Frankfort Plant Board

Water
Cable
Electric
Security
Local Phone
Digital Cable
Long Distance
Community TV
Ethernet/Internet
Cable Modem/ISP
Cable Advertising

August 2, 2013

Mr. Jeff R. Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: Public Service Commission Case No. 2013-00250

Dear Mr. Derouen:

Pursuant to the Commission's July 3, 2013 Order, please find enclosed for filing an original and ten (10) copies of the Frankfort Electric and Water Plant Board's written memorandum in the above captioned case.

If you have any questions regarding the enclosed filing, please do not hesitate to contact me at (502) 352-4541 or hprice@fewpb.com.

Sincerely,

Hance Price

Hance Price
Staff Attorney

HP/kp
Enclosures

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE PROPOSED WATER SUPPLY AGREEMENT BETWEEN FRANKFORT ELECTRIC AND WATER PLANT BOARD AND SOUTH ANDERSON WATER DISTRICT	))))	**CASE NO. 2013-00250**

BRIEF OF FRANKFORT ELECTRIC AND WATER PLANT BOARD

Submitted by:

Hance Price
317 W. Second Street
Frankfort, KY 40601
(502) 352-4541

Attorney for FEWPB

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APPENDIX

I. INTRODUCTION

For thirteen (13) years, since June of 2000, the Electric and Water Plant Board of the City of Frankfort, KY ("FPB") has sold water on a wholesale basis to South Anderson Water District ("SAWD"). These sales are made pursuant to a mutually agreeable long term contract. This relationship has been, and is, beneficial to the ratepayers of both organizations.

On October 23, 2012, FPB and SAWD entered into their most recent contract to extend these purchases. Like many contracts currently on file with the Kentucky Public Service Commission ("Commission"), the contract contains a requirement that SAWD purchase a minimum amount of water each month. FPB filed this contract on October 25, 2012 and the parties have already taken steps to implement its provisions.

However, on July 3rd, 2013, the Commission opened the instant case to determine whether minimum purchase requirements in a water supply agreement are evidences of indebtedness requiring prior Commission approval pursuant to KRS 278.300(1). Case No. 2013-00250, In the Matter of: Investigation into the Proposed Water Supply Agreement Between Frankfort Electric and Water Plant Board and South Anderson Water District (Ky. PSC July 3, 2013) at 1. The Commission has never promulgated a rule or held that such provisions are an evidence of indebtedness and the parties relied on this when they executed the agreement. FPB maintains such minimum purchase provisions do not require prior approval and cannot be defined as an evidence of indebtedness. KRS 278.300 cannot be reasonably interpreted to include a minimum purchase requirement as an evidence of indebtedness. Finally, other authorities that have considered this question have concluded that a mere obligation to pay in the

future is not an evidence of indebtedness because such a rule would require prior approval of nearly all routine contracts.

II. THE COMMISSION SHOULD BE ESTOPPED FROM HOLDING THAT THE MINIMUM PURCHASE REQUIREMENT IS AN EVIDENCE OF INDEBTEDNESS REQUIRING PRIOR APPROVAL.

A. The FPB-SAWD water purchase agreement executed June 3, 2000 has been examined by the Commission in three (3) prior cases.

FPB's June 3, 2000 contract with SAWD has been examined in at least three (3) cases before the Commission. In all of these cases, the Commission required FPB to produce its wholesale water supply agreements. And in all three (3) cases, the Commission asked specifically whether there are minimum purchase requirements in these agreements.

In Case No. 2006-00444, FPB noted in its Response to Item Fourteen (14) of the Commission's Order dated October 20, 2006 that its contract with SAWD contains a minimum purchase requirement of 50,000 gallons per day. Likewise, in Case No. 2008-00250, FPB noted in its Response to Item Thirteen (13) of the Commission's Order dated July 2, 2008 that its contract with SAWD contains a minimum purchase requirement of 50,000 gallons per day. Finally, FPB provided the same data to the Commission in its Response to Item Fourteen (14) of the Commission's Order dated December 17, 2010 in Case No. 2010-00485.

The minimum purchase requirement contained in the SAWD contract was never questioned by the Commission in any of these three (3) cases. Consequently, the Commission should be estopped from claiming that prior approval is now required. In Electric & Water Plant Board v. Suburban Acres Development, Inc., 513 S.W.2d 489 (Ky. 1974), the Frankfort Plant Board told a developer that service was available at a particular parcel. Id. at 490. Thereafter, the Plant Board "at a regular meeting voted to delay water service." Id. at 490. However, the

developer had relied on the Plant Board's representations to arrange financing. Id. at 491. The court noted that "[w]e are of the opinion that this situation presents a state of facts which constitute estoppel." Id. at 491.

In the instant case, the Commission was aware of the minimum purchase requirement in the SAWD agreement and never questioned it. In a similar circumstance, the Arizona Corporation Commission found that it was reasonable for Arizona-American Water to rely on past Commission practice when the company did not seek prior approval of an infrastructure agreement. Docket No. W-01303A-09-0343, In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem Water District and its Sun City Water District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts; In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem/Agua Fria Wastewater District, its Sun City Wastewater District and its Sun City West Wastewater District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts, 2011 Ariz. PUC LEXIS 11 (Ariz. Corp. Comm'n Jan. 6, 2011) at *64. Here, FPB has relied on longstanding Commission practice holding that such minimum purchase requirements are acceptable when it negotiated and executed the October 23, 2012 SAWD agreement. The Commission should not retroactively now seek to abrogate the minimum purchase term of the contract.

B. The Commission has never announced a rule that a minimum purchase requirement in a wholesale water purchase agreement is an evidence of indebtedness requiring prior approval.

FPB has been unable to locate any case decided by this Commission holding that KRS 278.300(1) applies to minimum purchase provisions in a wholesale water purchase agreement. Likewise, FPB is unaware of any rule announced by this Commission requiring prior approval of such provisions. Consequently, the Commission should not require prior approval when the parties have relied on the most current authority when crafting their agreement.

The Commission has not defined an evidence of indebtedness. In Administrative Case No. 350, the Commission discussed KRS 278.300(1) in the context of wholesale electric power supply contracts. The Commission wrote "these contracts **may** well require prior approval under 278.300 **if** they constitute evidences of indebtedness. In particular, the inclusion in such contracts of minimum payment obligations or take/pay provisions **may** necessitate prior approval." Administrative Case No. 350, In the Matter of: The Consideration and Determination of the Appropriateness of Implementing a Ratemaking Standard Pertaining to the Purchase of Long-Term Wholesale Power by Electric Utilities as Required In Section 712 of the Energy Policy Act of 1992 (Ky. PSC October 25, 1993) at 8-9 (emphasis added). Even with respect to electric power purchase agreements, the Commission never held that such agreements **shall** require approval. In fact, the Commission wrote that "utilities should be able to purchase power without prior Commission approval." Id. at 8.

Nearly twenty (20) years have passed since this case was decided by the Commission. During that time, and before, cities and water districts relied on Commission practice, negotiated

mutually agreeable contracts and filed them with the Commission. This system has served the industry well and there is no need to modify it.

III. AN EVIDENCE OF INDEBTEDNESS CANNOT BE INTERPRETED TO INCLUDE A MINIMUM PURCHASE REQUIREMENT CONTAINED IN A WHOLESALE WATER PURCHASE AGREEMENT.

KRS 278.300(1) cannot be reasonably interpreted to mean that a minimum purchase provision in a wholesale water purchase agreement is an evidence of indebtedness. The Kentucky Supreme Court in Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713 (Ky. 2012) outlined the principles of statutory interpretation used in order to "carry out the intent of the legislature." Id. at 718 (citation omitted). First, consider "the language employed by the legislature itself, relying generally on the common meaning of the particular words chosen, which meaning is often determined by reference to dictionary definitions." Id. at 719. Next, "[t]he particular word, sentence or subsection . . . must also be viewed in context rather than in a vacuum; other relevant parts of the legislative act must be considered in determining the legislative intent." Id. at 719. A court will also "presume that the General Assembly intended for the statute to . . . harmonize with related statutes . . . [and] that [it] did not intend an absurd statute." Id. at 718-19 (citation omitted). Finally, a court may use "canons of statutory construction" in its analysis. Id. at 720 (citation omitted).

A. The plain language contained in KRS 278.300(1) does not suggest that it applies to water purchase agreements.

KRS 278.300(1) provides:

> No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the commission.

Nothing in the plain language of this section suggests that it applies to agreements other than those involved in the issuance of securities used to raise funds for the utility. KRS 278.300(1) refers to an "issue." The Attorney General of Washington, interpreting similar language, wrote that "issue" means "'[t]o put into circulation, to emit.'" 1950 Wash. AG LEXIS 279 at *5 (citation omitted). The Opinion also noted that "'[t]he execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of as an issue of such instrument.'" Id. at *5-6 (citation omitted). Here, wholesale water agreements are not circulated. They are not sold or traded on any securities market.

Moreover, as to the meaning of evidence of indebtedness, the Washington Attorney General opined that "'other evidence of indebtedness means such as has been issued and distinct from such indebtedness as may have been merely incurred or created.'" Id. at *6 (citation omitted). That is, an evidence of indebtedness is a security. Id. at *6. In Smith v. Wedding, 303 S.W.2d 322 (Ky. 1957) the court held that "the term 'security' carries with it the idea that the investor will earn his profit through the efforts of others than his own." Id. at 323 (citation omitted). Wholesale water agreements are not issued or delivered to investors who trade them to earn a profit. Consequently, such agreements are not properly considered securities or evidences of indebtedness.

B. Other sections of KRS 278.300 suggest that it does not apply to water purchase agreements.

In addition to the section in question, the language contained in the entire statute must be considered when discerning its meaning. KRS 278.300(4) and KRS 278.300(7) both suggest that the statute was not intended to apply to minimum purchase requirements in wholesale water purchase agreements. KRS 278.300(4) notes that the Commission's order "shall specify that the

securities or evidences of indebtedness, or the proceeds thereof, shall be used only for the lawful purposes specified in the application." KRS 278.300(7) requires the utility "issuing any security or evidence of indebtedness" to provide reports to the Commission showing "the disposition made of such securities or evidences of indebtedness, and the application of the proceeds thereof." Unlike securities, wholesale water contracts are not sold by a utility to raise funds. There are no proceeds from the disposition of a wholesale water contract. The statute simply has no application to this circumstance.

KRS 278.300(8) and KRS 278.300(9) also suggest that the statute does not apply to wholesale water agreements with minimum purchase requirements. KRS 278.300(8) discusses the "renewal" or "refunding" of "notes issued by a utility" with payment terms of less than two (2) years. Wholesale water agreements are not refunded. KRS 278.300(9) indicates that the state does not guarantee securities or evidences of indebtedness and notes the section places no limit on a court's jurisdiction "to authorize or cause receiver's certificates or debentures to be issued." The state would have no need to guarantee water purchase contracts and they would not be issued in a receivership proceeding. The statute's terms could not have been meant to apply to wholesale water purchase agreements.

C. Statutory construction principles require a narrow reading of the term evidence of indebtedness that cannot include water purchase agreements.

In addition to inspecting the statute's language, Kentucky courts also apply rules of statutory construction. One such principle, ejusdem generis, "'is used . . . when a general word or phrase follows a list of specific persons or things. The general word or phrase will be interpreted to include only persons or things of the same type of those listed.'" Workforce Dev. Cabinet v. Gaines, 276 S.W.3d 789, 795 (Ky. 2008) (citation omitted). That is, general words contained in a

list are not considered broadly. Id. at 795. Rather, they are interpreted narrowly in light of other words contained in the list or statute. Id. at 795.

Here, the term evidence of indebtedness follows security. A security "carries with it the idea that the investor will earn his profit through the efforts of others than this own." Lewis v. Creasey Corp., 248 S.W. 1046, 1048 (Ky. 1923). No such idea is associated with a wholesale water purchase agreement containing a minimum purchase requirement.

The Hawaii Public Utilities Commission applied this principle when it found that a lease for office space was not an evidence of indebtedness requiring Commission approval. Docket No. 05-0084, In the Matter of: the Petition of Hawaiian Electric Co., Inc.; For a Declaratory Ruling on the Applicability of Hawaii Revised Statutes Section 269-17, for a Capital Lease Arrangement, 2005 Haw. PUC LEXIS 248 (Haw. PUC May 12, 2005). The Hawaii PUC wrote that "'other evidences of indebtedness' is limited to things of like character to stocks, stock certificates, bonds, and notes, usually issued a means of raising funds . . . [to] become part of the utility's capital structure."' Id. at *16-17. The Hawaii PUC noted "that the lease agreement was not a loan and was never intended to be issued or sold to others, and thus, was not a method of generating capital." Id. at *8. Likewise, wholesale water purchase agreements are not sold or used to raise capital.

D. An interpretation that KRS 278.300(1) does not apply to minimum purchase requirements promotes consistency with other sections of the Kentucky Revised Statutes and leads to a reasonable result.

Finally, when interpreting a statute courts should harmonize its meaning "with other parts of the [KRS] beyond [the chapter in which it is contained.]" Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713, 725 (Ky. 2012). "[H]armony and consistency are both factors frequently noted

in statutory construction cases as further evidence of the appropriateness of a particular interpretation of a statute." Id. at 725. Although KRS Chapter 278 does not define the term "security", KRS Chapter 292 does. KRS 292.310(19) defines security. It states:

> "Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, life settlement investment, voting-trust certificate, certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest in or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Minimum purchase requirements are not an evidence of indebtedness in the same sense that an evidence of indebtedness is a security. Water contracts are not of the same character as stocks, bonds, notes or other securities issued by a utility to raise funds. They are not bought, sold or otherwise traded for a profit or loss. There are no proceeds when the contract is executed by the parties. To find that a minimum purchase requirement is an evidence of indebtedness, a type of security, would not harmonize KRS Chapter 278 with Chapter 292.

The Kentucky Supreme Court also wrote that it is "presume[d] that the General Assembly did not intend an absurd statute." Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713, 718-19 (Ky. 2012). To find that a water contract, or any contract containing any obligation to pay, is an evidence of indebtedness requiring prior Commission approval would lead to at least an unintended, if not absurd, result. Such an interpretation would require the Commission to review even the most mundane agreements such as those for: cleaning services, copier services, computer services, cell phones or vending machines. The Commission would likely have difficulty reviewing the overwhelming number of such commonplace agreements that would be

submitted for approval within the sixty (60) day limitation contained in KRS 278.300(2). The Legislature could not have intended such a result.

IV. AN EVIDENCE OF INDEBTEDNESS DOES NOT INCLUDE AN ORDINARY COMMERCIAL CONTRACT CONTAINING MUTUAL OBLIGATIONS.

A. The essential element of an evidence of indebtedness under Kentucky law is an expectation of profit based on another's efforts.

Courts have distinguished between an evidence of indebtedness that is an obligation to pay a certain amount from an evidence of indebtedness that is a type of security. The fact that an agreement may provide an obligation to pay, or an evidence of indebtedness, does not transform it into a security. In Lewis v. Creasey Corp., 248 S.W. 1046 (Ky. 1923) the court discussed the application of the Kentucky Blue Sky laws to a service contract. Id. at 1047. There, the Creasey Corporation sold grocery supply contracts. Id. at 1047.

The court began by noting that "words [in a statute] will not be given their literal meaning when to do so would evidently carry the operation of the statute far beyond the purposes which the legislature had in view, and which would make its provisions apply to transactions never contemplated by the legislative body." Id. at 1048. The court reasoned that all contracts could be securities since any contract "'guarantees to the parties thereto something of value.'" Id. at 1049 (citation omitted). However, the court distinguished between securities and "any ordinary commercial contract." Id. at 1048.

A security is an investment whereby the purchaser earns a "profit through the efforts of others than his own." Id. at 1048. In contrast, an ordinary commercial contract involves a mutual obligation requiring the parties to earn profits by their own efforts. Id. at 1048-49. Here, a

wholesale water purchase contract involves a mutual obligation. There is no expectation of profits based on the efforts of another that is characteristic of a security.

B. Wholesale water purchase agreements containing minimum purchase requirements are bilateral agreements and as such are not evidences of indebtedness.

Other courts have adopted this distinction between contracts where there is an expectation of profit based on the efforts of another and bilateral contracts finding that the latter are not securities. In Berman v. Dean Witter & Co., 353 F. Supp. 669 (C.D. Cal. 1973) the court considered whether yen futures contracts were securities. Id. at 670. The court wrote that "[t]he fact that the agreement is executory – the seller being obligated to make delivery in the future, the purchaser being obligated to tender payment in the future – does not transform it into a securities contract." Id. at 671. To adopt such a rule "would be tantamount to a declaration that all bilateral executory contracts are securities." Id. at 671.

The Texas Court of Criminal Appeals also reviewed the term evidences of indebtedness in the context of a securities fraud case. Thomas v. State, 65 S.W.3d 38, 46 (Tex. Crim. App. 2001). The court noted that "a literal application [of the term evidences of indebtedness] turn[s] all bilateral contracts into securities despite having a commercial instead of an investment character." Id. at 46.

In addition, the California Public Utilities Commission utilized the distinction between bilateral and unilateral contracts when deciding whether an agreement qualifies as a security requiring prior Commission approval. Pacific Gas & Electric Co. ("PG&E") asked that the California PUC "adopt an additional guideline for buyouts of [qualifying facility contracts] under which utilities pay the [qualifying facility, i.e. another power generator] over a period of more than one year (multiyear QF buyouts) by determining that such buyouts are not 'evidences of

indebtedness' under PU Code § 818, and therefore do not require prior Commission authorization." Decision No. 97-08-016, Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation; Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, 1997 Cal. PUC LEXIS 667 (Cal. PUC August 1, 1997) at *4. PG&E argued that evidences of indebtedness are akin to notes or bonds and the qualifying facility contracts were not because the QF buyout was "not a unilateral promise to pay." Id. at *5. Moreover, PG&E maintained that Section 818, the California counterpart to KRS 278.300, addressed "indebtedness in the sense of borrowing, the proceeds of which would be used for utility purposes." Id. at *5.

The California PSC found that the multiyear buyouts did not require approval because they were bilateral agreements and the term evidences of indebtedness should be narrowly construed. Id. at *14-16. Here, the QF buyout was "not a unilateral promise to pay" and did not raise funds for the utility. Id. at *15. Rather, "each party . . . [had] certain duties and obligations, and [had] certain liabilities." Id. at *14. The California PUC also noted that the term "'evidences of indebtedness' has a narrower, as opposed to a broader reading, so that it would encompass only things 'of the same general nature as notes or bonds.'" Id. at *14-15. The buyouts, like the minimum purchase contracts, shared none of the characteristics of a note or bond issued to raise funds for the utility and contained mutual obligations.

The Arizona Corporation Commission also employed this paradigm. In 2011, the Arizona Commission discussed whether Arizona-American Water Company's Infrastructure Agreement with Pulte Homes was an evidence of indebtedness requiring prior approval. Docket No. W-

01303A-09-0343, In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem Water District and its Sun City Water District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts; In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem/Agua Fria Wastewater District, its Sun City Wastewater District and its Sun City West Wastewater District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts, 2011 Ariz. PUC LEXIS 11 (Ariz. Corp. Comm'n Jan. 6, 2011) at *39, 51. The Arizona Commission agreed with its Staff's findings and held that "the Infrastructure Agreement is not a stock or bond, but an agreement that provides terms and conditions of service, as well as refund obligations, and that its approval . . . was not necessary." Id. at *63. The Arizona Commission also noted that the Infrastructure Agreement was not used to "build[] up the utility's general and permanent capital structure like an issuance of stock." Id. at *63.

The Arizona Commission rejected an interpretation that "any contract that a utility enters into that requires the payment of money over a term [should] require prior Commission approval." Id. at *62. The Commission's Staff noted that were such an interpretation accepted "then nearly every existing . . . extension agreement in the State of Arizona would become invalid, and the Commission would be inundated with agreements that could potentially qualify as 'other evidences of indebtedness.'" Id. at *62.

V. CONCLUSION

The Commission has never required prior approval of wholesale water purchase agreements containing minimum purchase requirements and there is no need to implement such a rule. A finding that KRS 278.300(1) requires prior approval of a mere obligation to pay at some future time would require the Commission to review a myriad of commonplace contracts executed by utilities in the normal course of their business. That could not have been the statute's intent. An obligation to pay contained in a bilateral agreement is not an evidence of indebtedness. Rather, that term can only apply to securities issued and circulated to raise capital for the utility.

WHEREFORE, for the foregoing reasons, FPB respectfully requests that the Commission allow the parties to implement the terms of their agreement, find that no prior approval of such minimum purchases is required and grant such other relief as the Commission finds appropriate.

Respectfully Submitted,

Hance Price

Hance Price
317 W. Second Street
Frankfort, KY 40601
(502) 352-4541

Attorney for FEWPB

CERTIFICATE OF SERVICE

I, Hance Price, certify that on the 2nd day of August, 2013 a copy of this Brief of Frankfort Electric and Water Plant Board was served by mail to Honorable Ray Edelman, Attorney at Law, 148 South Main Street, Lawrenceburg, KY 40342 and an original and ten copies by hand delivery to Jeff Durouen, Executive Director, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky, 40601.

Hance Price

Hance Price

2011 Ariz. PUC LEXIS 11

Arizona Corporation Commission
January 6, 2011
DOCKET NO. W-01303A-09-0343; DOCKET NO. SW-01303A-09-0343; DECISION NO. 72047

Reporter: 2011 Ariz. PUC LEXIS 11

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM WATER DISTRICT AND ITS SUN CITY WATER DISTRICT, AND POSSIBLE RATE CONSOLIDATION FOR ALL OF ARIZONA-AMERICAN WATER COMPANY'S DISTRICTS; IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT, ITS SUN CITY WASTEWATER DISTRICT AND ITS SUN CITY WEST WASTEWATER DISTRICT, AND POSSIBLE RATE CONSOLIDATION FOR ALL OF ARIZONA-AMERICAN WATER COMPANY'S DISTRICTS

Core Terms

staff, wastewater, consolidate, meter, customer, recommend, gallons, plant, reply, infrastructure, notice, phase, refund, city water, water district, direct testimony, rate base, valley, resort, residential, paradise, fair value, low income, rate case, ratepayer, usage, phase-in, pension, effluent, tank

Counsel

[*1] APPEARANCES: Mr. Thomas H. Campbell and Mr. Michael T. Hallam, LEWIS AND ROCA, LLP, on behalf of Applicant; Mr. Greg Patterson, on behalf of Water Utility Association of Arizona; Ms. Judith M. Dworkin, SACKS TIERNEY PA, and Mr. Lawrence V. Robertson, Jr., on behalf of Anthem Community Council; Mr. Larry Woods, President, on behalf of Property Owners and Residents Association; Mr. Norman D. James and Mr. Jay L. Shapiro, FENNEMORE CRAIG, P.C., on behalf of DMB White Tank, LLP; Mr. W.R. Hansen, in propria persona; Mr. Daniel Pozefsky, Chief Counsel, on behalf of Residential Utility Consumer Office; Ms. Maureen Scott, Senior Staff Counsel, Ms. Robin Mitchell, and Mr. Wesley Van Cleve, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission; Ms. Roxanne S. Gallagher, SACKS TIERNEY PA; Mr. Robert J. Metli, SNELL & WILMER, LLP, on behalf of The Camelback Inn, Sanctuary on Camelback Mountain, the Intercontinental Montelucia Resort and Spa, and the Scottsdale Cottonwoods Resort and Suites; Mr. Andrew M. Miller, Town Attorney, on behalf of the Town of Paradise Valley; Mr. Bradley J. Herrema, BROWNSTEIN HYATT FARBER SCHRECK, LLP, on behalf of [*2] Anthem Golf and Country Club; Ms. Joan S. Burke, LAW OFFICE OF JOAN S. BURKE, on behalf of Mashie, L.L.C. dba Corte Bella Golf Club; Mr. Larry Woods, in propria persona; Mr. Marshall Magruder, in propria persona; Mr. Philip H. Cook, in propria persona

Panel: COMMISSIONERS, KRISTIN K. MAYES, Chairman; GARY PIERCE; PAUL NEWMAN; SANDRA D. KENNEDY; BOB STUMP; Teena Wolfe, Administrative Law Judge

Opinion By: WOLFE

Opinion

[EDITOR'S NOTE: THE ORIGINAL SOURCE CONTAINED ILLEGIBLE WORDS AND/OR MISSING TEXT. THE LEXIS SERVICE WILL PLACE THE CORRECTED VERSION ON-LINE UPON RECEIPT.]

OPINION AND ORDER

PUBLIC COMMENTS: April 7, 2010, at Anthem, Arizona

May 17, 2010, at Sun City, Arizona

DATE OF PRE-HEARING CONFERENCE: April 16, 2010

DATES OF HEARING - PHASE I, REVENUE REQUIREMENT: April 19, 20, 21, 22, 23, and 29, 2010

DATES OF HEARING - PHASE II, RATE DESIGN AND RATE CONSOLIDATION ISSUES: May 18, 19, 20, 21, 25, 28, June 2, and 3, 2010

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

IN ATTENDANCE: Kristen K. Mayes, Chairman

Gary Pierce, Commissioner

Bob Stump, Commissioner, Sandra D. Kennedy, Commissioner, Paul Newman, Commissioner

BY THE COMMISSION:

I. PROCEDURAL [*3] HISTORY

On July 2, 2009, Arizona-American Water Company ("Arizona-American" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for rate increases for its Anthem Water District, Sun City Water District, Anthem/Agua Fria Wastewater District, Sun City Wastewater District and Sun City West Wastewater District. Arizona-American filed supplements to its rate application on July 13, 2009, and August 21, 2009. The application is based on a test year ended December 31, 2008.

On August 24, 2009, the Commission's Utilities Division ("Staff") filed a Letter of Sufficiency indicating that Arizona -American had satisfied the requirements of *Arizona Administrative Code R14-2-103* and classifying the Company as a Class A utility.

On August 26, 2009, a procedural order was issued setting a procedural conference to provide an opportunity for discussion of a hearing schedule, public notice, and other procedural issues prior to the issuance of a rate case procedural order.

On September 2, 2009, the procedural conference was convened as scheduled. Appearances were entered by counsel for the Company, the Residential Utility [*4] Consumer Office ("RUCO"), and Staff. At the procedural conference, the Company indicated that it planned to file a separate rate consolidation application in the near future. [1] Based on that indication, the issue of appropriate customer notice of a rate consolidation proposal was brought to the attention of the parties present. [2] The procedural conference was then recessed to allow the parties time to meet and discuss an appropriate form of notice.

On September 3, 2009, the procedural conference reconvened as requested by the parties. The Company stated that it intended to proceed with the application as filed, and not to file the rate consolidation application discussed the previous day. [3] The Company agreed to prepare a form of public notice of the application in cooperation with RUCO and Staff, and to file it for consideration.

[*5]

On September 14, 2009, Arizona-American filed a proposed form of notice. In the filing, the Company indicated that Staff had found the proposed form of notice acceptable, and that RUCO had informed the Company that RUCO did not expect to have comments on it. The proposed form of notice made no mention of rate consolidation, and

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[1] Transcript of September 2, 2009 Procedural Conference at 5.

[2] *Id.* at 14-20.

[3] *Id.* at 27.

was designed to be provided only to customers of the Anthem Water district, Sun City Water district, Anthem/Agua Fria Wastewater district, Sun City Wastewater district and Sun City West Wastewater district.

On September 24, 2009, a procedural order was issued setting a hearing on the application to commence on April 19, 2010, setting associated procedural deadlines, and requiring the Company to provide public notice of the application in the form proposed by the Company and agreed to by Staff and RUCO.

On December 8, 2009, Decision No. 71410 was issued in Docket Nos. W-01303A-08-0227 et al. ("08-0227 Docket"). Decision No. 71410 ruled on the Company's previous rate application for its Agua Fria Water district, Havasu Water district, Mohave Water and Mohave Wastewater districts, Paradise Valley Water district, Sun City West Water district and Tubac Water district.

[*6]

Decision No. 71410 stated that Docket No. 08-0227 would

> remain open for the limited purpose of consolidation in the Company's next rate case with a separate docket in which a revenue-neutral change to rate design of all Arizona-American Water Company's water districts or other appropriate proposals or all Arizona-American's water and wastewater districts or other appropriate proposals may be considered simultaneously, after appropriate public notice, with appropriate opportunity for informed public comment and participation. [4]

On March 1, 2010, The Camelback Inn, Sanctuary on Camelback Mountain, the Intercontinental Montelucia Resort and Spa, and the Scottsdale Cottonwoods Resort and Suites (collectively the "Resorts") filed a Motion to Intervene. The Resorts are customers of the Company's Paradise Valley Water district. In the filing, the Resorts stated that on February 10, 2010, the Resorts learned that the instant case was pending, and were provided an agenda to a meeting at **[*7]** the offices of the Company entitled "Rate Consolidation Scenarios." The Resorts attached a copy of the agenda to their Motion to Intervene, and stated that the agenda informed the Resorts that Staff would be making a rate consolidation proposal on March 22, 2010, in this docket, and that responsive testimony to Staff's proposal would be due on or about April 5, 2010. The Resorts stated that February 10, 2010, was the first time the Resorts had notice that a possible consolidated rate structure would be developed for the Commission's consideration in this case that would then be applied to the other districts. The Resorts noted that there might be other Arizona-American customers in other districts that had not been provided notice of this proceeding and might be directly and substantially affected by rate consolidation. The Resorts requested a waiver of the intervention deadline based upon lack of notice, and that they be granted intervention.

On March 9, 2010, a procedural order was issued granting the Resorts' Motion to Intervene and Staff's Motion for Extension and Request for Procedural Conference. The procedural order stated that in light of Staff's plans to file a rate consolidation **[*8]** proposal with its rate design testimony in this docket, the notice issues initially raised at the September 2, 2009, procedural conference must be properly addressed. A procedural conference was set to commence on March 12, 2010, for the purpose of discussing proper and appropriate notice related to any rate consolidation proposal made in this docket.

On March 12, 2010, the Town of Paradise Valley ("Paradise Valley") filed a Motion to Intervene, which stated that the first time it had notice that a possible consolidated rate structure would be developed for the Commission's consideration in this case that would then be applied to the other districts was February 10, 2010.

On March 12, 2010, the procedural conference was convened as scheduled. Appearances were entered through counsel for the Company, Anthem Community Council ("Council"), the Resorts, RUCO, and Staff. Paradise Valley also appeared and was granted intervention. At the procedural conference, Staff confirmed that it planned to file rate consolidation proposals with testimony on March 29, 2010. Staff stated that while it was unknown at that time what Staff's recommendation would be, any Staff rate consolidation proposal **[*9]** would likely affect customers in all of Arizona -American's districts. Some parties present expressed the concern that a solution to the rate consolidation notice issue should not delay the scheduled April 19, 2010, commencement of the hearing on the Company's application. The parties were informed that in order to allow an appropriate opportunity for informed public comment, intervention, and full participation of any party wishing to participate in the rate consolidation portion of the upcoming hearing, that a portion of the hearing would have to be delayed. Staff was directed to proceed with its proposed March 29, 2010, filing of testimony and exhibits on rate design/rate consolidation, and the Company was directed to file its rebuttal testimony on rate design/rate consolidation on April 5, 2010, as proposed. The parties were informed that a pro-

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[4] Decision No. 71410 at 78.

cedural schedule for the filing of intervenors' responsive testimony to rate design/rate consolidation testimony would be forthcoming.

On March 18, 2010, a procedural order was issued bifurcating the hearing in this matter into two phases, with the second phase ("Phase II") to include Commission consideration of rate design and rate consolidation **[*10]** issues. The procedural order directed the Company to mail to each of its customers in all its districts public notice of the bifurcation, the new intervention deadline for Phase II, and the hearing dates and filing deadlines for both Phase I and Phase II of the proceedings. The ordered form of public notice was based on the Company's March 16, 2010, filing of a form of notice which the Company had circulated to all parties, and which incorporated all comments received from the parties at the time of filing.

Intervention in this matter was granted to RUCO, the Council, the Sun City West Property Owners and Residents Association ("PORA"), W.R. Hansen, the Water Utility Association of Arizona ("WUAA"), the Resorts, Paradise Valley, Anthem Golf and Country Club ("Anthem Golf"), Marshall Magruder, Larry D. Woods, [5] Philip H. Cook, DMB White Tank, LLC ("DMB"), and Mashie, LLC dba Corte Bella Golf Club ("Corte Bella").

[*11]

The written public comment filed in this matter was extensive, with approximately 3,681 customers filing comments. In addition, local public comment sessions were held by Commissioners in Anthem and Sun City, Arizona, and the record includes the transcribed public comments made orally at those sessions.

On April 19, 2010, the evidentiary hearing commenced on Phase I issues as scheduled, and concluded on April 30, 2010. Phase II of the evidentiary hearing commenced as scheduled on May 18, 2010, and concluded on June 3, 2010. Prior to the taking of evidence on both April 19, 2010 and May 18, 2010 public comment was received orally and transcribed for the record.

Initial closing briefs were filed on July 16, 2010, by the Company, the Council, the Resorts, Paradise Valley, Marshall Magruder, W.R. Hansen, Larry Woods, DMB, Corte Bella, RUCO, and Staff. Reply closing briefs were filed on August 16, 2010, by the Company, the Council, Anthem Golf, Marshall Magruder, DMB, Corte Bella, RUCO, and Staff, and this matter was taken under advisement.

II. APPLICATION

A. Company

Arizona-American, an Arizona public service corporation, is a wholly owned subsidiary of American Water Works **[*12]** ("American Water"), the largest investor-owned water and wastewater utility in the United States. American Water owns a number of regulated water and wastewater subsidiaries that operate in 32 states, in addition to non-regulated subsidiaries. American Water raises debt capital for its subsidiaries through its financing subsidiary American Water Capital Corp. American Water is listed on the New York stock exchange as AWK. American Water has undertaken several ownership changes over the past several years. [6] Until 2003, American water was a publicly traded company headquartered in Voorhees, New Jersey. [7] In 2003, American Water's stock was acquired by RWE Aktiengesellschaft ("RWE"), and became a wholly-owned subsidiary of RWE. [8] In 2005, RWE announced its intention to exit from its water activities in the United States and elsewhere and, in connection with this, sold approximately 63.2 million shares in an initial public offering ("IPO") of American Water's shares. [9] This sale amounted to approximately 40 percent of American Water's shares being owned by the investing public and the remaining 60 percent still owned by RWE. [10] During the fourth quarter of 2009, RWE fully divested **[*13]** its remaining ownership of American Water through the consummation of additional IPOs, and all associated board members have resigned from the Board of Directors.

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[5] In Phase I of this proceeding, Mr. Woods represented PORA subject to the conditions required by Rule 31(d)(28) of the Rules of the Arizona Supreme Court. Mr. Woods participated in Phase II of this proceeding on his own behalf, and not on behalf of PORA.

[6] Direct Testimony of Staff witness Gerald Becker (Exh. S-9) at 3.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

Arizona-American is Arizona's largest investor-owned water and wastewater utility, operating twelve water and wastewater systems in Arizona, serving approximately 150,000 customers located in portions of Maricopa, Mohave, and Santa Cruz Counties. During the test year, the Anthem Water district served approximately 8,700 customers in the Anthem Community, [11] the Sun City Water district served approximately 23,000 customers in Sun City, the Town of Youngtown, and small sections of Peoria and Surprise, [12] the Anthem/Agua Fria Wastewater district served approximately 10,121 customers in the Anthem, Verrado, and Russell Ranch communities, [13] the Sun City Wastewater district served approximately 21,965 customers in Sun City, **[*14]** the Town of Youngtown, and small sections of Peoria and Surprise, [14] and the Sun City West Wastewater district served approximately 14,968 customers in Sun City West and the Corte Bella community. [15]

Arizona-American's President Paul Townsley testified that the Company's financial position is poor and that Arizona-American has lost approximately $ 30 million since American Water purchased the water and wastewater assets of Citizens Utilities in 2002. [16] According to Mr. Townsley, Arizona-American experienced a net loss of $ 1.8 million in 2008, an improvement over its $ 4.6 million loss in 2007. [17] Arizona-American has not paid a dividend to its shareholders since 2003. [18] Mr. Townsley stated that as of December 31, 2008, Arizona-American's times interest earned ratio ("TIER") **[*15]** [19] was 0.52.

During this proceeding, the Company proposed that the Commission consider statewide rate consolidation, citing, among other considerations, improved rate case efficiency, improved ability to make needed capital investments in smaller districts, and a desire to bring the tariff structure of water and wastewater utilities more in line with those of other regulated utilities in Arizona. [20]

B. Summary of Revenue Recommendations

By district, adjusted test year revenues were as **[*16]** follows:

Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
$ 7,492,744	$ 9,283,101	$ 8,637,123	$ 5,940,381	$ 5,661,710

By district, Arizona-American's proposed revenues and the revenue recommendations of the parties who submitted schedules are as follows:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 13,455,431	$ 11,166,039	$ 13,926,904	$ 8,097,263	$ 7,142,475
RUCO	$ 12,516,000	$ 9,787,589	$ 13,684,829	$ 7,435,703	$ 6,419,979
Staff	$ 13,420,925	$ 11,126,179	$ 13,668,321	$ 7,665,720	$ 7,137,298

The Council did not present revenue schedules, but based on its recommended reductions to the rate bases and rates of return recommended by the Company, RUCO and Staff for the Anthem/Agua Fria Wastewater and Anthem Wa-

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[11] *Id.* at 4.

[12] *Id.*

[13] Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at Exhibit DMH-3 at 4, DMH-4 at 6, and DMH-6 at 4.

[14] *Id.* at Exhibit DMH-5 at 4.

[15] *Id.* at Exhibit DMH-6 at 5.

[16] Direst Testimony of Company witness Paul Townsley (Exh. A-3) at 3.

[17] *Id.*

[18] *Id.* at 7.

[19] TIER represents the number of times earnings will cover interest expense on short-term and long-term debt. A TIER of less than 1.0 is not sustainable in the long term.

[20] Direst Testimony of Company witness Paul Townsley (Exh. A-3) at 14.

ter districts, [21] the Council recommends reductions to the revenue requirements recommended by those parties for those districts. [22]

[*17]

III. RATE BASE

A. Rate Base Recommendations

The parties recommend the following rate bases for the districts in their final schedules:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 57,422,164	$ 28,376,946	$ 45,322,775	$ 15,656,720	$ 18,207,774
Staff	$ 57,248,934	$ 28,192,680	$ 45,115,225	$ 15,488,742	$ 18,098,487
RUCO	$ 57,258,174	$ 26,212,284	$ 45,260,942	$ 14,595,027	$ 18,095,016

The differences in rate base recommendations by the Company, RUCO and Staff are due to disputes about post-test year plant in the Sun City Water district, recovery of costs under an agreement the Company has with the City of Glendale affecting the Sun City West Wastewater district, and calculation of cash working capital in each of the districts.

The Council did not present rate base schedules, but recommends reductions to the rate bases recommended by the Company, RUCO and Staff for the Anthem/Agua Fria Wastewater and Anthem Water districts. [23] The Council's recommended reductions [*18] are related to its position on the Company's refund payments made to Pulte and to its position on the Northwest Plant allocations between Anthem/Agua Fria Wastewater and the Sun City West Wastewater districts.

B. Post Test Year Plant (Sun City Water)

The application proposes inclusion in plant in service of a new Well 5.1 which was completed in May 2009 to replace a retired well in the Sun City Water district, at a cost of $ 1,587,149. [24] The Company's witness testified that Arizona-American completed this project on an expedited basis and under budget in May 2009, which helped to ensure an adequate water supply for the peak summer season. [25]

RUCO recommends that Well 5.1 not be allowed in plant in service because RUCO believes [*19] its inclusion would violate the matching principle, and there are no exceptional or extraordinary circumstances that would justify its inclusion. [26] RUCO argues that the project's cost is not significant enough to justify a departure from the requirement that plant be in service during the test year, because it comprises just 0.47 percent of the combined gross utility plant in service in this rate case filing. [27]

Staff disagrees with RUCO's recommendation to exclude Well 5.1 from plant in service. [28] Staff recommends that Well 5.1 be included in plant in service because the old Well 5.1 was retired in 2007 and abandoned in 2008, the new Well 5.1 was in service at the time of Staff's inspection, and is used and useful. [29]

[*20]

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21 Council Final Schedules Anthem-Legal 1, Anthem-Legal 2, Anthem-3.

22 *Id.*

23 *Id.*

24 Rebuttal Testimony of Company witness Joseph Gross (Exh. A-9) at 2.

25 Phase I Tr. at 525-26.

26 RUCO Br. at 5.

27 *Id;* Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 7.

28 Co. Br. at 8-9; Staff Br. at 5.

29 Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at 13.

The Company argues that Well 5.1 meets criteria under which the Commission has allowed post-test year plant in rate base, because the project cost is significant and substantial, representing approximately 5.6 percent of the Sun City Water district's rate base; is revenue neutral; and that the project was prudent and necessary to provide adequate water supply to customers during the summer peak demand period in 2009. [30]

The construction of Well 5.1 was necessary in order to replace an aged retired well in order to provide continuous, reliable and adequate service to customers. Staff has verified that it is in service and that it is used to provide service to existing customers. We agree with Staff and the Company that it is reasonable and appropriate to include Well 5.1 in rate base at this time.

C. City of Glendale Sewage Transportation Agreement - 99th Avenue Interceptor Replacement Costs (Sun City Wastewater)

Arizona-American has long been a party to a City of Glendale Sewage Transportation **[*21]** Agreement ("Glendale Agreement"), by which the Company acquired rights from the City of Glendale to utilize the 99th Avenue Interceptor to transport sewage from the Sun City Wastewater district to the Tolleson Treatment Plant. [31] The 99th Avenue Interceptor is a sewer trunk main that is owned by multiple municipalities. [32] The Company's participation in the Glendale Agreement has provided it with a cost-effective means to transport Sun City Wastewater sewage flows instead of constructing its own treatment plant. [33]

In November 2009, the Company received an invoice in the amount of $ 917,906.09 for replacement costs related to the 99th Avenue Interceptor incurred prior to that date. [34] The Company paid the invoice on April 2, 2010. [35] At the hearing, the Company provided the testimony of Mr. Weber, an employee of the City of Glendale, who discussed the replacement costs **[*22]** and the process the City of Glendale used to validate the costs prior to invoicing Arizona -American for its proportionate share. [36]

The Company requested an accounting order authorizing the deferral of $ 917,906 in capital improvement costs for the Company's proportionate share of the 99th Avenue Interceptor project under the Glendale Agreement. [37] The Company stated that their requested treatment is similar to the costs included in rate components 3 and 4 of the Tolleson Agreement for which the Company obtained an accounting order from the Commission. [38]

Staff recommends denial of the **[*23]** request for an accounting order. Staff's witness testified that deferral is unnecessary, because the proper classification ratemaking treatment of the 99th Avenue Interceptor costs is known at this time, unlike the Tolleson Agreement costs. [39] During Phase II of the hearing, after having an opportunity to consider the testimony presented during Phase I, Staff's witness testified that capitalization of the costs as prescribed by the Uniform System of Accounts ("USOA") and generally accepted accounting principles ("GAAP") provides for appropriate cost recovery. [40] Staff recommends that the amounts paid by the Company under its agreement with the City of Glendale to use the 99th Avenue Interceptor for sewer transport be treated as a capital lease, and should be included in rate base for the Sun City Wastewater district. [41] Staff determined that the Company's payment for 100 percent of the 99th Avenue Interceptor's capacity it uses equals the fair value of the invoiced improvement cost, such that the $ 917,906 in capital improvement costs should be capitalized beginning on the date the replacement be-

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30 Co. Br. at 8.

31 Rebuttal Testimony of Company witness Miles Kiger (Exh. A-14) at 2 and Exhibit MHK-1R.

32 Phase I Tr. at 550-51.

33 *Id.*

34 Rebuttal Testimony of Company witness Miles Kiger (Exh. A-14) at 2 and Exhibit MHK-2R.

35 Phase I Tr. at 135; Exh. A-24.

36 Phase I Tr. at 458-464.

37 Rebuttal Testimony of Company witness Miles Kiger (Exh. A-14) at 2.

38 *Id.* at 2-3.

39 Phase II Tr. at 973.

40 *Id.* at 970-971.

41 Staff Reply Br. at 3; Tr. at 972; Exhs. S-13 and S-14.

came effective. [42] Staff recommends that because the replacement was performed primarily **[*24]** before, but also during and shortly after the test year, that the replacement costs should be included in rate base, net of accumulated depreciation using the authorized depreciation rate for the plant account in which the replacement costs are recorded. [43]

The Company accepted Staff's position on the 99th Avenue Interceptor replacement costs. RUCO does not object to inclusion of identified 99th Avenue Interceptor test year replacement costs in rate base, but did not include any of the costs in its final schedules, because during Phase I of the hearing, RUCO's witness was unable to readily identify the test year amount from the Company's hearing exhibit. [44]

[*25]

Staff's recommended treatment of the of $ 917,906 in capital improvement costs, net of accumulated depreciation, for the Company's proportionate share of the 99th Avenue Interceptor project under the Glendale Agreement, is reasonable and will be adopted.

D. Cash Working Capital (All Districts)

In preparing its cash working capital requirement for this case, the Company performed a lead/lag study. [45] A utility must have cash on hand to finance cost of service in the time period between when service is rendered and associated revenues are collected, and the cash working capital component of a utility's working capital allowance measures the amount of investor-supplied capital necessary for a utility to meet this need. A lead/lag study measures the actual lead and lag days attributable to individual revenue and expense items, and is the most accurate way to measure the cash working capital requirement. Revenue lag days are determined by measuring the amount of time between provision of services and the receipt of payment for those services. Expense lag days are determined by measuring the time between the incurrence of expenses and the payment of those obligations. Expense lag days **[*26]** offset revenue lag days. The resulting cash working capital amount is added to or subtracted from the Company's rate base.

The parties' cash working capital recommendations as represented in their final schedules are as follows, by district:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 200,095	$ 627,027	$ 336,115	$ 255,760	$ 311,580
Staff	[59,108)	$ 272,781	$ 5,948	$ 9,426	$ 116,869
RUCO	$ 36,104	$ 415,091	$ 198,901	$ 102,182	$ 198,822

1. Expense Lag - Management Fees

The Company uses a shared services model through which it procures certain management services through an affiliate, American Water Works Services Company ("Service Company"). The Company pays management fees for its share of services a month in advance, and the Service Company uses the payments to pay payroll, rent, insurance, utilities, and other expenses. **[*27]** [46] The Company states that it makes the advance payments pursuant to a 1989 agreement with the Service Company. [47] The Service Company bills Arizona-American in advance, and on the following bill, trues up the actual amount charged for the prior month, with a credit for any interest earned by the Service

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[42] Phase II Tr. at 972.

[43] Staff Br. at 10.

[44] RUCO Reply Br. at 12, citing to Phase I Tr. at 932-933.

[45] Direct Testimony of Company witness Linda J. Gutowski (Exh. A-17) at 3.

[46] Rebuttal Testimony of Company witness Linda J. Gutowski (Exh. A-18) at 10; Phase I Tr. at 589.

