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APPLICATION OF FOREST GLEN §  
UTILITY COMPANY FOR § STATE OFFICE OF ADMINISTRATIVE  
AUTHORITY TO CHANGE RATES § HEARINGS

**OBJECTIONS TO DIRECT TESTIMONY AND EXHIBITS OF ANDREW NOVAK**

COMES NOW, Forest Glen Utility Company ("FGU" or "Applicant") and files these Objections to Direct Testimony and Exhibits of Andrew Novak and in support thereof, would respectfully show the following:

**I. BACKGROUND**

On August 23, 2018, Andrew Novak, financial analyst for the Public Utility Commission of Texas ("PUC" or "Commission") filed his Direct Prefiled Testimony and Exhibits ("PFT"). SOAH Order No. 2 established a deadline of September 3, 2018<sup>1</sup> to object to Staff's testimony. Accordingly, FGU's Objections are timely filed.

**II. OBJECTIONS**

FGU generally objects to Mr. Novak's testimony because he provides no evidence that he is qualified as an expert witness to testify on the issues of capital structure and rate of return.<sup>2</sup> Testimony in one contested rate case over his almost three (3) years at the Commission does not yield the requisite scientific, technical, or other specialized knowledge Mr. Novak must have to assist the trier of fact to understand the facts at issue in a sewer rate case.<sup>3</sup> Nor has he demonstrated that he is qualified by knowledge, skill, experience, training, or education to testify on capital structure, rate of return and related issues.<sup>4</sup> The referenced testimony is full of speculative opinions or inferences that are not rationally based nor helpful to a determination of facts in issue in this

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<sup>1</sup> The parties inadvertently agreed and the ALJ adopted September 3, 2018 as the deadline despite being a national holiday, Labor Day.

<sup>2</sup> Tex. R. Civ. Evid. 702.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

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case.<sup>5</sup> Here, Mr. Novak not only concedes that his testimony is “hypothetical” and “theoretical” throughout, but he also relies on a number of out-of-court statements asserted for the truth of the matters cited therein (i.e., hearsay), which he may only do if he is qualified as an expert.<sup>6</sup> Additionally, since he is not qualified as an expert, Mr. Novak may only testify as a lay or fact witness based on his personal knowledge.<sup>7</sup> However, there is also no indication that he has any personal knowledge of the capital structure of FGU’s sewer utility in the Potranco Ranch Subdivision. On the contrary, Mr. Novak dismisses actual test year facts that FGU is a small Investor-Owned-Utility (“IOU”) with few customers, no debt, and limited future growth. Instead, he supplants facts in evidence with his arbitrary analysis more appropriate for a large publicly-traded utility with many customers and debt.

Finally, in order to assist the trier of fact, the testimony must be both relevant<sup>8</sup> and reliable.<sup>9</sup> “To be relevant, the [evidence] must tend to make the existence of a material fact more or less probable than it would otherwise have been.”<sup>10</sup> Mr. Novak’s referenced testimony does not relate to material facts in this case because FGU has no debt and pays no dividends,<sup>11</sup> yet his recommendation is made as if it did. As FGU’s rate consultant and witness Steven Greenberg explained, FGU is much too small to receive a commercial loan.<sup>12</sup> Nevertheless, Mr. Novak employs arbitrary analysis throughout his testimony like his use of the hypothetical proxy or barometer group and Discounted Cash Flow (“DCF”) methods which may be appropriate for large publicly-traded utilities with wide customer bases and access to public financing markets,<sup>13</sup> but not for a small IOU with less than 300 connections. His use of hypothetical cost rate of long-term debt “to better simulate the typical capital structure of the average water utility,” simply has no bearing on the actual structure of FGU’s small no-debt sewer utility and contradicts Commission

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<sup>5</sup> Tex. R. Civ. Evid. 701.

<sup>6</sup> Tex. R. Civ. Evid. 801.

