

Exhibit No.: _____
Witness: Derek Sherry
Type of Exhibit: Direct Testimony
Issues: Compensation/Time Sheets/Overtime; Rate Case
Expenses; Alternative Energy Gas Well Cost Recovery; PSC
Assessment; Contingency/Emergency Repair Fund
Sponsoring Party: Timber Creek Sewer Company
Case No.: SR-2010-0320

MISSOURI PUBLIC SERVICE COMMISSION
UTILITY DIVISION

TIMBER CREEK SEWER COMPANY
CASE NO. SR-2010-0320

DIRECT TESTIMONY OF
DEREK SHERRY

November 23, 2010

In the matter of Small Company Rate Increase)
of Timber Creek Sewer Company) Case No. SR-2010-0320

AFFIDAVIT OF DEREK SHERRY

STATE OF MISSOURI)
COUNTY OF Clay) ss

Derek Sherry, of lawful age, on his oath states: That he has reviewed the attached written testimony in question and answer form, all to be presented in the above cases, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; that such matters are true to the best of his knowledge, information and belief.

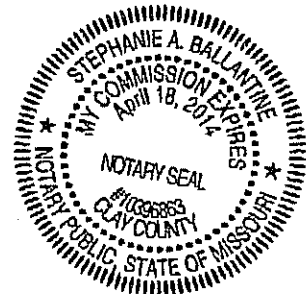
Derek Sherry
Derek Sherry

Subscribed and sworn to before me this 19 day of November, 2010.

Stephanie A. Ballantine
Notary Public

[SEAL]

My Commission expires: 4/18/2014



TIMBER CREEK SEWER COMPANY
SR-2010-0320
DIRECT TESTIMONY OF DEREK SHERRY

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

2 A. My name is Derek L. Sherry. My address is 14398 Lucille Ct,
3 Olathe, Kansas 66062.

4

5 **Q: ON WHOSE BEHALF ARE YOU APPEARING?**

6 A: Timber Creek Sewer Company.

7

8 **Q: WHAT IS YOUR POSITION WITH TIMBER CREEK SEWER COMPANY?**

9 A: I am President and General Manager of the Company and have
10 been in those positions since February 2008. Prior to that
11 date, I was a Vice President of the Company since 1995.

12

13 **Q: PLEASE STATE YOUR QUALIFICATIONS.**

14 A: I graduated with an Engineering degree from University of
15 Missouri - Rolla in 1985. I worked for 5 years as an
16 engineer for Johnson County Wastewater in Johnson County,
17 Kansas that serves over 150,000 customers. I was the

1 engineer for rehabilitation projects, project manager for
2 new construction, completed planning analysis for potential
3 new service areas, performed feasibility and financial
4 analysis for numerous undertakings (capital improvements
5 plan, new administration building, new 8-10 mgd plant and
6 interceptors, etc.), and led environmental studies for
7 sensitive watersheds. Additionally, I've held numerous
8 executive positions at Johnson County and Sprint for over 17
9 years.

10
11 **Q: PLEASE PROVIDE YOUR WORK EXPERIENCE WITH TIMBER CREEK.**

12 **A:** As the President and General Manager, I'm the chief
13 executive and responsible for all facets of a sewer utility.
14 My primary responsibilities include:

- 15 • regulatory oversight and interaction with MoDNR, MoPSC,
16 EPA, Cities, Counties, and other government entities
17 where the Company provides service;
- 18 • all aspects of financial management of company including
19 revenue generation, expense management, capital budget
20 development, securing loans and investments, billing,
21 and collections;
- 22 • administrative management including legal issues, office
23 systems, customer service, and personnel management;
- 24 • operations and maintenance oversight, engineering and

1 construction oversight, and strategic planning;
2 • business development for company opportunities and
3 growth;
4 • Board president for planning, organizing, facilitating,
5 and leading the company shareholders and investment
6 community for company strategic direction setting,
7 establishment of high-level company goals and policies,
8 and ensuring the company achieves its mission.
9

