

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES
CHAIRMAN

3 GARY PIERCE
COMMISSIONER

4 SANDRA D. KENNEDY
COMMISSIONER

5 PAUL NEWMAN
COMMISSIONER

6 BOB STUMP
COMMISSIONER

7
8 IN THE MATTER OF THE APPLICATION OF
9 ARIZONA-AMERICAN WATER COMPANY,
10 AN ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE CURRENT FAIR
12 VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER DISTRICT AND ITS SUN CITY
WATER DISTRICT.

Docket No. W-01303A-09-0343

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ANTHEM/AGUA FRIA WASTEWATER
DISTRICT, ITS SUN CITY WASTEWATER
DISTRICT AND ITS SUN CITY WEST
WASTEWATER DISTRICT.

Docket No. SW-01303A-09-0343

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1 **INTRODUCTION**

2 The Residential Utility Consumer Office (“RUCO” submits this Reply Brief on the
3 matters raised at Arizona American Water Company’s (“AAWC” or “Company”) recent rate
4 hearing.

5 **RATE BASE ADJUSTMENTS**

6 **SUN CITY WATER POST-TEST-YEAR PLANT (Well 5.1)**

7 The Company objects to RUCO’s reason for opposing the inclusion of post-test-year
8 plant of Sun City Water Well 5.1. However, RUCO’s reasoning is consistent with that of the
9 Commission in its previous Decision to exclude post-test-year plant in other Arizona-American
10 systems. In Decision No. 71410, the Commission declined to include over \$2 million of post-
11 test-year plant in the Agua Fria Water district and over \$600,000 of post-test-year plant in the
12 Mohave Water district noting “the Company has not demonstrated special or unusual
13 circumstances to justify inclusion of these post-test-year plant additions.” (at 21) In this case
14 the Company has also failed to demonstrate unusual or extraordinary circumstances.
15 Decision No. 71410 noted, “Staff contends that the matching principle is the reason the
16 Commission has allowed inclusion of post-test-year plant in rate base only in special and
17 unusual situations that warranted the recognition of post-test-year plant.” (at. 20) The
18 replacement of an old and aging well is not a special and unusual situation. The Company
19 knew this well would need to be replaced and controlled the timing of its replacement as well
20 as the selection of the test year.

21 Rather, the Company argues in support of the plant’s inclusion that the post-test-year
22 plant meets Staff’s standards for inclusion of post test year plant, which the Commission did
23 not even adopt in Decision No. 71410. However, for the sake of argument, the post-test-year
24

1 plant in question does not meet Staff's standards as set forth in the dicta of Decision No.
2 71410.

3 Staff states that it has traditionally recognized two scenarios in which
4 Staff believes recognition of post-test-year plant is appropriate (1) when
5 the magnitude of the investment relative to the utility's total investment
6 is such that not including the post-test-year plant in the cost of service
7 would jeopardize the utility's financial health; and (2) when certain
8 conditions exist as follows: (a) the cost of the post-test-year plant is
9 significant and substantial, (b) the net impact on revenue and expenses
10 for the post-test-year plant is known and insignificant or is revenue
11 neutral, and (c) the post-test-year plant is prudent and necessary for the
12 provision of services and reflects appropriate, efficient, effective, and
13 timely decision-making.

9 Decision No. 71410 at 20.

10 The cost of the post-test-year plant in question, \$1.587 million, is approximately 1.06
11 percent of the Gross Utility Plant in Service of \$149,301,020 that AAWC proposed in its initial
12 filing for the water districts involved in this rate case. It is only 0.47 percent of the combined
13 total water and wastewater Gross Utility Plant in Service in AAWC's filing. RUCO-10 at 7.
14 Thus, inclusion of this post-test-year plant is inappropriate because it does not meet Staff's
15 requirement that the "magnitude of the investment relative to the utility's **total investment** is
16 such that not including the post-test-year plant in the cost of service would jeopardize the
17 utility's financial health." (emphasis added).

18 The districts in the current case only represent a portion of AAWC's total investment in
19 Gross Utility Plant in Service, so the percent of AAWC's total company amount represented by
20 the \$1.587 million post-test year plant item is even smaller. Id. The utility's total investment is
21 not simply limited to its investment in Sun City Water as the Company argues. Sun City Water
22 is one District, and is by no means the Company's "total investment" in plant. The denial of the
23

1 post-test-year plant in question will not place AAWC in financial jeopardy. The Commission
2 should reject the Company's request to include the post-test-year plant.

3 **CASH WORKING CAPITAL**

4 1. Revenue Lag

5 The Company's comment concerning the Company's unusually long revenue lags is
6 that RUCO "ignores the realities of the collection process." Company Brief at 14.
7 Nonetheless, on its face, revenue lags of over 45 days per district seem totally out of line with
8 a billing due date of 20 days. At the very least, revenue lags that long would suggest an
9 inefficient billing and/or collection system which the Company adamantly denies. The
10 "realities" of this Company's collection process are clearly unusual if it takes the Company
11 more than 25 days past the due date to collect its revenues. Since the Company can assess a
12 penalty to customers who submit payment past the 25th day, ratepayers who pay their bills on
13 time should not be penalized by an increased working capital requirement resulting from the
14 Company's lead/lag study that includes a 26-day collection lag.

15 2. Pre-payment of Management Fees

16 The Company's request to include a pre-payment of affiliated Service Company
17 charges in its cash working capital calculation is overreaching. Why should the payment of
18 affiliated services be treated differently than how the Company pays its non-affiliated services?
19 The normal way of doing business with the non-affiliates is to pay when the service is
20 performed, not to pre-pay. Dealings with the affiliate should be scrutinized even closer than
21 dealings with the non-affiliates since these are not arms-length transactions. RUCO-10 at 25.
22 The Commission should adopt RUCO's adjustments to the Company's Cash Working Capital
23 recommendation.
24

1 **OPERATING INCOME**

2 **RATE CASE EXPENSE**

3 RUCO incorporates its position set forth in its Closing Brief¹. Closing Brief at 12-14.

4 **PENSION EXPENSE**

5 There appears to be some confusion for both RUCO and the Company as to what the
6 other party is recommending for pension expense. RUCO, based on the rebuttal testimony of
7 Miles Kiger, was under the impression that the Company was proposing to average the
8 Company's 2009 and 2010 ERISA funding amounts. RUCO Brief at 14, A-14 at 14-15.
9 However, the Company, in its Opening Brief argues that its 2010 "pension expense remained
10 high" which supports its recommendation to use the very high 2009 pension expense amounts.
11 Company Brief at 27. The Company argues that if the Commission were inclined to normalize
12 pension expense, the Commission should ignore the test year pension amount which is
13 unusually high to begin with, and should average the even higher 2009 and 2010 ERISA
14 amounts. This argument is absurd and the Commission should reject the Company's
15 recommendation. The point of normalizing an expense is to arrive at an amount that is in line
16 with what is the normal amount of the expense in question. Where the evidence shows that
17 what is normal are historical amounts much less than the test year, the Commission should not
18 average post-test-year amounts that are significantly higher as the Company recommends.

19 In its Post Hearing Brief, the Company mistakenly argues that RUCO's use of the
20 average 2007-2008 FAS-87 figures to normalize pension expense is not appropriate.
21 (Company Brief at 28) However, while RUCO had initially recommended normalizing the

22 ¹ Where RUCO's Closing Brief replies to the arguments raised in the Company's Closing Brief and RUCO has
23 nothing more to add or where the Company has not addressed an issue in its Closing Brief, RUCO will simply
24 incorporate the argument that it made in its Closing Brief as its reply.

1 **ERISA** years (2007-2008) to obtain what RUCO believed was a fair amount of pension
2 expense using the ERISA methodology, RUCO later changed its position. As the proceeding
3 progressed, RUCO announced that it would be changing its recommendation from normalizing
4 the 2007-2008 ERISA expense to a **test year FAS-87 amount**. RUCO made this change only
5 after it obtained information from the Company revealing the FAS-87 amount, which RUCO
6 had previously asked for, and the Company provided, late in the proceeding. R-12.

7 The Company chooses its pension plan and has input into its design. Transcript at 973-
8 976. The plan has been severely underfunded since its inception, is designed poorly, and is
9 tied to a market that has been subject to abnormal conditions over the past several years. The
10 Company's future pension funding projections indicate no relief in sight. Company Brief at 27.
11 The Company now asks the Commission to place all the risks associated with the Company's
12 pension funding choices on its customers and require the Company's customers to pay for its
13 poorly designed pension plan. The Company believes that this is a reasonable proposition.

14 The Company further balks at RUCO's suggestion that the Company transition to FAS-
15 87. Company Brief at 29. RUCO proposes this change for two important reasons. First, a
16 transition to FAS-87 would provide some relief to ratepayers.² Again, the Company's position
17 shows the Company's unwillingness to work toward a rate increase that is reasonable to its
18 ratepayers. Second, it is appropriate to use FAS-87 to recover pension expenses because the
19 Company's parent, American Water Works, uses FAS-87 accounting to account for pension
20 expense. RUCO-10 at 82. For all of the reasons RUCO addressed in its Closing Brief, RUCO
21 believes that its recommendation to use the test year FAS-87 amount of \$958,949 is not only
22 fair but very reasonable in this case. RUCO Brief at 14-18.

23
24 ² Admittedly, the 2009 FAS 87 amount is abnormally high, \$2,143,743 but the test year and even 2010 amounts are more reasonable than the same ERISA years.

1 **AMORTIZATION OF PENSION REGULATORY ASSET**

2 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 18-20.

3 **NORMALIZE OTHER POST EMPLOYMENT BENEFITS (“OPEB”)**

4 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 20-21.

5 **TANK MAINTENANCE RESERVE FUND (SUN CITY)**

6 The Company notes that RUCO’s position has changed on this issue since the last case
7 and that this change is inexplicable. Company Brief at 31. In the last case, the Company
8 made a similar request to establish a tank maintenance reserve fund which RUCO supported
9 “...based on RUCO’s review of the estimates the Company has received, but not accepted,
10 through a request for proposals process.” Decision No. 71410 at 36. Despite RUCO’s
11 support, the Commission denied the Company’s request:
12

13 ... we do not believe that it is necessary or reasonable to adopt the
14 Company’s proposal for advance funding of a Reserve for Tank
15 Maintenance at this time. Because the tank maintenance expense
16 reserve account balance proposed by the Company is not based on
17 known and measureable Company expenditures, we find the
18 normalization of tank maintenance expenses proposed by Staff, which
19 is based on a three year average of expenses for each district, to be
20 the more reasonable alternative. Staff’s normalization adjustment will
21 therefore be adopted for each of the six water districts. Decision No.
22 71410 at 37.

23 The Company’s request for a tank maintenance reserve fund for Sun City Water in this
24 case is basically the same as in the last case. The Commission rejected the request in the
earlier Decision and the Company has not provided any new or different evidence which would
persuade RUCO, or this Commission for that matter, to deviate from the Commission’s
decision in the last case.

1 **TANK MAINTENANCE DEFERRAL ACCOUNT (ANTHEM)**

2 As mentioned above, RUCO opposes a tank maintenance reserve fund accrual account
3 for the Sun City Water and the Anthem Water districts. RUCO does not oppose approval of a
4 deferral account for the maintenance expenses in the Anthem district (Sun City already has a
5 deferral account).

6 **AFFILIATED MANAGEMENT FEES**

7 **POST-TEST-YEAR WAGE INCREASE**

8 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 23-24.
9

10 **AFFILIATE MANAGEMENT FEES – REMOVAL OF 22.22 PERCENT POST-**
11 **TEST-YEAR INCREASE FOR AFFILIATE EMPLOYEE BENEFITS**

12 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 24-26.

