

# State Office of Administrative Hearings



Cathleen Parsley  
Chief Administrative Law Judge

June 15, 2009

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

2009 JUN 15 PM 1:57  
CHIEF CLERKS OFFICE  
TEXAS  
COMMISSION  
ON ENVIRONMENTAL  
QUALITY

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

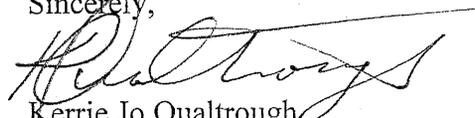
Dear Mr. Trobman:

The above-referenced matter will be considered by the Texas Commission on Environmental Quality on a date and time to be determined by the Chief Clerk's Office in Room 201S of Building E, 12118 N. Interstate 35, Austin, Texas.

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the original documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than July 6, 2009. Any replies to exceptions or briefs must be filed in the same manner no later than July 16, 2009.

This matter has been designated **TCEQ Docket No. 2007-1708-UCR; SOAH Docket No. 582-08-0698**. All documents to be filed must clearly reference these assigned docket numbers. Copies of all exceptions, briefs and replies must be served promptly on the State Office of Administrative Hearings and all parties. Certification of service to the above parties and an **original and seven copies** shall be furnished to the Chief Clerk of the Commission. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

  
Kerrie Jo Qualtrough  
Administrative Law Judge

KJQ/ap  
Enclosures  
cc: Mailing List

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**STYLE/CASE:** DOUBLE DIAMOND UTILITIES COMPANY, INC

**SOAH DOCKET NUMBER:** 582-08-0698

**REFERRING AGENCY CASE:** 2007-1708-UCR

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SOAH DOCKET NO. 582-08-0698  
TCEQ DOCKET NO. 2007-1708-UCR

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APPLICATION OF DOUBLE § BEFORE THE STATE OFFICE  
DIAMOND UTILITIES, INC. TO §  
CHANGE ITS WATER RATES AND §  
TARIFF, IN HILL, PALO PINTO, AND § OF  
JOHNSON COUNTIES, TEXAS, §  
APPLICATION NO. 35771-R § ADMINISTRATIVE HEARINGS

CHIEF CLERKS OFFICE

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CHIEF CLERKS OFFICE

PROPOSAL FOR DECISION

I. INTRODUCTION

Double Diamond Utilities, Inc. (DDU) has filed an application to increase the rates for its retail water utility service. DDU serves three separate developments and seeks to change its rates for all three public water systems: The Cliffs in Palo Pinto County,<sup>1</sup> the Retreat in Johnson County,<sup>2</sup> and the White Bluff development in Hill County.<sup>3</sup>

The Executive Director (ED), the Office of Public Interest Counsel (OPIC), White Bluff Subdivision Ratepayers (WBSR), and other Protestants contend that DDU failed to meet its burden of proof to demonstrate that the proposed increase would be just and reasonable. They differ, however, on what DDU's rates should ultimately be at the conclusion of this proceeding. The ED recommends that DDU's rates should revert back to their levels before the filing of this application. WBSR, on the other hand, would roll back DDU's rates to levels lower than those previously in effect.

The Administrative Law Judge (ALJ) agrees that DDU has not met its burden of proof. There are numerous discrepancies between DDU's applications and its supporting documentation. DDU failed to demonstrate how it set its rates and how those rates were just and reasonable. DDU also failed to demonstrate how it met the regulatory criteria to allow consolidation of two of its water systems under one rate. Furthermore, DDU apparently failed to

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<sup>1</sup> The Cliffs water system was begun in 1993 and has 228 connections.

<sup>2</sup> The Retreat water system was begun in 2003 and has 48 connections.

<sup>3</sup> The White Bluff water system was begun in 1990 and has 553 connections.

account for developer contributions in this rate case. Along with these issues and the other numerous discrepancies between its application and its supporting documentation, the ALJ recommends that the application be denied. The ALJ also recommends that the Commission set DDU's rates at those levels existing before DDU filed its application in August of 2007. DDU should also be ordered to refund or credit to customers all sums collected since the effective date of the rates at issue in this hearing that exceeded its prior rates, plus six percent interest on the over-collections.

## II. JURISDICTION

No party disputes the jurisdiction of either the Commission or the State Office of Administrative Hearings (SOAH).

## III. PROCEDURAL HISTORY

On August 7, 2007, DDU filed its first application to change its rates for the water service provided under Certificate of Convenience and Necessity (CCN) No. 12087.<sup>4</sup> Notices of the application were mailed to DDU's customers on July 27, 2007.<sup>5</sup> The effective date of the increase was September 28, 2007.<sup>6</sup> In December of 2007, DDU submitted a new document purporting to make corrections to the August 2007 application.<sup>7</sup>

More than ten percent of DDU's customers filed protests by the applicable deadline. On November 14, 2007, the Chief Clerk mailed notice of a preliminary hearing to DDU. However, on November 29, 2007, SOAH issued an order requiring that the preliminary hearing be held in Hillsboro, Texas, on February 5, 2008.

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<sup>4</sup> DDU Exh. 30. DDU's exhibits were marked in the hearing as "App. Exh." For ease of reference and clarity, the ALJ will refer to all of DDU's exhibits as "DDU Exh." in this proposal for decision.

<sup>5</sup> DDU Exh. 30, pg. 36. Unless otherwise noted, all references to page numbers refer to the Bates stamped number of the exhibit, not the page number of the document itself.

<sup>6</sup> DDU Exh. 30, pg. 36.

<sup>7</sup> DDU Exh. 25.

Accordingly, the Chief Clerk mailed the revised notice of a preliminary hearing to DDU on December 13, 2007. DDU mailed the revised notice of the preliminary hearing to its customers on January 9, 2008.<sup>8</sup> The notice contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.<sup>9</sup>

On February 5, 2008, SOAH held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

<b>PARTY</b>	<b>REPRESENTATIVE</b>
DDU	Michael Skahan
ED	Stephanie Skogen
OPIC	Eli Martinez
WBSR	Shari Heino
Jack and Sandra McCartney	Themselves
The Cliff's Subdivision Ratepayers	Todd McCall

The ALJ held the hearing on the merits on February 23-24, 2009, and all of the parties appeared and participated. The following witnesses testified in this case:

<b>WITNESS</b>	<b>PARTY</b>	<b>SUBJECT</b>
Kevin Shea, Vice President, Accounting	DDU	Accounting issues
Randy Gracy, President	DDU	Corporate issues
Charles Gillespie, Jr., Consultant	DDU	Application issues
Nelisa Heddin	WBSR	Application issues
Elsie Pascua, Accountant/Auditor	ED	Cost of service and revenue requirement
Brian David Dickey, General Engineering Specialist	ED	Rate design and depreciation schedules.

<sup>8</sup> ED Exh. D.

<sup>9</sup> ED Exh. D.

#### IV. OVERVIEW OF THE PROPOSED RATE INCREASE

At the end of the test year, on December 31, 2006, DDU provided water service to the following customer classes at the three water systems.

<b>Metered Connections: All three subdivisions</b>	<b>Total<sup>10</sup></b>
5/8" X 3/4"	749
1"	38
1 1/2"	10
2"	31
<b>Total</b>	<b>828</b>

In its applications, DDU proposed the following rate increases:

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<sup>10</sup> DDU Exh. 25, pg. 15.

	Previous Rates	August 2007 Application <sup>11</sup>	December 2007 Application <sup>12</sup>
<b>The Cliffs - Minimum Bill</b>			
5/8"	\$ 30.00	\$ 52.00	NA
1"	50.10	127.00	NA
1 1/2"	99.90	253.00	NA
2"	159.80	405.00	NA
3"	320.00	757.00	NA
<b>Gallonage Charge per 1000 gallons</b>			
0-10,000 Gallons	\$ 1.85	\$ 2.60	NA
10,001-20,000 Gallons	4.75	5.20	NA
Over 20,001 Gallons	6.75	7.80	NA
<b>White Bluff and the Retreat - Minimum Bill</b>			
5/8"	\$ 30.00	\$ 42.00	\$ 42.00
1"	50.10	65.00	65.00
1 1/2"	99.90	128.00	128.00
2"	159.80	280.00	280.00
3"	320.00	425.00	425.00
<b>Gallonage Charge per 1000 gallons</b>			
0-10,000 Gallons	\$ 1.85	\$ 2.50	\$ 2.50
10,001-20,000 Gallons	2.10	2.75	2.75
Over 20,001 Gallons	4.75	5.25	3.20

On September 28, 2007, DDU began charging the rates in the August 2007 application.<sup>13</sup> However, the December 2007 application reduced the volumetric rate for water used over 20,001 gallons for the White Bluff and the Retreat ratepayers from the rate of \$5.25 per thousand gallons to \$3.20. DDU did not send notice of the reduction in the requested rate to the White Bluff and Retreat ratepayers and did not charge the ratepayers the lower gallonage charge found in its December 2007 application.

<sup>11</sup> DDU Exh. 30, pgs. 37, 39.

<sup>12</sup> DDU Exh. 25, pg. 21.

<sup>13</sup> Tr., pg. 280, ln. 2-11.

On October 24, 2008, DDU submitted another application for a rate increase,<sup>14</sup> which remains pending and is not the subject of this case. Therefore, DDU only charged the rates in its August 2007 application until December of 2008.<sup>15</sup> The rates at issue here were only in effect for approximately 15 months and are no longer being charged.

## V. APPLICABLE LAW

In setting the rates for water service, the Commission must fix a utility's overall revenues at a level that will "(1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and (2) preserve the financial integrity of the utility."<sup>16</sup> DDU has the burden of proving that its proposed rates are just and reasonable. Section 13.184(c) of the Texas Water Code provides that "[i]n any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change, if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable." The Commission is generally prohibited from setting rates that would allow DDU to earn more than a fair return on its capital that is used and useful in providing water service. Section 13.184(a) of the Texas Water Code states "[u]nless the commission establishes alternate rate methodologies in accordance with Section 13.183(c), the commission may not prescribe any rate that will yield more than a fair return on the invested capital used and useful in rendering service to the public . . . ."

The Commission may promulgate reasonable rules with respect to the allowance or disallowance of certain expenses for ratemaking purposes.<sup>17</sup> Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the

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<sup>14</sup> Tr. pg. 43, ln. 16-18.

<sup>15</sup> Tr. pg. 280, ln. 15-19.

<sup>16</sup> TEX. WATER CODE ANN. § 13.183(a).

<sup>17</sup> TEX. WATER CODE ANN. § 13.185(g).

ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered.<sup>18</sup> "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing.<sup>19</sup>

Utility rates shall be based on the original cost of property used by and useful to the utility in providing service. Original cost is the actual money cost or the actual money value of any consideration paid, other than money, of the property at the time it shall have been dedicated to public use, whether by the utility that is the present owner or by a predecessor, less depreciation. Utility property funded by explicit customer agreements or customer contributions in aid of construction, such as surcharges, may not be included in invested capital.<sup>20</sup> Also, developer contributions must also be excluded from invested capital.<sup>21</sup>

Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service.<sup>22</sup>

Under 30 TAC § 291.31(b)(1), allowable expenses, to the extent they are reasonable and necessary, and subject to that section, may include the following general categories:

- (A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in

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<sup>18</sup> 30 TEX. ADMIN. CODE (TAC) § 291.31(a) and (b).

<sup>19</sup> TEX. WATER CODE ANN. § 13.002(22).

<sup>20</sup> TEX. WATER CODE ANN. § 13.185(b).

<sup>21</sup> 30 TAC § 267.31(c)(3)(A)(iv) & (v).

<sup>22</sup> TEX. WATER CODE ANN. § 13.185(j).

providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), § 13.185(e));

- (B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;
- (C) assessments and taxes other than income taxes;
- (D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, § 13.185(f), if applicable);
- (E) reasonable expenditures for ordinary advertising, contributions, and donations; and
- (F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

Certain types of expenses are specifically not allowed as a component of cost of service.<sup>23</sup>

Under 30 TAC § 291.31(c)(2), the rate of return is applied to the invested capital, also referred to as rate base. Components to be included in determining the invested capital are as follows:

- (A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:
  - (i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;

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<sup>23</sup> TEX. WATER CODE ANN. § 13.185(h); 30 TAC § 291.31(b)(2).

- (ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;
  - (iii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC, § 13.185(e);
  - (iv) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and
- (B) working capital allowance to be composed of, but not limited to, the following:
- (i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;
  - (ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, § 13.185(e); and
  - (iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management.<sup>24</sup>

According to 30 TAC § 291.31(c)(1), the return on invested capital is the rate of return multiplied by invested capital. The Commission shall allow each utility a reasonable opportunity

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<sup>24</sup> TEX. WATER CODE ANN. § 13.184 (b).

to earn a reasonable rate of return, which is expressed as a percentage of invested capital. The Commission fixes the rate of return in accordance with the following principles.

- (A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.
- (B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.
- (C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

## VI. MAJOR ISSUES

### A. What is the Application?

The parties differ on what they consider to be “the application” in this proceeding. DDU submitted an application in August 2007.<sup>25</sup> In December 2007, DDU submitted another application,<sup>26</sup> purportedly to correct its August 2007 application. However, there is conflicting testimony on whether DDU intended this December 2007 application to constitute a complete application or to provide substitute pages for the August 2007 application.

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<sup>25</sup> DDU Exh. 30.

<sup>26</sup> DDU Exh. 25.

### **1. DDU's position**

DDU entered into evidence the August and December 2007 versions but gave conflicting testimony on the status of the December 2007 application. Mr. Charles Gillespie, Jr. a consultant for DDU, stated that the December 2007 application "is a revised application for a rate change . . . ." <sup>27</sup> On cross-examination, Mr. Gillespie, Jr. testified that DDU viewed the two versions as one application. <sup>28</sup>

### **2. WBSR's position**

WBSR pointed out the discrepancies between the August and December 2007 versions. <sup>29</sup> For the purposes of its analysis, WBSR "assumed the information provided in the December 2007 'Application' would be more correct than the August 2007 Application." <sup>30</sup>

### **3. The ED's position**

It is the ED's position that the original, August 2007 application is the application at issue in the case. <sup>31</sup> According to the ED, in December 2007, DDU submitted a letter with several attachments, including the December 2007 version of the application. This December letter was in response to the ED's request for additional items to complete the audit of DDU's books and records and to support the application. DDU also submitted another letter in January of 2008 explaining that "[a] complete corrected application was submitted with the information submitted December 21, 2007." <sup>32</sup>

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<sup>27</sup> DDU Exh. C, pg. 2, ln. 16-18.

<sup>28</sup> Tr., pg. 94, ln. 21 – pg. 95, ln. 24.

<sup>29</sup> WBSR Closing, pg. 6.

<sup>30</sup> WBSR Closing, pg. 6.

<sup>31</sup> ED Closing, pg. 4.

<sup>32</sup> ED Exh. 6.

The ED refers to 30 TAC § 291.25(g) for the proposition that a rate application may be modified for good cause. The ED asserts that DDU never asked for leave to modify its application and never received leave to modify from either the ED or the ALJ.<sup>33</sup> Even if the December 2007 application is the application at issue in this case, the ED states that there is conflicting testimony on whether DDU intended it to be the complete application. Furthermore, the ED asserts that the first time anyone would have known that that they were to look at a combination of the August and December applications was the first day of the hearing when Mr. Gillespie, Jr. testified that DDU did not intend for the December 2007 application to be the complete application.

#### 4. ALJ's analysis

The ALJ compared the August 2007 application page by page with the December 2007 application. Some pages in the December 2007 application are identical to the August 2007 application, so there was no reason for DDU to include those pages in its December version if DDU was truly supplementing the August application. Some pages in the December 2007 application are different from the August 2007 application. Some pages in the August 2007 application are simply missing from the December 2007 application.

It is apparent to the ALJ that the December 2007 application supplemented the August 2007 application. DDU's prefiled testimony discussed entries in the December 2007 application. For example, Mr. Gillespie, Jr., testified that DDU's net book value was \$1,766,007.17.<sup>34</sup> This figure comes from the December 2007 application.<sup>35</sup> The net book value in the August 2007 application was \$1,782,176.43.<sup>36</sup> Therefore, it is clear from DDU's prefiled testimony that it considered the December 2007 application to at least supplement the August 2007 application.

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<sup>33</sup> ED Closing, pg. 5.

<sup>34</sup> DDU. Exh. C, pg. 4, ln. 21-23.

<sup>35</sup> DDU. Exh. 25, pg. 25.

<sup>36</sup> DDU Exh. 30, pg. 17.

Had the parties understood that the December 2007 application was a complete and total substitute for the August 2007 application, the ALJ assumes that some party would have argued that the December 2007 application was not complete and should be denied on that basis. The December 2007 application is missing a signature page and a notice to the Cliffs' ratepayers, two items vital to an application to change rates.<sup>37</sup> However, no one argued or stated that the December 2007 should be considered the sole application for purposes of this hearing. Furthermore, while 30 TAC § 291.25(g) requires good cause to modify an application, the ED did not direct the ALJ to a requirement that a utility must obtain leave from the ED or the ALJ prior to making the modification.

Therefore, the ALJ has considered both applications to constitute one application to change DDU's rates. The ALJ will refer to each version of the application as the discussion warrants.

## **B. Multiple Systems Consolidated Under One Tariff and Rate Design**

In its rate application, DDU proposed one new rate for the ratepayers in the Cliffs and one new rate for both the White Bluff and the Retreat ratepayers. This two-rate structure for the three subdivisions was in effect prior to the filing of the August 2007 application. The issue is whether the White Bluff and the Retreat water systems can be consolidated under a single rate.

### **1. Legal Requirements**

“Every utility is required to file tariffs showing all rates that are subject to the jurisdiction of the regulatory authority,”<sup>38</sup> and the utility's rules are part of that tariff.<sup>39</sup> The TCEQ defines tariff as “[t]he schedule of a retail public utility containing all rates, tolls, and charges stated

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<sup>37</sup> 30 TAC § 291.22.

<sup>38</sup> TEX. WATER CODE ANN. § 13.136(a).

<sup>39</sup> *Id.*

separately by type or kind of service and the customer class, and the rules and regulations of the retail public utility stated separately by type or kind of service and the customer class.”<sup>40</sup>

Before multiple systems can be consolidated under a single tariff or rate design, a utility must meet certain conditions. Section 13.145(a) of the Texas Water Code provides that a utility “may consolidate more than one system under a single tariff only if: (1) the systems under the tariff are substantially similar in terms of facilities, quality of service, and cost of service; and (2) the tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.” The TCEQ’s rules impose the same requirements before a utility can consolidate systems under one tariff and rate design.<sup>41</sup>

## **2. DDU’s position**

Prior to filing its August 2007 application, DDU utilized the same two-rate structure for the three subdivisions: The ratepayers in White Bluff and the Retreat paid the same rate while the ratepayers at the Cliffs paid a different rate. DDU continues this same rate structure in its 2007 application. DDU did not present evidence on why the two water systems should be consolidated under one rate in either its direct or rebuttal cases. DDU also does not provide argument for its rate structure in its closing arguments or in its response to the closing arguments of the other parties.

## **3. WBSR’s position**

WBSR argues that DDU has the burden of proof to show that the multiple systems can be consolidated under one tariff. Specifically, WBSR asserts that under section 13.145(a) of the Texas Water Code, it is DDU’s burden to show that the two systems are similar in terms of facilities, quality of service, and cost of service, and that the rate promotes water conservation.<sup>42</sup>

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<sup>40</sup> 30 TAC § 291.3(48).

<sup>41</sup> 30 TAC § 291.21(m).

<sup>42</sup> WBSR Closing, pg. 4.

WBSR argues that “the systems have never been similar, are not similar now and will not be similar in the future.”<sup>43</sup> WBSR asserts that there are differences in the facilities used by the systems and differences in the cost of service, including differences in developer contributions, types of community served, the age of the systems, and buildout of the developments.<sup>44</sup> Regarding cost of service, WBSR alleges that there are great variations in the cost of service for all three water systems. For White Bluff and the Retreat, WBSR calculated that the “gross cost of water” for White Bluff is \$2.14 per 1,000 gallons and \$3.68 for the Retreat.<sup>45</sup> Therefore, according to WBSR, DDU has failed to demonstrate that the first prong of section 13.145(a) is met.

WBSR argues that DDU also failed to meet the second prong of section 13.145(a) of the Texas Water Code. WBSR asserts that in the White Bluff development, the White Bluff Property Owner’s Association (POA) is governed by a board and 50 percent of the board’s members are representatives of DDU’s affiliates. The board has imposed strict landscaping requirements within the White Bluff development. WBSR questions whether DDU’s inclining block rate structure would encourage water conservation given the strict landscaping requirements.

#### **4. Jack D. and Sandra A. McCartney**

The McCartneys live in the Retreat development. In their closing arguments, the McCartneys state that “[they] do not support separating the DDU water systems at The Cliffs, The Retreat and White Bluff for rate making purposes . . . .” They argue that “would create unnecessary expenses and cause ratepayers in the Retreat to pay a higher minimum rate simply

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<sup>43</sup> WBSR Closing, pg. 30.

<sup>44</sup> WBSR Closing, pg. 30-32.

<sup>45</sup> WBSR Exh. 22. To calculate the “gross cost of water” for the systems, WBSR prepared a revenue requirement for each system, and then divided the revenue requirement by the total annual billing units in thousand gallon increments.

because their development is new and had not developed a sufficient customer base for the 2006 test year . . . .”<sup>46</sup>

## **5. The Cliffs Subdivision Ratepayers’ position**

The Cliffs Ratepayers “see no benefit to fragmenting the utilities at the various resorts within the Double Diamond Corporation into separate entities. This would create an unnecessary expense and would provide no benefit to the rate payers. Appropriate utility rates for each resort can be fairly calculated based upon actual expenses for each resort.”<sup>47</sup>

## **6. OPIC’s position**

OPIC takes the position that DDU failed to show that the White Bluff and the Retreat water systems should be consolidated under one rate.<sup>48</sup> According to OPIC, one factor that DDU did not meet was the requirement that the systems have a similar cost of service.<sup>49</sup> OPIC argues that since DDU “combined the cost of service for all three water systems in its rate application, [it] did not demonstrate the manner in which the two requested rates were calculated from this figure.”<sup>50</sup> OPIC relies on the ED’s per-meter equivalent costs to argue that there is not substantial similarity between the two systems to justify consolidation. The ED’s accountant/auditor Elsie Pascua calculated that the per-meter equivalent cost for the White Bluff subdivision is \$30.08 per month while the per-meter equivalent cost for the Retreat ratepayers is \$77.35 per month.<sup>51</sup> OPIC asserts that this variation would result in one water system subsidizing the other. Therefore, according to OPIC, DDU has failed to meet its burden regarding the consolidation of the two water systems under one rate design.

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<sup>46</sup> The McCartneys’ Closing.

<sup>47</sup> The Cliffs Ratepayers Closing.

<sup>48</sup> OPIC Closing, pg. 3.

<sup>49</sup> TEX. WATER CODE ANN. § 13.145(a); 30 TAC § 291.21(m).

<sup>50</sup> OPIC Closing, pg. 3.

<sup>51</sup> OPIC Closing, pg. 3.

## 7. ED's position

The ED argues that “DDU has not provided any information regarding why these systems are substantially similar.”<sup>52</sup> Therefore, the ED did his own analysis of this issue and it is the ED's position that the White Bluff and Retreat systems should not be consolidated under one rate.

The ED's witness, Brian Dickey, a general engineering specialist, examined all the factors in 30 TAC § 291.21(m) except for cost of service.<sup>53</sup> He determined that the Retreat and White Bluff developments are similar in terms of facilities in that they are both groundwater systems and have pressure tanks, ground storage tanks, and distribution lines.<sup>54</sup> He also testified that the inclining block gallonage charge generally promotes water conservation.<sup>55</sup>

However, the ED also presented evidence on the cost of service for both systems. Ms. Pascua compared the two water systems' costs of service, and did not find them to be substantially similar.<sup>56</sup> In her testimony, Ms. Pascua stated that “the total *cost of service* for White Bluff is \$244,875.00 with a per meter equivalent cost of \$30.08 per month, and the total *cost of service* for The Retreat is \$57,550.00 with a per meter equivalent cost of \$77.35 per month.”<sup>57</sup> In his closing argument, the ED stated that “[c]alculating a *revenue requirement* of \$244,875 for White Bluff and \$57,550 for The Retreat, [Ms. Pascua] found that White Bluff has a monthly *revenue requirement* of \$30.08 per meter equivalent, and The Retreat has a monthly *revenue requirement* of \$77.35 per meter equivalent.”<sup>58</sup> In a footnote, the ED stated “the revenue requirement is the cost of service minus other revenues. Using just the costs of service for the two systems would give a monthly cost of service per meter equivalent of \$87.57 for The

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<sup>52</sup> ED Closing, pg. 6.

<sup>53</sup> ED Closing, pg. 7.

<sup>54</sup> ED Exh. 2, pg. 4, line 14-15.

<sup>55</sup> ED Exh. 2, pg. 4, line 17-19.

<sup>56</sup> ED Exh. 1, pg. 4, ln. 13-14.

<sup>57</sup> ED Exh. 1, pg. 4, ln. 13-14 (emphasis added).

<sup>58</sup> ED Closing, pg. 7 (emphasis added).

Retreat and \$33.74 for White Bluff. [ED Exh. 1], atts. A (cost of service of \$65,153 for The Retreat), I (cost of service of \$274,677 for White Bluff).”<sup>59</sup>

There is a discrepancy between the ED’s Closing Argument and his Ms. Pascua’s prefiled testimony.

The components of a utility’s cost of service are allowable expenses and return on invested capital.<sup>60</sup> After reviewing Ms. Pascua’s testimony, her attachments A and I, the ED’s Closing Argument, and the components of “cost of service,” the ALJ has determined that the statements in the ED’s footnote 34 in his closing are accurate: The Retreat’s cost of service for is \$65,153 with a per meter equivalent of \$87.57 and White Bluff’s cost of service is \$274,677 with a per meter equivalent of \$33.74. If the ED files exceptions to this PFD, the ALJ requests clarification of this issue.

The ED argues that there is a large discrepancy between both the revenue requirements and the costs of service for the White Bluff and the Retreat water systems. Since the two systems do not have substantially similar costs of service, it is the ED’s opinion that the two water systems cannot be consolidated under one rate design.