10 **Q: HAVE YOU PREVIOUSLY TESTIFIED IN A PROCEEDING BEFORE THE**
11 **MISSOURI PUBLIC SERVICE COMMISSION ("MoPSC")**

12 **A:** I have testified on several occasions before the MoPSC on a
13 variety of issues affecting Timber Creek, including Timber
14 Creek's last rate case, Case No. SR-2008-0080. I also
15 prepared and filed Direct and Surrebuttal Testimony in one
16 of Timber Creek's certification case, Case No. SA-2010-0063.
17

18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

19 **A:** The purpose of my testimony is to support the \$63,500 annual
20 increase being sought by Timber Creek. While the Company
21 originally sought a \$63,500 increase, it is aware that under
22 4 CSR 240-3.050(25) the Commission sets the just and
23 reasonable rates and that the rates set by the Commission
24 may result in a revenue increase more than the increase

1 originally sought.

2

3 **Q. WHAT IS THE STATUS OF THE PROPOSED INCREASE?**

4 A: The parties (Timber Creek, PSC Staff and OPC) on October 7,
5 2010 have entered into a Unanimous Partial Agreement
6 ("Partial Agreement") regarding the partial disposition of
7 the revenue increase request resolving a substantial number
8 of the issues in the case as set forth on pp. 2-4,
9 subparagraphs (1) through (11). A copy of the Partial
10 Agreement is attached hereto as **Schedule DS-1** and
11 incorporated by reference herein. The Partial Agreement
12 also provides on p.4 that other issues have not been
13 resolved and requested that those issues be resolved through
14 the contested case process.

15 On October 18, 2010, the parties filed a Joint Procedural
16 Schedule and Joint Motion for Approval of Procedural
17 Agreements. In Paragraph 5 thereof the parties identified
18 the remaining issues in the case and agreed that pre-filed
19 testimony and issues to be addressed in this matter be
20 limited to the following unresolved issues:

- 21 a. Timber Creek Staff Compensation/Timesheets/Overtime
- 22 b. Rate Case Expenses
- 23 c. Alternative Energy Gas Well Cost Recovery
- 24 d. PSC Assessment

1 e. Contingency/Emergency Repair Fund

2
3
4 **I. TIMBER CREEK STAFF COMPENSATION/TIMESHEETS/OVERTIME**

5
6 **Q: WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF COMPENSATION**
7 **FOR ITS STAFF?**

8 **A:** The Company believes that the accumulated salaries for
9 Timber Creek's personnel are below market salary levels for
10 similar positions in the Kansas City region and the salaries
11 should be increased.

12
13 **Q: WHY DOES THE COMPANY'S BELIEVE THE SALARY FOR ITS STAFF IS**
14 **BELOW MARKET?**

15 **A:** A salary analysis has been conducted by the company to
16 determine market levels in the industry and comparison to
17 local salaries for analogous positions. For the salary
18 analysis, two industry sources were used:

19 1. Missouri Economic Research and Information Center's
20 Occupational Wages - Kansas City Region, and

21 2. American Water Works Association 2009 Salary Study for
22 Water and Wastewater.

23 Timber Creek's four (4) staff positions of General Manager,

1 Operations Manager, Office Manager, and Plant and Collection
2 System Operator, whose current annual salaries are shown on
3 **Schedule DS-2**, Table 1 were compared to similar position
4 descriptions in the Missouri Economic Research and
5 Information Center (MERIC) database and this information is
6 depicted in **Schedule DS-2**, Table 2. Additionally, the
7 American Water Works Association (AWWA) 2009 Salary Study
8 and Analysis information is included in **Schedule DS-2**, Table
9 3.

10 To validate and confirm the industry survey data, additional
11 market data was collected from positions in the Kansas City
12 Area. All the market data in **Schedule DS-2**, Tables 4 thru 7
13 is from public entities - this is due to the availability of
14 information. All salary information is reported as 2009
15 data.