13 **AFFILIATE MANAGEMENT FEES – REMOVE AFFILIATE INCENTIVE**
14 **COMPENSATION EXPENSE (“AIP”)**

15 The Company argues that RUCO has failed to provide adequate justification to explain
16 why it has moved off of its previous recommendations to disallow 30 percent of AIP and is now
17 recommending removal of 100 percent of the identifiable incentive compensation expense
18 included in the affiliate Management Fees for the 2008 test year. Company Brief at 33. It is
19 true that RUCO has recommended a 30 percent disallowance for incentive compensation for
20 the Company in prior cases. However, in those cases RUCO supported the 30 percent
21 disallowance because the parties to those prior cases did not attempt to distinguish the source
22 of the financial trigger leading to the payment of incentive compensation, and made no
23 distinction between incentive compensation for AAWC’s own employees, and the incentive
24

1 compensation expense charged to AAWC for affiliated Service Company employees as part of
2 the Management Fee. RUCO-10 at 96.

3 As set forth in more detail in RUCO's Closing Brief, in prior cases a very high
4 percentage of the operating target for the entire Company had to be reached before AIP was
5 awarded. In this case, American Water Work's corporate financial income is only moderately
6 influenced by AAWC's operating results and is heavily influenced by non-Arizona jurisdictional
7 operations as well as American Water Works' non-regulated operations. Id. As discussed in
8 RUCO's Closing Brief, Illinois and West Virginia regulatory bodies have denied recovery of
9 incentive compensation expense. (RUCO Brief at 27-28).

10 A disallowance of 100 percent of the incentive compensation for the affiliated Service
11 Company employees who charge AAWC via the Management Fee is appropriate because the
12 award to Service Company employees is dependent upon the parent, AAWC's corporate
13 operating income and corporate financial targets. Id. at 98. It is inappropriate to charge
14 AAWC's ratepayers for affiliate incentive compensation that is premised on a parent
15 company's financial trigger whose operating income and corporate financial results are
16 influenced by operating income of non-jurisdictional and non-regulated operations of American
17 Water Works. Id. at 98.

18 **AFFILIATE MANAGEMENT FEES – NORMALIZE AFFILIATE PENSION EXPENSE**
19 **AND OPEB EXPENSE**

20 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 29.

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1 **OTHER OPERATING ADJUSTMENTS**

2 **INTEREST SYNCHRONIZATION (ALL DISTRICTS)**

3 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 30.

4 **DEPRECIATION EXPENSE (SUN CITY WATER)**

5 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 30.

6 **DEPRECIATION EXPENSE (ANTHEM/AGUA FRIA WASTEWATER)**

7 RUCO incorporates its positions set forth in its Closing Brief. Closing Brief at 30 -
8 31.

9 **DEPRECIATION EXPENSE (ANTHEM WATER)**

10 RUCO incorporates its position set forth in its Closing Brief. Closing Brief at 31.

11 **FUEL AND POWER EXPENSE ADJUSTMENT**

12 RUCO does not oppose Staff's adjustment. RUCO-10 at 99.

13 **AAWC'S REQUEST FOR AUTHORITY TO DEFER REPLACEMENT COSTS PAID TO**
14 **THE CITY OF GLENDALE IN ASSOCIATION WITH THE 99TH AVENUE INTERCEPTOR,**
15 **PURSUANT TO A CITY OF GLENDALE SEWAGE TRANSPORTATION AGREEMENT**
16 **("GLENDALE AGREEMENT")**

17 The Company claims RUCO's objection to the amounts in question is without merit.
18 Company Brief at 12. RUCO is not objecting to the **test year** replacement costs. However,
19 RUCO did not include any costs in its final schedules because RUCO could not identify the
20 test year amount from the documents the Company provided. As testified by RUCO witness,
21 Ralph Smith,

22 "...but the periods are not necessarily segregated in a way
23 which makes test year 2008 amounts really identifiable...So
24 when I was informed about RUCO's position of accepting the
2008 amounts as perhaps an addition to O&M expense in the

1 current case, I guess I want to caveat that and make sure that
2 that is based on some reasonable identification of these
amounts, which this exhibit does not appear to provide.” (Tr. I
at 932-933)

3 The evidence in the record does not establish the test year amounts, which is the
4 reason why RUCO did not include any replacement costs in its final schedules. A-14, Rebuttal
5 Exhibit MHK-1R. The Company has the burden of establishing which costs were incurred
6 during the test year and which are pre and post test year. The Company should be required to
7 meet its burden of proof on this issue, and in RUCO’s opinion, it has failed to do so.

8 Furthermore, the Company has not shown an unusual circumstance or provided a
9 reason why the Commission should allow recovery of replacement costs outside of the test
10 year. While the Commission will allow some post-test-year costs, the Commission seldom, if
11 ever, allows pre test year costs absent a deferral order. The Company chooses the test year
12 and the Company should not have the expectation that all of its replacement costs, including
13 pre and post-test-year costs will be automatically allowed on agreements that were not even
14 approved by the Commission.

15 Accordingly, the Commission should only allow the properly-identified test year
16 replacement costs.

18 **INFRASTRUCTURE IMPROVEMENT SURCHARGE**

19 The Company claims that there is nothing “ordinary” about the improvements that will
20 be necessary over the next few years in Sun City. Company Brief at 41. The Encarta
21 Dictionary defines “ordinary” as being “of a common everyday kind.” The improvements in
22 question include replacement mains, hydrants, meter, (including AMR replacements), services,
23 tanks, and booster stations. The Company also seeks to include infrastructure relocations as
24 a selected addition that would be eligible for cost recovery under the Company-proposed

1 surcharge. RUCO-17 at 3. These improvements are normal, common and routine for a water
2 utility. The Sun City infrastructure is old and needs repair. Company Brief at 39.

3 To the extent there is anything extraordinary, it is the request itself. The costs in
4 question have not even been incurred and are not even known at this point. The Company's
5 request, if successful, would result in perhaps the most egregious abuse of an adjustor
6 mechanism to date. The future expenses in question are routine plant costs incurred in
7 between rate cases and, like all of Arizona's other regulated utilities who seek similar
8 accounting treatment, the Company should seek recovery in a rate case where all of the rate
9 case elements will be considered.

10
11 **RUCO'S RESPONSE TO THE LEGAL PRE-TRIAL MEMEORANDUM OF THE
12 ANTHEM COMMUNITY COUNCIL AND COMMISSIONER PIERCE'S REQUESTS**

13 In this rate case, the Company seeks to recover two repayments made to Pulte totaling
14 \$23,294,422.57.³ All prior repayments have already been recovered in rates and total
15 approximately \$23 million. Besides the two repayments totaling \$23.3 million at issue in this
16 case, there remains one more outstanding repayment for \$6.7 million.

17 The Company defends its position that the Infrastructure Agreement was not subject to
18 Commission approval. The Company argues that the Agreement is not an evidence of
19 indebtedness under A.R.S. §40-301. Company Brief at 22-24. The Company relies on the
20 statutory construction doctrine of *ejusdem generis* which relates back the meaning of the
21 phrase "evidence of indebtedness" to the term's preceding phrase in the statute. Thus, the
22 company argues that "evidence of indebtedness" is limited to characteristics of stocks, bonds
23 and notes. In so doing, the Company applies a narrow interpretation of the phrase to its

24 ³ In RUCO's Closing Brief, RUCO incorrectly identifies this amount as \$20,226,122.00. RUCO Brief at 37.

1 preceding terminology, which would indicate that contracts such as the Agreement would not
2 be encompassed in the phrase.

3 The Company's narrow interpretation does have support. In *Jones v. Hawaiian Electric*
4 *Co., Inc., 64 Haw. 289 (Haw. 1982)*⁴ the Supreme Court of Hawaii determined that a lease
5 agreement, under which the utility agreed to lease land for 30 years, which was expensed
6 rather than capitalized, by the utility, was not "evidence of an indebtedness" within the meaning
7 of an Hawaiian statute similar to A.R.S. §40-301. The Hawaiian Supreme Court applied the
8 rule of statutory construction of *ejusdem generis* in reaching its conclusion. *Id.* at 94. The
9 Hawaiian Supreme Court also noted that the rule of *ejusdem generis* had been applied in other
10 states with statutes similar to Hawaii's. See for example *Wisconsin Southern Gas Co. v.*
11 *Public Service Commission, 57 Wis.2d 643, 205 N.W.2d 403 (1973); Re Washington Gas Light*
12 *Co., 58 Pub.U.Rep.3d 1 (1965).*

13 The rule of *ejusdem generis* also has been followed in Arizona. In *Day v. Buckeye*
14 *Water Conservation, 28 Ariz. 466, 237 P. 636,* the Arizona Supreme Court noted that the rule
15 of *ejusdem generis* has been applied by the court as well as other courts, repeatedly, and is
16 recognized as one of the cardinal principles of statutory construction. *Day v. Buckeye Water*
17 *Conservation, 28 Ariz. 466, 473, 237 P. 636, 643 (1925).* However, the Arizona Supreme
18 Court has also noted that the rule *ejusdem generis* is only a rule of construction, to be applied
19 as an aid in ascertaining the legislative intent, and is not always controlling. *Arizona Superior*
20 *Mining Co. v. Anderson, 33 Ariz. 64, 67, 262 P. 489, 492 (1927).*

21 In RUCO's Closing Brief, RUCO recognizes Anthem Council's argument for a broader
22 interpretation to the phrase "evidence of indebtedness." This broader, more plain meaning
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24 ⁴ Overruled on other grounds, *Camara v. Agsalud, 67 Haw. 212, 215 (Haw. 1984).*

1 approach would encompass the Agreement within the phrase, and also has support in some
2 states. For example, in *Thomas v. the State of Texas*, 919 S.W.2d 427 (1996), the Texas
3 Court of Criminal Appeals had to determine whether “other evidence of indebtedness” as used
4 in the state statutory definition of securities included a document similar to a mortgage
5 certificate (mortgage certificate is a term that precedes the phrase “evidence of indebtedness”
6 in the statute in question). The Texas Court of Criminal Appeals, relying on the broad
7 definition given to the phrase “evidence of indebtedness” in the Federal Act, determined that
8 the phrase “evidence of indebtedness” meant “all contractual obligations to pay in the future for
9 consideration presently received”. *Id.* at 432, relying on *United States v. Austin*, 462 F.2d 724,
10 736 (10th Cir.), *cert. denied*, 409 U.S. 1048, 93 S.Ct. 518, 34 L.Ed.2d 501 (1972). The
11 *Thomas* case was a criminal case, and was decided in that context. But it does point out that
12 there is legal support for the Council’s broader interpretation of the statute.

13 As explained in RUCO’s Closing Brief, it is clear to RUCO that the Agreement does not
14 meet the standards of A.A.C.R14-2-406. RUCO Brief at 37-40. Yet, as discussed above,
15 RUCO is less clear whether the Company’s repayment obligation to Pulte falls within the
16 meaning of “evidence of indebtedness” within the context of ARS §40-301. With that said,
17 RUCO wishes to point out that the Commission has already allowed the Company to recover
18 \$23 million of the refunds, and as a matter of equity, to change its direction at this point is
19 unfair. Second, there is no evidence in the record questioning the reasonableness of these
20 repayment amounts. Third, there is nothing in the record alleging that the assets built by the
21 Pulte funds are not used and useful.

