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APPLICATION OF LIBERTY UTILITIES (WOODMARK SEWER) CORP. (CCN NO. 20679), LIBERTY UTILITIES (TALL TIMBERS SEWER) CORP. (CCN NO. 20694), AND LIBERTY UTILITIES (SUB) CORP. TO CHANGE RATES FOR SEWER SERVICES IN SMITH COUNTY, TEXAS	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

OFFICE OF PUBLIC UTILITY COUNSEL'S OBJECTIONS AND MOTION TO STRIKE REBUTTAL TESTIMONY

The Office of Public Utility Counsel (OPUC) files this objection to and motion to strike certain portions of Liberty Utilities (Woodmark Sewer) Corp., Liberty Utilities (Tall Timbers Sewer) Corp., and Liberty Utilities (Sub) Corp., (collectively, Liberty) rebuttal case, including portions of Gerald Becker, Matthew Garlick, Bruce Fairchild, and Mark Zeppa rebuttal testimony and attachments.

Much of Liberty's filed rebuttal case does not constitute testimony that is responsive to arguments and evidence presented in the direct testimony of other parties to the case, and thus is not appropriate for inclusion in rebuttal. Instead, these objectionable portions constitute fundamentally new, non-responsive testimony in support of Liberty's *prima facie* case, and therefore must have been presented in the Company's direct case. Liberty had ample opportunities to include this testimony as a part of its direct case: first, Liberty was permitted to, and did, supplement its direct testimony on February 17, 2017[1]; then, Liberty again amended its testimony on March 31, 2017.[2] Nevertheless, Liberty for the first time submits testimony on

[1] SOAH Order No. 4 at 3 (Feb. 3, 2017).

[2] Commission Order on Appeal of SOAH Order No. 2 at 3 (March 14, 2017); SOAH Order No. 5 at 2 (April 13, 2017).

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prudence (Mathew Garlick[3] and Mark Zeppa[4]) and on rate of return (Bruce Fairchild[5]). Allowing this information to be included as rebuttal testimony impedes other parties' ability to respond to this testimony.

In support of its Objection and Motion to Strike, OPUC would show the following:

I. ARGUMENT

The Texas standard for including invested capital into rate base and for setting the rate of return is well-established. A utility has the burden to prove the prudence[6] and reasonableness of its expenditures before a rate increase can be approved.[7] Prudence in the form of prudent decision-making may be demonstrated in one of two ways: "[A] utility may show either that its decision-making process was prudent, or that the same decision is in the select range of options that would have resulted had prudent decision-making been employed."[8] Liberty omitted any evidence on prudence in its direct case, and waited until the hearing on the merits was just over three weeks away to present new evidence on prudence in their rebuttal testimony.

In setting rate of return the Commission must set the utilities' overall revenues such that the utility is permitted a "reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public." TWC § 13.183(a)(1). Return should be sufficient to maintain financial integrity and attract capital commensurate with the risks faced

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[3] Rebuttal Testimony of M. Garlick at 3 thru 22.

[4] Rebuttal Testimony of M. Zeppa at 8 thru 20.

[5] Rebuttal Testimony of B. Fairchild at *passim* and Appendix A.

[6] Prudence is: "the exercise of that judgment and the choosing of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives at the point in time such judgment is exercised or option is chosen." *Gulf States Utilities Co. v. Public Utility Comm'n of Texas*, 841 S.W.2d 459, 475 (Tex. App—Austin 1992, writ denied).

[7] *Coalition of Cities for Affordable Utility Rates v. Public Utility Comm'n of Texas*, 798 S.W.2d 560, 563 (Tex.1990).

[8] *Gulf States Utilities*, 841 S.W.2d at 475-76.

by the equity investor.[9] Instead of analyzing return according to these principles, the Applicants chose to use the first method[10] set out in the rate filing package and did not calculate ROE by any other method.[11]

Liberty's late presentation of what is essentially supplemental direct testimony substantially and impermissibly prejudices the parties because it has deprived them of the opportunity to fully assess and respond to the evidence in question.[12] In a contested case, each party is entitled to an opportunity "to respond and to present evidence and argument *on each issue* involved in the case."[13] Presenting this evidence in Liberty's rebuttal case rather than in its case in chief deprives the parties of the ability to take this evidence into account when formulating their respective cases and offering responsive testimony. To be sure, Liberty, as the party with the burden of proof under TWC § 13.184(c), is entitled to present evidence within the proper scope of rebuttal to address the direct cases presented by intervenors and Staff.[14] The Company does not, however, have the right to hold back affirmative evidence to support its direct case—including, as relevant here, economic analyses and testimony purporting to establish the prudence of the capital expenditures that represent major cost drivers in this case and return thereon—until after the other parties have finished discovery on Liberty's direct case and have filed all their testimony.