<sup>7</sup> Tex. R. Civ. Evid. 602; *Reid Rd. MUD v. Speedy Stop Food Stores*, 337 S.W.3d 846, 851-52 (Tex. 2011).

<sup>8</sup> Tex. R. Civ. Evid. 401-402.

<sup>9</sup> *Helena Chemical Co. v. Wilkins*, 47 S.W.3d 486, 499 (Tex. 2001).

<sup>10</sup> *Edwards v. TEC*, 936 S.W.2d 462, 466-67 (Tex. App. -- Fort Worth 1996, no writ).

<sup>11</sup> Exhibit FGU-1, Direct Testimony of Steven Greenberg at p. 23, line 16-20.

<sup>12</sup> *Id.* See also, FGU-1, p. 24, lines 9-16.

<sup>13</sup> Direct Testimony of Andrew Novak, p. 8, line 16.

rules that the cost of debt capital is the *actual* cost of debt.”<sup>14</sup> Accordingly, the Administrative Law Judge (“ALJ”) should strike the testimony specifically referenced below.

**a. Novak PFT, p. 7, lines 3-4.**

FGU objects to the referenced testimony because Mr. Novak is not an expert on the issue of rate of return.<sup>15</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences about the rate of return rationally based and helpful to a determination of facts in issue.<sup>16</sup> Additionally, Mr. Novak’s recommendation of a 50/50 debt to equity ratio is irrelevant to the subject matter of this hearing since it does not reflect FGU’s actual capital structure during the test year.<sup>17</sup>

**b. Novak PFT, p. 7, line 5 through p. 8, line 23.**

FGU objects to the referenced testimony because Mr. Novak is not an expert on the issue of rate of return, including the use of a proxy group or barometer group of comparative utilities.<sup>18</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences comparing large publicly-traded barometer group utilities to FGU helpful to a determination of facts in issue.<sup>19</sup> Additionally, Mr. Novak’s use of a large, publicly-traded water utilities in his barometer group to derive the appropriate rate of return is irrelevant to the subject matter of this hearing, since it does not reflect FGU’s actual capital structure during the test year.<sup>20</sup>

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<sup>14</sup> 30 TAC § 24.31(c)(B)(i).

<sup>15</sup> Tex. R. Civ. Evid. 702.

<sup>16</sup> Tex. R. Civ. Evid. 701.

<sup>17</sup> Tex. R. Civ. Evid. 401-402.

<sup>18</sup> Tex. R. Civ. Evid. 702.

<sup>19</sup> Tex. R. Civ. Evid. 701.

<sup>20</sup> Tex. R. Civ. Evid. 401-402.

**c. Novak PFT, p. 9, line 13 through p. 10, line 17.**

FGU objects to the referenced testimony because Mr. Novak is not an expert on the issue of capital structure, including the imposition of a hypothetical 50/50 debt to equity ratio.<sup>21</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences imputing a 50/50 debt to equity ratio on this no-debt small IOU helpful to a determination of facts in issue.<sup>22</sup> Mr. Novak's use of an arbitrary ratio is not only irrelevant to the subject matter of this hearing since it does not reflect FGU's actual capital structure during the test year,<sup>23</sup> but it is also impermissibly based on hearsay since his testimony depends heavily on exhibits AN-7, the Value Line article, and AN-8, the Mergent Bond Record which are not hearsay exceptions as public records.<sup>24</sup>

**d. Novak PFT, p. 11, line 1 through p. 12, line 8.**

FGU objects to the referenced testimony because Mr. Novak is not an expert on the issue of cost of equity, including the use of the DCF method.<sup>25</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences about the DCF method helpful to a determination of facts in issue since it does not reflect FGU's actual capital structure during the test year, as FGU has never paid dividends.<sup>26</sup> Additionally, Mr. Novak's use of the DCF approach is irrelevant to the subject matter of this hearing since FGU has a small customer base, serving a subdivision which will not grow significantly nor pay dividends in order to do so.<sup>27</sup>

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<sup>21</sup> Tex. R. Civ. Evid. 702.

