

**Monarch Water, L.P.**  
**Example Calculation of the Weather Adjustment**

Line	Description	Notes	Value
1	Average Water Consumption (kgal) - June 2015		7.667
2	Number of Customers		143
3	Total Monthly Consumption (kgal)		1,096
4	Actual Average Temperature		75.97
5	Normal Average Temperature	30-year normal value	77.36
6	Difference between Actual and Normal Temperature	Line 5 minus Line 4	1.39
7	Average Temperature Coefficient for Summer Month		0.233035
8	Weather Adjustment for Average Temperature	Product of Lines 6 and 7	0.324
9	Actual Rainfall		7.72
10	Actual Rainfall Capped to 5 Inches		5.00
11	Normal Rainfall	30-year normal value	4.64
12	Difference between Actual and Normal Rainfall	Line 11 minus Line 10	-0.36
13	Rainfall Coefficient for Summer Month		-0.171599
14	Weather Adjustment for Rainfall	Product of Lines 12 and 13	0.061
15	Total Weather Adjustment	Sum of Lines 8 and 14	0.385
16	Average Water Consumption (kgal) - June 2015 - Adjusted		8.052
17	Total Monthly Consumption (kgal) - Adjusted		1,151

PUC DOCKET NO. 45570

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

DIRECT TESTIMONY

OF

JAMES I. WARREN

ON BEHALF OF

MONARCH UTILITIES I, L.P.

FEBRUARY 29, 2016

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**ATTACHMENTS:**

JIW-1                      List of Schedules Sponsored

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JAMES I. WARREN

I. INTRODUCTION

1

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is James I. Warren. My business address is 655 Fifteenth Street, N.W.,  
4 Washington, D.C. 20005.

5 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 A. I am a tax partner in the law firm of Miller & Chevalier Chartered ("M&C").

7 Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES AT M&C.

8 A. I am engaged in the general practice of tax law. I specialize in the taxation of and the  
9 tax issues relating to regulated public utilities. Included in this area of specialization  
10 is the treatment of taxes in regulation.

11 Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?

12 A. I am submitting this testimony on behalf of Monarch Utilities I, L.P. ("Monarch").

13 Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

14 A. For more than 25 years, I have been involved in the provision of tax services almost  
15 exclusively to companies in various segments of the utility industry. I joined M&C in  
16 February of 2012. For the three years prior, I was a partner in the law firm Winston  
17 & Strawn and for the five years prior to that, I was a partner in the law firm of Thelen  
18 Reid Brown Raysman & Steiner LLP. Before that, I was affiliated with the  
19 international accounting firms of Deloitte LLP (October 2000 – September 2003),

1 PricewaterhouseCoopers LLP (January 1998 – September 2000) and Coopers &  
2 Lybrand (March 1979 – June 1991) and the law firm Reid & Priest LLP (July 1991 –  
3 December 1997). At each of these professional services firms, I provided tax services  
4 primarily to electric, gas, telephone, and water industry clients. My practice has  
5 included tax planning for the acquisition or transfer of business assets, operational tax  
6 planning, and the representation of clients in tax controversies with the Internal  
7 Revenue Service (“IRS”) at the audit and appeals levels. I have often been involved  
8 in procuring private letter rulings or technical advice from the IRS National Office.  
9 On several occasions, I have represented one or more segments of the utility industry  
10 before the IRS and/or the Department of Treasury regarding certain tax positions  
11 adopted by the federal government. I have testified before several Congressional  
12 committees and subcommittees and at Department of Treasury hearings regarding  
13 legislative and administrative tax issues of significance to the utility industry. I am a  
14 member of the New York, New Jersey, and District of Columbia Bars and also am  
15 licensed as a Certified Public Accountant in New York and New Jersey. I am a  
16 member of the American Bar Association, Section of Taxation where I am a past  
17 chair of the Committee on Regulated Public Utilities. I am also a member of the  
18 Federal Bar and the District of Columbia Bar Associations.

19 **Q. HAVE YOU TESTIFIED IN ANY REGULATORY PROCEEDINGS?**

20 A. Yes I have. I have testified regarding tax, tax accounting, and regulatory tax matters  
21 before a number of regulatory bodies including the Federal Energy Regulatory  
22 Commission and the utility commissions in Arizona, Arkansas, California, the City of  
23 New Orleans, Connecticut, Delaware, the District of Columbia, Florida, Illinois,

1 Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Missouri, Nevada, New  
2 Jersey, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Vermont,  
3 Virginia, and West Virginia.

4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

5 A. I earned a B.A. (Political Science) from Stanford University, a law degree (J.D.) from  
6 New York University School of Law, a Master of Laws (LL.M.) in Taxation from  
7 New York University School of Law and a Master of Science (M.S.) in Accounting  
8 from New York University Graduate School of Business Administration.

9 **II. PURPOSE OF TESTIMONY**

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 A. The purpose of my testimony is to sponsor and support the tax-related information  
12 provided by Monarch in compliance with the Public Utility Commission of Texas's  
13 ("Commission") rate filing rules and regulations.

14 **Q. WERE YOU INVOLVED IN THE PREPARATION OF THE TAX-RELATED**  
15 **INFORMATION SUBMITTED IN THIS PROCEEDING?**

16 A. The primary effort for the preparation of the tax-related schedules was undertaken by  
17 Monarch personnel and an outside contractor Monarch engaged for the purpose. I  
18 consulted with Monarch and its contractor during the preparation of the information  
19 and reviewed the results when they were finalized.

20 **Q. SPECIFICALLY, WHAT SCHEDULES DO YOU SPONSOR?**

21 A. I sponsor Schedules II-E-3 through II-E-3.23. A complete list of the Schedules I  
22 sponsor is attached as Attachment JIW-1.

1 Q. HOW IS YOUR TESTIMONY ORGANIZED?

2 A. My testimony consists of seven sections. The first six describe factors that underlie  
3 the preparation of Monarch's tax-related schedules. These are:

- 4 1. Monarch's tax status and the derivation of its accumulated deferred income  
5 tax ("ADIT") balance;
- 6 2. Monarch's Involuntary Conversion Transaction;
- 7 3. Normalization;
- 8 4. Monarch's net operating loss carryforward ("NOLC");
- 9 5. Investment tax credit ("ITC") and excess deferred income taxes ("EDIT");  
10 and
- 11 6. Consolidated tax adjustments ("CTA").

12 The seventh walks through the computation of the tax expense element of cost of  
13 service.

14 Q. DOES YOUR TESTIMONY AND THE TAX SCHEDULES YOU ARE  
15 SUPPORTING REFLECT ANY IMPACT OF THE DEPRECIATION  
16 RESERVE FUND WHICH IS BEING REFUNDED IN RATES?

17 A. No, it does not. That matter is being addressed elsewhere in this case.

18 III. MONARCH'S TAX STATUS AND THE DERIVATION  
19 OF ITS ADIT BALANCE

20 Q. PLEASE DESCRIBE MONARCH'S TAX STATUS?

21 A. Monarch is a limited partnership for state law purposes. Its partners are Monarch  
22 Utilities, Inc. ("MUI"), a corporation (which owns 99.9%), and Texas Water Services  
23 Group, LLC ("TWSG"), a limited liability company (which owns the remaining .1%).  
24 MUI owns all of the membership interests in TWSG which, for income tax purposes,

1 is a disregarded entity. Consequently, for income tax purposes, MUI owns both the  
2 99.9% interest in Monarch it owns directly as well as the .1% interest through TWSG.  
3 Since, for income tax purposes, a partnership must have two or more partners, for  
4 those purposes Monarch is not a partnership but a disregarded entity. The result of  
5 this structure is that, for federal income tax purposes, Monarch is a division of MUI—  
6 a taxable corporation.

7 **Q. WHAT IS THE RATEMAKING SIGNIFICANCE OF THIS STRUCTURE?**

8 A. For ratemaking purposes, this structure means that Monarch's rates should be set as if  
9 it were an income tax-paying corporation.

10 **Q. ARE THERE ALSO ACCOUNTING IMPLICATIONS OF THIS**  
11 **STRUCTURE?**

12 A. Yes there are. Because Monarch is not a legal entity that is subject to income tax,  
13 Monarch has never calculated (and has never needed to calculate) income tax  
14 expense, either current or deferred, for purposes of its stand-alone income statement  
15 and has not reflected ADIT on its stand-alone balance sheet.

