Buddy Garcia, *Chairman*
Larry R. Soward, *Commissioner*
Bryan W. Shaw, Ph.D., *Commissioner*
Mark R. Vickery, P.G., *Executive Director*

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

December 28, 2009

Ms. LaDonna Castañuela, Chief Clerk
Office of the Chief Clerk
Texas Commission on Environmental Quality
P.O. Box 13087, MC-105
Austin, Texas 78711-3087

Re: Application of Texas Landing Utilities to change its water and sewer rates/tariff under CCN Nos. 11997 and 20569 in Polk and Montgomery Counties. SOAH Docket No. 582-08-1023; TCEQ Docket No. 2007-1867-UCR.

Dear Ms. Castañuela:

Enclosed for filing with the Texas Commission on Environmental Quality is the original plus seven copies of "The Executive Director's Response to Exceptions to the Proposal for Decision" for the above referenced matter.

If you have any questions, please call me at (512) 239-0608.

Sincerely,

Ron

Ron M. Olson
Staff Attorney
Environmental Law Division

Enclosure

cc: Mailing List

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

APPLICATION OF TEXAS LANDING UTILITIES FOR A WATER RATE/TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11997 IN POLK AND MONTGOMERY COUNTIES; AND FOR A SEWER RATE/TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 20569 IN POLK AND MONTGOMERY COUNTIES	§	BEFORE THE TEXAS COMMISSION ON ENVIRONMENTAL QUALTIY

THE EXECUTIVE DIRECTOR'S RESPONSE TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

DECEMBER 24, 2009

TABLE OF CONTENTS

SECTION PAGE

I. THE ALJ HAS RECOMMENDED APPROPRIATE ADJUSTMENTS BASED ON THE EVIDENCE.. 1

A. The ALJ correctly found that TLU's two water systems are substantially similar and can be consolidated into a single tariff.. 2

1. *Double Diamond* did not change the guidance on consolidation of water systems offered in the *Aqua Texas* case.. 2

2. The ALJ correctly determined that the cost of service for TLU's two water systems are substantially similar.. 3

3. The ALJ correctly determined that the quality of service for TLU's two water systems are substantially similar.. 5

4. The ALJ correctly determined that the facilities for TLU's two water systems are substantially similar.. 6

B. The ALJ correctly found that $20,326 was developer contribution-in-aid-of-construction and should be removed from invested capital.. 6

1. The ALJ appropriately found that the assets owned by Evergreen Country, L.L.C. are developer contributions-in-aid-of-construction.. 7

2. The ALJ appropriately found that the rate filing package cannot be modified. 8

C. The ALJ correctly determined Texas Landing Utilities' just and reasonable rate of return to be 9.48%. 10

1. The ALJ appropriately relied on the ED's testimony in determining the appropriate rate of return.. 12

2. The ALJ correctly analyzed the Rate of Return Worksheet to determine that TLU's rate of return is 9.48%. 13

a) Rate of Return Worksheet Step 'A'.. 13

b) Rate of Return Worksheet Step 'C'.. 14

c) Rate of Return Worksheet Step 'F'. 14

d) Rate of Return Worksheet Step 'G'.. 15

e) Rate of Return Worksheet Step 'H'.. 16

3. Summary of Rate of Return Worksheet.. 17

D. The ALJ properly denied TLU's proposed increase in tap fees. 18

E. The ALJ correctly determined that the ratepayers should only be required to fund the 7% of line loss that results from the normal operation of the utility.. 19

F. The ALJ correctly determined the amount of customer contribution-in-aid-of-construction that should be used for this application. 20

G. The ALJ correctly determined that the application was properly filed.. 21

II. CONCLUSION. 22

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

APPLICATION OF TEXAS LANDING UTILITIES FOR A WATER RATE/TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11997 IN POLK AND MONTGOMERY COUNTIES; AND FOR A SEWER RATE/TARIFF CHANGE, CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 20569 IN POLK COUNTY	§ § § § § § § § § § §	BEFORE THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

THE EXECUTIVE DIRECTOR'S RESPONSE TO EXCEPTIONS TO THE PROPOSAL FOR DECISION

TO THE HONORABLE COMMISSIONERS OF THE TCEQ:

COMES NOW, the Executive Director (ED) of the Texas Commission on Environmental Quality (TCEQ or Commission) and files the following Response to Exceptions to the Administrative Law Judge's (ALJ) Proposal for Decision (PFD) in the above captioned matter.

I. THE ALJ HAS RECOMMENDED APPROPRIATE ADJUSTMENTS BASED ON THE EVIDENCE.

The Executive Director reviewed Texas Landing Utilities' (TLU) rate application and information provided by the parties, including discovery responses and pre-filed testimony. Based on that information, the Executive Director made recommendations in his pre-filed testimony for a rate that staff determined was just and reasonable. The ALJ determined that the evidence adduced showed that it would not have been just and reasonable to grant the Applicant's requested rate as it was submitted in the application, or as adjusted in TLU's pre-filed testimony, and ultimately adopted the recommendations made by the Executive Director.

A. The ALJ correctly found that TLU's two water systems are substantially similar and can be consolidated into a single tariff.

The Protestants and OPIC argue that TLU's two water systems are not substantially similar and should not be consolidated into a single tariff. They assert that the two water systems are not substantially similar with regards to the cost of service, quality of service, and facilities. In their exceptions to the PFD, both the Protestants and OPIC rely on the Commission's ruling in the *Double Diamond* [1] case to support their arguments.

1. *Double Diamond* did not change the guidance on consolidation of water systems offered in the *Aqua Texas* case.

