



0000056364

**CITIZENS COMMUNICATIONS COMPANY  
ARIZONA GAS DIVISION  
DOCKET NO. G-01032A-02-0598**

**TESTIMONY OF RAYMOND C. MASON**

**REVISED**

1 **INTRODUCTION**

2 Q. Please state your name.

3 A. My name is Raymond J. Mason.

4

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

6 A. I am employed by Citizens Communications Company ("Citizens") and its  
7 subsidiaries as Director, Corporate Regulatory Affairs. This includes both  
8 the Northern Arizona Gas Division ("NAGD") and the Santa Cruz Gas  
9 Division ("SCGD") that are identified as the Arizona Gas Division ("AGD" or  
10 the "Company") for this combined rate case application.

11

12 Q. Please state your business address.

13 A. My business address is 3 High Ridge Park, Stamford, Connecticut 06905.

14

15 Q. What are your duties and responsibilities in your current position?

16 A. As Director of Corporate Regulatory Affairs, I am involved in a wide range  
17 of issues that affect numerous items that arise in Citizens' regulatory  
18 proceedings. Among other duties, I am responsible for the preparation,  
19 review, and presentation of the allocation of corporate costs to the  
20 operating units of Citizens, including the NAGD and SCGD. I am  
21 responsible for the development of Citizens' positions regarding the  
22 allocation of common costs and recovery of those costs in regulatory  
23 proceedings. In addition, I oversee the preparation of depreciation studies  
24 and have testified concerning capital recovery before state and federal  
25 regulatory commissions.

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1 Q. Please describe your education, training and other experience

2 A. I graduated from the University of Connecticut with a Bachelor of Science  
3 degree in Accounting and a Bachelor of Arts Degree in Economics. I also  
4 have an Associates Degree in Computer Programming. Since joining  
5 Citizens, I have attended numerous seminars in the fields of capital  
6 recovery and public utility ratemaking. I have attended and appeared as a  
7 panelist in conferences concerning state and federal regulatory issues. In  
8 addition, I have prepared, directed and reviewed depreciation studies for  
9 many of Citizens' operating divisions and subsidiaries.

10  
11 I have presented testimony on behalf of Citizens in the states of Arizona,  
12 California, Hawaii, Ohio, Illinois, Louisiana, New York, Nevada,  
13 Pennsylvania, West Virginia, and Vermont. My testimony addressed areas  
14 of the rate base and the income statement, including employee benefits,  
15 executive compensation, property insurance, property liability and personal  
16 damages, incentive compensation, and depreciation.

17  
18 Q. Please describe your employment history with Citizens.

19 A. I joined Citizens in May of 1988, as Senior Financial Tax Accountant, with  
20 responsibility for financial tax accounting as it relates to tax depreciation,  
21 deferred income taxes, reconciliation between financial and tax accounting,  
22 and related consolidation entries. In September of 1989, I was promoted  
23 to Supervisor of Capital Recovery and Plant Analysis, where I focused on  
24 book depreciation, Industrial Development Revenue Bond ("IDRB")  
25 financing, and Allowance for Funds Used During Construction ("AFUDC")  
26 accounting. I was promoted to Manager of Corporate Regulatory Affairs in  
27 June of 1993 and to my current position in July of 1994.

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29

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

2 A. I will present direct testimony on:

- 3 • General Description of the Contents of the Application
- 4 • Testimony Responsibilities
- 5 • Summary of Financial Statements ("A" Schedules)
- 6 • Net Common Plant Allocation
- 7 • Reconstruction Cost New ("RCN") Rate Base Calculation
- 8 Methodology
- 9 • AFUDC Calculation Compliance
- 10 • Computation of Working Capital (Schedule B-65)
- 11 • CARES Program (Schedule B-11)
- 12 • Salaries and Wages (Schedule C-2, Adjustment B)
- 13 • Regulatory, Miscellaneous and Per Diem (Schedule C-2,
- 14 Adjustment D)
- 15 • Insurance Expense (Schedule C-2, Adjustment E)
- 16 • Injuries and Damages Expenses (Schedule C-2, Adjustment F)
- 17 • Welfare and Pension Benefits Expenses (Schedule C-2,
- 18 Adjustment G)
- 19 • Stamford Administrative Office ("SAO") Expense (Schedule C-2.
- 20 Adjustment L)
- 21 • Public Service Organization ("PSO") Expenses (Schedule C-2,
- 22 Adjustment L)
- 23 • LAN - WAN - Email Services ("LWES") Expense (Schedule C-2.
- 24 Adjustment L)
- 25 • CARES Discount and Expense (Schedule C-2, Adjustment Q)
- 26 • Cost of Debt and Preferred Stock ("D" Schedules)
- 27 • Projections and Forecasts ("F" Schedules)

1 **OVERVIEW OF APPLICATION**

2 Q. Please describe the contents of the filing.

3 A. The application is made in accordance with the requirements of Arizona  
4 Administrative Code Section R14-2-103. Data for the NAGD and SCGD is  
5 filed on a combined AGD basis. This filing is organized into nine sections:

- 6 • Section A contains summary financial statements.
- 7 • Section B includes the required rate base schedules.
- 8 • Section C includes test period operating revenues and expenses  
9 schedules with related adjustments.
- 10 • Section D contains schedules presenting capital structure and the  
11 costs of capital.
- 12 • Section E includes schedules containing historical financial  
13 information.
- 14 • Section F reflects forecasted financial information.
- 15 • Section G contains the customer class cost of service study.
- 16 • Section H includes test year revenue and sales data and the proposed  
17 tariffs reflected the rate increases being sought.
- 18 • Section I of the application includes the working papers prepared in  
19 support of the filing.

20 These schedules were filed as part of this rate application and are found in  
21 their own bound volume.

22  
23 Q What test year is reflected in the Company's filing?

24 A. The application reflects a historical test year ended December 31, 2001,  
25 normalized and adjusted for certain known and measurable changes in  
26 prices and rates that have occurred through June 30, 2002, and an end-of-

1 period rate base, presented on both a net original cost and depreciated  
2 reproduction cost basis.

3  
4 Q. What is the amount of the requested annual increase in gross revenues?

5 A. The requested increase in annual revenues is \$21,005,521~~2~~, or 28.93  
6 percent.

7  
8 Q. When were the most recent rate cases for the NAGD and the SCGD?

9 A. On October 29, 1996, the Arizona Corporation Commission ("Commission")  
10 issued Decision No. 59875, approving a settlement agreement between the  
11 NAGD and the parties to the case. The Decision approved a \$2.7 million  
12 annual increase in revenues. The twelve-month test year ended on June  
13 30, 1995.

14  
15 The last rate order for the SCGD was Commission Decision No. 55585,  
16 issued on June 3, 1987, providing for an \$86,824 reduction in annual  
17 operating revenues. The test year used in that proceeding was the twelve  
18 months ended June 30, 1985.

19  
20 **TESTIMONY RESPONSIBILITIES**

21 Q. Please identify the other witnesses filing direct testimony in support of the  
22 Company's application and their respective issue areas.

23 A. The other witnesses filing direct testimony are:

- 24 ● Mr. Kenneth Cohen, President and Chief Operating Officer of the Public  
25 Service Sector ("PSS") (and the Vice President and Controller of the PSS  
26 during the test year) will testify on the need for rate relief, the  
27 consolidated filing of the Arizona gas properties, the accounting systems

1 and procedures used by the PSS, corporate policy, and the status of  
2 Citizens' plans for divesting its public services properties.

- 3 • Mr. Gary Smith, the Vice President and General Manager of the Arizona  
4 Gas Division, will testify on the Arizona Gas operations and service  
5 territories, the need for rate relief, the recently completed NAGD Build-  
6 Out Program, budgeted capital expenditures and operating results  
7 underlying the projected financial data reflected in the filing, the  
8 consolidation of the two Arizona gas operations for ratemaking and  
9 operational purposes, the sale of the Yale Street office building,  
10 programs benefiting low income customers, and the transfer of a gas  
11 line from the Santa Cruz Electric Division to the SCGD; and the  
12 increased requirements and safety standards at both federal and state  
13 level.
- 14 • Mr. Kevin Doherty, Regulatory Manager for Citizens Communications  
15 Company, will testify on all of the rate base components (except working  
16 capital and accumulated deferred income taxes) including plant-related  
17 items, contributions and advances in aid of construction, gains on sale of  
18 utility property, customer deposits, and yet-to-be disbursed amounts  
19 collected under the Company's Warm Spirit Program. Mr. Doherty's  
20 testimony also addresses the income statement and summary of pro  
21 forma adjustments, certain revenue adjustments, certain expense  
22 adjustments relating to uncollectible expenses, depreciation, lease  
23 expenses, gains on sale, Y2K expenses, and postage expenses. He will  
24 present the Gross Revenue Conversion Factor. In addition, Mr. Doherty  
25 is sponsoring the Section E schedules containing recorded historical  
26 financial and statistical data for the test year and two preceding calendar  
27 years.

- 1           • Mr. Anthony Apuzzo, Director of Tax and Actuarial Compliance for  
2           Citizens Communications Company, will testify on the balance of  
3           Accumulated Deferred Income Taxes deducted from rate base. He will  
4           also testify to certain operating expense items relating to taxes other  
5           than income taxes, an adjustment pertaining to prior period tax refunds,  
6           and Federal and State income taxes.
- 7           • Dr. Ronald White, Executive Vice President and Senior Consultant of  
8           Foster Associates, Inc., will testify in support of proposed new book  
9           depreciation rates.
- 10          • Mr. Robert Rosenberg, Principal of Edgewood Consulting Inc., will testify  
11          about the cost of capital and appropriate capital structure. He is  
12          sponsoring certain schedules contained in Section D of the Company's  
13          application.
- 14          • Mr. John Cogan, Managing Member of The Johnco Group, LLC, will testify  
15          regarding proposed changes to the Company's Transportation of  
16          Customer-Secured Gas tariff, the AGD's Negotiated Sales Program, and  
17          the Company's base cost of gas.
- 18          • Mr. James Harrison, Vice President of Management Applications  
19          Consulting, Inc., will testify regarding annualized and weather-  
20          normalized customer revenues. He will also explain the fully-allocated,  
21          embedded customer class cost of service study and his proposed new  
22          tariffs, as presented in Sections G and H, respectively.

1 **SUMMARY OF FINANCIAL STATEMENTS**

2 Q. Please describe Schedule A-1 contained in Section A of the Company's  
3 application.

4 A. Schedule A-1 presents the calculation of the increase in gross annual  
5 revenues required by the AGD based on the test year ended December 31,  
6 2001. This schedule shows the rate of return on the fair value rate base at  
7 present rates. It compares the adjusted test year operating income with  
8 the required operating income, computed as the product of the end-of-test-  
9 year rate base and the requested rate of return. The resulting operating  
10 income deficiency is then converted to the equivalent annual increase in  
11 revenues by using the Gross Revenue Conversion Factor.

12  
13 Q. Please describe Schedule A-2.

14 A. Schedule A-2 is the Summary Results of Operation. Gross revenues,  
15 operating revenue deductions and operating income are shown for the  
16 twelve months ended December 31, 1999, December 31, 2000, and for the  
17 test year ended December 31, 2001, as recorded. The test year data are  
18 shown at present and proposed revenue levels. This information is also  
19 presented for the projected year 2002, calculated at present and proposed  
20 rates.

21  
22 Q. What is shown on Schedule A-3?

23 A. Schedule A-3 is a Summary of Capital Structure, based on Citizens' actual  
24 capital structure, for the years 1999, 2000, 2001 and the projected year  
25 2002. That schedule also provides the pro forma capital structure that Mr.  
26 Rosenberg has recommended be used in this case. Schedule A-3 further  
27 shows ~~and~~ the calculation of fair value rate base using an equal weighting

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1 of fifty percent for the reproduction costs and original cost components.

2  
3 Q. Please describe Schedule A-3A.

