

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

TOM FORESE, Chairman  
BOB BURNS  
ANDY TOBIN  
BOYD DUNN  
JUSTIN OLSON

IN THE MATTER OF THE APPLICATION  
OF EPCOR WATER ARIZONA INC. FOR A  
DETERMINATION OF THE CURRENT  
FAIR VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR  
INCREASES/DECREASES IN ITS RATES  
AND CHARGES BASED THEREON FOR  
UTILITY SERVICE BY ITS AGUA FRIA,  
ANTHEM, CHAPARRAL, HAVASU,  
MOHAVE, NORTH MOHAVE, PARADISE  
VALLEY, SUN CITY, SUN CITY WEST,  
TUBAC, AND WILLOW VALLEY WATER  
DISTRICTS AND FOR CONSIDERATION  
OF CONSOLIDATION PROPOSALS

DOCKET NO: WS-01303A-17-0257

**REJOINDER TESTIMONY  
OF  
PAULINE M. AHERN, CRRA  
ON BEHALF OF  
EPCOR WATER ARIZONA INC.  
MAY 9, 2018**

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1 **EXECUTIVE SUMMARY**  
2

3 Ms. Ahern's Rejoinder Testimony responds to certain aspects of the Surrebuttal Testimony of  
4 Mr. Yue "Nick" Liu, witness for the Arizona Corporation Commission's Utilities Division  
5 ("Commission Staff"), and the Surrebuttal Testimony of Mr. John A. Cassidy, witness for the  
6 Residential Utility Consumer Office ("RUCO"), on the following issues:  
7

8 **Response to Mr. Liu**  
9

10 Ms. Ahern has previously provided evidence in both her Direct and Rebuttal Testimonies which  
11 details academic and empirical support for the use of a non-price regulated proxy group as well  
12 as company specific credit and business risk adjustments which Mr. Liu rejects in his Surrebuttal  
13 Testimony.  
14

15 **Response to Mr. Cassidy**  
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17 Ms. Ahern also provides evidence that the Company's currently-proposed cost of common  
18 equity is not her updated recommended common equity cost rate as Mr. Cassidy asserts in his  
19 executive summary.  
20

21 Ms. Ahern also provides evidence that when Mr. Cassidy's Discounted Cash Flow analysis  
22 ("DCF") is adjusted to reflect per share growth rates from *Value Line Investment Survey* ("*Value*  
23 *Line*") which is consistent with those upon which Mr. Liu relied from *Value Line*, his  
24 recommended common equity cost rate would be 9.91%. She also provides evidence that when  
25 the 8.9% return on common equity authorized by the California Public Utility Commission for  
26 San Jose Water Company ("SJW") in Applications 17-04-001, 002, 003, and 006 is adjusted to  
27 reflect the greater financial risk of EPCOR Arizona Water Inc. ("EWAZ") relative to SJW, a  
28 10.89% return on common equity is implied. In addition, Ms. Ahern provides evidence of a  
29 more recently authorized fully litigated return on common equity of 10.5% on May 2, 2018 for  
30 Carolina Water Service, Inc. of South Carolina ("CWS of SC"), which, when also adjusted to  
31 reflect the greater financial risk of EWAZ relative to CWS of SC indicates an implied return on  
32 common equity for EWAZ of 12.89%. Common equity cost rates of 9.91%, 10.89% and 12.89%  
33 all confirm that EWAZ's requested 10.1% common equity cost rate does not significantly  
34 overstate EWAZ's actual cost of common equity.  
35

36 Ms. Ahern also provides evidence that the CPUC in Decision 18-03-035 relative to the above  
37 Applications considered all of the evidence in the proceeding including all the financial models  
38 of all witnesses, in determining its authorized rates of return for the Applicants.  
39

40 **Response to Mr. Michlik**  
41

42 Ms. Ahern provides evidence that contrary to Mr. Michlik's citations from Decision 18-03-035  
43 that the Office of Ratepayer Advocates ("ORA") recommended a reduction in the authorized

Page iii

1 cost of common equity, neither ORA's witness nor any of the Applicants' witnesses  
2 recommended such a reduction as confirmed by the CPUC in Decision 18-03-035.  
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**I. INTRODUCTION**

**Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.**

A. My name is Pauline M. Ahern and I am an Executive Advisor with ScottMadden, Inc.  
My address is 202 Nathan Place, Mount Laurel, NJ 08054.