## **8. ALJ’s analysis**

The ALJ agrees with WBSR, OPIC, and the ED that DDU has not met its burden of proof to show that the White Bluff and the Retreat water systems meet the requirements for consolidation under one tariff and one rate design. By combining all three systems to calculate one revenue requirement, DDU has not shown that all of the requirements of section 13.143(a) of the Texas Water Code and 30 TAC § 291.21(m) have been met. DDU did not provide any evidence or argument on this issue. Instead, DDU may have been relying on the way its rates were structured in the past.

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<sup>59</sup> ED Closing, pg. 7, n.34.

<sup>60</sup> 30 TAC § 291.31(a).

The ED's witness, Ms. Pascua, testified that "DDU did not address how the water systems at the Retreat and White Bluff are substantially similar in terms of the cost of service, which DDU was required to do under section 291.21(m)(1) if it wishes to consolidate those systems under a single rate."<sup>61</sup> DDU did not refute or rebut this testimony. Nor does DDU point to the record where there is evidence to support the consolidation of the White Bluff and the Retreat systems under one rate. While the ALJ recognizes that the TCEQ has approved DDU's rate structure in the past, that does not relieve DDU of its burden in this rate proceeding to justify its request. There is no evidence that the Commission has found in a prior *contested* case that the two systems are substantially similar and should be consolidated under a single tariff or rate design. Thus, the doctrine of *res judicata* is not applicable. Furthermore, it is conceivable that costs of service for systems can change over time. Therefore, it is necessary to demonstrate that the costs of service remain substantially similar to continue to combine two systems under one rate design. In this case, DDU failed to show that by combining the White Bluff and the Retreat systems under one rate design, a just and reasonable rate would result.

Regarding the discrepancy between the ED's testimony and his closing arguments over the proper amount of the systems' costs of service, it is the ALJ's opinion that the discrepancy is not material to this analysis. Both the ED's use of revenue requirement and the ED's use of cost of service to calculate a per meter equivalent show a large variation between the White Bluff and the Retreat water systems in terms of costs. It is clear from the ED's testimony and arguments that White Bluff and the Retreat do not have substantially similar costs so that consolidation of the systems under one rate design would result in just and reasonable rates.

The ALJ appreciates the position of the McCartneys that the ratepayers at the Retreat may pay higher rates if the Commission requires different rates for the Retreat and White Bluff water systems. The Retreat is a relatively new development with few ratepayers paying the expenses of a system designed to serve more connections. Nevertheless, as pointed out by OPIC, by combining the Retreat and White Bluff water systems under one rate, an older, established

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<sup>61</sup> ED Exh. 1, pg. 4, ln. 6-9.

development would be subsidizing the newer development. This would not result in water rates that are just and reasonable for the White Bluff ratepayers.

### **C. Developer Contributions and the Effect on Invested Capital**

In setting the rates for water service, the Commission must fix a utility's overall revenues at a level that will, among other things, "permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses . . . ." <sup>62</sup> However, developer contributions are not included in a utility's invested capital. <sup>63</sup> Developer contributions are those assets paid for by the developer instead of the utility. Since the developer paid for those assets, they are not considered to be the invested capital of the utility because the utility made no investment in the asset. To the utility, the capital contributed by the developer was cost free. Therefore, developer contributions are not included in the invested capital calculation. <sup>64</sup>

#### **1. Evidentiary Record**

DDU did not indicate in either version of its application for test year 2006 that a portion of its assets came from developer contributions. <sup>65</sup> However, DDU's witness testified that developer contributions should have been noted in the application. In discussing Table III.C. of DDU's August 2007 application, <sup>66</sup> Kevin Shea, DDU's vice president of accounting, stated:

Q Can you read that -- that section?

A "Developer's contribution, water."

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<sup>62</sup> TEX. WATER CODE ANN. § 13.183(a).

<sup>63</sup> 30 TAC § 291.31(c)(3)(A)(iv) & (v).

<sup>64</sup> DDU Exh. 25, pg. 13, Table IV.E, line [F]; Developer Contributions subtracted from the sum of Net Book Value, Working Cash Allowance, and Materials and Supplies.

<sup>65</sup> DDU Exh. 25, pg. 11, Table III.C. and pg. 13, Table IV.E., line [E]; and DDU Exh. 30, pg. 25, Table III.C. and pg. 27, Table IV.E, line [E].

<sup>66</sup> DDU Exh. 30, pg. 25.

Q Can you tell me, are there any developer contributions listed here?

A No, there's not.

Q Should there be any developer contributions listed?

A There probably should be, yes. Yeah.

Q In what amount?

A I guess I don't have that number in front of me. We -- we -- we, in accounting, we didn't -- back in '06, we didn't -- the way we did our accounting back in '06 is that we didn't really account for the developer contributions in the utility department, in the utility company.

Q But -- so there should be a number there?

A Well, we do contribute -- there are assets that are being contributed, yes, by the developer.<sup>67</sup>

Randy Gracy, DDU's president, was questioned about the developer contributions. Mr. Gracy testified:

Q What is Double Diamond Utilities' policy on developer contributions to assets?

A The Double Diamond Utilities pays for 20 percent of the distribution and collection lines that go into the service territory of DDU.

Q And developers --

A And the developer --

Q -- contribute the remaining assets?

A Yes.<sup>68</sup>

Mr. Gracy went on to testify that the two applications were prepared by two different consultants and he did not know how the consultants arrived at their numbers.<sup>69</sup> He testified:

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<sup>67</sup> Tr., pg. 12, ln. 13 – pg. 13, ln. 5.

<sup>68</sup> Tr. pg. 42, ln. 9-17.

[Mr. Gillespie, Jr.] reviewed our books with our accounting department, and this is what they came up with. Again, not being an accountant, I relied on my accounting staff and my consultants to prepare the application, and therefore, to the best of my knowledge, in the information they provided within the application was correct.<sup>70</sup>

Mr. Gillespie, Jr. did not testify regarding developer contributions or the issues raised by WBSR and the ED.

DDU also entered into evidence Exhibit 26, which is a list of asset additions from 2001 through June 2006. This list shows “developer cost” for several assets, including “CL Lake pump improvements,” “CL water system improvement,” “RT Phase 1 & 2 Water/Sewer,” and “RT water well & tank.”<sup>71</sup>

WBSR entered into evidence Exhibit 23, a document it had obtained in discovery from DDU. Exhibit 23 is a fax from Lynn Robertson, the former vice president of accounting for DDU to Charles Gillespie, III, the son of Charles Gillespie, Jr., DDU’s consultant on this application. The fax indicates that there were \$930,547 worth of developer contributions for the White Bluff and the Cliffs water systems.<sup>72</sup> This exhibit also shows that for the “WB” and “CL” water systems,<sup>73</sup> there were \$249,153.86 in developer contributions in aid of construction in 1998.<sup>74</sup>

WBSR also entered into evidence pages from DDU’s subsequent application for a rate change dated October 24, 2008.<sup>75</sup> In this subsequent, pending application, DDU

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<sup>69</sup> Tr. pg. 45, ln. 11-14.

<sup>70</sup> Tr. pg. 45, ln. 19-25.

<sup>71</sup> DDU Exh. 26.

<sup>72</sup> WBSR Exh. 23, pg. 2.

<sup>73</sup> The ALJ assumes that “WB” and “CL” references the White Bluff and the Cliffs systems, respectively.

<sup>74</sup> WBSR Exh. 23, pg. 3 and 4.

<sup>75</sup> WBSR Exh. 24.

listed \$1,904,489 in developer contributions.<sup>76</sup> The ED provided additional documents from DDU's October 2008 rate change application.<sup>77</sup> These documents show the installation dates for the developer contributed water assets that comprise the \$1,904,489 contribution.<sup>78</sup> The vast majority of these installation dates of these developer contributed assets preceded the 2006 test year that is the subject of this proceeding.

## **2. DDU's position**

DDU offered no evidence on rebuttal regarding this issue. Furthermore, DDU made no argument in either its closing or its response to closings to address the issue of developer contributions.

## **3. WBSR's position**

WBSR identified this lack of accounting for developer contributions as one of many inaccuracies in DDU's application.<sup>79</sup> WBSR introduced exhibits indicating that DDU should have shown developer contributions in both its August and December 2007 applications. According to WBSR, DDU failed to meet its burden of proof because of this and other omissions.

## **4. OPIC's position**

OPIC pointed out that there is credible evidence in the record that \$1.9 million in developer contributions were included in the DDU's October 2008 application that are "noticeably" not included in this application.<sup>80</sup>

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<sup>76</sup> WBSR Exh. 24, pg. 2, Table III.C.

<sup>77</sup> ED Exh. 4.

<sup>78</sup> ED Exh. 4, "Att. 6" (noted in upper right hand corner of document).

<sup>79</sup> WBSR Closing, pg. 7.

<sup>80</sup> OPIC Closing, pg. 5.

## 5. ED's position

The ED recognized that DDU did not list any developer contributions in its August 2007 application. The ED states that DDU's subsequent October 2008 application shows \$1,904,489 in developer contributions with a majority of the assets installed before the filing of the August 2007 application that is the subject of this proceeding. According to the ED, "[t]his means that in this case, DDU has possibly included items in its rate base that were paid for with developer contributions."<sup>81</sup>

## 6. The ALJ's analysis

DDU had ample opportunity to clarify this issue in its rebuttal case or in its closing arguments and responses. There is credible evidence in the record, including testimony from DDU's own witness, that some portion of the amount DDU claims as invested capital came from developer contributions, which should be shown in the December 2007 application. The October 2008 rate change application lists \$1.9 million in developer contributions with installation dates for assets dating back to 1990.<sup>82</sup> Some of the assets are listed on both the developer contribution list from the October 2008 application and in DDU's December 2007 application. The record does not show whether the amounts listed in DDU's December 2007 application depreciation schedule include or exclude the developer contributions shown in the October 2008 application.

DDU is claiming a total invested capital of \$1,840,362 in its December 2007 application.<sup>83</sup> The ALJ doubts the accuracy of these representations given that a year later, DDU filed another rate change application showing \$1.9 million in developer contributions for many assets that were installed prior to the 2006 test year. Given the potential magnitude of the discrepancy and the lack of evidence to the contrary, the ALJ is of the opinion that the accuracy

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<sup>81</sup> ED Closing, pg. 14.

<sup>82</sup> ED Exh. 4, "Att. 6."

<sup>83</sup> DDU Exh. 25, pg. 13.

of DDU's calculations of its invested capital is suspect. Invested capital is a major component in setting just and reasonable rates. The ALJ cannot conclude that the rates DDU has requested are just and reasonable and DDU has failed to meet its burden of proof in this regard. On this basis alone, the ALJ would recommend that DDU's application be denied.

#### **D. General Concerns with DDU's Application**

In addition to the major issues already discussed, the ALJ has several concerns with DDU's application and the presentation of its case. A major concern is with the accounting documents provided by DDU in its exhibits. DDU's accounting methods do not separate expenses and assets for the water system from those attributable to the companion wastewater system. When asked if the detailed trial balances included costs for both the water and wastewater systems, DDU's Vice President testified that "Yeah. We – the way we account for everything is that the – each – each development has their own department number,<sup>84</sup> so everybody has their unique department number. That's how we account for all the expenses and revenues and things like that, is by the department. . . ."<sup>85</sup> Therefore, DDU's accounting documents entered into evidence in its water rate case contain entries for both the water and wastewater systems. This approach made it difficult to use DDU's financial exhibits to support its application to change its water rates.

Furthermore, DDU did not show how exhibits 1 through 26 correspond to the entries in its applications. While Mr. Shea sponsored the financial exhibits, he did not match his exhibits to the entries in the application. As will be discussed below, few of the amounts in the exhibits matched the entries in the application. Also, neither Mr. Gillespie, Jr. nor Mr. Gracy attempted to reconcile the financial documents and invoices in the two 5-inch binders containing the exhibits with either of the two applications.

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<sup>84</sup> The Retreat development has department number 6090; the Cliffs, 8090; and White Bluff, 9090. DDU Exh. A., pg. 1, ln. 20-29, pg. 2, ln. 27-28.

<sup>85</sup> Tr., pg. 18, ln. 15-25.

In addition, all of DDU's witnesses disclaimed having personal knowledge of the application or could not answer specific questions. DDU President Randy Gracy testified that he was familiar with the applications, but he relied on his accounting staff and his consultants in developing the information submitted.<sup>86</sup> He also stated that he relies on "others" for accounting services, hires consultants to prepare applications, and did not verify the application line by line.<sup>87</sup> DDU Vice President of Accounting Kevin Shea testified that he did not prepare the application<sup>88</sup> and could not testify to the information contained in the application. DDU's consultant, Charles Gillespie, Jr., testified that the application was "prepared under [his] direction" when he was asked if he actually prepared the application.<sup>89</sup> When asked if he knew where the numbers came from, Mr. Gillespie, Jr. would only state that he was "aware."<sup>90</sup> His son, Charles Gillespie III, actually prepared the application<sup>91</sup> but did not testify. Mr. Gillespie, Jr., testified that he was "aware of everything that was involved in creating this application . . . in a general sense,"<sup>92</sup> but he did not calculate the rates in the application.<sup>93</sup> He did not recognize DDU's emails regarding the setting of the rates.<sup>94</sup> When asked if he knew "offhand" what the two revenue requirements were for the different water systems, Mr. Gillespie, Jr. testified that "[he] had no idea. . . . not offhand."<sup>95</sup> Mr. Gillespie, Jr. did not know how much revenue the proposed rate structure would recover.<sup>96</sup> He did state that it was "very likely" and "most likely" that the rates would recover revenues less than DDU's revenue requirement.<sup>97</sup> Furthermore, Mr. Gillespie, Jr. initially did not recall that the December 2007

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<sup>86</sup> Tr., pg. 30, ln. 12 – pg. 31, ln. 1; Tr., pg. 45, ln. 19-25.

<sup>87</sup> Tr., pg. 61, ln. 14 – pg. 62, ln. 8.

<sup>88</sup> Tr., pg. 17, ln. 6-8.

<sup>89</sup> Tr., pg. 73, ln. 2-12.

<sup>90</sup> Tr., pg. 73, ln. 13-15.

<sup>91</sup> Tr., pg. 74, ln. 7-14.

<sup>92</sup> Tr., pg. 73, ln. 5-7.

<sup>93</sup> Tr., pg. 74, ln. 7-9.

<sup>94</sup> Tr., pg. 75, ln. 8 – pg. 76, ln. 1 (referencing WBSR Exh. 26).

<sup>95</sup> Tr., pg. 111, ln. 2-10.

<sup>96</sup> Tr., pg. 123, ln. 5-9.

<sup>97</sup> Tr., pg. 83, ln. 8-14.

application changed DDU's August 2007 total revenue requirement,<sup>98</sup> when the revenue requirement was actually reduced by \$237,518.<sup>99</sup>

All these factors describe a lack of evidentiary support for DDU's applications and the proposed rates. Both the McCartneys and the Cliffs Ratepayers argue that DDU's application should be denied on this basis alone.<sup>100</sup> The ALJ agrees. Amounts in the applications could not be verified either through DDU's exhibits or its witnesses. Therefore, the ALJ cannot determine whether DDU's proposed rates are just and reasonable. DDU has simply failed to meet its burden of proof.

## VII. REVENUE REQUIREMENT

Despite the major problems discussed above, the ALJ recognizes that the Commission might not agree that those issues justify denial of the application. For that reason, the ALJ will attempt to determine DDU's revenue requirement based on the evidence in the record.

### A. One Combined Revenue Requirement for Three Water Systems

This issue is similar to the issue of whether it is appropriate to consolidate the two water systems under one rate design. The issue here regarding the revenue requirement is whether it is appropriate to set rates for three different water systems in reliance on one revenue requirement.

#### 1. DDU's Approach

DDU grouped together the expenses for all three water systems to develop one revenue requirement. For test year 2006, DDU's revenue requirement for all three systems combined

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<sup>98</sup> Tr., pg. 86, ln. 10-13.

<sup>99</sup> Compare, DDU Exh. 30, pg. 28, Table IV.A., ln. [T] (Aug. 2007 revenue requirement of \$1,281,476) with DDU Exh. 25, pg. 14, Table IV.A., ln. [T] (Dec. 2007 revenue requirement of \$1,043,958).

<sup>100</sup> McCartneys' Closing; the Cliffs Ratepayers Closing.

was \$1,043,958 as shown in the December 2007 application.<sup>101</sup> In an effort to support its request, DDU also offered into evidence two 5-inch binders containing detailed trial balances, general ledgers, job cost usage details, and invoices. Again, DDU's detailed trial balances in its exhibits contain both water and wastewater expenses.<sup>102</sup>

## **2. WBSR's Approach**

WBSR's analysis did not rely on one revenue requirement for the three water systems. Instead, WBSR calculated three separate revenue requirements, one for each water system.<sup>103</sup> Also, WBSR looked at both the August and December 2007 applications to develop its case, with an assumption that the December 2007 application was more accurate.<sup>104</sup>

After the evidentiary hearing, WBSR amended its recommended revenue requirement based on the evidence presented. As a result of the evidence in the hearing, WBSR's ultimate recommended revenue requirement was substantially reduced. WBSR's original total revenue requirement was \$676,105, but its final recommendation regarding the total revenue requirement is \$301,813.<sup>105</sup>

## **3. The ED's Approach**

The ED employed a somewhat different approach to analyze DDU's request for a rate change. Like WBSR, the ED calculated three revenue requirements, one for each water system. Unlike WBSR, the ED considered the August 2007 application to be the proper application since DDU had not shown good cause to submit a revised application pursuant to 30 TAC § 291.25(g).

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<sup>101</sup> DDU Exh. 25, pg. 14.

<sup>102</sup> Tr., pg. 18, ln. 15-25.

<sup>103</sup> WBSR Exh. 17, pg. 65.

<sup>104</sup> WBSR Closing, pg. 6.

<sup>105</sup> WBSR Closing, pg. 15, Table 6, ln. 20.

While the ED considered the August 2007 application as the application at issue, the ED did not rely solely on DDU's application in making his calculations. According to the ED,

[Elsie Pascua, the ED's financial expert] based her calculations off the general ledger rather than the application because she had no way of knowing what expenses had been included in the application, as the amounts in the application and the general ledgers did not match. This is how she started from a different company test year revenue requirement (\$1,367,805) than what was listed in the [August 2007] application (\$1,281,476). She then made her adjustments based on the line items in the general ledgers, many of which were due to the fact that the general ledgers contained costs and expenses associated with DDU's sewer systems. Because she made so many deductions due to sewer costs and expenses, it can be assumed that at least some of those costs and expenses were in the application as well.<sup>106</sup>

As a result, the ED calculated a different revenue requirement from the other parties.

#### 4. Summary of the Parties' Recommendations of Revenue Requirements

In order to illustrate the wide disparity in the parties' positions, they are summarized below:

Item #	Description	August 2007 Application <sup>107</sup>	December 2007 Application <sup>108</sup>	WBSR Initial Recommendation <sup>109</sup>	WBSR Final Recommendation <sup>110</sup>	ED Recommendation <sup>111</sup>
1	Salaries and Wages	\$ 272,369	\$ 272,369	\$ 176,658	\$ 116,721	\$ 115,638
2	Contract Labor		-	-	-	-
3	Purchase Water	7,363	7,363	7,363	7,363	10,322
4	Chemicals for Treatment	12,300	12,300	12,300	7,427	7,427

<sup>106</sup> ED Closing, pg. 11.

<sup>107</sup> DDU Exh. 30, pg. 28.

<sup>108</sup> DDU Exh. 25, pg. 14.

<sup>109</sup> WBSR Exh. 17 (the sum of the values of all individual three water systems).

<sup>110</sup> WBSR Closing, pg. 15.

<sup>111</sup> ED Exh. 1, atts. A, B, E, F, I, and J (the sum of the values of all individual three water systems).

Item #	Description	August 2007 Application <sup>107</sup>	December 2007 Application <sup>108</sup>	WBSR Initial Recommendation <sup>109</sup>	WBSR Final Recommendation <sup>110</sup>	ED Recommendation <sup>111</sup>
5	Utilities (Electricity)	58,775	58,775	58,775	58,775	172,004
6	Repairs/Maintenance/Supplies	203,729	203,729	203,729	107,808	107,808
7	Office Expenses	5,500	5,500	5,500	5,500	5,579
8	Accounting & Legal Fees	6,100	6,100	6,100	0	0
9	Insurance	12,200	12,200	12,200	12,200	21,593
10	Rate Case Expense	4,500	4,500	0	0	0
11	Miscellaneous		-	-	-	-
<b>12</b>	<b>Subtotal</b>	<b>\$ 582,836</b>	<b>\$ 582,836</b>	<b>\$ 482,625</b>	<b>\$ 315,794</b>	<b>\$ 441,454</b>
13	Payroll Taxes	\$ 90,789	\$ 90,789	\$ 25,013	\$ 0	\$ 0
14	Property and Other Taxes	4,500	4,500	4,500	4,500	5,704
15	Annual Depreciation and Amortization	234,372	144,573	92,550	23,565	25,543
16	Income Taxes	0	5,206	0	2,121	2,121
17	Return	368,979	216,054	65,473	4,168	20,887
<b>18</b>	<b>Subtotal</b>	<b>\$ 698,640</b>	<b>\$ 461,122</b>	<b>\$ 187,536</b>	<b>\$ 34,355</b>	<b>\$ 54,255</b>
19	Other Revenues		-	-	(48,336)	(48,336)
<b>20</b>	<b>Revenue Requirement</b>	<b>\$ 1,281,476</b>	<b>\$ 1,043,958</b>	<b>\$ 670,161</b>	<b>\$ 301,813</b>	<b>\$ 447,373</b>

## 5. ALJ's analysis

DDU has failed to meet its burden of proof in this rate making proceeding. DDU does not discuss how one revenue requirement is appropriate for setting rates for all three separate water systems. The three water systems are different in terms of age,<sup>112</sup> size,<sup>113</sup> type of

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<sup>112</sup> The Cliffs' water system was purchased in 1993, the first purchase for the White Bluff system was in 1990, and the first purchase of assets for the Retreat system occurred in 2003. WBSR Exh. A, pg. 14, ln. 11-13.

development served,<sup>114</sup> and sources of water.<sup>115</sup> The ALJ agrees with WBSR and the ED that DDU should have prepared three separate revenue requirements for the three separate water systems. For this additional reason, it is the ALJ's recommendation that the Commission deny DDU's application to change its rates.

## **B. Return on Invested Capital**

Generally, a utility is entitled to "a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering [water] service to the public . . . ."<sup>116</sup> To determine a reasonable return on invested capital, a utility must prepare a list of its assets, original costs, and annual depreciation.

### **1. Depreciation Schedules**

#### **a. DDU's Position**

As an exhibit to its application, DDU prepared one depreciation schedule listing all the assets for the three water systems combined.<sup>117</sup> In its December 2007 application, DDU had the following entries for the three systems, including general items, such as trucks and backhoes, rounded to the nearest dollar:

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<sup>113</sup> The Retreat water system has 48 connections, the White Bluff system has 553 connections, and the Cliffs system has 228 connections, for a total of 829 connections. WBSR Exh. 16, ln. 9-13. DDU represents that it has 828 connections. DDU Exh. 25, pg. 15.

<sup>114</sup> The White Bluff and the Cliffs developments are more resort-style communities with a hotel and conference center that are open to the public. Tr., pg. 302, ln. 18-24. The Retreat is a private, country club-type of development with primary residential development. Tr. pg. 302, ln. 25 – pg. 303, ln. 1-4.

<sup>115</sup> The White Bluff and the Retreat water systems rely on groundwater. The Cliffs water system relies on surface water.

<sup>116</sup> TEX. WATER CODE ANN. § 13.183(a)(1).

<sup>117</sup> DDU Exh. 25, pg. 24 – 32, Table III.B., Exh. II.

	Total Original Cost	Total Annual Depreciation	Total Net Book Value
General Items <sup>118</sup>	\$ 300,100	\$ 26,502	\$ 94,295
The Cliffs <sup>119</sup>	898,290	63,504	305,309
The Retreat <sup>120</sup>	603,709	18,591	552,969
White Bluff <sup>121</sup>	1,167,269	35,965	813,434
Total <sup>122</sup>	\$ 2,969,368	\$ 144,561 <sup>123</sup>	\$ 1,766,007

DDU also entered into evidence several exhibits containing job cost usage details and invoices.<sup>124</sup> DDU provided another depreciation schedule for its assets, however, this depreciation schedule contained both water and wastewater assets.<sup>125</sup>

DDU does not explain where the various amounts shown in the exhibits can be found in the application. The ALJ attempted to reconcile the amounts shown on the summary pages of the exhibits with the amounts shown on DDU's depreciation schedule in its application. Out of Exhibits 13 through 24, the ALJ made four matches between the amounts in the depreciation schedule in the application<sup>126</sup> and the summary pages of the exhibits:

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<sup>118</sup> DDU Exh. 25, pg. 25.

<sup>119</sup> DDU Exh. 25, pg. 27.

<sup>120</sup> DDU Exh. 25, pg. 29.

<sup>121</sup> DDU Exh. 25, pg. 32.

<sup>122</sup> DDU Exh. 25, pg. 25.

<sup>123</sup> The total of \$144,561 does not match with the annual amortization expense in DDU's revenue requirement, DDU Exhibit 25, pg. 14, ln. [O], \$144,573. Although there is a \$12 discrepancy between the amounts in the depreciation schedule and the revenue requirement, the ALJ assumes those two amounts should be identical.

<sup>124</sup> DDU Exh. 13-24.

<sup>125</sup> DDU Exh. 12.

<sup>126</sup> DDU Exh. 25, pg. 24-32.

DDU's Exhibit	Amount	Asset in DDU's Application	Discussion
Exhibit 14, pg. 1	\$ 8,882	White Bluff, "structures/improvement" matches Exh. 25, pg. 8.	Job Cost Usage Detail entry is for "Engineering Water System."
Exhibit 18, pg. 1	80,770	Cliffs, "Reverse Osmosis," matches Exh. 25, pg 27.	
Exhibit 23, pg. 9	58,942	Retreat, "Well," matches Exh. 25, pg. 28.	Amount is "20%" of amount on job cost usage detail, no invoices to support. The term "20%" may refer to DDU's cost as opposed to developer contributions.
Exhibit 24, pg. 1	115,909	Retreat, "Distribution System," matches Exh. 25, pg. 6.	Amount includes entries for wastewater, golf course, and wastewater treatment plant. No invoices to support amounts.

