

- BEFORE THE UTAH PUBLIC SERVICE COMMISSION -

IN THE MATTER OF APPLICATION OF)	DOCKET NO. 17-098-01
COMMUNITY WATER COMPANY FOR)	
APPROVAL OF GENERAL RATE)	DPU EXHIBIT NO. 2.0 DIR
INCREASE AND SPECIAL CHARGE FOR)	
MAJOR PLANT UPGRADE/REPAIR.)	

REDACTED DIRECT TESTIMONY

OF

GARY SMITH

**DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH**

February 13, 2018

**CONFIDENTIAL - SUBJECT TO
UTAH PUBLIC SERVICE COMMISSION RULE R746-1-602 AND 603**

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	IDENTIFICATION OF WITNESS	1
III.	PURPOSE OF TESTIMONY	1
IV.	ANALYSIS OF UTILITY’S CURRENT RATE STRUCTURE	2
V.	DIVISION PROPOSED RATE STRUCTURE	14
VI.	CONCLUSION	15
VII.	LIST OF DIVISION’S SUPPORTING EXHIBITS	16

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND BY WHOM YOU ARE EMPLOYED.

A. My name is Gary Smith; I am employed as a Utility Analyst for the State of Utah, Division of Public Utilities (DPU or Division). My business address is Heber M. Wells Building, 160 East 300 South, 4th Floor, Salt Lake City, Utah 84111.

II. IDENTIFICATION OF WITNESS

Q. FOR WHICH PARTY WILL YOU BE OFFERING TESTIMONY IN THIS CASE?

A. I will be offering testimony on the Division’s behalf.

III. PURPOSE OF TESTIMONY

Q. WHAT IS YOUR INVOLVEMENT IN THE DIVISION’S REVIEW OF COMMUNITY WATER COMPANY, LLC (CWC OR UTILITY) IN THIS DOCKET?

20 A. I am serving as a Division analyst, charged to review and analyze CWC's
21 operations and maintenance expense documentation and data. My review uses
22 information provided by CWC in its application, annual reports, past rate cases,
23 and supplemental information obtained through data requests during discovery.
24 The purpose of my testimony is to present DPU's review, analysis, and
25 recommendations regarding CWC's operation and maintenance expenses to
26 determine the Utility's revenue requirements and rate structure.

27 **Q. BRIEFLY DESCRIBE THE DIVISION'S MISSION.**

28 A. The Division's mission is to promote the public interest in utility regulation,
29 ensuring all utility customers within its jurisdiction have access to safe, reliable
30 service at reasonable prices.

31

32 **IV. ANALYSIS OF UTILITY'S CURRENT RATE STRUCTURE**

33

34 **Q. WHEN WAS CWC'S LAST GENERAL RATE CASE?**

35 A. The Division filed a rate case on behalf of CWC under Docket No. 16-098-01 in
36 2016. Under this docket, the Utah Public Service Commission (Commission)
37 issued an order approving a general rate increase on November 28, 2016. CWC
38 had filed prior applications seeking rate increases on November 06, 2014 and July
39 21, 2015, but withdrew both for various reasons.

CONFIDENTIAL - SUBJECT TO
UTAH PUBLIC SERVICE COMMISSION RULE R746-1-602 AND 603

40 **Q. WHAT IS CWC’S CURRENT RATE STRUCTURE?**

41 A. CWC included its current Tariff approved in Docket No. 16-098-01 with its
42 September 14, 2017, Application. The Utility’s current Tariff contains the
43 following Monthly Rate Schedule:
44

**Current Rate Schedule
Approved in Docket No. 16-098-01**

Monthly Rates		Monthly Water Usage Amounts			
<i>Standby Rate</i>	\$16.05				
<i>Connected Customer Base Rate</i>	\$30.65				
Tier 1 (Per 1,000 Gallons)	\$ 0.70	0 gals	12,000 gals		
Tier 2 (Per 1,000 Gallons)	\$1.40	12,001 gals	24,000 gals		
Tier 3 (Per 1,000 Gallons)	\$2.80	24,001 gals	36,000 gals		
Tier 4 (Per 1,000 Gallons)	\$4.20	36,001 gals	48,000 gals		
Tier 5 (Per 1,000 Gallons)	\$6.30	48,001 gals	<i>Over</i>		

45
46 **Q. DESCRIBE THE RATE REVIEW MODEL THE DIVISION USED TO**
47 **ANALYZE CWC’S REQUEST FOR A GENERAL RATE INCREASE.**

48 A. The Division has developed and utilized a review model over several years to
49 evaluate and produce recommended rate structures that are just, reasonable, and
50 promote financial sustainability within Commission guidelines.

