

SOAH DOCKET NOS. 582-05-2770, 582-05-2771

TCEQ DOCKET NOS. 2004-1120-UCR, 2004-1671-UCR

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CHIEF CLERKS OFFICE

APPLICATION BY AQUA UTILITIES, § BEFORE THE STATE OFFICE  
INC., d/b/a AQUA TEXAS, INC. TO §  
CHANGE ITS WATER AND SEWER §  
TARIFFS AND RATES IN VARIOUS §  
COUNTIES, AND APPEAL OF RATE- § OF  
MAKING ACTIONS OF VARIOUS §  
MUNICIPALITIES DENYING §  
REQUESTED CHANGES TO WATER §  
AND SEWER TARIFFS AND RATES § ADMINISTRATIVE HEARINGS

**THE SOUTHEAST AND SOUTHWEST REGIONS' RESPONSE TO  
THE EXECUTIVE DIRECTOR'S AND AQUA TEXAS' EXCEPTIONS TO  
THE ADMINISTRATIVE LAW JUDGES' PROPOSAL FOR DECISION**

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TO THE HONORABLE COMMISSIONERS OF THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY:

COME NOW, the Southeast Region Homeowners Group (and Numerous Individual Customers, including Crighton Ridge Homeowners Association) (the "SE Region") and Southwest Region Homeowners Group (the "SW Region"), and file this "Response to the ED's and Aqua Texas' Exceptions to the Administrative Law Judges' Proposal for Decision" in the above-referenced dockets, and would show the Commission as follows:

**I. INTRODUCTION**

**A. Introductory Response to the ED's Response to Order No. 49 and Exceptions to the Proposal for Decision**

The SE and SW Region continue to disagree with the Executive Director's ("ED") continued support for Aqua Texas' Application in this matter, as well as support for the Administrative Law Judges ("ALJs") Proposal for Decision ("PFD"). Similarly, the SE and SW Regions continue to object to the manner in which the ED processed Aqua Texas' Application,

including the failure to follow the express language of Section 13.301, TEX. WATER CODE, and Section 291.109 (30 T.A.C.) of the TCEQ's rules to requiring an approved Sale, Transfer Merger ("STM") from Aqua Source Utility, Inc. to either the Aqua Texas entities or to Aqua America, Inc.<sup>1</sup> Furthermore, the ED's Response to Order No. 49 (Requiring Submission of Rate Setting Data) and the ED's Exceptions to the Proposal for Decision fail to identify any evidence of record or calculations as to how the ED determined the rates set for the North Region, the SE Region or the SW Region.<sup>2</sup> By not providing calculations, the ED's rate calculations cannot be considered reliable.

Finally, and what is possibly more revealing, is what the ED does not discuss in its Exceptions to the PFD and/or Response to Order No. 49. Specifically, in a related companion case involving the rate increase requested by the Applicant,<sup>3</sup> the ED has made substantially different, if not contradictory, recommendations on rates to be established based upon the same May, 2004 Application at issue in these Dockets.

#### **B. Introductory Response to Aqua Texas' Exceptions to the PFD**

Assuming *arguendo*, Aqua Texas is granted a rate increase, the SE and SW Regions continue to disagree with Aqua Texas' efforts to obtain phased rates which create the possibility of gross over recovery and the improper shifting of costs to later rate payers.<sup>4</sup> Aqua Texas relies upon its decision to implement a phase-in of rate increases as the basis to request that the resulting deferred expenses to be accounted for as "regulatory assets." The SE and SW Regions oppose Aqua Texas' proposed (i) "rate based treatment" for regulatory assets and/or (ii) a

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<sup>1</sup> See SE and SW Regions' Closing Argument, pgs. 8-10.

<sup>2</sup> See ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Proposal for Decision, p. 1.

<sup>3</sup> See SOAH Docket No. 582-06-1366; TCEQ Docket No. 2006-0072-UCR: the Wood Creek Ratepayers Coalition's Petition to Appeal the City of Wood Creek's Decision to Establish Water and Sewer Rates Charged by Aqua Utilities, Inc. d/b/a Aqua Texas, Inc. and Aqua Development, Inc. d/b/a Aqua Texas, Inc.

<sup>4</sup> See ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Proposal for Decision. p. 6.

recovery of these deferred expenses via surcharge as being both unreasonable and unnecessary. The SE and SW Regions also oppose Aqua Texas' request for recovery of rate case expense reimbursements for settled parties, including municipalities, from the non-settling parties.<sup>5</sup> Rate case expenses of settled parties, as well as transcription costs, should not be recovered from the remaining parties. The result of that practice, if implemented, would be discriminatory because it would impose a disproportionate amount of those expenses on the non-settling parties. Finally, contrary to Aqua Texas' argument, TEX. WATER CODE Section 13.145 does apply to all systems in this case as a condition precedent to the inclusion of the systems under a consolidated tariff. Having failed to meet its burden, Aqua Texas should not be allowed to have any consolidated rate tariffs.

## II.

### **RESPONSE TO THE ED'S RESPONSE TO ORDER NO. 49 (REQUIRING SUBMISSION OF RATE SETTING DATA) AND EXCEPTIONS TO THE ADMINISTRATIVE LAW JUDGES' PROPOSAL FOR DECISION**

#### **A. Responses to ED's Response to Order No. 49 (and related Order No. 48).**

##### **1. Responses to ED's Calculated Base Rates**

Due to Aqua Texas' failure to produce any readily discernable rate design information during either the processing of the Application or the contested case hearing, the ALJs issued Order No. 48 directing the Parties to identify the rate base evidence of record to the ALJs for their rate setting purposes, as well as all identifiable adjustments to cost of service and revenue requirements from the record.<sup>6</sup> Even with the additional explanation provided to them in the Parties' responses to Order No. 48, the ALJs were not able to discern a rate design to develop a recommended set of rates. Accordingly, contemporaneously with the publication of the PFD, the

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<sup>5</sup> See Aqua Texas' Exceptions to the PFD pgs. 17-19.

<sup>6</sup> See Order No. 48.

ALJs issued Order No. 49 directing the ED to develop rates based upon the Findings & Conclusions in the PFD. The ED's response to Order No. 49, like its response to Order No. 48, however, does not appear to be based upon evidence of record provided by Aqua Texas either in the application process or during the contested case hearing.<sup>7</sup>

The rate base calculations provided by the ED in its Response to Order No. 49 are, as presented, unsupported by the evidence of record. The ED's bald rate calculations provide no source(s) of the information relied upon by the ED to make the calculations resulting in the recommended rate base.<sup>8</sup> Aqua Texas did not submit a rate design evidence in conformity with Commission rules or practice, and neither has the Executive Director, during this hearing process. Accordingly, the Commission should not consider the unsubstantiated final rate base numbers recommended by the ED to be reliable.

