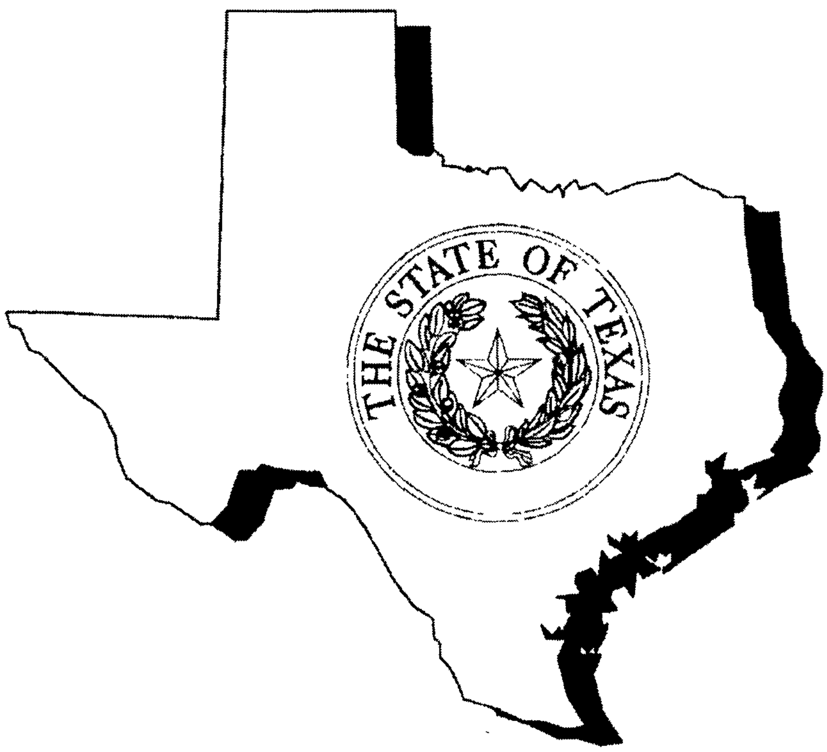
SOAH DOCKET NO. 473-19-6297.WS
PUC DOCKET NO. 49189

APPLICATION OF THE CITY OF AUSTIN DBA AUSTIN WATER FOR AUTHORITY TO CHANGE WATER AND WASTEWATER RATES	§ § § § §	**BEFORE THE STATE OFFICE** **OF** **ADMINISTRATIVEHEARINGS**



DIRECT TESTIMONY OF
EMILY SEARS
RATE REGULATION
PUBLIC UTILITY COMMISSION OF TEXAS
NOVEMBER 15, 2019

Table of Contents

I. INTRODUCTION OF WITNESS

Q. Please state your name and business address.

A. Ms. Emily Sears, Public Utility Commission of Texas, 1701 N. Congress Avenue, Austin, Texas 78711-3326.

Q. By whom are you currently employed and in what capacity?

A. I have been employed by the Public Utility Commission of Texas (Commission) since January 1, 2015 as a Financial Analyst, currently in the Rate Regulation Division.

Q. What are your principal responsibilities at the Commission?

A. My principal responsibilities at the Commission are tariff/rate change applications and appeals. I am also responsible for preparing testimony and exhibits for contested case matters involving investor-owned, non-profit and governmental water and sewer retail public utilities and wholesale matters and participating in settlement negotiations.

Q. Please state your educational background and professional experience.

A. I have provided a summary of my educational background and professional experience in Attachment ES-1 to my direct testimony.

Q. Have you previously testified before this Commission or the State Office of Administrative Hearings (SOAH)?

A. Yes. I have also testified before the Pennsylvania Public Utility Commission (PA PUC). Attachment ES-2 provides a summary of the cases in which I have testified or submitted testimony.

II. PURPOSE AND SCOPE OF TESTIMONY

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to address the following issues from the Commission's *Preliminary Order* issued August 8, 2019 in this case (as numbered therein) for the City of Austin d/b/a Austin Water (Austin Water):

1. Is the City's proposed cash-needs method with the additional debt-service coverage methodology appropriate to determine just and reasonable rates in this docket? If not, what is the appropriate methodology to determine just and reasonable rates in this proceeding?

3. Does the City's proposed revenue requirement in this docket include any category of cost that in Docket No. 42857 the Commission disallowed because it was not a reasonable and necessary cost of providing water and wastewater services to the districts?
   a. If so, what are those categories?

5. What is the City's cost of debt, if any?
   a. What series or issues of bonds of the City are outstanding?
   b. For each series or issues of outstanding bonds, what is the annual servicing cost?
   c. What debt service coverage, if any, is required for each series or issues of outstanding bonds?
   d. For each series or issues of outstanding bonds, has revenue from water or wastewater service been pledged?
   e. For each series or issues of outstanding bonds, what contract or contracts have been pledged as security?
   f. For each such contract, who are the parties to the contract, and what rate, formula, or methodology is specified in each such contract related to the amount paid for water or wastewater service and the amount pledged to the bond?

14. What entities, if any, other than the districts, purchase wholesale water or wastewater services from the City?
   b. What is the gross amount of revenues, if any, received from such entities by the City on an annual basis?
      i. Is any of such revenue pledged to support any bonds issued by the City? If so, how much is pledged and for which series or issues of bonds?

