ORIGINAL

0000008368

RECEIVED

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

SEP 05 2000

DOCKETED BY

2000 SEP -5 P 3:41

AZ CORP COMMISSION
DOCUMENT CONTROL

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.

DOCKET NOS. W-01032A-00-0192
W-01032B-00-0192
W-01032C-00-0192
W-01656B-00-0192
S-02276A-00-0192
WS-02334A-00-0192
WS-03454A-00-0192
WS-03455A-00-0192
W-02013A-00-0192
W-01595A-00-0192
W-01303A-00-0192

NOTICE OF FILING

Citizens Communications Company hereby provides Notice of Filing Carl W. Dabelstein's Rebuttal Testimony in the above-referenced docket matter.

RESPECTFULLY SUBMITTED on September 5, 2000.

Craig A. Marks

Craig A. Marks
Associate General Counsel
2901 North Central Avenue, Suite 1660
Phoenix, Arizona 85012

Original and ten copies filed on
September 5, 2000, with:

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

Copies of the foregoing mailed/delivered
on September 5, 2000, to:

Jerry Rudibaugh
Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Deborah R. Scott
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Teena Wolfe
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Paul Foran
V.P., Regulatory Affairs
American Water Works Service Co., Inc.
1025 Laurel Oak Road
P.O. Box 1770
Voorhees, New Jersey 08043

Jan S. Driscoll
David P. Stephenson
Arizona-American Water Company
880 Kuhn Drive
Chula Vista, California 91914

Norman D. James
Fennemore Craig
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012-2913

Scott Wakefield
RUCO
2828 North Central Avenue
Suite 1200
Phoenix, Arizona 85004

By ____________________
Joann Zychlewicz

G:\Craig~docs\Az Water Disposition~Am Water Works\NOF Customer Notification.doc

CITIZENS COMMUNICATIONS

ARIZONA WATER/WASTEWATER PROPERTIES

REBUTTAL TESTIMONY OF CARL W. DABELSTEIN

SEPTEMBER 2000

Q. Please state your name and address.

A. My name is Carl W. Dabelstein. My business address is 2901 North Central Avenue, Phoenix, Arizona 85012.

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

A. I am employed by Citizens Communications Company ("Citizens") as Vice President-Regulatory Affairs for its Public Service Sector, that portion of Citizens that provides water and wastewater, electric, and gas service through operating divisions and subsidiaries in ten states, including Arizona.

Q. Please state your professional qualifications.

A. A description of my education and professional qualifications is attached as Appendix A.

Q. What is the purpose of your testimony?

A. My testimony is submitted in rebuttal to a portion of the direct testimony filed by Mr. Gordon Fox representing the Residential Utility Consumer Office. Specifically, I am responding to that portion of Mr. Fox's testimony beginning at Page 9 concerning the gain on the sale of assets to Arizona-American.

Q. Please describe your understanding of Mr. Fox's testimony.

A. It is my understanding that Mr. Fox proposes that Citizens be required to share the projected gain on the sale equally with the customers of the utility operations whose assets are being sold.

Q. On what basis is Mr. Fox making that recommendation?

A. In his testimony, Mr. Fox states that it is his understanding that the Arizona Corporation Commission normally provides for a sharing of such gains. Moreover, he opines that the parties that share in the risks related to utility assets should be entitled to share in the gains on the sales of those assets. Finally, Mr. Fox makes references to the Uniform System of Accounts ("USofA") of the National Association of Regulatory Utility Commissioners ("NARUC") as containing some support for his proposed sharing of the gains.

Q. Do you agree with the sharing of the gains recommendation of Mr. Fox?

A. No, I do not.

Q. Please explain.

A. First, I believe that Mr. Fox has misinterpreted the Commission's past practice concerning the treatment of gains on the sale of assets.

Q. What is the Commission's practice?

A. Typically, when a utility sells an asset that has been included in rate base, and that asset will no longer be used to provide utility service, the Commission requires a sharing of the after-tax gain associated with the disposition.

Q. Please provide examples of this practice?

A. One example is the sale by Arizona Public Service Company of its street lighting systems to the respective municipalities. Another is more recent, in 1999, when Citizens sold its office building on San Francisco Street in Flagstaff. The transaction produced a $140,650 gain and Citizens recorded a regulatory liability in the amount of $70,325, representing 50% of the gain, in anticipation of regulatory disposition in a future rate proceeding. At that time, I sent a letter to the Acting Director of the Utilities Division at the Commission notifying him of such accounting treatment. What is common to both examples is that:

- a discrete asset was sold and removed from rate base;
- the selling utility continued to provide service in the same territory; and
- the purchaser was not going to use the asset to provide utility service to the public.