## **2. Responses to the ED's Projection of Over/Under Collections**

Assuming *arguendo*, the ALJs determine that the ED's numbers are sufficiently reliable to be used to support this Application, the ALJs should take into consideration both the over and under charging of Aqua Texas' customers. The SE and SW Regions strongly disagree with the broad distribution among all systems of the \$6 Million over-collection for water and the \$6 Million under-collection for wastewater.<sup>9</sup> For example, the homeowners' and property owners' associations, represented as the protesting "SW Region" do not have any wastewater systems served by Aqua Texas. Therefore, it is discriminatory to require systems in the SW Region to

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<sup>7</sup> See ED's Response to Order No. 48; *see also* ED's Response to Order No. 49 and the ED's Exceptions to the Administrative Law Judges' Proposal for Decision p. 1.

<sup>8</sup> See ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Administrative Law Judges' Proposal for Decision p. 2.

<sup>9</sup> See ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Proposal for Decision, p. 2.

have paid, and get denied reimbursement, for the over-collection of water when they do not receive any benefit from Aqua Texas' under-collection of wastewater.<sup>10</sup>

The ED also errs in calculating this over/under collection because the ED used Aqua Texas' "test year" as a foundation for the projected calculations.<sup>11</sup> In violation of TEX. WATER CODE Section 13.002(22) and TEX. ADMIN. CODE Section 291.31 (b), however, Aqua Texas did not submit an Application with a defined test year.<sup>12</sup> For the ED to base its recommendations regarding the under and over collections on a hypothetical test year of unconfirmed data that fails to comply with the statutes and/or the Commission's rules is neither just nor reasonable.

## **B. Responses to the ED's Exceptions to the PFD**

### **1. Responses to the ED's (II.1. Adjustments for Settled Customers)**

The ED stated that it failed to anticipate the number of systems that would eventually settle in this case and the resultant "numerous revised calculations to the account for additional settled systems" and, therefore determined that accounting for the settled systems caused too much complexity in this case.<sup>13</sup> The SE and SW Regions respectfully request the Commissioners to take official notice of the settlements in this case. Those settlements must be submitted to TCEQ, and relied upon by the ED to establish the rates for the settled parties before the Order can be issued in this case. Because TCEQ has been provided these settlement agreements, the TCEQ can easily calculate base rates of the non-settled systems on the same. Assuming these settlements are not considered, or can not be considered to develop the base rates due to the

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<sup>10</sup> TEX. WATER CODE § 13.1182(b) states: Rates shall *not* be unreasonably preferential, prejudicial, or *discriminatory* but shall be sufficient, equitable and consistent in application to each class of consumers." (Emphasis added.)

<sup>11</sup> ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Administrative Law Judges' Proposal for Decision p. 2.

<sup>12</sup> See PFD p. 5; see also Hugus testimony, pg. 48, ln 14 to pg. 58, ln. 14.

<sup>13</sup> ED's Response to Order No. 49 (requiring submission of rate setting data) and the ED's Exceptions to the Administrative Law Judges' Proposal for Decision pp. 3-4.

“complexity”<sup>14</sup> of this case, it is unreasonable, unjust, discriminatory, and “inconsistent”<sup>15</sup> to use those same settlement agreements in finalizing the Orders for rates for the settled parties to reach those settlements, while charging the remaining systems with the costs incurred.

## 2. Responses to the ED’s (II, 3., a. Deferred Expense/Regulatory Asset)

The SE and SW Regions agree in part, and disagree in part, with the ED’s conclusions related to Aqua Texas’ deferred expense regulatory assets. The SE and SW Regions agree with both the ALJs’ and ED’s recommendation that no “regulatory asset” be included in the rate base. In addition to *not* being authorized by Texas law, recognizing the so-called regulatory asset would allow Aqua Texas to over-recover deferred expenses and improperly shift costs to the rate payers. Allowing Aqua Texas phased rates to create the deferred expenses actually costs the customers more money and serves only to make more money for the Applicant’s Parent Company, AquaAmerica, which holds all of the capital in the corporation’s structure and serves as the Applicant’s “banker.” This is not an arms-length transaction, nor is it a necessary one. It does, however, create an unnecessary and unjust burden on the ratepayers.

Specifically, allowing Aqua Texas to create this fictional capital asset and recover both (i) a rate of return on that asset and (ii) the interest on the same would unjustly enrich Aqua Texas by allowing it to recover more than it would have, had they merely charged the higher rate from “day one” over the same period of time. To the extent that Aqua Texas is trying to charge their customers a rate that will be collected through “deferred revenue,” which Aqua Texas wants to be considered as a “regulatory asset,”<sup>16</sup> the ED should be telling the ALJs that they must

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<sup>14</sup> ED’s Response to Order No. 49 (requiring submission of rate setting data) and the ED’s Exceptions to the Administrative Law Judges’ Proposal for Decision p. 3.

<sup>15</sup> The ED admitted in his Response to Order No. 49 (requiring submission of rate setting data) and his Exceptions to the Administrative Law Judges’ Proposal for Decision that the rationale for removing settled systems throughout the hearing was to maintain “consistency with how other systems had been treated.”

<sup>16</sup> See Hugus testimony, pg. 110, ln. 14 through pg. 117, ln. 22.

deny the request pursuant to Section 13.135 TEX. WATER CODE, which provides that a utility may not charge, collect, or receive any rate for utility service, or impose any rule or regulation, “*other than as provided in this chapter.*” (Emphasis added.)

The ED, however, recommends the possible recovery of the so-called “deferred expenses” through a surcharge.<sup>17</sup> Under current Texas law, these deferred expenses are not recognized as an item eligible to be recovered or as a surcharge<sup>18</sup> in the context of water and wastewater utility rates. Even as a “surcharge,” for the reasons set forth above, its recovery is unnecessary and unjust. Accordingly, it should not be allowed.

### **3. Responses to the ED’s (II, 3., b. Appropriate Rate Base Numbers to Use in Setting Rates)**

The ALJs found a discrepancy of \$2.8 Million in rate base numbers, which existed even when the requested \$8 Million deferred asset was taken into account.<sup>19</sup> It appears that neither the ALJs nor the ED can determine the derivation of the \$2.8 Million discrepancy.<sup>20</sup> Apparently, no evidence exists in the record by which the ED can form a rate base, because Aqua Texas failed to provide a rate design, chart, formula or explanation as to how to determine the rate within the Application as required by Chapter 13 and the Commission’s rates. The Commission cannot form a base rate on such incomplete information and unsupported assumptions.

