

Direct Testimony

of

Gary Hanson

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

NOV 16 2011

In the Matter of the Application of Suburban Water, Inc.,)
d/b/a Suburban Water Company, for Approval of the)
Commission to Make Certain Changes in its Rates for)
Water Service, for Approval of an Amendment to a)
Contract for Sale of Water with Board of Public Utilities,)
an Administrative Agency of the Unified Government of)
Wyandotte County/Kansas City, Kansas("BPU") and for)
Approval of a Purchase Water Adjustment ("PWA") Tariff)

by
State Corporation Commission
of Kansas

Docket No. 12-SUBW-359 -RTS

DIRECT TESTIMONY OF GARY HANSON

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Gary Hanson. My business address is 2887 SW MacVicar Avenue, Topeka,
3 Kansas 66611.

4 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

5 A. I am testifying on behalf of Suburban Water Company ("SWC").

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?**

7 A. I am a partner in the law firm of Stumbo Hanson, LLP.

8 **Q. PLEASE BRIEFLY OUTLINE YOUR LAW PRACTICE.**

9 A. My practice includes an emphasis on municipal law, serving as city attorney for the cities of
10 Silver Lake, Mayetta and Alta Vista. I am counsel to over three (3) dozen rural water districts.
11 I have published articles in national and state publications and have made presentations on
12 various aspects of the water utility industry. I have served as moderator of the Attorney's
13 Forum, a program for water utility attorneys held in conjunction with the Kansas Rural Water

1 Association annual meeting.

2 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

3 A. I graduated from Eastern New Mexico University in 1978, majoring in political science and
4 economics. I graduated from the law school at the University of Kansas in 1982.

5 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

6 A. I worked as a law clerk for the Kansas Attorney General's Office, a mid-size Kansas City law
7 firm and the Stumbo firm. I worked as an associate attorney in the Stumbo firm beginning in
8 1982 and became a partner in the Stumbo firm in 1986.

9 **Q. DO YOU HOLD ANY PROFESSIONAL LICENSES?**

10 A. Yes. I am licensed to practice law in the State of Kansas.

11 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY AT THE KANSAS CORPORATION
12 COMMISSION ("COMMISSION") ON BEHALF OF A WATER UTILITY?**

13 A. No. As this Commission knows, all but a handful of water utilities in Kansas are not regulated
14 by the Commission.

15 **II. ASSIGNMENT**

16 **Q. WHAT IS YOUR ASSIGNMENT IN THIS PROCEEDING?**

17 A. My assignment was to review the water supply purchasing practices of SWC, with a focus on
18 the concerns raised by the Commission in previous cases involving SWC, and to provide an
19 opinion with respect to (1) whether SWC is being prudent in its purchasing practices; and (2)
20 the concerns raised by the Commission.

21 **Q. CAN YOU IDENTIFY WHAT IS ATTACHED TO YOUR TESTIMONY AS EXHIBIT
22 GH-1?**

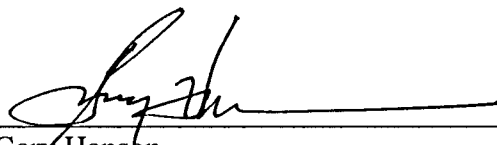
1 A. Yes. Exhibit GH-1 is a copy of the report I prepared that contains my opinion on the above
2 mentioned issue.

3 **Q. THANK YOU.**

VERIFICATION OF GARY HANSON

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

Gary Hanson, being first duly sworn deposes and states that he is Gary Hanson referred to in the foregoing document entitled "Direct Testimony Prepared by Gary Hanson" in Docket No. 12-SUBW-____-RTS before the State Corporation Commission of the State of Kansas and the statements therein were prepared by him or under his direction and are true to the best of his information, knowledge and belief.



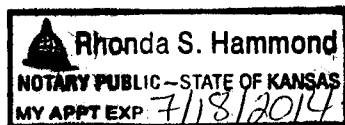
Gary Hanson

SUBSCRIBED AND SWORN to before me this 4th day of November, 2011.



