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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

DOCKETED

AUG 23 2010

DOCKETED BY 

IN THE MATTER OF THE  
APPLICATION OF LAS QUINTAS  
SERENAS WATER CO., AN  
ARIZONA CORPORATION, FOR (i) A  
DETERMINATION OF THE FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND (ii) AN INCREASE  
IN ITS WATER RATES AND  
CHARGES FOR UTILITY SERVICE  
BASED THEREON.

DOCKET NO. W-01583A-09-0589

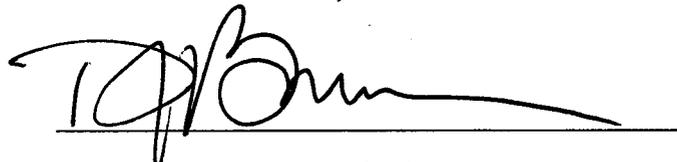
NOTICE OF FILING REBUTTAL  
TESTIMONY

Las Quintas Serenas Water Company, LLC ("LQSWC" or the "Company") hereby  
submits this Notice of Filing Rebuttal Testimony in the above-referenced matter.  
Specifically file herewith are the Company's Rebuttal Testimonies, which include the  
following testimonies, along with supporting schedules and/or attachments:

1. Rebuttal Testimony of Thomas J. Bourassa, CPA (Rate Base); and
2. Rebuttal Testimony of Thomas J. Bourassa, CPA (Cost of Capital)

Dated this 23 day of August, 2010.

Thomas J. Bourassa, CPA



Thomas J. Bourassa, CPA  
129 W. Wood Drive  
Phoenix, Arizona 85029

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1 ORIGINAL and thirteen  
2 (13) copies of the  
3 foregoing were filed the  
4 23<sup>rd</sup> day of August, 2010.

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE  
APPLICATION OF LAS QUINTAS  
SERENAS WATER CO., AN  
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BASED THEREON.

DOCKET NO. W-01583A-09-0589

PREPARED TESTIMONY

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REBUTTAL TESTIMONY OF  
THOMAS J. BOURASSA  
ON BEHALF OF LAS QUINTAS SERENAS WATER COMPANY  
(RATE BASE, INCOME STATEMENT, RATE DESIGN)

August 23, 2010

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**I. INTRODUCTION AND PURPOSE OF TESTIMONY.**

**Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A1. My name is Thomas J. Bourassa. My business address is 139 W. Wood Drive, Phoenix, Arizona 85029.

**Q2. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?**

A2. On behalf of the applicant, Las Quintas Serenas Water Company ("LQLQSWC" or the "Company").

**Q3. HAVE YOU PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THE INSTANT CASE?**

A3. Yes, my direct testimony was submitted in support of the initial application in this docket. There were two volumes, one addressing rate base, income statement and rate design, and the other addressing cost of capital.

**Q4. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?**

A4. I will provide rebuttal testimony in response to the direct filing by Staff. More specifically, this first volume of my rebuttal testimony relates to rate base, income statement and rate design for LQSWC. In a second, separate volume of my testimony, I also present an update to the Company's requested cost of capital as well as provide responses to Staff on the cost of capital and rate of return applied to the fair value rate base, and the determination of operating income.

**II. SUMMARY OF LQSWC'S REBUTTAL POSITION**

**Q5. WHAT IS THE REVENUE INCREASE THAT THE COMPANY IS PROPOSING IN THIS REBUTTAL TESTIMONY?**

A5. The Company is proposing a total revenue requirement of \$685,047 which constitutes an increase in revenues of \$196,777, or 40.30% over adjusted test year revenues.

1 **Q6. HOW DOES THIS COMPARE WITH THE COMPANY'S DIRECT**  
2 **FILING?**

3 A6. In the direct filing, the Company requested a total revenue requirement of  
4 \$691,799, which required an increase in revenues of \$203,528, or 41.68%.

5 **Q7. WHY IS THE REQUESTED REVENUE INCREASE LOWER IN LQSWC'S**  
6 **REBUTTAL FILING?**

7 A7. While the Company is recommending a higher rate of return of 9.44 percent  
8 compared to 9.03 percent in its direct filing, in its rebuttal filing, LQSWC has  
9 adopted a number of adjustments recommended by Staff, as well as proposed a  
10 number of adjustments of its own based on known and measurable changes to the  
11 test year. The net result of these adjustments is: (1) the Company's proposed  
12 operating expenses have decreased by \$4,819, from \$440,721 in the direct filing to  
13 \$435,901 and a net decrease of \$109,680 in rate base from the direct filing of  
14 \$2,109,539 to \$1,999,859.

15 **Q8. PLEASE SUMMARIZE THE COMPANY'S REBUTTAL RATE BASE**  
16 **ADJUSTMENTS?**

17 A8. The rebuttal rate base adjustments proposed by the Company are summarized as  
18 follows:

19 Plant Retirements – The Company has adopted the Staff recommendation to  
20 adjustment plant for retirements. Plant in service ("PIS") is reduced by \$7,488.

21  
22 Debt Financing Costs – The Company has adopted Staff recommendation to  
23 remove debt financing costs from PIS. PIS is reduced by \$185,625.

24  
25 Plant Not Used and Useful – The Company has adopted Staff recommendations  
26 regarding plant not used and useful and has made a corresponding adjustment to

1 advances-in-aid of construction ("AIAC") that was used to fund this plant through  
2 a refundable line extension agreement. PIS is reduced by \$20,918 and advances-  
3 in-aid of construction ("AIAC") is reduced by \$20,918.

4  
5 Accumulated Depreciation – The Company proposes to remove accumulated  
6 depreciation ("A/D") totaling \$33,281 related to the removal of retirement costs,  
7 financing costs, and not used and useful plant from PIS.

8  
9 Accumulated Deferred Income Taxes – The Company proposes to include  
10 accumulated deferred income taxes ("ADIT") as an asset of \$77,709 reflecting the  
11 Company proposed PIS, A/D, CIAC, and AIAC.

12  
13 Customer Security Deposits – The Company has adopted Staff's recommendation  
14 to include customer security deposits totaling \$7,475 in rate base in order to help  
15 minimize the issues between the parties.

16  
17 **Q9. WHAT ARE THE PROPOSED REVENUE REQUIREMENTS AND RATE**  
18 **INCREASES FOR THE COMPANY AND STAFF AT THIS STAGE OF**  
19 **THE PROCEEDING?**

20 A9. The proposed revenue requirements and proposed rate increases are as follows:

	<u>Revenue Requirement</u>	<u>Revenue Incr.</u>	<u>% Increase</u>	
21				
22	Company-Direct	\$691,799	\$203,528	41.68%
23	Staff	\$648,334	\$160,064	32.78%
24	Company Rebuttal	\$685,047	\$196,777	40.30%

25  
26

1 **III. RATE BASE**

2 **Q10. WOULD YOU PLEASE IDENTIFY THE PARTIES' RESPECTIVE RATE**  
3 **BASE RECOMMENDATIONS?**

4 A10. Yes, the rate bases proposed by the parties in the case, are as follows:

	<u>OCRB</u>	<u>FVRB</u>
5		
6	Company-Direct	\$2,109,539
7	Staff	\$1,911,646
8	Company Rebuttal	\$1,999,859

9 **A. Plant-in-service.**

10

11 **Q11. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROPOSED**  
12 **ORIGINAL COST RATE BASE, AND IDENTIFY ANY ADJUSTMENTS**  
13 **YOU HAVE ACCEPTED FROM STAFF?**

14 A11. The Company's rebuttal rate base adjustments to OCRB are detailed on rebuttal  
15 schedules B-2, pages 3 through 6. Rebuttal Schedule B-2, page 1 and 2,  
16 summarize the Company's proposed adjustments and the rebuttal OCRB.

17 Rebuttal B-2 adjustment 1, as summarized on Rebuttal Schedule B-2, page  
18 2, consists of three adjustments labeled as "A", "B", and "C" on Rebuttal Schedule  
19 B-2, page 3.

20 Adjustment A reduces PIS for a retirement of plant costing \$7,488. This  
21 adjustment reflects the adoption of Staff proposed adjustment.<sup>1</sup>

22 Adjustment B, of rebuttal B-2 adjustment 1, removes debt issuance costs  
23 which were inadvertently included as part of new arsenic treatment facilities in the  
24

25

26 <sup>1</sup> See Direct Testimony of Crystal S. Brown ("Brown Dt.") at 6.

1 Company's direct filing. This adjustment reflects the adoption of Staff proposed  
2 adjustment.<sup>2</sup>

3 Adjustment C, of rebuttal B-2 adjustment 1, removes \$41,000 of plant that  
4 is not used and useful. Staff proposes a similar adjustment.<sup>3</sup> While both the  
5 Company and Staff propose to remove \$41,000 of plant costs, the Company  
6 removes \$20,082 from plant account 311 – Pumping Equipment and \$20,918 from  
7 plant account 331 – Transmission and Distribution Mains. On the other hand, Staff  
8 removes all of the plant costs from plant account 331 – Transmission and  
9 Distribution Mains.

10 **Q12. WHY DID THE COMPANY REMOVE PLANT COSTS FROM PLANT**  
11 **ACCOUNTS 311 AND 331?**

12 A12. Because that is the recommendation of the Staff Engineering witness, Mr. Marlin  
13 Scott.<sup>4</sup>

14 **Q13. DO STAFF AND THE COMPANY AGREE ON THE PLANT-IN-SERVICE**  
15 **BALANCE?**

16 A13. Yes. Both Staff and the Company propose a PIS balance of \$3,594,472.<sup>5</sup>  
17 However, there are some differences in the individual plant account balances as the  
18 result of differences between Staff and the Company as which accounts related to  
19 the removal of plant not used and useful are adjusted as discussed previously.

20 **B. Accumulated Depreciation.**

21 **Q14. PLEASE EXPLAIN YOUR ADJUSTMENTS TO ACCUMULATED**  
22 **DEPRECIATION.**

24 \_\_\_\_\_  
25 <sup>2</sup> See Brown Dt. at 6-7.

26 <sup>3</sup> *Id.* at 7-8.

<sup>4</sup> See Table H-1 in Direct Testimony of Marlin Scott Jr. ("Scott Dt.") at 8.

<sup>5</sup> Compare Staff Schedule CSB-3 and Company Rebuttal Schedule B-2, page 1.

1 A14. Rebuttal B-2 adjustment 2, as summarized on Rebuttal Schedule B-2, page 2,  
2 consists of one adjustments labeled as "A", "B", "C", and "D" on Rebuttal  
3 Schedule B-2, page 4.

4 Adjustment A reflects a decrease to accumulated depreciation ("A/D") for  
5 the plant retirement totaling \$7,488. This a corresponding adjustment to the  
6 retirement of plant as discussed above.

7 Adjustment B reflects a decrease to A/D for the depreciation related to debt  
8 issuance costs that were included in the Company's A/D balance in its direct filing.  
9 This a corresponding adjustment to the removal of debt issuance costs from plant  
10 as discussed above.

11 Adjustment C reflects a decrease to A/D for the plant not used and useful  
12 totaling \$20,605. This a corresponding adjustment to the removal of plant not used  
13 and useful as discussed above.

14 Adjustment D reflects the reconciliation adjustment to the computed balance  
15 of A/D as shown on Rebuttal Schedule B-2, pages 3.10.

16 **Q15. DO STAFF AND THE COMPANY AGREE ON THE ACCUMULATED**  
17 **DEPREICATION BALANCE?**

18 A15. No. The Company recommends an A/D balance of \$1,044,147 whereas Staff  
19 recommends and A/D balance of \$1,002,426.<sup>6</sup> The difference of \$41,721 is due, in  
20 part, to the amount of depreciation that is removed for not used and useful plant.  
21 Staff appears to remove \$41,000 of depreciation<sup>7</sup> whereas the Company removes  
22 \$20,605 of depreciation<sup>8</sup> – a difference of \$20,395. The remaining difference in  
23 A/D of \$21,326 (\$41,721 less \$20,395) appears to be related to the amount of  
24

25 <sup>6</sup> Compare Staff Schedule CSB-3 and Company Rebuttal Schedule B-2, page 1.

26 <sup>7</sup> See Staff Schedule CSB-8, page 7 of 7.

<sup>8</sup> See Company Rebuttal Schedule B-2, page 4.

1 depreciation computed for 2009 (ending June 30). I believe Staff should have  
2 computed depreciation expense for nine months rather than six months for 2009.<sup>9</sup>  
3 The reason for this is that, as with the Company's Rebuttal Schedule B-2 (pages  
4 3.5 to 3.10) where accumulated depreciation is re-computed for all years, all of the  
5 years prior to 2009 employ a fiscal year-end date of September 30<sup>10</sup>. For 2009, the  
6 end-date is June 30. There are nine months between September 30, 2008 and June  
7 30, 2009, not six months.

8 **C. Advances-in-aid of Construction ("AIAC").**

9  
10 **Q16. PLEASE DISCUSS THE COMPANY'S ADJUSTMENT TO ADVANCES-IN-**  
11 **AID OF CONSTRUCTION?**

12 A16. In rebuttal B-2 adjustment 3, as shown on Schedule B-2, page 2, the Company  
13 proposes a decrease to AIAC of \$20,918 to reflect the funding of the plant not used  
14 and useful which has been excluded from PIS and rate base. The \$20,918 of  
15 transmission and distribution mains removed from PIS is related to the Santa Cruz  
16 Meadows subdivision. A copy of the refundable line extension agreement is  
17 attached as Rebuttal Exhibit TJB-RB1. Staff does not propose a similar adjustment  
18 to AIAC.

19 **D. Accumulated Deferred Income Taxes ("ADITs").**

20  
21 **Q17. PLEASE EXPLAIN THE COMPANY'S REBUTAL PROPOSED**  
22 **ACCUMULATED DEFERRED INCOME TAXES.**

23  
24  
25 <sup>9</sup> A review of Staff's work papers indicates a 6 month period for the depreciation computation for 2009 was used.

26 <sup>10</sup> Company's fiscal year is from July 1 to September 30.

1 A17. The Company proposes accumulated deferred income taxes ("ADIT") in rate base  
2 in response to Staff's proposal to include ADIT. In rebuttal B-2 adjustment 4, as  
3 shown on Schedule B-2, page 2, the Company's ADIT (an asset) \$84,951. The  
4 ADIT reflects the Company's rebuttal proposed PIS, A/D, CIAC and AIAC. The  
5 details of the Company's rebuttal proposed ADIT adjustment is shown on Schedule  
6 B-2, page 6.

7 **Q18. HOW DOES STAFF'S PROPOSED ACCUMULATED DEFERRED**  
8 **INCOME TAX BALANCE COMPARE TO THE COMPANY'S?**

9 A18. Staff proposes a net ADIT liability of \$31,307 compared to the Company's ADIT  
10 asset of \$77,709. Staff's ADIT reduces rate base, where as the Company's ADIT  
11 increases rate base. The primary difference between Staff and the Company with  
12 respect to ADIT is in the recognition of deferred taxes associated with net  
13 operating loss (NOL) carry forward from bonus depreciation. The Company's  
14 ADIT recognizes this component of ADIT whereas Staff's does not.

15 **Q19. PLEASE EXPLAIN WHAT A NET OPERATING LOSS CARRY**  
16 **FORWARD IS AND HOW IT GENERATES DEFERRED INCOME TAXES.**

17 A19. For starters, let me provide some background. With the enactment of the  
18 Economic Stimulus Act of 2008 (ESA) in February 2008 a special 50 percent  
19 depreciation allowance for qualifying property purchased in 2008. In essence, a  
20 business could deduct 50 percent of the cost for tax purposes under the bonus  
21 depreciation provisions. The purchase of qualifying property had to be made by  
22 the end of 2008. A year later, the American Recovery and Reinvestment Act  
23 (ARRA) extended the bonus depreciation deduction through the end of 2009.  
24 Attempts to have Congress extend the bonus depreciation provisions through 2010  
25 have thus far been unsuccessful.  
26

1 **Q20. WHAT WAS THE PURPOSE OF THE BONUS DEPRECIATION**  
2 **PROVISIONS?**

3 A20. The purpose of the bonus depreciation provisions was to encourage investments by  
4 enabling businesses to write them off more quickly for tax purposes.

5 **Q21. PLEASE CONTINUE.**

6 A21. For the Company's tax year 2009 (October 1, 2008 to September 30, 2009), the  
7 Company elected to take bonus depreciation on assets in purchased and placed into  
8 service during the tax year. The resulting total tax depreciation deduction was  
9 over \$1 million. Book depreciation for this same period was about \$34,000. The  
10 large tax depreciation deduction far exceeded the Company's income and the result  
11 was a NOL (the excess of allowable deductions over gross income) for 2009.

12 **Q22. ARE THERE TAX BENEFITS ASSOCIATED WITH A NET TAX**  
13 **OPERATING LOSS?**

14 A22. Yes. An NOL can be used to reduce a tax liability by applying the NOL incurred  
15 in a current fiscal year against income reported in earlier years (tax loss carry back)  
16 and in future years (tax loss carry forward). IRS tax rules permit carrying back  
17 losses over the three prior years, resulting in a tax refund. A tax loss carry forward  
18 (NOL carry forward), on the other hand, is an NOL charged against income in  
19 future years.

20 **Q23. WILL THE COMPANY CARRY BACK THE NET OPERATING LOSS**  
21 **FROM 2009 TO THE EXTENT IT CAN OFFSET PRIOR YEAR TAX**  
22 **LIABILITIES?**

23 A23. Yes. And, I have accounted for this in my ADIT computations so that rate payers  
24 receive the benefit of the resulting book-tax timing difference through the end of  
25  
26

1 the year.<sup>11</sup> The remaining unused NOL will be carried forward to offset future tax  
2 liabilities. In other words, the NOL will provide future tax benefits as an offset to  
3 future taxable income and accordingly results in an ADIT asset.

4 Another way to looking at the NOL carry forward in the instant case is that  
5 not all of the bonus depreciation deduction could be utilized by the Company to  
6 offset income for tax purposes. Basically, the NOL represents unused tax  
7 depreciation that will be used (deducted) against future income for tax purposes.  
8 The tax benefits from the unused bonus depreciation can be accounted for in the  
9 ADIT computation by either recognizing the tax benefit as a separate component of  
10 ADIT (as is shown in the Company's ADIT computation as an NOL carry-forward  
11 and a tax asset component<sup>12</sup>) or by adding back the unused bonus depreciation to  
12 the tax value of PIS. Adding back the unused bonus depreciation will lower the  
13 difference between the book and tax fixed asset values and will ultimately lower  
14 the ADIT liability component of ADIT. Either way, the ADIT balance will be the  
15 same. Without recognition of the NOL carry forward, the ADIT balance at the end  
16 of the test year will be incomplete and a mismatch will occur between rate base,  
17 revenues, and expenses.

18 **Q24. DOES THE STATEMENT OF FINANCIAL ACCOUNTING STANDARDS**  
19 **NUMBER 109 REQUIRE THE RECOGNITION OF BOOK-TAX TIMING**  
20 **DIFFERENCE FROM AN OPERATING LOSS CARRY FORWARD?**

21 A24. Yes.<sup>13</sup>

25 <sup>11</sup> See Company Rebuttal Schedule B-2, page 6, line 12.

26 <sup>12</sup> See Company Rebuttal Schedule B-2, page 6.2, footnote 5.

<sup>13</sup> Statement of Financial Accounting Standards No. 109, Financial Accounting Standards Board, 1992, p. 11.

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**E. Customer Security Deposits.**

**Q25. PLEASE COMMENT ON STAFF PROPOSAL TO INCLUDE CUSTOMER SECURITY DEPOSITS IN RATE BASE.**

A25. Staff recommends the inclusion of customer security deposits (key deposits) totaling \$7,475 in rate base (a reduction in rate base).<sup>14</sup> While the Company disagrees with the inclusion of customer deposits in rate base it has adopted Staff's proposal to help eliminate issues between the parties.

**Q26. DOES THE COMPANY PAY INTEREST ON KEY DEPOSITS?**

A26. No. These are not security deposits to secure the payment from customers: rather, they are deposits to insure the return of keys given to customers to provide access to standpipe service. Accordingly, I have not included any interest expense associated with these deposits in operating expenses.

**IV. INCOME STATEMENT**

**Q27. WOULD YOU PLEASE DISCUSS THE COMPANY'S PROPOSED REBUTTAL ADJUSTMENTS TO REVENUES AND EXPENSES AND IDENTIFY ANY ADJUSTMENTS YOU HAVE ACCEPTED FROM STAFF?**

A27. The Company's proposed rebuttal adjustments are detailed on Rebuttal Schedule C-2, pages 1-6. The rebuttal income statement with adjustments is summarized on Rebuttal Schedule C-1, page 1-2.

Rebuttal adjustment 1 annualizes depreciation and amortization expense. Depreciation and amortization expense is somewhat lower due to the impacts of the Company proposed rebuttal adjustments to plant-in-service.

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<sup>14</sup> Michlik Dt. at 10.

1 **Q28. IS THERE AGREEMENT BETWEEN STAFF AND THE COMPANY ON**  
2 **THE LEVEL OF DEPREICATION EXPENSE?**

3 A28. No. Despite having the same total balance of PIS at \$3,594,472<sup>15</sup>, Staff's  
4 recommended level of depreciation expense is higher than the Company's by  
5 \$12,919<sup>16</sup>. The primary reason for this difference is a computational error  
6 contained in Staff determination of depreciation expense. Specifically, Staff uses  
7 an incorrect depreciation rate for account 331 – Transmission and Distribution  
8 mains. The depreciation rate used in Staff's computation is 3.33 percent<sup>17</sup> whereas  
9 Staff's recommended rate is 2.0 percent.<sup>18</sup> Using Staff's plant balance of \$883,616  
10 for account 331, the depreciation expense should be \$17,762 (\$883,616 times  
11 2.0%) and not \$29,424 as shown in the Staff schedules<sup>19</sup> - a difference of \$11,752  
12 (\$29,424 minus \$17,762).

13 **Q29. WHAT IS THE REMAINING DEFFIERNCE IN THE RECOMMENDED**  
14 **DEPRECIATION EXPENSE BETWEEN THE PARITES?**

15 A29. Two other relatively minor differences are the cause of the difference between  
16 Staff and the Company with respect to depreciation expense. The first relates to  
17 the removal of not used and useful plant. The Company removes \$20,082 of not  
18 used and useful plant cost from acct 311 – Pumping Equipment whereas Staff  
19 removes the \$20,082 of cost from account 331 – Transmission and Distribution  
20 Mains. This was discussed earlier in my rebuttal testimony at page 5. These two  
21 accounts have different depreciation rates<sup>20</sup>. And, because Staff made its

22 <sup>15</sup> Compare Staff Schedule CSB-15 and Company Rebuttal Schedule C-2, page 2.

23 <sup>16</sup> Staff recommends depreciation expense of \$124,300 per Staff Schedule CSB-15 whereas the Company  
24 recommends depreciation expense of \$111,381 per Company Schedule C-2, page 2.

<sup>17</sup> See Staff Schedule CSB-15, line 9, column D.

<sup>18</sup> See Table I-1 of Staff Exhibit MSJ at page 16.

25 <sup>19</sup> See Staff Schedule CSB-15, line 9, column E.

26 <sup>20</sup> For plant account 311 – Pumping Equipment, the depreciation rate is 12.5 percent and for plant account 331 –  
Transmission and Distribution mains, the depreciation rate is 2.0 percent.

1 adjustment for not used and used plant to a plant account with a lower depreciation  
2 rate, Staff computes more depreciation expense.

3 The second minor difference relates to the amount of CIAC amortization  
4 contained in each of the party's depreciation computations. Staff employs a higher  
5 CIAC amortization rate at 3.84 percent than does the Company at 3.57 percent.  
6 The higher amortization rate results in a higher amortization amount there by  
7 lowering depreciation expense.

8 **Q30. PLEASE COMMENT ON STAFF'S CIAC AMORTIZATION RATE USED**  
9 **IN THE COMPUTATION OF DEPREICATION EXPENSE.**

10 A30. Staff computes amortization of CIAC using a composite rate based on depreciable  
11 plant only.<sup>21</sup> Staff's Composite rate is higher as a result. All things being equal,  
12 Staff's composite rate results in a higher amount of CIAC amortization. The  
13 higher amount of CIAC amortization results in a lower amount of depreciation and  
14 amortization expense. The Company employs a CIAC amortization rate based on  
15 a composite of all plant in service which is the correct method of determining the  
16 composite rate.

17 **Q31. WHY?**

18 A31. Under the concept of using a composite rate for amortization of CIAC, a key  
19 assumption is that CIAC is used to fund all plant, not just depreciable plant.  
20 Further, Staff's approach to computing a composite rate is inconsistent with the  
21 composite rates used to re-compute accumulated amortization of CIAC through the  
22 end of the test year.<sup>22</sup> If a composite rate based on only depreciable plant were  
23 used to re-compute CIAC amortization through the end of the test year,  
24 accumulated amortization of CIAC would be higher. As a result, net CIAC would

25 <sup>21</sup> See Staff Schedule CSB-15.

26 <sup>22</sup> See Company Direct Schedule B-2, page 5.1 to 5.3.

1 be lower and rate base would be higher. Yet, Staff has not disputed the Company's  
2 accumulated CIAC balance.

3 **Q32. PLEASE CONTINUE.**

4 A32. Using the correct composite rate is revenue neutral. This is because the  
5 depreciation expense will be exactly offset by the CIAC amortization.