<sup>22</sup> Tex R. Civ. Evid. 701.

<sup>23</sup> Tex R. Civ. Evid. 401-402.

<sup>24</sup> Tex R. Civ. Evid. 801 and 803(8).

<sup>25</sup> Tex R. Civ. Evid. 702.

<sup>26</sup> Tex R. Civ. Evid. 701.

<sup>27</sup> Tex R. Civ. Evid. 401-402.

**e. Novak PFT, p. 12, line 11 through p. 13, line 1.**

FGU objects to the referenced testimony because Mr. Novak is not an expert on the issue of growth rates.<sup>28</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences about growth rates helpful to a determination of facts in issue since it does not reflect FGU's actual growth during the test year or even reasonably projected growth, as Mr. Novak's six-company barometer group of large companies have vastly different growth rates than FGU did during the 2016 test year, serving a residential subdivision which will reach final build-out soon with no significant potential for growth in the future.<sup>29</sup> Additionally, Mr. Novak's use of a six-company growth rate is irrelevant to the subject matter of this hearing since it does not reflect FGU's actual or even reasonably projected growth rate.<sup>30</sup>

**f. Novak PFT, p. 13, lines 3-4.**

FGU objects to Mr. Novak's overall rate of return because he is not an expert on this issue.<sup>31</sup> The ALJ should strike it from the record pursuant to Rule 702 of the Texas Rules of Evidence. Nor are his speculative opinions or inferences about the rate of return helpful to a determination of facts in issue since the various models used do not reflect actual debt, equity, and growth of FGU's sewer utility during the test year.<sup>32</sup>

**g. Novak Exhibits AN-3 through AN-8**

FGU also objects to Mr. Novak's exhibits, AN-3 through AN-8 on the basis of hearsay.<sup>33</sup> Exhibits AN-3 through AN-8 are out-of-court statements offered for the truth of the matters discussed in those documents which may not be relied upon by a witness who is not an expert. Some of these exhibits, like AN-3 (Summary of Cost of Capital"), AN-4 (Dividend Yields of Eight Company Peer Group citing Barrons and Value Line as sources), AN-5 (Five Year Growth

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<sup>28</sup> Tex R. Civ. Evid. 702.

<sup>29</sup> Tex R. Civ. Evid. 701.

<sup>30</sup> Tex R. Civ. Evid. 401-402.

<sup>31</sup> Tex R. Civ. Evid. 702.

<sup>32</sup> Tex R. Civ. Evid. 701.

<sup>33</sup> Tex R. Civ. Evid. 801.

Estimate Forecast for Eight Company Barometer Group), and AN-6 (Expected Market Cost Rate of Equity) appear to be compilations based on other cited and non-cited sources, all improper hearsay pursuant to Rule 801 of the Texas Rules of Civil Evidence.<sup>34</sup> In addition, Exhibit AN-7 and AN-8 purport to be published articles/public reports for which no proper predicate or foundation has been established to constitute an exception to hearsay.<sup>35</sup> In all cases, there is no foundation for the information, it has not been shown to be reliable and it is irrelevant as it is not germane to a small no-debt IOU that does not pay dividends and expects limited future growth.

### III. PRAYER

WHEREFORE, PREMISES CONSIDERED, Forest Glen Utility Company respectfully requests that the ALJ sustain FGU's objections and enter an order excluding and striking Andrew Novak's Direct Testimony as noted above at the hearing for this matter, and such and further relief to which it may be entitled.

Respectfully submitted,

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**ATTORNEYS FOR FOREST GLEN  
UTILITY COMPANY**

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<sup>34</sup> *Id.*

<sup>35</sup> Tex R. Civ. Evid. 803(8).

**CERTIFICATE OF SERVICE**

I hereby certify that I have or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail, or Certified Mail Return Receipt Requested on all parties on the 4th of September 2018.

By: Helen S. Gilbert