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NEW APPLICATION

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BEFORE THE ARIZONA CORPORATION COMMI

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COMMISSIONERS

2010 NOV 18 P 3: 02

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

AZ CORP COMMISSION
DOCKET CONTROL

WS-01303A-10-0470

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA PUBLIC SERVICE CORPORATION, FOR AUTHORITY TO INCUR LONG-TERM DEBT VIA AMERICAN WATER CAPITAL CORP.	DOCKET NO. WS-01303A-10-____ **FINANCING APPLICATION**

FINANCING APPLICATION
ARIZONA-AMERICAN WATER COMPANY
November 18, 2010

Introduction. As more fully set forth below, Arizona-American Water Company ("Arizona-American" "AZ-Am" or "the Company") hereby applies in accordance with A.R.S. § 40-301 *et. seq.,* for authority to be obligated for up to **$50 million in long-term debt** not previously approved by the Arizona Corporation Commission ("Commission") to be issued, in increments, during the period 2010 - 2015. The debt is expected to be issued in the public/private markets, through American Water Capital Corp. ("Capital Corp.") the financing subsidiary of American Water Works Company, Inc. ("AWW") and an affiliate of the Company, or through any other third party which will produce the least cost of financing to the Company.

1. **Supporting Exhibits**. As more fully discussed below, Arizona-American provides the following Exhibits in support of its Application:

- **Exhibit A** – 2010 – 2015 Capital Budget
- **Exhibit B** – 2009 Audited Balance Sheet & Income Statement
- **Exhibit C** – Form of Public Notice

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- **Exhibit D** – Certificate of Board Resolution[1]

2. **Company Description**. Arizona-American is an Arizona public service corporation engaged in providing water and wastewater utility services in portions of Maricopa, Mohave, and Santa Cruz Counties, Arizona, pursuant to various certificates of public convenience and necessity granted by the Commission to Arizona-American and its predecessors in interest. The Company presently provides utility service to approximately 107,000 water customers and 52,000 sewer customers in Arizona and is Arizona's largest investor-owned water and wastewater utility. Arizona-American is a wholly-owned subsidiary of AWW.

3. **Principal Office**. The Company's principal business office is located at 2355 West Pinnacle Peak Road, Suite 300, Phoenix, Arizona 85027, and its telephone number is (623) 445-2455.

4. **Authorized Representative**. The person authorized to receive notices and communications regarding this Application is:

Thomas M. Broderick
Director, Rates & Regulation
Arizona-American Water Company
2355 W. Pinnacle Peak Rd.
Suite 300
Phoenix, Arizona 85027
Telephone: (623) 445-2420
Thomas.Broderick@amwater.com

All discovery and other requests for information concerning this Application should be directed to Mr. Broderick, with a copy to undersigned counsel for the Company.

5. **Description of Lender**. Following approval by the Commission, Arizona-American intends to borrow the requested funds from Capital Corp. which, in turn, will borrow from the lender or lenders which will produce the least cost of financing to AZ-Am at the time, based on market conditions and then current funding requirements of the Company. Arizona-

[1] The Resolution authorized $35 million which is effectively the ceiling for the first incremental issue under the total $50 million requested. Subsequent Board authorization(s) will be obtained for the remainder. The Resolution mentions a June 30, 2010 application to borrow $35 million – that application was not filed and the instant application is the filing.

American – under earlier authorizations – has presently outstanding approximately $186 million in long-term debt from Capital Corp.

6. **Background.** Arizona-American's outstanding short-term debt balance was $53,986,609 as of October 31, 2010. Arizona-American completed construction of the White Tanks surface water treatment plant in its Agua Fria Water District November 30, 2009, at a cost of approximately $63 million, which was temporarily financed with short-term debt. In keeping with sound financial management, Arizona-American must bring its short-term debt balance to (near) zero periodically and the requested authority herein will enable that to occur during the current financial planning horizon (2010 – 2015).

7. **Purpose of Borrowing**. Arizona-American seeks to use the borrowing authority to discharge its existing short-term indebtedness by reimbursing its corporate treasury for past capital expenditures. As of the June 30, 2010 test year utilized in the Company's most recent rate filing, total long-term debt and equity for ratemaking purposes was $340.6 million. Therefore, short-term debt represents more than 15% of the Company's existing permanent investment – a percentage the Company believes is too high. On the other hand, paying down short-term debt quickly will increase substantially the Company's interest expense at a time when earnings are already far below authorized returns. Therefore, the Company must balance the need to reduce short-term debt at higher interest cost with the associated impact on earnings and customers' rates. As a result, the Company intends to issue the requested $50 million in several steps.

The Financial Services Agreement with Capital Corp. does not prohibit or restrict Arizona-American from borrowing from other parties or obtaining financial services from other parties whenever and on whatever terms it deems appropriate. Arizona-American may have the opportunity to finance certain capital projects through low-cost or tax-advantaged government programs due to the public benefits associated with certain projects. As such, Arizona-American discloses this intention and seeks Commission authority in this Application to engage in these types of borrowings and debt financings during the proposed 2010-2015 period.

While Arizona American is not required to borrow from Capital Corp., Arizona-American does not have as ready access to liquid markets as does Capital Corp. and the Capital Corp. securities – to the extent utilized in this $50 million request - would be issued in transactions of sufficient size to ensure that each financing is able to obtain the most favorable market rate possible in the circumstance. The Commission has previously recognized the benefits of Arizona-American's financing arrangements with Capital Corp., an affiliated company. Through its agreement with Capital Corp., Arizona-American has the ability to attract capital for necessary investment through Capital Corp. and achieve flexibility and savings with Capital Corp.'s credit rating that Arizona-American could not obtain on a stand-alone basis. Capital Corp. can respond quickly to, and take advantage of, changes in the debt market through its shelf registration with the United States Securities and Exchange Commission, thereby allowing flexibility to adapt to the most favorable method of sale given prevailing market conditions.

Arizona-American and its ratepayers can also obtain tax-exempt financing on an unsecured basis through Capital Corp. If available, Arizona-American will enjoy the advantage of tax-exempt interest rates based upon the rating of Capital Corp. Arizona-American will not issue tax-exempt notes (or taxable notes) to Capital Corp. unless it can determinate that, based on market conditions applicable at the time, such issuance will result in the lower overall cost to Arizona-American for the securities of comparable type, maturity and terms.

With long-term interest rates presently at or near historically low levels, the timing is good for Arizona-American to begin to convert its existing short-term debt to long-term debt.

9. **Proposed Interest Rate**. Based on current market conditions, Arizona-American anticipates an interest rate of between 5.75% and 6.50% if it borrows from Capital Corp. on a taxable unsecured basis, but since market conditions can and do change quickly, Arizona-American requests the Commission to authorize a maximum interest rate of 7.5% which would apply to each increment of debt issued.

10. **Financing Term**. Financing terms for each increment will be up to 30 years.

11. **Debt Security**. The proposed debt will most likely be issued on an unsecured basis. There will also be debt issuance costs the Company will later also include for cost recovery in rates and the Company likewise requests the Commission explicitly acknowledge recoverability of debt issuance costs in its decision in this Application. These costs are not included in the requested 7.5% maximum interest rate. Absent the assurance of the recoverability of debt issuance costs, Arizona-American may not be allowed to record these amounts as regulatory assets on its balance sheet until a future rate case which considers these amounts.

12. **Financial Statements**. Exhibit B is a copy of the Company's 2009 Audited balance sheet and income statement.