6 **Q33. CAN YOU DEMONSTRATE THIS?**

7 A33. Yes. Assume that a utility has \$10 of non-depreciable plant such as land and \$90  
8 of depreciable plant funded with \$100 of CIAC. Rate base is zero (\$100 minus  
9 \$100). The depreciation rate for depreciable plant is 3.33% and the annual  
10 depreciation is \$3 (\$90 times 3.33%). The composite rate for amortizing CIAC  
11 using all plant, not just depreciable plant is 2.96% (\$3 divided by \$100). The  
12 annual amortization of CIAC is \$3 (\$100 times 3%). Thus, the annual depreciation  
13 of \$3 is exactly offset by the annual amortization of \$3 so there is zero net impact  
14 on operating expense. Rate base also continues to be zero into the future.  
15 Depreciable net plant is reduced by \$3 and net CIAC is reduced by \$3.

16 In contrast, Staff's approach has a negative impact on cash flows related to  
17 depreciation and amortization. Using the example above, the composite rate for  
18 amortizing CIAC using just depreciable plant is 3.33% (\$3 divided by \$90). The  
19 annual amortization of CIAC is \$3.33 (\$100 times 3.33%). Thus, the annual  
20 depreciation is \$3 and it is offset by annual amortization of \$3.33 resulting in a  
21 negative cash flow of \$0.33.

22 **Q34. PLEASE CONTINUE WITH YOUR DISCUSSION OF THE OTHER  
23 REVENUE AND EXPENSE ADJUSTMENTS.**

24 A34. Rebuttal adjustment number 2 increases property tax expense and reflects the  
25 rebuttal proposed revenues. All the parties are in agreement on the method of  
26

1 computing property taxes at proposed rates, but each computes the property taxes  
2 based on their proposed revenues.

3 Rebuttal adjustment 3 reduces testing expense by \$3,161 to reflect known  
4 and measurable changes to this expense. This adjustment reflects the Company's  
5 acceptance of Staff's proposed adjustment to water testing expense.<sup>23</sup>

6 Rebuttal adjustment 4 reflects the synchronization of interest expense with  
7 the Company's proposed rate base.

8 Rebuttal adjustment 5 reflects income taxes at Company's proposed rates.

9 **Q35. PLEASE COMMENT ON STAFF'S PROPOSED RATE CASE EXPENSE.**

10 A35. At this stage of the proceeding, Staff and the Company agree on the total amount of  
11 proposed rate case expense of \$80,000. However, Staff proposes to normalize rate  
12 case expense over 4 years for an annual amount of \$20,000 while the Company  
13 proposes to amortize rate case expense over 3 years for an annual amount of  
14 \$26,667. The Company believes a 3 year period is appropriate in the instant case  
15 whether a normalized or amortized.

16 **Q36. DOES THE COMPANY EXPECT TO FILE ANOTHER RATE CASE  
17 WITHIN 3 YEARS, AND, IF SO, WHY?**

18 A36. Yes, because there are expected increases in operating expenses that are not being  
19 captured in the revenue requirement in the instant case. In addition, the Company  
20 has an aging infrastructure that will require the replacement of several miles of old  
21 transmission and distribution mains<sup>24</sup>. Because of severe cash flow problems over  
22 the past several years the Company has not made typical operational expenditures,  
23 hired appropriate levels personnel, and has not begun to address its needed capital  
24

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25 <sup>23</sup> Brown DT. at 10.

26 <sup>24</sup> The anticipated capital expenditures to replace mains over the next 3 years are over \$900,000. After three years, the Company anticipates to spend between \$300,000 and \$400,000 annually for several more years.

1 improvements. While forgoing these expenditures has helped to get the Company  
2 through the last few years this situation is not sustainable in the long-term.

3 **Q37. HASN'T THE COMPANY ASKED THE WATER INFRASTRUCTURE**  
4 **AND FINANCE AUTHORITY TO LOWER ITS DEBT PAYMENTS**  
5 **TEMPORARILY?**

6 A37. Yes. The Company contacted the Water Infrastructure Authority of Arizona  
7 ("WIFA") in June 2009 because of severe cash flow problems. In fact, this was  
8 one of the reasons the Company has sought new rates. In any case, WIFA granted  
9 the Company's request, but the reduction is only temporary and payments will  
10 begin to resume their required levels in the next few months.

11 **Q38. WHAT ARE THE MONTHLY WIFA REQUIRED PAYMENTS?**

12 A38. The required month WIFA payments for debt service and debt reserves are slightly  
13 over \$18,000. Annually, this requires cash flows of over \$217,000.

14 **Q39. IF A RATE INCREASE IS GRANTED IN THE INSTANT CASE, WOULD**  
15 **THE COMPANY'S CASH FLOW SITUATION IMPROVE?**

16 A39. Yes. Of course, the ability of the Company to cash flow its debt payments and  
17 begin to address its needed capital improvements will ultimately depend on the size  
18 of the increase granted. Further, the ability to attract additional capital in order to  
19 make the needed improvements will also be dependent upon the increase granted  
20 and the ability of the Company to earned its authorized return. Having said that, as  
21 the Company invests more capital, and hires additional personnel, it will need  
22 additional rate increases in order to earn its authorized rate of return and be able to  
23 continue to attract new capital and maintain its credit. The Company should be  
24 filing another rate case in the next 2-3 years to minimize its losses and to sustain  
25 long-term financial health.

26

1 V. RATE DESIGN

2 Q40. WHAT ARE THE COMPANY'S REBUTTAL PROPOSED RATES?

3 A40. LQSWC's rebuttal proposed rates are:

4 MONTHLY SERVICE CHARGES

5	5/8" x 3/4" meters	\$20.00
6	3/4" Meters	\$30.00
7	1" Meters	\$50.00
8	1 1/2" Meters	\$100.00
9	2" Meters	\$160.00
10	3" Meters	\$320.00
11	4" Meters	\$500.00
12	6" Meters	\$1,000.00
13	Standpipe	\$20.20

14  
15 COMMODITY RATES

16	5/8" X 3/4" Meters	1 to 4,000 gals	\$ 1.86
17		4,001 to 10,000 gals	\$ 2.36
18		Over 10,000 gals	\$ 2.96
19	3/4" Meters	1 to 4000 gals	\$ 1.86
20		4,001 to 10,000 gals	\$ 2.36
21		Over 10,000 gals	\$ 2.96
22	1" Meters	1 to 25,000 gals	\$ 2.36
23		Over 25,000 gals	\$ 2.96
24	1 1/2" Meters	1 to 50,000	\$ 2.36
25		Over 50,000	\$ 2.96
26	2" Meters	1 to 80,000	\$ 2.36

1		Over 80,000	\$ 2.96
2	3" Meters	1 to 160,000	\$ 2.36
3		Over 160,000	\$ 2.96
4	4" Meters	1 to 250,000	\$ 2.36
5		Over 250,000	\$ 2.96
6	6" Meters	1 to 500,000	\$ 2.36
7		Over 500,000	\$ 2.96
8	Standpipe	0 to 4,000 gals	\$ 1.90
9		4,001 to 23,000 gals	\$ 2.36
10		Over 23,000 gals	\$ 2.96
11	<b>Arsenic Surcharge</b>	<b>Eliminated</b>	

12

13 **Q41. WHAT WILL BE THE AVERAGE 5/8 INCH CUSTOMER AVERAGE**  
14 **MONTHLY BILL UNDER THE NEW RATES?**

15 A41. As shown on Schedule H-2, page 2, the average monthly bill under proposed rates  
16 for a 5/8 inch customer using an average 10.768 gallons is \$43.84 – a \$10.89  
17 increase over the present monthly bill or a 33.05 percent increase.

18 **Q42. PLEASE COMMENT ON THE STAFF PROPOSED RATE DESIGN.**

19 A42. Like the Company, Staff is proposing an inverted three tier design for the smaller  
20 metered customers (5/8 inch and 3/4 inch) and an inverted two tier design for the 1  
21 inch and larger metered customers). Staff break-over points are similar to the  
22 Company's but are higher than the Company's particularly for the 1 1/2 inch and  
23 larger metered customers. However, like the Company, Staff's break-over points  
24 increase with meter size. And, like the Company, the first tier commodity rate of  
25 the 1 inch and larger metered customers is the same as the second tier of the small  
26

1 metered customers. The second tier of the 1 inch and larger metered customers is  
2 the same as the third tier of the small residential metered customers.

3 While the Company and Staff rate designs produce very similar results with  
4 respect to revenue recovery from the monthly minimums as well as from the  
5 monthly minimums and the first tier commodity rates. I have included as Rebuttal  
6 Exhibit TJB-RB2 schedules showing the revenue recovery from the monthly  
7 minimums and the commodity rates under present rates and under the proposed  
8 rates for each of the parties.

9 **Q43. WHAT IS THE DISTINGUISHING CHARACTERISTIC BETWEEN THE**  
10 **PARTY'S RATE DESIGNS FOR WHICH YOU HAVE CONCERNS?**

11 A43. The first tier commodity rate for the small metered customers is relatively low. In  
12 fact, Staff only increases the first tier commodity rate by about 15 percent over the  
13 present first tier commodity rate. This relatively low first tier commodity rate is  
14 only available to the smaller meter customers. Further, in order to make up the  
15 revenues that would otherwise be captured by a higher first tier commodity rate for  
16 the smaller metered customers, the second tier and third tier commodity rates have  
17 to be much higher. In fact, the differential between the first and second tier  
18 commodity rate under Staff's rate design is \$1.00 (an increase of 82.6 percent over  
19 the present second tier commodity rate) and the differential between the second and  
20 third tier commodity rate under Staff's rate design is \$1.09 (an increase of 136.5  
21 percent over the present second tier commodity rate). Also remember, the first tier  
22 of the 1 inch and larger meters is the second tier of the smaller meters and the  
23 second tier of the 1 inch and larger meters is the third tier of the smaller meters.  
24 So, the commodity rates available to the 1 inch and larger meters are increased  
25 significantly. The result is more of a shift in revenue recovery away from the  
26 smaller metered customers and to the larger metered customers.

1 **Q44. CAN YOU DEMONSTRATE THIS?**

2 A44. Yes. Under present rates, the 5/8x3/4 inch metered customers provide  
3 approximately 67.0 percent of revenues. Under the Staff proposed rates, the  
4 percentage drops to approximately 64.8 percent. Under the Company's proposed  
5 rates, the percentage also drops, but only to 65.8 percent. The decrease in revenue  
6 recovery, from the Company's largest customer class, has to be made up by the  
7 other customer classes.<sup>25</sup> So, under Staff's design, more of the recovery is shifted  
8 to the other customer classes than is under the Company's rate design. I have  
9 included as Rebuttal Exhibit TJB-RB3 schedules similar to the H-1 schedule for  
10 both Staff and the Company which shows the percentage of total revenue recovered  
11 from each customer class.

12 **Q45. IS THERE ANY DISAGREEMENT BETWEEN THE STAFF AND THE**  
13 **COMPANY REGARDING SERVICE LINE AND METER INSTALLATION**  
14 **CHARGES?**

15 A45. No. The Company has adopted the meter and service line installation charges

16 **Q46. IS THERE ANY DISAGREEMENT BETWEEN THE STAFF AND THE**  
17 **COMPANY REGARDING SERVICE LINE AND METER INSTALLATION**  
18 **CHARGES?**

19 A46. No. The Company has adopted the meter and service line installation charges  
20 proposed by Staff.

21 **Q47. IS THERE ANY DISAGREEMENT BETWEEN THE STAFF AND THE**  
22 **COMPANY REGARDING MISCELLANEOUS CHARGES?**

23 A47. No.

24

25

26 <sup>25</sup> In particular, the 2 inch and 4 inch metered customers see an increase in the percent of revenues under proposed rates

1 **Q48. HAS THE COMPANY ACCEPTED STAFF RECOMMENDATION TO**  
2 **CONTINUE WITH AN ARSENIC IMPACT HOOK-UP FEE AND OFF-**  
3 **SITE FACILITIES HOOK-UP FEE?**

4 A48. Yes. Rather than eliminate the Arsenic Impact Hook-up Fee and replace the  
5 existing \$250 Off-site Facilities Hook-up Fee as the Company recommended in its  
6 direct filing<sup>26</sup>, the Company accepts Staff's recommendation to continue with the  
7 Arsenic Impact Hook-up Fee and the \$250 Off-site Hook-up Fee.

8 **Q49. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

9 A49. Yes. Although my silence on any issue not discussed herein does not necessarily  
10 constitute agreement with Staff.

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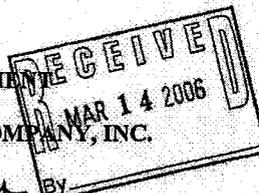
<sup>26</sup> See Direct testimony of Thomas J. Bourassa ("Bourassa Dt.") at 17-18.

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(RATE BASE, INCOME STATEMENT, AND RATE DESIGN)  
August 23, 2010**

**EXHIBIT TJB-RB1**

REFUNDABLE  
LINE EXTENSION AGREEMENT  
BETWEEN  
LAS QUINTAS SERENAS WATER COMPANY, INC.



THIS AGREEMENT, made and entered into this 6<sup>th</sup> day of January, 2006, by and between LAS QUINTAS SERENAS WATER COMPANY, an Arizona Corporation, hereinafter called "UTILITY", whose address is P.O. Box 68, Sahuarita, Arizona 85629, and Title Security Agency of Arizona, an Arizona corporation, as Trustee under its Trust No. 898, and not otherwise, and whose address is 7840 E. Broadway Blvd., Suite 210, Tucson, Arizona 85710, hereinafter called "Applicant".

WITNESSETH:

WHEREAS, APPLICANT is desirous of securing water service to Lots 1-239 of Santa Cruz Meadows, Common Areas A, B, and C, a subdivision located in Section 26, T17S, R13E G&SRM, Pima County, Arizona, recorded in Book 46 of Plats at Page 62 in the Official Records of the Pima County Recorder (the "Plat") as more particularly described in Exhibit "A" as attached hereto and made a part hereof by reference (the "Property"), and will advance monies in aid of construction for such purpose; and,

WHEREAS, UTILITY is willing to supply water to APPLICANT in accordance with the Rules and Regulations of the Arizona Corporation Commission ("Commission"), and in accordance with the terms of this Agreement;

NOW, THEREFORE, in consideration of the mutual covenants, conditions and agreements set forth hereinbelow, it is agreed as follows:

1. In accordance with the plans submitted by APPLICANT and approved UTILITY, APPLICANT agrees to install the water facilities necessary for the purpose of furnishing water to the Property. A copy of said plans is attached hereto as Exhibit "B" and made a part hereof by reference. Water service to Common Areas A, B, and C as shown on the Plat shall be provided for by separate agreement with UTILITY.

2. APPLICANT'S cost of installing the water facilities is estimated to be \$20,918.00 which is to be incurred by APPLICANT. In addition APPLICANT will pay to UTILITY the sum of \$59,750.00 for the applicable Off-site Facilities Hook-up Fee. Payment of the Off-Site Facilities Hook-up Fee in the total amount of \$59,750.00 shall be made on or before commencement of construction of the aforesaid water facilities by APPLICANT. The water facilities will not be accepted by UTILITY for use until this payment is made.

In Summary:

- (a) The \$20,918.00 shall be treated as a refundable advance in aid of construction for the water facilities to be installed pursuant to this Agreement;

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5. All water facilities installed under this Agreement shall be the sole property of UTILITY, and APPLICANT shall have no right, title or interest to or in any such facilities. Upon completion of the installation of the water facilities, APPLICANT shall provide UTILITY with "as built" drawings satisfactory to UTILITY and a copy of the approval of construction (water certificate) as issued by Pima County Department of Environmental Quality.

6. The (i) size, design, type and quality of materials for the water facilities, (ii) location in the ground, and (iii) manner of installation and construction shall be as specified by UTILITY. In addition, APPLICANT shall also comply with the requirements of the Commission or other public agencies having authority and jurisdiction relating to the installation and construction of the water facilities.

7. This Agreement shall be subject to APPLICANT providing to UTILITY recordable easements in favor of utility and required surveying, over, under, and across all

396781.3

portions of such main extension routes as may be necessary to serve each parcel or lot to be served under this Agreement. APPLICANT agrees that all easements and rights-of-way that are used by UTILITY shall be free of obstacles which may interfere with the construction, operation, maintenance repair and/or replacement of UTILITY'S water facilities. If APPLICANT'S subdivision, tract, development, or project involves road construction, all roads and drainageways will be brought to grade by APPLICANT prior to the commencement of the installation of the water facilities. No pavement or curbs shall be installed prior to the completion of all water facilities. If any streets, roads, alleys or drainageways are installed at a different grade or location after the beginning of the installation of the water facilities, APPLICANT shall be solely responsible for and bear all costs incurred by UTILITY to relocate water facilities as a result of said facilities having improper cover or location.

8. APPLICANT shall pay any additional costs incurred as a result of (i) design changes made or caused by APPLICANT or its agent, the Arizona Department of Environmental Quality, the Pima County Department of Environmental Quality, the Commission or any other public agency under whose jurisdiction the subject construction may fall; or (ii) anticipated or un-anticipated changes in existing UTILITY facilities, due to any work associated with this subdivision, tract, development or project which causes said facilities to have improper cover, sizing capacity or location.

9. The effectiveness of this Agreement shall be contingent upon the approval of the Arizona Department of Environmental Quality and/or the Pima County Department of Environmental Quality of the plans attached hereto as Exhibit C said form of approval being shown as Exhibit "D" to this Agreement and attached hereto and made a part hereof by reference.

10. This Agreement shall be subject to the approval of the Commission. It is further understood and agreed that APPLICANT is knowledgeable of the Rules and Regulations of the Commission as they apply to line and main extension agreements, and APPLICANT acknowledges that UTILITY has furnished it or its agent with a copy of A.C.R.R. R14-2-406 relating to main extension agreements.

11. This Agreement shall be binding upon and for the benefit of the heirs, administrators, executors, successors and assigns of UTILITY and APPLICANT, respectively, provided, however, that an assignment or other transfer of this Agreement by APPLICANT shall not be binding upon UTILITY or create any rights in the Assignee until such assignment or other transfer is first approved and accepted in writing by UTILITY.

12. This Agreement, and all rights and obligations hereunder, including those regarding water service to APPLICANT, shall be subject to the Commission's "Rules and Regulations Relating to the Operation of Domestic Water Utility Companies" and all applicable rates, fees, charges and tariffs of UTILITY as approved by the Commission now or as they may be changed in the future.

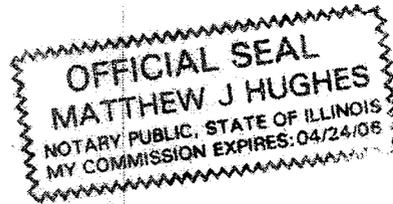


STATE OF Illinois )  
 )ss.  
COUNTY OF Cook )

This Instrument was acknowledged before me this 5<sup>th</sup> day of January, 2006, by Sheldon S. Mendell as President of MDC Arizona, Manager of Tucson Land, L.L.C., an Arizona limited liability company, the sole beneficiary of Trust No. 898.

Matthew J. Hughes

My commission expires:



Date Approved: 3-10-06

Decision No.: \_\_\_\_\_

Director of Utilities

Arizona Corporation Commission

By: Bradley B. Morton

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(RATE BASE, INCOME STATEMENT, AND RATE DESIGN)  
August 23, 2010**

**EXHIBIT TJB-RB2**

Las Quintas Serenas Water Company  
 Revenue Breakdown Summary  
 Company Present Rates

Attachment  
 Page 1

	Monthly <u>Mins+Surcharge</u>	Commodity <u>First Tier</u>	Commodity <u>Second Tier</u>	Commodity <u>Third Tier</u>	<u>Total</u>
5/8x3/4 Inch	\$ 97,680	\$ 28,216	\$ 155,882	\$ 44,023	\$ 325,801
3/4 Inch	\$ 1,620	\$ 20	\$ 1,893	\$ 562	\$ 4,095
1 Inch	\$ 8,700	\$ 13,325	\$ 3,085		\$ 25,111
1.5 Inch	\$ 4,620	\$ 6,290	\$ 3,728		\$ 14,637
2 Inch	\$ 3,360	\$ 5,455	\$ 8,229		\$ 17,044
4 Inch	\$ 5,400	\$ 6,738	\$ 14,806		\$ 26,944
Subtotal	\$ 121,380	\$ 60,045	\$ 187,623	\$ 44,585	\$ 413,632
Standpipe	\$ 19,028	\$ 14,433	\$ 9,084	\$ 24,899	\$ 67,445
Fire Sprinkler	\$ 480				\$ 480
Subtotal	\$ 19,508	\$ 14,433	\$ 9,084	\$ 24,899	\$ 67,925
<b>TOTALS</b>	<b>\$ 140,888</b>	<b>\$ 74,478</b>	<b>\$ 196,707</b>	<b>\$ 69,483</b>	<b>\$ 481,557</b>
Percent of Total	29.26%	15.47%	40.85%	14.43%	100.00%
Cummulative %	29.26%	44.72%	85.57%	100.00%	

Las Quintas Serenas Water Company  
 Revenue Breakdown Summary  
 Company Proposed Rates

Attachment  
 Page 2

	Monthly Mins	Commodity First Tier	Commodity Second Tier	Commodity Third Tier	Total
5/8x3/4 Inch	\$ 195,360	\$ 7,705	\$ 165,163	\$ 79,723	\$ 447,951
3/4 Inch	\$ 2,160	\$ 7	\$ 1,910	\$ 863	\$ 4,940
1 Inch	\$ 17,400	\$ 9,814	\$ 4,730		\$ 31,943
1.5 Inch	\$ 8,400	\$ 5,343	\$ 6,270		\$ 20,013
2 Inch	\$ 7,680	\$ 4,049	\$ 16,394		\$ 28,123
4 Inch	\$ 12,000	\$ 5,136	\$ 30,470		\$ 47,606
Subtotal	\$ 243,000	\$ 32,053	\$ 224,936	\$ 80,585	\$ 580,575
Standpipe	\$ 38,057	\$ 3,277	\$ 6,733	\$ 48,843	\$ 96,910
Fire Sprinkler	\$ 480				\$ 480
Subtotal	\$ 38,537	\$ 3,277	\$ 6,733	\$ 48,843	\$ 97,390
<b>TOTALS</b>	<b>\$ 281,537</b>	<b>\$ 35,330</b>	<b>\$ 231,670</b>	<b>\$ 129,428</b>	<b>\$ 677,965</b>
Percent of Total	41.53%	5.21%	34.17%	19.09%	100.00%
Cummulative %	41.53%	46.74%	80.91%	100.00%	

Las Quintas Serenas Water Company - Staff Proof  
 Revenue Breakdown Summary  
 Staff Proposed Rates

	<u>Monthly</u> <u>Mins</u>	<u>Commodity</u> <u>First Tier</u>	<u>Commodity</u> <u>Second Tier</u>	<u>Commodity</u> <u>Third Tier</u>	<u>Total</u>
5/8x3/4 Inch	\$ 195,360	\$ 4,563	\$ 140,395	\$ 81,132	\$ 421,451
3/4 Inch	\$ 2,160	\$ 4	\$ 1,707	\$ 862	\$ 4,734
1 Inch	\$ 17,400	\$ 8,801	\$ 4,651		\$ 30,852
1.5 Inch	\$ 8,400	\$ 4,679	\$ 6,035		\$ 19,114
2 Inch	\$ 7,680	\$ 3,559	\$ 16,967		\$ 28,206
4 Inch	\$ 12,000	\$ 6,318	\$ 28,034		\$ 46,352
Subtotal	<u>\$ 243,000</u>	<u>\$ 27,925</u>	<u>\$ 197,790</u>	<u>\$ 81,995</u>	<u>\$ 550,710</u>
Standpipe	\$ 38,057	\$ 1,941	\$ 4,883	\$ 51,220	\$ 96,100
Fire Sprinkler	\$ 480				\$ 480
Subtotal	<u>\$ 38,537</u>	<u>\$ 1,941</u>	<u>\$ 4,883</u>	<u>\$ 51,220</u>	<u>\$ 96,580</u>
TOTALS	<u>\$ 281,537</u>	<u>\$ 29,866</u>	<u>\$ 202,673</u>	<u>\$ 133,215</u>	<u>\$ 647,290</u>
Percent of Total	43.49%	4.61%	31.31%	20.58%	100.00%
Cummulative %	43.49%	48.11%	79.42%	100.00%	

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(RATE BASE, INCOME STATEMENT, AND RATE DESIGN)  
August 23, 2010**

