

8112	160020	334	20007376 WDMN 133 - 5/8 AMR METERS	26,881.26	(5,219.04)	302112.32	30200092 Wynnwood HavenWtOperations	5/1/2011 020/000
3318	160020	310	20002470 Electrical System	24,816.00	(24,816.00)	-	30200091 Wynnwood HavenWtOperations	6/30/1999 015/000
3176	160020	330	20002325 Storage Tank 2 Bolted Steel 22000 gal	19,289.00	11,940.32	7,348.68	30200092 Wynnwood HavenWtOperations	6/30/1945 015/000
3168	160020	330	20002317 Storage Tank 2 Bolted Steel 22000 gal	19,222.00	(14,338.28)	4,883.72	30200092 Wynnwood HavenWtOperations	6/30/1978 015/000
3057	160020	311	20002208 WELL PUMPS ABOVE 5 HP	14,768.74	(13,138.79)	1,629.95	30200092 Wynnwood HavenWtOperations	6/30/2009 015/000
4928	160020	311	20004122 Wall Repair-W1	13,085.67	(9,265.73)	3,784.94	30200092 Wynnwood HavenWtOperations	12/31/2006 015/000
488	160020	304	30000408 Building Wood 16.5' X24.5'	11,899.00	(11,899.00)	-	30200092 Wynnwood HavenWtOperations	6/30/1978 015/000
2855	160020	330	20001990 Pressure Tank Steel 5000 gal	9,391.00	(6,571.00)	2,720.19	30200092 Wynnwood HavenWtOperations	6/30/1993 015/000
775	160020	304	10000687 CYCLE STOP VALVES AND RAB FOR HYDR TANK-WYNNWOOD	7,779.41	(1,896.83)	5,782.58	30200092 Wynnwood HavenWtOperations	12/31/2006 015/000
2754	160020	331	10001898 Distribution System	7,187.00	(1,896.83)	5,284.42	30200092 Wynnwood HavenWtOperations	6/30/1999 015/000
451	160020	304	10000328 Fencing Chain Link 6-ft.	6,244.00	(3,241.78)	3,002.24	30200092 Wynnwood HavenWtOperations	6/30/2005 015/000
3022	160020	330	30004218 Chemstation System	4,888.00	(4,888.00)	-	30200092 Wynnwood HavenWtOperations	12/31/1996 015/000
16	160020	309	300017 Land & land rights	4,800.00	(2,633.31)	1,866.69	30200092 Wynnwood HavenWtOperations	12/31/2000 015/000
389	160020	304	10000382 FT WORTH FENCE,INSTALL CHAINLINK FENCE AROUND WELL	3,896.00	(1,462.66)	2,126.44	30200092 Wynnwood HavenWtOperations	6/30/1988 015/000
2379	160020	311	20001488 Distribution System	3,700.00	(3,700.00)	-	30200092 Wynnwood HavenWtOperations	6/30/2000 015/000
2355	160020	311	20001858 Booster pump No 3 Berkeley 10 hp	3,700.00	(3,700.00)	-	30200092 Wynnwood HavenWtOperations	6/30/2000 015/000
2254	160020	311	20001860 Booster pump No 2 Berkeley 10 hp	3,700.00	(3,700.00)	-	30200092 Wynnwood HavenWtOperations	6/30/2000 015/000
2162	160020	311	20001260 15 HP GRINDPDS & PUMP END AND LABOR TO INSTALL Inc	3,698.00	(3,679.80)	29.80	30200092 Wynnwood HavenWtOperations	4/30/2006 015/000
1670	160020	333	20004812 WATER MAIN CAPITAL REPAIR-10551 BUCCANEER PT	2,875.11	(871.64)	2,003.47	30200092 Wynnwood HavenWtOperations	6/30/2005 015/000
5704	160020	310	20000752 WTR ELECTRICAL & ELECTRICAL CONTROLS	2,838.99	(1,048.19)	1,790.81	30200092 Wynnwood HavenWtOperations	12/31/2003 015/000
5443	160020	333	20000689 CAPITAL WATER MAIN REPAIR-10584 BUCCANEER PT	2,278.51	(982.97)	1,295.70	30200092 Wynnwood HavenWtOperations	12/31/2010 015/000
2500	160020	335	20001808 HYDRANT - 10627 BUCCANEER PT	1,887.60	(171.19)	1,716.41	30200092 Wynnwood HavenWtOperations	6/30/2006 015/000
6065	160020	331	20008385 WATER MAIN CAPITAL REPAIR-11828 WINDHAMMER	1,760.38	(258.83)	1,501.55	30200092 Wynnwood HavenWtOperations	5/1/2011 015/000
3146	160020	334	20007910 WDMN 7 - 3 inch AMR METERS	1,615.28	(398.12)	1,217.27	30200092 Wynnwood HavenWtOperations	12/31/2005 015/000
3181	160020	330	20004881 Tank Hydroponic Tanks	1,086.50	(907.20)	182.30	30200092 Wynnwood HavenWtOperations	6/30/2005 015/000
4494	160020	331	30000889 WATER DISTRIBUTION PLANS (MAPS)-WYNNWOOD HAVEN	700.00	(100.58)	591.44	30200092 Wynnwood HavenWtOperations	6/30/2007 015/000
5050	160020	347	20004246 Air Compressor Speedline, 5 hp	600.00	(600.00)	-	30200092 Wynnwood HavenWtOperations	6/30/2007 015/000
9899	160020	310	20006192 2 TURBINE METER Inch-WINNEY WELL 3 (W2)	675.34	(230.83)	344.81	30200092 Wynnwood HavenWtOperations	7/30/2008 015/000
1091	160020	331	20000388 CAPITAL WATER MAIN	590.80	(33.79)	526.24	30200092 Wynnwood HavenWtOperations	10/1/2011 015/000
8287	160020	334	20007911 5/8 AMR METER-10548 BUCCANEER PT	504.44	(38.87)	442.99	30200092 Wynnwood HavenWtOperations	5/1/2011 015/000
7718	160020	334	20007051 5/8 AMR METER	194.02	(40.00)	144.98	30200092 Wynnwood HavenWtOperations	6/30/2008 015/000
1696	160020	310	20002091 BULD JBO AMP 480V 30 SERVICE POLE	125.00	(112.50)	11.42	30200092 Wynnwood HavenWtOperations	5/1/2011 015/000
1373	160020	331	20000389 WATER SYSTEM MAP-WDMN	100.00	(9.19)	90.82	30200092 Wynnwood HavenWtOperations	6/30/2008 015/000
5965	160020	333	20005180 NEW METER BOX W/LID-10584 BUCCANEER PT	62.50	(18.19)	44.37	30200092 Wynnwood HavenWtOperations	7/31/2008 015/000
				181,829,263.84	(92,995,348.88)	78,899,687.02		

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

GEORGE FREITAG, P.E.

ON BEHALF OF

MONARCH UTILITIES I, L.P.

FEBRUARY 29, 2016

**DIRECT TESTIMONY OF
GEORGE FREITAG, P.E.**

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ATTACHMENTS:

GF-1 List of Schedules Sponsored

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
GEORGE FREITAG, P.E.**

I. INTRODUCTION

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is George Freitag. My business address is 1620 Grand Avenue Parkway, Suite 150, Pflugerville, TX 78660.

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

A. I am employed by SouthWest Water Company ("SouthWest"), as the Texas Regulatory Manager. I am responsible for preparing and monitoring certain regulatory filings for all of SouthWest's regulated utilities in Texas. These include filings before the Public Utility Commission of Texas ("Commission") related to Certificate of Convenience and Necessity amendments, Sale, Transfer, and Merger applications, purchased water pass-through applications, minor tariff amendments, and rate change applications. Additionally, I work closely with our customer service and operations staff in matters related to customer service issues.

Q. BRIEFLY DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I have bachelor degrees in engineering from Mississippi State University and in business from the University of Texas at Austin. I am licensed as a Professional Engineer in Texas. My trade association memberships include the American WaterWorks Association and the Water Environment Federation. I am on the board

1 of directors of the Independent Water and Sewer Companies of Texas. Over the
2 years, I have attended numerous seminars and training classes on utility ratemaking,
3 finance, and technical operations.

4 I have approximately 40 years of experience in water and wastewater utility
5 functions. Before joining SouthWest in January 2010, I worked for the consulting
6 firm of GDS Associates, Inc. ("GDS") for ten years. While there, I completed a
7 variety of projects, including preparation of water and wastewater rate studies for
8 utilities of various sizes and types, support for aquifer district water use pass-through
9 fees and related issues, water and wastewater capacity exception requests, utility asset
10 valuation studies, facilities and operations review of military base systems for
11 privatization proposals, support of clients in water and wastewater compliance
12 proceedings, preparation of a capital asset accounting manual, and energy efficiency
13 surveys of hospitals. I was part of the technical advisory team to the 2004 State of
14 Texas Water Conservation Task Force that prepared the comprehensive *Water*
15 *Conservation Best Management Practices Guide*.

