

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

Application of California Water Service
Company (U60W) for Authority to Establish
its Authorized Cost of Capital for the period
from January 1, 2012 through December 31,
2014.

Application 11-05-001
(Filed May 2, 2011)

And Related Matters.

Application 11-05-002
Application 11-05-003
Application 11-05-004

JOINT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT

January 13, 2012

JOINT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT

California Water Service Company (“Cal Water”), San Jose Water Company (“San Jose”), California-American Water Company (“California American Water”), Golden State Water Company (“Golden State”), and the Division of Ratepayer Advocates (“DRA”) of the California Public Utilities Commission (“Commission”) (all of the foregoing, collectively, the “Parties”) jointly present this testimony (“Joint Testimony”) in support of the proposed settlement agreement that was filed in this proceeding on November 2, 2011 (“Settlement Agreement”). This Joint Testimony is sponsored by Thomas F. Smegal,¹ Palle Jensen,² David P. Stephenson,³ Keith Switzer,⁴ and Danilo E. Sanchez.⁵ Witness qualifications are set forth in Attachment A.

I. INTRODUCTION AND BACKGROUND

On May 2, 2011, Cal Water, San Jose, California American Water, and Golden State (each individually an “Applicant,” and collectively, the “Applicants”) each submitted separate applications (each individually an “Application,” and collectively, “Applications”) supported by direct testimony seeking an authorized cost of capital for their 2012-2014 water utility operations as directed by the Commission in Decision (“D.”) 07-05-062 and D.10-10-035. Subsequently, DRA served testimony in response to the Applications that contested many of the proposals put forth by the Applicants. The

¹ Thomas F. Smegal is the Vice President of Regulatory Matters and Corporate Relations for Cal Water.

² Palle Jensen is the Senior Vice President of Regulatory Affairs for San Jose.

³ David P. Stephenson is the Director of Rate Regulation for California American Water.

⁴ Keith Switzer is the Vice President of the Regulatory Affairs Department for Golden State.

⁵ Danilo E. Sanchez is the Water Branch Manager for DRA.

Applicants each served rebuttal testimony on September 21, 2011, and the Parties began settlement discussions in October 2011.

After being informed on October 17, 2011 at the commencement of hearings that the Parties had reached an agreement in principle on all contested issues, Administrative Law Judge (“ALJ”) Bemesderfer suspended evidentiary hearings to allow the Parties time to complete and submit a Settlement Agreement. As required, the Parties held a noticed settlement conference on October 26, 2011, and entered into the Settlement Agreement on November 2, 2011. In light of these developments, ALJ Bemesderfer cancelled the evidentiary hearings. On November 2, 2011, the Parties moved for adoption of the Settlement Agreement and moved for the admission of their witnesses’ testimony into evidence.

On November 28, 2011, ALJ Bemesderfer issued a ruling requiring additional record development prior to consideration of the motion to adopt the Settlement Agreement (“Ruling”). In his Ruling, ALJ Bemesderfer ordered rescheduled evidentiary hearings on the Applications and required the Parties to submit supplemental testimony addressing (a) the current risk-free rate of return, (b) the Water Cost of Capital Mechanism (“WCCM”), (c) the Water Rate Adjustment Mechanism (“WRAM”), and (d) other applicable Commission policies that “insulate the applicant from financial risk.”

In accordance with the Ruling, the Parties present this Joint Testimony, which addresses each of the topics identified in the Ruling. However, the Parties believe that the testimony already developed and submitted in this proceeding provides more than

ample support demonstrating that the Settlement Agreement is reasonable in light of the whole record, is consistent with the law, and is in the public interest.

As a preliminary matter, the Commission should be mindful that the Settlement Agreement resulted from a collaborative effort among all the Parties and was only reached after extensive testimony had been prepared, and extensive discovery had been completed. The Settlement was meticulously crafted to take into account the facts and circumstances relevant to each of the Parties. Thus, while the percentage cost of equity for each Applicant is identical under the Settlement Agreement, a review of the overall financial package for each utility (which includes a unique cost of debt and capital structure) reveals that the Settlement Agreement carefully balances each company's unique interests and needs.

