SOAH DOCKET NO. 582-08-1023
TCEQ DOCKET NO. 2007-1867-UCR

APPLICATION FOR A WATER RATE/TARIFF CHANGE OF TEXAS LANDING UTILITIES, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11997 IN POLK AND MONTGOMERY COUNTIES, APPLICATION NO. 35838-R, AND FOR A SEWER/RATE TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 20569 IN POLK COUNTY, APPLICATION NO. 35840-R	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

TEXAS LANDING UTILITIES' EXCEPTIONS AND PROPOSED CORRECTIONS TO THE PROPOSAL FOR DECISION ON REMAND AND PROPOSED FINAL ORDER

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

Applicant, Texas Landing Utilities ("TLU"), Certificates of Convenience and Necessity Nos. 11997 and 20569, respectfully submits its Exceptions and Proposed Corrections to the Administrative Law Judge's ("ALJ's") Proposal for Decision on Remand ("PFD") and Proposed Final Order, and in support thereof would show the following:

I. SUMMARY OF TLU'S EXCEPTIONS AND PROPOSED FINAL ORDER CORRECTIONS

TLU agrees with the PFD on Remand and Proposed Final Order on the remanded issue of rate case expenses. TLU appreciates the thorough and well-reasoned analysis provided by Hon. ALJ Keeper and respectfully requests that the Commission adopt his recommendations on all rate case expense issues. However, TLU disagrees with the ALJ's PFD on Remand and Proposed Final Order as it pertains to the remanded line loss issue. Additionally, it appears that a few minor corrections to the Proposed Final Order are appropriate, including some the Hon. ALJ Smith recommended previously.

II. TLU'S EXCEPTIONS

In Section IX, pp. 29-36 of the PFD on Remand, the ALJ addresses Line Loss Issues and ultimately concludes that the ED's recommended handling of line loss in this case is reasonable. The recommended approach involves calculating a TLU gallonage charge using an altered gallons billed figure that is higher than TLU's actual test year gallons billed figure. The ALJ's conclusion is premised on evidence that shows gallons sold in years beyond the test year have caught up to the ED's hypothetical volume figure. The ALJ acknowledges that TLU's test year gallons billed figure would not allow TLU to fulfill its revenue requirement, but justifies use of the ED number based on post-test year data that shows TLU water sales above the altered gallons billed figure. PFD on Remand, at 34. Thus, the ALJ reasons, TLU can meet its revenue requirement. This is problematic in several respects.

Reaching outside the Application test year for rate design data is improper unless other corresponding adjustments to relevant cost of service data are also made. Generally, test year data in the rate filing package is used to set rates based on a historic 12-month period. TEX. WATER CODE § 13.002(22); 30 TEX. ADMIN. CODE §§291.3(30) and 291.31(b). Some of that data may be adjusted for known and measurable changes as appropriate. 30 TEX. ADMIN. CODE § 291.31(b). However, if known and measurable adjustments are made to test year data, other impacted cost of service data should also reasonably be adjusted as appropriate. The recommended approach to the line loss issue in the PFD on Remand does not do that.

Instead, the PFD on Remand recommends adjusting test year billing determinants included in the Application and supports the adjustment with post-test year data without consideration for any corresponding post-test year cost of service increases. For example, TLU expert Marvin B. Morgan, C.P.A., testified about specific increased service costs attributable to increased water production.

TLU-G at 11:17 - 12:1, 13:2 -15:21 (Morgan Additional Prefiled); TLU-64; TLU-65; TLU-75. He even offered alternative adjustment mechanisms to the ED's that focused on increased variable costs or the actual value of lost water instead of artificially inflating the billing determinants as the ED recommended. *Id.* Importantly, potential variable cost increases attributable to larger production volumes can include increased electricity or chemical costs associated with pumping, treating and delivering extra water. *Id.; see also,* ED-4, at 11 (Adhikari Supplemental Prefiled) (expressing concern for "extra costs associated with pumping and treating"). These costs, along with certain fixed costs, can increase along with higher customer consumption just as they can with higher "line loss" volume. But if the post-test year production is higher because of changes other than "line loss," such as customer growth, TLU's reasonable cost of service increases would also need to be considered. Otherwise, TLU will end up unreasonably shorted from achieving its actual revenue requirement.

Here, the same record exhibits relied upon by the ALJ show that TLU in fact experienced significant water customer growth between 2007 and 2009, the post-test year period, during which TLU increased its number of active water connections to approximately 185. TLU-39; TLU-40; ED-5 (2007-2009 TLU Annual Reports). In contrast, it was found in this case that TLU had about 143 active water connections during the test year 2006. PFD on Remand, at FOF 31. The precise impact of that customer growth on TLU's actual cost of service has simply not been fully examined in this case because TLU's Application was compiled using test year cost of service data as adjusted for known and measurable changes from an earlier time period. Data from later years did not become known or measurable until very late in the hearing process. It is unfair to partially infuse that post-test year data into the rate-setting process as the PFD on Remand recommends without making other appropriate adjustments. Partially mixing data sets to set rates without additional adjustments is neither just nor reasonable.

Not only is this unfair for the reasons discussed above, this approach is inconsistent with earlier decisions in this case. In the initial hearing on the merits, TLU offered post-test year data which would have increased its invested capital amount used for calculating return. PFD, at 12-13. Both the ED and prior ALJ determined that this post-test year data could not be considered in this docket even though it was known and measurable at the time of the hearing. *Id.* Now, both the ED and current ALJ are specifically recommending use of post-test year data to set TLU's gallonage charge. These recommendations are conflicting.

Finally, the ALJ does not consider that TLU was already penalized for its line loss. By adopting the ED's Rate of Return, the prior ALJ incorporated a penalty for TLU's line loss using the Rate of Return Worksheet. The Commission adopted a return figure using the ED's rate of return before remand. Unless the Commission decides to re-visit that issue, a double penalty will be assessed against TLU should the Commission adopt the ALJ's approach to line loss in the PFD on Remand. This double penalty approach to line loss is unreasonable and unfair.

The alternatives for dealing with line loss offered by Mr. Morgan are much more reasonable than the ED's recommended approach supported by the ALJ. Mr. Morgan offered TLU gallonage charge calculations to consider in the following forms: (1) with the ED's recommendation; (2) without any adjustment; and (3) with either of two other adjustment methods that accurately focus on the ED's stated goals for making adjustments for line loss in rate design. TLU-G at 9:7-10, 10:17-20, 13:15-18 and 15: 10-14 (Morgan Additional Prefiled); TLU-64; TLU-65; TLU-75. Those stated goals are to make sure customers are not paying for extra production costs. ED-4, at 11 (Adhikari Supplemental Prefiled). Mr. Morgan offered methods that focus specifically on those costs. TLU-G at 11:17 - 12:1, 13:2 -15:21 (Morgan Additional Prefiled); TLU-64; TLU-65; TLU-75. In contrast, the ED's approach, supported by the ALJ, makes an overly broad adjustment and sets unfair policy for Texas utilities.

In sum, TLU respectfully requests that the Commission adopt a Final Order that sets rates using either no adjustment for line loss or one of the methods offered by Mr. Morgan in his testimony. Additional review of the ED's recommended policy on this issue outside the scope of this contested case hearing may be warranted. Should the Commission adopt the recommendation in the PFD on Remand on the line loss issue, it would set a bad precedent for all Texas utility rate cases in the near term.

