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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
UTILITY SOURCE, L.L.C. FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PROPERTY AND
FOR AN INCREASE IN ITS WATER AND
WASTEWATER RATES AND CHARGES FOR
UTILITY SERVICES.

DOCKET NO. WS-04235A-06-0303

**NOTICE OF FILING
SURREBUTTAL TESTIMONY**

Staff of the Arizona Corporation Commission hereby files the Surrebuttal Testimony of
Jeffrey M. Michlik and Steven P. Irvine of the Utilities Division, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 19th day of March, 2007.

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Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

MAR 19 2007

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28


SURREBUTTAL

TESTIMONY

OF

JEFFREY M. MICHLIK

STEVEN P. IRVINE

DOCKET NO. WS-04235A-06-0303

**IN THE MATTER OF THE APPLICATION OF
UTILITY SOURCE, L.L.C. FOR A
DETERMINATION OF THE CURRENT FAIR
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MARCH 19, 2007

BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. WS-04235A-06-0303
UTILITY SOURCE, L.L.C. FOR A)
DETERMINATION OF THE CURRENT FAIR)
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FOR AN INCREASE IN ITS WATER AND)
WASTEWATER RATES AND CHARGES FOR)
UTILITY SERVICES.)
_____)

SURREBUTTAL

TESTIMONY

OF

JEFFREY M. MICHLIK

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MARCH 19, 2007

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EXECUTIVE SUMMARY
UTILITY SOURCE, LLC-WATER DIVISION
DOCKET NO. W-04235A-06-0303

Staff's surrebuttal testimony recommends revised rates that would increase operating revenues by \$192,688 to produce operating revenues of \$367,015 resulting in operating income of \$171,466, or a 110.53 percent increase over test year revenues of \$174,327. Staff also recommends a revised fair value rate base of \$2,752,271.

Revenue Requirement

Staff responds to the Company's rescission of its proposal to include 350 projected customer homes in the rate application, and Staff's attempt to alleviate rate shock.

Rate Base

Staff further comments on why the Company chose to rescind its proposal based on Staff's adjustments to rate base, and why Staff has now decided to include a deep well. In addition, Staff responds to the Company's adjustment to accumulated amortization of contributions in aid of construction ("CIAC").

Income Statement

Staff responds to the Company's unfounded and incorrect assertions regarding why Staff originally accepted the Company's proposal.

Rate of Return on Rate Base

Staff explains why it recommends a downward adjustment to the Company's rate of return on rate base, and the benefits it will have on current and future rate payers.

Rate Design

Staff recommends and comments on the new rate design.

1 **INTRODUCTION**

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

3 A. My name is Jeffrey M. Michlik. I am a Public Utilities Analyst V 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. Are you the same Jeffrey M. Michlik who filed direct testimony in this case?**

8 A. Yes, I am.
9

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

11 A. The purpose of my surrebuttal testimony in this proceeding is to provide Staff's response
12 to the rebuttal testimony of Utility Source, LLC ("Company") witness, Mr. Thomas J.
13 Bourassa, regarding revenue requirement, rate base, operating revenues and expenses, and
14 rate design.
15

16 **Q. Please explain how Staff's surrebuttal testimony is organized.**

17 A. Staff's surrebuttal testimony is generally organized to present issues in the same sequence
18 as presented in Mr. Bourassa's rebuttal testimony.
19

20 **Q. Does Staff's lack of response to a particular issue mean it is accepting the Company's
21 position on that issue?**

22 A. No. Staff's lack of response to any issue in this surrebuttal testimony should not be
23 construed as agreement with the Company's rebuttal testimony; rather, where there is no
24 response, Staff relies on its original direct testimony.

1 **RESPONSE TO MR. THOMAS J. BOURASSA'S REBUTTAL TESTIMONY**

2 **Revenue Requirement**

3 **Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding revenue**
4 **requirement?**

5 A. Yes.

6
7 **Q. Please summarize the proposed and recommended revenue requirement, revenue**
8 **increase, and percentage increase.**

9 A. The proposed and recommended revenue requirement, revenue increase, and percentage
10 increase are as follows:

11
12

| | <u>Revenue Requirement</u> | <u>Revenue Increase</u> | <u>Percentage Increase</u> |
|----------------------|----------------------------|-------------------------|----------------------------|
| 13 Company-Direct | \$575,955 | \$401,245 | 230.17 percent |
| 14 Staff-Direct | \$367,449 | \$193,122 | 110.78 percent |
| 15 Company-Rebuttal | \$382,187 | \$291,420 | 321.06 percent |
| 16 Staff-Surrebuttal | \$367,015 | \$192,688 | 110.53 percent |

17

18 **Q. What has the Company changed since it filed its direct testimony?**

19 A. The Company now wants to rescind its proposal to include 350 future customer homes in
20 the rate application. See Rebuttal Testimony of Thomas J. Bourassa ("Bourassa RT") at 2.
21 This results in an elimination of pro forma revenue in the amount of \$83,560 from
22 adjusted test year revenues of \$277,740. In an effort to alleviate rate shock to current and
23 future customers, as originally proposed by the Company, Staff will accept the Company's
24 counter proposal to include some plant in service that it would ordinarily not accept, (as
25 explained in Staff's direct testimony), and as a result will include the pro forma revenues
26 in the amount of \$83,560. See Staff Surrebuttal Schedule W-4.

1 **Q. Why does the Company now want to rescind its proposal?**

2 A. Staff recommended that the Company's original cost rate base ("OCRB"), which in this
3 case is equal to the fair value rate base ("FVRB"), be reduced by \$1,025,721. This
4 triggered the Company's decision to rescind its revenue proposal of including 350 future
5 customers. *See* Bourassa RT at 5.

6

7 **Q. Was the Company's original offer in the application to include the 350 future**
8 **customers unusual?**

9 A. Yes, as stated in Staff's direct testimony. *See* Direct Testimony of Jeffrey M. Michlik
10 ("Michlik DT") at 15.

11

12 **Q. Did Staff accept the Company's original proposal to include these 350 future**
13 **customers?**

14 A. Yes, *See* Michlik DT at 17.

15

16 **Q. Why did Staff accept the Company's original proposal?**

17 A. As stated in Staff's direct testimony, the Company was willing to ameliorate rate shock to
18 its current and future customers by including these 350 customers in its pro forma revenue
19 and rate design, and as a result Staff was willing to accept the Company's original
20 proposal.

21

22 **Q. Now that the Company has withdrawn its original proposal in its rebuttal testimony,**
23 **what is Staff's position?**

24 A. Staff's position is unchanged from its direct testimony, other than Staff will accept the
25 Company's proposal to include some plant (Deep Well #4) in service that Staff did not
26 include in its direct testimony.

1 **Rate Base**

2 **Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding rate base?**

3 A. Yes.

4
5 **Q. Would Staff please identify each party's respective rate base recommendations?**

6 A. Yes. The rate bases proposed and recommended by all parties in the case are as follows:

7
8

| | <u>OCRB</u> | <u>FVRB</u> |
|----------------------|-------------|-------------|
| 9 Company-Direct | \$3,079,513 | \$3,079,513 |
| 10 Staff-Direct | \$2,048,228 | \$2,048,228 |
| 11 Company-Rebuttal | \$2,053,792 | \$2,053,792 |
| 12 Staff-Surrebuttal | \$2,752,271 | \$2,752,271 |

13

14 **Q. Why has Staff increased its rate base by \$704,043, from \$2,048,228 in the direct**
15 **testimony filed to \$2,752,271 in the surrebuttal testimony?**

16 A. Staff, after reviewing the Company's rebuttal testimony, has increased the rate base in
17 order to match rate base with customers, i.e., include the future well that will serve the
18 future customers as proposed by the Company.

19
20 **Q. In the Company's rebuttal testimony it now appears that the Company wants to**
21 **rescind its proposal to include 350 customers in its application. Is that correct?**

22 A. Yes, the Company now states that "This growth may not materialize for several years
23 especially given that the housing sector has experienced a significant downturn in the past
24 year or so. By excluding plant from rate base which is necessary to serve future growth,
25 the risk to the Company is greatly magnified and which the Company is not willing to
26 accept. If Staff is not going to acknowledge those plant additions, the customers to be
27 served by that plant must also be excluded." See Bourassa RT at 2.

1 **Q. Can you please elaborate on this?**

2 A. Yes, Staff made \$961,229 in adjustments (reductions) to plant in service, of this amount
3 \$224,646 deals with costs that are misclassified or double counted, which the Company
4 does not dispute. The remaining balance of \$736,583, is related to Deep Well # 4, and
5 was found not to be used and useful in the test year. It is because of this adjustment that
6 the Company now wants to rescind its proposal to include the future growth of the 350
7 customers as summarized below:

8
9 “The well is functional and is being used to conduct certain ADWR required tests, but it is
10 not interconnected to the system. Therefore, the Company does not disagree with Staff.
11 However, Deep Well # 4 is necessary to serve the future growth of the 350 customers. As
12 I previously testified, because this plant has been excluded from rate base at this time, the
13 Company is no longer proposing pro forma revenues for the future growth in the
14 determination of the revenue requirement and rate increase.” *See Bourassa RT at 4.*

15
16 **Q. Is Staff willing to accept the Company’s rebuttal argument that it should be allowed
17 to include deep well # 4 in rate base, as the future growth of the 350 customers in the
18 water division depends on this well?**

19 A. Yes. This adjustment is shown on Surrebuttal Schedule JMM-W4.

20
21 **Q. Staff usually does not include in rate base, plant that is not used and useful in the test
22 year. Why is this case any different?**

23 A. Staff would not normally include in rate base, plant that is not used and useful in the test
24 year. However, as mentioned earlier as a benefit to current and future ratepayers in this
25 case, and as an attempt to ameliorate rate shock; Staff has decided to accept the

1 Company's offer. The results of these benefits will be clearly explained in the rate design
2 section.

3

4 **Q. Does Staff agree that Deep Well # 4 is needed to service the additional 350 future**
5 **customers?**

6 A. Yes, according to Staff's Engineer the Company will need this well to service the 350
7 future customers. As the Company will need this well to service the future 350 customers,
8 and Staff is including the revenue from these 350 customers, it is logical that we include
9 this amount in rate base.

10

11 **Q. Since this is a combined water and wastewater case did the Company also make a**
12 **similar proposal in its direct testimony for the wastewater division?**

13 A. Yes, the proposal is identical to the water division, in which the Company proposed to
14 include future growth of 350 customers.

15

16 **Q. Does the Company still continue to propose to include future growth of 350**
17 **customers for the wastewater division?**

18 A. Yes, the Company comments that "At this stage of the proceeding the Company has not
19 changed its position on including pro forma revenues in the determination of the revenue
20 requirement and rate increase for the sewer division. Unlike the water division, the
21 wastewater division presently has capacity that will serve at least a portion of the demand
22 from those 350 customers." *See Bourassa RT at 9.*

23

24 **Q. So, if you include these 350 customers in the wastewater division, is it logical to**
25 **include these 350 customers in the water division?**

26 A. Yes.

1 **Q. Mr. Bourassa states that accumulated amortization of Contributions in Aid of**
2 **Construction (“CIAC”) should be increased to reflect 2 years of amortization. See**
3 **Bourassa RT at 6. Does Staff accept this number?**

4 A. Yes. However, the amount will differ due to Staff’s CIAC amortization rate which is
5 calculated from the plant in service depreciation composite rate. Staff’s adjustment
6 decreases accumulated amortization by \$500, from \$16,694 to \$16,194 as the associated
7 accumulated amortization should include 2 years of amortization (using a ½ year
8 convention) starting in 2004. This adjustment is shown on Surrebuttal Schedule JMM-
9 W6.

10
11 **Income Statement**

12 **Q. Has Staff reviewed Mr. Bourassa’s rebuttal testimony regarding the income**
13 **statement?**

14 A. Yes.

15
16 **Q. Please comment on Mr. Bourassa’s statement that Staff’s acceptance of the**
17 **Company’s direct proposal to include the 350 projected customers is justified in**
18 **order to further penalize the Company? See Bourassa RT at 9.**

19 A. This statement is unfounded and incorrect. If you read through the direct testimony
20 submitted, Staff specifically states throughout its testimony that it has accepted the
21 **Company’s proposal to alleviate the rate burden on customers**, as shown below:

22
23 “Staff, in an *effort to alleviate the rate burden on customers*, has accepted the
24 **Company’s proposal** and will include estimated usage of 350 homes that are currently
25 being built, in the rate design” See Michlik DT in the Executive Summary.

1 “Why is Staff accepting these projected numbers? The numbers submitted by the
2 Company are known projects currently under development and assume that the homes will
3 be built. The **Company has provided these numbers in an effort to minimize the**
4 **impact on the rates** and is not intended to set any precedent for this or any other utility
5 regulated by the Commission.” See Michlik DT at 11.

6
7 “In an effort to lessen the rate impact on customers, **the Company in its rate application**
8 **proposed including 350 homes that are currently being built.** Staff accepted the
9 Company’s proposal and has included these 350 customers in the rate design *in order to*
10 *ameliorate the rate shock that current and future customers will experience.*” See Michlik
11 DT at 17.

12
13 **Rate of Return on Rate Base**

14 **Q. Why is Staff recommending a required rate of return/cost of capital of 6.23 percent**
15 **in the water division instead of 8.9 percent as it is in the wastewater division?**

16 A. In order to be consistent between the water and wastewater customer bases and rate bases
17 and in Staff’s effort to ameliorate rate shock to customers recommends a lower rate of
18 return for the water division.

19
20 **Q. Does Staff believe that a rate of return/cost of capital of 8.9 percent is appropriate?**

21 A. Yes, as was calculated by Staff witness Steve Irvine. However, in this case, for the
22 reasons as previously described, Staff believes the fair value rate of return for the water
23 division should be 6.23%.

1 **Q. Is this an attempt to penalize the Company?**

2 A. No, the Company has already been fined for its violations of Commission requirements.
3 However, Staff believes that allowing the Company to receive a larger increase on the
4 water division than is recommended by Staff would not only allow it to benefit from its
5 violations, but would also penalize its captive customers.

6

7 **Q. If Staff is recommending a rate of return on rate base of 8.9 percent for the sewer
8 division, isn't this inconsistent?**

9 A. No, by using a 8.9 percent rate of return on rate base, this produced a required increase in
10 revenue of 96.70 percent in the wastewater division. In the water division Staff was able
11 to use a 6.23 percent rate of return on rate base to produce a required increase in revenue
12 of 110.53 percent.

13

14 **Q. How did Staff arrive at the 6.23 percent rate of return and the 110.53 increase in
15 revenue?**

16 A. Staff in an effort to be consistent with its direct testimony, wanted to produce a revenue
17 requirement and rates that were similar to the direct testimony. In Staff's direct testimony
18 we produced a required increase in revenue of 110.78 percent and similar rates.

19

20 **Q. So you are stating that Staff reduced its rate of return on rate base to 6.23 percent to
21 make the required increase in revenue similar to the wastewater division and the
22 ultimate increase to be passed on to rate payers similar for both divisions. Is this
23 correct?**

24 A. Yes.

1 **Q. If Staff lowers the rate of return on rate base for the water company, will it have**
2 **enough money to operate?**

3 A. Yes, the operating margin for the water division is 47 percent, and operating margin for
4 the sewer division is 41 percent.

5
6 **Q. Are there any other reasons why Staff has decided to lower the rate of return on rate**
7 **base?**

8 A. Yes, taking a step back Staff believes this case is a hybrid somewhere between a
9 Certificate of Convenience and Necessity case and a regular rate case, due to the unusual
10 circumstances in this case, in which the Company began operating with rates not approved
11 by the Commission and the Commission requiring the Company to file a rate application
12 using a 2005 test year.

13
14 **Q. Did the Commission make any comments about the rates Staff recommended in the**
15 **prior CC&N case?**

16 A. Yes, Staff recommended a monthly minimum rate of \$24.37 which is 24 percent higher
17 than the monthly minimum rate of \$18.50 that Staff is currently recommending. The
18 Commission commented that "the approval of such rates in this proceeding would result in
19 an unconscionable increase for existing customers." *See* Decision no. 67446 at 16.

20
21 **Q. Has Staff used other means than rate of return on rate base to calculate the revenue**
22 **requirement in other rate cases?**

23 A. Yes, Staff has used operating margin, cash flows, and Water Infrastructure Financing
24 Authority loan amounts to recommend revenue requirements for companies.

1 **Q. Has an Administrative Law Judge or the Commission ever reduced a Company's**
2 **rate of return on rate base?**

3 A. Yes.
4

5 **Q. You have mentioned that Staff's water rate proposal takes into account gradualism,**
6 **benefits to the customers and the idea that the Company should not benefit from past**
7 **violations. Please explain.**

8 A. Staff will present three scenarios' below, which will demonstrate why Staff's
9 recommendation is the most fair to the rate payers, following the principles of gradualism.

10
11 Under scenario one, which Staff recommends, Staff includes the pro forma revenue,
12 includes Deep Well # 4, and includes the 350 future customers in rate design, but reduces
13 the rate of return on rate base from 8.9 percent to 6.23 percent. *See* Staff Surrebuttal
14 Schedule JMM-W1. The results are a monthly minimum charge of \$18.50 for a ¾-inch
15 residential customer. *See* Staff Surrebuttal Schedule JMM-W12. The median usage of
16 residential ¾-inch meter customers is 4,500 gallons per month. The ¾-inch meter
17 residential customer would experience a \$22.07 or 114.83 percent increase in his/her
18 monthly bill from \$19.22 to \$41.28 under Staff's recommended rates. *See* Staff
19 Surrebuttal Schedule JMM-W13

20
21 Under scenario two, Staff includes the pro forma revenue, includes Deep Well # 4, and
22 includes the 350 future customers in rate design, and uses an 8.9 percent rate of return on
23 rate base. *See* Staff Surrebuttal Schedule JMM-W14. The results are a monthly minimum
24 charge of \$23.00 for a ¾-inch residential customer. *See* Staff Surrebuttal Schedule JMM-
25 W15. The ¾-inch meter residential customer would experience a \$30.53 or 158.86

1 percent increase in his/her monthly bill from \$19.22 to \$49.74 under Staff's recommended
2 rates. *See* Staff Surrebuttal Schedule JMM-W16.

3
4 Under scenario three, which the Company proposes in its rebuttal testimony, Staff
5 eliminates the pro forma revenue, does not include Deep Well # 4, and excludes the 350
6 future customers in rate design, and uses an 8.9 percent rate of return on rate base. *See*
7 Staff Surrebuttal Schedule JMM-W17. The results are a monthly minimum charge of
8 \$34.00 for a ¾-inch residential customer. *See* Staff Surrebuttal Schedule JMM-W18. The
9 ¾-inch meter residential customer would experience a \$55.80 or 290.37 percent increase
10 in his/her monthly bill from \$19.22 to \$75.01 under Staff's recommended rates. *See* Staff
11 Surrebuttal Schedule JMM-W19.

12
13 Staff believes the above clearly demonstrates that Staff's proposal is the most fair to
14 customers while still providing sufficient revenues and a fair rate of return to the
15 Company.

