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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

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, HAVASU WATER DISTRICT, AND MOHAVE WATER DISTRICT	**DOCKET NO. W-01303A-10-0448** **SUN CITY GRAND'S NOTICE OF FILING DIRECT TESTIMONY OF MICHAEL L. ARNDT**

In accordance with the January 20, 2011, and June 15, 2011, Procedural Orders in this docket, Sun City Grand Community Association hereby files the Direct Testimony of

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Michael L. Arndt in the above-referenced matter

RESPECTFULLY SUBMITTED this 27th day of June, 2011.

EKMARK & EKMARK, L.L.C.

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ORIGINAL and thirteen (13) copies of the foregoing filed this 27 day of June, 2011, with:

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

COPY of the foregoing hand-delivered this 27 day of June 2011 to:

Teena Jibilian, Administrative Law Judge
Legal Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

COPIES of the foregoing mailed this 27 day of June 2011 to:

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DOCKET NO. W-01303A-10-0448

**DIRECT TESTIMONY OF
MICHAEL L. ARNDT**

**ON BEHALF OF
SUN CITY GRAND COMMUNITY ASSOCIATION**

June 27, 2011

PRE-FILED DIRECT TESTIMONY AND EXHIBITS OF MICHAEL L. ARNDT

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EXHIBITS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Michael L. Arndt. I am a public utility rate consultant and my address is 3602 S.W. Zona Circle, Ankeny, Iowa 50023.

Q. HAVE YOU PROVIDED AN ATTACHMENT WHICH DETAILS YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE?

A. Yes. Attached Appendix A is a statement of my education and experience.

Q. HAVE YOU TESTIFIED BEFORE THIS COMMISSION PREVIOUSLY?

A. Yes. In addition to the Arizona Corporation Commission ("ACC" or "Commission"), I have presented testimony before the Federal Energy Regulatory Commission and state regulatory commissions in Alabama, Arkansas, Colorado, Iowa, Maryland, Nebraska, Oklahoma, Pennsylvania, Rhode Island, Texas, Utah, Vermont and West Virginia. In addition, I have worked on cases in several other states, the District of Columbia and Barbados. I have testified in more than 100 public utility rate proceedings.

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

A. I am appearing on behalf of the Sun City Grand Community Association ("SCGCA"). SCGCA has intervened in this proceeding since it is comprised of over 16,000 residents that are water customers of Arizona-American Water Company ("AAWC" or "Company") located in the Agua Fria Water District.

II. PURPOSE AND SUMMARY OF TESTIMONY

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

A. The purpose of my testimony is to address certain revenue requirement issues in this case. Specifically, my testimony will address cost of capital issues, the White Tanks Regional Water Treatment Plant ("White Tanks Plant"), the declining residential usage adjustment, the Company's proposed new irrigation rate, tank maintenance expenses, inflation adjustments and depreciation rates.

Q. HAVE YOU PERFORMED A COMPLETE AND COMPREHENSIVE REVENUE REQUIREMENT ANALYSIS FOR PURPOSES OF THIS RATE CASE?

A. I have reviewed the Company's entire application and responses to data requests provided by the Company. As of the deadline for filing this testimony, however, I have not undertaken what I would call an extensive analysis of this multifaceted rate filing due to time and budget constraints. With that said, my review of the application, prior rate cases and decisions, and responses to data requests has resulted in the identification of multiple issues which call into question the reasonableness of the rates being requested by the Company.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. The Company alleges that the White Tanks Regional Water Treatment Plant increased its rate base in this case by **$74,745,355** (i.e., $63,877,959 as of June 30, 2010 plus $10,867,396 of deferred costs). The Company's proposed inclusion of all costs from the White Tanks Plant in this case increases the Company's alleged annual revenue requirements by approximately **$14,377,580**. Since the White Tanks Plant is used to service only Agua Fria Water District customers, costs stemming from the White Tanks Plant account for $14,377,580 or 80.24 percent of the Company's proposed $17,918,540 total increase in its Agua Fria Water District rates in this case. The Agua Fria Water District had 36,600 total customers at the end of the test year June 30, 2010. **The Company, therefore, proposes to saddle 36,600 Agua Fria customers with a $74,745,355 investment and an annual revenue requirement of $14,377,580 for a White Tanks Plant which has not been shown to be prudent or necessary at this time.**

Given the massive increase in rates that would occur, my recommendations are as follows:

* **Capital Structure:** The Company proposes to exclude short term debt in the capital structure and recommends a capital structure of 54.66 percent debt and 45.34 percent common equity. The Commission has consistently denied the exclusion of short term debt in the capital structure in prior cases. Inclusion of short term debt in the capital structure consistent with prior Commission precedent results in a capital structure of 62.43 percent debt and 37.57 percent common equity.

* **Cost of Debt:** The Company proposes to exclude short term debt in the determination of the cost of debt and recommends a cost of debt of 5.66 percent. The Commission has consistently denied the exclusion of short term debt in the

determination of the cost of debt in prior cases. Inclusion of short term debt in the cost of debt consistent with prior Commission precedent results in a cost of debt of 4.21 percent.

* **Cost of Common Equity:** The Company requests a return on common equity allowance of 11.50 percent. The Commission recently concluded an analysis of the Company's cost of common equity in Docket No. W-01303A-09-0343 involving the Company's Anthem and Sun City Water Districts. The Commission's Decision No. 72047 issued January 6, 2011, granted a return on common equity of 9.50 percent. The Commission's allowed return on common equity in this case should be no greater than 9.50 percent.
* **Cost of Capital:** The Company proposes a cost of capital of 8.30 percent based on the exclusion of short term debt from the capital structure and cost of debt and a requested return on common equity of 11.50 percent Consistent with prior Commission decisions, the cost of capital should be 6.19 percent based on the inclusion of short term debt in the capital structure, the resulting changes to cost of debt, and a return on common equity of no greater than 9.50 percent. A cost of capital of 6.19 percent reduces the Company's total alleged revenue deficiency by $4,775,137 and reduces the Company's alleged revenue deficiency for the Agua Fria Water District by $4,296,434.
* **White Tanks Regional Water Treatment Plant:** The White Tanks Plant was placed into service on November 30, 2009. The Company alleges in this case that the White Tanks Regional Water Treatment Plant increased its rate base by

$74,745,355 (i.e., $63,877,959 as of June 30, 2010 plus $10,867,396 of deferred costs). The Company's proposed inclusion of all costs from the White Tanks Plant in this case increases the Company's alleged annual revenue requirements by approximately $14,377,580. In Docket No. W-01303A-05-0718, the Company indicated that the post-in-service AFUDC would not affect customer rates because the post-in-service AFUDC would be "completely offset" by hook-up fee funds. The fact that customer growth has not materialized as the Company expected is a shareholder risk not a ratepayer risk. Ratepayers, therefore, should not be forced to pay for deferred plant and O&M expenses as requested by the Company in this case. In addition, the Company's proposed increases in depreciation rates related to White Tanks Plant have not been supported and should be rejected.

* **Declining Residential Usage Adjustment:** The Company's proposed declining residential usage adjustments should be rejected. The Company's adjustments are based on forecasts through the year ended June 30, 2012, and are not known and measurable. In addition, the Company has made no attempt to recognize increases in future residential customer levels or changes in other customer classes such as small and large commercial customers. Also, there has been no showing that any conservation efforts in the past by residential customers can be sustained by additional new conservation possibilities in the future.

* **New Irrigation Rate:** The Commission should reject the Company's proposed new irrigation rate for potable water customers. The Company has provided no class cost of service studies to support a new irrigation rate for potable water customers.

In addition, the new irrigation rate will result in a significant increase in the Company's alleged annual revenue deficiency by $363,107 which will have to be funded by remaining customers in the residential and commercial classes. The Company has not provided significant justification for such a change at this time.

