

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

TO: **DOCKET CLERK
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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
P.O. BOX 13087
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RE: **SOAH** SOAH Docket No. 582-08-1023; TCEQ Docket No. 2007-1867-UCR; In Re: Application for a Water Rate/Tariff Change of Texas Landing Utilities, Certificate of Convenience and Necessity No. 11997 in Polk County, Application No. 35838-R and Conveyance and Necessity No. 20569 in Polk County, Application No. 35840-R

On _____, the following items were delivered to the Chief Clerk's Office.

1 Original Proposal for Decision with 10 copies

Your signature below acknowledges receipt of the above referenced documents from the State Office of Administrative Hearings.


Signature of Receiving Party

Date

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State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

November 24, 2009

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

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CHIEF CLERKS OFFICE

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

Re: SOAH Docket No. 582-08-1023; TCEQ Docket No. 2007-1867-UCR; In Re: Application for a Water Rate/Tariff Change of Texas Landing Utilities, Certificate of Convenience and Necessity No. 11997 in Polk County, Application No. 35838-R and Conveyance and Necessity No. 20569 in Polk County, Application No. 35840-R

Dear Mr. Trobman:

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

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than December 14, 2009. Any replies to exceptions or briefs must be filed in the same manner no later than December 24, 2009.

This matter has been designated **TCEQ Docket No. 2007-1867-UCR; SOAH Docket No. 582-08-1023**. All documents to be filed must clearly reference these assigned docket numbers. All exceptions, briefs and replies along with certification of service to the above parties shall be filed with the Chief Clerk of the TCEQ electronically at <http://www10.tceq.state.tx.us/epic/efilings/> or by filing an original and seven copies with the Chief Clerk of the TCEQ. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in cursive script that reads "Katherine L. Smith".

Katherine L. Smith
Administrative Law Judge

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STYLE/CASE: TEXAS LANDING UTILITIES

SOAH DOCKET NUMBER: 582-08-1023

REFERRING AGENCY CASE: 2007-1867-UCR

STATE OFFICE OF ADMINISTRATIVE
HEARINGS

ADMINISTRATIVE LAW JUDGE
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REPRESENTATIVE / ADDRESS

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

2009 NOV 24 PM 4:38

<p>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</p>	<p>§ § § § § § § § § § §</p>	<p style="text-align: right;">CHIEF CLERKS OFFICE</p> <p style="text-align: center;">BEFORE THE STATE OFFICE</p> <p style="text-align: center;">OF</p> <p style="text-align: center;">ADMINISTRATIVE HEARINGS</p>
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PROPOSAL FOR DECISION

Texas Landing Utilities (TLU) filed applications with the Texas Commission on Environmental Quality (Commission or TCEQ) to consolidate and increase the rates for its retail water and sewer services. The Executive Director (ED) supports the increase with changes. The Office of Public Interest Counsel (OPIC) and the Texas Landing Property Owners Association (TLPOA) and other protestants dispute the consolidated rate and contend that TLU failed to meet its burden of proof. The Administrative Law Judge (ALJ) recommends approval of the rate increases with the changes proposed by the ED.

I. JURISDICTION AND PROCEDURAL HISTORY

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

More than 10 percent of the utility's customers protested the rate increase. Preliminary hearings were held on February 11 and May 28, 2008. The following parties were named: TLU,

TLPOA, Bill Bryan, John Stacey, the ED and OPIC. The hearing on the merits was held on May 21-22, 2009. The record closed on August 21, 2009.

II. BACKGROUND

TLU is the assumed business name for David Sheffield's privately-owned, investor-owned utility, located in East Texas, which provides retail water and sewer utility service to customers in Polk and Montgomery Counties.¹ TLU's water service is certificated under Certificate of Convenience and Necessity (CCN) No. 11997 and its sewer service is certificated under CCN No. 20569.

TLU's Montgomery County and Polk County service areas are located 30-35 miles away from each other separated by one county. During the January 1 to December 31, 2006, test year, TLU served 143 water connections and 86 sewer connections. Customers who have both water and sewer connections are located in the Texas Landing Subdivision and part of the Mangum Estates Section 1 Subdivision in Polk County.