16
17 **Rate Design**

18 **Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding rate design?**

19 A. Yes.

20
21 **Q. Please restate the Company's and Staff's proposed and recommended monthly**
22 **minimum rates.**

23 A. In the Company's rebuttal testimony it proposes a monthly minimum charge of \$35.74 for
24 ¾-inch meter residential customers. Staff has recommended a monthly charge of \$18.50
25 for ¾-inch meter residential customers. *See* Staff Surrebuttal Schedule JMM-W12.

1 **Q. What is the rate impact on a ¾-inch meter residential customer using a median**
2 **consumption of 4,500 gallons?**

3 A. The median usage of residential ¾-inch meter customers is 4,500 gallons per month. The
4 ¾-inch meter residential customer would experience a \$59.73 or 310.82 percent increase
5 in his/her monthly bill from \$19.22 to \$78.94 under the Company's proposed rates and a
6 \$22.07 or 114.83 percent increase in his/her monthly bill from \$19.22 to \$41.28 under
7 Staff's recommended rates. *See* Staff Surrebuttal Schedule JMM-W13
8

9 **Q. Do you have any other comments or disagreements with the Company on rate**
10 **design?**

11 A. Yes, the Company now proposes "that the irrigation class of customers also have an
12 inverted tier design consistent with the other customer classes." *See* Bourassa RT at 13.
13

14 **Q. Does Staff agree with the Company's proposal?**

15 A. No, customarily irrigation customers are typically made up of agriculture and ranching
16 interests and have been treated similar to other bulk water users such as standpipe and
17 construction customers. In this case, the Company first proposed a flat rate for its
18 irrigation customers of \$9.26, which Staff accepted. The Company now wants to change
19 the irrigation class of customers from a flat rate to a tier rate design, but gave no
20 explanation. Therefore, Staff continues to believe that the original Company proposed
21 rate is the most appropriate for this customer class.
22

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

24 A. Yes, it does.

REVENUE REQUIREMENT

| LINE NO. | DESCRIPTION | (A) COMPANY REBUTTAL COST | (C) COMPANY REBUTTAL FAIR VALUE | (D) STAFF SURREBUTTAL COST | (E) STAFF SURREBUTTAL FAIR VALUE |
|----------|---------------------------------------|------------------------------------|---|-------------------------------------|--|
| 1 | Adjusted Rate Base | \$ 2,052,792 | \$ 2,052,792 | \$ 2,752,271 | \$ 2,752,271 |
| 2 | Adjusted Operating Income (Loss) | \$ (75,772) | \$ (75,772) | \$ (21,222) | \$ (21,222) |
| 3 | Current Rate of Return (L2 / L1) | -3.69% | -3.69% | -0.77% | -0.77% |
| 4 | Required Rate of Return | 10.50% | 10.50% | 6.23% | 6.23% |
| 5 | Required Operating Income (L4 * L1) | \$ 215,543 | \$ 215,543 | \$ 171,466 | \$ 171,466 |
| 6 | Operating Income Deficiency (L5 - L2) | \$ 291,420 | \$ 291,420 | \$ 192,688 | \$ 192,688 |
| 7 | Gross Revenue Conversion Factor | 1.0000 | 1.0000 | 1.0000 | 1.0000 |
| 8 | Required Revenue Increase (L7 * L6) | \$ 291,420 | \$ 291,420 | \$ 192,688 | \$ 192,688 |
| 9 | Adjusted Test Year Revenue | \$ 90,767 | \$ 90,767 | \$ 174,327 | \$ 174,327 |
| 10 | Proposed Annual Revenue (L8 + L9) | \$ 382,187 | \$ 382,187 | \$ 367,015 | \$ 367,015 |
| 11 | Required Increase in Revenue (%) | 321.06% | 321.06% | 110.53% | 110.53% |
| 12 | Rate of Return on Rate Base (%) | 10.50% | 10.50% | 6.23% | 6.23% |

References:

Column (A): Company Rebuttal Schedule B-1
Column (B): Company Rebuttal Schedule B-1
Column (C): Staff Surrebuttal Schedules JMM-W2, JMM-W7
Column (D): Staff Surrebuttal Schedules JMM-W2, JMM-W7

RATE BASE - ORIGINAL COST

| LINE NO. | (A) COMPANY REBUTTAL AS FILED | (B) STAFF SURREBUTTAL ADJUSTMENTS | REF | (C) STAFF SURREBUTTAL AS ADJUSTED |
|--------------|---|--|---------|---|
| 1 | \$ 2,458,236 | \$ 736,583 | ADJ # 1 | \$ 3,194,819 |
| 2 | 127,392 | 36,605 | ADJ # 2 | 163,997 |
| 3 | <u>\$ 2,330,844</u> | <u>\$ 699,978</u> | | <u>\$ 3,030,822</u> |
| <u>LESS:</u> | | | | |
| 4 | \$ 294,745 | \$ - | | \$ 294,745 |
| 5 | 16,694 | (500) | ADJ # 3 | 16,194 |
| 6 | <u>278,051</u> | <u>500</u> | | <u>278,551</u> |
| 7 | - | - | | - |
| 8 | - | - | | - |
| 9 | - | - | | - |
| <u>ADD:</u> | | | | |
| 10 | - | - | | - |
| 11 | - | - | | - |
| 12 | - | - | | - |
| 13 | <u>\$ 2,052,793</u> | <u>\$ 699,478</u> | | <u>\$ 2,752,271</u> |

References:

Column (A), Company Rebuttal Schedule B-1
Column (B): Surrebuttal Schedule JMM-W3
Column (C): Column (A) + Column (B)

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

| LINE NO. | ACCT. NO. | DESCRIPTION | (A) COMPANY REBUTTAL AS FILED | (B) STAFF PLANT IN SERVICE ADJ. NO. 1 | (C) STAFF SURREBUTTAL ACCUM DEPREC ADJ. NO. 2 | (D) STAFF SURREBUTTAL AIAC TO CIAC ADJ. NO. 3 | (E) STAFF SURREBUTTAL ADJUSTED |
|--------------------------|-----------|---|--|--|---|---|---|
| PLANT IN SERVICE: | | | | | | | |
| 1 | | | \$ | | | | |
| 2 | 301 | Organization | - | - | - | - | - |
| 3 | 302 | Franchises | - | - | - | - | - |
| 4 | 303 | Land and Land Rights | 210,000 | - | - | - | 210,000 |
| 5 | 304 | Structures & Improvements | 72,998 | - | - | - | 72,998 |
| 6 | 305 | Collecting & Impounding Reservoirs | - | - | - | - | - |
| 7 | 306 | Lakes, Rivers, Other Intakes | - | - | - | - | - |
| 8 | 307 | Wells and Springs | 1,335,238 | 736,583 | - | - | 2,071,821 |
| 9 | 308 | Infiltration Galleries and Tunnels | - | - | - | - | - |
| 10 | 309 | Supply Mains | - | - | - | - | - |
| 11 | 310 | Power Generation Equipment | 87,400 | - | - | - | 87,400 |
| 12 | 311 | Pumping Equipment | 157,711 | - | - | - | 157,711 |
| 13 | 320 | Water Treatment Plant | 5,487 | - | - | - | 5,487 |
| 14 | 330 | Distribution Reservoirs & Standpipes | 321,452 | - | - | - | 321,452 |
| 15 | 331 | Transmission & Distribution Mains | 147,200 | - | - | - | 147,200 |
| 16 | 333 | Services | 86,250 | - | - | - | 86,250 |
| 17 | 334 | Meters | - | - | - | - | - |
| 18 | 335 | Hydrants | 34,500 | - | - | - | 34,500 |
| 19 | 336 | Backflow Prevention Devices | - | - | - | - | - |
| 20 | 339 | Other Plant & Misc. Equipment | - | - | - | - | - |
| 21 | 340 | Office Furniture & Equipment | - | - | - | - | - |
| 22 | 341 | Transportation Equipment | - | - | - | - | - |
| 23 | 342 | Stores Equipment | - | - | - | - | - |
| 24 | 343 | Tools, Ship & Garage Equipment | - | - | - | - | - |
| 25 | 344 | Laboratory Equipment | - | - | - | - | - |
| 26 | 345 | Power Operated Equipment | - | - | - | - | - |
| 27 | 346 | Communication Equipment | - | - | - | - | - |
| 28 | 347 | Miscellaneous Equipment | - | - | - | - | - |
| 29 | 348 | Other Tangible Plant | - | - | - | - | - |
| 30 | | | 2,458,236 | 736,583 | - | - | 3,194,819 |
| 31 | Add: | | | | | | |
| 32 | | | | | | | |
| 33 | | | | | | | |
| 34 | | | | | | | |
| 35 | Less: | | | | | | |
| 36 | | | | | | | |
| 37 | | | | | | | |
| 38 | | | | | | | |
| 39 | | Total Plant in Service | \$ 2,458,236 | \$ 736,583 | \$ - | \$ - | \$ 3,194,819 |
| 40 | | Less: Accumulated Depreciation | 127,392 | - | 36,605 | - | 163,997 |
| 41 | | Net Plant in Service (L59 - L 60) | \$ 2,330,844 | \$ 736,583 | \$ (36,605) | \$ - | \$ 3,030,822 |
| 42 | | | | | | | |
| 43 | | | | | | | |
| 44 | LESS: | | | | | | |
| 45 | | Contributions in Aid of Construction (CIAC) | | | | | |
| 46 | | Less: Accumulated Amortization | 294,745 | - | - | (500) | 294,745 |
| 47 | | Net CIAC (L25 - L26) | 16,994 | - | - | 500 | 16,194 |
| 48 | | Advances in Aid of Construction (AIAC) | 278,051 | - | - | - | 278,051 |
| 49 | | Customer Meter Deposits | - | - | - | - | - |
| 50 | | Deferred Income Tax Credits | - | - | - | - | - |
| 51 | | | | | | | |
| 52 | ADD: | | | | | | |
| 53 | | Unamortized Finance Charges | - | - | - | - | - |
| 54 | | Deferred Tax Assets | - | - | - | - | - |
| 55 | | Working Capital | - | - | - | - | - |
| 56 | | | | | | | |
| 57 | | Original Cost Rate Base | \$ 2,052,793 | \$ 736,583 | \$ (36,605) | \$ (500) | \$ 2,752,271 |

| ADJ.# | Plant in Service | Accumulated Depreciation | AIAC Reclassification to CIAC | Surrebuttal Schedule JMM-W4 | Surrebuttal Schedule JMM-W5 | Surrebuttal Schedule JMM-W6 |
|-------|------------------|--------------------------|-------------------------------|-----------------------------|-----------------------------|-----------------------------|
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |

References:

RATE BASE ADJUSTMENT NO. 1 - PLANT ADJUSTMENTS

| LINE NO. | DESCRIPTION | [A] | [B] | [C] |
|----------|---|---------------------------|-------------------------------|-------------------------------|
| | | COMPANY REBUTTAL AS FILED | STAFF SURREBUTTAL ADJUSTMENTS | STAFF SURREBUTTAL AS ADJUSTED |
| 1 | Wells and Springs (Account 307) | \$ 1,335,238 | \$ 736,583 | \$ 2,071,821 |
| 2 | <u>Staff's Calculation of Wells and Springs (Account 307)</u> Staff's inclusion of Deep Well # 4 | \$ 736,583 | | |

References:

Column A: Company Rebuttal Schedule B-1, Page 1
 Column B: Testimony, JMM, Surrebuttal Schedule JMM-W3
 Column C: Column [A] + Column [B]

RATE BASE ADJUSTMENT NO. 2 - ACCUMULATED DEPRECIATION

| LINE NO. | DESCRIPTION | [A] COMPANY AS FILED | [B] STAFF ADJUSTMENTS | [C] STAFF AS ADJUSTED |
|----------|--------------------------|-------------------------|--------------------------|--------------------------|
| 1 | Accumulated Depreciation | \$ 127,392 | \$ 36,605 | \$ 163,997 |

| ACCT NO. | DESCRIPTION | AT ENGINEER RECOMMENDED RATES | | | | AD 12/31/2004 | AD 12/31/2005 | RETIREMENTS 12/31/2005 | PLT BAL 12/31/2005 | DEP EXP FULL YR 12/31/2005 | A/D 12/31/2005 |
|----------|---|---------------------------------------|------------------|----------------|----------------|---------------|---------------|------------------------|--------------------|----------------------------|----------------|
| | | Total Plant Staff Adjusted 12/31/2004 | Recommended Rate | HALF YEAR DEP. | A/D 12/31/2004 | | | | | | |
| 2 | 301 Organization Cost | - | - | - | - | - | - | - | - | - | - |
| 3 | 302 Franchise Cost | - | - | - | - | - | - | - | - | - | - |
| 4 | 303 Land & Land Rights | 210,000 | - | - | - | 210,000 | - | - | 210,000 | - | - |
| 5 | 304 Structures & Improvements | 72,998 | 3.33% | 1,215 | 1,215 | 72,998 | - | - | 72,998 | 2,431 | 3,646 |
| 6 | 307 Wells & Springs | 2,071,821 | 3.33% | 34,496 | 34,496 | 2,071,821 | - | - | 2,071,821 | 68,992 | 103,487 |
| 7 | 310 Power Generation Equipment | 87,400 | 5.00% | 2,185 | 2,185 | 87,400 | - | - | 87,400 | 4,370 | 6,555 |
| 8 | 311 Electric Pumping Equip. | 157,711 | 12.50% | 9,857 | 9,857 | 157,711 | - | - | 157,711 | 19,571 | 29,571 |
| 9 | 320 Water Treatment Equipment | 5,487 | 3.33% | 91 | 91 | 5,487 | - | - | 5,487 | 183 | 274 |
| 10 | 320.1 Water Treatment Plants | - | 3.33% | - | - | - | - | - | - | - | - |
| 11 | 320.2 Solution Chemicals Feeders | - | 20.00% | - | - | - | - | - | - | - | - |
| 12 | 330 Distribution Reservoirs | 321,452 | 2.22% | 3,568 | 3,568 | 321,452 | - | - | 321,452 | 7,136 | 10,704 |
| 13 | 330.1 Storage Tanks | - | 2.22% | - | - | - | - | - | - | - | - |
| 14 | 330.2 Pressure Tanks | - | 5.00% | - | - | - | - | - | - | - | - |
| 15 | 331 Transmission & Distribution-Mains | 147,200 | 2.00% | 1,472 | 1,472 | 147,200 | - | - | 147,200 | 2,944 | 4,416 |
| 16 | 333 Services | 86,250 | 3.33% | 1,436 | 1,436 | 86,250 | - | - | 86,250 | 2,872 | 4,308 |
| 17 | 334 Meters | - | 8.33% | - | - | - | - | - | - | - | - |
| 18 | 335 Hydrants | 34,500 | 2.00% | 345 | 345 | 34,500 | - | - | 34,500 | 690 | 1,035 |
| 19 | 336 Backflow Preventors | - | 6.67% | - | - | - | - | - | - | - | - |
| 20 | 339 Other Plant and Miscellaneous Equipment | - | 6.67% | - | - | - | - | - | - | - | - |
| 21 | 340 Office Furniture & Equip. | - | 6.67% | - | - | - | - | - | - | - | - |
| 22 | 341 Transportation Equip. | - | 20.00% | - | - | - | - | - | - | - | - |
| 23 | 343 Tools and Work Equipment | - | 5.00% | - | - | - | - | - | - | - | - |
| 24 | 344 Laboratory Equipment | - | 10.00% | - | - | - | - | - | - | - | - |
| 25 | 345 Power Operated Equipment | - | 5.00% | - | - | - | - | - | - | - | - |
| 26 | 346 Communications Equipment | - | 10.00% | - | - | - | - | - | - | - | - |
| 27 | 347 Miscellaneous Equipment | - | 10.00% | - | - | - | - | - | - | - | - |
| 28 | 348 Other Tangible Plant | - | - | - | - | - | - | - | - | - | - |
| 29 | 350.1 OFI Engineering and Planning | - | 3.33% | - | - | - | - | - | - | - | - |
| 30 | 350.2 OFI Well Site | - | 3.33% | - | - | - | - | - | - | - | - |
| 31 | 105 Materials and Supplies Inventory | - | - | - | - | - | - | - | - | - | - |
| Totals | | 3,194,819 | - | 54,666 | 54,666 | 3,194,819 | - | - | 3,194,819 | 109,331 | 163,997 |

CIAC Composite Rate 3.6629% Non Depreciable Plant 2,984,819

References:
 Column A: Company Rebuttal Schedule B-1, Page 1
 Column B: Testimony, JMM, Surrebuttal Schedule JMM-W3
 Column C: Column [A] + Column [B]

RATE BASE ADJUSTMENT NO. 3 - RECLASSIFICATION OF AIAC TO CIAC

| LINE NO. | DESCRIPTION | [A] | [B] | [C] |
|-------------------------------------|--|------------------|-------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Accumulated Amortization of CIAC | \$ 16,694 | \$ (500) | \$ 16,194 |
| <u>Staff's amortization of CIAC</u> | | | | |
| 2 | Amortization of CIAC: | | \$ 294,745 | |
| 3 | Composite amortization rate (see JMM-WW5): | | 3.6629% | |
| 4 | Amortized CIAC for test year: | | \$ 10,796 | |
| 5 | Plus prior year amortization (using 1/2 year convention) | | \$ 5,398 | |
| 6 | Accumulated Amortization of CIAC | | \$ 16,194 | |

References:

- Column A: Company Rebuttal Schedule B-1, Page 1
- Column B: Testimony, JMM, Surrebuttal Schedule JMM-W3
- Column C: Column [A] + Column [B]

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

| LINE NO. | DESCRIPTION | [A] COMPANY REBUTTAL ADJUSTED TEST YEAR AS FILED | [B] STAFF SURREBUTTAL TEST YEAR ADJUSTMENTS | | [C] STAFF SURREBUTTAL TEST YEAR AS ADJUSTED | [D] STAFF SURREBUTTAL PROPOSED CHANGES | [E] STAFF SURREBUTTAL RECOMMENDED |
|----------|--|---|---|---------|--|--|--|
| 1 | REVENUES: | | | | | | |
| 2 | Metered Water Sales | \$ 89,110 | \$ 83,560 | Adj # 1 | \$ 172,670 | \$ 192,688 | \$ 365,358 |
| 3 | Water Sales - Unmetered | - | - | | - | - | - |
| 4 | Other Operating Revenue | 1,657 | - | | 1,657 | - | 1,657 |
| 5 | Total Operating Revenues | <u>\$ 90,767</u> | <u>\$ 83,560</u> | | <u>\$ 174,327</u> | <u>\$ 192,688</u> | <u>\$ 367,015</u> |
| | OPERATING EXPENSES: | | | | | | |
| 6 | Salaries and Wages | \$ - | \$ - | | \$ - | \$ - | \$ - |
| 7 | Purchased Water | \$ - | - | | - | - | - |
| 8 | Purchased Power | \$ 36,292 | - | | 36,292 | - | 36,292 |
| 9 | Chemicals | \$ - | - | | - | - | - |
| 10 | Repairs and Maintenance | \$ 8,747 | - | | 8,747 | - | 8,747 |
| 11 | Office Supplies and Expense | \$ 4,292 | - | | 4,292 | - | 4,292 |
| 12 | Outside Services | \$ 12,428 | - | | 12,428 | - | 12,428 |
| 13 | Water Testing | \$ 2,446 | - | | 2,446 | - | 2,446 |
| 14 | Rents | \$ - | - | | - | - | - |
| 15 | Transportation Expenses | \$ - | - | | - | - | - |
| 16 | Insurance - General Liability | \$ - | - | | - | - | - |
| 17 | Insurance - Health and Life | \$ - | - | | - | - | - |
| 18 | Regulatory Commision Expense - Rate Case | \$ 12,500 | - | | 12,500 | - | 12,500 |
| 19 | Miscellaneous Expense | \$ 10,222 | - | | 10,222 | - | 10,222 |
| 20 | Depreciation Expense | \$ 73,799 | 24,736 | Adj # 2 | 98,535 | - | 98,535 |
| 21 | Taxes Other Than Income | \$ - | - | | - | - | - |
| 22 | Property Taxes | \$ 5,813 | 4,274 | Adj # 3 | 10,087 | - | 10,087 |
| 23 | Income Tax | \$ - | - | | - | - | - |
| 26 | | | | | | | |
| 27 | Total Operating Expenses | <u>\$ 166,539</u> | <u>\$ 29,010</u> | | <u>\$ 195,549</u> | <u>\$ -</u> | <u>\$ 195,549</u> |
| 28 | Operating Income (Loss) | <u>\$ (75,772)</u> | <u>\$ 54,550</u> | | <u>\$ (21,222)</u> | <u>\$ 192,688</u> | <u>\$ 171,466</u> |

