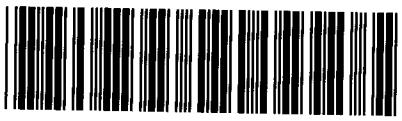

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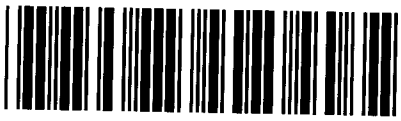

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Addendum StartPage: 0

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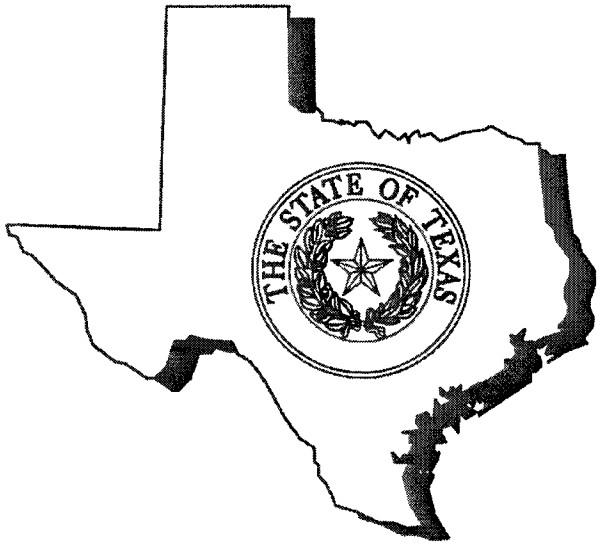
PUBLIC UTILITY COMMISSION
FILING CLERK

SOAH DOCKET NO. 473-16-1834.WS
PUC DOCKET NO. 45283

RATEPAYERS' APPEAL OF THE	§	**BEFORE THE STATE OFFICE**
DECISION BY NORTH SAN SABA	§	**OF**
WATER SUPPLY CORPORATION	§	**ADMINISTRATIVE**
TO CHANGE RATES	§	**HEARINGS**



DIRECT TESTIMONY OF
FRED BEDNARSKI, III
WATER UTILITY REGULATION DIVISION
PUBLIC UTILITY COMMISSION OF TEXAS
MAY 2, 2016

TABLE OF CONTENTS

ATTACHMENTS

I. PROFESSIONAL QUALIFICATIONS

Q. Please state your name and business address.

A. Fred Bednarski, III, 1701 N. Congress Avenue, P.O. Box 13326, Austin, Texas 78711.

Q. By whom are you currently employed and how long have you been employed there?

A. I have been employed by the Public Utility Commission (PUC or Commission) in the Water Utility Regulation Division since September 2014. Prior to that, I was employed by the Water Supply Division of the Texas Commission on Environmental Quality (TCEQ) from April 2013 to August 2014 as a Financial & Managerial Review Specialist.

Q. Please describe your educational background and past work experience.

A. I graduated from the University of Texas in Austin with a Bachelor of Liberal Arts degree with a major in economics and Bachelor of Business Administration degree with a major in accounting from Texas State University. I was previously employed as an Auditor for the Health & Human Services Commission Office of Inspector General in Austin, Texas. My responsibilities included examining, investigating, and reviewing financial documentation and management practices to ensure legal compliance with state and federal laws, rules, and regulations pertaining to the Medicaid and Children's Health Insurance Programs. I was also employed as a Trading Operations Analyst with the Texas Teacher Retirement System and the State Auditor's Office of Texas as an Auditor. I have worked in the accounting field since August of 1993.

Q. Please describe your current work responsibilities.

A. My responsibilities include reviewing water and sewer retail rate/tariff change applications and conducting audits to review, analyze, and to recommend a revenue requirement. I am also responsible for participating in water and sewer utility case settlement negotiations, preparing and providing testimony for evidentiary hearings, and reviewing the outcome of audits of utilities for contested rate applications, wholesale rate appeals, retail rate appeals and cost of service appeals. In addition, I review and processing certificate of convenience and necessity (CCN) related applications including Sale/Transfer/Mergers (STM) applications. I also review, audit, analyze, and prepare comprehensive reports based on my review of complex business plans and/or financial and managerial information with the purpose of making a recommendation on the financial and managerial capability of a retail public water or sewer utility to the PUC.

Q. Do you have a prepared resume discussing your professional experience, education, and background?

A. Yes, I do. A copy of my professional resume is attached to my testimony as Attachment FB-1 Resume of Fred Bednarski.

Q. Did you prepare this testimony and all the attachments?

A. Yes, I did.

Q. Please describe specific training you have had in the rate making area.

A. I have worked in water utility regulation for the State of Texas since April 01, 2013. I have received one-on-one rate training sessions conducted by experienced TCEQ and PUC staff. I attended the National Association of Regulatory Utility Commissioners National Utility Rate School, from May 12–16, 2014. I have also spent time evaluating rate applications and making recommendations regarding costs of service and utility rates. I work under the guidance of experienced experts in the field.

Q. How many rate/tariff change applications and/or rate appeals or cost of obtaining service petitions have been previously assigned to you?

A. I have been assigned approximately 41 rate/tariff change applications and/or rate appeals or cost of obtaining service appeals during my employment with the Commission and have provided direct testimony regarding the following cases:

- Docket No. 42862 – *Appeal of Water and Sewer Rates Charged by the Town of Woodloch CCN Nos. 12312 and 20141;* and,
- Docket No. 43554 – *Petition of Mansions at Turkey Creek, LP Pursuant to Texas Water Code § 13.043 for Review of the Decision by Northwood Municipal Utility Districts No. 1 to Change Rates in Harris County.*

II. PURPOSE & SCOPE OF TESTIMONY

Q. Are you familiar with the present case?

A. Yes, I am.

Q. Please explain the purpose of your testimony and your role in this case.

A. The purpose of my testimony is to present Commission Staff's recommendation as to the overall cost of service or revenue requirement for the rates being contested in this case. The cost of service will be used by staff engineering specialist, Sean Scaff, to determine the rate that should have been set at the time North San Saba Water Supply Corporation (NSS WSC) changed the rates subject to this proceeding. My role in this case also includes conducting a financial review of NSS WSC's records and information that were available to the Board of NSS WSC at the time the rate change was approved on August 11, 2015[1] for the test period of 2014 used by NSS WSC to set the rates which are the subject of this proceeding.

Q. What documents have you examined?

A. I reviewed all written responses and documents that were provided by NSS WSC in response to requests for information which includes rate information, annual financial reports, budgets, and cash forecasts. I also reviewed all testimonies filed in this docket, the Commission's rules and guiding water rate making principles. For the purposes of my analysis, I only used documents and information that were available to the board of directors at the time the decision was made to increase rates subject to this appeal.

[1] NSS WSC's Response to Second Request for Information NO. 2-5, Documents Bates –labeled NSSWWSC 000331-000335.

III. METHODOLOGY

Q. What is the basis of your recommendation?

A. The basis of my recommendation is, in part, the Texas Water Code Ann. § 13.043(e) (TWC), which states in relevant part:

> "...in an appeal under Subsection (b), the commission shall hear the appeal de novo and shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken. . . The utility commission may consider only the information that was available to the governing body at the time the governing body made its decision and evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings. . ."

I also used TWC § 13.043(j) to develop my recommendation, which states in relevant part that "the utility commission shall use a methodology that preserves the financial integrity of the retail public utility."

Finally, I used publications which speak to generally accepted practices for ratemaking and my experience in other cases to develop my recommendation.

Q. What information was available to NSS WSC's board of directors when it fixed its rate?

A. In support of its rate increase, NSS WSC provided its 2014 Audited Financial Statements, Annual 2014 Budget, Loan Agreements, Board Minutes, and other supporting documents.

Q. What methods are used by water supply corporations to determine their revenue requirements and which one did you use in this case?

A. The most common methods used by water supply corporations to determine revenue

requirements are the cash-needs method and the utility method. I used the cash-needs method.

Q. What are the cash-needs and utility methods?

A. Both methods are used to develop a revenue requirement. I have provided a comparative schedule below for the equations used in each method.