In her PFD, the ALJ expressed her belief that the issue of consolidating rate cases has inconsistent precedent between the *Aqua Texas*[2] case and the more recent case of *Double Diamond*.[3] However, the ED's position is that *Double Diamond* did not change the guidance established in *Aqua Texas* regarding the consolidation issue. The distinguishing factor is that *Double Diamond* was not decided on the merits of the consolidation issue. Double Diamond Utilities simply did not present any evidence on why the two water systems in that case should be consolidated under one rate in either its direct case, rebuttal case, or in closing arguments.[4] Judge Qualtrough determined that Double Diamond did not meet its burden of proof because it "did not provide any evidence or argument on this issue."[5] Thus, Judge Qualtrough did not fully analyze whether the systems should be consolidated based on the characteristics of the two systems. Conversely, in *Aqua Texas*, the consolidation issue was highly litigated by the parties. The applicant presented evidence that the systems were substantially similar. The ALJs in *Aqua Texas* granted consolidation based on a thorough analysis of the evidence presented during the hearing specifically on the consolidation issue.[6] In the

---

[1] *In re 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, SOAH Docket No, 582-08-0698.
[2] *In re Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc. to Change Water and Sewer Rates*, SOAH Dockets 582-05-2770 and 582-05-2771.
[3] PFD at 6.
[4] *Double Diamond* PFD, Pg. 14.
[5] *Double Diamond* PFD, Pg. 18.
[6] *Aqua Texas* PFD, Pg. 23-45.

Aqua Texas PFD, the ALJs offered a prospective, long term approach to determine whether utility systems are substantially similar. The Commissioners adopted that approach by agreeing with the ALJs and granting the consolidation.

The outcome in *Double Diamond* only seems contrary to the guidance established in *Aqua Texas* because the systems in *Double Diamond* were denied consolidation due to the complete lack of evidence, not due to consideration of the characteristics of the systems. Had the applicant in *Double Diamond* put on some type of evidence, Judge Qualtrough would have analyzed the characteristics of the systems. Regardless, the prospective approach to consolidating systems established in *Aqua Texas* was not changed by the outcome of *Double Diamond*.

In the case at bar, the ALJ also noted that the ED derived its own cost of service numbers in the *Double Diamond* case but did not do so for TLU.[7] However, the reason the ED attempted to calculate the cost of service in *Double Diamond* is because Double Diamond Utilities did not provide any information regarding why the water systems are substantially similar.[8] There was simply no evidence in the record on the cost of service issue. In contrast, Texas Landing Utilities presented evidence during the hearing process, based on the Commission's guidance in *Aqua Texas*, in support of its position that the cost of service is substantially similar. Since there was evidence in the record on this issue, there was no need for the ED to calculate the cost of service for TLU.

Nevertheless, the ALJ correctly recognized that TLU's two water systems are substantially similar based on the Commission's guidance established in *Aqua Texas*.[9]

2. The ALJ correctly determined that the cost of service for TLU's two water systems are substantially similar.

The Protestants focus on the cost of service component as the major area of contention in the consolidation of the water systems. They argue that the cost of service for Texas Landing should be significantly lower than that of the newer Goode City Subdivision.[10] However, as the ALJ noted, the Protestants only focus on system assets

[7] PFD at 6,
[8] *Double Diamond* PFD, Pg. 17.
[9] PFD at 9.
[10] *Direct Testimony of David Veinotte*, Pg. 30, Lines 2-8.

and failed to follow the TCEQ rules in determining TLU's cost of service.[11] Mr. Adhikari, the ED's engineer, testified that comparing only the assets in determination of the cost of service would not create a fair analysis for determining whether the systems are substantially similar because there are many costs included in the total cost of service.[12] Likewise, by not following the TCEQ rules, the Protestants' cost of service calculations are not accurate. Therefore, the Protestants' calculations cannot be used to determine if the two water systems are substantially similar.

Moreover, the Protestants, as well as OPIC, argue that the substantial similarity of the cost of service should be determined during the test year.[13] However, the Commissioners agreed in *Aqua Texas* that the test for substantially similar cost of service is not a snapshot of the test year but a prospective, long term view with an understanding that all systems will incur maintenance, improvement and replacement costs over time.[14]

Ms. Perryman, the ED's auditor, testified that she weighed the costs associated with the new and older water systems and evaluated the related depreciation of assets, tap fees, and repair and maintenance expenses that both water systems encounter.[15] Based on her analysis, Ms. Perryman testified that by

> taking the repairs & maintenance expense, fixed costs shared between the two water systems, depreciation expense, and assumptions of revenue generated from new taps for Goode City and comparing that to Texas Landing Subdivision, it is reasonable to assume that the expenses and additional revenue for each system relatively off-set each other and balance out.[16]

The Commission's guidance on the consolidation issue takes a broad approach to determining substantial similarity. The Commission has approved a prospective, long term approach that understands that all systems will incur maintenance, improvement and replacement costs over time.[17] By using this prospective, long term approach, TLU's two water systems will incur maintenance and repair to a level where the cost of service in

---

[11] PFD at 7.
[12] *Direct Testimony of Kamal Adhikari*, Pg. 14, Lines 3-6.
[13] Tr. at 313:18-22; OPIC's Exceptions to PFD, Pg. 6-7.
[14] *Aqua Texas* PFD, Pg. 27.
[15] *Direct Testimony of Sheresia Perryman*, Pg. 11, Line 19 through Pg. 12, Line 18.
[16] *Id.* at 12, Lines 19-24.
[17] *Id.* at 27.

both systems will be substantially similar. The ALJs in the *Aqua Texas* case recognized this fact and stated that "it is implicit that systems of varying ages and states of repair will be consolidated together..."[18] In the case at bar, the ALJ recognized the broad approach established in *Aqua Texas* and found that TLU's two water systems are substantially similar in terms of cost of service.