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[9] *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 693 (1923); *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944).

[10] Direct Testimony of B. Fairchild at 29:20.

[11] Liberty Response to Staff RFI No. 2-9.

[12] "In administrative proceedings, due process requires that parties be accorded a full and fair hearing on disputed fact issues." *Office of Public Utility Counsel v. Public Utility Comm'n*, 185 S.W.3d 555, 574 (Tex.App.—Austin 2006, pet. denied) *citing City of Corpus Christi,* 51 S.W.3d 231, 262.

[13] Administrative Procedure Act § 2001.051(2) (emphasis added).

[14] *See* 16 Tex. Admin. Code (TAC) § 22.203(b)(3); *see also* Tex. R. Civ. P. 265.

Any claim by Liberty that the testimony, workpapers, and prudence testimony in question is presented to rebut intervenors must be evaluated against this backdrop: In a case such as this, a party should not be allowed to wait until intervenors and Staff file their testimony and then subsequently improperly supplement the Company's direct case in the guise of rebuttal. This is not a new concept; dating back at least as far as 1890, Texas has not allowed parties with the burden of proof to provide a small portion of evidence in its direct case to satisfy *prima facie*[15] and save the stronger evidence for rebuttal.[16] Yet, this is precisely what Liberty attempts in this proceeding. Faced with intervenor testimony that calls into question the prudence of Liberty's capital investments, including the Company's failure to submit a written request for wholesale service to the City of Tyler,[17] Liberty now seeks to cure that deficiency in its direct case by describing a conflicted relationship with the City of Tyler.[18]

The Commission has long recognized the impropriety of saving evidence for rebuttal such as what Liberty has sought to do here. For example, in the 2015 Oncor transfer proceeding, Docket No. 45188, the Commission struck rebuttal testimony that should have been presented in the Purchasers' direct case and that impacted the parties' opportunity to conduct discovery and develop responsive testimony.[19] As the Commission clearly explained in Order No. 14:

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[15] OPUC does not concede that Liberty has met its *prima facie* case.

[16] *Ayers v. Harris*, 13 S.W. 768, 772–73, 77 Tex. 108, 120–21 (Tex. 1890). SOAH employs this standard as well: "The Applicant is hereby warned against trying to obtain a tactical advantage by saving evidence for rebuttal that is more reasonably part of a direct case. Such evidence will not be admitted as 'rebuttal' absent a showing of good cause, particularly that the need for such 'rebuttal' evidence could not have been reasonably anticipated and prefiled with the direct case." *In the Matter of the Following Application for Initial Regular Permit to Withdraw Groundwater from the Edwards Aquifer: Day & McDaniel*, 2002 WL 34186101, Proposal for Decision at *15, n.9.

[17] See Rebuttal Testimony of M. Garlick at 11:21-22 ("That is why none of the Applicants have sent a formal request to Tyler for wholesale capacity offer.").

[18] Rebuttal Testimony of M. Garlick at 3 thru 22; Rebuttal Testimony of M. Zeppa at 8 thru 20.

[19] *Joint Report and Application of Oncor Electric Delivery Company LLC, Ovation Acquisition I, LLC, Ovation Acquisition II, LLC, and Sharyland Holdings, LLC for Regulatory Approvals Pursuant to PURA*, Docket No. 45188, Order No. 14 (Dec. 31, 2015).

"Rebuttal testimony is narrower than direct, not broader. On rebuttal, a party is limited to evidence that directly answers or disproves the last round of the other party's evidence."[20] Yet in this proceeding, Liberty has presented a rebuttal case that is broader than its direct—going beyond simply answering or disproving intervenors' evidence. In rebuttal, Liberty has introduced testimony on prudence and return that was entirely absent in their direct case. In fact, in the rebuttal testimonies of Mark Zeppa and Matthew Garlick, Liberty introduces new testimony regarding the strained relationship it has had with the City of Tyler throughout the years. Likewise, in the rebuttal testimony of Bruce Fairchild, Liberty provides entirely new rate of return analysis, including capital structure, cost of debt and cost of capital. For these aforementioned reasons, the OPUC submits that the portions of Liberty's rebuttal case identified below must be stricken.