The cost of equity proposed in the Settlement Agreement is lower than the cost of equity adopted in the previous cost of capital proceedings in California. For Cal Water, California American Water, and Golden State, the return on equity authorized in D.09-05-019 was 10.20%. The return on equity authorized for San Jose in D.10-10-035 was also 10.20%. Thus, a cost of equity of 9.99% represents a 21 basis-point reduction for each company. Similarly, the cost of equity proposed in the Settlement Agreement is lower than the 10.15% cost of equity adopted in other jurisdictions.⁶ Given that the relevant factors involved in setting a cost of capital were thoroughly investigated and vetted by the various Parties' testimony in this case, as well as the Joint Testimony presented here, the Settlement Agreement represents a fair and reasonable resolution of

⁶ Testimony of Dr. J. Randall Woolridge on behalf of DRA, Attachment JRW-12, p. 2 of 4.

the disputed issues, and the Parties urge the Commission to adopt the Settlement Agreement as submitted expeditiously.

II. RISK PREMIUM AND RISK-FREE RATE

A. Overview

As ALJ Bemesderfer states in the Ruling, standard rate-making practice calculates the equity premium, or risk premium, as the difference between the rate of return necessary to attract investor capital in sufficient amounts to meet a company's needs and the "risk-free" rate of return. The risk-free rate is the interest rate that can be earned with certainty and is commonly measured by the return on the U.S. government's Treasury bills and bonds. In the Ruling, ALJ Bemesderfer subtracts what he identifies as the current risk-free rate of return of "less than 3%" from the cost of equity of approximately 10% proposed in the Settlement Agreement to calculate that a "historically unprecedented" risk premium in excess of 7% is implied in the Settlement Agreement.

As illustrated by the extensive testimony in this proceeding bearing on this issue (which is briefly summarized below), using current interest rates, rather than forecasted interest rates for the period during which new rates will be in effect, to calculate the risk premium is not necessarily an appropriate basis for comparison and, in fact, was a contested issue in this proceeding. In light of the testimony submitted in this case, the risk premium embedded within the Settlement Agreement actually falls between 4.83% and 5.65%,⁷ well below the 7% the ALJ suggests. Risk premiums in and above this

⁷ See Section II.B for a discussion of this testimony.

range have previously been adopted by the Commission.⁸ The risk premium proposed by DRA in its prepared testimony also falls within this range.

Moreover, even if one were to accept that the risk premium embedded within the Settlement Agreement is 7% or more, that fact alone does not mean that the risk premium, or the resulting return on equity, is unreasonable. Even if the risk premium embedded within the Settlement Agreement appears to be unusually high, this apparent discrepancy is attributable to the reality that interest rates on Treasury bills are currently unusually, and artificially, low. In fact, the real rate of interest (i.e., the nominal or stated interest rate minus expected inflation) has recently been negative.⁹ A negative real rate of interest is indicative of heightened investor uncertainty and offers support for a higher cost of capital for risky assets because investors are willing to accept very low or negative rates of return on safe assets rather than commit their funds to riskier investments.

Finally, the rates of return on equity agreed upon in the Settlement Agreement reflect a reasonable and balanced compromise of the positions presented in the record. In fact, the agreed upon returns on equity are lower than the midpoint between the proposed returns on equity of DRA and the Applicants.

⁸ See, e.g., *San Jose Water Company, et al.*, D.10-10-035 (risk premium of 6.98%); *California Water Service Company, et al.*, D.09-05-019 (risk premium of 6.94%); *San Gabriel Valley Water Company*, D.08-06-022 (risk premium of 6.84%); *California-American Water Company*, D.08-05-018 (risk premium of 6.49%).

⁹ DAILY TREASURY REAL YIELD CURVE RATES, <http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=realyieldYear&year=2011> (last visited January 11, 2012).

B. The Risk Premium Embedded in the Settlement Agreement is Properly Viewed as Falling Between 4.83% and 5.65%

Cal Water's testimony requested a return on equity of 11.25%. Cal Water's expert witness, Dr. Michael J. Vilbert, explained in his testimony that the allowed return for a regulated company should be based upon the forecast of interest rates over the period that rates are expected to be in effect, and not on current rates. Further, Dr. Vilbert noted that textbook derivations of cost of equity clearly indicate that the risk-free rate to be used to determine the risk premium reflects an expected return and not current returns.¹⁰ With this in mind, Dr. Vilbert stated that he utilized a conservative value of 4.34% for the long-term risk-free interest rate as the benchmark risk-free interest rate in his risk premium analyses.¹¹ Dr. Vilbert obtained estimates of the risk-free interest rates used in his analyses from the reported government debt yields from the "constant maturity series" provided by Bloomberg.

