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BEFORE THE ARIZONA CORPORATION COMMISSION
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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
CORDES LAKES WATER COMPANY FOR
APPROVAL OF A RATE INCREASE.

DOCKET NO. W-02060A-12-0356

**STAFF'S NOTICE OF FILING
SURREBUTTAL TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby submits the Surrebuttal Testimony of Staff witnesses Mary J. Rimback and John A. Cassidy in the above-referenced matter.

RESPECTFULLY SUBMITTED this 17th day of May, 2013.

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Original and thirteen (13) copies of the foregoing were filed this 17th day of May, 2013 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing were mailed this 17th day of May, 2013 to:

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Arizona Corporation Commission
DOCKETED

MAY 17 2013

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BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP

Chairman

GARY PIERCE

Commissioner

BRENDA BURNS

Commissioner

BOB BURNS

Commissioner

SUSAN BITTER SMITH

Commissioner

IN THE MATTER OF THE APPLICATION OF)
CORDES LAKES WATER COMPANY FOR)
AN INCREASE IN ITS RATES)
_____)

DOCKET NO. W-02060A-12-0356

SURREBUTTAL

TESTIMONY

OF

MARY J. RIMBACK

PUBLIC UTILITIES ANALYST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MAY 17, 2013

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**EXECUTIVE SUMMARY
CORDES LAKES WATER COMPANY
DOCKET NO. W-02060A-12-0356**

The Surrebuttal Testimony of Staff witness Mary J. Rimback addresses the issues of rate base, operating income, revenue requirement, and rate design for Cordes Lakes Water Company (“Cordes Lakes” or “Company”).

The Company’s Rebuttal Testimony requests an increase in revenue of \$50,372 (11.95 percent) increase over test year revenue of \$420,536. The total annual revenue of \$470,807 produces operating income of \$23,508 for a 10.55 percent rate of return on fair value rate base (“FVRB”) which is also its original cost rate basis (“OCRB”) of \$222,825. The Company’s Rebuttal Testimony withdraws the request for surcharges made in its original rate application.

The Utilities Division (“Staff”) recommends total operating revenue of \$441,810, a \$21,274 (5.06 percent) increase over the \$420,536 Staff-adjusted test year revenue, to provide a \$13,069 operating income and a 9.0 percent rate of return on the \$145,210 Staff-adjusted FVRB and OCRB. Staff’s Surrebuttal revenue requirement represents a \$13,072 increase from its Direct Testimony. Staff recommended rates would increase the typical 5/8 x 3/4-inch meter residential water bill with median usage of \$3,088 by \$0.49 (2.48 percent) from \$19.78 to \$20.27.

1 **I. INTRODUCTION**

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

3 A. My name is Mary J. Rimback; I am a Public Utilities Analyst Arizona Corporation
4 Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business
5 address is 1200 West Washington Street, Phoenix, Arizona 85007.

6

7 **Q. Are you the same Mary J. Rimback who previously submitted Direct Testimony in
8 this case?**

9 A. Yes, I am.

10

11 **Q. How is your testimony organized?**

12 A. My testimony is presented in four sections. Section I is this introduction. Section II
13 provides the purpose of the testimony. Section III is a summary of recommendations.
14 Section IV presents Staff's response to the Rebuttal Testimony of Mr. Matthew Rowell.

15

16 **II. PURPOSE OF SURREBUTTAL TESTIMONY**

17 **Q. What is the purpose of your Surrebuttal Testimony in this proceeding?**

18 A. The purpose of my Surrebuttal Testimony in this proceeding is to respond to the Rebuttal
19 Testimony of Cordes Lakes Water Company ("Cordes Lakes" or "Company") witness Mr.
20 Matthew Rowell and to present Staff's Surrebuttal position regarding rate base, operating
21 income, revenue requirement and rate design issues.

22

1 **Q. Do you attempt to address every issue raised by the Company in its Rebuttal**
2 **Testimony?**

3 A. No, my silence on any particular issue raised in the Company's Rebuttal Testimony does
4 not indicate that Staff agrees with the Company's rebuttal position on that issue. I rely on
5 my Direct Testimony unless modified by this Surrebuttal Testimony.

6
7 **Q. What issues will you address?**

8 A. My Surrebuttal Testimony addresses the following issues presented in Rebuttal Testimony
9 of Mr. Rowell:

- 10
11 1) Contributions in Aid of Construction ("CIAC") balance and CIAC amortization
12 2) Real property included in rate base
13 3) Bad debt expense
14 4) Staff's plant disallowance
15 5) Rate Case Expense
16 6) Post Test Year Plant
17 7) Accounting Expenses
18 8) Purchased Power Expenses
19 9) Revenue Requirement and Rate Design
20

21 **III. SUMMARY OF RECOMMENDATIONS**

22 **Q. What Rebuttal revenue requirement is the Company proposing?**

23 A. The Company's Rebuttal Testimony is requesting total operating revenue of \$470,807, a
24 \$50,271 or an 11.95 percent increase over test year revenue of \$420,536, to provide a
25 \$23,508 operating income and a 10.55 percent rate of return on a proposed \$222,825 fair

1 value rate base (“FVRB”) which is also the Company-proposed original cost rate base
2 (“OCRB”).
3

4 **Q. Please provide a summary of Staff’s Surrebuttal recommendations.**

5 A. The Staff’s Surrebuttal revenue requirement of \$441,810 represents an increase of \$21,274
6 or 5.06 percent over test year revenue of \$420,536 to provide a \$13,069 operating income
7 and a 9.00 percent rate of return on a proposed \$145,210 fair value rate base (“FVRB”).
8 Staff’s Surrebuttal revenue requirement represents a \$13,072 increase from its Direct
9 Testimony. Staff’s recommended rates would increase the typical 5/8 x 3/4-inch meter
10 residential water bill with median usage of 3,088 gallons by \$0.49 (2.48 percent), from
11 \$19.78 to \$20.27.
12

13 **IV. RESPONSE TO REBUTTAL TESTIMONY OF MATTHEW ROWELL**

14 *CIAC Balance and Accumulated Amortization of CIAC*

15 **Q. What is the Company proposing for CIAC and Accumulated Amortization of CIAC
16 in its Rebuttal?**

17 A. The Company’s Rebuttal proposes \$92,754 for CIAC and \$53,720 for Accumulated
18 Amortization of CIAC resulting in a \$39,034 Net CIAC balance. The Company presents
19 Schedule 1 that list CIAC and CIAC amortizations for the period beginning in 1999 and
20 continuing through to December 31, 2012. The Company provided no support for the
21 amounts presented in Schedule 1. The Company also asserts that Staff misinterpreted
22 Decision No. 54526 and that the CIAC that Decision directed not to be amortized refers to
23 additional advances to be converted to CIAC that are not included in Staff \$76,247 CIAC
24 balance. Further the Company claims that these additional CIAC amounts pertain to the
25 Verde Village System that the City of Cottonwood condemned and that the CIAC

1 associated with the Verde Village System would have been conveyed with the
2 condemnation.

3
4 **Q. What is Staff's response to the Company's assertions regarding CIAC and**
5 **Accumulated Amortization of CIAC?**

6 A. First, it appears that Staff and the Company agree that the CIAC related to the Verde
7 Village System should not be included in rate base. Second, whether the CIAC balance
8 should reflect amortization is determined by the Commission Orders. Staff has further
9 reviewed Decision Nos. 54526 and 70170¹ for the Company's prior two rate cases and
10 concluded that Decision No. 54526 did not authorize amortization of CIAC; however,
11 Decision No. 70170 did authorize amortization of CIAC. The latter authorization is
12 inferred by the adoption of Staff's recommendations which included Staff's depreciation
13 expenses. Staff Surrebuttal Schedule GTM-18 in that case shows that Staff deducted an
14 amount for the amortization of CIAC in its calculation of depreciation expense. Thus,
15 amortization of the \$76,247 CIAC balance should have begun on the effective date of
16 rates in the prior rate case, but not before that date. Staff's Surrebuttal reflects the
17 accumulation of amortization from March 2008 through the end of the test year.

18
19 **Q. How did Staff calculate depreciation expense in Surrebuttal Schedule GTM-18 in the**
20 **prior rate case?**

21 A. Schedule GTM-18 shows that Staff recommended \$25,137 for depreciation expense. The
22 recommended depreciation expense represents a gross (prior to CIAC amortization)
23 depreciation of \$30,063 reduced by \$4,926 for the amortization of CIAC. The
24 amortization of CIAC is calculated using a composite rate of depreciation expense. The

¹ Docket No. W-02060A-07-0256 (February 28, 2008).

1 composite rate is the depreciation expense for the test year divided by the amount of
2 depreciable plant in the test year.

3

4 **Q. What adjustment does Staff recommend for CIAC and Accumulated Amortization**
5 **of CIAC?**

6 A. Staff recommends the CIAC balance adopted in Decision No. 70170 of \$76,247 and an
7 accumulated amortization of CIAC balance adjusted upward from \$0 in Direct Testimony
8 to \$18,710. The accumulated amortization balance is based on the composite rate of
9 depreciation expense for each annual period from March 1, 2008, through the end of the
10 test year December 31, 2011, as shown in Surrebuttal Schedule MJR-9. Amortization of
11 CIAC in the test year of \$3,514 is deducted from depreciation expense as shown in
12 Surrebuttal Schedule MJR-16.

13

14 *Real Property included in Rate Base*

15 **Q. Did the Company's Rebuttal Testimony propose to revise from its original**
16 **application the amount of real property it is proposing to include in rate base?**

17 A. Yes. The Company's original filing proposed including \$35,665 for *Land and Land*
18 *Rights*. Staff removed this amount entirely because the investment pertains to a parcel of
19 land that is not used and useful, and the Company's Rebuttal position agrees with Staff's
20 determination for that parcel. However, in Rebuttal the Company claims that its books
21 carry a balance of \$85,599 for land, and therefore is requesting to include the \$49,934
22 (\$85,599 - \$35,665) balance in rate base.

23

1 **Q. What support did the Company provide for its revised land request?**

2 A. The Company's only support is Schedule 3 attached to the Rebuttal Testimony of
3 Company witness Mr. Matthew Rowell and a statement that this is a reasonable amount
4 considering that its wells and booster pumps are positioned on land.

5
6 **Q. Does Staff consider the Company's support for its land request adequate?**

7 A. No. The Company should provide support showing the owner's name, date(s), transaction
8 values, locations and dimensions of the claimed land along with an explanation of the
9 plant located on each parcel. Also if this land is for utility use, the Company should
10 explain why its Schedule 3 shows five sales transactions reducing the land account
11 balance.