### **C. Response to What is *Not* in the ED’s Exceptions.**

In the Wood Creek Ratepayers’ Coalition of the appeal of the Aqua Texas water and sewer rates (SOAH Docket No. 582-06-1366; TCEQ Docket No. 2006-0072-UCR) based upon the same May, 2004 Aqua Texas rate application at issue in these proceedings, Elsie Pascua and

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<sup>17</sup> ED’s Response to Order No. 49 (requiring submission of rate setting data) and the ED’s Exceptions to the Administrative Law Judges’ Proposal for Decision p. 7.

<sup>18</sup> See TEX. ADMIN. CODE § 291.21(k), § 291.30(b), § 291.31(d)(2), and § 291.32(b)(2).

<sup>19</sup> PFD p. 59.

<sup>20</sup> See ED’s Response to Order No. 49 (requiring submission of rate setting data) and the ED’s Exceptions to the Administrative Law Judges’ Proposal for Decision, pg. 9.

Kamal Adhikari testified as Expert Witnesses for the ED. These are the same witnesses who testified for the ED in these Dockets.

In her prefiled testimony in the Wood Creek case Ms. Pascua testified that she concluded that “the debt to equity ratio used by Aqua Texas in the consolidated case is *not accurate or appropriate, . . .*” See prefiled testimony of Ms. Pascua at 7, lines 8-9. (emphasis is added).<sup>21</sup> She also testified that while she started with “the presumptive rate” of 12 percent when calculating an appropriate rate of return for Aqua Texas, she “reduced the weighted average rate to 8.23%.” Ms. Pascua explained that the reduction was the result of concluding that Aqua Texas’ debt to equity ratio was *not* 50/50, but “should actually be 52.9/47.2.” See *id.* at 10, lines 19-23. She also noted that “Aqua Texas proposed a debt to equity ratio of 50/50 during the consolidated case. *This ratio was hypothetical since Aqua Texas has no debts or equity. Only the parent company, Aqua America, has debt and equity.*” *Id.* at 12, lines 6-8 (emphasis added).

Mr. Adhikari, the ED’s other witnesses in both these Dockets and the Wood Creek Docket testified on rate calculations, and made rate recommendations for both base rate and gallonage charges. In his Prefiled Testimony,<sup>22</sup> Mr. Adhikari recommended unphased rates for Wood Creek of a “29.61 per month” for a base rate and a gallonage charge of \$3.61 per 1000 gallons.” See Prefiled Testimony of Mr. Adhikari at 13, lines 19-21. The base rate for Wood Creek, a system geographically part of the SW Region in these Dockets and that under the rationale adopted by the ALJs in the PFD in these Dockets should be considered to be “substantially similar to the other systems in the SW Region,” is almost twenty percent (20%) lower than the base rate the ED recommended in its Response to Order No. 49. Specifically, in that Response the ED recommended an unphased base rate for the SW Region of \$36.86 per

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<sup>21</sup> Excerpts of Ms. Pascua’s Prefiled Testimony in the Wood Creek case are attached hereto as Attachment “B.”

<sup>22</sup> Excerpts from Mr. Adhikari’s Prefiled Testimony in the Wood Creek case are attached hereto as Attachment “C.”

month. *See* ED's Response to Order No. 49 (Regarding Submission of Rate Setting Data) and the Executive Director's Exceptions to the Proposal for Decision.

The SE and SW Regions request the Commission take Official Notice of the Prefiled Testimony of Ms. Pascua and Mr. Adhikari, both documents filed as a matter of public record in proceedings pending before the Commission. While those filings are not part of the record in this case, they are directly related to, and based in part, upon the matters of record in these Dockets.

Specifically, the May, 2004 rate application referred to in their respective testimony as the "consolidated case" is the same application before the Commission in these Dockets. In the interest of fairness and justice, and good public policy, the Commission should consider making inquiry of the ED as to the sufficiency and accuracy of its investigations into and scrutiny of both the Aqua Texas application and the ED's conclusions and recommendations made thereon in these Dockets. Thereafter, the Commission may wish to re-open the record in this matter, or otherwise inquire further into the validity of the assumptions and conclusions giving rise to the recommendations, findings of fact and conclusions of law set forth in the ALJ's PFD.

### III.

#### **RESPONSE TO AQUA TEXAS' EXCEPTIONS/RESPONSES TO THE PFD**

##### **A. Responses to Aqua Texas' Exceptions (II. A. Aqua Texas' phased rates and rate base treatment of the resulting regulatory asset)**

As previously stated, Texas law does not recognize Aqua Texas' proposed "Regulatory Asset" in the context of water and wastewater utility rates. Accordingly, there is no basis for the Commission to consider, and/or authorize the Regulatory Asset.<sup>23</sup> Moreover, allowing the use

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<sup>23</sup> TEX. WATER CODE § 13.135, UNLAWFUL RATES, RULES, AND REGULATIONS, makes clear types of rates which cannot be lawfully charged. Specifically, Section 13.135 provides: A utility may not charge, collect, or

of this fictitious asset in this case would result in an over-recovery by the Applicant, which increases the rate burden to the customers. On its face, that is both unnecessary and unjust. Accordingly, the ALJs properly recommended denial of the Regulatory Asset.

**1. Response to Aqua Texas' Exceptions (II., A., 1. Aqua Texas should be allowed phased rates)**

Aqua Texas asserts that the deferral of the rate increases protects to the consumers from "rate shock."<sup>24</sup> However, allowing Aqua Texas to create a fictional capital asset not recognized by Texas law and recover both (i) a rate of return on that asset and (ii) the interest on the same would unjustly enrich Aqua Texas by allowing it to recover more than it would by initially charging the higher rate over the same period of time. This result is particularly egregious where the applicant is borrowing the funds from its Parent Company, which is at little or no risk in recovering its investment. This over-recovery harms the consumers as opposed to providing protection. By denying the "regulatory asset," the ALJs properly provide for an un-phased rate.

**2. Response to Aqua Texas' Exceptions (II., A., 2. Aqua Texas' regulatory asset should be allowed rate base treatment)**

**a. NARUC Chart of Accounts does not allow deferred assets in this case.<sup>25</sup>**

Aqua Texas bases part of its rationale regarding the allowance of "regulatory assets" by referring to the NARUC chart of accounts from 1996, specifically Account No. 186.3.<sup>26</sup> However, in their Exceptions, Aqua Texas failed to provide the NARUC definition of "Regulatory Asset," which contradicts the proffered argument. NARUC defines "**Regulatory Assets and Liabilities**" as:

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receive any rate for utility service or impose any rule or regulation other than as provided in this chapter. (Emphasis added).

<sup>24</sup> See Aqua Texas' Exceptions to the PFD p. 5.

<sup>25</sup> See Aqua Texas' Exceptions to the PFD pp. 7-8.

<sup>26</sup> See Aqua Texas' Exceptions to the PFD pp 7-8.

