

Control Number: 47897



Item Number: 245

Addendum StartPage: 0

RECEIVED  
2018 SEP 10 PM 2:12

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

**COMMISSION STAFF'S RESPONSE TO FOREST GLEN UTILITY COMPANY'S  
OBJECTIONS TO DIRECT TESTIMONY AND EXHIBITS OF ANDREW NOVAK**

**COMES NOW** the Staff of the Public Utility Commission of Texas (Staff), representing the public interest, and files this Response to Forest Glen Utility Company's Objections to Direct Testimony and Exhibits of Andrew Novak and would show the following:

**I. BACKGROUND**

On December 21, 2017, Forest Glen Utility Company (Forest Glen) filed an application for authority to change rates under sewer certificate of convenience and necessity No. 21070 in Medina and Bexar County, Texas. SOAH Order No. 2, issued May 21, 2018, adopted the parties' agreed procedural schedule. Pursuant to the schedule, Staff filed the Direct Testimony of Andrew Novak on August 23, 2018, and Forest Glen filed objections to Mr. Novak's testimony on September 4, 2018. SOAH Order No. 2 also set a deadline of September 10, 2018, to file replies to objections to Staff's direct testimony. Therefore, this pleading is timely filed.

**II. INTRODUCTION**

The Commission employs staff to review rate/tariff change applications for compliance with the Texas Water Code (TWC), rules adopted by the Commission, and Commission precedent. Expertise in evaluating compliance with these statutes and rules does not require a specific type of training, a specific number of years of experience at the Commission, a requisite number of rate applications reviewed, or a requisite number of testimonies filed.

Texas Rule of Evidence 702 does not restrict expert testimony to those with formal training. Instead, it allows a person to testify as an expert witness so long as: (1) the person is qualified by knowledge, skill, experience, training, or education; (2) the proposed testimony provides scientific,

245

technical, or other specialized knowledge; and (3) the testimony will assist the trier of fact to determine a fact issue.<sup>1</sup> Additionally, the agency's rulings in admitting expert testimony are within its broad discretion and will not be disturbed on appeal.<sup>2</sup>

Staff witness Andrew Novak has been actively analyzing water and sewer rate/tariff rate change applications at the Commission for almost three years, and this is the fourth contested case in which he has filed direct testimony on rate of return.<sup>3</sup> Moreover, the Commission adopted Mr. Novak's recommended return on equity, cost of debt, and capital structure in Docket No. 45720.<sup>4</sup> Thus, Mr. Novak is qualified to render the conclusions that are a part of his testimony in this case.

### III. REPLY TO OBJECTIONS

Forest Glen's general objections to Mr. Novak as an expert witness on the grounds that testifying in one contested rate case during his almost three years at the Commission does not yield the requisite scientific, technical, or other specialized knowledge necessary to assist the trier of fact, and does not demonstrate his qualifications by knowledge, skill, experience, training, or education, are unsupported.<sup>5</sup> Contrary to Forest Glen's erroneous assertion, this is the fourth (not the second) case in which Mr. Novak has testified regarding rate of return,<sup>6</sup> and he is qualified to provide expert testimony on that topic. In fact, Mr. Novak served as the rate of return witness in one of the only two contested water/sewer cases that have been decided by the Commission.<sup>7</sup>

---

<sup>1</sup> Tex. R. Evid. 702.

<sup>2</sup> *Austin Chevrolet, Inc. v. Motor Vehicle Bd.*, 212 S.W.3d 425, 432 (Tex. App.—Austin 2006, pet. denied).

<sup>3</sup> *Application of Southwest Liquids, Inc. for Authority to Change Rates*, Docket No. 47626, Direct Testimony of Andrew Novak (Apr. 27, 2018); *Application of The Commons Water Supply, Inc., for Authority to Change Rates*, Docket No. 47275, Direct Testimony of Andrew Novak (Feb. 26, 2018); *Application of Rio Concho Aviation, Inc., for a Rate/Tariff Change*, Docket No. 45720, Direct Testimony of Andrew C. Novak (Sept. 9, 2016).