16 **Q. WHAT ARE THE RAMIFICATIONS OF THIS SITUATION FOR THIS**  
17 **RATE CASE?**

18 A. Monarch has had to derive an ADIT balance from its books and records for the very  
19 first time. For this purpose, Monarch engaged the accounting firm of Peasley,  
20 Aldinger & O'Bymachow ("PAO") of Huntington Beach, California who produced  
21 an ADIT calculation under the supervision of Monarch personnel and myself.



1 Q. HOW WAS THIS ACCOMPLISHED?

2 A. There were two parts to the project. This first part was to determine the ADIT credit  
3 balance. PAO used Monarch's tax returns and its fixed asset records to derive the  
4 annual differences between book and tax depreciation for the years 2004 (the year in  
5 which the Monarch assets were acquired) through June 2015. From this, it calculated  
6 the ADIT balance associated with those levels of book/tax differences assuming that  
7 all of those differences gave rise to the deferral of tax. The second part was to  
8 determine the level of NOLC attributable to these book/tax differences.

9 **IV. MONARCH'S INVOLUNTARY CONVERSION TRANSACTION**

10 Q. WAS MONARCH INVOLVED IN A TRANSACTION APPROVED BY THE  
11 TEXAS COMMISSION ON ENVIRONMENTAL QUALITY THAT  
12 CONTINUES TO HAVE AN IMPACT AND WHICH GIVES RISE TO THE  
13 NECESSITY TO MAKE AN ADJUSTMENT ON THE TAX SCHEDULES  
14 FILED IN THIS PROCEEDING?

15 A. Yes it was. Prior to 2011, Monarch had a water company affiliate, New Mexico  
16 Utilities, Inc. ("NMUI"), which was, like itself at the time, a direct subsidiary of  
17 SouthWest Water Company ("SWWC"). In 2009, the assets of NMUI were  
18 condemned by a governmental authority. NMUI received compensation for the  
19 taking. NMUI would have incurred a large taxable gain on the transaction save for  
20 the fact that a provision of the Internal Revenue Code (Section 1033) allows a  
21 company who has experienced an involuntary conversion (like a condemnation) to  
22 defer the tax gain if it replaces the condemned assets with similar assets within a  
23 specified period of time. Under the federal income tax law, NMUI could satisfy this

1 replacement requirement by purchasing the stock of Monarch, its affiliate, from  
2 SWWC, the parent of both. This it did in 2011. The way in which the tax law  
3 implements the tax deferral is that Monarch's tax basis in its operating assets had to  
4 be reduced by the gain NMUI generated on the condemnation.

5 **Q. WHAT TAX IMPACT DID THIS TRANSACTION HAVE ON MONARCH?**

6 A. The reduction in Monarch's tax basis in its assets would, over time, produce less tax  
7 depreciation and, hence, more taxable income and more tax—thereby reversing the  
8 prior tax deferral. So, in effect, Monarch ends up paying the tax deferred by NMUI  
9 on the condemnation of its assets.

10 **Q. DID THE TRANSFER OF MONARCH STOCK TO NMUI REQUIRE**  
11 **REGULATORY APPROVAL?**

12 A. Yes it did. Pursuant to Section 13.302 of the Texas Water Code, in September 2001,  
13 NMUI informed the Texas Commission on Environmental Quality ("TCEQ") of the  
14 proposed transfer of the Monarch stock. In December of 2011, the TCEQ responded  
15 to the notice and granted permission for the transfer. A fact cited by the TCEQ in  
16 conjunction with its grant of permission was that, "The stock acquisition will not  
17 affect the rates charged by Monarch Utilities I, LP (LP) and will not alter any of the  
18 existing operations."

19 **Q. WHAT ADJUSTMENTS WERE NECESSARY TO ENSURE THAT THE**  
20 **ACQUISITION OF MONARCH STOCK BY NMUI WILL NOT AFFECT**  
21 **MONARCH'S RATES?**

22 A. In order to ensure that the transfer of Monarch stock does not impact its rates,  
23 Monarch made three adjustments to its tax schedules. First, the reduction in tax

1 depreciation attributable to the transaction was removed from the computation of the  
2 provision for tax expense. In this regard, it decreased the current provision and  
3 increased the deferred provision. Second, in calculating Monarch's ADIT balance,  
4 the impact of the reduced tax depreciation was removed, thereby increasing the ADIT  
5 balance. Finally, the impact was also removed in the calculation of Monarch's  
6 NOLC, thereby increasing the NOLC.

7 **V. NORMALIZATION**

8 **Q. IS CALCULATING THE TAX EXPENSE ELEMENT OF COST OF SERVICE**  
9 **A SIMPLE UNDERTAKING?**

10 A. Not usually. There are two primary reasons for the complexity. First, the tax law is,  
11 itself, enormously complicated such that its application to any business transaction or  
12 set of transactions is highly complex. However, even more problematic is the fact  
13 that certain items of income and expense incurred by most utilities are treated very  
14 differently for regulatory (*i.e.*, book) purposes than they are for tax purposes—and  
15 there may be further differences between how they are treated for federal and state tax  
16 purposes. There are, in effect, two or even three different accounting regimes.

17 **Q. WHAT IS THE NATURE OF THE GAP BETWEEN TAX REPORTING AND**  
18 **RATEMAKING?**

19 A. For purposes of this proceeding, the differences that matter are those items of income  
20 or expense that are reflected in rate-setting and on the tax return at different times.  
21 These are commonly referred to as "timing" or "temporary" differences. With  
22 respect to these items, the same aggregate quantity of dollars ultimately gets reflected  
23 for both purposes—just at different times.

1 Q. WHAT IS THE CRITICAL FEATURE OF TIMING DIFFERENCES?

2 A. They reverse. In each case, the same item of income or expense is reported for both  
3 tax and book purposes—just over differing time frameworks. Thus, it is a “zero sum”  
4 game. For example, the more by which tax depreciation exceeds regulatory  
5 depreciation early in the life of an asset, the more by which regulatory depreciation  
6 must exceed tax depreciation later on in its life. The two are equal over time.

7 Q. WHAT IS THE IMPACT OF THESE TIMING DIFFERENCES ON THE  
8 UTILITY AND ITS CUSTOMERS?

9 A. Generally, but not always, timing differences work in favor of the utility and its  
10 customers. That is, the utility’s tax liability is reduced when the timing item  
11 originates and is increased when it reverses. This is most prominently illustrated by  
12 accelerated tax depreciation. Due to the large “up front” deductions allowed under  
13 the tax law, the utility’s tax liability is reduced early in the life of the asset. This can  
14 be thought of as the extension of an interest-free “loan” from the government. On the  
15 other hand, its tax liability is increased towards the end of its life. This can be viewed  
16 as the repayment of the governmental interest free “loan.” In the interim, the utility  
17 has in its possession incremental cash. This cash, this capital, has zero cost because it  
18 will be paid back through the filing of future tax returns—without the imposition of  
19 interest. The loan does, however, get entirely repaid in the future (assuming no  
20 change in federal income tax rates).

1 Q. HOW IS THE GAP BETWEEN THE REGULATORY AND THE TAX  
2 TREATMENT OF ITEMS TREATED IN THE CONTEXT OF UTILITY  
3 RATEMAKING?

4 A. In utility ratemaking, there are two alternative approaches to the treatment of this  
5 gap—normalization tax accounting and flow through tax accounting.

6 Q. WHAT IS NORMALIZATION TAX ACCOUNTING?

7 A. Using normalization tax accounting, one calculates regulatory tax expense by  
8 reference to the revenues and expenditures that are recognized for ratemaking  
9 purposes. In other words, tax expense is calculated by reference to “book”  
10 numbers—irrespective of how those items are reflected on the utility’s tax return.  
11 The effect of this is that customers get the tax benefit commensurate with the  
12 expenses they fund.

13 Q. WHAT IS FLOW THROUGH TAX ACCOUNTING?

14 A. Using flow through tax accounting, one calculates regulatory tax expense by  
15 reference to the receipts and expenditures that are reflected on the utility’s tax return.  
16 In other words, it is calculated by reference to “tax” numbers—irrespective of how  
17 those items are reflected for ratemaking purposes. Thus, if comprehensive flow  
18 through tax accounting were applied (which, as I will discuss hereafter, it never is),  
19 the utility’s tax expense element of cost of service would equal the tax it would pay to  
20 the government at the time.

