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BEFORE THE ARIZONA CORPORATION COMMIS
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COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS SUN CITY
AND SUN CITY WEST WASTEWATER
DISTRICTS

DOCKET NO. WS-01303A-06-0491

ARIZONA-AMERICAN WATER
COMPANY

NOTICE OF FILING TESTIMONY
SUMMARIES

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Arizona-American Water Company hereby files in the above-referenced matter testimony summaries for the following witnesses:

- Todd Walker
- Troy Day (Sponsoring Brian K. Biesemeyer's Testimony)
- Chuck E. Loy
- Dr. Bente Villadsen
- Sheryl L. Hubbard (Also sponsoring a portion of Mr. Joel M. Reiker's Testimony)
- Thomas M. Broderick (Also sponsoring a portion Joel M. Reiker's Testimony)

Respectfully submitted on August 21, 2007, by:

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Arizona Corporation Commission
DOCKETED

AUG 21 2007

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2 on August 21, 2007, with:
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9 Copies of the foregoing **mailed** on
10 August 21, 2007. to:
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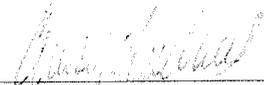
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49

50
51
52 By: 
53 Courtney Appelhans

1
2
3 **Summary – Testimony of Todd Walker**
4
5

6 In his direct testimony, Mr. Walker testifies as follows:
7

8 The required public notice about this rate case was published in the Arizona Business
9 Gazette on March 1, 2007. The public notice was sent to affected customers via self
10 mailers on March 21, 2007. Arizona-American also published the public notice about the
11 Public Comment sessions in the Arizona Business Gazette on May 10, 2007 and the
12 Daily News Sun on May 12, 2007.
13

14 Company-sponsored community meetings in Sun City and Sun City West will be held on
15 Monday, August 6th, at the Lake View Recreation Center, 10626 W. Thunderbird Blvd.,
16 Sun City, AZ at 9:30 am, and at the Palm Ridge Recreation Center, 13800 W. Deer
17 Valley Drive, Sun City West, AZ at 2:00 pm. Arizona-American representatives will be
18 available at the community meetings to explain the proposed rate increase, process and
19 case timeline. Arizona-American will also staff information booths before and after the
20 meetings with materials on water conservation, rates, and customer service.
21

22 The rate increase application is now available at the Sun City Library, 16828 N. 99th
23 Ave., Sun City, AZ, Sun City Library Fairway Branch, 10620 W. Peoria Avenue, Sun
24 City, AZ, R.H. Johnson Rec. Center, 19803 R.H. Johnson Blvd., Sun City West, AZ.
25 Arizona-American also distributed the application to the Property Owners and Residents
26 Association of Sun City West (PORA) and it is available at their offices located at 13815
27 Camino del Sol, Sun City West, AZ. The rate increase application is also available at
28 Arizona-American's Sun City office.
29

30 Mr. Walker did not submit rebuttal or rejoinder testimony.
31

32 **Summary – Testimony of Brian K. Biesemeyer**
33

34
35 Mr. Troy Day will sponsor Mr. Biesemeyer's testimony. In his direct testimony, Mr.
36 Biesemeyer testifies as follows:
37

38 Mr. Biesemeyer first presents his qualifications, including his work history and
39 educational background.
40

41 Mr. Biesemeyer next provides an overview of the facilities used to provide wastewater
42 service for Arizona-American's Sun City Wastewater and Sun City West Wastewater
43 Districts.
44

45 Mr. Biesemeyer next discusses how treatment services are provided for waste collected in
46 the Sun City Wastewater District at the Tolleson Wastewater Treatment Plant. Service is
47 provided under the terms of the Sewage Treatment and Transportation Agreement dated
48 June 21, 1985, as amended ("Tolleson Agreement"). There are four Rate Components in

1 the Tolleson Agreement. Rate Component Four obligates Arizona-American for an
2 estimated \$9,878,400 in capital improvements. Constructing its own treatment facility
3 would not be a viable option for the Company.
4

