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12 **BEFORE THE ARIZONA CORPORATION COMMISSION**

13 **COMMISSIONERS**

14 GARY PIERCE, Chairman
15 BOB STUMP
16 SANDRA D. KENNEDY
17 PAUL NEWMAN
18 BRENDA BURNS

19 **IN THE MATTER OF THE
20 APPLICATION OF ARIZONA-
21 AMERICAN WATER COMPANY, AN
22 ARIZONA CORPORATION, FOR A
23 DETERMINATION OF THE CURRENT
24 FAIR VALUE OF ITS UTILITY PLANT
25 AND PROPERTY AND FOR INCREASES
26 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
**INTERVENOR CLASS MOTION
TO DISMISS**

27 **I. INTRODUCTION**

28 Sun City Grand Community Association ("SCGCA"), as the designated representative
29 for the class of intervening homeowner associations (the "Class")¹, hereby moves the
30 Commission to dismiss Arizona-American Water Company's Application as premature.
31 There are three separate grounds for dismissal.

Arizona Corporation Commission

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¹ The Class represents approximately 24,000 people.

1 First, a rate determination by the Commission at this time would be unconstitutional.
2 Specifically, the Arizona Constitution requires that the Commission determine just and
3 reasonable rates. The Company's current Application relies on the capital structure of its
4 parent corporation and an increasingly obsolete rate base. However, the Company is in the
5 final stages of being sold. This pending sale renders the cost of capital and rate base factors
6 presented by the Company in its Application non-representative and completely irrelevant.
7 It makes no sense for the Commission to entertain a potentially massive rate increase based
8 on data that will become obsolete in a matter of months. Simply put, a "fair and just" rate
9 cannot be known and measurable at this time.

10 Second, any rate determination at this time would be a significant waste of
11 administrative resources because it would be based on figures that will be obsolete at the
12 time the Commission makes its determination. A re-hearing is inevitable once the post-sale
13 capital structure of the Company becomes clear. This would render the current, accelerated
14 proceedings a complete waste of time.

15 Third, assuming the sale is approved by the Commission, the Company's parent
16 stands to gain \$18,683,000.00 on the sale of the Company and the White Tanks plant, yet the
17 Company's Application does not account for this nearly \$19 million return on its investment.
18 This amount should be accounted for in any calculation of a reasonable rate of return.
19 Specifically, the Company's current owner (*i.e.*, its parent and the parent's shareholders) will
20 realize a tremendous return on its investment in the White Tanks plant, and it would be
21 double-dipping to then add the full cost of the plant into the rate base. Why should the
22 ratepayers have to pay rates based on the full cost of the plant, when the investor who built
23 the plant stands to realize millions in profit?

24 Alternatively, the Class requests a continuance of the hearings in this matter until the
25 sale of the Company is concluded and the Company is in a position to provide data that
26

1 accurately reflects the Company's cost of capital and fair value of rate base under new
2 ownership.

3 **II. FACTUAL BACKGROUND**

4 **A. The Pending Sale of the Company to EPCOR USA.**

5 On November 3, 2010, the Company filed an Application with the Commission
6 requesting valuation of its property and seeking corresponding rate increases. Less than 90
7 days later, on January 24, 2011, the Company's parent company and sole shareholder
8 American Water Works Company, Inc. ("American Water Works") announced the sale of
9 Arizona-American to EPCOR Water (USA) Inc. ("EPCOR USA"). EPCOR USA is an
10 indirect wholly-owned subsidiary of EPCOR Utilities Inc. ("EPCOR"), which is a
11 municipally owned Canadian corporation and holding company. EPCOR's sole shareholder
12 is the City of Edmonton, Alberta, Canada.

13 American Water Works and EPCOR USA have not produced an unedited version of
14 the purchase contract. However, it appears that American Water Works will realize a net
15 gain of \$18.683 million on the sale of the Company and its White Tanks plant.

16 On March 2, 2011, the Company filed an application with the Commission requesting
17 a waiver of the affiliated interest rules with respect to the pending sale of the Company by
18 American Water Works to EPCOR USA. According to the Company, the sale is scheduled
19 to be completed by the end of 2011.²

20 Under the current, accelerated procedural schedule for the Company's Application,
21 the Commission's decision in this rate case is not expected until 2012. Accordingly, any
22 Commission rate determination in this case would be obsolete because of the new ownership
23 by EPCOR USA.