13. **DSC and TIER**. As of December 2009[2] Arizona-American's Debt Service Coverage Ratio ("DSC") was 3.03 and its Times Interest Earned Ratio (TIER") was 0.69 (audited operating income was $6.137 million, interest on long-term debt was $8.917 million and depreciation and amortization was $20.860 million). Based on its DSC, the Company should be able to adequately cover its expected debt payments from operating cash flow, but its TIER is unsustainable in the long-run and further rate relief (two rate cases are already pending) is necessary to return it to a normal range well above 1.0. Exhibit A is a copy of the Company's 2010 – 2015 capital budget. It indicates that Arizona-American's annual capital budget is roughly equivalent to internally generated funds for the 2010 to 2015 period. Arizona-American updates its capital budget at least annually.

14. **Corporate Powers**. The Company will file copies of the certificates of resolution of Arizona-American's Board of Directors authorizing the modification of each increment of the Company's debt obligation with respect to the stand alone financing. Arizona-American will

[2] Docket No. W-01303A-10-0448 has additional financial result information through June 30, 2010.

accept a Commission compliance requirement to file each subsequent resolution to incur additional debt under the requested $50 million request.

15. **Compliance**. Arizona-American has not been informed of any unfulfilled compliance requirements at the Commission, the Arizona Department of Environmental Quality, or the Arizona Department of Water Resources.

16. **Compatibility**. The proposed financing is needed to reduce the short-term debt level of Arizona-American.

Therefore, the requested financing approval is compatible with

- the public interest;
- sound financial practices; and
- the proper performance by Arizona-American of service as a public service corporation (and will not impair the Company's ability to perform that service).

17. **Prompt & Expedited Approval**. The Company requests prompt and expedited approval as the interest rate environment is currently favorable.

18. **Requested Relief**. As more fully set forth in this Application, Arizona-American asks that the Commission approve its request under A.R.S. § 40-301 *et. seq,* to incur up to $50 million in new long-term debt through 2015 at an annual interest rate not to exceed 7.5%.

Respectfully submitted on November 18, 2010, by:

Mil Hll

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Attorney for Arizona-American Water Company

Original and 13 copies filed
November 18, 2010, with:

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

Copies of the foregoing mailed on
November 18, 2010, to:

Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Lyn Farmer
Chief Hearing Officer
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Residential Utility Consumer Office
1110 West Washington Street
Suite 220
Phoenix, Arizona 85007

By: ____________________
Courtney Appelhans

Arizona-American Water Company
2010 Financing Application
Exhibit A – 2010 – 2015 Capital Budget

	A	N	AA	AN	BA	BN	CA
1	**Arizona 2010 Q2RF and 2011-2015 Business Plan**	**2010 TOTAL**	**2011 Total**	**2012 Total**	**2013 Total**	**2014 Total**	**2015 Total**
2	Recurring Project Total	6,770,000	7,433,847	8,605,197	7,565,618	7,991,470	8,159,103
3	Investment Project Total	2,325,228	3,290,351	3,465,759	6,483,306	9,008,471	11,558,309
4	Business Transformation Total	2,070,520	3,507,201	3,806,796	3,181,267	1,561,629	0
5	Developer Project Total	6,158,002	7,480,000	18,456,000	22,556,000	23,516,000	14,835,000
6	**Gross CapEx Total**	**17,323,749**	**21,711,400**	**34,333,751**	**39,786,191**	**42,077,570**	**34,552,412**
7	Contributions	(3,564,999)	(480,000)	(1,070,000)	(7,335,000)	(8,415,000)	(2,990,000)
8	Advances	(3,023,000)	(7,480,000)	(18,206,000)	(16,356,000)	(16,966,000)	(14,835,000)
9	Refunds	9,847,208	2,389,783	3,021,709	3,071,415	3,339,964	2,783,197
10	**Net CapEx Total**	**20,582,958**	**16,141,183**	**18,079,460**	**19,166,606**	**20,036,534**	**19,510,610**

	A	B	O	AB	AO	BB	BO	CB
1	**FP #**	**FP Type**	**2010 Total**	**2011 Total**	**2012 Total**	**2013 Total**	**2014 Total**	**2015 Total**
111		**TOTAL RP**	6,770,000	7,433,847	8,605,197	7,565,618	7,991,470	8,159,103
112								
126		**TOTAL DV**	**6,158,002**	**7,480,000**	**18,456,000**	**22,556,000**	**23,516,000**	**14,835,000**
127								
129		**TOTAL CS**	**2,070,520**	**3,507,201**	**3,806,796**	**3,181,267**	**1,561,629**	**-**
130								
168		**TOTAL IP**	**2,325,534**	**3,290,351**	**3,465,759**	**6,483,306**	**9,008,471**	**11,558,309**

	A	B	O	AB	AO	BB	BO	CB
1	District	ACR	2010 Total	2011 Total	2012 Total	2013 Total	2014 Total	2015 Total
2	2302	DV	2,425,000	50,000	930,000	5,535,000	290,000	150,000
3	2302	AIAC	(209,785)	(50,000)	(930,000)	(835,000)	(290,000)	(150,000)
4	2302	CIAC	(2,198,896)	0	0	(4,700,000)	0	0
5	2302	Refund	12,884	12,810	12,743	12,683	12,630	12,583
6								
7	2361	DV	2,926,000	4,358,000	9,540,000	9,380,000	15,070,000	10,900,000
8	2361	AIAC	(2,286,724)	(4,358,000)	(9,290,000)	(9,380,000)	(10,570,000)	(10,900,000)
9	2361	CIAC	(1,093,510)	(480,000)	(1,070,000)	(1,135,000)	(6,365,000)	(2,990,000)
10	2361	Refund	2,035,764	1,052,636	1,569,375	1,868,055	2,105,589	1,508,191
11								
12	2362	DV	125,000	1,535,000	815,000	2,320,000	930,000	900,000
13	2362	AIAC	(43,540)	(1,535,000)	(815,000)	(820,000)	(880,000)	(900,000)
14	2362	CIAC	(45,000)	0	0	(1,500,000)	(50,000)	0
15	2362	Refund	37,580	40,946	40,540	40,130	39,735	39,355
16								
17	2363	DV	20,000	220,000	240,000	170,000	45,000	45,000
18	2363	AIAC	(18,088)	(220,000)	(240,000)	(170,000)	(45,000)	(45,000)
19	2363	CIAC	0	0	0	0	0	0
20	2363	Refund	20,538	23,752	23,752	23,752	23,752	23,752
21								
22	2364	DV	115,000	195,000	45,000	95,000	20,000	45,000
23	2364	AIAC	(93,625)	(195,000)	(45,000)	(95,000)	(20,000)	(45,000)
24	2364	CIAC	0	0	0	0	0	0
25	2364	Refund	13,611	13,414	13,220	13,028	12,839	12,653
26								
27	2365	DV	71,001	141,000	36,000	86,000	36,000	40,000
28	2365	AIAC	(47,633)	(141,000)	(36,000)	(86,000)	(36,000)	(40,000)
29	2365	CIAC	0	0	0	0	0	0
30	2365	Refund	2,452	2,761	2,761	2,761	2,761	2,761
31								
32	2371	DV	75,000	70,000	65,000	1,090,000	2,065,000	100,000
33	2371	AIAC	(3,966)	(70,000)	(65,000)	(1,090,000)	(65,000)	(100,000)
34	2371	CIAC	0	0	0	0	(2,000,000)	0
35	2371	Refund	89,391	90,345	91,397	92,551	93,814	95,188
36								
37	2372	DV	75,000	70,000	315,000	765,000	565,000	100,000
38	2372	AIAC	(29,259)	(70,000)	(315,000)	(765,000)	(565,000)	(100,000)
39	2372	CIAC	(785)	0	0	0	0	0
40	2372	Refund	18,363	18,363	18,363	18,363	18,363	18,363
41								
42	2373	DV	20,000	140,000	2,325,000	225,000	30,000	35,000
43	2373	AIAC	(13,256)	(140,000)	(2,325,000)	(225,000)	(30,000)	(35,000)
44	2373	CIAC	(870)	0	0	0	0	0
45	2373	Refund	27,411	27,332	27,270	27,225	27,199	27,190
46								
47	2383	DV	20,000	195,000	145,000	150,000	150,000	150,000
48	2383	AIAC	(17,106)	(195,000)	(145,000)	(150,000)	(150,000)	(150,000)
49	2383	CIAC	0	0	0	0	0	0
50	2383	Refund	5,027,115	424,239	418,008	412,025	406,051	400,163
51								
52	2384	DV	15,000	135,000	140,000	145,000	145,000	145,000
53	2384	AIAC	(13,253)	(135,000)	(140,000)	(145,000)	(145,000)	(145,000)
54	2384	CIAC	(169,819)	0	0	0	0	0
55	2384	Refund	2,219,834	197,222	197,222	197,222	197,222	197,222
56								
57	2385	DV	233,000	287,000	2,870,000	2,105,000	3,930,000	2,000,000
58	2385	AIAC	(233,211)	(287,000)	(2,870,000)	(2,105,000)	(3,930,000)	(2,000,000)
59	2385	CIAC	0	0	0	0	0	0
60	2385	Refund	332,988	481,433	602,595	359,221	395,674	441,503
61								
62	2389	DV	38,000	84,000	990,000	490,000	240,000	225,000
63	2389	AIAC	(13,555)	(84,000)	(990,000)	(490,000)	(240,000)	(225,000)
64	2389	CIAC	(56,119)	0	0	0	0	0
65	2389	Refund	5,277	4,530	4,464	4,399	4,336	4,273
66								
67	Total	AIAC	(3,023,000)	(7,480,000)	(18,206,000)	(16,356,000)	(16,966,000)	(14,835,000)
68	Total	CIAC	(3,564,999)	(480,000)	(1,070,000)	(7,335,000)	(8,415,000)	(2,990,000)
69	Total	Refund	9,847,208	2,389,783	3,021,709	3,071,415	3,339,964	2,783,197