**EXHIBIT TJB-RB3**

Las Quintas Serenas Water Company

Test Year Ended June 30, 2009

Revenue Summary

With Annualized Revenues to Year End Number of Customers

Exhibit

Page 1

Line No.	Meter Size	Company Present Revenues	Company Proposed Revenues	Dollar Change	Percent Change	Percent of Present Water Revenues	Percent of Proposed Water Revenues
1	5/8x3/4 Inch	\$ 327,234	\$ 450,859	\$ 123,625	37.78%	67.02%	65.81%
2	3/4 Inch	4,095	4,940	844	20.62%	0.84%	0.72%
3	1 Inch	24,612	30,934	6,322	25.69%	5.04%	4.52%
4	1.5 Inch	14,756	20,245	5,489	37.20%	3.02%	2.96%
5	2 Inch	17,044	28,123	11,079	65.00%	3.49%	4.11%
6	4 Inch	19,237	30,562	11,325	58.87%	3.94%	4.46%
7	Subtotal	\$ 406,979	\$ 565,663	\$ 158,684	38.99%	83.35%	82.57%
8							
9							
10	Standpipe	\$ 67,100	\$ 96,222	\$ 29,122	43.40%	13.74%	14.05%
11	Fire Sprinkler	480	480	-	0.00%	0.10%	0.07%
12	Subtotal	67,580	96,702	29,122	43.09%	13.84%	14.12%
13							
14							
15	Total Revenues before Annualization	\$ 474,558	\$ 662,365	\$ 187,806	39.57%	97.19%	96.69%
16							
17							
18	Meter Size	Company Present Revenues	Company Proposed Revenues	Dollar Change	Percent Change	Percent of Present	Percent of Proposed
19							
20							
21	5/8x3/4 Inch	\$ (1,434)	\$ (2,908)	\$ (1,474)	102.84%	-0.29%	-0.42%
22	3/4 Inch	-	-	-	0.00%	0.00%	0.00%
23	1 Inch	499	1,009	510	102.33%	0.10%	0.15%
24	1.5 Inch	(118)	(232)	(114)	96.65%	-0.02%	-0.03%
25	2 Inch	-	-	-	0.00%	0.00%	0.00%
26	4 Inch	7,707	17,044	9,337	121.16%	1.58%	2.49%
27	Subtotal	\$ 6,654	\$ 14,912	\$ 8,259	124.13%	1.36%	2.18%
28							
29							
30	Standpipe	345	688	343	99.28%	0.07%	0.10%
31	Fire Sprinkler	-	-	-	0.00%	0.00%	0.00%
32							
33	Total Revenue Annualization	\$ 6,999	\$ 15,600	\$ 8,601	122.90%	1.43%	2.28%
34							
35	Total Revenues with Rev. Annual.	\$ 481,557	\$ 677,965	\$ 196,408	40.79%	98.63%	98.97%
36							
37	Misc. Serv. Rev.	6,778	6,778	-	0.00%	1.388%	0.989%
38	Annualization of Misc Service Rev.	-	-	-	0.00%	0.000%	0.000%
39	Unreconciled Difference to C-1	(65)	304	369	-567.69%	-0.013%	0.044%
40							
41	Total Revenues	\$ 488,270	\$ 685,047	\$ 196,777	40.30%	100.00%	100.00%
42							

**Las Quintas Serenas Water Company - Staff Proposed Rates**  
**Test Year Ended June 30, 2009**  
**Revenue Summary**  
**With Annualized Revenues to Year End Number of Customers**

Exhibit  
Page 2

Line No.	Meter Size	Company Present Revenues	Staff Proposed Revenues	Dollar Change	Percent Change	Percent of Present Water Revenues	Percent of Proposed Water Revenues
1	5/8x3/4 Inch	\$ 327,234	\$ 424,067	\$ 96,832	29.59%	67.02%	64.85%
2	3/4 Inch	4,095	4,734	638	15.59%	0.84%	0.72%
3	1 Inch	24,612	29,894	5,282	21.46%	5.04%	4.57%
4	1.5 Inch	14,756	19,330	4,574	31.00%	3.02%	2.96%
5	2 Inch	17,044	28,206	11,162	65.49%	3.49%	4.31%
6	4 Inch	19,237	29,651	10,414	54.13%	3.94%	4.53%
7	Subtotal	\$ 406,979	\$ 535,881	\$ 128,902	31.67%	83.35%	81.94%
8							
9							
10	Standpipe	\$ 67,100	\$ 95,492	\$ 28,392	42.31%	13.74%	14.60%
11	Fire Sprinkler	480	480	-	0.00%	0.10%	0.07%
12	Subtotal	67,580	95,972	28,392	42.01%	13.84%	14.68%
13							
14							
15	Total Revenues <u>before</u> Annualization	\$ 474,558	\$ 631,853	\$ 157,294	33.15%	97.19%	96.62%
16							
17							
18	Meter Size	Company Present Revenues	Staff Proposed Revenues	Dollar Change	Percent Change	Percent of Present	Percent of Proposed
19							
20							
21	5/8x3/4 Inch	\$ (1,434)	\$ (2,616)	\$ (1,182)	82.43%	-0.29%	-0.40%
22	3/4 Inch	-	-	-	0.00%	0.00%	0.00%
23	1 Inch	499	959	460	92.20%	0.10%	0.15%
24	1.5 Inch	(118)	(215)	(97)	82.24%	-0.02%	-0.03%
25	2 Inch	-	-	-	0.00%	0.00%	0.00%
26	4 Inch	7,707	16,701	8,995	116.71%	1.58%	2.55%
27	Subtotal	\$ 6,654	\$ 14,829	\$ 8,175	122.87%	1.36%	2.27%
28							
29							
30	Standpipe	345	609	263	76.35%	0.07%	0.09%
31	Fire Sprinkler	-	-	-	0.00%	0.00%	0.00%
32							
33	Total Revenue Annualization	\$ 6,999	\$ 15,437	\$ 8,439	120.58%	1.43%	2.36%
34							
35	Total Revenues <u>with</u> Rev. Annual.	\$ 481,557	\$ 647,290	\$ 165,733	34.42%	98.63%	98.98%
36							
37	Misc. Serv. Rev.	6,778	6,778	-	0.00%	1.388%	1.036%
38	Annualization of Misc Service Rev.	-	-	-	0.00%	0.000%	0.000%
39	Unreconciled Difference to C-1	(65)	(105)	(40)	61.54%	-0.013%	-0.016%
40							
41	Total Revenues	\$ 488,270	\$ 653,963	\$ 165,693	33.93%	100.00%	100.00%
42							

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(RATE BASE, INCOME STATEMENT, AND RATE DESIGN)  
August 23, 2010**

**SCHEDULES**

**Las Quintas Serenas Water Company**  
**Test Year Ended June 30, 2009**  
**Computation of Increase in Gross Revenue**  
**Requirements As Adjusted**

Exhibit  
 Rebuttal Schedule A-1  
 Page 1  
 Witness: Bourassa

Line No.					
1	Fair Value Rate Base			\$	1,999,859
2					
3	Adjusted Operating Income				52,369
4					
5	Current Rate of Return				2.62%
6					
7	Required Operating Income			\$	188,787
8					
9	Required Rate of Return on Fair Value Rate Base				9.44%
10					
11	Operating Income Deficiency			\$	136,418
12					
13	Gross Revenue Conversion Factor				1.4425
14					
15	Increase in Gross Revenue Revenue Requirement				196,777
16					
17	Adjusted Test Year Revenues			\$	488,270
18	Increase in Gross Revenue Revenue Requirement			\$	196,777
19	Proposed Revenue Requirement			\$	685,047
20	% Increase				40.30%
21					
22	<b>Customer</b>	<b>Present</b>	<b>Proposed</b>	<b>Dollar</b>	<b>Percent</b>
23	<b><u>Classification</u></b>	<b><u>Rates</u></b>	<b><u>Rates</u></b>	<b><u>Increase</u></b>	<b><u>Increase</u></b>
24	5/8 Inch	\$ 327,234	\$ 450,859	\$ 123,625	37.78%
25	3/4 Inch	4,095	4,940	844	20.62%
26	1 Inch	24,612	30,934	6,322	25.69%
27	1.5 Inch	14,756	20,245	5,489	37.20%
28	2 Inch	17,044	28,123	11,079	65.00%
29	4 Inch	19,237	30,562	11,325	58.87%
30	Subtotal	<u>\$ 406,979</u>	<u>\$ 565,663</u>	<u>\$ 158,684</u>	<u>38.99%</u>
31					
32					
33	Standpipe	\$ 67,100	\$ 96,222	\$ 29,122	43.40%
34	Fire Sprinkler	480	480	-	0.00%
35	Subtotal	<u>\$ 67,580</u>	<u>\$ 96,702</u>	<u>\$ 29,122</u>	<u>43.09%</u>
36					
37	<b>Subtotal Revenues before Annualization</b>	<u>\$ 474,558</u>	<u>\$ 662,365</u>	<u>\$ 187,806</u>	<u>39.57%</u>
38					
39	Revenue Annualization	6,999	15,600	8,601	122.90%
40	Miscellaneous Revenues	6,778	6,778	-	0.00%
41	Reconciling Amount H-1 to C-1	(65)	304	369	-567.69%
42	<b>Total of Water Revenues</b>	<u><u>\$ 488,270</u></u>	<u><u>\$ 685,047</u></u>	<u><u>\$ 196,777</u></u>	<u><u>40.30%</u></u>
43					
44					
45	<b><u>SUPPORTING SCHEDULES:</u></b>				
46	Rebuttal B-1				
47	Rebuttal C-1				
48	Rebuttal C-3				
49	Rebuttal H-1				

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Summary of Rate Base

Exhibit  
 Rebuttal Schedule B-1  
 Page 1  
 Witness: Bourassa

Line No.		<u>Original Cost</u> <u>Rate base</u>	<u>Fair Value</u> <u>Rate Base</u>
1			
2	Gross Utility Plant in Service	\$ 3,594,472	\$ 3,594,472
3	Less: Accumulated Depreciation	<u>1,044,147</u>	<u>1,044,147</u>
4			
5	Net Utility Plant in Service	\$ 2,550,325	\$ 2,550,325
6			
7	<u>Less:</u>		
8	Advances in Aid of		
9	Construction	351,405	351,405
10	Contributions in Aid of		
11	Construction	333,555	333,555
12			
13	Accumulated Amortization of CIAC	(83,901)	(83,901)
14			
15	Service Line and Meter Installation Chgs	19,641	19,641
16	Deferred Income Taxes & Credits	(77,709)	(77,709)
17	Customer Security Deposits	7,475	7,475
18			
19			
20	<u>Plus:</u>		
21	Unamortized Debt Issuance		
22	Costs	-	-
23	Deferred Reg. Assets	-	-
24	Working capital	-	-
25			
26			
27			
28			
29	Total Rate Base	<u>\$ 1,999,859</u>	<u>\$ 1,999,859</u>
30			
31			
32			
33	<u>SUPPORTING SCHEDULES:</u>		<u>RECAP SCHEDULES:</u>
34	Rebuttal B-2		Rebuttal A-1
35	Rebuttal B-3		
36	Rebuttal B-5		
37			
38			

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Original Cost Rate Base Proforma Adjustments

Exhibit  
 Schedule B-2  
 Page 1  
 Witness: Bourassa

Line No.		Actual at End of Test Year	Proforma Adjustment Amount	Adjusted at end of Test Year
1	Gross Utility			
2	Plant in Service	\$ 3,828,585	(234,113)	\$ 3,594,472
3				
4	<b>Less:</b>			
5	Accumulated			
6	Depreciation	1,077,428	(33,281)	1,044,147
7				
8				
9	Net Utility Plant			
10	in Service	\$ 2,751,157	\$ (200,832)	\$ 2,550,325
11				
12	<b>Less:</b>			
13	Advances in Aid of			
14	Construction	372,323	(20,918)	351,405
15				
16	Contributions in Aid of			
17	Construction	333,555	-	333,555
18				
19	Accumulated Amort of CIAC	(83,901)	-	(83,901)
20				
21	Service Line and Meter Installation Chgs	19,641	-	19,641
22	Deferred Income Taxes & Credits	-	(77,709)	(77,709)
23	Customer Security Deposits	-	7,475	7,475
24				
25				
26	<b>Plus:</b>			
27	Unamortized Debt Issuance			
28	Costs	-	-	-
29	Deferred Reg. Assets	-	-	-
30	Working capital	-	-	-
31				
32				
33				
34				
35	<b>Total</b>	<b>\$ 2,109,539</b>	<b>\$ (109,680)</b>	<b>\$ 1,999,859</b>
36				
37				
38				
39	<u>SUPPORTING SCHEDULES:</u>			<u>RECAP SCHEDULES:</u>
40	Rebuttal B-2, pages 2			Rebuttal B-1
41				
42				
43				
44				
45				
46				
47				
48				

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Original Cost Rate Base Proforma Adjustments

Exhibit  
 Rebuttal Schedule  
 Page 2  
 Witness: Bourassa

Line No.	Description	Actual at End of Test Year	Proforma Adjustments			Adjusted at end of Test Year
			1 Plant	2 Accumulated Depr.	3 AIAC	
1	Gross Utility Plant in Service	\$ 3,828,585	(234,113)			\$ 3,594,472
2	Less: Accumulated Depreciation	1,077,428	(33,281)			1,044,147
3						
4						
5						
6						
7						
8						
9	Net Utility Plant in Service	\$ 2,751,157	\$ (234,113)	\$ 33,281	\$ -	\$ 2,550,325
10	Less: Advances in Aid of Construction	372,323		(20,918)		351,405
11						
12						
13						
14						
15						
16	Contributions in Aid of Construction (CIAC)	333,555				333,555
17						
18						
19	Accumulated Amort of CIAC	(83,901)				(83,901)
20						
21	Service Line and Meter Installation Chgs	19,641				19,641
22	Deferred Income Taxes & Credits	-			(77,709)	(77,709)
23	Customer Security Deposits	-				7,475
24						
25	Plus:					
26	Unamortized Finance Charges	-				-
27						
28						
29	Allowance for Working Capital	-				-
30						
31	Total	\$ 2,109,539	\$ (234,113)	\$ 33,281	\$ 77,709	\$ 1,999,859
32						
33						
34						
35						
36						
37						

SUPPORTING SCHEDULES:  
 Rebuttal B-2, pages 3-6

RECAP SCHEDULES:  
 B-1



**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 1 - A

Exhibit  
Schedule B-2  
Page 3.1  
Witness: Bourassa

Line  
No.

1	<u>Plant Retirement</u>		
2			
3	Acct 331 - Pumping Equipment	Pump Bowl Assembly	\$ (7,488)
4			
5			
6	Adjustment to Acct 331 - Pumping Equipment		<u>\$ (7,488)</u>
7			
8			
9			
10			
11			
12			
13	<u>SUPPORTING SCHEDULES</u>		
14	Staff Schedule CSB-5		
15			
16			
17			
18			
19			
20			

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 1 - B

Exhibit  
Rebuttal Schedule B-2  
Page 3.2  
Witness: Bourassa

Line  
No.

1	<u>Remove Debt Issuance Costs</u>	
2		
3	Acct 320.1 - Water Treatment Equipment	\$ (185,625)
4		
5		
6	Adjustment to Acct 320.1 - Water Treatment Equipment	<u>\$ (185,625)</u>

7  
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SUPPORTING SCHEDULES  
Staff Schedule CSB-6

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 1 - C

Exhibit  
Rebuttal Schedule B-2  
Page 3.3  
Witness: Bourassa

Line  
No.

1	<u>Not Used and Useful Plant</u>		
2			
3	Acct 311 - Electric Pumping Equipment		
4	Well #6 - Natural gas well engine	\$ (10,090)	
5	Natural gas well engine - spare	<u>(9,992)</u>	
6	Total Acct 311 - Electric Pumping Equipment		\$ (20,082)
7			
8	Acct 331 - Transmission and Distribution Mains		
9	Sun Cruz Meadows Subdivision		<u>\$ (20,918)</u>
10			
11	Total Plant Not Used and Useful		\$ (41,000)
12			
13			
14	Adjustment to Plant in Service		<u>\$ (41,000)</u>
15			
16			
17			
18	<u>SUPPORTING SCHEDULES</u>		
19	Exhibit MSJ Table H-1		
20			

Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.4

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	Per Decision 67445		2004 Plant Additions	2004 Plant Adjustment	2004 Adjusted Additions	2004 Plant Retirements	2004 Salvage A/D Only	September 2004	
				Plant At 9/30/2003	9/30/2003 Depr. Accum.						Plant Balance	Deprec.
301	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-	-	-
302	Franchise Cost	0.00%	0.00%	-	-	-	-	-	-	-	-	-
303	Land and Land Rights	0.00%	0.00%	217	-	-	-	-	-	217	-	-
304	Structures and Improvements	3.33%	3.33%	6,599	3,110	-	-	-	-	6,599	330	-
305	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-	-	-
306	Lake River and Other Intakes	5.00%	2.50%	-	-	-	-	-	-	-	-	-
307	Wells and Springs	5.00%	3.33%	300,389	141,585	-	-	-	-	300,389	15,019	-
308	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-	-	-
309	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-	-	-
310	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-	-
311	Electric Pumping Equipment	5.00%	12.50%	103,684	48,870	11,131	-	11,131	-	-	114,815	5,462
320	Water Treatment Equipment	5.00%	3.33%	830	391	-	-	-	-	-	830	42
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	-	-	-
320.2	Chemical Solution Feeders	5.00%	20.00%	-	-	-	-	-	-	-	-	-
330	Distribution Reservoirs & Standpipe	5.00%	2.22%	94,798	44,662	1,546	-	1,546	-	-	96,344	4,779
330.1	Storage tanks	5.00%	2.22%	-	-	-	-	-	-	-	-	-
330.2	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-	-	-
331	Transmission and Distribution Mains	5.00%	2.00%	820,492	386,729	78,445	-	78,445	-	-	898,937	42,989
333	Services	5.00%	3.33%	2,427	1,144	-	-	-	-	-	2,427	121
334	Meters	5.00%	6.33%	100,610	47,421	-	-	-	-	-	100,610	5,031
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	1,137	536	-	-	-	-	-	1,137	57
339	Other Plant and Miscellaneous Equipment	5.00%	6.67%	-	-	-	-	-	-	-	-	-
340	Office Furniture and Fixtures	5.00%	6.67%	13,721	6,467	5,695	-	5,695	-	-	19,416	828
340.1	Computers and Software	5.00%	20.00%	-	-	-	-	-	-	-	-	-
341	Transportation Equipment	5.00%	20.00%	9,000	4,242	-	-	-	-	-	9,000	450
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	5.00%	2,592	1,222	-	-	-	-	-	2,592	130
346	Communications Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-	-
347	Miscellaneous Equipment	5.00%	10.00%	4,424	2,065	2,746	-	2,746	-	-	2,746	69
348	Other Tangible Plant	5.00%	10.00%	1	0	-	-	-	-	-	4,424	221
	Rounding								(1)			(0)

Plant Held for Future Use  
TOTAL WATER PLANT

1,460,921	688,486	99,563	99,563	(1)	1,560,483	75,524
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See B-2, page 3.6 See B-2, page 3.9



Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.6

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	2006 Plant Additions	2006 Plant Adjustments	Adjusted Plant Additions	2006 Plant Retirements	2006 Salvage A/D Only	September 2006 Plant Balance	2006 Deprec.
301	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-
302	Franchise Cost	0.00%	0.00%	-	-	-	-	-	217	-
303	Land and Land Rights	0.00%	0.00%	-	-	-	-	-	12,229	407
304	Structures and Improvements	5.00%	3.33%	-	-	-	-	-	-	-
305	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-
306	Lake River and Other Intakes	5.00%	2.50%	-	-	-	-	-	-	-
307	Wells and Springs	5.00%	3.33%	-	-	-	-	-	314,484	10,472
308	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-
309	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-
310	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-
311	Electric Pumping Equipment	5.00%	12.50%	-	-	-	-	-	119,815	14,977
320	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	1,740	58
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	-
320.2	Chemical Solution Feeders	5.00%	20.00%	-	-	-	-	-	-	-
330	Distribution Reservoirs & Standpipe	5.00%	2.22%	-	-	-	-	-	99,896	2,218
330.1	Storage tanks	5.00%	2.22%	-	-	-	-	-	-	-
330.2	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-
331	Transmission and Distribution Mains	5.00%	2.00%	-	-	-	-	-	903,698	18,074
333	Services	5.00%	3.33%	-	-	-	-	-	2,427	81
334	Meters	5.00%	8.33%	808	-	808	-	-	101,418	8,414
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	-	-	-	-	-	1,137	76
339	Other Plant and Miscellaneous Equipment	5.00%	6.67%	-	-	-	-	-	22,618	1,509
340	Office Furniture and Fixtures	5.00%	6.67%	-	-	-	-	-	-	-
340.1	Computers and Software	5.00%	20.00%	-	-	-	-	-	27,292	5,458
341	Transportation Equipment	5.00%	20.00%	-	-	-	-	-	-	-
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	10.00%	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	5.00%	-	-	-	-	-	2,592	130
346	Communications Equipment	5.00%	10.00%	-	-	-	-	-	3,165	317
347	Miscellaneous Equipment	5.00%	10.00%	-	-	-	-	-	4,424	442
348	Other Tangible Plant	5.00%	10.00%	-	-	-	-	-	-	-
	Rounding			-	-	-	-	-	-	-

808	-	808	-	1,617,152	62,633
Plant Held for Future Use					868,274
TOTAL WATER PLANT					

Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.7

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	2007 Plant Additions	2007 Plant Adjustments	2007 Adjusted Plant Additions	2007 Plant Retirements	2007 Salvage A/D Only	September 2007 Plant Balance	2007 Deprec.
301	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-
302	Franchise Cost	0.00%	0.00%	-	-	-	-	-	-	-
303	Land and Land Rights	0.00%	0.00%	-	-	-	-	217	-	-
304	Structures and Improvements	5.00%	3.33%	-	-	-	-	12,229	407	-
305	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-
306	Lake River and Other Intakes	5.00%	2.50%	-	-	-	-	-	-	-
307	Wells and Springs	5.00%	3.33%	-	-	-	-	314,484	10,472	-
308	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-
309	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-
310	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-
311	Electric Pumping Equipment	5.00%	12.50%	-	-	-	-	119,815	14,977	-
320	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	1,740	58	-
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	-
320.2	Chemical Solution Feeders	5.00%	20.00%	-	-	-	-	-	-	-
330	Distribution Reservoirs & Standpipe	5.00%	2.22%	-	-	-	-	99,896	2,218	-
330.1	Storage Tanks	5.00%	2.22%	-	-	-	-	-	-	-
330.2	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-
331	Transmission and Distribution Mains	5.00%	2.00%	-	-	-	-	903,688	18,074	-
333	Services	5.00%	3.33%	-	-	-	-	2,427	81	-
334	Meters	5.00%	8.33%	-	-	-	-	101,418	8,448	-
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	-	-	-	-	1,137	76	-
339	Other Plant and Miscellaneous Equipment	5.00%	6.67%	-	-	-	-	-	-	-
340	Office Furniture and Fixtures	5.00%	6.67%	3,885	-	3,885	-	26,483	1,638	-
340.1	Computers and Software	5.00%	20.00%	-	-	-	(500)	-	-	-
341	Transportation Equipment	5.00%	20.00%	-	-	-	-	26,792	5,408	-
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	10.00%	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	5.00%	-	-	-	-	2,592	130	-
346	Communications Equipment	5.00%	10.00%	-	-	-	-	-	-	-
347	Miscellaneous Equipment	5.00%	10.00%	-	-	-	-	3,165	317	-
348	Other Tangible Plant	5.00%	10.00%	-	-	-	-	4,424	442	-
	Rounding			-	-	-	-	-	-	-
	Plant Held for Future Use			3,885	-	3,885	-	-	1,620,517	62,745
	TOTAL WATER PLANT			3,885	-	3,885	(500)	-	1,620,517	931,019

Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.8

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	2008 Plant Additions	2008 Plant Adjustments	Rebuttal Plant Adjustments	2008 Adjusted Additions	2008 Plant Retirements	2008 Salvage A/D Only	September 2008 Plant Balance	2008 Deprec.
301	Deaeriation	0.00%	0.00%	-	-	-	-	-	-	-	-
302	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-	-
303	Franchise Cost	0.00%	0.00%	-	-	-	-	-	-	217	-
304	Land and Land Rights	0.00%	0.00%	-	-	-	-	-	-	12,229	407
305	Structures and Improvements	5.00%	3.33%	-	-	-	-	-	-	-	-
306	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-	-
307	Lake River and Other Inakes	5.00%	2.50%	-	-	-	-	-	-	-	-
308	Wells and Springs	5.00%	3.33%	-	-	-	-	(5,390)	-	309,094	10,383
309	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-	-
310	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-	-
311	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
320	Electric Pumping Equipment	5.00%	12.50%	-	-	-	-	-	-	119,815	14,977
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	1,740	58
320.2	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	-	-
330	Chemical Solution Feeders	5.00%	20.00%	-	-	-	-	-	-	-	-
330.1	Distribution Reservoirs & Standpipe	5.00%	2.22%	-	-	-	-	-	-	99,896	2,218
330.2	Storage tanks	5.00%	2.22%	-	-	-	-	-	-	-	-
331	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-	-
332	Transmission and Distribution Mains	5.00%	2.00%	20,918	-	(20,918)	-	-	-	903,898	18,074
333	Services	5.00%	3.33%	-	-	-	-	-	-	2,427	81
334	Meters	5.00%	8.33%	-	-	-	-	-	-	101,418	8,448
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	-	-	-	-	-	-	1,137	76
338	Other Plant and Miscellaneous Equipment	5.00%	6.67%	-	-	-	-	-	-	-	-
340	Office Furniture and Fixtures	5.00%	6.67%	303	-	-	303	-	-	26,788	1,777
340.1	Computers and Software	5.00%	20.00%	-	-	-	-	-	-	-	-
341	Transportation Equipment	5.00%	20.00%	-	-	-	-	(3,500)	-	23,292	4,604
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	10.00%	-	-	-	-	-	-	2,592	130
346	Communications Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
347	Miscellaneous Equipment	5.00%	10.00%	-	-	-	-	-	-	3,165	317
348	Other Tangible Plant	5.00%	10.00%	-	-	-	-	-	-	4,424	442
	Rounding			-	-	-	-	-	-	-	-
	Plant Held for Future Use			-	-	-	-	-	-	-	-
	TOTAL WATER PLANT			21,221	-	(20,918)	303	(6,890)	-	1,611,930	61,980

Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.9

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	2009 Plant Additions	2009 Plant Adjustments	Rebuttal Plant Adjustments	2009 Adjusted Plant Additions	2009 Plant Retirements	2009 Salvage A/D Only	June 2009 Plant Balance	2009 Deprec.
301	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-	-
302	Franchise Cost	0.00%	0.00%	-	-	-	-	-	-	-	-
303	Land and Land Rights	0.00%	0.00%	-	-	-	-	217	-	12,229	305
304	Structures and Improvements	5.00%	3.33%	-	-	-	-	-	-	-	-
305	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-	-
306	Lake River and Other Intakes	5.00%	2.50%	-	-	-	-	-	-	-	-
307	Wells and Springs	5.00%	3.33%	-	-	-	-	-	-	309,094	7,720
308	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-	-
309	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-	-
310	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
311	Electric Pumping Equipment	5.00%	12.50%	-	31,523	-	31,523	(27,570)	-	123,768	9,840
320	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	1,740	43
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	1,977,069	24,689
320.2	Chemical Solution Feeders	5.00%	20.00%	2,162,894	-	(185,625)	1,977,069	-	-	-	-
330	Distribution Reservoirs & Standpipe	5.00%	2.22%	-	-	-	-	-	-	99,896	1,663
330.1	Storage tanks	5.00%	2.22%	-	-	-	-	-	-	-	-
330.2	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-	-
331	Transmission and Distribution Mains	5.00%	2.00%	-	31,523	-	-	-	-	903,688	13,555
333	Services	5.00%	3.33%	-	-	-	-	-	-	2,427	61
334	Meters	5.00%	6.33%	-	-	-	-	-	-	101,418	6,336
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	-	-	-	-	-	-	1,137	57
339	Other Plant and Miscellaneous Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
340	Office Furniture and Fixtures	5.00%	6.67%	1,520	-	-	1,520	-	-	28,306	1,378
340.1	Computers and Software	5.00%	20.00%	-	-	-	-	-	-	-	-
341	Transportation Equipment	5.00%	20.00%	-	-	-	-	-	-	23,282	3,500
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	5.00%	-	-	-	-	-	-	2,582	97
346	Communications Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-
347	Miscellaneous Equipment	5.00%	10.00%	-	-	-	-	-	-	3,165	237
348	Other Tangible Plant	5.00%	10.00%	-	-	-	-	-	-	4,424	348
	Rounding			-	-	-	-	-	-	-	-
	Plant Held for Future Use										
	TOTAL WATER PLANT			2,164,214	31,523	(185,625)	2,010,112	(27,570)	-	3,594,472	69,830

Plant Held for Future Use  
TOTAL WATER PLANT

Las Quintas Serenas Water Company  
Plant Additions and Retirements

Exhibit  
Rebuttal Schedule B-2  
Page 3.10

Account No.	Description	Prior Deprec. Rate	Current Deprec. Rate	Year End Accumulated Depreciation by Account								
				Sep 2003	Sep 2004	Sep 2005	Sep 2006	Sep 2007	Sep 2008	June 2009		
301	Organization Cost	0.00%	0.00%	-	-	-	-	-	-	-	-	-
302	Franchise Cost	0.00%	0.00%	-	-	-	-	-	-	-	-	-
303	Land and Land Rights	0.00%	0.00%	-	-	-	-	-	-	-	-	-
304	Structures and Improvements	5.00%	3.33%	3,110	3,440	3,754	4,161	4,568	4,975	5,281	-	-
305	Collecting and Impounding Res.	5.00%	2.50%	-	-	-	-	-	-	-	-	-
306	Lake River and Other Intakes	5.00%	2.50%	-	-	-	-	-	-	-	-	-
307	Wells and Springs	5.00%	3.33%	141,585	156,604	166,842	177,314	187,787	192,779	200,489	-	-
308	Infiltration Galleries and Tunnels	5.00%	6.67%	-	-	-	-	-	-	-	-	-
309	Supply Mains	5.00%	2.00%	-	-	-	-	-	-	-	-	-
310	Power Generation Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-	-
311	Electric Pumping Equipment	5.00%	12.50%	48,870	54,333	68,997	83,974	98,951	113,928	96,198	-	-
320	Water Treatment Equipment	5.00%	3.33%	391	433	476	533	591	649	683	-	-
320.1	Water Treatment Equipment	5.00%	3.33%	-	-	-	-	-	-	-	-	-
320.2	Chemical Solution Feeders	5.00%	20.00%	-	-	-	-	-	-	-	-	-
330	Distribution Reservoirs & Standpipe	5.00%	2.22%	44,682	49,460	51,639	53,856	56,074	58,292	59,955	-	-
330.1	Storage tanks	5.00%	2.22%	-	-	-	-	-	-	-	-	-
330.2	Pressure Tanks	5.00%	5.00%	-	-	-	-	-	-	-	-	-
331	Transmission and Distribution Mains	5.00%	2.00%	388,729	429,715	447,742	465,815	483,889	501,963	515,519	-	-
333	Services	5.00%	3.33%	1,144	1,265	1,346	1,427	1,508	1,589	1,649	-	-
334	Meters	5.00%	6.33%	47,421	52,452	60,833	69,247	77,695	86,143	92,479	-	-
335	Hydrants	5.00%	2.00%	-	-	-	-	-	-	-	-	-
336	Backflow Prevention Devices	5.00%	6.67%	536	593	669	744	820	896	853	-	-
339	Other Plant and Miscellaneous Equipment	5.00%	6.67%	-	-	-	-	-	-	-	-	-
340	Office Furniture and Fixtures	5.00%	6.67%	6,467	7,298	8,697	10,206	11,844	13,620	14,998	-	-
340.1	Computers and Software	5.00%	20.00%	-	-	-	-	-	-	-	-	-
341	Transportation Equipment	5.00%	20.00%	4,242	4,692	8,321	13,780	18,688	18,792	23,292	-	-
342	Stores Equipment	5.00%	4.00%	-	-	-	-	-	-	-	-	-
343	Tools and Work Equipment	5.00%	5.00%	-	-	-	-	-	-	-	-	-
344	Laboratory Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-	-
345	Power Operated Equipment	5.00%	5.00%	1,222	1,351	1,481	1,611	1,740	1,870	1,967	-	-
346	Communications Equipment	5.00%	10.00%	-	-	-	-	-	-	-	-	-
347	Miscellaneous Equipment	5.00%	10.00%	-	69	364	881	997	1,314	1,551	-	-
348	Other Tangible Plant	5.00%	10.00%	2,085	2,306	2,749	3,191	3,634	4,076	4,424	-	-
	Rounding			0	-	-	-	-	-	-	-	-
				688,486	764,010	823,909	886,541	948,787	1,001,887	1,044,147	-	-
	Plant Held for Future Use			-	-	-	-	-	-	-	-	-
	TOTAL WATER PLANT			688,486	764,010	823,909	886,541	948,787	1,001,887	1,044,147	-	-

Line No.	Accumulated Depreciation	A	B	C	D	E	Rebuttal Adjusted Accum. Depr.
		Plant Retirements	Debt Issuance Costs	Not Used and Useful Plant	Reconciliation To Computed A/D	Intentionally Left Blank	
1							
2							
3	Acct. No.	Adjusted Accum. Depr.					
4	301	Organization Cost					
5	302	Franchise Cost					
6	303	Land and Land Rights					
7	304	Structures and Improvements					5,281
8	305	Collecting and Impounding Res.					
9	306	Lake River and Other Intakes					
10	307	Wells and Springs					200,499
11	308	Infiltration Galleries and Tunnels					
12	309	Supply Mains					
13	310	Power Generation Equipment					
14	311	Electric Pumping Equipment	(7,488)		(2,870)		96,198
15	312	Water Treatment Equipment					693
16	313	Water Treatment Plant		(2,318)			24,689
17	314	Chemical Solution Feeders					
18	315	Dist. Reservoirs & Standpipe					59,955
19	316	Storage tanks					
20	317	Pressure Tanks					
21	318	Trans. and Dist. Mains					
22	319	Services		(523)			515,519
23	320	Meters					1,649
24	321	Hydrants					92,479
25	322	Backflow Prevention Devices					
26	323	Other Plant and Misc. Equip.					953
27	324	Office Furniture and Fixtures					
28	325	Computers and Software					14,998
29	326	Transportation Equipment					
30	327	Stores Equipment					23,292
31	328	Tools and Work Equipment					
32	329	Laboratory Equipment					
33	330	Power Operated Equipment					1,967
34	331	Communications Equipment					
35	332	Miscellaneous Equipment					1,551
36	333	Other Tangible Plant					4,424
37	334						
38	335						
39	336						
40	337						
41	338						
42	339						
43	340						
44	341						
45	342						
46	343						
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206	503						
207	504						
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211	508						
212	509						
213	510						
214	511						
215	512						
216	513						

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 2 - A

Exhibit  
Rebuttal Schedule B-2  
Page 4.1  
Witness: Bourassa

Line  
No.

1	<u>Plant Retirement</u>		
2			
3	Acct 331 - Pumping Equipment	Pump Bowl Assembly	\$ (7,488)
4			
5			
6	Adjustment to A/D Acct 331 - Pumping Equipment		<u>\$ (7,488)</u>
7			
8			
9			
10			
11			
12			
13	<u>SUPPORTING SCHEDULES</u>		
14	Rebuttal B-2, page 3.1		
15			
16			
17			
18			
19			
20			

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 2 - B

Exhibit  
Rebuttal Schedule B-2  
Page 4.2  
Witness: Bourassa

Line

No.

1	<u>Remove Debt Issuance Costs</u>	
2		
3	Acct 320.1 - Water Treatment Equipment added in 2009	\$ (185,625)
4		
5	Depreciation (\$185,625 times 3.33% times 1/2 times 3/4)	\$ (2,318)
6		
7	Adjustment to A/D for Acct 320.1 - Water Treatment Equipment	<u>\$ (2,318)</u>
8		
9		
10		
11		
12		
13		
14	<u>SUPPORTING SCHEDULES</u>	
15	Rebuttal B-2, page 3.2	
16		
17		
18		
19		
20		
21		

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 2 - C

Exhibit  
Rebuttal Schedule B-2  
Page 4.3  
Witness: Bourassa

Line

No.

1	<u>Not Used and Useful Plant</u>		
2			
3	Acct 311 - Electric Pumping Equipment		
4	1996 Well #6 - Natural gas well engine fully depreciated	\$ (10,090)	
5	1997 Natural gas well engine - spare - fully depreciated	<u>(9,992)</u>	
6	Total Depreciation Acct 311 - Electric Pumping Equipment		\$ (20,082)
7			
8	Acct 331 - Transmission and Distribution Mains		
9	2008 Sun Cruz Meadows Subdivision	\$ (20,918)	
10	Depreciation (\$20,918 times 2% times 1.25 years)		\$ (523)
11			
12			
13	Total A/D for Plant Not Used and Useful		\$ (20,605)
14			
15			
16	Adjustment to A/D for plant not used and useful		<u>\$ (20,605)</u>
17			
18			
19			
20	<u>SUPPORTING SCHEDULES</u>		
21	Rebuttal B-2, page 3.3		
22			

Las Quintas Serenas Water Company  
Test Year Ended June 30, 2009  
Original Cost Rate Base Proforma Adjustments  
Adjustment Number 3

Exhibit  
Rebuttal Schedule B-2  
Page 5  
Witness: Bourassa

Line

No.

1	<u>Advances-in-aid of Construction ("AIAC")</u>	
2		
3	Remove AIAC funding for not used and useful plant	
4	Sun Cruz Meadows Subdivision	\$ (20,918)
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16	Adjustment to AIAC for plant not used and useful	<u>\$ (20,918)</u>
17		
18		
19		
20	<u>SUPPORTING SCHEDULES</u>	
21	Rebuttal B-2, page 3.3	
22		



Line No.		Federal	State
1			
2	<sup>1</sup> Adjusted per Rebuttal Schedule B-2, page 2		
3			
4	<sup>2</sup> Tax Basis as of June 30, 2009		
5	Unadjusted Cost Basis per 2009 Tax Return (Fiscal Year Ended 09/30/2009)	\$ 3,357,452	\$ 3,357,452
6	Adjustments:		
7			
8	Assets added after 6/30/2009, not on books but on tax	\$ -	\$ -
9	Tax Accumulated Depreciation through 9/30/2008	\$ (758,969)	\$ (742,979)
10	Section 179 deductions through 9/30/2008	\$ (105,561)	\$ (105,561)
11	Tax Depreciation Including Bonus Depr. per 2009 Tax Return	\$ 1,090,620	\$ 78,051
12	Less: Tax Depreciation related to assets added after 6/30/2009		
13	Tax Depreciation Including Bonus Depr. per 2009 Tax Return	\$ 1,090,620	\$ 78,051
14	Factor (9 months through 6/30/2009)	0.75	0.75
15	Adjusted 2009 Tax Depreciation Including Bonus Depr.	\$ (817,965)	\$ (58,538)
16	Remove Plant Retirements per B-2 adjustment 1--A	\$ (7,488)	\$ (7,488)
17	Tax Depr on retired plant (\$7,488 times 4% times 11.25 yrs)	\$ 3,370	\$ 3,370
18	Remove Not Used and Useful Plant per B-2 adjustment 1-C	\$ (41,000)	\$ (41,000)
19	Tax Depr on not used and useful plant - Natural gas Engine Generator per Depr Rpt	\$ 5,314	\$ 5,314
20	Tax Depr on not used and useful plant - Natural gas Engine Generator per Depr Rpt	\$ 4,996	\$ 4,996
21	Tax Depr on not used and useful plant - Trans and Dist Mains (Fed - \$20,198 times 4% times .25 yrs plus \$20,918 times 50%; State - \$20,918 times 4% times .5 times .75)	\$ 10,762	\$ 303
22			
23			
24	Net Tax Value	\$ 21,072	\$ 10,613
25		\$ 1,650,911	\$ 2,415,868
26			
27	<sup>3</sup> Impact of change to probability of realization		
28			
29	Gross CIAC per B-2	\$ 333,555	
30	A.A per B-2	(83,901)	
31	Net CIAC per B-2	\$ 249,654	
32	Unrealized AIAC Component		
33	AIAC	\$ 351,405	
34	Unrealized AIAC Component % (1-Realized AIAC Component)	70.0%	
35	Addition to CIAC	\$ 245,984	
36	Total CIAC	\$ 495,638	
37			
38	<sup>4</sup> AIAC (including impact of change in probability of realization)		
39	AIAC per B-2 before unrealized portion	\$ 351,405	
40	Less: Unrealized AIAC (from Note 4, above)	\$ (245,984)	
41	Net realizable AIAC	\$ 105,422	
42			
43			
44			
45			

Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Original Cost Rate Base Proforma Adjustments  
 Adjustment 4 (footnotes)

Line No.					
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<sup>5</sup> NOL from Bonus Depreciation

5	Net Income 12 months ended 6/30/2009 (per E-1 schedule)				
6	Plus: Book Depreciation (07/01/2008 to 6/30/2009)				
7	Book Depreciation 12 months ended 09/30/2008	\$	35,894		
8	Factor (3 months 7/1/2008 to 9/30/2008)		0.333	\$	11,953
9					
10	Book Depreciation 12 months ended 09/30/2009	\$	28,497		
11	Factor (9 months 10/01/2008 to 6/30/2009)		0.75	\$	21,373
12					

Less: Tax Depreciation (07/01/2008 to 6/30/2009)  
 Tax Depreciation and Section 179 (10/01/2007 to 9/30/2008)  
 Factor (3 months 7/1/2008 to 9/30/2008)

13		\$	35,759		
14			0.333		
15				\$	(11,908)
16					
17	Adjusted Tax Depreciation (10/01/2008 to 9/30/2009) from above	\$	1,090,620		
18	Factor (9 months 10/01/2008 to 6/30/2009)		0.75	\$	(817,965)
19					

NOL from Bonus Depreciation

20					\$	(711,562)
21						

Less: NOL Carry back to prior years

22					\$	222,553
23						

NOL Carryforward from bonus depreciation

24					\$	(489,009)
25						

<sup>6</sup> Effective tax rates Per C-3 schedule

26						
27						
28						
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**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Computation of Working Capital

Exhibit  
 Rebuttal Schedule B-5  
 Page 1  
 Witness: Bourassa

Line			
<u>No.</u>			
1	Cash Working Capital (1/8 of Allowance		
2	Operation and Maintenance Expense)	\$	30,375
3	Pumping Power (1/24 of Pumping Power)		3,104
4	Purchased Water (1/24 of Purchased Water)		-
5	Materials and Supplies		4,220
6	Prepays		1,583
7			
8			
9	Total Working Capital Allowance	<u>\$</u>	<u>39,282</u>
10			
11			
12	Working Capital Requested	<u>\$</u>	<u>-</u>
13			
14			
15	<u>SUPPORTING SCHEDULES:</u>	<u>RECAP SCHEDULES:</u>	
16	Rebuttal C-1	Rebuttal B-1	
17	E-1		
18			Adjusted
19	<u>Cash Working Capital Detail</u>		<u>Test Year Results</u>
20			
21	Total Operating Expense	\$	435,901
22	Less:		
23	Income Tax		(19,507)
24	Property Tax		26,528
25	Depreciation		111,381
26	Purchased Water		-
27	Pumping Power		74,502
28	Allowable Expenses	<u>\$</u>	<u>242,997</u>
29	1/8 of allowable expenses	<u>\$</u>	<u>30,375</u>
30			
31			

Las Quintas Serenas Water Company  
Test Year Ended June 30, 2009  
Income Statement

Exhibit  
Rebuttal Schedule C-1  
Page 1  
Witness: Bourassa

Line No.		Test Year Adjusted Results	Adjustment	Test Year Adjusted Results	Proposed Rate Increase	Adjusted with Rate Increase
1	<b>Revenues</b>					
2	Metered Water Revenues	\$ 481,492	\$ -	\$ 481,492	\$ 196,777	\$ 678,269
3	Unmetered Water Revenues	-	-	-		-
4	Other Water Revenues	6,778	-	6,778		6,778
5		<u>\$ 488,270</u>	<u>\$ -</u>	<u>\$ 488,270</u>	<u>\$ 196,777</u>	<u>\$ 685,047</u>
6	<b>Operating Expenses</b>					
7	Salaries and Wages	\$ 150,775	-	\$ 150,775		\$ 150,775
8	Purchased Water	-	-	-		-
9	Purchased Power	74,502	-	74,502		74,502
10	Fuel for Power Production	4,217	-	4,217		4,217
11	Chemicals	765	-	765		765
12	Materials & Supplies	21,840	-	21,840		21,840
13	Outside Services	-	-	-		-
14	Outside Services- Legal	-	-	-		-
15	Outside Services- Other	6,568	-	6,568		6,568
16	Water Testing	7,408	(3,161)	4,247		4,247
17	Equipment Rental	-	-	-		-
18	Rents	11,874	-	11,874		11,874
19	Transportation Expenses	7,012	-	7,012		7,012
20	Insurance - General Liability	2,825	-	2,825		2,825
21	Insurance - Health and Life	-	-	-		-
22	Reg. Comm. Exp.	-	-	-		-
23	Reg. Comm. Exp. - Rate Case	26,667	-	26,667		26,667
24	Miscellaneous Expense	6,177	-	6,177		6,177
25	Bad Debt Expense	31	-	31		31
26	Depreciation Expense	117,586	(6,205)	111,381		111,381
27	Taxes Other Than Income	-	-	-		-
28	Property Taxes	26,078	450	26,528		26,528
29	Income Tax	(23,603)	4,097	(19,507)	60,359	40,852
30	<b>Total Operating Expenses</b>	<u>\$ 440,721</u>	<u>\$ (4,819)</u>	<u>\$ 435,901</u>	<u>\$ 60,359</u>	<u>\$ 496,260</u>
31	<b>Operating Income</b>	<u>\$ 47,550</u>	<u>\$ 4,819</u>	<u>\$ 52,369</u>	<u>\$ 136,418</u>	<u>\$ 188,787</u>
32	<b>Other Income (Expense)</b>					
33	Interest Income	-	-	-		-
34	Other income (loss)	-	-	-		-
35	Interest Expense	(103,237)	6,781	(96,456)		(96,456)
36	Other Expense	-	-	-		-
37						
38	<b>Total Other Income (Expense)</b>	<u>\$ (103,237)</u>	<u>\$ 6,781</u>	<u>\$ (96,456)</u>	<u>\$ -</u>	<u>\$ (96,456)</u>
39	<b>Net Profit (Loss)</b>	<u>\$ (55,687)</u>	<u>\$ 11,600</u>	<u>\$ (44,087)</u>	<u>\$ 136,418</u>	<u>\$ 92,331</u>

41 SUPPORTING SCHEDULES:  
42 Rebuttal C-1, page 2  
43

RECAP SCHEDULES:  
Rebuttal A-1

**Las Quintas Serenas Water Company**  
**Test Year Ended June 30, 2009**  
**Income Statement**

Exhibit  
 Rebuttal Schedule C-1  
 Page 2  
 Witness: Bourassa

Line No.	Revenues	1	2	3	4	5	Test Year Adjusted Results	Proposed Rate Increase	Adjusted with Rate Increase
1	Revenues								
2	Metered Water Revenues	\$ 481,492					\$ 481,492	\$ 196,777	\$ 678,269
3	Unmetered Water Revenues	-					-	-	-
4	Other Water Revenues	6,778					6,778		6,778
5		\$ 488,270	\$ -	\$ -	\$ -	\$ -	\$ 488,270	\$ 196,777	\$ 685,047
6	Operating Expenses								
7	Salaries and Wages	\$ 150,775					\$ 150,775	\$ -	\$ 150,775
8	Purchased Water	-					-	-	-
9	Purchased Power	74,502					74,502		74,502
10	Fuel for Power Production	4,217					4,217		4,217
11	Chemicals	765					765		765
12	Materials & Supplies	21,840					21,840		21,840
13	Outside Services	-					-	-	-
14	Outside Services- Legal	-					-	-	-
15	Outside Services- Other	6,568					6,568		6,568
16	Water Testing	7,408		(3,161)			4,247		4,247
17	Equipment Rental	-					-	-	-
18	Rents	11,874					11,874		11,874
19	Transportation Expenses	7,012					7,012		7,012
20	Insurance - General Liability	2,825					2,825		2,825
21	Insurance - Health and Life	-					-	-	-
22	Reg. Comm. Exp.	-					-	-	-
23	Reg. Comm. Exp. - Rate Case	26,667					26,667		26,667
24	Miscellaneous Expense	6,177					6,177		6,177
25	Bad Debt Expense	31					31		31
26	Depreciation Expense	117,586	(6,205)				111,381		111,381
27	Taxes Other Than Income	-					-	-	-
28	Property Taxes	26,078	450				26,528		26,528
29	Income Tax	(23,603)				4,097	(19,507)		40,852
30	Total Operating Expenses	\$ 440,721	\$ (6,205)	\$ (3,161)	\$ -	\$ 4,097	\$ 435,901	\$ 60,359	\$ 496,260
31	Operating Income	\$ 47,550	\$ 6,205	\$ 3,161	\$ -	\$ (4,097)	\$ 52,369	\$ 136,418	\$ 188,787
32	Other Income (Expense)	-					-	-	-
33	Interest Income	-					-	-	-
34	Other income (loss)	-					-	-	-
35	Interest Expense	(103,237)			6,781		(96,456)		(96,456)
36	Other Expense	-					-	-	-
37									
38	Total Other Income (Expense)	\$ (103,237)	\$ -	\$ -	\$ 6,781	\$ -	\$ (96,456)	\$ -	\$ (96,456)
39	Net Profit (Loss)	\$ (55,687)	\$ 6,205	\$ 3,161	\$ 6,781	\$ (4,097)	\$ (44,087)	\$ 136,418	\$ 92,331

RECAP SCHEDULES:  
 Rebuttal C-1, page 1

SUPPORTING SCHEDULES:  
 Rebuttal C-2



**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Adjustments to Revenues and Expenses  
 Adjustment Number 1

Exhibit  
 Rebuttal Schedule C-2  
 Page 2  
 Witness: Bourassa

Line No.	Acct.	Description	Adjusted Original Cost	Proposed Rates	Depreciation Expense
1		<u>Depreciation Expense</u>			
2					
3					
4	<u>No.</u>	<u>Description</u>			
5	301	Organization Cost	-	0.00%	-
6	302	Franchise Cost	-	0.00%	-
7	303	Land and Land Rights	217	0.00%	-
8	304	Structures and Improvements	12,229	3.33%	407
9	305	Collecting and Impounding Res.	-	2.50%	-
10	306	Lake River and Other Intakes	-	2.50%	-
11	307	Wells and Springs	309,094	3.33%	10,293
12	308	Infiltration Galleries and Tunnels	-	6.67%	-
13	309	Supply Mains	-	2.00%	-
14	310	Power Generation Equipment	-	5.00%	-
15	311	Electric Pumping Equipment	123,768	12.50%	15,471
16	320	Water Treatment Equipment	1,740	3.33%	58
17	320.1	Water Treatment Plant	1,977,069	3.33%	65,836
18	320.2	Chemical Solution Feeders	-	20.00%	-
19	330	Dist. Reservoirs & Standpipe	99,896	2.22%	2,218
20	330.1	Storage tanks	-	2.22%	-
21	330.2	Pressure Tanks	-	5.00%	-
22	331	Trans. and Dist. Mains	903,698	2.00%	18,074
23	333	Services	2,427	3.33%	81
24	334	Meters	101,418	8.33%	8,448
25	335	Hydrants	-	2.00%	-
26	336	Backflow Prevention Devices	1,137	6.67%	76
27	339	Other Plant and Misc. Equip.	-	6.67%	-
28	340	Office Furniture and Fixtures	28,306	6.67%	1,888
29	340.1	Computers and Software	-	20.00%	-
30	341	Transportation Equipment	23,292	20.00%	-
31	342	Stores Equipment	-	4.00%	-
32	343	Tools and Work Equipment	-	5.00%	-
33	344	Laboratory Equipment	-	10.00%	-
34	345	Power Operated Equipment	2,592	5.00%	130
35	346	Communications Equipment	-	10.00%	-
36	347	Miscellaneous Equipment	3,165	10.00%	317
37	348	Other Tangible Plant	4,424	10.00%	-
38					
39		SUBTOTAL	\$ 3,594,472		\$ 123,296
40					
41					
42					
43		Less: Amortization of Contributions	\$ 333,555	3.5721%	\$ (11,915)
44					
45					
46		Total Depreciation Expense			\$ 111,381
47					
48		Test Year Depreciation Expense			117,586
49					
50		Increase (decrease) in Depreciation Expense			(6,205)
51					
52		Adjustment to Revenues and/or Expenses			\$ (6,205)
53					

SUPPORTING SCHEDULE

55 Rebuttal B-2, page 1  
 56 Rebuttal B-2, page 3

\* Fully Depreciated

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Adjustment to Revenues and Expenses  
 Adjustment Number 2

Exhibit  
 Rebuttal Schedule C-2  
 Page 3  
 Witness: Bourassa

Line No.			
1	<u>Property Taxes:</u>		
2			
3	Adjusted Revenues in year ended 6/30/09	\$	488,270
4	Adjusted Revenues in year ended 6/30/09		488,270
5	Proposed Revenues		<u>685,047</u>
6	Average of three year's of revenue	\$	553,863
7	Average of three year's of revenue, times 2	\$	1,107,725
8	Add:		
9	Construction Work in Progress at 10%	\$	-
10	Deduct:		
11	Book Value of Transportation Equipment		<u>-</u>
12			
13	Full Cash Value	\$	1,107,725
14	Assessment Ratio		<u>21%</u>
15	Assessed Value		232,622
16	Property Tax Rate		11.4039%
17			
18	Property Tax		26,528
19	Plus: Tax on Parcels		0
20			
21	Total Property Tax at Proposed Rates	\$	<u>26,528</u>
22	Adjusted Property Taxes per Direct		<u>26,078</u>
23	Change in Property Taxes	\$	<u><u>450</u></u>
24			
25			
26	Adjustment to Revenues and/or Expenses	\$	<u><u>450</u></u>
27			
28			

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
**ADJUSTMENTS TO REVENUES AND/OR EXPENSES**  
Adjustment Number 3

Exhibit  
Rebuttal Schedule C-2  
Page 4  
Witness: Bourassa

Line

No.