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² See, generally, Docket No. W-01303A-11-0101 and Company Response to SCGCA DR No. 6.3 by Paul G. Townsley ("... the completion date of the sale of Arizona-American Water Company is on track to occur before the end of the year.") [Exhibit A].

1 **B. The Company's Application is Based Exclusively on Pre-Sale Data.**

2 The Company's Application is based exclusively on pre-sale financial data tied to its
3 ownership by American Water Works. Significantly, the Company admits that costs under
4 EPCOR USA's ownership "**are not known and measurable**" at this time.³ Thus, there is
5 no way the Commission can form a decision on the Application without resorting to
6 guesswork regarding the applicable costs. In short, substantial evidence for an accurate rate
7 increase does not yet exist. Moreover, the Company has not produced any pro forma
8 adjustments to the test year in order to "obtain a more realistic" revenue requirement under
9 EPCOR USA's ownership as required by the Administrative Code.⁴

10 All parties agree that the historical test year must be representative of the future
11 period in which new rates will be effective.⁵ However, the Company relies exclusively on
12 historical costs under American Water Works' ownership. These historical costs cannot
13 possibly represent the future rate period (or more accurately, current rate period) because, as
14 the Company itself admits, the costs under EPCOR USA's pending ownership "are not
15 known and measurable" at this time.

16 **C. The Pending Sale Will Change the Cost of Capital and the Rate Base.**

17 The sale will change several key components of the rate base currently being
18 determined by the Commission. First, cost of capital in this case is linked exclusively to
19 American Water Works, yet will undoubtedly change under EPCOR's ownership before this
20 rate case concludes. Second, operational and labor costs under EPCOR USA's ownership
21 are not known and measurable at this time, so the numbers will deviate from the numbers
22 presented by the Company in its Application. Finally, it is likely that the sale of capacity in
23 the White Tanks plant by EPCOR USA will radically change the fair value of rate base, yet
24 will be unaccounted for in this rate determination. It would be fundamentally unfair to allow
25 EPCOR USA to impose a huge rate increase on the limited number of people currently in the

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³ See Company Response to SCGCA DR No. 8.16 by Thomas Broderick [Exhibit B].

⁴ See Ariz. Admin. Code §§ R14-2-103(3)(h) and (3)(i).

⁵ See Ariz. Admin. Code § R14-2-103(3)(p).

1 Agua Fria Water District and then turn around and use the White Tanks plant to sell capacity
2 to consumers outside the district.

3 **III. ANALYSIS**

4 **A. A Rate Determination by the Commission Based on Pre-Sale Financial**
5 **Data Would be Unconstitutional.**

6 To set rates for public service corporations, the Commission must make a fair value
7 finding.⁶ This mandate is set forth in Section 14 of Article XV of the Arizona Constitution,
8 which states that the Commission “shall, to aid it in the proper discharge of its duties,
9 ascertain the fair value of the property within the State of every public service corporation
10 doing business therein.” Thus, before the Commission can set rates based upon any new,
11 used and useful property placed into service by the Company, it must determine the fair
12 value of that property.

13 Next, the Commission must determine relevant cost of capital before it can set just
14 and reasonable rates for a provider of monopoly services.⁷ The cost of capital established by
15 the Commission **must be** applied to rate base in order to arrive at the Company’s revenue
16 requirement.⁸ Therefore, when determining the appropriate revenue requirement, the
17 Commission needs to consider **both** the fair value of rate basis **and** the cost of capital. Cost
18 of capital has two essential components; the Company’s return on equity and the Company’s
19 cost of debt.

20 Arizona case law requires substantial evidence to support the Commission’s
21 determination.⁹ However, no such evidence has been offered. Indeed, it is doubtful any such
22 evidence could even exist prior to the actual ownership of the Company by EPCOR USA.
23 Likewise, the Arizona Constitution requires that the Commission ascertain the fair value of
24 the Company’s property utilizing information and data that is not capricious and irrelevant at
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26 ⁶ See *US West Communications, Inc. v. Arizona Corp. Comm’n*, 201 Ariz. 242, 245, 34 P.3d 351 (Ariz. 2001).

⁷ *Id.* at 246.

⁸ See *Scates v. Ariz. Corp. Comm’n*, 118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (Ariz. Ct. App. 1978)

⁹ See *Tucson Electric Power Co. v. Ariz. Corp. Comm’n.*, 132 Ariz. 240, 243, 645 P.2d 231, 235 (Ariz. 1982).

