

V I R G I N I A:

IN THE CIRCUIT COURT FOR FAIRFAX COUNTY

- - - - - x
 FAIRFAX COUNTY WATER :
 AUTHORITY, :
 Plaintiff : Civil Action No.
 vs. : 2008-16114
 CITY OF FALLS CHURCH, :
 Defendant :
 - - - - - x

Fairfax County Circuit Court
 4110 Chain Bridge Road
 Fairfax, Virginia 22030

September 21, 2009

VOLUME V

The parties met, pursuant to the notice of
 the Judge, at 10:16 a.m.

BEFORE: THE HONORABLE R. TERRENCE NEY

1 APPEARANCES:
 2 On Behalf of the Plaintiff:
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 11 On behalf of the Defendant:
 12 ALEXANDER "SANDY" THOMAS, ESQ.
 13 RICHARD D. HOLZHEIMER, JR., ESQ.
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 21 ALSO PRESENT: Charles Murray, Fairfax County Water
 22 Authority; John Tuohy, City of Falls Church

1 PROCEEDINGS
 2 - - - - -
 3 THE COURT: Good morning.
 4 Our schedule has changed slightly
 5 through circumstances here. We'll go from now
 6 until 4 today, but from 9:30 tomorrow instead of
 7 9 because I have scheduling at 8:30, which will
 8 take about an hour. Till 4 because of school.
 9 From 9 until 5 on Wednesday.
 10 At the moment we're out of luck on
 11 Thursday, because they've preassigned me something
 12 or another, plea in bar or something. So if we're
 13 not finished by Wednesday, then we'll pick up
 14 again on Monday.
 15 Okay. Yes, sir.
 16 MR. THOMAS: I think that's fine. I was
 17 going to offer -- I will see how the pace goes
 18 today. I think that we might be able to finish by
 19 the end of the day today or, you know, tomorrow.
 20 THE COURT: All the better.
 21 MR. THOMAS: In which case we would just
 22 want to talk to the Court about it.

1 CONTENTS
 2 WITNESS DIRECT CROSS REDIRECT
 3 GLENN WATKINS 922
 4 967
 5
 6 EXHIBITS
 7 EXHIBIT NO. RECEIVED
 8 PLAINTIFF'S
 9 REBUTTAL 17 Debt service schedule for
 10 2008 bond 1045
 11
 12 DEFENDANT'S
 13 70-A Schedules I through IX of
 14 Exhibit 70 965
 15
 16
 17
 18
 19
 20
 21
 22

1 THE COURT: I just wanted to let you
 2 know in advance. I just found that out.
 3 Okay. That's fine.
 4 Are you ready for redirect?
 5 MR. THOMAS: I am. I think Mr. Raphael
 6 had some housekeeping.
 7 THE COURT: Yes, sir.
 8 MR. RAPHAEL: I can do it now or I can
 9 do it after this witness.
 10 THE COURT: I'm sorry?
 11 MR. RAPHAEL: I just have some minor
 12 housekeeping things that we could do now, or I
 13 could do it after the witness.
 14 THE COURT: Your preference.
 15 MR. RAPHAEL: We filed this morning the
 16 original transcripts for the past 4 days.
 17 THE COURT: All right.
 18 MR. RAPHAEL: I provided a copy to
 19 opposing counsel. And I would like to hand Your
 20 Honor the condensed versions of those with a word
 21 index.
 22 THE COURT: Thank you, sir. Glad to

1 have them.
 2 And I suspect you'll do the same with
 3 the final day or day and a half of testimony.
 4 MR. RAPHAEL: Yes, absolutely.
 5 THE COURT: Because this probably will
 6 be submitted on briefs. Maybe not. But I'm just
 7 guessing it may.
 8 MR. RAPHAEL: We're happy to do whatever
 9 the Court thinks is most helpful to it. I also
 10 had promised we would submit substituted copies of
 11 two exhibits where the minutes were redacted.
 12 THE COURT: Yes.
 13 MR. RAPHAEL: I have those now and I
 14 would like to hand those to the Court.
 15 THE COURT: The Court will be pleased to
 16 receive those.
 17 MR. RAPHAEL: The first one is
 18 Plaintiff's Exhibit 30, and I've got the redacted
 19 form here. I've got two copies. I can hand one
 20 to Your Honor and one to the clerk if that's
 21 helpful.
 22 THE COURT: Great. That's terrific.

1 Thank you.
 2 MR. RAPHAEL: And then, in addition to
 3 that, I have Plaintiff's Exhibit 37, which has
 4 been similarly redacted. These are the minutes of
 5 the June 13, 2005 meeting and the adopted rate
 6 resolution that goes with it.
 7 THE COURT: All right. That will be
 8 fine.
 9 MR. RAPHAEL: Thank you, Your Honor.
 10 THE COURT: Thank you very much,
 11 Mr. Raphael.
 12 All right. Good morning, Mr. Watkins.
 13 THE WITNESS: Good morning, Your Honor.
 14 THE COURT: So we're going to have
 15 redirect of Mr. Watkins.
 16 MR. THOMAS: Yes.
 17 THE COURT: You may proceed, Mr. Thomas.
 18 MR. THOMAS: Thank you, Judge.
 19 THE COURT: Yes, sir.
 20 Whereupon,
 21 GLENN WATKINS
 22 having been previously duly sworn, was examined

1 and testified further as follows:
 2 REDIRECT EXAMINATION
 3 BY MR. THOMAS:
 4 Q Good morning, Mr. Watkins.
 5 A Good morning, counsel.
 6 Q Mr. Watkins, you were asked on Friday
 7 about certain of the CAFRs that you testified
 8 about in direct examination, and in particular
 9 about the City of Newport News' CAFR. Would you
 10 please pull Defendant's Exhibit 64, which is that
 11 Newport News CAFR.
 12 A I'm sorry. Was that 64?
 13 Q 64. Yes.
 14 A Yeah.
 15 Q In particular, you were asked about
 16 whether Newport News, the City of Newport News
 17 water works provides service outside of its
 18 boundaries. I would ask you to look four pages
 19 into that exhibit, please.
 20 A Would that be page Roman numeral IV?
 21 Q No, it's the first page of the City of
 22 Newport News letter, dated January 27, 2009.

1 A Yes, sir, I'm there.
 2 Q That's okay. Don't worry about that.
 3 Look down at the bottom of that first
 4 page of that letter from the City of Newport News,
 5 at the last paragraph. Do you see that?
 6 A Beginning with "the City of Newport News
 7 provides a full range"?
 8 Q Correct.
 9 MR. RAPHAEL: I'm sorry. I don't mean
 10 to interrupt. I don't have what page you're on.
 11 MR. THOMAS: Okay.
 12 MR. RAPHAEL: Can you show me the bottom
 13 of the page number you're on?
 14 Thank you very much.
 15 THE COURT: I'm sorry. Which exhibit?
 16 MR. THOMAS: Defendant's Exhibit 64,
 17 Your Honor.
 18 THE COURT: 64.
 19 MR. THOMAS: Yes.
 20 THE COURT: Okay. Just give me one
 21 second. And which page?
 22 MR. THOMAS: I believe it's four pages

1 back from the beginning of the exhibit, Your
2 Honor. It's a letter from the office of the City
3 Manager of the City of Newport News.

4 THE COURT: I have it.

5 MR. THOMAS: Thank you.

6 BY MR. THOMAS:

7 Q Mr. Watkins, do you see down at the
8 bottom of this first page of this letter from the
9 City of Newport News, where it says, "In addition
10 to general government services, the City provides
11 street lighting, water and wastewater services to
12 its citizens. The City's public utility
13 department (water works) also provides water to
14 the Cities of Hampton, Poquoson, and parts of York
15 and James City Counties." Do you see that?

16 A Yes, sir.

17 Q Does that refresh your recollection as
18 to whether the City of Newport News provides water
19 service outside of its boundaries?

20 A Yes, it does.

21 Q Is that consistent with your
22 understanding of where the City of Newport News

1 provides water service outside of its boundaries?

2 A Correct.

3 Q All right. You were also asked about
4 the Town of Vienna water service. Would you --
5 I'm going to ask you to switch books again, if you
6 would, please. Take a look at Plaintiff's
7 Exhibit 2. It's going to be in the first
8 plaintiff's book.

9 THE COURT: I'm sorry, plaintiff's
10 exhibit which?

11 MR. THOMAS: 2.

12 THE WITNESS: Yes, sir, I'm there.

13 BY MR. THOMAS:

14 Q Okay. Have you seen this document
15 before?

16 A Yes, I have.

17 Q What do you understand it to be?

18 A If you will, a map of the various
19 service areas, so to speak -- I'm sure that's not
20 the correct legal term -- up here in Northern
21 Virginia. The area in question, if you will.

22 Q All right. And you were asked yesterday

1 about the Town of Vienna's water service. Do you
2 see where the Town of Vienna is shown there on the
3 left-hand side of Plaintiff's Exhibit 2?

4 A Yes. Dark orange.

5 Q Right. And does looking at the legend
6 over to the right -- do you see where it says
7 "Town of Vienna," "within Town" and "within
8 County"?

9 A Yes. The Town of Vienna's water system
10 extends outside of its Town boundaries into
11 Fairfax County.

12 Q Okay. And does this refresh your
13 recollection as to whether the Town of Vienna
14 actually provides service outside of its Town
15 boundaries?

16 A Yes. At the time I wasn't sure, but,
17 indeed, it does.

18 Q All right. Thank you.

19 Now, Mr. Watkins, you were asked some
20 questions on Friday about a rate study that you
21 conducted in your work in this case. Do you
22 remember that?

1 A Yes.

2 Q All right. And in fact you were asked,
3 also, about whether Falls Church has engaged in
4 any gouging of its customers. Do you remember
5 that?

6 A I remember that characterization, yes.

7 Q All right. Have you in fact examined
8 whether -- have you examined Falls Church's rates
9 and charges in this case?

10 A Yes, I have.

11 Q All right. And have you made any
12 examination of whether Falls Church's current
13 rates are reasonable?

14 A Yes. I found them to be fair and
15 reasonable.

16 MR. RAPHAEL: Your Honor, I object. Can
17 I be heard on the objection?

18 THE COURT: Yes, sir.

19 MR. RAPHAEL: Your Honor, this goes to
20 the 90 percent of Mr. Watkins' report that was not
21 inquired into on direct examination. The only
22 point I brought out was that they hadn't asked

1 about it.

2 And I believe counsel's now trying to go
3 into the 95 percent that wasn't mentioned on
4 direct examination. And I think it's improper on
5 redirect, because I didn't get into the detail of
6 what Mr. Watkins did. And if he's going to open
7 the door here, I think I'm entitled to spend about
8 what I think is going to be between 2 and 3 hours
9 cross-examining him on the detail of the report he
10 did, which he never testified about.

11 THE COURT: Is Fairfax Water challenging
12 the reasonableness of the City's rates as opposed
13 to the -- the reasonableness per se as opposed to
14 the burden of the rates?

15 MR. RAPHAEL: It's both, Your Honor.
16 Yes.

17 THE COURT: Mr. Thomas.

18 MR. THOMAS: Well, Judge, Mr. Raphael
19 did in fact ask him about -- this witness about
20 the study that he conducted in this case. He
21 asked him about whether the City's -- he asked him
22 about whether a city needed to charge rates that

1 were fair and reasonable. And as I said, he asked
2 him about whether the City had engaged in any
3 gouging of Fairfax County customers, including
4 Fairfax Water.

5 So I think -- and inasmuch as that was
6 on cross-examination, redirect on that subject is
7 perfectly appropriate.

8 Judge, as the Supreme Court has said, a
9 party who voluntarily brought out evidence on
10 cross-examination of a witness will not be heard
11 to object when that evidence is brought out by his
12 adversary on reexamination of the same witness.

13 So I think this -- over some objection
14 on my part, this evidence came in on
15 cross-examination. I think at a minimum for
16 purposes of completeness, the Court -- and
17 especially given the representation that Fairfax
18 Water has just made, the Court should take this
19 evidence about the reasonableness of the rates.

20 MR. RAPHAEL: If I may, Your Honor. The
21 question I asked on cross-examination was whether
22 he had taken into account past rates or past

1 overcharging. And he said he had not. And my
2 only question about the current rates is whether
3 he -- the fact that he was not asked about it on
4 direct examination.

5 I don't think it's proper redirect. If
6 it is, if the Court should determine that it is,
7 then I think I'm entitled to then cross-examine
8 him on the full scope of the report, which is what
9 he's trying to bring out right now.

10 MR. THOMAS: And I don't have any
11 objection to that.

12 THE COURT: That's the way we'll do it
13 then. Objection overruled. But the plaintiff
14 will be permitted to have surcross-examination on
15 this area and certainly any other areas if any
16 others arise. But at least this one. Okay?

17 MR. THOMAS: Thank you, Judge.

18 THE COURT: Yes, sir.

19 BY MR. THOMAS:

20 Q Mr. Watkins, I asked you whether you had
21 examined whether Falls Church's current rates are
22 reasonable.

1 A Yes, sir, I have.

2 Q All right. Can you tell the Court
3 generally what you did to examine that issue?

4 A Yes. I conducted a rate study in which
5 I examined the current costs associated with
6 providing water service for the City of Falls
7 Church.

8 And then considered that in conjunction
9 with the consumption. We call them billing units
10 in the industry. And developed a cost based rate
11 from that and made a determination that the
12 current charges are certainly within the range of
13 reasonableness.

14 Q All right. And what approach did you
15 take? What method did you use?

16 A It's known by the AWWA as the utility
17 method. It's called the rate based rate of return
18 in most other industries and in other terms of
19 art.

20 Q All right.

21 A The utility method I think has probably
22 been referred to here, would be my guess. That's

1 what the AWWA calls it.
 2 Q Thank you. If you could turn to
 3 Defendant's Exhibit 70, please.
 4 A Yes, sir. I'm there.
 5 Q Okay. And in particular, if you can
 6 turn to Schedule I, which is in the back of that
 7 exhibit behind the cover page that says schedules.
 8 A Yes, sir. I'm there.
 9 Q All right. Would you identify to the
 10 Court what Schedule I is?
 11 A Schedule I is a summary of the analysis
 12 that takes all of the various components in
 13 determining the rate and puts it together.
 14 It's -- it provides, again, a summary of the cost,
 15 expenses, capital cost, et cetera, et cetera. And
 16 then as well as the billing units or the
 17 consumption. And at the bottom, it develops the
 18 final rate using the current rate structure or
 19 design of rates in effect for Falls Church.
 20 Q All right. Okay. Looking at the
 21 category of expenses, in particular item number 1,
 22 would you explain to the Court what the operating

1 and maintenance category here on Schedule I is.
 2 A Yes. Operating and maintenance expenses
 3 are, as in any business, they're the day-to-day
 4 expenses of Falls Church's water system. It's not
 5 entirely correct to say out-of-pocket expenses.
 6 But that's a reasonable way to look at it.
 7 They're the operating expenses, the maintenance
 8 expenses, the cost of running the system, if you
 9 will.
 10 Q All right. And category 2, where it
 11 says depreciation and amortization expenses, would
 12 you explain to the Court what that is?
 13 A Yes. I believe we went over this in my
 14 direct examination. In determining the revenue
 15 requirement under the utility approach, which is
 16 similar to that of any business enterprise, public
 17 or private, you have what's known as operating
 18 expenses, operating costs, and capital costs.
 19 Depreciation is a return of your
 20 investment. So it's one of the capital costs.
 21 It's common in any business enterprise. So it's
 22 the depreciation, annual depreciation for the

1 Falls Church water system.
 2 Q All right. And would you explain to the
 3 Court your -- what your entry, payment in lieu of
 4 taxes is at item number 3 on Schedule I.
 5 A Payment in lieu of taxes is not uncommon
 6 in municipal utilities, in which the Town of Falls
 7 Church charges itself, if you will, a fee in lieu
 8 of taxes. In other words, it does not charge
 9 itself real estate taxes or property taxes
 10 associated with its facilities within the City of
 11 Falls Church. So this is a surrogate for taxes,
 12 real estate taxes paid on the property within the
 13 City.
 14 Q All right. Thank you. And item
 15 number 4, indicating total expenses, that's --
 16 A That's simply the sum of 1 through 3,
 17 correct.
 18 Q Would you explain to the Court what item
 19 number 5 is, where it says "required return"?
 20 A Required return consists of two
 21 components. It's a product. It is a required
 22 rate of return, which is a weighted average of

1 debt and equity. And I believe we got into that
 2 in direct. The debt would be more commonly known
 3 as interest expense. And the equity is the fair
 4 rate of return considering the risks of the
 5 system, and would be more commonly known as fair
 6 profit or fair rate of return on equity
 7 investment.
 8 The -- you take that fair rate of
 9 return, or in the industry you call it the cost of
 10 capital, and multiply it by something called rate
 11 base. And the rate base is the investment
 12 required to provide service to ratepayers.
 13 So the product of those two is the
 14 required return. Interest and profit.
 15 Q Okay. Your line number 6, it says total
 16 revenue requirement. Would you explain to the
 17 Court what that is?
 18 A Yes. The total revenue requirement is
 19 simply the sum of columns 4 and 5, the total
 20 expenses and the required return.
 21 Q Thank you. Now, your item number 7
 22 appears to back some things out. Would you

1 explain what that item is?
 2 A Once we know the total revenue required
 3 to provide service, based on the cost of operating
 4 the system, there are certain additions and
 5 deductions.
 6 I have subtracted out wholesale revenues
 7 and miscellaneous revenues in determining the
 8 usage rate. I mean, the ultimate goal here is to
 9 develop a usage rate.
 10 The City of Falls Church receives a
 11 significant amount of revenue from Vienna for the
 12 wholesale sale of water, to the tune of, as you
 13 can see there, about \$1.6 million. So I have
 14 credited, if you will, to ratepayers that amount
 15 of revenue, taking it out of the revenue
 16 requirement.
 17 Similarly, the City of Falls Church also
 18 receives several types of miscellaneous revenue
 19 that are not rate revenue, if you will. Those
 20 types of revenues would include revenues
 21 associated with providing billing services to the
 22 County of Fairfax Water for wastewater. It would

1 include rentals on its water towers to cellular
 2 telephone companies, late payment fees, things of
 3 that nature.
 4 Q What is the effect, if any, on retail
 5 sales as a result of the treatment you've given to
 6 wholesale revenues here?
 7 A As I indicated earlier, that's an offset
 8 to the rate, so it reduces the rate to the retail
 9 revenue requirement.
 10 Q Okay. Your item number 8 on Schedule I
 11 indicates retail revenue requirement. And what is
 12 that?
 13 A Again, that's -- it's a subtraction.
 14 It's simply line 6, the total revenue requirement,
 15 minus the miscellaneous revenues and wholesale
 16 revenues.
 17 Q And your item number 9 indicates less
 18 customer charge revenue. Would you explain to the
 19 Court what that is?
 20 A Right. The customer charge revenue
 21 reflects the fixed monthly fee that is charged to
 22 all customers. Most utilities have them. You pay

1 a flat fee per month or per quarter for being a
 2 customer of the system.
 3 I've subtracted that because what I'm
 4 trying to get at is the usage charge.
 5 Now, in some cases, in utility
 6 rate-making cases, sometimes this customer charge,
 7 you know, is controversial. I didn't see this to
 8 be a rate design case in the sense that I didn't
 9 think there was going to be much quibbling over
 10 the structure of the rates, but rather the
 11 magnitude of the rates.
 12 So I have subtracted out the revenue
 13 that is received from the fixed monthly charges
 14 each month from customers to, again, whittle down
 15 to a revenue requirement that I'm trying to get
 16 from the user fees from retail rates.
 17 Q All right. And then what does item
 18 number 10 reflect, retail consumption charge
 19 revenue requirement?
 20 A Again, as I indicated, I'm whittling
 21 down that revenue requirement. So that's simply
 22 line 8 minus line 9.

1 Q Okay. All right. Now, you have an item
 2 here for number 11, which is retail consumption on
 3 a per gallon basis. Can you explain to the Court
 4 what that is?
 5 A Yes. Earlier I referred to a term
 6 called billing units or billing determinants.
 7 This is the amount of billed usage during the
 8 12-month period that I want to take my revenues
 9 and divide it through by units to get a price per
 10 unit or a rate.
 11 And the current structure is comprised
 12 of two components. One is called a nonpeak or a
 13 base rate, and all customers pay that throughout
 14 the year. And then the second component is called
 15 the peak rate. And individual customers may or
 16 may not be subject to that peak rate depending on
 17 your usage during the off peak seasons.
 18 In the summertime, as is common
 19 knowledge, a lot more water is used, primarily for
 20 irrigation, washing cars, et cetera, et cetera.
 21 If a particular customer's usage in the summer
 22 months exceeds a particular threshold, they are

1 then subject to this peak charge.

2 So the point is there's two different
3 rate components within the usage charge.

4 Q Right. Is it your experience that it's
5 typical to have a peak and a nonpeak rate?

6 A It's -- it's common. I don't know if
7 it's typical. Some do, some don't. But it's very
8 common up here in Northern Virginia.

9 Q All right. Now, your category number 12
10 here, item number 12 indicates retail consumption
11 rates. And would you explain to the Court what
12 that shows?

13 A Yes. The retail consumption rate is
14 ultimately what we are developing here. It takes
15 the retail consumption charge revenue requirement
16 from line 10 and divides it through by the peak
17 and nonpeak rate. Actually, you have to solve
18 simultaneously, because I wanted to maintain the
19 relationship between the current base charge and
20 the peak charge, again, so we're not debating over
21 a rate design case.

22 So it considers the current

1 relationship. And then using that -- maintaining
2 that same relationship, develops the cost-based
3 retail rates for nonpeak of \$3.33 and a peak
4 consumption rate of \$5.07.

5 Q Okay. And your item number 13 indicates
6 a revenue proof?

7 A Right. All this does is to show to the
8 reader that the rates generated in line 12, when
9 multiplied by the consumptions in line 11,
10 generate the revenue requirement that we were
11 looking for in line 10. And due to rounding, it's
12 off on line 14 by \$8,000.

13 And I say rounding because I've rounded
14 the rate, as is standard industry practice, to two
15 decimal places; i.e., \$3.33, but the actual
16 calculation might be 3.331, for example.

17 So the revenue proof just shows that the
18 development of the rates equals the revenue
19 requirement. And you can see due to rounding it's
20 off approximately \$8,600.

21 Q All right. Mr. Watkins, did you prepare
22 this Schedule I and the schedules that appear

1 behind it?

2 A I did, sir.

3 Q All right. Have you reached any
4 conclusion based on your expertise as to whether
5 the retail rate -- retail consumption rates shown
6 in item number 12 are reasonable?

7 A Yes.

8 MR. RAPHAEL: Your Honor, if I can
9 revert to my standing objection on this
10 gentleman's qualifications.

11 THE COURT: Yes, sir.

12 MR. RAPHAEL: Thank you.

13 THE COURT: Thank you.

14 THE WITNESS: Yes. I compared the
15 calculated rate based on current information with
16 the rates in effect. And the current nonpeak rate
17 is \$3.03 compared to my \$3.33.

18 The current peak charge -- let me check
19 what it is so I don't misspeak on the record here.
20 The current peak charge is \$4.62 compared to the
21 calculated rate of \$5.07. And as a result, I
22 found that the current rates are certainly within

1 the range of reasonableness; if anything, slightly
2 lower, deficient from the calculated rate.

3 MR. RAPHAEL: Objection, Your Honor. I
4 think the applicable rules require me to lodge an
5 objection here that he has not found these
6 conclusions to a reasonable degree of professional
7 certainty.

8 THE COURT: All right. Do you want to
9 ask him that question?

10 BY MR. THOMAS:

11 Q Yes, I would be glad to. Mr. Watkins,
12 to a reasonable degree of professional certainty,
13 have you reached a conclusion as to the
14 reasonableness of the Falls Church rates as you've
15 calculated them appearing on Schedule I?

16 A I have, indeed.

17 Q And would you state that conclusion,
18 please.

19 A Yes. It is my opinion within a -- with
20 reasonable professional certainty that the rates
21 contained in Schedule I are -- reflect the cost to
22 provide service and, therefore, support the

1 current charges -- or support the current charges
2 in the sense that they are at least fair and
3 reasonable.

4 MR. RAPHAEL: And just so the record is
5 clear, this is all subject to my standing
6 objection --

7 THE COURT: Yes, sir.

8 MR. RAPHAEL: -- as to this gentleman's
9 qualifications to render this opinion.

10 THE COURT: No, I understand that.

11 MR. RAPHAEL: Thank you.

12 THE COURT: Yes, sir.

13 BY MR. THOMAS:

14 Q Now, Mr. Watkins, there are a number of
15 schedules that are behind Schedule I here. I want
16 to ask you about a couple of those. First
17 Schedule II. And if you could explain to the
18 Court how that schedule relates to Schedule I
19 which you've just testified about?

