

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION  
OF ARTESIAN WASTEWATER  
MANAGEMENT, INC. FOR AUTHORITY  
TO INCREASE EXISTING RATES AND  
CHARGES FOR WASTEWATER SERVICE

PSC Docket No. 13-27WW

**REBUTTAL TESTIMONY  
OF  
DAVID L. VALCARENGHI  
ON BEHALF OF**

**ARTESIAN WASTEWATER MANAGEMENT, INC.**

Artesian Wastewater Management, Inc.  
664 Churchmans Road  
Newark, DE 19702  
Telephone: (302) 453-6900  
Facsimile: (302) 453-6957  
E-mail: [artesian@artesianwater.com](mailto:artesian@artesianwater.com)

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I. INTRODUCTION

1 Q. PLEASE STATE YOUR NAME.

2 A. My name is David L. Valcarenghi.

3 Q. ARE YOU THE SAME INDIVIDUAL THAT PREVIOUSLY PRESENTED DIRECT  
4 AND SUPPLEMENTAL TESTIMONY IN THIS PROCEEDING?

5 A. Yes, I am.

6 II. PURPOSE OF TESTIMONY

7 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

8 A. The purpose of my testimony is to rebut intervener testimonies submitted by the parties in  
9 this docket on June 17, 2013. Specifically, I will respond to the direct testimony of  
10 Howard J. Woods submitted on behalf of the Division of the Public Advocate (“DPA”);  
11 the direct testimonies of Vincent Ikwuagwu, Amy Woodward and Toni Loper submitted  
12 on behalf of the Staff of the Public Service Commission (“Staff”); and the direct  
13 testimony of Howard Klein submitted on behalf of the Stonewater Creek Homeowners  
14 Association (“HOA”).

15 Q. PLEASE INDICATE HOW YOUR TESTIMONY IS ORGANIZED.

16 A. I will rebut claims with regard to the development of Rate Base then discuss issues with  
17 respect to operating revenue, operating expenses, rate of return issues, and finally issues  
18 with respect to AWTMI’s operating tariff.

19 III. RATE BASE

20 Q. PLEASE SUMMARIZE THE POSITIONS OF THE PARTIES WITH RESPECT TO  
21 THE DEVELOPMENT OF RATE BASE.

1 A. DPA witness Woods agrees with the development of AWTMI's recommended rate base  
2 except with regard to the inclusion of Cash Working Capital ("CWC"). Staff witness  
3 Ikwuagwu recommends the Commission establish Rate Base premised on actual plant at  
4 the end of March 2013, but recommends that typical offsets to Rate Base such as  
5 Accumulated Depreciation and Contributions in Aid of Construction be valued at the  
6 projected level for June 2013- the end of the Test Period in this proceeding. Staff based  
7 its Rate Base solely on actual cost data available through the end of April 2013, but  
8 indicated a willingness to include additional data through the remainder of the Test  
9 Period ended June 2013 if actual data for that period is made available. Staff also  
10 endorses the inclusion of CWC in Rate Base based on the same methodology  
11 recommended by AWTMI. HOA witness Klein does not provide an overall  
12 recommendation with respect to the development of Rate Base but does assert his belief  
13 that AWTMI should not be entitled to CWC.

14 Q. DO YOU AGREE WITH THE POSITIONS ADVANCED BY THE INTERVENERS  
15 WITH RESPECT TO THE DEVELOPMENT OF AWTMI'S RATE BASE?

16 A. No. I will separately discuss my disagreements with the Rate Base advanced by each  
17 intervener.

18 Q. PLEASE DISCUSS YOUR DISAGREEMENTS WITH DPA'S OVERALL RATE  
19 BASE.

20 A. DPA and AWTMI are in agreement with respect to the development of Rate Base except  
21 in regard to the inclusion of CWC. DPA witness Woods asserts at page 15, line 3 of his  
22 testimony that AWTMI should not be entitled to include CWC in Rate Base because  
23 AWTMI bills for services in advance on a monthly cycle. The fact that AWTMI bills in

1 advance should not be an impediment to granting the Company the necessary cash  
2 resources it needs to conduct and carry out its business functions. There is always a  
3 delay in receiving payment from customers.

4 Q. HAVE THE CASH RESOURCES PROVIDED FROM OPERATIONS BEEN  
5 SUFFICIENT TO FUND AWTMI'S OPERATIONS?

6 A. No. In simplest terms cash receipts received from customers have been insufficient to  
7 fund AWTMI's ongoing operating expenses. The argument that billing in advance  
8 provides sufficient resources thereby negating a working capital requirement is belied by  
9 AWTMI's operating record. During the Test Year revenues from customers were clearly  
10 insufficient to fund operating expenses. Indeed, in each month of the Test Year operating  
11 expenses were greater than flat-rate revenues provided by customers. This is shown  
12 graphically in AWTMI Exhibit 5 attached to my testimony.

13 Operating Subsidy revenue was not reflected in this analysis because the future levels are  
14 unpredictable and there is often a considerable lag in receiving payment from developers.  
15 The Company's requested CWC allowance developed by including \$183,122 1/8 of  
16 operating expenses in Rate Base translates to a requirement of \$15,766 ( $183,122 \times 5.16\%$   
17  $\times 1.668541$ ). Revenues are not sufficient to fund all of AWTMI's operating costs, and it  
18 demonstrates the point that billing in advance does not negate the need for CWC. The  
19 Company funds this deficiency and should be entitled to a return on the funds advanced.

20 Q. HAS MR. WOODS CONSISTENTLY RECOMMENDED THE EXCLUSION OF CWC  
21 IN OTHER CASES?

22 A. No. In PSC Docket No. 11-329WW, a rate case involving Tidewater Environmental  
23 Services, Inc. ("TESI"), DPA witness Woods testified that it was appropriate to include

1 CWC in Rate Base and that it be developed according to the 1/8 method as a proxy for  
2 the appropriate amount of CWC to be included Rate Base. This is precisely the same  
3 approach used by AWTMI to develop CWC in this docket. TESI's tariff (AWMI Exhibit  
4 6) states that it, like AWTMI, bills in advance for flat-rate service. It is AWTMI's  
5 understanding that although TESI bills in this manner, a large majority of Milton  
6 customers are billed quarterly in arrears. This means a portion of the system is billed in  
7 advance just like AWTMI. Mr. Woods apparently believed the existence of a large  
8 contingent of quarterly billed customers was sufficient to justify the CWC at the amount  
9 recommended by TESI. In any event, regardless of the billing procedures TESI's  
10 operating expenses significantly outstripped revenues received from customers.

