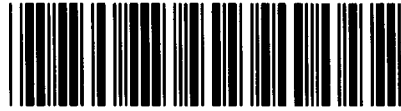




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OF

DIRECT TESTIMONY AND ATTACHMENTS OF DENNIS P. WALEY

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APPLICATION OF THE CITY OF AUSTIN FOR AUTHORITY TO CHANGE THE WATER AND WASTEWATER RATES FOR NORTH AUSTIN MUNICIPAL UTILITY DISTRICT NO. 1, NORTHTOWN MUNICIPAL UTILITY DISTRICT, TRAVIS COUNTY WATER CONTROL AND IMPROVEMENT DISTRICT NO. 10, AND WELLS BRANCH MUNICIPAL UTILITY DISTRICT IN WILLIAMSON AND TRAVIS COUNTIES

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BEFORE THE STATE OFFICE

OF

ADMINISTRATIVE HEARINGS

TO THE HONORABLE JUDGE SIANO AND JUDGE DREWS:

I. BACKGROUND

¹ Statement of Intent to Change Rates for Wholesale Water and Wastewater Service (April 15, 2019).

Districts' Objections to and Motion to Strike City's Direct Testimony and Attachments of Dennis P. Waley

October 23, 2019, establishes a deadline of November 1, 2019, for filing objections to the City's Direct Testimony.³ Therefore, this Objection and Motion to Strike is timely filed.

II. LEGAL BACKGROUND

Rule 403 provides the basis for excluding otherwise relevant testimony: "Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, or needless presentation of cumulative evidence." The rule seeks to curtail abuse of the evidentiary system in civil court by providing a check on what can be admitted. Otherwise, for any given case, there would be a massive amount of information and evidence that could be admitted.

Rule 701 governs the role of opinion testimony by lay witnesses and specifies that "if the witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is limited to those opinions or inferences which are (a) rationally based on the perception of the witness and (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue."⁴ The lay witness must have personal knowledge of the matter and may not rely on what another has said about an experience.⁵ Rule 701 further bars speculative lay opinion testimony because the witness has no specialized knowledge or personal experience.⁶

Rule 702 states: "A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue."⁷ The burden is on the proponent of the witness to show that they are an expert in their particular field.⁸ A witness may qualify as an expert if they have the sufficient

³ SOAH Order No. 9, Memorializing Second Prehearing Conference; Adopting Second Revised Procedural Schedule at 2 (October 23, 2019).

⁴ Tex. R. Civ. Evid. § 701.

⁵ See *Bigby v. State*, 892 S.W.2d 864, 888 (Crim. App. 1994).

⁶ *E-Z Mart Stores, Inc. v. Havner*, 832 S.W.2d 368, 374 (Tex. App. –Texarkana 1992, den.).

⁷ Tex R. Civ. Evid. § 702.

⁸ *General Motors Corp. v. Iracheta*, 161 S.W.3d 462, 470 (Tex. 2005).

knowledge, skill, experience, training, or education.⁹ However, generalized experience in a particular may not qualify the witness as an expert.¹⁰ Occupational status alone generally will not suffice to show that a particular witness is qualified as an expert witness.¹¹

Rules 801 and 802 lay out the definition of hearsay and prohibit hearsay from admission as evidence. Rule 801 states:

“(a) Statement. “Statement” means a person’s oral or written verbal expression, or nonverbal conduct that a person intended as a substitute for verbal expression.

(b) Declarant. “Declarant” means the person who made the statement.

(c) Matter Asserted. “Matter asserted” means:

- (1) any matter a declarant explicitly asserts; and
- (2) any matter implied by a statement, if the probative value of the statement as offered flows from the declarant’s belief about the matter.

(d) Hearsay. “Hearsay” means a statement that:

- (1) the declarant does not make while testifying at the current trial or hearing; and
- (2) a party offers in evidence to prove the truth of the matter asserted in the statement.

