected 2003	Projected 2004	2004-2008
American States	8.2%	8.0%	9.5%	10.5%
Cal. Water Services	7.2%	8.0%	9.0%	10.5%
Connecticut Water	11.4%	—	—	—
Middlesex Water	9.6%	—	—	—
Philadelphia Suburban	16.0%	12.0%	13.0%	14.5%
SJW Corporation	9.7%	—	—	—
Average	**10.4%**	**9.3%**	**10.5%**	**11.8%**

Source: Current returns on equity reported in C.A. Turner Utility Reports (November 2003). Projected returns on equity reported in Value Line (Oct. 31, 2003).

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EXHIBIT
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Admitted

ARIZONA-AMERICAN WATER COMPANY

CURRENT AND PROJECTED RETURNS ON EQUITY FOR NATURAL GAS UTILITIES

Company	Current ROE	Projected 2003	Projected 2004	2004-2008
AGL Resources	14.6%	13.5%	13.0%	11.5%
Atmos Energy	9.4%	10.5%	10.5%	14.0%
Laclede Group	11.1%	11.5%	11.0%	10.5%
Northwest Natural	8.5%	9.0%	9.0%	10.0%
Peoples Energy	12.3%	12.0%	11.0%	11.5%
Piedmont Natural	10.7%	10.5%	11.5%	13.0%
WGL Holdings	13.0%	12.0%	10.5%	11.5%
Average	**11.4%**	**11.3%**	**10.9%**	**11.7%**

Source: Current returns on equity reported in C.A. Turner Utility Reports (November 2003). Projected returns on equity reported in Value Line (Sept. 19, 2003), reproduced as Exhibit TZ-3, pages 8-16, attached to the Rebuttal Testimony of Thomas M. Zepp.

NOVEMBER 2003

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NATURAL GAS DISTRIBUTION & INTEGRATED NAT. GAS COMPANIES

COMPANY	LATEST 12 MONTHS EARNINGS AVAILABLE	PER SHARE EARNINGS	PER SHARE CURRENT ANNUAL DIVIDEND	DATA ($) BOOK VALUE (1)	DATA ($) STOCK PRICE 10/20	DATA ($) COMMON SHARES O/S MILL	PERCENT (2) DIV PAYOUT	PERCENT (2) DIV YIELD	PERCENT (2) MKT/ BOOK	DIV/ BOOK (2)	PRICE EARN MULT
AGL Resources Inc. (NYSE-ATG)	6/03	1.99	1.12	13.23	27.98	67.7	56	4.0	212	8.5	14.1
Atmos Energy Corporation (NYSE-ATO)	6/03	1.83	1.20	17.99	24.71	46.0	66	4.9	137	6.7	13.5
Cascade Natural Gas Corporation (NYSE-CGC)	6/03	0.81	0.96	10.70	19.56	11.1	119	4.9	183	9.0	24.1
Chesapeake Utilities Corporation (NYSE-CPK)	6/03	1.41	1.10	12.98	24.55	5.6	78	4.5	189	8.5	17.4
Delta Natural Gas Company (NDQ-DGAS)	6/03	1.46	1.18	18.14	23.54	2.5	81	5.0	130	6.5	16.1