4 A. Schedule A-3A, page 1, shows the detail underlying the Citizens capital  
5 structure for 1999, 2000, and 2001 set forth on Schedule A-3. Page 2 of  
6 that schedule presents the year-end weighted cost rate for Citizens' debt  
7 and preferred stock for the years 1999, 2000, 2001 and projected for year  
8 2002. The earned common equity amount (for 1999, 2000, and 2001)  
9 shown on that page represents Citizens' achieved net income divided by  
10 common equity, and is not a calculated cost of equity consistent with the  
11 testimony provided by Mr. Rosenberg.

12  
13 Q. What information is provided on Schedule A-4?

14 A. Schedule A-4 presents information concerning the construction  
15 expenditures, net plant placed in service and gross utility plant in service  
16 for the twelve months ended December 31, 1999 and 2000, and the test  
17 year ended December 31, 2001. In addition, construction expenditures,  
18 net plant placed in service and gross utility plant in service are projected  
19 for the years 2002, 2003 and 2004.

20  
21 Q.7 Please describe Schedule A-5 of the Company's application.

22 A. Schedule A-5 is a Summary of Changes in Financial Position. This  
23 information is shown for the twelve months ended December 31, 1999, and  
24 December 31, 2000, and for the test year ended December 31, 2001, as  
25 recorded. The December 31, 2002, projected data is shown at present and  
26 proposed revenue levels.

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**NET COMMON PLANT ALLOCATION**

- Q. Has the AGD included a portion of the net common plant for SAO, PSO, LWES or the Phoenix Administrative Office in its request for new rates in this proceeding?
- A. No. For this rate proceeding, Citizens has chosen to not seek recognition in rate base (or associated expenses) of the portion of net common plant from these administrative offices relating to the services provided to AGD. As a result, net common plant is not reflected in the plant, accumulated depreciation, or accumulated deferred income taxes components of rate base.

1 Q. Is this consistent with previous Citizens rate applications and approved  
2 Commission treatment?

3 A. No, it is not. Historically, Citizens has sought and received recovery of a  
4 portion of net common plant allocated to the operation under consideration  
5 in-rate proceedings brought before this Commission. Citizens has chosen  
6 to exclude these items from consideration for this rate application in an  
7 effort to narrow the focus on the key components of the requested rate  
8 increase. Instead, this rate application focuses on the capital investment in  
9 plant to extend natural gas facilities to unserved areas and to maintain and  
10 improve its existing facilities.

11  
12 Q. What is the nature of this common plant for these administrative offices?

13 A. This plant includes office furniture, computers and office equipment that  
14 are used in an administrative office for the administrative office personnel  
15 to perform their services to operating properties.

16  
17 Q. How was the net common plant allocated in previous rate proceedings in  
18 this jurisdiction?

19 A. It was allocated using the four-factor allocation, described in my discussion  
20 of SAO costs below.

21  
22 Q. Does Citizens agree, by making this adjustment in this filing, that these  
23 items should not be included in rate base or expenses for ratemaking  
24 purposes?

25 A. No it does not. Citizens has been and continues to be of the opinion that  
26 net common plant should be included and, correspondingly, should be  
27

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1 recovered in rates. These plant assets are necessary and appropriate and  
2 are neither extraordinary nor excessive for a typical utility office.  
3

4 Q. Why then is Citizens voluntarily making this adjustment?

5 A. The adjustment is offered in an attempt by Citizens to remove from  
6 contention items that have a lesser impact on rates, but have in the past  
7 required a significant expenditure of human, financial and other resources  
8 to support. By eliminating issues, the customers, Citizens, and all parties  
9 involved will benefit from this approach.  
10

11 Q. Does the inclusion of this adjustment mean that Citizens intends to forgo  
12 recovery of such plant items in future rate filings?

13 A. Absolutely not. The adjustment being offered here regarding the net  
14 common plant for the identified administrative offices is unique to this  
15 filing. It is not meant to waive Citizens' right to include net common plant  
16 in any future rate applications in this or any other jurisdiction. Citizens in  
17 no way intends to establish any precedent for future filings with respect to  
18 the treatment of these plant items.  
19

20 Q. Has the Company reflected the common plant adjustment made to rate  
21 base components in its depreciation expense calculation?

22 A. Yes, it has. Consistent with the elimination of common plant allocations in  
23 rate base, the AGD has excluded depreciation expense for the amounts  
24 associated with that plant from this case.  
25  
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1 **RECONSTRUCTION COST NEW RATE BASE**

2 Q. What is the total adjusted reconstruction cost new less depreciation rate  
3 base ("RCN") for the combined AGD at test year-end?

4 A. The total adjusted RCN rate base for AGD is \$190,131,622~~189,987,155~~.  
5 As-Mr. Doherty explains, Schedule B-34 summarizes the recorded utility  
6 plant in service and accumulated depreciation using RCN values. Schedule  
7 B-45 lists the original cost and trended RCN value for AGD by each plant  
8 account. The original cost for contributions in aid of construction ("CIAC"),  
9 advances in aid of construction and the amortization of CIAC have been  
10 trended for inclusion in this RCN rate base calculation.

11  
12 Q. What trending indices are used in establishing the trended RCN values?

13 A. The Handy-Whitman Indices for Gas Utility Construction, Plateau Region,  
14 were used for other production plant, transmission and distribution plant,  
15 as well as structures and improvements. For general plant, the Producer  
16 Price Index was used.

17  
18 Q. Have these indices been used in prior rate applications for this and other  
19 Citizens' operations before the Commission?

20 A. Yes. They were used for the two previous NAGD cases and in all other  
21 recent Citizens' rate cases for determining the RCN values.

22  
23 Q. How is the RCN plant amount calculated?

24 A. The base established for a vintage asset of specific plant account is divided  
25 by the corresponding Handy-Whitman valuation index. The result is a  
26 trend factor that is multiplied by the original cost of the vintage asset,  
27

1 producing the trended cost consistent with reconstruction cost for that  
2 plant new.

3  
4 Q. Are there elements to the RCN rate base that are not trended?

5 A. Yes, there are. A detail summary of all the components are found in  
6 column 2 of Schedule B-1.

7  
8 Q. Does the proposed RCN rate base reflect all adjustments ordered in  
9 Decision No. 58664 for Original Cost Rate Base ("OCRB") by the  
10 Commission?

11 A. Yes, it does.

12  
13 **AFUDC CALCULATION COMPLIANCE**

14 Q. Please explain the basis for your testimony relating to AFUDC.

15 A. In conjunction with Docket Nos. E-1032A-94-0139, et. al, Citizens filed a  
16 Joint Application for an Order Approving the Accounting Method used to  
17 Record an AFUDC. The application sought approval from the Commission  
18 of the accounting method used to record an allowance for funds used  
19 during construction on IDRBs. As a result of those and related  
20 proceedings, Citizens, Staff, and the Residential Utility Consumers Office  
21 ("RUCO") reached a Settlement Agreement, which the Commission adopted  
22 in Decision No. 61848, dated July 21, 1999. A copy of that Decision has  
23 been provided as Exhibit RJM-01, pages 1-14.

24  
25 Q. What were the terms of the Settlement Agreement?

26 A. Citizens agreed to use the procedures outlined in the Settlement  
27 Agreement for the calculation of AFUDC and for AFUDC in connection with  
28

1 the Federal Energy Regulatory Commission's Release Number 13 ("AR-13  
2 AFUDC") for all of its Arizona utility operations. The Settlement Agreement  
3 outlined a ten-step process, with relevant characteristics, for each of the  
4 areas/properties identified within the Settlement Agreement. Other  
5 procedures for calculating AFUDC in subsequent years described in the  
6 Settlement Agreement included:

- 7 • Use of a budgeted rate for the ten months of the following year  
8 (p. 6, line 10-12);
- 9 • Preparation of an initial "true-up" calculation to be used for the  
10 months of November and December (p. 6, line 13-16); and
- 11 • Performing a final true-up for the previous year by June of each  
12 successive year (p. 6, line 18-19).

13  
14 Additionally, the parties agreed that if the difference between the initial  
15 true-up AFUDC and the final AFUDC rate were more than 25 basis points,  
16 Citizens would make an adjustment to the financing costs in the final true-  
17 up year. If the difference were 25 basis points or fewer, no adjustment  
18 would be made.

19  
20 Q. Did the Settlement Agreement address details of the mechanics of the  
21 calculation that are exclusive to AR-13 AFUDC?

22 A. Yes, it did. The Settlement Agreement provided specific procedures to be  
23 used in calculating AR-13 AFUDC. In the copy of Decision No. 61848  
24 provided as Exhibit RJM-01, pages 1-15, these specific procedures can be  
25 referenced.

1 Q. Were there any other conditions in the Settlement Agreement directly  
2 pertinent to this rate application?

3 A. Yes. Citizens agreed that it would provide the Commission, in each of its  
4 future rate cases, a comparative calculation showing the AFUDC rates and  
5 overall rate of return using short-term debt, as part of the long-term debt  
6 component, as compared with using short-term debt as part of the AFUDC  
7 calculation.

8  
9 Q. Has Citizens made such a comparative calculation available for this rate  
10 proceeding?

11 A. Yes it has. Exhibit RJM-01, page 16, provides the required comparison.  
12

13 Q. Has compliance with this Decision No. 61848 been reflected in this rate  
14 application?

15 A. Yes. Citizens has exceeded the 25 basis points threshold difference  
16 between the initial true-up and the final true-up. Correspondingly, it is  
17 necessary for an adjustment to be made to the plant basis to reflect the  
18 terms of the Settlement Agreement. Mr. Doherty is sponsoring the  
19 calculation and proposed rate base adjustment associated with the AR-13  
20 AFUDC.  
21

22 **COMPUTATION OF WORKING CAPITAL**

23 Q. Please describe Schedule B-56.

24 A. Schedule B-56 summarizes the allowance for working capital requested by  
25 the Company in this proceeding. Working capital is a measure of investor  
26 funding for daily operating expenditures and non-plant investments that are  
27  
28  
29

1 needed to support ongoing operations. This Schedule consists of three  
2 pages, labeled Schedule B-56, Schedule B-65A and Schedule B-65B.

3  
4 Q. Please explain how working capital requirement on Schedule B-65 was  
5 determined.?

6 A. The working capital requirement was determined through a lead/lag study,  
7 as required by the Commission for Class A gas utilities the size of AGD.

8  
9 Q. Does the Company's methodology conform to recommendations of other  
10 parties in prior Citizens cases?

11 A. Yes. The AGD has conformed elements of the lead/lag study to prior Staff  
12 lead/lag schedules and recommendations in prior Citizens rate cases in  
13 Arizona. For instance, depreciation expense has been excluded from the  
14 study and interest expense has been included. The same lag days are  
15 shown for rate case expense as were used by Staff in prior Arizona Electric  
16 Division and prior Arizona gas cases. The lag days used for interest  
17 expense represents an average of the positions presented in prior Citizens  
18 Arizona cases by Staff and the Residential Utility Consumer Office.

19  
20 Q. How did you determine the lead or lag days for other expense items?

21 A. In order to determine the lead or lag days for other expense items, all  
22 invoices were reviewed for the calendar year 2001. Because gas purchases  
23 represent a significant portion of total test year expenses, and because  
24 Enron ceased to be a supplier to the AGD, the Company sampled invoices  
25 from the months of November 2001 through February 2002 for this item.  
26 This time period is considered representative of the costs that will be  
27 incurred in the first year of new rates.

1 Q. What is the amount of working capital included in rate base?

2 A. As shown on line 35 of Schedule B-56, the amount of working capital  
3 included in rate base is a negative \$2,924,2197.

4  
5 Q. Please describe Schedules B-65A and B-65B.

6 A. Schedule B-65A shows the reconciliation of expenses for the lead/lag study.  
7 Schedule B-65B presents the distribution of the working capital amount  
8 among the various cost of service classes.

9

10 **CARES PROGRAM**

11 Q. Please summarize Schedule B-11.

12 A. The settlement agreement approved in the last NAGD rate case provided  
13 for an annual revenue increase that included an annual \$100,000 allowance  
14 for Low Income Residential Assistance Programs. As more fully described  
15 in the testimony of Mr. Smith, that includes CARES Program discounts and  
16 other low-income initiatives. In approving the settlement agreement,  
17 Commission Decision No. 59875 provided that Citizens create a special  
18 balance sheet account for tracking the program costs and recoveries.