16 Before working at GDS, I worked for the Texas Natural Resource
17 Conservation Commission, now the Texas Commission on Environmental Quality
18 ("TCEQ") and its predecessor agencies, where my duties included providing general
19 management and technical assistance to water and wastewater utilities. I participated
20 in numerous rate, certification, and enforcement proceedings. I was a principal point
21 of contact for both utilities and consumers in resolving water conservation and
22 drought contingency issues, quality of service questions, and water utility
23 management issues. I was instrumental in the development of a multi-agency

1 program to assist small and low-income communities in resolving water and
2 wastewater facility needs. From 1997 to 1999, I was chairman of the National
3 Association of Regulatory Utility Commissioners Staff Subcommittee on
4 Technology.

5 In the early years of my professional career, I worked for an engineering
6 consulting firm and the Texas Water Quality Board and successor environmental
7 regulatory agencies in the areas of wastewater compliance inspections and design
8 plan and specifications review.

9 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

10 **A.** I am testifying on behalf of Monarch Utilities I, L.P. ("Monarch").

11 **II. PURPOSE OF TESTIMONY**

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

14 **A.** The purpose of my direct testimony in this proceeding is to discuss Monarch's
15 proposed phase-in of rate increases, proposed rates and rate design, and proposed
16 tariff changes.

17 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR**
18 **SUPERVISION?**

19 **A.** Yes, it was.

20 **Q. INsofar AS THIS TESTIMONY IS FACTUAL IN NATURE, DO YOU**
21 **BELIEVE IT TO BE CORRECT?**

22 **A.** Yes, I do.

1 Q. INsofar AS THIS TESTIMONY IS IN THE NATURE OF OPINION OR
2 JUDGMENT, DOES IT REPRESENT YOUR BEST JUDGMENT?

3 A. Yes, it does.

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

6 A. I am sponsoring the following schedules and associated workpapers shown on
7 Attachment GF-1.

8 **III. REQUESTED RATES**

9 Q. PLEASE DESCRIBE THE AMOUNT AND RATIONALE FOR MONARCH'S
10 PROPOSED PHASE-IN OF NEW RATES.

11 A. Commission rules at 16 Tex. Admin. Code § 24.34(b) (TAC) allow Monarch to
12 request a phased, multi-year approach to setting and implementing rates to eliminate
13 the requirement that a utility file multiple successive rate applications. Avoiding rate
14 shock is a primary goal for phasing rate increases, as well as avoiding extensive costs
15 associated with preparing rate change applications on an annual basis. Commonly
16 known as "gradualism," Monarch remains committed to this goal by proposing a
17 three-year phase-in of its requested rates. For water, Monarch proposes a \$3,213,438
18 revenue increase, or 14.50%, in the first phase; a \$276,966 increase, or 1.09%, in the
19 second phase; and a \$279,989 increase, or 1.09%, in the third phase. For wastewater,
20 Monarch proposes a \$506,973 revenue increase, or 14.50%, in the first phase; a
21 \$247,265 increase, or 6.18%, in the second phase; and a \$262,538 increase, or 6.18%,
22 in the third phase. The underlying rationale for the first year increases is for
23 customers who receive both water and wastewater services to see equal rate increases

1 for the two services. Second-phase and third-phase increases are designed to provide
2 necessary increases in both years of identical percentages so that full cost of service is
3 recovered at the end of Year Three.

4 The effective date of the first phase will be at least 35 days after required
5 notice in compliance with Commission rules at 16 TAC § 24.22(d). In the event that
6 the proposed rates are suspended (pursuant to Commission rules at 16 TAC
7 § 24.26(a)(2)), Monarch reserves the right to seek interim rates during the pendency
8 of this proceeding in accordance with Commission rules at 16 TAC § 24.29.

9 **IV. RATE DESIGN**

10 **Q. PLEASE EXPLAIN MONARCH'S CONSOLIDATED RATE DESIGN.**

11 A. Pursuant to Texas Water Code § 13.145(b), Monarch is unique among Texas multi-
12 system water and wastewater utilities in that the rates of its multiple systems are
13 consolidated under a common tariff. Under this rate structure, all Monarch customers
14 pay the same rate for service even though the individual systems providing service
15 may vary in terms of the number of customers served, operating characteristics, and
16 stand-alone costs. This rate is sometimes referred to as a "postage stamp rate." This
17 common tariff structure provides substantial benefits to Monarch customers by
18 lowering administrative and regulatory costs, enhancing capital deployment,
19 improving rate and revenue stability, and ensuring affordability for customers in very
20 small service areas. Consolidated rates are inherently fair in that all individual
21 systems will eventually require infusions of capital for improvements, only the timing
22 varies. Equalizing rates smoothes the effect of cost spikes in a period of rising
23 investment needs.

1 **Q. PLEASE EXPLAIN MONARCH'S PROPOSED RATE DESIGN.**

2 A. Monarch proposes to retain its current rate designs for both water and wastewater.
3 The water rate design consists of a monthly minimum charge based on meter size,
4 and a gallonage charge per 1,000 gallons based on the amount of water consumed in
5 the billing period. The gallonage charge is a four-tier inclining block rate structure:
6 0 - 2,000 gallons, 2,001 to 10,000 gallons, 10,001 to 20,000 gallons, and all usage
7 over 20,000 gallons thereafter.

8 The wastewater rate design consists of a monthly minimum rate based on the
9 water meter size and gallonage charges based on average winter water consumption
10 during December, January, and February. Single-family residential service
11 connections without an historic average will have an imputed average of 5,000
12 gallons until they have established an average. There is only one single charge per
13 1,000 gallons for all usage levels. Non-residential wastewater service is billed based
14 on actual monthly water consumption.

15 **Q. HAS MONARCH APPLIED INCREASES UNIFORMLY TO MINIMUM**
16 **CHARGES AND GALLONAGE CHARGES?**

17 A. Yes. Customers subject to the increases are uniformly impacted; that is, no customer
18 group subject to increases is unduly burdened compared to any other customer group.

19 **Q. PLEASE EXPLAIN FURTHER THE CONSIDERATIONS MONARCH**
20 **EMPLOYED IN CALCULATING THE PROPOSED WATER RATES?**

21 A. First, we determined the total increase in revenue needed and translated that to a
22 percentage increase required. Next, we started with the actual volumes of water sold
23 in the test year and made adjustments for the loss of Blue Mound and Midway

1 customers. An additional adjustment was made for the expected decrease in volume
2 sales due to water conservation. The resulting volumes in the respective usage tiers
3 were increased by a uniform percentage to calculate the revenues produced in each
4 usage tier. We did not change the structure of the usage tiers.

5 Likewise, the number of active customers at the end of the test year was
6 adjusted for the loss of Blue Mound and Midway customers. The number of
7 customers in each meter size was converted to meter equivalents using the standard
8 equivalency factors. Then the monthly charge for a meter equivalent was increased
9 by the uniform percentage so that the remaining revenue requirement would be
10 recovered. The individual rates for each meter size were determined by using the
11 equivalency factors.

12 **Q. PLEASE EXPLAIN FURTHER THE CONSIDERATIONS MONARCH**
13 **EMPLOYED IN CALCULATING THE PROPOSED SEWER RATES?**

14 A. The process was similar to that previously explained in developing the water rates.
15 We used a uniform increase percentage to provide equal rate increases for all meter
16 sizes and consumption levels. We adjusted both the volumes sold and numbers of
17 test year-end customers to reflect the loss of Blue Mound customers (there were no
18 wastewater customers in the Midway system).

19 **Q. DOES MONARCH SEGREGATE CUSTOMERS BY CLASS?**

20 A. No. Historically the TCEQ had classified the customers of the utilities it regulated
21 solely by the various meter sizes based on meter equivalency factors, and also it
22 distinguished between customers inside or outside of municipalities who are subject
23 to different regulatory processes. Monarch consists of separate, mostly small rural

1 systems located throughout the state, making impractical any analysis based on
2 segregation of customer classes. In addition, customers with 5/8 meters, the smallest
3 meter size Monarch offers, make up 98.8% of its customer base.

4 **Q. IN THE PROPOSED RATE DESIGN, HOW HAS MONARCH CONSIDERED**
5 **CUSTOMERS SUBJECT TO CONTRACT OR AGREEMENT THAT ARE**
6 **NOT IMPACTED BY THE PROPOSED INCREASE?**

7 A. Monarch has ensured in the rate calculations that non-contract customers are not in
8 any way burdened as result of some customers not receiving increases, or receiving
9 lesser increases due to being served under contract. The rate calculations assume that
10 all customers, including contract customers, receive increases, with the result that
11 Monarch shareholders effectively absorb foregone rate increases that would otherwise
12 be paid by contract customers.

13 **Q. HOW HAVE MONARCH'S PROPOSED RATES BEEN AFFECTED BY THE**
14 **PROPOSED THEORETICAL DEPRECIATION RESERVE REFUND?**

15 A. As discussed more fully in the Direct Testimony of Robert Kelly, Monarch recently
16 prepared a theoretical depreciation reserve study as required by the Commission's
17 Rate Filing Package. As a result of that study, Monarch proposes during the three-
18 year phase-in period to equalize the over-depreciation through the rate process in
19 amounts totaling \$937,968 for water and \$114,416 for wastewater.