1	<u>Water Testing Expense</u>		
2			
3	Water Testing Expense per Staff	\$	4,247
4			
5	Test Water Tear Testing Expense		<u>7,408</u>
6			
7	Increase (decrease) in Water Testing Expense	\$	(3,161)
8			
9			
10			
11			
12			
13			
14			
15	Adjustment to Revenue and/or Expense	\$	<u>(3,161)</u>
16			
17			
18			
19			
20	<u>SUPPORTING SCHEDULE</u>		
21	Staff Schedule CSB-13		
22			
23			
24			

Las Quintas Serenas Water Company  
Test Year Ended June 30, 2009  
Adjustment to Revenues and Expenses  
Adjustment Number 4

Exhibit  
Rebuttal Schedule C-2  
Page 5  
Witness: Bourassa

Line  
No.

1	<u>Security Deposit Interest</u>		
2			
3			
4	Test Year Security Deposits included in rate base	\$	7,475
5	Interest rate		6.00%
6	Annual Interest Expense	\$	449
7			
8	Increase (decrease) in interest expense	<u>\$</u>	<u>449</u>
9			
10			
11	Adjustment to Revenue and/or Expense	<u>\$</u>	<u>449</u>
12			
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Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Adjustment to Revenues and Expenses  
 Adjustment Number 4

Exhibit  
 Rebuttal Schedule C-2  
 Page 5  
 Witness: Bourassa

Line  
No.

1	<u>Interest Synchronization</u>				
2					
3					
4	Fair Value Rate Base		\$	1,999,859	
5	Weighted Cost of Debt			4.82%	
6	Interest Expense		\$	96,456	
7					
8	Test Year Interest Expense		\$	<u>103,237</u>	
9					
10	Increase (decrease) in Interest Expense			(6,781)	
11					
12					
13					
14	Adjustment to Revenue and/or Expense		\$	<u>6,781</u>	
15					
16					
17	<u>Weighted Cost of Debt Computation</u>				
18					
19		<u>Amount</u>	<u>Percent</u>	<u>Cost</u>	<u>Weighted Cost</u>
20	Debt	\$ 1,725,175	67.93%	7.10%	4.82%
21	Equity	\$ 814,405	32.07%	14.40%	4.62%
22	Total	\$ 2,539,580	100.00%		9.44%
23					
24					

**Las Quintas Serenas Water Company**  
**Test Year Ended June 30, 2009**  
**Adjustment to Revenues and/or Expenses**  
**Adjustment Number 5**

Exhibit  
 Rebuttal Schedule C-2  
 Page 6  
 Witness: Bourassa

Line No.		Adjusted with Rate Increase	
1	<u>Income Tax Computation</u>		
2			
3			
4			
5			
6			
7	Taxable Income	\$ (63,594)	\$ 133,183
8			
9	Taxable Income	<u>\$ (63,594)</u>	<u>\$ 133,183</u>
10			
11			
12			
13	Income Before Taxes		<u>\$ 133,183</u>
14			
15	Arizona Income Before Taxes		\$ 133,183
16			
17	Less Arizona Income Tax		<u>\$ 9,280</u>
18	Rate =	6.97%	
19	Arizona Taxable Income		\$ 123,903
20			
21	Arizona Income Taxes		\$ 9,280
22			
23	Federal Income Before Taxes		\$ 133,183
24			
25	Less Arizona Income Taxes		<u>\$ 9,280</u>
26			
27	Federal Taxable Income		<u>\$ 123,903</u>
28			
29			
30			
31	FEDERAL INCOME TAXES:		
32	15% BRACKET		\$ 7,500
33	25% BRACKET		\$ 6,250
34	34% BRACKET		\$ 8,500 Federal
35	39% BRACKET		\$ 9,322 Effective
36	34% BRACKET		\$ - Tax
37			Rate
38	Federal Income Taxes		<u>\$ 31,572</u> 23.71%
39			
40			
41	Total Income Tax		<u>\$ 40,852</u>
42			
43	Overall Tax Rate		<u>30.67%</u>
44			
45	Income Tax at Proposed Rates Effective Rate	<u>\$ (19,507)</u>	
46			

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Computation of Gross Revenue Conversion Factor

Exhibit  
 Schedule C-3  
 Page 1  
 Witness: Bourassa

Line No.	<u>Description</u>	Percentage of Incremental Gross <u>Revenues</u>
1	Federal Income Taxes	23.71%
2		
3	State Income Taxes	6.97%
4		
5	Other Taxes and Expenses	0.00%
6		
7		
8	Total Tax Percentage	30.67%
9		
10	Operating Income % = 100% - Tax Percentage	69.33%
11		
12		
13		
14		
15	<u>1</u> = Gross Revenue Conversion Factor	
16	Operating Income %	1.4425
17		
18	<u>SUPPORTING SCHEDULES:</u>	<u>RECAP SCHEDULES:</u>
19		Rebuttal A-1
20		



Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Analysis of Average Bill by Detailed Class

Exhibit  
 Rebuttal Schedule H-2  
 Page 1  
 Witness: Bourassa

Line No.	Meter Size and Class	(a)	Average Consumption	Average Bill		Proposed Increase	
		Average Number of Customers at 6/30/2009		Present Rates	Proposed Rates	Dollar Amount	Percent Amount
1	5/8x3/4 Inch	820	10,768	\$ 32.95	\$ 43.84	10.89	33.05%
2	3/4 Inch	6	15,598	56.69	68.13	11.44	20.18%
3	1 Inch	28	16,842	72.79	89.70	16.91	23.23%
4	1.5 Inch	7	52,477	172.19	225.19	53.00	30.78%
5	2 Inch	4	153,057	337.57	564.63	227.06	67.26%
6	4 Inch	2	401,611	971.37	1,537.66	566.29	58.30%
7	Subtotal	<u>867</u>					
8							
9							
10	Standpipe	156	11,823	\$ 34.27	\$ 47.16	12.90	37.64%
11	Fire Sprinkler	4	-	\$ 10.00	\$ 10.00	-	0.00%
12	Subtotal	<u>160</u>					
13							
14	Totals	<u><u>1,026</u></u>					

(a) Average number of customers of less than one (1), indicates that less than 12 bills were issued during the year.

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Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Analysis of Average Bill by Detailed Class

Exhibit  
 Rebuttal Schedule H-2  
 Page 2  
 Witness: Bourassa

Line No.	Meter Size and Class	(a)	Average Consumption	Median Bill		Proposed Increase	
		Average Number of Customers at 6/30/2009		Present Rates	Proposed Rates	Dollar Amount	Percent Amount
1	5/8x3/4 Inch	820	10,768	\$ 30.35	\$ 38.04	7.69	25.35%
2	3/4 Inch	6	15,598	55.43	64.88	9.46	17.06%
3	1 Inch	28	16,842	67.80	79.47	11.67	17.21%
4	1.5 Inch	7	52,477	153.82	186.04	32.22	20.95%
5	2 Inch	4	153,057	206.37	253.11	46.75	22.65%
6	4 Inch	2	401,611	911.70	1,385.04	473.34	51.92%
7	Subtotal	867					
8							
9							
10	Standpipe	156	11,823	\$ 34.27	\$ 47.16	\$ 12.90	37.64%
11	Fire Sprinkler	4	-	-	-	-	0.00%
12	Subtotal	160					
13							
14	Totals	1,026					

(a) Average number of customers of less than one (1), indicates that less than 12 bills were issued during the year.

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**Las Quintas Serenas Water Company**  
**Test Year Ended June 30, 2009**  
**Present and Proposed Rates**

Line No.	Customer Classification and Meter Size	Present Rates	Proposed Rates	Dollar Change	Percentage Increase
1					
2					
3					
4	<b>Monthly Usage Charge for:</b>				
5	<u>Residential, Commercial, Irrigation, Resale and Miscellaneous Customers</u>				
6	5/8 x 3/4 Inch	\$ 10.00	\$ 20.00	\$ 10.00	100.00%
7	3/4 Inch	22.50	30.00	7.50	33.33%
8	1 Inch	25.00	50.00	25.00	100.00%
9	1 1/2 Inch	55.00	100.00	45.00	81.82%
10	2 Inch	70.00	160.00	90.00	128.57%
11	3 Inch	125.00	320.00	195.00	156.00%
12	4 Inch	225.00	500.00	275.00	122.22%
13	6 Inch	350.00	1,000.00	650.00	185.71%
14					
15	Standpipe	10.10	20.20	650.00	100.00%
16					
17	Fire Sprinkler Connection, less than 6 inch	10.00	10.00		
18	Fire Sprinkler Connection, larger than 6 inch	15.00	15.00		
19					
20					
21					
22					
23	Arsenic Remedial Surcharge				
24	5/8 x 3/4 Inch	\$ 11.37	\$ -	\$ (11.37)	-100.00%
25	3/4 Inch	17.05	-	(17.05)	-100.00%
26	1 Inch	28.42	-	(28.42)	-100.00%
27	1 1/2 Inch	56.84	-	(56.84)	-100.00%
28	2 Inch	90.94	-	(90.94)	-100.00%
29	3 Inch	170.52	-	(170.52)	-100.00%
30	4 Inch	284.20	-	(284.20)	-100.00%
31	6 Inch	568.40	-	(568.40)	-100.00%
32					
33	Standpipe	11.37	-	(11.37)	-100.00%
34					
35					
36					
37	<u>Gallons In Minimum</u>				
38	All Meter Sizes	-	-		
39					
40					
41					
42	<u>Tier 1: Gallons upper limit (over minimum gallons)</u>				
43	Gallons Proposed, but not over stated Amount				
44	5/8 Inch Residential	4,000	4,000		
45	3/4 Inch Residential	4,000	4,000		
46	5/8 Inch Commerical, Irr	4,000	4,000		
45	3/4 Inch Commerical, Irr	4,000	4,000		
46	1 Inch Residential, Commerical, Irr	40,000	25,000		
47	1.5 Inch Residential, Commerical, Irr	100,000	50,000		
48	2 Inch Residential, Commerical, Irr	150,000	80,000		
49	3 Inch Residential, Commerical, Irr		160,000		
50	4 Inch Residential, Commerical, Irr	400,000	250,000		
51	6 Inch Residential, Commerical, Irr	400,000	500,000		
52	8 Inch Residential, Commerical, Irr	N/A	N/A		
53	Standpipe	4,000	4,000		
54					
55					

Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Present and Proposed Rates

Exhibit  
 Rebuttal Schedule A - H-3  
 Page 2  
 Witness: Bourassa

Line No.	Customer Classification and Meter Size		Present Rates	Proposed Rates	
1					
2					
3	<u>Tier 2: (Gallon upper limit, up to, but not exceeding)</u>				
4	5/8 Inch	Residential	23,000	10,000	
5	3/4 Inch	Residential	23,000	10,000	
6	5/8 Inch	Commerical, Irr	23,000	10,000	
7	3/4 Inch	Commerical, Irr	23,000	10,000	
8	1 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
9	1.5 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
10	2 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
11	3 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
12	4 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
13	6 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
14	8 Inch	Residential, Commerical, Irr	N/A	N/A	
15	Standpipe		23,000	23,000	
16					
17					
18					
19	<u>Tier 3: (Gallon over)</u>				
20	5/8 Inch	Residential	999,999,999	999,999,999	
21	3/4 Inch	Residential	999,999,999	999,999,999	
22	5/8 Inch	Commerical, Irr	999,999,999	999,999,999	
23	3/4 Inch	Commerical, Irr	999,999,999	999,999,999	
24	1 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
25	1.5 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
26	2 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
27	3 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
28	4 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
29	6 Inch	Residential, Commerical, Irr	999,999,999	999,999,999	
30	8 Inch	Residential, Commerical, Irr	N/A	N/A	
31	Standpipe		999,999,999	999,999,999	
32					
33					
34					
35					
			<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Percent Change</u>
36	<u>Commodity Rates (per 1,000 gallons over minimum and per Tier)</u>				
37	All	Tier 1	\$ 0.95	\$ 1.86	95.50%
38	All	Tier 2	\$ 1.15	\$ 2.36	104.98%
39	All	Tier 3	\$ 1.35	\$ 2.96	119.06%
40					
41	Construction Water	All gallons			
42	All	Tier 1	\$ 0.95	\$ 1.86	95.50%
43	All	Tier 2	\$ 1.15	\$ 2.36	104.98%
44	All	Tier 3	\$ 1.35	\$ 2.96	119.06%
45					
46					
47					
48					
49					
50					

**Las Quintas Serenas Water Company**  
**Changes in Representative Rate Schedules**  
**Test Year Ended June 30, 2009**

Exhibit  
 Rebuttal Schedule H- 3  
 Page 4  
 Witness: Bourassa

Line No.	<u>Other Service Charges</u>	Present Rates	Proposed Rates
1	Establishment	\$ 20.00	\$ 20.00
2	Establishment (After Hours)	\$ 30.00	\$ 30.00
3	Reconnection (Delinquent)	\$ 20.00	\$ 20.00
4	Reconnection (Delinquent and After Hours)	\$ 30.00	\$ 30.00
5	Meter Test (If meter reading correctly)	\$ 25.00	\$ 25.00
6	Deposit	*	*
7	Deposit Interest	*	*
8	Re-Establishment (With-in 12 Months)	**	**
9	NSF Check	\$ 15.00	\$ 15.00
10	Deferred Payment, Per Month	N/T	1.50%
11	Meter Re-Read (if correct)	\$ 15.00	\$ 15.00
12	After hours service charge, per Rule R14-2-403D	N/T	Cost
13	Late Charge per month (per R-14-2-409G(6))	1.50%	1.50%
14			
15	Stanpipe Charges		
16	Original Key Deposit	\$ 30.00	\$ 30.00
17	Additional Set	\$ 5.00	\$ 5.00
18	Offsite Facilities Hook-Up Fee	\$ 250.00	See H-3, page 6
19	Arsenic Impact Hook-Up Fee	See H-3 page 6	See H-3 page 6
20			
21	* PER COMMISSION RULE (R14-2-403.B)		
22	** Months off system times the minimum. PER COMMISSION RULE (R14-2-403.D)		
23			
24	N/T = No tariff.		
25			
26			
27	IN ADDITION TO THE COLLECTION OF REGULAR RATES, THE UTILITY WILL COLLECT FROM		
28	ITS CUSTOMERS A PROPORTIONATE SHARE OF ANY PRIVILEGE, SALES, USE, AND FRANCHISE		
29	TAX. PER COMMISSION RULE (14-2-409.D 5).		
30			
31	ALL ADVANCES AND/OR CONTRIBUTIONS ARE TO INCLUDE LABOR, MATERIALS, OVERHEADS,		
32	AND ALL APPLICABLE TAXES.		
33			
34			

**Las Quintas Serenas Water Company**  
**Test Year Ended June 30, 2009**  
**Service Charges**  
**Meter and Service Line Charges**

Exhibit  
 Rebuttal Schedule H-3  
 Page 5  
 Witness: Bourassa

Line No.		Total Present Charge	Proposed Service Line Charge*	Proposed Meter Installation Charge*	Total Proposed Charge*
1					
2					
3					
4					
5					
6	5/8 x 3/4 Inch	\$ 150.00	\$ 445.00	\$ 155.00	\$ 600.00
7	3/4 Inch	NT	445.00	255.00	700.00
8	1 Inch	225.00	495.00	315.00	810.00
9	1 1/2 Inch	475.00	550.00	525.00	1,075.00
10	2 Inch	625.00	N/A	N/A	N/A
11	2 Inch / Turbine	NT	830.00	1,045.00	1,875.00
12	2 Inch / Compound	NT	830.00	1,890.00	2,720.00
13	3 Inch	850.00	N/A	N/A	N/A
14	3 Inch / Turbine	NT	1,045.00	1,670.00	2,715.00
15	3 Inch / Compound	NT	1,165.00	2,545.00	3,710.00
16	4 Inch	1,800.00	N/A	N/A	N/A
17	4 Inch / Turbine	NT	1,490.00	3,670.00	5,160.00
18	4 Inch / Compound	NT	1,670.00	3,645.00	5,315.00
19	6 Inch	3,000.00	N/A	N/A	N/A
20	6 Inch / Turbine	NT	2,210.00	5,025.00	7,235.00
21	6 Inch / Compound	NT	2,330.00	6,920.00	9,250.00
22	8 Inch	NT	At Cost	At Cost	At Cost
23					
24					
25					
26	*Based on Staff update of typical service line and meter installation charges dated				
27	February 21, 2008.				
28					

**Las Quintas Serenas Water Company**  
**Changes in Representative Rate Schedules**  
**Test Year Ended June 30, 2009**

Exhibit  
 Rebuttal Schedule H- 3  
 Page 6  
 Witness: Bourassa

Line No.		Present Charge	Proposed Charge
1			
2	<b><u>Arsenic Impact Hook-up Fee</u></b>		
3			
4		Present	Proposed
5		<u>Charge</u>	<u>Charge</u>
6	5/8 x 3/4 Inch	\$ 1,135	\$ 1,135
7	3/4 Inch	1,703	\$ 1,703
8	1 Inch	2,838	\$ 2,838
9	1 1/2 Inch	5,675	\$ 5,675
10	2 Inch	9,080	\$ 9,080
11	3 Inch	18,160	\$ 18,160
12	4 Inch	28,375	\$ 28,375
13	6 Inch	56,750	\$ 56,750
14			
15			
16	<b><u>Offsite Facilities Hook-up Fee</u></b>		
17			
18		Present	Proposed
19		<u>Charge</u>	<u>Charge</u>
20	5/8 x 3/4 Inch	\$ 250	\$ 250
21	3/4 Inch	250	250
22	1 Inch	250	250
23	1 1/2 Inch	250	250
24	2 Inch	250	250
25	3 Inch	250	250
26	4 Inch	250	250
27	6 Inch	250	250
28			
29			



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**I. INTRODUCTION AND QUALIFICATIONS**

**Q1. PLEASE STATE YOUR NAME AND ADDRESS.**

A1. My name is Thomas J. Bourassa. My business address is 139 W. Wood Drive, Phoenix, Arizona 85029.

**Q2. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?**

A2. I am testifying on behalf of the applicant, Las Quintas Serenas Water Company ("LQSWC" or the "Company").

**Q3. ARE YOU THE SAME THOMAS J. BOURASSA THAT FILED DIRECT TESTIMONY IN THIS DOCKET?**

A3. Yes, my direct testimony was presented in two volumes. My background information and qualifications are set forth in the rate base and revenue requirement volume of my direct testimony.

**Q4. DID YOU ALSO PREPARE REBUTTAL TESTIMONY ON THOSE ISSUES IN THIS DOCKET?**

A4. Yes, my rebuttal testimony on rate base, income statement, revenue requirement and rate design is being filed in a separate volume at the same time as this testimony.

**II. SUMMARY OF REBUTTAL TESTIMONY AND THE PROPOSED COST OF CAPITAL FOR THE COMPANY**

**A. Summary of Company's Rebuttal Recommendation**

**Q5. WHAT IS THE PURPOSE OF THIS VOLUME OF YOUR REBUTTAL TESTIMONY?**

A5. I will provide updates of my cost of capital analysis and recommended rate of return using more recent financial data. I also will provide rebuttal as appropriate to the direct testimony of Mr. Manrique on behalf of Staff.

1 **Q6. HOW HAS THE INDICATED RETURN ON EQUITY CHANGED SINCE**  
2 **THE DIRECT FILING WAS MADE LAST JUNE?**

3 A6. The cost of equity has decreased, as indicated by the Discounted Cash Flow  
4 (“DCF”) model and the Capital Asset Pricing Model (“CAPM”). The table below  
5 summarizes the results of my updated analysis using those models:  
6

<u>Method</u>	<u>Low</u>	<u>High</u>	<u>Midpoint</u>
7 Range DCF Constant Growth Estimates	9.1%	11.3%	10.5%
8 Range of CAPM Estimates	<u>10.4%</u>	<u>15.8%</u>	<u>13.2%</u>
9 Average of DCF and CAPM midpoint			
10 estimates	<u>10.2%</u>	<u>13.5%</u>	<u>11.9%</u>
11 Financial Risk Adjustment	1.5%	1.5%	1.5%
12 Specific Company Risk Premium	<u>1.0%</u>	<u>1.0%</u>	<u>1.0%</u>
13 <b>Indicated Cost of Equity</b>	<b>12.7%</b>	<b>16.0%</b>	<b>14.4%</b>

14 The schedules containing my updated cost of capital analysis attached to this  
15 rebuttal testimony. Also attached is one exhibit, which is discussed below.  
16

17 **Q7. PLEASE SUMMARIZE YOUR RECOMMENDED REBUTTAL COST OF**  
18 **DEBT AND EQUITY, AND YOUR RECOMMENDED REBUTTAL RATE**  
19 **OF RETURN ON RATE BASE.**

20 A7. The Company’s rebuttal recommended capital structure consists of 67.9 percent  
21 debt and 32.1 percent common equity as shown on Rebuttal Schedule D-1. Based  
22 on my updated cost of capital analysis, I am recommending a cost of equity of 14.4  
23 percent and a cost of debt of 7.1 percent. Based on my 14.4 percent recommended  
24 cost of equity and 7.1 percent cost of debt, the Company’s weighted cost of capital  
25 (“WACC”) is 9.44 percent, as shown on Rebuttal Schedule D-1.

26 **Q8. IS THE COMPANY ADOPTING THE STAFF RECOMMENDED COST OF**

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**DEBT?**

A8. Yes. Staff recommends a cost of debt of 7.1 percent which reflects the consideration of the impact of debt issuance costs on the cost of debt.<sup>1</sup>

**Q9. WHY IS YOUR COST OF EQUITY RECOMMENDATION LOWER IN YOUR REBUTTAL THAN IN YOUR DIRECT TESTIMONY?**

A9. As stated, my updated analysis indicates cost of equity is 14.4 percent, which is 160 basis points lower than the 16.0 percent cost of equity I proposed for LQSWC in my direct testimony. There are two primary reasons for the reduction in the cost of equity. First, my DCF cost of equity estimate is much lower and this is a direct result of much lower growth estimates. Previously, my cost of equity estimates based on the DCF model ranged from 11.1 percent to 12.6 percent with a mid-point of 11.9 percent. My updated analysis shows the cost of equity estimates for the DCF model rate from 9.7 percent to 11.3 percent with a mid-point of 10.5 percent.

Second, because the Company recommends a change in the capital structure, which has less debt and therefore less financial risk, my financial risk adjustment is much lower. In the Company's direct filing, I recommended a capital structure of 74.1 percent debt and 25.9 percent equity.<sup>2</sup> This was based on the capital structure at the end of the test year (June 20, 2009). The Company now recommends a capital structure consisting of 67.93 percent debt and 32.07 percent equity. This is the capital structure of the Company on September 30, 2009. Because there is less leverage in the capital structure, my financial risk adjustment is much lower dropping from 290 basis points to 150 basis points.<sup>3</sup>

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<sup>1</sup> See Direct Testimony of Juan C. Manrique ("Manrique Dt.") at 34.  
<sup>2</sup> See Direct testimony of Thomas J. Bourassa ("Bourassa COC Dt.") at 22.  
<sup>3</sup> Compare Company Direct and Rebuttal schedules D.4-1.