III. TLU'S PROPOSED FINAL ORDER CORRECTIONS

TLU notes a few items that appear to need correction as opposed to substantive modification in the Final Orders as proposed:

> **FOF No. 28** - Unless the Commission agrees with TLU that the ALJ's PFD on Remand does not recommend a reasonable gallonage charge, this FOF should include a $2.36 gallonage charge in line with FOF No. 53. This change was previously recommended by ALJ Smith in her February 2, 2010 letter to the Commission.
>
> **FOF No. 34** - This FOF should specify that "TLU's amount of invested capital should be reduced by $20,326 <u>for the purpose of calculating TLU's return on invested capital</u> because it is developer contribution-in-aid-of-construction." Developer contribution-in-aid-of-construction ("CIAC") amounts do not impact the amount of invested capital that may be used to calculate depreciation expense. In contrast, customer CIAC amounts are completely excluded from invested capital for both the purposes of calculating return and depreciation expense. As written, the FOF dose not make this clear.
>
> **FOF No. 46** - This FOF should identify the same invested capital amount as FOF No. 37. According to Exhibit C of the initial PFD, the proper amount is $162,935 as identified in FOF No. 37. This change was previously recommended by ALJ Smith in her February 2, 2010 letter to the Commission.
>
> **COL No. 15** - COL No. 15 should properly reference FOF No. 53, which sets forth rates and gallonage charges. This change was previously recommended by ALJ Smith in her February 2, 2010 letter to the Commission.
>
> **Ordering Provision No. 2** - TLU wants to ensure that the ALJ/Commission's intent is implemented with respect to refunds, and this provision is a bit unclear. The provision appears to require complete refunds/credits within 45 days, but also indicates refunds/credits should be made "over the same period of time that the excess rate was collected." The provision could be read as requiring complete refunds/credits within 45 days with interest applied only to the "over-collection"

period, or it could be intended to permit distribution of refunds/credits over the "over-collection" period to begin within 45 days. However, if full refunds/credits with interest in the short-term is what the Commission deems reasonable, TLU respectfully requests this ordering provision be revised to allow TLU at least 60 days, or two monthly billing periods, to complete the refunds/credits.

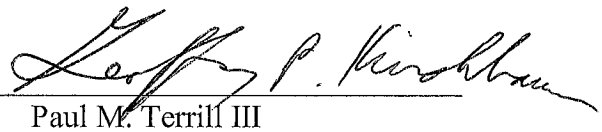
Referenced Exhibits - The exhibits referenced and included with the original PFD should be included with the new proposed Order as appropriate.

IV. CONCLUSION AND PRAYER

After considering the foregoing, TLU respectfully requests that the Commission adopt the ALJ's PFD on Remand and issue the ALJ's Proposed Final Order with the changes discussed herein. TLU respectfully requests approval of Application Nos. 35838-R and 35840-R, the rate/tariff changes requested by TLU in this proceeding, recovery of TLU's reasonable and necessary rate case expenses as recommended by the presiding ALJ, and all other and further relief to which TLU may be entitled at law or in equity.

Respectfully submitted,

THE TERRILL FIRM, P.C.

By: 

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CERTIFICATE OF SERVICE

I hereby certify that on June 7, 2011, a true and complete copy of the foregoing was sent to the following by facsimile, first-class mail or courier:

Parties	Representative / Address	Service
State Office of Administrative Hearings	Judge Paul D. Keeper 300 West 15th Street, Suite 502 Austin, TX 78701	*via electronic filing*
TCEQ	Docket Clerk Office of the Chief Clerk P.O. Box 13087 Austin, TX 78711	*via electronic filing*
TCEQ Executive Director	Ron Olson TCEQ, MC-173 P.O. Box 13087 Austin, TX 78711-3087	*via fax to: 239-0606*
Office of Public Interest Counsel of TCEQ	Eli Martinez TCEQ, OPIC MC-103 P.O. Box 13087 Austin, TX 78711-3087	*via fax to: 239-6377*
Bill Bryan and Texas Landing Homeowners Association and Subdivision	Bill Bryan 235 Branding Iron Livingston, TX 77351	*via first-class mail*
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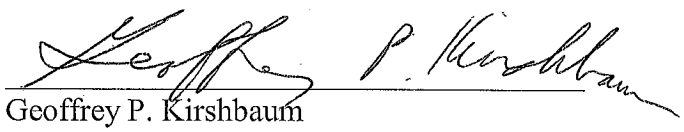
John Stacey and Texas Landing Homeowners Association and Subdivision	John Stacey 154 Buffalo Ct. Livingston, TX 77351	*via first-class mail*



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CHIEF CLERKS OFFICE
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

APPLICATION FOR A WATER RATE/TARIFF CHANGE OF TEXAS LANDING UTILITIES, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11997 IN POLK AND MONTGOMERY COUNTIES, APPLICATION NO. 35838-R, AND FOR A SEWER/RATE TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 20569 IN POLK COUNTY, APPLICATION NO. 35840-R	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

TEXAS LANDING UTILITIES' EXCEPTIONS AND PROPOSED CORRECTIONS TO THE PROPOSAL FOR DECISION AND PROPOSED ORDER

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

Applicant Texas Landing Utilities ("TLU"), water Certificate of Convenience and Necessity (CCN) No. 11997 and sewer CCN No. 20569, respectfully submits its Exceptions and Proposed Corrections to the Administrative Law Judge's ("ALJ's") Proposal for Decision ("PFD") and Proposed Order, and in support thereof would show the following:

I. SUMMARY OF TLU'S EXCEPTIONS AND PROPOSED CORRECTIONS

For the most part, TLU concurs with the conclusions reached in the ALJ's PFD and her proposed Findings of Fact ("FOFs") and Conclusions of Law ("COLs") reflected in her proposed Order, and TLU respectfully requests that the Commission adopt her recommended FOFs and COLs not excepted to herein. However, TLU excepts to certain portions of her PFD and Proposed Order that impact the final rates set in this matter. TLU's exceptions primarily relate to disagreements with certain TCEQ Executive Director ("ED") recommendations adopted by the ALJ in this case over TLU's objections.

TLU incorporates the discussions on those points in by reference here, but provides

additional analysis based on the ALJ's PFD and proposed Order FOFs and COLs. There are also a few minor corrections that TLU submits for consideration. TLU respectfully requests Commission consideration of all these issues as it reviews the ALJ's PFD and proposed Order, and issue a final decision incorporating the requested modifications discussed in these exceptions.

II. TLU'S EXCEPTIONS

TLU excepts to several sections of the PFD and corresponding proposed Order FOFs and COLs for which TLU requests Commission consideration. The exceptions include: (1) TLU's invested capital amount used to calculate its total return amount used for rate-setting; (2) TLU's approved rate of return on equity/overall rate of return used to calculate TLU's total return amount used for rate-setting, including use of a Rate of Return Worksheet; (3) a recommended water line loss penalty that impacts TLU's rate design; (4) the amount of TLU's approved tap fees; (5) the amount of customer contributions-in-aid-of-construction used for rate-setting; (6) TLU's overall total revenue requirement and corresponding rate design which are impacted by some of the other issues mentioned above; and (7) the analysis of the consolidated tariff statute, TEX. WATER CODE § 13.145, for TLU's rate/tariff change Applications.