20 **Q. IS MONARCH ASKING FOR ANY OTHER RATE CHANGES?**

21 A. Yes. We have a Supplemental Emergency Services Rate that is applicable only to
22 water customers that have an auxiliary meter and service line used for internal, non-
23 potable stand-by emergency needs. We have very few customers (currently four) that

1 need this type of private stand-by service, and typically no water is ever used. The
2 rate is based on inch-diameter of the service line. We are proposing increases to that
3 fee of 13.7% for Phase 1 and 1.09% each year for Phase 2 and Phase 3.

4 **Q. IS MONARCH ASKING FOR ANY OTHER CHANGES TO RATES OR**
5 **FEES?**

6 A. No. With the exception of four tariff changes (discussed below), we are not
7 proposing any changes or increases to the various customer service fees already
8 included on our approved tariffs.

9 **V. PROPOSED TARIFF CHANGES**

10 **Q. IS MONARCH REQUESTING ANY TARIFF CHANGES OTHER THAN**
11 **RATES?**

12 A. Yes. Monarch requests four tariff changes.

13 1. Monarch proposes to replace its "Purchased Sewer Pass-Through Clause"
14 with a "Sewer Pass-Through Gallonage Charge Adjustment." The revised
15 pass-through clause adds a true-up feature that adjusts for over- or under-
16 collections in the past 12 months.

17 2. Monarch proposes to update Section 2.12 in its Sewer Tariff regarding
18 "Residential Single Family Grinder / Sewage Stations" relating to ownership
19 and repairs to onsite grinder pumps, storage tanks, controls and other
20 appurtenances. Regarding multi-family and commercial receiving tank / lift
21 stations, Monarch proposes to delete certain language regarding responsibility
22 for maintaining and repairing all equipment necessary to connect service
23 locations to Monarch's collection lines.

1 3. In the Water Tariff Monarch proposes to replace its "Purchased Water and / or
2 District Fee Pass-Through Clause" with a "Water Pass-Through Gallonage
3 Charge Adjustment." The revised pass-through clause adds a true-up feature
4 that adjusts for over- or under-collections in the past 12 months.

5 4. With regard to the previously discussed Supplemental Emergency Service
6 Rate, we are clarifying in our Water Tariff that the rate is determined based on
7 inch-diameter of the service line and not the meter size, and also clarifying
8 that any metered usage on that account will be billed at the highest tier.

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

10 **A. Yes, it does.**

Schedules Sponsored

- Schedule II-D-10 Regulatory Expenses
- Schedule II-G Historic Operating Revenues
- Schedule II-G (W) Historic Operating Revenues
- Schedule II-G (S) Historic Operating Revenues
- Schedule II-G-1.a(W) Number of Active and Inactive Connections - Water
- Schedule II-G-1.a(S) Number of Active and Inactive Connections - Sewer
- Schedule II-G-1.b Average Number of Connections
- Schedule II-G-1.c Gallons Sold by Usage Block (unadjusted)- Water
- Schedule II-G-1.d Changes in Volumes due to Abnormal Weather - Water
- Schedule II-G-1.e Volume Adjustments due to Changes in Number of Customers - Water
- Schedule II-G-1.c. Gallons Sold by Usage Block (unadjusted)- Sewer
- Schedule II-G-1.d. Changes in Volumes due to Abnormal Weather - Sewer
- Schedule II-G-1.e. Volume Adjustments due to Changes in Number of Customers - Sewer
- Schedule II-G-1.f Other Changes in Volume
- Schedule II-G-1.g(W) Fixed and Variable Revenues - Water
- Schedule II-G-1.g(S) Fixed and Variable Revenues - Sewer
- Schedule II-G-1.2 (W) Revenue Impact Data - Water Volume Sales
- Schedule II-G-1.2(S) Revenue Impact Data - Wastewater Volumes
- Schedule II-G-1.3(W) Rate Comparison
- Schedule II-G-1.3(S) Rate Comparison
- Schedule II-G-1.4(W) Customer Consumption
- Schedule II-G-1.4(S) Customer Consumption
- Schedule II-G-2.1(W) Connections Added and Lost - Water
- Schedule II-G-2.1(S) Connections Added and Lost - Wastewater

Schedules Sponsored

- Schedule II-G-2.2(W) Monthly Water Usage Data - Water
- Schedule II-G-2.2(S) Monthly Water Usage Data - Wastewater
- Schedule II-G-2.3(W) Customer Classification History - Water
- Schedule II-G-2.3(S) Customer Classification History - Wastewater
- Schedule II-G-2.4 Wholesale/Sales for Resale
- Schedule II-G-2.5(W) Large Users - Water
- Schedule II-G-2.5(S) Large Users - Wastewater
- Schedule II-G-2.6 Customer Adjustments
- Schedule II-G-2.7 Customer Adjustment Data
- Schedule II-G-2.8(W) Test Year Coincident Peak Data - Water
- Schedule II-G-2.8(S) Test Year Coincident Peak Data - Wastewater
- Schedule II-G-3 Revenue Calculation Methodologies
- Schedule II-G-6 Tariff
- Schedule II-H-2 Contracts
- Schedule III (W) Water Rate Design
- Schedule III (S) Wastewater Rate Design
- Schedule V-4 Unaccounted for Water
- Schedule V-4 (1) Unaccounted for Water - Narrative
- Schedule VI-4 Water Conservation
- Schedule VI-5 Meter Replacement Policy

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

ROBERT L. KELLY

ON BEHALF OF

MONARCH UTILITIES I, L.P.

FEBRUARY 29, 2016

**DIRECT TESTIMONY OF
ROBERT L. KELLY**

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ATTACHMENTS:

RLK-1	List of Schedules Sponsored
RLK-2	Monarch I, L.P. Revenue Held in Abeyance
RLK-3	Monarch I, L.P. Revenue Held In Abeyance Excluding Blue Mound
RLK-4	Civil Solution, Inc., Opinion of Probable Cost
RLK-5	Summary Of Earnings At Proposed Rates Before And After Theoretical Depreciation Reserve Adjustment

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
ROBERT L. KELLY

I. INTRODUCTION

1

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Robert L. Kelly. My business address is 1325 N. Grand Avenue, Suite
4 100, Covina, California.

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

6 A. I am employed by SouthWest Water Company ("SouthWest") as Vice President of
7 Regulatory Affairs.

8 Q. BRIEFLY DESCRIBE YOUR PRESENT EMPLOYMENT.

9 A. My present responsibilities consist of management of all rate filings for SouthWest's
10 utilities.

11 Q. BRIEFLY DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL
12 BACKGROUND.

13 A. My educational background consists of a Bachelor of Science in Accounting from the
14 State University of New York at Binghamton and a Masters in Business
15 Administration from the University of North Florida. I have also completed all the
16 requirements for an additional Masters in Business Administration from California
17 Polytechnic University at Pomona. My professional background prior to being
18 employed by SouthWest includes 18 years of financial experience with regulated
19 investor owned water utilities. I have been employed by SouthWest for 20 years. I

1 am a Certified Public Accountant in Florida and in Arizona. I also am a Certified
2 Management Accountant.

3 **II. PURPOSE OF DIRECT TESTIMONY**

4 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

5 A. I am testifying on behalf of Monarch Utilities I, L.P. ("Monarch").

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

8 A. The purpose of my direct testimony in this proceeding is to discuss 1) two
9 dispositions of utility property, that is, the sale on September 11, 2015, of Monarch's
10 Blue Mound water and wastewater systems, and the pending sale of Monarch's
11 Midway Water System; 2) the Monarch Cost of Service Study as required by the
12 Commission's Rate Filing Package, Schedule II-H; 3) the Theoretical Depreciation
13 Reserve Study as required by the Commission's Rate Filing Package, Schedule II-B-
14 3; 4) rate case expense as required by the Commission's Rate Filing Package,
15 Schedule II-E-4.4; and 5) affiliate expenses as required by the Commission's Rate
16 Filing Package, Schedule IV.

17 **Q. WAS THIS MATERIAL PREPARED BY YOU OR UNDER YOUR**
18 **SUPERVISION?**

19 A. Yes, it was.

20 **Q. INsofar AS THIS MATERIAL IS FACTUAL IN NATURE, DO YOU**
21 **BELIEVE IT TO BE CORRECT?**

22 A. Yes, I do.

1 Q. INsofar AS THIS MATERIAL IS IN THE NATURE OF OPINION OR
2 JUDGMENT, DOES IT REPRESENT YOUR BEST JUDGMENT?

3 A. Yes, it does.

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

6 A. I am sponsoring the schedules and associated workpapers shown in Attachment RLK-
7 1.

8 **III. BLUE MOUND SALE**

9 Q. PLEASE DESCRIBE THE BLUE MOUND SYSTEMS.

10 A. The Blue Mound systems have 800 water and 800 sewer connections and are entirely
11 contained within the City of Blue Mound ("City"). The City has no separate water or
12 sewer utility serving the City, apart from Monarch. Blue Mound was originally
13 platted as Saginaw Park. A private water company, Saginaw Park Utility Company,
14 was established to serve the area. Construction began in the area in the mid 1950's.
15 SouthWest purchased the Blue Mound systems from Tecon Water Company in 2004.
16 All of the Tecon systems were later renamed "Monarch Utilities I, L.P."

17 Q. ARE THE BLUE MOUND WATER AND WASTEWATER SYSTEMS
18 INCLUDED AS PART OF THE COST OF SERVICE IN THIS
19 PROCEEDING? IF NOT, WHY NOT?