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**B. Summary of the Staff Recommendation.**

**Q10. PLEASE SUMMARIZE THE RECOMMENDATION OF STAFF FOR THE RATE OF RETURN ON FAIR VALUE RATE BASE.**

A10. Staff is recommending a hypothetical capital structure consisting of 60 percent debt and 40 percent equity.<sup>4</sup> Staff determined a cost of equity of 10.6 percent based on the average cost of equity produced by its DCF and CAPM models.<sup>5</sup> As stated, Staff also determined the cost of debt to be 7.1 percent.<sup>6</sup> Based on its 60 percent debt and 40 percent equity hypothetical capital structure, Staff determined the WACC for LQSWC to be 8.5 percent.<sup>7</sup>

**Q11. PLEASE SUMMARIZE THE PARTIES RESPECTIVE COST OF EQUITY ESTIMATES.**

A11. The range of cost of equity estimates (before consideration of financial risk and small company risk) for the DCF and CAPM are as follows:

<u>Party</u>	<u>DCF</u>	<u>CAPM</u>	<u>Average</u>
LQSWC	10.2%	13.5%	11.9%
Staff	9.8%	11.3%	10.6%

**Q12. DOES STAFF RECOMMEND A FINANCIAL RISK ADJUSTMENT TO RECOGNIZE THE HIGHER FINANCIAL RISK OF STAFF'S RECOMMENDED HYPOTHETICAL CAPITAL STRUCTURE**

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<sup>4</sup> Manrique Dt. at 33.  
<sup>5</sup> *Id.* at 34.  
<sup>6</sup> *Id.* at 35.  
<sup>7</sup> *Id.*

1           **COMPARED TO THE CAPITAL STRUCTURE OF THE PUBLICLY**  
2           **TRADED WATER UTILITY COMPANIES?**

3 A12. No. Staff justifies its recommendation to employ a hypothetical capital structure in  
4 the instant case based on two prior Commission decisions in which a hypothetical  
5 capital structure consisting of 60 percent debt and 40 percent equity was used to  
6 address highly leveraged capital structures.<sup>8</sup> However, in both of those decisions,  
7 Staff recommended, and the Commission adopted, cost of equity estimates which  
8 included a financial risk adjustment.

9           In the Southwest Gas Corporation decision (Decision 68487, February 23,  
10 2006), the Commission adopted a hypothetical capital structure consisting of 60  
11 percent debt and 40 percent equity and a cost of equity of 9.5 percent which  
12 reflected Staff's cost of equity estimate of 9.2 percent and Staff's recommended  
13 upward adjustment of 30 basis points for recognition of Southwest Gas' highly  
14 leveraged capital structure.<sup>9</sup>

15           In the Arizona-American decision (Decision 69440, May 1, 2007), the  
16 Commission adopted a hypothetical capital structure consisting of 60 percent debt  
17 and 40 percent equity and a cost of equity of 10.7 percent which reflected Staff's  
18 cost of equity estimate of 9.7 percent and Staff's recommended upward adjustment  
19 of 100 basis points for recognition of Arizona-American's highly leveraged capital  
20 structure.<sup>10</sup>

21 **Q13. WHAT WOULD BE THE APPROPRIATE FINANCIAL RISK**  
22 **ADJUSTMENT TO STAFF'S COST OF EQUITY ANALYSIS?**

23 \_\_\_\_\_  
24 <sup>8</sup> Southwest Gas Corporation, Decision 68487, February 23, 2006 and Arizona-American Mohave Water and  
Wastewater Districts, Decision 69440, May 1, 2007.

25 <sup>9</sup> Southwest Gas Corporation, Decision 68487, at 29-30.

26 <sup>10</sup> Arizona-American, Decision 69440, at 18-20.

1 A13. Using the typical Staff methodology for computing a financial risk adjustment,  
2 Staff's financial risk adjustment would be 230 basis points. I have included as  
3 Rebuttal Exhibit TJB-COC-RB1 the computation of the financial risk adjustment  
4 based upon Staff's cost of equity analysis and Staff's typical approach to  
5 implementing the Hamada financial risk adjustment.<sup>11</sup>

6 **Q14. WHAT WOULD BE THE RESULTING COST OF EQUITY ESTIMATE**  
7 **FOR STAFF IF STAFF HAD INCLUDED A FINANCIAL RISK**  
8 **ADJUSTMENT TO REFLECT LQSWC'S HIGHLY LEVERAGED**  
9 **CAPITAL STRUCTURE?**

10 A14. 12.9 percent (10.6 percent cost of equity based on Staff's DCF and CAPM plus 2.3  
11 percent financial risk adjustment based upon the Hamada method).

12 **Q15. HAD STAFF USED THE 12.9 PERCENT COST OF EQUITY IN ITS**  
13 **RECOMMENDED HYPOTHETICAL CAPITAL STRUCTURE WHAT**  
14 **WOULD BE THE RESULTING WEIGHTED AVERAGE COST OF**  
15 **CAPITAL?**

16 A15. 9.42 percent, computed as follows:

	<u>Percent (Weight)</u>	<u>Cost</u>	<u>Weighted Cost</u>
18 Debt	60%	7.1%	4.26%
19 Equity	40%	12.9%	<u>5.16%</u>
20		Overall ROR	9.42%

21 Had Staff's approach to the cost of equity in the instant case been consistent with  
22 the two Commission decisions upon which Staff relied, Staff's recommended cost  
23 of equity would have been over 90 basis points higher (9.42 percent less 8.5  
24 percent).

25 <sup>11</sup> Staff typically uses the Hamada method for computing financial risk adjustments and uses book values of debt and  
26 equity.

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**Q16. IS IT NECESSARY TO ADD AN UPWARD FINANCIAL RISK ADJUSTMENT TO THE COST OF EQUITY IF THE HYPOTHETICAL CAPITAL STRUCTURE THAT STAFF RECOMMENDS IS ADOPTED?**

A16. Yes. This is because there is more debt in the Staff proposed hypothetical capital structure compared to the capital structure of Staff's sample publicly traded utility companies.

**Q17. DOES STAFF PROVIDE AN EXPLANATION AS TO WHY IT IGNORED THE HIGHER FINANCIAL RISK CONTAINED IN ITS HYPOTHETICAL CAPITAL STRCUTURE RECOMMENDATION COMPARED TO THE CAPITAL STRCUTURES OF THE PUBLICLY TRADED WATER UTILIOTY COMPANIES?**

A17. No.

**Q18. DO YOU HAVE ANY OTHER COMMENTS REGARDING STAFF RECOMMENDATIONS?**

A18. Yes. Despite Staff's criticisms of my approach to the cost of capital, which I will respond to below, had Staff properly accounted for the higher financial risk of Staff's recommended hypothetical capital structure, the overall cost of capital of 9.42 percent would have been approximately the same as my overall cost of capital recommendation of 9.44 percent.

**III. REBUTTAL TO STAFF'S COST OF CAPITAL ANALYSIS, TESTIMONY AND RECOMMENDATIONS**

**A. Rebuttal to Staff's Criticisms of Analysts' Estimates of Growth**

**Q19. MR. MANRIQUE CRITICIZES YOU FOR GIVING MORE WEIGHT TO ANALYSTS' ESTIMATES THAN TO HISTORICAL GROWTH RATES.**

1           **HOW DO YOU RESPOND?**

2   A19. First, it is important to note that Mr. Manrique does not reject analyst estimates of  
3       growth; he just disagrees with the amount of weight I gave these estimates.<sup>12</sup> Staff  
4       gives 50 percent weight to analysts' estimates and 50 percent weight to historical  
5       growth data. So the dispute between Mr. Manrique and me comes down to  
6       something between 50 percent and my "greater" emphasis. In my direct testimony  
7       I explained why a weight greater than 50 percent should be given to analysts'  
8       estimates.<sup>13</sup>

9   **Q20. WHAT ABOUT MR. MANRIQUE'S CLAIM ON PAGE 36 THAT ONLY**  
10   **ONE-EIGHTH (OR 12.5 PERCENT) OF YOUR GROWTH ESTIMATES**  
11   **RELIES ON HISTORICAL DIVIDEND GROWTH?**

12   A20. It is true that one-eighth (or 12.5 percent) of my growth estimate relies on historical  
13       dividend growth. However, only one-sixth (or 16.7 percent) of Staff's growth  
14       estimate for its constant growth DCF model relies on historical dividend growth.  
15       Furthermore, if one considers the implied growth from Staff's two-stage DCF  
16       model (which is based upon growth in GDP) and recognize the fact that Staff's  
17       two-stage DCF result is given 50 percent weight in Staff's overall DCF estimate,  
18       historical dividend growth has a weighting of only about one-twelfth (or 8.35  
19       percent) under the Staff approach – a lower weighting than I provide in my growth  
20       estimate.

21   **Q21. WHAT ABOUT MR. MANRIQUE'S ASSERTION THAT ANALYSTS'**  
22   **ESTIMATES ARE "OVERLY OPTIMISTIC"?**

23   A21. I refer back to my direct testimony at page 29. Gordon, Gordon, and Gould  
24

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25   <sup>12</sup> Manrique Dt. at 39.

26   <sup>13</sup> See Direct Testimony of Thomas J. Bourassa – Cost of Capital ("Bourassa COC Dt.") at 29-30.

1 conducted a study and found analyst forecasts of growth outperformed three  
2 measures of historical growth. They explain that this result should be expected  
3 because analysts would consider historical data in making future projections. Now,  
4 Mr. Manrique characterizes the study as merely an "article" that "describes more  
5 generally the methods exclusively using analysts' forecasts are 'popular and  
6 attractive models', but the article does not support the conclusion that these  
7 forecasts should be used alone."<sup>14</sup> The authors' own words undermine Mr.  
8 Manrique's characterization. In their own formal study, the authors concluded:

9  
10 We have compared the accuracy of four methods for  
11 estimating the growth component of the discounted cash flow  
12 yield on a share: past growth in earnings (KEGR), past  
13 growth in dividends (KDGR), past retention growth rate  
(KBRG), and forecasts of growth by security analysts  
(KFRG). ... For our sample of utility shares, KFRG  
performed well, with KBRG, KDGR, and KEGR following in  
that order, and with KEGR a distant fourth....

14 Before closing, we have three observations to make. First,  
15 the superior performance by KFRG should come as no  
16 surprise. All four estimates of growth rely upon past data, but  
17 in the case of KFRG a larger body of past data is used,  
18 filtered through a group of security analysts who adjust for  
19 abnormalities that are not considered relevant for future  
20 growth....<sup>15</sup>

19 As I have testified, to the extent that past results provide useful indications of  
20 future growth prospects, analysts' forecasts of growth would already incorporate  
21 that information.<sup>16</sup> In addition, a stock's current price already reflects known  
22 historic information on that company, including its past dividend and earnings  
23

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24 <sup>14</sup> Manrique Dt. at 38.

25 <sup>15</sup> David A. Gordon, Myron J. Gordon and Lawrence I. Gould, "Choice Among Methods of Estimating Share Yield,"  
*Journal of Portfolio Management* (Spring 1989) 50-55.

26 <sup>16</sup> Bourassa COC Dt. at 29.

1 history.<sup>17</sup> If investors rely on analysts' growth rate forecasts, those are the relevant  
2 forecasts for determining equity costs.

3 In summary, Mr. Manrique offers no quantitative or conceptual argument to  
4 rebut Gordon, Gordon, and Gould, and offers no evidence that any of the measures  
5 of past growth he has used – historical EPS, historical DPS, historical sustainable  
6 growth – provides better a forecast of future growth for utilities than analysts'  
7 estimates of growth. Mr. Manrique is using Staff's inputs into the DCF model  
8 mechanically without considering the reasons for using those inputs.  
9 Unfortunately, Staff's inputs gives less weight to the best estimate of future growth  
10 in order to drive down the cost of equity.

11 **Q22. DOESN'T MR. MANRIQUE'S TESTIMONY ON PAGE 38 REFERENCING**  
12 **PROFESSOR GORDON'S REMARKS AT THE 30<sup>TH</sup> ANNUAL FORUM OF**  
13 **THE SOCIETY OF UTILITY AND REGULATORY FINANCIAL**  
14 **ANALYSTS CONTRADICT WHAT THE AUTHORS HAVE**  
15 **CONCLUDED?**

16 **A22.** No. In the quoted remarks, Professor Gordon does not say anything about past  
17 growth rates. There is no guidance on which past growth rates (EPS, DPS, or book  
18 value) should be used, if any, or what weight past growth rates should be given  
19 when estimating the growth rate in the DCF model. That is the issue. Mr.  
20 Manrique agrees that "Professor Gordon would temper the typically higher  
21 analysts' growth rates with the typically lower GNP growth rate."<sup>18</sup> I am sure Mr.  
22 Manrique would also agree that I have tempered my estimate by considering past  
23 growth rates that are well below the long-term GNP (or GDP) growth rate.<sup>19</sup>

24 \_\_\_\_\_  
<sup>17</sup> *Id.*

25 <sup>18</sup> Manrique Dt. at 39.

26 <sup>19</sup> See Rebuttal Schedule D.4-4, column 5. The average of historical growth rates is 5.87%. The long-term GDP

1 **Q23. DOES MR. MANRIQUE STATE THAT INVESTORS RELY ON ANALYST**  
2 **ESTIMATES?**

3 A23. Yes.<sup>20</sup> He also states that investors rely “to some extent on past growth as well.”<sup>21</sup>  
4 That is true, but he does not demonstrate the extent to which investors rely on past  
5 growth rates – he simply states that they are considered. Again, if analysts’  
6 estimates already consider past growth, then Staff vastly overstates the impact of  
7 past growth rates in its DCF model. It is, basically, a type of “double-counting”  
8 that produces extremely low results.

9 **Q24. DO YOU HAVE FURTHER REBUTTAL TO MR. MANRIQUE’S**  
10 **“OVERLY OPTIMISTIC” TESTIMONY?**

11 A24. Yes. For my second specific response to the assertion that analysts’ estimates are  
12 “overly optimistic,” I point to Value Line. Value Line is in the business of selling  
13 information to investors, and all of the parties have relied on Value Line in their  
14 cost of equity estimates. Value Line has every incentive to provide accurate  
15 forecasts to encourage investors to continue to subscribe to its publications. Value  
16 Line does not sell stock and has no incentive to bias upward its buy/sell  
17 recommendations and estimates of future growth. Zacks and Morningstar provide  
18 similar investment services. Neither markets stock – they sell information, which  
19 won’t be purchased if it is inaccurate or biased. Yahoo Finance is a free service,  
20 but it does not earn commissions from the sales of stock. In sum, Mr. Manrique’s  
21 testimony is simply wrong. None of these services has any reason to provide  
22 inaccurate information to its users.

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23  
24 growth rate is 6.6% as shown on Staff’s Schedule JCM-9.

25 <sup>20</sup> Manrique at 39.

26 <sup>21</sup> *Id.*

1 Q25. DO YOU HAVE ANY FURTHER COMMENTS ON THE TOPIC OF  
2 STAFF'S DCF GROWTH ESTIMATES, MR. BOURASSA?

3 A25. Yes. I am attaching a copy of document filed with the public utilities commission  
4 in a 2005 California rate case to this volume of my rebuttal testimony.<sup>22</sup> This  
5 document was prepared by Mr. Gary Hayes, a witness for San Diego and Electric  
6 Company. It lists a number of sources that further contradict Mr. Manrique's claim  
7 that analysts typically make upwardly biased forecasts of growth.

8           Additionally, to further support the use of analyst forecasts of growth, Dr.  
9 Morin states:

10           Because of the dominance of institutional investors and their  
11 influence on individual investors, analysts' forecasts of long-  
12 run growth rates provide a sound basis for estimating required  
13 returns. Financial analysts exert a strong influence on the  
14 expectations of many investors who do not possess the  
15 resources to make their own forecasts, that is, they are a cause  
16 of g. *The accuracy of these forecasts in the sense of whether*  
17 *they turn out to be correct is not at issue here, as long as they*  
18 *reflect widely held expectations. As long as the forecasts are*  
19 *typical and/or influential in that they are consistent with*  
20 *current stock price levels, they are relevant. The use of*  
21 *analysts' forecasts in the DCF model is sometimes denounced*  
22 *on the grounds that it is difficult to forecast earnings and*  
23 *dividends for only one year, let alone for longer time periods.*  
24 *This objection is unfounded, however, because it is present*  
25 *investor expectations that are being priced; it is the consensus*  
26 *forecast that is embedded in price and therefore, in required*  
*return, and not the future as it will turn out to be.*<sup>23</sup>

21           Dr. Myron Gordon, the same Professor Gordon Mr. Manrique quotes in his  
22 testimony and the "father" of the standard regulatory version of the DCF model  
23 utilized by Mr. Manrique and myself in the instant case, has also recognized the  
24 significance of analysts' forecasts of growth in EPS in a speech he gave in March

25 <sup>22</sup> Exhibit TJB-COC-RB2.

26 <sup>23</sup> Roger A. Morin. *New Regulatory Finance* (2006) 298 (emphasis added).

1 1990 before the Institute for Quantitative Research and Finance. He said:

2  
3 We have seen that earnings and growth estimates by security  
4 analysts were found by Malkiel and Cragg to be superior to  
5 data obtained from financial statements for the explanation of  
6 variation in price among common stocks. ... Estimates by  
7 security analysts available from sources such as IBES are far  
8 superior to the data available to Malkiel and Cragg. Eq (7) is  
9 not as elegant as Eq (4), but it has a good deal more intuitive  
10 appeal. It says that investors buy earnings, but what they will  
11 pay for a dollar of earnings increases with the extent to which  
12 the earnings are reflected in the dividend or in appreciation  
13 through growth.<sup>24</sup>

14  
15 Professor Gordon recognized that total return is largely affected by the terminal  
16 price, which is mostly affected by earnings (hence the common use of  
17 price/earnings multiples in evaluating stock prices).

18  
19 As noted by Dr. Gordon, studies performed by Cragg and Malkiel  
20 demonstrate that analysts' forecasts are superior to historical growth rate  
21 extrapolations. These studies show that:

22  
23 Efficient market hypotheses suggest that valuation should reflect the  
24 information available to investors. Insofar as analysts' forecasts are  
25 more precise than other types we should therefore expect their  
26 differences from other measures to be reflected in the market. It is  
27 therefore noteworthy that our regression results do support the  
28 hypothesis that analysts' forecasts are needed even when calculated  
29 growth rates are available. As we noted when we described the data,  
30 *security analysts do not use simple mechanical methods to obtain  
31 their evaluations of companies.* The growth-rate figures we obtained  
32 were distilled from careful examination of all aspects of the  
33 companies' records, evaluation of contingencies to which they might  
34 be subject, and whatever information about their prospects the  
35 analysts could glean from the companies themselves from other  
36 sources. *It is therefore notable that the results of their efforts are  
37 found to be so much more relevant to the valuation than the various  
38 simpler and more "objective" alternatives that we tried.*<sup>25</sup>

24 Gordon, Myron J., "Pricing of Common Stocks", Seminar (March 27, 1990) at 12-13.

25 John G. Cragg and Burton G. Malkiel, "Expectations and the Structure of Share Prices" *National Bureau of Economic Research* (University of Chicago Press, 1982) Chapter 4.

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Vander Weide and Carleton further note:

[O]ur studies affirm the superiority of analyst's forecasts over simple historical growth extrapolations in the stock price formation process. Indirectly, this finding lends support to the use of valuation models whose input includes expected growth rates.<sup>26</sup>

**Q26. THAT'S A LOT OF EXPERT COMMENTARY, BUT WHAT DOES IT ALL MEAN IN THIS CASE?**

A26. It means that the level of accuracy of analysts' forecasts is an after-the-fact evaluation with little relevance to the issues at hand here. What really matters is that analysts' forecasts strongly influence investors and hence the market prices they are willing to pay for stocks. Therefore, they should play a prominent role in a proper equity cost determination. Staff, however, has failed to give these forecasts sufficient weight in its analysis. Even Mr. Dreman, who Mr. Manrique relies on<sup>27</sup>, admits that:

We have also seen that in spite of high error rates being recognized for decades, neither analysts nor investors who religiously depend on them have altered their methods in any way.<sup>28</sup>

This is my point. If investors rely on analysts' growth rate forecasts, those forecasts should be used to determine the cost of equity, proportionate to investor reliance, not in a manner that depresses the import of that reliance. Analysts' growth rates influence the prices investors will pay for stocks and thus impact the

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<sup>26</sup> James H. Vander Weide and Willard T. Carleton, "Investor Growth Expectations: Analysts vs. History" (*The Journal of Portfolio Management*, Spring 1988) 78-82.  
<sup>27</sup> Manrique Dt. at 36.  
<sup>28</sup> David Dreman, *Contrarian Investment Strategies: The Next Generation* 115-116 (Simon & Schuster 1998).

1 dividend yields. The dividend yields change until the sum of the dividend yield  
2 plus the growth rate equals investors' perceived cost of equity. Had the growth  
3 forecasts been lower – as Mr. Manrique suggests they should be – the stock prices  
4 would be lower and dividend yields would be higher, but there would not  
5 necessarily be any difference in the ultimate estimate of the cost of equity.

6 **Q27. HOW DO YOU RESPOND TO MR. MANRIQUE'S REFERENCE TO**  
7 **PROFESSOR JEREMY SIEGEL?**

8 A27. Mr. Manrique's reliance on the quote from Jeremy Siegel that "dividends and not  
9 earnings are meaningful" is puzzling.<sup>29</sup> The DCF model assumes, among other  
10 things, that a firm will have a stable dividend payout policy and a stable return on  
11 the book value of its stock. Thus, it is assumed that the stock's price, its book  
12 value, dividends paid, and earnings all grow at the same rate. While it is  
13 appropriate to make such assumptions for forecasting purposes, these assumptions  
14 are frequently violated when examining historical data. As it turns out, the  
15 historical growth in the stock price, book value, dividends, and earnings for the  
16 water utility industry has not been the same.<sup>30</sup> Estimates of long-term growth rates  
17 should take this into account. Furthermore, I have not used earnings in my DCF  
18 model; I used earnings growth as a proxy for growth. Earnings generate the funds  
19 used to pay dividends. Growth in earnings provides more cash flows from which  
20 dividends are paid. As a consequence, earnings growth is obviously extremely  
21 important to investors, and is therefore an entirely appropriate proxy for growth in  
22 the DCF model.

23 Of course, I'd also note that I don't disagree with Professor Siegel that the  
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25 <sup>29</sup> Manrique Dt. at 38-39.

26 <sup>30</sup> See Rebuttal Schedule D.4-3 and Rebuttal Schedule D.4-4.

1 price of a stock is always equal to the present value of all future cash flows. I am  
2 sure Professor Siegel would agree that future cash flows would not only include  
3 dividends but the future sales price of the stock. I would also add that an  
4 investment in the stock of a publicly traded utility is much more liquid than an  
5 investment in LQSWC. If investors are unhappy with the return provided by a  
6 publicly traded stock they can sell the stock within minutes. On the contrary, an  
7 investment in LQSWC does not provide the same level of liquidity. This lack of  
8 liquidity creates additional investment risk.

9 **Q28. DO YOU HAVE ANY FURTHER RESPONSE TO MR. MANRIQUE**  
10 **REGARDING THE ISSUE OF USING ANALYSTS' FORECASTS AND**  
11 **THE APPROPRIATE WEIGHT THEY SHOULD BE GIVEN?**

12 A28. Yes, I have one more comment. I find Mr. Manrique's reliance on a quotation  
13 from Dr. Burton G. Malkiel is somewhat confusing. Dr. Malkiel is the Chemical  
14 Bank Chairman's Professor of Economics at Princeton University and author of the  
15 widely read national bestseller book on investing entitled, "A Random Walk Down  
16 Wall Street." Mr. Manrique quotes Dr. Malkiel's apparent criticism of analysts'  
17 estimates. Yet, in November 2002, Professor Malkiel affirmed his belief in the  
18 superiority of analysts' earnings forecasts when he testified before the South  
19 Carolina PUC:

20  
21 With all the publicity given to tainted analysts' forecasts and  
22 investigations instituted by the New York Attorney General,  
23 the National Association of Securities Dealers, and the  
24 Securities & Exchange Commission, I believe the upward  
25 bias that existed in the late 1990s has indeed diminished. In  
26 summary, I believe that current analysts' forecasts are more  
reliable than they were during the late 1990s. *Therefore,*  
*analysts' forecasts remain the proper tool to use in*  
*performing a Gordon Model DCF analysis.*<sup>31</sup>

<sup>31</sup> See Rebuttal testimony of Dr. Burton G. Malkiel, South Carolina Electric and Gas Co., Docket No. 2002-223-E, pp. 16-17 (emphasis added).

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I believe that Dr. Malkiel's testimony should eliminate any disagreement on this issue.

**B. Firm Specific Risk**

**Q29. IS MR. MANRIQUE CORRECT THAT PRIOR COMMISSION DECISIONS DID NOT FIND A FIRM SIZE PHENOMENON FOR REGULATED UTILITIES?**

A29. Yes, Mr. Manrique is correct, although the Commission's failure to recognize that small firms are riskier than large firms - despite an abundance of empirical financial evidence indicating otherwise - is another reason why it is more risky for smaller utilities to do business in Arizona. Putting that aside, there are many reasons why smaller utilities are more risk than larger utilities. I have discussed these reasons extensively in my direct testimony and will not repeat that testimony here.<sup>32</sup> The simple fact is that a rational investor is not going to view an equity investment in LQSWC as having the same risk as the purchase of publicly traded stock in a substantially larger utility such as Aqua America, American States Water or California Water Service.

The bottom line is that if the differences in risk between small utilities like LQSWC and the large, publicly traded water utilities used to estimate the cost of equity are ignored, LQSWC's equity cost will be understated and unreasonable.