Comparison of Cash-needs and Utility Methods	
Cash Needs	**Utility**
Equation: RR = E + DS + DSC + CI Where:	RR = E + D + T + (RB x ROR) Where:
RR = Revenue requirement or cost of service	RR = Revenue requirement or cost of service
E = Operating Expenses	E = Operating Expenses
DS = Debt Service	D = Depreciation
DSC = Debt Service Coverage	T = Taxes
CI = Capital Expenditures (annually recurring)	RB = Rate Base
	ROR = Rate of Return

Simply stated, the cash-needs method uses debt service and coverage payments for recovering revenues to pay for long term assets while the utility method uses depreciation and return for recovering revenues to pay for long term assets. As stated in the *"Principles of Water Rates, Fees, and Charges: Manual of Water Supply Practices M1"* by the American Water Works Association *(AWWA M1 Manual)* (Attachment FB-3), "the objective of the cash-needs approach for developing a cost of service is to provide revenues sufficient to recover total cash requirements for a given time period." The *AWWA M1 Manual* also states that the cash-needs approach is used by government-owned utilities (GOU). GOU are water utilities created by state or other government agency legislative action. They are typically not-for-profit entities, similar to NSS WSC. A GOU's primary purpose is to provide its designated service area with potable water in an adequate supply

at reasonable costs so that people of the area may promote their health, safety and welfare. GOUs operate financially to recover their total costs of providing service to their customers and do not have a goal of earning a profit from the provision of such service. GOUs focus on paying their cash expenses and debt service, which is normally used to pay for long term assets such as plant and equipment. The focus on debt service upholds a GOU's ability to obtain debt for future required improvements. The cash-needs method provides confidence that cash will be available to provide debt payments and preserve the financial integrity of the retail public utility. Under the cash-needs method, the cost of service includes the following: allowable operating and maintenance expenses; reasonable and prudently incurred debt service costs; recurring capital improvements that are not debt-financed or contributed, and reasonable contributions to a cash reserve account, typically in the form of debt service coverage. For a larger GOUs, bond covenants will define debt service coverage requirements. Furthermore, under the cash basis method, revenues must be adequate to cover all cash-needs, including debt obligations as they become due.

Q. Is NSS WSC considered a GOU?

A. No. NSS WSC was formed under the TWC, Chapter 67 as a non-profit member-owned, member controlled water supply corporation (WSC). WSCs typically operate in a not-for-profit economy like a GOU, and use the cash-needs method.

Q. Why did you chose the cash-needs method rather than the utility method?

A. I chose the cash-needs method so that the Commission can set a rate, based on my

recommended cost of service that preserves the financial integrity of the entity. The cash-needs method focuses on the amount of cash needed to pay debt and operating expenses, which meets the goal of TWC § 13.043(j). NSS WSC has no profit motive and its members are concerned about the level of the current rates. The cash-needs method is appropriate because the focus is not on profit, but on covering expenses and debt service. Furthermore, the information for this method was supplied by NSS WSC, but the information on plant and equipment required to set a utility method cost of service was not supplied by NSS WSC.

Q. What is NSS WSC's requested revenue requirement?

A. NSS WSC's revenue requirement for Fiscal Year (FY) 2014 is $388,723 as listed in Attachment FB-2 Column C.[2] This amount consists of NSS WSC's operating expense amounts reported in Note 5 and Note 6 of NSS WSC's 2014 Audited Financial Statements,[3] long term debt service of $10,332, and TCEQ Fine Expense amount of $7,020.

Q. Did you use NSS WSC's revenue requirement?

A. I did not use all of the amount requested by NSS WSC and I will elaborate on why below in my testimony. My recommendation is based on the actual cash-needs of NSS WSC for the reasons previously stated.

[2] Direct Testimony of Katharine Gage (March 30, 2016), EXH. KG-3.
[3] NSS WSC's Response to First Request for Information NO. 1-5, Documents Bates –labeled NSSWWSC 000004-000024.

Q. What test period is your review of the cost of service based on?

A. January 2014 thru December 2014 or FY 2014.[4]

Q. Why did you use this test period?

A. I used this test period since NSS WSC provided written documentation specifying that this was the test period they used as well as NSS WSC's rate increase was approved by their board on August 11, 2015. Furthermore, it is a representative test year because it is within a year of when the rates were set and it was based on NSS WSC's actual costs of service.

Q. Please explain your process for reviewing a WSC's records to determine the cost of service to provide retail water service.

A. I use the information provided by the WSC to determine the WSC's cost of service for providing water service. For a WSC, this normally consists of historical financial information and a budget. I requested and reviewed the records NSS WSC had available at the time it made the decision to change its water utility rates on August 11, 2015. I reviewed the financial statements to determine debt service and coverage requirement amounts and the cost of operations and maintenance. I further reviewed the operations and maintenance expenses to determine if they produce a rate that is just and reasonable as required by TWC § 13.043(j). In order to make this determination, I reviewed the individual expenses included in the cost of service for reasonableness and necessity in providing utility service.

[4] North San Saba's Response to First Request for Information NO. 1-4, Documents Bates –labeled NSSWWSC 000003.

Q. Based upon the information provided through the parties' testimony and responses to requests for information, what is your recommended revenue requirement for North San Saba's water services?

A. Based on my review of the information provided, I recommend a revenue requirement for water service of $354,500, as documented in Attachment FB-2, column E, row 34.

Q. Please explain how you arrived at the revenue requirement or cost of service.

A. I arrived at this amount by using the cost of service amounts reported in Katherine Gage's revenue requirement in her testimony EXH-KG for NSS WSC.[5] These amounts are listed in my Attachment FB-2 column C. Ms. Gage obtained most of the amounts from NSS WSC's Audited Financial Statements.[6] Based on review of this information I determined NSS WSC's total operating and maintenance cost is $225,683.68 as listed in my Attachment FB-2 column E, row 25. Furthermore, I determined NSS WSC's annual debt service requirement is $103,053.48 based on the outstanding loan terms and balances as listed in Attachment FB-2, column E, row 32 and documents provided by NSS WSC.[7] To provide for recurring capital improvements that are not debt-financed or contributed, cash reserve balance, and non-reoccurring expenses (such as fines or penalties), I included debt

[5]Direct Testimony of Katharine Gage (March 30, 2016), EXH. KG-3.
[6] NSS WSC's Response to First Request for Information NO. 1-5, Documents Bates –labeled NSSWWSC 000004-000024.
[7] NSS WSC's Response to First Request for Information NO. 1-19, Documents Bates –labeled NSSWWSC 000222, North San Saba's Response to Second Request for Information NO. 2-6, Documents Bates –labeled NSSWWSC 000336 to NSSWSC 000348, North San Saba's Response to Second Request for Information NO. 2-7, Documents Bates –labeled NSSWWSC 000349 to NSSWSC 000375, North San Saba's Response to Second Request for Information NO. 2-8, Documents Bates –labeled NSSWWSC 000376 to NSSWSC 000378, and North San Saba's Response to Second Request for Information NO. 2-9, Documents Bates – labeled NSSWWSC 000379 to NSSWSC 000380.

coverage of $25,763.37 (Attachment FB-2, column E, row 33). The sum of these amounts listed above equals the revenue requirement of $354,500.

Q. Does the revenue requirement you recommend support the future cash needs of NSS WSC and appear reasonable in amount?

A. Yes, I compared NSS WSC's 2014 Budget[8] to the 2014 Audited Financial Statements[9] and the 2015 Budget[10] to the NSS WSC's Cash Flow Projection spreadsheet.[11] The total revenue requirement amount I used appears reasonable to cover future operations.

Q. How did you determine the fixed and variable water expenses?

A. I assigned a percentage amount to each cost category included in the cost of service to determine the total fixed and variable portion of the cost of service. I used my experience, and discussion with experienced peers to make this judgement. The percentage amounts were determined based on whether or not water usage was a cost driver for a particular expense. These percentages were then multiplied by the total expense category to determine the fixed and variable amount resulting in a revenue requirement. The total calculated amounts are $253,329.04 (Attachment FB-2, column G, row 34) for fixed costs and $101,171.49 (Attachment FB-2, column I, row 34) for variable costs.

[8] NSS WSC's Response to First Request for Information NO. 1-6, Documents Bates –labeled NSSWWSC 000025.
[9] NSS WSC's Response to First Request for Information NO. 1-5, Documents Bates –labeled NSSWWSC 000004-000024.
[10] NSS WSC's Response to Third Request for Information NO. 3-17, Documents Bates –labeled NSSWWSC 000718 & 000774.
[11] NSS WSC's Response to Third Request for Information NO. 3-16, Documents Bates labeled NSSWWSC 000772.

