

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

In the matter of

SUMMIT VIEW WATER WORKS LLC

Request for a General Rate Revision

Docket No. UW-

**PREFILED DIRECT TESTIMONY
OF DANNY P. KERMODE, CPA (RETIRED)**

JULY 31, 2024

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EXHIBIT LIST

Exhibit No.	Description	Page Referenced
DPK-02	Statement of Qualifications of Danny Kermode	1 & 3
DPK-03	GRC Model - Schedules Supporting Revenue Requirement	3-6, 9, 10
DPK-04	Water Usage and Revenue Supporting Schedules (including Rate Phase-In Supporting Schedule)	3 & 11- 12

I. INTRODUCTION

1 **Q. Please state your name and business address.**

2
3 A. My name is Danny Kermode, and my business address is 5326 75th CT SW, Olympia,
4 Washington 98512. My business email address is dannykermode@aol.com.

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

6 A. I am self-employed providing consulting services for organizations in regulatory utility
7 matters.

8 **Q. Please state your qualifications to provide testimony in this proceeding.**

9
10 A. I have more than 40 years of regulatory accounting experience within both private
11 practice and in government. A more detailed description of my qualifications is set forth
12 in my Statement of Qualifications, found at DPK-02. I have appeared as an expert
13 witness in numerous contested cases presenting financial, income tax and regulatory
14 accounting issues. I last worked as the Assistant Director for Water and Transportation at
15 the Washington Utilities and Transportation Commission (UTC). Prior to being
16 appointed Assistant Director, I was the UTC's Director of Policy and Legislation. I also
17 was previously the Commissioners' chief accounting advisor and a senior energy policy
18 advisor. I am a retired Certified Public Accountant with an undergraduate degree in
19 accounting from Arizona State University.

20
21 I worked for the UTC for over 25 years. Prior to working at the UTC, I had accumulated
22 over ten years of experience in private accounting practice specializing in public utility
23 regulation and was a Certified Financial Planner, although that certification is now
24 inactive.

Q. What other qualifications and experience do you have?

1 A. I am also a visiting faculty member and Senior Fellow at Michigan State University's
2 Institute of Public Utilities where I continue to teach advanced regulatory studies and
3 basic ratemaking. Previously, I was on the faculty of the annual National Association of
4 Regulatory Utility Commissioner ("NARUC") Rate School in San Diego California. In
5 2014, I worked as an adjunct professor at St. Martin's University teaching business
6 taxation. In addition, I have written various articles on public utility regulation in
7 nationally- recognized publications over the years, including the Public Utility
8 Fortnightly and the National Regulatory Research Institute Journal of Applied
9 Regulation.
10

11 **Q. Have you testified previously before a regulatory commission?**

12 A. Yes, I have testified before the UTC at least 13 times, covering various industries
13 including electric, natural gas, telecom, marine pilotage, oil pipeline, and water utility
14 cases. For example, I filed testimony in two PacifiCorp d/b/a Pacific Power general rate
15 cases, and two Avista Utilities general rate cases. I have also testified specifically on
16 income tax issues in a rate case involving the Olympic Pipeline Company. Additionally, I
17 have filed testimony in various investor-owned water company general rate cases.
18

19 II. SCOPE AND SUMMARY OF TESTIMONY

20 **Q. What is the purpose and scope of your testimony here?**

21 A. The purpose is to provide testimony in support of Summit View Water Works LLC's
22 ("SVWW" or "Summit View") proposed rates and resulting revenue requirement. I will
23 be testifying regarding the overall revenue requirement, rate base, and cost of capital. My
24 testimony is in conjunction with testimony filed by Ann LaRue, CPA. I will also provide
testimony introducing the company's supporting schedules filed with the case.

1 Specifically, I will testify concerning six restating adjustments and one pro forma
2 adjustment which include a reclassification of an insurance refund and revenue sensitive
3 adjustments (i.e., adjustments to the commission regulatory fee to actual, and an
4 adjustment to the public utility tax for the test year). Finally, I will present testimony
5 regarding adjustments to test year revenues and the addition of working capital.

