–BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH–

IN THE MATTER OF WATERPRO, INC.'S APPLICATION FOR CULINARY WATER RATE INCREASE	))))))))	**DOCKET NO. 23-2443-01** **Exhibit No. DPU 1.0 DIR** **Paul Hicken**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

Redacted

Corrected Direct Testimony of

Paul Hicken

November 22, 2023

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INTRODUCTION

Q: PLEASE STATE YOUR NAME, BY WHOM YOU ARE EMPLOYED, AND IN WHAT CAPACITY.

A: My name is Paul Hicken. I am employed as a Utility Technical Consultant by the Utah Division of Public Utilities (Division or DPU). I am the lead analyst on this case.

Q: PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A: I received a Master of Business Administration degree from Utah State University in 1985. I am also a Certified Government Financial Manager (CGFM). I have been employed by the Division of Public Utilities since June 2005. Prior to that, I was employed by the Office of the Legislative Auditor General for 19 years.

Q: HAVE YOU TESTIFIED BEFORE THE UTAH PUBLIC SERVICE COMMISSION BEFORE?

A: Yes, on several occasions. Most recently, I testified before the Utah Public Service Commission (Commission) as the Division's witness in a teleconference hearing on July 29, 2020, in the WaterPro, Inc. General Rate Case, Docket No. 20-2443-01.

BACKGROUND

Q: CAN YOU DESCRIBE THE BACKGROUND AND ISSUES OF THIS CASE?

A: Yes. On or about March 7, 2023, the Commission received a notice of intent (dated March 3, 2023) from WaterPro, Inc. (WaterPro or Company) to file a petition for a general rate increase (rate modification) of culinary water rates. On May 9, 2023, the Commission received a comprehensive application from WaterPro (dated May 3, 2023) and a docket number was assigned. The Division received an action request from the Commission on May 9, 2023, to review the application and make recommendations by May 23, 2023. The Division reviewed the application and found it to be substantially complete and submitted a response to the Commission on May 22, 2023. During the next few months, the Division reviewed the application and initial documentation, which included proposed rate changes, annual reports, consolidated audit reports, and summaries of expenses and revenues. The Division also sent 2 sets of data requests and made several phone calls to the Company seeking further information and clarification of operations, assets, and expense details. The Company cooperated completely and provided the information and clarification needed.

PROPOSED RATE MODIFICATIONS

Q: CAN YOU EXPLAIN THE COMPANY'S PROPOSED RATE CHANGES AND ANY ISSUES WITH THE REQUESTED MODIFICATIONS?

A: The Company is not proposing rate increases necessarily, rather it is proposing to reduce the volume of water allowed in each tier, along with a slight reduction in Tier 2 rates. The rate modifications are discussed in detail in WaterPro's Application for Rate Increase[1] and in the consultant's testimony.[2] Specifically, the tier volumes are reduced, and the proposed adjustments are summarized in Table 1:

Table 1		
	Existing Volume (gallons/month)	Proposed Volume (gallons/month)
Tier 1	0-18,000	0-12,000
Tier 2	18,001-57,000	12,001-30,000
Tier 3	57,001-150,000	30,001-75,000
Tier 4	150,001 and over	75,001 and over

As noted by its consultant, the Company's existing tier volumes are approximately double the average tier cutoff for similar entities in the region, and the proposed changes will bring the tier volume cutoff more in line with the American Water Works Association (AWWA) cost-of-service guidelines.[3]

[1] Docket No. 23-2443 -01, WaterPro, Inc.'s Application for Culinary Water Rate Increase, P.9-11.
[2] Docket No. 23-2443-01, Written Testimony of Joshua Bean, P.7-8.
[3] Docket No. 23-2443-01, Written Testimony of Joshua Bean, P.7.

In addition, the Company proposes a slight reduction in Tier 2 rates for all tariff zones as shown in Table 2.

Table 2		
Zone	Existing Tier 2 Rate	Proposed Tier 2 Rate
General Residents	$ 2.27	$ 2.00
South Mountain Upper	$ 2.44	$ 2.17
South Mountain Lower	$ 2.37	$ 2.10
Bear Cove Canyon	$ 2.47	$ 2.20
Little Valley	$ 2.56	$ 2.29

Q: ARE THE PROPOSED RATE CHANGES SUSTAINABLE AND DO THEY SUPPORT FINANCIAL STABILITY FOR THE COMPANY?

A: Yes. The financial effect of these modifications will generate more revenue based on the assumption that customers will continue to utilize the same amount of water as in the past. The Company estimates that the tier volume reductions will generate about 5.4% increase to rate revenues in 2024, as shown in Appendix H of WaterPro's Culinary System Rate Model[4] and explained in the Company consultant's testimony.[5]

Q: HOW DOES THE COMPANY FINANCE ITS CAPITAL IMPROVEMENTS AND SYSTEM MAINTENANCE?