**b. WBSR's Position**

WBSR complains about the different net book values for its assets that DDU has put forth in this and other proceedings. Below is a WBSR's summary of the different representations DDU has made regarding the value of its assets.

**WBSR's Table 5: Comparison of Net Book Value of Assets per Various DDU Documents<sup>127</sup>**

	Total
August 2007 Application <sup>128</sup>	\$ 1,782,176
December 2007 Application <sup>129</sup>	1,766,007
DDU Balance Sheet <sup>130</sup>	873,544
Asset Listing Provided During Discovery and Relied Upon by WBSR <sup>131</sup>	2,088,294
October 2008 Application <sup>132</sup>	1,904,489

<sup>127</sup> WBSR Closing, pg. 11. The footnotes in the table were prepared by WBSR.

<sup>128</sup> DDU Exh. 30, pg 27.

<sup>129</sup> DDU Exh. 25, pg. 13.

<sup>130</sup> DDU Exh. 34, pg. 1. (ALJ unable to locate \$873,544 on pg. 1, DDU Exh. 34).

<sup>131</sup> WBSR Exh. 13, pg. 61.

<sup>132</sup> WBSR Exh 24, pg. 2. (The October 2008 application is a rate case DDU filed after the 2007 rate change application at issue here).

WBSR notes that although the October 2008 application has a higher net book value than the December 2007 application that is the subject of this proceeding, none of the assets were installed after 2006, the test year in this proceeding.<sup>133</sup>

WBSR also argues that DDU “did not exercise prudence in the installation of infrastructure at the Retreat,” which affects its annual depreciation expense.<sup>134</sup> Specifically, WBSR’s witness, Nelissa Heddin, testified that the Retreat was overbuilt, therefore, much of the infrastructure was not used and useful in providing water utility service. According to Ms. Heddin, at the end of the test year, there were only 48 active connections at the Retreat.<sup>135</sup> However, the Retreat’s distribution system was installed to serve approximately 1,900 homes,<sup>136</sup> and the plant infrastructure was installed to serve approximately 400 homes.<sup>137</sup> Therefore, a large percentage of the infrastructure is not used and useful in providing service and the cost of overbuilding the Retreat should not be born by the current ratepayers. WBSR would reduce the ED’s recommended depreciation expense by 75 percent. WBSR would also reduce the ED’s determination of net book value for the Retreat water system by 75 percent because the Retreat is overbuilt and 75 percent of the system is not used and useful.<sup>138</sup> WBSR makes the following recommendation regarding the net book value and proper depreciation expense for DDU.

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<sup>133</sup> WBSR Closing, pg. 10.

<sup>134</sup> WBSR Closing, pg. 23.

<sup>135</sup> WBSR Exh. 4, pg 41, ln 2, column [C] amended, during hearing to 48.

<sup>136</sup> Tr., pg. 146, ln. 6 and Tr., pg. 283-284.

<sup>137</sup> Tr., pg. 146, ln. 5 and Tr., pg. 284-285.

<sup>138</sup> WBSR Closing, pg. 26.

**WBSR’s Table 8. Recommended Adjusted Net Book Value<sup>139</sup>**

	White Bluff	The Retreat	The Cliffs	Total
TCEQ’s Adjusted Net Book Value of Assets	\$143,602	\$125,782	\$47,434	\$316,818
Less 75% for Assets Not Currently Used and Useful		(95,087)		221,731

**WBSR’s Table 7. Recommended Adjusted Depreciation Expense<sup>140</sup>**

	White Bluff	The Retreat	The Cliffs	Total
TCEQ Adjusted Annual Depreciation Expense <sup>141</sup>	\$12,113	\$2,637	\$10,793	\$25,543
Adjusted for Current Connection Used and Useful <sup>142</sup>	12,113	659	10,793	23,565

**c. OPIC’s Position**

Regarding whether DDU exercised prudence in sizing the Retreat water system, OPIC is persuaded that DDU used prudent business judgment in the buildout at the Retreat.<sup>143</sup> OPIC bases its recommendation on Mr. Gracy’s 26 years of experience and the principle that prudence should be measured at the time of construction and not in hindsight. Therefore, OPIC concludes that “the full cost of service associated with the Retreat that has been reliably substantiated by evidence should be included in the rate base.”<sup>144</sup>

**d. The ED’s Position**

Brian Dickey testified on behalf of the ED. In an effort to verify installation dates and original cost of DDU’s plants and equipment, Mr. Dickey made a site visit to the three water

<sup>139</sup> WBSR Closing, pg. 29, as corrected.

<sup>140</sup> WBSR Closing, pg. 25.

<sup>141</sup> ED Exh. 1, atts. A (\$2,637), E (\$10,793), and I (\$12,113).

<sup>142</sup> WBSR “multiplied TCEQ adjusted expense for the Retreat by 25%.” WBSR Closing, p. 25, n. 149.

<sup>143</sup> OPIC Closing, pg. 7.

<sup>144</sup> OPIC Closing, pg. 7.

systems on November 14, 2008.<sup>145</sup> He also made an office visit on January 28 and 29, 2008.<sup>146</sup> He reviewed TCEQ’s official CCN files and determined that there were no previous rate case orders that established a rate base for the utility.<sup>147</sup> The ED also requested invoices and supporting documentation from DDU during the application review process, during an audit of the utility, and through discovery. The ED represents that DDU supplied invoices and documentation for some of its assets but not for all.<sup>148</sup> The following is the depreciation table of assets that, in the ED’s opinion, DDU has adequately supported:

	<b>DDU’s Total Claimed Original Cost</b>	<b>Ver/Est. Original Cost</b>	<b>Annual Depreciation</b>	<b>Total Net Book Value<sup>149</sup></b>
The Cliffs <sup>150</sup>	\$ 1,135,770	\$ 101,137	\$ 10,793	\$ 47,434
The Retreat <sup>151</sup>	564,190	131,832	2,637	125,782
White Bluff <sup>152</sup>	1,457,930	186,425	12,113	143,602
Total	\$ 3,157,890	\$ 419,394	\$ 25,543	\$ 316,818

The “Claimed Original Cost” is that cost claimed by DDU in its August 2007 application<sup>153</sup> plus an amount the ED allocated to each individual water system for the use of the general items, like trucks and backhoes.<sup>154</sup> The “Ver/Est. Original Cost” is the ED’s recommendations of the original cost of assets based on what Mr. Dickey could verify from a review of invoices and other documentation.

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<sup>145</sup> ED Exh. 2, pg. 5, ln. 1-3.

<sup>146</sup> ED Exh. 2, pg. 5, ln. 1-6.

<sup>147</sup> ED Exh. 2, pg. 5, ln. 6-17.

<sup>148</sup> ED Exh. 2, pg. 6, ln. 6-9.

<sup>149</sup> This amount includes the general assets allocated to each system on the basis of the number of connections. The ALJ is construing the terms “net plant” and “net book value” as synonymous terms.

<sup>150</sup> ED Exh. 2, att. D.

<sup>151</sup> ED Exh. 2, att. C.

<sup>152</sup> ED Exh. 2, att. B.

<sup>153</sup> DDU Exh. 30, pg. 16-24.

<sup>154</sup> ED Exh. 2, atts. B, C, and D.

**e. The ALJ's Analysis**

DDU has failed to meet its burden of proof because it did not support the amounts listed in its depreciation schedule in its December 2007 application. DDU has presented the ALJ with pages and pages of documents in its exhibits that the ALJ cannot reconcile with the depreciation schedule in the application. It has supported the cost of some assets with invoices but has not provided sufficient documentation to support all its claims. As WBSR points out, there are conflicting amounts for what should properly be reflected by the depreciation schedule.

DDU takes issue with the ED for disallowing such large amounts of expenses and assets. In its closing, DDU states that in 2001, many of the assets were accepted by the ED in an uncontested rate case. DDU states that “[m]any of the depreciable assets listed in the DDU Depreciation Schedule ([DDU] Ex. 12, Pg.1) were scheduled in the 2001 Application, which was not contested by TCEQ.”<sup>155</sup> However, DDU made no reference to the record for evidentiary support for that statement, and the 2001 depreciation schedule is not part of this record. While the ALJ understands DDU’s apparent frustration that the ED allegedly accepted a similar depreciation schedule in 2001, a previous acceptance does not relieve DDU of meeting its burden of proof in this hearing on this application when there is no previous TCEQ order establishing a rate base.

DDU also asserts that the ED applied an unreasonable standard in the analysis of its assets. In the TCEQ’s application form, the instructions advise that an applicant is “responsible for supporting [its original cost] information with invoices *or other documentation*.”<sup>156</sup> DDU argues that its accounting documents qualify as “other documentation” and should be sufficient to support the original costs of its assets and the amount of its expenses. In his sole testimony in DDU’s rebuttal case, Mr. Gillespie, Jr. testified that in the 15 to 20 rate applications he has worked on in his 45 years of experience, he “had seen a case where a rate was approved without

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<sup>155</sup> DDU Closing, pg. 3.

<sup>156</sup> *See generally*, DDU Exh. 25, pg. 10 (emphasis added).

presenting an invoice for every asset or expense.”<sup>157</sup> He stated that in those applications, “site visits were made, and I think a determination that the assets existed and the general recognition that it was – in these cases, were new systems and the assets were there, the existence of the asset.”<sup>158</sup>

The difficulty with DDU’s argument is that there are discrepancies between the amounts in the application and the amounts in DDU’s accounting documents found in its exhibits. Therefore, relying solely on the accounting documents without more substantiation of the original costs of the assets will not meet DDU’s burden of proof. DDU provided no references to its exhibits to establish its costs and the ALJ was generally unable to reconcile the amounts in the exhibits with the amounts in the application. Furthermore, assuming *arguendo* that accounting documents qualify as “other documentation,” DDU’s accounting documents include costs and expenses attributable to both the water and wastewater systems. The short-hand notations in its job cost usage details are simply insufficient to demonstrate the original costs of the assets. Also, as Ms. Pascua pointed out, an invoice could verify a ledger entry because in her experience, what is shown in a utility’s ledger is not always supported by the actual invoice.<sup>159</sup>

To further demonstrate its argument, DDU uses a water storage tank and “structures” as examples of assets that the ED disallowed by imposing an unfair standard upon DDU. Regarding the water storage tank, DDU notes that it listed \$98,182 for a tank for the White Bluff system on a depreciation schedule found on page 1 of DDU Exhibit 12.<sup>160</sup> DDU argues that the ED disallowed this asset because there was no water storage tank shown on in the depreciation schedule in the application for \$98,182.<sup>161</sup> The amount shown on the application for the water storage tank was \$96,240. DDU argues that the ED should not have disallowed the asset because of a \$1,942 discrepancy between the application and documentation submitted by DDU to

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<sup>157</sup> Tr., pg. 246, ln. 5-9.

<sup>158</sup> Tr., pg. 246, ln. 10-16.

<sup>159</sup> Tr., pg. 184, ln. 1-12.

<sup>160</sup> DDU Closing, pg. 3.

<sup>161</sup> DDU Closing, pg. 3, referring to Mr. Dickey’s testimony, Tr. pg. 231, ln. 11-12.

support the asset. At a minimum, DDU contends that the ED should have allowed the asset for the lower cost shown in the application because DDU provided documentation to support a higher cost.

The problem with this example is that it is unclear which storage tank DDU is trying to support with its documentation. In its application, DDU listed three water storage tanks at White Bluff with three different original costs and three different dates of installation.<sup>162</sup> DDU's depreciation schedule in Exhibit 12 only lists one water storage tank at White Bluff. The single water storage tank shown on DDU's Exhibit 12 has an "acquired date" of September 2001.<sup>163</sup> None of the three water storage tanks in the application have that same date of installation. Neither the amount nor the date of installation shown for the tank in Exhibit 12 corresponds with any of the amounts and acquisition dates for the three tanks shown in the application. DDU provided no testimony to allow the ALJ to connect the one tank in Exhibit 12 with any of the three tanks in the application.

DDU also argues that the ED inappropriately disallowed an asset involving "Structures" that was listed on both of DDU's depreciation schedules in Exhibit 12 and its application<sup>164</sup> for the amount of \$8,882.68.<sup>165</sup> DDU argues that it also provided a job cost usage detail with supporting documentation in the form of a check and an "Accounts Payable Coding Form" in the amount of \$8,882.68. It is DDU's position that this provided sufficient evidence that the "Structures" were depreciable assets that the ED should not have disallowed.

The ALJ disagrees that DDU provided sufficient documentation of the asset "Structures." DDU's depreciation schedule in the December 2007 application refers to "Structures" in the amount of \$8,882.58. However, DDU's accounting documentation includes assets and expenses attributable to both its water and wastewater systems. Therefore, a reference to "structures" in

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<sup>162</sup> DDU Exh. 25, pg. 31.

<sup>163</sup> DDU Exh. 12, pg. 1.

<sup>164</sup> DDU Exh. 25, pg. 23.

<sup>165</sup> DDU Closing pg. 4.

its accounting documents without an explanation could include structures used by the wastewater system. A review of the depreciation schedule in DDU Exhibit 12 shows references to “water & sewer,” “engineering waste water,” “Retreat wast [sic] treatment plant,” and “Retreat water/sewer system.” Based on DDU’s accounting documents, it is unclear whether the “structures” are used and useful solely in providing water service.

Furthermore, the job cost usage detail in Exhibit 14 shows that DDU incurred a cost of \$8,882.68 for an “Engineering Wtr system” not for a “structure.”<sup>166</sup> The “Accounts Payable Coding Form” in Exhibit 14 shows that DDU also incurred a cost of \$8,882.68 for “Engineering Wtr System” and “Engineering – Water System Improvements at WB.”<sup>167</sup> Other than the summary page prepared for the hearing,<sup>168</sup> there is no reference in DDU’s supporting documentation in Exhibit 14 that the \$8,882.68 was the original cost of any “Structures” as shown in the application. DDU did not provide testimony to clarify this entry.

In summary, it is the ALJ’s opinion that DDU failed to meet its burden of proof to support all of the assets and amounts listed in its depreciation schedule in its application. In the event the Commission decides to grant DDU’s application, the ALJ recommends that the net book value and the depreciation expense on the depreciation schedules developed by the ED be used to calculate a reasonable rate for each individual water system. The ALJ does not recommend reducing the depreciation expense or the net book value for the Retreat by 75 percent, as recommended by WBSR because the Retreat is allegedly overbuilt. Mr. Gracy testified that the Retreat is designed for approximately 300 to 400 customers.<sup>169</sup> In Mr. Gracy’s opinion, to design a water system to serve fewer connections would make it more expensive in the long term, since a utility would have to expand its systems more often.<sup>170</sup> Therefore, the ALJ would recommend that, in the event the Commission grants DDU’s application, the Commission

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<sup>166</sup> DDU Exh. 14, pg. 2.

<sup>167</sup> DDU Exh. 14, pg. 4.

<sup>168</sup> DDU Exh. 14, pg. 1.

<sup>169</sup> Tr., pg. 284, ln. 19 – pg. 285, ln. 7.

<sup>170</sup> Tr., pg. 284, ln. 15-18.

utilize the ED's adjustments for annual depreciation and net book value without a reduction for that portion of the plant WBSR contends is not used and useful.

## 2. Invested Capital, Rate of Return, and Return

To determine the amount of a utility's invested capital, a utility's net book value, working cash allowance,<sup>171</sup> and materials and supplies are added together as components of invested capital.<sup>172</sup> The developer contributions are then deducted from that total to determine the total invested capital since developer contributions are not included in the rate base.<sup>173</sup>

To calculate a utility's rate of return (ROR) on its invested capital, a utility utilizes a ROR worksheet.<sup>174</sup> The number of factors a utility meets on the worksheet determines the ROR. The ROR is then used to determine the weighted average cost of "investment/equity" of the utility.<sup>175</sup> Once the weighted average cost of equity is determined, it is added to the total weighted average cost of debt. The resultant weighted rate of return is then used to calculate the amount of the utility's return on invested capital. This return is then included in the utility's revenue requirement.

### a. DDU's Position

To determine its invested capital for all three systems combined, DDU showed on its application a net book value of \$1,766,007, working cash allowance of \$72,855, and materials

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<sup>171</sup> The working cash allowance is one-eighth of the operations and maintenance expense total, which is the total of line A through K on table VI.A. 30 TAC § 291.31(c)(2)(B)(iii); ED Exh. 1, pg 16, ln. 24 – 25, atts. F – G, U at 28.

<sup>172</sup> 30 TAC § 293.31(c)(2).

<sup>173</sup> *Id.* § 293.31(c)(3)(A)(iv). The ED represents that developer contributions are considered contributions in aid of construction. However, developer contributions may be more properly classified as cost free capital and excluded from the rate base under by section 291.31(c)(3)(A)(v).

<sup>174</sup> See DDU's Exh. 32 for an example of the ROR worksheet.

<sup>175</sup> See generally, DDU's Exh. 25, pg. 12, Table IV.D, boxes 4 and 7.

and supplies of \$1,500 for a total of \$1,840,362.<sup>176</sup> DDU shows -0- for developer contributions.<sup>177</sup>

DDU seeks an ROR of 12 percent and DDU's Exhibit 32 is its ROR worksheet. DDU claimed that it met all the factors and thereby calculated a 12.48 percent ROR on its investment, rounded to 12 percent. However, DDU did not explain how it met many of the factors on the ROR worksheet.<sup>178</sup>

In determining the weighted average cost of debt DDU has in the three water systems, DDU showed an unpaid balance of \$734,990 on a loan from Double Diamond Delaware, Inc.<sup>179</sup> the interest rate on this loan from its "parent company," Double Diamond Delaware, Inc., is 10 percent.<sup>180</sup> Mr. Gracy testified that 10 percent was a reasonable amount of interest at the time in 1997<sup>181</sup> as determined by "the mutual decision between Double Diamond Utilities and Double Diamond Delaware."<sup>182</sup> Mr. Gracy assumes the 10 percent interest rate is still reasonable since the "finance department" has not informed Mr. Gracy that the rate is unreasonable.<sup>183</sup> DDU did not present other evidence on the reasonableness of the 10 percent interest rate.

In determining the weighted average cost of equity, DDU listed \$3,024,118 as its equity in the three water systems combined.<sup>184</sup> That is more than \$1.2 million higher than the \$1,766,007 in net book value previously discussed. When Mr. Gillespie, Jr. was asked in his prefiled testimony how the amount of equity was derived, the answer to that question was left

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<sup>176</sup> DDU Exh. 25, pg. 13, Table IV.E., ln. [A] – [D].

<sup>177</sup> DDU Exh. 25, pg. 13, Table IV.E., ln. [E].

<sup>178</sup> DDU Exh. C, pg. 5, ln. 2-41.

<sup>179</sup> DDU Exh. 25, pg. 12, Table IV.D. Column [E].

<sup>180</sup> Tr. pg. 53, ln. 5-8; DDU Exh. 25, pg. 12.

<sup>181</sup> DDU Exh. 27, pg. 1. The loan is dated January 13, 1997.

<sup>182</sup> Tr., pg. 40, ln. 14-16; pg. 41, ln. 12-18.

<sup>183</sup> Tr., pg. 42, ln. 3-6.

<sup>184</sup> DDU Exh. 25, pg. 11.

blank.<sup>185</sup> DDU used 12 percent from the ROR worksheet to calculate its weighted average cost of investment/equity.<sup>186</sup>

Combining the weighted average cost of debt and equity, DDU calculated a weighted rate of return of 11.6 percent.<sup>187</sup> DDU used this 11.6 percent to determine its return on its total invested capital of \$1,840,362 for a return of \$213,482.<sup>188</sup>

The TCEQ application instructs DDU to carry its \$213,482 return on invested capital to its revenue requirement calculations.<sup>189</sup> However, DDU's revenue requirement in Table VI.A.<sup>190</sup> shows a return of \$216,054, a \$2,572 discrepancy from the amount listed in Table IV.E, line [H].<sup>191</sup>

Below is a summary of DDU's calculations regarding its total invested capital and return.<sup>192</sup>

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<sup>185</sup> DDU Exh. C, pg. 6, ln. 29-31.

<sup>186</sup> DDU Exh. 25, pg. 12, box 4.

<sup>187</sup> DDU Exh. 25, pg. 12.

<sup>188</sup> DDU Exh. 25, pg. 13, Table IV.E., ln. [H].

<sup>189</sup> DDU Exh. 25, pg. 13, Table IV.E., ln. [H]; DDU Exh. 25, pg. 14, Table VI.A., ln [P].

<sup>190</sup> DDU Exh. 25, pg. 14, ln. [Q].

<sup>191</sup> DDU Exh. 25, pg. 13, Table IV.E., ln. [H], *see also*, Table V., ln. [A].

<sup>192</sup> DDU Exh. 25, pg. 13, Table IV.E.

DDU's Net Book Value of Assets	\$ 1,766,007
Working Cash Allowance	72,855
Materials and Supplies	1,500
Subtotal	\$ 1,840,362
Subtract Developer Contributions <sup>193</sup>	0
Total Invested Capital	\$ 1,840,362
Rate of Return	11.6%
Return	\$ 213,482

**b. WBSR's Position**

WBSR makes several recommendations to adjust DDU's return and its rate of return on invested capital. While DDU calculated its return based on the combined assets of the three water systems, WBSR analyzed the three systems separately.

First, WBSR argues that DDU failed to deduct developer contributions from DDU's net book value. WBSR claims that due to the conflicting evidence, the correct amount of developer contributions to the three water systems cannot be determined.<sup>194</sup> As a solution, WBSR suggests that based on DDU's testimony, the cost of assets as verified by the ED be reduced by 80 percent. Mr. Gracy testified that "Double Diamond Utilities pays for 20 percent of the distribution and collection lines that go into the service territory of DDU" and that "developers . . . contribute the remaining assets."<sup>195</sup>

Second, WBSR contends that the interest rate for the loan between DDU and its affiliated interest should be reduced to zero percent because DDU failed to put on evidence that the

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<sup>193</sup> Mr. Gillespie, Jr. testified that total invested capital is the "sum" of net book value, working cash allowance, and allowable materials. DDU Exh. C, pg. 6, ln. 33-41. This is incorrect according to the TCEQ's application form. Developer contributions are subtracted from these entries. See, DDU Exh. 25, pg. 13, Table IV.E., ln. [F].

<sup>194</sup> WBSR Closing, pg. 26.

<sup>195</sup> Tr., pg. 42, ln. 9-16.

interest rate is reasonable.<sup>196</sup> WBSR also argues that since DDU testified that the loan was predominantly for operating expenses, such a use of the loan is not an allowable purpose for the rate of return calculations.

WBSR prepared a table showing its adjustments to DDU's return calculations:

**WBSR Table 8: Revised Return Calculation<sup>197</sup>**

	White Bluff	The Retreat	The Cliffs	Total
ED's Adjusted Net Book Value of Assets <sup>198</sup>	\$ 143,602	\$ 126,782 <sup>199</sup>	\$ 47,434	\$ 317,818
Less Reduction for Currently Used and Useful <sup>200</sup>	-	(95,087)	-	(95,087)
Working Cash Allowance <sup>201</sup>	31,588	5,905	17,690	55,182 <sup>202</sup>
Materials and Supplies <sup>203</sup>	2,513	225	1,013	3,751
Subtotal	\$ 177,703	\$ 37,825	\$ 66,137	\$ 281,664
Less Developer Contributions <sup>204</sup>	(114,882)	(25,356)	(37,947)	(178,185)
Total Invested Capital	\$ 62,821	\$ 12,469	\$ 28,189	\$ 103,479
Rate of Return <sup>205</sup>	3.65%	9.75%	2.34%	
Return	\$ 2,293	\$ 1,216	\$ 660	\$ 4,168

<sup>196</sup> WBSR Closing, pg. 27.

<sup>197</sup> WBSR Closing, pg. 29. The footnotes in WBSR Table 8 were prepared by WBSR, unless otherwise noted in parentheses.

<sup>198</sup> ED Exh. 1, atts B, G, and K. (The correct ED exhibit for the Retreat is ED Exh. 1, att. C.).

<sup>199</sup> (The correct amount is \$125,782, which changes the totals for the total of the ED's adjusted net book value, total invested capital, and return. The correction also impacts WBSR's calculations regarding the Retreat's total invested capital and return.).

<sup>200</sup> (WBSR asserts that this 75% adjustment will rectify the situation created by DDU by overbuilding the Retreat so that current ratepayers will only pay for that part of the Retreat system that is used and useful in providing water service.)

<sup>201</sup> Calculated as subtotal of operations and maintenance from Table 1, divided by 8.

<sup>202</sup> (The correct amount is \$55,183.).

<sup>203</sup> ED Exh. 1, atts. B, G, and K.

<sup>204</sup> Calculated as TCEQ adjusted net book value of assets plus reduction for currently used and useful times 80%.

<sup>205</sup> ED Exh. 1, atts. B, G, and K.

**c. OPIC's Position**

OPIC refers to 30 TAC § 291.31(c)(1)(A) and its directive that the return should be sufficient to assure the financial soundness of the utility.<sup>206</sup> OPIC points out that under section 291.31(c)(1)(A), the return should be adequate, “under efficient and economical management, to maintain and support [the utility’s] credit and enable it raise money necessary for the proper discharge of its public duty.” According to OPIC, there is testimony in the record that DDU has not been guided by “efficient and economical management.”<sup>207</sup> Relying on the testimony of the ED’s witness, Elsie Pascua, DDU would have been entitled to a greater return if it had invested its loan proceeds into capital investment instead of using it for operational expenses, in addition to properly recording its assets and expenses.<sup>208</sup> Therefore, OPIC supports the ED’s assessment regarding DDU’s return.

**d. The ED’s Position**

The ED calculated total invested capital and return separately for each water system. The ED reviewed DDU’s ROR worksheet, prepared ROR worksheets for each individual water system, and made adjustments.<sup>209</sup> For each system, the ED disallowed several percentage points because DDU failed to provide documentation that it met the required factors. The ED calculated the following RORs for each water system: The Cliffs, ROR of 8.48 percent; the Retreat, ROR of 10.48 percent; and White Bluff, ROR of 8.48 percent.<sup>210</sup>

The ED disagreed with the 10 percent interest rate DDU claimed for its loan with its affiliated interest, Double Diamond Delaware, Inc. Ms. Pascua testified:

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<sup>206</sup> OPIC Closing, pg. 5.