12
13 **Q. What does Staff recommend?**

14 A. Staff continues to recommend disallowance of all amounts the Company requests for
15 including land in rate base

16
17 *Bad Debt Expense*

18 **Q. Did the Company's Rebuttal Testimony introduce a new request for bad debt
19 expense?**

20 A. Yes, the Company in its Rebuttal Testimony is requesting \$4,049 for bad debt expense -
21 all of which it recorded in October of 2011.

22
23 **Q. What are Staff's comments regarding bad debt expense?**

24 A. Bad debt expense typically varies significantly from year to year for various reasons
25 including the variances in the consistency used by the Company to write-off receivables.
26 Thus, it is appropriate to review a multi-year history of bad debts to determine whether a

1 normalized amount is more representative of the likely on-going amount versus the actual
2 test year amount. In response to Staff data request MJR 2-1, the Company provided
3 support to the following write-offs by year: 2007, \$43; 2008, \$1,488; 2009, \$4,079 and
4 2010, \$2,048 which Staff calculated as approximately 0.46 percent of revenue.
5 Accordingly, Staff concludes that normalizing bad debt expense at 0.46 percent of
6 revenues is appropriate.

7
8 **Q. What does Staff recommend for bad debts expense?**

9 A. Staff recommends \$1,934 for test year bad debt expense, as shown in Surrebuttal Schedule
10 MJR-24 and recognition of a 0.46 percent bad debt rate in the gross revenue conversion
11 factor, as shown in Surrebuttal Schedule MJR-2.

12
13 *Plant Disallowance*

14 **Q. Did Staff request the Company to provide support for all plant additions since the**
15 **end of the test year (December 31, 2006) in the prior rate case?**

16 A. Yes, Staff requested invoices to support all amounts added to plant since test year 2006.

17
18 **Q. Did the Company provide invoices to verify all of its plant additions from 2006**
19 **through the test year?**

20 A. Not completely, the Company provided invoices for \$97,600 of the \$100,635 plant
21 additions in its application, a shortfall of \$3,035.

22
23 **Q. Did Staff's recommended \$11,818 disallowance its Direct Testimony include this**
24 **\$3,035 shortfall?**

25 A. Yes.

26

1 **Q. Does Exhibit 4 in the Company s Rebuttal Testimony represent the invoice for the**
2 **\$3,035 shortfall as it claims?**

3 A. No. Exhibit 4 attached to the Company’s Rebuttal Testimony is a copy of an invoice
4 amounting to \$20,299. Handwritten on the invoice are the amounts: CLWC \$6,766 and
5 BWC \$13,533 indicating that \$6,766 pertains to Cordes Lakes and \$13,533 pertains to
6 Berneil Water Company (Cordes Lakes and Berneil Water Company (“BWC”) have
7 common ownership). Neither of these amounts account for the \$3,035 of missing invoices
8 for the claimed plant. The \$6,766.67 charge to Cordes Lakes is not the missing \$3,035,
9 and while Schedule 2 of the Company’s Rebuttal Testimony labels the amount of \$13,533
10 for Invoice No. S1016897 as a missing amount, as noted above, the handwriting on the
11 invoice (Rebuttal Exhibit 4) indicates that the \$13,533 amount is for BWC, not Cordes
12 Lakes.

13
14 **Q. Does the Company have a written capitalization policy?**

15 A. No. Staff asked the Company whether it had a written capitalization policy, and it replied
16 that it did not have a written capitalization policy. In response to Staff Data Request
17 MJR1-10, the Company gave the following explanation of its expense versus capitalized
18 method:

19
20 Almost all purchases are expensed or are considered section 179 property
21 for tax purposes. The decision is based upon how long the items are
22 expected to last. There is no written policy. During the test year a
23 replacement pump was expensed for \$5,200.

24
25 **Q. How did Staff interpret the Company statement regarding capitalization versus**
26 **expensing costs?**

27 A. The Company’s response indicates to Staff that its dollar capitalization threshold is greater
28 than \$5,200. However, absence of a written policy increases the potential for inconsistent

1 application of the Company's capitalization policy. The statement also implies that the
2 Company utilizes tax accounting versus the Commission authorized National Association
3 of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts
4 ("USoA").

5
6 **Q. Is the Company's proposed capitalization as shown in Exhibit 5 of its Rebuttal**
7 **Testimony consistent with the explanation it provided Staff of its capitalization**
8 **policy?**

9 A. No. The Company's explanation of its capitalization policy indicates that it expenses
10 instead of capitalizing amounts of \$5,200 or less. Exhibit 5 shows the Company
11 capitalizing the much lower amount of \$865. The Company apparently does not
12 consistently apply a capitalization policy, and its proposed capitalization of the costs as
13 shown on Schedule 2 of its Rebuttal Testimony is not supported by its policy.

14
15 **Q. What does Staff recommend regarding plant additions since the prior rate case?**

16 A. Staff continues to recommend the \$11,818 disallowance of plant that it recommended in
17 Direct Testimony. Staff also recommends that the Company adopt a written capitalization
18 policy.

19
20 *Rate Case Expense*

21 **Q. Did the Company newly propose an amount for rate case expense in its Rebuttal**
22 **Testimony?**

23 A. Yes, the Company proposed to amortize \$18,000 of rate case expense over three years,
24 i.e., \$6,000 per year.

25

1 **Q. What does Staff recommend?**

2 A. Staff recommends approval of the Company's request to include \$6,000 for annual rate
3 case expense as an amortization of \$18,000 over three years, as shown in Surrebuttal
4 Schedule MJR-22. Staff also recommends that the Order specify that no rate case expense
5 from this case is to be included in rates in any future rate case.
6

7 *Post Test Year Plant*

8 **Q. Did the Company's Rebuttal Testimony increase plant, accumulated depreciation
9 and depreciation expense by amounts attributed to post-test year plant?**

10 A. Yes, the Company proposes to include in rate base post-test year plant in the amount of
11 \$16,324 (\$7,680 for 2013 and \$8,643 for 2012) and to increase accumulated depreciation
12 by \$2,641 and to increase depreciation expense by \$1,560.
13

14 **Q. Did the Company provide support for any of its requested post-test year plant?**

15 A. No. The Company needs to provide documentation of its proposed post-test year plant
16 improvements for them to be considered in rates.
17

18 **Q. What is Staff's recommendation?**

19 A. Staff recommends not including the Company's proposed post-test year amounts in the
20 rate base or expenses without adequate documentation.
21

22 *Accounting Expenses*

23 **Q. Does the Company request in its Rebuttal Testimony an increase operating expense
24 for outside accounting services?**

25 A. Yes, the Company requests to increase by \$6,340, from \$3,660 to \$10,000 its outside
26 accounting services expense.

1 **Q. What is Staff's recommendation as to the outside accounting services?**

2 A. Staff recommends approval of the revised accounting services expense to \$10,000 subject
3 to the Company submitting documentation of entering a contract for accounting services
4 prior to the date of the hearing in this rate proceeding, as shown in Surrebuttal Schedule
5 MJR-23.

6

7 *Purchased Power Expenses*

8 **Q. Did the Company's Rebuttal Testimony request a pro forma adjustment to increase
9 purchased power expense?**

10 A. Yes, the Company requests a pro forma \$917 increase in purchased power expense due to
11 changes in the charges the Commission authorized in its power provider (APS) in
12 Decision No. 73183.

13

14 **Q. Did the Company provide any support for the amount of its pro form request in its
15 Rebuttal Testimony?**

16 A. No. While Staff supports the concept of recognizing a pro forma adjustment for the
17 change in the rates charged by the Company's power provider, the Company has not
18 provided calculations to support its \$917 quantification of the impact on its purchased
19 power costs. Absent this support, Staff does not recommend adoption of this pro forma
20 request.

21

22 *Revenue Requirement and Rate Design*

23 **Q. Did Staff update its rate design to reflect its Surrebuttal revenue requirement?**

24 A. Yes.

25

1 **Q. Does Staff have any comments regarding the Company's Rebuttal Testimony**
2 **pertaining to the issue of rate design?**

3 A. Yes. The Company's primary concern with Staff's rate design is that it does not provide
4 the level of revenue stability the Company desires. To support its position the Company
5 notes that Staff assigned all of the revenue increase to the second and third commodity
6 rate tiers and the recommended rate design generates 41 percent of the revenue from the
7 monthly minimum charges and 59 percent from the commodity charges.

8
9 Staff's assignment of the entire revenue increase to the commodity rates was a function of
10 the relatively small revenue increase. Since Staff typically targets generating 30 percent
11 to 40 percent of the revenue from the minimum monthly charge, the 41 percent result is
12 consistent with providing adequate revenue stability. Since Staff's Surrebuttal rate design
13 generates more revenue than its direct rate design, Staff is now recommending increases to
14 the monthly minimum charges for some meter sizes. In addition, Staff's Surrebuttal rate
15 design reduces the break-over points to provide additional revenue stability. Staff's
16 Surrebuttal rate design generates 41.6 percent of the revenue from the minimum monthly
17 charges and 58.4 percent from the commodity rates. Staff's recommended rates are shown
18 in Schedule MJR-24 and the typical bill analysis for 3/4-inch meter customers is shown in
19 Schedule MJR-25.

20
21 **Q. Does this conclude your testimony?**

22 A. Yes, it does.

CORDES LAKES WATER COMPANY

Docket No. W-02060A-12-0356

Test Year Ended December 31, 2011

SURREBUTTALTESTIMONY OF Mary J. Rimback

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MJR	25 Rate Design
MJR	26 Typical Bill Analysis - 3/4-inch Meter

REVENUE REQUIREMENT

LINE NO.	DESCRIPTION	(A) COMPANY ORIGINAL COST	(B) STAFF ORIGINAL COST
1	Adjusted Rate Base	\$ 496,789	\$ 145,210
2	Adjusted Operating Income (Loss) ¹	\$ (17,373)	\$ (3,363)
3	Current Rate of Return (L2 / L1) ²	0.00%	-2.32%
4	Required Rate of Return	8.00%	9.00%
5	Required Operating Income (L4 * L1) ^{3,4}	\$ 37,000	\$ 13,069
6	Operating Income Deficiency (L5 - L2) ⁵	\$ 68,000	\$ 16,432
7	Gross Revenue Conversion Factor	None	1.2946
8	Required Revenue Increase (L7 * L6) ⁶	\$ 77,000	\$ 21,274
9	Adjusted Test Year Revenue	\$ 403,993	\$ 420,536
10	Proposed Annual Revenue (L8 + L9) ⁷	\$ 498,366	\$ 441,810
11	Required Increase in Revenue (%)	19.06%	5.06%

References:

Column (A): Company Schedule B-1 Rate Base, Revised E-2 (9/24/2012) Income Statement
Column (B): Staff Schedule MJR-3 & MJR-11

¹ The Company's application (Schedule A-1) uses Net Income as Operating Income.

