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Arizona Corporation Commission  
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JAN 21 2005

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IN THE MATTER OF THE APPLICATION OF  
PINEVIEW WATER COMPANY, INC., FOR  
AUTHORITY TO ISSUE PROMISSORY  
NOTE(S) AND OTHER EVIDENCES OF  
INDEBTEDNESS PAYABLE AT PERIODS OF  
MORE THAN TWELVE MONTHS AFTER  
THE DATE OF ISSUANCE.

DOCKET NO. W-01676A-04-0463

IN THE MATTER OF THE APPLICATION OF  
PINEVIEW WATER COMPANY, INC. FOR  
AN INCREASE IN ITS WATER RATES FOR  
CUSTOMERS WITHIN NAVAJO COUNTY,  
ARIZONA.

DOCKET NO. W-01676A-04-0500

**NOTICE OF FILING DIRECT  
TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission hereby provides notice that it has filed the Direct Testimony of Elena Zestrijan, Alejandro Ramirez, Dorothy Hains and James Johnson in the above-referenced matter. Counsel for Pineview Water Company, Inc. granted Staff a one-day extension to file its Direct Testimony.

**RESPECTFULLY SUBMITTED** this 21<sup>st</sup> day of January 2005.

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1 The original and fifteen (15) copies  
of the foregoing were filed this  
2 21<sup>st</sup> day of January 2005 with:

3 Docket Control  
Arizona Corporation Commission  
4 1200 West Washington Street  
Phoenix, Arizona 85007

5  
6 Copies of the foregoing were mailed this  
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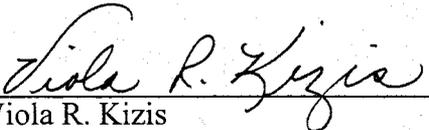
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**DIRECT  
TESTIMONY  
OF  
ELENA ZESTRIJAN  
ALEJANDRO RAMIREZ  
JAMES H. JOHNSON  
DOROTHY HAINS**

**DOCKET NOS. W-01676A-04-0500 AND W-01676A-04-0463**

**IN THE MATTER OF THE APPLICATIONS  
OF PINEVIEW WATER COMPANY, INC.  
FOR A RATE INCREASE AND  
FINANCING**

**JANUARY 21, 2005**

ZESTRIJAN

**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATIONS OF )  
PINEVIEW WATER COMPANY, INC. )  
FOR AN INCREASE IN ITS WATER RATES )  
FOR CUSTOMERS WITHIN NAVAJO COUNTY, )  
ARIZONA AND FOR APPROVAL OF A )  
FINANCING REQUEST. )  
\_\_\_\_\_ )

DOCKET NO. W-01676A-04-0463  
DOCKET NO. W-01676A-04-0500

DIRECT  
TESTIMONY  
OF  
ELENA ZESTRIJAN  
PUBLIC UTILITIES ANALYST III  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

JANUARY 20, 2005

**TABLE OF CONTENTS**

|   | <u>Page</u> |
|---|-------------|
| INTRODUCTION .....                                | 1           |
| PURPOSE OF TESTIMONY .....                        | 2           |
| BACKGROUND .....                                  | 2           |
| SUMMARY OF TESTIMONY AND RECOMMENDATIONS .....    | 3           |
| ORIGINAL COST RATE BASE .....                     | 6           |
| PLANT IN SERVICE .....                            | 7           |
| ACCUMULATED DEPRECIATION .....                    | 7           |
| CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC) ..... | 8           |
| CIAC ACCUMULATED AMORTIZATION .....               | 8           |
| CUSTOMER DEPOSITS .....                           | 8           |
| METER ADVANCES .....                              | 8           |
| OPERATING REVENUE .....                           | 8           |
| OPERATING EXPENSES .....                          | 9           |
| REVENUE REQUIREMENT .....                         | 14          |
| RATE DESIGN .....                                 | 14          |
| ARSENIC REMOVAL .....                             | 15          |
| FINANCING .....                                   | 15          |
| STAFF RECOMMENDATIONS .....                       | 15          |

**SCHEDULES**

|   |       |
|---|-------|
| Revenue Requirements .....                        | ENZ-1 |
| Gross Revenue Conversion Factor .....             | ENZ-2 |
| Original Cost Rate Base .....                     | ENZ-3 |
| Summary of Rate Base Adjustments .....            | ENZ-4 |
| Plant in Service .....                            | ENZ-5 |
| Accumulated Depreciation .....                    | ENZ-6 |
| Contributions in Aid of Construction (CIAC) ..... | ENZ-7 |
| CIAC Amortization .....                           | ENZ-8 |
| Customer Deposits .....                           | ENZ-9 |

|                                      |        |
|--------------------------------------|--------|
| Meter Advances .....                 | ENZ-10 |
| Statement of Operating Income .....  | ENZ-11 |
| Summary of Staff Adjustments.....    | ENZ-12 |
| Salaries Expense .....               | ENZ-13 |
| Employee Pensions and Benefits ..... | ENZ-14 |
| Purchased Power Expense .....        | ENZ-15 |
| Repairs and Supplies Expense .....   | ENZ-16 |
| Contractual Services Expense.....    | ENZ-17 |
| Rent Expense .....                   | ENZ-18 |
| Materials and Supplies Expense ..... | ENZ-19 |
| Transportation Expense .....         | ENZ-20 |
| Miscellaneous Expense.....           | ENZ-21 |
| Depreciation Expense .....           | ENZ-22 |
| Property Tax Expense.....            | ENZ-23 |
| Income Tax Expense.....              | ENZ-24 |
| Rate Design.....                     | ENZ-25 |
| Typical Bill Analysis .....          | ENZ-26 |

**EXECUTIVE SUMMARY**  
**PINEVIEW WATER COMPANY, INC.**  
**DOCKET NO. W-01676A-04-0463 AND W-01676A-04-0500**

Pineview Water Company, Inc. ("Pineview" or "Company") is an Arizona public service corporation engaged in providing water utility services in a portion of Navajo County, Arizona, pursuant to certificates of convenience and necessity granted by the Arizona Corporation Commission to Pineview. At the present time Pineview provides utility service to approximately 918 customers within its certificated area located southeast of Show Low, Arizona. Pineview's previous rate case was based on a test year ended December 31, 1994.

The Company proposes an increase in revenues of \$126,453, or 24.19 percent, on an original cost rate base ("OCRB") of \$730,084, for a rate of return of 10.51 percent. This would increase the typical residential bill having a median usage of 3,250 gallons from \$27.60 to \$33.54, for an increase of \$5.94 or 21.50 percent.

Staff recommends an increase in revenue of \$15,495 or 2.96 percent, on an OCRB of \$662,093 for a 7.20 percent rate of return. Due to the Staff's recommended three-tier rates, the typical residential bill having a median usage of 3,250 gallons will decrease from \$27.60 to \$26.97, for a decrease of \$.63 or 2.30 percent.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Elena Zestrijan. My business address is 1200 West Washington Street,  
4 Phoenix, Arizona 85007.

5  
6 **Q. By whom are you employed and in what capacity?**

7 A. I am employed by the Arizona Corporation Commission ("Commission" or "ACC") as a  
8 Public Utilities Analyst III.

9  
10 **Q. Please describe your work experience.**

11 A. I completed my education in accounting at Remington Rand Business College, South  
12 Melbourne, Australia and began my accounting career in 1968. In 1978, I was hired by the  
13 Phoenix Newspapers, Inc. in the capacity of Budget/Financial Analyst until March of 2000.  
14 My responsibilities included coordination of annual operating budgets/forecasts, capital  
15 expenditures, quarterly projections/revisions, monthly budget/history variance  
16 commentary/analysis, quarterly Board of Director's schedules. I also participated in the  
17 implementation of two budget systems.

18  
19 On September 18, 2000, I joined the Financial and Regulatory Analysis Section within the  
20 Utilities Division ("Staff") of the Commission. My duties include review and analysis of  
21 financial records and other documents of regulated utilities for accuracy, consistency,  
22 completeness, and reasonableness. I also prepare work papers and schedules supporting  
23 expert testimony and Staff reports in connection with utility applications for changes in  
24 rates.

1 **PURPOSE OF TESTIMONY**

2 **Q. What is the purpose of your testimony in this proceeding?**

3 A. The purpose of my testimony in this proceeding is to present Staff's analysis and  
4 recommendations concerning the original cost rate base ("OCRB"), revenue requirement,  
5 and rate design regarding the Pineview Water Company, Inc's. ("Pineview" or "Company")  
6 rate increase application received on July 9, 2004.

7  
8 **Q. Are you Staff's only witness?**

9 A. No, there are three other Staff witnesses. Mr. Alejandro Ramirez is presenting Staff's cost  
10 of capital testimony. Mr. James Johnson is presenting Staff's recommendations regarding  
11 the Company's authorization to issue long-term debt. Ms. Dorothy Hains is presenting  
12 Staff's engineering analysis, inspection and evaluation of the Company's water systems.

13  
14 **BACKGROUND**

15 **Q. Please provide a brief description of Pineview and the services it provides.**

16 A. Pineview is an Arizona public service corporation, supplying potable water service to  
17 approximately 918 customers in Navajo County, Arizona.

18  
19 Pineview's current rates were approved in Decision No. 59934, dated December 16, 1996,  
20 and went into effect on December 1, 1996. Pineview is using a test year ending December  
21 31, 2003, in this proceeding.

1 **SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

2 **Q. Please summarize the Company's proposals and Staff's recommendations.**

3 A. The Company's rate application proposes an increase in revenues of \$126,453 from the test  
4 year adjusted amount of \$522,724, or a 24.19 percent increase over its test year revenue as  
5 shown in Schedule ENZ-1.

6  
7 Staff is recommending an increase in revenues of \$15,495 from the test year adjusted  
8 amount of \$522,724, or a 2.96 percent increase over the test year revenue as shown in  
9 schedule ENZ-1.

10  
11 The Company proposes a rate of return of 10.51 percent on an OCRB of \$730,084. Staff  
12 recommends a rate of return of 7.20 percent on Staff's recommended OCRB of \$662,093.  
13 The 7.20 rate of return is based on the testimony of Staff's witness, Mr. Ramirez.

14  
15 **Q. What is the basis of Staff's recommendations?**

16 A. Staff performed a regulatory audit of the Company's books and records to determine  
17 whether sufficient evidence exists to support the Company's request for an increase in its  
18 rates and charges. The regulatory audit consisted of examining and testing the Company's  
19 accounting ledgers and reports, checking the accumulation of amounts in the records,  
20 tracing recorded amounts to source documents, verifying the correct application of data with  
21 applicable standards of third parties, and verifying whether the accounting principles applied  
22 are in accordance with the Commission-authorized National Association of Regulatory  
23 Utility Commissioners ("NARUC") Uniform System of Accounts ("USOA"). In preparing  
24 its case, Staff visited the office of Pineview, to conduct the audit. Staff also reviewed  
25 previous rate and other Commission Decisions applicable to this Company. Staff held

1 discussions with Company representatives and composed a number of written requests for  
2 data.

3  
4 **Q. What test year was used by the Company in this filing?**

5 A. Pineview used a historical test year covering the twelve months ending December 31, 2003.  
6

7 **Q. Did Staff accept the test year as filed by the Company?**

8 A. Yes. The December 31, 2003, test year selected was a 12-month period, which was recent  
9 enough for purposes of preparing the rate case filing. The Company chose not to include  
10 pro forma plant, but included revenue and expense adjustments. Staff evaluated and either  
11 accepted, adjusted, or removed the Company's adjustments.  
12

13 **Q. What test year was used by the Company in this filing?**

14 A. Pineview used a historical test year covering the twelve months ending December 31, 2003.  
15

16 **Q. Did Staff's audit reveal any concerns about commingling?**

17 A. Yes. Staff discovered numerous instances where there were inappropriate transactions with  
18 other affiliates of Pineview, or with members of the Sutter family (which controls  
19 Pineview). These problems are described in the testimony that follows. This pattern of  
20 behavior is not new. In Pineview's last rate Order the Commission observed that: "Staff's  
21 audit identified a number of questionable transactions between Pineview and construction  
22 companies owned by the Sutter family. There appears to be an inter-mingling of Pineview's  
23 operations" Decision No. 59934, page 4. Staff is concerned that, 8 years later, these  
24 problems continue.  
25

1 In addition to its water company operations, the owners also conduct other non-water  
2 company related business activities. In Commission Decision No. 59934, the Company was  
3 authorized to borrow funds to acquire a backhoe. In the Company's current application the  
4 plant in service includes the acquired backhoe and an additional lease expense for another  
5 backhoe. Staff is aware that the Sutter's also own a heavy equipment rental business. Staff  
6 was unable to determine if the backhoe acquired by Pineview is being used exclusively by  
7 Pineview or otherwise utilized to generate revenues for an equipment leasing business  
8 operated by the same owners. Staff recommends that the Company be required to maintain  
9 written documentation describing the actual use of the Company owned backhoe. Staff  
10 disallowed the lease expense for a second backhoe.

11  
12 Staff also noted that the Sutters appear on the Pineview's payroll. Staff requested detailed  
13 information on the positions and responsibilities held by the Sutters only to confirm that the  
14 Sutter's involvement in the water company is minimal. The Company's responses to Staff's  
15 data requests confirms that Mr. and Mrs. Sutter travel together to promote land development  
16 which supports another business they own.

17  
18 Accordingly, Staff recommends that the Commission order that Pineview cease and desist  
19 from further commingling of expenses and capital equipment. Staff further recommends  
20 that the Commission order; 1) mandatory training for equipment operators, 2) requirement  
21 for Commission approval of all further transactions with affiliates or members of the Sutter  
22 family pursuant to R14-2-804, 3) shall maintain written usage reports for its Transportation  
23 and Power Operated Equipment. 4)<sup>1</sup> Such records will include the date, time of use or

---

<sup>1</sup> See National Association of Regulatory Commissioners Uniform System of Accounts for Transportation  
(Account 341) and Power Operated Equipment (account 345)

1 mileage and the purpose of the equipment usage. 5) Require Pineview file a new rate case  
2 within 3 years.

3  
4 Staff further recommends that the Company and its owners be ordered to eliminate the  
5 commingling of expenses and capital equipment that the Commission discussed in Decision  
6 No. 59934 and continues today to the detriment of ratepayers.

7  
8 **ORIGINAL COST RATE BASE**

9 **Q. Has Staff prepared a schedule detailing the Company's proposed OCRB and Staff's**  
10 **recommended OCRB?**

11 A. Yes. Schedule ENZ-3 shows the Company's proposed OCRB and Staff's recommended  
12 OCRB.

13  
14 **Q. Is Staff recommending any changes to the Company's proposed OCRB?**

15 A. Yes. The Company proposed an OCRB of \$730,084. Staff recommends an OCRB of  
16 \$662,093, or a net reduction of \$67,991. Staff's specific adjustments are outlined later in  
17 this section.

18  
19 **Q. Did the Company prepare a schedule of reconstruction cost new less depreciation**  
20 **("RCND") rate base?**

21 A. No. The Company did not file RCND rate base schedules.

22  
23 **Q. What is the Company's fair value rate base ("FVRB")?**

24 A. Since no RCND schedules were filed, the Company's FVRB is equal to its OCRB.  
25

1 **PLANT IN SERVICE**

2 **Q. Please outline your adjustments to plant in service.**

3 A. Staff's adjustments to plant in service resulted in a decrease of \$61,549 as shown on  
4 Schedules ENZ-3 and ENZ-5.

5  
6 **Q. Please explain Staff's adjustment to plant in service.**

7 A. The adjustment to reduce plant in service by \$61,549 represents the total of numerous  
8 adjustments in various categories as outlined on schedule ENZ-5. Staff removed land  
9 purchased and a storage tank that are not used or useful. Staff further removed remodeling  
10 of office space rented from Katherine Sutter. Staff also removed a truck the Company sold,  
11 a 1979 Ford truck not used or useful. Staff added two GMC trucks leased from Henry  
12 Sutter, although the loans are paid by the Company. Staff further reclassified a touchreader  
13 from operating expense to plant.

14  
15 **ACCUMULATED DEPRECIATION**

16 **Q. Please explain Staff's adjustment to accumulated depreciation.**

17 A. Staff recommends accumulated depreciation of \$1,091,936, a \$17,305 decrease to the  
18 Company-proposed amount of \$1,109,241, as shown on Schedules ENZ -3 and ENZ-6.

19  
20 Staff calculated accumulated depreciation by adding depreciation expense for the  
21 intervening years to the Commission-approved balance of December 31, 1994, which was  
22 the test year in the prior rate case. Staff's accumulated depreciation calculation resulted in a  
23 decrease to accumulated depreciation of \$17,305.

1 **CONTRIBUTIONS IN AID OF CONSTRUCTION ("CIAC")**

2 **Q. Please explain Staff's adjustment to CIAC.**

3 A. Staff's adjustment of \$622 is to record actual CIAC amount of \$15,334. Company's  
4 application as submitted reflected net CIAC amount of \$14,712 as shown on schedule ENZ-  
5 7.

6  
7 **CIAC ACCUMULATED AMORTIZATION**

8 **Q. Please explain Staff's adjustment to CIAC accumulated amortization.**

9 A. Staff's adjustment of \$622 is to record CIAC accumulated amortization of \$622, as shown  
10 on schedule ENZ-8.

11  
12 **CUSTOMER DEPOSITS**

13 **Q. Please explain Staff's adjustment of \$7,769 to customer deposits.**

14 A. Staff's analysis of Company's general ledger, discovered that the Company omitted  
15 customer deposits from its application. Staff's adjustment of \$7,769 is to record customer  
16 deposits as shown on schedule ENZ-9.

17  
18 **METER ADVANCES**

19 **Q. Please explain Staff's adjustment to meter advances.**

20 A. Staff's adjustment of \$15,978, is to record meter advances difference between Company's  
21 application and its general ledger/balance sheet as shown on schedule ENZ-10.

22  
23 **OPERATING REVENUE**

24 **Q. Did Staff prepare a schedule showing the Company's proposed test year revenue and**  
25 **Staff's recommended test year revenue?**

26 A. Yes. This information is found on Schedule ENZ-11.

1 **Q. Has Staff recommended any changes to the Company's test year operating revenue?**

2 A. No. Staff concurs with the Company's revenue as filed.  
3

4 **OPERATING EXPENSES**

5 **Q. What is the Company's proposed operating expenses and Staff's recommended**  
6 **operating expenses?**

7 A. This information is found on Schedule ENZ-11. The Company claimed expenses of  
8 \$542,950. Staff is recommending operating expenses of \$487,306, or a \$55,644 decrease.  
9 Staff's recommended changes are detailed below.  
10

11 **Q. Please discuss Staff's \$47,015 adjustment to reduce salaries and wages.**

12 A. Staff's disallowance in salaries and wages is based on information received during Staff's  
13 audit visit at the Company office and Company responses to Staff's data requests. The  
14 application includes salaries for (1) Mr. Henry Sutter of \$3,000 per month for 11 months  
15 amounting to \$33,000, (2) Mrs. Katherine Sutter of \$3,000 per month for 11 months  
16 amounting to \$33,000, (3) Ms. Mandy Sutter of \$240 per week for 53 weeks, amounting to  
17 \$12,720, and (4) Taren Sutter 5 weeks at \$440 per week amounting to \$2,200, for a total of  
18 \$80,920. Staff removed these amounts as unnecessary for the Company to provide service.  
19 Staff added director's fees of \$150 per month for Henry, Katherine and Mandy Sutter,  
20 amounting to \$5,400 for 12 months. Mr. Ron McDonald joined the Company in the  
21 capacity of Operations Manager. With the help of several other positions listed below, the  
22 Company is fully staffed and appears to be well managed. Staff's audit visit confirms that  
23 there is no physical appearance and miniscule involvement of any members of the Sutter  
24 family. No office space is available for any additional personnel including any of the  
25 Sutters. It was also confirmed that Mr. Henry Sutter travels within Arizona, parts of New  
26 Mexico, Colorado, Nevada and California promoting land development. It was explained to

1 Staff that land development promotion will incidentally bring additional water customers.  
2 Such expenses are not reasonably chargeable to the water customers in this system. Staff  
3 believes that promoting land development is in the best interest of the Land Development  
4 and Investment Company, located at the same address in a separate building behind  
5 Pineview's building and owned by the Sutter family.

6  
7 Staff's recommendation for salaries is based upon position descriptions for each employee.  
8 Positions included are as follows: General Manager, Staff Accountant, Customer  
9 Service/Billing Clerk, Senior Serviceman, Operations Superintendent and Site  
10 Project/Inspection Manager. Please see Schedule ENZ-13 for more details.

11  
12 **Q. Please explain Staff's \$7,557 adjustment to reduce employee pension and benefits.**

13 A. Staff's calculation is based on the Company's benefits percentage as submitted by the  
14 Company, and salaries adjusted by Staff as previously described.

15  
16 **Q. Please explain Staff's \$3,441 adjustment to purchased power.**

17 A. Staff reduced purchased power by \$3,441. Reduction is based on the Company's e-mail  
18 response of November 22, 2004 responding to Staff's e-mail request for information. The  
19 response showed purchased power breakdown by location totaling to \$39,512, so Staff  
20 reduced the Company's application amount of \$42,953. See schedule ENZ-15.

21  
22 **Q. Please explain Staff's \$7,017 adjustment to repairs and supplies expense.**

23 A. Staff's reduction includes reclassification of \$1,089 to transportation expense for the repairs  
24 related to the two 2001 GMC trucks. Staff also removed a septic clean up in the amount of  
25 \$350 charged twice. Staff also removed \$5,578 pertaining to heavy equipment repairs. The  
26 receipts and invoices Staff audited, were not specific on which piece of equipment any

1 particular repairs applied to and Staff could not determine if the repairs were for Pineview's  
2 one backhoe.

3  
4 **Q. Please explain Staff's \$3,157 adjustment to contractual services expense.**

5 A. Please refer to Ms. Hains' testimony at page 23 for a breakdown and explanation of this  
6 adjustment. This adjustment is detailed on schedule ENZ-17.

7  
8 **Q. Please explain Staff's \$37,468 adjustment to rent expense.**

9 A. Staff removed leases for two GMC trucks, in the amount of \$14,400. Staff reclassified these  
10 trucks to plant in service. Staff also removed the heavy equipment lease entirely. Based on  
11 Decision No. 59934 dated December 18, 1996, the newest backhoe is included in the plant  
12 in service, therefore, the Company owns and utilizes this backhoe and has no need to rent  
13 this or other heavy equipment. Staff also removed rent expense of \$5,069 for  
14 unsubstantiated expenses, such as checks issued directly to Henry Sutter for the lease of a  
15 1979 truck that is not used or useful, and installation of a toolbox. This adjustment is shown  
16 on schedule ENZ-18.

17  
18 **Q. What adjustments did Staff make to the Company's miscellaneous expense?**

19 A. These adjustments are shown on schedule ENZ-21 and briefly described below.

20  
21 **Q. Please explain Staff's \$1,152 adjustment to office supplies and expense.**

22 A. Staff removed uniform service expense, as it is no longer used (\$1,152). Staff verified this  
23 during its on-site visit.

1 **Q. Please explain Staff's adjustment to transportation expense.**

2 A. Staff's adjustments include an addition of \$1,089, for the reclassification from the repairs  
3 and maintenance category related to the two 2001 GMC trucks. Staff also removed Henry  
4 Sutter's fuel expense amounting to \$480, for mileage unrelated to the Company. Staff also  
5 removed an unsubstantiated \$79 fuel expense, and fuel expenses of \$530 for the 1979 Ford,  
6 which is not used or useful. The positive adjustment was offset by the negative adjustments,  
7 so that there was no net adjustment to this expense category. See schedule ENZ-20.

8  
9 **Q. Please explain Staff's \$311 adjustment to postage and freight expense.**

10 A. Mercon, Inc. is a construction company owned by the Sutter Family. See Decision No.  
11 59934 at page 4. Staff removed Mercon postage and freight (\$311) paid with Pineview's  
12 funds, for this other Sutter family business.

13  
14 **Q. Please explain Staff's \$1,994 adjustment to telephone expense.**

15 A. Staff adjusted telephone expense to reflect going-forward actual expenses only of 2 land  
16 lines, fax line, 4 cellular phones and a long distance carrier. The \$1,994 adjustment  
17 represents landlines and cell phones which are no longer needed to conduct utility business.  
18 Staff's adjustment is based on actual bills, invoices and discussion with Company manager  
19 during Staff's audit visit.

20  
21 **Q. Please explain Staff's \$422 adjustment to materials and supplies expense.**

22 A. Staff reclassified a purchase of a touchreader (\$422) to plant in service.

23  
24 **Q. Please explain Staff's \$8,347 adjustment to bad debt expense.**

25 A. Staff adjusted bad debt expense to reflect the average of four years of written-off  
26 uncollected receivables.

1 **Q. Please summarize Staff's adjustment to miscellaneous expense.**

2 **A. Transportation expense** combined adjustments equal zero. **Office supplies and expense**  
3 adjustments equal a reduction of \$1,152. **Postage and freight** adjustments equal a  
4 reduction of \$311. **Telephone expense** adjustment equals a reduction of \$1,994. **Bad debt**  
5 **expense** adjustment equals a reduction of \$8,347.

6  
7 Staff noted that the Company is consolidating too many expense accounts into the  
8 miscellaneous expense. Staff recommends that the Company be ordered that, in the future,  
9 it keeps all information at the detail level in accordance with the NARUC USOA. Staff's  
10 testimony reflects all adjustments made to the respective categories.

11  
12 Staff recommends that the Company be required that, in the future, it keeps all information  
13 at the detail level specified by the NARUC USOA. The Company should be ordered to file  
14 an affidavit within 120 days of the effective date of this Order, in this docket attesting to its  
15 completion of altering its accounting system to be in compliance with the NARUC USOA.

16  
17 **Q. Please summarize Staff's adjustment to increase depreciation expense.**

18 **A.** Staff calculated depreciation expense on a going-forward basis using the recommended  
19 depreciation rates as shown in Section J of the Engineering Report. This resulted in an  
20 increase in depreciation expense of \$38,362. This adjustment is shown on schedule ENZ-  
21 22.

22  
23 **Q. Please explain Staff's adjustment to property tax expense.**

24 **A.** Staff's adjustment in the amount of \$370 is an increase due to Staff's audit findings  
25 increasing operating income in the test year. This adjustment is shown on schedule ENZ-  
26 23.

1 **Q. Please explain Staff's adjustment to federal and state income tax expense.**

2 A. Staff's adjustment of \$17,191 increases federal and state income tax due to Staff's audit  
3 findings increasing operating income in the test year. This adjustment is shown on schedule  
4 ENZ-24.

