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BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK  
Chairman  
JIM IRVIN  
Commissioner  
WILLIAM A. MUNDELL  
Commissioner

1999 OCT -5 P 4: 04

AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION ) DOCKET NOS. W-01656A-98-0577  
OF SUN CITY WATER COMPANY AND ) SW-02334A-98-0577  
SUN CITY WEST UTILITIES COMPANY )  
FOR APPROVAL OF CENTRAL ARIZONA )  
PROJECT WATER UTILIZATION PLAN )  
AND FOR AN ACCOUNTING ORDER )  
AUTHORIZING A GROUNDWATER )  
SAVINGS FEE AND RECOVERY OF )  
DEFERRED CENTRAL ARIZONA PROJECT )  
EXPENSES )  
STAFF'S NOTICE OF FILING  
TESTIMONY

Staff of the Arizona Corporation Commission hereby files the direct testimony of Claudio M. Fernandez, of the Utilities Division, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 5<sup>th</sup> day of October, 1999.

*Christopher C. Kempley*

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The original and ten copies of the foregoing filed this 5<sup>th</sup> day of October, 1999, with:

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Arizona Corporation Commission

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OCT 05 1999

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**SURREBUTTAL  
TESTIMONY OF**

**CLAUDIO M. FERNANDEZ**

**DOCKET NOS. W-01656A-98-0577  
SW-02334A-98-0577**

**OCTOBER 5, 1999**

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE JOINT APPLICATION )  
OF SUN CITY WATER COMPANY AND SUN )  
CITY WEST UTILITIES COMPANY FOR )  
APPROVAL OF CENTRAL ARIZONA PROJECT )  
WATER UTILIZATION PLAN AND FOR AN )  
ACCOUNTING ORDER AUTHORIZING A )  
GROUNDWATER SAVINGS FEE AND )  
RECOVERY OF DEFERRED CENTRAL )  
ARIZONA PROJECT EXPENSES )  
\_\_\_\_\_ )

DOCKET NOS. W-01656A-98-0577  
SW-02334A-98-0577

SURREBUTTAL

TESTIMONY

OF

CLAUDIO M. FERNANDEZ

MANAGER, REVENUE REQUIREMENTS ANALYSIS

UTILITIES DIVISION

OCTOBER 5, 1999

**TABLE OF CONTENTS**

	<u>Page</u>
Introduction.....	1
Purpose of Testimony .....	1
Summary of Company's Rebuttal Testimony.....	2
Deferred CAP Costs.....	2
Amortization Period.....	3
Disallowance of Rate of Return.....	4
Accounting Order.....	5
Financing Application.....	7

**SCHEDULES**

Computation of Deferred CAP Charges-Revised .....	CF-1
Deferred CAP Charges Rate Design-Revised.....	CF-2

1 **INTRODUCTION**

2 Q. Please state your name and business address.

3 A. My name is Claudio M. Fernandez. My business address is 1200 West Washington,  
4 Phoenix, Arizona 85007.

5  
6 Q. Are you the same Claudio M. Fernandez who filed direct testimony in this case?

7 A. Yes, I am. I filed direct testimony and supporting schedules on behalf of the Utilities  
8 Division Staff (Staff) on September 10, 1999.

9  
10 **PURPOSE OF TESTIMONY**

11 Q. What is the purpose of your testimony in this proceeding?

12 A. I am presenting Staff's analysis and recommendations concerning Sun City Water  
13 Company and Sun City West Utilities Company ("Sun Cities" or "Company") rebuttal  
14 testimony regarding the Company's application for approval of Central Arizona Project  
15 ("CAP") water utilization plan and an accounting order authorizing a Groundwater  
16 Savings Fee.

17  
18 Q. As a result of your review of the Company's rebuttal testimony, is Staff changing any of  
19 its recommendations found in direct testimony?

20 A. Yes. Staff is changing its recommendation of deferred CAP charges to be recovered and  
21 the rate design schedules presented in direct testimony as shown in Schedule CF-1 and  
22 CF-2 as a result of the Company's rebuttal testimony.

23  
24 **SUMMARY OF COMPANY'S REBUTTAL TESTIMONY**

25 Q. Would you briefly summarize the Company's rebuttal testimony?

26 A. The Company has indicated disagreement with Staff's recommendations on the following  
27 issues in its rebuttal testimony.

28 1. The amount of deferred CAP costs to be recovered.

- 1                   2. The amortization period for the recovery of deferred CAP costs.
- 2                   3. The disallowance of interest applied by the Company to the deferred CAP
- 3                   costs (carrying charges).
- 4                   4. Staff's characterization of the requested accounting order.
- 5                   5. Staff's recommendations regarding the Sun Cities financing application.
- 6

7 Q. Please explain how Staff organized its surrebuttal testimony.

8 A. Staff utilized the Company's major points of disagreements listed above and made  
9 appropriate comments accordingly.