5 Mr. Biesemeyer next discusses the Northwest Valley Regional Water Reclamation
6 Facility, which provides sewage treatment for Arizona-American's customers in Sun City
7 West. The facility was recently expanded and also provides treatment for certain
8 wastewater customers in Arizona-American's Anthem/Agua Fria Wastewater District.
9

10 Finally, Mr. Biesemeyer explains why Arizona-American has added a new sewer
11 maintenance crew (two system maintenance operators). This crew was added to comply
12 with the Arizona Department of Environmental Quality's new Capacity, Management,
13 Operation, and Maintenance regulations (Arizona Administrative Code R18-9-C305).
14 This crew performs routine and periodic cleaning of sewer systems as well as providing
15 emergency response to potential sewer overflow situations. It supports both the Sun City
16 Wastewater and Sun City West Wastewater Districts.
17

18 Mr. Day and Mr. Biesemeyer did not submit rebuttal or rejoinder testimony.
19

20
21 **Summary – Testimony of Chuck E. Loy**
22

23 In his direct testimony, Mr. Loy testifies as follows:
24

25 Charles E. Loy, Sr. Project Manager with GDS Associates, proposes minor adjustments
26 to Sun City and Sun City West revenues and provides rate design recommendations that
27 equitably spread the proposed revenue increases to the various customer classes of each
28 company.
29

30 Mr. Loy's proposed rate design meets the following criteria:
31

- 32 • Proposes conservation based wastewater rate design for both companies. The
33 design includes volumetric rates with caps to provide an incentive for water
34 conservation while protecting high water Residential and small Commercial users
35 from unreasonably large wastewater bills.
- 36 • Addresses the following three questions raised by the Commission in Decision No
37 67093 regarding wastewater rates.
 - 38 1. Whether wastewater rates based on water consumption encourage water
39 conservation;
 - 40 2. Whether higher bills for those who use the system more is a fairer way to
41 collect revenue; and
 - 42 3. What tiered wastewater rates based on water consumption would look like
43 compared to a flat rate design?
- 44 • Proposes an alternative wastewater rate design that maintains the current rate
45 structure should the Commission find the Company's conservation oriented rate
46 structure proposal too drastic.
- 47 • Steadily moves toward cost based rates while treating customers equitably.
- 48 • Proposes an Industrial Discharge Fee that recovers all related costs associated
49 with the program developed to comply with applicable Federal regulations.
50

1 Mr. Loy developed cost-of-service studies for both companies by customer class to use as
2 a guideline when designing the proposed rates. A comparison of the proposed rate design
3 and the cost-of-service study results are presented below in Tables 1 and 2 and in Mr.
4 Loy's Pre-filed Direct Testimony. The tables below show that the proposed revenue
5 increases by class are not strictly guided by the cost of service study results but do rest
6 within a reasonable range indicating progress toward cost based rates.
7

8 In his rebuttal testimony, Mr. Loy testifies as follows:
9

10 RUCO's proposed flat rate design is more appropriate in the Sun Cities, especially for
11 residential customers. Exhibits CEL-R1 and CEL-R2 reflect RUCO's flat rate design,
12 with Arizona-American's revised rebuttal revenue requirements for Sun City and Sun
13 City West.
14

15 A wastewater rate design based on water consumption will not have a large conservation
16 impact on customers who do not directly pay their monthly water and wastewater bills,
17 such as customers who live in condominiums, apartments, and retirement communities.
18 Also, approximately 30% of the Sun Cities residents are seasonal residents. Since the
19 majority of the costs associated with any wastewater system are fixed or semi-fixed, the
20 year round residents would pay more with a volumetric rate design. Given these
21 circumstances, the existing flat rate design is a more equitable way to collect revenues,
22 especially for residential customers.
23

24 Staff has proposed a volumetric conservation type rate design which is an improvement
25 over what Arizona-American initially presented, because Staff recommends lower usage
26 ceilings for larger meter sizes. However, it is not the conservation rate design per se that
27 Arizona-American objects to, but its appropriateness for Sun City and Sun City West
28 Wastewater customers.
29