Arizona-American Water Company
2010 Financing Application
Exhibit B – 2009 Audited Balance Sheet and Income Statement

Arizona-American Water Company

(a wholly-owned subsidiary of American Water Works Company, Inc.)

Financial Statements

As of and for the years ended December 31, 2009 and 2008

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

To the Board of Directors and Stockholder of
Arizona-American Water Company

In our opinion, the accompanying balance sheets and statements of capitalization and the related statements of operations, of changes in common stockholder's equity and of cash flows present fairly, in all material respects, the financial position of Arizona-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

July 15, 2010

ARIZONA-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2009 and 2008
(Dollars in thousands)

Assets

	2009	2008
Property, plant and equipment		
Utility plant - at original cost, net of accumulated depreciation	$ 658,906	$ 625,237
Utility plant acquisition adjustments, net	26,318	27,318
Total property, plant and equipment	685,224	652,555
Current assets		
Cash and cash equivalents	234	262
Customer accounts receivable	3,957	5,554
Allowance for uncollectible accounts	(423)	(1,027)
Unbilled revenues	4,160	3,088
Accounts receivable - associated company	249	322
Other accounts receivable, net	592	950
Federal income tax refund due from associated company	-	233
Materials and supplies	524	375
Prepaid other	745	279
Other	11	107
Total current assets	10,049	10,143
Regulatory and other long-term assets		
Deferred income taxes	8,997	12,689
Other receivable	1,949	2,684
Regulatory assets	19,966	19,539
Other	776	821
Total regulatory and other long-term assets	31,688	35,733
Total Assets	$ 726,961	$ 698,431

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2009 and 2008
(Dollars in thousands)

Capitalization and Liabilities

	2009	2008
Capitalization		
Common stockholder's equity	$ 154,887	$ 154,949
Long-term debt, excluding current portion	175,530	175,552
Total capitalization	330,417	330,501
Current liabilities		
Notes payable-associated company	67,649	52,584
Current portion of advances for construction	9,349	3,343
Current portion of long-term debt	8,582	19,216
Accounts payable	3,802	6,378
Accounts payable - associated company	658	1,805
Federal income tax payable due to associated company	1,160	-
Accrued taxes	1,357	844
Other	7,106	7,011
Total current liabilities	99,663	91,181
Regulatory and other long-term liabilities		
Advances for construction	203,592	191,172
Deferred investment tax credits	53	56
Deferred revenue	3,188	3,357
Regulatory liabilities	1,464	2,879
Accrued pension expense	1,129	1,076
Accrued postretirement benefit expense	47	43
Other	1,287	2,236
Total regulatory and other long-term liabilities	210,760	200,819
Contributions in aid of construction	86,121	75,930
Commitments and contingencies (see Note 16)	-	-
Total Capitalization and Liabilities	$ 726,961	$ 698,431

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Statements of Operations
For Years Ended December 31, 2009 and 2008
(Dollars in thousands)

	2009	2008
Operating revenues	$ 80,322	$ 74,278
Operating expenses		
Operation and maintenance	50,737	47,996
Depreciation	20,180	18,551
Amortization	680	739
General taxes	2,843	2,616
Gain on disposition of property	(255)	(60)
Total operating expenses, net	74,185	69,842
Operating income	6,137	4,436
Other income (deductions)		
Interest on long-term debt	(8,917)	(10,424)
Interest on short-term debt	(467)	(1,221)
Allowance for other funds used during construction	3,018	1,523
Allowance for borrowed funds used during construction	1,586	744
Amortization of debt issuance costs	(84)	(88)
Other (deductions) income, net	(95)	239
Total other deductions	(4,959)	(9,227)
Income (loss) before income taxes	1,178	(4,791)
Income tax provision (benefit)	1,274	(1,645)
Net loss	$ (96)	$ (3,146)

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Statements of Cash Flows
For Years Ended December 31, 2009 and 2008
(Dollars in thousands)

	2009	2008
Cash flows from operating activities		
Net loss	$ (96)	$ (3,146)
Adjustments		
Depreciation and amortization	20,860	19,290
Amortization of debt issuance costs	84	88
Provision for deferred income taxes	3,722	294
Amortization of deferred investment tax credits	(4)	(4)
Provision for losses on accounts receivable	164	797
Allowance for other funds used during construction	(3,018)	(1,523)
Gain on disposition of property	(255)	(60)
Pension and non-pension postretirement benefits	2,240	952
Other, net	(2,566)	(2,807)
Changes in assets and liabilities		
Receivables and unbilled utility revenues	(243)	(946)
Federal income tax refund due from associated company	1,393	2,220
Other current assets	(88)	2,001
Pension and non-pension postretirement benefit contributions	(2,187)	(1,784)
Accounts payable	(41)	445
Accrued taxes, including federal income	450	(116)
Other current liabilities	(1,052)	2,710
Net cash provided by operating activities	19,363	18,411
Cash flows from investing activities		
Capital expenditures	(29,820)	(49,869)
Removal costs from property, plant and equipment retirements, net of salvage	(27)	23
Net cash used in investing activities	(29,847)	(49,846)
Cash flows from financing activities		
Repayment of long-term debt	(10,656)	(4,519)
Net borrowings of notes payable-associated company	15,065	32,267
Advances (refunds) and contributions for construction, net of refunds of $2,412 in 2009 and $24,022 in 2008	6,047	(16,551)
Capital contributions	-	20,000
Debt issuance costs	-	(3)
Net cash provided by financing activities	10,456	31,194
Net decrease in cash and cash equivalents	(28)	(241)
Cash and cash equivalents at beginning of year	262	503
Cash and cash equivalents at end of year	$ 234	$ 262
Cash paid (received) during the year for:		
Interest, net of capitalized amount	$ 10,565	$ 11,972
Income tax refunds	$ (3,809)	$ (3,521)
Non-cash investing activity		
Capital expenditures acquired on account but unpaid as of year-end	$ 1,034	$ 3,569
Non-cash financing activity		
Capital contributions (See Note 12)	$ 34	$ 192