20 A. No. The Blue Mound water and wastewater systems have been excluded because
21 they were sold to the City on September 11, 2015, about two months after the end of
22 the test year. All costs associated with the systems have been excluded from the
23 filing as a known and measurable change, i.e., a post-test year adjustment to test year

1 amounts that is known, measurable, and verifiable, consistent with 16 Tex. Admin.
2 Code §§ 24.3(33), .31(b) (TAC).

3 **Q. PLEASE DESCRIBE THE TERMS OF THE SALE.**

4 A. On March 13, 2015, Monarch and the City of Blue Mound filed an application with
5 the Commission for approval of the sale, transfer, or merger of facilities and
6 certificate rights in Tarrant County. The Commission approved the sale on July 30,
7 2015. The sale price for Blue Mound water and wastewater systems assets was
8 \$5,900,000 payable in cash at time of closing.

9 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF EVENTS THAT LED TO THE**
10 **SALE OF THE BLUE MOUND WATER AND WASTEWATER SYSTEMS TO**
11 **THE CITY.**

12 A. In 2007, Monarch filed an application with the City, which had original jurisdiction,
13 for a rate increase. The City denied the rate request. Monarch appealed the denial to
14 the Texas Commission on Environmental Quality ("TCEQ"). The TCEQ referred the
15 case to the State Office Of Administrative Hearings ("SOAH"). SOAH combined the
16 case with the environs rate case application for Monarch, which at the time had been
17 pending with the TCEQ. In December 2008, the City approved a settlement with
18 Monarch, and the rate case was subsequently settled. In February 2009, the City
19 Council approved the rate increase. At that time, the City informed Monarch that it
20 was interested in purchasing the water and wastewater systems. The City's stated
21 goal in purchasing the utility was to offer its citizens lower rates. The rate estimated
22 by the City that it would charge would have been approximately \$20 to \$40 a month
23 less than that charged by Monarch.

1 **Q. PLEASE BRIEFLY DESCRIBE THE CITY'S CONDEMNATION**
2 **PROCEEDING AGAINST MONARCH.**

3 A. On December 2, 2011, the City filed condemnation proceedings for the acquisition of
4 the real property and fixtures of the Blue Mound water and wastewater systems. The
5 City's condemnation petition alleged that the City sought to exercise its powers of
6 eminent domain under Texas Local Government Code § 251.001 and Texas Property
7 Code Chapter 21 to acquire Monarch's entire water and wastewater systems.
8 Monarch responded by filing a combined no-evidence and traditional motion for
9 summary judgment asserting four grounds for summary judgment. The City filed a
10 response and a plea in abatement. The trial court granted the City's plea in abatement
11 and abated the case while the City attempted to have legislation approved, House Bill
12 1160, purporting to amend the Texas Local Government Code by providing
13 procedures for the TCEQ to transfer Monarch's CCNs to the City so that the City
14 could take over the operation of the Blue Mound water and wastewater systems.
15 Although the legislation was passed, the Governor vetoed the bill. The trial court
16 then reinstated the condemnation suit, granted summary judgment for Monarch, and
17 signed a judgment dismissing the case. The City filed an appeal. The Second Court
18 of Appeals, Fort Worth, Texas, affirmed the trial court's summary judgment for
19 Monarch.

20 **Q. WHAT HAPPENED AFTER THE CONDEMNATION ATTEMPT BY THE**
21 **CITY?**

22 A. On September 5, 2013, Monarch filed another application for a water and sewer rate
23 change with the City. On October 22, 2013, the City denied the rate increase and set

1 lower water rates for Monarch. On January 24, 2014, Monarch appealed the Blue
2 Mound rate ordinance to the TCEQ. On June 17, 2014, Monarch and Blue Mound
3 entered into a Settlement Agreement to resolve the appeal.

4 **Q. PLEASE DISCUSS THE NEGOTIATIONS THAT PRECEDED THE SALE**
5 **AND THAT DETERMINED THE ULTIMATE SALE PRICE.**

6 A. On March 6, 2009, at the time that the City first expressed its interest in purchasing
7 the systems, Monarch provided the City with its fair market value estimate of \$4.475
8 million for the entire combined water and wastewater systems. The City then made a
9 series of counter offers: December 2, 2009, \$1.9 million; March 30, 2010, \$3.8
10 million; April 20, 2010, \$4.3 million.

11 In the June 2014 rate appeal Settlement Agreement, Monarch agreed that by
12 July 31, 2014, it would provide the City with a firm, cash price offer for the City's
13 purchase of the water and sewer systems. On July 9, 2014, Monarch offered to sell
14 the systems to Blue Mound for what was eventually the sale price—\$5.9 million. The
15 price was based on Monarch's March 2009 \$4.475 million offer, plus capital
16 expenditures since March 2009, capital expenditures anticipated to be made prior to
17 closing, and legal and consulting expenses since December 2011. On January 5,
18 2015, Monarch and Blue Mound signed the sale agreement, and on September 11,
19 2015, the sale was successfully closed.

20 **Q. WHAT IS THE AMOUNT OF MONARCH'S GAIN ON THE SALE OF BLUE**
21 **MOUND WATER AND WASTEWATER ASSETS?**

22 A. Monarch's gain on sale is \$3,843,970, calculated as follows:

Table 1

Blue Mound Gain On Sale		
Sale Price		\$5,900,000
Original Cost Of Assets	(2,801,825)	
Less Accumulated Depreciation	1,210,573	
Net Book Value		(1,591,252)
Professional Fees		(477,173)
Gain On Sale		3,831,575

1 Q. HAS THE SUPREME COURT OF TEXAS ESTABLISHED EQUITABLE
2 PRINCIPLES COMMONLY USED FOR SHARING UTILITY GAINS ON
3 SALE?

4 A. Yes. In *Public Utility Commission of Texas v. Gulf States Utilities Company*, 809
5 S.W.2d 201 (Tex. 1991) ("Decision"), the Supreme Court established nine principles
6 that must be weighed in allocating gains on sale. I will discuss each of the criteria as
7 it applies to the sale of Blue Mound water and wastewater assets.

8 **Principle No. 1: The group that has borne the financial**
9 **burdens (e.g., depreciation, maintenance, taxes) of the**
10 **assets sold.**

11 The Decision admonished the Commission for basing its resolution of the Gulf States
12 case entirely on this one criteria, and also for interpreting this principle too literally,
13 i.e., basing sharing on exactly the percentage each paid for.

14 Applying this standard to Blue Mound is made more difficult as a result of a
15 history of Monarch voluntarily requesting less than the full amount of substantial
16 needed rate increases. This has resulted in Monarch's shareholders having borne
17 substantially more of Monarch's financial burden than they otherwise would have.
18 This voluntary absorption of needed rate increases by Monarch has been called
19 "Revenue Held In Abeyance." This was also the practice of Tecon, the prior owner
20 of the Blue Mound and the other systems acquired in 2005. Attachment RLK-2

1 shows the enormous burden Monarch has voluntarily absorbed: first in its 2007 rate
2 case, \$2.6 million annually for water and \$.6 million annually for sewer, then in its
3 2011 rate case (as amended), \$6.5 million annually for water and \$1.9 million
4 annually for sewer, and then in its 2013 rate case, \$6.0 million for water and \$1.3
5 million for sewer.

6 Attachment RLK-3 provides an estimate of that enormous burden since 2008
7 for all of Monarch. The estimated total burden, excluding Blue Mound, is \$43.3
8 million, over 11 times the amount of the gain on the Blue Mound sale.

9 In the interest of full disclosure, the Monarch Revenue Held in Abeyance
10 amounts shown in Attachments RLK-2 and RLK-3 are based entirely on Monarch
11 rate filings that ultimately resulted in TCEQ-approved settlements with no mention of
12 cost of service. Nevertheless, in all three Monarch rate cases, as well as the earlier
13 Tecon rate case, the utilities ultimately received lesser increases than even the
14 reduced increases the utilities had originally requested. Hopefully, the point here is
15 clear: it would be egregious to effectively penalize Monarch for its efforts to avoid
16 rate shock by requiring Monarch to share with customers any portion of the gain on
17 the sale of Blue Mound assets.

18 **Principle No. 2: Whether the asset sold has been included**
19 **in the rate base over the years.**

20 This principle has interesting relevance for Monarch given Monarch's historic
21 customer-centric practice of voluntarily absorbing needed rate increases. Monarch's
22 extensive efforts to limit rate increases and avoid customer rate shock, combined with
23 not having had any rate base determinations in recent memory, means that for
24 Monarch the concept of rate base historically has had little significance. More to the

1 point, Monarch's underearning has effectively diluted the economic value of
2 Monarch's assets, and in terms of earning capability very little of Monarch's
3 investment in Blue Mound assets has ever effectively been in rate base. This is one
4 more reason why gain on sale of Monarch assets should be attributed entirely to
5 Monarch.

6 **Principle No. 3: The group that has borne the risks of the**
7 **assets sold.**

8 It is clear that risks associated with Blue Mound were predominately borne by
9 Monarch. After purchasing the systems, Monarch willingly invested \$1.1 million in
10 Blue Mound infrastructure while requesting rate increases lower than necessary to
11 recover costs, and then compromised through settlement on rate increases that were
12 lower still.