*“assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains or losses that would have been included in determination of net income in one period under the general requirements of the Uniform System of Accounts but for it being probable that; 1) such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or 2) in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required. Regulatory assets and liabilities can also be created in reconciling differences between the requirements of generally accepted accounting principles, regulatory practice and tax laws.”*<sup>27</sup>  
(Emphasis added).”

Even assuming that Texas Law allowed the “Regulatory Asset,” Aqua Texas has not presented evidence that its proposed use of the concept in this rate case meets the criteria set out in the NARUC definition.

Specifically, no “rate action” by the Commission (the pertinent “regulatory agency”) has taken place in this case. Furthermore, the NARUC definition also refers to “costs” which occur when a plant comes “online” at a time different than the time the rate increase was filed. That is not the case for Aqua Texas. Specifically, the “regulatory asset” requested in this case does *not* provide for “CWIP” or “Construction Work in Progress.” Finally, there is nothing in this case that refers to “regulatory liabilities.” Accordingly, the NARUC uniform system of accounts does not include Aqua Texas’ “regulatory asset.”<sup>28</sup>

**b. Texas Case law does not allow deferral of assets in this case.**<sup>29</sup>

Aqua Texas bases its “regulatory asset” argument on a series of Public Utility Commission cases cited from their Closing Argument.<sup>30</sup> These decisions are premised upon the

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<sup>27</sup> National Association of Regulatory Commissioners, *Uniform System of Accounts for Class A Water Utilities* pg. 12 (1996), attached hereto as Attachment “A.” (Note: Attachment A is not produced in its entirety. The pages produced are 9-13, 49, 74, & 116. Within these excerpts, (i) “Definitions” are found on pages 9-13; (ii) “Accounting Instructions” related to “Operation Income – Regulatory Assets and Liabilities,” are found on page 49; (iii) §186.3 relating to Regulatory Assets is found on page 74; and (iv) §407.4 related to the Amortization of Regulatory Assets is found on page 116.)

<sup>28</sup> See 30 TEX. ADMIN. CODE §291.72 (2)(a); See also Aqua Texas’ Exceptions to the PFD p. 8.

<sup>29</sup> See Aqua Texas’ Exceptions to the PFD p. 8.

<sup>30</sup> See Aqua Texas’ Exceptions to the PFD p. 8.

Public Utility Regulatory Act (“PURA”).<sup>31</sup> Aqua Texas’ argument ignores the distinct differences between PURA and the Water Code. The Texas Legislature has separated the governance of water and wastewater utilities from electric and gas utilities by providing the Public Utility Commission and the Texas Commission on Environmental Quality. Title 30 of the TEX. ADMIN. CODE and Chapter 13 of the TEX. WATER CODE are the controlling legal authorities for water and wastewater utility rate cases. Laws enacted for the electric and/or gas utilities rate cases, the decisions of the separate agency created to regulate the same and/or court decisions interpreting the unique agency’s interpretation, are *not* applicable or controlling in the case at hand.<sup>32</sup>

Aqua Texas requests a deferred accounting method to be allowed for a revenue requirement based on an undefined set of expenses and undefined debt. Aqua Texas attempts to parallel their need of a “regulatory asset” with the electric and gas utilities, but falls short. The cases cited by Aqua Texas in support of its proposed “regulatory asset,” in light of the facts of record would not support granting the same even if this case was an electric or gas rate case.

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<sup>31</sup> Aqua Texas’ use of the PURA statutes, rely on Sections 16, 27(a), 39 (a), and 41(a) of a 1994 statute that have been changed significantly since the deregulation of utilities. The present correlating statutes are TEX. UTILITIES CODE §§ 14.001, 14.151, 53.053, 104.051 and 104.053 respectively. The most significant change relates to the definition of invested capital. Section 104.053 provides: § 104.053. COMPONENTS OF ADJUSTED VALUE OF INVESTED CAPITAL. (a) Gas utility rates shall be based on the adjusted value of invested capital used and useful to the utility in providing service and that adjusted value shall be computed on the basis of a reasonable balance between: (1) original cost, less depreciation; and 2) current cost, less an adjustment for present age and condition. b) The regulatory authority may determine a reasonable balance that reflects: (1) not less than 60 percent nor more than 75 percent of the original cost of the property at the time the property was dedicated to public use, whether by the gas utility that is the present owner or by a predecessor, less depreciation; and (2) not less than 25 percent nor more than 40 percent of the current cost less an adjustment for present age and condition. c) In determining a reasonable balance, the regulatory authority may consider inflation, deflation, quality of service being provided, growth rate of the service area, and need for the gas utility to attract new capital. d) Construction work in progress, at cost as recorded on the gas utility's books, may be included as part of the adjusted value of invested capital used by and useful to the utility in providing service, as necessary to the financial integrity of the utility. e) Costs of facilities, revenues, expenses, taxes, and reserves shall be separated or allocated as prescribed by the regulatory authority. (f) In this section, "original cost" means the actual money cost or the actual money value of consideration paid other than money.

<sup>32</sup> See TEX. WATER CODE § 13.041.

**3. Responses to Aqua Texas' Exceptions to the ED's Exceptions (II., D., 1. Municipal Reimbursements; II., D. 2. Reduction of Rate Case Expenses for Settled Customers.)**

Aqua Texas seeks to recover rate case expenses under Section 13.084 of TEX. WATER

CODE.<sup>33</sup> Section 13.084 states:

§ 13.084. AUTHORITY OF GOVERNING BODY; COST REIMBURSEMENT. The governing body of any municipality or the commissioners court of an affected county shall have the right to select and engage rate consultants, accountants, auditors, attorneys, engineers, or any combination of these experts to conduct investigations, present evidence, advise and represent the governing body, and assist with litigation on water and wastewater utility ratemaking proceedings. The water and wastewater utility engaged in those proceedings shall be required to reimburse the governing body or the commissioners court for the reasonable costs of those services and shall be allowed to recover those expenses through its rates with interest during the period of recovery.

First, Aqua Texas is not one of the entities entitled to reimbursement under Section 13.084. Aqua Texas is *not* the governing body of a municipality nor the commissioners court of an affected county. Instead, Aqua Texas is the utility that is required to reimburse those governmental entities.

As the members of the SE and SW Regions *do not* include systems subject to the original ratemaking jurisdiction of a municipality or an affected County, they did not have interests which were examined by the municipal and county governments. Accordingly, none of Aqua Texas' costs related to the original ratemaking jurisdiction of the municipalities should be passed to the systems of the SE and SW Regions.