² The Company's rate of return, as filed, is not a mathematical product of Operating Income divided by rate base.

³ Rate base (\$496,789) times ROR (8.0%) equals \$39,743.

⁴ The Company requests a \$30,000 water loss repair surcharge and a \$10,000 meter replacement surcharge.

⁵ The Company's amount is not mathematically correct.

⁶ The Company's amount is the total of Required Operating Income and both surcharges (\$37,000 + \$30,000 + \$10,000). However, the Company's request for a \$30,000 water loss surcharge only extends for two years and the \$10,000 meter replacement surcharge only extends for three years.

⁷ Company's amount represents test year revenue (\$403,993) plus adjusted operating loss (\$17,373) plus required operating income (\$37,000) plus annual water loss surcharge (\$30,000) plus annual meter replacement surcharge (\$10,000).

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
<i>Calculation of Gross Revenue Conversion Factor:</i>					
1	Revenue	100.0000%			
2	Uncollectible Factor (Line 11)	0.3638%			
3	Revenues (L1 - L2)	99.6362%			
4	Combined Federal and State Tax Rate (Line 17) + Property Tax Factor (Line 22)	22.3951%			
5	Subtotal (L3 - L4)	77.2412%			
6	Revenue Conversion Factor (L1 / L5)	1.294647			
<i>Calculation of Uncollectible Factor:</i>					
7	Unity	100.0000%			
8	Combined Federal and State Tax Rate (Line 17)	20.9228%			
9	One Minus Combined Income Tax Rate (L7 - L8)	79.0772%			
10	Uncollectible Rate	0.4600%			
11	Uncollectible Factor (L9 * L10)	0.3638%			
<i>Calculation of Effective Tax Rate:</i>					
12	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
13	Arizona State Income Tax Rate	6.9680%			
14	Federal Taxable Income (L12 - L13)	93.0320%			
15	Applicable Federal Income Tax Rate (Line 53)	15.0000%			
16	Effective Federal Income Tax Rate (L14 x L15)	13.9548%			
17	Combined Federal and State Income Tax Rate (L13 +L16)	20.9228%			
<i>Calculation of Effective Property Tax Factor</i>					
18	Unity	100.0000%			
19	Combined Federal and State Tax Rate (Line 17)	20.9228%			
20	One Minus Combined Income Tax Rate (L18 - L19)	79.0772%			
21	Property Tax Factor (MJR-17, L24)	1.8618%			
22	Effective Property Tax Factor (L 21 * L 22)	1.4723%			
23	Combined Federal and State Tax and Property Tax Rate (L17+L22)		22.3951%		
24	Required Operating Income (Schedule MJR-1, Line 5)	\$ 13,069			
25	Adjusted Test Year Operating Income (Loss) (Schedule MJR-11, Line 40)	\$ (3,363)			
26	Required Increase in Operating Income (L24 - L25)		\$ 16,432		
27	Income Taxes on Recommended Revenue (Col. (D), L52)	\$ 3,458			
28	Income Taxes on Test Year Revenue (Col. (B), L52)	\$ (890)			
29	Required Increase in Revenue to Provide for Income Taxes (L27 - L28)		\$ 4,348		
30	Recommended Revenue Requirement (Schedule MJR-1, Line 10)	\$ 441,810			
31	Uncollectible Rate (Line 10)	0.4600%			
32	Uncollectible Expense on Recommended Revenue (L24 * L25)	\$ 2,032			
33	Adjusted Test Year Uncollectible Expense	\$ 1,934			
34	Required increase in Revenue to Provide for Uncollectible Exp. (L32 - L33)		\$ 98		
35	Property Tax with Recommended Revenue (MJR-17, L19)	\$ 23,825			
36	Property Tax on Test Year Revenue (MJR-17, L 16)	\$ 23,429			
37	Increase in Property Tax Due to Increase in Revenue (MJR-17, L22)		\$ 396		
38	Total Required Increase in Revenue (L26 + L29 + L34+L37)		\$ 21,274		
<i>Calculation of Income Tax:</i>					
		Test Year	STAFF Recommended		
39	Revenue (Schedule MJR-11, Col.(C), Line 5 & Sch. MJR-1, Col. (B), Line 10)	\$ 420,536	\$ 21,274	\$ 441,810	
40	Operating Expenses Excluding Income Taxes	\$ 424,789		\$ 425,283	
41	Synchronized Interest (L47)	\$ -		\$ -	
42	Arizona Taxable Income (L36 - L317- L38)	\$ (4,253)		\$ 16,527	
43	Arizona State Income Tax Rate	6.9680%		6.9680%	
44	Arizona Income Tax (L39 x L40)		\$ (296)	\$ 1,152	
45	Federal Taxable Income (L42- L43)	\$ (3,956)		\$ 15,375	
46	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ (593)		\$ 2,306	
47	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	\$ -		\$ -	
48	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -		\$ -	
49	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -		\$ -	
50	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -		\$ -	
51	Total Federal Income Tax	\$ (593)		\$ 2,306	
52	Combined Federal and State Income Tax (L44 + L51)	\$ (890)		\$ 3,458	
53	Applicable Federal Income Tax Rate [Col. (D), L51 - Col. (B), L51] / [Col. (C), L45 - Col. (A), L45]				15.0000%
<i>Calculation of Interest Synchronization:</i>					
54	Rate Base (Schedule MJR-3, Col. (C), Line 17)	\$ 145,210			
55	Weighted Average Cost of Debt	0.00%			
56	Synchronized Interest (L54 X L56)	\$ -			

RATE BASE - ORIGINAL COST

LINE NO.	(A) COMPANY AS FILED	(B) STAFF ADJUSTMENTS REF	(C) STAFF AS ADJUSTED
1	Plant in Service	\$ 601,634	\$ 1,137,023
2	Less: Accumulated Depreciation	139,712	894,996
3	Net Plant in Service	<u>\$ 461,922</u>	<u>\$ 242,027</u>
<u>LESS:</u>			
4	Contributions in Aid of Construction (CIAC)	\$ -	\$ 76,247
5	Less: Accumulated Amortization	-	18,710
6	Net CIAC	-	<u>57,537</u>
7	Advances in Aid of Construction (AIAC)	21,110	21,110
8	Customer Deposits	18,170	18,170
9	Deferred Income Tax Liabilities	-	-
<u>ADD:</u>			
10	Unamortized Finance Charges	-	-
11	Deferred Tax Assets	-	-
12	Working Capital	74,147	(74,147)
17	Original Cost Rate Base	<u>\$ 496,789</u>	<u>\$ 145,210</u>

References:

Column (A), Company Schedule B-1,
Column (B): Schedule MJR-4
Column (C): Column (A) + Column (B)

CORDES LAKES WATER COMPANY
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SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

LINE NO.	ACCT. NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] Rec & Res Land ADJ #1 Ref. Sch MJR-5	[C] Used & Useful ADJ #2 Ref. Sch MJR-6	[D] Net Plant Additions ADJ #3 Ref. Sch MJR-7	[E] Acc Depr ADJ #4 Ref. Sch MJR-8	[F] Recognize CIAC ADJ #5 Ref. Sch MJR-9	[G] Working Capital ADJ #6 Ref. Sch MJR-10	[H] STAFF ADJUSTED
PLANT IN SERVICE.										
1		Organization	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2	301	Franchises	-	-	-	-	-	-	-	-
3	302	Land and Land Rights	-	-	-	-	-	-	-	-
4	303	Structures & Improvements	35,665	(35,665)	-	-	-	-	-	-
5	304	Collecting & Impounding Reservoirs	6,657	-	-	-	-	-	-	6,657
6	305	Lakes, Rivers, Other Intakes	-	-	-	-	-	-	-	-
7	306	Wells and Springs	-	-	-	-	-	-	-	-
8	307	Infiltration Galleries and Tunnels	167,348	-	-	-	-	-	-	167,348
9	308	Supply Mains	-	-	-	-	-	-	-	-
10	309	Power Generation Equipment	-	-	-	-	-	-	-	-
11	310	Pumping Equipment	26,568	-	-	-	-	-	-	26,568
12	311	Water Treatment Plant	-	-	-	-	-	-	-	-
13	320	Distribution Reservoirs & Standpipes	141,632	-	-	-	-	-	-	141,632
14	330	Transmission & Distribution Mains	15,089	-	3,698	-	-	-	-	19,350
15	331	Services	-	-	(16,025)	-	-	-	-	54,817
16	333	Meters & Meter Installation	70,842	-	-	-	-	-	-	-
17	334	Hydrants	-	-	-	-	-	-	-	-
18	335	Backflow Prevention Devices	-	-	-	-	-	-	-	-
19	336	Other Plant & Misc. Equipment	59,315	-	1,235	-	-	-	-	60,550
20	339	Office Furniture & Equipment	7,027	-	(926)	-	-	-	-	6,101
21	340	Stores Equipment	71,461	-	-	-	-	-	-	71,461
22	341	Tools, Ship & Garage Equipment	-	-	-	-	-	-	-	-
23	342	Laboratory Equipment	-	-	-	-	-	-	-	-
24	343	Power Operated Equipment	-	-	-	-	-	-	-	-
25	344	Communication Equipment	-	-	-	-	-	-	-	-
26	345	Miscellaneous Equipment	-	-	-	-	-	-	-	-
27	346	Other Tangible Plant	-	-	-	-	-	-	-	-
28	347		-	-	-	-	-	-	-	-
29	348		-	-	-	-	-	-	-	-
30			601,634	(35,665)	582,872	(11,818)	-	-	-	1,137,023
31										
32	Add:	Post Test Year Plant	-	-	-	-	-	-	-	-
33		General Office Plant Allocation	-	-	-	-	-	-	-	-
34			-	-	-	-	-	-	-	-
35	Less:		-	-	-	-	-	-	-	-
36			-	-	-	-	-	-	-	-
37			-	-	-	-	-	-	-	-
38			-	-	-	-	-	-	-	-
39			-	-	-	-	-	-	-	-
40		Total Plant in Service	\$ 601,634	\$ (35,665)	\$ 582,872	\$ (11,818)	\$ 755,284	\$ -	\$ -	\$ 1,137,023
41		Less: Accumulated Depreciation	139,712	-	-	-	-	-	-	894,996
42		Net Plant in Service (L59 - L 60)	\$ 461,922	\$ (35,665)	\$ 582,872	\$ (11,818)	\$ (755,284)	\$ -	\$ -	\$ 242,027
43	LESS:									
44		Contributions in Aid of Construction (CIAC)	-	-	-	-	-	-	-	-
45		Less: Accumulated Amortization	-	-	-	-	-	-	-	-
46		Net CIAC (L25 - L26)	-	-	-	-	-	-	-	-
47		Advances in Aid of Construction (AIAC)	21,110	-	-	-	-	76,247	-	76,247
48		Customer Deposits	18,170	-	-	-	-	18,710	-	18,710
49		Deferred Tax Liabilities	-	-	-	-	-	57,537	-	57,537
50			-	-	-	-	-	-	-	-
51			-	-	-	-	-	-	-	-
52	ADD:									
53		Unamortized Finance Charges	-	-	-	-	-	-	-	-
54		Deferred Tax Assets	-	-	-	-	-	-	-	-
55		Working Capital	74,147	-	-	-	-	-	(74,147)	-
56			-	-	-	-	-	-	-	-
57		Original Cost Rate Base	\$ 496,789	\$ (35,665)	\$ 562,872	\$ (11,818)	\$ (755,284)	\$ (57,537)	\$ (74,147)	\$ 145,210