13 **Principle No. 4: Whether the asset was depreciable**
14 **property, nondepreciable property, or a combination of the**
15 **two types.**

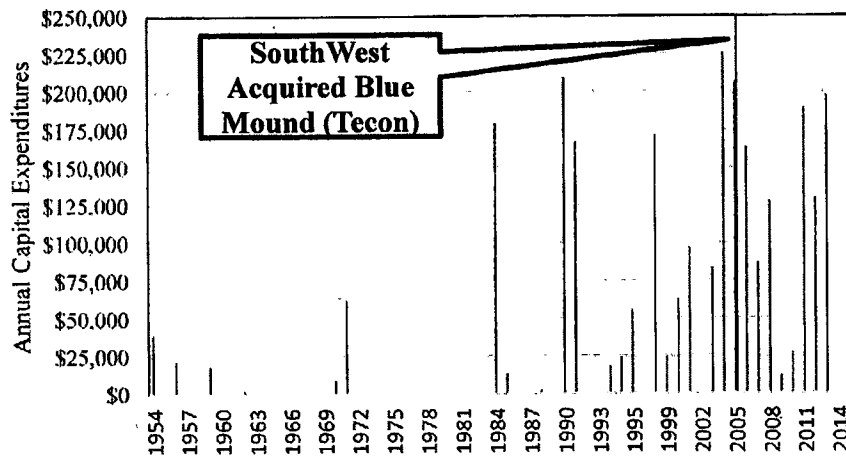
16 Virtually all of the current Blue Mound \$1.9 million plant investment is depreciable.
17 Only \$45,000 is nondepreciable. However, Monarch has recovered very little of Blue
18 Mound investment in rates as a result of the substantial amounts of revenue held in
19 abeyance discussed earlier.

20 **Principle No. 5: The impact of the proposed allocation on**
21 **the financial strength of the utility.**

22 Since the acquisition of Blue Mound in 2004, Monarch has invested \$1.1 million in
23 Blue Mound systems, or about 41% of the total Blue Mound plant investment.

Table 2

Blue Mound Annual Capital Expenditures



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Furthermore, had Monarch retained Blue Mound, it would have faced further investments in infrastructure of \$1.6 million for additional needed capital improvements. Avoiding these additional investments substantially benefited remaining customers who would have largely absorbed those costs in their water rates. See Attachment RLK-4, Opinion of Probable Cost, prepared by CivilSolutions Inc. This cost estimate was the result of a Monarch-sponsored investigation prepared in 2010 into the current condition of the system and capabilities of the system for meeting TCEQ requirements for providing water service.

Principle No. 6: The reason for the asset's appreciation (e.g., inflation, a general increase in property values in the area).

Only \$45,000 of the Blue Mound investment was represented by land. The transaction price was based on market value agreed to by a willing buyer and a willing seller.

Principle No. 7: Any advantages enjoyed by the shareholders because of favored treatment accorded the asset.

1 Monarch's shareholder enjoyed no special advantages by way of favored treatment of
2 Blue Mound assets. In fact, as previously discussed, there is a tortured history of
3 costly litigation leading up to the Blue Mound sale, largely brought about by
4 Monarch's refusal to acquiesce to the City of Blue Mound's insistence on
5 preferentially lower rates for Blue Mound customers.

6 **Principle No. 8: The dividends paid out to the shareholders**
7 **over the years.**

8 Monarch has never paid any dividends to its shareholder, Monarch Utilities Inc.

9 **Principle No. 9: Any extraordinary burdens borne by the**
10 **ratepayers in connection with the asset.**

11 There clearly were extraordinary burdens associated with the Blue Mound systems,
12 and they were almost entirely borne by Monarch. Again, both the water and
13 wastewater systems consistently under-earned, largely resulting from Monarch's
14 concerns about customer rate shock, while at the same time Monarch invested \$1.1
15 million in Blue Mound infrastructure.

16 **Q. IN YOUR OPINION, HOW SHOULD THE GAIN ON THE SALE OF THE**
17 **BLUE MOUND WATER AND WASTEWATER SYSTEMS ASSETS BE**
18 **ALLOCATED BETWEEN SHAREHOLDERS AND CUSTOMERS?**

19 **A.** For the reasons I just explained, the gain should be allocated 100% to shareholders.

20 **IV. MIDWAY SALE**

21 **Q. PLEASE DESCRIBE THE MIDWAY WATER SYSTEM.**

22 **A.** Ni America, LLC purchased the stock of Midway Water Utilities, Inc. ("Midway")
23 from Amanda P. Tinsley in 2005. That same year Ni America, LLC assigned its
24 interests in the stock purchase to SouthWest. Midway's assets were subsequently

1 transferred to Monarch on October 3, 2011. Midway has 421 water connections and
2 is entirely contained within the City of Oak Point. Monarch and the City entered into
3 a sale agreement on June 18, 2015, and then entered into an amendment to the sale
4 agreement on August 25, 2015, for the extension of some deadlines. The City and
5 Mustang Special Utility District ("Mustang SUD") entered into an agreement on
6 August 26, 2015, for the City to assign its rights under the sale agreement with
7 Monarch.

8 **Q. IS THE MIDWAY WATER SYSTEM INCLUDED AS PART OF THE COST**
9 **OF SERVICE IN THIS PROCEEDING? IF NOT, WHY NOT?**

10 A. No. The Midway water system has been excluded because there is a pending sale to
11 the City of Oak Point effective June 18, 2015, before the end of the test year. The
12 sale agreement had anticipated that the sale would close before year end. The
13 agreement included a termination provision that in the event the sale was not closed
14 by December 31, 2015, either party would have the right to terminate the agreement.
15 Because of this belief by both parties that the sale would occur before year end, all
16 costs associated with the system were excluded from the filing as a known and
17 measurable change, i.e. a post-test year adjustment to test year amounts that is known,
18 measurable and verifiable, consistent with 16 TAC §§ 24.3(33), 24.31(b).

19 **Q. HAS THE SALE CLOSED?**

20 A. No. The City of Oak Point's assignment of its interest in the sale to the Mustang
21 SUD caused a delay in requesting approval from the Commission, which did not
22 occur until September 16, 2015. Commission approval has been given, and the
23 closing is expected to occur early in March 2016.

1 Q. WHAT IS THE AMOUNT OF MONARCH'S GAIN ON THE SALE OF
2 MIDWAY WATER SYSTEM ASSETS?

3 A. Monarch's gain on sale on Midway water system assets is \$917,017, calculated as
4 follows:

Table 3

Midway Gain On Sale		
Sale Price		\$1,500,000
Original Cost Of Assets	(1,218,154)	
Less Accumulated Depreciation	648,271	
Net Book Value		(569,883)
Professional Fees		(13,100)
Gain On Sale		\$917,017

5 Q. IN YOUR OPINION, HOW SHOULD THE GAIN ON THE SALE OF
6 MIDWAY WATER SYSTEM ASSETS BE ALLOCATED BETWEEN
7 SHAREHOLDERS AND CUSTOMERS?

8 A. In my opinion, the gain should be allocated 100% to shareholders.

9 Q. PLEASE EXPLAIN THE BASIS FOR YOUR OPINION.

10 A. Midway was included in the 2011 and 2013 Monarch rate filings, and the benefits to
11 customers relating to Revenue Held in Abeyance discussed earlier relating to Blue
12 Mound apply equally to Midway. All of the reasons supporting my opinion
13 concerning the gain on the sale of the Blue Mound systems also apply to the gain on
14 the sale of the Midway water system. As with Blue Mound, it would be egregious to
15 effectively penalize Monarch for its efforts to avoid rate shock by requiring Monarch
16 to share with customers any portion of the gain on the sale of Midway assets.

1 **V. COST OF SERVICE STUDY**

2 **Q. PLEASE DESCRIBE THE APPROACH THAT MONARCH HAS TAKEN IN**
3 **PREPARING THE COST OF SERVICE STUDY REQUIRED BY THE**
4 **COMMISSION'S RATE FILING PACKAGE, SCHEDULE II-H.**

5 A. We modeled our cost of service study for water and sewer service after the approach
6 used by the TCEQ in its rate filing package, Alternative Sections IX and X – Rate
7 Design Calculations and Rate Design.

8 **Q. DOES MONARCH'S CURRENT RATE DESIGN MAKE A DISTINCTION**
9 **AMONG CUSTOMER CLASSES FOR EITHER WATER OR**
10 **WASTEWATER, AND IF NOT, WHY NOT?**

11 A. No. Historically the TCEQ rules did not define different types of customer classes.
12 The classification for water and wastewater rates has been solely the identification of
13 rates set for various meter sizes based on meter equivalency factors (unless negotiated
14 otherwise), and classification of system ratepayers as inside v. outside of
15 municipalities who are subject to a different regulatory process. For Monarch,
16 customers with 5/8-inch meters, the smallest meter size Monarch offers, make up
17 98.8% of the customer base. The TCEQ did not typically require utilities to identify
18 different customer classes.

1 Q. DOES MONARCH'S COST OF SERVICE STUDY PROVIDE THE
2 NECESSARY DATA TO SHOW THAT THE EXISTING WATER AND
3 WASTEWATER RATE STRUCTURES, ON THE WHOLE, ARE FAIR AND
4 EQUITABLE?

