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

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates

Application No. 12-04-019
(Filed April 23, 2012)

SUPPLEMENTAL TESTIMONY OF JEFFREY T. LINAM

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Date: December 15, 2015

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Company (U210W) for Approval of the
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SUPPLEMENTAL TESTIMONY OF JEFFREY T. LINAM

I. WITNESS QUALIFICATIONS

Q1. Please state your name, business address and telephone number.
A1. My name is Jeffrey T. Linam. My business address is 1033 B Avenue, Suite 200,
Coronado, CA 92118. My telephone number is (619) 522-6376.

Q2. Have you previously supplied your qualifications in this proceeding?
A2. Yes, I provided my qualifications in my Direct Testimony in this proceeding
which was served on April 23, 2012.

Q3. Are there any changes to your qualifications?
A3. No.

II. INTRODUCTION AND PURPOSE OF TESTIMONY

Q4. What is the purpose of this supplemental testimony?
A4. The purpose of my testimony is to provide an update to certain cost components
within the Monterey Peninsula Water Supply Project (“MPWSP”) model used to
evaluate the plant scenarios and calculate the associated revenue requirements.
This testimony has been prepared in compliance with the November 17, 2015
Administrative Law Judge’s Ruling Setting Evidentiary Issues and Schedule to

1
2 *Complete the Record For Phase 1 and 2* (“November 17, 2015 Ruling”) that
3 requires California-American Water Company (“California American Water” or
4 the “Company”) to provide supplemental testimony with updated MPWSP costs.
5

6 Q5. What specific issues will you cover in your Supplemental Testimony?

7 A5. I will address the following issues related to the financial modeling:

- 8 (i) Discuss changes in the functionality of the MPWSP model;
- 9 (ii) Provide an update to the inflationary factors used in the model;
- 10 (iii) Address future updates to Groundwater Replenishment (GWR)
11 assumptions; and
- 12 (iv) Provide an updated financing and cash flow schedule.

13
14 Q6. You mentioned that your testimony provides an update to certain cost
15 components within the MPWSP model used to compare the project scenarios and
16 calculate the respective revenue requirements. Are others providing testimony to
17 respond to other issues?

18 A6. Yes. Mr. Richard Svindland provides supplemental testimony on the latest
19 capital and operations and maintenance (“O&M”) costs for the two sizes of the
20 desalination plants and related conveyance facilities and pipelines, as well as
21 aquifer storage and recovery. The MPWSP model takes the updated capital and
22 O&M costs along with all of the other assumptions to develop the revenue
23 requirement and cash flow information, which is provided in Attachment 1 and
24 Attachment 2 to my supplemental testimony.
25

26 **III. FUNCTIONALITY OF MPWSP FINANCIAL MODEL**

27 Q7. Briefly discuss the changes in the functionality of the MPWSP model since the
28 last submission of financial data to the Commission.

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A7. The last submission of financial data to the Commission was made on November 22, 2013 in response to the *Administrative Law Judge’s Ruling Setting Forth Questions to be Addressed at the Hearings on the Proposed Settlement Agreements* (“November 4, 2013 Ruling”). The Ruling required California American Water to provide estimated capital and O&M costs for the MPWSP based on the July 31, 2013 Settlement Agreement under various plant sizes. A hearing was subsequently held on December 2, 2013, where witnesses from California American Water and other parties to the Settlement Agreement responded to questions from the Administrative Law Judge on the cost and other information contained in the November 22, 2013 compliance filing.

In response to the November 17, 2015 Ruling, which requests an update to the “estimated costs for the MPWSP, including all of its components,” California American Water made three changes to the functionality of the model. First, an inflation rate for power cost was created as an input to the model to allow for a separate factor to apply to what is the largest component of O&M costs. In the prior version of the model, a single non-labor escalation rate was used to apply to all non-labor costs, including fuel and power. The model now allows for the option to change power cost escalation to better see the impact of changes in power cost assumptions on the revenue requirement calculation and the comparisons under the 9.6 million gallons per day (“MGD”) and the 6.4 MGD plant size. The second change was to eliminate two plant size options that are no longer under consideration, the 6.9 MGD and 9.0 MGD plant sizes. Updated cost information is available for the 9.6 MGD plant and the 6.4 MGD plant with GWR. The supplemental testimony of Mr. Richard Svindland addresses the plant size and associated capital issues. The third change to the model was to incorporate the actual spending to date on the project. The worksheets and