References:

Column (A): Company Schedule C-1
Column (B): Schedule JMM-W9
Column (C): Column (A) + Column (B)
Column (D): Schedules JMM-1
Column (E): Column (C) + Column (D)

Utility Source, LLC - Water Division
 Docket No. WS-04235A-06-0303
 Test Year Ended December 31, 2005

Surrebuttal Schedule JMM-W8

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

| LINE NO. | DESCRIPTION | [A] COMPANY REBUTTAL TEST YEAR AS FILED | [B] STAFF SURREBUTTAL PRO FORMA REVENUES ADJ # 1 | [F] STAFF SURREBUTTAL DEPERCIATION ADJ # 2 | [G] STAFF SURREBUTTAL PROPERTY TAX ADJ # 3 | [H] STAFF SURREBUTTAL ADJUSTED |
|----------|---|---|---|--|--|---|
| 1 | <u>REVENUES:</u> | | | | | |
| 2 | Metered Water Sales | \$ 89,110 | 83,560 | - | - | 172,670 |
| 3 | Water Sales - Unmetered | - | - | - | - | - |
| 4 | Other Operating Revenue | 1,657 | - | - | - | 1,657 |
| 5 | Total Operating Revenues | \$ 90,767 | 83,560 | | | 174,327 |
| | <u>OPERATING EXPENSES:</u> | | | | | |
| 6 | Salaries and Wages | - | - | - | - | - |
| 7 | Purchased Water | - | - | - | - | - |
| 8 | Purchased Power | 36,292 | - | - | - | 36,292 |
| 9 | Chemicals | - | - | - | - | - |
| 10 | Repairs and Maintenance | 8,747 | - | - | - | 8,747 |
| 11 | Office Supplies and Expense | 4,292 | - | - | - | 4,292 |
| 12 | Outside Services | 12,428 | - | - | - | 12,428 |
| 13 | Water Testing | 2,446 | - | - | - | 2,446 |
| 14 | Rents | - | - | - | - | - |
| 15 | Transportation Expenses | - | - | - | - | - |
| 16 | Insurance - General Liability | - | - | - | - | - |
| 17 | Insurance - Health and Life | - | - | - | - | - |
| 18 | Regulatory Commission Expense - Rate Case | 12,500 | - | - | - | 12,500 |
| 19 | Miscellaneous Expense | 10,222 | - | - | - | 10,222 |
| 20 | Depreciation Expense | 73,799 | - | 24,736 | - | 98,535 |
| 21 | Taxes Other Than Income | - | - | - | - | - |
| 22 | Property Taxes | 5,813 | - | - | 4,274 | 10,087 |
| 23 | Income Tax | - | - | - | - | - |
| 24 | | | | | | |
| 25 | Total Operating Expenses | 166,539 | - | 24,736 | 4,274 | 195,549 |
| 26 | Operating Income (Loss) | (75,772) | 83,560 | (24,736) | (4,274) | (21,222) |

| ADJ # | References: |
|-------|------------------------------|
| 1 | Pro-Forma Revenues |
| 2 | Depreciation Expense |
| 3 | Property Taxes |
| | Surrebuttal Schedule JMM-W10 |
| | Surrebuttal Schedule JMM-W14 |
| | Surrebuttal Schedule JMM-W15 |

Utility Source, LLC. - Water Division
Docket No. WS-04235A-06-0303
Test Year Ended December 31, 2005

Surrebuttal Schedule JMM-W9

OPERATING INCOME ADJUSTMENT # 1 - PRO FORMA REVENUES

| | | [A] | [B] | [C] |
|----------|---------------------|------------------|-------------------|-------------------|
| LINE NO. | DESCRIPTION | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Metered Water Sales | \$ 89,110 | \$ 83,560 | \$ 172,670 |

Staff's Calculation

Inclusion of Pro Forma Revenues

\$ 83,560

References:

Column A: Company Schedule C-1

Column B: Testimony, JMM, Schedule JMM-W9

Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT NO. 2 - DEPRECIATION EXPENSE

| LINE NO. | DESCRIPTION | [A] | | [B] | | [C] | |
|----------|----------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | COMPANY AS FILED | STAFF ADJUSTMENTS | COMPANY AS FILED | STAFF ADJUSTMENTS |
| 1 | Depreciation Expense | \$ 73,799 | \$ 24,736 | \$ 98,535 | | | |

| ACCT NO | DESCRIPTION | AT ENGINEER RECOMMENDED RATES | | A.D. | | PLT BAL 12/31/2005 | RETIREMENTS 12/31/2005 | ADDITIONS 12/31/2005 | DEP EXP FULL YR 12/31/2005 | A.D. 12/31/2005 |
|---------|---|---------------------------------------|----------------|------------|------------|--------------------|------------------------|----------------------|----------------------------|-----------------|
| | | Total Plant Staff Adjusted 12/31/2004 | Half Year Dep. | 12/31/2004 | 12/31/2004 | | | | | |
| 301 | Organization Cost | - | - | - | - | - | - | - | - | - |
| 302 | Franchise Cost | - | - | - | - | - | - | - | - | - |
| 303 | Land & Land Rights | 210,000 | - | - | - | 210,000 | - | - | - | - |
| 304 | Structures & Improvements | 72,998 | 1,215 | 1,215 | - | 72,998 | - | - | 2,431 | 3,646 |
| 307 | Wells & Springs | 2,071,821 | 3,33% | 34,496 | - | 2,071,821 | - | - | 68,992 | 103,487 |
| 310 | Power Generation Equipment | 87,400 | 5.00% | 2,185 | - | 87,400 | - | - | 4,370 | 6,555 |
| 311 | Electric Pumping Equip. | 157,711 | 12.50% | 9,857 | - | 157,711 | - | - | 19,714 | 29,571 |
| 320 | Water Treatment Plants | 5,487 | 3.33% | 91 | - | 5,487 | - | - | 183 | 274 |
| 320.2 | Solution Chemicals Feeders | - | 20.00% | - | - | - | - | - | - | - |
| 330 | Distribution Reservoirs | 321,452 | 2.22% | 3,568 | - | 321,452 | - | - | 7,136 | 10,704 |
| 330.1 | Storage Tanks | - | 2.22% | - | - | - | - | - | - | - |
| 330.2 | Pressure Tanks | - | 5.00% | - | - | - | - | - | - | - |
| 331 | Transmission & Distribution-Mains | 147,200 | 2.00% | 1,472 | - | 147,200 | - | - | 2,944 | 4,416 |
| 333 | Services | 86,250 | 3.33% | 1,436 | - | 86,250 | - | - | 2,872 | 4,308 |
| 334 | Meters | - | 8.33% | - | - | - | - | - | - | - |
| 335 | Hydrants | 34,500 | 2.00% | 345 | - | 34,500 | - | - | 690 | 1,035 |
| 336 | Backflow Preventors | - | 6.67% | - | - | - | - | - | - | - |
| 339 | Other Plant and Miscellaneous Equipment | - | 6.67% | - | - | - | - | - | - | - |
| 340 | Office Furniture & Equip. | - | 6.67% | - | - | - | - | - | - | - |
| 341 | Transportation Equip. | - | 20.00% | - | - | - | - | - | - | - |
| 343 | Tools and Work Equipment | - | 5.00% | - | - | - | - | - | - | - |
| 344 | Laboratory Equipment | - | 10.00% | - | - | - | - | - | - | - |
| 345 | Power Operated Equipment | - | 5.00% | - | - | - | - | - | - | - |
| 346 | Communications Equipment | - | 10.00% | - | - | - | - | - | - | - |
| 347 | Miscellaneous Equipment | - | 10.00% | - | - | - | - | - | - | - |
| 348 | Other Tangible Plant | - | - | - | - | - | - | - | - | - |
| 350.1 | O&I Engineering and Planning | - | 3.33% | - | - | - | - | - | - | - |
| 350.2 | O&I Well Site | - | 3.33% | - | - | - | - | - | - | - |
| 105 | Materials and Supplies Inventory | - | - | - | - | - | - | - | - | - |
| Totals | | 3,194,819 | - | 54,666 | - | 3,194,819 | - | - | 109,331 | 163,997 |

Non Depreciable Plant 2,984,819

| | | |
|----|-----------------------------------|------------|
| 32 | CIAC Composite Rate | 3.6629% |
| 33 | Depreciation Expense Calculation: | \$ 109,331 |
| 34 | Depreciation 2005: | (10,796) |
| 35 | Net Amortization of CIAC: | \$ 98,535 |

References:
 Column A: Company Schedule C-1
 Column B: Testimony, JMM, Schedule JMM-W9
 Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT #3 - PROPERTY TAXES

| LINE NO. | Property Tax Calculation | [A] COMPANY AS FILED | [B] STAFF ADJUSTMENT | (C) STAFF AS ADJUSTED |
|---|---|----------------------------|----------------------------|-----------------------------|
| 1 | Property Taxes | \$ 5,813 | \$ 4,274 | \$ 10,087 |
| <u>Staff's Calculation of Property Taxes to Reflect Recommended Revenues:</u> | | | | |
| 2 | Staff Adjusted Test Year Revenues - 2002 | | | \$ 174,327 |
| 3 | Weight Factor | | | 2 |
| 4 | Subtotal (Line 1 * Line 2) | | | 348,654 |
| 5 | Staff Recommended Revenue, Per Schedule JMM-1 | | | 367,015 |
| 6 | Subtotal (Line 4 + Line 5) | | | 715,669 |
| 7 | Number of Years | | | 3 |
| 8 | Three Year Average (Line 5 / Line 6) | | | 238,556 |
| 9 | Department of Revenue Mutilplier | | | 2 |
| 10 | Revenue Base Value (Line 7 * Line 8) | | | 477,113 |
| 11 | Plus: 10% of CWIP | | | - |
| 12 | Less: Net Book Value of Licensed Vehicles | | | - |
| 13 | Full Cash Value (Line 9 + Line 10 - Line 11) | | | 477,113 |
| 14 | Assessment Ratio | | | 23.50% |
| 15 | Assessment Value (Line 12 * Line 13) | | | 112,122 |
| 16 | Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16) | | | 8.9963% |
| 17 | Staff Proposed Property Tax Expense (Line 14 * Line 15) | | | \$ 10,087 |
| 18 | Company Proposed Property Tax | | | 5,813 |
| 19 | Increase/(Decrease) to Property Tax Expense | | | \$ 4,274 |

References:

Column A: Company Schedule C-1
Column B: Testimony, JMM, Schedule JMM-W9
Column C: Column [A] + Column [B]

RATE DESIGN

| Monthly Usage Charge | Present Rates | Company Proposed Rates | Staff Recommended Rates |
|--|---------------|------------------------|-------------------------|
| 5/8x3/4" Meter | \$ - | \$ 35.74 | 18.50 |
| 3/4" Meter | 6.48 | 35.74 | 18.50 |
| 1" Meter | 8.02 | 89.34 | 46.50 |
| 1 1/2" Meter | 9.62 | 178.69 | 92.50 |
| 2" Meter | 14.00 | 285.90 | 148.00 |
| 3" Meter | - | 571.80 | 296.00 |
| 4" Meter | 58.00 | 893.43 | 462.50 |
| 6" Meter | 89.80 | 1,786.86 | 925.00 |
| Commodity Rates | | | |
| 5/8x3/4" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 4.80 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 7.16 |
| Over 9,000 Gallons | N/A | N/A | 8.60 |
| 3/4" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 4.80 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 7.16 |
| Over 9,000 Gallons | N/A | N/A | 8.60 |
| 1" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 30,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 30,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 27,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 27,000 Gallons | N/A | N/A | 8.60 |
| 1 1/2" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 60,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 60,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 57,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 57,000 Gallons | N/A | N/A | 8.60 |
| 2" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 96,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 96,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 94,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 94,000 Gallons | N/A | N/A | 8.60 |
| 3" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |

| | | | |
|---|----------|----------|-----------|
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 192,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 192,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 195,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 195,000 Gallons | N/A | N/A | 8.60 |
| 4" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 300,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 300,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 309,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 309,000 Gallons | N/A | N/A | 8.60 |
| 6" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 600,000 Gallons | N/A | 12.48 | N/A |
| Over 600,000 Gallons | N/A | 16.22 | N/A |
| Over 15,000 Gallons | N/A | N/A | N/A |
| From Zero to 615,000 Gallons | N/A | N/A | \$ 7.16 |
| Over 615,000 Gallons | N/A | N/A | 8.60 |
| <u>Multi-Family Mobile Home, and Commercial Customers</u> | | | |
| All consumption per 1,000 gallons | \$ 2.97 | \$ 9.26 | N/A |
| <u>Irrigation Meters</u> | | | |
| Charge per 1,000 gallons for usage | N/A | N/A | \$ 9.26 |
| <u>Standpipe or Bulk Water</u> | | | |
| Standpipe or bulk water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Construction Water</u> | | | |
| Construction Water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Service Line and Meter Installation Charges</u> | | | |
| 5/8" x 3/4" Meter | \$ - | \$ - | \$ 520.00 |
| 3/4" Meter | 575.00 | 575.00 | 575.00 |
| 1" Meter | 660.00 | 660.00 | 660.00 |
| 1½" Meter | 900.00 | 900.00 | 900.00 |
| 2" Turbine Meter | 1,525.00 | 1,525.00 | 1,525.00 |
| 2" Compound Meter | - | - | 2,320.00 |
| 3" Turbine Meter | - | - | 2,275.00 |
| 3" Compound Meter | - | - | 3,110.00 |
| 4" Turbine Meter | 3,360.00 | 3,360.00 | 3,360.00 |
| 4" Compound Meter | - | - | 4,475.00 |
| 6" Turbine Meter | 6,035.00 | 6,035.00 | 6,035.00 |
| 6" Compound Meter | - | - | 8,050.00 |
| <u>Service Charges</u> | | | |
| Establishment | \$ 20.00 | \$ 20.00 | \$ 20.00 |
| Establishment of Services after hours | 40.00 | 40.00 | 40.00 |
| Re-establishment of Service | * | * | * |
| Reconnection Service | 50.00 | 50.00 | 50.00 |
| Reconnection (Delinquent and After Hours) | 40.00 | 40.00 | 40.00 |
| Charge for moving meter | Cost | Cost | Cost |
| After hours service charge | 40.00 | 40.00 | 40.00 |
| Minimum Deposit Requirement | ** | ** | ** |
| Deposit Interest | 3.00% | 3.00% | Per Rule |
| Meter Test | 20.00 | 20.00 | 20.00 |
| Meter Re-Read | 10.00 | 10.00 | 10.00 |
| Charge for NSF Check | 20.00 | 20.00 | 20.00 |
| Late Payment charge for delinquent bill | 1.50% | 1.50% | *** |
| Deferred Payment Finance Charge | 1.50% | 1.50% | *** |
| Main Extension and additional facility agreements | *** | *** | *** |

* Per Commission Rule Rule R14-2-403(D)
** Per Commission Rule Rule R14-2-403(B)
*** Per Commission Rule Rule R14-2-406(B)

Typical Bill Analysis
 General Service 3/4-Inch Meter

| Company Proposed | Gallons | Present Rates | Proposed Rates | Dollar Increase | Percent Increase |
|--------------------------|---------|---------------|----------------|-----------------|------------------|
| Average Usage | 4,740 | \$ 19.89 | \$ 81.24 | \$ 61.35 | 308.38% |
| Median Usage | 4,500 | 19.22 | 78.94 | \$ 59.73 | 310.82% |
| Staff Recommended | | | | | |
| Average Usage | 4,740 | \$ 19.89 | \$ 43.00 | \$ 23.10 | 116.14% |
| Median Usage | 4,500 | 19.22 | 41.28 | \$ 22.07 | 114.83% |

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

| Gallons Consumption | Present Rates | Company Proposed Rates | % Increase | Staff Recommended Rates | % Increase |
|---------------------|---------------|------------------------|------------|-------------------------|------------|
| - | \$ 6.48 | \$ 35.74 | 451.54% | \$ 18.50 | 185.49% |
| 1,000 | 9.31 | 45.34 | 387.00% | 23.30 | 150.27% |
| 2,000 | 12.14 | 54.94 | 352.55% | 28.10 | 131.47% |
| 3,000 | 14.97 | 64.54 | 331.13% | 32.90 | 119.77% |
| 4,000 | 17.80 | 74.14 | 316.52% | 37.70 | 111.80% |
| 5,000 | 20.63 | 83.74 | 305.91% | 44.86 | 117.45% |
| 6,000 | 23.95 | 96.22 | 301.75% | 52.02 | 117.20% |
| 7,000 | 27.27 | 108.70 | 298.61% | 59.18 | 117.02% |
| 8,000 | 30.59 | 121.18 | 296.14% | 66.34 | 116.87% |
| 9,000 | 33.91 | 133.66 | 294.16% | 73.50 | 116.75% |
| 10,000 | 37.23 | 146.14 | 292.53% | 82.10 | 120.52% |
| 11,000 | 40.55 | 158.62 | 291.17% | 90.70 | 123.67% |
| 12,000 | 43.87 | 171.10 | 290.02% | 99.30 | 126.35% |
| 13,000 | 47.19 | 183.58 | 289.02% | 107.90 | 128.65% |
| 14,000 | 50.51 | 196.06 | 288.16% | 116.50 | 130.65% |
| 15,000 | 53.83 | 208.54 | 287.40% | 125.10 | 132.40% |
| 16,000 | 58.54 | 224.76 | 283.94% | 133.70 | 128.39% |
| 17,000 | 63.25 | 240.98 | 281.00% | 142.30 | 124.98% |
| 18,000 | 67.96 | 257.20 | 278.46% | 150.90 | 122.04% |
| 19,000 | 72.67 | 273.42 | 276.25% | 159.50 | 119.49% |
| 20,000 | 77.38 | 289.64 | 274.31% | 168.10 | 117.24% |
| 25,000 | 100.93 | 370.74 | 267.32% | 211.10 | 109.15% |
| 30,000 | 124.48 | 451.84 | 262.98% | 254.10 | 104.13% |
| 35,000 | 148.03 | 532.94 | 260.02% | 297.10 | 100.70% |
| 40,000 | 171.58 | 614.04 | 257.87% | 340.10 | 98.22% |
| 45,000 | 195.13 | 695.14 | 256.24% | 383.10 | 96.33% |
| 50,000 | 218.68 | 776.24 | 254.97% | 426.10 | 94.85% |
| 75,000 | 336.43 | 1,181.74 | 251.26% | 641.10 | 90.56% |
| 100,000 | 454.18 | 1,587.24 | 249.47% | 856.10 | 88.49% |