Q. Based on your review, what adjustments did you make to the cost of service and other revenues as a credit to the cost of service?

A. My adjustments to operations and maintenance expenses and other revenues appear in Attachment FB-2, column D, rows 2 through 7 and rows 19, 21, 23, and 24. The explanations for the adjustments follow.

1. I reduced the cost of service recoverable through the rate design by the following revenue amounts since these revenues supplement revenues collected by rates and pay for expenses included in the cost of service. These revenues are generated through fees and are used to offset the cost of service. Therefore, these other revenues reduce the amount of revenue required to be collected from the base rate and gallonage charges in the rate design by a total of $6,699.32. Other revenues include the following: a) capital fee of $1,500, b) membership fee of $1,000, c) late fees of $720, d) line extension revenues of $3,275, e) expense rebate of $165, and f) interest income of $39.32.[12]

2. I reduced depreciation expense amounts to zero since depreciation expense is not typically included in the cash-needs method. The reductions to depreciation expense are made as follows: depreciation of $10,484 and system depreciation of $128,504. As previously discussed, the cash-needs method includes debt service and coverage in lieu of depreciation and return.

3. I reduced long term debt of $10,332 on row 21 to zero since all annual loan payment amounts are calculated and included on rows below the operations and maintenance

[12] NSS WSC's Response to First Request for Information NO. 1-10, Documents Bates –labeled NSSWWSC 000062

expenses in the annual total debt payment amount; and,

4. I reduced TCEQ's fine expense $7,020 on row 24 to zero since this is not an annual reoccurring expense to provide water. The 25% debt service coverage amount and cash reserves are sufficient to pay for the non-recurring fine.

Q. Do you have any comments on debt service and debt service coverage?

A. Yes, I do.

Q. Please explain your debt service amount included in the cost of service and how you arrived at the amount.

A. I recommend a debt service amount of $103,053.48 (Attachment FB-2, column E, row 32) which is the total annual interest expense and principal payment amounts based on all loans executed to finance system improvements. I based this amount on the actual note payment schedules with the exception of one note, for which I included a hypothetical payment amount based on a reasonable amount of time and cost to cover loan costs associated with long-term assets.

For all but one note, I calculated the annual payments amount based on Note 4: Notes Payable in 2014 Audited Financial Statements of NSS WSC[13] and the loan agreements and amortization schedules submitted.[14] I calculated the annual principal and interest payment for each note based on the terms of the agreements except for the loan for $70,000. I

[13]NSS WSC's Response to First Request for Information NO. 1-5, Documents Bates –labeled NSSWWSC 000013.
[14]NSS WSC's Response to Second Request for Information NO. 2-6, Documents Bates –labeled NSSWWSC 000336 to NSSWSC 000348, and NSS WSC's Response to Second Request for Information NO. 2-7, Documents Bates – labeled NSSWWSC 000349 to NSSWSC 000375

calculated the annual payment terms for this note based on 30 years instead of three years because this loan was executed for future capital improvement needs and to cover the short fall from the most recent system improvements.[15] It is inappropriate to include the actual debt service for long term assets in the cost of service when the life of the note is so much shorter than the life of the assets. To do so would overstate the cost of service and not be reasonable and necessary. To ensure financial integrity, I note that the difference in the actual payment amount and what I recommend is covered by the debt service coverage amount that I have recommended.

Q. Please provide your recommendation as to debt service coverage (DSC) included in the cost of service and how you arrived at this amount.

A. Based on the annual debts payment amount of $103,053.48, I multiplied this amount by 25%, or 0.25 for a total of DSC amount $25,763.37(Attachment FB-2, column E, row 33).

Q. Why did you include DSC in the cost of service?

A. My decision to include a coverage amount is based on the *AWWA M1 Manual* discussions with regard to cash-needs approach and DSC, and my experience. The recommended amount is intended to ensure NSS WSC's ability to pay its debts, cover unexpected or non-recurring costs and variations in revenue caused by changing usage. I also reviewed the level of cash reserves that NSS WSC maintains. At the end of the test year, cash reserves

[15] NSS WSC's Response to First Request for Information NO. 1-19, Documents Bates labeled NSSWWSC 000222, NSS WSC's Response to Second Request for Information NO. 2-8, Documents Bates labeled NSSWWSC 000376 to NSSWSC 000378, and NSS WSC's Response to Second Request for Information NO. 2-9, Documents Bates –labeled NSSWWSC 000379 to NSSWSC 000380

totaled $220,677. The reserves together with my recommended DSC included in the cost of service provide an excellent opportunity for NSS WSC to preserve its financial integrity as long as its expenses are controlled.

DSC is typically either required by bond covenants or added to the cost of service as a reserve to ensure payment of debt. Additionally, it is prudent, just, and reasonable to add 25% DSC to the cost of service so that debt service may be possible as expenses change and to preserve the financial integrity of the utility. This coverage amount will help provide for operating capital and enable NSS WSC to cover unforeseen costs as well as help pay provide ample funds to pay for the annual debt service on the $70,000 loan that will be paid off in June 2018.

Q. Do you think the cost of service you recommend will allow NSS WSC to charge a just and reasonable rate?

A. Yes.

IV. SUMMARY & CONCLUSION

Q. What are your final revenue requirements recommendation in this case?

A. Based on the information presented in this case that was available to NSS WSC at the time it made its decisions to approve the rate change, I am recommending a final revenue requirement of $354,500 (Attachment FB-2, column E, row 24).

Q. Does this conclude your direct testimony at this point in the proceeding?

A. Yes. However, I reserve the right to supplement or adjust this testimony during the course of the proceeding as new facts or evidence becomes available.

Attachment FB-1

FRED BEDNARSKI III
820 San Remo Blvd.
Lakeway, Texas 78734
512-786-3989 (H)
512-239-4758 (W)

Education

The University of Texas May 1989
Austin, Texas
Degree: BA/Economics

Southwest Texas State University August 1995
San Marcos, Texas
Degree: BBA/Accounting
GPA Major 3.2

Work Experience

Texas Commission on Environmental Quality
Public Utility Commission of Texas April 13–Present
Austin, Texas
Financial and Managerial Review Specialist

Review water/sewer utility retail rate change applications for utility costs of service and follow up on applications through the final action date to ensure rates are just and reasonable. Conduct special utility audits as directed. Participate in utility case [certificates of convenience and necessity (CCN) or rate] settlement negotiations, prepare/provide testimony for evidentiary hearings, including describing the outcome of audits on the books and records of utilities related to rate case proceedings for contested applications/cost of service appeals, CCNs/sale, transfer, and mergers (STMs); and maintain effective communication and coordination with legal staff and co-workers. Review, audit, analyze, and prepare comprehensive reports of complex business plans and/or financial and managerial information for public water or sewer utilities as well as provide assistance for public water systems and retail public water or sewer utilities in developing business plans.

Office of Inspector General Texas HHSC Aug 10–March 13
Austin, Texas
Auditor

Performed moderately complex (journey-level) auditing work for the Medicaid/CHIP Audit Unit (MCAU). The work involved examining, investigating, and reviewing financial documentation and management practices to ensure legal compliance with state and federal laws, rules, and regulations pertaining to the Medicaid and Children's Health Insurance Programs. Worked as part of audit teams within the MCAU in conducting audits for program economy, efficiency, and effectiveness with a goal of identifying and eliminating waste, abuse, and fraud within the programs. Worked under general supervision with limited latitude for the use of initiative and independent judgment.

Texas Teacher Retirement System Aug 04–July 10
Austin, Texas
Trading Operations Analyst

Performed complex analysis, support and accounting of equity trading operations. Work involved assisting in developing and implementing automated processes, assisting in administering trading systems, monitoring the trading and execution and settlement process, researching, reconciling and resolving problems and discrepancies, performing pre- and post-trade analytics, verifying exchange rates and conversions, and providing back up assistance to the Senior Trading Operations Specialist. Assisted in preparation of Board Commission Report.

Texas State Auditor April 98–Aug 04
Austin, Texas
Staff Auditor

Work involved the examination, investigation, and review of records, reports, financial statements, and management practices to ensure legal compliance with state statutes and internal regulations, and performance of audits for program economy, efficiency, and effectiveness. Team member on several financial audits as well as compliance and management control audits, and Team leader for 2 Performance Measure Audits.

JI Specialty Services, Inc. Aug 97–Dec 97
Austin, Texas
Corporate Accountant

Prepared Financial statements, consolidation of statements, intercompany transactions, reconciliations, managed cash and payroll.