Aqua Texas also argues that because the municipal cases were consolidated and many of the issues addressed by the municipalities concerned Section 13.145 of the Water Code, they should receive reimbursement of the municipalities' rate case expenses. Those municipalities,

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<sup>33</sup> See Aqua Texas Exceptions to the PFD p. 17.

however, as well as most of the customers in those systems, have settled with Aqua Texas on a rate which presumably Aqua Texas has agreed. Despite having agreed to those rates, in its Exceptions,<sup>34</sup> Aqua Texas asserts,

“if those settlements were in evidence. . . they would reflect that each settling party acknowledges that Aqua Texas incurred rate case expenses were legitimate, and that Aqua Texas did not compromise its right to seek recovery of any rate case expenses from non-settling protestants. While Aqua Texas may have agreed to forego the collection from the settling parties, it did not waive the recovery of those expenses. Moreover, Aqua Texas’ agreement to forego the collection of those expenses is a matter of contract, and must be enforced consistent with contract law not by the Commission through its final Order.”<sup>35</sup>

Aqua Texas is asking to “have its cake and eat it too.” Specifically, it is asking the ALJs to endorse Aqua Texas’ business decision to contractually waive the right to collect rate case expenses associated with the “settling parties,” and to then collect all of the rate case expenses due and owing from the settled parties from the remaining non-settled systems. Aqua Texas should not be allowed to assign the rate case expenses from the “settling parties” (including the costs of the municipalities’ Original Jurisdiction hearings, and settlement discussions) to the non-settling parties.

**4. Responses to Aqua Texas’ Exceptions to the EDs Responses (II. D. 4. Rate Case Expenses Accruing After the Close of Evidence.)**

Aqua Texas requests the recovery of rate case expenses incurred between February 19, 2007 and the issuance of the Final Order by the Commission based on TEX. WATER CODE Sections 13.043(e), 13.185(d) and 13.084.<sup>36</sup> None of these sections provide authority for Aqua Texas to recover rate case expenses for non-municipal, original jurisdiction hearings.<sup>37</sup> Furthermore, Aqua Texas has not provided any evidence of costs incurred during the time

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<sup>34</sup> Aqua Texas’ Exceptions to the PFD, p. 19.

<sup>35</sup> Aqua Texas’ Exceptions to PFD, pg. 19.

<sup>36</sup> Aqua Texas’ Exceptions to PFD p. 20.

<sup>37</sup> See TEX. WATER CODE §§ 13.043, 13.185 (d), and 13.084.

between September 2006 and present, nor have the ED or the SE and SW Regions had an opportunity to review such costs or examine whether the same are just, reasonable and/or necessary. Accordingly, the SE and SW Region request a denial of Aqua Texas' rate case expenses.

#### IV.

#### CONCLUSION & PRAYER

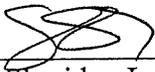
WHEREFORE, PREMISES CONSIDERED, the SE and SW Regions respectfully pray that (i) the ALJs modify their Proposal for Decision in accordance with the SE and SW Regions' Exceptions to the PFD, (ii) adopt Findings of Fact and Conclusions of Law consistent with those previously submitted by the SE and SW Regions, and (iii) recommend the Commissioner deny Aqua Texas' Application.

Assuming *arguendo*, that the ALJs determine that Aqua Texas is entitled to a rate increase, the SE and SW Regions respectfully request that:

- a. Aqua Texas not be allowed to recover any rate case expenses that were not testified to, by the Company or individual whose work product was invoiced, not be allowed to recover any rate case expenses which relate to the settled systems, not be allowed to recover any rate case expenses regarding legal fees, and not be allowed any rate case expenses due to the duplicative efforts used in filing the Application and amendments made thereto. The Southeast and Southwest Regions respectfully request the ALJs proportionately allocate the rate case expenses on a per-connection basis, including all Aqua Texas customers.
- b. Aqua Texas not be allowed to receive a rate of return of 12% based on an unwritten policy of TCEQ which violates the Administrative Procedures Act, TEX. GOV'T. CODE Sections 2001.004 and 2001.005.
- c. Aqua Texas not be allowed to recover for a deferred asset because it violates TEX. WATER CODE Section 13.135.
- d. Aqua Texas should not be allowed to recover in their rate base for the assets which were not verified to be used and useful, and have included in the rate base the asset of the settled systems.

Respectfully submitted,

**JACKSON, SJOBERG, MCCARTHY & WILSON L. L. P.**

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**Attorneys for Southeast Region Homeowners Group  
(and Numerous Individual Customers, including  
Crighton Ridge Homeowners Group) (the "SE Region")  
and The Southwest Region (the "SW Region")**

**CERTIFICATE OF SERVICE**

I hereby certify, by my signature below, that a true and correct copy of the above was forwarded via Hand Delivery, Certified Mail or regular, U.S. mail, as indicated, on the 8<sup>th</sup> day of August, 2007, to those persons on the attached service list.

  
\_\_\_\_\_  
Sheridan L. Gilkerson

SERVICE LIST

SOAH DOCKET NOS. 582-05-2770, 582-05-2771  
TCEQ DOCKET NOS. 2004-1120-UCR, 2004-1671-UCR

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<p><b>Docket Clerk, Office of the Chief Clerk</b></p>	<p><b>Ms. La Donna Castanuela</b>  <b>TCEQ, Office of the Chief Clerk</b>  <b>12100 Park 35 Circle</b>  <b>Building F, 1<sup>st</sup> Floor</b>  <b>Austin, TX 78711-3087</b>  <b>512-239-3311 (Fax)</b></p>

\* Regular Mail

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# UNIFORM SYSTEM OF ACCOUNTS FOR CLASS A WATER UTILITIES

1996



NATIONAL ASSOCIATION OF  
REGULATORY UTILITY COMMISSIONERS

1201 Constitution Avenue, N.W., Suite 1102

Post Office Box 684

Washington, DC 20044-0684

Telephone No. (202) 898-2200

Facsimile No. (202) 898-2213

Price: \$25.00

DEFINITIONS

LIBRARY  
Texas Natural Resource  
Conservation Commission  
Austin, Texas

When used in this system of accounts:

1. "Accounts" means the accounts prescribed in this system of accounts.

2. "Actually issued," as applied to securities issued or assumed by the utility, means those which have been sold to bona fide purchasers for a valuable consideration, those issued as dividends on stock, and those which have been issued in accordance with contractual requirements direct to trustees of sinking funds.

3. "Actually outstanding," as applied to securities issued or assumed by the utility, means those which have been actually issued and are neither retired nor held by or for the utility; provided, however, that securities held by trustees shall be considered as actually outstanding.

4. "Amortization" means the gradual extinguishment of an amount in an account by distributing such amount over a fixed period, over the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefit will be realized.

5. A. "Associated companies" means companies or persons that, directly or indirectly, through one or more intermediaries, control, or are controlled by, or are under common control with, the accounting company.

B. "Control" (including the terms "controlling," "controlled by," and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a company, whether such power is exercised through one or more intermediary companies, or alone, or in conjunction with, or pursuant to an agreement, and whether such power is established through a majority or minority ownership or voting of securities, common directors, officers, or stockholders, voting trusts, holding trusts, associated companies, contract or any other direct or indirect means.