20 A Yes. Schedule II relates to Schedule I
21 in that this provides details and a starting point
22 for the determination of forward-looking O&M

1 expenses, operating and maintenance expenses.

2 As I indicated during direct
3 examination, prices should be forward-looking. It
4 is common practice in the industry to consider
5 recent historical experience and then make
6 adjustments from actual experience. We call it
7 for known and measurable changes.

8 There's always going to be certain
9 extraordinary items or nonrecurring items in any
10 given period of time.

11 So we developed what is known, again, in
12 the industry as a test year. And a test year
13 should reflect the most recent period available,
14 or at least the most recent period which you can
15 use as a basis for measuring cost forward.

16 From that test year, you're going to
17 make certain adjustments, both positive and
18 negative, to reflect the going-forward business
19 nature cost structure.

20 So in Schedule II 2, you will see in the
21 various columns I have shown 2007 and 2008 actual.
22 Those are per books as recorded. And then you'll

1 see 2009 year to date actual. As indicated in the
2 footnote, so we don't have to find it, that's
3 roughly -- that's for 11 months. When I conducted
4 my analysis there were only 11 months of data
5 available.

6 I used 2007 and 2008 actual as a test in
7 conjunction with the experience for the 11 months
8 in 2009 as a test to determine what I expect these
9 various detailed accounts or expenses to be going
10 forward.

11 I used 2009, even though it's less than
12 a full test year -- it's only 11 months -- as the
13 most representative going forward because, as
14 we'll get into this, you'll see 2008 was a very
15 abnormal year. There were some extraordinary
16 expenses that I felt that would significantly
17 overstate the cost of service, or overstate the
18 rate had I selected 2008 as a test year. But be
19 that as it may, I did consider 2007, 2008 and
20 11 months of 2009, fiscal year 2009.

21 The fourth column there you see is test
22 year annualized. And except as noted with

1 footnotes, by and large that's simply 11 months
2 annualized for the year.

3 The final three columns, you'll see a
4 reference to an adjustment number. That will --
5 I'm sure we'll be referring to those. And then
6 the test year adjustment. The test year
7 adjustment reflects adjustments either upwards or
8 downwards for what I consider to be abnormalities
9 or not reflective of what's going forward on a
10 known and measurable basis.

11 And then the last column is
12 quote-unquote the adjusted test year. That is the
13 expenses that we expect going forward.

14 These numbers in this last column flow
15 through to page 1.

16 Q Schedule I, you mean?

17 A I'm sorry. Schedule I. Thank you.

18 Q All right.

19 A As can be seen on Schedule III, which
20 consists of five pages --

21 Q Before we go to Schedule III?

22 A I'm sorry. As can be seen on Schedule

1 II, which is comprised of five pages, there are
2 various Roman numerals, and they coincide with the
3 financial classification system of the City. I
4 won't go through them all. But you see water
5 administration, customer service, source of
6 supply, et cetera. Those are basic cost
7 classifications.

8 And then within each of those, there are
9 very specific accounts. And these specific
10 accounts come straight from the books and records,
11 financial records of the City.

12 Q All right. Can you tell the Court what
13 your total adjustments were with respect to your
14 work here on Schedule II?

15 A Yes, counselor. If we turn to page 4 of
16 5 and we go, about in the middle there, you'll see
17 total. I have reduced 2009 expenses by
18 \$5,684,475.

19 Q And what effect, if any, does this
20 adjustment have on the retail rate you calculated?

21 A Again, this reduces the O&M expenses.
22 So I have lowered the -- lowered expenses, which

1 then lowers the calculated rate.

2 Q All right. Look if you would at
3 Schedule III, please. Could you explain to the
4 Court what Schedule III is?

5 A Yes. Schedule III consists of 12 pages.
6 And these are the various revenue requirement
7 adjustments, or adjustments that I referenced on
8 Schedule II there for adjustment number. And
9 there's a specific adjustment and detail
10 supporting each of the adjustments on each of the
11 12 pages of Schedule III.

12 So, for example, on page 1 of
13 Schedule III, the first adjustment is for other
14 post-employment retirement benefits. We call them
15 OPEBs in the industry.

16 And just so the Court understands what
17 we're doing here, if we go back to Schedule II --
18 and I know this gets a little bit messy, but this
19 is unfortunately the way we do it. If we go back
20 to Schedule II and look on page 1 and look for
21 adjustment 1, you'll see it there. You'll notice
22 that there is zero expenses for the test year that

1 was actually booked or annualized. But we expect
2 to have some. These adjustments -- not
3 adjustments. But these type of expenses are
4 typically made at the end of the year after all of
5 the books are closed, so I need to reflect a going
6 level or a normal basis for OPEBs. And as we can
7 see in adjustment 1, the amounts that I have
8 included are from the City budget for fiscal year
9 2009.

10 Q 2009. Okay.

11 A Correct. They just had not been booked
12 here. Because they're end of period entries, if
13 you will.

14 Q Okay. Thank you. Now, looking within
15 Schedule III, can you turn to page 5. Page 5 of
16 12.

17 A Yes, sir, I'm there.

18 Q Do you recall giving testimony in your
19 deposition about an error that you found on
20 page 5?

21 A Yes. During my deposition, Mr. Raphael
22 pointed out something that was confusing for him.

1 And it certainly was. And I apologize. I did
2 make an error. And I'm referring to two entries.
3 I'm referring to one, two, three -- the fourth
4 entry down called Arlington Boulevard W/M
5 replacement. And then moving down a couple more,
6 you'll see Mayflower W/M replacement.

7 Q Right.

8 A Those are two capital projects. And if
9 you will look by each of those, those are
10 amortized over 10 years each. And that is an
11 error. That should be 30 years. W/M, when we
12 were doing this, it was questionable whether that
13 stood for water meters or water mains. In fact it
14 stands for water mains, which has a much longer
15 life. So it should have been amortized over
16 30 years for each of those. And by making that
17 correction the rate changes from \$3.33 to \$3.29.

18 Q Okay.

19 A So a de minimis change, but a change
20 nonetheless.

21 Q Thank you. Now, would you look at
22 Schedule IV, please, at the end of the 12 pages of

1 Schedule III. Do you see Schedule IV there,
 2 Mr. Watkins?
 3 A Yes, sir, I'm there.
 4 Q At the top it says "rate base"?
 5 A Yes, I'm there.
 6 Q And what does that mean?
 7 A I referred to this briefly earlier
 8 when -- back in Schedule I when we were talking
 9 about the required return. You multiplied the
 10 cost of capital or the required rate of return by
 11 something known as rate base. And the rate base
 12 is the investment used for rate making. It's not
 13 entirely correct, but you can get a pretty good
 14 idea by, if you substitute the word rate base for
 15 assets. It's the assets employed, required to be
 16 employed for rendering service.
 17 There is a cost associated with capital.
 18 And these are the capital items associated with
 19 providing retail water service by the City of
 20 Falls Church.
 21 Q All right. And can you explain the
 22 items included in rate base here?

1 A Absolutely. They're fairly standard.
 2 They vary a little bit from utility to utility.
 3 But the concepts are the same. You begin with
 4 what's called gross plant in service. That's your
 5 gross depreciable assets, including -- well, it's
 6 your gross assets, depreciable fixed assets plus
 7 land. And then from that you deduct accumulated
 8 depreciation or depreciation reserve as in any
 9 business practice. So your gross minus your
 10 depreciation reserve is called -- I called it here
 11 total plant in service. It's really net plant in
 12 service. Your net book value, if you will.
 13 And then in addition to that there is,
 14 in the utility industry there's something called
 15 construction work in progress. Because of the
 16 large capital expenditures and infrastructure in
 17 the utility business, there are considerable sums
 18 of capital tied up while you're building a
 19 project. So you -- you include that within your
 20 rate base or your total plant.
 21 The sum of all of those is what is known
 22 as net utility plant. And you'll see that there

1 is 51,061,907.
 2 Q All right. And you made certain
 3 additions?
 4 A Yes. As is typical, there's additions
 5 and deductions to rate base. The rate base
 6 additions reflect the amortization expense that
 7 we'll get into in a little bit. You can see it's
 8 footnoted there. Materials and supplies, those
 9 are typically your shop tools, things of that
 10 nature, that are not included in your physical
 11 plant in service.
 12 And what is known as cash working
 13 capital. Cash working capital is just what it
 14 says, in that -- it's a little different than the
 15 accounting concept. It's the cash you need to
 16 operate the business on a going-forward basis. In
 17 the water industry, you bill in arrears, either
 18 3 month in arrears or 1 month in arrears,
 19 depending on the particular customer. In other
 20 words, you provide the service first, then you
 21 bill, and then you collect. And just like any
 22 business, you incur your operating expenses

1 monthly. So there's a lag between the revenue
 2 receipts and the cash expenditures. So you need
 3 working capital. So this is the working capital
 4 allowance. Again, it's -- it's an asset required.
 5 Q All right. And did you arrive at a
 6 total rate base?
 7 A Yes. With all of that, the total rate
 8 base is \$39,293,517.
 9 Q All right. And are there certain
 10 deductions, looking just above the total rate
 11 base, certain deductions that you made from it?
 12 A Yes. I've deducted customer deposits,
 13 which are self-explanatory. The net balance of
 14 availability fees and developer contributions.
 15 Because those are -- that's capital contributed
 16 either by developers or by the ratepayers.
 17 Q All right. Now looking at Schedule V,
 18 Mr. Watkins, would you explain to the Court what
 19 this chart shows.
 20 A Yes. Chart V provides details for the
 21 determination of the availability fee deduction
 22 from rate base. In other words, I'm reducing the

1 amount of what you're going to earn a return on.

2 We saw the availability fees on
3 Schedule IV. Governmental accounting has its
4 quirk, as all accountings do, but the City
5 collects availability fees each year from
6 ratepayers as they hook into the system. And then
7 in order to allow those contributions, not to be
8 confused with developer contributions, but allow
9 those -- for those contributions to be taken off
10 the books and records, you amortize that over a
11 reasonable period of time.

12 And I have used a 3.33 percent
13 amortization rate, which is, you know, equivalent
14 to a 30-year life.

15 Q Okay.

16 A So you write this off. And this is an
17 actuarial table that shows the, by vintage year,
18 the net balance, and you add them all up.

19 Q All right. And so is this a reduction
20 to rate base?

21 A Yes. This reduces rate base.

22 Q All right. And what if anything does

1 that mean in terms of the impact on the rate that
2 you calculate as a reasonable rate here?

3 A It reduces the retail rate, the
4 calculated retail rate.

5 Q Now, turn if you would, please, to
6 Schedule VI. Would you explain to the Court what
7 this schedule shows?

8 A Schedule VI is identical in concept to
9 Schedule V except for it considers what's known as
10 developer contributions. Developer contributions
11 represent capital paid by developers. The most
12 common thing is when there's a new neighborhood, a
13 developer will come in and actually lay the water
14 pipes and supply the water pipes. Once they're
15 in, they'll donate those to the City.

16 So the concept is exactly the same as
17 availability fees. And it represents capital that
18 was not contributed by the City and, therefore, is
19 a deduction or reduction to rate base and tends to
20 reduce their rates.

21 Q I'm sorry?

22 A And reduces their retail rates.

1 Q Turn, if you would, to Schedule VII,
2 Mr. Watkins. Would you briefly explain to the
3 Court what this schedule is, entitled "City of
4 Falls Church Customer Charge Calculation"? And it
5 says residential.

6 Go ahead.

7 A Yes. As you may recall, back on
8 Schedule I where we put everything together, I
9 subtracted out what's known as the customer charge
10 revenue or the fixed monthly fee revenue charged
11 to each customer.

12 What Schedule VII does is it calculates
13 the revenue generated from that. There are
14 different charges based on the meter size.

15 As you can see, there's 5/8-inch meters,
16 3/4-inch, et cetera, et cetera. And the customer
17 charge increases with the size of the meters, you
18 can see there under the column entitled "customer
19 charge."

20 So you take the number of bills,
21 multiply it by the effective tariff rate. And
22 that gets you the customer charge.

1 The information is provided or
2 maintained by the City for each political
3 jurisdiction as well as by meter size. So I
4 simply presented it in that fashion.

5 The first -- the first page of
6 Schedule I is the residential customer charge.

7 Q I think you mean Schedule VII, right?

8 A And the second page is the
9 nonresidential. And the reason for the
10 distinction is there's a different rate.

11 Q Okay. And you were talking about
12 Schedule VII, right?

13 A Yes. I'm sorry if I misspoke.

14 Q Okay. Now, would you take a look,
15 please, at Schedule VIII, entitled "City of Falls
16 Church water, cost of capital and required return
17 on investment." Do you see that?

18 A Yes, I do.

19 Q And would you explain to the Court what
20 this schedule shows?

21 A Yes. Again, as you may recall, we have
22 previously discussed what's known as the rate

1 base. And in developing the required return, you
2 take the rate base and multiply it by the cost of
3 capital.

4 Schedule VIII is the development of the
5 cost of capital or, as encaptioned here, required
6 return on investment. Cost of capital and
7 required return on investment.

8 There are two components to the cost of
9 capital, that being debt -- one being debt and one
10 being equity.

11 I have used, excuse me, a hypothetical
12 capital structure for the City of Falls Church.
13 And I'll explain why in a minute. But I've used a
14 hypothetical capital structure of 50/50, 50 debt,
15 50 equity. And I multiplied that by the embedded
16 cost of debt of 4.4 percent, and as well as the --
17 a reasonable required return on equity or cost of
18 equity of 8.93 percent.

19 You take the weighted average of those
20 two, and you can see there for weighted cost, and
21 you arrive at an overall cost of capital of
22 6.66 percent.

1 Q All right. What is Falls Church's
2 actual capital structure?

3 A Its actual capital structure, I don't
4 have the precise number, but it's in the
5 neighborhood of about 65 percent equity,
6 35 percent debt. And there are a couple reasons
7 why I use the -- the hypothetical capital
8 structure. There's one major reason.

9 Equity costs invariably have a higher
10 cost than debt costs. I mean it's widely known in
11 the business community that your return on stocks
12 is higher than that on mortgage bonds. I mean,
13 it's widely known. It's foundation of financial
14 theory.

15 Therefore, had I used a capital
16 structure of roughly 65 percent equity, 35 percent
17 debt, clearly that would have resulted in a
18 weighted average cost of capital, you know, quite
19 a bit higher than the 6.66 percent that I used.

20 I used a 50/50 because I didn't want to
21 quibble over these capital costs, quite frankly.

22 The -- the 50/50 is an industry standard of

1 investor owned utilities. And it's important to
2 understand why that serves as a reasonable proxy.
3 And the reason that that serves as a reasonable
4 proxy is because that is where we develop our
5 financial models and that form the basis of our
6 cost of equity.

7 The point being that there is an
8 efficient -- most efficient capital structure in
9 the industry is right on the nose at 50/50.

10 So, again, I wanted to be conservative.
11 I didn't want to quibble in this litigation over
12 what the capital structure would be. And I wanted
13 to be conservative. So I gave the benefit of the
14 doubt to the customers of Fairfax Water and used a
15 much lower capital structure of 50/50.

16 Q All right. In your experience, is it a
17 common practice to use a hypothetical capital
18 structure like you have used?

19 A Oh, absolutely. It's used all the time.
20 Sometimes your actual capital structure is used,
21 if it's right, you know, within the industry norm,
22 but if it's out, either way, it's common practice

1 to use a hypothetical capital structure,
2 consistent with what the industry norm is.

3 Q All right. And had you utilized Falls
4 Church's actual capital structure, what impact
5 would this have had on the rate of return?

6 A It would have increased it quite a bit.

7 Q All right. And, Mr. Watkins, what is
8 your rate of profit allowance after consideration
9 of debt?

10 A As indicated, it's 8.93 percent. That
11 is the required return on equity as compared to
12 the cost of debt of 4.4 percent. So slightly less
13 than 9 percent.

14 Q Mr. Watkins, there is a schedule right
15 behind Schedule VIII, the last schedule in this
16 packet, Schedule IX. Would you explain to the
17 Court what that is?

18 A Yes. Schedule IX simply provides a
19 breakdown of the consumption billing units that I
20 referred to earlier. And those are carried
21 forward, as with all of these, back to Schedule I.
22 It provides the total consumption throughout the

1 year, for 12 months by the way, of fiscal year
2 2009.

3 So the total consumption is the total
4 annual consumption for fiscal year 2009. And then
5 the peak consumption is the billed consumption
6 subject to the peak charge.

7 And you can see that the grand total for
8 the total consumption is 5.374 billion gallons.
9 And then the peak consumption, which is the amount
10 just subject to the peak charge, is 325.236
11 million gallons.

12 Q All right.

13 MR. THOMAS: Your Honor, I would move
14 Mr. Watkins's Schedules I through IX into
15 evidence. They are part of Exhibit 70. I can
16 separate them out from Exhibit 70 and make them a
17 separate exhibit as Exhibit 70-A.

18 THE COURT: All right. Yes, sir.

19 MR. RAPHAEL: With regard to the last
20 points first, I do object to the exhibit, but I
21 don't object to the redaction, assuming the Court
22 allows the exhibit in. But I would renew my

1 objection to this based on this gentleman's
2 qualifications --

3 THE COURT: Right.

4 MR. RAPHAEL: -- and failure to testify
5 that this is to a reasonable degree of
6 professional certainty.

7 THE COURT: Right. I understand that.
8 I've already ruled upon it. So the exhibit will
9 be received subject to the objection of Fairfax
10 Water. The exhibit I understand being offered are
11 simply the Schedules I through IX, correct?

12 MR. THOMAS: Schedules I through IX,
13 correct.

14 THE COURT: They will be received.
15 (Defendant's Exhibit 70-A was received
16 into evidence.)

17 MR. THOMAS: And if I can just have one
18 moment?

19 THE COURT: Yes, sir.

20 BY MR. THOMAS:

21 Q Mr. Watkins, the opinions that you
22 expressed today, are they within a reasonable

1 degree of professional certainty?

2 A Yes, they are.

3 MR. THOMAS: All right. Thank you.
4 Judge, I don't have any further
5 questions at this time. Thank you.

6 THE COURT: Do you want to take a minute
7 or are you ready to go?

8 MR. RAPHAEL: Either way. I'm ready to
9 go.

10 THE COURT: It's up to you.

11 MR. RAPHAEL: May I ask for a break in a
12 little while?

13 THE COURT: Oh, I'll give you a break in
14 25 minutes.

15 MR. RAPHAEL: All right.

16 THE COURT: Are you okay for 25 minutes?

17 MR. RAPHAEL: Yes, sir.

18 THE COURT: All right.

19 MR. RAPHAEL: I would ask the Court's
20 indulgence. I believe I'm going to need at times
21 to come back to my laptop to operate an Excel
22 sheet.

1 THE COURT: Then why don't we take a few
2 minutes right now. In other words, do you want to
3 do this right this minute?

4 MR. RAPHAEL: Well, it's coming up.

5 THE COURT: Oh, okay. All right.

6 THE WITNESS: By the way, thank you for
7 a request for a break shortly, Mr. Raphael. I'm
8 going to need one too.

9 THE COURT: Are you good for 25 minutes,
10 Mr. Watkins?

11 THE WITNESS: Yes, sir. Thank you for
12 asking.

13 THE COURT: All right.

14 RE-CROSS-EXAMINATION
15 BY MR. RAPHAEL:

16 Q Good morning, Mr. Watkins.

17 A Good morning, sir.

18 Q Did you discuss your testimony with
19 anyone or the case with anyone since your
20 testimony here Friday and before you testified
21 this morning?

22 A No. I took a much needed break this

1 whole weekend.

2 Q Congratulations. I'm glad you did.

3 A Thank you.

4 Q Now, with regard to the Vienna system,
5 are you aware that there are negotiations pending
6 between Vienna and the City of Falls Church
7 concerning the wholesale customer status for the
8 Town of Vienna?

9 A I'm aware that they were still
10 negotiating the rate. The details I don't know
11 anything about.

12 Q All right. Do you know whether they've
13 reached agreement?

14 A No, I don't.

15 Q Do you know that the discussions center
16 around the charge by the City of Falls Church to
17 Vienna plus a management fee of 10 percent?

18 A No, I have no idea. I don't know what
19 the details are.

20 Q All right. Now, Mr. Watkins, with
21 regard to the schedules that you've testified
22 about today, I want to make sure I understand the

1 big picture first. Your Schedule I shows the
2 analysis you did to look at the past operating
3 costs and the revenues that would be needed to
4 meet those costs. And from that you generated a
5 proposed nonpeak consumption rate and a peak
6 consumption rate, correct?

7 A With one caveat. When you said the --
8 the past costs, these are the -- these are the
9 most recent current costs -- most recent booked
10 historical costs that I've adjusted on a
11 going-forward basis.

12 So they're most reflective of the
13 current cost structure of Vienna as opposed to
14 some older cost structure.

15 Q You said Vienna. Did you mean Falls
16 Church?

17 A I apologize. I'm sorry. Falls Church.

18 Q And the cost period, the primary period
19 that you looked at was the year corresponding to
20 fiscal year 2009, correct?

21 A That's correct.

22 Q So that the time period you drilled down

1 on was from July 1 of 2008 through June 30 of
2 2009, correct?

3 A Correct.

4 Q Okay.

5 A Drilled on is a good way to put it, with
6 adjustments to that of course.

7 Q All right. And just so we're clear,
8 this analysis doesn't address whether the City of
9 Falls Church in years past has overcharged its
10 Fairfax County customers, correct?

11 A It does not consider it, whether they're
12 overcharged, undercharged, it has -- you're
13 absolutely correct.

14 Q Right.

15 A It has nothing to do with the prior
16 charges.

17 Q Right. So, if in fact the City had
18 overcharged its Fairfax County customers in the
19 past, your rate analysis would not correct for
20 that, correct?

21 MR. THOMAS: Judge, if I could renew my
22 objection to the relevancy of past dates.

1 THE COURT: All right. So noted.

2 MR. THOMAS: Thank you.

3 THE WITNESS: My analysis does not
4 account for rates that were in effect in the past,
5 either way.

6 BY MR. RAPHAEL:

7 Q So if there was an overcharge in the
8 past, this analysis would not correct for that,
9 right?

10 A That's correct.

11 Q All right. Now, let me -- let's look --
12 am I correct, sir, that before you submitted your
13 expert report in this case, which contains these
14 schedules, that you didn't have anyone from the
15 City of Falls Church review it for accuracy?

16 A That's correct.

17 Q All right.

18 A In the sense that, of the rate analysis,
19 the determination of the individual expenses we
20 went through, went through quite carefully with
21 Melissa Ryman, who is Mr. Tuohy's assistant at the
22 City.

1 Q Sure. Melissa helped you with the
2 inputs of your analysis, right?

3 A That's correct. As well as verifying
4 the -- not verifying but going through the
5 adjustments. But as far as the methodology and
6 the end result, there was no input from the City.

7 Q And just so we're clear, the City didn't
8 vet the output of your analysis, right?

9 A That's correct.

10 Q They didn't check your math either, did
11 they?

12 A That's correct.

13 Q Am I correct, sir, that as part of your
14 rate study, you didn't actually evaluate the tap
15 fees that are charged by the City of Falls Church
16 with regard to connection fees, local facilities
17 charges and connection charges, right?

18 A That's correct. My analysis is devoted
19 to the user fees.

20 Q Right. Well, but not all the user fees,
21 right? You didn't look at the quarterly use
22 charge to each customer, did you?

1 A Yes. That's reflected in Schedule I.
2 And then we went through the details of that, I
3 believe it was in Schedule V. Was it Schedule V?
4 That's what I'm referring to as customer charges.

5 Q Right. Well, I'm talking about
6 something different from the commodity charge.
7 I'm talking about the quarterly use charge to each
8 customer. Are you aware that for a 5/8-inch
9 meter, for example, the City charges a \$10 cost,
10 right?

11 A Let me get to that. It's \$7.47 per
12 quarter for a 5/8-inch meter, which is the
13 standard residential meter.

14 Q And larger meters are as high as \$292
15 per quarter, correct?

16 A I'm not going to disagree with you, per
17 se. The highest number that I see is \$212.63 for
18 an 8-inch meter. Perhaps there may be one that
19 high for a very large meter. But the highest I
20 see is for an 8-inch meter of \$212 per month.