San Jose's testimony requested a return on equity of 11.50%. In her testimony supporting this proposal, Ms. Pauline Ahern used a risk-free rate of return of 4.88% based upon the average consensus forecast of the reporting economists in the April 1, 2011 Blue Chip Financial Forecasts.¹² Ms. Ahern's testimony asserts that it is entirely appropriate to utilize the prospective risk-free rate, and not a current or historical rate, in a risk premium analysis.¹³

¹⁰ Rebuttal Testimony of Michael J. Vilbert on behalf of Cal Water at 29.

¹¹ Testimony of Michael J. Vilbert on behalf of Cal Water at 35; Rebuttal Testimony of Michael J. Vilbert on behalf of Cal Water at 28.

¹² Testimony of Pauline M. Ahern on behalf of San Jose at 48.

¹³ Rebuttal Testimony of Pauline M. Ahern on behalf of San Jose at 25.

Golden State's testimony requested a return on equity of 11.50%. In his testimony supporting this proposal, Dr. Thomas Zepp used a risk-free rate of return of 5.15% that he derived by averaging forecasts of Treasury rates. Dr. Zepp states in his testimony that, in past water utility cases in which DRA Staff has prepared cost of equity estimates, DRA and the Commission relied on forecasts of interest rates expected during the period new rates were to be in effect for various utilities.¹⁴ Dr. Zepp asserts that this is the conceptually correct approach.¹⁵ Further, Dr. Zepp points to a recent Arizona Corporation Commission Staff study finding as support for using forecasts of interest rates for the period new rates will be in effect instead of current interest rates.¹⁶

California American Water's testimony requested a return on equity of 11.50%. In her testimony supporting this value, Dr. Bente Villadsen used a risk-free rate of return of 4.34% based on an increased spread between A-rated utility bond and government bond yields and the Federal Reserve Bank of Philadelphia's forecast that Treasury bond yields will increase by more than 100 basis points.¹⁷ Dr. Villadsen indicated that a failure to consider that the current risk-free rate is unusually low will lead to cost of equity estimates for the forecast period that are artificially low.¹⁸ Dr. Villadsen also asserted in her testimony that the allowed return for a regulated company should be based upon the forecast of interest rates over the period that rates are expected to be in effect, and not on the then-current rates.

¹⁴ Rebuttal Testimony of Tom Zepp on behalf of Golden State at 60.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Rebuttal Testimony of Bente Villadsen on behalf of California American Water at 24.

¹⁸ *Id.*

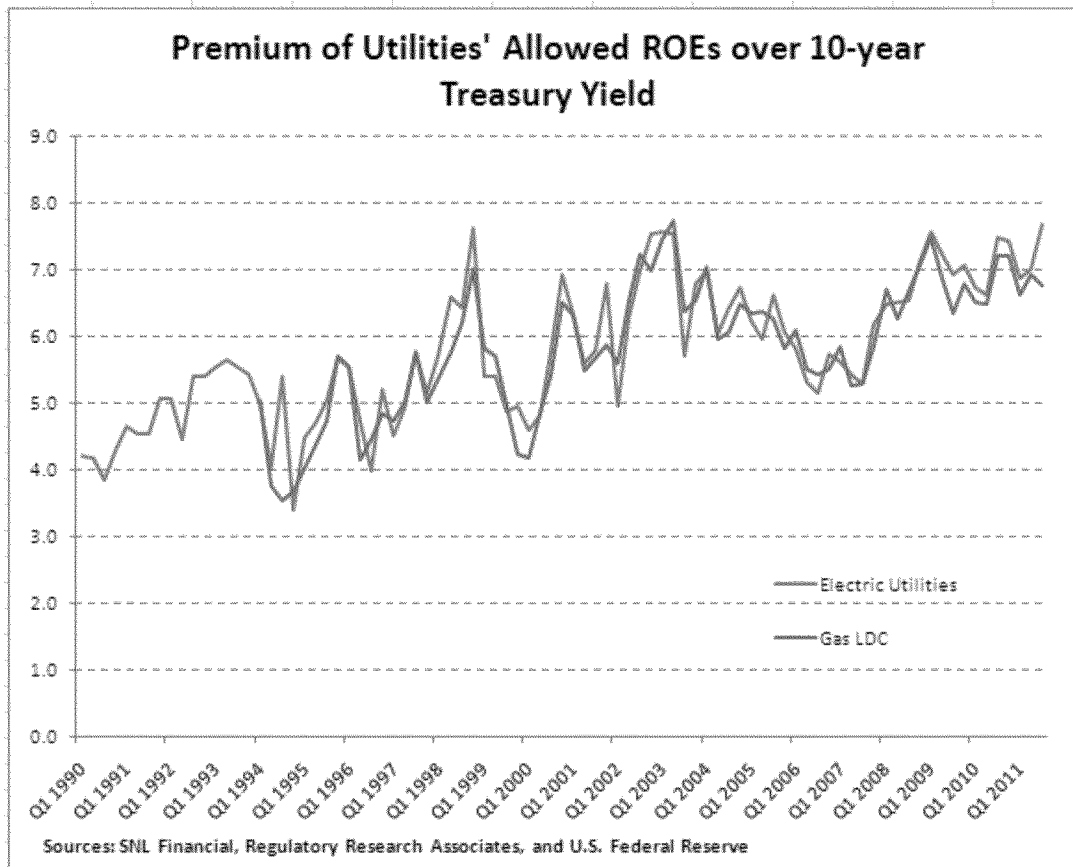
DRA submitted testimony supporting a return on equity of 8.75% for Cal Water, San Jose, and Golden State and a return on equity of 9.00% for California American Water. DRA's expert witness, Dr. J. Randall Woolridge proposed a risk premium of 5.1%, noting that the current yield on 30-year Treasury bonds is in the 3.5% range.