Much of the same testimony is also objectionable because it is irrelevant under TRE 402. "Evidence is relevant if (a) it has any tendency to make a fact more or less probable than it would be without the evidence; and (b) the fact is of consequence in determining the action." TRE 401. Although evidence will pass the relevance standard so long as there is a "reasonable logical nexus" between the offered evidence and the proposition sought to be proved,[21] there is no logical connection between the Applicants' relationship with the City of Tyler[22] and whether the applicant has provided "contemporaneous documentation of its decision-making process" or

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[20] Docket No. 45188, Order No. 14 at 4.

[21] *Goodwin v. State*, 91 S.W.3d 912, 917 (Tex. App.—Fort Worth, 2002, no pet.) (citation omitted), see also *PPC Transportation v. Metcalf*, 254 S.W.3d 636, 642 (Tex. App.—Tyler 2008, no pet.) citing *Natural Gas Pipeline of America v. Pool*, 30 S.W.3d 618, 632 (Tex. App.—Amarillo 2000) *rev'd on other grounds*, 124 S.W.3d 188 (Tex. 2003) ("If there is some logical connection, either directly or by interference, between the evidence and a fact to be proved, the evidence is relevant.")

[22] Rebuttal Testimony of Matthew Garlick at 3:14 through 22:3, and Rebuttal Testimony of Mark Zeppa at 8:1 though 20:14.

after-the-fact "independent retrospective analyses" required to prove prudence under the *Gulf States* standard.[23]

II. PORTIONS OF LIBERTY'S REBUTTAL THAT SHOULD BE STRICKEN

Below are identified the specific provisions in the Applicants' rebuttal testimony that should be stricken.

A. Matthew Garlick

For the reasons discussed above, the portions of Garlick's testimony relating to prudence, identified below, should have been included in the applicants' direct case. Additionally, this testimony is largely irrelevant, as the dealings between the Applicants and the City of Tyler are not relevant to whether the rates are just and reasonable and whether the capital investments were prudently incurred. For these reasons, Mr. Garlick's testimony, pages 3, line 14 through page 22, line 33, should be stricken.

Moreover, portions of this testimony are made without personal knowledge. Specifically, in pages 16, lines 22 through pages 18, line 7, Mr. Garlick attempts to justify its decision making process prior to the 2009 improvements. However, Mr. Garlick did not begin working with Texas systems until March 2012, when he became "Director of Operations – Arizona, and was responsible for operations throughout Arizona, as well as Texas, Missouri, and Illinois."[24] As such, he was not involved with the decision making at the time and has no personal knowledge of the matters upon which he is testifying, and should be disallowed under TRE 602. Other parts are simply hearsay, namely, pages, 19, line 13 through 20, line 18, including MG-R-6, include

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[23] *Gulf States Utilities Co. v. Public Utility Comm'n of Texas*, 841 S.W.2d 459, 476 (Tex. App—Austin 1992, writ denied).

[24] M. Garlick Direct Testimony at 2:7-16.

out of court statements offered to prove the matter asserted and, as such, should be stricken under TRE 801(b).

page 3:14-22:33	The prudence of Liberty's capital investments should have been in its direct case.
page 4:19 ("Since the...") – page 5:24 (". . . similar factors.")	Cumulative. This is simply repetitive of direct testimony.
page 6:11-21	The prudence of Liberty's capital investments should have been in its direct case. The history relations with the City of Tyler is irrelevant. TRE 402.
page 6:27 ("On that issue . . .") – 11:8 (". . . circumstances." ; including MG-R-1	The prudence of Liberty's capital investments should have been in its direct case. The history relations with the City of Tyler is irrelevant. TRE 402.
page 11:16-21 ("It was not considered . . . from that option.")	The prudence of Liberty's capital investments should have been in its direct case. The history relations with the City of Tyler is irrelevant. TRE 402.
page 12:23-25 ("Obviously, . . . Tyler.")	The prudence of Liberty's capital investments should have been in its direct case. The history relations with the City of Tyler is irrelevant. TRE 402.
page 13:10-12 ("Preferably . . . permit proceeding.")	How future relations might proceed and depart from the past are irrelevant. TRE 402.
page 12:22-25 ("I am . . . difficult.")	Mr. Garlick's personal efforts to improve relations are irrelevant. TRE 402.
page 14:9-14 ("This action is . . . obligations.")	The applicants' relations with the City of Tyler are irrelevant. TRE 402.
page 15:17-16:20; including MG-1-4	The April 2017 consent decree is irrelevant because it could not have been considered in the decision to make the capital investments at issue here. TRE 402.
page 16:22-18:7	The prudence of Liberty's capital investments, should have been in its direct case. Moreover, Mr. Garlick has no personal knowledge of events prior to 2009. TRE 602.
page 18:9-27	The prudence of the phase II investments should have been a part of Liberty's direct case.