1 **RUCO'S ALTERNATIVE REFUND RECOVERY PROPOSAL**

2 In our Closing Brief, RUCO stated that it is unfair for the Commission to allow the
3 Company to allow immediate recovery of the two repayments totaling \$23.3 million. This
4 amount is similar in size to all the previous repayment amounts made over the past several
5 years **combined**. RUCO's alternative proposal for recovery would reduce the size of the rate
6 increase for Anthem, while at the same time the Company would still be made whole. Under
7 RUCO's alternative proposal the Company will be able to recover the amount of the refunds it
8 paid over a period of time and still be allowed a return on the refunds paid. This will allow the
9 Company to be made whole, and provide ratepayers with gradual rate increases over time.

10 As detailed in RUCO's Closing Brief at 42-43, RUCO's proposal is patterned on the
11 standard ratemaking treatment for AIAC. One-tenth of the repayments would be recovered in
12 this rate case and the remaining nine-tenths would be treated as deductions from Anthem's
13 water and wastewater rate bases. AAWC would earn a return on one-tenth of the refund until
14 it files a future rate case application. At that time, the amount of the original deduction to rate
15 base would be reduced at a rate of one-tenth per year for each of the years between the time
16 that rates go into effect in this proceeding and the end of the test year in the next rate case.

17 RUCO believes its proposal better serves the Anthem ratepayers because it will reduce
18 the rate increase. The Company originally asked for a 100.80 percent increase in water rates
19 and an 81.77 percent increase in wastewater rates. At hearing, RUCO recommended a 73.35
20 percent increase in water rates and a 59.27 percent increase in wastewater rates. Under
21 RUCO's treatment of the \$23.3 million, the rate increase would fall to 61.26 percent and 54.78
22 percent, respectively. If the Commission chooses to include the final \$6.7 million repayment in
23
24

1 this plan (for a total recovery of approximately \$30 million), Anthem's rate increase is further
2 reduced to 57.91 percent for water and 53.58 percent for wastewater.⁵

3 Exhibit 1 attached to the Reply Brief provides detail for the recovery of the
4 \$3,068,300.57 and the \$20,226,122.00 in repayments. In Exhibit 2, RUCO adds the 2010
5 payment for \$6,742,041.00. Although the Company did not request recovery of this final \$6.7
6 million repayment, RUCO believes the Commission could allow this repayment to be
7 recovered if it so chooses. Including the final \$6.7 million repayment reduces the rate increase
8 because adding it to the AIAC balance creates a larger deduction from rate base.
9 Furthermore, its inclusion puts this controversial matter to rest at last. The requested recovery
10 of the 2010 refund is inevitable and RUCO believes it is appropriate to package it at this time in
11 a manner that will provide the least amount of pain to the ratepayers. At the same time, for the
12 reasons set forth in its Closing Brief, RUCO's proposal will make the Company whole. There
13 is absolutely no reason why the Company should not agree to RUCO's proposal as a way to
14 ameliorate the impact of the rate increase on its customers.

15 **COST OF CAPITAL**

16 RUCO agrees with the Company that the primary difference in the cost of capital issues
17 relates to the cost of equity. Company Brief at 35. The Company claims that RUCO's cost of
18 equity recommendation is unreasonable and lacks support. While RUCO, the Company and
19 Staff can argue over what is reasonable, it can hardly be claimed that RUCO's
20 recommendation lacks support. The Company adopted Staff's Cost of Capital
21 recommendations. RUCO and Staff did the same type of cost of capital analysis to arrive at
22

23
24 ⁵ RUCO points out that the Exhibit attached to its Closing Brief included only the \$20,226,122.00 repayment as well as the final \$6,742,041 repayment, and did not include the \$3,068,300.57 repayment.

1 their respective recommendations. To argue that RUCO's recommendation lacks support
2 would be the same as arguing that Staff's cost of capital analysis lacks support. Neither
3 RUCO nor Staff's cost of capital recommendation lacks support based on the evidence in this
4 record.

5 To the extent the Company is critical of RUCO's cost of capital analysis, RUCO has
6 addressed the Company's criticism in its Closing Brief. RUCO Brief at 44-53. However, there
7 is one point the Company makes which deserves further discussion. The Company claims
8 that RUCO's recommendation fails to recognize the impact of the current financial crises on
9 the cost of capital. Nothing could be further from the truth.

10 It is counter-intuitive to assign a higher cost of equity to a utility in the current economic
11 environment. In fact, in markets experiencing a downturn, regulated utilities are an attractive
12 investment to investors. Regulated utilities are monopolies with a guaranteed customer base.
13 Hence, the risk associated with regulated utilities is generally lower than their non-regulated
14 counterparts. The lower risk is attractive to investors in a bad economic climate. However,
15 investors understand that the lower risk comes at a price--lower returns.

16 In addition, the Company's parent continues to rely on low cost debt financing to fund its
17 capital improvements. The average rate on the Company's commercial paper issuances has
18 also lowered significantly resulting in a lower cost of short-term debt which should result in a
19 lower weighted average cost of capital. This point was raised during the first phase of the
20 evidentiary hearing when Anthem's witness, Dan Neidlinger responded to questions regarding
21 the drop in the Company's commercial paper rate to an average of 0.75 percent. RUCO-8,
22 Tr. I at 861-862.

23 Finally, the Federal Reserve has also issued several recent rulings which support
24 RUCO's lower weighted average cost of capital recommendation. In March of this year, the

1 Federal Reserve decided not to increase or decrease the federal funds rate and kept it
2 between zero and 0.25 percent. In doing so, the Federal Reserve confirmed its plan to keep
3 interest rates “exceptionally low” for a long time.⁶

4 The Company and Staff are recommending a return on equity of 10.7 percent. RUCO is
5 recommending a return on equity of 9.5 percent. In what appears to be the Commission’s
6 recognition of the current “financial crisis” the Commission has started to reduce the cost of
7 equity awards it has been making in water cases from the usual 10 percent. There are no
8 circumstances in this case, or nothing unique or unusual to this company, which should
9 persuade the Commission to change course here and actually increase significantly the cost of
10 equity award in this case. RUCO’s cost of capital recommendation is fair and reasonable and
11 should be adopted by the Commission.

12 **RATE DESIGN**

13 **RATE CONSOLIDATION**

14 RUCO continues to oppose a consolidated rate design for the reasons set forth in the
15 testimony of its witness, Jodi Jerich, and further explained in detail in its Closing Brief. RUCO
16 Brief at 58-67. Staff also continues to recommend stand-alone rates for all of the districts in
17 this case. Staff Brief at 16.

18 The Company has moved from a position favoring stand-alone rates to what can best
19 be described as “being on the fence” over consolidation. Company Brief at 45. The Company
20 no longer wants to state a position on consolidation but now “seeks the Commission’s
21 leadership” on the issue. Yet, the Company, who seeks direction, does not hesitate to offer
22

23 ⁶ Minutes of the Federal Open Market Committee meeting held on March 16, 2010
24 <http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20100316.pdf>

1 direction as to when the best time for consolidation would be. Company Brief at 45. According
2 to the Company, now is the “best opportunity.”

3 The Company’s opinion that now is the best time to consolidate rates, is misplaced.
4 RUCO explained in its Closing Brief why now is a bad time to implement consolidation. To
5 recap, Jodi Jerich’s testimony is instructive:

6 Frankly, RUCO believes this is the worst time to consolidate
7 rates because we have so many problems associated with this case. If
8 you just take a look, you have Staff opposing consolidation, RUCO
9 opposing rate consolidation. I’m a little bit confused about the
10 Company, but I thought the Company was opposing consolidation at
11 one point. Many intervenors are formally opposing rate consolidation.
12 There are rate ratepayers who are not -- who have not intervened in
13 this case but we have heard in public comment meetings that they
14 oppose rate consolidation.

15 There is very bad timing here because just a few months ago
16 most of Arizona-American's water systems just got a rate increase.
17 Some districts had rate increases that went up as high as 66 percent,
18 and those were increases based on their own cost of service. And now
19 some of those districts are going to be asked to have an increase in
20 rates in order to subsidize and mitigate the cost of service for other
21 districts.

22 Like I said, there are legal problems with this case regarding the
23 two different test years and revenue neutrality requirements, and there
24 is a problem with the economy. I know the Commissioners have often
asked companies how the Commission should consider the economy or
how they should consider their rate application in light of the economy.
Well, the economy has hit all of Arizona-American ratepayers, and a
bad economy affects all. You can't look at Anthem ratepayers in a
vacuum. You have to consider how shifting some of Anthem costs to
other ratepayers affect those family budgets.

And also -- again, we have talked about it, but there are notice
problems. And, yes, the Company has held meetings and put forth
some information, but they really let a good opportunity to educate
customers fall through their fingertips. And what we are left with is
some angry customers, uninformed customers, and now the issue shifts
to the Commission to make a decision in this type of an environment.

Frankly, this is a bad -- this is probably the worst time to consider
rate consolidation for this Company.

Tr. I at 1092-1094, RUCO Brief at 60-61.

1 The Company, in its final schedules, has offered a five-step rate consolidation proposal.
2 Company Brief at 46. The Anthem Community Council also recommends a five-step
3 consolidation implementation plan. Anthem Brief at 15. RUCO recommends that the
4 Commission should reject a five-step consolidation plan for the same reasons the Commission
5 should reject the three-step consolidation proposals offered in this case. Both the three-step
6 and five-step proposals:

7 1. Do not resolve the legal infirmity of consolidating rates with some districts' fair value
8 rate base calculated using a 2007 test year and other districts' fair value rate base
9 using a 2008 test year. In order to consolidate rates based on two different test years,
10 the Commission will have to average or blend the rate bases and the rates of return of
11 the various systems that are determined using different inputs from two different test
12 years to come up with consolidated rates, thus arbitrarily adjusting the calculation of the
13 FVRB and the FVROR.

14 2. Do not resolve the violation of Commission Rule that a utility's rates be set based on
15 a one-year historical period (R14-2-103).

16 3. Do not conform to the revenue neutrality requirement of Decision No. 71410.⁷

17 4. Do not mitigate rate shock for Anthem residents until completion of all the steps.

18 5. Impair the Commission's goal of water conservation. Consolidated commodity rates
19 distort the actual cost to deliver safe and reliable water to customers. (Tr. II at 1110)
20
21

22
23 ⁷ The revenue neutrality of the Company's five-step proposal keeps the Company's total revenue requirement
24 intact throughout the five steps. The Company's revenue requirement is not phased-in over the five steps.
Rather, the total revenue requirement is being constantly shifted among the districts throughout the five-step
period. This "revenue neutral" five step plan does not comply with the revenue neutrality requirement for each
system as required by Decision No. 71410.

1 6. Do not come with sufficient safeguards to preserve adequate detail and
2 recordkeeping so that the Commission can properly monitor and inspect their books.

3 (Tr. II at 1111-1113)

4
5 7. Increase rates for certain ratepayers who already are paying higher rates due to the
6 2009 increases set forth in Decision No. 71410.⁸

7 8. Will not provide rate stability. RUCO believes rate stability is an important
8 consideration. Under the Company's five-step consolidation proposal, ratepayers in
9 Sun City, Paradise Valley and Mohave will be caught in a continuous cycle of rate
10 increases. Furthermore, RUCO is concerned that as soon as the third, fourth or fifth
11 step increase is borne by the ratepayers, Arizona-American will be back before the
12 Commission asking for yet another rate increase – causing ill will for the Company and
13 the Commission. At hearing, when RUCO asked Mr. Townsley if the Company would
14 be willing to agree to any period of time as far as a stay-out is concerned, Mr. Townsley
15 replied, "Maybe one day." (Tr. I at 424)

16
17 In sum, RUCO maintains that rate consolidation would not be in the ratepayer's best
18 interest in this case. There are legal impediments, passionate divisiveness among ratepayers,
19 public policy constraints and numerous other reasons set forth in RUCO's testimony and
20 Briefs. The Commission should reject rate consolidation in this case.

