

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

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

PSC Docket No. 13-27WW

**DIRECT TESTIMONY
OF
HOWARD M. KLEIN
ON BEHALF OF**

STONEWATER CREEK HOMEOWNERS ASSOCIATION

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June 17, 2013

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PREFACE

This testimony will not be in a question and answer format since there are no questioners or deponents. The format of this testimony will be in the form of analysis of testimony given by Artesian Wastewater Management, Inc. personnel and their responses to data requests made by Public Service Commission Staff/ DPA/ Intervenor.

II. INTRODUCTION

My name is Howard M. Klein. I am a resident of the community of Stonewater Creek, Millsboro, DE and have been a resident of that community since August 10, 2010. The Stonewater Creek Homeowners Association has chosen me to act as Intervenor on their behalf in the matter of the application of Artesian Wastewater Management, Inc for authority to increase existing rates and charges for wastewater service, PSC Docket No. 13-27WW. I present this testimony on their behalf.

III. PURPOSE OF TESTIMONY

The purpose of my testimony is to dispute claims made by Artesian Wastewater Management, Inc. (AWMI) personnel in testimonies of January 18, 2013 and subsequent testimony of May 31, 2013 as to the validity of their claim of need for an increase in their wastewater rate. This testimony will be presented in the form of analysis.

IV. ANALYSIS

1. Artesian Wastewater Management, Inc. (AWMI) is a regulated component of the Artesian Resources Corporation (ARTNA), a publicly traded corporation on the NASDAQ Stock Exchange. According to the testimony of Mr. David L. Valcarengi on January 18, 2013 "AWMI has no direct employees." This statement was reinforced by Mr. Valcarengi's response to Stonewater Creek HOA's request for follow-up data June 7, 2013.

Q. Since AWMI claims to have no employees on their payroll; who provides personnel for bookkeeping, billing, and field maintenance of facilities?

A. AWMI relies on personnel employed by either AWC or AUDI to perform such functions.

Based on the fact that AWMI has no direct employees, has no direct payroll expense, pays no payroll taxes or medical benefits it is not reasonable for AWMI to claim a 3% projected increase in payroll costs of employee compensation as Mr. Valcarengi stated in his January 18, 2013 testimony (pg. 15, line 7 – 8). As a matter of fact AWMI has no valid claims of increased employee labor or benefit costs at all.

2. In Mr. Valcarengi's testimony of January 18, 2013 he was asked:

Q. What data did AWMI use in the development of its proposed revenue requirement?

A. AWMI utilized a Test Year consisting of the twelve month period ended September 30, 2012 and a Test Period consisting of the twelve month period ended June 30, 2013.

This "Test Period" is not valid for such calculations since it takes in a time frame that hasn't been reached yet and has too many variables to be accurate.

3. It is apparent that AWMI does not control its finances. It appears that ARTNA, its parent holding company, controls all AWMI financial matters. As a matter of fact it is very difficult to financially separate AWMI from ARTNA. This is evidenced by the following:

- a) AWMI files no tax return. All federal tax returns are filed by ARTNA.
- b) AWMI has no publically traded stock. All stock is ARTNA stock.
- c) As previously stated AWMI has no employees of its own. All employees belong to other subdivisions of ARTNA.
- d) All financing of AWMI projects comes from ARTNA lines of credit.

To hold AWMI up as an independent entity is unrealistic at best. AWMI is tied inextricably to ARTNA and its financial performance is directly tied to ARTNA financial performance since funds between all ARTNA components are mixed. This includes regulated and non regulated sections of the parent company.

4. In Mr. Valcarengi's testimony of January 18, 2013 Mr. Valcarengi was asked about "an appropriate benchmark/ target for evaluating financial performance of AWMI."

Q. What does the company recommend? (Pg 5, Line 12)

A. "AWMI proposes to establish an overall return that incorporates a benchmark rate of return on equity of 10.0 percent." (Pg 5, Lines 13 - 14)

The Stonewater Creek HOA asked AWMI what its definition of equity was in context of this testimony. (HOA - 4, Data request April 26, 2013).

AWMI response was: "The term equity refers to the Balance Sheet definition of total Shareholders Equity for AWMI, which includes par value of shares, additional paid in capital and retained earnings."

This appears to be an invalid statement since AWMI has no shares of par value. All par value shares are ARTNA shares. AWMI has no capital stock and no market capitalization. All market capitalization belongs to, and is listed as, ARTNA. Thus, AWMI's return on

equity is ARTNA's return on equity. ARTNA's return on equity for the fourth quarter of 2012 was 8.52 % according to market data provided by Thompson Reuters Limited. This seems to be in line with the industry norm of 7.30%. The benchmark rate of return on equity of 10.0% is unreasonable.

Furthermore, AWTMI has attempted to justify their request for a 10.0% return on equity by comparing itself to Tidewater Environmental Services, Inc. (TESI) capital structure in their testimony of January 18, 2013.

Q. Are you aware of other companies utilizing this strategy? (Pg 5, Line 16)

A. It is the Company's understanding that Tidewater Environmental Services, Inc. ("TESI") followed this strategy for a wastewater case filed in 2011 docketed as 11-329WW. (Pg 5, Lines 17 – 18).

This is a totally invalid argument since TESI's financial structure and tariff are completely different than that of AWTMI/ ARTNA.