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Surrebuttal MJR - 5

RATE BASE ADJUSTMENT #1 - REMOVE NON-USED AND USEFUL LAND

<u>Line No.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Land	\$ 35,665	\$ (35,665)	\$ -

References:

Col [A]: Company Schedule B-1
Col [B]: Col [C] - Col [A]
Col [C]: MJR Testimony

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Surrebuttal MJR-6

RATE BASE ADJUSTMENT #2 REINSTATE USED AND USEFULL PLANT

LINE NO.	ACCT NO.	DESCRIPTION	[A]	[B]	[C]
			COMPANY 2006 Balance AS FILED	Decision No. 70170 STAFF ADJUSTMENTS	STAFF RECOMMENDED
1	311	Pumping Equipment	\$ 10,558	\$ -	\$ 10,558
2	331	Transmission & Distribution Mains	9,444	562,940	572,384
3	333	Services	-	19,350	19,350
4	347	Miscellaneous Equipment	-	582	582
5		Totals	\$ 20,002	\$ 582,872	\$ 602,874

[A]: Company Schedule E-5 and Detail 11/8/2012
 [B]: Col [C] - Col [A]
 [C]:MJR Testimony

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Surrebuttal MJR-7

RATE BASE ADJUSTMENT #3 NET PLANT ADDITIONS

LINE NO.	ACCT NO.	DESCRIPTION	[A]	[B]	[C]
			COMPANY Additions 11/8/2012	STAFF ADJUSTMENTS	STAFF RECOMMENDED
1	331	Transmission & Distribution Mains	\$ 5,655	\$ 3,898	\$ 9,553
2	334	Meters & Meter Installation	35,253	(16,025)	19,228
3	339	Other Plant & Misc. Equipment	5,166	1,235	6,401
4	340	Office Furniture & Equipment	2,537	(926)	1,611
5		Totals	<u>\$ 48,611</u>	<u>\$ (11,818)</u>	<u>\$ 36,793</u>

[A]: Company Schedule E-5 and Detail provided 11/8/2012

[B]: Col [C] - Col [A]

[C]:MJR Testimony

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Surrebuttal MJR-8

RATE BASE ADJUSTMENT #4 - ACCUMULATED DEPRECIATION

<u>LINE</u> <u>NO.</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>PROPOSED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1	Accumulated Depreciation	<u>\$ 139,712</u>	<u>\$ 755,284</u>	<u>\$ 894,996</u>

References:

Col [A]: Company Schedule B-1

Col [B]: Col [C] - Col [A]

Col [C]: MJR Testimony

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Surrebuttal MJR-9

RATE BASE ADJUSTMENT #5 - CIAC AND ACCUMULATED AMORTIZATION OF CIAC

<u>LINE</u> <u>NO.</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>PROPOSED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1	Contributions in aid of construction	\$ -	\$ 76,247	\$ 76,247
2	Accumulated Amortization of CIAC	\$ -	\$ 18,710	\$ 18,710

References:

Col [A]: Company Schedule B-1

Col [B]: Col [C] - Col [A]

Col [C]: Decision 70170

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Surrebuttal MJR-10

RATE BASE ADJUSTMENT #6 - WORKING CAPITAL ALLOWANCE

<u>LINE</u> <u>NO.</u>	<u>DESCRIPTION</u>	<u>[A]</u> <u>COMPANY</u> <u>PROPOSED</u>	<u>[B]</u> <u>STAFF</u> <u>ADJUSTMENTS</u>	<u>[C]</u> <u>STAFF</u> <u>RECOMMENDED</u>
1	Working Capital Allowance	\$ 74,147	\$ (74,147)	\$ -

References:

Col [A]: Company Schedule B-1

Col [B]: Col [C] - Col [A]

Col [C]: MJR Testimony

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

Surrebuttal MJR-11

LINE NO.	DESCRIPTION	[A] COMPANY ADJUSTED TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF PROPOSED CHANGES	[E] STAFF RECOMMENDED
1	<u>REVENUES:</u>					
2	Metered Water Sales	\$ 403,353	\$ 9,093	\$ 412,446	\$ 21,274	\$ 433,720
3	Received for Contract Labor	167,692	(167,692)	-	-	-
4	Miscellaneous Revenue	640	7,450	8,090	-	8,090
5	Total Operating Revenues	\$ 571,685	\$ (151,149)	\$ 420,536	\$ 21,274	\$ 441,810
6	<u>OPERATING EXPENSES:</u>					
7	Payroll	\$ 309,095	\$ (167,692)	\$ 141,403	\$ -	\$ 141,403
10	Contract Labor	10,312	-	10,312	-	10,312
11	Employee Benefits	29,422	-	29,422	-	29,422
13	Purchased Power	31,723	-	31,723	-	31,723
14	Repairs and Maintenance	12,650	1,012	13,662	-	13,662
15	Office Supplies and Expense	14,491	-	14,491	-	14,491
16	Outside Sevices - Accounting	3,660	6,340	10,000	-	10,000
17	Outside Sevices - Billing Services	24,118	-	24,118	-	24,118
18	Outside Sevices - Computer Programming	3,511	-	3,511	-	3,511
19	Water Testing	1,806	4,052	5,858	-	5,858
20	Rents	28,150	-	28,150	-	28,150
21	Transportation Expenses	8,995	-	8,995	-	8,995
22	Insurance - General Liability	33,033	-	33,033	-	33,033
23	Insurance - Health and Life	14,936	-	14,936	-	14,936
24	Rate Case Expense	-	6,000	6,000	-	6,000
25	Regulatory Expense	-	-	-	-	-
26	Misc Expense - Permits	2,000	-	2,000	-	2,000
27	Misc Expense - Travel	-	-	-	-	-
28	Misc. Expenses - Utilities except Electricity	3,391	-	3,391	-	3,391
29	Misc. Expenses - Bank Charges	1,304	1,934	3,238	98	3,336
30	Misc. Expenses - Payroll Services	859	-	859	-	859
31	Depreciation Expense	37,195	(22,162)	15,033	-	15,033
32	Payroll Taxes	175	-	175	-	175
33	Taxes other than Income (Sales Tax)	-	-	-	-	-
34	Property Taxes	18,187	5,242	23,429	396	23,825
35	Income Tax	45	(935)	(890)	4,348	3,458
36	Interest Income	-	-	-	-	-
37	Interest Expense	-	1,050	1,050	-	1,050
38						
39	Total Operating Expenses	\$ 589,058	\$ (165,159)	\$ 423,899	\$ 4,842	\$ 428,741
40	Operating Income (Loss)	\$ (17,373)	\$ 14,010	\$ (3,363)	\$ 16,432	\$ 13,069

References:

Column (A): Company Revised Schedule E-2, 11/8/2012
Column (B): Schedule Surrebuttal MJR-12
Column (C): Column (A) + Column (B)
Column (D): Surrebuttal Schedules MJR-1 and MJR-2
Column (E): Column (C) + Column (D)

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED 9/24/2012	(B) Contract Labor ADJ #1 Ref. Sch. M.J.R-13	(C) Repairs & Maint. ADJ #2 Ref. Sch. M.J.R-14	(D) Metered Rev. ADJ #3 Ref. Sch. M.J.R-15	(E) Dep. Exp. ADJ #4 Ref. Sch. M.J.R-16	(F) Prop. Tax ADJ #5 Ref. Sch. M.J.R-17	(G) Inc. Tax ADJ #6 Ref. Sch. M.J.R-18	(H) Water Testing ADJ #7 Ref. Sch. M.J.R-19	(I) Un-metered Rev. ADJ #8 Ref. Sch. M.J.R-20	(J) Customer Dep. ADJ #9 Ref. Sch. M.J.R-21	(K) Rate Case Expense ADJ #10 Ref. Sch. M.J.R-22	(L) Outside Acctg Svcs ADJ #11 Ref. Sch. M.J.R-23	(M) Bad Debt ADJ #12 Ref. Sch. M.J.R-24	(N) STAFF ADJUSTED
1	REVENUES:														
2	Interest Revenue	\$ 403,853			\$ 9,093										\$ 412,446
3	Received for Contract Labor	\$ 167,692	\$ (167,692)												\$ 6,950
4	Other Water Revenue	640													\$ 6,950
5	Total Operating Revenues	\$ 571,885	\$ (167,692)		\$ 9,093										\$ 429,336
6	OPERATING EXPENSES:														
7	Payroll	\$ 309,095	\$ (167,692)												\$ 141,403
8	Contract Labor	10,312													10,312
9	Employee Benefits	29,422													29,422
10	Purchased Power	31,723													31,723
11	Professional Fees	1,650		1,012											1,650
12	Office Supplies and Expense	14,481													14,481
13	Outside Services - Accounting	3,660										6,340			10,000
14	Outside Services - Billing Services	24,118													24,118
15	Outside Services - Computer Programming	3,841													3,841
16	Water Testing	893						4,052							5,858
17	Water Treatment	28,150													28,150
18	Transportation Expenses	8,695													8,695
19	Medical Insurance	33,033													33,033
20	Liability Insurance	14,936													14,936
21	Auto Insurance	1,000													1,000
22	Regulatory Expense	2,000													2,000
23	Misc. Expense - Permits	3,204													3,204
24	Misc. Expense - Travel	3,304													3,304
25	Misc. Expense - Utilities exclud. Electricity	1,650													1,650
26	Misc. Expense - Fuel	1,650													1,650
27	Misc. Expense - Payroll Services	37,166													37,166
28	Depreciation Expense	175													175
29	Payroll Taxes	175													175
30	Taxes other than Income (Sales Tax)	18,187													18,187
31	Income Tax	45													45
32	Interest Income														
33	Interest Expense														
34															
35	Total Operating Expenses	\$ 589,058	\$ (167,692)	\$ 1,012	\$ 9,093	\$ (22,162)	\$ 5,242	\$ (935)	\$ 4,052	\$ 7,450	\$ 1,050	\$ 6,000	\$ 6,340	\$ 1,934	\$ 428,899
36	Operating Income (Loss)	\$ (17,373)		\$ (1,012)	\$ 9,093	\$ 22,162	\$ (5,242)	\$ 935	\$ (4,052)	\$ 7,450	\$ (1,050)	\$ (6,000)	\$ (6,340)	\$ (1,934)	\$ (8,363)