**Q. ARE YOU THE SAME PAULINE M. AHERN WHO PREVIOUSLY  
SUBMITTED DIRECT AND REBUTTAL TESTIMONY IN THIS  
PROCEEDING?**

A. Yes, I am.

**Q. HAVE YOU PREPARED AN EXHIBIT WHICH SUPPORTS YOUR REBUTTAL  
TESTIMONY?**

A. Yes. It is Exhibit PMA-RJ1, which includes Schedules 1 through 3.<sup>1</sup>

**II. PURPOSE**

**Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

A. The purpose of my testimony is to provide a response on behalf of EPCOR Water  
Arizona Inc. (“EWAZ” or “Company”) in rejoinder to certain aspects of the Surrebuttal  
Testimony of Mr. Yue “Nick” Liu (“Mr. Liu”), witness for the Arizona Corporation  
Commission’s Utilities Division (“Commission Staff”), and the Surrebuttal Testimony of  
Mr. John A. Cassidy (“Mr. Cassidy”), witness for the Residential Utility Consumer  
Office (“RUCO”), concerning the currently requested common equity cost rate which  
EWAZ should be allowed an opportunity to earn on its authorized rate base as well as in

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<sup>1</sup> Throughout this testimony, unless otherwise indicated, a reference to a “Schedule” is to a Schedule in Exhibit PMA-RJ1.

1 response to my Rebuttal Testimony. I will also address the Surrebuttal Testimony of  
2 Jeffrey M. Michlik (“Mr. Michlik”), also a witness for RUCO, regarding his response to  
3 my Rebuttal Testimony regarding a reduction in the authorized return on common equity  
4 in the presence of various surcharge and adjustment mechanisms.

5 First, I will make some brief comments related to Mr. Liu’s Surrebuttal  
6 Testimony relative to my use of non-price regulated proxy group as well as EWAZ-  
7 specific adjustments to a recommended common equity cost rate based upon his water  
8 proxy.

9 Second, I will address Mr. Cassidy’s Surrebuttal Testimony relative to: 1) a  
10 mischaracterization of my Rebuttal Testimony; 2) his updated DCF analysis; 3) his  
11 reliance upon the California Public Utility Commission’s (“CPUC”) March 22, 2018  
12 Decision 18-03-035 in Applications 17-04-001, 002, 003 and 006, in addition, I will also  
13 respond to certain of the comments and critiques of my Rebuttal Testimony by Mr.  
14 Cassidy.

15 Third, I will address Mr. Michlik’s comments relative the CPUC’s Decision  
16 18-03-035 relative to adjustments to the authorized cost of common equity in the  
17 presence of requested surcharge and adjustment mechanisms.

18 **III. RESPONSE TO THE SURREBUTTAL TESTIMONY OF MR. LIU**

19 **Q. DO YOU HAVE ANY COMMENTS TO MAKE ON MR. LIU’S SURREBUTTAL**  
20 **TESTIMONY RELATIVE TO HIS REJECTION OF YOUR USE OF A NON-**

1           **PRICE REGULATED PROXY GROUP AS WELL AS HIS REJECTION OF**  
2           **COMPANY-SPECIFIC CREDIT AND BUSINESS RISK ADJUSTMENTS?**<sup>2</sup>

3 A.    Yes. The only comments I have are that since both my Direct Testimony and my  
4        Rebuttal Testimony have provided clear support, including academic and empirical  
5        support, for the use of a non-price-regulated proxy group as well as company-specific  
6        credit and business risk adjustments, I will not repeat those discussions here.

7 **IV.   RESPONSE TO THE SURREBUTTAL TESTIMONY OF MR. CASSIDY**

8 **Q.    PLEASE DESCRIBE MR. CASSIDY’S MISCHARACTERIZATION OF YOUR**  
9        **REBUTTAL TESTIMONY.**

10 A.    On page iii of his Executive Summary<sup>3</sup>, when Mr. Cassidy states that the “updated 10.10  
11        percent cost of equity recommendation put forth by EPCOR Water Arizona witness, Ms.  
12        Pauline M. Ahern, continues to significantly overstate the Company’s actual cost of  
13        equity”, he is implying that I “put forth” an update of my common equity analysis and  
14        recommended common equity cost rate. I did not. A comprehensive reading (or word  
15        search) of my Rebuttal Testimony demonstrates that I did not update my cost of equity  
16        recommendation for EWAZ. In fact, the word “update” does not appear anywhere in my  
17        Rebuttal Testimony. The Company decided to “put forth” a rebuttal position of 10.10%.

18           Moreover, a 10.10% cost of common equity does not “overstate the Company’s  
19        actual cost of equity”, especially when Mr. Cassidy’s Discounted Cash Flow Model  
20        (“DCF”) is adjusted to replicate the DCF growth rate to be consistent with Mr. Liu’s DCF  
21        analysis.