6 **Q. Are you introducing any exhibits with your testimony?**

7 A. Yes, I am providing three exhibits in addition to my testimony (Exh DPK-01T). As I
8 noted above, Exhibit DPK-02, Statement of Qualifications describes my professional
9 experience. I am also providing Exh. DPK-03 which is a multi-schedule exhibit showing
10 the full development of the revenue requirement, while Exh DPK-04 supports the
11 proposed rate design.

12 **Q. Could you please expand on your Exhibit DPK-03 including its purpose and what
13 schedules it includes?**

14 A. DPK-03 is the main support for SVWW's tariff revision. It is made up of 14 interrelated
15 supporting schedules reflecting the company's pro forma income statement, rate base.
16 The exhibit is made up of the following schedules:

- 17 • Sch 1.0 – Income Statement and rate base with adjustments
- 18 • Sch 1.1 – Income Statement (detail)
- 19 • Sch 1.2 – Restating Adjustments matrix
- 20 • Sch 1.3 – Pro Forma Adjustments matrix
- 21 • Sch 2.1 – Rate Base detail
- 22 • Sch 2.2 – Contributions in Aid of Construction
- 23 • Sch 2.3 – Working Capital
- 24 • Sch 3.1 – Plant in Service
- Sch 3.2 – Depreciation Expense
- Sch 4.1 – Capital Structure
- Sch 4.2 – Cost of Debt
- Sch 4.3 – Pro Forma Debt

- Sch 5.1 – Income Taxes
- Sch 5.2 – Balance Sheet – Regulatory Basis

1
2
3 **Q. Please describe Schedule 1.0 of Exhibit DPK-03.**

4 A. Schedule 1.0 of Exhibit DPK-03 reflects the development of the pro forma income
5 statement and rate base. Column (A) provides account titles. The related test year
6 amounts in Column (C) originate directly from the company's books and records.
7 However, if any accounts were combined for rate case purposes, Column (B) provides
8 the source of the data presented. Column (D) lists Restating Adjustments required to
9 adjust the company's books to regulatory accounting or to true-up accounts to test year
10 amounts. Column (F) provides a detail of the Pro Forma Adjustments proposed to
11 correctly match test year results to the results expected in the rate year.

12
13 The pro forma results of operations are shown in Column (G), whereas Column (H) and
14 (I) show, respectively, the proposed rate increases and the total revenues the company
15 proposes to realize at the requested rates by each class affected.

16 **Q. Please now describe the schedules labeled 1.2 Restating Adj and 1.3 Pro Forma Adj**
17 **of your Exhibit DPK-03.**

18
19 A. The two above schedules show each proposed restating and pro forma adjustment and
20 their impact on the revenue or expense item being adjusted, and the impact on income
21 taxes or rate base if the proposed adjustment implicates the company's regulatory rate
22 base.

23 **Q. Continuing your description of Exhibit DPK-03, please discuss the Rate Base**
24 **supporting schedules.**

1 A. The Rate Base is supported by the next three schedules labeled 2.1 Rate Base, 2.2 CIAC,
2 and 2.3 Working Capital. Schedule 2.1 Rate Base shows the derivation of the rate base
3 various components per books including the impact of the pro forma adjustment for new
4 meters. Schedule 2.2 CIAC details the company's Contributions in Aid of Construction
5 (CIAC) balance at the close of the test year, whereas Schedule 2.3 Working Capital
6 supports the company's requested working capital amount in rate base.

7
8 **Q. Exhibit DPK-03, also details the company's plant in service, please discuss the two**
9 **supporting schedules 3.1 Plant and 3.2 Depr Exp.**

10 A. Schedule 3.1 Plant is a listing of the plant-in-service assigned to Domestic, Irrigation or
11 Common plant. In addition, Schedule 3.2 details the related depreciation expense also by
12 plant category - Domestic, Irrigation or Common plant. These schedules are also
13 supported by Ms. LaRue's Exhibit AML-02 for regulatory depreciation.