El Paso Corporation (NYSE-EP)	6/03	-2.94	0.16	11.32	7.15	598.9	NM	2.2	63	1.4	NM
Energen Corporation (NYSE-EGN)	6/03	2.76	0.74	18.93	37.60	34.5	27	2.0	199	3.9	13.6
Energy West Incorporated (NDQ-EWST)	6/03	-0.03	0.00	5.89	6.78	2.6	0	0.0	115	NM	NM
EnergySouth, Inc. (NDQ-ENSI)	6/03	2.11	1.14	16.63	34.43	5.1	54	3.3	207	6.9	16.3
Equitable Resources, Inc. (NYSE-EQT)	6/03	2.61	1.20	13.51	41.19	62.3	46	2.9	305	8.9	15.8
KeySpan Corp. (NYSE-KSE)	6/03	2.53	1.78	22.72	34.80	157.9	70	5.1	153	7.8	13.8
Kinder Morgan, Inc. (NYSE-KMI)	6/03	2.87	1.60	20.83	55.01	122.0	56	2.9	264	7.7	19.2
Laclede Group, Inc. (NYSE-LG)	6/03	1.77	1.34	16.20	28.40	19.0	76	4.7	175	8.3	16.0
National Fuel Gas Company (NYSE-NFG)	6/03	1.66	1.08	14.18	23.05	80.9	65	4.7	163	7.6	13.9
New Jersey Resources Corp. (NYSE-NJR)	6/03	2.42	1.24	16.03	36.86	27.1	51	3.4	230	7.7	15.2
NICOR Inc. (NYSE-GAS)	6/03	3.25	1.86	17.23	35.55	44.0	57	5.2	206	10.8	10.9
Northwest Natural Gas Co. (NYSE-NWN)	6/03	1.61	1.26	19.48	29.40	25.7	78	4.3	151	6.5	18.3
NUI Corporation (NYSE-NUI)	6/03	0.87	0.98	17.03	16.50	16.0	113	5.9	97	5.8	19.0
ONEOK, Inc. (NYSE-OKE)	6/03	1.95	0.68	12.76	20.69	96.7	35	3.3	162	5.3	10.6
Peoples Energy Corporation (NYSE-PGL)	6/03	2.91	2.12	24.42	40.72	35.9	73	5.2	167	8.7	14.0
Piedmont Natural Gas Co., Inc. (NYSE-PNY)	7/03	2.02	1.66	19.29	39.70	33.4	82	4.2	206	8.6	19.7
Questar Corporation (NYSE-STR)	6/03	2.18	0.82	14.31	33.05	82.7	38	2.5	231	5.7	15.2
RGC Resources, Inc. (NDQ-RGCO)	6/03	1.80	1.14	17.45	22.99	2.0	63	5.0	132	6.5	12.8
SEMCO Energy, Inc. (NYSE-SEN)	6/03	-0.65	0.30	5.10	5.06	19.1	NM	5.9	99	5.9	NM
South Jersey Industries, Inc. (NYSE-SJI)	6/03	2.73	1.54	21.05	39.19	12.3	56	3.9	186	7.3	14.4
Southern Union Company (NYSE-SUG)	6/03	0.84	0.00	15.39	17.38	59.8	0	0.0	113	NM	20.7
Southwest Gas Corporation (NYSE-SWX)	6/03	1.28	0.82	18.16	22.89	33.8	64	3.6	126	4.5	17.9
Southwestern Energy Company (NYSE-SWN)	6/03	0.98	0.00	8.35	19.68	35.6	0	0.0	236	NM	20.1
UGI Corporation (NYSE-UGI)	6/03	1.73	1.14	13.80	31.26	42.5	66	3.6	226	8.3	18.1
WGL Holdings, Inc. (NYSE-WGL)	6/03	2.20	1.28	17.51	28.25	48.6	58	4.5	161	7.3	12.8
Williams Companies, Inc. (NYSE-WMB)	6/03	-1.97	0.04	7.76	10.05	520.9	NM	0.4	130	0.5	NM
AVERAGE							58	3.6	173	6.8	16.0