11 Q. IN YOUR OPINION SHOULD CWC BE INCLUDED IN RATE BASE?

12 A. Yes. CWC enables the funding of operations in the short-term. Both AWTMI and TESI  
13 are similarly situated utilities in terms of size and operations and should be treated  
14 similarly for ratemaking purposes. The DPA surmises that the existence of billing in  
15 advance negates the need for CWC, but the fact remains that AWTMI's operating expenses  
16 are sufficiently greater than revenues which warrants the inclusion of CWC in Rate Base.  
17 It should be pointed out that while bills may be rendered in advance customers rarely if  
18 ever pay in advance. The lead/lag is a measurement of the lag in cash between the time  
19 services are rendered and when payment is received from the customer rather than billed  
20 and it is entirely appropriate for a company the size of AWTMI to use the 1/8<sup>th</sup> method. At  
21 the end of the day, the Company pre-funds the day to day responsibilities of the business  
22 until it receives payment from customers. Although the revenue requirement includes  
23 developer revenues, there is a significant delay in receiving cash receipts from

1 developers. If the Company calculated the lag in receipt of payment associated with the  
2 operating subsidiaries, which fund better than 50% of operating expenses, the resulting  
3 CWC would increase significantly and would provide ample support for the modest  
4 CWC request sought by AWMI in this proceeding. To suggest this value is zero is just  
5 not reasonable. During the Test Year, AWMI's operating costs were clearly larger than  
6 the revenues received from customers.

7 Q. DOES HOA WITNESS KLEIN ALSO RECOMMEND THE EXCLUSION OF CWC  
8 FROM RATE BASE?

9 A. Yes, HOA witness Klein also proffers to exclude CWC from Rate Base due to advance  
10 billing. For the same reasons discussed above, the HOA's proposal should also be  
11 rejected.

12 Q. WHAT DOES AWMI RECOMMEND WITH RESPECT TO CWC?

13 A. AWMI respectfully requests that the Commission reject proposals by DPA and HOA to  
14 exclude CWC from AWMI's Rate Base. Specifically, AWMI recommends that it be  
15 authorized to include \$183,122 of CWC in Rate Base calculated according to the 1/8  
16 proxy method.

17 Q. ARE THERE OTHER DISAGREEMENTS WITH RESPECT TO THE  
18 DEVELOPMENT OF AWMI'S RATE BASE?

19 A. Yes. Staff has proffered an alternative calculation of Rate Base wherein the assets (plant)  
20 are valued based on the balance at the end of March 2013, but traditional offsets to Rate  
21 Base, such as Accumulated Depreciation and Contributions in Aid of Construction, are  
22 valued based on the projected balance at the end of June 2013, a full three months beyond  
23 the period used to value assets. Ratemaking principles require that the assets and related

1 offsets be valued from the same period. Staff's unsound approach should be rejected for  
2 several reasons. First and most foremost, each component in Rate Base must be valued  
3 from the same period to avoid a calculated Rate Base that can be seen as either too low or  
4 too high. In the case at hand, a Rate Base developed with a greater level of offsets  
5 produces a lower rate base which is inequitable for AWMI and necessarily amounts to  
6 taking without just compensation. Not only is the Staff methodology flawed because it  
7 seeks to use data from two different periods, it fails to consider the law and applicable  
8 regulations approved for use by the Commission. AWMI developed its presentation in  
9 accordance with the Delaware Administrative Code. The minimum filing requirements  
10 set forth in Paragraph 1.2.2 of Section 1002 Part A allows a utility to utilize a test period  
11 consisting of not more than nine months of projected data. In this proceeding, AWMI  
12 developed its recommended Rate Base in accordance with these prescribed regulations  
13 and utilized data consistent with the Test Period that ended June 2013, which is 9 months  
14 after the end of the September 2012 Test Year.

15 Q. HAVE PROPOSED CAPITAL PROJECTS BEEN COMPLETED?

16 A. Yes. The proposed capital projects, outlined on Exhibit 3, Schedule 2A of my  
17 Supplemental testimony, were complete as of the end June 2013. A final tally of the  
18 costs for these projects is not yet available since June is still open, but can be made  
19 available when that information becomes known.

20 Q. PLEASE STATE AWMI'S OVERALL RATE BASE RECOMMENDATIONS.

21 A. AWMI recommends the Commission authorize the use of a \$4.4 million Rate Base  
22 consistent with the 12-month period ended June 2013. Specifically, AWMI recommends  
23 the Commission develop Rate Base as follows:

1	Plant in Service	\$19,596,475
2	Accumulated Depreciation	(1,942,854)
3	Customer Advances	(563,910)
4	CIAC	( 11,685,736)
5	Deferred Income Taxes	(1,190,879)
6	CWC	<u>183,122</u>
7	Rate Base	\$4,396,218

8 AWMI recommends the Commission reject Staff’s methodology for developing Rate  
9 Base for the reasons outlined above. Additionally, AWMI recommends the Commission  
10 reject the HOA and DPA attempts to exclude CWC and incorporate this component in  
11 Rate Base at the level cited above.

12 IV. OPERATING REVENUES

13 Q. PLEASE DISCUSS INTERVENER POSITIONS WITH RESPECT TO OPERATING  
14 REVENUES.

15 A. Operating revenues include both Flat-Rate and Operating Subsidy revenues. Flat-rate  
16 revenues reflect payments from customers for the provision of wastewater service from  
17 AWMI; Operating Subsidies reflect contractual amounts received from developers in  
18 regard to housing starts in specific wastewater communities. Interveners have made  
19 separate adjustments to each revenue group, which I will discuss below.

20 Q. PLEASE DISCUSS HOW DPA AND STAFF DEVELOP THEIR RECOMMENDED  
21 FLAT-RATE REVENUES.

22 A. DPA and Staff base Flat-Rate revenues on 14,016 annualized equivalent dwelling units  
23 (“EDUs”) as set forth in Schedule 6 of my Supplemental Testimony. This annualized

1 EDU level translates to a revenue level of \$1,051,200, which is approximately \$33,863  
2 greater than the level advanced by AWTMI (see Exhibit 3, Schedule 3A page 1) in my  
3 Supplemental Testimony.