As discussed above, although DRA's expert employed a current risk free rate in his cost of equity projections, each of the Applicants challenged this approach. The testimony in this proceeding provides ample evidence to support the use of forecasted risk-free rates when calculating the risk premium. Although DRA may not support this view if the matter were to be litigated, the Commission should be mindful that the equity premium that results from the Settlement Agreement falls within the range of 4.83% and 5.65%, a range that is not without precedent and that is also consistent with DRA's filed testimony.

C. The Settlement Risk Premium is reasonable given the abnormal economic times

Even if the measured risk premium were 7%, it is certainly not unreasonable in light of the current financial situation. Although a risk premium higher than 7% may be unusual for water utilities in California, higher than usual risk premiums are attributable—in part—to the unusual responses that investors' have made to the economic uncertainty which resulted from the recent credit crisis in the U.S. Furthermore, a risk premium of 7% is consistent with allowed returns for electric utilities and gas local distribution companies ("LDCs"). The graph below displays the risk premium measured as the difference between the allowed ROE and the yield on 10-year

Treasury bonds for the period Q1-1990 to Q3-2011. The current average risk premium for electric utilities is greater than 7% while the risk premium for gas LDCs is just below 7%.



The equity risk premium implicit in adopted returns on equity for Class A water utilities also has been near the 7% level in recent years. Over the past decade, the equity risk premiums implicit in adopted Commission decisions setting Class A water utility rates of return in litigated cases have ranged from 5.00% to 6.98%. The two most recent cost of capital decisions, setting returns on equity at 10.20% for eight class A water utilities, have implied equity risk premiums of 6.94% (in D.09-05-019) and 6.98% (in D.10-10-035).

Economic uncertainty has caused what is generally described as a “flight to safety” which is also sometimes called a “flight to quality.” In times of uncertainty investors seek investments likely to preserve value, and U.S. government debt is usually regarded as the safest possible investment.¹⁹ The increased demand for government debt leads to higher prices and lower yields on government debt. The yield on government debt is lower for an additional reason: since the outset of the financial crisis in 2008, the Federal Reserve has repeatedly worked to stimulate the economy through lower interest rates, particularly lower interest rates on government debt. The result is that one element in the calculation of the risk premium, the risk-free interest rate, is at an unusually low level.

Increased economic uncertainty and the resulting flight to safety also affect the other element in the calculation of the risk premium. During times of increased economic uncertainty, the required return on risky assets increases relative to times of less economic uncertainty. The record has considerable testimony about economic uncertainty and its effect on the cost of capital. For example, the price-to-earnings ratio (the “P/E ratio”) is lower now than before the crisis, which means that investors require a higher level of expected earnings before they are willing to purchase an investment.²⁰ A higher required rate of return results in a lower P/E ratio.

¹⁹ Demand for gold also increases during times of uncertainty, but gold is not a typical investment.