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Statements of Changes in Capitalization
For Years Ended December 31, 2009 and 2008
(Dollars in thousands)

	2009	2008
Common stockholder's equity		
Common stock - no par value, authorized 600,000 shares 104,576 shares issued and outstanding in 2009 and 2008	$ 523	$ 523
Paid-in capital	184,694	184,660
Accumulated deficit	(30,330)	(30,234)
Total common stockholder's equity	154,887	154,949
Long-term debt		
General mortgage bonds		
6.26% series due 2012	24	33
7.18% series due 2015	28	33
1.05% series due 2015	8,560	8,560
7.18% series due 2015	34	38
5.76% series due 2013	16	19
Notes payable-associated company		
5.52% series due 2016	11,200	11,200
5.62% series due 2018	123,100	123,100
5.39% series due 2013	24,700	24,700
Variable rate tax exempt redeemed 2009	-	10,635
6.59% series due 2037	16,450	16,450
	184,112	194,768
Less: Current portion of long-term debt	(8,582)	(19,216)
Total long-term debt, net of current portion	175,530	175,552
Total Capitalization	$ 330,417	$ 330,501

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Statements of Changes in Common Stockholder's Equity
For the Years Ended December 31, 2009 and 2008
(Dollars in thousands)

	Common Stock		Paid-in	(Accumulated)	
	Shares	**Par Value**	**Capital**	**(Deficit)**	**Total**
Balance at December 31, 2007	104,576	$ 523	$ 164,468	$ (27,088)	$ 137,903
Net loss	-	-	-	(3,146)	(3,146)
Capital contributions	-	-	20,192	-	20,192
Balance at December 31, 2008	104,576	$ 523	$ 184,660	$ (30,234)	$ 154,949
Net loss	-	-	-	(96)	(96)
Capital contributions	-	-	34	-	34
Balance at December 31, 2009	104,576	$ 523	$ 184,694	$ (30,330)	$ 154,887

The accompanying notes are an integral part of these financial statements.

ARIZONA-AMERICAN WATER COMPANY
Notes to Financial Statements
For the Years Ended December 31, 2009 and 2008
(Dollars in thousands)

Note 1: Organization and Operation

Arizona-American Water Company (the "Company") provides water service to approximately 105,600 (unaudited) customers and wastewater service to approximately 51,400 (unaudited) customers. These services are provided in 26 (unaudited) communities located in 3 (unaudited) counties in the state of Arizona. As a public utility operating in Arizona, the Company functions under rules and regulations prescribed by the Arizona Corporation Commission (the "Commission"). The Company is a wholly-owned subsidiary of American Water Works Company, Inc. ("AWW").

Note 2: Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company considers benefit plan assumptions, the carrying value of long-lived assets, including regulatory assets and liabilities, revenue recognition and accounting for income taxes to be its critical accounting estimates. The Company's significant estimates that are particularly sensitive to change in the near term are amounts reported for pension and other post-employment benefits, and contingency-related obligations.

Regulation

The Company is subject to regulation by the Commission and the local governments of the State of Arizona (collectively the "Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with authoritative guidance provided by U.S. GAAP. Regulated utilities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in operations by an non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of income in the period in which the costs and credits are reflected in the rates charged for service.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. Repairs and maintenance are charged to current operations.

Note 2 (continued):

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates, a regulatory asset or liability may occur where timing differences exist between when the Company incurs costs of removal and when the Company recovers such costs in rates. Removal costs, net of salvage, are recorded as reductions to the regulatory liability or an increase to the regulatory asset, as applicable.

The cost of utility property, plant and equipment is depreciated using the straight-line average remaining life using the composite method.

Computer software is either purchased or internally developed and their costs are capitalized as a unit of property. These assets were fully amortized at December 31, 2009 and 2008.

Utility plant acquisition adjustments represent the difference between the fair value of plant at the date of purchase and its original cost when first devoted to public service (less accumulated depreciation) and are amortized to expense over the useful lives of the corresponding purchased assets. Amortization of utility plant acquisition adjustments were $1,000 for 2009 and 2008, respectively. The remaining lives range from 17 to 40 years.

Cash and Cash Equivalents

Substantially all of the Company's cash is invested in interest-bearing accounts. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. There were no cash equivalents held at December 31, 2009 or 2008, respectively.

Accounts Receivable

The majority of the Company's accounts receivable is due from utility customers. Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators, and generally, collateral is not required.

Long-term Receivable

In 1997, the Company entered into a Water/Wastewater Infrastructure Agreement with a developer (the "Developer") to construct the local water/wastewater infrastructure and become the water and wastewater service provider for a new community. To reimburse the Company for certain capital expenditures, the Developer agreed to make payments to the Company totaling $9,140 beginning in 2004 and continuing through 2013. The Company accounted for the reimbursement as a long-term receivable and deferred revenue.

(Dollars in thousands)

Note 2 (continued):

As of December 31, 2009, the Company is expected to receive cash payments of $715 in 2010, $600 in 2011, $484 in 2012, $358 in 2013 and $0 thereafter. The Company is accreting the receivable at a 6.5% discount rate, which was the average rate at inception of the Company's debt incurred to fund the capital expenditures, and amortizing the deferred revenue over 30 years, the depreciable life of the corresponding assets in the agreement. Income recognized related to this agreement totaled $338 in 2009 and $388 in 2008.

Allowance for Uncollectible Accounts

Allowance for uncollectible accounts is maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes-off accounts when they become uncollectible.

The following table summarizes the changes in the Company's allowance for uncollectible accounts:

	2009	2008
Balance as of January 1	$ 1,027	$ 564
Provision charged to expense	164	797
Accounts written-off	(866)	(365)
Recoveries of accounts previously written-off	98	31
Balance as of December 31	$ 423	$ 1,027

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Advances and Contributions in Aid of Construction

The Company may receive advances and contributions from customers, homebuilders, real estate developers, and others to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances, which are no longer refundable, are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such contributions generally serves as a rate base reduction, since it represents non-investor supplied funds. Non-cash utility property has been received, primarily from developers, as advances or contributions of $26,031 and $13,605 for the years ended December 31, 2009 and 2008, respectively.

The Company depreciates utility plant funded by advances and contributions. The Company amortizes the balances in contributions as a reduction to depreciation expense,

Note 2 (continued):

producing a result, which is functionally equivalent to reducing the original cost of the utility plant for contributions. Amortization of contributions in aid of construction was $2,924 and $2,476 for the years ended December 31, 2009 and 2008, respectively.

In March 2010, the Company made an obligated lump-sum refund payment under its advances for construction agreement with the Developer in the amount of $6,742. Letters of credit have been issued with the Developer as the beneficiary to guarantee these refund payments.

Adjustments related to prior periods

The Consolidated Statements of Operations include adjustments related to prior periods, which have increased net income for the year ended December 31, 2009 by $598. For the year ended December 31, 2009, these adjustments have increased pre-tax income by $348 and reduced income tax expense by $250. These adjustments related to prior periods have not been reflected retroactively, as the amounts are not considered material.

Recognition of Revenues

Revenues are recognized as water and wastewater services are provided and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period. Other operating revenues are recognized when services are performed.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

Income Taxes

AWW and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns. Federal income tax expense for financial reporting purposes is provided on a separate return basis.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates anticipated to be in effect when such temporary differences are projected to reverse. Anticipated tax rates are the currently enacted tax rates, as the Company is not aware of any tax rate changes. In addition, regulatory assets and liabilities are recognized for the effect on

Note 2 (continued):

revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse.

Investment tax credits have been deferred and are being amortized to income over the average estimated service lives of the related assets.

The Company recognizes accrued interest and penalties related to tax positions as a component of income tax expense.