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<sup>2</sup> See Surrebuttal Testimony of Yue “Nick” Liu (hereinafter “Liu”) at 6–7.

<sup>3</sup> See Surrebuttal Testimony of John Cassidy (hereinafter “Cassidy”) at iii.

1 **Q. PLEASE EXPLAIN.**

2 **A.** Mr. Cassidy's updated DCF result was 8.69%<sup>4</sup> while the midpoint of Mr. Liu's updated  
3 range of DCF results was 9.60%.<sup>5</sup> I find this discrepancy between Mr. Cassidy's and Mr.  
4 Liu's DCF analyses very curious, since both Mr. Cassidy and Mr. Liu updated their DCF  
5 analyses using market data available through March 2018, including *Value Line*  
6 *Investment Survey* ("Value Line") and the same FirstCall / Yahoo projected earnings per  
7 share ("EPS") growth. Although Mr. Cassidy included American Water Works Co., Inc.  
8 and Artesian Resources Corp. in his proxy group companies, excluding these two  
9 companies does not explain the discrepancy between their results.<sup>6</sup> In reviewing each  
10 page of their nearly identical DCF surrebuttal schedules, I discovered that their historical  
11 and projected per share growth rates, both from the April 13, 2018 issue of *Value Line*,  
12 did not match. While Mr. Liu used the historical and projected per share growth rates  
13 (based upon 3-year average base and average ending periods) directly from each proxy  
14 group company's *Value Line* Ratings and Report, Mr. Cassidy calculated his compound  
15 growth rates from *Value Line*'s per share data, using a single beginning year and single  
16 ending year.<sup>7</sup>

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<sup>4</sup> Cassidy at ii.

<sup>5</sup> Liu at 2.

<sup>6</sup> I did not address this in my Rebuttal Testimony because there was little discrepancy between their DCF results in their Direct Testimonies. Mr. Liu's DCF result had a midpoint of 9.25% (*Liu Direct* at 3) with Mr. Cassidy's DCF result 9.57% (*Cassidy* at 4).

<sup>7</sup> Note that in my Direct Testimony, in using *Value Line*'s 5-year projected growth in EPS, I, like Dr. Liu, used the growth rates published by *Value Line* i.e., the 3-year average base and 3-year average ending period.



1                    However, *Value Line* is clear as to why it is appropriate to use 3-year average  
2                    periods<sup>8</sup>:

3                    **CALCULATING ANNUAL RATES**  
4                    **OF CHANGE (GROWTH RATES)**

5  
6                    In an attempt to eliminate short-term fluctuations that may distort results,  
7                    Value Line uses a three-year base period and a three-year ending period  
8                    when calculating growth rates. Investors often try to calculate a growth  
9                    rate from one starting year to one ending year, and then can't understand  
10                    why the number they get is not the same as the one published by Value  
11                    Line. If they used a three-year base period (2009-2011) and three-year  
12                    ending period, (2015-2017), they would get the same results we do.  
13

14                    Had Mr. Cassidy relied upon the same 3-year average base and average ending  
15                    period historical and projected per share growth rates published by *Value Line*, his<sup>9</sup>  
16                    highest DCF result would have been 10.20% as shown on page 1 of Schedule 1.

17 **Q.        WHAT WOULD MR. CASSIDY'S CONCLUSION FOR COST OF COMMON**  
18 **EQUITY BE HAD HE RELIED UPON THE HISTORICAL AND PROJECTED**  
19 **PER-SHARE GROWTH RATES PUBLISHED BY *VALUE LINE*.**

20 **A.**        Mr. Cassidy's conclusion of EWAZ's cost of common equity would be 9.91%, shown on  
21                    Schedule 2 and summarized in Table 1 below:

22                    **Table 1**

23		
24	DCF	10.20%
25	CAPM	7.93%
26	CE	<u>11.60%</u>

<sup>8</sup> Complete Overview - The Value Line Investment Survey ©2013 at 12.

<sup>9</sup> Mr. Cassidy chose the highest DCF result in both his Direct Testimony (page 33) and Surrebuttal Testimony (Surrebuttal Schedule JAC – 3, at 1).

9.91%

Consequently, the Company's rebuttal position of a cost of common equity of 10.10% does not overstate, significantly or otherwise, EWAZ's actual cost of common equity.

