

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

September 18, 2009

Les Trobman, General Counsel
Texas Commission on Environmental Quality
PO Box 13087
Austin Texas 78711-3087

Re: SOAH Docket No. 582-08-0698; TCEQ Docket No. 2007-1708-UCR; Application of Double Diamond Utilities, Inc. to Change its Water Rates and Tariff, in Hill, Palo Pinto, and Johnson Counties, Texas, Application No. 35771-R

Dear Mr. Trobman:

On July 6, 2009, Double Diamond Utilities (DDU), the Executive Director (ED), and the White Bluff Subdivision Ratepayers (WBSR) filed exceptions to the Administrative Law Judge's (ALJ) June 15, 2009 Proposal for Decision (PFD). On July 16, 2009, the ED and WBSR filed responses to the other parties' exceptions. The ALJ files these replies to the parties' post-PFD submissions. As a result of these exceptions, the ALJ makes relatively minor changes to the proposed order but still recommends that the Commission deny DDU's application.

I. DDU's Exceptions

A. Multiple Systems Consolidated Under One Tariff and Rate Design

DDU took exception to the ALJ's finding that DDU failed to meet its burden of proof on whether the White Bluff and the Retreat water systems should be consolidated under one rate design. This was a major issue in the evidentiary hearing and DDU addresses it for the first time in its Exceptions.¹ DDU did not present evidence during its direct or rebuttal cases and did not present argument in its closing arguments or its responses to the other parties' closings.

In its exceptions on this issue, DDU relies on the PFD and final order in TCEQ Docket Nos. 2004-1120-UCR and 2004-1671-UCR, Re: Application by Aqua Development Company and Aqua Utilities, Inc. d/b/a Aqua Texas, Inc. to Change Water and Sewer Tariffs and Rates in Various Counties (Aqua Texas). DDU argues that Aqua Texas is precedent for DDU's rate case

¹ DDU Exceptions, pg. 1-7.

that the ALJ “clearly ignored.”² However, during the hearing and in its closing arguments and responses, DDU did not put forth arguments regarding the Aqua Texas case for the ALJ to consider.

DDU did not present evidence in an attempt to demonstrate how the Aqua Texas case is similar to DDU’s rate case. There is no expert testimony comparing the two cases to establish that the Aqua Texas’ and DDU’s rate cases are so similar that Aqua Texas controls the outcome in this case. No party has had the opportunity to present evidence or cross-examine DDU’s witnesses to explore the alleged similarity between the two cases.³ The ALJ recommends that the Commission overrule this exception for the reasons stated in the PFD and the lack of evidentiary support for DDU’s exception.

B. Developer Contributions

The ALJ recommends that the Commission disregard DDU’s exceptions on pages 7 through 9 on the issue of developer contributions. DDU’s entire argument rests on evidence that is outside the record and cannot be the basis of any findings of fact.⁴ DDU recognizes that “the record is less than clear” on whether it included developer contributions in determining its return on invested capital.⁵ Then, in an attempt to clarify the record, DDU argues facts from its October 2008 application that are not in the evidentiary record in this proceeding on its August and December 2007 applications. The veracity of DDU’s unsworn assertions cannot be determined. None of DDU’s experts testified to this information and none of DDU’s experts were subject to cross-examination regarding these statements. Therefore, these statements should not be considered now and the ALJ recommends that the Commission overrule this exception.

C. Rate of Return/Return on Invested Capital

In its exceptions, DDU takes issue with the ED’s methodology in calculating DDU’s rate of return, in light of the findings of fact in the Aqua Texas case.⁶ DDU takes exception to the ALJ’s reliance on the ED’s methodology because “the ED has committed serious errors in its

² DDU Exceptions, pg. 4.

³ At least one fact makes these two cases very dissimilar. In the Aqua Texas case, the applicant apparently presented evidence and argument to justify its consolidation of its systems under a regional tariff. In the DDU case, the applicant failed to address the issue.

⁴ TEX. GOV’T CODE ANN. § 2001.141(c).

⁵ DDU Exceptions, pg. 7.

⁶ DDU Exceptions, pg. 9-10.

methodology and calculations which results in an unjust and unreasonable return on invested capital to DDU.”⁷ The ALJ recommends that the Commission overrule these exceptions.

1. Calculation of Separate Rates of Return for Each Water System

DDU takes issue with the ED’s methodology in calculating a separate rate of return for each water system instead of one overall rate of return as was calculated in the Aqua Texas case. DDU argues that it was discriminated against because the ED utilized a different methodology than what was utilized in the Aqua Texas case.