4 Q. DO YOU CONCUR WITH THE LEVEL OF FLAT-RATE REVENUES  
5 RECOMMENDED BY THE INTERVENERS?

6 A. Yes. The proper level of flat-rate revenues that should be used in setting rates is  
7 \$1,051,200. AWTMI discovered an error in its adjustment to annualize Flat-Rate revenues  
8 that duplicates the removal of revenues associated with the transfer of the Villages of  
9 Herring Creek.

10 Q. WHILE THE INTERVENERS REFLECT FLAT-RATE REVENUE THAT INCLUDES  
11 CUSTOMER GROWTH DO THEY ALSO REFLECT ADDITIONAL EXPENSES  
12 NECESSARY TO SERVE THESE CUSTOMERS?

13 A. No. AWTMI Flat-Rate revenues were developed based on 985 customers at the end of  
14 September 2012 plus the addition of 110 customers expected to connect through the end  
15 of the Test Period for a total of 1,095 customers. Indeed, Flat-Rate revenues were  
16 specifically increased by \$99,000 (110 x \$75 x 12) to reflect the additional revenue  
17 associated with the addition of 110 customers to the system. At the same time there are  
18 costs associated with serving new customers. AWTMI recognized and specifically  
19 included an operating expense adjustment of \$15,058 (see Exhibit 3, Schedule 3B, page  
20 15) to account for the expected costs necessary to serve the new customers. The DPA's  
21 normalized expenses do not appear to address in any specific manner the cost of serving  
22 these new customers. In AWTMI's view this presents an unbalanced approach that is  
23 inequitable.

1 Q. DO THE INTERVENERS RECOMMEND ADJUSTMENTS TO OPERATING  
2 SUBSIDY REVENUES?

3 A. Yes. DPA witness Woods develops an average level of Operating Subsidy revenues  
4 calculated based on a rolling 12-month balance of data for the 7-month period ended  
5 March 2013. Mr. Woods does not present sufficient justification for normalizing or the  
6 manner in which normalized revenues were developed. Operating Subsidy revenues are  
7 received pursuant to contract and reconciled on a calendar year basis. Therefore, actual  
8 Operating Subsidy revenues at year end provide the best measure of subsidy revenue for  
9 any year. Mr. Woods proffers a normalized level of Operating Subsidy revenue of  
10 \$773,375 in his initial direct testimony, which was subsequently adjusted downward to  
11 \$748,610 due to a calculation error (see Woods revised Exhibit HJW-2). Mr. Woods'  
12 attempt to present a normalized level of Operating Subsidy revenue resulted in an  
13 adjustment of \$53,052, based on his recommended level of \$798,139 in operating subsidy  
14 revenue. However, since Mr. Woods adjusted his recommended level of Operating  
15 Subsidy revenue down to \$773,375 his adjustment should be reduced accordingly to  
16 \$28,288, which is the net of Mr. Woods' position of \$773,375 and AWTMI's pro forma  
17 level of \$745,087 (see AWTMI Exhibit 3, Schedule 3, page 3).

18 Q. DO YOU CONCUR WITH THE LEVEL OF OPERATING SUBSIDY REVENUE  
19 RECOMMENDED BY THE DPA?

20 A. No. I disagree for several reasons. As indicated above, Mr. Woods presents a  
21 normalized level based on rolling 12 month data for the 7 months ended March 2013.  
22 Mr. Woods presented no rationale for calculating Operating Subsidy revenue on an  
23 average basis, let alone an average based on the 7 month period ended March 2013. Not

1 only are Subsidy revenues contractual, but the assumption that they can be readily  
2 extended is unfounded and definitely strains the known and measureable concept. It is  
3 neither known nor certain that AWTMI will be successful in extending developer contracts  
4 once they have terminated. The continued inclusion of revenue from contracts that have  
5 terminated is inequitable to AWTMI and should be rejected in the development of rates.  
6 AWTMI presented actual Operating Subsidy revenues based on contractual commitments  
7 with developers adjusted for known and measureable events. In fact, AWTMI reflected a  
8 reduction in Operating Subsidies of \$60,062 as the net effect of the projected Operating  
9 Subsidy revenues to be realized through the end of the Test Period.

10 Q. DOES DPA'S NORMALIZATION OF OPERATING SUBSIDIES REFLECT THE  
11 CESSATION OF CONTRACTS WHERE OPERATION SUBSIDY PAYMENTS  
12 HAVE TERMINATED?

13 A. No. Pursuant to contracts, previously provided to the parties, developers are required to  
14 provide AWTMI a negotiated level of revenue based on a specified level of housing starts  
15 over a required term. Once AWTMI has received the agreed upon level of revenue from  
16 the contract the Operating Subsidy revenue ceases. In December 2012, the developer of  
17 the Oakwood Village community satisfied the performance commitments in the  
18 Oakwood Village Developer agreement; hence AWTMI will not realize revenue pursuant  
19 to this particular contract or agreement in the future.

20 Q. HAS THE DPA SOUGHT TO ADJUST THE OPERATING SUBSIDY REVENUES  
21 FOR CONTRACTS THAT WILL NO LONGER BE PROVIDING REVENUES TO  
22 AWTMI?

1 A. No. The DPA made no attempt to remove revenues for agreements where the developer  
2 has satisfied his performance commitments. A review of Woods revised Exhibit HJW-2  
3 shows he continued to reflect revenues from Oakwood Village in the development of his  
4 “normalized” Operating Subsidy revenues. When the non-recurring revenues are  
5 removed from Mr. Woods’ calculation, it produces a normalized Operating Subsidy of  
6 \$698,526 (see AWTMI Exhibit 7) which is \$50,084 lower than Mr. Woods’ revised level  
7 of \$748,610 and \$9,636 lower than the \$708,162 level recommended by AWTMI (see  
8 AWTMI Exhibit 3, Schedule 3, page 3). For the reasons cited, AWTMI recommends the  
9 Commission reject DPA’s normalization adjustment and utilize the Company’s level of  
10 Operating Subsidy revenues in the development of the revenue requirement in this  
11 proceeding.