* **Tank Maintenance Expenses:** The Company has proposed tank maintenance expense adjustments for each water district based on projected future maintenance costs forecasted by the Tank Inspection Company. In Decision No. 71410, the Commission determined that tank maintenance expenses should be based on a three year average of actual known and measurable expenditures. The use of actual known and measurable expenditures should be continued.

* **Inflation Adjustments:** The Company has proposed inflation adjustments for certain expense items. Inflation adjustments are not known and measurable and should be rejected by the Commission.

* **Other Depreciation Issues:** The Company has proposed major increases in the depreciation rates for several accounts. The T&D Mains, Services and Hydrant account increases result from the Company's proposal to increase the net salvage values from the Commission-approved 0 percent to a negative 50 percent. The Company proposes to increase the net salvage value on the Structures and Improvements from 0 percent to a negative 20 percent. Each of these changes results in significant increases in depreciation expense and have not been adequately supported in direct testimony. The Commission should reject the Company's proposed changes and continue using the previously approved rates.

* **Phase-In of Rate Increase:** In Docket No. W-01303A-09-0343 involving the Anthem and Sun City Water Districts, the Company agreed to a three year phase-in of the rate increase granted by the Commission. SCGCA will review the revenue requirement recommendations filed on June 27, 2011, by Staff, RUCO and other parties in this case and will make a determination of whether or not to recommend a phase-in of any rate increase granted in this case. Any recommendation regarding phase-in will be made in the Rate Design Phase testimony of this proceeding which is due July 5, 2011.

III. OVERVIEW

Q. BEFORE DISCUSSING THE CURRENT RATE APPLICATION, PLEASE PROVIDE A BRIEF REVIEW OF THE COMPANY'S LAST RATE APPLICATION INVOLVING THE AGUA FRIA, HAVASU AND MOHAVE WATER DISTRICTS.

A. On May 2, 2008, Arizona-American Water filed a rate application with the Arizona Corporation Commission designated Docket No. W-01303A-08-0227 based on a 2007 test year. The Company proposed annual rate increases of $7,804,796 or 41.47 percent for the Agua Fria Water District, $425,011 or 36.82 percent for the Havasu Water District and $943,515 or 18.45 percent for the Mohave Water District.[1] This represented a total proposed rate increase for the three water districts of $9,173,322 annually.

On December 8, 2009, the Commission issued Decision No. 71410 which denied

1 Arizona Corporation Commission Decision No. 71410, pages 6 and 7.

most of the Company's requested rate increase and approved a rate increase of $3,295,538 for the three water districts (*i.e.,* a $2,875,120 increase for the Agua Fria Water District, a $265,007 increase for the Havasu Water District, and a $152,411 increase for the Mohave Water District).[2]

The Commission's Decision No. 71410 granted the Company a 7.33 percent overall cost of capital and a 9.90 percent return on common equity.

Q. PLEASE PROVIDE A BRIEF REVIEW OF THE COMPANY'S CURRENT RATE APPLICATION.

A. The Company's current rate application designated Docket No. W-01303A-10-0448 was filed on November 3, 2010, based on a test year ending June 30, 2010. The Company proposes a total annual rate increase for the three water districts of $20,756,111 (*i.e.*, a $17,918,540 increase for the Agua Fria Water District, a $630,633 increase for the Havasu Water District and a $2,206,937 increase for the Mohave Water District).[3] As noted above, the Company's proposed inclusion of all costs from the White Tanks Plant in this case increases the Company's alleged annual revenue requirement for the 36,600 Agua Fria Water District customers by approximately **$14,377,580**.

The following is a summary of the Company's proposed rate increases by customer class.

2 Arizona Corporation Commission, Decision No. 71410, pages 45 and 46.
3 Company witness Thomas M. Broderick, Exhibit TMB-1, page 1.

	Company Proposed Percentage Increases
Agua Fria Water District	
Residential	**71.97%**
Commercial	(21.46)
OPA	83.96
Irrigation/Miscellaneous	1228.13
Total	78.63%
Havasu Water District	
Residential	**50.23%**
Commercial	27.64
Irrigation	0.00
Total	49.96%
Mohave Water District	
Residential	**45.54%**
Commercial	38.60
OPA	49.56
Irrigation	0.00
Private Fire	49.56
Public Fire	49.56
Total	47.96%

Source: Company Schedule H-1, page 1.

Q. HAS THE COMPANY PROVIDED A CLASS OF SERVICE STUDY SUPPORTING THE PROPOSED INCREASES BY CUSTOMER CLASS?

A. No.

Q. COMPANY WITNESS PAUL G. TOWNSLEY CLAIMS THAT ARIZONA-AMERICAN WATER COMPANY EARNED LITTLE IF ANY RETURN ON ITS ARIZONA INVESTMENT IN RECENT YEARS. PLEASE COMMENT.

A. The Agua Fria Water District represents 89.98 percent of the rate base and 79.52 percent of the revenues in this case. The Company's actual reported earned returns on average common equity in the last three years are shown below. As noted previously, the Commission's allowed return on common equity in Decision No. 71410 was 9.90 percent.

	Company Returns on Average Common Equity
Agua Fria Water District	
Year ended June 30, 2008	17.43%
Year ended June 30, 2009	9.22%
Year ended June 30, 2010	7.89%

Source: Company Exhibit Schedule A-2, page 1.

IV. CORPORATE OVERVIEW

Q. PLEASE DESCRIBE ARIZONA-AMERICAN WATER COMPANY.

A. Arizona-American Water Company is a wholly-owned subsidiary of American Water Works Company, Inc. ("American Water Works"). American Water Works is headquartered in Voorhees, New Jersey and is the parent company for nineteen state subsidiaries.[4] American Water Works is the largest investor-owned water and wastewater utility company in the United States. American Water Works serves approximately 15,000,000 people in 30 states and approximately 1,600 communities in the United States and Manitoba and Ontario, Canada. In 2010, American Water Works reported total revenues of $2,710,700,000 and total net plant of

4 American Water Corporation's wholly-owned regulated water and wastewater subsidiaries include Arizona-American Water, California American Water, Hawaii American Water, Illinois American Water, Indiana American Water, Iowa American Water, Kentucky American Water, Long Island American Water, Maryland American Water, Michigan American Water, New Jersey American Water, New Mexico American Water, Ohio American Water, Pennsylvania American Water, Tennessee American Water, Texas American Water, Virginia American Water and West Virginia American Water. Tennessee American Water provides water service to part of northern Georgia.

$11,057,000,000.[5]

V. COST OF CAPITAL

A. CAPITAL STRUCTURE

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED CAPITAL STRUCTURE AND REQUESTED COST OF CAPITAL IN THIS CASE.

A. The Company has proposed a **"hypothetical"** capital structure of 54.66 percent debt and 45.34 percent equity.[6] Yet again, the Company has proposed to exclude short term debt in the capital structure.

The Company requests an overall cost of capital of 8.30 percent based on a return on common equity of 11.50 percent.[7]

Q. YOU STATE ABOVE THAT THE COMPANY HAS ONCE AGAIN PROPOSED TO EXCLUDE SHORT TERM DEBT FROM THE CAPITAL STRUCTURE. PLEASE COMMENT.

A. In prior cases, the Company has proposed capital structures excluding short term debt. The Commission has consistently rejected the exclusion of short term debt in the capital structure.

In Decision No. 71410 in Docket No. W-01303A-08-0227, the Commission rejected the exclusion of short term debt in the capital structure stating:

> "The Company argues, as it has in prior rate cases, against the inclusion of short term debt in its capital structure. The Company contends that its short term debt balance should be excluded because it has increased due to interim financing of the White Tanks plant, a

5 American Water Works Company, Inc. website and Value Line, April 22, 2011, page 1793.
6 Company witness Thomas M. Broderick, Direct Testimony, page 8, lines 4-5.
7 Company Schedule D-1, pages 1 and 2.