- a) TESI is not a publically traded company and has not market capitalization.
- b) TESI does not utilize a "one size fits all" pricing structure for EDU's

The benchmark for return on equity should be different for each company based on financial reality. Return on equity is greatly affected by the efficiency of management in operating the company. According to financial reports from Thompson Reuters Limited, Ford Equity Research, and The Street Ratings, ARTNA is only average at managing their owners equity and below average at generating revenues from employees. Providing additional funds to AWTMI/ ARTNA by saddling rate payers with higher monthly rates is not going to make AWTMI/ ARTNA more efficient at managing revenue or operating their company.

5. In Mr. Valcarengi's testimony of January 18, 2013 he was asked:

Q. Are there components that serve to increase base rate? (Pg 10, Line 9).

A component of his answer was:

- A. AWTMI must have sufficient cash resources to fund its operations until it receives payment from customers. (Pg 10, Lines 20 – 21).

This statement has no basis in fact since AWTMI bills in advance of services rendered and is paid by customers in advance of services rendered.

6. In the direct testimony of Mr. Brian C. Carbaugh, P.E. of January 18, 2013 Mr. Carbaugh states "As of September 30, 2012, the Stonewater facility has an operating capacity of 750 units and is serving 402 units, or a utilization of 53.6%". (Pg 14, Line 3-4)

Each of these 402 EDU's pays \$75.00/ Mo. for wastewater service for a collective total of \$30,150.00/ Mo. or \$361,800.00/ annum. The number of EDU's has since increased, and increases each month, as new units are built and connected to the system. AWMI will gain additional income from another 348 EDU's which translates into \$26,100.00/ Mo. or \$313,200.00/ annum over the next few years before having to invest another dime in facility expansion. Increasing the present rate of \$75.00/Mo./ EDU to \$88.00/Mo./ EDU would increase that revenue gain by another 17.33%. That increase is totally unwarranted and unjustifiable. In reality, once the community of Stonewater Creek is totally built out the wastewater rate charged by AWMI should be re-evaluated and reduced.

7. Based on the fact that AWMI finances are controlled by their parent holding company, ARTNA, and finances are moved freely between regulated and non-regulated component of ARTNA, it is reasonable to look at AWMI/ ARTNA finances as one entity. In analyzing ARTNA financial performance based on reports from several industry standard stock analysts, it is obvious that ARTNA is a very profitable entity. Its historic growth over the last five years is as follows:

a) Earning/ Share (EPS)	4.58%
b) Revenue	6.08%
c) Dividend	3.70%

The stock appreciation of ARTNA from May 3, 2010 to April 22, 2013 was 27.9%. Rising from \$17.80/ share to \$22.77/ share. On May 6, 2013 ARTNA reported 1st quarter earnings of \$0.287/ share, an increase of 39% over the previous quarter.

On April 29, 2013 ARTNA's Board of Directors approved a 1.5% rise in its Class A Common Stock dividend as reported by Market Watch, PRNewswire, Businesswire, and COMTEX. It is interesting to note that 8.1% of ARTNA Class A Common Stock is owned by "Directors" or "Principles" of Artesian Resources Corp. (ARTNA). This was confirmed during Stonewater Creek HOA's second set of data requests directed to ARTNA.

Q. What percentage of ARTNA stock is owned by "Directors" and "Principles" of the Artesian Resources Corp.?

A. As of March 2013, ARTNA Directors and Officers controlled 8.1% of Class A shares.

In 2012 ARTNA Earnings/ Share (EPS) were 1.13. EPS for 2013 is forecast to be 1.16 and EPS for 2014 is forecast at 1.25. This shows a steady increase in EPS even in a bad economy. Going back to 2011 EPS was only 0.83. Earnings were up 36.14% year over year between 2011 and 2012.

V. CONCLUSION

AWMI and ARTNA in reality are financially inseparable. If each had its own separate Class A Stock issue, credit line, and funds weren't freely transferred between ARTNA and its components you would be able to look at AWMI as a truly separate entity, but this is not the case. ARTNA has the ability to make AWMI look as profitable or non-profitable as it wants. It certainly appears that AWMI is being manipulated to look less profitable than it really is in order to get a rate increase which will increase the profitability of ARTNA and its stockholders. The present ARTNA stock dividend yielding better than 3.73% / annum far exceeds the 2.80% industry average of the few water utility companies that pay a dividend. The ARTNA stock dividend also exceeds that of the average S&P 500 Index yield of 2.09%. Rate payers, especially those on fixed incomes, should not be subsidizing continually increasing dividends for ARTNA Class A stockholders of which 8.1% is owned by ARTNA Directors.

The Stonewater Creek Homeowners Association requests all parties in this rate request examine the possibility of a wastewater rate reduction for the community of Stonewater Creek based on future revenues AWMI will receive as the community is built out. This is also true of the community of Independence which is also tied into the Stonewater Wastewater Treatment Facility.

This concludes the testimony of the Stonewater Creek Homeowners Association.

CERTIFICATE OF SERVICE

I Howard M. Klein certify that on June 17, 2013 I sent copies of my testimony in regard to PSC Docket No. 13-27WW as Intervenor for the Stonewater Creek Homeowners Association to all parties on the attached service list by electronic mail. Hard copies of this testimony were mailed via US Postal Service regular mail on June 25, 2013 to all parties.

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HOWARD M. KLEIN
STONEWATER CREEK HOMEOWNERS ASSOCIATION
DIRECTOR/ INTERVENOR
June 25,2013

Service List
PSC Docket No. 13-27WW (Artesian Wastewater Rate Case)
As of 4/19/13

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