12 Q. ARE THERE OTHER REASONS TO REJECT DPA’S ADJUSTMENT TO  
13 NORMALIZE OPERATING SUBSIDY REVENUE?

14 A. At page 7, lines 7 through 14, of Mr. Woods’ direct testimony he appears to proffer the  
15 notion that Operating Subsidy revenue can be counted on to mitigate the revenue  
16 requirement in future proceedings. He makes this assertion based on his viewpoint that  
17 AWTMI is serving only a small portion of the customers expected when the system is  
18 built-out. He proffers the illogical and unsupported assertion that although many of the  
19 developer agreements will expire in the years ahead that it would be reasonable to expect  
20 that developers will negotiate extensions warranting a continuance of Operating Subsidy  
21 revenues to be realized by AWTMI. Once a developer has achieved the level of  
22 performance required by their contract with AWTMI, Operating Subsidy payments  
23 terminate causing a decline in utility operating revenues. There can be no certainty



1 Services and Rate Case Expenses. I will discuss each of the alternate calculations and  
2 statements regarding AWTMI's operating expenses separately below. It should be noted  
3 that the absence of discussion about a specific point or issue does not necessarily mean  
4 that AWTMI concurs.

5 Q. WHAT LEVEL OF OPERATING EXPENSES DO THE INTERVENERS  
6 RECOMMEND?

7 A. DPA recommends operating expenses of \$1,332,003 (Woods Exhibit HJW-3), which is  
8 \$94,999 lower than the \$1,427,002 (AWMI Exhibit 3, Schedule 3, page 3) recommended  
9 by AWTMI. It is unclear what amount is recommended by Staff. Staff witness Amy  
10 Woodward proffers \$77,867 (Woodward Schedule AJW-1) in operating expense  
11 adjustments, but Staff witness Ikwuagwu reflected \$79,588 (Ikwuagwu VOI Exhibit 3,  
12 Schedule 2) in operating expense adjustments in his revenue requirement. Deducting Ms.  
13 Woodward's recommended adjustments of \$77,867 from AWTMI's pro forma level of  
14 \$1,427,002 results in a pro forma level of operating expenses of \$1,349,135. However, if  
15 the amount reflected in Mr. Ikwuagwu's testimony is deducted a pro forma level of  
16 \$1,347,414 results. It should also be noted that DPA, and to a lesser extent Staff, seek to  
17 normalize expenses as a standard operating practice without regard to what levels  
18 transpired or what expenses are expected in the near term.

19 Q. PLEASE DISCUSS THE DPA'S APPROACH TO DEVELOPING ITS  
20 RECOMMENDED LEVEL OF OPERATING EXPENSES.

21 A. The DPA presents an alternate amount for each expense component in AWTMI's cost of  
22 service primarily by utilizing a median level based on actual costs incurred during the  
23 period 2009 through 2012 and the expected costs to be incurred through the end of the

1 Test Period ended June, 2013. In some instances, Mr. Woods disregarded the median  
2 level altogether and utilized either a calculated amount or another amount that in his view  
3 represented an appropriate amount for the Test Period. Mr. Woods' recommended  
4 approach results in a \$94,999 reduction to the \$1,427,002 level presented by AWMI (see  
5 AWMI Exhibit 8).

6 Q. DO YOU AGREE WITH THE EXPENSE LEVEL RECOMMENDED BY THE DPA?

7 A. No. I disagree with the approach proffered by Mr. Woods. He opines that because  
8 AWMI is a small company with a small base of customers that it is appropriate to  
9 normalize expenses because periodic fluctuations can be a significant challenge in setting  
10 rates. This median value represents the "middle value" of costs over the 2009 to 2012  
11 timeframe and actual costs incurred through April 2013. Mr. Woods provides no  
12 rationale for reflecting expenses based on median values over a periodic range. Mr.  
13 Woods does not indicate in any manner that expense levels incurred by AWMI during  
14 Test Year or Test Period are inappropriate. A higher level of expense does not in and of  
15 itself signify the expenses are inappropriate. In the area of Payroll expenses, Mr. Woods  
16 selected a value of \$518,267, which represents the actual costs incurred in the Test Year.

17 Q. WHY IS THIS INAPPROPRIATE?

18 A. Mr. Woods' approach grants AWMI payroll expenses based on actual costs incurred in  
19 the Test Year without regard to the 3% wage increase granted in December 2012 by the  
20 affiliated organizations that AWMI uses for labor. Failure to factor the wage increase  
21 into pro forma payroll costs ensures that AWMI will not have an opportunity to earn an  
22 acceptable return because costs built into rates will be lower than costs AWMI is likely to  
23 see in the rate effective period. AWMI reflected an adjustment of \$16,737 to recognize

1 the added costs it will realize through the use of the affiliated labor. Additionally, the  
2 level recommended by DPA is lower than the actual costs of \$532,555 incurred for the  
3 12-month period ended April 2013 and lower than the \$535,004 AWMI projected for the  
4 Test Period.

5 Q. IS MR. WOODS CONSISTENT WITH REGARD TO LABOR-RELATED COSTS?

6 A. No. In the area of benefit costs, Mr. Woods reflected actual costs incurred at April 2013  
7 of \$207,499. Mr. Woods, apparently mindful that benefit costs are rising, decided to  
8 disregard his median approach, reflecting an amount in line with costs DPA believes  
9 AWMI is likely to experience in the near term. This amount is still \$9,170 lower than the  
10 \$216,669 level sought by AWMI. AWMI reflected an amount that is representative of a  
11 conservative 8% increase to costs incurred in the Test Year. Benefits costs for AWMI  
12 are largely a function of labor costs incurred. It is not reasonable for Mr. Woods to  
13 reflect increased costs in the area of benefits but not for the actual cost of labor itself.  
14 AWMI believes its recommended level of labor and benefit costs (shown on AWMI  
15 Exhibit 8) reflect a reasonable level of costs that should be reflected in the development  
16 of the revenue requirement.

17 Q. PLEASE INDICATE HOW LABOR-RELATED CHARGES ARE ASSIGNED TO  
18 AWMI.

19 A. AWMI relies on personnel from affiliated entities to handle the day to day functions and  
20 is charged directly based on the time involved in such activities. In addition, AWMI is  
21 also allocated charges for labor based on an approved cost allocation manual. The use of  
22 affiliate labor allows AWMI the capability of relying on experienced, qualified personnel  
23 at a fraction of the cost. If AWMI had to fund the entire cost of the labor it relies upon,

1 its expenses would be considerably larger. HOA witness Klein's argument that AWMI is  
2 not entitled to payroll costs because it has no employees is simply an unreasonable  
3 position and should be rejected.