**Q. DO YOU HAVE ANY COMMENT REGARDING MR. CASSIDY'S RELIANCE UPON CPUC'S DECISION 18-03-035 RELATIVE TO THE APPROPRIATE COST OF COMMON EQUITY APPLICABLE TO THE COMPANY?**

A. Yes. Mr. Cassidy's reliance upon CPUC Decision 18-03-035 is flawed in three respects. First, the 8.9% common equity cost rate authorized for San Jose Water Company ("SJW") is not directly applicable to EWAZ.

Second, CPUC Decision 18-03-035 has since been superseded by at least one fully litigated regulatory decision for a water utility since March 22, 2018, of which I am aware.

Third, notwithstanding Mr. Cassidy's citation from CPUC Decision 18-03-035 relative to the use of non-price regulated groups, the CPUC ultimately considered all the evidence in the proceeding in arriving at its authorized common equity cost rate for SJW.

I will discuss each of these in order below.

**Q. PLEASE EXPLAIN WHY SJW'S 8.9% COMMON EQUITY COST RATE AUTHORIZED IN THE CPUC DECISION 18-03-035 IS NOT DIRECTLY APPLICABLE TO EWAZ.**

A. Even assuming similar economic and market conditions at the closing of the evidence of record, SJW's cost of common equity of 8.9% as authorized in CPUC Decision 18-03-

1           035 is not directly applicable to EWAZ. The 8.9% is relative to SJW's authorized  
2           common equity ratio of 53.28%, which is significantly greater than that of Mr. Cassidy's  
3           recommended common equity ratio of 48.06% for EWAZ. Thus, there is greater  
4           financial risk inherent in EWAZ's capital structure than in SJW's authorized capital  
5           structure.

6           The relationship between leverage and financial risk has been formalized by  
7           financial economists, such as Modigliani and Miller ("M&M")<sup>10</sup> who concluded that,  
8           regardless of capital structure, the pre-tax cost of capital remains constant over varying  
9           capital structures. The cost of common equity may be expressed as:

$$k_{e,L} = k_{e,U} + (k_{e,U} - k_d)(1 - T)(D/E)$$

11           Where:

12	$k_{e,U}$	=	Cost of Equity for an unlevered firm
13	$k_{e,L}$	=	Cost of Equity for a levered firm
14	$k_d$	=	cost of debt (interest rate)
15	$D$	=	level of debt
16	$E$	=	level of equity
17	$T$	=	tax rate

18  
19           Thus, the cost of common equity for a levered firm is expressed as the cost of  
20           common equity for an unlevered firm, which only reflects business risk, plus a premium  
21           for financial risk.

22           For the 8.9% common equity cost rate authorized for SJW to be applicable to  
23           EWAZ, a financial risk adjustment must be made. Schedule 3, page 1, shows the  
24           derivation of the M&M adjustment to SJW's 8.9% authorized return on common equity

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<sup>10</sup> F. Modigliani and M. Miller, The Cost of Capital, Corporation Finance, and the Theory of Investment, The American Economic Review 48 No. 3, June 1958, at 261-297; F. Modigliani and M. Miller, Corporate Income Taxes and the Cost of Capital: A Correction, The American Economic Review 53 No. 3, June 1963 433 – 443.

1 necessary to make it applicable to EWAZ's capital structure. As shown, a 1.99% (199  
2 basis points) adjustment is necessary and the implied applicable cost of common equity,  
3 based upon SJW's authorized 8.9% return on common equity and authorized common  
4 equity ratio of 53.28%, is 10.89%.<sup>11</sup>

5 **Q. PLEASE DISCUSS THE MORE RECENT FULLY LITIGATED COST OF**  
6 **COMMON EQUITY AUTHORIZED FOR A WATER UTILITY MENTIONED**  
7 **ABOVE.**

8 A. At its May 2, 2018 Commission Business Meeting<sup>12</sup>, the Public Service Commission of  
9 South Carolina ("PSC SC") authorized Carolina Water Service, Inc. of South Carolina  
10 ("CWS of SC") a return on common equity of 10.5% relative to a common equity ratio of  
11 51.89%. As with SJW's 8.9% authorized return on common equity, CWS of SC's  
12 authorized 10.5% return on common equity is not directly applicable to EWAZ, because  
13 CWS of SC's authorized common equity ratio also reflects lower financial risk relative to  
14 that of EWAZ. Page 2 of Schedule 3 derives the same M&M adjustment as shown on  
15 page 1, but relative to the CWS of SC decision. As shown, a financial risk adjustment of  
16 2.31% (231 basis points) adjustment is necessary and the implied applicable cost of  
17 common equity, based upon CWS of SC's authorized 10.5% return on common equity  
18 and authorized common equity ratio of 51.89%, is 12.81%.

