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APPLICATION OF MONARCH §
UTILITIES I, L.P. TO CHANGE RATES §
FOR WATER AND SEWER SERVICE §

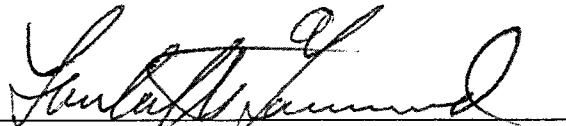
BEFORE THE STATE OFFICE
OF PUBLIC UTILITY COMMISSION
ADMINISTRATIVE HEARINGS

MONARCH UTILITIES I, L.P.'S ERRATA NO. 9
TESTIMONY OF CHARLES W. PROFILET, JR.

Monarch Utilities I, L.P.'s ("Monarch") files the attached errata to the testimony of Charles W. Profilet, Jr. The errata to Mr. Profilet's testimony is attached as Pages 4, 5, 11, 12, 12A, 13, 14, 16, and 17, and should be substituted for the testimony included within Monarch's rate filing package. The errata (1) adds a topic to his testimony on page 4, line 23, which causes the remainder of the answer to be shifted to the top of page 5; (2) reframes the question on page 11, lines 19-23; (3) deletes testimony on page 12 and inserts new testimony on page 12, lines 1-19 through page 12A, lines 1-21; (4) corrects the percentages for the steps 2 and 3 increases for sewer service on page 13, line 22; (5) corrects the increases in the average 4,000 gallon sewer bill for steps 2 and 3 on page 14, line 2; (6) corrects the number on page 16, line 13; and (7) corrects the numbers in Table 1 on page 17.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of June, 2016, a true and correct copy of the foregoing document has been sent via facsimile, certified mail, return receipt requested, first class mail, or hand-delivered to all parties of record.


LAMBETH TOWNSEND

1 serve as the Managing Director, Texas Utilities. My responsibilities include customer
2 service, operations and maintenance, capital investments, financial performance, and
3 regulatory compliance of SouthWest's utility assets in Texas. Under my supervision,
4 Texas Utilities is currently generating revenues of \$48 million per year and operating
5 with a capital budget of \$9 million per year.

6 Before joining SouthWest, I was Vice President of MWH Global, Inc.
7 ("MWH"), an international engineering-construction company in the water industry.
8 While at MWH, I was responsible for the company's Houston Northeast Water
9 Purification Plant, where the company provided design, construction, start-up, testing,
10 and operations and maintenance of the 80 million gallon per day surface water
11 treatment facility. I joined MWH in 1985. During my 22 year tenure at MWH, I was
12 project manager for water and wastewater infrastructure projects, Texas regional
13 manager, operations officer for the Utility Asset Management Services Group, and
14 leader of the Advanced Treatment Group specializing in design, construction, and
15 start-up of membrane treatment facilities.

16 Before joining MWH, I was a reservoir engineer for Exxon Production
17 Research Company in Houston, Texas from 1982 to 1985.

18 II. PURPOSE OF TESTIMONY

19 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

20 A. I will testify about the ownership structure of Monarch Utilities I, L.P. ("Monarch"),
21 the benefits of SouthWest's stewardship of Monarch, performance since the
22 acquisition of Tecon's utility systems, efforts to achieve regulatory compliance for
23 the systems acquired, and the charges for services provided by ECO Resources. I will

1 also give an overview of Monarch's request. The individuals providing testimony in
2 support of Monarch's request and the subject matter of their testimonies are in
3 Attachment CWP-1 attached to my testimony

4 **Q. WHAT SCHEDULES IN THE RATE FILING PACKAGE ARE YOU**
5 **SPONSORING?**

6 A. I am sponsoring the schedules listed in Attachment CWP-2.

7 **III. OWNERSHIP STRUCTURE**

8 **Q. PLEASE DESCRIBE THE OWNERSHIP STRUCTURE OF MONARCH.**

9 A. Monarch Utilities I, L.P. is a Texas limited partnership. Texas Water Services Group,
10 LLC, is the general partner and owns 0.1 percent of Monarch Utilities I, LP.
11 Monarch Utilities, Inc., is a limited partner and owns 99.9 percent of Monarch
12 Utilities I, L.P., and is the sole member of Texas Water Services Group, LLC. New
13 Mexico Utilities, Inc., owns 100 percent of Monarch Utilities, Inc. SouthWest owns
14 100 percent of New Mexico Utilities, Inc.