14 **Q. You address SVWW's capital structure and financing costs in this exhibit, could**
15 **you please describe those supporting schedules?**

16
17 A. Schedule 4.1 Capital shows the company's test year-end capital structure indicating the
18 company is financing rate base with approximately 58 percent debt. The equity portion of
19 the capital structure makes up the remaining 42 percent of the total structure resulting in
20 an overall weighted cost of capital of 9.69 percent.

21 **Q. Could you please explain why you do not include CIAC in your computation of**
22 **capital structure?**

23
24 A. Yes. Although CIAC is considered a form of financing, for ratemaking purposes, CIAC is
commonly used as a deduction from rate base rather than a component of the capital
structure. The deduction from rate base is consistent with the premise that, with CIAC

1 being a zero-cost form of financing, the company should not earn a return on any plant
2 provided as a contribution in aid of construction.

3 **Q. Please continue your description of schedules in your Exhibit DPK-03 supporting**
4 **your proposed capital structure.**

5 A. Schedule 4.2 Cost of Debt provides details of the long-term debt that is financing the
6 company's rate base reflecting a combined weighted cost of debt of 8.38 percent. Finally,
7 Schedule 4.3 PF Debt includes the computation to synchronize the cost of debt to rate
8 base, providing the adjusted test year interest expense and the resulting adjustment to
9 income tax expense.
10

11 **Q. Could you now please describe your income tax supporting schedule included in**
12 **your Exhibit DPK-03?**

13 A. Yes. Schedule 5.1 Income Taxes, details the computation of the adjusted test-year income
14 tax expense. Although SVWW is a Limited Liability Company (LLC) it has elected
15 under the Internal Revenue Code to be taxed as a corporation.¹ Using the current
16 corporate federal income tax rate of 21 percent applied against operating income,
17 adjusted for synchronized interest in Schedule 4.3, I derive the test year income tax
18 expense.
19

20 **Q. Now, would you please discuss the last schedule included in your Exhibit DPK-03?**

21 A. Schedule 6.1 Bal Sheet reflects SVWW's regulatory basis 2023 balance sheet used to
22 compute the company's capital structure. The regulatory balance sheet differs from the
23 income tax basis balance sheet used in the company's past cases due to accounting
24 differences between the two bases of accounting.

¹ 26 U.S. Code § 1362.

III. RESTATING ADJUSTMENTS

1
2 **Q. In Restating Adjustment R-01, you reduce test year revenues by \$732. Could you**
3 **explain the reason for this reduction in revenue?**

4 A. Yes. I reduced test year revenues by an amount equal to an insurance policy refund
5 received by the company which, for income tax purposes, was included in revenue.
6 However, for regulatory purposes, it should be used to reduce maintenance expense, the
7 area where the original loss was incurred. But since the amount relates to a prior period
8 and is non-recurring, I removed the amount entirely to avoid distorting the company's
9 maintenance expense on a forward-looking basis.
10

11 **Q. In Restating Adjustment R-04 you make an adjustment to UTC regulatory fees,**
12 **what is the adjustment's purpose?**

13 A. Restating adjustment R-04 for \$31 is an adjustment to true up the UTC regulatory fee to
14 reflect the correct test year expense. Since the UTC fee is revenue based, it can be
15 quickly computed and adjusted to reflect the actual test-year adjusted revenue.
16

17 **Q. R-05, a restating adjustment to Public Utility Tax is a similar adjustment, please**
18 **explain this adjustment to the company's test year expense.**

19 A. In contrast to the UTC fee that is paid to the Commission, the Public Utility Tax is a tax
20 paid to the state of Washington. Like the UTC fee, it is based on revenue. This
21 adjustment trues-up the test year Public Utility Tax expense to the test-year adjusted
22 revenues. I applied the applicable tax rate, (presently 5.029 percent) to domestic water
23 service gross revenue, to derive the expense. It should be noted that unlike the UTC fee,
24 the Public Utility Tax is not collected on irrigation revenues.