> large capital project, and that it is inappropriate to include short term debt in rate base when it is financing CWIP. Staff responds that the Commission's filing requirements, which include schedules that require a listing of an applicant's short term debt as a component of the cost of capital, contemplate the inclusion of short term debt in capital structure. <u>**As we stated in Decision No. 70351 (May 16, 2008), short term debt is a source of funds available to the Company, and should therefore be included in the Company's capital structure. Excluding a portion of the Company's 58.68 percent debt would in effect compensate shareholders for a non-existent equity investment."**</u>

(Emphasis added) (Commission Decision No. 71410, page 41.)

Q. DID THE COMMISSION REJECT THE EXCLUSION OF SHORT TERM DEBT IN THE CAPITAL STRUCTURE IN THE RECENT DOCKET NO. W-01303A-09-0343 INVOLVING THE ANTHEM WATER DISTRICT AND SUN CITY WATER DISTRICT?

A. Yes. In Docket No. W-01303A-09-0343, the Company initially proposed to exclude short term debt from the capital structure. In its rebuttal testimony, however, the Company conceded the issue and agreed to include short term debt in the capital structure. In Decision No. 72047, the Commission stated the following:

> "The Company's application proposed a capital structure of 45.15 percent equity and 54.85 percent debt excluding short term debt. However, in order to limit the number of issues in this case, the Company agreed in its rebuttal testimony to accept the Staff's cost of capital recommendations. RUCO recommends a capital structure of approximately 13.29 percent short term debt, 47.56 percent long term debt and 39.15 percent equity. Staff recommends a capital structure of 38.86 percent equity and 61.14 percent debt which includes short term debt. There is very little difference between the capital structures recommended by RUCO and Staff witnesses. For purposes of this proceeding, we adopt the capital structure of the Company consisting of 38.86 percent equity and 61.14 percent debt, which includes short term debt.

(Decision No. 72047, page 59.)

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE CAPITAL STRUCTURE IN THIS CASE?

A. Consistent with its decisions in prior cases, the Commission should approve a capital structure which includes short term debt. As stated by the Commission in Decision No. 71410, short term debt is a source of funds available to the Company, and should therefore be included in the Company's capital structure. Excluding a portion of the Company's debt would in effect compensate shareholders for a non-existent equity investment.

The inclusion of short term debt in the capital structure results in a capital structure of 62.43 percent debt and 37.57 percent common equity. Details of my recommended capital structure are provided on Exhibit MLA-1.

B. <u>COST OF DEBT</u>

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED COST OF DEBT IN THE CURRENT RATE CASE.

A. The Company has proposed a **"hypothetical"** capital structure of 54.66 percent debt and a cost of debt rate of 5.66 percent.[8] As noted above, the Company has proposed to exclude short term debt in the determination of its cost of debt.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE COST OF DEBT IN THIS CASE?

8 Company witness Thomas M. Broderick, Direct Testimony, page 8, lines 4-5.

A. Consistent with its decisions in prior cases, the Commission should approve a cost of debt which includes short term debt. The inclusion of short term debt in the cost of debt results in an accurate cost of debt of 4.21 percent. Details of my recommended cost of debt are provided on Exhibit MLA-1.

C. COST OF COMMON EQUITY

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED RETURN ON COMMON EQUITY IN THE CURRENT RATE CASE.

A. The Company requests a return on common equity allowance of 11.50 percent.[9]

Q. DO YOU AGREE WITH THE COMPANY'S REQUESTED 11.50 PERCENT RETURN ON COMMON EQUITY?

A. No. The Commission recently concluded an analysis of Arizona-American Water Company's cost of common equity in Docket No. W-01303A-09-0343 involving the Company's Anthem and Sun City Water Districts. The Commission's Decision No. 72047 issued January 6, 2011, granted a return on common equity of 9.50 percent.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE COST OF COMMON EQUITY IN THIS CASE?

A. Based on its recent decision in Docket No. W-01303A-09-0343, the Commission should approve a return on common equity allowance of no greater than 9.50 percent.

D. COST OF CAPITAL SUMMARY

Q. PLEASE SUMMARIZE YOUR COST OF CAPITAL RECOMMENDATION

9 Company witness Dr. Bente Villadsen, Direct Testimony, page 5.

IN THIS CASE.

A. Consistent with its prior decisions, the Commission should approve a capital structure and a cost of debt allowance which includes short term debt. The capital structure should be 62.43 percent debt and 37.57 percent equity and the cost of debt should be 4.21 percent. The allowed return on common equity should be no greater than 9.50 percent. These recommendations result in an overall cost of capital allowance of 6.19 percent. Details of the overall cost of capital are provided on Exhibit MLA-1.

Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF YOUR 6.19 PERCENT COST OF CAPITAL RECOMMENDATION?

A. The 6.19 percent overall cost of capital recommendation reduces the Company's total alleged revenue deficiency by $4,755,137 (*i.e.,* from $20,756,111 to $15,980,974) and reduces the Company's alleged revenue deficiency for the Agua Fria Water District by $4,296,434 (*i.e.*, from $17,918,540 to $13,622,106). Details of these calculations are provided on Exhibit MLA-1.

VI. RATE BASE ISSUES

A. WHITE TANKS REGIONAL WATER TREATMENT PLANT

1. GENERAL

Q. PLEASE DESCRIBE THE WHITE TANKS REGIONAL WATER TREATMENT PLANT ("WHITE TANKS PLANT").

A. The White Tanks Regional Water Treatment Plant was designed to treat Arizona-American Water's 11,093 acre-feet per year allotment of Central Arizona Project

("CAP") water for distribution to customers in its Agua Fria Water District. The Maricopa County Municipal Water Conservation District Number One ("MWD") constructed the water-supply intake on the Beardsley Canal, and Arizona-American Water constructed the water transmission main to connect the White Tanks Plant to Arizona-American Water's existing transmission system. Arizona-American Water designed the White Tanks Plant to treat 13.5 million gallons per day ("MGD") in Phase 1(a), and to expand to treat 20 MGD in Phase 1(b) with the addition of one more treatment tank. The White Tanks Plant is designed to eventually accommodate three additional 20 MGD phases, for a total treatment capacity of 80 MGD at the 45-acre plant site.

According to Company's original application in Docket No. W-01303A-05-0718, original plans were for the White Tanks Plant to be financed, built and owned by MWD. Arizona-American Water was to obtain treatment services through a long term capital lease with MWD, and an Arizona-American Water affiliate was to operate the plant through an Operation and Maintenance ("O&M") agreement with MWD.

On September 1, 2006, the Company filed a revised application indicating that the Company planned to construct the White Tanks Plant on its own.[10] The Company indicated that negotiations between MWD and the Company fell apart and did not come to a final agreement. The revised application requested: (1) approval of an adjustment to the Company's existing Water Facilities Hook-Up Fee for new home

10 Commission Decision No. 69914, page 3.

construction; (2) accounting orders related to the White Tanks Plant; and (3) that the Company be ordered to make certain associated filings. In fact, MWD then proposed to build its own competing water treatment facility and requested that the Commission deny the Company such requests.

Commission Decision No. 69915 issued September 27, 2007, granted the Company authority to implement the Water Facilities Hook-Up Fee ("WHU-1"), to be recorded as Contributions in Aid of Construction ("CIAC"), as a means of financing the White Tanks Plant, but did not make a decision regarding the prudence of the Company's decision to build the plant itself.[11] Indeed, the Commission said of the Company's decision to build the White Tanks Plant that,

> "As with all business decisions of regulated utilities, the prudence of the Company's decision will be subject to examination, if necessary, in a future rate proceeding."