5 A. Yes. Monarch's cost of service study shows that moving to a strict fixed/variable
6 cost allocation scheme such as used by the TCEQ would substantially increase costs
7 attributable to residential water customers. Service charges would increase by 44.0%,
8 from \$12.0 million to \$17.3 million, and quantity charges would increase by 10.2%,
9 from \$7.6 million to \$8.4 million.

10 Q. WHAT IS THE RESULT OF YOUR COST OF SERVICE STUDY AS IT
11 RELATES TO WASTEWATER CUSTOMERS?

12 A. Wastewater customers would see minimal change in their monthly bills under a strict
13 fixed/variable cost allocation scheme. Service charges would decrease by 1.2%.
14 Quantity charges would likely remain the same depending on target average winter
15 water consumption.

16 Q. PLEASE PROVIDE YOUR RECOMMENDATION REGARDING
17 MONARCH'S RATE STRUCTURE.

18 A. Monarch recommends the current rate structure be maintained, and that any change in
19 rates be applied on a pro-rata basis to all customers without any distinction as to
20 customer class other than meter size.

1 **VI. THEORETICAL DEPRECIATION RESERVE ADJUSTMENT**

2 **Q. WHY WAS A THEORETICAL DEPRECIATION RESERVE STUDY**
3 **PREPARED FOR THIS FILING?**

4 A. A Theoretical Depreciation Reserve Study derived from the most recent depreciation
5 study is required by the Commission's Rate Filing Package, Schedule II-B-3.

6 **Q. WHO IS SPONSORING THE THEORETICAL DEPRECIATION RESERVE**
7 **STUDY?**

8 A. AUS Consultants. The Theoretical Depreciation Reserve Study is discussed in the
9 Direct Testimony of Earl Robinson.

10 **Q. PLEASE DISCUSS THE PURPOSE AND RECOMMENDATIONS OF YOUR**
11 **DIRECT TESTIMONY AS IT RELATES TO THE THEORETICAL**
12 **DEPRECIATION RESERVE STUDY.**

13 A. The purpose of my direct testimony is to address the results of the Study that show
14 surpluses of \$5.339 million in water reserves, \$0.660 million in wastewater reserves,
15 and \$0.060 million in shared equipment reserves. My direct testimony addresses my
16 proposed disposition of those surpluses.

17 **Q. HOW DO YOU PROPOSE FOR SURPLUS RESERVES TO BE HANDLED?**

18 A. I propose that the surpluses be refunded to customers expeditiously, over a five-year
19 period beginning with the effective date of new rates in this proceeding. Monarch is
20 proposing in this proceeding to phase-in the needed rate increases over a three-year
21 period in order to limit rate shock. Monarch requests that the first three years' cost of
22 service impact of the five-year refund be included evenly in rates over the three-year
23 rate phase-in period. The calculation of refunds includes the rate base impact of

1 lower accumulated depreciation and higher deferred taxes. See Attachment RLK-5.
 2 As an example, the amount of the water-related annual reserve refunds during each of
 3 the three years would be \$937,968, calculated as shown below. These annual refunds
 4 are already embedded in the rates being proposed in this proceeding.

Table 4

WATER REFUNDS

Amount/Year	Cumulative Amount	Rate base Impact on Revenue Requirement 11.76%	Cumulative Deferred Taxes 34%	Revenue Requirement on Deferred Taxes 11.76%	Total Refund to Customers Before Franchise & Uncollectible	Total Refund to Customers After Franchise & Uncollectible 103.0132%	3 year Avg. Refund to Customers	Cumulative Refund to Customers
(a)	(b)	(c)=(b)x11.76%	(d)=(b)x34%	(e)=(d)x11.76%	(f)=(a+c+e)	(g)=(f)x103.0132%	(h)=sum (f)+3	(i) Cum.
Year 1	\$1,077,889	(\$126,786)	\$366,482.28	\$43,107	\$994,210	\$1,024,168	\$937,968	\$937,968
Year 2	\$1,077,889	(\$253,572)	\$732,964.55	\$86,215	\$910,531	\$937,968	\$937,968	\$1,875,935
Year 3	\$1,077,889	(\$380,359)	\$1,099,447	\$129,322	\$826,852	\$851,767	\$937,968	\$2,813,903
Year 4	\$1,077,889	(\$401,432)	\$1,465,929	\$172,429	\$743,173			
Year 5	\$1,077,889	(\$633,931)	\$1,832,411	\$215,537	\$659,495			

5 Wastewater depreciation surplus refunds would be handled similarly with annual
 6 refunds in the first three years of \$114,416.

Table 5

WASTEWATER REFUNDS

Amount/Year	Cumulative Amount	Rate base Impact 11.76%	Cumulative Deferred Taxes 34%	Revenue Requirement on Deferred Taxes 11.76%	Total Refund to Customers Before Franchise & Uncollectible	Total Refund to Customers After Franchise & Uncollectible 101.2223%	3 year Avg. Refund to Customers	Cumulative Refund to Customers
(a)	(b)	(c)=(b)x11.76%	(d)=(b)x34%	(e)=(d)x11.76%	(f)=(a+c+e)	(g)=(f)x101.2223%	(h)=sum (f)+3	(i) Cum.
Year 1	\$133,811	(\$15,739)	\$45,496	\$5,351	\$123,423	\$124,931	\$114,416	\$114,416
Year 2	\$133,811	(\$31,479)	\$90,991	\$10,703	\$113,035	\$114,416	\$114,416	\$228,833
Year 3	\$133,811	(\$47,218)	\$136,487	\$16,054	\$102,647	\$103,901	\$114,416	\$343,249
Year 4	\$133,811	(\$62,958)	\$181,983	\$21,406	\$92,259			
Year 5	\$133,811	(\$78,697)	\$227,478	\$26,757	\$81,871			

7 **Q. HOW TO YOU PROPOSE TO REFUND YEARS 4 AND 5?**

8 A. Years 4 and 5 refunds would follow on in the first two years of Monarch's next rate
 9 proceeding, which is also assumed will incorporate a three year phase-in. The third
 10 year (of the future three year phase-in), if shown on Tables 4 and 5, would be Year 6
 11 and would reflect zero refunds, indicating all necessary reserve refunds having been
 12 accomplished.

1 Q. IF FOR ANY REASON MONARCH DOES NOT APPLY FOR A RATE
2 CHANGE IN YEARS 4 AND 5, WILL CUSTOMERS BE DEPRIVED OF
3 REFUNDS IN THOSE YEARS?

4 A. No. Presumably, if Monarch does not request a rate change for Years 4 and 5, the
5 rates in effect in Year 3 would remain unchanged and the Year 3 refunding level
6 would continue in effect. In fact, refunds post-Year 3 would be higher than if
7 updating were to occur because, as can be seen from the "Total Refund to Customers"
8 column in the previous analyses, the level of refunds declines over time. Any
9 ultimate over-or under-refunding would be collected or paid to customers in a
10 subsequent rate proceeding.

11 Q. HOW ARE YOU PROPOSING TO REFUND SHARED EQUIPMENT
12 DEPRECIATION RESERVE SURPLUSES OF \$.060 MILLION?

13 A. Shared equipment depreciation reserve surpluses have already been allocated between
14 water and wastewater using an allocation methodology consistent with other
15 calculations in this filing.

16 Q. IS THE METHODOLOGY YOU ARE PROPOSING FOR REFUNDING
17 THESE THEORETICAL DEPRECIATION RESERVE SURPLUSES FAIR TO
18 CUSTOMERS?

19 A. Yes, it is. This refunding methodology avoids complicated surcredits and balancing
20 accounts, instead embedding the refunds in cost of service in a manner that fairly and
21 accurately reflects the associated rate base and deferred tax impacts.

1 **VII. RATE CASE EXPENSE**

2 **Q. PLEASE DESCRIBE THE PURPOSE OF YOUR DIRECT TESTIMONY ON**
3 **RATE CASE EXPENSES.**

4 A. The purpose of my direct testimony on rate case expenses is to 1) support Rate Filing
5 Package Schedule II-E-4.4 Rate Case Expenses, 2) explain the reasonableness of rate
6 case expenses incurred in filing this application, and 3) explain how Monarch is
7 seeking to recover its rate case expenses.

8 **Q. IN YOUR PROFESSIONAL EXPERIENCE, ARE THE RATE CASE**
9 **EXPENSES INCURRED IN FILING THIS APPLICATION REASONABLE?**

10 A. I believe the rate case expenses incurred in preparing this filing are entirely
11 reasonable given the highly unusual circumstances involved. Rate case expenses
12 have been largely driven by the advent of the Commission's new Rate Filing Package
13 and the lack of any precedent, given that Monarch is the first Class A water and
14 wastewater utility filing under the new requirements.

15 For example, Monarch had to retain a consultant to assist in developing the
16 complex electronic template that served as an indispensable guide. Several of the
17 Rate Filing Package's requirements are new to water, such as the required used and
18 useful study and affidavit, also the theoretical depreciation reserve study and the cost
19 of service study. The new requirement for extensive showings about accumulated
20 deferred income taxes required extensive effort by outside consultants with expertise
21 in utility tax accounting. The continuing downward trend in water demand in
22 Monarch's service areas required a weather normalization study and supporting direct

1 testimony that Monarch had never before prepared. The study places Monarch's
2 weather experience in context of the overall statewide downward trend in water use.