6. "Book cost" means the amount at which property is recorded in these accounts without deduction of related provisions for accrued depreciation, amortization, or for other purposes.

7. "Commission", unless otherwise indicated by the context, means the commission prescribing this system of accounts.

8. "Composite depreciation rate" is a percentage based on the weighted average service life of a number of units of plant, each of which may have a different individual life expectancy. Composite

## DEFINITIONS

depreciation rates may be determined for (a) a single depreciable plant account, (b) a single rate for several depreciable accounts or (c) a single composite rate may be determined for all depreciable plant of the utility.

9. "Cost" means the amount of money actually paid for property or service. When the consideration given is other than cash, the value of such consideration shall be determined on a cash basis.
10. "Cost of removal" means the cost of demolishing, dismantling, tearing down or otherwise removing utility plant, including the cost of transportation and handling incidental thereto.
11. "Debt expense" means all expenses in connection with the issuance and initial sale of evidences of debt, such as fees for drafting mortgages and trust deeds; fees and taxes for issuing or recording evidences of debt; cost of engraving and printing bonds and certificates of indebtedness; fees paid trustees; specific costs of obtaining governmental authority; fees for legal services; fees and commissions paid underwriters, brokers, and salesmen or marketing such evidences of debt; fees and expenses of listing on exchanges; and other like costs.
12. "Depreciation", as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of providing service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public authorities.
13. "Discount", as applied to the securities issued or assumed by the utility, means the excess of the par (stated value of no-par stocks) or face value of the securities plus interest or dividends accrued at the date of the sale over the cash value of the consideration received from their sale.
14. "Fire main" means any main forming part of an integrated system used exclusively for fire protection purposes.
15. "Gross-up of contributions in aid of construction" is the method by which a utility extracts, from developers or others, a sum of money sufficient to pay all or a portion of the tax obligation due to the change in the federal tax law in 1987 which resulted in contributions made to utilities in aid of construction (CIAC) being considered ordinary income instead of contributions of capital. Because the sum extracted to pay the tax is also considered income subject to tax, the term tax-on-tax has been used to describe the

## DEFINITIONS

additional sum of money that must be extracted in order to pay the tax on the initial amount.

Common gross-up methods include the full gross-up method and the net present value method. Under the full gross-up method, a sum sufficient to meet the full tax obligation, including the tax-on-tax, is extracted. Under the net present value method, the sum extracted is the net present value of the estimated future stream of tax benefits resulting from the depreciation deductions for the contributed asset to be taken on the tax returns of the utility.

16. "Investment advances" means advances, represented by notes or by book accounts only, with respect to which it is mutually agreed or intended between the creditor or debtor that they shall be settled by the issuance of securities or shall not be subject to current settlement.

17. "Minor items of property" means the associated parts or items of which retirement units are composed.

18. "Multiple family dwelling" means a residential structure or group of structures which is capable of separately housing more than one family unit.

19. "Net salvage value" means the salvage value of property retired less the cost of removal.

20. "Nominally issued", as applied to securities issued or assumed by the utility means those which have been signed, certified, or otherwise executed, and placed with the proper officer for sale and delivery, or pledged, or otherwise placed in some special fund of the utility, but which have not been sold, or issued direct to trustees of sinking funds in accordance with contractual requirements.

21. "Nominally outstanding", as applied to securities issued or assumed by the utility, means those which, after being actually issued, have been reacquired by or for the utility under circumstances which require them to be considered as held alive and not retired; provided, however, that securities held by trustees shall be considered as actually outstanding.

22. "Original cost", as applied to utility plant, means the cost of such property to the person first devoting it to the public service.

23. "Person" means an individual, a corporation, a partnership, an association, a joint stock company, a business trust, or any organized group of persons whether incorporated or not, or any receiver or trustee.

## DEFINITIONS

24. "Premium", as applied to the securities issued or assumed by the utility, means the excess of the cash value of the consideration received from their sale over the sum of their par (stated value of no-par stocks) or face value and interest or dividends accrued at the date of sale.
25. "Property retired", as applied to utility plant, means property which has been removed, sold, abandoned, destroyed, or which for any cause has been permanently withdrawn from service.
26. "Reclaimed water" means water that has received at least secondary treatment and basic disinfection and is reused after flowing out of a wastewater treatment plant.
27. "Regulatory Assets and Liabilities" are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains or losses that would have been included in determination of net income in one period under the general requirements of the Uniform System of Accounts but for it being probable that; 1) such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or 2) in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required. Regulatory assets and liabilities can also be created in reconciling differences between the requirements of generally accepted accounting principles, regulatory practice and tax laws.
28. "Replacing" or "replacement", when not otherwise indicated in the context, means the construction or installation of utility plant in place of property of retired, together with the removal of the property retired.
29. "Research and development" means expenditures incurred by public utilities which represent research and development costs in the experimental or laboratory sense. The term includes generally all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property, and the improvement of already existing property of the type mentioned.
30. "Retained earnings" means the accumulated net income of the utility less distributions to stockholders and transfers to other capital accounts, and other adjustments (See account 439 - Adjustments to Retained Earnings).
31. "Retirement units" means those items of utility plant which, when retired, with or without replacement, are accounted for by crediting the original costs.

## DEFINITIONS

32. "Reuse" means the deliberate application of reclaimed water, in compliance with Federal and State environmental rules and regulations, for a beneficial purpose.
33. "Salvage value" means the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale, or, if retained, the amount at which the material recoverable is chargeable to materials and supplies, or other appropriate account.
34. "Service life" means the time between the date utility plant is includible in utility plant in service, or utility plant leased to others, and the date of its retirement. If depreciation is accounted for on a production basis rather than on a time basis, then service life should be measured in terms of the appropriate unit of production.
35. "Service value" means the difference between the original cost and net salvage value of utility plant.
36. "Straight-line remaining life method", as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses (and to clearing accounts if used), and credited to the accumulated depreciation account through equal annual charges during its service life. "Remaining life" implies that estimates of future life and salvage will be reexamined periodically and that depreciation rates will be corrected to reflect any changes in these estimates.
37. "Straight-line method" as applied to depreciation accounting means the plan under which the service value of property is charged to operating expenses (and to clearing accounts if used), and credited to the accumulated depreciation account through equal annual charges during its service life. Estimates of the service life and salvage will be reexamined periodically and depreciation rates will be corrected to reflect any changes in these estimates.
38. "Supply main" means any main, pipe, aqueduct or canal the primary purpose of which is to convey water from one unit to another unit in the source of supply, water treatment or pumping plant and generally providing no service connections with customers.
39. "Transmission and distribution main" means any main the primary purpose of which is to convey water, requiring no further processing except incidental chlorination or pressure boosting, from a unit in the source of supply, water treatment or pumping plant and generally providing no service connection with customers.
40. "Utility", as used herein and when not otherwise indicated in the context, means any public utility to which this system of accounts is applicable.