21
22
23
24 ⁸ While Ms. Heppenstall's Exhibit CEH-1 details the step increases for both the monthly minimum and commodity charges, she does not provide a typical bill impact for the average residential ratepayer.

1 **CONCLUSION**

2 For the reasons discussed above and in RUCO's Closing Brief, RUCO recommends the
3 Commission adopt its position in this case, and reject the positions of Staff, the Company and
4 the other intervenors, to the extent they conflict with RUCO's recommendations.

5
6 RESPECTFULLY SUBMITTED this 6th day of August, 2010.

7
8
9

Daniel W. Pozefsky
Chief Counsel

10
11
12 AN ORIGINAL AND THIRTEEN COPIES
13 of the foregoing filed this 6th day
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Arizona American Water Company – W-01303A-09-0343, SW-01303A-09-0343
RUCO's Reply Brief

EXHIBIT 1

Arizona American Water Company - Anthem Water
 Calculation of Revenue Deficiency (Sufficiency)

Attachment RCS-6
 Schedule A (A)
 Docket No. W-01303A-09-0343
 Page 1 of 1
 Revised

Test Year Ended December 31, 2008

Line No.	Description	Reference	Per Company (A)	Per RUCO (B)	Difference (C)	RUCO Without Rate Shock Mitigation (D)	Difference (E) = B-D
1	Adjusted rate base	B (A)	\$ 57,430,025	\$ 47,844,020	\$ (9,586,005)	\$ 57,259,174	\$ (9,415,154)
2	Rate of return	D	8.53%	6.77%		6.77%	
3	Net operating income required		\$ 4,898,781	\$ 3,240,954	\$ (1,657,827)	\$ 3,878,736	\$ (637,782)
4	Adjusted net operating income	C (A)	\$ 514,448	\$ 573,068	\$ 58,620	\$ 684,058	\$ (110,990)
5	Net operating income deficiency		\$ 4,384,333	\$ 2,667,886	\$ (1,716,447)	\$ 3,194,678	\$ (526,792)
6	Gross revenue conversion factor	A-1 (A)	1.6578	1.6578		1.6578	
7	Revenue deficiency (Sufficiency)		\$ 7,268,177	\$ 4,422,715	\$ (2,845,462)	\$ 5,296,009	\$ (873,294)
<u>Percentage Increase Over Current Rates</u>							
8	Revenue from Sales to Retail Customers	Sch C (A), L.1	\$ 7,210,624	\$ 7,220,082		\$ 7,220,082	\$ 7,220,082
9	Percentage Increase	L.7 / L.8	100.80%	61.26%		73.35%	-12.10%

Notes and Source

Col.A: AAWC Filing, Schedule A-1

Calculation of RUCO recommended percentage increase to AAWC's base rates		RUCO Proposed
AAWC's adjusted water revenues per Schedule C (A)		\$ 7,220,082
RUCO recommended rate increase (line 7 above)		\$ 4,422,715
Total revenues after reflecting RUCO recommended increase		\$ 11,642,797
Percentage change in revenues		61.26%
Calculation of AAWC's proposed percentage increase to base rates		AAWC Proposed
AAWC's adjusted water revenues per Schedule C (A)		\$ 7,210,624
AAWC proposed rate increase (line 7 above)		\$ 7,268,177
Total revenues after reflecting AAWC proposed increase		\$ 14,478,801
Percentage change in revenues		100.80%

Arizona American Water Company - Anthem Water
Gross Revenue Conversion Factor

Test Year Ended December 31, 2008

Attachment RCS-6
Schedule A-1 (A)
Docket No. W-01303A-09-0343
Page 1 of 1
Revised

Line No.	Description	Company Proposed (A)	RUCO Proposed (B)
1	Gross Revenue	100.00%	100.00%
	Less:		
2	Property Taxes	0.80%	0.80%
3	Bad Debt Expense	0.28%	0.28%
4	Taxable Income as a Percent	98.92%	98.92%
5	Less: Federal Income Taxes	31.63%	31.63%
6	Taxable Income as a Percent	67.29%	67.29%
7	Less: State Income Taxes	6.97%	6.97%
8	Change in Net Operating Income	60.32%	60.32%
9	Gross Revenue Conversion Factor	1.6578	1.6578

Notes and Source

Col.A:	AAWC Filing, Schedule C-3		
	Combined state and federal income tax rate	38.60%	38.60%

Components of Revenue Requirement Increase

	Amount	Percent
11	Net Income	60.32%
12	Federal Income Taxes	31.63%
13	State Income Taxes	6.97%
14	Property Taxes	0.80%
15	Uncollectibles	0.28%
16	Total Revenue Increase	100.00%
17	Total Revenue Increase (From Schedule A (A))	

Arizona American Water Company - Anthem Water
Adjusted Rate Base

Test Year Ended December 31, 2008

Attachment RCS-6
Schedule B (A)
Docket No. W-01303A-09-0343
Page 1 of 1
Revised

Line No.	Description	Company Proposed (A)	RUCO Adjustments (B)	RUCO Proposed (C)
1	Gross Utility Plant in Service	\$ 85,684,602	\$ -	\$ 85,684,602
2	Phoenix Interconnection	\$ 5,000,000	\$ -	\$ 5,000,000
3	Amortization of Phoenix Interconnection	\$ (116,667)	\$ -	\$ (116,667)
4	Accumulated Depreciation	\$ (12,789,099)	\$ -	\$ (12,789,099)
5	Net Utility Plant in Service	<u>\$ 77,778,836</u>	<u>\$ -</u>	<u>\$ 77,778,836</u>
Less:				
6	Advances in Aid of Construction	\$ (18,557,742)	\$ (15,333,848)	\$ (33,891,590)
7	Contributions in Aid of Construction (net of amortization)	\$ (2,393,271)	\$ (30,271)	\$ (2,423,542)
8	Imputed Regulatory Advances	\$ -	\$ -	\$ -
9	Imputed Regulatory Contributions	\$ (326,764)	\$ -	\$ (326,764)
10	Customer Meter Deposits	\$ (1,920)	\$ -	\$ (1,920)
11	Deferred Income Taxes and Credits	\$ 720,067	\$ 5,900,114	\$ 6,620,181
12	Investment Tax Credits and Deferred Credits	\$ -	\$ -	\$ -
13	Total Reductions	<u>\$ (20,559,630)</u>	<u>\$ (9,464,005)</u>	<u>\$ (30,023,635)</u>
Plus:				
13	Unamortized Finance Charges	\$ -	\$ -	\$ -
14	Deferred Tax Assets	\$ -	\$ -	\$ -
15	Deferred Debits	\$ 51,714	\$ -	\$ 51,714
16	Allowance for Working Capital	\$ 159,104 *	\$ (122,000)	\$ 37,104
17	Utility Plant Acquisition Adjustment	\$ -	\$ -	\$ -
18	Total Additions	<u>\$ 210,818</u>	<u>\$ (122,000)</u>	<u>\$ 88,818</u>
19	Total Rate Base	<u>\$ 57,430,025</u>	<u>\$ (9,586,005)</u>	<u>\$ 47,844,020</u>

Notes and Source

Col.A: AAWC Filing, Schedule B-1

Col.B: Schedule B.1

* Per Revised Schedule B-5 (Company did not revise Schedule B-1 for Anthem Water)

Arizona American Water Company - Anthem Water
Summary of Adjustments to Rate Base

Test Year Ended December 31, 2008

Attachment RCS-6
Schedule B.1 (A)
Docket No. W-1303A-09-0343
Page 1 of 1
Revised

Line No.	Description	RUCO Adjustments	Contributions in Aid of Construction B-3	Cash Working Capital B-4 Revised	Accumulated Deferred Income Taxes B-9 Surrebuttal	RUCO Rate Shock Mitigation Proposal Rate Base Adjustment B-10
1	Gross Utility Plant in Service	\$ -				
2	Phoenix Interconnection	\$ -				
3	Amortization of Phoenix Interconnection	\$ -				
4	Accumulated Depreciation	\$ -				
5	Net Utility Plant in Service	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	Less:					
6	Advances in Aid of Construction	\$ (15,333,848)				\$ (15,333,848)
7	Contributions in Aid of Construction (net of amortization)	\$ (30,271)	\$ (30,271)			
8	Imputed Regulatory Advances	\$ -				
9	Imputed Regulatory Contributions	\$ -				
10	Customer Meter Deposits	\$ -				
11	Deferred Income Taxes and Credits	\$ 5,900,114			\$ (18,580)	\$ 5,918,694
12	Investment Tax Credits and Deferred Credits	\$ -				
13	Total Reductions	<u>\$ (9,464,005)</u>	<u>\$ (30,271)</u>	<u>\$ -</u>	<u>\$ (18,580)</u>	<u>\$ (9,415,154)</u>
	Plus:					
13	Unamortized Finance Charges	\$ -				
14	Deferred Tax Assets	\$ -				
15	Deferred Debits	\$ -				
16	Allowance for Working Capital	\$ (122,000)		\$ (122,000)		
17	Utility Plant Acquisition Adjustment	\$ -				
18	Total Additions	<u>\$ (122,000)</u>	<u>\$ -</u>	<u>\$ (122,000)</u>	<u>\$ -</u>	<u>\$ -</u>
19	Total Rate Base	<u>\$ (9,586,005)</u>	<u>\$ (30,271)</u>	<u>\$ (122,000)</u>	<u>\$ (18,580)</u>	<u>\$ (9,415,154)</u>
		\$ (9,586,005)				

Notes and Source

See referenced exhibit for each adjustment

Arizona American Water Company - Anthem/Agua Fria Wastewater
 Calculation of Revenue Deficiency (Sufficiency)

Attachment RCS-7
 Schedule A (AAF)
 Docket No. SW-01303A-09-0343
 Page 1 of 1
 Revised

Test Year Ended December 31, 2008

Line No.	Description	Reference	Per Company (A)	Per RUCO (B)	Difference (C)	RUCO Without Rate Shock Mitigation (D)	Difference (E) = B-D
1	Adjusted rate base	B (AAF)	\$ 47,735,732	\$ 41,807,364	\$ (5,928,368)	\$ 45,264,942	\$ (3,457,578)
2	Rate of return	D	8.53%	6.77%		6.77%	
3	Net operating income required		\$ 4,071,858	\$ 2,832,031	\$ (1,239,827)	\$ 3,066,247	\$ (234,216)
4	Adjusted net operating income	C (AAF)	\$ (191,785)	\$ (24,301)	\$ 167,484	\$ (24,301)	\$ -
5	Net operating income deficiency		\$ 4,263,643	\$ 2,856,332	\$ (1,407,311)	\$ 3,090,548	\$ (234,216)
6	Gross revenue conversion factor	A-1 (AAF)	1.6561	1.6561		1.6561	
7	Revenue deficiency (Sufficiency)		\$ 7,060,837	\$ 4,730,256	\$ (2,330,581)	\$ 5,118,132	\$ (387,876)
<u>Percentage Increase Over Current Rates</u>							
8	Revenue from Sales to Retail Customers	Sch C (AAF), L.1	\$ 8,634,567	\$ 8,634,567		\$ 8,634,567	\$ 8,634,567
9	Percentage Increase	L.7 / L.8	81.77%	54.78%		59.27%	-4.49%