TLU's wastewater treatment plant and discharge point is located in the Texas Landing Subdivision on Lake Livingston in Polk County, Texas. In 1995, Mr. Sheffield and his partners purchased the subdivision and TLU's water and sewer system assets from the Resolution Trust Corporation. In 1997, Mr. Sheffield purchased the utility system assets from the partnership. In 1999, Mr. Sheffield purchased the Mangum Estates water system, which had a better water supply, to serve the Texas Landing Subdivision. He also acquired an easement along the Texas Department of Criminal Justice's prison property so that he could provide sewer service to lots

¹ Although Texas Landing Utilities, L.L.C., is identified as the applicant in the applications, the utility seeking the rate/tariff change is Texas Landing Utilities, which is the assumed business name for both David Sheffield, individually, and Texas Landing Utilities, L.L.C.

within Mangum Estates. TLU's Polk County service areas are connected by a single water system and sewer system.

In 2005, a TLU affiliate, Evergreen County, L.L.C., constructed a new water system for the Goode City subdivision in Montgomery County. The system was constructed and the area incorporated into TLU's water CCN in 2005 pursuant to Application No. 34879-C and started serving customers in 2006. TLU Ex. 10. TLU has operated the Goode City water system under the same management as its Polk County water systems.

TLU has not had a system-wide rate increase since 1997. The noticed rates proposed by TLU in its applications would result in an overall annual rate increase of 94.3%, consisting of a 103.5% annual increase in water revenues and an 80.3% annual increase in wastewater revenues. The applications were filed by TLU on or about September 27, 2007. The applications were accepted by the ED as administratively complete on October 13, 2007. Proper public notice of the applications was provided.

TLU currently has a single tariff with multiple rate schedules that have been tacked on as TLU's service area has expanded. In this proceeding, TLU is proposing a consolidated tariff that would apply to all its service areas because it functions as a single entity with shared costs. TLPOA and the other protestants oppose the consolidated tariff because they believe that the consolidated tariff requires its subdivision's 82 customers to subsidize the costs of the newer Goode City subdivision, which only has 14 customers.

III. CONSOLIDATED WATER RATE

Before multiple systems can be consolidated under a single tariff or rate, a utility must meet certain conditions. Section 13.145(a) of the Texas Water Code provides that a utility "may consolidate more than one system under a single tariff only if: (1) the systems under the tariff are substantially similar in terms of facilities, quality of service, and cost of service; and (2) the

tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.” The Commission’s rules impose the same requirements. 30 TEX. ADMIN. CODE (TAC) § 291.21(m).

Relying on the PFD in *Aqua Texas*, TLU contends; at page 26 of its closing argument, that Section 13.145 of the Texas Water Code does not apply to this case because the TLU’s tariff has been compiled over the years via Commission orders approving its CCN amendments and because those orders should be given presumptive weight of proper consolidation or regionalization of the TLU systems. *In re Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas Inc. to Change Water and Sewer Rates*, 582-05-2770 and 582-05-2771, PFD at 22 (July 5, 2007). The ALJ finds that TLU is clearly incorrect. Unlike in the *Aqua Texas* case, there has never been a consolidated TLU rate and as pointed out by the protestants, they were never given notice of those CCN amendments.

Moreover, the conclusion in *Aqua Texas* upon which TLU relies, is even less relevant in light of the Commission’s more recent decision in *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*, 582-08-0698, adopted at the open meeting on Oct. 7, 2009. In *Double Diamond*, the ALJ found that although the Commission had approved the applicant’s rate structure in the past, the applicant was not relieved of its burden because the Commission had not found in a prior contested case that systems were substantially similar and should be consolidated under a single tariff. PFD at 18-19 (June 15, 2009).

The protestants and OPIC assert that TLU has not satisfied the requirement that the two systems are substantially similar in terms of cost of service. There is little dispute, however, regarding the three other criteria: substantial similarity in terms of facilities and quality of service, and conservation efforts.

A. Facilities, Quality of Service, and Conservation

With regard to the facilities, TLU witness Karen Mann, who is TLU's water and wastewater operator, set forth their similarities. Both the Goode City subdivision water system and TLU's Polk County water system are relatively small groundwater systems that serve residential customers. The systems are operated and managed together. Their water sources have similar water quality and quantity. They both operate with wells pumping groundwater that is disinfected by chlorination and distributed by pressure tanks through primarily PVC pipes. TLU Ex. C at 16-17; tr. at 131.

ED witness Kamal Adhikari, the ED's engineer, reiterated much of what Karen Mann stated, testifying that even though the two systems varied in terms of their size and age, they are similar in terms of their source of water and system components, that is, both water systems are small, rural groundwater systems served through pressure tanks that do not use surface or purchased water, and which used similar disinfection systems. ED Ex. 2 at 9-10; tr. at 438-39.