<sup>11</sup> 10.89% = 8.90% + 1.99%

<sup>12</sup> The final order is expected to be issued on May 11, 2018, However, a video of the PSC SC's May 2, 2018 Commission Business Meeting can be found using the following link: <https://www.periscope.tv/PSCofSC/11PKqnezaoMGb>. The Commission's discussion begins about 10 minutes into the video with the vote at about 25 minutes into the video.

1           Furthermore, the PSC of SC adopted CWS of SC's rate of return witness's<sup>13</sup>  
2           10.5% indicated common equity cost rate (based upon the same proxy group as mine)  
3           before any company-specific risk adjustments, but, including both a non-regulated proxy  
4           group and the Predictive Risk Premium Model ("PRPM"), all applied as in my Direct  
5           Testimony.

6   **Q. PLEASE COMMENT UPON MR. CASSIDY'S CITATION FROM THE CPUC**  
7   **DECISION 18-03-035 RELATIVE TO THE USE OF NON-PRICE REGULATED**  
8   **PROXY GROUPS.**

9   A. Mr. Cassidy's citation<sup>14</sup> is moot for three reasons. First, as noted above, the PSC of SC  
10   more recently authorized a return on common equity for a water utility which included  
11   the use of a non-price regulated proxy group.

12           Second, the CPUC, notwithstanding Mr. Cassidy's citation, clearly stated on page  
13   18 of Decision 18-03-035<sup>15,16</sup>:

14           We find no reason to adopt the financial modeling results of any one party.  
15           Therefore, we will establish a base ROE range from the financial model  
16           results. After considering all the evidence which includes the financial  
17           model results, adjustments to financial models, interest rate forecast [sic],  
18           CD forecast [sic], and applying informed judgement we arrive at a base  
19           ROE range of 7.40% to 9.40%. From that ROE range we consider the  
20           appropriate ROE for each of the Applicants. (emphasis added)  
21

22           Third, just because the CPUC made the statements in Decision 18-03-035 cited by  
23   Mr. Cassidy, it does not negate the empirical and academic support for the criteria I used

<sup>13</sup> Dylan W. D'Ascendis, CRRRA, Director, ScottMadden, Inc. and my colleague.

<sup>14</sup> Cassidy at 7.

<sup>15</sup> See Attachment D to the Surrebuttal Testimony of Jeffrey M Michlik (hereinafter "Michlik").

<sup>16</sup> In Table 6 preceding this citation, SJW's Requested/Proposed ROE is listed incorrectly as 10.80% (my proposed was actually 10.75%). It can therefore be assumed that the ROE cited for SJW includes ALL of my analysis, which includes both a non-price regulated proxy group and the PRPM.

1 to select the non-price regulated proxy group, i.e., unadjusted betas and the standard  
2 errors of the regression<sup>17</sup> indicate that companies, price regulated (utilities) or non-price  
3 regulated, with similar unadjusted betas and standard errors of the regression giving rise  
4 to those betas, have similar total investment risk. Moreover, if one accepts the use of  
5 betas in a Capital Asset Pricing Model (“CAPM”) analysis, then one must also accept the  
6 regression analyses which give rise to betas. Since betas represent systematic risk only,  
7 about 13.20% of total risk (with an average R-Squared of 0.1320 for Mr. Cassidy’s water  
8 proxy group<sup>18</sup>), one must also accept that the standard error of the regression, therefore,  
9 reflects 86.80%<sup>19</sup> of total risk. Consequently, one must also accept that combined, beta  
10 and the standard error of the regression reflects total risk.

11 **Q. PLEASE COMMENT UPON MR. CASSIDY’S “POINT OF CONFUSION**  
12 **REGARDING HOW MS. AHERN ARRIVED AT HER 10.30 PERCENT**  
13 **INDICATED COST OF COMMON EQUITY BEFORE ADJUSTMENT”<sup>20</sup>.**

14 A. Mr. Cassidy’s entire discussion is moot for two reasons. First, my 10.30% indicated cost  
15 of common equity before adjustment is no longer part of the Company’s current rebuttal  
16 position of 10.10% relative to the return on common equity.

17 Second, a comprehensive reading of my Direct Testimony makes clear that the  
18 10.30% is based upon the average of the mean and median cost rate results for the Water  
19 Proxy Group before any risk adjustment<sup>21</sup>:

<sup>17</sup> Ahern Direct at 47, 63-64, Exhibit PMA-RT2, Schedule 13 and Schedule 30.

<sup>18</sup> Ahern at 77.

<sup>19</sup> 86.80% = 100.00% - 13.20%.