References:
 Column (A): Company Revised Schedule E-2 11/8/2012

OPERATING INCOME ADJUSTMENT #1 - REMOVE NON-UTILITY REVENUES AND EXPENSES FOR CONTRACT LABOR

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Contract Labor Revenue	\$ 167,692	\$ (167,692)	\$ -
2	Payroll	\$ 167,692	(167,692)	\$ -
3	Operating Income Affect	\$ -	\$ -	\$ -

References:

Col [A]: Company Schedule E-2
Col [B]: Col [C] - Col [A]
Col [C]: MJR Testimony

OPERATING INCOME ADJUSTMENT #2 - NORMALIZATION OF REPAIRS & MAINTENANCE EXPENSES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	<u>Repairs & Maintenance</u>	\$ 12,650	\$ 1,012	\$ 13,662
2	Repairs & Maintenance - Company's Test Year: 2011			\$ 12,650
3	Repairs & Maintenance - 2010 Annual Stmt			17,221
4	Repairs & Maintenance - 2009 Annual Stmt			11,116
5	Repairs & Maintenance expenses, past three years			\$ 40,987
6	Average Repair & Maintenance expense (line 5/3)			\$ 13,662

References:

Col [A]: Company Schedule C-1

Col [B]: Col [C] - Col [A]

Col [C]: Normalized Repairs & Maintenance Expense Col [C] L6.

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OPERATING INCOME ADJUSTMENT #3 - METERED REVENUE

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Metered Revenue	<u>\$ 403,353</u>	<u>\$ 9,093</u>	<u>\$ 412,446</u>

References:

Col [A]: Company Schedule E-2 Revised 9/24/2012

Col [B]: Col [C] - Col [A]

Col [C]: MJR Testimony

<u>Bill Count Revenue</u>	
3/4 inch Meter	\$ 404,597
1 inch Meter	2,397
2 inch Meter	5,452
Subtotal	<u>\$ 412,446</u>

OPERATING INCOME ADJUSTMENT #4 - DEPRECIATION EXPENSE

Line No.	ACCT NO.	DESCRIPTION	[A] AMOUNT	Depreciable Amount	[B] Projected RATE	[C] EXPENSE
Plant In Service						
1	301	Organization	\$ -	\$ -	0.00%	\$ -
2	302	Franchises	-	-	0.00%	-
3	303	Land and Land Rights	-	-	0.00%	-
4	304	Structures & Improvements	6,657	4,400	3.33%	147
5	305	Collecting & Impounding Reservoirs	-	-	2.50%	-
6	306	Lakes, Rivers, Other Intakes	-	-	2.50%	-
7	307	Wells and Springs	167,348	151,979	3.33%	5,061
8	308	Infiltration Galleries and Tunnels	-	-	6.67%	-
9	309	Supply Mains	-	-	2.00%	-
10	310	Power Generation Equipment	-	-	5.00%	-
11	311	Pumping Equipment	26,588	16,030	12.50%	2,004
12	320	Water Treatment Plant	-	-	3.33%	-
13	330	Distribution Reservoirs & Standpipes	141,632	94,458	2.22%	2,097
14	331	Transmission & Distribution Mains	581,937	19,442	2.00%	389
15	333	Services	19,350	-	3.33%	-
16	334	Meters & Meter Installation	54,817	47,078	8.33%	3,922
17	335	Hydrants	-	-	2.00%	-
18	336	Backflow Prevention Devices	-	-	6.67%	-
19	339	Other Plant & Misc. Equipment	60,550	60,550	6.67%	4,039
20	340	Office Furniture & Equipment	6,101	6,101	6.67%	407
21	341	Transportation Equipment	71,461	2,412	20.00%	482
22	342	Stores Equipment	-	-	4.00%	-
23	343	Tools, Ship & Garage Equipment	-	-	5.00%	-
24	344	Laboratory Equipment	-	-	10.00%	-
25	345	Power Operated Equipment	-	-	5.00%	-
26	346	Communication Equipment	-	-	10.00%	-
27	347	Miscellaneous Equipment	582	-	10.00%	-
28	348	Other Tangible Plant	-	-	0.00%	-
29		Subtotal General	\$ 1,137,023	\$ 402,450		\$ 18,547
30		Less: Non- depreciable Account(s) (L3)	-	-		-
31		Depreciable Plant (L29-L30)	\$ 1,137,023	\$ 402,450		
32		Contributions-in-Aid-of-Construction (CIAC) Per Decision No. 54526 (1/28/1985) - Not Amortized	\$ 76,247			
33		Composite Depreciation/Amortization Rate	4.61%			
34		Less: Amortization of CIAC (L32 x L33)				\$ 3,514
35		Depreciation Expense - STAFF [Col. (C), L29 - L34]				\$ 15,033

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED	[B] STAFF ADJUSTMENT	[C] STAFF RECOMMENDED
36	Depreciation Expense	\$ 37,195	\$ (22,162)	\$ 15,033

References:
Col [A]: MJR-4
Col [B]: Decision No. 70170 and updated Plant Schedules
Col [C]: MJR Testimony

OPERATING INCOME ADJUSTMENT #5 - PROPERTY TAXES

LINE NO.	Property Tax Calculation	(C)	
		STAFF AS ADJUSTED	STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues - 2011	\$ 420,536	\$ 420,536
2	Weight Factor	2	2
3	Subtotal (Line 1 * Line 2)	841,073	\$ 841,073
4	Staff Recommended Revenue, Per Schedule MJR-1	420,536	\$ 441,810
5	Subtotal (Line 4 + Line 5)	1,261,609	1,282,882
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	420,536	427,627
8	Department of Revenue Multiplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	841,073	855,255
10	Plus: 10% of CWIP -	-	-
11	Less: Net Book Value of Licensed Vehicles	2,171	2,171
12	Full Cash Value (Line 9 + Line 10 - Line 11)	838,902	\$ 853,084
13	Assessment Ratio	20.0%	20.0%
14	Assessment Value (Line 12 * Line 13)	167,780	\$ 170,617
15	Composite Property Tax Rate	13.9638%	13.9638%
16	Staff Test Year Adjusted Property Tax (Line 14 * Line 15)	\$ 23,429	\$ -
17	Company Proposed Property Tax	18,187	
18	Staff Test Year Adjustment (Line 16-Line 17)	\$ 5,242	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)		\$ 23,825
20	Staff Test Year Adjusted Property Tax Expense (Line 16)		\$ 23,429
21	Increase in Property Tax Expense Due to Increase in Revenue Requirement		\$ 396
22	Increase to Property Tax Expense		\$ 396
23	Increase in Revenue Requirement		21,274
24	Increase to Property Tax per Dollar Increase in Revenue (Line 22/Line 23)		1.861840%

CORDES LAKES WATER COMPANY
Docket No. W-02060A-12-0356
Test Year Ended December 31, 2011

Surrebuttal MJR-18

OPERATING INCOME ADJUSTMENT #6 - TEST YEAR INCOME TAXES

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Income Tax Expense	<u>\$ 45</u>	<u>\$ (935)</u>	<u>\$ (890)</u>

References:

Col [A]: Company Schedule E-2 Revised 9/24/2012

Col [B]: Col [C] - Col [A]

Col [C]: Schedule MJR-2, Line 43

CORDES LAKES WATER COMPANY
Docket No. W-02060A-12-0356
Test Year Ended December 31, 2011

Surrebuttal MJR-19

OPERATING INCOME ADJUSTMENT #7 WATER TESTING

<u>LINE NO.</u>	<u>DESCRIPTION</u>	<u>[A] COMPANY PROPOSED</u>	<u>[B] STAFF ADJUSTMENTS</u>	<u>[C] STAFF RECOMMENDED</u>
1	Water Testing Expense	<u>\$ 1,806</u>	<u>\$ 4,052</u>	<u>\$ 5,858</u>

References:

Col [A]: Company Schedule E-2

Col [B]: Col [C] - Col [A]

Col [C]: Engineering Report

CORDES LAKES WATER COMPANY
 Docket No. W-02060A-12-0356
 Test Year Ended December 31, 2011

Surebuttal MJR-20

OPERATING INCOME ADJUSTMENT #8 - NON-METERED REVENUE FEES

LINE NO.	DESCRIPTION	[A] COMPANY PROPOSED 9/24/2012	[B] STAFF ADJUSTMENTS	[C] STAFF RECOMMENDED
1	Misc Income Net	\$ 640	\$ (640)	\$ -
2	Establishment	-	\$ 6,825	6,825
3	Reconnection	-	\$ 1,045	1,045
4	After Hours Reconnection	-	\$ 150	150
5	Re-Establishment	-	\$ 70	70
6		\$ 640	\$ 7,450	\$ 8,090

	COMPANY Revised 8/17/2012
Misc Income Net	\$ -
Establishment	6,825
Reconnection	1,045
After Hours Reconnection	150
Re-Establishment	70

References:

- Col [A]: Company Schedule A-2 (B)
- Col [B]: Col [C] - Col [A]
- Col [C]: Schedule Column A plus Column B

OPERATING INCOME ADJUSTMENT #9 - INTEREST ON CUSTOMER DEPOSITS

LINE		[A]	[B]	[C]
<u>NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY PROPOSED</u>	<u>STAFF ADJUSTMENTS</u>	<u>STAFF RECOMMENDED</u>
1	Interest on Customer Deposits	<u>\$ -</u>	<u>\$ 1,050</u>	<u>\$ 1,050</u>

References:

Col [A]: Company Schedule A-2 (B)

Col [B]: Col [C] - Col [A]

Col [C]: MJR Testimony

CORDES LAKES WATER COMPANY
Docket No. W-02060A-12-0356
Test Year Ended December 31, 2011

Surrebuttal MJR-22

OPERATING INCOME ADJUSTMENT #10 - RATE CASE EXPENSE

LINE		[A]	[B]	[C]
<u>NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY PROPOSED</u>	<u>STAFF ADJUSTMENTS</u>	<u>STAFF RECOMMENDED</u>
1	Rate Case Expense	<u>\$ -</u>	<u>\$ 6,000</u>	<u>\$ 6,000</u>

References:

