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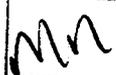
Arizona Corporation Commission

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AZ CORP COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE APPLICATION
9 OF CHAPARRAL CITY WATER
10 COMPANY, INC., AN ARIZONA
11 CORPORATION, FOR A
12 DETERMINATION OF THE FAIR VALUE
13 OF ITS UTILITY PLANT AND
14 PROPERTY AND FOR INCREASES IN
15 ITS RATES AND CHARGES FOR
16 UTILITY SERVICE BASED THEREON.

DOCKET NO: W-02113A-07-0551

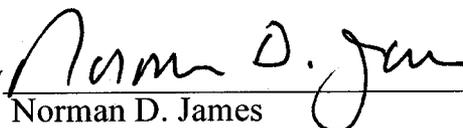
NOTICE OF FILING SUMMARIES
OF WITNESSES' PRE-FILED
TESTIMONY

17 Chaparral City Water Company hereby submits this Notice of Filing in the above-
18 referenced matter. Specifically filed herewith are the summaries of the pre-filed
19 testimony of the following witnesses:

- 20 1. Robert N. Hanford (summary attached hereto as **Exhibit A**);
- 21 2. Thomas J. Bourassa – Rate Base, Income Statement, Revenue Requirement,
22 Rate Design (summary attached hereto as **Exhibit B**);
- 23 3. Thomas J. Bourassa – Cost of Capital (summary attached hereto as
24 **Exhibit C**); and
- 25 4. Robert J. Sprowls (summary attached hereto as **Exhibit D**).

26 DATED this 4th day of December, 2008.

FENNEMORE CRAIG, P.C.

By 
Norman D. James
Jay L. Shapiro
Attorneys for Chaparral City Water Company

1 ORIGINAL and thirteen (13) copies
2 of the foregoing were filed
3 this 4th day of December, 2008, with:

4 Docket Control
5 Arizona Corporation Commission
6 1200 W. Washington St.
7 Phoenix, AZ 85007

8 **Copy of the foregoing was hand
9 delivered**
10 this 4th day of December, 2008, to:

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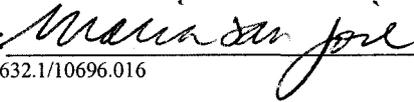
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7 this 4th day of December, 2008, to

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14 2139632.1/10696.016

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Exhibit A

CHAPARRAL CITY WATER COMPANY
Docket No. W-02113A-07-0551

WITNESS SUMMARY

Robert N. Hanford

Robert N. Hanford is the District Manager of Chaparral City Water Company (“the Company” or “CCWC”) and is testifying on its behalf on issues relating to the management and operation of the Company’s water system.

General Background

The Company’s service area is located in the northeastern portion of the Phoenix metropolitan area, in the Town of Fountain Hills and a small portion of the City of Scottsdale. This area is within the Phoenix Active Management Area, which has been created by the Arizona Groundwater Code. As a result, the Company is subject to certain water conservation requirements imposed by the Third Management Plan, adopted by the Arizona Department of Water Resources in order to reduce groundwater pumping.

The Company serves approximately 13,500 customers, most of which are residential, but there are a small number of commercial, industrial and irrigation customers.

The Company’s primary water supply is imported Colorado River water, which is delivered by means of the Central Arizona Project (“CAP”). This water is transported to the Company’s service territory, and, because it is surface water, it must be treated before being used for potable water service. The Company also uses a small amount of groundwater to augment its CAP water deliveries.

The Company’s current rates were approved in Decision No. 68176 (September 30, 2005) based on a test year ending December 31, 2003. New rates became effective on October 1, 2005. The Company’s return on equity was less than 4 percent during 2006 – the test year in this case, and has continued to decline. At the same time, the Company has invested more than \$6 million in additional plant and improvements since the last rate case. Due to low earnings, the Company is curtailing its plant investment to the minimum needed to operate safely.