[47] n47 *Id.* Ms. Gutowski's testimony states that Article IV, BILLING PROCEDURES, Section 4.1 of the 1989 Service Company agreement states:

> As soon as practicable after the last day of each month, Service Company shall render a bill to Water Company for all amounts due from Water Company for services and expenses each month ***plus an amount equal to the estimated cost of such services and expenses for the current month*** . . . All amounts so billed shall reflect the credit for pay-

Company. [48] The Company calculated a lead of 11.25 days for the expense lag as it relates to management fees. [49] The Company's witness testified that 11.25 lead days is reflective of the Company's actual lead days for payment of management fees to its service company affiliate. [50] The Company's witness stated that the payments are made in advance because the Service Company has no water or sewer customers; and that the Service Company is an "at cost" affiliate, and that without the advance payments, the Service Company's working capital costs would increase and subsequently be passed on to Arizona-American. [51] The Company's witness testified that given the unique nature of the business relationship between Arizona-American and the Service Company, the terms of the agreement are reasonable. [52] The Company argues that because this piece of the expense lag is based on the Company's **[*28]** actual experience, it should be accepted by the Commission. [53] The Company's witness also testified that its calculation in this case used the same kind of lead days used in the 2008 Working Capital calculation that was approved as part of Decision No. 71410. [54]

[*29]

Staff disagrees with the Company's calculation of a lead of 11.25 days for the expense lag as it relates to management fees. Staff witnesses testified that lead/lag days should not be based on internal agreements made between the Company and its unregulated affiliate. [55] Staff argues that were the Service Company not an affiliate, the procurement and payment services would be at arms' length, and might be more commercially reasonable. [56] Staff expressed concern that the use of an internal agreement to calculate lead/lag days might result in a situation where an unregulated utility affiliate may expect payments even sooner than one month in advance, or prepayment of management fees, with ratepayers supporting this internal circumstance through cash working capital. [57]

[*30]

Staff further argues that the cash working capital approved in Decision No. 71410 was based on a lead of 3.88 days for management expenses, and not 11.25 lead days as implied by the Company's statement that the same type of lead days were used in that case. [58] Staff recommends that the Company's proposed 11.25 lead days be disregarded in the calculation of cash working capital. [59] Staff does not recommend using the 3.88 lead days allowed in Decision No. 71410, because no lead/lag study was performed to establish the payment pattern of the affiliate service provided. [60]

RUCO also argues that the prepayment **[*31]** of affiliate management fees is unreasonable and constitutes overreaching because affiliated transactions are not arms' length transactions, and recommends that the lag applied to manage-

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ments made on the estimated portion of the prior bill and shall be paid by Water Company within a reasonable time after receipt of the bill therefore. (emphasis added by Ms. Gutowski.)

[48] Phase I Tr. at 389, 760.

[49] Rebuttal Testimony of Company witness Linda J. Gutowski (Exh. A-18) at 10; Exh. A-30.

[50] Rebuttal Testimony of Company witness Linda J. Gutowski (Exh. A-18) at 11.

[51] *Id.* at 10.

[52] *Id.* at 10-11.

[53] Co. Br. at 15.

[54] Rebuttal Testimony of Company witness Linda J. Gutowski (Exh. A-18) at 11.

[55] Surrebuttal Testimony of Staff witnesses Gerald Becker (Exh. S-10) at 5, and Garry McMurry (Exh. S-6) at 4.

[56] Staff Reply Br. at 2.

[57] Surrebuttal Testimony of Staff witnesses Gerald Becker (Exh. S-10) at 5, and Garry McMurry (Exh. S-6) at 4; Staff Reply Br. at 3.

[58] Staff Br. at 4.

[59] Surrebuttal Testimony of Staff witnesses Gerald Becker (Exh. S-10) at 6, and Garry McMurry (Exh. S-6) at 5.

[60] Staff Br. at 4.

ment fees be adjusted to commercially reasonable terms. [61]

2. Revenue Lag

RUCO disagrees with the Company's proposed collection lag. [62] For the test year, the Company calculated an average of 26.1 collection lag days district-wide. [63] The collection lag is the calculation of the time from the billing date to the date collections are received. [64] RUCO recommends instead that twenty collection lag days be used in calculating the Company's cash working capital, because the due date for payment of billings for water and wastewater service is twenty days and does not differ by the type of customer, and that the Company's proposed revenue lags assume that customers, on average, throughout the year, are **[*32]** not complying with the payment terms. [65] RUCO argues that the Company's revenue lags are excessive and should be rejected. [66]

The Company responds that RUCO's recommendation for a twenty day collection lag, based solely on the due date of each bill, ignores the realities of the collection process and should not be adopted. [67] The Company explains that while each bill is sent out with a due date that is twenty days after the billing date, the Commission's rules and the Company's tariffs contemplate that payment may be made after the due date, with a late payment fee to be charged after the twenty-fifth **[*33]** day. [68] After that time, the Company also attempts to provide customers with additional notices prior to disconnection. [69] The Company asserts that in light of its collection process, and the Company's increasing number of charge-offs, a collection lag of 26.1 days is reasonable and appropriate. [70]

Staff did not brief this issue.

3. Conclusion

We fully agree with RUCO and Staff that the Company's internal arrangement with its unregulated affiliate should not dictate its need for cash working capital. However, we are not convinced, based on the record in this proceeding, that inclusion of the 26.1 collection lag days in the cash working capital calculation is inappropriate. Overall, we find that Staff's proposed cash working capital is the most reasonable and appropriate recommendation in light of the facts presented, and will adopt it.

We find that a reasonable and appropriate amount of **[*34]** cash working capital for the districts for purposes of this proceeding is as follows:

Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
[66,082)	$ 268,966	$ 7,650	$ 10,661	$ 114,920

E. Allocation of Northwest Valley Treatment Plant (Anthem/Agua Fria Wastewater and Sun City West Wastewater)

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[61] RUCO Br. at 10-11, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 25-26, 28; RUCO Reply Br. at 6.

[62] Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 12-22; RUCO Br. at 10.

[63] Rebuttal Testimony of Company witness Linda J. Gutowski (Exh. A-18) at 9.

[64] Phase I Tr. at 586.

[65] RUCO Br. at 7-8, 11, citing to Direct Testimony of RUCO witness Ralph Smith (Exh. R-9) at 21 and Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 11.

[66] RUCO Br. at 10; RUCO Reply Br. at 6.

[67] Co. Br. at 14.

[68] Co. Br. at 13, citing to Exh. A-36.

[69] Phase I Tr. at 587-88.

[70] Co. Br. at 14.

The Northwest Valley Regional Water Reclamation Facility ("Northwest Valley") treats wastewater flows from both the Anthem/Agua Fria Wastewater district and the Sun City West wastewater district. In Decision No. 70209 (March 20, 2008), the Company was ordered to allocate 68 percent of the Northwest Valley plant costs to the Sun City West Wastewater district. [71] Decision No. 70372 (June 13, 2008) ordered the allocation of 32 percent of the Northwest Valley plant costs to the Anthem/Agua Fria Wastewater district. [72]

Based on its growth projections in this proceeding, Staff recommends **[*35]** that the Northwest Valley plant be allocated 28 percent to the Anthem/Agua Fria Wastewater district and 72 percent to the Sun City West Wastewater district. [73] The Company and RUCO are in agreement with Staff's recommended allocation.

Staff conducted a linear regression analysis, using actual and projected growth numbers, to determine that the Sun City West Wastewater district could have approximately 15,055 customers by the end of 2013, and will use approximately 72 percent of the Northwest Valley plant's capacity. [74] Staff anticipates rapid growth in the Northeast Agua Fria area known as Corte Bella, which lies within the Agua Fria Wastewater district, but whose flows are treated by the Northwest Valley plant due to its proximity. [75] Staff's growth analysis for the Corte Bella area was not performed with linear regression, due to the unavailability of sufficient data points, as Staff had access to accurate **[*36]** growth numbers for that area only for 2007 and 2008. [76] Using the available growth numbers for 2007 and 2008, Staff projected that 28 percent of the Northwest Plant's capacity will be needed to serve customers in the Northeast Agua Fria area. [77]

The Council disagrees with Staff's recommended Northwest Valley plant allocation. [78] The Council argues that Staff's customer growth projections are inaccurate in light of the current sluggish real estate market that the Council believes will likely experience a sustained delay in recovery. [79] The Council asserts that its witness Mr. Neidlinger's growth projection appropriately accounts for recent and continuing reductions in customer growth rates due to the foreseeable sustained flat housing market, and should be adopted in lieu **[*37]** of Staff's growth projections. [80]

Staff contends that Mr. Neidlinger's assertion that Staff's projection was based on the assumption that there were no customers in the Northeast Agua Fria area at the end of 2004 is incorrect. [81] Staff states that Mr. Neidlinger's growth analysis completely disregarded the customer counts for the years 2005 and 2006, based on his assumption that it would be unrealistic to use them because they don't represent what is going to happen in the future in the area. [82] Staff argues that by disregarding the customer counts for the years 2005 and 2006, the Council's methodology does not give an accurate portrayal of growth in the area, and would result in a skewed allocation. [83] Staff argues that while projecting growth is not an exact science, Staff's growth projections are more reflective of future growth, and Staff's **[*38]** allocation recommendation is reasonable. [84]

The Company has accepted Staff's allocation of the Northwest Valley plant, and states that Staff's more moderate ad-

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71 Decision No. 70209 at 5.

72 Decision No. 70372 at 12.

73 Phase I Tr. at 767, 770; Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at Exhibit DMH-6 at 5.

74 n74 Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at Exhibit DMH-6 at 5.

75 Staff Br. at 8.

76 Phase I Tr. at 793, 798.

77 Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at Exhibit DMH-6 at 5, fn 3.

78 Surrebuttal Testimony of Dan Neidlinger (Exh. Anthem-3) at 6; Council Br. at 12-13; Council Reply Br. at 13-15.

79 Council Reply Br. at 13.

80 *Id.* at 14.

81 Staff Br. at 9.

82 Phase I Tr. at 873.

83 Staff Reply Br. at 3.

84 Staff Br. at 9.

justment to the Anthem/Agua Fria Wastewater district will lead to less adjustment in the future, [85] and that extensive back-and-forth modification of the allocation percentage based on real estate cycles is not good public policy. [86]

Staff used a reasonable methodology for its growth projections in this case. Staff's growth projection methodology was based on available facts and is more likely to reflect future growth than the methodology advocated by the Council. We find that Staff's growth projection **[*39]** methodology results in a reasonable estimate for the allocation of the Northwest Valley plant, and will therefore adopt it.

F. Anthem Infrastructure Agreement (Anthem Water and Anthem/Agua Fria Wastewater)

1. Background

In 1997, Arizona-American's predecessor Citizens Utilities Company ("Citizens") and Del Webb [87] Corporation ("Del Webb"), the predecessor of Pulte Corporation ("Pulte"), and subsidiaries of Citizens and Del Webb entered into an Agreement for the Villages at Desert Hills Water/Wastewater Agreement ("Infrastructure Agreement" or "Agreement") regarding the construction and funding of the extensive new water and wastewater infrastructure required to serve the master-planned community of Anthem. [88] Under the Agreement, Del Webb was to fund much of the water and wastewater infrastructure, and Arizona-American would eventually have to refund Del Webb's advanced funds in accordance with Exhibit B of the Agreement, with a large balloon payment when build-out occurred. Only after projects were completed and refunds made to Pulte did the plant become eligible for inclusion in rate base.

[*40]

In October 1997, Citizens, DistCo and TreatCo filed a joint application in Docket No. W-01032A-97-0599 *et al.* for a Certificate of Convenience and Necessity ("CC&N") to provide water and wastewater utility service to the planned community development that ultimately became known as Anthem. That application specifically sought approval of the Infrastructure Agreement. On June 19, 1998, Decision No. 60975 was issued in that docket granting Citizens a water and wastewater CC&N for the Anthem service territory. Decision No. 60975 adopted the recommendation made by Staff that the Commission not consider any determination regarding the requested approval of the Infrastructure Agreement. [89]

[*41]

Over the course of the build-out at Anthem, there were several modifications to the Agreement. The first modification was the November 30, 1998 Letter Agreement. [90] In the Letter Agreement, Del Webb agreed in part to compensate Citizens for the additional costs and reduced revenues resulting from the requirements of Decision No. 60975. The Letter Agreement established a ten-year revenue stream from Del Webb to Citizens in recognition of the difference between what had been agreed to by the parties to the Agreement and the requirements of Decision No. 60975.

The second modification to the Infrastructure Agreement was by the First Amendment, dated May 8, 2000. [91] The purpose of the First Amendment was to add the 195-acre Jacka Parcel acquired by Del Webb to the Anthem project and required the parties to take certain actions related to the addition of the land parcel to Anthem.

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[85] Co. Br. at 15; Co. Reply Br. at 6.

[86] Co. Br. at 16; Phase I Tr. at 146-47.

[87] The original parties to the Agreement were Del Webb and its subsidiary The Villages at Desert Hills, Inc. (as the Anthem project was called at the time), Citizens, and Citizens' subsidiaries Citizens Water Services Company of Arizona ("DistCo"), and Citizens Water Resources Company of Arizona ("TreatCo").

[88] A copy of the Agreement was admitted into the record of Docket No. WS-1303A-06-0403 as Exhibit A-16. During the hearing in this matter, on April 20, 2010, administrative notice was taken of Decision No. 70372 (June 13, 2008) issued in Docket No. WS-1303A-06-0403, and the entire record of Docket No. WS-1303A-06-0403.

[89] Decision No. 60975 at 6, 10.

[90] A copy of the Letter Agreement was admitted into the record of Docket No. WS-130 3 A-06-0403 as Exhibit A-17.

[91] A copy of the First Amendment was admitted into the record of Docket No. WS-1303A-06-0403 as Exhibit A-18.

In May 2000, Citizens, TreatCo and DistCo filed a an application to extend the CC&Ns in the Anthem service area to include the Jacka Parcel and requested approval of the First Amendment to the Infrastructure Agreement. On March 13, 2001, the Commission issued Decision No. 63445 approving the CC&N extension application and the First Amendment.

In December 2000, Citizens again requested approval of the Infrastructure Agreement, in connection with an application to delete an area in the City of Phoenix from its certificated territory. In that case, Citizens argued that the Commission had approved the Infrastructure Agreement by its approval of the First Amendment in Decision No. 63445. On June 5, 2002, the Commission issued Decision No. 64897 in which it did not approve the Infrastructure Agreement, and specifically found that "[a]pproval of the addition of the Jacka Parcel in Decision No. 63445 did not result in approval of the underlying Infrastructure Agreement that the Commission declined to approve in Decision No. 60975." [92]

[*43]

In November and December of 2002, Arizona-American filed applications in Docket Nos. WS-01303A-02-0867 et al. requesting rate adjustments for several of its districts, including its Anthem Water and Anthem/Agua Fria Wastewater districts. A refund payment was included in the rate filing. [93] Decision No. 67093 was issued in that docket on June 30, 2004.

The third modification to the Infrastructure Agreement was the Second Amendment, dated September 21, 2000. [94] The Second Amendment revised the Capacity Reservation Section 3.2 of the Agreement and adjusted the equivalent residential unit ("ERU") benchmarks due to the withdrawal of the portion of Anthem located within the City of Phoenix from the Arizona-American CC&N, and the addition of the Jacka Parcel to the CC&N. The Second Amendment also addressed the effect of the Phoenix Agreement, and other matters. The Second Amendment included a consent by Del Webb to the assignment by Citizens of its rights and obligations under the Infrastructure Agreement [*44] to Arizona-American.

On September 27, 2001, Citizens, Arizona-American, Del Webb and Anthem Arizona LLC entered into the Refund Coordination Agreement, [95] which addressed the allocation of responsibilities between Citizens (including TreatCo and DistCo) and Arizona-American. It also adopted a new schedule for the calculation and allocation of refunds.

The fourth modification to the Infrastructure Agreement, the Third Amendment, dated December 12, 2002, [96] increased the water allocation under the Ak-Chin Lease and again recognized Arizona-American's substitution for Citizens in the Infrastructure Agreement.

[*45]

In June and August of 2006, Arizona-American filed applications in Docket Nos. WS-01303A-06-0403 et al. requesting rate adjustments for its Anthem Water and Anthem/Agua Fria Wastewater districts. The Council participated as an intervenor in that prior rate case.

Prior to the conclusion of that rate case, on or about October 8, 2007, Arizona-American and Pulte entered into the Fourth Amendment to the Agreement. The Fourth Amendment was intended to address Commission concerns and Arizona-American's financial circumstances by providing further rate relief to Anthem customers, utilizing the following measures:

1. Pulte agreed to delay the final true-up payment by approximately six months, until March 31, 2008;

2. Pulte agreed to reduce the total refundable developer advance by $ 1.5 million; and

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[92] Decision No. 64897, Findings of Fact No. 7.

[93] Staff Br. at 13.

[94] A copy of the Second Amendment was admitted into the record of Docket No. WS-1303A-06-0403 as Exhibit A-19.

[95] A copy of the Refund Coordination Agreement was admitted into the record of Docket No. WS-1303A-06-0403 as Exhibit A-21.

[96] A copy of the Refund Coordination Agreement was admitted into the record of Docket No. WS-1303A-06-0403 as Exhibit A-20.

> 3. Pulte agreed to defer for two years, without interest, 25 percent of the true-up payment that would otherwise have been due at build-out.

As in this case, in the prior rate case including the Anthem and Anthem/Agua Fria Wastewater districts, in Docket No. WS-1303A-06-0403, numerous public comments, both oral and written, were received in opposition to the requested rate increase. **[*46]** Also, as in this case, the public comments expressed displeasure that the Company's proposed rates reflected repayment by Arizona-American to Pulte for infrastructure costs paid by Pulte, and particularly, that existence of the advances was not disclosed to homebuyers at the time of purchase.

On June 13, 2008, the Commission issued Decision No. 70372 in Docket No. WS-1303A-06-0403. Decision No. 70372 included in rate base the developer refunds Arizona-American had made and for which it requested recovery in that case. Decision No. 73072 stated:

> We take the public comment received in this case seriously and recognize the gravity of the customers' concerns regarding the infrastructure costs required to provide water and wastewater utility services for the Anthem community. At this time, no party has alleged, and we do not find, that the Company's repayment of developer advances under the Anthem Agreements has been imprudent or improper . . . .
>
> Our determination in this case is not intended to have any bearing on our determination in any subsequent case filed by the Company for these districts regarding the reasonableness of the Company's agreement to refund to Pulte almost all of **[*47]** the costs required to construct Anthem's water infrastructure. [97]

Decision No. 73072 ordered the Company to ensure that the term of the Fourth Amendment to the Infrastructure Agreement deferring 25 percent of the true-up payment due from Arizona-American would inure to the benefit of ratepayers by an appropriate choice of test year for filing its next rate case. [98]

2. Pulte Refund True-Up Payments at Issue in this Proceeding

On June 29, 2007, Arizona-American refunded $ 3,068,300.57 of advances due to Pulte pursuant to the Infrastructure Agreement and the subsequent amendments thereto. [99] Of that amount, $ 2,147,810.40 was for water and $ 920,490.17 was for wastewater. [100] On March 31, 2008, pursuant to the terms of the Infrastructure Agreement and subsequent amendments thereto, as modified **[*48]** by the Fourth Amendment described above, Arizona-American refunded $ 20,226,122 of the advances due to Pulte at build-out of the Anthem community, which occurred in September 2007. [101] Of that amount, $ 14,889,798.55 was for water and $ 5,336,323.45 was for wastewater. [102] On March 31, 2010, Arizona-American paid Pulte the remaining 25 percent of the deferred interest-free payment, $ 6,742,041, pursuant to the terms of the Infrastructure Agreement and subsequent amendments thereto, as modified by Fourth Amendment described above. [103] Of that amount, $ 4,719,428.70 was for water and $ 2,022,612.30 was for wastewater. [104] The Company is not seeking recovery of the March 31, 2010 refund payment in this proceeding. [105]

[*49]

3. Council's Proposed Exclusion of Refunds from Rate Base

Prior to commencement of the evidentiary hearing in this case, the Council filed a pre-hearing memorandum alleg-

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97 Decision No. 73072 at 43.

98 *Id.* at 62.

99 n99 Exh. Anthem-7.

100 *Id.*

101 *Id.*; Rebuttal Testimony of Company witness Paul Townsley (Exh. A-4) at 10; Direct Testimony of Company witness Paul Townsley (Exh. A-3) at 9.

102 Exh. Anthem-7.

103 *Id.*; Direct Testimony of Company witness Paul Townsley (Exh. A-3) at 9.

104 Exh. Anthem-7.

105 Phase I Tr. at 241-42.

ing that the Infrastructure Agreement constituted an evidence of indebtedness as contemplated in *A.R.S. §§ 40-301 to 303*. The Council also argues that the Infrastructure Agreement is a main extension agreement as contemplated by *A.A.C. R14-2-406*. Based on the fact that the Company did not obtain Commission approval pursuant to A *A.R.S. §§ 40-301 to 303* and *A.A.C. R14-2-406*, the Council requests that the Company's 2007 repayment of $ 3,068,300.57 and 2008 repayment of $ 20,226,122 to Pulte for infrastructure costs pursuant to the Infrastructure Agreement be excluded from rate base and receive no ratemaking recognition. [106] The Council accordingly proposes adjustments reducing the rate base of the Anthem Water district by $ 17,037,609, and reducing the rate base of the Anthem/Agua Fria Wastewater district by $ 6,256,813. [107]

[*50]

The Company argues that the Council's position is not only entirely void of legal merit but also manifestly unfair, because the refund payments represent investment in plant found used and useful in providing service to the Anthem community. [108] Arizona-American states that it is legally entitled to a fair return on and of the investment it has made in the used and useful plant, and that the Council does not provide any reasons that justify a disallowance. [109] The Company states that ratepayers in the Anthem community have enjoyed the benefits of the system since 1998 without the full carrying cost of that system being reflected in rates, and that the Company has not earned any return on the investments it has made in Anthem since 2003. [110] The Company contends that although some in the Anthem community believe that they were misled by Del Webb/Pulte Homes when they purchased their homes, that issue is appropriately addressed in the pending class action lawsuit against Pulte in federal court, and not in this proceeding. [111]

[*51]

FTRUCO states that the refund payments the Company made constitute infrastructure costs, which are legitimate costs of service, and that in fairness, the Company should be able to recover its legitimate costs. [112]

It is Staff's position that all of the plant for which Arizona-American paid Pulte is used and useful, and Staff's recommendations in this case accordingly include the plant in rate base. [113] Staff agrees with RUCO that the infrastructure costs at issue are legitimate costs of service and that the Company should be allowed to recover those costs. [114] Staff states that the Council's argument is effectively a request that plant be disallowed, and that the Council has not alleged a legally sound basis upon which to alter the ratemaking treatment of the refund payments. **[*52]** [115]

a. Whether the Infrastructure Agreement Constitutes "Evidence of Indebtedness" Pursuant to *A.R.S. §§ 40 -301 through 40-303*

The Council alleges that the Infrastructure Agreement constitutes an evidence of indebtedness as contemplated in *A.R.S. § 40-301et seq.* Based on the fact that the Company did not obtain Commission approval of the Infrastructure Agreement pursuant to *A.R.S. §§ 40-301 to 303*, the Council requests that the Company's 2007 and 2008 repayment of advances totaling $ 23,294,422 by Arizona-American to Pulte pursuant to the Infrastructure Agreement be excluded from rate base and receive no ratemaking recognition.

The Company states that the Commission's prior Decisions declining to approve or disapprove the Infrastructure Agreement indicate that it is a "private contract," and not the type of **[*53]** agreement that requires Commission ap-

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106 Council Br. at 1-7; Council Reply Br. at 2; Council Final Schedules.

107 Council Final Schedules.

108 Co. Reply Br. at 10.

109 *Id.*

110 Co. Reply Br at 3, citing to Phase I Tr. at 299-300.

111 Co. Reply Br. at 2.

112 n112 RUCO Br. at 41.

113 n113 Staff Br. at 16.

114 Staff Reply Br. at 7.

115 Staff Br. at 12.

proval. [116] The Company states that the Council has not provided a single example of the Commission treating an agreement of the nature of the Infrastructure Agreement as "evidence of indebtedness" under *A.R.S. §§ 40-301 to 303*, that to the Company's knowledge the Commission has not done so, and that if the Commission were to now change course and require prior approval under these statutes, nearly every existing main extension and line extension agreement in the State of Arizona would become invalid. [117] The Company asserts that proper statutory construction [118] and application of pertinent equitable principles [119] also compel the conclusion that the Infrastructure Agreement does not constitute "evidence of indebtedness."

The Company additionally states that the Infrastructure Agreement **[*54]** is not required to be treated as debt under GAAP and is not booked as such, which the Company argues is a strong indication that it is not "evidence of indebtedness," citing to Commission Decision No. 69947. [120] The Council charges that by referencing Decision No. 69947's reference to GAAP treatment being indicative of "evidence of indebtedness" the Company "erroneously extends the scope of the Commission's application of GAAP in order to reach the conclusion Arizona-American desires in this proceeding." [121] We disagree. The declaratory order APS sought in that case, and which the Commission declined to issue, would have allowed APS to exclude from treatment as debt two agreements which were classified as long-term debt per GAAP. [122] Instead of issuing the requested declaratory order, Decision No. 69947 set out guidelines for the Company to follow in the event of changes in GAAP or changes in interpretation of GAAP. [123]

[*55]

The Company argues that because *A.R.S. §§ 40-301 to 303* restrict a public utility's right to contract, they must be narrowly construed and must not be extended to transactions outside their plain terms, [124] and that under the statutory doctrine of *ejusdem generis*, the phrase "other evidence of indebtedness" must be interpreted in light of the character of other terms that precede it, [125] which in this case are "stocks," "stock certificates," "bonds," and "notes." [126] The Company states that agreements such as the Infrastructure Agreement are not designed for the purpose of building up the utility's general and permanent capital structure like an issuance of stock, but rather serve the specific and limited purpose of placing the risks of development on the developer rather than the public utility. [127] The Council advances the argument that the Infrastructure Agreement constitutes a financing agreement whereby Pulte financed the construction of Anthem's water **[*56]** and wastewater facilities through an interest-free loan, and that Arizona-

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[116] Co. Br. at 22; Co. Reply Br. at 10-11.

[117] Co. Br. at 22, 24; Co. Reply Br. at 10.

[118] Co. Br. at 22-24.

[119] *Id.* at 24-25.

[120] n120 *Id.* at 22, citing to *In Re APS*, Docket No. E-01345A-06-0779, Decision No. 69947 (October 30, 2007) at 10-13 (indicating that GAAP guides the determination as to whether an "evidence of indebtedness" exists), and at 11, fn 16 ("GAAP status is the determinant for compliance filings and how the condition test for issuance of debt or equity is calculated."). Decision No. 69947 ruled on an APS request for general financing authority, and denied APS's request for "a declaratory order that confirms that only traditional indebtedness for borrowed money constitutes an 'evidence of indebtedness' under A.R.S. §§ 40-301 and 40-302 and that such other arrangements do not require prior Commission authorization and do not count against the Continuing Long-Term Debt or Continuing Short-Term debt authorizations requested in the application." Decision No. 69947 at 1-2.

[121] Council Reply Br. at 3.

[122] Decision No. 69947 at 11.

[123] *Id.* at 17-18.

[124] Co. Br. at 23, citing to, *e.g.*, Webster Mfg. Co. v. Byrnes, 207 Cal 630, 637 (Cal. 1929) (analogous California statute)("The right of contract is by the statute abridged to a certain extent and no reason exists for making an application of the statute not plainly warranted by the language employed in it."), and Wis. So. Gas Co. v. Pub. Serv. Comm'n, 57 Wis. 2d 643, 648 (Wis. 1973) (reasoning that similar Wisconsin statute should be "reasonably construed and [not applied] to transactions not clearly covered" by statutory language) (internal quotation marks omitted).

[125] Co. Br. at 23, citing to Wilderness World, Inc. v. Dep't of Revenue, 182 Ariz. 196, 199 (Ariz. 1995) ("where general words follow the enumeration of particular classes of persons or things, the general words should be construed as applicable only to persons or things of the same general nature or class of those enumerated.").

[126] Co. Br. at 23.

[127] Co. Reply Br. at 11.

American secured its indebtedness to Pulte through the issuance of two letters of credit. [128] In regard to the Council's reliance on *United States v. Austin*, the securities case cited by the Council in support of its position, the Company does not believe it provides relevant or persuasive authority, because it involves interpretation of the federal securities laws, which are of a different nature and purpose than a state law regulating a public utility's debt and equity. [129] The Company states that the Infrastructure Agreement was a private contract prescribing the terms of the parties' agreement, including a schedule for refund of funds advanced, and the fact that it was backed by letters of credit does not alter its character in that regard. [130] The Company asserts that the Council appears to be relying on a bare-bones argument that the Infrastructure Agreement is "evidence of indebtedness" merely because it creates contractual payment obligations that extend more than one year into the future, and that such simplistic logic would amount to a requirement that any routine contractual arrangement extending **[*57]** over one year, whether it be for cleaning services, computer software, or document support services, be docketed and presented to the Commission for approval. [131]

[*58]

The Council argues that the Infrastructure Agreement constitutes evidence of indebtedness because Arizona-American's audited financial statements list advances in aid of construction ("AIAC"), together with proceeds from debt issuances, net borrowings from notes, and capital contributions under the heading "Cash flows from financing activities," and that the Staff Report in the Company's recent financing **[*59]** application docket considered AIAC in its calculation of short-term and long-term debt. [132] The Council's argument is misguided on this point. While the Staff Report the Council cited did include AIAC in the analysis of the Company's capital structure, AIAC was not included in the calculation of debt. [133]

The Company argues that **[*60]** the doctrine of equitable estoppel precludes treating the Infrastructure Agreement as "evidence of indebtedness." [134] Arizona-American contends that it was perfectly reasonable for it to rely on the Commission's past practice of not requiring prior approval for this type of agreement, as well as on the Commission's past Decisions declining to approve or disapprove the Infrastructure Agreement, and states that Arizona-American in fact did so rely. [135] The Company states that it would suffer substantial injury if the Commission were now to decide that the refund payments should be excluded from rate base due to lack of prior approval, and argues that such a determination would be inequitable. [136]

[*61]

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[128] Council Br. at 5, citing to U.S. v Austin, 462 F.2d 724, 736 (10th Cir. 1072) (citing Keller v. City of Scranton, 49 A. 781,782 (1901) and Nelson v. Wilson, 264 P. 679, 682 (1928) for the proposition that the term "evidence of indebtedness is not limited to a promissory note or other simple acknowledgement of a debt owing and is held to include all contractual obligations to pay in the future for consideration presently received."); Council Reply Br. at 4-5.

[129] Co. Br. at 12.

[130] Co. Reply Br. at 11.

[131] *Id.* at 11-12.

[132] Council Reply Br. at 5, citing to the Staff Report in Docket No. WS-01303A-09-0407 at 3.

[133] n133 *Capital Structure inclusive of AIAC and CIAC*

> The Company's actual capital structure at December 31, 2008, inclusive of advances-in-aid-of-construction ("AIAC") and net contributions-in-aid-of-construction ("CIAC"), modified to reflect issuance of the aforementioned $ 2.3 million WIFA loan, results in a pro forma capital structure consisting of 8.9 percent short-term debt, 28.1 percent long -term debt, 23.1 percent equity, 28.5 percent AIAC and 11.3 percent CIAC (Schedule JCM-I, Column [A], lines 28-38).

Staff Report in Docket No. WS-01303A-09-0407 at 3 (footnote omitted).

[134] Co. Br. at 25, citing to Valencia Energy v. Arizona Dep't of Revenue, 191 Ariz. 565, 567-77 (Ariz. 1998), the Company argues that equitable estoppel applies where three elements are present: (1) a party engages in acts inconsistent with a position it later adopts, (2) reasonable reliance by the other party, and (3) injury to the latter resulting from the former's repudiation of its prior conduct. The Company further argues that equitable estoppel may be maintained against a governmental entity as long as its application "will not substantially and adversely affect the exercise of governmental powers," citing to *Valencia* at 576-78.

[135] Co. Br. at 25.

[136] *Id.*

Staff states that A.R.S. § 40-301(A) requires public service corporations to seek prior Commission approval before issuing stocks, bonds, notes or other evidence of indebtedness, and that the Council is attempting to shoehorn the Infrastructure Agreement into the category of "evidence of indebtedness," but that the attempt does not work. [137] Staff argues that while headings are not law, [138] the title of A.R.S. § 40-301, "Issuance of stocks and bonds; authorized purposes," indicates the types of instruments the Arizona Legislature intended to be governed by the provision. [139] Staff states that the Infrastructure Agreement is not a stock or bond, but an agreement that provides terms and conditions of service, as well as refund obligations. [140] Staff does not believe that the Agreement and associated agreements constitute "evidence of indebtedness." [141] Staff also points out that while the Council would use the Company's failure to obtain Commission approval under A.R.S. §§ 40-301 to 303 **[*62]** to permanently exclude the full amount of the refund payments from rate base, the Council fails to explain how it reconciles this position with the fact that the Company sought Commission approval on several occasions but was unsuccessful in obtaining it. [142] Staff argues that taking the Council's interpretation of A.R.S. §§ 40-301 to 303 to its logical conclusion would mean that any contract that a utility enters into that requires the payment of money over a term would require prior Commission approval. [143] Staff agrees with the Company's observation that if the Commission were to adopt the Council's interpretation of A.R.S. §§ 40-301 to 303, then nearly every existing main extension and line extension agreement in the State of Arizona would become invalid, and the Commission would be inundated with agreements that could potentially qualify as "other evidences of indebtedness." [144]

[*63]

RUCO states that whether the Infrastructure Agreement is an evidence of indebtedness is academic at this point, and that the "right and fair thing" is to allow the Company to recover the refunds it made. [145]

We agree with Staff that the Infrastructure Agreement is not a stock or bond, but an agreement that provides terms and conditions of service, as well as refund obligations, and that its approval under A.R.S. §§ 40-301 to 303 was not necessary. As the Company states, agreements such as the Infrastructure Agreement are not designed for the purpose of building up the utility's general and permanent capital structure like an issuance of stock, but rather serve the specific and limited purpose of placing the risks **[*64]** of development on the developer rather than the public utility, as the Infrastructure Agreement did in this case. We find that it was reasonable for Arizona-American not to seek approval under A.R.S. §§ 40-301 to 303 in reliance on the Commission's past practice of not requiring prior approval under that statute for this type of agreement, as well as on the Commission's past Decisions declining to approve or disapprove the Infrastructure Agreement. We are not persuaded by the Council's arguments that the Company's 2007 and 2008 repayment of advances to Pulte pursuant to the Infrastructure Agreement should be excluded from rate base and receive no ratemaking recognition because the Infrastructure Agreement constitutes "evidence of indebtedness" and is void because the Company failed to obtain Commission approval thereof pursuant to A.R.S. §§ 40-301 to 303.

b. A.A.C. R14-2-406

The Council argues that if the Infrastructure Agreement is not "evidence of indebtedness" that it is a main extension agreement as contemplated by A.A.C. R14-2-406 **[*65]** . Based on the fact that the Company did not obtain Commission approval of the Infrastructure Agreement pursuant to A.A.C. R14-2-406, the Council requests that the Company's 2007 and 2008 repayment of advances totaling $ 23,294,422 by Arizona-American to Pulte pursuant to the Infrastructure Agreement be excluded from rate base and receive no ratemaking recognition.

The Commission has on multiple occasions had requests for approval of the Infrastructure Agreement, but has declined to approve or disapprove it. The Company argues that in fairness, the Commission's determination that ap-

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137 Staff Br. at 14.

138 *Id.*, referring to A.R.S. § 1-212.

139 Staff Br. at 14.

140 Staff Br. at 14; Staff Reply Br. at 5.

141 Staff Reply Br. at 5.

142 *Id.*

143 Staff Br. at 14-15.

144 Staff Reply Br. at 6.

145 RUCO Br. at 41.

proval was not required cannot now serve as a basis for disallowing the Pulte refund payments. [146] The Company further argues that even assuming, for the sake of argument, that approval of the Infrastructure Agreement should have been obtained under A.A.C. R14-2-406, that failure to obtain approval would not provide a basis for excluding the refund payments from rate base. The Company states that the main extension rule's specific remedy for failing to obtain necessary approval is that the refundable advance shall be immediately **[*66]** due and payable to the person making the advance, a condition that has already been met in this case, as the Company has satisfied its repayment obligations to Pulte. [147]

RUCO states that the Infrastructure Agreement does not meet the requirements for a main extension agreement, and for the reasons the Commission provided in Decision No. 64897, does not require Commission approval under A.A.C. R14-2-406 **[*67]** . [148]

Staff states that the Commission has treated the Infrastructure Agreement somewhat like a main extension agreement, by treating the prior refund payments as AIAC, but that the Commission has never approved the Infrastructure Agreement, even though the Company has sought approval. **[*68]** [149] Staff argues that equitable considerations strongly weigh against the Commission taking the harsh action proposed by the Council, and recommends that the proposal be disregarded. [150] Staff explains that under the Commission's main extension rules, if a utility does not obtain Commission approval of a main extension agreement, the remedy is to require the utility to refund all of the money advanced, and that the main extension rules do not require the disallowance of plant. [151] Staff's position is that the plant has been found to be used and useful, and Staff believes it would be inequitable now to penalize the Company as the Council suggests for not obtaining approval of the Agreement, when it had sought such approval on several occasions. [152]

The Council acknowledged in its Closing Brief that A.A.C. R14-2-406 requires advances made under the provisions of **[*69]** an unapproved agreement to be refunded. [153] The Council did not respond in its Reply Brief to the arguments presented by the Company, RUCO and Staff regarding the effects of A.A.C. R14-2-406 on the Infrastructure Agreement.

As Staff points out, Arizona-American (or its predecessor) sought approval of the Infrastructure Agreement and various associated agreements several times, but because the agreements went well beyond the typical main extension agreement, the Commission did not approve what amounted to private agreements between the parties. The Com-

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[146] Co. Br. at 25; Co. Reply Br. at 12-13.

[147] n147 Co Br. at 26; Co. Reply Br. at 13. R14-2-406 (M) provides as follows:

> M. All agreements under this rule shall be filed with and approved by the Utilities Division of the Commission. No agreement shall be approved unless accompanied by a Certificate of Approval to Construct as issued by the Arizona Department of Health Services. Where agreements for main extensions are not filed and approved by the Utilities Division, the refundable advance shall be immediately due and payable to the person making the advance.

[148] n148 RUCO Reply Br. at 16; RUCO Br. at 37-40, citing the following:

> There are other reasons for declining to approve the Infrastructure Agreement in this proceeding. Staff points out that the Agreement is a private contract between the Companies and a third party developer that contains "unequal refunding structures, cost caps, priority services, and penalties" that may be inconsistent with the Commission's standards (Staff Report at 3). According to Staff, the Infrastructure Agreement does not require the Commission's approval and, by not making a determination regarding the Agreement, the Commission "protects its rights to set rates and conditions it deems necessary to protect the public interest" *(Id.)*.
> Decision No. 64897 at 6.

[149] Staff Br. at 15.

[150] *Id.;* Staff Reply Br. at 6.

[151] Staff Br. at 15.

[152] *Id.*

[153] Council Br. at 5-6.

pany has refunded all the advances under the Infrastructure Agreement, which is the remedy provided under *A.A.C. R14-2-406* for failure to obtain approval of a main extension agreement. We find that the fact that the Company did not obtain approval of the Infrastructure Agreement pursuant to *A.A.C. R14-2-406* does not **[*70]** provide a valid basis for excluding the refund payments from rate base.

c. Reasonableness of the Refund Payments

In the alternative to its arguments under *A.R.S. §§ 40-301 to 303* A.A.C. and *R14-2-406*, the Council argues that any portion of the disputed refund payments that has not been shown by Arizona-American to be reasonable and proper should be permanently excluded from rate base and denied any rate base recognition. [154]

In response to the concern expressed by several parties that there is a degree of unfairness in asking Anthem residents to bear the full amount of the balloon payment in rates at this time, Staff states that if there is any issue presented regarding the balloon payment, it is one of reasonableness. [155] Staff states that it is mindful of the evidence in the record that suggests that an agreement to refund the entire advance to Pulte may not have been typical of main extension agreements **[*71]** entered into at that time, [156] and other evidence that suggests that the Anthem build-out occurred much sooner than expected. [157] Staff states that should the Commission desire to balance the equities and interests of the ratepayers and stockholders, the Commission could give some recognition to those facts in the record which question the reasonableness of the original build-out projections and the Agreement itself. [158]

The Council states that evidence introduced in the two latest hearings involving Anthem suggest that the Company was aware that the accelerated build-out of the Anthem community ten years ahead of schedule could require the balloon payment to become due in 2007, with payment showing up in the Company's rates years in advance of the dates indicated to the Commission in the 1998 CC&N proceedings; [159] and that the Company was aware **[*72]** that Citizens' agreement to refund 100 percent of developer-funded development costs apparently deviated from the usual practice of developers to include approximately 50 percent of development costs in home prices. [160]

The Company disagrees with the Council's allegation that it agreed to refund 100 percent of developer advances for the Anthem infrastructure. Rather, the Company asserts, the total amount of reimbursement to Pulte approximates only 71 percent of Pulte's total investment in the Anthem water and wastewater infrastructure and when interest is factored in, the amount of reimbursement drops to only approximately 55 percent. [161]

[*73]

The Company contends that it was not unreasonable, imprudent or improper for Citizens and Arizona-American to rely on the Commission's Decisions declining to approve or disapprove the Infrastructure Agreement, and proceed to make refund payments. [162] The Council asserts that the facts do not support Arizona-American's claim that equitable estoppel applies. [163] The Council argues that assuming, *arguendo,* that the estoppel doctrine applies in this in-

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[154] Council Reply Br. at 7.

[155] Staff Br. at 16.

[156] *Id.,* citing to Exhibit S-2.

[157] Staff Br. at 16, citing to Exhibit S-1.

[158] Staff Br. at 16; Staff Reply Br. at 7-8.

[159] Council Br. at 6, citing to Exh. S-1 at 2 and Exh. S-2.

[160] Council Br. at 8, citing to Exh. S-1 at 2.

[161] Co. Reply Br. at 14, citing to Phase I Tr. at 415; Docket No. WS-01303A-06-0403 Tr. at 983-84 (testimony of Pulte witness Daniel Christopher Ward), Tr. at 1118 (testimony of Paul Townsley), and Exhibit P-7.

[162] Co. Br. at 25, fn 123.

[163] Council Reply Br. at 8.

stance, [164] Arizona-American cannot claim that it made the refunds in reasonable reliance on the Commission's words or actions, because the attempts to obtain Commission approval of the Infrastructure Agreement indicate the existence of a belief that Commission approval was necessary, and Arizona-American knew that the Commission had never approved the Infrastructure Agreement. [165] The Council asserts that Arizona-American knew there was a possibility that the Commission would not allow ratemaking recognition of the refunds, citing to language in the Fourth Amendment stating that "[t]he ACC's decision regarding rate treatment for any amounts refunded pursuant to the previous agreement or other amounts included in this Fourth Amendment **[*74]** shall not affect the terms in this Fourth Amendment." [166] The Council further asserts that Arizona-American knew that the Commission had left the status of the reasonableness of the Infrastructure Agreement refund provisions as an open question in Arizona-American's last rate case involving the Anthem districts. [167] The Council takes the position that "it would be unfair and against the public interest to require Anthem residents to shoulder the burden of AAWC's imprudent decision to enter into a questionable financing arrangement and to pay the Disputed Refund Payments particularly, where the Commission's previously expressed discomfort with the Infrastructure Agreement provided adequate advance notice to AAWC that the Disputed Refund Payments were vulnerable to the prospect of disallowance in AAWC's future rate cases." [168]

[*75]

The Company asserts that the refund payments provided for in the Infrastructure Agreement are reasonable, and that there is no evidence to suggest that the plant is not prudent. [169] Arizona-American contends that the Pulte refund payments, which represent its reasonable investment in used and useful plant, should be allowed in rate base. [170] The Company states that the Anthem system was an expensive one to build, serving a unique community located in a relatively less populated area well to the north of Phoenix. [171] The Company points to the fact that both RUCO and Staff recognize that all the plant is used and useful, and that its infrastructure costs are a legitimate cost of service that should be recovered. [172]

[*76]

RUCO believes that by having allowed the Company to recover eligible refunds in past Decisions, the Commission has sent the message that the Commission approves of the Company's recovery of the refunds, and it would therefore be unfair to deny recovery of the refunds now. [173] RUCO states that there is no evidence in the record questioning the reasonableness of the repayment amounts; and nothing in the record alleging that the assets built by the Pulte funds are not used and useful. [174] RUCO contends that for the Commission to change its direction on the recovery of refunds, some of which it has already allowed, would be unfair as a matter of equity. [175]

d. Analysis

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[164] Council Reply Br. at 7-8, referring to the elements of equitable estoppel listed by the Company in its Closing Brief at 25, fn 122 where the Company argues that equitable estoppel applies where three elements are present: (1) a party engages in acts inconsistent with a position it later adopts, (2) reasonable reliance by the other party, and (3) injury to the latter resulting from the former's repudiation of its prior conduct. *Valencia Energy* at 567-77. The Company further argues that equitable estoppel may be maintained against a governmental entity as long as its application "will not substantially and adversely affect the exercise of governmental powers," citing to *Valencia Energy* at 576-78.

[165] Council Reply Br. at 8, citing to Phase I Tr. at 377-78.

[166] Council Reply Br. at 8, citing to Phase I Tr. at 359.

[167] Council Reply Br. at 8, citing to Phase I Tr. at 353, 281-82, 285-86.

[168] Council Reply Br. at 8.

[169] Co. Reply Br. at 14.

[170] *Id.*

[171] *Id.*

[172] *Id.*

[173] RUCO Br. at 41.

[174] RUCO Reply Br. at 16.

[175] *Id.*

In Decision No. 73072, we stated that our determination in that case was not intended to have any bearing on our determination in any subsequent case filed by the Company for the **[*77]** Anthem districts regarding the reasonableness of the Company's agreement to refund to Pulte almost all of the costs required to construct Anthem's infrastructure. [176] In that case, the Council recommended that in order to lessen the rate impacts of the remaining Pulte payments, the Company be required to file its next rate case for the districts prior to refunding the last 25 percent of the reduced true-up payment that the Company had negotiated with Pulte in the Fourth Amendment. [177] Decision No. 73072 adopted the Council's suggestion, and the Company has complied with the Decision.

The Council now urges that any portion of the disputed refund payments that has not been shown by Arizona-American to be reasonable and proper should be permanently excluded from rate base and denied any rate base recognition. However, we can find no evidence in the record of this proceeding that the refund **[*78]** payments, which paid for infrastructure that is used and useful and necessary in the provision of service to the districts, were not reasonable and proper. No party disputed the fact that the Anthem system was an expensive one to build, that all the plant is used and useful, and that the infrastructure costs are a legitimate cost of service. No party disputed the evidence that Arizona-American refunded to Pulte approximately 71 percent of Pulte's total investment in the Anthem water and wastewater infrastructure and that when interest is factored in, the amount of reimbursement drops to only approximately 55 percent.

In Decision No. 64897, the Commission recognized that the Infrastructure Agreement contained unequal refunding structures, cost caps, priority services, and penalties that may be inconsistent with the Commission's standards. [178] While there was significant dispute in this proceeding regarding whether the Infrastructure Agreement required Commission approval, no party has demonstrated that any elements of the Infrastructure Agreement which led the Commission to decline to approve it on several occasions were actually, in practice, unreasonable or improper.

[*79]

The record evidence does not support a disallowance of Arizona-American's prudently made equity investments in the infrastructure required to provide reasonable and adequate water and wastewater utility service to the Anthem districts. In conformance with the fundamental ratemaking principle that a public utility must be allowed an opportunity to earn a reasonable return on its prudent investments, the equity investment that the Company made in the Anthem districts' infrastructure in the form of advance refunds will be allowed in rate base.

However, the public interest requires us to consider the risk-shifting effects of the infrastructure agreement, which has resulted in the Company shifting to ratepayers the risks related to the costs of the infrastructure agreement and the timing of the balloon payments. This risk-shifting justifies a lower cost of capital, as discussed in the cost of capital section of this Order.

4. Proposed "Phase-In" Plans

a. Council's Phase-In Proposals

The Council urges that if the refund payments are recognized, that a phase-in plan should be adopted in regard to the water and wastewater plant associated with the 2007 and 2008 Pulte refunds. [179] The **[*80]** Council argues that a phase-in plan is appropriate considering the controversy surrounding the refund payments, the need to mitigate rate shock for Anthem ratepayers, and because Arizona-American benefitted from the interest-free use of the plant financed with AIAC for many years. [180]

Under the Council's proposed "ratable plant transfer plan," water and wastewater plant and related accumulated depreciation associated with the 2007 and 2008 Pulte refunds would be removed from plant in service for purposes of ratemaking in this proceeding. [181] The Company would be required to file future rate cases to recover the transferred

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[176] Decision No. 73072 at 43.