DDU did not question the ED’s witnesses regarding the calculation of separate rates of return, did not present expert testimony on the issue, and did not address this issue in its closing arguments or responses. DDU did not argue during the evidentiary phase of this contested case hearing that the findings of fact in the Aqua Texas case are relevant to this proceeding. The Commission considered the Aqua Texas case at its agenda on August 20, 2008⁸ and DDU had ample opportunity to present evidence in the February 2009 hearing on the merits.

DDU makes the following factual allegations to support its contention of discrimination through the alleged use of a different methodology.

- a. DDU is a company that operates water and wastewater systems in Texas.
- b. DDU maintains a single balance sheet and all its utilities contribute to the financial position of DDU.
- c. DDU has only one source of debt and equity capital.⁹

It is the ALJ’s opinion that these facts do not provide sufficient evidentiary support to justify the use of the methodology utilized in the Aqua Texas case. Just and reasonable rates are determined on a case-by-case basis. Therefore, the ALJ recommends that this exception be overruled.

2. Cost of Debt

DDU complains of the ED’s methodology in determining DDU’s cost of debt with an affiliated interest.¹⁰ DDU did not present evidence to rebut the ED’s methodology or calculation of cost of debt. Nor did DDU make any arguments on this issue in its closing arguments or

⁷ DDU Exceptions, pg. 9.

⁸ <http://www5.tceq.state.tx.us/eenf/index.cfm?fuseaction=search.searchByDocket>

⁹ DDU Exceptions, pg. 10.

¹⁰ DDU Exceptions, pg. 10-11.

responses. The ALJ recommends that the Commission overrule DDU's exceptions regarding the calculation of its cost of debt.

While acknowledging that it has the burden of proof, DDU states that "the ALJ seems content to disregard [DDU's] request in favor of a random [interest rate] which is significantly lower" than that requested by DDU.¹¹ However, DDU failed to support its requested 10 percent interest rate. DDU had the burden to show that a 10 percent interest rate on a loan with an affiliated interest is reasonable, yet DDU provided no facts to meet this burden. The 10 percent interest rate on a loan was the result of an agreement between two affiliated interests. The only evidence DDU presented on this issue was a statement by its president that the "finance department for [DDU]" found a 10 percent interest rate is reasonable.¹² The president clarified that the 10 percent interest rate "was a mutual decision between [DDU] and Double Diamond Delaware [DDU's parent S corporation]."¹³ DDU did not refute the ED's allegation that "any income incurred by DDU belongs to the parent company, including any interest on the loan DDU collects from its customers through its rates."¹⁴

Section 13.185(e) of the Texas Water Code requires that interest payments to affiliated interests must be reasonable. DDU did not meet its burden of proof to show that the 10 percent interest rate was reasonable and the ALJ recommends that the Commission overrule DDU's exception.

3. Return on Equity

DDU argues that setting a return of equity lower than 12 percent "violates clear precedent set by the Commission."¹⁵ DDU asserts that "[t]he ED's actions of calculating a lower rate of return but recommending a higher rate of return for one utility [Aqua Texas], while not performing the same action for DDU, appears on its surface to be unreasonable and discriminatory."¹⁶

The ALJ recommends that the Commission overrule DDU's exceptions regarding the return on equity. DDU argues that since the Commission granted a 12 percent return on equity in the Aqua Texas case and in other utility cases, the ALJ should have recommended a 12 percent return in DDU's case. However, DDU does not point to any evidence *in this record* that would warrant a 12 percent rate of return. Nor does DDU dispute the ALJ's determination on

¹¹ DDU Exceptions, pg. 11.

¹² Tr., pg. 40, ln. 14-16.

¹³ Tr., pg. 41, ln. 12-18.

¹⁴ ED Exh. 1, pg. 16, ln. 20-21.

¹⁵ DDU Exceptions, pg. 11.

¹⁶ DDU Exceptions, pg. 11.

page 50 of the PFD that it made errors on the rate of return worksheet.¹⁷ It appears that the sole argument in DDU's Exceptions on this issue is that the Commission has approved a 12 rate of return in other rate cases and this sets a precedent for this rate case. However, TCEQ rules require an analysis of a utility's individual financial information to determine the appropriate rate of return.¹⁸ The ALJ recommends that the Commission overrule this exception.

4. Calculation of Weighted Average Return

DDU argues that the ALJ's recommendation "punishe[s]" systems with negative equity and would not allow DDU to generate sufficient revenue to cover the interest on its borrowing.¹⁹ The ALJ recommends that the Commission overrule DDU's exceptions regarding this issue.