## ACCOUNTING INSTRUCTIONS

### 37. Operating Income - Operation and Maintenance Expense Account Matrix

A. Class A utilities (as defined in general instruction 1) are required to subdivide the operation and maintenance expenses into functions. Each object account shall be subdivided by the functions as shown in the matrix schedule which proceeds the Operation and Maintenance Expense Accounts (page 138). The function will be designated by adding an additional one digit suffix to the basic object account.

B. The "functional" operations for the water system are listed with the designated suffix:

- .1 Source of supply and pumping expenses - operations
- .2 Source of supply and pumping expenses - maintenance
- .3 Water treatment expenses - operations
- .4 Water treatment expenses - maintenance
- .5 Transmission and distribution expenses - operations
- .6 Transmission and distribution expenses - maintenance
- .7 Customer accounts expense
- .8 Administrative and general expenses

### 38. Operating Income - Regulatory Assets and Liabilities

Regulatory debits and credits will often be used to reconcile differences between the requirements of Generally Accepted Accounting Principles, regulatory practice and federal, state, and local tax laws. For example, when there is a change in a federal, state or local income tax rate, Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, (SFAS 109) requires that adjustments be made to existing debit and credit deferred tax balances through the income statement in the year in which the change is known or can be reasonably estimated. However, the Tax Reform Act of 1986 requires the effect of a federal income tax rate change to be recognized over a different period. Some state tax codes piggy-back the provisions of the federal tax code. Regulatory agencies may require that SFAS 109 be implemented in a revenue neutral method or they may accept the period of time and method required by tax law for the adjustment of deferred income tax balances. These different requirements can be accommodated through the use of Account 186.3 - Regulatory Assets, Account 253.1, Regulatory Liabilities, Account 407.4 - Amortization of Regulatory Assets and Account 407.5 - Amortization of Regulatory Liabilities. By debiting and crediting these accounts, as appropriate, the difference between the existing deferred tax balances and the re-stated deferred tax balances can be flowed through the income statement as required by SFAS 109, without affecting the revenue requirement or violating the normalization requirements of the Internal Revenue Code. Further, the differences can be retained on the balance sheet so there is also no effect on either rate base or the utility's allowed rate of return.

## BALANCE SHEET ACCOUNTS

- 186.1 Deferred Rate Case Expense
- 186.2 Other Deferred Debits
- 186.3 Regulatory Assets

### 186.1 Deferred Rate Case Expense

This account shall include all deferred debits associated with the cost of conducting rate cases before the commission.

### 186.2 Other Deferred Debits

This account shall include all deferred debits not properly includable in any other subaccount of account 186.

### 186.3 Regulatory Assets

A. This account shall include the amounts of regulatory-created assets, not included in other accounts, resulting from the ratemaking actions of regulatory agencies. (See Definition 27.)

B. The amounts included in this account are to be established by those charges which would have been included in net income determination in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing the rates that the utility is authorized to charge for its utility services. When specific identification of the particular source of a regulatory asset cannot be made, such as in plant phase-ins, rate moderation plans or rate levelization plans, Account 407.5 - Amortization of Regulatory Liabilities shall be credited. The amounts recorded in this account are generally to be charged, concurrently with the recording of the amount in rates, to the same account that would have been charged if included in income when incurred, except all regulatory assets established through the use of Account 407.5 shall be charged to Account 407.4 - Amortization of Regulatory Assets, concurrent with the recovery of the amounts in rates.

C. If rate recovery of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426 - Miscellaneous Nonutility Expenses, or Account 434 - Extraordinary Deductions, in the year of the disallowance.

## 187. Research and Development Expenditures

A. This account shall include the cost of all expenditures coming within the meaning of Definition 29 of the Uniform System of

## INCOME ACCOUNTS

term franchises, licenses, patent rights, limited term interests in land, and expenditures on leased property where the service life of the improvements is terminable by action of the lease. The charges to this account shall be such as to distribute the book cost of each investment evenly over the period of benefit to the utility (See account 110.1 - Accumulated Amortization of Utility Plant in Service).

### 407.2 Amortization of Property Losses

This account shall be charged with amounts credited to account 182, Extraordinary Property Losses, when the Commission has authorized the amount in the latter account to be amortized by charges to operating expenses.

### 407.3 Amortization of Other Utility Plant

A. When authorized by the Commission, this account shall include charges for amortization of intangible or other utility plant in service which does not have a definite or terminable life and which is not subject to depreciation expense.

B. This account shall be supported in such detail as to show the amortization applicable to each investment being amortized, together with the book cost of the investment and the period of the amortization.

### 407.4 Amortization of Regulatory Assets

This account shall be debited, when appropriate, with the amounts credited to Account 253.1 - Regulatory Liabilities, to record regulatory liabilities imposed on the utility by the ratemaking actions of regulatory agencies. This account shall also be debited, when appropriate, with the amounts credited to Account 186.3 - Regulatory Assets, concurrent with the recovery of such amounts in rates.

### 407.5 Amortization of Regulatory Liabilities

This account shall be credited, when appropriate, with amounts debited to Account 186.3 - Regulatory Assets, to establish regulatory assets. This account shall also be credited, when appropriate, with the amounts debited to Account 253.1 - Regulatory Liabilities, concurrent with the return of such amount to customers through rates.

SOAH DOCKET NO. 582-06-1366  
TCEQ DOCKET 2006-0072-UCR

THE WOODCREEK RATEPAYERS §  
COALITION'S PETITION TO APPEAL §  
THE CITY OF WOODCREEK'S §  
DECISION TO ESTABLISH WATER AND §  
SEWER RATES CHARGED BY AQUA §  
UTILITIES D/B/A AQUA TEXAS, INC., AND §  
AQUA DEVELOPMENT, INC., D/B/A AQUA §  
TEXAS, INC. §

BEFORE THE STATE OFFICE

OF

ADMINISTRATIVE HEARINGS



DIRECT TESTIMONY OF  
ELSIE N. PASCUA  
UTILITIES & DISTRICTS SECTION  
WATER SUPPLY DIVISION  
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY  
AUGUST 1, 2007

CHIEF CLERK'S OFFICE

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TEXAS  
COMMISSION  
ON ENVIRONMENTAL  
QUALITY

1 Q. Can you explain in greater detail what is shown on these exhibits?

2 A. Column (b) on Exhibit ED-EP-1 (SW water) and Exhibit ED-EP-5 (SW sewer), itemizes  
3 the prorated revenue requirement for Woodcreek based on the Administrative Law Judge  
4 (ALJ)'s Proposal for Decision (PFD) for Aqua Texas Southwest Region. Column (c) is the  
5 sum brought forward from column 2. Column (d), represent my recommended adjustments  
6 to the PFD and the calculation of the Federal Income Taxes and Return due to changes in  
7 weighted cost of capital. This adjustment is based upon new evidence put forth by the  
8 ratepayers that the debt to equity ratio used by Aqua Texas in the consolidated case is not  
9 accurate or appropriate, this will be addressed later in this prefiled testimony. See Exhibits  
10 JES 10 and 11. Column (e) shows my proposed revenue requirement.