<sup>207</sup> OPIC Closing, pg. 6.

<sup>208</sup> OPIC Closing, pg. 6, citing Tr., pg. 205, ln. 2-21.

<sup>209</sup> ED Exh. 1, att. R.

<sup>210</sup> ED Exh. 1, att. R.

Staff calculated an interest rate of 4.87% to use in lieu of the 10% rate because DDU's loan transaction was with an affiliated company with an affiliated interest and was not an arm's length transaction. DDU is a Qualified Subchapter S Subsidiary (QSub) of [Double Diamond Delaware, Inc.] and is not treated as a separate company for federal tax purposes. Rather, its assets, liabilities, and all items of income, deduction, and credit are treated as those of the parent S Corporation, [Double Diamond Delaware, Inc.]. Therefore, any income incurred by DDU belongs to the parent company, including any interest on the loan that DDU collects from its customers through its rates.<sup>211</sup>

The ED then allocated the unpaid balance of the loan between the three water systems to determine each system's individual weighted ROR.

Below is a summary of the ED's adjustments to DDU's total invested capital, rate of return, and return.<sup>212</sup>

	<b>White Bluff</b>	<b>The Retreat</b>	<b>The Cliffs</b>	<b>ED's Total</b>
ED's Adjusted Net Book Value of Assets	\$143,602	\$125,782	\$47,434	\$316,818
Working Cash Allowance	31,588	5,905	17,690	55,183
Materials and Supplies	2,513	225	1,013	3,751
Total Invested Capital	\$177,702	\$131,912	\$66,136	\$375,752
Rate of Return	3.65%	9.75%	2.34%	
Return	\$6,485	\$12,857	\$1,545	\$20,887

**e. Summary**

To show the magnitude of the difference between the parties' recommendations, each total is summarized below.

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<sup>211</sup> ED Exh. 1, pg. 16, ln. 14-21.

<sup>212</sup> ED Exh. 1, atts. B, G, and K.

	<b>Applicant's Totals</b>	<b>WBSR's Totals<sup>213</sup></b>	<b>ED's Total</b>
Net Book Value of Assets	\$1,766,007	\$316,818	\$316,818
Less Used and Useful Adjustments		(95,087)	
Working Cash Allowance	72,855	55,183	55,183
Materials and Supplies	1,500	3,751	3,751
Subtotal	\$1,840,362	\$280,665	\$375,752
Less Developer Contributions		(178,185)	
Total Invested Capital	\$1,840,362	\$102,480	\$375,752
Weighted Average Rate of Return			
White Bluff		3.65%	3.65%
The Retreat		9.75%	9.75%
The Cliffs		2.34%	2.34%
DDU one ROR	11.6%		
Return	\$213,482	\$4,168	\$20,887

**f. The ALJ's Analysis**

The ALJ has several concerns with DDU's total invested capital, rate of return, and return on investment. Foremost, as previously discussed, is the failure of DDU to account for any developer contributions in its application. In calculating a utility's invested capital, developer contributions are subtracted from the utility's total of net book value, working cash allowance, and materials and supplies. There is credible evidence in the record that DDU should have declared at least some amount as developer contributions. DDU made no attempt to clarify the record in its rebuttal case or closing arguments. Therefore, based on the evidentiary record, the accuracy of DDU's representation in its application that its total invested capital is \$1,840,362 is suspect. Since its ROR and its actual return are based on its total invested capital, the ALJ has no confidence that any water rates ultimately determined from its total invested capital will be just and reasonable.

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<sup>213</sup> As corrected.

There are other issues that cast doubt on the accuracy of DDU's calculations. In determining its rate of return, DDU filled out one ROR worksheet for all three water systems.<sup>214</sup> In this worksheet, DDU claimed that it met every factor to arrive at an ROR of 12.48 percent. However, there is little in the evidentiary record to show that DDU met many of the conditions that would entitle it to additional percentage points in its ROR, and the ED reduced the ROR accordingly. In his prefiled testimony, Mr. Gillespie, Jr. testified that that DDU met "at least four of the five conditions" but he did not specify which conditions DDU met or explain how it met the conditions.<sup>215</sup> On cross-examination, Mr. Gillespie, Jr. was questioned on Step D of the ROR worksheet, and he stated that DDU met two conditions: unstable population and low growth. He stated that DDU "probably" met the condition of aging systems.<sup>216</sup> He stated that he does not have quantitative numbers or anything to prove it but claimed to know that DDU has low growth and an unstable population because "it's a resort."<sup>217</sup> On re-direct, he testified that there are guidelines on how to determine those conditions.<sup>218</sup> When asked if DDU "met those, at least two of those," Mr. Gillespie, Jr. only said that "[w]e use those guidelines, yes."<sup>219</sup>

Mr. Gillespie, Jr.'s testimony is contradicted by the testimony of Mr. Gracy, DDU's president. Mr. Gracy testified that the Cliffs and the White Bluff developments were resort communities.<sup>220</sup> The Retreat is a country-club type of development, with an expected faster buildout than White Bluff and the Cliffs. The Retreat is closer to the metroplex and is "more of a primary residential development as opposed to the others being resort[s]."<sup>221</sup> Furthermore, the Retreat was started in 2003, negating the assertion that DDU as a whole is an aging system.<sup>222</sup>

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<sup>214</sup> DDU Exh. 32.

<sup>215</sup> DDU Exh. C, pg. 5, ln 18-33.

<sup>216</sup> Tr., pg. 108, ln. 25 – pg. 109, ln. 4.

<sup>217</sup> Tr., pg. 109, ln. 5-13.

<sup>218</sup> Tr., pg. 121, ln. 13-22.

<sup>219</sup> Tr., pg. 121, ln. 18-25.

<sup>220</sup> Tr., pg. 302, pg. 18 – pg. 303, ln. 8.

<sup>221</sup> Tr., pg. 302, pg. 18 – pg. 303, ln. 8.

<sup>222</sup> Tr., pg. 302, ln. 8-10.

Therefore, it appears that all three water systems combined do not meet the two conditions of aging system and unstable population.

Furthermore, at least one of DDU's representations on its ROR worksheet is clearly erroneous. On Step E of the worksheet, Mr. Gillespie, Jr. testified that DDU added 1.00 percent to its ROR because DDU "is a stand alone system . . . ." <sup>223</sup> However, Mr. Gillespie, Jr. misstates the criterion on the worksheet to be entitled to this additional 1.00 percent. The ROR worksheet provides that a utility can add 1.00 percent if it is "a stand alone *sewer* system . . . ." <sup>224</sup> This is a water rate case, and DDU does not meet this condition to entitle it to an additional 1 percent in its ROR.

In Step B of its worksheet, DDU added 2.00 percent to its ROR because it claimed it was a utility of 200 or less connections. <sup>225</sup> Mr. Gillespie, Jr. testified that the Retreat is a small utility with less than 200 customers. <sup>226</sup> However, DDU did not fill out the ROR worksheet for the Retreat alone. DDU chose to combine all three water systems together for a total of 828 connections. <sup>227</sup> Therefore, it is inappropriate for DDU to claim a percentage point for a small system of less than 200 connections when it has combined all three systems together for a total of 828 connections.

Regarding DDU's equity, DDU fails to support the amount of equity it claims in its systems. DDU represented that its equity "in the utility" is \$3,024,118. <sup>228</sup> When asked how that number was calculated, DDU's witness did not provide an answer. <sup>229</sup> The ED stated that a utility's equity is equal to the total invested capital minus unpaid loans. <sup>230</sup> Applying that

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<sup>223</sup> DDU Exh. C, pg. 5, ln. 22-25.

<sup>224</sup> DDU Exh. 32 (emphasis added).

<sup>225</sup> DDU Exh. 32.

<sup>226</sup> DDU Exh. C, pg. 5, ln. 14-16.

<sup>227</sup> Only the Retreat water system has less than 200 connections.

<sup>228</sup> DDU Exh. 30, pg. 11, Sec. IV.C.

<sup>229</sup> DDU Exh. C, pg. 6, ln. 29-31.

<sup>230</sup> ED Closing, pg. 19.

formula, subtracting DDU's unpaid loan balance of \$734,990 from its claimed total invested capital of \$1,840,362 equals \$1,105,372, not the \$3,024,118 claimed by DDU. Therefore, the ALJ cannot determine how DDU calculated its equity of \$3,024,118. Again, since the weighted average rate of return is based on the utility's equity, DDU has not met its burden of proof to show that it properly calculated its return on its invested capital.

In the event the Commission decides to grant DDU's application, the ALJ recommends that the Commission adopt the methodology utilized by the ED in calculating the invested capital, ROR, and return on invested capital. The ED analyzed each system individually and allocated the unpaid loan amount to each system based on the number of connections or the identified purpose of the loan. The ED recognized that the loan between DDU, the QSub, and its parent S Corporation is a loan between affiliated interests and the ED adjusted the interest rate accordingly. Except for Mr. Gracy's general conclusion that the 10 percent interest rate is reasonable, DDU provided no other evidence on the issue to support his conclusion. Regarding the ROR, the ED considered the conditions and factors for each individual water system and derived an ROR unique to each. Based on these and other factors, the ED's approach in determining DDU's invested capital and return is more reasoned and more accurate.

The ED does not address developer contributions in his analysis. The ED stated that "if the ALJ calculates rates that would result in a rate change, the ED recommends that the ALJ look at the developer contribution asset list [from the pending October 2008 application] and compare it to DDU's depreciation schedule to determine which items need to be removed from the rate base."<sup>231</sup>

The ALJ is reluctant to use the October 2008 developer contribution list prepared by another consultant in another rate case to make further reductions in DDU's total invested capital, or rate base. There is no evidence in the record regarding the accuracy of that other list. Its inclusion in this record raises legitimate questions about the accuracy of DDU's calculations in this case. Furthermore, the ED made drastic reductions in DDU's rate base generally due to

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<sup>231</sup> ED Closing, pg. 14.

DDU's failure to substantiate the original costs of its assets, not because the listed assets were not used and useful. The ED verified that many assets are in use at the utility<sup>232</sup> but the assets were excluded from the depreciation schedule because DDU did not prove up the assets' original costs.<sup>233</sup> Therefore, the issue is an evidentiary one. For these reasons, the ALJ declines to use DDU's October 2008 developer contribution list to make further reductions in DDU's rate base.

### **C. Operation and Maintenance Expenses**

A utility may recover a reasonable return on its invested capital over and above its reasonable and necessary operating expenses.<sup>234</sup> As with DDU's failure to support the amount claimed for its invested capital, DDU also failed to fully support its allowable expenses. The following discussion outlines the parties' disagreement with DDU's claims of allowable expenses that are reasonable and necessary to providing water service.

#### **1. Salary or Contract Services and Payroll Taxes**

##### **a. DDU's Position**

In its application, DDU asserts that its salary and wage expenses are \$272,369 for all three water systems combined.<sup>235</sup> DDU also listed a payroll tax expense of \$90,789.<sup>236</sup>

In the August 2007 application, DDU included an "Exhibit I" to the application that purports to list DDU's employees for the three systems.<sup>237</sup> This Exhibit I to the August 2007

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<sup>232</sup> Tr., pg. 233, ln. 2-13.

<sup>233</sup> One exception was a storage tank at White Bluffs. "Since there was not a ground storage tank in the application for \$98,182, [the ED's witness] did not know . . . if [the storage tank] was for the water system or if it was for the irrigation system. . . ." Tr., pg. 231, ln. 8-14.

<sup>234</sup> TEX WATER CODE ANN. § 13.183 (a)(1)

<sup>235</sup> DDU Exh. 25, pg 14, Table VI.A., ln. [A].

<sup>236</sup> DDU Exh. 25, pg. 14, Table VI.A., ln. [M].

<sup>237</sup> DDU Exh. 30, pg. 12. This "Exhibit I" to the application was not included in DDU's December 2007 application.

application listed the “hours worked” and “salary” for the employees. The employees have “short job descriptions” such as “Chief Operating Utility – Water,” “POA/Const. Mgr/Utility Director,” *etc.* Mr. Gillespie, Jr. testified that he is “generally” familiar with this page of the application.<sup>238</sup> However, Mr. Gillespie, Jr. could not testify whether these employees worked on the water systems only or split their time between the water and wastewater systems.<sup>239</sup> He did not know whether the \$45,209 salary shown for the “POA/Const. Mgr/Utility Director” was the total salary or somehow split between the employee’s functions of Utility Director, “POA,” and Construction Manager.<sup>240</sup> Mr. Gillespie, Jr. believed the information in Exhibit I was the “gross income” for the listed employees and “think[s the amounts] came from a W-2” and is “the annual cost for these employees total.”<sup>241</sup> Later, on re-direct, Mr. Gillespie, Jr. stated that he had no personal knowledge of how the employees listed on Exhibit I to the August 2007 application were assigned or what duties they performed.<sup>242</sup> Unfortunately, DDU made no further attempt to clarify the actual employment status of its employees.

Mr. Gillespie, Jr. testified that he got the numbers for the application from DDU and only checked them for reasonableness but did not verify the expense.<sup>243</sup> He testified that the \$272,369 salary expense in the application represented an allocation of the salary expense between the water and wastewater systems. Regarding this allocation the following testimony occurred:

Q Okay. All right. I want to try this on you, since -- since we haven't had anyone else who's been able to answer the questions. In terms of the employee salaries --

A Yes.

Q -- and prorating the employee salaries, do you -- do you know how that was done?

A Yes, I do.

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<sup>238</sup> Tr., pg. 99, ln. 8-10.

<sup>239</sup> Tr., pg. 99, ln. 12 - 14.

<sup>240</sup> Tr., pg. 99, ln. 17 - pg. 100, ln. 9.

<sup>241</sup> Tr., pg. 100, ln. 22 - pg. 101, ln. 25.

<sup>242</sup> Tr., pg. 119, ln. 20.

<sup>243</sup> Tr., pg. 96, ln. 8-19.

Q Okay. I -- I would like to ask you to explain how that was done.

A In areas where we're not able to allocate exactly, we use some scheme that we feel is representative. In this particular case, we used the ratio of the billings from wastewater and the billings from the water utility, and if the revenues of water are twice what they were for wastewater, we would charge twice the expenses on the theory that expenses are related to income directly. So that's how we did it.

However, when asked if he knew the percentage allocation of the salary expense between the water and wastewater systems, Mr. Gillespie, Jr., stated he did not recall.<sup>244</sup> He further testified regarding the amount listed on page 14 of DDU Exhibit 25 for the salary expense:

Q. So you're saying that the first number, the [\$]200,369, that number is an allocated number?

A Yes, ma'am.

Q So it's not their total salaries?

A That's correct.

Q And what about the [\$]72,000 that's in the known and measurable changes?

A It would, too, be allocated.

Q Do you know how many employees were involved in that?

A No, I don't.

Q You don't.<sup>245</sup>

Mr. Gillespie, Jr.'s testimony seems to conflict with that of Mr. Gracy. While Mr. Gillespie, Jr. testified that the allocation was based on a "ratio of billings" for the water and wastewater systems, Mr. Gracy testified that "[w]ithin, the application . . . the labor expense is

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<sup>244</sup> Tr., pg. 102, ln. 11-16.

<sup>245</sup> Tr., pg. 98, ln. 11-22.

prorated based on an estimated division of labor between work on the public water system and other tasks, such as the waste water system.”<sup>246</sup>

To support the salary expense in its application, DDU entered into evidence DDU Exhibit 9, which contains the detailed trial balances for the expense of “Employee compensation and labor transfers.”<sup>247</sup> On the first page of Exhibit 9 is a copy of an adding machine tape with an ending total of \$216,637.17. This number does not correspond with the salary expense of \$200,369 listed in the application. The remaining pages of Exhibit 9 are the actual detailed trial balances. These detailed trial balances contain the salary expenses for both water and wastewater.<sup>248</sup>

In its rebuttal case, DDU did not present evidence to address the salaries and allocation issues presented in the hearing. Also, DDU did not put forth any arguments addressing this issue in either its closing arguments or its response to closing arguments.

**b. WBSR Position**

WBSR takes issue with the fact that DDU’s numbers are inconsistent between the applications, exhibits, and discovery documents. WBSR points out that Mr. Gillespie, Jr. testified that the salary expense in the application represented an allocation between water and wastewater salaries based on a ratio of billings from wastewater and the billings from the water utility. However, WBSR argues:

[T]he data and information presented by DDU clearly demonstrates that if an allocation was made, Mr. Gillespie’s source of information must have been very different than any of the sources cited . . . because presumably, his firm must have started with a much higher salary/wage total for water and sewer combined. Even though DDU Witness Kevin Shea acknowledge[d] that detailed trial balances contain *both water and wastewater expenses*, the detail trial balances show a total of salary/wages which is

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<sup>246</sup> DDU Exh. B, pg. 5, ln. 5-8.

<sup>247</sup> DDU Exh. A, pg. 4, ln 12 - 23.

<sup>248</sup> Tr., pg. 18, ln. 18-20, and pg. 98, ln 11 - 15.

within \$2000 of the amount of actual employee wage/salary expenses claimed for 2006. Mr. Shea and Mr. Gillespie both testified at hearing that the salary/wage amounts contained in the Application were prorated to be only the amounts allocable to the water systems. Therefore, if any allocations were made to the sewer systems, they must have been de minimis, certainly not reflective of the allocation method Mr. Gillespie described or the labor allocation described in WBSR Ex. 28.<sup>249</sup>

In developing its own revenue requirement for DDU, WBSR's expert, Nelisa Heddin, relied upon DDU's list of employees, including their salaries or hourly wages. Ms. Heddin then relied upon a December 20, 2007 letter<sup>250</sup> from DDU to Brian Dickey, of the TCEQ. In the letter, DDU stated that "DDU employees work both water and sewer duties based on need. A 60-65% water to 40-35% sewer split is the normal average for the division of their time."<sup>251</sup> Ms. Heddin used this 60/40 split to make an allocation of salaries and wages between the water and wastewater systems. WBSR determined that the total salary expense for the three water systems is \$176,658<sup>252</sup> and a total payroll tax burden of \$25,751.<sup>253</sup>

However, in its closing, WBSR supported the ED's method of calculating the salary expense using a 50/50 split.<sup>254</sup> WBSR's position is that since the 60-40 allocation stated in DDU's letter was not supported by any sort of analysis or documentation, the ED's allocation method of 50-50 based on a review of employee W-2s may be a more reasonable approach.

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<sup>249</sup> WBSR Closing, pg. 9-10 (footnotes omitted, emphasis in orig.).

<sup>250</sup> WBSR Exh. 28.

<sup>251</sup> WBSR Exh. 28.

<sup>252</sup> WBSR Exh. 2, pg. 39, l.11, column F.

<sup>253</sup> WBSR Exh. 3, pg. 40, l. 9, column B.

<sup>254</sup> WBSR Closing, pg. 18.

**c. The ED's Position**

The ED calculated a salary expense for each individual system based on a review of the employees' 2006 and 2007 W-2s.<sup>255</sup> If an employee worked for more than one water system, the ED allocated their salaries according to the number of connections for each system.<sup>256</sup> Ms. Pascua testified that since DDU did not allocate employee costs between the water and wastewater systems and did not provide a wastewater customer count, she further allocated these costs using a 50 percent split, *i.e.* half the expense allocated to water and half of the expense allocated to wastewater.<sup>257</sup> Additionally, Ms. Pascua's analysis included the known and measurable change associated with the addition of a new employee.<sup>258</sup> Ms. Pascua's adjusted salary expenses include the payroll tax burden for the three water systems and are stated below:

Item #	Description	The Cliffs <sup>259</sup>	The Retreat <sup>260</sup>	White Bluff <sup>261</sup>	ED Recommendation
1	Salaries and Wages	\$ 34,943	\$ 3,790	\$ 76,905	\$115,638
13	Payroll Taxes				\$0

**d. Summary**

Here is a summary of the parties' calculations regarding the total salary expense for all three water systems:

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<sup>255</sup> ED Exh. 1, att. P.

<sup>256</sup> ED Exh. 1, pg. 8, ln. 23 – pg. 9, ln. 2.

<sup>257</sup> ED Exh. 1, pg. 5, ln. 10 – 15.

<sup>258</sup> ED Ex 1, att. P.

<sup>259</sup> The adjusted payroll amount for the Cliffs water system found in ED Exh. 1, att. P was corrected at the hearing. Tr., pg. 164, ln 17-23. The correct amount \$34,943.

<sup>260</sup> ED Exh. 1, att. B, P.

<sup>261</sup> ED Exh 1, att. J, P.

Item #	Description	DDU's December 2007 Application <sup>262</sup>	WBSR Final Recommendation <sup>263</sup>	ED Recommendation <sup>264</sup>
1	Salaries and Wages	\$272,369	\$116,721	\$115,638
13	Payroll Taxes	\$90,789	\$0	\$0

**e. ALJ's Analysis**

DDU did not meet its burden of proof that the \$272,369 of salary and wage expenses claimed in its application are allowable expenses that are reasonable and necessary to provide water service. The ALJ cannot determine that the salary expense of \$200,369 was actually incurred in test year 2006 as an expense for the water systems only. The ALJ assumes that DDU's Exhibit 9 is intended to support the \$200,369 amount. However, the ALJ cannot determine how the \$200,369 figure was derived and no witness testified how Exhibit 9 supports the salary expense in the application.

The first page of Exhibit 9 is a copy of an adding machine tape. The following amounts are reflected on the tape<sup>265</sup> and DDU offers no explanation:

The Retreat (6090)	\$ 21,066.31
The Cliffs (8090)	\$ 86,289.45
White Bluff (9090)	<u>\$122,219.41</u>
	\$229,575.17
	<u>(12,938.00)</u>
Total	\$216,637.17

After reviewing Exhibit 9, the ALJ has determined that \$229,575.17 represents the sum of the three detailed trial balances for the three developments. The amount of \$12,938 was subtracted from the detailed trial balance total of \$299,575.17. This \$12,938 represents the total

<sup>262</sup> DDU Exh. 25, pg. 14.

<sup>263</sup> WBSR Closing, pg. 15.

<sup>264</sup> Sum of values from ED Exh. 1, atts. A, B, E, F, I, and J.

<sup>265</sup> DDU Exh. 9, pg. 1.

for “Acct Servs-NRM” for both the Cliffs (8090) and White Bluff (9090).<sup>266</sup> DDU offered no explanation for what the entry, “Acct Servs-NRM,” in the detailed trial balances represents. The resulting \$216,637.17 does not match the salary expense found in the application of \$200,369,<sup>267</sup> a \$16,269 discrepancy.

A review of DDU Exhibit 9 does not clarify whether it contains only water utility salary expenses. There are entries under “employee compensation” that account for the salaries on a monthly basis with no indication of which employees were included in the monthly totals. There are entries for employees who were not listed in DDU’s application as employees of the water systems.<sup>268</sup> DDU Exhibit 9 does not support the salary expenses shown in DDU’s December 2007 application.

There is conflicting testimony regarding the water and wastewater allocation issue that only makes the issue murkier. Mr. Shea was asked if there was “any accounting to isolate the work [the employees listed in the application] did for the sewer system?”<sup>269</sup> Mr. Shea responded, “[n]o. When it comes to our salaries, we just record it all in salaries expense – or salaries.”<sup>270</sup> Mr. Gracy testified that “proration of labor expenses for employees between water, sewer, or any other duty they may perform, that internal accounting measures were in place to account for those labor expenses[.]”<sup>271</sup> However, on re-cross, Mr. Gracy “assume[d]” that the salary expense in the application was prorated between the water and wastewater systems<sup>272</sup> and did not know if his accounting personnel or his consultant had provided any accounting or worksheets that show how the assumed proration was done.<sup>273</sup>

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<sup>266</sup> DDU Exh. 9, pg. 5, 8, and 9.

<sup>267</sup> DDU Exh. 25, pg. 14, Table VI.A., ln. [A].

<sup>268</sup> Compare DDU Exh. 9, pg. 5 (The Cliffs, debit activities for labor transfers for Martin and Hafer) with DDU Exh. 30, pg. 12 (Martin and Hafer not listed as employees of any DDU water system).

<sup>269</sup> Tr., pg. 16, ln. 23-24.

<sup>270</sup> Tr., pg. 16, ln. 25 – pg. 17, ln. 1.

<sup>271</sup> Tr., pg. 63, ln. 24 – pg. 64, ln. 4.

<sup>272</sup> Tr., pg. 65, ln. 7.

<sup>273</sup> Tr., pg. 65, ln. 25 – pg. 66, ln. 9.

Regarding DDU's consultant, Mr. Gillespie, Jr. could only testify in a general nature that the allocation was done based on some method related to billing. He could not testify to specifics, such as what was DDU's total, unallocated salary expense and what percentage of this total expense was allocated to the water systems.

Oddly, the only specific evidence in the record supporting DDU's \$200,369 figure as an allocated, water-only expense is an unsigned, handwritten note contained in the ED's Exhibit 5, which is a December 21, 2007 letter from DDU's consultant to the TCEQ.<sup>274</sup> Charles Gillespie, III, the son of Charles Gillespie, Jr., sent the letter and attachments to the TCEQ to respond to a letter from Mr. Dickey sent on November 15, 2007. On page 65 of ED's Exhibit 5 is the handwritten note. The unknown author of this handwritten note apparently took the figure \$256,883 and multiplied it by 78 percent for a product of \$200,369, the amount in the application shown as a salary expense. Apparently, the billing allocation referenced by Mr. Gillespie, Jr. is 78 percent.

This handwritten note tends to support Mr. Gillespie, Jr.'s testimony that \$200,369 salary expense in its application is an allocated number. However, the source of the \$256,883 unallocated salary expense is unknown. It is not found in DDU's Exhibit 9 or in any other testimony or evidence. Furthermore, the handwritten note conflicts with DDU's December 20, 2007 letter to the TCEQ stating that "[a] 60-65% water to 40-35% sewer split is the normal average for the division of [the employees'] time."<sup>275</sup> This handwritten note presents yet another inconsistency between DDU's application and the evidence in the record.

While it is the ALJ's recommendation that DDU's application for a rate change be denied for its failure to meet its burden of proof, in the event the Commission decides to grant the application, the ALJ would recommend that the Commission use the ED's method of calculation of the salary and wages expense for DDU. The ED calculated the salary expense for each individual water system by reviewing the employees' W-2s, not DDU's accounting documents.

