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BEFORE THE ARIZONA CORPORATION CO

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COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02113A-04-0616 **NOTICE OF FILING**

Staff of the Arizona Corporation Commission hereby provides notice of filing the Direct Testimonies of David C. Parcell and Ralph C. Smith in the above-referenced matter.

RESPECTFULLY submitted this 30th day of August, 2007.

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TESTIMONY

OF

DAVID C. PARCELL

RALPH C. SMITH

DOCKET NO. W-02113A-04-0616

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON

AUGUST 30, 2007

Parcell

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 CHAPARRAL CITY WATER COMPANY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF THE ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	)	DOCKET NO. W-02113A-04-0616

DIRECT

TESTIMONY

OF

DAVID C. PARCELL

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

AUGUST 30, 2007

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

A. My name is David C. Parcell. I am President and Senior Economist of Technical Associates, Inc. My business address is Suite 601, 1051 East Cary Street, Richmond, Virginia 23219.

Q. Please summarize your educational background and professional experience.

A. I hold B.A. (1969) and M.A. (1970) degrees in economics from Virginia Polytechnic Institute and State University (Virginia Tech) and a M.B.A. (1985) from Virginia Commonwealth University. I have been a consulting economist with Technical Associates since 1970. I have provided cost of capital testimony in public utility ratemaking proceedings dating back to 1972. In connection with this, I have previously filed testimony and/or testified in about 400 utility proceedings before some 40 regulatory agencies in the United States and Canada. Schedule 1 provides a more complete description of my education and relevant work experience.

Q. Have you previously testified before the Arizona Corporation Commission?

A. Yes, I have testified in a number of prior Arizona Corporation Commission ("Commission") proceedings, including the recent electric rate case involving Arizona Public Service Company (Docket No. E-01345A-05-0816), the recent gas rate case involving UNS Gas, Inc. (Docket No. G-01345A-05-0463), and the recent electric rate case involving UNS Electric, Inc. (Docket No. E-04204A-06-0783). Those testimonies were provided on behalf of the Commission Staff.

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

A. This proceeding is a remand from Chaparral City's court challenge to Decision No. 68176. I have been retained by the Commission Staff to evaluate the cost of capital aspects of the request by Chaparral City Water Company ("Chaparral City" or "Company") to have its rates established by applying its weighted cost of capital ("WCOC"), which was determined by reference to Chaparral City's original cost rate base, to its fair value rate base ("FVRB").

Q. What cost of capital did the Commission determine was fair and reasonable for Chaparral City in Decision No. 68176?

A. In that decision, dated September 30, 2005, the Commission determined the following cost of capital to be appropriate for Chaparral City for application to the Original Cost Rate Base ("OCRB"):

Item	Percent	Cost	Return
Long-term Debt	41.2%	5.1%	2.1%
Equity	58.8%	9.3%	5.5%
Total	100.0%		7.6%

In Decision No. 68176, the Commission determined that a lower fair value rate of return ("FVROR") was appropriate for application to the FVRB. However, the Commission's specific method for determining the lower FVROR was called into question by a recent Court of Appeals decision.

Q. Does your testimony in this proceeding address either the cost of equity or WCOC for Chaparral City?

A. Not in the traditional sense. The cost of equity and WCOC have already been decided by the Commission and, further, have withstood an Appeals Court challenge. As a result, my analyses begin with the cost of equity and WCOC previously established by the Commission, and my testimony only discusses the fair value rate of return to be applied to Chaparral City's FVRB.

Q. What is your understanding of Chaparral City's proposal to apply the Company's cost of capital to a fair value rate base?

A. According to its filing, Chaparral City is proposing to apply the WCOC (i.e., 7.6 percent) that the Commission authorized for the Company's OCRB, without adjustment, to the "fair value" of the Company's rate base. This request is the Company's response to a recent (February 13, 2007) Arizona Court of Appeals decision regarding the Company; i.e., <u>Chaparral City Water Company v. Arizona Corporation Commission</u>.

Q. Have you reviewed the Arizona Court of Appeals decision and do you have any comments on your understanding of its implications for this case?

A. Yes, I do. My "non-legal understanding" of this decision is that the Commission must consider the fair value of a utility's assets in setting rates. However, Chaparral City suggests that this requires the Commission to apply, without adjustment, the WCOC that was developed for application to the Company's OCRB to the FVRB.

Q. Do you agree with the Company's assertion?

A. No, I do not. My "non-legal understanding" of the Court decision indicates that the Court agreed with the Commission that "the cost of capital analysis 'is geared to concepts of original cost measures of rate base, not fair value measures of rate base . . . ." The decision goes on to make the following statement: "If the Commission determines that the cost of capital analysis is not the appropriate methodology to determine the rate of return to be applied to the FVRB, the Commission has the discretion to determine the appropriate methodology." It is correspondingly the purpose of my testimony to recommend an "appropriate methodology" for use in conjunction with a FVRB.

Q. Do you have any observations based upon your own experience in cost of capital determination, as to whether a cost of capital developed for application to an original cost rate base is consistent with a fair value rate base?

A. Yes, I do. It is my personal experience, based upon over 35 years of providing cost of capital testimony, that the concept of cost of capital is designed to apply to an original cost rate base. This is the case since the cost of capital is derived from the liabilities/owners' equity side of a utility's balance sheet using the book values of the capital structure components. The cost of capital, once determined, is then applied to (i.e., multiplied by) the rate base, which is derived from the asset side of the balance sheet (i.e. OCRB). From a financial perspective, the rationale for this relationship is that the rate base is financed by the capitalization. Under this relationship, a provision is provided for investors (both lenders and owners) to receive a return on their invested capital. Such a relationship is meaningful as long as the cost of capital is applied to the original cost (i.e., book value) rate base, because there is a matching of rate base and capitalization.

When the concept of fair value rate base is incorporated, however, this link between rate base and capital structure is broken. The amount of fair value rate base that exceeds original cost rate base is not financed with investor-supplied funds and, indeed, is not financed at all. As a result, a customary cost of capital analysis cannot be automatically applied to the fair value rate base since there is no financial link between the two concepts. In my "non-legal" opinion, both the Commission and Appeals Court have also recognized this lack of compatibility between a customary WCOC analysis and FVRB.

Q. Why is it important that there be a link between the concepts of rate base and cost of capital?

A. This link is important since financial theory indicates that investors should be provided an opportunity to earn a return on the capital they provided to the utility. Since the capital finances the rate base (in an original cost world), the link between cost of capital and rate base satisfies this financial objective.

Q. Based on your experience as a cost of capital witness over the past 35 years, do you have a suggestion as to how to account for the use of a FVRB in setting rates for Chaparral City?

A. Yes, I do. Since the increment between fair value rate base and original cost rate base is not financed with investor-supplied funds, it is logical and appropriate, from a financial standpoint, to assume that this increment has no financing cost. As a result, the cost of capital, through the capital structure, can be modified to account for a level of cost-free capital in an equal dollar amount to the increment of FVRB over the OCRB. Such a procedure would still provide for a return being earned on all investor-supplied funds and would thus be consistent with financial standards.

Q. Have you made such a proposal in this proceeding?

A. Yes, I have. As is shown below, I have developed a capital structure and FVROR that applies to Chaparral's FVRB.

Item	Amount	Percent	Cost	Fair Value Return
Long-term Debt	$7,016,675	34.50%	5.10%	1.76%
Common Equity	$10,014,090	49.23%	9.30%	4.58%
FVRB Increment[1]	$3,309,533	16.27%	0.00%	0.00%
Total FVRB Capital	$20,340,299	100.00%		6.34%

[1] FVRB minus OCRB.

Applying this 6.34 percent to the FVRB provides for a return on all investor-supplied capital and is therefore an appropriate rate to apply to the FVRB from a financial and economic standpoint. As such, it provides for an appropriate fair value rate of return to be applied to a FVRB.

Q. **Have you developed an alternative method with which to apply a FVROR to a FVRB?**

A. Yes, I have. Should the Commission determine that there should be a specific return (greater than zero) applied to the FVRB Increment, I have provided such a procedure.

Q. **Why is it necessary to add a return on only the portion of FVRB that exceeds the OCRB?**

A. The WCOC authorized by the Commission has already provided for a full cost of equity return and cost of debt on the portions of equity and debt capital that are supporting the OCRB portion of the FVRB. As a result, there is no need to provide any additional return on the portions of FVRB supported by common equity and debt.

Stated differently, both the cost of debt and the return on common equity (i.e., capital stock, paid-in capital, and retained earnings - the investment of common shareholders) are already provided for in a traditional WCOC. Only the portion of the FVRB that exceeds OCRB ("Fair Value Increment") needs to have a specific return identified in order to reflect a return component on that Fair Value Increment.

Q. **What is the proper cost rate to apply to the Fair Value Increment?**

A. As I indicated previously, from a financial perspective, it should not be necessary to provide for any return on the Fair Value Increment since this is not investor-supplied capital. However, the Commission may choose to evaluate this issue from both a financial and a public policy perspective. I am aware that Chaparral City may claim that the concept of fair value carries with it the notion that investors should receive some benefit when fair value is greater than original cost and should suffer some detriment when fair value is less than original cost. It is possible that the Commission may determine that Arizona's fair value provision, which is somewhat unique, is not inconsistent with these concepts. Nonetheless, the idea that the Company should receive some benefit from the Fair Value Increment does not mean that one should automatically apply to the FVRB a WCOC developed by reference to original cost rate base. If it is determined that it is desirable to provide an additional (non-zero) return on the Fair Value Increment, the proper return should be no larger than the real (i.e., after inflation is removed) risk-free rate of return.

Q. What is the risk-free return?

A. The risk-free return is, in financial terms, the return on an investment that carries little or no risk. Risk-free investments are universally defined as U.S. Treasury Securities, with short-term maturities usually being used as the risk-free rate. Over the past several months, virtually all maturities of U.S. Treasury securities have yielded about 5.0 percent in nominal terms. Most recently, however, the shorter maturities of U.S. Treasury securities have yielded less, or about 4 percent to 4.25 percent. I also note that 2007-2008 forecasts of U.S. Treasury securities are about 5.0 percent. As a result, I use 5.0 percent as the nominal risk-free rate.

Q. What is the "real" risk-free rate?

A. The concept of real rates involves the removal of the rate of inflation from the nominal risk-free rate. In 2006, the rate of inflation, as measured by the Consumer Price Index

("CPI"), was 2.5 percent. Forecasts of the CPI for 2007-2008 are also about 2.5 percent. As a result, I propose to use a 2.5 percent inflation rate for computing the real risk-free rate, which is computed as follows:

Nominal Risk-Free Rate	5.0%
Less: Inflation Rate	2.5%
Equals: Real Risk-Free Rate	2.5%

Q. Please explain why Chaparral City's FVROR should consider the real risk-free rate, as opposed to the nominal risk-free rate.