3 The detail of rate case expense can be found in Schedule II-E-4.4.
4 Cumulative rate case costs paid to consultants, accountants, and others based on bills
5 received from Lloyd Gosselink Rochelle & Townsend, P.C. as of the date of filing are
6 \$328,621.52. Supporting invoices as of the date of filing for this amount can be
7 found in the Direct Testimony of Lambeth Townsend, Attachments RLT-2 and RLT-
8 3. Additional rate case costs have been incurred totaling \$114,694 representing
9 employee travel and payments made directly to a vendor. Supporting invoices as of
10 the date of filing for this amount can be found in the Rate Filing Package as Schedule
11 II-E-4-4. Total rate case expense as of the date of filing is \$443,315.

12 **Q. HOW IS MONARCH SEEKING TO RECOVER ITS RATE CASE**
13 **EXPENSES?**

14 A. Pursuant to 16 TAC § 24.33, Monarch seeks to recover all reasonable and necessary
15 rate case expenses that it incurs in connection with this and related proceedings.
16 Monarch proposes to recover reasonable and necessary rate case expenses through a
17 surcharge assessed over a 36-month period. Monarch reserves the right to request
18 that all rate case expense issues be severed from this proceeding and considered in a
19 separate docket, if such severance would serve the interest of efficiency, and avoid
20 the need to estimate and update rate case expenses before the expenses are finalized.

1 **VIII. AFFILIATE EXPENSES**

2 **Q. BROADLY SPEAKING, HOW ARE SOUTHWEST'S AFFILIATES**
3 **ORGANIZED?**

4 A. SouthWest's affiliates are grouped under three major business segments:
5 1) Suburban Water Systems ("Suburban"), which is a regulated class A water utility
6 in California, 2) Texas Utilities, which comprises regulated water and wastewater
7 utilities and related customer service operations throughout Texas, and 3) Southeast
8 Utilities, which represents water, wastewater, and to a much smaller extent operations
9 and maintenance contracts in Alabama. A more extensive discussion of the
10 SouthWest organization is in the Direct Testimony of Charles Profilet.

11 **Q. IN THIS FILING HAS MONARCH DOCUMENTED SOUTHWEST'S**
12 **CORPORATE COST ALLOCATION METHODOLOGIES?**

13 A. Yes. SouthWest fully understands that the process of properly allocating costs is
14 important in setting just and reasonable rates as well as in minimizing cost subsidies
15 among entities. As a result, a Cost Allocation Manual has been prepared and
16 included in this filing, which documents the cost allocation processes of SouthWest
17 and its affiliates.

18 **Q. PLEASE DISCUSS WHAT COSTS ARE CONSIDERED CORPORATE**
19 **INDIRECT COSTS ALLOCABLE TO THE THREE MAJOR BUSINESS**
20 **SEGMENTS DISCUSSED EARLIER, AND THE METHODOLOGY USED IN**
21 **THEIR ALLOCATION.**

22 A. First of all, indirect costs are those corporate costs that benefit all SouthWest business
23 segment operations and that are so general in nature as to require prorations based on

1 a combination of several pertinent factors. To allocate those costs among the three
2 major business segments, the Cost Allocation Manual describes the 3-factor
3 allocation methodology consisting of three factors: gross plant, operating expenses
4 including payroll expenses, and payroll.

5 **Q. PLEASE DESCRIBE THE INDIRECT CORPORATE SERVICES THAT**
6 **SOUTHWEST ALLOCATES TO AFFILIATES.**

7 A. Broad categories of costs being amortized are Executive, Legal, Information
8 Technology, Finance, Human Resources, and Facilities. A discussion of each
9 function's responsibilities and indirect costs will follow below.

10 **A. Executive**

11 In conjunction with the Board of Directors, the executive function is responsible for
12 providing strategic vision, business strategy, executive oversight, management and
13 overall direction to the Company. The executive function is comprised of the Chief
14 Executive Officer, Chief Financial Officer, General Counsel, and two administrative
15 staff.

16 **B. Legal**

17 The legal function is responsible for providing counsel on legal matters within the
18 Company, including legal representation of SouthWest and litigation strategy and
19 management. The legal resources of the Company consist of the Vice
20 President/General Counsel who is included in the Executive function and one Senior
21 Paralegal who resides in the legal function. SouthWest utilizes a number of outside
22 legal firms to address legal issues of an indirect nature that arise on an ongoing basis
23 and that impact all subsidiaries.

1 **C. Information Technology**

2 The information technology function is responsible for operating and maintaining a
3 uniform, efficient, and flexible information technology platform capable of
4 addressing the increasingly complex current and future operational, financial, and
5 business needs of SouthWest business segments. Information technology is
6 comprised of four internal groups as follows:

7 **Administration**—works with business segments and vendors to deliver
8 optimal service, develops short and long range technology objectives,
9 provides contract and project management, and advises business segments on
10 technology issues.

11 **Client Services**—provides frontline desktop and helpdesk technical support,
12 procurement of IT assets, governance of policy and procedures, network
13 application, and security.

14 **Technical Infrastructure**—provides planning, architecture, implementation,
15 administration, and support of data, telecom and network infrastructure and
16 servers.

17 **Business Applications**—provides ongoing systems related business
18 processes, administration, development, and project management for
19 enterprise systems (financials, customer service, mobile devices, reporting
20 tools, human resources, and payroll).

21 **D. Finance**

22 The finance function is responsible for the accurate and timely accounting for
23 corporate transactions, the accurate and timely preparation of financial statements,

1 preparation of budgets and forecasts, accounts payable, payroll, treasury, risk
2 management, audit, tax, and providing management with the financial information
3 necessary for informed operating and financial decision making.

4 **E. Human Resources**

5 The human resource function is responsible for employment policies, practices and
6 employee related matters, arranging for both company- and employee-paid benefits
7 such as medical, dental, vision, life, and disability insurance, and for managing the
8 company's workers compensation obligations.

9 **F. Facilities**

10 Occupied under a 25-year lease in a business park, the corporate office of SouthWest
11 is in a two-story, 32,000 sq. ft. facility located at 12535 Reed Road in Sugar Land,
12 Texas. The lease was entered in March 2001 and will expire in February 2026.

13 **Q. WHAT IS THE BASIS FOR THE 3-FACTOR INDIRECT ALLOCATION**
14 **FORMULA AND WHY IS IT BEING USED?**

15 A. The 3-factor allocation formula is the allocation methodology approved by the
16 California Public Utilities Commission in its decision 14-012-038 involving
17 Monarch's California affiliate Suburban. The 3-factor methodology is being used to
18 ensure that corporate costs are fairly allocated to Monarch customers when
19 considering that this is the same methodology being used to allocate costs to
20 Suburban customers. Using any other cost allocation methodology would likely
21 result in corporate costs being either over- or under-allocated to Monarch customers
22 when compared to Suburban customers.

1 Q. PLEASE DISCUSS THE COST ALLOCATION METHODOLOGY BEING
2 USED TO ALLOCATE TEXAS UTILITIES' COSTS TO MONARCH AND
3 OTHER AFFILIATES.

4 A. Texas Utilities' costs are allocated to benefiting affiliates using the well-established
5 meter equivalent factors method, and using prior year-end "active" connections. This
6 is a well-documented and widely-used method of allocating costs.

7 Q. PLEASE SUMMARIZE THE BENEFITS THAT ACCRUE TO CUSTOMERS
8 AS A RESULT OF USING SOUTHWEST'S CORPORATE SERVICES.

9 A. Corporate has a lean workforce and a lean budget with a minimum number of people.
10 It pays reasonable wages, and the workforce has been trimmed significantly over the
11 last four years. Corporate provides shared services more effectively and efficiently
12 than could be provided to the individual affiliates individually.

13 IX. ACCOUNTING FOR ECO MARGIN

14 Q. IN MR. ROSE'S TESTIMONY, HE DESCRIBES THE DESIGN-BUILD
15 SERVICES PROVIDED TO MONARCH BY ECO RESOURCES ("ECO")
16 PRIOR TO 2008. WHY IS IT NOW IMPORTANT TO UNDERSTAND THE
17 REASONABLENESS OF THE SERVICES AND THE PAYMENTS MADE TO
18 ECO BY THE COMPANY?

19 A. Mr. Rose describes in his testimony the payments to ECO that included a margin to
20 fully compensate ECO, an affiliate of Monarch, for the design-build services
21 provided to Monarch. When Monarch accounted for the original cost of the projects
22 constructed through the design-build services, Monarch recorded as plant in service
23 the total amount of the costs for each project, including the margin paid to ECO, and

1 reflected these amounts in rate filings with the TCEQ as rate base. However, those
2 margins no longer appear in the current trial balance of Monarch, and as a result
3 Monarch has made an adjustment to restore the amounts of the margin back to plant
4 in service and to rate base in this proceeding.