²⁰ The average price-to-trailing operating earnings ratio for the S&P 500 is currently 14.5; by comparison, the average ratio from 1989 to October 2008 was 19.3. Source: Standard and Poor’s Earnings Estimate and Report, November 30, 2011.

Another measure of economic uncertainty is the Chicago Board Options Exchange Market Volatility Index (the “VIX”). Often referred to as the “fear index,” the VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period. Higher levels of the VIX imply that investors expect larger market upward or downward movements in the next 30 days and indicate increased economic uncertainty. In other words, investors expect higher variance in market returns. Recently, the VIX has been at much higher levels than before the start of the financial crisis,²¹ presumably due to uncertainties related to the impact of the European debt situation on global financial markets. While the VIX is not a long-term measure and, therefore, not directly pertinent to the three year return on equity that is being established in this proceeding, its elevated level does suggest that investors are more than normally concerned about risk.

Capital flows for mutual funds also indicate a flight to safety because funds continue to flow *out* of equity funds and *into* bond funds. Other readily observable factors indicating higher capital market uncertainty include high unemployment rates, falling home prices, and the ongoing budget battles in the U.S. and in Europe. The sovereign debt crisis has become so severe in Europe that the survival of the Euro is now in doubt.

The increased uncertainty in the market as measured by the factors noted above affects all risky investments. Therefore, the measured risk premiums for all risky

²¹ HISTORICAL PRICES, <http://finance.yahoo.com/q/hp?s=%5EVIX+Historical+Prices> (last visited January 11, 2012).

investments are higher today than before the crisis. Utility investments are less risky than the market, but they are certainly not risk free. As a result, utility investments have been affected by the flight to safety just as other non-secure investments have been. This is illustrated by the increase in the yield spread on investment grade utility debt, which is higher than it was before the credit crisis, and utility equity investments are riskier than utility debt investments.

Finally, the Commission should be mindful that other regulatory agencies have accepted risk premiums above 7%. For example, the Surface Transportation Board in its 2008 decision on the cost of capital for railroads under its jurisdiction adopted a market risk premium above 7%.²²

Thus, even if the risk premium embedded within the Settlement Agreement is perceived to be high, this is not unexpected given the fact that the average of expected Treasury rates for 2012, 2013, and 2014 is unusually and artificially low, substantially lower than the average of past Treasury rates, which prevailed from 1983 to 2010.

D. Irrespective of the Risk Premium, the Settlement Agreement's Proposed Return on Equity is a Reasonable Compromise in light of the Record

Looking beyond the Ruling's focus on risk premiums, a 9.99% cost of equity falls squarely within the range of the original proposals in this proceeding. Parties' proposals ranged from 8.75% (DRA) to 11.50% (San Jose, California American Water, and Golden State), with Cal Water proposing an 11.25% cost of equity. Furthermore, in developing recommendations and proposals, each Party relied upon the guidance of several different

²² STB Ex. Parte 664 (issued January 17, 2008), p. 8.

estimation methods. No Party relied exclusively on the output of any single estimation method, such as risk premium models, but rather incorporated the insights and findings of the various models based upon their best professional judgment. Therefore, 9.99% represents a fair compromise in light of the many contested issues in this proceeding and reflects a balanced outcome considering each of the Parties' strengths and weaknesses.

III. WCCM AND WRAM

The impacts of both the WCCM and the WRAM on the cost of equity were taken into account by the Parties' experts in their cost of capital analyses, and likewise were considered in the development of the Settlement Agreement. The testimony previously submitted in this proceeding supports the view of the analysts in this case that capital markets have already acknowledged the effect of these mechanisms on utilities' risk profiles. Presented below are some of the points that were raised or would have been raised if the matter had not settled, demonstrating that the Settlement Agreement values are reasonable.²³

First, the Parties recommend continuation of the WCCM in the Settlement Agreement.²⁴ The proposed WCCM provides for an up or down adjustment in the return on equity if the cost of long-term debt as defined by an index of utility debt rates varies from the most recent index by 100 basis points or more in 2013 and 2014. Thus, the

²³ Contrary to the Ruling's indication that the WCCM "effectively insulated [the Applicants] against loss of income resulting from water conservation practices adopted by consumers," the WCCM has not had that effect and is not intended to do so. The only function of the WCCM, as further discussed in this testimony, is to adjust the return on equity in the event of substantial fluctuations in the cost of long-term debt.