3. The ALJ correctly determined that the quality of service for TLU's two water systems are substantially similar.

Both the Protestants and OPIC argue that the quality of service is not substantially similar because the system in Texas Landing Subdivision has a high level of arsenic in the water well which requires blending to meet the state standards.[19] What the Protestants and OPIC fail to consider is that the proper point to determine the quality of water is at the point of consumption by the customers. The quality of water, and thus the quality of service, is the same in both systems at the point of consumption by the customers. Both systems meet the state and federal guidelines for the quality of water served at the point of consumption. The ALJ agreed and found that both of TLU's water systems comply with the Commission's drinking water rules, which implement the EPA's drinking water standards.[20]

Furthermore, Mr. Adhikari testified that the customers of both water systems are "receiving substantially similar quality of service from TLU in terms of management, operation, maintenance, supplies, materials and chemicals, billing, and customer service."[21] Both systems have the "same operator and management, utilize gas chlorine, share materials and supplies inventory and bill customers in a similar and consistent manner."[22] The ALJ agreed that the quality of service is substantially similar and found that the "evidence is uncontroverted that the two water systems operate very similarly and provide the same quality of customer service to customers with respect to its public drinking water supply..."[23]

---

[18] *Id.* at 38.
[19] Protestant's Exceptions to PFD, Pg. 3; OPIC's Exceptions to PFD, Pg. 4.
[20] PFD at 5.
[21] *Direct Testimony of Kamal Adhikari*, Pg. 6, Lines 15-19.
[22] *Id.*
[23] PFD at 5.

Accordingly, since both systems are operated in the same manner and by the same personnel, the ALJ properly concluded that both of TLU's water systems are substantially similar in terms of quality of service.[24]

4. The ALJ correctly determined that the facilities for TLU's two water systems are substantially similar.

The ALJ correctly determined TLU's facilities to be substantially similar. In her PFD, the ALJ noted the similarities between TLU's water systems based on the evidence provided. Both the Goode City water system and the Texas Landing Subdivision water system are relatively small groundwater systems that serve residential customers. Both systems operate wells pumping groundwater that is disinfected by chlorination and distributed by pressure tanks though primarily PVC pipes.[25]

The ALJ also noted that after an on-site inspection, Mr. Adhikari, the ED's engineer, testified that the two systems "vary in size and age, but are similar in terms of their source of water and the components of each system. Both water systems are groundwater systems served through pressure tanks, serve residential communities, utilize similar disinfection systems, and are managed and operated by the same company."[26]

Accordingly, the ALJ correctly determined that TLU's facilities are substantially similar.

B. The ALJ correctly found that $20,326 was developer contribution-in-aid-of-construction and should be removed from invested capital.

As the ALJ pointed out in her PFD, Evergreen Country, L.L.C. paid for the construction of the water system that now serves Goode City Subdivision.[27] A portion of that water system was transferred to TLU. However, ownership of the remaining portion of that water system stayed with Evergreen Country, L.L.C. at the time the rate application was filed.[28] Based on this fact, Mr. Adhikari reclassified the assets that had

---

[24] *Id.*
[25] *Id.*
[26] *Id.*; *See also Direct Testimony of Kamal Adhikari*, Pg. 10, Lines 1-4.
[27] PFD at 12; *See also, Direct Testimony of David Sheffield*, Pg. 15, Lines 14-15.
[28] *Direct Testimony of David Sheffield*, Pg. 15, Lines 15-17.

not been transferred to TLU as developer contribution-in-aid-of-construction.[29] TLU claims that those non-transferred assets should not be classified as developer contribution-in-aid-of-construction and that the assets can be added to the application after it has been filed.

1. The ALJ appropriately found that the assets owned by Evergreen Country, L.L.C. are developer contributions-in-aid-of-construction.

TLU claims that the total cost of the Goode City water system should be included in its invested capital despite the fact that the utility did not own those assets when the rate application was filed. As the ALJ noted, the "$20,326 represents the value of portions of Goode City water system paid for and owned by Evergreen Country, L.L.C., Mr. Sheffield's development company..."[30] TLU asserts that an expense paid for by Evergreen Country, L.L.C. translates into an expense by the utility as a result of common ownership; however, the ALJ found this argument unpersuasive.[31] The TCEQ rules expressly state that the components of cost of service are based upon a *utility's* cost of rendering service.[32] Evergreen Country, L.L.C. is not a utility, it is Mr. Sheffield's development company; a completely separate legal entity from Texas Landing Utilities. The utility, TLU, did not incur an expense for those assets.

Section 291.31(b) of the TCEQ rules states that 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."[33] The utility did not incur an expense for the remaining portion of the Goode City assets in the test year; it was transferred three days prior to the hearing on the merits.[34] As the TCEQ rules and Mr. Adhikari point out, a utility that has not incurred an expense for assets is not entitled to earn a return on that

[29] *Direct Testimony of Kamal Adhikari*, Pg. 9, Lines 3-11.
[30] PFD at 12.
[31] PFD at 12-13.
[32] 30 TEX. ADMIN. CODE § 291.31(a)
[33] 30 TEX. ADMIN. CODE § 291.31(b) (emphasis added)
[34] Tr. at 105:1-2.

particular investment.[35] Furthermore, the transfer was not included in the application as a known and measurable change.[36]

TLU's accounting method of combining assets owned by Mr. Sheffield's development company and the utility[37] might be appropriate when determining the depreciation expense on used and useful assets, but it is clearly against TCEQ rules when determining the amount of invested capital. The utility did not own those assets and is not allowed a return on those assets in accordance with Section 291.31(c)(3) of the TCEQ rules.[38] Accordingly, the ALJ correctly found that the $14,076.28 for distribution system lines and $6,250 in the well costs should be classified as developer contribution-in-aid-of-construction.[39]