5  
6 **REVENUE REQUIREMENT**

7 **Q. What is the Company's proposed revenue requirement and Staff's recommended**  
8 **revenue requirement?**

9 A. The Company's proposed rates produce operating revenues of \$649,177 and operating  
10 income of \$76,695 or a 10.51 percent rate of return on an OCRB of \$730,084.

11  
12 Staff's recommended rates result in operating revenues of \$538,219 and operating income of  
13 \$47,671 for a 7.20 percent rate of return on an OCRB of \$662,093.

14  
15 **Q. Did Staff prepare a schedule summarizing its recommended revenue requirement?**

16 A. Yes. Please refer to Schedule ENZ-1.

17  
18 **RATE DESIGN**

19 **Q. Please explain Staff's recommended rate design.**

20 A. Staff's recommended rates produce a revenue level of \$538,219. This represents an increase  
21 of \$15,495 from adjusted test year revenues of \$522,724. However, due to Staff's  
22 recommended three-tier rates, the typical residential bill having a median usage of 3,250  
23 gallons will decrease from \$27.60 to \$26.97 for a decrease of \$.63, or 2.30 percent.

24  
25 The present rate design consists of a single-tier commodity rate and the Company's  
26 proposed rates consist of three tiers for all classes of customers.

1           The residential customer class consumed 76 percent of the total water sold. Consequently,  
2           Staff recommended a three-tier rate structure and is designed for the usage of residential and  
3           commercial customers. This is compatible with water conservation efforts. Staff's  
4           recommended rates are shown on schedule ENZ-25.

5  
6           The first tier-break at 3,000 gallons applies to 100 percent of the residential customers. The  
7           second-tier break at 20,000 gallons applies to 80 percent of the residential customers. The  
8           third-tier break is in excess of 20,000 gallons and applies to 20 percent of the residential  
9           customers.

10  
11       **ARSENIC REMOVAL**

12       **Q.    Does the Company have an arsenic problem?**

13       A.    No. (See Ms. Hains' testimony).

14  
15       **FINANCING**

16       **Q.    Has the Company filed a financing application?**

17       A.    Yes. (See Mr. Johnson's testimony).

18  
19       **STAFF RECOMMENDATIONS**

20       **Q.    Please summarize Staff's recommendations.**

21       A.    Staff recommends approval of its rates and charges as depicted on Schedule ENZ - 25.

22  
23           Staff further recommends a 7.20 percent rate of return on Staff's recommended FVRB of  
24           \$662,093.

1 Staff further recommends that the Company and its owners be ordered to eliminate the  
2 commingling of expenses and capital equipment that the Commission discussed in Decision  
3 No. 59934 and continues today to the detriment of ratepayers.

4  
5 Staff recommends that the Company be required to maintain written documentation  
6 describing the actual use of the Company owned backhoe.

7  
8 Staff recommends that the Commission order that Pineview cease and desist from further  
9 commingling of expenses and capital equipment. Staff further recommends that the  
10 Commission order; 1) mandatory training for equipment operators, 2) requirement for a  
11 Commission approval of all further transactions with affiliates or members of the Sutter  
12 family pursuant to R14-2-804, 3) shall maintain written usage reports for its Transportation  
13 and Power Operated Equipment. 4)<sup>1</sup> Such records will include the date, time of use or  
14 mileage and the purpose of the equipment usage. 5) Require Pineview to file a new rate case  
15 within 3 years, of the effective date of the Order in this proceeding.

16  
17 Staff further recommends that Pineview, be ordered to use the individual depreciation rates  
18 as shown in Exhibit 6 of the Engineering Report.

19  
20 Staff recommends that the Company be required that, in the future, it keeps all information  
21 at the detail level specified by the NARUC USOA. The Company should be ordered to file  
22 an affidavit within 120 days of the effective date of this Order, in this docket attesting to its  
23 completion of altering its accounting system to be in compliance with the NARUC USOA.  
24

---

<sup>1</sup> See National Association of Regulatory Commissioners Uniform System of Accounts for Transportation  
(Account 341) and Power Operated Equipment (account 345)

1 Staff further recommends a provision be included in the Company's tariff to allow for the  
2 flow-through of all appropriate state and local taxes as provided for in Arizona  
3 Administrative Code Rule 14-2-409(D)(5).

4  
5 **Q. Does this conclude your direct testimony?**

6 **A. Yes, it does.**

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ-1

**REVENUE REQUIREMENT**

| <u>LINE NO.</u> | <u>DESCRIPTION</u>                       | <u>[A]<br/>COMPANY<br/>ORIGINAL<br/>COST</u> | <u>[B]<br/>STAFF<br/>ORIGINAL<br/>COST</u> |
|-----------------|--|--|--|
| 1               | Adjusted Rate Base                       | \$ 730,084                                   | \$ 662,093                                 |
| 2               | Adjusted Operating Income (Loss)         | \$ (20,226)                                  | \$ 35,418                                  |
| 3               | Current Rate of Return (L2 / L1)         | -2.77%                                       | 5.35%                                      |
| 4               | Required Rate of Return                  | 10.51%                                       | 7.20%                                      |
| 5               | Required Operating Income (L4 * L1)      | \$ 76,695                                    | \$ 47,671                                  |
| 6               | Operating Income Deficiency (L5 - L2)    | \$ 96,921                                    | \$ 12,253                                  |
| 7               | Gross Revenue Conversion Factor          | 1.30470                                      | 1.26459                                    |
| 8               | Increase In Gross Revenue (L7 * L6)      | \$ 126,453                                   | \$ 15,495                                  |
| 9               | Adjusted Test Year Revenue               | \$ 522,724                                   | \$ 522,724                                 |
| 10              | Proposed Annual Revenue (L8 + L9)        | \$ 649,177                                   | \$ 538,219                                 |
| 11              | Required Increase in Revenue (%) (L8/L9) | 24.19%                                       | 2.96%                                      |

**GROSS REVENUE CONVERSION FACTOR**

Line  
No.

Calculation of Gross Revenue Conversion Factor:

|   |  |           |                        |
|---|--|-----------|------------------------|
| 1 | Recommended Revenue Increase:              |           |                        |
| 2 | Billings                                   |           | 1.000000               |
| 3 | Combined Federal and State Income Tax Rate | 20.92280% |                        |
| 4 | Uncollectible Rate After Income Taxes      | 0.00000%  |                        |
| 5 | Total Tax Rate                             |           | <u>20.92280%</u>       |
| 6 | Gross Revenue Conversion Factor            |           | <u><u>1.264587</u></u> |

Calculation of Effective Income Tax Rate:

|    |  |                         |
|----|--|-------------------------|
| 7  | Operating Income Before Taxes (Arizona Taxable Income) | 100.00000%              |
| 8  | Arizona State Income Tax Rate                          | <u>6.96800%</u>         |
| 9  | Federal Taxable Income (L7 - L8)                       | <u>93.03200%</u>        |
| 10 | Applicable Federal Income Tax Rate (Line 36)           | <u>15.00000%</u>        |
| 11 | Effective Federal Income Tax Rate (L9 x L10)           | <u>13.95480%</u>        |
| 12 | Combined Federal and State Income Tax Rate (L8 +L11)   | <u><u>20.92280%</u></u> |

Calculation of Uncollectible Rate After Income Taxes:

|    |  |           |                        |
|----|--|-----------|------------------------|
| 13 | Uncollectible Rate                                 |           | 0.00000%               |
| 14 | Combined Federal and State Income Tax Rate         | 20.92280% |                        |
| 15 | 1 minus Combined Federal and State Income Tax Rate |           | <u>79.07720%</u>       |
| 16 | Uncollectible Rate After Income Taxes              |           | <u><u>0.00000%</u></u> |

Revenue Reconciliation:

|    |  |                         |        |
|----|--|-------------------------|--------|
| 17 | Recommended Increase in Revenue (from ENZ-1, L8)           | <u>\$ 15,495</u>        |        |
| 18 | Uncollectible Rate   | 0.000000%               |        |
| 19 | Required Increase in Revenue to Provide for Uncollectibles | \$ -                    |        |
| 20 | Recommended Increase in Revenue (from ENZ-1,L8)            | <u>\$ 15,495</u>        |        |
| 21 | Required Increase in Revenue to Provide for Uncollectibles | -                       |        |
| 22 | Incremental Taxable Income                                 | <u>\$ 15,495</u>        |        |
| 23 | Combined Federal and State Income Tax Rate                 | <u>20.92280%</u>        |        |
| 24 | Required Increase in Revenue to Provide for Income Taxes   |                         | 3,242  |
| 25 | Required Operating Income                                  | \$ 47,671               |        |
| 26 | Adjusted Test Year Operating Income (Loss)                 | <u>35,418</u>           |        |
| 27 | Required Increase in Operating Income                      |                         | 12,253 |
| 28 | Total Required Increase/Decrease In Revenue                | <u><u>\$ 15,495</u></u> |        |

Calculation of Income Tax:

|    | Test Year                                       |                   | STAFF<br>Recommended |              |
|----|---|-------------------|----------------------|--------------|
| 29 | Revenue   | <u>\$ 522,724</u> | \$                   | 538,219      |
| 30 | Less: Operating Expenses Excluding Income Taxes | \$ 482,665        | \$                   | 482,665      |
| 31 | Less: Synchronized Interest                     | \$ 17,877         | \$                   | 17,877       |
| 32 | Arizona Taxable Income                          | \$ 22,182         | \$                   | 37,677       |
| 33 | Arizona State Income Tax Rate                   | 6.968%            |                      | 6.968%       |
| 34 | Arizona Income Tax                              | \$ 1,546          | \$                   | 2,625        |
| 35 | Federal Taxable Income                          | \$ 20,637         | \$                   | 35,052       |
| 36 | Federal Income Tax @ 15%                        | \$ 3,095          | \$                   | 5,258        |
| 37 | Combined Federal and State Income Tax           | <u>\$ 4,641</u>   | <u>\$</u>            | <u>7,883</u> |
|    |   |                   | \$                   | 3,242        |

Calculation of Interest Synchronization:

|    |                               |                   |
|----|-------------------------------|-------------------|
| 38 | Rate Base                     | <u>\$ 662,093</u> |
| 39 | Weighted Average Cost of Debt | <u>2.700%</u>     |
| 40 | Synchronized Interest         | <u>\$ 17,877</u>  |

**RATE BASE - ORIGINAL COST**

| LINE<br>NO.  | (A)<br>COMPANY<br>AS<br>FILED               | (B)<br>STAFF<br>ADJUSTMENTS | (C)<br>STAFF<br>AS<br>ADJUSTED |
|--------------|---|-----------------------------|--------------------------------|
| 1            | Plant in Service                            | \$ 2,162,941                | \$ 2,101,392                   |
| 2            | Less: Accumulated Depreciation              | (1,109,241)                 | (1,091,936)                    |
| 3            | Net Plant in Service                        | <u>\$ 1,053,700</u>         | <u>\$ 1,009,456</u>            |
| <u>LESS:</u> |   |                             |                                |
| 4            | Advances in Aid of Construction (AIAC)      | (243,473)                   | (243,473)                      |
| 5            | Contributions in Aid of Construction (CIAC) | \$ (14,712)                 | \$ (15,334)                    |
| 6            | Less: Accumulated Amortization              | -                           | 622                            |
| 7            | Net CIAC                                    | <u>(14,712)</u>             | <u>(14,712)</u>                |
| 8            | Total Advances and Contributions            | (258,185)                   | (258,185)                      |
| 9            | Customer Deposits                           | -                           | (7,769)                        |
| 10           | Meter Advances                              | (72,414)                    | (88,392)                       |
| 11           | Deferred Income Tax Credits                 | -                           | -                              |
| <u>ADD:</u>  |   |                             |                                |
| 12           | Working Capital                             | -                           | -                              |
| 13           | Other Additions                             | 6,983                       | 6,983                          |
| 14           | <b>Total Rate Base</b>                      | <u>\$ 730,084</u>           | <u>\$ 662,093</u>              |

SUMMARY OF RATE BASE ADJUSTMENTS

| LINE NO.                 | DESCRIPTION                                 | [A]<br>COMPANY<br>AS FILED | [B]<br>ADJ.No.1 | [C]<br>ADJ.No.2 | [D]<br>ADJ.No.3 | [E]<br>ADJ.No.4 | [N]<br>ADJ.No.5 | [O]<br>STAFF<br>ADJUSTED |
|--------------------------|---|----------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|--------------------------|
| <u>PLANT IN SERVICE:</u> |   |                            |                 |                 |                 |                 |                 |                          |
| 1                        | Organization                                |                            | \$ -            | \$ -            | \$ -            | \$ -            | \$ -            | \$ -                     |
| 2                        | Land and Land Rights                        | 73,175                     | (50,750)        | -               | -               | -               | -               | 22,425                   |
| 3                        | Structures and Improvements                 | 94,930                     | (1,725)         | -               | -               | -               | -               | 93,205                   |
| 4                        | Wells and Structures                        | 239,855                    | (14,374)        | -               | -               | -               | -               | 225,481                  |
| 5                        | Pumping Equipment                           | 104,629                    | 14,373          | -               | -               | -               | -               | 119,002                  |
| 6                        | Water Treatment Equipment                   | 304,911                    | (58,299)        | -               | -               | -               | -               | (58,299)                 |
| 7                        | Distribution Reservoirs and Standpipes      | 1,057,174                  | -               | -               | -               | -               | -               | 304,911                  |
| 8                        | Transmission and Distribution Mains         | 10,116                     | -               | -               | -               | -               | -               | 1,057,174                |
| 9                        | Services                                    | 185,262                    | -               | -               | -               | -               | -               | 10,116                   |
| 10                       | Meter and Meter Installations               | 14,810                     | (38,543)        | -               | -               | -               | -               | 185,262                  |
| 11                       | Hydrants                                    | 40,209                     | -               | -               | -               | -               | -               | (23,733)                 |
| 12                       | Other Plant and Misc Equipment              | 28,994                     | 48,805          | -               | -               | -               | -               | 40,209                   |
| 11                       | Office Furniture and Equipment              | 8,343                      | 38,542          | -               | -               | -               | -               | 77,799                   |
| 12                       | Transportation Equipment                    | -                          | -               | -               | -               | -               | -               | 46,885                   |
| 13                       | Tool and Work Equipment                     | 533                        | 422             | -               | -               | -               | -               | -                        |
| 14                       | Communications Equipment                    |                            |                 |                 |                 |                 |                 | 955                      |
| 15                       | Total Plant in Service - Actual             | 2,162,941                  | (61,549)        | -               | -               | -               | -               | \$ 2,101,392             |
| 16                       | Less: Accumulated Depreciation - Actual     | (1,109,241)                |                 | 17,305          | -               | -               | -               | (1,091,936)              |
| 17                       | Net Plant in Service                        | \$ 1,053,700               | \$ (61,549)     | \$ 17,305       | \$ -            | \$ -            | \$ -            | \$ 1,009,456             |
| <u>LESS:</u>             |   |                            |                 |                 |                 |                 |                 |                          |
| 18                       | Advances in Aid of Construction (AIAC)      | \$ (243,473)               | \$ -            | \$ -            | \$ -            | \$ -            | \$ -            | (243,473)                |
| 19                       | Contributions in Aid of Construction (CIAC) | (14,712)                   | -               | -               | (622)           | -               | -               | (15,334)                 |
| 20                       | Less: Accumulated Amortization              |                            |                 |                 |                 | 622             |                 | 622                      |
| 21                       | Net CIAC (L25 - L26)                        | (14,712)                   | -               | -               | (622)           | 622             | -               | (14,712)                 |
| 22                       | Total Advances and Contributions            | (258,185)                  | -               | -               | (622)           | 622             | -               | (258,185)                |
| 23                       | Customer Meter Deposits                     | -                          | -               | -               | -               | -               | (7,769)         | (7,769)                  |
| 24                       | Meter Advances                              | (72,414)                   | -               | -               | -               | -               | (15,978)        | (88,392)                 |
| 25                       | Deferred Tax Credits                        | -                          | -               | -               | -               | -               | -               | -                        |
| <u>ADD:</u>              |   |                            |                 |                 |                 |                 |                 |                          |
| 26                       | Working Capital Allowance                   | -                          | -               | -               | -               | -               | -               | -                        |
| 27                       | Deferred Debits                             | -                          | -               | -               | -               | -               | -               | -                        |
| 28                       | CWIP  | 6,983                      | -               | -               | -               | -               | -               | 6,983                    |
| 29                       | Total Rate Base                             | \$ 730,084                 | \$ (61,549)     | \$ 17,305       | \$ (622)        | \$ 622          | \$ (23,747)     | \$ 662,093               |

**RATE BASE ADJUSTMENT NO. 1 - PLANT IN SERVICE**

| LINE NO. | DESCRIPTION                         | [A]                 | [B]                | [C]                 |
|----------|-------------------------------------|---------------------|--------------------|---------------------|
|          |                                     | COMPANY AS FILED    | STAFF ADJUSTMENTS  | STAFF AS ADJUSTED   |
| 1        | Land and Land Rights                | 73,175              | (50,750)           | 22,425              |
| 2        | Structure and Improvements          | 94,930              | (1,725)            | 93,205              |
| 3        | Wells and Springs                   | 239,855             | (14,374)           | 225,481             |
| 4        | Electric Pumping Equipment          | 104,629             | 14,373             | 119,002             |
| 5        | Storage Tanks                       | 304,911             | (58,299)           | 246,612             |
| 6        | Transmission and Distribution-Mains | 1,057,175           | -                  | 1,057,175           |
| 7        | Services                            | 10,116              | -                  | 10,116              |
| 8        | Meters                              | 185,262             | -                  | 185,262             |
| 9        | Hydrants                            | 14,810              | -                  | 14,810              |
| 10       | Plant Structure and Improvements    | 40,209              | (38,543)           | 1,666               |
| 11       | Office Furniture and Equipment      | 28,993              | -                  | 28,993              |
| 12       | Transportation Equipment            | 8,343               | 48,805             | 57,148              |
| 13       | Tools and Work Equipment            | -                   | 38,542             | 38,542              |
| 14       | Communication Equipment             | 533                 | -                  | 533                 |
| 15       | Miscellaneous Equipment             | -                   | 422                | 422                 |
| 14       | Plant in Service                    | <u>\$ 2,162,941</u> | <u>\$ (61,549)</u> | <u>\$ 2,101,392</u> |

References:

Column [A]: Company Schedule E-5  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

Adjustment Notes:

|  |                    |
|--|--------------------|
| 1 Staff engineer removed purchased land.   | (50,750)           |
| 2 Staff removed remodeling expense - landlord's expense.   | (1,725)            |
| 3 Wells and springs - reclassified to electric pumping equipment.  | (14,374)           |
| 4 Electric Pumping Equipment - reclassified from wells and springs.  | 14,373             |
| 5 Staff engineer removed storage tank not used or useful.  | (58,299)           |
| 6 Plant Structure and Improvements - reclassified to tools and work equipment.   | (38,543)           |
| 7 Staff removed truck sold and 1979 truck not used and usefull and reclassified two 2001 GMC trucks leased from Henry Sutter yet paid by Pineview. | 48,805             |
| 8 Tools and Work Equipment - reclassified from plant structure and improvements.   | 38,542             |
| 9 Miscellaneous Equipment - touchreader reclassified from operating expense.   | 422                |
|  | <u>\$ (61,549)</u> |

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ-6

**RATE BASE ADJUSTMENT NO. 2 - ACCUMULATED DEPRECIATION**

| LINE<br>NO. | DESCRIPTION                      | [A]                  | [B]                  | [C]                   |
|-------------|----------------------------------|----------------------|----------------------|-----------------------|
|             |                                  | COMPANY<br>AS FILED  | STAFF<br>ADJUSTMENTS | STAFF<br>AS ADJUSTED  |
| 1           | Accumulated Depreciation, Actual | <u>\$(1,109,241)</u> | <u>\$ 17,305</u>     | <u>\$ (1,091,936)</u> |

References:

- Column [A]: Company Schedule E-5
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 7

RATE BASE ADJUSTMENT NO. 3 - CIAC

| LINE NO. | DESCRIPTION                          | [A]              | [B]               | [C]               |
|----------|--------------------------------------|------------------|-------------------|-------------------|
|          |                                      | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1        | Contributions in Aid of Construction | \$ (14,712)      | \$ (622)          | \$ (15,334)       |

References:

- Column [A]: Company Schedule B-5
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 8

**RATE BASE ADJUSTMENT NO. 4 - CIAC AMORTIZATION**

| LINE<br>NO. | DESCRIPTION                   | [A]                 | [B]                  | [C]                  |
|-------------|-------------------------------|---------------------|----------------------|----------------------|
|             |                               | COMPANY<br>AS FILED | STAFF<br>ADJUSTMENTS | STAFF<br>AS ADJUSTED |
| 1           | Amortization of Contributions | \$ -                | \$ 622               | \$ 622               |

References:

- Column [A]: Company Schedule B-5
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 9

**RATE BASE ADJUSTMENT NO. 5 - CUSTOMER DEPOSITS**

| LINE<br>NO. | DESCRIPTION       | [A]                 | [B]                  | [C]                  |
|-------------|-------------------|---------------------|----------------------|----------------------|
|             |                   | COMPANY<br>AS FILED | STAFF<br>ADJUSTMENTS | STAFF<br>AS ADJUSTED |
| 1           | Customer Deposits | \$ -                | \$ (7,769)           | \$ (7,769)           |

References:

- Column [A]: Company Schedule B-5
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 10

**RATE BASE ADJUSTMENT NO. 6 - METER ADVANCES**

| LINE<br>NO. | DESCRIPTION    | [A]                 | [B]                  | [C]                  |
|-------------|----------------|---------------------|----------------------|----------------------|
|             |                | COMPANY<br>AS FILED | STAFF<br>ADJUSTMENTS | STAFF<br>AS ADJUSTED |
| 1           | Meter Advances | \$ (72,414)         | \$ (15,978)          | \$ (88,392)          |

References:

- Column [A]: Company Schedule B-5
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

**OPERATING INCOME - TEST YEAR AND STAFF PROPOSED**

| LINE NO.         | DESCRIPTION                          | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>TEST YEAR<br>ADJUSTMENTS | [C]<br>STAFF<br>TEST YEAR<br>AS<br>ADJUSTED | [D]<br>STAFF<br>PROPOSED<br>CHANGES | [E]<br>STAFF<br>RECOMMENDED |
|------------------|--------------------------------------|----------------------------|--|---|-------------------------------------|-----------------------------|
| <u>REVENUES:</u> |                                      |                            |  |   |                                     |                             |
| 1                | Total Operating Revenues             | \$ 522,724                 | \$ -                                     | \$ 522,724                                  | \$ 15,495                           | \$ 538,219                  |
| <u>EXPENSES:</u> |                                      |                            |  |   |                                     |                             |
| 1                | Salaries and Wages                   | 231,295                    | (47,015)                                 | 184,280                                     | -                                   | 184,280                     |
| 2                | Employee Pensions and Benefits       | 37,171                     | (7,557)                                  | 29,614                                      | -                                   | 29,614                      |
| 3                | Purchased Power                      | 42,953                     | (3,441)                                  | 39,512                                      | -                                   | 39,512                      |
| 4                | Repairs and Supplies                 | 29,243                     | (7,017)                                  | 22,226                                      | -                                   | 22,226                      |
| 5                | Water Testing                        | -                          | -  | -   | -                                   | -                           |
| 6                | Office Supplies and Expense          | -                          | (1,152)                                  | (1,152)                                     | -                                   | (1,152)                     |
| 7                | Contractual Services                 | 13,252                     | 3,157                                    | 16,409                                      | -                                   | 16,409                      |
| 8                | Rate Case Expense                    | -                          | -  | -   | -                                   | -                           |
| 9                | Rent                                 | 52,035                     | (37,468)                                 | 14,567                                      | -                                   | 14,567                      |
| 10               | Materials and Supplies               | 4,120                      | -  | 4,120                                       | -                                   | 4,120                       |
| 11               | Transportation Expenses              | -                          | -  | -   | -                                   | -                           |
| 12               | Insurances - General Liability       | -                          | -  | -   | -                                   | -                           |
| 13               | Insurance Health and Life            | -                          | -  | -   | -                                   | -                           |
| 14               | Bank Service Charges                 | -                          | -  | -   | -                                   | -                           |
| 15               | Dues and Subscriptions               | -                          | -  | -   | -                                   | -                           |
| 16               | Licenses and Fees                    | -                          | -  | -   | -                                   | -                           |
| 17               | Postage and Freight                  | -                          | (311)                                    | (311)                                       | -                                   | (311)                       |
| 18               | Printing and Reproduction            | -                          | -  | -   | -                                   | -                           |
| 19               | Telephone Expense                    | -                          | (1,994)                                  | (1,994)                                     | -                                   | (1,994)                     |
| 20               | Meals and Entertainment              | -                          | -  | -   | -                                   | -                           |
| 21               | Travel                               | -                          | -  | -   | -                                   | -                           |
| 22               | Other Utilities                      | -                          | -  | -   | -                                   | -                           |
| 23               | Small Tools                          | -                          | (422)                                    | (422)                                       | -                                   | (422)                       |
| 24               | Bad Debt Expense                     | -                          | (8,347)                                  | (8,347)                                     | -                                   | (8,347)                     |
| 25               | Certified Operator Fee               | -                          | -  | -   | -                                   | -                           |
| 26               | Penalties Expense                    | -                          | -  | -   | -                                   | -                           |
| 27               | Miscellaneous Expense                | 72,950                     | -  | 72,950                                      | -                                   | 72,950                      |
| 28               | Taxes Other than Property and Income | -                          | -  | -   | -                                   | -                           |
| 29               | Administrative Expenses              | -                          | -  | -   | -                                   | -                           |
| 30               | Total Operation and Maintenance      | 483,019                    | (111,567)                                | 371,452                                     | -                                   | 371,452                     |
| 31               | Depreciation and Amortization        | 44,684                     | 38,362                                   | 83,046                                      | -                                   | 83,046                      |
| 32               | Ad Valorem (Property)                | 27,797                     | 370                                      | 28,167                                      | -                                   | 28,167                      |
| 33               | Taxes:                               |                            |  |   |                                     |                             |
| 34               | Federal & State Income Tax           | (12,550)                   | 17,191                                   | 4,641                                       | 3,242                               | 7,883                       |
| 35               | Other                                | -                          | -  | -   | -                                   | -                           |
| 36               | <b>Total Operating Expenses</b>      | <u>\$ 542,950</u>          | <u>\$ (55,644)</u>                       | <u>\$ 487,306</u>                           | <u>\$ 3,242</u>                     | <u>\$ 490,548</u>           |
| 37               | <b>Operating Income (Loss)</b>       | <u>\$ (20,226)</u>         | <u>\$ 55,644</u>                         | <u>\$ 35,418</u>                            | <u>\$ 12,253</u>                    | <u>\$ 47,671</u>            |