Hydrolab Corporation Sept. 95–Aug 97
Austin, Texas
Staff Accountant

Responsible for accounts receivable, monthly sales and commission report preparation, reconciliation of various G/L accounts, deposit preparation, monthly and quarterly sales tax returns, and credit analysis.

Ricon Products and Fast Sept. 95–Sept. 96
Stop Stores, Inc.
Austin, Texas
Accountant

Responsible for payroll, accounts receivable, accounts payable, reconcile statements, and post entries to the general ledger.

William Bonner CPA Aug 93-Sept. 94
Austin, Texas
Bookkeeper

Reconciled bank statements, coded and posted checks to the general ledger, and conducted general administrative duties.

Austin Teachers Federal Credit Union April 93-Sept 94
Austin, Texas
Financial Service Representative

Awards Received

- Employee of the month (July 29, 1994 Austin Teachers Federal Credit Union)
- The University of Texas Football Letterman 1986 and 1988
- Passed the Audit and Business Law sections of the CPA exam
- Bushel of Fun Award from TRS for demonstrating outstanding dedication by working flexible and long hours to accommodate both International and Domestic Trade Operations
- CGAP exam passed 12/4/2010

Special Skills

- Software Experience: Bloomberg Trading System, Gateway (data management software) PAM (equity security accounting system), Windows, Microsoft Office, Microsoft Excel, Teammate (auditing software), and other accounting software (Peachtree, Mapics, & Quickbooks)
- Attended the National Association of Regulatory Utility Commissioners Utility Rate School from May 12-16, 2014

Attachment FB-2

Ratepayers' Appeal Of The Decision By North San Saba Water Supply Corporation (NSSWSC) To Change Rates
SOAH Docket 473-16-1834.WS, PUC Docket 45283
Staff's Recommended Revenue Requirement

Attachment FB-2
Fred Bednarski
4/22/2016

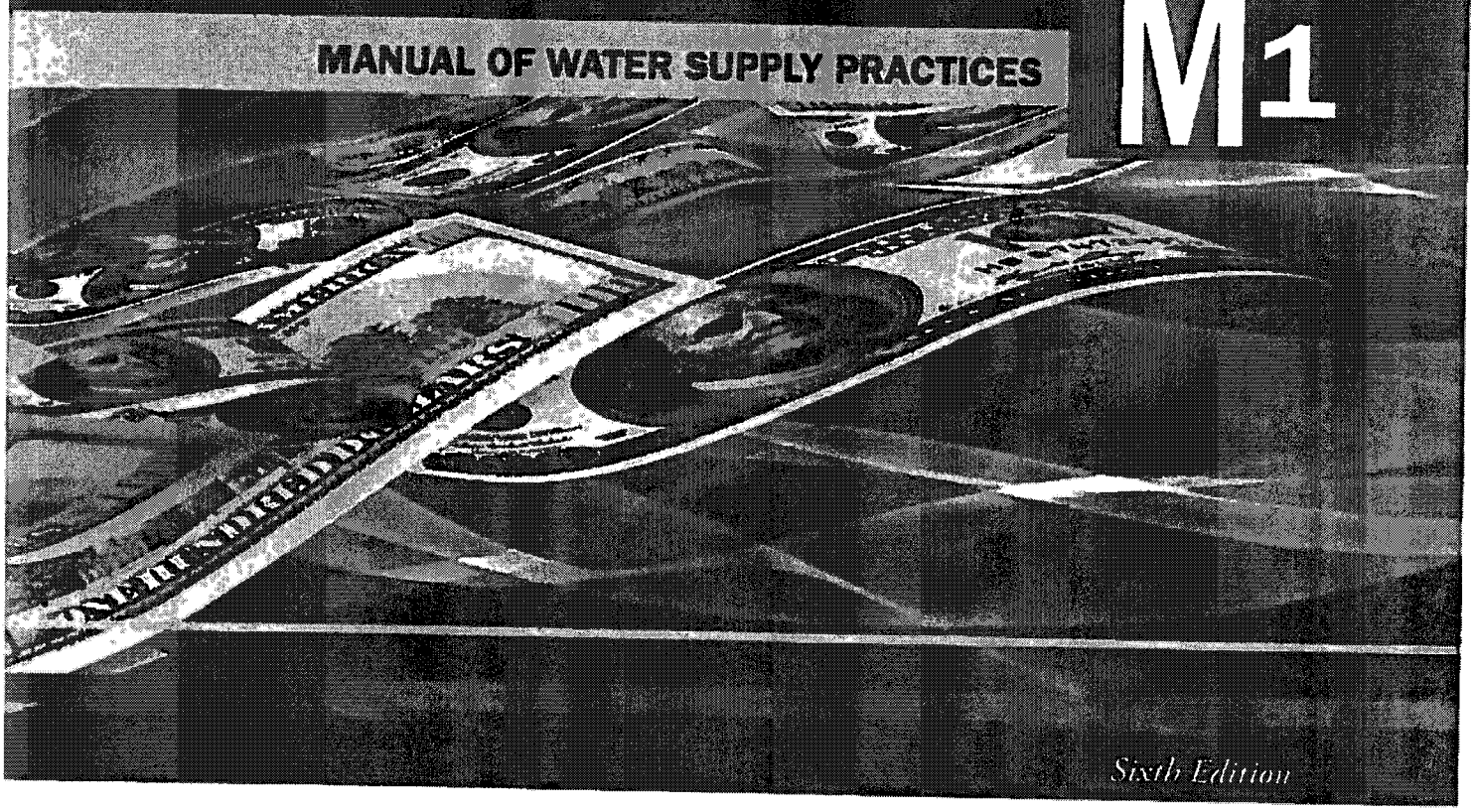
A	B	C	D	E	F	G	H	I
Line #		NSSWSC Revenue Requirement	Staff Adjustments	Staff Revenue Requirement	% Fixed	Water Fixed Cost	% Variable	Water Variable Cost
1	**Revenue Account**							
2	Capital Fee	-	(1,500.00)	(1,500.00)	50%	(750.00)	50%	(750.00)
3	Membership Fee	-	(1,000.00)	(1,000.00)	50%	(500.00)	50%	(500.00)
4	Late Fee	-	(720.00)	(720.00)	50%	(360.00)	50%	(360.00)
5	Line Extension	-	(3,275.00)	(3,275.00)	50%	(1,637.50)	50%	(1,637.50)
6	Expense Rebate		(165.00)	(165.00)	50%	(82.50)	50%	(82.50)
7	Interest Income	-	(39.32)	(39.32)	50%	(19.66)	50%	(19.66)
8	**Total Income**	-	**(6,699.32)**	**(6,699.32)**	**50%**	**(3,349.66)**	**50%**	**(3,349.66)**
9	**Expense Account**							
10	Salaries	16,590.00		16,590.00	100%	16,590.00	0%	-
11	Contract Labor	66,000.00		66,000.00	100%	66,000.00	0%	-
12	Utilities	29,096.00		29,096.00	0%	-	100%	29,096.00
13	Repairs and Maintenance	30,051.00		30,051.00	55%	16,528.05	45%	13,522.95
14	Office Expenses	10,260.00		10,260.00	100%	10,260.00	0%	-
15	Accounting & Legal	4,680.00		4,680.00	100%	4,680.00	0%	-
16	Insurance - WC & Liability	5,914.00		5,914.00	100%	5,914.00	0%	-
17	License & Dues	5,467.00		5,467.00	100%	5,467.00	0%	-
18	Postage & Freight	2,316.00		2,316.00	100%	2,316.00	0%	-
19	Depreciation	10,484.00	(10,484.00)	-		-		-
20	Miscellaneous	534.00		534.00	20%	106.80	80%	427.20
21	Long Term Debt	10,332.00	(10,332.00)	-		-		-
22	Water Purchased	61,475.00		61,475.00	0%	-	100%	61,475.00
23	System Depreciation	128,504.00	(128,504.00)	-		-		-
24	TCEQ Fine	7,020.00	(7,020.00)	-		-		-
25	**Total Operations & Maintenance Cost**	**388,723.00**	**(163,039.32)**	**225,683.68**	**55%**	**124,512.19**	**45%**	**101,171.49**
26								
27	**Debt Service (Notes to Financial Statements and Agreements Provided)**							
28	USDA Annual Loan Pmt Amount (5%, 40 Years, $650,000, 9/2031)	-	37,680.00	37,680.00	100%	37,680.00	0%	-
29	TWDB Annual Loan Pmt Amount (4.07%, 10 Years, $310,000, 1/2022)	-	38,664.00	38,664.00	100%	38,664.00	0%	-
30	TWDB Annual Loan Pmt Amount (0.28%-5.79%, 30 Years, $335,000, 1/2043)	-	22,699.20	22,699.20	100%	22,699.20	0%	-
31	Nelson Lewis, Inc. Annual Loan Pmt Amount (4%, 3 Years, $70,000, 6/2018, annual PMT = $24,800.16) Normalized for 30 years for supplement to original loan cost of $335,000)	-	4,010.29	4,010.29	100%	4,010.29	0%	-
32	**Total Annual Debt Payments**		**103,053.48**	**103,053.48**	**100%**	**103,053.48**	**0%**	-
33	**Debt Coverage 1.25**		**25,763.37**	**25,763.37**	**100%**	**25,763.37**	**0%**	-
34	**Total Revenue Requirement**	**$ 388,723.00**	**$ (34,222.47)**	**$ 354,500.53**	**71.46%**	**$ 253,329.04**	**28.54%**	**$ 101,171.49**