[177] *See* Decision No. 70372 at 40, citing to the Council's suggestion in its Reply Brief.

[178] Decision No. 64897 at 6.

[179] Council Br. at 9; Council Reply Br. at 8-9.

[180] Council Reply Br. at 13.

[181] Council Br. at 9.

amounts in rates. [182] The net plant would be "parked" or deferred as plant held for future use and then transferred into plant in service ratably over the five year period of 2009 through 2013, with the transfer of 40 percent or $ 8 million of the aggregate 2007 and 2008 Pulte refunds to plant in 2010, conceivably [*81] allowing the Company to earn a return on that portion of the 2007 and 2008 Pulte refunds by the year 2012, depending on rate case timing. [183] Under the ratable plant transfer plan, 80 percent or $ 16 million of the aggregate 2007 and 2008 refunds would become eligible for ratemaking recognition by the end of 2012, thereby enabling the Company to be earning a return on the bulk of the 2007 and 2008 Pulte refunds by the year 2014, depending on rate case timing. [184] The Council explains that the 2010 Pulte refund would be accorded the same treatment under the plan, but transferred to plant in service over the five year period of 2011 through 2015, and that depreciation on all the refunds would be stayed as reclassified to plant in service. [185] The Council explained that for accounting purposes, since the AIAC was used to fund infrastructure recorded in many separate plant accounts, it believes the most efficient accounting would be the establishment of two contra control plant accounts: one for gross utility plant and one for accumulated depreciation, and that the offsetting entries for both gross plant and accumulated depreciation would be recorded in separate plant held for future [*82] use accounts. [186] Accumulated depreciation would be based on overall accumulated depreciation percentages at December 31, 2008, at 14.93 percent for water plant and 17.38 percent for wastewater plant. [187]

The Company believes that the Council's phase-in proposal would be subject to Accounting Standards Codification ("ASC") 980-340 (formerly Statement of Financial Accounting Standards ("SFAS") 92) pertaining to Phase-In Plans and ASC [*83] 980-360 (formerly SFAS 90) pertaining to Plant Disallowances, [188] and that in accordance with those accounting guidelines, the phase-in proposal would require a substantial write off of the plant, resulting in severe financial consequences for the Company. [189]

The Council disagrees. The Council argues that because under Mr. Neidlinger's plan Arizona-American can eventually recover all the costs of the Anthem plant associated with the 2007 and 2008 refunds, it is not probable that part of the cost of the plant will be disallowed for ratemaking purposes, and therefore the Company's asserted SFAS 90 concerns do not apply. [190] The Council's witness Mr. Arndt testified to his belief that SFAS 92 is not an impediment to the Commission's adoption of Mr. Neidlinger's ratable transfer plan, and that SFAS 90 does not address refunds relating to prior AIACs. [191] In the opinion of the Council's witness, because Arizona-American [*84] has not abandoned any water or wastewater plant in this case, and Mr. Neidlinger's ratable plant transfer proposal does not contemplate or require a disallowance of utility plant, SFAS 90 does not apply. [192] Mr. Arndt also opined that for purposes of the American Water's consolidated financial statements, any adjustment that Arizona-American elected as a result of a phase-in plan could be supported by disclosure notes explaining the Commission's adoption of the ratable transfer plan, and that "[i]f properly reported, the notes would not suggest that the Commission had 'disallowed' the 2008 $ 20.2 million refund payment to Pulte Homes, nor would the plant be characterized as 'abandoned.'" [193] Mr. Neidlinger testified that SFAS 92 is not applicable in this case because the amount of plant involved is not material to American Water's consolidated plant balance. [194]

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182 Direct Testimony of Council witness Dan Neidlinger Exh. Anthem-1; Exh. A-45 at 2-3.

183 Council Br. at 9, citing to Direct Testimony of Council witness Dan Neidlinger (Exh. Anthem-1) at 4; Surrebuttal Testimony of Council witness Dan Neidlinger (Exh. Anthem-3) at 3.

184 Council Br. at 9.

185 Council Br. at 9, citing to Direct Testimony of Council witness Dan Neidlinger (Exh. Anthem-1) at 4.

186 Council Br. at 9.

187 *Id.* at 9-10, citing to Direct Testimony of Council witness Dan Neidlinger (Exh. Anthem-1) at 4-5.

188 Redacted Testimony of Company witness James Jenkins (Exh. A-45) at 1, 3.

189 Phase I Tr. at 18.

190 Council Reply Br. at 10.

191 Co. Br. at 11, citing to Direct Testimony of Council witness Michael L. Arndt (Exh. Anthem-13) at 6, 7-8.

192 Direct Testimony of Council witness Michael L. Arndt (Exh. Anthem-13) at 9.

193 *Id.* at 9-10.

194 Phase I Tr. at 846-48.

The Council states that as an alternative to its proposed ratable plant transfer plan, the Commission could allow Arizona -American to include the full amount of the 2008 refund in rate base, but order a phase-in of recognition of the rate of return on it, beginning with this case. [195] The Council argues that this approach would allow the Company to realize an immediate return on its Anthem plant investments while recognizing that it has benefitted from the interest -free use of plant financed with AIAC for many years. [196]

b. Company's Response

The Company opposes both the Council's phase-in proposals. In regard to the alternate proposal, the Company contends that the Council's argument that the Company has enjoyed "interest free use of the plant financed with AIAC for many years" ignores the fact that the use of AIAC to fund the **[*86]** plant has allowed the Anthem community to enjoy interest-free use of this plant since 1998 without full recognition of the used and useful plant in rate base. [197]

In regard to the Council's proposed ratable plant transfer plan, the Company's witness Mr.James Jenkins, who is the Company's Vice President, Finance for American Water's Western Division, testified that he is not aware of a phase-in plan of the type proposed by the Council being approved by any Commission in any state in which American Water's affiliates operate. [198] As stated above, the Company believes that the Council's phase-in proposal would be subject to ASC 980-340 (formerly SFAS 92) pertaining to Phase-In Plans and ASC 980-360 (formerly SFAS 90) pertaining to Plant Disallowances, [199] and that in accordance with those accounting guidelines, the phase-in proposal would require a substantial write off of the plant, and would result in severe financial consequences for the Company. [200]

[*87]

The Company contends that the testimony of the Council's witness Mr. Neidlinger on the accounting implications of the Council's phase-in plan was not credible, because as Mr. Neidlinger conceded, he has no direct experience in applying FAS 92, has not addressed the issue in the role of an auditor, and has never advised any public utilities with regard to the application of FAS 92. [201] In regard to the testimony of the Council's witnesses Mr. Arndt on the accounting implications of the Council's phase-in plan, the Company contends that his testimony was also not credible, because despite the clear language of the accounting guidelines relied upon by the Company's witness Mr. Jenkins, [202] Mr. Arndt testified that the accounting provisions to do not apply to plant constructed after 1988, or to water or wastewater utilities. [203] The Company argues that ultimately, however, the most telling evidence is that both Mr. Neidlinger and Mr. Arndt conceded that it is the Company that would make the **[*88]** decision regarding the accounting treatment of the Council's phase-in proposal. [204]

The Company states that putting aside the accounting implications of the Council's proposed phase-in plan, the fundamental effect of the plan would be to deny the Company a return on and of its investment, in violation of the law. [205] The Company argues that the Council's phase-in plan does not recommend applying any carrying costs and would not make the Company whole in the present value sense, and that given the Company's current financial position, it cannot agree to a phase-in of plant as proposed by the Council, or any phase-in plan that delays its autho-

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195 Council Br. at 12.

196 *Id.*

197 Co. Reply Br. at 8.

198 Phase 1 Tr. at 515-16.

199 Redacted Testimony of Company witness James Jenkins (Exh. A-45) at 1, 3.

200 Phase 1 Tr. at 18.

201 Co. Br. at 18, citing to Phase 1 Tr. at 882-83.

202 Co. Br. at 18, citing to Exh. A-46 at P 4 (describing application of FAS 92).

203 Co. Br. at 18, citing to Direct Testimony of Council witness Michael Arndt (Exh. Anthem-13) at 6-7; Phase II Tr. at 610-18; Exh. A-46.

204 Co. Br. at 18, citing to Phase II Tr. at 622-23 and Phase I Tr. at 888.

205 Co. Br. at 19.

rized revenue [*89] increase. [206] The Company states that any type of phase-in plan would require the Company to forego revenue on plant that the Commission has found to be in rate base. [207] The Company states that as RUCO's witness testified, phase-in plans ultimately have a detrimental effect on ratepayers, as the Company is entitled to receive its authorized revenue at a later date, which results in higher rates following the phase-in. [208]

c. RUCO's Withdrawal of its Alternate Phase-In Proposal

On October 1, 2010, RUCO docketed a Notice of Filing Withdrawal of Phase-In Proposal. In its Closing Brief, RUCO expressed concerns about the impact on the Anthem ratepayers that would result should the Commission allow full and immediate recovery of the Pulte refunds, and had proposed an alternate phase-in [*90] rate design proposal which would allow for recovery of the refunds over a ten year period of time. [209] Staff, in its Reply Brief, stated that conceptually it did not have a problem with most aspects of the RUCO proposal, but that in the event the Commission decided to adopt it, Staff recommended several changes. [210] Staff pointed out several critical issues the proposal had not addressed. [211]

RUCO stated in its October 1, 2010 filing that in making its alternate phase-in rate design proposal, RUCO initially believed it would provide a rate design option that would ameliorate the impact of the rate increase for Anthem customers. RUCO explained in its filing that subsequent to filing its Closing Brief, RUCO invited interested parties to go over the relevant numbers, and that during the course of those meetings, it became apparent to RUCO that due to carrying costs and other costs that allow the Company full recovery of its revenue [*91] requirement, no version of RUCO's proposal, or modification to it, would actually result in a rate design more beneficial to Anthem ratepayers than RUCO's stand-alone rate design. RUCO stated that it withdraws its alternate phase-in proposal for that reason.

d. Staff's Position

Staff does not support the Council's proposal to phase-in the refunds to rate base over time. [212] Staff states that it does not support the proposal because the record is not clear what impacts it would have on the Company and what accounting treatment it would necessitate. [213] Staff stated that while the Council disagrees with the Company's position regarding SFAS 92 pertaining to Phase-In Plans and SFAS 90 pertaining to Plant Disallowances, in the end it is ultimately the Company and its auditors that must make the determination, and therefore, the Council's opinion may be of little import in the matter. [214]

e. Analysis

In its Reply Brief, the Council disputes [*92] the Company's claim that severe financial consequences would result if the Company elects to write off the 2007 and 2008 refunds, charging that the claims are "exaggerated and unsubstantiated" because in 2009, the Company recorded positive net income; that in 2009, the Company indicated that it had sufficient revenue to cover its expected debt service payments; and because the Company is wholly-owned by the largest investor-owned water and wastewater utility in the United States. [215] While the Council argues that a phase-in plan is appropriate considering the controversy surrounding the refund payments, the need to mitigate rate shock for Anthem ratepayers, and the fact that Arizona-American benefitted from the interest-free use of the plant financed with AIAC for many years, the Council's arguments fail to address how the phase-in will allow the Company an opportunity to earn a return on and of its equity investment in the used and useful plant necessary to provide reasonable and adequate service to the Anthem districts. The Council's arguments also fail to take into account the fact that the

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206 Co. Br. at 19.

207 *Id.*, citing to Rate Design Direct Testimony of RUCO witness Rodney Moore (Exh. R-13) at 5; Phase II Tr. at 728-29.

208 Co. Br. at 19, citing to Phase II Tr. at 729-30.

209 RUCO Br. at 41-43.

210 Staff Reply Br. at 8-9.

211 *Id.* at 9.

212 Staff Reply Br. at 6.

213 *Id.*

214 Staff Reply Br. at 6-7.

215 Council Reply Br. at 10.

Company's use of AIAC to fund the plant has allowed the Anthem districts to enjoy interest-free [***93**] use of the AIAC -funded used and useful plant for many years, without full recognition of that plant in rates.

As RUCO recognized in withdrawing its well-considered phase-in plan, such plans ultimately have a detrimental effect on ratepayers, because ratemaking principles require that utilities receive authorized revenue at a later date. Unless a utility voluntarily agrees to forego its authorized revenues, phase-in plans ultimately result in higher rates following the phase-in, due to the need for recovery of carrying costs that allow the Company full recovery of its revenue requirement. The Company has not agreed to forego authorized revenues in this proceeding. After careful consideration, RUCO determined that no version of RUCO's proposal, or modification to it, would actually result in a rate design more beneficial to Anthem ratepayers than RUCO's standalone rate design. For the same reasons, we must decline to approve the Council's phase-in proposals.

f. Open Meeting Agreement

The [***94**] Company, the Council, RUCO and Staff met during a recess from the Open Meeting to discuss possible resolution to a phase-in proposal and other issues. The aforementioned parties agreed to the following:

Phase-in:

1) Three year phase-in of revenue requirement based on the 2007 and 2008 Pulte refund payments for both water and wastewater (as set forth in item 2).

2) As compared to the authorized revenues in the Recommended Opinion and Order, Anthem Water district revenues are reduced by a total of $ 2.342 million as follows:

a. In 2011 the revenue requirement is reduced $ 1.561 million.

b. In 2012 the revenue requirement is reduced $ 0.781 million.

c. In 2013 revenues equal the authorized revenues.3) There is no recovery of the carrying costs associated with the reduced revenues.

4) There is no recovery of the foregone reduced revenues.

5) The 2007 and 2008 Pulte refunds are included in rate base in the overall authorized revenue requirement in the Recommended Opinion and Order.

6) The 2012 and 2013 revenue increases associated with the phase-in are implemented automatically effective January 1 of each year without further Commission action.

Other [*95] Matters

7) The overall revenue requirement is based on a 6.70 percent rate of return (as per Mayes Proposed Amendment # 1)

8) Initiation of Anthem/Agua Fria Deconsolidation proceeding (as per Pierce Amendment # 1)

a. Company to file initial application no later than April 11, 2011.9) The Anthem/Agua Fria Wastewater district winter average residential sewer rate is not implemented until June 1, 2012. Prior to June 1, 2012, the Company's existing rate design for this tariff shall continue, but be increased based on the percentage increase in the authorized revenue requirement.

10) Add language to Exhibit A of Recommended Opinion and Order to reflect, "Each residential customer will be billed based on that customer's average water usage for the months of January, February, and March."

11) Support Hearing Division Amendment # 2.

12) This will be full and complete resolution of the 2007 and 2008 Pulte refunds and there is no need for further Commission proceedings on this issue.

13) As contemplated in the Recommended Opinion and Order, the parties agree the new rates are effective January 1, 2011.

14) The Company will immediately file supporting schedules.

[*96]

We find this resolution reasonable and it appropriately balances the interest of ratepayers and shareholders. We therefore adopt this Agreement.

G. Fair Value Rate Base Summary

The Company did not prepare schedules showing the elements of Reconstruction Cost New Rate Base ("RCND"), [216] and thereby waived a determination of the fair value of its property using an RCND valuation. Therefore, the Original Cost Rate Base ("OCRB") and the Fair Value Rate Base ("FVRB") for the districts are the same for purposes of this application. Based on the discussion of rate base issues set forth above, we find the FVRB for each district to be as follows:

Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
$ 57,249,836	$ 28,188,865	$ 45,116,927	$ 15,489,997	$ 18,096,538

IV. OPERATING INCOME

A. Proposed Test Year Operating Income

The parties propose adjusted test [*97] year operating income by district as follows:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 528,986	$ 898,210	$ 67,162	[67,374)	$ 397,489
Staff	$ 545,925	$ 906,189	$ 210,381	$ 65,615	$ 404,542
RUCO	$ 684,046	$ 1,371,776	$ 16,411	$ 75,904	$ 763,200

B. Test Year Revenues

Adjusted test year revenues were not contested, and are as follows by district:

Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
$ 7,492,744	$ 9,283,101	$ 8,637,123	$ 5,940,381	$ 5,661,710

C. Test Year Operating Expenses

The parties propose adjusted test year operating expenses by district as follows:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 6,963,758	$ 8,384,892	$ 8,569,840	$ 6,008,401	$ 5,264,220
Staff	$ 6,946,819	$ 8,376,912	$ 8,426,742	$ 5,874,766	$ 5,257,168
RUCO	$ 6,808,685	$ 7,911,325	$ 8,620,712	$ 5,864,477	$ 4,898,510

The parties were able to resolve many disputed operating expense issues. [*98] Issues remaining in dispute are addressed below.

1. Pension Expense (All Districts)

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[216] Direct Testimony of Company witness Linda Gutowski (Exh. A-17) at 2.

By district, the parties' final schedules show the following recommended amounts for test year pension expense:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 119,955	$ 269,873	$ 240,306	$ 86,994	$ 159,930
Staff	$ 119,955	$ 269,873	$ 240,306	$ 64.196 *	$ 159,931
RUCO	$ 48,320	$ 115,594	$ 115,351	$ 38,661	$ 75,664

* With the correction of a computational error in Staff's final schedules, Staff's recommendation is $ 86,994.

The Company utilized 2009 ERISA based pension expense amounts, totaling approximately $ 2.09 million, as the most appropriate known and measurable calculation of this expense item. [217] The Company states that its 2009 pension expense is known and measurable and reflects its actual expense, based on the Company's minimum contributions required by law. [218] The Company asserts that its actual pension expense remained high in 2010 and that the Company expects pension expense to continue to increase in the near future, and remain at levels near the current level thereafter. **[*99]** [219]

RUCO states that the Company's 2009 pension expense amount is abnormally high whether it is measured under ERISA or FAS 87 accounting method, and recommends that recovery based on 2009 amounts be denied. [220] RUCO advocates that instead of using the 2009 ERISA amount of pension expense, that the Company's pension expense **[*100]** be based instead on the 2008 test year FAS 87 amount of $ 958,949. [221] RUCO asserts that the ERISA method of accounting for pension expense provides for a wide amount of management discretion on how to fund the plan each year, and that FAS 87 provides for funding amounts that are consistent with GAAP. [222] RUCO argues that use of FAS 87 accounting for pension expense is appropriate because it is the pension expense accounting method used by American Water. [223]

The Company responds that while its management does have some discretion in relation to pension funding, it does

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[217] Co. Reply Br. at 15, citing to Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 10 and Rebuttal Testimony of Company witness Miles Kiger (Exh. A-14) at 14-15.

[218] Phase I Tr. at 137-38; Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 10.

[219] n219 Co. Br. at 27, citing to Exh. A-25. Exh. A-25, provided at the hearing, shows the Company's projected ERISA based minimum contributions to be as follows:

Actual 2010 Contribution	Projected 2011 Minimum Contribution	Projected 2012 Minimum Contribution	Projected 2013 Minimum Contribution	Projected 2014 Minimum Contribution
$ 2.062M	$ 2.591M	$ 2.794M	$ 2.147M	$ 2.034M

[220] RUCO Br. at 17.

[221] *Id.* at 14.

[222] *Id.* at 16, citing to Phase I Tr. at 919.

[223] RUCO Reply Br. at 8, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 82.

not have discretion to fund at levels below the minimum ERISA based amounts. [224] The Company objects to RUCO's recommendation to use of a FAS 87 based amount of pension expense, because for ratemaking purposes, the Company is ERISA based **[*101]** in its accounting for pension expense. [225] The Company states that it is not seeking to transition to FAS 87 accounting in this case, but that if the Commission wishes it to transition to FAS 87 as recommended by RUCO, then it would be necessary for the Commission to order the Company to use FAS 87, and to identify the specific FAS 87 amount for ratemaking purposes. [226] The Company explained that in the event it is ordered to transition from ERISA to FAS 87, the Company would request recovery of the accumulated difference between FAS 87 based and ERISA based accounting for pension expense that is on the Company's books, and that the amounts be amortized over a period of five years. [227] The Company's witness noted that because FAS 87 amounts have historically exceeded ERISA amounts, the Company has regulatory assets on its balance sheet in two accounts for the accumulated amounts by which FAS 87 has exceeded ERISA, and that the balances of the two accounts as of February 28, 2010 were $ 746,347 for Deferred Service Company Pension Cost and $ 1,050,173 for Deferred Pension Cost for Arizona-American employees. [228]

[*102]

RUCO is opposed to amortization of the regulatory assets that would result from a transition from ERISA based pension expense recognition to FAS 87 based pension expense recognition because the Company has not previously requested authority for such a deferral. [229]

Consistent with Staff's recommended treatment of pension expense in the Company's prior rate case, Staff proposes no adjustment to the Company's pension expense request. [230] In regard to RUCO's recommendation to use FAS 87 amounts, Staff expressed concern that a full record regarding the costs **[*103]** to transition from ERISA to FAS 87 has not been developed. [231]

The dramatic increase in pension expense experienced by the Company is a result of market forces outside the Company's control. While RUCO alleges in its Reply Brief that the Company designed its pension plan poorly, that the plan has been underfunded for years, and that it is tied to a market that has been subject to abnormal conditions over the past several years, [232] RUCO did not point to any evidence supporting the allegations regarding plan design or underfunding, and RUCO's witness testified that "the really poor market performance in 2008 . . . affected just about any kind of investment." [233] We do not disagree with RUCO that the Company's management has discretion in relation to ERISA pension funding. However, as the Company states, it does not have discretion to fund at levels below the minimum ERISA based amounts for which it is seeking recovery. As acknowledged by RUCO, the Company changed its **[*104]** plan from a defined-benefit plan to a defined-contribution plan beginning January 1, 2006, which RUCO's witness agreed is a reasonable way to provide retirement benefits. [234] The pension expense recovery requested by the Company in this proceeding is based on minimum funding required by law, and the record demonstrates that Company's qualified plan contributions are projected to annually rise above 2009 levels through the year 2013 before moving back to the current expense level in 2014. RUCO's recommendation that recovery of the Company's pension expenses be based on 2008 FAS 87 amounts, which are less than half of the known and measurable 2009 minimum ERISA amounts accepted by Staff, would lead to under-recovery of a known and measurable expense. The 2009 ERISA amounts are known and measurable actual expenses incurred by the Company, and based on the evidence presented, reflect a reasonable level of expenses.

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224 Phase I Tr. at 137-38; Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 10.

225 Co. Br. at 28, citing to Phase I Tr. at 139-40.

226 Co. Br. at 29, citing to Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 13.

227 Co. Br. at 29, citing to Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 14-15.

228 Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 12.

229 RUCO Br. at 18-20.

230 Staff Reply Br. at 4.

231 *Id.*

232 RUCO Reply Br. at 8.

233 Phase I Tr. at 973.

234 RUCO Br. at 16 citing to Phase I Tr. at 982.

[*105]

We find that the pension expense amounts proposed by the Company and accepted by Staff are known and measurable. Because they more accurately reflect the Company's actual operating expense on a going-forward basis than the amounts advocated by RUCO, they will be adopted.

2. Normalization of Other Post-Employment Benefit Expenses (All Districts)

As with pension expense, the Company proposes other post-employment benefit ("OPEB") expense based on known and measurable actual 2009 expense levels. The Company's witness testified that the larger than typical 22 percent pro forma increase to the test year level of employee benefits expense was driven by increased funding obligations due to the severe deterioration in financial markets. [235] As with pension expenses, the Company expects OPEB expenses to remain at a higher level in the future and believes that the adjustment to reflect actual 2009 OPEB expense for its employees and Service Company employees is appropriate. [236]

[*106]

Instead of the pro forma adjustments to recognize known and measurable increases in OPEB expenses, RUCO proposes adjustments normalizing the OPEB expense using an average of 2007-2008 expenses, for a reduction of $ 296,761 spread across the districts in this case. [237] RUCO states that it proposed the adjustments because the OPEB expense, like the Company's pension expense, has been affected by investment market conditions, though not as egregiously. [238] RUCO argues that ratepayers should not be responsible for unusually high expenses incurred outside of a test year which were the result of unprecedented market conditions. [239]

[*107]

Staff did not propose any similar adjustments.

The Company states that the same reasoning that supports the Company's pension expense figures also support recovery of the Company's increased cost for OPEB expense. [240]

RUCO's recommendation that recovery of the Company's OPEB expenses be normalized based on past years, which are known to be unrepresentative of demonstrated cost levels on a going-forward basis, would lead to under-recovery of a known and measurable expense. While it is lamentable that market conditions have led to the increased costs, the 2009 OPEB amounts are known and measurable actual expenses incurred by the Company, and based on the evidence presented, reflect a reasonable level of expenses.

We find that the OPEB amounts for direct employees and Service Company employees proposed by the Company and accepted by Staff are known and measurable. Because they more accurately [*108] reflect the Company's actual operating expense on a going-forward basis than the amounts advocated by RUCO, they will be adopted.

3. Annual Incentive Plan ("AIP") for Service Company Employees

The Company's request includes 70 percent of Arizona-American's Arizona Corporate allocated AIP management fees expenses paid to the Service Company for the districts in this proceeding.

RUCO proposes an adjustment that removes 100 percent of identifiable incentive compensation expense included in

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235 Direct Testimony of Company witness Sheryl Hubbard (Exh. A-16) at 15.

236 *Id.*

237 RUCO Br. at 20-21, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 81-82; RUCO Br. at 24-26, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 95; RUCO Br. at 29, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 99 ($ 7,206 of RUCO's proposed adjustments are based on a three year average of 2006-2008 expenses).

238 RUCO Br. at 20-21, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 82.

239 RUCO Br. at 25.

240 Co. Br. at 30.

the management fees the Company paid to the Service Company during the test year. [241] Mr. Hansen believes that management fees bear far greater scrutiny; and believes incentive bonuses should be disallowed; and that the Commission should also review its policy on pensions. [242] RUCO's proposed adjustment would remove a total of $ 265,853 in test year operating expenses, spread across the districts in this case. [243] RUCO states that its recommendation differs from the 30 percent disallowance for AIP compensation approved by the Commission in Decision No. 71410 last year and Decision No. 68858 (July 28, 2006). RUCO supported the 30 percent disallowance in the prior cases. [244] RUCO now argues that **[*109]** its 100 percent proposed Service Company disallowance in this case is appropriate because the award to the Service Company employees is dependent upon American Water operating income and corporate financial targets. [245] RUCO's witness testified that in the prior cases disallowing 30 percent, there was no distinction made between AIP expense for Arizona-American's employees and the AIP expense charged to Arizona-American by the Service Company for its employees. [246] RUCO argues that "Arizona ratepayers should not have to pay for incentive compensation that is tied to American Water Works corporate or non-jurisdictional and non-regulated income or on non-Arizona jurisdictional operations or non-regulated operations-based financial achievements." [247]

[*110]

Staff did not make any adjustment.

The Company opposes RUCO's proposal to completely disallow AIP for Service Company employees. The Company argues that the Commission should not treat AIP costs for Service Company employees differently simply because these employees are employed by a different entity. [248] The Company states that as with AIP for direct employees, AIP is an important part of compensation for Service Company employees, which include many members of the Arizona-American team. [249] The Company points out that through its relationship with the Service Company, Arizona-American is able to take advantage of expertise and economies of scale. [250]

Arizona-American is supported not only by its own direct employees, but also by employees of the Service Company. [251] The evidence **[*111]** presented does not support a deviation from past practice to disallow 30 percent of all Arizona-American's AIP compensation expenses, including the Service Company employee-related AIP costs. In past cases, we have adopted a 30 percent disallowance of AIP costs in order to account for the portion of AIP based on the Company's financial performance. We declined to disallow any of the remaining AIP expenses because they are closely tied to salary expense. [252] We find that the 30 percent disallowance of all AIP costs continues to provide an appropriate balance between ratepayers and shareholders, and it will again be adopted in this case.

4. Management Fees Labor Expense (All Districts)

RUCO proposes an adjustment reducing Arizona-American's requested labor expense across the districts by $ 89,678, which represents a 4 percent March 2009 pay increase for Service Company employees. [253]

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241 RUCO Br. at 26.

242 Hansen Br. at 3.

243 RUCO Br. at 28, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 96.

244 RUCO Reply Br. at 10.

245 RUCO Br. at 28 and RUCO Reply Br. at 10-11, both citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10)at 96.

246 Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 96.

247 RUCO Br. at 28.

248 Co. Reply Br. at 18.

249 Rebuttal Testimony of Company witness Paul Townsley (Exh. A-4) at 7.

250 *Id.* at 8.

251 *Id.*

252 Decision No. 68858 at 20-21.

253 Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 92.

[*112]

The Company opposes RUCO's adjustment, stating that its requested expense allowance is based on a known and measurable increase like that accepted by RUCO and adopted by the Commission in the Company's prior rate cases and accepted by Staff in this case. [254]

Arizona-American is supported not only by its own direct employees, but also by employees of the Service Company. [255] We find that the salary expense proposed by the Company and accepted by Staff is based on actual known and measurable incurred expense. Because it more accurately reflects the Company's actual operating expense on a going-forward basis than the amount advocated by RUCO, it will be adopted.

[*113]

5. Rate Case Expense

The parties' proposed allowances for rate case expense, normalized over three years, are as follows, by district:

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Company	$ 51,989	$ 69,395	$ 68,439	$ 40,277	$ 34,388
Staff	$ 51,989	$ 69,395	$ 68,439	$ 40,277	$ 34,388
RUCO	$ 37,486	$ 50,982	$ 49,260	$ 29,110	$ 24,840

In calculating its rate case expense, the Company initially included an "estimated unrecovered portion of Commission -Approved rate case expenses from the last rate case" from its prior Anthem Water district and Anthem/Agua Fria Wastewater district rate cases. [256] As Staff stated in its direct testimony, the Commission has adopted Staff's recommendations in prior proceedings that rate case expense be normalized instead of amortized. [257] While amortized expenses are permanent accounts that carry over from prior years, normalized expenses are operating income accounts which are closed out each year and are not eligible for consideration in future rate cases. [258] As RUCO points out, Decision No. 69440 (May 1, 2007) did not allow the Company's similar [*114] request, because it contravened the ratemaking convention of setting rates at a normal recurring level of expenses. [259] The Company has subsequently removed those amounts from its proposed allowance for rate case expense. [260]

RUCO recommends that the Company's allowed rate case expense recovery in this case be limited to an amount similar to that allowed in Decision No. 71410, the Company's previous rate case. [261] RUCO argues that the costs sought by the Company are unreasonable and not supported by the record. [262] RUCO asserts that the Company should not be compensated for the actual costs incurred to send out the consolidation [*115] notice ordered prior to Phase II of the hearing, because the Company could have reduced the mailing expense by including the notice as a bill insert. [263] RUCO also alleges a "concern of double counting raised by charging for Company and affiliate la-

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254 Co. Reply Br. at 18, citing to Phase I Tr. at 654 and Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 92.

255 Rebuttal Testimony of Company witness Paul Townsley (Exh. A-4) at 8.

256 Direct Testimony of Company witness Miles Kiger (Exh. A-13) at 10.

257 Direct Testimony of Staff witness Gerald Becker (Exh. S-9) at 20-21.

258 *See* Direct Testimony of Staff witness Gerald Becker (Exh. S-9) at 20-21.

259 Direct Testimony of RUCO witness Ralph Smith (Exh. R-9) at 36-37.

260 Rebuttal Testimony of Company witness Miles Kiger (Exh. A-14) at 17.

261 Direct Testimony of RUCO witness Ralph Smith (Exh. R-9) at 37; Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 46-47.

262 RUCO Br. at 12.

263 *Id.* at 12-13.

bor cost in rate case expense." [264]

Other than the removal of the "unrecovered costs," accepted by the Company, Staff proposed no further adjustments to the Company's proposed rate case expense. [265]

The Company states that the direct accounting method the Company uses for Service **[*116]** Company labor is efficient and eliminates the possibility of double counting, [266] and points out that the separate mailing of additional notice regarding rate consolidation was ordered by the Commission. [267]

The hearing in this proceeding was extraordinary, with numerous parties, numerous witnesses and many issues. It required a great deal more time and expense than the prior case to which RUCO compares it. The normalized amount of rate case expense proposed by the Company and agreed to by Staff is reasonable, supported by the record, and will be allowed.

6. Non-Account Chemical Expense and Fuel and Power Expense Adjustment (Sun City Water)

In Decision No. 70351 (May 16, 2008), the most recent rate Decision for the Sun City Water district, the Commission ordered the Company to institute water loss reporting and to devise a water loss reduction **[*117]** plan if the Sun City Water district's water loss was greater than 10 percent at any time before its next rate case. Decision No. 70351 was based on a 2006 test year.

In this proceeding, Staff found that the Sun City Water district had water loss of 11.1 percent in the test year. [268] Staff recommends that the Company be required to reduce water loss in the Sun City Water district in PWS No. 07-099 to below 10 percent by December 31, 2010 or before it files its next rate case, CC&N, or financing application, whichever comes first. Staff further recommends that the Company continue tracking the water loss for PWS No. 07-099 for three years and submit the data collected every six months, with the first water loss tracking report for PWS No. 07-099 to be filed as a compliance item in this docket within 180 days of this Order.

Because water loss for the Sun City Water district exceeded 10 percent during the test year, Staff believes **[*118]** that the cost of purchased power and fuel and chemicals used to pump and treat water above the acceptable water loss threshold of 10 percent does not provide a benefit to ratepayers. [269] Staff recommends that these costs therefore be disallowed, and proposed an adjustment decreasing fuel and power expense by $ 19,511, and chemicals expense by $ 367. [270]

The Company does not object to the water loss tracking requirements recommended by Staff, but opposes Staff's recommended expense disallowance. [271] The Company argues that Staff's recommendation for the reduction to operating expenses fails to recognize the efforts Arizona-American has undertaken to reduce water loss in all its districts. [272] The Company states that at the time of the hearing, the Company had reduced water loss in the Sun City Water district to 8.31 percent, [273] and that it has complied with the requirements of Decision No. 70351. [274] The Company **[*119]** argues that due to its efforts, it should not be penalized by an expense disallowance. [275]

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[264] *Id.* at 13, citing to Surrebuttal Testimony of RUCO witness Ralph Smith (Exh. R-10) at 44.

[265] Staff Reply Br. at 4.

[266] Co. Reply Br. at 17, citing to Phase I Tr. at 142.

[267] Co. Reply Br. at 17, citing to page 10 of the Procedural Order issued in this docket on March 18, 2010.

[268] Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at Exhibit DMH-2, pp. 8-9.

[269] Staff Br. at 6-7.

[270] Direct Testimony of Staff witness Gerald Becker (Exh. S-9) at 31-32.

[271] Co. Br. at 17; Co. Reply Br. at 7.

[272] Co. Br. at 16; Co. Reply Br. at 6.

[273] Co. Reply Br. at 6, citing to Direct Testimony of Company witness Bradley Cole (Exh. A-23) at 17, Exh. A-26, and Phase I Tr. at 556.

[274] Co. Reply Br. at 7-8.

[275] *Id.* at 7.

There is no dispute that the Company has undertaken measures to reduce water loss since the issuance of Decision No. 70351 in 2008. However, the 11.1 percent water loss existed during the 2008 test year, and the water loss problem had been ongoing since the prior test year of 2006, during which the Sun City Water district was already experiencing a water loss of 10 percent. By 2008, the test year for this case, instead of correcting the district's water loss, the Company had allowed it to increase to 11.1 percent. We agree with Staff that the Sun City Water district's customers should not be burdened with fuel and power and chemical expenses **[*120]** to treat the excess lost water over 10 percent. Staff's reporting requirements and expense disallowance recommendations are reasonable and will be adopted.

7. Bad Debt Expense

The Company and Staff agreed that bad debt expense should be normalized based on the Company's three year experience. [276] However, Staff disagrees with the Company's calculation of bad debt expense, and recommends that its calculation of allowable expense be adopted instead. [277] Staff asserts that the Company calculated the bad debt expense based on net write-offs without giving consideration to the accrued provision. [278] Staff argues that the Company's proposed methodology for computing bad debt expense departs from the two established methodologies for treating uncollectible accounts: (1) the direct charge-off method under which uncollectibles and any associated, subsequent recoveries are recorded directly, or "charged off" to bad debt expense; and (2) the allowance method by which a company systematically records expense to bad debt expense with an offset to an allowance for doubtful accounts, and by which, unlike the charge-off method, the charge offs and any subsequent recoveries are then made to **[*121]** the allowance for doubtful accounts account, rather than to the bad debt expense account. [279] According to Staff, the Company used a kind of hybrid method in this case whereby its charge-offs, as well as its systematic provision for bad debts, were both reflected in the bad debt expense account. [280]

The Company did not brief the issue. Staff's recommended bad debt expense amounts, which correct the Company's erroneous calculations, are reasonable and will be adopted.

8. Tank Maintenance Expense (Sun City Water)

The Company requested approval to establish a tank maintenance reserve account to address ongoing tank maintenance requirements in its Sun City Water district. [281] In 2009, the Company commissioned a consultant to examine the condition of the tanks in the Sun City Water district and provide a recommendation for maintenance. [282] Based on the recommendation, the Company plans to commence a tank **[*122]** maintenance program for all the tanks in this district over the next fourteen years, beginning with those most in need of maintenance. [283]

Staff recommends that instead of establishment of a tank maintenance reserve account, the Company be authorized to include the known and measurable costs associated with tank maintenance as a normalized expense, in the amount of $ 362,000. [284] Staff's witness testified that Staff supports the Company's planned program of regular tank maintenance because of the long term benefits that accrue to ratepayers by reducing long term capital costs. [285] The Company is in agreement with Staff's recommendation. [286]

[*123]

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276 Staff Br. at 5.

277 *Id.* at 5.

278 *Id.* at 6.

279 *Id.*

280 *Id.*

281 Direct Testimony of Company witness Bradley Cole (Exh. A-23) at 16.

282 *Id.* at 15; Exh. A-35.

283 Direct Testimony of Company witness Bradley Cole (Exh. A-23) at 16.

284 Staff Br. at 6, citing to Phase I Tr. at 815, 962-963.

285 Phase I Tr. at 815.

286 Co. Reply Br. at 16.

RUCO opposes the establishment of a tank maintenance expense reserve fund, but did not object to the normalization adjustment proposed by Staff. [287]

We agree with RUCO and Staff that establishment of a tank maintenance expense reserve fund for the Sun City Water district is not appropriate at this time and will not authorize such an account. However the Company has demonstrated that it will begin, in the Sun City Water district, a program with demonstrated known and measurable ongoing expense amounts that are reasonable and will provide long term system benefits. Staff's recommendation for normalized tank maintenance expense is based on those demonstrated known and measurable ongoing expense amounts. The normalized expense amount recommended by Staff is reasonable and will be adopted for purposes of this proceeding.

9. Tank Maintenance Deferral Account (Anthem Water)

The Company also requests authority to establish a deferral account to allow it to defer tank maintenance **[*124]** expenses for the Anthem Water district until the next rate case for the district, at which time the Company may seek recovery of the deferred amounts. [288] RUCO does not oppose the establishment of such a deferral account, as the Company already has such an account in place for the Sun City Water district. [289] We agree with the Company that establishment of such an account is appropriate, and find that it is reasonable and in the public interest to authorize the Company to establish a deferral account to allow it to defer tank maintenance expenses for the Anthem Water district until the next rate case for the district, at which time the Company may present evidence in support of recovery of the deferred expense amounts for consideration.

D. Operating Income Summary

	Anthem Water	Sun City Water	Anthem/ Agua Fria Wastewater	Sun City Wastewater	Sun City West Wastewater
Adjusted Test Year Revenues	$ 7,492,744	$ 9,283,101	$ 8,637,123	$ 5,940,381	$ 5,661,710
Adjusted Test Year Operating Expenses	$ 6,946,809	$ 8,376,956	$ 8,426,722	$ 5,888,749	$ 5,257,191
Adjusted Test Year Operating Income	$ 545,935	$ 906,145	$ 210,401	$ 51,632	$ 404,519

[*125]

V. COST OF CAPITAL

The final rate of return recommendations are as follows:

	Cost of Debt	Cost of Equity	Capital Structure Equity/Debt	Weighted Average Cost of Capital
Company	4.91%	10.70%	38.86% / 61.14%	7.20%
RUCO	5.02% *	9.50%	39.15% / 60.85%*	6.77%
Council				6.37% **
Staff	4.91%	10.70%	38.86% / 61.14%	7.20%
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[287] RUCO Br. at 21-22; RUCO Reply Br. at 9.

[288] Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 10.

[289] RUCO Reply Br. at 10.

	Cost of Debt	Cost of Equity	Capital Structure Equity/Debt	Weighted Average Cost of Capital
term and short-term debt combined.				
** The Council did not perform a cost of capital analysis.				
The Council originally based its rate of return recommen-dation				
of 6.77 percent on that recom-mended by RUCO. [290] However, in				
its Reply Brief, the Council states a belief that a 6.37				
percent rate of return is reasonable and appropri-ate. [291]				

A. Capital Structure

The Company's application proposed a capital structure of 45.15 percent equity and 58.85 percent debt, excluding short -term debt. [292] However, in order to limit the number of issues in this case, the Company agreed in its **[*126]** re-buttal testimony to accept Staff's cost of capital recommendations. [293] RUCO recommends a capital structure of ap-proximately 13.29 percent short-term debt, 47.56 percent long-term debt and 39.15 percent equity. [294] Staff recommends a capital structure of 38.86 percent equity and 61.14 percent debt, which includes short-term debt. [295]

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[290] Council Br. at 14.

[291] *Id.* at 15-[ILLEGIBLE TEXT].

[292] Direct Testimony of Company witness Thomas Broderick (Exh. A-6) at 8-10.

[293] Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 4; Phase I Tr. at 490.

[294] Surrebuttal Testimony of RUCO witness William Rigsby (Exh. R-4) at 3.

[295] Direct Testimony of Staff witness Juan Manrique (Exh. S-3) at 10.

There is very little difference between the capital structures recommended by RUCO and Staff's witnesses. [296] For purposes of this proceeding, we adopt a capital structure for the Company consisting of 38.86 percent equity and 61.14 percent debt, which includes short-term debt.

[*127]

B. Cost of Debt

The Company's application stated a cost of debt of 5.468 percent. [297] The Company agreed to accept Staff's recommended cost of debt of 4.91 percent. [298] RUCO recommends a cost of short-term debt of 3.41 percent, and a cost of long-term debt of 5.47 percent. [299] RUCO's witness notes that RUCO's recommended combined long-term and short -term debt cost of debt would be 5.02 percent, and would produce the same WACC as that produced by the separated debt costs. [300]

A 4.91 percent cost of debt is reasonable and will be adopted for purposes of this rate case.

C. Cost of Equity

Unlike the cost of debt, which is based on actual costs, Arizona-American's **[*128]** cost of equity must be estimated. The Company, RUCO and Staff each presented a witness who testified as to the analysis used to reach their estimated cost of equity recommendations. Each witness used data from selected sample groups of publicly traded companies in order to perform the estimates.

The Company contends that the cost of equity analysis of its witness, which included two versions of the Discounted Cash Flow ("DCF") model, three versions of the Capital Asset Pricing model ("CAPM"), and an after-tax weighted average cost of capital ("ATWACC") analysis, supports a 12.25 percent cost of equity. [301] However, in order to limit the number of issues in this case, the Company agreed in its rebuttal testimony to accept Staff's cost of capital recommendations, [302] and proposes a cost of equity of 10.7 percent. [303]

[*129]

The analysis of Staff's witness included use of two DCF models and a CAPM. Staff's average DCF and CAPM results produce a 9.9 percent cost of equity capital, which after Staff's 80 basis point risk adjustment, produces Staff's recommendation of 10.7 percent as the Company's estimated cost of equity. [304]

RUCO's witness also used a DCF and CAPM analysis, and based on the results, RUCO recommends a cost of equity of 9.50 percent. [305]

The Company contends that Staff's analysis supports a cost of equity of 10.7 percent. [306] The Company points out that Staff's resulting weighted average cost of capital of 7.2 percent is lower than the 7.33 percent approved for the Company in Decision No. 71410, the Company's most recent rate Decision, but that the recommendation **[*130]** recog-

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296 Surrebuttal Testimony of RUCO witness William Rigsby (Exh. R-4) at 3.

297 Direct Testimony of Company witness Thomas Broderick (Exh. A-6) at 8-10.

298 Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 15-16; Direct Testimony of Staff witness Juan Manrique (Exh. S-3) at Schedule JCM-1.

299 Surrebuttal Testimony of RUCO witness William Rigsby (Exh. R-4) at 4.

300 *Id.* at 5.

301 Co. Br. at 36, citing to Direct Testimony of Company witness Bente Villadsen (Exh. A-20) at 36-37, Appendix B and 65-69.

302 Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 4; Phase I Tr. at 490.

303 Co Br. at 35.

304 Schedule JCM-3.

305 Surrebuttal Testimony of RUCO witness William Rigsby (Exh. R-4) at 5.

306 Co. Br. at 39.

nizes the level of risk in the Company's capital structure, and is within the range of returns allowed by other jurisdictions and within the range of what credit rating agencies consider appropriate for a utility such as Arizona-American. [307]

The Company is critical of RUCO's cost of equity analysis and asserts that its resulting 6.7 percent weighted average cost of capital is unreasonable, lacks support, and should not be adopted. [308] The Company argues that RUCO's recommendation fails to recognize the impact of the current financial crisis on the cost of equity and the need to attract necessary investment. [309]

RUCO objects to the Company's claim that RUCO's cost of equity recommendation lacks support. [310] RUCO contends that its recommendation recognizes **[*131]** the impact of the current financial crisis on the cost of capital, because the risk associated with regulated utilities is lower than their non-regulated counterparts. [311] RUCO states that while the parties can argue over what is reasonable, it can hardly be argued that RUCO's recommendation lacks support, as RUCO performed the same type of cost of capital analysis as Staff, and the Company has accepted Staff's recommendation. [312] RUCO states that neither RUCO nor Staff's cost of capital recommendation lacks support based on the evidence in the record. [313]

The Company's witness testified that the facts that financial markets are in turmoil and that stock market volatility has increased dramatically mean that equity investors face increased uncertainty, which leads them to seek lower risk investments or to demand a higher expected rate of return before they are willing to invest their money, and in part, this **[*132]** is an explanation of why market prices have fallen. [314] While RUCO argues that the lower risk of regulated utilities is attractive to investors in a bad economic climate, and that the Company's parent relies on low cost debt financing to fund its capital improvements, [315] neither argument addresses the undisputed fact that Arizona-American faces more risk than many comparable companies because it has more debt in its capital structure.

Article 15, Section 3 of the Arizona Constitution provides in relevant part that the Commission "shall have full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein." In determining just and reasonable rates, the Commission has broad discretion subject to the obligation to ascertain the fair value of the **[*133]** utility's property, and establishing rates that "meet the overall operating costs of the utility and produce a reasonable rate of return." [316] Under the Arizona Constitution, a utility company is entitled to a fair rate of return on the fair value of its properties, "no more and no less." [317] The oft cited *Hope, Bluefield, and Duquesne* cases [318] provide that the return determined by the Commission must be equal to an investment with similar risks made at generally the same time, and should be sufficient under efficient management to enable the Company to maintain its credit standing and raise funds needed for the proper discharge of its duties.

[*134]

As RUCO points out, the lower risk of regulated utilities is attractive to investors in a bad economic climate, and the Company's parent relies on low cost debt financing to fund its capital improvements. Given the current eco-

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307 *Id.*

308 *Id.* at 36.

309 *Id.* at 37.

310 RUCO Reply Br. at 18.

311 *Id.* at 19.

312 *Id.* at 18-19.

313 *Id.* at 19.

314 Rebuttal Testimony of Company witness Bente Villadsen (Exh. A-21) at 4.

315 RUCO Reply Br. at 19.

316 Scates, et al. v. Arizona Corp. Comm'n, 11 8 Ariz. 53 1, 534, 578 P.2d 612 (Ct. App. 1978).

317 Litchfield Park Service Co. v. Arizona Corp. Comm'n, 78 Ariz. 431, 434, 874 P.2d 988 (Ct. App. 1994),*citing* Arizona Corp. Comm'n v. Citizens Utilities Co., 120 Ariz. 184 (Ct. App. 1978).

