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

RATEPAYERS' APPEAL OF THE DECISION BY NORTH SAN SABA WATER SUPPLY CORPORATION TO CHANGE RATES	§ § § §	PUBLIC UTILITY COMMISSION OF TEXAS

COMMISSION STAFF'S REPLY TO THE NORTH SAN SABA WATER SUPPLY CORPORATION'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

Commission Staff of the Public Utility Commission of Texas files its Reply to North San Saba Water Supply Corporation's (North San Saba WSC) Exceptions to the Proposal for Decision (PFD). In support of its Reply to North San Saba Water Supply Corporation's Exceptions to the Proposal for Decision, Staff states the following:

Pursuant to the Notice of Revised Open Meeting Date, filed on February 27, 2017, the deadline for exceptions is March 2, 2017. Therefore, Staff's Reply to Exceptions is timely filed. Based on discussions with the parties, it is Staff's understanding that settlement negotiations between North San Saba WSC and the appealing ratepayers are ongoing, but that any agreement resulting from those discussions would not be ready for filing until after March 2.

I. Reply to North San Saba WSC's Exceptions to the Proposal for Decision

A. North San Saba WSC's exception to Finding of Fact No. 12 (debt service coverage)

North San Saba's exceptions to the PFD alleges that the "ALJ did not include in her calculations the Nelson Lewis Loan."[1] That statement is incorrect. The ALJ did include the Nelson Lewis Loan in her revenue requirement for recovery at a reasonable annual amount as recommended by Staff. Staff recommended that the Nelson Lewis Loan be amortized over the life of the asset constructed. The current ratepayers have paid rates that permitted North San Saba to accrue a cash reserve that was more than sufficient to pay the loan amount in its entirety. Instead, of funding the construction project from the cash reserve, North San Saba WSC decided to collect it from customers over a three (3) year period.

Staff proposed a thirty (30) year amortization and recovery of the Nelson-Lewis loan

[1] North San Saba WSC's Exceptions to the Proposal for Decision at 2.

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because "[i]t is inappropriate to include the actual debt service for long term assets in the cost of service when the life of the note [the Nelson-Lewis loan] is so much shorter than the life of the assets."[2] Katherine Gage, a current North San Saba WSC board member, acknowledged on cross-examination that the construction project attributable to the Nelson-Lewis loan will provide benefits to future North San Saba WSC ratepayers. North San Saba WSC's proposed three-year repayment of the Nelson-Lewis loan is inequitable to North San Saba WSC's current ratepayers because they will be paying a disproportionate amount of costs for infrastructure improvements that will also benefit North San Saba WSC's future ratepayers. The repayment terms of the Nelson-Lewis loan require a monthly payment of $2,066.70.[3] Spreading this cost over North San Saba WSC's two hundred and ninety-three (293) connections[4] results in a $7.05 charge per month solely for the Nelson-Lewis loan.

In contrast, a thirty year (30) amortization period recommended by Staff requires a monthly payment of $334.19. Spreading this cost over North San Saba WSC's two hundred and ninety-three (293) connections results in a $1.14 charge per month for the Nelson-Lewis loan. This is more equitable than a three-year repayment of the Nelson-Lewis loan because it reduces the amount of costs that will be paid by North San Saba WSC's current ratepayers and because it results in a more equitable apportionment of costs between North San Saba WSC's current ratepayers and future ratepayers. Additionally, there is no financial integrity concern because Staff's recommended debt service coverage amount of $25,763.37[5] is available to pay for any unexpected expenses. "This coverage amount will help provide for operating capital and enable NSS WSC [North San Saba WSC] to cover unforeseen costs as well as help provide ample funds to pay the annual debt service on the $70,000 loan that will be paid off in June 2018."[6]

The PFD correctly adopted Staff's recommended amortization of the Nelson-Lewis loan. North San Saba WSC could have paid the Nelson-Lewis loan in full. As of December 2014, North

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[2] Direct Testimony of Fred Bednarksi III, Staff Ex. 1 at 16.

[3] *See* Direct Testimony of Katherine Gage, North San Saba WSC Ex. 2 at 9.