17. Has the City's water or sewer utility made any payments to other City departments (e.g., general fund transfers)?

I will also recommend a debt service coverage ratio to include in determining the appropriate revenue requirement.

Q. If you do not address an issue or position in your testimony, should that be interpreted as Staff supporting Austin Water's position on that issue?

A. No. The fact that I do not address an issue in my testimony should not be construed as agreeing, endorsing, or consenting to any position taken by Austin Water.

III. DEBT SERVICE COVERAGE

A. METHODOLOGY

Q. What is a debt-service-coverage methodology?

A. A debt-service-coverage (DSC) methodology acts as "return on invested capital" that is allowed as a component of the cost of service for investor-owned utilities (IOUs) in 16 Texas Administrative Code (TAC) § 24.41(a). For IOUs, the return on invested capital commonly funds the utility's interest on debt, and dividends paid on common equity stock, and can also allow the utility to retain earnings. In the case of a municipally-owned utility (MOU), DSC commonly includes the amount needed to fund the principal and interest on outstanding debt plus additional coverage that can be used by MOUs in a manner similar to the way IOUs use equity (to retain earnings or "pay dividends" to the owner[1]). In other words, a MOU's DSC

[1] Rather than pay dividends, Austin Water transfers funds to the City of Austin's General Fund.

ratio (DSCR) takes into account the amount of revenue a utility recovers through rates that is over and above the allowable operating expenses.

Q. Is the DSC methodology recommended by the Commission for a MOU to use in a rate case?

A. The Commission does not currently have a rate filing package for MOUs, or any other type of non-IOU, to request a rate increase, as the Commission does not typically have original jurisdiction over a MOU's rates. The Commission rules also do not address whether a DSC methodology is appropriate for a MOU. The Commission rule that provides limited guidance is 16 TAC § 24.101(i), which states only that the Commission shall use a methodology that preserves the financial integrity of the retail public utility. However, this rule applies specifically to appeals brought under Texas Water Code (TWC) § 13.043, and this proceeding is the result of an appeal brought under TWC § 13.044.

Q. Do you believe Austin Water's proposed cash-needs methodology with the additional debt-service-coverage methodology is appropriate to determine just and reasonable rates in this docket?

A. As presented in the application, yes. Austin Water is requesting allowable expenses and adding the debt service coverage.[2] I believe the methodology presented by Austin Water is an appropriate approach for evaluating the utility's financial integrity and determining just and reasonable rates, and therefore, is a reasonable methodology to use in this case.

[2] Direct Testimony of David A. Anders at 36 (Apr. 15, 2019) (Anders Direct). All citations to the application and direct testimony are to bates page numbers.

B. DEBT SERVICE

Q. Please define debt service.

A. Debt service is the annual amount of principal and interest due on outstanding loans.

Q. What is Austin Water's current debt service?

A. According to the errata to the application filed October 4, 2019, Austin Water's total debt service is $98,261,313[3] for water and $82,100,914[4] for wastewater.

Q. Do you have any recommended adjustments to the debt service?

A. Yes. I recommend reducing debt service by $11,924 for water and $5,110 for wastewater.[5] This adjustment reduces debt service by the amount of additional interest expense caused by Austin Water's swap-related financing activities, which as I discuss later in my testimony has been disallowed as a financing mechanism in previous cases by the Commission. This disallowance covers the difference between the variable and fixed interest rates that Austin Water had to pay in the test year as the result of its swap agreement. I have allocated the $17,035 disallowance between water and wastewater based on the percentage split of actual administrative costs of the swap between water and wastewater.[6]

I also recommend a reduction of $4,961,272 to the wastewater debt service due to Staff witness Greg Charles' recommendation to remove the Govalle Plant from the calculation of net plant for the wastewater system. Mr. Charles' recommendation reduces net plant by 6.04%. Because debt service is allocated based on total net plant, if total net plant is reduced

[3] AW Water COS Model, tab 1 FS Water, column K, line 151.
[4] AW Wastewater COS Model, tab 1 FS Wastewater, column K, line 146.
[5] Attachment ES-3.
[6] ES Workpapers 1-7, Attachment ES-3.

for a disallowance, debt service should correspondingly be reduced for that disallowance. Therefore, I recommend reducing debt service by the same 6.04%.[7]

Q. What is your recommended debt service?

A. I recommend a debt service of $98,249,389 for water and $77,134,531 for sewer.[8]

C. AUSTIN WATER CREDIT RATINGS

Q. What is Austin Water's current credit rating?

A. Austin Water has a credit rating of AA- by Fitch Ratings (Fitch), Aa2 by Moody's Investors Service (Moody's), and AA by Standard & Poor's Financial Services (S&P).[9]

Q. What are the key factors reflected in Fitch's AA- rating for Austin Water?

A. Fitch states that the key rating drivers are Austin Water's sizeable service territory, including the city of Austin, along with its growing customer base, Austin's low unemployment and above-average wealth levels. Additionally, Fitch cites Austin Water's history of enacting rate increases as needed; rate restructuring to increase fixed charges; substantial increases of capital recovery fees on new development; Austin Water's healthy financial margins (including Fitch's calculation of an all-in 1.84x DSCR and 181 days of cash on hand); Austin Water's sufficient water supply and treatment capacity; and effective management of its capital needs. Finally, Fitch's rating takes into account Austin Water's high debt levels for the rating category. Fitch also does not see the possibility of additional improvement in

[7] Attachment ES-4.