318 Federal Power Commission et al. v. Hope Natural Gas Co., 320 U.S. 591 (1944);Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, et al., 262 U.S. 679 (1923);Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).

nomic climate, we find that Staff's financial risk adjustment is not appropriate in this case. We find that of the proposed cost of equity estimates, RUCO's is the more reasonable. Applying the 9.50 percent cost of equity and 4.91 percent cost of debt to the capital structure adopted herein results in an overall weighted cost of capital for Arizona-American of 6.70 percent.

Even if we were to agree with the Company's arguments about RUCO's recommended return on equity, we would nonetheless adopt it, as we believe that a reduced return on equity is justified under the facts of this case. Our decision in this matter gives rate base treatment to the Anthem plant associated with the balloon payments to Pulte. We recognize the heavy burden that this result will place upon Anthem ratepayers. In our view, the Anthem ratepayers appear to have been caught between a developer that failed to fully inform them of the relevant facts and a water company that failed to keep **[*135]** their best interests at heart.

Unfortunately, we cannot address these issues by taking any action against the developer. Much as we might want to craft a remedy that is comprehensive and directed to all the responsible actors, we do not have jurisdiction over the developer, nor do we have the comprehensive authority of a court of general jurisdiction.

Earlier in this decision we referred to the Federal District Court case that was initiated by certain Anthem ratepayers against Pulte, among others. In a recent order, the United States District Court for the District of Arizona granted summary judgment to the plaintiffs, concluding that Pulte had failed to disclose to prospective homebuyers the costs of the infrastructure for which they would ultimately be responsible. The Court specifically stated, "the issue is not whether a developer has a duty to predict future utility rates, but whether Pulte was required to disclose the "estimated costs related to the improvements [and facilities] that will be borne by purchasers." [319] This would appear to be a positive outcome for these plaintiffs, and we note that the case is currently on appeal before the 9th Circuit.

[*136]

Because Arizona-American is not a party to the Federal District Court ruling, the Commission is unable to take direct action herein related to the litigation. That does not mean that we cannot take appropriate regulatory action against Arizona-American. While the Company's actions related to the infrastructure agreement may not justify a plant disallowance, we think that the Company nonetheless failed to adequately consider the risks that the infrastructure agreement posed for its ratepayers. The Company appears to have made concessions to the developer in an effort to win the project. [320] The result is an infrastructure agreement that is significantly different from standard agreements; furthermore, these differences tend to place the risk of accelerated build-out and accelerated payments entirely upon the ratepayers. The anticipated build-out schedule - and the corresponding balloon payments - were anticipated to occur over a much longer time period. Actual build-out occurred much more quickly. As a result, the Company has sought rate base treatment for the plant associated with those balloon payments much sooner than expected and over a shorter time period. Although we have not **[*137]** disallowed the plant, we recognize what we believe is unreasonable risk -shifting to the ratepayers. We believe the infrastructure agreement and its corresponding balloon payments are an unreasonable risk shifting to the ratepayers, and we believe that this serves as an alternative justification for a lower cost of equity in this case.

D. Cost of Capital Summary			
	Percentage	Cost	Weighted Cost
Short-Term and Long-Term Debt	61.1%	4.91%	3.0%
Common Equity	38.9%	9.50%	3.7%
Weighted Average Cost of Capital			6.7%

VI. REVENUE REQUIREMENT

Based on the discussion herein, revenue increases for each of the districts are authorized as follows:

Anthem Water

Based on our findings herein, we determine that the Anthem Water district's gross revenue should increase by $ 5,453,750, or 72.79 percent.

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[319] Grimmelmann v. Pulte Home Corporation, 2010 U.S. Dist. LEXIS 89695, Pg 7 13-15.

[320] *See* Ex. S-1 at 2.

Fair Value Rate Base	$ 57,249,836
Adjusted Operating Income	545,935
Required Fair Value Rate of Return	6.70%
Required Operating Income	3,835,739
Operating Income Deficiency	3,289,804
Gross Revenue Conversion Factor	1.6578
Gross Revenue Increase	$ 5,453,750

[*138]
Sun City Water

Based on our findings herein, we determine that the Sun City Water district's gross revenue should increase by $ 1,611,522, or 17.36 percent.

Fair Value Rate Base	$ 28,188,865
Adjusted Operating Income	906,145
Required Fair Value Rate of Return	6.70%
Required Operating Income	1,888,654
Operating Income Deficiency	982,509
Gross Revenue Conversion Factor	1.6402
Gross Revenue Increase	$ 1,611,522

Anthem/Agua Fria Wastewater

Based on our findings herein, we determine that the Anthem/Agua Fria Wastewater district's gross revenue should increase by $ 4,657,770, or 53.93 percent.

Fair Value Rate Base	$ 45,116,927
Adjusted Operating Income	210,401
Required Fair Value Rate of Return	6.70%
Required Operating Income	3,022,834
Operating Income Deficiency	2,812,433
Gross Revenue Conversion Factor	1.6561
Gross Revenue Increase	$ 4,657,770

Sun City Wastewater

Based on our findings herein, we determine that the Sun City Wastewater district's gross revenue should increase by $ 1,621,157, or 27.29 percent.

Fair Value Rate Base	$ 15,489,977
Adjusted Operating Income	51,632
Required Fair Value Rate of Return	6.70%
Required Operating Income	1,037,828
Operating Income Deficiency	986,197
Gross Revenue Conversion Factor	1.6438
Gross Revenue Increase	$ 1,621,157

[*139]
Sun City West Wastewater

Based on our findings herein, we determine that the Sun City West Wastewater district's gross revenue should increase by $ 1,326,805, or 23.43 percent.

Fair Value Rate Base	$ 18,096,538
Adjusted Operating Income	404,519
Required Fair Value Rate of Return	6.70%
Required Operating Income	1,212,468

Operating Income Deficiency	807,949
Gross Revenue Conversion Factor	1.6422
Gross Revenue Increase	$ 1,326,805

VII. RATE DESIGN

A. Consolidation

1. Company

Arizona-American states that this proceeding has made clear that for various reasons, the benefits of consolidation are championed by certain parties, and not accepted by other parties. [321] The Company states that while it will never be possible to convince all parties that consolidation is beneficial, this proceeding is the best opportunity to do so, [322] and that ample evidence exists in the record to support its implementation. [323] The Company states that if the Commission determines that it is appropriate to implement rate consolidation in this proceeding, it will use its best efforts to ensure that consolidation is implemented effectively in the manner ordered by the **[*140]** Commission. [324]

The Company believes that if consolidation is ordered in this proceeding, the best method to achieve the full benefits of consolidation is a Company-wide consolidation. [325] Arizona-American's final rate design schedules include both stand-alone rates and the Company's Preferred Consolidation Scenario One (Company Consolidation Model Version 4). For comparison purposes, the Company provided, as part of its final rate design schedules, the consolidation scenarios requested at the hearing by Chairman Mayes, which set forth consolidation if Sun City is excluded and if both Sun City and Sun City West are excluded. [326]

The Company lists important features of its Preferred **[*141]** Consolidation Scenario One (Company Consolidation Model Version 4) as follows:

. it includes all of the Company's water and wastewater districts;

. it is proposed to occur in up to five "revenue neutral" steps;

. the residential 1-inch meter water monthly minimum charge is reduced to 1.25 times the 5/8 and 3/4-inch meters charge;

. the consolidated non-potable water tariff is $ 1.24 per 1,000 gallons in all steps; and

. beginning in Step 1, there are five residential rate tiers for all meter sizes, and three commercial rate tiers for meter sizes two inches and smaller, and two commercial rate tiers for larger commercial meters.

2. Council

The Council believes that rate consolidation is a long-term solution that, over the long haul benefits all customers. The Council recommends that in order to achieve the maximum benefits of consolidation, all of Arizona-American's water and wastewater districts be consolidated through a five step implementation plan. [327] The Council supports the Company's Preferred Consolidation Scenario One (Company Consolidation Model Version 4). [328]

[*142]

The Council cites as benefits of rate consolidation the following:

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321 Co. Br. at 45.

322 *Id.*

323 Co. Reply Br. at 26.

324 Co. Br. at 45.

325 n325 *Id* at 46; Co. Reply Br. at 26.

326 Co. Reply Br. at 46.

327 Council Br. at 15; Council Reply Br. at 16.

328 *Id.*

. lower administrative costs through unified customer accounting and billing systems;

. reduction in the number of rate cases and associated expenses;

. elimination of distorted cost allocations among districts in rate filings;

. implementation of standard customer service policies and related service rates and charges;

. improved rate stability and elimination of rate shock;

. reduced customer confusion with respect to the Company's currently differing rate schedules;

. development and implementation of a targeted and comprehensive water conservation program for all of its systems; and

. improved opportunities for future acquisitions, especially of troubled water systems. [329]

The Council states that the benefits of consolidation are particularly true for older and smaller districts that may experience disproportionately **[*143]** higher rates without consolidation, pointing to the Company's testimony that customers residing in Sun City, despite their current opposition to consolidation, are likely to be the greatest beneficiaries of consolidation due to the aging infrastructure in the Sun City Water district. [330] The Council states that the five residential tiers in the commodity rate component allow the Company to address the variation in customer use patterns across the various districts, and that that the five-step consolidation plan proposed by the Company will allow for a smoother transition and will reduce "rate shock" for customers in those districts whose rates will increase more than they would without consolidation. [331]

In the event that Company-wide consolidation is not instituted in this proceeding, the Council prefers the current rate structure for the Anthem districts. [332] The Council asserts that partial consolidation is not consistent **[*144]** with the purposes of consolidation, and would not provide any meaningful improvement for Anthem residents over the current stand-alone rate design. [333]

3. Paradise Valley

Paradise Valley states that now is not the opportune time to implement rate consolidation for the Company's districts. [334] Paradise Valley contends consolidation should be more thoroughly analyzed in a future case, with more detailed information identified from the outset of the process. [335]

Paradise Valley believes that consolidation should not be implemented in this case due to lack of clarity and inadequate direction in Decision **[*145]** No. 71410 as to how the consideration of consolidation should be accomplished, and due to the lack of meaningful "Town Halls" conducted prior to the hearing, or other education of the affected customer base. [336] Due to the numerous factors presented in this case, Paradise Valley contends it is nearly impossible for any customer to predict how consolidation would affect that customer, what factors would be considered in the final analysis, and which scenario might be selected by the Commission. [337] Further, Paradise Valley contends that the lack of a defined consolidation scenario has made the probability of having a meaningful Town Hall discussion on rate consolidation minimal. [338] Paradise Valley would prefer that the Commission identify a rate consolidation proposal which would provide a basis for customers to use their individual consumption data to ana-

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329 Council Br. at 16.

330 Council Reply Br. at 16, citing to Phase II Tr. at 347-52.

331 Council Br. at 17.

332 *Id.* at 18.

333 *Id.* at 15.

334 Paradise Valley Br. at 4.

335 *Id.* at 8, 14. Paradise Valley noted that only five residents attended the Town Hall the Company conducted in Paradise Valley on July 12, 2010 at 5:30 p.m.

336 Paradise Valley Br. at 14.

337 *Id.* at 6.

338 *Id.* at 9.

lyze how that proposal would impact them, prior to Town Hall meetings. [339]

[*146]

Aside from procedural issues, however, Paradise Valley argues that consolidation is not likely to result in any customer benefits, but only in a shifting of costs from one set of customers to others, and that consolidation may even lead to higher customer rates in general. [340] Paradise Valley's witness testified that the Town Council of Paradise Valley does not support the concept of rate consolidation, as it does not believe there is any purpose for consolidating the Paradise Valley Water district with other Arizona-American districts at this time, including assisting with funding needed system upgrades or needed capital improvements, which it believes can be made regardless of consolidation. [341] Paradise Valley argues that public policy goals such as water conservation can be better addressed in individual rate cases. [342] Paradise Valley contends that any comparison between the state-wide rates of APS and the rate consolidation of the Company's unique districts is flawed, because Arizona-American's districts have varying needs and requirements and have no centralized grid or physical interconnection between their geographically separate facilities. [343]

[*147]

Paradise Valley believes that the only business logic behind rate consolidation is simplicity for regulators, because the Company already treats its districts as if they are one in its cost allocations, such that the only savings would be bookkeeping costs. [344] Paradise Valley states that the centralization of the districts' rate bases could actually lead to overall customer rate increases as it would make it more difficult for customers to dissect the information discrete to their locality in order to voice their opinion, [345] and customers would be less likely to question costs when ratepayers from other districts are going to help pay them. [346] Conversely, Paradise Valley argues that if the "combined customer" does request a vigorous vetting of requested improvements in each district, consolidation could lead to the result of pitting customers of one district against those of another. **[*148]** [347]

4. Resorts

The Resorts state that under the Company's Preferred Consolidation Scenario One (Company Consolidation Model Version 4), consolidated rates would raise the revenue requirement on the Paradise Valley Water district by about 10 percent, but that the individual resorts' estimated rate increase would be 32 percent. [348] The Resorts claim that they would be unduly harmed by the increases in commodity charges. [349] The Resorts state that under the Company's Preferred Consolidation Scenario One (Company Consolidation Model Version 4), the commercial class in the Paradise Valley Water district bears a 31.5 percent increase, while the residential class bears 3.3 percent. [350] The Resorts contend that both the Company's and Staff's system-wide consolidation proposed rates for the Resorts will exceed the costs **[*149]** of providing service in the Paradise Valley Water district, [351] and object to both proposals because no cost of service study was done to determine whether the proposed rates achieve fairness in the apportionment of to-

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339 *Id.*

340 *Id.*

341 *Id.* at 10, citing to Direct Testimony of Paradise Valley witness James Bacon, Town Manager of Paradise Valley (Exh. PV-1) at 6 and Exhibit A.

342 Paradise Valley Br. at 10.

343 *Id.* at 11.

344 *Id.*

345 Direct Testimony of Paradise Valley witness James Bacon, Town Manager of Paradise Valley (Exh. PV-I) at 8.

346 Paradise Valley Br. at 12.

347 *Id.* at 12-13.

348 Resorts Br. at 2, citing to Direct Testimony of Resorts witness John Thornton (Exh. RES-1) at 2 and Resorts Final Schedules, Attachment 2.

349 Resorts Br. at 3.

350 *Id.*

351 *Id.* at 4, citing to Direct Testimony of Resorts witness John Thornton (Exh. RES-1) at 20.

tal costs of service among different consumers. [352] The Resorts contend that if rate consolidation is implemented, they should be excluded from consolidation or in the alternative, a "Resort Class" or commercial class of service should be established that recognizes their unique status, and the fact that there is no other customer class with which the Resorts can be combined. [353] The Resorts have therefore proposed modifications to the Company's Preferred Consolidation Scenario One (Company Consolidation Model Version 4) that would limit the rate impact of consolidation on the Resorts to 12 percent. [354]

[*150]

Staff states that it does not believe the Resorts have met their burden of proof with respect to exclusion from any consolidation proposal the Commission might adopt, or that the Resorts have shown that their specific proposal serves the public interest. [355] Staff contends that while at some point consideration of a special classification may be appropriate, the specifics associated with any special resort classification would require further review. [356]

The Company believes that the commercial tiers in its Preferred Consolidation Scenario One (Company Consolidation Model Version 4) should address the issues raised by the Resorts in relation to consolidation. [357]

[*151]

5. W.R. Hansen

Mr. Hansen is opposed to any rate consolidation proposal, and offers six reasons why consolidation should be rejected:

. centralization of production in concentrated plant facilities is not contemplated or plausible;

. cost savings of significant proportion are absent;

. there is no singular rate but a move toward a centralized average, resulting in a bonus for Anthem and Tubac at the expense of Sun City and Mohave in particular;

. the current range of rates is too wide and the ages of the infrastructure in the districts differs too widely;

. consolidation would encourage the Company to acquire poorly performing utilities and burden existing customers with their costs; and

. spreading the cost of service entails legal impediments. [358]

6. Larry Woods

Mr. Woods opposes the implementation of rate consolidation, which he states is technically not consolidation, but "rate leveling." [359] Mr. Woods asserts that sources of water, age of processing equipment, **[*152]** methods of purification, and distribution systems are locally unique and vary greatly from district to district, and therefore there cannot be a case made that all ratepayers should be charged the same rates for delivery of water to the faucet. [360] Mr. Woods believes that the idea of cost-sharing is different for a municipal utility than for a for-profit utility, whose

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352 *Id.*

353 Resorts Br. at 6, citing to Direct Testimony of Resorts witness John Thornton (Exh. RES-1) at 24.

354 *Id.*

355 Staff Reply Br. at 14.

356 *Id.*

357 Co. Br. at 46.

358 Hansen Br. at 1-3.

359 Woods Br. at 1-2.

360 *Id.* at 2.

goal is profit to the shareholder, in contrast to a municipal utility, whose focus is service. [361] Mr. Woods is of the opinion that situations such as that in the Tubac Water district, where a small group of residents is forced to incur exorbitant costs that are outside their control, should be addressed by government. [362] Mr. Woods also contends that if consolidation is approved, there will be increased acquisition activities by Arizona-American of small water systems in states of disrepair, funded by current ratepayers at no business risk to the Company. [363]

[*153]

Mr. Woods states that he cannot identify any significant savings that would be had through consolidation. [364] He states that since a consolidated rate request would affect all ratepayers in all districts, then potentially there could be intervenors from all districts in consolidated rate cases, and that the actual review of consolidated rate requests would result in more review and longer proceedings, as opposed to cost savings. [365]

7. Marshall Magruder

Mr. Magruder proposes the following:

. rate consolidation for all water and wastewater districts in five steps over a five year period;

. adoption of either Magruder consolidated rates or a modified version of the Company's scenario one;

. implementation of a new $ 500 fee for changing a water meter to a smaller size along with a safety certification recorded on the deed for such customers with fire sprinklers;

. cancellation of all low income programs with the exception of the Sun City Low Income Program **[*154]** proposed by the Company for condominium residents, and the institution of new similar programs for all multi-residential units served by the Company, along with a new low first residential tier at less than $ 1.00/thousand gallons for the first 3,000 gallons;

. rate structure design to provide lowest rates for lowest consumption users and increasingly higher rates for the highest consumption users to conserve water by sending price signals to residential and commercial customers;

. conservation incentive rate structure with five residential and four commercial inclined block tiers, so customers can more easily use less water and move to a lower usage tier more easily;

. consolidation of all "Fees and Miscellaneous Charges;"

. consolidation for the Company's "Rules and Regulations" in one document;

. that the Company be required to submit within 90 days with a water demand side management ("DSM") adjustment not to exceed 2 percent, at least five water DSM programs in several rate classes including residential, commercial and large hotels/resorts and golf courses that include specified performance measurement objective criteria and goals for all rate categories, including customer **[*155]** water audits;

. that the Company provide a water loss DSM program including incentives for decreased water loss and penalties for increased water loss over 10 percent;

. that the Company activate a Citizens Advisory Committee with at least one person per small (less than 5,000 customers) district and at least two for larger districts representing different rate classes, with at least semi-annual meetings; that the Company establish a regular "Town Hall" schedule; that the Company publish a multi-page newsletter as a way to receive customer feedback and review rules and regulations and inform the public of water DSM programs and of ongoing projects or Company changes that im-

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361 *Id.* at 5.

362 *Id.* at 5-6.

363 *Id.* at 4-6.

364 *Id.* at 6.

365 *Id.* at 3.

pact customers. [366]

8. RUCO

RUCO contends that rate consolidation would not be in the ratepayers' best interests in this case, and that due to legal impediments, the passionate divisiveness among ratepayers, and public policy constraints, rate consolidation should be rejected. **[*156]** [367] RUCO points out that on brief, the Company avoids stating a position on consolidation, but instead states that it "seeks the Commission's leadership" on the issue. [368] While the Company states that if consolidation is to be accomplished, now is the best opportunity, [369] RUCO disagrees. RUCO believes that now is a bad time to implement consolidation due to the recent rate increase for several of the Company's systems just last year, vehement ratepayer public comment in opposition, uninformed customers, and a bad economic environment. [370] RUCO contends that it cannot say when the best time would be to approve rate consolidation for Arizona-American, but believes that a better time than the present will be when there is one application before the Commission that includes all the districts based on a single test year, with a single revenue requirement, when the public has had adequate notice and all of the facts, and when there is more public support. [371]

[*157]

RUCO argues that it is impossible to consolidate rates without some initial subsidization of some districts by other districts, and that while ratepayers may be willing to pay a little bit more in the beginning, knowing the benefits will be returned to them in the future due to consolidation, there will be ratepayer resistance to consolidation if the initial cost shift is too great. [372]

RUCO contends that neither of the Company's (three-step or five-step) rate consolidation proposals resolve the following issues:

> . the legal infirmity of consolidated rates based on some districts' fair value rate base calculated on a 2007 test year and others based on a 2008 test year (RUCO argues that in order to consolidate rates based on two different test years, the rate bases and rates of **[*158]** return will have to be averaged or blended);
>
> . the violation of the Commission's rule that a utility's rates must be set based on a one-year historical test period;
>
> . the lack of conformity to the revenue neutrality requirement of Decision No. 71410 (RUCO argues that during the phase-in to consolidation proposed by the Company, the total revenue requirement is being constantly shifted among the districts, which RUCO argues does not comport with language in Decision No. 71410 requiring consideration of "a revenue neutral change to rate design"); [373]
>
> . failure to mitigate "rate shock" for Anthem ratepayers until completion of all the steps;
>
> . impairment of the Commission's goal of water conservation because consolidated commodity rates distort the actual cost to deliver safe and reliable water to customers; [374]
>
> . failure to include sufficient safeguards to preserve adequate detail and recordkeeping so that the Commission can properly monitor and inspect the books;

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366 Magruder Br. at 1-2; Marguder Reply Br. at 1, 9-10, 95.

367 RUCO Reply Br. at 23.

368 RUCO Reply Br. at 20; *see* Co. Br. at 45.

369 *See* Co. Br. at 45.

370 RUCO Br. at 60-61 and RUCO Reply Br. at 21, citing to Tr. at 1092-94.

371 RUCO Br. at 61.

372 RUCO Br. at 65-66, citing to Direct Rate Design/Rate Consolidation Testimony of RUCO witness Jodi Jerich (Exh. R-14) at 22.

373 *See* Decision No. 71410 at 78.

374 Direct Rate Design/Rate Consolidation Testimony of RUCO witness Jodi Jerich (Exh. R-14) at 14.

. increases in rates for ratepayers who recently received a rate increase in 2009 pursuant to Decision No. 71410; and

. failure to provide rate stability, because ratepayers in the Sun City, Paradise Valley **[*159]** and Mohave districts will be caught in a continuous cycle of rate increases, and because the Company will likely be back requesting more rate increases before all the steps toward full implementation of consolidation are completed, which RUCO believes will cause ill will for the Company and the Commission. [375]

RUCO is also opposed to partial consolidation scenarios. RUCO states that if the intent of separating the Sun City and Sun City West districts from consolidation is to shield retired ratepayers living on fixed incomes from subsidizing rates for others, the effort fails, because there are retirees living on fixed incomes, as well as low-income ratepayers, living in other Arizona-American districts as well. [376] RUCO also makes the point that keeping two of the largest systems out of a consolidated rate design only shifts more costs **[*160]** to ratepayers in other districts that also include retirees and low-income customers. [377]

The Company indicates that it does not believe RUCO's legal arguments create any impediment to consolidation. [378]

The Council states that it opposes RUCO's policy arguments against consolidation. [379] The Council also discounts RUCO's legal arguments against consolidation, and contends that the Commission has the authority and the discretion to consider the different test years, costs of equity and costs of debt to which RUCO refers, with the objective of determining whether the rates and charges under a given Company-wide rate consolidation proposal would result in just and reasonable rates and charges. [380] The Council states that it is not proposing to, and the Commission is not required to, **[*161]** "average" the fair value determinations of the two rate cases, and that the passage of time between the fair value determinations in Decision No. 71410 and this case is not such as to make unreasonable the Commission's consideration of all the fair value determinations. [381] As to the issue of revenue neutral consolidated rate designs, the Council states that as RUCO has noted, it is mathematically impossible to create a consolidated rate design whereby each water and wastewater district retains its individual revenue requirement, and that RUCO's interpretation that consolidation violates the language of Decision No. 71410 requiring "revenue neutrality" cannot be reconciled with the Commission's stated desire to explore consolidation. [382]

Staff states that the issues RUCO raised about the use of different test years and the interpretation of the directive that consolidated rates be "revenue neutral" could be addressed, **[*162]** to the extent they are valid, should the Commission desire to adopt a consolidated rate design proposal. [383]

9. Staff

Staff does not support consolidation of the rate design for all or some of the Company's districts at this time, and recommends that the Commission adopt Staff's stand-alone rate design. [384]

In compliance with Decision No. 71410, Staff put forward consolidation proposals. Staff presented three alternative consolidated rate design proposals, using the consolidation model provided by the Company, should the Commission decide that consolidation was appropriate in this case. [385] Staff presented three separate rate consolidation scenarios:

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375 RUCO Reply Br. at 22-23.

376 RUCO Br. at 65.

377 *Id.*

378 Co. Reply Br. at 26.

379 Council Reply Br. at 19-20.

380 *Id.* at 18.

381 *Id.*

382 *Id.* at 19.

383 Staff Reply Br. at 14.

384 Staff Br. at 16; Staff Reply Br. at 13.

385 Direct Testimony of Staff witness Jeffrey Michlik (Exh. S-15) at 21-23.

. Staff's Consolidation Scenario One is a total consolidation of all the Company's respective water and wastewater districts **[*163]** in Arizona. [386]

. Staff's Consolidation Scenario Two consolidates the following water districts: Agua Fria, Anthem, Tubac, Mohave, Havasu, and Paradise Valley as one consolidation, and Sun City and Sun City West as a separate consolidation. Scenario Two also consolidates the wastewater districts as follows: Sun City and Sun City West as one consolidation, and Anthem/Agua Fria and Mohave as a separate consolidation. [387]

. Staff's Consolidation Scenario Three consolidates only water districts as follows: Sun City and Sun City West together; Agua Fria, Anthem and Paradise Valley together; and Tubac, Mohave and Havasu together. [388]

Staff states that it has always been concerned by the fact that the Company did not propose a consolidated rate design in its direct case. **[*164]** [389] Staff states that the Company has the burden of proof, and the Company's failure to present a direct case in support of rate consolidation means that much of the information Staff believes is needed to do a cost/benefit analysis was not in the record. [390] Staff's witness Mr. Abinah identified the following factors that Staff believes should be considered:

. public health and safety;

. proximity and location;

. economies of scale/rate case expense;

. price shock/mitigation;

. public policy; and

. how other jurisdictions/municipalities are addressing the issue. [391]

Staff also expressed concern that although the Company took action late in the **[*165]** proceeding to hold additional Town Hall meetings throughout its service territory where such meetings had not previously been held, the Company had not complied with the Commission's directive to hold Town Hall meetings in each district on the issue of rate consolidation at the time of the hearing. [392]

B. Stand-Alone Rate Design Proposals - Water Districts

1. Arizona-American Stand-Alone Rate Design

With respect to a stand-alone rate design, the Company requests that the Commission institute its rate design, which consists of a pro-rata increase to the existing rate design for the districts. [393]

The Council states that if Company-wide consolidated rates are not adopted, the current rate structure of the Anthem Water district should be retained, and that it prefers the Company's **[*166]** stand-alone proposal to Staff's because it retains the current tier levels for all meter sizes and increases all customers' bills by the same percentage rather than shifting revenues from residential to commercial lasses of customers. [394]

2. RUCO Stand-Alone Rate Design

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386 *Id.* at 21-22 and Schedule JMM-3 and JMM-4.

387 *Id.* at 23-23 and Schedule JMM-5 and JMM-6.

388 *Id.* at 23 and Schedule JMM-7 and JMM-8.

389 Staff Br. at 22, citing to Direct Testimony of Staff witness Elijah Abinah (Exh. S-16) at 7; Staff Reply Br. at 13.

390 Staff Br. at 22, citing to Direct Testimony of Staff witness Elijah Abinah (Exh. S-16) at 6-7; Staff Reply Br. at 13.

391 Staff Br. at 22, citing to Direct Testimony of Staff witness Elijah Abinah (Exh. S-16) at 4-5.

392 Staff Reply Br. at 13.

393 Co. Br. at 42; Co. Reply Br. at 24.

394 Council Reply Br. at 20.

RUCO's proposed rate design is generally the same as that proposed by the Company. RUCO recommends that it be adopted. [395]

3. Staff Stand-Alone Rate Design Issues

a. Private Fire Rate

Consistent with its proposal adopted in other cases, Staff proposes a change to the private fire rate for the Anthem and Sun City Water districts to the greater of $ 10 or two percent of the monthly minimum charge for the applicable meter size. [396] The Company opposes the change, arguing that it is unwarranted. The **[*167]** Company believes the change will lead to a dramatic shift of revenues to other classes of customers. [397]

Staff recommends that its proposed Private Fire Rate be adopted in this case. [398]

b. Staff's Tier Structure

The Council takes issue with Staff's proposed tier breakpoints and rates, arguing that they are "without adequate foundation or support and would adversely affect Anthem customers." [399] The Council opposes Staff's proposed increase in the rates for higher usage water customers and the tier break-points for larger meter sizes, arguing that Staff's lowering in the tier break points for commercial customers, coupled with greater-than-average increases in the second tier rate, could increase some commercial customers' bills by as much as 250 percent. [400] **[*168]** The Council faults Staff for not having performed a cost of service study to support its proposal and for not discussing non-cost factors that it considered in arriving at its rate proposals. [401]

Staff states that one of the Commission's primary objectives in setting water rates is efficient use of water, and that Staff's proposed revisions are intended to accomplish this objective. [402] Staff responds that no party prepared a cost of service study in this case, including the Council, and that it was not the responsibility of Staff, any more that it was the responsibility of the Council, to perform a cost of service study. [403] Staff argues that the lack of a cost of service study should not act to prevent Staff from considering important Commission objectives and proposing rate designs in line with those objectives. [404] Staff further argues that rates are not designed on cost of service principles alone, but that non-cost **[*169]** factors are often used by the Commission to set rates as well. [405]

c. Staff's Alternative 5-Tier Water Rate Design

As requested at the hearing, Staff provided a five tier rate design for the Anthem Water and Sun City Water districts. Staff states that its five tier rate design for those water districts would provide a "lifeline" level of rates suitable for low-income water users, which some parties support in this case. [406]

The Company requests that Staff's alternative five-tier water rate design be rejected. [407] The Company believes that the initial breakpoints in Staff's alternative is too low, at 1,000 gallons per month for Sun City Water and 2,000 gal-

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395 RUCO Br. at 67; RUCO Reply Br. at 24.

396 Phase II Tr. at 1259.

397 Co. Br. at 44.

398 Staff Reply Br. at 11.

399 Council Br. at 18.

400 *Id.*; Council Reply Br. at 20.

401 Council Br. at 18.

402 Staff Reply Br. at 12.

403 *Id.* at 12-13.

404 *Id.* at 13.

405 *Id.*

406 Staff Reply Br. at 12, citing to Magruder Br. at 29.

407 Co. Br. at 42, 44-45; Co. Reply Br. at 24.

lons per month for Anthem Water. **[*170]** [408] The Company argues that the tiers are not appropriate for the Company's entire system, and that if the Commission wishes to move the Company to five tiers, the Company would prefer that the tiers included in its consolidated rate design be adopted instead, because they are appropriate for all the Company's districts. [409]

d. Elimination of Capacity Reservation Charges

Staff recommends the elimination of the Capacity Reservation Charges for the Anthem Water district, as there were no associated revenues in the test year and no significant change is forecasted. [410] No other party briefed this issue.

4. 5/8 x 3/4-inch and 1-inch Meter Monthly Usage Charges for Anthem Water **[*171]**

Staff recommends against charging 1-inch meter customers the same rate as the 5/8 x 3/4-inch customers, because the average consumption of Anthem ratepayers with larger meter sizes is greater, at 11,203 gallons per month for 1-inch meter customers, in contrast to 9,616 gallons per month for 5/8 x 3/4-inch meter customers. [411] Staff recommends that if it is determined appropriate to charge a single monthly usage charge for both meter sizes, with a lower monthly usage charge for 1-inch meter residential customers, that the monthly usage charge for 5/8 x 3/4-inch customers should also be increased, and some adjustment should be made to the tier breakpoints. [412]

C. Stand-Alone Rate Design Proposals - Wastewater Districts

1. Anthem/Agua Fria Wastewater District Effluent Rate

DMB is the developer of a master planned community called Verrado located in the Town of Buckeye north of Interstate 10 in the southeastern foothills of the White Tank Mountains. [413] DMB requests **[*172]** that a specific rate be set for effluent produced by the Anthem/Agua Fria Wastewater district. [414] Currently, the Anthem/Agua Fria Wastewater district does not charge DMB for the effluent that it delivers. Instead, the Agua Fria Water district charges DMB for the effluent delivered by the Anthem/Agua Fria Wastewater district. [415] DMB submits that $ 250 an acre-foot is an appropriate and reasonable rate for effluent, as it is consistent with the $ 227 per acre-foot rate charged by Arizona-American for its Mohave Wastewater district and with effluent rates charged by other regulated sewer companies, and as it is slightly less than DMB's cost to use groundwater for turf irrigation and other non-potable uses. [416]

Corte Bella also urges the Commission to adopt an effluent water rate of $ 250 per acre-foot for effluent produced by the Anthem/Agua Fria Wastewater district. [417] Anthem Golf **[*173]** concurs with DMB and Corte Bella that an effluent rate be set for effluent produced by the Anthem/Agua Fria Wastewater district. [418]

Staff agrees that the effluent rate should be set at a level that encourages the use of effluent for turf irrigation. [419]

The Company requests that the effluent rate of $ 250 per acre-foot or $ 0.77 per 1,000 gallons recommended by DMB

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408 Co. Br. at 44-45.

409 *Id.*

410 Direct Testimony of Staff witness Jeffrey Michlik (Exh. S-15) at 9.

411 Staff Reply Br. at 16.

412 *Id.*

413 DMB Br. at 3.

414 *Id.* at 2.

415 *Id.* at 4, citing to Phase II Tr. at 184-85.

416 DMB Br. at 2-3, 8.

417 Corte Bella Br. at 2.

418 Anthem Golf Reply Br. at 2.

419 Staff Reply Br. at 15.

for the Anthem/Agua Fria Wastewater district be adopted to govern the direct use of effluent only. [420]

2. Anthem/Agua Fria Wastewater District Rate Design

The Anthem/Agua Fria Wastewater district **[*174]** is the only Company wastewater district that currently has a volumetric charge incorporated into its residential rate structure. The volumetric rate is based on customers' water usage. The current monthly minimum charge for all residential customers is $ 27.76 and the volumetric charge is $ 3.4800 per 1,000 gallons with a 7,000 gallon per month ceiling, such that a customer using 7,000 gallons of water per month is charged the same amount as a customer using 29,000 gallons of water per month. [421] For commercial customers, the minimum charges and commodity charges vary by meter size.

Staff recommends that the Company change its method of billing its residential wastewater customers to the method currently used by some municipalities, with each residential customer being billed based on that customer's average water usage for the months of January, February and March. [422] The customer's billing would be reset every year based upon the customer's water usage for these three months, at **[*175]** a rate of $ 9.5966 per 1,000 gallons. [423] Staff states that while the Anthem/Agua Fria Wastewater district is the only wastewater district of the Company with volumetric wastewater rates, the current volumetric rate design does not encourage conservation. [424] Staff states that it proposed this wastewater rate design because water usage during winter months provides a more accurate representation of the amount of wastewater being discharged from the customer's home year-round, and results in a more appropriate basis for wastewater charges. [425]

The Company argues that Staff's proposed stand-alone rate design for the Anthem/Agua Fria Wastewater district should be rejected because it would unduly increase the dependence of wastewater revenues on water sales, which vary significantly from year to year, and which the **[*176]** Company asserts are declining in Anthem. [426] The Company argues that no party has fully analyzed the potential significant water conservation effect of this proposal. [427] At the same time, the Company also argues that Staff's proposal would be likely to increase summer water usage. [428]

The Council agrees with the Company that Staff's rate design would increase the Company's dependence on wastewater revenues based on water sales which vary significantly, and also argues that a pure commodity rate as Staff proposes would inappropriately deviate from basic cost of service principles. [429]

Staff responds that it is not aware of evidence in the record that water sales **[*177]** are declining in Anthem, or that they vary significantly from year to year or more significantly than is typical or experienced by other water companies. [430] Staff contends that the months of January, February and March provide a more accurate representation of customers' water usage that the Company actually treats as wastewater. [431]

In an attempt to rebut Staff's position that the months of January, February and March would be a more accurate representation of water usage that is actually treated as wastewater, both the Company and the Council point to the requirement in the Anthem community that winter lawns be overseeded. [432] Staff states that while a document regarding the specifics of the overseeding requirement was filed in the docket, there is no evidence in the record as to how

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420 Co. Reply Br. at 25.

421 Phase II Tr. at 1260-61.

422 Direct Testimony of Staff witness Jeffrey Michlik (Exh. S-15) at 12.

423 *Id.*

424 Staff Reply Br. at 10.

425 Direct Testimony of Staff witness Jeffrey Michlik (Exh. S-15) at 11.

426 Co. Br. at 43.

427 *Id.*

428 Co. Br. at 44, citing to Rate Design Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-39) at 5.

429 Council Br. at 19.

430 Staff Reply Br. at 10-11.

431 *Id.* at 10.

432 Co. Br. at 44, citing to Exh. A-49; Council Br. at 19.

many customers the overseeding requirement would impact, and to what degree. [433] As to the Council's recommended elimination of the commodity charge and reversion back to **[*178]** a fixed charge for all wastewater, [434] Staff believes this would constitute a significant step backwards on the issue of efficient use of water. [435]

D. Deconsolidation of Anthem/Agua Fria Wastewater District

The Council favors consolidation of all of Arizona-American's districts under Scenario One. [436] However, the Council also takes the position that absent a consolidation of all of Arizona-American's districts, the Anthem/Agua Fria Wastewater district should be separated into two separate wastewater districts, with separate stand-alone rates set for each district. [437] The Council argues that the rate design of the current Anthem/Agua Fria Wastewater district burdens Anthem community customers because it "in effect is a subsidization of Agua Fria wastewater **[*179]** customers under the existing rate design." [438] The Council proposes that in the event the record in this proceeding does not contain sufficient data to generate stand-alone rate designs for its proposed separate wastewater districts, that a consolidated rate design be adopted on an interim basis and that this docket be kept open for the limited purpose of designing and implementing stand-alone revenue requirements and rate designs for separate wastewater districts as soon as practicable, and in advance of the Company's next rate proceeding. [439]

The Company contends that there is no evidence in the record in this case to support de-consolidated revenue requirements for the district. [440] Staff agrees. [441] The Company states that if the Commission determines that it is appropriate, it does not object to future deconsolidation of the district in the **[*180]** Company's next rate case, and requests direction from the Commission on whether to file individual rate cases on a de-consolidated basis. [442]

Good public policy requires the Commission to correctly assign cost responsibility for all ratemaking components in as expeditious a manner as possible, and deconsolidation of Anthem/Agua Fria Wastewater District is consistent with such action. However, the record does not include adequate rate base or operating income information to immediately implement stand-alone rate designs for the resulting Anthem Wastewater district and Agua Fria Wastewater district at this time. Therefore, we will (i) approve the rates adopted herein for Anthem/Agua Fria Wastewater district as a consolidated district on an interim basis, and (ii) order the docket in the instant proceeding to remain open for the sole purpose of considering the design and implementation of stand-alone revenue requirements and rate **[*181]** designs as agreed to in the settlement reached during the Open Meeting for the Anthem Wastewater district and Agua Fria Wastewater district as soon as possible. The Company shall file its initial application no later than April 1, 2011.

E. Conclusions

1. Consolidation

As RUCO acknowledges, the goal of rate consolidation is admirable, but each case considering rate consolidation must be considered independently based on the facts and circumstances of the particular case. In this case, the facts demonstrate that the existing large disparity in rates among the Company's districts presents an insurmountable impediment, at this time, to statewide consolidation of rates for the Arizona-American water and wastewater districts. We agree with RUCO that, while statewide rate consolidation would undoubtedly help to ameliorate rate increases for some ratepayers in this case, when all other facts are considered, that amelioration comes at too high a cost. The proponents of consolidation do not propose partial consolidation. After careful consideration of the facts and arguments pre-

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433 Staff Br. at 19; Staff Reply Br. at-10.

434 Council Br. at 19; Direct Rate Design Testimony of Council witness Dan Neidlinger (Exh, Anthem-18) at 4.

435 Staff Br. at 19.

436 Council Br. at 20.

437 *Id.* at 19-20; Council Reply Br. at 21.

438 Council Br. at 19-20, citing to Tr. 331-334.

439 Council Reply Br. at 21.

440 Co. Reply at 25.

441 Staff Reply Br. at 14.

442 Co. Reply Br. at 25-26.

sented by the parties, we decline to order the implementation of consolidated rates for the Arizona-American [*182] districts at this time.

Also, in their comments, parties asserted that the topic of rate consolidation should occur where all of Arizona-American's systems are being considered, which would allow for full consideration of all the consolidation options and rate impacts. In the instant proceeding, most, but not all, systems are being considered. In light of party comments, we believe it is appropriate to order the Company to develop a consolidation proposal that includes all of its systems, as well as all of its systems without Sun City, and to file those consolidation proposals in a future rate application.

2. Stand-Alone Rate Design Issues

Of the stand-alone rate design proposals presented, we find Staff's proposal to be the most appropriate and reasonable, and will adopt it, as set forth in Exhibit A, attached hereto and incorporated herein,

Exhibit A includes the five-tier water rate design provided by Staff for the Anthem Water and Sun City Water districts. The adoption of Staff's five-tier rate design serves two purposes. While we are not adopting consolidated rates in this case, Staff's alternative design moves the two water districts from the current three-tier rate [*183] design to a five-tier rate design, so that if consolidation is considered in the future, these two districts will already have a rate design more amenable to consolidation. Also, unlike the Company's preferred five-tier rate design, Staff's lower first tier will provide a "lifeline" level of rates suitable for low-income water users, as advocated by Mr. Magruder.

Exhibit A adopts the private fire rate proposed by Staff, in accordance with our adoption of similar private fire rates for other water utilities in the state.

Exhibit A also adopts Staff's proposed changes to the current volumetric rate design for the Anthem/Agua Fria Wastewater district, based on the model used by many municipalities, and will more accurately represent of the amount of wastewater being discharged from the customer's home. After considering the record facts and the arguments of the Company, the Council, and Staff, we find that Staff's wastewater rate design for the Anthem/Agua Fria Wastewater district will result in a more appropriate and fairer basis to ratepayers for wastewater charges than the current rate design. The current rate design results in the same residential wastewater charges for customers [*184] using 7,000 gallons of water a month as for those customers using many times more. The existence of a volumetric rate design allows us to remedy this inequity. The change we adopt to the wastewater rate design will allow customers to know more about how their water usage impacts their wastewater billing, and will therefore give them more control over their wastewater bills. Staff's recommendation is reasonable and appropriate and will be adopted.

Staff's recommendation that the Capacity Reservation Charges for the Anthem Water district be eliminated is reasonable and will be adopted.

The requests of DMB, Corte Bella and Anthem Golf in regard to establishment of an effluent rate are reasonable. We find that an effluent rate of $ 250 per acre foot, or $ 0.77 per 1,000 gallons for all usage of non-potable effluent by the Anthem/Agua Fria Wastewater district, as agreed to by the Company, is reasonable and it will be adopted. The adjusted test year revenues in the parties' final schedules included revenues from effluent water sold by Anthem Water at $ 2.56 per 1,000 gallons, and no revenues for effluent water sales by Anthem/Agua Fria Wastewater. According to the Company, under the $ 0.77 [*185] per 1,000 gallon effluent rate, Anthem/Agua Fria Wastewater would have realized test year revenues of $ 449,603. In order to establish the new effluent rate for Anthem/Agua Fria Wastewater, Anthem Water's rates must be designed to recover the resulting difference in revenues from other water sales, and Anthem/Agua Fria Wastewater's rates must be designed to reflect the increase revenues. The new effluent rate for the Anthem/Agua Fria Wastewater district is reflected on Exhibit A.

VIII. OTHER ISSUES

A. Sun City Water Low Income Program

At the hearing, in response to public comment regarding the applicability of the current Sun City Low Income Program to condominium dwellers, the Company was asked to look into a means of administering the program so that condominium dwellers can participate.

In a filing dated July 30, 2010, the Company submitted a proposal and recommended in a post-hearing filing docketed on July 30, 2010 a means to administer the existing Sun City low income program (presently a $ 4 per month credit)

to the many thousands of condominium [443] residents in the Sun City Water district. As requested during the hearing, the Company investigated and conducted **[*186]** outreach in relation to the Sun City Low Income Program and its applicability to condominium residents. The Company noted that condominium residents are not the direct customers of Arizona-American, but rather are served in groups, on larger water meters for which the name on the account is the condominium association or the management company that pays the bills for the condominium association. When a low income resident served in this way wishes to receive a low income water credit on a water bill, neither the resident nor the Company can require the association to provide that credit to the particular resident. To date, therefore, only single dwelling unit residents have been eligible for Sun City's Low Income Program.

The Company states that following the hearing in this matter, the Company investigated and conducted outreach on three possible options, only one of which is viable at **[*187]** this time:

Option 1. The first (non-viable) option would involve the Company providing the low income credit as usual via the water bill and the association in turn providing that credit to the qualified low income resident, most likely through a reduction in the periodic homeowner's association fee. The association fee is the means by which a condominium resident pays for charges for water and many other services, such as landscaping, incurred by the association on behalf of its residents. The Company states that the associations with which the Company spoke do not want to undertake this responsibility, and that among their concerns are that they would be taking on a liability to accurately transmit low income credits.

Option 2. As an alternative to providing the low income credit via the water bill, a second (non-viable) option was investigated and would involve the Company periodically (quarterly or annually) providing checks to condominium residents who qualify for the low income program. The Company states that a number of computer system and logistics challenges make this option too expensive and unworkable, with the primary challenge being that this effort must occur **[*188]** outside of the Company's billing systems, because the residents are not the Company's direct customers. The Company states that it would need to create and maintain a separate process and separate database with handoffs from various Company employees in order to accurately provide checks. First, local Company employees would need to determine in which association the resident resides and next determine the appropriate multi-dwelling water account number for that dweller. Next, other Service Company employees would need to set up a process and system to provide the resident a check to be periodically mailed to the resident. The local Company employees would later need to periodically re-contact each low income resident to ensure he/she is still residing in that unit. In addition, the credits provided under this program would need to be periodically totaled and added to the credits provided to single housing dwellers to be tracked against overall funding. That would require another set of accounting entries (probably monthly) to the regulatory asset used for that purpose. This process would involve the training of employees and the establishment of new responsibilities and would be **[*189]** subject to periodic internal or external audit. As a result, significant resources would need to be devoted to a relatively minor activity to ensure effectiveness and accuracy for this option.

Option 3. As a viable alternative to the Company sending checks directly to residents, the Company states that it has on several occasions discussed with the Sun City Taxpayers Association ("SCTPA") a means of administering this program at a nominal cost. Under this alternative, the Company would periodically (probably semi-annually) provide the SCTPA with a lump sum of funding, (e.g., $ 20,000) in order for the SCTPA to cut checks to qualified low income condominium residents. Essentially, SCTPA would handle all tasks described in the second option above. The Company states that key features of this option would include the following:

> a. SCTPA would process $ 4 credits for condominium residents only, as single housing residents would continue to be processed by the Company. [444]
>
> b. SCTPA would establish accounting procedures to record information about each qualified condominium resident and low income credit amounts provided. SCTPA would maintain a separate bank account for this effort **[*190]** and would periodically and also upon request make records available to the Company or another intervenor for review in future rate cases (e.g., Commission Staff). SCTPA would only be reimbursed for reasonable direct costs to administer this program (e.g., banking and record keeping fees) and an allocation of SCTPA labor costs.