Allowance for Funds Used During Construction ("AFUDC")

AFUDC is a non-cash credit to income with a corresponding charge to utility plant, which represents the cost of borrowed funds and a return on equity funds devoted to plant under construction. AFUDC is recorded to the extent permitted by the Regulators.

Environmental Costs

The Company's water and wastewater operations are subject to federal, state, and local requirements relating to environmental protection, and as such the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. There were no remediation costs accrued at December 31, 2009 and 2008.

Long-Lived Assets

Long-lived assets and certain identifiable intangible assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the future cash flows expected to result from the use of the assets and their eventual disposition is less than the carrying amount of the assets, an impairment loss is recognized. Measurement of an impairment loss would be based on the fair value of the assets. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

New Accounting Standards

Fair Value Measurements

In January 2010, the Financial Accounting Standards Board ("FASB") issued authoritative guidance that requires new disclosures of (i) the amounts of significant transfers into and out of Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers and (ii) information in the reconciliation of recurring Level 3 measurements (those using significant unobservable inputs) about purchases, sales, issuances, and settlements on a gross basis. This update also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for interim and annual periods beginning after December 15, 2009, except for requirement to

Note 2 (continued):

disclose information about purchases, sales, issuances and settlements in the reconciliation of Level 3 measurements, which does not become effective until interim and annual periods beginning after December 15, 2010. As this guidance clarifies and provides for additional disclosure requirements only, the adoption of this guidance is not expected to have an impact on the Company's results of operations, financial position, or cash flows.

In August 2009, FASB issued authoritative guidance clarifying the measurement of the fair value of liabilities. The amendments reduce potential ambiguity in financial reporting when measuring fair value of liabilities and help improve consistency in the application of authoritative guidance. This update is effective for the first reporting period, including interim period, beginning after issuance, which for the Company was October 1, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

In April 2009, the FASB provided additional guidance on fair value of measurements in inactive markets when the volume and level of activity for the asset and liability have significantly decreased. This amendment also includes guidance on identifying circumstances that indicate a transaction is not orderly. This guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

In February 2008, the FASB provided additional guidance that allowed a one-year deferral of adoption of the guidance for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment, and goodwill) that required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, adopted this guidance for the Company's nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009. The adoption of this guidance did not have a significant impact on the Company's results of operations, financial position, or cash flows.

Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board ("FASB) issued authoritative guidance that establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative U.S. GAAP recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature note included in the Codification is non-authoritative. This guidance is effective for interim and annual periods ending after September 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

Note 2 (continued):

Consolidation of Variable Interest Entities

In June 2009, the FASB issued authoritative guidance that replaces the quantitative-based risk and rewards calculation for determining which reporting entity has a controlling financial interest in a variable interest entity with a qualitative approach. This revised guidance also requires additional disclosures about a reporting entity's involvement in variable interest entities. This guidance is effective for the Company beginning January 1, 2010. The Company does not believe the adoption of this update to have a significant impact on the Company's results of operations, financial position or cash flows.

Subsequent Events

In May 2009 and clarified in February 2010, the FASB issued authoritative guidance that establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard sets forth: (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions, (ii) the circumstances under which an entity should recognize events or transactions, and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows. The Company performed an evaluation of subsequent events for the accompanying financial statements through July 15, 2010, the date this Report was issued, to determine whether the circumstances warranted recognition and disclosure of those events or transactions in the financial statements as of December 31, 2009.

Recognition and Presentation of Other-Than-Temporary Impairments

In April 2009, the FASB amended authoritative guidance related to the impairment of certain debt securities and will require an entity to assess whether it (i) has the intent to sell the debt security or (ii) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the entity must recognize an other-than-temporary impairment. If an entity is able to meet the criteria to assert that it will not have to sell the security before recovery, impairment charges related to credit losses would be recognized in earnings, while impairment charges related to non-credit losses (for example, liquidity risk) would be reflected in other comprehensive income. The amended guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

Contingencies Acquired in a Business Combination

In April 2009, the FASB amended and clarified the authoritative guidance related to accounting for the initial recognition and measurement, subsequent measurement and accounting, and related disclosures arising form contingencies in a business combination. Assets acquired and liabilities assumed in a business combination that arise from contingencies should

(Dollars in thousands)

Note 2 (continued):

be recognized at fair value on the acquisition date if the fair value can be determined during the measurement period. If the fair value can not be determined, companies should account for the acquired contingencies using existing guidance. This guidance is effective for the Company for business combinations finalized after January 1, 2009.

Reclassifications

Certain reclassifications have been made to conform previously reported data to the current presentation.

Note 3: Utility Plant

The components of utility plant at December 31 are as follows:

	Range of remaining useful lives	2009	2008
Land and other non-depreciable assets	-	$ 16,039	$ 16,272
Sources of supply	7 to 90 years	51,642	42,735
Treatment and pumping	8 to 60 years	195,679	144,289
Transmission and distribution	23 to 67 years	258,274	239,787
Services, meters and fire hydrants	14 to 66 years	75,712	72,345
General structures and equipment	3 to 60 years	32,648	16,903
Wastewater	4 to 60 years	195,884	195,384
Construction work in progress	-	3,957	47,940
		829,835	775,655
Less: Accumulated depreciation		(170,929)	(150,418)
		$ 658,906	$ 625,237

The provision for depreciation expressed as a percentage of the aggregate average depreciable asset balance was 3.36% in 2009 and 3.40% in 2008.

Note 4: Regulatory Assets and Liabilities

Regulatory Assets

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Except for income taxes, regulatory assets and liabilities are excluded from the Company's rate base and do not earn a return.

(Dollars in thousands)

Note 4 (continued):

The components of regulatory assets are as follows:

	2009	2008
Interconnection costs	$ 4,683	$ 4,883
Income taxes recoverable through rates	4,107	3,017
Tolleson rate component costs	2,740	1,926
Treatment facility costs	2,432	2,953
Pension expense	1,900	1,998
Rate proceedings expense	934	921
Year 2000 costs	811	841
Arsenic filtering media costs	435	978
Other	1,924	2,022
	$ 19,966	$ 19,539

The Phoenix Anthem interconnect is a pipeline connecting the Company's Anthem water system to the City of Phoenix water system to create a redundant water supply for its Anthem water system and was recorded as a regulatory asset in 2009. The Company paid $5,000 for this interconnection and will amortize the amount over 25 years, as authorized by the Commission in 2008.

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the Commission of full normalization for rate-making purposes. The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

The Company utilizes the City of Tolleson's Wastewater Treatment Plant for its Sun City wastewater district customers. The Company has agreed to partially fund a treatment plant expansion and upgrade project. Although the plant is not owned by the Company, it is used to serve its customers; therefore capital improvement costs are capitalized and amortized over the life of the respective asset. The unamortized balances as of December 31, 2009 and 2008 are $2,740 and $1,926, respectively and were recorded as a regulatory asset. Recovery was granted in the past by the Commission and a request was filed in July 2009 for recovery of investment recorded through the end of the test year or December 31, 2008.

Treatment facility costs represent the Company's capital costs for the City of Tolleson Wastewater Treatment Plant, which is being amortized on a straight-line basis beginning in 2007 through 2014. The amortization is being recovered in rates.

(Dollars in thousands)

Note 4 (continued):

Pension expense in excess of the amount contributed to the pension plan is deferred. These costs will be recovered in future service rates as increased contributions are made to the pension plan.

Expense associated with rate proceedings are deferred and amortized on a straight-line basis as authorized by the Commission in its determination of rates charged for service. The unamortized balance as of December 31, 2009 consists of $748 of authorized expenses and $186 in expenses for ongoing cases. The Company is currently amortizing $1,105 on a straight-line basis over an average three-year period, as authorized by the Commission.

Year 2000 costs represent expenses associated with ensuring the Company's systems were ready for Year 2000. The balance is being recovered over thirty-two years beginning in July 2004.