REVENUE REQUIREMENT

| LINE NO. | DESCRIPTION | (A) COMPANY REBUTTAL COST | (C) COMPANY REBUTTAL FAIR VALUE | (D) STAFF SURREBUTTAL COST | (E) STAFF SURREBUTTAL FAIR VALUE |
|----------|---------------------------------------|------------------------------------|---|-------------------------------------|--|
| 1 | Adjusted Rate Base | \$ 2,052,792 | \$ 2,052,792 | \$ 2,752,271 | \$ 2,752,271 |
| 2 | Adjusted Operating Income (Loss) | \$ (75,772) | \$ (75,772) | \$ (22,272) | \$ (22,272) |
| 3 | Current Rate of Return (L2 / L1) | -3.69% | -3.69% | -0.81% | -0.81% |
| 4 | Required Rate of Return | 10.50% | 10.50% | 8.90% | 8.90% |
| 5 | Required Operating Income (L4 * L1) | \$ 215,543 | \$ 215,543 | \$ 244,952 | \$ 244,952 |
| 6 | Operating Income Deficiency (L5 - L2) | \$ 291,420 | \$ 291,420 | \$ 267,225 | \$ 267,225 |
| 7 | Gross Revenue Conversion Factor | 1.0000 | 1.0000 | 1.0000 | 1.0000 |
| 8 | Required Revenue Increase (L7 * L6) | \$ 291,420 | \$ 291,420 | \$ 267,225 | \$ 267,225 |
| 9 | Adjusted Test Year Revenue | \$ 90,767 | \$ 90,767 | \$ 174,327 | \$ 174,327 |
| 10 | Proposed Annual Revenue (L8 + L9) | \$ 382,187 | \$ 382,187 | \$ 441,552 | \$ 441,552 |
| 11 | Required Increase in Revenue (%) | 321.06% | 321.06% | 153.29% | 153.29% |
| 12 | Rate of Return on Rate Base (%) | 10.50% | 10.50% | 8.90% | 8.90% |

References:

- Column (A): Company Rebuttal Schedule B-1
- Column (B): Company Rebuttal Schedule B-1
- Column (C): Staff Surrebuttal Schedules JMM-W2, JMM-W8
- Column (D): Staff Surrebuttal Schedules JMM-W2, JMM-W8

RATE DESIGN

| Monthly Usage Charge | Present Rates | Company Proposed Rates | Staff Recommended Rates |
|---|---------------|------------------------|-------------------------|
| 5/8x3/4" Meter | \$ - | \$ 35.74 | 23.00 |
| 3/4" Meter | 6.48 | 35.74 | 23.00 |
| 1" Meter | 8.02 | 89.34 | 57.50 |
| 1 1/2" Meter | 9.62 | 178.69 | 115.00 |
| 2" Meter | 14.00 | 285.90 | 184.00 |
| 3" Meter | - | 571.80 | 368.00 |
| 4" Meter | 58.00 | 893.43 | 575.00 |
| 6" Meter | 89.80 | 1,786.86 | 1,150.00 |
| Commodity Rates | | | |
| 5/8x3/4" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 5.63 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 8.44 |
| Over 9,000 Gallons | N/A | N/A | 10.13 |
| 3/4" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 5.63 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 8.44 |
| Over 9,000 Gallons | N/A | N/A | 10.13 |
| 1" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 30,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 30,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 27,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 27,000 Gallons | N/A | N/A | 10.13 |
| 1 1/2" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 60,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 60,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 57,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 57,000 Gallons | N/A | N/A | 10.13 |
| 2" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 96,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 96,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 94,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 94,000 Gallons | N/A | N/A | 10.13 |
| 3" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |

| | | | |
|---|----------|----------|-----------|
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 192,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 192,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 195,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 195,000 Gallons | N/A | N/A | 10.13 |
| 4" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 300,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 300,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 309,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 309,000 Gallons | N/A | N/A | 10.13 |
| 6" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 600,000 Gallons | N/A | 12.48 | N/A |
| Over 600,000 Gallons | N/A | 16.22 | N/A |
| Over 15,000 Gallons | N/A | N/A | N/A |
| From Zero to 615,000 Gallons | N/A | N/A | \$ 8.44 |
| Over 615,000 Gallons | N/A | N/A | 10.13 |
| <u>Multi-Family Mobile Home, and Commercial Customers</u> | | | |
| All consumption per 1,000 gallons | \$ 2.97 | \$ 9.26 | N/A |
| <u>Irrigation Meters</u> | | | |
| Charge per 1,000 gallons for usage | N/A | N/A | \$ 9.26 |
| <u>Standpipe or Bulk Water</u> | | | |
| Standpipe or bulk water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Construction Water</u> | | | |
| Construction Water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Service Line and Meter Installation Charges</u> | | | |
| 5/8" x 3/4" Meter | \$ - | \$ - | \$ 520.00 |
| 3/4" Meter | 575.00 | 575.00 | 575.00 |
| 1" Meter | 660.00 | 660.00 | 660.00 |
| 1 1/2" Meter | 900.00 | 900.00 | 900.00 |
| 2" Turbine Meter | 1,525.00 | 1,525.00 | 1,525.00 |
| 2" Compound Meter | - | - | 2,320.00 |
| 3" Turbine Meter | - | - | 2,275.00 |
| 3" Compound Meter | - | - | 3,110.00 |
| 4" Turbine Meter | 3,360.00 | 3,360.00 | 3,360.00 |
| 4" Compound Meter | - | - | 4,475.00 |
| 6" Turbine Meter | 6,035.00 | 6,035.00 | 6,035.00 |
| 6" Compound Meter | - | - | 8,050.00 |
| <u>Service Charges</u> | | | |
| Establishment | \$ 20.00 | \$ 20.00 | \$ 20.00 |
| Establishment of Services after hours | 40.00 | 40.00 | 40.00 |
| Re-establishment of Service | * | * | * |
| Reconnection Service | 50.00 | 50.00 | 50.00 |
| Reconnection (Delinquent and After Hours) | 40.00 | 40.00 | 40.00 |
| Charge for moving meter | Cost | Cost | Cost |
| After hours service charge | 40.00 | 40.00 | 40.00 |
| Minimum Deposit Requirement | ** | ** | ** |
| Deposit Interest | 3.00% | 3.00% | Per Rule |
| Meter Test | 20.00 | 20.00 | 20.00 |
| Meter Re-Read | 10.00 | 10.00 | 10.00 |
| Charge for NSF Check | 20.00 | 20.00 | 20.00 |
| Late Payment charge for delinquent bill | 1.50% | 1.50% | *** |
| Deferred Payment Finance Charge | 1.50% | 1.50% | *** |
| Main Extension and additional facility agreements | *** | *** | *** |

* Per Commission Rule Rule R14-2-403(D)
 ** Per Commission Rule Rule R14-2-403(B)
 *** Per Commission Rule Rule R14-2-406(B)

Typical Bill Analysis
 General Service 3/4-Inch Meter

| Company Proposed | Gallons | Present Rates | Proposed Rates | Dollar Increase | Percent Increase |
|--------------------------|---------|---------------|----------------|-----------------|------------------|
| Average Usage | 4,740 | \$ 19.89 | \$ 81.24 | \$ 61.35 | 308.38% |
| Median Usage | 4,500 | 19.22 | 78.94 | \$ 59.73 | 310.82% |
| Staff Recommended | | | | | |
| Average Usage | 4,740 | \$ 19.89 | \$ 51.77 | \$ 31.87 | 160.20% |
| Median Usage | 4,500 | 19.22 | 49.74 | \$ 30.53 | 158.86% |

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

| Gallons Consumption | Present Rates | Company Proposed Rates | % Increase | Staff Recommended Rates | % Increase |
|---------------------|---------------|------------------------|------------|-------------------------|------------|
| - | \$ 6.48 | \$ 35.74 | 451.54% | \$ 23.00 | 254.94% |
| 1,000 | 9.31 | 45.34 | 387.00% | 28.63 | 207.52% |
| 2,000 | 12.14 | 54.94 | 352.55% | 34.26 | 182.21% |
| 3,000 | 14.97 | 64.54 | 331.13% | 39.89 | 166.47% |
| 4,000 | 17.80 | 74.14 | 316.52% | 45.52 | 155.73% |
| 5,000 | 20.63 | 83.74 | 305.91% | 53.96 | 161.56% |
| 6,000 | 23.95 | 96.22 | 301.75% | 62.40 | 160.54% |
| 7,000 | 27.27 | 108.70 | 298.61% | 70.84 | 159.77% |
| 8,000 | 30.59 | 121.18 | 296.14% | 79.28 | 159.17% |
| 9,000 | 33.91 | 133.66 | 294.16% | 87.72 | 158.68% |
| 10,000 | 37.23 | 146.14 | 292.53% | 97.85 | 162.83% |
| 11,000 | 40.55 | 158.62 | 291.17% | 107.98 | 166.29% |
| 12,000 | 43.87 | 171.10 | 290.02% | 118.11 | 169.23% |
| 13,000 | 47.19 | 183.58 | 289.02% | 128.24 | 171.75% |
| 14,000 | 50.51 | 196.06 | 288.16% | 138.37 | 173.95% |
| 15,000 | 53.83 | 208.54 | 287.40% | 148.50 | 175.87% |
| 16,000 | 58.54 | 224.76 | 283.94% | 158.63 | 170.98% |
| 17,000 | 63.25 | 240.98 | 281.00% | 168.76 | 166.81% |
| 18,000 | 67.96 | 257.20 | 278.46% | 178.89 | 163.23% |
| 19,000 | 72.67 | 273.42 | 276.25% | 189.02 | 160.11% |
| 20,000 | 77.38 | 289.64 | 274.31% | 199.15 | 157.37% |
| 25,000 | 100.93 | 370.74 | 267.32% | 249.80 | 147.50% |
| 30,000 | 124.48 | 451.84 | 262.98% | 300.45 | 141.36% |
| 35,000 | 148.03 | 532.94 | 260.02% | 351.10 | 137.18% |
| 40,000 | 171.58 | 614.04 | 257.87% | 401.75 | 134.15% |
| 45,000 | 195.13 | 695.14 | 256.24% | 452.40 | 131.85% |
| 50,000 | 218.68 | 776.24 | 254.97% | 503.05 | 130.04% |
| 75,000 | 336.43 | 1,181.74 | 251.26% | 756.30 | 124.80% |
| 100,000 | 454.18 | 1,587.24 | 249.47% | 1,009.55 | 122.28% |

REVENUE REQUIREMENT

| LINE NO. | DESCRIPTION | (A) COMPANY REBUTTAL COST | (C) COMPANY REBUTTAL FAIR VALUE | (D) STAFF SURREBUTTAL COST | (E) STAFF SURREBUTTAL FAIR VALUE |
|----------|---------------------------------------|------------------------------------|---|-------------------------------------|--|
| 1 | Adjusted Rate Base | \$ 2,052,792 | \$ 2,052,792 | \$ 2,052,793 | \$ 2,052,793 |
| 2 | Adjusted Operating Income (Loss) | \$ (75,772) | \$ (75,772) | \$ (77,464) | \$ (77,464) |
| 3 | Current Rate of Return (L2 / L1) | -3.69% | -3.69% | -3.77% | -3.77% |
| 4 | Required Rate of Return | 10.50% | 10.50% | 8.90% | 8.90% |
| 5 | Required Operating Income (L4 * L1) | \$ 215,543 | \$ 215,543 | \$ 182,699 | \$ 182,699 |
| 6 | Operating Income Deficiency (L5 - L2) | \$ 291,420 | \$ 291,420 | \$ 260,162 | \$ 260,162 |
| 7 | Gross Revenue Conversion Factor | 1.0000 | 1.0000 | 1.0000 | 1.0000 |
| 8 | Required Revenue Increase (L7 * L6) | \$ 291,420 | \$ 291,420 | \$ 260,162 | \$ 260,162 |
| 9 | Adjusted Test Year Revenue | \$ 90,767 | \$ 90,767 | \$ 90,767 | \$ 90,767 |
| 10 | Proposed Annual Revenue (L8 + L9) | \$ 382,187 | \$ 382,187 | \$ 350,929 | \$ 350,929 |
| 11 | Required Increase in Revenue (%) | 321.06% | 321.06% | 286.63% | 286.63% |
| 12 | Rate of Return on Rate Base (%) | 10.50% | 10.50% | 8.90% | 8.90% |

References:

Column (A): Company Rebuttal Schedule B-1
Column (B): Company Rebuttal Schedule B-1
Column (C): Staff Surrebuttal Schedules JMM-W2, JMM-W3
Column (D): Staff Surrebuttal Schedules JMM-W2, JMM-W3

RATE DESIGN

| Monthly Usage Charge | Present Rates | Company Proposed Rates | Staff Recommended Rates |
|--|---------------|------------------------|-------------------------|
| 5/8x3/4" Meter | \$ - | \$ 35.74 | 34.00 |
| 3/4" Meter | 6.48 | 35.74 | 34.00 |
| 1" Meter | 8.02 | 89.34 | 85.00 |
| 1 1/2" Meter | 9.62 | 178.69 | 170.00 |
| 2" Meter | 14.00 | 285.90 | 272.00 |
| 3" Meter | - | 571.80 | 544.00 |
| 4" Meter | 58.00 | 893.43 | 850.00 |
| 6" Meter | 89.80 | 1,786.86 | 1,700.00 |
| Commodity Rates | | | |
| 5/8x3/4" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 8.63 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 12.98 |
| Over 9,000 Gallons | N/A | N/A | 15.52 |
| 3/4" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 4,000 Gallons | N/A | \$ 9.60 | N/A |
| From 4,001 to 12,000 Gallons | N/A | 12.48 | N/A |
| Over 12,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 4,000 Gallons | N/A | N/A | \$ 8.63 |
| From 4,001 to 9,000 Gallons | N/A | N/A | 12.98 |
| Over 9,000 Gallons | N/A | N/A | 15.52 |
| 1" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | \$ 2.83 | N/A | N/A |
| From 6,001 to 15,000 Gallons | 3.32 | N/A | N/A |
| In excess of 15,000 Gallons | 4.71 | N/A | N/A |
| From 1 to 30,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 30,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 27,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 27,000 Gallons | N/A | N/A | 15.52 |
| 1 1/2" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 60,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 60,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 57,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 57,000 Gallons | N/A | N/A | 15.52 |
| 2" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 96,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 96,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 94,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 94,000 Gallons | N/A | N/A | 15.52 |
| 3" Meter (Residential and Commercial) Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |

| | | | |
|---|----------|----------|-----------|
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 192,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 192,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 195,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 195,000 Gallons | N/A | N/A | 15.52 |
| 4" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 300,000 Gallons | N/A | \$ 12.48 | N/A |
| Over 300,000 Gallons | N/A | 16.22 | N/A |
| From Zero to 309,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 309,000 Gallons | N/A | N/A | 15.52 |
| 6" Meter (Residential and Commercial) | | | |
| Gallons Included in Minimum | - | - | - |
| Excess of Minimum - per 1,000 Gallons | | | |
| From 1 to 6,000 Gallons | N/A | N/A | N/A |
| From 6,001 to 15,000 Gallons | N/A | N/A | N/A |
| In excess of 15,000 Gallons | N/A | N/A | N/A |
| From 1 to 600,000 Gallons | N/A | 12.48 | N/A |
| Over 600,000 Gallons | N/A | 16.22 | N/A |
| Over 15,000 Gallons | N/A | N/A | N/A |
| From Zero to 615,000 Gallons | N/A | N/A | \$ 12.98 |
| Over 615,000 Gallons | N/A | N/A | 15.52 |
| <u>Multi-Family Mobile Home, and Commercial Customers</u> | | | |
| All consumption per 1,000 gallons | \$ 2.97 | \$ 9.26 | N/A |
| <u>Irrigation Meters</u> | | | |
| Charge per 1,000 gallons for usage | N/A | N/A | \$ 9.26 |
| <u>Standpipe or Bulk Water</u> | | | |
| Standpipe or bulk water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Construction Water</u> | | | |
| Construction Water per 1,000 gallons | \$ 6.00 | \$ 10.35 | \$ 10.35 |
| <u>Service Line and Meter Installation Charges</u> | | | |
| 5/8" x 3/4" Meter | \$ - | \$ - | \$ 520.00 |
| 3/4" Meter | 575.00 | 575.00 | 575.00 |
| 1" Meter | 660.00 | 660.00 | 660.00 |
| 1 1/2" Meter | 900.00 | 900.00 | 900.00 |
| 2" Turbine Meter | 1,525.00 | 1,525.00 | 1,525.00 |
| 2" Compound Meter | - | - | 2,320.00 |
| 3" Turbine Meter | - | - | 2,275.00 |
| 3" Compound Meter | - | - | 3,110.00 |
| 4" Turbine Meter | 3,360.00 | 3,360.00 | 3,360.00 |
| 4" Compound Meter | - | - | 4,475.00 |
| 6" Turbine Meter | 6,035.00 | 6,035.00 | 6,035.00 |
| 6" Compound Meter | - | - | 8,050.00 |
| <u>Service Charges</u> | | | |
| Establishment | \$ 20.00 | \$ 20.00 | \$ 20.00 |
| Establishment of Services after hours | 40.00 | 40.00 | 40.00 |
| Re-establishment of Service | * | * | * |
| Reconnection Service | 50.00 | 50.00 | 50.00 |
| Reconnection (Delinquent and After Hours) | 40.00 | 40.00 | 40.00 |
| Charge for moving meter | Cost | Cost | Cost |
| After hours service charge | 40.00 | 40.00 | 40.00 |
| Minimum Deposit Requirement | ** | ** | ** |
| Deposit Interest | 3.00% | 3.00% | Per Rule |
| Meter Test | 20.00 | 20.00 | 20.00 |
| Meter Re-Read | 10.00 | 10.00 | 10.00 |
| Charge for NSF Check | 20.00 | 20.00 | 20.00 |
| Late Payment charge for delinquent bill | 1.50% | 1.50% | *** |
| Deferred Payment Finance Charge | 1.50% | 1.50% | *** |
| Main Extension and additional facility agreements | *** | *** | *** |

* Per Commission Rule Rule R14-2-403(D)
** Per Commission Rule Rule R14-2-403(B)
*** Per Commission Rule Rule R14-2-406(B)