[8] *Id.*

[9] Application of the City of Austin dba Austin Water for Authority to Change Rates, Schedule II-C-10 Rating Agency Reports/Prospectus at 691 (Apr. 15, 2019) (Application).

financial margins given the expectation of limited or no rate increases over the next five years.[10]

Q. What are Fitch's comments regarding debt service coverage?

A. Fitch calculated an all-in debt service coverage for Fiscal Year (FY) 2016 of 1.84x, up from 1.45x in FY 2015 and 1.25x in FY 2014. Fitch's coverage levels include the capital recovery fee revenue that doubled to $22 million in FY 2017 from $14 million in FY 2014. The revenue is being used by Austin Water to defease outstanding debt in future years.[11]

Q. What are Fitch's comments regarding a long-term credit rating?

A. Fitch states that rating stability over the two years following the 2017 refunding bond issuance would be determined by Austin Water's ability to achieve and sustain financial margins and liquidity in line with FY 2016.[12]

Q. What are the key factors reflected in Moody's Aa2 rating for Austin Water?

A. Moody's 2017 rating reflects strong system characteristics, improving (as of 2017) financial metrics bolstered by recent rate increases, and strong rate management and capital planning.[13] The rating also takes into consideration a manageable debt profile and adequate legal provisions for the bonds, with the lack of an established debt service reserve.[14] Moody's lists credit strengths as a strong service area and expanding customer base, a history of regular rate increases that has afforded solid debt service coverage levels and improving

[10] *Id.* at 692.
[11] *Id.* at 694.
[12] *Id.* at 692.
[13] *Id.* at 700.
[14] *Id.*

days cash on hand.[15]

Moody's 2018 rating reflects similar factors as the 2017 rating. but also includes an above average debt profile.[16]

Q. What are Moody's comments regarding DSC?

A. Moody's calculates Austin Water's DSCR at 1.87x. Moody's also lists the FY 2014 DSCR at 1.21x, and FY 2015 DSCR at 1.42x. Moody's estimated that FY 2017 would produce a solid 1.74x DSCR.[17]

In Moody's 2018 rating, it estimated a FY 2018 DSCR of 1.83x and put FY 2017 at an actual DSCR of 1.61x.[18]

Q. What are Moody's comments regarding a long-term credit rating?

A. Moody's expects that sound coverage will continue, supported by regular rate increases and manageable future borrowing plans. This also incorporates Moody's expectation that Austin Water will prudently maintain its infrastructure and water supply.[19]

Q. What factors are reflected in S&P's AA rating for Austin Water?

A. S&P states that its ratings reflect its opinion of the system's general creditworthiness, including its extremely strong enterprise risk profile and its very strong financial risk profile.[20] This includes the service area, which has among the strongest and most diverse economies in the state and is stabilized by a number of public institutions.[21] Other factors

[15] *Id.* at 701.
[16] *Id.* at 709.
[17] *Id.* at 703.
[18] *Id.* at 710.
[19] *Id.* at 701.
[20] *Id.* at 716.
[21] *Id.*

are its water supply agreement and continued willingness to review and adjust rates, even as some of the previous commitments have made the nominal cost of the monthly residential bill above-average versus peer systems.[22]

Q. What are S&P's comments regarding debt service coverage?

A. S&P calculated Austin Water's all-in DSC for FY 2016 at 1.55x, and average 1.29x over the past three years. S&P's all-in coverage treats fixed charges (if applicable) as if they hypothetically were debt, and S&P treats transfers as if they were operating expenses. S&P states that it believes management's forecast of an all-in DSCR of 1.5x to 1.6x through 2022 to be attainable.[23]

Q. What are S&P's comments regarding a long-term credit rating?

A. S&P states that it recognizes management's commitment to improving Austin Water's financial risk profile and maintaining it at its current levels but believes that the improvements will be gradual. S&P does not expect to change the rating over the next two years (as of 2017).[24]

Q. Is having the highest possible credit rating a desirable objective in terms of minimizing costs to ratepayers?

A. No. While having a healthy credit rating is essential for maintaining financial strength and ensuring access to capital markets on reasonable terms, a utility that charges ever-higher rates solely for the purpose of increasing its margins and improving its credit rating will at some point end up imposing costs on its ratepayers that are higher than necessary.

---

[22] *Id.*
[23] *Id.* at 718.
[24] *Id.* at 719.

Q. Please explain how ratepayers could actually pay higher rates to a utility with a higher credit rating, given that higher credit ratings are generally expected to result in lower financing costs for bonds.

A. At least two reasons can explain why this happens. First, the amount of additional revenues a utility must recover through rates in order to be granted a given credit rating may be more than the amount of financing savings associated with reaching that credit rating. In other words, the savings to customers resulting from a low interest rate on bonds may not make up for the higher rates charged by the utility to achieve the credit rating that allowed for the low interest rate.