(Decision No. 69915, Page 21.)

Q. DID THE COMPANY PROFFER ANY TESTIMONY IN DOCKET NO. W-01303A-05-0718 REGARDING WHETHER IT BELIEVED THAT ITS PLANT WAS A MORE PRUDENT INVESTMENT THAN MWD'S PROPOSED PLANT?

A. Yes. The Company argued against MWD's proposal to build a treatment plant. For example, the Company argued that the competing MWD proposal to build a treatment plant and have Arizona-American purchase treatment capacity would require a large rate increase of an additional $21.07 per month for Arizona-

11 Commission Decision 71410, pages 10-11.

American's customers.[12] This compares with the Company's requested rate increase in this case, which amount to an additional $25.13 per month for average consumption residential customers of the Agua Fria District.[13]

Q. HAVE THE HOOK-UP FEES PROVIDED ADEQUATE FINANCING OF THE WHITE TANKS PLANT?

A. No. In Decision No. 71410 issued December 8, 2009, the Commission stated:

> "The Company states that because of the recent decline in new home construction, hook-up fee forecasts have declined precipitously, and the general assumption at the time of Decision No. 69914 that housing market growth would make enough hook-up fees available to finance the White Tanks Plant construction was proven wrong."

(Commission Decision No. 71410, pages 11-12.)

Q. WHEN WAS THE WHITE TANKS PLANT PLACED IN SERVICE AND WHAT WAS THE COST OF THE PLANT AT THAT DATE?

A. The White Tanks Plant was placed into service on November 30, 2009, and the reported cost was $63,534,962.[14]

Q. HAS THE WHITE TANKS PLANT EXPERIENCED SIGNIFICANT SHUTDOWNS SINCE IT WAS PLACED IN SERVICE?

A. Yes. The White Tanks Plant was placed into service on November 30, 2009. However, the White Tanks Plant was shut down from December 9, 2009, to February 22, 2010. In addition, the White Tanks Plant experienced reduced

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12 Surrebuttal testimony of Company witness Thomas Broderick, Exhibit A-7 at page 6 from Docket No. W-01303A-05-0718.

13 Form of Public Notice from Procedural Order dated January 20, 2011, page 6.

14 Company witness Thomas M. Broderick, Exhibit TMB-3.

production levels in April, July and August 2010.[15]

Q. HAS THE COMPANY PROVIDED ANY PRUDENCE REVIEW IN THIS CASE TO DETERMINE WHETHER OR NOT ALL COSTS REQUESTED IN THIS CASE FOR THE WHITE TANKS PLANT ARE PRUDENT?

A. No, no such review has been provided by the Company despite the requested costs for the White Tanks Plant in this case of $74,745,355.

Q. HAS THE COMPANY PERFORMED ANY STUDIES IN THIS CASE TO DETERMINE IF THE WHITE TANKS PLANT REPRESENTS EXCESS CAPACITY GIVEN THE SIGNIFICANT DECLINE IN NEW HOME CONSTRUCTION IN THE AGUA FRIA WATER DISTRICT SERVICE TERRITORY?

A. No, despite the fact that the plant is expandable to 80 MGD at significant economies of scale, no studies to determine whether the plant represents excess capacity were performed by the Company.

Q. ARE YOU PROVIDING A PROFESSIONAL ENGINEERING OPINION REGARDING WHETHER THE WHITE TANKS PLANT HAS EXCESS CAPACITY?

A. As previously stated, due to time and budgetary constraints, SCGCA was not able to engage a registered professional engineer to provide an opinion on this specific issue, but SCGCA intends to pursue additional discovery and to monitor this and other issues throughout the hearing process. It anticipates that Staff and RUCO will

15 Company witness Ian C. Crooks, Direct Testimony, page 5.

address this issue, as well as other issues. At some point during these proceedings, such as in rebuttal testimony, at hearing or in pre or post-hearing briefs, SCGCA intends to take a position on this and other issues.

Q. YOU NOTED ABOVE THAT THE TOTAL REVENUE REQUIREMENT IMPACT OF THE WHITE TANKS PLANT IN THIS CASE INCLUDING PLANT COSTS, OPERATING EXPENSES, DEFERRED COSTS AND DEPECIATION EXPENSE IS $14,377,580 FOR AGUA FRIA CUSTOMERS. PLEASE PROVIDE DETAILS OF THE REVENUE REQUIREMENT IMPACT OF THE WHITE TANKS PLANT?

A. The revenue requirement impact of the White Tanks Plant on Agua Fria customers is detailed on Exhibit MLA-2 and summarized below:

	Annual Revenue Requirement Impact on Agua Fria Customers
White Tanks Plant investment at June 30, 2010	$7,531,211
White Tanks net post in service AFUDC deferrals	$1,281,266
White Tanks depreciation expense	$2,898,708
White Tanks MWD wheeling expense	$1,353,346
White Tanks chemical expense	$224,715
White Tanks O&M expenses	$90,698
White Tanks water testing expense	$14,200
Amortization of White Tanks O&M deferrals (3 years)	$813,936
Other White Tanks expenses	$169,500
Total annual revenue requirement impact	$14,377,580

Q. WAS THE WHITE TANKS PLANT ORIGINALLY INTENDED TO SERVE ONLY AGUA FRIA CUSTOMERS?

A. No. In Docket No. W-01303A-05-0718, the Company indicated that, "[t]he facility would treat Central Arizona Project surface water for three or more entities, one of which is the Company." The anticipated other entities in addition to the Agua Fria customers included the Maricopa County Water Conservation District Number One, Arizona Water Company and the City of Goodyear.[16]

Q. IN DOCKET NO. W-01303A-05-0718, DID THE COMPANY INDICATE TO THE COMMISSION THAT THE WHITE TANKS PLANT WOULD BE FUNDED BY HOOK-UP FEES?

A. Yes. The Commission's Decision No. 69914 in Docket No. W-01303A-05-0718 stated the following:

> "Arizona-American believes that its proposal to finance the White Tanks Project with hook-up fees, which will be treated as contributions in aid of construction ("CIAC"), is equitable because **customer growth is largely driving the need for the plant** (Surrebuttal Testimony of Thomas M. Broderick, Exhibit A-7 at 7)."

(Emphasis added) (Commission Decision No. 69914, page 6.)

Q. DID THE COMMISSION APPROVE MAJOR INCREASES IN THE HOOK-UP FEES FOR AGUA FRIA CUSTOMERS IN DOCKET NO. W-01303A-05-0718?

A. Yes. For example, the Commission-approved an increase in hook-up fees for residential 5/8 x ¾ inch meters from $1,150 to $3,280, representing a 185.22 percent increase. The Commission-approved an increase in hook-up fees for commercial 6 inch or larger meters from $57,500 to $164,000, representing a 185.22 percent

16 Company Response RUCO 11.09.

increase.[17]

Q. WHAT WERE THE TOTAL ACTUAL HOOK-UP FEES RECEIVED BY ARIZONA-AMERICAN, AS APPROVED IN DOCKET NO. W-01303A-05-0718, FROM THE TIME OF THE IMPLEMENTATION OF THE TARIFF UNTIL THE MOST RECENT AVAILABLE MONTH?

A. From March 2008 to May 2011, the Company has collected only $2,634,573 in additional hook-up fees,[18] while the Company's requested costs for the White Tanks Plant in this rate case is $74,745,355.

Q. YOU MENTIONED THAT THE WHITE TANKS PLANT WAS COMPLETED ON NOVEMBER 30, 2009, BUT THE COMPANY DID NOT FILE THIS RATE CASE UNTIL NOVEMBER 3, 2010. HAS THE COMPANY EXPLAINED WHY IT WAITED ALMOST ONE YEAR BEFORE FILING THIS RATE CASE?

