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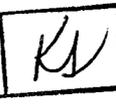
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BEFORE THE ARIZONA CORPORATION COMMISSION

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1
2 JEFF HATCH-MILLER
Chairman
3 WILLIAM A. MUNDELL
Commissioner
4 MARC SPITZER
Commissioner
5 MIKE GLEASON
Commissioner
6 KRISTIN K. MAYES
Commissioner
7
8

Arizona Corporation Commission
DOCKETED
JUN 15 2005

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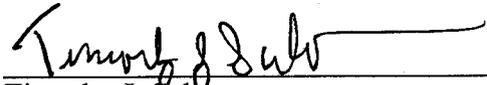
9 IN THE MATTER OF THE APPLICATION OF
10 ARIZONA WATER COMPANY, AN ARIZONA
11 CORPORATION, FOR ADJUSTMENTS TO ITS
12 RATES AND CHARGES FOR UTILITY SERVICE
13 FURNISHED BY ITS WESTERN GROUP AND FOR
14 CERTAIN RELATED APPROVALS.

DOCKET NO. W-01445A-04-0650

Staff's Notice of Filing

15 The Utilities Division ("Staff") hereby provides notice of filing of Staff's Summary of
16 Direct and Surrebuttal Testimonies of Staff Witness Alejandro Ramirez (to be adopted by Gordon
17 L. Fox).

18 RESPECTFULLY SUBMITTED this 15th day of June 2005.

19 
20 Timothy J. Sabo
21 Diane M. Targovnik
22 Attorneys, Legal Division
23 Arizona Corporation Commission
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25 Phoenix, Arizona 85007

26 The original and thirteen (13) copies
27 of the foregoing were filed this
28 15th day of June 2005 with:

Docket Control
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1 Copies of the foregoing were mailed
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27 Deborah A. Amaral
28 Secretary to Timothy J. Sabo

**SUMMARY OF THE DIRECT AND SURREBUTTAL TESTIMONIES
OF
STAFF WITNESS
ALEJANDRO RAMIREZ
(TO BE ADOPTED BY GORDON L. FOX)
IN THE RATE CASE FILED BY
ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650**

Staff's Recommended Rate of Return

Staff recommends the following rate of return:

	Weight	Cost	Weighted Cost
Debt	26.6%	8.4%	2.2%
Equity	73.4%	9.1%	6.7%
Cost of Capital/ROR			8.9%

Staff's recommended rate of return ("ROR") is based on its updated return on equity ("ROE") recommendation, its updated cost of debt recommendation, and updated capital structure.

Staff's ROE recommendation is based on the results of its updated discounted cash flow ("DCF") and capital asset pricing model ("CAPM") cost of equity estimates, shown below:

Model	Estimate
Discounted Cash Flow	9.0%
Capital Asset Pricing Model	9.2%
Average	9.1%

Staff's Comments on the Testimony of Company Witness Thomas M. Zepp.

The Commission should reject Dr. Zepp's ROE estimates for the following reasons:

Dr. Zepp's exclusive reliance on analysts' forecasts in his restatement of Staff's discounted cash flow ("DCF") analysis is inappropriate because it assumes that investors ignore other information such as past growth.

The Commission should *not* rely on Dr. Zepp's restatement of Staff's constant growth DCF estimate because Dr. Zepp relies solely on analysts' forecast which causes inflated growth, thus, inflated cost of equity estimates.

The Commission should *not* rely on Dr. Zepp's restatement of Staff's multi-stage DCF estimate because Dr. Zepp misapplies Staff's br growth projections, and his assumptions are speculative.

The Commission should *not* rely on interest rate "projections" made by professional analysts because "the direction of interest rates cannot be predicted any better than by a flip of a coin." Analysts who project interest rates do not have any more information than what is already reflected in the current rate.

The Commission should *not* rely on Dr. Zepp's restatement of Staff's CAPM estimate because Dr. Zepp incorrectly uses the forecast of long-term treasury bond as his risk-free rate which results on upwardly biased estimates.

The "risk premium" analysis presented by Dr. Zepp should be rejected because (1) it relies on analysts' forecasts of future interest rates, and (2) it relies on past accounting returns on equity and past authorized returns on equity which cannot be meaningfully compared to the cost of equity.

Dr. Zepp's proposal for additional basis points due to unique risk should be rejected because it is (1) inconsistent with financial theory, and (2) Dr. Zepp has not demonstrated that these risks affect the cost of equity for Arizona Water.

Dr. Zepp's assumption that the spread between the cost of Arizona Water's last bond issue and A-rated/AA-rated bonds is due to business risk is unreasonable. The likely cause of this spread is default risk or liquidity risk, neither of which increase Arizona Water's cost of equity.