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ARIZONA CORPORATION COMMISSION

Memorandum

DATE: AUGUST 19, 2016

DOCKET NO: W-01445A-15-0277

TO ALL PARTIES:

The copies of the Recommended Opinion and Order filed in the above-captioned matter on August 18, 2016, were missing Page 30. A copy of Page 30 is enclosed. Please include it with your copy of the Recommended Opinion and Order. The original Recommended Opinion and Order included Page 30, and the scanned copy of the Recommended Opinion and Order available on the Commission's eDocket is being corrected to include it as well.

The deadline for filing exceptions remains unchanged.

A handwritten signature in black ink, appearing to read "Sarah N. Harpring".

Sarah N. Harpring
Administrative Law Judge

Arizona Corporation Commission

DOCKETED

AUG 19 2016

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	AWC			RUCO			Staff		
	Weight	Cost	Weighted Avg. Cost	Weight	Cost	Weighted Avg. Cost	Weight	Cost	Weighted Avg Cost
Common Equity	53.69%	11.45% ³⁸	6.15%	53.69%	8.95%	4.81%	53.69%	9.05%	4.86%
Debt	46.31%	6.82%	3.16%	46.31%	5.43%	2.51%	46.31%	6.82%	3.16%
Weighted Average Cost of Capital			9.31%			7.32%			8.02%

2. AWC

To determine AWC's proposed cost of equity, Ms. Ahern performed discounted cash flow ("DCF") model, risk premium model ("RPM"), and capital asset pricing model ("CAPM") analyses with a proxy group of eight publicly traded water companies.³⁹ (Ex. A-7 at 3, 7.) Ms. Ahern's DCF model, RPM, and CAPM analyses resulted in COEs of 8.64 percent,⁴⁰ 10.76 percent,⁴¹ and 9.58 percent,⁴² respectively, which Ms. Ahern averaged to reach a COE of 9.60 percent. (Ex. A-7 at 3, 7.)

Ms. Ahern opined that due to the federal government's influence on the market and the historically low interest rates resulting from the recent recession, traditional COE models (including the models she used) tend to understate the investor-required COE. (Ex. A-7 at 12.) Ms. Ahern concluded that AWC required a 0.50 percent business risk premium due to the unique risks it faces as a result of its smaller size compared to the proxy group utilities. (Ex. A-7 at 3, 13-14, 21-22, 44-45.) Ms. Ahern further concluded that AWC required a 0.63 percent financial risk premium due to its greater

³⁸ AWC originally proposed a cost of equity of 10.75 percent, but increased its proposed cost of equity to 11.45 percent on rebuttal. (See Ex. A-7 at 6; Ex. A-13 at 75.)

³⁹ The proxy group included American States Water Co.; American Water Works Co., Inc.; Aqua America, Inc.; California Water Service Group; Connecticut Water Service, Inc.; Middlesex Water Co.; SJW Corp.; and York Water Co. (Ex. A-7 at 24-25.) Ms. Ahern stated that for the five years ending in 2014, the proxy group utilities had average earnings on book common equity of 10.03 percent and average common equity based upon permanent capital (excluding short-term debt) of 51.24 percent. (Ex. A-7 at 25.)

⁴⁰ Ms. Ahern's single-stage DCF model analysis resulted in a range of DCF COEs for the proxy group from 7.35 percent to 12.92 percent, an average of 8.93 percent, and a median of 8.35 percent, which she averaged to reach 8.64 percent. (Ex. A-7 at 28, ex. PMA-5.)

⁴¹ Ms. Ahern's Predictive Risk Premium Model ("PRPM") analysis resulted in an average of 11.94 percent and a median of 11.24 percent, which she averaged to reach 11.59 percent. (Ex. A-7 at 29-31.) Ms. Ahern's Adjusted Total Market Approach RPM analysis resulted in an adjusted prospective bond yield of 5.06 percent and an equity risk premium of 4.87 percent, which she added to reach 9.93 percent. (Ex. A-7 at 31-37, ex. PMA-7.) The two RPM analysis results were averaged to reach 10.76 percent. (Ex. A-7 at 37.)

⁴² Ms. Ahern used a risk-free rate of 3.69 percent and performed both a traditional CAPM analysis and an empirical CAPM analysis, reaching average results of 9.31 and 9.76 and median results of 9.40 and 9.82, respectively, which were then averaged to reach a rate of 9.58 percent. (Ex. A-7 at 39-40.)

On this 19th day of August, 2016, the foregoing document was filed with Docket Control as a Hearing Division Memorandum, and copies of the foregoing were mailed on behalf of the Hearing Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service

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