A. No, the Company has not provided an explanation for the delay.

Q. WHAT IS THE IMPACT OF THE COMPANY DELAYING THE FILING OF THIS RATE CASE FOR ALMOST ONE YEAR?

A. The Company delay in filing the case significantly increases the White Tanks Plant deferred costs. This has the effect of increasing the Agua Fria Water District's revenue requirement. There has been no showing that the Company's delay in filing this rate case was prudent or in the best interests of its ratepayers.

2. <u>POST-IN-SERVICE ALLOWANCE FOR</u>

17 Commission Decision No. 69914, pages 5 and 26.
18 Company Response RUCO 11.06.

FUNDS USED DURING CONSTRUCTION

Q. WHAT WAS THE COMPANY'S POSITION ON POST-IN-SERVICE ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION ("AFUDC") IN DOCKET NO. W-01303A-05-0718?

A. The Company requested permission to record post-in-service AFUDC on the excess of the construction cost of the White Tanks Project over the amount of directly related hook-up fees collected through December 31, 2015, or the date that rates become effective subsequent to a rate case that includes 80 percent of the White Tanks Project in rate base, whichever comes first.

The Company indicated **that the post-in-service AFUDC would not affect customer rates** because the post-in-service AFUDC would be "completely offset" by hook-up fee funds. The Commission's Decision No. 69914 noted:

> "The Company requests the ability to book post-in-service AFUDC in order to keep it whole on its investment until such time that the accumulated hook-up fees are sufficient to fund the entire plant balance. **This treatment will not affect customer rates because the additional post-in-service AFUDC will later be completely offset by hook-up fees.**"

(Emphasis added) (Commission Decision No. 69914, page 6.)

The Company further indicated that the financing costs of the White Tanks Plant should fall on new customers that caused the need for the plant rather than be borne by existing customers. The Commission's Decision No. 69914 stated:

> "The Company states that **the proposal to finance the White Tanks Project with hook-up fees places the costs on new customers, whose addition to the system is causing the need for the plant.** Arizona American believes **this is preferable to placing**

> **the cost on both existing and new customers**, which it asserts would be the result if Arizona American were to purchase treatment capacity from an MWD plant."

(Emphasis added) (Commission Decision No. 69914, page 8.)

Q. WHAT IS THE COMPANY REQUESTING IN RATE BASE FOR POST-IN-SERVICE AFUDC?

A. The Company is requesting $10,161,706 in rate base for post-in-service AFUDC related to the White Tanks Plant. In addition, the Company is requesting $4,318,345 in rate base for 24 months of deferred White Tanks Plant depreciation offset by $3,231,316 of hook-up fee amortization and $318,332 of accumulated amortization. In total, the Company is requesting $10,867,396 in rate base for White Tank Plant deferrals.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED REQUEST FOR $10,867,396 IN RATE BASE FOR POST-IN-SERVICE AFUDC AND DEPRECIATION DEFERRED COSTS?

A. No. In Docket No. W-01303A-05-0718, the Company indicated that the White Tanks Plant would be financed though hook-up fees paid by new customers whose addition to the system brought about the need for the new plant. In addition, the Company indicated that the financing costs of the new White Tanks Plant should not be borne by existing customers. Moreover, the Company stated that increasing the hook-up fees in Docket No. W-01303A-05-0718 would not affect customer rates because any post-in-service AFUDC would be completely offset by hook-up fees.

Q. ARE THERE OTHER REASONS FOR NOT ALLOWING POST-IN-

SERVICE AFUDC AND DEPRECIATION DEFERRED COSTS RELATED TO THE WHITE TANKS PLANT IN RATE BASE IN THIS CASE?

A. Yes. In Docket No. W-01303A-05-0718, the Company assured the Commission that post-in-service AFUDC would not affect the rates of existing customers since customer growth and increased hook-up fees would completely pay for the financing of the White Tanks Plant. The risk of whether the Company's forecasts were accurate and whether the projected future customer growth would occur is a shareholder risk and not a ratepayer risk. If the Commission were to include post-in-service AFUDC and depreciation deferred costs in rate base in this case because the Company's forecasts of future customer growth were inaccurate, existing customers would be harmed and the risk of future customer growth would inappropriately be transferred to current ratepayers rather than stockholders.

Q. IF THE COMMISSION ALLOWED ANY POST-IN-SERVICE AFUDC IN RATE BASE, WHAT AFUDC RATE SHOULD BE USED?

A. If any post-in-service AFUDC is allowed in rate base, the AFUDC rate used should be the short term debt interest rate of 0.45 percent. The Company has stated in prior cases that short term debt was used to finance the White Tanks Plant. A calculation of post-in-service AFUDC using the short term debt interest rate is provided in Exhibit MLA-2, page 2. Use of the short term debt interest rate would reduce post-in-service AFUDC from $10.162 million to $586,000.

VII. <u>OPERATING INCOME ISSUES</u>

A. <u>WHITE TANKS REGIONAL WATER TREATMENT PLANT</u>

1. <u>AMORTIZATION OF WHITE TANKS O&M DEFERRALS</u>

Q. PLEASE LIST THE COMPANY'S PROPOSED AMORTIZATION OF WHITE TANKS PLANT OPERATION AND MAINTENANCE EXPENSE DEFERRALS IN THIS CASE.

A. As shown on Company Schedule C-2, page 28, the Company proposes a $813,936 adjustment to amortize deferred White Tanks O&M expenses over three years (*i.e.*, $2,441,808 divided by 3 years).

Q. DID THE COMMISSION IN DOCKET NO. W-01303A-05-0718 APPROVE THE DEFERRAL OF WHITE TANKS O&M EXPENSES?

A. No. The Commission's Decision No. 69914 stated:

> If is further ordered that this Decision does not predetermine the necessity for or the appropriateness of any mechanism proposed in the future by Arizona American Water Company for recovery of Operation and Maintenance Expense incurred for the White Tanks Project.

(Commission Decision No. 69914, page 30.)

Q. HAS THE COMPANY JUSTIFIED THE NEED FOR SUCH AN ADJUSTMENT IN ITS DIRECT TESTIMONY?

A. No. The adjustment is sponsored by Company witness Sandra L. Murrey in Adjustment SLM-1. Ms. Murrey, however, provides no justification for the adjustment in her direct testimony.

Q. DO YOU AGREE WITH AN ADJUSTMENT TO AMORTIZE DEFERRED WHITE TANKS O&M EXPENSES IN THIS CASE?

A. No. The Commission never approved the deferral of White Tanks O&M expenses and the Company has provided no justification for such a deferral in its direct testimony. In addition, if any amortization were allowed, it should be amortized over the remaining life of the plant rather than three years.

2. <u>WHITE TANKS DEPRECIATON EXPENSE</u>

Q. HAS THE COMPANY PROPOSED ANY MAJOR CHANGES TO THE DEPRECIATION RATE APPLICABLE TO THE WHITE TANKS PLANT?

A. Yes. The Company has proposed to increase the depreciation rate on Account 320.1, White Tanks Equipment Non-Media, from 4.00 percent to 5.75 percent representing an annual increase of $621,520. In addition, the Company has proposed to increase the depreciation rate on Account 320.2, White Tanks Equipment Filter Media, from 4.00 percent to 11.50 percent representing an annual increase of $140,408.

Q. WHAT IS THE COMPANY'S BASIS FOR THESE INCREASES?

A. The Commission's approved depreciation rates for these two accounts is 4.00 percent based on an average service life of 25 years and no net salvage value. For Account 320.1, the Company proposes to reduce the average service life from 25 years to 20 years and to reduce the net salvage value to a negative 15 percent. For Account 320.2, the Company proposes to reduce the average service life from 25 years to 10 years and to reduce the net salvage value to a negative 15 percent.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED DEPRECIATION CHANGES?

