

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the APPLICATION of) REGULATORY DIVISION
AQUAFLO, LLC for Authority to Permanently)
Increase Rates and Charges and Amend Tariff) DOCKET NO. D2011.4.34
Rules and Regulations for Water and Sewer)
Service to its Helena, Montana, Customers)

**MONTANA CONSUMER COUNSEL DATA RESPONSES
TO PUBLIC SERVICE COMMISSION DATA REQUESTS**

PSC-029 RE: Return On Equity (ROE)
Witness: Schulz

MCC has testified in the past that a utility that has decoupled revenues is less risky than a company that has volumetric charges. (See Direct Testimony of John Wilson, Page 25 of 36 in Docket D2009.9.129 recommending a 1 to 2 percent reduction in ROE.)

Considering the above testimony, please explain why AquaFlo, moving away from almost complete revenue certainty and as you state “a reverse decoupling,” is now less risky.

RESPONSE:

In my testimony I did not say that AquaFlo is less risky; rather, I indicated that no risk transfer has occurred and thus no compensating adjustment for risk needs to be made. Dr. Wilson in his Reply Testimony, Page 25 of 26, in Docket No. D2009.9.129 recommended a reduction in ROE because of “risk-shifting issues”.

PSC-030 RE: ROE
Witness: Schulz

You state that AquaFlo is gaining the possibility of earning more than its authorized rate of return if water use rises above test year levels.

- a. Given the above, would not AquaFlo also gain the possibility of earning less than its authorized rate of return if water use was below test year levels? Why or why not?
- b. Does the variability and volatility of consumption based revenues increase the risk of a company? Why or why not?

RESPONSE:

a) Yes, as I indicate in lines one through eight on page five of my testimony, both parties are assuming a new financial opportunity and a new financial risk. If usage levels dropped low enough, it is possible that the Utility would not earn its authorized revenue requirement. However, I also explained in my pre-filed testimony that the 2010 test year volumes in use already account for a drop in usage so there is a pre-existing bias protecting the Utility from revenue losses due to low usage.

b) It depends if there has been a change in the allocation of the overall pool of risk as I discuss on pages four and five of my testimony. In this case, both parties (Utility and consumers) continue to shoulder similar proportions of risk as they did prior to the implementation of volumetric rates.

PSC-031 RE: ROE
Witness: Schulz

You state that the greater risk burden lies with consumers because of the existence of the excess usage fee which acts as an inclining block rate thus accelerating the cost to consumers as they reach higher levels of consumption.

- a. Do you believe that the normal usage customers will be affected by the excess usage fee on a regular basis? Why or why not?
- b. Based on your estimation and understanding of the AquaFlo customer usage patterns, what is the percentage risk exposure for a normal usage customer to be affected by the excess usage fee? Please provide all supporting calculations.
- c. In a volumetric charge, doesn't the consumer have a better opportunity to affect the expense incurred by the consumer? Why or why not?

RESPONSE:

- a) As the question is stated, by mere definition the answer would have to be that they will not incur the excess usage fee on a regular basis, although they are subject to it like any other customer. A data point near the mean of a normal distribution cannot be representative of data points at the tails. In other words, a "normal" customer would not regularly exhibit excess usage unless the consumption trigger point for the excess usage rate was set too low.
- b) There are far too many variables to make a meaningful calculation. A customer could choose to add more lawn area to their landscaping and the extra watering needed could trigger the excess usage fee. A customer could unknowingly have a service line installed that is made of substandard materials. This could result in a leak leading to application of the excess usage fee. Summer weather could be particularly hot and dry requiring more lawn watering. A family could add a new member resulting in increased use of water. These and many other scenarios would then have to have reasonable probabilities assigned to them in order to even begin to generate such a calculation.
- c) If the question is comparing a volumetric charge to a fixed rate only, and if the question is referring to the *total* expense, then as defined by the constraints of the question the answer would have to be, yes. A fixed charge is just that. It does not vary over different usage levels whereas a volumetric charge is based on the volume consumed. The total expense cannot be affected by the consumer who is subject to a fixed rate but the consumer can affect their average cost per unit of consumption.