<sup>4</sup> Docket No. 45720, Order at Finding of Fact Nos. 38-40 (Jun. 29, 2017).

<sup>5</sup> Objections to Direct Testimony and Exhibits of Andrew Novak at 1 of 7 (Sept. 4, 2018) (Objections to Novak Testimony).

<sup>6</sup> Direct Testimony of Andrew Novak, Attachment AN-2 (Aug. 23, 2018).

<sup>7</sup> See *Application of Double Diamond Utility Company, Inc. for Authority to Change Rates*, Docket No. 46245, Final Order (Aug. 30, 2018); Docket No. 45720, Order (Jun. 29, 2017).

Furthermore, Mr. Novak has received on-the-job training related to the review of rate/tariff change applications from other Commission employees and specific rate of return training from the staff of the Water Utility Regulation Division since joining the Commission in October 2015. He has also attended training provided by the Society of Utility and Regulatory Financial Analysts (SURFA). As a financial analyst, Mr. Novak's job responsibilities include reviewing water and sewer rate tariff/change applications for compliance with the TWC and Commission rules, and he specifically reviews these applications for rate of return issues and cost of service issues. Accordingly, Mr. Novak's testimony is admissible under Texas Rule of Evidence 702 because his educational background combined with his job training and experience while employed by the Commission show he is qualified as an expert by knowledge, skill, experience, training, *and* education.<sup>8</sup>

Forest Glen also claims Mr. Novak's testimony is irrelevant<sup>9</sup> and repeatedly characterizes his recommendations as "speculative opinions" or "inferences"<sup>10</sup> simply because it disagrees with those recommendations. For example, Forest Glen objects to Mr. Novak's recommended capital structure of 50% equity and 50% debt on the grounds that it does not reflect Forest Glen's actual capital structure during the test year<sup>11</sup> and decries the use of large, publicly-traded water utilities in his barometer group.<sup>12</sup> The Preliminary Order adopted by the Commission identified Issue Nos. 7 and 8 related to the appropriate debt-to-equity capital structure of the utility and the appropriate weighted cost of capital, including return on equity and cost of debt.<sup>13</sup> Mr. Novak's testimony is relevant because it answers these questions and explains how he reached those answers. If Forest

---

<sup>8</sup> Because Mr. Novak qualifies as an expert, Forest Glen's argument that he has impermissibly relied on the hearsay contained in Attachments AN-7 and AN-8 to form his opinion is moot. Tex. R. Evid. 703.

<sup>9</sup> Objections to Novak Testimony at 2 of 7.

<sup>10</sup> *Id.* at 1, 3, 4, and 5 of 7.

<sup>11</sup> *Id.* at 3 of 7. Staff notes that Forest Glen's own witness admitted that "sometimes the Commission will impute a hypothetical capital structure to reflect a cost efficient fair representation of a typical well-managed utility's capital structure." Direct Testimony of Steven Greenberg at 23:21-25 (Jul. 18, 2018) (Greenberg Direct).

<sup>12</sup> Objections to Novak Testimony at 3 of 7.

<sup>13</sup> Preliminary Order at 3 of 7 (Jun. 14, 2018).

Glen takes issue with the method Mr. Novak used to reach his answers,<sup>14</sup> then it has the opportunity to argue against Mr. Novak's position via rebuttal testimony or to cross-examine him on his methods during the hearing on the merits.

In addition to addressing the issues in the Preliminary Order, Mr. Novak's testimony is relevant because it is integral to Staff's representation of the public interest in this proceeding. The instructions for a Class B rate/tariff change application allow a utility to calculate a return on equity (ROE) using the most recent Moody's Baa bond rating for public utilities and a risk premium and states that this method for determining ROE is "presumed reasonable if no other party provides testimony."<sup>15</sup> Forest Glen's application employed this method for calculating a ROE.<sup>16</sup> Without Mr. Novak's testimony, Forest Glen's requested ROE of 11.99% is entitled to a presumption of reasonableness even though it is significantly higher than the 8.48% and 8.79% ROEs adopted by the Commission in Docket Nos. 45720 and 46245, respectively. Thus, Mr. Novak's testimony is relevant to rebutting the presumption of reasonableness and ensuring that the ROE adopted in this case does not grossly depart from Commission precedent.