Second, when paying water rates that have increased solely as a result of the utility's pursuit of higher credit ratings, ratepayers incur "opportunity costs" due to the reduced amount of funds available to them for other purposes. For example, the more a customer spends on water, the less they will be able to pay down high interest costs on their credit card bill. While these kinds of opportunity costs may not be directly observable, they are still real, and if ratepayers are deprived of the ability to pay certain high-cost bills because they are being charged an inordinately high water rate, the overall net effect is a greater economic burden on the ratepayer.

Q. Does empirical evidence support the notion that striving to achieve the highest possible credit rating is appropriate because it will be beneficial to ratepayers, given that it reduces the revenue requirement to pay debt service?

A. No, and in fact, I would say that empirical evidence suggests just the opposite. If striving for the highest possible credit rating were an economically optimal policy (one that would benefit both utilities and their ratepayers), one would see many—or possibly even all utilities possessing the highest possible rating. Given that we do not observe such a situation, one can reasonably conclude that such a policy is not an optimal economic objective.

D. DEBT SERVICE COVERAGE AND RATIO

Q. Please define debt service coverage.

A. Debt service coverage is a ratio of annual funds available to cover annual debt service divided by the annual debt service requirement (principal and interest).

Q. What are the specific debt service coverages required by Austin Water's bond ordinance?

A. City Ordinance No. 0006008-56A, sets a rate covenant that requires the City to set rates and charges that produce a 1.25x DSCR.[25]

Q. What is Austin Water's requested DSCR?

A. Austin Water is requesting a DSCR of 1.85x.[26]

Q. What is your recommended DSCR for Austin Water?

A. I recommend a DSCR of 1.50x, which equates to a 1.75x DSCR as calculated by Fitch.

Q. How did you calculate the 1.75x DSCR?

A. As stated previously in my testimony, Fitch includes the capital recovery fee in what is available for debt service to calculate the DSCR. The capital recovery fee may only be used

[25] ES Workpaper 8.

[26] Anders Direct at 38.

to pay direct costs or the principal and interest on bonds issued for constructing capital improvements or facility expansions.[27] In order to calculate the DSCR as Fitch does, I started with Austin Water's "AW Water COS Model Docket 49189."[28] I then added the capital recovery fee[29] of $24,800,000 to the total revenues and let it flow through Austin Water's model. The result of adding the capital recovery fee is a 2.10x DSCR, when starting with Austin Water's 1.85x coverage request. I then started with Austin Water's model again, without any changes, and reduced revenues by $34,391,460 to achieve Staff's recommended 1.50x DSCR. To calculate the $34,391,460 reduction, I took Austin Water's debt service of $98,261,313 and multiplied it by 1.5 which resulted in $147,391,970 Net Available for Debt Service. I then calculated the difference between Austin Water and Staff's Net Available for Debt Service to be $34,391,460 ($181,783,430 - $147,391,970). After reducing revenues by the difference, I added the capital recovery fee to the total revenues, which resulted in a 1.75x DSCR.[30]

I applied the same method to wastewater, which resulted in a DSCR of 1.96x when starting with Austin Water's 1.85x coverage request and adding the capital recovery fee. Starting with Staff's recommended 1.50x coverage results in a DSCR of 1.61x for wastewater.[31]

Q. What is the basis for your recommendation?

A. A DSCR of 1.5x is in line with the City of Austin's financial policy, it exceeds the 1.25x

---

[27] Direct Testimony of Joseph H. Gonzales at 101 (Apr. 15, 2019) (Gonzales Direct).

[28] Application, AW Water COS Model Docket 49189, Tab 1.FS Water, Table 1-4.

[29] *Id.* at Line 86 "TRF CRF to Debt Defeasance."

[30] Attachment ES-5.

[31] Attachment ES-6.

covenant requirements, it balances the interests of both Austin Water and the ratepayers, and it takes into consideration Austin Water's ability to use the capital recovery fee from developers to defease debt.

Q. Please discuss how a 1.50x DSCR balances the interests of both Austin Water and the ratepayers.

A. A DSCR of 1.50x balances the interests of both Austin Water and the ratepayers by allowing Austin Water the ability to maintain its credit rating (as the all-in coverage is 1.75x for water and 1.61x for wastewater) while keeping water bills reasonable. As stated above, Austin Water's bill is above average versus its peers.

Q. What is debt defeasance?

A. Debt defeasance, in its simplest form, is when a company sets aside the amount of cash needed to completely pay off a debt issuance early. Because a company can incur certain penalties for paying off debt early, the company sets aside the cash in advance and then uses it to pay the debt as it comes due. Using cash to offset debt in this manner allows the company to take the debt and the associated cash off its books for accounting purposes.

Q. How does your recommendation take debt defeasance into account?

A. Debt defeasance reduces the total amount of debt on the books of Austin Water, which reduces the debt service requirement in dollars. If the debt service requirement decreases, and the amount of revenues collected through rates for "net available for debt service" remains the same, the DSCR will increase. Given Austin Water's plans for future capital projects, if more debt is issued, it is possible to maintain the DSCR with continued debt defeasance. Also, reducing total debt is a credit positive.

Q. If the capital recovery fee is charged only to developers, and not to the ratepayers, why are you taking it into consideration for the DSCR?