21 Q And in addition to the quarterly use
22 charge, there is a service charge that the City

1 imposes also, right?

2 A A service charge?

3 Q Yeah. So for a 5/8-inch meter, there's
4 a service charge, for example, of \$7.47, true?

5 A I'm not -- the fixed monthly charge of
6 \$7.47.

7 Q Right. And for larger meters, that goes
8 as high as \$236, doesn't it?

9 A Correct.

10 Q Okay. And you didn't do a cost of
11 service study relating to the monthly billing
12 charges, correct?

13 A The monthly billing charges. The
14 determination of the commodity rate? When you say
15 monthly billing charges.

16 Q There are charges besides the commodity
17 rate that people have to pay if they get water
18 from Falls Church, right?

19 A Right.

20 Q My question is you didn't do a cost of
21 service study relating to those charges, did you?

22 A No. I limited it to the commodity

1 charges, the rates that are in question.

2 Q Right. And you also didn't do a cost of
3 service study to determine if the charges by Falls
4 Church for things like reconnection charges, water
5 hydrant charges or late fees were reasonable. You
6 didn't look at that either, did you?

7 A No. I accepted them as -- you know, at
8 face value. Whether they're high or low, I don't
9 know. I just accepted those at face value,
10 correct.

11 Q Correct?

12 A It's my understanding those are not in
13 question in this case.

14 Q You were focusing on the commodity
15 charge and the peak use charge, right?

16 A That's correct.

17 Q And the big picture here of what you're
18 doing is you're saying let's figure out, based on
19 the study you did, what Falls Church could be
20 charging for its water service. And you came out
21 with a rate of \$3.33, which you've, in your direct
22 testimony, adjusted to \$3.29, right?

1 A I -- no, I can't accept that
2 characterization at all. And the characterization
3 is what Falls Church could be charging. What I
4 did is I used industry standards to determine a
5 cost-based rate.

6 And with that, once that was determined,
7 I compared that to the rate in effect to serve as
8 a basis for opining whether the current rate,
9 commodity rates are excessive, reasonable or
10 deficient.

11 Q Right. You're saying that Falls Church
12 could justify in your view charging \$3.33, which
13 you've corrected to \$3.29?

14 A Right.

15 Q And you can justify charging that?

16 A Yes.

17 Q And because they're only charging \$3.03,
18 you think that rate must be reasonable, right?

19 A That's exactly right.

20 Q Now, let's go, please, to your
21 Schedule I, which is the summary of your analysis.
22 And line -- Ken, could you bring up, please,

1 The required return in line 5, that's where you
2 have the return on equity multiplied by what you
3 have computed for the rate base, right?

4 A No. It's the total cost of capital
5 multiplied by the rate base. The return on equity
6 is 50 percent of that.

7 Q Okay.

8 A Interest is the other 50 percent.

9 Q So you have a rate of return. And the
10 rate you ended up using was 6.66 percent, true?

11 A That is correct.

12 Q And you multiplied that by the rate base
13 to come up with the required return?

14 A That's exactly right.

15 Q And Schedule VIII is where you do your
16 rate base analysis, I think. But let me stick
17 with -- let me stick, for the moment, with this
18 schedule.

19 From line 6 of total revenue
20 requirement, you deduct in line 7 wholesale
21 revenues to the Town of Vienna, right?

22 A That's correct.

1 Defendant's Exhibit 70 at page 17. Okay. And
2 call out, please, line 6.

3 All right. So line 6 shows what you
4 have determined to be the total revenue
5 requirement for the system, right?

6 A Correct.

7 Q And that includes, obviously, items 1
8 through 5. And the total revenue requirements
9 include 1 through 5. So they include operating
10 and maintenance costs, depreciation and
11 amortization, payments in lieu of taxes, total
12 expenses, and the required return. Do you see
13 that?

14 A That's exactly right, sir.

15 Q Okay. So the return on equity you're
16 including in the revenue requirement for the
17 system, true?

18 A Yes. That would be reflected on --

19 Q Yes.

20 A -- line 5.

21 Q All right. And the required return in
22 line 5 -- Ken, if you could show that, please.

1 Q And that's because that's a separate
2 source of revenue from the retail commodity rate,
3 right?

4 A In part. I -- I wanted to be
5 conservative. The cost of providing wholesale
6 service to Vienna is the -- the incremental cost
7 is very small. You obviously have the cost of
8 purchasing the water from the Aqueduct.

9 But, typically, in rate cases, the
10 utility will be provided an incentive, if you
11 will, for going out and trying to minimize costs
12 to all of its ratepayers. And we call that
13 off-system sales sometimes.

14 And even though the incremental cost of
15 providing wholesale service to Vienna may be very
16 small, by generating that additional revenue, it
17 reduces the -- you know, the cost to the
18 consumers.

19 Typically in the industry, there is an
20 incentive for these off-system sales given to the
21 utilities, anywhere between 25 and 50 percent. I
22 gave 100 percent credit of the cost of service

1 because, again, I didn't -- well, I wanted to be
2 conservative.

3 Q Right. And you wanted to be --

4 A So I -- so in this sense I've deducted
5 100 percent as opposed to some -- some level to
6 provide an incentive to the Town for retaining
7 some of that.

8 So, in other words, all of the money
9 that they -- all of the margins that they receive
10 is credited back to the retail revenue
11 requirement.

12 Q Right. And the more money that Falls
13 Church gets from its Vienna wholesale contract,
14 the less has to be made up in revenue payments
15 from the commodity rate charged to Falls Church
16 and Fairfax County customers, right?

17 A That's exactly right.

18 Q And you were being conservative by
19 including all of that because it gives the benefit
20 of the doubt to the Fairfax County ratepayers?

21 A That's correct.

22 Q And is that -- wherever you could you

1 tried to be conservative in your analysis, to give
2 the benefit of the doubt to the Fairfax County
3 ratepayers, right?

4 A Right. Within reason, yes.

5 Q Now, you also deduct, in addition to the
6 wholesale payments from the Town of Vienna, you
7 deduct in line -- in footnote 5 you indicate that
8 you're deducting various miscellaneous revenues
9 which show up in line 7. And those include the
10 connection charges, the reconnection charges,
11 hydrant charges, the things we talked about just
12 earlier, right? You deduct those from the revenue
13 requirement?

14 A That is correct.

15 Q And that's -- those are the ones out --
16 you didn't do a separate rate study on those,
17 right?

18 A That is correct. Right. I accepted
19 those.

20 Q Now, you also deduct in line 9 customer
21 charge revenue as shown in Schedule VII, correct?
22 That's \$1.4 million?

1 A That's correct.

2 Q And that's the monthly or quarterly
3 customer charges that we talked about earlier,
4 correct?

5 A That's right.

6 Q And then -- and that gave you in line 10
7 the total retail consumption charge revenue
8 requirement, right?

9 A Yes, sir.

10 Q That's \$16.8 million?

11 A Correct.

12 Q And then in line 11, you have the retail
13 consumption money coming from the sale of water,
14 right?

15 A But line 11 is the billing units.

16 Q Right. That's how much water was sold
17 in thousands of gallons?

18 A That's correct. That's correct.

19 Q And that's what you used to figure out
20 how much money is going to be coming in for the
21 sale of water, right?

22 A How much -- no. How much --

1 Q You need the volume of water being sold
2 to determine how much revenue is going to be
3 obtained from selling the water?

4 A Right. Those are the billing
5 determinants. That's going to be the denominator
6 in my rate calculation.

7 Q Yes, sir. And then in line 11 -- and
8 the data that you use for the amount of water that
9 is going to be sold is for the period July 1,
10 2008, through June 30, 2009, right?

11 A Correct. Yes. Correct.

12 Q And that -- and that information is
13 found on Schedule IX, which we'll get to later.

14 A That's right.

15 Q Okay. Now, in line 12, you have
16 calculated what the nonpeak and peak consumption
17 rates should be in order to produce the revenue
18 needed in line 10, right?

19 A That's correct.

20 Q And with regard to the difference
21 between the \$3.33 shown here for the commodity
22 rate, nonpeak rate, and the \$5.07 shown here for

1 the peak rate, am I correct that you simply kept
2 the same ratio as between the current commodity
3 charge and the peak charge?

4 A That's exactly right.

5 Q Okay. You don't know how Falls Church
6 set its peak use rate in comparison to its
7 commodity rate, correct?

8 A No. But that rate is -- but that
9 differential and that rate design, that rate
10 structure is fairly common in Northern Virginia.

11 Q Well --

12 A But I don't know exactly how they came
13 up with that --

14 Q And isn't it --

15 A -- relationship.

16 Q Isn't it also fairly common when doing a
17 rate study to investigate the relationship between
18 the peak rate and the nonpeak rate?

19 A No. Sometimes it is, sometimes it
20 isn't. The relationship between the peak rate and
21 the nonpeak rate -- rate design is as much an art
22 as a science, perhaps more of an art than a

1 science. There are a lot of policy considerations
2 that go into determining these peak usage rates or
3 peak surcharges, one of which primarily, one of
4 the most important is to send a price signal for
5 conservation.

6 There is -- that is simply a policy
7 determination. And there can be quantitative
8 analyses in developing that. But more often than
9 not, it's simply a policy of the Town or the City
10 to set a surcharge rate considerably higher than
11 the base rate so as to, again, provide a pricing
12 signal to use -- conserve water and use it more
13 efficiently.

14 Q So just to be clear, you weren't asked
15 to look at the ratio that Falls Church used, and
16 you didn't do that investigation, right?

17 A I wasn't asked either way. I did not.
18 I accepted the current differential.

19 Q All right. Now, are you familiar with
20 the phrase "sensitivity analysis"?

21 A I believe so.

22 Q And a sensitivity analysis is where you

1 look at the effect on the output of potentially
2 different inputs and see what magnitude change
3 there would be, right?

4 A Right.

5 Q Okay. And when you prepared this
6 analysis, you didn't include any sensitivity
7 analysis to show the effect of changes in the
8 various inputs, right?

9 A That is correct.

10 Q And would you agree with me that
11 relatively small changes in the inputs in your
12 analysis can have a significant effect on the
13 calculated commodity rate?

14 A It would depend on which one it may be.
15 It may or may not, depending on the individual
16 input.

17 Q All right. Well, you gave an example on
18 direct examination of one change you made where
19 you changed the amortization schedules on two
20 projects from 10 years to 30 years.

21 A Correct.

22 Q And those two changes had a collective

1 effect on your commodity rate of 4 cents, right?

2 A Yes.

3 Q Okay.

4 A Very small change, effect.

5 Q All right. Now let's talk about the
6 water sales assumptions that you used. You have
7 the water sales information on Schedule IX,
8 correct?

9 A That's correct.

10 Q And if we can go to Schedule IX. Ken,
11 that's page 41 of 41, DX-70.

12 Okay. And we're showing Schedule IX of
13 Defendant's Exhibit 70 here on the screen. And
14 this is your sales information for water, right?

15 A That's correct. That's the billing
16 consumption.

17 Q And, Ken, if you could magnify, please,
18 the bottom line, "grand total."

19 All right. And so you had for this
20 period, July 1 of '08 through June 30 of '09, a
21 total of 5.374 billion gallons sold by the City of
22 Falls Church, right?

1 A Correct.

2 Q And the peak consumption of that was

3 326 million gallons?

4 A I'm sorry?

5 Q The peak consumption of that --

6 A Of the 5-point --

7 Q Of that that was sold during peak

8 consumption period was 326.2 million gallons,

9 right?

10 A Right. So as we all understand, the

11 total consumption was 5.3 billion. And then of

12 that 5.3 billion, there's 325 million subject to

13 the peak consumption charge. I think that's what

14 you're saying.

15 Q So the 325 is included in the

16 5.3 billion?

17 A Yes, right, right.

18 Q Now if we divide the total amount of

19 5.3 million by 365 days, we'll get the water

20 figure for the City of Falls Church consumed,

21 right?

22 A Yes. Known as average use per day.

1 Q Yes. And I'll represent to you that

2 I've done that math and that dividing the

3 5.374 billion figure by 365 days gives

4 14.7 million gallons a day.

5 A Okay.

6 Q Does that sound about right?

7 A I don't have a calculator, but --

8 Q Okay.

9 A I'll accept your math.

10 Q All right. Thank you. And did you

11 compare the sales, million gallons per day figures

12 for the City for the 2008 to 2009 period that you

13 looked at with prior years' sales?

14 A Not in that -- not in that manner. I

15 looked at -- I considered the customer growth as

16 well as the rainfall. But I did not consider --

17 look at the billing records --

18 Q Okay.

19 A -- going back. And one thing that needs

20 to be understood is that these are billed amounts,

21 not flow amounts. There's certain write-offs, et

22 cetera, et cetera. So this is what was actually

1 billed to the customers.

2 Q All right. Let me, if I may, ask the

3 deputy to hand you a document that I have marked

4 as Plaintiff's Rebuttal Exhibit 3.

5 And I have a copy for the Court.

6 THE COURT: Thank you.

7 BY MR. RAPHAEL:

8 Q Do you recognize Plaintiff's Rebuttal

9 Exhibit 3 as the City of Falls Church 2008 annual

10 water report?

11 A Yes. I've seen it. It's been a while.

12 Q All right. And if you would direct your

13 attention, sir, to page -- we're going to bring it

14 up on the screen. But it's page 8 of the

15 document.

16 Ken, could you bring up page 8, please,

17 on the screen.

18 And do you see where it has under

19 "Operating Performance," it's got the information

20 on the millions of gallons per day purchased from

21 the Aqueduct? Do you see that?

22 A Uh-huh.

1 Q You need to say yes or no.

2 A I'm sorry, yes, I apologize.

3 Q All right. So for the past two fiscal

4 years it's been 17 million gallons per day,

5 correct?

6 A Correct.

7 Q And that's higher than the 14.7 million

8 gallons a day that you came up with. It's about

9 13 percent less, isn't it?

10 A Yes. It's a little bit less.

11 Q Do you know what the leak rate is, how

12 much water that Falls Church buys is lost through

13 leaks?

14 A Yeah. I'm very familiar with it. No, I

15 don't. And those vary tremendously. Older

16 systems can be as high as 14, 15 percent. New

17 systems can be in the 5 percent range.

18 A reasonable rule of thumb is 7 to

19 10 percent, but I don't know specifically what

20 Falls Church did.

21 Q You didn't inquire of Falls Church what

22 the leak rate was, did you?

1 A No, I didn't.
 2 Q And no one ever told you that, did they?
 3 A No.
 4 Q All right. Now, you're aware that water
 5 usage normally goes up a lot in the summertime
 6 compared to the wintertime, right?
 7 A Correct.
 8 Q And you're aware that the rainfall on
 9 this area in the second quarter of 2009, the April
 10 to June period was significantly greater than
 11 normal, right?
 12 A I don't know if it was significantly,
 13 but we did have a wet summer, wet spring. There's
 14 no doubt.
 15 Q Right. And isn't it normal practice
 16 when you're doing a rate-making study to determine
 17 what a normal yearly sales rate is based on
 18 average rainfall?
 19 A Not always. It's not uncommon to do
 20 that. In the years of an extreme drought, clearly
 21 an adjustment may be warranted. Some people do,
 22 some people don't. And likewise, in a period of

1 an extremely wet summer, you may want to make an
 2 adjustment.
 3 I looked at the rainfall amounts in
 4 Virginia, Northern Virginia in particular. And
 5 even though, yes, we did have a very wet spring,
 6 the summer months were not that out of line in
 7 2009.
 8 And, remember that this is a fiscal
 9 year. So my fiscal year begins in July and ends
 10 in June. So I had to go back to the summer of '08
 11 as well.
 12 Q All right. Did you analyze why the
 13 14.7 million gallon per day figure that you used
 14 was less than what was purchased from the Aqueduct
 15 in FY '07 and FY '08?
 16 A No. Not specifically. But as you
 17 alluded to, the 17 -- you're somewhat comparing
 18 apples and oranges. The 14-point whatever number
 19 you calculated from my Exhibit IX, that's billed
 20 consumption after leaks. And the 17 million
 21 gallons per day, that's purchased water before
 22 leaks. You're going to have leaks in any system.

1 Q Okay. So if we add 5 percent for leaks
 2 to the 14.7 figure, that gives us 15.4 million
 3 gallons a day, right?
 4 A Okay. I'll agree with your --
 5 Q All right. Did you analyze what effect
 6 on your commodity rate would occur with each
 7 percentage or 5 percent increase in the amount of
 8 water sold?
 9 A No.
 10 Q All right. Well, let's do that.
 11 MR. RAPHAEL: Your Honor, may I work
 12 from my laptop here?
 13 THE COURT: Yes, sir.
 14 MR. RAPHAEL: Thank you, Your Honor.
 15 BY MR. RAPHAEL:
 16 Q Now, Mr. Watkins, you were good enough
 17 to provide us the native Excel files for the
 18 schedules that you prepared for your expert
 19 report, right?
 20 A Yes. I remember.
 21 Q We looked at these in your deposition,
 22 right?

1 A Yes, we did.
 2 Q Okay. And I've got displayed here on
 3 the screen the Schedule I.
 4 A Uh-huh.
 5 Q Do you see that?
 6 A Yes, I do.
 7 Q And I'm going to switch over now and go
 8 to the consumption page -- no, I'm not. I'm
 9 sorry. Let me go back to Schedule I.
 10 Okay. In line 11 on Schedule I is
 11 your -- are your retail consumption figures. Do
 12 you see that?
 13 A Yes.
 14 Q So I'm illuminating here the cell for
 15 K-41, where you've got 4.5 million gallons --
 16 4.5 billion gallon figure. And if you watch what
 17 I'm doing here, I'm going to put in -- let's put
 18 over in cell L-41 the number 1.05, to show what a
 19 5 percent increase would be.
 20 A Okay.
 21 Q Are you with me so far?
 22 A I believe so.

1 Q And I'm going to do the same in cell
2 L-42, to show what a 5 percent increase would be.
3 Now I'm going to come back to K-41, and I'm going
4 to put in a plus sign before the figure. And then
5 I'm going to multiply that by cell L-41 with the
6 5 percent increase.

7 A I'm with you.

8 Q I'm going to do the same thing in cell
9 K-42, put in a plus there and multiply it by cell
10 L-42.

11 All right. So you see I've taken a
12 5 percent increase in your -- the amount of water
13 sold. Do you see that?

14 A Yes, I do.

15 Q And that changes your commodity rate
16 from \$3.33 to \$3.17, right?

17 A It sure seems to, yes.

18 Q Yes. And if we just -- just to see what
19 another 5 percent effect would be, if we change
20 this from a 5 percent increase to a 10 percent
21 increase in both cells, it drops your commodity
22 charge from \$3.33 to \$3.03, right?

1 A Yeah. But you've made a major mistake
2 by doing that. You forgot that we have to pay for
3 that water that's lost. You haven't increased --
4 you haven't increased the cost of water. That
5 water is not free. We have to purchase that
6 water.

7 Q Right. But my point is that if you had
8 a drier year, and you sold more water, you would
9 have more revenue coming in, right?

10 A But that means I have to buy more water.
11 You're just increasing the billing units. You're
12 not increasing the cost of the water that I have
13 to purchase.

14 Q Fair enough. Fair enough.

15 A So mathematically you're correct, but
16 it's nonsensical.

17 Q And where would you increase the cost of
18 that?

19 A That would be within the cost of water,
20 wholesale cost of water, which would be in
21 Schedule II, under source of supply, which would
22 be seen on page 2, Roman numeral III, source of

1 supply. See the purchased water about halfway
2 down?

3 Q Yes.

4 A You would increase that. Perhaps you
5 can get a better feel for it if -- you'll see
6 there's an adjustment 8 associated with that. So
7 on Schedule III, page 8, you'll see details
8 supporting the purchased water.

9 Q Okay.

10 A So --

11 Q Where does that --

12 A So the effect wouldn't be as great as
13 that. There would be effect, of course. But see,
14 we have to pay 767 gallons -- \$767 per million
15 gallons. So if you increase the consumption, you
16 have to increase the cost, because I've got to --
17 I've got to buy that water. I don't produce it
18 for free.

19 Q No. I understand that. Where does the
20 figure flow back to summary Schedule I?

21 A Okay. We see purchased water. You see
22 the 4,875,200. That number appears at the bottom

1 of page 8 of Schedule III. Total adjusted. And
2 there's three adjustments. We went through this
3 in the deposition. But there's three adjustments
4 here.

5 I have 11 months of data that I also had
6 to add one more month in for 2008. And then there
7 were some de minimis purchases from Fairfax County
8 Water Authority. And then I had a rate change
9 during the year. You can see at the bottom, the
10 rate went from \$850 per million gallons to \$767
11 per million gallons.

12 Each of those amounts are subtotaled.
13 And then they're added together at the bottom for
14 a total adjustment of 4,875,200 gallons -- 200
15 dollars, excuse me. 4.875 million.

16 So the point is, if you're going to
17 increase your consumption, you also have to
18 increase the purchased water cost.

19 Q Okay. Fair enough. Let's go to your
20 adjustment 8. And here you have in cell C-47,
21 this is your water purchase detail, you've got
22 \$5.3 million for water paid, right?

1 A I'm sorry, you're on Schedule III,
2 page 8?
3 Q Yes.
4 A And the question is?
5 Q The -- I'm sorry. You show \$4,875,200
6 paid to the Aqueduct, right?
7 A Right. On an adjusted basis to reflect
8 12 months of data annualized as well as the
9 current rate structure.
10 Q Right. Now, what I did here, I took
11 your number, and do you see how I multiplied it in
12 cell D-47 by 10 percent, right? Let's assume
13 hypothetically there's a 10 percent increase in
14 the cost, okay?
15 A Okay.
16 Q And that gives \$5.3 million.
17 A Uh-huh.
18 Q And then let's paste the value of that
19 cell in the cell below it, so we keep track of the
20 number. And we'll paste the \$5.3 million back
21 into cell C-47.
22 So instead of the \$4.8 million cost for

1 water, we're going to assume sales went up
2 10 percent and the cost was 5.3 million. Are you
3 with me so far?
4 A Not exactly. If you go to cell D,
5 whatever this is, I can't see it on the screen.
6 There you go. You took C-47.
7 Q And I increased it by 10 percent.
8 A Yeah. But it's circular now. You
9 screwed up.
10 Q No, I know. It is circular. And that's
11 why I pasted the value before down below.
12 A Well, then that's not the right number.
13 The number is 4,875,200. You're messing up.
14 Q Walk with me, Mr. Watkins.
15 A Okay.
16 Q We start with your original number,
17 4.8 million?
18 A Correct.
19 Q In cell C-47?
20 A Correct.
21 Q I then take 10 percent of that again and
22 added cell D-47.

1 A Okay.
2 Q That gives me 5.3 million?
3 A Okay.
4 Q You're exactly right that these cells
5 are referring to each other. So we have to paste
6 the value in another one to make sure the number
7 doesn't change. That's what I did below it. Do
8 you see that? I pasted 5.3 million.
9 A I see. I'm with you now.
10 Q So now I'm going to take that figure --
11 A And cut and paste it over there.
12 Q -- and cut and paste it over there.
13 A I got you.
14 Q And so that would be a 10 percent
15 increase in what you had for sales.
16 And if I go back to the summary sheet
17 now, cell K-45 shows that the adjusted figure for
18 the commodity rate is now \$3.11 rather than the
19 \$3.33 that you had. That's assuming a
20 10 percent --
21 A Whoa. You're losing me. You took that
22 4 -- \$5.3 million and did what with it, now?

1 Q I wanted to see what effect that would
2 have to take account of your point that you have
3 to increase the amount of water purchased.
4 A Okay. Well, you should go to -- if
5 you're going to do that then, go to Schedule II
6 under source of supply. You see it down there.
7 It's in the middle under Roman numeral III. You
8 see the 4.875.
9 Q Yes.
10 A It should pick it up automatically. But
11 we better check.
12 Q You want me to change it there, too, is
13 that what you're saying?
14 A No. It should flow through
15 automatically.
16 Q I see what you're saying.
17 A So if you go to Schedule II, I
18 believe -- I think it's up, Mr. Raphael.
19 Number 3. You're getting there. Okay. C.
20 Q Right there?
21 A Purchase of water. Right.
22 Q So it flowed through.

1 A Right. It flowed throughout
2 automatically. Correct.

3 Q So we've done a little exercise here.
4 We assumed a 10 percent increase in the amount of
5 water sold and a 10 percent increase in the amount
6 of water purchased. And that affect changes your
7 calculated commodity rate from \$3.33 to \$3.11,
8 right?