A. The investors of Chaparral City are already receiving an inflation factor due to the inclusion of inflation in the FVRB Increment. Specifically, the Fair Value Increment incorporates inflation by considering the current value of assets, which reflect, in part, past inflation. It would be double-counting to also include the inflation components in the return to be applied to the FVRB Increment.

Q. What return on the Fair Value Increment do you recommend in your alternative FVROR proposal?

A. My alternative FVROR proposal incorporates a return on the Fair Value Increment with a maximum value of 2.5 percent, as developed above. However, I wish to emphasize that this 2.5 percent value is the maximum value that could be applied to the FVRB Increment. In reality, any value between zero percent and 2.5 percent could be used as the cost rate on the FVRB Increment. As I stated above, this Fair Value Increment return is in addition to the return that the Company's investors already earn on their investment in the Company. In this sense, an above-zero cost rate for the fair value increment represents a bonus to the Company that would have to find its justification in policy considerations instead of in pure economic or financial principles; for that reason, the selection of an appropriate cost rate within this range should fall to the Commission's discretion. I would propose the mid-point of this range, or 1.25 percent.

Q. What is the resulting impact of your alternative proposal in this proceeding?

A. I am proposing the following modified FVROR for Chaparral City:

Capital Item	Percent	Cost	Return
Long-term Debt	34.50%	5.1%	1.76%
Common Equity	49.23%	9.3%	4.58%
FVRB Increment	16.27%	1.25%	0.20%
Total	100.0%		6.54%

As shown in the above table, this alternative proposal provides for a non-zero return on the Fair Value Increment of Chaparral City, and provides for an overall fair value rate of return of 6.54 percent on the FVRB.

Q. Of the two alternative proposals for determining the fair value rate of return that should be applied to the FVRB, which one do you believe is more appropriate and why?

A. From a financial perspective, I believe the first proposal (i.e., zero-cost for FVRB Increment) is most appropriate. This proposal is consistent with financial principles and would fully compensate the Company's investors for their investment. In addition, this proposal utilizes the FVRB of the Company. If the Commission were to determine that a non-zero return on the Fair Value Increment is desirable, the alternative (i.e., a 1.25 percent cost-rate for the FVRB increment) is not inappropriate.

Q. Do these proposals provide for a return on the FVRB of Chaparral City?

A. Yes, they do.

Q. Will Staff continue to evaluate appropriate methods for determining the fair value rate of return on fair value rate base?

A. It is my understanding that the Commission Staff will continue to consider these issues in the context of future rate cases. Individual rate cases present different issues and varying sets of circumstances. For example, if one were to assign a non-zero cost rate to the fair value increment, it may be appropriate to determine the cost of equity to reflect a reduction in risk. I have not proposed such an adjustment in this case, but these issues may appear as Staff continues to consider appropriate methods for determining and evaluating the concept of fair value rate of return on fair value rate base.

Q. Does this conclude your pre-filed Direct Testimony?

A. Yes, it does.

Smith

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 CHAPARRAL CITY WATER COMPANY, INC. 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 FOR UTILITY SERVICES BASED THEREON	))))))))	DOCKET NO. W-02113A-04-0616

DIRECT

TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

AUGUST 30, 2007

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. REVENUE REQUIREMENT 4

A. Test Year *8*
B. Summary of Company Proposed and Staff Adjusted Revenue Requirement *9*
C. Company-Proposed Revisions to the Test Year Amount of Net Operating Income Determined by the Commission in Decision No. 68176 .... *13*
D. Fair Value Rate of Return to Apply to Fair Value Rate Base *14*
E. Rate Case Expense *18*

III. REVISED SCHEDULES OF RATES AND CHARGES FOR UTILITY SERVICE 21

ATTACHMENTS

Background and Qualifications RCS-1

Staff Revenue Deficiency Schedules, Alternative 1 ....RCS-2

Staff Revenue Deficiency Schedules, Alternative 2 ....RCS-3

EXECUTIVE SUMMARY
CHAPARRAL CITY WATER COMPANY, INC.
DOCKET NO. E-02113A-04-0616

My testimony addresses the following issues:

- The development of Staff's recommended revenue requirement for the Company using an appropriate fair value rate of return developed for application to the Fair Value Rate Base (FVRB) ordered by the Commission in Decision No. 68176 (9/30/05).

My findings and recommendations for each of these areas are as follows:

- The Company's proposed additional revenue requirement of approximately $1.122 million is overstated.

- Staff is presenting the Commission with two alternative sets of calculations of the fair value rate of return for application to the Fair Value Rate Base ("FVRB"). The first set of calculations is shown on Attachment RCS-2 and the second set is shown on Attachment RCS-3.

- As shown on Attachment RCS-2, Schedule D, Staff's first alternative is based on applying a 6.34 percent fair value rate of return to the FVRB. The fair value rate of return for FVRB results from adjusting the rate of return applicable to Original Cost Rate Base ("OCRB"). In the capital structure applicable to FVRB, a zero cost of capital is applied to the difference between FVRB and OCRB. As explained in my testimony and in the testimony of Staff witness David C. Parcell ("Parcell"), a zero cost rate for that portion of the FVRB is appropriate because that amount of FVRB has not been financed by investors. As shown on Attachment RCS-2, Schedule A, under this alternative, the revenue increase of $1,107,596 granted in Decision No. 68176 is revised downward by $7,734 to $ $1,099,862.

- If the Commission determines that it is appropriate to apply an above-zero cost rate to the fair value increment (i.e., the difference between FVRB and OCRB), Staff recommends that the Commission consider a range bounded by zero and a maximum of 2.5 percent. As described in the testimony of Staff witness Parcell, 2.5 percent is the real risk-free rate of return (i.e., it is the rate of return on a risk-free investment, less inflation). As shown on Attachment RCS-3, Schedule D, applying the mid-point of this range, 1.25 percent, to the difference between FVRB and OCRB produces an overall fair value rate of return of 6.54 percent to be applied to the FVRB. As shown on Attachment RCS-3, Schedule A, the application of the 6.54 percent fair value rate of return to the Fair Value Rate Base results in a revenue requirement of $1,166,116, which is an increase of $58,520 over the $1,107,596 granted in Decision No. 68176.

- The amount of net operating income of $614,247 that was determined by the Commission in Decision No. 68176 was not in dispute in the Company's appeal and should therefore not be subject to revision in this remand proceeding.

- In its July 6, 2007 amended filing, the Company requested an additional $100,000 of rate case cost. Staff recommends that no additional amount of rate case cost be charged to ratepayers because: (1) Staff legal counsel has advised me that Arizona law prohibits the recovery of attorney fees and costs related to an appeal of a rate order; (2) the Company's rationale for the additional rate case expense appears questionable; and (3) a normalized level of reasonable and prudent rate case cost was already reflected in the determination of net operating income; consequently, to increase the rate case expense beyond that normalized level would result in ratepayers paying an abnormal level of such expense.

I. INTRODUCTION

Q. Please state your name, position and business address.

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

Q. Please describe Larkin & Associates.

A. Larkin & Associates is a Certified Public Accounting and Regulatory Consulting firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous telephone, water and sewer, gas, and electric matters.

Q. Mr. Smith, please summarize your educational background.

A. I received a Bachelor of Science degree in Business Administration (Accounting Major) with distinction from the University of Michigan - Dearborn, in April 1979. I passed all parts of the Certified Public Accountant ("C.P.A.") examination in my first sitting in 1979, received my CPA license in 1981, and received a certified financial planning certificate in 1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law degree (J.D.) cum laude from Wayne State University, 1986. In addition, I have attended a variety of continuing education courses in conjunction with maintaining my accountancy license. I am a licensed C.P.A. and attorney in the State of Michigan. I am also a Certified Financial Planner™ professional and a Certified Rate of Return Analyst ("CRRA"). Since 1981, I have been a member of the Michigan Association of Certified Public Accountants. I am also a member of the Michigan Bar Association and the Society of Utility and Regulatory Financial Analysts ("SURFA"). I have also been a member of the American Bar Association ("ABA"), and the ABA sections on Public Utility Law and Taxation.

Q. Please summarize your professional experience.

A. Subsequent to graduation from the University of Michigan, and after a short period of installing a computerized accounting system for a Southfield, Michigan realty management firm, I accepted a position as an auditor with the predecessor CPA firm to Larkin & Associates in July 1979. Before becoming involved in utility regulation where the majority of my time for the past 27 years has been spent, I performed audit, accounting, and tax work for a wide variety of businesses that were clients of the firm.

During my service in the regulatory section of our firm, I have been involved in rate cases and other regulatory matters concerning numerous electric, gas, telephone, water, and sewer utility companies. My present work consists primarily of analyzing rate case and regulatory filings of public utility companies before various regulatory commissions, and, where appropriate, preparing testimony and schedules relating to the issues for presentation before these regulatory agencies.

I have performed work in the field of utility regulation on behalf of industry, state attorney generals, consumer groups, municipalities, and public service commission staffs concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Indiana, Illinois, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Washington, Washington D.C., and Canada as well as the Federal Energy Regulatory Commission and various state and federal courts of law.

Q. Have you prepared an attachment summarizing your educational background and regulatory experience?

A. Yes. Attachment RCS-1 provides details concerning my experience and qualifications.

Q. On whose behalf are you appearing?

A. I am appearing on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. Have you previously testified before the Arizona Corporation Commission?

A. Yes. I have testified before the Commission previously on a number of occasions. Recently, I testified before the Commission in Docket No. E-01345A-06-0009, involving an emergency rate increase request by Arizona Public Service Company ("APS" or "Company"), and concerning APS's proposed depreciation rates in Docket Nos. E-01345A-05-0816, E-01345A-05-0826 and E-01345A-05-0827, a proceeding involving APS base rates and other matters. I also testified before the Commission in the most recent UNS Gas, Inc. rate case, Docket Nos. G-04204A-06-0463, G-04204A-06-0013 and G-04204A-05-0831.

Q. What is the purpose of the testimony you are presenting?

A. The purpose of my testimony is to address the revenue requirement of Chaparral City Water Company ("CCWC or "Company") in view of the decision of the Arizona Court of Appeals in *Chaparral City Water Company v. Arizona Corporation Commission*, No. 1 CA-CC 05-002 (2/13/2007), which remanded the case to the Commission for reconsideration of the fair value rate of return ("FVROR") to apply to the Company's Fair Value Rate Base ("FVRB").

Q. Have you prepared any exhibits to be filed with your testimony?

A. Yes. Attachments RCS-2 and RCS-3 contain the results of my analysis.

II. REVENUE REQUIREMENT

Q. What issues are addressed in your testimony?

A. My testimony addresses the Company's proposed revenue requirement and its revised schedules of rates and charges for utility service that was filed with the Commission on July 6, 2007 in *Chaparral City Water Company's Amended Notice of Filing Revised Schedules of Rates and Charges for Utility Service*. Page 2 of that amended filing states that it supersedes and replaces the Company's June 8, 2007 filing.