In the PFD, the ALJ expressed no confidence in the accuracy of DDU's purported total invested capital and any rates or calculations derived therefrom.²⁰ The ALJ determined that DDU made errors in calculating its rate of return and failed to substantiate its equity in the systems.²¹ DDU does not quarrel with these determinations in its Exceptions.

As pointed out in the PFD, the problem with setting a rate in this case was created by a lack of evidence because DDU failed "to substantiate the original costs of its assets"²² By failing to adequately substantiate its costs, its total invested capital was greatly reduced by the ED.²³ Accordingly, its return on its invested capital was greatly reduced as well.

DDU's exception on this issue points out the problem with granting any rate change in this proceeding. The ED's calculations are based on incomplete information since DDU provided incomplete information to substantiate its invested capital. Therefore, the ALJ recommends that the Commission overrule this exception and deny DDU's application.

¹⁷ This may explain DDU's errors on the rate of return worksheet. The only way DDU could arrive at a 12 percent rate of return was to assert that it met all the conditions on the worksheet. Therefore, DDU would have had to represent that it was a sewer utility in a water rate case and a utility of less than 200 connections to arrive at the 12 percent rate of return by meeting all the factors listed on the worksheet. (*See*, DDU Exh. 32).

¹⁸ 30 TAC §§ 291.31(a) & (c).

¹⁹ DDU Exceptions, pg. 12-13.

²⁰ PFD, pg. 48.

²¹ PFD, pg. 49-51.

²² PFD, pg. 52.

²³ PFD, pg. 48, Summary of parties' recommendations.

D. Operation and Maintenance Expenses

In general, DDU excepts “to the allocation of costs by both the ED and the ALJ which leads to the reduction in expenses attributable to water service.”²⁴ In some instances, DDU impermissibly relies on information that is outside the evidentiary record in this proceeding and that information should be disregarded.

1. Salary or Contract Services/Payroll Taxes

DDU excepts to the ALJ’s findings regarding the salary expense in that “the ALJ . . . recommended excessive reductions in salary and wage expense”²⁵ In its Exceptions, DDU asserts that the proper ratio of billings is 77.6 percent.²⁶ This percentage is outside the record and cannot be considered. The proper allocation for the salary expense between the water and wastewater systems was a major issue in the hearing. In their prefiled testimony, the witnesses for both WBSR and the ED testified on the proper allocation of the salary expense. WBSR’s witness recommended a 60/40 allocation while the ED’s witness determined that 50/50 was appropriate.²⁷ DDU’s expert testified that he did not recall the percentage of the allocation that was represented by the amount in DDU’s application.²⁸ The 77.6 percent allocation is unsworn, unverified, and no witness was subject to cross-examination on this percentage. DDU points to no evidence in the record to support this percentage. The ALJ recommends that the Commission overrule this exception.

2. Chemicals

For the first time, DDU argues that \$14,853.65 should be multiplied by 77.6 percent to arrive at an amount for this expense that is different from the amount in its application.²⁹ The ALJ recommends that the Commission overrule this exception because it relies on assertions made outside the record and for the reasons stated in the PFD.

²⁴ DDU Exceptions, pg. 13.

²⁵ DDU Exceptions, pg. 14.

²⁶ DDU Exceptions, pg. 14.

²⁷ DDU misstates the record by alleging that “[t]he ALJ and ED rely on a 60/40 split” (DDU’s Exceptions, pg. 14, emphasis added). The ED recommended a 50/50 split and asserts in his exceptions that 50/50 is the appropriate way to allocate expenses. (ED Exceptions, pg. 3).

²⁸ Tr., pg. 102, ln. 11-16.

²⁹ Compare DDU Exh. 25, pg. 14 (Chemical expense, \$12,300) with DDU Exceptions, pg. 15 (“Water” expense, \$11,526.71).

3. Repairs/Maintenance/Supplies

DDU disagrees with the ALJ's recommendation regarding the appropriate amount for this expense. DDU states that the ALJ failed to adequately address the specific points raised by DDU in its closing arguments and that four expenses should have been allowed.³⁰ The ALJ recommends that the Commission overrule DDU's exceptions regarding this expense. The ED raised valid concerns regarding these claimed expenses and DDU failed to respond to the issue of whether the amounts should be properly categorized as either expenses or assets. Given the ALJ's concerns regarding this application, the ALJ does not recommend relying solely on DDU's representations that the following items are expenses.

a. Toray membranes:

DDU relies on an invoice offered by the ED in his prefiled testimony³¹ to support this expense. The ED's witness testified that she "disallowed \$12,046.00 for the cost of Toray membrane . . . because the item[] can not [sic] be identified as expendable or assets."³² The ED's witness testified that she "[did] not know what this is for, if you can provide explanation on what is this for."³³ The ED's witness asked for an explanation and DDU had an opportunity in its rebuttal case to show that the invoice was properly coded as an expense.