1 **Q. Please discuss your adjustment to revenues reflected in your proposed Restating**
2 **Adjustment R-06.**

3 A. Certainly. Adjustment R-06 is an adjustment to both the domestic and irrigation test
4 year, based on bill count analysis and adjusts test-year revenues to actual, removing any
5 impact from revenue payments from prior periods or other abnormalities. The bill count
6 studies are based on either actual usage or actual acreage billed for the period.

7 **Q. Restating Adjustment R-07 is an adjustment for working capital, please explain why**
8 **an adjustment to rate base is required.**

9
10 A. Adjustment R-07 creates, on a restated basis, a working capital component for Summit's
11 proposed rate base. Working capital is the amount of additional investment a company
12 must make to provide liquidity in order to pay short-term obligations such as payroll and
13 taxes during the period prior when related revenues are received from customers.

14
15 **IV. EXHIBITS**

16 **Q. Could you explain how your proposed adjustment for working capital was**
17 **computed?**

18 A. The computation of Restating Adjustment R-07 for \$40,872, supported by Schedule 2.3
19 Working Capital, reflects on a restated basis, the working capital component of Summit's
20 rate base. The amount was computed using the formula approach also known as the 1/8th
21 method.

22
23 **Q. Please explain some of the mechanics of this adjustment.**

24 The formula approach assumes an average 45-day lag from the time when an expense is
paid, and the analogous revenue that the expense created is received. A common example
of this is payroll, which is paid every two weeks. Because the revenue from services is

1 not actually received for approximately 45 days (billed at month end with approximately
2 15 days before the customer pays) there is a lag. During that “lag days” interval, the
3 company must continue to pay its operating costs.

4 **Q. Is there a supporting workpaper that demonstrates this?**

5 A. Yes. My Schedule 2.3 Working Capital details the methodology described above. The
6 process of deriving working capital using the formula approach begins by taking the total
7 operating expenses shown on my exhibit DPK-03 Schedule 1.0 and reducing that amount
8 by depreciation expense because it is a non-cash expense. The total operating expense
9 amount is further reduced by other taxes because those tax payments are paid around the
10 time revenue is received. Finally, working capital associated with pumping power is
11 separately computed as a reduction to working capital because power costs are normally
12 paid after the revenue is received by an average lead period of 15 days. The result is an
13 annual provision of required working capital.
14

15
16 **Q. On your Schedule 2.3 Working Capital, you reduce the working capital allowance
17 by half, could you please explain why you are proposing this reduction?**

18 A. Irrigation customers pre-pay for services for the months of April through October. I thus
19 assume for this case that the prepayment covers working capital needs for those seven
20 months and that there would be no allowance required by the company, reducing the
21 overall annual requirement by half.

22 **Q. Pro Forma Adjustment P-07 is also apparently an adjustment to rate base for
23 working capital, please explain this adjustment.**
24

A. Certainly. The \$9,584 increase in the working capital allowance reflects the changes in
expenses from recognizing known and measurable expenses for the rate year. That is, the

1 working capital requirement increases due to the increased expenses that must be paid
2 before the related revenue is received. The computation of the working capital allowance
3 for the adjusted pro forma results of operations is shown in my Schedule 2.3 Working
4 Cap column (D).

5 V. REVENUE REQUIREMENT

6 **Q. Exhibit DPK-03 also addresses SVWW's revenue requirement. Please describe how**
7 **the company's proposed revenue requirement was derived.**

8 A. The proposed revenue requirement was derived by adjusting the test year results of
9 operations for known and measurable changes in an effort to match future rate year
10 results to current revenues (Schedule 1.0). The cost of capital (Schedule 4.1) was then
11 multiplied by the company's rate base (Schedule 2.1) to provide the required operating
12 income. As shown on Schedule 1.0, the revenue shortfall is \$514,200 or 54 percent
13 comprising the overall revenue requirement request.