16 The market and salary survey information indicates that 3
17 out of 4 positions are below market levels (General Manager,
18 Office Manager, and Plant and Collection System Operator),
19 and one position is above market level (Operations Manager).
20
21

22 **Q: WHAT DOES THE PSC AUDIT STAFF REPORT STATE REGARDING TIMBER**
23 **CREEK'S EMPLOYEE POSITIONS?**

24 **A:** In a Memorandum dated August 2nd, 2010 (**Schedule DS-3**, Pages

1 4-7) from the PSC Auditing staff on the top of page 7, the
2 report states: "the salary levels paid to Timber Creek
3 employees are conservatively priced in relationship to
4 salaries paid for other similar positions for other
5 entities." The report indicates that the salary survey
6 information used for comparison to Timber Creek salaries
7 was:

- 8 • General Manager was compared to Management Occupations
9 for Kansas City region - median annual salary \$94,529
- 10 • Office Manager was compared to Executive
11 Secretary/Admin - mean annual salary \$41,142
- 12 • System Operator (Timber Creek's Plant and Collection
13 System Operator) - mean salary level of \$49,290
- 14 • Plant Operations Manager (Timber Creek's Operations
15 Manager) is "paid more than the mean of the salary
16 shown in the survey but given all of his duties and
17 responsibilities, Staff considered this salary level to
18 be reasonable. Mr. Jochim is actually considered a
19 plant manager but no specific salary base was available
20 for an exact comparison."

21
22 **Q: WHAT DID THE PSC STAFF OFFER FOR SALARIES?**

23 **A:** A 3% cost of living increase over current salaries.

24

1Q: WHAT IS THE COMPANY SEEKING FOR ANNUAL SALARIES?

2A: For the position of General Manager, - \$94,529, Office
3 Manager - \$43,263, Operations Manager - \$78,660, and Plant
4 and Collection System Operator - \$49,290.

6Q: WHY IS THERE SUCH A LARGE GAP IN CURRENT SALARIES AND MARKET
7 LEVELS FOR THE POSITION OF GENERAL MANAGER?

8A: Timber Creek registered with the MoPSC as a sewer utility in
9 1994 with less than 50 customers. At that time, the Company
10 did not have any paid staff and was solely supported by real
11 estate development activities by the owners. The Company
12 continued to grow with customers and infrastructure
13 throughout the years, which required the organic addition of
14 staff. First, a part time operator position was added in
15 the late 1990's, which became full time in early 2000's. We
16 added a part time office administration in early 2000's
17 (permitting, billing, and accounts payables), which became a
18 full time position in 2006. We added a 2nd operator in
19 2005, and finally a professional general manager was added
20 in 2008.

21 From 1994 with less than 50 customers to 2010 with 1540
22 retail customers and a wholesale customer of 325 units,
23 Timber Creek has been playing catch up with growth as well
24 as maturing the Company. Part of the business maturation

1 process is to evaluate staffing levels and compensation as
2 it relates to market conditions. Through this evaluation
3 the Company has found that increases should be made to
4 salaries to better reflect market conditions and retain
5 valuable employees.

6 The salary for the General Manager was originally set lower
7 than that of the Operations Manager and is still lower than
8 that of the Operations Manager, which does not make sense
9 based on the duties of the General Manager. Timber Creek
10 believes that it is necessary to bring this salary up to
11 market rate in order to have a fair and reasonable salary
12 structure and to retain the General Manager, who has an open
13 continuing offer of a position elsewhere at a more
14 substantial salary, and to be able to attract a competent
15 General Manager should the current General Manager decide to
16 move on to greener pastures.
17

18 **Q. WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF TIMESHEETS**
19 **AND OVERTIME FOR ITS STAFF?**

20 **A:** Timber Creek has historically paid all staff on a salary
21 basis as exempt employees - not eligible for overtime and,
22 consequently, has not required time records. As part of
23 this rate case, the MoPSC staff has recommended and
24 requested that all company personnel keep timesheets (see
25 **Schedule DS-3, Page 7**). Timber Creek consulted with an

1 attorney to perform a risk analysis in requiring employees
2 to track time and assess the company's liability exposure
3 regarding potential claims under the Fair Labor Standards
4 Act. The opinion letter from Timber Creek's attorney
5 advising of the potential liability Timber Creek would face
6 if it were to adopt time records is attached as **Schedule DS-**
7 **4.** Because of such potential liability, the increased time
8 and effort required by the Company's four employees in
9 keeping time records, and because the employees now perform
10 many services after hours or on weekends which work is not
11 compensated by overtime, if Timber Creek is required to
12 adopt time records, it would also need to establish overtime
13 for its employees.