A. Recommended Return and Revenue Requirement Should be Adjusted

TLU excepts to several adjustments recommended by the ED and ALJ that impact TLU's return, and consequently TLU's total revenue requirement, used for rate-setting purposes. First, TLU objects to the removal of $20,326 of TLU assets that comprise its Goode City water system from TLU's invested capital amount used to calculate return. Second, TLU objects to the overall ED/ALJ approach to rate of return ("ROR") in this case using a Rate of Return Worksheet attached to the TCEQ rate/tariff change application instructions, not the application form, but not required by either the rate/tariff change application instructions or form. Finally, TLU objects to the ED/ALJ approach to customer-contributed capital. These adjustments create other changes that flow through to TLU's total revenue requirement and corresponding rate design which should similarly be

adjusted.

1. Invested Capital

TLU excepts to the removal of $20,326 worth of TLU assets from its rate base for the purpose of calculating return on TLU's water invested capital. PFD, at 12-13. As noted by the ALJ, these assets are used and useful by TLU in providing water service using its Goode City Subdivision water system in Montgomery County *Id.* The ALJ correctly recommends that the Commission allow TLU to recover depreciation expense based in part on these assets. *Id.*; FOF No. 36. However, the ALJ incorrectly recommends excluding the assets from TLU's invested capital or rate base for the purpose of TLU's return calculation based on treatment as a developer contribution-in-aid-of construction ("DCIAC") and the ALJ's recommended finding that TLU did not own the assets at the time the application was filed even though those assets were paid for by an entity David L. Sheffield (*i.e.*, TLU) owns. PFD, at 12-13; FOF No. 34-35. *Id.* Moreover, TLU excepts to the ALJ's rejection of including these assets in TLU's invested capital for return purposes as a known and measurable change item. PFD, at 12-13.

a. David Sheffield Funded Assets are TLU Assets

TLU's expert witness, Mr. Marvin Morgan, C.P.A., testified during the hearing that he disagreed with the ED's recommended treatment of these TLU assets as DCIAC. Tr. at 208:15 - 209:15 (Marvin Morgan, May 22, 2009); Tr. at 505:10 - 506:5 (Marvin Morgan, May 22, 2009). Mr. Morgan's expert opinion is that these facilities should be combined with the rest of TLU's utility assets since they were paid for by Evergreen Country, L.L.C., a David Sheffield-owned affiliate of TLU. *Id.* Kimberly Comstock, TLU's bookkeeper, testified that when assets are transferred to TLU, she routinely debits the asset and either credits a loan from DLS, which is David Lee Sheffield, or just credits equity. Tr. at 103:14 - 25 (Kimberly Comstock, May 21, 2009). Most of the time it is a loan from DLS. *Id.* Despite this testimony, the ALJ has apparently accepted the ED's approach.

This does not make sense because Mr. Sheffield does business as Texas Landing Utilities

individually, so whatever is paid for by him or one of his companies and provided for use by the utility should be treated as invested capital for all ratemaking purposes. Tr. at 208:15 - 209:15 (Marvin Morgan, May 21, 2009); Tr. at 505:10 - 506:5 (Marvin Morgan, May 22, 2009). This accords with Mr. Morgan's overall utility accounting method of gathering all TLU's used and useful assets initially paid for by Mr. Sheffield or an affiliate and treating them as belonging to a single rate entity for rate-setting purposes. Tr. at 198:6 - 200:9 (Marvin Morgan, May 21, 2009). The important thing is that the utility is using the assets to provide service and they were paid for by David Sheffield or one of his affiliated business entities. *Id.* They were not paid for by a developer entity unrelated to Mr. Sheffield.

b. Known and Measurable Change was Implemented Reflecting TLU Asset Ownership

Mr. Morgan also testified about known and measurable changes. Tr. at 506:6 - 507:4 (Marvin Morgan, May 22, 2009). The term "known and measurable" is a utility ratemaking/accounting standard used in Texas which means the change represented in a pro forma adjustment is "known," or certain and not speculative, as well as "measurable," or there is enough data that will allow for a reasonable estimation or forecast. TLU-D at 8:13 - 9:4 (Morgan Prefiled). Mr. Morgan's opinion is, since there is no Commission rule on the subject, a known and measurable change can be accepted by the Commission up to the time of the final decision in a rate case such as this one that takes several years to litigate as long as the "known and measurable" standard is met. Tr. at 506:6 - 507:4 (Marvin Morgan, May 22, 2009).

This issue was addressed in a 2004 decision styled *In re Applications of North Orange Water & Sewer, L.L.C. to Change Water and Sewer Rates*; TCEQ Docket No. 2003-0597-UCR; SOAH Docket No. 582-03-3827. *North Orange* PFD, at 17-20. The ALJ cited 30 TEX. ADMIN. CODE § 291.31(b)(1)(B), which states that "allowable expenses" includes depreciation expense and that "depreciation shall be allowed on all *currently* used depreciable property owned by the utility." *Id.* (Emphasis added). The ALJ also found that the plain meaning of "currently used" supported

inclusion in invested capital of equipment acquired after the test year that was used and useful during the pendency of the rate case and at the time of the hearing. *Id.* The Executive Director advocated a 12-month post test year limit on known and measurable change additions in the *North Orange* case. *North Orange* ED's Exceptions to PFD at 8. This approach was rejected and equipment added after the post-test year 12 month-period was ultimately included in invested capital as part of the Commission's final rate approval. *North Orange* Order. While the ALJ is correct that the focus in *North Orange* was primarily on whether the assets should be included in invested capital for depreciation purposes, the ALJ seems to be overlooking the portion of the PFD indicating those assets were also included in invested capital for the return purposes, although it was determined that an adjustment to the value of those assets was necessary to prevent over-recovery. *North Orange*, PFD at 19.

While the issue here is primarily return, the concept reflected in this TCEQ precedent about inclusion of post-test year assets supports Mr. Morgan's position and would allow for consideration of the adjustment Ms. Comstock made to TLU's books shortly before the hearing to properly reflect the transfer of the remaining Goode City subdivision water system assets to TLU. Tr. at 104:8 - 106:12 (Kimberly Comstock, May 21, 2009). This interpretation would render moot the debate about the treatment of the previously un-transferred assets as DCIAC because they will be treated as transferred.

TLU excepts not only to the ALJ's rejection of Mr. Morgan's sound recommendations regarding treatment of the Goode City assets, but TLU also excepts to the ALJ's affirmative recommendation for the Commission to set arbitrary limits on the addition of known and measurable changes in a rate application proceeding without the use of proper rulemaking procedures. The ALJ recommends either: (1) limiting known and measurable changes to only the expense changes specifically allowed for in 30 TEX. ADMIN. CODE § 291.31(b); (2) permitting known and measurable changes to invested capital added by the time an applicant' pre-filed testimony is submitted; or (3)

requiring a showing of good cause per 30 TEX. ADMIN. CODE § 291.25(g). PFD, at 13. None of these deadlines are specifically provided for in the Texas Water Code or TCEQ rules and are contrary to general utility ratemaking/accounting principles advocated by TLU's expert witness.

Alternatively, if a bookkeeping omission may be considered good cause, at a minimum, the record evidence supports option #3. Tr. at 104:8 - 106:12 (Kimberly Comstock, May 21, 2009).[1] Although the bookkeeping transfer was not entered until shortly before the hearing, Ms. Comstock testified that it was intended to be. *Id.* The bookkeeping entry prepared shortly before hearing could just as well have been made after the hearing to reflect TLU's intentions to place the assets completely under TLU rather than Evergreen Country, L.L.C., but TLU made the change so that the ED's approach would be satisfied. However, the ED maintained objection to the inclusion despite the change because of its position regarding known and measurable changes. Both objections have been accepted by the ALJ over TLU's objections and the recommendations of TLU's testifying expert witness.