page 19:13 ("Have you spoken . . .") – 20:5(". . . at that meeting."; 20:10-13 ("Finally, it should . . . in-city customers."); 20:16-18 ("Mr. Pamatat . . . from Tyler."); including attachment MG-R-6	This testimony contains impermissible hearsay. MG-R-6 is hearsay. TRE 801(b).
page 20:24-21:16	This is irrelevant. TRE 402. Garlic is not an expert witness and not qualified to testify on the prudence of its investments. TRE 602.
page 26:5-6 ("Liberty Utilities is . . . encourage.")	Mr. Garlick's opinion of what type of utility the Commission should encourage is irrelevant, and beyond his personal knowledge. TRE 402; TRE 602.
page 28:1-29:10	This testimony relates to the substantial similarity of the systems. This should have been in the applicant's direct testimony.

B. Gerald Becker

Mr. Becker testifies on the capitalization policies of municipalities. However, he is not an expert witness and has no personal knowledge of such matters. Therefore, this portion of his testimony should be stricken under TRE 602.

Mr. Becker also claims on page 17, line 22, that they have paid a "certain amount" for the systems, and that purchase price should have been considered. However, the purchase price of assets is irrelevant to the value of the assets. The only proper value to be considered is the original costs of the assets, which "is the *actual money cost* or the actual money value of any consideration paid, other than money, of the property *at the time it shall have been dedicated to public use*, whether by the utility that is the present owner or by a predecessor, less depreciation."[25] What amount, if any, Liberty paid for these systems is irrelevant, absent an acquisition adjustment, which Liberty does not claim. For this reason, Mr. Becker's testimony on

[25] TWC § 13.185(b) (emphasis).

pages 17-18 is irrelevant. TRE 402. For these reasons, the following portions of his testimony should be stricken:

16:10-12 ("Municipalities likely use . . . the Commission.")	Mr. Becker's speculation on the capitalization policies of municipalities lack personal knowledge. TRE 602.
17:21 ("Liberty Utilities did . . .") – 18:3(". . . value of the assets purchased.")	Irrelevant. TRE 402.

C. Bruce Fairchild

For the first time on rebuttal, the Applicants' witness Mr. Fairchild provided a "comprehensive analysis of the cost of equity for water/sewer utilities as the basis for my recommended ROE," which is inappropriate as rebuttal testimony and should be stricken. Mr. Fairchild justifies its inclusion by stating that "Because the Commission Staff and OPUC have challenged this requested ROE, I have conducted a comprehensive analysis of the cost of equity for water/sewer utilities as the basis for my recommended ROE for Liberty Woodmark and Liberty Tall Timbers, which is contained in the Rebuttal Appendix A attached to this testimony."[26] The Applicants' direct testimony recommended a return on equity of 10.16%, a cost of debt of 4.95%, and a capital structure of 30% debt and 70% equity, which results in a rate of return (ROR) of 8.60%.[27] The rebuttal testimony and Appendix A recommends a return on equity of 10.50%, a cost of debt of 3.68%, and a capital structure of 39.34% debt and 60.66% equity, which results in a ROR of 7.82%.[28] In performing this analysis, Mr. Fairchild uses methods (DCF, CAPM, risk premium, comparable earnings) not used in the direct case, and therefore Intervenors were deprived of the opportunity to conduct discovery on this testimony or

[26] B. Fairchild Rebuttal Testimony at 11:18.

[27] Direct Testimony of B. Fairchild at 29-30; Schedule 6 (LU000322).

