

Exhibit No.:

Issue(s):

Witness/Type of Exhibit:

Sponsoring Party:

Case No.:

Rate Design
Phased-In Rates
Russo/Rebuttal
Public Counsel
WR-2016-0064

REBUTTAL TESTIMONY

OF

JAMES M. RUSSO

Submitted on Behalf of the Office of the Public Counsel

HILLCREST UTILITY OPERATING COMPANY, INC.

CASE NO. WR-2016-0064

May 16, 2016

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

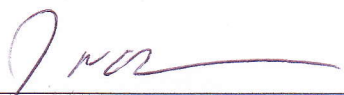
In the Matter of the Rate Increase)
Requests of the Hillcrest Utility) File No. WR-2016-0064
Operating Company, Inc)

AFFIDAVIT OF JAMES M. RUSSO

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

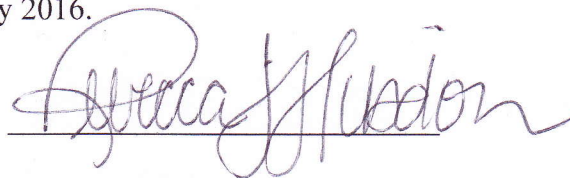
James M. Russo, of lawful age and being first duly sworn, deposes and states:

1. My name is James M. Russo. I am a Consultant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



James M. Russo
Consultant

Subscribed and sworn to me this 11th day of May 2016.



Notary Public

My Commission expires 09-12-17

REBECCA J. HIBDON Notary Public - Notary Seal STATE OF MISSOURI County of Morgan My Commission Expires 9/12/2017 Commission # 13762153

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **JAMES M. RUSSO**

4 **HILLCREST UTILITY OPERATING COMPANY, INC.**

5 **CASE NO. WR-2016-0064**

6 **Q. Please state your name and business address.**

7 A. James M. Russo, 2215 Minnow Branch Road Stover, Missouri 65102.

8 **Q. Are you the same James M. Russo who prepared the proposed rate**
9 **design and alternative of phased-in rates direct testimony for the Office of the Public**
10 **Counsel (“OPC”) filed in Case No. WR-2016-0064?**

11 A. Yes.

12 **Q. Have you made any changes to your previously filed Direct Testimony?**

13 A. No.

14 **Q. What is the purpose of your Rebuttal Testimony?**

15 A. The purpose of my rebuttal testimony is in response to Missouri Public
16 Service Commission Staff (“Staff”) witness Jarrod J. Robertson’s direct testimony.

17 **Staff Witness Jarrod J. Robertson**

18 **Q. Does OPC agree with Staff’s proposed rate design?**

19 A. No. OPC is uncertain by what Staff is actually proposing after a review of
20 Staff’s Direct Testimony as well as corresponding work papers and schedules provided to
21 OPC in this case.

22 **Q. Please elaborate on your above statement.**

1 A. It is difficult to determine Staff’s exact rate design proposal because of
2 numerous discrepancies in the numbers cited as well as the schedules attached in direct
3 testimony. The discrepancies include numbers related to the actual increase in revenue
4 requirement, proposed customer classes, residential customer usage, and the percent of
5 increase for the monthly customer charge as well as the volumetric rate.

6 **Q. What is the proposed revenue requirement increase proposed by Staff**
7 **for Hillcrest Utility Operating Company, Inc. (“Hillcrest” or “Company”) water and**
8 **sewer operations?**

9 A. In reviewing Staff’s Direct Testimony and attached schedules, I observed
10 dollar amounts for the proposed revenue requirement increase for water operations ranging
11 from \$139,361 to \$144,778 (Direct Testimony of Paul R, Harrison, Page 8 Line 4, Direct
12 Testimony of Kimberly K. Bolin, Page 3 Line 9 and Schedule KKB-d2 page 13 of 167,
13 Direct Testimony of Jarrod J. Robertson, Page 7 Line 22) as well as dollar amounts for the
14 proposed revenue requirement increase for the sewer operations ranging from \$148,493 to
15 \$167,413(Direct Testimony of Paul R, Harrison, Page 8 Line 4, Direct Testimony of
16 Kimberly K. Bolin, Page 3 Line 10 and Schedule KKB-d2 page 14 of 167, Direct
17 Testimony of Jarrod J. Robertson, Page 8 Line 6).