30 Arizona-American offers an alternative to the Staff rate design proposal, which maintains
31 the flat rates for the Residential class while adopting conservation volumetric based rates
32 for the Commercial and Large Commercial classes. It maintains flat rates for residential
33 customers, thereby protecting them from the problems addressed by Mr. Broderick and
34 Mr. Coley. It limits the exposure to volumetric rates as the Commercial customer base is
35 much smaller than the Residential class in the Sun Cities. Thus, Arizona-American
36 would be better able to manage the cost and public relations issues associated with the
37 move from flat to volumetric rates. If the Commission eventually concludes that
38 volumetric wastewater rates for all classes of Sun City and Sun City West are most
39 appropriate, starting with a much smaller population of customers will give both Arizona-
40 American and the Commission a good indication of the problems, issues, and costs for
41 implementing the much larger and complicated Residential move in the future.
42

43 The alternative rate structures and their bill impacts are presented in Exhibit CEL-R3 and
44 CEL-R4 for Sun City and CEL-R5 and CEL-R6 for Sun City West.

1 In his rejoinder testimony, Mr. Loy testifies as follows:
2

3 The *new alternative* rates proposed for residential single family housing *sewer only*
4 customers (rate schedules AIMS10 and BIMS10) in my rebuttal testimony should reflect
5 the rates Arizona-American proposed for residential customers with 5/8" meters with
6 water service. For the Sun City Residential rate code AIMS10 with 5/8 inch meters
7 would be \$13.63 rather than \$109.03. For the Sun City West Residential rate code
8 BIMS10 with 5/8 inch meters would be \$28.67 rather than \$229.33.
9

10 Arizona-American proposes to implement the revenue increase using the existing rate
11 structure. I provided an acceptable alternative in my rebuttal testimony – to apply the
12 volumetric rate to the Commercial class and create meter size equivalents for single
13 family residential accounts.
14

15 Summary –Testimony of Bente Villadsen 16

17
18 In her direct testimony, Dr. Villadsen testifies as follows:
19

20 Dr. Villadsen selects two benchmark samples, water utilities and gas LDC companies.
21 She estimates the sample companies' cost of equity, associated after-tax-weighted-
22 average cost of capital, and the corresponding cost of equity at 40 percent equity. She
23 also reviews recent Arizona water and wastewater decisions. In undertaking her analysis,
24 Dr. Villadsen notes that the overall cost of capital is constant within a broad middle range
25 of capital structures although the distribution of costs and risks among debt and equity
26 holders is not. Because Sun City's requested target of 40 percent equity is lower than the
27 percentage equity among many utilities, its financial risk is higher and the return required
28 by investors increases with the level of risk they carry.
29

30 Based on the evidence from samples, Dr. Villadsen estimates a cost of equity for the
31 benchmark samples to be in the range of 11 ¼ to 12 ¾ percent. In reviewing the
32 samples' cost of equity estimates, Dr. Villadsen determined that the best midpoint
33 estimate for Sun City is between 11 ¾ to 12 percent. Dr. Villadsen also reviewed recent
34 Arizona decision and found that the decisions when applied to an entity with 40 percent
35 equity corresponds to a cost of equity of approximately 12 ¼ percent. She therefore finds
36 that Sun City's request for 11.75 percent return on equity at 40 percent equity is
37 reasonable and fully supported by her analysis.
38

39 In her rebuttal testimony, Dr. Villadsen testifies as follows:
40

- 41 • First, Dr. Villadsen discuss the developments in risks factors and financial
42 parameters that affect the cost of capital for the water industry. Specifically, the
43 industry's risk is increasing as large infrastructure investments are needed, some
44 parts of the country faces drought issues, and environmental requirements are
45 changing.
- 46 • Second, the financial leverage of Sun City Wastewater and Sun City West
47 Wastewater ("Sun Cities") districts is higher than that of most water utilities. For
48

1 reasons it is important to take financial leverage into account when determining
2 the cost of equity for Sun Cities.

- 3
4 • Third, I discuss the Direct Testimonies of Mr. Pedro Chaves and Mr. William A.
5 Rigby and why the testimonies underestimate the cost of equity for Sun Cities.
6 Specifically, long-term interest rates are higher now than at the time the witnesses
7 determined their recommendation and back at the level they were when I filed my
8 Direct Testimony. Further, the witnesses rely on growth rates that are quite old
9 which is an issue in a changing industry. I also disagree with Mr. Rigsby's
10 reliance on the historical geometric market risk premium.
- 11
12 • Fourth, I conclude the midpoint estimate of the cost of equity for Sun Cities
13 remains at 11 $\frac{3}{4}$ percent.