19  
20 Specifically, as described in Decision No. 59875, beginning at line 18 on  
21 page 4, Citizens should "calculate a recovery rate for the Programs by  
22 dividing the \$100,000 annual allowance by the total test year normalized,  
23 annualized sales therms." Using the final adjusted test year sales of  
24 102,040,360 therms in that rate case produces an implied cost recovery  
25 rate of \$.00098 per therm. All program costs are to be charged to a special  
26 balance sheet amount. At the end of each month, the total sales billed are  
27 to be multiplied by the cost recovery rate to establish a measure of

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1 Program costs billed to ratepayers. The computed amount is to be  
2 deducted from the balance sheet account and charged to operating  
3 expenses. If customer revenues from the CARES surcharge exceed the  
4 low-income program expenses and discounts, the balance sheet account  
5 increases.

6  
7 The rate base element labeled "CARES" represents the cumulative  
8 difference between the amount incurred in connection with CARES  
9 discounts and other low-income programs and amounts recovered in  
10 current service rates since they were implemented in November 1996.  
11 Schedule B-11 reflects the development of the required balance in the  
12 special tracking account as of the end of the test year. The \$364,945 credit  
13 balance is identified as a deduction from rate base.

14  
15 There is a companion adjustment (Schedule C-2, Adjustment Q) relating to  
16 the annual pro forma amortization expense level proposed for inclusion in  
17 operating expenses.

18  
19 **SALARIES AND WAGES**

20 Q. Please explain the Salaries and Wages calculation.

21 A. Adjustment B to Schedule C-2 adjusts test year salary and wage expense to  
22 reflect an annualized level. It reflects the actual number of active  
23 employees plus temporary vacancies (in previously filled positions) existing  
24 at the end of the test year. This adjustment was computed using the most  
25 current known and measurable salary and wage rates. The computation  
26 also reflects an average annual overtime level for the past five years and  
27 the actual test year account distribution of payroll expense.

1 **REGULATORY, MISCELLANEOUS AND PER DIEM EXPENSES**

2 Q. Please describe Adjustment D on Schedule C-2.

3 A. Adjustment D on Schedule C-2, provides a summary of the estimated legal,  
4 regulatory, consulting and special studies expenses, as well as  
5 miscellaneous and per diem expenses for this filing. These expenses are  
6 broken into two groups: (1) the current rate case annual amortization and  
7 (2) ongoing amortization of the Build Out Program allowed expense from  
8 the last rate case.

9  
10 Q. Please describe how the amount of rate case expense for this application  
11 has been estimated.

12 A. The basic procedure is the same as the procedure used by Citizens in other  
13 cases filed before this Commission. First, after a review of the filing  
14 requirements and potential issues in the proceeding, the Company  
15 determined subject-matter witnesses and, where necessary, identified and  
16 contacted outside consultants. Second, outside consultant cost estimates  
17 are made. Third, for the SAO, PSO, and LWES personnel, the Company  
18 estimated the travel, lodging, meals, and other out-of-pocket costs  
19 required to participate in the rate case proceeding. As in prior cases, all  
20 estimates will be replaced with actual charges as soon as the actual  
21 charges are available.

22  
23 Q. Does the rate case expense reflect any salaries and wages costs for any  
24 Citizens employees listed on the AGD payroll or charged to AGD from  
25 affiliates in other sections of the test year income statement?

1 A. No. Neither the employees on the payroll of AGD or Citizens affiliates are  
2 included in the estimates for rate case expenses. Only the direct (travel,  
3 lodging, meals and other out-of-pocket) expenses described previously are  
4 being requested concerning internal employees.

5  
6 Q. Will these estimates be updated as the rate case is processed?

7 A. Yes. We will update the expenses with supporting documentation and  
8 replace the estimates with actual amounts.

9  
10 Q. Is the AGD proposing to recover the full amount of its estimated rate case  
11 expenses?

12 A. No, it is not. For purposes of this proceeding, I reviewed Commission-  
13 authorized rate case expenses for prior Citizens rate cases in Arizona. I  
14 used those prior allowances, adjusted for inflation, to derive the rate case  
15 expense for which the AGD is seeking recovery in this proceeding. This  
16 requested amount is considerably lower than the costs the Company  
17 expects to incur, as shown on Adjustment D of Schedule C-2.

18  
19 Q. What period has been used for the amortization of rate case expense  
20 requested in this application?

21 A. The total requested current rate case expenses of \$500,000 have been  
22 amortized over a three-year period, as shown in Schedule C-2, resulting in  
23 annual amortization of \$166,667. This period is consistent with  
24 amortization periods in prior Citizens' Arizona rate cases.

25

26

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29

1 Q. Please describe the component of Adjustment D relating to Build Out  
2 Program case expenses.

3 A. In Decision No. 59875, issued October 29, 1996, the Commission  
4 authorized the NAGD to amortize case expenses of \$125,000 associated  
5 with the Build Out Program over a ten-year period. The amount shown in  
6 Adjustment D includes one year's amortization of those costs.

7

8 **INSURANCE EXPENSE**

9 Q. Please describe Adjustment E in Schedule C-2.

10 A. Adjustment E of Schedule C-2 provides the 2001 recorded test year ending  
11 insurance expense for AGD, the pro forma insurance expense, and the  
12 resultant pro forma adjustment. Exhibit RJM-02 lists the insurance  
13 coverages and details the calculation for each of the pro forma insurance  
14 coverages included in the pro forma total. Insurance expense for AGD  
15 consists of: (a) all-risk property insurance; (b) comprehensive crime  
16 insurance; (c) directors and officers insurance; (d) fiduciary and excess  
17 fiduciary insurance; (e) travel accident insurance; (f) bond insurance; and  
18 (g) other miscellaneous insurances. The amounts for 2001 reflect actual  
19 insurance expense charged to AGD.

20

21 Q. How are the specific insurance coverage expenses calculated?

22 A. The coverages are common to all the regulated operations of Citizens and  
23 are negotiated for Citizens in total, or for a specific utility service where  
24 appropriate. The expense is apportioned based on a rate per property  
25 value amount for all-risk insurance. Expenses for all other insurance

26

27

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1 coverages are allocated using (i) the number of employees, (ii) the four-  
2 factor formula, or (iii) a ratio of the AGD coverage item as a percentage of  
3 total item coverage, as appropriate for each type of coverage.  
4

5 Q. What is the total pro forma insurance expense for the AGD?

6 A. The total pro forma expense requested in this proceeding for the AGD, as  
7 shown on Schedule C-2, is \$114,036.  
8

9 Q. What is the total pro forma insurance expense adjustment?

10 A. The total pro forma insurance expense adjustment is an increase of  
11 \$11,255 from the recorded amount.  
12

13 **INJURIES AND DAMAGE EXPENSES**

14 Q. Please explain Adjustment F in Schedule C-2.

15 A. This adjustment restates recorded expenses for injuries and damages to  
16 pro forma levels. Pro forma amounts for comprehensive general liability,  
17 general coverage and worker's compensation are based on property  
18 specific information, such as number of employees, pro forma salaries and  
19 wages, premium liability factors, and the four- factor formula. Schedule C-  
20 2, Adjustment F provides the calculation for the pro forma expense.  
21

22 Q. What is the basis on which the recorded amount is calculated?

23 A. The year-end 2001 recorded amount for test year-end injuries and  
24 damages expenses is based on the allocated portion of the total policy  
25 premium for comprehensive general liability and excess general liability.  
26 The general coverage insurance is determined at a per customer rate, while  
27 the worker's compensation amount is calculated by multiplying a rate  
28  
29

1 based on job classification times the total salaries for that job classification  
2 rate per \$100 multiple times the estimated percentage increase in the total  
3 premium for the coverage. The specific formulas are set forth in Exhibit  
4 RJM-03.

5  
6 Q. What is the total pro forma injuries and damages expense for the AGD?

7 A. The total pro forma injuries and damages expense requested in this  
8 proceeding is \$ 282,564. The calculation of this amount is shown on  
9 Exhibit RJM-03.

10  
11 Q. What is the total pro forma injuries and damages expense adjustment?

12 A. The total pro forma insurance expense adjustment is an increase of  
13 \$54,158 from the recorded amount.

14  
15 **EMPLOYEE WELFARE AND PENSION BENEFITS EXPENSES**

16 Q. Please describe Adjustment G in Schedule C-2.

17 A. Adjustment G provides a summary of the employee welfare expense and  
18 pension expenses for the pro forma levels. The employee benefits costs  
19 consist of: (a) medical and dental benefit; (b) vision care; (c) long-term  
20 disability; (d) personal accident insurance; (e) group life insurance; (f)  
21 pension benefit; (g) 401K; and (h) the Incentive Deferred Compensation  
22 Program ("IDCP"). The pro forma expense of \$2,109,756 is an increase  
23 from that for the 2001 year-end recorded expense level. The calculation of  
24 the expense for each of these benefits is contained in the Exhibit RJM-04.

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1 Q. How much is the total pro forma employee welfare and pension  
2 adjustment?

3 A. The total pro forma employee welfare and pension adjustment is an  
4 increase of \$369,753 from the recorded level.  
5

6 **STAMFORD ADMINISTRATIVE OFFICE EXPENSE**

7 Q. What is the SAO?

8 A. The Stamford Administrative Office, located in Stamford, Connecticut,  
9 provides essential services to all divisions and subsidiaries of Citizens,  
10 mainly by providing oversight and policy guidance for all Citizens'  
11 operations. The specific services provided include the following:

- 12 • Internal audit
  - 13 • Corporate & Consolidation accounting
  - 14 • Financial Reporting
  - 15 • Tax Accounting
  - 16 • Information Systems Support
  - 17 • Risk & Cash Management
  - 18 • Shareholder & Investment Community Services
  - 19 • Corporate & Employee Communication
  - 20 • Human Resource & Employee Benefits Policy Oversight
  - 21 • Corporate Regulatory
  - 22 • Corporate Legal
  - 23 • Financing & Investment Services
  - 24 • Accounting Policy & Procedures Oversight
- 25  
26  
27  
28  
29

1 Q. What types of expenses are charged to AGD from SAO?

2 A. SAO expenditures incurred on behalf of divisions and subsidiaries include  
3 the following: (a) salaries, payroll taxes, and employee benefits of SAO  
4 personnel who provide services to the AGD; (b) rent, taxes, and other  
5 costs of operation necessary to support the personnel at the SAO; (c)  
6 financing expense, shareholder expense, and directors' fees required for  
7 the operations of the corporation; (d) expense for subscriptions,  
8 memberships in and dues to professional organizations; (e) legal expenses;  
9 (f) travel and per diem expenses relating to each of the above; and (g)  
10 insurance.

11  
12 Q. Please explain the SAO expense calculation.

13 A. Schedule C-2, Adjustment L, page 2 of 4, provides a summary of the  
14 calculation of pro forma SAO expense at test year-end, December 31,  
15 2001. Line 7 provides the corresponding pro forma expense adjustment.  
16 Exhibit RJM-05 summarizes the pro forma administrative office expenses to  
17 be charged to the AGD for the test year.

18  
19 Q. What amount of SAO expenses is charged to AGD in the test year?

20 A. The recorded SAO expense charged to AGD for the test year is \$1,148,857.  
21 The total pro forma SAO expense distributed to AGD operations is  
22 \$435,363. Page 2 of Exhibit RJM-05 provides the details of the pro forma  
23 calculation.