18 **Q. What does OPC believe is Staff’s actual proposed revenue increase for**
19 **the Company’s water and sewer operations?**

20 A. OPC relied on the dollar amounts listed in item number one from page two
21 of the signed *Company/Staff Partial Agreement Regarding Disposition of Small Water*
22 *Company Revenue Increase Request*, the dollar amounts listed in item number one from
23 page two *Company/Staff Partial Agreement Regarding Disposition of Small Sewer*

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1 *Company Revenue Increase Request*, and the accounting schedules attached to those partial
2 agreements with all the cited documents being filed in the *Partial Disposition Agreement*
3 *and Request for Evidentiary Hearing* by Staff on March 25, 2016. A review of those
4 documents indicate the proposed revenue increase for the Company's water operations is
5 \$144,630 and the proposed revenue increase for the Company's sewer operations is
6 \$167,263. These two numbers are the agreed-upon increases for water and sewer
7 operations as agreed upon by Staff and the Company. The use of any other number
8 distorts and, ultimately, invalidates this agreement.

9 **Q. What is Staff's proposed customer classifications?**

10 A. Mr. Roberson discusses the creation of a new customer class for customers
11 residing in apartments in the Company's water operations on lines 10 thru 15 on page 7 of
12 his direct testimony. He states this new customer class will make the water operations rate
13 structure consistent with the sewer operations. He then inserts, without any previous
14 reference, a commercial class with the same proposed rates as a residential customer class.

15 **Q. Did you explore this further?**

16 A. Yes. I reviewed Staff's proposed tariff sheets for further clarification.
17 Unfortunately, this was not instructive. Both the proposed "PSC MO #3" water service
18 tariff on Original Sheet No. 4 and the proposed "PSC MO # 4" sewer service tariff on
19 Original Sheet No. 4 were attached to the *Partial Disposition Agreement and Request for*
20 *Evidentiary Hearing* filed by Staff show the Company's current customer classifications.
21 None of these documents offer detail sufficient to explain Staff's reasoning in the creation
22 of these classifications.

1 **Q. Does OPC agree with Staff's proposed customer classes assuming Mr.**
2 **Robertson is actually proposing residential, apartment and commercial customer**
3 **classes?**

4 A. Yes. OPC is proposing the creation of a residential, apartment, and
5 commercial customer class based on the usage characteristics of each class.

6 **Q. Do you agree with the way Staff designed rates for the Company's**
7 **water operations as stated in Mr. Robertson's direct testimony?**

8 A. No, I disagree with the way Staff designed the rates for the Company's
9 water operations as to how the residential customer class are being weighted the same as
10 the commercial customer class in determining the monthly customer charge. Further, I
11 disagree with the way costs are allocated between the customer charge and the volumetric
12 rate on many of the expense items for the Company's water operations.

13 **Q. Why do you disagree with the water residential customer class being**
14 **weighted the same as the water commercial customer class?**

15 A. The two classes are not equal. As stated in my direct testimony, the
16 commercial class represents 1.65% of the total water customers but uses 8.41% of the total
17 water consumed. The commercial customers are putting a greater demand on both the
18 Company's water and sewer systems and it is appropriate for a greater portion of the costs
19 to be allocated to this class.

20 **Q. Why do you disagree with Staff's cost allocations between the monthly**
21 **customer charge and the volumetric rate for the Company's water operations?**

22 A. First, Mr. Robertson improperly allocated a portion of the bank fees,
23 uncollectible accounts, and property taxes expense line items to the volumetric rate. These

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1 types of expenses are not necessary for the production of water. The correct way to treat
2 these expenses is to assign all of it to the monthly customer charge.

3 Second, Mr. Robertson allocated 50% of systems repairs and maintenance expense
4 to the volumetric rate. I am concerned with Mr. Robertson's allocation between the
5 monthly customer charge and the volumetric rate based on the condition of the water
6 system. The Company invested substantially in plant related to the source of supply,
7 pumping equipment, and water treatment. New plant items will typically require less
8 repairs and maintenance when compared to the old, replaced plant items. Based on this, the
9 systems repairs and maintenance expense should be allocated 20% to the volumetric rate.

10 Third, Mr. Robertson improperly allocated a flat 25% of the following expenses to
11 the volumetric rate: administrative and general salaries, transportation, employee pension
12 & benefits, employer FICA taxes, and state unemployment taxes. These items can be
13 allocated between monthly customer charge and the volumetric rate based on actual data
14 such as time sheets, contacts, and responses to data requests.