15 SouthWest also owns 100 percent of SWWC Utilities, Inc. ("SWWCU").
16 SWWCU acquired eight Texas water utilities (some with more than one public water
17 supply system), and three Texas sewer utilities. After merging the acquired utilities
18 into it, SWWCU does business under the names of the utilities that it acquired and
19 under their Certificates of Convenience and Necessity ("CCNs"). These utilities are
20 Class B or Class C utilities. Also, within Texas, SouthWest operates an unregulated,
21 wholesale water supply company called Metro-H2O Ltd. ("Metro"). SouthWest
22 refers to Monarch, SWWCU, and Metro, collectively, as the Texas Utilities.

23 An organization chart of SouthWest is Schedule IV-3 in the Rate Filing
24 Package.

1 TCEQ and documented in the form of Agreed Orders, Compliance Agreements, and
2 Voluntary Compliance Agreements.

3 **Q. WHAT IS THE CURRENT COMPLIANCE STATUS?**

4 A. Monarch completed each and every item outlined in the Agreed Orders, Compliance
5 Agreements, and Voluntary Compliance Agreements.

6 **Q. ARE THERE ANY NEW COMPLIANCE ISSUES?**

7 A. Yes. Monarch has two active Agreed Orders related to drinking water quality
8 violations, as shown on Schedule VI-1(a). Plans are in place to remediate each
9 violation by the deadline stipulated in the applicable Order. Mr. Williford provides
10 additional details in his testimony.

11 **VII. ECO RESOURCES**

12 **Q. IN YOUR DESCRIPTION OF YOUR PRIOR WORK EXPERIENCE WITH**
13 **MHW GLOBAL, YOU STATED THAT COMPANY PROVIDED DESIGN,**
14 **CONSTRUCTION, AND OPERATIONS AND MAINTENANCE SERVICES**
15 **FOR A LARGE WATER TREATMENT FACILITY. ARE YOU FAMILIAR**
16 **WITH DESIGN-BUILD SERVICES, AND HOW THEY ARE PRICED?**

17 A. Yes, I have had significant experience in undertaking and managing design-build
18 services for utilities.

19 **Q. IN HIS TESTIMONY, MR. ROSE DESCRIBES THE CONSTRUCTION**
20 **MANAGEMENT AND DESIGN-BUILD SERVICES BY ECO RESOURCES**
21 **("ECO") IN PAST YEARS, AND ALSO THE MARGINS THAT ECO**
22 **CHARGED FOR THOSE SERVICES. ARE YOU FAMILIAR WITH ECO'S**
23 **CHARGE FOR THOSE SERVICES?**

1 A. Yes. Under ECO's contract with Monarch, Windermere, and Hornsby Bend, each
2 utility paid ECO the 30% margin for the design-build services, which applied to all
3 capital expenditures to repair, replace, or expand the utility systems.

4 **Q. HOW WERE THE CONSTRUCTION MANAGEMENT SERVICES**
5 **CHARGED?**

6 A. Because ECO was not providing the construction labor for the construction
7 management services, labor was being separately charged to the non-affiliated third
8 party utilities. ECO's charges were simply for the non-labor overhead costs, such as
9 group overhead, corporate overhead, office costs, and profit. This was calculated and
10 applied as a 15% margin. All of the non-affiliated third party utilities' contracts with
11 ECO included this 15% margin.

12 **Q. HOW WERE THE DESIGN-BUILD SERVICES CHARGED?**

13 A. ECO charged the three affiliated utilities for actual labor and material costs, and an
14 additional amount to cover payroll and fringe benefits for the employees, group
15 overhead, corporate overhead, office costs, and profit. Because the amounts
16 attributable to each of these items are difficult to determine, ECO added a "margin"
17 amount that was calculated to be 30% of the total project revenues. In other words,
18 the direct costs plus the margin equaled the revenues for the project, and the margin
19 accounted for 30% of the revenues.