(e) Statements That Are Not Hearsay. A statement that meets the following conditions is not hearsay:

(1) A Declarant-Witness’s Prior Statement. The declarant testifies and is subject to cross-examination about a prior statement, and the statement:

(A) is inconsistent with the declarant’s testimony and:

- (i) when offered in a civil case, was given under penalty of perjury at a trial, hearing, or other proceeding or in a deposition; or
- (ii) when offered in a criminal case, was given under penalty of perjury at a trial, hearing, or other proceeding—except a grand jury proceeding—or in a deposition;

(B) is consistent with the declarant’s testimony and is offered to rebut an express or implied charge that the declarant recently fabricated it or acted from a recent improper influence or motive in so testifying; or

⁹ See, e.g., *Negrini v. State*, 853 S.W.2d 128, 130-31 (Tex. App.—Corpus Christi 1993, no pet.); *Massey v. State*, 933 S.W.2d 141, 156-57 (Crim. App. 1996); *Sciarrilla v. Osborne*, 946 S.W.2d 919 (Tex. App.—Beaumont 1997, den.).

¹⁰ Cf. *Houghton v. Port Terminal R.R. Ass’n*, 999 S.W.2d 39, 49 (Tex. App.—Houston [14th Dist.] 1999, no writ).

¹¹ *Broders v. Heise*, 924 S.W.2d 148, 153-53 (Tex. 1996).

(C) identifies a person as someone the declarant perceived earlier.

(2) *An Opposing Party's Statement.* The statement is offered against an opposing party and:

(A) was made by the party in an individual or representative capacity;

(B) is one the party manifested that it adopted or believed to be true;

(C) was made by a person whom the party authorized to make a statement on the subject;

(D) was made by the party's agent or employee on a matter within the scope of that relationship and while it existed; or

(E) was made by the party's coconspirator during and in furtherance of the conspiracy."¹²

Rule 802, meanwhile, states: "Hearsay is not admissible unless any of the following provides otherwise: (a) a statute; (b) these rules; or (c) other rules prescribed under statutory authority. Inadmissible hearsay admitted without objection may not be denied probative value merely because it is hearsay."¹³

III. OBJECTIONS TO DIRECT TESTIMONY

A. Waley Testimony at page 5, lines 15 through 19.

Q. HOW CAN FISCAL HEALTH BE MEASURED?

Financially strong utilities are more likely to increase rates incrementally as necessary over time, whereas weak utilities may resist raising rates until very large increases are needed to maintain solvency. AW has, over the past few years, undertaken the prudent approach of setting financial targets and incrementally increasing rates to achieve strong financial metrics.

Petitioners object to the referenced testimony because it is opinion testimony prohibited under Tex. R. Civ. Evid. 701 and 702. Mr. Waley is the Managing Director of PFM Financial Advisors. He is not an expert on water ratemaking or wastewater ratemaking. By testifying that "AW has, over the past few years, undertaken the prudent approach of setting financial targets and incrementally increasing rates to achieve strong financial metrics," Mr. Waley is offering his

¹² Tex. R. Civ. Evid. § 801.

¹³ Tex. R. Civ. Evid. § 802.

opinion on a matter for which he has no knowledge, skill, experience, training, or education that would qualify him as an expert. Given that Mr. Waley is not an expert on water ratemaking or wastewater ratemaking, his opinion testimony must be: “(a) rationally based on the witness’s perception; and (b) helpful to clearly understanding the witness’s testimony or to determining a fact in issue.” Tex. R. Civ. Evid. 701. Mr. Waley testimony does not explain the basis for his perception, nor does it aid in understanding his testimony or assist in determining a fact in issue, because he has no specialized knowledge regarding water ratemaking or wastewater ratemaking.

The Petitioners further object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue, and he provides no testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding water ratemaking or wastewater ratemaking. Mr. Waley is offering an opinion that is not rationally based on his perception because has no foundation on which to base his opinion.

B. Waley Testimony at page 6, line 18 and lines 23 through 24.

Q. WHAT WOULD THE CONSEQUENCES BE TO AW OF A CREDIT DOWNGRADE?

The consequences would be harmful to AW and it customers... For these reasons, AW has established financial metrics at certain targeted levels to support its credit ratings.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue and he provides no testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding AW’s established financial metrics.

C. Waley Testimony at page 7, lines 3 through 9.

WHY DID AW ADOPT POLICIES AND TARGETS TO SUPPORT ITS CREDIT RATING?