**Q30. DO INVESTORS CONSIDER SMALL FIRM RISKS AS WELL AS REGULATORY RISKS?**

A30. Of course. Contrary to Mr. Manrique's assertions, the investment related to such factors as firm size and Arizona's regulatory environment are important to

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<sup>32</sup> Bourassa COC Dt. at 16-23

1 investors. These risks are not captured by the market data of the water utility proxy  
2 group Staff uses to estimate the cost of equity for LQSWC. None of the utilities in  
3 Staff's water proxy group are of comparable size to LQSWC.<sup>33</sup> In fact, LQSWC is  
4 but a small fraction of the size of the water utilities in Staff's proxy group. And  
5 none of the water utilities in Staff's water proxy group operate exclusively in  
6 Arizona and are subject to this jurisdiction's regulatory requirements and policies.<sup>34</sup>

7 **Q31. IS THERE A WAY TO PRECISELY QUANTIFY THE EFFECT OF THESE**  
8 **ADDITIONAL RISKS ON THE RETURN REQUIRED BY AN INVESTOR?**

9 A31. No. But that does not justify ignoring the differences between the sample utilities  
10 and LQSWC, as Staff proposes.

11 **Q32. HOW DO YOU RESPOND TO MR. MANRIQUE'S ASSERTION THAT**  
12 **THE ARIZONA REGULATORY ENVIRONMENT IS NO LESS**  
13 **FAVORABLE THAN THE REGULATORY ENVIRONMENTS FACED BY**  
14 **THE SAMPLE UTILITIES?**

15 A32. I disagree with him. Mr. Manrique testifies that the regulatory environment in  
16 Arizona has many "attractive attributes," including the ability to seek accounting  
17 orders, the recognition of known and measurable changes, the wide use of hook-up  
18 fees, and regulatory responsiveness, such as the approval of arsenic recovery  
19 mechanisms and arsenic remedial surcharge mechanisms.<sup>35</sup> I will address each of  
20 the alleged "attractive attributes" Mr. Manrique has identified.

21 **Q33. LEST START WITH ACCOUNTING ORDERS. ARE ACCOUNTING**  
22 **ORDERS AN "ATTRACTIVE ATTRIBUTE" OF REGULATION IN**  
23 **ARIZONA?**

24 <sup>33</sup> Bourassa COC Dt. at 17.

25 <sup>34</sup> *Id.* at 19.

26 <sup>35</sup> Manrique Dt. at 41.

1 A33. No. I am not aware that regulatory mechanisms similar to accounting orders are  
2 not available to any of the sample water utilities in the regulatory jurisdictions in  
3 which they operate. Therefore, accounting orders do not make Arizona attractive  
4 to investors relative to other investments. Besides, the nature of accounting orders  
5 limits their attractiveness.

6 **Q34. WHAT DO YOU MEAN?**

7 A34. In Arizona, accounting orders are narrowly tailored for specific circumstances and  
8 generally only allow utilities to track certain, specified costs. No rate recovery is  
9 authorized or assured. Rather, accounting orders issued by this Commission  
10 postpone consideration of any cost recovery until a future rate case. In fact, the  
11 uncertainty inherent in an accounting order is illustrated in the pending Litchfield  
12 Park Service Company rate case, where Staff opposes recovery of costs incurred  
13 pursuant to a recent Commission-issued accounting order.<sup>36</sup> Staff testimony  
14 regarding the LQSWC's request for an accounting order in the instant case for  
15 future consideration of significant arsenic media costs that were not recognized in  
16 the Company's initial rate application demonstrates how difficult and how  
17 narrowly Staff views the applicability of accounting orders.<sup>37</sup>

18 **Q35. WHAT ABOUT THE RECOGNITION OF "KNOWN AND**  
19 **MEASURABLE" CHANGES?**

20 A35. Again, this is not a regulatory attribute unique to Arizona. In fact, I am not aware  
21 of any jurisdictions that utilize an historic test year where adjustments based on  
22 known and measurable changes cannot be made to either the test year rate base or  
23

24 <sup>36</sup> See Direct Testimony of Jeffery M. Michlik (water division) in Docket W-01427A-09-0104 at 12-14. Staff is  
25 recommending denial of recovery of costs related to the potential contamination of its water supply due to the  
proximity of a federally designated superfund site, although Staff has suggested consideration in a future rate case.

26 <sup>37</sup> See Direct Testimony of Jeffery M. Michlik ("Michlik Dt.") at 29-30.

1 to test year revenue and expenses in order to make the test year a more “normal”  
2 representation of the costs of service during the period in which the rates will be in  
3 effect. Arguably, the failure to allow such changes would be unlawful.

4 In contrast, California, in which three of the six sample water companies  
5 (American States, California Water, and SJW Corp.) primarily operate, uses future  
6 test years in setting rates. Under that state’s rate making system, future expenses  
7 can be increased to reflect expected changes including projected inflation, revenues  
8 can be adjusted to reflect expected future erosion of revenues from water  
9 conservation, and future expected capital investment can be recognized in rate  
10 base. This regulatory approach is more attractive to investors than the simple  
11 recognition of known and measurable changes to an historical test year.

12 Moreover, California allows adjuster mechanisms that permit utilities to  
13 recover increases in purchased power and purchased water costs due to increases  
14 rates charged by power and water providers. More recently, in connection with  
15 implementing conservation-oriented rate structures, California has authorized water  
16 revenue adjustment mechanisms to be implemented in order to offset revenue  
17 erosion due to conservation. In some cases, California allows utilities to file for  
18 adjustment mechanisms when unexpected significant capital investment has to be  
19 made. By allowing revenues to change between rate cases to match known  
20 increases in investment and operating expenses, utilities are given a reasonable  
21 chance to earn their authorized return.

22 In contrast, adjuster mechanisms for purchased water and purchased water  
23 have been uniformly opposed by Staff over the past decade, and they have denied  
24 by the Commission.<sup>38</sup> And, I don’t believe that I have ever seen a revenue

25  
26 <sup>38</sup> See, e.g. *Chaparral City Water Company*, Decision 68176 (Sept. 30, 2005); *Arizona Water Company (Eastern Group)*, Decision No. 66849 (March 19, 2004).

1 conservation adjustment adopted by the Commission for an Arizona water utility  
2 with inverted-tier rates designed to encourage water conservation.

3 **Q36. DIDN'T THE COMMISSION PROVIDE ARSENIC COST RECOVERY**  
4 **MECHANISMS IN THE PAST?**

5 A36. To some extent. But generally these mechanisms have only for allowed recovery  
6 of debt service costs not capital and depreciation. That was beneficial, particularly  
7 for utilities that could not cash flow the debt service without this mechanism in  
8 place. However, these mechanisms typically do not include recovery of increases  
9 in operating and maintenance costs associated with the arsenic facilities. And, the  
10 Commission has made it clear that such mechanisms were special cases intended to  
11 address extraordinary circumstances, and their approval did not establish a  
12 precedent for adjuster mechanisms in general. Thus, while approval of the ACRMs  
13 was certainly helpful to the water utilities that obtained them, they do not make  
14 Arizona's regulatory environment more attractive to investors than other  
15 jurisdictions, which routinely authorize cost recovery mechanisms.

16 **Q37. ARE THERE ANY OTHER "ATTRACTIVE ATTRIBUTES" THAT MAKE**  
17 **OTHER JURISDICTIONS ATTRACTIVE RELATIVE TO ARIZONA?**

18 A37. Yes. For instance, as I discussed in my direct testimony, in many states in which  
19 Aqua America operates, utilities are permitted to implement surcharges to recover  
20 additional depreciation and capital costs outside the context of a rate case.<sup>39</sup> Aqua  
21 America also operates in jurisdictions that allow utilities to implement rates before  
22 a final decision in a rate case.<sup>40</sup> In addition, in certain states in which Aqua  
23 America operates, utilities are allowed surcharges to reflect changes in certain costs  
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25 <sup>39</sup> Bourassa COC Dt at 21.

26 <sup>40</sup> *Id.*

1 until such time as the costs are incorporated into base rates.<sup>41</sup> Pennsylvania allows  
2 water utilities to collect a distribution system improvement charge (“DISC”) for the  
3 replacement of mains, storage tanks and other distribution system infrastructure.  
4 Similarly, Middlesex operates utilities in Delaware, which also allows for the  
5 implementation of a DISC for the recovery of depreciation and capital costs outside  
6 the context of a rate case. Delaware also allows plant expected to be constructed  
7 within three years from the end of the test period to be included in rate base. These  
8 attributes are attractive to investors, and none of them are available in Arizona.

9 **Q38. ARE YOU AWARE OF ANY STUDIES THAT SUPPORT YOUR**  
10 **TESTIMONY THAT ARIZONA IS NOT AN ATTRACTIVE**  
11 **REGULATORY ENVIRONMENT?**

12 A38. Yes. Standard and Poor’s, for example, issued a report in November 2008 that  
13 ranked Arizona among the least credit supportive regulatory environments.<sup>42</sup>  
14 Investors do recognize the overall effect of the unfavorable regulatory environment  
15 here in Arizona.

16 **Q39. PLEASE RESPOND TO MR. MANRIQUE’S TESTIMONY ON PAGE 42**  
17 **THAT REGULATORY RISK IS A FIRM-SPECIFIC RISK AND**  
18 **INVESTORS CANNOT EXPECT TO BE COMPENSATED FOR FIRM-**  
19 **SPECIFIC RISKS.**

20 A39. Mr. Manrique’s assertion is undermined by the fact that the *Bluefield* standard  
21 requires the return on equity be commensurate with returns on enterprises with  
22 comparable risks (the “comparable earning standard”). The impact of the various  
23 factors on investment risk that I have discussed throughout my testimony, such as  
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25 <sup>41</sup> *Id.*

26 <sup>42</sup> Assessing U.S. Utility Regulatory Environments, Rating Directs, Standard and Poor’s (November 7, 2008).

1 small size, construction risk, regulatory risk, lack of diversification, small customer  
2 base, liquidity risk, etc., are factors which make LQSWC more risky and therefore  
3 not comparable to the large publicly traded water companies.

4 Mr. Manrique does not dispute the data contained in Morningstar supporting  
5 small company risk premiums.<sup>43</sup> It stands to reason that LQSWC would have  
6 higher beta than the sample water companies.<sup>44</sup> Yet, Mr. Manrique blindly accepts  
7 that the average beta of the much larger publicly traded water utilities as the beta  
8 for LQSWC.<sup>45</sup>

9 **Q40. ON PAGE 43 OF HIS TESTIMONY MR. MANRIQUE STATES THAT**  
10 **THERE IS NO ACCEPTED ANALYSIS THAT DEMONSTRATES THAT**  
11 **UTILITIES ARE SUBJECT TO THE SAME SIZE DEPENDENT BETAS AS**  
12 **THE MARKET. PLEASE RESPOND.**

13 A40. I find it ironic that Mr. Manrique has now essentially admitted that the Staff's often  
14 cited Annie Wong study<sup>46</sup> does not prove that a firm size effect does not exist in  
15 the regulated utility industry. It would appear that the Commission's reliance on  
16 Staff's unequivocal conclusion that the firm size phenomenon does not exist for  
17 regulated utilities in the Black Mountain Gas and the Arizona Water rate cases was  
18 unwarranted.<sup>47</sup>

19 **Q41. PLEASE CONTINUE.**

20 A41. Risks that would obviously be considered by any rational investor are simply  
21 ignored by Mr. Manrique. Would a rational investor really regard an equity

22 <sup>43</sup> Small company risk premiums are the risk premiums not explained by the higher betas for small companies.

23 <sup>44</sup> Bourassa COC Dt. at 8.

24 <sup>45</sup> Manrique Dt. at 28.

25 <sup>46</sup> Wong, Annie. "Utility Stocks and the Size Effect: An Empirical Analysis." *Journal of the Midwest Finance*  
*Association*. 1993. Pp. 95-101.

26 <sup>47</sup> Manrique Dt. at 42-43.

1 investment in LQSWC as presenting less risk than an equity investment in Aqua  
2 America or in Connecticut Water Services, which have AA- and A bond ratings,  
3 respectively? The answer is a resounding "no".

4 **Q42. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY ON COST OF**  
5 **CAPITAL?**

6 A42. Yes. Although my silence on any issue not discussed herein does not necessarily  
7 constitute agreement with Staff.

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**Las Quintas Serenas Water Company**  
**Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA**  
**REBUTTAL TESTIMONY**  
**(COST OF CAPITAL)**  
**August 23, 2010**

**EXHIBIT TJB-COC-RB1**

Las Quintas Serenas Water Company  
 Estimate of Financial Risk Computation using Staff Hamada Method

Exhibit  
 Page 1

Line No.									
1	<u>CAPM</u>								
2									
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	<u>CAPM</u>								
	Historical Market Risk Premium	Rf	+	$\beta$	x	(Rp)	=	k	
	Current Market Risk Premium	2.6%	+	0.78	x	7.2%	=	8.2%	
	Average	4.1%	+	0.78	x	13.0%	=	14.2%	
									11.2%

	<u>CAPM Relevered Beta</u>								
	Historical Market Risk Premium	Rf	+	$\beta$	x	(Rp)	=	k	
	Current Market Risk Premium	2.6%	+	1.00	x	7.2%	=	9.8%	
	Average	4.1%	+	1.00	x	13.0%	=	17.1%	
	Financial Risk Adjustment								13.5%
									<u>2.3%</u>

<sup>1</sup> From Staff Schedule JCM-3.  
<sup>2</sup> Relevered beta found on Page 3.

Las Quintas Serenas Water Company  
 Financial Risk Computation  
 Unlevered Beta

Line No.	Company	VL Beta $\beta_{VL}^1$	Raw Beta $\beta_{Raw}^2$	Tax Rate $t^3$	Book Value Debt $D^4$	Book Value Equity $E^4$	Unlevered Raw Beta $\beta_U^5$
1	American States	0.80	0.70	37.8%	46.8%	53.2%	0.45
2	Aqua America	0.65	0.48	39.4%	56.6%	43.4%	0.27
3	California Water	0.75	0.63	38.0%	48.0%	52.0%	0.40
4	Connecticut Water	0.80	0.70	19.5%	55.8%	44.2%	0.35
5	Middlesex	0.75	0.63	34.1%	53.3%	46.7%	0.36
6	SJW Corp.	0.95	0.93	40.4%	49.0%	51.0%	0.59
11							
12							
13	Sample Water Utilities	0.78	0.68	34.8%	40.0%	60.0%	0.47
14							
15							
16							
17							
18							
19							

<sup>1</sup> Value Line Investment Analyzer data. See Schedule D-4.13  
 Value Line uses the historical data of the stock, but assumes that a security's beta moves toward the market average over time. The formula is as follows:  
 Adjusted beta =  $.33 + (.67) * \text{Raw beta}$   
<sup>2</sup> Raw Beta =  $(VL \text{ beta} - .33) / (.67)$   
<sup>3</sup> Effective tax rates for year ended December 31, 2009.  
<sup>4</sup> See Staff Schedule JCM-4.  
<sup>5</sup> Raw  $\beta_U = \text{Raw } \beta_L / (1 + (1-t) * D/E)$

Las Quintas Serenas Water Company  
Financial Risk Computation  
Relevered Beta

Line No.	Unlevered Raw Beta $\beta_{UL}^1$	Book Value Book Debt $\frac{BD^2}{EC^2}$	Book Value Equity Capital $\frac{EC^2}{L^3}$	Tax Rate $\tau$	Relevered Raw Beta $\beta_{RL} = \beta_{UL} (1 + (1 - \tau) \frac{BD}{EC})$	VL Adjusted Relevered Beta $\beta_{RL} = .33 + .67(\text{Raw Beta})$
1	0.47	60.0%	40.0%	24.69%	1.00	1.00
2						
3						
4						
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Las Quintas Serenas Water Compan

<sup>1</sup> Unlevered Beta from Schedule D-4.14.  
<sup>2</sup> Hypothetical capital structure consisting of 60 percent debt and 40 percent equity as recommended by Staff.  
<sup>3</sup> From Staff Schedule CSB-2.

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(COST OF CAPITAL)  
August 23, 2010**

**EXHIBIT TJB-COC-RB2**

Application No.: 07-05-007  
Exhibit No.: \_\_\_\_\_  
Witness: Gary H. Hayes  
Date: August 28, 2007

Exhibit	40
CPLC Proceeding	A-07-05-007-AL
Sponsor/Witness	SDGE/HAYES
Date Ident.	7/12/07
Recd.	7/12/07
Michael J. Galvin Administrative Law Judge	

Application No. 07-05-007  
Exhibit No. SDGE-5

**SAN DIEGO GAS & ELECTRIC COMPANY**  
**PREPARED REBUTTAL TESTIMONY OF**  
**GARY H. HAYES**

**BEFORE THE PUBLIC UTILITIES COMMISSION**  
**OF THE STATE OF CALIFORNIA**

August 28, 2007

## Appendix B

### Analyst Growth-Forecast Research

This survey, prepared at the request of SDG&E by Dr. James H. Vander Weide, Research Professor of Finance and Economics at Duke University, summarizes nine articles that address whether analysts' growth forecasts are overly optimistic. Seven of the nine articles reviewed find no evidence that analysts' growth forecasts are overly optimistic. Two find evidence of optimism, but also conclude that optimism has been declining significantly over time. Of these two studies, one finds that analysts' forecasts for the S&P 500 are pessimistic for the last four years of the study. The summaries are listed in chronological order.

Crichfield, T., Thomas Dyckman and Josef Lakonishok (1978). "An evaluation of security analysts' forecasts." *The Accounting Review* 53(3): 651-668.

The authors study the ability of security analyst to provide unbiased estimates of earnings per share and compare analysts' forecasts to forecasts made using simple statistical models based on historical EPS data. Their study is based on data during the period 1967 - 1976 from the *Earnings Forecaster* published by Standard & Poor's, and the final sample consists of 46 firms. The authors conclude that the analysts perform well in terms of forecast accuracy when compared to the forecasts produced by five statistical models. Their tests also support the hypothesis that analysts predict EPS changes without significant systematic bias.

Elton, E. J., Martin J. Gruber and Mustafa N. Gultekin (1984). "Professional expectations: accuracy and diagnosis of errors." *Journal of Financial and Quantitative Analysis* 19(4): 351-363.

The authors examine five questions regarding analysts' EPS forecasts: (1) what is the size and pattern of analysts' errors; (2) what is the source of errors; (3) are some firms more difficult to predict than others; and (4) is there an association between errors in forecasts and divergence of analysts' estimates. The authors use the I/B/E/S database of earnings forecasts for a sample of 414 firms for the three years 1976 through 1978, and they compare the I/B/E/S forecasts to actual earnings for each of the next two years. The authors conclude that analysts were accurate in estimating the average level of growth in

earnings for all stocks in the sample. However, analysts did have greater divergence of opinion for some industries, and the diversion in analysts' opinions is positively related to forecast error.

Givoly, D., and Josef Lakonishok (1984). "Properties of analysts' forecasts of earnings: a review and analysis of the research." *Journal of Accounting Literature*.3: 119-148.

Givoly and Lakonishok review the status of the research on security analysts' forecasts up to 1984, and they conclude that: (1) the performance of analysts' forecasts is in general superior to that of statistical models, a result that is consistent with a rational market for forecasting services, where the higher costs of financial analysts' forecasts is compensated with better performance; and (2) financial analysts' forecasts incorporate the past history of realizations and predictions in an unbiased manner.

Brown, L. D. (1997). "Analyst forecasting errors: additional evidence." *Financial Analysts Journal* November/December: 81-88.

Using data from I/B/E/S for the period 1985 - 1996, Brown studies whether: (1) analysts' forecasts are optimistic; (2) potential optimistic bias is constant over time; and (3) analysts' forecasting errors are smaller for S&P 500 firms, firms with large market capitalization, firms with greater analyst following, and firms in particular industries. For the entire period, Brown finds that model and median values of analysts' forecast errors are zero, but mean errors are negative. He finds that the negative mean forecast error results from a relatively small number of large forecast errors, indicating that these errors are associated with large accounting write-offs for a small number of firms in certain years. In addition, he finds that: (1) the mean analyst forecast error decreases significantly over the period of his study; and (2) optimistic bias of mean forecasts for S&P 500 firms is significantly less than optimistic bias for all firms, and, indeed, analysts for S&P 500 firms are, on average, pessimistic for the years 1993 - 1996; (3) optimistic bias is less for large firms than for small firms; and (4) optimistic bias is less for firms in certain industries compared to other industries, with the best forecasts for the following industries: food and related products, transportation equipment, communications, and electric, gas, sanitary services.

Keane, M. P., and David E. Runkle (1998). "Are financial analysts' forecasts of corporate profits rational." *The Journal of Political Economy* 106(4): 768-805.

Keane and Runkle demonstrate that previous inferences regarding analyst optimism are strongly affected by correlation in analyst forecast errors across forecasts and firms and by unexpected accounting write-offs and special charges. They develop a new estimator of bias that gives correct statistical inference when forecast errors are correlated, and they show that previous studies' failure to account for correlation led to a conclusion that analysts are optimistic. Using an I/B/E/S database over the period 1983 - 1991, they also demonstrate that a correct test for analyst optimism leads to the conclusion that analysts are unbiased.

In addition to problems caused by correlation in analysts' earnings forecasts, the authors also address the problems caused by unanticipated accounting accruals. Similar to Abarbanell (2003), they demonstrate that statistical tests of optimism are distorted by discretionary special accounting charges in the forecast period. Failure to adjust for discretionary special accounting charges in the company sample under study distorts statistical results in the direction of favoring the conclusion of biased analysts' forecasts. The authors conclude that the evidence in their paper strongly supports the view that professional stock market analysts make rational forecasts of earnings per share for the companies they follow.

Abarbanell, J., and Reuven Lehavy (2003). "Biased forecasts or biased earnings? The role of reported earnings in explaining apparent bias and over/underreaction in analysts' earnings forecasts." *Journal of Accounting & Economics* 36: 105-146.

Abarbanell and Lehavy investigate whether the apparent bias in analysts' earnings forecasts that appears in some research studies is explained by large accounting write-offs and special charges made by a small number of sample firms. The Abarbanell/Lehavy study is based on a large database of consensus earnings forecasts provided by Zacks for the period 1985 – 1998. When Abarbanell/Lehavy examine the distribution of analysts' forecast errors over this time period, they find that the only statistical indication that supports the argument for analyst optimism is a fairly large negative mean forecast error. In contrast, the median error is zero, suggesting unbiased forecasts, while the percentage of positive errors is significantly greater than the percentage of negative errors (48 percent versus 40 percent), suggesting apparent analyst pessimism. Similar to Brown (1997), Abarbanell/Lehavy explain this phenomenon by observing that the left tail (the optimistic tail of the distribution) contains significantly more extreme errors of greater magnitude than the right tail (the pessimistic tail) of the distribution. Abarbanell/Lehavy's conclusion is supported by a correlation study that examines the relationship between extreme negative forecast errors with extreme negative unexpected accruals. The correlation study indicates a direct connection between the extreme errors in the left tail of the error distribution and unexpected accounting accruals. Once the effect of accounting accruals is removed the study, Abarbanell/Lehavy find that the mean forecast error becomes zero, indicating that there is no tendency for analysts' forecasts to be optimistic.

Ciccone, S. J. (2005). "Trends in analyst earnings forecast properties." *International Review of Financial Analysts* 14: 1-22.

Ciccone examines trends in analysts forecast dispersion, error, and optimism using First Call 120,022 quarterly observations from 1990 – 2001. He finds that analyst optimism declined significantly over the period of his study and that analysts' forecasts for profitable firms became pessimistic in the last several years of his study period. He concludes that analyst optimism is no longer an issue and that, "[i]f anything, analysts have a new concern: earnings pessimism for profit firms."

Clarke, J., Stephen P. Ferris, Narayanan Jayaraman, and Jinsoo Lee (2006). "Are analyst recommendations biased? Evidence from corporate bankruptcies." *Journal of Financial and Quantitative Analysis* 41(1): 169-196.

The authors test whether a bias exists in analysts' recommendations for firms that filed for bankruptcy in the period 1995 – 2001. Their database consists of a final set of 289 firms that filed for bankruptcy during this period and that have I/B/E/S analysts' forecasts. As a comparison sample, the authors identify a matching group of firms with the same SIC code and that have a similar likelihood of bankruptcy as measured by the Altman z-score. The authors test for optimism by comparing the analysts' recommendations for the companies in the bankrupt group to the matched sample of companies in the non-bankrupt group in five categories—strong buy, buy, hold, under-perform, and sell. They find that, on average, analysts' recommendations are significantly lower for the companies that eventually go bankrupt than for the matched companies that do not file for bankruptcy. From this comparison, the authors conclude that the hypothesis that analysts' recommendations are optimistic should be rejected.

Yang, R., and Yaw M. Mensah (2006). "The effect of the SEC's regulation fair disclosure on analyst forecast attributes." *Journal of Financial Regulation and Compliance* 14(2): 192-209.

Regulation fair disclosure ("Reg. FD"), issued on October 23, 2000, prohibits selective disclosure of material non-public information to financial analysts, institutional investors, and others prior to making it available to the general public. Before the implementation of Reg. FD, most conference calls with analysts were accessible only to certain analysts and institutional investors. The authors examine whether Reg. FD has influenced analysts' earnings forecast accuracy and forecast dispersion for companies that routinely conduct conference calls as well as for companies that do not conduct conference calls. Using I/B/E/S forecast data for the period October 1998 through September 2002 and 12,806 firm-quarter observations in pre-Reg FD period and 13,104 firm-quarter observations in the post-Reg FD period, the authors examine the descriptive statistics of analysts' forecast errors in the pre-Reg. FD and post-Reg. FD environments. They conclude that Reg. FD had little influence on analysts' forecast errors: the mean forecast error was approximately zero in both the pre-and post-Reg. FD periods.