1 Q. WHAT IS THE ESSENCE OF THE DIFFERENCE BETWEEN  
2 NORMALIZATION AND FLOW THROUGH TAX ACCOUNTING?

3 A. Basically, the two approaches differ in who holds the tax money, the governmental  
4 "loan," that is generated by the timing differences. Applying normalization, the  
5 utility holds the tax money until it must be paid back to the government, at which  
6 time it simply pays it. Where flow through tax accounting is applied, customers hold  
7 the tax money and they must pay it back to the utility when the utility must pay it to  
8 the government. Note that, in either case, the utility has the obligation to pay the  
9 money to the government. Regulatory tax accounting does not impact the  
10 relationship between the utility and the government. Again, it only determines who  
11 holds the money that will be used to pay the government in the interim. The  
12 applicable accounting requirements reflect this reality.

13 Q. PLEASE PROVIDE A SIMPLE EXAMPLE.

14 A. Assume a utility purchases an asset that costs \$3,000. The cost of the asset will be  
15 depreciated over 10 years using the straight-line method (\$300 per year) for  
16 regulatory purposes. Under the 100% bonus depreciation rules, the cost of the asset  
17 can be deducted as incurred. The asset is placed in service on the first day of Year 1.  
18 The federal tax rate is 35%.

19 Q. HOW DOES THIS SITUATION GET REFLECTED IN RATES UNDER  
20 NORMALIZATION TAX ACCOUNTING?

21 A. In Year 1, customers will be charged \$300 in depreciation for the asset. The tax  
22 expense, which they also fund, will be reduced by \$105 ( $\$300 \times 35\%$ )—the tax  
23 benefit commensurate with the amount they are funding. However, the utility will

1 deduct \$3,000 on its tax return for that year and, thus, garner a \$1,050 ( $\$3,000 \times$   
2 35%) cash tax benefit. The \$945 of the cash tax benefit not passed through to  
3 customers ( $\$1050 - \$105$ ) is the amount of the governmental "loan." It will be  
4 retained by the utility as a deferred tax "fund"(an ADIT) and will be available to be  
5 reflected as zero cost capital so long as it exists. In this way, ratepayers indirectly  
6 receive the entire economic benefit of the interest-free feature of the loan. In each of  
7 the 9 years from Year 2 through Year 10, customers will be charged (and the utility  
8 will collect) \$300 in depreciation for the asset. The \$300 in revenue will be fully  
9 taxable (there will be no tax deductions flowing from the asset since its entire cost  
10 was deducted in Year 1) and will give rise to a tax of \$105 ( $\$300 \times 35\%$ ) in each  
11 year. However, customers will not be charged for this tax. Instead, the utility will  
12 fund each year's tax out of the \$945 in cash it derived from the Year 1 tax deduction.  
13 By the end of Year 10, the entire deferred tax fund will have been paid to the  
14 government ( $9 \times \$105 = \$945$ ). Customers will, in effect, be given a credit each year  
15 equal to the utility's weighted average cost of capital times the balance of ADIT  
16 included in the rate base calculation.

17 **Q. HOW DOES THIS SITUATION GET REFLECTED IN RATES UNDER**  
18 **FLOW THROUGH TAX ACCOUNTING?**

19 A. Because in Year 1 the utility claims a tax deduction for the \$3,000 cost of the asset, it  
20 enjoys a \$1,050 tax benefit that will be flowed through to customers in that year by  
21 reducing the tax expense for which they are charged by that amount. In short, the  
22 benefit of the large tax deduction is immediately passed through to customers. This is

1 so notwithstanding that, in Year 1, customers funded only \$300 of the cost of the  
2 asset through depreciation.

3 **Q. WHAT IS THE RATE IMPLICATION OF REDUCING TAX EXPENSE BY**  
4 **\$1,050?**

5 A. Customer rates will be reduced not only by the \$1,050 tax benefit, but by a “gross up”  
6 factor. This gross-up factor is necessary to capture the incremental tax benefit  
7 produced by passing the \$1,050 tax benefit through to customers (that is, taxable  
8 revenues will be reduced and that will further reduce the utility’s tax liability). The  
9 actual reduction in Year 1 revenue requirement would be \$1,615 ( $\$1,050/[1 - 0.35]$ ).  
10 [Note that this example only considers the federal tax gross-up.]

11 **Q. WHAT WOULD HAPPEN IN YEARS 2 THROUGH 10?**

12 A. Even though in each of those years customers would be charged \$300 in depreciation  
13 for the asset, they would be provided no tax benefit. In fact, they already received the  
14 full tax benefit of the \$3,000 expenditure in their Year 1 rates. In each of those 9  
15 subsequent years, the utility will have a tax of \$105 to pay on account of the utility’s  
16 collection of the \$300 in depreciation-related revenues (again, there will be no tax  
17 deductions flowing from the asset since its entire cost was deducted in Year 1).  
18 However, unlike the normalization situation, the utility will have no fund from which  
19 to pay the tax—it passed the entire benefit (\$1,050) through to customers in Year 1 by  
20 reducing their rates. Therefore, in each of the 9 subsequent years, customers must  
21 fund the tax. This will be done by increasing their tax expense sufficient to increase  
22 their revenue requirement by \$162 each year. After paying \$57 ( $\$162 \times 35\%$ ) of tax



1 on the receipt of the money, the utility would have the \$105 to pay each year's tax  
2 due to the government.

3 **Q. ARE THE INCREMENTAL TAX PAYMENTS THAT MUST BE**  
4 **COLLECTED FROM CUSTOMERS IN YEARS 2 THROUGH 10 THE**  
5 **EFFECT OF THE REVERSAL OF THE FLOW THROUGH FROM YEAR 1?**

6 A. Exactly. These amounts are merely the required repayment from customers of the tax  
7 benefit they enjoyed earlier in order to enable the utility to repay the governmental  
8 "loan."

9 **Q. WOULD IT BE ACCURATE TO SAY THAT, UNDER NORMALIZATION**  
10 **ACCOUNTING, THE LEVEL OF TAX A COMPANY PAYS IN ANY**  
11 **PARTICULAR YEAR AND ITS LEVEL OF TAX EXPENSE FOR**  
12 **RATEMAKING PURPOSES WILL VIRTUALLY NEVER BE THE SAME?**

13 A. That is absolutely true.

14 **Q. DOES THIS COMMISSION FULLY NORMALIZE BOOKS AND TAX**  
15 **DIFFERENCES?**

16 A. Yes. 16 Tex. Admin. Code § 24.31(b)(1)(D) requires that federal income taxes be  
17 calculated on a normalized basis.

18 **Q. IN ITS FEDERAL TAX EXPENSE CALCULATION, DID MONARCH**  
19 **NORMALIZE ALL OF ITS TEMPORARY DIFFERENCES?**

20 A. Yes, Monarch has normalized all of its temporary differences in this proceeding.

21 **Q. DID MONARCH REDUCE ITS RATE BASE BY ITS ADIT BALANCE?**

22 A. Yes, it did.

1 VI. MONARCH'S NOLC

2 Q. WHAT IS A TAX NET OPERATING LOSS ("NOL")?

3 A. An NOL is created when, in any year, a taxpayer reports more deductions than it has  
4 taxable income. Under the applicable tax rules, an NOL can, in general, be carried  
5 back two years or forward 20 years. In the year to which it is carried, an NOL is  
6 treated like an additional deduction, reducing the taxable income otherwise produced  
7 in that year. The general rule is that an NOL must be carried back to the earliest  
8 possible year and then, to the extent not absorbed, applied to subsequent years in  
9 chronological order (at which point it becomes an NOLC).

10 Q. WHAT ARE THE CONSEQUENCES OF CARRYING AN NOL FORWARD?

11 A. When an NOL must be carried forward, some quantity of the deductions claimed by  
12 the taxpayer in the year the NOL is produced will not offset taxable income and not  
13 reduce the taxpayer's tax liability—that is, until a subsequent year when the  
14 carryforward is used.

15 Q. WHAT, THEN, IS THE SIGNIFICANCE OF AN NOLC?

16 A. In terms of the "loan" analogy I used previously, the government does not extend a  
17 loan until the accelerated tax depreciation deduction is *both* claimed on a tax return  
18 *and* is used to reduce a tax liability.

19 Q. DOES MONARCH HAVE AN NOLC?

20 A. Yes it does.

1 Q. WHAT ARE THE IMPLICATIONS OF MONARCH HAVING A FEDERAL  
2 NOLC?

3 A. Some quantity of the deductions claimed by Monarch in the years in which it  
4 generated NOLs did not offset taxable income and did not reduce its income tax  
5 liability.