1 the time the decision is made.¹⁰ A determination of fair value that is arbitrary and unfair at
2 the time it is made is reversible error.¹¹

3 Any Commission decision based upon the current cost of capital and fair value of rate
4 base currently relied upon by the Company would be arbitrary and capricious, and thus
5 reversible error, because the Company's revenue requirement is not known and measurable
6 at this time.

7 **1. Cost of capital is not known and measurable at this time.**

8 The Company's capital structure is tied and inextricably to its current parent
9 company, American Water Works. However, American Water Works will be irrelevant
10 immediately upon the sale. After the sale, the only relevant evidence would pertain to
11 EPCOR USA's finances. None of the Company's witnesses have submitted testimony
12 concerning any review of EPCOR USA's cost of capital for the purposes of this proceeding.
13 All Company testimony to date has been based upon the cost of capital under American
14 Water Works, and the effect of the proposed rate increase upon the Company's financial
15 health with American Water Works as its parent.

16 For example, the Company acknowledges that the "entire balance of the Company's
17 short term debt is owed to American Water Capital Corp., an affiliate."¹² Cost of debt is a
18 key component of cost of capital. Similarly, the Company has based its operations overhead
19 and operations labor costs on information derived from its parent-subsidiary relationship
20 with American Water Works. Finally, return on equity is industry-specific. The change in
21 parent company will necessarily change what a reasonable return on equity would be since
22 American Water Works is publicly traded on the New York Stock Exchange, and EPCOR
23 USA is a subsidiary of a municipally-owned Canadian company.

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¹⁰ See *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 153, 294 P.2d 378, 383 (Ariz. 1956) ("[T]he company is entitled to a reasonable return upon the fair value of its properties at the time the rate is fixed.").

¹¹ *Id.* at 155, 384.

¹² See Company Response to SCGCA DR No. 8.11 by Thomas Broderick [Exhibit C].

1 EPCOR USA's application regarding the acquisition is pending before the
2 Commission. This is the last step for the sale to be completed. Thus, if the acquisition is
3 approved, it is likely that EPCOR USA will finalize its purchase of the Company from
4 American Water Works well before this rate case concludes. In other words, the financial
5 link between the Company and American Water Works will be broken before the
6 Commission makes its decision in this case and likely before the Presiding Officer even
7 issues a recommended opinion and order in this case. It makes little sense for the parties to
8 argue over cost of debt calculations and return on equity models that everyone knows will be
9 obsolete. Likewise, the Commission cannot determine just and reasonable rates based upon
10 out of date and obsolete information. The Commission cannot make its determination
11 regarding Arizona-American's cost of capital without known and measurable financial data
12 from EPCOR USA.

13 **2. Fair value of rate base is not known and measurable at this time.**

14 The White Tanks regional plant, as well as its operating and maintenance costs,
15 accounts for over 80% of the Company's requested rate increase for the Agua Fria District.
16 However, the information provided by the Company concerning its proposed fair value of
17 rate base ignores the fact that EPCOR USA will very likely sell capacity from the plant after
18 the acquisition. Otherwise, the Company's purchase price, reflecting a net gain of nearly
19 \$19 million, makes little sense. Tellingly, the Company has not offered any assurance
20 regarding EPCOR USA's intention to sell capacity.¹³ Needless to say, the sale of such
21 capacity would radically lower rate base. This should result in an adjustment to the rates
22 charged to ratepayers.

23 Likewise, the operating and maintenance costs for the White Tanks plant will change
24 as EPCOR USA implements new, and modifies current, processes. However, the extent of
25 these changes is unknown at this time. As the Company freely acknowledges, "the Company
26 has neither developed nor been provided detailed amounts or descriptions of any or all of the

13 See Company Response to SCGCA DR No. 7.1 by Thomas Broderick [Exhibit D].

1 types of operation costs that may change under EPCOR ownership.”¹⁴ The Company needs
2 to do this before seeking a rate increase.