4 Q. DOES STAFF PRESENT ALTERNATIVE CALCULATIONS WITH RESPECT TO  
5 LABOR AND BENEFITS?

6 A. Yes. Staff witness Woodward calculates an average level of payroll and benefit costs  
7 based on actual costs incurred in 2010, the Test Year and for the year ended 2012. Ms.  
8 Woodward's prepared adjustments reflect a downward adjustment of \$6,107- \$2,703 for  
9 payroll and \$3,404 for benefits.

10 Q. DO YOU AGREE WITH THE LEVEL PROFFERED BY THE STAFF?

11 A. No. Ms. Woodward's calculated averages fail to consider data in 2009 and 2011 as she  
12 deemed that data to be either too high or low; however Ms. Woodward does not establish  
13 why these expenses need to be normalized. Ms. Woodward's calculated average ignores  
14 the rising level of costs for both expense components. As of April 2013 AWMI's actual  
15 labor and benefits costs were \$532,555 and \$207,499, respectively. For labor and  
16 benefits, Ms. Woodward reflected \$515,564 and \$197,215, respectively. Ms.  
17 Woodward's calculated averages fail to consider the impact of a wage increase granted in  
18 December 2012. The wage increase is known and certain and should be factored into  
19 AWMI's pro forma costs. DPA witness Woods was so concerned about the rising costs  
20 of benefits he recommended that the actual costs as of April 2013 of \$207,499 be used  
21 for ratemaking. Ms. Woodward's prepared average is approximately \$10,000 below the  
22 level recommended by the DPA. Ms. Woodward simply fails to acknowledge that  
23 AWMI's costs are rising and have risen consistently over the period she analyzed. In

1 addition, an average over the period simply does not consider the labor requirements  
2 necessitated by a growing system or increasing requirements placed upon the system  
3 from more customers or more testing requirements.

4 Q. DO YOU AGREE WITH THE LEVEL OF PURCHASED POWER COSTS  
5 REFLECTED BY THE DPA?

6 A. No. DPA witness Woods presents a calculated amount for this expense component by  
7 developing a linear relationship between customers, rainfall, and purchased power costs  
8 as stated at page 12, line 6 of his testimony. Based on the assumed linear relationship  
9 between these items, Mr. Woods calculates that \$72,960 is an acceptable level for this  
10 cost component. Mr. Woods presents no information to support the reasonableness of  
11 this stated level of expense or that a causal relationship exists between the components he  
12 attempted to develop an estimate with or upon. Additionally, Mr. Woods' estimated  
13 expense, based on 1,095 customers, reflects a lower level of expense than the \$74,543 of  
14 actual costs incurred in 2011 when the Company was serving 981 customers. AWTMI's  
15 \$84,955 expense level reflects an expected \$21,205 increase in the costs of electric  
16 energy and propane costs necessary to serve current customers. The Company also  
17 reflected an additional \$6,863 of costs necessary to service 110 customers that were  
18 added in the cost of service. There are costs associated with connecting customers to the  
19 system. The Company believes its recommended level of costs is reasonable. For the  
20 reasons cited, the level of purchased power costs recommended by DPA witness Woods  
21 is unreasonable and should be rejected. The Commission should include \$84,955 in  
22 purchased power costs in the development of the revenue requirement.

1 Q. DID THE DPA USE THE MEDIAN APPROACH FOR THE REMAINDER OF ITS  
2 EXPENSE ADJUSTMENTS?

3 A. The DPA used this methodology for each expense component except for the calculated  
4 level of Administrative & General Costs. Mr. Woods use of the median approach results  
5 in a pro forma level of \$64,622 in Sludge Removal costs, the actual level incurred in the  
6 Test Year. This level is lower than actual costs incurred in 2010 and 2011 of \$64,796  
7 and \$72,726, respectively. Again, AWMI's recommended expense level includes an  
8 adjustment of \$7,216, which is precipitated by the expected addition of 110 customers to  
9 the system. The DPA's recommended expense does not appear to account for the  
10 additional costs the Company will bear resulting from the addition of new customers; the  
11 DPA simply offered a level based on historic activity.

12 In the area of Materials & Supplies, DPA witness Woods recommends the Commission  
13 incorporate \$22,155 for Materials and Supplies based on the actual costs incurred in  
14 2009. AWMI has recommended a level \$16,910, which is actually lower than the costs  
15 incurred in the years ended 2011 and 2012 or actual costs of \$30,117 incurred for the  
16 period ended April 2013. DPA's recommended level is supportive of the amount actually  
17 recommended by AWMI. AWMI recommends that rates be established based on  
18 \$16,910 in Materials & Supplies costs.

19 In the area of Customer Accounts, Mr. Woods recommends the use of actual costs  
20 incurred in the Test Year of \$25,589. AWMI reflected a total of \$26,101, which reflects  
21 the Test Year level of \$25,589 plus a small adjustment of \$512. AWMI's projected level  
22 of \$26,101 is \$1 greater than actual costs incurred in 2012. AWMI therefore  
23 recommends that rates be set based on AWMI's pro forma costs of \$26,101.

1 In the area of Transportation costs, Mr. Woods recommends a total of \$80,144, the actual  
2 costs incurred in the Test Year, be used to set rates. AWTMI recommended a pro forma  
3 level of \$79,939 in costs in this area developed by reducing Test Year costs of \$80,144  
4 by \$206. The level recommended by the DPA is supportive of the pro forma level  
5 recommended by AWTMI; therefore the level recommended by AWTMI should be used for  
6 ratemaking purposes.