Acquisition of Additional CAP Water

In 2007, the Company invested \$1,280,000 to acquire an additional 1,931 acre-feet of CAP water from the Central Arizona Water Conservation District. This was a one-time opportunity to acquire the right to additional CAP that resulted from the passage of legislation by Congress called the Arizona Water Settlement Act. The Company elected to acquire this additional surface to ensure that it will have a reliable, long-term water supply, and as a buffer against reductions in Colorado River water supplies and other events that could lead to curtailment of CAP supplies.

The Company believes this was a prudent investment, and that the investment should be included in rate base. The Company also requests that it be allowed to recover the additional water service capital costs that must be paid to retain the allocation.

The Company believes that Staff's recommendation in this regard is reasonable, and will allow the Company to retain the additional CAP allocation. RUCO, in contrast, opposes full cost recovery and rate base treatment, which would not allow the Company to retain the additional CAP allocation.

Settlement with the Fountain Hills Sanitary District ("FHSD")

The activities of FHSD threatened to impair two of the Company's wells, Well No. 8 and Well No. 9. When FHSD was unable to provide replacement water sources, a settlement was negotiated and a payment in the amount of \$1.52 was made to the Company.

The Company believes that the settlement proceeds should be treated in a manner that shares the benefit equally between the Company and its customers. We believe this is fair, and is consistent with past treatment of settlement proceeds in Commission proceedings. This treatment also encourages utilities to be proactive and protect their assets in situations like this.

Staff, however, opposes sharing of the benefits of the settlement, and believes that all of the benefits should go to the customers. The Company opposes this treatment as unfair, and believes it is bad public policy.

The Company is willing to share any future gain on the sale of the two wells. However, the wells have little value. Well 8 is a small 60 x 60 foot parcel in a condo complex, while Well 9 is an impaired well on a parcel containing about one-third of an acre and located next to a strip center. In either case, the buyer would have to have an independent right to pump groundwater from these wells because they are located in an Active Management Area.

Irrigation Rates

Although the Company did not ask that its rate design be changed in this proceeding, there is one apparent anomaly that should be corrected. While the Company's rate design is based on the idea that larger users should pay more for water in order to encourage conservation, there is a disparity between what irrigation customers pay and what commercial and residential customers pay for exactly the same water. The current commodity rate for a 3/4-inch meter using in excess of 9,000 gallons monthly is \$3.03 per 1,000 gallons, while the irrigation commodity rate regardless of meter size is only \$1.56 per 1,000 gallons. This encourages exterior water use for turf and landscaping.

To eliminate this disparity, the Company recommends that the irrigation commodity rate be increased so that this rate is the same as the lower rate block for the commercial and industrial customers.

Reduction in Water Use By Golf Courses

In the last rate case, the Commission ordered the Company to take steps to increase customer use of effluent and reduce reliance on groundwater to supply water to golf courses, ornamental lakes and other aesthetic water features. Based on this direction, and in cooperation with the FHSD, new facilities were constructed, allowing two of the golf courses to rely almost entirely on sewage effluent. FHSD's rate for effluent is 75% of the Company's rate for potable water.

As a result of the increased availability of effluent and its lower cost, the golf courses' use of effluent has increased dramatically. This caused a substantial reduction in water use (from 765.4 acre-feet in 2006 to 196.5 acre-feet in 2007). This in turn caused revenue from water sales to decrease. The Company has proposed a pro forma adjustment to test revenues to account for these lost revenues.

Expense Normalizations Proposed by Staff and RUCO

The Company opposes the expense normalizations proposed by Staff and RUCO. Specifically, those parties have used data from 2004 and 2005 to recompute the Company's 2006 test year expenses. Given that new rates will become effective in 2009, this creates a significant mismatch. There is no evidence that the expenses during the test year were unusual or overstated. Instead, expenses such as Chemicals and Repairs and Maintenance have increased since the end of the test year.

Rate Case Expense

The Company has requested recovery of \$280,000 in rate case expense, based on the amount authorized by the Commission in the Company's previous rate case (\$285,000). Staff has recommended rate case expense of only \$150,000, but was unable to provide support for its recommendation.