Notes and Source

Col.A: AAWC Filing, Schedule A-1

Calculation of RUCO recommended percentage increase to AAWC's base rates		RUCO Proposed
AAWC's adjusted water revenues per Schedule C (AAF)		\$ 8,634,567
RUCO recommended rate increase (line 7 above)		\$ 4,730,256
Total revenues after reflecting RUCO recommended increase		\$ 13,364,823
Percentage change in revenues		54.78%
Calculation of AAWC's proposed percentage increase to base rates		AAWC Proposed
AAWC's adjusted water revenues per Schedule C (AAF)		\$ 8,634,567
AAWC proposed rate increase (line 7 above)		\$ 7,060,837
Total revenues after reflecting AAWC proposed increase		\$ 15,695,404
Percentage change in revenues		81.77%

Arizona American Water Company - Anthem/Agua Fria Wastewater
Gross Revenue Conversion Factor

Attachment RCS-7
Schedule A-1 (AAF)
Docket No. SW-01303A-09-0343
Page 1 of 1
Revised

Test Year Ended December 31, 2008

Line No.	Description	Company Proposed (A)	RUCO Proposed (B)
1	Gross Revenue	100.00%	100.00%
	Less:		
2	Property Taxes	0.71%	0.71%
3	Bad Debt Expense	0.31%	0.31%
4	Taxable Income as a Percent	98.98%	98.98%
5	Less: Federal Income Taxes	31.63%	31.63%
6	Taxable Income as a Percent	67.35%	67.35%
7	Less: State Income Taxes	6.97%	6.97%
8	Change in Net Operating Income	60.38%	60.38%
9	Gross Revenue Conversion Factor	1.6561	1.6561

Notes and Source

Col.A:	AAWC Filing, Schedule C-3		
	Combined state and federal income tax rate	38.60%	38.60%

Components of Revenue Requirement Increase

	Amount	Percent	
11	Net Income	\$ 2,856,336	60.38%
12	Federal Income Taxes	\$ 1,496,222	31.63%
13	State Income Taxes	\$ 329,604	6.97%
14	Property Taxes	\$ 33,416	0.71%
15	Uncollectibles	\$ 14,678	0.31%
16	Total Revenue Increase	\$ 4,730,256	100.00%
17	Total Revenue Increase (From Schedule A (AAF))	\$ 4,730,256	

Arizona American Water Company - Anthem/Agua Fria Wastewater
Adjusted Rate Base

Test Year Ended December 31, 2008

Attachment RCS-7
Schedule B (AAF)
Docket No. SW-01303A-09-0343
Page 1 of 1
Revised

Line No.	Description	Company Proposed (A)	RUCO Adjustments (B)	RUCO Proposed (C)
1	Gross Utility Plant in Service	\$ 131,361,186	\$ (2,931,096)	\$ 128,430,090
2	Accumulated Depreciation	\$ (22,837,366)	\$ 682,880	\$ (22,154,486)
3	Net Utility Plant in Service	<u>\$ 108,523,819</u>	<u>\$ (2,248,216)</u>	<u>\$ 106,275,603</u>
	Less:			
4	Advances in Aid of Construction	\$ (48,273,364)	\$ (5,631,132)	\$ (53,904,496)
5	Contributions in Aid of Construction (net of amortization)	\$ (13,829,151)	\$ (65,490)	\$ (13,894,641)
6	Imputed Regulatory Advances	\$ -	\$ -	\$ -
7	Imputed Regulatory Contributions	\$ (143,475)	\$ -	\$ (143,475)
10	Deferred Income Taxes and Credits	\$ 1,049,621	\$ 2,146,470	\$ 3,196,091
11	Investment Tax Credits and Other Deferred Credits	\$ -	\$ -	\$ -
12	Total Reductions	<u>\$ (61,196,369)</u>	<u>\$ (3,550,152)</u>	<u>\$ (64,746,521)</u>
	Plus:			
13	Unamortized Finance Charges	\$ -	\$ -	\$ -
14	Deferred Tax Assets	\$ -	\$ -	\$ -
15	Deferred Debits	\$ 75,382	\$ -	\$ 75,382
16	Allowance for Working Capital	\$ 332,901	\$ (130,000)	\$ 202,901
17	Utility Plant Acquisition Adjustment	\$ -	\$ -	\$ -
18	Total Additions	<u>\$ 408,282</u>	<u>\$ (130,000)</u>	<u>\$ 278,282</u>
19	Total Rate Base	<u>\$ 47,735,732</u>	<u>\$ (5,928,368)</u>	<u>\$ 41,807,364</u>

Notes and Source

Col.A: AAWC Filing, Schedule B-1

Col.B: Schedule B.1

Arizona American Water Company - Anthem/Agua Fria Wastewater
 Summary of Adjustments to Rate Base

Test Year Ended December 31, 2008

Attachment RCS-7
 Schedule B.1 (AAF)
 Docket No. SW-01303A-09-0343
 Page 1 of 1
 Revised

Line No.	Description	RUCO Adjustments	Plant		Cash Working Capital B-4 Revised	Verrado Wastewater Plant B-6 Surrebuttal	Allocation of NWVTP B-8 Surrebuttal	Accumulated Deferred Income Taxes B-9 Surrebuttal	RUCO Rate Shock Mitigation Proposal Rate Base Adjustment B-10
			Retirements - Anthem/Agua Fria Wastewater B-2	Contributions in Aid of Construction B-3					
1	Gross Utility Plant in Service	\$ (2,931,096)	\$ (52,636)			\$ (1,838,637)	\$ (1,039,823)		
2	Accumulated Depreciation	\$ 682,880	\$ 52,636				\$ 630,244		
3	Net Utility Plant in Service	<u>\$ (2,248,216)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,838,637)</u>	<u>\$ (409,579)</u>	<u>\$ -</u>	<u>\$ -</u>
Less:									
4	Advances in Aid of Construction	\$ (5,631,132)							\$ (5,631,132)
5	Contributions in Aid of Construction (net of amortization)	\$ (65,490)		\$ (65,490)					
6	Imputed Regulatory Advances	\$ -							
7	Imputed Regulatory Contributions	\$ -							
10	Deferred Income Taxes and Credits	\$ 2,146,470						\$ (27,084)	\$ 2,173,554
11	Investment Tax Credits and Other Deferred Credits	\$ -							
12	Total Reductions	<u>\$ (3,550,152)</u>	<u>\$ -</u>	<u>\$ (65,490)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (27,084)</u>	<u>\$ (3,457,578)</u>
Plus:									
13	Unamortized Finance Charges	\$ -							
14	Deferred Tax Assets	\$ -							
15	Deferred Debits	\$ -							
16	Allowance for Working Capital	\$ (130,000)			\$ (130,000)				
17	Utility Plant Acquisition Adjustment	\$ -							
18	Total Additions	<u>\$ (130,000)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (130,000)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
18	Total Rate Base	<u>\$ (5,928,368)</u>	<u>\$ -</u>	<u>\$ (65,490)</u>	<u>\$ (130,000)</u>	<u>\$ (1,838,637)</u>	<u>\$ (409,579)</u>	<u>\$ (27,084)</u>	<u>\$ (3,457,578)</u>

Notes and Source

See referenced exhibit for each adjustment

Test Year Ended December 31, 2008

Line No.	Description	Per Company (A)	RUCO Adjustments (B)	Per RUCO (C)
Revenues				
1	Sewer Revenues	\$ 8,634,567	\$ -	\$ 8,634,567
2	Other Revenues	\$ 2,556	\$ -	\$ 2,556
3	Total Revenues	\$ 8,637,123	\$ -	\$ 8,637,123
Operating Expenses				
4	Labor	\$ 1,335,278	\$ (30,484)	\$ 1,304,794
5	Purchased Water	\$ 3,368	\$ -	\$ 3,368
6	Fuel & Power	\$ 278,664	\$ -	\$ 278,664
7	Chemicals	\$ 303,374	\$ -	\$ 303,374
8	Waste Disposal	\$ 199,095	\$ -	\$ 199,095
9	Management Fees	\$ 1,528,005	\$ (205,507)	\$ 1,322,498
10	Group Insurance	\$ 396,599	\$ (2,682)	\$ 393,917
11	Pensions	\$ 221,640	\$ (106,289)	\$ 115,351
12	Regulatory Expense	\$ 80,939	\$ (31,679)	\$ 49,260
13	Insurance Other Than Group	\$ 94,566	\$ -	\$ 94,566
14	Customer Accounting	\$ 242,170	\$ -	\$ 242,170
15	Rents	\$ 84,483	\$ -	\$ 84,483
16	General Office Expense	\$ 85,697	\$ -	\$ 85,697
17	Miscellaneous	\$ 534,489	\$ (4,289)	\$ 530,200
18	Maintenance Expense	\$ 246,204	\$ -	\$ 246,204
19	Depreciation & Amortization	\$ 3,830,808	\$ 10,539	\$ 3,841,347
20	General Taxes - Property Taxes	\$ 296,804	\$ -	\$ 296,804
21	General Taxes - Other	\$ 87,538	\$ -	\$ 87,538
22	Income Taxes	\$ (1,020,813)	\$ 202,906	\$ (817,907)
23	Total Operating Expenses	\$ 8,828,908	\$ (167,484)	\$ 8,661,424
24	Utility Operating Income	\$ (191,785)	\$ 167,484	\$ (24,301)
Other Income & Deductions				
25	Other Income & Deductions	\$ -	\$ -	\$ -
26	Interest Expense	\$ (1,432,072)	\$ -	\$ (1,432,072)
27	Other Expense	\$ (18,575)	\$ -	\$ (18,575)
28	Gain/Loss Sale of Fixed Assets	\$ (4)	\$ -	\$ (4)
29	Total Other Additions/Deductions From Income	\$ (1,450,651)	\$ -	\$ (1,450,651)
30	Net Profit (Loss)	\$ (1,642,436)	\$ 167,484	\$ (1,474,952)
31	Rate Base	\$ 47,735,732	\$ (5,928,368)	\$ 41,807,364
32	Earned Rate of Return	-0.40%		-0.06%

Notes and Source

Col.A: AAWC Filing, Schedule C-1
Col.B: Schedule C.1
Col.C: Col.A + Col.B

Arizona American Water Company - Anthem/Agua Fria Wastewater
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	RUCO Adjustments	Rate Case Expense C-2	Achievement Incentive Pay C-3	Stock-Based Compensation C-4 Revised	Pension Expense C-5 Revised	OPEB Expense C-6
Revenues							
1	Sewer Revenues	\$ -					
2	Other Revenues	\$ -					
3	Total Revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Operating Expenses							
4	Labor	\$ (30,484)		\$ (17,639)	\$ (12,845)		
5	Purchased Water	\$ -					
6	Fuel & Power	\$ -					
7	Chemicals	\$ -					
8	Waste Disposal	\$ -					
9	Management Fees	\$ (205,507)			\$ (8,595)		
10	Group Insurance	\$ (2,682)					\$ (2,682)
11	Pensions	\$ (106,289)				\$ (106,289)	
12	Regulatory Expense	\$ (31,679)	\$ (31,679)				
13	Insurance Other Than Group	\$ -					
14	Customer Accounting	\$ -					
15	Rents	\$ -					
16	General Office Expense	\$ -					
17	Miscellaneous	\$ (4,289)					
18	Maintenance Expense	\$ -					
19	Depreciation & Amortization	\$ 10,539					
20	General Taxes - Property Taxes	\$ -					
21	General Taxes - Other	\$ -					
15	PRE-TAX OPERATING EXPENSES	<u>\$ (370,390)</u>	<u>\$ (31,679)</u>	<u>\$ (17,639)</u>	<u>\$ (21,440)</u>	<u>\$ (106,289)</u>	<u>\$ (2,682)</u>
16	PRE-TAX OPERATING INCOME	<u>\$ 370,390</u>	<u>\$ 31,679</u>	<u>\$ 17,639</u>	<u>\$ 21,440</u>	<u>\$ 106,289</u>	<u>\$ 2,682</u>
17	Income Taxes	\$ 202,906	\$ 12,228	\$ 6,809	\$ 8,276	\$ 41,027	\$ 1,035
18	TOTAL OPERATING EXPENSES	<u>\$ (167,484)</u>	<u>\$ (19,451)</u>	<u>\$ (10,830)</u>	<u>\$ (13,164)</u>	<u>\$ (65,262)</u>	<u>\$ (1,647)</u>
19	OPERATING INCOME	<u>\$ 167,484</u>	<u>\$ 19,451</u>	<u>\$ 10,830</u>	<u>\$ 13,164</u>	<u>\$ 65,262</u>	<u>\$ 1,647</u>