9 A I -- I'm sitting here studying this.
10 The increase, 5-point -- that was about 8 --
11 450,000. If you go to my Schedule I for O&M
12 expenses, I just want to verify what you're doing.
13 I have no idea what you're doing with my
14 spreadsheet here. So -- and I don't mean that
15 you're making any mistakes.

16 If you go to Schedule I, the total of
17 O&M expenses now are somewhere in the neighborhood
18 of 15.1 million.

19 Q What page?

20 A I'm on Schedule I, which is a one-page
21 exhibit.

22 Q Okay. And which line do you want to

1 return figure. This is the -- this is the figure
2 that appears on Schedule I in line 5. And we
3 alluded to it earlier. And when the City includes
4 a return on equity as part of the required return
5 that it's charging, that's the same as taking a
6 profit, correct?

7 A I'm sorry?

8 Q When the City includes a return on
9 equity in the rates that it's charging to outside
10 City customers, that's the same in your view as
11 taking a profit, right?

12 A It's a profit provision, correct.

13 Q And the -- Ken, if you could illuminate,
14 please, page 17 of 41, that Schedule I.

15 All right. And I'm going to put my
16 cursor in the required return box here, which is
17 cell K-26. Do you see that?

18 A Yes, I do.

19 Q If we go to cell K-26 of your schedule
20 for the required return. Do you see that? I'm
21 there now.

22 A Yes, I do.

1 look at?

2 A 1. Yep. It's -- so 15.1 sounds about
3 right.

4 Q Right.

5 A And then we go -- so we have the
6 wholesale revenue requirements should increase --
7 the total revenue requirement in line 6 should
8 increase by about \$450,000, which it does.

9 And then we're subtracting the wholesale
10 revenues, which remain constant. And then we have
11 line 11, the retail consumption that you increase
12 by that.

13 Yes. It looks like your arithmetic
14 would be -- with that, it would go from 3.33 to
15 \$3.11. And from 5.07 to 4.75. That's right, if
16 you were to make that assumption.

17 Q Thank you. I'm going to close out of
18 this and open this again because I don't want to
19 save any of those changes by accident.

20 A Okay.

21 Q Okay. Ken, you can take that off.

22 Now, let's talk about the required

1 Q And it illuminates the formula that is
2 in this cell. And the formula is 0.0666 times
3 rate base, right?

4 A That's correct.

5 Q So the percentage that you used is
6 6.66 percent multiplied by rate base, right?

7 A That's correct.

8 Q Okay. And you agree with me, do you
9 not, that there's a difference between including a
10 return in the computation of the rate to be
11 charged to an out-of-town customer on the one
12 hand, and a decision whether to actually transfer
13 that money as a profit from the water fund to the
14 general fund, right?

15 A Yeah, with the exception of that money
16 is profit. The two are independent of each other.
17 You are correct.

18 Q Yes, sir.

19 THE COURT: I'm sorry. Could you repeat
20 your question. I didn't -- I thought I understood
21 it correctly, but I would just like to hear it one
22 more time.

1 MR. RAPHAEL: Yes. My question was that
2 he agrees with me that there's a difference
3 between including a rate of return in determining
4 what the rates should be to outside-City customers
5 on the one hand.

6 THE COURT: Right.

7 MR. RAPHAEL: And the decision whether
8 to take that money and transfer it out of the
9 water fund to the general fund on the other.

10 THE COURT: I understood correctly.
11 Thank you.

12 BY MR. RAPHAEL:

13 Q What effect, Mr. Watkins, does a
14 1 percent change in your rate of return here have?
15 You used 6.66 percent. What effect is there from
16 a 1 percent change?

17 A In other words, if we -- on the overall
18 weighted cost of capital or on the cost of equity?

19 Q Let's stick here with Schedule I. And
20 you used a total weighted return of 6.66 percent,
21 right?

22 A Correct.

1 Q All right. Let's see what happens if we
2 change that from 6.66 percent to 5.66 percent. Do
3 you see I just changed that? And so K-26, I
4 changed your 6.66 percent figure, I've moved it
5 down 1 percent, right?

6 A Correct.

7 Q I'm going to hit Enter. And we're going
8 to see what effect it has on the calculated rate.

9 A You should have about a \$260,000
10 difference.

11 Q All right. Do you see -- if I make a
12 1 percent change in your rate of return, from
13 6.66 percent to 5.66 percent, it drops your rate
14 from \$3.33 to \$3.25 per thousand gallons, right?

15 A If you were to do that, arithmetically
16 you're correct.

17 Q So getting back to this issue of
18 sensitivity analysis, a 1 percent change in your
19 rate of return has an 8-cent swing on your
20 calculated commodity rate, right?

21 A Right. Right. On the overall cost of
22 capital. I -- I guess it is just a hypothetical

1 calculation that you were doing. I don't know.
2 The implication, is that on debt or equity or it
3 could be either?

4 Q We're going to get there. I wanted to
5 see what the sensitivity is here to a 1 percent
6 change.

7 A Yeah. Arithmetically, that looks like
8 that's correct.

9 Q And if I put in, instead of 5.66
10 percent, if I put in 4 percent, .04 in cell K-26,
11 that drops the calculated rate from \$3.33 to
12 \$3.12, right?

13 A That's right.

14 Q Okay. Let me cancel these changes so we
15 go back to the original.

16 Now, you did your required return
17 analysis on Schedule VIII, right?

18 A That's correct.

19 Q And, Ken, would you bring up on the hard
20 copy, DX-70, Schedule VIII, please, page 40 of 41.

21 Okay. We've got Schedule VIII on the
22 screen here, right?

1 A Yes.

2 Q And here is where you calculate the
3 6.66 percent figure. Do you see that?

4 A Yes.

5 Q You can highlight that, Ken.

6 And you get the 6.66 percent figure as
7 your return on capital by coming up with a cost of
8 equity and cost of debt which you weighted
9 50 percent each, right?

10 A That's correct.

11 Q And you came up with the 50/50 split
12 between those two things by looking at the debt to
13 equity ratio for private companies as reported in
14 the Value Line Investment Survey, right?

15 A That is correct. In determining the
16 cost of equity, as we discussed earlier, I do rate
17 of return and cost of equity studies quite often.

18 The models that we use are market
19 driven. The cost of equity -- what is the rate of
20 return that you require on a particular project.
21 It's very subjective, and it varies from investor
22 to investor, township to township, et cetera, et

1 cetera.
2 And so, therefore, financial theory
3 tells us and then in practice the best measure of
4 risk, the relationship between risk and return is
5 market returns, and investor owned utilities is
6 the data that we have available, and that's what's
7 typically used.

8 Q And that's why you look to the Value
9 Line Investment Survey?

10 A That's correct.

11 Q And the Value Line Investment Survey
12 reports the information on investor owned
13 companies like Virginia American or United Water,
14 right?

15 A That's right.

16 Q It doesn't report information for
17 municipally owned utilities like the City of Falls
18 Church, right?

19 A That's correct. Typically the
20 municipalities have a higher debt percentage than
21 50 percent. More often than not, they -- they are
22 in the 60 to 65 percent debt range.

1 Q More debt than equity?

2 A That's correct.

3 Q Right. Now, as between the cost of debt
4 and equity, the cost of equity has a much higher
5 return, right?

6 A Yes.

7 Q And in your analysis, equity has a
8 return of 8.93 percent versus debt of 4.4 percent,
9 right?

10 A Correct.

11 Q Okay. And I think you said that you
12 gave the Fairfax County ratepayers the benefit of
13 the doubt by using a 50/50 split on debt to
14 equity, right?

15 A Right. That wasn't a precontrived
16 motive. But I wanted to be very conservative so
17 we would not quibble over capital structure
18 issues. And so I used an industry --

19 Q Right. But isn't it --

20 A -- norm.

21 Q -- true, Mr. Watkins, that if you'd

22 weighted it more towards debt, your rate of return

1 would have been lower?

2 A Oh, absolutely.

3 Q Right. And that would have resulted in
4 a lower commodity rate than what you came up with,
5 right?

6 A That's correct.

7 Q And that would have been more favorable
8 to the Fairfax County ratepayers in the analysis,
9 wouldn't it have been?

10 A Only in part. But you're forgetting the
11 leverage effect on the interest rate. As your
12 leverage increases, the financial risk to
13 bondholders increases. And so the -- there would
14 have to be somewhat of an adjustment to the cost
15 of debt.

16 But, I will -- I will tell you it's not
17 going to be herculean. It's not going to be
18 tremendous. It might be a few basis points is
19 all.

20 Q You came up with, for the cost of equity
21 here, the 8.93 percent that you used in your
22 analysis, you came up with that based on a recent

1 case before the Virginia State Corporation
2 Commission involving Virginia American, correct?

3 A Yes. I used that as an example.

4 Q And you've got the Virginia American
5 reference at the bottom of this. Ken, can you
6 highlight that sentence second from the bottom.
7 The 10.5 -- it reads: "The 10.5 percent is based
8 on a recent settlement in the Virginia American
9 water case before the Virginia SCC and other
10 similar water rate case findings."

11 Do you see that?

12 A Yes.

13 Q Okay. And so you took the 10.5 percent
14 from that proceeding involving Virginia American,
15 and you reduced it by 15 percent, right?

16 A That's correct.

17 Q Why did you reduce it by 15 percent?

18 A The theoretical reason is to reflect the
19 fact that there are no taxes associated with the
20 return on equity for a municipal.

21 Q Right.

22 A And as you or I, as individuals, if we

1 receive a dividend, we have to pay income taxes on
2 it. If we have a capital gains, we pay the
3 capital gains tax.

4 It's -- it's subjective because my
5 pension plan, my profit-sharing and pension plan
6 also has investments. Well, we don't pay -- we
7 don't pay an income tax on that. Neither do
8 governmental pension funds that own within their
9 portfolio various stocks, bonds, et cetera, et
10 cetera.

11 But I didn't want to quibble on what a
12 cost of equity is. I wanted to be very
13 conservative. So I used a 15 percent tax rate on
14 average, and reduced that 15 -- the 10.5 percent
15 to arrive at the 8.93.

16 Q And you might have used a percentage
17 higher than 15 percent?

18 A Yeah. One could arguably use higher or
19 lower. In rate cases, for municipal rate cases,
20 there -- people have advanced reducing the cost of
21 equity for this, because it helps the ratepayer,
22 if you will.

1 In Pennsylvania it has not been
2 accepted. But, again, I wanted to be very
3 conservative. So I gave the benefit of the doubt
4 to -- to the County of Fairfax for the
5 determination of cost of equity.

6 Q But wouldn't you have given them more of
7 a benefit of the doubt if you used a higher rate,
8 wouldn't you, higher discount rate?

9 A Yeah. And less if I had given them less
10 of a rate. The reasonable cost of equity I found
11 was 10 percent, 10-1/2 percent. But you can see
12 in my calculations I've imputed a cost of equity
13 of slightly less than 9 percent.

14 Q Okay. Now, if we go back to the
15 10.5 percent, you discounted that by 15 percent to
16 account for the fact that Falls Church operates
17 tax free, right?

18 A Correct.

19 Q All right. And that gives you the
20 figure 8.925 percent, which you've rounded to
21 8.93 percent that you use as your cost of equity,
22 right?

1 A Okay.

2 Q Is that -- is what I said correct?

3 A It seems. I haven't done the math. But
4 if you say I rounded it, I'll accept that.

5 Q Incidentally, why aren't the City's
6 operations, when it operates the water system, why
7 aren't those taxed?

8 MR. THOMAS: Objection, Judge. That's
9 beyond the scope of certainly anything I've asked
10 this witness.

11 THE COURT: Well, he may be able to
12 answer it, though. I think it's a permissible
13 question. Objection overruled.

14 THE WITNESS: It's my understanding that
15 they're not subject to taxation either from the
16 federal government or the state.

17 BY MR. RAPHAEL:

18 Q Because why?

19 MR. THOMAS: Same objection, Judge.

20 THE WITNESS: Again, these are not --
21 these are -- I believe you're thinking of
22 corporate income taxes. These are income taxes

1 that would be paid by the shareholders. If you
2 will, the owners of Falls Church are the citizens.
3 There is no taxation associated with either the
4 capital gains or dividends paid, you know, to
5 the -- by the -- by the City of Falls Church to
6 the citizens or whatever.

7 BY MR. RAPHAEL:

8 Q Mr. Watkins, isn't the reason that Falls
9 Church doesn't pay taxes because it's a government
10 entity?

11 A Yes. Exactly. I thought -- that's
12 obvious. I thought everybody knew that. I was
13 maybe reading more into your question than that.
14 But, yes, it's a government entity.

15 Q Now, let's talk about the Virginia
16 American case where you got this 10.5 percent as
17 your starting point.

18 A That and other rate case findings.

19 Q You specifically chose the 10.5 percent
20 from the Virginia American case, didn't you?

21 A No. It says "and other similar water
22 rate case findings." I do this for a living. I

1 do it day in and day out. And the vast majority
2 of water cases are in the 10-1/4, 10-1/2 range.
3 And to -- to point you to something in Virginia,
4 there was a recent case for the Virginia American,
5 which was the most recent case in which there was
6 a -- an actual rate of return specified in an
7 order.

8 Usually when these cases are settled
9 it's a black box settlement, and there has not
10 been a fully litigated rate case in quite a while
11 in Virginia.

12 Q There has not been?

13 A Correct.

14 Q Now, you've never testified in any State
15 Corporation Commission proceeding as to what
16 Virginia American's return on equity should be,
17 have you?

18 A No. I don't believe I have on Virginia
19 American. I testify in cost of capital a lot.
20 But my engagements for Virginia American I believe
21 are pretty much limited to cost allocations and
22 jurisdictional revenue requirement.

1 Q And the reason you picked the
2 10.5 percent rate that you used from the Virginia
3 American case is because you believe it falls
4 right in the middle of the range of returns that
5 are approved by the Virginia State Corporation
6 Commission, right?

7 A No. The reason I picked it -- I don't
8 want to get into this quibbling with you. The
9 range of reasonableness that experts in the cost
10 of equity, it's very judgmental and very
11 subjective, are somewhere in the neighborhood of 9
12 to 12 percent.

13 There's a case in Pennsylvania now in
14 which a professor has asked for 12-1/2 percent. I
15 didn't want to get into a debate. This is what
16 rate cases are about.

17 Q Didn't --

18 A And this is not a rate case. So I
19 wanted to pick -- I picked a number of 10-1/2
20 percent as a starting point, as which no
21 reasonable expert would quibble with.

22 Q Isn't it true, Mr. Watkins --

1 A May I finish? May I finish?

2 Q Sure.

3 A Then I reduced it further from 10-1/2
4 percent to 8.93 percent as a cost of equity or a
5 cost of business risk to the City of Falls Church.
6 And no reasonable economist would quibble that a
7 9 percent rate of return on equity is anything but
8 the bottom end of the range of reasonableness. I
9 mean the rock bottom end. I didn't want to get
10 into an argument over, again, should it be 9 or
11 13. I gave every benefit of the doubt in my
12 calculation to lowering the rate.

13 Q Every benefit of the doubt to Fairfax
14 County ratepayers, right?

15 A Yes. With respect to this issue.

16 Q Isn't it true that you picked the
17 10.5 percent because you thought it fell right in
18 the middle of the range of returns?

19 A Well, yeah. That goes without reason.
20 Between 9 and 13 is right in the middle.

21 Q All right. All right. And I asked you
22 this question in your deposition, right?

1 A Yes. I believe you're right.

2 Q And you told me the reason you picked it
3 was because it was right in the middle of the
4 range?

5 A Yes. Right in the range of
6 reasonableness. And in fact, this is an example
7 of a settlement rate found by the commission to
8 be -- to be correct or within the range of
9 reasonableness.

10 Q Okay. It's true, isn't it, that you did
11 fundamentally the same approach in rate-making
12 analysis in the Town of Leesburg case, right?

13 A Yes, sir.

14 Q And your testimony in that case was in
15 January of this year, wasn't it?

16 A January or February, one of the two.

17 Q Yes. Didn't you testify, Mr. Watkins,
18 in the Town of Leesburg case that you picked the
19 10.5 percent rate of return for Virginia American
20 because it was at the high end of what the State
21 Corporation Commission's approved?

22 A No.

1 Q All right.

2 A I don't believe I did.

3 Q At page 170 of your trial testimony, you
4 said: "I defer to the highest range of a water
5 company awarded by a State Corporation Commission,
6 which is a competent expert tribunal in the State
7 of Virginia."

8 A That's right.

9 Q Right?

10 A And that's exactly what I said. At the
11 highest end. Like I said, most are in the range
12 of 10 to 10-1/2 percent. In Pennsylvania -- I do
13 a tremendous amount of work in Pennsylvania. Most
14 of those are in the 10 to 10-1/4. The state of
15 Washington are in the 10 to 10-1/4. 10-1/2, I
16 didn't want to get into any quibbling. So 10-1/2
17 is the highest that I was aware of.

18 Q Right.

19 A Not to say that there's not -- you
20 couldn't find one higher, but.

21 Q You said in the Town of Leesburg case at
22 page 81, "I did not want to get into a debate with

1 the Town over this level, so I accepted the 10-1/2
2 percent cost of equity, which again is a bit on
3 the high side."

4 A Okay. Yes.

5 Q You said that, right?

6 A Yes.

7 Q So in the Town of Leesburg case you said
8 it was on the high side. In this case you're
9 saying it's right in the middle?

10 A Okay.

11 Q All right.

12 A I didn't want to get into a debate. But
13 I think you're taking the -- that a little bit out
14 of context, counselor. Remember, what you
15 referred to straight out of the transcript was
16 referring to a comparison of other awards. And
17 10-1/2 percent is on the high side for those other
18 awards.

19 Q Isn't it true, Mr. Watkins, that the
20 reason you picked a rate on the high side in the
21 Town of Leesburg case was because it gave the
22 benefit of the doubt to the Town?

1 A Counselor, that is absolutely
2 ridiculous. As I indicated in my deposition, any
3 economist that knows anything about cost of
4 capital would agree that the cost -- a fair cost
5 of equity or a reasonable range is anywhere
6 between approximately 9 and 12-1/2, 13 percent.

7 Now, had -- had I wanted to get this
8 rate as high as possible, I would have simply
9 recommended to Mr. -- Mr. Thomas, hire a rate of
10 return witness -- and there's a million of them
11 out there that are recommending 13 percent, we
12 would have plugged in 13 percent. So that's
13 absolutely absurd.

14 Q That wasn't my question, Mr. Watkins.
15 My question was, isn't it true that the reason you
16 said in the Town of Leesburg case that you picked
17 a rate at the high end, was to give the benefit of
18 the doubt to the Town of Leesburg?

19 A No. As we discussed in the transcript,
20 the 10-1/2 percent was the high end of the awarded
21 ranges.

22 Now, if you want to say that -- should

1 it be -- if you want to quibble over 25 basis
2 points, should it be 10-1/4, 10-1/2, fine. The
3 point is a range of 10-1/2 percent on equity is
4 certainly within the range of reasonableness.

5 I used 10-1/2 percent because it, again,
6 is in the range of reasonableness. It's a
7 documented amount for those not familiar with cost
8 of capital. But most importantly, remember that's
9 not the cost of equity I'm using. I'm using
10 8.93 percent, sir.

11 Q In the Town of Leesburg case, the higher
12 the rate of return was, the more the Town could
13 have justified charging to its outside-Town
14 customers, right?

15 A That's correct.

16 Q Right. And so by choosing a rate on the
17 high end, you were giving the benefit of the doubt
18 to the Town by showing that the rates that they
19 were actually charging grossly exceeded that,
20 right?

21 A Right. And the point is I used exactly
22 the same number.

1 Q I understand. In the other case you
2 said you picked the number because it was at the
3 high end.

4 A It was the same number.

5 Q And in this case you picked the number
6 because you said it was in the middle.

7 A I've already asked and answered that.

8 Q Yes, you have.

9 A You're taking my testimony totally out
10 of context. I used the exact same number in the
11 Leesburg case as in this case a few months ago.
12 End of story.

13 Q Let's talk now about your use of the
14 Value Line Investment Survey on Schedule VIII.

15 THE COURT: Do you want to take a break
16 now?

17 MR. RAPHAEL: Sure.

18 THE COURT: We've been at it an hour
19 and -- we'll just take a few minutes.

20 MR. RAPHAEL: That would be fine.

21 THE COURT: The Court will be in recess.
22 (Whereupon, a recess was taken between

1 12:05 p.m. and 12:33 p.m.)

2 THE COURT: All right. Mr. Raphael, you
3 may continue, sir.

4 MR. RAPHAEL: Thank you, Your Honor.

5 BY MR. RAPHAEL:

6 Q Let's go back, Mr. Watkins, to
7 Schedule XIII of your analysis where you do your
8 cost of equity and cost of debt analysis.

9 Ken, can you bring up Defendant's
10 Exhibit 70 at page 40, please. Defendant's
11 Exhibit 70.

12 Okay. And the 50/50 split you indicated
13 between equity and debt, you got from the Value
14 Line Investment Survey of water companies, right?

15 A Well, that's -- that supports it. The
16 50/50 is used routinely in rate cases. But that
17 is the ultimate source.

18 Q But that's -- your footnote 1 there
19 refers to the Value Line Investment Survey, right?

20 A That's correct.

21 Q And so that's where you derive this
22 50/50 split.

1 A Correct.

2 Q Okay. Now, you were good enough, when I
3 took your deposition, to give me a copy of your
4 working papers.

5 Do you remember that?

6 A Yes, I do.

7 Q And the Value Line Investment Survey
8 that you used was included in your working papers,
9 was it not?

10 A That's right.

11 Q And you picked the most recent one that
12 you had dealing with the water industry, right?

13 A That's right.

14 Q All right. And I have a copy of that
15 here, Your Honor, I'm going to identify as
16 Plaintiff's Rebuttal 9. And I'm going to ask
17 Mr. Sapp to display that on the screen.

18 Can we go, Mr. Sapp, to page 62 of
19 Plaintiff's Rebuttal 9.

20 Okay. And do you recognize this as the
21 Value Line Investment Survey form that you used?

22 A Yes.

1 Q And the -- the data -- Mr. Sapp, can you
2 magnify, please, the box in the bottom left
3 corner.

4 Okay. Do you see the fourth row down,
5 it says long-term debt ratio, 50 percent; common
6 equity ratio, 50 percent?

7 A Indeed, I do.

8 Q And it shows the 50/50 split that you
9 used, right?

10 A That's right.

11 Q And it's got the years to the left side
12 of the table. And on the right side, the header
13 is 12 to 14?

14 A Yes.

15 Q Does that mean a 12- to 14-month
16 outlook?

17 A No. That's the forecast for the period
18 2012 through 2014. So what we do is usually take
19 the middle of that. So that would be the
20 forecasted amount for approximately the year 2013.

21 Q Okay. So, here again, this is the
22 debt/equity ratio for privately owned or

1 investor-owned water utilities, right?

2 A That's correct.

3 Q And Value Line is saying that, based on
4 that sampling, they project the debt/equity ratio
5 for those utilities to be 50/50 through the year
6 2014.

7 A Correct.

8 Q Okay. Now, there's another row on here
9 which I'd ask Mr. Sapp to illuminate, where --
10 Mr. Sapp, do you see where it says 9.8 percent in
11 the two boxes? Illuminate that whole row, please.

12 Okay. Now, according to Value Line
13 Investment Survey, the outlook for water utilities
14 for the return on shareholder equity is 7 percent
15 for the period 2012 to 2014, correct?

16 A Right. And what that is is the expected
17 booked return on equity for that period of time.
18 In other words, what Value Line expects the water
19 industry to actually achieve.

20 Q And the return on common equity is also
21 7 percent for that period, right?

22 A That's right.

1 Q And it's actually been less than that in
2 the periods 2008 through 2010, right?

3 A That's correct.

4 Q Okay. But you didn't use this as the
5 source for your 10.5 percent for your cost of
6 equity, did you?

7 A No. That never is used. What that
8 shows is a historical performance.

9 As you may or may not be aware, there's
10 been a tremendous amount of infrastructure
11 improvements in the nation, in the country for the
12 water utilities due to Clean Water Act, et cetera,
13 et cetera.

14 A tremendous amount of water treatment
15 facilities have been built in the last few years.
16 And the actual profitability achieved in the water
17 industry has been considerably less than what the
18 expected or the authorized rates are, what their
19 fair rate of return is.