6 Q. WHAT DOES THIS MEAN IN TERMS OF ADIT?

7 A. As I indicated above, deferred taxes represent a fund of available cost-free capital that  
8 is created by reducing a utility's tax liability when tax deductions like the  
9 depreciation in the illustration are claimed. This fund is reflected in the utility's  
10 ADIT balance. When a utility claims a tax deduction such as the depreciation  
11 deduction in the illustration above, it records deferred taxes in its Accounts 281, 282,  
12 and 283, as appropriate, regardless of whether or not it has an NOLC. However, to  
13 the extent it does have an NOLC, the utility's tax liability has not yet been reduced by  
14 some portion of those deductions. Thus, to that extent, no tax has been deferred and  
15 no cost-free capital produced. The tax effect of deductions that do not defer tax is  
16 reflected in the utility's Account 190, as asset (debit) account. It is necessary to  
17 consider the balance in this account in conjunction with the balances in the three  
18 credit accounts (Accounts 281, 282, and 283) because the credit accounts, taken  
19 alone, overstate the level of cost-free capital the utility possesses. In effect, the ADIT  
20 credit balance needs to be adjusted so that the correct level of cost-free capital can be  
21 reflected as a reduction in rate base.

1 Q. HAS MONARCH CONSIDERED BOTH ITS ADIT CREDITS AS WELL AS  
2 THE ADIT DEBIT ATTRIBUTABLE TO ITS NOLC IN CALCULATING  
3 THE ADIT BALANCE BY WHICH IT REDUCED RATE BASE?

4 A. Yes it has.

5 VII. ITC AND EDIT

6 Q. DID MONARCH REFLECT ANY INVESTMENT TAX CREDIT ("ITC") IN  
7 ITS TAX SCHEDULES?

8 A. No it did not. The water assets Monarch first acquired were purchased from Tecon  
9 Water Holdings, L.P. in July of 2004. Monarch was not able to claim ITC on any of  
10 the purchased assets, and none of the assets it has since acquired have been eligible  
11 for ITC. Consequently, it has never claimed any ITC, and there is nothing to reflect.

12 Q. DID MONARCH REFLECT ANY EDIT IN ITS TAX SCHEDULES?

13 A. No it did not. EDIT was produced by depreciable assets that were owned by a utility  
14 at the time the Tax Reform Act of 1986 reduced the corporate tax rate from 46% to  
15 40" and then to 34%. The first reduction was effective on January 1, 1987 and the  
16 second on January 1, 1988. Because Monarch did not acquire any water assets until  
17 July of 2004, no EDIT was ever generated by its assets.

18 VIII. CONSOLIDATED TAX ADJUSTMENT

19 Q. DOES MONARCH FILE ITS FEDERAL INCOME TAX RETURN AS A  
20 MEMBER OF A CONSOLIDATED GROUP?

21 A. Yes, it does. It files as a member of the consolidated group of which SW Merger  
22 Acquisition Corp. ("SWMAC") is the common parent.

1 Q. DID MONARCH COMPUTE FEDERAL INCOME TAXES IN  
2 ACCORDANCE WITH THE PROVISIONS OF TWC § 13.185(F) AS  
3 REQUIRED BY 16 TEX. ADMIN. CODE §24.31(B)(1)(D)?

4 A. Yes it did. The first sentence of TWC § 13.185(f) applies to a utility that is a member  
5 of a consolidated group that is eligible to file a consolidated income tax return, it  
6 would be advantageous to the utility to file on that basis, the group does not file on a  
7 consolidated basis, and it cannot be shown that its failure to do so was reasonable.  
8 Monarch was included in a consolidated tax group and did participate in the filing of  
9 a consolidated federal income tax return. Monarch's share of the tax benefits of filing  
10 on that basis was zero.

11 Q. PLEASE EXPLAIN.

12 A. Monarch has actually received its fair share of benefits, and there is no basis upon  
13 which to impute any additional benefits. While there are many reasons why I believe  
14 the imposition of a consolidated tax adjustment ("CTA") would be wrong from  
15 various perspectives including technical, equitable, economic, and policy  
16 perspectives, there is a single, dispositive mathematical reason in Monarch's case that  
17 would preclude the imposition of a CTA even if all of my objections on all of those  
18 bases were rejected.

19 Q. WHY IS IT MATHEMATICALLY IMPOSSIBLE FOR A CTA TO BE  
20 IMPOSED ON MONARCH?

21 A. Monarch has generated an NOL (after adjustment for the impact of the  
22 condemnation) in every year from 2004 through 2014. Thus, Monarch's tax results  
23 for those years did not enable any other affiliate to monetize its NOL—the triggering

1 event for the imposition of a CTA. In short, no member of the SWMAC consolidated  
2 group benefitted by virtue of the fact that Monarch was a member of the group.  
3 Therefore, there is absolutely no basis on which to assign to Monarch any incremental  
4 “fair share” of consolidated benefits. It simply did not even arguably contribute to  
5 the creation of any such benefits.

6 **IX. THE CALCULATION OF INCOME TAX EXPENSE**

7 **Q. PLEASE DESCRIBE THE CALCULATION OF INCOME TAX EXPENSE.**

8 A. Monarch’s federal income tax calculation is set forth on Schedule II-E-3. That  
9 schedule employs the return method (also referred to as “Tax Method 1”).

10 **Q. WHAT IS THE STARTING POINT FOR THE CALCULATION?**

11 A. The starting point for the calculation is the requested return. In this case, Monarch is  
12 requesting a return of \$6,918,233 (\$5,957,561 water and \$960,672 wastewater).

13 **Q. HOW DOES THE FEDERAL INCOME TAX CALCULATION PROCEED?**

14 A. The return is first adjusted by synchronized interest of \$2,339,990 (\$2,015,057 water  
15 and \$324,933 wastewater). This is done because part of the return consists of this  
16 interest. Monarch can, for tax purposes, deduct its interest expense. As a  
17 consequence, when it collects from its customers the amount necessary to fund its  
18 interest expense, there is no net tax cost—that is, the taxable revenue it receives is  
19 offset by the deductible interest it pays. Therefore, the portion of return attributable  
20 to interest does not incur a net tax. On that basis, synchronized interest is removed  
21 from the return so that only the equity component remains.

1 Q. WHAT OTHER ADJUSTMENTS ARE MADE TO THE RETURN?

2 A. The template provides for a number of such adjustments. However, in Monarch's  
3 case, most of them do not apply. The template accommodates adjustments for the  
4 amortization of ITC and EDIT. Because Monarch has no ITC or EDIT, there are no  
5 adjustments for these items on its schedule. Adjustments are also made for items of  
6 income or expense that are now, or were in the past, flowed through. Because  
7 Monarch is fully normalized and this is its first rate case, there are no such  
8 adjustments. Finally, adjustments would be appropriate for regulatory expenses that  
9 provide no tax benefit because they are never deductible for tax purposes. Expenses  
10 such as certain meals and entertainment expenditures, fines and penalties,  
11 depreciation of the portion of an asset's basis attributable to equity AFUDC, etc. are  
12 non-tax-deductible. To recognize the lack of a tax benefit, these amounts must be  
13 added back to the equity return to derive the Taxable Component of Return.  
14 Monarch's calculation includes no such adjustments. Monarch's Taxable Component  
15 of Return is \$4,578,242 (\$3,942,504 water and \$635,739 wastewater).

16 Q. WHAT, THEN, IS DONE WITH THE TAXABLE COMPONENT OF  
17 RETURN?

18 A. The Taxable Component of Return is then multiplied by a Tax Factor. The Tax  
19 Factor is a factor that, when multiplied by the Taxable Component of Return,  
20 produces the income tax that would be paid on the revenue that would be required to  
21 yield an after-tax amount equal to the Taxable Component of Return. The formula  
22 for deriving the Tax Factor is 1 divided by the inverse of the tax rate with the result  
23 multiplied by the tax rate. Assuming an income tax rate of 35%, the Tax Factor is

1 53.85%  $((1/(1-.35)) \times 35\%)$ . A simple example proves the propriety of this formula.  
2 If the Taxable Component of Return is \$100, then the associated federal income tax  
3 expense would be \$53.85 ( $\$100 \times 53.85\%$ ). The proof is that if customers are  
4 charged the aggregate of the Taxable Component of Return (\$100) and the income  
5 tax expense (\$53.85), then Monarch would have taxable income of \$153.85. A 35%  
6 income tax levied on that level of taxable income would produce an income tax of  
7 \$53.85 ( $\$153.85 \times 35\%$ ). So, after paying its income tax, Monarch would retain  
8 \$100—the Taxable Component of Return.