Typical Bill Analysis
General Service 3/4-Inch Meter

| Company Proposed | Gallons | Present Rates | Proposed Rates | Dollar Increase | Percent Increase |
|--------------------------|---------|---------------|----------------|-----------------|------------------|
| Average Usage | 4,740 | \$ 19.89 | \$ 81.24 | \$ 61.35 | 308.38% |
| Median Usage | 4,500 | 19.22 | 78.94 | \$ 59.73 | 310.82% |
| Staff Recommended | | | | | |
| Average Usage | 4,740 | \$ 19.89 | \$ 78.13 | \$ 58.23 | 292.70% |
| Median Usage | 4,500 | 19.22 | 75.01 | \$ 55.80 | 290.37% |

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

| Gallons Consumption | Present Rates | Company Proposed Rates | % Increase | Staff Recommended Rates | % Increase |
|---------------------|---------------|------------------------|------------|-------------------------|------------|
| - | \$ 6.48 | \$ 35.74 | 451.54% | \$ 34.00 | 424.69% |
| 1,000 | 9.31 | 45.34 | 387.00% | 42.63 | 357.89% |
| 2,000 | 12.14 | 54.94 | 352.55% | 51.26 | 322.24% |
| 3,000 | 14.97 | 64.54 | 331.13% | 59.89 | 300.07% |
| 4,000 | 17.80 | 74.14 | 316.52% | 68.52 | 284.94% |
| 5,000 | 20.63 | 83.74 | 305.91% | 81.50 | 295.06% |
| 6,000 | 23.95 | 96.22 | 301.75% | 94.48 | 294.49% |
| 7,000 | 27.27 | 108.70 | 298.61% | 107.46 | 294.06% |
| 8,000 | 30.59 | 121.18 | 296.14% | 120.44 | 293.72% |
| 9,000 | 33.91 | 133.66 | 294.16% | 133.42 | 293.45% |
| 10,000 | 37.23 | 146.14 | 292.53% | 148.94 | 300.05% |
| 11,000 | 40.55 | 158.62 | 291.17% | 164.46 | 305.57% |
| 12,000 | 43.87 | 171.10 | 290.02% | 179.98 | 310.26% |
| 13,000 | 47.19 | 183.58 | 289.02% | 195.50 | 314.28% |
| 14,000 | 50.51 | 196.06 | 288.16% | 211.02 | 317.78% |
| 15,000 | 53.83 | 208.54 | 287.40% | 226.54 | 320.84% |
| 16,000 | 58.54 | 224.76 | 283.94% | 242.06 | 313.50% |
| 17,000 | 63.25 | 240.98 | 281.00% | 257.58 | 307.24% |
| 18,000 | 67.96 | 257.20 | 278.46% | 273.10 | 301.85% |
| 19,000 | 72.67 | 273.42 | 276.25% | 288.62 | 297.17% |
| 20,000 | 77.38 | 289.64 | 274.31% | 304.14 | 293.05% |
| 25,000 | 100.93 | 370.74 | 267.32% | 381.74 | 278.22% |
| 30,000 | 124.48 | 451.84 | 262.98% | 459.34 | 269.01% |
| 35,000 | 148.03 | 532.94 | 260.02% | 536.94 | 262.72% |
| 40,000 | 171.58 | 614.04 | 257.87% | 614.54 | 258.17% |
| 45,000 | 195.13 | 695.14 | 256.24% | 692.14 | 254.71% |
| 50,000 | 218.68 | 776.24 | 254.97% | 769.74 | 251.99% |
| 75,000 | 336.43 | 1,181.74 | 251.26% | 1,157.74 | 244.13% |
| 100,000 | 454.18 | 1,587.24 | 249.47% | 1,545.74 | 240.34% |

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. WS-04235A-06-0303
UTILITY SOURCE, L.L.C. FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PROPERTY AND)
FOR AN INCREASE IN ITS WATER AND)
WASTEWATER RATES AND CHARGES FOR)
UTILITY SERVICES.)
_____)

SURREBUTTAL

TESTIMONY

OF

JEFFREY M. MICHLIK

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MARCH 19, 2007

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**EXECUTIVE SUMMARY
UTILITY SOURCE, LLC-WASTEWATER
DOCKET NO. WS-04235A-06-0303**

Staff's surrebuttal testimony recommends revised rates that would increase operating revenues by \$110,149 to produce operating revenues of \$224,054 resulting in operating income of \$92,039, or a 96.70 percent increase over test year revenues of \$113,905. Staff also recommends a revised FVRB of \$1,034,141.

Revenue Requirement

Staff recommends its revenue requirement, revenue increase, and percentage of revenue increase.

Rate Base

Staff responds to the Company's adjustment to accumulated amortization of contributions in aid of construction ("CIAC"), and further comments on why some of the plant in service items should still be disallowed.

Income Statement

Staff responds to the Company's unfounded and incorrect assertions regarding why Staff originally accepted the Company's proposal.

Rate Design

Staff explains the new rate design and the effects it will have on wastewater customers.

1 **INTRODUCTION**

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

3 A. My name is Jeffrey M. Michlik. I am a Public Utilities Analyst V 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. Are you the same Jeffrey M. Michlik who filed direct testimony in this case?**

8 A. Yes, I am.
9

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

11 A. The purpose of my surrebuttal testimony in this proceeding is to provide Staff's response
12 to the rebuttal testimony of Utility Source, LLC ("Company") witness, Mr. Thomas J.
13 Bourassa, regarding revenue requirement, rate base, operating revenues and expenses, and
14 rate design.
15

16 **Q. Please explain how Staff's surrebuttal testimony is organized.**

17 A. Staff's surrebuttal testimony is generally organized to present issues in the same sequence
18 as presented in Mr. Bourassa's rebuttal testimony.
19

20 **Q. Does Staff's lack of response to a particular issue mean it is accepting the Company's
21 position on that issue?**

22 A. No. Staff's lack of response to any issue in this surrebuttal testimony should not be
23 construed as agreement with the Company's rebuttal testimony; rather, where there is no
24 response, Staff relies on its original direct testimony.

1 **RESPONSE TO MR. THOMAS J. BOURASSA'S REBUTTAL TESTIMONY**

2 **Revenue Requirement**

3 **Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding revenue**
4 **requirement?**

5 A. Yes.

6
7 **Q. Please summarize the proposed and recommended revenue requirement, revenue**
8 **increase, and percentage increase.**

9 A. The proposed and recommended revenue requirement, revenue increase, and percentage
10 increase are as follows:

11
12

| | <u>Revenue Requirement</u> | <u>Revenue Increase</u> | <u>Percentage Increase</u> |
|----------------------|----------------------------|-------------------------|----------------------------|
| 13 Company-Direct | \$301,124 | \$187,220 | 164.37 percent |
| 14 Staff-Direct | \$224,908 | \$111,003 | 97.45 percent |
| 15 Company-Rebuttal | \$283,384 | \$169,479 | 148.79 percent |
| 16 Staff-Surrebuttal | \$224,054 | \$110,149 | 96.70 percent |

17

18 **Q. Why is the Company's revenue requirement and proposed increase higher than**
19 **Staffs?**

20 A. As Mr. Bourassa suggests, the differences in revenue requirement are primarily a result of
21 the differences in rate base, cost of capital, and depreciation expense; with the balance
22 being attributed to the level of property taxes. *See* Rebuttal Testimony of Thomas J.
23 Bourassa ("Bourassa RT") at 2.

1 Q. Does the Company still propose to include pro forma revenues from future customer
2 growth in the determination of the revenue requirement and rate increase for the
3 sewer division?

4 A. Yes, See Bourassa RT at 2.

5

6 Q. Is Staff still willing to accept the Company's proposal to include future growth of 350
7 customers in the sewer division?

8 A. Yes.

9

10 **Rate Base**

11 Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding rate base?

12 A. Yes.

13

14 Q. Would you please identify each party's respective rate base recommendations?

15 A. Yes. The rate bases proposed and recommended by all parties in the case are as follows:

| | <u>OCRB</u> | <u>FVRB</u> |
|----------------------|-------------|-------------|
| 16 | | |
| 17 Company-Direct | \$1,401,953 | \$1,401,953 |
| 18 Staff | \$989,576 | \$989,576 |
| 19 Company Rebuttal | \$1,314,093 | \$1,314,093 |
| 20 Staff Surrebuttal | \$1,034,141 | \$1,034,141 |

1 **Q. Are there any adjustments to plant in service that were overlooked by Staff in direct**
2 **testimony?**

3 **A. Yes, Account 380 – Treatment and Disposal Equipment was valued at \$1,106,874 in the**
4 **original application and, per examination of the general ledger, was broken out as follows:**
5

| <u>Memo</u> | <u>Amount</u> |
|---------------------|------------------|
| Treatment Plant #1 | \$ 333,500 |
| Treatment Plant #2 | \$ 546,704 |
| Evaporative Lagoons | \$ 161,000 |
| Power to Site | \$ 16,100 |
| WWTP | \$ 3,750 |
| <u>WWTP</u> | <u>\$ 45,819</u> |
| Total | \$1,106,874 |

14
15 In response to Staff data request JCB 3.18 regarding Account #380 Treatment and
16 Disposal Equipment, Treatment Plant #2, and JCB 3.19 regarding Account #380
17 Treatment and Disposal Equipment – Evaporative Lagoons, the Company states that there
18 were mistakes in both sub accounts as one was understated and the other overstated. In
19 the case of Treatment Plant # 2 the Company stated that the original amount of \$546,704
20 was incorrect and the total treatment cost for Treatment Plant #2 should be \$463,011 a
21 decrease of \$83,693. In the case of the Evaporative Lagoons the Company stated that the
22 original amount of \$161,000 was understated and the total evaporative lagoons cost should
23 be \$220,586, an increase of \$59,586. The net effect of the overstatement of the costs for
24 Treatment Plant # 2 in the amount of \$83,693 and the understatement of the costs for the
25 evaporative lagoons in the amount of \$59,586 nets to a decrease of \$24,107 (i.e., 83,693-
26 59,586). This adjustment is reflected at line 3 of Staff Surrebuttal Schedule JMM-WW4.

1 **Q. Are there any other adjustments that you would like to make changes to in Staff's**
2 **direct testimony?**

3 A. Yes, due to a typographical error, the amount which Staff disallowed in the direct
4 testimony for account 380 treatment and disposal Equipment for Evaporative lagoons was
5 \$178,231, but should have been \$178,703. This adjustment is reflected at line 4 of Staff
6 Surrebuttal Schedule JMM-WW4.

7

8 **Q. Mr. Bourassa states that \$68,271 in costs related to wastewater treatment should be**
9 **included in plant in service. See Bourassa RT at 4. Has the Company provided**
10 **additional information to Staff to support its claim?**

11 A. Yes, per examination of the rebuttal testimony, contract, and additional information
12 provided by the Company, Staff has determined that this amount should be included in
13 wastewater treatment plant # 1, and has removed its adjustment of it in Staff Surrebuttal
14 Schedule JMM-WW4.

15

16 **Q. Mr. Bourassa states that \$178,231 (which is now \$178,703) of costs related to**
17 **evaporative lagoons consisting of water falls, streams, pond is an integral component**
18 **of the wastewater treatment system. See Bourassa RT at 5. Does Staff agree?**

19 A. No, per examination of the Arizona Department of Environmental Quality Aquifer
20 Protection Permit ("APP") # 104083, Flagstaff Meadows Wastewater Treatment Plant
21 ("WWTP"). Under the Facility Description:

22

23 "The WWTP process will consist of an influent lift station, headwork with bars screens,
24 an equalization basin, anoxic and aeration tanks for nitrification-denitrification, secondary
25 clarifiers, filters, a chlorine disinfection contact tank, dechlorination, a sludge holding
26 tank, sludge belt press thickeners, and effluent pump station, and a clay lined effluent

1 holding pond. The effluent generated is discharged into an unnamed tributary to
2 Volunteer Wash as regulated by the Arizona Discharge Elimination System permit
3 AZ0024708 and/or by reuse under a valid reuse permit.”
4

5 There is no mention of a lake with a fountain, waterfalls, streambeds or other additional
6 pond within the Company’s APP.
7

8 **Q. What is Staff’s understanding of an APP?**

9 A. It is Staff’s understanding that the APP serves as a blue print as to what the Company is
10 allowed to construct.
11

12 **Q. So Staff would agree after reading the Company’s APP, that the Company is allowed
13 to construct a clay lined effluent holding pond?**

14 A. Yes.
15

16 **Q. In Staff data request 5.3, did Staff specifically ask the Company why the lake,
17 waterfalls, streambeds and other pond were not mentioned in the APP?**

18 A. Yes.
19

20 **Q. What was the Company’s response?**

21 A. The Company responded that “the lake, water fall, stream and pond and all water features,
22 are lined and part of the APP facilities.

1 **Q. What is Staff's position?**

2 A. Staff does not agree. Staff, as stated earlier, believes the Company is allowed to construct
3 a clay lined effluent holding pond, and that any additional, decorative features beyond that
4 are at the Company's discretion and not required by ADEQ.

5

6 **Q. Please comment on Mr. Bourassa's statement that effluent used for the purpose of**
7 **turf irrigation is beneficial to the Company? See Bourassa RT at 9.**

8 A. Staff agrees with the Company's statement that the use of effluent for turf irrigation is
9 beneficial. However, that is not at issue, what is at issue is whether the rate payers should
10 pickup the costs of these additional water features that were not included in the APP.

11

12 **Q. Was the Company able to respond to Staff's data request 5.2 which asked for a**
13 **breakout of significant items included in the wastewater aeration system such as the**
14 **lake, waterfalls, streambeds and pond?**

15 A. No, Staff e-mailed a copy of an invoice in the amount of \$178,703 from Red Rock
16 Contractors which contained the Flagstaff Meadows Water Feature Project Overview, and
17 asked the Company to breakout these costs. The Company responded that it was unable to
18 breakout these costs.

19

20 **Q. Does Staff know if the pond mentioned in the APP is included in this invoice?**

21 A. No, the invoice does not mention the upper pond, and the Company was unable to
22 breakout the pond costs for Staff. Therefore, Staff, as in its direct testimony, believes the
23 water features are not a necessary component of the utility system, but contribute to a
24 park-like setting for the general development which has already profited the owners
25 through the sale of homes in the Flagstaff Meadows development project, and these costs
26 should be disallowed.

1 **Q. Are there also power costs involved to pump water from the holding pond to the**
2 **lake, and other costs related to operating the lake fountain?**

3 A. Yes, however at this point Staff is unable to breakout these costs, but recommends that the
4 Company be required to separate these costs in its next rate application so that these
5 expenses can be independently analyzed.

6

7 **Q. Mr. Bourassa states that Staff disallowed \$99,272 of costs related to wastewater**
8 **treatment plant #2, but should have included this amount as there is other sufficient**
9 **supporting documentation to substantiate the costs. See Bourassa RT at 5. Does**
10 **Staff accept this number?**

11 A. No, as mentioned earlier in response to Staff data request 2.1, the Company supplied Staff
12 with a detailed schedule of account balances in which the Company stated that account
13 380 Treatment and Disposal Equipment Treatment Plant # 2 was valued at \$546,704.
14 However, per examination of the Company's response to Staff data request number 3.18,
15 in which Staff asked for a detailed line item schedule of all costs incurred from Santec for
16 Treatment Plant # 2, the Company presented Staff with a different amount. The Company
17 stated that: "Our review of these costs, contract billings and change order billings found
18 the following Santec invoices to be applicable to the costs for account # 380 Treatment
19 and Disposal Equipment, Treatment Plant # 2." The revised cost presented by the
20 Company for Treatment Plant # 2 is \$463,011, a shortfall of \$83,693. Therefore, this
21 lends credence to Staff's adjustment as there is not other sufficient supporting
22 documentation to substantiate these costs (\$83,693) due to the Company's own admission
23 that it does not exist. Therefore, Staff is only making a \$13,579 adjustment (i.e.,
24 \$463,011-\$449,432 the number of cancelled checks) for unsubstantiated documentation.

1 **Q. Mr. Bourassa states that accumulated amortization of CIAC should be increased to**
2 **reflect 2 years of amortization. See Bourassa RT at 6. Does Staff accept this?**

3 A. Yes. However, the amount will differ due to Staff's CIAC amortization rate which is
4 calculated from the plant in service depreciation composite rate. Staff's adjustment
5 increases accumulated amortization by \$4,083, from \$8,167 to \$12,250 as the associated
6 accumulated amortization should include 2 years of amortization (using a ½ year
7 convention) starting in 2004. This adjustment is shown on Surrebuttal Schedule JMM-
8 WW6.

9
10 **Income Statement**

11 **Q. Has Staff reviewed Mr. Bourassa's rebuttal testimony regarding the income**
12 **statement?**

13 A. Yes.

14
15 **Q. Please comment on Mr. Bourassa's statement that Staff's acceptance of the**
16 **Company's direct proposal to include the 350 projected customers is justified in**
17 **order to further penalize the Company? See Bourassa RT at 9.**

18 A. This statement is unfounded and incorrect. If you read through its direct testimony
19 submitted, Staff specifically states throughout its testimony that it has accepted the
20 **Company's proposal in *an effort to alleviate the rate burden on customers***, as shown
21 below:

22
23 "Staff, in an *effort to alleviate the rate burden on customers*, has accepted the
24 **Company's proposal** and will include estimated usage of 350 homes that are currently
25 being built, in the rate design" See Direct Testimony of Jeffrey M. Michlik ("Michlik
26 DT") in the Executive Summary.

1 “Why is Staff accepting these projected numbers? The numbers submitted by the
2 Company are known projects currently under development and assume that the homes will
3 be built. The **Company has provided these numbers in an effort to minimize the**
4 **impact on the rates** and is not intended to set any precedent for this or any other utility
5 regulated by the Commission.” See Michlik DT at 11.

6
7 “In an effort to lessen the rate impact on customers, **the Company in its rate application**
8 **proposed including 350 homes that are currently being built.** Staff accepted the
9 Company’s proposal and has included these 350 customers in the rate design *in order to*
10 *ameliorate the rate shock that current and future customers will experience.*” See Michlik
11 DT at 17.

12
13 **Rate Design**

14 **Q. Has Staff reviewed Mr. Bourassa’s rebuttal testimony regarding Rate Design?**

15 A. Yes.

16
17 **Q. Has Staff’s rate design changed as a result of the Company’s rebuttal testimony?**

18 A. Yes, Staff has provided a revised rate design. See Surrebuttal Schedule JMM-WW11.

19
20 **Q. What is the rate impact on a ¾-inch meter residential customer using a median**
21 **consumption of 4,500 gallons?**

22 A. The median usage of residential ¾-inch meter customers is 4,500 gallons per month. The
23 ¾-inch meter residential customer would experience \$18.54 or 150.92 percent increase in
24 their monthly bill from \$12.29 to \$30.83 under the Company’s proposed rates and a
25 \$12.71 or 103.50 percent increase in their monthly bill from \$12.29 to \$25.00 under
26 Staff’s recommended rates. See Staff Surrebuttal Schedule JMM-WW12.