In sum, contrary to the ALJ's recommendations, TLU asks the Commission to recognize that the Goode City assets are properly included in TLU's invested capital/rate base for all purposes, including return, because: either (1) David Sheffield, *i.e.*, TLU, funds actually went toward those assets prior to TLU filing the Applications; or (2) the bookkeeping correction placed the Goode City assets squarely under TLU ownership after TLU filed the Applications creating a known and measurable change in the amount of TLU's invested capital available for return. It is not disputed that TLU has used the assets to provide water service since their installation. TLU respectfully requests the Commission recognize that the Goode City assets are truly a David L. Sheffield/TLU investment and allow him to earn return on that investment via TLU rates. Such a conclusion would

[1] This evidence also undermines the suggestion by the ALJ that Mr. Sheffield may have left the facilities in Evergreen Country, L.L.C. to derive some sort of benefit, such as liability protection. PFD, at 13 (citing testimony discussing liability benefit of having assets owned by an L.L.C. as opposed to personally). If he did, it was not intentional and was not a quantifiable benefit impacting TLU's cost of service.

warrant modifying FOFs Nos. 34, 37, 46, 52, 53 and proposed Order Exhibits A-C.

2. 12% or 14.46% Rate of Return Should be Approved

The ALJ has accurately characterized, but not accepted, TLU's position with respect to rate of return ("ROR") in this case. PFD, at 15-16. In this case, because TLU has 100% equity and no debt, its ROR is determined solely by its ROR on equity. The evidence shows that TLU requested a 12% ROR on equity based on multiple recommendations it received, past Commission precedent, years of TCEQ practice, and the TCEQ application form which specifies that use of the "Rate of Return Worksheet" form ("ROR Worksheet") attached to the application instructions is optional, not mandatory. In contrast, the ALJ and ED advocate the Commission adopt use of the ROR Worksheet form, attached as Appendix "A" to the TCEQ Rate/Tariff Change Application form instructions, as *the mandatory method* to set ROR for all TCEQ investor-owned utility rate/tariff change applications similar to TLU's that are contested. PFD, at 17-18. Primarily, this is based on language in the application instructions, not the application form, stating, "If your application is contested, the staff will compute your rate of return based on the rate of return worksheet." *Id.* Therefore, according to the ALJ, "TLU chose the risk of not using it and relied instead on a non-existent safe harbor of 12%." *Id.*

TLU respectfully excepts to this portion of the PFD and corresponding FOFs and COLs for several reasons. First, the ALJ's recommendation discounting the existence of a 12% "safe harbor" ROR on equity is contrary to the record evidence. Second, the fact that the application instructions create "risk" the application form does not creates a notice issue and injustice for all Texas investor-owned utilities who are required to apply to TCEQ for rate changes using the form. Finally, the ROR Worksheet has inherent flaws that have led to its improper and unjust implementation in this case, counseling against its use. TLU respectfully requests the Commission reject use of the ROR Worksheet in this case, even if it may deem its future use proper after further review and rulemaking as appropriate.

a. 12% Rate of Return on Equity for IOUs Repeatedly Accepted by TCEQ

The evidence shows that the ROR worksheet is simply not a TCEQ rate/tariff change application requirement and never has been. TLU-1 (Texas Landing Utilities Rate/Tariff Change Application), at 002060 and 002075; ED-SP-13, at 12; TLU-D at 27:15 - 30:12 (Morgan Prefiled); Tr. at 349:21 - 350:3 (Sheresia Perryman, May 22, 2009). TLU's testifying expert witness, Mr. Morgan, testified that a 12% ROR on equity is reasonable, consistent with past TCEQ practice and Commission precedent, and should be accepted in TLU's case. TLU-D at 29:15 - 30:12 (Morgan Prefiled). Mr. Morgan's position advocating a 12% ROR on equity for TLU is backed by years of TCEQ practice and Commission precedent in addition to his over 40 years of experience dealing with utility accounting matters. TLU-D at 29:15 - 30:12 (Morgan Prefiled); Tr. at 205:6 - 206:14 (Marvin Morgan, May 21, 2009). Mr. Morgan has worked on hundreds of rate applications during that time. *Id.*

Mr. Morgan testified that in all the water and wastewater utility rate applications he has prepared for IOUs over the past 15 years submitted to TCEQ and its predecessor agencies, he has used 12% as the presumptive ROR on equity and it has been considered a "safe harbor" ROR on equity for utility applicants. *Id.* In other words, if an applicant requested a ROR on equity up to 12%, it was not challenged. *Id.* This testimony was confirmed by the Executive Director's expert staff accounting witness during the hearing, Ms. Sheresia Perryman, who confirmed that utilities have been allowed up to a 12% ROR on equity over the years. Tr. at 350:25 - 351:3 (Sheresia Perryman, May 22, 2009).

Recent Commission precedent affirms Mr. Morgan's position. In the *Aqua Texas* decision decided September 23, 2008, the Commission found that "[a] 12% return on equity is reasonable in light of Aqua Texas' risk and the capital-intensive nature of water and sewer utilities and is consistent with the returns available from other investments of similar risk." TLU-43 (TCEQ Order Approving Aqua Utilities, Inc. Water and Sewer Rates issued 9/23/08), at 15 (Finding of Fact No.

73). In that case, the ALJs rejected an approach that included no risk premium. TLU-42 (Application of Aqua Utilities, Inc. SOAH Docket No. 582-05-2770 and 582-05-2771), at 63-64. The ALJs ruled:

> The Commission has consistently allowed a 12% return on equity on the basis that it is similar to returns available from other investments of similar risk. Although the Protestants argue that the use of a benchmark 12% return by the Commission is tantamount to *ad hoc* rulemaking, the ALJs do not agree. The ED's practice of using a benchmark 12% return on equity when reviewing rate applications is not the equivalent of a rule or policy. Rather, it is a practice that is not specifically binding on the outcome of any given case. Instead, as is occurring in this case, the parties may challenge the proper rate of return to be used, and the Commission will review the evidence to determine whether a 12% return on equity is appropriate. Ultimately, in light of the testimony showing that a 12% rate of return on equity is comparable to the return available for investments of similar risk, the ALJs see no reason why a different return on equity should be utilized for Aqua Texas in this case.

TLU-42 (Application of Aqua Utilities, Inc. SOAH Docket No. 582-05-2770 and 582-05-2771), at 64.[2] The ROR worksheet was not used to determine rate of return on equity.