Pineview Water Company, Inc.  
 Docket No. W-01676A-04-0463 and 0500  
 Test Year Ended December 31, 2003

SUMMARY OF OPERATING INCOME ADJUSTMENTS - TEST YEAR

| LINE NO.         | DESCRIPTION                          | [A]<br>COMPANY<br>AS FILED | [B]                | [C]               | [D]               | [J]               | [E]               | [F]                | [G]             | [H]                | [I]             | [K]               | [L]<br>STAFF<br>ADJUSTED |
|------------------|--------------------------------------|----------------------------|--------------------|-------------------|-------------------|-------------------|-------------------|--------------------|-----------------|--------------------|-----------------|-------------------|--------------------------|
|                  |                                      | ADJ #1                     | ADJ #2             | ADJ #3            | ADJ #4            | ADJ #5            | ADJ #6            | ADJ #7             | ADJ #8          | ADJ #9             | ADJ #10         | ADJ #11           |                          |
|                  |                                      | \$                         | \$                 | \$                | \$                | \$                | \$                | \$                 | \$              | \$                 | \$              | \$                | \$                       |
| <b>REVENUES:</b> |                                      |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 1                | Metered Water Revenue                | 518,560                    |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 518,560                  |
| 2                | Other Water Revenue                  | 4,164                      |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 4,164                    |
| 3                | <b>Total Operating Revenues</b>      | <b>\$ 522,724</b>          |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | <b>\$ 522,724</b>        |
| <b>EXPENSES:</b> |                                      |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 4                | Salaries and Wages                   | 231,295                    | (7,557)            |                   |                   |                   |                   |                    |                 |                    |                 |                   | 184,280                  |
| 5                | Employee Pensions and Benefits       | 37,171                     |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 29,614                   |
| 6                | Purchased Power                      | 42,953                     |                    | (3,441)           |                   |                   |                   |                    |                 |                    |                 |                   | 39,512                   |
| 7                | Repairs and Supplies                 | 29,243                     |                    |                   | (7,017)           |                   |                   |                    |                 |                    |                 |                   | 22,226                   |
| 8                | Water Testing                        |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 9                | Office Supplies and Expense          |                            |                    |                   |                   | (1,152)           |                   |                    |                 |                    |                 |                   | (1,152)                  |
| 10               | Contractual Services                 | 13,252                     |                    |                   |                   |                   | 3,157             |                    |                 |                    |                 |                   | 16,409                   |
| 11               | Rate Case Expense                    |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 12               | Rent                                 | 52,035                     |                    |                   |                   |                   |                   | (37,468)           |                 |                    |                 |                   | 14,567                   |
| 13               | Materials and Supplies               | 4,120                      |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 4,120                    |
| 14               | Transportation Expenses              |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 15               | Insurances - General Liability       |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 16               | Insurance Health and Life            |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 17               | Bank Service Charges                 |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 18               | Dues and Subscriptions               |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 19               | Licenses and Fees                    |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 20               | Postage and Freight                  |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 21               | Printing and Reproduction            |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 22               | Telephone Expense                    |                            |                    |                   |                   |                   |                   |                    |                 | (311)              |                 |                   | (311)                    |
| 23               | Meals and Entertainment              |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 24               | Travel                               |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 25               | Other Utilities                      |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 26               | Small Tools                          |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 27               | Bad Debt Expense                     |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 28               | Certified Operator Fee               |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 29               | Penalties Expense                    |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 30               | Insurance                            |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 31               | Miscellaneous Expense                | 72,950                     |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 72,950                   |
| 32               | Taxes Other than Property and Income |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 33               | Administrative Expenses              |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 34               | Total Operation and Maintenance      | 483,019                    | (47,015)           | (3,441)           | (7,017)           | (1,152)           | 3,157             | (37,468)           | (311)           | (1,994)            | (422)           | (8,347)           | 371,452                  |
| 35               | Depreciation and Amortization        | 44,684                     |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   | 83,046                   |
| 36               | Ad Valorem (Property)                | 27,797                     |                    |                   |                   |                   |                   |                    |                 |                    | 370             |                   | 28,167                   |
| 37               | Taxes                                |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 38               | Federal & State Income Tax           | (12,550)                   |                    |                   |                   |                   |                   |                    |                 |                    |                 | 17,191            | 4,641                    |
| 39               | Other (Deferred Income Tax)          |                            |                    |                   |                   |                   |                   |                    |                 |                    |                 |                   |                          |
| 40               | <b>Total Operating Expenses</b>      | <b>\$ 542,950</b>          | <b>\$ (47,015)</b> | <b>\$ (3,441)</b> | <b>\$ (7,017)</b> | <b>\$ (1,152)</b> | <b>\$ 3,157</b>   | <b>\$ (37,468)</b> | <b>\$ (311)</b> | <b>\$ 36,368</b>   | <b>\$ (422)</b> | <b>\$ 8,844</b>   | <b>\$ 487,306</b>        |
| 41               | <b>Operating Income (Loss)</b>       | <b>\$ (20,226)</b>         | <b>\$ 7,557</b>    | <b>\$ 3,441</b>   | <b>\$ 7,017</b>   | <b>\$ 1,152</b>   | <b>\$ (3,157)</b> | <b>\$ 37,468</b>   | <b>\$ 311</b>   | <b>\$ (36,368)</b> | <b>\$ 52</b>    | <b>\$ (8,844)</b> | <b>\$ 35,418</b>         |

Pineview Water Company, Inc.  
 Docket No. W-01676A-04-0463 and 0500  
 Test Year Ended December 31, 2003

Schedule ENZ- 13

**OPERATING INCOME ADJUSTMENT NO 1 - SALARIES EXPENSE**

| LINE NO. | DESCRIPTION | [A]<br>COMPANY AS FILED | [B]<br>STAFF ADJUSTMENT | [C]<br>STAFF AS ADJUSTED |
|----------|-------------|-------------------------|-------------------------|--------------------------|
| 1        | Salaries    | \$ 231,295              | \$ (47,015)             | \$ 184,280               |
| 2        | Total       | <u>\$ 231,295</u>       | <u>\$ (47,015)</u>      | <u>\$ 184,280</u>        |

Per Job Descriptions submitted by the Company - going forward salaries.

|    |   |                  |               |                   |
|----|---|------------------|---------------|-------------------|
| 3  | Billing Clerk   | \$10.00 per hour | 20,800        |                   |
| 4  | Staff Accountant  | \$13.00 per hour | 27,040        |                   |
| 5  | Senior Serviceman   | \$14.50 per hour | 30,160        |                   |
| 6  | Operations Superintendent   | \$15.00 per hour | 31,200        |                   |
| 7  | Site Project/Inspection Manager   | \$16.00 per hour | 33,280        |                   |
| 8  | General Manager   | \$700 per week   | <u>36,400</u> | 178,880           |
| 9  | Add Director fee of \$150 per meeting. Company holds monthly Board of Directors meetings, 12 meetings @ \$150 per month X 3 = (Henry, Katherine and Mandy Sutter) |                  |               | <u>5,400</u>      |
| 10 | Staff's recommended salaries expense  |                  |               | <u>\$ 184,280</u> |

References:

Column [A]: Company Schedule C-1  
 Column [B]: Testimony ENZ  
 Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 14

**OPERATING INCOME ADJUSTMENT NO 2 - EMPLOYEE PENSIONS AND BENEFITS**

| LINE NO. | DESCRIPTION                    | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|--------------------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Employee Pensions and Benefits | 37,171                     | \$ (7,557)                 | 29,614                      |
| 2        | Total                          | <u>\$ 37,171</u>           | <u>\$ (7,557)</u>          | <u>\$ 29,614</u>            |

References:

- Column [A]: Company Schedule C-1
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 15

**OPERATING INCOME ADJUSTMENT NO 3 - PURCHASED POWER EXPENSE**

| LINE NO. | DESCRIPTION             | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|-------------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Purchased Power Expense | \$ 42,953                  | \$ (3,441)                 | \$ 39,512                   |
| 2        | Total                   | \$ 42,953                  | \$ (3,441)                 | \$ 39,512                   |

References:

Column [A]: Company Schedule C-1  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
 Docket No. W-01676A-04-0463 and 0500  
 Test Year Ended December 31, 2003

Schedule ENZ- 16

**OPERATING INCOME ADJUSTMENT NO 4 - REPAIRS AND SUPPLIES EXPENSE**

| LINE NO. | DESCRIPTION   | [A]<br>COMPANY AS FILED | [B]<br>STAFF ADJUSTMENT | [C]<br>STAFF AS ADJUSTED |
|----------|---|-------------------------|-------------------------|--------------------------|
| 1        | Septic clean-up   | \$ -                    | \$ (350)                | 1 \$ (350)               |
| 2        | Truck Repairs   | \$ -                    | \$ (1,089)              | 2 \$ (1,089)             |
| 3        | Backhoe and Skidsteer Repairs   | \$ -                    | \$ (5,578)              | 3 \$ (5,578)             |
| 4        | Repairs and Supplies  | 29,243                  | \$ -                    | 29,243                   |
| 5        | Total   | <u>\$ 29,243</u>        | <u>\$ (7,017)</u>       | <u>\$ 22,226</u>         |
| 6        | Roto Rooter charged twice in one year   |                         | (350)                   |                          |
| 7        | Truck repairs expense - reclass to Transportation Expense                         |                         | (1,089)                 |                          |
| 8        | These charges appear to belong to Mr. Sutter's heavy equipment rental operations. |                         | <u>(5,578)</u>          |                          |
|          |   |                         | \$ (7,017)              |                          |

References:

Column [A]: Company Schedule C-1  
 Column [B]: Testimony ENZ  
 Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 17

**OPERATING INCOME ADJUSTMENT NO 6 - CONTRACTUAL SERVICES EXPENSE**

| LINE NO. | DESCRIPTION          | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|----------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Contractual Services | 13,252                     | 3,157                      | 16,409                      |
| 2        | Total                | <u>\$ 13,252</u>           | <u>\$ 3,157</u>            | <u>\$ 16,409</u>            |

References:

Column [A]: Company Schedule C-1  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

Adjustment Notes:

Water testing expense increased per Staff engineer recommendation

Pineview Water Company, Inc.  
 Docket No. W-01676A-04-0463 and 0500  
 Test Year Ended December 31, 2003

Schedule ENZ- 18

**OPERATING INCOME ADJUSTMENT NO 7 - RENT EXPENSE**

| LINE NO. | DESCRIPTION  | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|--------------|----------------------------|----------------------------|-----------------------------|
| 1        | Rent Expense | 52,035                     | (37,468)                   | 14,567                      |
| 2        | Total        | <u>\$ 52,035</u>           | <u>\$ (37,468)</u>         | <u>\$ 14,567</u>            |

Adjustment Notes:

|   |                  |
|---|------------------|
| 3 Staff removed lease expense. Decision No. 59934 dated December 18, 1996 orders the newest backhoe be included in the Company's plant in service. Staff confirmed the inclusion of the Commission ordered backhoe. Company has no need to rent or lease any other heavy equipment. | 18,000           |
| 4 Staff removed lease expense of the two 2001 GMC trucks which Staff reclassified to plant in service.  | 14,400           |
| 5 Unsubstantiated expense, checks issued to Henry Sutter.   | <u>5,067</u>     |
|   | <u>\$ 37,467</u> |

References:

Column [A]: Company Schedule C-1  
 Column [B]: Testimony ENZ  
 Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 19

**OPERATING INCOME ADJUSTMENT NO 10 - MATERIALS AND SUPPLIES EXPENSE**

| LINE NO. | DESCRIPTION                    | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|--------------------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Materials and Supplies Expense | 4,120                      | (422)                      | 3,698                       |
| 2        | Total                          | \$ 4,120                   | \$ (422)                   | \$ 3,698                    |

References:

Column [A]: Company Schedule C-1  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

**OPERATING INCOME ADJUSTMENT - TRANSPORTATION EXPENSE**

| LINE NO. | DESCRIPTION            | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|------------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Transportation Expense | -                          | -                          | -                           |
| 2        | Total                  | \$ -                       | \$ -                       | \$ -                        |

Adjustments

|   |  |  |              |  |
|---|--|--|--------------|--|
| 3 | Reclassification from Repairs and maintenance  |  | 1,089        |  |
| 4 | Removal of fuel expense - Henry Sutter         |  | (480)        |  |
| 5 | Unsubstantiated fuel expense                   |  | (79)         |  |
| 6 | Fuel expense for Ford truck not used or useful |  | <u>(530)</u> |  |

Total Adjustment

-

References:

Column [A]: Company Schedule C-1  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
 Docket No. W-01676A-04-0463 and 0500  
 Test Year Ended December 31, 2003

Schedule ENZ- 21

**OPERATING INCOME ADJUSTMENT NOS 5, 8, 9 and 11 - MISCELLANEOUS EXPENSE**

| LINE NO. | DESCRIPTION           | [A]<br>COMPANY AS FILED | [B]<br>STAFF ADJUSTMENT | [C]<br>STAFF AS ADJUSTED |
|----------|-----------------------|-------------------------|-------------------------|--------------------------|
| 1        | Miscellaneous Expense | 72,950                  | (11,804)                | 61,146                   |
| 2        | Total                 | <u>\$ 72,950</u>        | <u>\$ (11,804)</u>      | <u>\$ 61,146</u>         |

Adjustments

|   |   |  |              |  |
|---|---|--|--------------|--|
| 3 | Company is no longer using uniforms service.                  |  | 1,152        |  |
| 4 | Postage/freight expense incurred by Mercon.                   |  | 311          |  |
| 5 | Excess telephone charges, will not be repeated going forward. |  | 1,994        |  |
| 6 | Four year average, accounts receivable write-offs             |  | <u>8,347</u> |  |
|   |   |  | 11,804       |  |

References:

Column [A]: Company Schedule C-1  
 Column [B]: Testimony ENZ  
 Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ-22

OPERATING INCOME ADJUSTMENT NO. 7 - DEPRECIATION EXPENSE

| LINE NO. | DESCRIPTION          | [A]              | [B]              | [C]               |
|----------|----------------------|------------------|------------------|-------------------|
|          |                      | COMPANY AS FILED | STAFF ADJUSTMENT | STAFF AS ADJUSTED |
| 1        | Depreciation Expense | \$ 44,684        | \$ 38,984        | \$ 83,668         |
| 2        | CIAC Amortization    | -                | (622)            | (622)             |
|          |                      | <u>\$ 44,684</u> | <u>\$ 38,362</u> | <u>\$ 83,046</u>  |

References:

- Column [A]: Company Schedule C-1
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 23

OPERATING INCOME ADJUSTMENT NO. 8 - PROPERTY TAX EXPENSE

| LINE NO. | DESCRIPTION  | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTMENT |
|----------|--|----------------------------|----------------------------|-------------------------------|
| 1        | 2001 Annual Gross Revenues                                     |                            |                            | \$ 245,292                    |
| 2        | 2002 Annual Gross Revenues                                     |                            |                            | \$ 289,174                    |
| 3        | 2003 Annual Gross Revenues                                     |                            |                            | \$ 287,332                    |
| 4        | Plus Staff's Recommended Increase                              |                            |                            | \$ 15,495                     |
| 5        | Subtotal (Lines 1 + 2 + 3 + 4)                                 |                            |                            | \$ 837,293                    |
| 6        | Three Year Average Calculation                                 |                            |                            | 3                             |
| 7        | Three Year Average (Line 5 / Line 6)                           |                            |                            | \$ 279,098                    |
| 8        | Department of Revenue Multiplier                               |                            |                            | 2                             |
| 9        | Revenue Base Value (Line 7 x Line 8)                           |                            |                            | \$ 558,195                    |
| 10       | Plus: 10% of 2001 CWIP   |                            |                            |                               |
| 11       | Less: Net Book Value of Leased Vehicles                        |                            |                            | \$                            |
| 12       | Full Cash Value (Line 9 + Line 10 - Line 11)                   |                            |                            | \$ 558,195                    |
| 13       | Assessment Ratio   |                            |                            | 0.25                          |
| 14       | Assessed Value (Line 12 x Line 13)                             |                            |                            | \$ 139,549                    |
| 15       | Composite Property Tax Rate                                    |                            |                            | 0.142877                      |
| 16       | <b>Staff Proposed Property Tax Expense (Line 14 x Line 15)</b> | <b>\$ 19,568</b>           | <b>\$ 370</b>              | <b>\$ 19,938</b>              |

References:

- Column [A]: Company Schedule C-1
- Column [B]: Testimony ENZ
- Column [C]: Column [A] plus column [B]

Pineview Water Company, Inc.  
Docket No. W-01676A-04-0463 and 0500  
Test Year Ended December 31, 2003

Schedule ENZ- 24

OPERATING INCOME ADJUSTMENT NO. 9 - INCOME TAX EXPENSE

| LINE NO. | DESCRIPTION          | [A]<br>COMPANY<br>AS FILED | [B]<br>STAFF<br>ADJUSTMENT | [C]<br>STAFF AS<br>ADJUSTED |
|----------|----------------------|----------------------------|----------------------------|-----------------------------|
| 1        | Federal Income Taxes |                            |                            | \$ 3,095                    |
| 2        | State Income Taxes   |                            |                            | 1,546                       |
| 3        | Total Income Taxes   | \$ (12,550)                | \$ 17,191                  | \$ 4,641                    |

References:

Column [A]: Company Schedule C-1  
Column [B]: Testimony ENZ  
Column [C]: Column [A] plus column [B]

**RATE DESIGN**

| Minimum Monthly Usage Charge |                      |       |
|------------------------------|----------------------|-------|
| Present Rates                | ---Proposed Rates--- |       |
|                              | Company              | Staff |

**Monthly Usage Charge:**

|                   |             |             |             |
|-------------------|-------------|-------------|-------------|
| 5/8" x 3/4" Meter | \$ 17.00    | \$ 21.25    | \$ 16.75    |
| 3/4" Meter        | \$ 24.14    | \$ 30.25    | \$ 26.00    |
| 1" Meter          | \$ 42.27    | \$ 53.00    | \$ 45.00    |
| 1 1/2" Meter      | \$ 82.49    | \$ 103.00   | \$ 86.00    |
| 2" Meter          | \$ 130.76   | \$ 163.00   | \$ 132.00   |
| 3" Meter          | \$ 241.35   | \$ 300.00   | \$ 255.00   |
| 4" Meter          | \$ 402.25   | \$ 500.00   | \$ 418.75   |
| 6" Meter          | \$ 804.50   | \$ 1,000.00 | \$ 837.50   |
| 8" Meter          | \$ 1,206.75 | \$ 1,500.00 | \$ 1,675.00 |
| 10" Meter         | \$ 1,609.00 | \$ 2,000.00 | \$ 2,512.50 |

**Gallons Included In Minimum Charge:**

|                   |   |   |   |
|-------------------|---|---|---|
| 5/8" x 3/4" Meter | 0 | 0 | 0 |
| 3/4" Meter        | 0 | 0 | 0 |
| 1" Meter          | 0 | 0 | 0 |
| 1 1/2" Meter      | 0 | 0 | 0 |
| 2" Meter          | 0 | 0 | 0 |
| 3" Meter          | 0 | 0 | 0 |
| 4" Meter          | 0 | 0 | 0 |
| 6" Meter          | 0 | 0 | 0 |
| 8" Meter          | 0 | 0 | 0 |
| 10" Meter         | 0 | 0 | 0 |

**RATE DESIGN**

**Commodity Rates :**

**5/8" x 3/4" Meter**

|   | Present Rates | ---Proposed Rates--- |         |
|---|---------------|----------------------|---------|
|   |               | Company              | Staff   |
| Per 1,000 Gallons 0 to 5,000 Gallons      | \$ 3.26       | \$ 3.78              | N/A     |
| Per 1,000 Gallons 0 to 3,000 Gallons      | \$ 3.26       | N/A                  | \$ 3.10 |
| Per 1,000 Gallons 5,001 to 20,000 Gallons | \$ 3.26       | \$ 4.10              | N/A     |
| Per 1,000 Gallons 3,001 to 20,000 Gallons | \$ 3.26       | N/A                  | \$ 3.66 |
| Per 1,000 Gallons Over 20,000 Gallons     | \$ 3.26       | \$ 4.50              | N/A     |
| Per 1,000 Gallons Over 20,000 Gallons     | \$ 3.26       | N/A                  | \$ 4.20 |

**Commodity Rates :**

**3/4" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 10,000 Gallons      | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 3,000 Gallons       | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 10,001 to 40,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 3,001 to 20,000 Gallons  | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 40,000 Gallons      | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 20,000 Gallons      | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**1" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 20,000 Gallons      | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 30,000 Gallons      | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 20,001 to 80,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 30,001 to 75,000 Gallons | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 80,000 Gallons      | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 75,000 Gallons      | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**1 1/2" Meter**

|   |         |         |         |
|---|---------|---------|---------|
| Per 1,000 Gallons 0 to 20,000 Gallons       | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 50,000 Gallons       | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 20,001 to 80,000 Gallons  | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 50,001 to 100,000 Gallons | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 80,000 Gallons       | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 100,000 Gallons      | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**2" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 60,000 Gallons        | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 120,000 Gallons       | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 60,001 to 200,000 Gallons  | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 120,001 to 200,000 Gallons | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 200,000 Gallons       | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 200,000 Gallons       | \$ 3.26 | N/A     | \$ 4.20 |

**RATE DESIGN**

**Commodity Rates :**

**3" Meter**

|  | Present Rates | ---Proposed Rates--- |         |
|--|---------------|----------------------|---------|
|  |               | Company              | Staff   |
| Per 1,000 Gallons 0 to 100,000 Gallons       | \$ 3.26       | \$ 3.78              | N/A     |
| Per 1,000 Gallons 0 to 150,000 Gallons       | \$ 3.26       | N/A                  | \$ 3.10 |
| Per 1,000 Gallons 100,001 to 400,000 Gallons | \$ 3.26       | \$ 4.10              | N/A     |
| Per 1,000 Gallons 150,001 to 250,000 Gallons | \$ 3.26       | N/A                  | \$ 3.66 |
| Per 1,000 Gallons Over 400,000 Gallons       | \$ 3.26       | \$ 4.50              | N/A     |
| Per 1,000 Gallons Over 250,000 Gallons       | \$ 3.26       | N/A                  | \$ 4.20 |

**Commodity Rates :**

**4" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 200,000 Gallons       | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 150,000 Gallons       | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 200,001 to 600,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 150,001 to 250,000 Gallons | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 600,000 Gallons       | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 250,000 Gallons       | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**6" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 700,000 Gallons         | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 150,000 Gallons         | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 700,001 to 2,000,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 150,001 to 250,000 Gallons   | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 2,000,000 Gallons       | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 250,000 Gallons         | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**8" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 1,000,000 Gallons         | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 150,000 Gallons           | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 1,000,001 to 3,000,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 150,001 to 250,000 Gallons     | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 3,000,000 Gallons         | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 250,000 Gallons           | \$ 3.26 | N/A     | \$ 4.20 |

**Commodity Rates :**

**10" Meter**

|  |         |         |         |
|--|---------|---------|---------|
| Per 1,000 Gallons 0 to 2,000,000 Gallons         | \$ 3.26 | \$ 3.78 | N/A     |
| Per 1,000 Gallons 0 to 150,000 Gallons           | \$ 3.26 | N/A     | \$ 3.10 |
| Per 1,000 Gallons 2,000,001 to 5,000,000 Gallons | \$ 3.26 | \$ 4.10 | N/A     |
| Per 1,000 Gallons 150,001 to 250,000 Gallons     | \$ 3.26 | N/A     | \$ 3.66 |
| Per 1,000 Gallons Over 5,000,000 Gallons         | \$ 3.26 | \$ 4.50 | N/A     |
| Per 1,000 Gallons Over 250,000 Gallons           | \$ 3.26 | N/A     | \$ 4.20 |

|                               |         |         |         |
|-------------------------------|---------|---------|---------|
| Contruccion Water - All Usage | \$ 3.26 | \$ 4.75 | \$ 4.75 |
|-------------------------------|---------|---------|---------|

**RATE DESIGN**

| Present Rates | ---Proposed Rates--- |       |
|---------------|----------------------|-------|
|               | Company              | Staff |

**Service Line and Meter Installation Charge:**

|                      |             |              |             |
|----------------------|-------------|--------------|-------------|
| 5/8" x 3/4" Meter    | \$ 400.00   | \$ 475.00    | \$ 475.00   |
| 3/4" Meter           | \$ 440.00   | \$ 550.00    | \$ 550.00   |
| 1" Meter             | \$ 500.00   | \$ 650.00    | \$ 650.00   |
| 1 1/2" Meter         | \$ 715.00   | \$ 900.00    | \$ 900.00   |
| 2" Meter (Turbine)   | \$ 1,170.00 | \$ 1,550.00  | \$ 1,550.00 |
| 2" Meter (Compound)  | \$ 1,700.00 | \$ 2,300.00  | \$ 2,300.00 |
| 3" Meter (Turbine)   | \$ 1,585.00 | \$ 2,200.00  | \$ 2,200.00 |
| 3" Meter (Compound)  | \$ 2,190.00 | \$ 3,100.00  | \$ 3,100.00 |
| 4" Meter (Turbine)   | \$ 2,540.00 | \$ 3,400.00  | \$ 3,600.00 |
| 4" Meter (Compound)  | \$ 3,215.00 | \$ 4,400.00  | \$ 4,400.00 |
| 6" Meter (Turbine)   | \$ 4,615.00 | \$ 6,200.00  | \$ 6,200.00 |
| 6" Meter (Compound)  | \$ 6,270.00 | \$ 7,900.00  | \$ 7,900.00 |
| 8" Meter (Turbine)   | \$ 6,655.00 | \$ 8,850.00  | \$ 7,543.00 |
| 8" Meter (Compound)  | \$ 7,040.00 | \$ 9,350.00  | \$ 7,980.00 |
| 10" Meter (Turbine)  | \$ 8,495.00 | \$ 11,300.00 | \$ 9,629.00 |
| 10" Meter (Compound) | \$ 9,950.00 | \$ 13,200.00 | 11,278.00   |