14 **Q. Summit View serves two classes of customers, could you please describe the two**
15 **classes and what makes their service different?**

16 A. The two classes of customers that Summit View serves are domestic class, which
17 represents residential customers where water is used for such things as laundry, cleaning,
18 home landscaping and consumption, whereas the second class represents irrigation
19 customers that use water solely for agricultural purposes. It should be noted here that
20 residential domestic customers' water usage is measured by water meters and their
21 monthly bills are computed based on the base charge and the amount of water used in the
22 period. This is in contrast to the company's irrigation customers whose water usage is not
23
24

1 measured but rather the customer pays a flat fee based on the acreage to be irrigated, plus
2 a base fee.

3 **Q. Did the company perform a cost-of-service study in this case?**

4 A. No.

5 **Q. Please explain why the company did not?**

6 A. The company did not perform a cost-of-service study because the cost of doing one
7 would further increase the ongoing attrition in costs confronting the company. The
8 company relied on the historical customer allocation (73 percent irrigation and 27 percent
9 domestic) previously determined by the Commission staff and Mr. Rathbun in the
10 company's 2018 case, (Docket UW-180801).
11

12 **Q. How was the revenue shortfall allocated between the two different customer classes?**

13 A. Using the historical allocation, the revenue shortfall is allocated to maintain a 27 percent
14 (for domestic customers) and 73 percent (for irrigation customers) spread. Since no major
15 changes to the customer base mix have occurred since the 2018 rate case, we continue to
16 use 27/73 percent calculation going forward and are confident this metric is reasonable
17 and accurate in spreading the revenue requirement between customer classes.
18

19 **VI. RATE DESIGN**

20 **Q. Please describe the company's proposed rate spread and its supporting exhibits.**

21 A. The company's proposed rate design is designed to collect the company's revenue
22 requirement. As mentioned above, the increased revenue is spread to the different
23 customer classes using the previous 73 percent / 27 percent separation. The proposed
24 rates and the supporting schedules are contained in my exhibit labeled DPK-04 - Usage
and Revenue Supporting Schedules which includes a rate phase-in supporting schedule.

1 **Q. Could you please expand on your Exhibit DPK-04, including its purpose and what**
2 **schedules it includes?**

3 A. Yes. DPK-04 is the main support for SVWW's rate design. It is made up of 14
4 interrelated supporting schedules reflecting the company's test year domestic water sales
5 reconciled to the company's pro forma financial statement. The exhibit is made up of the
6 following schedules:

- 7 • Schedule 5.0 - Proposed Rates and Revenue
 - 8 (a) Phase 1 Rates and Revenue
 - 9 (b) Phase 2 Rates and Revenue
- 10 • Schedule 5.1/5.2/5.3 – Current Revenue 3/4"/1"/IRR
- 11 • Schedule 6.1a/6.1b - Proposed Phase-In Revenue 3/4"
- 12 • Schedule 6.2a/6.2b - Proposed Phase-In Revenue 1"
- 13 • Schedule 6.3 - Proposed Revenue Irrigation
- 14 • Schedule 6.3 - Proposed Revenue Irrigation
- 15 • Schedule 7.1 - Bill Count revenue reconciliation to booked Revenue
- 16 • Schedule 7.2 - Cross-over Table for Metered Customers
- 17 • Schedule - 8.x - Bill Counts for 3/4" and 1" Metered Customers
- 18 • Schedule 9 - Schedule of Rates for Domestic Phase-in

19 I have also included three additional workpapers in the exhibit workbook. WP 1 reflects
20 the company's usage in gallons. WP 2 reflects the company's usage in cubic feet and
21 WP 3 shows the domestic meter readings for the test year.

22 **Q. Could you please discuss your proposal to phase in the rates for the domestic**
23 **residential users?**

24 A. Yes, due to the significant increase we are seeking, we are proposing to defer 35 percent
of the proposed increase until the following year. Schedule 9.0 of my Exhibit DPK-04

1 describes the proposal. Line 5 of Schedule 9.0 shows the increase in revenue requirement
2 associated with metered customers. Line 10 of Year 1 reflects a deferral of increased
3 revenue of 35 percent until Year 2. At the start of Year 2, the deferred amount would then
4 be added to rates, allowing the company to recover its full operating costs of providing
5 water to domestic customers.

6 **Q. Does this complete your testimony?**

7
8 A. Yes it does.