51 At the commencement of a Division review for a general rate increase, a test year
52 is set as a reference point. The Division uses the latest financial information,
53 usually the company's last Annual Report or information submitted in the
54 company's request for a rate increase, to obtain a baseline test year of its reported
55 revenues and expenses, as well as number of water users, standby customers, total
56 gallons delivered, etc. The Division reviews and analyzes this information relative
57 to all invoices received, the company's historical trends, and known and
58 measurable changes to the company's cost of service. The Division recommends
59 making appropriate adjustments to the test year. These adjustments can reduce or
60 increase the amounts submitted by the company, allowing the model to adapt to
61 each individual case, accounting for the company's unique circumstances. The
62 resulting adjusted expenses are classified as either fixed or variable.
63 Recommended rates are calculated that recover all fixed costs through the base
64 rates charged equitably to each customer class. This model ensures that the
65 company will have the opportunity to recover all fixed expenses. The Division
66 utilized this model in its review of CWC.

67 **Q. WHY DOES THE DIVISION RECOMMEND FULL COST PRICING,**
68 **WHICH INCLUDES A CAPITAL RESERVE ACCOUNT?**

69 A. In the past, when a water company applied for a rate increase, the Division
70 reviewed other water companies of similar size, the number of customers, and

71 general geographical location to verify that the rates and fees of the applicant
72 were comparable. If the applicant company met this criterion, the Division gave a
73 favorable recommendation to the Commission for approval. In recent years, after
74 seeing several cases of under-funding and neglect involving regulated water
75 companies that were no longer able to recover their cost of service, the Division
76 developed a full-cost pricing model. This model develops rates that cover the full
77 cost of service, including a capital reserve account. New applicants, as well as
78 established water companies seeking a rate increase, are required to maintain rates
79 that cover the full cost of service and establish a reserve account funded and
80 restricted to cover future capital needs.

81 **Q. HOW DOES THE DIVISION RECOMMEND OVERCOMING THE**
82 **POTENTIAL UNAUTHORIZED OVER-EARNINGS OF FULL COST**
83 **PRICING AND WATER CONSERVATION RATE TIERS?**

84 A. The full cost pricing model utilized by DPU ensures that the company will have
85 the opportunity to recover all fixed expenses. Since no water is included in the
86 base rate, the customer pays for the total volume of water used. The rate set for
87 the volume of water used by each customer is based on a tiered use schedule. The
88 first rate tier is set to cover the actual expenses used to pump, treat, and deliver
89 the water to the consumer. All usage tiers after the first tier are set at rates that
90 encourage conservation. Using this model, when consumers use more than the

91 first tier allotment in a month, the company potentially earns more than the
92 amount allowed by the Commission. To overcome this potential “over-earning”
93 scenario, the company is required to deposit any excess earnings from water
94 usage into its established restricted capital reserve account. The establishment of a
95 Capital Reserve Account was included in CWC’s current tariff established under
96 Docket No. 16-098-01.

97 **Q. WHAT DID DPU USE AS THE TEST YEAR TO BASE ITS**
98 **RECOMMENDATION?**

99 A. DPU used proforma 2018 as the test year as provided in CWC’s Supplemental
100 Direct Testimony. DPU analyzed the 2018 numbers using information provided
101 by CWC’s in its annual reports, prior Docket No. 16-098-01, and additional
102 information provided in response to data requests during discovery.
103 CWC has experienced changes in its operations and maintenance expenses since
104 2016, including system, and administrative changes. These changes, as detailed
105 by CWC in its Supplemental Direct Testimony, were included in DPU’s analysis.
106 Details of these changes are described in the following explanation of adjustments
107 to CWC’s proposed rate structure.