A: WaterPro's annual report showed revenue from metered water sales to be about [redacted] in 2021 and [redacted] in 2022. Maintenance and repair expenses for the same years totaled [redacted] and [redacted].[6] Under normal operations, maintenance expenses are covered by the metered water revenues. The proposed tariff changes may bring some fluctuations in metered water sales. The

[4] WaterPro, Inc.'s Culinary System Rate Model, Appendix H, P.2.
[5] Docket No. 23-2443-01, Written Testimony of Joshua Bean, P.7-8.
[6] Annual Report of WaterPro, Inc. to the Public Service Commission, December 31, 2022. Income Statement tab.

Company's Culinary Rate Model – Appendix H, indicates that proposed tier reductions may generate less revenue from Tiers 1 & 2 sales, but revenue should increase and offset any decreases with Tiers 3 & 4 sales.[7]

General system maintenance is included in the net income projections and is part of the budget and forecasting process. Some years, however, may require extraordinary maintenance and repairs, and/or capital expenditures beyond the normal budget. When this occurs, additional sources of revenue are needed. According to the Company's consultant,[8] capital improvements have been funded by a variety of sources such as rate revenues, grants, and loans. In addition, WaterPro has been able to rely on the parent company, Draper Irrigation Company, for cash reserves if needed. If financing is not secured, some scheduled capital improvement projects may be delayed until financing becomes available. The Company's consultant anticipated that a loan will be obtained from the Division of Natural Resources to pay for capital improvements scheduled during 2024 and 2025.[9] According to the consultant, a loan had been authorized based on the Company's prior application.[10] The Company had also obtained a loan of [redacted] from American West Bank in 2013. About [redacted] was used to finance capital improvements to the irrigation operations and [redacted] was used for capital improvements to the culinary distribution system.[11]

Q: DOES THE COMPANY HAVE A CAPITAL RESERVE ACCOUNT?

A: No, WaterPro does not have a capital reserve account. However, the Company's consultant indicated that Draper Irrigation Company, the parent company, has a cash reserve account that could be available for capital improvements if needed.[12] It should be noted that while the Commission does have the power to require public utilities to maintain a capital reserve account to replace depreciated assets,[13] the

[7] WaterPro, Inc.'s Culinary System Rate Model, Appendix H, P.9.
[8] DPU Data Request 1.4, October 2, 2023.
[9] Ibid.
[10] Docket No. 23-2443-01, Written Testimony of Joshua Bean, P.5.
[11] Docket No. 23-2442-01, WaterPro, Inc.'s Application for Culinary Water Rate Increase, P.12.
[12] DPU Data Request 1.4, October 2, 2023.
[13] Utah Code Ann. 54-4-24 Depreciation Accounts and Fund.

Commission currently does not require WaterPro to establish or maintain such an account. The Division generally supports the establishment and maintenance of a capital reserve account when warranted. However, WaterPro has demonstrated the ability to manage sufficient monthly cash flows and budget for routine maintenance and has been able to borrow money for capital investment projects when necessary. A mandated capital reserve account is currently not necessary for WaterPro.

Q: DOES WATERPRO HAVE A WATER CONSERVATION PLAN AND HOW DO THE PROPOSED RATE CHANGES SUPPORT THE PLAN?

A: Yes, the Company does have a water conservation plan. The plan incorporates strategies and goals to conserve water and reduce consumption from both the culinary water and pressurized irrigation systems. The plan evaluates the Company’s current conservation efforts and discusses ways to improve water conservation. It adopts the current State conservation goal to reduce water consumption by 25% between the years 2000 and 2025, or roughly 1% reduction per year.[14] The current proposed volumetric reductions per tier is one way that WaterPro is attempting to reduce culinary consumption. For example, the current Tier 1 rate allows up to 18,000 gallons of consumption per month at the same rate. The proposed Tier 1 rate would allow up to 12,000 gallons per month for the same rate, a 33% reduction in consumption. The other proposed tier rates suggest similar reductions in volume allowed at the same fixed monthly rate. This motivates the customers to consume less water per month rather than pay the higher tier rate. The proposed tier volume reductions are significant, but the Company’s consultant expects they will encourage conservation and allow the Company to remain financially viable.[15] The revenue increases from the higher tiers may bring in more revenue even if usage reduces overall.

[14] 2019 Water Conservation Plan, WaterPro Inc. P. 10
[15] DPU Data Request 1.2, October 2, 2023.

REVENUE REQUIREMENT

Q: CAN YOU EXPLAIN THE REVENUE REQUIREMENT MODEL USED IN THIS RATE CASE?