24

25

26

27

28

29

1 Q. How were the total SAO expenses distributed to Citizens operations for  
2 year ended December 31, 2001?

3 A. The four-factor formula was used to distribute SAO expenses to operations.  
4

5 Q. What is the four-factor formula?

6 A. This formula, developed by the California Public Utilities Commission in the  
7 1950s, is used for charging general administrative items to separate  
8 operations. It has been shown to be a reasonable method of distributing  
9 general charges. The four-factor formula is a mathematical calculation that  
10 results in an average of the relationship of each property to the total  
11 properties for four elements: (1) utility plant-in-service; (2) operation and  
12 maintenance ("O&M") expense; (3) customers; and (4) payroll charged to  
13 O&M. These four categories represent areas of administrative review and  
14 oversight performed by SAO or other administrative personnel, and also for  
15 common functions. The amounts for each of Citizens' operating divisions  
16 and subsidiaries are listed and the percent of each property is determined  
17 by dividing the property amount by the total amount for the category. The  
18 same process is completed for each of the other three categories and the  
19 four percentages are averaged to obtain the four-factor allocator for each  
20 specific operating property.  
21

22 Q. Has the use of the four-factor method been accepted by this Commission  
23 and other commissions which regulate Citizens' operating properties?

24 A. Yes. It has been reviewed many times and accepted in all proceedings  
25 over the last 25 years.  
26  
27  
28  
29

1 Q. How was the pro forma 2001 SAO expense calculation prepared?

2 A. The SAO expense amount for the test year reflects recorded SAO expenses  
3 for the year ending December 31, 2001 with pro forma adjustments.  
4 Exhibit RJM-05, page 2, shows the pro forma SAO Costs calculation  
5 distributed to AGD, adjusted for the pro forma changes that include  
6 previously disallowed items.

7  
8 Q. What events have made the greatest impact upon the distribution of SAO  
9 expenses to AGD since the last rate proceeding?

10 A. Clearly, Citizens' business strategy to pursue the acquisition of telephone  
11 access lines to become a pure telecommunications entity, while seeking to  
12 divest of its public services operations, has had the most profound impact  
13 on the SAO expenses since the last rate proceeding.

14  
15 Q. How have the completed acquisitions of telecommunications operations and  
16 sales of public service operations affected the calculation of the pro forma  
17 SAO expenses charged to AGD?

18 A. Citizens' strategy to become a telecommunications company has resulted in  
19 a significant increase in the number of telecommunications customers  
20 served, while the number of public service customers has declined. These  
21 changes have greatly impacted the amount of SAO expenses allocated to  
22 each operation where the four-factor method of allocation is employed.  
23 The current four-factor allocation reflects a significant reduction for all the  
24 operations of Citizens that received allocable SAO expenses prior to the  
25 close of the announced communications acquisitions by December 2001.

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1 While Citizens also closed on the sale of some public service operations, the  
2 impact of the added communications properties more than offset the effect  
3 of the sale of those public services properties.  
4

5 Q. Has this factor been included into the four-factor formula in the pro forma  
6 allocated SAO expenses?

7 A. Yes, I have. Exhibit RJM-05, page 2, shows the 2001 year-end closing pro  
8 forma four-factor calculation that reflects the telephone access line  
9 acquisitions and the divestitures of public service operations that had  
10 closed as of December 31, 2001. That page also reflects adjustments  
11 made to remove Griffith operations and other related plant adjustments  
12 from the AGD basis.  
13

14 Q. Have other adjustments been made in preparing the pro forma SAO  
15 allocable cost calculation?

16 A. Yes. I have made adjustments to remove items that have previously been  
17 disallowed by the Commission. The items include allocable charges for  
18 divestiture efforts, donations and contributions, and other selected  
19 expenses. In addition, I have removed some items that have not been  
20 denied in previous proceedings but have been of a contentious nature.  
21 These adjustments are summarized on page 2 of Exhibit RJM-05.  
22

23 Q. How is the adjustment calculated and applied to the 2001 SAO expenses?

24 A. The total amount of 2001 SAO expenses to be removed are identified and  
25 then multiplied by the pro forma AGD four-factor to calculate the allocable  
26 amount for AGD. This amount is then subtracted from the unadjusted pro  
27 forma SAO costs being charged to AGD.  
28  
29

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1 Q. Have you made any additional adjustments to the pro forma SAO expense  
2 that you are recommending in this case?

3 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
4 experience through the first four months of 2002. I derive this adjustment  
5 by annualizing the monthly average based on 2002 actuals for the first four  
6 months. I then calculated a percentage of annualized 2002 total of the  
7 recorded 2001 total SAO expense, and subtracted 100% from that  
8 calculated percentage. The resulting percentage was applied to the  
9 adjusted 2001 test year total SAO expense for AGD. The amount produced  
10 by that calculation represents my adjustment to reflect 2002 actuals.  
11

12 Q. Is the pro forma SAO expense charged to AGD of \$435,363 a reasonable  
13 amount?

14 A. Yes. The pro forma charges from SAO to AGD are reasonable. Performance  
15 of certain administrative functions by a central office allows AGD to take  
16 advantage of economies of scale that would not otherwise be available.  
17 This means service for the customers of Citizens at reduced costs.  
18 Moreover, the SAO charges represent a portion of the reasonable and  
19 necessary costs that Citizens incurs to operate a publicly-held utility  
20 company. The Commission should allow the AGD to recover its share of  
21 these legitimate operating expenses.  
22

23 **PSO DISTRIBUTED EXPENSE**

24 Q. What is the PSO?

25 A. The Public Service Organization, or PSO, is an administrative support office  
26 located in Louisiana that provides accounting, management information  
27 and engineering services for the PSS of Citizens, which includes all  
28  
29

1 operations and/or properties that provide electric and gas (and previously  
2 water and wastewater) services.

3  
4 Q. Was the same procedure used for the SAO also used to calculate the  
5 amount of PSO charges allocated to AGD?

6 A. Yes, with a slight alteration. Because the services provided by the PSO are  
7 exclusive to the public service segment of Citizens' operations, the four-  
8 factor formula excludes the telecommunications operations from the pool of  
9 operations used in the various factors. The principles and premises that  
10 make use of the four-factor method appropriate are the same as discussed  
11 earlier.

12  
13 Q. Have the details of the Public Service four-factor calculation been provided  
14 in this testimony?

15 A. Yes. Exhibit RJM-05, page 3, summarizes the pro forma calculation. This  
16 calculation excludes the telecommunications operations and amounts  
17 associated with Griffith and the Paulden Line (described in Mr. Doherty's  
18 testimony). This resulted in a four-factor formula allocation of 9.65% for  
19 AGD as of the end of the test year.

20  
21 Q. Where are the charges to AGD from PSO provided in the rate filing?

22 A. The charges for the PSO are included in Schedule C-2, Adjustment L, page  
23 3 of 4. Exhibit RJM-05 provides a summary of the calculation for the  
24 \$971,292 PSO pro forma amount charged to AGD.

1 Q. Have you made any additional adjustments to the pro forma PSO expense  
2 that you are recommending in this case?

3 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
4 experience through the first four months of 2002. I derive this adjustment  
5 in the same manner discussed in connection with SAO expense.

6  
7 Q. What future business decisions could partially offset the increase in costs  
8 being allocated to each public service operation?

9 A. A decrease in the size of staff for PSO would reduce costs being allocated,  
10 but the magnitude of any such reduction cannot be readily determined at  
11 this time.

12  
13 Q. Is the total pro forma PSO expense of \$971,292 charged to AGD a  
14 reasonable amount?

15 A. Yes. The pro forma charges from PSO are reasonable. Using the four-  
16 factor formula ensures that each operation, including AGD, supports its fair  
17 share of all general PSO expenses.

18  
19 There is an additional factor supporting the reasonableness of these  
20 charges. For the purposes of this rate filing, Citizens has capped the  
21 allocable pro forma PSO expenses to an amount that results in a total  
22 administrative offices (i.e., SAO, PSO, and LWES) allocated expense  
23 distribution that is approximately the same as that approved in the last  
24 litigated NAGD rate proceeding. In Decision No. 58664, this amount was  
25 approximately \$1.2 million. Although that proceeding related only to  
26 NAGD, the Company is limiting its request for the whole AGD to that level.  
27 The purpose of this proposed expense limit is to facilitate expeditious

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1 consideration of this rate application as well as to allow attention to be  
2 directed to the key factor for the requested revenue increase in this  
3 proceeding, the increase in plant investment.  
4

5 **LWES ORGANIZATION DISTRIBUTED EXPENSE**

6 Q. Are there other administrative groups that support the operation of AGD?

7 A. Yes. The LWES Organization, previously known as the Dallas  
8 Administrative Office ("DAO") provides specific computer support, local  
9 area network, intranet management and other information technology-  
10 related services to all of Citizens' operations. This organization has  
11 relocated to Rochester, New York, and continues to provide similar services  
12 to all of Citizens' properties.

13  
14 Q. How are LWES charges distributed?

15 A. For those services described, the charges are distributed using the same  
16 four-factor formula utilized for SAO, since all of Citizens' operations are  
17 beneficiaries of their services.  
18

19 Q. What is the pro forma amount of LWES expenses?

20 A. The pro forma amount is \$59,423 as shown on page 4 of Schedule C-2,  
21 Adjustment L. Exhibit RJM-05, page 4, provides the pro forma calculation  
22 that uses the distribution as of December 31, 2001.  
23

24 Q. Have you made any additional adjustments to the pro forma LWES expense  
25 that you are recommending in this case?  
26  
27  
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1 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
2 experience through the first four months of 2002. I derive this adjustment  
3 in the same manner discussed in connection with SAO expense.

4  
5 Q. Is the \$59,423 LWES pro forma amount reasonable?

6 A. Yes. The pro forma calculation takes into consideration all the previously  
7 described forces that would work to alter AGD's four-factor allocation. As a  
8 result, the pro forma amount is significantly less than what has historically  
9 been experienced.

10

11 **CARES DISCOUNT AND EXPENSE**

12 Q. Please explain Adjustment Q, entitled CARES Discount and Expense.

13 A. Adjustment Q represents the operating expense adjustment that  
14 corresponds to the rate base component contained in Schedule B-11. This  
15 adjustment is made to reflect a proper test year amortization of the Low  
16 Income Residential Assistance Program costs as required under the  
17 procedure set forth in Commission Decision No. 59875. It also incorporates  
18 the annual effect of changes being proposed to the CARES program and  
19 other low-income initiatives, as more fully described in Mr. Smith's  
20 testimony.

21

22 **COST OF CAPITAL DEBT AND PREFERRED STOCK**

23 Q. Please describe Schedule D-1.

24 A. Schedule D-1 shows the test year capital structure and cost of capital  
25 based on the recommendations contained in Mr. Rosenberg's testimony.  
26 That schedule also shows the fair value rate of return using Mr.  
27 Rosenberg's proposed capital structure and cost rates.

28

29

1

2 Q. What does Schedule D-1A show?

3 A. Schedule D-1A sets forth Citizens' actual capitalization and capital structure  
4 for the test year, as well as the actual cost of preferred securities and long-  
5 term debt. The schedule also shows the components of the long-term debt  
6 capitalization amount. This information is provided in accordance with the  
7 Commission's standard filing requirements. However, the Company is  
8 proposing the capital structure and costs based on Mr. Rosenberg's  
9 testimony, which is shown on Schedule D-1.

10

11 Q. Please describe Schedule D-2A.

12 A. Schedule D-2A presents the AGD's actual cost of long-term debt. This  
13 information is shown in compliance with the Commission's standard filing

14

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1 requirements. However, as Mr. Rosenberg explains, the Company is using  
2 a cost of debt based on a group of proxy companies identified in Mr.  
3 Rosenberg's testimony.

4  
5 Q. What is shown on Schedules D-3 and D-3A?

6 A. The standard filing requirements include a schedule showing the cost of  
7 preferred stock. As Mr. Rosenberg states, the capital structure based on  
8 his proxy group has no preferred stock. However, for purposes of  
9 complying with the Commission's standard filing requirements, Schedule D-  
10 3A, ~~page 2,~~ shows the detailed cost of Citizens' existing preferred stock.

11  
12 **FINANCIAL PROJECTIONS**

13 Q. Please describe briefly what information is contained in Section F of the  
14 AGD's rate application.

15 A. Section F contains Schedules F-1 through F-4. These schedules present  
16 financial data for the test year ended December 31, 2001, and the  
17 projected year ending December 31, 2002. Schedule F-1 shows income  
18 statements for the test year and for the projected year ending December  
19 31, 2002, at present and proposed rates. Schedule F-2 identifies the  
20 changes in financial position for the test year and for the projected year at  
21 both present and proposed rates. Schedule F-3 lists construction  
22 expenditures for the test year ended December 31, 2001, and the  
23 projected construction expenditures for calendar years ending 2002, 2003  
24 and 2004. Schedule F-4 provides the assumptions used to develop these  
25 Section F projections.