14 In order to cover the Company's liability exposure for
15 tracking time, Timber Creek is seeking additional revenue of
16 \$10,033 to pay for overtime for two positions, Plant and
17 Collection System Operator and Office Manager and for
18 increased workman's comp and general liability insurance as
19 indicated in **Schedule DS-5.**
20

1 **II. RATE CASE EXPENSES**

2

3 **Q: WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF RATE CASE**
4 **EXPENSES?**

5 A: The Company is seeking to recover all rate case expenses
6 from the previous rate case SR-2008-0080, as well as rate
7 case expenses incurred for this rate case SR-2010-0320.

8

9 **Q: WHAT ARE THE RATE CASE EXPENSES IN DISPUTE?**

10 A: Rate case expenses for SR-2008-0080 that were not included
11 is \$18,175 as indicated in **Schedule DS-6**. The disputed
12 amount of \$18,175 is the invoiced amount from Derek Sherry
13 to manage the company's rate case SR-2008-0080. While Mr.
14 Sherry was an officer of Timber Creek, he was not an
15 employee of Timber Creek at the time of the rate case and
16 did not become an employee until after the completion of
17 Case No. SR-2008-0080. Had the Company not used Mr. Sherry
18 to manage the rate case, it would have had to pay a utility
19 consultant to perform the duties and the fees and expenses
20 would have doubtlessly cost much more than the \$18,175
21 requested to be recovered over a three year period.

22

23 **Q: WHAT IS TIMBER CREEK'S REQUEST?**

24 A: The Company is requesting to recover \$18,175 from SR-2008-

1 0080 and an estimated additional \$40,000 to be incurred in
2 the pursuit of this case, now that it is a contested case,
3 to be normalized over three (3) years (\$19,391 per year).
4
5
6

7 **III. ALTERNATIVE ENERGY GAS WELL COST RECOVERY**
8

9 **Q. WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF ALTERNATIVE**
10 **ENERGY GAS WELL COST RECOVERY?**

11 **A:** Timber Creek's electrical utility costs have increased year
12 over year. In 2007 electrical costs were approximately
13 \$43,000, 2008 was \$56,000, and \$64,000 in 2009. While the
14 costs have increased approximately 49% over this 3-year
15 period, the usage has only increased 5% for this same
16 period. This area of increasing costs with more increases
17 on the horizon had Timber Creek evaluate potential
18 alternative energy options in late 2008 in an effort to
19 reduce on-going operational costs.
20

21 **Q: WHAT ALTERNATIVE ENERGY SOURCES DID THE COMPANY EVALUATE?**

22 **A:** The alternative energy sources considered were solar, wind,
23 and natural gas. The Company selected its Prairie Creek

1 WWTP as the site location for analyses because this location
2 consumes the most power and could potentially reap the
3 largest cost savings.

4 To summarize the cost and payback period for the various
5 energy options were as follows:

- 6 • Solar (panels) was estimated at \$750K with a 22 year
7 payback
- 8 • Wind (turbine) estimated at \$500K with a 14 year
9 payback
- 10 • Natural Gas (on-site well) at \$130K with a 4-year
11 payback.

12 Since the natural gas option had a financial attractive
13 payback period, this source of energy was further
14 investigated as a potential viable alternative.

15
16 **Q: WHAT ANALYSIS DID THE COMPANY DO TO DETERMINE IF NATURAL GAS**
17 **MIGHT BE PRESENT AT THE SITE?**

18 **A:** Extensive research was performed as to the potential of
19 natural gas in the selected site area by contacting the USGS
20 and Missouri DNR. From *the Geologic Column of Missouri*,
21 Volume 2, Issue 1, published in the summer of 2007 by the
22 Missouri Department of Natural Resources Division of Land
23 and Geology, there is a large basin that has produced oil

1 and natural gas called the Forest City Basin. The Forest
2 City basin incorporates northwest Missouri, portions of
3 Iowa, Nebraska, and Kansas. With this information, the
4 Company continued its research by requesting and receiving
5 oil and gas well logs from the Missouri DNR. These logs
6 indicated natural gas production at the Tiffany Springs
7 location - approximately 7 to 8 miles from selected site.
8 The Company continued its research through several
9 discussions with USGS, DNR, manufacturers of natural gas
10 generators and oil/gas drillers.