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<sup>274</sup> ED. Exh. 5, pg. 65.

<sup>275</sup> WBSR Exh. 28.

By relying on the employees' W-2s, the ED was able to include the payroll tax burden within the salary expense. The ED then split the expense evenly between the water and wastewater systems. However, instead of splitting the salary expense between the water and wastewater systems evenly, the ALJ recommends that the ED utilize a 60/40 percent allocation between the water and wastewater systems. This may more accurately reflect the actual division of labor as set out in DDU's December 20, 2007 letter.<sup>276</sup>

## **2. Purchased Water**

### **a. DDU's Application**

In its application, DDU showed a purchased water expense of \$7,363<sup>277</sup> and the Cliffs is the only surface water-based system. DDU did not direct the ALJ to the evidence in the record that supports this expense.

### **b. WBSR's Position**

WBSR did not make any recommendations regarding adjustments to this expense amount. WBSR recognized that although the ED recommended a higher amount, WBSR "see[s] no reason to grant DDU more expenditures than it has claimed in its application or demonstrated in evidence."<sup>278</sup>

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<sup>276</sup> WBSR Exh. 28.

<sup>277</sup> DDU Exh. 30, pg. 28.

<sup>278</sup> WBSR Closing, pg. 18.

**c. The ED's Position**

The ED recommended an expense of \$10,322 for the purchased water expense for the Cliffs' water system.<sup>279</sup> However, the ED did not state the source of its recommendation, other than the review of DDU's general ledgers and detailed trial balances.

**d. Summary**

Here is a summary of the parties' positions on this expense.

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>280</sup></b>	<b>WBSR Final Recommendation<sup>281</sup></b>	<b>ED Recommendation<sup>282</sup></b>
3	Purchase Water	\$7,363	\$7,363	\$10,322

**e. The ALJ's Analysis**

DDU has not identified evidence to support this amount as an expense. The ED has performed an audit of DDU's general ledgers and has determined that \$10,322 is an appropriate amount for this expense. The ALJ recommends that if the Commission decides to grant DDU's application, then it should use the ED's recommendation.

**3. Chemicals**

**a. DDU's Application**

In its application, DDU indicates that it incurred \$12,300 as a chemical expense for the three water systems combined.<sup>283</sup> In apparent support of this amount, DDU entered into

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<sup>279</sup> ED. Exh. 1, att. F.

<sup>280</sup> DDU Exh. 25, pg. 14.

<sup>281</sup> WBSR Exh. 17, pg. 65.

<sup>282</sup> ED Exh. 1, atts. B, F, and J.

evidence DDU Exhibit 11. DDU Exhibit 11 is the detailed trial balance for chemicals and shows that DDU incurred an expense of \$14,853.65.<sup>284</sup> However, DDU has not demonstrated how the expenses in DDU Exhibit 11 can be allocated between the water and wastewater systems since DDU's accounting documents include expenses for both the water and wastewater systems.<sup>285</sup>

**b. WBSR's Position**

WBSR points out that the ED verified through his audit an adjusted amount for chemicals of \$7,427. WBSR asserts that since the ED verified its amount through its audit of DDU and allocated the expenses between the water and wastewater systems evenly, WBSR recommends that the ED's amount of \$7,427 be utilized to calculate DDU's revenue requirement.

**c. The ED's Position**

The ED allocated 50 percent of the expenses shown on DDU's accounting documentation to each water system since DDU's general ledger lists expenses for both the water and wastewater systems. This resulted in a final amount of \$7,427.<sup>286</sup> The ED made the following recommendations to allocate the chemical expense between the three water systems: The Cliffs, \$3,865; The Retreat, \$326; and White Bluff, \$3,236; for a total of \$7,427.

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<sup>283</sup> DDU Exh. 25, pg. 14, ln [D]; and DDU Exh. 30, pg. 28, ln. [D].

<sup>284</sup> DDU Exh. 11, adding amounts for each detailed trial balance: 6090, The Retreat (\$652.06); 8090, the Cliffs (\$7,729.88); and 9090, White Bluff (\$6,471.71).

<sup>285</sup> Tr., pg. 18, ln. 18-20.

<sup>286</sup> ED Exh. 1, atts. B, F, and J.

**d. Summary**

Here is a summary of this expense:

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>287</sup></b>	<b>WBSR Final Recommendation<sup>288</sup></b>	<b>ED Recommendation<sup>289</sup></b>
4	Chemicals for Treatment	\$12,300	\$7,427	\$7,427

**e. ALJ's Analysis**

DDU has failed to support the expense for chemicals shown its application by citation to the record showing that the expenses claimed were for the water systems. Since it is uncontested by the parties that DDU incurred at least \$7,427 in expenses for its three water systems, the ALJ recommends that if the Commission grants DDU's application, it use the amounts found by the ED for each individual system, modified to show a 60/40 percent split between the water and wastewater systems. This may more accurately reflect the actual allocation of the expense as set out in DDU's December 20, 2007 letter.<sup>290</sup>

**4. Utilities (electricity)**

**a. DDU's Position**

DDU listed \$58,775 in electricity expenses purportedly for the three water systems combined.<sup>291</sup> DDU entered into evidence Exhibit 5 in support of this amount.<sup>292</sup> An adding

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<sup>287</sup> DDU Exh. 25, pg. 14.

<sup>288</sup> WBSR Closing, pg. 15.

<sup>289</sup> ED Exh. 1, att. B, F, and J.

<sup>290</sup> WBSR Exh. 28.

<sup>291</sup> DDU Exh. 25, pg. 14, ln. [E].

<sup>292</sup> DDU Exh. A, pg. 3, ln. 6-17.

machine tape for “Utilities” shows a total of \$249,681.66.<sup>293</sup> This is substantially higher than what DDU listed in its application as a utility expense.

By reviewing the detailed trial balances in Exhibit 5, the ALJ is able to determine that the adding machine tape shows amounts for the Retreat (6090) and White Bluff (9090) systems as \$51,011.51 and \$129,978.78, respectively. The ALJ is unable to determine how the remaining figure of \$68,691.37 on the adding machine tape was derived and can only assume it somehow represents the utility expense for the Cliffs since this figure is not indicated on the detailed trial balance. DDU has not shown that the utility expense in its application reflects an appropriate allocation between the water and wastewater systems.

**b. WBSR’s Position**

WBSR did not make any recommendations regarding changes to the amount DDU claimed as a utility expense. WBSR recognizes that while the ED performed an audit of DDU’s invoices and allocated the expense between the water and wastewater systems, DDU should not receive a higher expense than it requested in its application.<sup>294</sup>

**c. The ED’s Position**

The ED performed an audit of DDU expenses for each water system individually. For the utility expense, the ED recommended the following amounts: the Cliffs, \$35,181;<sup>295</sup> the Retreat, \$17,344;<sup>296</sup> and White Bluff \$119,479.<sup>297</sup> The ED found support for \$172,004 in utility

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<sup>293</sup> DDU Exh. 5, pg. 1.

<sup>294</sup> WBSR Closing, pg. 19.

<sup>295</sup> ED Exh. 1, pg. 11, ln. 22-23, att. F.

<sup>296</sup> ED Exh. 1, pg. 9, ln. 20-21, att. B.

<sup>297</sup> ED Exh. 1, pg. 14, ln. 11, att. J.

expenses. The ED deducted specific amounts for utilities attributable to the wastewater systems.<sup>298</sup>

**d. Summary**

Here is a summary of the parties' positions on this expense:

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>299</sup></b>	<b>WBSR Final Recommendation<sup>300</sup></b>	<b>ED Recommendation<sup>301</sup></b>
5	Utilities (Electricity)	\$58,775	\$58,775	\$172,004

**e. The ALJ's Analysis**

DDU failed to reconcile its detailed trial balances with its application. However, it is uncontested that DDU has incurred a minimum of \$58,775 as a utility expense. The problem is that there is no consensus on how to allocate this amount between the three water systems. To adopt the ED's recommendations regarding this expense would result in DDU recouping expenditures it did not prove, although the ED's audit uncovered them. Nevertheless, if the Commission decides to grant DDU's application, the ALJ recommends that the Commission adopt the ED's analysis since it allocates the total utility expense between the three water systems.

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<sup>298</sup> ED Closing, pg. 16, 22, and 28.

<sup>299</sup> DDU Exh., 25, pg. 14.

<sup>300</sup> WBSR Closing, pg. 15.

<sup>301</sup> ED Exh. 1, atts. B, F, and J.

## **5. Repairs/Maintenance/Supplies**

### **a. DDU's Position**

DDU listed \$203,729 as an allowable expense for all three water systems combined for repairs, maintenance, and supplies.<sup>302</sup> In support of this amount, DDU entered into evidence Exhibit. 4, shown on DDU's Exhibit List as "Detail Trial Balance – R&M Building, R&M Equipment, Smallware/Tools." The first page of Exhibit 4 shows an adding machine tape with a total of \$208,629.26. The ALJ has determined from reviewing Exhibit 4 that the adding machine tape reflects the amount for the detailed trial balances for each development: the Retreat, \$38,205.96; the Cliffs, \$110,575.35; and White Bluff, \$59,847.95; for a total of \$208,629.26.

The amounts added together and reflected on the adding machine tape were derived straight from the detailed trial balances for the Retreat, the Cliffs, and White Bluff.<sup>303</sup> However, since DDU's accounting system groups the expenses for water and wastewater, the ALJ cannot determine how much of the total expense should be allocated to each water system.

### **b. WBSR's Position**

WBSR did not make any recommended changes to this expense amount. However, WBSR argues that the ED presented an adjusted amount of \$107,808 that reflects adjustments not supported by invoices or that were reported as expenses but were actually assets. Therefore, since DDU did not meet its burden of proof, WBSR recommends relying on the ED's adjusted amount.<sup>304</sup>

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<sup>302</sup> DDU Exh. 30, pg. 14, ln. [F].

<sup>303</sup> DDU Exh. 4, pg. 1 reflects an error. The amount of \$2,114.07 was added instead of \$2,144.07.

<sup>304</sup> WBSR Closing, pg. 19-20.

**c. The ED's Position**

The ED analyzed this expense on the basis of an audit it performed for each individual water system. The ED disallowed various expenses because they either lacked support by an invoice or other documentation or they were more properly characterized as an asset needing to be amortized.

The ED made several requests for more documentation from DDU. In one discovery request, the ED asked for a detailed summary and invoices to support DDU's repair expense.<sup>305</sup> DDU responded that it "objected to this request as it pertains to producing hardcopy of invoices because it is overly burdensome to retrieve these invoices from archive storage. To the extent DDU does not object, detailed trial balances responsive to this request will be produced with these responses."<sup>306</sup> Ms. Pascua testified that she needed the invoices and other documentation since the general ledger may not always reflect what is on the actual invoice.<sup>307</sup>

For the Cliffs' water system, the ED recommended a total of \$46,527 for this expense.<sup>308</sup> The ED made the following downward adjustments:

<b>Exhibit No.</b>	<b>Amount</b>	<b>Item</b>	<b>Reason</b>
ED Exh. 1, pg. 11, ln 26 – pg. 12, ln 2, att. V at 1-3	\$12,046	Toray membranes	Invoices did not indicate whether this was an expense or an asset.
ED Exh. 1, pg. 11, ln 26 – pg. 12, ln 2, att. V at 1-3	\$11,158	Shelco filter housing	Invoices did not indicate whether this was an expense or an asset.
ED Exh. 1, pg. 12, ln 2-5.	\$6,884		No invoice or documentation

<sup>305</sup> ED Exh. 3, pg. 5, Interrogatory No. 9.

<sup>306</sup> ED Exh. 3, pg. 5, Interrogatory No. 9; *see also*, pg. 8, Request for Production No. 19.

<sup>307</sup> Tr. pg. 184, ln. 1-12.

<sup>308</sup> ED Exh. 1, att. F.

Exhibit No.	Amount	Item	Reason
ED Exh. 1, pg. 12, ln 2-5.	\$2,760		No invoice or documentation
ED Exh. 1, pg. 12, ln 6-8, ex. ED Exh. 2, pg. 9, ln. 6.	\$31,300	Rental of a reverse osmosis system.	TCEQ had not approved use of reverse osmosis system. Therefore, this item could not be listed as an expense.

For the Retreat water system, the ED made one adjustment for this expense. The ED determined that \$18,294 was an unidentified expense because it was not supported by an invoice or other documentation.<sup>309</sup> The ED recommended a total of \$19,912 for this expense amount at the Retreat.<sup>310</sup>

For the White Bluff water system the ED recommended a total of \$41,369 for this expense.<sup>311</sup> The ED made the following downward adjustments:

Exhibit No.	Amount	Item	Reason
ED Exh. 1, pg. 14, ln. 14-16; att. V, pg. 4	\$3,550	Electrical bid for ratio control for front wells	Invoices did not indicate whether this was an expense or an asset.
ED Exh. 1, pg. 14, ln. 16-19.	\$14,929		No invoice or documentation.

While the ED calculated this expense for each water system individually, the total amount the ED recommended for this expense is \$107,808.

<sup>309</sup> ED Exh. 1, pg. 9, ln. 23-25.

<sup>310</sup> ED Closing, pg. 22.

<sup>311</sup> ED Exh. 1, att. J.

**d. Summary**

Here is a summary of the parties' positions on this expense:

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>312</sup></b>	<b>WBSR Final Recommendation<sup>313</sup></b>	<b>ED Recommendation<sup>314</sup></b>
6	Repairs/Maintenance/Supplies	\$203,729	\$107,808	\$107,808

**e. ALJ's Analysis**

DDU has failed to meet its burden of proof to show that the amount it claimed in its application included allowable expenses for repairs, maintenance, and supplies for the water systems. DDU has not supported its claimed expense of \$203,729 through specific citation to its testimony or its exhibits. DDU's accounting documentation could contain references to both the water and wastewater systems but DDU does not show how the amount in its application represents expenses for the water systems only.<sup>315</sup> The ALJ cannot reconcile the amount in the application with the detailed trial balances.

DDU argues that it was subjected to an arbitrary and evolving standard regarding the ED's disallowance of its operation and maintenance expenses, particularly the repair and maintenance expense.<sup>316</sup> DDU contends that the ED disallowed "the largest dollar figure expenses booked by Applicant . . . either for (i) no invoice, (ii) where there was a matching

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<sup>312</sup> DDU Exh. 25, pg. 14.

<sup>313</sup> WBSR Closing, pg. 15.

<sup>314</sup> ED Exh. 1, atts. B, F, and J.

<sup>315</sup> For example, throughout DDU Exh. 4, there are references to expenses for "R&M - Water Plant" and "R&M - Distribution Lines," which could represent repair and maintenance expenses for the water utility service only. See, DDU Exh. 4, pg. 1 (detailed trial balance for the Retreat, Dep't 6090). However, there are also references to "R&M Equipment" and "R&M Building," which apparently include expenses for backhoe repairs and parts. See, DDU Exh. 4, pg. 2 (detailed trial balance for the Retreat, Dep't 6090). DDU did not provide testimony that the repair and maintenances expenses in DDU Exhibit 4 exclude wastewater expenses or that DDU allocated the claimed expenses between the water and wastewater systems.

<sup>316</sup> DDU Closing, pg. 4.

invoice, in [the ED's witness's] opinion it provided an inadequate explanation, or (iii) for being an asset (which was not correspondingly transferred to the depreciation schedule as an asset by [the ED]).<sup>317</sup> DDU entered into evidence Exhibit 38 which purportedly shows percent reductions the ED made in DDU's operation and maintenance expenses. For example, DDU claims that the ED reduced its repairs and maintenance expense by 49.5 percent, its depreciation and amortization expense by 89.1 percent, its property tax expense by 114.1 percent, and its rate case expense by 268.5 percent.<sup>318</sup>

The ED disputes that the percentages in DDU's Exhibit 38 are an accurate reflection of the ED's analysis. In response to DDU's arguments, the ED stated:

Regarding [DDU's] analysis of the ED's deductions, the percentages found in exhibit [DDU]-38 are the percentages that would result from subtracting ED staff's deductions from the amounts found in *the application*. However . . . Ms. Pascua's deductions were made from the totals for each category listed in the *general ledgers* for the individual systems, *not the totals for all three systems as provided in the application*. With regard to the assets, Mr. Dickey actually added an asset to White Bluff's depreciation schedule, making the total before deductions higher than what was listed in the application. Therefore, exhibit [DDU]-38 does not accurately reflect the ED's analysis of DDU's application.<sup>319</sup>

The ALJ agrees with the ED that DDU Exhibit 38 makes improper comparisons between DDU's application and the ED's analysis. The ED made deductions from the amounts found in DDU's general ledgers, not from the amounts found in DDU's application as depicted by Exhibit 38. It is inappropriate to take the ED's deductions and subtract them from the amounts in the application to come up with a percentage of reductions. Furthermore, there cannot be reductions over 100 percent. If the ED made a 100 percent reduction, then the amount in his revenue requirement would have been \$0. Had the ED made reductions over 100 percent for some expenses as Exhibit 38 represents, then the ED would have had negative numbers as entries

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<sup>317</sup> DDU Closing, pg. 5.

<sup>318</sup> DDU Exh. 38.

<sup>319</sup> ED Reply to Closing Arguments, pg. 10 (emphasis added).

in his revenue requirements, which did not occur. This demonstrates that the analysis shown in Exhibit 38 is flawed.

DDU focuses on the amount and size of the ED's reductions. However, DDU did not respond with citations to the record that demonstrated support for the expenses claimed in its application. Instead of addressing the specifics of the parties' concerns, DDU attempted to show the alleged magnitude of the deductions. DDU simply left the specific issues unaddressed. For example, DDU complains that the ED should have allowed an expense of \$12,045.63 for a "Toray Membrane Installed."<sup>320</sup> The ED's position was that this membrane may be more properly characterized as an asset and amortized over time instead of a one-time expense to be recovered every year through the rates. In its rebuttal case, DDU provided no testimony to show that it had correctly characterized the Toray Membranes as a repair expense and not as an asset.<sup>321</sup> DDU did not avail itself of the opportunity to counter the adjustments made by the ED to this expense category.

If the Commission decides to grant DDU's application, the ALJ recommends that the Commission utilize the ED's analysis for each individual water system for a total of \$107,808 for this expense. It is apparently uncontested that at a minimum, DDU has incurred \$107,808 as an allowable expense for repairs, maintenance, and supplies. The ED's allocation of this expense to each individual water system is the appropriate method.

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<sup>320</sup> DDU Closing, pg. 4.

<sup>321</sup> The ALJ is unable to locate a reference to "Toray Membranes" in DDU's Exhibit 4. There is a reference to "PROGWAT MEMBRANES FOR" in the amount of \$12,045.63. DDU Exh. 4, pg. 7 (8090, the Cliffs), and pg. 23 (8090, the Cliffs). It appears that pg. 23 is simply a duplicate of the detailed trial balance entry shown on pg. 7. The only invoice for these membranes that the ALJ could locate is found in ED Exh. 1, att. V, not in DDU's direct case, although it may be located somewhere in DDU's exhibits.

**6. Office Expenses**

**a. DDU's Position**

DDU included \$5,500 an office expense in its application.<sup>322</sup> The ALJ was unable to locate an exhibit that supports this amount.

**b. WBSR's Position**

WBSR did not make any recommended changes to this amount. WBSR recognizes that the ED recommended \$5,579 for this expense. WBSR does not recommend granting DDU more in expenditures than it requested in this application.

**c. ED's Position**

The ED reviewed the general ledgers and divided that amount evenly between the water and wastewater systems. The ED analyzed each water system separately and made the following recommendations:

<b>Item #</b>	<b>Description</b>	<b>The Cliffs</b>	<b>The Retreat</b>	<b>White Bluff</b>	<b>ED Recommendation</b>
7	Offices Expenses	\$2,189	\$87	\$3,303	\$5,579

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<sup>322</sup> DDU Exh. 30, pg. 14, ln. [G].

**d. Summary**

Here is a summary of the parties' positions on this expense.

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>323</sup></b>	<b>WBSR Final Recommendation<sup>324</sup></b>	<b>ED Recommendation<sup>325</sup></b>
7	Office Expenses	\$5,500	\$5,500	\$5,579

**e. ALJ's Analysis**

DDU has not directed the ALJ to its exhibits or other evidence that supports this amount for an office expense. However, if the Commission decides to grant DDU's application, the ALJ recommends that the Commission use the ED's amounts for this expense for the three water systems, allocated on a 60/40 basis.

**7. Accounting and Legal Fees**

**a. DDU's Position**

DDU has represented that it incurred \$6,100 as an allowable expense for accounting and legal fees.<sup>326</sup> DDU entered into evidence general ledgers that combine all the expenses for all three water systems and all three wastewater systems. DDU produced Exhibit 7 with the detailed trial balances for "Professional fees for outside engineers and specialists." However, the first page of Exhibit 7 contains a handwritten notation that references "rate case expense." It is unclear whether the "professional fees" were incurred as an operating expense or incurred as a rate case expense.

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<sup>323</sup> DDU Exh. 25, pg. 14.

<sup>324</sup> WBSR Closing, pg. 15.

<sup>325</sup> ED Exh. 1, atts. B, F, and J.

<sup>326</sup> DDU Exh. 30, pg. 14, ln. [H].

Also, there are handwritten check marks by the amount \$1,066 for all three systems. Assuming only the checked items are properly considered for the accounting and legal fees expense, the checked items only add up to \$3,200. This amount does not match the application where DDU indicated \$6,100 is the amount for this allowable expense. If you add up the totals of all three detailed trial balances, the total is \$12,080, again, not the amount shown in the application.

**b. WBSR's Position**

WBSR recommends adopting the ED's position and exclude this expenditure.

**c. ED's Position**

The ED takes no position on this expense in its closing arguments. In its prefiled testimony, the ED recommended \$0 as the appropriate amount for this expense.<sup>327</sup>

**d. Summary**

Here is a summary of the parties' position on this expense:

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>328</sup></b>	<b>WBSR Final Recommendation<sup>329</sup></b>	<b>ED Recommendation<sup>330</sup></b>
8	Accounting & Legal Fees	\$6,100	\$0	\$0

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<sup>327</sup> ED Exh. 1, atts. B, F, and J.

<sup>328</sup> DDU Exh., 25, pg. 14.

<sup>329</sup> WBSR Exh. 17, pg. 65.

<sup>330</sup> ED Exh. 1, atts. B, F, and J.

**e. The ALJ's Analysis**

DDU does not direct the ALJ to the evidentiary record for support for this amount for accounting and legal fees as an allowable expense. Whether you take the total of all three detailed trial balances in Exhibit 7 or add the checked amounts, the exhibit and the application cannot be reconciled. Also, it is difficult to reconcile the application with DDU's financial documentation because it combines the expenses for the water and wastewater systems.<sup>331</sup> Since DDU does not show how the evidentiary record supports this amount, the ALJ recommends that no amount be entered for this expense.

**8. Insurance**

**a. DDU's Position**

DDU shows \$12,200 as an allowable expense for insurance.<sup>332</sup> DDU's Exhibit 6 contains the detailed trial balance for this expense for all three systems. An adding machine tape in this exhibit shows a total of \$43,284.18.

**b. WBSR's Position**

WBSR did not make recommendations in its prefiled regarding this insurance expense. Recognizing that the ED recommended an adjusted amount of \$21,593, WBSR does not support granting DDU more expenditures than it requested.

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<sup>331</sup> For example, page 1 of Exhibit 7 has an entry for "CONSERV Renew WW Permit-D."

<sup>332</sup> DDU Exh. 30, pg. 14, ln. [I].

**c. The ED's Position**

The ED analyzed this expense separately for each water system. The ED allocated this expense evenly between the water and wastewater systems since the general ledger shows entries for both types of systems. The ED made the following recommendations:

Item #	Description	The Cliffs <sup>333</sup>	The Retreat <sup>334</sup>	White Bluff <sup>335</sup>	ED Recommendation <sup>336</sup>
9	Insurance	\$7,407	\$5,777	\$8,409	\$21,593

**d. Summary**

Here is a summary of the parties' positions on this expense.

Item #	Description	December 2007 Application <sup>337</sup>	WBSR Final Recommendation <sup>338</sup>	ED Recommendation <sup>339</sup>
9	Insurance	\$12,200	\$12,200	\$21,593

**e. The ALJ's Analysis**

DDU failed to demonstrate that this insurance expense was an allowable expense for the water systems. If the Commission decides to grant DDU's application, the ALJ would recommend that the Commission utilize the ED's amounts and allocation of this expense for each individual water system, even though it is more than DDU requested.

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<sup>333</sup> ED Exh. 1, pg. 12, ln. 10 – 12; att. F.

<sup>334</sup> ED Exh. 1, pg. 10, ln. 1 – 2; att. B.

<sup>335</sup> ED Exh. 1, pg. 14, ln. 21-22; att. J.

<sup>336</sup> ED Exh. 1, atts. B, F, and J.

<sup>337</sup> DDU Exh. 25, pg. 14.

<sup>338</sup> WBSR Closing, pg. 15.

<sup>339</sup> ED Exh. 1, atts. B, F, and J.

Also, instead of splitting the office expense between the water and wastewater systems evenly, the ALJ recommends that the ED utilize a 60/40 percent split between the water and wastewater systems. This may more accurately allocate this expense as set out in DDU's December 20, 2007 letter.<sup>340</sup>

## 9. Rate Case Expense

The TCEQ's rules specifically address whether a utility can recover its rate case expenses. "A utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest."<sup>341</sup> Furthermore, "[a] utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate."<sup>342</sup>

### a. DDU's Position

DDU claimed \$4,500 for rate case expenses.<sup>343</sup> As previously stated, DDU's Exhibit 7 is a detailed trial balance for professional fees<sup>344</sup> On the first page of Exhibit 7 is the handwritten notation of "rate case expense." The total of these detailed trial balances is \$12,080 for all three systems combined. However, there are entries in the detailed trial balances that could refer to wastewater expenses.

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<sup>340</sup> WBSR Exh. 28.

<sup>341</sup> 30 TAC § 291.28(7).

<sup>342</sup> *Id.* § 291.28(8).

<sup>343</sup> DDU Exh. 30, pg. 14, ln. [J].