The ALJ recommends that the Commission overrule this exception. DDU classified \$12,046 as an expense and requested that its rates be set to recover this large amount every year. DDU did not address the question whether such an amount should be properly categorized as an asset and depreciated over time or whether it was in fact proper to classify this as a recurring expense to recover every year. DDU had an opportunity in its rebuttal case to explain why it categorized this invoice as an expense. It did not. The ED raised a valid issue and DDU failed to respond. In fact, the only documentary evidence on Toray Membranes is apparently found in the ED's prefiled testimony.³⁴ In light of this and the other issues with this application, the ALJ recommends that the Commission overrule this exception.

b. Shelco Filter Housing:

The ALJ recommends that the Commission overrule this exception regarding an \$11,158 expense for a Shelco Filter Housing. DDU makes the same argument here it asserted about the Toray Membranes above. Again, DDU failed to respond to the concerns raised by the ED on whether the item was an expense to be recovered by DDU every year or whether it should be

³⁰ DDU Exceptions, pg. 15.

³¹ Tr. pg. 183, ln. 9-11, ED Exh. 1, att. V.

³² ED Exh. 1, pg. 11, ln. 26 – pg. 12, ln. 2.

³³ Tr. pg. 183, ln. 10-11.

³⁴ See, PFD, pg. 72, n. 321 (discussion on references to Toray membranes).

claimed as an asset and amortized over time. Given the concerns with DDU's application and supporting documentation, the ALJ recommends that the Commission overrule this exception.

c. Pull and Inspect Motor Pipe:

DDU complains that the ED categorized this \$14,581.95 as an asset and not as an expense. According to the ED, he allowed this as an expense³⁵ and the Commission should overrule this exception.

d. Electrical Bid for Ratio Control:

DDU cites to the ED's prefiled testimony and claims that it properly included this \$3,550 invoice as an expense that the ED should not have disallowed.³⁶ DDU makes the same argument here it asserted about the Toray Membranes and Shelco Filter Housing above. DDU failed to respond to the concerns raised by the ED on whether the item was an expense to be recovered by DDU every year or whether it should be claimed as an asset and amortized over time. Given the concerns with DDU's application and supporting documentation, the ALJ recommends that the Commission overrule this exception.

e. DDU's Alternative Argument:

DDU appears to ask the Commission to apply the 77.6 percent allocation to the repair and maintenance expense shown in its 2006 Statement of Operations, again referring to documents in the ED's prefiled testimony.³⁷ DDU argues "that if the Commission does not accept its application as submitted, that \$202,604 is a more representative depiction of allowable R&M expenses than those recommended by the ALJ and ED."³⁸

Again, DDU did not present evidence regarding 77.6 percent as a proper ratio for allocation of amounts between the water and wastewater systems. The Commission should disregard this argument in its entirety.

4. Rate Case Expense

According to DDU, its exceptions to the PFD demonstrate that unjust reductions were made by the ED and the ALJ. Therefore, if the reductions are reinstated, DDU's revenues

³⁵ ED's Reply to Exceptions, pg. 14. See, ED Reply to Closing, pg. 9.

³⁶ DDU Exceptions, pg. 16.

³⁷ DDU Exceptions, pg. 17. Although DDU entered into evidence its 2007 and 2008 Statements of Operations during rebuttal, (DDU Exh. 37), it did not include a Statement of Operations for the 2006 test year in its prefiled testimony.

³⁸ DDU Exceptions, pg. 17.

should be raised significantly so that its rate expenses are recoverable under 30 TAC § 291.38(8). The ALJ recommends that all of DDU's prior exceptions be overruled. If the Commission agrees with the ALJ's recommendations, then DDU is not eligible to recover its rate case expenses.

5. Payroll Taxes

In its application, DDU claimed \$90,789 in expenses for payroll taxes.³⁹ It now concedes that that amount is in error and that 77.6 percent of \$28,883, or \$22,413, is "a more representative amount."⁴⁰ This is a \$68,376 discrepancy.

Again, DDU relies on evidence outside the record regarding the 77.6 percentage and its use to allocate an expense between DDU's water and wastewater systems. Therefore, on this basis alone, DDU's exception should be disregarded. However, DDU concedes that it made a large error in its application but provides no support on why an amount in its 2006 Statement of Operations found in the ED's prefiled testimony is somehow more reliable. The ALJ recommends that the Commission overrule DDU's exceptions regarding its payroll taxes.