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schedules in the MPWSP model have been updated to reflect actual costs through November 30, 2015. As discussed in the supplemental testimony of Mr. Richard Svindland, the remaining project costs to be spent have been spread over the construction period based on the current cash flow estimates. Lastly, California American Water will continue to work with Monterey Peninsula Water Management District (“MPWMD”) and Monterey Regional Water Pollution Control Agency (“MRWPCA”) to incorporate the financial data for the GWR Project into the MPWSP model so that comparisons can more easily be made of the revenue requirement for the combination of the GWR Project and the 6.4 MGD desalination plant, including the projected debt equivalence for the GWR project, if any, and the revenue requirement for the 9.6 MGD desalination plant. California American Water anticipates these changes to be incorporated into the model to coincide with the January 22, 2016 testimony on the Phase 2 costs. As we have offered previously in this proceeding, we will make the model available to parties upon request. Attachment 1 to this supplemental testimony provides a comparison of the current capital assumptions for the 9.6 MGD plant and the 6.4 MGD plant with GWR and the components of the year 1 revenue requirement for comparison purposes. The capital scenarios align with the latest capital information provided in the supplemental testimony of Mr. Richard Svindland.

Q8. Are there any other comments on the MPWSP financial model that needs to be discussed?

A8. Yes. I would like to include one clarification with respect to Allowance for Funds Used During Construction (“AFUDC”) in the model. As with the November 22, 2013 Compliance Filing, Attachment 1 to this supplemental testimony presents AFUDC in the summary of capital costs capitalized net of tax. It is presented in this fashion because it aligns properly when talking about the

1
2 project costs. However, the revenue requirement presented on Attachment 1
3 reflects the gross up of taxes for AFUDC and is consistent with the income
4 statement presentation in the model.

5
6 **IV. INFLATION FACTORS**

7
8 Q9. Please identify changes in the inflation factors used in the MPWSP model since
9 the last submission to the Commission.

10 A9. There have been changes to four inflation factors used in the MPWSP. Those
11 include: 1) the construction cost index, 2) labor escalation factor, 3) non-labor
12 escalation factor, and 4) the power cost escalator, discussed in question 7 above.

13
14 Q10. Please discuss the rationale for the changes to these four factors.

15 A10. California American Water has updated the construction cost index, which is
16 used to escalate future capital cost replacements. The revised escalation rate of
17 3.2% reflects the latest information for the ENR published Construction Cost
18 Index as of October 2015, which is widely used in the construction industry. The
19 3.2% rate reflects the 10-year average of the historical ENR Construction Cost
20 Index for the period 2004 through 2014. The previous escalation rate of 5.6%
21 was based on a water and sewer maintenance CPI published by the Bureau of
22 Labor Statistics for the 10 year period 2002 through 2012. Mr. Svindland's
23 supplemental testimony discusses the rationale as to why the ENR Construction
24 Cost Index is a preferable measure as to the likely cost escalation for future
25 replacement capital costs.

26
27 The labor and non-labor escalation rates of 1.68% and 0.93%, respectively, are
28 based on the Escalation Memorandum provided by ORA staff, which is based on

1
2 the October 2015 IHS Global Insight U.S. Economic Outlook. The escalation
3 rates are based on an average for years 2014 through 2019. Finally, the power
4 cost escalator is based on a U.C. Davis study titled, “The Future of Electricity
5 Prices in California” dated December 2013¹. The escalation rate is based on the
6 reference case for the PG&E service area that assumes a statewide 33%
7 Renewable Portfolio Standard is achieved, the price of emissions allowances is
8 \$10 per ton in 2012 dollars and the 2020 price of natural gas is \$7.85 per million
9 British thermal units (“MMBtu”)². The nominal rate for 2008-2020 is 4.4% and
10 the real escalation rate is 2.6%. California American Water has assumed a rate of
11 3.0% as a reasonable approximation of the nominal escalation rate in today’s
12 dollars. This rate is further supported by recent projections provided by the
13 California Energy Commission in their January 2014 Statewide Forecast.³
14

15 **V. OTHER FINANCIAL ASSUMPTIONS**

16
17 Q11. Please discuss any additional financial issues to be highlighted.

18 A11. The MPWSP model assumed a price for purchased water from the GWR Project
19 of \$2,500 per acre foot (“AF”) for 3,500 AF. This is consistent with the previous
20 model assumptions. Updates to this assumption are likely to be provided on
21 January 22, 2016 with the testimony on Phase 2 costs. Changes in purchased
22 water costs from GWR impact the revenue requirement for the 6.4 MGD plant
23 with GWR. Finally, all of the financing assumptions from the July 31, 2013
24 Settlement Agreement, use of a customer surcharge during construction, State

25 ¹ <http://eec.ucdavis.edu/files/02-06-2014-The-Future-of-Electricity-Prices-in-California-Final-Draft-1.pdf>

26 ² Ibid, pp. 27-30.