1 **Q. Does this conclude your surrebuttal testimony?**

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

REVENUE REQUIREMENT

| LINE NO. | DESCRIPTION | (A) COMPANY REBUTTAL ORIGINAL COST | (B) COMPANY REBUTTAL FAIR VALUE | (C) STAFF SURREBUTTAL ORIGINAL COST | (D) STAFF SURREBUTTAL FAIR VALUE |
|----------|---------------------------------------|--|---|---|--|
| 1 | Adjusted Rate Base | \$ 1,314,093 | \$ 1,314,093 | \$ 1,034,141 | \$ 1,034,141 |
| 2 | Adjusted Operating Income (Loss) | \$ (31,551) | \$ (31,551) | \$ (70,893) | \$ (70,893) |
| 3 | Current Rate of Return (L2 / L1) | -2.40% | -2.40% | -6.86% | -6.86% |
| 4 | Required Rate of Return | 10.50% | 10.50% | 8.90% | 8.90% |
| 5 | Required Operating Income (L4 * L1) | \$ 137,980 | \$ 137,980 | \$ 92,039 | \$ 92,039 |
| 6 | Operating Income Deficiency (L5 - L2) | \$ 169,531 | \$ 169,479 | \$ 162,931 | \$ 162,931 |
| 7 | Gross Revenue Conversion Factor | 1.0000 | 1.0000 | 1.0000 | 1.0000 |
| 8 | Required Revenue Increase (L7 * L6) | \$ 169,479 | \$ 169,479 | \$ 162,931 | \$ 162,931 |
| 9 | Adjusted Test Year Revenue | \$ 113,905 | \$ 113,905 | \$ 59,552 | \$ 59,552 |
| 10 | Proposed Annual Revenue (L8 + L9) | \$ 283,384 | \$ 283,384 | \$ 222,483 | \$ 222,483 |
| 11 | Required Increase in Revenue (%) | 148.79% | 148.79% | 273.59% | 273.59% |
| 12 | Rate of Return on Rate Base (%) | 10.50% | 10.50% | 8.90% | 8.90% |

References:

Column (A): Company Rebuttal Schedule B-1
Column (B): Company Rebuttal Schedule B-1
Column (C): Staff Surrebuttal Schedules JMM-WW2, JMM-WW7
Column (D): Staff Surrebuttal Schedules JMM-WW2, JMM-WW7

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Surrebuttal Schedule JMM-WW2

RATE BASE - ORIGINAL COST

| LINE NO. | (A) COMPANY REBUTTAL AS FILED | (B) STAFF SURREBUTTAL ADJUSTMENTS | REF | (C) STAFF SURREBUTTAL AS ADJUSTED |
|--------------|---|--|---------|---|
| 1 | \$ 1,595,481 | \$ (302,082) | ADJ # 1 | \$ 1,293,399 |
| 2 | 96,191 | (22,656) | ADJ # 2 | 73,535 |
| 3 | <u>\$ 1,499,290</u> | <u>\$ (279,426)</u> | | <u>\$ 1,219,864</u> |
| <u>LESS:</u> | | | | |
| 4 | \$ 197,973 | \$ - | | \$ 197,973 |
| 5 | 12,777 | (527) | ADJ # 3 | 12,250 |
| 6 | <u>185,196</u> | <u>527</u> | | <u>185,723</u> |
| 7 | - | - | | - |
| 8 | - | - | | - |
| 9 | - | - | | - |
| <u>ADD:</u> | | | | |
| 10 | - | - | | - |
| 11 | - | - | | - |
| 12 | - | - | | - |
| 13 | <u>\$ 1,314,094</u> | <u>\$ (279,953)</u> | | <u>\$ 1,034,141</u> |

References:

Column (A), Company Rebuttal Schedule B-1
 Column (B): Surrebuttal Schedule JMM-WW3
 Column (C): Column (A) + Column (B)

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

| LINE NO. | ACCT. NO. | DESCRIPTION | (A) COMPANY REBUTTAL AS FILED | (B) STAFF SURREBUTTAL PLANT IN SERVICE ADJ.NO.1 | (C) STAFF SURREBUTTAL ACCUM DEPREC ADJ.NO.2 | (D) STAFF SURREBUTTAL AIAC TO CIAC ADJ.NO.3 | (E) STAFF ADJUSTED |
|--------------------------|-----------|---|--|---|---|---|--------------------------|
| PLANT IN SERVICE: | | | | | | | |
| 1 | | Organization | \$ - | \$ - | \$ - | \$ - | \$ - |
| 2 | 351 | Franchises | - | - | - | - | - |
| 3 | 352 | Land and Land Rights | 105,000 | - | - | - | 105,000 |
| 4 | 353 | Structures & Improvements | 56,350 | - | - | - | 56,350 |
| 5 | 354 | Power Generation Equipment | 2,879 | - | - | - | 2,879 |
| 6 | 355 | Collection Sewers - Force | - | - | - | - | - |
| 7 | 360 | Collection Sewers - Gravity | 260,553 | - | - | - | 260,553 |
| 8 | 361 | Special Collecting Structures | - | - | - | - | - |
| 9 | 362 | Services to Customers | 60,375 | - | - | - | 60,375 |
| 10 | 363 | Flow Measuring Devices | - | - | - | - | - |
| 11 | 364 | Flow Measuring Installations | 3,450 | - | - | - | 3,450 |
| 12 | 365 | Receiving Wells | - | - | - | - | - |
| 13 | 370 | Pumping Equipment | - | - | - | - | - |
| 14 | 371 | Treatment and Disposal Equipment | 1,106,874 | (302,082) | - | - | 804,792 |
| 15 | 380 | Plant Sewers | - | - | - | - | - |
| 16 | 381 | Outfall Sewer Lines | - | - | - | - | - |
| 17 | 382 | Other Plant & Misc. Equipment | - | - | - | - | - |
| 18 | 389 | Office Furniture & Equipment | - | - | - | - | - |
| 19 | 390 | Transportation Equipment | - | - | - | - | - |
| 20 | 391 | Tools, Ship & Garage Equipment | - | - | - | - | - |
| 21 | 393 | Laboratory Equipment | - | - | - | - | - |
| 22 | 394 | Power Operated Equipment | - | - | - | - | - |
| 23 | 395 | Other Tangible Plant | - | - | - | - | - |
| 24 | 398 | | - | - | - | - | - |
| 25 | | | 1,595,481 | (302,082) | - | - | 1,293,399 |
| 26 | | | - | - | - | - | - |
| 27 | | Add: | - | - | - | - | - |
| 28 | | | - | - | - | - | - |
| 29 | | | - | - | - | - | - |
| 30 | | | - | - | - | - | - |
| 31 | | Less: | - | - | - | - | - |
| 32 | | | - | - | - | - | - |
| 33 | | | - | - | - | - | - |
| 34 | | | - | - | - | - | - |
| 35 | | Total Plant in Service | \$ 1,595,481 | \$ (302,082) | \$ - | \$ - | \$ 1,293,399 |
| 36 | | Less: Accumulated Depreciation | 96,191 | - | (22,656) | - | 73,535 |
| 37 | | Net Plant in Service (L59 - L 60) | \$ 1,499,290 | \$ (302,082) | \$ 22,656 | \$ - | \$ 1,219,864 |
| 38 | | | - | - | - | - | - |
| 39 | | LESS: | - | - | - | - | - |
| 40 | | Contributions in Aid of Construction (CIAC) | - | - | - | - | - |
| 41 | | Less: Accumulated Amortization | 197,973 | - | - | - | 197,973 |
| 42 | | Net CIAC (L25 - L26) | 12,777 | - | - | (527) | 12,250 |
| 43 | | Advances in Aid of Construction (AIAC) | 185,196 | - | - | - | 185,196 |
| 44 | | Customer Meter Deposits | - | - | - | - | - |
| 45 | | Deferred Income Tax Credits | - | - | - | - | - |
| 46 | | | - | - | - | - | - |
| 47 | | ADD: | - | - | - | - | - |
| 48 | | Unamortized Finance Charges | - | - | - | - | - |
| 49 | | Deferred Tax Assets | - | - | - | - | - |
| 50 | | Working Capital | - | - | - | - | - |
| 51 | | | - | - | - | - | - |
| 52 | | | - | - | - | - | - |
| 53 | | Original Cost Rate Base | \$ 1,314,094 | \$ (302,082) | \$ 22,656 | \$ - | \$ 1,034,668 |

| ADJ.# | References: |
|-------|-------------------------------|
| 1 | Plant in Service |
| 2 | Accumulated Depreciation |
| 3 | AIAC Reclassification to CIAC |
| | Surrebuttal Schedule JMM-WW4 |
| | Surrebuttal Schedule JMM-WW5 |
| | Surrebuttal Schedule JMM-WW6 |

RATE BASE ADJUSTMENT NO. 1 - PLANT ADJUSTMENTS

| LINE NO. | DESCRIPTION | [A] | [B] | [C] |
|--|--|---------------------|---------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Treatment and Disposal Equipment (Account 380) | 1,106,874 | (302,082) | 804,792 |
| 2 | Totals | <u>\$ 1,106,874</u> | <u>\$ (302,082)</u> | <u>\$ 804,792</u> |
| <u>Staff's Calculation of Treatment and Disposal Equipment (Account 380)</u> | | | | |
| 3 | Adjustments for the Company's overstatement and understatement of sub accounts | \$ (24,107) | | |
| 4 | Removal of manmade water falls, streams, ponds and lakes | (178,703) | | |
| 5 | Unsubstantiated costs of \$99,272 relating to Treatment Plant No. 2 | <u>(99,272)</u> | | |
| 6 | Total | <u>\$ (302,082)</u> | | |

References:

Column A: Company Rebuttal Schedule B-1, Page 1
 Column B: Testimony, JMM, Surrebuttal Schedule JMM-WW3
 Column C: Column [A] + Column [B]

RATE BASE ADJUSTMENT NO. 2 - ACCUMULATED DEPRECIATION

| LINE NO. | DESCRIPTION | [A] | | [B] | | [C] | |
|----------|--------------------------------------|---------------------------------------|-------------------------------|------------------|----------------|------------|------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS AS ADJUSTED | Recommended Rate | HALF YEAR DEP. | 12/31/2004 | 12/31/2005 |
| 1 | Accumulated Depreciation | \$ 96,191 | \$ (22,656) | \$ | \$ 73,535 | | |
| ACCT | | AT ENGINEER RECOMMENDED RATES | | A.D. | | A.D. | |
| NO | DESCRIPTION | Total Plant Staff Adjusted 12/31/2004 | Recommended Rate | HALF YEAR DEP. | 12/31/2004 | 12/31/2005 | 12/31/2005 |
| 2 | 351 Organization | - | - | - | - | - | - |
| 3 | 352 Franchises | - | - | - | - | - | - |
| 4 | 353 Land and Land Rights | 105,000 | 0.00% | - | - | 105,000 | - |
| 5 | 354 Structures & Improvements | 56,350 | 3.33% | 938 | 938 | 56,350 | 1,876 |
| 6 | 355 Power Generation Equipment | 2,879 | 5.00% | 72 | 72 | 2,879 | 144 |
| 7 | 360 Collection Sewers - Force | - | 2.00% | - | - | - | - |
| 8 | 361 Collection Sewers - Gravity | 260,553 | 2.00% | 2,606 | 2,606 | 260,553 | 5,211 |
| 9 | 362 Special Collecting Structures | - | 2.00% | - | - | - | - |
| 10 | 363 Services to Customers | 60,375 | 2.00% | 604 | 604 | 60,375 | 1,208 |
| 11 | 364 Flow Measuring Devices | - | 10.00% | - | - | - | - |
| 12 | 365 Flow Measuring Installations | 3,450 | 10.00% | 173 | 173 | 3,450 | 345 |
| 13 | 370 Receiving Wells | - | 3.33% | - | - | - | - |
| 14 | 371 Pumping Equipment | - | 12.50% | - | - | - | - |
| 15 | 380 Treatment and Disposal Equipment | 804,792 | 5.00% | 20,120 | 20,120 | 804,792 | 40,240 |
| 16 | 381 Plant Sewers | - | 5.00% | - | - | - | - |
| 17 | 382 Outfall Sewer Lines | - | 3.33% | - | - | - | - |
| 18 | 389 Other Plant & Misc. Equipment | - | 6.67% | - | - | - | - |
| 19 | 390 Office Furniture & Equipment | - | 6.67% | - | - | - | - |
| 20 | 391 Transportation Equipment | - | 20.00% | - | - | - | - |
| 21 | 393 Tools, Ship & Garage Equipment | - | 5.00% | - | - | - | - |
| 22 | 394 Laboratory Equipment | - | 10.00% | - | - | - | - |
| 23 | 395 Power Operated Equipment | - | 5.00% | - | - | - | - |
| 24 | 398 Other Tangible Plant | - | 10.00% | - | - | - | - |
| 25 | | - | - | - | - | - | - |
| 26 | | 1,293,399 | | 24,512 | 24,512 | 1,293,399 | 49,024 |
| 27 | | | | | | | |
| 28 | | | | | | | |

Composite Rate: 4.1252%
 Depreciable Plant: 1,188,399

References:
 Column A: Company Rebuttal Schedule B-1, Page 1
 Column B: Testimony, JMM, Surrebuttal Schedule JMM-WW3
 Column C: Column [A] + Column [B]

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Surrebuttal Schedule JMM-WW6

RATE BASE ADJUSTMENT NO. 3 - ACCUMULATED AMORTIZATION OF CONTRIBUTIONS IN AID OF CONSTRUCTION

| LINE NO. | DESCRIPTION | [A] | [B] | [C] |
|----------|--------------------------------|------------------|-------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Accumated Amortization of CIAC | \$ 12,777 | \$ (527) | \$ 12,250 |

Staff's amortization of CIAC

| | | |
|---|--|------------|
| 3 | Amortization of CIAC: | \$ 197,973 |
| 4 | Composite amortization rate (see JMM-WW5): | 4.1252% |
| 5 | Amortized CIAC: | \$ 8,167 |
| | Plus prior year amortization (using 1/2 year convention) | \$ 4,083 |
| 6 | Accumulated Amortization of CIAC | \$ 12,250 |

References:

Column A: Company Rebuttal Schedule B-1, Page 1
 Column B: Testimony, JMM, Surrebuttal Schedule JMM-WW3
 Column C: Column [A] + Column [B]

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

| LINE NO. | DESCRIPTION | [A] COMPANY REBUTTAL TEST YEAR AS FILED | [B] STAFF SURREBUTTAL TEST YEAR ADJUSTMENTS | [C] STAFF SURREBUTTAL TEST YEAR AS ADJUSTED | [D] STAFF SURREBUTTAL PROPOSED CHANGES | [E] STAFF SURREBUTTAL RECOMMENDED |
|----------|---|---|---|--|--|--|
| 1 | <u>REVENUES:</u> | | | | | |
| 2 | Metered Water Sales | \$ 112,248 | \$ (54,353) ADJ # 1 | \$ 57,895 | \$ 162,931 | \$ 220,826 |
| 3 | Water Sales - Unmetered | - | - | - | - | - |
| 4 | Other Operating Revenue | 1,657 | - | 1,657 | - | 1,657 |
| 5 | Total Operating Revenues | \$ 113,905 | \$ (54,353) | \$ 59,552 | \$ 162,931 | \$ 222,483 |
| | <u>OPERATING EXPENSES:</u> | | | | | |
| 6 | Salaries and Wages | \$ - | \$ - | \$ - | \$ - | \$ - |
| 7 | Purchased Wastewater Treatment | - | - | - | - | - |
| 8 | Sludge Removal Expense | - | - | - | - | - |
| 9 | Purchased Power | 17,423 | - | 17,423 | - | 17,423 |
| 10 | Fuel for Power Production | - | - | - | - | - |
| 11 | Chemicals | 3,945 | - | 3,945 | - | 3,945 |
| 12 | Materials and Supplies | 4,793 | - | 4,793 | - | 4,793 |
| 13 | Contractual Services- Professional | 1,195 | - | 1,195 | - | 1,195 |
| 14 | Contractual Services- Testing | 24,902 | - | 24,902 | - | 24,902 |
| 15 | Contractual Services- Other | 15,000 | - | 15,000 | - | 15,000 |
| 16 | Repairs and Maintenance | - | - | - | - | - |
| 17 | Waste Water Testing Expense | - | - | - | - | - |
| 18 | Rents | - | - | - | - | - |
| 19 | Transportation Expenses | - | - | - | - | - |
| 20 | Insurance | - | - | - | - | - |
| 21 | Regulatory Commission Expense - Rate Case | 12,500 | - | 12,500 | - | 12,500 |
| 22 | Miscellaneous Expense | 4,965 | - | 4,965 | - | 4,965 |
| 23 | Depreciation Expense | 55,610 | (14,753) ADJ # 2 | 40,857 | - | 40,857 |
| 24 | Taxes Other Than Income | - | - | - | - | - |
| 25 | Property Taxes | 5,123 | (258) ADJ # 3 | 4,865 | - | 4,865 |
| 26 | Income Tax | - | - | - | - | - |
| 27 | | | | | | |
| 28 | Total Operating Expenses | \$ 145,456 | \$ (15,011) | \$ 130,445 | \$ - | \$ 130,445 |
| 29 | Operating Income (Loss) | \$ (31,551) | \$ (39,342) | \$ (70,893) | \$ 162,931 | \$ 92,039 |

References:

Column (A): Company Rebuttal Schedule C-1
Column (B): Surrebuttal Schedule JMM-WW8
Column (C): Column (A) + Column (B)
Column (D): Surrebuttal Schedule JMM-WW1
Column (E): Column (C) + Column (D)

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

| LINE NO. | DESCRIPTION | [A] COMPANY REBUTTAL AS FILED | [B] STAFF SURREBUTTAL ADJ #1 Revenues | [D] STAFF SURREBUTTAL ADJ #2 Depreciation Exp | [D] STAFF SURREBUTTAL ADJ #3 Property Tax | [E] STAFF SURREBUTTAL ADJUSTED |
|----------|---|--|---|---|---|---|
| 1 | REVENUES: | | | | | |
| 2 | Fiat Rate and Metered Revenues | 112,248 | (54,353) | - | - | 57,895 |
| 3 | Misc. Service Revenues | - | - | - | - | - |
| 4 | Other Wastewater Revenues | 1,657 | - | - | - | 1,657 |
| 5 | Total Operating Revenues | <u>113,905</u> | <u>(54,353)</u> | <u>-</u> | <u>-</u> | <u>59,552</u> |
| 6 | OPERATING EXPENSES: | | | | | |
| 7 | Salaries and Wages | - | - | - | - | - |
| 8 | Purchased Wastewater Treatment | - | - | - | - | - |
| 9 | Sludge Removal Expense | - | - | - | - | - |
| 10 | Purchased Power | 17,423 | - | - | - | 17,423 |
| 11 | Fuel for Power Production | - | - | - | - | - |
| 12 | Chemicals | 3,945 | - | - | - | 3,945 |
| 13 | Materials and Supplies | 4,793 | - | - | - | 4,793 |
| 14 | Contractual Services- Professional | 1,195 | - | - | - | 1,195 |
| 15 | Contractual Services- Testing | 24,902 | - | - | - | 24,902 |
| 16 | Contractual Services- Other | 15,000 | - | - | - | 15,000 |
| 17 | Repairs and Maintenance | - | - | - | - | - |
| 18 | Waste Water Testing Expense | - | - | - | - | - |
| 19 | Rents | - | - | - | - | - |
| 20 | Transportation Expenses | - | - | - | - | - |
| 21 | Insurance | - | - | - | - | - |
| 22 | Regulatory Commission Expense - Rate Case | 12,500 | - | - | - | 12,500 |
| 23 | Miscellaneous Expense | 4,965 | - | - | - | 4,965 |
| 24 | Depreciation Expense | 55,610 | - | (14,753) | - | 40,857 |
| 25 | Taxes Other Than Income | - | - | - | - | - |
| 26 | Property Taxes | 5,123 | - | (258) | (258) | 4,865 |
| 27 | Income Tax | - | - | - | - | - |
| 28 | Total Operating Expenses | <u>145,456</u> | <u>-</u> | <u>(15,011)</u> | <u>(258)</u> | <u>130,445</u> |
| 29 | Operating Income (Loss) | <u>(31,551)</u> | <u>(54,353)</u> | <u>15,011</u> | <u>258</u> | <u>(70,893)</u> |

| ADJ # | | References: |
|-------|----------------------|-------------------------------|
| 1 | Pro Forma Revenues | Surrebuttal Schedule JMM-WW9 |
| 2 | Depreciation Expense | Surrebuttal Schedule JMM-WW10 |
| 3 | Property Taxes | Surrebuttal Schedule JMM-WW11 |