[28] Rebuttal Testimony of B. Fairchild at 2 and 28.

address it in their analyses. Moreover, some of these methods (risk premium, comparable earnings) were not used by either Ms. Winker's or Ms. Sears' testimony, and therefore this part of his testimony goes beyond the scope of Intervenors' and Staff's testimony. Accordingly, Mr. Fairchild's analysis was not provided as part of the Applicants' case in chief and prejudices the Staff and Intervenors and should not be allowed now on rebuttal. The Applicant's decision to use the "first method" in the rate application in is direct case, does not mean it gets to lie behind the log. Accordingly, the comprehensive analysis in Fairchild Appendix A, including all attachments and exhibits, should be stricken. Additionally, Fairchild rebuttal testimony makes many references to his analysis and therefore the following provisions should also be stricken, specifically:

page 1:8-16, ending with "of return for the Applicants."	ROR analysis. Should have been provided in direct.
page 2:4-7 including summary table	ROR analysis. Should have been provided in direct.
page 3:20-6:18	ROR analysis. Should have been provided in direct.
page 9:20-10:10	ROR analysis. Should have been provided in direct.
page 11:15-18	ROR analysis. Should have been provided in direct.
page 12:1-13:21	ROR analysis. Should have been provided in direct.
page 27:4-28:2	ROR analysis. Should have been provided in direct.
Rebuttal Testimony of Bruce Fairchild, Appendix A	ROR analysis. Should have been provided in direct.

D. Mark Zeppa

Mr. Zeppa purports to testify as an expert on various legal issues in his rebuttal testimony. Setting aside the fact that Mr. Zeppa is one of the attorneys representing Liberty in this case,[29] his legal opinions do not help the trier of facts. Expert testimony is allowed only if the expert's "specialized knowledge will help the trier of fact to understand the evidence or to

[29] Tex. Disciplinary Rules of Professional Conduct 3.08(a) forbids an attorney from testifying unless certain exceptions are met.

determine a fact in issue." TRE 702. Mr. Zeppa does not testify on any legal issues that are not equally within the expertise of the ALJ or the Commission to determine after briefing with proper citation, which can be responded to in kind. Moreover, Mr. Zeppa is incorrect in his assertions. For example, on page 5, lines 18-19, he states: "TWC § 13.145 and § 13.182(b) address the preference for consolidation or regionalized system rate tariffs." This is false. TWC § 13.145 does not address any preference for consolidation or regionalization. On the contrary, this provision is expressed in the negative, thereby disfavoring consolidation of systems under a single tariff, and permitting them "only if" certain criteria are met. His second referenced section, TWC § 13.182(b), does not address regionalization or consolidation at all, but rather prohibits rates that are "unreasonably preferential, prejudicial, or discriminatory" and requires them to "be sufficient, equitable, and consistent in application to each class of consumers." TWC § 13.182(*d*) (which may have been intended) addresses a preference only for consolidating rates by region that are under a consolidated tariff, and that the same are to be determined on a case-by-case basis. *If* TWC § 13.182(d) was intended, he does not provide an explanation as to how this provision even applies to Liberty Utilities as it does not have any regional systems or rates under a single tariff. Accordingly, OPUC objects to all of Mr. Zeppa's testimony relating to "Regionalization and Wastewater permitting Requirements."

Additionally, Mr. Zeppa's chronicles, as a fact witness, the conflicts between Liberty (and its predecessor) and the City of Tyler, as rebuttal to the Intervenors prudence adjustments. For the reasons discussed above, evidence relating to the prudence of the Applicants' capital investments should have been provided on direct, not on rebuttal. Moreover, the various motives of the respective parties are irrelevant to whether the Applicants have provided contemporaneous documentation showing the prudence of their decisions or an independent retrospective

investigation, as required under *Gulf States*, or whether the Applicants' rates are just and reasonable. Accordingly, all of the testimony relating to the "Prudence of Investments and History of Liberty Utilities Dealings With City of Tyler," should be stricken under TRE 402.

page 2:14 ("Second, I . . .") – line 20 (". . . which is false.")	Summary statement referencing the objectionable testimony to follow.
pages 3:12-7:19	Regionalization; not helpful to the trier of fact. TRE 702.
Pages 8:1-20:14, including Attachments MZ-R-1	Prudence; history of dealings with Tyler; irrelevant, TRE 402, and should have been in direct.

III. CONCLUSION AND PRAYER

Liberty has impermissibly presented evidence in their rebuttal case that should have been presented in their direct. Much of this information is also nonresponsive and irrelevant. For the objections set out above, OPUC respectfully requests that the identified portions of Liberty's rebuttal filing be stricken and not included in the evidentiary record. Moreover, OPUC requests that it be granted any further relief to which it may be entitled.

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Respectfully submitted,

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CERTIFICATE OF SERVICE
SOAH Docket No. 473-17-1641.WS
PUC Docket No. 46256

I certify that today, July 11, 2017, I served a true copy of the foregoing Office of Public Utility Counsel's Objections and Motion to Strike Rebuttal Testimony on all parties of record via electronic mail.

Christiaan Siano