27 ³ http://www.energy.ca.gov/mwg-internal/de5fs23hu73ds/progress?id=0dbJD0I8ok-Yo6SaMi8P1fY3QPz0Q_pgc34SSGPrFjs, Table 7, p.37.
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Revolving Fund (“SRF”) debt, public agency contribution and equity have not changed. However, the model has updated cash flow forecast for the 9.6 MGD and 6.4 MGD plant sizes based on the new expected date for a final decision from the Commission in Phase 1, the new construction schedule and the construction cost forecast provided in the supplemental testimony of Mr. Svindland. The sources of financing and alternatives remain the same. An updated sources and uses or cash flow forecast for 2015 through 2019 is provided as Attachment 2 to this supplemental testimony.

Q12. Does this conclude your supplemental testimony?

A12. Yes it does.

ATTACHMENT 1

**Monterey Peninsula Water Supply Project
Capital and Revenue Requirement Summary**

	<u>9.6 MGD</u>	<u>6.4 MGD</u>
<u>Capital Investment</u>		
Desal Plant	\$227.1	\$211.0
CAW-Only Facilities	110.8	110.8
Capitalized AFUDC, Net of Tax	16.5	15.9
Total Project Cost	\$354.4	\$337.7
<u>Total Cost to Customer</u>		
CAW Pre-Tax Equity Cost	\$17.2	\$16.4
Purchased Water	-	8.8
Depreciation & Amortization	1.1	1.0
General Taxes	1.0	1.0
Other O&M	10.3	7.9
Year 1 CAW Rev Req (\$MM)	\$29.7	\$35.2
Customer SRF Surcharge	5.4	5.1
Public Agency Costs	6.0	5.6
Total Yr 1 Cost to Customer	\$41.1	\$45.8

ATTACHMENT 2

**Monterey Peninsula Water Supply Project
Sources and Uses of Cash**

9.6 MGD Plant

USES OF CASH						
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Total</u>
Desal Plant	\$30.4	\$11.0	\$69.0	\$115.5	\$1.2	\$227.1
CAW-Only Facilities	11.6	4.2	48.4	46.5	0.0	110.8
Total Uses of Cash	\$42.0	\$15.3	\$117.4	\$162.0	\$1.2	\$337.9
SOURCES OF CASH						
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Total</u>
Net CAW Equity	\$11.7	\$6.9	\$50.3	\$11.6	\$2.6	\$83.1
Net CAW LT Debt	0.0	0.0	0.0	0.0	0.0	0.0
Net CAW ST Debt	20.0	0.0	0.0	0.0	(20.0)	0.0
Net SRF Debt	10.3	6.1	44.6	10.3	2.3	73.7
Surcharge 2	0.0	2.2	22.5	30.5	16.3	71.5
Public Agency Contrib	0.0	0.0	0.0	109.6	0.0	109.6
Total Sources of Cash	\$42.0	\$15.3	\$117.4	\$162.0	\$1.2	\$337.9

6.4 MGD Plant

USES OF CASH						
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Total</u>
Desal Plant	\$30.3	\$10.2	\$63.5	\$105.9	\$1.1	\$211.0
CAW-Only Facilities	11.6	4.2	48.4	46.5	0.0	110.8
Total Uses of Cash	\$41.9	\$14.4	\$111.9	\$152.4	\$1.1	\$321.8
SOURCES OF CASH						
	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>Total</u>
Net CAW Equity	\$11.6	\$6.4	\$47.4	\$11.0	\$2.6	\$79.0
Net CAW LT Debt	0.0	0.0	0.0	0.0	0.0	0.0
Net CAW ST Debt	20.0	0.0	0.0	0.0	(20.0)	0.0
Net SRF Debt	10.3	5.7	42.0	9.8	2.3	70.1
Surcharge 2	0.0	2.2	22.5	30.5	16.3	71.5
Public Agency Contrib	0.0	0.0	0.0	101.2	0.0	101.2
Total Sources of Cash	\$41.9	\$14.4	\$111.9	\$152.4	\$1.1	\$321.8

Note: Timing of SRF, securitization or other elements may differ depending upon operational or other needs