NATURAL GAS DISTRIBUTION & INTEGRATED NAT. GAS COMPANIES

COMPANY	OPER REV $ MILL (1)	% GAS REV	NET PLANT $ MILL	NET PLANT PER $ REV (1)	S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE COMMON EQUITY (4)	% RETURN ON BOOK VALUE TOTAL CAPITAL	REGULATION ALLOWED ROE	REGULATION ORDER DATE
AGL Resources Inc. (NYSE-ATG)	978.4	95	2,224.8	2.27	A-	A3	43	14.6	9.5	10.99	-
Atmos Energy Corporation (NYSE-ATO)	1,487.9	99	1,494.4	1.00	A-	A3	49	9.4	8.5	12.10	-
Cascade Natural Gas Corporation (NYSE-CGC)	302.6	100	305.2	1.01	BBB+	Baa1	42	7.4	7.6	11.75	-
Chesapeake Utilities Corporation (NYSE-CPK)	166.2	63	166.7	1.00	NR	NR	49	11.4	9.1	-	-
Delta Natural Gas Company (NDQ-DGAS)	68.4	66	111.4	1.63	NR	NR	45	9.6	8.2	-	12/99
El Paso Corporation (NYSE-EP)	11,149.0	23	22,890.0	2.05	BB-	B1	22	NM	NM		
Energen Corporation (NYSE-EGN)	788.4	61	427.7	0.54	A-	A1	54	15.6	11.5	13.40	06/02
Energy West Incorporated (NDQ-EWST)	79.1	40	39.6	0.50	NR	NR	42	NM	4.3	12.63	-
EnergySouth, Inc. (NDQ-ENSI)	96.5	94	192.0	1.99	NR	NR	45	13.4	10.1	13.60	10/01
Equitable Resources, Inc. (NYSE-EQT)	1,206.8	32	1,687.9	1.40	A	A2	53	20.2	14.2	11.00	-
KeySpan Corp. (NYSE-KSE)	6,807.8	59	7,533.4	1.11	A+	A2	37	11.8	7.5	11.00	-
Kinder Morgan, Inc. (NYSE-KMI)	1,080.9	31	6,002.0	5.55	BBB	Baa2	36	14.7	7.4	-	-
Laclede Group, Inc. (NYSE-LG)	1,014.8	74	612.0	0.60	A	A3	42	11.1	8.4	-	10/02
National Fuel Gas Company (NYSE-NFG)	1,982.9	57	3,108.6	1.57	BBB+	A3	40	12.1	8.6	11.50	-
New Jersey Resources Corp. (NYSE-NJR)	2,658.0	30	768.8	0.29	AA-	Aa3	53	16.5	9.9	11.50	01/94
NICOR Inc. (NYSE-GAS)	2,578.6	88	1,802.2	0.70	AA	Aa3	51	19.4	12.9	-	11/99
Northwest Natural Gas Co. (NYSE-NWN)	585.0	98	1,026.4	1.75	A	A2	50	8.5	7.9	10.20	-
NUI Corporation (NYSE-NUI)	428.6	86	635.8	1.48	BBB-	Ba1	37	7.2	4.9	10.75	-
ONEOK, Inc. (NYSE-OKE)	2,573.2	57	1,234.6	0.48	A-	Baa1	38	12.2	9.2	-	-
Peoples Energy Corporation (NYSE-PGL)	2,086.1	71	1,818.0	0.87	A-	Aa3	49	12.3	8.7	11.20	-
Piedmont Natural Gas Co., Inc. (NYSE-PNY)	1,162.9	56	1,168.3	1.00	A	A3	56	10.7	9.5	11.30	-
Questar Corporation (NYSE-STR)	1,314.0	48	2,647.7	2.01	A+	A2	52	16.0	10.8	11.20	12/02
RGC Resources, Inc. (NDQ-RGCO)	100.4	73	70.6	0.70	NR	NR	50	10.6	8.4	9.85	-
SEMCO Energy, Inc. (NYSE-SEN)	525.6	80	515.1	0.98	BB	Ba2	13	NM	7.2	11.98	-
South Jersey Industries, Inc. (NYSE-SJI)	629.9	78	683.7	1.09	A	Baa1	39	13.6	8.1	11.25	01/97
Southern Union Company (NYSE-SUG)	1,236.2	95	3,106.6	2.51	BBB+	Baa3	25	5.8	4.8	11.09	-
Southwest Gas Corporation (NYSE-SWX)	1,219.4	83	2,017.1	1.65	BBB-	Baa2	35	7.2	7.1	11.48	-
Southwestern Energy Company (NYSE-SWN)	289.0	79	693.3	2.40	BBB	Ba2	53	12.5	9.3	11.30	11/96
UGI Corporation (NYSE-UGI)	2,882.9	24	1,336.9	0.46	BBB+	A3	29	21.4	10.6	-	07/96
WGL Holdings, Inc. (NYSE-WGL)	2,072.9	63	1,629.8	0.79	AA-	A2	54	13.0	10.0	11.05	-
Williams Companies, Inc. (NYSE-WMB)	12,363.3	11	12,188.8	0.99	B+	B1	24	NM	2.4		
AVERAGE							42	12.5	8.6	11.46	

ARIZONA-AMERICAN WATER COMPANY

COMPARISON OF KEY FINANCIAL DATA FOR PUBLICLY TRADED WATER UTILITIES

	Philadelphia Suburban	SJW Corp.	Middlesex Water
Current Return on Equity	16.0%	9.7%	9.6%
2004 Return on Equity	13.0%	--	--
Operating Revenue	$418.1 million	$145.0 million	$63.1 million
Net Plant	$1,377.3 million	$286.3 million	$198.1 million
Bond Rating	AA -	NR	A+/A2
States With Operations	15	1	1
Equity Percentage	43%	56%	41%
Value Line Beta	0.70	0.50	0.55
Raw Beta	0.52	0.22	0.30
Shares Outstanding	87 million	3 million	8 million

Source: Data from Value Line (Oct. 31, 2003) (Ex. A-83), C.A. Turner Reports (Nov. 2003) (Ex. A-82) and Schedule JMR-S5.