2. The ALJ appropriately found that the rate filing package cannot be modified.

TLU argues that the non-test year transfer of the assets owned by Mr. Sheffield's development company can be added as a known and measurable change to the rate application after filing.[40] TLU erroneously asserts that there is no TCEQ rule on point that controls the addition of data to the rate application.[41] However, TLU ignores Section 291.25(b) of the TCEQ rules. As the ALJ noted in her PFD, Section 291.25(b) limits what must be considered at trial to the data that has been submitted in the rate filing package.[42] The rate filing package lays out the information that will be subject to scrutiny by the Executive Director and the Protestants. If the review of the rate data is not generally confined to the data submitted in the application, it inhibits the Executive Director's ability to determine what expenses are reasonable and necessary in providing water and sewer service to the ratepayers. The ALJ agreed and stated that at a "minimum, any substantial change in the rate filing application should be in place by the

---

[35] *Direct Testimony of Kamal Adhikari*, Pg. 9, Lines 14-17.
[36] Texas Landing Utilities rate application, Ex. TLU-1, Bates labeled page 002066. *See also,* Tr. at 179:19-21.
[37] Tr. at 163:21 – 164:7.
[38] 30 TEX. ADMIN. CODE § 291.31(c)(3)(A)(iv)
[39] PFD at 12.
[40] Tr. at 507:3-4; *See also* TLU's Exceptions to PFD, Pg. 4.
[41] Tr. at 506:6-507:4; *See also*, TLU's Exceptions to PFD, Pg. 4.
[42] 30 TEX. ADMIN. CODE § 291.25(b): "A utility filing for a change in rates under the Texas Water Code § 13.197, shall be prepared to go forward at a hearing on the data which has been submitted under subsection (a) of this section and sustain the burden of proof of establishing that its proposed rate changes are just and reasonable."

time an applicant's prefiled testimony is filed... so that the other parties have the opportunity to evaluate and make any counter-recommendations."[43]

The transfer of the Goode City assets that remained in Evergreen Country, L.L.C.'s name was not included in the rate filing package. TLU attempted to change its rate application during the hearing on the merits to include only current data that was beneficial for TLU. However, as the ALJ stated "allowing TLU to benefit from the transfer of assets three days before the hearing, a year-and-a-half after the application was filed, without taking into consideration other changes, is unfair."[44] It is not appropriate to change only one part of the application while holding all others constant. Changes to the application affect and flow through all calculations for the determination of the rates. Changing the application at such a late date does not allow the Executive Director, or the Protestants, an opportunity to properly scrutinize the new data, effectively making it a new application without any review by the ED. Neither the Executive Director nor the Protestants had an opportunity to evaluate TLU's newly claimed expense.

Furthermore, the importance of the rate filing package is emphasized in the TCEQ rules by allowing only very limited situations in which the rate filing package can be modified.[45] Section 291.25(g) states that items in the application may be modified only on a showing of good cause.[46] TLU did not present any evidence to show good cause why the change to its application should be permitted.

Moreover, the ALJ correctly pointed out that the previous commission ruling in *North Orange*[47] does not support TLU's assertion that the Goode City assets can be added to the application at such a late date.[48] The ALJ correctly stated that the issue addressed in *North Orange* was whether the depreciation expense for the plant and equipment acquired after the test year should have been included in the cost of service because they were used and useful.[49] In this case, the ED's engineer testified that he allowed the depreciation for all of the Goode City water system, in accordance with

---

[43] PFD at 13.
[44] PFD at 13.
[45] 30 TEX. ADMIN. CODE § 291.25(g)
[46] *Id.*
[47] *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.
[48] PFD at 13.
[49] PFD at 13; *See also, North Orange* PFD at 19.

TCEQ rules, because those assets were used and useful in providing service to its customers.[50]

Accordingly, the ALJ correctly determined that the $20,326 in assets that were still owned by Evergreen Country, L.L.C. at the time of the application should be removed from net plant and classified as developer contribution-in-aid-of-construction.[51]

C. The ALJ correctly determined Texas Landing Utilities' just and reasonable rate of return to be 9.48%.

TEX. WATER CODE § 13.184(b) and 30 TEX. ADMIN. CODE § 291.31(c)(1) establish very clear principles that the Commission must consider when determining the rate of return. However, conspicuously absent from any of TLU's discussions on this issue is any proof of how those principles apply to Texas Landing Utilities and how that translates into a just and reasonable rate of return. In fact, the Applicant's rate consultant admitted that he did not even consider those principles established in the law.[52]

Instead, TLU ignores the law and asserts that the Commission should approve a 12% rate of return for TLU merely because the Commission has approved such a return in other separate, unrelated cases.[53] TLU erroneously claims that there is an automatic rule which guarantees a utility a 12% return on invested capital without regard to the specific utility filing the rate application. However, as Mr. Morgan admits, there are no TCEQ rules that guarantee an applicant a 12% return.[54]

TLU's approach fails to consider that it is the applicant's burden of proof to establish that the rate of return is just and reasonable.[55] TLU seeks to circumvent that statutory obligation by requesting the Commission to approve a rate of return that the Applicant did not prove was just and reasonable for Texas Landing Utilities. To approve a 12% rate of return without considering the required principles established in the Texas Water Code and TCEQ rules violates the directive set in TEX. WATER CODE § 13.184(b) and 30 TAC § 291.31(c)(1). Even the ALJs, in the *Aqua Texas* PFD, expressly pointed

---

[50] Tr. at 418:11-15.
[51] PFD at 12.
[52] Tr. at 185:22-23.
[53] Tr. at 173:8-22.
[54] Tr. at 181:24- 182:1.
[55] TEX. WATER CODE § 13.184(c)

out that the ED's use of a 12% return is not specifically binding on the outcome of any given case.[56] The Applicant must prove that the proposed rate of return is just and reasonable for the specific utility that filed the application.

TLU failed to provide any evidence of how the principles established in the Texas Water Code and TCEQ rules are specifically applicable to Texas Landing Utilities. As such, TLU failed to quantify the specific rate of return based on those principles. Furthermore, the Applicant provided no evidence showing what a fair return on invested capital would be specifically for TLU and did not prove that a return of 12% is consistent with the returns from other investments of similar risk in today's economy. The Applicant simply did not apply the law specifically to TLU in order to determine the appropriate rate of return.