7 Q. PLEASE DISCUSS ADJUSTMENTS PROFFERED BY DPA AND STAFF FOR  
8 CHEMICAL COSTS.

9 A. DPA witness Woods recommends a level of \$8,075 for chemical costs based on actual  
10 costs as of April 2013. AWTMI's actual costs were \$8,765 in the Test Year and \$8,375 in  
11 2011. The DPA's recommendation reflects a lower level than the historic activity.  
12 AWTMI included a total of \$9,744, which is \$979 greater than the amount realized in the  
13 Test Year. The conservative adjustment is intended to reflect additional expenses  
14 associated with the cost of serving new customers. Staff, on the other hand, developed an  
15 average level of Chemical costs of \$6,197, which is \$2,568 lower than the actual costs  
16 incurred in the Test Year. Staff provides no support for normalizing this expense  
17 component or the averaging methodology used for this particular expense component.  
18 For this expense Staff attempted to normalize costs by averaging costs incurred during  
19 the years ended 2009 through 2012 and the Test Year, which is fundamentally different  
20 than its approach for the labor-related adjustments it sponsors. In the case of labor-  
21 related expenses, Staff sought to develop an adjustment that removed high and low  
22 balances experienced over the period 2009 through 2012. Indeed, Staff's normalization  
23 for labor-related expenses excluded data for the years 2009 and 2011 because, in Staff's

1 view, the costs were deemed either too high or too low. Staff's averaging technique used  
2 for Chemical costs did not seek to exclude costs that could be seen as either high or low,  
3 in fact a simple average for the entire period was used. Staff has not expressed why the  
4 different approach is necessary, or for that matter, why it's recommended level of \$6,197  
5 is a reasonable level given AWMI's actual costs. AWMI recommends the Commission  
6 reject the recommendations of the DPA and Staff in regard to Chemical costs and set  
7 rates based on a level of \$9,744 as recommended by AWMI.

8 Q. PLEASE DISCUSS DPA'S ADJUSTMENT TO OTHER COSTS.

9 A. DPA witness Woods recommends the inclusion of \$43,670 in Other costs, based on the  
10 actual level experienced in 2010. This level is \$21,131 lower than the \$64,801 in actual  
11 costs incurred for the period ended April 2013. AWMI's recommended level of \$48,184  
12 was developed by adjusting the Test Year expense of \$36,154 to include an additional  
13 \$12,030 in adjustments primarily to incorporate additional costs for safety-related  
14 endeavors and process controls, which were discussed in my direct testimony. Indeed,  
15 AWMI reflected an adjustment of \$5,000 for increase in Process Control costs and  
16 \$6,000 for the cost of Safety Measures (AWMI Exhibit 3, Schedule 3B, pages 14 and  
17 16). These additional expense components are completely ignored in Mr. Woods'  
18 analysis. AWMI recommends that Other costs of \$48,184 be used to set rates in this  
19 proceeding.

20 Q. PLEASE DISCUSS POSITIONS RELATED TO THE LEVEL OF CONTRACTUAL  
21 SERVICES.

22 A. AWMI has recommended a total of \$124,455 in Contractual Services be used in setting  
23 rates. This recommended level is determined by reducing the Test Year balance of

1 \$144,093 by several operating adjustments that total \$19,637. Staff witness Woodward  
2 recommends a total of \$140,565 for Contractual Services, the 5-year average of costs  
3 incurred through the end of 2012. Based on her calculated average, Ms. Woodward  
4 recommends an adjustment of \$3,528 to AWTMI's operating expenses, the net of her  
5 recommended level of \$140,565 and \$144,093 incurred in the Test Year. This would be  
6 appropriate if AWTMI were recommending the Test Year level be used for setting rates. It  
7 is not. The development of AWTMI's recommended level of expenses is shown on  
8 AWTMI Exhibit 8. There is absolutely no basis or logic to Ms. Woodward's  
9 recommended adjustment and therefore it should be rejected. On the other hand DPA  
10 reviewed the historic activity in this area and recommends a total of \$126,527 be utilized  
11 for ratemaking, the actual costs incurred in 2010. Although this level is lower than actual  
12 costs incurred in 2011, 2012, the Test Year, and for the period ended April 2013, it is  
13 greater than AWTMI's recommended pro forma costs of \$124,455. AWTMI recommends  
14 that rates be set based on AWTMI's pro forma operating expenses in this area.

15 Q. PLEASE DISCUSS POSITIONS RELATED TO ADMINISTRATIVE AND GENERAL  
16 COSTS.

17 A. Both DPA and Staff develop recommended positions with respect to a pro forma level of  
18 Administrative & General ("A&G") costs. DPA presents a normalized level through the  
19 use of its median approach and then adds an amount for the recovery of rate case  
20 expenses. Staff does not take issue with the level of A&G costs presented by AWTMI;  
21 Staff's adjustment in this area relates solely to the recovery of rate case expenses. DPA  
22 witness Woods recommends a total for A&G of \$146,020, based on the actual costs  
23 incurred in 2010. This level is lower than actual costs of \$176,475 and \$150,737 incurred

1 respectively in 2011 and 2012, and \$171,456 in the Test Year. AWTMI submits the 2010  
2 level is clearly below actual activity that has transpired and therefore does not represent a  
3 viable nor reasonable level that can be used for ratemaking purposes. AWTMI  
4 recommended a total of \$213,204, based on a Test Year level of \$171,456 and \$41,748 in  
5 adjustments. The recovery of rate case costs represents a significant portion of AWTMI's  
6 prepared adjustments in this area. AWTMI included an estimate of \$57,950 (see AWTMI  
7 Exhibit 3, Schedule 3B, page 9) in costs expected to be incurred in litigating this case  
8 with a two-year amortization period. DPA concurs with AWTMI's costs and recovery  
9 period, except in regard to the expected level for Intervener Consultant costs. AWTMI  
10 provided an estimate of \$40,000 (see Exhibit 3, Schedule 3B, page 9) for this component;  
11 DPA provided an estimate of \$15,000. Mr. Woods indicates the \$15,000 level is  
12 sufficient to cover his time should this case progress to full litigation. However, the level  
13 does not reflect any costs with respect to costs billed by the Staff. To date, AWTMI has  
14 been billed a total of \$11,771.83 from the Delaware PSC for Staff's work in Docket 13-  
15 27WW. Staff's response to AWTMI Data Request 1-7 notes there is a ceiling of \$16,609  
16 with regard to billable charges pursuant to this docket. Copies of costs invoiced and  
17 Staff's response to AWTMI Data Request No. 1-7 are provided in AWTMI Exhibit 9.  
18 Given billings to date, the use of \$16,609 for charges billed by the Staff is appropriate.  
19 When Staff charges of \$16,609 are combined with DPA charges of \$15,000 it results in  
20 total Intervener Costs of \$31,609, which are \$8,391 less than the \$40,000 originally  
21 estimated by AWTMI and results in total rate case costs of \$49,559 (\$57,950 - \$8,391).  
22 Amortizing the costs over a two-year period results in an annual amortization of \$24,780.  
23 Staff witness Woodward prepared an adjustment that removes \$25,000 from the level of

1 AWTMI's rate case costs under the assumption that the Staff did not retain a consultant.  
2 Ms. Woodward's prepared adjustment fails for several reasons. The adjustment does not  
3 consider costs billed to AWTMI for Staff's work in this docket, and she mysteriously  
4 increases AWTMI's recommended costs from \$40,000 to \$45,000 and fails to consider that  
5 the costs should be amortized over a two year period. For the reasons cited, Ms.  
6 Woodward's adjustment should be completely rejected.

