- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

IN THE MATTER OF THE RATE APPLICATION OF COMMUNITY WATER COMPANY FOR APPROVAL OF GENERAL RATE INCREASE AND SPECIAL CHARGE FOR MAJOR PLANT UPGRADE/REPAIR	)))))	**DOCKET NO. 17-098-01** **DPU Exhibit No. 1.0**

DIRECT TESTIMONY

OF

WILLIAM DUNCAN

DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

October 13, 2017

Q. Please state your name, address and by whom you are employed.

A. My name is William Duncan. I am Manager of the Telecommunications and Water Section for the Utah Division of Public Utilities (DPU or Division). My business address is 160 E. 300 South, Salt Lake City, Utah, 84111.

Q. What is the purpose of your testimony?

A. My testimony will present the DPU's position concerning Community Water Company's (CWC) proposed onetime assessment of $1,103.75 per ERU as explained in CWC direct testimony. My testimony will also reiterate the recommendations of the DPU for all items mentioned in the October 4, 2017 scheduling order and notice of interim rate hearing. I will also comment on certain statements from CWC direct testimony.

Q. What is the DPU's position on the onetime assessment?

A. The DPU is opposed to the onetime assessment.

Q. What is the basis of the DPU's opposition?

A. The DPU believes that allowing recovery of a cost on a onetime surcharge or assessment unfairly burdens the current group of customers, while providing benefits to future customers that do not pay for those benefits.

Standard utility ratemaking normally allows for a cost to be recovered over the life of an asset, rather than immediate cost recovery. This general principle helps ensure customers pay for the cost of their service.

Q. Can you provide an example?

A. Yes. Suppose a current homeowner pays the onetime assessment, he or she has provided cost recovery for an asset that in this case should be spread over the life of an approved loan, or longer if the asset survives beyond that period. If that homeowner sells his home two years later, the new occupant receives the benefit of the first homeowner's payment, but never has to contribute to the capital investment, even though he will receive a benefit from that investment.

Q. Community Water has indicated that it wants a method of cost recovery prior to investing approximately $525,000 in a new tank. How does the Division propose that CWC should recover the cost of its investment?

A. Community Water has an obligation to provide adequate service as a condition of obtaining a CPCN from the Public Service Commission of Utah (PSC). That obligation exists regardless of current rates or pending rate cases.

CWC should be treated like any other utility. Capital investments are normally made using investor funds anticipating a reasonable rate of return. A utility may also rely on borrowing to complete infrastructure construction. When an infrastructure project is complete, the utility capitalizes the entire cost of the project and it is added to rate base. The utility then earns a return on that investment, or is allowed cost recovery based on terms of a loan, over the life of an asset.

In the immediate case, CWC should record all of the costs for the tank replacement including engineering, site preparation, construction, labor, interest and demolition of the old tank and then capitalize that amount. When new rates are approved, the rates will provide adequate revenue to recover the cost of the investment.

Q. Does CWC have access to borrowed funds?

A. In its application CWC describes having applied for and received approval for a loan from the Division of Drinking Water State Revolving Fund (DDW loan) for up to $3,662,000. In its direct testimony, CWC stated that it pulled the request for the tank replacement from the DDW loan request and the total loan is now $2,984,013. This has been confirmed in discussions with DDW.

Q. Could CWC apply for additional funds from DDW?

A. Yes. According to DDW staff, CWC could apply for a second project loan for replacement of the tank that could reasonably be presumed to be available under the same terms and conditions.

Q. Why did CWC pull the request for the tank replacement from the DDW loan?

A. In a courtesy update to the PSC on 6/15/2017 (filed in docket 16-098-01) CWC explained that it believed that financing through DDW or through the PSC approval process would delay construction of the tank until summer, 2018.

Q. Did CWC offer an alternative financing source at that time?

A. Yes. In the same letter to the PSC, CWC stated it had secured financing from its parent company.

Q. If CWC pursued financing for the tank from DDW, are there additional requirements for CWC to begin using the funds?

A. Yes. In conversations with DDW staff, the DPU has learned that two items are necessary to access the funds: First, a letter or other document from the governing authority allowing the water provider to increase rates at the completion of construction; Second, proof of customer notification that rates will be increasing. Additionally, the DPU learned that the first payment on the loan is not due until one year after the completion of construction.

In this case, the DPU believes a PSC order allowing increased rates would satisfy the first condition.

Q. **Does the Division have an estimate of the additional revenue required to recover the cost of rebuilding the failed water tank?**

A. Yes, based on an investment of $525,000 and loan repayment conditions of 20 years at 3.39%, the monthly repayment would be $3,015. The additional annual revenue requirement would be $36,180.