The ALJ seems to have discounted as "conclusory" Mr. Morgan's expert testimony in this case, despite his years of experience working with investor-owned utilities, that a 12% ROR on equity is reasonable in light of investor-owned utilities investments of similar risk, in line with the *Aqua Texas* decision. PFD, at 18. The 12% rate was supported in TLU's case, not only by the testimony of Mr. Morgan, but other TLU witnesses that testified about TLU's capital investments

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[2] The Commission decisions relied upon by the ALJs where a 12% rate of return on equity was allowed were: TCEQ Docket No. 2003-0153-UCR; SOAH Docket No. 582-03-2283; *An Order on Appeal of Tall Timbers Utility Company, Inc., to Review the Ratemaking Actions of the City of Tyler for Sewer/Tariff Increase in Smith County Sewer CCN 20694* at 3 ("Tall Timbers rate of return on invested capital should be 10.27 percent, including a 12-percent cost of equity and an 8.66 percent return on long-term debt"); TCEQ Docket No. 2005-0875-UCR; SOAH Docket No. 582-05-7838; *An Order Setting Retail Water Rates for Don M. Bryant d/b/a Buena Vista Water System, Under CCN No. 11656* at 5("A return of 12 percent upon the Applicant's invested capital is just and reasonable"); TCEQ Docket No. 2003-0597-UCR; SOAH Docket NO. 582-03-3827; *An Order Approving the Applications of North Orange Water & Sewer L.L.C., to Change Water and Sewer Rates* at 9 ("Twelve percent (12%) is a fair return on investment for Applicant to receive because it is reasonable in light of Applicant's weighted cost of capital and is consistent with the returns available from other investment of similar risk"); TNRCC Docket No. 97-0241-UCR; SOAH Docket No. 582-97-0899; *An Order Setting Retail Sewer Rates for Tanglewood Water Company, Inc.* at 6 (Utility's allowed equity "should earn at a return rate of 12.25%"); TCEQ Docket No. 2004-0630-UCR; SOAH Docket No. 582-04-6463; *An Order Setting Retail Water Rates for WaterCo., Inc., under CCN 10130 in Trinity and Walker Counties.* PFD at 15 (The ALJ recommends a conclusion that a 12-percent rate of return on Applicant's invested capital is appropriate).

over the years. TLU-D at 13:12 - 19:19 (Morgan Prefiled); TLU-C at 15:15 - 16:19 (Mann Prefiled); TLU-A at 18:5-10 (Sheffield Prefiled). For example, Mr. Sheffield estimates that TLU has spent thousands of dollars since TLU's last system-wide rate increase in 1997 on capital improvements to ensure compliance with state and federal requirements. TLU-A at 18:5-10 (Sheffield Prefiled). The depreciation schedules prepared by Mr. Morgan show all the capital items TLU has installed over the years. TLU-25 (Depreciation Schedule - Water); TLU-26 (Depreciation Schedule - Sewer). Contrary to the ALJ's assessment, Mr. Morgan's analysis of this evidence combined with his experience should be enough to assess the reasonableness of the requested 12 % ROR on equity in this case.

Even if the Commission finds the *Aqua Texas* decision is not binding in TLU's case, at a minimum, the decision provides added support for Mr. Morgan's conclusion that TLU's requested 12% rate of return on equity is consistent with the capital-intensive nature of providing water and sewer service versus other types of utility service and reflects an appropriate risk premium for TLU's capital investment. TLU-43 (TCEQ Order Approving Aqua Utilities, Inc.'s Water and Sewer Rates Issued 9/23/08), at 15 (Finding of Fact No. 73); TLU-D at 29:15 - 30;12 (Morgan Prefiled); Tr. at 516:11 - 517:2 (Marvin Morgan, May 22, 2009). The Commission should seriously consider Mr. Morgan's point that if a 12% ROR on equity is acceptable for a larger utility such as Aqua Texas, it should also be acceptable for a small utility like TLU with greater risk. Tr at 184:21- 24 (Marvin Morgan, May 21, 2009). The *Aqua Texas* decision has not lost its "relevance" as suggested by the ALJ. PFD, at 18.

The ALJ's determination that the 12% "safe harbor" ROR on equity is "non-existent" is contrary to the record evidence. PFD, at 18. The evidence shows that such a practice has existed at TCEQ for years. Similarly, the record evidence shows that the 12% ROR on equity is reasonable for TLU This should be enough for the Commission to grant TLU a 12% ROR on equity and an overall 12% ROR. However, there are additional policy reasons not to use the ROR Worksheet.

b. TCEQ Rate/Tariff Change Application Form Should Not Create "Risk" for IOUs

Both the ED and ALJ take the position reflected in the PFD that, "TLU chose the risk of not using [the ROR Worksheet] and relied instead on a non-existent safe harbor of 12%." PFD, at 18. However, contrary to the ALJ's statement in her PFD, Ms. Perryman and Mr. Morgan testified that, as a practical matter, 12% is in fact the "average equity return" established by staff as a safe harbor rate, and an option specifically provided for in the rate/tariff change application instructions and in the form itself. Tr. at 381:6 - 382:23 (Sheresia Perryman, May 22, 2009); Tr. at 520:22 - 522:8 (Marvin Morgan, May 22, 2009). As recognized by the ALJ, Ms. Perryman differed from Mr. Morgan in that she would limit implementation of such a 12 % ROR on equity to utilities possessing debt, but not 100% equity as in TLU's case. PFD, at 18; Tr. at 381:6 - 382:23 (Sheresia Perryman, May 22, 2009). This approach makes no sense and neither the ALJ nor ED has articulated a logical reason for making this distinction.

The fact that TLU has no debt should not make a difference. PFD, at 17-18; ED Closing Arguments, at 4-5. The ED's own worksheets demonstrate that the weighted average cost of capital is calculated even when a utility has no debt. ED-SP-3 (Revised - Weighted and Invested Capital-Water) and ED-SP-7 (Revised - Weighted and Invested Capital-Sewer). 0% ascribed to debt is weighted with 100% equity, resulting in the ROR on equity being the same as the overall ROR. *Id.* That does not mean that the ROR on equity is somehow determined differently, nor should it be.

Ms. Perryman also testified that the choice to apply the ROR worksheet was based in large part on the fact that the Applications were protested, a choice that accords with the ALJ's approach and is reflected in the flawed application instructions. Tr. at 375:19 - 376:5 (Sheresia Perryman, May 22, 2009). That should not be the determining factor for whether the ROR worksheet is an application requirement for purposes of determining ROR on equity.

The ALJ/ED approach allows applicant IOUs to choose a method for satisfying an application requirement, but then penalizes them in any later contested case hearing for choosing any

but one particular method. Applicants for rate/tariff changes should not be forced to make such an application choice. The options are included for a reason. If they are not true options, then the application requirements and TCEQ rules should be clear enough to put applicants on notice with respect to that fact. The ALJ's recommended approach discounts this concern and would lead to problems for future TCEQ rate/tariff change applicants that are similarly situated to TLU

In TLU's case, TLU was put in the unfair position of attempting to prove up various elements of the ROR Worksheet for the first time primarily through its rebuttal case. Much of the information was not provided in TLU's application when filed or its pre-filed direct testimony because TLU did not elect to propose a ROR on equity using the ROR Worksheet. But the ALJ faults TLU with not meeting its burden of proof with respect to certain ROR worksheet issues. *See, e.g.*, PFD, at 25 (discussing Step H analysis, upholding ED's finding of no educational program for lack of documentation despite lack of ED investigation and TLU witness testimony to the contrary, stating, "It is not the ED's job to prove up TLU's case.").