6. Federal Income Taxes

DDU reasserts that the ALJ's analysis regarding return, total invested capital, and weighted cost of debt capital is erroneous.⁴¹ DDU asserted no other basis for why the findings regarding its federal income tax expense are in error.

To the extent this exception relies on evidence outside the record, the ALJ recommends that the Commission disregard this exception. Based on the ALJ's discussion regarding these topics, the ALJ recommends that the Commission overrule this exception.

7. Annual Depreciation and Amortization

DDU asserts that the ALJ's analysis is flawed and applies an unreasonable documentary standard to DDU to provide adequate support for its claimed costs of assets.⁴² The ALJ recommends that the Commission overrule this exception.

³⁹ DDU Exh. 25, pg. 14, ln. [M].

⁴⁰ DDU Exceptions, pg. 18.

⁴¹ DDU Exceptions, pg. 18.

⁴² DDU Exceptions, pg. 19.

a. The Retreat: Wells

DDU asserts that it “could not locate invoices dating to 2003 for this job”⁴³ This statement is outside the record and should be disregarded.

DDU asserts that the ALJ should have relied on its general ledger as support for the cost of this asset. However, as pointed out, the ALJ was unable to reconcile the amounts in DDU’s application with the amounts in its exhibits. Since its general ledgers also include assets for its wastewater systems, further substantiation is necessary.

In its application, DDU shows \$98,363 for the original cost of one of the wells at the Retreat.⁴⁴ In its Exceptions, DDU states that it’s “Exhibit 26 lists matching entries for this well under Job #6021 and 6036 (first entries).”⁴⁵ In a footnote, DDU states “Total cost \$368,793; water utility share of \$98,363.”⁴⁶ The cover page of its Exhibit 23 claims \$228,191 was apparently the cost of the well and \$140,601 was attributable to the plant, for a total of \$368,792.⁴⁷ However, DDU’s explanation in its Exceptions does not clarify how it calculated its “share” as \$98,363 as shown in the application.

b. The Retreat: Well Pumps

DDU cites to the ED’s prefiled testimony referring to two well pumps that allegedly cost \$26,280 and \$24,525 but were not allowed by the ED because of a lack of documentation.⁴⁸ DDU’s argument on why the costs of these two well pumps should be reflected in its depreciation schedule is that “it is reasonable to recognize the associated well pump for the well which ED accepted.”⁴⁹

DDU failed to provide sufficient documentation of the costs of its well pumps at the Retreat. Given the discrepancies between DDU’s exhibits and the amounts in the application, the ALJ determined that it was not reasonable to rely on DDU’s representations regarding costs due to the conflicting amounts presented by DDU. For example, DDU’s depreciation schedule in its application indicates that there are two well pumps at the Retreat that cost \$26,280 and \$24,525.⁵⁰ In DDU’s depreciation schedule in its Exhibit 12, DDU shows an entry for

⁴³ DDU Exceptions, pg. 19.

⁴⁴ DDU Exh. 25, pg. 28.

⁴⁵ DDU Exceptions, pg. 19.

⁴⁶ DDU Exceptions, pg. 19, n. 68.

⁴⁷ DDU Exh. 23, pg. 1.

⁴⁸ DDU Exceptions, pg. 19.

⁴⁹ DDU Exceptions, pg. 19.

⁵⁰ DDU Exh. 25, pg. 28.

“JLMYERS WTR WELL #4-NEW PMP, NEW MOTOR” for \$28,525.50.⁵¹ It is unclear from Exhibit 12 whether this reference to a new pump is for the Retreat water system. Also, this amount does not match the amount in DDU’s application. Therefore, the ALJ recommends that the Commission overrule this exception.

c. White Bluff - Wells

DDU excepts to the ALJ’s findings regarding the wells at White Bluff. For the first time, DDU argues that its consultant used a “deflationary scale to calculate a reasonable value for wells #1 through #3, as original invoices dating back to the period ranging from 1990-1999 could not be located.”⁵² DDU also includes a table to demonstrate its new argument.

DDU’s entire argument regarding the wells at White Bluff is outside the record and should be disregarded. Therefore, the ALJ recommends that the Commission not consider DDU’s references to a deflationary scale, the table on page 20, and DDU’s inability to locate records.

d. White Bluff – Water Tank

DDU admits that “[t]here is a discrepancy of \$1,942.00 between the job cost usage detail and the amount scheduled in the application.”⁵³ DDU also acknowledges that the installation dates between the two exhibits are different. However, DDU’s application lists three storage tanks for the White Bluff water system, in the amounts of \$85,000, \$93,171, and \$96,240.⁵⁴ None of these three storage tanks have a “date of installation” that matches the “date acquired” in DDU’s depreciation schedule shown in Exhibit 12. Due to these discrepancies, the ALJ recommends that the Commission overrule this exception.

e. White Bluff – Structures

DDU argues that the ED failed to include \$8,882.68 listed as “structures” in its depreciation schedule shown in its application while its exhibits referred to “engineering” and “improvements.”⁵⁵ DDU claims that “[w]hat the ALJ ignore[d] is the fact that ‘Structures’ is a pre-printed term on the TCEQ mandated form for a depreciation schedule.”⁵⁶

⁵¹ DDU Exh. 12, pg. 2.