[4] *See* Errata to the Direct Testimony of Sean Scaff, Staff Ex. 2A at 6 (stating that North San Saba WSC has a meter count of 293).

[5] Staff Ex. 1 at 16.

[6] *Id.* at 17.

San Saba WSC had $220,677 in cash on hand, $80,426 of which was restricted as to use.[7] There was no need for North San Saba WSC to let an excess balance accrue on its construction projects. By the beginning of May 2015, North San Saba WSC had $141,447 in cash on hand.[8] This amount is approximately 5.5 times (or 550%) of Staff's recommended annual debt service coverage expense of $25,763.37. North San Saba WSC could have easily paid off the Nelson-Lewis loan in its entirety without having a rate impact on its ratepayers.

North San Saba WSC's exceptions reframe North San Saba WSC's arguments and instead allege that that the ALJ should have adopted a debt service coverage of 45%.[9] Staff disagrees with North San Saba WSC's recommended debt service coverage of 45% and the PFD's recommended debt service coverage of 35%. There is no evidentiary basis for any level of debt service coverage greater than 25%, which is the standard. Staff has addressed the PFD's proposed 35% debt service coverage in its exceptions to the PFD. The PFD reasoned that a 35% debt service coverage was reasonable because North San Saba could be assessed another TCEQ penalty or may need to make additional required infrastructure improvements.[10] These expenses are purely hypothetical. Rates should not be set, and the debt service coverage should not be increased by 40% under the PFD's proposal or 80% under the recommendation North San Saba WSC made for the first time in its exceptions to the PFD,[11] to recover hypothetical penalties. And any needed infrastructure, if required in the next year and half, may be financed through additional debt and included in rates when known with some reasonable degree of certainty.

A debt service coverage of 25% is sufficient because it allows North San Saba WSC to pay its debts and grow its cash reserves. Under a debt service coverage of 25%, North San Saba WSC

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[7] *See* Staff Ex. 1 at Workpapers, Bates Nos. 71 and 75 (North San Saba WSC's Statement of Financial Position).

[8] *See id.*, Bates No. 191 (North San Saba WSC's cash flow projections).

[9] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 2.

[10] *See* Docket No. 45283, Proposal for Decision at 11-12.

[11] The PFD recommended increasing debt service coverage from 25% to 35%, which is an increase of 40%. (40% = (35-25)/25). North San Saba WSC exceptions, at page 2, recommend increasing the debt service coverage to 45%, which is an increase of 80%. (80% = (45-25)/25). Neither of these recommendations were addressed through testimony or presented in evidence.

will have $128,816.85 ($103,053.48 + $25,763.37) to pay its actual debt repayment expense of $123,843.63 (actual payment of $24,800.16 for the Nelson Lewis loan + $99,043.20 for other debt).[12] This would allow North San Saba Water Supply Corporation to grow its cash reserves over the next year and a half by approximately $7,500 (or $4,973.22 annually). Once the Nelson-Lewis loan is fully repaid by June 2018, a debt service coverage of 25% would allow North San Saba WSC to grow its cash reserves each year by $29,773.65 ($128,816.85 – $99,043.20).

B. North San Saba WSC's exception to Finding of Fact No. 13 (overall revenue requirement)

North San Saba WSC also asserts that its revenue requirement should be $413,167.88 when taking into account its recommended shorter amortization of the Nelson-Lewis loan, an additional $6,943 in water purchase costs, and $1,737 in regulatory fees.[13] The revenue requirement should not be increased to take into account these three things. As discussed in Section IA of this Reply, the Nelson-Lewis loan should be amortized over thirty (30) years, not over the duration of its repayment, and the debt service coverage should be 25%.

Likewise, as discussed in Staff's Exceptions to the PFD, the Commission should not make an upward adjustment of $6,943 for water purchase costs because the $6,943 increase is not a known and measureable change because it is not certain, identified, quantified, and matched.[14] As an initial matter, future water usage is uncertain. Roger Whatley, the chairman of North San Saba Water Supply Corporation's board of directors, confirmed in his testimony that water demand "was a fundamentally unknowable quantity, being the future."[15] Additionally, the recommended water purchase cost of $68,418 is inconsistent with actual costs for 2014 and inconsistent with annualized costs for 2015. In 2014, North San Saba Water Supply Corporation budgeted $60,000

[12] *See* Staff Ex. 1 at Attachment FB-2.