108 **Q. DESCRIBE THE DIVISION’S ADJUSTMENTS TO CWC’S PROPOSED**
109 **RATE STRUCTURE INCLUDED IN ITS REQUEST FOR A GENERAL**
110 **RATE INCREASE.**

111 A. DPU made adjustments outlined in the attached Exhibits and as more fully
112 detailed below:

113 Exhibit 2.4 DIR, Adjustments to Expenses.

114 Line 5 – Purchased Water – from Weber Basin. The line total of [REDACTED] is for
115 water rights No. [REDACTED] and No. [REDACTED] administered by Weber Basin Water
116 Conservancy District. These water rights allow for a maximum combined
117 allocation of [REDACTED] acre feet of water available to CWC annually. These fees are
118 assessed annually and are not based on the amount of water used by CWC or its
119 customers. DPU did not adjust this expense.

120 Line 6 – Purchased Water – from Summit Water Distribution Company (SWDC).

121 The line total of [REDACTED] included [REDACTED] for annual anticipated purchased water
122 from SWDC; [REDACTED] for estimated emergency water supplied by SWDC during
123 water tank replacement; and [REDACTED] for system interconnection improvements
124 required to allow for the emergency water supply during water tank replacement.

125 DPU removed a total of [REDACTED] in adjustments as follows: [REDACTED] was treated
126 as a direct volumetric use charge and included as temporary water use rate Tier 2
127 at CWC’s cost of [REDACTED] (as detailed in the Direct Testimony of

128 William Duncan); [REDACTED] for system interconnection was disallowed for inclusion
129 as an operational expense for rate making purposes because it would be a water
130 system capital improvement; [REDACTED] for annual anticipated purchased water was
131 reduced by [REDACTED] to reflect historical average costs and invoices received.

132 Line 7 – Purchased Power (Electricity for Treatment Plant). The line total of
133 [REDACTED] for electricity for the water system was reduced [REDACTED] by DPU to reflect
134 historical average costs and invoices received.

135 Line 8 – Fuel for Power Production. We adjusted the line total of [REDACTED] for fuel
136 used in power production due to lack of supporting documentation and no
137 evidence of need.

138 Line 9 – Chemicals. DPU increased the line total of [REDACTED] for chemicals by
139 [REDACTED] to reflect historical average costs and invoices received.

140 Line 10 – Materials and Supplies. We removed the line total of [REDACTED] for
141 materials and supplies due to lack of supporting documentation.

142 Line 11 – Contractual Services - Engineering. DPU increased the line total of
143 [REDACTED] for engineering services by [REDACTED] to reflect historical average costs and
144 invoices received.

145 Line 12 – Contractual Services - Accounting. The line total of [REDACTED] for
146 accounting services is a reasonable expense.

CONFIDENTIAL - SUBJECT TO
UTAH PUBLIC SERVICE COMMISSION RULE R746-1-602 AND 603

147 Line 13 – Contractual Services - Legal. The line total of [REDACTED] for legal services
148 is a reasonable expense.

149 Line 14 – Contractual Services – Management Fees. The line total of [REDACTED] for
150 management and maintenance of the water system represents a reasonable
151 expense. On January 8, 2018, the Division received a copy of SWDC’s written
152 notice of termination of its 2004 Water System Service Agreement (2004
153 Agreement). A copy of the letter of termination is included as Exhibit 2.12 DIR.

154 [REDACTED]
155 [REDACTED]
156 [REDACTED]
157 [REDACTED]
158 [REDACTED] The Division

159 was not provided with an endorsed copy of the letter of termination.

160 Line 15 – Contractual Services – Management Fees – Admin Fees. The line total
161 of [REDACTED] for administrative services is as a reasonable expense. In response to
162 DPU’s 2nd Set of Data Requests, CWC outlined that this line total includes
163 salaries, wages, overhead, and other general and administrative services,
164 employee pensions and benefits, office rent, and office utilities.

165 Line 17 – Water Sampling. The line total of [REDACTED] for required water sampling
166 services, including services provided by Summit County, was included by DPU as

167 a necessary operational expense to reflect historical average costs and invoices
168 received.

169 Line 19 – Water System Repairs. The line total of [REDACTED] for water system
170 repairs was reallocated by DPU from Line 39 – Miscellaneous Repairs with a line
171 total of [REDACTED]. This reallocation was made to correctly match the expense to the
172 NARUC category definition.

173 Line 23 – Transportation Expense (incl. winter access). The line total of [REDACTED]
174 for transportation expense, including snowmobile and winter access, is a
175 reasonable expense.