AW's policies to maintain financial metrics at certain target levels were first implemented during a period of relative financial distress. In 2012, AW was facing decreased revenues due to a severe drought. Over this period, revenues decreased enough that AW's financial metrics were not in line with its highly rated peers. This set of factors put AW's creditworthiness at risk. Management worked to create a set of rate increases that, over

time, restored financial health to the utility. Maintaining this financial health over time is the best way to keep capital costs low.

The Petitioners object to the referenced testimony, because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue and he provides no testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding management's actions to restore financial health to the utility.

D. Waley Testimony at page 7, lines 13 through 15.

Q. WHAT ARE THE BENEFITS OF AW MANAGEMENT'S APPROACH SINCE THAT TIME?

The use of incremental rate adjustments supported by COS analyses indicating a need for those adjustments is a prudent course, and avoids ratepayer shock due to large rate adjustments.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue and he provides no testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding management's actions to restore financial health to the utility.

E. Waley Testimony at page 8, lines 12 through 16.

Q. HOW DO THE RATING AGENCIES VIEW DEBT SERVICE COVERAGE?

Two metrics targeted in AW's financial policies are based on factors that are important to credit rating agencies. Although many factors contribute to the final credit rating, the rating agencies place emphasis on the debt service coverage ratio, as well as the level of reserves (commonly measured as days-cash-on-hand) when evaluating the financial strength of a utility.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue, and he provides no foundation for his opinion regarding how rating agencies view debt service coverage.

F. Waley Testimony at page 8, line 19 through page 9, line 6.

Q. IS DEBT SERVICE COVERAGE A KEY METRIC USED BY THE RATINGS AGENCIES?

It is an important data point that each ratings agency considers in arriving at a credit rating... The debt service coverage metric provides an indication of a utility's ability to pay its obligations as well as overall financial flexibility. Additionally, investors and rating agencies evaluate the trend of this ratio over time to determine changes in the financial health of a utility system.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue and he provides no foundation for his opinion regarding how rating agencies view debt service coverage.

G. Waley Testimony at page 10, lines 7 through 9, and line 15.

Q. HOW HAS AW'S CREDIT RATINGS CHANGED IN RECENT YEARS?

As shown above, in 2014-2015 AW's ratings from Fitch and Moody's were under pressure due to weak financial metrics caused by decreased revenues, which led to lower debt service coverage and reserve levels... As Days Cash on Hand and coverage increased, rating outlooks stabilized.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on the reason why AW's Water Rating changed but provides no foundation for his opinion. He states his opinion as an evidentiary fact without supporting it with a foundation of evidence.

H. Waley Testimony at page 11, lines 3 through 8 and line 12.

Q. HOW DID THE RATINGS AGENCIES VIEW THE DEBT SERVICE COVERAGE DECLINE OF 2014?

Unfavorably; as I describe above. This caused Moody's and Fitch to place AW's credit ratings on negative outlook... "The revision on Outlook to Negative from Stable on the water and wastewater bonds reflects the diminishing prospect of any material improvement in AWU's financial profile over the near term, due in part to ongoing drought conditions."... AW's DSC improved from 2015 through 2017.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on the reason why AW's Water

Rating changed but provides no foundation for his opinion. He states his opinion as an evidentiary fact without supporting it with a foundation of evidence.

Furthermore, Mr. Waley testifies as to the words of Fitch Ratings, which brings in irrelevant and therefore inadmissible statements. Petitioners object to the referenced testimony and exhibit on the basis of relevance. Tex R. Civ. Evid. 401-402. "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." *Edwards v. TEC*, 936 S.W.2d 462, 466-67 (Tex. App. -- Fort Worth 1996, no writ) (emphasis added). The testimony and exhibit offered do not relate to a material fact related to the question asked of Mr. Waley and should be stricken.

I. Waley Testimony at page 12, lines 10 through 12.

Q. HAVE THE RATING AGENCIES PUBLISHED GUIDANCE ON DSC TRENDS FOR COMPARABLY-RATED ENTITIES AS AW?

None of these customers provide a level of debt service coverage meeting the rating agency targets. None of these customers provide even 1.0 DSC for water service.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on the reason why AW's Water Rating changed but provides no foundation for his opinion. He states his opinion as an evidentiary fact without supporting it with a foundation of evidence.