1 **Q. DID ECO CHARGE ITS AFFILIATES THE SAME AMOUNT FOR THE**
2 **SAME SERVICES?**

3 A. Yes. Under ECO's contracts with Monarch, Windermere, and Hornsby Bend, each
4 utility paid ECO the 30% margin for the design-build services which applied to all
5 capital expenditures to repair, replace, or expand the utility systems.

6 **Q. DO YOU HAVE AN OPINION AS TO THE REASONABLENESS OF THE**
7 **LEVEL OF MARGIN THAT MONARCH PAID TO ECO?**

8 A. In my opinion, which is based on my professional work experience and knowledge of
9 design-build contracts, I believe the margin paid by Monarch to ECO was reasonable
10 and within industry standards. For a company to stay in business, it must charge
11 enough for its services to recover its costs, both direct and indirect, plus recover a
12 profit. A firm providing design-build services is no different. The margin charged by
13 ECO to Monarch had to be sufficient to cover its overhead expenses and ECO's
14 profits on services provided to affiliates were in fact nil. Within the margin amount,
15 ECO was reimbursed for payroll related costs such as Social Security taxes, Medicare
16 taxes, health insurance, vacation and other fringe benefits; regional and group
17 overhead costs for office space, management and administrative personnel, carrying
18 costs of labor and materials, and related expenses; and SWWC's corporate overhead.
19 Monarch's projects were relatively small and delivered in rural locations, remote
20 from the regional office, increasing the amount of management overhead. Thus, the
21 30% margin paid to ECO for the design-build services was reasonable.

1 **VIII. OVERVIEW OF THE APPLICATION**

2 **Q. PLEASE SUMMARIZE MONARCH'S REQUEST IN THIS PROCEEDING.**

3 A. Monarch is continuing its policy of rate gradualism by proposing to phase-in needed
4 rate increases over three years. The request proposes that cost of service will not be
5 fully recovered until Year Three when rates are calculated to fully recover costs.

6 **Q. IS MONARCH SEEKING A RATE BASE DETERMINATION IN THIS**
7 **PROCEEDING?**

8 A. Yes.

9 **Q. IS MONARCH SEEKING TO MAKE REVISIONS TO ANY OF THE**
10 **SERVICE PROVISIONS IN ITS TARIFFS?**

11 A. Yes. Mr. Freitag provides the details of those revisions in his testimony.

12 **Q. WHAT IMPACT WILL THIS RATE INCREASE HAVE ON MONARCH'S**
13 **RESIDENTIAL CUSTOMERS?**

14 A. With the increased revenues resulting from the new rates, Monarch will have the
15 financial integrity necessary to provide excellent customer service. As I noted above,
16 Monarch proposes to increase water and sewer rates in three steps. The first step
17 increase for water is 14.50%. The next step increases for water are 1.09%, effective
18 on the first anniversary, and 1.09% on the second anniversary. The average 5,000
19 gallon water bill will increase from today's bill of \$84.25 to \$96.44 on the first step,
20 to \$97.52 on the second step, and \$98.60 on the third step.

21 The first step increase for sewer is 14.50%. The next step increases for sewer
22 are 2.20%, effective on the first anniversary, and 2.20% on the second anniversary.

1 The average 4,000 gallon sewer bill will increase from today's bill of \$77.32 to
2 \$88.55 on the first step, to \$90.50 on the second step, and \$92.49 on the third step.

3 **Q. WHAT TEST YEAR IS THE BASIS OF THE RATE FILING PACKAGE?**

4 A. The test year is July 1, 2014, to June 30, 2015.

5 **Q. DOES MONARCH SERVE CUSTOMERS INSIDE ANY CITY?**

6 A. Yes. Monarch serves water customers within the cities of Aurora, Buda, Coffee City,
7 Flower Mound, Ivanhoe, Keene, Kyle, Point Blank, Shepherd, and Willis.