Q. Has the Commission's traditional calculation of fair value rate of return on fair value rate base been called into question by a recent Court of Appeals decision?

A. Yes. The Commission's traditional calculation of fair value rate of return on fair value rate base has been called into question by a recent Arizona Court of Appeals ruling involving Chaparral City Water Company. In that ruling, the Arizona Court of Appeals found that the Commission's determination of operating income ignored fair value rate base, and that the Commission must use fair value rate base to set rates per the Arizona Constitution.

Q. What revenue increase has been requested by CCWC?

A. Schedule A-1 to the Company's July 5, 2007 amended filing shows that it is requesting an additional amount of $1,121,813 to be recovered through a surcharge.

Q. Does Staff agree with the amount that CCWC proposes?

A. No. Not at all. Staff is presenting two alternative calculations for the Commission's consideration. Compared with either of Staff's alternative calculations, the amount requested by CCWC is excessive.

Q. Please briefly explain the Staff's alternative calculations of the fair value rate of return on fair value rate base, and the results produced by each calculation.

A. As shown on Attachment RCS-2, Schedule D, Staff's first alternative is based on applying a 6.34 percent fair value rate of return to the FVRB. The fair value rate of return for FVRB results from adjusting the rate of return applicable to Original Cost Rate Base ("OCRB"). In the capital structure applicable to FVRB, a zero cost rate is applied to the difference between FVRB and OCRB (i.e., the Fair Value Increment). As explained in my testimony and in the testimony of Staff witness David C. Parcell ("Parcell"), a zero cost rate for that portion of the FVRB is appropriate because that amount of FVRB has not been financed by investors. As shown on Attachment RCS-2, Schedule A, under this alternative, the revenue increase of $1,107,596 granted in Decision No. 68176 is revised downward by $7,734 to $1,099,862. Because the $7,734 change is immaterial, Staff is not recommending that the Company's rates be revised downward by that amount, or that a sur-credit be applied.

If the Commission determines that it is appropriate to apply an above-zero cost rate to the difference between FVRB and OCRB, Staff recommends that the Commission consider a range bounded by a minimum of zero to a maximum of 2.5 percent. As described in the testimony of Parcell, the 2.5 percent is the real risk-free rate of return (i.e., the rate of return on a risk-free investment less inflation). As shown on Attachment RCS-3, Schedule D, using the mid-point of this range, applied to the Fair Value Increment (the difference between FVRB and OCRB) produces an overall fair value rate of return of 6.54 percent to be applied to the FVRB. As shown on Attachment RCS-3, Schedule A, the application of the 6.54 percent fair value rate of return to the Fair Value Rate Base results in a revenue requirement of $1,166,116, which is an increase of $58,520 over the $1,107,596 granted in Decision No. 68176.

Q. What revenue adjustment do you recommend?

A. In order to address the remand issue of what fair value rate of return should be applied to the fair value rate base, I am presenting two alternatives for the Commission's consideration. The first alternative is shown on Attachment RCS-2, Schedule A. This alternative results in a downward revision to the revenue increase of $1,107,596 that was granted in Decision No. 68176 by $7,734 to $1,099,862, as shown on Attachment RCS-2, Attachment A, columns C and D, lines 1-16.

This first alternative is based on the application of a zero cost rate to the difference between FVRB and OCRB. As explained in my testimony and in the testimony of Parcell, a zero cost rate for that portion of the FVRB is appropriate because that amount of Rate Base (i.e., the fair value increment) has not been financed by investors. As shown on Attachment RCS-2, Schedule D, the appropriate fair value rate of return to be applied to the FVRB determined under this method is 6.34 percent.

Q. What is shown on Attachment RCS-2, Schedule A, lines 18-40?

A. This part of Schedule A reproduces CCWC's proposed computation of the amount to be recovered over a 12-month period through a surcharge that would collect the difference between CCWC's proposed revenue increase and the increase that was authorized by the Commission in Decision No. 68176, including the application of an interest rate. In the

Company's calculation, interest is applied through March 2008 (the mid-point of the collection period). CCWC's calculation assumes that the recovery period starts October 2007 and proceeds for a period of 12 months (September 2008) or when full recovery is made. As shown in columns E and F, CCWC proposed to collect $1,121,812 (line 38) via a surcharge of $0.595 per thousand gallons (line 40). Columns G and H show Staff's calculation under Staff's first alternative, which results in an $18,053 amount to be refunded to ratepayers, inclusive of interest, for a sur-credit of 1 cent ($0.010) per thousand gallons of water consumption.

Q. Does Staff recommend that the Commission require CCWC to provide ratepayers with a sur-credit of 1 cent ($0.010) per thousand gallons of water consumption?

A. No. The $7,734 downward adjustment to the revenue requirement and 1 cent per thousand gallons sur-credit that result under Staff's first alternative is believed to be too small to warrant a rate adjustment.

Q. Please explain the second alternative for the fair value rate of return that Staff is presenting to the Commission for its consideration.

A. If the Commission determines that the Company should receive a return on the difference between FVRB and OCRB at a cost rate that is above zero, Staff has developed an alternative for the Commission's consideration that is based on a range from zero to a maximum of 2.5 percent. As explained in the testimony of Parcell, the 2.5 percent maximum end of the range is based upon a risk-free cost rate less inflation. The mid-point of this range is 1.25 percent. As shown on Attachment RCS-3, Schedule D, applying the 1.25 percent to the difference between FVRB and OCRB (and applying the cost of capital developed for application to the OCRB to the original cost components of the FVRB) results in a fair value rate of return to be applied to the FVRB of 6.54 percent.

This second alternative results in a revenue requirement of $1,166,116, which is an increase of $58,520 over the $1,107,596 granted in Decision No. 68176. The calculation appears on Attachment RCS-3, Schedule A, column C. As shown on Attachment A, lines 18-40, columns G and H, with interest, this alternative would produce a total amount to be recovered through a surcharge of $137,264 and a surcharge of 7.3 cents per thousand gallons ($0.073). Parcell explains the basis for Staff's second alternative for the fair value rate of return. As shown on Attachment RCS-3, Schedule D, if the Commission adopts this method, the fair value rate of return that would be applied to the fair value rate base is 6.54 percent.

A. Test Year

Q. What test year is being used in this case?

A. CCWC's filing is based on the historic test year ended December 31, 2003. Staff's calculations use the same historic test year.

Q. Could you please discuss the test year concept?

A. Yes. In Arizona, a historic test year approach is used. Various adjustments are made to the historic test year amounts to ensure that there is a matching of investment, revenues and expenses. Rate base items, such as plant in service and accumulated depreciation, are based on the actual level as of the end of the historic test year. Several rate base items that tend to fluctuate from month to month, such as materials and supplies and prepayments, are based on a test year average level. Since end of test year net plant in service is used, revenues are annualized based on end of test year customer levels. Additionally, certain expenses, such as depreciation and payroll costs, are annualized based on end of test year levels. This is to ensure that the going-forward revenue and expense levels are matched with the investment (net plant-in-service) used to serve those customers.

As time goes forward, changes in the Company's cost structure will occur. For example, rate base will increase as new plant is added to serve new customers, revenue will increase as customers are added, expenses will fluctuate, etc. It is very important to be consistent with a test period approach to ensure that there is a consistent matching between investment, revenues and costs. Any adjustments that reach beyond the end of the historic test year must be very carefully considered before being adopted.

B. Summary of Company Proposed and Staff Adjusted Revenue Requirement

Q. What did your review of CCWC's filing indicate?

A. As summarized on Attachment RCS-2, Schedule A, in column A, in Decision No. 68176, the Commission determined a revenue deficiency of $1,107,596 for CCWC based on the application of a fair value rate of return of 6.36 percent to a FVRB of $20,340,298.

As also summarized on Attachment RCS-2, Schedule A, in column B, CCWC has calculated a revenue deficiency of $1,532,440, based on applying the original cost rate of return of 7.60 percent to a FVRB of $20,340,298 and making pro forma adjustments to test year adjusted net operating income in addition to those adopted by Decision No. 68176. The $1,532,440 revenue deficiency calculated by CCWC exceeds the $1,107,596 revenue deficiency that the Commission determined in Decision No. 68176 by $424,844.

As shown on Attachment RCS-2, Schedule A, in column C, based on Staff's first alternative for the fair value rate of return recommended by Parcell and CCWC's fair value rate base and net operating income that were determined by the Commission in Decision No. 68176, I have calculated a revised revenue requirement deficiency of $1,099,862 for CCWC. This is $7,734 below the revenue deficiency of $1,107,596 determined by the Commission in Decision No. 68176.

Attachment RCS-3, Schedule A, Column A shows that using Staff's second alternative for the fair value rate of return results in a revenue requirement of $1,166,116, which is an increase of $58,520 over the $1,107,596 granted in Decision No. 68176.

Q. Please explain what is shown on your Attachments RCS-2 and RCS-3.

A. On Attachments RCS-2 and RCS-3, Schedule A to each attachment shows the determination of the revenue requirement and revenue deficiency on lines 1 through 16. This format follows the presentation by CCWC on its amended filing of July 6, 2007 where the Company presented its revised calculations (as of 6/23/07) on Schedule A-1 to that filing. Schedule A to each of my attachments, in essence, presents the change in the Company's gross revenue requirement needed for the Company to have the opportunity to earn Staff's recommended fair value rate of return on FVRB.

On Attachments RCS-2 and RCS-3, Schedule D to each attachment shows the development of the appropriate fair value rate of return to be applied to the FVRB. Attachments RCS-2 and RCS-3, respectively, presents Staff's two alternative derivations of the fair value rate of return for application to the FVRB that Staff is presenting for the Commission's consideration.

Q. Has Staff made any revisions to the adjusted net operating income or fair value rate base that was determined by the Commission in Decision No. 68176?

A. No. Because there are no other issues identified in the Court of Appeals remand, Staff has used the same FVRB and the same net operating income that was determined by the Commission in Decision No. 68176.

Q. How was the FVRB determined in Decision No. 68176?

A. In Decision No. 68176, the Commission determined the FVRB by averaging the OCRB and Reconstruction Cost New Depreciated Rate Base ("RCND"). I am advised by Staff legal counsel that none of these rate base amounts were in dispute at the Court of Appeals, and therefore the FVRB is not subject to revision in this remand proceeding.

Q. What amount of adjusted net operating income did the Commission determine in Decision No. 68176?

A. As shown on Attachment RCS-2, Schedule A, line 3, in columns A and C, the adjusted test year operating income of $614,247 was determined by the Commission in Decision No. 68176.[1] I am advised by Staff legal counsel that this amount was not in dispute at the Court of Appeals, and therefore should not be subject to revision in this remand proceeding.