PSC-032 RE: Usage volumes
Witness: Schulz

Is it possible to estimate and quantify what percentage of the decrease in volumes from 2010 was due to the cooler temperatures and higher levels of rainfall that occurred in 2010 versus the price signal sent by having a volumetric cost? Please explain.

RESPONSE:

Any calculated estimate would require the use of numerous assumptions that would call in to question the accuracy of the results. It is also possible that two different customers could be motivated to different degrees by the same factor. Additionally, the same customer's sensitivity to one factor such as price could vary over time. For example, if that customer was unemployed they may be highly aware of the overall level of their water bill. Once they were employed again, they may become more reactive to how green their lawn is. Nonetheless, the difficulty in calculating the precise effect of one variable does not remove weather as a significant factor in explaining the decline in water usage in 2010.

PSC-033 RE: Rate Case Expense
Witness: Schulz

- a. When you examined the information supplied by AquaFlo in its response to PSC-026, did you include legal fees from Gallagher and Associates that pertained to the general rate case? Why or why not?
- b. Conversely, did you exclude out of legal expenses the expenses associated with rate case expense? Why or why not?

RESPONSE:

- a) In my testimony I proposed adopting the Company's proposal of using \$12,955 estimated annual Professional Services and Fees. I interpreted this proposal as not including Professional Services associated with rate case expense.
- b) See answer to part a.

PSC-034 RE: Rate Case Expense in Rate Base
Witness: Schulz

You state that the utility must hire an attorney and regulatory consultant in order to apply for new rates with the Commission and that is a necessary expense of doing business as a regulated utility. You go on to state that those professionals are hired to specifically represent the interests of the utility and not any other party.

a. Are the professionals used by the company, hired to determine from the company's point of view, just and reasonable rates? Does this differ from the role of the MCC in the converse? Please explain.

b. When a regulated entity incurs costs associated with hiring the professionals, and requests recapturing those costs, are those costs considered a necessary and ordinary business expense? Please explain.

c. If this is a necessary business expense and occurs in the test year, why is it not allowed to be recaptured 100% in the general rate case? Please explain.

d. Please explain why the company should not be allowed a return on the expense if the expense is allowed to be recaptured over a period of greater than one year.

e. Given all other things being equal, doesn't the incurrence of rate case expense decrease the amount of equity in a company? Why or why not?

RESPONSE:

a) There are certainly similarities along with some important distinctions. The MCC represents consumer interests but does not represent specific individuals or legal entities. Likewise, the resources available to the MCC to fulfill its responsibilities are not determined by what a particular "client" is willing and able to pay.

b) Yes, subject to the Commission's determination of prudence. In other words, a necessary and ordinary expense may be fulfilled in a way that is far from ordinary. For example, hiring a Montana attorney at \$200 an hour may be ordinary whereas hiring a \$600 an hour lawyer from Chicago may fulfill a necessary and ordinary expense but at an extraordinary cost.

c) Generally, the absolute amount applied for is allowed to be recaptured in a general rate case.

d) Please see Page 8, lines 1–18 of the pre-filed testimony of Paul R. Schulz in this docket.

e) Viewed in isolation, apart from matching revenues, any expense will increase liabilities (such as accounts payable), or reduce the amount of assets (such as cash) and will reduce stockholder's or owner's equity.

PSC-035 RE: Rate Case Expense Handling (Pg 8, lines 23-30, Pg 9, lines 1-5)
Witness: Schulz

- a. Would it be preferable to have rate case expense adjusted to actual at the conclusion of the general rate case, to ensure that the company does not receive more or less than its cost of the general rate case? Why or why not?
- b. If this expense is collected over time, and is financed by the company, why shouldn't it be capitalized and the company allowed to earn a return on that asset that is created and being forced to their regulatory balance sheet by the regulatory process, especially in the context that rate case expense exceeds the original estimate?
- c. Doesn't not allowing a return on that asset amount to confiscatory ratemaking? Please explain.