1494839.1/73244.034

EXHIBIT
A-100
Admitted

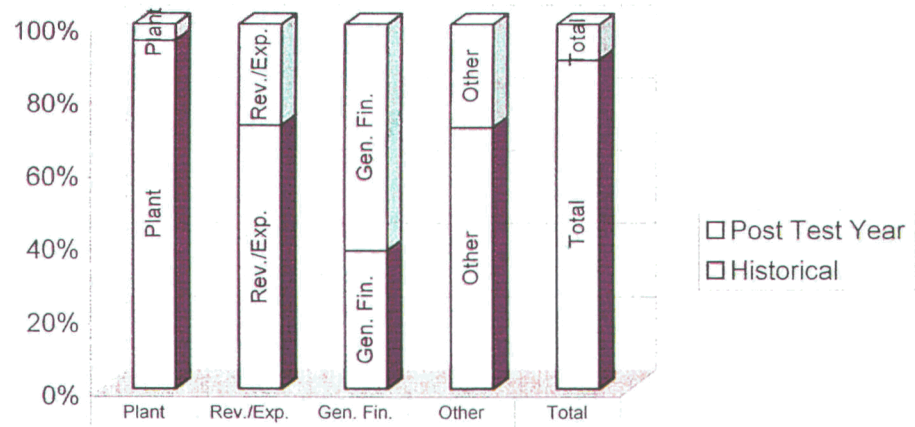
EXHIBIT
A-101
Admitted

Arizona American
ACC Staff Rebuttal Returns
(Source: DWC-1)

District			RCND	OCRB	FVRB
Sun City Water		Required Rate of Return	**3.20%**	**6.50%**	**4.20%**
		Revenue Requirement	1,411,735	1,411,735	1,411,735
		Interest Expense	627,195	627,195	627,195
		Rate Base	43,955,934	21,853,479	32,904,707
	0.601	Debt Rate Base	13,133,941	13,133,941	13,133,941
		Equity Rate Base	30,821,993	8,719,538	19,770,766
		Equity Return	**2.55%**	**9.00%**	**3.97%**
Sun City Wastewater		Required Rate of Return	**3.30%**	**6.50%**	**4.30%**
		Revenue Requirement	562,884	562,884	562,884
		Interest Expense	250,074	250,074	250,074
		Rate Base	17,199,992	8,713,382	12,956,687
	0.601	Debt Rate Base	5,236,743	5,236,743	5,236,743
		Equity Rate Base	11,963,249	3,476,639	7,719,944
		Equity Return	**2.61%**	**9.00%**	**4.05%**
Sun City West Water		Required Rate of Return	**5.00%**	**6.50%**	**5.70%**
		Revenue Requirement	773,345	773,345	773,345
		Interest Expense	343,576	343,576	343,576
		Rate Base	15,314,756	11,971,281	13,643,019
	0.601	Debt Rate Base	7,194,740	7,194,740	7,194,740
		Equity Rate Base	8,120,016	4,776,541	6,448,279
		Equity Return	**5.29%**	**9.00%**	**6.66%**
Sun City West Wastewater		Required Rate of Return	**4.70%**	**6.50%**	**5.40%**
		Revenue Requirement	575,975	575,975	575,975
		Interest Expense	255,890	255,890	255,890
		Rate Base	12,222,469	8,916,017	10,569,243
	0.601	Debt Rate Base	5,358,526	5,358,526	5,358,526
		Equity Rate Base	6,863,943	3,557,491	5,210,717
		Equity Return	**4.66%**	**9.00%**	**6.14%**
Agua Fria		Required Rate of Return	**5.90%**	**6.50%**	**6.20%**
		Revenue Requirement	1,076,571	1,076,571	1,076,571
		Interest Expense	478,291	478,291	478,291
		Rate Base	18,283,746	16,665,182	17,474,464
	0.601	Debt Rate Base	10,015,774	10,015,774	10,015,774
		Equity Rate Base	8,267,972	6,649,408	7,458,690
		Equity Return	**7.24%**	**9.00%**	**8.02%**
Anthem Water		Required Rate of Return	**6.20%**	**6.50%**	**6.30%**
		Revenue Requirement	598,784	598,784	598,784
		Interest Expense	266,023	266,023	266,023
		Rate Base	9,629,285	9,269,095	9,449,190
	0.601	Debt Rate Base	5,570,726	5,570,726	5,570,726
		Equity Rate Base	4,058,559	3,698,369	3,878,464
		Equity Return	**8.20%**	**9.00%**	**8.58%**
Anthem Wastewater		Required Rate of Return	**6.30%**	**6.50%**	**6.40%**
		Revenue Requirement	176,479	176,479	176,479