1 **INTRODUCTION**

2 Q. Please state your name.

3 A. My name is Raymond J. Mason.

4  
5 Q. By whom and in what capacity are you employed?

6 A. I am employed by Citizens Communications Company ("Citizens") and its  
7 subsidiaries as Director, Corporate Regulatory Affairs. This includes both  
8 the Northern Arizona Gas Division ("NAGD") and the Santa Cruz Gas  
9 Division ("SCGD") that are identified as the Arizona Gas Division ("AGD" or  
10 the "Company") for this combined rate case application.

11  
12 Q. Please state your business address.

13 A. My business address is 3 High Ridge Park, Stamford, Connecticut 06905.

14  
15 Q. What are your duties and responsibilities in your current position?

16 A. As Director of Corporate Regulatory Affairs, I am involved in a wide range  
17 of issues that affect numerous items that arise in Citizens' regulatory  
18 proceedings. Among other duties, I am responsible for the preparation,  
19 review, and presentation of the allocation of corporate costs to the  
20 operating units of Citizens, including the NAGD and SCGD. I am  
21 responsible for the development of Citizens' positions regarding the  
22 allocation of common costs and recovery of those costs in regulatory  
23 proceedings. In addition, I oversee the preparation of depreciation studies  
24 and have testified concerning capital recovery before state and federal  
25 regulatory commissions.

1 Q. Please describe your education, training and other experience

2 A. I graduated from the University of Connecticut with a Bachelor of Science  
3 degree in Accounting and a Bachelor of Arts Degree in Economics. I also  
4 have an Associates Degree in Computer Programming. Since joining  
5 Citizens, I have attended numerous seminars in the fields of capital  
6 recovery and public utility ratemaking. I have attended and appeared as a  
7 panelist in conferences concerning state and federal regulatory issues. In  
8 addition, I have prepared, directed and reviewed depreciation studies for  
9 many of Citizens' operating divisions and subsidiaries.

10  
11 I have presented testimony on behalf of Citizens in the states of Arizona,  
12 California, Hawaii, Ohio, Illinois, Louisiana, New York, Nevada,  
13 Pennsylvania, West Virginia, and Vermont. My testimony addressed areas  
14 of the rate base and the income statement, including employee benefits,  
15 executive compensation, property insurance, property liability and personal  
16 damages, incentive compensation, and depreciation.

17  
18 Q. Please describe your employment history with Citizens.

19 A. I joined Citizens in May of 1988, as Senior Financial Tax Accountant, with  
20 responsibility for financial tax accounting as it relates to tax depreciation,  
21 deferred income taxes, reconciliation between financial and tax accounting,  
22 and related consolidation entries. In September of 1989, I was promoted  
23 to Supervisor of Capital Recovery and Plant Analysis, where I focused on  
24 book depreciation, Industrial Development Revenue Bond ("IDRB")  
25 financing, and Allowance for Funds Used During Construction ("AFUDC")  
26 accounting. I was promoted to Manager of Corporate Regulatory Affairs in  
27 June of 1993 and to my current position in July of 1994.

28

29

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

2 A. I will present direct testimony on:

- 3 • General Description of the Contents of the Application
- 4 • Testimony Responsibilities
- 5 • Summary of Financial Statements ("A" Schedules)
- 6 • Net Common Plant Allocation
- 7 • Reconstruction Cost New ("RCN") Rate Base Calculation
- 8 Methodology
- 9 • AFUDC Calculation Compliance
- 10 • Computation of Working Capital (Schedule B-5)
- 11 • CARES Program (Schedule B-11)
- 12 • Salaries and Wages (Schedule C-2, Adjustment B)
- 13 • Regulatory, Miscellaneous and Per Diem (Schedule C-2,
- 14 Adjustment D)
- 15 • Insurance Expense (Schedule C-2, Adjustment E)
- 16 • Injuries and Damages Expenses (Schedule C-2, Adjustment F)
- 17 • Welfare and Pension Benefits Expenses (Schedule C-2,
- 18 Adjustment G)
- 19 • Stamford Administrative Office ("SAO") Expense (Schedule C-2.
- 20 Adjustment L)
- 21 • Public Service Organization ("PSO") Expenses (Schedule C-2,
- 22 Adjustment L)
- 23 • LAN - WAN - Email Services ("LWES") Expense (Schedule C-2.
- 24 Adjustment L)
- 25 • CARES Discount and Expense (Schedule C-2, Adjustment Q)
- 26 • Cost of Debt and Preferred Stock ("D" Schedules)
- 27 • Projections and Forecasts ("F" Schedules)

1 **OVERVIEW OF APPLICATION**

2 Q. Please describe the contents of the filing.

3 A. The application is made in accordance with the requirements of Arizona  
4 Administrative Code Section R14-2-103. Data for the NAGD and SCGD is  
5 filed on a combined AGD basis. This filing is organized into nine sections:

- 6 • Section A contains summary financial statements.
- 7 • Section B includes the required rate base schedules.
- 8 • Section C includes test period operating revenues and expenses  
9 schedules with related adjustments.
- 10 • Section D contains schedules presenting capital structure and the  
11 costs of capital.
- 12 • Section E includes schedules containing historical financial  
13 information.
- 14 • Section F reflects forecasted financial information.
- 15 • Section G contains the customer class cost of service study.
- 16 • Section H includes test year revenue and sales data and the proposed  
17 tariffs reflected the rate increases being sought.
- 18 • Section I of the application includes the working papers prepared in  
19 support of the filing.

20 These schedules were filed as part of this rate application and are found in  
21 their own bound volume.

22  
23 Q. What test year is reflected in the Company's filing?

24 A. The application reflects a historical test year ended December 31, 2001,  
25 normalized and adjusted for certain known and measurable changes in  
26 prices and rates that have occurred through June 30, 2002, and an end-of-

1 period rate base, presented on both a net original cost and depreciated  
2 reproduction cost basis.

3  
4 Q. What is the amount of the requested annual increase in gross revenues?

5 A. The requested increase in annual revenues is \$21,005,521, or 28.93  
6 percent.

7  
8 Q. When were the most recent rate cases for the NAGD and the SCGD?

9 A. On October 29, 1996, the Arizona Corporation Commission ("Commission")  
10 issued Decision No. 59875, approving a settlement agreement between the  
11 NAGD and the parties to the case. The Decision approved a \$2.7 million  
12 annual increase in revenues. The twelve-month test year ended on June  
13 30, 1995.

14  
15 The last rate order for the SCGD was Commission Decision No. 55585,  
16 issued on June 3, 1987, providing for an \$86,824 reduction in annual  
17 operating revenues. The test year used in that proceeding was the twelve  
18 months ended June 30, 1985.

19  
20 **TESTIMONY RESPONSIBILITIES**

21 Q. Please identify the other witnesses filing direct testimony in support of the  
22 Company's application and their respective issue areas.

23 A. The other witnesses filing direct testimony are:

- 24 ● Mr. Kenneth Cohen, President and Chief Operating Officer of the Public  
25 Service Sector ("PSS") (and the Vice President and Controller of the PSS  
26 during the test year) will testify on the need for rate relief, the  
27 consolidated filing of the Arizona gas properties, the accounting systems

1 and procedures used by the PSS, corporate policy, and the status of  
2 Citizens' plans for divesting its public services properties.

- 3 • Mr. Gary Smith, the Vice President and General Manager of the Arizona  
4 Gas Division, will testify on the Arizona Gas operations and service  
5 territories, the need for rate relief, the recently completed NAGD Build-  
6 Out Program, budgeted capital expenditures and operating results  
7 underlying the projected financial data reflected in the filing, the  
8 consolidation of the two Arizona gas operations for ratemaking and  
9 operational purposes, the sale of the Yale Street office building,  
10 programs benefiting low income customers, and the transfer of a gas  
11 line from the Santa Cruz Electric Division to the SCGD; and the  
12 increased requirements and safety standards at both federal and state  
13 level.
- 14 • Mr. Kevin Doherty, Regulatory Manager for Citizens Communications  
15 Company, will testify on all of the rate base components (except working  
16 capital and accumulated deferred income taxes) including plant-related  
17 items, contributions and advances in aid of construction, gains on sale of  
18 utility property, customer deposits, and yet-to-be disbursed amounts  
19 collected under the Company's Warm Spirit Program. Mr. Doherty's  
20 testimony also addresses the income statement and summary of pro  
21 forma adjustments, certain revenue adjustments, certain expense  
22 adjustments relating to uncollectible expenses, depreciation, lease  
23 expenses, gains on sale, Y2K expenses, and postage expenses. He will  
24 present the Gross Revenue Conversion Factor. In addition, Mr. Doherty  
25 is sponsoring the Section E schedules containing recorded historical  
26 financial and statistical data for the test year and two preceding calendar  
27 years.

- 1       • Mr. Anthony Apuzzo, Director of Tax and Actuarial Compliance for  
2       Citizens Communications Company, will testify on the balance of  
3       Accumulated Deferred Income Taxes deducted from rate base. He will  
4       also testify to certain operating expense items relating to taxes other  
5       than income taxes, an adjustment pertaining to prior period tax refunds,  
6       and Federal and State income taxes.
- 7       • Dr. Ronald White, Executive Vice President and Senior Consultant of  
8       Foster Associates, Inc., will testify in support of proposed new book  
9       depreciation rates.
- 10      • Mr. Robert Rosenberg, Principal of Edgewood Consulting Inc., will testify  
11      about the cost of capital and appropriate capital structure. He is  
12      sponsoring certain schedules contained in Section D of the Company's  
13      application.
- 14      • Mr. John Cogan, Managing Member of The Johnco Group, LLC, will testify  
15      regarding proposed changes to the Company's Transportation of  
16      Customer-Secured Gas tariff, the AGD's Negotiated Sales Program, and  
17      the Company's base cost of gas.
- 18      • Mr. James Harrison, Vice President of Management Applications  
19      Consulting, Inc., will testify regarding annualized and weather-  
20      normalized customer revenues. He will also explain the fully-allocated,  
21      embedded customer class cost of service study and his proposed new  
22      tariffs, as presented in Sections G and H, respectively.

1 **SUMMARY OF FINANCIAL STATEMENTS**

2 Q. Please describe Schedule A-1 contained in Section A of the Company's  
3 application.

4 A. Schedule A-1 presents the calculation of the increase in gross annual  
5 revenues required by the AGD based on the test year ended December 31,  
6 2001. This schedule shows the rate of return on the fair value rate base at  
7 present rates. It compares the adjusted test year operating income with  
8 the required operating income, computed as the product of the end-of-test-  
9 year rate base and the requested rate of return. The resulting operating  
10 income deficiency is then converted to the equivalent annual increase in  
11 revenues by using the Gross Revenue Conversion Factor.

12  
13 Q. Please describe Schedule A-2.

14 A. Schedule A-2 is the Summary Results of Operation. Gross revenues,  
15 operating revenue deductions and operating income are shown for the  
16 twelve months ended December 31, 1999, December 31, 2000, and for the  
17 test year ended December 31, 2001, as recorded. The test year data are  
18 shown at present and proposed revenue levels. This information is also  
19 presented for the projected year 2002, calculated at present and proposed  
20 rates.

21  
22 Q. What is shown on Schedule A-3?