Q. Referring to Schedule A of Attachments RCS-2 and RCS-3, what is shown on lines 18 through 38?

A. Lines 18 through 38 present the calculations of CCWC's and Staff's amount to be recovered or refunded through a surcharge. Columns E and F present CCWC's calculations and columns G and H present Staff's calculations. The format for this presentation is similar to Schedule A-1 of CCWC's July 6, 2007 amended filing.

[1] See, e.g., Decision No. 68176, page 38, finding of fact #15.

Q. Please identify the areas of agreement and disagreement between Staff and CCWC regarding the calculations shown on your Attachments RCS-2 and RCS-3, Schedule A.

A. The areas of apparent agreement between Staff and CCWC concerning the calculation include the following:

- The FVRB is $20,340,298, as shown on line 1, per the Commission's determination in Decision No. 68176. For purposes of this presentation, both CCWC and I have used the FVRB of $20,340,298 that was determined by the Commission in Decision No. 68176.

- The calculation method shown on lines 1 through 16 should be used to determine the revenue deficiency.

- The gross revenue conversion factor ("GRCF") of 1.6286, shown on line 13, should be used. This is the same GRCF that the Commission used to determine the revenue requirement in Decision No. 68176.

- It would be appropriate to apply a financing cost to the amount of the annual deficiency or excess.

- The overall fair value rate of return that the Commission determines should be applied to the FVRB should be used to determine the amount of financing cost on the annual deficiency or excess.

The areas of disagreement include the following:

- The amount of adjusted net operating income. CCWC's July 6, 2007 amended filing includes additional pro forma adjustments that serve to reduce test year adjusted net operating income by $9,320. Staff has used the same test year adjusted net operating income of $614,247 that the Commission determined in Decision No. 68176. As noted above, I am advised by Staff legal counsel that this amount was not in dispute at the Court of Appeals, and therefore should not be subject to revision in this remand proceeding. The issue for this remand proceeding is how to determine the fair value rate of return that should be applied to fair value rate base, and to recalculate the revenue requirement based on that.

- What fair value rate of return should be applied to the fair value rate base?

- Whether CCWC's ratepayers should be surcharged for additional rate case expense, and, if so, what is a reasonable and appropriate amount?

C. Company-Proposed Revisions to the Test Year Amount of Net Operating Income Determined by the Commission in Decision No. 68176

Q. Should revisions be made to the test year amount of net operating income that the Commission determined in Decision No. 68176?

A. No. The test year amount of net operating income was determined by Decision No. 68176 and was not subject to dispute in CCWC's appeal and therefore should not be part of the instant remand proceeding. The Company's "minor adjustments to property tax and income tax expense" listed on its Remand Schedule C-1, should therefore be rejected. CCWC notes on page 5 of its July 6, 2007 amended filing that, in its opinion, the issues before the Commission on remand are extremely narrow and that the bulk of the Commission's determinations in Decision No. 68176 were not challenged on appeal. The

Company's attempt to retroactively revise the Commission's determination of test year net operating income is therefore inconsistent with this observation in the Company's filing.

D. Fair Value Rate of Return to Apply to Fair Value Rate Base

Q. How did CCWC determine the fair value rate of return to apply to fair value rate base in its filing?

A. In CCWC's July 6, 2007 amended filing, as shown on Schedule A-1, the Company has attempted to apply the 7.60 percent rate of return that was developed for application to an original cost rate base, to the FVRB.

Q. What did the Court of Appeals decision state concerning whether the rate of return that was developed for application to an original cost rate base should be applied, without adjustment, to the fair value rate base?

A. The Court of Appeals specifically stated that the Commission was not bound to apply a rate of return that was developed for use with an original cost rate base, without adjustment, to the fair value rate base. Page 9 of the Court of Appeals decision stated that: "Chaparral City ... asks that the Commission be directed to apply the 'authorized rate of return' to the fair value rate base rather than to the OCRB, as Chaparral City contends was done here." At page 13, paragraph 17, the Court of Appeals decision states as follows: "The Commission asserts that it was not bound to use the weighted average cost of capital as the rate of return to be applied to the FVRB. The Commission is correct." Thus, the Court of Appeals clearly stated that the Commission is not bound to apply to the FVRB the same weighted average cost of capital that was developed for application to the OCRB.

Q. What other guidance did the Court of Appeals provide for determining an appropriate fair value rate of return to apply to the FVRB?

A. At pages 13-14, paragraph 17, the Court of Appeals decision stated that: "… the Commission cannot ignore its constitutional obligation to base rates on a utility's fair value. The Commission cannot determine rates based on the original cost, or OCRB, and then engage in a superfluous mathematical exercise to identify the equivalent FVRB rate of return." At page 13, the decision states: "If the Commission determines that the cost of capital analysis is not the appropriate methodology to determine the rate of return to be applied to the FVRB, the Commission has the discretion to determine the appropriate methodology." Thus, a superfluous mathematical exercise cannot be used, i.e., there must be appropriate economic and financial logic and support underlying the determination of the fair value rate of return that is applied to the FVRB. The Court of Appeals clearly indicated that the Commission has the discretion to determine the appropriate methodology.

Q. How has Staff addressed the ruling in the Court of Appeals' decision for purposes of the current remand proceeding concerning the CCWC rate case?

A. In view of the Court of Appeals' decision in the Chaparral City case, Staff has appropriately adjusted the weighted cost of capital to develop an appropriate fair value rate of return to apply to the utility's fair value rate base. David Parcell's Direct Testimony in the instant case describes Staff's revision to the fair value rate of return on fair value rate base calculations in view of the recent Court of Appeals' decision concerning Chaparral. As I noted above, Staff is presenting the Commission with two alternatives for determining the appropriate fair value rate of return for application to the FVRB.

Attachment RCS-2, Schedule D shows the derivation of the fair value rate of return for application to the FVRB for Staff's first alternative based on the recommendation of Parcell. On Schedule A of that exhibit, I have applied Staff's fair value rate of return as described by Mr. Parcell in his Direct Testimony. The cost rate applicable to the amount of FVRB that is in excess of the OCRB is zero, since that rate base is not reported on the utility's financial statements and therefore has not been financed by any source of capital (such as debt or equity) that is reported on the utility's financial statements. As explained by Mr. Parcell, the financing cost rate for items in the fair value rate base that have not been financed with debt or equity on the utility's books is zero. As shown on Exhibit RCS-2, Schedule A, the application of Staff's fair value rate of return to the FVRB results in a revenue increase of $1,099,862. In this instance, the application of this fair value rate of return to the FVRB produces a slightly lower revenue requirement than does the application of the customary WCOC to OCRB.

Q. Has Staff selectively tested this method on other utilities?

A. Yes. Staff has performed calculations using this method for other Arizona utilities. In each instance, it resulted in a different amount of revenue deficiency than did applying the original cost-based rate of return to the original cost rate base. Thus, it is not a mere superfluous mathematical exercise.

Q. Please summarize the economic and financial logic supporting the use of a zero cost rate to the portion of the FVRB that is in excess of the OCRB.

A. The weighted average cost of capital is initially developed to apply to the OCRB. The original cost rate base is based on amounts recorded on the utility's books. The original cost rate base is financed with debt and equity (and sometimes other sources of cost free capital) that are recorded on the utility's books. The difference between the FVRB and the OCRB has not been financed by any identifiable debt or equity capital on the utility's books. Thus, that portion of the FVRB essentially has a zero cost. In other words, as shown on Attachment RCS-2, Schedule D, the weighted average cost of capital developed for the application to the OCRB is appropriately adjusted for application to a FVRB by recalculating the capital structure ratios and assigning a zero financing cost to the component of FVRB that is not supported by debt and equity on the utility's books. Additional explanation of the support for this method, from a financial perspective, is presented in the testimony of Parcell.

Q. Please explain Staff's second alternative for the fair value rate of return for application to the FVRB that Staff is presenting for the Commission's consideration.

A. Attachment RCS-3, Schedule D shows the derivation of the fair value rate of return for Staff's second alternative for application to the FVRB. This alternative is described in Mr. Parcell's Direct Testimony and applies a cost rate to the amount of FVRB that is in excess of the OCRB. The cost rate applicable to the amount of FVRB that is in excess of the OCRB is based on the mid-point of a range from zero to 2.5 percent. As explained by Mr. Parcell, the 2.5 percent maximum point in the range is based on a risk-free cost rate, less inflation. This method results in a fair value rate of return for FVRB of 6.54 percent, as shown on Schedule D.

On Schedule A of that exhibit, I have applied this 6.54 percent fair value rate of return as described by Mr. Parcell in his Direct Testimony, to determine an alternative revenue requirement for the Commission's consideration. As shown on Exhibit RCS-3, Schedule A, the application of Staff's alternative fair value rate of return to the FVRB results in a revenue increase of $1,166,116. If this alternative method of determining the fair value rate of return to apply to the FVRB is used, a higher revenue requirement results for

CCWC. The $1,166,116 revenue deficiency produced by this method exceeds the $1,107,596 determined by the Commission in Docket No. 68176 by $58,520. In other words, the application of the alternative fair value rate of return to the FVRB produces a higher revenue requirement than does the application of the unadjusted weighted cost of capital to OCRB.

E. Rate Case Expense

Q. What amount of additional rate case expense is CCWC requesting?

A. In its July 6, 2007 amended filing, at page 2, CCWC is requesting an additional $100,000 of rate case expense. This is double the $50,000 for additional rate case expense that CCWC requested in its June 3, 2007 filing.

At page 6 of its July 6, 2007 amended filing, CCWC states that:

"The amount requested by the Company, $100,000, is approximately the amount the Company has incurred since October 1, 2005, through the date of this filing. The Company will incur additional costs in connection with the remand proceedings before the Commission, including (but not limited to) review of the direct and surrebuttal testimony of Staff and RUCO; the preparation of rebuttal and rejoinder testimony by its witnesses; an evidentiary hearing (that is likely to take two days to complete); and post-hearing briefing and other proceedings, including an open meeting. The Company estimates that total rate case expense from October 1, 2005, through the completion of the remand proceeding will be approximately $200,000. The Company has elected to substantially reduce its adjustment to rate case expense in order to eliminate any disputes about the amount of rate case expense and simplify the issues on remand."

Q. On what basis does CCWC state that it is requesting additional rate case expense?

A. Page 2 of CCWC's July 6, 2007 amended filing states as follows concerning its request for additional rate case expense:

"... Chaparral City's rate case expense has been increased by $100,000 to take into account the additional fees and costs incurred by Chaparral City since October 1, 2005, including its successful appeal of Decision No. 68176 and costs related to the remand proceeding."

Q. Didn't the Court of Appeals reject a large portion of CCWC's arguments?

A. Yes, it appears so. In its appeal CCWC had challenged two issues: (1) the methodology employed by the Commission in Decision No. 68176 to estimate the cost of equity capital, and (2) the rate of return applicable to FVRB. Concerning the first issue, the Court of Appeals determined that CCWC failed to make a clear and convincing showing that the Commission's adoption of the Commission's Utilities Division Staff's recommendation was unlawful or unreasonable. The Court affirmed the Commission's determination of the cost of equity capital. Thus, one would tend to conclude that CCWC was unsuccessful in its appeal of that issue.