9 **Q. USING THE RETURN METHOD, WHAT IS MONARCH'S FEDERAL**  
10 **INCOME TAX EXPENSE?**

11 A. Monarch's federal income tax expense computed as described above is \$2,358,488  
12 (\$2,030,987 water and \$327,502 wastewater).

13 **Q. WHY DOES MONARCH USE A 51.52% TAX FACTOR RATHER THAN**  
14 **THE 53.85% TAX FACTOR USED IN THE EXAMPLE ABOVE?**

15 A. While the applicable federal income tax rate for corporations that earn more than \$10  
16 million of taxable income is the 35% used in the example, the tax rate for  
17 corporations that earn less than \$10 million is only 34%. Since Monarch's pre-tax  
18 book income is anticipated to be less than \$10 million, the availability of its  
19 accelerated tax deductions (particularly accelerated depreciation) avoid tax at that  
20 lower rate. Thus, Monarch proposes to charge customers for its deferred tax expense  
21 computed at the beneficial 34% rate.



X. CONCLUSION

1

2 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

3 A. Yes it does.

## Schedules Sponsored

- Schedule II-E-3 Federal Income Tax Calculation
  - Schedule II-E-3.1 Federal Income Tax Reconciliation
  - Schedule II-E-3.2 Federal Income Tax Timing Differences Reconciliation
  - Schedule II-E-3.3 Plant Adjustments
    - Schedule II-E-3.3(W) Water
    - Schedule II-E-3.3(S) Wastewater
    - Schedule II-E-3.3(SH) Shared
  - Schedule II-E-3.4 Consolidation/Inter-Corporate Tax Allocation
  - Schedule II-E-3.5 ADFIT
  - Schedule II-E-3.6 ADFIT - Description of Timing Differences
  - Schedule II-E-3.7 Adjustments to ADFIT
    - Schedule II-E-3.7.a Reconciliation of Accumulated Depreciation - Book and Tax
  - Schedule II-E-3.8 ADFIT - Plant Adjustments
  - Schedule II-E-3.9 Analysis of ITCs
    - Schedule II-E-3.10 ITC Utilized
    - Schedule II-E-3.11 ITC Generated But Not Utilized
    - Schedule II-E-3.12 ITC Utilized - Stand Alone Basis
    - Schedule II-E-3.13 ITC Election
    - Schedule II-E-3.14 NARUC Account 255
    - Schedule II-E-3.15 Analysis of Additional Depreciation Requested
    - Schedule II-E-3.16 Amortization of Protected and Unprotected Excess Deferred Taxes
    - Schedule II-E-3.17 Analysis of Excess Deferred Taxes by Timing Difference
    - Schedule II-E-3.18 Effects of Post Test Year Adjustment
    - Schedule II-E-3.19 List of FIT Testimony

## Schedules Sponsored

Schedule II-E-3.20 History of Tax Normalization

Schedule II-E-3.21 Tax Elections, IRS Audit Status and Private Letter Rulings

Schedule II-E-3.22 Method of Accounting for ADFIT Related to NOL Carryforward

Schedule II-E-3.23 Federal Tax Returns (Confidential)

**PUC DOCKET NO. 45570**

<b>APPLICATION OF MONARCH</b>	<b>§</b>	<b>PUBLIC UTILITY COMMISSION</b>
<b>UTILITIES I, L.P. TO CHANGE RATES</b>	<b>§</b>	
<b>FOR WATER AND SEWER SERVICE</b>	<b>§</b>	<b>OF TEXAS</b>

**DIRECT TESTIMONY**

**OF**

**LAMBETH TOWNSEND**

**ON BEHALF OF**

**MONARCH UTILITIES I, L.P.**

**FEBRUARY 29, 2016**

**DIRECT TESTIMONY OF  
LAMBETH TOWNSEND**

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**ATTACHMENTS:**

- RLT-1           Lambeth Townsend Biography
- RLT-2           Legal Invoices
- RLT-3           Consultant Invoices

PUC DOCKET NO. 45570

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

DIRECT TESTIMONY OF LAMBETH TOWNSEND

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Lambeth Townsend. I am an attorney and a principal at the law firm of Lloyd Gosselink Rochelle & Townsend, P.C. ("Lloyd Gosselink"), which has its principal place of business located at 816 Congress Ave., Suite 1900, Austin, TX 78701.

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

A. I am filing direct testimony on behalf of Monarch Utilities I, L.P. ("Monarch"), which filed the Application to Change Rates for Water and Sewer Service ("Rate Application" or "Rate Filing Package" ("RFP")) with the Public Utility Commission of Texas ("Commission") in this case.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL AND EDUCATIONAL BACKGROUND.

A. I have been licensed to practice law in Texas since 1975. I was legal counsel to the Local and Consent Calendar Committee, Texas House of Representatives in 1975 and 1976. I served as an Assistant Attorney General for the State of Texas from 1977 to 1984, where my practice focused on defending state agency orders and representing the agencies in litigation. I was in private practice from 1984 to 1987. From 1987 to 1989, I served as the General Counsel for the Public Utility Commission of Texas. I

1 returned to private practice in 1989 and have been focusing my practice on electric,  
2 water, and gas utility law and litigation. I am Board Certified in Administrative Law  
3 by the Texas Board of Legal Specialization. I have represented regulatory agencies,  
4 utilities, and consumers in numerous rate proceedings in my forty years of experience  
5 as an attorney. A copy of my biography is attached to my testimony as Attachment  
6 RLT-1.

7 **II. PURPOSE AND SCOPE**

8 **Q. WHAT IS THE PURPOSE AND SCOPE OF YOUR TESTIMONY IN THIS**  
9 **PROCEEDING?**

10 A. The purpose of my testimony is to present expert opinion testimony concerning the  
11 reasonableness of the rate case expenses Monarch incurred in preparing and  
12 prosecuting this rate application.

13 Reimbursable rate case expenses were incurred by Monarch before the  
14 February 29, 2016, application was filed with the Commission, beginning in May  
15 2015. Monarch is requesting reimbursement of all reasonable rate case expenses.  
16 My testimony supports the reasonableness of the legal and consultant expenses  
17 incurred by Monarch regarding the rate application proceeding at the Commission.  
18 My testimony also provides the legal support under which Monarch is seeking to  
19 recover its non-legal and non-consultant rate case expenses, as supported by the  
20 Direct Testimony of Robert L. Kelly. The direct testimony of Mr. Kelly explains  
21 how Monarch proposes to recover rate case expenses, including information  
22 concerning all the allocations of expenses by water and sewer functions, and sponsors

1 Schedule II-E-4.4 as required under the Commission's Class A Investor-Owned  
2 Utilities Water and/or Sewer Rate Filing Package for Cost of Service Determination.

3 **Q. ARE YOU SPONSORING ANY SCHEDULES?**

4 A. No.

5 **III. RECOMMENDATIONS**

6 **Q. WHAT ARE YOUR RECOMMENDATIONS?**

7 A. Based upon my review, I recommend that Monarch be allowed to recover the  
8 reasonable and necessary legal and consultant rate case expenses of \$328,621.52 as of  
9 January 31, 2016, plus the supplemental amount that will be provided at hearing. I  
10 also recommend that the Commission allow Monarch to recover its non-legal and  
11 non-consultant rate case expenses described in the Direct Testimony of Robert L.  
12 Kelly, pursuant to Texas Water Code Ann. §§ 13.183, 13.185(c), and 13.187, and 16  
13 Texas Administrative Code § 24.33 ("TAC").

14 **Q. PLEASE DESCRIBE THE PROCESS YOU UNDERTOOK TO REACH  
15 YOUR CONCLUSION.**

16 A. Based on my experience and education, and following a thorough and critical review  
17 of all of the relevant information, I concluded that the reasonable and necessary  
18 Monarch rate case expenses for legal and consultant services as of January 31, 2016,  
19 is \$328,621.52. I recommend that the Commission find this amount to be the  
20 reasonable and necessary reimbursable legal rate case expense for Monarch in this  
21 proceeding.

22 Monarch engaged the services of Lloyd Gosselink in May 2015. I have  
23 directed the work performed by Lloyd Gosselink employees on behalf of Monarch



1 since that time. I have reviewed the billings of Lloyd Gosselink submitted to  
2 Monarch for legal services from July 14, 2015, through February 3, 2016, in  
3 connection with Monarch's proposed rate increase. I affirm that those billings  
4 accurately reflect the time spent and expenditures incurred by Lloyd Gosselink on  
5 Monarch's behalf. Those billings were accurately calculated before they were  
6 tendered and did not include any double billing. None of the charges billed to  
7 Monarch have been recovered through reimbursement for other expenses. The  
8 expenses charged were associated with the review and prosecution of Monarch's rate  
9 application and were necessary to advise Monarch and to accomplish tasks in the rate  
10 proceeding.