20 Q Right. And my --

21 A The point is they have not been very
22 profitable in the last few years.

1 Q Yes, sir. And my point was you didn't
2 use this as your source for the rate of return for
3 the equity, did you?

4 A No. That never would be used.

5 Q And you used it for one purpose but not
6 another.

7 A It never would be used. This is a
8 historical snapshot.

9 In determining the cost of equity, you
10 look at the risks on a forward-looking basis as to
11 what are the risks of providing this water
12 service. Now, when we set rates, what happened in
13 the past happened in the past. So you look at
14 what the expectations are going forward relative
15 to the risk.

16 No analyst would look at the historical
17 returns and say, ah-hah. Because you only earned
18 2 percent last year, that means you're only
19 authorized to earn 2 percent this year.
20 Hypothetically.

21 Q Mr. Watkins, that wasn't my question.

22 My question was: You used this document

1 for one purpose; namely, the debt-to-equity split
2 ratio, but not for the purpose of determining
3 return on equity, right?

4 A That is correct.

5 Q Okay.

6 A However, information used within the
7 Value Line is used to develop other costs of
8 equity, not on this sheet, but on projected
9 dividend growth, dividend yield, price-to-earnings
10 ratios, things of that nature. All of those are
11 in the financial models that we used, and we rely
12 upon Value Line heavily for that.

13 Q You didn't undertake a survey, did you,
14 of the lowest rates of return on equity that have
15 been approved by the Virginia State Corporation
16 Commission for investor-owned water utilities, did
17 you?

18 A Not a formal survey. I work with the
19 State Corporation Commission on a daily basis and
20 inquired as to that effect. But there hasn't been
21 a litigated water case in several years.

22 And, in fact, in Virginia, the only

1 thing recent was this Virginia American that was
2 not a black box settlement in which there was an
3 authorized rate of return.

4 Q Okay. Mr. Watkins, that wasn't my
5 question.

6 My question was: You didn't do a survey
7 of the lowest rates that have been charged by --
8 that have been obtained from return on equity for
9 rates that were approved by the Virginia State
10 Corporation Commission for water utilities.

11 A I thought I did answer that.

12 A survey per se is there have been no --
13 this is the only litigated case in -- recently in
14 Virginia. So there is no survey to do.

15 Q I see.

16 A There's nothing higher; there's nothing
17 lower.

18 Q All right. So that's what you had? You
19 had what you had. It was the Virginia American
20 case.

21 A That's right. For Virginia.

22 Now, as indicated in the exhibit, it's

1 also consistent with other jurisdictions that are
2 authorized in the 10-1/4, 10-1/2 range, somewhere
3 in there.

4 Q Now, Falls Church has from time to time,
5 has it not, issued refunding bonds to take
6 advantage of low interest rates?

7 A Historically, I believe that's correct.

8 Q In fact, in the 2008 CAFR identifies a
9 number of them, doesn't it?

10 A It may.

11 Q Okay.

12 A I'm not going to dispute that.

13 Q Mr. Sapp, please bring up Plaintiff's
14 Exhibit 75 at page 63.

15 This is the CAFR for 2008 for Falls
16 Church, right?

17 A Yes.

18 Q Okay. Let's go to page 63. It's
19 actually page 67 of the document.

20 A Of --

21 Q Okay. Yeah, you had it. It's 63 on the
22 bottom right. It's 67 of 118. Okay.

1 A Oh, I see what you're saying.

2 Q If you could magnify, Ken, please, the
3 top half.

4 Okay. Do you see this is a list of the
5 bonds that have been issued by the City of Falls
6 Church --

7 A Yes.

8 Q -- as of the 2008 fiscal year, right?

9 A Yes.

10 Q And we've highlighted several of them
11 that are refunding bonds. There's one for
12 \$32 million for school refunding bonds. And
13 \$4.8 million to refund bonds that were GO bonds.
14 And there's another for \$6.2 million for refunding
15 bonds.

16 A Which simply means callable. Yes.

17 Q Right. So a locality, a municipality
18 does this when the interest rates go down because
19 you can refund bonds and get a better rate.

20 A Municipalities typically have callable
21 provisions in there so they can exercise their
22 right to their best advantage. Whether they

1 expect rates to go up or go down, they're still
2 going to want this in there so, in case they do go
3 down, they can call them.

4 Q Of course. So if you get a better rate
5 because the interest rates have gone down, you
6 want to be able to refund the bonds and replace
7 them with a better interest rate.

8 A Right. Subject to the call provision.
9 Sometimes call provisions are well above par.
10 Sometimes the transaction costs are so that they
11 prevent that.

12 But that's exactly right. I mean,
13 that's the intent to --

14 Q Right.

15 A -- protect yourself; hedge on the
16 interest rate risk.

17 Q Sure. And did you look at any of the
18 bonds that were issued by the City of Falls Church
19 in terms of looking at the bond documents
20 themselves?

21 A Not the bond covenants or bond
22 documents. As indicated on Schedule XIII, what I

1 have looked at is the weighted cost of debt, the
2 embedded cost of debt. And it is variable. So I
3 took a midpoint, as you can see there.

4 Q Right. You -- you -- in looking at the
5 City's cost of debt, you looked at two bond issues
6 that the City -- you may not have looked at the
7 actual bond indentures, but you looked at two bond
8 issues, right?

9 A That's right.

10 Q And, Ken, if we can go back to
11 schedule -- DX-70 at page 40, Schedule XIII.

12 Okay. Here we're back on your
13 Schedule XIII.

14 And, Mr. Sapp, if you would illuminate
15 that -- the rows associated with footnote 2 and
16 debt costs. You can leave it like that. That's
17 just fine.

18 All right. So here we see the two bonds
19 that you looked at for the water system. One was
20 a \$5.5 million bond issue, right?

21 A That's right.

22 Q And the interest rate that the City got

1 on that one was 3.89 percent?

2 A Correct.

3 Q And another one you looked at was a bond
4 issue of \$8.2 million. And you have an interest
5 rate of 4.4 percent there.

6 Do you see that?

7 A Right. Which it's a variable rate.

8 Q Right. And footnote A refers you to the
9 CAFR where it says, for that \$8.2 million bond,
10 the rate is variable ranging from 3.7 percent to
11 5.1 percent, right?

12 A Yes, sir.

13 Q And so to get to the 4.4 percent, you
14 just took the average of the 3.7 and the 5.1?

15 A That's correct.

16 Q Okay. Now, since this refers to the
17 CAFR, let's go back to that.

18 Mr. Sapp, can you go back to Plaintiff's
19 Exhibit 75. And can you scroll down, please, to
20 see the portion of this page that, which is
21 page 63 of the CAFR that refers to these two bond
22 issues.

1 Okay. And here we see them displayed,
2 right?

3 A Correct.

4 Q All right. And the -- the \$5.5 million
5 bond issue where the rate was 3.89 percent, that's
6 a 20-year bond; is that right?

7 A I'm not sure.

8 Q Was it 15 years or --

9 A Interest rate, variable, principals --

10 Q That looks like a 15-year bond. Isn't
11 it?

12 A Consumer interest rate at variable
13 amounts.

14 I can't tell from --

15 Q Well, you see where the bond was issued
16 on November 1, 2006, right?

17 A Right.

18 Q And it was variable principal amounts
19 maturing through March 1, 2021?

20 A Thank you. You're absolutely correct.

21 Q So that's a 15-year bond, right?

22 A It looks that to me, yes.

1 Q Okay. And then the next one is
2 \$8.2 million general obligation bond issued
3 December 1, 2007. And that has variable principal
4 amounts maturing through October 1, 2027, right?

5 A That's right.

6 Q And so that's a 20-year bond?

7 A Correct.

8 Q Okay. With regard to this 20-year bond
9 where you took the average of the interest rates
10 from 3.7 percent to 5.1 percent, isn't it true,
11 Mr. Watkins, that the rates actually start at
12 3.7 percent in 2008 and they don't go up to
13 5.1 percent until the year 2020?

14 A You may be correct. I -- I just know
15 that they varied from that, so I took the
16 midpoint.

17 Q All right. Well, let's see if this is
18 right.

19 Mr. Sapp, would you bring up Plaintiff's
20 Rebuttal Exhibit 17, please.

21 MR. RAPHAEL: Your Honor, I have paper
22 copies. I would like to offer one to the witness

1 and to the Court.
 2 THE COURT: All right. Thank you.
 3 BY MR. RAPHAEL:
 4 Q And here is a paper copy for you of
 5 Plaintiff's Rebuttal 17.
 6 Do you recognize this as the debt
 7 service schedule for the 2008 bond we were just
 8 talking about?
 9 A That's what it appears to be, yes.
 10 Q Right. And the rate starts at
 11 3.7 percent in 2008.
 12 Do you see that?
 13 A Yes.
 14 Q And it goes up to 5.1 percent in the
 15 year 2020, right?
 16 A Correct.
 17 Q And this is a 20-year bond, right?
 18 A Correct.
 19 I think you meant 2027.
 20 Q Well, do you see -- look at the entry
 21 for the year October 1, 2020. The rate goes to
 22 5.1 percent, right?

1 A Yes.
 2 Q Okay. Now --
 3 MR. RAPHAEL: Your Honor, I would move
 4 Plaintiff's Rebuttal 17.
 5 THE COURT: Any objection?
 6 MR. THOMAS: No objection.
 7 THE COURT: Thank you, Mr. Thomas.
 8 It will be received.
 9 (Plaintiff's Rebuttal Exhibit 17 was
 10 received into evidence.)
 11 BY MR. RAPHAEL:
 12 Q All right. So this is a 20-year bond,
 13 right?
 14 A Yes.
 15 Q All right. Now, isn't it true,
 16 Mr. Watkins, that municipal bonds recently have
 17 been getting very low interest rates?
 18 A No.
 19 Q I beg your pardon?
 20 A No.
 21 Q All right. Let me show you -- Ken,
 22 would you bring up Plaintiff's Rebuttal

1 Exhibit 16, please.
 2 Do you ever -- do you ever check
 3 municipal bond rates with any of the rating
 4 agencies like Bloomberg's?
 5 A On a daily basis.
 6 Q Is Bloomberg's one the ones you look at?
 7 A No. But there's nothing wrong with
 8 Bloomberg's. I tend to use Moody's. But they're
 9 all about the same.
 10 Q But you would accept a Bloomberg's
 11 display.
 12 A Probably.
 13 Q All right. Let me show you what I've
 14 marked as Plaintiff's Rebuttal 16. This is a
 15 printout from Bloomberg's from Saturday, a week
 16 ago Saturday.
 17 MR. RAPHAEL: Your Honor, I have a copy
 18 here for the witness and for the Court.
 19 THE COURT: Thank you.
 20 BY MR. RAPHAEL:
 21 Q And if you turn to the second page of
 22 Plaintiff's Rebuttal 16, you see the yields on the

1 various bonds, the municipal bond yields for
 2 between 2-year bonds and 30-year bonds, right?
 3 A Yes, I do.
 4 Q Okay. And the current yield for a
 5 15-year bond is 3.86 percent.
 6 Do you see that?
 7 A That's right.
 8 Q And the current yield on a 20-year bond
 9 is 4.16 percent, right?
 10 A Right. That's on average --
 11 Q Right.
 12 A -- correct.
 13 Q And the better your bond rating, the
 14 lower the bond interest that you have to pay in
 15 order to get a bond, right?
 16 A Typically, that's correct.
 17 Q And Falls Church has pretty good -- a
 18 pretty good bond rating, does it not?
 19 A Yes. I -- yes, they do. I'm not sure
 20 exactly what it is right now. I did at one time.
 21 Q And the higher the cash you have in the
 22 cash and investments associated with the -- a

1 water system or with the general fund of a
2 locality, the better the bond rating that you can
3 get, right?

4 A Usually. Almost always, yes.

5 Q And the better the interest rate you can
6 get.

7 A That's right.

8 Q Okay. Can the City -- let me shift
9 gears a little bit here and ask you: Can the City
10 borrow money tax free through municipal bonds at a
11 rate of 4 percent and then reap a return on
12 investment of 6.66 percent from its Fairfax County
13 customers? Is that permitted under the arbitrage
14 laws?

15 MR. THOMAS: Objection, Judge. I think
16 the question at the end at a minimum was is it
17 permitted under the arbitrage laws. So I think
18 that calls for legal conclusion. It's beyond the
19 scope of what this witness has been offered for.

20 And if I could have a continuing
21 objection, Judge, to questions about Fairfax
22 County ratepayers who are those that pay for Falls

1 Church rates in Fairfax County. This is a single
2 plaintiff here; Fairfax Water is. It's not all of
3 eastern Fairfax County, as I think the plaintiff
4 would like to suggest.

5 THE COURT: All right.

6 MR. THOMAS: So two bases for the
7 objection.

8 THE COURT: All right.

9 MR. RAPHAEL: Judge, I think his first
10 objection was well taken. And I'd like to --

11 THE COURT: I was going to say the
12 second part is overruled. The first part, please
13 rephrase it.

14 MR. RAPHAEL: Thank you, Your Honor.

15 THE COURT: Thank you.

16 BY MR. RAPHAEL:

17 Q Hypothetically, Mr. Watkins, the City
18 can borrow -- let's suppose -- let's suppose the
19 City borrows money on a 20-year bond at
20 4.16 percent.

21 A Okay.

22 Q Okay. Which, according to Bloomberg, is

1 the current rate. And then, under your view, the
2 City could get a return on investment from its
3 Fairfax County ratepayers of 6.66 percent, right?

4 A That's the overall cost of capital,
5 correct --

6 Q Right.

7 A -- and equity.

8 Q Right. And do you know whether it
9 violates the arbitrage laws for a City to borrow
10 money at a low rate and then to invest it and reap
11 a profit from customers at a higher rate and use
12 that money to repay the bond?

13 MR. THOMAS: Objection, Judge. Calls
14 for a legal conclusion.

15 THE COURT: Is he in a position to
16 answer this question?

17 MR. RAPHAEL: I asked if he knew.

18 THE COURT: Do you --

19 THE WITNESS: I don't know either way,
20 Your Honor.

21 THE COURT: Okay.

22 MR. RAPHAEL: That's the answer.

1 THE COURT: Well, that takes care of the
2 objection. He doesn't know.

3 BY MR. RAPHAEL:

4 Q Is that a subject you've ever had an
5 occasion to look into, the arbitrage rules?

6 A No.

7 Q All right. Now, going back to your
8 Schedule XIII of your analysis, Mr. Sapp, let's go
9 back to DX-70 at page 40, please.

10 You took your -- in the analysis of the
11 debt costs, you came up with a weighted cost for
12 debt of 4.2 percent based on the two bond issues.

13 Do you see that?

14 A Yes.

15 Q Can you highlight the 4.2 percent. It's
16 right here.

17 Okay. And then, am I correct, sir, you
18 added another 2 basis -- 20 basis points to that
19 .2 percent as a premium, right?

20 A That's right.

21 Q Okay. And you added a premium to
22 reflect the fact that these were general

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1 obligation bonds rather than revenue bonds, right?
2 A That's right.
3 Q Now, are you aware, Mr. Watkins, that
4 the City has booked this transaction such that the
5 repayment obligation will come from its water
6 revenues rather than from taxpayer dollars, the
7 two bonds we're talking about here?
8 A When they booked it?
9 Q Yes.
10 A Well, they haven't booked anything for
11 in the future. They only book things that has
12 actually occurred.
13 Q Right.
14 A So I'm not sure I understand your
15 question.
16 Q My question is: Did you know that the
17 City has booked these two bond transactions such
18 that the repayment obligation will come from its
19 water revenues as opposed to general taxes?
20 A That would -- I have read that to that
21 effect. And to the extent that there is revenue
22 shortfall, the Town has also placed its full faith

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1 and credit in repaying that debt.
2 Q Can you identify the date of any
3 previous general obligation bond issued by the
4 City of Falls Church for improvements to the water
5 system that was repaid with taxpayer money rather
6 than from revenues from the water system?
7 A No. But that's not -- that's not the
8 purpose of this 20 basis point adjustment. The
9 20 basis point adjustment is a very minimal, and
10 we talked about this in my deposition, is a very
11 minimal risk adjustment to reflect the additional
12 risk to the -- to the City as a general obligation
13 bond.
14 Q I understand that. And we're going to
15 get to that. But that wasn't my question, sir.
16 My question was whether you had
17 identified the date of any previous general
18 obligation bond issued for the water system, for
19 improvements to the water system, that was repaid
20 with taxpayer dollars rather than from the
21 revenues from the water system.
22 MR. THOMAS: Objection, Judge. He

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1 answered the question.
2 THE COURT: Sir?
3 MR. THOMAS: He's answered the question.
4 THE COURT: I must have missed it, then.
5 I was writing something down.
6 MR. RAPHAEL: Yeah, he didn't. He went
7 off on something else, and I didn't -- and I
8 wanted to get an answer to my question.
9 THE COURT: Can you answer that
10 question.
11 THE WITNESS: Yeah. I started with
12 "no," and I explained why. The answer is no.
13 BY MR. RAPHAEL:
14 Q Okay. Thank you, sir.
15 Now, you have not undertaken any study
16 or analysis, have you, to quantify any risk that
17 Falls Church would have with regard to not being
18 able to repay these bonds from its water revenues
19 such that it would have to look to taxpayer
20 dollars?
21 A Personally, I have not relied on the
22 treatise by Dr. Broadus with the Federal Reserve

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1 system. And he indicated that that difference --
2 MR. RAPHAEL: Objection. Hearsay, Your
3 Honor.
4 THE WITNESS: I'm trying to answer your
5 question.
6 THE COURT: You asked the question.
7 MR. RAPHAEL: I know. But he's about to
8 say what somebody else said. That is hearsay.
9 THE COURT: It is. It's true.
10 But you asked the question. He already
11 answered it.
12 MR. RAPHAEL: My question, Your Honor --
13 my question was: Have you undertaken any study or
14 analysis to quantify any risk that Falls Church
15 would not be able to repay these bonds from its
16 water revenues and would have to look at taxes to
17 do so?
18 THE COURT: Right.
19 MR. RAPHAEL: And he said no, and then
20 he started to talk about what somebody else said.
21 THE COURT: All right. Let's move on.
22 BY MR. RAPHAEL:

1 Q You included the 20 basis point premium
2 in your Leesburg analysis, too, did you not?

3 A Yes, I did.

4 Q And just to refresh us on that, the
5 higher the interest rate in the Town of Leesburg
6 case, the more that the City could justify
7 charging to its outside City customers, right?

8 A That would make sense, yes.

9 Q And so you were giving the City the
10 benefit of the doubt by showing that they were
11 charging even more than that, right?

12 A That's a fair assessment.

13 But with that said, the City's argument
14 was that the -- the risk differential was
15 infinitesimally high. And in the Leesburg case, I
16 said that's not infinitesimally high, it's 20
17 measly basis points, two-tenths of 1 percent
18 consistent with the academic literature. So...

19 Q Didn't you testify, Mr. Watkins, in the
20 Town of Leesburg case, that with regard to the
21 20 basis points you just added here and there,
22 that, quote, frankly, it's a double count on my

1 part because the cost of equity already reflects
2 the risk, the business risk and the financial
3 risk?

4 A That's right. And that's what I
5 indicated in my deposition to you.

6 If you want to take 20 basis points
7 away, that's fine. I've put it in there to be
8 consistent with the Leesburg case just like I did
9 with the cost of equity. I've used the same
10 numbers in that. And it's also consistent with
11 the academic literature.

12 If you want to take 20 basis points
13 away, I certainly have no objection.

14 Q Right. And that would have about a
15 2 cents -- just this point would make a 2-cent
16 swing on the commodity rate that you've calculated
17 here, right?

18 A I don't know if I would think -- I don't
19 know if it would be that great or not. You may be
20 right. I don't think so.

21 What it would have would be a one-tenth
22 of 1 percent difference in the required rate of

1 return. So it would go from 6.66 percent to
2 6.56 percent. Because it's 20 basis points. And
3 then half of that is 10 basis points. So it would
4 go from 6.66 to 6.56. De minimus. You're
5 splitting hairs at this juncture.

6 Q In the Town of Leesburg case, it was
7 okay to double-count this because you were trying
8 to err on the side of coming up with a rate that
9 favored the City, right?

10 A I wished you would quit taking my
11 testimony out of context, sir.

12 I already explained that the reason that
13 that adjustment was made in Leesburg is because
14 the Town of Leesburg argued that the financial
15 risk to the Town was infinitesimally high, that it
16 could not be quantified.

17 And in the Town of Leesburg, I said, of
18 course it can be quantified as 20 basis points as
19 supported by the academic research and academic
20 literature. Plain and simple.

21 Q Your -- you indicated that you would --
22 you wouldn't want to quibble about this, though,

1 right? You're happy to give up the .2 percent
2 premium.

3 A I'll be more than happy to, sir.

4 Q All right. Now, let's -- we talked a
5 lot about the percent -- the 6.66 percent that's
6 used to come up with the required return. Let's
7 talk about the other side of the equation, the
8 rate base and how you came up with the rate base.

9 Am I correct, sir, that your rate base
10 analysis is at Schedule IV of Defendant's
11 Exhibit 70?

12 A Yes, sir. That's correct.

13 Q Page 35 of 41 of DX-70.

14 Okay. Now, the bottom of this schedule,
15 sir, you have -- you show a total rate base of
16 \$39,293,517, right?

17 A Yes, sir.

18 Q Okay. Does this represent the
19 investment that the City has in the water system?

20 A No. Not necessarily. What this
21 represents is a term of art, rate base as a term
22 of art. And it represents a reasonable basis upon

1 which your profitability should be determined.
2 There are certain imputed amounts in
3 there such as the cash working capital, et cetera,
4 et cetera.

5 Q All right. With regard to this figure,
6 the 39 point -- let's round up to 39.3 million.

7 With regard to this 39.3 million --
8 \$39.3 million figure that you calculated, is there
9 any way to determine how much of that came from
10 Falls Church City customers?

11 A Unfortunately, no.

12 Q And similarly, is there any way to
13 determine how much of that came from Fairfax
14 County customers who comprise 92 percent of the
15 City's customer base?

16 MR. THOMAS: Judge, this is the same
17 objection as previously about -- inquiries about
18 Fairfax County customers as opposed this customer.

19 THE COURT: Right. It'll be noted.

20 THE WITNESS: Same answer.

21 Unfortunately, no.

22 BY MR. RAPHAEL:

1 Q All right. But given that Fairfax
2 County customers comprise 92 percent of the
3 customer base, isn't it a reasonable assumption
4 that a good portion of this \$39 million originated
5 from Fairfax County customers?

6 MR. THOMAS: If I could, Judge, same
7 objection.

8 And if I could have a continuing
9 objection.

10 THE COURT: All right. That will be
11 fine.

12 MR. THOMAS: Thank you.

13 THE WITNESS: I think it would be
14 reasonable to assume that some of the retained
15 earnings to the extent there are generated from
16 business from the City of -- excuse me, the County
17 of Fairfax.

18 I don't know what the initial investment
19 was back in the early '50s, late '40s, the initial
20 equity infusion. And for that matter, I don't
21 know what the retained earnings are between in
22 town, out of town. So the answer is it's

1 impossible to determine.

2 BY MR. RAPHAEL:

3 Q That's not something that you looked at,
4 right?

5 A No. It would be impossible to
6 determine.

7 Q So you didn't try to calculate how much
8 of the current rate base is -- was created by
9 Falls Church City customers versus Fairfax County
10 customers of the City?

11 A Was created by?

12 Q Yes. You didn't decide -- you didn't
13 determine how much of the wealth in the system
14 came from City customers versus County customers.

15 A Well, this is the -- this is the wealth
16 owned by the City of Falls Church for their -- for
17 the water system net of reflection of credits for
18 availability fees and contributions paid for by
19 Falls Church and by the County of Fairfax.

20 In other words, remember when we had
21 those deductions from rate base.

22 Q Right. But that wasn't my question.

1 My question was: You agree with me that
2 at least part of this amount comes from Fairfax
3 County ratepayers, don't you?

4 A No. These -- this is the rate base
5 owned by the City of Falls Church.

6 If I understand your question, you're
7 saying if I look at Dominion Power, I'm a customer
8 of Dominion Power. Of the equity in Dominion
9 Power, how much of the equity in Dominion Power
10 came from Glenn Watkins as a customer.

11 Q Right.

12 A That's nonsensical.

13 Q I don't want to ask you about privately
14 owned or investor-owned utilities. I want to ask
15 you about this municipal utility, okay.

16 And my question is -- do you remember
17 when I asked you this question in your deposition
18 about this number?

19 And you said: "Some of those retained
20 earnings presumably in the past would come from
21 outside customers, yes.

22 "Question: Because they are 92 percent

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1 of the system?

