

Exhibit T ____ (DPK-1T)
Docket No. UW-041181
Witness: Danny P. Kermode

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

MARBELLO WATER COMPANY,

Respondent.

DOCKET NO. UW-041181

TESTIMONY OF
DANNY P. KERMODE, CPA
IN SUPPORT OF THE SETTLEMENT AGREEMENT

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

OCTOBER 15, 2004

1 **Q. Please State Your Name And Business Address.**

2 A. My name is Danny P. Kermode. My business address is 1300 South
3 Evergreen Park Drive S.W., PO Box 47250, Olympia, Washington 98504-7250.
4 My e-mail address is dkermode@wutc.wa.gov.

5

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

7 A. I am employed by the Washington Utilities and Transportation Commission
8 as a Regulatory Analyst.

9

10 **Q. What are your education and experience qualifications?**

11 A. I graduated in 1982 from Arizona State University in Tempe, Arizona with a
12 Bachelor of Science in Accounting. Later that same year, I attended San
13 Carlos University in the Philippines for postgraduate studies in Economic
14 Analysis and Quantitative Business Analysis. I am a licensed as a Certified
15 Public Accountant (CPA).

16 I was a member of the faculty at the National Association of
17 Regulatory Commissioners (NARUC) Annual Regulatory Studies Program
18 held at Michigan State University in East Lansing, Michigan in 1992 and

1 1993. I taught classes in Financial and Regulatory Accounting Standards and
2 in Deferred Tax Accounting.

3 I have been employed by the Washington Utilities and Transportation
4 Commission as a regulatory analyst since 1998.

5

6 **I. PURPOSE OF TESTIMONY AND SUMMARY**

7 **Q. What is the purpose of your testimony in this case?**

8 A. The purpose of my testimony is to describe and support the Settlement
9 between Staff and Marbello Water Company, Inc. (Marbello or Company).

10

11 **Q. Please provide the current status of Docket No. UW-040366, the complaint
12 against Marbello.**

13 A. In response to the complaint filed by the Commission against the Company,
14 the Company agreed to file an initial tariff and the parties reached agreement
15 on how Staff would proceed. On March 29, 2004, the Commission accepted
16 the stipulation between Marbello and Staff under which Staff would "...go
17 forward with evidence to establish rates different than those set out in the
18 Company's initial tariff if Staff concludes that the tariffed rates are not just
19 and reasonable," [*Stipulation of Parties page 2 paragraph 3 item (2)*].

1 On April 21, 2004, Marbello filed financial information in compliance with
2 the stipulation. Upon review of the submitted information, along with other
3 requested data provided by the Company, Staff concluded that the
4 Company's initial rates were just and reasonable.

5 Consistent with the stipulation and the Schedule of Proceedings dated
6 June 17, 2004 (as modified by the Notice of Continuance dated July 30, 2004)
7 Staff filed a motion to dismiss the complaint in Docket No. UW-040366 on
8 September 10, 2004. By order dated October 12, 2004, the Commission
9 dismissed Docket No. UW-040366.

10

11 **Q. Please discuss the processing of Marbello's general rate case.**

12 A. On June 28, 2004, Marbello filed a revision to its initial tariff requesting an
13 increase of approximately \$7,700 (10.5%) in its annual revenue. The filing
14 was based on a test year ended December 31, 2003, the same test period used
15 by Staff in its analysis of the Company's rates filed in its initial tariff. The
16 Commission suspended the filing at its July 28, 2004, Open Meeting.

17 On July 29, 2004, Staff made a motion to consolidate the general rate
18 case and the Complaint. Marbello did not object to consolidation and on

1 August 10, 2004, the Commission issued an order consolidating the two
2 dockets.

3

4 **Q. When did Settlement discussions commence between the parties?**

5 A. Staff and the Company have had numerous discussions following the filing
6 of its general rate case in a good faith effort to understand each other's
7 positions. In order to avoid the time and expense of a fully litigated rate case,
8 the parties have worked to reach a mutually acceptable result. The initial
9 discussions indicated a Settlement was a possibility if certain issues could be
10 agreed upon. After additional discussions, the parties agreed to a Settlement
11 that addressed most of the concerns of both the Staff and Marbello.