A. No. Each of these changes results in significant increases in White Tanks depreciation expense and neither change has been adequately supported in direct testimony.

Q. WHAT IS YOUR RECOMMENDATION REGARDING DEPRECIATION RATE APPLICABLE TO THE WHITE TANKS PLANT?

A. The depreciation rates for White Tanks' Accounts 320.1 and 320.2 should remain at the Commission's prior approved rate of 4.00 percent. The Company has failed to justify any increase in these depreciation rates.

B. <u>DECLINING RESIDENTIAL USAGE ADJUSTMENT</u>

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED ADJUSTMENTS FOR DECLINING RESIDENTIAL USAGE.

A. The Company has proposed adjustments to reduce test year operating revenues for forecasts of future declining residential usage. The Company's proposed adjustments reduce operating revenues by $83,035 for the Agua Fria Water District, by $14,551 for the Havasu Water District and by $77,217 for the Mohave Water District. The Company forecasts future declining residential usage of 0.4 percent for the Agua Fria Water District, 1.5 percent for the Havasu Water District and 2.1 percent for the Mohave Water District. The Company projects declining residential usage to the future year ended June 30, 2012.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED DECLINING RESIDENTIAL USAGE ADJUSTMENTS?

A. No. The Company's adjustments are not based on known and measurable changes. Customer usage changes for a variety of reasons from year to year. There is no guarantee that prior changes in customer usage are indicative of future changes in customer usage.

Q. ARE THERE OTHER REASONS FOR REJECTING THE COMPANY'S PROPOSED DECLINING RESIDENTIAL USAGE ADJUSTMENTS?

A. Yes. The Company proposes to recognize changes in residential customer usage levels through June 30, 2012. The Company makes no attempt to forecast changes in future residential customer levels.

Exhibit MLA-3 provides a summary of the number of residential customers for each water district for the years 2002 to 2010. As shown, the number of residential customers continues to grow. The Company has not made an attempt to forecast increases in residential customer levels which would offset declines in residential customer usage levels.

Q. ARE THERE OTHER REASONS FOR REJECTING THE COMPANY'S PROPOSED DECLINING RESIDENTIAL USAGE ADJUSTMENTS?

A. Yes. The Company proposes to recognize changes in **only** residential customer usage levels through June 30, 2012. The Company makes no attempt to forecast future changes in customer usage levels or number of customers for other customer classes such and small and large commercial customers.

Q. ARE THERE OTHER REASONS FOR REJECTING THE COMPANY'S PROPOSED DECLINING RESIDENTIAL USAGE ADJUSTMENTS?

A. Yes. To the extent that any past declines in residential water usage are due to conservation efforts, there has been no showing that these conservation efforts can be sustained in the future. It is likely that any conservation efforts by the residential customers have been maximized and there are no future conservation possibilities available in the future to sustain usage declines experienced in the past.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE COMPANY'S PROPOSED DECLINING RESIDENTIAL USAGE ADJUSTMENTS?

A. The Company's proposed declining residential usage adjustments should be rejected. The Company's adjustments are based on forecasts through the year ended June 30, 2012, and are not known and measurable. In addition, the Company has made no attempt to recognize increases in future residential customer levels or changes in other customer classes such as small and large commercial customers. Finally, there has been no showing that any conservation efforts in the past by residential customers can be sustained by additional new conservation possibilities in the future.

C. <u>NEW IRRIGATION RATE</u>

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED ADJUSTMENT FOR A NEW IRRIGATION RATE.

A. The Company has proposed a new irrigation rate for potable irrigation customers with infinite water consumption at the same price.[19] The Company's proposed new irrigation rate will shift certain current residential and commercial usage to the new irrigation rate class resulting in increases to the Company's alleged revenue deficiency. The new irrigation rate will increase the Company's alleged annual

19 Company witness Miles H. Kiger, Direct Testimony, page 13.

revenue deficiency by $363,107 (i.e., $354,420 for the Agua Fria Water District, $6,455 for the Havasu Water District and $2,232 for the Mohave Water District).[20]

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED NEW IRRIGATION RATE FOR POTABLE WATER CUSTOMERS?

A. No. The Company has provided no class cost of service studies to support a new irrigation rate for potable water customers. In addition, the new irrigation rate will result in a significant increase in the Company's alleged revenue deficiency which will have to be funded by remaining customers in the residential and commercial classes. The Company has not provided significant justification for such a change at this time.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE COMPANY'S PROPOSED NEW IRRIGATION RATE FOR POTABLE WATER CUSTOMERS?

A. The Commission should reject the Company's proposed new irrigation rate for potable water customers. The Company has provided no class cost of service studies to support a new irrigation rate for potable water customers. In addition, the new irrigation rate will result in a significant increase in the Company's alleged revenue deficiency which will have to be funded by remaining customers in the residential and commercial classes. The Company has not provided significant justification for such a change at this time.

D. <u>TANK MAINTENANCE EXPENSES</u>

20 Company Schedule H-1.

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED TANK MAINTENANCE EXPENSE ADJUSTMENTS.

A. The Company has proposed tank maintenance expenses for each water district adjustment based on projected future maintenance costs forecasted by the Tank Inspection Company ("TIC"). The Company proposes total annual tank maintenance expenses of $697,406 consisting of $376,478 for the Agua Fria Water District, $76,320 for the Havasu Water District and $244,608 for the Mohave Water District.[21] All of the expenses are based on forecasted, not actual, costs.

Q. DO YOU AGREE WITH THE USE OF FORECASTED AMOUNTS FOR TANK MAINTENANCE EXPENSES?

A. No. In the Company's last rate case involving the Agua Fria, Havasu and Mohave water districts, the Company rejected the Company's proposal to base tank maintenance expenses based on projections of future costs. The Commission stated:

> "We are not opposed to the Company instituting a 14-year interior and exterior painting program for its water tanks. However, we do not believe that it is necessary or reasonable to adopt the Company's proposal for advance funding of a Reserve For Tank Maintenance at this time. Because the tank maintenance expense reserve account balance proposed by the Company is **not based on known and measurable Company expenditures**, we find the normalization of tank maintenance expenses proposed by Staff, which is based on a three year average of expenses for each district, to be the more reasonable alternative."

(Commission Decision No. 71410, page 37.) (Emphasis added)

Q. WHAT IS YOUR RECOMMENDATION REGARDING TANK

21 Company witness Linda J. Gutowski, Direct Testimony, page 10.

MAINTENANCE EXPENSES?

A. The Commission should continue basing tank maintenance costs on an average of known and measurable Company expenditures. In Decision No. 71410, the Commission determined that tank maintenance expenses should be based on a three year average of actual known and measurable expenditures. The use of actual known and measurable expenditures should be continued.

E. INFLATION ADJUSTMENTS

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED INFLATION ADJUSTMENTS.

A. The Company has proposed inflation adjustments for certain expense items.[22]

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED INFLATION ADJUSTMENTS?

A. Inflation adjustments are not known and measurable and should be rejected by the Commission.

F. OTHER DEPRECIATION ISSUES

Q. YOU HAVE RECOMMENDED SOME CHANGES TO THE COMPANY'S PROPOSED DEPRECIATION RATES RELATED TO WHITE TANKS PLANT. HAS THE COMPANY PROPOSED OTHER MAJOR CHANGES IN DEPRECIATION RATES RELATED TO OTHER ACCOUNTS?

A. Yes. The Company has proposed significant changes to other accounts. The

22 Company Responses to RUCO 2.06 and 2.07.

Company's proposed changes include the following:

Account Number	Description	Commission Approved	Company Proposed	Increase Amount
304.5	Structures and Improvements	1.67%	3.00%	$153,953
331.1	T&D Mains (4" and less)	1.53%	3.00%	317,714
331.2	T&D Mains (6" to 8")	.53%	2.14%	235,978
331.3	T&D Mains (10" to 16")	1.53%	2.14%	194,638
333.1	Services	2.48%	3.75%	168,078
335.0	Hydrants	2.00%	2.99%	135,448

Source: Company witness John F. Guastella, Schedule D-1.