10  
11 **DEFERRED CAP COSTS**

12 Q. Does Staff agree with the Company's deferred CAP charges?

13 A. Regarding the total deferred CAP charges of \$1,195,515 as of December 31, 1999 to be  
14 recovered through a surcharge mechanism, Staff is in agreement. Staff's recalculations,  
15 as shown in its revised schedules (which removed late charges of \$4,023), reflected a  
16 balance of \$1,197,209, or an immaterial difference of \$1,694. Staff's revised schedules  
17 are based on \$1,197,209 to be consistent with the corresponding schedules filed in direct  
18 testimony.

19  
20 Staff confirmed with the Company that the appropriate amounts for recovery of deferred  
21 CAP charges found in Mr. Dabelstein's Rebuttal Testimony at Page 3, Lines 3 and 4,  
22 should be \$762,320 instead of \$861,354 and \$433,195 instead of \$494,866.

23  
24 It should be noted that Schedule CWD-1 shows one payment of \$157,464 for 1999. With  
25 the exception of that year (1999), the remaining years (1993 through 1998) reflected that  
26 at least two payments were made in those years.

27 ...

28 ...

1 The rebuttal testimony of Mr. Jones indicated that in December an additional payment of  
2 \$423,696 (\$157,464 attributed to the Sun Cities) will be due. If the payment alluded to  
3 by the Company is for the 1999 capital charges, it would represent an increase of  
4 \$159,158 (\$1,694+157,464) over the Staff recommended deferred CAP charges to be  
5 recovered. Mr. Jones also stated in his rebuttal testimony that the Company is asking for  
6 recovery of only \$1,356,220, an amount that Staff has not been able to reconcile with  
7 the schedules submitted in rebuttal testimony.

8  
9 Staff's calculations of deferred CAP charges to be recovered (Revised Schedule CF-1)  
10 were based on the actual cost per acre-foot for the corresponding year. Staff's Schedule  
11 CF-1 recognized the expense in the year that the charge was incurred not when it was  
12 paid. Staff's recommended deferred CAP charges as of December 31, 1999 of \$1,197,209  
13 includes the 1999 accrued capital charges.

14  
15 **AMORTIZATION PERIOD**

16 Q. Please explain the Company's position regarding the amortization period for the recovery  
17 of deferred CAP charges.

18 A. The Company's rebuttal testimony rejects Staff's recommended five-year amortization  
19 period because there is no historical linkage or precedent between the time period during  
20 which capital costs are accumulated and their prescribed recovery period. However, the  
21 Company's major concern is that Staff is not recommending the Task Force expected  
22 amortization period of 42 months, which coincides with the construction of the golf  
23 course.

24  
25 Q. Please explain Staff's position regarding its recommended amortization period.

26 A. Staff's recommended five-year amortization period, as stated in the Company's rebuttal  
27 testimony, was not based on any historical linkage. It was simply based on the same time  
28 period that it took to accumulate the deferred CAP charges (from 1995 through 1999).

1 Staff is aware of the Task Force's position as well as the estimated time of the golf course  
2 construction period of 42 months. However, Staff believes that due to the Company's  
3 possible change of ownership, Citizens Utilities Company (the parent company of the  
4 Sun Cities) might not be able to complete the pipeline project. However, Schedule CF-2  
5 reflects Staff's recommended rates in the event that the Commission's decision adopts an  
6 amortization period of 42 months.  
7

8 **DISALLOWANCE OF RATE OF RETURN ON THE DEFERRED CAP COSTS**

9 Q. Does Staff agree with the Company's inclusion of a rate of return to the deferred CAP  
10 costs?

11 A. No. Staff is not in agreement with the Company's position that since the same  
12 ratemaking standard that applies to plant assets ("used and useful") has been imposed on  
13 the deferred

14  
15 CAP costs, it is only appropriate that the same cost recovery opportunity be made  
16 available as well.  
17

18 The Company also used the example of a plant asset that accrues an Allowance for Funds  
19 Used During Construction ("AFUDC") until the asset becomes used and useful,  
20 consequently, a component of rate base earning a rate of return.  
21

22 Staff believes that the deferred CAP costs should be treated as a pass-through cost to  
23 ratepayers and as such should not earn a rate of return. The Company's approach is  
24 consistent with the revenue requirement criteria where a rate of return is sought.  
25

26 In Staff's opinion, unlike a plant asset that accumulates AFUDC and is allowed in rate  
27 base when it becomes used and useful, the foregone allocation of CAP water from 1985  
28 through 1999 more than likely will never be utilized. In other words, the Company could

1 not increase their allocation for more than the contracted 17,654 acre-feet at any given  
2 time because the Company did not take physical possession of their water allocation for  
3 15 years. Consequently, the Company should not be allowed to collect carrying charges  
4 of \$108,257.