Arsenic filtering media replacement costs represent expenses incurred to ensure the Company is in compliance with Environmental Protection Agency mandated arsenic standards. The unamortized balances as of December 31, 2009 and 2008 are $435 and $978, respectively. These costs are being amortized to expense over an average seven-year period, as authorized by the Commission.

Regulatory Liabilities

The components of regulatory liabilities are as follows:

	2009	2008
Debt extinguishment	$ -	$ 1,134
Gains on asset sales	1,405	1,745
Low income program	59	-
	$ 1,464	$ 2,879

Regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts recovered from customers in advance of incurring the costs.

The note payable issued to American Water Capital Corporation ("AWCC"), a subsidiary of AWW (4.92% due 2014) was redeemed in October, 2007 by the Company. The difference between book value of the note and cash consideration required to extinguish the debt was deferred as a regulatory liability. As per Decision No. 69344, the Regulators did not authorize the regulatory liability even though it was disclosed that the 4.92% note due in 2014 would be refinanced at a higher interest cost. The balance of $985 in the regulatory liability was credited to interest on long-term debt in 2009.

The Company has set up regulatory liabilities for certain gains on sales of properties. The liability that has been recognized is based on sharing the net gain after tax with the ratepayers on a 50/50 basis. Per Decision 68858, the Commission has granted a surcharge credit

Note 4 (continued):

refund based on the after tax gain over a three-year period beginning in October 2006 for the gain on sale of land at Casa Blanca Drive. The decrease in the regulatory liability balance is attributed to Casa Blanca Drive being fully refunded to ratepayers in 2009.

As authorized by the Commission, the Company has recognized a regulatory liability for its obligation to implement a low income program. The liability outstanding was $59 and $0 at December 31, 2009 and 2008, respectively.

Note 5: Long-Term Debt

Annual payments of principal and interest are required under the provisions of the 6.26%, 7.18%, 7.18% and 5.76% series general mortgage bonds. General mortgage bonds are collateralized by utility plant.

The senior notes payable to affiliate are unsecured and were issued to AWCC for the principal amount. AWCC provided the funding for these notes by issuing senior notes to institutional investors at a price equal to the principal amount.

The variable rate tax-exempt bond was remarketed for periods up to 270 days. The bond may be converted to an other short-term variable-rate structure, a fixed-rate structure or subject to redemption. At December 31, 2008, the debt was included in current portion of long-term debt since the Company could not be certain remarketing would be successful. During 2009, the Company purchased the bond for $10,635 because no buyer was willing to purchase the bond at market rate. Since the Company cannot be certain future remarketing would be successful, the debt was held in treasury by the Company on December 31, 2009.

On August 26, 2009, the Company filed a financing application with the Commission seeking approval for AWCC to modify the remarketing period of the variable rate tax-exempt bond to fix the interest rate until maturity.

The re-issued $8,560 bond included in current portion of long-term debt at December 31, 2009, represents a fixed rate tax-exempt bond remarketed for periods up to 270 days. During 2009, the Company purchased the bond for $8,560 because no buyer was willing to purchase the bond at market rate.

Maturities of long-term debt, including sinking funds, will amount to $8,582 in 2010, $24 in 2011, $22 in 2012, $24,715 in 2013, $13 in 2014, and $150,757 thereafter.

Other interest, net includes interest income of approximately $9 and $1 at December 31, 2009 and 2008, respectively.

(Dollars in thousands)

Note 6: Short-Term Borrowings

The Company maintains a line of credit through AWCC of $75,000 and $65,000 at December 31, 2009 and 2008, respectively. The line was increased by $10,000 in 2009, per an amendment to the agreement with AWCC. The Company may borrow from, or invest in, the line of credit. No compensating balances are required under the agreements.

The Company had short-term borrowings outstanding of $67,649 and $52,584 at December 31, 2009 and December 31, 2008, respectively. The weighted average annual interest rates on these borrowings at December 31, 2009 and 2008 were 0.70% and 3.41%, respectively.

The Company received a cash capital contribution of $20,000 during 2008, which was used to pay down short-term debt.

AWW, through AWCC, has committed to make additional financing available to the Company, as needed to pay its obligations as they come due.

At December 31, 2009, the Company had $7,907 of outstanding stand-by letters of credit.

Note 7: General Taxes

Components of general tax expense for the years presented in the statements of operations are as follows:

	2009	2008
Property and capital stock	$ 2,139	$ 1,938
Payroll and other general	704	678
	$ 2,843	$ 2,616

(Dollars in thousands)

Note 8: Income Taxes

Components of income tax expense for the years presented in the statements of operations are as follows:

	2009	2008
State income taxes:		
Current	$ (363)	$ 430
Deferred:		
Current	(3)	(104)
Non-current	2,222	(274)
	1,856	52
Federal income taxes:		
Current	(2,081)	(2,365)
Deferred:		
Current	(14)	(488)
Non-current	1,517	1,160
Amortization of deferred investment tax credits	(4)	(4)
	(582)	(1,697)
Total income tax provision (benefit)	$ 1,274	$ (1,645)

In December 2008, the Company as a member of the consolidated group filed a request with the Internal Revenue Service ("IRS") to change its tax accounting method for repair and maintenance costs on its utility assets. The IRS partially approved the request in October 2009, with the Company receiving final approval in February 2010, allowing the Company to take a tax deduction for costs that were previously capitalized for tax purposes. As a result, the Company recorded a deferred income tax liability for this temporary difference. In addition, the change in tax accounting method generated a net operating loss which the Company has substantially monetized.

The primary components of the net deferred tax assets at December 31, 2009 include basis differences in utility plant, advances and contributions, and net operating losses.

As of December 31 2009, the Company recorded gross operating loss carryforwards for Arizona state income tax purposes that begin to expire in 2009. The Company has determined that its Arizona state net operating loss carryforwards are not more likely than not to be recovered and has recognized a full valuation allowance as of December 31, 2009 and 2008, respectively.

The federal net operating loss carryforwards differ from the state net operating loss carryforwards due to the Company's participation in AWW's consolidated federal income tax

Note 8 (continued):

return. The company believes that its federal net operating loss carryforwards are more likely than not to be recovered and require no valuation allowance.

As of December 31, 2009 and 2008, the reserve for uncertain tax positions is $2,318 and $0, respectively, excluding accrued interest and penalties. The Company does not expect a material change in this estimate in the next twelve months. The reserve for uncertain tax positions could increase or decrease for such things as expiration of statutes of limitations, audit settlement, and tax examination.

The Company recognizes interest and penalties related to income tax matters in income tax expense; however, none were accrued as of December 31, 2009 and 2008, respectively.

The federal tax years that remain open are 2006 to 2008, with the earliest year's statute expiring in 2010. The Company is subject to state taxes. The state tax returns from 2003 to 2008 are currently open and will not close until the respective statutes of limitations expire. The statutes of limitations will begin to expire in 2010.

Note 9: Rate Matters

As necessary, the Company applies to the Commission for changes in the rates charged for service. The rate increase request is based on the actual level of operating expenses and capital costs during a historic test year adjusted for known and measurable changes. The revenues requested are based on actual sales during the historic test year also adjusted for known changes such as test year customer growth. The Company can provide no assurances that any rate request will be granted by the Commission.

Per Decision 70703 inJa nuary 2009, the Commission granted the Company a rate increase of an estimated annual amount of $156 in annual revenue and an additional $156 for amortization related to the arsenic filtering media cost (See Note 4) for the Sun City West water district's Arsenic Cost Recovery Mechanism ("ACRM").

Per Decision 71192 in June 2009, the Commission granted the Company a rate increase of an estimated annual amount of $1,110 in annual revenue for the Agua Fria water district's ACRM and $683 for amortization related to the arsenic filtering media costs (See Note 4).