**Las Quintas Serenas Water Company  
Docket No. W-01583A-09-0589**

**THOMAS J. BOURASSA  
REBUTTAL TESTIMONY  
(COST OF CAPITAL)  
August 23, 2010**

**SCHEDULES**

**Las Quintas Serenas Water Company**  
 Test Year Ended June 30, 2009  
 Summary of Cost of Capital

Exhibit  
 Rebuttal Schedule D-1  
 Page 1  
 Witness: Bourassa

	<u>As of September 30, 2009</u>				<u>End of Projected Year</u>				
Line No.	Item of Capital	Dollar Amount	Percent of Total	Cost Rate	Weighted Cost	Dollar Amount	Percent of Total	Cost Rate	Weighted Cost
1	Long-Term Debt	1,725,175	67.93%	7.10%	4.82%	\$ 1,667,815	64.78%	7.10%	4.60%
2									
3	Adjusted Stockholder's Equity <sup>1</sup>	814,405	32.07%	14.40%	4.62%	906,736	35.22%	14.40%	5.07%
4									
5	Totals	\$ 2,539,580	100.00%		9.44%	\$ 2,574,551	100.00%		9.67%
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SUPPORTING SCHEDULES:

- Rebuttal D-2
- Rebuttal D-3
- Rebuttal D-4
- Direct D-1

RECAP SCHEDULES:  
 Rebuttal A-1.

Las Quintas Serenas Water Company  
 Test Year Ended June 30, 2009  
 Cost of Long Term Debt

Exhibit  
 Rebuttal Schedule D-2  
 Page 1  
 Witness: Bourassa

Line No.	Description of Debt	As of September 30, 2009				End of Projected Year			
		Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost	Amount Outstanding	Annual Interest	Interest Rate	Weighted Cost
1	WIFA Loan	1,725,175	122,487	7.10%	7.10%	1,667,815	118,415	7.10%	7.10%
2			-	0.00%	0.00%	-	-	0.00%	0.00%
3			-	0.00%	0.00%	-	-	0.00%	0.00%
4			-	0.00%	0.00%	-	-	0.00%	0.00%
5			-	0.00%	0.00%	-	-	0.00%	0.00%
6			-	0.00%	0.00%	-	-	0.00%	0.00%
7			-	0.00%	0.00%	-	-	0.00%	0.00%
8			-	0.00%	0.00%	-	-	0.00%	0.00%
9			-	0.00%	0.00%	-	-	0.00%	0.00%
10			-	0.00%	0.00%	-	-	0.00%	0.00%
11			-	0.00%	0.00%	-	-	0.00%	0.00%
12			-	0.00%	0.00%	-	-	0.00%	0.00%
13	Totals	\$ 1,725,175	\$ 122,487		7.10%	\$ 1,667,815	118,415		7.10%
14									

15 SUPPORTING SCHEDULES:  
 16 E-1  
 17  
 18  
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 20

Las Quintas Serenas Water Company  
Test Year Ended June 30, 2009  
Cost of Preferred Stock

Exhibit  
Rebuttal Schedule D-3  
Page 1  
Witness: Bourassa

End of Test Year

End of Projected Year

Line No.	Description of Issue	Shares Outstanding	Dividend Amount	Dividend Requirement	Shares Outstanding	Dividend Amount	Dividend Requirement
1							
2							
3	NOT APPLICABLE, NO PREFERRED STOCK ISSUED OR OUTSTANDING						
4							
5							
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17	<u>SUPPORTING SCHEDULES:</u>				<u>RECAP SCHEDULES:</u>		
18					Rebuttal D-1		
19							
20							

**Las Quintas Serenas Water Company**  
Test Year Ended June 30, 2009  
Cost of Common Equity

Exhibit  
Rebuttal Schedule D-4  
Page 1  
Witness: Bourassa

Line

No.

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The Company is proposing a cost of common equity of 14.40% .

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SUPPORTING SCHEDULES:  
Rebuttal Schedules D-4.0 to D-4.16

RECAP SCHEDULES:  
Rebuttal D-1

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**Las Quintas Serenas Water Company  
Summary of Results**

**Exhibit  
Rebuttal Schedule D-4.1**

Line No.	<u>Method</u>	<u>Low</u>	<u>High</u>	<u>Midpoint</u>
1				
2				
3				
4				
5				
6	Range DCF Constant Growth Estimates <sup>1</sup>	9.7%	11.3%	10.5%
7				
8	Range of CAPM Estimates <sup>2</sup>	10.7%	15.8%	13.2%
9				
10				
11	Average of DCF and CAPM midpoint estimates	10.2%	13.5%	11.9%
12				
13				
14	Financial Risk Adjustment <sup>3</sup>	1.5%	1.5%	1.5%
15				
16	Small Company Risk Premium <sup>4</sup>	1.0%	1.0%	1.0%
17				
18	Indicated Cost of Equity	12.7%	16.0%	14.4%
19				
20				
21				
22	Recommended Cost of Equity			14.4%
23				
24				
25				
26				
27				
28				
29				

<sup>1</sup> See Schedule D-4.8

<sup>2</sup> See Schedule D-4.12

<sup>3</sup> See Schedule D-4.16

<sup>4</sup> See testimony.

**Las Quintas Serenas Water Company**  
**Selected Characteristics of Sample Group of Water Utilities**

**Exhibit**

**Rebuttal Schedule D-4.2**

Line No.	Company <sup>1</sup>	% Water Revenues	Operating Revenues (millions)	Net Plant (millions)	S&P Bond Rating	Moody's Bond Rating
1	1. American States	74%	\$ 371.6	\$ 769.0	A	A2
2	2. Aqua America	97%	\$ 676.6	\$ 2,813.6	AA-	NR
3	3. California Water	98%	\$ 453.0	\$ 1,095.8	AA-	NR
4	4. Connecticut Water	90%	\$ 68.0	\$ 274.7	A	NR
5	5. Middlesex	88%	\$ 92.3	\$ 332.7	A	NR
6	6. SJW Corp.	96%	\$ 216.5	\$ 536.5	NR	NR
7	Average	91%	\$ 313.0	\$ 970.4		
8	Las Quintas Serenas Water Company	100%	\$ 0.5	\$ 2.8	NR	NR
9	(as of December 31, 2009)					

<sup>1</sup>AUS Utility Reports (August 2010).

**Las Quintas Serenas Water Company  
Capital Structures**

**Exhibit  
Rebuttal Schedule D-4.3**

No.	Company	Book Value <sup>1</sup>		Market Value <sup>1</sup>	
		Long-Term Debt	Common Equity	Long-Term Debt	Common Equity
1	1. American States	47.7%	52.3%	35.0%	65.0%
2	2. Aqua America	55.7%	44.3%	34.8%	65.2%
3	3. California Water	47.2%	52.8%	34.2%	65.8%
4	4. Connecticut Water	51.0%	49.0%	38.4%	61.6%
5	5. Middlesex	47.4%	52.6%	36.7%	63.3%
6	6. SJW Corp.	49.8%	50.2%	37.2%	62.8%
10	Average	49.8%	50.2%	36.1%	63.9%
13	Las Quintas Serenas Water Co <sup>2</sup> (Adjusted as of December 31, 2009)	18.3%	81.7%	N/A	N/A

<sup>1</sup> Value Line Analyzer Data (August 13, 2010)

<sup>2</sup> Adjusted Per Schedule D-1

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**Las Quintas Serenas Water Company  
Comparisons of Past and Future Estimates of Growth**

Line No.	[1]	[2]	[3]	[4]	[5]	[6]	[7]
3	<b>Ten-year historical average annual changes</b>						
4		Book			Average	Average	Average of
5		Value <sup>2</sup>	EPS <sup>2</sup>	DPS <sup>2</sup>	Col 1-4	Future Growth <sup>3</sup>	Future and Historical Growth
6	Price <sup>1</sup>						Col 5-6
7	7.97%	4.50%	4.00%	1.50%	4.49%	5.00%	4.75%
8	7.21%	9.50%	6.50%	7.50%	7.68%	8.37%	8.02%
9	6.01%	4.00%	1.00%	1.00%	3.00%	6.31%	4.65%
10	3.10%	4.00%	1.00%	1.50%	2.40%	7.44%	4.92%
11	4.05%	4.50%	1.50%	2.00%	3.01%	8.00%	5.51%
12	1.81%	6.00%	2.00%	5.00%	3.70%	9.50%	6.60%
13							
14							
15		5.42%	2.67%	3.08%	4.05%	7.44%	5.74%
16	GROUP AVERAGE	4.50%	1.75%	1.75%	3.36%	7.72%	5.21%
17	GROUP MEDIAN						

<sup>1</sup> Average of changes in annual stock prices ending August 13, 2010. Data from Yahoo Finance website.

<sup>2</sup> Value Line Analyzer Data, Aug 13, 2010

<sup>3</sup> See Rejoinder Schedule D-4.6.

Line No. 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28

**Las Quintas Serenas Water Company**  
**Analysts Forecasts of Earnings Per Share Growth**

**Exhibit**  
**Rebuttal Schedule D-4.6**

Line No.	[1]	[2]	[3]	[4]	[5]
	<b>ESTIMATES OF EARNINGS GROWTH</b>				
	<u>Company</u>	<u>Zacks</u> <sup>1</sup>	<u>Morningstar</u> <sup>1</sup>	<u>Yahoo</u> <sup>1</sup>	<u>Value Line</u> <sup>1</sup>
1	1. American States	4.00%	4.00%	4.00%	8.00%
2	2. Aqua America	7.00%	8.30%	6.67%	11.50%
3	3. California Water	4.00%	6.00%	8.73%	6.50%
4	4. Connecticut Water			15.00%	
5	5. Middlesex		8.00%	8.00%	
6	6. SJW Corp.		9.00%	10.00%	
7					<b>Average Growth (G)</b> <b>(Cols 1-4)<sup>2</sup></b>
8					5.00%
9					8.37%
10					6.31%
11					7.44%
12					8.00%
13					9.50%
14					
15	<b>GROUP AVERAGE</b>	5.00%	7.06%	8.73%	8.67%
16	<b>GROUP MEDIAN</b>				7.72%
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					

<sup>1</sup> Data as of August 13, 2010

<sup>2</sup> Where no data available or single estimate, average of other utilities assumed to estimate for utility.

Las Quintas Serenas Water Company  
Current Dividend Yields for Water Utility Sample Group

Line No.	Company	Current Stock Price (P <sub>0</sub> ) <sup>1</sup>	Current Dividend (D <sub>0</sub> ) <sup>1</sup>	Current Dividend Yield (D <sub>0</sub> /P <sub>0</sub> ) <sup>1</sup>	Average Annual Dividend Yield (D <sub>0</sub> /P <sub>0</sub> ) <sup>1,2</sup>
1	1. American States	\$ 32.80	\$ 1.04	3.17%	2.94%
2	2. Aqua America	\$ 19.18	\$ 0.59	3.08%	3.09%
3	3. California Water	\$ 34.72	\$ 1.19	3.43%	3.07%
4	4. Connecticut Water	\$ 21.15	\$ 0.91	4.31%	4.11%
5	5. Middlesex	\$ 16.06	\$ 0.72	4.49%	4.71%
6	6. SJW Corp.	\$ 22.90	\$ 0.70	3.04%	2.84%
7	Average			3.59%	3.46%
8	Median			3.30%	3.08%

<sup>1</sup> Value Line Analyzer Data. Stock prices as of August 13, 2010.

<sup>2</sup> Average Annual Dividend is dividends declared per share for a year divided by the average annual price of the stock in the same year, expressed as a percentage. For comparison purposes only.

Line No. 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25

**Las Quintas Serenas Water Company**  
**Discounted Cash Flow Analysis**  
**DCF Constant Growth**

**Exhibit**  
**Rebuttal Schedule D-4.8**

Line No.	[1] Average Spot Dividend Yield ( $D_0/P_0$ ) <sup>1</sup>	[2] Expected Dividend Yield ( $D_1/P_0$ ) <sup>2</sup>	[3] Growth (g)	[4] Indicated Cost of Equity k=Div Yld + g (Cols 2+3)
8	3.59%	3.80%	5.87%	9.7%
10	3.59%	3.85%	7.44%	11.3%
13	3.59%	3.82%	6.65%	10.5%

<sup>1</sup> Spot Dividend Yield =  $D_0/P_0$ . See Schedule D-4.7.

<sup>2</sup> Expected Dividend Yield =  $D_1/P_0 = D_0/P_0 * (1+g)$ .

<sup>3</sup> Growth rate (g). Average of Past and Future Growth. See Schedule D-4.4, column 7

<sup>4</sup> Growth rate (g). Average of Analyst Estimates Future Growth. See Schedule D-4.6.

Line No. 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28

**Las Quintas Serenas Water Company  
Market Betas**

**Exhibit  
Rebuttal Schedule D-4.9**

<u>Line No.</u>	<u>Company</u>	<u>Beta (<math>\beta</math>)<sup>1</sup></u>
1	American States	0.80
2	Aqua America	0.65
3	California Water	0.75
4	Connecticut Water	0.80
5	Middlesex	0.75
6	SJW Corp.	0.95
7		
8		
9	Average	<b>0.78</b>
10		
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13		
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17		
18		
19		
20		

<sup>1</sup> Value Line Investment Analyzer data (August 13, 2010)

Note: Beta is a relative measure of the historical sensitivity of a stock's price to overall fluctuations in the New York Stock Exchange Composite Index. A Beta of 1.50 indicates a stock tends to rise (or fall) 50% more than the New York Stock Exchange Composite Index. The "Beta coefficient" is derived from a regression analysis of the relationship between weekly percent-age changes in the price of a stock and weekly percentage changes in the NYSE Index over a period of five years. In the case of shorter price histories, a smaller time period is used, but two years is the minimum. The Betas are adjusted for their long-term tendency to converge toward 1.00.

**Las Quintas Serenas Water Company  
Forecasts of Long-Term Interest Rates  
2011-2012**

**Exhibit  
Rebuttal Schedule D-4.10**

Line No.	Description	<u>2012</u>	<u>2013</u>	<u>Average</u>
1				
2				
3				
4				
5				
6	Blue Chip Consensus Forecasts <sup>1</sup>	5.3%	5.7%	5.5%
7				
8	Value Line <sup>2</sup>	5.2%	5.6%	5.4%
9				
10	Average			5.5%
11				
12				
13				
14				

<sup>1</sup> June 2010 Blue Chip Financial Forecasts consensus forecast of 30 Year U.S. Treasury

<sup>2</sup> Value Line Quarterly forecast, dated May 28, 2010, Long-term Treasury

Line No. 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24

**Las Quintas Serenas Water Company**  
**Computation of Current Market Risk Premium**

**Exhibit**  
**Rebuttal Schedule D-4.11**

Line No.	Month	Dividend Yield ( $D_t/P_t$ ) <sup>1</sup>	Expected Dividend Yield ( $D_t/P_t$ ) <sup>2</sup>	+ Growth (g) <sup>3</sup>	= Expected Market Return (k)	- Monthly Average 30 Year Treasury Rate <sup>4</sup>	= Market Risk Premium (MRP)
4	Jan 2009	4.86%	6.32%	+ 30.02%	= 36.34%	- 3.13%	= 33.21%
5	Feb	5.50%	7.43%	+ 35.13%	= 42.56%	- 3.59%	= 38.97%
6	Mar	4.21%	5.36%	+ 27.33%	= 32.69%	- 3.64%	= 29.05%
7	April	3.66%	4.47%	+ 22.05%	= 26.52%	- 3.76%	= 22.76%
8	May	3.46%	4.14%	+ 19.67%	= 23.81%	- 4.23%	= 19.58%
9	Jun	3.25%	3.87%	+ 19.16%	= 23.03%	- 4.52%	= 18.51%
10	Jul	2.90%	3.37%	+ 16.31%	= 19.68%	- 4.41%	= 15.27%
11	Aug	2.82%	3.22%	+ 14.21%	= 17.43%	- 4.37%	= 13.06%
12	Sept	2.80%	3.20%	+ 14.32%	= 17.52%	- 4.19%	= 13.33%
13	Oct	2.75%	3.15%	+ 14.49%	= 17.64%	- 4.19%	= 13.45%
14	Nov	2.68%	3.05%	+ 13.88%	= 16.93%	- 4.31%	= 12.62%
15	Dec 2009	2.56%	2.88%	+ 12.58%	= 15.46%	- 4.35%	= 11.11%
16	Jan 2010	2.64%	3.00%	+ 13.71%	= 16.71%	- 4.48%	= 12.23%
17	Feb	2.59%	2.97%	+ 14.65%	= 17.62%	- 4.48%	= 13.14%
18	Mar	2.44%	2.75%	+ 12.69%	= 15.44%	- 4.48%	= 10.96%
19	April	2.36%	2.63%	+ 11.61%	= 14.24%	- 4.69%	= 9.55%
20	May	2.61%	3.00%	+ 14.80%	= 17.80%	- 4.29%	= 13.51%
21	June	2.79%	3.30%	+ 18.20%	= 21.50%	- 4.13%	= 17.37%
22	July	2.61%	3.03%	+ 15.95%	= 18.98%	- 3.99%	= 14.99%
23							
24	Recommended	2.59%	2.96%	+ 14.23%	= 17.19%	- 4.36%	= 13.25%
25							
26	Short-term Trends						
27	Recent Twelve Months Avg	2.64%	3.01%	+ 14.26%	= 17.27%	- 4.33%	= 12.94%
28	Recent Nine Months Avg	2.59%	2.96%	+ 14.23%	= 17.19%	- 4.36%	= 12.83%
29	Recent Six Months Avg	2.57%	2.95%	+ 14.65%	= 17.60%	- 4.34%	= 13.25%
30	Recent Three Months Avg	2.67%	3.11%	+ 16.32%	= 19.42%	- 4.14%	= 15.29%
31							
32							

<sup>1</sup> Average Current Dividend Yield ( $D_t/P_t$ ) of dividend paying stocks. Data from Value Line Investment Analyzer Software Data - Value Line 1700 Stocks  
<sup>2</sup> Expected Dividend Yield ( $D_t/P_t$ ) equals average current dividend yield (D0/P0) times one plus growth rate(g).  
<sup>3</sup> Average 3-5 year price appreciation (annualized). Data from Value Line Investment Analyzer Software Data - Value Line 1700 Stocks  
<sup>4</sup> Monthly average 30 year U.S. Treasury. Federal Reserve.

**Las Quintas Serenas Water Company  
Capital Asset Pricing Model (CAPM)**

**Exhibit  
Rebuttal Schedule D-4.12**

Line									
<u>No.</u>									
1		Rf <sup>1</sup>	+	beta <sup>3</sup>	x	Rp	=	k	
2									
3		Historical Market Risk Premium CAPM	+	0.78	x	6.7%	=	10.7%	
4									
5		Current Market Risk Premium CAPM	+	0.78	x	13.3%	=	15.8%	
6									
7		Average							13.2%
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
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19									
20									

<sup>1</sup> Forecasts of long-term treasury yields. See Schedule D-4.10.

<sup>2</sup> Value Line Investment Analyzer data. See Schedule D-4.9.

<sup>3</sup> Historical Market Risk Premium from (Rp) MorningStar S&P 500 Valuation Yearbook Table A-1 Long-Horizon ERP 1926-2009

<sup>4</sup> Computed using DCF constant growth method to determine current market return on Value Line 1700 stocks and CAPM with beta of 1.0 to compute Current Market Risk Premium (Rp). See Schedule D-4.11.

**Las Quintas Serenas Water Company**  
**Financial Risk Computation**

**Exhibit**  
**Rebuttal Schedule D-4.13**

Line No.							
1	<u>CAPM</u>						
2		Rf	+	$\beta$	x	(Rp)	k
3	Historical Market Risk Premium	5.5%	1	0.78	2	6.7%	10.7%
4	Current Market Risk Premium	5.5%	1	0.78	2	13.3%	15.8%
5							
6	Average						13.3%
7							
8							
9	<u>CAPM Relevered Beta</u>						
10		Rf	+	$\beta$	x	(Rp)	k
11	Historical Market Risk Premium	5.5%	1	0.94	5	6.7%	11.7%
12	Current Market Risk Premium	5.5%	1	0.94	5	13.3%	17.9%
13							
14	Average						14.8%
15							
16	Financial Risk Adjustment						<u>1.5%</u>
17							
18							
19							
20							
21							
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23							
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25							

<sup>1</sup> Forecast of long-term treasury yields. See Schedule D-4.10

<sup>2</sup> Value Line Investment Analyzer data. See Schedule D-4.9

<sup>3</sup> Historical Market Risk Premium from (Rp) MorningStar SBBi 2010 Valuation Yearbook Table A-1 Long-Horizon ERP 1926-2009

<sup>4</sup> Computed using DCF constant growth method to determine current market return on Value Line 1700 stocks

and CAPM with beta of 1.0 to compute Current Market Risk Premium (Rp). See Schedule D-4.11

<sup>5</sup> Relevered beta found on Schedule D-4.15

**Exhibit**  
**Rebuttal Schedule D-4.14**

**Las Quintas Serenas Water Company**  
**Financial Risk Computation**  
**Unlevered Beta**

Line No.	Company	VL Beta $\beta_L^1$	Raw Beta $\frac{\text{Raw } \beta_L^2}{\text{Raw } \beta_L^2}$	Tax Rate $t^3$	MV Debt $D^4$	MV Equity $E^4$	Unlevered Raw Beta $\beta_U^5$
1	American States	0.80	0.70	37.8%	35.0%	65.0%	0.52
2	Aqua America	0.65	0.48	39.4%	34.8%	65.2%	0.36
3	California Water	0.75	0.63	38.0%	34.2%	65.8%	0.48
4	Connecticut Water	0.80	0.70	19.5%	38.4%	61.6%	0.47
5	Middlesex	0.75	0.63	34.1%	36.7%	63.3%	0.46
6	SJW Corp.	0.95	0.93	40.4%	37.2%	62.8%	0.69
11							
12							
13	Sample Water Utilities	0.78	0.68	34.8%	36.1%	63.9%	0.50
14							
15							
16							
17							
18							
19							

<sup>1</sup> Value Line Investment Analyzer data. See Schedule D-4.13  
<sup>2</sup> Value Line uses the historical data of the stock, but assumes that a security's beta moves toward the market average over time. The formula is as follows:  

$$\text{Adjusted beta} = .33 + (.67) * \text{Raw beta}$$

<sup>3</sup> Raw Beta =  $(VL \text{ beta} - .33) / (.67)$

<sup>4</sup> Effective tax rates for year ended December 31, 2009.

<sup>5</sup> See Schedule D-4.3

<sup>6</sup> Raw  $\beta_U = \text{Raw } \beta_L / (1 + (1-t)D/E)$

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Las Quintas Serenas Water Company  
Financial Risk Computation  
Relevered Beta

Exhibit  
Rebuttal Schedule D-4.15

Line No.	Unlevered Raw Beta $\beta_{LL}^1$	MV Book Debt $BD^2$	MV Equity Capital $EC^2$	Tax Rate $t^3$	Relevered Raw Beta $\beta_{RL} = \beta_U (1 + (1-t)BD/EC)$	VL Adjusted Relevered Beta $\beta_{RAL}$
1	0.50	54.4%	45.6%	30.67%	0.91	0.94

Las Quintas Serenas Water Corr

<sup>1</sup> Unlevered Beta from Schedule D-4.14.

<sup>2</sup> Capital Structure of Company (As of September 30, 2009)

	BV	MV	%
	(in Thousands)	(in Thousands)	
Long-term Debt	\$ 1,725.18	\$ 1,725	54.40%
Preferred Stock	-	-	0.0%
Common Stock	814.41	1,447	45.6%
Total Capital	\$ 2,539.58	\$ 3,173	100.0%

(a) Current market-to-book ratio of sample water utilities. See work papers.

<sup>3</sup> Current Tax rate based on test year ending 3/31/2009. See Schedule D-1.

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Las Quintas Serenas Water Company  
Size Premium<sup>1</sup>

Exhibit  
Rebuttal Schedule D-4.16

Line No.	Beta(β)	Size Premium	Risk Premium for Small Water Utilities <sup>7</sup>
1			
2			
3			
4			
5			
6	1.13	1.00%	
7			
8	1.26	1.64%	
9			
10	1.51	3.00%	
11			
12	1.64	4.74%	2.46%
13			
14			
15			
16			
17			
18			
19			
20			
21			
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43			

Estimated Risk Premium for small water utilities<sup>5</sup>

0.99%

<sup>1</sup> Data from Table 7-11 of Morningstar, Ibbotson S&P 500 2010 Valuation Yearbook.

<sup>2</sup> Mid-Cap companies includes companies with market capitalization between \$1,602 million and \$5,936 million.

<sup>3</sup> Low-Cap companies includes companies with market capitalization between \$432 million and \$1,600 million.

<sup>4</sup> Micro-Cap companies includes companies with market capitalization less than \$431 million.

<sup>5</sup> Decile 10 includes companies with market capitalization between \$1.0 million and \$214 million.

<sup>6</sup> From Table 2, Thomas M. Zepp, "Utility Stocks and the Size Effect Revisited," *The Quarterly Review of Economics and Finance*, 43 (2003), 578-582.

<sup>7</sup> Computed as the weighted differences between the Decile 10 risk premium and the indicated risk premiums for the sample water utilities as shown below. Excludes risk due to differences in beta.

Market Cap.	(Millions)	Class	Size Premium	Difference to Decile 10	Weight	Weighted Size Premium
1.	\$ 567	Low-Cap	1.64%	3.10%	0.1666667	0.52%
2.	\$ 2,597	Mid-Cap	1.00%	3.74%	0.1666667	0.62%
3.	\$ 719	Low-Cap	1.64%	3.10%	0.1666667	0.52%
4.	\$ 180	Decile 10	4.74%	0.00%	0.1666667	0.00%
5.	\$ 215	Micro-Cap	3.00%	1.74%	0.1666667	0.29%
6.	\$ 417	Low-Cap	1.64%	3.10%	0.1666667	0.52%
Weighted Size Premium for Small Companies						2.46%