11 For the period May 22, 2015, through January 31, 2016, Lloyd Gosselink  
12 billed \$95,092.65 for legal services in connection with Monarch's proposed rate  
13 increase. This figure includes legal fees and expenses. The fees and expenses were  
14 necessary and for the legal representation of Monarch. The legal work included  
15 advising Monarch on rates, review of the application, preparation of pleadings,  
16 review and preparation of evidentiary exhibits, and preparation of testimony to be  
17 submitted for the rate application to be filed with the Commission.

18 The attorneys' hourly rates of \$250-\$350, upon which the billings are based,  
19 are the same hourly rates charged other clients for comparable services during the  
20 same time frame. Our firm's hourly rates are at the lower end of the range compared  
21 to the rates charged by other lawyers with similar experience providing similar  
22 services. To minimize expenses, I used associates and paralegals where possible  
23 because of their lower billing rates. In assigning the tasks to attorneys, I ensured that

1 the attorneys did not duplicate the work of one another. The hours spent to perform  
2 the tasks assigned to Lloyd Gosselink were necessary to complete those tasks in a  
3 professional manner and on a timely basis. All of the work performed by Lloyd  
4 Gosselink to date was accomplished by just four lawyers, one of which left the firm in  
5 September 2015. My many years of experience participating in utility rate cases aid  
6 in our efforts to keep rate case expenses reasonable.

7 The invoices submitted by Lloyd Gosselink include a description of services  
8 performed and time expended on each activity. The invoices dated from July 14,  
9 2015, through February 3, 2016, for this proceeding are attached to my testimony as  
10 Attachment RLT-2. Lloyd Gosselink has documented all charges with time sheets,  
11 invoices, and records. Neither Lloyd Gosselink nor any consultants for Monarch  
12 have charged for luxury items, including first-class airfare, limousine service,  
13 entertainment, or alcoholic beverages. No meals were charged in excess of \$25 per  
14 person, and no individual billed for more than 12 hours per day. The documentation  
15 in this case is similar to that provided in many previous rate cases before the  
16 Commission.

17 The current amount requested for legal expenses of \$95,092.65 is reasonable  
18 given the complexity of this case. Monarch anticipates that it will incur additional  
19 attorney fees associated with its rate application, especially if a contested case hearing  
20 is conducted, and reserves the right to request additional incurred rate case expenses  
21 at the appropriate time.

1 Q. DOES MONARCH'S RATE APPLICATION INCLUDE ANY NOVEL OR  
2 DIFFICULT ISSUES THAT A TYPICAL WATER OR WASTEWATER  
3 UTILITY APPLICATION DOES NOT INCLUDE?

4 A. The preparation of Monarch's Rate Application included a variety of novel, difficult,  
5 and complex issues. First, the Rate Application includes multiple water utility  
6 systems and wastewater utility systems that each require evaluation and analysis.  
7 Second, because the Commission's rules governing rate applications for Class A  
8 utilities such as Monarch were recently adopted and because this is the first Class A  
9 utility rate application filed at the Commission, Monarch has no precedent upon  
10 which Monarch could rely in preparing its application. Although the Commission's  
11 new rules are generally patterned after prior rules and regulations governing rate  
12 setting for water and wastewater utilities, the current rules contain some significant  
13 differences from prior rules and regulations.

14 Q. ARE THE LEGAL EXPENSES THAT MONARCH IS SEEKING TO  
15 RECOVER JUST, REASONABLE, NECESSARY, AND IN THE PUBLIC  
16 INTEREST? PLEASE EXPLAIN.

17 A. Yes. The legal expenses that Monarch seeks to recover are just, reasonable,  
18 necessary, and in the public interest. An Investor-Owned Utility ("IOU") such as  
19 Monarch, cannot change its rates to allow it to recover its reasonable expenses and  
20 earn a reasonable return on its investment unless a rate change application is  
21 prepared. Recovery of reasonable and necessary legal expenses associated with  
22 preparation of a rate application have long been recoverable, is allowed by  
23 Commission rule, and is authorized by Texas Water Code Ann. § 13.185(g). For the

1 reasons I mentioned above, it was reasonable and necessary for Monarch to seek legal  
2 advice and assistance in the preparation of Monarch's Rate Application, the time  
3 spent was reasonable and necessary, and the hourly rates charges are reasonable.

4 **Q. WAS IT REASONABLE AND NECESSARY FOR MONARCH TO INCUR**  
5 **LEGAL EXPENSES TO PREPARE PREFILED DIRECT TESTIMONY?**

6 A. Yes. The Commission's rules at 16 TAC § 24.22(b)(3) recognize the complexities  
7 that may be involved in the preparation of a rate application for Class A utilities such  
8 as Monarch, and expressly provides that pre-filed direct testimony may be submitted  
9 with the rate application. Although the preparation of pre-filed testimony is time-  
10 consuming, such testimony is required to provide a robust, detailed explanation of  
11 Monarch's rate application to Commission Staff, Office of Public Utility Counsel,  
12 and the ratepayers in light of the multiple, complex legal issues involved, which are  
13 discussed above. Preparation of pre-filed testimony requires a substantial amount of  
14 legal guidance, and provides a robust, detailed explanation of Monarch's rate  
15 application.

16 **Q. DID MONARCH INCUR ANY CONSULTANT EXPENSES IN THIS RATE**  
17 **CASE?**

18 A. Yes. Monarch incurred the expenses associated with the following experts: AUS  
19 Consultants, Inc., B & D Environmental, Inc., Freese and Nichols, GDS Associates,  
20 Inc., Miller & Chevalier, P. Moul & Associates, and Peasley, Aldinger &  
21 O'Bymachow.

1 Q. ARE THE CONSULTANT EXPENSES FOR AUS CONSULTANTS, INC.  
2 ("AUS") INCURRED IN THIS RATE CASE REASONABLE AND  
3 NECESSARY?

4 A. Yes. For the period of April 29, 2015, through January 3, 2016, the expenses for AUS  
5 are \$42,449.65. Based on my years of experience working with utility consultants,  
6 Mr. Robinson's hourly rate of \$240, upon which the billings are based, is comparable  
7 to rates charged by consultants with similar levels of expertise and experience as Mr.  
8 Robinson. I have also reviewed the number of hours Mr. Robinson has spent on his  
9 review, analysis, and testimony in this proceeding, and can testify that this amount is  
10 appropriate given the level of complexity of this case. The amount requested for  
11 consultant expenses of \$42,449.65, as of the date of filing, is reasonable. The  
12 consultant expenses will be supplemented at the hearing on the merits.

13 Q. ARE THE CONSULTANT EXPENSES FOR B & D ENVIRONMENTAL, INC.  
14 ("B&D") INCURRED IN THIS RATE CASE REASONABLE AND  
15 NECESSARY?

16 A. Yes. For the period of October 12, 2015, through November 30, 2015, the expenses  
17 for B&D are \$7,713.02. Based on my years of experience working with utility  
18 consultants, Mr. Fenner's hourly rate of \$175, upon which the billings are based, is  
19 comparable to rates charged by consultants with similar levels of expertise and  
20 experience as Mr. Fenner. I have also reviewed the number of hours Mr. Fenner has  
21 spent on his review, analysis, and testimony in this proceeding, and can testify that  
22 this amount is appropriate given the level of complexity of this case. The amount

1 requested for consultant expenses of \$7,713.02, as of the date of filing, is reasonable.  
2 The consultant expenses will be supplemented at the hearing on the merits.

3 **Q. ARE THE CONSULTANT EXPENSES FOR FREESE AND NICHOLS**  
4 **(“F&N”) INCURRED IN THIS RATE CASE REASONABLE AND**  
5 **NECESSARY?**

6 A. Yes. For the period of November 11, 2015, through January 13, 2016, the expenses  
7 for F&N are \$9,876.50. Based on my years of experience working with utility  
8 consultants, Mr. Gooch’s hourly rate of \$347 and hourly rates of his associates, upon  
9 which the billings are based, are comparable to rates charged by consultants with  
10 similar levels of expertise and experience as Mr. Gooch. I have also reviewed the  
11 number of hours Mr. Gooch and his associates have spent on his review, analysis, and  
12 testimony in this proceeding and can testify that this amount is appropriate given the  
13 level of complexity of this case. The amount requested for consultant expenses of  
14 \$9,876.50, as of the date of filing, is reasonable. The consultant expenses will be  
15 supplemented at the hearing on the merits.