14
15 Dr. Villadsen did not submit rejoinder testimony.

16
17 **Summary – Testimony of Sheryl L. Hubbard**

18
19 Ms. Hubbard did not submit direct testimony. Ms. Hubbard sponsors a portion of Mr. Reiker's
20 direct testimony, in which Mr. Rieker testifies as follows:

21
22 Mr. Reiker addresses the rate base schedules and the Company's associated adjustments.
23 He next addresses the income statement schedules, including adjustments. He provides a
24 table summarizing each income statement adjustment for Sun City Wastewater and Sun
25 City West Wastewater.

26
27 In her rebuttal testimony, Ms. Hubbard testifies as follows:

28
29 The tables below summarize the original and revised requested revenue requirement as
30 filed by Arizona-American for its Sun City and Sun City West districts and the
31 recommendations proposed by the Staff and RUCO:

32
33 Table 1
34 Summary Revenue Requirement – Sun City Wastewater
35

	Revenue Requirement	Revenue Increase	Percentage Increase
Arizona-American – Original Application	\$ 6,089,350	\$ 1,606,495	35.84%
Staff	\$ 5,678,767	\$ 1,195,912	26.68%
RUCO	\$ 5,508,189	\$ 1,000,620	22.20%
Arizona-American - Rebuttal	\$ 5,762,159	\$ 1,279,305	28.54%

36
37 Table 2
38 Summary Revenue Requirement – Sun City West Wastewater
39

	Revenue Requirement	Revenue Increase	Percentage Increase
Arizona-American -- Original Application	\$ 6,875,594	\$ 2,337,050	51.50%
Staff	\$ 6,110,691	\$ 1,572,286	34.64%
RUCO	\$ 5,989,409	\$ 1,442,884	31.74%
Arizona-American - Rebuttal	\$ 6,414,217	\$ 1,875,812	41.33%

1
2 For Sun City Wastewater, Ms. Hubbard accepts Staff Rate Base Adjustment Nos. 1-3,
3 and Operating Adjustment Nos. 1 and 2, and Staff's depreciation rates.
4

5 For Sun City West Wastewater, Ms. Hubbard accepts Staff Rate Base Adjustment Nos. 1-
6 3, and Operating Adjustment Nos. 1 and 2, and Staff's depreciation rates.
7

8 With a minor modification, Ms. Hubbard accepts Staff's methodology for calculating
9 Adjusted Test Year Property Tax Expenses for both Districts.
10

11 Ms. Hubbard accepts only one of RUCO's proposed rate base adjustments, No. 5, which
12 removes Y2K expense from rate base.
13

14 Ms Hubbard rejects RUCO's proposed rate base adjustment No. 3, which would create a
15 negative cash working capital balance. RUCO's proposal is not supported by the
16 required lead/lag study; instead it is a back-of-the-envelope estimate.
17

18 Ms. Hubbard rejects RUCO's proposed rate base adjustment No. 6, which would remove
19 a portion of the Post-Test-Year Tolleson De-Chlorination Upgrade. This plant was in
20 service and available for examination by Staff and RUCO during the course of their field
21 examinations. The upgrade is intended for customers existing at the end of the test year
22 and is a legitimate, prudent investment by Arizona-American.
23

24 Ms. Hubbard rejects RUCO's proposed rate base adjustment No. 7, which reduces the
25 amortization of the Tolleson Trickling Filter to reflect a test year end of December 9,
26 2005. The test year ended on December 31, 2005. As such it should be rejected by the
27 Commission.
28

29 Ms. Hubbard accepts RUCO's proposed operating adjustment Nos. 4, 5, 7, and 13.
30

31 Ms. Hubbard rejects RUCO's proposed operating adjustment Nos. 1, 2, 3, and 12, which
32 would reduce test-year labor expense. Each of these expenses was adjusted for wage
33 increases that went into effect on March 1, 2006, or only 60 days after the end of the test
34 year. It would be unreasonable to disallow a labor rate increase that was effective 60
35 days after the end of the test year, especially given that another increase has already gone
36 into effect in 2007.
37