5 **Q. INTERCOMPANY TRANSACTIONS ARE TYPICALLY ELIMINATED IN**
6 **FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH**
7 **GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. ON WHAT BASIS**
8 **HAD MONARCH BEEN ALLOWED TO RECORD THE INTERCOMPANY**
9 **ECO MARGINS?**

10 A. Accounting for affiliated sales to regulated utilities is governed by the Financial
11 Accounting Standards Board's Accounting Standards Codification 980-810-45-1:

12 Profit on sales to regulated affiliates shall not be eliminated in general-
13 purpose financial statements if both of the following criteria are met:

- 14 a. The sales price is reasonable.
15 b. It is probable that, through the rate-making process, future
16 revenue approximately equal to the sales price will result from
17 the regulated affiliate's use of the products.

18 This provision is a reaffirmation of an earlier accounting standard, Accounting
19 Research bulletin No. 51. It was on the basis of what is today referred to as "ASC
20 980" that Monarch costs related to the ECO margins were not eliminated in financial
21 reporting.

22 **Q. WHY DOES MONARCH'S TRIAL BALANCE NOW EXCLUDE THESE**
23 **AMOUNTS FROM PLANT IN SERVICE?**

24 A. In the year of the change, 2009, SouthWest's external auditor made a determination
25 that costs related to the ECO margin did not comply with the above standard. As a
26 result Monarch's 2009 audited financial statements included the following disclosure:

1 The TCEQ has allowed regulated rates which are designed to recover the
2 Company's costs of providing the regulated services or products and require
3 the refund of certain credits; however, the rates currently established do not
4 support earning at a nominal rate of return on equity. Therefore, in accordance
5 with GAAP [Generally Accepted Accounting Principles], the Company does
6 not account for the future recovery of certain costs and the future refund of
7 certain credits as regulatory assets and liabilities. (p.5)

8 Monarch, as well as all of its affected affiliates, expensed ECO margin amounts and
9 recorded contra assets in order to reflect the reduced plant in service.

10 **Q. WAS THE AUDITOR'S DETERMINATION RELATING TO THE ECO**
11 **MARGIN DRIVEN BY CONCERNS ABOUT THE LEVEL OF BENEFIT TO**
12 **CUSTOMERS PROVIDED BY ECO MARGIN COSTS, OR CONCERNS**
13 **ABOUT WHETHER THE EXPENDITURES WERE PRUDENT?**

14 A. Absolutely not. While the auditor's determination impacted the accounting for the
15 ECO margin, the determination was not in any way driven by any concerns about the
16 ECO margin costs having been prudent. Rather the determination resulted entirely
17 from Monarch's commitment to the concept of gradualism when pursuing rate relief,
18 which had resulted in Monarch having rates that did not fully recover its costs.

19 **Q. HAS MONARCH INCLUDED IN RATE BASE FOR THIS FILING**
20 **AMOUNTS REPRESENTING MARGINS PAID TO ECO RESOURCES FOR**
21 **DESIGN-BUILD SERVICES PERFORMED BY ECO PRIOR TO 2008?**

22 A. Yes. The amounts shown on Schedule II-B-1 for original cost of Plant in Service
23 includes \$8,428,839 that is directly attributable to margins paid to ECO for design-
24 build services.

1 **Q. WHY IS MONARCH MAKING THIS ADJUSTMENT TO MONARCH'S**
2 **TRIAL BALANCE?**

3 A. As I mentioned above, Monarch has historically always recorded these amounts in the
4 accounts maintained for regulatory purposes, but as a result of the accounting
5 determination in 2009 to remove the margin amounts from the published financial
6 statements, plant in service is substantially understated. Consequently, Monarch is
7 effectively correcting its books for regulatory purposes in order to properly reflect
8 ECO margin amounts that were prudently incurred and that have substantially
9 benefited customers.

10 **Q. WASN'T MONARCH'S RATE BASE ESTABLISHED IN PRIOR RATE**
11 **CASES?**

12 A. No. Since its acquisition by SouthWest in 2004, Monarch's rate cases in 2007, 2011,
13 and 2013 were all settled on a "black box" basis, with no particular values ascribed to
14 any of the elements of cost of service including rate base. As a result, this docket is
15 the first review by the Commission of Monarch's rate base since its acquisition by
16 SouthWest.

17 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 A. Yes, it does.

Schedules Sponsored

- Schedule II-A-2.3(1) Comparison Year 2013 Affiliate Income
- Schedule II-A-3.9 Accounts Payable to Associated Companies
- Schedule II-A-3.13 Advances to/from Parent Corporation
- Schedule II-B-3 (7) Accumulated Depreciation - Affidavit
- Schedule II-E-4.4 Rate Case Expenses
- Schedule II-F.g Allocation Factor Calculation
- Schedule II-F.h Allocation or Classification Factor Special Studies
- Schedule II-H-1 Cost of Service Study
- Schedule IV-1 Affiliate Expenses by NARUC Account
- Schedule IV-2 Adjusted Affiliate Expenses
- Schedule IV-4.1 Allocation Manual
- Schedule IV-5 Capital Projects
- Schedule IV-6 Adjustment to Test Year Expenses
- Schedule IV-7 Statutory Requirements
- Schedule IV-8 Services Provided to Affiliates
- Schedule IV-9 Allocation of Affiliate Costs
- Schedule IV-10 Controls
- Schedule IV-11 Affiliate Billing Methods
- Schedule IV-12.1 Affiliate Multijurisdictional Costs
- Schedule IV-12.2 Texas Affiliates and Regions
- Schedule IV-13 Affiliate Project Codes Created/Closed in Test Year
- Schedule IV-14 Affiliate Payroll
- Schedule IV-14.1 Affiliate Contracts

ATTACHMENT RLK-2

MONARCH I, L.P. REVENUE HELD IN ABEYANCE

\$000

Filer	TCEQ Docket No.	Current Rates	Annual Revenue Increase			% Revenue Increase		
			Requested	Allowable	Held In Abeyance	Requested	Allowable	Held In Abeyance
Tecon 2001 Rate Case								
Water	2001-1079-UCR	7,856	10,251	17,673	7,423	30.5%	125.0%	94.5%
Wastewater	2001-1080-UCR	978	1,310	3,779	2,470	34.0%	286.6%	252.7%
Monarch 2007 Rate Case								
Water	2007-1896-UCR	14,170	20,128	22,732	2,603	42.1%	60.4%	18.4%
Wastewater	2007-1896-UCR	1,866	3,896	4,464	568	108.8%	139.2%	30.5%
Monarch 2011 Rate Case (as amended)								
Water	2011-1280-UCR	19,950	22,795	29,272	6,477	14.3%	46.7%	32.5%
Wastewater	2011-1280-UCR	3,595	3,589	5,485	1,896	-0.2%	52.6%	52.7%
Monarch 2013 Rate Case								
Water	2014-0413-UCR	21,498	24,769	30,773	6,010	15.2%	43.1%	27.9%
Wastewater	2014-0413-UCR	4,034	4,387	5,673	1,286	8.8%	40.6%	31.9%

ATTACHMENT RLK-3

MONARCH I, L.P. REVENUE HELD IN ABEYANCE, EXCLUDING BLUE MOUND

	2005 **	2006 **	2007 **	2008	2009	2010	2011	2012	2013	2014	2015 YTD 9/11/15 *	Total
Total Monarch - RHIA \$												
Water - RHIA \$												
Wastewater - RHIA \$												
	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	2,603,000	31,256,266
	568,000	568,000	568,000	568,000	568,000	568,000	568,000	568,000	568,000	568,000	568,000	6,857,248
	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	3,171,000	38,113,514
Blue Mound												
Water - Revenue \$												
Wastewater - Revenue \$												
	544,407	634,214	634,214	678,783	702,656	712,692	745,624	762,471	762,471	762,471	762,471	648,573
	394,521	606,968	606,968	685,803	671,691	672,937	677,761	711,673	677,761	711,673	711,673	571,918
	938,928	1,241,182	1,241,182	1,364,586	1,374,346	1,385,629	1,423,385	1,474,144	1,423,385	1,474,144	1,474,144	1,220,491
Total Blue Mound - Revenue \$												
	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	18.40%	27.90%
	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	31.90%
Water - Total System - RHIA %												
Wastewater - Total System - RHIA %												
	100,171	116,695	116,695	124,896	228,363	231,625	242,328	212,729	242,328	212,729	212,729	1,437,759
	120,329	185,125	185,125	209,170	353,981	354,638	357,180	227,024	357,180	227,024	182,442	1,989,889
	220,500	301,821	301,821	334,066	582,344	586,263	599,508	439,753	599,508	439,753	363,394	3,427,648
Total Monarch Excluding Blue Mound - RHIA \$												
Water - RHIA \$												
Wastewater - RHIA \$:												
	2,502,829	2,486,305	2,486,305	2,478,104	6,248,637	6,245,375	6,234,672	5,797,271	6,234,672	5,797,271	3,825,314	35,818,507
	447,671	382,875	382,875	358,830	1,542,019	1,541,362	1,538,820	1,058,976	1,538,820	1,058,976	674,806	7,545,359
	2,950,500	2,869,179	2,869,179	2,836,934	7,790,656	7,786,737	7,773,492	6,856,247	7,773,492	6,856,247	4,500,120	43,363,866

* Blue Mound Sold On 9/11/15

** Information Not Available