Furthermore, Petitioners object to the referenced testimony, because it is opinion testimony prohibited under Tex. R. Civ. Evid. 701 and 702. Mr. Waley is the Managing Director of PFM Financial Advisors. He is not an expert on debt service coverage for water utilities. By testifying as he did above, Mr. Waley is offering his opinion on a matter for which he has no knowledge, skill, experience, training, or education that would qualify him as an expert. Given that Mr. Waley is not an expert on debt service coverage for water utilities, his opinion testimony must be: "(a) rationally based on the witness's perception; and (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue." Tex. R. Civ. Evid. 701. Mr. Waley testimony does not explain the basis for his perception, nor does it aid in understanding his testimony or assist in determining a fact in issue, because he has no specialized knowledge regarding debt service coverage for water utilities.

J. Waley Testimony at page 13, lines 6 through 9.

Q. IF AW HAD ITS CREDIT RATINGS DOWNGRADED IN THE 2014-2015 TIMEFRAME, WHAT WOULD HAVE BEEN THE IMPACT ON AW AND ITS CUSTOMERS?

Had AW been downgraded by Fitch in 2015, it would have been the only major Texas city—among the top five most populous—with a utility system with a rating in the A category. Ratings in this lower category generally translate into higher interest rates and higher debt service costs that must be passed on to the ratepayers.

The Petitioners object to the referenced testimony, because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue and he provides no testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding management's actions to restore financial health to the utility.

Furthermore, Mr. Waley assumes facts not in evidence and therefore his opinion is irrelevant. Even if it were determined that Mr. Waley's testimony regarding what might have happened is deemed relevant, it is in violation of Rule 403 of the Texas Rules of Civil Evidence, which states that "evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice [or] confusion of the issues." Mr. Waley's exploration of theoretical changes to AW's credit rating given a particular set of circumstances is clearly confusing the issues and irrelevant to this proceeding. Mr. Waley's statement regarding theoretical changes to the credit rating should be stricken from the record.

K. Waley Testimony at page 13, line 12 through page 14, line 1.

Q. IS THE POTENTIAL EFFECT OF A DOWNGRADE FROM "AA" TO "A" ON THE ABILITY OF AW TO OBTAIN DEBT FINANCING SIGNIFICANT?

Yes. Over the past five years, credit spreads for a twenty year bond between an "AA" rated and an "A" rated credit averaged 35 basis points.⁷ An additional 35 basis points in the interest rate would add \$7 million in interest costs to a \$100 million bond over twenty years...however, as interest rates increase, credit spreads tend to widen, and the cost of a credit rating downgrade could become more expensive.

The Petitioners object to the referenced testimony because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion on an issue, but he provides no

testimony regarding his personal knowledge about the matter. No foundation has been laid for Mr. Waley to provide his opinion regarding management's actions to restore financial health to the utility.

Furthermore, Mr. Waley assumes facts not in evidence and therefore his opinion is irrelevant. Even if it were determined that Mr. Waley's testimony regarding what might have happened is deemed relevant, it is in violation of Rule 403 of the Texas Rules of Civil Evidence which states that "evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice [or] confusion of the issues." Mr. Waley's exploration of theoretical changes to AW's credit rating given a particular set of circumstances is clearly confusing the issues and irrelevant to this proceeding. Mr. Waley's statement regarding theoretical changes to the credit rating should be stricken from the record.

L. Waley Testimony at page 7, lines 13 through 15.

Q. WHAT DOES THIS LEAD YOU TO CONCLUDE REGARDING AW'S DEBT SERVICE COVERAGE PRESENTED IN THIS CASE?

As I have discussed, debt service coverage is a critical factor upon which the agencies base their ratings.

The Petitioners object to the referenced testimony, because it is prohibited hearsay under Tex R. Civ. Evid. 801 and 802. Mr. Waley states his opinion regarding AW's debt service coverage. Mr. Waley provides his opinion with no foundation, and it is therefore inadmissible hearsay, because he has no personal knowledge of it.

IV. PRAYER

WHEREFORE, PREMISES CONSIDERED, the Districts respectfully request that the Administrative Law Judges sustain its objections, enter an order excluding and striking the Direct Testimony and Attachments of Dennis P. Waley as requested above and grant other such relief to which Districts may be entitled.

Respectfully submitted,



John J. Carlton

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ATTORNEYS FOR DISTRICTS

CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested to all parties on this the 1st day of November, 2019.



John J. Carlton