THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA

DOCKET NO. 2006-107-W/S

IN RE:	)	
	)	
Application of United Utility Companies,	)	**SURREBUTTAL TESTIMONY**
Inc. for adjustment of rates and charges	)	**OF JON M. BOULET, Ph.D.**
and modifications to certain terms	)	
and conditions for the provision of	)	
water and sewer service.	)	
	)	

Q. Please state your name and occupation.

A. My name is Jon M. Boulet, and I am the Program Coordinator for Economics at North Greenville University (the "University") and am also an Assistant Professor at the University.

Q. Please describe your educational background and professional experience.

A. I received my Bachelor of Science/Business Administration in Economics in 1987 at Bryan College in Smithfield, Rhode Island. I received my Masters of Science degree in Economics in June 1990 from Clark University in Worcester, Massachusetts and my Ph.D. in Economics from Clark University in 1999.

From 1989 through 1991 I was a teaching assistant in the field of Economics for Clark University. In addition, from 1994 through 1995, as well as for the summers of 1996 and 1997, I was an instructor of Economics at Clark University. During the spring of 1995, I was an instructor of Economics at Worcester State College in Worcester, Massachusetts, and from the spring of 1995 to the spring of 1999, I was an instructor of Economics at Fitchburg State College in Fitchburg, Massachusetts. I became an Assistant Professor of Economics at Fitchburg State

1 **College in 1999 and remained so until the Spring of 2001. During this time I was**
2 **also an instructor of Economics at Bryant College in Smithfield, Rhode Island, and I**
3 **was an instructor of Economics at Bentley College in Waltham, Massachusetts from**
4 **1999 until 2002. Finally, from Fall 2001 until Spring 2002, I was an assistant**
5 **professor of Economics in West Liberty State College. I have been an assistant**
6 **professor of Economics at North Greenville University since the spring of 2002.**
7 **In addition to my educational and professional background in Economics, I**
8 **am also a member of the American Economics Association.**
9 Q. Dr. Boulet, what is the purpose of your surrebuttal testimony?
10 **A. The purpose of my surrebuttal testimony is to express my opinion on the testimony**
11 **filed by B.R. Skelton, Ph.D. and Pauline M. Ahern, CRRA on behalf of United**
12 **Utility Companies, Inc. ("United Utility").**
13 Q. Dr. Boulet, have you read the pre-filed direct testimony and the rebuttal testimony of Ms.
14 Ahern, as well as the rebuttal testimony of Dr. Skelton?
15 **A. Yes, I have read the direct and rebuttal testimony of Ms. Ahern, as well as the**
16 **rebuttal testimony of Dr. Skelton.**
17 Q. Please describe your response to the testimony filed by Dr. Skelton and Ms. Ahern.
18 **A. The economic question raised in the dispute is whether the current rate increase**
19 **sought by United Utility Companies, Inc. ("United Utility") is a fair and competitive**
20 **one and in line with those of any company in a competitive situation and if this rate**
21 **increase is justified on the basis of the ability of the customers to afford the rate**
22 **increase.**

First it must be recognized that United Utility is not a competitive firm but is a localized monopoly that enjoys the monopoly power of being a sole seller of goods and service in this case water and sewer treatment to North Greenville University and other localized clients. To that extent, the buyers have no alternative supplier which gives United Utility what is referred to in economics as monopoly power and requires its regulation under South Carolina law under the boards to which Dr. Skelton has sat on. It must be remembered that United Utility enjoys such monopoly power and thus must seek rate increase approvals to which its *'customers'* have no alternative but to appeal on the basis of the consumers ability to bear such a cost. Thus a monopoly is in a recognized position to arbitrarily raise rates on its customers in order to maximize its own profits at the expense of its customers instead of the standard firm's need to seek customer benefits in order to make profit. Therefore, it must be recognized that United Utility is not a standard firm competing for customers with others, but is in a position of exploitive economic power over its customers for whom there is little recourse to resist this exploitation save for an appeal like they are taking now.

Dr. Skelton and Ms. Ahern have raised the point that United Utility is a firm entitled to earn a justified rate of return on its assets. No firm in a competitive market environment is ever entitled to a return on any investment. It is expected to make good and cognizant business decisions to which it will earn a return. This is why the term risk is used to denote the potential dangers involved in any business operation. United Utility is not a firm in competition, it is a localized monopoly. With a local market under its control, the issue of United Utility facing some great