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3 38.60%

Arizona American Water Company - Anthem/Agua Fria Waste
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	Dues, Donations & Misc. Expenses C-7	Management Fees - Other Expenses C-9	Management Fees - 4% Post-Test Year Wage Increase C-9A New	Management Fees - Affiliate Employee Benefits C-10	Management Fees - Affiliate Incentive Compensation C-11	Management Fees - Normalize Affiliate Pension Expense C-12
Revenues							
1	Sewer Revenues						
2	Other Revenues						
3	Total Revenues	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses							
4	Labor						
5	Purchased Water						
6	Fuel & Power						
7	Chemicals						
8	Waste Disposal						
9	Management Fees		\$ (21,050)	\$ (23,154)	\$ (70,978)	\$ (66,317)	\$ (1,099)
10	Group Insurance						
11	Pensions						
12	Regulatory Expense						
13	Insurance Other Than Group						
14	Customer Accounting						
15	Rents						
16	General Office Expense						
17	Miscellaneous	\$ (4,289)					
18	Maintenance Expense						
19	Depreciation & Amortization						
20	General Taxes - Property Taxes						
21	General Taxes - Other						
15	PRE-TAX OPERATING EXPENSES	\$ (4,289)	\$ (21,050)	\$ (23,154)	\$ (70,978)	\$ (66,317)	\$ (1,099)
16	PRE-TAX OPERATING INCOME	\$ 4,289	\$ 21,050	\$ 23,154	\$ 70,978	\$ 66,317	\$ 1,099
17	Income Taxes	\$ 1,656	\$ 8,125	\$ 8,937	\$ 27,398	\$ 25,598	\$ 424
18	TOTAL OPERATING EXPENSES	\$ (2,633)	\$ (12,925)	\$ (14,217)	\$ (43,580)	\$ (40,719)	\$ (675)
19	OPERATING INCOME	\$ 2,633	\$ 12,925	\$ 14,217	\$ 43,580	\$ 40,719	\$ 675

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3

Arizona American Water Company - Anthem/Agua Fria Waste
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	Management Fees - Normalize Affiliate OPEB Expense C-13	Management Fees - Remove Business Development Expenses C-14	Interest Synchronization C-15 Revised	Depreciation Expense Related to Plant Retirements C-17	Depreciation Expense - Anthem/Agua Fria Wastewater Reclassified Accounts C-19 New
Revenues						
1	Sewer Revenues					
2	Other Revenues					
3	Total Revenues	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses						
4	Labor					
5	Purchased Water					
6	Fuel & Power					
7	Chemicals					
8	Waste Disposal					
9	Management Fees	\$ (1,860)	\$ (12,453)			
10	Group Insurance					
11	Pensions					
12	Regulatory Expense					
13	Insurance Other Than Group					
14	Customer Accounting					
15	Rents					
16	General Office Expense					
17	Miscellaneous					
18	Maintenance Expense					
19	Depreciation & Amortization				\$ (2,853)	\$ 13,392
20	General Taxes - Property Taxes					
21	General Taxes - Other					
15	PRE-TAX OPERATING EXPENSES	\$ (1,860)	\$ (12,453)	\$ -	\$ (2,853)	\$ 13,392
16	PRE-TAX OPERATING INCOME	\$ 1,860	\$ 12,453	\$ -	\$ 2,853	\$ (13,392)
17	Income Taxes	\$ 718	\$ 4,807	\$ 59,936	\$ 1,101	\$ (5,169)
18	TOTAL OPERATING EXPENSES	\$ (1,142)	\$ (7,646)	\$ 59,936	\$ (1,752)	\$ 8,223
19	OPERATING INCOME	\$ 1,142	\$ 7,646	\$ (59,936)	\$ 1,752	\$ (8,223)

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3

Arizona American Water Company
RUCO Rate Shock Mitigation Proposal Rate Base Adjustment

Attachment RCS-7
Schedule B-10
Docket No. SW-01303A-09-0343
Page 1 of 1
New

Test Year Ended December 31, 2008

Line No.	Description	Amount (A)	Reference
Anthem/Agua Fria Wastewater			
1	Advances in Aid to Construction	\$ (5,631,132)	See below
2	ADIT Offset	\$ 2,173,554	See below
3	Net adjustment to rate base	<u>\$ (3,457,578)</u>	
Anthem/Agua Fria Water			
4	Advances in Aid to Construction	\$ (15,333,848)	See below
5	ADIT Offset	\$ 5,918,694	See below
6	Net adjustment to rate base	<u>\$ (9,415,154)</u>	

Notes and Source

AAWC Payment History to Del Webb/Pulte for Anthem					
Description	Payment Date	Wastewater (B)	Water (C)	Total (D)	
7	Payment for 2006	6/29/2007	\$ 920,490	\$ 2,147,810	\$ 3,068,300
8	4th Agreement, first payment	3/25/2008	\$ 5,336,323	\$ 14,889,799	\$ 20,226,122
9	4th Agreement, second payment	3/31/2010			
10	AIAC		<u>\$ 6,256,813</u>	<u>\$ 17,037,609</u>	<u>\$ 23,294,422</u>
11	Over 10 years - reduce TY RB by 9/10ths	90%	\$ 5,631,132	\$ 15,333,848	
12	Combined federal and state income tax rate	Schedule A-1 (AAF)	<u>38.60%</u>	<u>38.60%</u>	
13	Decrease to ADIT (increases rate base)		<u>\$ (2,173,554)</u>	<u>\$ (5,918,694)</u>	

Arizona American Water Company – W-01303A-09-0343, SW-01303A-09-0343
RUCO's Reply Brief

EXHIBIT 2

Arizona American Water Company - Anthem Water
 Calculation of Revenue Deficiency (Sufficiency)

Attachment RCS-6
 Schedule A (A)
 Docket No. W-01303A-09-0343
 Page 1 of 1
 Revised

Test Year Ended December 31, 2008

Line No.	Description	Reference	Per Company (A)	Per RUCO (B)	Difference (C)	RUCO Without Rate Shock Mitigation (D)	Difference (E) = B-D
1	Adjusted rate base	B (A)	\$ 57,430,025	\$ 45,236,016	\$ (12,194,009)	\$ 57,259,174	\$ (12,023,158)
2	Rate of return	D	8.53%	6.77%		6.77%	
3	Net operating income required		\$ 4,898,781	\$ 3,064,288	\$ (1,834,493)	\$ 3,878,736	\$ (814,448)
4	Adjusted net operating income	C (A)	\$ 514,448	\$ 542,324	\$ 27,876	\$ 684,058	\$ (141,734)
5	Net operating income deficiency		\$ 4,384,333	\$ 2,521,964	\$ (1,862,369)	\$ 3,194,678	\$ (672,714)
6	Gross revenue conversion factor	A-1 (A)	1.6578	1.6578		1.6578	
7	Revenue deficiency (Sufficiency)		\$ 7,268,177	\$ 4,180,811	\$ (3,087,366)	\$ 5,296,009	\$ (1,115,198)
<u>Percentage Increase Over Current Rates</u>							
8	Revenue from Sales to Retail Customers	Sch C (A), L.1	\$ 7,210,624	\$ 7,220,082		\$ 7,220,082	\$ 7,220,082
9	Percentage Increase	L.7 / L.8	100.80%	57.91%		73.35%	-15.45%

Notes and Source

Col.A: AAWC Filing, Schedule A-1

Calculation of RUCO recommended percentage increase to AAWC's base rates		RUCO Proposed
AAWC's adjusted water revenues per Schedule C (A)		\$ 7,220,082
RUCO recommended rate increase (line 7 above)		\$ 4,180,811
Total revenues after reflecting RUCO recommended increase		\$ 11,400,893
Percentage change in revenues		57.91%
Calculation of AAWC's proposed percentage increase to base rates		AAWC Proposed
AAWC's adjusted water revenues per Schedule C (A)		\$ 7,210,624
AAWC proposed rate increase (line 7 above)		\$ 7,268,177
Total revenues after reflecting AAWC proposed increase		\$ 14,478,801
Percentage change in revenues		100.80%

Arizona American Water Company - Anthem Water
Gross Revenue Conversion Factor

Attachment RCS-6
Schedule A-1 (A)
Docket No. W-01303A-09-0343
Page 1 of 1
Revised

Test Year Ended December 31, 2008

Line No.	Description	Company Proposed (A)	RUCO Proposed (B)
1	Gross Revenue	100.00%	100.00%
	Less:		
2	Property Taxes	0.80%	0.80%
3	Bad Debt Expense	0.28%	0.28%
4	Taxable Income as a Percent	98.92%	98.92%
5	Less: Federal Income Taxes	31.63%	31.63%
6	Taxable Income as a Percent	67.29%	67.29%
7	Less: State Income Taxes	6.97%	6.97%
8	Change in Net Operating Income	60.32%	60.32%
9	Gross Revenue Conversion Factor	1.6578	1.6578

Notes and Source

Col.A:	AAWC Filing, Schedule C-3		
	Combined state and federal income tax rate	38.60%	38.60%

Components of Revenue Requirement Increase

	Amount	Percent	
11	Net Income	\$ 2,521,962	60.32%
12	Federal Income Taxes	\$ 1,322,427	31.63%
13	State Income Taxes	\$ 291,319	6.97%
14	Property Taxes	\$ 33,487	0.80%
15	Uncollectibles	\$ 11,615	0.28%
16	Total Revenue Increase	\$ 4,180,810	100.00%
17	Total Revenue Increase (From Schedule A (A))	\$ 4,180,811	

Arizona American Water Company - Anthem Water
Adjusted Rate Base

Test Year Ended December 31, 2008

Attachment RCS-6
Schedule B (A)
Docket No. W-01303A-09-0343
Page 1 of 1
Revised

Line No.	Description	Company Proposed (A)	RUCO Adjustments (B)	RUCO Proposed (C)
1	Gross Utility Plant in Service	\$ 85,684,602	\$ -	\$ 85,684,602
2	Phoenix Interconnection	\$ 5,000,000	\$ -	\$ 5,000,000
3	Amortization of Phoenix Interconnection	\$ (116,667)	\$ -	\$ (116,667)
4	Accumulated Depreciation	\$ (12,789,099)	\$ -	\$ (12,789,099)
5	Net Utility Plant in Service	<u>\$ 77,778,836</u>	<u>\$ -</u>	<u>\$ 77,778,836</u>
Less:				
6	Advances in Aid of Construction	\$ (18,557,742)	\$ (19,581,334)	\$ (38,139,076)
7	Contributions in Aid of Construction (net of amortization)	\$ (2,393,271)	\$ (30,271)	\$ (2,423,542)
8	Imputed Regulatory Advances	\$ -	\$ -	\$ -
9	Imputed Regulatory Contributions	\$ (326,764)	\$ -	\$ (326,764)
10	Customer Meter Deposits	\$ (1,920)	\$ -	\$ (1,920)
11	Deferred Income Taxes and Credits	\$ 720,067	\$ 7,539,596	\$ 8,259,663
12	Investment Tax Credits and Deferred Credits	\$ -	\$ -	\$ -
13	Total Reductions	<u>\$ (20,559,630)</u>	<u>\$ (12,072,009)</u>	<u>\$ (32,631,639)</u>
Plus:				
13	Unamortized Finance Charges	\$ -	\$ -	\$ -
14	Deferred Tax Assets	\$ -	\$ -	\$ -
15	Deferred Debits	\$ 51,714	\$ -	\$ 51,714
16	Allowance for Working Capital	\$ 159,104 *	\$ (122,000)	\$ 37,104
17	Utility Plant Acquisition Adjustment	\$ -	\$ -	\$ -
18	Total Additions	<u>\$ 210,818</u>	<u>\$ (122,000)</u>	<u>\$ 88,818</u>
19	Total Rate Base	<u>\$ 57,430,025</u>	<u>\$ (12,194,009)</u>	<u>\$ 45,236,016</u>