2 "Answer: That's a reasonable

3 assumption, yes."

4 A Yes.

5 Q All right.

6 A Some of that money would come from

7 retained earnings. Some would come from initial

8 equity infusions. Some of it is from deductions

9 from availability fees.

10 So that's my answer --

11 Q Okay.

12 A -- is exactly the same. It's impossible

13 to determine.

14 Q And you've not -- I'm sorry.

15 A The assumption -- but if your question

16 is, is it safe to assume that roughly 90 percent

17 of retained earnings are attributable to out of

18 town, that would probably not be unreasonable.

19 Q Okay. Thank you.

20 And you've not undertaken an analysis to

21 determine how much of the City's investment in the

22 water system came from funds that originated with

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1 Fairfax County ratepayers as opposed to City

2 ratepayers?

3 A No. Again, these are the funds owned

4 by -- legally owned by the City of Falls Church.

5 Q That wasn't my question. I understand

6 that.

7 My question is: You haven't undertaken

8 an analysis to determine the source of those

9 monies as to how much came from City ratepayers

10 versus Fairfax County ratepayers?

11 A No. No.

12 Q Thank you.

13 A Those records don't exist.

14 THE COURT: It's a little bit after

15 1:00, Mr. Raphael. We'll take a break for lunch.

16 MR. RAPHAEL: Yes, Your Honor. Thank

17 you.

18 THE COURT: We'll meet at 2:00.

19 The Court will be in recess.

20 (Whereupon, at 1:05 p.m., the hearing

21 was recessed, to be reconvened at 2:00 p.m. this

22 same day.)

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1 AFTERNOON SESSION (2:10 p.m.)

2 THE COURT: All right. Mr. Raphael, you

3 may continue.

4 MR. RAPHAEL: Thank you, Your Honor.

5 THE COURT: Yes, sir.

6 Whereupon,

7 GLENN WATKINS

8 having been previously duly sworn, was examined

9 and testified further as follows:

10 RE-CROSS-EXAMINATION (Continued)

11 BY MR. RAPHAEL:

12 Q Good afternoon, Mr. Watkins.

13 A Hello.

14 Q Let's go to Schedule IV of your

15 analysis. Mr. Sapp, that's page 35 of DX-70.

16 Okay. Schedule IV lays out your rate-based

17 calculations, right?

18 A That's correct.

19 Q And you've taken -- Ken, can you magnify

20 the area that you've got highlighted there,

21 please, the whole -- to the bottom. There you go.

22 You've taken total plant in service plus

1 construction work in progress, right?
 2 A That's right.
 3 Q And you've added, quote, other additions
 4 to rate base, the 20.5 million. Do you see that?
 5 A Correct.
 6 Q And then you've subtracted from that
 7 various deductions. And that gives you a total
 8 rate base of 39.2 -- almost \$39.3 million, right?
 9 A Yes, sir.
 10 Q Okay. I want to look at different
 11 components here in these figures. And let's
 12 start, please, with the entry you have here for
 13 other additions to rate base. You list that as
 14 18.3, almost \$18.4 million. Do you see that?
 15 A Yes.
 16 Q And if I want to see where you got that
 17 information from, I look down to footnote 2. And,
 18 Ken, will you show us footnote 2 at the bottom of
 19 the page. And footnote 2 says you go to
 20 Schedule III at pages 5 and 6, right?
 21 A Yes.
 22 Q Okay. And so let's go to Schedule III

1 at page 5. Mr. Sapp, that's page 27 of 41 of
 2 Defendant's Exhibit 70.
 3 And that's Schedule III at page 5 of 12,
 4 correct?
 5 A Yes, sir.
 6 Q All right. Now, the total amount in the
 7 column here that says net rate base amount,
 8 18.3 million, that's the figure that goes back to
 9 Schedule IV where we just came from, right?
 10 A That's right.
 11 Q Okay. Now, am I correct that the
 12 purpose of this Schedule III, at page 5 of 12, is
 13 to take certain expenses that the City of Falls
 14 Church had characterized on its own books as
 15 expenses, and to reclassify them in your analysis
 16 as capital expense?
 17 A That's a reasonable characterization,
 18 yes.
 19 Q Okay. And you've got a couple entries
 20 in here that relate to the Washington Aqueduct,
 21 right?
 22 A That's right.

1 Q And one of them is for the Washington
 2 Aqueduct residuals project. And, Mr. Sapp, if you
 3 could highlight that, please.
 4 There are actually two Aqueduct
 5 expenses. That's the first one right there. It's
 6 Washington Aqueduct residuals project, \$434,250 in
 7 2009.
 8 A Right.
 9 Q The next one is below that. It reads
 10 2008 Washington Aqueduct, 8.7 million, almost
 11 \$8.8 million in 2009, correct?
 12 A That's correct.
 13 Q And both these entries refer to a
 14 project that the Washington Aqueduct is
 15 undertaking to deal with its solids loading to the
 16 Potomac River when it treats the water, right?
 17 A In part. That's the majority of it.
 18 Q The Aqueduct was ordered by EPA to not
 19 discharge solids into the Potomac like it had been
 20 doing, but to remove those solids from the water
 21 and dispose of them other than putting it back in
 22 the river?

1 A That's right.
 2 Q Okay. And the Aqueduct is undertaking
 3 that project currently. And it's -- including
 4 billing for that to its wholesale customers to
 5 help pay for it, right?
 6 A Yes. It's joint owners, if you will.
 7 That's correct.
 8 Q Right. Well, Falls Church is not an
 9 owner in the Aqueduct, is it?
 10 A Thank you. Participants. I'm sorry.
 11 Q Right. It's a wholesale customer --
 12 Falls Church is a wholesale customer of the
 13 Aqueduct, isn't it?
 14 A I guess that's a fair characterization.
 15 Q Sure. And another wholesale customer of
 16 the Aqueduct is Arlington County, right?
 17 A That's right.
 18 Q And the D.C. WASA is another customer of
 19 the Washington Aqueduct for water service, right?
 20 A Right.
 21 Q D.C. WASA supplies water to the District
 22 of Columbia?

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1 A That's right.
2 Q And Arlington County supplies water that
3 it buys from the Aqueduct to the people of
4 Arlington County, right?
5 A Yes, sir.
6 Q And those three wholesale customers are
7 paying the Aqueduct for this expense, right?
8 A That's correct.
9 Q Okay. Now, isn't it true that the
10 capital that's being funded with this is capital
11 owned by the Washington Aqueduct?
12 A The capital --
13 Q The solids treatment facilities are
14 owned by the Aqueduct?
15 A Well, the members, the three members, or
16 actually I believe there's four, but the three
17 members are putting in pro rata shares for that --
18 for this major capital project.
19 Q Right.
20 A And they're being assessed -- each of
21 the members are being assessed a pro rata share.
22 Q Understood.

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1 A So it's being funded by the members.
2 Q But that wasn't my question. The owner
3 of the project is the Aqueduct, isn't it?
4 A I think the -- yes, the legal owner is
5 the Aqueduct or the Army Corps of Engineers, or
6 whatever military -- the US government.
7 Q Right. So the Aqueduct is a division of
8 the Army Corps of Engineers, right?
9 A I believe that's correct.
10 Q Which is part of the Department of the
11 Army, right?
12 A (Nodding head.)
13 Q Which is part of the federal government?
14 A Correct.
15 Q So the \$8.3 million that you've treated
16 here as capital expenses -- or capital of Falls
17 Church is really not capital of Falls Church; it's
18 capital owned by the Aqueduct?
19 A No. It's -- the title of the Aqueduct,
20 the legal title is owned by the federal
21 government.
22 Q Yes.

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1 A This is a capital project in which, as I
2 indicated, all of the members are being assessed.
3 Q That wasn't my question.
4 A They were expensed in 2008 and is being
5 expensed in 2009. It would be unfair and improper
6 for rate making to expense that. It would greatly
7 exaggerate the cost of service. So it is proper
8 to capitalize that for rate making.
9 Q That wasn't my question, sir. The
10 capital facilities themselves we've already shown
11 are owned by the Aqueduct, right?
12 A The assets are legally owned by the
13 federal government, that's right.
14 Q And the City of Falls Church has
15 actually booked this as an expense on its books
16 and you're reclassifying it in your analysis,
17 correct?
18 A That's correct.
19 Q Have any of Falls Church's auditors ever
20 booked this expense as capital versus an expense?
21 A The auditors don't book it; the City
22 books it. I had a long discussion with Mr. Tuohy

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1 regarding the accounting treatment for this
2 particular item.
3 Q All right. And it was booked as an
4 expense, not as capital, right?
5 A Correct.
6 Q All right. Have Falls Church's auditors
7 ever treated any capital asset owned by the
8 Aqueduct as a capital asset belonging to Falls
9 Church?
10 A I don't know if they ever have or not.
11 I try to never say never or always say always. I
12 try not to use those. I don't know.
13 Q Now, in order to determine what impact
14 this has on your analysis, what I would like to do
15 is go to your Excel schedule for adjustment 5.
16 Ken, if we could switch over to that, please.
17 A I'm sorry. You were on page? --
18 Schedule V, is that right?
19 Q Let's go to your Schedule III at page 5
20 of 12. That's your adjustment 5, correct?
21 A Yes, yes. Thank you.
22 Q And I've got the Excel version displayed

1 here on the screen. Do you see that?
 2 A Yes.
 3 Q All right. Now, I've illuminated the
 4 cell B-27 for Washington Aqueduct residuals
 5 project. Do you see that?
 6 A Yes.
 7 Q And if I put a zero in there, treating
 8 this as an expense rather than capital, and I put
 9 a zero in cell B-31, treating this as an expense
 10 rather than capital, it changes -- it makes
 11 changes in the formula.
 12 And if we go back to the Schedule I to
 13 see what impact that has, am I correct, sir, that
 14 by treating the Washington Aqueduct charges as an
 15 expense rather than capital, it drops the
 16 commodity charge from \$3.33 to \$3.13?
 17 A No. And I don't mean this to be funny,
 18 but you're a better lawyer than a rate analyst.
 19 It would be totally improper to treat
 20 that for rate making as an expense, first of all.
 21 But as a matter of arithmetic, you clearly don't
 22 understand my model. You would need to add in the

1 expenses associated with that in the revenue
 2 requirement, which would increase the revenue
 3 requirement.
 4 I have capitalized it as opposed to
 5 expense it. So --
 6 Q Mr. Watkins, that wasn't my question,
 7 sir. My question was --
 8 A What you're doing is nonsensical. It
 9 would be incorrect to do that.
 10 Q All right. You'll have your chance to
 11 explain that with your own counsel. My question
 12 is really one of how the math works, okay? My
 13 question is, if I replace -- if I treat the
 14 capital expense here that you use for the Aqueduct
 15 as an expense rather than capital, and I zero it
 16 out, the effect of that is to lower your commodity
 17 rate from \$3.33 to \$3.13. True or false?
 18 A False.
 19 Q Are you saying the math is not correct?
 20 A I'm saying that it would be nonsensical
 21 to do that.
 22 Q That's not my question, sir. My

1 question is --
 2 A If you want to make an error and do that
 3 arithmetic, that would result. But it would be
 4 totally incorrect to do that.
 5 Q You agree with me that the arithmetic is
 6 correct?
 7 A It would appear to be.
 8 Q All right. Thank you.
 9 All right. Now, let's -- another
 10 adjustment you made was to -- for rate base on
 11 Schedule IV. Ken, can we go back to Schedule IV,
 12 please.
 13 A Yes, sir, I'm there.
 14 Q Okay. Another adjustment you made here
 15 was to deduct developer contributions and
 16 availability fees. Do you see that, those two?
 17 A Those are not adjustments. Those are
 18 rate-making treatments. But that is a line item
 19 in the rate base.
 20 Q Right. You've deducted \$13.9 million
 21 for availability fees, right?
 22 A Yes, sir.

1 Q And you've deducted 17.8 million, almost
 2 \$17.9 million for developer contributions, right?
 3 A Yes, sir.
 4 Q And the reason you deduct the developer
 5 contributions is because, when a developer builds
 6 a water system and gives it over to the City, that
 7 doesn't represent any money invested by the City,
 8 right? It's essentially a gift from the
 9 developer?
 10 A That's right. That's a good analogy.
 11 Q Okay. And similarly --
 12 THE COURT: Thank you.
 13 BY MR. RAPHAEL:
 14 Q And just like with the developer
 15 contributions, which you deduct because it doesn't
 16 represent an investment by the City, it's donated
 17 capital, you also deduct availability fees that
 18 are paid by new users because, likewise, that's
 19 not an investment by the City. It's given to the
 20 City by the new users.
 21 A Right. That's my -- my treatment and my
 22 opinion. I will note that certain economists

1 disagree with that. But this is a very
 2 conservative approach that I've used.
 3 Q And for those who you say think that you
 4 don't deduct availability fees or developer
 5 contribution, you disagree with that, right?
 6 A I did. I do.
 7 Q So you think it's proper to deduct
 8 availability fees and developer contributions?
 9 A I do.
 10 Q All right. Now, I want to look at the
 11 methodology by which you made these deductions and
 12 see how you derive your deduction. Let's start
 13 with developer contributions. According to your
 14 Schedule IV, we look to, according to your
 15 footnote 5, we look to your Schedule VI, right?
 16 A Yes, sir.
 17 Q Okay. And if we go to Schedule VI --
 18 Mr. Sapp, that's page 37 of 41. It's really hard
 19 to read, isn't it?
 20 A Yeah. But I've got a copy that I
 21 believe I can read.
 22 Q Okay. And I -- you were also good

1 enough to provide me with an Excel version of this
 2 as well.
 3 A Yes.
 4 Q So maybe if I -- let me work from the
 5 Excel version.
 6 A Okay.
 7 Q All right. Now we've switched over
 8 here. I've switched over to the Excel version.
 9 And this is the developer contribution triangle.
 10 Do you see that?
 11 A Yes, I do.
 12 Q And you have calculated a total amount
 13 for developer contributions of \$39.1 million to
 14 the Falls Church system for its history, correct?
 15 A Yes.
 16 Q All right. And then you reasoned that
 17 those monies would be spent by the City over a
 18 40-year period, correct?
 19 A That's a reasonable way to put it.
 20 Q Okay.
 21 A They -- they have -- I have amortized it
 22 over that period of time to allow for the

1 replacement of that.
 2 Q Okay. And that's your footnote 3 here
 3 on your schedule. It says based on service life
 4 of 40 years.
 5 A That's right.
 6 Q And the idea is that developer
 7 contributions of things like water mains and
 8 capital facilities like that have -- you assigned
 9 an amortization life of 40 years to those?
 10 A That's right.
 11 Q Now --
 12 A With the exception of the first year.
 13 Q When you amortized the \$39.1 million
 14 over the 40 years, you determined that, of the
 15 original \$39.1 million in total developer
 16 contributions, the City had not yet spent about
 17 17.9 million. That's in cell Z-34. Do you see
 18 that?
 19 A Yes.
 20 Q Okay. And so you deducted the
 21 17.9 million from the rate base, right? That's
 22 the number you used?

1 A That's right, yes, sir.
 2 Q So you deducted an amortized number.
 3 You didn't deduct the full number, \$39.1 million
 4 number?
 5 A That's correct. I used it as the
 6 deduction from rate base to net number.
 7 Q So you're not deducting 100 percent of
 8 the developer contributions. You're deducting an
 9 amortized percentage of the developer
 10 contributions?
 11 A That's right.
 12 Q So let's go back to your Schedule IV --
 13 A Uh-huh.
 14 Q -- for rate base. And if you can --
 15 let's go to my computer, please.
 16 And this is the Excel version of your
 17 rate base chart. And instead of deducting -- if
 18 we go to cell F-42 -- let me make this a little
 19 bit bigger so everybody can see it.
 20 Okay. If we go to cell F-42, and
 21 instead of deducting the \$17,886,279, which is the
 22 amortized version.

1 A Right.
 2 Q Suppose we deduct 39 million --
 3 A 137.
 4 Q -- 137 --
 5 A 753.
 6 Q -- 753. And that drops the rate base
 7 18 million, right?
 8 A That's right.
 9 Q And the effect on the commodity rate is
 10 to drop it from \$3.33 to \$3.05, right?
 11 A That would be the result of the
 12 arithmetic. That's right.
 13 Q Yes, sir. Okay. Let's go back to
 14 the -- zero out that change.
 15 Now, you mentioned that you based your
 16 analysis, at least in part, on AWWA guidance,
 17 right?
 18 A Yes. I used them as a reference, right.
 19 Q And the AWWA M1 manual doesn't say
 20 anything about amortizing developer contributions
 21 in determining rate base, does it?
 22 A I don't know if it mentions that or not.

1 It's standard industry practice, though.
 2 Q It's not -- let's go to the M1.
 3 A I don't have it with me.
 4 MR. RAPHAEL: Your Honor, I would like
 5 to provide to the Court and the witness what I've
 6 marked as Plaintiff's Rebuttal 19.
 7 THE COURT: All right.
 8 BY MR. RAPHAEL:
 9 Q And Mr. Sapp, if you can go to page 4 of
 10 6 of this document.
 11 Okay. And we have on the display here
 12 page 38 from the M1 manual. Mr. Sapp, can you
 13 magnify, please, the paragraph under "Contribution
 14 and advances."
 15 Do you see where it says under the M1
 16 manual for contributions and advances -- and this
 17 is under the section about determining rate base.
 18 It reads: "Contributions in aid of construction
 19 (CIAC), that is, capital or plant supplied by
 20 customers, developers, or public authorities, is
 21 excluded from rate base."
 22 Did I read that correctly?

1 A Yes.
 2 Q And this paragraph doesn't say anything
 3 about amortizing it, does it?
 4 A No. It's standard industry practice.
 5 As we discussed earlier, this is -- this is a
 6 reference guide. It doesn't get into it.
 7 As you can see in the last sentence
 8 here, "the ambiguities of what constitutes a CIAC
 9 or advance have resulted in numerous legal
 10 challenges and court decisions."
 11 Virtually every regulatory commission in
 12 the United States amortizes the CIAC, because if
 13 they didn't, that amount would be on the books in
 14 perpetuity.
 15 In other words, the contribution that a
 16 developer made in, hypothetically, 1780 would
 17 still be on your books for 500 years if you didn't
 18 amortize it. That's of course nonsensical.
 19 Q And what the developer contributed in
 20 1780 or 1880, likewise, was not any money that was
 21 risked or ventured by the municipality. It was
 22 given over by the developer, wasn't it?

1 A No. And that's exactly why you deduct
 2 it from rate base the way that we did.
 3 Q And other portions of the M1 guide in
 4 terms of -- concerning how you calculate rate base
 5 do talk about depreciation, right? Look right
 6 above the paragraph, under "accumulated
 7 depreciation."
 8 A I believe it does.
 9 Q And this section dealing with exactly
 10 the subject we're talking about here doesn't
 11 mention anything about depreciation, does it?
 12 A No. There are libraries devoted to
 13 depreciation. In fact we have a complete library
 14 on depreciation.
 15 Q Can you cite to me --
 16 A This particular manual does not deal
 17 with the specifics of depreciation at all.
 18 Q Are you sure about that?
 19 A In a very broad sense it does, excuse
 20 me. In a very broad sense.
 21 Q Can you cite -- cite me a manual that
 22 you would rely on that says that one is supposed

1 to depreciate the developer contributions in
2 determining rate base? Give me the citation,
3 please.

4 A It is standard practice of virtually
5 every commission that I practice in, which is in
6 30, 35.

7 Q That wasn't my question, sir. I would
8 like the citation.

9 A The citation of a book. There are
10 various manuals put out by the National
11 Association of Regulatory Utility Commissioners.
12 But whether they -- whether they have a
13 depreciation manual or not, I don't know.

14 I can't think of a quote-unquote
15 textbook other than accepted regulatory practice.

16 Q So as you sit here today, you can't
17 identify for me a citation to a rate manual that
18 says that it's proper to depreciate developer
19 contribution in determining rate base?

20 A No. Rate manuals speak in general
21 terms, not very specific. And you're getting into
22 the very specific items.

1 Depreciation studies are based on
2 engineering studies. Rate manuals don't get into
3 that. You're getting into very specific areas
4 that you won't find in a rate manual.

5 Q So I take it the answer to my question
6 is no. My question was you can't -- as you're
7 sitting here now, you can't identify to me a
8 single rate manual that says it's proper to
9 depreciate developer contributions when you
10 calculate rate base?

11 A No. Nor can I think of one that says
12 it's not. I'm just telling you it's standard
13 industry practice to do that.

14 Q All right. Let's -- likewise, let's
15 move on to availability fees. You pursued a
16 similar amortization approach with your
17 availability fees, right?

18 A Yes, sir. The same concept.

19 Q And as we noted earlier, availability
20 fees are the -- is a tap fee that a new customer
21 would pay essentially to buy into the system and
22 pay for his share of making the water available,

1 right?

2 A That's not a bad way of putting it.

3 Q All right. That's why you might call it
4 an availability fee?

5 A Correct.

6 Q Okay. And as we saw on Schedule IV, at
7 Defendant's Exhibit 70, you deducted 13.9, almost
8 \$14 million in availability fees from the rate
9 base, right?

10 A Yes, sir. That's correct.

11 Q And the schedule that corresponds to
12 that is Schedule V, right?

13 A That's right.

14 Q And if we go to Schedule V, Mr. Sapp. I
15 believe it's the next page. Page 36 of 41.

16 Okay. And this one, likewise, is very
17 hard to read. So let me go, if I may, to the
18 Excel version.

19 All right. Do you see we've got the
20 availability fee triangle here from your analysis
21 displayed, right?

22 A Yes, sir.

1 Q Okay. Now, you deducted -- let's see.
2 Strike that. Sorry.

3 The total availability fees you have for
4 the Falls Church system is 22,385,585 -- 855
5 dollars, right?

6 A Yes, sir.

7 Q And you amortized that over a 30-year
8 period rather than a 40-year period, correct?

9 A That's right.

10 Q That's reflected in footnote 3?

11 A That's correct.

12 Q In cell A-33, right?

13 A Correct.

14 Q And when you amortized that amount, the
15 \$22.3 million, over a 30-year period, that left
16 \$13.9 million in availability fees that you think
17 had not yet been spent, right?

18 A Well, that's not a good way to put it,
19 but that's the unamortized balance. That will
20 reflect the deduction from rate base.

21 Q And that's the figure -- that
22 \$13.9 million figure is the one you used that you

1 plugged into Schedule IV for the deduction for
2 availability fees, right?

3 A Yes, sir.

4 Q Okay. Now, if instead of deducting the
5 \$13.9 million for availability fees -- and here I
6 am back on your Schedule IV with the Excel version
7 in cell F-41.

8 A Correct.

9 Q And if instead of deducting the
10 \$13.9 million, we deduct the full amount, the
11 22 million --

12 A 385,855.

13 Q That lowers the rate base to
14 30.8 million, right?

15 A That's correct.

16 Q And the mathematical effect on your
17 commodity rate is to drop the rate from \$3.33 to
18 \$3.22, correct?

19 A Yes.

20 Q And likewise the M1 manual that we just
21 looked at in Plaintiff's Rebuttal Exhibit 19
22 doesn't say anything about amortizing availability

1 fees, does it?

2 A No. I don't know that there's hardly
3 any discussion on that. There is some on
4 connection fees. But no, there's no discussion of
5 it either way.

6 Q And let me ask you the same question
7 here I just asked you before. Can you identify
8 for me any rate manual that says, in determining
9 rate base, you should amortize the availability
10 fees?

11 A No, sir. Availability fees are unique
12 to municipalities. Investor owned aren't allowed
13 to have these tap fees or connection fees. But
14 the concept is the same as contributed capital.
15 So the answer is the same.

16 Q So the answer is you can't identify a
17 rate manual that says you should amortize
18 availability fees when determining rate base?

19 MR. THOMAS: Asked and answered, Judge.

20 THE COURT: He did answer that, I think,
21 Mr. Raphael.

22 BY MR. RAPHAEL:

1 Q I believe you have said that you think
2 that you are taking a middle of the road approach
3 and giving the Fairfax County ratepayers the
4 benefit of the doubt by amortizing the
5 availability fees rather than deducting all of
6 them, right?

7 A Yes, sir. We discussed that in my
8 deposition.

9 Q Right. But isn't it true, sir, by doing
10 that, it led to a worse result for Fairfax Water's
11 position than if you had deducted all of the
12 availability fees?

13 A While that is true on the -- since I
14 took the middle of the road, while that is true on
15 the one side, on the other side of the middle of
16 the road is that it was favorable to Fairfax had I
17 not taken any deduction.