**Service Charges:**

|  |           |           |           |
|--|-----------|-----------|-----------|
| Establishment - Regular Hours              | \$ 20.00  | \$ 25.00  | \$ 20.00  |
| Establishment Fee (After hours)            | \$ 35.00  | \$ 50.00  | \$ 35.00  |
| Re-Establishment Fee (Within 12 Months)    | (b)       | (b)       | (b)       |
| Re-Connection of Service - Regular Hours   | \$ 15.00  | \$ 50.00  | \$ 15.00  |
| Re-Connection of Service - After Hours     | NR (1)    | \$ 75.00  | \$ 30.00  |
| Water Meter Test - if Correct              | \$ 20.00  | Cost (2)  | \$ 20.00  |
| Water Meter Relocation At Customer Request | NR (1)    | Cost (2)  | Cost (2)  |
| Meter Re-read - if Correct                 | \$ 15.00  | No Charge | No Charge |
| NSF Check Charge                           | \$ 15.00  | \$ 25.00  | \$ 15.00  |
| Late Charge                                | 1.5%      | 1.5%      | 1.5%      |
| Deferred Payment Finance Charge            | 1.5%      | 1.5%      | 1.5%      |
| Service Calls - Regular Hours              | No Charge | No Charge | No Charge |
| Service Calls - After Hours                | NR (1)    | \$ 50.00  | \$ 25.00  |
| Deposits Requirements                      | (a)       | (a)       | (a)       |
| Deposit Interest                           | (a)       | (a)       | (a)       |

(a) Number of months off system X minimum monthly charge

(b) Per Commission Rule A.C.C. R14-2-403D

(c) 1.5 percent per Commission Rule.R14--2-403B

**NOTES:**

(1) No Currently Approved Rate

(2) Cost Includes Materials, Labor and Overheads

**TYPICAL BILL ANALYSIS**

General Service 5/8 x 3/4 - Inch Meter

Average Number of Customers: 813

| <u>Company Proposed</u> | <u>Gallons</u> | <u>Present Rates</u> | <u>Proposed Rates</u> | <u>Dollar Increase</u> | <u>Percent Increase</u> |
|-------------------------|----------------|----------------------|-----------------------|------------------------|-------------------------|
| Average Usage           | 5,277          | \$34.20              | \$41.29               | \$7.09                 | 20.7%                   |
| Median Usage            | 3,250          | \$27.60              | \$33.54               | \$5.94                 | 21.5%                   |
| <u>Staff Proposed</u>   |                |                      |                       |                        |                         |
| Average Usage           | 5,277          | \$34.20              | \$34.38               | \$0.18                 | 0.5%                    |
| Median Usage            | 3,250          | \$27.60              | \$26.97               | (\$0.63)               | -2.3%                   |

Present & Proposed Rates (Without Taxes)  
General Service 5/8 x 3/4 - Inch Meter

| <u>Gallons Consumption</u> | <u>Present Rates</u> | <u>Company Proposed Rates</u> | <u>% Increase</u> | <u>Staff Proposed Rates</u> | <u>% Increase</u> |
|----------------------------|----------------------|-------------------------------|-------------------|-----------------------------|-------------------|
| 0                          | \$17.00              | \$21.25                       | 25.0%             | \$16.75                     | -1.5%             |
| 1,000                      | 20.26                | 25.03                         | 23.5%             | 19.85                       | -2.0%             |
| 2,000                      | 23.52                | 28.81                         | 22.5%             | 22.95                       | -2.4%             |
| 3,000                      | 26.78                | 32.59                         | 21.7%             | 26.05                       | -2.7%             |
| 4,000                      | 30.04                | 36.37                         | 21.1%             | 29.71                       | -1.1%             |
| 5,000                      | 33.30                | 40.15                         | 20.6%             | 33.37                       | 0.2%              |
| 6,000                      | 36.56                | 44.25                         | 21.0%             | 37.03                       | 1.3%              |
| 7,000                      | 39.82                | 48.35                         | 21.4%             | 40.69                       | 2.2%              |
| 8,000                      | 43.08                | 52.45                         | 21.8%             | 44.35                       | 2.9%              |
| 9,000                      | 46.34                | 56.55                         | 22.0%             | 48.01                       | 3.6%              |
| 10,000                     | 49.60                | 60.65                         | 22.3%             | 51.67                       | 4.2%              |
| 15,000                     | 65.90                | 81.15                         | 23.1%             | 69.97                       | 6.2%              |
| 20,000                     | 82.20                | 101.65                        | 23.7%             | 88.27                       | 7.4%              |
| 25,000                     | 98.50                | 124.15                        | 26.0%             | 109.27                      | 10.9%             |
| 50,000                     | 180.00               | 236.65                        | 31.5%             | 214.27                      | 19.0%             |
| 75,000                     | 261.50               | 349.15                        | 33.5%             | 319.27                      | 22.1%             |
| 100,000                    | 343.00               | 461.65                        | 34.6%             | 424.27                      | 23.7%             |
| 125,000                    | 424.50               | 574.15                        | 35.3%             | 529.27                      | 24.7%             |
| 150,000                    | 506.00               | 686.65                        | 35.7%             | 634.27                      | 25.3%             |
| 175,000                    | 587.50               | 799.15                        | 36.0%             | 739.27                      | 25.8%             |
| 200,000                    | 669.00               | 911.65                        | 36.3%             | 844.27                      | 26.2%             |

**RAMIREZ**

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATION OF )  
PINEVIEW WATER COMPANY, INC. FOR )  
AN INCREASE IN ITS WATER RATES FOR )  
CUSTOMERS WITHIN NAVAJO COUNTY, )  
ARIZONA )  
\_\_\_\_\_ )

DOCKET NO. W-01676A-04-0500

DIRECT  
TESTIMONY  
OF  
ALEJANDRO RAMIREZ  
PUBLIC UTILITIES ANALYST III  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

JANUARY 20, 2005

## TABLE OF CONTENTS

|  | <u>Page</u> |
|--|-------------|
| INTRODUCTION .....                                     | 1           |
| SUMMARY OF TESTIMONY AND RECOMMENDATIONS .....         | 2           |
| PINEVIEW'S PROPOSED OVERALL RATE OF RETURN .....       | 3           |
| I. The Weighted Average Cost of Capital.....           | 3           |
| II. Capital Structure.....                             | 5           |
| Background .....                                       | 5           |
| Pineview Capital Structure .....                       | 6           |
| III. Cost of debt .....                                | 6           |
| IV. Return on Equity.....                              | 7           |
| Background .....                                       | 7           |
| Risk.....  | 10          |
| V. Estimating the Cost of Equity .....                 | 12          |
| Introduction .....                                     | 12          |
| Discounted Cash Flow Model Analysis .....              | 13          |
| <i>The Constant-Growth DCF</i> .....                   | 14          |
| <i>The Multi-Stage DCF</i> .....                       | 23          |
| Q. What is Staff's multi-stage DCF estimate? .....     | 24          |
| Capital Asset Pricing Model.....                       | 25          |
| VI. Findings of Staff's Cost of Equity Analysis .....  | 29          |
| VII. Final Cost of Equity Estimates for Pineview ..... | 32          |
| VIII. Rate of Return Recommendation .....              | 33          |
| CONCLUSION.....  | 33          |

## SCHEDULES

|   |       |
|---|-------|
| Capital Structure and Weighted Cost of Capital.....             | AXR-1 |
| Capital Structures of Sample Water Utilities.....               | AXR-2 |
| Growth in Earnings & Dividends of Sample Water Utilities .....  | AXR-3 |
| Intrinsic Growth for Sample Water Utilities.....                | AXR-4 |
| Selected Financial Data of Sample Water Utilities.....          | AXR-5 |
| Expected Infinite Annual Growth.....                            | AXR-6 |
| Multi-Stage DCF Estimates .....                                 | AXR-7 |
| Final Cost of Equity Estimates for Sample Water Utilities ..... | AXR-8 |

## EXECUTIVE SUMMARY

The direct testimony of Staff witness Alejandro Ramirez addresses the following issues:

Capital Structure – Staff recommends that the Commission adopt a capital structure for Pineview for this proceeding consisting of 49.0 percent debt and 51.0 percent equity.

Cost of Debt – Staff recommends that the Commission adopt the Applicant's actual cost of debt of 5.43 percent.

Cost of Equity – Staff recommends that the Commission adopt an 8.9 percent return on equity ("ROE"). Staff's estimated ROE for the Applicant is based on cost of equity estimates ranging from 8.5 percent capital asset pricing model ("CAPM") to 9.3 percent discounted cash flow ("DCF").

Overall Rate of Return – Staff recommends the Commission adopt an overall rate of return ("ROR") of 7.2 percent.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Alejandro Ramirez. I am a Public Utilities Analyst employed by the Arizona  
4 Corporation Commission (“ACC” or “Commission”) in the Utilities Division (“Staff”).  
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6  
7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst.**

8 A. In my position as a Public Utilities Analyst, I perform studies to estimate the cost of  
9 capital component of revenue requirement in rate proceedings. I also perform other  
10 financial analyses.

11  
12 **Q. Please describe your educational background and professional experience.**

13 A. In 2002, I graduated summa cum laude from Arizona State University, receiving a  
14 Bachelor of Science degree in Global Business with a specialization in finance. While  
15 attending Arizona State University, I successfully completed the Barrett Honors College  
16 curriculum. My course of studies included classes in corporate and international finance,  
17 investments, accounting, statistics, and economics. I began employment as a Staff Public  
18 Utilities Analyst in 2003. Since that time, I have provided Staff’s recommendations to the  
19 Commission on financings and prepared various studies in the field of cost of capital and  
20 econometrics. I have also attended seminars related to general regulatory and business  
21 issues.

1 **Q. What is the scope of your testimony in this case?**

2 A. I provide Staff's recommended rate of return in this case. I discuss the appropriate rate of  
3 return ("ROR") for establishing the revenue requirement for Pineview Water Company,  
4 Inc. ("Pineview" or "Applicant").

5

6 **SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

7 **Q. Briefly summarize how Staff's cost of capital testimony is organized.**

8 A. Staff's cost of capital testimony is organized in eight sections. Section I discusses the  
9 concept of weighted average cost of capital ("WACC"). Section II presents the concept of  
10 capital structure and presents Staff's recommended capital structure for Pineview in this  
11 proceeding. Section III presents Staff's recommended cost of debt for the Applicant.  
12 Section IV discusses the concepts of return on equity ("ROE") and risk. Section V  
13 presents the methods employed to estimate Pineview's ROE. Section VI presents the  
14 findings of Staff's ROE analysis. Section VII presents the final cost of equity estimates  
15 for Pineview. Finally, section VIII presents Staff's ROR recommendation.

16

17 **Q. Have you prepared any exhibits to your testimony?**

18 A. Yes. I prepared eight schedules (AXR-1 to AXR-8) that support Staff's cost of capital  
19 analysis.

20

21 **Q. What is Staff's recommended rate of return for Pineview?**

22 A. Staff recommends a 7.2 percent ROR, which is based on Pineview's cost of debt of 5.43  
23 percent and the cost of equity estimates that range from 8.5 percent to 9.3 percent. This  
24 rate is calculated on Schedule AXR-1.

25

1 **PINEVIEW'S PROPOSED OVERALL RATE OF RETURN**

2 **Q. Briefly summarize the Applicant's proposed capital structure, cost of debt, return on**  
3 **equity and overall rate of return for this proceeding.**

4 **A.** Table 1 summarizes the Applicant's proposed capital structure, cost of debt, return on  
5 equity and overall rate of return in this proceeding:

6  
7 **Table 1**

|                            | <b>Weight</b> | <b>Cost</b> | <b>Weighted<br/>Cost</b> |
|----------------------------|---------------|-------------|--------------------------|
| Long-term Debt             | 49.03%        | 5.43%       | 2.662%                   |
| Common Equity              | 50.97%        | 15.39%      | 7.843%                   |
| <b>Cost of Capital/ROR</b> |               |             | <b>10.505%</b>           |

8

9 Pineview is proposing an overall rate of return of 10.505 percent.

10

11 **I. THE WEIGHTED AVERAGE COST OF CAPITAL**

12 **Q. Please define the cost of capital concept.**

13 **A.** The cost of capital is the opportunity cost of the funds employed as the result of an  
14 investment decision. The cost of capital represents the returns that could be expected to  
15 be earned in other investments with equivalent risk. In other words, the cost of capital is  
16 the return that stakeholders expect for committing their resources in a determined business  
17 enterprise. The cost of capital is calculated by using the weighted average cost of capital  
18 ("WACC").

1 **Q. How is the WACC calculated?**

2 **A.** The WACC is calculated by adding the weighted expected returns of the firm's securities.  
3 The following equation shows how the WACC is calculated:

4 Equation 1.

5  
6 
$$\text{WACC} = \sum_{i=1}^n W_i * r_i$$
  
7

8 Where  $W_i$  is the weight given to the  $i^{\text{th}}$  security (the proportion of the  $i^{\text{th}}$  security relative  
9 to the portfolio) and  $r_i$  is the expected return on the  $i^{\text{th}}$  security.

10

11 **Q. Can you provide an example applying Equation 1?**

12 **A.** Yes. Assume that a firm has a capital structure composed of 75 percent debt and 25  
13 percent equity. Also assume that the embedded cost of debt is 7.8 percent and the  
14 expected return on equity (cost of equity) is 10.5 percent. The WACC calculation is as  
15 follows:

16

17 
$$\text{WACC} = 75\% * 7.8\% + 25\% * 10.5\%$$

18

19 
$$\text{WACC} = 5.85\% + 2.63\%$$

20

21 
$$\text{WACC} = 8.48\%$$

22

23 The weighted average cost of capital in this case is 8.48 percent. Given the firm's capital  
structure, the company would have to earn an overall rate of return of 8.48 percent to  
cover its cost of capital.

1 **II. CAPITAL STRUCTURE**

2 **Background**

3 **Q. Please explain the capital structure concept.**

4 **A.** The capital structure of a firm shows how its assets are financed over the long-run. The  
5 capital structure of a firm is the mix of capital leases, long-term debt, preferred stock and  
6 common stock that are used to finance the firm's assets.

7  
8 **Q. How is the capital structure calculated?**

9 **A.** The capital structure of a company is calculated by finding the percentage of each  
10 component of the capital structure (capital leases, long-term debt, preferred stock and  
11 common stock) relative to the total capital (the total sum of all the components of the  
12 capital structure).

13  
14 For illustrative purposes, suppose that company A is financed by \$15,000 of capital leases,  
15 \$80,000 of long-term debt, \$5,000 of preferred stock and \$35,000 of common stock.  
16 Company A's capital structure would be calculated as follows:

17  
18

| Component       |           |                        | %     |
|-----------------|-----------|------------------------|-------|
| Capital Leases  | \$15,000  | $(\$15,000/\$135,000)$ | 11.1% |
| Long-Term Debt  | \$80,000  | $(\$80,000/\$135,000)$ | 59.3% |
| Preferred Stock | \$5,000   | $(\$5,000/135,000)$    | 3.7%  |
| Common Stock    | \$35,000  | $(\$35,000/135,000)$   | 25.9% |
| Total           | \$135,000 |                        | 100%  |

1 Company A's capital structure is composed of 11.1 percent capital leases, 59.3 percent  
2 long-term debt, 3.7 percent preferred stock and 25.9 percent common stock.

3  
4 **Q. Is there a relationship between capital structure and cost of equity capital?**

5 **A.** Yes. As a firm's leverage increases, so does its cost of equity capital. I will explain this  
6 relationship in more depth further in my testimony (Page 11).

7  
8 **Pineview Capital Structure**

9 **Q. What capital structure does Staff recommend for Pineview?**

10 **A.** Staff recommends Pineview's actual capital structure at the end of the test year (December  
11 31, 2003) which consists of 49.0 percent long-term debt and 51.0 percent common equity.  
12 This is the same capital structure proposed by the Applicant.

13  
14 **Q. How does Pineview's capital structure compare to capital structures of publicly  
15 traded water utilities?**

16 **A.** The Applicant's capital structure is composed of 49.0 percent long-term debt and 51.0  
17 percent equity. Schedule AXR-2 shows the capital structures of six publicly traded water  
18 companies ("sample water companies") as of June 2004. The sample water utilities were  
19 capitalized with approximately 49.9 percent debt and 50.1 percent equity, on average.

20  
21 **III. COST OF DEBT**

22 **Q. What cost of debt does the Applicant propose?**

23 **A.** Pineview proposes a 5.43 percent cost of debt. This cost of debt is based on the annual  
24 interest rate of the Applicant's existing Water Infrastructure Finance Authority ("WIFA")  
25 loan.

1 **Q. Does Staff agree with the cost of debt that Pineview is proposing?**

2 **A.** Yes, it does.  
3

4 **IV. RETURN ON EQUITY**

5 **Background**

6 **Q. Please define the term cost of equity capital.**

7 **A.** The cost of equity to a firm is the rate of return that investors expect to earn on their equity  
8 investment in that firm given its risk. In other words, the cost of equity to a firm is the  
9 investors' expected rate of return on other investments of similar risk. The cost of equity  
10 capital is determined by the market.  
11

12 **Q. Is there any relationship between interest rates and the cost of equity?**

13 **A.** Yes. According to the capital asset pricing model ("CAPM")<sup>1</sup>, the cost of equity moves in  
14 the same direction as interest rates. It is helpful to take into account how current interest  
15 rates compare to historical interest rates to have an idea of how the current cost of equity  
16 capital might be compared to the cost of equity capital historically.  
17

18 **Q. What has been the general trend of interest rates in recent years?**

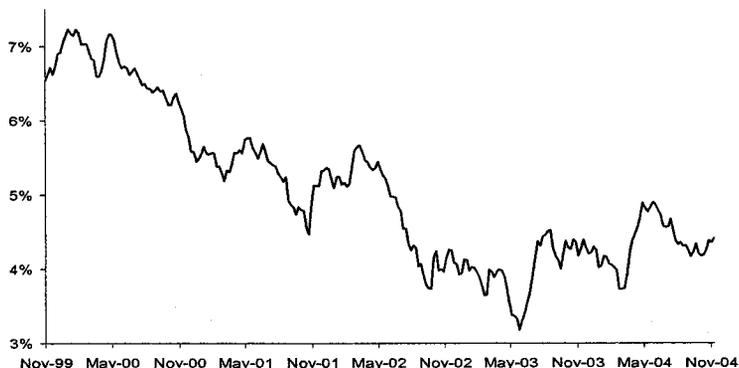
19 **A.** Interest rates have decreased in recent years. Current interest rates are lower than what  
20 they were at the end of 1999. Chart 1 graphs intermediate U.S. treasury rates from  
21 November 1999 to November 2004:  
22

---

<sup>1</sup> The CAPM is a market-based model used for estimating the cost of equity discussed further later in this testimony.

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Chart 1: Average Yield on 5-, 7-, & 10-Year Treasuries

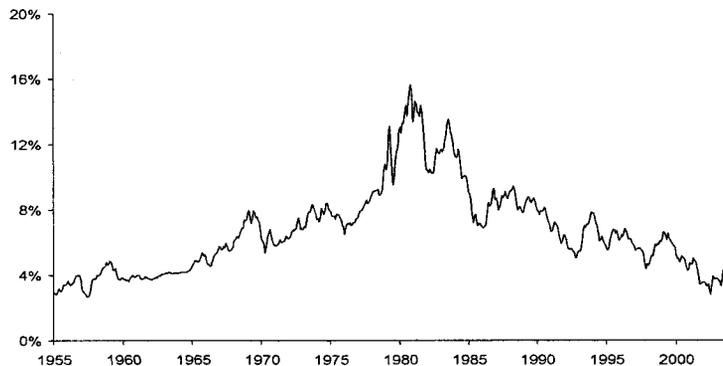


Source: Federal Reserve

**Q. What has been the long-term trend in interest rates and what does it suggest for capital costs?**

Chart 2 shows that interest rates have declined in the past twenty years and are currently at levels comparable to the 1960's. In retrospective, Chart 2 suggests that capital costs in general have declined significantly in the last 20 years.

Chart 2: History of 5- and 10-Year Treasury Yields



Source: Federal Reserve

- 1 **Q. Does the cost of equity represent actual returns?**
- 2 **A.** No. As mentioned earlier, the cost of equity represents the investors' *expected* returns as  
3 opposed to actual returns.  
4
- 5 **Q. What have historical returns been for average risk securities?**
- 6 **A.** Jeremy Siegel, a Wharton School finance professor, found that the average arithmetic and  
7 compound annual returns on U.S. equities have been 9.7 percent and 8.3 percent,  
8 respectively, using 199 years of data through 2001.<sup>2</sup>  
9
- 10 **Q. What do these historical returns suggest about the cost of equity capital?**
- 11 **A.** These historical returns suggest that an allowed ROE at or above 15.4 percent as proposed  
12 by the Applicant exceeds the arithmetic and compound average historical return on U.S.  
13 equities for the period studied by Professor Siegel.  
14
- 15 **Q. What information is available to provide insight into the relationship between the  
16 required return on equity for a regulated water utility and the average return on the  
17 market?**
- 18 **A.** The average beta (0.66)<sup>3</sup> for a water utility is lower than the theoretical average beta for all  
19 stocks (1.0). This implies that the required return on equity for a regulated water utility is  
20 below the average required return on the market.

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<sup>2</sup> Siegel, Jeremy J. *Stocks for the Long Run*, third edition. McGraw-Hill, New York. 2002. p.13.

<sup>3</sup> See Schedule AXR-5

1 **Risk**

2 **Q. Please define risk.**

3 A. Risk can be defined as the level of uncertainty which is inherent in a financial  
4 opportunity<sup>4</sup>. Risk is usually separated into two categories: market risk (also known as  
5 systematic risk) and non-market risk (also known as unique risk).

6  
7 **Q. What is market risk?**

8 A. Market risk (systematic risk) is defined as the sensitivity of an investment's return to  
9 market returns. Market risk is related to the economy-wide perils that affect all business  
10 such as inflation, interest rates, and general business cycles. Market risk affects all stocks.  
11 But the impact on each company is not necessarily the same. Given that market risk  
12 affects all the stocks, this risk is non-diversifiable (it cannot be eliminated). Accordingly,  
13 market risk is the only risk that affects the cost of equity, and it is measured by beta. Beta  
14 reflects both the business risk and financial risk of a firm.

15  
16 **Q. What is non-market risk?**

17 A. Non-market risk (unique risk) is the one which is uncorrelated across firms in the  
18 economy. Unique risk is related to the risk of an individual project or firm; therefore, it  
19 can be eliminated through diversification. Investors can eliminate unique risk by holding  
20 a diversified portfolio. Unique risk is not measured by beta, nor does it affect the cost of  
21 equity because these firm-specific risks can be eliminated through shareholder  
22 diversification.

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<sup>4</sup> Jacob, Nancy, Pettit, Richardson R. *Investments*, second edition. Irwin, Homewood. 1988. p.34.

1 **Q. Do Investors require additional return to account for unique risk?**

2 **A.** No. Investors who hold diversified portfolios do not require additional return for unique  
3 risk because as mentioned earlier, non-market risk is eliminated through diversification.  
4 Because investors who choose to be less than fully diversified must compete in the market  
5 with fully diversified investors, the former cannot expect to be compensated for unique  
6 risk.

7

8 **Q. It was mentioned that beta includes both the business and the financial risk of a firm.  
9 How are business risk and financial risk defined?**

10 **A.** Business risk is that risk which is associated with the fluctuation in earnings due to the  
11 basic nature of a firm's business. Financial risk is that risk which affects shareholders due  
12 to a firm's reliance on debt financing.

13

14 **Q. Do both business and financial risk affect the cost of equity?**

15 **A.** Yes, they do.

16

17 **Q. What is the relationship between the capital structure of a firm and its financial  
18 risk?**

19 **A.** Financial risk is closely related to how a firm finances its assets (capital structure of the  
20 firm). A greater percentage of debt in a capital structure results in a higher level of  
21 financial risk, which in turns affects the cost of equity. As a firm increases its reliance on  
22 debt, it becomes more leveraged, increasing the firm's financial risk. Financial risk  
23 affects the cost of equity: as a firm becomes more leveraged, it becomes more risky. As  
24 the firm's risk increases, the firm's cost of equity also increases.

25

1 **Q. How does Pineview's financial risk compare to the sample water companies'**  
2 **financial risk?**

3 **A.** As discussed earlier, the Applicant's capital structure is very similar to the average capital  
4 structure of the sample water companies (Refer to schedule AXR-2). Therefore,  
5 Pineview's financial risk is about the same as that of the sample water companies'  
6 financial risk.

7  
8 **V. ESTIMATING THE COST OF EQUITY**

9 **Introduction**

10 **Q. Did Staff directly estimate the cost of equity for the Applicant?**

11 **A.** No. Staff did not directly estimate Pineview's cost of equity for two reasons. First, the  
12 Applicant does not have publicly traded stock; therefore, the required information to  
13 estimate Pineview's cost of equity is not available. Second, any estimate of the cost of  
14 equity for a single company stock would likely contain a high degree of random  
15 fluctuations and thus be subject to considerable error. Using the average of a sample  
16 group gives a more reliable estimate. Accordingly, Staff used a sample of water utilities  
17 to estimate Pineview's cost of equity.

18  
19 **Q. What companies did Staff select as proxies or comparables for Pineview?**

20 **A.** Staff selected six publicly traded water utilities shown on Schedule AXR-2. These  
21 companies represent the water utilities that are currently analyzed by *The Value Line*  
22 *Investment Survey Small and Mid Cap Edition* ("*Value Line Small Cap*") and *The Value*  
23 *Line Investment Survey* ("*Value Line*") that have a significant amount of revenues derived  
24 from regulated operations.

1 **Q. What models did Staff implement to estimate Pineview's cost of equity?**

2 **A.** As mentioned earlier, the cost of equity is determined by the market; therefore, Staff used  
3 two widely accepted and known market-based models to estimate the Applicant's cost of  
4 equity: the discounted cash flow ("DCF") model and the CAPM.

5  
6 **Q. Explain why Staff chose the DCF and CAPM market-based models?**

7 **A.** Staff chose to use the DCF and CAPM models because they are widely recognized and  
8 used. Further explanation of these models is provided later in the following section of this  
9 testimony.

10  
11 **Discounted Cash Flow Model Analysis**

12 **Q. Please provide a brief summary of the theory upon which the DCF method of**  
13 **estimating the cost of equity is based.**

14 **A.** The DCF method of estimating the cost of capital is based on the theory that the present  
15 value of a stock (current market price) is calculated the same way as it is for the present  
16 value of any other asset. In other words, the current market price of a stock (asset) is  
17 equal to the present value of all expected future dividends (cash flows).