Since ROR worksheet use is not required by rule or application requirements, failure to use it should not be held against an applicant. Following traditional TCEQ practice here makes more sense even if the Executive Director or the Commission desires to change that practice in the future because "[t]he rate of return is becoming an increasingly debated and challenged issue." ED Closing Arguments, at 3. The ALJ expresses a similar concern that "[g]uaranteeing a 12% rate of return on equity forever would clearly be arbitrary." PFD, at 18. The way to address these issues is for TCEQ to change its rules, or at least the rate/tariff change application form, if in fact that is appropriate. Its appropriateness should be determined via the normal notice and comment process afforded in all TCEQ rulemaking procedures. However, as things stand, TLU and similarly situated applicants should not be penalized for following accepted TCEQ practices. The ROR issue should be analyzed here consistent with past rate/tariff change applications.

c. The ROR Worksheet is Flawed and Should Not Be Used

The ROR Worksheet has inherent flaws that should restrict its use with respect to TLU's application, if not for all TCEQ rate/tariff change applications. These flaws led to the parties' respective ROR Worksheet recommendations. While TLU maintains the ROR Worksheet should not be used, it presented a method by which the ROR Worksheet could be used to develop a 14.46% rate of return if properly analyzed. TLU-46 (Rate of Return Worksheet with Handwritten Changes). TLU excepts to the ALJ's rejection of this analysis if the ROR Worksheet is used in this case. Regardless, the ROR Worksheet's flaws are evident in several recommendations proposed by the ED, and now the ALJ, in this case. PFD, at 19-26.

First, it is not clear whether test year information or information from a different time period is required for use in completing the ROR Worksheet. The parties had several different versions of this presented during the hearing. In some instances, the ED recommended application of test year information, but in others recommended application of more current information. For example, Step "A" calls for the "Most current BAA Public Utility Bond average." Right from the start there is ambiguity. The ALJ applies the ED recommended end-of-test year 2006 rate of 6.48% even though the rate at the end of 2008 was 8.46%, but there is no rule or guidance on this issue. PFD, at 19. Mr. Morgan's position on known and measurable changes, discussed previously, would support using a more recent rate of return since there is no final rate decision in the case yet. The issue of time frame is problematic for other ROR Worksheet issues too, such as Step F, in which both 2006 and more current information was considered by the ED and ALJ. PFD, at 22-24. The applicable time period is also an issue in Step "H" for determining reduction in water loss. PFD, at 25. The ROR on equity recommended for TLU was less as a result of these issues.

Second, there are terms used in the ROR Worksheet that lack clear guidance from the Commission either through rules or policy guidance documents. For example, TLU excepts to the finding for Step C that there are "no affiliated companies with access to revenues or other funds to

support utility operations". PFD, at 21-22. The ED originally recommended a 10.48% ROR, but subtracted 1% and recommended 9.48% because of what Ms. Perryman construed to be testimony affecting this issue. *Id.* However, there is no clear guidance about what the sentence means. Ms Perryman testified that she does not know whether paying for capital items is the same as paying "to support utility operations." Tr. at 361:15 - 362:11 (Sheresia Perryman, May 22, 2009) Mr. Morgan testified that is an important distinction. Tr. at 518:22 - 519:18 (Marvin Morgan, May 22, 2009). He has not seen any records that indicate that the operations of TLU are being paid for by affiliates. *Id.* Operations are expended and paid for as they occur, while capital is generally borrowed money from somebody or somewhere characterized as a long-term asset recovered over its estimated useful life. *Id.* Moreover, Mr. Morgan's understanding was that TLU was almost at a break even cash flow for 2008 undermining Ms. Perryman's theory. *Id.* Yet, both the ED and ALJ recommended not awarding ROR percentage points because of this issue. PFD, at 21-22.

Another example is Step F of the Rate of Return Worksheet. The TCEQ has multiple rules that specify what constitutes a TCEQ "enforcement action", but the ED and ALJ recommend application of a completely different standard for purposes of analyzing Step "F.3" of the ROR Worksheet. PFD, at 22-24; *compare also* ED-SP-9 (Revised Staff's Calculation of Rate of Return) and Tr. at 370:13 - 372:2 (Sheresia Perryman, May 22, 2009), *with* TLU-46 (Rate of Return Worksheet with Handwritten Changes); TEX. WATER CODE, Chapter §§ 7.001 - 7.358; 30 TEX. ADMIN. CODE §§ 3.2(12), 70.1-70.206, 291.140. The standard the ALJ recommends for "enforcement action" is much broader and contrary to the definition provided for in the Texas Water Code and TCEQ rule provisions applicable to TCEQ enforcement activities. TLU excepts to the ALJ's Step F findings regarding enforcement actions.

Another Step F issue was what constitute "major deficiencies". PFD, at 22. The report does not identify the items as "major" or "minor". TLU-4 (March 10, 2006 Letter from the TCEQ re: January 11, 2006 Compliance Investigation). Classifications in the TCEQ's compliance history

classification rules could be used as guidance, but those standards were not applied in TLU's case. 30 TEX. ADMIN. CODE § 60.2(c). TLU excepts to the ED and ALJ Step F findings that certain occurrences discussed in 2006 investigation reports were "major deficiencies", but there is not clear guidance in that regard.

Other problematic undefined terms are the words "program" and " loss" as used in Step H. PFD, at 24-25. Despite PFD findings, the ROR Worksheet does not use the term "unaccounted for" water loss even though the ED determined the worksheet contemplates that limited type of loss. PFD, at 25. The PFD states the ALJ did not understand the distinction, but gave no credit to TLU for meeting the criteria based on her rulings on other Step H factors despite evidence about TLU's water loss reduction efforts. PFD, at 24-25. Also, testimony provided by TLU's Karen Mann contradicts the ALJ's finding that TLU's billing inserts and educational efforts did not promote water conservation, but the lack of clear guidance on that point led to differences about what constitutes an adequate educational "program" for Step H purposes. Tr. 488:23 - 489:16 (Karen Mann, May 22, 2009). TLU excepts to the ALJ's Step H findings.

In sum, vague undefined ROR Worksheet terms caused TLU to lose ROR points in this case in accordance with the ED and ALJ recommended application of the ROR Worksheet. PFD, at 24-25. However, TLU's expert witness Mr. Morgan pointed out other major shortcomings in the entire concept underlying the ROR Worksheet that counsel against its use. Tr. at 172:2 - 173:12 (Marvin Morgan, May 21, 2009); Tr. at 516:11 - 517:10 (Marvin Morgan, May 22, 2009).

TLU understands that the ED and ALJ intend use of the ROR Worksheet as an effort to apply principles set forth in TEX. WATER CODE § 13.184 and 30 TEX. ADMIN. CODE § 291.31(c). PFD, at 14. However, Commission precedent demonstrates that if the ROR worksheet is used in this case, it would constitute a new method of calculating rate of return on equity. The United States Supreme Court rejected that approach in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315 (U.S. 1989):

[A] State's decision to arbitrarily switch back and forth between methodologies in

> a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.