3 In sum, determination of the fair value of rate base is premature at this time.

4 **B. A Rate Determination at This Time Would be a Significant Waste of**
5 **Administrative Resources.**

6 A rate determination by the Commission at this time would be based upon obsolete
7 and inapplicable information regarding the Company’s revenue requirement. Once the sale
8 occurs, which is likely to take place in the next 90 days, a re-hearing would be necessary to
9 determine an accurate rate based on relevant costs and data. Thus, proceeding with a rate
10 determination based on the Company’s Application at this time would be a tremendous
11 waste of administrative resources. Ratepayers should not be forced to pay for what would
12 amount to two multi-day hearings. Frankly, the only parties that would benefit from this
13 situation would be the attorneys. Unlike the Company, the ratepayers, many of whom are on
14 fixed incomes, would pay the price. The Company would no doubt request that the
15 Commission include its attorneys’ fees incurred in the post-sale rate re-hearing in rate base,
16 leaving the ratepayers to foot the bill.

17 **C. The Company’s Current Application Does Not Accurately Reflect its**
18 **Financial Condition.**

19 In its Application, the Company repeatedly bemoans its financial condition.
20 However, American Water Works stands to make an expected **\$18,683,000.00 net gain** on
21 the sale of Arizona-American to EPCOR USA.¹⁵ How can the Company be in such dire
22 straits if EPCOR USA has agreed to pay a substantial premium for its operations? The only
23 explanation is that the Company’s Application does not accurately reflect its current
24 financial condition.

25 It would be inequitable to burden ratepayers with an enormous rate increase
26 when American Water Works is profiting from the sale of its Arizona operations. By adding

14 See Company Response to SCGCA DR No. 8.17 by Thomas Broderick [Exhibit E].

15 Direct Testimony of Staff witness Gerald Becker dated July 22, 2011, at page 10 in Docket No. W-01303A-11-0101.

1 the full cost of the White Tanks plant to the rate base, even though the Company's parent
2 will realize massive profit on the sale of the plant to EPCOR USA, the Company appears to
3 be asking the ratepayers to pay for a return on an investment that has already been realized.
4 Specifically, the Company's current investor (*i.e.*, its parent and the parent's shareholders)
5 will realize a tremendous return on investment in the White Tanks plant, and it would be
6 double-dipping to then add the full cost of the plant to the rate base. The Company's
7 Application should therefore be dismissed, or the rate case continued, until such time as the
8 Company is in a position to provide accurate representation of its financial condition.

9 **IV. CONCLUSION**

10 The Company's Application should be dismissed. First, it would be unconstitutional,
11 and thus reversible error, for the Commission to base a rate determination on obsolete data.
12 Second, it would be a tremendous waste of administrative resources. It is bad enough that
13 the Company has forced the Class to incur significant legal expenses to intervene on an
14 Application that is based on data that will be irrelevant within 90 days. Finally, the
15 Company's purchase price reflects a significant return on investment. The ratepayers should
16 not be forced to pay another investor a significant return on the same investment.

17 Alternatively, the hearings should be continued until the sale of Arizona-American to
18 EPCOR USA is concluded, new financial data is submitted, and there is substantial evidence
19 upon which the Commission can determine the Company's revenue requirement.

20 DATED this 13th day of October, 2011.

21
22 EKMARK & EKMARK, L.L.C.

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24 
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1 **Certificate of Service**

2 **ORIGINAL** and thirteen (13) copies
3 of the foregoing filed this 13th day of
4 October, 2011 with:

5 Docket Control
6 Arizona Corporation Commission
7 1200 West Washington Street
8 Phoenix, AZ 85007

9 **COPY** of the foregoing hand-delivered
10 this 13th day of October, 2011 to:

11 Dwight Nodes, Administrative Law Judge
12 Legal Division
13 Arizona Corporation Commission
14 1200 W. Washington Street
15 Phoenix, AZ 85007

16 **COPIES** of the foregoing mailed
17 this 13th day of October, 2011 to:

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EXHIBIT A

COMPANY: ARIZONA AMERICAN WATER COMPANY
DOCKET NO: W-01303A-10-0448

Response provided by: Paul G. Townsley

Title: President, Arizona-American Water Company

Address: 2355 W. Pinnacle Peak Rd., #300
Phoenix, AZ 85027

Company Response Number: Sun City Grand 6.3

Q: When is the estimated closing or completion date of the pending sale of Arizona-American Water Company's Arizona assets to EPCOR USA?

A: Arizona-American objects to this request as it seeks information that is not relevant to the rate case proceeding. Notwithstanding the objection, Arizona-American responds as follows: Although subject to completion of the regulatory process in both Arizona and New Mexico, the completion date of the sale of Arizona-American Water Company is on track to occur before the end of the year.