18  
19 In the 1960s, Professor Myron Gordon pioneered the use of the DCF method to estimate  
20 the cost of capital for a public utility. This model has become widely used due to its  
21 theoretical merit and its simplicity.

22  
23 Through a mathematical formula, the discount rate, or cost of capital, can be estimated  
24 from the expected dividend, the market price, and a dividend growth rate. The formula is  
25 then applied to each company included in a sample that exhibits similar risk to the

1 company whose cost of equity is being estimated. The results are averaged to arrive at the  
2 estimate of the cost of equity.

3  
4 **Q. How did Staff apply the DCF Model?**

5 **A.** Staff applied two different versions of the DCF model. The first version of the DCF used  
6 by Staff is the constant-growth DCF Model. The second version is a multi-stage or non-  
7 constant growth DCF. The constant-growth DCF Model assumes that a company will  
8 grow at the same rate indefinitely. The main assumption and advantage in the non-  
9 constant growth DCF model is that it does not assume that dividends grow at a constant  
10 rate over time.

11 *The Constant-Growth DCF*

12 **Q. What is the constant-growth DCF formula used in Staff's analysis?**

13 **A.** The constant-growth DCF formula used in Staff's analysis is:

Equation 2:

$$K = \frac{D_1}{P_0} + g$$

where :     $K$     = the cost of equity  
               $D_1$     = the expected annual dividend  
               $P_0$     = the current stock price  
               $g$      = the expected infinite annual growth rate of dividends

14 Equation 2 assumes that the company has a constant retention rate and that its earnings are  
15 expected to grow at a constant rate. Therefore, if a stock has a current market price of \$10  
16 per share, an expected annual dividend of \$0.25 per share, and if its dividends were  
17 expected to grow 5 percent per year, then the cost of equity to the company would be 7.5  
18 percent (the 2.5 percent dividend yield plus the growth rate of 5.0 percent per year).

1 **Q. How did Staff calculate the dividend yield component ( $D_1/P_0$ ) of the constant-growth**  
2 **DCF formula?**

3 **A.** Staff calculated the yield component of the DCF formula by dividing the expected annual  
4 dividend ( $D_1$ ) by the spot stock price ( $P_0$ ) after the close of the market on November 16,  
5 2004, as reported by *Yahoo Finance*.

6  
7 **Q. Why did Staff use the spot stock price rather than a historical average stock price to**  
8 **calculate the dividend yield component of the DCF formula?**

9 **A.** Staff used the current market stock price (spot stock price) rather than a historical average  
10 to be consistent with finance theory. According to the efficient market hypothesis, the  
11 current stock price includes investors' expectations of future returns and it is the best  
12 indicator of those expectations.

13  
14 **Q. How did Staff estimate the dividend growth (g) component of the DCF model?**

15 **A.** Equation 2 shows that the DCF model depends on dividend growth (g). Staff used a  
16 combination of historical and projected dividend-per-share ("DPS") growth provided by  
17 *Value Line*. In addition, Staff also examined historical and projected growth in earnings-  
18 per-share ("EPS") and intrinsic growth when estimating the dividend growth rate.

19  
20 **Q. Why did Staff examine EPS growth to estimate the dividend growth component of**  
21 **the constant-growth DCF model?**

22 **A.** Staff took into account EPS growth (both historical and projected) when estimating the  
23 dividend growth component of the constant-growth DCF model because dividends are not  
24 independent of earnings. It would be unreasonable to assume that investors expect long-  
25 term dividend growth to exceed long-term earnings growth because it would lead to

1 payout ratios in excess of 100 percent. Therefore, Staff considered historical and  
2 projected EPS growth when estimating expected dividend growth.

3  
4 **Q. How did Staff estimate historical DPS growth?**

5 A. Staff estimated historical DPS growth by calculating the average rate of growth in DPS of  
6 the sample water companies from 1993 to 2003. The results of the analysis are shown on  
7 Schedule AXR-3. Staff's analysis indicates an average historical DPS growth rate of 2.6  
8 percent for the sample water utilities.

9  
10 **Q. What DPS growth rate does *Value Line* project for the sample water utilities?**

11 A. *Value Line* projects a 3.2 percent DPS growth rate for the sample water utilities, also  
12 shown in Schedule AXR-3.

13  
14 **Q. What is Staff's historical EPS growth rate?**

15 A. Schedule AXR-3 shows Staff's historical average rate of growth in EPS for the sample  
16 water utilities. Staff's average historical EPS growth rate is 1.5 percent for the period  
17 1993 to 2003.

18  
19 **Q. What EPS growth rate does *Value Line* project?**

20 A. *Value Line's* projected EPS growth rate is 14.3 percent for the sample water utilities, as  
21 shown in Schedule AXR-3. It is important to take into account that Analysts' projections  
22 of the future earnings are usually high<sup>5</sup> and vary widely.

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<sup>5</sup> See Seigel, Jeremy J. Stocks for the Long Run. 2002. McGraw-Hill. New York. p. 100. Malkiel, Burton G. A Random Walk Down Wall Street. 1999. W.W. Norton & Co. New York. p. 169. Dreman, David. Contrarian Investment Strategies: The Next Generation. 1998. Simon & Schuster. New York. pp. 97-98. Testimony of Professors Myron J. Gordon and Lawrence I. Gould, consultant to the Trial Staff (Common Carrier Bureau), FCC Docket 79-63, p. 95.

1 **Q. How was Staff's intrinsic growth rate calculated?**

2 **A.** Staff's intrinsic growth rate was calculated by adding the retention growth rate term (br) to  
3 the stock financing growth rate term (vs).

4  
5 **Q. What is retention growth?**

6 **A.** Retention growth is the growth in dividends due to the retention of earnings. This concept  
7 is based on the theory that dividend growth will not be achieved unless the company  
8 retains and reinvests some of its earnings. In other words, retention growth rate is the  
9 product of the retention ratio and the book/accounting return on equity. Retention growth  
10 is a component of Staff's intrinsic growth calculation.

11  
12 **Q. What is the formula for the retention growth rate?**

13 **A.** The retention growth rate formula is:

14  
Equation 3 :

$$\text{Retention Growth Rate} = br$$

where :  $b$  = the retention ratio (1 – dividend payout ratio)  
 $r$  = the accounting/book return on common equity

15  
16 **Q. What historical retention (br) growth rate did Staff calculate for the sample water  
17 utilities?**

18 **A.** Staff calculated a historical average retention (br) growth of 3.1 percent for the sample  
19 water utilities, shown on Schedule AXR-4. This rate was calculated by averaging the  
20 retention growth rate for the years 1994 through 2003.

21

- 1    **Q.    Does *Value Line* project retention growth?**
- 2    A.    Yes, it does. *Value Line* projects an average retention growth rate of 5.3 percent for the  
3        period 2007-2009 for the sample water utilities, as shown on Schedule AXR-4.  
4
- 5    **Q.    When is the br growth a reasonable estimate of future dividend growth?**
- 6    A.    The br growth rate is a reasonable estimate of future dividend growth when the retention  
7        ratio is fairly constant and the company's market price to book value ("market-to-book  
8        ratio") is expected to be 1.0. The average retention ratio has been fairly constant over the  
9        past several years. However, the market to book ratio for the sample water utilities is  
10       higher than 1.0 (As shown is Schedule AXR-5, it is 2.3). Staff assumes that investors  
11       expect the market-to-book ratio to remain above 1.0.  
12
- 13   **Q.    Is there any financial implication of a market-to-book ratio greater than 1.0?**
- 14   A.    Yes. A market-to-book ratio greater than 1.0 implies that investors expect the company to  
15        earn an accounting/book return on its equity higher than its cost of equity.  
16
- 17   **Q.    How has Staff accounted for the assumption that investors expect the average  
18        market-to-book ratio of the sample water utilities to remain above 1.0?**
- 19   A.    Staff added a second growth term (stock financing growth rate or vs) to the br growth rate  
20        to account for the assumption that investors expect the average market-to-book ratio of the  
21        sample water utilities to remain above 1.0.

1 **Q. What is stock financing growth?**

2 **A.** Stock financing growth is the growth in a company's dividends due to the sale of stock.  
3 This term, derived by Myron Gordon in his book, *The Cost of Capital to a Public Utility*<sup>6</sup>,  
4 is the product of the fraction of the funds raised from the sale of stock that accrues to  
5 existing shareholders (v) and the funds raised from the sale of stock as a fraction of the  
6 existing common equity (s).

7

8 **Q. What is the formula for the stock financing growth rate?**

9 **A.** The stock financing growth formula is:

10

Equation 4 :

$$\text{Stock Financing Growth} = vs$$

where :  $v$  = Fraction of the funds raised from the sale of stock that accrues  
to existing shareholders

$s$  = Funds raised from the sale of stock as a fraction of the existing  
common equity

11

12 **Q. How is the variable v presented above calculated?**

13 **A.** Variable v is calculated as follows:

---

<sup>6</sup> Gordon, Myron J. *The Cost of Capital to a Public Utility*. MSU Public Utilities Studies, Michigan, 1974. pp 31-35.

Equation 5 :

$$v = 1 - \left( \frac{\text{book value}}{\text{market value}} \right)$$

1

2

For example, let's assume that a share of stock has a \$20 book value and is selling for \$25.

3

Then, to find the value of v, the formula is applied:

$$v = 1 - \left( \frac{20}{25} \right)$$

4

In this example, v would be equal to 0.20. Staff found that the average v for the sample water utilities is 0.50.

5

6

7

**Q. How is the variable s presented above calculated?**

8

**A.** Variable s is calculated as follows:

9

Equation 6:

10

$$s = \frac{\text{Funds raised from the issuance of stock}}{\text{Total existing common equity before the issuance}}$$

11

12

13

For example, assume that a company has \$100 in existing equity, and it sells \$10 of stock.

14

Then, to find the value of s, the formula is applied:

$$s = \left( \frac{10}{100} \right)$$

15

In this example, s would be equal to 10.0 percent. Staff found the average s for the sample water utilities to be 3.7 percent.

16

1 **Q. What would happen to the vs term if the market-to-book ratio is equal to 1.0?**

2 **A.** As mentioned earlier, when investors expect to earn a book/accounting return on their  
3 equity investment equal to the cost of equity, the market-to-book ratio will be equal to 1.0.  
4 If the market-to-book ratio is equal to 1.0, then the term v will equal zero (0.0), and  
5 consequently, the stock financing growth term will equal zero (0.0). In summary, when the  
6 market-to-book ratio is equal to 1.0, no funds raised from sale of stock will accrue to  
7 existing stock holders, and dividend growth will depend on the br term.

8  
9 **Q. How does the vs term work when the market-to-book ratio is higher than 1.0?**

10 **A.** When investors expect a company to earn a book/accounting return on equity higher than  
11 its cost of equity, the market-to-book ratio will be higher than 1.0. In this case, the v term  
12 will be different from zero (0.0).

13  
14 When new shares are issued and sold, the book value per share of outstanding stock is less  
15 than the contribution per share of the new stockholders. This excess per share  
16 contribution over the book value per share will accrue to existing stockholders in the form  
17 of a higher book value. The resulting higher book value leads to higher expected earnings  
18 and dividends.

19  
20 **Q. What is the vs estimate for the sample water utilities?**

21 **A.** Staff estimated an average stock financing growth (vs) of 2.2 percent for the sample water  
22 utilities, as it is shown on Schedule AXR-4.

1 **Q. When investors expect the company to earn a book/accounting return on equity**  
2 **higher than its cost of equity, the market-to-book ratio is higher than 1.0. What**  
3 **would happen to a utility's market-to-book ratio if its authorized (book/accounting)**  
4 **ROE is set equal to its cost of equity?**

5 **A.** In theory, if a utility's authorized ROE is set equal to its cost of equity, the utility's  
6 market-to-book ratio should decline to 1.0. This implies that in the long-run, the vs term  
7 is unnecessary. However, in reality, rate orders might not force the market-to-book ratios  
8 to 1.0 for a variety of reasons. For example, the company might have sources of income  
9 that are not regulated, and regulatory commissions do not issue orders simultaneously for  
10 utilities that operate in different jurisdictions. Staff's inclusion of the vs term in its  
11 constant-growth DCF analysis might result in an over estimate of its intrinsic dividend  
12 growth rate and the resulting DCF estimate. Staff's DCF estimates are too high if  
13 investors expect the average market-to-book ratio of the sample water utilities' to fall to  
14 1.0 due to falling authorized ROEs.

15  
16 **Q. What is Staff's intrinsic growth rate?**

17 **A.** Staff estimated an intrinsic growth rate of 5.3 percent when using historical retention  
18 growth and an intrinsic growth rate of 8.4 percent when using retention growth projected  
19 by *Value Line*. Schedule AXR-4 presents Staff's estimates of the intrinsic growth rate.

20  
21 **Q. What is Staff's expected infinite annual growth rate in dividends?**

22 **A.** Staff averaged historical and projected growth in dividends per share ("DPS"), earnings  
23 per share ("EPS"), and intrinsic growth to calculate the expected infinite annual growth  
24 rate in dividends. Schedule AXR-6 presents the calculation of the expected infinite annual  
25 growth rate in dividends. Staff's estimate is 5.9 percent.

1 Q. What is Staff's constant-growth DCF estimate?

2 A. Staff's constant-growth DCF estimate is 9.1 percent, which is shown on Schedule AXR-8.

3 *The Multi-Stage DCF*

4 Q. Why did Staff implement the multi-stage DCF model to estimate Pineview's cost of  
5 equity?

6 A. As previously stated, Staff implemented the multi-stage DCF model to account for the  
7 assumption that dividends may not grow at a constant rate. Staff's multi-stage DCF model  
8 incorporates two growth rates: a near term growth rate and a long-term growth rate.

9  
10 Q. What is the multi-stage DCF formula?

11 A. The multi-stage DCF formula is shown in the following equation:  
12

Equation 7 :

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n} \left[ \frac{1}{(1+K)} \right]^n$$

Where :  $P_0$  = current stock price  
 $D_t$  = dividends expected during stage 1  
 $K$  = cost of equity  
 $n$  = years of non - constant growth  
 $D_n$  = dividend expected in year n  
 $g_n$  = constant rate of growth expected after year n

13

14

15

16

As mentioned above, Staff incorporated two growth rates. This assumes that investors expect dividends to grow at a non-constant rate in the near-term ("Stage -1 growth"), and then to grow at constant rate in the long-term ("Stage-2 growth").

1 **Q. How did Staff implement the multi-stage DCF model to find the cost of equity?**

2 A. First, Staff forecasted a stream of dividends for each of the sample water utilities. The  
3 forecasted stream of dividends was calculated based on two different growth rates (near-  
4 term growth and long-term growth). Second, given the current stock price for each of the  
5 sample water utilities, Staff found the rate (cost of equity) which equates the present value  
6 of the stream of dividends to the current stock price.

7

8 **Q. How did Staff calculate stage-1 growth (near-term growth)?**

9 A. Staff forecasted four years of dividends for each of the sample water utilities using  
10 expected dividends over the next twelve months for the first year and *Value Line's*  
11 projected DPS growth rate for the subsequent years (Refer to Schedule AXR-7).

12

13 **Q. How did Staff estimate stage-2 growth (long-term growth)?**

14 A. Staff used the rate of growth in gross domestic product ("GDP") from 1929 to 2003. This  
15 historical growth is appropriate because it assumes that the water utility industry is  
16 expected to grow neither faster, nor slower, than the overall economy.

17

18 **Q. What is the historical growth in GDP that Staff used to estimate stage-2 growth?**

19 A. The historical growth in GDP that Staff used to estimate stage-2 growth is 6.5 percent  
20 (1929-2003).

21

22 **Q. What is Staff's multi-stage DCF estimate?**

23 A. Staff's multi-stage DCF estimate is 9.5 percent, as shown on Schedule AXR-7.

1 **Q. What is Staff's overall DCF estimate?**

2 **A.** Staff's overall DCF estimate is 9.3 percent, as shown in Schedule AXR-8. Staff's overall  
3 DCF estimate was calculated by averaging Staff's constant growth DCF and Staff's multi-  
4 stage DCF estimates.

5

6 **Capital Asset Pricing Model**

7 **Q. Please describe the capital asset pricing model.**

8 **A.** The CAPM is the best known model of risk and return. This model is concerned with the  
9 determination of prices of capital assets in a competitive market. An important  
10 assumption of the CAPM is that investors are risk adverse—they require a greater return  
11 for bearing greater risk. This model also assumes that investors diversify because it  
12 allows them to reduce the level of risk exposure for a given level of expected return.<sup>7</sup> In  
13 1990, Professors Harry Markowitz, William Sharpe, and Merton Miller earned the Nobel  
14 Prize in Economic Sciences for their contribution to the development of the CAPM.

---

<sup>7</sup> The CAPM also assumes the following: 1. Single holding period 2. Perfect and competitive securities market 3. No transaction costs 4. No restrictions on short selling or borrowing 5. The existence of a risk-free rate 6. Homogeneous expectations.

1 **Q. What is the CAPM formula?**

2 **A.** The CAPM formula is shown in the following equation:

Equation 8 :

$$K = R_f + \beta (R_m - R_f)$$

where :  $R_f$  = risk free rate  
 $R_m$  = return on market  
 $\beta$  = beta  
 $R_m - R_f$  = market risk premium  
 $K$  = expected return

3 Mathematically represented, the expected return on a risky asset is equal to the prevailing  
4 risk-free interest rate plus the market risk premium which is adjusted for the riskiness  
5 (beta) of the investment relative to the market.

6  
7 **Q. What does beta measure?**

8 **A.** Beta measures the systematic risk of a company. As stated previously, systematic risk is  
9 the only form of risk that is relevant when estimating a company's required return because  
10 it is the only risk that cannot be eliminated through diversification. The market's beta is  
11 1.0; therefore, a security with a beta higher than 1.0 is riskier than the market, and a  
12 security with a beta lower than 1.0 is less risky than the market.

13  
14 **Q. How was the CAPM implemented to estimate Pineview's cost of equity?**

15 **A.** Staff implemented the CAPM on the same sample water utilities used in Staff's DCF  
16 analysis.

17

1 Q. What risk-free rate of interest did Staff estimate?

2 A. Staff calculated an estimate of the risk-free rate of interest by averaging intermediate-term  
3 U.S. Treasury securities' spot rates published in *The Wall Street Journal*. Staff averaged  
4 the yields-to-maturity of three intermediate-term<sup>8</sup> (five-, seven, and ten-year) U.S.  
5 Treasury securities published in the November 17<sup>th</sup>, 2004, edition of *The Wall Street*  
6 *Journal*. Staff estimated the risk-free rate to be 3.9 percent.<sup>9</sup>

7  
8 Q. Why did Staff use U.S Treasury security spot rates to calculate an estimate of the  
9 risk-free rate?

10 A. Staff used U.S. Treasury securities' spot rates published in *The Wall Street Journal*  
11 because they are verifiable, objective and readily available.

12  
13 Q. What beta ( $\beta$ ) did Staff use?

14 A. Staff estimated Pineview's beta ( $\beta$ ) to be 0.66. Staff averaged the *Value Line* betas of the  
15 sample water utilities and used this average as a proxy for Pineview's beta. Schedule  
16 AXR-5 shows the *Value Line* betas for each of the sample water utilities.

17  
18 Q. What is the expected market risk premium ( $R_m - R_f$ )?

19 A. The expected market risk premium is the additional amount of return over the risk-free  
20 rate that investors expect to receive from investing in the market (or an average-risk

---

<sup>8</sup> The use of intermediate-term securities is based on the theoretical specification that the time to maturity approximates the investor's holding period, and assumes that most investors consider the intermediate time frame (5-10 years) a more appropriate investment horizon. See Reilly, Frank K., and Keith C. Brown. Investment Analysis and Portfolio Management. 2003. South-Western. Mason, OH. p. 439.

<sup>9</sup> Average yield on 5-, 7-, and 10-year Treasury notes according to the November 17<sup>th</sup>, 2004, edition of *The Wall Street Journal*: 3.56%, 3.86%, and 4.21%, respectively.

1 security). Staff used two approaches to calculate the market risk premium: the historical  
2 market risk premium approach and the current market risk premium approach.

3  
4 **Q. Could you describe the historical market risk premium estimate approach?**

5 **A.** In this approach, Staff assumed that if one consistently uses the long-run average market  
6 risk premium to estimate the expected market risk premium, one should, on average, be  
7 correct. In this approach Staff assumed that the average historical market risk premium  
8 estimate is a reasonable estimate of the expected market risk premium.

9  
10 **Q. How did Staff calculate the historical market risk premium?**

11 **A.** For the market risk premium estimate, Staff used the intermediate-horizon equity risk  
12 premium published in the Ibbotson Associates' *Stocks, Bonds, Bills, and Inflation 2003*  
13 *Yearbook* for the period 1926-2002. Ibbotson Associates calculated the historical risk  
14 premium by averaging the historical arithmetic differences between the S&P 500 and the  
15 intermediate-term government bond income returns. Staff's historical market risk  
16 premium estimate is 7.6 percent.

17  
18 **Q. How did Staff calculate the current market risk premium estimate?**

19 **A.** In this approach, Staff found a DCF-derived ROE using the expected dividend yield (over  
20 the next twelve months) and growth that *Value Line* projects for all dividend-paying  
21 stocks under its review (November 12, 2004). Given the DCF-derived ROE, the market's  
22 average beta of 1.0 and the current long-term risk-free rate, Staff used the CAPM formula  
23 to solve for the implied current market risk premium.

24

1 According to the November 12, 2004, edition of *Value Line*, the expected dividend yield is  
2 1.6 percent and the expected annual growth in share price is 9.73 percent.<sup>10</sup> Therefore, the  
3 constant-growth DCF estimate of the cost of equity to all dividend-paying stocks followed  
4 by *Value Line* is 11.33 percent (9.73 percent + 1.6 percent). The current market risk  
5 premium implied by the CAPM equation using the yield on the 30-year Treasury note  
6 (4.90 percent) is 6.43 percent.<sup>11</sup>

7  
8 **Q. What is Staff's expected market risk premium estimate?**

9 **A.** Staff's market risk premium estimate is 6.4 percent to 7.6 percent.

10  
11 **Q. What is the result of Staff's CAPM analysis?**

12 **A.** Staff's overall CAPM estimate is 8.5 percent, as shown in Schedule AXR-8. Staff's  
13 overall CAPM estimate was calculated by averaging Staff's historical market risk  
14 premium CAPM (8.9 percent) and the current market risk premium CAPM (8.1 percent)  
15 estimates.

16  
17 **VI. FINDINGS OF STAFF'S COST OF EQUITY ANALYSIS**

18 **Q. What is the result of Staff's constant-growth DCF analysis?**

19 **A.** Schedule AXR-8 shows the result of Staff's constant-growth DCF Analysis. The result of  
20 Staff's constant-growth DCF analysis is as follows:

21 
$$k = 3.2\% + 5.9\%$$

22  
23 
$$k = 9.1\%$$

<sup>10</sup> 3 to 5 year price appreciation potential is 45%.  $1.45^{1/4} - 1 = 9.73\%$

<sup>11</sup>  $11.33\% = 5.22\% + (1) (6.11\%)$

1 Staff's constant-growth DCF estimate of the cost of equity to the sample water utilities is  
2 9.1 percent.

3  
4 **Q. What is the result of Staff's multi-stage DCF analysis?**

5 **A.** Schedule AXR-7 shows the result of Staff's multi-stage DCF Analysis. The result of  
6 Staff's multi-stage DCF analysis is:

7

| 8 <b>Company</b>         | 9 <b>Equity Cost<br/>Estimate (k)</b> |
|--------------------------|---------------------------------------|
| 10 American States Water | 9.8%                                  |
| 11 California Water      | 9.7%                                  |
| 12 Aqua America          | 8.7%                                  |
| 13 Connecticut Water     | 9.6%                                  |
| 14 Middlesex Water       | 9.9%                                  |
| 15 SJW Corp              | 9.2%                                  |
| 16 <b>Average</b>        | <b>9.5%</b>                           |

17 Staff's multi-stage DCF estimate of the cost of equity to the sample water utilities is 9.5  
18 percent.

19  
20 **Q. What is Staff's overall DCF estimate?**

21 **A.** Staff's overall DCF estimate is 9.3 percent, as shown in Schedule AXR-8. Staff's overall  
22 DCF estimate was calculated by averaging Staff's constant growth DCF and Staff's multi-  
23 stage DCF estimates.

24

1 **Q. What is the result of Staff's CAPM analysis using the historical market risk**  
2 **premium estimate?**

3 **A.** Schedule AXR-8 shows the result of Staff's CAPM analysis using the historical risk  
4 premium estimate. The result is as follows:

5  $k = 3.9\% + 0.66*(7.6\%)$

6  $k = 8.9\%$

7 Staff's CAPM estimate (using the historical market risk premium) of the cost of equity to  
8 the sample water utilities is 8.9 percent.

9  
10 **Q. What is the result of Staff's CAPM analysis using the current market risk premium**  
11 **estimate?**

12 **A.** Schedule AXR-8 shows the result of Staff's CAPM Analysis using the current market risk  
13 premium estimate. The result is:

14  $k = 3.9\% + 0.66*(6.4\%)$

15  $k = 8.1\%$

16  
17 Staff's CAPM estimate (using the current market risk premium) of the cost of equity to the  
18 sample water utilities is 8.1 percent.

19  
20 **Q. What is Staff's overall CAPM estimate?**

21 **A.** Staff's overall CAPM estimate is 8.5 percent, as shown in Schedule AXR-8. Staff's  
22 overall CAPM estimate was calculated by averaging Staff's historical market risk  
23 premium CAPM (8.9 percent) and the current market risk premium CAPM (8.1 percent)  
24 estimates.

1 **Q. Please summarize the results of Staff's cost of equity analysis.**

2 **A.** The following table shows the results of Staff's cost of equity analysis:  
3

4 **Table 2**

| <b>Method</b>          | <b>Estimate</b> |
|------------------------|-----------------|
| Average DCF Estimate   | 9.3%            |
| Average CAPM Estimate  | 8.5%            |
| <b>Overall Average</b> | <b>8.9%</b>     |

5

6 Staff's average estimate of the cost of equity to the sample water utilities is 8.9 percent.  
7

8 **VII. FINAL COST OF EQUITY ESTIMATES FOR PINEVIEW**

9 **Q. Does Pineview's cost of equity depend on its capital structure?**

10 **A.** Yes, it does. It was mentioned previously in this testimony that as a company increases its  
11 leverage (debt), its cost of equity increases. The average capital structure for the sample  
12 water utilities is composed of 49.9 percent equity and 50.1 percent debt, as shown on  
13 Schedule AXR-2. As mentioned previously, Staff's recommended capital structure for the  
14 Applicant in this proceeding consists of 49.0 percent debt and 51.0 percent equity.  
15 Therefore, Pineview's stockholders bear similar financial risk to that of the water sample  
16 utilities.  
17

18 **Q. What is Staff's ROE recommendation for Pineview?**

19 **A.** Staff estimated an 8.9 percent ROE for the Applicant based on cost of equity estimates  
20 ranging from 8.5 percent (CAPM) to 9.3 percent (DCF).