In her PFD, the ALJ found that TLU's reliance on a non-existent guarantee of 12% is misguided.[57] In fact, the ALJ recognized that "guaranteeing a 12% rate of return on equity forever would clearly be arbitrary."[58] The ALJ also found that even though "prior utilities have been rewarded 12% rates of return just because they asked and no one stepped forward to protest is no basis for doing so in this case…"[59] Moreover, the ALJ found no evidence presented in this case about the returns of other investments of similar risk in today's economy, except for conclusory statements made by an Applicant's witness.[60] The ALJ appropriately determined that TLU did not present sufficient evidence to prove that its proposed rate of return was just and reasonable. Accordingly, the ALJ correctly found that TLU failed to meet its burden of proof in establishing the just and reasonable rate of return for Texas Landing Utilities.[61]

---

[56] *Aqua Texas* PFD, SOAH Docket 582-05-2770, Pg. 64.
[57] PFD at 18.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.*

1. The ALJ appropriately relied on the ED's testimony in determining the appropriate rate of return.

In its exceptions to the PFD, TLU argues that the ALJ, by agreeing with the ED, is requiring TLU to use the rate of return worksheet in order to determine the appropriate rate of return. However, TLU misinterprets the ED's argument and the ALJ's decision.

As was stated in the ED's Reply to Closing Arguments,[62] the ED did not argue that the Applicant must use the rate of return worksheet. It is the ED's position that the appropriate rate of return must be determined, in accordance with the Texas Water Code and TCEQ rules, specifically for TLU. The only way that can be done is by analyzing the established principles in terms specifically relating to Texas Landing Utilities. TLU could have presented sufficient evidence based on the principles in the Texas Water Code and the TCEQ rules that satisfied its burden of proof without using the rate of return worksheet. However, instead of providing such evidence, TLU relied on a non-existent guarantee which was not specific to TLU and had no bearing on what the just and reasonable rate should be specifically for Texas Landing Utilities. As the record clearly demonstrates, TLU did not provide any evidence based on the principles the Commission must consider.

One method of determining the appropriate rate of return that specifically relates to TLU is using the rate of return worksheet. The worksheet applies the principles established in the Texas Water Code and TCEQ rules to the specific utility that filed the application. That is why the instructions to the rate application states that staff will use the worksheet to determine the appropriate rate of return.[63]

TLU claims that its method of choosing a rate of return is consistent with the first option described in the instructions to the rate application – using the average equity return established by staff.[64] However, what TLU neglects to realize is that the options described in the instructions are methods used to *propose* a rate of return. TLU must still meet its burden of proof to *prove* that its percentage is just and reasonable.[65] Just because

[62] Executive Director's Reply to Closing Arguments, Pg. 3.
[63] ED Ex. ED-SP-13, Pg. 12.
[64] TLU's Exceptions to the PFD, Pg. 11.
[65] TEX. WATER CODE § 13.184(c)

TLU picks a certain percentage for a rate of return does not mean that it has satisfied its burden of proof. As the ALJ's PFD correctly illustrates, it does not.

TLU further claims that it was placed in an unfair position of attempting to prove various elements of the rate of return worksheet for the first time in its rebuttal case.[66] However, TLU's position is not a characteristic of the process being flawed; it is a consequence of the Applicant not meeting its burden of proof in its direct case. The ALJ found no evidence in the record presented by TLU to prove its rate of return was just and reasonable and, therefore, relied on the ED's analysis.

In the PFD, the ALJ stated that she relied on the rate of return worksheet because "TLU did not meet its burden of proving the need for a 12% rate of return..."[67] Due to the absence of sufficient evidence presented by TLU, the ALJ appropriately determined TLU's rate of return based on the ED's completion of the rate of return worksheet.

2. The ALJ correctly analyzed the Rate of Return Worksheet to determine that TLU's rate of return is 9.48%.

In the PFD, the ALJ conducted a very detailed and thorough analysis of each factor listed in the rate of return worksheet based on the evidence presented during the hearing. The ALJ correctly found, based on that evidence, that TLU's just and reasonable rate of return should be 9.48%. As the ALJ pointed out, steps B, D, and E of the worksheet were largely undisputed by the parties. The discrepancy between the parties' recommendations results from the remaining worksheet steps. The ALJ's determination on each step accurately reflects the proper findings based on the evidence.

a) Rate of Return Worksheet Step 'A'

As the ALJ found, the most current Baa Public Utility Bond average should be determined at the time of the test year.[68] TLU claims that the average should be determined at the time of the hearing on the merits and included in the application as a known and measurable change. However, as Ms. Perryman testified, the determination of the Baa Public Utility Bond is done at the time the applicant files the application and is

[66] TLU's Exceptions to the PFD, Pg. 12.
[67] PFD at 18.
[68] PFD at 19.

thus considered at the time of the test year.[69] Furthermore, as the ALJ correctly pointed out, known and measurable changes are for fluctuations in future expenses, not for changes in the financial market.[70] The Baa Public Utility Bond for TLU's 2006 test year was 6.48%. Accordingly, the ALJ correctly determined that percentage as the appropriate one to use.

b) Rate of Return Worksheet Step 'C'

The ALJ correctly found that TLU was not entitled to a percentage point for Step C.[71] The ALJ found that TLU does have affiliated companies with access to revenues or other funds to support the utility operations.[72] The evidence presented during the hearing is quite clear on this issue. As the ALJ noted in her PFD, Mr. Sheffield, owner of TLU, testified that TLU relies on affiliated companies Tejas Properties and Sheffield Family, L.P. to operate the system.[73] Also, Sheffield Land, Inc., another affiliated company, provided access to a Kubota tractor that it owns to make line repair and install lines for TLU's benefit.[74] The ALJ stated in her PFD that "access to a tractor paid for by another company is clear evidence that affiliated companies exist with access to revenues."[75] Even Mr. Morgan, the Applicant's consultant, testified, when directly asked, that Mr. Sheffield's other affiliated companies do support the operation of Texas Landing Utilities.[76] Accordingly, the ALJ properly concluded that TLU is not entitled to a percentage point for Step C.