5  
6 **STAFF'S CHARACTERIZATION OF THE REQUESTED ACCOUNTING ORDER**

7 Q. Does Staff agree with the Company's characterization of Staff's direct testimony  
8 regarding an accounting order authorizing the general concept of the construction of a  
9 pipeline?

10 A. No. Staff does not agree with the Company's perception of Staff's recommendation  
11 regarding the pipeline project.

12  
13 In Staff's opinion, the Company's requested accounting order should not be for the  
14 deferral and recovery of the deferred CAP charges since the Commission has issued two  
15 Decisions regarding those issues (Decision No. 58750, dated August 31, 1994, and  
16 Decision No. 60172, dated May 7, 1997). Furthermore, Staff is not opposing the  
17 recovery of the deferred CAP charges.

18  
19 Decision No. 58750, dated August 31, 1994, agreed with the Company recognizing that  
20 the 1995 capital charges represented a significant operating expense and should be  
21 deferred. The accounting order authorizing the deferral of CAP charges also stated at  
22 Page 3, Lines 11 through 17, that:

23  
24 "Neither Sun City nor Agua Fria made payments in 1993 and 1994  
25 because the Interim Subcontract Charges previously paid and associated  
26 interest credited to their accounts satisfied the 1993 and 1994 Capital  
27 Charge liability. Additionally, these amounts have already been paid and  
28 should have, absent specific authorization from the Commission, been  
expensed in the period incurred".

1 Decision No. 60172, dated May 7, 1997, reiterated the Commission's Decision  
2 No. 58750. This decision ordered the Company to defer CAP capital costs for future  
3 recovery from ratepayers when the CAP allocation has been put to beneficial use for the  
4 ratepayers.

5  
6 Staff believes that an accounting order is not necessary for the Company to recover the  
7 on-going CAP costs because Staff is recommending approval for the recovery of those  
8 costs through a separate surcharge as outlined in Direct Testimony. The Commission  
9 could accept Staff's recommendations, modify them or reject them. If the Commission  
10 accepts Staff's recommended recovery of the on-going CAP costs and authorizes a  
11 recovery rate, there is no need for an accounting order.

12  
13 The only remaining issue is approval of the pipeline concept. The Company's rebuttal  
14 testimony stated that the Company is simply asking for approval of the pipeline concept  
15 as the correct plan to implement and the level of approval requested would not constitute  
16 an accounting order.

17  
18 If an accounting order is not necessary, the Company should refer to Mr. Scott's Direct  
19 Testimony where he recommended the pipeline concept as the long-term most favorable  
20 solution. Mr. Scott also stated in his recommendation that the estimated costs were very  
21 preliminary and extremely conservative and was unable to give a final opinion as to the  
22 reasonableness and appropriateness of those costs.

23  
24 In Staff's opinion, based on the above, there should be no conflict regarding the issue of  
25 the approval of the pipeline concept with the understanding that it in no way implies  
26 approval of any construction cost estimates used in this proceeding.

27 ...

28 ...

1 The Company's position is that they are not requesting pre-approval of the construction  
2 costs or any special treatment for those costs. However, the Company's rebuttal  
3 testimony asked the Commission to rely upon the Brown and Caldwell cost estimates to  
4 approve the plan because it is unlikely that the actual costs will exceed the estimate. In  
5 Staff's opinion, those statements seemed contradictory.

6  
7 **FINANCING APPLICATION**

8 Q. Please explain the Company's position regarding Staff's recommended financing  
9 application.

10 A. The Company, in its rebuttal testimony, indicated that Citizens is prepared to finance this  
11 project using existing sources of capital and should an alternative financing method be  
12 identified prior to construction, Citizens would then file for Commission approval.

13  
14 The Company in the CAP Task Force Final Report (top of Page 14) supported finding  
15 alternative methods of financing. Consequently, consistent with the Company's desire  
16 not to fund the project, Staff believed that a financing plan to fund the project was  
17 necessary to implement the long-term permanent solution. Typically, utility companies  
18 look for outside sources to finance projects of the magnitude of the proposed pipeline.

19  
20 In Staff's opinion, the Commission should require the Company to file a financing plan  
21 to fund the pipeline project. Staff is requesting that the Company comply with its request  
22 by June 30, 2000. Staff believes that this deadline is necessary to adhere to the  
23 Company's and Task Force's recommended time of completion of 42 months. If the  
24 Company is not willing to finance the project, the longer it waits to secure a source of  
25 financing the longer the construction project would last.

26  
27 Q. Does this conclude Staff's surrebuttal testimony?

28 A. Yes, it does.