		Interest Expense	78,405	78,405	78,405
		Rate Base	2,790,224	2,731,868	2,761,046
	0.601	Debt Rate Base	1,641,853	1,641,853	1,641,853
		Equity Rate Base	1,148,371	1,090,015	1,119,193
		Equity Return	**8.54%**	**9.00%**	**8.76%**
Tubac Water		Required Rate of Return	**4.20%**	**6.50%**	**5.10%**
		Revenue Requirement	72,847	72,847	72,847
		Interest Expense	32,364	32,364	32,364
		Rate Base	1,734,478	1,127,661	1,431,070
	0.601	Debt Rate Base	677,724	677,724	677,724
		Equity Rate Base	1,056,754	449,937	753,346
		Equity Return	**3.83%**	**9.00%**	**5.37%**
Havasu Water		Required Rate of Return	**4.60%**	**6.50%**	**5.40%**
		Revenue Requirement	53,109	53,109	53,109
		Interest Expense	23,595	23,595	23,595
		Rate Base	1,142,665	822,117	982,391
	0.601	Debt Rate Base	494,092	494,092	494,092
		Equity Rate Base	648,573	328,025	488,299
		Equity Return	**4.55%**	**9.00%**	**6.04%**
Mohave Water		Required Rate of Return	**4.70%**	**6.50%**	**5.40%**
		Revenue Requirement	618,688	618,688	618,688
		Interest Expense	274,866	274,866	274,866
		Rate Base	13,216,710	9,577,221	11,396,966
	0.601	Debt Rate Base	5,755,910	5,755,910	5,755,910
		Equity Rate Base	7,460,800	3,821,311	5,641,056
		Equity Return	**4.61%**	**9.00%**	**6.09%**

Data Requests Historical vs. Post Test Year Information



	Plant	Rev./Exp.	Gen. Fin.	Other	Total
Post Test Year	3.86%	2.45%	2.82%	0.74%	9.87%
Historical	80.27%	6.31%	1.71%	1.85%	90.13%

*Includes data request subparts.

EXHIBIT
A-102
Admitted

Arizona-American
Summary of Data Requests
Includes subparts to requests

Party	Request No.	Historical Plant Related	Post Test Year Plant Related	Historical Revenue and Expense Related	Post Test Year Revenue and Expense Related	Historical General Financial and Accounting	Post Test Year General Financial and Accounting	Historical Other	Post Test Year Other	Total Number of Questions
Staff	1					3		1		4
	2	10								10
	3	7		2		1		1		11
	4	20		42				6		68
	5	1		1		1				3
	6			4	2	1		5		12
	7	25								25
	8				1		9	2		12
	9	226								226
	10	8								8
	11	39			1					40
	12		4							4
	13	82	1			1		1		85
	14	8	2		1					11
	15	228								228
	16	25								25
	17		8							8
	18		3							3
	19	25								25
	20	8								8
	21	19		6	4					29
	22	3	4							7
	23	9	3							12
	24		7	1	1					9
	25	5								5
	26	14					1			15
	27	2								2
	28	9								9
	29	220								220
	30	7								7
	31	73								73
	32								7	7
	33						1			1
	34			2	2					4
	35	1								1
	36							1		1
	37					4	11			15
	38								2	2
	39			2	4	1	2			9
	40									0
Subtotal		1074	32	60	16	12	24	17	9	1244
Percent		86.33%	2.57%	4.82%	1.29%	0.96%	1.93%	1.37%	0.72%	100.00%

RUCO										
	1	3	8	21	3	10	1	6		52
	2	4	3		5		4	1		17
	3		5	2	2	1				10
	4	1	4	2	7			1	1	16
	5						9			9
										0
	Subtotal	8	20	25	17	11	14	8	1	104
	Percent	7.69%	19.23%	24.04%	16.35%	10.58%	13.46%	7.69%	0.96%	100.00%

	Hist. Plant	PTY Plant	Hist. Rev./Exp.	PTY Rev./Exp.	Hist. Gen. Financial	PTY Gen. Financial	Hist. Other	PTY Other	Total
Total	1082	52	85	33	23	38	25	10	1348
Percent	80.27%	3.86%	6.31%	2.45%	1.71%	2.82%	1.85%	0.74%	100.00%

Chart Table

Historical	90.13%
Post Test Year	9.87%

	Historical	Post Test Year
Plant	80.27%	3.86%
Rev./Exp.	6.31%	2.45%
Gen. Financial	1.71%	2.82%
Other	1.85%	0.74%
Total	90.13%	9.87%

Plant	Rev./Exp.	Gen. Fin.	Other	Total

ARIZONA-AMERICAN WATER COMPANY

CHRONOLOGIES OF KEY EVENTS

PRIOR CITIZENS DECISIONS

Sun City Water and Wastewater, Sun City West Water and Wastewater, Agua Fria Water and Tubac Water

Test Year: **April 1, 1994 – March 31, 1995**

Decision: Decision No. 60172 (**May 7, 1997**)

Mohave Water

Test Year: **April 1, 1987 – March 31, 1988**

Decision: Decision No. 56806 (**Feb. 1, 1990**)

Havasu Water

Test Year: **January 1, 1990 – December 31, 1990**

Decision: Decision No. 57743 (**Feb. 21, 1992**)

Anthem Water and Anthem/Agua Fria Wastewater

No previous rate cases.

CC&N: Decision No. 60975 (**June 19, 1998**)

Initial rates were agreed to by Citizens, Staff and RUCO.