11 The common advice and recommendation from the multitude of
12 discussions with firms and organizations in the industry was
13 that the most practical and definitive method to determine
14 if natural gas is present is to drill a pilot well.

15

16 **Q: WHAT WAS THE COST AND RESULT OF A PILOT NATURAL GAS WELL?**

17 **A:** Timber Creek contacted 15 drilling companies and received
18 three bids from oil/gas well drillers ranging from \$12,000
19 to \$30,000 to drill a pilot, exploratory well. The pilot
20 well was drilled in the summer of 2009 to over 900 feet at a
21 cost of \$10,849, but natural gas was not present.

22

23

1 **Q: WHAT IS THE COMPANY LOOKING TO RECOVER?**

2 **A:** Timber Creek is requesting to recover \$10,849 annualized
3 over 3 years (\$3,616 per year) to continue to explore
4 alternative energy options that could potentially reduce its
5 energy costs to the benefit of its customers.

6
7

8 **IV. PSC ASSESSMENT**

9

10 **Q. WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF THE PSC**
11 **ASSESSMENT?**

12 **A:** The Company believes the PSC assessment for sewer companies
13 the past four years is inequitable and overly financially
14 burdensome on the Company and its ratepayers. For FY2008
15 the PSC Assessment allocation percentage for sewer companies
16 was 6.94%, FY2009 was 8.47%, FY2010 was 11.22% and FY2011 is
17 9.34%. During this same time frame, no other utility
18 industry in Missouri had an assessment above 1%. Sewer
19 companies and their ratepayers are paying 700% to 1100% more
20 for regulatory oversight than other regulated utilities in
21 Missouri.

22

23 **Q. WHAT HAS BEEN THE FINANCIAL IMPACT TO TIMBER CREEK?**

24 **A:** Timber Creek's last rate case, Case No. SR-2008-0080
25 utilized the FY2008 allocation percentage of 6.94%. If the

1 PSC assessment for sewer companies had remained at 6.94%,
2 the Company would not have paid an additional \$45,902 from
3 FY2009-2011 to the PSC. Because there was no rate case
4 during that period, none of such amount was passed on to its
5 customers.

6

7Q: **WHY DIDN'T THE COMPANY FILE A RATE CASE SOONER TO COVER THE**
8 **PSC ASSESSMENT INCREASES?**

9A: Rate cases are an expensive, time consuming, resource
10 consuming, and an onerous process for most small companies,
11 including Timber Creek. Timber Creek typically will only
12 file a rate case as a last resort when absolutely necessary.
13 The informal rate case process for small companies is
14 scheduled to take 150 days to complete and typically runs
15 longer due to extensions granted to resolve outstanding
16 items and issues. Further, if all issues are not resolved
17 the expense of the rate case increases substantially under
18 the contested case process. By the time the rate case is
19 completed, the order issued, tariff sheets updated and
20 filed, new rates established and implemented, a new PSC
21 assessment allocation has been issued, thus the Company is
22 unable to "catch up" due to regulatory lag.

23

24

1 **Q: WHAT IS TIMBER CREEK TRYING TO RECOVER AND RECOMMEND?**

2 **A:** The Company is seeking to recover \$45,902 over the period of
3 3 years and recommends that the PSC assessment for sewer
4 companies become more equitable to other utility industries
5 with percentage allocation of less than 2%. Further, until
6 such time as the assessment becomes more equitable for sewer
7 companies, the Company is asking that the Commission allow
8 Timber Creek to segregate the annual assessment from its
9 operating costs and instead allow Timber Creek to pass it on
10 directly to the customers as a separately stated surcharge
11 on the customers' monthly bills identified as "PSC
12 Assessment Charge." Such procedure would go a long way in
13 reducing the frequency of rate case filings by Timber Creek
14 that would benefit both the Company and Customers, who in
15 the end pay the prudently incurred costs of the rate cases.