Q. Are any of these circumstances present in this case?

A. No. Citizens is selling its entire line of business to Arizona-American ("AZ-Am"). After the closing, all the assets that were in Citizens' rate base will be in AZ-Am's rate base and will be used to provide regulated utility service. In turn, Citizens will have completely exited the water and wastewater utility business in Arizona. These facts are totally different from those in the transactions that produced gains that were required by the Commission to be shared with utility customers.

Q. What is the difference to customers between the sale of an asset and the sale of a business?

A. The sale of an asset in rate base to a non-utility means that the asset will no longer be used to serve utility customers. In contrast, the sale of a utility business means that the assets will still be used to provide utility service. The same wells, mains, and trucks will be in service the day after the transaction closes as were in service the day before.

Q. Does the Commission recognize the distinction between the sale of an asset and the sale of a business?

A. Yes. The Commission does not require the sharing of gains on the sale of a business. Focusing on at least three such decisions, both involving gains associated with assets representing complete businesses that were purchased by Citizens from other utilities leaving the State.

Q. Please discuss the first case.

A. In July 1991, Citizens and Southern Union Gas Company ("Southern") signed an agreement under which Citizens purchased all of Southern's natural gas transmission and distribution system assets in Arizona. At the conclusion of that transaction, Southern retained no further business interests in the State.

The purchase price was reported as $46 million, less certain working capital liabilities assumed and certain prorations after the closing. The net book value of the assets acquired was approximately $27.6 million, producing a gain on the sale of some $17 million. The asset purchase was approved by the Commission in Decision No. 57847 issued on December 2, 1991. No portion of the gain realized by Southern was required to be shared.

Q. What was the second case?

A. In May 1993, Citizens and Contel of the West ("Contel") signed an agreement under which Citizens purchased all of Contel's telephone properties and assets located in Arizona. At the conclusion of that transaction, Contel had no further telephone operations in the State. The purchase agreement contained a sales price of approximately $88.6 million, which produced a gain for Contel on the transaction of approximately $45 million. In the hearing that was conducted before the Commission in response to the parties' application for approval of the transaction, the Commission Staff recommended that a 50%-50% sharing of the gain between customers and investors be made. According to the Staff, such sharing was consistent with what it believed was the Commission's policy with respect to gains realized on the sale of utility property. RUCO did not present any testimony on the issue.

As cited in the Commission's Order, among the reasons given in the Contel testimony for opposing any sharing of the gain, were the following:

- It is Contel, not the ratepayers, that is the legal owner of the tangible and intangible assets being sold, and therefore, requiring Contel to rebate 50% of the gain to ratepayers would constitute a governmental confiscation of private property and a violation of the constitution.
- The Commission policy in transactions involving the sale of the complete businesses, where the selling utility is exiting the state subsequent to consummation of the transaction, has been to allow the selling company to retain 100% of the gain.

On October 17, 1994, the Commission issued Decision No. 58819 approving the Contel asset sale and agreeing with the Company that a sharing of the gain was inappropriate. Specifically, the Commission found that such proposed sharing was not mandated by previous Commission decisions. Accordingly, there was no sharing of the gains.

Q. What is the third case?

A. This case was very recent. In June 1999, GTE California and Citizens Utilities Rural Company signed an agreement under which Citizens purchased the GTE telephone assets in the State of Arizona. The Commission approved the transfer in Decision No. 62648, issued on June 13, 2000. Although it did not discuss the gain on the sale, no portion was required to be shared.

Q. You have established that the Commission does not require gain sharing when a utility sells all or part of its line of business to another utility; is that consistent with U.S. regulatory practice?

A. To my knowledge, yes. California has articulated a policy that is consistent with Arizona's. In a case very similar to this one, the California Public Utilities Commission ("CalPUC") was asked to approve the sale of an entire regulated water utility to California-American Water Company (an affiliate of the co-applicant in this case, Arizona-American Water Company).[1] The CalPUC rejected arguments that the selling utility should share its gain on the sale with its customers. Relying on its long-standing policy, it stated:

> [G]ain on sale of utility plant shall accrue to the shareholders to the extent that the remaining ratepayers are not adversely affected when the sale is to a public entity. That same policy applies when the sale is to other than a public entity when the conveying utility was relieved of its public utility obligation to serve the geographic region being conveyed.[2]

---

[1] *Application of Ambler Park Water Utility and California-American Water Company*, 1998 Cal. PUC LEXIS 936 (1998).

[2] *Id.*, at 12-13.