<sup>344</sup> DDU Exhibit 7 may also be used to support expense of accounting and legal fees. DDU Exh. A, pg. 3, ln. 29-39. DDU did not clarify which expenses the entries in Exhibit 7 are intended to support.

**b. WBSR's Position**

WBSR argues that 30 TAC § 291.28(8) precludes DDU from recovering its rate case expenses since DDU has not demonstrated that it is entitled to higher rates<sup>345</sup> and the \$4,500 should not be included in DDU's cost of service.

**c. OPIC's Position**

OPIC recommends denial of the rate increase.<sup>346</sup> Therefore, according to OPIC, 30 TAC 291.28(8) requires that DDU not recover rate case expenses. OPIC argues that Mr. Gillespie, Jr. testified that the rates were justified but that justification cannot be found in the record. Therefore, all the rate case expenses should be disallowed.

**d. The ED's Position**

Since the ED recommends no rate change in this case, the ED asserts that the increase in revenue would be less than 51 percent of the increase in revenue from the proposed rate change and DDU is not entitled to recover the expenses for this rate case. In the event the ALJ disagrees with the ED's analysis, the ED made the following recommendations on how much of its rate case expenses DDU should recover:

Item #	Description	The Cliffs <sup>347</sup>	The Retreat <sup>348</sup>	White Bluff <sup>349</sup>	ED Total Recommendation <sup>350</sup>
10	Rate Case Expense	\$1,067	\$1,067	\$1,067	\$3,201

<sup>345</sup> WBSR Closing, pg. 21.

<sup>346</sup> OPIC Closing, pg. 7.

<sup>347</sup> ED Exh. 1, pg. 12, ln. 14 – pg. 13, ln. 12.

<sup>348</sup> ED Exh. 1, pg. 10, ln. 3-26.

<sup>349</sup> ED Exh. 1, pg. 14, ln. 23 – pg. 15, ln. 23.

<sup>350</sup> ED Exh. 1, atts. B, F, and J.

**e. Summary**

Here is a summary of the parties' positions on this expense:

<b>Item #</b>	<b>Description</b>	<b>December 2007 Application<sup>351</sup></b>	<b>WBSR Final Recommendation<sup>352</sup></b>	<b>OPIC Adjustment</b>	<b>ED Recommendation<sup>353</sup></b>
10	Rate Case Expense	\$4,500	\$0	\$0	\$0

**f. The ALJ's Analysis**

The ALJ recommends, pursuant to 30 TAC § 291.28(8), that DDU not recover its rate case expenses. The ALJ has recommended that DDU's application to change its rates be denied. Therefore, DDU should not recover its rate case expenses. In the event the Commission grants DDU's application and the resultant rate complies with 30 TAC § 291.28(8), the ALJ recommends that the Commission utilize the ED's analysis in allocating the rate case expense between the three water systems, in the event the rates meet the requirements in 30 TAC § 291.28(8).

**10. Payroll Taxes**

**a. DDU's Position**

DDU claimed \$90,789 in expenses for payroll taxes.<sup>354</sup> DDU did not give a reference to evidence where this amount is supported by a general ledger, detailed trial balance, or some other form of documentation.

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<sup>351</sup> DDU Exh. 25, pg. 14.

<sup>352</sup> WBSR Closing, pg. 15.

<sup>353</sup> ED Exh. 1, atts. B, F, and J.

<sup>354</sup> DDU Exh. 30, pg. 14, ln. [M].

**b. WBSR's Position**

Although WBSR's evidence analyzed DDU's historical tax burden as reported on its 2006 operating statement, WBSR now supports the ED's analysis of this issue and the inclusion of DDU's payroll tax burden in the ED's analysis of DDU's salaries and wages expense.<sup>355</sup>

**c. The ED's Position**

As previously discussed, the ED included the payroll tax burden within each water system's salary and wages expense since the ED based his calculations from the employees' W-2s. Therefore, the ED did not recommend a separate expense for payroll taxes.

**d. Summary**

The following table is a summary of the parties' positions regarding this expense:

Item #	Description	December 2007 Application <sup>356</sup>	WBSR Final Recommendation <sup>357</sup>	ED Recommendation <sup>358</sup>
13	Payroll Taxes	\$90,789	\$0	\$0

**e. The ALJ's Analysis**

As previously stated by the ALJ, DDU did not meet its burden of proof on the salary and wages expense and likewise, did not establish that the \$90,789 payroll burden is an allowable expense. The ALJ recommends that if the Commission determines to grant DDU's application for a rate change, the Commission should use the ED's analysis of DDU's salaries and wages,

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<sup>355</sup> WBSR Closing, pg. 22.

<sup>356</sup> DDU Exh., 25, pg. 14.

<sup>357</sup> WBSR Closing, pg. 15.

<sup>358</sup> ED Exh. 1, atts. B, F, and J.

which includes the payroll burden, subject to a 60/40 percent allocation between the water and wastewater systems.

**11. Property and other taxes**

**a. DDU's Position**

DDU claimed \$4,500 in property and other taxes.<sup>359</sup> DDU introduced into evidence Exhibit 8, which contains the detailed trial balances for "property taxes." An adding machine tape on the first page of Exhibit 8 shows a total of \$6,901.38. Again, DDU does not distinguish between property taxes attributable to the wastewater or the water systems.

**b. WBSR's Position**

WBSR did not make a recommendation regarding an appropriate amount for this expense. While acknowledging that the ED's review resulted in a higher amount for this expense, WBSR did not recommend that DDU be granted more expenditures than what it claimed in its application.<sup>360</sup>

**c. The ED's Position**

Based on a cost allocation process, the ED recommended the following property tax expenses for each individual water system.

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<sup>359</sup> DDU Exh. 30, pg. 14, ln. [N].

<sup>360</sup> WBSR Closing, pg. 22.

Item #	Description	The Cliffs <sup>361</sup>	The Retreat <sup>362</sup>	White Bluff <sup>363</sup>	ED Recommendation <sup>364</sup>
14	Property and Other Taxes	\$2,023	\$303	\$3,378	\$5,704

**d. Summary**

The following table is a summary of the parties' positions regarding the property tax expense:

Item #	Description	December 2007 Application <sup>365</sup>	WBSR Final Recommendation <sup>366</sup>	ED Recommendation <sup>367</sup>
14	Property and Other Taxes	\$4,500	\$4,500	\$5,704

**e. The ALJ's Analysis**

DDU failed to meet its burden of proof in establishing that this amount was for an allowable expense. DDU's detailed trial balances that it used to establish its expenses contain entries for both the water and wastewater systems.

The ED reviewed the invoices and general ledgers for each individual water utility and attempted to allocate the expenses between the water and wastewater systems. If the Commission determines to grant DDU's application, the ALJ recommends that the Commission use the adjustments developed by the ED for each individual water system.

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<sup>361</sup> ED Exh. 1, att. F.

<sup>362</sup> ED Exh. 1, att. B.

<sup>363</sup> ED Exh. 1, att. J.

<sup>364</sup> ED Exh. 1, atts. B, F, and J.

<sup>365</sup> DDU Exh. 25, pg. 14.

<sup>366</sup> WBSR Closing, pg. 15.

<sup>367</sup> ED Exh. 1, atts. B, F, and J.

**12. Annual Depreciation and Amortization**

As discussed above, the ALJ has concerns regarding DDU’s depreciation schedule. Therefore, the ALJ will not restate those arguments again but provides a brief summary of the parties’ positions on this expense.

**a. DDU’s Position**

DDU calculated its annual depreciation expense for all three water systems combined. DDU’s annual depreciation expense is \$144,560.90.<sup>368</sup> On its Table IV.A. demonstrating its revenue requirement, DDU lists \$144,573 as its amount of annual depreciation, a \$12 discrepancy.<sup>369</sup>

**b. WBSR’s Position**

WBSR calculated the annual depreciation expense for each individual water system:<sup>370</sup>

Item #	Description	The Cliffs	The Retreat	White Bluff	WBSR Recommendation
15	Annual Depreciation and Amortization	\$24,737	\$14,606	\$53,207	\$92,550

**c. The ED’s Position**

For the general items, such as backhoes and trucks, the ED allocated 50 percent of their costs to the water systems. The ED then allocated the water portion of these general assets to each water system on the basis of the number of connections. The ED calculated the following annual depreciation expense for each individual water system:

<sup>368</sup> DDU Exh. 25, pg. 25.

<sup>369</sup> DDU Exh. 25, pg. 14, Table IV.A., ln. [O].

<sup>370</sup> WBSR Exh. 17, ln. 34.

Item #	Description	The Cliffs <sup>371</sup>	The Retreat <sup>372</sup>	White Bluff <sup>373</sup>	ED Recommendation
15	Annual Depreciation and amortization	\$10,793	\$2,637	\$12,113	\$25,543

**d. Summary**

The following table is a summary of the parties' positions regarding this expense:

Item #	Description	December 2007 Application <sup>374</sup>	WBSR Final Recommendation <sup>375</sup>	ED Recommendation <sup>376</sup>
15	Annual Depreciation and Amortization	\$144,573	\$23,565	\$25,543

**e. The ALJ's Analysis**

As previously stated, the ALJ is of the opinion that DDU has failed to properly demonstrate the original costs of a majority of its assets listed in the depreciation schedule in its application. However, in the event the Commission decides to grant DDU's application, the ALJ recommends that the Commission utilize the ED's analysis of the annual depreciation expense for each individual water system.

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<sup>371</sup> ED Exh. 2, att. D.

<sup>372</sup> ED Exh. 2, att. C.

<sup>373</sup> ED Exh. 2, att. B.

<sup>374</sup> DDU Exh. 25, pg. 14.

<sup>375</sup> WBSR Closing, pg. 15.

<sup>376</sup> ED Exh. 1, atts. B, F, and J.

### **13. Federal Income Taxes**

#### **a. DDU's Position**

As set out in the application, DDU calculated the income tax expense by taking the return of \$213,482 and subtracting the product of total invested capital (\$1,840,362) and the weighted cost of debt capital percentage (10 percent), to derive a taxable income of \$29,446.<sup>377</sup> The amount of income tax is derived from a tax table.

DDU listed an income tax expense of \$5,206.<sup>378</sup> This amount was entered from Table V, Line [F] of its December 2007 application.<sup>379</sup>

#### **b. WBSR's Position**

WBSR did not perform an analysis regarding the appropriate amount of income tax. WBSR recommends relying on the ED's income tax calculations.<sup>380</sup>

#### **c. The ED's Position**

As discussed above, the ED reduced the weighted average cost of DDU's debt for each individual water system, primarily because the loan from Double Diamond Delaware, Inc. was a loan from an affiliated interest. The ED also reduced the total invested capital. For the Cliffs and the White Bluff systems, the ED's analyses resulted in a negative taxable income, and therefore, zero federal income tax. The ED made the following determinations for the amounts of federal income tax:

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<sup>377</sup> DDU Exh. 25, pg. 13, Table V.

<sup>378</sup> DDU Exh. 25, pg. 14, ln. [P].

<sup>379</sup> DDU Exh. 25, pg. 13, Table V., ln. [F].

<sup>380</sup> WBSR Closing, pg. 25.

Item #	Description	The Cliffs <sup>381</sup>	The Retreat <sup>382</sup>	White Bluff <sup>383</sup>	ED Recommendation <sup>384</sup>
16	Income Taxes	\$0	\$2,121	\$0	\$2,121

**d. Summary**

The following table is a summary of the parties' positions regarding this expense:

Item #	Description	December 2007 Application <sup>385</sup>	WBSR Final Recommendation <sup>386</sup>	ED Recommendation <sup>387</sup>
16	Income Taxes	\$5,206	\$2,121	\$2,121

**e. The ALJ's Analysis**

DDU's taxable income is dependent on properly calculating its return, total invested capital, and its weighted cost of debt capital.<sup>388</sup> Since DDU did not meet its burden of proof on these entries, it likewise did not meet its burden regarding the amount of its federal income tax expense. Therefore, DDU has not supported the income tax expense in its revenue requirement. However, in the event the Commission decides to grant DDU's application, the ALJ recommends that the Commission utilize the ED's analysis in calculating DDU's income tax expense.

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<sup>381</sup> ED Exh. 1, att. H. Since the Cliffs has a taxable income of -\$3,936, the federal income tax is \$0.

<sup>382</sup> ED Exh. 1, att. D. The Retreat has a taxable income of \$12,017, which falls within the 15 percent tax bracket.

<sup>383</sup> ED Exh. 1, att. J. Since White Bluff has a taxable income of -\$5,096, the federal income tax is \$0.

<sup>384</sup> ED Exh. 1, atts. B, F, and J.

<sup>385</sup> DDU Exh. 25, pg. 14.

<sup>386</sup> WBSR Closing, pg. 15.

<sup>387</sup> ED Exh. 1, atts. B, F, and J.

<sup>388</sup> DDU Exh. 25, pg. 13.

#### 14. Return

As discussed above, the ALJ has concerns regarding DDU's calculations of its return. The ALJ will not restate those arguments but will provide the following table as a summary of the parties' positions regarding the proper amounts for this item in DDU's revenue requirement:

Item #	Description	December 2007 Application <sup>389</sup>	WBSR Final Recommendation <sup>390</sup>	ED Recommendation <sup>391</sup>
17	Return	\$216,054	\$4,168	\$20,887

As previously stated, the ALJ is of the opinion that DDU has failed to properly calculate its return. However, in the event the Commission decides to grant DDU's application, the ALJ recommends that the Commission utilize the ED's analysis to arrive at a return for each individual water system.

#### 15. Other Revenues

In determining a utility's revenue requirement, other revenues are deducted from the utility's expenses.

##### a. DDU's Position

DDU did not subtract any amount for other revenues in its revenue requirement.<sup>392</sup>

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<sup>389</sup> DDU Exh. 25, pg. 14, ln. [Q].

<sup>390</sup> WBSR Closing, pg. 15.

<sup>391</sup> ED Exh. 1, atts. C, G, and K.

<sup>392</sup> DDU Exh. 25, pg. 14, ln. [S].

**b. WBSR's Position**

WBSR did not analyze this item in the revenue requirement.<sup>393</sup> However, WBSR recommends that since the ED identified other revenues, the revenue requirement should reflect \$48,336 in other revenues found by the ED.

**c. The ED's Position**

The ED stated that a utility collects the cost of installing a tap through its tap fees.<sup>394</sup> If a utility collects that amount through its rates, it would collect that amount twice. Therefore, the ED subtracted a total of \$48,336 from DDU's revenue requirement as other revenue.

Item #	Description	The Cliffs <sup>395</sup>	The Retreat <sup>396</sup>	White Bluff <sup>397</sup>	ED Recommendation
19	Other Revenues	(\$10,977)	(\$7,522)	(\$29,837)	(\$48,336)

**d. Summary**

This is a summary of the parties' recommendations regarding "other revenues":

Item #	Description	December 2007 Application <sup>398</sup>	WBSR Final Recommendation <sup>399</sup>	ED Recommendation
19	Other Revenues	(\$0)	(\$48,336)	(\$48,336)

<sup>393</sup> WBSR Closing, pg. 29.

<sup>394</sup> ED Closing, pg. 20.

<sup>395</sup> ED Exh. 1, att. E.

<sup>396</sup> ED Exh. 1, att. A.

<sup>397</sup> ED Exh. 1, att. I.

<sup>398</sup> App. Exh. 25, pg. 14.

<sup>399</sup> WBSR Closing, pg. 15.

**e. The ALJ's Analysis**

The ALJ is unaware of evidence in the record to support the ED's contention that DDU is generating \$48,336 in other revenues from tap fees. During the 2006 test year, DDU added four metered connections.<sup>400</sup> Assuming it collected \$400 for each new connection,<sup>401</sup> DDU would have only generated \$1,600 in tap fees for that period. Since the record is relatively silent regarding DDU's other revenues, the ALJ recommends that no amount should be deducted from DDU's revenue requirement.

**D. Summary of ALJ's Recommendations Regarding DDU's Revenue Requirements**

As previously discussed, the ALJ recommends that DDU's application to change its water rates be denied. However, in the event the Commission disagrees, the table below represents the total of the ALJ's recommendations for DDU's revenue requirements for the three water systems. The ALJ recommends that the Commission use the ED's analysis for calculating the revenue requirement for each water system separately. The ALJ requests that the ED recalculate the referenced expenses to allocate 60 percent of the expense to the water system, make any other necessary changes as a result of the recalculations, and include those recalculations in his exceptions.

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<sup>400</sup> DDU Exh. 25, pg. 15. The number of DDU customers increased from 824 to 828 from the beginning to the end of the 12 month test year.

<sup>401</sup> See, DDU Exh. 25, pg. 21.

Item #	Description	ALJ's Recommendation
1	Salaries and Wages	\$115,638 <sup>402</sup>
2	Contract Labor	-
3	Purchase Water	10,322
4	Chemicals for Treatment	7,427 <sup>403</sup>
5	Utilities (Electricity)	172,004
6	Repairs/Maintenance/Supplies	107,808
7	Office Expenses	5,579 <sup>404</sup>
8	Accounting & Legal Fees	0
9	Insurance	21,593 <sup>405</sup>
10	Rate Case Expense	0
11	Miscellaneous	0
<b>12</b>	<b>Subtotal</b>	<b>\$440,371<sup>406</sup></b>
13	Payroll Taxes	0
14	Property and Other Taxes	5,704
15	Annual Depreciation and Amortization	25,543
16	Income Taxes	2,121
17	Return	20,887
<b>18</b>	<b>Subtotal</b>	<b>\$54,255</b>
19	Other Revenues	(0)
<b>20</b>	<b>Total Cost</b>	<b>\$494,626<sup>407</sup></b>

<sup>402</sup> To be adjusted for a 60/40 percent allocation to the water/wastewater systems.

<sup>403</sup> To be adjusted for a 60/40 percent allocation to the water/wastewater systems.

<sup>404</sup> To be adjusted for a 60/40 percent allocation to the water/wastewater systems.

<sup>405</sup> To be adjusted for a 60/40 percent allocation to the water/wastewater systems.

<sup>406</sup> To be adjusted by the ED.

<sup>407</sup> To be adjusted by the ED.

**E. Financial Integrity**

The Texas Water Code allows the Commission to set rates at a level necessary to preserve a utility's financial integrity.<sup>408</sup> In some cases, a utility's financial integrity might be at risk if it charged only the amounts necessary to recover a reasonable return on its investment over and above its reasonable and necessary expenses.

DDU offered evidence that the company as a whole had been operating at a loss for the last several years.<sup>409</sup> 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.<sup>410</sup> DDU offered no evidence that it was at risk of a financial collapse if this application to change its rates was denied.

**VIII. RATE DESIGN**

Once a utility's reasonable and necessary allowable expenses are calculated, the Commission must fix the utility's rates so that its costs are apportioned among its customers. To do that, each cost item must be separated into fixed and variable components. The fixed portion should be recovered through base rates per meter and the variable portion should be recovered by a per-1000-gallons charge.<sup>411</sup> When some customers receive service through larger meters, each of their meters is equivalent to several smaller meters; and an equivalency factor must be included to account for that difference. No party disputes these principles.

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<sup>408</sup> TEX. WATER CODE ANN. § 13.183(a)(2).

<sup>409</sup> DDU Exh. B, pg. 2, ln. 10-11.

<sup>410</sup> DDU Exh. B, pg. 2, ln. 24-30.

<sup>411</sup> 30 TAC § 291.32(c).

**A. DDU's Rate Design**

As previously stated, DDU developed one revenue requirement for all three systems. Table IX.B of the application "is used to make base rate calculations."<sup>412</sup> Through its calculations of fixed and variable costs and total meter equivalents, DDU determined a monthly base rate per meter of \$49.22.<sup>413</sup> DDU also calculated "an alternate method of rate design"<sup>414</sup> but did not provide testimony to indicate that this alternate rate design met the regulatory requirements<sup>415</sup> or was being implemented by DDU.

From the one rate calculation in its application, DDU proposed two rates: one rate for the Cliffs development and a different rate for the White Bluff and the Retreat developments. The notice to the Cliffs ratepayers was included in DDU's August 2007 application<sup>416</sup> but was not included in the December 2007 application. The notice showed that the Cliffs ratepayers would pay a \$52 monthly base rate that included 1,000 gallons. There would also be the following gallonage charges per 1,000 gallons over the minimum:

\$2.60 per 1,000 gallons, 1,001-10,000 gallons  
\$5.20 per 1,000 gallons, 10,001-20,000 gallons  
\$7.80 per 1,000 gallons, 20,001 gallons and over thereafter<sup>417</sup>

Although DDU reduced the revenue requirement in its December 2007 application by \$237,518,<sup>418</sup> DDU did not revise the Cliffs' rates in its December application.

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<sup>412</sup> DDU Exh. C, pg. 8, ln. 40.

<sup>413</sup> DDU Exh. C., pg. 8, ln. 40-43; DDU used a total fixed cost of \$674,472. DDU Exh. 25, pg. 17, Table IX.B., ln. [A]. According to the TCEQ application, the total fixed costs should have been derived from either Table VI. A., Line [T], box 9 or Line [U], Box 10, or \$679,325 and \$344,506, respectively.

<sup>414</sup> DDU Exh. 25, pg. 18, Table X.A. and X.B.

<sup>415</sup> See, 30 TAC § 291.34.

<sup>416</sup> DDU Exh. 30, pg. 38-39.

<sup>417</sup> DDU Exh. 30, pg. 39.

<sup>418</sup> Compare, DDU Exh. 30, pg. 28, ln. [T] (revenue requirement in Aug. 2007 app. = \$1,281,476) with DDU Exh. 25, pg. 14, ln. [T] (revenue requirement in Dec. 2007 app. = \$1,043,958) for a reduction of \$237,518.

DDU's August 2007 application also included a notice to White Bluff and the Retreat ratepayers with a \$42 monthly base rate that included 1,000 gallons.<sup>419</sup> DDU indicated that the White Bluff and Retreat ratepayers would pay the following gallonage charges:

\$2.50 per 1,000 gallons, 1001-10,000 gallons  
\$2.75 per 1,000 gallons, 10,001–20,000 gallons  
\$5.25 per 1,000 gallons, 20,001 gallons thereafter<sup>420</sup>

In DDU's December 2007 application, DDU reduced its revenue requirement and revised the notice for the White Bluff and the Retreat ratepayers.<sup>421</sup> The only change in the rates for these two developments was in the highest tier of the gallonage charges. DDU reduced the amount per 1,000 gallons used over 20,001 gallons from \$5.25 to \$3.20.<sup>422</sup>

The rates in the August 2007 application went into effect on September 28, 2007. Even though DDU lowered its gallonage charge for the highest tier for the White Bluff and the Retreat ratepayers in its December 2007 application, DDU did not charge the lower rate and apparently never sent out the December 2007 notice. DDU charged the rates in the August 2007 application until December of 2008, when the rates requested in the October 2008 rate application went into effect.<sup>423</sup> Therefore, the rates requested in the August 2007 application were in effect for approximately 15 months.

Regarding rate design, Mr. Gillespie, Jr. testified that as a consultant, he calculates rates by allocating the fixed and the variable costs.<sup>424</sup> He makes the recommendations to the client, who then ultimately sets the rate. While the rates in the August 2007 application "may or may not be" the rates calculated by the consultant, the rates in the application "are supported" by the

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<sup>419</sup> DDU Exh. 30, pg. 36-37.

<sup>420</sup> DDU Exh. 30, pg. 37.

<sup>421</sup> DDU Exh. 25, pg. 21.

<sup>422</sup> DDU Exh. 25, pg. 21.

<sup>423</sup> Tr., pg. 280, ln. 13-19.

<sup>424</sup> Tr., pg. 80, ln. 15 – pg. 81, ln. 1.

consultant's calculations.<sup>425</sup> When testifying about whether the rates would recover revenues over or under the revenue requirement shown in the August 2007 application, Mr. Gillespie, Jr. testified that "it was very likely" that the rates would recover an amount under the revenue requirement, but he did not know for sure, presumably because "[he] did not make that calculation personally."<sup>426</sup>

DDU did not present evidence demonstrating how much revenue would be recovered from its proposed rates. DDU did present evidence that after the fact, the rates it implemented generated \$1,044,931 in "water revenue" for the period of December 31, 2007 through December 28, 2008.<sup>427</sup> There is no testimony in the record discussing whether this entry for "water revenues" in any way indicates that DDU's rates adequately recovered the revenue requirement shown in the December 2007 application.

## **B. WBSR's Position**

WBSR calculated rates for each individual water system that are lower than the rates in effect prior to the filing of the August 2007 application.<sup>428</sup> WBSR prepared rates with a monthly base rate and one volumetric rate.<sup>429</sup> WBSR also prepared rates with an inclining block rate structure for each system.<sup>430</sup> This inclining block rate structure is similar to the structure proposed by DDU.<sup>431</sup> The following table was prepared by WBSR and sets out the rates necessary to recover a revenue requirement of \$301,813.

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<sup>425</sup> Tr., pg. 81, ln. 19-24.

<sup>426</sup> Tr., pg. 82, ln. 19 – pg. 83, ln. 14.

<sup>427</sup> DDU Exh. 37, 5th pg. (exhibit pages are not numbered).

<sup>428</sup> WBSR Closing, pg. 35.

<sup>429</sup> WBSR Exh. A, pg. 21, ln. 9-15. The pages referenced in WBSR's prefiled testimony are to the actual page number of the prefiled testimony, not the bates stamped number.

<sup>430</sup> WBSR Exh. 18.

<sup>431</sup> WBSR Exh. A, pg. 21, ln. 16-20.