Per Decision 71410 in December 2009, a permanent rate increase was granted for the Agua Fria Water, Havasu Water, Mohave Water, Paradise Valley Water, Sun City West Water, Tubac Water and Mohave Wastewater districts. The total annual estimated revenue increase is $8,023.

In July 2009, the Company filed rate increase applications for its Anthem Water, Sun City Water, Anthem/Agua Fria Wastewater, Sun City Wastewater, and Sun City West Wastewater districts. The total requested revenue increase is $20,629. Any rate increase granted

Note 9 (continued):

would be effective upon completion of the Arizona Corporation Commission's audit and investigation of the Company's application and contested public hearings. The Company can not provide any assurance that requested rate increases will be granted but anticipate the completion of the proceedings in the fourth quarter of 2010.

Note 10: Employee Benefit Plans

Savings Plan for Employees

The Company maintains a 401(k) savings plan, sponsored by AWW that allows employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution subject to certain limitations. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay as a defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plans totaling $291 during 2009, and $267 during 2008. All of the Company's contributions are invested in one or more funds at the direction of the employee.

Note 11: Postretirement Benefits

Pension Benefits

The Company participates in a Company funded defined benefit pension plan sponsored by AWW covering employees hired before January 1, 2006. Benefits under the plan are based on the employee's years of service and average annual compensation for those 60 consecutive months of employment which yield the highest average. The pension plan has been closed for any employee hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan. Pension cost of the Company is based on an allocation from AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of $2,144 and $881 for 2009 and 2008, respectively.

AWW's funding policy is to contribute at least the minimum amount required under the Employee Retirement Income Security Act of 1974. The Company made contributions to the AWW plan of $2,091 in 2009 and $1,713 in 2008. The Company expects to contribute $2,063 to the AWW plan in 2010.

Postretirement Benefits Other Than Pensions

Note 11 (continued):

The Company participates in a Company funded plan sponsored by AWW that provides certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. The retiree welfare plans are closed for union employees hired on or after January 1, 2006 and non-union employees hired on or after January 1, 2002. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Employees who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are covered by a Medicare supplement plan.

Costs of the Company are based on an allocation from AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of $96 in 2009 and $71 in 2008.

The Company made contributions to trust funds established for these postretirement benefits of $96 in 2009 and $71 in 2008. The Company's policy is to fund postretirement benefits costs accrued. The Company expects to contribute $97 to the AWW plan in 2010.

Note 12: Stock-Based Compensation

Stock Options and Restricted Stock Units

On February 20, 2009, AWW granted restricted stock units and stock options to certain employees of the Company under the AWW 2007 Omnibus Equity Compensation Plan ("Omnibus Plan"). The restricted stock units vest ratably over the three year performance period beginning January 1, 2009 (the "Performance Period"); however distribution of the shares is contingent upon the achievement of certain market thresholds over the performance period. The stock options vest ratably over a three year service period from January 1, 2009.

On April 22, 2008, AWW granted restricted stock awards, restricted stock units and stock options to certain employees of the Company under the Omnibus Plan. The restricted stock units and the stock options were awarded in two grants with "Grant 1" vesting on January 1, 2010 and "Grant 2" vesting January 1, 2011.

The value of restricted stock units at the date of the grant is amortized through expense over the requisite service period using the straight-line method for restricted stock units with service and/or performance vesting. The grant date fair value of restricted stock awards that have market and service conditions and vest ratably is amortized through expense over the requisite service period using the graded-vesting method. The value of stock options at the date of the grant is amortized through expense over the requisite service period using the straight-line method.

Costs of the Company are based on an allocation from AWW of the total cost for employees of the Company in the plan. The Company recorded compensation expense of $27 and $189, included in operation and maintenance expense, during the years ended December 31,

(Dollars in thousands)

Note 12 (continued):

2009 and 2008, respectively. As the Company does not reimburse the cost of the awards to AWW, the offsetting entry to paid-in-capital is a capital contribution from AWW.

Employee Stock Purchase Plan

AWW's Nonqualified Employee Stock Purchase Plan ("ESPP") was effective as of July 1, 2008. Under the ESPP, the Company's employees can use payroll deductions to acquire AWW common stock at the lesser of 90% of the fair market value as of a) the beginning or b) end of each three-month purchase period. AWW's ESPP is considered compensatory under SFAS 123(R). Costs of the Company are based on an allocation from AWW of the total cost for employees of the Company in the plan. Compensation costs of $7 and $3 were included in operation and maintenance expense for the years ended December 31, 2009 and 2008, respectively. As the Company does not reimburse the cost of the awards to AWW, the offsetting entry to paid-in-capital is a capital contribution from AWW.

Note 13: Related Party Transactions

American Water Works Service Company, Inc., a subsidiary of AWW, provides certain management services to the Company (administration, accounting, data processing, engineering, etc.) and other operating water companies in the AWW system on an at-cost, not-for-profit basis in accordance with a management and service agreement.

Purchases of such services by the Company were accounted for as follows:

	2009	2008
Included in operation and maintenance expense as a charge against income	$ 12,105	$ 11,716
Capitalized primarily in utility plant	1,323	950
	$ 13,428	$ 12,666

The Company had a payable to American Water Enterprises, another subsidiary of AWW, for meter reading and field customer service costs in the amount of $281 and $1,278 for 2009 and 2008,r espectively.

The Company maintains a line of credit with AWCC (See Note 6). The Company also participates in AWCC's centralized treasury function whereby the Company transfers its cash to AWCC and the Company's checks are issued out of AWCC. Under the arrangement, available cash is used to pay-down the line of credit and outstanding credits increase the Company's line of credit balance. The Company paid AWCC fees of $94 in 2009 and $57 in 2008, and recorded interest expense on borrowings of $467 in 2009 and $1,221 in 2008. Interest expense on long-term debt with AWCC amounted to $9,972 and $10,206 for 2009and 2008, respectively. Accrued interest included interest due to AWCC of $448 and $455 as of December 31, 2009 and 2008, respectively.

Note 14: Fair Values of Financial Instruments

The Company used the following methods and assumptions in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the balance sheet for current assets and current liabilities approximate their fair value.

Long-term debt: The fair values of the Company's long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the Company's financial instruments at December 31 are as follows:

	2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	$ 184,112	$ 196,053	$ 194,768	$ 182,330

Fair Value Measurements

To increase consistency and comparability in fair value measurements, FASB guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels as follows;

• Level 1—quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date. Financial assets and liabilities utilizing Level 1 inputs include active exchange-traded equity securities, exchange-based derivatives, mutual funds and money market funds.

• Level 2—inputs other than quoted prices included within level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data. Financial assets and liabilities utilizing Level 2 inputs include fixed income securities, non-exchanged-based derivatives, commingled investment funds not subject to purchase and sale restrictions and fair-value hedges.

• Level 3—unobservable inputs, such as internally-developed pricing models for the asset or liability due to little or no market activity for the asset or liability. Financial assets and liabilities utilizing Level 3 inputs include infrequently-traded non-exchange-based derivatives and commingled investment funds subject to purchase and sale restrictions.

(Dollars in thousands)

Note 14 (continued):

Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of December 31, 2009 and 2008, respectively:

	At Fair Value as of December 31, 2009			
Recurring Fair Value Measures	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Deposits	$ 245	$ -	$ -	$ 245
Total assets	245	-	-	245
Liabilities:				
Deferred compensation obligation	-	3	-	3
Total liabilities	-	3	-	3
Total net assets (liabilities)	$ 245	$ (3)	$ -	$ 242

	At Fair Value as of December 31, 2008			
Recurring Fair Value Measures	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Deposits	$ 235	$ -	$ -	$ 235
Total assets	235	-	-	235
Liabilities:				
Deferred compensation obligation	-	3	-	3
Total liabilities	-	3	-	3
Total net assets (liabilities)	$ 235	$ (3)	$ -	$ 232

Deposits – Deposits includes escrow funds and certain other deposits held in trust. The Company includes cash deposits in other long-term assets.