⁵² DDU Exceptions, pg. 20.

⁵³ DDU Exceptions, pg. 20.

⁵⁴ DDU Exh. 25, pg. 31.

⁵⁵ DDU Exceptions, pg. 21.

⁵⁶ DDU Exceptions, pg. 21.

DDU's assertion that it used a mandated, pre-printed form is outside the record and should be disregarded. In its rebuttal case, DDU had the opportunity to prove that its claimed cost for a "structure" and "engineering" referred to the same asset. However, DDU did not present the necessary testimony to clarify this entry. While this may be the only asset where the dollar amounts are consistent between the application and DDU's exhibits, it remains unclear that the terms "structure," "Engineering Wtr system," and "Engineering – Water System Improvements at W.B." all refer to an asset. The ALJ recommends that the Commission overrule this exception.

E. Financial Integrity

DDU argues that the ALJ has applied an unreasonable standard to its case and demonstrated a "complete disregard for [DDU's] financial well-being."⁵⁷ DDU asserts:

The ALJ stated that DDU offered evidence that the company as a whole had been operating at a loss for the last several years, however conclude[d] that DDU did not distinguish between losses attributable to the water systems and the wastewater systems. . . . [T]his analysis does not face the reality that one cannot distinguish between the wastewater and water systems in such a situation.⁵⁸

In support of its exception, DDU further states:

[It is] ironic that in virtually all categories of expense, the ALJ concurred with recommendations put forth by ED that applied some method of allocation based on either a 60/40 or 50/50 split, however the ALJ elects not to apply such standard to the income (or loss) side of the ledger. This action further represents the unreasonable standard applied to DDU in this case and illustrates the complete disregard for the Utility's financial well-being.⁵⁹

The ALJ did not make an election regarding a standard applicable to DDU's losses. The ALJ pointed out in the PFD that "DDU did not distinguish between losses attributable to the water systems and those attributable to the wastewater systems. DDU attributed its operating losses from 2001 to 2006 to a number of factors, including capital improvements."⁶⁰ The ALJ further stated that "DDU offered no evidence that it was at risk of a financial collapse if this application to change its rates was denied."⁶¹

⁵⁷ DDU Exceptions, pg. 22.

⁵⁸ DDU Exceptions, pg. 22.

⁵⁹ DDU Exceptions, pg. 22.

⁶⁰ PFD, pg. 92.

⁶¹ PFD, pg. 92.

The ALJ recommended the allocation of expenses between the water and wastewater systems when calculating DDU's revenue requirement. DDU does not point to another calculation involving losses where some method of allocation would be performed. DDU does not refer to evidence or put forth an argument as to how or why such an allocation regarding DDU's losses should be made.

DDU's argument regarding financial integrity also relies on its prior exceptions about developer contributions, consolidation of multiple systems, the methodology for calculating the rate of return, and the allocation of its expenses.⁶² As previously stated, most of DDU's exceptions on these issues are based on statements that are outside the record and these arguments should be disregarded here as well.

DDU has presented evidence that the utility has suffered losses. However, it is the ALJ's recommendation that these losses do not require the granting of DDU's application when a just and reasonable rate cannot be determined as required by section 13.182 of the Texas Water Code. The ALJ recommends that the Commission overrule DDU's exceptions regarding financial integrity.

F. Refund or Credit?

DDU argues that instead of a refund, the Commission should require DDU to give its customers a credit for any amounts that exceed the rates ordered. DDU states that this credit "should be applied over an equal fifteen month period over which they were collected to avoid a potentially catastrophic financial impact on the utility."⁶³ DDU also alleges that any payment of interest would "unjustly punish" the utility.⁶⁴ Although in the context of a refund, the ED recommends that "the Commission order DDU to administer refunds over a 15-month period. This is the length of time the refunds were collected, so it is appropriate to require that the over-collected amounts be refunded for the same period."⁶⁵

The ALJ does not make a recommendation as to whether DDU should refund or credit the amounts over-collected. However, the ALJ does recommend that the Commission require DDU to provide a refund or a credit as applied over fifteen months.