15 However, Hillcrest does not have any employees of its own to allocate between the
16 monthly customer charge and the volumetric rate. The parent corporation, Central States
17 Water Resources ("CSWR"), has three employees and only a portion of their time is
18 allocated to the regulated utility. These three employees and their self-designated titles are
19 Josiah Cox as President, Jack Chalfant as Chief Financial Officer ("CFO") and Brenda
20 Eaves as office manager. A review of the information provided by the Company to Staff
21 and OPC clearly shows the CFO and the office manager do not visit the water and sewer
22 systems. The job description for the CFO shows he does not perform any duties related to
23 the production of water. It is possible an extremely small portion of the office manager's

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1 time may include duties related to the production of water and, as a result, I have allocated
2 2% of the office manager's time to volumetric rate. The President does visit the system
3 and performs a portion of his time to duties related to the production of water. I have
4 allocated 10% of the President's time to the volumetric rate. The result of my review is a
5 total allocation of approximately 5% of expenses described in lines 11-13 of page five of
6 this testimony should be assigned to the volumetric rate. The Company's transportation
7 expense is 100% related to the president's travel to the Company's facilities. To be
8 consistent, I allocated the same 10% to the volumetric rate for transportation expense
9 allocated of the President's time.

10 Fourth, Mr. Robertson improperly allocated a flat 33% to the volumetric rate for
11 state and federal income taxes, interest expense, and return on investment. These expense
12 items are allocated between the monthly customer charge and the volumetric rate based on
13 actual plant. The plant categories of source of supply, pumping equipment and water
14 treatment are allocated to the volumetric rate. An analysis of the investment in these plant
15 categories, less the accumulated depreciation expense, shows approximately 67.3% of
16 these expense items should be allocated to the volumetric rate.

17 **Q. Do you agree with Mr. Roberson's typical residential customer usage**
18 **for a water customer?**

19 **A.** No. Mr. Robertson used 5,300 gallons a month as the typical residential
20 customer usage for a water customer. This overstates the actual water consumed by
21 approximately 35% and effectively distorts the percentage increase on a typical residential
22 customer's water bill. Mr. Robertson states the impact on the typical residential water
23 customer is 368.96%. However, when using his proposed numbers for the monthly

1 customer charge and the volumetric rate attached to his direct testimony labeled schedule
2 JRR-d4, his proposed increase is 276.49%. If Mr. Robertson used the actual water
3 consumed by a typical residential customer, the increase would be 323.26%.

4 **Q. Do you agree with the way Staff designed rates for the Company's**
5 **sewer operations as stated in Mr. Robertson's direct testimony?**

6 A. No. I note Mr. Robertson weighed the residential and commercial
7 customers equally.

8 **Q. Why do you disagree with the sewer residential customer class being**
9 **weighted the same as the sewer commercial customer class?**

10 A. I disagree for the same reasons as I disagreed in the water operations.
11 Commercial customers use more water and provide a greater volume of materials to be
12 treated by the sewer plant. It is appropriate for commercial customers to pay a greater
13 portion of the costs related to the Company's sewer operations.

14 **Q. How does your factoring of the sewer commercial customer class**
15 **benefit the sewer residential customer class and the sewer apartment customer class?**

16 A. Each customer class pays its appropriate share when costs are properly
17 allocated. Hillcrest sewer residential customer class and the sewer apartment customer
18 class will pay a lower monthly sewer bill when the sewer commercial class is paying costs
19 related to their level of usage of the system.

20 **Q. Do you agree with Staff's second proposal which Staff refers to as a**
21 **phase-in of rates?**

22 A. No. Staff's proposal is not a true phase-in of rates based on general
23 standards of accounting. Staff is including so-called non-cash flow items. It appears in

1 reviewing the schedules attached to Mr. Robertson’s direct testimony that the expenses
2 Staff includes as non-cash flow items are uncollectable accounts, depreciation expense,
3 and return on rate base. Staff proposes these non-cash items plus carrying costs are
4 “carried over” for inclusion in the next rate case and will be part of the Company’s new
5 cost of service established in that proceeding.