16 **Q. ARE THE CONSULTANT EXPENSES FOR GDS ASSOCIATES, INC.**  
17 **(“GDS”) INCURRED IN THIS RATE CASE REASONABLE AND**  
18 **NECESSARY?**

19 A. Yes. For the period of July 8, 2015, through January 13, 2016, the expenses for GDS  
20 are \$57,452.72. Based on my years of experience working with utility consultants,  
21 the hourly rates charged by GDS, upon which the billings are based, are comparable  
22 to rates charged by consultants with similar levels of expertise and experience as  
23 GDS. I have also reviewed the number of hours Mr. Loy and his associates have

1 spent on their review, analysis, and testimony in this proceeding and can testify that  
2 this amount is appropriate given the level of complexity of this case. The amount  
3 requested for consultant expenses of \$57,452.72, as of the date of filing, is  
4 reasonable. The consultant expenses will be supplemented at the hearing on the  
5 merits.

6 **Q. ARE THE CONSULTANT EXPENSES FOR MILLER & CHEVALIER**  
7 **(“M&C”) INCURRED IN THIS RATE CASE REASONABLE AND**  
8 **NECESSARY?**

9 A. Yes. For the period of August 12, 2015, through January 13, 2016, the expenses for  
10 M&C are \$27,720.00. Based on my years of experience working with utility  
11 consultants, Mr. Warren’s hourly rate of \$840, upon which the billings are based, is  
12 comparable to rates charged by consultants with similar levels of expertise and  
13 experience as Mr. Warren. I have also reviewed the number of hours Mr. Warren has  
14 spent on his review, analysis, and testimony in this proceeding and can testify that  
15 this amount is appropriate given the level of complexity of this case. The amount  
16 requested for consultant expenses of \$27,720.00, as of the date of filing, is  
17 reasonable. The consultant expenses will be supplemented at the hearing on the  
18 merits.

19 **Q. ARE THE CONSULTANT EXPENSES FOR P. MOUL & ASSOCIATES**  
20 **(“MOUL”) INCURRED IN THIS RATE CASE REASONABLE AND**  
21 **NECESSARY?**

22 A. Yes. For the period of September 16, 2015, through January 11, 2016, the expenses  
23 for Moul are \$26,478.00. Based on my years of experience working with utility

1 consultants, Mr. Moul's hourly rate of \$290, upon which the billings are based, is  
2 comparable to rates charged by consultants with similar levels of expertise and  
3 experience as Mr. Moul. I have also reviewed the number of hours Mr. Moul has  
4 spent on his review, analysis, and testimony in this proceeding and can testify that  
5 this amount is appropriate given the level of complexity of this case. The amount  
6 requested for consultant expenses of \$26,478.00, as of the date of filing, is  
7 reasonable. The consultant expenses will be supplemented at the hearing on the  
8 merits.

9 **Q. ARE THE CONSULTANT EXPENSES FOR PEASLEY, ALDINGER &**  
10 **O'BYMACHOW ("PAO") INCURRED IN THIS RATE CASE REASONABLE**  
11 **AND NECESSARY?**

12 A. Yes. For the period of October 26, 2015, through November 30, 2015, the expenses  
13 for PAO are \$61,838.98. Based on my years of experience working with utility  
14 consultants, PAO's hourly rate, upon which the billings are based, are comparable to  
15 rates charged by accountants with similar levels of expertise and experience as PAO.  
16 I have also reviewed the number of hours PAO has spent on its review, analysis, and  
17 account preparation in this proceeding and can testify that this amount is appropriate  
18 given the level of complexity of this case. The amount requested for consultant  
19 expenses of \$61,838.98, as of the date of filing, is reasonable. The consultant  
20 expenses will be supplemented at the hearing on the merits.

21 **Q. DOES MONARCH INTEND TO RECOVER ITS RATE CASE EXPENSES?**

22 A. Yes.



1 Q. HOW DOES MONARCH INTEND TO RECOVER ITS RATE CASE  
2 EXPENSES?

3 A. Rate case expenses (legal, consultants, and non-legal/non-consultants) are non-  
4 recurring expenses and are generally recovered through a surcharge on customers'  
5 bills. That is what Monarch is requesting in this case. Monarch proposes to recover  
6 reasonable and necessary rate case expenses through a surcharge assessed over a 36-  
7 month period.

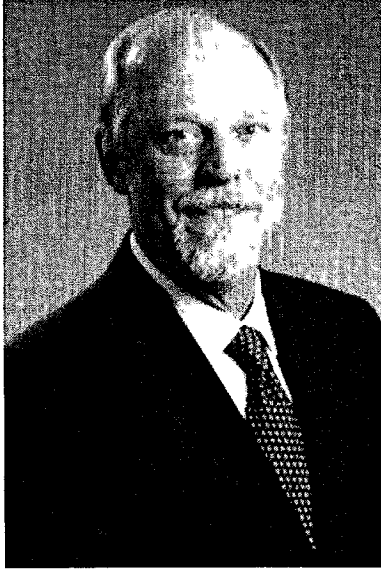
8 Water and sewer utilities are permitted to recover their reasonable expenses,  
9 including rate case expenses, from their customers pursuant to Texas Water Code  
10 Ann. §§ 13.183, 13.185, and 13.187, and 16 TAC § 24.33. Therefore, I recommend  
11 that Monarch be permitted to recover through a surcharge its reasonable legal,  
12 consultant, and non-legal/non-consultant rate case expenses.

13 IV. CONCLUSION

14 Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

15 A. Yes, it does. I reserve the right to make corrections, revisions, or deletions at the time  
16 of a hearing on the merits.

# Townsend, Lambeth



ltownsend@lglawfirm.com

In State and Federal courts and administrative tribunals, Lambeth represents companies and political subdivisions across a wide spectrum of regulatory and commercial activities. Lambeth focuses on all aspects of utility and water law. Prior to joining Lloyd Gosselink, Lambeth was General Counsel for the Public Utility Commission of Texas, 1987 - 89, and Assistant Attorney General for the State of Texas, 1977 - 84.

## Practice Areas

- Electric, Water, and Gas Utility Law
- Litigation
- Administrative Law and Contested Permits
- Water Law
- Utility Transactions and Acquisitions
- Renewable Energy

## Education

- J.D., St. Mary's University
- B.A., University of Texas at Austin

## Professional Licenses

- Admitted to the State Bar of Texas
- Admitted to U.S. Supreme Court, U.S. Court of Appeals for the Fifth Circuit and District of Columbia, and U.S. District Court for the Western, Eastern, and Northern Districts of Texas
- Board Certified in Administrative Law, Texas Board of Legal Specialization

## Representative Experience

- Represents clients in permitting matters at the Texas Commission on Environmental Quality and Public Utility Commission and in appeals of agency actions in state courts, including District Courts, Courts of Appeal, and the Texas Supreme Court
- Represents utility and political subdivision clients in contract litigation and defend clients in agency enforcement actions
- Represents political subdivisions in securing wastewater discharge permits and municipal solid waste disposal permits
- Represents investor, cooperative, and municipally owned electric, water, and wastewater utilities in all aspects of their business and regulation

# Townsend, Lambeth

- Represents and advises clients in negotiating and contracting for the sale and purchase of electric, water, and wastewater utilities and obtaining the required regulatory approvals
- Represents clients in negotiating wholesale supply and wholesale services contracts
- Represents clients at the Railroad Commission of Texas concerning intrastate pipeline rates and retail distribution rates
- Represents clients at Public Utility Commission concerning rates, services, and certificates of convenience and necessity
- Represents utility and political subdivision clients at Public Utility Commission in rulemaking proceedings, including open access transmission, restructure of the regulation of electric utilities for retail competition, market design for the competitive wholesale power market, and applications for certificates of convenience and necessity ("CCN") for transmission lines

## Publications & Presentations

- Author, Cancellation of Water Rights in Texas: Use It, or Lose It, 17 St. Mary's Law Journal 1217 (1986)
- Co-author, "Standards for Determining the Public Interest in Merger Cases: Application to Texas Public Utilities," 13 Tex. Journal of Corporate Counsel 84 (1994)