A. While the ratepayers are not charged the capital recovery fee, the credit rating agencies include the revenues from this fee to determine the DSCR. If I did not include these revenues in my analysis, my recommendation would allow Austin Water to collect more than the recommended amount of debt service coverage. For example, if I recommended a 1.85x DSCR, the rating agencies, after taking into account the effects of the capital recovery fee, would view Austin Water as having a 2.10x DSCR. Because my recommendation partly takes into account how credit rating agencies will calculate and view Austin Water's DSCR in its ratings, I took the capital recovery fee revenues into account.

Q. Using your recommended debt service requirements, what is the additional coverage (the 0.50 of the 1.50x) in dollars?

A. Using my recommended debt service, my coverage amounts in dollars equal $49.124.694 for water and $38,567,266 for wastewater.[32]

Q. What are your recommended total amounts for debt service plus coverage in dollars?

A. The debt service plus coverage for water equals $147.374.084 and for wastewater equals $115,701,797.[33]

[32] Attachment ES-7.

[33] *Id.*

IV. PREVIOUS DISALLOWANCES

A. DISALLOWANCE FOR COSTS ASSOCIATED WITH SWAP TRANSACTIONS

Q. Does Austin Water's proposed revenue requirement in this docket include any category of cost that the Commission disallowed in Docket No. 42857 because it was not a reasonable and necessary cost of providing water and wastewater services to the Districts?[34]

A. Yes. In Docket No. 42857, the Administrative Law Judges (ALJs) recommended that the costs associated with Austin Water's commercial paper administrative expenses and swap-related debt were to be removed from cost of service when the Commission sets rates for Petitioners.[35] The ALJs stated that the administrative fees related to commercial paper and swap activities are typically recovered through capital and not expensed.[36] This is reflected in Finding of Fact 52d. as shown in relevant part below:

> 52. If the rates set under the Rate Ordinance are found to be just and reasonable, the following revenue requirements must be adjusted because the City failed to prove that these revenue requirements are reasonable and necessary costs of providing water and wastewater services to Petitioners:
>
> d. City's reclassification of SWAP and commercial paper administration costs from capital to expense...[37]

[34] The Districts include 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. These four entities were the Petitioners in Docket No. 42857.

[35] Docket No. 42857, Proposal for Decision at 38 (Jul. 10, 2015) (PFD).

[36] *Id.*

[37] Docket No. 42857, PFD at 59-60.

On January 14, 2016, the Commission adopted the proposal for decision's findings of fact and conclusions of law with respect to this adjustment.[38]

Q. What is an interest rate swap agreement?

A. An interest rate swap agreement is an agreement between two parties where one stream of future interest payments is exchanged for another. It usually involves the exchange of a fixed interest rate for a floating rate, or vice versa. In Austin Water's case, it pays a fixed rate of 3.6% and receives the benchmark floating rate as determined by the Securities Industry and Financial Markets Association.

Q. What costs associated with its interest rate swap agreement is Austin Water requesting to recover in this case?

A. In this case, Austin Water is requesting to recover the principal payments, the interest payments, and the yearly administrative costs related to the swap agreement.

Q. Was any new information provided by Austin Water in this case regarding swap administrative costs?

A. Yes. Mr. Anders testifies that the Governmental Accounting Standards Board (GASB) in Pronouncement No. 65 has required these swap administrative costs to be expensed in the year they were incurred, and not charged to specific projects as assets.[39] Mr. Anders also states that the swap agreement resulted in debt service savings to all of Austin Water's customers.[40]

Q. What is your recommendation regarding these swap administrative costs?

---

[38] Docket No. 42857, Order on Rehearing at Finding of Fact No. 52d.
[39] Anders Direct at 43.
[40] *Id.* at 42.

A. I recommend that the administrative costs associated with the interest rate swap agreement be removed from the cost of service from the following accounts:[41]

Account number	Amount
Water - 5860	($317,241)
Water - 8142	($8,135)
Water - 8316	($3,710)
Wastewater – 5860	($132,554)
Wastewater – 8142	($3,890)
Wastewater – 8316	($2,982)

Q. How did you take the additional information provided by Austin Water into consideration regarding the swap administrative costs?

A. While GASB requires Austin Water to expense the swap administrative costs in the year they were incurred, I recommend disallowance of all swap-related costs. Although Mr. Anders stated that Austin Water is saving the customers interest expense, Austin Water's swap-related activities have, to date, cost the customers an additional $1,537,317.12 in interest costs.[42]

Q. Is there a Commission precedent disallowing swap costs?

A. Yes. In AEP Texas, Inc.'s financing Order in Docket No. 49308, the Commission stated:

> In prior financing orders, the Commission determined that the costs and risks of swap transactions outweighed the expected benefits and prohibited the use of interest rate-swaps.[43]

[41] ES Workpapers 1-3.
[42] ES Workpapers 4-7.
[43] *Application of AEP Texas, Inc. for a Financing Order*, Docket No. 49308, Finding of Fact No. 41 (Jun. 17, 2019).

The Commission also stated:

> Also in prior financing orders, the Commission determined that the use of floating-rate notes, notes denominated in foreign currencies, interest-rate hedges, and interest-rate swaps would be not be expected to result in the lowest system restoration bond charges, and would expose ratepayers to higher risks and greater uncertainty about future costs. Accordingly, AEP Texas has not asked for permission, and the Commission has determined that AEP Texas should not be permitted to use floating-rate notes, notes denominated in foreign currencies, hedges, or interest-rate swaps in this transaction.[44]

Consistent with the above, I recommend disallowance of the administrative swap costs Austin Water is requesting to recover as an expense in this case.