7 Q. PLEASE DISCUSS THE ISSUE OF LAND RENT.

8 A. Land Rental charges were inadvertently included in AWTMI's original revenue  
9 requirement submission. However AWTMI's prepared Supplemental testimony presented  
10 an adjustment to remove \$40,665 in Land Rental charges incurred during the Test Year.  
11 Both Staff and DPA appear to be in agreement that these charges should not be  
12 considered in the development of the revenue requirement. Staff witness Woodward  
13 reflected a total of \$77,867, including an adjustment for Land Rental charges, (see  
14 Woodward Schedule AJW-1) in operating expense adjustments that are deducted from  
15 AWTMI's pro forma level of operating expenses of \$1,427,002 to derive Staff's pro forma  
16 operating expenses of \$1,349,135 (see Ikwuagwu Exhibit 3, Schedule 2). A review of  
17 AWTMI Supplemental Exhibit 3, Schedule 3B, page 4 shows that AWTMI included an  
18 adjustment for \$40,665 to properly remove these charges from the Test Year. Stated  
19 differently, Staff's recommended adjustment is duplicative of the prepared adjustment  
20 proffered by AWTMI and should therefore be rejected.

## 21 VI. RATE OF RETURN

22 Q. DO THE INTERVENERS PRESENT ISSUES WITH RESPECT TO AWTMI'S  
23 REQUESTED RATE OF RETURN?

1 A. DPA, Staff and HOA witness Klein take issue with the rate of return proffered by  
2 AWMI. To summarize, AWMI requested an overall rate of return of 5.16% which  
3 incorporates a 10.0% return on common equity. The sole issue among the parties appears  
4 to be the level of return on common equity that should be afforded AWMI as  
5 compensation for the risks incurred as a wastewater utility. No arguments were raised  
6 with respect to the capital structure or the weighted cost of debt.

7 Q. PLEASE DISCUSS THE RANGE OF RETURNS ON EQUITY PROFFERED BY THE  
8 INTERVENERS.

9 A. DPA witness Woods advocates the use of 9.75% return on equity, Staff witness  
10 Ikwuagwu recommends a 7.81% return on equity, and HOA witness Klein asserts that a  
11 7.30% return is compensatory.

12 Q. DO YOU AGREE WITH THE RANGES PROFFERED BY THE INTERVENERS?

13 A. No. HOA witness Klein's use of a 7.30% return on equity is wholly inadequate. Mr.  
14 Klein states in response to AWMI Data Request No. 1-4 to HOA (see AWMI Exhibit 10)  
15 that a return level of 7.30% is in line with water industry averages. Not only does Mr.  
16 Klein fail to offer any supporting information to buttress this point, but it bears  
17 mentioning that AWMI is a wastewater utility. A wastewater utility is a much riskier  
18 business as evidenced by the larger amount of capital needed for the operations. Indeed,  
19 a wastewater utility not managed properly becomes a health hazard. Mr. Klein's  
20 recommended return level is inconsistent with the business risks faced by AWMI and  
21 should be rejected. Staff witness Ikwuagwu invents a new methodology for determining  
22 the return on equity. Staff witness Ikwuagwu's approach limits the equity return to the  
23 average return earned for the 5 years ended 2012 based on the actual earnings of Artesian

1 Resources Corporation (“ARC”), the parent organization of AWTI. Indeed, equity  
2 returns based solely on actual earnings would institutionalize regulatory lag and cause a  
3 death spiral for the utility. Staff’s novel approach is not supported by logic or precedent  
4 and should therefore be rejected. DPA witness Woods, as noted above, reflects a 9.75%  
5 return on equity. Mr. Woods recommended a 10.0% return on equity in TESI Docket  
6 No. 11-329WW. Although Mr. Woods filed his testimony in early 2012, the parties in  
7 that particular docket were successful in resolving that case toward the end of 2012. In  
8 AWTI’s view there is sufficient closeness in the timing of the two cases to warrant  
9 granting AWTI the same return on equity. To be clear, AWTI and TESI are both  
10 wastewater utilities, of similar size and business risk. DPA witness Woods indicates the  
11 9.75% return on equity is more indicative of the prevailing returns that have been granted  
12 by the Delaware Public Service Commission. DPA states in response to AWTI Data  
13 Request 1-8 (see AWTI Exhibit 11) that Tidewater Utilities, Inc. (“Tidewater”) Docket  
14 No. 11-397 and Delmarva Power & Light Company (“Delmarva”) Docket No. 11-528 are  
15 important cases that are illustrative of the Commission’s general thinking with respect to  
16 the return on common equity. To be clear, neither of the cited cases are wastewater  
17 utilities. Delmarva is an electric utility, and Tidewater is a water utility. AWTI is a  
18 much smaller entity than Tidewater and extremely smaller in comparison to Delmarva  
19 and therefore has a greater level of business risk. A review of case literature for both of  
20 these dockets indicates they were resolved in 2012, Delmarva’s toward the end of 2012  
21 and the Tidewater case in May 2012. AWTI premised its return on common equity in  
22 this docket based on the 10.0% return authorized for TESI in Docket 11-329WW. At the  
23 time AWTI filed its case in this docket that TESI case represented the last decision for a

1 wastewater utility. However, a proposed settlement in TESI Docket No. 12-497/8  
2 indicates the parties have discussed granting TESI a 10.0% return on equity. This  
3 settlement appears to be supported by all groups except a customer group. Testimony  
4 proffered by Mr. Woods in that docket in April 2013 indicates he was supportive of  
5 maintaining a 10.0% return on equity for TESI approved by the Commission in 11-  
6 329WW. Mr. Woods' recommendation of a 9.75% return on equity in this docket is  
7 inconsistent with the recommendation he made 2 months earlier in TESI docket No. 12-  
8 497/8. AWTMI reiterates the point that it should be afforded the same return on equity  
9 provided to TESI as both AWTMI and TESI are similarly situated utilities.