Citizens was ordered to file a rate application utilizing a Test Year of 2003, or within six months of the time when 3,500 ERUs are being served. (That level of ERUs was reached in early 2002. See Schedule H-2 for Anthem Water (Ex. A-12), showing number of customers at December 31, 2001.)

CITIZENS ACQUISITION

October 15, 1999 – Citizens Communications, Arizona-American and American Water Works entered into asset purchase agreement.

March 24, 2000 – Citizens Communications and Arizona-American filed a joint application for approval of the transfer of assets and Citizens' CC&Ns.

EXHIBIT
A-104
Admitted

September 27, 2000 – hearing on application.

November 15, 2000 – Arizona-American Water filed an application for authority to issue debt in an aggregate principal amount not to exceed $180 million in connection with purchasing Citizens' assets. (No hearing.)

April 24, 2001 – Decision No. 63584 docketed, approving transfer.

August 30, 2001 – Decision No. 64002 docketed, authorizing Arizona-American Water to borrow up to $180 million and to assume certain IDRBs.

January 15, 2002 – Citizens' acquisition closed.

AMERICAN WATER WORKS/RWE TRANSACTION

September 16, 2001 – American Water Works ("AWW"), RWE and Thames Water enter into Agreement and Plan of Merger.

December 17, 2001 – Arizona-American filed its application for a waiver of the Affiliated Interests Rules or, in the alternative, for an order declaring the AWW/RWE transaction is not subject to the Rules.

July, 2002 – meeting between Staff and Arizona-American; partial settlement reached on certain conditions recommended by Staff.

August 8, 2002 – hearing on Arizona-American's application.

December 12, 2002 – Decision No. 65453 docketed, approving AWW/RWE transaction subject to 15 conditions, including a condition prohibiting Arizona-American from filing any non-emergency rate increase requests for three years from the closing date of the transaction.

January 10, 2003 – the transaction between AWW and RWE/Thames Water closed, and the outstanding shares of AWW's common stock were acquired.

PENDING RATE APPLICATIONS

November 22, 2002 – rate applications were filed by Arizona-American for nine water and wastewater systems acquired from Citizens.

December 13, 2002 – rate application for the Tubac Water District filed.

EXHIBIT
H-1
Admitted

ARIZONA AMERICAN WATER COMPANY
RATE CASE
Hearing 12/04/03
Company's Exhibits Checklist

WITNESS	DOCUMENT	EXHIBIT
Thomas J. Bourassa	Direct **Testimony** Sun City Water and Wastewater Districts	**A-1**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-2**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-3**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-4**
	Direct **Testimony** Tubac Water District	**A-5**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Sun City Water District	**A-6**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Sun City Wastewater District	**A-7**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Sun City West Water District	**A-8**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Sun City West Wastewater District	**A-9**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Mohave Water District	**A-10**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Havasu Water District	**A-11**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Anthem Water District	**A-12**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Agua Fria Water District	**A-13**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Anthem/Agua Fria Wastewater District	**A-14**
	Direct Testimony **Schedules** (Bourassa and Kozoman) Tubac Water District	**A-15**
	Supplemental Direct **Testimony** Sun City Water and Wastewater Districts	**A-16**
	Supplemental Direct **Testimony** Sun City West Water and Wastewater Districts	**A-17**
	Supplemental Direct **Testimony** Mohave and Havasu Water Districts	**A-18**

ARIZONA AMERICAN WATER COMPANY
RATE CASE
Hearing 12/04/03
Company's Exhibits Checklist

WITNESS	DOCUMENT	EXHIBIT
Thomas J. Bourassa (cont.)	Supplemental Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-19**
	Supplemental Direct **Testimony** Tubac Water District	**A-20**
	Rebuttal **Testimony Vol. #1**	**A-21**
	Rebuttal **Exhibits**	**A-22**
	Rebuttal **Schedules**	**A-23**
	Rejoinder **Testimony Vol. #1**	**A-24**
Blaine Akine	Direct **Testimony** Sun City Water and Wastewater Districts	**A-25**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-26**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-27**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-28**
	Direct **Testimony** Tubac Water District	**A-29**
Kent Turner	Direct **Testimony** Sun City Water and Wastewater Districts	**A-30**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-31**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-32**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-33**
	Direct **Testimony** Tubac Water District	**A-34**
Ray Jones	Rejoinder **Testimony Vol. #1**	**A-35**
Frederick Schneider	Robert **Kuta** Direct **Testimony** Sun City Water and Wastewater Districts	**A-36**
	Robert **Kuta** Direct **Testimony** Sun City West Water and Wastewater Districts	**A-37**

ARIZONA AMERICAN WATER COMPANY
RATE CASE
Hearing 12/04/03
Company's Exhibits Checklist