The Company was also ordered in Decision No. 70441 (July 28, 2008) to seek recovery of its additional rate case expense incurred in Docket No. W-02113A-04-0616. The Company made a supplemental filing, based on that decision, requesting the recovery of \$258,511 of rate case expense, which related to the Company's successful appeal of Decision No. 68176 and the proceedings on remand, which took over one year to complete. The amount requested is approximately one-half of the Company's actual expenses. The Company believes this is reasonable, and fairly allocates the burden of the appeal and remand proceeding.

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Exhibit B

CHAPARRAL CITY WATER COMPANY
Docket No. W-02113A-07-0551

WITNESS SUMMARY

Thomas J. Bourassa

Thomas J. Bourassa is a Certified Public Accountant who provides consulting services to public utilities. He has testified on numerous occasions before the Arizona Corporation Commission (“the Commission”) on behalf of Arizona water and wastewater utilities. In this case he is testifying on behalf of Chaparral City Water Company (“the Company”) on the topics of the Company’s rate base, its income statement (i.e., revenue and operating expenses), its required increase in revenue and its rate design and proposed rates and charges for service.¹

Overview of the Company’s Request Rate Relief

The Company is requesting a gross revenue increase of \$2,990,957, which is an increase of approximately 39 percent over test year (2006) revenues. The following is a summary of the Company’s revenue requirement:

Fair Value Rate Base	\$27,751,114
Adjusted Operating Income	\$ 979,859
Current Rate of Return	3.53%
Required Operating Income	\$ 2,764,011
Required Rate of Return	9.96%
Operating Income Deficiency	\$ 1,784,152
Gross Revenue Conversion Factor	1.6286
Increase in Gross Revenues	\$ 2,905,731

The Company is adopting the same rate design that was proposed by Staff and approved by the Commission in the Company’s prior rate case, with the exception of increasing the commodity rate for exterior irrigation and construction water. Under the Company’s proposed rates, a typical residential customer on a 3/4-inch meter using 8,450 gallons of water during a month (average usage) would experience an increase of \$10.90 (about 34 percent), from \$32.38 per month to \$43.27 per month.

There are a small number of issues in dispute in this case. The Company has accepted many of the adjustments proposed by Staff and RUCO in order to reduce disputes and simplify the rate case. The following is a brief summary of the major unresolved issues.

¹ Mr. Bourassa is also testifying on the cost of capital, including the cost of equity, which testimony is separately summarized.

Rate Base Issues

1. CAP Allocation Capital Costs. In 2007, the Company invested \$1,280,000 to acquire an additional 1,931 acre-feet of CAP water from the Central Arizona Water Conservation District. This additional allocation ensures that the Company will have access to renewable surface water in the event that water from the Colorado River is curtailed, as Mr. Hanford explains. The Company has accepted Staff's recommended treatment of this investment, which is to record it as a water right in the Land and Land Rights account. Under this classification, the investment is included in rate base, but no depreciation or amortization may be recovered. RUCO agrees with rate base treatment but would still disallow recovery of a return on and of one-half of the investment. RUCO's position ignores the fact that the Company had a take it or leave it option for the whole allocation. Because of this, if one acre foot is used and useful, it is all used and useful.

2. Settlement With Fountain Hills Sanitary District ("FHSD"). The Company and the FHSD entered into settlement under which the Company was paid \$1,520,000 based on activities of the district impairing two of the Company's wells. The Company proposes an equal sharing of the settlement proceeds with ratepayers, and deducted half of the settlement payment, less amortization, from its rate base. Staff, and now RUCO, oppose this treatment, and believe that the entire amount should be deducted from rate base, effectively punishing the Company for negotiating the settlement. The Company believes this treatment is unfair, inconsistent with Commission's treatment of a settlement involving similar circumstances in Arizona Water Company's Eastern Group rate case (Decision No. 66849), and would create a strong disincentive for utilities to pursue claims of this nature.