23 A. Schedule A-3 is a Summary of Capital Structure, based on Citizens' actual  
24 capital structure, for the years 1999, 2000, 2001 and the projected year  
25 2002. That schedule also provides the pro forma capital structure that Mr.  
26 Rosenberg has recommended be used in this case. Schedule A-3 further  
27 shows the calculation of fair value rate base using an equal weighting of

1 fifty percent for the reproduction costs and original cost components.  
2

3 Q. Please describe Schedule A-3A.

4 A. Schedule A-3A, page 1, shows the detail underlying the Citizens capital  
5 structure for 1999, 2000, and 2001 set forth on Schedule A-3. Page 2 of  
6 that schedule presents the year-end weighted cost rate for Citizens' debt  
7 and preferred stock for the years 1999, 2000, 2001 and projected for year  
8 2002. The earned common equity amount (for 1999, 2000, and 2001)  
9 shown on that page represents Citizens' achieved net income divided by  
10 common equity, and is not a calculated cost of equity consistent with the  
11 testimony provided by Mr. Rosenberg.  
12

13 Q. What information is provided on Schedule A-4?

14 A. Schedule A-4 presents information concerning the construction  
15 expenditures, net plant placed in service and gross utility plant in service  
16 for the twelve months ended December 31, 1999 and 2000, and the test  
17 year ended December 31, 2001. In addition, construction expenditures,  
18 net plant placed in service and gross utility plant in service are projected  
19 for the years 2002, 2003 and 2004.  
20

21 Q. Please describe Schedule A-5 of the Company's application.

22 A. Schedule A-5 is a Summary of Changes in Financial Position. This  
23 information is shown for the twelve months ended December 31, 1999, and  
24 December 31, 2000, and for the test year ended December 31, 2001, as  
25 recorded. The December 31, 2002, projected data is shown at present and  
26 proposed revenue levels.  
27  
28  
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1  
2 **NET COMMON PLANT ALLOCATION**

3 Q. Has the AGD included a portion of the net common plant for SAO, PSO,  
4 LWES or the Phoenix Administrative Office in its request for new rates in  
5 this proceeding?

6 A. No. For this rate proceeding, Citizens has chosen to not seek recognition in  
7 rate base (or associated expenses) of the portion of net common plant  
8 from these administrative offices relating to the services provided to AGD.  
9 As a result, net common plant is not reflected in the plant, accumulated  
10 depreciation, or accumulated deferred income taxes components of rate  
11 base.

12  
13 Q. Is this consistent with previous Citizens rate applications and approved  
14 Commission treatment?

15 A. No, it is not. Historically, Citizens has sought and received recovery of a  
16 portion of net common plant allocated to the operation under consideration  
17 in rate proceedings brought before this Commission. Citizens has chosen  
18 to exclude these items from consideration for this rate application in an  
19 effort to narrow the focus on the key components of the requested rate  
20 increase. Instead, this rate application focuses on the capital investment in  
21 plant to extend natural gas facilities to unserved areas and to maintain and  
22 improve its existing facilities.

23  
24 Q. What is the nature of this common plant for these administrative offices?

25 A. This plant includes office furniture, computers and office equipment that  
26 are used in an administrative office for the administrative office personnel  
27 to perform their services to operating properties.

1

2 Q. How was the net common plant allocated in previous rate proceedings in  
3 this jurisdiction?

4 A. It was allocated using the four-factor allocation, described in my discussion  
5 of SAO costs below.

6  
7 Q. Does Citizens agree, by making this adjustment in this filing, that these  
8 items should not be included in rate base or expenses for ratemaking  
9 purposes?

10 A. No it does not. Citizens has been and continues to be of the opinion that  
11 net common plant should be included and, correspondingly, should be  
12 recovered in rates. These plant assets are necessary and appropriate and  
13 are neither extraordinary nor excessive for a typical utility office.

14  
15 Q. Why then is Citizens voluntarily making this adjustment?

16 A. The adjustment is offered in an attempt by Citizens to remove from  
17 contention items that have a lesser impact on rates, but have in the past  
18 required a significant expenditure of human, financial and other resources  
19 to support. By eliminating issues, the customers, Citizens, and all parties  
20 involved will benefit from this approach.

21  
22 Q. Does the inclusion of this adjustment mean that Citizens intends to forgo  
23 recovery of such plant items in future rate filings?

24 A. Absolutely not. The adjustment being offered here regarding the net  
25 common plant for the identified administrative offices is unique to this  
26 filing. It is not meant to waive Citizens' right to include net common plant  
27 in any future rate applications in this or any other jurisdiction. Citizens in

28

29

1 no way intends to establish any precedent for future filings with respect to  
2 the treatment of these plant items.

3  
4 Q. Has the Company reflected the common plant adjustment made to rate  
5 base components in its depreciation expense calculation?

6 A. Yes, it has. Consistent with the elimination of common plant allocations in  
7 rate base, the AGD has excluded depreciation expense for the amounts  
8 associated with that plant from this case.

9  
10 **RECONSTRUCTION COST NEW RATE BASE**

11 Q. What is the total adjusted reconstruction cost new less depreciation rate  
12 base ("RCN") for the combined AGD at test year-end?

13 A. The total adjusted RCN rate base for AGD is \$190,131,622. As Mr. Doherty  
14 explains, Schedule B-3 summarizes the recorded utility plant in service and  
15 accumulated depreciation using RCN values. Schedule B-4 lists the original  
16 cost and trended RCN value for AGD by each plant account. The original  
17 cost for contributions in aid of construction ("CIAC"), advances in aid of  
18 construction and the amortization of CIAC have been trended for inclusion  
19 in this RCN rate base calculation.

20  
21 Q. What trending indices are used in establishing the trended RCN values?

22 A. The Handy-Whitman Indices for Gas Utility Construction, Plateau Region,  
23 were used for other production plant, transmission and distribution plant,  
24 as well as structures and improvements. For general plant, the Producer  
25 Price Index was used.

1 Q. Have these indices been used in prior rate applications for this and other  
2 Citizens' operations before the Commission?

3 A. Yes. They were used for the two previous NAGD cases and in all other  
4 recent Citizens' rate cases for determining the RCN values.  
5

6 Q. How is the RCN plant amount calculated?

7 A. The base established for a vintage asset of specific plant account is divided  
8 by the corresponding Handy-Whitman valuation index. The result is a  
9 trend factor that is multiplied by the original cost of the vintage asset,  
10 producing the trended cost consistent with reconstruction cost for that  
11 plant new.  
12

13 Q. Are there elements to the RCN rate base that are not trended?

14 A. Yes, there are. A detail summary of all the components are found in  
15 column 2 of Schedule B-1.  
16

17 Q. Does the proposed RCN rate base reflect all adjustments ordered in  
18 Decision No. 58664 for Original Cost Rate Base ("OCRB") by the  
19 Commission?

20 A. Yes, it does.  
21

22 **AFUDC CALCULATION COMPLIANCE**

23 Q. Please explain the basis for your testimony relating to AFUDC.

24 A. In conjunction with Docket Nos. E-1032A-94-0139, et. al, Citizens filed a  
25 Joint Application for an Order Approving the Accounting Method used to  
26 Record an AFUDC. The application sought approval from the Commission  
27 of the accounting method used to record an allowance for funds used  
28  
29

1 during construction on IDRBs. As a result of those and related  
2 proceedings, Citizens, Staff, and the Residential Utility Consumers Office  
3 ("RUCO") reached a Settlement Agreement, which the Commission adopted  
4 in Decision No. 61848, dated July 21, 1999. A copy of that Decision has  
5 been provided as Exhibit RJM-01, pages 1-14.  
6

7 Q. What were the terms of the Settlement Agreement?

8 A. Citizens agreed to use the procedures outlined in the Settlement  
9 Agreement for the calculation of AFUDC and for AFUDC in connection with  
10 the Federal Energy Regulatory Commission's Release Number 13 ("AR-13  
11 AFUDC") for all of its Arizona utility operations. The Settlement Agreement  
12 outlined a ten-step process, with relevant characteristics, for each of the  
13 areas/properties identified within the Settlement Agreement. Other  
14 procedures for calculating AFUDC in subsequent years described in the  
15 Settlement Agreement included:

- 16 • Use of a budgeted rate for the ten months of the following year  
17 (p. 6, line 10-12);
- 18 • Preparation of an initial "true-up" calculation to be used for the  
19 months of November and December (p. 6, line 13-16); and
- 20 • Performing a final true-up for the previous year by June of each  
21 successive year (p. 6, line 18-19).

22  
23 Additionally, the parties agreed that if the difference between the initial  
24 true-up AFUDC and the final AFUDC rate were more than 25 basis points,  
25 Citizens would make an adjustment to the financing costs in the final true-  
26 up year. If the difference were 25 basis points or fewer, no adjustment  
27 would be made.  
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Q. Did the Settlement Agreement address details of the mechanics of the calculation that are exclusive to AR-13 AFUDC?

A. Yes, it did. The Settlement Agreement provided specific procedures to be used in calculating AR-13 AFUDC. In the copy of Decision No. 61848 provided as Exhibit RJM-01, pages 1-15, these specific procedures can be referenced.

Q. Were there any other conditions in the Settlement Agreement directly pertinent to this rate application?

A. Yes. Citizens agreed that it would provide the Commission, in each of its future rate cases, a comparative calculation showing the AFUDC rates and overall rate of return using short-term debt, as part of the long-term debt component, as compared with using short-term debt as part of the AFUDC calculation.

Q. Has Citizens made such a comparative calculation available for this rate proceeding?

A. Yes it has. Exhibit RJM-01, page 16, provides the required comparison.

Q. Has compliance with this Decision No. 61848 been reflected in this rate application?

A. Yes. Citizens has exceeded the 25 basis points threshold difference between the initial true-up and the final true-up. Correspondingly, it is necessary for an adjustment to be made to the plant basis to reflect the terms of the Settlement Agreement. Mr. Doherty is sponsoring the calculation and proposed rate base adjustment associated with the AR-13

1 AFUDC.  
2

3 **COMPUTATION OF WORKING CAPITAL**

4 Q. Please describe Schedule B-5.

5 A. Schedule B-5 summarizes the allowance for working capital requested by  
6 the Company in this proceeding. Working capital is a measure of investor  
7 funding for daily operating expenditures and non-plant investments that are  
8 needed to support ongoing operations. This Schedule consists of three  
9 pages, labeled Schedule B-5, Schedule B-5A and Schedule B-5B.  
10

11 Q. Please explain how working capital requirement on Schedule B-5 was  
12 determined.

13 A. The working capital requirement was determined through a lead/lag study,  
14 as required by the Commission for Class A gas utilities the size of AGD.  
15

16 Q. Does the Company's methodology conform to recommendations of other  
17 parties in prior Citizens cases?

18 A. Yes. The AGD has conformed elements of the lead/lag study to prior Staff  
19 lead/lag schedules and recommendations in prior Citizens rate cases in  
20 Arizona. For instance, depreciation expense has been excluded from the  
21 study and interest expense has been included. The same lag days are  
22 shown for rate case expense as were used by Staff in prior Arizona Electric  
23 Division and prior Arizona gas cases. The lag days used for interest  
24 expense represents an average of the positions presented in prior Citizens  
25 Arizona cases by Staff and the Residential Utility Consumer Office.  
26  
27  
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29

1 Q. How did you determine the lead or lag days for other expense items?

2 A. In order to determine the lead or lag days for other expense items, all  
3 invoices were reviewed for the calendar year 2001. Because gas purchases  
4 represent a significant portion of total test year expenses, and because  
5 Enron ceased to be a supplier to the AGD, the Company sampled invoices  
6 from the months of November 2001 through February 2002 for this item.  
7 This time period is considered representative of the costs that will be  
8 incurred in the first year of new rates.

9

10 Q. What is the amount of working capital included in rate base?

11 A. As shown on line 35 of Schedule B-5, the amount of working capital  
12 included in rate base is a negative \$2,924,219.

13

14 Q. Please describe Schedules B-5A and B-5B.

15 A. Schedule B-5A shows the reconciliation of expenses for the lead/lag study.  
16 Schedule B-5B presents the distribution of the working capital amount  
17 among the various cost of service classes.

18

19 **CARES PROGRAM**

20 Q. Please summarize Schedule B-11.

21 A. The settlement agreement approved in the last NAGD rate case provided  
22 for an annual revenue increase that included an annual \$100,000 allowance  
23 for Low Income Residential Assistance Programs. As more fully described  
24 in the testimony of Mr. Smith, that includes CARES Program discounts and  
25 other low-income initiatives. In approving the settlement agreement,  
26 Commission Decision No. 59875 provided that Citizens create a special  
27 balance sheet account for tracking the program costs and recoveries.