WITNESS	DOCUMENT	EXHIBIT
Frederick Schneider (cont.)	Robert **Kuta** Direct **Testimony** Mohave and Havasu Water Districts	**A-38**
	Robert **Kuta** Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-39**
	Robert **Kuta** Direct **Testimony** Tubac Water District	**A-40**
	Robert **Kuta** Supplemental Direct **Testimony** Sun City Wastewater District	**A-41**
	Schneider Rebuttal **Testimony Vol. #1**	**A-42**
	Schneider Rejoinder **Testimony Vol. #1**	**A-43**
Thomas Zepp	Direct **Testimony** Sun City Water and Wastewater Districts	**A-44**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-45**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-46**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-47**
	Direct **Testimony** Tubac Water District	**A-48**
	Rebuttal **Testimony Vol. #1**	**A-49**
	Rejoinder **Testimony Vol. #2**	**A-50**
William Stout	Rebuttal **Testimony Vol. #1**	**A-51**
Ron Kozoman	Direct **Testimony** Sun City Water and Wastewater Districts	**A-52**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-53**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-54**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-55**
	Direct **Testimony** Tubac Water District	**A-56**
	Supplemental Direct **Testimony** Sun City Water and Wastewater Districts	**A-57**

ARIZONA AMERICAN WATER COMPANY
RATE CASE
Hearing 12/04/03
Company's Exhibits Checklist

WITNESS	DOCUMENT	EXHIBIT
Ron Kozoman (cont.)	Supplemental Direct **Testimony** Sun City West Water and Wastewater Districts	**A-58**
	Supplemental Direct **Testimony** Mohave and Havasu Water Districts	**A-59**
	Supplemental Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-60**
	Supplemental Direct **Testimony** Tubac Water District	**A-61**
	Rebuttal **Testimony Vol. #2**	**A-62**
	Rejoinder **Testimony Vol. #2**	**A-63**
Dave Stephenson	Direct **Testimony** Sun City Water and Wastewater Districts	**A-64**
	Direct **Testimony** Sun City West Water and Wastewater Districts	**A-65**
	Direct **Testimony** Mohave and Havasu Water Districts	**A-66**
	Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-67**
	Direct **Testimony** Tubac Water District	**A-68**
	Supplemental Direct **Testimony** Sun City Water and Wastewater Districts	**A-69**
	Supplemental Direct **Testimony** Sun City West Water and Wastewater Districts	**A-70**
	Supplemental Direct **Testimony** Mohave and Havasu Water Districts	**A-71**
	Supplemental Direct **Testimony** Agua Fria Water, Anthem Water, and Anthem/Agua Fria Wastewater Districts	**A-72**
	Supplemental Direct **Testimony** Tubac Water District	**A-73**
	Rebuttal **Testimony Vol. #1**	**A-74**
	Rejoinder **Testimony Vol. #1**	**A-75**

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ACC STAFF WITNESS AND EXHIBITS LISTING
Arizona-American Rate Application WS-01303A-02-0867 et al.

Witness	Document	Exhibit
	Third Amendment to Tolleson Agreement	S-1
	ACC Decision No. 60172	S-2
	FAS 71 (FASB)	S-3
	ACC Decision No. 56806	S-4
	ACC Decision No. 59079	S-5
	ACC Decision No. 60220	S-6
	ACC Decision 61831	S-7
	Arizona-American Response to Staff DR AII 39-3	S-8
	Arizona-American Response to Staff DR AII 39-7	S-9
	Suelflow, *Public Accounting: Theory and Application,* page 205	S-10
	Arizona-American Response to Staff DR AII 39-4	S-11
	Arizona-American Response to Staff DR AII 39-1	S-12
	Transcript excerpts (pages 131-132) of 4/29/1999 hearing in Docket W-01303A-98-0507	S-13

Witness	Document	Exhibit
Alex Igwe	**Igwe Direct Testimony**	S-14
	Sun City West Water Direct Testimony Schedules AII-1 through AII-10	S-15
	Sun City West Wastewater Direct Testimony Schedules AII-1 through AII-10	S-16
	Sun City Water Direct Testimony Schedules AII-1 through AII-10	S-17
	Sun City Wastewater Direct Testimony Schedules AII-1 through AII-10	S-18
	Mohave Direct Testimony Schedules AII-1 through AII-10	S-19
	Havasu Direct Testimony Schedules AII-1 through AII-10	S-20
	Agua Fria Water Direct Testimony Schedules AII-1 through AII-11	S-21
	Anthem Water Direct Testimony Schedules AII-1 through AII-11	S-22
	Anthem/Agua Fria Water Direct Testimony Schedules AII-1 through AII-10	S-23
	Tubac Direct Testimony Schedules AII-1 through AII-10	S-24

ALL-STATE LEGAL®
EXHIBIT
H-2
Admitted

ACC STAFF WITNESS AND EXHIBITS LISTING
Arizona-American Rate Application WS-01303A-02-0867 et al.