The large number of privately owned water and sewer utilities in Texas provides investors in water and sewer utilities with a regular source of consistent information regarding rates of return. Past TCEQ orders, including but not limited to the *Aqua Texas* decision, establish that investors in water and sewer utilities presently can generally expect to recover a 12% return on equity.[3] TLU-43 (TCEQ Order Approving Aqua Utilities, Inc.'s Water and Sewer Rates Issued 9/23/08), at 15 (Finding of Fact No. 73). Mr. Morgan testified about the origin of TCEQ's use of the 12% ROR on equity as a presumptive standard. Tr. at 516:11 - 517:2 (Marvin Morgan, May 22, 2009). The 12% came from a BAA utility bond at approximately 8 % plus 400 basis points added as a risk premium. *Id.*

The ROR worksheet substantially deviates from past Commission practice in that it provides no basis points as a risk premium and, instead, uses a single risk component (C.1. - debt/equity ratio) along with other penalty components related to utility management that have nothing to do with risk. Tr. at 172:2 - 173:3 (Marvin Morgan, May 21, 2009); Tr. at 516:11 - 517:10 (Marvin Morgan, May 22, 2009). Mr. Morgan's opinion is that the ROR Worksheet is a "feeble attempt" to follow rule provisions found in 30 TEX. ADMIN. CODE § 291.31(c)(1), but "falls short." *Id.* The ROR Worksheet improperly starts with a risk-free BAA bond, then adds, but doesn't subtract. *Id.* Therefore, the ROR Worksheet does not follow the rules. *Id.* Mr. Morgan recommends against using the ROR Worksheet. *Id.*; Tr. at 173:4-12 (Marvin Morgan, May 21, 2009). TLU excepts to the ALJ's rejection of Mr. Morgan's recommendations and respectfully requests the Commission not use the ROR worksheet to set ROR on equity or overall ROR in this case.

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[3] *See* Note 2, *supra*.

d. Rate of Return - Summary

In sum, TLU excepts to the use of the ROR Worksheet in this case and requests a 12% ROR on equity and, consequently, an overall 12% ROR. If used, TLU excepts to the ALJ's recommendations with respect to Step A, Step G, Step F, and Step H because, as demonstrated in TLU-46 and supporting testimony, and as discussed in *Texas Landing Utilities' Closing Argument* and herein, TLU is entitled to additional ROR percentage points under those sections. If the Commission determines that the ROR Worksheet should be used in this case, TLU respectfully requests the TCEQ apply use of the ROR Worksheet in the manner set forth in TLU-46 (Rate of Return Worksheet with Handwritten Changes) and supporting testimony establishing a 14.46 % ROR on equity/overall ROR. TLU's exceptions, if accepted, would warrant modification to proposed Order FOFs 39, 40, 41, 44, 45, 46, 47, 52, 53 and Exhibits A through F. Additionally, FOFs 40, 41, 42, 43, 44, and 45 would not be needed if TLU's exceptions to use of the ROR Worksheet in its entirety are accepted.

B. Water Line Loss

TLU excepts to the ALJ's recommendations, based on ED recommendations, penalizing TLU for water line loss in its rate design. PFD, at 28-29. One of TLU's exhibits provides a break down of TLU's water pumped and sold during the test year 2006. TLU-17 (TLU Water Line Loss Chart and Test Year Water Pumped). The total amount billed in 2006 was 7,376,330. *Id.* This is the number Mr. Morgan recommended using to calculate TLU's gallonage charge. TLU-24 (Corrected Application Schedules). This represents the variable cost portion of rate design. *Id.*; *see also* Tr. at 419:22 - 420:14 (Kamal Adhikari, May 22, 2009). In contrast, Mr. Adhikari recommended using a fictitious higher "billed" amount (8,663,000) as a penalty against TLU for water loss. ED-2 at 10:17 - 11:17 (Adhikari Prefiled); Tr. at 420:12 - 433:7 (Kamal Adhikari, May 22, 2009); ED-KA-3 (Revised Meter Consumption - Water); ED-KA-5 (Revised Rate Design - Water). He reduces the total TLU amount pumped by 6.9%, but not the entire 21% that TLU actually lost in 2006. *Id.*

TLU's annual report exhibits show there was an abnormally high spike in water loss during 2006. TLU-37-40 (TLU Water and Wastewater Utilities Annual Report 12/31/04, 12/31/05, 12/31/07, and 12/31/08). There was a total 21% line loss, but only 14% was unaccounted for. TLU-17 (TLU Water Line Loss Chart and Test Year Water Pumped and Sold). The remainder was attributed to either leaks that were detected and repaired or line flushing. TLU-17 (TLU Water Line Loss Chart and Test Year Water Pumped and Sold; TLU-C at 13:6 - 14:10 (Mann Prefiled). Mr. Adhikari admits that patterns, normalization, and known and measurable changes are normal utility accounting procedures, but has not changed his recommendation. Tr. at 428:10-14 (Kamal Adhikari, May 22, 2009). Mr. Adhikari also admitted that his approach will not allow TLU to recover its revenue requirement. Tr. at 432:16 - 433:1 (Kamal Adhikari, May 22, 2009).

Mr. Morgan testified that there are two problems with the Executive Director's approach. First, the company should not be penalized for unaccounted for line loss that is less than 15% in light of AWWA standards. Tr. at 186:10 - 187:22 (Marvin Morgan, May 21, 2009); Tr. at 507:5 - 508:22 (Marvin Morgan. May 22, 2009). Mr. Morgan's reference to the 15% standard in purchased water pass through provisions is reflected in the example pass through provision included in TCEQ's *Pass Through Provision Rate Application*, Form TCEQ-10417 (Revised 03/09), at 2, limiting the loss factor to 15%.[4] Second, Mr. Adhikari's penalty is not focused on increasing certain expenses that may be attributable to water loss, such as electricity needed for additional pumping. *Id.* ED-2 at 10:17 - 11:17 (Adhikari Prefiled); Tr. at 420:12 - 433:7 (Kamal Adhikari, May 22, 2009); ED-KA-3 (Revised Meter Consumption - Water); ED-KA-5 (Revised Rate Design - Water). Instead, it acts as an across the board penalty. *Id.* Mr. Morgan recommends including the entire 21% line loss in TLU's rate design and using the total volume billed in test year 2006. Tr. at 186:10 - 187:22 (Marvin Morgan, May 21, 2009); Tr. at 507:5 - 508:22 (Marvin Morgan, May 22, 2009). TLU

[4] Also, AWWA standards are incorporated by reference in the TCEQ rules for operation of water facilities. 30 TEX. ADMIN. CODE § 291.95.

excepts to the ALJ's recommendations to the contrary. PFD, at 28-29. TLU also excepts to FOFs 51, 52, 53, and proposed Order Exhibits A-F as affected by the recommended water line loss penalty.

C. Tap Fees

TLU excepts to the ALJ's recommendation to keep TLU's tap fee amounts unchanged. PFD, at 26 and FOF No. 48. TLU proposed set tap fees based on estimates it received from outside contractors and the evidence shows the tap fee amounts proposed by TLU are reasonable. Tr. at 472:19 - 473:5 (Kimberly Comstock, May 22, 2009); Tr. at 478:14 - 481:1 (Kimberly Comstock, May 22, 2009); TLU-D at 32:11-12 (Morgan Prefiled). However, TLU does not dispute that it lacks documentation supporting those amounts. The ED recommended using "actual cost" as the tap fee amount. In contrast, the ALJ recommends using TLU's existing tap fee amounts without the "actual cost" language. TLU respectfully requests, in the absence of approval for the requested increase in tap fee amounts, the "actual cost" language recommended by the ED be added to TLU's tariffs with respect to tap fees. The evidence shows that a tap fee increase is warranted to prevent adverse impact on TLU's financial integrity as prohibited by the Texas Water Code. TEX. WATER CODE § 13.183.

D. Surcharge

In *Texas Landing Utilities' Closing Argument*, TLU included briefing detailing its accounting of the surcharge over-collection credit it believes is due customers based on review of documents related to the 1997 rate case settlement referenced in the PFD. TLU's Closing Argument, at 37-38 & Exhibit D. The ED and ALJ recommend use of certain customer contribution-in-aid-of-construction ("CIAC") amounts for rate-setting purposes in this case that TLU has determined are too high. Artificially low rates result from the use of customer CIAC amounts that are too high because neither return nor depreciation is allowed on customer CIAC.