Deferred compensation obligations – The Company's deferred compensation plan allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company's deferred compensation obligations is based on the market value of the participants' notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

Note 15: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expense under operating leases was $1,015 for 2009 and $1,038 for 2008. The operating leases for the facilities expire by 2022.

At December 31, 2009, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancelable terms in excess of one year are, $785 in 2010,$ 644 in 2011, $566 in 2012, $464 in 2013, and $408 in 2014 and $782 thereafter.

Note 16: Commitments and Contingencies

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legally binding contracts amounted to $455 at December 31, 2009.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At December 31, 2009, the Company has not accrued for any probable losses; it is reasonably possible that additional losses could range up to $4,500 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

Sewage Treatment and Transportation Services Agreement

In 1988, the Company entered into a 40 year Sewage Treatment and Transportation Services Agreement with a municipality to utilize a wastewater treatment plant for waste treatment. The contract allows the municipality to bill the Company up to $200 annually.

During 2003, the Company agreed to fund in advance its pro-rata share of capital improvements needed to keep the municipality-owned wastewater treatment plant operating within regulatory compliance. At December 31, 2009, the Company's anticipated costs under the improvement program are $6,975 in 2010 and none thereafter. The Company is accounting for the payments as regulatory assets when paid and will amortize them over their useful lives upon approval by the Regulators. Costs incurred for capital improvements through December 31, 2009 are recorded as a regulatory asset (See Note 4 – Tolleson rate component costs).

Water Purchase Agreements with Developer

The Company maintains agreements with the Developer for the purchase of water through year 2102. The agreements stipulate the maximum entitlement of water the Company can purchase. Water charges are based on delivered volumes as requested by the Company prior to each calendar year. The Company has ordered $559 for 2010. The delivery schedule subsequent to 2010 is not set. The Company recognized expense of $508 and $295 in water

Note 16 (continued):

charges to the developer under these agreements during the years ended December 31, 2009 and 2008, respectively. The charges vary based upon usage and vendor costs and cannot be determined precisely; however, costs disclosed are indicative of the level of annual expenditures anticipated under the agreement.

Water Purchase Agreements with Central Arizona Project

The Company maintains agreements with the Central Arizona Project ("CAP") for the purchase of water through year 2107. The agreements stipulate the maximum entitlement of water the Company is allocated from CAP and outlines capital and delivery charges for the purchase of water. Capital charges are based on a take-or-pay contract provision and are calculated based on the maximum entitlements per the agreements. The Company recognized expense of $2,123 and $1,372 in capital and delivery charges to CAP under these agreements during the years ended December 31, 2009 and 2008, respectively. The charges vary based upon capital and delivery costs that are established each July for the subsequent calendar year allocations. Costs disclosed are indicative of the level of annual expenditures anticipated under the agreement.

Including all of the above, the Company maintains agreements with other water and transportation purveyors for the purchase or transport of water. The agreements stipulate purchases of minimum quantities of water through 2107. The estimated annual commitments related to the minimum quantities of water purchased or transported are expected to approximate $3,386 in 2010, $306 in 2011, $67 in 2012 through 2014, and $2,282 thereafter. The Company's purchased water expense, including CAP costs amounted to approximately $2,595 and $2,014 during the years ended December 31, 2009 and 2008, respectively.

Arizona-American Water Company
2010 Financing Application
Exhibit C – Form of Public Notice

PUBLIC NOTICE
OF AN APPLICATION OF ARIZONA-AMERICAN WATER COMPANY
FOR AUTHORITY TO INCUR LONG-TERM DEBT

Arizona-American Water Company ("the Company") filed an Application with the Arizona Corporation Commission ("the Commission") for an order authorizing the Applicant to incur $50 million in new debt. The application is available for inspection during regular business hours at the office of the Commission at 1200 W. Washington, Phoenix, Arizona 85007, and the Company's offices in 2355 W. Pinnacle Peak Rd., Suite 300, Phoenix, Arizona 85027.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

1. The name, address, and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.

2. A short statement of the proposed intervenor's interest in the proceeding.

3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.

4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice.

Arizona-American Water Company
2010 Financing Application
Exhibit D – Certificate of Board Resolution

CERTIFICATE OF RESOLUTION
ARIZONA-AMERICAN WATER COMPANY

Martin J. Stanek, Secretary of Arizona-American Water Company hereby certifies that the following is a true and correct copy of a resolution duly adopted by the by the Board of Directors at their meeting on July 13, 2010, in accordance with law and the bylaws of said Corporation, that said resolution has not been amended and that it is still in full force and effect:

PROPOSED RESOLUTIONS REGARDING
$35 MILLION SHORT-TERM DEBT REFINANCING

WHEREAS, as of May 30, 2010 the Company's outstanding short-term debt was $74,953,000 and long-term interest rates are favorable; and

WHEREAS, it is in the Company's best interests to refinance a portion of its short-term debt with long-term debt at a favorable interest rate; and

WHEREAS, the Company completed on November 30, 2009, the White Tanks regional water treatment plant; and

WHEREAS, the Arizona Water Infrastructure Finance Authority ("WIFA") may be able to lend to the Company based on the cost of the White Tanks project; and

WHEREAS, on June 30, 2010, the Company filed an application at the Arizona Corporation Commission (the "ACC") for approval to borrow $35 million in long-term debt from WIFA or another entity; and

WHEREAS, if WIFA or another entity approves the borrowing by the Company, the Company expects to be required to secure its repayment obligations with a letter of credit issued on behalf of American Water Capital Corp. ("AWCC") and approximately equal to the outstanding principal amount of the loan;

NOW, THEREFORE, BE IT:

RESOLVED, that, the Board of Directors of the Company hereby finds that the Company's conversion of a portion of its short-term debt into long-term debt at an annual interest rate of not more than 9% per annum is advisable and in the best interests of the Company and its stockholders; and

RESOLVED FURTHER, that, subject to appropriate approvals by the ACC, the Board of Directors of the Company hereby approves the borrowing by the Company of up to $35 million for a term of not more than 30 years and at a fixed interest rate not to exceed 9% per annum and on such other terms and conditions deemed reasonable and in the best interests of the Company by the President and Treasurer of the Company; and

RESOLVED FURTHER, that, if WIFA or another lender requires the Company to secure its repayment obligations with a letter of credit issued on behalf of AWCC, the Board of Directors of the Company hereby approves the Company's payment to AWCC of the appropriate charges associated with that letter of credit on terms and conditions deemed reasonable and in the best interests of the Company by the President and Treasurer of the Company; and

RESOLVED FURTHER, that the President and Treasurer of the Company are hereby authorized to take such actions as are necessary and desirable to consummate the foregoing financing arrangements; and

RESOLVED FURTHER, that the Officers of the Company and their designees are hereby authorized and empowered to apply for and obtain any required approvals from the ACC, WIFA or any other regulatory authority to consummate the purposes of the foregoing resolutions and are further authorized to retain the services of outside legal counsel as required to advise in any resulting negotiations or regulatory proceedings; and

RESOLVED FURTHER, that each of the Officers of the Company is hereby authorized and directed to do and perform, or cause to be done and performed, all such acts, deeds and things and to make, execute and deliver or cause to be made, executed and delivered all such agreements or documents in the name and on behalf of the Company or otherwise as each such officer may deem necessary or advisable to effectuate or carry out fully the purpose and intent of the foregoing resolutions, without further authority or approval by the Board of Directors of the Company, the taking of any such actions and the execution and delivery of such agreements and documents to be conclusive evidence of the authority therefore.

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the corporate seal of Arizona-American Water Company this ____ day of July 2010.

Martin J. Stanek,
Vice President Legal and Secretary