WBSR's Table 10: Calculation of Recommended Rates.<sup>432</sup>

DDU Statement of Operations		White Bluff	The Retreat	The Cliffs	Total
1	Total Revenue Requirement, Net Adjustments per WBSR and TCEQ <sup>433</sup>	\$157,578	\$30,017	\$114,217	\$301,813
<b>Total Customer Count at End of Year<sup>434</sup></b>					
2	5/8" Meter	518	44	201	
3	1" Meter	19	-	12	
4	1 1/2" Meter	5	3	1	
5	2" Meter	11	1	14	
6	3" Meter	-	-	-	
<b>Meter Equivalents<sup>435</sup></b>		Factor			
7	5/8" Meter	1	518	44	201
8	1" Meter	2.5	48	-	30
9	1 1/2" Meter	5	25	15	5
10	2" Meter	8	88	8	112
11	3" Meter	15	-	-	-
12		679	67	348	1,094
13	<b>Proposed Minimum Bill</b>	<b>\$5.00</b>	<b>\$5.00</b>	<b>\$15.00</b>	<b>\$7.50</b>
14	Revenues Recovered Through Minimum Bill	\$40,710	\$4,020	\$62,640	\$98,415
15	Revenues to Recover from Volumetric Rate	\$116,868	\$25,997	\$51,577	\$203,398
<b>Volumetric Rate</b>					
16	0-1000	\$-	\$-	\$-	\$-
17	1001-10000	\$0.68	\$0.38	\$1.32	\$0.81
18	10001-20000	\$1.18	\$0.88	\$1.82	\$1.31
19	20001 and up	\$1.68	\$1.38	\$2.32	\$1.81
<b>Consumption within Blocks<sup>436</sup></b>					

<sup>432</sup> WBSR Closing, pg. 35. Footnotes within table were prepared by WBSR.

<sup>433</sup> WBSR Closing, pg. 5, Table 1.

<sup>434</sup> WBSR Exh. 17, pg. 65, ln. 39-43.

<sup>435</sup> WBSR Exh. 17, pg. 65, ln. 44-49.

<sup>436</sup> WBSR Exh. 18, pg. 67, ln. 20-24.

DDU Statement of Operations		White Bluff	The Retreat	The Cliffs	Total
20	0-1000	5,621,106	429,590	1,786,688	7,837,384
21	1001-10000	36,823,750	3,141,030	9,044,816	49,009,596
22	10001-20000	22,207,081	2,643,995	5,270,315	30,121,391
23	20001 and up	39,194,851	16,252,870	12,931,850	68,379,571
24		103,846,788	22,467,485	29,033,669	155,347,942
<b>Revenues Recovered from Volumetric Rates</b>					
25	0-1000	\$-	\$-	\$-	\$-
26	1001-10000	24,956	1,200	11,954	39,855
27	10001-20000	26,154	2,332	9,601	39,556
28	20001 and up	65,758	22,464	30,023	123,987
29		\$116,868	\$25,997	\$51,577	\$203,398
30	Total Revenue Recovery Through Rates	\$157,578	\$30,017	\$114,217	\$301,813
31	Revenue Over/(Under) Recovery	\$-	\$-	\$-	\$-

As can be seen from the above table, WBSR calculated the amount of revenues DDU could anticipate to recover based on WBSR's proposed rates. To calculate the proposed rates, WBSR relied on the revenue requirement as adjusted by WBSR and the ED. WBSR's calculations show that its proposed rate would recover the revenue requirement. WBSR argues that while the rates are lower than those in effect before DDU filed its August 2007 application, section 13.187(h) the Texas Water Code requires that "if the Commission finds the rates currently begin charged or those proposed to be charged are unreasonable or in violation of law, the regulatory authority shall determine the rates to be charged by the utility and shall fix the rates by order served on the utility."<sup>437</sup>

### C. The Cliffs Subdivision Ratepayers' Position

In the Closing Arguments, the Cliffs Ratepayers state that the new water rate for the Cliffs is unfair and inappropriate. They point out that the majority of private owners are

<sup>437</sup> WBSR Closing, pg. 36.

vacationers that have minimal water usage. The Cliffs Ratepayers argue that the high base rate proposed for the Cliffs water system “places a disproportionately high cost on the customers that use the water system the least.” They state that heavy water users “benefit from a comparatively low average cost per 1000 gallons with [DDU’s] rate structure.” According to the Cliffs Ratepayers, “the heaviest water user is Double Diamond in support of its public-use hotel, conference center, restaurant, spa, golf shop, marina and two pools at The Cliffs Resort. [Therefore], the major beneficiary of volume discounting on water consumption is Double Diamond itself.”<sup>438</sup>

#### **D. The ED’s Position**

The ED argues that while DDU calculated one rate from one revenue requirement, DDU has never shown how it calculated a different rate for the Cliffs and a different rate for White Bluff and the Retreat.<sup>439</sup> It is the ED’s position that without showing how it arrived at its ultimate rates, DDU made it difficult to determine if the rates are based on the financial information included in the application. The ED states that the only “hint” of how DDU arrived at its rates is an email that states that Mr. Gracy “want[ed] to charge the same as Sportsman’s World.”<sup>440</sup> The ED argues that “[w]hile DDU can use Sportsman’s World charges or any other amounts for its gallonage charges, it still must use its revenue requirement to calculate its base rate.”<sup>441</sup> The ED asserts that this issue alone warrants a denial of DDU’s application because of its failure to meet its burden of proof.<sup>442</sup>

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<sup>438</sup> The Cliffs Ratepayers’ Closing. The ALJ assumes that the Cliffs ratepayers are referring to Double Diamond Delaware, Inc., an affiliated interest of DDU.

<sup>439</sup> ED Closing, pg. 8.

<sup>440</sup> ED Exh. 5, pg. 80. Sportsman’s World is a “neighboring” municipal utility district. ED Exh. 5, pg. 78.

<sup>441</sup> ED Closing, pg. 9.

<sup>442</sup> ED Closing, pg. 9.

Based on his adjustments to DDU's revenue requirements, the ED proposed the following rates for each individual water system:

White Bluff<sup>443</sup>

Monthly Base rate with 1,000 gallons included	\$10.33
Gallorage charges	\$ 1.51 per 1,000 gallons

The Retreat<sup>444</sup>

Monthly Base rate with 1,000 gallons included	\$31.36
Gallorage charges	\$ 1.58 per 1,000 gallons

The Cliffs<sup>445</sup>

Monthly Base rate with 1,000 gallons included	\$16.90
Gallorage charges	\$ 3.73 per 1,000 gallons

These proposed rates would recover the revenue necessary to meet the ED's revenue requirement for each individual water system.<sup>446</sup> The ED's proposed rates are significantly lower than DDU's rates in effect before and after the filing of the August 2007 application. Even though the ED calculated rates lower than DDU's prior rates, the ED recommends that DDU's application be denied and that the rates revert back to those rates existing prior to the August 2007 application increases.<sup>447</sup>

**E. The ALJ's Analysis**

DDU failed to meet its burden of proof that the rates it proposed in its August 2007 and December 2007 applications are just and reasonable. DDU failed to provide any evidence on

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<sup>443</sup> ED Exh. 2, pg. 12, ln. 17-23.

<sup>444</sup> ED Exh. 2, pg. 13, ln. 7-13.

<sup>445</sup> ED Exh. 2, pg. 13, ln. 20 – pg. 14, ln. 3.

<sup>446</sup> Compare ED Exh. 2, att. E, F, & G, with DDU Exh. 25, pg. 21 (White Bluff and the Retreat notice) with DDU Exh. 30, pg. 39 (the Cliffs notice).

<sup>447</sup> ED Closing, pg. 3, 20-21, 27, and 33.

how its proposed rates were calculated. Based on the analysis of DDU's fixed and variable costs, DDU's December 2007 application showed a base rate of \$51.56 for a 5/8" meter.<sup>448</sup> For the Cliffs, DDU proposed a \$52 base rate<sup>449</sup> and for White Bluff and the Retreat, DDU proposed a \$42 base rate.<sup>450</sup> However, even though DDU calculated one revenue requirement, DDU came up with two very different gallonage charges for the developments:

#### The Cliffs

\$2.60 per 1000 gallons, 1,001-10,000 gallons  
\$5.20 per 1000 gallons, 10,001–20,000 gallons  
\$7.80 per 1000 gallons, 20,001 gallons thereafter<sup>451</sup>

#### White Bluff and the Retreat

\$2.50 per 1000 gallons, 1,001-10,000 gallons  
\$2.75 per 1000 gallons, 10,001–20,000 gallons  
\$5.25 per 1000 gallons, 20,001 gallons thereafter<sup>452</sup>

DDU does not provide calculations on how these varying gallonage charges were determined. Mr. Gillespie, Jr. testified that “[the consultants] make a recommendation based on straight calculations on the rates, and then the client makes adjustments based on intangible things and information that we don't have about the operation.”<sup>453</sup> He defined intangibles as “a thing that, in my view is not provable or touchable or—intangible benefits are things that don't accrue directly, that don't fall right to the bottom line. Goodwill being a good example of an intangible benefit. . . .”<sup>454</sup> Mr. Gillespie, Jr. also stated “I don't really know what basis they used to make [adjustments to the rate recommended by the consultant]. But I'm assuming that intangible things like, is the economy dumped? Is – is there a serious unemployment in the area

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<sup>448</sup> DDU Exh. 25, pg. 17, IX. B, ln. [D].

<sup>449</sup> DDU Exh. 30, pg. 39.

<sup>450</sup> DDU Exh. 25, pg. 21.

<sup>451</sup> DDU Exh. 30, pg. 39.

<sup>452</sup> DDU Exh. 30, pg. 37.

<sup>453</sup> Tr., pg. 114, ln. 19 – pg. 115, ln. 1.

<sup>454</sup> Tr., pg. 127, ln. 16-22.

where they're operating? These are not specific to Double Diamond, but all of my clients have to make these decisions. . . ."<sup>455</sup>

Mr. Gillespie, Jr.'s testimony that it is the client who sets the rates based upon intangibles peculiar to the system is somewhat supported by the evidence. As pointed out by the ED, the only evidence in the record of how DDU set its rates is an email stating that the president of DDU wants to charge the same rates at the Cliffs that are charged at Sportsman's World, a neighboring municipal utility district.<sup>456</sup> In this email, a DDU employee stated: "I was looking at my attached letter here and see that the rate that [the President of DDU] wanted to charge at the Cliffs is wrong. He wants to charge the same as Sportsman's World. It will be \$2.60/1000-9000 - \$5.20/9001-17000 gal & \$7.80/17001+ gal."<sup>457</sup> Other than some differences in the gallonage ranges, these are the same rates that DDU proposed for the Cliffs. DDU appears to use the gallonage ranges in its August 2007 application, with the Sportsman's World MUD's gallonage charges. Mr. Gracy testified that DDU's revenue requirement governs the setting of its rates and gave a general discussion of rate setting considerations.<sup>458</sup> However, DDU offered no specific evidence to demonstrate how the actual base rates and gallonage charges were in fact derived.

As stated by the ED, the fact that DDU's proposed rates are the same as the rates at Sportsman's World MUD would not by itself indicate that DDU inappropriately set its gallonage charges. However, this is the only evidence in the record to suggest how DDU actually set its gallonage charges.

Furthermore, DDU provided no evidence on how much revenue would be generated by its proposed rates. The ALJ is aware that Exhibit 37 contains an entry that indicates that

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<sup>455</sup> Tr., pg. 122, ln. 7-17.

<sup>456</sup> ED Exh. 5, pg. 80.

<sup>457</sup> ED Exh. 5, pg. 80.

<sup>458</sup> Tr., pg. 299, ln. 20 – pg. 301, ln. 7.

for 2008, DDU had “water revenues” of \$1,044,931.<sup>459</sup> DDU offered this exhibit into evidence “to demonstrate the impact on Double Diamond Utilities of the noticed rates collected since September 28, 2007.”<sup>460</sup> Mr. Shea testified that DDU operated at a net loss for 2008.<sup>461</sup>

That is the extent of the testimony regarding Exhibit 37. There is no discussion of whether this amount accurately reflects water revenue generated from rates alone. There is no discussion of the number of connections that generated this amount or how this amount was actually calculated. Any further explanation of Exhibit 37 would now be outside the record and cannot be considered. Therefore, the ALJ does not rely on this lone figure in eight pages of DDU’s Statement of Operations as an indication that DDU’s rates would adequately recover the revenue requirement and not more.

The other evidence in the record also fails to clarify how much revenue DDU’s rates would recover. Mr. Gillespie, Jr. stated that while he did not make the calculations, his firm would have determined whether the actual rate structure DDU requested would recover the revenue requirement exactly.<sup>462</sup> He testified that his firm has a spreadsheet program that was run in this case to determine the revenue that the requested rates would generate.<sup>463</sup> However, that spreadsheet is not part of the record. DDU has not provided sufficient information to determine that its proposed rates would not recover more revenue than needed to meet the revenue requirement.

The question is now whether new rates should be imposed as calculated by WBSR or the ED or to require that the rates revert back to those in effect before the filing of the August 2007 application. WBSR argues that the Commission should set the rates that are dictated by the evidence and that DDU should not benefit from its failure to meet its burden of proof. Since

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<sup>459</sup> DDU Exh. 37, 5th page.

<sup>460</sup> Tr., pg. 254, ln. 10-12.

<sup>461</sup> Tr., pg. 256, ln. 5-9.

<sup>462</sup> Tr., pg. 83, ln. 13-21.

<sup>463</sup> Tr., pg. 83, ln. 24 – pg. 84, ln. 7.

WBSR incurred the expense of participating in the hearing, it asks that the lower rates be set by Commission order.

Even though he calculated new rates that are lower than DDU's rates as they existed before the August 2007 application, the ED recommends that DDU's application should simply be denied and the rates should revert back to their prior levels. The ED stated that "[i]t is difficult to imagine how DDU's water systems will continue to function if their rates are reduced far below their current rates."<sup>464</sup>

The decision regarding the rates that DDU should charge after this case is a difficult one. Clearly, DDU has failed to meet its burden of proof to show that its proposed rates are just and reasonable. It simply did not provide sufficient documentation for the entries in its application. It is not disputed that DDU has assets on the ground that are used and useful. However, what is disputed is the original costs of those assets and the level of developer contributions in those assets. The ALJ is convinced that DDU incurred some allowable expenses that are reasonable and necessary. However, the ALJ is not convinced that DDU incurred all the expenses claimed in its application to provide water service and properly excluded expenses attributable to the wastewater system. The problem in this case is one of a lack of evidentiary proof.

As previously discussed, DDU failed to show that the Retreat and White Bluff are substantially similar in their costs of service to allow DDU to charge one rate for both water systems. That is the problem with returning the rates to the pre-August 2007 levels. Allowing the rates to revert back to those in effect before the August 2007 application would simply continue the inappropriate rate structure. However, as pointed out by the ED,<sup>465</sup> DDU had the burden to prove that its proposed rates are just and reasonable. It had no burden at all in this hearing to show that its rates as they existed before DDU filed its August 2007 application were just and reasonable. Therefore, the ALJ agrees with the ED that DDU's application should be denied and the rates should revert back to those existing prior to this rate case.

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<sup>464</sup> ED Reply to Closings, pg. 7.

<sup>465</sup> ED Reply to Closings, pg. 5.

## IX. REFUNDS

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 finally ordered plus interest as determined by the regulatory authority.” The question remains what interest should be paid to the ratepayers.

### A. DDU’s Position

DDU did not take a position on this issue.

### B. WBSR’s Position

WBSR argued that since DDU presented testimony from its president that 10 percent was reasonable for interest on a loan, 10 percent should be reasonable for interest on a refund, especially since the overpayment of rates is a type of loan from the ratepayers to the utility.<sup>466</sup>

### C. The Cliffs Subdivision Ratepayers’ Position

The Cliffs Ratepayers seek a refund with 10 percent interest.<sup>467</sup>

### D. The McCartneys’ Position

The McCartneys seek a refund plus interest. However, the McCartneys do not request a specific interest rate.<sup>468</sup>

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<sup>466</sup> WBSR Closing, pg. 38.

<sup>467</sup> The Cliffs Subdivision Ratepayers’ Closing.

<sup>468</sup> The McCartneys’ Closing.

**E. ED's position**

The ED argues that the interest on any refunds should be 5.21 percent but does not explain his position on why the interest rate should be 5.21 percent.<sup>469</sup>

**F. ALJ's Analysis**

In the recent case of the *Application of Buena Vista Water System to Change its Water Rates and Tariff*, the Commission denied the utility's request to raise its rates.<sup>470</sup> The Commission ordered a refund with 6.00 percent interest. Based on this prior agency action, the ALJ recommends that DDU refund the difference between the rates collected and DDU's prior rates plus 6.00 percent interest. This was the rate originally suggested by the ED in his prefiled testimony.<sup>471</sup> The ALJ is unaware of the reason for the ED amending his recommendation to 5.21 percent at the hearing.

In the event the Commission decides to grant DDU's application, the ratepayers at the Retreat and White Bluff are still entitled to a refund plus interest. In its December 2007 application, DDU reduced the gallonage charge for water use over 20,001 gallons from \$5.25 per thousand gallons to \$3.20 per thousand gallons.<sup>472</sup> These ratepayers paid the higher rate for 15 months even though DDU reduced the proposed rates. If the Commission grants DDU's application, DDU should be required to refund these ratepayers the amount they paid over the proposed rates, plus 6.00 percent interest.

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<sup>469</sup> ED Closing, 34; ED Exh. 2, pg. 17, ln. 14 (as amended at Tr., pg. 216, ln. 6).

<sup>470</sup> TCEQ Docket No. 2007-1787-UCR (Apr. 17, 2009).

<sup>471</sup> ED Exh. 2, pg. 17, ln. 14.

<sup>472</sup> DDU Exh. 25, pg. 21.

## X. MISCELLANEOUS MATTERS

### A. Miscellaneous Fees

In addition to the rate change, DDU requested to change its tariff by increasing its miscellaneous fees, such as tap fees, return check fees, deposits, and meter test fees.<sup>473</sup> The ALJ was unable to locate any testimony from DDU to support these fees. WBSR took no position on these miscellaneous fees and the ED recommended that DDU's request for the increase of these fees be granted.<sup>474</sup>

This part of DDU's application seems to be uncontested and should have been the subject of a stipulation. However, the definition of rate is very broad and encompasses charges in a tariff like the miscellaneous fees at issue here.<sup>475</sup> Since DDU had the burden of proof to show that its "proposed change of rates" is just and reasonable,<sup>476</sup> the ALJ cannot recommend granting this portion of DDU's application in the absence of evidence to support the change.

### B. National Association of Regulatory Utility Commissioners (NARUC)

The ED recommended that DDU "be ordered to . . . [r]eview any future system construction and/or purchase costs closely and maintain cost records by using National Association of Regulatory Utility Commissioners (NARUC) property accounts to facilitate future rate adjustment filings."<sup>477</sup> The ED did not elaborate on how following NARUC standards would in fact facilitate future rate cases. Nevertheless, given DDU's failure to produce cost records sufficient to prove the original cost of its assets and the amount of expenses, the ALJ would recommend that DDU use such NARUC property accounts.

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<sup>473</sup> DDU Exh. 25, pg. 21 & 23; DDU Exh. 30, pg. 39 & 42.

<sup>474</sup> ED Closing, pg. 2.

<sup>475</sup> TEX. WATER CODE ANN. § 13.002(17).

<sup>476</sup> TEX. WATER CODE ANN. § 13.184(c).

<sup>477</sup> ED Exh. 2, pg. 17, ln. 7-11.

### C. Transcription Costs

According to its rules, the Commission will consider the following factors in allocating reporting and transcription costs among the other parties:

(d) Assessment of reporting and transcription costs.

- (1) Upon the timely filed motion of a party or upon its own motion, the commission may assess reporting and transcription costs to one or more of the parties participating in the proceeding. The commission shall consider the following factors in assessing reporting and transcription costs:
  - (A) the party who requested the transcript;
  - (B) the financial ability of the party to pay the costs;
  - (C) the extent to which the party participated in the hearing;
  - (D) the relative benefits to the various parties of having transcript;
  - (E) the budgetary constraints of a state or federal administrative agency participating in the proceeding;
  - (F) in rate proceedings, the extent to which the expense of the rate proceeding is included in the utility's allowable expenses; and
  - (G) any other factor which is relevant to a just and reasonable assessment of costs.<sup>478</sup>

The Commission's rules provide that the Commission will not assess transcript costs against the ED or the OPIC.<sup>479</sup>

Because the hearing was scheduled for more than one day, DDU was ordered to arrange for a court reporter to record and transcribe the hearing on the merits.<sup>480</sup> DDU was required to

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<sup>478</sup> 30 TAC § 80.23(d)(1).

<sup>479</sup> 30 TAC § 80.23(d)(2); TEX. WATER CODE ANN. §§ 5.275 & 5.356.

pay the cost of the recording and transcription subject to an allocation of those costs among all the parties at the end of the case.<sup>481</sup> At the conclusion of the hearing, the court reporter prepared a transcript and submitted it to the Chief Clerk.

DDU, WBSR, OPIC, and the ED utilized the transcript in making their closing arguments and responses. The McCartneys and the Cliffs Ratepayers did not. During cross-examination, all parties used their time efficiently and did not waste time or ask repetitive or unnecessary questions.

DDU has not requested that the reporting and transcription costs be allocated among the parties. Apparently, the assessment of these costs is not an issue in this case since no party presented evidence or argument on this issue.<sup>482</sup> Therefore, given the absence of a request for allocation, the ALJ recommends that DDU be assessed the full cost of the reporting and transcription costs for this contested case hearing.

## XI. RECOMMENDATION

The ALJ recommends that the Commission adopt the attached order denying DDU's 2007 application for a rate change in its entirety. The ALJ also recommends that the Commission order DDU to:

- Refund or credit to customers all sums collected from September 28, 2007 to December 2008 under the rates proposed in the August 2007 application that exceed the rates approved by the Commission in this case, plus six percent interest.

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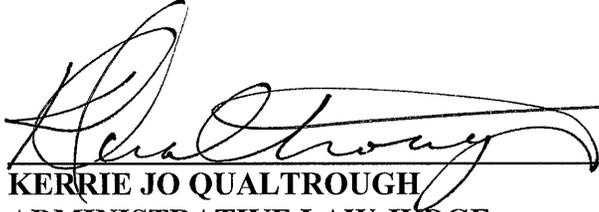
<sup>480</sup> 1 TAC § 155.43(b); 30 TAC § 80.23(b)(4).

<sup>481</sup> Feb. 13, 2008 Order No. 2, pg. 5, § VIII.

<sup>482</sup> 30 TAC § 80.23(d)(3).

- Review any future construction and purchase costs closely and maintain records by NARUC property accounts.
- Pay all of the reporting and transcription costs.

**SIGNED June 15, 2009.**



**KERRIE JO QUALTROUGH  
ADMINISTRATIVE LAW JUDGE  
STATE OFFICE OF ADMINISTRATIVE HEARINGS**

# TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



**AN ORDER  
DENYING THE APPLICATION OF DOUBLE DIAMOND  
UTILITIES TO INCREASE ITS RATES  
SOAH DOCKET NO. 582-08-0698  
TCEQ DOCKET NO. 2007-1708-UCR**

On \_\_\_\_\_, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Double Diamond Utilities (DDU) to change its water rates and its tariff in Hill, Palo Pinto, and Johnson Counties, Texas, under Certificate of Convenience and Necessity No. 12087. A Proposal for Decision (PFD) was presented by Kerrie Jo Qualtrough, an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH).

After considering the ALJ's PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

## **I. FINDINGS OF FACT**

### **Procedural History and Jurisdiction**

1. DDU provides retail water utility service under Certificate of Convenience and Necessity No. 12087, in Hill, Johnson, and Palo Pinto Counties, Texas.
2. DDU operates three water systems serving three separate developments: White Bluff water system (Hill County), the Retreat water system (Johnson County), and the Cliffs water system (Palo Pinto County).

3. In addition to its three water systems, DDU operates three wastewater systems, one for each development.
4. Notices of the proposed rate change were mailed to DDU's customers on July 27, 2007.
5. On August 7, 2007, DDU filed its application to increase its water rates and amend its tariff.
6. The effective date of the increase was September 28, 2007.
7. In December 2007, DDU filed an additional application to supplement the August 7, 2007 application. These two applications are collectively referred to as the "2007 application."
8. More than ten percent of DDU's customers filed protests by the applicable deadline.
9. On October 24, 2007, the Commission's Chief Clerk referred the application to SOAH for hearing.
10. On November 14, 2007, the Chief Clerk mailed notice of a preliminary hearing to DDU.
11. On November 29, 2007, SOAH issued an order requiring that the preliminary hearing be held in Hillsboro, Texas, on February 5, 2008.
12. On December 13, 2007, the Chief Clerk mailed the revised notice of a preliminary hearing to DDU.
13. DDU mailed the revised notice of the preliminary hearing to its customers on January 9, 2008.
14. The notice contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.

15. On February 5, 2008, an ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

<b>PARTY</b>	<b>REPRESENTATIVE</b>
DDU	Michael Skahan
Executive Director (ED)	Stephanie Skogen
Office of Public Interest Counsel (OPIC)	Eli Martinez
White Bluff Subdivision Ratepayers (WBSR)	Shari Heino
Jack and Sandra McCartney	Themselves
The Cliff's Subdivision Ratepayers	Todd McCall

16. No party disputes either the Commission's or SOAH's jurisdiction.

17. The ALJ held the hearing on the merits of the application on February 23-24 and all of the parties appeared and participated.

**Overview of the Proposed Rate Increase**

18. At the end of the 2006 test year, on December 31, 2006, the three water systems combined had the following number of metered connections:

<b>Metered Connections: All three subdivisions</b>	<b>Total</b>
5/8" X 3/4"	749
1"	38
1 1/2"	10
2"	31
<b>Total</b>	<b>828</b>

19. In its August 2007 application, DDU asserted that it had a revenue requirement of \$1,281,476.

20. In the December 2007 application, DDU asserted it had a revenue requirement of \$1,043,958.
21. In both the August and December 2007 applications, DDU calculated its revenue requirement by combining the financial information for all three water systems. DDU did not calculate the revenue requirement for each water system separately.
22. In its application, DDU requested to change its rates as follows:

	<b>Previous Rates</b>	<b>August 2007 Application</b>	<b>December 2007 Application</b>
<b>The Cliffs - Minimum Bill</b>			
5/8"	\$ 30.00	\$ 52.00	NA
1"	50.10	127.00	NA
1 1/2"	99.90	253.00	NA
2"	159.80	405.00	NA
3"	320.00	757.00	NA
<b>Gallonge Charge per 1000 gallons</b>			
0-10,000 Gallons	\$ 1.85	\$ 2.60	NA
10,001-20,000 Gallons	4.75	5.20	NA
Over 20,001 Gallons	6.75	7.80	NA
<b>White Bluff and the Retreat - Minimum Bill</b>			
5/8"	\$30.00	\$42.00	\$42.00
1"	\$50.10	\$65.00	\$65.00
1 1/2"	\$99.90	\$128.00	\$128.00
2"	\$159.80	\$280.00	\$280.00
3"	\$320.00	\$425.00	\$425.00
<b>Gallonge Charge per 1000 gallons</b>			
0-10,000 Gallons	\$1.85	\$2.50	\$2.50
10,001-20,000 Gallons	\$2.10	\$2.75	\$2.75
Over 20,001 Gallons	\$4.75	\$5.25	\$3.20

23. On September 28, 2007, DDU began charging the rates in the August 2007 application.

24. The December 2007 application reduced the volumetric rate for over 20,001 gallons for the White Bluff and the Retreat ratepayers from the rate of \$5.25 per thousand gallons to \$3.20 per thousand gallons.
25. DDU prepared a notice to the White Bluff and the Retreat ratepayers. This notice reflecting the lower rate of \$3.20 per thousand gallons over 20,001 gallons was included in the December 2007 application. DDU did not send notice of the reduction in the requested rate to the White Bluff and Retreat ratepayers and did not charge the ratepayers the lower gallonage charge found in its December 2007 application.
26. DDU charged the rates in its August 2007 application until December of 2008.
27. On October 24, 2008, DDU submitted another application for a rate increase, which is not the subject of this case.
28. The rates at issue in this proceeding were in effect approximately 15 months.