0000024

Attachment FB-3

Principles of Water Rates, Fees, and Charges

MANUAL OF WATER SUPPLY PRACTICES M1



Sixth Edition

American Water Works Association

The Authoritative Resource on Safe Water™

Advocacy
Communications
Conferences
Education and Training
Science and Technology
Sections

0000026

Principles of Water Rates, Fees, and Charges

AWWA MANUAL M1
Sixth Edition

American Water Works Association

Contents

Foreword

In 1954, the American Water Works Association (AWWA) published the report *Determination of Water Rate Schedules*, which later was issued as the first AWWA manual on water rates. Since then, AWWA Manual M1, *Water Rates*, has been updated several times, most recently in 2000. The Fifth Edition, titled *Principles of Water Rates, Fees, and Charges*, consolidated a number of previous publications into what has been referred to as the new *M1 Super Manual*.

The issues associated with water rates and charges have continued to evolve, and this update of M1, the Sixth Edition, is a reflection of that evolution. For example, this edition makes current the numeric examples used throughout the manual, consolidates chapters where appropriate, and includes new material reflective of changes in the industry (e.g., chapter IV.6, Water-Budget Rates). In the future, the AWWA Rates and Charges Committee will continue to update this manual as new issues and questions arise.

As with the other manuals prepared by the Rates and Charges Committee and AWWA in general, this manual will not prescribe a solution. Rather, it is intended to provide guidance and advice. The examples presented are used only to demonstrate the generally accepted methodologies discussed in this manual. The underlying data and assumptions are not endorsed or recommended either by AWWA or the Rates and Charges Committee for use elsewhere. The purpose of this manual is to describe and present issues associated with developing water rates, fees, and charges, to enumerate the advantages and disadvantages of various alternatives, and to provide information to help users determine water rates, fees, and charges that are most relevant to a particular situation.

Acknowledgments

The AWWA Management Division Board of Trustees gratefully acknowledges the contributions made by members (past and present) of the Rates and Charges Committee, particularly the Editorial Committee, and others who drafted, edited, and provided the significant and critical commentary essential to developing this manual. The Editorial Committee dedicated countless hours in the final stages of preparation of this edition to ensure the overall technical quality, consistency and accuracy of the manual.

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A special thanks to Fernando Aranda, with StepWise Utility Advisors, Parker, Colo., for his assistance in updating the numeric examples used throughout the manual.

Introduction

During the last 20 years of the twentieth century and into the twenty-first century, the cost of supplying potable water increased significantly. This rapid increase can be attributed to many factors, including the passage and implementation of the US Safe Drinking Water Act and corollary legislation in other countries, population growth, the need to develop more remote and expensive water supplies, the need to replace aging infrastructure, and rapid economic development in some areas. The increased costs of meeting water quality requirements and utility plant needs have resulted in increased water rates and charges.

Historically, customers generally paid little attention to their water bills or the structure of the rates. However, as the rates and charges increased and water bills became a more significant percentage of customers' overall expenses, consumers have become increasingly interested in the rate-setting process. And with the heightened focus on conservation and water-use efficiency, water utilities are also recognizing the effect that rates and charges can have on customer use patterns.

With this recognition, new challenges in customer engagement, revenue stability, and the use of accepted cost-of-service and rate-design approaches become apparent. As the challenges of the industry change, so do the "tools" available including how customers are charged for service. To this end, the types of rate structures used by utilities and discussed in this manual now include an emerging rates design approach: water-budget rates (chapter IV.6). This approach attempts to reflect the unique water-use requirements of individual account holders and is gaining in use in some water-supply constrained utilities/geographies.

Additional changes to the manual include expansion of the chapters on System Development Charges (chapter VI.2) and Rates for Fire Protection Service (chapter IV.8), consolidation of the chapter on Value of Service Pricing into the Marginal Cost Pricing chapter (chapter V.8), and a significant rework of the chapter on Wholesale Rates—now renamed as Outside-City and Wholesale Rates (chapter V.1). Many of the other chapters have been updated to reflect current practices, and the numeric example used throughout the manual has also been revised.

The AWWA Rates and Charges Committee believes that a utility's full revenue requirements should be equitably recovered from classes of customers in proportion to the cost of serving those customers. However, the committee also recognizes that other considerations may, at times, be equally important in determining rates and charges and may better reflect emerging objectives of the utility or the community it serves, including: water-use efficiency, revenue stability, and affordability.

The emergence of new rate and pricing policies has brought a continuing evolution in rate structures. In some cases, water rates and charges may have been adopted to achieve certain goals without a full understanding of the impacts or resulting implications. Some rate alternatives, if not properly designed, may even have impacts that are counter to what was intended.

This manual is intended to help policymakers, managers, and rate analysts consider all relevant factors when evaluating and selecting rates, charges, and pricing policies. It is a comprehensive collection of discussions and guidance on a variety of issues associated with designing and developing water rates and charges.

This manual contains seven sections:

- Section I provides an overview of the rate-setting process and the key steps in completing a cost-of-service analysis.

- Section II discusses the determination of revenue requirements.
- Section III presents the process in which costs are functionalized, allocated, and distributed to classes of customers.
- Section IV presents various rate structures and how they are developed.
- Section V presents pricing alternatives related to specific customers or groups of customers and a number of rate-design considerations.
- Section VI discusses the derivation and implementation of capacity and development charges.
- Section VII presents various implementation considerations.

is that it may be difficult to project costs, and it lacks the certainty of a historical test year. The advantage of a projected test year is that the rates to be developed for the test year will likely match up to the utility's budget or anticipated costs. Finally, a pro forma is a combination of the historical and projected test year. A pro forma test period begins with historical data and costs and then adjusts only for those "known and measurable" costs or changes. An example of a known and measurable change would be a labor agreement that specifies a certain percent adjustment to labor rates. Simple inflation is not considered a known and measurable change in costs. The disadvantage of the pro forma test year is that it may not fully capture changes in costs, but the advantage is that it has adjusted for only those costs that can clearly be documented as needing adjustment in the test year.

Generally, government-owned utilities are free to set their own policies regarding test-year periods. However, investor-owned utilities and those government-owned utilities that are under the jurisdiction of utility commissions are subject to particular legislative and regulatory practices that must be followed. These practices vary from jurisdiction to jurisdiction.

Methods of Accumulating Costs

Once the test year or time period for establishing the revenue requirements has been determined, the next decision is the method that will be used to accumulate costs within the revenue requirement analysis. The two generally accepted methods of accumulating costs for the revenue requirements are the *cash-needs approach* and the *utility-basis approach*. Each of these methods and the component costs contained within each method is discussed in more detail in the following sections.

Cash-Needs Approach

The objective of the cash-needs approach for developing revenue requirements is to provide revenues sufficient to recover total cash requirements for a given time period. Generally, the cash-needs approach is used by government-owned utilities (except in those jurisdictions where regulation requires the use of the utility approach). As used in this manual, the term *cash needs*, as it applies to measuring revenue requirements of a utility, should not be confused with the accounting terminology of the *cash-basis* accounting method of revenue and expense recognition. From a rate-making perspective, *cash needs* refers to the total revenues required by the utility to meet its annual cash expenditures, whereas the accounting term *cash basis* refers to revenues being recognized as earned when cash is received and expenses charged when cash is disbursed. The cash-needs approach to measuring revenue requirements of a utility may be evaluated on the cash, accrual, or modified accrual basis of accounting.