²⁴ The only substantive change to the WCCM arising from the Settlement Agreement is with regard to San Jose, for which the deadband zone will be reduced from one of plus or minus 200 basis points to one of plus or minus 100 basis points to align San Jose's WCCM with the WCCM for the other Applicants.

WCCM adjusts the utility's cost of capital in either direction based upon the specific market conditions. The WCCM simply maintains the level of return in a volatile market environment. By potentially lowering the return on equity when debt costs decline, the WCCM eliminates possible upside benefits that the utilities may have experienced prior to adoption of the WCCM.

Second, the Parties previously litigated the impact of the WRAM on the cost of capital in Applications 08-05-002 *et al.* and 09-05-001 *et al.* The Commission found in D.09-05-019 that:

Finding of Fact 22: "The WRAM and the MCBA have reduced the revenue recovery risks for the applicants caused by adopting conservation programs and other inherent risks of recovery such as forecast differences and weather;" and

Finding of Fact 23: "The market data for the proxy group has not recognized the risk reduction for the applicants caused by the Commission's adoption of a WRAM and MCBA;" and

Finding of Fact 25: "We cannot determine a precise adjustment to risk for the newly adopted WRAM and MCBA and therefore do not adopt DRA's proposed adjustment of 0.25%. The reasonable range for return on equity should therefore be higher than DRA's recommendation."

Third, in this proceeding, California American Water recommended that the Commission find that the market has fully considered the WRAM/Modified Cost Balancing Account ("MCBA") in its risk profiles for the water industry and that no further return on equity adjustment should be adopted. California-American Water's expert Dr. Villadsen argues that the WRAM was intended to offset the loss of revenue caused by tiered rates meant to encourage water conservation. As such, Dr. Villadsen

argues that the WRAM cannot be viewed in isolation from water conservation initiatives and their impact on water utilities' finances because the two are inextricably linked. Furthermore, Dr. Villadsen argues that the WRAM will only impact the cost of equity capital to the extent that it affects the systematic risk, but it is not clear that it does impact systematic risk, making it unlikely that there is a measurable effect. Dr. Villadsen also argues that since California water utilities included in the peer assessment group have a WRAM, the effect of the WRAM has already been incorporated, at least partially, into the cost of equity determination. Cal Water's witness Martin Kropelnicki argues that any theoretical benefit arising from the decoupling mechanism could be nullified from a financial reporting standpoint if the Commission adopts longer amortization periods in pending application A.10-09-017. DRA argues that many of the risk adjustments proposed by Parties are likely to have been captured in the market models that Parties' experts have utilized.

The Parties considered all of these issues when negotiating the Settlement Agreement and the agreed upon cost of capital values reflect a reasonable and fair compromise of the contested issues. As a result, it would be reasonable for the Commission to adopt these values.

IV. OTHER POLICIES INSULATING APPLICANTS FROM FINANCIAL RISK

The final subject on which the Ruling requires additional testimony is the consideration of "other applicable Commission policies that insulate the applicant from

financial risk.”²⁵ Some elements of Commission policy tend to mitigate the Applicants’ risk exposure, whereas other elements of Commission policy tend to increase risk. With the exception of the WCCM and the WRAM, discussed above, none of these Commission policies and procedures have changed significantly in recent years and so they can reasonably be considered to be embedded in the Applicants’ currently authorized costs of capital.

V. CONCLUSION

For the reasons stated above, the 9.99% return on equity provided for in the proposed settlement agreement is just and reasonable in light of the current risk-free rate of return (considered in combination with the current equity risk premium), the WCCM and WRAM, and other Commission policies relevant to the Applicants’ financial and business risks.

²⁵ In the jargon of risk analysis, “financial risk” is limited to risk to the equity investor that “results from incurring fixed obligations in the form of debt.” Testimony of Dr. J. Randall Woolridge on behalf of DRA at 17. The Ruling’s concern appears to be directed at policies that offer insulation from “business risk,” which, as Professor Woolridge states, “encompasses all factors that affect a firm’s operating revenues and expenses.” *Id.*

ATTACHMENT A
TO THE JOINT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT

QUALIFICATIONS OF
THOMAS F. SMEGAL, PALLE JENSEN, DAVID P. STEPHENSON,
BRYAN KEITH SWITZER, AND DANILO E. SANCHEZ
(ATTACHED)

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Qualifications of Thomas F. Smegal
Vice President
California Water Service Company

Q. What is your current position?

A. I am Vice President of Regulatory Matters and Corporate Relations for California Water Service Company.

Q. What is your education background?

A. I received a Bachelor of Science degree in Civil Engineering and a Bachelor of Arts Degree in History from Stanford University in 1990. I completed two years of graduate study focusing on water resources management at the University of California at Berkeley's Energy and Resources Group.