3. Cash Working Capital and Related Adjustments. In order to simplify the case, the Company did not prepare a lead/lag study and did not request any cash working capital allowance. Staff recommended that other working capital components also be removed from rate base, including Prepayments of \$192,485 and Material and Supplies of 14,521 from rate base, and Unamortized Debt Issuance costs of \$424,010. To minimize disputes, the Company has accepted RUCO's negative cash working capital allowance of \$111,606, which results in total working capital of \$95,400. Unamortized Debt Issuance costs are not part of working capital, and should not be removed unless it is included in calculating the cost of debt (which Staff has not done).

Revenue and Income Statement Issues

1. "Normalization" of Test Year Operating Expenses. Staff and RUCO have proposed adjustments to the Company's actual test year Chemicals Expense, Repairs and Maintenance Expense and Insurance Expense based on averaging the test year amount with the amount in prior years, i.e., before 2006. This is obviously backward-looking, given that rate will not become effective in this case until 2009 and there is no evidence that the Company's expenses during the test year were unusual or extraordinary.

2. Property Tax Expense. The Company has accepted Staff's method of calculating property taxes at proposed rates, which is the method normally used by the Commission. RUCO has proposed a different method, which results in lower property tax expense. RUCO also argues that the Company "over recovered" property tax expense since 2006. However, the Company actually earned a return of just over 3 percent on its common equity and approximately 3 percent on its fair value rate base in 2006, and its earnings have further deteriorated since that time. Also, RUCO has ignored key facts, such as a change in the assessment ratio and a reduction in the tax rate, which was not known when rates were previously set.

3. Rate Case Expense. The Company has requested recovery of rate case expense for this case totaling \$280,000, which is slightly less than the expense authorized in its prior case, \$285,000, and is consistent with the expense authorized for other Arizona water utilities. Staff has recommended that the Company recover \$150,000, or nearly half of what was authorized in its prior case, which recommendation appears to be based primarily on expenses approved for electric and gas utilities in Kansas. Staff also reduced the Company's rate case expense for the appeal and remand from roughly \$258,000 to \$100,000, meaning the Company would be forced to absorb over 80% of the costs. RUCO suggests that the Company absorb 100% of the cost because appealing the Commission's violation of the Arizona Constitution was a "business decision." The Company's request to recover roughly half of the amount it was forced to incur is reasonable and should be approved.

Rate Design and Proposed Rates

The Company's rate design is based on the inverted-block rate design recommended by Staff and approved by the Commission in the Company's prior rate case. Under this rate design, residential customers on 3/4-inch meters have three commodity rate blocks, with the rate for the first 3,000 gallons being substantially less than the remaining rate blocks. All other customers, regardless of class, have two inverted rate blocks. This rate design is intended to encourage water conservation.

The only area of disagreement concerns the commodity rate for irrigation, i.e., exterior water use for turf and landscaping, and construction water. Presently, the rate for irrigation and construction water is lower than the other commodity rates, including the lowest rate block for residential customers. This low rate encourages the use of potable water for exterior watering and construction-related purposes.

The Company recommends that the commodity rate for irrigation and construction water be increased so that this rate is the same as the middle rate block for residential customers and the initial rate block for commercial and industrial customers. Staff agrees with the Company in principle, but proposes to raise the commodity rate for irrigation and construction water to a smaller extent, so that is closer to the middle rate block for residential customers and the initial rate block for commercial and industrial customers. RUCO has taken no position on rate design.

At the Company's proposed revenue level, rates will increase by approximately 33 percent. The average bill for a residential customer on a 3/4-inch meter will increase from \$32.38 per month to \$43.27 per month, an increase of 33.66 percent. The average bill for a residential customer on a 1-inch meter will increase from \$48.14 per month to \$64.21 per month, an increase of 33.38 percent. These two customer classes make up about 93 percent of the Company's total customer base.

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Exhibit C

CHAPARRAL CITY WATER COMPANY
Docket No. W-02113A-07-0551

WITNESS SUMMARY

Thomas J. Bourassa
(Cost of Capital)

Thomas J. Bourassa is also testifying on behalf of Chaparral City Water Company (“the Company”) on the topic of the cost of capital, including the cost of equity.