[13] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 2.

[14] *See* Commission Staff's Exceptions to the Proposal for Decision at 2-3.

[15] *See* Rebuttal Testimony of Roger Whatley, North San Saba WSC Ex. 4 at 10.

for the water purchase cost.[16] The actual amount spent was $57,246.84, which was $2,753.16 under the budgeted figure.[17] Similarly, the North San Saba Water Supply Corporation likewise budgeted $60,000 for the water purchase cost for 2015.[18] However, the North San Saba Water Supply Corporation projected to be under its 2015 budgeted water purchase cost because it projected a monthly water purchase cost of $4,075, resulting in a yearly cost of $48,906 and being $11,094 under the budgeted figure.[19] Staff's recommended water purchase cost of $61,475 is consistent with the actual water costs for 2014, and, given the projections for 2015, ensures that North San Saba Water Supply Corporation has additional funds should the water purchase cost unexpectedly increase. Implicit in the PFD's extrapolation and annualization of water purchase costs is the premise that water usage would be constant throughout 2015. The PFD does not take into account that water usage in the latter half of 2015, which includes the fall and winter months, may decrease when compared to the first half of 2015, which includes the spring and summer months. Thus, the upward adjustment of $6,943 to North San Saba WSC's water purchase cost is not a known and measureable change and should not be included in the revenue requirement.

Finally, the $1,737 in regulatory fees should not be included because such fees are not a recurring expense that is needed to provide service to North San Saba WSC's ratepayers. Staff's recommended debt service coverage of 25% and North San Saba WSC's cash reserves are sufficient to pay for these regulatory fees.[20] Thus, once the Nelson-Lewis loan is amortized and recovered over thirty (30) years, there is no upward adjustment of $6,943 to North San Saba WSC's water purchase cost, and the $1,737 in regulatory fees is not included as an expense, the total revenue requirement is $378,500.53.[21]

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[16] *See* Staff Ex. 1 at Bates Page No. 89 (North San Saba Water Supply Corporation's comparison between 2014 budgeted costs and 2014 actual costs); at Bates Page No. 77 (independent auditor's report for 2014 that indicated $61,475 was the water purchase cost).

[17] *See id.* at Bates Page No. 89 (North San Saba Water Supply Corporation's comparison between 2014 budgeted costs and 2014 actual costs).

[18] *See id.* at Bates Page No. 190 (North San Saba Water Supply Corporation's approved annual budget for 2015).

[19] *See id.* at Bates Page No. 191 (cash flow projections for 2015).

[20] *See* Staff Ex. 1 at 15 (excluding regulatory fine expense of $7,020).

[21] *See* Errata to the Direct Testimony of Fred Bednarski III, Staff Ex. 1A at Attachment FB-2.

C. North San Saba WSC's exception to Finding of Fact No. 15 (fixed costs)

Similar to its assertion regarding the revenue requirement, North San Saba WSC asserts that the fixed costs are $305,631.53 when taking into account the shorter amortization of the Nelson-Lewis loan.[22] As discussed in Section IA of this Reply, the Nelson-Lewis loan should be amortized over thirty (30) years, not over the duration of its repayment, and the debt service coverage should be 25%. Additionally, as discussed in Section IB of this Reply, neither the $6,943 in additional water purchase costs nor the $1,737 in regulatory fees should be included in the revenue requirement. Thus, the appropriate amount for fixed costs is $277,329.04.[23]

D. North San Saba WSC's exception to Findings of Fact Nos. 17 (monthly base rate) and 19 (gallonage charges)

North San Saba WSC asserts that the monthly base charge should be $82, with the remaining $1.94 collected from gallonage charges.[24] Staff agrees with North San Saba WSC's exceptions on this point. In fact, in Staff's exceptions to the PFD, Staff recommended that the Commission adopt Staff's proposed allocation of repairs and maintenance expense 55% to fixed costs and 45% to variable costs, based upon the recommendation of Staff's expert witness in the course of exercising sound professional judgment.[25] Staff's recommended allocation of repairs and maintenance expenses would reduce the base charge approximately to the level desired by North San Saba while allowing North San Saba to collect the expense through volumetric rates.