1 **VIII. RATE OF RETURN RECOMMENDATION**

2 **Q. What is Staff's overall rate of return recommendation for Pineview?**

3 **A.** Staff recommends a ROR of 7.2 percent for the Applicant, as shown in Schedule AXR-1  
4 and the following table:

6 **Table 3**

|                            | <b>Weight</b> | <b>Cost</b> | <b>Weighted<br/>Cost</b> |
|----------------------------|---------------|-------------|--------------------------|
| Long-term Debt             | 49.0%         | 5.43%       | 2.7%                     |
| Common Equity              | 51.0%         | 8.9%        | 4.5%                     |
| <b>Cost of Capital/ROR</b> |               |             | <b>7.2%</b>              |

7  
8 **CONCLUSION**

9 **Q. Please summarize Staff's recommendations.**

10 **A.** Staff recommends that the Commission adopt a capital structure for Pineview in this  
11 proceeding composed of 49.0 percent long-term debt and 51.0 percent equity.

12 Staff also recommends that the Commission to adopt a 7.2 percent ROR for the Applicant,  
13 which is based on Pineview's cost of debt of 5.43 percent and Staff's cost of equity  
14 estimates that range from 8.5 percent to 9.3 percent.

15  
16 **Q. Does this conclude your direct testimony?**

17 **A.** Yes, it does.

Pineview Water Company, Inc.  
Staff's Recommended  
Capital Structure  
And Weighted Cost of Capital

| [A]                                  | [B]               | [C]         | [D]                  |
|--------------------------------------|-------------------|-------------|----------------------|
| <u>Description</u>                   | <u>Weight (%)</u> | <u>Cost</u> | <u>Weighted Cost</u> |
| Long-term Debt                       | 49.0%             | 5.43%       | 2.7%                 |
| Common Equity                        | 51.0%             | 8.9%        | 4.5%                 |
| Weighted Average Cost of Capital/ROR |                   |             | 7.2%                 |

Pineview Water Company, Inc.  
Average Capital Structure of Sample Water Utilities

| [A]                            | [B]                      | [C]                     | [D]           |
|--------------------------------|--------------------------|-------------------------|---------------|
| Company                        | Long-Term<br><u>Debt</u> | Common<br><u>Equity</u> | <u>Total</u>  |
| American States Water          | 50.1%                    | 49.9%                   | 100.0%        |
| California Water               | 50.5%                    | 49.5%                   | 100.0%        |
| Aqua America                   | 52.8%                    | 47.2%                   | 100.0%        |
| Connecticut Water              | 43.5%                    | 56.5%                   | 100.0%        |
| Middlesex Water                | 55.7%                    | 44.3%                   | 100.0%        |
| SJW Corp                       | <u>46.9%</u>             | <u>53.1%</u>            | <u>100.0%</u> |
| Average Sample Water Utilities | <b>49.9%</b>             | <b>50.1%</b>            | <b>100.0%</b> |
| Pineview Water Company, Inc.   | <b>49.0%</b>             | <b>51.0%</b>            | <b>100.0%</b> |

Source: Value Line, Pineview's application

Pineview Water Company, Inc.  
 Growth in Earnings and Dividends  
 Sample Water Utilities

| [A]<br>Company                 | [B]<br>Dividends<br>Per Share<br>1993 to 2003<br><u>DPS</u> | [C]<br>Dividends<br>Per Share<br>Projected<br><u>DPS</u> | [D]<br>Earnings<br>Per Share<br>1993 to 2003<br><u>EPS</u> | [E]<br>Earnings<br>Per Share<br>Projected<br><u>EPS</u> |
|--------------------------------|---|--|--|---|
| American States Water          | 1.1%  | 1.8%   | -4.2%  | 22.7%   |
| California Water               | 1.6%  | 1.0%   | -1.1%  | 10.6%   |
| Aqua America                   | 5.5%  | 6.8%   | 8.7%   | 9.6%  |
| Connecticut Water              | 1.3%  | No Projection  | 2.6%   | No Projection   |
| Middlesex Water                | 2.5%  | No Projection  | -0.9%  | No Projection   |
| SJW Corp                       | <u>3.6%</u>   | <u>No Projection</u>                                     | <u>4.2%</u>  | <u>No Projection</u>                                    |
| Average Sample Water Utilities | <b>2.6%</b>   | <b>3.2%</b>  | <b>1.5%</b>  | <b>14.3%</b>  |

Source: Value Line

Pineview Water Company, Inc.  
 Intrinsic Growth  
 Sample Water Utilities

| [A]                            | [B]  | [C]   | [D]                                       | [E]   | [F]  |
|--------------------------------|--|---|---|---|--|
| Company                        | Retention<br>Growth<br>1994 to 2003<br><u>br</u> | Retention<br>Growth<br>Projected<br><u>br</u> | Stock<br>Financing<br>Growth<br><u>vs</u> | Intrinsic<br>Growth<br>1994 to 2003<br><u>br + vs</u> | Intrinsic<br>Growth<br>Projected<br><u>br + vs</u> |
| American States Water          | 2.5%   | 5.5%  | 1.1%                                      | 3.6%  | 6.6%   |
| California Water               | 2.5%   | 4.5%  | 1.4%                                      | 4.0%  | 5.9%   |
| Aqua America                   | 4.0%   | 6.0%  | 6.8%                                      | 10.8%   | 12.8%  |
| Connecticut Water              | 3.0%   | No Projection                                 | 0.6%                                      | 3.5%  | No Projection                                      |
| Middlesex Water                | 1.7%   | No Projection                                 | 3.6%                                      | 5.3%  | No Projection                                      |
| SJW Corp                       | 4.8%   | No Projection                                 | 0.0%                                      | 4.8%  | No Projection                                      |
| Average Sample Water Utilities | 3.1%   | 5.3%  | 2.2%                                      | 5.3%  | 8.4%   |

Source: Value Line, MSN Money

Pineview Water Company, Inc.  
Selected Financial Data of Sample Water Utilities

| [A]                   | [B]    | [C]                    | [D]                    | [E]            | [F]                        | [G]                          |
|-----------------------|--------|------------------------|------------------------|----------------|----------------------------|------------------------------|
| Company               | Symbol | Spot Price<br>11/16/04 | Book Value<br>11/16/04 | Mkt To<br>Book | Value Line<br>Beta $\beta$ | Raw<br>Beta<br>$\beta_{raw}$ |
| American States Water | AWR    | 24.66                  | 14.57                  | 1.7            | 0.70                       | 0.52                         |
| California Water      | CWT    | 30.96                  | 15.63                  | 2.0            | 0.70                       | 0.52                         |
| Aqua America          | WTR    | 23.55                  | 7.50                   | 3.1            | 0.75                       | 0.60                         |
| Connecticut Water     | CTWS   | 25.58                  | 10.69                  | 2.4            | 0.65                       | 0.45                         |
| Middlesex Water       | MSEX   | 18.97                  | 7.42                   | 2.6            | 0.60                       | 0.37                         |
| SJW Corp              | SJW    | 36.33                  | 18.21                  | 2.0            | 0.55                       | 0.30                         |
| Average               |        |                        |                        | 2.3            | 0.66                       | 0.46                         |

Source: Msn Money, Value Line

Pineview Water Company, Inc.  
Calculation of Expected Infinite Annual Growth in Dividends  
Sample Water Utilities

| [A]                                 | [B]         |
|-------------------------------------|-------------|
| <u>Description</u>                  | g           |
| DPS Growth - Historical             | 2.6%        |
| DPS Growth - Projected              | 3.2%        |
| EPS Growth - Historical             | 1.5%        |
| EPS Growth - Projected              | 14.3%       |
| Intrinsic Growth - Historical       | 5.3%        |
| <u>Intrinsic Growth - Projected</u> | <u>8.4%</u> |
| Average                             | <b>5.9%</b> |

Supporting Schedules: Schedule AXR-3 and Schedule AXR-4

Pineview Water Company, Inc.  
 Multi-Stage DCF Estimates  
 Sample Water Utilities

| [A]                   | [B]                          | [C]   | [D]   | [E]   | [F]   | [H]                                   | [I]                          |
|-----------------------|------------------------------|---|-------|-------|-------|---------------------------------------|------------------------------|
| Company               | Current Mkt. Price ( $P_0$ ) | Projected Dividends <sup>1</sup> (stage 1 growth) ( $D_t$ ) |       |       |       | Stage 2 growth <sup>2</sup> ( $g_n$ ) | Equity Cost Estimate ( $K$ ) |
|                       |                              | $d_1$   | $d_2$ | $d_3$ | $d_4$ |                                       |                              |
| American States Water | 24.7                         | 0.90  | 0.92  | 0.94  | 0.96  | 6.5%                                  | 9.8%                         |
| California Water      | 31.0                         | 1.13  | 1.15  | 1.16  | 1.18  | 6.5%                                  | 9.7%                         |
| Aqua America          | 23.6                         | 0.52  | 0.56  | 0.60  | 0.64  | 6.5%                                  | 8.7%                         |
| Connecticut Water     | 25.6                         | 0.85  | 0.88  | 0.91  | 0.95  | 6.5%                                  | 9.6%                         |
| Middlesex Water       | 19.0                         | 0.70  | 0.72  | 0.75  | 0.78  | 6.5%                                  | 9.9%                         |
| SJW Corp              | 36.3                         | 1.07  | 1.10  | 1.14  | 1.18  | 6.5%                                  | 9.2%                         |

Average **9.5%**

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n} \left[ \frac{1}{(1+K)} \right]^n$$

Where:  $P_0$  = current stock price

$D_t$  = dividends expected during stage 1

$K$  = cost of equity

$n$  = years of non - constant growth

$D_n$  = dividend expected in year  $n$

$g_n$  = constant rate of growth expected after year  $n$

<sup>1</sup>  $d_1$  = "Est'd Div'd next 12 mos." 11/12/2004, Value Line Summary & Index.

<sup>2</sup> Average annual growth in GDP 1929 - 2003 in current dollars. <http://www.bea.doc.gov/>

Pineview Water Company, Inc.  
 Final Cost of Equity Estimates  
 Sample Water Utilities

| [A]                               | [B]   | [C]                     | [D]            | [E]                   |
|-----------------------------------|-------|-------------------------|----------------|-----------------------|
| <b><u>Constant Growth DCF</u></b> |       |                         |                |                       |
| Constant Growth DCF Estimate      |       | $\frac{D_1/P_0}{3.2\%}$ | +              | $\frac{k}{9.1\%}$     |
| Multi-Stage DCF Estimate          |       |                         | +              | $\frac{9.5\%}{9.3\%}$ |
| <b>Average of DCF Estimates</b>   |       |                         |                | <b>9.3%</b>           |
| <b><u>CAPM Method</u></b>         |       |                         |                |                       |
| Historical Market Risk Premium    | $R_f$ | $\beta$                 | x              | $\frac{k}{8.9\%}$     |
| Current Market Risk Premium       | 3.9%  | 0.66                    | x              | $\frac{8.1\%}{8.5\%}$ |
| <b>Average of CAPM Estimates</b>  |       |                         | x              | <b>8.5%</b>           |
|                                   |       |                         | <b>Average</b> | <b>8.9%</b>           |

Source: The Wall Street Journal, Value Line, Ibbotson Associates SBBI 2004 Yearbook  
 Supporting Schedules: Schedule AXR-7

JOHNSON

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATION OF )  
PINEVIEW WATER COMPANY, INC. FOR )  
AUTHORIZATION OF LONG-TERM )  
FINANCING )

DOCKET NO. W-01676A-04-0463

DIRECT

TESTIMONY

OF

J. H. JOHNSON

PUBLIC UTILITIES ANALYST III

UTILITIES DIVISION

JANUARY 20, 2005

**TABLE OF CONTENTS**

|                    | <u>Page</u> |
|--------------------|-------------|
| INTRODUCTION ..... | 1           |

**SCHEDULES**

|                              |       |
|------------------------------|-------|
| SELECTED FINANCIAL DATA..... | JHJ-1 |
|------------------------------|-------|

**EXHIBIT**

EXHIBIT A MEMORANDUM

NOTICE

**EXECUTIVE SUMMARY**  
**PINEVIEW WATER COMPANY, INC.**  
**DOCKET NO. W-01676A-04-0463**

The direct testimony of Staff witness J. H. Johnson addresses the following issues:

**Request for Debt Financing Authorization** - Staff recommends granting authorization to incur \$577,578 of the requested \$730,978 in new long-term debt financing subject to implementation of Staff's recommended rates.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is James H. Johnson. I am a Public Utilities Analyst III employed by the  
4 Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division  
5 ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.  
6

7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst III.**

8 A. In my capacity as a Public Utilities Analyst III, I provide recommendations to the  
9 Commission on mergers, acquisitions, financings and asset sales and other ratemaking  
10 issues.  
11

12 **Q. Please describe your educational background and professional experience.**

13 A. I am a graduate of Utah State University with a Bachelor of Science degree in Economics  
14 and a minor in Business Administration. My courses of study included accounting,  
15 statistics, money and banking, business management, and economics. I have also  
16 completed training offered by Robert Morris Associates (the national association of  
17 commercial loan officers), the American Institute of Banking (Advanced Certificate), the  
18 Conference of State Bank Supervisors, and the Office of Thrift Supervision. I have been  
19 employed by banks, financial institutions, the Arizona State Banking Department, and the  
20 Commission for a total of over 38 years. Principal responsibilities have included branch  
21 management, commercial lending, loan officer supervision, consumer lending, bank and  
22 franchise financial analysis, bank examination, loan workouts, and customer portfolio  
23 management. I have been an adjunct instructor at San Juan College in Farmington, New  
24 Mexico teaching Economics for Bankers, Consumer Lending, and Real Estate Finance.

1 **Q. What is the purpose of your testimony in this case?**

2 A. The purpose of my testimony is to present Staff's recommendations regarding Pineview  
3 Water Company, Inc.'s request for authorization to issue long-term debt in the form of a  
4 \$577,578 twenty-year fully amortizing loan from the Water Infrastructure Finance  
5 Authority ("WIFA").  
6

7 **Q. Was this testimony prepared by you?**

8 A. Yes.  
9

10 **Q. Briefly summarize how the remainder of Staff's financing authorization testimony is  
11 presented.**

12 A. Testimony is presented in the form of a memorandum to Staff witness Elena Zestrijan.  
13 That memorandum is attached as Exhibit A. Exhibit A presents the purpose of the  
14 financing, a description of the financing, a financial analysis, and Staff's  
15 recommendations.  
16

17 **Q. What is Staff's recommendation regarding the financing request?**

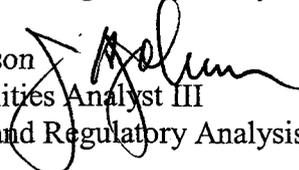
18 A. Staff recommends authorization to obtain \$577,578 of long-term debt financing on the  
19 terms and conditions consistent with or better than those used in Staff's pro forma  
20 analysis, subject to establishment of rates that provide Staff's recommended operating  
21 income.  
22

23 **Q. Does this conclude your direct testimony?**

24 A. Yes, it does.

**EXHIBIT A  
MEMORANDUM**

TO: Elena Zestrijan  
Public Utilities Analyst III  
Financial and Regulatory Analysis Section, Utilities Division

FROM: J. H. Johnson   
Public Utilities Analyst III  
Financial and Regulatory Analysis Section, Utilities Division

DATE: January 10, 2005

RE: PINEVIEW WATER COMPANY, INC.  
DOCKET NO. W-01676A-04-0463

---

**Introduction**

Pineview Water Company, Inc. ("Pineview" or "Company") filed a Financing Application on June 18, 2004, with the Arizona Corporation Commission ("Commission") for authorization to borrow \$730,798.

On June 18, 2004, Pineview filed a tariff with the Commission seeking approval to implement an Off-site Facilities Hook-up Fee Tariff of \$1,500 for all new 5/8 by 3/4-inch service connections. Pineview plans to use the tariff revenues for debt service. On July 9 the Commission issued Decision No. 67106 suspending the tariff filing through and including September 29, 2004.

On July 9, 2004, Pineview filed an application for an increase in its rates.

On October 5, 2004, the Commission issued Decision No. 67275 authorizing an offsite facilities hookup fee tariff that provided for fees by meter size based on the National Association of Regulatory Utility Commissioners multipliers (NARUC meter factors). For a 5/8 by 3/4 inch meter, Decision No. 67275 approved a hook-up fee of \$500

On December 7, 2004, Staff filed a motion to consolidate the rate case and the financing case. Pineview does not opposing the consolidation motion.

**Notice**

Pineview published Notice in the White Mountain Independent on July 2, 2004, and provided Staff with a copy of the Notice and affidavit of the publisher. A copy of that published

notice is attached along with a copy of the notice the Company mailed to all customers receiving service.

### **Background**

Pineview was formed in 1957 as a for-profit Arizona perpetual corporation. Pineview is located in Navajo County, Arizona, southeast of the Town of Show Low. The Company serves a 2.5 square mile certificated area and has 936 metered customers.

### **Purpose of Financing**

Pineview proposed to use the proceeds of its \$730,978 borrowing to construct an additional well and additional storage and transmission facilities. Pineview also asks that authorization be given for the reasonable charging of loan funds to operating expenses or income.

### **Description of Proposed Financing**

The loan as requested by the Company would be a \$730,978 twenty-year fully amortizing loan obtained from the Water Infrastructure Finance Authority ("WIFA") at 4.20 percent with monthly debt service of \$4,507.

### **Financial Analysis**

Schedule JHJ-1 presents historical financial information for the year ended December 31, 2003 in Column A. Column B presents financial information as adjusted by Staff in the rate case and the imposition of a \$577,578<sup>1</sup> loan over twenty years at 5.60 percent. This interest rate represents the current prime rate plus 2 percent times the current subsidy rate of 80 percent. The subsidy rate may differ slightly at loan closing.

The resulting times interest earning ratio ("TIER") and debt service coverage ratio ("DSC") are 1.14 and 1.99, respectively. These results are based on Staff's pro forma financial information and assume that Pineview will not incur expenses that have been disallowed by Staff in the rate proceeding.

TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

---

<sup>1</sup> Staff recommends approval of \$577,578 of the proposed \$730,978 capital improvements.

DSC represents the number of times internally generated cash will cover required principal and interest payment on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule JHJ-1 shows a pro forma capital structure resulting from a \$577,578 loan consisting of 3.3 percent short-term debt, 68.2 percent long-term debt and 28.5 percent equity. This capital structure is highly leveraged limiting Pineview's capacity for additional debt financing.

### **Staff Conclusions and Recommendations**

The Staff Engineering Report concludes that only \$577,578 of the expenditures are necessary for the continuation of service to present customers and that existing wells will provide an adequate source of water for the foreseeable future.

Staff concludes that Pineview can support \$577,578 in new long-term debt with implementation of recommended rates and a reduction in expenses consistent with Staff recommendations.

Staff further concludes that use of loan proceeds for operating expenses or income is an inappropriate use of the funds.

Staff further concludes that issuance of debt in the amount of \$577,578 is within Pineview's corporate powers, compatible with the public interest; compatible with sound financial practices, and will not impair its ability to perform service.

Staff recommends authorization to obtain \$577,578 of long-term debt financing on the terms and conditions consistent with or better than those used in Staff's pro forma analysis subject to establishment of rates that provide Staff's recommended operating income.

Staff further recommends approval of granting of liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends denial of Pineview's request to use loan funds for operating expenses or income.

Staff further recommends authorizing Pineview to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that Pineview be ordered to file copies of all executed financing documents with Docket Control within 90 days of loan closing.

**FINANCIAL ANALYSIS**

Selected Financial Data  
Including Immediate Effects of the Proposed Debt

|    | [A]<br><u>12/31/2003</u> |             | [B]<br><u>Pro Forma</u><br>Staff Recommended |                    |
|----|--------------------------|-------------|--|--------------------|
| 1  | Operating Income         | \$ (20,030) | \$ 48,230                                    |                    |
| 2  | Depreciation & Amort.    | 44,684      | 83,046                                       |                    |
| 3  | Income Tax Expense       | 0           | 7,976  |                    |
| 4  |                          |             |  |                    |
| 5  | Interest Expense         | 16,328      | 49,413                                       |                    |
| 6  | Repayment of Principal   | 29,600      | 45,374                                       |                    |
| 7  |                          |             |  |                    |
| 8  |                          |             |  |                    |
| 9  | <b>TIER</b>              |             |  |                    |
| 10 | [1+3] ÷ [5]              | 1.80        | 1.14   |                    |
| 11 | <b>DSC</b>               |             |  |                    |
| 12 | [1+2+3] ÷ [5+6]          | 0.89        | 1.99   |                    |
| 13 |                          |             |  |                    |
| 14 |                          |             |  |                    |
| 15 |                          |             |  |                    |
| 16 |                          |             |  |                    |
| 17 |                          |             |  |                    |
| 18 | Short-term Debt          | \$29,600    | 3.7%   | \$45,374 3.3%      |
| 19 |                          |             |  |                    |
| 20 | Long-term Debt           | \$383,620   | 47.4%  | \$945,424 68.2%    |
| 21 |                          |             |  |                    |
| 22 | Common Equity            | \$395,345   | 48.9%  | \$395,345 28.5%    |
| 23 |                          |             |  |                    |
| 24 | Total Capital            | \$808,565   | 100.0%                                       | \$1,386,143 100.0% |
| 25 |                          |             |  |                    |
| 26 |                          |             |  |                    |
| 27 |                          |             |  |                    |

1 Richard L. Sallquist  
 Sallquist & Drummond, P.C.  
 2 4500 S. Lakeshore Drive  
 Suite 339  
 3 Tempe, Arizona 85282  
 Phone: (480) 839-5202  
 4 Fax: (480) 345-0412  
 Attorneys for Applicant

6 **BEFORE THE ARIZONA CORPORATION COMMISSION**

7  
 8 IN THE MATTER OF THE APPLICATION OF )  
 PINEVIEW WATER COMPANY, INC. FOR AN ) DOCKET NO. W-01676A-04-0500  
 INCREASE IN ITS WATER RATES FOR )  
 9 CUSTOMERS WITHIN NAVAJO COUNTY, ) **AFFIDAVIT OF MAILING**  
 ARIZONA. )  
 10 )

11 STATE OF ARIZONA )  
 )ss  
 12 County of Navajo )

- 13 1. I am Ron McDonald, General Manager of Pineview Water Company. My business  
 14 address is 5198 Cub Lake Road, Showlow, Arizona 85901.  
 15 2. On October 18, 2004, I caused the Notice in the form attached hereto as Exhibit 1  
 16 and incorporated herein by reference for all purposes, to be mailed by first class mail,  
 17 postage prepaid, to all customers receiving service as of October 18, 2004.  
 18 3. Further affiant sayeth naught.

20 DATED this 18 day of October 2004.

21 PINEVIEW WATER COMPANY

22  
 23 By: Ronald L. McDonald

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Ron McDonald

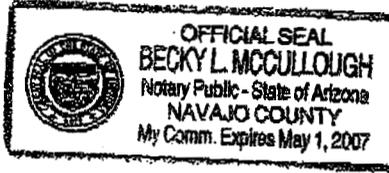
The foregoing instrument was acknowledged before me this 18 day of October 2004,

by Ron McDonald

*Becky L McCullough*  
Notary Public

My Commission Expires:

May 1, 2007



State of Arizona )  
 )  
County Of Navajo )

ss.

# Affidavit of Publication

## White Mountain Independent

PUBLIC NOTICE  
OF  
AN APPLICATION FOR AN ORDER AUTHORIZING  
THE ISSUANCE OF PROMISSORY NOTE(S) AND  
OTHER EVIDENCE OF INDEBTEDNESS

BY  
PINEVIEW WATER COMPANY, INC.  
Pineview Water Company, Inc. (Applicant) has filed an Application with the Arizona Corporation Commission (Commission) for an order authorizing Applicant to issue up to \$730,700 in promissory notes and other evidence of indebtedness.

In addition, Pineview Water Company, Inc. (Applicant) has filed an Application with the Arizona Corporation Commission (Commission) for an order authorizing Applicant to add "Hook-Up" fees to the company's Tariff Schedule.

The Applications are available for inspection during regular business hours at the offices of the commission in Phoenix, Arizona, and Applicant's office at 8108 Cub Lake Road, Show Low, Arizona 85901.

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

1. The name, address and telephone of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceedings.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the Application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice. If you have any questions or concerns about this application or have any objections to its approval or wish to make a statement in support of it, you may contact the Consumer Services Section of the Commission at 1200 West Washington, Phoenix, Arizona 85007, 400 W. Congress Street, Tucson, Arizona 85701 or call 1-800-222-7000.

Published in the White Mountain Independent July 2, 2004  
(WMI 6218, N, 1x, 7/2/2004)

I, Jackie Hostler, being first duly sworn, depose and say: I am the agent of the White Mountain Publishing Company, publisher of the White Mountain Independent, a semi-weekly newspaper of general circulation published at Show Low, County of Navajo, Arizona and that the copy hereto attached is a true copy of the advertisement as published in the White Mountain Independent on the following dates:

July 2, 2004

White Mountain Independent

Jackie Hostler

Sworn to me this day of

July 2, A.D. 2004

Elizabeth N. Whittier  
Notary Public



# Public Notice of Rate Increase Mailed on October 18, 2004



Public Notices  
Rate Increase

10/18/2004

HAINS

**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

|  |                             |
|--|-----------------------------|
| IN THE MATTER OF THE APPLICATIONS OF ) | DOCKET NO. W-01676A-04-0500 |
| PINEVIEW WATER COMPANY, )              | (RATE)                      |
| AN ARIZONA CORPORATION, FOR A RATE )   | DOCKET NO. W-01676A-04-0463 |
| <u>INCREASE &amp; FINANCING</u> )      | (FINANCING)                 |

DIRECT TESTIMONY

OF

DOROTHY HAINS

UTILITIES ENGINEER

UTILITIES DIVISION

JANUARY 20, 2005

**TABLE OF CONTENTS**

|                                       | <u>PAGE</u> |
|---------------------------------------|-------------|
| INTRODUCTION.....                     | 3           |
| PURPOSE OF TESTIMONY.....             | 4           |
| ENGINEERING REPORT .....              | 5           |
| CONCLUSIONS AND RECOMMENDATIONS ..... | 5           |
| Engineering Report.....               | 10          |
| For Pineview Water Company.....       | 10          |
| EXECUTIVE SUMMARY .....               | 10          |
| F. GROWTH PROJECTION.....             | 17          |

**SCHEDULES**

|   |           |
|---|-----------|
| Engineering Report for Pineview Water Company ..... | EXHIBIT-1 |
|---|-----------|

1    **INTRODUCTION**

2    **Q.    Please state your name and business address.**

3    A.    My name is Dorothy Hains. My business address is 1200 West Washington Street, Phoenix,  
4           Arizona 85007.