Generally, revenue requirement studies using the cash-needs approach are more straightforward to calculate than revenue requirement studies using the utility-basis approach. Many utilities budget in a format that may be very similar to the cash-needs approach.

Revenue requirement components. Basic revenue requirement components of the cash-needs approach include O&M expenses, taxes or transfer payments, debt-service payments, contributions to specified reserves, and the cost of capital expenditures that are not debt-financed or contributed (i.e., capital improvements funded directly from rate revenues). Depreciation expense is not included within the cash-needs revenue requirement.

Operation and maintenance expenses. Depending on the test year selected, the O&M expense component can be projected based on actual expenditures and adjusted to reflect anticipated changes in expenditures during the projected test-year period

Pro forma adjustments to historical O&M expenses are determined by incorporating known and measurable changes to recorded expenses, and by using well-considered estimates of future expenses.

Generally O&M expenses include salaries and wages, fringe benefits, purchased power, purchased water, other purchased services, rent, chemicals, other materials and supplies, small equipment that does not extend the useful life of major facilities, and general overhead expenses. For a government-owned utility, other elements of O&M expense might also include the costs of support services rendered by the municipality to the utility, such as the use of computer facilities, assistance in collecting water bills, procurement activities, human resources administration, fleet management, and other support services.

Taxes or transfer payments. A utility may be required to pay certain taxes as a part of their normal operations (e.g., a state utility tax on gross revenues). A utility may have a number of tax payments for their locality. In contrast to a tax payment, a transfer payment may be for items such as a payment in lieu of taxes (PILOT). AWWA's policy statement on Finance, Accounting, and Rates* states that "Water utility funds should not be diverted to uses unrelated to water utility services. Reasonable taxes, payments in lieu of taxes, and/or payments for services rendered to the water utility by a local government or other divisions of the owning entity may be included in the water utility's revenue requirements after taking into account the contribution for fire protection and other services furnished by the utility to the local government or to other divisions of the owning entity." Accordingly, payments made to a municipality's general fund should reimburse the general fund for the necessary cost of goods and/or services required by the water utility to provide water service. Transfers from the water fund to a municipal general fund, in addition to those specifically identified above, may be applicable to unique local situations and should be considered in conjunction with legal requirements and in conformance with the previously referenced AWWA policy statement.

Debt-service payments and specified reserves. The debt-service component of the cash-needs approach usually consists of principal and interest payments on bonds or other outstanding debt instruments. It may also include debt-service reserve requirements as established by the indenture or covenant. Other reserves are often required to provide for operating working capital, emergency repairs and replacements, as well as for routine replacements and extensions. In addition to debt service and payments to reserve fund accounts, many utilities are required to provide net revenues sufficient to cover the bonded debt, particularly if revenue bonds are involved. Typically, debt-service coverage requirements specify that revenues be sufficient to meet O&M expenses and taxes and, at a minimum, to equal or exceed a stated percentage of the annual debt-service payments. Coverage requirements are a test of the adequacy of utility revenues and do not necessarily represent a specific cash requirement or funding obligation, unless debt-service coverage is the controlling factor in terms of the overall annual revenue needs of the utility, which may be the case in a particular year. The coverage requirements are intended to provide a measure of security for bondholders. As such, coverage requirements must also be considered in determining the total annual revenue needed to comply with the utility's debt covenant agreements.

Rate-funded capital expenditures. This component of the cash-needs approach is not all capital expenditures, but rather, only that portion of the capital expenditures to be paid during the test year from current rate revenues. Capital expenditures may be classified into three broad categories: (1) normal annual (routine) replacement of existing facilities; (2) normal annual extensions and improvements; and (3) major

* AWWA Officers & Committee Directory, *Statements of Policy on Public Water Supply Matters.*

capital replacements and improvements. A utility should periodically review and update its needs in each of these areas to recognize changing conditions. Projections for such needs are essential in developing overall revenue requirement projections. These projections of total capital needs should be accompanied by estimates of contributions received from developers or customers, government grants, and other nonutility sources.

Government-owned utilities commonly use current revenues to finance

- Normal annual replacements,
- Extensions, and
- Improvements (such as meters, services, vehicles, smaller mains, valves, hydrants, and similar items that occur regularly each year).

Major capital projects are typically financed with a combination of long-term debt and equity or cash generated from annual utility revenues. Capital costs are distributed over the term of the bonds by repaying the debt over a number of years and using equity. An advantage of using long-term debt to fund major capital expenditures is that it results in a better matching of customers' charges with the use of the facilities so that existing customers will not be paying 100 percent of the initial cost of facilities that will be used for many years. Debt-service coverage compliance may result in the generation of annual revenues that may be available for funding of a portion of major capital improvements from annual revenues.

Utility-Basis Approach

The utility-basis approach to measuring revenue requirements is typically mandated for investor-owned water utilities and mandated or permitted for government-owned utilities in jurisdictions where the utility is regulated by a utility commission or other similar regulatory body.

The utility-basis approach for determining revenue requirements consist of O&M expenses, taxes or transfer payments, depreciation expense, and a "fair" return on rate base investment. While the utility-basis approach is in some ways similar to the cash-needs approach, where these two methods diverge is in how capital infrastructure is funded within the rates. The cash-needs approach utilizes debt-service and capital expenditures funded from rates. In contrast to this, the utility-basis approach uses depreciation expense and a return on rate base.

Municipal or government-owned utilities may also use the utility-basis approach for purposes of cost allocation. It is considered an appropriate method for calculating the costs of service applicable to all classes of customers, but is particularly applicable to those customers located outside the geographical limits of a government-owned utility. When a government-owned utility provides service to customers outside its geographical limits or corporate boundary, the situation is similar to the relationship of an investor-owned utility to its customers because the owner (political subdivision) provides services to nonowner customers (customers outside its geographical limits). In this situation, the government-owned utility, like an investor-owned utility, is entitled to earn a reasonable return from nonowner customers based on the value of its plant investment required to serve those customers. Some jurisdictions have laws or guidelines to regulate the rates that government-owned utilities charge customers located outside their limits. Chapter V.1 discusses the considerations in using the utility-basis approach for determining rates for outside-city and/or wholesale customers.

capacity – The water utility's ability to have a certain quantity or level of resources available to meet the water service needs of its customers. Capacity is the combination of plant- and service-related activities required to provide the amount of service required by the customers. The plant facilities required are a composite of all types of facilities needed to provide service. It represents the ability of the water utility to meet the quantity, quality, peak loads, and other service requirements of the various customers or classes of customers served by the utility.

capital expenditures – Expenditures that result in the acquisition of or the addition of fixed assets.

capital program – A multiyear plan for capital expenditure spending to meet the regulatory, renewal, replacements, and expansion needs of a water utility. It sets forth each project or other contemplated expenditure in which the water utility is to have a part and specifies the full resources estimated to be available to finance the projected expenditures.

cash basis – The basis of accounting under which revenues are recorded when cash is received and expenditures are recorded when cash is disbursed.

cash-needs revenue requirements – The method of establishing annual revenue requirements giving consideration to the annual budget expenditures for operation and maintenance expenses, debt-service payments, cash-financed capital improvements, reserve fund requirements, and taxes. Debt-service coverage requirements must also be taken into account to establish cash-needs revenue requirements.

combined approach – An approach to determining system development charges based on a blended value of both the existing and expanded system's capacity. This method is typically used where some capacity is available in parts of the existing system (e.g., source of supply), but new or incremental capacity will need to be built in other parts (e.g., treatment plant) to serve new development at some point in the future; a combination of the buy-in and incremental cost approaches.

commodity costs (variable costs) – Costs that tend to vary with the quantity of water produced, including the costs of chemicals, a large part of power costs, and other elements that follow or change almost directly with the amount of water produced. Purchased water costs, if the water is purchased on a unit volume basis without minimum charges or any associated demand charges, may also be considered as commodity costs.

commodity demand – The method of cost allocation in which the annual cost of service by functional cost category is allocated to the cost components of commodity, demand, customer, and direct fire protection costs.