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Surrebuttal Schedule JMM-WW9

OPERATING INCOME ADJUSTMENT # 1 - REMOVAL OF PRO FORMA REVENUES

| | | [A] | [B] | [C] |
|----------|---------------------|------------------|-------------------|-------------------|
| LINE NO. | DESCRIPTION | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Metered Water Sales | \$ 112,248 | \$ (54,353) | \$ 57,895 |

Staff's Calculation

Removal of Pro forma Revenues in response to Company's rebuttal testimony. \$ 54,353

References:

- Column A: Company Schedule C-1
- Column B: Testimony, JMM, Schedule JMM-W9
- Column C: Column [A] + Column [B]

OPERATING EXPENSE ADJUSTMENT NO. 3 - PROPERTY TAX

| LINE NO. | Property Tax Calculation | [A] | [B] | (C) |
|----------|---|------------------|------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENT | STAFF AS ADJUSTED |
| 1 | Property Taxes | \$ 5,123 | \$ (258) | \$ 4,865 |
| | <u>Staff's Calculation of Property Tax</u> | | | |
| 2 | Staff Adjusted Test Year Revenues - 2002 | | | \$ 59,552 |
| 3 | Weight Factor | | | <u>2</u> |
| 4 | Subtotal (Line 1 * Line 2) | | | 119,104 |
| 5 | Staff Recommended Revenue, Per Schedule JMM-WW1 | | | 222,483 |
| 6 | Subtotal (Line 4 + Line 5) | | | 341,587 |
| 7 | Number of Years | | | 3 |
| 8 | Three Year Average (Line 5 / Line 6) | | | 113,862 |
| 9 | Department of Revenue Multiplier | | | 2 |
| 10 | Revenue Base Value (Line 7 * Line 8) | | | 227,725 |
| 11 | Plus: 10% of CWIP - 2002 | | | - |
| 12 | Less: Net Book Value of Licensed Vehicles | | | - |
| 13 | Full Cash Value (Line 9 + Line 10 - Line 11) | | | 227,725 |
| 14 | Assessment Ratio | | | 23.50% |
| 15 | Assessment Value (Line 12 * Line 13) | | | 53,515 |
| 16 | Composite Property Tax Rate (Per Company Schedule C-2, Page 3, Line 16) | | | <u>9.0903%</u> |
| 17 | Staff Proposed Property Tax Expense (Line 14 * Line 15) | | | \$ 4,865 |
| 18 | Company Proposed Property Tax | | | <u>5,123</u> |
| 19 | Increase/(Decrease) to Property Tax Expense | | | <u>\$ (258)</u> |

References:

Column A: Company Rebuttal Schedule B-1, Page 1
Column B: Testimony, JMM, Surrebuttal Schedule JMM-WW8
Column C: Column [A] + Column [B]

RATE DESIGN

| Monthly Minimum Charge | Present Rates | Company Proposed Rates | Staff Recommended Rates |
|--|---------------|------------------------|-------------------------|
| Rate per 1,000 gal. water usage | | | |
| Residential | \$ 2.73 | \$ 6.85 | \$ 10.43 |
| Car washes, Laundromats, commercial, manufacturing | 2.67 | 6.70 | 10.20 |
| Hotels and Motels | 3.58 | 8.99 | 13.68 |
| Restaurants | 4.42 | 11.09 | 16.88 |
| Industrial Laundries | 3.92 | 9.84 | 14.97 |
| Waste Haulers | 80.00 | 200.80 | 305.60 |
| Restaurant Grease | 70.00 | 175.70 | 267.40 |
| Treatment Plant Sludge | 80.00 | 200.80 | 305.60 |
| Mud Sump Waste | 250.00 | 627.50 | 955.00 |
| Service Charges | | | |
| Establishment | \$ 20.00 | \$ 20.00 | \$ 20.00 |
| Establishment of Services after hours | 40.00 | 40.00 | 40.00 |
| Re-establishment of Service | * | * | * |
| Reconnection Services | 50.00 | 50.00 | 50.00 |
| Reconnection (Delinquent and After Hours) | 40.00 | 40.00 | 40.00 |
| Minimum Deposit Requirement | ** | ** | ** |
| Deposit Interest | 3.00% | 3.00% | Per Rule |
| Charges for NSF Check | 20.00 | 20.00 | 20.00 |
| Deferred Payment Finance Charge | 1.50% | 1.50% | *** |
| Late Payment, Per Month | *** | *** | *** |
| Service Calls, per hour (After hours only) | 40.00 | 40.00 | 40.00 |
| Service Lateral Connection Charge: | | | |
| Residential | 500.00 | 500.00 | 500.00 |
| Commercial | Cost | Cost | Cost |
| Main Extension Tariff | Cost | Cost | Cost |

* Per Commission Rule R14-2-603(D)
 ** Per Commission Rule R14-2-603(B)
 *** Per Commission Rule R14-2-608(F)

Typical Bill Analysis
 General Service 3/4-Inch Meter

| Company Proposed | Gallons | Present Rates | Proposed Rates | Dollar Increase | Percent Increase |
|--------------------------|---------|---------------|----------------|-----------------|------------------|
| Average Usage | 4,740 | \$ 12.94 | \$ 34.51 | \$ 21.57 | 166.67% |
| Median Usage | 4,500 | 12.29 | 32.76 | \$ 20.48 | 166.67% |
| Staff Recommended | | | | | |
| Average Usage | 4,740 | \$ 12.94 | \$ 49.43 | \$ 36.49 | 282.00% |
| Median Usage | 4,500 | 12.29 | 46.93 | \$ 34.64 | 282.00% |

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

| Gallons Consumption | Present Rates | Company Proposed Rates | % Increase | Staff Recommended Rates | % Increase |
|---------------------|---------------|------------------------|------------|-------------------------|------------|
| - | \$ - | \$ - | - | \$ - | - |
| 1,000 | 2.73 | 7.28 | 166.67% | 10.43 | 282.00% |
| 2,000 | 5.46 | 14.56 | 166.67% | 20.86 | 282.00% |
| 3,000 | 8.19 | 21.84 | 166.67% | 31.29 | 282.00% |
| 4,000 | 10.92 | 29.12 | 166.67% | 41.71 | 282.00% |
| 5,000 | 13.65 | 36.40 | 166.67% | 52.14 | 282.00% |
| 6,000 | 16.38 | 43.68 | 166.67% | 62.57 | 282.00% |
| 7,000 | 19.11 | 50.96 | 166.67% | 73.00 | 282.00% |
| 8,000 | 21.84 | 58.24 | 166.67% | 83.43 | 282.00% |
| 9,000 | 24.57 | 65.52 | 166.67% | 93.86 | 282.00% |
| 10,000 | 27.30 | 72.80 | 166.67% | 104.29 | 282.00% |
| 11,000 | 30.03 | 80.08 | 166.67% | 114.71 | 282.00% |
| 12,000 | 32.76 | 87.36 | 166.67% | 125.14 | 282.00% |
| 13,000 | 35.49 | 94.64 | 166.67% | 135.57 | 282.00% |
| 14,000 | 38.22 | 101.92 | 166.67% | 146.00 | 282.00% |
| 15,000 | 40.95 | 109.20 | 166.67% | 156.43 | 282.00% |
| 16,000 | 43.68 | 116.48 | 166.67% | 166.86 | 282.00% |
| 17,000 | 46.41 | 123.76 | 166.67% | 177.29 | 282.00% |
| 18,000 | 49.14 | 131.04 | 166.67% | 187.71 | 282.00% |
| 19,000 | 51.87 | 138.32 | 166.67% | 198.14 | 282.00% |
| 20,000 | 54.60 | 145.60 | 166.67% | 208.57 | 282.00% |
| 25,000 | 68.25 | 182.00 | 166.67% | 260.72 | 282.00% |
| 30,000 | 81.90 | 218.40 | 166.67% | 312.86 | 282.00% |
| 35,000 | 95.55 | 254.80 | 166.67% | 365.00 | 282.00% |
| 40,000 | 109.20 | 291.20 | 166.67% | 417.14 | 282.00% |
| 45,000 | 122.85 | 327.60 | 166.67% | 469.29 | 282.00% |
| 50,000 | 136.50 | 364.00 | 166.67% | 521.43 | 282.00% |
| 75,000 | 204.75 | 546.00 | 166.67% | 782.15 | 282.00% |
| 100,000 | 273.00 | 728.00 | 166.67% | 1,042.86 | 282.00% |

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. WS-04235A-06-0303
UTILITY SOURCE, L.L.C. FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PROPERTY AND)
FOR AN INCREASE IN ITS WATER AND)
WASTEWATER RATES AND CHARGES FOR)
UTILITY SERVICE)

SURREBUTTAL
TESTIMONY
OF
STEVEN P. IRVINE
PUBLIC UTILITIES ANALYST III
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

MARCH 19, 2007

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**EXECUTIVE SUMMARY
UTILITY SOURCE, L.L.C.
DOCKET NO. WS-04235A-06-00303**

The surrebuttal testimony of Staff witness Steven P. Irvine addresses the following issues:

Capital Structure – Staff recommends that the Arizona Corporation Commission (“Commission”) adopt a capital structure for Utility Source, L.L.C. (“Applicant” or “Company”) for this proceeding consisting of 0 percent debt and 100 percent equity.

Cost of Equity – Staff’s estimated return on equity (“ROE”) for the Applicant is based on cost of equity estimates for the sample companies of 9.4 percent for the capital asset pricing model (“CAPM”) and 8.4 percent for the discounted cash flow method (“DCF”).

Overall Rate of Return – Staff recommends that the Commission adopt an overall rate of return (“ROR”) of 8.9 percent.

Response to Mr. Bourassa’s Rebuttal Testimony – The Commission should reject the Company proposed 10.5 percent ROE for the following reasons:

1. The Company’s DCF estimates rely exclusively on analyst’s forecasts. In addition, the Company’s DCF constant growth analysis does not include dividend growth.
2. The Company’s risk premium analysis is not market based and inappropriately relies on forecasted interest rates for 10-year Treasuries for 2007-2008.

1 **I. INTRODUCTION**

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

3 A. My name is Steve Irvine. 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. Did you previously file direct testimony dealing with cost of capital in this case?**

8 A. Yes.

9
10 **Q. What matters are addressed in your surrebuttal testimony?**

11 A. This surrebuttal testimony presents an update of Staff's cost of capital analysis and related
12 recommendations for Utility Source, L.L.C. ("Utility Source" or "Company") and
13 responds to cost of capital elements of the rebuttal testimony of Utility Source Witness
14 Mr. Thomas J. Bourassa.

15
16 **Q. Please explain how Staff's surrebuttal testimony is organized.**

17 A. Staff's surrebuttal testimony is presented in four sections. Section I is this introduction.
18 Section II discusses Staff's updated cost of capital analysis. Section III presents Staff's
19 comments on the cost of capital elements of the rebuttal testimony of the Applicant's cost
20 of capital witness, Mr. Thomas J. Bourassa. Section III contains five subheadings that
21 group together common issues related to the Company's cost of capital rebuttal testimony.
22 The subheadings are: unique risk and size; comparison to actual and authorized returns;
23 analyst forecasts; Staff inputs; and capital asset pricing model ("CAPM"). Lastly, Section
24 IV presents Staff's cost of capital recommendations.

1 **II. UPDATED COST OF CAPITAL ANALYSIS**

2 **Q. Has Staff updated its cost of capital (“COC”) analysis since filing direct testimony?**

3 A. Yes. Staff has updated the analysis to reflect more current market data. Surrebuttal
4 schedules SPI-1 through SPI-8 are included to support the new results and analysis.

5

6 **Q. Has Staff updated the capital structure?**

7 A. No. Staff continues to recommend a capital structure composed of 0 percent debt and 100
8 percent equity.

9

10 **Q. Has Staff changed its method of calculating rate of return (“ROR”)?**

11 A. No. The methodology has not been changed.

12

13 **Q. What is Staff’s updated return on equity (“ROE”)?**

14 A. The ROE in Staff’s direct testimony was 9.6 percent. Staff now recommends an 8.9
15 percent ROE.

16

17 **Q. What is Staff’s updated ROR estimate?**

18 A. The ROR in Staff’s direct testimony was 9.6 percent. Staff now recommends an 8.9
19 percent overall ROR for Utility Source. Staff’s recommendation is based on an ROE of
20 8.9 percent and a cost of debt of 0 percent.

1 **III. RESPONSE TO THE REBUTTAL TESTIMONY OF THE APPLICANT'S COST**
2 **OF CAPITAL WITNESS MR. THOMAS J. BOURASSA**

3 **Q. Are there any overriding issues with the Company's position that sheds light on the**
4 **Company's cost of capital testimony?**

5 A. Yes. The Company's rebuttal testimony contains wrong conclusions, inconsistencies,
6 misapplies concepts, and ignores important factors. However, the most revealing aspect
7 of the Company's cost of capital testimony is its demonstration of a fundamental
8 misunderstanding of the cost of equity itself. A major criticism by the Company of Staff's
9 approach is the selection of inputs to the models. However, the Company has no credible
10 grounds to criticize the inputs used by Staff in its cost of capital models. In addition, the
11 Company has not selected superior inputs for cost of capital models.

12
13 **Unique Risk and Size**

14 **Q. What is Staff's response to the Company's assertion that, "If there is a lack of**
15 **diversification, limited revenues and cash flow, small customer base, higher**
16 **regulatory risk, and higher liquidity risk, investors do care and risk is higher"?¹**

17 A. It is unclear whether the reference to lack of diversification refers to diversification of an
18 investor's portfolio or the business lines of a company. If the statement means to convey
19 that unique risks are important to an investor who does not hold a diversified portfolio, the
20 statement may be true but is irrelevant to determination of cost of equity. Investors who
21 hold diverse portfolios can eliminate non-systematic risk. Therefore, only systematic risk
22 affects the cost of equity. The market does not reward for unique risk as it can be
23 diversified away. If the statement means to cite lack of diversification of a company's
24 business lines as an example of a unique risk that is a concern to investors, the statement
25 may be true of investors who do not hold diverse portfolios, but is untrue for investors

¹ Thomas J. Bourassa's rebuttal testimony. Page 17.

1 holding diverse portfolios. Again, investors who hold diverse portfolios can eliminate
2 non-systematic risk. Therefore, only systematic risk affects the cost of equity. The
3 market does not reward for unique risk as it can be diversified away.
4

5 **Q. Referring more specifically to the matter of size, what is Staff's response to the**
6 **Company's argument that Utility Source faces additional risk related to the small**
7 **size of the Company compared to the sample group?²**

8 A. A firm's size is a unique risk. The market does not reward for unique risk as it can be
9 diversified away. In previous decisions the Commission has determined that small size is
10 not grounds for a risk premium.³
11

12 **Q. What is Staff's response to the Company's assertion that the averages of the sample**
13 **companies' betas do not reflect Utility Source's level of risk.⁴**

14 A. The Commission has regularly adopted Staff's recommended ROE's for utilities whose
15 stock is not traded based on use of these same sample companies. Furthermore, Staff's
16 use of the sample companies for its CAPM analysis is just as valid as the Company's use
17 of the sample for its DCF analysis. The sample companies and Utility Source are similar
18 in that they are regulated utilities and serve captive customers. Any unique risks which
19 may differentiate Utility Source from the sample companies are diversifiable and not
20 grounds for a risk premium.

² Ibid. Page 17.

³ Examples can be found in Decision Nos. 64282, 64727, and 66849.

⁴ Thomas J. Bourassa's rebuttal testimony. Page 17.

1 **Q. What is Staff's response to the Company's Exhibit No. 2 that contains a 2004 staff**
2 **memorandum from the California Public Utilities Commission ("CPUC") detailing**
3 **differing rate of return guidelines based on company size?**

4 A. The Arizona Corporation Commission has previously ruled that firm size does not warrant
5 recognition of a risk premium. Furthermore, as investors' expectations change over time,
6 cost of equity findings made in 2004 should not be used as a basis for cost of equity
7 estimation in 2007.

8
9 **Q. Can Staff cite any studies that address the effects of a utility's small size on its cost of**
10 **capital?**

11 A. Yes. This matter is the subject of a study by Annie Wong, which was published in the
12 *Journal of the Midwest Finance Association* in 1993. The study concluded that while a
13 firm size risk factor may be required for industrial firms, it is not required for utilities:

14
15 The objective of this study is to examine if the size effect exists in the
16 utility industry. After controlling for equity values, there is some weak
17 evidence that firm size is a missing factor from the CAPM for the
18 industrial but not for the utility stocks. This implies that although the size
19 phenomenon has been strongly documented for the industrials, the
20 findings suggest that there is no need to adjust for the firm size in utility
21 rate regulations.⁵

22

⁵ Wong, Annie. "Utility Stocks and the Size Effect: An Empirical Analysis." *Journal of the Midwest Finance Association*. 1993. Page 98.

1 **Q. Does Wong explain why size is not relevant in the utility industry?**

2 A. Yes. Wong explains that the main reasons are monopolistic power and the regulated
3 financial structure of utilities:

4
5 First, given firm size, utility stocks are consistently less risky than
6 industrial stocks. Second, industrial betas tend to decrease with firm size
7 but utility betas do not. These findings may be attributed to the fact that
8 all public utilities operate in an environment with regional monopolistic
9 power and regulated financial structure. As a result, the business and
10 financial risks are very similar among the utilities regardless of their sizes.
11 Therefore, utility betas would not necessarily be expected to be related to
12 firm size.⁶

13
14 **Q. Does Staff have any comments regarding the article by Dr. Thomas Zepp that argues
15 that a firm size effect exists for utilities?⁷**

16 A. Yes. The study shown in Table 2 of the article shows sample size limited to a comparison
17 between DCF based cost of equity estimates for two smaller companies and two larger
18 companies.⁸ Based on this limited sample, the article claims to find a significant
19 difference.⁹ The article fails to identify essential elements to support that finding. For
20 example, there is no explanation of the sample selection process to demonstrate that the
21 sample companies are representative of these respective populations.

⁶ Ibid. Page 98.