<sup>20</sup> Cassidy at 8 – 13.

<sup>21</sup> Ahern at 4. I inadvertently neglected to cite this in my Rebuttal Testimony and I apologize for any confusion this has caused.

1 After reviewing the cost rates based upon these models, I conclude that a  
2 common equity cost rate of 10.30%, based upon the average of the mean  
3 and median cost rate results, is appropriate *before* any adjustment for the  
4 greater credit and business risks. . .  
5

6 **V. RESPONSE TO THE SURREBUTTAL TESTIMONY OF MR. MICHLIK**

7 **Q. DO YOU HAVE ANY COMMENTS RELATIVE TO MR. MICHLIK'S**  
8 **RESPONSE TO YOUR REBUTTAL TESTIMONY?**

9 A. Yes. Mr. Michlik challenges my comment that I cannot recall one matter where any  
10 party has recommended reducing the authorized cost of common equity due to the  
11 presence of any of the mechanisms outlined by Mr. Michlik, by citing CPUC Decision  
12 18-03-035.<sup>22, 23</sup> In response, I stand by the statements he challenges from my Rebuttal  
13 Testimony. Yes, I do remember that proceeding clearly, as I was indeed a rate of return  
14 witness for that proceeding.

15 Notwithstanding Mr. Michlik's citation from Decision 18-03-035, NO party to  
16 that proceeding recommended a reduction in their recommended cost of common equity  
17 rate; neither any of the Companies' witnesses NOR Aaron L. Rothschild, witness for the  
18 Office of Ratepayer Advocates ("ORA"). In fact, CPUC Decision 18-03-035 confirms  
19 this clearly when it states:<sup>24</sup>

20 Applicants included upward adjustments in their financial modeling  
21 results for: (1) flotation costs; (2) non-regulated comparable earnings  
22 approach (Non-Reg. Com.); (3) after tax weighted average cost of capital  
23 (ATWACC); (4) financial leverage; and (5) small size. ORA did not

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<sup>22</sup> Michlik at 22-28.

<sup>23</sup> Mr. Michlik also cites the CPUC Decision relative to the use of non-price regulated proxy groups. Since I have already discussed the issue previously relative to Mr. Cassidy's citation of same, I will not repeat that discussion here.

<sup>24</sup> Michlik at Attachment D at 9.

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1                   propose any adjustments to its 7.26% to 8.63% and 5.27% to 10.43%  
2                   CAPM financial model results. (emphasis added)  
3

4                   Consequently, Mr. Michlik's response to my Rebuttal Testimony should be  
5                   rejected by the Commission.

6   **Q.    DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?**

7   A.    Yes.



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EPCOR Water Arizona, Inc.  
Test Year Ending December 31, 2016  
Docket No. WS-01303A-17-0257, et al.

		<b>PROXY GROUP -- DCF ANALYSIS</b>								
Line No	Proxy Group Companies	(A) Current Dividend Yield (D <sub>t</sub> /P <sub>t</sub> )	(B) Historic Retention Growth	(C) Projected Retention Growth	(D) Historical Per Share Growth Rates	(E) Projected Per Share Growth Rates	(F) Projected EPS Growth	(G) Average Growth	(H) Expected Dividend Yield (D <sub>t</sub> /P <sub>t</sub> )	(I) DCF Rates
1	American States Water Co.	1.9%	6.0%	5.7%	8.3%	6.0%	4.00%	6.0%	1.9%	7.9%
2	American Water Works Co., Inc	2.0%	4.5%	4.5%	8.0%	7.8%	8.20%	6.6%	2.0%	8.6%
3	Aqua America, Inc.	2.3%	5.6%	4.8%	8.8%	7.5%	5.00%	6.4%	2.4%	8.7%
4	Artesian Resources	2.5%	2.4%	N/A	4.3%	N/A	4.00%	3.6%	2.6%	6.2%
5	California Water Service Group	1.8%	3.3%	5.7%	3.8%	6.3%	9.80%	5.8%	1.9%	7.7%
6	Connecticut Water Service, Inc.	2.1%	4.4%	4.7%	8.0%	5.2%	6.00%	5.6%	2.2%	7.8%
7	Middlesex Water	2.4%	3.4%	5.0%	4.2%	4.7%	2.70%	4.0%	2.4%	6.4%
8	SJW Corporation	1.9%	7.1%	7.7%	10.5%	6.7%	14.00%	9.2%	2.0%	11.2%
9	York Water Company	2.2%	3.6%	4.2%	4.5%	6.8%	4.90%	4.8%	2.2%	7.0%
<hr/>										
10	Mean	2.12%	4.48%	5.27%	6.72%	6.38%	6.51%	5.77%	2.18%	<b>7.96%</b>
<hr/>										
11	Median	2.14%	4.40%	4.92%	8.00%	6.50%	5.00%	5.79%	2.20%	<b>7.85%</b>
<hr/>										
12	Composite-Mean		6.67%	7.45%	<b>8.91%</b>	8.56%	8.70%	7.96%		
<hr/>										
12	Composite-Median		6.60%	7.12%	<b>10.20%</b>	8.70%	7.20%	7.99%		
<hr/>										