Regarding interest, section 13.187(i) of the Texas Water Code provides that "[u]nless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate

⁶² DDU Exceptions, pg. 23.

⁶³ DDU Exceptions, pg. 24.

⁶⁴ DDU Exceptions, pg. 24.

⁶⁵ ED Exceptions, pg. 12.

finally ordered *plus interest* as determined by the regulatory authority.”⁶⁶ While the Commission has the flexibility to order a refund or a credit, the language of section 13.187(i) provides that customers are entitled to either a refund or credit for all sums in excess of the final rate “plus interest.” Since the statute requires the utility to pay interest to its customers, the ALJ recommends that the Commission overrule DDU’s exception.

II. The ED’s Exceptions

The ED supports the denial of DDU’s application.⁶⁷ Also, when filing his exceptions, the ED provided various clarifications and calculations that the ALJ had requested in the PFD. Specifically, the ALJ requested that the ED recalculate the ED’s revenue requirements based on an expense allocation of 60/40 between the water and wastewater systems. This necessitated changes to the ED’s attachments. The ED provided substituted attachments and listed the attachments in his exceptions with the corresponding attachments in the testimony.⁶⁸ In the event the Commission decides to grant DDU’s application, the ALJ recommends that the Commission adopt the ED’s revised attachments.

While the ED performed the recalculations as requested by the ALJ, the ED argues that his allocation of expenses between the water and wastewater systems on a 50/50 basis is more appropriate than the 60/40 split recommended by the ALJ. The ED argues that other than a letter from a DDU officer, DDU provided no supporting documentation that would justify a 60/40 allocation.⁶⁹

In the event the Commission decides to grant the application, the ALJ does not recommend that the Commission allocate the expenses based on a 50/50 allocation. What little evidence is in the record supports the 60/40 allocation of expenses between the water and wastewater systems.

A. Finding of Fact No. 7.

The ED excepts to the ALJ’s determination that DDU’s August and December 2007 applications constitute one application to change DDU’s rates.⁷⁰ The ALJ recommends that the Commission overrule this exception for the reasons stated on pages 12 through 13 of the PFD.

⁶⁶ TEX. WATER CODE ANN. 13.187(i) (emphasis added); *see also*, 30 TAC § 291.29(h).

⁶⁷ ED Exceptions, pg. 1.

⁶⁸ ED Exceptions, pg. 3.

⁶⁹ ED Exceptions, pg. 4.

⁷⁰ ED Exceptions, pg. 5.

B. Finding of Fact No. 69.

For the reasons stated in the ED's Exceptions regarding the purchased water expense,⁷¹ the ALJ recommends that the Commission sustain this exception and strike the second sentence in Finding of Fact No. 69.

C. Finding of Fact Nos. 107 and 108.

In the PFD, the ALJ stated that there was no evidence in the record to support the ED's deduction of \$48,366 in other revenues.⁷² The ED argues that the record does demonstrate that DDU had other revenues of \$38,800 that should be deducted from DDU's cost of service.⁷³ In its 2006 Statement of Operations found in the ED's exhibits, DDU claimed "water tap" sales during the 2006 test year in the amount of \$38,800.⁷⁴ The ED argues that DDU's own Statement of Operations shows that it generated revenues for the water system that was unaccounted for in its revenue requirement.⁷⁵ The ED would allocate this \$38,800 in revenue to the three individual water systems based on the connection counts for each system: The Retreat, \$2,328; the Cliffs, \$10,476; and White Bluff, \$25,996.⁷⁶

It is unclear how DDU could generate \$38,800 in "water tap" sales⁷⁷ when the system only added four connections during the test year⁷⁸ when the "tap fees" were \$400 for each tap.⁷⁹ This discrepancy only highlights how difficult it would be to set just and reasonable rates in this case based on the inconsistencies between DDU's application and its financial information. However, the ALJ is not aware of any testimony on this issue nor did DDU present rebuttal evidence on why the ED's reduction for other revenues was erroneous. Due to this uncertainty in the record and lack of evidence on the issue, the ALJ recommends that the Commission overrule this exception.

⁷¹ ED Exceptions, pg. 9.

⁷² PFD, pg. 90.

⁷³ ED Exceptions, pg. 9.

⁷⁴ ED Exh. 1, att. S, pg. 1.

⁷⁵ DDU Exh. 25, pg. 14, ln. [S].

⁷⁶ ED Exceptions, pg. 9-10.

⁷⁷ ED Exh. 1, att. S, pg. 1.

⁷⁸ DDU Exh. 25, pg. 15.

⁷⁹ DDU Exh. 30, pg. 37 & 39.