Notes and Source

Col.A: AAWC Filing, Schedule B-1

Col.B: Schedule B.1

* Per Revised Schedule B-5 (Company did not revise Schedule B-1 for Anthem Water)

Arizona American Water Company - Anthem Water
Summary of Adjustments to Rate Base

Test Year Ended December 31, 2008

Attachment RCS-6
Schedule B.1 (A)
Docket No. W-1303A-09-0343
Page 1 of 1
Revised

Line No.	Description	RUCO Adjustments	Contributions in Aid of Construction B-3	Cash Working Capital B-4 Revised	Accumulated Deferred Income Taxes B-9 Surrebuttal	RUCO Rate Shock Mitigation Proposal Rate Base Adjustment B-10
1	Gross Utility Plant in Service	\$ -				
2	Phoenix Interconnection	\$ -				
3	Amortization of Phoenix Interconnection	\$ -				
4	Accumulated Depreciation	\$ -				
5	Net Utility Plant in Service	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	Less:					
6	Advances in Aid of Construction	\$ (19,581,334)				\$ (19,581,334)
7	Contributions in Aid of Construction (net of amortization)	\$ (30,271)	\$ (30,271)			
8	Imputed Regulatory Advances	\$ -				
9	Imputed Regulatory Contributions	\$ -				
10	Customer Meter Deposits	\$ -				
11	Deferred Income Taxes and Credits	\$ 7,539,596			\$ (18,580)	\$ 7,558,176
12	Investment Tax Credits and Deferred Credits	\$ -				
13	Total Reductions	<u>\$ (12,072,009)</u>	<u>\$ (30,271)</u>	<u>\$ -</u>	<u>\$ (18,580)</u>	<u>\$ (12,023,158)</u>
	Plus:					
13	Unamortized Finance Charges	\$ -				
14	Deferred Tax Assets	\$ -				
15	Deferred Debits	\$ -				
16	Allowance for Working Capital	\$ (122,000)		\$ (122,000)		
17	Utility Plant Acquisition Adjustment	\$ -				
18	Total Additions	<u>\$ (122,000)</u>	<u>\$ -</u>	<u>\$ (122,000)</u>	<u>\$ -</u>	<u>\$ -</u>
19	Total Rate Base	<u>\$ (12,194,009)</u>	<u>\$ (30,271)</u>	<u>\$ (122,000)</u>	<u>\$ (18,580)</u>	<u>\$ (12,023,158)</u>
		\$ (12,194,009)				

Notes and Source

See referenced exhibit for each adjustment

Arizona American Water Company - Anthem/Agua Fria Wastewater
 Calculation of Revenue Deficiency (Sufficiency)

Attachment RCS-7
 Schedule A (AAF)
 Docket No. SW-01303A-09-0343
 Page 1 of 1
 Revised

Test Year Ended December 31, 2008

Line No.	Description	Reference	Per Company (A)	Per RUCO (B)	Difference (C)	RUCO Without Rate Shock Mitigation (D)	Difference (E) = B-D
1	Adjusted rate base	B (AAF)	\$ 47,735,732	\$ 40,689,648	\$ (7,046,084)	\$ 45,264,942	\$ (4,575,294)
2	Rate of return	D	8.53%	6.77%		6.77%	
3	Net operating income required		\$ 4,071,858	\$ 2,756,317	\$ (1,315,541)	\$ 3,066,247	\$ (309,930)
4	Adjusted net operating income	C (AAF)	\$ (191,785)	\$ (37,477)	\$ 154,308	\$ (37,477)	\$ -
5	Net operating income deficiency		\$ 4,263,643	\$ 2,793,794	\$ (1,469,849)	\$ 3,103,724	\$ (309,930)
6	Gross revenue conversion factor	A-1 (AAF)	1.6561	1.6561		1.6561	
7	Revenue deficiency (Sufficiency)		\$ 7,060,837	\$ 4,626,690	\$ (2,434,147)	\$ 5,139,952	\$ (513,262)
<u>Percentage Increase Over Current Rates</u>							
8	Revenue from Sales to Retail Customers	Sch C (AAF), L.1	\$ 8,634,567	\$ 8,634,567		\$ 8,634,567	\$ 8,634,567
9	Percentage Increase	L.7 / L.8	81.77%	53.58%		59.53%	-5.94%

Notes and Source

Col.A: AAWC Filing, Schedule A-1

Calculation of RUCO recommended percentage increase to AAWC's base rates		RUCO Proposed
AAWC's adjusted water revenues per Schedule C (AAF)		\$ 8,634,567
RUCO recommended rate increase (line 7 above)		\$ 4,626,690
Total revenues after reflecting RUCO recommended increase		\$ 13,261,257
Percentage change in revenues		53.58%
Calculation of AAWC's proposed percentage increase to base rates		AAWC Proposed
AAWC's adjusted water revenues per Schedule C (AAF)		\$ 8,634,567
AAWC proposed rate increase (line 7 above)		\$ 7,060,837
Total revenues after reflecting AAWC proposed increase		\$ 15,695,404
Percentage change in revenues		81.77%

Arizona American Water Company - Anthem/Agua Fria Wastewater
Gross Revenue Conversion Factor

Attachment RCS-7
Schedule A-1 (AAF)
Docket No. SW-01303A-09-0343
Page 1 of 1
Revised

Test Year Ended December 31, 2008

Line No.	Description	Company Proposed (A)	RUCO Proposed (B)
1	Gross Revenue	100.00%	100.00%
	Less:		
2	Property Taxes	0.71%	0.71%
3	Bad Debt Expense	0.31%	0.31%
4	Taxable Income as a Percent	98.98%	98.98%
5	Less: Federal Income Taxes	31.63%	31.63%
6	Taxable Income as a Percent	67.35%	67.35%
7	Less: State Income Taxes	6.97%	6.97%
8	Change in Net Operating Income	60.38%	60.38%
9	Gross Revenue Conversion Factor	1.6561	1.6561

Notes and Source

Col.A:	AAWC Filing, Schedule C-3		
	Combined state and federal income tax rate	38.60%	38.60%

Components of Revenue Requirement Increase

	Amount	Percent	
11	Net Income	\$ 2,793,799	60.38%
12	Federal Income Taxes	\$ 1,463,463	31.63%
13	State Income Taxes	\$ 322,388	6.97%
14	Property Taxes	\$ 32,684	0.71%
15	Uncollectibles	\$ 14,357	0.31%
16	Total Revenue Increase	\$ 4,626,691	100.00%
17	Total Revenue Increase (From Schedule A (AAF))	\$ 4,626,690	

Arizona American Water Company - Anthem/Agua Fria Wastewater
Adjusted Rate Base

Test Year Ended December 31, 2008

Attachment RCS-7
Schedule B (AAF)
Docket No. SW-01303A-09-0343
Page 1 of 1
Revised

Line No.	Description	Company Proposed (A)	RUCO Adjustments (B)	RUCO Proposed (C)
1	Gross Utility Plant in Service	\$ 131,361,186	\$ (2,931,096)	\$ 128,430,090
2	Accumulated Depreciation	\$ (22,837,366)	\$ 682,880	\$ (22,154,486)
3	Net Utility Plant in Service	<u>\$ 108,523,819</u>	<u>\$ (2,248,216)</u>	<u>\$ 106,275,603</u>
	Less:			
4	Advances in Aid of Construction	\$ (48,273,364)	\$ (7,451,483)	\$ (55,724,847)
5	Contributions in Aid of Construction (net of amortization)	\$ (13,829,151)	\$ (65,490)	\$ (13,894,641)
6	Imputed Regulatory Advances	\$ -	\$ -	\$ -
7	Imputed Regulatory Contributions	\$ (143,475)	\$ -	\$ (143,475)
10	Deferred Income Taxes and Credits	\$ 1,049,621	\$ 2,849,105	\$ 3,898,726
11	Investment Tax Credits and Other Deferred Credits	\$ -	\$ -	\$ -
12	Total Reductions	<u>\$ (61,196,369)</u>	<u>\$ (4,667,868)</u>	<u>\$ (65,864,237)</u>
	Plus:			
13	Unamortized Finance Charges	\$ -	\$ -	\$ -
14	Deferred Tax Assets	\$ -	\$ -	\$ -
15	Deferred Debits	\$ 75,382	\$ -	\$ 75,382
16	Allowance for Working Capital	\$ 332,901	\$ (130,000)	\$ 202,901
17	Utility Plant Acquisition Adjustment	\$ -	\$ -	\$ -
18	Total Additions	<u>\$ 408,282</u>	<u>\$ (130,000)</u>	<u>\$ 278,282</u>
19	Total Rate Base	<u>\$ 47,735,732</u>	<u>\$ (7,046,084)</u>	<u>\$ 40,689,648</u>

Notes and Source

Col.A: AAWC Filing, Schedule B-1

Col.B: Schedule B.1

Arizona American Water Company - Anthem/Agua Fria Wastewater
 Summary of Adjustments to Rate Base

Attachment RCS-7
 Schedule B.1 (AAF)
 Docket No. SW-01303A-09-0343
 Page 1 of 1
 Revised

Test Year Ended December 31, 2008

Line No.	Description	RUCO Adjustments	Plant		Cash Working Capital B-4 Revised	Verrado Wastewater Plant	Allocation of NWVTP B-8 Surrebuttal	Accumulated Deferred Income Taxes B-9 Surrebuttal	RUCO Rate Shock Mitigation Proposal Rate Base Adjustment
			Anthem/Agua Fria Wastewater B-2	Contributions in Aid of Construction B-3		B-6 Surrebuttal			B-10
1	Gross Utility Plant in Service	\$ (2,931,096)	\$ (52,636)			\$ (1,838,637)	\$ (1,039,823)		
2	Accumulated Depreciation	\$ 682,880	\$ 52,636				\$ 630,244		
3	Net Utility Plant in Service	<u>\$ (2,248,216)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,838,637)</u>	<u>\$ (409,579)</u>	<u>\$ -</u>	<u>\$ -</u>
Less:									
4	Advances in Aid of Construction	\$ (7,451,483)							\$ (7,451,483)
5	Contributions in Aid of Construction (net of amortization)	\$ (65,490)		\$ (65,490)					
6	Imputed Regulatory Advances	\$ -							
7	Imputed Regulatory Contributions	\$ -							
10	Deferred Income Taxes and Credits	\$ 2,849,105						\$ (27,084)	\$ 2,876,189
11	Investment Tax Credits and Other Deferred Credits	\$ -							
12	Total Reductions	<u>\$ (4,667,868)</u>	<u>\$ -</u>	<u>\$ (65,490)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (27,084)</u>	<u>\$ (4,575,294)</u>
Plus:									
13	Unamortized Finance Charges	\$ -							
14	Deferred Tax Assets	\$ -							
15	Deferred Debits	\$ -							
16	Allowance for Working Capital	\$ (130,000)			\$ (130,000)				
17	Utility Plant Acquisition Adjustment	\$ -							
18	Total Additions	<u>\$ (130,000)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (130,000)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
18	Total Rate Base	<u>\$ (7,046,084)</u>	<u>\$ -</u>	<u>\$ (65,490)</u>	<u>\$ (130,000)</u>	<u>\$ (1,838,637)</u>	<u>\$ (409,579)</u>	<u>\$ (27,084)</u>	<u>\$ (4,575,294)</u>