TLU has commenced crediting the customers as recommended by the ED and ALJ, but would like recognition that there are lower customer CIAC amounts than those recommended by the

ED and ALJ that constitute the actual customer CIAC amounts for both TLU's water and sewer facilities. If not used for rate-setting in this case, TLU respectfully requests Commission approval to revisit the issue in its next water and sewer rate/tariff change application submissions in order to properly set rates based on correct customer CIAC totals.

E. Rate Design/Revenue Requirement

Based on other exceptions to the ALJ's PFD, TLU excepts to the ALJ's proposed rate design and total revenue requirement totals set forth in FOF 53 and proposed Order Exhibits A through F. As detailed in TLU's closing briefs, all of TLU's exceptions, with some modifications recommended by the ED that TLU has accepted, result in the following final rates TLU requests the Commission approve:

Water Rates		**Sewer Rates**	
Monthly minimum including 0 gallons:		Monthly minimum including 0 gallons:	
5/8" X 3/4"	37.86	5/8" X 3/4"	31.57
3/4"	56.79	3/4"	47.36
1"	94.65	1"	78.93
1 ½"	189.30	1 ½"	157.85
2"	302.88	2"	252.56
3"	567.90	3"	473.55
Volumetric Charge	2.42 per 1,000 gals.	Volumetric Charge	3.23 per 1,000 gals.

The revenue requirement amounts originally proposed in TLU's Applications break down as follows:

Water: $86,834 **Sewer:** $48,321 **Total:** $135,155

The adjusted revenue requirement amounts recommended by the ED and TLU based on the totality of hearing evidence supporting their respective recommended rates are as follows:

	TLU	**ED**
Water	$83,499	$75,283
Sewer	$46,944	$44,674
Total	$130,433	$119,957

Detail supporting TLU's final requested rates were provided to the ALJ and all parties in exhibits included with *Texas Landing Utilities' Closing Argument* brief.[5] As mentioned in TLU's Closing Arguments, the sewer revenue requirement identified above was lowered by Mr. Morgan so that TLU's total revenue requirement fits within the $61,051.00 annual revenue increase amount noticed. Without that adjustment, Mr. Morgan's recommended revenue requirement amounts would be:

Water: $83,733 **Sewer:** $48,776 **Total:** $132,509

Finally, though not specifically addressed in the ALJ's PFD, TLU respectfully requests that TLU's final tariffs include rates set using proper meter equivalency factors for all the meter sizes set forth above using the final 5/8" x 3/4" residential meter size monthly minimum charge as the starting point. This accords with past TCEQ rate/tariff change application practices.

F. Applicability of TEX. WATER CODE § 13.145

TLU respectfully disagrees with the ALJ's conclusion regarding the applicability of TEX. WATER CODE § 13.145 to a situation where a utility has a single approved tariff with varying rate schedules. The ALJ has concluded that before multiple systems can be consolidated under a single tariff *or rate*, a utility must meet certain conditions. PFD, at 3. However, the plain language of that statute indicates applicability when a utility seeks to "consolidate more than one system under a single tariff." TEX. WATER CODE § 13.145. TCEQ rules define "tariff" as "the 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 § 291.3(48). Under that definition, the "tariff" is the document that sets forth a utility's rates and policies. If the goal of TEX. WATER CODE § 13.145 is to promote TCEQ's policies in favor of regionalization as appropriate,

[5] Certain of those exhibit pages were corrected by TLU correspondence dated August 12, 2009.

such analysis would be futile where systems have already been consolidated (*i.e.*, regionalized) by other TCEQ procedures.

Here, TLU's tariffs have included a consolidation of TLU's systems under a single water and a single sewer tariff for some time per prior TCEQ approvals.[6] However, the rate schedules within those single tariff documents were separately approved over the years and included in the consolidated tariffs. The ALJ has concluded it is appropriate when requesting a consolidated rate structure to re-open the appropriateness of consolidated systems under a single tariff using TEX. WATER CODE § 13.145 as the guide.

If it is appropriate to review TLU's request for a consolidated rate schedule under its water and sewer tariffs under the TEX. WATER CODE § 13.145 factors, TLU concurs with the ALJs conclusions set forth in the PFD applying a TEX. WATER CODE § 13.145 analysis to TLU's Applications using the standards set forth in the Commission decision styled *In re Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc. to Change Water and Sewer Rates*, SOAH Docket Nos. 582-05-2770 and 582-05-2771, TCEQ Docket Nos. 2004-1120-UCR, et al.). Any standard that is viewed as contrary from the *Double Diamond* decision discussed in the PFD decided after the TLU hearing should not be applied to TLU's Application. However, if the Commission agrees that TEX. WATER CODE § 13.145 is inapplicable here, the ALJ's proposed FOF Nos. 18-28 and COLs 6-10 are all irrelevant.

III. TLU'S PROPOSED CORRECTIONS TO THE PFD AND PROPOSED FINAL ORDER

TLU notes a few items that appear to need of correction as opposed to substantive modification:

PFD, at 13 - Last sentence in first full paragraph should read: "TLU has operated the Goode City water system under the same management as its Polk County water system." TLU only has one

[6] TLU only has one sewer system. However, during the contested case hearing, the protestants made contrary contentions that the ALJ has properly rejected.

water system in Polk County.

FOF No. 34 - If not reversed, this FOF should specify that TLU's amount of invested capital should be reduced by $20,326 for the purpose of calculating TLU's return on invested capital because it is developer contribution-in-aid-of-construction. As proposed, the FOF is not consistent with FOF No. 36 which permits this amount to be included in invested capital for the purpose of calculating TLU's depreciation expense.

COL No. 15 - as the proposed order is drafted, it appears that COL No. 15 should properly reference FOF No. 53.

IV. CONCLUSION AND PRAYER

After considering the foregoing, TLU respectfully requests that the Commission adopt the ALJ's PFD and issue the ALJ's proposed Order with the changes discussed herein. TLU respectfully requests approval of Application Nos. 35838-R and 35840-R and the rate/tariff changes requested by TLU in this proceeding.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on December 14, 2009, a true and complete copy of the foregoing was sent to the following by facsimile, first-class mail or courier:

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State Office of Administrative Hearings	SOAH - Docket Clerk 300 West 15th Street, Suite 502 Austin, TX 78701 Tel: 475-4993 Fax: 475-4994	*via fax to: 475-4994*
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FAX COVER SHEET

DATE : December 14, 2009 **TIME : 4:05pm**

NAME :	**Judge Katherine L. Smith**	FAX NUMBER :	512-475-4994
	SOAH - Docket Clerk		512-475-4994
	TCEQ - Docket Clerk		512-239-3311
	Ron Olson **TCEQ**		512-239-0606
	Eli Martinez **TCEQ, OPIC**		512-239-6367
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FROM :	Macy Minze, Paralegal		
CM #	9476		

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REMARKS : *Application for a Water and Sewer Rate/Tariff Change of Texas Landing Utilities*
SOAH Docket No. 582-08-1023; TCEQ Docket No. 2007-1867

Attached please find the following document:

TEXAS LANDING UTILITIES' EXCEPTIONS AND PROPOSED CORRECTIONS TO THE PROPOSAL FOR DECISION AND PROPOSED ORDER

Please feel free to contact our office if you have any questions in this regard.

Thank you.

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