Col [A]: Company Schedule E-2

Col [B]: Col [C] - Col [A]

Col [C]: MJR Surrebuttal Testimony

CORDES LAKES WATER COMPANY
Docket No. W-02060A-12-0356
Test Year Ended December 31, 2011

Surrebuttal MJR-23

OPERATING INCOME ADJUSTMENT #11 - OUTSIDE ACCOUNTING SERVICES

LINE		[A]	[B]	[C]
<u>NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY</u> <u>PROPOSED</u>	<u>STAFF</u> <u>ADJUSTMENTS</u>	<u>STAFF</u> <u>RECOMMENDED</u>
1	Outside Sevices - Accounting	<u>\$ 3,660</u>	<u>\$ 6,340</u>	<u>\$ 10,000</u>

References:

Col [A]: Company Schedule E-2

Col [B]: Col [C] - Col [A]

Col [C]: MJR Surrebuttal Testimony

OPERATING INCOME ADJUSTMENT #12 - BAD DEBT EXPENSE

LINE		[A]	[B]	[C]
<u>NO.</u>	<u>DESCRIPTION</u>	<u>COMPANY PROPOSED</u>	<u>STAFF ADJUSTMENTS</u>	<u>STAFF RECOMMENDED</u>
1	Misc. Expense - Bank Charges	\$ 1,304	\$ -	\$ 1,304
2	Bad Debt Expense	-	\$ 1,934	1,934
3	Total	<u>\$ 1,304</u>	<u>\$ 1,934</u>	<u>\$ 3,238</u>
	\$ 43 Write-off in 2007			
	1,488 Write-off in 2008			
	4,079 Write-off in 2009			
	2,048 Write-off in 2010			
	<u>\$ 7,658</u>			
	4.00 Years			
	<u>\$ 1,914</u>			
	\$ 420,536 Test Year Revenue			
	0.46% Average write-off rate			

References:

Col [A]: Company Schedule E-2

Col [B]: Col [C] - Col [A]

Col [C]: MJR Surrebuttal Testimony

RATE DESIGN

Monthly Usage Charge	Present	-Proposed Rates-	
	Rates	Company	Staff
5/8" x 3/4" Meter	N/A	N/A	N/A
3/4" Meter	\$ 11.00	\$ 13.50	\$ 11.50
1" Meter	19.50	24.50	20.00
1½" Meter	39.00	48.75	39.00
2" Meter	62.50	78.00	62.50
3" Meter	125.00	156.00	125.00
4" Meter	220.00	275.00	192.50
6" Meter	390.00	485.00	385.00
8" Meter	N/A	N/A	N/A
10" Meter	N/A	N/A	N/A
12" Meter	N/A	N/A	N/A
Gallons Included in Minimum	0	0	0
Commodity Rate Charge			
<i>3/4" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 3,000 gallons	2.80	3.30
Tier 2	From 3,001 to 8,000 gallons	4.30	5.25
Tier 3	Over 8,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 3,000 gallons		2.80
Tier 2	From 3,001 to 8,000 gallons		4.20
Tier 3	Over 8,000 gallons		6.45
<i>1" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 18,000 gallons	4.30	5.25
Tier 2	Over 18,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 10,000 gallons		4.20
Tier 2	Over 10,000 gallons		6.45
<i>1½" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 43,500 gallons	4.30	5.25
Tier 2	Over 43,500 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 17,000 gallons		4.20
Tier 2	Over 17,000 gallons		6.45
<i>2" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 75,000 gallons	4.30	5.25
Tier 2	Over 75,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 26,000 gallons		4.20
Tier 2	Over 26,000 gallons		6.45
<i>3" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 160,000 gallons	4.30	5.25
Tier 2	Over 160,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 50,000 gallons		4.20
Tier 2	Over 50,000 gallons		6.45
<i>4" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 290,000 gallons	4.30	5.25
Tier 2	Over 290,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 75,000 gallons		4.20
Tier 2	Over 75,000 gallons		6.45
<i>6" Meter</i>			
<i>Company</i>			
Tier 1	From 0 to 530,000 gallons	4.30	5.25
Tier 2	Over 530,000 gallons	5.00	6.00
<i>Staff</i>			
Tier 1	From 0 to 150,000 gallons		4.20
Tier 2	Over 150,000 gallons		6.45

RATE DESIGN

Service Line and Meter Installation Charges

	N/T	N/T	Service	Meter	Total
			Line	Installation	
5/8" x 3/4" Meter	N/T	N/T	N/T	N/T	N/T
3/4" Meter	520.00	Same as Staff	426.00	198.00	624.00
1" Meter	610.00	Same as Staff	486.00	246.00	732.00
1½" Meter	855.00	Same as Staff	528.00	498.00	1,026.00
2" Meter	1,515.00	Same as Staff	720.00	1,098.00	1,818.00
3" Meter	2,195.00	Same as Staff	930.00	1,764.00	2,694.00
4" Meter	3,360.00	Same as Staff	1,332.00	2,700.00	4,032.00
6" Meter	6,115.00	Same as Staff	2,000.00	5,350.00	7,350.00

Service Charges

Establishment	\$25.00	\$30.00	\$30.00
Establishment (After Hours)	\$35.00	\$40.00	NT
Reconnection (Delinquent)	\$15.00	\$20.00	\$20.00
Reconnection (Delinquent) After Hours	\$25.00	\$30.00	NT
NSF Check	\$12.50	\$15.00	\$15.00
Meter Re-Read (If Correct)	\$10.00	\$12.00	\$12.00
Meter Test (If Correct)	\$25.00	\$30.00	\$30.00
Deferred Payment (per Month)	1.5%	1.5%	***
Deposit Amount	*	*	*
Deposit Interest	*	*	*
Re-Establishment (Within 12 Months)	**	**	**
Late Fee (per Month)	1.5%	1.5%	***
Road Cutting or Boring	Cost	Cost	Cost
After Hours Service Charge (Customer Request)	N/T	N/T	\$35.00

NT = No Tariff

Monthly Service Charge for Fire Sprinkler

4" or Smaller	\$0.00	\$0.00	****
6"	0.00	0.00	****
8"	0.00	0.00	****
10"	0.00	0.00	****
Larger than 10"	0.00	0.00	****

- * Per Commission Rules (R14-2-403.B)
- ** Months off system times the minimum (R14-2-403.D)
- *** 1.5% on the unpaid balance per month
- **** 2.00% of Monthly Minimum for a Comparable Sized Meter Connection, but no less than \$10.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.

TYPICAL BILL ANALYSIS
General Service 3/4 - Inch Meter

Average Number of Customers: 1,291

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	4,169	\$24.42	\$29.54	\$5.11	20.92%
Median Usage	3,088	\$19.78	\$23.86	\$4.08	20.65%
<u>Staff Recommend</u>					
Average Usage	4,169	\$24.42	\$24.81	\$0.38	1.57%
Median Usage	3,088	\$19.78	\$20.27	\$0.49	2.48%

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

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$11.00	\$13.50	22.73%	\$11.50	4.55%
1,000	13.80	16.80	21.74%	14.30	3.62%
2,000	16.60	20.10	21.08%	17.10	3.01%
3,000	19.40	23.40	20.62%	19.90	2.58%
4,000	23.70	28.65	20.89%	24.10	1.69%
5,000	28.00	33.90	21.07%	28.30	1.07%
6,000	32.30	39.15	21.21%	32.50	0.62%
7,000	36.60	44.40	21.31%	36.70	0.27%
8,000	40.90	49.65	21.39%	40.90	0.00%
9,000	45.90	55.65	21.24%	47.35	3.16%
10,000	50.90	61.65	21.12%	53.80	5.70%
15,000	75.90	91.65	20.75%	86.05	13.37%
20,000	100.90	121.65	20.56%	118.30	17.24%
25,000	125.90	151.65	20.45%	150.55	19.58%
50,000	250.90	301.65	20.23%	311.80	24.27%
75,000	375.90	451.65	20.15%	473.05	25.84%
100,000	500.90	601.65	20.11%	634.30	26.63%
125,000	625.90	751.65	20.09%	795.54	27.10%
150,000	750.90	901.65	20.08%	956.79	27.42%
175,000	875.90	1,051.65	20.07%	1,118.04	27.64%
200,000	1,000.90	1,201.65	20.06%	1,279.29	27.81%

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner
BOB BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF)
CORDES LAKES WATER COMPANY FOR)
AN INCREASE IN ITS RATES)
_____)

DOCKET NO W-02060A-12-0356

SURREBUTTAL

TESTIMONY

OF

JOHN A. CASSIDY

PUBLIC UTILITIES ANALYST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MAY 17, 2013

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SURREBUTTAL SCHEDULES

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**EXECUTIVE SUMMARY
CORDES LAKES WATER COMPANY
DOCKET NO. W-02060A-12-0356**

The Surrebuttal Testimony of Staff witness John A. Cassidy addresses the following issues:

Capital Structure – Staff continues to recommend that the Commission adopt a capital structure for Cordes Lakes Water Company (“Cordes Lakes” or “Company”) for this proceeding consisting of 0.0 percent debt and 100.0 percent equity.

Cost of Equity – Staff recommends that the Commission adopt a 9.0 percent return on equity (“ROE”) for the Company, a decrease from the 9.1 percent ROE Staff recommended in Direct Testimony. Staff’s estimated ROE for the Company is based on the average of its discounted cash flow method (“DCF”) and capital asset pricing model (“CAPM”) cost of equity methodology estimates for the sample companies of 8.1 percent for the CAPM and 8.7 percent for the DCF. Staff’s recommended ROE includes an upward economic assessment adjustment of 60 basis points.

Cost of Debt – Staff recommends that the Commission adopt a 0.0 percent cost of debt for the Company, as the Company has no debt in its capital structure.

Overall Rate of Return – Staff recommends that the Commission adopt a 9.0 percent overall rate of return, a decrease from the 9.1 percent ROE Staff recommended in Direct Testimony.

Company-Proposed Cost of Capital – The Company’s Rebuttal Testimony proposes a 10.55 percent ROE, an increase from the 8.1 percent ROE it requested in its initial filing. This request should be rejected because it is not based on comprehensive cost of capital analysis. The Company’s criticisms of Staff’s ROE recommendation reflect a fundamental misunderstanding of the ROE analysis applied to regulated utilities.

1 **I. INTRODUCTION**

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

3 A. My name is John A. Cassidy. I am a Public Utilities Analyst employed by the Arizona
4 Corporation Commission (“Commission”) in the Utilities Division (“Staff”). My business
5 address is 1200 West Washington Street, Phoenix, Arizona 85007.