1 **risk of market collapse or danger of failure due to competition is specious at best.**
2 **Most small firms face higher risks due to market forces over which they have no**
3 **control and are subject to them. Small firms also face competitors that they are**
4 **competing with for consumers. Neither the competitors nor the consumers are**
5 **controlled by them. North Greenville University is in such a competitive**
6 **environment as is the Clubs at Cherokee Valley and as are those who may sell**
7 **houses in this locality and are subject to United Utility. No one guarantees them a**
8 **return on their investment and they must make do in a market environment.**
9 **United Utility is not such an entity. It is not subject to market forces nor does it**
10 **have competitors to which its customers can turn to in dissatisfaction.**
11 **Over the last few years, it is true that interest rates have risen, but that does**
12 **not guarantee a firm the right to raise rates on its customers to ensure it earns an**
13 **interest rate comparable to the national average. Rather, firms must seek those**
14 **opportunities to invest its own money wisely in projects or equipment that will earn**
15 **it the best return on their investment. Not even GM, Ford or Toyota can claim, that**
16 **since interest rates are up, they should be able to earn a higher rate of return for**
17 **their shareholders so they should automatically be able to pass on a 45 percent price**
18 **increase to cover their pension plans and ensure a good rate of return for their**
19 **investors. In spite of all their size and power they cannot do that. Instead they must**
20 **seek other ways of maximizing profits even though interest rates are rising.**
21 **To say that United Utility deserves higher profits due to higher interest rates**
22 **is a condition no competitor can claim. It creates the paradox that high interests**
23 **automatically mean more profits for the firm through higher charges to its**

consumers for no other reason than interest rates are higher. Prices of US government instruments issued in lower interest rate periods fall to account for the change in interest rates and these are considered safe financial instruments. Instead United Utility is asking for the equivalent right to raise the interest rate and the price of the instrument to make a return they deem suitable without regard to market conditions and especially consumers' condition.

To grant United Utility the ability to just arbitrarily shift costs onto its consumers, is to invite the firm to spend wastefully and be secure in the knowledge that it can recoup any wasted or ill spent money through the exploitation of its rate payers under the guise of the firm merely earning a comparable market rate of return. This is known as cost shifting in economics when a firm pushes costs or expenses on another who has no choice in the matter.

The question of an over valued market price for United Utility and sewer companies in general is not a justification for a prohibitive rate increase. It ignores the status of the primary consumers and their ability to afford such a prohibitive burden placed upon them. Often times speculation or risk hedging cause stock prices to rise on what are considered safe stocks. In times of economic uncertainty as in times of growth, core companies will always tend to do well. Water and sewer companies like power companies are considered safe secure investments due to the combination of people and firms always needing water and sewerage and the fact that they benefit from the monopoly power mentioned earlier. To use the inflated book values as justification for a large rate increase to support the high book value, or investors will get hurt, is to invite potential large scale abuse and exploitation of

consumers. For example, a large firm holding the closed stock of a small water/sewer company could inflate the stock price with the intent of being able to use that price inflation of the stock as a justification of price increases on the consumers because they are due a certain return on the value of the stock. A value increased due to the artificial manipulation of the stock price by the primary holder to the detriment of the consumers who lack any alternative but to pay the price, is not a reflection of a standard market rate of return for a firm in the industry, but of the power of the firm to manipulate its stock price for its own advantage.

Even without intentional manipulation, just because investors have made a surge up on water/sewer stocks in general does not justify such rate increases. In normal competitive business operations firms increase efficiency and normally lower prices to consumers to gain more customers or at worse give marginal price increases to stay competitive. The increased efficiency of the firm is recorded in the increase in profit margins. Increases in profit margins then cause stock prices to increase in value as a result of the increase in efficiency. To say that United Utility deserves higher profits because of higher stock prices is to 'put the cart before the horse'. Efficiency justifies good book values, book values should not justify higher stock prices. One needs only look at the computer industry where prices on computers have fallen constantly relative to the capacity of the machine themselves. In others the firms made money by seeing the consumers' needs were met.

Also, the over valued stock price of United Utility should not even be in consideration as it is not a publicly traded company. Thus United Utility price and book value are not vetted by market forces that naturally point potential flaws or

1 problems that may exist in a company. In fact since it is a close held stock that is
2 more reason to look askew at attempts of using book value to justify price increases.
3 Even if it was a publicly traded firm, it would not eliminate the cart-horse problem
4 mentioned above. We should not look at United Utility end of day books and say
5 they should be making so much money. The natural response of any firm to such a
6 boon is that the firm will not need to try and seek efficiency.

7 The concept of a water/sewer operation needing a higher return due to the
8 slower depreciation of capital is also suspect. In reality if a firm can expect its
9 capital to last 20 years instead of five or in the case of the water/sewer industry the
10 100 year life expectancy of the average plant and system given by Ms. Ahern in
11 direct testimony, the firm can expect to pay off the principle of any capital
12 investment rather quickly and enjoy the benefits of paid off fixed costs for several
13 decades to a century at least. A water/sewer company is actually in an enviable
14 position in which it can yield good returns on assets which have a long life
15 expectancy as opposed to say the computer industry where capital turnover is often
16 measured in months. Once the fixed capital is paid off plus interest all returns to
17 that capital are pure profit.