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[443] The Company noted that the program can also include some other multi-housing situations such as mobile homes as appropriate.

[444] The Company stated that the credit amount may be increased or decreased by the Commission upon completion of future Sun City Water district rate cases. A condo resident's credit would equal the credit provided to single housing residents.

c. SCTPA would periodically inform the Company of the number of low income participants in order for the Company to effectively monitor the 1,000 customer ceiling for this program. The Company would periodically replenish the account via a lump sum as per anticipated requirements of the program as communicated by SCTPA to the Company as regards near term funding requirements.

d. The SCTPA (which annually prepares tax returns for approximately 4,000 residents) has informed the Company that this approach would help the SCTPA to better identify persons eligible for some of its other low income related programs (e.g., property tax assistance), and the Company believes SCTPA would be a trustworthy and reliable partner.

[*191]

The Company stated that while details still remain to be worked out between the Company and the SCTPA, including a contract between them, they reached general agreement following a July 29, 2010 meeting. The Company attached a copy of documents prepared by SCTPA and provided to the Company as their response to earlier informal discussions. The Company stated that while a few minor changes are anticipated to this document before it is final, the parties intend to proceed to contracting in order to make the expansion of this important low income program to condominium dwellers occur as soon as possible. The Company stated that it is very appreciative of the SCTPA's receptiveness to this low income program.

The Commission commends the Company and the SCPTA in their joint efforts to extend the benefit of the Sun City Low Income Program to condominium and other multi-housing dwellers. A copy of the documents prepared by the SCPTA and attached to the Company's July 30, 2010 filing are attached hereto as Exhibit B and incorporated herein by reference. We will direct the Company to file within 60 days, or sooner if possible, an application for approval of changes to the Sun City Low Income **[*192]** Program to extend the benefit of the Sun City Low Income Program to condominium and other multi-housing dwellers, that generally incorporates the program outlined in Exhibit B, for review by Staff. We will direct Staff to subsequently review the Company's Sun City Low Income Program filing and to prepare and docket, within 60 days of the Company's filing, a Recommended Order regarding the Company's proposed changes to the Sun City Low Income Program.

The Company states that the current Sun City Low Income Program assumes participation of 1,000 customers, and assuming the 50 percent discount for 5/8-inch low income customers, the updated annual subsidy is $ 54,000. [445] Enrollment in the program is presently less than 1,000 customers and the fund is over-collected. [446] The Company states that the current program's balancing account feature allows the Company to late refund any over charge or recover any under charge, and authorizes a surcharge which can be trued up annually. [447] The program serves up to 1,000 customers at a recommended discount of $ 4.50 per month at an annual cost of $ 54,000 (1,000 times $ 4.50 times 12 bills). In the test year, the thousands of gallons used by **[*193]** the residential and commercial Sun City Water high block customers was 2,093,842. Therefore, the amount of $ 0.026 per 1,000 gallons must be added to the high block rate in order to fund the Sun City Low Income Program. We find that the current high block funding mechanism remains a reasonable means of funding the Sun City Low Income Program, and will order the Company to continue it.

B. Infrastructure Improvement Surcharge (Sun City Water)

The Company proposed the institution of a surcharge to fund the replacement of existing assets such as mains, hydrants, meters, tanks, and booster stations for the Sun City Water district. [448] The Company states that much of Sun City's water infrastructure is fifty years old, and major improvements will be required to continue provision of safe and reliable water service in this district. [449] Under the Company's Infrastructure **[*194]** Improvement Surcharge ("IIS") proposal, the Company would assess, twice per year, assets that had been placed in service, and using the most recently approved return on equity, depreciation rates, cost of debt, capital structure and revenue gross-up factors, along with the estimated service life, the Company would calculate an appropriate return on the assets and the de-

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445 Rebuttal Testimony of Company witness Thomas Broderick to Staff's Rate Design Testimony (Exh. A-39) at 11.

446 *Id.*

447 *Id.*

448 Direct Testimony of Company witness Christopher Buls (Exh. A-5) at 4.

449 Co. Br. at 39-40.

preciation expense on the assets. [450] The total amount of the IIS would be the return on and of the qualifying assets, calculated as a percentage of the base revenue requirement from the prior rate case, capped at 10 percent. [451] Following the implementation of new rates from any subsequent rate case, in which the assets would be subject to a prudency review, a revised surcharge would be calculated removing from the surcharge qualifying assets included in the rate base in that case. [452] The Company's witness Mr. Townsley testified that this type of surcharge is used in other jurisdictions to replace aged infrastructure, and that the National Association of Regulatory Utility Commissioners ("NARUC") water subcommittee has endorsed such a surcharge mechanism as a regulatory best practice. [453]

[*195]

Mr. Townsley testified that the IIS would allow the Company to make prudent investments in replacing existing infrastructure and would alleviate large rate increases for customers. [454] The Company asserts that although the types of replacements required for the Sun City Water district are ordinary, the costs for the replacements projected to occur are not ordinary, but quite large. [455] The Company argues that the surcharge would allow the Company to earn a return on its investments in a timely manner, while at the same time alleviating "rate shock" it alleges will occur if all of the anticipated replacements in Sun City are addressed in one rate case without any intervening means to address the replacements in rates. [456]

[*196]

RUCO opposes the IIS, and recommends that the request be denied. RUCO does not disagree with the Company that the Sun City Water district infrastructure is old and needs repair, but argues that the needed improvements are normal, common and routine for a water utility. [457] RUCO states that the costs in question are routine, are not extraordinary, have not been shown to be volatile, have not yet been incurred, and their amount is not known at this point. [458] RUCO argues that the recovery of expenditures for plant additions and improvements therefore does not warrant the extraordinary ratemaking device of an adjustor mechanism, [459] but that the Company should instead seek recovery of the costs in a rate case where all of the rate case elements can be considered. [460]

[*197]

Staff also opposes approval of the IIS. Staff's witness testified that ordinary infrastructure improvements of the types contemplated by the Company's proposal should instead be handled in the normal fashion through a rate case after making the investment. [461] Like RUCO, Staff does not believe that the Company has offered any reasons to justify its request of extraordinary treatment of routine plant in service improvements. [462]

Staff and RUCO both argue that while the Commission has approved surcharge mechanisms in circumstances such as the imposition of arsenic treatment standards by the U. S. Environmental Protection Agency ("EPA") which have required significant investment by water companies, that the Commission has reserved the use of adjustment mechanisms to extraordinary circumstances to mitigate the effect of uncontrollable price volatility or uncertainty in the mar-

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450 Direct Testimony of Company witness Christopher Buls (Exh. A-5) at 4.

451 *Id.* at 6; Phase II Tr. at 435-436.

452 Direct Testimony of Company witness Buls (Exh. A-5) at 4-6.

453 Phase II Tr. at 15-22.

454 *Id.*

455 Co. Reply Br. at 24.

456 *Id.*

457 RUCO Reply Br. at 14.

458 RUCO Br. at 36.

459 *Id.* at 33, 36.

460 RUCO Reply Br. at 14.

461 Direct Testimony of Staff witness Jeffrey Michlik (Exh. S-15) at 9.

462 *Id.*

ketplace. [463]

[*198]

The Company admits the surcharge would cover routine investments in such items as meters, mains, hydrants, tanks and booster stations, and while the Company proposed a cap on the increase between rate cases, the Company has not quantified the amount of the proposed surcharge. [464] We agree with RUCO and Staff that the recovery of expenditures for plant additions and improvements does not warrant the extraordinary ratemaking device of an adjustor mechanism, and will therefore not grant the request for institution of an IIS.

C. Anthem/Agua Fria Water District Facilities Hook-Up Fee Tariff

Staff proposed several revisions to the Company's hook-up fee tariff for the Anthem/Agua Fria Wastewater district to include certain reporting requirements now required by the Commission, and to add additional lateral fees. [465] The Company accepted the modifications. [466] Staff's proposed revisions are reasonable, and the Company should file revised tariffs conforming with those appearing in Hearing [*199] Exhibit S-7 at DMH-3, Figure 6 and DMH-4, Figure 7 at the time it files new schedules of rates and charges.

D. Depreciation Rates

Staff recommends that the Company be required to use the depreciation rates delineated by district on the schedule attached hereto and incorporated herein as Exhibit C. Staff's recommendation is reasonable and will be adopted.

* * * *

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

FINDINGS OF FACT

Procedural History

1. On July 2, 2009, Arizona-American filed with the Commission an application for rate increases for its Anthem Water district, Sun City Water district, Anthem/Agua Fria Wastewater district, Sun City Wastewater district and Sun City West Wastewater district. The application was accompanied [*200] by the pre-filed direct testimony of eleven Company witnesses.

2. On July 13, 2009, Arizona-American filed a supplement to its application.

3. On August 21, 2009, Arizona-American filed an additional supplement to its application.

4. On August 24, 2009, Staff filed a Letter of Sufficiency indicating that Arizona-American has satisfied the requirements of *A.A.C. R14-2-103* and classifying the Company as a Class A utility.

5. On August 26, 2009, a procedural order was issued setting a procedural conference to provide an opportunity for discussion of a hearing schedule, public notice, and other procedural issues prior to the issuance of a rate case procedural order.

6. On August 27, 2009, RUCO filed an Application to Intervene, which was granted at the procedural conference held on September 3, 2009.

7. On September 2, 2009, the procedural conference was convened as scheduled. Appearances were entered by counsel for the Company, RUCO, and Staff. At the procedural conference, the Company indicated its plans to file a sepa-

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463 Staff Br. at 11; RUCO Br. at 33.

464 Phase II Tr. at 433-434.

465 Direct Testimony of Staff witness Dorothy Hains (Exh. S-7) at DMH-3, Figure 6 and DMH-4, Figure 7.

466 Rebuttal Testimony of Company witness Thomas Broderick (Exh. A-7) at 18.

rate rate consolidation application. [467] Based on that indication, the issue of appropriate customer notice of a rate consolidation **[*201]** proposal was brought to the attention of the parties present. [468] The procedural conference was recessed to allow the parties time to meet and discuss an appropriate form of notice.

8. On September 3, 2009, the procedural conference reconvened as requested by the parties. The Company stated that it intended to proceed with the application as filed, and not to file the rate consolidation application discussed the previous day. [469] The Company agreed to prepare a form of public notice of the application in cooperation with RUCO and Staff, and to file it for consideration.

9. On September 14, 2009, Arizona-American filed a proposed form of notice as was discussed at the September 2 and 3, 2009 procedural conference. The filing indicated **[*202]** that Staff had found it acceptable and that RUCO did not expect to have comments on it. The proposed form of notice made no mention of rate consolidation and was to be provided only to customers of the Anthem Water district, Sun City Water district, Anthem/Agua Fria Wastewater district, Sun City Wastewater district and Sun City West Wastewater district.

10. On September 24, 2009, a procedural order was issued setting a hearing on the application for April 19, 2010, setting associated procedural deadlines, and requiring the Company to provide public notice of the application. The Company was ordered to provide notice of the application in the form proposed by the Company and agreed to by Staff.

11. On November 3, 2009, the Council filed an Application to Intervene, which was granted by procedural order issued November 19, 2009.

12. On December 8, 2009, Decision No. 71410 was issued in the 08-0227 Docket. Decision No. 71410 ruled on the Company's previous rate application for its Agua Fria Water district, Havasu Water district, Mohave Water and Mohave Wastewater districts, Paradise Valley Water district, Sun City West Water district and Tubac Water district. Decision No. 71410 stated **[*203]** that Docket No. 08-0227 would "remain open for the limited purpose of consolidation in the Company's next rate case with a separate docket in which a revenue-neutral change to rate design of all Arizona-American Water Company's water districts or other appropriate proposals or all Arizona-American's water and wastewater districts or other appropriate proposals may be considered simultaneously, after appropriate public notice, with appropriate opportunity for informed public comment and participation." [470]

13. On December 21, 2009, the Company filed affidavits of publication.

14. On December 29, 2009, the Company filed an affidavit of customer notice, indicating that notice was provided as a bill insert to customers in the Company's Anthem Water district, Sun City Water district, Anthem/Agua Fria Wastewater district, Sun City Wastewater district, and Sun City West Wastewater district.

15. On January 8, 2010, Mr. W.R. Hansen filed a Motion to Intervene.

16. On January 8, 2010, a Motion **[*204]** to Intervene was filed by PORA's President.

17. On January 11, 2010, a Motion to Intervene was filed by Anthem Golf's General Manager.

18. On January 20, 2010, the Company docketed a Notice of Filing indicating that it had provided to Staff, RUCO, and all intervenors a CD containing a rate consolidation spreadsheet including formulas and databases to model different consolidation scenarios.

19. On January 22, 2010, notice was filed in this docket that PORA's Board of Directors had specifically authorized Larry Woods, its President, to represent it as an intervenor in this matter.

20. By procedural order issued January 25, 2010, PORA was granted intervention, and in the discretion of the Commission, pursuant to Rule 31 (d)(28) of the Rules of the Arizona Supreme Court, Larry Woods was allowed to represent PORA before the Commission for purposes of this proceeding.

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[467] Transcript of September 2, 2009 Procedural Conference at 5.

[468] *Id.* at 14-20.

[469] *Id.* at 27.

[470] Decision No. 71410 at 78.

21. On January 25, 2010, Staff filed a Motion for Extension, requesting an extension of time to March 22, 2010, to file its rate design testimony, which was due to be filed by Staff and intervenors on March 8, 2010. The Motion for Extension indicated that the Company had agreed to Staff's proposed extension of time.

22. By **[*205]** procedural order issued February 2, 2010, the deadlines for Staff and intervenors to file rate design testimony, and for the Company to file rebuttal thereto, were extended. The February 2, 2010 procedural order granted intervention to Mr. W.R. Hansen.

23. On February 2, 2010, WUAA filed a Motion to Intervene, which was granted by procedural order issued February 16, 2010.

24. On February 18, 2010, RUCO filed a Motion to Extend the Time to File its Direct Required Revenue Testimony, requesting a one week extension of time for RUCO to file its direct testimony on issues other than rate design due to the amount of discovery on issues that had required analysis, and indicating that counsel for the Company had informed RUCO that it did not object to RUCO's proposed extension of time.

25. By procedural order issued February 19, 2010, RUCO's time extension request was granted.

26. On February 19, 2010, a letter was filed by W.R. Hansen objecting to WUAA having been granted intervention.

27. On February 22, 2010, Brownstein Hyatt Farber Schreck, LLP filed a Notice of Appearance of Counsel for Anthem Golf indicating that its *pro hac vice* admission was pending.

28. On February 22, 2010, **[*206]** the direct testimony of Anthem Golf's witness Desi Howe was docketed.

29. On February 24, 2010, a revised version of the letter filed by W.R. Hansen on February 19, 2010 was filed.

30. On February 24, 2010, RUCO filed a Notice of Disclosure indicating that its Director is the daughter of a member of the Anthem Community Council's Board of Directors.

31. On February 26, 2010, Staff filed a Request for an Extension of Time to File Direct Testimony, requesting an additional one week extension of time to file its direct testimony in this case due to new unresolved issues related to plant in one of the Company's districts, and that Staff might need to request additional time, depending on information received from the Company.

32. On March 1, 2010, a procedural order was issued granting the requested time extension and ordering Staff to convene representatives of all the parties to this case in order to discuss possible changes to other filing deadlines in this proceeding, and to request a procedural conference at which alternative scheduling proposals might be discussed by all parties if necessary.

33. On March 1, 2010, the Resorts filed a Motion to Intervene. The Resorts are customers **[*207]** of the Company's Paradise Valley Water district. In the filing, the Resorts stated that on February 10, 2010, the Resorts learned that this case was pending, and were provided an agenda to a meeting at the offices of the Company entitled "Rate Consolidation Scenarios." The Resorts attached a copy of the agenda to their Motion to Intervene, and stated that it informed them that Staff would be making a rate consolidation proposal on March 22, 2010, in this docket, and that responsive testimony to Staff's proposal would be due on or about April 5, 2010. The Resorts stated that February 10, 2010, was the first time that the Resorts had notice that a possible consolidated rate structure would be developed for the Commission's consideration in this case that would then be applied to the Company's other districts. The Resorts noted that there might be other Arizona-American customers in other districts that had not been provided notice of this proceeding, and might be directly and substantially affected by rate consolidation. The Resorts requested a waiver of the intervention deadline based upon lack of notice, and that they be granted intervention.

34. On March 2, 2010, the Council filed **[*208]** its response to Staff's February 26, 2010 Request for an Extension of Time to File Direct Testimony.

35. On March 5, 2010, Arizona-American filed its Response to the Resorts' Motion to Intervene and Request for Additional Intervention. In its Response, Arizona-American did not object to the granting of intervention and also re-

quested that the intervenors from the 08-0227 Docket be granted intervention in this case. [471]

[*209]

36. On March 5, 2010, Staff filed a Motion for Extension and Request for Procedural Conference. Staff stated that in accordance with the March 1, 2010 Procedural Order, Staff met with the parties to discuss any proposed schedule changes. Staff included a proposed schedule in its filing.

37. On March 8, 2010, the Council filed its Support for the Commission Staff's Motion for Extension and Request for Procedural Conference.

38. On March 8, 2010, the Council filed the direct testimony of Council witness Dan L. Neidlinger.

39. On March 8, 2010, Staff filed the direct testimony of Staff witnesses Gerald Becker, Dorothy Hains, Juan Manrique and Garry McMurry.

40. On March 8, 2010, RUCO filed the direct testimony of RUCO witnesses William A. Rigsby and Ralph C. Smith.

41. On March 9, 2010, a procedural order was issued granting the Resorts' Motion to Intervene and Staff's Motion for Extension and Request for Procedural Conference. The procedural order stated that in light of the Resorts' indication that Staff planned to file a rate consolidation proposal with its rate design testimony in this docket, the notice issues initially raised at the September 2, 2009, procedural conference must **[*210]** be properly addressed. A procedural conference was set to commence on March 12, 2010, for the purpose of discussing proper and appropriate notice related to any rate consolidation proposal made in this docket.

42. On March 10, 2009, Thomas J. Ambrose filed a letter in this docket requesting that his name be removed for all intervenor listings related to any and all dockets pertaining to the Arizona-American Water Company, including but not limited to this docket.

43. On March 12, 2010, Paradise Valley filed a Motion to Intervene, which stated that the first time it had notice that a possible consolidated rate structure would be developed for the Commission's consideration in this case that would then be applied to the other districts was February 10, 2010.

44. On March 12, 2010, the procedural conference was convened as scheduled. Appearances were entered through counsel for the Company, the Council, the Resorts, RUCO, and Staff. Counsel for Paradise Valley also appeared, and was granted intervention. At the procedural conference, Staff confirmed that it planned to file rate consolidation proposals with testimony on March 29, 2010. Staff stated that while it was unknown at that time **[*211]** what Staff's recommendation would be, any Staff rate consolidation proposal would likely affect customers in all of Arizona-American's districts. Some parties present expressed the concern that a solution to the rate consolidation notice issue should not delay the scheduled April 19, 2010, commencement of the hearing on the Company's application. The parties were informed that in order to allow an appropriate opportunity for informed public comment, intervention, and full participation of any party wishing to participate in the rate consolidation portion of the upcoming hearing, that portion of the hearing would have to be delayed. Staff was directed to proceed with its proposed March 29, 2010, filing of testimony and exhibits on rate design/rate consolidation, and the Company was directed to file its rebuttal testimony on rate design/rate consolidation on April 5, 2010, as proposed. The parties were informed that a procedural schedule for the filing of intervenors' responsive testimony to rate design/rate consolidation testimony would be forthcoming. The Company agreed to draft a form of public notice for provision to all its customers, and to circulate the draft among the parties **[*212]** for comments prior to filing an agreed-upon form of notice by March 19, 2010. Due to the need to provide public notice to all customers, the Company agreed that further consideration of the Company's request for additional intervention was not necessary.

45. On March 15, 2010, Robert J. Saperstein, local counsel for Anthem Golf, filed a Motion to Associate Counsel

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[471] The following parties were intervenors in the 08-0227 Docket: RUCO, Clearwater Hills Improvement Association ("Clearwater Hills"), the Town of Paradise Valley ("Town"), George E. Cocks, Patricia A. Cocks, Nicholas Wright, Raymond Goldy, Lance Ryerson, Patricia Elliott, Boyd Taylor, Keith Doner, Hallie McGraw, Rebecca M. Szimhardt, Wilma E. Miller, Joe M. Souza, Steven D. Colburn, Shanni Ramsay, Dennis Behmer, Ann Robinett, Betty Newland, Don Grubbs, Liz Grubbs, Mike Kleman, Jacquelyn Valentino, Louis Wilson, Ikuko Whiteford, Marshall Magruder, the Camelback Inn and Sanctuary on Camelback Mountain. Tom Sockwell, Andy Panasuk, Thomas J. Ambrose, and PORA.

Pro Hac Vice.

46. Also on March 15, 2010, the Council docketed a Notice of Filing Revised Exhibit.

47. On March 16, 2010, the Company filed a Notice of Filing Form of Notice. The Company indicated that it had circulated the attached proposed form of notice to all parties, and had incorporated all comments received from the parties at the time of filing.

48. On March 18, 2010, a procedural order was issued bifurcating the hearing in this matter into two phases, with Phase II to include Commission consideration of rate design and rate consolidation issues, and setting the hearing on Phase II issues to commence on May 18, 2010. The procedural order directed the Company to mail to each of its customers in all its districts public notice of the bifurcation, the new intervention deadline for Phase II, and the hearing dates **[*213]** and filing deadlines for both Phase I and Phase II of the proceedings. The ordered form of notice was based on the Company's March 16, 2010 filing. The notice stated that intervenors who would be participating in Phase II of the hearing would be required to appear at the prehearing conference scheduled for April 16, 2010. The procedural order also granted admission *pro hac vice* to Bradley J. Herrema.

49. On March 19, 2010, W.R. Hansen docketed comments on the proposed form of notice.

50. On March 22, 2010, the Company filed the rebuttal testimony of its witnesses Paul Townsley, Thomas M. Broderick, Joseph E. Gross, Sandra L. Murrey, Miles H. Kiger, Linda J. Gutowski and Bente Villadsen.

51. On March 23, 2010, the Company filed revised rebuttal schedules in support of the positions of its witnesses' rebuttal testimony filed on March 22, 2010.

52. On March 23, 2010, a procedural order was issued setting a public comment session to be held by Commissioners in Anthem, Arizona, on April 7, 2010, in order to allow customers of Arizona-American to provide public comment for the record in this case at Anthem, and ordering the Company to provide public notice thereof.

53. On March 24, **[*214]** 2010, Marshall Magruder filed a Motion to Intervene, which was granted by procedural order issued April 8, 2010.

54. On March 29, 2010, Staff filed the direct testimony of its witness Jeffrey A. Michlik on rate design and rate consolidation.

55. On March 30, 2010, Staff filed the direct testimony of its witness Elijah O. Abinah on rate design and rate consolidation.

56. On March 30, 2010, the Company filed a Notice of Filing Affidavit of Customer Notice as required by the March 18, 2010 procedural order.

57. On March 31, 2020, the Company requested issuance of a procedural order allowing its witness Bente Villadsen to appear telephonically at the hearing. The request was granted by procedural order issued April 13, 2010.

58. On April 1, 2010, Arizona-American filed a Motion to Extend Deadline to File Rebuttal Testimony, in which the Company requested two additional days, until April 7, 2010, to file its rebuttal testimony on the issue of rate design, including Staff's rate consolidation proposals. Arizona-American indicated in its request that none of the parties had an objection to the extension.

59. On April 2, 1010, a procedural order was issued granting the Company's request for **[*215]** a deadline extension.

60. On April 6, 2010, DMB filed a Motion to Intervene.

61. On April 7, 2010, W.R. Hansen filed his rate design and rate consolidation rebuttal testimony.

62. On April 7, 2010, the Company filed the rate design and rate consolidation rebuttal testimony of its witnesses Thomas M. Broderick and Constance E. Heppenstall.

63. On April 7, 2010, the Commission conducted a public comment as scheduled in Anthem, Arizona.

64. On April 13, 2010, Larry D. Woods filed a Motion to Intervene.

65. On April 14, 2010, Corte Bella and W. R. Hansen each filed a Motion to Intervene.

66. On April. 14, 2010, Anthem Golf filed a Notice of Errata.

67. On April 15, 2010, Philip H. Cook filed a Motion to Intervene.

68. On April 15, 2010, the Company filed a Notice of Adoption of Testimony and Certain Corrections.

69. On April 15, 2010, the Council filed the surrebuttal testimony of its witness Dan L. Neidlinger.

70. On April 15, 2010, Staff filed the surrebuttal testimony of its witnesses Gerald Becker, Dorothy Hains and Garry McMurry.

71. On April 15, 2010, the Company filed a Notice of Filing Testimony Summaries.

72. On April 15, 2010, RUCO filed the surrebuttal testimony of its witnesses **[*216]** William A. Rigsby and Ralph C. Smith.

73. On April 16, 2010, RUCO filed the revised surrebuttal testimony of its witness William A. Rigsby.

74. On April 16, 2010, the Council filed a Prehearing Memorandum on Disputed Refund Payment Issue.

75. On April 16, 2010, the prehearing conference was held as scheduled. During the prehearing conference, entities who had timely filed requests for intervention in order to participate in Phase II of the hearing in this matter appeared. The parties requesting intervention in Phase II of this proceeding were informed that their participation would be limited to the procedural parameters set forth in the March 18, 2010 procedural order, and that aside from the effects of possible rate consolidation, the rate designs of the Company's districts other than its Anthem Water District, Sun City Water District, Anthem/Agua Fria Wastewater District, Sun City Wastewater District, and Sun City West Wastewater District will not be revisited in this proceeding.

76. On April 19, 2010, a procedural order was issued granting intervention to DMB, Larry D. Woods, Corte Bella and Philip H. Cook subject to the procedural parameters set forth in the March 18, 2010 procedural **[*217]** order.

77. On April 19, 2010, the Council filed Summaries of Direct and Surrebuttal Testimony of Dan. L. Neidlinger.

78. On April 19, 2010, Phase I of the hearing in this matter commenced.

79. On April 20, 2010, RUCO filed a Notice of Filing Testimony Summary.

80. On April 20, 2010, Staff filed a Notice of Filing Testimony Summaries.

81. On April 20, 2010, Senator David Braswell, State Senator for Legislative District 6, filed a letter stating that he was opposed to the Company's proposed water and sewer rate increases for its Anthem customers.

82. On April 21, 1010, Staff filed a Notice of Filing Testimony Summaries.

83. On April 22, 2010, a filing signed by "Glenn W. Smith, Treasurer," and "Richard Alt, Leader," was docketed. The filing requested intervention for Scottsdale Citizens for Sustainable Water ("SWAT"), and stated that SWAT is a representative for 17 homeowners associations.

84. On April 27, 2010, Arizona-American filed its Response to Motion to Intervene in which it requested that SWAT's Motion to Intervene be denied. The Company stated that the intervention request was not docketed until April 22, 2010, well past the April 15, 2010, deadline for intervention of Phase **[*218]** II of this proceeding. Arizona -American also stated that contrary to the requirements of Rule 31(d)(28) of the Rules of the Arizona Supreme Court, it did not appear from the filing that SWAT had authorized representation by a lay person in this proceeding,

85. On April 27, 2010, RUCO filed a Notice of Filing Testimony Summaries.

86. On April 27, 2010, W.R. Hansen filed a Notice of Errata.

87. On April 29, 2010, Phase I of the hearing in this matter concluded.

88. On May 3, 2010, a letter from the Commission's Utilities Division Director was docketed. In the letter, the Utilities Division Director recommended and requested that a public comment session be scheduled in Sun City, Arizona due to the number of requests from customers of the Company's Sun City Water Division for a public comment session in Sun City regarding the pending rate case and the proposed rate consolidation, as well as the number of written complaints and/or inquiries received from Sun City Water customers.

89. On May 3, 2010, a procedural order was issued scheduling a local public comment session to be held by the Commissioners on May 17, 2010, in Sun City, Arizona in order to allow customers to make comments regarding **[*219]** the pending rate case and the proposed rate consolidation.

90. On May 3, 2010, the Resorts filed the rate design and rate consolidation direct testimony of their witness John S. Thornton.

91. On May 3, 2010, RUCO filed the rate design and rate consolidation direct testimony of its witnesses Jodi A. Jerich and Rodney L. Moore.

92. On May 3, 2010, the Council filed the rate design and rate consolidation direct testimony of its witness Dan L. Neidlinger.

93. On May 3, 2010, Paradise Valley filed the rate design and rate consolidation direct testimony of its witness Paradise Valley Town Manager James C. Bacon.

94. On May 3, 2010, W.R. Hansen filed his rate design and rate consolidation direct testimony.

95. On May 3, 2010, Marshall Magruder filed his rate design and rate consolidation direct testimony.

96. On May 3, 2010, Larry D. Woods filed his rate design and rate consolidation direct testimony.

97. On May 3, 2010, Anthem Golf filed the rate design and rate consolidation testimony of its witness Desi Howe.

98. On May 4, 2010, RUCO filed a Notice of Errata.

99. On May 4, 2010, the Company filed a Motion for Protective Order.

100. On May 5, 2010, the Company filed a Notice of Filing **[*220]** Form of Protective Order.

101. On May 5, 2010, the same filing docketed on April 22, 2010 was filed, but with an additional page attached. The attached page stated in part that " . . . SWAT has authorized Richard Alt, President and Glenn Smith, Treasurer, to file necessary papers to qualify as Interveners in the Rate Consolidation Request of Arizona-American Water Company . . ."

102. On May 6, 2010, a procedural order was issued conditionally granting intervention to SWAT. SWAT's intervention was made conditional on SWAT filing, no later than May 17, 2010, a document demonstrating compliance with the conditions required by Rule 31 (d)(28) of the Rules of the Arizona Supreme Court, or in the alternative, filing no later than May 17, 2010, a notice of appearance of counsel. The procedural order further provided that if SWAT filed the required documents to make its conditional intervention effective, it would be allowed to participate in this proceeding through its appointed representative, subject to the parameters of the March 18, 2010 procedural order issued in this docket. The procedural order stated that in the event SWAT did not file the required documents to make its conditional **[*221]** intervention effective, its individual members could appear at the commencement of Phase II of this proceeding on May 18, 2010, and orally provide public comment on their own behalf.

103. Following issuance of the May 6, 2010 procedural order, no further filings were made by Glenn W. Smith, Richard Alt, or any other person representing SWAT.

104. On May 6, 2010, a procedural order was issued approving the protective order which was attached thereto as Exhibit A.

105. Parties filing executed copies of the protective order include the Council, W.R. Hansen, Marshall Magruder, RUCO, and Staff. The Company also filed copies of the protective order executed by Arizona Court Reporting Service.

106. On May 6, 2010, the Company filed a late-filed exhibit consisting of email correspondence between the Company and the Daisy Mountain Fire District.

107. On May 7, 2010, the Company filed the redacted testimony of its witness James Jenkins regarding the impact on the Company of a proposal made by the Council's witness Dan L. Neidlinger to phase in the Pulte advance repayments made during the 2008 test year and March 2010.

108. On May 11, 2010, RUCO filed a late-filed exhibit regarding the Company's [*222] Arizona pension costs.

109. On May 11, 2010, Paradise Valley filed a Notice of Errata.

110. On May 11, 2010, the Company filed an objection to the revenue requirement testimony of RUCO's witness Rodney L. Moore set forth on page 5 of Mr. Moore's rate design testimony.

111. On May 14, 2010, DMB filed a Notice of Filing Summary of Testimony.

112. On May 14, 2010, the Company filed the rate design and rate consolidation rebuttal testimony of Company witnesses Thomas M. Broderick and Constance E. Heppenstall.

113. On May 14, 2010, Marshall Magruder filed his rate design and rate consolidation rebuttal testimony.

114. On May 17, 2010, the Company filed a Notice of Filing Testimony Summaries.

115. On May 14, 2010, Marshall Magruder filed a Summary of Testimony.

116. On May 18, 2010, the Council filed a Notice of Filing Testimony Summary.

117. On May 18, 2010, Anthem Golf filed a Notice of Filing Testimony Summary.

118. On May 18 and 19, 2010, the Council filed Testimony Summaries.

119. On May 18, 2010, Phase II of the hearing in this matter commenced as scheduled.

120. On May 19, 2010, the Council filed a copy of a May 17, 2010 letter from Jack Noblitt, President of its Board of Directors, [*223] to Jodi L. Jerich, Director of RUCO.

121. On May 20, 2010, RUCO filed a Notice of Filing Testimony Summaries.

122. On May 21, 2010, Staff filed a Notice of Filing Testimony Summaries.

123. On May 26, 2010, the Company filed as a late-filed exhibit a description of its community outreach in relation to rate consolidation.

124. On May 27, 2010, the Company filed the rate consolidation scenarios requested by Commissioner Mayes during Phase II of the hearing.

125. On June 3, 2010, Phase II of the hearing in this matter concluded.

126. On June 4, 2010, Supervisor Tom Sockwell, Mohave County District 2 Supervisor, filed a letter in opposition to rate consolidation.

127. On June 9, 2010, the Company filed as a late-filed exhibit its responses to Staff's data requests relating to rate consolidation.

128. On June 11, 2010, the Company filed its revenue requirement final schedules.

129. On June 17, 2010, the Company filed the redacted version of the evidentiary hearing transcript Volume 3, Phase II, dated May 20, 2010.

130. On June 18, 2010, Staff filed its revenue requirement final schedules.

131. On June 18, 2010, the Council filed its revenue requirement final schedules.

132. On June 22, **[*224]** 2010, a letter from the Sun City Grand Community Association ("Association") was docketed. The Association's letter requested that "either the district of which the Association is a part (the Agua Fria Water District) be permanently removed from the rate consolidation proposal, or that the Association be granted a reasonable extension of time to file a motion to intervene in this matter."

133. On June 24, 2010, RUCO filed its revenue requirement final schedules.

134. On June 25, 2010, the Company filed a Response to the Association's June 22, 2010 filing. The Company viewed the June 22, 2010 letter as a request for intervention, and recommended that such request be denied as untimely. The Company further noted that intervention is not necessary for the Association to express its opposition to consolidation

135. On June 25, 2010, Staff filed its rate design and rate consolidation final schedules.

136. On June 25, 2010, the Company filed its stand-alone rate design final schedules.

137. On June 25, 2010, the Resorts filed their rate design and rate consolidation final schedules.

138. On June 28, 2010, a June 24, 2010, letter from Jack Noblitt, President of the Council's Board of Directors, **[*225]** to the Commissioners and Mr. Broderick was filed.

139. On June 28, 2010, Marshall Magruder filed final rate design and rate consolidation schedules.

140. On June 30, 2010, the Company filed a Notice of Additional Town Hall Meetings indicating that it had scheduled additional town hall meetings in Lake Havasu City (July 6, 2010), Bullhead City (July 7, 2010), Sun City (July 9, 2010), Scottsdale (July 12, 2010), Tubac (July 13, 2010), Surprise (July 14, 2010), Sun City West (July 15, 2010), and Anthem (July 26, 2010), to discuss the issue of rate consolidation.

141. On June 30, 2010, a copy of the June 22, 2010, letter docketed by the Sun City Grand Community Association was mailed to all parties of record.

142. On July 1, 2010, the Company filed revised revenue requirement and stand-alone rate design schedules for its Sun City Wastewater district.

143. On July 2, 2010, the Council filed a Notice of Filing Rate Design Schedules.

144. On July 6, 2010, the Company filed a notice of change of address for its July 7, 2010 town hall meeting on rate consolidation issues for Bullhead City.

145. On July 6, 2010, the Company filed revised revenue requirement schedules for its Sun City Water **[*226]** district.

146. On July 8, 2010, the Council filed a Notice of Errata to its June 28, 2010 filing.

147. On July 12, 2010, Staff filed a Notice of Errata Regarding Rate Design Schedules for the Sun City Water District.

148. On July 12, 2010, a filing was docketed by Ekmark & Ekmark, LLC. The filing stated that the firm represented the Association with respect to matters of general counsel, and that the Association had retained different counsel to represent the Association with respect to this matter. The July 12, 2010 filing stated that the June 22, 2010 filing was made "on behalf of the Association in order to provide a public comment with respect to the pending water rate case."

149. On July 14, 2010, a procedural order was issued indicating that that the Association's June 22, 2010, letter expressing its opposition to rate consolidation in this proceeding would be considered public comment by the Association in the record of this case.

150. On July 16, 2010, closing briefs were filed by the Company, the Council, Paradise Valley, W.R. Hansen, Larry Woods, Marshall Magruder, DMB, Corte Bella, RUCO, and Staff.

151. On July 20, 2010, Paradise Valley filed a Notice of Errata.

152. On [*227] July 30, 2010, the Company filed a Notice Regarding Town Hall Meetings indicating that it had completed the town hall meetings set forth in its June 30, 2010 filing. Attached to the Notice was an example of the slide presentation made at the meetings and the handout distributed to attendees of the meetings.

153. On July 30, 2010, the Company filed a recommendation regarding the administration of its Sun City district low -income program to condominium and other multi-housing residents, in addition to the already-eligible single dwelling unit residents.

154. On August 6, 2010, reply briefs were filed by the Company, the Council, Anthem Golf, Marshall Magruder, DMB, Corte Bella, RUCO, and Staff.

155. On August 16, 2010, Marshall Magruder filed a Notice of Errata.

156. On October 1, 2010, RUCO filed a Notice of Filing Withdrawal of Phase-In Proposal. RUCO stated that subsequent to filing its closing brief, it became apparent to RUCO that due to carrying costs and other costs that allow the Company full recovery of its revenue requirement, no version of RUCO's proposal, or modification to it, would actually result in a rate design more beneficial to Anthem's ratepayers than RUCO's stand-alone [*228] rate design, and accordingly, RUCO withdraws its alternate phase-in proposal.

157. On November 2, 2010, a letter dated October 13, 2010 addressed to the Commissioners from the Council was filed. The letter stated that it listed the Council's enacted and planned water conservation measures for the Anthem community. The letter invited Commissioners to contact the Council.

158. On November 9, 2010, RUCO and the Council filed a Notice of Joint Filing of Supplemental Information.

159. On November 12, W.R. Hansen filed a Notice of Change of Email Address.

160. Approximately 3,681 written public comments were filed in this docket, including petition signatures, in opposition to the Company's requested rate increases in the districts. Many comments were related to rate consolidation. While a few public comments were filed in support of rate consolidation, the great majority of public comments filed expressed opposition to rate consolidation.

Determinations

161. Arizona-American is a wholly owned subsidiary of American Water Works, the largest investor-owned water and wastewater utility in the United States. American Water Works owns a number of regulated water and wastewater subsidiaries [*229] that operate in 32 states, in addition to non-regulated subsidiaries. American Water Works raises debt capital for its subsidiaries through its financing subsidiary American Water Capital Corp. Arizona-American operates twelve water and wastewater systems in Arizona. Arizona-American is Arizona's largest investor-owned water and wastewater utility, operating twelve water and wastewater systems in Arizona, serving approximately 150,000 customers located in portions of Maricopa, Mohave, and Santa Cruz Counties.

162. During the test year, the Anthem Water district served approximately 8,700 customers in the Anthem Community, the Sun City Water district served approximately 23,000 customers in Sun City, the Town of Youngtown, and small sections of Peoria and Surprise, the Anthem/Agua Fria Wastewater district served approximately 10,121 customers in the Anthem, Verrado, and Russell Ranch communities, the Sun City Wastewater district served approximately 21,965 customers in Sun City, the Town of Youngtown, and small sections of Peoria and Surprise, and the Sun City West Wastewater district served approximately 14,968 customers in Sun City West and the Corte Bella community.

Anthem Water [*230]

163. For the Anthem Water district, Applicant recommends a revenue requirement of $ 13,455,431, which is an increase of $ 5,962,687, or 79.58 percent, over its adjusted test year revenues of $ 7,492,744. Applicant's recommendation for the Anthem Water district would result in an approximate $ 37.37 increase for the average 5/8 x 3/4 inch water meter residential customer, from $ 37.22 per month to $ 74.59 per month, or approximately 100.40 percent. Under the Company's proposal, a median usage (8,000 gallons/ month) Anthem Water district residential customer on a 5/8 x 3/4-inch meter would experience an increase of $ 33.46, approximately 100.39 percent, from $ 33.33 per month to $ 66.79 per month, or approximately 100.39 percent.

164. For the Anthem Water district, RUCO recommends a revenue requirement of $ 12,516,000, which is an increase of $ 5,023,268, or 67.04 percent, over its adjusted test year revenues of $ 7,492,732. RUCO's recommendation for the Anthem Water district would result in an approximate $ 27.34 increase for the average (9,616 gallons/ month) 5/8 x 3/4 inch water meter residential customer, from $ 37.22 per month to $ 64.56 per month, or approximately 73.46 percent. **[*231]** A median usage (8,000 gallons/ month) Anthem Water district residential customer on a 5/8 x 3/4-inch meter would experience an increase of $ 24.48, approximately 73.45 percent, from $ 33.33 per month to $ 57.81 per month.

165. For the Anthem Water district, Staff recommends a revenue requirement of $ 13,420,925, which is an increase of $ 5,928,181, or 79.12 percent, over its adjusted test year revenues of $ 7,492,744. Staff's recommendation for the Anthem Water district would result in an approximate $ 28.62 increase for the average (9,616 gallons/ month) 5/8 x 3/4 inch water meter residential customer, from $ 37.22 per month to $ 65.84 per month, or approximately 76.90 percent. A median usage (8,000 gallons/ month) Anthem Water district residential customer on a 5/8 x 3/4-inch meter would experience an increase of $ 22.67, approximately 68.02 percent, from $ 33.33 per month to $ 56.00 per month. Staff's alternative 5-tier rate design would result in an approximate $ 24.09 increase for the average (9,616 gallons/ month) 5/8 x 3/4 inch water meter residential customer, from $ 37.22 per month to $ 61.31 per month, or approximately 64.72 percent. A median usage (8,000 gallons/ month) Anthem **[*232]** Water district residential customer on a 5/8 x 3/4-inch meter would experience an increase of $ 18.67, approximately 56.02 percent, from $ 33.33 per month to $ 52.00 per month.

166. The fair value rate base of the Anthem Water district is $ 57,249,836.

167. A fair value rate of return for the Anthem Water district of 6.70 percent is reasonable and appropriate.

168. The revenue increases requested by the Applicant for the Anthem Water district would produce an excessive return on FVRB.

169. The gross revenues of the Anthem Water district should increase by $ 5,453,750.

170. The revenue requirement authorized herein for the Anthem Water district is $ 12,946,494, which is an increase of $ 5,453,750, or 72.79 percent, over adjusted test year revenues of $ 7,492,744. The bill effects of the rates adopted herein for Anthem Water district residential customers are shown in Exhibit A.

171. According to Staff, the Maricopa County Environmental Services Division ("MCESD") has determined that the Anthem Water district is currently delivering water that meets the water quality standards required by Title 18, Chapter 4 of the Arizona Administrative Code.

172. The Anthem Water district is located **[*233]** within the Phoenix Active Management Area ("AMA") and the Arizona Department of Water Resources ("ADWR") has determined that it is in compliance with the ADWR requirements governing water providers.

173. It is reasonable and in the public interest to authorize the Company to establish a deferral account to allow it to defer tank maintenance expenses for the Anthem Water district until the next rate case for the district, at which time the Company may present evidence in support of recovery of the deferred expense amounts for consideration.

Sun City Water

174. For the Sun City Water district, Applicant recommends a revenue requirement of $ 11,161,011, which is an increase of $ 1,877,910, or 20.23 percent, over its adjusted test year revenues of $ 9,283,101. Applicant's recommendation for the Sun City Water district would result in an approximate $ 4.64 increase for the average (7,954 gallons/ month) 5/8 x 3/4 inch water meter residential customers, from $ 16.73 per month to $ 21.37 per month, or approximately 27.74 percent.

175. For the Sun City Water district, RUCO recommends a revenue requirement of $ 9,787,589, which is an increase of $ 504,488, or 5.43 percent, over its adjusted **[*234]** test year revenues of $ 9,283,101. RUCO's recommendation for the Sun City Water district would result in an approximate $ 1.22 increase for the average (7,954 gallons/ month) 5/8 x 3/4 inch water meter residential customers, from $ 16.73 per month to $ 17.95 per month, or approximately 7.29 percent.

176. For the Sun City Water district, Staff recommends a revenue requirement of $ 11,126,179, which is an increase of $ 1,843,078, or 19.85 percent, over its adjusted test year revenues of $ 9,283,101. Staff's recommendation for

the Sun City Water district would result in an approximate $ 1.42 increase for the average (7,954 gallons/ month) 5/8 x 3/4 inch water meter residential customer, from $ 16.73 per month to $ 18.15 per month, or approximately 8.49 percent. Staff's alternative 5-tier rate design would result in an approximate $ 2.16 increase for the average (7,954 gallons/ month) 5/8 x 3/4 inch water meter residential customer, from $ 16.73 per month to $ 18.89 per month, or approximately 12.91 percent.

177. The fair value rate base of the Sun City Water district is $ 28,188,865.

178. A fair value rate of return for the Sun City Water district of 6.70 percent is reasonable and appropriate. **[*235]**

179. The revenue increases requested by the Applicant for the Sun City Water district would produce an excessive return on FVRB.

180. The gross revenues of the Sun City Water district should increase by $ 1,611,522.

181. The revenue requirement authorized herein for the Sun City Water district is $ 10,894,623, which is an increase of $ 1,611,522, or 17.36 percent, over its adjusted test year revenues of $ 9,283,101.

182. The bill effects of the rates adopted herein for Sun City Water district residential customers are shown on Exhibit A.

183. According to Staff, MCESD has determined that the Sun City Water district is currently delivering water that meets the water quality standards required by Title 18, Chapter 4 of the Arizona Administrative Code.

184. The Sun City Water district is located within the Phoenix AMA and ADWR has determined that it is in compliance with the ADWR requirements governing water providers.

185. It is reasonable and in the public interest to require the Company to reduce water loss in the Sun City Water district's PWS No. 07-099 to below 10 percent before it files its next rate case, CC&N, or financing application for the Sun City Water district, not including **[*236]** currently pending cases, whichever comes first, and to require that the Company continue tracking the water loss for PWS No. 07-099 for three years and submit the data collected every six months, with the first water loss tracking report for PWS No. 07-099 to be filed as a compliance item in this docket within 180 days of this Order.

186. It is reasonable and in the public interest to require the Company to file, within 60 days, or sooner if possible, for review by Staff, an application for approval of changes to the Sun City Low Income Program that generally incorporate the program outlined in Exhibit B, in order to extend the benefit of the Sun City Low Income Program to condominium and other multi-housing dwellers.

187. It is reasonable and in the public interest to require Staff to review the Company's Sun City Low Income Program and to prepare and docket, within 60 days of the Company's filing, a Recommended Order regarding the Company's proposed changes to the Sun City Low Income Program.

188. It is reasonable and in the public interest to authorize the Company to continue the current high block funding mechanism for the Sun City Low Income Program.

Anthem/Agua Fria Wastewater [*237]

189. For the Anthem/Agua Fria Wastewater district, Applicant recommends a revenue requirement of $ 13.929,889, which is an increase of $ 5,292,887, or 68.21 percent, over its adjusted test year revenues of $ 8,637,002. Applicant's recommendation for the Anthem/Agua Fria Wastewater district would result in an approximate $ 38.74 increase for an average water usage (5,632 gallons per month) 5/8 x 3/4 inch water meter residential customer, from $ 47.36 per month to $ 86.10 per month, or approximately 81.80 percent.