EXHIBIT B

COMPANY: ARIZONA AMERICAN WATER COMPANY
DOCKET NO: W-01303A-10-0448

Response provided by: Thomas Broderick

Title: Director, Rates & Regulation

Address: 2355 W. Pinnacle Peak Rd., #300
Phoenix, AZ 85027

Company Response Number: Sun City Grand 8.16

Q: Explain how the Company's revenue requirement in this case is known and measurable given that American Water Works, Inc.'s Arizona water and wastewater operations will be sold and new ownership with new costs will occur prior to the effective date of new rates in this case.

A: Arizona-American objects to this Request to the extent it calls for a legal conclusion.

Objection notwithstanding, the Company responds that the Company's proposed revenue requirement is based on the historic test year ending June 30, 2010 and was prepared in accordance with Commission rules, requirements and precedents for, among other items, post test year pro forma adjustments. The sale of the Company did not occur during the test year. The Company has neither developed nor been provided cost estimates by EPCOR for future periods subsequent to the pending sale. Such future costs are not known and measurable.

EXHIBIT C

COMPANY: ARIZONA AMERICAN WATER COMPANY
DOCKET NO: W-01303A-10-0448

Response provided by: Thomas Broderick

Title: Director, Rates & Regulation

Address: 2355 W. Pinnacle Peak Rd., #300
Phoenix, AZ 85027

Company Response Number: Sun City Grand 8.11

Q: Referring to Company response to SCGCA 6.10, do the outstanding short term debt balances represent debt owed by Arizona American Water Company ("AAWC") to third parties or to affiliated companies? If owed to third parties, identify the parties loaning the short term debt. If owed to affiliated companies, identify the affiliated companies loaning the short term debt.

A: The entire balance of the Company's short term debt is owed to American Water Capital Corp., an affiliate. American Water Capital Corp., in turn, has identical borrowing terms for its commercial paper with various entities which are the ultimate source for the short term borrowings.

(Please note short term debt does not include the \$24,481 loan due September 2012 listed as "Sept '12 PILR – Monterrey" in revenue requirement Schedule D-2, as its maturity was more than one year away at the time the case was filed.)

EXHIBIT D

COMPANY: ARIZONA AMERICAN WATER COMPANY
DOCKET NO: W-01303A-10-0448

Response provided by: Thomas Broderick

Title: Director, Rates & Regulation

Address: 2355 W. Pinnacle Peak Rd., #300
Phoenix, AZ 85027

Company Response Number: Sun City Grand 7.1

- Q:** Do American Water Works Company, Inc. and/or Epcor USA, and/or their respective subsidiaries or affiliates have any intent (evidenced via written document or verbal discussions) to sell capacity (including, but not limited to, water treatment for other CAP subcontractors) in the White Tanks Water Treatment Plant within the next five years? If no, or if this information is not available, can the Company confirm that it will not sell capacity (including, but not limited to, water treatment for CAP subcontractors) in the White Tanks Plant for the next five years, given that the Company has applied to include the entire cost of the plant in rate base? If the Company cannot confirm that capacity in the White Tanks plant will not be sold in the next five years, please explain why this cannot be verified. Conversely, if the Company does intend to sell capacity within the next five years, please provide details of all such potential sales, including the parties and any pricing details discussed to date.
- A:** Arizona American Water is the owner of the White Tanks Plant and it does not have any intention to sell the existing capacity in the White Tanks Plant.

EXHIBIT E

COMPANY: ARIZONA AMERICAN WATER COMPANY
DOCKET NO: W-01303A-10-0448

Response provided by: Thomas Broderick

Title: Director, Rates & Regulation

Address: 2355 W. Pinnacle Peak Rd., #300
Phoenix, AZ 85027

Company Response Number: Sun City Grand 8.17

Q: Provide (1) a listing; and (2) detailed description of all types of Arizona water operation costs which will change under the new ownership by EPCOR USA.

A: Arizona-American objects to this Request to the extent it calls for speculation.

Objection notwithstanding, the Company anticipates that the operation will stay substantially the same at the time of the change of control and the operating costs will not significantly change under the new ownership. However, the Company has neither developed nor been provided detailed amounts or descriptions of any or all of the types of operation costs that may change under EPCOR ownership. Such future costs are not known and measurable.