## Professional Associations & Memberships

- American Bar Association
- State Bar of Texas
- Austin Bar Association

## Honors & Awards

- AV Peer Review Rated by Martindale-Hubbell
- Best Lawyers in America: 2010, 2011, 2012, 2013, 2014, and 2015 by Woodward/White, Inc.
- Selected for inclusion by Thomson Reuters in Super Lawyers Texas: 2011, 2012, 2014, and 2015

July 14, 2015

Monarch Utilities I LP  
Attn Ken Dix  
1325 North Grand Avenue Suite 100  
Covina, CA USA 91724

Invoice: 97465936  
Client: 3176  
Matter: 18  
Billing Attorney: RLT

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**INVOICE SUMMARY**

For professional services and disbursements rendered through June 30, 2015:

**RE: 2016 Rate Case**

Professional Services	\$ 2,231.00
Total Disbursements	<u>\$ 251.40</u>
<b>TOTAL THIS INVOICE</b>	<b>\$ 2,482.40</b>

## Lloyd Gosselink Rochelle &amp; Townsend, P.C.

Monarch Utilities I LP  
2016 Rate Case  
I.D.3176-18-RLT

July 14, 2015  
Invoice: 97465936

**PROFESSIONAL SERVICES RENDERED**

Date	Atty	Description Of Services Rendered	Hours
5/22/15	RLT	Telephone conference with G. Freitag; telephone conference with E. Robinson.	.50
6/08/15	PLM	Review and respond to emails.	.30
6/24/15	RLT	Telephone conference with C. Profilet; review correspondence; draft agreement with GDS; telephone conference with C. Loy.	.80
6/25/15	RLT	Correspondence.	.40
6/26/15	RLT	Prepare engagement letter; correspondence.	.30
6/26/15	MAL	Review rate base testimony research and discuss with E. Adams.	.60
6/29/15	RLT	Office conference with M. Long regarding researching rate base testimony at PUC.	.20
6/29/15	MAL	Review and pull rate base testimony for C. Profilet.	2.10
6/30/15	RLT	Telephone conference with C. Profilet and follow-up; telephone conference with C. Loy.	.60
6/30/15	MAL	Pull and organize rate base testimony for C. Profilet.	1.80

**TOTAL PROFESSIONAL SERVICES**

**\$ 2,231.00**

**SUMMARY OF PROFESSIONAL SERVICES**

Name	Staff Level	Hours	Rate	Total
R Lambeth Townsend	Principal	2.80	350.00	980.00
Melissa A Long	Associate	4.50	270.00	1,215.00
Paula L McCormick	Paralegal	.30	120.00	36.00
<b>TOTALS</b>		<b>7.60</b>		<b>\$ 2,231.00</b>

**DISBURSEMENTS**

Date	Description	Amount
	Photocopying	251.40

**TOTAL DISBURSEMENTS**

**\$ 251.40**

**TOTAL THIS INVOICE**

**\$ 2,482.40**

\\MIS-PRINT05\Riley	6/25/2015	3176	18	26
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\\MIS-PRINT05\Riley	6/25/2015	3176	18	11
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\\MIS-PRINT05\Ferdinand	6/29/2015	3176	18	59
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\\MIS-PRINT05\Riley	6/29/2015	3176	18	98
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\\MIS-PRINT05\Riley	6/29/2015	3176	18	83
\\MIS-PRINT05\Riley	6/29/2015	3176	18	54

Total copies 1257

1257 pages x .05 / page = \$ 251.40

Photocopying 3176-18

August 13, 2015

Monarch Utilities I LP  
Attn Ken Dix  
1325 North Grand Avenue Suite 100  
Covina, CA USA 91724

Invoice: 97466647  
Client: 3176  
Matter: 18  
Billing Attorney: RLT

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**INVOICE SUMMARY**

For professional services and disbursements rendered through July 31, 2015:

**RE: 2016 Rate Case**

Professional Services	\$ 7,180.00
Total Disbursements	<u>\$ 5,276.26</u>
<b>TOTAL THIS INVOICE</b>	<b>\$ 12,456.26</b>
Previous Balance	<u>\$ 2,482.40</u>
<b>TOTAL BALANCE DUE</b>	<b><u>\$ 14,938.66</u></b>

**Lloyd Gosselink Rochelle & Townsend, P.C.**

Monarch Utilities I LP  
2016 Rate Case  
I.D.3176-18-RLT

August 13, 2015  
Invoice: 97466647

**PROFESSIONAL SERVICES RENDERED**

<b>Date</b>	<b>Atty</b>	<b>Description Of Services Rendered</b>	<b>Hours</b>
7/02/15	RLT	Telephone conference with B. Kelly and follow-up; office conference with M. Long regarding research project.	.60
7/06/15	RLT	Research rate base issues; office conference with M. Long regarding research concerning cost allocation manual; research regarding consolidated tax savings adjustment; research cost allocation issues.	4.00
7/06/15	MAL	Pull allocation model testimony and discuss with L. Townsend.	.80
7/06/15	PLM	Review and respond to emails; case management.	.50
7/07/15	RLT	Telephone conference with E. Blumenthal; conference with B. Kelly, C. Loy, and G. Freitag; review correspondence; correspondence; research regarding consolidated tax savings; telephone conference with a potential expert; correspondence.	2.80
7/07/15	PLM	Review emails; case management.	.40
7/08/15	RLT	Review correspondence; correspondence; review trial balance data.	1.20
7/08/15	PLM	Review and respond to emails;	.90
7/10/15	RLT	Review correspondence; correspondence.	.20
7/14/15	RLT	Review consolidated tax calculation; telephone conference with E. Taussig, K. Cauley, M. Long, and others; research CTSA precedent.	2.50
7/14/15	MAL	Call regarding CTSA.	.20
7/15/15	RLT	Conference call with C. Profilet, E. Taussig, K. Cauley, and others; research CTSA issue and PUC precedent; correspondence; telephone conference with potential expert.	2.40
7/15/15	MAL	Conference call regarding CTSA; review correspondence regarding same.	1.20
7/24/15	RLT	Telephone conference with B. Kelly; correspondence.	.60
7/27/15	RLT	Review potential expert's testimony.	.50
7/28/15	RLT	Review summary of PUC's proposed rate filing package for Class A utilities; office conference with C. Brewster regarding decoupling efforts at PUC.	.90
7/29/15	RLT	Review correspondence regarding new RFP; correspondence; review testimony of potential expert.	2.20
7/30/15	RLT	Research PUC precedent regarding rate design.	.30

**TOTAL PROFESSIONAL SERVICES**

**\$ 7,180.00**

**SUMMARY OF PROFESSIONAL SERVICES**

<b>Name</b>	<b>Staff Level</b>	<b>Hours</b>	<b>Rate</b>	<b>Total</b>
R Lambeth Townsend	Principal	18.20	350.00	6,370.00
Melissa A Long	Associate	2.20	270.00	594.00
Paula L McCormick	Paralegal	1.80	120.00	216.00
<b>TOTALS</b>		<b>22.20</b>		<b>\$ 7,180.00</b>

Lloyd Gosselink Rochelle & Townsend, P.C.

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**Lloyd Gosselink Rochelle & Townsend, P.C.**

Monarch Utilities I LP  
2016 Rate Case  
I.D.3176-18-RLT

August 13, 2015  
Invoice: 97466647

**DISBURSEMENTS**

<b>Date</b>	<b>Description</b>	<b>Amount</b>
6/30/15	Consulting Services, AUS Consultants, 6/30/2015, 138712 - For Professional services and/or expenses incurred and rendered from May 24, 2015 through June 27, 2015	5,202.75
	Photocopying	58.20
7/16/15	Federal Express, 5-096-70040 - 7/6/15 Delivery to Charles Profilet, Jr. - Sugar Land TX 77478	15.31
<b>TOTAL DISBURSEMENTS</b>		<b>\$ 5,276.26</b>
<b>TOTAL THIS INVOICE</b>		<b>\$ 12,456.26</b>

**Lloyd Gosselink Rochelle & Townsend, P.C.**

Monarch Utilities I LP  
2016 Rate Case  
I.D.3176-18-RLT

August 13, 2015  
Invoice: 97466647

**OUTSTANDING INVOICES**

INVOICE NUMBER	DATE	INVOICE TOTAL	PAYMENTS RECEIVED	ENDING BALANCE
97465936	7/14/15	2,482.40	.00	2,482.40

Previous Balance	\$ 2,482.40
Balance Due This Invoice	<u>\$ 12,456.26</u>
<b>TOTAL BALANCE DUE</b>	<b><u>\$ 14,938.66</u></b>