18 Q But you agree that it would be improper
19 not to take any deduction because both
20 availability fees and developer contributions are
21 not investment ventured by the City, right?

22 A In my opinion, I agree. But the General

1 Assembly of Virginia disagrees with that in that
2 in House Bill--- I worked for the legislature.
3 House Bill 1518 or whatever it was in 1996, the
4 General Assembly --

5 MR. RAPHAEL: Your Honor, I must
6 interrupt the witness. I'm sorry. I've got to
7 move to strike this. He's talking about what the
8 General Assembly opined or did based on his
9 involvement. He's not answering my question.

10 THE COURT: But I think he's trying to
11 explain the reason why he's giving you the answer
12 he is.

13 MR. RAPHAEL: All right.

14 THE COURT: I don't think it's improper.

15 THE WITNESS: That's exactly right.
16 The -- the General Assembly allows municipalities
17 to have these availability fees. And what they
18 are is you pay up front to have the right to
19 connect to the system. And then you pay your
20 normal things.

21 Those are treated as revenue in
22 municipal accounting. For municipalities, they

1 don't treat it as capital. It's simply revenue, a
2 revenue source for the utility. So the General --
3 even though economically my way is the correct
4 way, but the General Assembly of Virginia says,
5 no, municipalities are allowed to collect these
6 availability fees. And those are to be booked as
7 revenue, not as a capital item or not as a
8 restricted asset. The true technical word is a
9 restricted asset.

10 So the point is the law in Virginia
11 allows the municipalities to do this. Every
12 municipality in the country does it -- or in the
13 State of Virginia records it as revenue.

14 So the point being, to answer your
15 question, if I followed the letter of the law,
16 there would be no deduction for availability fees.
17 But I don't think that's proper for rate making
18 because I think that overcharge -- would overstate
19 the rate to Fairfax County.

20 BY MR. RAPHAEL:

21 Q You mentioned the General Assembly
22 saying something. What state are you referring

1 to?

2 A Actually I believe I can help you with
3 that.

4 If you look on my vitae, it was House
5 Bill 1513. I believe it was in 1996 in which the
6 treatment of availability fees, the codification
7 was changed, in '96 or '97. That bill was passed
8 and enacted. And it has to do with the fair and
9 reasonable charges of the availability fees.

10 Q Is this a statute affecting the State
11 Corporation Commission?

12 A No, sir.

13 Q What's the --

14 A It only has to do with municipalities.

15 Q And where is it codified?

16 A I don't know that -- the code -- the
17 code -- I believe, and I stand to be corrected, I
18 believe it's the code where it says that the
19 charges shall be fair and reasonable, and the
20 availability fees should be fair and reasonable.
21 And none of that was in the code before.

22 And during the legislative process in

1 which I testified before the legislature, that
2 these were just simply revenues that were being
3 collected by the municipalities, and booked as
4 such, and that they should -- they should be
5 reflected as restricted assets.

6 Q Right --

7 A The General Assembly just disagreed.
8 They said, no, the way they're recorded is fine.
9 We're not going to put any restriction on that.

10 Q What you just testified to, what you
11 just said, that's not actually reflected in the
12 statute, is it?

13 A Those exact words, no. I'm just giving
14 you the legislative history since I testified
15 before the legislature, and it was a two-year
16 ordeal, actually.

17 MR. RAPHAEL: Your Honor, I think that
18 the gentleman's testimony about what he thinks the
19 legislature did is not proper for the same reason
20 you wouldn't let in the minutes. So I would move
21 to strike that part of his testimony.

22 THE COURT: Motion denied.

1 MR. RAPHAEL: Okay.

2 BY MR. RAPHAEL:

3 Q Now, which code section is this? Is
4 this a code section affecting what municipalities
5 can charge for water service?

6 A Yes. There's actually one for water and
7 one for wastewater.

8 Q Okay. And just so we're clear, the code
9 section doesn't address availability fees, does
10 it?

11 A I believe there's something in there.
12 Because that's what this -- that's what this House
13 bill was about that ultimately passed. The whole
14 issue in that House bill had to do with the
15 availability fees.

16 Q All right. And is this your
17 understanding --

18 A It may be -- they're not called
19 availability fees everywhere. Sometimes they're
20 called connection fees. Sometimes they're called
21 impact fees, things of that nature.

22 Where it is in the code, I don't know.

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1 My best recollection is, in the code section
2 dealing with the fairness and reasonableness of
3 rates and -- for water, and the equitable, I
4 believe is the language, rates for the wastewater,
5 prior to that time, that language was not in
6 the -- in the statute.

7 Q All right. Let's take a look at that.
8 Let me show you the provision -- Ken,
9 can we go to my computer, please. Let me show you
10 the provision from the Virginia code dealing with
11 the rates charged by localities for water service.
12 This is 15.2-2143. And bear with me. The
13 Internet connection is quite slow.

14 A I understand.

15 Q Okay. Here you see the text of
16 15.2-2143. And perhaps you can point out for me
17 in the text the language that you're talking
18 about?

19 A Well, I'm not sure if this is the right
20 code section or not. I'm just telling you what
21 that legislation was in 1996. What the
22 codification is, I don't know. It would be easily

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1 determined if you went back to that bill in the
2 '95 and '96 sessions of the General Assembly.

3 Q I'm sorry. Which -- I'm sorry, which
4 session was it, '95 or '96?

5 A Let's refresh my memory. I remember
6 seeing that in my list of testimony appearances
7 which we went over the other day. I believe it's
8 an exhibit. 1996. So it would have been -- it
9 would be '95 and '96 or '96 and '97. I believe it
10 was the '95 and '96, but certainly the 1996
11 session. It was carried over one year, as I
12 recall.

13 Q All right. Perhaps at a break we'll
14 take a look at that and come back to it.

15 A Yes. It was House Bill 1513.

16 Q 1513?

17 A Yes, sir.

18 Q All right. Now, you wouldn't say it
19 would be unreasonable if another rate consultant
20 said that one should deduct all of the
21 availability fees or developer contributions
22 without amortizing them, would you?

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1 A No. I mean it's -- it's theoretically,
2 to the letter, the proper way to do it. There's
3 no doubt about it.

4 Q A reasonable rate consultant could
5 deduct all of the availability fees and developer
6 contributions without amortizing, right?

7 A Yes. It's certainly debatable.

8 Q Now, let's go, please, Mr. Sapp, to
9 Defendant's Exhibit 70 at page 17. This is your
10 Schedule I. And I want to focus on the deductions
11 that you have at line 7.

12 A Uh-huh.

13 Q You deducted wholesale revenues. And
14 you deducted miscellaneous revenues. But you
15 didn't include interest income as another source
16 of revenue to the water fund, right?

17 A Correct. It would be inappropriate to
18 do so.

19 Q And you didn't -- and because you think
20 it was inappropriate, you didn't deduct it, right?

21 A That is correct.

22 Q And interest income in the water fund in

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1 FY '07 and FY '08 exceeded \$800,000, did it not?

2 A Can you point me to a reference? I'm
3 not going to quibble with you. But I can do a
4 quick calculation to see if that's reasonable.

5 Q Well, Mr. Sapp, bring up Plaintiff's
6 Exhibit 3.1-A.

7 A 4 percent return on \$20 million is
8 \$800,000, so that sounds about right.

9 Q Okay. And now isn't it true, sir, that
10 although investor-owned utilities don't include
11 investment income in -- as a deduction in
12 determining the revenue requirement, a number of
13 municipal utilities do?

14 A If they were to use the cash needs
15 approach, they may. But, as an offset to that,
16 they also include the capital improvement program
17 and the budgeted amounts going forward.

18 So you've got to take the good with the
19 bad. But in -- I have seen it done using the
20 cash-needs approach. It is not done using the
21 utility or rate-based rate of return approach.

22 Q And can you cite to me any rate manual

1 that stands for that proposition, that you don't
2 deduct interest income for a municipal utility in
3 determining revenue requirements?

4 A Charles Phillips, James Bonbright,
5 National Association of Regulatory Utility
6 Commissioners.

7 The -- the provision for the cash that
8 you need and the return thereof is reflected in
9 cash working capital. And, again, the -- we have
10 not included the investment income because we have
11 a rate base. And we multiply that by a fair rate
12 of return. It's totally nonsensical to do that.

13 You -- I don't think you would find
14 anything that would say you do not deduct or you
15 do not include investment income in the
16 rate-making process. You have to have a
17 fundamental understanding of economics to know
18 that you would not do that. So it's never
19 mentioned.

20 Q Well, but my question focused on
21 authorities that would say that. And if I
22 understand your last point correctly, you're

1 saying you might not find your point in a
2 published treatise, right?

3 A No, no, no, no. Dr. James Bonbright in
4 his treatise. Charlie Phillips. Oh, my goodness.
5 There is -- there's --

6 Q Can you spell --

7 A I have several.

8 Q Spell the first one, please,
9 Mr. Broaden?

10 A Bonbright. James Bonbright. James
11 Bonbright's treatise is entitled Principles of
12 Public Utility Rates. It's the bible of our
13 industry. He was a professor. He first published
14 his book in the '50s. It's still used today. I
15 think the last edition came out in the late '80s.
16 It is considered the bible of public utility rate
17 making.

18 Q And are you saying that treatise says
19 that for a municipal utility, you do not deduct
20 interest income in determining the revenue
21 requirement?

22 A No. The question was can you name a

1 treatise in which the utility method says that you
2 do not do that. In those treatises, it indicates
3 the items that are included within the revenue
4 requirement.

5 Q All right. I don't think I'm hearing --
6 I'm sorry. But I don't think I'm hearing an
7 answer to my question, which is does the treatise
8 say that you do not deduct interest income from
9 the total revenue requirement? Does it say that?

10 A I don't think it would. Because it
11 would be nonsensical. Anybody with a fundamental
12 understanding of economics would know that you
13 would not --

14 Q All right.

15 A -- under this approach.

16 Q Now, to see what effect it has, let's
17 see -- I understand you don't agree with it. But
18 let's see what effect it has if we were in fact to
19 deduct \$800,000 in interest income in determining
20 the revenue requirement.

21 A Okay. And if you're going to do that
22 you need to add \$20 million to rate base because

1 you need the basis upon which you earn that
2 800,000.

3 So again, even though it would be wrong
4 to do that, if you're going to do it, you can't be
5 totally absurd that you would have to add
6 \$20 million to the rate base, again, the basis
7 upon which you earned that \$800,000 of investment
8 income.

9 Q Okay. We're back to your Excel sheet.
10 This is the summary page. And if I go to line 7,
11 here where you have taken -- you've deducted
12 wholesale revenues, and you've deducted
13 miscellaneous revenues.

14 A Uh-huh.

15 Q And if I put in cell K-34 an additional
16 deduction for \$800,000 -- are you with me so far?

17 A So far.

18 Q That would reduce the rate -- the
19 calculated commodity rate from \$3.33 to \$3.17,
20 correct?

21 A No.

22 Q Mathematically that's not correct?

1 A No. This is getting to be totally
2 absurd nonsense. It really is.

3 Q Mr. Watkins, my question --

4 A If you're going to take --

5 Q My question was, mathematically, if I
6 deduct \$800,000 from the retail revenue
7 requirement, isn't it true that reduces the rate
8 from \$3.33 to \$3.17?

9 A The numbers are there. It is totally
10 inappropriate. Because if you're going to do
11 that, you have to add in \$20 million of investment
12 from which you received that 800,000.

13 So this mechanical thing here, if you do
14 something totally absurd, you're going to get
15 totally absurd results. But even accepting your
16 absurdity, the only way that you can even
17 mathematically do that is add \$20 million to the
18 rate base.

19 So let's -- I suggest that we do that
20 and then we'll see what happens.

21 Q I was asking you to follow my math. And
22 you agree my math is correct?

1 A This is my spreadsheet, sir. I
2 understand my own spreadsheet.

3 Q I understand.

4 A You're making it all screwed up. It's
5 making no sense what you're doing. The arithmetic
6 is not -- anybody can add one plus two. But what
7 you're doing is totally nonsensical and is totally
8 biased. And I don't want the Court to
9 misunderstand something that you're doing here.

10 If you're going to do something
11 inappropriate, don't be ridiculous about it. Add
12 \$20 million to the rate base. Which would be
13 incorrect as well, but --

14 Q Mr. Watkins, I was asking you a simple
15 question, sir. My question was mathematically,
16 isn't it true that if you deduct \$800,000 from the
17 retail revenue requirement, it reduces the
18 calculated commodity rate from \$3.33 to \$3.17.
19 True or false?

20 A The arithmetic on here would result --
21 if you reduced it by 800,000, that is correct.

22 Q Okay. Thank you.

1 Now, you're not actually recommending
2 that the City adopt a rate of \$3.33, are you?

3 A No, sir.

4 Q And in fact, when I asked you this in
5 your deposition, you said what the City ought to
6 do is wait and see what happens this year and then
7 decide whether it needs any rate adjustment,
8 right?

9 A Well, let's tell the whole story. What
10 I said is would you recommend that these rates,
11 the \$3.33 be adopted going forward today. And I
12 said likely not. And then you asked me why. And
13 I said, given the state of the economy, the
14 recession, et cetera, et cetera, I felt that the
15 current rates are adequate. The \$3.33 indicate
16 that the current rate certainly is within the
17 range of reasonableness.

18 Q Isn't it true, sir, it's quite possible
19 that the circumstances could change such that the
20 revenues that come in based on the old rate are
21 more than adequate to cover the City's needs?

22 A They may. I mean, it's possible that,

1 going forward, in a year or so, that we would be
2 faced with a rate reduction. It's possible we
3 would be faced with a rate increase. I don't
4 know.

5 Q And your analysis was not based on the
6 existing rate -- strike that.

7 Let's move on to a different issue. I
8 want to talk about amortization treatment in your
9 different schedules. At various points in your
10 testimony you've talked about where -- when you
11 amortize and what you amortize. Am I correct,
12 Mr. Watkins, that you were the one who decided, in
13 doing this analysis, what amortization periods to
14 use in the different schedules that comprise your
15 analysis?

16 A Yes, sir. That's right.

17 Q And you didn't ask anyone at Falls
18 Church to look at your amortization periods to see
19 if they thought that those periods were correct,
20 right?

21 A No. I had discussions with Mr. Tuohy
22 and Ms. Ryman, the Chief Financial Officer and his

1 assistant, as to the depreciation practices and
2 depreciation rates of the City. And Mr. Tuohy and
3 I had a conversation as to the reasonableness of
4 the numbers that I selected. And he concurred
5 that they were certainly -- certainly reasonable.

6 Q Do you remember when I asked you this
7 question in your deposition: Question, did you
8 ask anyone at Falls Church to look at your
9 schedule and tell you whether they thought it
10 looked right?

11 Answer: No.

12 A Correct. You were asking about my work
13 product. They had not seen it. Mr. Tuohy and I
14 had a discussion as to the reasonableness of a
15 proper amortization period.

16 Q But they didn't actually look at the
17 amortization periods you applied, right?

18 A No. We had a telephone conversation,
19 and I gave him the amortization period to -- that
20 I was using. And that he indicated that that is
21 reasonable.

22 The question in the deposition was did

1 anybody at the -- at Falls Church review my work
2 product. And the answer was no.

3 Q All right. Well, let's go to
4 Schedule VI, Mr. Watkins, of your analysis. And
5 let's go to my computer.

6 Okay. I think as we saw earlier, for
7 developer contributions, you picked an
8 amortization rate of 40 years, right?

9 A That's correct.

10 Q And 40 years you think is about the
11 amount of time you expect water pipes and pump
12 stations, that sort of thing, built by developers
13 to last? About 40 years?

14 A Well, mains. Pump stations a little
15 less. I wanted to be conservative here, so I used
16 a 2-1/2 percent amortization rate here. Again, I
17 didn't want there to be any quibbling over these
18 amortization periods. As you will notice, I've
19 used a longer period for this, to be conservative,
20 than I did for availability fees of 30 years.

21 Q Well, isn't it true, sir, that the
22 longer the amortization period here, the less you

1 deducted in developer contributions from rate
2 base?

3 A That would be the correct relationship.

4 Q Right.

5 A The longer is the amortization period on
6 this, the -- the less that will be deducted. The
7 shorter is the amortization period, the more that
8 will be deducted.

9 Q Right. So the longer the amortization
10 period here, the less you deducted in developer
11 contributions, and the higher the rate base number
12 for Falls Church, right?

13 A No. No, no, no, no. You need to
14 compare this with the amortization period used for
15 availability fees in Schedule V and that in
16 Schedule VI. You can see that, for the
17 availability fees, I used 3.33 percent or a
18 30-year life amortization.

19 To be conservative and give the benefit
20 to Fairfax County for the developer contributions,
21 I used an even longer period, of 40 years.

22 Q Okay. If you just stick with my

1 question, please.

2 A So the answer is no with an explanation.

3 Q Mr. Sapp, go back, please, to
4 Schedule IV of --

5 A Mr. Sapp?

6 Q Yes. Of Defendant's Exhibit 70. It's
7 page 35 of 41.

8 Mr. Watkins, my hot seat guy over here
9 is Ken Sapp. So that's who I'm talking to.

10 A I'm terribly sorry. Thank you. I
11 understand now.

12 Q I wasn't talking to you.

13 A I see. I'm very sorry. We've resolved
14 one thing today.

15 Q Okay. It's page 35 of -- I'm sorry. 35
16 of 41.

17 Okay. We're showing Schedule IV, which
18 is your rate base computation. And you see that
19 you deducted the developer contributions there,
20 the amortized contributions of 17.8, almost
21 17.9 million, right?

22 A Yes, sir.

1 Q And my point before was, the longer the
 2 amortization period, the less you deducted in
 3 developer contribution. And you agree with that,
 4 right?
 5 A The longer is the amortization period.
 6 Q Yes. The less you deducted in developer
 7 contributions from rate base.
 8 A We need to go back to Schedule VI.
 9 Back to the point in question. The
 10 amortization amount is 2-1/2 percent or 40 years.
 11 If I had used 30 years, which is the basis for
 12 most mains and also the basis for availability
 13 fees, if I had used 30 years instead of 40 years,
 14 that means there's going to be more amortized each
 15 year. That means the accumulated reserve is going
 16 to be more. So that means that the net balance is
 17 going to be less. Now, that's a deduction from
 18 rate base, so that means there would be less
 19 deducted from rate base.
 20 Q I asked you to go the other way. My
 21 question was: The longer the amortization period,
 22 the less you deduct in developer contribution from

1 rate base, right?
 2 A I'm terribly sorry. You're saying, if I
 3 had used, like, an average of 50-year or 60-year
 4 life?
 5 Q Yes.
 6 A That's right. That would be the result.
 7 You're absolutely correct.
 8 Q And the less you deduct in developer
 9 contribution from rate base, the higher the rate
 10 base number for Falls Church?
 11 A That's right.
 12 Q Okay.
 13 A Mechanically. You're correct.
 14 Q All right. So the longer the
 15 amortization period here, the higher the rate base
 16 for Falls Church. I want to compare that to a
 17 different amortization schedule. Can we go,
 18 please, Mr. Sapp, to Schedule III, which is on
 19 Defendant's Exhibit 70 at page 27 of 41. For the
 20 record, this is Defendant's Exhibit 70 at page 5
 21 of 12.
 22 A Schedule III. Page 5.

1 Q Schedule III.
 2 Do you have that?
 3 A Yes, sir, I do.
 4 Q Does it look like what's on the screen
 5 here?
 6 A Yes.
 7 Q Okay. Now, this is your schedule where
 8 you reclassified various expenses as capital
 9 outlays and you applied your own amortization
 10 periods, right?
 11 A That's right.
 12 Q And you identified two corrections that
 13 you made on direct examination, one for the
 14 Arlington Boulevard water main replacement, which
 15 you changed from 10 years to 30 years.
 16 A Yes, sir.
 17 Q Another for the Mayflower water main
 18 replacement, which you also changed from 10 years
 19 to 30 years. Do you remember that line of
 20 questioning?
 21 A Yes, sir. Yes, sir.
 22 Q And those were the two changes that had

1 a 4 cent effect on the commodity rate that you
 2 talked about on direct examination, right?
 3 A Yes, sir.
 4 Q Okay. And in this instance, for the
 5 water mains and capital facilities, you used an
 6 amortization period of 30 years rather than the
 7 40 years you used for developer contributions,
 8 right?
 9 A That's right. Again, to be
 10 conservative. That's why I did that.
 11 Q Okay. Now, in the context of this
 12 schedule, this Schedule III, the shorter the
 13 period of amortization, the higher the annual
 14 amortization expense, right?
 15 A Oh, yes.
 16 Q Okay. And those comparatively short
 17 amortization periods, as applied here, add up to
 18 an annual amortization expense of \$1.5 million.
 19 Do you see that in the middle column there?
 20 Mr. Sapp, if you would illuminate the
 21 bottom line, the whole bottom row, please.
 22 So the annual amortization expense is

1 1.5 million as shown at the bottom of
 2 Schedule III, page 5 of 12, right?
 3 A Yes. I take exception to the
 4 characterization of relatively short. But that's
 5 what this shows.
 6 Q Okay. And then that \$1.5 million number
 7 goes right onto your Schedule I as an expense that
 8 has to be covered by the commodity charge, right?
 9 A That's exactly right.
 10 Q Okay. And just to show where that is --
 11 A Well, as an expense that has to be
 12 covered by all the charges. It's part of the
 13 total revenue requirement.
 14 Q Schedule I. And if you could magnify
 15 lines (2)A. and B., Mr. Sapp.
 16 And that \$1.5 million figure we just
 17 talked about comes in back here on Schedule I at
 18 line (2)B., right?
 19 A Yes, sir. It does.
 20 Q So am I correct, Mr. Watkins, that the
 21 lower the amortization period here, the higher the
 22 expense you have to pay with the various charges,

1 including the commodity charge?
 2 A That's correct.
 3 Q Right.
 4 A And the offsetting balance would be the
 5 change in the reserve for rate base on the balance
 6 sheet side.
 7 Q Okay. Now, you mentioned, Mr. Watkins,
 8 that no one from Falls Church gave you -- no one
 9 vetted your math on your report, right?
 10 A Correct.
 11 Q Can you turn, please, to Schedule VII.
 12 And, Mr. Sapp, this is page 39 of 41 of
 13 Defendant's Exhibit 70.
 14 THE COURT: Mr. Raphael, just out of
 15 curiosity, it's an excellent examination, of
 16 course, but how does this bear on the
 17 constitutional question, whether their rates are
 18 reasonable or unreasonable? I mean, I know he
 19 said they're reasonable. And you said, well,
 20 actually, I want to point out why they're
 21 unreasonable. Because if you had done these
 22 things, it would be a much lower rate and much

1 more reasonable.
 2 But if the only issue we have to decide
 3 in this instant in this case is the constitutional
 4 one, I'm thinking how does this fit into that.
 5 MR. RAPHAEL: Well, I hear you. I
 6 understand your point. But this gentleman was
 7 permitted to testify over my objection on redirect
 8 that he had done an analysis of the current Falls
 9 Church rates and that he believes that the rates
 10 are --
 11 THE COURT: Reasonable.
 12 MR. RAPHAEL: -- reasonable because if
 13 you --
 14 THE COURT: Well, and I was thinking,
 15 well, you might want to challenge that. Or even
 16 call Mr. Woodcock back and say, Mr. Woodcock, have
 17 you analyzed the rates? I have. Are they
 18 reasonable? No, they're not.
 19 Well, it's terrific but I'm not sure
 20 either one of those questions, whether I agree
 21 with Mr. Watkins or agree with Mr. Woodcock,
 22 touches on the constitutional issue.

1 MR. RAPHAEL: And --
 2 THE COURT: I'm not trying to cut you
 3 off or anything like that. But I just wanted to
 4 make sure, because I believe I understand what
 5 you're doing and where you're going, but whether
 6 I'm missing something with regard to the
 7 constitutional analysis.
 8 MR. RAPHAEL: Well, I mean, the City has
 9 chosen to defend in part by arguing that the
 10 current rates are reasonable and don't reflect any
 11 excess.
 12 THE COURT: But even if the current
 13 rates were totally reasonable, they may still be
 14 unconstitutional.
 15 MR. RAPHAEL: Yes.
 16 THE COURT: In your theory of the case.
 17 MR. RAPHAEL: If they're doing what we
 18 say they're doing. That's right.
 19 THE COURT: Right.
 20 MR. RAPHAEL: I take your point. I
 21 actually am fairly close to completing.
 22 THE COURT: Okay.