Forest Glen's arguments against relevancy and reliability also ignore Commission precedent. Mr. Novak's recommended return on equity is based on a discounted cash flow (DCF) analysis, which is "widely accepted by the regulatory industry and the Commission, and is often used to calculate the appropriate return on equity for a utility."<sup>17</sup> And, the Commission has approved two different returns on equity for investor-owned water utilities that were based on a DCF analysis and a barometer group.<sup>18</sup> In addition, the Commission found Mr. Novak's testimony on rate of return in Docket No. 45720, a proceeding in which the applicant was a water utility serving 243 connections, relevant and reliable enough to make the following findings of fact:

---

<sup>14</sup> See, e.g., Objections to Novak Testimony at 4 of 7 (objecting to Mr. Novak's use of a DCF analysis because "Forest Glen has a small customer base, serving a subdivision which will not grow significantly nor pay dividends in order to do so").

<sup>15</sup> Class B Investor-Owned Utilities Water and/or Sewer Instructions for Rate/Tariff Change 2015 at 10 (Sept. 17, 2015).

<sup>16</sup> Direct Testimony of Steven Greenberg, Ex. SAG-3 at FGU0633 (Jul. 18, 2018).

<sup>17</sup> Docket No. 46245, Final Order at 0000015.

<sup>18</sup> *Id.*, Final Order at Finding of Fact No. 110; Docket No. 45720, Order at Finding of Fact No. 38 and 40.

39. Rio Concho has no debt. It is reasonable to assign a cost of debt of 5.03%, based on the average rate for Baa utility bonds for every month of the 2015 test year.
40. It is reasonable to assign Rio Concho a capital structure of 50% debt and 50% equity, which is similar to the structure reported by the Value Line Investment Survey water proxy group.<sup>19</sup>

Accordingly, Commission precedent confirms that Mr. Novak's testimony in this proceeding regarding cost of debt and capital structure is relevant.

#### **IV. CONCLUSION**

For the reasons stated above, Staff respectfully requests the entry of an Order overruling Forest Glen's objections to the direct testimony of Andrew Novak. To entertain Forest Glen's objections would effectively place restrictions on Staff testimony that do not exist in the Commission's rules and would deprive the finders of fact in this case of an alternative to the rate of return requested in Forest Glen's application. Staff is the only party to this case that represents the public interest, which is a position that merits robust representation, and Mr. Novak's testimony makes a valuable contribution to Staff's efforts. His testimony falls squarely within the training and experience he has accrued working at the Commission and his recommendations will assist the triers of fact in setting rates that are just and reasonable. Any issues Forest Glen has with the methods Mr. Novak employed to make his recommendations can be addressed in rebuttal testimony or through cross-examination. Therefore, the ALJ should deny Forest Glen's request to exclude or strike Mr. Novak's testimony.

---

<sup>19</sup> Docket No. 45720, Order at Finding of Fact Nos. 39-40.

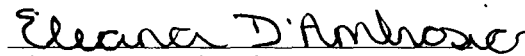
Dated: September 10, 2018

Respectfully Submitted,

**PUBLIC UTILITY COMMISSION OF TEXAS  
LEGAL DIVISION**

Margaret Uhlig Pemberton  
Division Director

Karen S. Hubbard  
Managing Attorney



Eleanor D'Ambrosio  
State Bar No. 24097559  
1701 N. Congress Avenue  
P.O. Box 13326  
Austin, Texas 78711-3326  
(512) 936-7295  
(512) 936-7268 (facsimile)  
Eleanor.Dambrosio@puc.texas.gov

**SOAH DOCKET NO. 473-18-3008.WS  
PUC DOCKET NO. 47897**

**CERTIFICATE OF SERVICE**

I certify that a copy of this document will be served on all parties of record on September 10, 2018, in accordance with 16 Texas Administrative Code § 22.74.

  
Eleanor D'Ambrosio