8 **Q. DOES MONARCH SEEK TO CHANGE RATES FOR CUSTOMERS INSIDE
9 THOSE CITIES AS WELL AS IN THE ENVIRONS?**

10 A. Yes, except for the cities of Buda, Ivanhoe, and Kyle. Monarch has rate change
11 agreements with these three cities, so they are not affected by this filing.

12 **Q. WHAT IS MONARCH'S CAPITAL STRUCTURE?**

13 A. Monarch is proposing to use a hypothetical capital structure that is 54 percent equity
14 and 46 percent debt. Mr. Paul Moul provides the details about the capital structure in
15 his testimony. I discuss capital structure further in the following section "Drivers of
16 the Rate Increase."

17 **Q. WHAT IS MONARCH'S PROPOSED RETURN ON EQUITY?**

18 A. Monarch is proposing a return on equity of 10.75 percent. Mr. Paul Moul testifies
19 about the return on equity and the overall rate of return.

20 **Q. WHAT METHOD OF DEPRECIATION IS MONARCH USING?**

21 A. Monarch is requesting to change the depreciation method to Group Depreciation. Mr.
22 Earl Robinson testifies about the depreciation studies that he prepared for the water
23 and wastewater assets and the appropriate depreciation rates.

1 **Q. IN LIGHT OF THERE NOT BEING ANY AUTHORIZED COST OF**
2 **SERVICE AMOUNTS WITH WHICH TO COMPARE, AS REQUIRED BY**
3 **GI 2, PLEASE RECONCILE THE AMOUNTS FROM MONARCH'S MOST**
4 **RECENT RATE CASE (FILED IN 2013). SPECIFICALLY, PLEASE**
5 **RECONCILE THE REVENUE REQUIREMENT REQUESTED IN THAT**
6 **FILING, BEFORE REDUCTION FOR REVENUE HELD IN ABEYANCE, TO**
7 **MONARCH'S CURRENT REVENUE REQUIREMENT.**

8 A. In the last two and one-half years, Monarch's revenue requirement has declined
9 dramatically. Unlike in the current filing where Monarch is requesting compensatory
10 rates designed to recover its full cost of service, in the 2013 filing, Monarch
11 voluntarily relinquished \$7,296,200 of revenue requirement to reduce customer rate
12 shock. The settled rates agreed on in that 2013 proceeding were close to the rates
13 requested. The current filing shows a gross revenue requirement that is \$3,886,682
14 lower than in the 2013 filing, which results from Monarch having achieved cost
15 savings that have effectively eliminated half of the earlier Revenue Held in Abeyance
16 without any further rate increases.

17 **Q. HOW DID MONARCH ACHIEVE THOSE COST REDUCTIONS?**

18 A. Monarch achieved these cost reductions in several ways, as shown in the following
19 analysis:

Table 1**Revenue Requirement Comparison (\$000)**

2013 Rate Request	
Requested	29,156.7
Revenues Held in Abeyance	<u>7,296.2</u>
Total Revenues Requirement	36,452.9
Changes Before Dispositions Of Blue Mound and Midway – Increase (Decrease)	
Return on Rate Base	
Debt	613.0
Equity	(2,073.5)
Income Taxes	(1,228.3)
Other	(207.0)
	(2,895.8)
Changes Due To Dispositions Of Blue Mound And Midway (Decrease)	
	<u>(990.9)</u>
2016 Revenue Requirement	<u>32,566.2</u>

1 We are proposing in this filing a hypothetical capital structure of 54%
2 equity/46% debt, down from 68%/32%, and we are also dropping the requested ROE
3 from 11.25% to 10.75%. We are prepared to fully support the requested higher-than-
4 energy ROE, which is fully justified for water utilities given that, unlike water,
5 energy customers don't ingest electricity. Cost of debt has also been lowered from
6 6.63% to 6.45%. The overall hypothetical cost of capital we are now proposing has
7 been reduced by 94 basis points, from 9.71% to 8.77%. Two recent dispositions,
8 Blue Mound and Midway, have also reduced revenue requirement.

9 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 **A. Yes.**