E. North San Saba WSC's exception to Finding of Fact No. 23 (Rate Case Expense Recovery Period)

Staff is not opposed to North San Saba's request to collect rate case expenses over a two year period. A two year recovery period may be more appropriate given that more than a year has

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[22] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 3.

[23] *See* Staff Ex. 1A at Attachment FB-2.

[24] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 3.

[25] *See* Staff Exhibit 1A at Attachment FB-2.

transpired since the original rate ordinance on appeal was adopted.

F. North San Saba WSC's assertion on price elasticity

North San Saba WSC asserts that the PFD should have considered price elasticity in recommending the gallonage charges.[26] In other words, North San Saba WSC argues that the Commission should increase rates, in excess of amounts required to collect the cost of service, for potential lost revenues. North San Saba argues that the volumetric rates of customers using in excess of 4,000 gallons a month should be increased by 5% to 15% above cost of service, thereby insinuating that the rate increase may cause customer usage to decrease.[27]

North San Saba WSC provided no evidence on the price elasticity between its proposed gallonage charges and its ratepayers' consumption. Instead, North San Saba WSC cites to the price elasticity of ratepayers for the City of Austin, the City of Corpus Christi, and the San Antonio Water System.[28] North San Saba WSC has provided no evidence that the consumption behavior of its ratepayers is similar to that of the ratepayers for these three entities. In addition, Commission precedent is clear that lost revenues due to conservation are not to be considered costs for recovery.[29] Staff recommends that the Commission continue to set rates based upon cost of service principles and decline North San Saba WSC's invitation to impose a 5% to 15% rate increase over and above North San Saba's cost of service based rate increase in an attempt to prevent or counteract lost revenues attributable to the rate increase. Thus, the Commission should disregard North San Saba WSC's assertion on price elasticity.

G. North San Saba WSC's assertion that its highest volume users should not get refunds

Finally, North San Saba WSC asserts that the PFD should not be adopted because its highest volume users will get refunds.[30] To support its assertion, North San Saba WSC states that

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[26] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 4-5.

[27] *See id.* 4-5.

[28] *See id.* at 4, fn 5.

[29] CenterPoint Energy Houston Electric, LLC v. Public Utility Commission, 354 S.W.3d 899, 903-905 (Tex. App.—Austin Nov. 10, 2011) (holding that the recovery of costs related to conservation measures did not authorize the recovery of lost revenues attributable to the decrease in usage attributable to the conservation measures).

[30] *See* North San Saba WSC's Exceptions to the Proposal for Decision at 5.

"this result does not reflect the wishes of the ratepayers who brought this appeal, nor does this result serve the best interest of its members."[31] This is irrelevant. The highest volume users will get refunds, either under the rates recommended by the PFD or by Staff, because North San Saba WSC inappropriately allocated a disproportionate amount of variable costs onto the highest volume users.

II. Conclusion

Staff requests that the Commission reject North San Saba WSC's exceptions and adopt Staff's recommended rates as follows:

Revenue Requirement: $378,500.53[32]

Minimum bill		*Rates per 1,000 gallons*	
Meter	Amount	Gallons	Rate
5/8"	$78.88	0-4,000	$2.70
1"	$118.32	4,001-8,000	$4.00
1 1/2"	$197.20	8,001-20,000	$5.00
2"	$394.40	20,000+	$6.00
3"	$631.04		

[31] *Id.* at 5.

[32] *See* Staff Ex. 1A at Attachment FB-2; Errata to the Direct Testimony of Sean Scaff, Staff Ex. 2A at 8.

Date: March 2, 2017

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of this document was served on all parties of record on March 2, 2017, in accordance with 16 Tex. Admin. Code § 22.74.

Kennedy R. Meier