176 Line 25 – Insurance – General Liability. The line total of [REDACTED] for General
177 Liability insurance was included by DPU as a necessary business expense.

178 Line 27 – Regulatory Expense – Rate Case Expense. The line total of [REDACTED] for
179 rate case expense was reduced [REDACTED] by DPU. These amounts are calculated as
180 follows: in its Supplemental Direct Testimony, CWC provided a total of
181 [REDACTED] for rate case related expenses [REDACTED] for legal fees, [REDACTED] for
182 engineering fees, and [REDACTED] for snowmobile expense). DPU recommends
183 annualizing rate case expenses over 3 years. Annualizing [REDACTED] over 3 years
184 totals [REDACTED] annually. DPU disallowed the [REDACTED] snowmobile as an operating
185 expense for rate making purposes, and subtracted it from the [REDACTED] total, thus
186 reducing the annualized total by [REDACTED]. The Division agrees that the purchase of

187 a snowmobile is a necessary, but the purchase should be recorded as a capital

188 investment and added to rate base.

189 Recovery of these rate case expenses equates to [REDACTED] for both

190 connected and standby customers. DPU recommends a rate structure that will be

191 reduced by this amount after 36 months as detailed in the Direct Testimony of

192 William Duncan.

193 Line 28 – Regulatory Commission Expense - Other. The line total of [REDACTED] for

194 other regulatory expenses is the annual state assessed fee. It is a necessary

195 business expense.

196 Line 32 – Association / Membership Dues. The line total of [REDACTED] for

197 membership dues was included by DPU to reflect historical average costs and

198 invoices received.

199 Line 35 – Postage. The line total of [REDACTED] for postage was reduced [REDACTED] by

200 DPU to reflect historical average costs and invoices received.

201 Line 36 – Office Supplies. The line total of [REDACTED] was included by DPU to

202 reflect invoices received.

203 Line 37 – Bank Charges. The line total of [REDACTED] for bank charges was included by

204 DPU as a business expense.

205 Line 39 – Miscellaneous Repairs. The line total of [REDACTED] was reallocated to
206 Line 19 – Contractual Services – Water System Repairs. This reallocation was
207 made to correctly match the expense to the NARUC category definition.

208 Line 40 – Administrative Expenses. DPU removed the line total of [REDACTED] for
209 administrative expenses because it duplicates items covered above including Line
210 15 – Contractual Services – Management Fees – Admin Fees as detailed above
211 and in CWC’s response to DPU’s 2nd Set of Data Requests.

212 Line 42 – Total Operation & Maintenance Expenses. The total proforma 2018
213 Operational and Maintenance Expenses of [REDACTED] was reduced by DPU
214 adjustments of [REDACTED] as detailed above.

215 Exhibit 2.7 DIR, Depreciation Expense and Accumulated Depreciation
216 Reconciliation.

217 The Division used a combination of information in CWC’s annual reports, the
218 asset inventory provided by Bowen, Collins and Associates, and invoices for
219 newer assets acquired by CWC to establish the asset inventory detailed in this
220 exhibit.

221 The combination of this information gives a more accurate view of CWC’s assets.
222 Along with the adjustment to the assets, the Division found that some items listed
223 as fully depreciated still had balances; the depreciation schedule reflects these
224 changes. The Bowen, Collins and Associates inventory gives an estimated

225 replacement value. That report also provides an estimated installation date (year)
226 of the equipment. The Division recognized that using estimated values for
227 equipment purchased as far back as the early 1970's, would produce a
228 depreciation expense that is not in line with equipment purchased from that era.
229 With that in mind, the Division used a Consumer Price Index (CPI) calculator to
230 produce dollar values approximately equal to the time period in which the
231 equipment was purchased. Based on assets currently in service, the Division in
232 Exhibit 1.1 DIR calculates the current annual depreciation expense to be [REDACTED]
233 and requests that this expense be included in current rates. Based on assets
234 planned to be added during the tank reconstruction (phase 1), the Division,
235 calculated the projected corresponding annual depreciation expense of phase 1 to
236 be [REDACTED] (phase 1 new assets of [REDACTED] from Exhibit 1.2 DIR + existing asset
237 total from Exhibit 2.7 DIR of [REDACTED]). The depreciation expense of Phase 2 was
238 calculated by the Division to be [REDACTED] (phase 2 new assets of [REDACTED] from
239 Exhibit 1.2 DIR + phase 1 assets of [REDACTED] + the total new assets from Exhibit
240 1.1 DIR of [REDACTED]). Under its current tariff, CWC is to make annual deposits to
241 its Capital Reserve Account equal to its calculated annual depreciation expense.
242 This reserve account is restricted to finance future capital replacement and
243 investments only.