28

29

1  
2 Specifically, as described in Decision No. 59875, beginning at line 18 on  
3 page 4, Citizens should "calculate a recovery rate for the Programs by  
4 dividing the \$100,000 annual allowance by the total test year normalized,  
5 annualized sales therms." Using the final adjusted test year sales of  
6 102,040,360 therms in that rate case produces an implied cost recovery  
7 rate of \$.00098 per therm. All program costs are to be charged to a special  
8 balance sheet amount. At the end of each month, the total sales billed are  
9 to be multiplied by the cost recovery rate to establish a measure of  
10 Program costs billed to ratepayers. The computed amount is to be  
11 deducted from the balance sheet account and charged to operating  
12 expenses. If customer revenues from the CARES surcharge exceed the  
13 low-income program expenses and discounts, the balance sheet account  
14 increases.

15  
16 The rate base element labeled "CARES" represents the cumulative  
17 difference between the amount incurred in connection with CARES  
18 discounts and other low-income programs and amounts recovered in  
19 current service rates since they were implemented in November 1996.  
20 Schedule B-11 reflects the development of the required balance in the  
21 special tracking account as of the end of the test year. The \$364,945 credit  
22 balance is identified as a deduction from rate base.

23  
24 There is a companion adjustment (Schedule C-2, Adjustment Q) relating to  
25 the annual pro forma amortization expense level proposed for inclusion in  
26 operating expenses.  
27

1

2 **SALARIES AND WAGES**

3 Q. Please explain the Salaries and Wages calculation.

4 A. Adjustment B to Schedule C-2 adjusts test year salary and wage expense to  
5 reflect an annualized level. It reflects the actual number of active  
6 employees plus temporary vacancies (in previously filled positions) existing  
7 at the end of the test year. This adjustment was computed using the most  
8 current known and measurable salary and wage rates. The computation  
9 also reflects an average annual overtime level for the past five years and  
10 the actual test year account distribution of payroll expense.

11

12 **REGULATORY, MISCELLANEOUS AND PER DIEM EXPENSES**

13 Q. Please describe Adjustment D on Schedule C-2.

14 A. Adjustment D on Schedule C-2, provides a summary of the estimated legal,  
15 regulatory, consulting and special studies expenses, as well as  
16 miscellaneous and per diem expenses for this filing. These expenses are  
17 broken into two groups: (1) the current rate case annual amortization and  
18 (2) ongoing amortization of the Build Out Program allowed expense from  
19 the last rate case.

20

21 Q. Please describe how the amount of rate case expense for this application  
22 has been estimated.

23 A. The basic procedure is the same as the procedure used by Citizens in other  
24 cases filed before this Commission. First, after a review of the filing  
25 requirements and potential issues in the proceeding, the Company  
26 determined subject-matter witnesses and, where necessary, identified and  
27 contacted outside consultants. Second, outside consultant cost estimates

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29

1 are made. Third, for the SAO, PSO, and LWES personnel, the Company  
2 estimated the travel, lodging, meals, and other out-of-pocket costs  
3 required to participate in the rate case proceeding. As in prior cases, all  
4 estimates will be replaced with actual charges as soon as the actual  
5 charges are available.

6  
7 Q. Does the rate case expense reflect any salaries and wages costs for any  
8 Citizens employees listed on the AGD payroll or charged to AGD from  
9 affiliates in other sections of the test year income statement?

10 A. No. Neither the employees on the payroll of AGD or Citizens affiliates are  
11 included in the estimates for rate case expenses. Only the direct (travel,  
12 lodging, meals and other out-of-pocket) expenses described previously are  
13 being requested concerning internal employees.

14  
15 Q. Will these estimates be updated as the rate case is processed?

16 A. Yes. We will update the expenses with supporting documentation and  
17 replace the estimates with actual amounts.

18  
19 Q. Is the AGD proposing to recover the full amount of its estimated rate case  
20 expenses?

21 A. No, it is not. For purposes of this proceeding, I reviewed Commission-  
22 authorized rate case expenses for prior Citizens rate cases in Arizona. I  
23 used those prior allowances, adjusted for inflation, to derive the rate case  
24 expense for which the AGD is seeking recovery in this proceeding. This  
25 requested amount is considerably lower than the costs the Company  
26 expects to incur, as shown on Adjustment D of Schedule C-2.

1 Q. What period has been used for the amortization of rate case expense  
2 requested in this application?

3 A. The total requested current rate case expenses of \$500,000 have been  
4 amortized over a three-year period, as shown in Schedule C-2, resulting in  
5 annual amortization of \$166,667. This period is consistent with  
6 amortization periods in prior Citizens' Arizona rate cases.

7  
8 Q. Please describe the component of Adjustment D relating to Build Out  
9 Program case expenses.

10 A. In Decision No. 59875, issued October 29, 1996, the Commission  
11 authorized the NAGD to amortize case expenses of \$125,000 associated  
12 with the Build Out Program over a ten-year period. The amount shown in  
13 Adjustment D includes one year's amortization of those costs.

14  
15 **INSURANCE EXPENSE**

16 Q. Please describe Adjustment E in Schedule C-2.

17 A. Adjustment E of Schedule C-2 provides the 2001 recorded test year ending  
18 insurance expense for AGD, the pro forma insurance expense, and the  
19 resultant pro forma adjustment. Exhibit RJM-02 lists the insurance  
20 coverages and details the calculation for each of the pro forma insurance  
21 coverages included in the pro forma total. Insurance expense for AGD  
22 consists of: (a) all-risk property insurance; (b) comprehensive crime  
23 insurance; (c) directors and officers insurance; (d) fiduciary and excess  
24 fiduciary insurance; (e) travel accident insurance; (f) bond insurance; and  
25 (g) other miscellaneous insurances. The amounts for 2001 reflect actual  
26 insurance expense charged to AGD.

27

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29

1 Q. How are the specific insurance coverage expenses calculated?

2 A. The coverages are common to all the regulated operations of Citizens and  
3 are negotiated for Citizens in total, or for a specific utility service where  
4 appropriate. The expense is apportioned based on a rate per property  
5 value amount for all-risk insurance. Expenses for all other insurance  
6 coverages are allocated using (i) the number of employees, (ii) the four-  
7 factor formula, or (iii) a ratio of the AGD coverage item as a percentage of  
8 total item coverage, as appropriate for each type of coverage.

9

10 Q. What is the total pro forma insurance expense for the AGD?

11 A. The total pro forma expense requested in this proceeding for the AGD, as  
12 shown on Schedule C-2, is \$114,036.

13

14 Q. What is the total pro forma insurance expense adjustment?

15 A. The total pro forma insurance expense adjustment is an increase of  
16 \$11,255 from the recorded amount.

17

18 **INJURIES AND DAMAGE EXPENSES**

19 Q. Please explain Adjustment F in Schedule C-2.

20 A. This adjustment restates recorded expenses for injuries and damages to  
21 pro forma levels. Pro forma amounts for comprehensive general liability,  
22 general coverage and worker's compensation are based on property  
23 specific information, such as number of employees, pro forma salaries and  
24 wages, premium liability factors, and the four- factor formula. Schedule C-  
25 2, Adjustment F provides the calculation for the pro forma expense.

26

27 Q. What is the basis on which the recorded amount is calculated?

28

29

1 A. The year-end 2001 recorded amount for test year-end injuries and  
2 damages expenses is based on the allocated portion of the total policy  
3 premium for comprehensive general liability and excess general liability.  
4 The general coverage insurance is determined at a per customer rate, while  
5 the worker's compensation amount is calculated by multiplying a rate  
6 based on job classification times the total salaries for that job classification  
7 rate per \$100 multiple times the estimated percentage increase in the total  
8 premium for the coverage. The specific formulas are set forth in Exhibit  
9 RJM-03.

10  
11 Q. What is the total pro forma injuries and damages expense for the AGD?

12 A. The total pro forma injuries and damages expense requested in this  
13 proceeding is \$ 282,564. The calculation of this amount is shown on  
14 Exhibit RJM-03.

15  
16 Q. What is the total pro forma injuries and damages expense adjustment?

17 A. The total pro forma insurance expense adjustment is an increase of  
18 \$54,158 from the recorded amount.

19  
20 **EMPLOYEE WELFARE AND PENSION BENEFITS EXPENSES**

21 Q. Please describe Adjustment G in Schedule C-2.

22 A. Adjustment G provides a summary of the employee welfare expense and  
23 pension expenses for the pro forma levels. The employee benefits costs  
24 consist of: (a) medical and dental benefit; (b) vision care; (c) long-term  
25 disability; (d) personal accident insurance; (e) group life insurance; (f)  
26 pension benefit; (g) 401K; and (h) the Incentive Deferred Compensation  
27 Program ("IDCP"). The pro forma expense of \$2,109,756 is an increase  
28

1 from that for the 2001 year-end recorded expense level. The calculation of  
2 the expense for each of these benefits is contained in the Exhibit RJM-04.

3  
4 Q. How much is the total pro forma employee welfare and pension  
5 adjustment?

6 A. The total pro forma employee welfare and pension adjustment is an  
7 increase of \$369,753 from the recorded level.  
8

9 **STAMFORD ADMINISTRATIVE OFFICE EXPENSE**

10 Q. What is the SAO?

11 A. The Stamford Administrative Office, located in Stamford, Connecticut,  
12 provides essential services to all divisions and subsidiaries of Citizens,  
13 mainly by providing oversight and policy guidance for all Citizens'  
14 operations. The specific services provided include the following:

- 15 • Internal audit
- 16 • Corporate & Consolidation accounting
- 17 • Financial Reporting
- 18 • Tax Accounting
- 19 • Information Systems Support
- 20 • Risk & Cash Management
- 21 • Shareholder & Investment Community Services
- 22 • Corporate & Employee Communication
- 23 • Human Resource & Employee Benefits Policy Oversight
- 24 • Corporate Regulatory
- 25 • Corporate Legal
- 26 • Financing & Investment Services
- 27 • Accounting Policy & Procedures Oversight

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1 Q. What types of expenses are charged to AGD from SAO?

2 A. SAO expenditures incurred on behalf of divisions and subsidiaries include  
3 the following: (a) salaries, payroll taxes, and employee benefits of SAO  
4 personnel who provide services to the AGD; (b) rent, taxes, and other  
5 costs of operation necessary to support the personnel at the SAO; (c)  
6 financing expense, shareholder expense, and directors' fees required for  
7 the operations of the corporation; (d) expense for subscriptions,  
8 memberships in and dues to professional organizations; (e) legal expenses;  
9 (f) travel and per diem expenses relating to each of the above; and (g)  
10 insurance.

11  
12 Q. Please explain the SAO expense calculation.

13 A. Schedule C-2, Adjustment L, page 2 of 4, provides a summary of the  
14 calculation of pro forma SAO expense at test year-end, December 31,  
15 2001. Line 7 provides the corresponding pro forma expense adjustment.  
16 Exhibit RJM-05 summarizes the pro forma administrative office expenses to  
17 be charged to the AGD for the test year.

18  
19 Q. What amount of SAO expenses is charged to AGD in the test year?

20 A. The recorded SAO expense charged to AGD for the test year is \$1,148,857.  
21 The total pro forma SAO expense distributed to AGD operations is  
22 \$435,363. Page 2 of Exhibit RJM-05 provides the details of the pro forma  
23 calculation.

24

25

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1 Q. How were the total SAO expenses distributed to Citizens operations for  
2 year ended December 31, 2001?

3 A. The four-factor formula was used to distribute SAO expenses to operations.  
4

5 Q. What is the four-factor formula?

6 A. This formula, developed by the California Public Utilities Commission in the  
7 1950s, is used for charging general administrative items to separate  
8 operations. It has been shown to be a reasonable method of distributing  
9 general charges. The four-factor formula is a mathematical calculation that  
10 results in an average of the relationship of each property to the total  
11 properties for four elements: (1) utility plant-in-service; (2) operation and  
12 maintenance ("O&M") expense; (3) customers; and (4) payroll charged to  
13 O&M. These four categories represent areas of administrative review and  
14 oversight performed by SAO or other administrative personnel, and also for  
15 common functions. The amounts for each of Citizens' operating divisions  
16 and subsidiaries are listed and the percent of each property is determined  
17 by dividing the property amount by the total amount for the category. The  
18 same process is completed for each of the other three categories and the  
19 four percentages are averaged to obtain the four-factor allocator for each  
20 specific operating property.  
21

22 Q. Has the use of the four-factor method been accepted by this Commission  
23 and other commissions which regulate Citizens' operating properties?