Combined with additional annual depreciation expense of $10,500/year (50 year depreciable life), the total additional annual revenue required would be $46,680.

Q. How does the DPU envision the rate be applied in this case?

A. The DPU envisions a two part order from this interim hearing. The first part would be to establish or reject an interim base rate as discussed in the testimony of DPU witness Gary Smith. The second part of the order would allow CWC to increase the base rate by an appropriate amount upon completion and inspection of the tank. As an example, if the additional revenue required is the same as described in the previous question, the increase in the monthly base rate would be $7.73. The amount is determined by the final additional revenue of $46,680 /503 water users[1] /12 months.

This amount is based on CWC funding the tank replacement from a DDW loan or with funding from CWC's parent company under similar terms and conditions. If CWC obtained other financing, the calculations could change based on the terms of that particular financing.

Q. In the application, CWC used Equivalent Residential Units (ERU) to allocate costs. Why is the DPU using total residential units?

A. The DPU has not had enough time to evaluate the use of ERUs in ratemaking. Since the concept was first explained in Company direct testimony on Oct 6, 2017, the DPU has only been able to concentrate its resources on evaluating the interim rate and the special assessment. At this time, the DPU is opposed to the use of ERU's because it may potentially establish discriminatory rates. The DPU will

[1] For reasons discussed below, this number does not refer to the Equivalent Residential Units measure CWC proposes.

opine more completely on ERU's in the February 13, 2018 non applicant direct testimony.

Q. How is the consumer protected if the cost of the tank replacement is less than the estimated $525,000? How is the company protected if the cost in in excess of $525,000?

A. The DPU believes that the $525,000 figure is a reasonable estimate of cost of the tank replacement. We also acknowledge that it is only an estimate to be used for approximating the additional revenue requirement for CWC.

The DPU proposes that upon completion of construction of the new tank, CWC would submit the entire cost of the project to the PSC, where it can be reviewed by the DPU and other parties. The DPU would then calculate the actual revenue required and rate change needed and submit the recommendation to the PSC for a final order. This could occur within the period of this case's pendency, depending on construction schedules.

Q. Please summarize the DPU recommendation?

A. 1) The PSC should reject the request for a onetime assessment to fund the tank replacement.

2) The PSC should reject the interim rate requested by CWC for the reasons stated in the testimony of DPU witness Gary Smith.

3) The PSC should reject the use of ERU in establishing interim rates.

4) The PSC should include in its order the ability for CWC to increase its base rate by approximately $7.73/month upon completion of construction of the new tank after review by the DPU.

Q. Does the DPU have any other comments on the CWC application or direct testimony?

A. Yes. The Division wishes to address the statement made by the Company's witness, Keith J. Larson, P.E. of Bowen Collins and Associates, Inc., in Exhibit 1 of his direct testimony filed October 6, 2017. He makes the following statement:

> *"In 2015, Community Water Company (CWC) authorized Bowen, Collins & Associates (BC&A) to prepare a water rate study. The purpose of that study was to update CWC water rates based on projected system revenue requirements as a result of the Company's recently completed master plan. Based on the results of the study, the Company went to the Public Service Commission of Utah seeking a rate increase consistent with study recommendations. Regrettably, the Public Service Commission did not follow the recommendations of the report and adopted a rate structure that underestimated operation and maintenance costs and almost completely neglected the system's need for capital investment.*
>
> *As a result of the rate structure ultimately adopted by the Public Service Commission, funding for improvements in the CWC water system have continued to be extremely limited. Not coincidentally, the system has deteriorated and has experienced a number of serious system failures over the past few years. System condition is to the point that major improvements can no longer be postponed."*

The DPU feels it needs to correct the record on this statement:

1) The 2015 rate case was filed by CWC on July 23, 2015 and was assigned docket 15-098-01. CWC withdrew the case on or about December 17, 2015.
2) The DPU filed for a rate increase for CWC on June 13, 2016 and the case was assigned docket number 16-098-01. In that case, the DPU used as a basis for its proposed rates the operation and maintenance costs reported on the CWC 2015 annual report to the Commission that were attested to as being accurate. During the course of that case the DPU made adjustments to **increase** revenue requirement by adding in costs for depreciation, return on investment and taxes. The DPU gave the company ample opportunity to provide evidence of any costs that were missed. Additionally, the DPU testimony in that case was clear that it did not intend for the proposed rates to fund capital improvements.

Q. Does that conclude your testimony?

A. Yes.