10 Q. WHAT DOES AWTMI RECOMMEND?

11 A. AWTMI believes the information shown above is entirely supportive of a 10.0% return on  
12 common equity and therefore supports the use of a 5.16% overall rate of return.

## 13 VII. TARIFF ISSUES

14 Q. DO THE INTERVENER'S TAKE ISSUE WITH PROPOSED TERMINATION  
15 PROVISIONS?

16 A. Yes. AWTMI has requested specific authority to terminate a customer's water service for  
17 non-payment of the customer's wastewater service obligations. Both DPA and Staff state  
18 that *26 Del Admin. Code* §2001.6.6.3 prohibits a utility from disconnecting service due to  
19 a failure pay for another utility service. DPA goes on to state that it that does not believe  
20 that AWTMI will be able to terminate wastewater service.

21 Q. PLEASE STATE AWTMI'S POSITION.

22 A. AWTMI believes that it already has the authority to arrange for the termination of water  
23 service as an alternative to discontinuing wastewater service based on the provisions in

1 Paragraph 18 of AWTMI's current tariff. The provision was in AWTMI's original tariff  
2 approved by the Commission when it commenced service in 2005 and then re-approved  
3 in 2008. The regulation cited by the DPA and Staff was issued by the Commission in  
4 1987 when wastewater was not a regulated public utility service. AWTMI's position is  
5 that to the extent there is conflict between the tariff and a regulation issued before the  
6 tariff was issued, the tariff controls. AWTMI would argue that its approved tariff already  
7 allows terminations of both wastewater and water accounts. Paragraph 18 (see AWTMI  
8 tariff page 17, provided at Exhibits 4 and 4b of AWTMI Supplemental testimony) of the  
9 Company's approved tariff states that service may be terminated for good cause,  
10 including but not limited to a number of conditions. AWTMI believes nonpayment of  
11 wastewater obligations falls into the "including but not limited to" category. AWTMI  
12 created subsection (f) to make it abundantly clear that nonpayment by the customer is  
13 grounds for disconnection. The Company's approved tariff already allows AWTMI to  
14 terminate water service accounts. Specifically, the tariff states the following:

15 In lieu of disconnection or discontinuance of wastewater  
16 service, the Company has the right to arrange for the shut  
17 off of water service to the property for any of the reasons  
18 herein without waiver of any other remedy available to the  
19 Company. (AWTMI Tariff Page 18)

20 The question is as a matter of public policy does the Commission want to provide the  
21 Company with sufficient enforcement tools to obtain payment from customers. The lack  
22 of appropriate enforcement controls inevitably leads to higher uncollectible costs which

1 are ultimately passed on to the general body of customers. AWMI believes its approved  
2 policy is in the public interest and should remain an active part of the tariff.

3 Q. HAS DPA PROPOSED A PAYMENT POSTING PROCESS FOR USE DURING  
4 CONSOLIDATED BILLING?

5 A. Yes. At pages 23 to 24 of his testimony, DPA witness Woods outlines a payment posting  
6 sequence that can be used when AWMI moves to consolidated billing. Under  
7 consolidated billing, customers would receive one bill that includes charges for both  
8 wastewater service and water service. AWMI believes the posting sequence proffered by  
9 DPA witness Woods effectively enables the Company to terminate water service for non-  
10 payment of wastewater service obligations. AWMI therefore supports the proposed  
11 payment posting sequence proffered therein.

12 Q. ARE THERE OTHER TARIFF ISSUES?

13 A. Staff raises two issues with respect to security deposits. Staff witness Loper opines that  
14 the Company's practices in the area of security deposits are both discriminatory and  
15 inconsistent. Ms. Loper argues at page 4 of her testimony that AWMI is implementing 2  
16 different rates that amounts to a discriminatory practice. Ms. Loper goes on to state that  
17 the Company's practices in the area of security deposits are inconsistent because the  
18 language regarding the deposits beholden to each group is different.

19 Q. DO YOU AGREE WITH THE PROFFERED RECOMMENDATIONS?

20 A. No. AWMI completely disagrees that its proposed security deposits are either  
21 discriminatory or inconsistent. At page 14 of the tariff, AWMI proffers that security  
22 deposits for residential customers should not exceed the maximum bill for 2 consecutive  
23 months and those for non-residential accounts should be equal to 2 months of service.

1 This is neither discriminatory nor inconsistent, in fact, the proposed language is modeled  
2 after the water tariff of AWMI's affiliate.

3 Q. PLEASE DISCUSS STAFF'S PROPOSED RECOMMENDATIONS WITH RESPECT  
4 TO PARAGRAPH 35 OF AWMI'S TARIFF.

5 A. Staff witness Loper disagrees with the proposed changes outlined in paragraph 35, on  
6 page 25 of the proposed tariff. Staff misreads the intent of the proposed language  
7 especially in regard to the term "discretionary". AWMI is not proposing something  
8 sinister regarding the new language. The Company was attempting to clarify and create  
9 less confusion through this proposed revision. The current tariff states the following:

10 Whenever Commission regulations in Title 26 of the  
11 Delaware Code are duly amended in such a way as would  
12 produce a difference between the Commission's regulations  
13 and this tariff, the tariff is deemed to be amended so as to  
14 be consistent with the amendments to the regulations,  
15 except that if application of the amendment to Title 26 is  
16 discretionary, this tariff will remain unchanged.  
17

18 AWMI proposed the following language:

19  
20 Whenever Commission regulations in Title 26 of the  
21 Delaware Code are duly amended in such a way as would  
22 produce a difference between the Commission's regulations  
23 and this tariff, the tariff is deemed to be amended so as to  
24 be consistent with the amendments to the regulations. The  
25 tariff will remain unchanged if amendment to Title 26  
26 regulations is deemed to be discretionary in nature.  
27

28 Indeed, AWMI is not proposing a new tariff condition or policy, rather AWMI was  
29 attempting to make existing language more clear. AWMI is not proposing to define what  
30 constitutes "discretionary" nor does the current tariff make any such claim. AWMI  
31 believes the proposed language is an insignificant textual change, but is willing to reflect  
32 whatever language the Commission deems is adequate.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes, it does.