16
17
18
19 **V. CONTINGENCY/EMERGENCY REPAIR FUND**

20
21 **Q. WHAT IS THE COMPANY'S POSITION ON THE ISSUE OF A**
22 **CONTINGENCY/EMERGENCY REPAIR FUND?**

23 **A:** Timber Creek's current rate structure supports routine
24 operations and maintenance type items but does not support

1 emergency, unplanned events that would substantially impact
2 utility operations. The Company believes that ratepayers
3 expect and are entitled to uninterrupted, dependable utility
4 service that is environmentally responsible. To support
5 uninterrupted service and implement a financially prudent
6 business practice, the company is seeking to establish and
7 maintain a contingency fund for emergency and extraordinary
8 unplanned events.

9 An additional benefit to utilities in maintaining a
10 contingency fund can be a more favorable interest rate since
11 many financial institutions evaluate cash reserves as a
12 parameter in determining risk and establishing interest
13 rates and/or bond ratings.

14

15 **Q. WHY WOULDN'T SIGNIFICANT REPAIRS TO INFRASTRUCTURE AND**
16 **UTILITY ASSETS BE VIEWED AS A CAPITAL INVESTMENT AND FUNDED**
17 **BY INVESTORS?**

18 **A:** The Company views capital investment as:

- 19 1. adding value by the addition of new functionality,
20 capability, or capacity;
- 21 2. prolonging the life of the asset in whole.

22 Additionally, the Company cites the following IRS court
23 cases in defining expense vs. capital:

1 In *FedEx Corp. v. United States*,^[1] the taxpayer performed
2 repairs upon jet engines by removing them from the
3 airplane and then having parts replaced. The taxpayer
4 argued that these expenses were deductible, but the IRS
5 stated that the costs should be capitalized. The court
6 held that the inspection and replacement costs could be
7 deducted as an expense because the improvements did not
8 add to the value and did not prolong the life of the
9 airplanes as a whole.^[2] In *Midland Empire Packing Co. v.*
10 *Commissioner*,^[3] the taxpayer added a concrete lining to
11 its basement floor to prevent oil from seeping into where
12 the taxpayer stored meat. The taxpayer argued that the
13 costs of installation were deductible and the tax court
14 agreed. The costs of installation only permitted the
15 taxpayer to continue the plant's operation. The expenses
16 did not add to the value of the business or permit the
17 taxpayer to make new uses of the basement.

18 1. [^] 291 F. Supp. 2d 699 (W.D. Tenn. 2003).

19 2. [^] Prop. Reg. § 1.263(a)-3(d)(2)(v) sets forth nine factors
20 to use when determining whether an item should be treated as
21 an individual piece of property or as part of a whole.

22 3. [^] 14 T.C. 635 (1950).

23 Using the definitions above, the company believes that most

1 repairs to utility infrastructure are an expense item since
2 the repair, by definition, typically is restoring existing
3 capability to the asset.

4
5 **Q. WHAT WOULD BE EXAMPLES OF CONTINGENCY/EMERGENCY REPAIR ITEMS**
6 **AND HOW WOULD YOU ESTIMATE THE FINANCIAL COSTS?**

7A: The Company has identified critical areas for the on going,
8 uninterrupted operations and management of the utility in
9 **Schedule DS-7** and determined potential unplanned events that
10 would have significant financial and operational impact.
11 Fiscal impacts (significant repair costs) are established
12 for each of the unplanned events and assigned a probability
13 for occurrence. A cash reserve is calculated for each event
14 by using the fiscal impact estimate times the probability of
15 occurrence times the number of units (assets) in that
16 category. The cash reserve total would be the ceiling, or
17 cap, for the contingency/emergency repair fund.

18
19 **Q. HOW WOULD THE CONTINGENCY/EMERGENCY REPAIR FUND BE FINANCED?**

20A: The emergency repairs would be for existing infrastructure
21 and assets serving the existing ratepayers. The Company
22 proposes an additional small amount to be charged per month
23 that would accumulate over a period of time until the cap is
24 reached. Once the cap is reached the monthly charge would

1 be removed. Additionally, the cap would be adjusted as
2 additional capital infrastructure is added.

3

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

5 **A.** Yes it does.