Q. Are you recommending removal of the entirety of the swap, including debt service?

A. No. I am allowing recovery of the debt service and interest minus the loss incurred in the test year for additional interest expenses resulting from the swap agreement.

Q. What interest expense in the test year are you disallowing?

A. I recommend disallowing the additional interest costs that were incurred in the test year due to Austin Water's choice to fund the issuance with a swap agreement. That amount is $17,035 total.[45]

Q. Why are you not removing the entirety of the swap, including all debt service?

A, Austin Water issued debt due to a need to fund capital expenditures. I agree with the issuance of debt for this purpose; however, I do not agree with the financing mechanism Austin Water chose to use (swap). Therefore, I am only recommending disallowance of the expenses related to the financing mechanism in this case.

---

[44] *Id.* at 42 (included in ES Workpapers 4-7).

[45] ES Workpapers 4-7.

B. DISALLOWANCE FOR COSTS ASSOCIATED WITH THE REVENUE STABILITY RESERVE FUND

Q. Has Austin Water requested any other expenses disallowed by the Commission Docket No. 42857?

A. Yes. In Docket No. 42857, the Petitioners and Staff agreed that Austin Water's Revenue Stability Reserve Fund was not based on the cost of service and should be excluded from the revenue requirement when setting Petitioner's rates.[46] The ALJs agreed.[47] Austin Water failed to show that the transfer for the stability fund was reasonable, especially given the proposed multimillion-dollar general fund transfers to the City of Austin that are taken out of the water and wastewater utility revenues.[48]

Q. What is the Revenue Stability Fund used for?

A. Austin Water's policies indicate that the water Revenue Stability Fund shall only be used to offset a current year water service revenue shortfall where actual water service revenue is less than budgeted levels by 10 percent or greater, with the maximum use in any one year limited to 50 percent of the existing balance at the time of the request.[49]

Q. What is the funding source for the Revenue Stability Reserve Fund?

A. Austin Water's policies indicate that sources of funding for the water Revenue Stability Fund may include a Water Reserve Fund volumetric surcharge charged to all customer classes,

[46] Docket No. 42857, PFD at 43.
[47] *Id.*
[48] *Id.* at 43-44.
[49] Gonzales Direct at 89.

operating reserves in excess of 60 days of operation, and any available net water service revenue after meeting all obligations of Austin Water.[50]

Q. Was any new information provided by Austin Water in this case regarding the Revenue Stability Reserve Fund?

A. No.

Q. What is your recommendation regarding the surcharge for the revenue stability reserve fund.

A. I recommend that the surcharge be disallowed.

Q. What is the basis for your recommendation?

A. First, this expense was disallowed in the previous case. Second, the Revenue Stability Reserve Fund was fully funded in 2018;[51] therefore, the annual amount Austin Water needs to collect from customers to maintain the fund at 120 days of operating expenses has decreased. Now, Austin Water only needs to collect the difference between the 120 days operating expenses calculated at the prior year's expense level and the 120 days operating expenses calculated at the current year's expense level. Finally, if Austin Water wants to continue to fund the revenue stability reserve fund under Staff's recommendations, it may do so with the additional coverage obtained through the DSC.

[50] *Id.*
[51] *Id.*

V. SUMMARY

Q. What are your recommendations?

A. I recommend a 1.5x debt service coverage ratio, a reduction to expenses for swap expenses, removal of the revenue stability reserve fund surcharge, and a reduction to debt service.

Q. Does this conclude your direct testimony?

A. Yes. I reserve the right to supplement this testimony during the course of the proceeding as new evidence is presented.

Emily Sears

Professional Experience

- **Public Utility Commission of Texas**
  Utility Rates Analyst
  Water Utilities Division
  January 2015 - Present
- **Commonwealth of Pennsylvania, Public Utility Commission**
  Fixed Utility Financial Analyst
  Bureau of Investigation and Enforcement
  May 2009 – December 2014
- **Commonwealth of Pennsylvania, Public Utility Commission**
  Fixed Utility Financial Analyst
  Bureau of Fixed Utility Services
  April 2008 – May 2009
- **Nationwide Insurance Company**
  Personal Lines Underwriting Screener
  October 2004 – May 2007

Education

- **University of Pittsburgh, College of Business Administration**
  Bachelors of Science in Business Administration
  Major – Finance
  August 2004
- **Annual Regulatory Studies Program: Camp NARUC**
  Week 1-Introduction to Regulation
  August 2008
- **Pennsylvania Public Utility Commission Rate Case Training**
  December 2008
- **Society of Utility and Regulatory Financial Analysts**
  Certified Rate of Return Analyst
  June 2010
- **Utility Finance and Accounting for Financial Professionals**
  Seminar June 20-21, 2019

Presentations

- **Pennsylvania Public Utility Commission Rate Case Training**
  Presented on Rate of Return/Return on Equity
  October 2012, September 2014
- **Public Utility Commission of Texas – Rate of Return Training**
  Presented on Rate of Return/Return on Equity
  August 2017 - Present