Second, as noted above in my testimony, concerning the second issue, i.e., the determination of an appropriate rate of return to the FVRB, the Court of Appeals specifically ruled that the Commission was not bound to apply to the FVRB the rate of return that was developed for OCRB. Specifically, the Court ruled that the Commission was not bound to apply an authorized rate of return that was developed for use with an original cost rate base, without adjustment, to the fair value rate base. Page 9 of the Court of Appeals decision stated that: "Chaparral City … asks that the Commission be directed to apply the 'authorized rate of return' to the fair value rate base rather than to the OCRB, as Chaparral City contends was done here." I note that in its July 6, 2007 amended remand filing, CCWC is again asking the Commission to apply the 'authorized rate of return' that was developed for OCRB, to the fair value rate base. At page 13, paragraph 17, the Court of Appeals decision states as follows: "The Commission asserts that it was not bound to use the weighted average cost of capital as the rate of return to be applied to the FVRB. The Commission is correct." Thus, the Court of Appeals clearly stated that the Commission is not bound to apply to the FVRB the same weighted average cost of capital that was developed for application to the OCRB, which is what CCWC is asking the Commission to do in this case.

Based on the above, CCWC's appeal of Decision No. 68176 appears to have met with only limited success, at best, and does not appear to represent justification for the substantially increased rate case expense that is now being requested by the Company.

Q. Should CCWC's ratepayers be charged for the Company's attorney fees and costs related to the appeal?

A. CCWC's July 6, 2007 amended filing states that its request for additional rate case expense is "to take into account the additional fees and costs incurred since October 1, 2005," including costs related to the appeal. I am informed by Staff legal counsel that a state statute, A.R.S. § 12-348, prevents a utility, such as CCWC, from recovering attorney fees related to an appeal of a rate order.

Q. What is Staff's position concerning whether CCWC should be permitted to charge ratepayers for additional rate case expense?

A. Staff's position concerning this is based upon the following analysis and considerations. CCWC took exception to a Commission decision and was unsuccessful in large part in getting its recommendations adopted by the Court of Appeals. As noted above, Staff believes that CCWC is prevented by law from recovering attorney fees related to that appeal. However, Staff does not object to CCWC's recovery of a normalized level of reasonable and prudent rate case expenses in the context of a rate case proceeding. In this regard, Staff notes that in Docket No. W-02113A-04-0616 a normalized amount of rate case expense for CCWC has already been included in the determination of net operating income.[2] In other words, a normalized level of rate case expense was already reflected in the determination of net operating income in Decision No. 68176. Consequently, Staff views the additional rate case expense requested by CCWC related to the remand proceeding as being in excess of a normalized level of reasonable and prudently incurred cost. Accordingly, I have not reflected any additional rate case cost on Attachments RCS-2 or RCS-3, Schedule A.

III. REVISED SCHEDULES OF RATES AND CHARGES FOR UTILITY SERVICE

Q. Have you calculated the amount of surcharge or sur-credit related to Staff's recalculation of the revenue requirement for CCWC?

A. Yes. This is shown on Attachments RCS-2 and RCS-3 on Schedule A. It follows a similar format, for ease of reference and comparison, to Remand Schedule A-1, page 2 of 2, that was presented by CCWC in its July 6, 2007 filing.

Under the first alternative, as shown on Attachment RCS-2, Schedule A, columns G and H, a refund of $18,053 (based on the annual revenue impact of $7,734) would be due from CCWC to its customers. Using the gallons of water sold in 2006, this would equate to a sur-credit of 1 cent ($0.010) per thousand gallons.

Under the second alternative, as shown on Attachment RCS-3, Schedule A, columns G and H, an amount of $137,264 would be recoverable by CCWC from its customers. Using

[2] I am advised by Staff that, in the rate case, CCWC had requested a normalized allowance for rate case expense $213,750, normalized over a three-year period for an annual allowance of $71,250. Staff reviewed this normalized amount and proposed no adjustment in the rate case. Staff did propose other normalization adjustments in the rate case, which were adopted by the Commission. Decision No. 68176 contains a section labeled "Normalization of Expenses" and the Order adopts Staff's recommendations on the normalization of four accounts. The Staff direct and surrebuttal testimonies discuss the "normalization" of four other expense accounts: office supplies and expense, outside services, transportation expense, and miscellaneous expense.

the gallons of water sold in 2006, this would equate to a surcharge of 7.3 cents ($0.073) per thousand gallons.

Q. Under Staff's first alternative, does Staff recommend a rate change for CCWC?

A. No. Because of the small size of the $18,053 and the resultant sur-credit of only 1 cent per thousand gallons, if the Commission finds that this alternative appropriately addresses the concerns expressed by the Court of Appeals concerning the fair value rate of return applicable to FVRB, Staff is recommending that no rate change (i.e., no sur-credit) be implemented.

Q. If the Commission were to adopt Staff's second alternative for the fair value rate of return as presented in Attachment RCS-3, would a rate change be necessary?

A. Yes. As shown on Attachment RCS-3, Schedule A, lines 18-40, the Company's and Staff's surcharge calculations are based on an assumed rate recovery period starting in October 2007 and continuing for a period of 12 months (September 2008) or when full recovery is made. As shown in column H lines 38-40, under Staff's alternative calculation, the initial surcharge, based on the $137,264, of $0.073 per thousand gallons, is anticipated to be in effect during the period October 2007 through September 2008. In addition to the surcharge that would be necessary to collect the past revenue deficiency, with interest, some minor adjustments to the Company's existing rates would be necessary to recover prospectively the annual revenue deficiency of $58,520 that would continue after September 2008. One way of addressing this would be via a lower amount of surcharge after the $137,264 "total amount to be recovered" on Attachment RCS-3, column H, line 38, were recovered. Using the 2006 gallons sold of 1,885,008,000, the $58,820 annual revenue deficiency that would continue after September 2008 equates to a surcharge of $0.031 (i.e., 3.1 cents) per thousand gallons. That reduced surcharge could then be applied commencing in October 2008, or earlier, if the $137,264 "total amount to be recovered" were recovered prior to September 30, 2008. Earlier recovery could potentially occur if water sales volumes during the recovery period exceed the 2006 gallons sold during 2006, which were used to derive the surcharge amount.

Q. Staff has presented two alternative calculations of the fair value rate of return on FVRB to the Commission. Do you have an opinion on which of the two alternatives is more appropriate and why?

A. Yes. Because the difference between the FVRB and OCRB has not been financed with any debt or equity capital that is recorded on the utility's books, I believe the assignment of a zero cost rate to that component of the FVRB, as shown on Attachment RCS-2, Schedule D, in order to compute the fair value rate of return on FVRB best conforms with economic and financial principles. For CCWC, therefore, I recommend that the Commission adopt the fair value rate of return of 6.34 percent shown on Attachment RCS-2, for application to the FVRB of $20,340,298. As noted elsewhere in my testimony, and shown on Attachment RCS-2, Schedule A, this alternative would produce a refund of $18,053 and a sur-credit of 1 cent per thousand gallons.

Q. Does this conclude your testimony?

A. Yes, it does.

Attachment RCS-1

QUALIFICATIONS OF RALPH C. SMITH

Accomplishments

Mr. Smith's professional credentials include being a Certified Financial Planner™ professional, a licensed Certified Public Accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. His involvement in public utility regulation has included project management and in-depth analyses of numerous issues involving telephone, electric, gas, and water and sewer utilities.

Mr. Smith has performed work in the field of utility regulation on behalf of industry, PSC staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New York, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Washington, Washington, D.C., Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on several occasions.

Project manager in Larkin & Associates' review, on behalf of the Georgia Commission Staff, of the budget and planning activities of Georgia Power Company; supervised 13 professionals; coordinated over 200 interviews with Company budget center managers and executives; organized and edited voluminous audit report; presented testimony before the Commission. Functional areas covered included fossil plant O&M, headquarters and district operations, internal audit, legal, affiliated transactions, and responsibility reporting. All of our findings and recommendations were accepted by the Commission.

Key team member in the firm's management audit of the Anchorage Water and Wastewater Utility on behalf of the Alaska Commission Staff, which assessed the effectiveness of the Utility's operations in several areas; responsible for in-depth investigation and report writing in areas involving information systems, finance and accounting, affiliated relationships and transactions, and use of outside contractors. Testified before the Alaska Commission concerning certain areas of the audit report. AWWU concurred with each of Mr. Smith's 40 plus recommendations for improvement.

Co-consultant in the analysis of the issues surrounding gas transportation performed for the law firm of Cravath, Swaine & Moore in conjunction with the case of Reynolds Metals Co. vs. the Columbia Gas System, Inc.; drafted in-depth report concerning the regulatory treatment at both state and federal levels of issues such as flexible pricing and mandatory gas transportation.

Lead consultant and expert witness in the analysis of the rate increase request of the City of Austin - Electric Utility on behalf of the residential consumers. Among the numerous ratemaking issues addressed was the economies of the Utility's employment of outside services; provided both written and oral testimony outlining recommendations and their bases. Most of Mr. Smith's recommendations were adopted by the City Council and Utility in a settlement.

Key team member performing an analysis of the rate stabilization plan submitted by the Southern Bell Telephone & Telegraph Company to the Florida PSC; performed comprehensive analysis of the Company's projections and budgets which were used as the basis for establishing rates.

Lead consultant in analyzing Southwestern Bell Telephone separations in Missouri; sponsored the complex technical analysis and calculations upon which the firm's testimony in that case was based. He has also assisted in analyzing changes in depreciation methodology for setting telephone rates.

Lead consultant in the review of gas cost recovery reconciliation applications of Michigan Gas Utilities Company, Michigan Consolidated Gas Company, and Consumers Power Company. Drafted recommendations regarding the appropriate rate of interest to be applied to any over or under collections and the proper procedures and allocation methodology to be used to distribute any refunds to customer classes.

Lead consultant in the review of Consumers Power Company's gas cost recovery refund plan. Addressed appropriate interest rate and compounding procedures and proper allocation methodology.

Project manager in the review of the request by Central Maine Power Company for an increase in rates. The major area addressed was the propriety of the Company's ratemaking attrition adjustment in relation to its corporate budgets and projections.

Project manager in an engagement designed to address the impacts of the Tax Reform Act of 1986 on gas distribution utility operations of the Northern States Power Company. Analyzed the reduction in the corporate tax rate, uncollectibles reserve, ACRS, unbilled revenues, customer advances, CIAC, and timing of TRA-related impacts associated with the Company's tax liability.

Project manager and expert witness in the determination of the impacts of the Tax Reform Act of 1986 on the operations of Connecticut Natural Gas Company on behalf of the Connecticut Department of Public Utility Control - Prosecutorial Division, Connecticut Attorney General, and Connecticut Department of Consumer Counsel.