Q. Is there any reason in this case to deviate from settled regulatory practice?

A. No. The policy is a sound one. It is investors that have provided the capital and should be entitled to any gain on their investment. As I stated above, customers should be indifferent because the same assets will be used to provide service after the sale as before. Moreover, gains associated with utility asset sales typically reflect the intangible values associated with the selling company's operations. I am unaware of any instance where the Arizona Corporation Commission has allowed a utility under its jurisdiction to charge its customers service rates that are based on a revenue requirement that reflects the intangible values of utility plant assets.

Q. With respect to Mr. Fox's assertion that the parties sharing in the risks should share in the gains, do you have a opinion?

A. Yes. In my opinion, his assertion is incorrect. Under traditional utility regulation and ratemaking, ratepayers incur no risk for which they are entitled to compensation, such as Mr. Fox's proposed sharing of the gains resulting from the sale of Citizens' assets. Unless they become investors, ratepayers do not acquire an equity interest in the assets of the utilities that serve them. Through service rates, utility customers pay for the use of assets, but not for the assets themselves. Such "rent" does not vest in ratepayers, any legal or equitable interest.

Q Does the Commission set rates based on asset market values?

A. No. Arizona rates are based on fair value, which different from market value. Rate base is neither marked-up to reflect increases in market value, nor marked-down to reflect decreases.

Q. Has RUCO or any party to this proceeding ever suggested that customers should compensate the selling utility if it sold its business below net book value?

A. Not to my knowledge.

Q. In his testimony, Mr. Fox refers to the NARUC Uniform System of Accounts in connection with his proposed sharing of the gains from the sale of assets. Do you agree with his testimony?

A. No, I do not. I believe he is attempting to ascribe greater significance to the USofA in this instance than is appropriate. Moreover, his example of the accounting that is required when an asset is prematurely retired as an illustration of the existence of ratepayer risk is misplaced.

Q. Please explain your comment concerning the USoA.

A. The NARUC Uniform System of Accounts contains the instructions, account definitions, and numbering systems necessary for financial accounting and reporting by utilities. Similar systems have been published by the Federal Communications Commission and the Federal Energy Regulatory Commission for telecommunications service providers and energy utilities under their respective jurisdictional authority. All three systems of accounts have been adopted by virtually every state utility regulatory agency, including the Arizona Corporation Commission, with minor exceptions necessary to address particular informational needs by individual states.

Although the Commission requires the utilities under its jurisdiction to follow the Uniform Systems of Accounts, it has long held that such requirements are for regulatory accounting and reporting purposes only, and do necessarily dictate ratemaking policies. Accordingly, any accounting practice associated with the sale of assets that is contained in the USofA is not obligatory on this Commission for ratemaking or asset sale approval purposes.

Q. Please explain your comment regarding Mr. Fox's example of the accounting that is done in connection with assets prematurely retired from service.

A. As I have previously discussed, from the ratepayers' perspective, this transaction is not a retirement in the traditional sense. It is merely a transfer of ownership of the assets from Citizens to Arizona-American. As Citizens removes the original cost of the assets and the related accumulated depreciation from its balance sheet, Arizona-American will simultaneously be adding the same amounts to the respective plant accounts and the depreciation reserve on its balance sheet.

The procedure described by Mr. Fox at page 10 of his testimony relates to the accounting that is performed when an asset is routinely retired from service, whether prematurely (as stated by Mr. Fox) or later than the expected average service life. I would agree that when an asset is retired prematurely, the accounting methodology described would preserve rate base at its pre-retirement level, reflecting the under-recovered capital cost of the asset removed. It must be noted, however, that when an asset is retired <u>after</u> the average service life, rate base is also preserved at the pre-retirement level, in that instance, an over- recovery of the capital cost of the respective asset. With depreciation rates based on projections of average service lives, the actual service life of any individual asset may differ from what was estimated. Conceptually, these differences are expected to balance out over time.

Q. What is your recommendation?

A. The Commission should not accept Mr. Fox's recommendation that the gain on the asset sale be shared with ratepayers.

Q. Does this conclude your testimony?

A. Yes it does.

G:\Craig~docs\Az Water Disposition~Am Water Works\CWD Water sale testimony.doc

PROFESSIONAL QUALIFICATIONS

Q. What is your educational background?

A. I graduated from the University of Nebraska with a Bachelor of Science Degree in Business Administration, major in Accounting. I also received a Master of Business Administration Degree, concentration in Finance from Rockhurst College in Kansas City, Missouri.

Q, What has been your professional experience?

A. Upon graduation from college in 1968, I was employed by the international public accounting firm Arthur Andersen & Co. in its Omaha office. During such employment, I participated in and directed audits and other engagements involving commercial banks, healthcare facilities, public utilities, insurance carriers, and other clients.