5  
6    **Q.    By whom and in what position are you employed?**

7    A.    I am employed by the Arizona Corporation Commission ("Commission" or "ACC") as a  
8           Utilities Engineer - Water/Wastewater in the Utilities Division.

9  
10   **Q.    How long have you been employed by the Commission?**

11   A.    I have been employed by the Commission since January 1998.

12  
13   **Q.    What are your responsibilities as a Utilities Engineer - Water/Wastewater?**

14   A.    My main responsibilities are to inspect, investigate and evaluate water and wastewater  
15           systems. This includes obtaining data, preparing reconstruction cost new and/or original cost  
16           studies, cost of service studies and investigative reports, interpreting rules and regulations,  
17           and to suggest corrective action and provide technical recommendations on water and  
18           wastewater system deficiencies. I also provide written and oral testimony in rate cases and  
19           other cases before the Commission.

20  
21   **Q.    How many companies have you analyzed for the Utilities Division?**

22   A.    I have analyzed approximately 81 companies covering these various responsibilities.

23  
24   **Q.    Have you previously testified before this Commission?**

25   A.    Yes, I have testified before this Commission.  
26  
27  
28

1 **Q. What is your educational background?**

2 A. I graduated from Alabama University in Birmingham in 1987 with a Bachelor of Science  
3 degree in Civil Engineering.

4  
5 **Q. Briefly describe your pertinent work experience.**

6 A. Before my employment with the Commission, I was an Environmental Engineer for the  
7 Arizona Department of Environmental Quality, for ten years. Prior to that time, I was an  
8 Engineering Technician with C. F. Hains, Hydrology in Northport, Alabama for  
9 approximately five years.

10  
11 **Q. Please state your professional membership, registrations, and licenses.**

12 A. I am a member of the American Society of Civil Engineering ("ASCE") and American Water  
13 Works Association ("AWWA"). I am a registered Civil Engineer in Arizona.

14  
15 **PURPOSE OF TESTIMONY**

16 **Q. What was your assignment in this rate proceeding?**

17 A. My assignment was to provide the Utilities Division Staff's ("Staff") engineering evaluation  
18 of the Pineview Water Company ("Pineview" or "Company").

19  
20 **Q. What is the purpose of your testimony in this proceeding?**

21 A. To present the findings of Staff's engineering evaluation of Pineview's operation. Those  
22 findings are contained in the Engineering Report that I have prepared for this proceeding.  
23 This report is included as Exhibit-1, in this pre-filed testimony.

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1 **ENGINEERING REPORT**

2 **Q. Would you briefly describe what was involved in preparing the Engineering Report for**  
3 **the water operations in this rate proceeding?**

4 A. After reviewing Pineview' rate application, I physically inspected the water system to  
5 evaluate its operations and to determine which plant items were or were not used and useful.  
6 I contacted the Arizona Department of Environmental Quality ("ADEQ") to determine if the  
7 system was in compliance with ADEQ requirements. I obtained information from Pineview  
8 regarding water testing and water usage and analyzed that information. Based on this data, I  
9 made Staff's evaluations and prepared the Engineering Report attached as Exhibit 1.

10  
11 **Q. Please describe the information contained in Exhibit-1.**

12 A. Exhibit 1 is the Engineering Report for Pineview's operation. This Report is divided into  
13 three general sections: 1) *Executive Summary*; 2) *Engineering Report Discussion*, and 3)  
14 *Engineering Report Exhibits*. The *Discussions* section can be further divided into twelve  
15 subsections: A) Purpose of Report; B) Location of System; C) Description of System; D)  
16 Arsenic; E) Water Usage; F) Growth Projection; G) ADEQ Compliance; H) Arizona  
17 Department of Water Resources ("ADWR") Compliance; I) Arizona Corporation  
18 Commission Compliance; J) Water Testing Expenses; K) Depreciation Rates; and L) Other  
19 Issues. These subsections provide information about the Pineview water system.

20  
21 **CONCLUSIONS AND RECOMMENDATIONS**

22 **Q. What are Staff's conclusions and recommendations regarding Pineview's operation?**

23 A. Based upon Staff's engineering evaluation of Pineview's operation, Staff concludes the  
24 following about the Company:

- 25 1) According to the Utilities Division Compliance Section, the Company has no  
26 outstanding ACC compliance issues;

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2) The Company is not in any ADWR Active Management Area and is not required to comply with ADWR monitoring and reporting requirements.

3) ADEQ has determined that Pineview Water Co. is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Staff recommendations are listed as follows:

1) Water testing expenses are based upon participation in the ADEQ Monitoring Assistance Program ("MAP"). Annual testing expenses should be adjusted to \$4,852.

2) Staff recommends that in the future the Company use depreciation rates by the National Association of Regulatory Utility Commissioners ("NARUC") category, as delineated in Exhibit 6.

3) Staff recommends accepting the Company's proposed service line and meter installation charges.

4) The Company experienced 11.6 percent non-account water loss during the test year. Staff recommends that the Company reduce its water loss to less than 10 percent before the next rate case. If the Company finds that water loss cannot be reduced to less than 10 percent before the next rate case, the Company shall submit a detailed cost analysis and explanation demonstrating why a water loss reduction to less than 10 percent is not cost effective, along with its new rate application.

5) The Company has estimated its total new construction cost to be \$730,978. Based on Staff's engineering analysis of the Pineview system, Staff has adjusted this estimate to

1           \$577,578 to remove excess plant capacity that is not needed to meet expected demand within  
2           the foreseeable future.

3  
4           6)     Staff observed the control panel for Well No. 2 had been damaged by lightning.  
5           According to the Company, lightning damaged this equipment in the summer of 2004. The  
6           Company has been manually operating this well since then. The Company's estimated repair  
7           cost is \$24,000. Staff believes the repair is urgently needed and finds the Company's cost  
8           estimate reasonable. Staff recommends that the Company undertake the needed repairs  
9           immediately and file a compliance status report indicating completion of this work with  
10          Docket Control under this same docket number within six months of the effective date of the  
11          decision in this matter.

12  
13          7)     Staff also observed a soil compactor stored at the Site of Well Nos. 3A & 3B that,  
14          according to the Company, was purchased in September 2003. The Company paid \$1,325  
15          for this equipment which is not listed in the Plant Additions. Staff recommends that \$1,325  
16          be listed in Account No. 345 (Power Operated Equipment) in 2003.

17  
18          8)     The Company purchased land to drill three new wells in the future. This land is  
19          currently not being used by the Company. In addition, Staff believes that the Company's  
20          existing wells will provide an adequate source of water for the foreseeable future. Staff  
21          recommends that \$50,750 (land expense) be removed from plant in service.

22  
23          9)     Engineering fees and other expenses associated with the construction of the proposed  
24          two million gallon storage tank were included in the Company's filing as plant in service.  
25          This tank has not yet been constructed, therefore Staff recommends that an adjustment be  
26          made to remove these amounts from plant in service.

1 **Q. Does this conclude your pre-filed testimony?**

2 A. Yes, it does.

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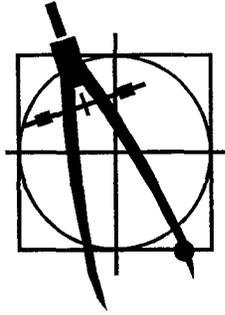
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**EXHIBIT 1**

ENGINEERING REPORT FOR PINEVIEW WATER COMPANY

BY DOROTHY HAINS

December, 2004



**Engineering Report  
For Pineview Water Company  
By Dorothy Hains  
Docket No. W-01676A-04-0500 (Rate)  
Docket No. W-01676A-04-0463 (Financing)  
November 16, 2004**

## **EXECUTIVE SUMMARY**

### **Recommendations:**

1. Water testing expenses are based upon participation in the Arizona Department of Environmental Quality ("ADEQ") Monitoring Assistance Program ("MAP"). Annual testing expenses should be adjusted to \$4,852. (See §J and Table 9 for discussion and details.)
2. Staff recommends that in the future Pineview Water Company ("Pineview" or "Company") use depreciation rates approved by the National Association of Regulatory Utility Commissioners ("NARUC") category, as delineated in Exhibit 6. (See §K and Exhibit 6 for a discussion and a tabulation of the recommended rates.)
3. Staff recommends accepting the Company's proposed service line and meter installation charges. (See §L of report for discussion and details.)
4. Staff recommends that the Company reduce its water loss to less than 10 percent before the next rate case. If the Company finds that water loss cannot be reduced to less than 10 percent before the next rate case, the Company shall submit a detailed cost analysis and explanation demonstrating why a water loss reduction to less than 10 percent is not cost effective, along with its new rate application. (See §E of report for discussion and details.)
5. The Company has estimated its total new construction cost to be \$730,978. Based on Staff's engineering analysis of the Pineview system, Staff has adjusted this estimate to \$577,578 to remove excess plant capacity that is not needed to meet expected demand within the foreseeable future. (See §L of the report for discussion and details.)
6. Staff observed the control panel in the Site of Well No. 2 had been damaged by lightning in summer 2004. The Company has been manually operating this well. The Company estimates the repair cost is \$24,000. Staff believes the repair is urgently needed and finds the Company's cost estimate reasonable. Staff recommends that the Company undertake the

needed repairs immediately and file a compliance status report indicating completion of this work with Docket Control under this same docket number within six months after the decision in this matter becomes effective. (See §L of the report for discussion and details.)

7. Staff also observed a soil compactor stored at the Site of Well Nos. 3A & 3B that was purchased in September 2003. The Company paid \$1,325 for this equipment which has not listed in the Plant Additions. Staff recommends that \$1,325 be listed in Account No. 345 (Power Operated Equipment) in 2003. (See §L of report for discussion and details.)
- 8 Staff recommends that \$50,750 (land expense) be removed from plant in service. (See §L of the report for discussion and details.)
9. Engineering fees and other expenses associated with the construction of the proposed two million gallon storage tank were included in the Company's filing as plant in service. This tank has not yet been constructed, therefore Staff recommends that an adjustment be made to remove these amounts from plant in service. (See §L of the report for discussion and details.)

**Conclusions:**

1. According to the Utilities Division Compliance Section, the Company has no outstanding ACC compliance issues.
2. The Company is not in any Arizona Department of Water Resources ("ADWR") Active Management Area and is not in subject to ADWR monitoring and reporting requirements.
3. ADEQ has determined that Pineview Water Co. is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

**TABLE OF CONTENTS**

|  | <b>PAGE</b> |
|--|-------------|
| <b>A. PURPOSE OF REPORT</b> .....  | 13          |
| <b>B. LOCATION OF SYSTEM</b> .....   | 13          |
| <b>C. DESCRIPTION OF SYSTEM</b> .....  | 13          |
| <b>I. SYSTEM DESCRIPTION</b> .....   | 13          |
| <b>II. SYSTEM ANALYSIS</b> .....   | 15          |
| <b>D. ARSENIC</b> .....  | 15          |
| <b>E. WATER USAGE</b> .....  | 15          |
| <b>I. WATER SOLD</b> .....   | 16          |
| <b>II. NON-ACCOUNTABLE WATER</b> .....   | 16          |
| <b>F. GROWTH PROJECTION</b> .....  | 17          |
| <b>G. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (“ADEQ”)<br/>    COMPLIANCE</b> .....            | 17          |
| <b>H. ARIZONA DEPARTMENT OF WATER RESOURCES (“ADWR”) COMPLIANCE</b> .....                          | 17          |
| <b>I. ARIZONA CORPORATION COMMISSION COMPLIANCE</b> .....  | 18          |
| <b>J. WATER TESTING EXPENSES</b> .....   | 18          |
| <b>K. DEPRECIATION RATES</b> .....   | 19          |
| <b>L. OTHER ISSUES</b> .....   | 19          |
| <b>I. SERVICE LINE AND METER INSTALLATION CHARGES</b> .....  | 19          |
| <b>II. FINANCING</b> .....   | 20          |
| <b>III. CURTAILMENT TARIFF</b> .....   | 22          |
| <b>IV. OFF-SITE HOOKUP FEE CHARGES</b> .....   | 22          |
| <b>V. ITEMS FOUND DURING STAFF’S INSPECTION</b> .....  | 22          |
| <br><b>EXHIBIT 1. PINEVIEW WATER COMPANY’S CERTIFICATE SERVICE AREA</b> .....                      | <br>23      |
| <br><b>EXHIBIT 2. LOCATION OF PINEVIEW WATER COMPANY</b> .....                                     | <br>24      |
| <br><b>EXHIBIT 3. SYSTEMATIC DRAWING</b> .....   | <br>25      |
| <br><b>EXHIBIT 4. WATER USAGE IN THE PINEVIEW WATER COMPANY SERVICE<br/>AREA</b> .....             | <br>26      |
| <br><b>EXHIBIT 5. ACTUAL AND PROJECTED GROWTH IN PINEVIEW WATER<br/>COMPANY SERVICE AREA</b> ..... | <br>27      |
| <br><b>EXHIBIT 6. DEPRECIATION RATES</b> .....   | <br>28      |

**ENGINEERING REPORT  
FOR  
PINEVIEW WATER COMPANY, INC.  
DOCKET NO. W-01676A-04-0500 (RATES)  
DOCKET NO. W-01676A-04-0463 (FINANCING)**

**A. PURPOSE OF REPORT**

This report was prepared in response to the application for a rate increase by Pineview Water Company. ("Pineview" or "Company"). An inspection and evaluation of the Company's water system was conducted by Dorothy Hains, Utilities Engineer, in the accompaniment of Ronald McDonald, the Company's water system Manager on September 21, 2004.

**B. LOCATION OF SYSTEM**

The Company serves an area which is southeast of the Town of Show Low in Navajo County. Exhibit 1 shows the approximate two and one-half square miles of its certificated area, and Exhibit 2 shows the location of the Company within Navajo County.

**C. DESCRIPTION OF SYSTEM**

**I. System Description**

The Company owns and operates a water system that consists of four wells, three storage tanks and a distribution system serving approximately 936 metered customers. Exhibit 3 is a schematic drawing of the water system; a detailed listing of the Company's water system facilities is as follows:

Table 1. Active Well Data

| Well Name | ADWR ID No. | Pump HP | Yield (in GPM) | Casing Size (in inch) & Depth (in ft) | (Meter Size inch) | Year drilled |
|-----------|-------------|---------|----------------|---------------------------------------|-------------------|--------------|
| Well #2   | 55-608847   | 30      | 115            | 6" x 660'                             | 3                 | 1962         |
| Well #3A  | 55-608846   | 40      | 115            | 8" x 800'                             | 3                 | 1978         |
| Well #3B  | 55-565467   | 40      | 130            | 10" x 820'                            | 3                 | 1997         |
| Well #4   | 55-521710   | 40      | 113            | 8" x 750'                             | 3                 | 1988         |
|           |             | TOTAL:  | 473            |                                       |                   |              |

Table 2. Abandoned Well Data

| Well Name | ADWR ID No. | Location                     | Year drilled | Year abandoned |
|-----------|-------------|------------------------------|--------------|----------------|
| Well #1   | N/A         | Lot # 6447<br>Lower Ridge Rd | 1957 (est.)  | 1997           |

Table 3. Storage Tanks

| Capacity (Gallons)      | Quantity | Location              |
|-------------------------|----------|-----------------------|
| 250,000                 | 1        | On Well #3A & 3B Site |
| 250,000                 | 1        | On Well #4 Site       |
| 40,000                  | 1        | On Well #2 Site       |
| 40,000*                 | 1        | One Well #1 Site      |
| Totals: 540,000 gallons |          |                       |

\*: This tank was abandoned in 1997.

Table 4. Pressure Tanks

| Capacity (Gallons)     | Quantity |
|------------------------|----------|
| 5,000**                | 1        |
| 5,000                  | 3        |
| Totals: 15,000 gallons |          |

\*\* : This pressure tank on Well No. 1 Site was abandoned in 1997.

Table 5. Distribution Mains

| Diameter (inches) | Material                      | Length (feet) |
|-------------------|-------------------------------|---------------|
| 2                 | polyvinyl chloride ("PVC")    | 6,560         |
| 2                 | steel                         | 150           |
| 3                 | Asbestos Cement Pipe ("ACP"), | 760           |
| 4                 | PVC                           | 18,630        |
| 4                 | Asbestos Cement ("AC")        | 23,700        |
| 6                 | PVC                           | 72,338        |
| 6                 | AC                            | 3,750         |
| 8                 | PVC                           | 12,268        |
| 12                | PVC                           | 7,523         |

Table 6. Meters

| Size (inches) | Quantity |
|---------------|----------|
| 5/8 x 3/4     | 832      |
| 3/4           | 66       |
| 1             | 11       |
| 1 1/2         | 5        |
| 2             | 21       |
| 3 (Comp)      | 1        |
| Total         | 936      |

## II. System Analysis

The system has adequate production and storage capacity to support the existing customer base.

**D. ARSENIC**

The U.S. Environmental Protection Agency (“EPA”) has reduced the arsenic maximum contaminant level (“MCL”) in drinking water from 50 micrograms per liter (“µg/l”) or parts per billion (“ppb”) to 10 µg/l. The date for compliance with the new MCL is January 23, 2006. The most recent lab analysis provided by the Company indicates that the arsenic levels are 3 µg/l which is below the new arsenic MCL.

**E. WATER USAGE**

Table 7 summarizes water usage in the Company’s Certificate of Convenience and Necessity (“CC&N”) area. Attached as Exhibit 4, is a graph that shows water consumption data in gallons per day per connection for the period of January 2003 through December 2003.

Table 7. Water Usage

| Month   | Number of Customers | Water Sold (gallons) | Water pumped (gallons) | Water purchased (gallons) | Daily Average (gal/day/customer) |
|---------|---------------------|----------------------|------------------------|---------------------------|----------------------------------|
| Jan 03  | 899                 | 5,455,249            | 5,905,400              | 0                         | 196                              |
| Feb 03  | 903                 | 4,849,644            | 5,635,200              | 0                         | 192                              |
| Mar 03  | 849                 | 2,938,300            | 4,761,698              | 0                         | 112                              |
| Apr 03  | 902                 | 5,618,610            | 5,938,600              | 0                         | 208                              |
| May 03  | 905                 | 8,959,196            | 9,536,000              | 0                         | 319                              |
| Jun 03  | 905                 | 12,380,777           | 12,875,900             | 0                         | 456                              |
| Jul 03  | 953                 | 13,158,410           | 14,831,400             | 0                         | 445                              |
| Aug 03  | 922                 | 7,739,551            | 8,857,900              | 0                         | 271                              |
| Sep 03  | 931                 | 7,968,056            | 7,950,700              | 0                         | 285                              |
| Oct 03  | 934                 | 6,338,574            | 7,647,200              | 0                         | 219                              |
| Nov 03  | 935                 | 5,979,921            | 6,910,600              | 0                         | 213                              |
| Dec 03  | 936                 | 4,577,589            | 6,360,800              | 0                         | 158                              |
| Total   |                     | 85,963,877           | 97,211,398             | 0                         |                                  |
| Average |                     |                      |                        |                           | 256                              |

**I. Water Sold**

Based on information provided by the Company, during this period, the Company experienced a daily average use of 256 gallons per day (“gpd”) per customer, a high use of 456 gpd per customer and a low use of 112 gpd per customer. The highest total monthly use occurred in July, when 14,831,400 gallons were sold to 953 customers. The lowest total monthly use occurred in March, when 2,938,300 gallons were sold to 849 customers.

**II. Non-account Water**

Non-account water should be 10 percent or less and never more than 15 percent. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a water company to identify water and revenue losses due to leakage, theft, and flushing. It is important to be able to reconcile the difference between water sold and the water produced by the source. Non-account water for Pineview was calculated to be 11.6 percent for the period beginning in January 2003 and ending in December 2003.

Staff recommends that the Company reduce its water loss to less than 10 percent before the next rate case. If the Company finds that water loss cannot be reduced to less than 10 percent before the next rate case, the Company shall submit a detailed cost analysis and explanation demonstrating why a water loss reduction to less than 10 percent is not cost effective, along with its new rate application.

**F. GROWTH PROJECTION**

Exhibit 5 details total actual and projected growth for the system using linear regression analysis. The number of service connections was obtained from annual reports submitted to the Commission by Pineview. Based on the service meter data contained in these reports, the number of customers increased from 765 at the end of 1995 to 937 by the end of 2003, with an average growth rate of 21 customers per year. Based on the linear regression analysis, the Company could have approximately 1,037 customers by the end of 2008. The following table summarizes actual and projected growth in the Company's existing certificated service area.

Table 8. Actual and Projected Growth

| Year | Nos. of Customers |           |
|------|-------------------|-----------|
| 1995 | 765               | Reported  |
| 1996 | 765               | Reported  |
| 1997 | 826               | Reported  |
| 1998 | 826               | Reported  |
| 1999 | 863               | Reported  |
| 2000 | 867               | Reported  |
| 2001 | 889               | Reported  |
| 2002 | 899               | Reported  |
| 2003 | 937               | Reported  |
| 2004 | 953               | Estimated |
| 2005 | 974               | Estimated |
| 2006 | 995               | Estimated |
| 2007 | 1,016             | Estimated |
| 2008 | 1,037             | Estimated |

**G. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (“ADEQ”) COMPLIANCE**

Staff received a compliance status report from ADEQ dated May 25, 2004, in which ADEQ stated that it has determined that the Company is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

**H. ARIZONA DEPARTMENT OF WATER RESOURCES (“ADWR”) COMPLIANCE**

Pineview is not in any ADWR Active Management Area. Therefore, the Company is not required to comply with ADWR’s monitoring and reporting requirements.

**I. ARIZONA CORPORATION COMMISSION (“ACC”) COMPLIANCE**

According to the Utilities Division Compliance Section, the Company has no outstanding ACC compliance issues.

**J. WATER TESTING EXPENSES**

Pineview is subject to mandatory participation in the ADEQ Monitoring Assistance Program (“MAP”). Staff calculated the testing costs based on the following assumptions:

1. MAP will do baseline testing on everything except copper, lead, nitrates, and bacteria.
2. ADEQ testing is performed in 3-year compliance cycles. Therefore, monitoring costs are estimated for a 3-year compliance period and then presented as a pro forma expense on an annualized basis.
3. MAP fees were calculated from the ADEQ MAP rules.
4. All monitoring expenses are based on Staff’s best knowledge of lab costs and methodology and two points of entry.
5. The estimated water testing expenses represent a minimum cost based on no “hits” other than lead and copper, and assume compositing of well samples. If any constituents were found, then the testing costs would dramatically increase.

Table 9 shows the estimated annual monitoring expense, assuming participation in the MAP

program. Water testing expenses should be adjusted to the annual expense amount shown in Table 9, which is **\$4,852**.

Table 9 Water Testing Cost

| Monitoring – 4 wells<br>(Tests per 3 years, unless<br>noted.) | Cost<br>per test | No. of<br>tests per 3<br>years | Total 3<br>year cost | Annual Cost    |
|---|------------------|--------------------------------|----------------------|----------------|
| Bacteriological – monthly                                     | \$15             | 144                            | \$2,160              | \$720          |
| Inorganics (& secondary)                                      | \$240            | 12                             | \$2,880              | \$960          |
| Radiochemical – (1/4 yr)                                      | \$55             |                                |                      | MAP            |
| IOC's, SOC's, VOC's   |                  |                                |                      | MAP            |
| Nitrites  | \$15             |                                |                      | MAP            |
| Nitrates – annual   | \$25             | 12                             | \$300                | \$100          |
| Asbestos – per 9 years  | \$180            |                                |                      | MAP            |
| Lead & Copper – annual  | \$25             | 30                             | \$750                | \$250          |
| MAP fees (annual)   |                  |                                |                      | \$2,791.96     |
| Total   |                  |                                |                      | <b>\$4,852</b> |

**K. DEPRECIATION RATES**

Staff has developed typical and customary depreciation rates within the range of anticipated equipment life. These rates are presented in Exhibit 6, and should be used to calculate the annual depreciation expense for the Company in this application. It is recommended that the Company use depreciation rates approved by the National Association of Regulatory Utility Commissioners (“NARUC”) category, as delineated in Exhibit 6 in the future.

**L. OTHERS**

**I. Service Line and Meter Installation Charges**

The Company is proposing to revise its meter and service line installation charges. These charges are refundable advances and the Company’s proposed charges are within Staff’s experience of what are reasonable and customary charges. Therefore, Staff accepts the Company’s proposed meter and service line installation charges.

Table 10. Service Line and Meter Installation Charges

| Meter Size            | Current Charges | Proposed Charges | Staff Recommendation |
|-----------------------|-----------------|------------------|----------------------|
| 5/8 x3/4-inch         | \$400           | \$475            | \$475                |
| 3/4-inch              | \$440           | \$550            | \$550                |
| 1-inch                | \$500           | \$650            | \$650                |
| 1-1/2-inch            | \$715           | \$900            | \$900                |
| 2-inch (turbine)      | \$1,170         | \$1,550          | \$1,550              |
| 2-inch<br>(compound)  | \$1,700         | \$2,300          | \$2,300              |
| 3-inch (turbine)      | \$1,585         | \$2,200          | \$2,200              |
| 3-inch<br>(compound)  | \$2,190         | \$3,100          | \$3,100              |
| 4-inch (turbine)      | \$2,540         | \$3,400          | \$3,400              |
| 4-inch<br>(compound)  | \$3,215         | \$4,400          | \$4,400              |
| 6" (turbine)          | \$4,615         | \$6,200          | \$6,200              |
| 6-inch<br>(compound)  | \$6,270         | \$7,900          | \$7,900              |
| 8-inch (turbine)      | \$6,655         | \$8,850          | \$7,543              |
| 8-inch<br>(compound)  | \$7,040         | \$9,350          | \$7,980              |
| 10-inch (turbine)     | \$8,495         | \$11,300         | \$9,629              |
| 10-inch<br>(compound) | \$9,950         | \$13,200         | \$11,278             |

## II. Financing

In June 2004, the Company filed a financing application (Docket No. W-01676A-04-0463) seeking approval to borrow \$730,978. The Company proposes to use these funds to install (1) a two million gallon storage tank, (2) a new well, (3) electrical work for Well site Nos.3 and 4; and (4) piping to convert the existing system from pressure flow to gravity flow. The Company proposed to use the revenues collected from off-site hookup fees to pay back a portion of this debt.