18 Supporters for the rate increase have stressed as noted earlier the need for
19 the firm to have a given rate of return. Yet that as mentioned earlier invites the
20 potential misuse of facts or figures to justify rates increase and does invite the
21 potential of cost shifting on to the consumer due to United Utility monopoly
22 situation and the concept of a guaranteed rate of return, a potentially exploitive
23 combination. To account for this, a series of comparisons are made with other firms

1 **to see if United Utility is getting the industrial average return for its stock value.**
2 **Again that question is putting the cart before the horse in this regard. TUI is**
3 **located in a different state and with potentially different rules. Yet in spite of those**
4 **differences the stress from United Utility was that TUI is making this rate of return**
5 **so United Utility should be making this return also. It was not mentioned the SFE**
6 **sewer rate for TUI was $33.00. How can United Utility need to double the rate of**
7 **TUI to make the same return? Carolina Water Service ("CWS") in South Carolina**
8 **is currently asking for a service raise to an SFE to $42.50 compared to United**
9 **Utility's desired raise to an SFE of $65.75. That proposed rate is roughly double the**
10 **rate of water/sewer for the state of North Carolina where TUI is located. It raises**
11 **the question to whether United Utility's situation justifies pushing a rate that is**
12 **already one of the highest in the state to twice the average of the state. United**
13 **Utility's poor returns may not be a question of consumers not paying enough but of**
14 **internal cost control considerations.**
15 **Also it must be remembered that United Utility received a large block of**
16 **capital equipment (roughly $1million) free of charge from North Greenville**
17 **University. That means the capital to which both Ms. Aherd and Dr. Skelton refer**
18 **to as justifications for these rate increases are actually based on United Utility**
19 **earning a return on equipment and facilities for which they paid absolutely nothing.**
20 **Effectively this is not granting United Utility a standard industry rate of return but**
21 **is in effect granting United Utility a rate of return over double the industry average.**
22 **How often can a firm have its customers pay for the facilities and then give those**
23 **facilities to the firm free of charge and then have the firm turn around and charge**

1 **the consumer for the practice? Furthermore, United Utility wishes to earn a return**
2 **on its investment for facilities on which it did not pay a dime. So we have United**
3 **Utility seeking rate increase justifications based in part on the cost of plant and**
4 **equipment in which it paid no money to acquire. This free transfer of capital is the**
5 **primary reason Dr. Epting expected the fee not to increase because the University**
6 **and the others already bore the core capital expenditure on assets expected to be**
7 **useful for up to a hundred or more years. Assets which United Utility did not spend**
8 **a dime creating are becoming the basis for United Utility to claim they need to earn**
9 **extra money through higher rates on its customers in order to pay off the expense of**
10 **those very facilities United Utility did not pay for.**
11 **Also the question is should a rate increase of 36.24% be passed on to**
12 **customers as outlined earlier. North Greenville University maintains itself in a**
13 **highly competitive industry and cannot merely decide to meet its budgetary**
14 **requirements by passing its costs on to its students and their parents. Part of what**
15 **makes the University highly competitive is lower than average tuition costs for a**
16 **private higher education institution. Passing any costs on to the students could**
17 **result in the loss of students to cheaper state run universities and colleges or to**
18 **pricier private colleges and universities. In fact just the proposed United Utility rate**
19 **increase of 36.24% is higher than the accumulated tuition increases at the**
20 **University of 31.2% since 2001 (See appendix one). While United Utility has not**
21 **suffered in its pricing, since 2001, the net increase in the rate from the initial $29.00**
22 **to the proposed $65.72 SFE represents a percentage increase of 127% far greater**
23 **than that which the University or the other both business and private customers can**

1 **afford. These costs cannot be eaten by the University's customers (students)**
2 **because the University exists in a competitive environment and unlike United Utility**
3 **cannot just claim to need more money to earn a comparable industry profit and**
4 **expect its consumers to eat the cost. It would lose customers (students) and run the**
5 **risk of failure as a non-profit firm. This is a cost increase that the Clubs at**
6 **Cherokee Valley also cannot afford. Another question is that of the standard rate**
7 **paying customers. How many consumers have seen their base pay increase by**
8 **127% in the last five years just to stay even with United Utility's demands?**
9 **United Utility does not even question whether or not it will lose customers**
10 **because its customers are locked in this monopoly relationship. Thus the University**
11 **will be forced to absorb costs it cannot easily afford because it exists in a competitive**
12 **environment while United Utility enjoys monopoly power. All this so that United**
13 **Utility can be guaranteed profits on assets originally provided free of charge by the**
14 **University. These are central not peripheral questions to be answered and ones not**
15 **addressed by Ms. Ahern nor Dr. Skelton in their assessments of the situation.**
16 Q. Does this conclude your surrebuttal testimony?
17 **A. Yes, it does.**

Appendix A

Percentage Increases in North Greenville University Tuition
and Percentage Increases in United Utility Companies, Inc. Rates

Year	University % tuition increases [1]		Year	UNITED UTILITY SFE % rate increases [3]
2001-02	5.6%		12/01-5/02	11.24%
2002-03	5.1%		5/02-6/04	52.82%
2003-04	7.3%			
2004-05	6.0%		6/04-04/06 [2]	-2.2%
2005-06	4.0%		proposed	36.24%
Net 2001-06	31.2%		Net 12/01-proposed rate	126.62%

[1] fall to fall increase in tuition rates for North Greenville University.
[2] This rate adjustment change was due to a previous protest of the severity of the rate increase.
[3] Percentage rate is calculated using SFE rate charged by United Utility during time period compared to previous charged rate.