–BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH–

IN THE MATTER OF WATERPRO, INC.'S APPLICATION FOR CULINARY WATER RATE INCREASE	))))))))	**DOCKET NO. 24-2443-01** **Exhibit No. DPU 1.0 DIR** **Jonathan Lee**

Redacted

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

Direct Testimony of

Jonathan Lee

December 17, 2024

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

A: My name is Jonathan Lee. I am employed by the Utah Division of Public Utilities (Division or DPU) as a Utility Analyst II. My business address is Heber Wells Building, 160 East 300 South, Salt Lake City, Utah 84114.

Q: PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A: I received a Bachelor of Science degree in Electrical Engineering from the University of Utah and a Master of Business Administration degree from San Francisco State University with an emphasis in accounting. I am also a Certified Government Financial Manager (CGFM). Prior to rejoining the Division in June 2023, I was employed by the Davis County, Utah Government for 19 years.

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

A: Yes, I have testified before the Public Service Commission of Utah since rejoining the Division and in the past when I was also with the Division.

BACKGROUND

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

A: Yes. On or about June 3, 2024, the Commission received a notice of intent (dated May 31, 2024) from WaterPro, Inc. (WaterPro or Company) to file a petition for a general rate increase (rate modification) of culinary water rates. On July 15, 2024, the Commission received a comprehensive application from WaterPro (dated July 8, 2024) and a docket number was assigned. The Division received an action request from the Commission on July 19, 2024, to review the application and make recommendations by August 2, 2024. The Division reviewed the application and found it to be substantially complete and submitted a response to the Commission on August 2, 2024. A scheduling conference was held, and a scheduling order was issued by the Commission on August 6, 2024. 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 a set of data requests and made 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 proposing a 9.5 percent increase to the customer's monthly base fee and a 9.5 percent rate increase across all rates within the Company's 4 tiers in its five service areas. The rate modifications are discussed in detail in WaterPro's Application for Rate Increase[1] and in the consultant's testimony.[2] Specifically, the proposed base rate adjustments are summarized in Table 1:

Table 1

Customer Category	Existing	Proposed	
Residential Monthly Base Fee	$21.67	$23.73	Monthly Fee
LifeLine Monthly Base Fee	$13.76	$15.07	Monthly Fee
Multiplex Monthly Base Fee	$21.67	$23.73	Each Month for First Unit
	$15.66	$17.15	Each Month for Additional Unit
Apartment Monthly Base Fee	$21.67	$23.73	Each Month for First Unit
	$15.66	$17.15	Each Month for Additional Unit

[1] Docket No. 24-2443-01, WaterPro, Inc.'s Application for Culinary Water Rate Increase, page 1-2.
[2] Docket No. 24-2443-01, Written Testimony of Joshua Bean, pages 2-7.

Table 2 below shows the proposed rate adjustment on the tiers for each of the Company's 5 service areas.

Table 2

Additional Usage Fees:		Existing	Proposed		
All Other Residents	Tier 1	$ 1.48	$ 1.62	per 1,000 gallons	0 gallons used up to 12,000 gallons
	Tier 2	$ 2.00	$ 2.19	per 1,000 gallons	12,001 gallons up to 30,000 gallons
	Tier 3	$ 3.12	$ 3.42	per 1,000 gallons	30,001 gallons up to 75,000 gallons
	Tier 4	$ 4.40	$ 4.82	per 1,000 gallons	75,001 gallons per month and over
South Mountain Upper (Country Club)	Tier 1	$ 1.64	$ 1.80	per 1,000 gallons	0 gallons used up to 12,000 gallons
	Tier 2	$ 2.17	$ 2.38	per 1,000 gallons	12,001 gallons up to 30,000 gallons
	Tier 3	$ 3.28	$ 3.59	per 1,000 gallons	30,001 gallons up to 75,000 gallons
	Tier 4	$ 4.56	$ 4.99	per 1,000 gallons	75,001 gallons per month and over
South Mountain Lower	Tier 1	$ 1.58	$ 1.73	per 1,000 gallons	0 gallons used up to 12,000 gallons
	Tier 2	$ 2.10	$ 2.30	per 1,000 gallons	12,001 gallons up to 30,000 gallons
	Tier 3	$ 3.22	$ 3.53	per 1,000 gallons	30,001 gallons up to 75,000 gallons
	Tier 4	$ 4.48	$ 4.91	per 1,000 gallons	75,001 gallons per month and over
Cove of Bear Canyon	Tier 1	$ 1.68	$ 1.84	per 1,000 gallons	0 gallons used up to 12,000 gallons
	Tier 2	$ 2.20	$ 2.41	per 1,000 gallons	12,001 gallons up to 30,000 gallons
	Tier 3	$ 3.31	$ 3.62	per 1,000 gallons	30,001 gallons up to 75,000 gallons
	Tier 4	$ 4.48	$ 4.91	per 1,000 gallons	75,001 gallons per month and over
Little Valley	Tier 1	$ 1.85	$ 2.03	per 1,000 gallons	0 gallons used up to 12,000 gallons
	Tier 2	$ 2.29	$ 2.51	per 1,000 gallons	12,001 gallons up to 30,000 gallons
	Tier 3	$ 3.31	$ 3.62	per 1,000 gallons	30,001 gallons up to 75,000 gallons
	Tier 4	$ 4.67	$ 5.11	per 1,000 gallons	75,001 gallons per month and over

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 roughly the same amount of water as in the past. The rate increase would sustain the Company and mitigate rate shock for its customers. A future rate case may be needed to address WaterPro's future capital expenditure projects as shown in Appendix H, or the capital projects timeline may be adjusted as funds allow.