6 **Q. What do you mean by your statement that Staff’s proposal is not “a**
7 **true phase-in of rates”?**

8 A. Staff’s recommendation sets the rates at a reduced level that does not
9 include non-cash items. These rates do not have an opportunity to change until the
10 Company files a subsequent rate case and rates are re-established to the Company’s current
11 cost of service established in that future proceeding. Phased-in rates are set at a reduced
12 level of the actual cost of service and are automatically raised at set intervals to what the
13 rates would have been without the phase-in of rates plus carrying costs of the deferred
14 amount.

15 **Q. Are there any authoritative sources that discuss phased-in rates of a**
16 **regulated utility?**

17 A. Yes, the Financial Accounting Standards Board (“FASB”) issued Statement
18 92, *Regulated Enterprises-Accounting for Phase-in Plans-an Amendment of FASB*
19 *Statement No. 71* in August of 1987.

20 **Q. Does FASB 92 discuss what types of allowable costs related to the**
21 **construction of new plant that are eligible for deferral?**

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1 A. Yes. FASB 92 discusses the allowable costs related to the construction of
2 the new plant eligible for deferral include current operating costs, depreciation, interest on
3 borrowed funds invested in the plant, and an allowance for earnings for the utility.

4 Q. **Does FASB 92 list any criteria for allowable costs that are deferred in**
5 **rates?**

6 A. Yes. FASB 92 lists four criteria that must be met: (a) the plan has been
7 agreed to by the regulator, (b) the plan specifies when recovery will occur, (c) all allowable
8 costs deferred under the plan are scheduled for recovery within ten years of the date when
9 deferrals begin, and (d) the percentage increase in rates scheduled for each future year
10 under the plan is not greater than the percentage increase in rates scheduled for each
11 immediately preceding year.

12 Q. **Do you believe Staff's proposed phase-in of rates meets the eligible**
13 **costs allowed to be deferred under FASB 92?**

14 A. No. Mr. Roberson states non-cash flow items will be removed from the
15 revenue requirement starting on line 17 of page 8 in his direct testimony. Staff is including
16 existing plant in their deferral; however, this is not allowed under FASB 92.

17 Q. **Do you believe Staff's proposal meets the other criteria cited above?**

18 A. No. First, Staff's phase-in of rates is not a true phase-in. Staff simply sets
19 rates at a lower number and requires the Company to file a subsequent case where the cost
20 of service will be determined at that time. Second, criteria (b) specifies when the recovery
21 will occur is not met as there is nothing in Staff's proposal stating when deferred cost will
22 actually be recovered. Third, it is unclear from Staff's proposal whether or not criteria (c)
23 requiring all allowable costs to be recovered within ten years will be met. Finally, it is not

1 possible to determine whether the percentage of increase under criteria (d) is met as the
2 size of any future increase is unknown.

3 **Q. Does OPC's alternate proposal for the phase-in of rates meet the**
4 **requirements of FASB 92?**

5 A. Yes, OPC's alternate proposal as described beginning on line 8 of Page 14
6 of my Direct Testimony meets the requirements of FASB 92.

7 **Q. Does OPC agree with Staff's recommendation that the Company file a**
8 **rate case after one year?**

9 A. No. OPC believes Staff's proposal leaves too many questions as to what
10 Staff will allow in the next case as well as the possibility of a disagreement between Staff
11 and the Company on several issues. OPC further believes the probability of a rate case
12 filed one year from resolution of this current case will also result in costly litigation with
13 the majority of said cost being passed on to the rate payer.

14 **Q. Please elaborate on your statement that OPC believes the possibility of**
15 **a disagreement between Staff and the Company is likely on several issues and that the**
16 **probability of a rate case filed one year from the settlement of this rate case will also**
17 **result in costly litigation.**

18 A. OPC believes there are too many unknowns and it is not possible to predict
19 what the issues will be involved in the next rate case. A lot can happen in a year. An
20 external factor, such as the general state of the national and local economy, may have an
21 influence on any subsequent rate case. In addition, OPC has no reason to believe items
22 litigated in this case will not be relitigated in a subsequent case. Salaries and the cost of
23 capital are two items that come to mind. Finally, the parent company of Hillcrest is in an

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1 expansion mode and acquiring new utilities. How corporate costs will be allocated in a
2 subsequent rate case is another item of internal uncertainty.

3 Q. **Does this conclude your Rebuttal Testimony?**

4 A. Yes, it does.