1 Ms. Hubbard rejects RUCO's proposed operating adjustment No. 8, which would
 2 disallow waste disposal costs of \$111,602. Arizona-American has an agreement with the
 3 City of Glendale for the use of its lines to transport sewage to the City of Tolleson
 4 treatment facility. The charges for this service, \$111,602, were recorded properly as
 5 waste-disposal expenses and should be included in Arizona-American's operating
 6 expenses.

7
 8 Ms. Hubbard rejects RUCO's proposed operating adjustment No. 11, which would
 9 remove expenses for Arizona-American's Industrial Pre-Treatment Program. The labor
 10 charges associated with the Industrial Pre-Treatment program ("IPP") are recorded at the
 11 corporate level, which means they are not included in the district's operating expenses in
 12 the test year. Hence, an additional adjustment was necessary to allocate the pro-rata cost
 13 of this function to Sun City and Sun City West.

14
 15 Ms. Hubbard rejects RUCO's proposed operating adjustment No. 15 concerning the
 16 North West Valley Treatment Facility. This facility is an owned facility used by both the
 17 Sun City West and Anthem/Agua Fria Wastewater Districts and the pending rate
 18 applications both have a December 31, 2005 test year end. There is no trade or transfer
 19 of investment involved. As a common-use facility, the rate base and operating expenses
 20 should be shared between the districts to avoid the customers of one district subsidizing
 21 the customers of the other district.

22
 23 In her rejoinder testimony, Ms. Hubbard testifies as follows:

24
 25 The tables below summarize the original and revised requested revenue requirement as
 26 filed by Arizona-American for its Sun City and Sun City West wastewater districts and
 27 the recommendations proposed by the Staff and RUCO:

28
 29 Table 1
 30 Summary Revenue Requirement – Sun City Wastewater
 31

	Revenue Requirement	Revenue Increase	Percentage Increase
Arizona-American – Original Application	\$ 6,089,350	\$ 1,606,495	35.84%
Staff – Direct	\$ 5,678,767	\$ 1,195,912	26.68%
RUCO - Direct	\$ 5,508,189	\$ 1,000,620	22.20%
Arizona-American - Rebuttal	\$ 5,762,159	\$ 1,279,305	28.54%
Staff - Surrebuttal	\$ 7,352,129	\$ 2,869,274	64.01%
RUCO - Surrebuttal	\$ 5,522,607	\$ 1,015,038	22.52%
Arizona-American - Rejoinder	\$ 6,248,414	\$ 1,740,845	38.62%

32
 33 Table 2
 34 Summary Revenue Requirement – Sun City West Wastewater
 35

	Revenue Requirement	Revenue Increase	Percentage Increase
Arizona-American – Original Application	\$ 6,875,594	\$ 2,337,050	51.50%
Staff – Direct	\$ 6,110,691	\$ 1,572,286	34.64%
RUCO – Direct	\$ 5,989,409	\$ 1,442,884	31.74%
Arizona-American - Rebuttal	\$ 6,414,217	\$ 1,875,812	41.33%
Staff - Surrebuttal	\$ 6,131,456	\$ 1,593,051	35.10%
RUCO – Surrebuttal	\$ 5,964,454	\$ 1,417,929	31.19%
Arizona-American - Rejoinder	\$ 6,397,761	\$ 1,859,356	40.97%

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Summary – Testimony of Thomas M. Broderick

In his direct testimony, Mr. Broderick testifies as follow:

Arizona American Water is requesting an increase in annual wastewater revenues of \$1,606,495, or 35.84 percent in Sun City, and an increase in annual wastewater revenues of \$2,337,050, or 51.49 percent in Sun City West, based on a test year ending December 2005. The Company is requesting that rates designed to recover these proposed increases become effective on or before September 1, 2007.