Lead Consultant for The Minnesota Department of Public Service ("DPS") to review the Minnesota Incentive Plan ("Incentive Plan") proposal presented by Northwestern Bell Telephone Company ("NWB") doing business as U S West Communications ("USWC"). Objective was to express an opinion as to whether current rates addressed by the plan were appropriate from a Minnesota intrastate revenue requirements and accounting perspective, and to assist in developing recommended modifications to NWB's proposed Plan.

Performed a variety of analytical and review tasks related to our work effort on this project. Obtained and reviewed data and performed other procedures as necessary (1) to obtain an understanding of the Company's Incentive Plan filing package as it relates to rate base, operating income, revenue requirements, and plan operation, and (2) to formulate an opinion concerning the reasonableness of current rates and of amounts included within the Company's Incentive Plan filing. These procedures included requesting and reviewing extensive discovery, visiting the Company's offices to review data, issuing follow-up information requests in many instances, telephone and on-site discussions with Company representatives, and frequent discussions with counsel and DPS Staff assigned to the project.

Lead Consultant in the regulatory analysis of Jersey Central Power & Light Company for the Department of the Public Advocate, Division of Rate Counsel. Tasks performed included on-site review and audit of Company, identification and analysis of specific issues, preparation of data requests, testimony, and cross examination questions. Testified in Hearings.

Assisted the NARUC Committee on Management Analysis with drafting the Consultant Standards for Management Audits.

Presented training seminars covering public utility accounting, tax reform, ratemaking, affiliated transaction auditing, rate case management, and regulatory policy in Maine, Georgia, Kentucky, and Pennsylvania. Seminars were presented to commission staffs and consumer interest groups.

Previous Positions

With Larkin, Chapski and Co., the predecessor firm to Larkin & Associates, was involved primarily in utility regulatory consulting, and also in tax planning and tax research for businesses and individuals, tax return preparation and review, and independent audit, review and preparation of financial statements.

Installed computerized accounting system for a realty management firm.

Education

Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979.

Master of Science in Taxation, Walsh College, Michigan, 1981. Master's thesis dealt with investment tax credit and property tax on various assets.

Juris Doctor, cum laude, Wayne State University Law School, Detroit, Michigan, 1986. Recipient of American Jurisprudence Award for academic excellence.

Continuing education required to maintain CPA license and CFP® certificate.

Passed all parts of CPA examination in first sitting, 1979. Received CPA certificate in 1981 and Certified Financial Planning certificate in 1983. Admitted to Michigan and Federal bars in 1986.

Michigan Bar Association.

American Bar Association, sections on public utility law and taxation.

Partial list of utility cases participated in:

79-228-EL-FAC	Cincinnati Gas & Electric Company (Ohio PUC)
79-231-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
79-535-EL-AIR	East Ohio Gas Company (Ohio PUC)
80-235-EL-FAC	Ohio Edison Company (Ohio PUC)
80-240-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
U-1933*	Tucson Electric Power Company (Arizona Corp. Commission)
U-6794	Michigan Consolidated Gas Co. --16 Refunds (Michigan PSC)
81-0035TP	Southern Bell Telephone Company (Florida PSC)
81-0095TP	General Telephone Company of Florida (Florida PSC)
81-308-EL-EFC	Dayton Power & Light Co.- Fuel Adjustment Clause (Ohio PUC)
810136-EU	Gulf Power Company (Florida PSC)
GR-81-342	Northern States Power Co. -- E-002/Minnesota (Minnesota PUC)
Tr-81-208	Southwestern Bell Telephone Company (Missouri PSC))
U-6949	Detroit Edison Company (Michigan PSC)
8400	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
18328	Alabama Gas Corporation (Alabama PSC)
18416	Alabama Power Company (Alabama PSC)
820100-EU	Florida Power Corporation (Florida PSC)
8624	Kentucky Utilities (Kentucky PSC)
8648	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
U-7236	Detroit Edison - Burlington Northern Refund (Michigan PSC)
U6633-R	Detroit Edison - MRCS Program (Michigan PSC)
U-6797-R	Consumers Power Company -MRCS Program (Michigan PSC)

U-5510-R	Consumers Power Company - Energy conservation Finance Program (Michigan PSC)
82-240E	South Carolina Electric & Gas Company (South Carolina PSC)
7350	Generic Working Capital Hearing (Michigan PSC)
RH-1-83	Westcoast Transmission Co., (National Energy Board of Canada)
820294-TP	Southern Bell Telephone & Telegraph Co. (Florida PSC)
82-165-EL-EFC (Subfile A)	Toledo Edison Company(Ohio PUC)
82-168-EL-EFC	Cleveland Electric Illuminating Company (Ohio PUC)
830012-EU	Tampa Electric Company (Florida PSC)
U-7065	The Detroit Edison Company - Fermi II (Michigan PSC)
8738	Columbia Gas of Kentucky, Inc. (Kentucky PSC)
ER-83-206	Arkansas Power & Light Company (Missouri PSC)
U-4758	The Detroit Edison Company – Refunds (Michigan PSC)
8836	Kentucky American Water Company (Kentucky PSC)
8839	Western Kentucky Gas Company (Kentucky PSC)
83-07-15	Connecticut Light & Power Co. (Connecticut DPU)
81-0485-WS	Palm Coast Utility Corporation (Florida PSC)
U-7650	Consumers Power Co. - Partial and Immediate (Michigan PSC)
83-662	Continental Telephone Company of California, (Nevada PSC)
U-7650	Consumers Power Company – Final (Michigan PSC)
U-6488-R	Detroit Edison Co., FAC & PIPAC Reconciliation (Michigan PSC)
U-15684	Louisiana Power & Light Company (Louisiana PSC)
7395 & U-7397	Campaign Ballot Proposals (Michigan PSC)
820013-WS	Seacoast Utilities (Florida PSC)
U-7660	Detroit Edison Company (Michigan PSC)
83-1039	CP National Corporation (Nevada PSC)
U-7802	Michigan Gas Utilities Company (Michigan PSC)
83-1226	Sierra Pacific Power Company (Nevada PSC)
830465-EI	Florida Power & Light Company (Florida PSC)
U-7777	Michigan Consolidated Gas Company (Michigan PSC)
U-7779	Consumers Power Company (Michigan PSC)
U-7480-R	Michigan Consolidated Gas Company (Michigan PSC)
U-7488-R	Consumers Power Company – Gas (Michigan PSC)
U-7484-R	Michigan Gas Utilities Company (Michigan PSC)
U-7550-R	Detroit Edison Company (Michigan PSC)
U-7477-R**	Indiana & Michigan Electric Company (Michigan PSC)
18978	Continental Telephone Co. of the South Alabama (Alabama PSC)
R-842583	Duquesne Light Company (Pennsylvania PUC)
R-842740	Pennsylvania Power Company (Pennsylvania PUC)
850050-EI	Tampa Electric Company (Florida PSC)
16091	Louisiana Power & Light Company (Louisiana PSC)
19297	Continental Telephone Co. of the South Alabama (Alabama PSC)
76-18788AA &76-18793AA	Detroit Edison - Refund - Appeal of U-4807 (Ingham County, Michigan Circuit Court)
85-53476AA & 85-534785AA	Detroit Edison Refund - Appeal of U-4758 (Ingham County, Michigan Circuit Court)
U-8091/U-8239	Consumers Power Company - Gas Refunds (Michigan PSC)
TR-85-179**	United Telephone Company of Missouri (Missouri PSC)
85-212	Central Maine Power Company (Maine PSC)
ER-85646001 & ER-85647001	New England Power Company (FERC)
850782-EI & 850783-EI	Florida Power & Light Company (Florida PSC)
R-860378	Duquesne Light Company (Pennsylvania PUC)

R-850267	Pennsylvania Power Company (Pennsylvania PUC)
851007-WU & 840419-SU	Florida Cities Water Company (Florida PSC)
G-002/GR-86-160	Northern States Power Company (Minnesota PSC)
7195 (Interim)	Gulf States Utilities Company (Texas PUC)
87-01-03	Connecticut Natural Gas Company (Connecticut PUC))
87-01-02	Southern New England Telephone Company (Connecticut Department of Public Utility Control)
R-860378	Duquesne Light Company Surrebuttal (Pennsylvania PUC)
3673-	Georgia Power Company (Georgia PSC)
29484	Long Island Lighting Co. (New York Dept. of Public Service)
U-8924	Consumers Power Company – Gas (Michigan PSC)
Docket No. 1	Austin Electric Utility (City of Austin, Texas)
Docket E-2, Sub 527	Carolina Power & Light Company (North Carolina PUC)
870853	Pennsylvania Gas and Water Company (Pennsylvania PUC)
880069**	Southern Bell Telephone Company (Florida PSC)
U-1954-88-102 T E-1032-88-102	Citizens Utilities Rural Company, Inc. & Citizens Utilities Company, Kingman Telephone Division (Arizona CC)
89-0033	Illinois Bell Telephone Company (Illinois CC)
U-89-2688-T	Puget Sound Power & Light Company (Washington UTC))
R-891364	Philadelphia Electric Company (Pennsylvania PUC)
F.C. 889	Potomac Electric Power Company (District of Columbia PSC)
Case No. 88/546*	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+Western, Inc. et al, defendants (Supreme Court County of Onondaga, State of New York)
87-11628*	Duquesne Light Company, et al, plaintiffs, against Gulf+ Western, Inc. et al, defendants (Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
890319-EI	Florida Power & Light Company (Florida PSC)
891345-EI	Gulf Power Company (Florida PSC)
ER 8811 0912J	Jersey Central Power & Light Company (BPU)
6531	Hawaiian Electric Company (Hawaii PUCs)
R0901595	Equitable Gas Company (Pennsylvania Consumer Counsel)
90-10	Artesian Water Company (Delaware PSC)
89-12-05	Southern New England Telephone Company (Connecticut PUC)
900329-WS	Southern States Utilities, Inc. (Florida PSC)
90-12-018	Southern California Edison Company (California PUC)
90-E-1185	Long Island Lighting Company (New York DPS)
R-911966	Pennsylvania Gas & Water Company (Pennsylvania PUC)
I.90-07-037, Phase II	(Investigation of OPEBs) Department of the Navy and all Other Federal Executive Agencies (California PUC)
U-1551-90-322	Southwest Gas Corporation (Arizona CC)
U-1656-91-134	Sun City Water Company (Arizona RUCO)
U-2013-91-133	Havasu Water Company (Arizona RUCO)
91-174***	Central Maine Power Company (Department of the Navy and all Other Federal Executive Agencies)
U-1551-89-102 & U-1551-89-103	Southwest Gas Corporation - Rebuttal and PGA Audit (Arizona Corporation Commission)
Docket No. 6998	Hawaiian Electric Company (Hawaii PUC)
TC-91-040A and TC-91-040B	Intrastate Access Charge Methodology, Pool and Rates Local Exchange Carriers Association and South Dakota Independent Telephone Coalition
9911030-WS & 911-67-WS	General Development Utilities - Port Malabar and West Coast Divisions (Florida PSC)
922180	The Peoples Natural Gas Company (Pennsylvania PUC)
7233 and 7243	Hawaiian Nonpension Postretirement Benefits (Hawaiian PUC)