References:

- Column [A] : Schedule JAC - 3, page 3 of 4
- Column [B] : Schedule JAC - 3, page 4 of 4
- Column [C] : Schedule JAC - 3, page 4 of 4
- Column [D] and Column [E] : From Value Line Investment Survey, April 13, 2018
- Column [F] : See Yahoo Finance, Growth Estimates - Next 5 Years - See Attachment 7 (Downloaded April 10, 2018)
- Column [G] : Average Columns [B] through [F]
- Column [H] : Column [A] \* (1 + (Column [G]\* (0.5)))
- Column [I] : Column [G] + Column [H]

EPCOR Water Arizona, Inc.  
Test Year Ending December 31, 2016  
Docket No. WS-01303A-17-0257, et al.

Surrebuttal Schedule JAC - 3  
Page 2 of 4

**PROXY GROUP -- PER SHARE GROWTH RATES**

Line No	Proxy Group Companies	5-Year Compound Average Annual Historical Growth, 2012-2016				5-Year Compound Average Annual Projected Growth, 2017-2021			
		EPS	DPS	BVPS	Average	EPS	DPS	BVPS	Average
1	American States Water Co.	9.5%	10.5%	5.0%	8.3%	6.5%	7.5%	4.0%	6.0%
2	American Water Works Co.	11.0%	9.0%	4.0%	8.0%	8.5%	10.0%	5.0%	7.8%
3	Aqua America, Inc.	11.0%	8.0%	7.5%	8.8%	7.0%	9.0%	6.5%	7.5%
4	Artesian Resources Corp.	7.0%	3.0%	3.0%	4.3%	N/A	N/A	N/A	N/A
5	California Water Service Group	4.0%	2.5%	5.0%	3.8%	9.5%	6.5%	3.0%	6.3%
6	Connecticut Water Service, Inc.	12.0%	3.0%	9.0%	8.0%	5.5%	5.5%	4.5%	5.2%
7	Middlesex Water	8.0%	1.5%	3.0%	4.2%	5.0%	5.0%	4.0%	4.7%
8	SJW Corporation	18.5%	5.0%	8.0%	10.5%	8.5%	8.5%	3.0%	6.7%
9	York Water Company	6.5%	3.5%	3.5%	4.5%	8.0%	8.0%	4.5%	6.8%
10	Average				6.72%				6.38%

**Reference:**  
Value Line Investment Survey (April 13, 2018)

EPCOR Water Arizona, Inc.  
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**Surrebuttal Schedule JAC - 2**  
**Page 1 of 1**

**Cost of Capital -- Common Equity**

[A]

<b><u>Line No</u></b>			<b><u>Cost Estimate</u></b>
1	Discounted Cash Flow Model ("DCF")	Schedule JAC - 3	10.20% (1)
2	Capital Asset Pricing Model ("CAPM")	Schedule JAC - 4	7.93%
3	Comparable Earnings Model ("CE")	Schedule JAC - 5	<u>11.60%</u>
4	Cost of Common Equity		<u>9.91%</u>

[A]: From Schedules JAC-3, JAC-4 and JAC-5

[B]: See Testimony

Notes: (1) From page 1 of Schedule 2.

EPCOR Water Arizona, Inc.  
EWAZ Return on Common Equity Implied in  
SJW Group's Capital Structure  
and Weighted Average Cost of Capital Decision 18-03-035

[A]	[B]	[C]	[D]	[E]
Description	Weight (%) (1)	Cost (1)	Weighted Cost (2)	Pre-Tax Weighted Cost
<b><u>SJW ROE Based on Decision 18-03-035 (Calif.)</u></b>				
Debt	46.60%	6.20%	2.89%	2.89%
Common Equity	53.28%	8.90%	4.74%	6.31% (4)
Weighted Average Cost of Capital			<u>7.63%</u>	<u>9.20%</u>
	Weight (%) (5)	Cost	Weighted Cost (2)	Pre-Tax Weighted Cost
<b><u>ROE Applicable to EPCOR Water Arizona, Inc.'s Proposed Capital Structure</u></b>				
Debt	51.81%	4.30% (3)	2.23%	2.23%
WIFA Debt	0.14%	3.94% (3)	0.01%	0.01%
Common Equity	48.06%	10.89% (8)	5.23% (7)	6.97% (5)
Weighted Average Cost of Capital			<u>7.47%</u>	<u>9.20%</u> (6)
<b>Indicated Financial Risk Adjustment</b>			<b>1.99%</b>	