c) Rate of Return Worksheet Step 'F'

TLU claims that it should have been granted a percentage point for Step F because TLU did not have any major deficiencies or prior enforcement actions. The ALJ correctly found, however, that TLU did have major deficiencies listed in its PWS

---

[69] Tr. at 358:21-24.
[70] PFD at 19.
[71] PFD at 22.
[72] *Id.*
[73] *Direct Testimony of David Sheffield*, Pg. 8, Lines 13-14.
[74] *Id.* at 12, Lines 11-16.
[75] PFD at 21.
[76] Tr. at 226:25-227:2.

inspection report.[77] Despite TLU's belief that failure to meet minimum capacity requirements is only a minor issue, the evidence clearly shows that failure to meet minimum capacity requirements is a major deficiency. Failure to meet minimum capacity requirements affects a utility's ability to provide an adequate supply of water to its customers. As Mr. Adhikari, the ED's engineer, testified, issues with the minimum capacity requirements are considered to be major violations.[78] The ALJ agreed and found that TLU failed to meet criterion 2 of Step F.[79]

TLU further argues that it did not have any prior enforcement actions since it entered into a voluntary agreement with the TCEQ to correct its failure to prevent inflow and infiltration from impacting the wastewater treatment plant and collection system.[80] However, Ms. Perryman testified that there was an enforcement action relating to the inflow and infiltration discharges listed in the TCEQ's enforcement database.[81] The ALJ also noted in her PFD that "the agreement that TLU signed was identified as Enforcement Case No. 36746. That TLU may have entered into a preemptive agreement, saving the Commission the trouble of bringing a formal action based upon its inspection, does not mean that there was not an enforcement action."[82] Therefore, the ALJ appropriately concluded that TLU should not get credit for meeting criterion 3 of Step F. Because the ALJ found that TLU failed to meet three criteria of Step F, TLU is not entitled to a percentage point for Step F.[83]

d) Rate of Return Worksheet Step 'G'

The Protestants contend that TLU should not be granted a percentage point for Step G. The Protestants claim that TLU's books were not well-maintained or up-to-date and that TLU does not have effective communications and good customer relations.[84] However, after review of TLU's general ledgers and invoices, Ms. Perryman, the ED's auditor, found TLU's books to be well-maintained and up-to-date. The ALJ agreed and

[77] PFD at 22.
[78] Tr. at 440:17-21; Tr. at 441:9-13.
[79] PFD at 23.
[80] TLU's Closing Arguments, Pg. 14.
[81] Tr. at 371:4-18.
[82] PFD at 23.
[83] PFD at 24.
[84] Protestant's Exceptions to PFD, Pg. 4.

noted that the Protestants' "points are not convincing to controvert Ms. Perryman's testimony."[85] Accordingly, the ALJ appropriately determined that TLU should get credit for meeting criterion 1 of Step G.

The Protestants further argue that TLU does not have good customer relations. However, TLU testified that Ms. Mann and Ms. Comstock have good relations with TLU's customers and personally know just about everyone in the system.[86] The ED's witness, Ms. Perryman, determined that TLU had good customer relations based on the low number of customer complaints against TLU listed in the TCEQ database.[87] The ALJ agreed and correctly concluded that TLU should get credit for meeting criterion 2 of Step G.[88] As a result the ALJ properly found that TLU is entitled to a percentage point for meeting Step G.[89]

e) Rate of Return Worksheet Step 'H'

TLU claims that it had a program to educate customers about water conservation. However, Ms. Perryman testified that TLU did not provide any documentation to indicate that there was a program to educate its customers.[90] The ALJ noted in her PFD that "[r]esponding to phone calls is not a program to educate, and the insert information that Ms. Comstock described addressed water quality, and not conservation."[91] As the ALJ correctly stated, it is not the ED's obligation to prove TLU's case.[92] The burden of proof falls on the applicant alone. Thus, without any documentation, the ALJ agreed that TLU did not meet criterion 4 of Step H. The ALJ also determined that TLU did not meet the required four of the five criteria for Step H and correctly found that TLU is not entitled to a percentage point for Step H.[93]

Additionally, the ALJ indicated in her PFD that she did not understand the distinction that the ED made in his explanation of criterion 5(b) of Step H. The ALJ

---

[85] PFD at 20.
[86] Tr. at 475:5-12; Tr. at 487:17-488:7
[87] TLU Ex. 36
[88] PFD at 21.
[89] *Id.*
[90] Tr. at 374:5-6.
[91] PFD at 25.
[92] *Id.*
[93] *Id.*

thought that the ED was making a distinction between total *line* loss and *water* loss.[94] However, the distinction being made by the ED is between *total* line loss and *unaccounted* for line loss. Total line loss is made up of accounted for water loss and unaccounted for water loss. Criterion 5(b) of Step H requires the utility to show that there has been a successful program to reduce losses of *unaccounted* for water – not the *total* line loss. TLU introduced its annual reports into evidence to show its total line loss in certain years. However, the annual report does not break down that total line loss to show how much of the lost water was unaccounted for. To receive credit for criterion 5(b) TLU would have to demonstrate that there was a reduction in the unaccounted for water loss rather than showing only a reduction in the total line loss. Without evidence presented by TLU, the ED could not determine if there was a 25% reduction in unaccounted for line loss as the rate of return worksheet requires. Nevertheless, as the ALJ stated in her PFD, even if the ALJ were to find that TLU meets the fifth criterion of Step H, TLU will not have met the required four out of five criteria for Step H. Accordingly, the ALJ correctly found that TLU is not entitled to a percentage point for Step H.[95]

3. Summary of Rate of Return Worksheet

The rate of return is not specified in the Texas Water Code or TCEQ rules as any exact percentage. Rather, it is a percentage based on established principles that the Texas Water Code and TCEQ rules require the Commission to consider. The rate of return worksheet applies those principles specifically to the utility that filed the rate application. The rate of return worksheet aids in quantifying a just and reasonable rate of return expressly for Texas Landing Utilities. The ALJ correctly relied on the ED's completion of the worksheet because TLU did not meet its burden of proof.[96] Through a very detailed and thorough analysis of the worksheet, the ALJ correctly determined that TLU's just and reasonable rate of return should be 9.48%.