R-00922314 & M-920313C006	Metropolitan Edison Company (Pennsylvania PUC)
R00922428	Pennsylvania American Water Company (Pennsylvania PUC)
E-1032-92-083 & U-1656-92-183	Citizens Utilities Company, Agua Fria Water Division (Arizona Corporation Commission)
92-09-19	Southern New England Telephone Company (Connecticut PUC)
E-1032-92-073	Citizens Utilities Company (Electric Division), (Arizona CC)
UE-92-1262	Puget Sound Power and Light Company (Washington UTC))
92-345	Central Maine Power Company (Maine PUC)
R-932667	Pennsylvania Gas & Water Company (Pennsylvania PUC)
U-93-60**	Matanuska Telephone Association, Inc. (Alaska PUC)
U-93-50**	Anchorage Telephone Utility (Alaska PUC)
U-93-64	PTI Communications (Alaska PUC)
7700	Hawaiian Electric Company, Inc. (Hawaii PUC)
E-1032-93-111 & U-1032-93-193	Citizens Utilities Company - Gas Division (Arizona Corporation Commission
R-00932670	Pennsylvania American Water Company (Pennsylvania PUC)
U-1514-93-169/ E-1032-93-169	Sale of Assets CC&N from Contel of the West, Inc. to Citizens Utilities Company (Arizona Corporation Commission)
7766	Hawaiian Electric Company, Inc. (Hawaii PUC)
93-2006- GA-AIR*	The East Ohio Gas Company (Ohio PUC)
94-E-0334	Consolidated Edison Company (New York DPS)
94-0270	Inter-State Water Company (Illinois Commerce Commission)
94-0097	Citizens Utilities Company, Kauai Electric Division (Hawaii PUC)
PU-314-94-688	Application for Transfer of Local Exchanges (North Dakota PSC)
94-12-005-Phase I	Pacific Gas & Electric Company (California PUC)
R-953297	UGI Utilities, Inc. - Gas Division (Pennsylvania PUC)
95-03-01	Southern New England Telephone Company (Connecticut PUC)
95-0342	Consumer Illinois Water, Kankakee Water District (Illinois CC)
94-996-EL-AIR	Ohio Power Company (Ohio PUC)
95-1000-E	South Carolina Electric & Gas Company (South Carolina PSC)
Non-Docketed Staff Investigation	Citizens Utility Company - Arizona Telephone Operations (Arizona Corporation Commission)
E-1032-95-473	Citizens Utility Co. - Northern Arizona Gas Division (Arizona CC)
E-1032-95-433	Citizens Utility Co. - Arizona Electric Division (Arizona CC)
	Collaborative Ratemaking Process Columbia Gas of Pennsylvania (Pennsylvania PUC)
GR-96-285	Missouri Gas Energy (Missouri PSC)
94-10-45	Southern New England Telephone Company (Connecticut PUC)
A.96-08-001 et al.	California Utilities' Applications to Identify Sunk Costs of Non-Nuclear Generation Assets, & Transition Costs for Electric Utility Restructuring, & Consolidated Proceedings (California PUC)
96-324	Bell Atlantic - Delaware, Inc. (Delaware PSC)
96-08-070, et al.	Pacific Gas & Electric Co., Southern California Edison Co. and San Diego Gas & Electric Company (California PUC)
97-05-12	Connecticut Light & Power (Connecticut PUC)
R-00973953	Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code (Pennsylvania PUC)
97-65	Application of Delmarva Power &Light Co. for Application of a Cost Accounting Manual and a Code of Conduct (Delaware PSC)
16705	Entergy Gulf States, Inc. (Cities Steering Committee)
E-1072-97-067	Southwestern Telephone Co. (Arizona Corporation Commission)
Non-Docketed Staff Investigation	Delaware - Estimate Impact of Universal Services Issues (Delaware PSC)

PU-314-97-12	US West Communications, Inc. Cost Studies (North Dakota PSC)
97-0351	Consumer Illinois Water Company (Illinois CC)
97-8001	Investigation of Issues to be Considered as a Result of Restructuring of Electric Industry (Nevada PSC)
U-0000-94-165	Generic Docket to Consider Competition in the Provision of Retail Electric Service (Arizona Corporation Commission)
98-05-006-Phase I	San Diego Gas & Electric Co., Section 386 costs (California PUC)
9355-U	Georgia Power Company Rate Case (Georgia PUC)
97-12-020 - Phase I	Pacific Gas & Electric Company (California PUC)
U-98-56, U-98-60, U-98-65, U-98-67	Investigation of 1998 Intrastate Access charge filings (Alaska PUC)
(U-99-66, U-99-65, U-99-56, U-99-52)	Investigation of 1999 Intrastate Access Charge filing (Alaska PUC)
Phase II of 97-SCCC-149-GIT	Southwestern Bell Telephone Company Cost Studies (Kansas CC)
PU-314-97-465	US West Universal Service Cost Model (North Dakota PSC)
Non-docketed Assistance	Bell Atlantic - Delaware, Inc., Review of New Telecomm. and Tariff Filings (Delaware PSC)
Contract Dispute	City of Zeeland, MI - Water Contract with the City of Holland, MI (Before an arbitration panel)
Non-docketed Project	City of Danville, IL - Valuation of Water System (Danville, IL)
Non-docketed Project	Village of University Park, IL - Valuation of Water and Sewer System (Village of University Park, Illinois)
E-1032-95-417	Citizens Utility Co., Maricopa Water/Wastewater Companies et al. (Arizona Corporation Commission)
T-1051B-99-0497	Proposed Merger of the Parent Corporation of Qwest Communications Corporation, LCI International Telecom Corp., and US West Communications, Inc. (Arizona CC)
T-01051B-99-0105	US West Communications, Inc. Rate Case (Arizona CC)
A00-07-043	Pacific Gas & Electric - 2001 Attrition (California PUC)
T-01051B-99-0499	US West/Quest Broadband Asset Transfer (Arizona CC)
99-419/420	US West, Inc. Toll and Access Rebalancing (North Dakota PSC)
PU314-99-119	US West, Inc. Residential Rate Increase and Cost Study Review (North Dakota PSC
98-0252	Ameritech - Illinois, Review of Alternative Regulation Plan (Illinois CUB)
00-108	Delmarva Billing System Investigation (Delaware PSC)
U-00-28	Matanuska Telephone Association (Alaska PUC)
Non-Docketed	Management Audit and Market Power Mitigation Analysis of the Merged Gas System Operation of Pacific Enterprises and Enova Corporation (California PUC)
00-11-038	Southern California Edison (California PUC)
00-11-056	Pacific Gas & Electric (California PUC)
00-10-028	The Utility Reform Network for Modification of Resolution E-3527 (California PUC)
98-479	Delmarva Power & Light Application for Approval of its Electric and Fuel Adjustments Costs (Delaware PSC)
99-457	Delaware Electric Cooperative Restructuring Filing (Delaware PSC)
99-582	Delmarva Power & Light dba Conectiv Power Delivery Analysis of Code of Conduct and Cost Accounting Manual (Delaware PSC)
99-03-04	United Illuminating Company Recovery of Stranded Costs (Connecticut OCC)
99-03-36	Connecticut Light & Power (Connecticut OCC)
Civil Action No. 98-1117	West Penn Power Company vs. PA PUC (Pennsylvania PSC)

Case No. 12604	Upper Peninsula Power Company (Michigan AG)
Case No. 12613	Wisconsin Public Service Commission (Michigan AG)
41651	Northern Indiana Public Service Co Overearnings investigation (Indiana UCC)
13605-U	Savannah Electric & Power Company – FCR (Georgia PSC)
14000-U	Georgia Power Company Rate Case/M&S Review (Georgia PSC)
13196-U	Savannah Electric & Power Company Natural Gas Procurement and Risk Management/Hedging Proposal, Docket No. 13196-U (Georgia PSC)
Non-Docketed	Georgia Power Company & Savannah Electric & Power FPR Company Fuel Procurement Audit (Georgia PSC)
Non-Docketed	Transition Costs of Nevada Vertically Integrated Utilities (US Department of Navy)
Application No. 99-01-016, Phase I	Post-Transition Ratemaking Mechanisms for the Electric Industry Restructuring (US Department of Navy)
99-02-05	Connecticut Light & Power (Connecticut OCC)
01-05-19-RE03	Yankee Gas Service Application for a Rate Increase, Phase I-2002-IERM (Connecticut OCC)
G-01551A-00-0309	Southwest Gas Corporation, Application to amend its rate Schedules (Arizona CC)
00-07-043	Pacific Gas & Electric Company Attrition & Application for a rate increase (California PUC)
97-12-020 Phase II	Pacific Gas & Electric Company Rate Case (California PUC)
01-10-10	United Illuminating Company (Connecticut OCC)
13711-U	Georgia Power FCR (Georgia PSC)
02-001	Verizon Delaware § 271(Delaware DPA)
02-BLVT-377-AUD	Blue Valley Telephone Company Audit/General Rate Investigation (Kansas CC)
02-S&TT-390-AUD	S&T Telephone Cooperative Audit/General Rate Investigation (Kansas CC)
01-SFLT-879-AUD	Sunflower Telephone Company Inc., Audit/General Rate Investigation (Kansas CC)
01-BSTT-878-AUD	Bluestem Telephone Company, Inc. Audit/General Rate Investigation (Kansas CC)
P404, 407, 520, 413 426, 427, 430, 421/ CI-00-712	Sherburne County Rural Telephone Company, dba as Connections, Etc. (Minnesota DOC)
U-01-85	ACS of Alaska, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-34	ACS of Anchorage, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-83	ACS of Fairbanks, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-87	ACS of the Northland, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
96-324, Phase II	Verizon Delaware, Inc. UNE Rate Filing (Delaware PSC)
03-WHST-503-AUD	Wheat State Telephone Company (Kansas CC)
04-GNBT-130-AUD	Golden Belt Telephone Association (Kansas CC)
Docket 6914	Shoreham Telephone Company, Inc. (Vermont BPU)

Attachment RCS-2
Docket No. W-02113A-04-0616
Schedule A
Page 1

Chaparral City Water Company
Test Year Ended December 31, 2003
Computation Increase in Gross Revenue and Revenue Deficiency (Excess)
Requirements As Adjusted