TESTIMONY SUBMITTED:

I have testified and/or submitted testimony in the following proceedings before the Pennsylvania Public Utility Commission:

- Duquesne Light Company, Docket No. M-2009-2093217
- West Penn Power Company d/b/a Allegheny Power, Docket No. M-2009-2093218
- Duquesne Light Company, Docket No. M-2009-2123948
- West Penn Power Company d/b/a Allegheny Power, Docket No. M-2009-2123951
- Utilities, Inc. – Westgate, Docket No. R-2009-2117389
- Utilities, Inc. of Pennsylvania, Docket No. R-2009-2117402
- PECO Energy Company - Electric Division, Docket No. P-2009-2143607
- PECO Energy Company – Gas Division, Docket No. P-2009-2143588
- Philadelphia Gas Works, Docket No. R-2009-2139884
- York Water Company, Docket No. R-2010-2157140
- City of Lancaster, Docket No. R-2010-2179103
- Columbia Gas of Pennsylvania, Inc., Docket No. R-2010-2215623
- CMV Sewage, Inc., Docket No. R-2011-2218562
- Pennsylvania American Water Company, Docket No. R-2011-2232243
- UGI Penn Natural Gas, Docket No. R-2011-2238943
- Aqua Pennsylvania, Inc., Docket No. R-2011-2267958
- Equitable Gas Company, LLC, Docket No. R-2012-2287044
- Peoples Natural Gas Company, LLC, Docket No. R-2012-2285985
- PPL Electric Utilities Corporation, Docket No. R-2012 2290597
- Columbia Gas of Pennsylvania, Inc., Docket No. R- 2012-2321748
- The City of Lancaster – Sewer Fund, Docket No. R-2012-2310366
- Columbia Gas of Pennsylvania, Inc., Docket No. R-2012-2321748 and M-2012-2323645
- UGI Penn Natural Gas, Docket No. R-2013-2361763
- City of DuBois – Bureau of Water, Docket No. R-2013-2350509
- Pennsylvania-American Water Company, Docket No. R-2013-2355276
- Duquesne Light Company, Docket No. R-2013-2372129
- Pike County Light and Power Company, Gas Division, Docket No. R-2013-2397353
- Pike County Light and Power Company, Electric Division, Docket No. R-2013-2397237
- UGI Penn Natural Gas, Docket No. R-2014-2420273
- Emporium Water Company, Docket No. R-2014-2402324
- City of Lancaster – Water Fund, Docket No. R-2014-2418872
- Peoples TWP, LLC, R-2014-2429613
- Peoples Natural Gas Company, LLC, R-2014-2429606

I have testified and/or submitted testimony in the following proceedings before the Public Utility Commission of Texas and the Texas State Office of Administrative Hearings:

- Custom Water Company, LLC., Docket No. 44236
- City of Austin water rate appeal, Docket No. 42857
- City of Austin wastewater rate appeal, Docket No. 42867 (consolidated with Dkt No. 42857)
- Consumers Water, Inc., Docket No. 43076
- Laguna Vista, LTD. and Laguna Tres, Inc., Docket No. 44046
- Quadvest, L.P., Docket No. 44809
- Monarch Utilities I, L.P., Docket No. 45570
- Corix Utilities (Texas), Inc., Docket No. 45418
- Double Diamond Properties Construction Co. dba Rock Creek, Docket No. 46247
- Liberty Utilities Corp., Docket No. 46256
- Double Diamond Utility Company, Inc., Docket No. 46245
- Wolfe Air Park Civic Club, Inc., Docket No. 46923
- Liberty Utilities, LLC, Docket No. 47976
- W. E. Vlasek, Docket No. 48640

Public Utility Commission of Texas — Attachment ES-3
Docket No. 49189

	Water	Wastewater	Total
Total SWAP Admin Fees[1]	$ 329,086	$ 139,426	$ 468,512
Percentage of total	70%	30%	
Additional Interest Expenses[2]	$ 11,924	$ 5,110	$17,035
Percentage of total	70%	30%	

Sources:

[1] Austin Water's resopnse to Commission Staff's ninth RFI, Staff RFI 9-5

[2] Austin Water's response to Commission Staff's first RFI, Staff 1-7
ES Workpapers 1-6

Public Utility Commission of Texas
Docket No. 49189

Attachment ES-4

	Water	Wastewater
Requested Net Plant[1]		$ 1,284,160,144
Recommended Reduction[2]		77,600,452
Recommended Net Plant		$ 1,206,559,692
Percentage Reduction		6.04%
Debt Service[3]	$98,261,313	$ 82,100,914
Percentage Reduction		6.04%
Dollar Reduction		$ 4,961,272
SWAP Expenses[4]	$ 11,924	$ 5,110
Total Debt Service	$98,249,389	$ 77,134,531

Sources:

[1] AW Wastewater COS Model Docket 49189, Tab 61. Assets to Func, column F, line 37

[2] Direct Testimony of Gregory Charles

[3] AW Water COS Model Docket 48189, Tab 1. FS Water, column K, line 151
AW Wastewater COS Model Docket 49189, Tab 1. FS Wastewater column K, line 146

[4] Attachment ES-3

	Austin Water Filing[1]		With CRF[2]
Debt Service Coverage Calculation			
Total Revenue	$ 316,559,190	$ 24,800,000	$ 341,359,190
Program Requirements	$ 103.449,021		103,449,021
Other Requirements	$ 12,716,898		12,716,898
Administrative Support	$ 16,540,282		16,540,282
Total O&M	$ 132,706,201		$ 132,706,201
Less Reserve Fund Transfer	$ 2,069,559		2,069,559
Net Available for Debt Service	$ 181,783,430	24,800,000	$ 206,583,430
Debt Service Requirements	$ 98,261,313		$ 98,261,313
Debt Service Coverage	1.85		2.10

Sources:

[1] Austin Water COS Model Docket 48189 Errata Filing, Tab 1. FS Water, Table 1-4.