Cost of Equity and WACC

Mr. Bourassa performed estimates of the cost of equity using the Commission’s preferred models, the Discounted Cash Flow (“DCF”) model and the Capital Asset Pricing Model (“CAPM”). Mr. Bourassa’s updated estimate of the cost of equity, 13.2 percent, is slightly higher than his rebuttal estimate, 13.0 percent. Chaparral City, however, continues to recommend an equity return of 11.5 percent to be conservative and minimize disputes over the cost of equity. The cost of short-term debt has decreased from 3.97 percent to 2.88 percent, while the cost of long-term debt, 5.33 percent, is unchanged. The resulting weighted cost of capital (“WACC”) is 9.96 percent.

The Company recommended cost of equity, 11.5 percent, is very similar to the cost of equity recommended by Staff’s cost of capital witness, Pedro Chaves, which is 11.8 percent. While there are some areas of disagreement, Mr. Bourassa and Mr. Chaves used the DCF and CAPM models with similar inputs to estimate the cost of equity. The Company’s primary areas of disagreement with Staff concern its financial risk adjustment and its proposed treatment of “inflation.”

RUCO, in contrast, used much different inputs, and recommends a cost of capital of only 8.80 percent, which is less the current yield on a Baa investment grade bond, which is about 9.0 percent. RUCO used different sample water utilities, eliminating Connecticut Water Service, Middlesex Water Company and SJW Corporation, and substituting Southwest Water Company even though only 45 percent of Southwest Water’s revenues are derived from regulated activities, and for the 12-month period ended June 30, 2008, Southwest Water had negative earnings per share, and its dividend pay out ratio, return on common equity and return on total capital are reported as “not meaningful.”

RUCO also used a group of publicly traded gas utilities, which depressed the cost of equity. RUCO’s gas utility sample has an average beta of 0.82, while RUCO’s water utility sample has an average beta of 1.05. Consequently, the gas utilities have substantially less risk and are not directly comparable to the water utilities. To make the gas utilities comparable, an upward risk adjustment of between 130 and 190 basis would need to be added to the gas utilities’ cost of equity.

Application of WACC to FVRB

Chaparral City continues to maintain that the WACC should be applied to the Company's fair value rate base ("FVRB") to determine the Company's required operating income, without any adjustment. The cost of equity is estimated using two market-based finance models, the DCF model and the CAPM. These models rely on current stock prices and other market data for a sample group of publicly traded water utilities, and therefore are appropriately applied to a market-based rate base to determine the Company's operating income. Neither of these models considers the rate bases of the sample utilities or Chaparral City's rate base. Moreover, because the WACC depends on the percentages of debt and equity in the Company's capital structure, and not on the actual amount invested in plant, a WACC-derived return can be used with any rate base. There is no "matching" problem, as has been suggested.

Adjustment for Financial Risk

Chaparral City opposes an adjustment to its cost of equity based on financial risk. The parties agree that the Company's capital structure consists of approximately 24 percent debt and 76 percent equity. The Commission has not reduced the cost of equity in situations like this, where approximately one-quarter of the utility's capital structure consists of debt. *See, e.g., Arizona Water Co., Decision No. 68302 (Nov. 14, 2005) (no adjustment for financial risk appropriate when the utility's capital structure contained 73 percent equity); Black Mountain Sewer Corporation, Decision No. 69164 (Dec. 5, 2006) (no financial risk adjustment based on capital structure consisting of 100 percent equity).* Where downward adjustments have been made, the utility's capital structure has typically contained 100 percent equity and no debt. Here approximately one-quarter of the Company's capital consists of debt. Moreover, even in cases where an adjustment for financial risk has been made, the adjustment has been no more than 100 basis points, not 180 basis points as proposed by Staff here.