The primary reason for the Company's request is to bring rates closer to Arizona American Water's actual cost of providing wastewater service. A prior settlement between the Company and the Commission Staff (approved in Decision No. 63584) resulted in the exclusion from rates throughout Arizona of the return on over \$125 million of plant and the exclusion from rates of over \$1 million in depreciation expense. Of the \$125 million excluded from rates, \$20.5 million is attributable to Sun City and Sun City West wastewater districts.

Arizona American Water's return on equity has been less than one percent since 2002, equity has deteriorated to the point where Commission Staff has indicated its concern, and all dividends have been suspended.

The economic and demographic profile of Sun City and Sun City West is that of a retirement community. As per the 2000 Census, 74.5% of Sun City residents were 65 years of age or older. That same statistic for Sun City West was 64.1%. The mean household income for Sun City was \$41,293 or 79% of the statewide mean of \$52,565 in the 2000 Census. That same statistic for Sun City West is \$52,300 or approximately the same as the statewide mean.

The Company has filed the standard schedules required by A.A.C. R14-2-103 as an attachment to its application. These schedules include all of the standard filing schedules required for Class A wastewater utilities.

1
2 Mr. Broderick also sponsors a portion of Mr. Reiker's testimony, which Mr. Reiker testifies as
3 follows:
4

5 Mr. Reiker discusses Arizona-American's cost of capital, including its capital structure,
6 cost of debt, and rate of return on equity. He concludes his testimony by demonstrating
7 that the Company's requested 8.33 percent overall rate of return is comparable to the
8 average overall rate of return awarded by the Commission since 2004.
9

10 In his rebuttal testimony, Mr. Broderick testifies as follows:
11

12 The following table summarizes the parties' revenue increase recommendations to-date,
13 including Arizona-American's rebuttal recommendation:
14

Table 1 – Wastewater District Revenue Requirement Increase Summary

	<u>Sun City</u>	<u>Sun City West</u>
Arizona-American Water - Direct	\$1,606,495	\$2,337,050
Arizona-American Water - Rebuttal	\$1,279,159	\$1,875,799
Commission Staff - Direct	\$1,195,912	\$1,572,280
RUCO - Direct	\$1,000,620	\$1,442,884

15
16 The primary reason for Arizona-American's revised and reduced revenue-increase
17 request is that we now agree, as recommended by the other parties, to measure imputed
18 advances and contributions as of the end of the 2005 test year instead of as of eighteen
19 months later when new rates go into effect. Arizona-American measures amortization
20 from January 15, 2002 through the end of the test year December 31, 2005.
21

22 Arizona-American does appreciate that all parties have validated that both Sun City and
23 Sun City West Wastewater districts require significant rate increases.
24

25 Rebuttal Schedules A-1, B-1, B-2, C-1, C-2, C-3 and D-1 prepared for both wastewater
26 districts support the revised revenue requirements and are sponsored by Arizona-
27 American witness Ms. Sheryl Hubbard.

28 Arizona-American revises its cost of debt downward from 6.05% to 5.41%. Arizona-
29 American rejects Staff's proposal to include short-term debt in the capital structure and
30 supports a known and measurable projected equity ratio of 41.1%. Arizona-American's
31 revised cost of capital of 8.02%.
32

33 Arizona-American agrees with RUCO's Mr. Coley that the rate design for residential
34 customers should remain flat and not volumetric.
35

1 In his rejoinder testimony, Mr. Broderick testifies as follows:
2

- 3 1. December 31 is the appropriate test year end for all purposes including measuring
4 imputed regulatory advances and contributions. However, if the Commission ultimately
5 disagrees, please use the imputed regulatory advances and contributions amounts
6 calculated by RUCO as those are correct.
7
- 8 2. The correct property tax rate is 23.5% as Staff now proposes.
9
- 10 3. With the corrections noted in Ms. Hubbard's testimony, the Company accepts Staff's
11 proposed rate treatment for the Tolleson obligation.
12
- 13 4. At hearing, the Company will submit a re-calculation of the \$308,780 additional
14 proposed refund pursuant to an alternative method in the meter reading and billing
15 investigation. The Company will provide Mr. Troy Day and Ms. Karen Cooper as
16 witnesses at the hearing in support of the Company's additional response to Staff witness
17 Mr. Joel Jeanson.
18