11

12 Exhibits ED-EP-2 (water) and ED-EP-6 (sewer), contain a more detailed explanation of  
13 the amounts shown on Exhibit EP-ED-1 and Exhibit EP-ED-5.

14

15 Exhibit ED-EP-3 (water) and Exhibit ED-EP-7 (sewer), show the invested capital and  
16 recommended rate of return for both water and sewer systems. I calculated the weighted  
17 average rate of 8.23% which is based upon new evidence put forth by the ratepayers that the  
18 debt to equity ratio used by Aqua Texas in the consolidated case is not accurate or  
19 appropriate, this will be addressed later in my testimony.

20

21 Exhibit ED-EP-4 (water) and Exhibit ED-EP-8 (sewer), show the calculation of Federal  
22 Income Taxes.

23

1 Q. How did you calculate the Other Utility Revenues (late fees, reconnect, etc.)?

2 A. I used the same allocation method as proposed above for Woodcreek customers within the  
3 Southwest Region. Other Utility Revenues for Southwest Region are \$138,707, for water  
4 and \$6,182.00, for sewer. Of these amounts, Woodcreek's prorated share for water is  
5 \$10,819.00 ( $\$138,707 * 7.8\%$ ), and the prorated share for sewer is \$1,490, ( $\$6,182 * 24.1\%$ ).  
6 Other Utility Revenues are reduction to the revenue requirement because they are associated  
7 to specific utility services.

8  
9 Q. How did you compute the Working Cash Allowance on Exhibits ED-EP-3 (water), and  
10 ED-EP-7 (sewer)?

11 A. Based on the Commission's rules, I computed an allowance of one-eighth of my  
12 recommended Operation and Maintenance expenses.

13  
14 Q. How did you compute the recommended return?

15 A. The recommended return on Exhibits ED-EP-3 (water) and ED-EP-7 (sewer), shows the  
16 invested capital and recommended rate of return for the water and sewer systems. The  
17 calculated amount of return is the product of the Rate of Return (ROR) times the Total  
18 Invested Capital listed on the above exhibits. Aqua Texas requested a 12% ROR with a  
19 weighted average rate of 8.44%. I propose a rate of 12 percent based on the presumptive rate  
20 that has been recommended by the ED and allowed by the Commission for previous  
21 contested cases, however I have reduced the weighted average rate to 8.23% based upon new  
22 evidence provided by the customers in this appeal which shows that Aqua America's  
23 requested 50/50 debt to equity ratio should actually be 52.8/47.2. See JES 10 and 11.

1 Q. Has your recommendation on the weighed cost of capital changed from the consolidated  
2 case to this appeal?

3 A. Yes.

4

5 Q. Why?

6 A. Aqua Texas proposed a debt to equity ratio of 50/50 during the consolidated case. This ratio  
7 was hypothetical since Aqua Texas has no debts or equity. Only the parent company, Aqua  
8 America has debt and equity. The Ratepayers brought evidence in this appeal that Aqua  
9 America's debt/equity ratio is actually 52.8/47.2 as reflected in its accounting statements.  
10 Aqua Texas should have the same debt to equity ratio as its parent. Exhibit JES 10 and 11.

11

12 Q. How does this affect your position in the consolidated case?

13 A. It does not, because this evidence was provided after the hearing on the merits was closed in  
14 the consolidated case.

15

16 Q. What are your final revenue requirement recommendations in this case?

17 A. After my adjustments to the ALJ's PFD, I recommend a base rate revenue requirement for the  
18 following:

19 Woodcreek - Water: \$605,376

20 Woodcreek - Sewer: \$413,238

21

22 Q. What is the purpose of the proposed cost of service adjustments and revenue  
23 requirements?

SOAH DOCKET NO. 582-06-1366  
TCBQ DOCKET 2006-0072-UCR

THE WOODCREEK RATEPAYERS §  
COALITION'S PETITION TO APPEAL §  
THE CITY OF WOODCREEK'S §  
DECISION TO ESTABLISH WATER AND §  
SEWER RATES CHARGED BY AQUA §  
UTILITIES D/B/A AQUA TEXAS, INC. AND §  
AQUA DEVELOPMENT, INC. D/B/A AQUA §  
TEXAS, INC. §  
§

BEFORE THE STATE OFFICE

OF

ADMINISTRATIVE HEARINGS



DIRECT TESTIMONY OF  
KAMAL ADHIKARI, E.I.T.  
UTILITIES & DISTRICTS SECTION  
WATER SUPPLY DIVISION  
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY  
AUGUST 1, 2007

CHIEF CLERK'S OFFICE

2007 AUG -1 PM 4: 32

TEXAS  
COMMISSION  
ON ENVIRONMENTAL  
QUALITY

1 revenue requirement is used to calculate the flat rate by dividing the revenue requirement by the  
2 number of customers and, dividing again by 12 to represent the number of months in a calendar  
3 year. This calculates a monthly cost per customer. Please see schedule attached as Exhibit ED-  
4 KA-5 (sewer).

5  
6 Conclusions

7 Q. Please summarize your recommendations concerning the proposed water rate for  
8 Woodcreek customers.

9 A. I calculated a base rate of \$39.36 per month for a 5/8x3/4 inch meter connection and a gallonage  
10 rate of \$2.56 per 1,000 gallons for the Woodcreek customers. Aqua Texas proposed an un-  
11 phased gallonage rate of \$3.61 per 1,000 gallons for Woodcreek. If the utility's proposed  
12 gallonage rate is close to the Executive Director's (ED's) gallonage rate recommendation, staff  
13 typically recommends adopting the utility's proposed gallonage rate and adjust the  
14 recommended base rate to a level that generates the same annual revenue as the staff's original  
15 recommended base rate and gallonage charge. In addition, we also typically recommend using  
16 the utility's proposed gallonage rate if it is higher than the ED's calculated gallonage charge,  
17 because a higher gallonage charge will encourage greater water conservation. In this case, if the  
18 gallonage rate is set at Aqua Texas' proposed rate of \$3.61, the base rate should be \$29.61 per  
19 month to generate the same annual revenue. Therefore, I recommend a base rate of \$29.61 for  
20 5/8x3/4 inch meters, with 0 gallons included with the base rate, and a gallonage charge of \$3.61  
21 per 1000 gallons.