Notes and Source

See referenced exhibit for each adjustment

Test Year Ended December 31, 2008

Line No.	Description	Per Company (A)	RUCO Adjustments (B)	Per RUCO (C)
Revenues				
1	Sewer Revenues	\$ 8,634,567	\$ -	\$ 8,634,567
2	Other Revenues	\$ 2,556	\$ -	\$ 2,556
3	Total Revenues	\$ 8,637,123	\$ -	\$ 8,637,123
Operating Expenses				
4	Labor	\$ 1,335,278	\$ (30,484)	\$ 1,304,794
5	Purchased Water	\$ 3,368	\$ -	\$ 3,368
6	Fuel & Power	\$ 278,664	\$ -	\$ 278,664
7	Chemicals	\$ 303,374	\$ -	\$ 303,374
8	Waste Disposal	\$ 199,095	\$ -	\$ 199,095
9	Management Fees	\$ 1,528,005	\$ (205,507)	\$ 1,322,498
10	Group Insurance	\$ 396,599	\$ (2,682)	\$ 393,917
11	Pensions	\$ 221,640	\$ (106,289)	\$ 115,351
12	Regulatory Expense	\$ 80,939	\$ (31,679)	\$ 49,260
13	Insurance Other Than Group	\$ 94,566	\$ -	\$ 94,566
14	Customer Accounting	\$ 242,170	\$ -	\$ 242,170
15	Rents	\$ 84,483	\$ -	\$ 84,483
16	General Office Expense	\$ 85,697	\$ -	\$ 85,697
17	Miscellaneous	\$ 534,489	\$ (4,289)	\$ 530,200
18	Maintenance Expense	\$ 246,204	\$ -	\$ 246,204
19	Depreciation & Amortization	\$ 3,830,808	\$ 10,539	\$ 3,841,347
20	General Taxes - Property Taxes	\$ 296,804	\$ -	\$ 296,804
21	General Taxes - Other	\$ 87,538	\$ -	\$ 87,538
22	Income Taxes	\$ (1,020,813)	\$ 216,082	\$ (804,731)
23	Total Operating Expenses	\$ 8,828,908	\$ (154,308)	\$ 8,674,600
24	Utility Operating Income	\$ (191,785)	\$ 154,308	\$ (37,477)
Other Income & Deductions				
25	Other Income & Deductions	\$ -		\$ -
26	Interest Expense	\$ (1,432,072)		\$ (1,432,072)
27	Other Expense	\$ (18,575)		\$ (18,575)
28	Gain/Loss Sale of Fixed Assets	\$ (4)		\$ (4)
29	Total Other Additions/Deductions From Income	\$ (1,450,651)	\$ -	\$ (1,450,651)
30	Net Profit (Loss)	\$ (1,642,436)	\$ 154,308	\$ (1,488,128)
31	Rate Base	\$ 47,735,732	\$ (7,046,084)	\$ 40,689,648
32	Earned Rate of Return	-0.40%		-0.09%

Notes and Source

Col.A: AAWC Filing, Schedule C-1
Col.B: Schedule C.1
Col.C: Col.A + Col.B

Arizona American Water Company - Anthem/Agua Fria Wastewater
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	RUCO Adjustments	Rate Case Expense C-2	Achievement Incentive Pay C-3	Stock-Based Compensation C-4 Revised	Pension Expense C-5 Revised	OPEB Expense C-6
Revenues							
1	Sewer Revenues	\$ -					
2	Other Revenues	\$ -					
3	Total Revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Operating Expenses							
4	Labor	\$ (30,484)		\$ (17,639)	\$ (12,845)		
5	Purchased Water	\$ -					
6	Fuel & Power	\$ -					
7	Chemicals	\$ -					
8	Waste Disposal	\$ -					
9	Management Fees	\$ (205,507)			\$ (8,595)		
10	Group Insurance	\$ (2,682)					\$ (2,682)
11	Pensions	\$ (106,289)				\$ (106,289)	
12	Regulatory Expense	\$ (31,679)	\$ (31,679)				
13	Insurance Other Than Group	\$ -					
14	Customer Accounting	\$ -					
15	Rents	\$ -					
16	General Office Expense	\$ -					
17	Miscellaneous	\$ (4,289)					
18	Maintenance Expense	\$ -					
19	Depreciation & Amortization	\$ 10,539					
20	General Taxes - Property Taxes	\$ -					
21	General Taxes - Other	\$ -					
15	PRE-TAX OPERATING EXPENSES	<u>\$ (370,390)</u>	<u>\$ (31,679)</u>	<u>\$ (17,639)</u>	<u>\$ (21,440)</u>	<u>\$ (106,289)</u>	<u>\$ (2,682)</u>
16	PRE-TAX OPERATING INCOME	<u>\$ 370,390</u>	<u>\$ 31,679</u>	<u>\$ 17,639</u>	<u>\$ 21,440</u>	<u>\$ 106,289</u>	<u>\$ 2,682</u>
17	Income Taxes	\$ 216,082	\$ 12,228	\$ 6,809	\$ 8,276	\$ 41,027	\$ 1,035
18	TOTAL OPERATING EXPENSES	<u>\$ (154,308)</u>	<u>\$ (19,451)</u>	<u>\$ (10,830)</u>	<u>\$ (13,164)</u>	<u>\$ (65,262)</u>	<u>\$ (1,647)</u>
19	OPERATING INCOME	<u>\$ 154,308</u>	<u>\$ 19,451</u>	<u>\$ 10,830</u>	<u>\$ 13,164</u>	<u>\$ 65,262</u>	<u>\$ 1,647</u>

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3 38.60%

Arizona American Water Company - Anthem/Agua Fria Waste
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	Dues, Donations & Misc. Expenses C-7	Management Fees - Other Expenses C-9	Management Fees - 4% Post-Test Year Wage Increase C-9A New	Management Fees - Affiliate Employee Benefits C-10	Management Fees - Affiliate Incentive Compensation C-11	Management Fees - Normalize Affiliate Pension Expense C-12
Revenues							
1	Sewer Revenues						
2	Other Revenues						
3	Total Revenues	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses							
4	Labor						
5	Purchased Water						
6	Fuel & Power						
7	Chemicals						
8	Waste Disposal						
9	Management Fees		\$ (21,050)	\$ (23,154)	\$ (70,978)	\$ (66,317)	\$ (1,099)
10	Group Insurance						
11	Pensions						
12	Regulatory Expense						
13	Insurance Other Than Group						
14	Customer Accounting						
15	Rents						
16	General Office Expense						
17	Miscellaneous	\$ (4,289)					
18	Maintenance Expense						
19	Depreciation & Amortization						
20	General Taxes - Property Taxes						
21	General Taxes - Other						
15	PRE-TAX OPERATING EXPENSES	\$ (4,289)	\$ (21,050)	\$ (23,154)	\$ (70,978)	\$ (66,317)	\$ (1,099)
16	PRE-TAX OPERATING INCOME	\$ 4,289	\$ 21,050	\$ 23,154	\$ 70,978	\$ 66,317	\$ 1,099
17	Income Taxes	\$ 1,656	\$ 8,125	\$ 8,937	\$ 27,398	\$ 25,598	\$ 424
18	TOTAL OPERATING EXPENSES	\$ (2,633)	\$ (12,925)	\$ (14,217)	\$ (43,580)	\$ (40,719)	\$ (675)
19	OPERATING INCOME	\$ 2,633	\$ 12,925	\$ 14,217	\$ 43,580	\$ 40,719	\$ 675

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3

Arizona American Water Company - Anthem/Agua Fria Waste
Summary of Net Operating Income Adjustments

Test Year Ended March 31, 2008

Line No.	Description	Management Fees - Normalize Affiliate OPEB Expense C-13	Management Fees - Remove Business Development Expenses C-14	Interest Synchronization C-15 Revised	Depreciation Expense Related to Plant Retirements C-17	Depreciation Expense - Anthem/Agua Fria Wastewater Reclassified Accounts C-19 New
Revenues						
1	Sewer Revenues					
2	Other Revenues					
3	Total Revenues	\$ -	\$ -	\$ -	\$ -	\$ -
Operating Expenses						
4	Labor					
5	Purchased Water					
6	Fuel & Power					
7	Chemicals					
8	Waste Disposal					
9	Management Fees	\$ (1,860)	\$ (12,453)			
10	Group Insurance					
11	Pensions					
12	Regulatory Expense					
13	Insurance Other Than Group					
14	Customer Accounting					
15	Rents					
16	General Office Expense					
17	Miscellaneous					
18	Maintenance Expense					
19	Depreciation & Amortization				\$ (2,853)	\$ 13,392
20	General Taxes - Property Taxes					
21	General Taxes - Other					
15	PRE-TAX OPERATING EXPENSES	\$ (1,860)	\$ (12,453)	\$ -	\$ (2,853)	\$ 13,392
16	PRE-TAX OPERATING INCOME	\$ 1,860	\$ 12,453	\$ -	\$ 2,853	\$ (13,392)
17	Income Taxes	\$ 718	\$ 4,807	\$ 73,112	\$ 1,101	\$ (5,169)
18	TOTAL OPERATING EXPENSES	\$ (1,142)	\$ (7,646)	\$ 73,112	\$ (1,752)	\$ 8,223
19	OPERATING INCOME	\$ 1,142	\$ 7,646	\$ (73,112)	\$ 1,752	\$ (8,223)

Notes and Source

Combined Effective Tax Rate per AAWC filing, Schedule C-3

Arizona American Water Company
RUCO Rate Shock Mitigation Proposal Rate Base Adjustment

Test Year Ended December 31, 2008

Attachment RCS-7
Schedule B-10
Docket No. SW-01303A-09-0343
Page 1 of 1
New

Line No.	Description	Amount (A)	Reference
Anthem/Agua Fria Wastewater			
1	Advances in Aid to Construction	\$ (7,451,483)	See below
2	ADIT Offset	\$ 2,876,189	See below
3	Net adjustment to rate base	<u>\$ (4,575,294)</u>	
Anthem/Agua Fria Water			
4	Advances in Aid to Construction	\$ (19,581,334)	See below
5	ADIT Offset	\$ 7,558,176	See below
6	Net adjustment to rate base	<u>\$ (12,023,158)</u>	

Notes and Source

AAWC Payment History to Del Webb/Pulte for Anthem

Description	Payment Date	Wastewater (B)	Water (C)
7	6/29/2007	\$ 920,490	\$ 2,147,810
8	3/25/2008	\$ 5,336,323	\$ 14,889,799
9	3/31/2010	\$ 2,022,612	\$ 4,719,429
10	AIAC	<u>\$ 8,279,425</u>	<u>\$ 21,757,038</u>
11	Over 10 years - reduce TY RB by 9/10ths	<u>90%</u>	\$ 19,581,334
12	Combined federal and state income tax rate	Schedule A-1 (AAF)	<u>38.60%</u>
13	Decrease to ADIT (increases rate base)	<u>\$ (2,876,189)</u>	<u>\$ (7,558,176)</u>