A: Yes. The Revenue Requirement shown in Confidential DPU Exhibit 1.1, compiles information from the Company's Annual Report to the Commission for the test year 2022. The model considers revenues and expenses, plus any applicable taxes, and calculates the net operating income or loss. The model also calculates the actual rate of return on the rate base and the estimated revenue needed based on a reasonable rate of return. The model also considers any upcoming known and measurable changes and adjustments that may be needed. A revenue requirement and rate of return are calculated based on the Company's requested rate increase, and a recommended revenue requirement and rate of return are also calculated based on the Division's analysis and what is deemed fair and reasonable.

RATE OF RETURN

Q: PLEASE EXPLAIN THE RATE OF RETURN USED IN THE MODEL.

A: The Rate of Return (ROR) is the return on rate base used to determine if the requested rate increase is just and reasonable. It is calculated by dividing the net operating revenue/loss by the total adjusted rate base. There are several rates considered in the model. The first is the actual ROR realized by the Company for the test period. This is shown to be 1.89% in Excel row 108, column F in the Revenue Requirement tab of the model in Confidential DPU Exhibit 1.1. The second is the requested ROR which incorporates the requested rate increase into the model. This is shown to be 5.4% in Excel row 108, column J of the model. The third is the Division's recommended ROR based on our analysis of the Company's net operating revenue or loss, the current adjusted rate base, and the existing capital structure of the Company. This is shown as 9.6% in Excel row 108, column M of the model. More details on the rate of return are shown in the ROR tab of Confidential DPU Exhibit 1.1. The Division considered the ROR authorized in several other recent utility cases, and the Company's weighted average cost of capital based on its own actual debt to equity ratio. In this case the Division supports the Company's request of 5.4% even though the model may support a higher return. The Company should have adequate revenue at its requested revenue requirement, as adjusted.

ADJUSTMENTS

Q: WERE ANY ADJUSTMENTS MADE FOR REVENUES OR EXPENSES?

A: Yes, there were several adjustments made for the revenue requirement shown in the Revenue Requirement tab of Confidential DPU Exhibit 1.1.

1. The first adjustment is shown on Excel row 13, column I: This shows the Company's requested 5.4 percent increase in revenue which equals [redacted] in additional revenue requirement. The Company requested volumetric reductions per tier, which would generate about a 5.4% increase to culinary water revenues. This adjustment simply adds 5.4% to all reported culinary water sales for 2022.

2. The second adjustment is shown on Excel row 41, column K: This deducts $6,533 from several employee benefits and compensation entries in the general ledger. The Division determined that 20% of these expense entries should have been allocated to non-regulated expenses based on the Company's general allocator for mixed use (regulated and non-regulated) expenses.

3. The third adjustment is shown on Excel row 48, column K: This deducts $2,120 from expenses identified in the General Ledger as cash donations. Donations are generally not allowed as regulatory expenses in rate calculations.

4. The fourth adjustment is shown on Excel row 72, column K: This deducts $16,800 from expenses identified in the general ledger as irrigation stock buyback from a customer. Irrigation stock transactions are not part of the regulated water operations and should not be included in the culinary rate case.

Q: CAN YOU EXPLAIN THE ALLOCATION FACTORS FURTHER?

A: Yes, the Company periodically reviews the costs of operations and determines the percentage attributed to culinary water provision and the costs attributed to irrigation or secondary water provision. Some costs are easily determined as direct allocation to either culinary or irrigation. However, most costs are a mixture of part allocation to culinary and part to irrigation. The allocation factors consider assets, labor and overhead, and cost of goods including materials & supplies. The most recent general allocation factor for mixed costs is 80/20 with the larger part going to culinary operations. Some specific parts of company operations may have specific allocation factors, but 80/20 is the general allocator.

DIVISION'S POSITION

Q: WHAT IS THE DIVISION'S POSITION AFTER REVIEW OF THE COMPANY'S OPERATIONS?

A: The Company's request to reduce the tier volumes, which would result in an increase of about 5.4% to culinary water revenues, is just and reasonable and in the public interest. The Division's analysis showed that rate revenues could sustain a higher return on the rate base and still be considered a fair rate of return. However, the Company believes a 5.4% increase will be adequate. That is the amount requested and recommended by the Company's consultant, and the Company does not want to incur any rate shock to the customers.

Q: DO YOU HAVE ANY FURTHER INFORMATION OR ANYTHING MORE TO ADD?

A: No, I do not have any further statements or information.

SUMMARY

Q: WHAT IS THE DIVISION'S RECOMMENDATION?

A: The Division recommends the Commission approve the proposed volumetric reductions to the tiers along with a slight reduction to Tier 2 rates, which will generate approximately 5.4% increase to culinary water revenues as presented in the application.

Q: DOES THIS CONCLUDE YOUR TESTIMONY?

A: Yes, this concludes my testimony.