D. Finding of Fact No. 111 and Conclusion of Law No. 30.

Based on the arguments in the ED's Exceptions regarding the alternative rate method for calculating rates,⁸⁰ the ALJ recommends that the Commission sustain this exception and strike Finding of Fact No. 111 and Conclusion of Law No. 30 from the proposed order.

E. Conclusion of Law No. 37.

Based on the arguments in the ED's Exceptions regarding the dates DDU charged the rates proposed in this application,⁸¹ the ALJ recommends that the Commission sustain this exception. Conclusion of Law No. 37 should read: "Based on the above Findings of Fact and Conclusions of Law, DDU should refund or credit to its customers all sums collected from September 28, 2007, which was the effective date of the rates at issue in this case, until December 2008, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection."

III. ED's Corrections

The ALJ recommends that the Commission make the corrections to the proposed order as set out by the ED on pages 11 through 12 in his Exceptions.

IV. WBSR's Exceptions

WBSR's Exceptions concentrated on DDU's failure to provide separate revenue requirements for each water system. WBSR referred to Findings of Fact Nos. 43 and 44.⁸² WBSR also recommended that the following ordering provisions be included in the proposed order:

- A. DDU shall maintain separate books and other accounting documents for each of the three water systems at issue in this proceeding (The Cliffs, the Retreat, and White Bluff) and each of its sewer systems and any future water or sewer systems it may develop or operate;
- B. To the extent any expenses are shared among its water systems and/or its sewer systems, DDU shall develop a reasonable methodology for allocating these expenses and shall maintain reasonable documentation demonstrating how such expenses are shared and in what amounts.

⁸⁰ ED Exceptions, pg. 10-11.

⁸¹ ED Exceptions, pg. 11.

⁸² WBSR Exceptions, pg. 1.

- C. DDU shall implement the above provisions within one month of the date of this order.
- D. In any water rate application filed after the date of the application at issue in this proceeding, DDU shall develop separate revenue requirements and separate rates for each of its water systems.⁸³

The ALJ makes no recommendations regarding WBSR's provision Nos. 1 through 3. As pointed out by the ED, the Commission has the statutory authority to adopt such requirements.⁸⁴ WBSR's recommendations may alleviate some of the issues encountered in this proceeding.

The ALJ recommends that the Commission not include WBSR's provision No. 4 as this will limit DDU's discretion in filing applications in the future. Facts may change and consolidation of the water systems under one rate design may become appropriate. Therefore, the ALJ recommends that the Commission overrule WBSR's exception regarding the inclusion of provision No. 4 in any order issued in this case.

V. Summary

The ALJ makes the following recommendations regarding the parties' Exceptions.

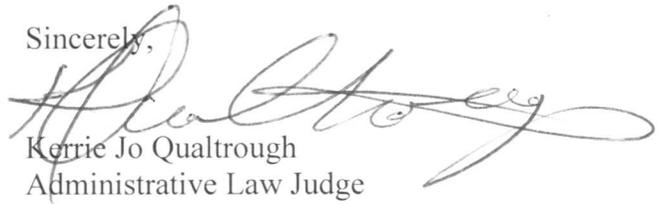
1. The ALJ recommends that the Commission sustain DDU's exception to allow DDU to either refund or credit, over a 15 month timeframe, amounts it received from its customers that exceed the rates finally set in this case.
2. The ALJ recommends that the Commission overrule all of DDU's other exceptions.
3. The ALJ recommends that the Commission adopt the ED's revised attachments that conform to the ALJ's recommendations in the PFD, in the event the Commission decides to grant DDU's application.
4. The ALJ recommends that the Commission overrule the ED's Exceptions regarding Findings of Fact Nos. 7, 107, and 108.
5. The ALJ recommends that the Commission sustain the ED's Exceptions regarding Findings of Fact Nos. 69 and 111 and Conclusions of Law Nos. 30 and 37.

⁸³ WBSR Exceptions, pg. 2.

⁸⁴ ED Reply to Exceptions, pg. 1-2 (referring to TEX. WATER CODE ANN. § 13.131(a) & (e)).

6. The ALJ recommends that the Commission make the corrections to the proposed order as set out on pages 11 through 12 of the ED's Exceptions.
7. The ALJ makes no recommendation regarding WBSR's proposed Ordering Provisions No. 1 through 3.
8. The ALJ recommends that the Commission not adopt WBSR's proposed Ordering Provision No. 4.

Sincerely,

A handwritten signature in black ink, appearing to read "Kerrie Jo Qualtrough", written in a cursive style.

Kerrie Jo Qualtrough
Administrative Law Judge

KJQ/ap
Enclosures
cc: Mailing List