The Company has estimated its total construction cost to be \$730,978. Based on Staff's engineering analysis of the Pineview system, Staff has adjusted this estimate to \$577,578 to remove excess plant capacity that is not needed to meet expected demand within the foreseeable future. The itemized costs are listed in the table below:

| Facility          | Description   | Company's cost estimate (\$) | For financing application Staff Adjusted (\$) |
|-------------------|---|------------------------------|---|
| Storage Tank      | One 2,000,000 gallon storage tank   | 304,150                      | 204,750 <sup>2</sup>                          |
| Transmission Line | 5,100' of 12" PVC   | 155,369                      | 155,369                                       |
| Additional Wells  | 1.5 Acres of land   | 54,000                       | 0 <sup>1</sup>                                |
|                   | 800 feet deep, 12-inch diameter well  | 38,000                       | 38,000  |
|                   | One 130 gpm, 40-HP pump   | 18,037                       | 18,037  |
|                   | One pump house with chlorination system   | 16,570                       | 16,570  |
|                   | Site preparation/ access road   | 17,600                       | 17,600  |
|                   | Electricity/ control panel  | 18,420                       | 18,420  |
|                   | Fencing   | 3,120                        | 3,120   |
|                   | Pressure & gravity water main extension   | 30,660                       | 30,660  |
|                   | Engineering & design  | 5,422                        | 5,422   |
|                   | Controls & Electrical work for Well #3 site & Well #4 site                      | 22,370                       | 22,370  |
|                   | Engineering & design (to control pressures @ various locations with the system) | 7,500                        | 7,500   |
|                   | Pressure reducing valves  | 39,760                       | 39,760  |
| Total             |   | 730,978                      | 577,578                                       |

- Notes:
1. The Company proposes to purchase land to drill three new wells sometime in the future. Staff believes that the Company's existing wells will provide an adequate source of water for the foreseeable future.
  2. Based on the projected growth rate, by 2024 there will be an estimated 1,437 customers in the Company's CC&N area. Based on Staff's engineering analysis one million gallons of additional storage capacity should be more than adequate to serve existing and future customers. Therefore, Staff adjusted the projected cost to reflect the addition of a one million gallon storage tank.

Staff believes that the Company's estimated costs, with Staff adjustments, are reasonable and appropriate. However, Staff has not made a determination of the capital improvements as "used and useful" at this time, but defers this determination until the Company files its next rate application.

### **III. Curtailment Tariff**

The Company has an existing curtailment tariff that was approved in Decision No. 66176.

### **IV. Off-site Hookup Fee Charges**

The Commission approved the Company's Off-site Hookup Fee tariff in Decision No. 67275, dated October 5 2004.

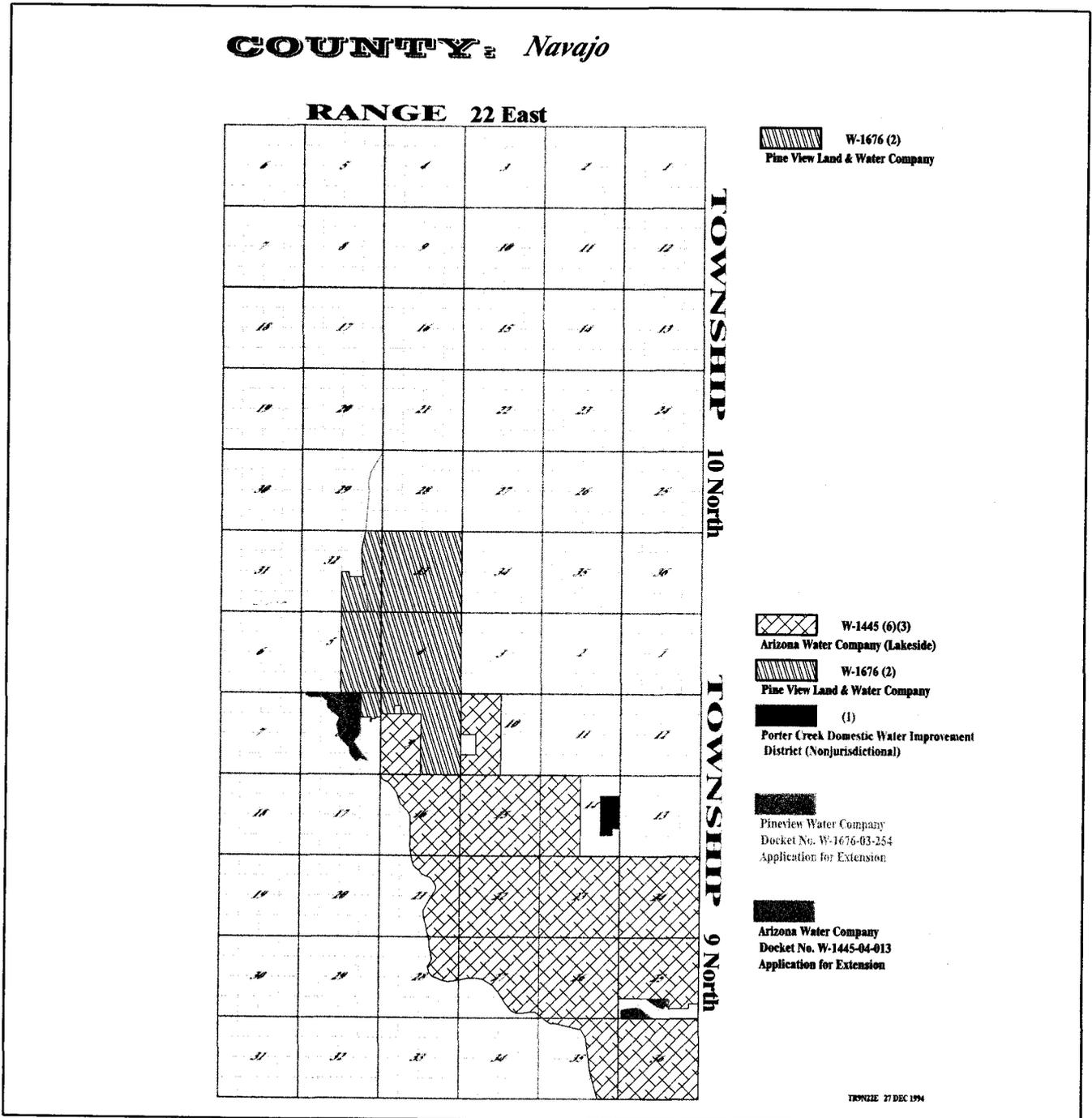
### **V. Items Found During Staff's Inspection**

- A. Staff observed the control panel in the Site of Well No. 2 had been damaged by lightning in summer 2004. The Company has been manually operating this well. The Company estimates the repair cost is \$24,000. Staff believes the repair is urgently needed and finds the Company's cost estimate reasonable. Staff recommends that the Company undertake the needed repairs immediately and file a compliance status report indicating completion of this work with Docket Control under this same docket number within six months after the decision in this matter becomes effective.
- B. Staff also observed a soil compactor stored at the Site of Well Nos. 3A & 3B that was purchased in September 2003. The Company paid \$1,325 for this equipment which has not listed in the Plant Additions. Staff recommends that \$1,325 be listed in Account No. 345 (Power Operated Equipment) in 2003.
- C. Engineering fees and other expenses associated with the construction of the proposed two million gallon storage tank were included in the Company's filing as plant in service. This tank has not yet been constructed, therefore Staff recommends that an adjustment be made to remove these amounts from plant in service.

- D. The Company purchased 3.05 acres for \$105,000 in 2000 and sold 1.55 acres for \$54,250 in 2002. The remaining 1.5 acres of land expense of \$50,750 is listed as plant in service. According to the Company, this 1.5 acres of land was to be used for the construction of an additional storage tank and wells. Neither the wells nor the additional storage tank have been constructed. Furthermore, with the addition of the new wells and storage tank proposed in the financing, the system will have adequate storage and production capacity. These additional wells and storage tank will not be needed, therefore, Staff finds this land not used and useful. Staff recommends that \$50,750 be removed from plant in service.

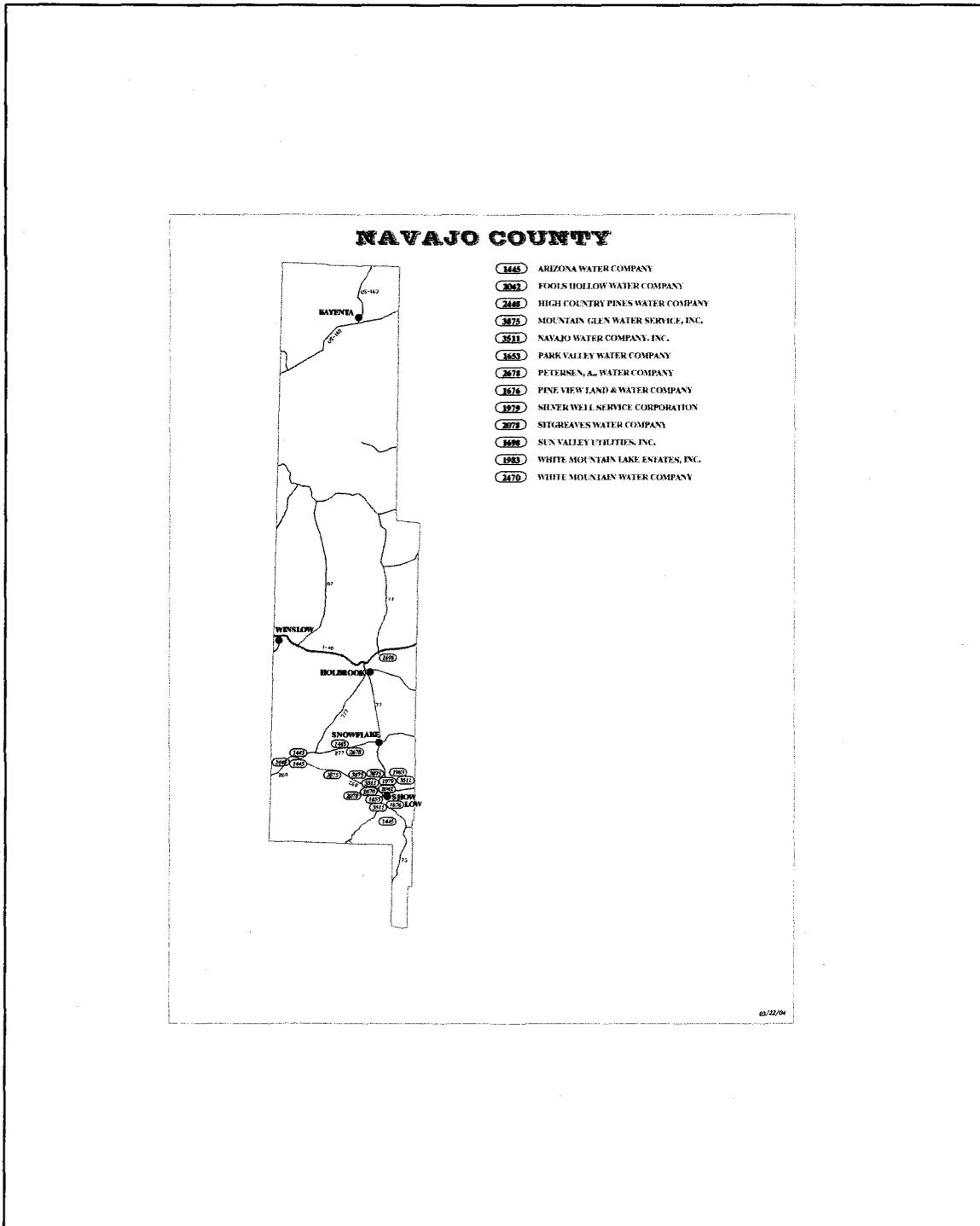
EXHIBIT 1

Pineview' Certificate Service Area



**EXHIBIT 2.**

**LOCATION OF PINEVIEW WATER COMPANY SERVICE AREA**



**EXHIBIT 3.**  
**SYSTEMATIC DRAWING**

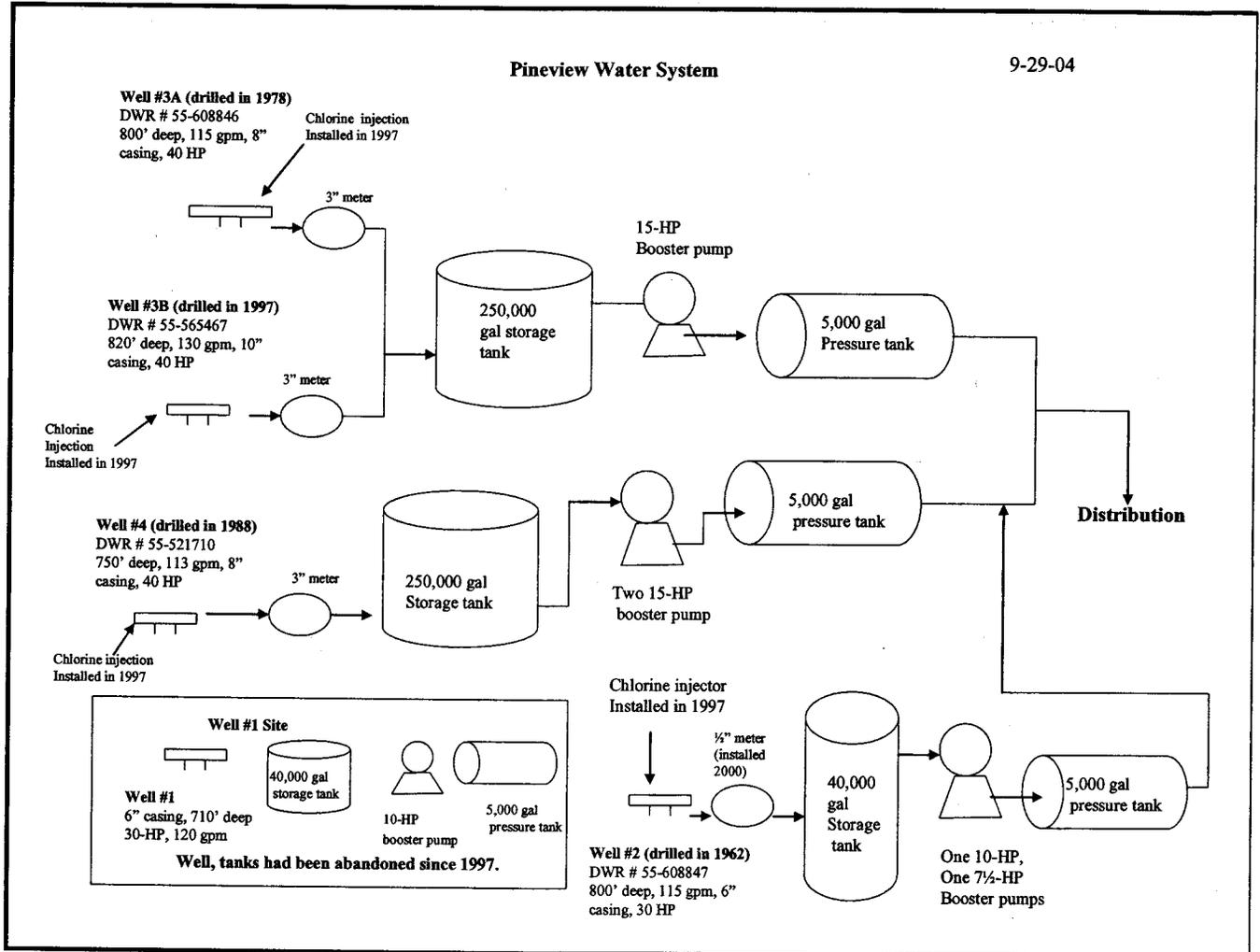
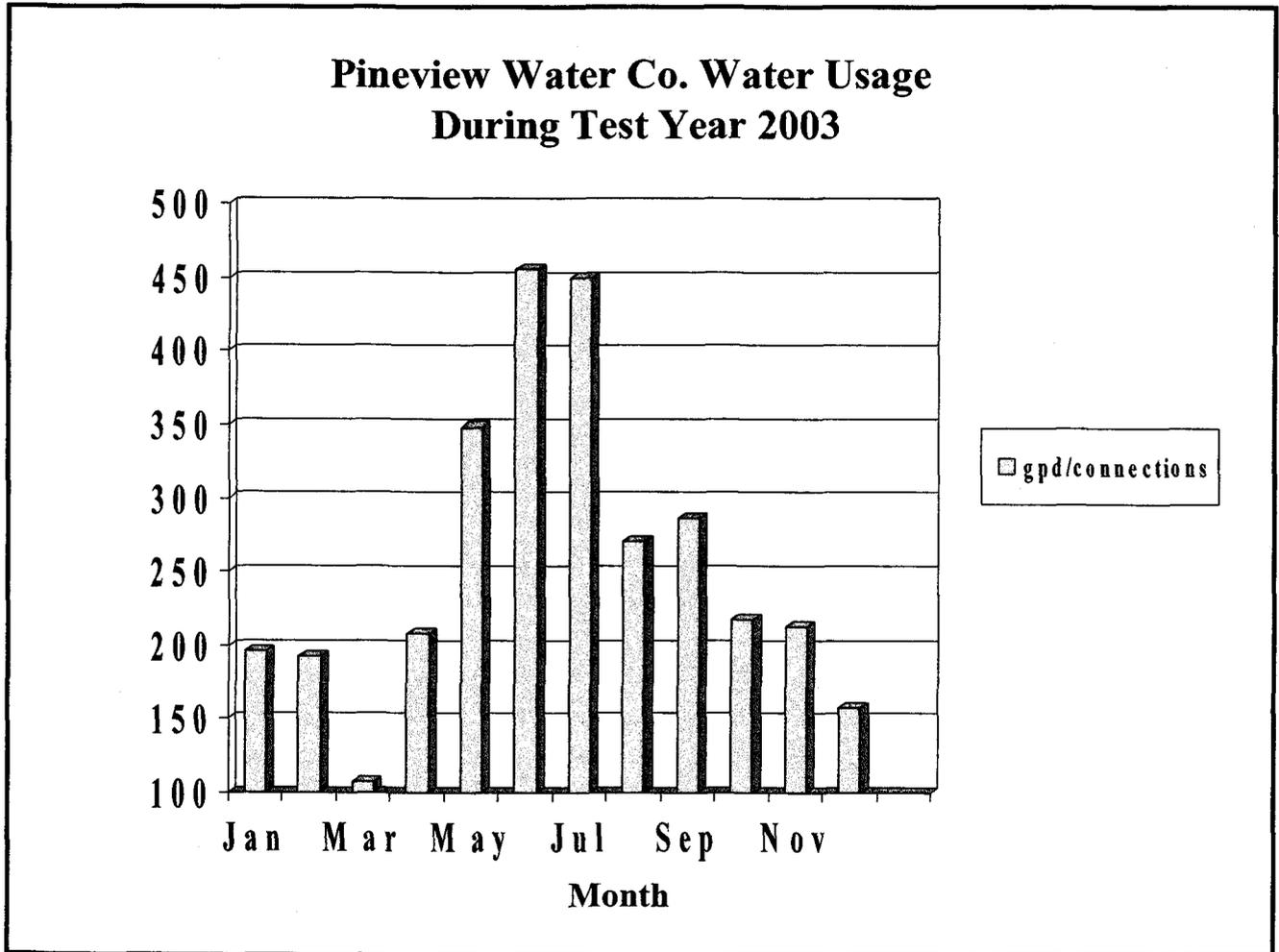


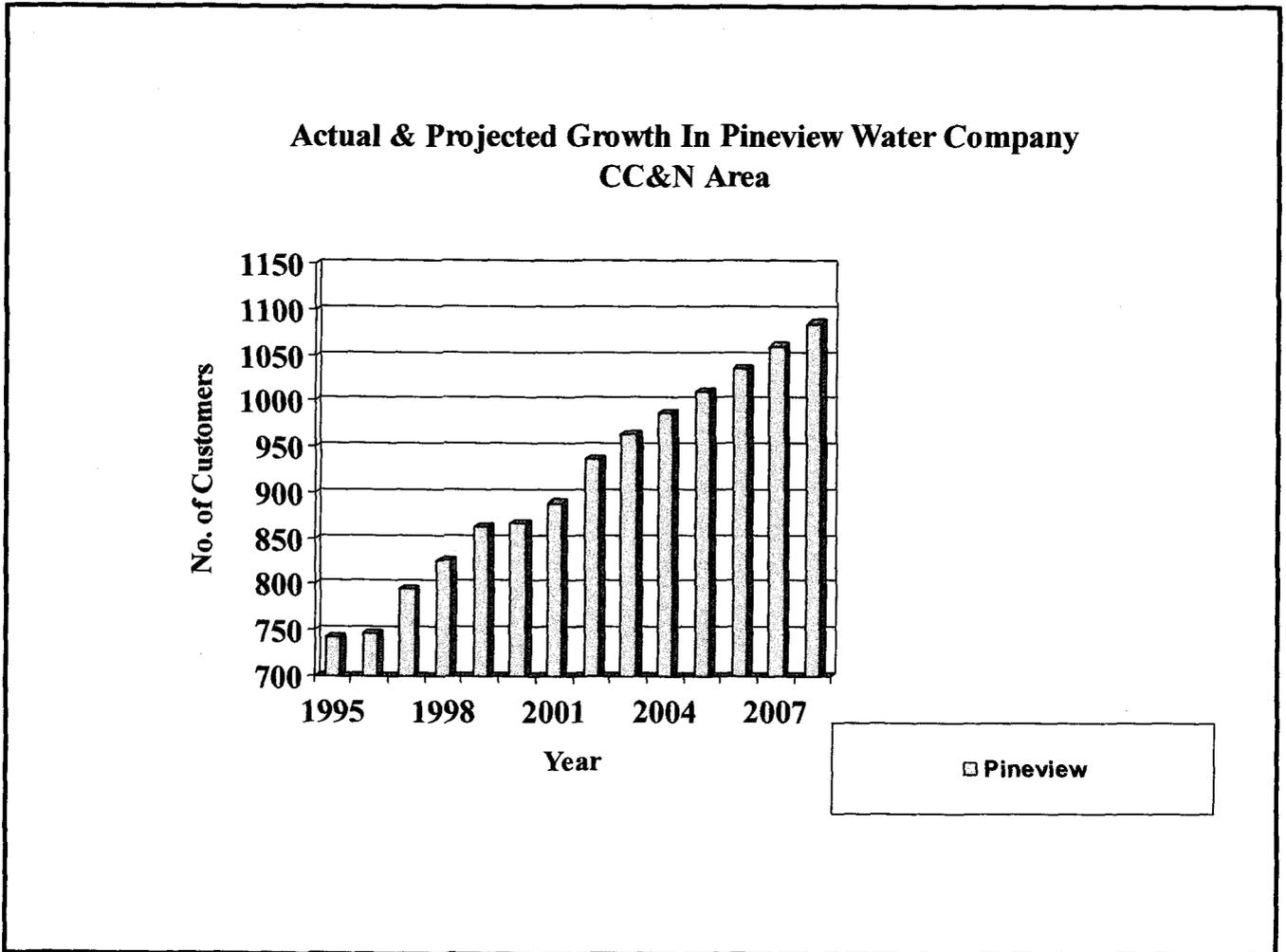
EXHIBIT 4

WATER USAGE ON THE PINEVIEW WATER COMPANY SERVICE AREA



**EXHIBIT 5**

**ACTUAL AND PROJECTED GROWTH IN PINEVIEW WATER COMPANY SERVICE AREA**



**Exhibit 6**

**Water Depreciation Rates**

| Acct. No. | Depreciable Plant                    | Average Service Life (Years) | Annual Accrual Rate (%) |
|-----------|--------------------------------------|------------------------------|-------------------------|
| 304       | Structures & Improvements            | 30                           | 3.33                    |
| 305       | Collecting & Impounding Reservoirs   | 40                           | 2.50                    |
| 306       | Lake, River, Canal Intakes           | 40                           | 2.50                    |
| 307       | Wells & Springs                      | 30                           | 3.33                    |
| 308       | Infiltration Galleries               | 15                           | 6.67                    |
| 309       | Raw Water Supply Mains               | 50                           | 2.00                    |
| 310       | Power Generation Equipment           | 20                           | 5.00                    |
| 311       | Pumping Equipment                    | 8                            | 12.5                    |
| 320       | Water Treatment Equipment            |                              |                         |
| 320.1     | Water Treatment Plants               | 30                           | 3.33                    |
| 320.2     | Solution Chemical Feeders            | 5                            | 20.0                    |
| 330       | Distribution Reservoirs & Standpipes |                              |                         |
| 330.1     | Storage Tanks                        | 45                           | 2.22                    |
| 330.2     | Pressure Tanks                       | 20                           | 5.00                    |
| 331       | Transmission & Distribution Mains    | 50                           | 2.00                    |
| 333       | Services                             | 30                           | 3.33                    |
| 334       | Meters                               | 12                           | 8.33                    |
| 335       | Hydrants                             | 50                           | 2.00                    |
| 336       | Backflow Prevention Devices          | 15                           | 6.67                    |
| 339       | Other Plant & Misc Equipment         | 15                           | 6.67                    |
| 340       | Office Furniture & Equipment         | 15                           | 6.67                    |
| 340.1     | Computers & Software                 | 5                            | 20.00                   |
| 341       | Transportation Equipment             | 5                            | 20.00                   |
| 342       | Stores Equipment                     | 25                           | 4.00                    |
| 343       | Tools, Shop & Garage Equipment       | 20                           | 5.00                    |
| 344       | Laboratory Equipment                 | 10                           | 10.00                   |
| 345       | Power Operated Equipment             | 20                           | 5.00                    |
| 346       | Communication Equipment              | 10                           | 10.00                   |
| 347       | Miscellaneous Equipment              | 10                           | 10.00                   |
| 348       | Other Tangible Plant                 | ----                         | ----                    |