1 MR. RAPHAEL: I just felt that if I --
2 and I was hoping not to have to go down this road.
3 That was my objection to his being asked about
4 this on redirect.

5 THE COURT: Right.

6 MR. RAPHAEL: So I'm just trying to put
7 the cross on that naturally flows.

8 THE COURT: And that's why I asked you,
9 are you really quarreling with whether they're
10 reasonable as opposed to unconstitutional. And
11 you responded both. And so, you know, there's a
12 lot going on up here, as you can tell. So I said
13 that's all right. Go right ahead. I'm not trying
14 to cut you off. Well, I -- that's my thinking.

15 MR. RAPHAEL: Thank you, Your Honor.
16 It's helpful to hear. Thank you.

17 BY MR. RAPHAEL:

18 Q All right, Schedule VII, please,
19 Mr. Sapp, Defendant's Exhibit 70.

20 Now, Schedule VII is where you accounted
21 for the monthly and quarterly charges paid by the
22 Falls Church customers in Falls Church and Fairfax

1 County, correct?

2 A Yes. Those are the fixed monthly and
3 quarterly charges, also known as customer charges.

4 Q Okay. And you also included this
5 schedule in what you sent me in the Excel version.

6 A I don't mean to turn my back on you.

7 THE COURT: Oh, no, sir. That's not a
8 problem.

9 BY MR. RAPHAEL:

10 Q Okay. Let's go back, Mr. Sapp. And I
11 have here the Excel version of this spreadsheet,
12 which has the -- it's -- the tab is called
13 Customer Charge.

14 And if you would go on the paper copy
15 you have, if you would turn, please, to
16 Schedule VII and page 2 of 2.

17 A Yes, sir. I'm there.

18 Q All right. And then I want to compare
19 it to the Excel version. And page 2 of 2 of
20 Schedule VII is -- are the charges for the
21 nonresidential customers, right?

22 A Yes, sir.

1 Q And if I -- some of these customers are
2 charged monthly and others are charged quarterly,
3 right?

4 A Yes, sir.

5 Q And if I put my cursor in cell G-71,
6 that reflects the formula that you used to
7 calculate the charges -- the revenue received for
8 Falls Church users with 3-inch meters, right?

9 A That's correct.

10 Q And you show under the column for the
11 number of bills 72 bills, right?

12 A Right.

13 Q So there's 72 bills for 3-inch meter
14 users, right?

15 A Yes.

16 Q But some of those bills are monthly and
17 some are quarterly, right?

18 A Correct.

19 Q So to figure out which is which, we have
20 to illuminate the cell G-71, and we see the
21 formula that you use there, right?

22 A Correct.

1 Q And it shows 48 bills of one variety and
2 24 bills of the other, which add to 72, right?

3 A That's right.

4 Q Which was quarterly and which was
5 monthly?

6 A Let's see. We're on 3-inch? Is that
7 correct?

8 Q I guess the 48 bills were monthly
9 because the charge there is \$43.91, right?

10 A Yes. I've got it right here. That's
11 right.

12 Q Okay. Now, if we go down to -- let's
13 try another cell. Let's go down to Fairfax County
14 users for 1-1/2-inch meters.

15 A Uh-huh.

16 Q And we illuminate that cell. You have a
17 total number of bills of 1,528, right?

18 A Uh-huh.

19 Q You need to say yes or no.

20 A Oh. Yes. I'm sorry.

21 Q And then when we look at your formula,
22 the numbers you've got are 1,464 monthly bills and

1 60 quarterly bills. Do you see that?
 2 A Yes, sir.
 3 Q And that adds to 1,524, which is four
 4 less than your total number.
 5 A You are correct.
 6 Q So that's a math error?
 7 A No, it's not.
 8 Q Why is that not a math error?
 9 A I knew that the revenue had to be --
 10 from the financial records because they record the
 11 revenue by meter size, but they don't record the
 12 revenue between those that are collected monthly
 13 and those that are charged quarterly.
 14 So I knew that the answer had to be --
 15 can you hit Escape real quick so I can see what
 16 the answer is? So I knew the answer had to be
 17 53,513. So that's the only way you can get it.
 18 So why is there a difference between four bills
 19 out of 1,528? Apparently four got it for free. I
 20 don't know.
 21 Q Well, how many -- the first cell we
 22 looked at, the numbers added up.

1 A Yes.
 2 Q The numbers don't add up here.
 3 A Right. So for whatever reason, there
 4 were four bills, which would be one customer,
 5 apparently, for whatever reason, I don't know, was
 6 not charged a customer charge. Maybe they weren't
 7 in the system right or something like that. I
 8 don't know.
 9 The way that these numbers were divvied
 10 up -- and quite frankly it took us quite a while,
 11 working with my associates as well as with
 12 Ms. Burke and the Town. Again, they record the
 13 revenue, the customer charge revenue by meter size
 14 and by jurisdiction, but they don't know the
 15 breakdown between those billed quarterly and those
 16 monthly. So we had to solve it.
 17 Sure, you may find one or two of those
 18 in which they didn't match exactly. So apparently
 19 there was one customer that wasn't charged a
 20 customer charge for whatever reason.
 21 Q Well, would you be surprised to learn
 22 that there are numerous entries here where the

1 numbers don't add up?
 2 A Yes, that don't add perfectly to the T,
 3 you're absolutely right. Again, these are from
 4 accounting records. You have what's called
 5 partials, finals and adjustments. If somebody
 6 moves during the middle of the month, they will
 7 waive the customer charge or they'll prorate it.
 8 So what I had to do is to, again,
 9 reconcile the revenue actually collected with the
 10 fact that some are charged quarterly and some are
 11 charged monthly. And it's not, you know, to the
 12 nickel precise. I was off by four, for example.
 13 Q Okay. Now, is it true, Mr. Watkins,
 14 that Falls Church charges a different quarterly
 15 charge to its residential versus its
 16 nonresidential users?
 17 A Yes, sir. You are correct.
 18 Q Okay. And if we go, on my Excel sheet
 19 here, which reflects your Schedule VII, the
 20 residential charge is \$7.47 for a 5/8-inch meter,
 21 right?
 22 A Quarterly. Yes, that's the quarterly

1 charge.
 2 Q And the nonresidential charge for a
 3 5/8-inch meter is \$15.24?
 4 A That is correct.
 5 Q Okay. Did you look at what would happen
 6 if you equalized the charges and used a
 7 nonresidential charge for the residential ones?
 8 Do you know what impact that has on the rate?
 9 A In other words, if I would have said
 10 that, instead of there being a \$7.47 residential
 11 customer charge, used the commercial rate of
 12 15.24?
 13 Q Yes.
 14 A No, I did not.
 15 Q Okay. And you didn't -- if I'm
 16 understanding your testimony correctly, you didn't
 17 analyze these particular charges based on a cost
 18 of service study to see if the rate differential
 19 here was appropriate, did you?
 20 A No. But I can tell you that these are
 21 certainly within the range of reasonableness. And
 22 when it comes to customer charges, this is very

1 much of an art as it is a science. I represent
2 consumer interests in utility cases. And so the
3 mentality that I use and the philosophy that I
4 have is that customer charges should be as low as
5 possible. They're fixed charges. Utilities want
6 to collect all their money in fixed fees, so
7 there's no risk associated with it.

8 With that being said, these numbers are
9 certainly in the range of reasonableness on both
10 sides.

11 Q Mr. Watkins, that wasn't my question,
12 sir. My question was you didn't do a rate study
13 to determine the rate -- if there should be a
14 differential rate for the residential versus
15 nonresidential charges here?

16 A And my answer was no, there was no need.

17 Q All right. Just to see what effect it
18 would have if you equalized the numbers, let's see
19 what happens. Instead of 7.47, \$7.47 for the
20 residential, suppose you changed that to the
21 nonresidential charge of \$15.24. Do you see how
22 I'm doing that in cell G-11? Are you with me,

1 sir?

2 A You're going to -- yeah. I tell you, if
3 you're going to start doing this, I don't trust
4 your math with this spreadsheet with all of these
5 formulas. But knock yourself out.

6 Q You see how in cell G-11, all I did is I
7 changed your figure --

8 A Right.

9 Q -- from 7.47 --

10 A Right.

11 Q -- to 15.24, correct?

12 A Yes. I see.

13 Q Okay. And then if we make the same
14 change -- that was for the City of Falls Church
15 5/8-inch meters users.

16 A Right.

17 Q If we made the same change for the
18 Fairfax County 5/8-inch meter users, we change the
19 7.47 to \$15.24?

20 A Right.

21 Q It makes that change. And if we want to
22 see what effect that has on the calculated

1 commodity rate, we come back to the summary, and
2 that change lowers the commodity rate from \$3.33
3 to \$3.16, right?

4 A Right. But it also increases the
5 revenue requirement associated with the Falls
6 Church -- with the Fairfax customers that they
7 have to pay on the customer charge. It's left
8 pocket, right pocket.

9 Q And all you looked at was the commodity
10 charge?

11 A Wait a minute. Let me finish. You've
12 increased -- you've increased the customer charge
13 rate, which is the fixed monthly fee. And the
14 revenue requirement remains the same. So by
15 definition, the commodity charge rate goes down.

16 So in evaluating whether the rates are
17 reasonable, it's -- it's sort of nonsensical to do
18 this. But if you are going to do that, you have
19 to recognize that the fees paid by Fairfax
20 customers, and all customers for that matter,
21 would go up on their fixed fee component.

22 This case -- this case I can't imagine

1 being an issue over the fixed monthly charge.

2 Q Right.

3 A I can't imagine that. So these are the
4 rates that are in effect. They're certainly
5 within the range of reasonableness. And, indeed,
6 they're probably at the low end.

7 Q But you didn't look at --

8 A The customer charges.

9 Q You didn't look at these -- the
10 quarterly charge rates; you looked at only the
11 commodity rate in doing your cost of service
12 analysis to see what the rate should be?

13 MR. THOMAS: Objection. Asked and
14 answered.

15 THE COURT: I think he did answer that,
16 Mr. Raphael.

17 MR. RAPHAEL: Your Honor, may I have
18 just a 5-minute break? I think I'm near the end.
19 But I want a chance to --

20 THE COURT: That will be fine. The
21 Court will be in a 5-minute recess.

22 (Whereupon, a recess was taken between

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1 3:18 p.m. and 3:34 p.m.)
2 THE COURT: Yes, sir.
3 MR. RAPHAEL: Thank you, Your Honor.
4 I have no further questions for this
5 witness.
6 THE COURT: Thank you, Mr. Raphael.
7 Sur-direct, Mr. Thomas?
8 MR. THOMAS: None, Your Honor.
9 THE COURT: All right. Mr. Watkins,
10 thank you very much, sir.
11 THE WITNESS: Thank you, Your Honor.
12 THE COURT: Yes, sir. I appreciate it.
13 Drive carefully back to the capital city of the
14 Commonwealth of Virginia.
15 THE WITNESS: Thank you. Am I excused
16 now?
17 THE COURT: Yes, sir, you are.
18 THE WITNESS: Thank you.
19 THE COURT: Mr. Thomas.
20 MR. THOMAS: Your Honor, we call David
21 Lasso.
22 MR. RAPHAEL: Your Honor, before

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1 Mr. Lasso enters, we filed an objection to this
2 witness on the ground that he was not disclosed in
3 the City's interrogatories nor was he on the
4 City's original trial witness list. He was
5 subsequently added to the witness list after the
6 15-day window before trial.
7 Now, as I indicated, he was not
8 identified by the City as a fact witness. If he
9 had been, I think -- I would have taken his
10 deposition.
11 It is true that Fairfax Water identified
12 Mr. Lasso as a person who would have knowledge of
13 past practices. But I identified every former
14 City Manager and City financial officer I was
15 aware of.
16 That doesn't mean that I expected them
17 to testify here. And I've taken the deposition of
18 most of the people the City identified as people
19 that they said would have knowledge.
20 So we objected to this on the ground
21 that he wasn't -- he wasn't identified in
22 accordance with a discovery order in response to

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1 an interrogatory. He wasn't on the trial witness
2 list.
3 THE COURT: I misunderstood something.
4 In other words, every person that the City
5 identified, you put on your list.
6 MR. RAPHAEL: No.
7 THE COURT: Every person they
8 identified, you deposed.
9 MR. RAPHAEL: No. I identified most of
10 the people I think they identified.
11 THE COURT: And you might have deposed
12 Mr. Lasso, but you did not receive his name.
13 MR. RAPHAEL: I would -- yes. I would
14 have deposed Mr. Lasso had he been identified by
15 the City in response to my interrogatory as a
16 person of knowledge.
17 THE COURT: Based upon what you know
18 about him now.
19 MR. RAPHAEL: That's correct.
20 THE COURT: Or later learned.
21 MR. RAPHAEL: That's correct.
22 THE COURT: And when was he first

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1 identified to you?
2 MR. RAPHAEL: He wasn't. He was first
3 identified to me less than 15 days before trial.
4 But as I indicated, we did identify him
5 as a former City Manager, along with every other
6 former City Manager and COO that we could
7 identify. That's different from knowing they're
8 going to show up and testify as a witness.
9 And my point is, if he had been
10 identified by the City as a witness, I would have
11 deposed him. I didn't as a result.
12 So I think they are in violation of the
13 scheduling order which says that any witness who
14 is not -- who was not identified in response to an
15 interrogatory shall not be permitted to testify
16 except for good cause shown.
17 And in this instance, he wasn't even on
18 the City's initial witness list. He was
19 identified in an amended list even after the
20 witness list was due.
21 THE COURT: I'm with you on all of that.
22 The part I'm still confused about is how did you

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1 know of Mr. Lasso.
2 MR. RAPHAEL: Because we were able to
3 identify from the City's CAFRs who --
4 THE COURT: Oh, you learned by just
5 looking through all these papers.
6 MR. RAPHAEL: Right.
7 THE COURT: But you did not learn from
8 them that he would be a person of any particular
9 knowledge in response to your interrogatory
10 requests.
11 MR. RAPHAEL: That's correct. I mean,
12 really the key issue is I had no idea he was going
13 to show up as a witness. The City was going to
14 say he had important knowledge. If they had done
15 that, I would have deposed him.
16 Now, his name has shown up on some
17 1995 minutes, and I read a portion of those into
18 evidence of what he said.
19 But that doesn't go to a question of
20 whether he was properly and early and fairly
21 identified in discovery in response to our
22 discovery requests.

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1 THE COURT: All right. Mr. Thomas.
2 MR. RAPHAEL: So I think it's a
3 discovery violation.
4 MR. THOMAS: A couple of points, Judge.
5 Fairfax Water identified Mr. Lasso all
6 the way back as of April and identified him as
7 someone who would have knowledge about how the
8 City has set its water rates and how it has
9 transfer monies --
10 THE COURT: But that wouldn't make him a
11 witness.
12 MR. THOMAS: -- from the water fund to
13 the general fund.
14 Moreover, Judge, there are plenty of
15 people that we identified on our, in our
16 interrogatories as people with knowledge or
17 information that they did not take the deposition
18 of. So I don't think that argument really
19 carries.
20 THE COURT: That's not the linchpin
21 either.
22 MR. THOMAS: Your Honor, Mr. Lasso's

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1 employment with the City ended in 1996. And as
2 we've said at the outset of this case and in a
3 motion in limine and throughout, this case relates
4 to -- this count of this case relates to the
5 City's current rates in 2005.
6 THE COURT: Right.
7 MR. THOMAS: And we've tried, I think
8 mightily, to have that be what this case is about,
9 since I do think that's what this case is about.
10 And since Mr. Lasso was not with the
11 City -- was absent from the City for a period of I
12 think almost 10 years before the 2005 rates went
13 into effect, I don't think he -- he has -- he has
14 knowledge of the sort of historical information
15 that I think Fairfax Water has been able to go
16 into in this case.
17 THE COURT: Well, that's the exception
18 that I have used to look back just for some
19 history. But not insofar as the -- the current
20 rate which is challenged as to its
21 constitutionality.
22 MR. THOMAS: Right.

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1 THE COURT: I haven't permitted
2 testimony to say, for example, well, 1984, they
3 did this and that was plainly unconstitutional.
4 And it continues to be, and let's take a look at
5 that.
6 I said we don't need to worry about
7 that. Whether it was or was not, it doesn't make
8 any difference.
9 What makes the difference is the 2005
10 rate. That's challenged as being unconstitutional
11 for really one reason and one reason alone,
12 because of the balance of the utility fund into
13 the general fund.
14 MR. THOMAS: Right. I understand that.
15 THE COURT: The transfer.
16 MR. THOMAS: And my difficulty with that
17 is that the Court has received in the plaintiff's
18 case a substantial amount of testimony and
19 evidence going back long before then.
20 THE COURT: I would hear from Mr. Lasso
21 probably pursuant -- I mean, for the same reasons
22 I've heard from the others.

1 But that's not the basis of the
2 objection. He's not objecting because he's going
3 to offer historical information. Mr. Raphael
4 knows that probably will be overruled. He said he
5 wasn't properly identified or at all.

6 MR. THOMAS: Right, and my -- well,
7 other than being identified by them and through
8 substantial documents produced by the City to --
9 historical documents requested by the City to
10 them.

11 And my point is I don't think he needed
12 to be identified in as much as Count 5 alleged
13 that the current rates of the City were
14 unconstitutional.

15 And for that -- now that we're into the
16 history, now it's clear from the exhibit list that
17 the plaintiff has provided, that there is going to
18 be examination of the City's historical practices
19 going back, you know, to 1981, as I mentioned with
20 respect to one exhibit, I think it's appropriate
21 to hear from him.

22 THE COURT: What would Mr. Lasso offer

1 with regard to historical practices?

2 MR. THOMAS: He would offer the
3 practices of the City beginning shortly after he
4 came with the City in 1982 and its efforts to
5 consult with others, consultants and experts,
6 about transfers from the water fund to the general
7 fund. And that practice up until the time that he
8 left the City until 1996.

9 And if I might add, he was added to the
10 witness list I think it was a day after we
11 submitted our original witness list.

12 So that's the context of the testimony
13 that he would offer. I think it's fair for him to
14 testify in as much as, you know, that's really --

15 THE COURT: That's only part of the
16 objection, though.

17 Do I understand, Mr. Raphael, correctly,
18 you object not only because he was not timely
19 identified as a witness but because he was not
20 identified in response to interrogatories as a
21 person who would have knowledge of the issues in
22 this case?

1 MR. THOMAS: That's true. It's both of
2 those.

3 MR. RAPHAEL: That's correct, Your
4 Honor.

5 I'm sorry. If I just may point out, the
6 people they identified in discovery who we didn't
7 depose were low-level people like, you know,
8 customer service people, customer service person.

9 Mr. Lasso was a former City Manager and
10 former City attorney. And that's a big dish. And
11 if he had shown up on the witness list, there's no
12 question I would have deposed him.

13 MR. THOMAS: Judge --

14 MR. RAPHAEL: So given that he was the
15 City Manager and the City attorney in the '80s, I
16 had no reason to think he would be a witness in
17 this case.

18 I identified -- I tried in good faith to
19 identify every person I could think of who might
20 have knowledge.

21 MR. THOMAS: Your Honor, if I --

22 MR. RAPHAEL: The City didn't do it that

1 way. They frankly didn't mention Mr. Lasso until
2 after the discovery cutoff, until after the
3 witness list was due, and then the day after that,
4 they said, oh, he's going to testify. I do think
5 that's unfair.

6 MR. THOMAS: If I could, just to round
7 out the factual situation with respect to those
8 that we did identify and they did not depose.
9 Item J on their interrogatory responses is Roy
10 Thorpe who was the City attorney during a period
11 of time that actually might have something to do
12 with Count 5. No deposition of Mr. Thorpe.

13 Robert Goff, director of operations of
14 the City of Falls Church.

15 THE COURT: But it doesn't make any
16 difference whether they chose to or not chose to
17 take a deposition. They never had the opportunity
18 to make that decision absent his name on the list.

19 MR. THOMAS: I offer that in as much as
20 their claim is had we identified him on the list,
21 they would have deposed. And I don't think
22 that's --

1 THE COURT: Well, they would have had
2 the opportunity to depose him is what Mr. Raphael
3 is saying. And he suspects given his position as
4 a former City Manager and one-time City attorney
5 would have made him a person of objection.

6 Objection sustained.

7 MR. THOMAS: Okay. Could I proffer what
8 he would say.

9 THE COURT: For the record, yes, sir.

10 MR. THOMAS: Thank you so much. Thank
11 you.

12 Your Honor, if called to testify,
13 Mr. Lasso would testify that he served as the --
14 he served the City of Falls Church from the dates
15 of 1982 to 1996. And during that time served as
16 the City attorney, City attorney and acting City
17 Manager. And then the City attorney of Falls
18 Church.

19 During that time, he engaged services of
20 a firm called Malcolm Pirnie, P-I-R-N-I-E, in
21 order to advise the City with respect to its
22 setting of rates for the water system of the City

1 of Falls Church and its transfers of ROE from its
2 general fund to its water fund.

3 He'd testify that the City relied on
4 Malcolm Pirnie's 1984 memorandum and analysis and
5 that the City thereafter engaged Malcolm Pirnie on
6 an annual basis to confirm the advice that it had
7 received from Malcolm Pirnie.

8 He would further testify that, during
9 the period 1985 through 1988, the City of Falls
10 Church and Fairfax Water engaged in negotiations
11 pursuant to which Fairfax Water attempted to
12 acquire the City of Falls Church water system.
13 And as part of that negotiations, offered to
14 replace the City's return and transfer from its
15 water fund to its general fund as consideration
16 for the transaction.

17 He would further testify that there was
18 no indication from Fairfax Water during those
19 negotiations with respect to any claim of
20 unlawfulness with respect to the City's rates and
21 charges.

22 Mr. Lasso would further testify that, in

1 the period of 1991, the City engaged Dr. Charles
2 F. Phillips, also known as Charlie Phillips, who
3 Mr. Lasso understood to be the dean of the
4 commerce school at Washington and Lee and the
5 Mayor of Lexington and a noted rate -- public
6 utility regulation consultant, in order to advise
7 the City on the City's return on equity rationale
8 and its transfers. And that the City thereafter
9 continued to make transfers from the water fund to
10 general fund and conducted itself in accordance
11 with what it understood to be Dr. Phillips'
12 advice.

13 Mr. Lasso would further testify that,
14 while he was employed in the City from 1982 to
15 1996, the City and its public utilities committee
16 held regular public meetings in which the water
17 system the City of Falls Church was discussed and
18 the transfers from the water fund to the general
19 fund were discussed, and at no time, to his
20 knowledge, did anyone from Fairfax Water appear
21 and object to anything having to do with the
22 City's water rates and structures or its transfers

1 from its water fund to its general fund.

2 Thank you, Judge.

3 THE COURT: All right. Thank you very
4 much, Mr. Thomas.

5 Anything further that we can do in
6 15 minutes?

7 MR. THOMAS: I can start with another
8 witness.

9 THE COURT: 15 minutes worth, I will be
10 glad to do it.

11 MR. THOMAS: Okay.

12 Well, I'm reversing course here.

13 THE COURT: Okay.

14 MR. THOMAS: So we can reconvene.

15 THE COURT: I'm doing scheduling
16 starting at 8:30, but it will be in the jury room.
17 There will be some activity in the courtroom. But
18 nobody will be sitting.

19 And so I'm going to ask Deputy Price,
20 since the courtroom will be open, to have Mr. Sapp
21 come in at 9:15 so he can set up. And we'll be
22 ready to go at 9:30 sharp.

1 MR. THOMAS: That's fine.
2 MR. RAPHAEL: Thank you very much.
3 THE COURT: Okay.
4 MR. THOMAS: Thank you, Judge.
5 THE COURT: You're all set. Thank you
6 all very much. See you all at 9:30 sharp.
7 The Court stands adjourned.
8 (Whereupon, at 3:48 p.m., the hearing
9 recessed, to reconvene at 9:30 a.m. on Tuesday,
10 September 22, 2009.)
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1 CERTIFICATE OF NOTARY PUBLIC
2 I, Vicky Reiner, RMR, CRR, the officer before
3 whom the foregoing hearing was taken, do hereby
4 certify that said transcript is a true record of
5 the proceedings; that I am neither counsel for,
6 related to, nor employed by any of the parties to
7 the action; and further that I am not a relative
8 or employee of any attorney or counsel employed by
9 the parties thereto, nor financially or otherwise
10 interested in the outcome of the action.
11
12
13
14 _____
15 Notary Public
16 in and for the
17 Commonwealth of Virginia
18 My Commission expires:
19 December 31, 2011
20 Registration No. 7117657
21
22