commodity demand rate – A multiple-part rate containing both fixed and variable components, generally requiring the fixed portion (or a percentage of it) to be paid independent of volume of water usage, while the variable portion is based on the volume of water usage. The fixed portion is generally based on the customer's peak demand requirements; it may also include customer charges (billing, metering, etc.).

connection charge – A charge made by the utility to recover the cost of connecting the customer's service line to the utility's facilities. This charge is often considered as contribution of capital by the customer or other agency applying for service.

construction work in progress (CWIP) – The utility's investment in facilities under construction, but not yet dedicated to service. The inclusion of CWIP in the rate base varies from one regulatory agency to another.

flat rate – A periodic stated charge for utility service not based on metered quantity of service. Such a rate is used where service is provided on an unmetered basis.

flotation costs – The costs incurred by the issuer of securities incident to the planning and sale of securities. These costs include the spread for underwriters, feasibility studies, printing, advertising, fees of counsel, costs of presentations to potential investors, and the value of staff time and facilities required in the planning and sale of the bonds. They ordinarily do not include the costs of holding elections when required as a part of the process of authorization.

functional cost category – Costs related to a particular operational function of a utility for which annual operation and maintenance expenses and utility plant investment records are maintained. Generally, specific cost accounting codes are assigned to each functional cost category for purposes of tracking the costs and maintaining generally accepted accounting records. Functional cost categories include those activities related to source of supply, pumping, treatment, transmission and distribution mains, distribution storage, customer meters and services, customer accounting, billing and collections, and general and administrative-related activities.

future capacity – The capacity for service in excess of immediate requirements that is built into a utility in anticipation of increased demands for service resulting from higher uses by existing customers or from growth in the service area.

government-owned water utility – A water utility created by state or other government agency legislative action, with the mandate that the purposes of the utility are public purposes and that its functions are essential governmental proprietary functions. Its primary purpose is to provide its designated service area with potable water in an adequate supply at reasonable costs so that people of the area may promote their health, safety, and welfare. A government-owned water utility may be part of a municipal government operation, a county agency, a regional authority, or take such other form as is appropriate for its service area. Government-owned utilities operate financially to recover their total costs of providing service to their customers and do not have a goal of earning a profit from the provision of such service.

gross receipts tax – Payments made to a government entity based on the gross revenues received by the water utility from its revenues.

increasing block rates – A schedule of rates applicable to blocks of increasing usage in which the usage in each succeeding block is charged at a higher unit rate than in the previous blocks. Each successive block rate may be applicable to a greater volume of water delivery than the preceding block(s).

incremental cost method – An approach to determining system development charges based on the value or cost to expand the existing system's capacity. This method is typically used when the existing system has limited or no capacity to serve new development and new or incremental facilities are needed to serve new development now and into the future; may also be used in conjunction with the buy-in method resulting in the combined cost approach.

indenture – The formal agreement between a group of bondholders, acting through a trustee, and the issuer as to the terms and security for the debt. Ordinarily, it involves the placement of a lien on either the income, property, or both, being acquired from expenditure of the proceeds of the bond issue.

investor-owned water utility – A utility owned by an individual, partnership, corporation, or other qualified entity with the equity provided by shareholders

service connection – That portion of the service line from the utility's water main to and including the curb stop at or adjacent to the street line or the customer's property line. It includes other valves or fittings that the utility may require at or between the main and the curb stop but does not include the curb box or meter.

standby service – Service provided occasionally under certain defined conditions, such as in the event of failure of the customer's normal water supply system. Fire protection is another form of standby service.

system development charge – A contribution of capital toward existing or planned future backup plant facilities necessary to meet the service needs of new customers to which such fees apply. Three methods used to determine the amount of these charges are the buy-in method, the incremental cost method, and the combined approach which includes elements of the first two methods. Various terms are used to describe these charges in the industry, but these charges are intended to provide funds to be used to finance all or part of capital improvements necessary to serve new customers.

system development charge facilities – Those facilities, or a portion of those facilities, that have been identified as being required for new customer growth. The cost of the facilities will be recovered in total or in part through system development charges. Typically these facilities include "backbone" facilities such as source of supply, pumping, treatment, and transmission mains.

test year – The annualized period for which costs are to be analyzed and rates established.

treated water – Water that has been obtained from supply sources and treated to produce potable water standards.

uniform volume charge – A single charge per unit of volume for all water used. A single uniform rate can be applicable to all customers of a utility or a separate uniform rate may be designed for each customer class.

unit cost – The cost of producing a unit of a product or service. An example would be the cost of treating a thousand gallons of potable water for use by the water utility's customers.

unit of service – An element of service for which a cost can be ascertained, such as thousand gallons, hundred cubic feet, million gallons per day, monthly bill, etc.

unmetered or flat rate – A fixed charge for unmetered service, often simply based on the number of fixtures and water-using devices of the customer.

used and useful – A term applicable to utility plant investment that is includable in the development of the rate base as part of the rate-making process. Plant investment is considered to be used and useful if it is actively used in the provision of service to customers.

user charges – The monthly, bimonthly, quarterly user charges made to the users of water service through the general water rate structures of the utility for the utility's share of the cost of providing water service. Typically these charges include both a fixed component and a variable or volume-based rate applied to metered water use.

utility-basis revenue requirements – The method of establishing annual revenue requirements giving consideration to annual operation and maintenance expense, depreciation expense, taxes, and return on rate base.

water-budget rates – A form of increasing block rates where the amount of water within the first block or blocks is based on the estimated, efficient water needs of the

Workpapers of Fred Bednarski, III

SOAH DOCKET NO. 473-16-1834.WS
PUC DOCKET NO. 45283

RATEPAYERS' APPEAL OF THE DECISION BY NORTH SAN SABA WATER SUPPLY CORPORATION TO CHANGE RATES	§ § § § § § § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

DIRECT TESTIMONY

OF

KATHERINE GAGE

ON BEHALF OF

NORTH SAN SABA WATER SUPPLY CORPORATION

March 30, 2016

30

INDEX TO THE DIRECT TESTIMONY OF

KATHERINE GAGE, WITNESS FOR

NORTH SAN SABA WATER SUPPLY CORPORATION

LIST OF EXHIBITS

DIRECT TESTIMONY OF KATHERINE GAGE

I. INTRODUCTION

Q. PLEASE STATE YOUR FULL NAME AND ADDRESS.

A. Katherine B. Gage – 7201 CR 124, San Saba, Texas 76877

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of the North San Saba Water Supply Corporation.

Q. ARE YOU EMPLOYED?

A. No, I am retired.

Q. WHAT IS YOUR RELATIONSHIP TO NSSWSC?

A. I am a Member of the North San Saba Water Supply Corporation since 1999. I am currently on the Board Directors for NSSWSC and have been since 2010. I served as President for four (4) years (2012 to 2016) and as Secretary-Treasurer for one year (2011-2012).

Q. WHAT IS YOUR PROFESSIONAL AND EDUCATIONAL BACKGROUND AND EXPERIENCE?

A. I worked in the homebuilding industry for the last 28 years of my career. I worked in many aspects of the homebuilding business including cost estimating and the bid process; contract review for land acquisition; home sales and closing documents; customer issues; sales payroll and builder bonuses; management of up to three (3) people; and interim loan process. Finally as executive secretary for an Area President who was responsible for four major housing markets, Austin, San Antonio, Denver and Phoenix. I am familiar with financial statements and other business practices. I have a high school diploma and a couple of years of college.

II. PURPOSE AND SCOPE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. To explain how and why the Board of Directors of NSSWSC raised the base and water rates it charges to its Members.

Q. HAVE YOU PREPARED ANY EXHIBITS OR SCHEDULES IN CONNECTION WITH YOUR TESTIMONY?

A. Yes. I have prepared, supervised the preparation of, or co-sponsored the exhibits listed in the table of contents to my testimony.

III. DUTIES OF THE BOARD OF DIRECTORS

Q. DO THE BOARD OF DIRECTORS MEETING REGULARLY?

A. Yes, we meet on the second Tuesday of each month at 5:30 PM in the Arrowhead Bank Building Board Room.

Q. WHO NORMALLY ATTENDS THESE MEETINGS?

A. Normally only Board Members, the Operator, Will Broyles, and the Office Manager, Cindy Hibler, attend the meetings. Participation in Board Meetings by the general Members of NSSWS is usually based on the Member's dissatisfaction with something that is on the Agenda which is posted per the Open Meeting Act; or with an invoicing issue.