244 In addition to this Capital Reserve Account, other reserve requirements of CWC
245 have been identified. CWC listed in its Supplemental Direct Testimony revenue
246 requirements including an annual Debt Service Reserve Fund expense of [REDACTED].
247 The Division was informed that this Debt Service Reserve Fund, as well as a
248 Replacement Reserve Fund, were required under the proposed Division of
249 Drinking Water Loan (Loan). This Replacement Reserve Fund is required to be
250 funded annually at [REDACTED] of the operations and maintenance expense budget. The
251 Division has calculated the annual required deposit to this Replacement Reserve
252 Fund at [REDACTED] [REDACTED]). The combined annual required deposits under
253 the Loan equals [REDACTED]. As referenced above, the reserve fund proposed by the
254 Division would be funded at [REDACTED] annually, and increase after the completion
255 of each of the two phases of construction. Thus, the amount of the annual Capital
256 Reserve Account deposits as calculated exceeds the amount required under the
257 Loan. The Division recommends, if possible under the loan covenants, that the
258 annual amounts required to be deposited into the Debt Service Reserve Fund and
259 the Replacement Reserve Fund be included in the Capital Reserve Account, to be
260 funded at the higher annual amount equal to the depreciation expense. If a
261 separate Debt Service Reserve Fund and a Replacement Reserve Fund are
262 required to be established in addition to the Capital Reserve Account, then the

263 Division recommends the proposed rate schedule and tariff be revised to account
264 for the additions.

265

266 **V. DIVISION PROPOSED RATE STRUCTURE**

267

268 **Q. DOES THE DIVISION RECOMMEND A GENERAL RATE INCREASE**
269 **AT THIS TIME?**

270 A. Yes. As detailed in the Direct Testimony of William Duncan, the Division has
271 recommended an immediate rate increase, with rate adjustments that would be
272 effective at the completion of each phase of the system infrastructure rebuild.

273 **Q. DOES THE RATE STRUCTURE RECOMMENDED BY THE DIVISION**
274 **PROMOTE CONSERVATION?**

275 A. Yes. As detailed in Direct Testimony of William Duncan, DPU's recommendation
276 utilizes a tiered rate schedule based on the volume of water consumed.

277

278 **VI. CONCLUSION**

279

280 The Division's analysis demonstrated that CWC's current rate structure is not
281 sufficient to recover the operations and maintenance expenses of CWC, does not
282 promote financial sustainability, and therefore is not in the public interest. The

283 Division recommends increasing CWC's rates to cover its expenses and promote
284 conservation as further detailed herein and in the Direct Testimony of William
285 Duncan.

286 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

287 A. Yes.

288

289 **VII. LIST OF DIVISION'S SUPPORTING EXHIBITS**

290

291 Exhibit 2.1 DIR, Index

292 Exhibit 2.2 DIR, Rate Schedule

293 Exhibit 2.2a DIR, Rate Schedule (Notes)

294 Exhibit 2.3 DIR, Allocation of Expenses

295 Exhibit 2.3a DIR, Allocation of Expenses (Notes)

296 Exhibit 2.4 DIR, Adjustments to Expenses

297 Exhibit 2.4a DIR, Adjustment to Expenses (Notes)

298 Exhibit 2.5 DIR, Summary of Revenues and Expenses (Revenue Requirement)

299 Exhibit 2.6 DIR, Capital Reserves

300 Exhibit 2.7 DIR, Depreciation Expense & Accumulated Depreciation

301 Reconciliation

- 302 Exhibit 2.7a DIR, Depreciation Expense & Accumulated Depreciation
- 303 Reconciliation (Notes)
- 304 Exhibit 2.8 DIR, Contribution in Aid of Construction (CIAC)
- 305 Exhibit 2.9 DIR, Rate Base
- 306 Exhibit 2.10 DIR, Return on Investment
- 307 Exhibit 2.11 DIR, Taxes
- 308 Exhibit 2.12 DIR, SWCD letter of termination