6

7 **Q. Are you the same John A. Cassidy who filed Direct Testimony in this case?**

8 A. Yes, I am.

9

10 **Q. What is the purpose of your Surrebuttal Testimony in this rate proceeding?**

11 A. The purpose of my Surrebuttal Testimony is to update Staff’s cost of capital analysis and
12 its recommendations regarding Cordes Lakes Water Company (“Cordes Lakes” or
13 “Company”) cost of capital, and to respond to the cost of capital Rebuttal Testimony of
14 Company witness, Matthew J. Rowell (“Mr. Rowell’s Rebuttal”).

15

16 **Q. Please explain how Staff’s Surrebuttal Testimony is organized.**

17 A. Staff’s Surrebuttal Testimony is presented in four sections. Section I is this introduction.
18 Section II discusses Staff’s updated cost of capital analysis. Section III presents Staff’s
19 comments on the Rebuttal Testimony of the Company’s cost of capital witness, Mr.
20 Rowell. Lastly, Section IV presents Staff’s recommendations.

21

22 **II. COST OF EQUITY AND OVERALL RATE OF RETURN**

23 **Q. Is Staff recommending a different capital structure for Cordes Lakes in its**
24 **Surrebuttal Testimony than it did in Direct Testimony?**

25 A. No. Staff continues to recommend a capital structure consisting of 0.0 percent debt and
26 100.0 percent common equity.

1 **Q. Has Staff updated its analysis concerning the Company's cost of equity ("COE")**
2 **since filing Direct Testimony in this proceeding?**

3 A. Yes. Staff updated its analysis to include more recent market data.
4

5 **Q. What is Staff's updated estimate for the COE?**

6 A. Staff's updated estimate for the COE is 8.4 percent. This figure is derived from cost of
7 equity estimates which range from 8.7 percent for the discounted cash flow ("DCF")
8 method to 8.1 percent for the capital asset pricing model ("CAPM") estimation
9 methodologies, as shown in Surrebuttal Schedule JAC-3. In direct testimony, Staff's
10 preliminary COE estimate was 8.5 percent.
11

12 **Q. In its Surrebuttal Testimony, does Staff continue to recommend the 60 basis point**
13 **(0.6 percent) upward economic assessment adjustment to Cordes Lakes' cost of**
14 **equity that it recommended in its Direct Testimony?**

15 A. Yes.
16

17 **Q. What ROE is Staff recommending for Cordes Lakes?**

18 A. Staff recommends a 9.0 percent ROE. This figure represents Staff's updated 8.4 percent
19 COE, derived from updated cost of equity estimates ranging from 8.7 percent for the DCF
20 method to 8.1 percent for the CAPM estimation methodologies, and includes Staff's
21 upward 60 basis point economic assessment adjustment.
22

23 **Q. Did Staff update its analysis concerning the Company's overall rate of return?**

24 A. Yes, the updated analysis is supported by Surrebuttal Schedules JAC-1 to JAC-9.
25

1 **Q. Does Staff's updated cost of equity analysis result in a change to Staff's weighted**
2 **average cost of capital?**

3 A. Yes. Based upon its updated cost of equity analysis, Staff's weighted average cost of
4 capital fell to 9.0 percent. In its Direct Testimony, Staff's weighted average cost of capital
5 had been 9.1 percent.

6

7 **Q. What overall rate of return is Staff recommending for Cordes Lakes?**

8 A. Staff recommends a 9.0 percent overall rate of return. Staff's recommendation is based on
9 an ROE of 9.0 percent, a cost of debt of 0.0, and a capital structure consisting of 0.0
10 percent debt and 100.0 percent common equity, as shown in Surrebuttal Schedule JAC-1.

11

12 **III. STAFF RESPONSE TO COMPANY WITNESS MATTHEW J. ROWELL**

13 **Q. Please summarize the capital structure, cost of equity and overall rate of return**
14 **proposed in Mr. Rowell's Rebuttal.**

15 A. Mr. Rowell's Rebuttal proposes a capital structure composed of 100 percent equity and a
16 cost of equity of 10.55, which equates to a 10.55 percent overall rate of return.

17

18 **Q. Did Mr. Rowell sponsor direct cost of capital testimony in this docket?**

19 A. No. Mr. Rowell was engaged by the Company to assist in the preparation of Rebuttal
20 Testimony subsequent to the filing of Staff's Direct Testimony in this docket.

21

1 **Q. Is the capital structure proposed in Mr. Rowell's Rebuttal the same capital structure**
2 **initially proposed by the Company?**

3 A. No. As filed, the Company's Application originally proposed a capital structure
4 consisting of 97.3 percent equity and 2.7 percent debt. In his Rebuttal Testimony, Mr.
5 Rowell adopts Staff's recommended 100.0 percent equity capital structure.¹

6
7 **Q. For purposes of his Rebuttal Testimony, did Mr. Rowell perform any formal cost of**
8 **capital analysis to support his proposed 10.55 percent ROE?**

9 A. No. Mr. Rowell simply gives consideration to the 10.55 percent ROE awarded Arizona
10 Water Company, Eastern Group ("AWC") in Decision No. 73736 (dated February 20,
11 2013).²

12
13 **Q. In his Rebuttal Testimony, does Mr. Rowell attempt to justify a 10.55 percent ROE**
14 **for Cordes Lakes on the grounds that (like AWC's Eastern Group) the Company**
15 **faces the need for substantial rehabilitation of older plant?**

16 A. Yes.³

17
18 **Q. Does Staff consider Mr. Rowell's claim in this regard to have merit?**

19 A. No. In Direct Testimony filed by AWC witness Fredrick K. Schneider, it was established
20 that installation of water mains in the AWC Eastern Group's Bisbee water system had
21 begun in the late 1800s, and that the oldest water main still in service dated from 1901.⁴
22 Furthermore, Mr. Schneider testified that based on AWC's current replacement rate, it
23 would take over 170 years to replace the existing Bisbee water infrastructure.⁵ In contrast,

¹ Rowell Rebuttal, p.3.

² Docket No. W-01445A-11-0310.

³ Rowell Rebuttal, p. 8, lines 15-18.

⁴ See Schneider Direct, Exhibit FKS-13 "Water Systems in the Eastern Group," p. 78 (Docket No. W-01445A-11-0310).

⁵ See Schneider Direct, p. 68, lines 10-12 (Docket No. W-01445A-11-0310).

1 Cordes Lakes is a water utility which was granted a Certificate of Convenience and
2 Necessity (“CC&N”) in 1968, thus rendering its infrastructure to be less than fifty years
3 old.⁶
4

5 **Q. In his Rebuttal Testimony, Mr. Rowell is critical of Staff for using two different risk-**
6 **free (R_f) rates in its CAPM analyses. What is Staff’s response?**

7 A. Staff incorporates two CAPM estimates into its cost of capital analyses, and as noted in
8 Staff’s Direct Testimony, utilizes separate parameters as surrogates for the risk-free rate in
9 each.⁷ The CAPM is assumed to be a single holding period model,⁸ and in order to be
10 reflective of an investor’s holding period, Staff’s historical market risk premium CAPM
11 utilizes intermediate-term inputs. Specifically, Staff utilizes intermediate-term inputs for
12 both the historical market risk premium component,⁹ as well as for its proxy of the
13 intermediate-term risk-free rate (i.e., the average of the 5-, 7- and 10-year spot U.S.
14 Treasury yields).¹⁰ Conversely, because Staff’s current market risk premium is DCF-
15 derived,¹¹ the inputs utilized by Staff in its current market risk premium CAPM are of a
16 longer duration. The constant growth DCF model assumes that dividend growth (g) will
17 continue indefinitely/indefinitely,¹² and for this reason Staff utilizes as its risk-free rate the
18 spot yield on the 30-year U.S. Treasury note.¹³
19

⁶ Decision No. 39646, dated September 13, 1968 (Docket No. U-2060).

⁷ Cassidy Direct, p. 29, lines

⁸ Cassidy Direct, p. 28, footnote 10.

⁹ Cassidy Direct, p. 30, lines 12-19.

¹⁰ Cassidy Direct, p.29, lines 8-12.

¹¹ Cassidy Direct, p. 30, line 23.

¹² Cassidy Direct, p. 15, lines 15-16; and p. 16, line 4.

¹³ Cassidy Direct, p. 29, lines 10-12.

1 **Q. Mr. Rowell suggests that Staff has used two different values for the risk-free (R_f) rate**
2 **in the same CAPM equation, and in so doing has not only abandoned the simple logic**
3 **of high school algebra, but by inference, has purposefully understated its historical**
4 **market risk premium CAPM estimate.¹⁴ Is this true?**

5 A. No.

6
7 **Q. Since this is not true, how does Staff explain Mr. Rowell's assertion that when the**
8 **risk-free (R_f) rate can have a "positive impact" on the COE estimate, "Staff plugs in**
9 **a low estimate of RF (1.29%)," yet when the risk-free rate can have a "negative**
10 **impact" on the COE, "Staff plugs in a high estimate of RF (4.66%)?"¹⁵**

11 A. As shown in Equation 8 of Staff's Direct Testimony,¹⁶ and as depicted below, the risk-free
12 (R_f) rate does, in fact, appear twice in the CAPM formula:

$$K = R_f + \beta (R_m - R_f)$$

13
14
15
16 First, as a value to be added to the quantity, [$\beta(R_m - R_f)$], and again, in the calculation of
17 the market risk premium, ($R_m - R_f$). However, as noted in Staff's Direct Testimony,¹⁷ for
18 purposes of its historical market risk premium CAPM, the market risk premium
19 component is calculated by taking the difference between the historical annual arithmetic
20 mean return on equity securities, as measured by the S&P 500, over the period 1926-2011,
21 and the arithmetic mean intermediate-term government bond income return over that same
22 period of time. Being that the market risk premium is a measure of the return equity
23 investors expect as compensation for exposure to market risk,¹⁸ quantifying an historical

¹⁴ Rowell Rebuttal, pp. 6-7.

¹⁵ Rowell Rebuttal, p.7, lines 2-5.

¹⁶ Cassidy Direct, p. 28, line 12.

¹⁷ Cassidy Direct, p. 30, lines 12-19.

¹⁸ Cassidy Direct, p. 30, line 6.

1 market risk premium necessitates using as inputs the average annual realized equity return
2 on the one hand, and an average of the risk-free rate in effect over that same period of time
3 on the other. Staff's historical market risk premium CAPM methodology utilizes this
4 approach; thus, the 7.2 percent market risk premium shown in Schedule JAC-3 represents
5 the difference between the 11.88 percent average annual total return on the S&P 500 and
6 the 4.66 percent average annual intermediate-term government bond return covering the
7 85-year period, 1926-2011 ($7.22\% = 11.88\% - 4.66\%$).¹⁹ Staff's utilization of a 1.3
8 percent spot intermediate-term risk-free rate as the other (R_f) value in the equation is
9 consistent with estimating the expected market cost of equity utilizing the risk-free rate
10 borne by investors in today's marketplace, calculated using the historical market risk
11 premium discussed above.