Q. HOW MANY MEMBERS HAVE ATTENDED THE MEETINGS?

A. Usually we only have one (1) or two (2) general Members at the meetings. NSSWSC sent a letter dated July 17, 2015 to its Members stating that Board of

Directors planned to approve a new rate at the next regular public meeting on August 11, 2015.

[NSSWSC OFFERS EXHIBIT KG-1 – NSSWSC Letter to Members, July 2015]

Nine general Members attended the August 11th meeting; we have had between six and ten general Members attend the September through December, 2015 regular Board Meetings. In 2016 there were two general Members in January, six in February and four in March. The NSSWSC's Annual Meeting on March 22, 2016 had eleven general Members in attendance.

Q. WHAT DOES SERVING ON THE BOARD OF DIRECTORS MEAN TO YOU?

A. I believe it is my duty to ensure that the NSSWSC is able to provide water to all its Members today and in the future.

IV. COMPLIANCE AND FINANCIAL ISSUES

Q. WHAT IS INVOLVED IN ENSURING WATER IS PROVIDED TO MEMBERS OF NSSWSC?

A. NSSWSC must comply with all TCEQ regulations and with the EPA Safe Drinking Water Act.

Q. HAS THIS BEEN AN ISSUE?

A. Yes. NSSWSC is a small rural water system that currently has 264 Members with a total of 297 meters. To the best of my knowledge it was started in the 1970s by a few individuals. The system has grown over the last thirty plus years with little regard to how NSSWSC could keep up with the growth and wear and tear of the system. I am aware of only two upgrades to the system that prior to 2014. Both

for replacement of transmission lines; one in approximately 2007 on County Road 124 and the other in 2012 for Highway 16 from FM 1480 to CR 111; FM 1480 to CR 110 and on FM 1480 starting .5 mile past CR 118 to Rabbit Creek. It is my understanding both were funded by grants. The County Road 124 project was not completed because the grant did not cover all the costs and NSSWSC ran out of funds.

On December 14, 2011 TCEQ did an inspection of NSSWSC system. The inspection resulted in ten violations, six of which were corrected and NSSWSC achieved compliance on March 28, 2012. NSSWSC did not have the money to correct the other violations. As a result TCEQ Assessed Administrative Penalties that required compliance and a monetary penalty of $21,079 on May 1, 2012. NSSWSC signed an agreement with TCEQ to pay the penalty and achieve compliance on the remaining four issues. The penalty was paid with a $604 initial payment followed by 35 monthly payments of $585. This penalty was paid in full in September 2015.

Sealy Engineering, who had been working for NSSWSC for several years, was aware of the violations and was working on obtaining funding through the Texas Water Development Board (TWDB) "Drinking Water State Revolving Fund." A $310,000 loan was given to NSSWSC on December 29, 2011 for planning, acquisition and design of the project. On February 28, 2013 NSSWSC was approved for additional funds from TWDB $2,168,816 loan forgiveness (grant) and $335,000 loan. These funds were not available to NSSWSC until November 2013, at which time the engineer started the bid process, and the "construction

project" started in January 2014 and completed in November 2014. The "construction project" was over budget due to change orders not approved by the Board of Directors by $113,705 as claimed by the General Contractor, Nelson Lewis, Inc. NSSWSC was able to negotiate a settlement of $100,000 with Nelson Lewis, Inc. payable with a $30,000 down payment and 36 month loan at 4% interest beginning May 1, 2015.

Q. HAS NSSWSC COMPLETED ALL THE NECESSARY IMPROVEMENTS TO THE SYSTEM?

A. No. Our "construction project" did not address all the issues that need attention. Due to the amount of money NSSWSC received in loans and loan forgiveness, NSSWSC could only correct a few of the items that need to be addressed.

Q. WHAT OTHER ITEMS NEED TO BE ADDRESSED?

A. In May 2015, we contracted with an engineering firm to determine those issues still needing to be addressed. They have provided us with a report.

[NSSWSC OFFERS EXHIBIT KG-2 – Jacob & Martin Feasibility Study]

This report shows that there are issues with the pumps at the FM 500 pump station installed during the "construction project" which NSSWSC is in the process of replacing. The Board has approved $22,500 to replace the pumps at FM500 pumping station and to also mitigate some premature wear effects and the cause of a serious cavitation problem with the new pumps at Stingy Lane pumping station.

There is an outstanding issue with TCEQ regarding elevated storage at the Shaw Bend Tower, although no violation has been written up as of now. NSSWSC

would like to make the required improvements to achieve compliance at the Shaw Bend tower before our next inspection.

There is an issue regarding the maximum contaminant levels (MCLs) for combine radium 226 and radium 228 with the Environmental Protection Agency (EPA) that was to be resolved in the "construction project" by enabling the FM 500 pump station to blend City of San Saba Water with FM 500 well water. We have had three quarterly radium samples done in 2015 all of which were over the MCLs. Therefore, NSSWSC may have to discontinue using the FM 500 well – which by itself has a very high radium level – and purchase all its water from the City of San Saba. If that becomes necessary it will mean even more expense for NSSWSC.

In the last 2 to 3 months a 6" transmission line on FM 500 and CR 111 has begun leaking and needs to be replaced.

NSSWSC has not been able to take any action on any of these outstanding projects needing immediate attention due to lack of funds.

Q. HOW DO YOU PROPOSE TO REMEDY THESE ISSUES?

A. NSSWSC is hoping to secure a $275,000 grant from the Texas Department of Agriculture for the 6" transmission line. NSSWSC would be responsible for $13,800, approximately, in order to qualify for the grant.

The Board of Directors is very aware that we cannot add any more long term debt and are working with grant writers and Jacob & Martin, our new engineers, to find additional grants. NSSWSC has to have a good financial history plus money in the bank to qualify for many of the grants.

Q. HOW HAS THE COST OF THE "CONSTRUCTION PROJECT" AFFECTED NSSWSC FINANCES?

A. NSSWS increased its long term debt (liabilities) by $715,000 in loans from the Texas Water Development Board (TWDB) and Nelson Lewis, Inc. The two TWDB loans totaling $645,000 and are financed for 30 years, with a total monthly payment for both loans of approximately $5,022 monthly or $60,264 annually. The Nelson Lewis, Inc. loan in the amount of $70,000 has a term of 3 years, with a monthly payment of $2,066.70 or $24,800 annually.

The Board Members were aware that there was a steady decline in the cash on hand, but it was not easily recognized in the financial reports. Each month the Treasurer's report is submitted as the "Profit & Loss" (report from Quick Books) the net income would fluctuate depending on the expenses for repairs, supplies or utilities. Although the net income was normally a positive number, it did not show the ***actual*** amount of cash being spent by NSSWSC. Because the loan payments only show the interest portion of the payment on the P&L expenses, the principal portion is shown as a reduction in the long term liability. The principal monthly payment averaged per month equals $4,510 in 2014, $8,379 in 2015 (due to $30,000 down payment on Nelson Lewis, Inc. loan), and is estimated to average $6,482 in 2016. Prior to incurring long term debt from TWDB and Nelson Lewis, Inc. the monthly average principal payment was $1,256. This is approximately a 41.2% increase in the principal payment only.

The increase in long term debt and its payments and the fact that NSSWSC must address the outstanding issues with TCEQ and the EPA are the reasons why NSSWSC had to raise the rates.

Q. DID THE BOARD OF DIRECTORS LOOK FOR WAYS TO REDUCE EXPENSES?

A. Yes. But the water supply system is like an old car: it keeps running, but it breaks regularly and when it does it is expensive.

Q. COULD YOU CUT EXPENSES BY LOWERING THE OPERATOR'S CONTRACT?

A. Yes, but I'm not sure we can replace our Operator with anyone that is qualified for less money. We have not had anyone send a resume or express an interest in being the Operator for NSSWSC in the last six years. It can be a very difficult job. The Operator goes when there is a problem, regardless of the weather or personal plans. Our current Operator, Will Broyles, has done an excellent job and has been more reliable and pleasant to deal with than the previous Operator. Mr. Broyles started with NSSWSC at $49,500 annually in 2010 and is now being paid $90,000 annually. Mr. Broyles is a contractor and provides all his own equipment, including a pick-up truck, trailer, trencher, excavator, hand tools, and additional help if needed, not to mention insurance on the pick-up and equipment, and liability insurance. The previous Operator was being paid approximately $92,000 when she left the system in 2010. She operated under the same conditions as our current Operator.