---

[94] *Id.*
[95] *Id.*
[96] PFD at 18.

D. The ALJ properly denied TLU's proposed increase in tap fees.

The ALJ's disallowance of TLU's proposed tap fees is proper based on the lack of supporting evidence in the record. TLU claims that its proposed tap fees are reasonable, despite not providing any documentation to support its assertions. The Applicant bears the burden of proving that its proposed rates are just and reasonable.[97] Therefore it was incumbent upon TLU to present sufficient evidence to support its proposed tap fees. TLU provided no documentation to support its claim that the tap fees are reasonable. In fact, TLU admits that it lacks documentation supporting the proposed amounts.[98] Furthermore it was reasonably foreseeable that TLU would need to present documentation during the hearing process to support its argument that the tap fees are reasonable. TLU failed to acquire any proof in support of its assertion. The TCEQ commissioners have stressed the importance of providing documentation to support the rates in the application.[99] They have approved the denial of costs for lack of documentation on several occasions. Accordingly, the ALJ correctly denied the increase in tap fees.

In its closing arguments, TLU wholly rejected placing the term "Actual Cost" in the tariff because it would not alert new customers as to what cost they might expect to pay for a new connection and that it would create "administrative difficulties" for TLU.[100] In apparent agreement with TLU's concerns, the ALJ correctly concluded that rather than approve an increase in tap fees that were not proven to be just and reasonable, the increase in tap fees should be denied because "TLU did not meet its burden of proof..."[101] The ED agrees with the administrative law judge's approach and recommends that the Commission deny TLU's proposed increase in tap fees.

---

[97] TEX. WATER CODE § 13.184(c)
[98] TLU's Exceptions to PFD, Pg. 19.
[99] *See* discussion at June 26, 2009 Agenda, New Business Item No. 1, Consideration of the Administrative Law Judge's Proposal for Decision and proposed Order regarding the application of HHJ, Inc., dba Decker Utilities; TCEQ Docket No. 2008-0164-UCR; SOAH Docket No. 582-08-1719.
[100] TLU's Closing Arguments, Pg. 70.
[101] PFD at 26.

E. The ALJ correctly determined that the ratepayers should only be required to fund the 7% of line loss that results from the normal operation of the utility.

In its exceptions to the PFD, the Applicant claims that it is a "penalty" on the utility to not be allowed to charge its 21% line loss to the customers.[102] However, the Applicant seeks to "penalize" the customers for water loss that can only be attributed to the utility. This water loss is completely beyond the control of the customers. Texas Landing Utilities is the only entity that is in the position, and who has the responsibility, to correct the line loss problem. The customers have no way of correcting the utility's line loss. As Mr. Adhikari testified, "when a utility cannot account for a large amount of water, it often indicates excessive leaks or inefficient operations."[103] The customers should not have to subsidize the inefficient operations of the utility. The ALJ agreed and appropriately found that the "customers should not be required to pay for unexplained line loss."[104]

The Applicant further asserts that the ED did not increase certain expenses for the utility that may be attributed to water loss, such as electricity needed for additional pumping of water.[105] Any additional increase in expenses that the utility would incur due to excessive water loss is not a just and reasonable expense that should be paid for by the ratepayers. If the utility was operating efficiently and had a lower line loss, additional expenses would not be necessary. Moreover, as the ALJ stated in her PFD, TLU's expenses in the test year, such as for electricity usage, was included as a test year expense.[106] If anything, TLU's test year expense for electricity should be reduced by a certain percentage to account for the superfluous expense it had due to its high line loss. That extra expense is not just and reasonable. The ALJ is correct in her determination that only the 7% of line loss that results from the normal operation of the utility should be included in the rate design.

The Applicant also argues in its exceptions that TLU's high water loss should be normalized over a period of time.[107] However, Mr. Adhikari testified that normalization

---

[102] TLU's Exceptions to PFD, Pg. 17. *See also*, Tr. at 508:5-6.
[103] *Direct Testimony of Kamal Adhikari*, Pg. 11, Lines 5-6.
[104] PFD at 30.
[105] TLU's Exceptions to PFD, Pg. 18.
[106] PFD at 30.
[107] TLU's Exceptions to PFD, Pg. 18; *See also*, Tr. at 428:17-23.

is not a TCEQ practice for line loss.[108] Mr. Adhikari also testified that the TCEQ rules do not require the commission to look outside of the test year with regard to line loss.[109] Furthermore, the rate application requires the Applicant to calculate the line loss based on the test year data in order to determine the appropriate rates.[110]

Additionally, the Applicant argues that TLU's water loss in the 2006 test year was an anomaly.[111] The Applicant asserts that TLU normally does not have such a high line loss. However, the Applicant's argument that the test year line loss is not normal only strengthens the ED's position. Higher line loss equals higher rates.[112] If TLU's rates are established using a non-typical, higher than normal line loss, the ratepayers will be paying higher rates for water loss that is not normally incurred by the utility. This inflates the utility's rates for subsequent years when the actual line loss is much lower. By charging rates based on the abnormally high line loss, TLU would recover more in rates than is just and reasonable. The ratepayers should not be required to pay higher rates for water loss that is not being incurred by the utility. The ALJ agreed and stated in her PFD that "[a]lthough the line loss in 2006 may have been an anomaly, it is not appropriate for ratepayers who will be paying rates on a going-forward basis to pay for something that was beyond their control."[113]

Accordingly, the ALJ correctly found that the "customers should only pay for the amount of line loss resulting from the normal operation of the utility, which in this case is 7%."[114]

F. The ALJ correctly determined the amount of customer contribution-in-aid-of-construction that should be used for this application.