24 A. Yes. It has been reviewed many times and accepted in all proceedings  
25 over the last 25 years.  
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1 Q. How was the pro forma 2001 SAO expense calculation prepared?

2 A. The SAO expense amount for the test year reflects recorded SAO expenses  
3 for the year ending December 31, 2001 with pro forma adjustments.  
4 Exhibit RJM-05, page 2, shows the pro forma SAO Costs calculation  
5 distributed to AGD, adjusted for the pro forma changes that include  
6 previously disallowed items.

7  
8 Q. What events have made the greatest impact upon the distribution of SAO  
9 expenses to AGD since the last rate proceeding?

10 A. Clearly, Citizens' business strategy to pursue the acquisition of telephone  
11 access lines to become a pure telecommunications entity, while seeking to  
12 divest of its public services operations, has had the most profound impact  
13 on the SAO expenses since the last rate proceeding.

14  
15 Q. How have the completed acquisitions of telecommunications operations and  
16 sales of public service operations affected the calculation of the pro forma  
17 SAO expenses charged to AGD?

18 A. Citizens' strategy to become a telecommunications company has resulted in  
19 a significant increase in the number of telecommunications customers  
20 served, while the number of public service customers has declined. These  
21 changes have greatly impacted the amount of SAO expenses allocated to  
22 each operation where the four-factor method of allocation is employed.  
23 The current four-factor allocation reflects a significant reduction for all the  
24 operations of Citizens that received allocable SAO expenses prior to the  
25 close of the announced communications acquisitions by December 2001.

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1 While Citizens also closed on the sale of some public service operations, the  
2 impact of the added communications properties more than offset the effect  
3 of the sale of those public services properties.  
4

5 Q. Has this factor been included into the four-factor formula in the pro forma  
6 allocated SAO expenses?

7 A. Yes, I have. Exhibit RJM-05, page 2, shows the 2001 year-end closing pro  
8 forma four-factor calculation that reflects the telephone access line  
9 acquisitions and the divestitures of public service operations that had  
10 closed as of December 31, 2001. That page also reflects adjustments  
11 made to remove Griffith operations and other related plant adjustments  
12 from the AGD basis.

13  
14 Q. Have other adjustments been made in preparing the pro forma SAO  
15 allocable cost calculation?

16 A. Yes. I have made adjustments to remove items that have previously been  
17 disallowed by the Commission. The items include allocable charges for  
18 divestiture efforts, donations and contributions, and other selected  
19 expenses. In addition, I have removed some items that have not been  
20 denied in previous proceedings but have been of a contentious nature.  
21 These adjustments are summarized on page 2 of Exhibit RJM-05.  
22

23 Q. How is the adjustment calculated and applied to the 2001 SAO expenses?

24 A. The total amount of 2001 SAO expenses to be removed are identified and  
25 then multiplied by the pro forma AGD four-factor to calculate the allocable  
26 amount for AGD. This amount is then subtracted from the unadjusted pro  
27 forma SAO costs being charged to AGD.  
28  
29

1 Q. Have you made any additional adjustments to the pro forma SAO expense  
2 that you are recommending in this case?

3 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
4 experience through the first four months of 2002. I derive this adjustment  
5 by annualizing the monthly average based on 2002 actuals for the first four  
6 months. I then calculated a percentage of annualized 2002 total of the  
7 recorded 2001 total SAO expense, and subtracted 100% from that  
8 calculated percentage. The resulting percentage was applied to the  
9 adjusted 2001 test year total SAO expense for AGD. The amount produced  
10 by that calculation represents my adjustment to reflect 2002 actuals.  
11

12 Q. Is the pro forma SAO expense charged to AGD of \$435,363 a reasonable  
13 amount?

14 A. Yes. The pro forma charges from SAO to AGD are reasonable. Performance  
15 of certain administrative functions by a central office allows AGD to take  
16 advantage of economies of scale that would not otherwise be available.  
17 This means service for the customers of Citizens at reduced costs.  
18 Moreover, the SAO charges represent a portion of the reasonable and  
19 necessary costs that Citizens incurs to operate a publicly-held utility  
20 company. The Commission should allow the AGD to recover its share of  
21 these legitimate operating expenses.  
22

23 **PSO DISTRIBUTED EXPENSE**

24 Q. What is the PSO?

25 A. The Public Service Organization, or PSO, is an administrative support office  
26 located in Louisiana that provides accounting, management information  
27 and engineering services for the PSS of Citizens, which includes all  
28  
29

1 operations and/or properties that provide electric and gas (and previously  
2 water and wastewater) services.

3  
4 Q. Was the same procedure used for the SAO also used to calculate the  
5 amount of PSO charges allocated to AGD?

6 A. Yes, with a slight alteration. Because the services provided by the PSO are  
7 exclusive to the public service segment of Citizens' operations, the four-  
8 factor formula excludes the telecommunications operations from the pool of  
9 operations used in the various factors. The principles and premises that  
10 make use of the four-factor method appropriate are the same as discussed  
11 earlier.

12  
13 Q. Have the details of the Public Service four-factor calculation been provided  
14 in this testimony?

15 A. Yes. Exhibit RJM-05, page 3, summarizes the pro forma calculation. This  
16 calculation excludes the telecommunications operations and amounts  
17 associated with Griffith and the Paulden Line (described in Mr. Doherty's  
18 testimony). This resulted in a four-factor formula allocation of 9.65% for  
19 AGD as of the end of the test year.

20  
21 Q. Where are the charges to AGD from PSO provided in the rate filing?

22 A. The charges for the PSO are included in Schedule C-2, Adjustment L, page  
23 3 of 4. Exhibit RJM-05 provides a summary of the calculation for the  
24 \$971,292 PSO pro forma amount charged to AGD.

1 Q. Have you made any additional adjustments to the pro forma PSO expense  
2 that you are recommending in this case?

3 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
4 experience through the first four months of 2002. I derive this adjustment  
5 in the same manner discussed in connection with SAO expense.  
6

7 Q. What future business decisions could partially offset the increase in costs  
8 being allocated to each public service operation?

9 A. A decrease in the size of staff for PSO would reduce costs being allocated,  
10 but the magnitude of any such reduction cannot be readily determined at  
11 this time.  
12

13 Q. Is the total pro forma PSO expense of \$971,292 charged to AGD a  
14 reasonable amount?

15 A. Yes. The pro forma charges from PSO are reasonable. Using the four-  
16 factor formula ensures that each operation, including AGD, supports its fair  
17 share of all general PSO expenses.  
18

19 There is an additional factor supporting the reasonableness of these  
20 charges. For the purposes of this rate filing, Citizens has capped the  
21 allocable pro forma PSO expenses to an amount that results in a total  
22 administrative offices (i.e., SAO, PSO, and LWES) allocated expense  
23 distribution that is approximately the same as that approved in the last  
24 litigated NAGD rate proceeding. In Decision No. 58664, this amount was  
25 approximately \$1.2 million. Although that proceeding related only to  
26 NAGD, the Company is limiting its request for the whole AGD to that level.  
27 The purpose of this proposed expense limit is to facilitate expeditious  
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1 consideration of this rate application as well as to allow attention to be  
2 directed to the key factor for the requested revenue increase in this  
3 proceeding, the increase in plant investment.  
4

5 **LWES ORGANIZATION DISTRIBUTED EXPENSE**

6 Q. Are there other administrative groups that support the operation of AGD?

7 A. Yes. The LWES Organization, previously known as the Dallas  
8 Administrative Office ("DAO") provides specific computer support, local  
9 area network, intranet management and other information technology-  
10 related services to all of Citizens' operations. This organization has  
11 relocated to Rochester, New York, and continues to provide similar services  
12 to all of Citizens' properties.

13  
14 Q. How are LWES charges distributed?

15 A. For those services described, the charges are distributed using the same  
16 four-factor formula utilized for SAO, since all of Citizens' operations are  
17 beneficiaries of their services.  
18

19 Q. What is the pro forma amount of LWES expenses?

20 A. The pro forma amount is \$59,423 as shown on page 4 of Schedule C-2,  
21 Adjustment L. Exhibit RJM-05, page 4, provides the pro forma calculation  
22 that uses the distribution as of December 31, 2001.  
23

24 Q. Have you made any additional adjustments to the pro forma LWES expense  
25 that you are recommending in this case?  
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1 A. Yes. I have adjusted the 2001 test year amounts to reflect actual  
2 experience through the first four months of 2002. I derive this adjustment  
3 in the same manner discussed in connection with SAO expense.  
4

5 Q. Is the \$59,423 LWES pro forma amount reasonable?

6 A. Yes. The pro forma calculation takes into consideration all the previously  
7 described forces that would work to alter AGD's four-factor allocation. As a  
8 result, the pro forma amount is significantly less than what has historically  
9 been experienced.  
10

11 **CARES DISCOUNT AND EXPENSE**

12 Q. Please explain Adjustment Q, entitled CARES Discount and Expense.

13 A. Adjustment Q represents the operating expense adjustment that  
14 corresponds to the rate base component contained in Schedule B-11. This  
15 adjustment is made to reflect a proper test year amortization of the Low  
16 Income Residential Assistance Program costs as required under the  
17 procedure set forth in Commission Decision No. 59875. It also incorporates  
18 the annual effect of changes being proposed to the CARES program and  
19 other low-income initiatives, as more fully described in Mr. Smith's  
20 testimony.  
21

22 **COST OF CAPITAL**

23 Q. Please describe Schedule D-1.

24 A. Schedule D-1 shows the test year capital structure and cost of capital  
25 based on the recommendations contained in Mr. Rosenberg's testimony.  
26 That schedule also shows the fair value rate of return using Mr.  
27 Rosenberg's proposed capital structure and cost rates.  
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Q. What does Schedule D-1A show?

A. Schedule D-1A sets forth Citizens' actual capitalization and capital structure for the test year, as well as the actual cost of preferred securities and long-term debt. The schedule also shows the components of the long-term debt capitalization amount. This information is provided in accordance with the Commission's standard filing requirements. However, the Company is proposing the capital structure and costs based on Mr. Rosenberg's testimony, which is shown on Schedule D-1.

Q. Please describe Schedule D-2A.

A. Schedule D-2A presents the AGD's actual cost of long-term debt. This information is shown in compliance with the Commission's standard filing requirements. However, as Mr. Rosenberg explains, the Company is using a cost of debt based on a group of proxy companies identified in Mr. Rosenberg's testimony.

Q. What is shown on Schedules D-3 and D-3A?

A. The standard filing requirements include a schedule showing the cost of preferred stock. As Mr. Rosenberg states, the capital structure based on his proxy group has no preferred stock. However, for purposes of complying with the Commission's standard filing requirements, Schedule D-3A shows the detailed cost of Citizens' existing preferred stock.

**FINANCIAL PROJECTIONS**

Q. Please describe briefly what information is contained in Section F of the AGD's rate application.

1 A. Section F contains Schedules F-1 through F-4. These schedules present  
2 financial data for the test year ended December 31, 2001, and the  
3 projected year ending December 31, 2002. Schedule F-1 shows income  
4 statements for the test year and for the projected year ending December  
5 31, 2002, at present and proposed rates. Schedule F-2 identifies the  
6 changes in financial position for the test year and for the projected year at  
7 both present and proposed rates. Schedule F-3 lists construction  
8 expenditures for the test year ended December 31, 2001, and the  
9 projected construction expenditures for calendar years ending 2002, 2003  
10 and 2004. Schedule F-4 provides the assumptions used to develop these  
11 Section F projections.

12

13 Q. Does this complete your direct testimony?

14 A. Yes, it does.

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