Adjustment for "Inflation"

Chaparral City opposes any adjustment based on "inflation" being "over-counted" because the cost of equity, estimated by means of the DCF and CAPM models, and the FVRB both contain an "inflation component." *See Chaparral City Water Co., Decision No. 70441 (July 28, 2008) at 33 (appeal pending).* In reality, inflation adversely impacts utilities to a far greater extent than other businesses because they cannot adjust their rates in response to price increases, and must wait until new rates are approved following a rate case. For this reason, inflation is continually eroding the Company's earnings. Yet the impact of inflation on earnings is ignored by Staff and RUCO, resulting in unlawful piecemeal rate-making.

Moreover, the Company's FVRB is not simply the "inflated" cost of its plant. Rather, it is based on the average of its original cost rate base ("OCRB") and its reconstruction cost rate base ("RCRB"). By definition, the original or book cost of the Company's plant contains no inflationary component, as Staff has acknowledged. *See Gordon Fox Direct Testimony at 7-8.* Further, the Company's RCRB is not based on the

CPI or other measures of inflation, but is the current value of its plant based on its reconstruction cost. That value is reduced by averaging the OCRB with the RCRB to derive fair value. If an adjustment for inflation is authorized, it must be reduced by at least one-half to properly account for the use of OCRB in the FVRB.

Finally, at present, inflation is non-existent. The parties agree that an appropriate method of estimating the expected, future inflation component in the cost of equity may be estimated by subtracting the yields on Treasury inflation protected securities ("TIPS") from the yields on Treasury securities with constant maturities. The present inflationary component indicated by this method is a negative 1.18 percent, based on the average yields on 5, 7 and 10-year Treasuries. According to Staff, most investors hold securities for an intermediate period, i.e., 5 to 10 years. Therefore, if an inflation adjustment is made, it should increase the cost of equity and overall rate of return. Even if 20-year Treasuries are used instead, the indicated inflation is about 80 basis points. In that case, however, the current yield on a 20-year Treasury should be used in the CAPM, producing a higher cost of equity.

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Exhibit D

CHAPARRAL CITY WATER COMPANY
Docket No. W-02113A-07-0551

WITNESS SUMMARY

Robert J. Sprowls

Robert J. Sprowls serves as Executive Vice President–Finance, Chief Financial Officer, and Corporate Secretary of American States Water Company (“AWR”), Golden State Water Company, and Chaparral City Water Company (“CCWC” or “Company”). He has been named as the next President and Chief Executive Officer of AWR and its subsidiaries, and will that position on January 1, 2009.

The purpose of Mr. Sprowls testimony is to discuss, in general terms, AWR’s concerns over the financial performance of CCWC and some of the positions taken by some parties in this proceeding regarding CCWC’s financial performance and its need for rate relief. Mr. Sprowls explains that it is extremely important to authorize rates that will generate sufficient earnings and allow CCWC to attract capital needed to ensure safe and reliable utility service.

CCWC is not currently earning its authorized rate of return. If it were a stand-alone company, it is doubtful that it would be able to attract either debt or equity. Moreover, since its last rate case was decided in September 2005, CCWC has earned less than its authorized rate of return every year. Based on year-end financial statements, even after removing goodwill from the equity balance, CCWC’s return on equity was 3.47% for 2006 and 3.04% for 2007.

CCWC’s current rates are based on a test year that ended December 31, 2003 – more than five years from when we can realistically hope to obtain rate relief in this case. Meanwhile, CCWC’s operating expenses have continued to increase, and the Company has continued to invest in additional plant to ensure reliable service. When new rates are finally approved in this case, CCWC will be two years behind and have to file another rate case, just as CCWC was required to seek rate increases based on a 2006 test year after receiving rate increases in September 2005.

AWR has no intention of allowing CCWC’s service to deteriorate to the point at which it is failing to meet minimum service requirements and applicable legal and regulatory standards. There is a difference, however, between simply maintaining the required minimum level of service and investing on a proactive basis to ensure that higher quality service can be continually ensured into the future.

In short, the Commission needs to balance the interests of utility shareholders and ratepayers by timely providing rate relief that provides both an adequate return on rate base and an adequate opportunity to actually earn that return in the future.