190. For the Anthem/Agua Fria Wastewater district, RUCO recommends a revenue requirement of $ 13,684,829, which is an increase of $ 5,047,706, or 58.44 percent, over its adjusted test year revenues of $ 8,637,123. RUCO's recommendation for the Anthem/Agua Fria Wastewater district would result in an approximate $ 28.72 increase for an average water usage (5,632 gallons per month) 5/8 x 3/4 inch water meter residential customer, from $ 47.36 per month to $ 76.08 per month, or approximately 60.64 percent.

191. For the Anthem/Agua Fria Wastewater district, Staff recommends a revenue requirement of $ 13,668,321, which is an increase of $ 5,031,198, or 58.25 percent, over its adjusted **[*238]** test year revenues of $ 8,637,123. Staff's recommendation for the Anthem/Agua Fria Wastewater district would result in an approximate $ 6.69 increase for an average water usage (5,632 gallons per month) 5/8 x 3/4 inch water meter residential customer, from $ 47.36 per month to $ 54.05 per month, or approximately 14.13 percent.

192. The fair value rate base of the Anthem/Agua Fria Wastewater district is $ 45,116,927.

193. A fair value rate of return for the Anthem/Agua Fria Wastewater district of 6.70 percent is reasonable and appropriate.

194. The revenue increases requested by the Applicant for the Anthem/Agua Fria Wastewater district would produce an excessive return on FVRB.

195. The gross revenues of the Anthem/Agua Fria Wastewater district should increase by $ 4,657,770.

196. The revenue requirement authorized herein for the Anthem/Agua Fria Wastewater district is $ 13,294,893, which is an increase of $ 4,657,770, or 53.93 percent, over its adjusted test year revenues of $ 8,637,123.

197. The bill effects of the rates adopted herein for Anthem/Agua Fria Wastewater district residential customers are shown in Exhibit A.

198. According to Staff, Anthem/Agua Fria Wastewater district **[*239]** is in full compliance with Arizona Department of Environmental Quality ("ADEQ") requirements for operation and maintenance, operator certification, and discharge permit limits.

199. It is reasonable and appropriate to approve consolidated rates for the Anthem/Agua Fria Wastewater district on an interim basis; to keep this docket open for the sole purpose of considering the design and implementation of stand-alone revenue requirements and rate designs as set forth in the Agreement reached during the Open Meeting for the Anthem Wastewater district and Agua Fria Wastewater district; and to require the Company to file, no later than April 1, 2011, an application supporting consideration of stand-alone revenue requirements and rate designs as set for the Agreement. Because the Sun City Grand Community Association is served by the Anthem/Agua Fria Wastewater district and expressed an interest in consolidation issues after the hearing, it should be provided notice of the application.

200. It is reasonable and appropriate to require the Company to file, at the time it files new schedules of rates and charges, revised hook-up fee tariffs for its Anthem/Agua Fria Wastewater district that conform **[*240]** with those appearing in Hearing Exhibit S-7 at DMH-3, Figure 6 and DMH-4, Figure 7.

Sun City Wastewater

201. For the Sun City Wastewater district, Applicant recommends a revenue requirement of $ 7,906,547, which is an increase of $ 1,965,520, or 33.08 percent, over its adjusted test year revenues of $ 5,941,027. Applicant's recommendation for the Sun City Wastewater district would result in an approximate $ 5.14 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ 13.69 per month to $ 18.83 per month, or approximately 37.55 percent.

202. For the Sun City Wastewater district, RUCO recommends a revenue requirement of $ 7,435,703, which is an increase of $ 1,495,322, or 25.17 percent, over its adjusted test year revenues of $ 5,940,381. RUCO's recommendation for the Sun City Wastewater district would result in an approximate $ 4.01 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ 13.69 per month to $ 17.70 per month, or approximately 29.29 percent.

203. For the Sun City Wastewater district, Staff recommends a revenue requirement of $ 7,665,720, which is an increase of $ 1,725,339, or 29.04 percent, over its adjusted **[*241]** test year revenues of $ 5,940,381. Staff's recommendation for the Sun City Wastewater district would result in an approximate $ 4.37 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ per month to $ 18.06 per month, or approximately 31.92 percent.

204. The fair value rate base of the Sun City Wastewater district is $ 15,489,977

205. A fair value rate of return for the Sun City Wastewater district of 6.70 percent is reasonable and appropriate.

206. The revenue increases requested by the Applicant for the Sun City Wastewater district would produce an excessive return on FVRB.

207. The gross revenues of the Sun City Wastewater district should increase by $ 1,621,157.

208. The revenue requirement authorized herein for the Sun City Wastewater district is $ 7,561,538, which is an increase of $ 1,621,157, or 27.29 percent, over its adjusted test year revenues of $ 5,940,381.

209. The bill effects of the rates adopted herein for Sun City Wastewater district residential customers are shown in Exhibit A.

210. The typical ADEQ compliance status is not applicable for the Sun City Wastewater district because the Company's system in that district does not include a **[*242]** wastewater treatment plant. The wastewater collected in the district is transported to a City of Tolleson wastewater treatment plant for treatment and disposal.

Sun City West Wastewater

211. For the Sun City West Wastewater district, Applicant recommends a revenue requirement of $ 7,161,933, which is an increase of $ 1,500,223, or 26.50 percent, over its adjusted test year revenues of $ 5,661,710. Applicant's recommendation for the Sun City West Wastewater district would result in an approximate $ 6.54 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ 25.01 per month to $ 31.55 per month, or approximately 26.15 percent.

212. For the Sun City West Wastewater district, RUCO recommends a revenue requirement of $ 6,419,979, which is an increase of $ 758,269, or 13.39 percent, over its adjusted test year revenues of $ 5,661,710. RUCO's recommendation for the Sun City West Wastewater district would result in an approximate $ 3.36 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ 25.01 per month to $ 28.37 per month, or approximately 13.43 percent.

213. For the Sun City West Wastewater district, Staff recommends a revenue **[*243]** requirement of $ 7,137,298, which is an increase of $ 1,475,588, or 26.06 percent, over its adjusted test year revenues of $ 5,661,710. Staff's recommendation for the Sun City West Wastewater district would result in an approximate $ 6.51 increase for the average 5/8 x 3/4 inch water meter residential customers, from $ 25.01 per month to $ 31.52 per month, or approximately 26.03 percent.

214. The fair value rate base of the Sun City West Wastewater district is $ 18,096,538.

215. A fair value rate of return for the Sun City West Wastewater district of 6.70 percent is reasonable and appropriate.

216. The revenue increases requested by the Applicant for the Sun City West Wastewater district would produce an excessive return on FVRB.

217. The gross revenues of the Sun City West Wastewater district should increase by $ 1,326,805.

218. The revenue requirement authorized herein for the Sun City West Wastewater district is $ 6,988,515, which is an increase of $ 1,326,805, or 23.43 percent, over its adjusted test year revenues of $ 5,661,710.

219. The bill effects of the rates adopted herein for Sun City West Wastewater district residential customers are shown in Exhibit A.

220. According **[*244]** to Staff, the Sun City West Wastewater is in full compliance with ADEQ requirements for operation and maintenance, operator certification, and discharge permit limits.

221. It is reasonable and appropriate to require the Company to utilize the depreciation rates Staff recommends that are delineated by district on the schedule attached hereto and incorporated herein as Exhibit C.

222. The Company, the Council, RUCO and Staff met during a recess from the Open Meeting to discuss possible resolution to a phase-in proposal and other issues. The aforementioned parties agreed to terms as set forth in the discussion of proposed phase-in plans herein.

223. It is just and reasonable and in the public interest to adopt the terms of the Agreement reached by the Company, the Council, RUCO and Staff as set forth herein.

224. The Commission believes it is in the public interest for Arizona-American to conserve groundwater by implementing Best Management Practices for all of its systems not already required to do so under Decision Nos. 71410 and 70372. We believe the Company should be required to, within 90 days of the effective date of this Decision, submit ten BMP's for each of these systems, as **[*245]** a compliance item in this docket, in the form of tariffs that substantially conform to the templates created by Staff (and available on the Commission's web site) for the Commission's review and consideration.

CONCLUSIONS OF LAW

1. Arizona-American is a public service corporation pursuant to Article XV of the Arizona Constitution and *A.R.S. §§ 40-250* and *40-251*.

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

3. Notice of the proceeding was provided in conformance with law.

4. The fair value of Arizona-American's Anthem Water district rate base is $ 57,249,836, and applying a 6.70 percent fair value rate of return on this fair value rate base produces rates and charges that, with the phase-in agreed to by the Company, are just and reasonable.

5. The fair value of Arizona-American's Sun City Water district rate base is $ 28,188,865, and applying a 6.70 percent fair value rate of return on this fair value rate base produces rates and charges that are just and reasonable.

6. The fair value of Arizona-American's Anthem/Agua Fria Wastewater district **[*246]** rate base is $ 45,116,927, and applying a 6.70 percent fair value rate of return on this fair value rate base produces rates and charges that, with the phase-in agreed to by the Company, are just and reasonable.

7. The fair value of Arizona-American's Sun City Wastewater district rate base is $ 15,489,977, and applying a 6.70 percent fair value rate of return on this fair value rate base produces rates and charges that are just and reasonable.

8. The fair value of Arizona-American's Sun City West Wastewater district rate base is $ 18,096,538, and applying a 6.70 percent fair value rate of return on this fair value rate base produces rates and charges that are just and reasonable.

9. The rates and charges approved herein are just and reasonable.

10. The rate design approved herein is just and reasonable.

11. It is reasonable and appropriate to approve consolidated rates for the Anthem/Agua Fria Wastewater district on an interim basis; to keep this docket open for the sole purpose of considering the design and implementation of stand-alone revenue requirements and rate designs as set forth in the Agreement reached during the Open Meeting for the Anthem Wastewater district and Agua Fria **[*247]** Wastewater district; and to require the Company to file, no later than April 1, 2011, an application supporting consideration of stand-alone revenue requirements and rate designs as set for the Agreement. Because the Sun City Grand Community Association is served by the Anthem/Agua Fria Wastewater district and expressed an interest in consolidation issues after the hearing, it should be provided notice of the application.

12. It is reasonable and appropriate to require the Company to file, at the time it files new schedules of rates and charges, revised hook-up fee tariffs for its Anthem/Agua Fria Wastewater district that conform with those appearing in Hearing Exhibit S-7 at DMH-3, Figure 6 and DMH-4, Figure 7.

13. It is reasonable and in the public interest to authorize the Company to establish a deferral account to allow it to defer tank maintenance expenses for the Anthem Water district until the next rate case for the district, at which time the Company present evidence in support of recovery of the deferred expense amounts for consideration.

14. It is reasonable and in the public interest to require the Company to reduce water loss in the Sun City Water district's PWS No. 07-099 **[*248]** to below 10 percent before it files its next rate case, CC&N, or financing applica-

tion for the Sun City Water district, not including currently pending cases, whichever comes first, and to require that the Company continue tracking the water loss for PWS No. 07-099 for three years and submit the data collected every six months, with the first water loss tracking report for PWS No. 07-099 to be filed as a compliance item in this docket within 180 days of this Order.

15. It is reasonable and in the public interest to require the Company to file, within 60 days, or sooner if possible, for review by Staff, an application for approval of changes to the Sun City Low Income Program that generally incorporate the program outlined in Exhibit B, in order to extend the benefit of the Sun City Low Income Program to condominium and other multi-housing dwellers.

16. It is reasonable and in the public interest to require Staff to review the Company's Sun City Low Income Program and to prepare and docket, within 60 days of the Company's filing, a Recommended Order regarding the Company's proposed changes to the Sun City Low Income Program.

17. It is reasonable and in the public interest to authorize **[*249]** the Company to continue the current high block funding mechanism for the Sun City Low Income Program.

18. It is reasonable and in the public interest to require the Company to utilize the depreciation rates Staff recommends that are delineated by district on the schedule attached hereto and incorporated herein as Exhibit C.

19. It is reasonable and in the public interest to adopt the terms of the Agreement reached by the Company, the Council, RUCO and Staff as set forth herein.

ORDER

IT IS THEREFORE ORDERED that Arizona-American Water Company is hereby authorized and directed to file with the Commission, on or before December 31, 2010, the schedules of rates and charges attached hereto and incorporated herein as Exhibit A, which shall be effective for all service rendered on and after January 1, 2011.

IT IS FURTHER ORDERED that Arizona-American Water Company shall notify its customers of the revised schedules of rates and charges authorized herein by means of an insert in their next regularly scheduled billing in a form and manner acceptable to the Commission's Utilities Division Staff.

IT IS FURTHER ORDERED that the docket in this proceeding shall remain open for the sole **[*250]** purpose of considering the design and implementation of stand-alone revenue requirements and rate designs as agreed to in the settlement reached during the Open Meeting for the Anthem Wastewater district and Agua Fria Wastewater district.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, no later than April 1, 2011, an application supporting consideration of stand-alone revenue requirements and rate designs as set forth in the Agreement reached during the Open Meeting for the Anthem Wastewater district and Agua Fria Wastewater district.

IT IS FURTHER ORDERED that the rates approved herein for the Anthem/Agua Fria Wastewater district are interim rates subject to change pursuant to a Commission determination on the above-ordered filing.

IT IS FURTHER ORDERED that Arizona-American Water Company shall serve a copy of the above-ordered application on the Sun City Grand Community Association at the time it is docketed.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, at the time it files new schedules of rates and charges, revised hook-up fee tariffs for its Anthem/Agua Fria Wastewater district that conform with those appearing in Hearing Exhibit **[*251]** S-7 at DMH-3, Figure 6 and DMH-4, Figure 7.

IT IS FURTHER ORDERED that Arizona-American Water Company shall file, within 60 days, or sooner if possible, for review by Staff, an application for approval of changes that generally incorporate the program outlined in Exhibit B, to the Sun City Low Income Program in order to extend the benefit of the Sun City Low Income Program to condominium and other multi-housing dwellers.

IT IS FURTHER ORDERED that Staff shall review the Company's Sun City Low Income Program filing and shall prepare and docket, within 60 days of the Company's filing, a Recommended Order regarding the Company's proposed changes to the Sun City Low Income Program.

IT IS FURTHER ORDERED that Arizona-American Water Company is hereby authorized to continue the current high block funding mechanism for the Sun City Low Income Program.

IT IS FURTHER ORDERED that Arizona-American Water Company is hereby authorized to establish a deferral account to allow it to defer tank maintenance expenses for the Anthem Water district until the next rate case for the Anthem Water district, at which time Arizona-American Water Company may present evidence in support of recovery of the deferred [*252] expense amounts for consideration.

IT IS FURTHER ORDERED that Arizona-American Water Company shall reduce water loss in the Sun City Water district's PWS No. 07-099 to below 10 percent before it files its next rate case, CC&N, or financing application for the Sun City Water district, not including currently pending cases, whichever comes first; and shall continue tracking the water loss for PWS No. 07-099 for three years and submit the data collected every six months; and shall file within 180 days, with the Commission's Docket Control, as a compliance item in this docket, the first water loss tracking report for PWS No. 07-099.

IT IS FURTHER ORDERED that the 2007 and 2008 Pulte refund payments are included in rate base.

IT IS FURTHER ORDERED that the revenue requirement for the Anthem districts based on the 2007 and 2008 Pulte refund payments shall be phased in over a three year period, with the first phase effective January 1, 2011, the second phase effective January 1, 2012, and the third phase effective January 1, 2013, at which time the revenue requirement shall equal the revenues authorized herein.

IT IS FURTHER ORDERED that the 2012 and 2013 revenue increases associated with [*253] the phase-in shall be implemented automatically without further Commission action.

IT IS FURTHER ORDERED that, consistent with the Agreement, there shall be no recovery of the carrying costs associated with the reduced revenues and no recovery of the foregone revenues occasioned by the phase-in.

IT IS FURTHER ORDERED that Arizona-American Water Company shall utilize the depreciation rates delineated by district on the schedule attached hereto and incorporated herein as Exhibit C.

IT IS FURTHER ORDERED that Arizona-American Water Company shall develop a consolidation proposal that includes all of its systems, as well as all of its systems without Sun City, and shall file those consolidation proposals in a future rate application.

IT IS FURTHER ORDERED that for all of its systems not already required to do so under Decision Nos. 71410 and 70372, Arizona-American Water Company shall, within 90 days of the effective date of this Decision, submit ten Best Management Practices for each of these systems, as a compliance item in this docket, in the form of tariffs that substantially conform to the templates created by Staff (and available on the Commission's web site) for the Commission's [*254] review and consideration.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

EXHIBIT A

ANTHEM WATER 2011

MONTHLY USAGE CHARGE	
Residential and Commercial	
5/8" x 3/4" Meter	$ 23.70
1" Meter	59.26
1-1/2" Meter	118.51
2" Meter	189.62
3" Meter	379.24
4" Meter	592.56
6" Meter	1,185.12
8" Meter	1,896.19
Private Fire	
Private Fire 3" Meter	$ 10.00
Private Fire 4" Meter	12.50

Private Fire 6″ Meter	25.00
Private Fire 8″ Meter	40.00
Private Fire 10″ Meter	57.50
COMMODITY CHARGES: (per 1,000 gallons)	
Residential (All Meter Sizes)	
First 2,000 gallons	$ 1.4221
2,001 to 5,000 gallons	2.8443
5,001 to 9,000 gallons	4.7405
9,001 to 21,000 gallons	6.6367
Over 21,000 gallons	8.0920
Commercial	
5/8 x 3/4″ Meter	
First 9,000 gallons	$ 4.7405
Over 9,000 gallons	8.0920
1″ Meter	
First 18, 000 gallons	$ 4.7405
Over 18,000 gallons	8.0920
1 1/2″ Meter	
First 34,000 gallons	$ 4.7405
Over 34,000 gallons	8.0920
2″ Meter	
First 53,000 gallons	$ 4.7405
Over 53,000 gallons	8.0920
3″ Meter	
First 107,000 gallons	$ 4.7405
Over 107,000 gallons	8.0920
4″ Meter	
First 168,000 gallons	$ 4.7405
Over 168,000 gallons	8.0920
6″ Meter	
First 340,000 gallons	$ 4.7405
Over 340,000 gallons	8.0920
8″ Meter	
First 547,000 gallons	$ 4.7405
Over 547,000 gallons	8.0920
Interruptible	$ 5.2376
Wholesale (Phoenix) OWU	0.5102

[*255]

SERVICE LINE AND METER INSTALLATION CHARGE: **(Refundable Pursuant to A.A.C. R14-2-405)**			
Meter Size	**Service Line Charges**	**Meter Charges**	**Total Charges**
5/8″ x 3/4″ Meter	$ 370.00	$ 130.00	$ 500.00
3/4″ Meter	370.00	205.00	575.00
1″ Meter	420.00	240.00	660.00
1-1/2″ Meter	450.00	450.00	900.00
2″ Turbine	580.00	945.00	1,525.00
2″ Compound	580.00	1,640.00	2,220.00

SERVICE LINE AND METER INSTALLATION CHARGE: (Refundable Pursuant to A.A.C. R14-2-405)	Service Line Charges	Meter Charges	Total Charges
3″ Turbine	745.00	1,420.00	2,165.00
3″ Compound	765.00	2,195.00	2,960.00
4″ Turbine	1,090.00	2,270.00	3,360.00
4″ Compound	1,120.00	3,145.00	4,265.00
6″ Turbine	1,610.00	4,425.00	6,035.00
6″ Compound	1,630.00	6,120.00	7,750.00
Over 6″	Cost	Cost	Cost

SERVICE CHARGES:	
Reconnection (During business hours)	$ 60.00
Reconnection (After business hours)	90.00
Insufficient Funds. NSF Fee	25.00
Customer Requested Meter Reread (if not in error)	10.00
Meter Test Charge (Less than 3% difference)	30.00

ANTHEM WATER 2012

MONTHLY USAGE CHARGE	
Residential and Commercial	
5/8″ x 3/4″ Meter	$ 25.39
1″ Meter	63.47
1-1/2″ Meter	126.94
2″ Meter	203.11
3″ Meter	406.21
4″ Meter	634.70
6″ Meter	1,269.41
8″ Meter	2,031.05
Private Fire	
Private Fire 3″ Meter	$ 10.00
Private Fire 4″ Meter	12.50
Private Fire 6″ Meter	25.00
Private Fire 8″ Meter	40.00
Private Fire 10″ Meter	57.50
COMMODITY CHARGES: (per 1,000 gallons)	
Residential (All Meter Sizes)	
First 2,000 gallons	$ 1.5233
2,001 to 5,000 gallons	3.0466
5,001 to 9,000 gallons	5.0776
9,001 to 21,000 gallons	7.1087
Over 21,000 gallons	8.6675
Commercial	
5/8 x 3/4″ Meter	
First 9,000 gallons	$ 5.0776
Over 9,000 gallons	8.6675
1″ Meter	
First 18, 000 gallons	$ 5.0776
Over 18,000 gallons	8.6675

1 1/2" Meter	
First 34,000 gallons	$ 5.0776
Over 34,000 gallons	8.6675
2" Meter	
First 53,000 gallons	$ 5.0776
Over 53,000 gallons	8.6675
3" Meter	
First 107,000 gallons	$ 5.0776
Over 107,000 gallons	8.6675
4" Meter	
First 168,000 gallons	$ 5.0776
Over 168,000 gallons	8.6675
6" Meter	
First 340,000 gallons	$ 5.0776
Over 340,000 gallons	8.6675
8" Meter	
First 547,000 gallons	$ 5.0776
Over 547,000 gallons	8.6675
Interruptible	$ 5.6101
Wholesale (Phoenix) OWU	0.5465

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SERVICE LINE AND METER INSTALLATION CHARGE:			
(Refundable Pursuant to A.A.C. R14-2-405)			
	Service Line		
Meter Size	**Charges**	**Meter Charges**	**Total Charges**
5/8" x 3/4" Meter	$ 370.00	$ 130.00	$ 500.00
3/4" Meter	370.00	205.00	575.00
1" Meter	420.00	240.00	660.00
1-1/2" Meter	450.00	450.00	900.00
2" Turbine	580.00	945.00	1,525.00
2" Compound	580.00	1,640.00	2,220.00
3" Turbine	745.00	1,420.00	2,165.00
3" Compound	765.00	2,195.00	2,960.00
4" Turbine	1,090.00	2,270.00	3,360.00
4" Compound	1,120.00	3,145.00	4,265.00
6" Turbine	1,610.00	4,425.00	6,035.00
6" Compound	1,630.00	6,120.00	7,750.00
Over 6"	Cost	Cost	Cost

SERVICE CHARGES:	
Reconnection (During business hours)	$ 60.00
Reconnection (After business hours)	90.00
Insufficient Funds, NSF Fee	25.00
Customer Requested Meter Reread (if not in error)	10.00
Meter Test Charge (Less than 3% difference)	30.00

ANTHEM WATER 2013

MONTHLY USAGE CHARGE
Residential and Commercial

5/8″ x 3/4″ Meter	$ 27.08
1″ Meter	67.69
1-1/2″ Meter	135.38
2″ Meter	216.61
3″ Meter	433.22
4″ Meter	676.90
6″ Meter	1.353.80
8″ Meter	2.016.09
Private Fire	
Private Fire 3″ Meter	$ 10.00
Private Fire 4″ Meter	12.50
Private Fire 6″ Meter	25.00
Private Fire 8″ Meter	40.00
Private Fire 10″ Meter	57.50
COMMODITY CHARGES: (per 1,000 gallons)	
Residential (All Meter Sizes)	
First 2,000 gallons	$ 1.6246
2,001 to 5,000 gallons	3.2491
5,001 to 9,000 gallons	5.4152
9,001 to 21,000 gallons	7.5813
Over 21.000 gallons	9.2438
Commercial	
5/8 x 3/4″ Meter	
First 9,000 gallons	$ 5.4152
Over 9,000 gallons	9.2438
1″ Meter	
First 18,000 gallons	$ 5.4152
Over 18,000 gallons	9.2438
1 1/2″ Meter	
First 34,000 gallons	$ 5.4152
Over 34,000 gallons	9.2438
2″ Meter	
First 53,000 gallons	$ 5.4152
Over 53,000 gallons	9.2438
3″ Meter	
First 107,000 gallons	$ 5.4152
Over 107,000 gallons	9.2438
4″ Meter	
First 168,000 gallons	$ 5.4152
Over 168,000 gallons	9.2438
6″ Meter	
First 340,000 gallons	$ 5.4152
Over 340,000 gallons	9.2438
8″ Meter	
First 547,000 gallons	$ 5.4152
Over 547,000 gallons	9.2438
Interruptible	$ 5.9831
Wholesale (Phoenix) OWU	0.5828

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SERVICE LINE AND METER INSTALLATION CHARGE: (Refundable Pursuant to A.A.C. R14-2-405)			
Meter Size	Service Line Charges	Meter Charges	Total Charges
5/8" x 374" Meter	$ 370.00	$ 130.00	$ 500.00
3/4" Meter	370.00	205.00	575.00
1" Meter	420.00	240.00	660.00
1-1/2" Meter	450.00	450.00	900.00
2" Turbine	580.00	945.00	1,525.00
2" Compound	580.00	1,640.00	2,220.00
3" Turbine	745.00	1,420.00	2,165.00
3" Compound	765.00	2,195.00	2,960.00
4" Turbine	1,090.00	2,270.00	3,360.00
4" Compound	1,120.00	3,145.00	4,265.00
6" Turbine	1,610.00	4,425.00	6,035.00
6" Compound	1,630.00	6,120.00	7,750.00
Over 6"	Cost	Cost	Cost

SERVICE CHARGES:	
Reconnection (During business hours)	$ 60.00
Reconnection (After business hours)	90.00
Insufficient Funds, NSF Fee	25.00
Customer Requested Meter Reread (if not in error)	10.00
Meter Test Charge (Less than 3% difference)	30.00

EXHIBIT A

SUN CITY WATER

MONTHLY USAGE CHARGE	
Residential and Commercial	
5/8" x 3/4" Low Income	$ 4.38
5/8" x 3/4" Meter	8.76
1" Meter	21.89
1-1/2" Meter	43.78
2" Meter	70.05
3" Meter	140.10
4" Meter	218.90
6" Meter	437.81
8" Meter	700.50
Public Interruptible - Peoria	$ 8.16
Irrigation - 2"	77.59
Private Fire	
Private Fire 3" Meter	$ 9.73
Private Fire 4" Meter	9.73
Private Fire 6" Meter	9.73
Private Fire 8" Meter	14.01
Private Fire 10"Meter	20.14
Private Hydrant - Peoria	8.22

COMMODITY CHARGES: (per 1,000 gallons)	
Residential (All Meters)	
First 1,000 gallons	$ 0.7297
1,001 to 3,000 gallons	1.0702
3,001 to 9,000 gallons	1.3621
9,001 to 12,000 gallons	1.6539
Over 12,000 gallons	2.0156
Commercial	
5/8 x 3/4" Meter	
First 9,000 gallons	$ 1.3621
Over 9,000 gallons	2.0156
1" Meter	
First 20,000 gallons	$ 1.3621
Over 20,000 gallons	2.0156
1 1/2" Meter	
First 40,000 gallons	$ 1.3621
Over 40,000 gallons	2.0156
2" Meter	
First 64,000 gallons	$ 1.3621
Over 64,000 gallons	2.0156
3" Meter	
First 131,000 gallons	$ 1.3621
Over 131,000 gallons	2.0156
4" Meter	
First 205,000 gallons	$ 1.3621
Over 205,000 gallons	2.0156
6" Meter	
First 415,000 gallons	$ 1.3621
Over 415,000 gallons	2.0156
8" Meter	
First 670,000 gallons	$ 1.3621
Over 670,000 gallons	2.0156
Public Interruptible - Peoria	$ 1.1632
Irrigation - 2"	1.2551
Irrigation - Raw	1.0037
Central AZ Project	0.8480
Private Hydrant - Peoria	1.1400

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SERVICE LINE AND METER INSTALLATION CHARGE:			
(Refundable Pursuant to A.A.C. R14-2-405)			
	Service Line		
Meter Size	**Charges**	**Meter Charges**	**Total Charges**
5/8" x 3/4" Meter	$ 370.00	$ 130.00	$ 500.00
3/4" Meter	370.00	205.00	575.00
1" Meter	420.00	240.00	660.00
1-1/2" Meter	450.00	450.00	900.00
2" Turbine	580.00	945.00	1,525.00
2" Compound	580.00	1,640.00	2,220.00

SERVICE LINE AND METER INSTALLATION CHARGE: (Refundable Pursuant to A.A.C. R14-2-405)			
Meter Size	Service Line Charges	Meter Charges	Total Charges
3″ Turbine	745.00	1,420.00	2,165.00
3″ Compound	765.00	2,195.00	2,960.00
4″ Turbine	1,090.00	2,270.00	3,360.00
4″ Compound	1,120.00	3,145.00	4,265.00
6″ Turbine	1,610.00	4,425.00	6,035.00
6″ Compound	1,630.00	6,120.00	7,750.00
Over 6″	Cost	Cost	Cost

SERVICE CHARGES:	
Reconnection (During business hours)	$ 30.00
Reconnection (After business hours)	40.00
Insufficient Funds, NSF Fee	25.00
Customer Requested Meter Reread (if not in error)	5.00
Meter Test Charge	10.00

Groundwater Savings Fee:	
Residential (Per Unit)	$ 1.5650
Non-Residential (Per 1,000 gallons)	0.1192

ANTHEM/AGUA FRIA WASTEWATER

Monthly Usage Charge:	
Residential	$ 39.84
Commercial 5/8″	44.48
Commercial 3/4″	66.72
Commercial 1″	89.06
Commercial LG	178.05
Commodity Charge (Per 1,000 gallons water usage)	
Residential*(First 7,000 gallons only)	$ 4.9946
Commercial 5/8″ (First 10,000 gallons only)	5.5760
Commercial 3/4″ (First 15,000 gallons only)	5.5760
Commercial 1″ (First 20,000 gallons only)	5.5760
Commercial LG (All gallons)	5.5760
Wholesale Phoenix (All gallons)	5.5760
Effluent Charge:	
All gallons (Per Acre-foot)	$ 250.00
All gallons (Per 1,000 gallons	0.77
Annual Fee for Industrial Discharge Service	
<= 50,000 gallons water per month	$ 500.00
> 50,000 gallons water per month	1,000.00
Sewer Facilities Hook-Up Fees	
Fee per Equivalent Residential Unit ("ERU")	765.00
ERU Schedule:	
Single Family Home	1.00
Apartment Units	0.50
Commercial Units (per acre)	4.00
Resorts (per room)	0.50
SERVICE CHARGES:	

Establishment during business hours	$ 30.00
Establishment after business hours	45.00
Reconnection (delinquent)	40.00
Reconnection after hours	55.00
NSF Check	15.00
Late Fee (Per Month)	1.50%
* Commencing June 1, 2012, each residential	
customer's commodity charges will be based on that	
customer's average water usage for the most recent	
January, February and March combined average	
actual water usage for those months, without the	
current 7,000 gallon cap. The commodity charges	
will be reset annually based on the most recent	
January, February and March combined average	
actual water usage for those months.	

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SUN CITY WASTEWATER

Monthly Usage Charge:	
Residential	
Single Unit 5/8" x 3/4"	$ 18.11
Single Unit 1"	46.86
Single Unit 1-1/2"	93.73
Single Unit =>2"	149.96
Single Unit Non Water	18.11
Multi Unit All Water	18.11
Multi Unit Non Water	18.11
Commercial	
WC	$ 5.64
DW	43.03
WM	10.48
WR	21.31
RR	10.94
Paradise Park I/U	8,711.69
Single Unit 5/8" x 3/4"	9.20
Single Unit 1"	23.02
Single Unit 1-1/2"	46.02
Single Unit 2"	73.63
Single Unit >2"	73.63
Single Unit Non Water	73.63
Multi Unit 5/8" x 3/4"	9.20
Multi Unit 1"	23.02
Multi Unit 1-1/2"	46.02
Multi Unit 2"	73.63
Multi Unit >2"	73.63
Multi Unit Non Water	73.63
Large User => 2"	73.63
Commercial Volumetric Charge	
(Per 1,000 gallons water usage)	$ 1.2862
Paradise Park I/U Volumetric Charge	
(Per 1,000 gallons water usage)	$ 1.8770

Annual Fee for Industrial Discharge Service	
<=50,000 gallons water per month	$ 500.00
> 50,000 gallons water per month	1,000.00
SERVICE CHARGES:	
Reconnection (During business hours)	$ 30.00
Reconnection (After business hours)	40.00
Insufficient Funds, NSF Fee	10.00

SUN CITY WEST WASTEWATER

Monthly Usage Charge:	
Residential	
Single Unit 5/8" x 3/4"	$ 30.96
Single Unit 1"	77.40
Single Unit 1-1/2"	154.79
Single Unit =>2"	247.66
S Unit Non Water	30.96
M all Unit	30.96
Commercial	
WC	$ 11.65
DW	93.42
WM	21.80
WR	45.67
S Unit 5/8" x 3/4"	17.65
S Unit 1"	44.13
S Unit 1-1/2"	88.27
S Unit 2"	141.23
S Unit >2"	141.23
S Unit Non Water	141.23
M Unit 5/8" x 3/4"	17.65
M Unit 1"	44.13
M Unit 1-1/2"	88.27
M Unit 2"	141.23
S Unit >2"	141.23
S Unit LU =>2"	141.23
Commercial Volumetric Charge	
(Per 1,000 gallons water usage)	$ 2.6024
Annual Fee for Industrial Discharge Service	
<=50,000 gallons water per month	$ 500.00
> 50,000 gallons water per month	1,000.00
SERVICE CHARGES:	
Reconnection (During business hours)	$ 30.00
Reconnection (After business hours)	40.00
Insufficient Funds, NSF Fee	25.00

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TYPICAL BILL IMPACTS

09-0343

ANTHEM WATER:

Under the rates adopted herein, an average usage (9,616 gallons/ month) Anthem Water district residential customer on a 5/8 x 3/4-inch meter will experience in 2011 an increase of $ 20.91, or approximately 56.2 percent, from $ 37.22 per month to $ 58.13 per month and in 2012 an additional increase of $ 4.14 or approximately 7.1 percent to $ 62.27 per month. Rates will additionally increase in 2013 by $ 4.14 or approximately 6.7 percent to $ 66.41 per month according to the phase in plan.

SUN CITY WATER:

Under the rates adopted herein, an average water usage (7,954 gallons per month) Sun city Water district residential customer with a 5/8 x 3/4-inch water meter will experience an increase of $ 1.65, or approximately 9.9 percent, from $ 16.73 per month to $ 18.38 per month.

ANTHEM / AGUA FRIA WASTEWATER:

Under the rates adopted herein, an average water usage (5,632 gallons per month) Anthem/Agua Fria Wastewater district residential customer with a 5/8 x 3/4-inch water meter will experience an increase of $ 20.61, or approximately 43.5 percent, from $ 47.36 per month to $ 67.97 per month.

SUN CITY WASTEWATER:
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Under the rates adopted herein, an average water usage Sun City Wastewater district residential customer with a 5/8 x 3/4-inch water meter will experience an increase of $ 4.42, or approximately 32.3 percent, from $ 13.69 per month to $ 18.11 per month.

SUN CITY WEST WASTEWATER:

Under the rates adopted herein, an average water usage Sun City West Wastewater district residential customer with a 5/8 x 3/4-inch water meter will experience an increase of $ 5.95, or approximately 23.8 percent, from $ 25.01 per month to $ 30.96 per month.

EXHIBIT "B"

Sun City/Youngtown

Low Income Assistance Program For Condominium Residents

Planning Meeting

SCTA Office

July 29, 2010

[SEE ILLUSTRATION IN ORIGINAL]

[SEE FORM IN ORIGINAL]

EXHIBIT "C"

DE-PRE-CIA-TION RATES FOR WA-TER SYS-TEMS -An-them Water Dis-trict					
NARUC Acct	Company's Account #.	Depreciable Plant	Decision # # 70372	Company's proposed rate (%)	Rate (%)
301	301000	Organization	0	0	0
302	302000	Franchises	0	0	0
303	303200	Land & Ld Rights SS	0	0	0
	303300	Land & Ld Rights P	0	0	0
	303500	Land & Ld Rights TD	0	N/A	0
	303600	Land & Land Rights AG	0	N/A	0
304	304100	Struct & Imp SS	2.50	2.50	2.50
	304200	Struct & Imp P	1.67	1.67	1.67
	304300	Struct & Imp WT	1.67	1.67	1.67
	304400	Struct & Imp TD	1.67	1.67	1.67
	304510	Struct & Imp AG Cap Lease	0	N/A	0
	304600	Struct & Imp Offices	1.67	1.68	1.67
	304620	Struct & Imp Leasehold	1.67	0	1.67
	304700	Struct & Imp	0.00	N/A	0.00
		Store,Shop,Gar			
305	305000	Collect & Impounding	1.67	2.50	2.50
306	306000	Lake, River & Other	2.50	2.50	2.50
		Intakes			
307	307000	Wells & Springs	2.52	2.52	2.52
308	308000	Infiltration Galleries &	N/A	6.67	2.00 n3
		Tunne			
310	310100	Power Generation Equip	N/A	4.42	4.42
		Other			
311	311200	Pump Equip Electric	4.42	4.42	4.42
	311300	Pump Equip Diesel	N/A	4.42	4.42
	311500	Pump Equip Other	4.42	4.42	4.42
320	320100	WT Equip Non-Media	4.00	7.06 n4	7.06
	320200	WT Equip Filter Media	N/A	5.00 n4	5.00
330	330000	Dist Reservoirs &	1.67	1.67	1.67
		Standpipe			
331	331001	TD Mains Not Classified by	1.53	1.56	1.53
		size			
	331100	TD Mains 4-inch & Less	1.53	1.53	1.53
	331200	TD Mains 6-inch to 8-inch	1.53	1.53	1.53
	331300	TD Mains 10-inch to	1.53	1.53	1.53
		16-inch			
333	333000	Services	2.48	2.48	2.48

DE-PRE-CIA-TION RATES FOR WA-TER SYS-TEMS -An-them Water Dis-trict					
NARUC Acct	Company's Account #.	Depreciable Plant	Decision # # 70372	Company's proposed rate (%)	Rate (%)
334	334100	Meters	2.51	6.67 n4	6.67
	334200	Meter Installations	2.51	2.51	2.51
	334300	Meter Vaults	N/A	2.51	2.51
335	335000	Hydrants	1.99	2.00	2.00
336	N/A	Backflow Prevention	N/A	N/A	6.67
		Devices			
340	340100	Office Furniture & Equip	4.59	4.55	4.55
	340200	Comp & Periph Equip	4.59	10.00 n4	10.00
	340300	Computer Software	N/A	25.00 n4	25.00
	340330	Comp Software Other	N/A	25.00 n4	25.00
341	341100	Trans Equip Lt Duty Trks	25.00	20.00 n4	20.00
	341200	Trans Equip Hvy Duty Trks	25.00	15.00 n4	15.00
		Transportation Equipment -		25.00	
	341300	Other n1	N/A		20.00
	341400	Trans Equip Other n2	25.00	16.67	16.67
342	34.2000	Stores Equipment	0.00	N/A	0.00
343	343000	Tools, Shop, Garage Equip	1.53	4.14	4.14
344	344000	Laboratory Equipment	3.71	3.71	3.71
345	345000	Power Operated Equipment	1.53	5.14	5.14
346	346100	Comm Equip Non-Telephone	9.76	10.28	10.28
	346190	Remote Control &	N/A	9.76	9.76
		Instrumentation			
	346200	Comm Equip Telephone	9.76	9.76	9.76
	346300	Comm Equip Other	7.91	4.93	4.93
347	347000	Misc Equipment	0.00	6.19	6.19
Notes: 1. Per the Com-pany, this account reflects trans-porta-tion auto-mo-					

DE-PRE-CIA-TION RATES FOR WA-TER SYS-TEMS -An-them Water Dis-trict					
			Decision #	Company's	
NARUC	Company's		# 70372	proposed rate	
Acct	Account #.	Depreciable Plant		(%)	Rate (%)
biles.					
2. Per the Com-pany, this account reflects trans-porta-tion equip-ment					
other than trucks, such as trailers and cars, etc.					
3. Per the Compa-ny's re-sponse to Data Request No. STF 14.8,					
this account in-cludes source water supply facili-ties, such					
as,					

DE-PRE-CIA-TION RATES FOR WA-TER SYS-TEMS -An-them Water Dis-trict					
			Decision #	Company's	
NARUC	Company's		# 70372	proposed rate	
Acct	Account #.	Depreciable Plant		(%)	Rate (%)
the CAP pump-ing station and pipeline from the CAP canal					
to the Anthem Water Treat-ment Plant. The depre-ciation rate					
is consis-tent with that of Ac-count Nos. 331400 and 30900					
used in the Sun City Water District.					
4. Ap-proved in					

DEPRECIATION RATES FOR WATER SYSTEMS -Anthem Water District					
			Decision #	Company's	
NARUC	Company's		# 70372	proposed rate	
Acct	Account #.	Depreciable Plant		(%)	Rate (%)
Decision No. 71410.					

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DEPRECIATION RATES FOR SUN CITY WATER DISTRICT					
				Rate (%)	
				Sun City	
NARUC	Company's	Depreciable Plant	Decision #	Water	
Acct #	Account #.		70351	proposed	Rate (%)
301	301000	Organization	0	0	0
302	302000	Franchises	0	0	0
303		Land & Land Rights	0		0
	303200	Land & Land Rights SS	0	0	0
	303300	Land & Land Rights P	0	0	0
	303500	Land & Land Right TD	0	0	0
	303600	Land & Land Right AG	0	0	0
304		Structures & Improvements			
	304100	Structure & Improvement SS	2.50	2.50	2.50
	304200	Structure & Improvement P	1.67	1.67	1.67
	304300	Structures and Improvements	1.67	1.67	1.67
		WT			
	304400	Structure & Improvement TD	2.00	2.00	2.00
	304500	Structure & Improvement AG	N/A	3.99 n1,2	3.99
	304600	Structure & Improvement	4.63	4.63	4.63
		office			
	304620	Structure & Improvement	N/A	N/A	0

DE-PRE-CIA-TION RATES FOR SUN CITY WATER DIS-TRICT					
				Rate (%)	
				Sun City	
NARUC	Company's	Depreciable Plant	Decision #	Water	
Acct #	Account #.		70351	proposed	Rate (%)
		Leasehold			
	304800	Structure & Improvement	1.67	1.67	1.67
		Misc			
305	305000	Collection & Impounding	2.50	2.50	2.50
		reservoirs			
307	307000	Wells & Springs	2.52	2.52	2.52
309	309000	Supply Mains	N/A	2.00	2.00
310	310000	Power Generation Equip	4.42	4.42	4.42
	310100	Power Generation Equip	N/A	4.42	4.42
		Other			
311		Pumping Equipment			
	311200	Pump Equipment Electric	4.42	4.42	4.42
	311300	Pump Equipment Diesel	5.00	5.00	5.00
	311400	Pump Equipment Hydraulic	N/A	4.42	4.42
	311500	Pump Equipment Other - pump	5.01	5.01	5.01
		parts n1			
320		Water Treatment			
	320100	Water Treatment Equipment	4.00	7.06 n2	7.06
		Non-Media			
330		Distribution Reservoirs &			
		Standpipes			
	33000	Distribution Reservoirs &	1.67	1.67	1.67
		Standpipes			
331		Transmission and			
		Distribution			
	331001	TD mains not classified by	1.53	1.53	1.53
		size			
	331100	TD mains 4-inch & less	1.53	1.53	1.53
	331200	TD mains 6-inch to 8-inch	1.53	1.53	1.53
	331300	TD mains 10-inch to 16-inch	1.53	1.53	1.53
	331400	TD mains 18-inch & Grtr	N/A	2.00 n2	2.00
333	333000	Services	2.48	2.48	2.48
334		Meters			
	334100	Meters	2.51	6.67 n2	6.67 n5
	334200	Meter installations	2.51	2.51	2.51
335	335000	Hydrants	2.00	2.00	2.00
336	N/A	Backflow Prevention Devices	6.67	N/A	6.67
339		Other Plant & Misc			
		Equipment			

DE-PRE-CIA-TION RATES FOR SUN CITY WATER DIS-TRICT					
				Rate (%)	
				Sun City	
NARUC	Company's	Depreciable Plant	Decision #	Water	
Acct #	Account #.		70351	proposed	Rate (%)
	339100	Other P/E Intangible	0	0	0
	339500	Other P/E TD n3	2.00	20.00	0.00 n3
340					
	340100	Office Furniture &	4.59	4.59	4.59
		Equipments			
	340200	Computer & periph equipment	4.59	10.00 n2	10.00
	340300	Computer Software	N/A	25.00 n2	25.00
	340310	Computer Software	N/A	25.00 n2	25.00
	340325	Computer Software Custom	N/A	25.00 n2	25.00
	340330	Computer Software other	N/A	25.00 n2	25.00
	340500	Other Office Equip -	N/A	7.13 n1	7.13
		ice/water machine n1			
341		Transportation Equipment			
	341100	Transportation Equip, Lt	25.00	20.00 n2	20.00
		Duty Trucks			
	341200	Transportation Equip, heavy	25.00	15.00 n2	15.00
		Duty Trucks			
	341400	Trans Equip - Other -			
		trailer for flatbed			
		backhoe n1	N/A	16.67	16.67
342	342000	Store Equipments	3.91	3.91	3.91
343	343000	Tools Shop & Garage	4.02	4.02	4.02
		Equipments			
344	344000	Lab equipments	3.71	3.71	3.71
345	345000	Power operated equipments	5.20	5.20	5.20
346		Communication Equipments			
	346100	Communication Equip	10.30	10.30	10.30
		non-telephone			
	346190	Remote Control & Instrument	10.30	10.30	10.30
	346200	Communication Equip -	10.30	10.30	10.30
		Telephone			
	346300	Communication Equip Other	4.93	4.93	4.93
347	347000	Misc Equipment	0.0	6.19 n4	6.19
Notes:					
1. Per the District's response to Data Request					

DE-PRE-CIA-TION RATES FOR SUN CITY WATER DIS-TRICT					
				Rate (%)	
				Sun City	
NARUC	Company's	Depreciable Plant	Decision #	Water	
Acct #	Account #.		70351	proposed	Rate (%)
STF 14.1-14.7.					
2. Referred to Decision # 71410.					
3. This account is for easement/ right of way, the depreciation rate					
should be 0%.					
4. According to the District, this account only includes an eye					
wash drench for Well # 5.1 that was in service in May 2009.					
5. Per the District's February 18 and 19 e-mails, the Company					
had begun its 15-year					

DEPRECIATION RATES FOR SUN CITY WATER DISTRICT					
				Rate (%)	
				Sun City	
NARUC	Company's	Depreciable Plant	Decision #	Water	
Acct #	Account #.		70351	proposed	Rate (%)
automatic meter replacement program in 2009.					
The depreciation rate for meter should be 6.67%.					