12

13 **II. SETTLEMENT REVENUE REQUIREMENT**

14 **Q. What is the Settlement revenue requirement agreed to by the parties in the
15 Settlement?**

16 A. The parties agreed to an increase in revenues of \$723, resulting in a new
17 revenue requirement of \$74,297, a 1% increase over test year levels. The
18 Settlement also redesigns the Company's rate structure, by reducing the
19 commodity charge (i.e., the charge customers pay based on the amount of

1 water they consume, as opposed to the base rate) by 43% and eliminating the
2 750 cubic feet water allowance currently included in the base rate, which is
3 consistent with Commission policy.

4

5 **Q. Was the rate design a concern along with the Company's revenue**
6 **requirement?**

7 A. Yes, as discussed in Staff's motion to dismiss in Docket UW-040366, the
8 current rate design includes a high commodity charge (substantially above
9 the rate the Company pays for the water), which increases the risk of
10 revenue instability and also causes very high water charges for customers
11 that use larger amounts of water. Because the commodity charge is only
12 triggered after the first 750 cubic feet of water, per month, the current rate
13 structure gives the customer a false impression of "free water" provided in
14 the base rate where, in fact, the Company has shifted the cost of the water
15 and most of the fixed costs associated with the operation of the company to
16 the high volume customers.

17 Unfortunately, under the Company's current rate structure, as high
18 volume customers reduce their usage due to the high cost of water, the
19 company may experience a decrease in the cash flow that is needed to pay its

1 fixed costs. The Settlement commodity rate is set equal to the actual cost
2 paid by the Company to the City of Monroe for water, plus 13% to account
3 for water loss due to line loss and line breaks.

4

5 **Q. Please describe your Settlement Exhibit ___(DPK-2).**

6 A. Settlement Exhibit ___(DPK-2) is a schedule that shows the rate base and
7 income statement for (1) the Company's proposed rates in Docket No. UW-
8 041181, (2) Staff's results in Docket No. UW-040366, (3) the Company's
9 current rates and (4) the rate base and income statement for the proposed
10 Settlement. In addition, on line 31, the resulting return on investment is
11 reflected for each presentation.

12

13 **Q. What is the revenue impact of the Settlement on current rates as reflected**
14 **in your Settlement Exhibit ___(DPK-2)?**

15 A. As shown on line 7 of Settlement Exhibit ___(DPK-2), the Company would
16 receive a revenue impact of \$723, a 1% increase over current revenues.

17

1 **Q. Do the parties believe the Settlement revenue requirement increase of \$723**
2 **results in rates that are fair, just, reasonable, and sufficient?**

3 A. Yes. The parties discussed all proposed adjustments to revenue, expenses,
4 and rate of return. Both Staff and the Company ultimately accepted the final
5 result reflected in the Settlement.

6

7 **III. SETTLEMENT METHODOLOGY SUMMARY**

8 **Q. Did the parties agree to specific adjustments to revenue, expenses, and rate**
9 **base?**

10 A. The Parties agree to an overall revenue requirement increase for the
11 Company's operations of \$74,297. The Parties have negotiated this revenue
12 requirement increase without regard to any specified adjustments to
13 revenue, expense, and rate base items.

14

15 **Q. Is there a particular equity return or capital structure implied by this**
16 **Settlement?**

17 A. No, as with operating expenses, the cost of capital also is a negotiated
18 compromise with both parties agreeing that the overall cost of capital does
19 not represent a particular result of any individual issue.

1 **Q. Based on the Settlement, has any methodology, principles, facts, or**
2 **theories been accepted or deemed approved by Staff?**

3 A. No, the Settlement represents a negotiated compromise and therefore the
4 parties have agreed that no party shall be deemed to have approved the
5 facts, principles, methodology, or theories employed by the other party in
6 arriving at the Settlement. In addition, the parties have agreed that nothing
7 in the Settlement will be viewed as precedent in subsequent proceedings.

8

9 **IV. CONCLUSION**

10 **Q. What do you recommend regarding the Settlement Agreement?**

11 A. I recommend that the Commission admit the Settlement Agreement into the
12 record and adopt it in its entirety as resolution of Docket No. UW-041181.

13 WAC 480-07-750(1) states:

14 The commission will approve Settlements when doing so is
15 lawful, the Settlement terms are supported by an appropriate
16 record, and when the result is consistent with the public
17 interest in light of all information available to the commission.

18

19 In my opinion the Settlement meets the public interest standard, and the

20 results are fair, just, reasonable, and sufficient.

21

1 Q. Does this conclude your testimony?

2 A. Yes it does.