Witness	Document	Exhibit
Igwe, con't.	**Igwe Surrebuttal Testimony**	S-25
	Sun City West Water Surrebuttal Testimony Schedules AII-1 and AII-1	S-26
	Sun City West Wastewater Surrebuttal Testimony Schedules AII-1 and AII-1	S-27
	Sun City Water Surrebuttal Testimony Schedules AII-1 and AII-1	S-28
	Sun City Wastewater Surrebuttal Testimony Schedules AII-1 and AII-1	S-29
	Mohave Surrebuttal Testimony Schedules AII-1 and AII-1	S-30
	Havasu Surrebuttal Testimony Schedules AII-1 and AII-1	S-31
	Agua Fria Water Surrebuttal Testimony Schedules AII-1 and AII-1	S-32
	Anthem Water Surrebuttal Testimony Schedules AII-1 and AII-1	S-33
	Anthem/Agua Fria Wastewater Surrebuttal Testimony Schedules AII-1 and AII-1	S-34
	Tubac Surrebuttal Testimony Schedules AII-1 and AII-1	S-35

Witness	Document	Exhibit
Dennis Rogers	**Rogers Direct Testimony**	S-36
	Sun City West Water Direct Testimony Schedules DRR-1 and DRR-2	S-15
	Sun City West Wastewater Direct Testimony Schedules DRR-1 and DRR-2	S-16
	Sun City Water Direct Testimony Schedules DRR-1 and DRR-2	S-17
	Sun City Wastewater Direct Testimony Schedules DRR-1 and DRR-2	S-18
	Mohave Direct Testimony Schedules DRR-1 and DRR-2	S-19
	Havasu Direct Testimony Schedules DRR-1 and DRR-2	S-20
	Agua Fria Water Direct Testimony Schedules DRR-1 and DRR-2	S-21
	Anthem Water Direct Testimony Schedules DRR-1 and DRR-2	S-22
	Anthem/Agua Fria Water Direct Testimony Schedules DRR-1 and DRR-2	S-23
	Tubac Direct Testimony Schedules DRR-1 and DRR-2	S-24
	Rogers Surrebuttal Testimony	S-37

ACC STAFF WITNESS AND EXHIBITS LISTING
Arizona-American Rate Application WS-01303A-02-0867 et al.

Witness	Document	Exhibit
Marlin Scott	**Scott Direct Testimony**	S-38
	Scott Surrebuttal Testimony	S-39
John Chelus	**Chelus Direct Testimony**	S-40
Dorothy Haines	**Haines Direct Testimony**	S-41
Lyndon Hammon	**Hammon Direct Testimony**	S-42
Brian Bozzo	**Bozzo Direct Testimony**	S-43
	Bozzo Surrebuttal Testimony	S-44
Joel Reiker	**Reiker Direct Testimony**	S-45
	Reiker Surrebuttal Testimony	S-46
Darron Carlson	**Carlson Direct Testimony**	S-47
	Sun City West Water Direct Testimony Schedules DWC-1 through DWC-4	S-15
	Sun City West Wastewater Direct Testimony Schedules DWC-1 through DWC-4	S-16
	Sun City Water Direct Testimony Schedules DWC-1 through DWC-4	S-17

Witness	Document	Exhibit
Carlson, con't.	Sun City Wastewater Direct Testimony Schedules DWC-1 through DWC-4	S-18
	Mohave Direct Testimony Schedules DWC-1 through DWC-4	S-19
	Havasu Direct Testimony Schedules DWC-1 through DWC-4	S-20
	Agua Fria Water Direct Testimony Schedules DWC-1 through DWC-4	S-21
	Anthem Water Direct Testimony Schedules DWC-1 through DWC-4	S-22
	Anthem/Agua Fria Water Direct Testimony Schedules DWC-1 through DWC-4	S-23
	Tubac Direct Testimony Schedules DWC-1 through DWC-4	S-24
	Carlson Surrebuttal Testimony	S-48
	Sun City West Water Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-26
	Sun City West Wastewater Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-27
	Sun City Water Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-28

ACC STAFF WITNESS AND EXHIBITS LISTING
Arizona-American Rate Application WS-01303A-02-0867 et al.

Witness	Document	Exhibit
Carlson, con't.	Sun City Wastewater Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-29
	Mohave Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-30
	Havasu Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-31
	Agua Fria Water Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-32
	Anthem Water Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-33
	Anthem/Agua Fria Wastewater Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-34
	Tubac Surrebuttal Testimony Schedules DWC-1 through DWC-4	S-35