Q. Do you hold any professional certifications?

A. I am a licensed Civil Engineer in the State of California.

Q. Please summarize your business experience.

A. After graduating from Stanford University in 1990, I worked for the California Public Utilities Commission ("Commission") until 1997. During that time I worked for the Water Division and the Commission Advisory and Compliance Division, mainly processing rate case requests for small class B, C, and D water utilities. Since joining Cal Water's Rates Department in May 1997 as a regulatory analyst, I was promoted to Manager of Rates in 2001, and was later promoted to Vice President of Regulatory Matters in 2008. I have testified on numerous occasions before the Commission.

SAN JOSE WATER COMPANY

STATEMENT OF QUALIFICATIONS

PALLE JENSEN

My name is Palle Jensen, and my business address is 110 West Taylor Street, San Jose, California 95110.

I am the Senior Vice President of Regulatory Affairs for San Jose Water Company. In my current position I am responsible for all regulatory issues and policies, Government Relations, Corporate Communications, Community Outreach and the Utility Supplier Diversity Program. Previously I was the Vice President and Director of Regulatory Affairs, where I was responsible for revenue requirement determination, levels of rates, as well as all tariffs, rate and other compliance filings with the California Public Utilities Commission, including all financial analysis and forecasting. I also responded to all formal complaint matters and prepared all Company responses and testimony in proceedings before the Commission. I joined San Jose Water Company in 1995.

Before joining San Jose Water Company I was employed by the California Public Utilities Commission's Division of Ratepayer Advocates (DRA) where I, on a rotational basis, held positions in the Fuels Branch, Energy Rate Design and Economics Branch and the Energy Resources Branch as a Public Utility Regulatory Analyst. During my time at the Commission I provided testimony on behalf of DRA on operational and rate design matters in several proceedings.

Prior to my employment at the Commission I worked as a research assistant at Stanford University, where I completed cost evaluations of the replication of various research projects.

I am a graduate of San Jose State University with a Bachelor of Science Degree with Great Distinction in Economics and a Masters of Arts Degree in the Economics of Education from Stanford University.

I have previously testified before the California Public Utilities Commission.

Qualifications of David P. Stephenson
Director of Rate Regulation
California-American Water Company

Q1. Please state your name and business address.

A1. My name is David P. Stephenson and my business address is 4701 Beloit Drive, Sacramento , CA 95838.

Q2. By whom are you employed and in what capacity?

A2. I am employed by California-American Water Company ("California American Water") as the Director of Rate Regulation.

Q3. What are your responsibilities?

A3. I am responsible for overseeing the preparation, filing and processing of all requests for rate adjustment, financing, acquisition or any other applications before the California Public Utilities Commission.

Q4. Briefly describe your education background.

A4. I received a Bachelor of Science in Business Administration, with an emphasis in Accounting, from San Diego State University. Additionally, I have attended and instructed at various seminars on different aspects of the water industry, including the Biannual Utility Rate Seminar sponsored by the Water Committee of the National Association of Regulatory Utility Commissioners (NARUC) to educate NARUC members and their staff about regulated water utilities.

Q5. Please describe your professional experience.

A5. I have been employed by California American Water since 1978. The various positions I have held are: Accountant - 1978; Accounting Superintendent for the Los Angeles Region - 1981; Assistant Director of Accounting for the Western Region - 1983; Assistant Director of Rates and Revenues for the Western Region - 1984; Director of Rates and Revenues for the Western Region - 1986; Manager Rate Regulation for Hawaii, California and New Mexico - 2005; Manager of Rate Regulation for California American Water - 2007; Director of Rate Regulation for California American Water - 2008.

Q6. Have you testified before any regulatory agencies?

A6. Yes. I have testified on numerous occasions before public utility regulatory agencies in the states of Arizona, California and New Mexico. I also participated in regulatory matters before the public utility regulatory agencies for the states of Hawaii and Texas.

Qualifications of Bryan Keith Switzer

My name is Keith Switzer. I am the Vice President of the Regulatory Affairs Department at Golden State Water Company (GSWC). My business address is 630 E. Foothill Boulevard, San Dimas, California 91773.