**Multiple Systems Consolidated Under One Tariff and Rate Design**

29. Prior to filing its August 2007 application, DDU utilized the same two-rate structure for the three subdivisions: The ratepayers in White Bluff and the Retreat paid the same rate while the Cliffs ratepayers paid a different rate. DDU continues this same rate structure in its 2007 application.
30. DDU did not present evidence on why the two water systems should be consolidated under one rate.
31. DDU did not show how the Retreat and the White Bluff water systems are substantially similar in terms of their costs of service.

### **Developer Contributions and the Effect on Invested Capital**

32. DDU did not include developer contributions in either the August 2007 or December 2007 application for test year 2006.
33. DDU acquired assets from 2001 through June 2006 that had a “developer cost.” Some of these asset additions include “CL Lake pump improvements,” “CL water system improvement,” “RT Phase 1 & 2 Water/Sewer,” and “RT water well & tank.”
34. There were \$930,547 worth of developer contributions for the White Bluff and the Cliffs water systems. For the “WB” and “CL” water systems, there was \$249,153.86 in developer contributions in aid of construction in 1998.
35. DDU’s subsequent application for a rate change, dated October 24, 2008, listed \$1,904,489 in developer contributions. DDU’s October 24, 2008 rate change application also showed that for the vast majority of developer contributed assets listed, the installation dates occurred before the 2006 test year that is the subject of this proceeding.
36. Developers contributed a percentage of the cost of some of DDU’s assets. DDU’s application should have identified some amount of developer contributions to accurately determine DDU’s total invested capital.
37. DDU claimed a total invested capital of \$1,840,362 in its December 2007 application. The accuracy of this amount is questionable in light of DDU’s failure to account for developer contributions.

### **General Concerns with DDU’s Application**

38. DDU’s accounting documents in the evidentiary record do not separate expenses and assets for the water systems from those for the wastewater systems.

39. Few of the amounts in DDU's exhibits match the corresponding entries in the application. DDU's accounting documents and invoices do not generally reconcile with its application.
40. DDU's witnesses did not have sufficient knowledge of the application to answer specific questions about how the entries in the application were determined.
41. DDU did not provide a sufficient explanation of its application and the proposed rates. Amounts in the application could not be verified through either DDU's exhibits or its witnesses.

**One Combined Revenue Requirement for Three Water Systems**

42. DDU grouped all three water systems together to develop one revenue requirement. For test year 2006, DDU's revenue requirement for all three systems combined was \$1,043,958 as shown in the December 2007 application. DDU did not demonstrate how just and reasonable rates for the three separate water systems could be derived from one revenue requirement.
43. The Cliffs, the Retreat, and the White Bluff water systems are different in terms of age, size, type of development served, cost of service, and sources of water.
44. DDU should have prepared three separate revenue requirements for the three separate water systems.

**Return on Invested Capital**

45. DDU listed the assets for each water system in its depreciation schedule in the December 2007 application. DDU then totaled the entries for all three systems and added in DDU's general items to obtain the total net book value. DDU's general items include backhoes and trucks that are used for both the water and wastewater systems. DDU did

not show that it allocated the cost of its general items between the water and wastewater systems.

46. Rounded to the nearest dollar, the following table summarizes DDU's depreciation schedule and annual depreciation expense:

	<b>Total Original Cost</b>	<b>Total Annual Depreciation</b>	<b>Total Net Book Value</b>
General Items	\$300,100	\$ 26,502	\$ 94,295
The Cliffs	898,290	63,504	305,309
The Retreat	603,709	18,591	552,969
White Bluff	1,167,269	35,965	813,434
Total	\$2,969,368	\$144,562	\$1,766,007

47. DDU did not provide sufficient evidence to prove the original cost of all of the assets it claimed in its depreciation schedule in the application.
48. There is no prior TCEQ order establishing a rate base for any of DDU's water systems.

**Invested Capital, Rate of Return, and Return**

49. To determine its invested capital for all three systems combined, DDU showed on its application a net book value of \$1,766,007, working cash allowance of \$72,855, and materials and supplies of \$1,500 for a total of \$1,840,362. DDU showed \$0 for developer contributions.
50. In calculating a utility's invested capital, developer contributions are subtracted from the utility's total of net book value, working cash allowance, and materials and supplies.
51. To calculate its rate of return (ROR), DDU used one worksheet for all three water systems combined.

52. The three DDU water systems combined do not constitute a small water system of 200 or less connections. The three DDU water systems combined do not constitute a stand alone sewer system. The three DDU water systems combined do not meet both the conditions of aging system and unstable population listed on the TCEQ's ROR worksheet.
53. DDU should have prepared the ROR worksheet for each individual water system and determined whether the water system met the conditions in the worksheet to determine the appropriate ROR.
54. Other than a general conclusion that it met the factors in the ROR worksheet, DDU did not present specific evidence demonstrating how it met the other factors in the ROR worksheet.
55. DDU erroneously calculated an ROR of 12 percent.
56. In determining the weighted average cost of debt that DDU has in the three water systems, DDU showed an unpaid balance of \$734,990 on a loan from Double Diamond Delaware, Inc. DDU claimed an interest rate of 10 percent on the loan from its parent company, Double Diamond Delaware, Inc. DDU used this 10 percent interest to calculate its weighted rate of return.
57. DDU is a Qualified S Corporation of Double Diamond Delaware, Inc. and is not treated as a separate company for federal tax purposes. DDU's assets, liabilities, and all items of income, deduction, and credit are treated as those of Double Diamond Delaware, Inc. Any income incurred by DDU belongs to the parent company, including any interest on the loan that DDU collects from its customers through its rates.
58. Double Diamond Delaware, Inc. and DDU are affiliated interests.

59. In calculating just and reasonable rates, 10 percent is not an appropriate interest rate for a loan from an affiliated interest because a loan between affiliated interests is not an arm's length transaction.
60. DDU did not demonstrate that the 10 percent interest rate paid to its affiliated interest was reasonable and necessary.
61. In determining the weighted average cost of investment/equity, DDU listed \$3,024,118 as its equity in the three water systems combined. DDU did not prove how it calculated that it had \$3,024,118 in equity in the water systems.
62. DDU used the erroneous calculation of 12 percent from the ROR worksheet to calculate its weighted average cost of investment/equity.
63. In its December 2007 application, DDU's revenue requirement in Table VI.A. claimed a return of \$216,054. This is a \$2,572 discrepancy from the amount of DDU's return of \$213,462 shown in DDU's application at Table IV.E, line [H].
64. Based on errors in calculating its ROR, its weighted average costs of debt and equity, and its failure to include developer contributions in its total invested capital calculations, DDU erroneously calculated its return.

#### **Operation and Maintenance Expenses**

65. For each expense category, DDU presented one amount for all three water systems combined.
66. DDU should have calculated the expenses for each water system separately.

#### **Salary Expenses**

67. In its application, DDU claimed that its salary expense was \$272,369 for all three water systems combined.

68. DDU did not demonstrate that the \$272,369 in salary expenses claimed in its application was an allowable expense that was reasonable and necessary to provide water service.

**Purchased Water**

69. In its application, DDU indicated that it incurred a purchased water expense of \$7,363. The Cliffs is the only surface water-based system.

70. DDU did not demonstrate that the amount of \$7,363 as a purchased water expense is an allowable expense that is reasonable and necessary to provide water service.

**Chemicals**

71. In its application, DDU indicated that it incurred \$12,300 as a chemical expense for the three water systems combined.

72. DDU did not demonstrate how the claimed amount for chemical expenses excluded expenses for the wastewater systems.

73. DDU did not demonstrate that the amount of \$12,300 as a chemical expense is an allowable expense that is reasonable and necessary to provide water service.

**Utilities (electricity)**

74. In its application, DDU listed \$58,775 in electric utility expenses, purportedly for the three water systems combined.

75. DDU did not demonstrate how the claimed amount for electric utility expenses excluded expenses for the wastewater systems.

76. DDU did not demonstrate that the amount of \$58,775 in electric utility expenses is an allowable expense that is reasonable and necessary to provide water service.

### **Repairs/Maintenance/Supplies**

77. In its application, DDU listed \$203,729 as an allowable expense for repairs, maintenance, and supplies for all three water systems combined.
78. DDU did not demonstrate how the claimed amount for the expense of repairs, maintenance, and supplies excluded expenses for the wastewater systems.
79. DDU did not demonstrate that the amount of \$203,729 for the expense of repairs, maintenance, and supplies is an allowable expense that is reasonable and necessary to provide water service.

### **Office Expense**

80. DDU included the amount of \$5,500 as an office expense in its application.
81. DDU did not demonstrate how the claimed amount for office expenses excluded expenses for the wastewater systems.
82. DDU did not demonstrate that the amount of \$5,500 as an office expense is an allowable expense that is reasonable and necessary to provide water service.

### **Accounting and Legal Fees**

83. In its application, DDU represented that it incurred \$6,100 as an allowable expense for accounting and legal fees.
84. DDU did not demonstrate how the claimed amount for the expense of accounting and legal fees excluded expenses for the wastewater systems.
85. DDU did not demonstrate that the amount of \$6,100 as an expense for accounting and legal fees is an allowable expense that is reasonable and necessary to provide water service.

### **Insurance**

86. In its application, DDU indicated an amount of \$12,200 as an allowable expense for insurance.
87. DDU did not demonstrate how the claimed amount for insurance expenses excluded expenses for the wastewater systems.
88. DDU did not demonstrate that the amount of \$12,200 as an insurance expense is an allowable expense that is reasonable and necessary to provide water service.

### **Rate Case Expense**

89. In its application, DDU claimed \$4,500 for rate case expenses.
90. DDU did not demonstrate that the amount of \$4,500 as a rate case expense is an allowable expense that is reasonable and necessary to provide water service.
91. DDU's rates as a result of the hearing are less than 51 percent of the increase in revenue that would have been generated by DDU's proposed rate.

### **Payroll Taxes**

92. In its application, DDU claimed \$90,789 in expenses for payroll taxes.
93. DDU did not demonstrate how the claimed amount for payroll expenses excluded expenses for the wastewater systems.
94. DDU did not demonstrate that the amount of \$90,789 for payroll tax expenses is an allowable expense that is reasonable and necessary to provide water service.

### **Property and Other Taxes**

95. DDU claimed \$4,500 in property and other taxes.
96. DDU did not demonstrate how the claimed amount for the expense of property and other taxes excluded expenses for the wastewater systems.

97. DDU did not demonstrate that the amount of \$4,400 for property and other tax expenses is an allowable expense that is reasonable and necessary to provide water service.

#### **Annual Depreciation and Amortization**

98. DDU calculated its annual depreciation expense for all three water systems combined.
99. In the depreciation schedule included in its December 2007 application, DDU listed the amount of \$144,560.90 as an annual depreciation expense. In its revenue requirement found on its Table IV.A. of its application, DDU listed the amount of \$144,573 as its amount of annual depreciation. This is a \$12 discrepancy between the amounts shown for this expense in its application.
100. DDU failed to provide sufficient documentation to support its depreciation schedule and the amount of its depreciation expense in its application.
101. DDU failed to demonstrate that the amount of \$144,573 for annual depreciation is an allowable expense that is reasonable and necessary to provide water service.

#### **Federal Income Taxes**

102. As set out in the application, DDU calculated its claimed income tax by taking its claimed return of \$213,482 and subtracting the product of its claimed total invested capital (\$1,840,362) and its claimed 10 percent weighted cost of debt capital, to derive a taxable income of \$29,446. Based on that income, DDU listed an income tax expense of \$5,206.
103. Since DDU did not properly calculate its total invested capital, its ROR, and its return, DDU did not properly calculate its federal income tax expense.

104. DDU did not demonstrate that the amount in its application for its federal income tax expense is an allowable expense that is reasonable and necessary to provide water service.

### **Return**

105. Since DDU did not properly calculate its total invested income and its ROR, DDU did not properly calculate the amount of its return.

### **Other Revenues**

106. DDU did not enter any amount for other revenues in its revenue requirement.

107. The evidence does not indicate that DDU recovered \$48,336 in tap fees during the test year as other revenues.

108. For each water system, \$0 is the proper amount for "other revenues."

### **Financial Integrity**

109. DDU is not at risk of a financial collapse if this application to change its rates is denied.

### **Rate Design**

110. In its application, DDU calculated a monthly base rate per meter of \$49.22 through its calculations of fixed and variable costs and total meter equivalents.

111. DDU also calculated "an alternate method of rate design" but did not provide evidence to indicate that the alternate rate design met the regulatory requirements or was to be implemented by DDU.

112. DDU proposed two rates: one rate for the Cliffs water system and a different rate for the White Bluff and the Retreat water systems.

113. The notice to the Cliffs ratepayers was included in DDU's August 2007 application but was not included in the December 2007 application. The notice showed that the Cliffs

ratepayers would pay a \$52 monthly base rate that included 1,000 gallons. There would also be the following gallonage charges per 1,000 gallons over the minimum: \$2.60 per 1,000 gallons, 1,001-10,000 gallons; \$5.20 per 1,000 gallons, 10,001–20,000 gallons; \$7.80 per 1,000 gallons, 20,001 gallons and over thereafter.

114. Although DDU reduced the revenue requirement in its December 2007 application by \$237,518, DDU did not revise the Cliffs' rates.
115. DDU's August 2007 application included a notice to White Bluff and the Retreat ratepayers with a \$42 monthly base rate that included 1,000 gallons. DDU indicated that the White Bluff and Retreat ratepayers would pay the following gallonage charges: \$2.50 per 1,000 gallons, 1001-10,000 gallons; \$2.75 per 1,000 gallons, 10,001–20,000 gallons; and \$5.25 per 1,000 gallons, 20,001 gallons thereafter.
116. In DDU's December 2007 application, DDU reduced its revenue requirement by \$237,518 and revised the notice for the White Bluff and the Retreat ratepayers. The only change in the rates for these two developments was in the highest tier of the gallonage charges. DDU reduced the amount per 1,000 gallons used over 20,001 gallons from \$5.25 to \$3.20.
117. Even though DDU lowered its gallonage charge for the highest tier for the White Bluff and the Retreat ratepayers in its December 2007 application, DDU did not charge the lower rate and did not send out the December 2007 notice.
118. DDU charged the rates in the August 2007 application from September 28, 2007 until December of 2008, when the rates requested in DDU's October 2008 rate application went into effect. Therefore, the rates requested in the August 2007 application were in effect for approximately 15 months.

119. DDU did not demonstrate how it calculated two rates from one revenue requirement.
120. DDU did not demonstrate how the proposed gallonage charges were determined.
121. DDU did not demonstrate how much revenue would be recovered from its proposed rates.
122. DDU did not demonstrate whether the revenue from its proposed rates would fail to meet, meet, or exceed its revenue requirement.

### **Refunds**

123. DDU collected the proposed rates between September 28, 2007 and December 2008.

### **Miscellaneous Items**

124. DDU did not present evidence to support its request to increase its miscellaneous fees, such as deposits and return check charges.
125. DDU should review any future construction and purchase costs closely and maintain its records by National Association of Regulatory Utility Commissioners property accounts.

### **Transcription Costs**

126. DDU was required to pay the cost of recording and transcription subject to an allocation of those costs among all the parties at the end of the case.
127. DDU, WBSR, OPIC, and the ED benefitted from the use of a transcript.
128. DDU did not request that the reporting and transcription costs be allocated among the parties.
129. No party presented evidence or argument on the issue of assessment of reporting and transcription costs.
130. The assessment of the reporting and transcription costs is not an issue in this case.

## CONCLUSIONS OF LAW

### Procedural History and Jurisdiction

1. DDU is a retail public utility. TEX. WATER CODE ANN. § 13.002(19).
2. DDU is a water and sewer utility. TEX. WATER CODE ANN. § 13.002(23).
3. The Commission has jurisdiction to consider an application for a rate increase filed by a water and sewer utility. TEX. WATER CODE ANN. § 13.042(e).
4. All required notices of the application and the contested case hearing on it were given as required by law. TEX. WATER CODE ANN. § 13.187; TEX. GOV'T CODE ANN. §§ 2001.051 & 2001.052.
5. The ALJ conducted a contested case hearing and proposed a decision on the application under the authority of chapter 2003 of the Texas Government Code and chapter 13 of the Texas Water Code.

### Multiple Systems Consolidated Under One Tariff and Rate Design

6. “Every utility is required to file tariffs showing all rates that are subject to the jurisdiction of the regulatory authority.” The utility’s rules and regulations are part of the tariff. TEX. WATER CODE ANN. § 13.136(a).
7. The TCEQ defines tariff as “[t]he schedule of a retail public utility containing all rates, tolls, and charges stated separately by type or kind of service and the customer class, and the rules and regulations of the retail public utility stated separately by type or kind of service and the customer class.” 30 TEX. ADMIN. CODE (TAC) § 291.3(48).
8. Before multiple systems can be consolidated under a single tariff or rate design, a utility must meet certain conditions. “A utility may consolidate its tariff and rate design for more than one system if: the systems included in the tariff are substantially similar in

terms of facilities, quality of service, and cost of service; and the tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.”

30 TAC § 291.21(m); *see also* TEX. WATER CODE ANN. § 13.145(a).

9. DDU has the burden of proving that its proposed rates are just and reasonable. TEX. WATER CODE ANN. § 13.184(c).
10. Based on the above Findings of Fact, DDU failed to meet its burden of proof that the Retreat and White Bluff water systems are substantially similar in terms of their costs of service.
11. Because the costs of service for the two systems are not substantially similar, DDU has not met the 30 TAC § 291.21(m)(1) requirements and the White Bluff and the Retreat water systems cannot be consolidated under a single rate design.

#### **Developer Contributions and the Effect on Invested Capital.**

12. Developer contributions are not included in a utility’s invested capital. 30 TAC § 291.31(c)(3)(A)(iv) & (v).
13. Based on the above Findings of Fact, DDU included developer contributions in its claimed total invested capital, although the exact amount cannot be determined.

#### **Return**

14. The Commission, in setting the rates for water service, must fix a utility’s overall revenues at a level that will permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses and preserve the financial integrity of the utility. TEX. WATER CODE ANN. § 13.183.

15. The Commission is generally prohibited from setting rates that would allow DDU to earn more than a fair return on its capital that is used and useful in providing water service. TEX. WATER CODE ANN. § 13.184(a).
16. The Commission may promulgate reasonable rules with respect to the allowance or disallowance of certain expenses for ratemaking purposes. TEX. WATER CODE ANN. § 13.185(g).
17. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered. 30 TAC § 291.31(a) & (b).
18. "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing. TEX. WATER CODE ANN. § 13.002(22).
19. Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. Utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital. TEX. WATER CODE ANN. § 13.185(b).

20. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service. Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility, except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. TEX. WATER CODE ANN. § 13.185(j).
21. The rate of return is applied to the invested capital, also referred to as rate base. 30 TAC § 291.31(c)(2). Components to be included in determining the rate base are as follows:
- (A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:
    - (i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;
    - (ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;
    - (iii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC, § 13.185(e);
    - (iv) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and
  - (B) working capital allowance to be composed of, but not limited to, the following:
    - (i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

- (ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, § 13.185(e); and
  - (iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).
- 22. In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management. TEX. WATER CODE ANN. § 13.184 (b).
- 23. Payment to affiliated interests for costs of any services, or any property, right or thing, or for interest expense may not be allowed either as capital cost or as an expense except to the extent that the regulatory authority finds that payment is reasonable and necessary. TEX. WATER CODE ANN. § 13.185(e).
- 24. Based on the above Findings of Fact, DDU did not meet its burden of proof that the interest expense on the loan from its affiliated interest, Double Diamond Delaware, Inc., is reasonable and necessary.
- 25. Under 30 TAC § 291.31(c)(1), the return on invested capital is the rate of return multiplied by invested capital. The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital. The Commission fixes the rate of return in accordance with the following principles:

- (A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.
- (B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.
- (C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

26. Based on the above Findings of Fact, DDU failed to meet its burden of proof that its calculations regarding total invested capital, rate of return, and return comply with the TCEQ's rules.

### **Revenue Requirement**

27. Under 30 TAC § 291.31(b)(1), allowable expenses, to the extent they are reasonable and necessary, and subject to that section, may include, but are not limited to, the following general categories:

- (A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), §13.185(e));
- (B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;

- (C) assessments and taxes other than income taxes;
  - (D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, § 13.185(f), if applicable);
  - (E) reasonable expenditures for ordinary advertising, contributions, and donations; and
  - (F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.
28. Certain types of expenses are not allowed as a component of cost of service, such as those expenditures found by the Commission to be unreasonable or unnecessary, including civil penalties or fines. TEX. WATER CODE ANN. § 13.185(h)(3); 30 TAC § 291.31(b)(2)(I).
29. Based on the above Findings of Fact, DDU failed to meet its burden of proof that its claimed allowable expenses are reasonable and necessary to provide water service.

### **Rate Design**

29. The Commission has adopted rules concerning alternative rate methods. 30 TAC § 291.34. To ensure that retail customers receive a higher quality, more affordable, or more reliable water or sewer service, to encourage regionalization, or to maintain financially stable and technically sound utilities, the Commission may utilize alternate methods of establishing rates. The Commission shall assure that rates, operations, and service are just and reasonable to the consumers and to the utilities.
30. DDU did not demonstrate that it applied for rates adopted using alternative rates methods. There is no evidence to show that its rates should be set according to such an alternative method.

31. There is no evidence that any portion of the proposed rate increase is necessary to preserve DDU's financial integrity.
32. Based on the above Findings of Fact and Conclusions of Law, DDU has failed to meet its burden of proving that its application should be granted. DDU has failed to meet its burden of proof that its proposed rates are just and reasonable.
33. Based on the above Findings of Fact and Conclusions of Law, DDU's application for a change in its water utility rates should be denied.

**Rate Case Expenses**

34. Regarding rate case expenses, 30 TAC § 291.28(7) and (8) provide:
  - (7) A utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest.
  - (8) A utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.
35. Based on the above Findings of Fact and Conclusions of Law, DDU has failed to demonstrate that its rates should be increased. Therefore, in accordance with 30 TAC § 291.28(7) and (8), DDU should not be allowed to recover any rate case expenses for this case.
36. Based on the above Findings of Fact and Conclusions of Law, DDU's rates should revert back to those in effect before the filing of the August 2007 application to change DDU's water rates.

## **Refund**

36. “Unless 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 finally ordered plus interest as determined by the [Commission].”  
TEX. WATER CODE ANN. § 13.187(i).
37. Based on the above Findings of Fact and Conclusions of Law, DDU should refund or credit to its customers all sums collected since September 28, 2007, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection.

## **Transcription Costs**

38. The Commission will consider the following factors in allocating reporting and transcription costs among the parties, according to 30 TAC § 80.24(d)(1):
- (1) Upon the timely filed motion of a party or upon its own motion, the commission may assess reporting and transcription costs to one or more of the parties participating in the proceeding. The commission shall consider the following factors in assessing reporting and transcription costs:
    - (A) the party who requested the transcript;
    - (B) the financial ability of the party to pay the costs;
    - (C) the extent to which the party participated in the hearing;
    - (D) the relative benefits to the various parties of having a transcript;
    - (E) the budgetary constraints of a state or federal administrative agency participating in the proceeding;
    - (F) in rate proceedings, the extent to which the expense of the rate proceeding is included in the utility’s allowable expenses; and
    - (G) any other factor which is relevant to a just and reasonable assessment of costs.

39. The Public Interest Counsel may not appeal a ruling, decision, or other act of the Commission. TEX. WATER CODE ANN. § 5.275.
40. The Executive Director may not appeal a ruling, order, or other act of the Commission. TEX. WATER CODE ANN. § 5.356.
41. The Commission may not assess reporting or transcription costs to the Public Interest Counsel and the ED who, as statutory parties, are precluded by law from appealing any ruling, decision, or other act of the Commission. 30 TAC § 80.23(d)(2).
42. Based on the above Findings of Fact and Conclusions of Law, DDU shall be assessed the full amount of the reporting and transcription costs.

### **III. ORDERING PROVISIONS**

**NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY, IN ACCORDANCE WITH THESE FINDINGS OF FACT AND CONCLUSIONS OF LAW, THAT:**

1. The application of Double Diamond Utilities to increase the rates that it charges for the retail water utility service that it provides under Certificate of Convenience and Necessity No. 12087 in Hill, Johnson, and Palo Pinto Counties, is denied.
2. DDU shall immediately cease collecting the rates it proposed in this case.
3. Within \_\_\_\_\_ days, DDU shall refund or credit to customers all sums collected between September 28, 2007 and December of 2008, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection.
4. DDU shall review any future construction and purchase costs closely and maintain its records by National Association of Regulatory Utility Commissioners property accounts.
5. DDU shall be assessed the full amount of the reporting and transcription costs.

6. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
7. The effective date of this Order is the date the Order is final, as provided by 30 TAC § 80.273 and Texas Government Code § 2001.144.
8. If any provision, sentence, clause, or phrase of this Order is for any reason held to be invalid, the invalidity of any provision shall not affect the validity of the remaining portions of this Order.

**ISSUED:**

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**

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**Buddy Garcia, Chairman**  
**For the Commission**