RESPONSE:

- a) Please see Page 9, line 6 through page 10, line 11 of the pre-filed testimony of Paul R. Schulz in this docket.
 - b) Please see Page 8, line 1 through page 9, line 5 of the pre-filed testimony of Paul R. Schulz in this docket.
 - c) I offer no opinion on the legal definition of "confiscatory ratemaking". However, regulation by definition involves control and adjustment as it endeavors to serve the public interest. In utility regulation, efforts are made to place disciplines on natural monopolies that best approximate the disciplines of the market. In doing so, incentives as well as disincentives are used to promote desired behaviors. For example, decisions are subject to prudence review. Plant is only allowed in rate base if it is "used and useful for the convenience of the public." (MCA § 69-3-109). The nature and level of costs are scrutinized. Attempts are made to accurately allocate costs to the causers and beneficiaries of those costs. To suggest that disallowing a return on an expense recovered over time is confiscatory, simply because it can be proved that the cost was incurred, is to suggest that regulation has no capacity beyond a mere exercise in accounting.
- In addition, it is not unusual to "normalize" any cost that is particularly large in a test year by spreading it out over some period of time. Normalization would be moot, and would turn into a policy of capitalization if a return were allowed on any unusually large test year expense that a company incurred. Likewise, some test year expenses are increased for impending known and measurable changes. It would only then be fair to give consumers a return on any rates paid for increased test year expenses up to the time those expenses actually do increase.

PSC-036 RE: Rate case expense as a tracker
Witness: Schulz

- a. Should not a company be allowed recovery of prudently incurred expenses? Why or why not?
- b. Would not a tracker allow no more or no less than those prudently incurred expenses? Please explain.
- c. Please explain why this would be detrimental to other regulated utilities or ratepayers.

RESPONSE:

- a) Yes, the prudent amount that does not benefit the company exclusively and is therefore in the public interest. For example, incentive pay plans that are measured mostly on stock value primarily benefit shareholders and not ratepayers. A commission may decide that only a portion of that expense inures to the benefit of ratepayers and serves the public interest. Accordingly, only a portion of that expense may be allowed to be recoverable in rates even though the overall idea of incentive pay has not been deemed imprudent. In other words, there is an issue of assigning costs to parties in proportion to the benefit they receive from the incurrence of those costs.
- b) Once the prudent amounts of expenses that serve the public interest have been determined then over time a well administered tracker should allow for fairly accurate cost recovery.
- c) Please see Page 9, line 15 through page 10, line 21 of the pre-filed testimony of Paul R. Schulz in this docket.

PSC-037

Question was withdrawn pursuant to MT PSC Notice of Staff Action dated April 25, 2012.

PSC-038 RE: Rate case expense amortization
Witness: Schulz

a. Please identify each docket, your original recommendation, if your position changed in response to rebuttal testimony, what it was changed to, and if a contested case, what the final accepted amortization period was for rate case amortization since you became a rate analyst for the MCC.

b. Question was withdrawn pursuant to MT PSC Notice of Staff Action dated April 25, 2012.

RESPONSE:

a) Salish Shores (Docket No. D2006.10.146) - Company proposed a three year amortization period which I did not oppose. Case was settled.

Utility Solutions (Docket Nos. D2005.11.163 & 164) - Company proposed a three year amortization period which I did not oppose. Case was settled.

Big Mountain Water (Docket No. D2010.1.9) - Company did not seek recovery of rate case expenses so there was no amortization period proposal. Case was settled.

Treeline Springs (Docket No. D2010.9.98) – Company proposed a two year amortization period and I recommended a four year amortization period. Case was settled.

Aquanet (Docket No. D2009.12.156) – Company proposed a two year amortization period and I recommended a three year amortization period. Docket is still open.

Energy West (Docket No. D2010.9.90) – Company proposed a three year amortization period which I did not oppose. A three year amortization period was used in the final order.

PSC-039 RE: Organizational structure

Witness: Schulz

- a. Please provide your basis and support that AquaFlo LLC elected to be treated as a C Corp solely for income tax purposes.
- b. Is it your position that the only reason to become a C Corp is to allow a company to become publicly traded? Please explain.
- c. Do businesses change organizational structures as they grow, i.e., change from a sole proprietorship to a partnership or LLC or Corporation? Please explain.
- d. Is it your position that if a company chooses an other than pass through entity, and has the option of a pass through entity, that its request for income tax should be disallowed, regardless of the reasoning for the election? Please explain.