In my position as Regulatory Affairs Vice President, I have responsibility for all GSWC regulatory filings, including those for GSWC's water operations and its electric operations (Bear Valley Electric Service). As Vice President, I oversee the preparation of testimony and supporting materials for regulatory proceedings. I have held my current position since September 2004. I was initially employed by GSWC as the Special Projects/Tariff Manager in the Regulatory Affairs Department. I held that position from October 2000 to September 2004.

I have a Bachelor of Arts Degree in Economics from California State University, Fullerton, a Master of Arts Degree in Economics from the University of California, Los Angeles, and a Masters Degree in Public Administration from the University of Southern California.

In addition to my experience with GSWC, I have almost 20 years experience working in the area of utility regulation/rate design. Prior to joining GSWC, I held positions with a number of companies in the utility industry. I was employed by Southern California Edison for five years as a member of the Economics Division in the Treasurer's Department. After leaving SCE, I worked for four years at National Economic Research Associates in the utility consulting practice. In 1991, I left NERA and joined the Rate Department at Southern California Gas Company. In 1998, I accepted the position of Rate Department Manager for San Gabriel Valley Water Company, where I worked for 18 months. Immediately prior to joining SCWC, I worked at the now-defunct California Power Exchange as a Project Manager in the Settlements Department.

In addition to the utility experience listed above, I was the Finance Department Manager for the Willdan Group. Willdan is an engineering firm providing consulting services to public agencies. The Finance Department provided consulting services regarding the formation of Special Assessment and Mello-Roos Tax Districts.

**QUALIFICATIONS AND PREPARED TESTIMONY
OF
DANILO E. SANCHEZ**

Q.1 Please state your name and business address.

A.1 My name is Danilo E. Sanchez. My business address is 505 Van Ness Avenue, San Francisco, California 94102.

Q.2 By whom are you employed and in what capacity?

A.2 I am employed by the California Public Utilities Commission (Commission) as a Program Manger in the Water Branch of the Division of Ratepayer Advocates (DRA).

Q.3 Please describe your educational and professional experience.

A.3 In 1984, I received a Bachelor of Science degree in Accounting and Finance from San Francisco State University. In 1992, I received a Master of Business Administration in Corporate Finance from Golden Gate University.

In January 1988, I was employed by the Commission, and was assigned to the Energy Auditing Branch in DRA. During my first year, I completed various audits in conjunction with electric and gas utility general rate cases. In April 1989, I was transferred to the Financial and Economics Analysis Branch of DRA, where I was responsible for the development of cost of capital studies for regulated water and telecommunication companies.

In January 1990, I accepted an analyst position in DRA's telecommunications Operational Cost Branch. From 1990 through 1997, I completed testimony, and testified on my recommendations in numerous cases relating to the regulation of telecommunications utilities. Subsequent to the Commission's reorganization in January 1997, I was assigned to DRA's Monopoly Regulation Branch. My assignments in this branch included merger and acquisitions, pricing of partially competitive telecommunication services, affiliate transactions, and energy utility general rate cases. In September 2001, I was promoted to Program Project Supervisor in DRA's Energy Cost of Service Branch. From 2001 through August

2004, I was responsible for overseeing a section of 14 employees responsible for the audit review, and processing of energy general rate cases. In September 2004, I was promoted to Program Manager in DRA's Water Branch.

Q.5 What is the scope of your responsibility in presenting joint testimony with the Golden State Water Company, California Water Service Company, San Jose Water Company, and California American Water Company (Settlement Parties) in the consolidated Cost of Capital proceeding (Applications 11-05-001, et al)?

A.5 I am sponsoring joint testimony in support of the settlement reached with the Class A water utilities in Applications 11-05-001, et al consolidated Cost of Capital proceeding. The joint testimony addresses questions raised in the November 28, 2011, ALJ Bemserderfer ruling requiring additional supplemental testimony addressing (a) the current risk-free rate of return, (b) the Water Cost of Capital Mechanism ("WCCM"), (c) the Water Rate Adjustment Mechanism ("WRAM"), and (d) other applicable Commission policies that "insulate the applicant from financial risk." The Settlement Parties believe that the testimony already developed and submitted in this proceeding provides more than ample support demonstrating that the Settlement Agreement is reasonable in light of the whole record, is consistent with the law, and is in the public interest.

Q.6 Does this conclude your testimony?

A.6 Yes, it does.