In 1971, I accepted a position reporting to the controller at Central Telephone & Utilities Corporation at its then headquarters in Lincoln, Nebraska. During the five years I was employed by CTU, I directed such activities as financial and regulatory accounting and reporting, internal auditing, budgeting, corporate acquisitions and divestitures, rate cases and other regulatory filings, banking relations, and corporate financings.

From 1976 to 1981, I was employed by Kansas City Power & Light Company. My responsibilities included the corporate audit function, operations budgeting, and rate case filings in Kansas and Missouri and with the Federal Energy Regulatory Commission. During that period, I also served as a member of the Missouri Valley Electric Association, and the Finance and Accounting Committee of the Standardized Nuclear Unit Power Plant System.

From 1981 to 1991, I was employed as a Senior Project Manager for a regulatory consulting firm and successor firm, directing rate case, management audit, and other engagements for a clientele that included utility companies, public service commissions, and intervenors in regulatory proceedings.

From 1991 through 1996, I was employed as an internal consultant with Northern States Power Company in Minneapolis. My responsibilities included accounting, taxation and cost allocation issues in rate cases and special regulatory proceedings, performing capital investment evaluations, accounting and tax research, developing cost recovery plans, and advising senior management in connection with the development of performance-based ratemaking proposals and strategic policies for a successful transition to a competitive electric utility industry.

In late 1996, I accepted a position as Tax Research Coordinator for Tucson Electric Power Company. My chief responsibilities included tax research and planning, preparation, and review of corporate tax returns, and meeting with representatives of tax authorities. I also served on the corporate planning team addressing industry deregulation and competitive issues, and also directed the team charged with responsibility for creating and implementing a system for strategic business units, and developing the associated accounting and financial reporting practices.

In January, 1997, I was appointed Director of Utilities for the Arizona Corporation Commission. In that capacity, I directed a staff of approximately ninety professional and clerical employees responsible for overseeing railroad and pipeline safety in Arizona and for regulating the water, telephone, electric, and natural gas distribution utilities in the State.

I accepted my current position as Vice President-Regulatory Affairs of the Public Service Sector of Citizens Utilities in February, 1998. In that capacity, I coordinate regulatory activities in the ten states served by Sector utilities. In addition, I am a member of the Arizona Utility Tax Issues Group and the Arizona Corporation Commission's Water Utility Task Force.

Q. What are your professional certifications and affiliations?

A. I hold Certified Public Accountant Certificates issued by the respective Boards of Accountancy in Nebraska and Kansas. I am a member of the American Institute of Certified Public Accountants, the National Association of Radio and Telecommunications Engineers ("NARTE"), and the National Association of Railroad and Public Utility Tax Representatives.

Q. What technical licenses do you hold?

A. I hold an Advanced Class FCC Radio License and a Technician Class NARTE certification with regulatory and antennas endorsements.

Q. What is your teaching experience?

A. I have developed and conducted seminars on a variety of topics for employees of public utilities and regulatory agencies. I have also taught classes on behalf of the U.S. Telephone Association. Last May, I was an instructor at the NARUC Western Utility Rate School, and for the past eight years, have been a member of the faculty of the NARUC Regulatory Studies Program at the Public Utility Institute at Michigan State University. In connection with my teaching, I have written three instructional books: *Public Utility Income Taxation and Ratemaking*, *Public Utility Working Capital*, and *Generally Accepted Accounting Principles for Utilities*.

Q. What has been your experience in regulatory proceedings?

A. During the past twenty-eight years, I have participated in numerous rate cases and other regulatory and litigation proceedings involving electric, gas transmission and distribution, telephone, water, and wastewater utilities conducted in Alaska, Arizona, California, Colorado, Connecticut, District of Columbia, Florida, Illinois, Indiana, Kansas, Maryland, Minnesota, Missouri, Nevada, New Mexico, North Carolina, North Dakota, South Dakota, Virginia, and Wisconsin, as well as proceedings before the Federal Energy Regulatory Commission and the National Energy Board of Canada. I have also spoken before legislative bodies in connection with proposed legislation. I have testified on matters involving financial and regulatory accounting and reporting, auditing, cost allocation, financial forecasting, capital and operations budgeting, taxation, corporate acquisitions, holding companies, valuation and transfer pricing, deregulation, the cost of capital, industry restructuring, and regulatory policy.

\\PHOENIX\VOL1\PHOENIX\Craig~docs\Az Water Disposition~Am Water Works\CWD Testimony Qualifications.doc