In its exceptions to the PFD, TLU claims that the ALJ, by agreeing with the ED, has recommended use of certain customer contribution-in-aid-of-construction amounts that are not accurate.[115] However, the ALJ's determination of the correct amounts was

---

[108] Tr. at 466:13-24.
[109] Tr. at 459:18-21.
[110] TLU Ex. 1, Bates labeled page 002067.
[111] TLU's Exceptions to PFD, Pg. 18. *See also*, TLU's Closing Arguments, Pg. 69.
[112] Tr. at 188:7-9.
[113] PFD at 30.
[114] *Id.*
[115] TLU's Exceptions to PFD, Pg. 19.

based on the Applicant's own evidence introduced into the record.[116] TLU Exhibit 24 shows that the amount of customer contribution-in-aid-of-construction for water is $37,990 and for sewer is $15,144. TLU asserts that it had recalculated lower amounts for customer contribution-in-aid-of-construction after the close of the record. However, those amounts were not entered into evidence during the contested case hearing and were not subject to cross-examination. Accordingly, the ALJ correctly found that the $37,990 for water and $15,144 for sewer should be classified as customer contribution-in-aid-of-construction in the application.[117]

G. The ALJ correctly determined that the application was properly filed.

The Protestant's argue in their exceptions to the PFD that this rate application was filed under the wrong utility name; and therefore, Texas Landing Utilities' proposed rate increase should not be approved.[118] The Applicant is listed on the front page of the rate application as Texas Landing Utilities, L.L.C.[119] The Protestants claim that the wrong name on the first page of the application is a material defect.[120] However, as the ED stated in closing arguments, the name on the first page of the rate application does not determine whether the rate application is acceptable for filing.[121]

In order for the application to be accepted for filing by the TCEQ, Section 291.8 of the commission rules states that "*[n]otice* of rate/tariff change… shall be reviewed by the staff for administrative completeness within ten working days of receipt of the application."[122] In accordance with Section 291.8(a), ED staff reviewed the notice documentation when determining the administrative completeness of this rate application. Staff checks the notice to make sure it conforms to the TCEQ rules and is specific enough to place the ratepayers on notice that their utility provider has filed an application to increase their rates. The notice informs the customers of their right to protest the proposed rate change. In this case, the ED determined that the notice documents were sufficient to place the ratepayers on notice that their water and sewer rates could increase.

---

[116] TLU Ex. 24.
[117] PFD at 32.
[118] Protestant's Exceptions to PFD, Pg. 6.
[119] TLU Ex. 1, Bates labeled Pg. 002049
[120] *Id.*
[121] ED's Closing Arguments, Pg. 13.
[122] 30 TEX. ADMIN. CODE § 291.8 (emphasis added)

The name on the notice documents is "Texas Landing Utilities."[123] That is the same name listed as the certificate holder on the utility's certificate of convenience and necessity. Therefore, the certificate holder was the entity that notified its customers of the proposed rate increase. Thus, the ratepayers of TLU were sufficiently notified that TLU, their utility provider, had filed an application to increase rates. Accordingly, the ALJ correctly determined that the application was properly filed by the utility.[124]

II. CONCLUSION

The ALJ's PFD is well-reasoned, follows the laws, and recommends appropriate adjustments based on the evidence presented during the hearing on the merits. The ED supports the ALJ's adjustments and recommends that the Commission adopt the ALJ's PFD as revised by the Executive Director's previously filed exceptions.

Respectfully submitted,

Mark R. Vickery, P.G.
Executive Director

Robert Martinez, Director
Environmental Law Division

By _____
Ron M. Olson, Staff Attorney
Environmental Law Division
State Bar of Texas No. 24056070
P.O. Box 13087; MC-173
Austin, Texas 78711

REPRESENTING THE
EXECUTIVE DIRECTOR OF
THE TEXAS COMMISSIOIN ON
ENVIRONMENTAL QUALITY

[123] TLU Ex. 32
[124] PFD at 32.

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of December 2009, a true and correct copy of the foregoing document has been sent via facsimile, first class mail, or hand-delivered to the persons on the attached Mailing List.

Ron Olson, Staff Attorney
Environmental Law Division

MAILING LIST
Application of Texas Landing Utilities
to change its water and sewer rates/tariff under
CCN Nos. 11997 and 20569 in Polk and Montgomery Counties

SOAH Docket No. 582-08-1023
TCEQ Docket No. 2007-1867-UCR

FOR SOAH:
Honorable Katherine Smith
Administrative Law Judge
State Office of Administrative Hearings
P.O. Box 13025
Austin, Texas 78711-0325
Fax: 475-4994

FOR THE APPLICANT:
Geoffrey Kirshbaum, Attorney
The Terrill Firm, P.C.
810 West 10th Street
Austin, Texas 78701
Fax: 512.474.9888

FOR THE RATEPAYERS:
Michael Deitch
Law Office of Michael Deitch
800 Rio Grande
Austin, Texas 78701
Fax: 512.474.1579

FOR PUBLIC INTEREST COUNSEL:
Eli Martinez, Attorney
Texas Commission on Environmental Quality
Public Interest Counsel, MC 103
P.O. Box 13087
Austin, Texas 78711-3087
Fax: 512-239-6377

FOR THE CHIEF CLERK:
Ms. LaDonna Castañuela
Texas Commission on Environmental Quality
Office of the Chief Clerk, MC 105
P.O. Box 13087
Austin, Texas 78711-3087