Line No.	Description	Per Commission Decision 68176 (A)	CCWC Proposed (Revised 6/23/07) (B)	Staff Recommended (C)	Staff Difference From Decision 68176 (D) C - A
1	Fair Value Rate Base	$ 20,340,298	$ 20,340,298	$ 20,340,298 [A]	$ -
2					
3	Adjusted Operating Income	614,247	604,927	614,247 [A]	$ -
4					
5	Current Rate of Return	3.02%	2.97%	3.02%	$ -
6					
7	Required Operating Income	$ 1,294,338	$ 1,545,863	$ 1,289,575	$ (4,763)
8					
9	Required Rate of Return on Fair Value Rate Base	6.36%	7.60%	6.34% [B]	
10					
11	Operating Income Deficiency	$ 680,091	$ 940,936	$ 675,328	$ (4,763)
12					
13	Gross Revenue Conversion Factor	1.6286	1.6286	1.6286	
14					
15	Increase in Gross Revenue				
16	Requirement	$ 1,107,596	$ 1,532,440	$ 1,099,862	$ (7,734)
17					
18	**Computation of Amount to be Recovered**	Per CWCC Revised 6/23/207		Per Staff	
		(E)	(F)	(G)	(H)
19	Required Increase	$ 1,532,440		$ 1,099,862	
20	Increase per Decision 68176 (Sept. 30, 2005)	1,107,596		$ 1,107,596	
21	Annual Deficiency (Excess) Before Interest	$ 424,844		$ (7,734)	
22					
23	Number of Years[1]	2.5		2.5	
24	Annual Interest Rate[2]	7.60%		6.34%	
25	First Year Deficiency	$ 424,844		$ (7,734)	
26	First Year Deficiency Money Factor	1.20100		1.16610	
27	Total First Year Deficiency Including 2.5 Yrs. Interest Through March 2008		$ 510,237		$ (9,018)
28	Second Year Deficiency	$ 424,844		$ (7,734)	
29	Second Year Deficiency Money Factor	1.1161		1.0966	
30	Total Second Year Deficiency Including 1.5 Yr. Interest Through March 2008.		$ 474,168		$ (8,481)
31					
32	Average Balance of Deficiency During Recovery Period	$ 492,202		$ (8,749)	
33	Annual Interest Rate	7.60%		6.34%	
34	Interest during recovery period		$ 37,407		$ (555)
35	Subtotal		$ 1,021,812		$ (18,053)
36					
37	Additional Rate Case Expense		100,000		- [C]
38	**Total Amount to be Recovered (Refunded) Through Surcharge**		$ 1,121,812 [D]		$ (18,053)
39	Gallons Sold During 2006 (in 1,000's)		1,885,008 [D]		1,885,008 [D]
40	Commodity Rate (Sur-Credit) per 1,000 Gallons		$ 0.595 [D]		$ (0.010)

41 [1] Assumes recovery period starts March 2008.

42 [2] Carrying cost of money assmed to be weighted cost of capital.

43 [3] Assumes recovery period starts October 2007 and proceeds for a period of 12 months (September 2008) or when full recovery is made.

Note A: Decision 68176 (dated September 30, 2005)
The amount of adjusted net operating income was not revised in the Court of Appeals Decision and is therefore not being adjusted by Staff

Note B: Staff's recommended cost of capital for FVRB is calculated on Schedule D

Note C: See testimony

Note D: CWCC July 6, 2007 amended filing, Remand Schedule A-1, page 2, lines 1-7.

Chaparral City Water Company
Capital Structure & Cost Rates

Test Year Ended December 31, 2003

Attachment RCS-2
Docket No. W-02113A-04-0616
Schedule D

Line No.	Capital Source	Capitalization Amount	Capitalization Percent	Cost Rate	Weighted Avg. Cost of Capital
	Per Commission Decision No. 68176				
1	Long-Term Debt		41.20%	5.10%	2.10%
2	Common Stock Equity		58.80%	9.30%	5.50%
3	Total Capital		100.00%		7.60%
	ACC Staff - Proposed Cost of Capital for Fair Value Rate Base				
4	Long-Term Debt	$ 7,016,675	34.50%	5.10%	1.76%
5	Common Stock Equity	$ 10,014,090	49.23%	9.30%	4.58%
6	Capital financing OCRB	$ 17,030,766			
7	Appreciation above OCRB not recognized on utility's books	$ 3,309,533	16.27%	0% [a]	0.00%
8	Total capital supporting FVRB	$ 20,340,299	100.00%		6.3400%

Notes and Source

Lines 1-3: Decision No. 68176 at page 26

Lines 4-8:

Fair Value Rate Base	$ 20,340,298	Decision No. 68176, page 9
Original Cost Rate Base	$ 17,030,765	Decision No. 68176, page 9
Difference	$ 3,309,533	

Difference is appreciation of Fair Value over Original Cost that is not recognized on the utility's books.

[a] The appreciation of Fair Value over Original Cost has not been recognized on the utility's books. Such off-book appreciation has not been financed by debt or equity capital recorded on the utility's books. The appreciation over Original Cost book value is therefore recognized for cost of capital purposes at zero cost.

Attachment RCS-3
Docket No. W-02113A-04-0616
Schedule A
Page 1 of 1

Chaparral City Water Company
Test Year Ended December 31, 2003
Computation Increase in Gross Revenue and Revenue Deficiency (Excess)
Requirements As Adjusted - Staff Alternative ROR Applied to FVRB

Line No.	Description	Per Commission Decision 68176 (A)	CCWC Proposed (Revised 6/23/07) (B)	Staff Alternative ROR on FVRB (C)	Staff Difference From Decision 68176 (D) C - A
1	Fair Value Rate Base	$ 20,340,298	$ 20,340,298	$ 20,340,298 [A]	$ -
2					
3	Adjusted Operating Income	614,247	604,927	614,247 [A]	$ -
4					
5	Current Rate of Return	3.02%	2.97%	3.02%	$ -
6					
7	Required Operating Income	$ 1,294,338	$ 1,545,863	$ 1,330,255	$ 35,917
8					
9	Required Rate of Return on Fair Value Rate Base	6.36%	7.60%	6.54% [B]	
10					
11	Operating Income Deficiency	$ 680,091	$ 940,936	$ 716,008	$ 35,917
12					
13	Gross Revenue Conversion Factor	1.6286	1.6286	1.6286	
14					
15	Increase in Gross Revenue				
16	Requirement	$ 1,107,596	$ 1,532,441	$ 1,166,116	$ 58,520
17					
18	**Computation of Amount to be Recovered**	Per CWCC Revised 6/23/207		Per Staff	
		(E)	(F)	(G)	(H)
19	Required Increase	$ 1,532,441		$ 1,166,116	
20	Increase per Decision 68176 (Sept. 30, 2005)	1,107,596		$ 1,107,596	
21	Annual Deficiency (Excess) Before Interest	$ 424,845		$ 58,520	
22					
23	Number of Years[1]	2.5		2.5	
24	Annual Interest Rate[2]	7.60%		6.54%	
25	First Year Deficiency	$ 424,845		$ 58,520	
26	First Year Deficiency Money Factor	1.20100		1.17160	
27	Total First Year Deficiency Including 2.5 Yrs. Interest Through March 2008		$ 510,238		$ 68,562
28	Second Year Deficiency	$ 424,845		$ 58,520	
29	Second Year Deficiency Money Factor	1.1161		1.0997	
30	Total Second Year Deficiency Including 1.5 Yr. Interest Through March 2008.		$ 474,169		$ 64,355
31					
32	Average Balance of Deficiency During Recovery Period	$ 492,204		$ 66,459	
33	Annual Interest Rate	7.60%		6.54%	
34	Interest during recovery period		$ 37,407		$ 4,346
35	Subtotal		$ 1,021,815		$ 137,264
36					
37	Additional Rate Case Expense		100,000		[C]
38	**Total Amount to be Recovered (Refunded) Through Surcharge**		$ 1,121,815 [D]		$ 137,264
39	Gallons Sold During 2006 (in 1,000's)		1,885,008 [D]		1,885,008 [D]
40	Commodity Rate per 1,000 Gallons		$ 0.595 [D]		$ 0.073
41					

42 [1] Assumes recovery period starts March 2008.
43 [2] Carrying cost of money assmed to be weighted cost of capital.
44 [3] Assumes recovery period starts October 2007 and proceeds for a period of 12 months (September 2008) or when full recovery is made.
Note A: Decision 68176 (dated September 30, 2005)
The amount of adjusted net operating income was not revised in the Court of Appeals Decision and is therefore not being adjusted by Staff
Note B: Staff's recommended cost of capital for FVRB is calculated on Schedule D
Note C: See testimony for discussion of why no additional rate case expense is included in Staff's calculation
Note D: CWCC July 6, 2007 amended filing, Remand Schedule A-1, page 2, lines 1-7.

Chaparral City Water Company
Capital Structure & Cost Rates

Test Year Ended December 31, 2003

Attachment RCS-3
Docket No. W-02113A-04-0616
Schedule D
Page 1 of 1

Line No.	Capital Source	Capitalization Amount	Capitalization Percent	Cost Rate	Weighted Avg. Cost of Capital
	Per Commission Decision No. 68176				
1	Long-Term Debt		41.20%	5.10%	2.10%
2	Common Stock Equity		58.80%	9.30%	5.50%
3	Total Capital		100.00%		7.60%
	ACC Staff - Alternative Proposed Cost of Capital for Fair Value Rate Base				
4	Long-Term Debt	$ 7,016,675	34.50%	5.10%	1.76%
5	Common Stock Equity	$ 10,014,090	49.23%	9.30%	4.58%
6	Capital financing OCRB	$ 17,030,766			
7	Appreciation above OCRB not recognized on utility's books	$ 3,309,533	16.27%	1.25% [a]	0.20%
8	Total capital supporting FVRB	$ 20,340,299	100.00%		6.5400%

Notes and Source

Lines 1-3: Decision No. 68176 at page 26

Lines 4-8:

Fair Value Rate Base	$ 20,340,298	Decision No. 68176, page 9
Original Cost Rate Base	$ 17,030,765	Decision No. 68176, page 9
Difference	$ 3,309,533	

Difference is appreciation of Fair Value over Original Cost that is not recognized on the utility's books.

[a] The appreciation of Fair Value over Original Cost has not been recognized on the utility's books. Such off-book appreciation has not been financed by debt or equity capital recorded on the utility's books. Financial and economic theory would therefore indicate that the appreciation over Original Cost book value should be recognized for cost of capital purposes at zero cost as shown on Attachment RCS-2; however, as described in Mr. Parcell's testimony, Staff has also presented the Commission with an alternative, shown here, based on the mid-point of a range bounded by zero and the real risk-free rate (i.e., the risk free return less inflation) to the amount of appreciation above OCRB not recognized on the utility's books. As explained in the direct testimony of Staff witness Parcell, there is no risk to financing this component of FVRB, and this component of FVRB already reflects inflation above OCRB.

Range:

Minimum	0%
Maximum	2.50%
Mid-point of range	1.25%