RESPONSE:

- a) That is the purpose of a Form 8832 election. The instructions for Form 8832 state:

Purpose of Form

An eligible entity uses Form 8832 to elect how it will be classified for federal tax purposes, as a corporation, a partnership, or an entity disregarded as separate from its owner. An eligible entity is classified for federal tax purposes under the default rules described below unless it files Form 8832 or Form 2553, Election by a Small Business Corporation, to elect a classification or change its current classification.

- b) No, as I explain in my testimony, in order to be publicly traded a company generally needs to be organized as a C Corporation. However, I listed some of the features of a C Corporation and a company may choose to take advantage of one or more of those features for reasons other than to be publicly traded.
- c) Businesses may desire to change organizational structure because of growth or for a variety of other reasons. For example, a sole proprietor may want to change structure mainly to adopt some legal form that limits liability. This could be because there are now more assets to protect or because of a change in marital status. The owner of a family business may realize that his or her children will not run the business when they are grown and then decides that a different organizational structure that protects the business while providing some income to the children is best. Growth could fuel a change in structure as could a myriad of other circumstances.
- d) No. In this case, AquaFlo has not chosen to be a C Corporation but is actually organized as a Single Member LLC. It has made an affirmative election to be treated differently for tax purposes than it normally would be, given the organizational structure in place, and in my opinion AquaFlo has not demonstrated why the added tax burden to ratepayers that the election creates is justified.

PSC-040 RE: Accounting Hourly Rate
 Witness: Schulz

- a. What would you recommend for an hourly rate for accounting work performed in this business? Please explain.
- b. How many hours would you recommend be reimbursed for the accounting work performed in this business? Please explain.

RESPONSE:

- a) I would use the rate of \$25.00 per hour plus any out of pocket expenses which is the level of compensation listed in Exhibit B COMPENSATION, of the Independent Contractor Agreement between AquaFlo and Accounting Beans for “any other services”.
- b) The sole guidance I could find on this issue was the courier/bookkeeping/accounting hours submitted by Aquanet, another small MT water company, in response to Data Request MCC-001 in Docket D2009.12.156. The total non rate case hours for those activities in that docket were 217 hours per year. It appears that Accounting Beans does perform the courier type tasks listed in the Aquanet docket, the bookkeeping tasks, and some but not all of the Accounting tasks that amounted to 45 of the 217 hours. Therefore, I would recommend using an estimate of 200 hours annually.

PSC-041 RE: Working Cash
Witness: Schulz

- a. Please provide references to all PSC dockets in the last 5 years where adjustments to working cash for property tax lag were recommended by the MCC in its intervenor testimony.
- b. Please provide references to all PSC dockets in the last 5 years where adjustments to working cash for MCC and PSC tax lag were recommended by the MCC in its intervenor testimony.

RESPONSE:

a) No comprehensive study has been performed. However, I suspect the MCC has not previously indicated that property taxes were a “lag” item as they are a “lead” item for computing working cash. In that context, the following are the applicable dockets of which I am aware:

Treeline Springs, Docket No. D2010.9.98 – The Utility included property taxes as both a lag and a lead item. I testified that it should be calculated differently and included only as a lead item.

Aquanet, Docket No. D2009.12.156 - The Utility included property taxes as both a lag and a lead item. I testified that it should be calculated differently and included only as a lead item.

AquaFlo, Docket No. D2011.4.34 – The Utility did not propose an adjustment to working cash for property taxes and I recommended an adjustment to reflect the property tax lead.

b) No comprehensive study has been performed. The following is the applicable docket of which I am aware:

AquaFlo, Docket No. D2011.4.34 – The Utility proposed an adjustment to working cash for MCC/PSC taxes as a lag item and I testified that the MCC/PSC taxes are a lead item, not a lag item, and I adjusted the calculation for working cash accordingly.