Notary Public

Appointment/Commission Expires:



**REPORT TO SUBURBAN WATER COMPANY WITH RESPECT
TO ISSUES RELATING TO ITS WATER SUPPLY PURCHASING
PRACTICES RAISED BY THE KANSAS CORPORATION COMMISSION**

I. INTRODUCTION

This report provides my opinion on the following three issues raised by the Kansas Corporation Commission ("Commission") in Docket No. 11-SUBW-448-RTS relating to Suburban Water Company's ("SWC") water supply purchasing practices:

1. BPU's use of "surplus water" to supply water to SWC.
2. Analysis of BPU's payment in lieu of taxes ("PILOT") fee on water sold to SWC.
3. Whether SWC should obtain a supplemental wholesale water supplier to that of BPU.

This report also provides my opinion to the extent that it is possible on a comparison of water supply purchasing practices of SWC with other Kansas water utilities.

In preparing this report I reviewed what I believe to be the documents SWC has provided to the Commission and its Staff in the recent dockets that have considered SWC's water supply purchasing practices, including the testimony and exhibits filed by the Commission Staff and CURB in those dockets, the pleadings filed in those dockets and the orders issued by the Commission.

I have also interviewed SWC's management with respect to their water supply purchasing practices.

My opinions on the above-mentioned issues are as follows.

II. ISSUES RELATING TO "SURPLUS WATER" SALE BY BPU TO SWC

Article 1 of the Contract for Water Service between BPU and Suburban Water Company ("SWC") provides for water to be supplied by BPU to SWC to be "surplus water produced by the BPU not required for a use within the corporate limits of the Unified Government". That Article goes on to provide that in the event of interruption of service for any "cause reasonably beyond the control of the BPU or [SWC] no liability shall accrue by or against either party to this contract during the term of such interruption". This provision appears to be somewhat unique to BPU contracts as the governing statute for water sales, K.S.A. 13-1223, expressly limits BPU in this regard by allowing it to "sell and dispose of any surplus [water or electricity] outside of the city."

I am not aware of any other category of wholesale seller of water who is so limited by statute. (Contrast e.g., K.S.A. 12-808 ". . . Any city operating waterworks . . . may sell and dispose of water . . . to any person within or without said city" (emphasis added).) However, many wholesale water contracts are effectively "surplus water" contracts that relieve the seller of liability during periods in which the seller is unable to deliver. Examples of such contracts include those by the cities of Topeka and Lawrence, which, although not expressly limited by statute as is the case with BPU, those contracts reflect that the seller has more than sufficient capacity to meet current and projected needs and that the seller will make every reasonable effort to satisfy the buyers needs, but that there will be no liability in the event of an inability to do so.

Exceptions to the "surplus water" type of contract are most commonly found where the wholesale buyer has bought a specified capacity of the seller's treatment, storage and distribution system, essentially thereby buying an assured capacity from the wholesale seller. The BPU contract does not contain any such capacity purchase by SWC and given the statutory restrictions unique to BPU, it is unlikely that BPU would be willing to enter into such a wholesale contract.

Under the circumstances, I would encourage SWC to seek amendments to its contract with BPU to provide for the following:

1. That the contract obligates BPU to identify SWC's water service area as an additional place of use authorized for BPU's water rights. This is already required by applicable statute and regulations (See, K.S.A. 82a-708(b)).
2. Include a provision in the contract that obligates BPU to include SWC's usage in BPU's water use forecast.
3. Seek to extend the BPU contract for an additional ten year term (extending the primary term to a total of twenty years) and to further amend to provide for automatic renewal terms of five years each with notifications of intent to terminate required not less than three years prior to a scheduled termination.

III. ANALYSIS OF PILOT FEE ON WATER SOLD TO SWC

The contract between BPU and SWC does not appear to be a PILOT fee as that term is used in Kansas Statutes, K.S.A. 12-147. BPU is not a taxing subdivision, it having no direct authority to tax. In addition, the property of SWC is not exempt from ad valorem taxes. Finally, it does not appear that the PILOT fee is established in an amount designed to offset the loss of ad valorem taxes as it is based on a percentage of sales to all wholesale water customers of BPU without regard to the value of any such wholesale customers' facilities located within the jurisdictional boundaries of BPU and the taxes that would otherwise be assessed on those facilities (and in any event, it appears unlikely that there are any SWC facilities located within the jurisdictional boundaries of BPU).