Q. WHAT ACCOUNTS FOR THESE INCREASES?

A. The increases to the T&D Mains, Services and Hydrant accounts result from the Company's proposal to increase the net salvage values from the Commission-approved 0 percent to a negative 50 percent. The Company proposes to increase the net salvage value on the Structures and Improvements from 0 percent to a negative 20 percent.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED CHANGES?

A. No. Each of these changes results in significant increases in depreciation expense and have not been adequately supported in direct testimony. The Commission should reject the Company's proposed changes and continue using the previously approved rates.

VIII. OTHER ISSUES

A. PHASE-IN OF RATE INCREASE

Q. DID THE COMPANY IN ITS MOST RECENT RATE CASE, DOCKET NO.

W-01303A-09-0343, AGREE TO A PHASE-IN OF ITS RATE INCREASE?

A. Yes. In Docket No. W-01303A-09-0343 involving the Anthem Water District and the Sun City Water District, the Company agreed to a three year phase-in of the rate increase granted by the Commission.[23]

Q. ARE YOU PROPOSING A PHASE-IN OF ANY RATE INCREASES GRANTED BY THE COMMISSION IN THIS CASE?

A. Not at this time. SCGCA will review the revenue requirement recommendations filed on June 27, 2011, by Staff, RUCO, and other parties in this case and will make a determination of whether or not to recommend a phase-in of any rate increase granted in this case. Any recommendation regarding phase-in will be made in the Rate Design Phase testimony of this proceeding which is due July 5, 2011.

B. RATE DESIGN PHASE

Q. WHAT OTHER ISSUES WILL SCGCA ADDRESS IN THE RATE DESIGN PHASE OF THIS PROCEEDING?

A. SCGCA will oppose the Company's proposed Infrastructure System Replacement Surcharge ("ISRS") programs. SCGCA may also address other rate design issues and address rate shock.

Q. DOES THIS COMPLETE YOUR TESTIMONY IN THE REVENUE REQUIREMENT PHASE OF THIS PROCEEDING AT THIS TIME?

A. Yes, it does.

23 Commission Decision No. 72047, page 44.

DIRECT TESTIMONY
MICHAEL L. ARNDT

APPENDIX A
Statement of Education and Experience

STATEMENT OF EDUCATION AND EXPERIENCE

MICHAEL L. ARNDT

Arndt & Associates
3602 S.W. Zona Circle
Ankeny, Iowa 50023
(515) 964-8902

Mr. Arndt received a Bachelor of Arts degree in Business Administration from Northwestern College in 1974 and a Master of Business Administration degree from Drake University in 1978. He has also taken additional graduate level courses in accounting, auditing, economics, finance and taxation at the University of Maryland. Mr. Arndt is a Certified Public Accountant in Maryland.

Mr. Arndt has attended numerous seminars and training courses related to public utility regulation, income taxes and other issues, including the National Association of Regulatory Utility Commissioners ("NARUC") Annual Regulatory Studies Program at Michigan State University.

Following graduation in 1974, Mr. Arndt was employed by the Utilities Division of the Iowa State Commerce Commission in Des Moines, Iowa. His responsibilities with the Iowa Commission included analyses of cost of service issues and testifying in rate proceedings of electric, gas, telephone and water utilities.

In 1979, Mr. Arndt joined Hess & Lim, Inc., a public utility consulting firm located in the Washington, D.C. area providing consulting services to a variety of clients including state regulatory commissions, consumer advocate agencies, municipalities and corporations. His responsibilities included performing analyses of utility ratemaking issues and testifying in proceedings before federal and state regulatory commissions on behalf of the firm's clients.

In December 1990, Mr. Arndt formed the public utility consulting firm of Arndt & Associates and has continued performing analyses of utility rate filings and testifying in proceedings on behalf of various clients.

Mr. Arndt has testified in more than 100 public utility rate proceedings before the Federal Energy Regulatory Commission and the state regulatory commissions of Alabama, Arizona, Arkansas, Colorado, Iowa, Maryland, Nebraska, Oklahoma, Pennsylvania, Rhode Island, Texas, Utah, Vermont and West Virginia. In addition, Mr. Arndt has worked on cases in several other states, the District of Columbia and Barbados. His testimony in prior proceedings has involved issues related to the determination of revenue requirements, income taxes, affiliated transactions, depreciation, securitization, excess cost over market ("ECOM"), unbundling, allocations and rate design.

In addition to public utility rate cases, Mr. Arndt has participated in various court proceedings on behalf of clients involving antitrust, Modified Final Judgment ("MFJ") violations, breach of contract, utility property damage and telephone directory cases.

DIRECT TESTIMONY
MICHAEL L. ARNDT

MLA-1
Cost of Capital

ARIZONA AMERICAN WATER COMPANY
Arizona Corporation Commission
Docket No. W-01303A-10-0448
Cost of Capital
Test Year Ended June 30, 2010

Exhbit MLA-1
Page 1 of 1

	Description (A)	Amount (B)	Percent of Total (C)	Cost Rate (D)	Weighted Cost (E)	Revenue Conversion Factor (F)	Pre-Tex Weighted Cost (G)	Requirement Revenue Impact (H)
	Company proposed cost of capital:							
1	Long term debt	$186,187,365	54.66%	5.66%	3.09%	1.0121	3.13%	
2	Short term debt	0	0.00%	0.00%	0.00%	1.0121	0.00%	
3	Total debt	186,187,365	54.66%	5.66%	3.09%		3.13%	
4	Common equity	154,453,598	45.34%	11.50%	5.21%	1.6611	8.66%	
5	Total	$340,640,963	100.00%		8.31%		11.79%	
	Association proposed cost of capital:							
6	Long term debt	$184,966,901	44.99%	5.66%	2.55%	1.0121	2.58%	
7	Short term debt	71,663,702	17.43%	0.45%	0.08%	1.0121	0.08%	
8	Total debt	256,630,603	62.43%	4.21%	2.63%		2.66%	
9	Common equity	154,453,598	37.57%	9.50%	3.57%	1.6611	5.93%	
10	Total	$411,084,201	100.00%		6.19%		8.59%	
	Revenue requirement impacts:							
11	Agua Fria Water District rate base							$133,986,700
12	Change in pre-tax cost of capital							-3.21%
13	Revenue requirement impact							($4,296,434)
14	Havasu Water District rate base							$3,615,955
15	Change in pre-tax cost of capital							-3.21%
16	Revenue requirement impact							($115,950)
17	Mohave Water District rate base							$11,312,680
18	Change in pre-tax cost of capital							-3.21%
19	Revenue requirement impact							($362,754)
20	Total rate base							$148,915,336
21	Change in pre-tax cost of capital							-3.21%
22	Revenue requirement impact							($4,775,137)

Sources:
Lines 1-5: Company D-1, pages 1 and 2.
Lines 6-10: Company Schedule D-1, page 1, with 9.50% return on common equity per Decision No. 72047, page 64
Lines 11, 14, 17 and 20: Company Exhibit TMB-1, page 1

DIRECT TESTIMONY
MICHAEL L. ARNDT

MLA-2
White Tanks Revenue Requirement Impact

ARIZONA AMERICAN WATER COMPANY
Arizona Corporation Commission
Docket No. W-01303A-10-0448
White Tanks Regional Treatment Plant
Revenue Requirement Impact
Test Year Ended June 30, 2010