12
13 **Q. For purposes of its cost of capital analysis, how long has Staff employed the**
14 **methodology discussed above to calculate its historical market risk premium CAPM**
15 **COE estimate?**

16 A. To my knowledge, Staff has employed its historical market risk premium CAPM
17 methodology for over ten years.

18
19 **Q. To the best of your knowledge, has a cost of capital witness testifying on behalf of a**
20 **utility in another rate docket ever questioned the propriety of Staff's historical**
21 **market risk premium methodology in the manner Mr. Rowell has done in his**
22 **Rebuttal Testimony?**

23 A. No.
24

¹⁹ Staff's 7.2 percent historical market risk premium is rounded to a single digit.

1 **Q. How does Staff respond to Mr. Rowell's assertion that Staff's analysis fails to**
2 **address general economic conditions?**²⁰

3 A. While it is true that Staff's Direct Testimony does not include a discussion of general
4 economic conditions, consideration of general market conditions is inherently
5 incorporated in the market based DCF and CAPM models used by Staff. Inputs (e.g.,
6 stock prices, dividends, GDP, et al.) into the DCF and CAPM models reflect general
7 economic conditions through market forces. Use of market based CAPM and DCF
8 models is also a superior way to achieve compliance with the underlying criteria
9 established by *Hope and Bluefield* that Mr. Rowell's Rebuttal claims Staff's cost of capital
10 analysis fails to satisfy.²¹ The Company's criticisms of Staff's ROE recommendation
11 reflect a fundamental misunderstanding of the use of market based analyses as they apply
12 to regulated utilities.

13
14 **IV. STAFF RECOMMENDATIONS**

15 **Q. What are Staff's recommendations for Cordes Lakes' cost of capital?**

16 A. Staff recommends the following for Cordes Lakes' cost of capital:

- 17
18 1. A capital structure of 0.0 percent debt and 100.0 percent equity.
19 2. A 0.0 percent cost of debt.
20 3. A 9.0 percent return on equity (including a 0.6 percent (60 basis points) upward
21 economic assessment adjustment).
22 4. A 9.0 percent overall rate of return.
23

²⁰ Rowell Direct, p. 5, line 12.

²¹ Rowell Rebuttal, p. 4, lines 9-10. As enumerated in Mr. Rowell's Rebuttal, these criteria consist of: Commensurate Earnings, Financial Integrity, Capital Attraction, Changing Level of Returns, and "End Result" Doctrine.

1 **Q. Does this conclude your Surrebuttal Testimony?**

2 A. Yes, it does.

Cordes Lakes Cost of Capital Calculation
 Capital Structure
 And Weighted Average Cost of Capital
 Staff Recommended and Company Proposed

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Staff Recommended Structure			
Debt	0.0%	0.0%	0.0%
Common Equity	100.0%	9.0%	9.0%
Weighted Average Cost of Capital			9.0%
Company Proposed Structure ¹			
Debt	0.0%	0.0%	0.0%
Common Equity	100.0%	10.55%	10.55%
Weighted Average Cost of Capital			10.55%

[D] : [B] x [C]

Supporting Schedules: JAC-3 and JAC-4.

¹ Represents the Company's rebuttal position.

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Cordes Lakes Cost of Capital Calculation
Final Cost of Equity Estimates
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
DCF Method				
Constant Growth DCF Estimate		$\frac{D_1}{P_0} \cdot 1$	+	g^2
Multi-Stage DCF Estimate		3.1%	+	4.8%
Average DCF Estimate			=	<u>8.7%</u>
CAPM Method				
Historical Market Risk Premium ³	R_f	β^5	x	(R_p)
Current Market Risk Premium ⁴	1.1%	0.71	x	6.2%
Average CAPM Estimate	2.8%	0.71	x	9.9%
			=	<u>8.1%</u>
Average of Overall Cost of Equity Estimates				
				8.4%
			Economic Assessment Adjustment	<u>0.6%</u>
			Sub-Total	9.0%
			Financial risk adjustment	<u>0.0%</u>
			ROE	<u>9.0%</u>

1 MSN Money and Value Line
 2 Schedule JAC-8
 3 Risk-free rate (Rf) for 5, 7, and 10 year Treasury rates from the U.S. Treasury Department at www.ustreas.gov
 4 Risk-free rate (Rf) for 30 Year Treasury bond rate from the U.S. Treasury Department at www.ustreas.gov
 5 Value Line
 6 Historical Market Risk Premium (Rp) calculated from Ibbotson Associates SBBI 2012 Yearbook data
 7 Testimony

Cordes Lakes Cost of Capital Calculation
Average Capital Structure of Sample Water Utilities

[A]	[B]	[C]	[D]
<u>Company</u>	<u>Debt</u>	<u>Common Equity</u>	<u>Total</u>
American States Water	46.0%	54.0%	100.0%
California Water	53.3%	46.7%	100.0%
Aqua America	53.9%	46.1%	100.0%
Connecticut Water	57.1%	42.9%	100.0%
Middlesex Water	43.3%	56.7%	100.0%
SJW Corp	<u>55.7%</u>	<u>44.3%</u>	<u>100.0%</u>
Average Sample Water Utilities	51.6%	48.4%	100.0%
Cordes Lakes - Actual Capital Structure	0.0%	100.0%	100.0%

Source:
Sample Water Companies from Value Line

Cordes Lakes Cost of Capital Calculation
Growth in Earnings and Dividends
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
<u>Company</u>	Dividends Per Share 2003 to 2012 <u>DPS^{1,2}</u>	Dividends Per Share Projected <u>DPS^{1,3}</u>	Earnings Per Share 2003 to 2012 <u>EPS^{1,2}</u>	Earnings Per Share Projected <u>EPS^{1,3}</u>
American States Water	3.9%	6.0%	7.7%	1.2%
California Water	1.2%	7.4%	5.0%	5.8%
Aqua America	7.7%	8.3%	7.3%	8.0%
Connecticut Water	1.7%	2.8%	3.2%	2.1%
Middlesex Water	1.6%	1.6%	2.1%	5.0%
SJW Corp	<u>4.4%</u>	<u>4.9%</u>	<u>4.2%</u>	<u>6.3%</u>
Average Sample Water Utilities	3.4%	5.2%	4.9%	4.7%

1 Value Line

2 Value Line -- Ten-year historical DPS and EPS growth.

3 Value Line -- Projected DPS and EPS growth covers the five-year period, 2013-2017.

Cordes Lakes Cost of Capital Calculation
Sustainable Growth
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]
	Retention Growth 2003 to 2012 <u>br</u>	Retention Growth Projected <u>br</u>	Stock Financing Growth <u>vs</u>	Sustainable Growth 2003 to 2012 <u>br + vs</u>	Sustainable Growth Projected <u>br + vs</u>
<u>Company</u>					
American States Water	3.8%	5.6%	2.6%	6.5%	8.2%
California Water	2.4%	3.2%	2.3%	4.7%	5.5%
Aqua America	3.9%	4.4%	2.5%	6.4%	6.9%
Connecticut Water	2.0%	3.0%	0.9%	2.9%	4.0%
Middlesex Water	1.2%	2.8%	3.5%	4.7%	6.2%
SJW Corp	<u>3.5%</u>	<u>3.8%</u>	<u>0.1%</u>	<u>3.6%</u>	<u>3.9%</u>
Average Sample Water Utilities	2.8%	3.8%	2.0%	4.8%	5.8%

[B]: Value Line
 [C]: Value Line
 [D]: Value Line and MSN Money
 [E]: [B]+[D]
 [F]: [C]+[D]

Cordes Lakes Cost of Capital Calculation
Selected Financial Data of Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]	[G]
Company	Symbol	Spot Price 5/1/2013	Book Value	Mkt To Book	Value Line Beta β	Raw Beta β_{raw}
American States Water	AVR	54.22	22.51	2.4	0.70	0.52
California Water	CWT	19.71	11.52	1.7	0.65	0.45
Aqua America	WTR	31.43	9.61	3.3	0.60	0.37
Connecticut Water	CTWS	28.15	13.76	2.0	0.75	0.60
Middlesex Water	MSEX	19.00	12.10	1.6	0.70	0.52
SJW Corp	SJW	24.58	15.51	<u>1.6</u>	<u>0.85</u>	<u>0.75</u>
Average				2.1	0.71	0.53

[C]: Msn Money

[D]: Value Line

[E]: [C] / [D]

[F]: Value Line

[G]: (-0.35 + [F]) / 0.67

Cordes Lakes Cost of Capital Calculation
 Calculation of Expected Infinite Annual Growth in Dividends
 Sample Water Utilities

[A]	[B]
<u>Description</u>	<u>g</u>
DPS Growth - Historical ¹	3.4%
DPS Growth - Projected ¹	5.2%
EPS Growth - Historical ¹	4.9%
EPS Growth - Projected ¹	4.7%
Sustainable Growth - Historical ²	4.8%
<u>Sustainable Growth - Projected²</u>	<u>5.8%</u>
Average	4.8%

¹ Schedule JAC-5

² Schedule JAC-6

Cordes Lakes Cost of Capital Calculation
 Multi-Stage DCF Estimates
 Sample Water Utilities

[A] Company	[B] Current Mkt. Price (P ₀) ¹	[C] Projected Dividends ² (Stage 1 growth) (D _t)	[D] d ₁	[E] d ₂	[F] d ₃	[G] d ₄	[H] Stage 2 growth ³ (g _n)	[I] Equity Cost Estimate (K) ⁴
American States Water	54.2	5/1/2013	1.36	1.42	1.49	1.56	6.5%	8.9%
California Water	19.7		0.66	0.69	0.72	0.75	6.5%	9.7%
Aqua America	31.4		0.70	0.73	0.76	0.80	6.5%	8.6%
Connecticut Water	28.2		0.98	1.02	1.07	1.12	6.5%	9.8%
Middlesex Water	19.0		0.76	0.80	0.84	0.88	6.5%	10.4%
SJW Corp	24.6		0.74	0.78	0.81	0.85	6.5%	9.4%

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

Average **9.5%**

Where : P₀ = current stock price

D_t = dividends expected during stage 1

K = cost of equity

n = years of non – constant growth

D_n = dividend expected in year n

g_n = constant rate of growth expected after year n

1 [B] see Schedule JAC-7

2 Derived from Value Line Information

3 Average annual growth in GDP 1929 - 2011 in current dollars.

4 Internal Rate of Return of Projected Dividends