[2] Austin Water COS Model Docket 48189 Errata Filing, Tab 1. FS Water, lines 33 and 86.

	Austin Water Filing[1]		Staff Recommendation
Debt Service Coverage Calculation			
Total Revenue	$ 316,559,190	$ (34,391,460)	$ 282,167,730
Program Requirements	$ 103,449,021		103,449,021
Other Requirements	$ 12,716,898		12,716,898
Administrative Support	$ 16,540,282		16,540,282
Total O&M	$ 132,706,201		$ 132,706,201
Less Reserve Fund Transfer	$ 2,069,559		2,069,559
Net Available for Debt Service	$ 181,783,430	(34,391,460)	$ 147,391,970
Debt Service Requirements	$ 98,261,313		$ 98,261,313
Debt Service Coverage	1.85		1.50

Sources:

[1] Austin Water COS Model Docket 48189 Errata Filing, Tab 1. FS Water, Table 1-4.

	Staff Recommendation[1]		With CRF[2]
Debt Service Coverage Calculation			
Total Revenue	$ 282,167,730	$ 24,800,000	$ 306,967,730
Program Requirements	$ 103,449,021		103,449,021
Other Requirements	$ 12,716,898		12,716,898
Administrative Support	$ 16,540,282		16,540,282
Total O&M	$ 132,706,201		$ 132,706,201
Less Reserve Fund Transfer	$ 2,069,559		2,069,559
Net Available for Debt Service	$ 147,391,970	24,800,000	$ 172,191,970
Debt Service Requirements	$ 98,261,313		$ 98,261,313
Debt Service Coverage	1.50		1.75

Sources:

[1] Attachment ES-5, page 2 of 3.

[2] Austin Water COS Model Docket 48189 Errata Filing, Tab 1. FS Water, lines 33 and 86.

	Austin Water Filing[1]		With CRF[2]
Debt Service Coverage Calculation			
Total Revenue	$ 266,649,968	$ 9,400,000	$ 276,049,968
Program Requirements	$ 95,628,456		95,628,456
Other Requirements	$ 8,254,116		8,254,116
Administrative Support	$ 10,880,705		10,880,705
Total O&M	$ 114,763,277		$ 114,763,277
Less Reserve Fund Transfer	$ -		0
Net Available for Debt Service	$ 151,886,691	9,400,000	$ 161,286,691
Debt Service Requirements	$ 82,100,914		$ 82,100,914
Debt Service Coverage	1.85		1.96

Sources:

[1] AW Wastewater COS Model Docket 48189, Tab 1. FS Wastewater, Table 1-4.

[2] AW Wastewater COS Model Docket 48189, Tab 1. FS Wastewater, lines 29 and 79.

	Austin Water Filing[1]		Staff Recommendation
Debt Service Coverage Calculation			
Total Revenue	$ 266,649,968	$ (28,735,320)	$ 237,914,648
Program Requirements	$ 95,628,456		95,628,456
Other Requirements	$ 8,254,116		8,254,116
Administrative Support	$ 10,880,705		10,880,705
Total O&M	$ 114,763,277		$ 114,763,277
Less Reserve Fund Transfer	$ -		0
Net Available for Debt Service	$ 151,886,691	(28,735,320)	$ 123,151,371
Debt Service Requirements	$ 82,100,914		$ 82,100,914
Debt Service Coverage	1.85		1.50

Sources:

AW Wastewater COS Model Docket 48189, Tab 1. FS Wastewater, Table 1-4.

	Staff Recommendation[1]		With CRF[2]
Debt Service Coverage Calculation			
Total Revenue	$ 237,914,648	$ 9,400,000	$ 247,314,648
	$ -		
Program Requirements	$ 95,628,456		95,628,456
Other Requirements	$ 8,254,116		8,254,116
Administrative Support	$ 10,880,705		10,880,705
Total O&M	$ 114,763,277		$ 114,763,277
Less Reserve Fund Transfer	$ -		0
Net Available for Debt Service	$ 123,151,371	9,400,000	$ 132,551,371
Debt Service Requirements	$ 82,100,914		$ 82,100,914
Debt Service Coverage	1.50		1.61

Sources:

Attachment ES-6, page 2 of 3.

AW Wastewater COS Model Docket 48189, Tab 1. FS Wastewater, lines 29 and 79.

	Water	Wastewater
Debt Service[1]	$98,249,389	$77,134,531
DSCR	1.5	1.5
Total Debt Service	$147,374,084	$ 115,701,797

Sources:

[1] Attachment ES-4