	Description (A)	Rate Base Amounts (B)	Operating Expense Amounts (C)	Revenue Requirement Impact (D)
1	White Tanks plant cost at June 30, 2010	$63,877,959	$0	$7,531,211
2	White Tanks accumulated post in-service AFUDC after accumulated amortization hook-up fees through November 2011	10,867,396		1,281,266
3	White Tanks depreciation expense		2,898,708	2,898,708
4	White Tanks Maricopa Water Districti ("MWD") wheeling expense		1,353,346	1,353,346
5	White Tanks chemcal expense		224,715	224,715
6	White Tanks operation and maintenance ("O&M") expense		90,698	90,698
7	White Tanks water testing expense		14,200	14,200
8	Amortization of White Tanks O&M expense deferrals over three years		813,936	813,936
9	White Tanks expenses for waste disposal, rents, general office expenses, miscellaneous and maintenance expenses	0	169,500	169,500
10	Total	$74,745,355	$5,565,103	$14,377,580

Sources:
Line 1: Company Exhibit TMB-3 ($63,877,959) times 11.79% pre-tax rate
Line 2: Company Schedule B-2, page 1, column (I), times 11.79% pre-tax rate
Line 3: Company Response RUCO 3.01
Line 4: Company Schedule C-2, page 11
Line 5: Company Schedule C-2, page 13
Line 6: Company Schedule C-2, page 24
Line 7: Company Schedule C-2, page 26
Line 8: Company Schedule C-2, page 28
Line 9: Company Schedule C-2, page 33

ARIZONA AMERICAN WATER COMPANY
Arizona Corporation Commission
Docket No. W-01303A-10-0448
White Tanks Regional Treatment Plant
Post-In-Service Allowance for Funds
Used During Construction
Test Year Ended June 30, 2010

	Month (A)	White Tanks Original Cost (B)	Deferred Depreciation Expense (C)	Deferred Post-In-Service AFUDC Debt (D)	Deferred Post-In-Service AFUDC Equity (E)	Deferrals Before Hook-Up Fee Amortization (F)	Monthly Amortization of Hook-Up Fees (G)	Deferrals After Amortization of Hook-Up Fees (H)
	Company proposed:							
1	November.2009	$62,534,962		$72,543	$89,082	$161,624		$161,624
2	December	63,165,584	$176,424	163,017	209,210	548,651	$339,440	370,835
3	January.2010	63,566,465	178,223	166,198	213,293	557,715	344,421	584,129
4	February	63,596,345	179,367	168,623	216,404	564,394	347,989	800,534
5	March	63,687,691	179,452	170,677	219,041	569,170	350,129	1,019,575
6	April	63,711,117	179,713	172,465	221,336	573,514	352,178	1,240,911
7	May	63,897,069	179,779	174,631	224,115	578,524	354,410	1,465,025
8	June	63,877,959	180,310	176,817	226,921	584,048	226,335	1,822,738
9	July	63,890,460	180,256	178,553	229,149	587,958	15,975	2,394,721
10	August	63,893,324	180,291	179,317	230,129	589,738	143,775	2,840,684
11	September	63,893,324	180,302	180,776	232,002	593,080	15,000	3,418,763
12	October	63,893,324	180,302	181,880	233,419	595,601	15,000	3,999,364
13	November	63,893,324	180,302	182,991	234,844	598,138	15,000	4,582,502
14	December	63,893,324	180,302	184,109	236,279	600,690	15,000	5,168,192
15	January.2011	63,893,324	180,302	185,104	237,556	602,962	63,333	5,707,821
16	February	63,893,324	180,302	186,235	239,007	605,544	63,333	6,250,032
17	March	63,893,324	180,302	187,372	240,467	608,141	63,333	6,794,840
18	April	63,893,324	180,302	188,517	241,936	610,754	63,333	7,342,261
19	May	63,893,324	180,302	189,668	243,413	613,384	63,333	7,892,312
20	June	63,893,324	180,302	190,827	244,900	616,029	63,333	8,445,008
21	July	63,893,324	180,302	191,992	246,396	618,690	63,333	9,000,365
22	August	63,893,324	180,302	193,165	247,901	621,368	63,333	9,558,400
23	September	63,893,324	180,302	194,345	249,415	624,062	63,333	10,119,129
24	October	63,893,324	180,302	195,532	250,939	626,773	63,333	10,682,569
25	November	63,893,324	180,302	196,726	252,471	629,500	63,333	11,248,735
26	Total		$4,318,345	$4,452,081	$5,709,625	$14,480,050	$3,231,315	
	Association alternative proposed:							
27	November.2009	$62,534,962		$11,725	$0			
28	December	63,165,584		23,569	0			
29	January.2010	63,566,465		23,762	0			
30	February	63,596,345		23,843	0			
31	March	63,687,691		23,866	0			
32	April	63,711,117		23,887	0			
33	May	63,897,069		23,927	0			
34	June	63,877,959		23,958	0			
35	July	63,890,460		23,957	0			
36	August	63,893,324		23,959	0			
37	September	63,893,324		23,960	0			
38	October	63,893,324		23,960	0			
39	November	63,893,324		23,960	0			
40	December	63,893,324		23,960	0			
41	January.2011	63,893,324		23,960	0			
42	February	63,893,324		23,960	0			
43	March	63,893,324		23,960	0			
44	April	63,893,324		23,960	0			
45	May	63,893,324		23,960	0			
46	June	63,893,324		23,960	0			
47	July	63,893,324		23,960	0			
48	August	63,893,324		23,960	0			
49	September	63,893,324		23,960	0			
50	October	63,893,324		23,960	0			
51	November	63,893,324		23,960	0			
52	Total			$585,853	$0			

Sources:
Lines 1-26: Company Exhibit TMB-3
Lines 27-69, column : Based on short term debt rate of 0.45% per Company Schedule D-1, page 1.

DIRECT TESTIMONY
MICHAEL L. ARNDT

MLA-3
Residential Customers

ARIZONA AMERICAN WATER COMPANY
Arizona Corporation Commission
Docket No. W-01303A-10-0448
Number of Residential Customers
Test Year Ended June 30, 2010

	Description (A)	Agua Fria Residential Customers (B)	Havasu Residential Customers (C)	Mohave Residential Customers (D)	Total Residential Customers (E)
	Number of Residential Customers:				
1	December.2002	13,479	1,200	12,755	27,434
2	December.2003	14,951	1,248	12,907	29,106
3	December.2004	20,816	1,365	13,568	35,749
4	December.2005	25,847	1,425	14,473	41,745
5	December.2006	29,913	1,443	15,035	46,391
6	December.2007	32,040	1,464	14,844	48,348
7	December.2008	34,806	1,585	14,910	51,301
8	December.2009	35,261	1,579	14,831	51,671
9	December.2010	35,842	1,573	14,819	52,234
	Increase in Number of Residential Customers:				
10	December.2003	1,472	48	152	1,672
11	December.2004	5,865	117	661	6,643
12	December.2005	5,031	60	905	5,996
13	December.2006	4,066	18	562	4,646
14	December.2007	2,127	21	(191)	1,957
15	December.2008	2,766	121	66	2,953
16	December.2009	455	(6)	(79)	370
17	December.2010	581	(6)	(12)	563
	Percentage Increase in Residential Customers:				
18	December.2003	10.92%	4.00%	1.19%	6.09%
19	December.2004	39.23%	9.38%	5.12%	22.82%
20	December.2005	24.17%	4.40%	6.67%	16.77%
21	December.2006	15.73%	1.26%	3.88%	11.13%
22	December.2007	7.11%	1.46%	-1.27%	4.22%
23	December.2008	8.63%	8.27%	0.44%	6.11%
24	December.2009	1.31%	-0.38%	-0.53%	0.72%
25	December.2010	1.65%	-0.38%	-0.08%	1.09%

Source:
Company Response RUCO 3.01