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DEPRECIATION RATES FOR ANTHEM/ AGUA FRIA WASTEWATER DISTRICT					
NARUC	Co.'s		Decision #	Co's proposed	Depreciation
Acct #	Account	Description	70372	rate (%)	Rate (%)
304	304100 n1	Struct & Imp SS	2.50%	0	0
304	304200 n1	Struct & Imp P	N/A	0	0
304	304510 n1	Struct & Imp AG Cap	N/A	0	0
		Lease			
304	304600 n1	Struct & Imp Offices	N/A	0	0
304	304620 n1	Struct & Imp	N/A	0	0
		Leasehold			
304	304800 n1	Struct & Imp Misc	N/A	0	0
307	307000 n1	Wells & Springs	N/A	0	0
340	340100 n1	Office Furniture &	N/A	0	0
		Equip			
340	340200 n1	Comp & Periph Equip	0%	10.00	10.00

DE-PRE-CIA-TION RATES FOR AN-THEM/ AGUA FRIA WASTEWATER DIS-TRICT					
NARUC	Co.'s		Decision #	Co's proposed	Depreciation
Acct #	Account	Description	70372	rate (%)	Rate (%)
340	340300 n1	Computer Software	N/A	0	0
340	340330 n1	Comp Software Other	N/A	0	0
340	340500 n1	Other Office	N/A	0	0
		Equipment			
341	341100 n1	Trans Equip Lt Duty	N/A	20.00	20.00
		Trucks			
341	341200 n1	Trans Equip Hvy Duty	25.00%	15.00	15.00
		Trks			
341	341400 n1	Trans Equip Other n2	25.00%	16.67	16.67
343	343000 n1	Tools, Shop, Garage	4.47%	4.47	4.47
		Equip			
344	344000 n1	Lab Equipment	N/A	0	0
346	346100 n1	Comm Equip	N/A	0	0
		Non-Telephone			
346	346200 n1	Comm Equip Telephone	N/A	0	0
346	346300 n1	Comm Equip Other	N/A	0	0
347	347000 n1	Misc Equipment	N/A	0	0
352	352000	WW Franchises	0.00%	0	0
353	353200	WW Land & Ld Rights	0.00%	0	0
		Coll			
353	353500	WW Land & Ld Rights	0.00%	0	0
		Gen			
354	354200	WW Struct & Imp Coll	2.50%	1.67	1.67
354	354300	WW Struct & Imp SPP	N/A	0	0
354	354400	WW Struct & Imp TDP	0.00%	1.67	1.67
354	354500	WW Struct & Imp Gen	1.67%	1.68	1.67
355	355500	WW power gen equip	N/A	5.00	4.42
		RWTP			
		WW Collection Sewers		2.07	
360	360000	Forced	2.04%		2.07
361	361100	WW Collecting Mains	2.04%	2.04	2.04
362	362000	WW Special Coll	8.40%	2.04	2.04
		Struct			
363	363000	WW Services Sewer	2.04%	2.04	2.04
364	364000	WW Flow Measuring	5.42%	10.00	10.00
		Devices			
370	370000	WW Receiving Wells	5.42%	5.00	3.33
371	371100	WW Pump Equip Elect	5.42%	5.42	5.42

DE-PRE-CIA-TION RATES FOR AN-THEM/ AGUA FRIA WASTEWATER DIS-TRICT					
NARUC	Co.'s		Decision #	Co's proposed	Depreciation
Acct #	Account	Description	70372	rate (%)	Rate (%)
371	371200	WW Pump Equip Oth	5.42%	5.42	5.42
		Power			
380	380000	WW TD Equipment	5.00%	5.00	5.00
380	380050	WW TD Equip Grit	5.00%	5.00	5.00
		Removal			
380	380100	WW Equip Sed	5.00%	5.00	5.00
		Tanks/Acc			
		WW TD Equip		5.00	5.00
		Sludge/Eff			
380	380200	RMV	N/A		
380	380250	WW TD Equip Sldge Dig	5.00%	5.00	5.00
		Tnk			
380	380300	WW TD Equip Sldge	5.00%	5.00	5.00
		Dry/Filt			
380	380400	WW TD Equip Aux Eff	N/A	5.00	5.00
		Trmt			
380	380500	WW TD Equip Chem Trmt	5.00%	5.00	5.00
		Plt			
380	380600	WW TD Equip Oth Disp	5.00%	5.00	5.00
380	380625	WW TD Gen Trmt	N/A	8.40	5.00
		WW TD Equip Influent		8.40	
		Lift			
370	380650	Station	N/A		5.00
381	381.000	WW Plant Sewers	N/A	5.00	5.00
382	382000	WW Outfall Sewer Line	N/A	5.00	5.00
389	389100	WW Oth Plt & Misc	0.00%	4.98	4.98
		Equip			
		Int			
390	390000	WW Office Furniture &	4.59%	4.59	4.59
		Equip			
391	391000	WW Trans Equipment	N/A	20.00	20.00
392	392000	WW Stores Equipment	N/A	3.96	3.96
		WW Tool Shop & Garage		4.47	
393	393000	Equip	4.47%		4.47
394	394000	WW Laboratory	3.71%	3.71	3.71
		Equipment			
395	395000	WW Power Operated	5.88%	5.02	5.02
		Equip			

DEPRECIATION RATES FOR ANTHEM/AGUA FRIA WASTEWATER DISTRICT

NARUC Acct #	Co.'s Account	Description	Decision # 70372	Co's proposed rate (%)	Depreciation Rate (%)
396	396000	WW Communication Equip	10.30%	10.30	10.30
397	397000	WW Misc Equipment	N/A	5.10	5.10
398	398000	WW Other Tangible Plant	0.00%	0.00	0.00

Notes: 1. Per Company's response to Data Request No. STF 14.12 & 14.13, the account reflects allocation of Arizona Corporate plant.

2. Per Company, the account reflects any transportation equipments that are not light truck or heavy truck; it could be trailer, mules, etc.

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DE-PRE-CIA-TION RATES FOR SUN CITY WASTEWATER DIS-TRICT

NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209	Rate (%) Sun City Sewer District proposed	Rate (%)
304	304510 n1	Struct & Imp AG Cap Lease	N/A	0	0
	304600 n1	Struct & Imp Office	N/A	0	0
	304620 n1	Struct & Imp Leaseholds	N/A	0	0
340	340100 n1	Office furniture & Equip	N/A	0	0
	340200 n1	Computer & periph equip	N/A	0	0
	340300 n1	Computer software	N/A	0	0
	340330 n1	Computer software & other	N/A	0	0
341	341100 n1	Trans equip lt duty trucks	N/A	0	0
343	343000 n1	Tools, shop, garage equip	N/A	0	0
346	346100 n1	Comm equip non-telephone	N/A	0	0
	346300 n1	Comm. Equip other	N/A	0	0
347	347000 n1	Misc equip	N/A	0	0
351	351000	Wastewater ("WW")	0	0	0
		Organization			
352	352000	WW Franchise	0	0	0
353	353200	WW Collection: Land & Land	0	0	0
		Rights			
354	354200	WW Structures and	2.50	2.50	2.50
		Improvements: collection			
	354500	WW Structures and	2.00	2.00	2.00
		Improvements general			
355	355400	WW Power Generation	3.33	3.33	3.33
		Equipment			
360	360000	WW Force Mains	2.07	2.07	2.07
361	361100	WW collection Mains	2.03	2.03	2.03
362	362000	WW special collection	8.40	8.40	8.40
		structures			
363	363000	WW sewer service	2.04	2.04	2.04
		connections			
364	364000	Flow Measuring Devices	10.00	10.00	10.00
365	N/A	Flow Measuring	5.00	N/A	5.00
		Installations			
370	N/A	WW Receiving Wells	N/A	N/A	3.33
371	371100	WW pump equipment: electric	5.42	5.42	5.42
380					
	380050	Treatment & Disposal	2.00	2.00	2.00
		Equipment: Grit Removal			
	380100	WW Treatment & Disposal			

DE-PRE-CIA-TION RATES FOR SUN CITY WASTEWATER DIS-TRICT

NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209	Rate (%) Sun City Sewer District proposed	Rate (%)
		Equipment:			
		Sedimentation tanks/ACC		2.00	2.00
	380600	WW Treatment & Disposal		2.00	2.00
		Equipment other disposal			
	380625	WW Treatment & Disposal		2.00	2.00
		Equip general treatment			
	380650	WW Treatment & Disposal			
		Equipment :Influent lift			
		station	2.00	2.00	2.00
382	382000	WW Outfall Sewer Line	2.00	2.00	2.00
389	389100	WW Other Plant & Misc	4.98	4.98	4.98
		Equipment Int			
	389600	WW oth Plt & Misc Equip	N/A	4.98	4.98
390	390000	WW Office Furniture &	4.59	4.59	4.59
		Equipments			
390.1	N/A	WW Computer Equipments.	4.55	N/A	4.55
391	391000	WW transportation equipment	25.00	20.00	20.00
393	393000	Wastewater Tools, Shop,	4.47	4.47	4.47
		Garage Equipment			
394	394000	Lab equipments	3.71	N/A	0.00
395	N/A	Power Operated Equipment	5.14	N/A	0.00
396	396000	WW Communication Equipment	10.28	10.28	10.28
397	397000	WW Misc Equipment	5.10	5.10	5.10
398	398000	WW other tangible plant	10.30	0.00	0.00

Notes: 1. Per the Company response to Data Request No. STF 14.12 these accounts contain plant allocated to corporate use.

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Figure 6 Depreciation Rates for Sun City West Wastewater					
				Rate (%) Sun City West Sewer	Staff
NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209	District proposed	Recommended Rate (%)
304	304100 n1	Structure & Imp SS	2.50 n2	2.50	2.50
304	304200 n1	Structure & Imp P	1.67 n2	1.67	1.67
304	304510 n1	Structure & Imp AG &	N/A n2	0	0
		Cap lease			
304	304600 n1	Structure & Imp	4.63 n2	1.67	1.67
		Office			
304	304620 n1	Structure & Imp	1.67	4.63	4.63
		leasehold			
304	304800 n1	Structure &	0 n2	4.63	1.67
		Improvement Misc			
307	307000 n1	Wells & Springs	2.52 n2	2.52	2.52
340	340100 n1	Office Furniture &	4.59 n2	4.04	4.04
		Equip			
340	340200 n1	Comp & Periph Equip	10 n2	10	10
340	340300 n1	Computer Software	0 n2	25.00	25.00
340	340330 n1	Computer Software	0 n2	25.00	25.00
		Other			
340	340500 n1	Other Office Equip	0 n2	0	0
341	341100 n1	Transportation Equip	25.00 n2	20.00	20.00
		- light duty trucks			
343	3430001	Tools, shop and	4.02 n2	4.47	4.47
		garage			
344	344000 n1	Lab equip	3.71 n2	0	0
346	346100 n1	Comm. Equip -	10.30 n2	0	0
		non-telephone			
346	346300 n1	Comm. Equip other	4.93 n2	0	0
347	347000 n1	Misc equipment	N/A n2	0	0
351	351000	Wastewater ("WW")	0	0	0
		Organization			
352	352000	WW Franchise	0	0	0
353	353200	WW Collection: Land &	0	0	0
		Land Rights			
	353500	WW general: Land &	0	0	0
		Land Rights			
354	354200	WW Collection:	5.00	5.00	5.00
		Structures and			
		Improvements			
	354300	WW Structures and	5.00	5.00	5.00
		Improvements: System			
		Pump Plant			

Figure 6 Depreciation Rates for Sun City West Wastewater					
				Rate (%) Sun City West Sewer District proposed	Staff Recommended Rate (%)
NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209		
	354400	WW Structures and	N/A	N/A	0
		Improvements: TDP			
	354500	WW Collection:	1.67	1.67	1.67
		Structures and			
		Improvements general			
355	355200	WW Power Generation	3.33	N/A	0.00
		Equipment -			
		Collection			
	355300	WW Power Generation	N/A	3.33	3.33
		Equipment - SPP			
360	360000	WW Force Mains	2.07	2.07	2.07
361	361100	WW collection Mains	2.04	2.04	2.04
362	362000	WW special collection	8.40	8.40	8.40
		structures			
363	363000	WW sewer service	2.04	2.04	2.04
		Connections			
364	364000	Flow Measuring	10.00	N/A	10.00
		Devices			
365	N/A	Flow Measuring	5.00	N/A	5.00
		Installations			
370	370000	WW Receiving Wells	N/A	N/A	3.33
	380650	WW Treatment &	5.00	5.00	5.00
		Disposal Equipment			
		:Influent lift			
		station			
371	371100	WW pump equipment:	5.42	10.00	10.00
		electric			
375	380400	WW Treatment &	5.00	5.00	5.00
		Disposal Equipment			
		Aux Effluent			
		Treatment			
380			5.00		
	380000	Treatment & Disposal		5.00	5.00
		Equipment			
	380050	Treatment & Disposal		5.00	5.00
		Equipment: Grit			
		Removal			
	380100	WW Treatment &			
		Disposal Equipment			
		Sedimentation			

Figure 6 Depreciation Rates for Sun City West Wastewater					
				Rate (%) Sun City West Sewer District proposed	Staff Recommended Rate (%)
NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209		
		tanks/ACC		5.00	5.00
	380200	Treatment & Disposal Equipment: Sludge/Effluent removal		5.00	5.00
	380250	Treatment & Disposal Equipment: Sludge digester tank		5.00	5.00
	380300	Treatment & Disposal Equipment: sludge dry/filter		5.00	5.00
	380350	Treatment & Disposal Equipment: sec trmt filt		5.00	5.00
	380400	WW Treatment & Disposal Equipment Aux Effluent Treatment		5.00	5.00
	380500	Treatment & Disposal Equipment: chemical treatment plant		5.00	5.00
	380600	WW Treatment & Disposal Equipment - other disp		5.00	5.00
	380625	WW TD Equip - Gen Trmt			
381	381000	WW Plant Sewers	N/A	N/A	5.00
382	382000	WW Outfall Line	5.00	5.00	5.00
389	389100	WW Other Plant & Misc Equipment Int	4.98	6.67	4.98
390	390000	WW Office Furniture & Equipments	4.59	4.59	4.59
	390100	WW Computer Equip	N/A	10.00	10.00
390.1	N/A	Computer Equipments	4.55	N/A	4.55
391	391000	WW transportation equipment	25.00	20.00	20.00
392	392000	WW stores equipment	3.91	3.91	3.91
393	393000	Wastewater Tools, Shop, Garage	4.47	4.47	4.47

Figure 6 Depreciation Rates for Sun City West Wastewater

NARUC Acct #	Company's Acct #	Depreciable Plant	Decision # 70209	Rate (%) Sun City West Sewer District proposed	Staff Recommended Rate (%)
		Equipment			
394	394000	Lab equipments	3.71	10.00	10.00
395	395000	Power Operated	5.02	5.02	5.02
		Equipment			
396	396000	Communication	10.30	10.30	10.30
		Equipment			
397	397000	WW Misc Equipment	5.10	5.10	5.10
398	398000	WW other Tangible	N/A	N/A	0.00
		Plant			

Notes: 1. Per the Company response to Data Request No. STF 14.12 these accounts contain plant allocated to corporate use.

2. Rates are approved for the Arizona American Water Company Sun City West Water District in Decision # 70209.

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1950 Wash. AG LEXIS 279

Office of the Attorney General of the State of Washington
May 10, 1950

Reporter: 1950 Wash. AG LEXIS 279

[NO NUMBER IN ORIGINAL]

May 10, 1950

Core Terms

stock, evidence of indebtedness, indebtedness, conditional sales contract, certificate, ownership, common carrier, interstate, payment of dividends, intrastate business

Syllabus

[*1]

1. CONDITIONAL SALES CONTRACTS UNDER PUBLIC SERVICE LAWS RELATING TO SECURITIES.

2. DIVIDENDS BY COMMON CARRIERS NOT SUBJECT TO APPROVAL BY PUBLIC SERVICE COMMISSION.

1. Conditional sales contracts need not be submitted to the public service commission for approval. They are not included in the term "other evidence of indebtedness" as used in our law pertaining to securities.

2. The Washington Public Service Commission has no jurisdiction to regulate the payment of dividends on common stock by common carriers engaged in both intrastate and interstate business.

Request By: Honorable Owen Clarke, Chairman
Washington Public Service Commission
Insurance Building
Olympia, Washington

Question

We have your letter in which you request our opinion in connection with the necessity for approval of securities issued and dividends paid by public service companies in compliance with chapters 151 and 155, Laws of 1933, as amended. Your questions are as follows:

> "The first situation involves an inquiry from the Washington National Bank of Tacoma, concerning a transaction whereby a motor freight carrier holding a permit from this Commission under authority of Chapter 184 of the Laws of 1935, as amended, is purchasing [*2] some motor truck equipment under a conditional sales contract, the bank holding the contract. The bank has inquired of the Commission and we request your opinion as to whether this conditional sales [[Orig. Op. Page 2]] contract must be submitted to this Commission, and receive approval of the Commission in order to avoid the effect of Section 9 of Chapter 151 of the Laws of 1933, as amended (Rem. Rev. Stat. 10439-9) declaring unauthorized issues void.
>
> "The second question upon which we are requesting your opinion involves applications of the Reliable Transfer Company at Seattle, and the System Transfer Company at Seattle, who have respectively submitted applications to the Commission for approval of proposed dividend payments in compliance with Section 11 of Chapter 151 of the Laws of 1933 (Rem. Rev. Stat. 10458-5). These companies in addition to doing an intrastate business, are also engaged in transporting freight by motor vehicle under common carrier permit from this Commission in interstate commerce moving into or out of the City of Seattle

> from and to interstate origins and destinations. In view of the decision in *State ex rel. Washington Water Power Company v. Murray, in 181 Wash. 27,* [*3] does this Commission have jurisdiction under Rem. Rev. Stat. 10458-5 to regulate the payment of dividends upon common stock of these companies operating as common carriers under permit, under the provisions of Chapter 184 of the Laws of 1935, as amended."

The conclusions reached may be summarized as follows:

1. Conditional sales contracts need not be submitted to the Public Service Commission for approval. They are not included in the term "other evidence of indebtedness" as used in our law pertaining to securities.

2. The Washington Public Service Commission has no jurisdiction to regulate the payment of dividends on common stock by common carriers engaged in both intrastate and interstate business.

[[Orig. Op. Page 3]]

Opinion By: SMITH TROY, Attorney General; PHIL H. GALLAGHER, Assistant Attorney General

Opinion

ANALYSIS

Your first question, which involves section 9, chapter 151, Laws of 1933, as amended (Rem. Rev. Stat. Supp. 10439 -9), deals with unauthorized issues of stocks and other securities. Section 2, chapter 151, Laws of 1933, as amended (Rem. Rev. Stat. Supp. 10439-2), provides for the supervision, regulation restriction, and control of public service companies to issue stocks and stock [*4] certificates or other evidence of interest or ownership, and bonds, notes and other evidence of indebtedness and to create liens of their property situated within the state. Section 1, chapter 30, Laws of 1937 (Rem. Rev. Stat. Supp. 10439-3), sets forth the conditions under which a public service company may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes and other evidence of indebtedness.

The answer to your question seems to be dependent on the meaning of the words "to issue stocks and stock certificates or other evidence of interest or ownership and bonds, notes, and other evidence of indebtedness. " A conditional sales contract would not be included in the terms "stocks, stock certificates, bonds, and notes," and, therefore, we must determine whether the expression "other evidence of indebtedness, other evidence of interest or ownership" includes a conditional sales contract. We have been unable to find any decision by our supreme court on the term "other evidence of interest or ownership or indebtedness" in so far as the interpretation of our particular law is concerned.

It is to be noted that in all sections of the law above referred [*5] to the words "issue" or "issued" are used. The word "issue," as defined by Webster's New International Dictionary, is as follows:

> "To cause to issue, to send or let out, to emit, discharge, to deliver or give out as for use, to issue provisions, to put into circulation. "

To the same effect is the definition in Black's Law Dictionary. Anderson's Law Dictionary defines the meaning of the word "issue", when used as a verb, as follows:

> "To put into circulation, to emit * * *"

In the case of *Chicago and Northwestern Railway Co. v. Railroad Commission of Wisconsin, 155 N.W. 941, 942,* we find the following language:

> [[Orig. Op. Page 4]]
>
> "* * * These rules require us, when we find in a statute words relating to a particular or specific subject, followed by general words, to restrain these general words to persons or subjects of the same genus or family to which the particular person or subjects belong. * * *"

In the case of *Lusk v. Staughton State Bank, 115 N.W. 813, 815,* the court said:

> "The execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of [***6**] as an issue of such instrument. When we speak of bills, notes or other evidence of debt issued by any bank, it is quite difficult to believe that it is intended thereby to cover or include a contract made by the bank with one of its officers for his salary, or the execution of a bond and mortgage for the purchase money of its office site. * * *"

The expression "other evidence of interest or ownership or indebtedness" is referred to in the case of *State ex rel. Veale, County Attorney, v. School Board of Tecumseh Rural High School, District No. 4, et al., 204 Pac. 742,* as follows:

> "It is but giving a common and natural effect to the language used to say that the other evidence of indebtedness means such as has been issued and distinct from such indebtedness as may have been merely incurred or created."

To the same effect is the case of *Cincinnati H. & D. Railway Co. v. Kleybolte, 80 Ohio State 311, [[80 Ohio St. 311]] 88 N.E. 879, 880,* in which the court said:

> "The term 'evidence of indebtedness' is synonymous with 'securities.'"

Likewise, in the case of *Hiller v. Olmstead, 54 F. (2d) 5,* [***7**] the court there said:

> [[Orig. Op. Page 5]]
>
> "'Evidence of indebtedness' within the statute creating estate by entireties refers only to instruments of same general nature as those mentioned therein."

Contracts executed by husband and wife for sale of land owned by husband are held not "other evidence of indebtedness." *Hendricks v. Wolf, 279 Mich. 598, 273 N.W. 282, 284.*

In *Webster Mfg. Co. v. Byrnes, 207 Cal. 630, 280 Pac. 101,* the court, in construing a section of the public utilities act, which is similar to our law, stated:

> "* * * by use of word 'other' in portion providing that public utility may issue notes for proper purposes payable within year after issuance without consent of Railroad Commission, but that no note shall, in whole or in part, be refunded by any issue of stocks or stock certificates, or bonds, notes or any term or character, or any 'other' evidence of indebtedness, without consent of commission, was meant, under doctrine of ejusdem generis, such evidence of indebtedness as had preceded it, as bonds, notes, etc."

In the case of *State ex rel. Lyon v. McCown, 92 S.C. 81, 75 S.E. 392,* [***8**] the court held that:

> "The warehouse receipts authorized to be issued under the state warehouse act * * * are not 'scrip, certificates or "other evidence of state indebtedness" ' within the meaning of constitutional article * * * restricting the issuance of such paper."

In the case of *Industrial Loan Investment Co. v. Missouri State Life Insurance Co., 222 Mo. App. 128, 3 S.W. (2d) 1046, 1048,* the court, in construing the phrase "other evidence of debt", held:

> "Authorizing seizure under attachment of certain property and other evidences of debt, held to limit evidences of debt, under the rule of ejusdem generis, to those of like kind and character to those specifically mentioned."

[[Orig. Op. Page 6]]

In the case of *Ticer v. State ex rel. Holt, 35 Okla. 1, 128 Pac. 493, 494,* the court in discussing the phrase "other evidence of indebtedness" with reference to bonds, warrants, and other evidence of indebtedness, held that the rule of ejusdem generis applies only to bonds, warrants, and other evidence of indebtedness of that character.

To the same effect is the case of *Wood v. Williams, 142 Ill. 269, 31 N.E. 681,* [***9**] in which the court pointed out that:

> "'Other evidence of indebtedness in writing' as there used refers only to evidences of indebtedness of a similar nature to those particularly enumerated. "

In the case of *People v. New York Central and H. R. R. Co., 123 N.Y.S. 125, 127,* the court stated:

> "I agree that the words 'other evidence of indebtedness' as stated in the statute, refer to obligations of like character with stocks, bonds, and notes, and that a lease as such is not included therein."

In the above cited cases the courts have indicated that the general words "other evidence of interest, or ownership, or indebtedness, " refer to indebtedness of a similar nature to those particularly enumerated and to words of like kind and character of those specifically mentioned. We believe the same interpretation should be made with reference to these words as found in our laws.

As said in the Lusk v. Staughton State Bank case, supra,

> "The execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of as an issue of such instrument"

We think the same applies to a conditional sales contract. **[*10]** It is our opinion that the terms "other evidence of indebtedness, " as used in our law pertaining to securities, refers to the words preceding them, such as stocks, stock [[Orig. Op. Page 7]] certificates, bonds, and notes, and does not include conditional sales contracts without a plain declaration to that effect. It is, therefore, not necessary for the public service companies to submit such conditional sales, contracts to the Commission for its approval.

Your second question inquires whether or not the Commission has jurisdiction, under section 11, chapter 165, Laws of 1933 (Rem. Rev. Stat. Supp., sec. 10458-5), to regulate the payment of dividends upon common stock of companies operating as common carriers engaged in doing both an intrastate and an interstate business. This statute was passed upon by our supreme court in the case of *State ex rel. Washington Water Power Co. v. E. K. Murray, 181 Wash. 27, 42 P. (2d) 429.* The court at that time discussed the history of the statute and the meaning of various words found therein. The court, in that case, stated, page 35:

> "And so, to give the words 'engaged in intrastate business in this [*11] state' any meaning whatever, they must be treated as qualifying what immediately follows; and thus treated, the word 'only' was clearly intended and the clause should be read as limiting the application of § 11 to those companies doing only an intrastate business. * * *
>
> "We are, however, convinced that there was no intent by this act to regulate the payment of dividends by those engaged in interstate as well as in intrastate business, and that, as it now appears the appellant was actually so engaged, * * *"

In view of your statement that the companies to which you refer are common carriers engaged in both interstate and intrastate business, we believe the opinion in the above entitled case is controlling, and it is, therefore, our opinion that this Commission does not have jurisdiction, under Rem. Rev. Stat. Supp. § 10458-5, to regulate the payment of the dividends upon common stock of these companies operating as common carriers under permit.

2005 Haw. PUC LEXIS 248

Hawaii Public Utilities Commission
May 13, 2005, Filed; May 12, 2005, Done
Docket No. 05-0084; Decision and Order No. 21821

Reporter: 2005 Haw. PUC LEXIS 248

In the Matter of the Petition of HAWAIIAN ELECTRIC COMPANY, INC.; For a Declaratory Ruling on the Applicability of Hawaii Revised Statutes Section 269-17, for a Capital Lease Arrangement

Core Terms

lease, new lease, evidence of indebtedness, lease agreement, stock, issuance, lease arrangement, stock certificate, prior approval, capital structure, equity capital, expenditure, public utility, indebtedness, declaratory

Panel: [*1] Carlito P. Caliboso, Chairman; Wayne H. Kimura, Commissioner; Janet E. Kawelo, Commissioner

Opinion

DECISION AND ORDER

The commission declares that, based on the facts, circumstances, and HAWAIIAN ELECTRIC COMPANY, INC.'s ("HECO") representations, *Hawaii Revised Statutes ("HRS") § 269-17* does not apply to HECO's new lease, as further described herein.

I.

Background

HECO requests a declaratory order by May 23, 2005, ruling that: (1) *HRS § 269-17* does not apply to its capital lease arrangement with the Trustees of the Estate of Bernice Pauahi Bishop, for the lease of HECO's office building located at 233 South King Street, Honolulu, Hawaii; hence (2) the commission's approval of HECO's capital lease arrangement is not required under *HRS § 269-17*. [1] In the alternative, if the commission finds that its approval of HECO's capital lease arrangement is required pursuant to *HRS § 269-17*, HECO requests that the commission approve the capital lease arrangement. [2]

[*2]

HECO makes its underlying request pursuant to Hawaii Administrative Rules ("HAR") chapter 61, subchapter 16, relating to declaratory orders. HECO served copies of its Petition upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate")(collectively, the "Parties").

On May 5, 2005: (1) HECO responded to the commission's information requests; and (2) the Consumer Advocate filed its position statement. This Decision and Order addresses HECO's request for a declaratory ruling.

II.

HRS § 269-17

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[1] HECO's Petition for a Declaratory Ruling, Verification, Attachments A and B, and Certificate of Service (collectively, the "Petition"), filed on April 6, 2005. A copy of HECO's lease is attached as Attachment A to its Petition.

[2] Id.

HRS § 269-17 states:

> **Issuance of securities.** A public utility corporation may, on securing the prior approval of the public utilities commission, and not otherwise, issue stocks and stock certificates, bonds, notes, and other evidences of indebtedness, payable at periods of not more than twelve months after the date thereof, for the following purposes and no other, namely: for the acquisition of property or for the construction, completion, extension, or improvement [*3] of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the aforesaid purposes except maintenance of service, replacements, and substitutions not constituting capital expenditure in cases where the corporation has kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which the expenditures were made, and the sources of the funds in its treasury applied to the expenditures. As used herein, "property" and "facilities", mean property and facilities used in all operations of a public utility corporation whether or not included in its public utility operations or rate base. A public utility corporation may not issue securities to acquire property or to construct, complete, extend or improve or add to its facilities or service if the commission determines that the proposed purpose will have a material [*4] adverse effect on its public utility operations.
>
> All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void.

HRS § 269-17 (underscore added).

The first and fourth sentences of *HRS § 269-17* were enacted in 1933 as Section 2202-1 of the Revised Laws of Hawaii ("RLH") 1933. [3] In 1969, the second and third sentences of HRS § 219-17 were added, defining "property" and "facilities," and prohibiting a public utility's issuance of securities if the proposed purpose will have a materially adverse effect on the utility's operations. [4] Since 1969, the text of *HRS § 269-17* remains unchanged. Most notably, the "other evidences of indebtedness" language is unchanged since its inception in 1933. [5]

[*5]

III.

Jones v. HECO

Jones v. HECO arises out of the commission's dismissal of a complaint (Docket No. 2703), which the Hawaii Supreme Court ("Court") subsequently affirmed on appeal (Appeal No. 6433).

A.

Docket No. 2703

HECO entered into a lease agreement with the Estate of Bernice Pauahi Bishop ("Bishop Estate") for 219 acres of land in Heeia Kea Valley, Kaneohe, for thirty (30) years, beginning October 1, 1964. The lease agreement provided that HECO purchase the property on September 30, 1994, or at any earlier date, by giving ten (10) days prior written notice to Bishop Estate. At the time HECO entered into the lease agreement, HECO did not seek the commission's prior approval under *HRS §§ 269-17* or *269-19*.

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[3] Act 169, Laws of the Territory of Hawaii 1933, Section 4, at 189 - 190.

[4] Act 276, Session Laws of Hawaii 1969, Section 1, at 501. The purposes of these amendments were to: (1) broaden the scope of HRS § 291-17 to permit public utility corporation's to issue securities for non-utility operations and non-rate base items; and (2) preclude the issuance of securities in the event of a materially adverse effect upon the utility's operations. See House Stand. Comm. Rpt No. 552, House Journal 1969, at 839 - 840; and Senate Stand. Comm. Rpt No. 944, Senate Journal 1969, at 1240.

[5] See Act 169, Laws of the Territory of Hawaii 1933, Section 4, at 189 - 190; RLH 1935, Section 7955; RLH 1945, Section 4716; RLH 1955, Section 104-16; Act 276, Session Laws of Hawaii 1969, Section 1, at 501; and HRS § 269-17.

In Docket No. 2703, a group of [*6] HECO's ratepayers (the "Complainants") filed a complaint against HECO, seeking to have the commission declare the lease agreement null and void based on the commission's lack of prior approval under *HRS § 269-17*. [6]

The commission rejected the Complainants' claim, reasoning that: (1) *HRS § 269-17* deals with the issuance of securities, and the "other evidences of indebtedness" language refers to indebtedness as it relates to the issuance of securities; (2) both HECO and the Complainants agreed that a simple lease is not subject to *HRS § 269-17*, since it is not a form of indebtedness contemplated under the statute; (3) an executory contract is not an evidence of indebtedness or any type of security interest; and (4) the lease rental payments were at the expense of the stockholders and not the ratepayers. [7] The commission also rejected Complainants' [*7] other causes of action, then granted HECO's motion to dismiss the complaint.

B.

Appeal No. 6433: *Jones v. HECO*

Complainants appealed the commission's dismissal to the Court, contending that the lease agreement with the proviso to purchase the Heeia Kea property was an evidence of indebtedness under *HRS § 269-17*, and thus, void based on the commission's lack of prior approval of the lease agreement.

The Court reasoned [*8] that the lease agreement was not a loan and was never intended to be issued or sold to others, and thus, was not a method of generating capital. The Court, citing to the statutory rule of construction of *ejusdem generis,* [8] then held:

> Holding the rule of *ejusdem generis* applicable to *HRS § 269-17*, 'evidence of indebtedness' is limited to things of like character to stocks and stock certificates, bonds and notes. Stocks and stock certificates, bonds and notes are usually issued as a means of raising funds for the purposes specified in *HRS § 269-17* and become part of the capital structure of the public utility. The lease agreement is not a means of raising funds for the purchase of the Heeia Kea property and is not part of the capital structure of HECO. Thus, the lease agreement is not of like character to a stock, bond or note.
>
> The PUC's decision is also consistent with the principal purpose of *HRS § 269-17*. The Commission previously found that 'the main object of the legislature in enacting § 104-16 RLH 1955 (now *HRS § 269-17* [*9]) was to establish and preserve a proper rate base for regulation of rates and service, and the immediate design thereunder was to limit not only the capital of the utility as represented by its stock but also its other obligations as far as they were designed to supplement equity capital by borrowings of a permanent character.'
>
> The lease agreement does not involve the issuance of stock or borrowings of a permanent nature designed to supplement equity capital. The agreement has no effect on the capital structure ' of HECO or on its utility expenses. Therefore, the legislature did not intend for the PUC to regulate such an agreement under *HRS § 269-17*. [9]

[*10]

Accordingly, the Court: (1) concluded that the lease agreement was not an evidence of indebtedness under *HRS § 269*

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[6] In addition, the Complainants alleged other causes of action.

[7] Decision and Order No. 4412, filed on October 27, 1976, in Docket No. 2703. The commission also noted that under its provision governing the filing of capital expenditure applications by electric utilities (General Order No. 7, Section 2.3(g)(2)), HECO "has to submit a proposed capital expenditure that is in excess of $ 500,000 for inclusion into its rate base. No such application can be filed for the Heeia Kea property since [HECO] will purchase the property in 1994 and then has to make an application to place said property in its rate base." Id. at 8 - 9.

[8] "Under this established rule of statutory construction, where words of general description follow the enumeration of certain things, those words are restricted in their meaning to objects of like kind and character with those specified." Jones v. HECO, 64 Haw. at 294, 639 P.2d at 1108 (citations and footnote therein omitted).

[9] Id. at 295, 639 P.2d at 1108 - 1109 (citation omitted).

-17, and (2) affirmed the commission's decision to dismiss the complaint under *HRS § 269-17*. [10]

IV.

New Lease

HECO leases its office building located at 233 South King Street in Honolulu ("King Street building" or "building") from Bishop Estate, the owner of the building and underlying land. HECO has occupied the King Street building since 1927, and presently uses the building primarily for office and business-related purposes. [11] Two (2) system transformers are located in the basement of the building.

[*11]

The prior lease arrangement between HECO and Bishop Estate expired on November 30, 2004, and HECO is presently on a month-to-month lease term, "at the same monthly rate just prior to the expiration of the previous lease of $ 64,583.34 per month." [12] HECO has negotiated a new twenty (20)-year lease agreement, which: (1) is classified as a capital lease for accounting and financial reporting purposes ("new lease" or "capital lease arrangement"); [13] and (2) HECO and Bishop Estate plan to execute following the commission's action in this proceeding.

[*12]

The new lease includes:

1. Monthly lease rents of $ 64,583.34 from the effective date of the new lease through November 30, 2009; $ 71,041.67 from December 1, 2009 through November 30, 2014; $ 78,145.84 from December 1, 2014 through November 30, 2019; and $ 85,960.42 from December 1, 2019 through November 30, 2024; and

2. Nine (9) million dollars Bishop Estate is providing "for improvements to be used for replacing the elevators, air conditioning system, windows, electrical system and other similar projects." [14]

In justifying the new lease provisions, HECO asserts that:

1. The ten (10) per cent escalations every five (5) years, equivalent to less than a two (2) per cent annual escalation rate, are reasonable and eliminate its exposure to potentially volatile market conditions.

2. Bishop Estate is providing the nine (9) million dollars for improvements, in recognition of: (A) the need to sustain and upgrade the building due to its age; and (B) the term of the new lease.

3. "Based on the convenience **[*13]** of the current location for its customers, to minimize disruption to operations, the rental payment terms being consistent with the current King Street lease, and the commitment from Bishop Es-

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[10] The Court also examined the other issues raised by the Complainants on appeal, and ultimately held that the commission did not err in dismissing the complaint.

[11] In addition to certain HECO departments and divisions, HECO's executives and the executives of its parent corporation, Hawaiian Electric Industries, Inc. ("HEI"), occupy the King Street building. HEI reimburses a portion of rental payments, common area costs, and capital improvements paid by HECO. HEI's portion is determined based on the square footage occupied by HEI, i.e., approximately fifteen (15) per cent. HECO states that "this arrangement is expected to continue." HECO's Petition, at 4, footnote 1.

[12] Id. at 4.

[13] HECO states that its accounting treatment of its new lease is governed by generally accepted accounting principles, in particular, the Financial Accounting Standards Board's ("FASB"), Statement of Financial Accounting Standards 13, *Accounting for Leases* ("Statement 13"), paragraph 7. Pursuant to Statement 13, Paragraph 7(d), HECO will record the new lease as a capital lease. See HECO's Petition, Section VI, Accounting Treatment for Financial Reporting Purposes, and Attachment B. Under its analysis, HECO concludes: "Since the NPV [net present value] of the minimum lease payments exceeds 90% of the estimated fair value of the leased property at the lease inception, the proposed King Street lease appears to be a capital lease for financial reporting purposes." HECO's Petition, Attachment B.

On April 13, 2005, HECO produced a copy of Statement 13 for the docket record, in response to the commission's request.

[14] HECO's Petition, at 6.

tate to provide funds for building improvements, the proposed lease is reasonable." [15]

V.

Parties' Position

HECO states that: (1) the capital lease arrangement will primarily involve the recording of HECO's King Street building, and a corresponding long-term obligation, onto HECO's financial records; and (2) it is unclear as to whether *HRS § 269-17* applies to a capital lease arrangement determined as such under Statement 13. Thus, HECO essentially asks whether its new lease constitutes "other evidences of indebtedness" "for the acquisition of property[,]" such that *HRS § 269-17* applies, thus requiring the commission's prior approval.

HECO cites to the Court's decision in *Jones v. HECO*, and a decision by the Vermont Public Service **[*14]** Board, In re Green Mountain Power Corp., 76 PUR 4th 270 (Vt. Pub. Serv. Bd., July 24, 1986), in suggesting that *HRS § 269-17* is inapplicable to a capital lease arrangement determined as such under Statement 13. [16] HECO states that it intends to address the ratemaking treatment of its capital lease in Docket No. 04-0113, HECO's pending 2005 calendar test year rate case.

The Consumer Advocate finds that under the commission's and Court's respective decisions in *Jones v. HECO:*

> . . . both maintain that *HRS § 269-17* applies only to things of like character to stocks, stock certificates, bonds, notes, and other securities **[*15]** usually issued as a means of raising funds for the purposes specified in *HRS § 269-17* and to become part of the capital structure of the public utility. Both of these decisions do not view leases as "evidence of indebtedness" similar to stocks, bonds, and other securities mentioned, and are not intended to be issued or sold as a means to supplement equity capital. This would appear to be applicable to both ordinary and capital leases since both contain no characteristics of an issued negotiable security instrument to supplement equity capital. [17]

Based on these findings, the Consumer Advocate does not object to the commission's decision to declare that *HRS § 269-17* is not applicable to the new lease. That said, the Consumer Advocate emphasizes that: (1) no part of the Consumer Advocate's position should be construed as a determination that the new lease is reasonable; **[*16]** and (2) all ratemaking and accounting treatment issues relating to the new lease should be addressed in HECO's pending rate case (Docket No. 04-0113).

V.

Declaratory Ruling

HAR § 6-61-159 provides in part that, upon the petition of an interested person, "the commission may issue a declaratory order as to the applicability of any statute . . . of the commission." The dispositive issue, thus, is whether *HRS § 269-17* applies to HECO's new lease, necessitating the commission's prior approval. This Decision and Order is: (1) premised on HECO's representation that its new lease is a capital lease under Statement 13, Paragraph 7(d); and (2) based on the facts and circumstances as represented by HECO in this docket.

The commission reaffirms its ruling that *HRS § 269-17* deals with the issuance of securities, and the "other evidences of indebtedness" language refers to indebtedness as it relates to the issuance of securities. [18] Likewise, the Court held: (1) that "other evidences of indebtedness" is limited to things of like character to stocks, stock certificates, bonds, **[*17]** and notes, usually issued as a means of raising funds for the purposes specified in *HRS § 269-17*, and become part of the utility's capital structure; and (2) *HRS § 269-17* involves the issuance of stock or borrowings of a permanent nature (i.e., payable at period of more than twelve (12) months), designed to supplement equity capital.

Based on HECO's representations, the new lease: (1) is a long-term lease of real property; (2) is not a loan or

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[15] Id.

[16] In *Green Mountain Power Corp.*, the Vermont Public Service Board ("VPSB"), in interpreting the "other evidence of indebtedness" phrase in a similar statute as HRS § 269-17, held that capital leases are not subject to the VPSB's prior approval.

[17] Consumer Advocate's position statement, at 5 (underscore in original).

[18] Decision and Order No. 4412, at 8.

method of generating capital for the purposes specified in *HRS § 269-17*, including the purchase of the leased property; (3) does not involve the issuance of stock or borrowings of a permanent nature designed to supplement HECO's equity capital; and (4) is not a security instrument for any payment owed by HECO to Bishop Estate. [19]

[*18]

Under these circumstances, the new lease does not involve indebtedness as it relates to the issuance of securities for the purposes specified in *HRS § 269-17*. Accordingly, the commission finds and declares that *HRS § 269-17* is inapplicable to HECO's new lease.

VI.

Orders

THE COMMISSION DECLARES that, under the facts and circumstances of this case, *HRS § 269-17* does not apply to HECO's new lease, as long as the facts presented and representations made to the commission in this docket remain true and accurate.

THE COMMISSION ORDERS that this docket is closed.

DONE at Honolulu, Hawaii MAY 12 2005.

PUBLIC UTILITIES COMMISSION OF THE STATE OF HAWAII

By

Carlito P. Caliboso, Chairman

By

Wayne H. Kimura, Commissioner

By

Janet E. Kawelo, Commissioner

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[19] See HECO's response to PUC-IR-203. Concomitantly, HECO explains that: (1) for financial reporting purposes, the new lease will affect HECO's capital structure, in that it will be shown on its financial statements as a long-term obligation; (2) it proposes to include: (A) amortization of the property and interest expense of the new lease obligation as utility expenses; and (B) the net present value of the lease payments in rate base; and (3) for accounting purposes, the new lease will be capitalized. See HECO's responses to PUC-IR-201 to PUC-IR-203.

As the Consumer Advocate notes, all ratemaking and accounting treatment issues relating to the new lease is deferred to HECO's pending rate case (Docket No. 04-0113). Accordingly, the scope of this Decision and Order is specifically limited to HECO's request for a declaratory ruling on the applicability of HRS § 269-17, pursuant to HAR § 6-61-159.

Berman v. Dean Witter & Co.

United States District Court for the Central District of California
January 17, 1973
Civ. No. 72-2512

Reporter: 353 F. Supp. 669; 1973 U.S. Dist. LEXIS 15339; Fed. Sec. L. Rep. (CCH) P93,907

Jack BERMAN and Leona Berman, Plaintiffs, v. DEAN WITTER & CO., INCORPORATED, Norman Sobel, Defendants

Core Terms

investment contract, yen, broker, federal securities, common enterprise, evidence of indebtedness, discretionary account, third party, pendent jurisdiction, state claims, commodities, executory, delivery, handled, pendent, cocoa

Judges: [**1] Pregerson, District Judge.

Opinion by: PREGERSON

Opinion

[*670] MEMORANDUM AND ORDER GRANTING MOTION TO DISMISS

Pregerson, District Judge.

In counts one and two of their complaint, plaintiffs seek to recover damages for alleged violations of the federal securities laws. The remaining counts of the complaint, brought here under pendent jurisdiction, assert claims for breach of fiduciary duty and for negligence under California law.

Pursuant to *F.R. Civ. P. 12(b)(1)* and *12(b)(6)*, defendants move to dismiss counts one and two for lack of subject matter jurisdiction and for failure to state claims upon which relief can be granted; in addition, they ask for dismissal of the pendent state claims. Defendants' motions were heard by the Court on December 11, 1972.

This lawsuit arises out of the purchase of five futures contracts for Japanese yen. The Bermans purchased the yen futures through the brokerage firm of Dean Witter & Co.; their account was handled by defendant Sobel.

Defendants Dean Witter and Sobel maintain that counts one and two of the complaint must fail because these yen futures contracts do not constitute "securities" within the meaning of either the Securities Act of [**2] 1933 (*15 U.S.C. § 77a et seq.*) or the Securities Exchange Act of 1934 (*15 U.S.C. § 78a et seq.*) -- the federal securities laws on which plaintiffs' federal law claims are bottomed.

Both the 1933 Act and the 1934 Act define security to include an "investment contract." *15 U.S.C. §§ 77b(1), 78c(a)(10)*. Plaintiffs argue that these yen futures are investment contracts. "[An] investment contract for purposes of the [securities acts] means a contract, [*671] transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . ." *S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298-299, 66 S. Ct. 1100, 1103, 90 L. Ed. 1244 (1946)*. The test, then, is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301, 66 S. Ct. at 1104.

In *Sinva v. Merrill, Lynch, Pierce, Fenner & Smith, 253 F. Supp. 359 (S.D.N.Y. 1966)*, the court applied this test and found that sugar futures contracts were not investment contracts, and in *Berman v. Orimex Trading, Inc., 291 F. Supp. 701 (S.D.N.Y. 1968)*, the court similarly [**3] found that cocoa futures contracts were not investment contracts. *Accord Schwartz v. Bache & Co., Inc., 340 F. Supp. 995 (S.D. Iowa 1972)*. The court in *Sinva* said, "The purchaser [of futures contracts] gained no share in a common enterprise, either between plaintiff and defendant or plaintiff and anyone else. . . . Moreover, the purchase of commodities futures involves no reliance upon the efforts of promoters, managers, employees or any third party." *Sinva, supra*, 253 F. Supp. at 366-367. Here, plaintiffs also gained no share in a common enterprise, nor did they expect profits solely from the effort of a third party. The yen futures are therefore not investment contracts.

The 1933 Act also defines security to include an "evidence of indebtedness." *15 U.S.C. § 77b(1)*. Plaintiffs next argue that since the yen futures were purchased on mar-

gin they are evidences of indebtedness. Futures contracts are agreements for the delivery of a commodity on any day in a given future month at a specified price. The fact that the agreement is executory -- the seller being obligated to make delivery in the future, the purchaser being obligated to tender payment in the future -- **[**4]** does not transform it into a securities contract. To accept plaintiffs' view of "evidence of indebtedness" would be tantamount to a declaration that all bilateral executory contracts are securities under the federal securities laws.

Finally, plaintiffs argue that although the yen futures may not be securities, nonetheless, the money provided to the broker constituted an investment contract under *Orimex, supra.* In *Orimex* the court held "that [a] discretionary account . . . constituted an investment contract." *Orimex, supra,* 291 F. Supp. at 702. The broker in that case was given money to purchase cocoa futures, but -- unlike the defendants here -- the broker made all the investment decisions; *i.e.*, the broker was "to invest as [he] saw fit." *Id.* Likewise, in *Maheu v. Reynolds & Co., 282 F. Supp. 423 (S.D.N.Y. 1967)*, the court found that a discretionary account, "managed and supervised in all respects" by the broker, was an investment contract. *Id.* at 429.

No discretionary account is involved in this case. Here plaintiff, Jack Berman, not the defendants, managed the account and initiated the inquiry into the purchase of the yen futures contracts. At page **[**5]** two of his complaint, Jack Berman states that ". . . for some substantial period of time [he] maintained, cared for, and handled [the] account" through which the purchases were made. Therefore, the plaintiffs' account was not an investment contract.

Accordingly, this Court holds that the transaction described in counts one and two of the complaint does not involve a security under the federal securities laws. Consequently, those counts are not cognizable by this Court and must be dismissed. See, *Tcherepnin v. Knight, 389 U.S. 332, 334, 88 S. Ct. 548, 552, 19 L. Ed. 2d 564 (1967)*.