Rather, the PILOT fee appears to be a form of surcharge to all of BPU's customers,

including wholesale water customers, assessed by BPU in addition to the cost of services based water rate. Such surcharge is typical in wholesale water supply contracts, whether denominated as "profit," "return on investment" or simply imbedded in the wholesale water rate as an item of cost. These amounts are charged by wholesale water sellers as a way to monetize the investment the wholesale seller has made in plant and facilities needed to provide the wholesale water service as well as an incentive or reward to the seller for providing this service. In at least some contracts it also represents costs provided by the city to the water utility, such as legal or IT services. In many instances where the wholesale seller is a city, this may result in a transfer from the water fund to the general fund. In other cities, or with non-city wholesale water sellers (such as rural water districts) the proceeds of this surcharge are simply retained in the water fund and used to essentially subsidize the in-city or water district retail customers. In yet another variation, many wholesale sellers do "fund/splits" where shared costs, such as the use of legal services, offices, and other common expenses are charged in part to the water fund and in part to the general or other funds. When included as costs incurred in the delivery of wholesale water, this has the effect of producing fund transfers that also seem to accomplish the same purpose as BPU's PILOT fees.

It would be less confusing if BPU would amend the contract to rename this fee as a "surcharge," "return on investment," "transfer to general fund" or "expense reimbursement." This would much better describe the charge that is actually being made to wholesale customers like SWC. However, there is no legal prohibition against the imposition of such a fee, however denominated. The amount of the fee, taken together with the other costs of supply by a particular supplier should be weighed against the alternatives available and the best overall rate, along with other terms of service, should be determinative of who is selected as the water wholesale provider.

IV. SHOULD SWC OBTAIN A SUPPLEMENTAL WHOLESALE WATER SUPPLY TO THAT OF BPU

SWC currently has two sources of supply; BPU and SWC's water well field located in Leavenworth County, Kansas. Subject to the minimum purchase requirements contained in the contract between BPU and SWC, there is no contractual or other legal prohibition against SWC obtaining a third source of water supply.

Access to an alternate water supply is desirable for a public water supply like SWC. Having alternate supplies allows the water supplier like SWC to utilize the lowest cost and best quality of supply at any given time, subject to contractual restrictions. SWC has investigated options for obtaining of a third water supply, including the prospect of developing an additional water supply of its own, and the potential for contracting with others such as the City of Leavenworth and Johnson County Water District No. 1.

Although it is desirable to have alternate supplies, many public water suppliers in Kansas are reliant on only one or two sources of supply, whether one or both of such supplies is owned and operated by the public water supplier or through a wholesale water contract with a third party. Reliance on a single source or two sources may be determined by a number of factors including

availability and cost. Ultimately, the decision of whether the current supplier or combination of suppliers is sufficient is one involving a cost-benefit analysis that will be unique to each situation. If a wholesale supplier is providing a moderately priced, reliable supply of wholesale water, reasonably assured over a reasonable period of time, then the benefit to be derived from a second or third source of supply may be overcome by cost. If, on the other hand, the supplies are poor or unreliable in quality and quantity, or the commitment is unreasonably short with low potential for renewal or extension, then a relatively high cost of developing or obtaining an alternate supply may be justified.

In my experience, BPU has been regarded as a high quality, dependable supplier of water to its wholesale customers. Application of the cost-benefit analysis to this situation invokes both engineering and managerial considerations beyond the scope of my review. It may well be that the best, most economical option available is to obtain an extension on the current water supply contract with BPU, or to obtain options exercisable by SWC for extensions on that contract, as recommended in Section II, above.

V. THE COMPARISON OF WATER SUPPLY PURCHASING PRACTICES OF SWC WITH OTHER KANSAS WATER UTILITIES

It is difficult to draw meaningful comparisons between SWC's water supply contract with BPU and other wholesale water purchase contracts across the State. Such arrangements are widely divergent based on factors such as source of supply (ground water or surface water), the extent of treatment required, the state of existing facilities, efficiency of scale, etc. We have represented several public water suppliers in the vicinity of SWC specifically and Northeastern Kansas generally. The contractual relationship between BPU and SWC is not extraordinary or unusual.