- Notes:
- (1) From Decision 18-03-035 (Calif.)
  - (2) Column [B] \* Column [C].
  - (3) From page ii of the Surrebuttal Testimony of John Cassidy, CRRA on behalf of the Residential Utility Consumer Advocate.
  - (4) Assuming a company-provided effective composite Federal and State income tax rate of 24.87%, the pre-tax weighted cost of common equity based on SJW's authorized common equity cost rate of 8.90% (Decision 18-03-035 (Calif.)) and capital structure is: 6.33%.  $6.33\% = 4.75\% / (1 + 0.2487)$
  - (5) Pre-tax weighted cost rate of common equity of 6.98% equals the pre-tax overall weighted cost rate (9.22%) based upon SJW's authorized 8.90% common equity cost rate (Decision 05-03-035 (Calif.)) and SJW's authorized capital structure minus the weighted cost rates of debt based from page ii of the Surrebuttal Testimony of John Cassidy  $2.24\% + 6.98\% = 9.22\% - 2.23\% - 0.01\%$ .
  - (6) Pre-tax weighted overall cost of capital based on Decision 18-03-035 (Calif.).
  - (7)  $5.23\% = 6.97\% * (1 - 0.2487)$ .
  - (8)  $10.89\% = 5.23\% / 48.06\%$ .

EPCOR Water Arizona, Inc.  
EWAZ Return on Common Equity Implied in  
Carolina Water Service, Inc. of South Carolina Authorized ROE  
and Weighted Average Cost of Capital

[A]	[B]	[C]	[D]	[E]
<u>Description</u>	<u>Weight (%) (1)</u>	<u>Cost (1)</u>	<u>Weighted Cost (2)</u>	<u>Pre-Tax Weighted Cost</u>
<b><u>CWS-SC ROE Based on Decision in Docket 2017-292-WS</u></b>				
Debt	48.11%	6.60%	3.18%	3.18%
Common Equity	51.89%	10.50%	5.45%	7.25% (4)
Weighted Average Cost of Capital			<u>8.62%</u>	<u>10.43%</u>
	<u>Weight (%) (5)</u>	<u>Cost</u>	<u>Weighted Cost (2)</u>	<u>Pre-Tax Weighted Cost</u>
<b><u>ROE Applicable to EPCOR Water Arizona, Inc.'s Proposed Capital Structure</u></b>				
Debt	51.81%	4.30% (3)	2.23%	2.23%
WIFA Debt	0.14%	3.94% (3)	0.01%	0.01%
Common Equity	48.06%	12.81% (8)	6.16% (7)	8.19% (5)
Weighted Average Cost of Capital			<u>8.39%</u>	<u>10.43%</u> (6)
<b>Indicated Financial Risk Adjustment</b>			<b>2.31%</b>	

- Notes: (1) Voted on by the South Carolina Public Service Commission on May 2, 2018. Docket 2017-292-WS.  
(2) Column [B] \* Column [C].  
(3) From page ii of the Surrebuttal Testimony of John Cassidy, CRRA on behalf of the Residential Utility Consumer Advocate.  
(4) Assuming a company-provided effective composite Federal and State income tax rate of 24.87%, the pre-tax weighted cost of common equity based on CWS-SC's authorized common equity cost rate of 10.50% (Docket 2017-292-WS) and capital structure is: 7.25%.  $7.25\% = 5.45\% / (1 + 0.2487)$   
(5) Pre-tax weighted cost rate of common equity of 6.16% equals the pre-tax overall weighted cost rate (10.43%) based upon the authorized 10.50% common equity cost rate (Docket 2017-292-WS) and CWS-SC's authorized capital structure minus the weighted cost rates of debt based from page ii of the Surrebuttal Testimony of John Cassidy  $2.24\% + 8.19\% = 10.43\% - 2.23\% - 0.01\%$ .  
(6) Pre-tax weighted overall cost of capital based on Decision 18-03-035 (Calif.).  
(7)  $6.16\% = 8.19\% * (1 - 0.2487)$ .  
(8)  $12.81\% = 6.16\% / 48.06\%$ .