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 2022 and [redacted] in 2023. Maintenance and repair expenses for the same years totaled [redacted] and [redacted] respectively.[3] Under normal operations, maintenance expenses are covered by the metered water revenues. The proposed tariff changes may bring some fluctuations in metered water sales.

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,[4] 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.[5] According to the consultant, a loan had been authorized based on the Company's prior application.[6] 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.[7]

Q: DOES THE COMPANY HAVE A CAPITAL RESERVE ACCOUNT?

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[3] Annual Report of WaterPro, Inc. to the Public Service Commission, December 31, 2022. Income Statement tab.
[4] DPU Data Request 1.4, October 2, 2023.
[5] Ibid.
[6] Docket No. 24-2443-01, Written Testimony of Joshua Bean, page 5.
[7] Docket No. 24-2443-01, WaterPro, Inc.'s Application for Culinary Water Rate Increase, page 10.

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.[8] 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,[9] the 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.[10] The current volumetric tiers are one way that WaterPro is attempting to reduce culinary consumption. For example, the current Tier 1 rate allows up to 12,000 gallons of consumption per month at the same rate. The other tier rates, starting at 12,001 gallons, 30,001 gallons, and 75,001 gallons hopefully may motivate customers to consume less water per month rather than pay the higher tier rates. Each year, the Company looks for ways to help its customers conserve water, according to its representations to the Division. Recently, the Company has installed

[8] DPU Data Request 1.4, October 2, 2023.
[9] Utah Code Ann. 54-4-24 Depreciation Accounts and Fund.
[10] 2019 Water Conservation Plan, dated April 2020, WaterPro Inc., page 10

new smart water meters, which not only help the Company keep track of leaks but also allow the customers to see their usage and make sure they are using water wisely.[11]

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 2023. 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 return on equity is 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 two rates considered in the model. The first is the actual ROR realized by the Company for the test period. This is shown to be [redacted] in Excel row 108, column F in the Revenue Requirement tab of the model in Confidential DPU Exhibit 1.1. The second is the Company's requested ROR, which incorporates the requested rate increase into the model. This is shown to be [redacted] in Excel row 108, column J of the model. The

[11] Email from Darrin Jensen-Petersen, CEO/General Manager, WaterPro Inc., November 7, 2024.

Division considered the ROR authorized in several other recent utility cases, and the Company's weighted average cost of capital based on its actual debt-to-equity ratio. While a 9.6% return on equity is likely justifiable for the company's business and risk profile, the debt-to-equity ratio is very large and not warranted. Rather than attempting to establish an appropriate capital structure for ratemaking purposes, the Division evaluated the overall rate of return. When evaluating the range of reasonableness for capital structures and returns on equity, the Division used a weighted average cost of capital of 6.37%, as estimated based on the actual ratio of debt to equity. This utilizes a 6.5% return on equity, which has been adjusted downward to reflect the Company's heavier capital position. This cost of capital showed that the Company could impose an additional $459,238 of additional revenue if necessary. In this case, the Division supports the Company's request of an approximate 9.5% rate increase, which equates to a [redacted] Rate of Return even though the model may support a higher rate of equity. 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 9.5 percent increase in revenue, which equals [redacted] in additional revenue requirement. The Company requested that each tier would increase by the requested 9.5%. This adjustment simply adds 9.5% to all reported culinary water sales for 2025.

2. The second adjustment is shown on Excel row 41, column K: This deducts [redacted] 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 [redacted] 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 [redacted] from expenses identified in the general ledger as irrigation stock buyback from customers. 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 age 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 increase rates by 9.5 percent across all rates would result in an increase of [redacted] to culinary water revenues, which is just and reasonable and in the public interest. The Division's analysis showed that a higher return on the rate equity might be supportable, but only with significant adjustments to capital structure. However, the Company believes a 9.5 percent rate increase will be adequate. The Division's model shows that a 6.37 percent weighted average cost of capital (note, that this is not the same as the 9.5 percent in rate increase across all rates that the company proposes) would result in an additional $459,238 revenue requirement. This is above the amount requested and recommended by the Company's consultant, and the Company wants to mitigate rate shock to the customers. Thus, the Division supports the Company's request for a 9.5 percent rate increase, which would result in the $648,028 increase in culinary water revenues. Aside from the limited adjustments noted above, the Division finds the requested increase to be just and reasonable.

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 9.5 percent rate increase, with minor adjustments, which will generate approximately 9.5 percent increase to culinary water revenues as presented in the application. This would be in the public interest and a reasonable increase to maintain the operating integrity of WaterPro, Inc.

Q: DOES THIS CONCLUDE YOUR TESTIMONY?

A: Yes, this concludes my testimony.