⁷ Thomas J. Bourassa's rebuttal testimony. Page 18 and 19.

⁸ Zepp, Thomas M. "Utility Stocks and The Size Effect – Revisited." *The Quarterly Review of Economics and Finance* 2002. Page 580.

⁹ Ibid. Page 580.

1 **Q. Does Staff have any comments regarding the 18.8, 15.7 and 14.2 percent returns for**
2 **mid cap stocks that the Company cites as findings of the study by Ibbotson**
3 **Associates?¹⁰**

4 A, Yes. The returns cited are long-term returns for samples of stocks listed with New York
5 Stock Exchange, American Stock Exchange, and the Nasdaq National Market and are not
6 returns for utilities.¹¹

7
8 **Q. What is Staff's response to the Company's argument that the Commission's previous**
9 **decisions rejecting arguments for firm size adjustments do not apply to all Arizona**
10 **regulated utilities?¹²**

11 A. It is not customary for the Commission to make a judgment on a specific principle in an
12 individual rate case and expressly apply the principle to all other regulated Arizona
13 utilities. Such a global finding would more customarily be made in a generic docket.
14 However, it can be said that the Commission has repeatedly rejected the firm size
15 adjustment argument in recent cases.¹³

16
17 **Comparison to Actual and Authorized Returns**

18 **Q. What is Staff's response to the Company's view that earnings play a far greater role**
19 **in investment decisions than the results of a CAPM or DCF model?¹⁴**

20 A. Actual earnings are not the earnings expected by the market and thus cannot be equated
21 with cost of equity ("COE"). The return earned by other companies may be one
22 consideration in estimating COE, but such returns should not be given a far greater role in
23 consideration of COE estimation as asserted by the Company.¹⁵ The COE is the

¹⁰ Thomas J. Bourassa's rebuttal testimony. Page 15.

¹¹ Ibbotson Associates. *Stocks, Bonds, Bills, and Inflation Valuation Edition 2006 Yearbook*. 2006. Page 141.

¹² Thomas J. Bourassa's rebuttal testimony. Page 19 and 20.

¹³ Examples can be found in Decision Nos. 64282, 64727, and 66849.

¹⁴ Thomas J. Bourassa's rebuttal testimony. Page 11.

¹⁵ Ibid. Page 11.

1 expectation of investors, not the historical earnings. Recognizing this distinction is
2 necessary for understanding the COE concept.

3
4 **Q. What is Staff's response to the Company's argument that the current COE should be**
5 **higher than ROE's set by regulators in 2003 and 2004 for the sample companies as**
6 **shown in D-4.14 as a result of increased interest rates?¹⁶**

7 A. This argument ignores other important factors and displays a fundamental
8 misunderstanding of a financial concept. This comparison fails to recognize that COE
9 changes over time and that the returns authorized for the sample utilities in prior rate cases
10 cannot be compared directly to the market expectations that exist presently. The
11 Company itself notes that authorized ROE's may differ from COE if the authorized ROE's
12 are the result of settlement agreements.¹⁷ Furthermore, many variables influence COE and
13 an increase in interest rates does not necessarily result in an increase in cost of capital.

14
15 **Q. Does Staff have further comments regarding the Company's view that authorized**
16 **ROE's may be a conservative measure of COE?¹⁸**

17 A. Yes. Staff would note that settlement agreements could also result in an ROE above the
18 COE should parties allow a higher ROE in exchange for some other concession.
19 Similarly, a regulator could choose to set ROE above COE at its own discretion for
20 whatever reason it sees fit. This is one reason, as cited previously, that authorized ROE's
21 cannot be equated with COE.

¹⁶ Ibid. Page 9.

¹⁷ Ibid. Page 9.

¹⁸ Ibid. Page 9.

1 **Q. What comment does Staff have in regard to the 13.34 percent rate of return that the**
2 **Company calculates using a comparable earnings analysis?¹⁹**

3 A. Actual returns should not be equated with COE. Staff also notes that the percentages
4 shown in the annual average column appear to be the product of the percent increase in the
5 “5 Years” column divided by five. Such a product would not yield average annual growth
6 as it does not recognize compounding. The percentages in the average annual column
7 should reflect smaller percentages of growth to account for annual compounding.

8
9 **Q. What is Staff’s comment on the Company’s suggestion that projected interest rates**
10 **should be used rather than current interest rates in cost of equity estimation?²⁰**

11 A. Analysts who forecast interest rates do not have any more information about the future
12 than what is already reflected in the current rate. Present rates are more appropriate than
13 forecasted rates, as the best indicator of tomorrow’s yield is today’s yield.

14

15 **Use of Analyst’s Forecasts**

16 **Q. What comments does Staff have regarding Mr. Bourassa’s discussion of the merits of**
17 **analysts’ forecasts compared to other measures of growth such as historical growth**
18 **rates?**

19 A. Staff reiterates comments made in direct testimony as this matter has already been
20 addressed. As analysts projections may differ from historic growth rates and both
21 measures are available to the public, Staff includes both measures of growth in COE
22 estimation to provide a balanced approach.

¹⁹ Ibid. Page 10.

²⁰ Ibid. Page 13.

1 **Q. Are historical growth rates any less subjective than using analyst expectations of**
2 **growth?**

3 A. Yes. Historical growth rates are the product of calculations. Analysts' projections are the
4 products of human judgment. While analysts' projections are more subjective, Staff uses
5 both historical growth and analysts' projections to achieve a balanced approach to COE
6 estimation as discussed previously.

7
8 **Q. Please discuss the Company's exclusion of historical dividends per share ("DPS")**
9 **and EPS growth from its DCF model.**

10 A. Exclusion of inputs that tend to either increase or decrease results produces a skewed
11 result rather than the balanced outcome that is Staff's objective. Staff includes historical
12 DPS and EPS growth because this is information readily available, and it is reasonable to
13 expect investors to consider this information in making investment decisions. Had Staff
14 excluded historical DPS and EPS, it would have been necessary to also exclude the
15 highest growth components in order to maintain a balanced outcome. Staff's methodology
16 for calculation of growth for use in the DCF model gives equal weight to historical and
17 projected EPS, DPS and sustainable growth. Calculation of Staff's DCF growth rate
18 component is shown in Surrebuttal Schedule SPI-7.

19
20 **Q. What is Staff's comment regarding the Company's exclusion of DPS growth in its**
21 **DCF analysis?**²¹

22 A. Recently, in Decision No. 68487, dated February 23, 2006, the Commission rejected a
23 similar action by an applicant who had excluded several DCF return rates as the results
24 were less than returns being authorized in other jurisdictions.²² Exclusion of inputs that

²¹ Ibid. Page 7.

²² Docket No. G-01551A-04-0876.

1 produce results that are viewed as either too low or too high based on a comparison to a
2 benchmark of one's choosing is inappropriate.

3
4 **Staff Inputs**

5 **Q. Please comment on the Company's characterization of the inputs for Staff's models**
6 **as biased.**

7 A. Staff does not exclude inputs to the models because they produce results that are above or
8 below a selected benchmark and are viewed as too low or too high. In the case of Staff's
9 exclusion of Connecticut's negative EPS growth, Staff has excluded the negative growth
10 as it is inconsistent with the DCF model.

11
12 **Q. Please comment on Staff's use of both arithmetic and geometric means in cost of**
13 **equity estimation?**

14 A. Staff uses both arithmetic and geometric means in the cost of equity analysis as it provides
15 a balanced approach to the analysis. David Parcell's *The Cost of Capital- A Practitioner's*
16 *Guide* describes that a dispute frequently occurs related to the question of whether
17 arithmetic or geometric growth better portrays expected growth in the DCF model and that
18 neither viewpoint reigns supreme.²³ Parcell also states that findings of a study by Carleton
19 and Lakonishok on the matter lead to a conclusion that investors likely consider both
20 arithmetic and geometric growth rates.²⁴

²³ Parcell, David C. *The Cost of Capital - A Practitioner's Guide*. Parcell. 1997. Pages. 8 - 22 and 8 - 23.

²⁴ Ibid. Page 8 - 24.

1 **CAPM**

2 **Q. What comment does Staff have in response to the Company's assertion that Staff's**
3 **current market risk premium ("MRP") is very unstable?²⁵**

4 A. It is incorrect to conclude that changes in Staff's current MRP over time signify instability
5 in Staff's method for determining the MRP. Changes in Staff's current MRP results are a
6 reflection of changes in the market's current risk premium rather than instability in Staff's
7 method.

8
9 **Q. Please discuss the Company's comments regarding Staff's use of median values**
10 **rather than average (mean) values in deriving the current MRP.**

11 A. The Company represents that it has calculated the average price dividend yield and
12 average price appreciation potential and that the averages are higher than the medians used
13 by Staff. Staff has not calculated the averages for the appreciation potential and dividend
14 yield. Rather than calculating the averages, Staff has relied on the median values for these
15 indicators published on the front page of *Value Line's* weekly *Investment Survey*. Staff
16 notes that *Value Line* publishes the medians on the front page of the *Investment Survey*
17 and that the Company has calculated the averages as an alternative. Staff has chosen to
18 use the median dividend yields and median appreciation potential as the figures are highly
19 accessible both to Staff and the investment community. In addition to being more
20 accessible, median measures also have the benefit of being less affected by statistical
21 outliers.

²⁵ Thomas J. Bourassa's rebuttal testimony. Page 23.

1 **Q. Are there clear technical merits to the use of either median or average (mean) values**
2 **in calculation of dividend yield or appreciation potential?**

3 A. No. Both are measures of central tendency. One cannot know in advance whether a
4 random set of data will have a higher median or average. For this reason, Staff's use of
5 median values is not meant to reduce Staff's cost of equity estimation. Staff has relied on
6 the median values consistently in the past as they are less affected by statistical outliers
7 than average values and are published figures on *The Value Line Investment Survey's* front
8 page.

9

10 **IV. STAFF RECOMMENDATIONS**

11 **Q. What are Staff's recommendations for Utility Source's cost of capital?**

12 A. Staff makes the following recommendations for Utility Source's cost of capital:

- 13 1. Staff recommends a capital structure of 0 percent debt and 100 percent equity.
14 2. Staff recommends no cost of debt as it is not applicable.
15 3. Staff recommends a cost of equity of 8.9 percent.
16 4. Staff recommends an overall rate of return of 8.9 percent.

17

18 **Q. Does this conclude your surrebuttal testimony?**

19 A. Yes, it does.

Utility Source LLC
 Capital Structure
 And Weighted Average Cost of Capital
 Staff Recommended and Company Proposed

| [A] | [B] | [C] | [D] |
|--------------------------------------|---------------------|-------------------|----------------------|
| <u>Description</u> | <u>Weight (%)</u> | <u>Cost</u> | <u>Weighted Cost</u> |
| Staff Recommended Structure | | | |
| Debt | 0.0% ¹ | N/A | <u>0.0%</u> |
| Common Equity | 100.0% ¹ | 8.9% ² | <u>8.9%</u> |
| Weighted Average Cost of Capital/ROR | | | 8.9% |
| Company Proposed Structure | | | |
| Debt | 0.0% | 0.0% | 0.0% |
| Common Equity | 100.0% | 10.5% | <u>10.5%</u> |
| Weighted Average Cost of Capital/ROR | | | 10.5% |

[D] : [B] x [C]
 1 Supporting Schedules: SPI-3
 2 Supporting Schedule: SPI-2

Utility Source LLC
 Final Cost of Equity Estimates
 Sample Water Utilities

| [A] | [B] | [C] | [D] | [E] |
|---|-------|---------------------|----------------|---------------|
| DCF Method | | $\frac{D_u/P_u}{1}$ | + | $\frac{k}{2}$ |
| Constant Growth DCF Estimate | | 2.5% | + | 7.7% |
| Multi-Stage DCF Estimate | | | + | 9.1% |
| Average of DCF Estimates | | | | 8.4% |
| CAPM Method | R_f | β^5 | x | $\frac{k}{2}$ |
| Historical Market Risk Premium ³ | 4.7% | 0.85 | x | 11.0% |
| Current Market Risk Premium ⁴ | 4.8% | 0.85 | x | 7.8% |
| Average of CAPM Estimates | | | | 9.4% |
| | | | Average | 8.9% |
| | | | Total | 8.9% |

1 MSN Money and Value Line
 2 SPI-7
 3 Wall Street Journal (RJ) 5, 7, and 10 year Treasury rates
 4 Wall Street Journal (RJ) 30 Year Treasury bond rate
 5 Value Line
 6 Historical Market Risk Premium (Rp) from Ibbotson Associates S&P 2006 Yearbook
 7 Testimony

Utility Source LLC
Average Capital Structure of Sample Water Utilities

| [A] | [B] | [C] | [D] |
|--------------------------------|--------------|----------------------|---------------|
| <u>Company</u> | <u>Debt</u> | <u>Common Equity</u> | <u>Total</u> |
| American States Water | 51.7% | 48.3% | 100.0% |
| California Water | 49.8% | 50.2% | 100.0% |
| Aqua America | 54.6% | 45.4% | 100.0% |
| Connecticut Water | 45.0% | 55.0% | 100.0% |
| Middlesex Water | 59.4% | 40.6% | 100.0% |
| SJW Corp | <u>47.0%</u> | <u>53.0%</u> | <u>100.0%</u> |
| Average Sample Water Utilities | 51.3% | 48.7% | 100.0% |
| Utility Source LLC | 0.0% | 100.0% | 100.0% |

Source:
Sample Water Companies from Value Line

Utility Source LLC
Growth in Earnings and Dividends
Sample Water Utilities

| [A] | [B] | [C] | [D] | [E] |
|--------------------------------|--|---|---|--|
| <u>Company</u> | Dividends Per Share 1996 to 2005 <u>DPS¹</u> | Dividends Per Share Projected <u>DPS¹</u> | Earnings Per Share 1996 to 2005 <u>EPS^{1,2}</u> | Earnings Per Share Projected <u>EPS¹</u> |
| American States Water | 1.1% | 1.7% | 2.5% | 7.6% |
| California Water | 1.1% | 1.4% | 2.3% | 4.1% |
| Aqua America | 6.2% | 10.9% | 9.4% | 7.1% |
| Connecticut Water | 1.3% | No Projection | -0.9% | No Projection |
| Middlesex Water | 2.2% | No Projection | 0.4% | No Projection |
| SJW Corp | <u>4.2%</u> | <u>No Projection</u> | <u>6.6%</u> | <u>No Projection</u> |
| Average Sample Water Utilities | 2.7% | 4.7% | 4.2% | 6.3% |

¹ Value Line

² Note that the figure -0.9% has been excluded from the calculation.

Utility Source LLC
Sustainable Growth
Sample Water Utilities

| [A] | [B] | [C] | [D] | [E] | [F] |
|--------------------------------|--|---|---|---|--|
| | Retention Growth 1996 to 2005 <u>br</u> | Retention Growth Projected <u>br</u> | Stock Financing Growth <u>vs</u> | Sustainable Growth 1996 to 2005 <u>br + vs</u> | Sustainable Growth Projected <u>br + vs</u> |
| <u>Company</u> | | | | | |
| American States Water | 2.6% | 5.0% | 1.5% | 4.1% | 6.5% |
| California Water | 2.6% | 2.9% | 2.9% | 5.5% | 5.8% |
| Aqua America | 4.4% | 4.0% | 6.1% | 10.6% | 10.2% |
| Connecticut Water | 2.7% | No Projection | 0.6% | 3.4% | No Projection |
| Middlesex Water | 1.2% | No Projection | 4.3% | 5.4% | No Projection |
| SJW Corp | 5.2% | No Projection | 0.0% | <u>5.2%</u> | <u>No Projection</u> |
| Average Sample Water Utilities | 3.1% | 4.0% | 2.6% | 5.7% | 7.5% |

[B]: Value Line

[C]: Value Line

[D]: Value Line and MSN Money

[E]: [B]+[D]

[F]: [C]+[D]

Utility Source LLC
 Selected Financial Data of Sample Water Utilities

| [A] | [B] | [C] | [D] | [E] | [F] | [G] |
|-----------------------|--------|-------------------------|------------|----------------|--------------------|--------------------|
| Company | Symbol | Spot Price 2/21/2007 | Book Value | Mkt To Book | Value Line Beta | Raw Beta |
| American States Water | AWR | 40.02 | 16.42 | 2.4 | 0.80 | β_{raw} 0.67 |
| California Water | CWT | 41.20 | 16.08 | 2.6 | 0.90 | 0.82 |
| Aqua America | WTR | 23.57 | 7.76 | 3.0 | 0.90 | 0.82 |
| Connecticut Water | CTWS | 24.97 | 12.03 | 2.1 | 0.90 | 0.82 |
| Middlesex Water | MSEX | 18.34 | 8.79 | 2.1 | 0.85 | 0.75 |
| SJW Corp | SJW | 36.94 | 10.95 | 3.4 | 0.75 | 0.60 |
| Average | | | | 2.6 | 0.85 | 0.75 |

[C]: MSN Money

[D]: Value Line

[E]: [C] / [D]

[F]: Value Line

[G]: $-0.35 + [F] / 0.67$

Utility Source LLC
Calculation of Expected Infinite Annual Growth in Dividends
Sample Water Utilities

| [A] | [B] |
|---|-------------|
| <u>Description</u> | g |
| DPS Growth - Historical ¹ | 2.7% |
| DPS Growth - Projected ¹ | 4.7% |
| EPS Growth - Historical ¹ | 4.2% |
| EPS Growth - Projected ¹ | 6.3% |
| Sustainable Growth - Historical ² | 5.7% |
| <u>Sustainable Growth - Projected²</u> | <u>7.5%</u> |
| Average | 5.2% |

1 Schedule SPI-4

2 Schedule SPI-5

Utility Source LLC
Multi-Stage DCF Estimates
Sample Water Utilities

| [A] Company | [B] Current Mkt. Price (P_0) ¹ 2/21/2007 | [C] Projected Dividends ² (Stage 1 growth) (D_t) | | | | [E] d_3 | [F] d_4 | [H] Stage 2 growth ³ (g_n) | [I] Equity Cost Estimate (K) ⁴ |
|-----------------------|--|---|-------|-------|-------|-----------|-----------|---|---|
| | | d_1 | d_2 | d_3 | d_4 | | | | |
| American States Water | 40.0 | 0.72 | 0.75 | 0.79 | 0.83 | | 6.8% | 8.4% | |
| California Water | 41.2 | 1.16 | 1.22 | 1.28 | 1.35 | | 6.8% | 9.5% | |
| Aqua America | 23.6 | 0.47 | 0.50 | 0.52 | 0.55 | | 6.8% | 8.7% | |
| Connecticut Water | 25.0 | 0.88 | 0.93 | 0.98 | 1.03 | | 6.8% | 10.1% | |
| Middlesex Water | 18.3 | 0.55 | 0.57 | 0.60 | 0.64 | | 6.8% | 9.6% | |
| SJW Corp | 36.9 | 0.61 | 0.64 | 0.67 | 0.70 | | 6.8% | 8.3% | |

Average **9.1%**

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

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

1 [B] see schedule SPI-6
 2 Derived from Value Line Information
 3 Average annual growth in GDP 1925 - 2006 in current dollars.
 4 Internal Rate of Return of Projected Dividends