Counts three and four of the complaint, based on non-federal grounds, are brought to this Court via pendent jurisdiction. They too must be dismissed. In discussing pendent claims the Supreme Court has said, "[If] the federal claims are dismissed before trial, **[*672]** even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well." *United Mine Workers v. Gibbs, 383 U.S. 715, 726, 86 S. Ct. 1130, 1139, 16 L. Ed. 2d 218 (1966)* (footnotes omitted).

Thomas v. State

Court of Criminal Appeals of Texas
November 21, 2001, Delivered
NO. 108-00

Reporter: 65 S.W.3d 38; 2001 Tex. Crim. App. LEXIS 111

JIMMY WAYNE THOMAS, Appellant v. STATE OF TEXAS

Subsequent History: [**1] As Corrected February 20, 2002.

Prior History: ON STATE'S PETITION FOR DISCRETIONARY REVIEW FROM THE FIFTH COURT OF APPEALS, DALLAS COUNTY. Thomas B. Thorpe, Judge.

Thomas v. State, 3 S.W.3d 89, 1999 Tex. App. LEXIS 6486 (Tex. App. Dallas 1999)

Disposition: Affirmed.

Core Terms

evidence of indebtedness, certificate, literal, The Texas Securities Act, written instrument, ejusdem generis, debenture, mortgage, lenders, general words, indebtedness, investment contract, doctrine, edition, federal case, electronic

Case Summary

Procedural Posture
A jury convicted defendant of securities fraud. He appealed, and the Fifth Court of Appeals, Dallas County, Texas, reversed the conviction. The State sought further review.

Overview
Defendant induced the victim to become a salesman for his corporation, and to invest money in it. The only document defendant and the victim signed was a letter of agreement that described the victim's distribution territory. The letter mentioned a $ 50,000 equity deposit for the territory, but nowhere mentioned the victim's actual investments. Neither defendant nor the corporation signed any agreement concerning the investments; issued any shares, notes, or bonds; or paid the victim any profits. Defendant used the victim's investment funds for personal expenses, and filed bankruptcy. He disclosed neither fact to the victim. He was found guilty of two counts of securities fraud in the sale or offer of sale of a security, i.e., an "evidence of indebtedness." The intermediate appellate court held that an "evidence of indebtedness" required a writing under *Tex. Rev. Civ. Stat. Ann. art. 581-4* of the Texas Securities Act. The instant court agreed. As no writing constituting an "evidence of indebtedness " was admitted at trial, nor was there was evidence that defendant offered to sell such an instrument, his conviction was improper.

Outcome
The judgment was affirmed.

LexisNexis® Headnotes

Business & Corporate Law > ... > Corporate Finance > Initial Capitalization & Stock Subscriptions > Stock Certificates
Business & Corporate Law > ... > Corporate Finance > Initial Capitalization & Stock Subscriptions > Subscription Agreements
Contracts Law > Types of Contracts > Investment Contracts
Contracts Law > Types of Contracts > Lease Agreements > General Overview
Energy & Utilities Law > Financing > General Overview
Energy & Utilities Law > Mining Industry > Mineral Leases > General Overview
Governments > State & Territorial Governments > Elections
Securities Law > Blue Sky Laws > Investment Contracts & Stocks

HN1 *Tex. Rev. Civ. Stat. Ann. art. 581-1, § 4(A)* of the Texas Securities Act defines "security," in part, as: any share, stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not.

Governments > Legislation > Interpretation

HN2 "Ejusdem generis" means of the same kind, class, or nature. The doctrine states that when interpreting general words that follow an enumeration of particular or specific things, the meaning of those general words should be confined to things of the same kind.

Governments > Legislation > Interpretation

HN3 The doctrine of ejusdem generis gives effect to both the particular and the general words of a statute, by treating the particular words as indicating the class, and the general words as extending the provisions of the statute to everything embraced in that class, though not specifically named by the particular words.

Governments > Legislation > Interpretation
Securities Law > Blue Sky Laws > Investment Contracts & Stocks

HN4 *Language in Atwood v. State, 121 S.W. 2d 353 (1938)*, to the effect that the statutory definition of "security" renders the ejusdem generis doctrine inapplicable, is disavowed by the Court of Criminal Appeals of Texas .

Criminal Law & Procedure > ... > Fraud > Securities Fraud > Elements
Governments > Legislation > Interpretation
Securities Law > Initial Offerings of Securities > Definitions > General Overview
Securities Law > Initial Offerings of Securities > Definitions > Security Defined
Securities Law > Initial Offerings of Securities > Securities Act Actions > Definitions

HN5 Because of the similarities between the Federal Securities Act of 1933, *15 U.S.C.S. § 77(b)(1)*, and *Tex. Rev. Civ. Stat. Ann. art. 581-1, § 4(A)* of the Texas Securities Act, Texas courts often look to federal cases interpreting the Federal Securities Act of 1933 for guidance in interpreting the Texas Securities Act.

Commercial Law (UCC) > Sales (Article 2) > Form, Formation & Readjustment > General Overview
Criminal Law & Procedure > ... > Fraud > Securities Fraud > General Overview

HN6 A written instrument is required for an "evidence of indebtedness" under the Texas Securities Act. The exact form the writing takes, however, is not crucial. Furthermore, the context and the circumstances surrounding the transaction may be examined in determining whether a writing constitutes an "evidence of indebtedness. *Tex. Rev. Civ. Stat. Ann. art. 581-4*. This does not mean that an actual, physical exchange of a writing is required in order for there to be a violation of the Texas Securities Act concerning an "evidence of indebtedness." When a defendant sells or offers to sell an "evidence of indebtedness" that does not actually exist or was never actually issued, he is still subject to criminal penalty.

Counsel: ATTORNEYS FOR APPELLANT: Paul G. Kratzig, Corpus Christi.

ATTORNEYS FOR STATE: Anne B. Wetherholt, Assist. DA, Dallas. Jeffrey L. Van Horn, First Assist. St. Att., Austin. MATTHEW PAUL, STATE'S ATTORNEY, AUSTIN.

Judges: Price, J., delivered the unanimous opinion of the Court.

Opinion by: Price

Opinion

[*39] A jury found the appellant guilty of securities fraud. The Court of Appeals reversed the conviction and concluded that the term other "evidence of indebtedness", as used in the definition of security in the Texas Securities Act, requires a writing. We granted review to determine whether the term other "evidence of indebtedness" requires a written instrument. [1] Because the cases that we have found all involve some form of writing, the term is part of a group of securities that are all written instruments, and the common understanding of the term seems to envision a writing, we hold that the term other "evidence of indebtedness" requires a writing. Accordingly, we shall affirm the Court of Appeals.

[2]** FACTS

The appellant met Don Edwards through Sunday school classes at their church. Through his corporation United Media Group, Inc. (UMG), the appellant attempted to develop and market electronic kiosks that could dispense videotapes. **[*40]** The appellant suggested that Edwards become a salesman for UMG and further convinced Edwards to invest in the corporation. The appellant said that Edwards could expect the return of his original principal in thirty to sixty days, would receive five times the original investment in several months, and would receive an additional five times his investment within a year. Throughout June of 1991, Edwards in-

[1] We granted review of three grounds, the first presented by the District Attorney and the other two by the State Prosecuting Attorney: 1) The Court of Appeals erred under the law governing statutory construction by interpreting the Texas Securities Act to require that "other evidence of indebtedness" be written. 2) Whether a written instrument is necessary to constitute an "evidence of indebtedness," as provided for in the definition of the term "security" in Vernon's Ann. Civ. St. art. 581-4(A). 3) Whether the Court of Appeals erred in its review of the sufficiency of the evidence by employing a more restrictive definition of the term "evidence of indebtedness" than the jury was entitled to use. Because the grounds for review were granted before our decision in *Ex parte Taylor*, 36 S.W.3d 883 (Tex. Crim. App. 2001), *Taylor* does not apply.

vested a total of $ 50,000. The only document signed by the appellant and Edwards was a June 26, 1991, letter of agreement that described Edwards's kiosk distribution territory. The letter of agreement mentions a $ 50,000 equity deposit for the territory, but nowhere mentions Edwards's actual investments.

About a month later, the appellant informed Edwards that further investment, up to $ 20,000, had become available because a family in Tennessee needed the return of its principal immediately. On August 2, 1991, Edwards invested an additional [**3] $ 10,000. Like the other investments, neither the appellant nor UMG signed any agreement concerning the investments; issued any shares, notes, or bonds; or paid Edwards any profits on his investments. It was later discovered that the appellant had filed for personal bankruptcy and had used funds invested in UMG to cover his personal expenses. The appellant disclosed neither fact to Edwards.

The appellant was indicted and later convicted for violations of the Texas Securities Act concerning the August 2, 1991, transaction. *TEX. REV. CIV. STAT. art. 581*. Specifically, a jury found the appellant guilty of two counts of securities fraud in "the sale or offer of sale" of a security, namely an "evidence of indebtedness", by: 1) failing to disclose that he had previously spent funds invested in UMG for purposes unrelated to UMG and 2) failing to disclose that he had filed for personal bankruptcy.

On direct appeal, the Court of Appeals reversed the trial court's judgment and entered a judgment of acquittal in an unpublished opinion. *Thomas v. State*, No. 05-92-01844-CR (Tex. App.-Dallas Oct. 31, 1994) (not designated for publication). The Court of Appeals [**4] rejected a definition of the term "evidence of indebtedness" used by the Texas Supreme Court in *Searsy v. Commercial Trading Corp.*, 560 S.W.2d 637, 641 (Tex. 1977) (adopting the definition of "evidence of indebtedness" from *United States v. Austin*, 462 F.2d 724, 736 (10th Cir. 1972)), and held instead that the term referred to a mortgage certificate. *Thomas*, No. 05-92-01844-CR, slip op. at 10.

We reversed the Court of Appeals decision upon the State's petition for discretionary review and adopted the *Searsy* definition of "evidence of indebtedness". We held that an "evidence of indebtedness" was "all contractual obligations to pay in the future for consideration presently received." *Thomas v. State*, 919 S.W.2d 427, 432 (Tex. Crim. App. 1996) (*Thomas II*). We remanded the case to the Court of Appeals with instructions to consider whether an "evidence of indebtedness" requires a writing under the act.

On remand, the Court of Appeals held that, because the particular provision of the Act under which Thomas was convicted is penal in nature, the statute should be narrowly construed. *Thomas v. State*, 3 S.W.3d 89, 92-93 [**5] (Tex. App.-Dallas 1999) (*Thomas III*). The Court of Appeals then held that, under the Texas Securities Act, an "evidence of indebtedness" requires a writing. *Id.* at 95. The Court of Appeals relied largely on the common law doctrine of *ejusdem generis* and on our observations from *Thomas II* that the Act's purpose and context limits how the term is construed. *Id.* at 93. It concluded that, [*41] because "evidence of indebtedness" is grouped with written instruments that all acknowledge the owing of money by agreement, an "evidence of indebtedness" must also be in writing. *Id.* at 94. Since there was no writing constituting an "evidence of indebtedness" admitted into evidence, and because there is no evidence that the appellant offered to sell such an instrument, the Court of Appeals once again entered a judgment of acquittal. *Id.* at 96.

DISCUSSION

HN1 The Texas Securities Act defines "security," in part, as:

> any share, stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, [**6] note, bond, debenture, mortgage certificate or *other evidence of indebtedness*, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not. . . .

TEX. REV. CIV. STAT. art. 581-4(A) (emphasis added).

Strict Construction and *Ejusdem Generis*

Before addressing the question of whether a writing is required, several related issues need to be addressed. [2]

[**7] The State argues that the Court of Appeals's use of *ejusdem generis* was inappropriate because the doctrine had not been discussed since Judge Davidson's dissenting opinion in *Dossey v. State*, 165 Tex. Crim. 652, 310 S.W.2d 321 (Tex. Crim. App. 1958). We disagree that the use of *ejusdem generis* was inappropriate.

HN2 Ejusdem generis means "of the same kind, class,

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[2] The State argues that the Securities Act should be liberally construed based in part on Penal Code section 1.05(a) and Government Code section 312.006(b). We need not address these arguments as the result we reach today is not dependent on either a liberal or strict construction.

or nature." BLACK'S LAW DICTIONARY 464 (6th ed. 1990). The doctrine states that when interpreting general words that follow an enumeration of particular or specific things, the meaning of those general words should be confined to things of the same kind. *Lefevers v. State*, 20 S.W.3d 707, 711 (Tex. Crim. App. 2000); *Perez v. State*, 11 S.W.3d 218, 221 (Tex. Crim. App. 2000).

In *Thomas II*, we tacitly approved of the *ejusdem generis* doctrine in determining the meaning of "evidence of indebtedness" without using that exact phrase. We viewed other "evidence of indebtedness" as "expanding upon the grouping 'note, bond, debenture, mortgage certificate.' In other words, notes, bonds, debentures and mortgage certificates are types of evidence of indebtedness, but **[**8]** 'other' evidence of indebtedness might also fall within the act." *Thomas II*, 919 S.W.2d at 430. Furthermore, we emphasized that the definition was "limited by the purposes of the Act itself and by the context in which it appears. . . . an evidence of indebtedness is a similar *type* of security as a note, bond, debenture, and mortgage certificate." *Id.* at 432. The word type is similar to kind, class, or nature, and our **[*42]** analysis is consistent with ***HN3*** *ejusdem generis*, which gives "effect to both the particular and the general words, by treating the particular words as indicating the class, and the general words as extending the provisions of the statute to everything embraced in that class, though not specifically named by the particular words." *Lefevers*, 20 S.W.3d at 711-12. The application of *ejusdem generis* was not improper. [3]

[9]** Finally, relying on our holding in *Vernon v. State*, 841 S.W.2d 407 (Tex. Crim. App. 1992), the State argues that reviewing courts must not employ definitions of relevant statutory words that are different from or more restrictive than the jurors are legally entitled to use. In *Thomas II*, however, we held that within the context of the definition of security, an "evidence of indebtedness" must be of a similar *type* of security as a note, bond, or debenture. *Thomas II*, 919 S.W.2d at 430. "evidence of indebtedness" is grouped together with terms that have both technical and judicial meanings within securities law. *Cf. Reves v. Ernst & Young*, 494 U.S. 56, 108 L. Ed. 2d 47, 110 S. Ct. 945 (1990) (discussing definition of the term note); *Thomas II*, 919 S.W.2d at 432 n.7 (noting that an "evidence of indebtedness" must be an investment to fit within the act); LOSS & SELIGMAN, SECURITIES REGULATION, v. II p.962 (3d ed. 1989) (suggesting that like the term note, "evidence of indebtedness" might be so broad as to preclude a literal reading and suggesting that the criteria developed for "notes" may be helpful). While "evidence **[**10]** of indebtedness" may have a broad meaning, it nevertheless has meaning within the particular subject matter of investments and securities law; *Vernon*, therefore, does not apply. *Cf. Medford v. State*, 13 S.W.3d 769, 772 (Tex. Crim. App. 2000) (holding that the word arrest has an established and technical meaning that precluded the application of *Vernon*); *Thomas II*, 919 S.W.2d at 430, 432 n.7 (holding that an "evidence of indebtedness" must be of a similar type of security as notes, bonds, debentures, and mortgage certificates and requiring an "evidence of indebtedness" to be an investment).

Writing Requirement

HN5 Because of the similarities between *15 U.S.C. § 77(b)(1)* (Federal Securities Act of 1933) and article 581 -4(A), Texas courts often look to federal cases interpreting the Federal Securities Act of 1933 for guidance in interpreting the Texas Securities Act. *See Searsy*, 560 S.W.2d at 639 (noting "The term[] 'evidence of indebtedness' appears to have been taken from an almost identical definition of 'security' in the Federal Securities Act of 1933 . . . ."); *Grotjohn Precise Connexiones Int'l v. J.E.M. Fin., Inc.*, 12 S.W.3d 859, 868 **[**11]** (Tex. App.-Texarkana 2000, no pet.) (noting that because of the similarity to the Texas Act, Texas courts may look to the Federal Securities Act); *Campbell v. C.D. Payne & Geldermann Sec.*, 894 S.W.2d 411, 417 (Tex. App.-Amarillo 1995, writ denied) (same); *cf. Thomas II*, 919 S.W.2d at 431-32 (citing to numerous federal cases **[*43]** interpreting *15 U.S.C. § 77*). In addition to Texas sources, we will also look to federal cases and materials for guidance.

We have not found a federal or Texas case directly dealing with a writing requirement for the term "evidence of indebtedness". Significantly, we have found no cases where an oral agreement alone was characterized as an "evidence of indebtedness". To the contrary, the cases and secondary materials that we have found all deal with some form of written instrument. *See, e.g., S.E.C. v. G. Weeks Sec., Inc.*, 678 F.2d 649, 653 (6th Cir. 1982) (noting district court could have found that a stand-by contract, when considered with a commitment letter, was an "evidence of indebtedness"); *Austin*, 462 F.2d at 736 (holding that letter of commitment was an "evidence **[**12]** of indebtedness"); *L.T.V. Federal Credit Union v. UMIC Gov't Sec., Inc.*, 523 F. Supp. 819, 830-31 (N.D. Tex. 1981) (concluding standby commitment contracts

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[3] We are aware of our decision in *Atwood v. State*, 135 Tex. Crim. 543, 121 S.W.2d 353, 359-60 (1938) (op. on reh'g), in which we said the definition of security renders *ejusdem generis* inapplicable. *Atwood*, however, dealt with an oil and gas lease and not an "evidence of indebtedness". Moreover, we based our statement concerning *ejusdem generis* on the portion of the definition that reads, "or any other instrument commonly known as a security, whether similar to those herein referred to or not." *Id.* at 359-60. We think the phrase, "whether similar to those herein referred to or not," refers to "any other instrument commonly known as a security." It does not modify an "other evidence of indebtedness." ***HN4*** To the extent that this language in *Atwood* is inconsistent with our holdings today and in *Thomas II*, it is disavowed.

were not evidence of indebtedness); *United States v. Attaway*, 211 F. Supp. 682, 685 (W.D. La. 1962) (holding uncashed checks, when considered in light of oral representations, were evidence of indebtedness); *Searsy*, 560 S.W.2d at 642 (holding commodity option contracts to be evidence of indebtedness because of representations made in the defendant's literature); *Adickes v. Andreoli*, 600 S.W.2d 939, 944-45 (Tex. App.-Houston [1st Dist.] 1980, writ dism'd) (holding a written receipt for funds in the purchase of a partnership interest did not constitute an "evidence of indebtedness"); *King Commodity Co. of Texas, Inc. v. State*, 508 S.W.2d 439, 445 (Tex. App.-Dallas 1974, no writ) (holding that option certificates, when considered in the light of advertising brochures, constituted an "evidence of indebtedness" under the Texas Securities Act).

We find the case of *S.E.C. v. Addison*, 194 F. Supp. 709 (N.D. Tex. 1961), to be the closest **[**13]** case to the one at bar. In *Addison*, Addison and his associates obtained money from lenders for the operating and marketing costs of a machine that turned unmarketable uranium into marketable ore. *Id.* at 715. Addison and his agents orally represented to various lenders that the lenders would participate and share in the millions of dollars in profits that would be made from various ventures, in addition to being repaid the amount loaned in one year plus interest. *Id.* Most of the lenders received written notes, signed by Addison, acknowledging the loan and bearing a 10% interest rate. *Id.* at 716. Addison, however, neither issued nor delivered to some later lenders any "note or any instrument in writing evidencing such loan transaction or the promised participation and sharing in the profits to be made." *Id.* Addison's ventures were ultimately unprofitable, and the loans and investments were not repaid.The district court found that Addison had sold securities in the form of notes, evidence of indebtedness, certificates of interest and participation in profit-sharing agreements, and investment contracts. *Id.* at 721-22. **[**14]** The court characterized the personal loan notes issued by Addison as both notes and evidence of indebtedness. *Id.* at 721 ("The personal loan notes issued and delivered to the lenders are also securities by reason of being an evidence of indebtedness."). The court characterized the oral representations made to the later lenders who did not receive a note or writing as investment contracts and not as evidence of indebtedness. *Id.* at 722. "The oral agreements the defendants made with the lenders . . . to the effect that the lenders . . . would participate and share in the millions of dollars of profits that would be made by the defendants from their mining and other operations are investment contracts, and, as such, are securities." *Id.* (citing *Securities Exchange* **[*44]** *Commission v. W.J. Howey Co.*, 328 U.S. 293, 90 L. Ed. 1244, 66 S. Ct. 1100 (1946)). Unlike the personal loan notes that were characterized as both notes and evidence of indebtedness, the oral agreements were characterized only as investment contracts. *194 F. Supp. at 721-22*. This suggests that some form of writing is required for a security to be characterized as an "evidence **[**15]** of indebtedness".

In addition to case law, there are scholars who indicate that an "evidence of indebtedness" requires a writing. In explaining the coverage of the Federal Securities Act, Professor Loss observed that an "evidence of indebtedness" requires a writing by its own terms. "As we have seen, a writing is not essential for either an 'investment contract' or a 'transferable share' or an 'interest . . . commonly known as a security.' An 'evidence of indebtedness' does by its terms require a writing, but when a writing is available this phrase is sometimes a handy anchor to windward." LOSS, *Securities Regulation*, 488-89 (2d ed. 1961); *cf. Thomas II*, 919 S.W.2d at 430 ("Neither does strict construction mean that we ignore the plain meaning of the terms."); *Boykin v. State*, 818 S.W.2d 782 (Tex. Crim. App. 1991). Also, Professors Bromberg and Lowenfels have adopted the Fifth Circuit definition of an "evidence of indebtedness" as used in *U.S. v. Jones*, 450 F.2d 523, 525 (5th Cir. 1971). [4] BROMBERG AND LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD, v. 1 § 4.6 (414) (1981). The term "evidence of indebtedness" "embraces only **[**16]** such documents as promissory notes which on their face establish a primary obligation to pay the holders thereof a sum of money." *Id.*

Furthermore, we stated in *Thomas II* that the *Searsy/Austin* definition of "evidence of indebtedness" was consistent with other federal cases. *Thomas II*, 919 S.W.2d at 432. We cited *S.E.C. v. Thunderbird Valley, Inc.*, 356 F. Supp. 184, 187 (D. S.D. 1973), for this proposition and observed that the *Thunderbird* court viewed "evidence of indebtedness" as being a self-defining term, requiring no further definition. *Id.* If a term is self-defining, requiring no further definition, this suggests a common understanding **[**17]** of that term.

As the *Searsy* court pointed out, the term "evidence of indebtedness" in the Texas Securities Act appears to have been taken from the Federal Securities Act of 1933. *Searsy*, 560 S.W.2d at 639. A review of *Black's Law Dictionary* from 1933 does not yield a definition of "evidence of indebtedness," but it does have a definition of evidence of debt. The 1933 definition of evidence of debt was "a term applied to written instruments or securities for the payment of money, importing on their face the existence of a debt." BLACK'S LAW DICTIONARY 702 (3d ed. 1933). This same definition appeared in the earlier second edition and the later fourth edition. BLACK'S

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[4] *Jones* deals with the National Stolen Property Act. The *Austin* court, which is the source of the *Searsy* definition of "evidence of indebtedness," also looked to the National Stolen Property Act for guidance in interpreting the term in the Securities Act of 1933. *Austin*, 462 F.2d at 736.

LAW DICTIONARY 658 (4th ed. 1968); BLACK'S LAW DICTIONARY 449 (2d ed. 1910). Thus, in the immediate edition before the Securities Act of 1933, in the edition of the Act's actual enactment, and in the next edition after enactment (some 35 years later), the same definition of evidence of debt remained, and this definition envisioned some form of written instrument. Although evidence of debt is not the exact term, the terms are sufficiently similar for us to glean guidance. Based on the definition **[**18]** in these editions, we think that the **[*45]** common understanding implied by *Thunderbird Valley* entails a written instrument. [5]

Finally, the conclusion that a writing is required is consistent with our instructions and analysis in *Thomas II*. We said that the definition was limited not only by the purpose of the Act, but also by the context in which it appears. *Thomas II*, 919 S.W.2d at 432. **[**19]** The term appears in a group of four other terms that are all some form of written instrument that acknowledge money owed by agreement. *See id.* at 431 n.6. In context, the term "evidence of indebtedness" expands upon the terms note, bond, debenture, and mortgage certificates. *See id.* at 430. It appears that an "evidence of indebtedness" need not necessarily take on the exact form of these other terms, as it expands upon them, but it is similar to them in that it requires some writing that indicates a contractual obligation to pay in the future for consideration presently received. *See id.* at 432.

Based on the terms of the statute, as well as the persuasive authorities cited above, we hold that ***HN6*** a written instrument is required for an "evidence of indebtedness" under the Texas Securities Act. The exact form the writing takes, however, is not crucial. *See S.E.C. v. Joiner Leasing Corp.*, 320 U.S. 344, 351, 88 L. Ed. 88, 64 S. Ct. 120 (1943) (noting the reach of the Federal Securities Act does not stop with the obvious, but extends to novel and irregular devices and instruments as well); *Muse v. State*, 137 Tex. Crim. 622, 132 S.W.2d 596, 597 (Tex. Crim. App. 1939) **[**20]** (holding a security need not be a valid or perfect instrument for criminal liability). Furthermore, the context and the circumstances surrounding the transaction may be examined in determining whether a writing constitutes an "evidence of indebtedness." *See TEX. REV. CIV. STAT. art. 581-4* ("The following terms shall, unless the context otherwise indicates, have the following respective meanings . . ."); *Bruner*, 463 S.W.2d 205, 214 (holding that the surrounding circumstances will be reviewed to determine if an instrument is a security); *King Commodity Co. of Texas, Inc.*, 508 S.W.2d at 445 (considering representations made in advertising literature to determine if option certificates were securities).

We also emphasize that our holding today should not be read to mean that an actual, physical exchange of a writing is required in order for there to be a violation of the Texas Securities Act concerning an "evidence of indebtedness." When a defendant sells or offers to sell an "evidence of indebtedness" that does not actually exist or was never actually issued, he is still subject to criminal penalty. *See Shappley v. State*, 520 S.W.2d 766, 768-69 (Tex. Crim. App. 1974); **[**21]** *Sharp v. State*, 392 S.W.2d 127, 128 (Tex. Crim. App. 1965).

The State and the amicus curiae brief make several arguments against a writings requirement. The State primarily relies on Justice Bridges's dissent. He argued that the definition of "evidence of indebtedness" is "all contractual obligations," which would include oral obligations. *See Thomas III*, 3 S.W.3d at 96-97 (Bridges, J., dissenting). Furthermore, **[*46]** the "similarity [between notes, bonds, debentures, and mortgage certificates] is that all of these securities embody a promise to pay, whether or not they are reduced to writing." *Id.* at 97. The amicus brief also argues that the definition of "all contractual obligations" would include oral obligations. In addition, a writings requirement does not consider internet and electronic transactions. Because there is a growing trend to buy and sell securities electronically, many transactions that would normally be covered by the Act as an "evidence of indebtedness" would now be outside the reach of the statute. [6] We disagree with these arguments.

[22]** It is true that a common thread that runs through the group of notes, bonds, debentures, and mortgage certificates is that they embody a promise to pay. They also, however, are embodied by some form of writing. *See Thomas II*, 919 S.W.2d at 431 n.6. Furthermore, the fact that we have found no case that does not have some form of writing evidencing the indebtedness since passage of the Federal Securities Act of 1933 suggests to us that the one strand of a promise to pay is not the only important characteristic that these terms

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[5] *Thunderbird Valley* relied on *Farrell v. United States*, 321 F.2d 409, 417 (9th Cir. 1963), for the proposition that the term "evidence of indebtedness" was self-defining and required no further definition. *Thunderbird Valley*, 356 F. Supp. at 187. *Thunderbird Valley* was decided under the 1968 fourth edition of Black's Law Dictionary, while *Farrell* was decided under the 1933 third edition of Black's Law Dictionary. We further note that both cases dealt with written instruments. *Farrell*, 321 F.2d at 415-16; *Thunderbird Valley*, 356 F. Supp. at 187-88.

[6] In a supplemental brief, the State directs our attention to the recent Supreme Court case of *The Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 149 L. Ed. 2d 845, 121 S. Ct. 1776 (2001), where the Supreme Court held that oral contracts for sale are covered under the Securities Exchange Act of 1934. However, we find this case to be inapposite as the case does not deal with an "evidence of indebtedness." Furthermore, nothing in our opinion today should be read to mean that oral contracts for sale are outside the coverage of the Texas Securities Act; the issue we decide today is whether an "evidence of indebtedness" requires a writing.

share.

As for a literal reading of the definition of "evidence of indebtedness," we observe that not only do cases criticize a literal interpretation of the *Austin/Searsy* definition, there are also other authorities that caution against a literal interpretation of the term itself. *See* Cocklereece v. Moran, 532 F. Supp. 519, 529 (N.D. Ga. 1982) (noting a literal application would turn all bilateral contracts into securities); *LTV Fed. Credit Union v. UMIC Gov't Sec., Inc.*, 523 F. Supp. 819, 830-31 (N.D. Tex. 1981) (noting a literal application would turn all commercial notes into securities); *Plains Elec. Generation and Transmission Coop., Inc. v. New Mexico Pub. Util. Comm'n*, 1998 NMSC 38, 967 P.2d 827, 832-33, 126 N.M. 152 (N. M. 1998) **[**23]** (agreeing with *Cocklereece* and *LTV* criticisms of *Austin* definition); LOSS & SELIGMAN, *supra* at 962 (suggesting that the term "evidence of indebtedness" may be so broad as to preclude a literal reading); *cf. Thomas II*, 919 S.W.2d at 432 n.7 (noting that an "evidence of indebtedness" must be an investment). The Tenth Circuit has also shied away from a literal interpretation of the definition. *See McGovern Plaza Joint Venture v. First of Denver Mortgage Investors*, 562 F.2d 645, 648 (10th Cir. 1977) (holding that loan commitment letters were not part of a large scale fraud operation and not securities). Although these cases's criticisms focus primarily on a literal application turning all bilateral contracts into securities despite having a commercial instead of an investment character, they do stand for the proposition that courts are reluctant to apply the *Austin/Searsy* definition literally. This fact, combined with no cases that have found an "evidence of indebtedness" based only on oral agreements, [7] lead us to reject this literal interpretation.

[24]** **[*47]** Finally, we do not think that our decision today paves the way for internet securities fraud. Confirmation of any electronic sale or offer of sale of a security may still be printed or even saved to a disk. Also, the definition of "in writing" found in *Government Code section 312.011(17)* includes "any representation of words, letters, or figures, whether in writing, printing, or other means." Nothing in this definition precludes electronic representations.

Conclusion

The Court of Appeals held that an "evidence of indebtedness" requires a writing under the Texas Securities Act. We have reached the same conclusion today. The judgment of the Court of Appeals is affirmed.

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[7] The closest support for the position against a writing requirement that we have found is a section in Am. Jur. discussing notes and evidence of indebtedness. *See* 69a AM. JUR. 2D *Securities Regulation-State* § 30 (1993). This section states, "Arrangements do not have to be in writing to be securities . . . ." *Id.* Only one case is cited for this proposition, *Jenkins v. Jacobs*, 748 P.2d 1318 (Col. App. 1987). *Jenkins*, however, deals with and discusses only an investment contract; an "evidence of indebtedness" did not play a role in this decision. *See Jenkins*, 748 P.2d at 1320.

1997 Cal. PUC LEXIS 667

California Public Utilities Commission
August 1, 1997
Decision No. 97-08-016, Rulemaking No. 94-04-031 (Filed April 20, 1994), Investigation No. 94-04-032 (Filed April 20, 1994)

Reporter: 1997 Cal. PUC LEXIS 667

Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.; Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation

Core Terms

buyouts, multiyear, advisory opinion, restructure, evidence of indebtedness, electric, guideline, public utility, preapproval, public interest, ratepayer

Panel: [*1] P. Gregory Conlon, President, Jessie J. Knight, Jr., Henry M. Duque, Josiah L. Neeper, Richard A. Bilas, Commissioners

Opinion

OPINION ON PACIFIC GAS AND ELECTRIC COMPANY'S MOTION FOR ADOPTION OF ADDITIONAL GUIDELINE FOR MULTIYEAR QF BUYOUTS

I. Summary

This decision grants Pacific Gas and Electric Company's (PG&E) "Motion for Adoption of Additional Guideline for Multiyear QF Buyouts." This decision determines that multiyear buyouts of QF contracts, as specifically defined in this decision, are not subject to Public Utilities (PU) Code § 818.

II. Background

Procedural Background

On January 16, 1997, PG&E filed a "Motion for Adoption of Additional Guideline for Multiyear QF Buyouts" in the consolidated proceedings of the Biennial Resource Plan Update and the Transmission Investigation (Investigation (I.) 89-07-004/I.90-09-050). This motion requests that the Commission adopt an additional guideline for multiyear buyouts of qualifying facility (QF) [1] contracts by determining that multiyear buyouts of QF contracts are not "evidences of indebtedness" under *PU Code § 818*. On January 30, 1997, Southern California Edison Company (Edison) [*2] filed a response thereto, in which Edison supported PG&E's motion.

On April 30, 1997, the Administrative Law Judge (ALJ) assigned to certain QF contract issues in this proceeding issued a ruling transferring the PG&E motion and the Edison response from I.89-07-004/I.90-09-050 to this proceeding for further consideration together with other issues involving QF contract modifications, and attached a copy of PG&E's motion and Edison's response to the ruling. [2] The ALJ ruling explained that because the issue PG&E raises is related to QF contract restructuring issues, it was appropriate to transfer the motion to the Electric Industry Restructuring docket.

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[1] QFs are cogenerators and small power producers who qualify for certain benefits under the Public Utility Regulatory Policies Act of 1978.

[2] By separate ALJ ruling, the ALJ notified parties to I.89-07-004/I.90-09-050 about the transfer, the request for supplemental briefing by PG&E and Edison, and other interested parties' opportunity to respond. The ALJ ruling also stated that if a person is not

[*3]

In the ruling, the ALJ also requested that PG&E and Edison file supplemental briefing:

> "I wish to provide parties in this docket an opportunity to respond to the January 16, 1997 PG&E Motion. However, I am interested first in obtaining additional information from PG&E, as well as Edison, which filed in support of PG&E's motion. The Commission is generally not in the position of giving advisory opinions. Yet, the motion in essence, requests an advisory opinion of the Commission's view of the application of *Public Utilities Code Section 818* to certain restructured contracts, without presenting to the Commission the specific contract or contracts. The question I have of PG&E and Edison is what facts or circumstances make it necessary for the Commission to address this issue now, in absence of a specific application? Edison, for example, states that it has submitted multiyear QF buyouts to the Commission for its review in the past, and that neither the Commission, nor any party, has stated that Section 818 applies to those contracts. Based upon these comments, I do not understand what concern is underlying the motion." (April 30 ALJ Ruling [*4] at pp. 6-7.)

The ALJ's ruling provided for other parties to respond to the motion after PG&E and Edison filed their supplement. On May 12, 1997, both PG&E and Edison filed their supplemental briefing on Section 818 issues. No other party, either in I.89-07-004/I.90-09-050, or in this proceeding, filed an opposition or response to the motion and the supplemental briefing.

The Motion and Response

PG&E requests that the Commission adopt an additional guideline for buyouts of QF contracts under which utilities pay the QFs over a period of more than one year (multiyear QF buyouts) by determining that such buyouts are not "evidences of indebtedness" under *PU Code § 818*, and therefore do not require prior Commission authorization. PG&E cites to prior Commission decisions addressing and encouraging QF contract restructuring for the proposition that these cases "clearly suggest" that the Commission believes that multiyear QF buyouts are not subject to Section 818. (PG&E Motion at p. 4.) PG&E explains that its requested interpretation of Section 818 is consistent with other Commission decisions discussing the scope of Section 818. PG&E believes [*5] that prior Commission precedent indicates that "evidences of indebtedness" in Section 818 should be read only to cover agreements of the same general nature as notes or bonds, and that a multiyear QF buyout is not like a note or bond. For example, a multiyear QF buyout is not a unilateral promise to pay, since buyout agreements typically have commitments on the part of the QFs regarding shutting down of projects, any future sales from the projects, and future rights to QF status. PG&E also believes, based on the language of Section 818, that the Legislature had in mind indebtedness in the sense of borrowing, the proceeds of which would be used for utility purposes. PG&E explains that a multiyear QF buyout does not generate any proceeds or create any new financial commitment, but rather, involves a restructuring of an existing contract.

Alternatively, PG&E requests that if the Commission requires prior authorization of multiyear QF buyouts pursuant to Section 818, the Commission should grant generic advance authorization of such buyouts pursuant to *PU Code § 701*. [3] PG&E does not ask that the Commission prejudge the issue of the reasonableness [*6] of individual buyouts, which it concedes would still be subject to Commission review, but to confirm the legality of such buyouts with reference to Section 818.

PG&E explains that it has completed several QF buyouts to date which involve payments to the QFs over more than one year. PG&E has not sought prior authorization for these buyouts, which are pending reasonableness approval in PG&E's 1994 Energy Cost Adjustment Clause (ECAC) proceeding, since PG&E does not believe that these buyouts constitute evidence of indebtedness under Section 818. However, in light of electric industry restructuring and the provisions of Assembly Bill 1890, PG&E states that it expects to increase its QF buyouts significantly. [*7] Given the many millions of dollars typically involved in buying out these contracts, PG&E believes it is prudent to seek this authorization.

Edison filed a response in support of PG&E. Edison explains that it has completed several QF multiyear buyouts, which it believes are a benefit to ratepayers since the utility can obtain the benefit of a buyout without increasing rates.

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a party to the Electric Industry Restructuring proceeding, that person should file a motion to intervene in Rulemaking (R.) 94-04-031/I.94-04-032 together with his or her response.

[3] PU Code § 701 states: "The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction."

Edison states that it has submitted each of its multiyear QF buyouts except one (which Edison submitted in its ECAC filing) in a separate application to the Commission, and that neither the Commission nor any party has suggested that Section 818 applies.

Edison agrees with PG&E's interpretation of Section 818. Furthermore, Edison believes that Section 818's placement within Article 5 of the PU Code, which is entitled "Stocks and Security Transactions," suggests that it is limited to transactions in which the utility issues securities such as stocks and bonds. Edison also joins in PG&E's alternative request that if the Commission concludes that multiyear QF buyouts are subject to Section 818, the Commission should grant generic advance authorization of such buyouts.

Supplemental Responses

PG&E explains that **[*8]** seeking preapproval of every buyout will diminish the utility's buyout efforts since many of these deals are time-sensitive. The option of paying the full buyout amount to the QF in a single year to avoid the strictures of Section 818 is also costly since it reduces the value of the deal for the QF. PG&E explains that it could assume the risk of Section 818's applicability by doing multiyear QF buyouts without preapproval. In the past PG&E has done numerous buyouts without Commission preapproval. At that time, PG&E believed that the arguments that Section 818 did not apply were strong enough to justify the risks. "However, since then with the advent of electric restructuring and the passage of AB 1890, concern over this issue has risen afresh and with potentially tens of millions of dollars involved, PG&E needs to obtain assurance on this point." (PG&E Supplemental Response at p. 3.) PG&E also cites several Commission decisions where the Commission has granted advisory relief to further the Commission's policies and to provide a timely articulation of our views.

Edison's supplemental response reiterates its earlier comments. Essentially, Edison believes that since PG&E filed its motion, **[*9]** and since Edison has completed a number of multiyear QF buyouts in the past and intends to continue negotiating such transactions in the future, Commission clarification is appropriate and timely in order to avoid future controversies and uncertainties concerning the applicability of Section 818 to multiyear QF buyouts. Edison also explains that since *PU Code § 825* provides that debt commitments which do not comply with Section 818 are void, a lingering doubt on this issue could have a chilling effect on the willingness of QFs to enter into buyout agreements providing for installment payments. This might deprive electric ratepayers of any savings offered by multiyear QF buyouts.

III. Discussion

This motion seeks the issuance of an advisory opinion. In general, in order to conserve our scarce judicial resources, we do not favor issuing advisory opinions. (Carlin Communications, Inc. v. Pacific Bell, D.87-12-017, *26 CPUC2d 125, 130;* Re California-American Water Company, D.95-01-014, *58 CPUC2d 470, 476.)* We also disfavor issuing advisory opinions where the issue or controversy is not **[*10]** sufficiently developed to assist the Commission in reaching a reasoned decision.

However, we have the discretion to issue advisory opinions, and have done so, where the matter was of widespread public interest, and where parties might benefit from a timely expression of our views. (See In re SoCal Edison Co., D.93935, *6 CPUC2d 116, 136 (1981)* [utility sought preliminary assurance from Commission that costs of a geothermal project reasonably allocated risks and benefits of geothermal development between utility and ratepayers; advisory opinion issued to resolve critical questions respecting the development of alternative energy sources, an issue very important to California ratepayers] ; Carlin Communications, Inc., 26 CPUC2d at 130 [no act of wrongdoing alleged in complaint; Commission issued advisory opinion due to the widespread public interest in the operation of "live" 976 telephone service]; Re California-American Water Company, 58 CPUC2d at 476 [advisory opinion appropriate on matters of widespread public interest, especially when another governmental agency would benefit from a timely expression **[*11]** of the Commission's views; here, the issue was the Commission's assessment of standby charges for future water and sewer services, which issue was fully briefed by the parties].)

PG&E argues that an advisory opinion on Section 818 is warranted here, because multiyear QF buyouts which save ratepayers money are a key policy objective of the Commission and the potential impacts are widespread. PG&E also believes that the ruling would save time and uncertainty.

We consistently encourage cost-effective QF contract restructurings. (See e.g. D.95-12-063, as modified by D.96-01-009, slip op. at pp. 130-132.) Such cost-effective QF contract restructurings are of widespread public interest and timely, especially if they minimize transition costs as we implement electric industry restructuring. However, Edison states that it routinely submits its QF contract restructurings or buyouts to the Commission for preapproval, and

has not stated that our issuing this advisory opinion will change that course. Thus, this advisory opinion is necessary, if at all, solely for the benefit of PG&E, which does not routinely submit its QF contract restructurings or buyouts for preapproval and does not wish to **[*12]** begin to do so now. Thus, although the necessity of obtaining a timely expression on our views affects just PG&E, given the fact that the parties have had two opportunities to address this issue to date (one in I.89-07-004/I.90-09-050 and one in this proceeding), it is more efficient for us to address this issue here as best we can given the state of the briefing, rather than to refer the issue to yet another proceeding. [4] However, this is a unique situation, and should not be used as precedent for requesting an advisory opinion from us in the future.

PU Code § 818 states:

> "No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes, or other evidences of **[*13]** indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income."

PG&E requests that the Commission determine that multiyear buyouts of QF contracts are not "evidences of indebtedness" under Section 818. As to why it is necessary for the Commission to address this issue now, PG&E merely states that with the advent of electric restructuring and the passage of AB 1890, concern has risen afresh with respect to this issue, especially considering the large amounts of money involved. PG&E does not cite to any particular section of AB 1890 which might **[*14]** have generated its concern.

Before addressing the question posed by PG&E's motion, it is important to define the characteristics of a multiyear buyout of QF contracts for purposes of this advisory opinion, since we do not have a particular contract or factual circumstance before us. We address buyouts which involve a renegotiation of an existing contract between a utility and a QF, which the Commission, prior to December 20, 1995, had authorized for collection in rates. (See *PU Code § 330(s)*.) Under the buyout, the utility would pay the QF over a period of more than one year. The type of buyout we address should not be a unilateral promise to pay, but rather a bilateral agreement where each party must perform certain duties and obligations, and has certain liabilities. For example, PG&E states that buyouts typically have commitments on the part of the QFs regarding shutting down of the projects, any future sales from the projects, and future rights to QF status. (PG&E Motion at p. 4.)

In interpreting Section 818, the Commission has found that the Legislature intended that the phrase "other evidences of indebtedness" has a narrower, as opposed **[*15]** to a broader reading, so that it would encompass only things "of the same general nature as notes or bonds." (Delta Lines, Inc. et al., D.83-06-055, *11 CPUC2d 779 [1983 Cal. PUC LEXIS 1032].)* In Delta Lines, the Commission had before it several revolving credit agreements pursuant to which no notes or other evidences of indebtedness were issued. Each credit agreement states that the duty to repay the loan amount is evidenced solely by the credit agreement and the accompanying documents, but the obligation shall not be evidenced by notes or other similar evidences of indebtedness. (See also Application of Pacific Gas and Electric Company, D.91-12-057, *42 CPUC2d 421 [1991 Cal. PUC LEXIS 877],* where the Commission determined that PG&E's provision of long-term capital support to PG&E's regulated and unregulated subsidiaries and affiliates did not constitute "other evidences of indebtedness" under Section 818.)

Since a multiyear QF buyout, as defined in this decision, is not a unilateral promise to pay, and does not generate any proceeds or create a new financial commitment, but rather involves the restructuring **[*16]** of an existing long-term contract, we hold that such agreements, as defined above, do not constitute other evidences of indebtedness pursuant to Section 818. In reaching this holding, we understand that no notes or other evidences of indebtedness would be issued within the terms of the specific multiyear QF buyout. Furthermore, this decision does not address nor exempt from Section 818 any financing which the utility might obtain to pay its obligations. (See, e.g., *PU Code § 840*, et seq.)

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[4] Since this motion raises a legal issue, we address the motion in this decision. Other QF contract restructuring issues, which were the subject of a workshop in late May and a workshop report issued in late June, will be addressed separately from this decision.

The lack of a specific multiyear QF buyout before us makes us hesitant to issue this decision, not because we have doubts about the lack of applicability of Section 818 to these agreements in general, but because the specific terms of a specific agreement might cause our opinion to change, based upon the particular language of the agreement. That is one reason why we hesitate to give general advisory opinions in absence of a case or controversy, where the matter is not fully briefed. In any event, provided the multityear QF buyout is consistent with the assumptions we make in this decision, we hold that it is not subject to Section 818.

Findings of Fact [*17]

1. PG&E's January 16, 1997 "Motion for Adoption of Additional Guideline for Multiyear QF Buyouts" requests that the Commission adopt an additional guideline for multiyear buyouts of QF contracts by determining that such buyouts are not "evidences of indebtedness" under *PU Code § 818*.

2. In general, in order to conserve our scarce judicial resources, we do not favor issuing advisory opinions. We also disfavor issuing advisory opinions where the issue or controversy is not sufficiently developed to assist the Commission in reaching a reasoned decision.

3. We have the discretion to issue advisory opinions, and have done so, where the matter is of widespread public interest and where the parties might benefit from a timely expression of our views.

4. We consistently encourage cost-effective QF contract restructurings.

5. This advisory opinion is necessary, if at all, solely for the benefit of PG&E, which does not routinely submit its QP contract restructurings or buyouts for preapproval and does not wish to begin to do so now.

6. In this decision, we address multiyear buyouts of QF contracts, which involve a renegotiation of an existing contract **[*18]** between a utility and a QF, which the Commission, prior to December 20, 1995, had authorized for collection in rates. Under the buyout, the utility would pay the QF over a period of more than one year. The type of buyout we address in this decision should not be a unilateral promise to pay, but rather a bilateral agreement where each party must perform certain duties and obligations, and has certain liabilities. No notes or other evidences of indebtedness would be issued within the terms of the specific multiyear QF buyout.

Conclusions of Law

1. Our issuance of an advisory opinion in this unique situation should not be used as precedent for requesting an advisory opinion from us in the future.

2. Multiyear QF buyouts, as defined by this decision, should not constitute "evidences of indebtedness" pursuant to *PU Code § 818*.

3. To help facilitate cost-effective QF contract restructurings, this decision should take effect immediately upon approval.

ORDER

IT IS ORDERED that Pacific Gas and Electric Company's January 16, 1997 "Motion for Adoption of Additional Guideline for Multiyear QF Buyouts" is granted insofar as we determine that **[*19]** multiyear buyouts of QF contracts, as specifically defined in this decision, are not subject to *Public Utilities Code § 818*.

This order is effective today.

Dated August 1, 1997, at San Francisco, California.