With regard to quality of service, 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 and that they comply with the Commission's drinking water rules, which implement the EPA's drinking water standards. TLU Ex. C at 6-8, 14-15, 17. ED Ex. 2 at 9-10; tr. at 442.

TLU's proposed rate includes a gallonage charge of \$2 for each additional 1,000 gallons above the minimum, which promotes water conservation because it requires ratepayers to pay more as their consumption increases. The ED has recommended a rate design that has zero gallons included in the base rate and a higher volume charge. TLU is willing to adopt the ED's recommended rate design. Ex. A attached to TLU's closing argument. TLU's rates will, therefore, comply with the water conservation provision of TEX. WATER CODE ANN. § 13.145.

B. Cost of Service

In support of its proposed rate increases, TLU provided data setting forth the overall cost of providing water and sewer service. Cost of service is the amount of revenue required to cover the reasonable and necessary expenses incurred by the utility to provide water and sewer service to its customers and to provide a fair and reasonable return on the invested capital, also known as rate base, needed to provide the service. The proposed rates are based upon the test year of January 1 through December 31, 2006.

As the ALJ noted previously, the issue of consolidating rates now has inconsistent precedent between the *Aqua Texas* case, upon which TLU and the ED substantially relied, and *Double Diamond*. Furthermore, the difference between the ED's position in this case and *Double Diamond* is stark. Whereas the ED's witness Elsie Pascua² criticized the applicant in *Double Diamond* for "not address[ing] how the water systems . . . are substantially similar in terms of the cost of service," in this case Sheresia Perryman, the ED's auditor, agreed that TLU was not required to perform a separate cost of service study for each system. *Double Diamond*, PFD at 19; tr. at 437. Even more striking is that the ED derived its own cost of service numbers in the *Double Diamond* case. The ED found that the Retreat system's cost of service was "\$65,153 with a per meter equivalent of \$87.57" and White Bluff's was "\$274,677 with a per meter equivalent of \$33.74," from which the ED and the ALJ determined that the systems did not have substantially similar costs of service. *Double Diamond*, PFD at 18.

It could be that in the *Double Diamond* case the difference between the costs of service was starkly evident for the ED to make its point. Unfortunately, in this case, only TPLOA made an attempt, albeit a limited one that the ED roundly criticized, to make a comparison.

² Ms. Pascua was also the ED's accounting witness in *Aqua Texas*.

In support of its position, TLPOA provided the testimony of David Venoitte, who is a member of TLPOA, an accountant, and a former board member of Harris County Utility District #5. Mr. Venoitte took TLU's initial application (TLU Ex. 1 at 002100) and derived a total net book value of capital investment of \$124,679. Applying TLU's requested 12% return on investment and depreciation return of 5.5%, he determined that the allocated return due TLU to compensate it for the current value of its capital investment in the water system of the Texas Landing Subdivision is \$0.23 per month from each of its 82 customers. To compensate it for the current value of its capital investment in the new water system serving Goode City, it would be due \$32.02 per month from each of its 14 customers. TLPOA Ex. A at 29-30 and Ex. 6. Although Mr. Venoitte testified that he had done calculations that included estimated operating expenses for each system, overhead and operating capital, he did not provide them. TLPOA Ex. A at 30. The ED also points out that Mr. Venoitte did not incorporate relevant expenses, assets, and working capital allowance and failed to compute the depreciation expense "on a straight line basis over the useful life of the asset" as required by section 291.31(b)(1)(B) of the Commission's rules. Furthermore, Mr. Venoitte did not provided an updated assessment based upon TLU's revised application.

Mr. Venoitte also compared the cost of service between the sewer systems of Texas Landing Subdivision and Mangum Estates demonstrating that the Texas Landing residents would have to pay almost \$100 a year more in tariffs to subsidize the Mangum Estates sewer system. TLPOA Ex. A at 30-31 and Ex. 5.

In contrast, TLU's witness Marvin Morgan, who is a certified public accountant with utility ratemaking experience, testified that the cost of service for the TLU systems is substantially similar because they share the same management, operations personnel, providing for the same payroll rates and employee benefits, accounting systems, customer information and billing systems, work equipment, and purchasing policies. In addition, the company purchases materials and supplies by the bulk and contracts for all of its system services, such as fleet maintenance, electricity, and lab services. TLU Ex. D at 36-37.

At first glance, focusing on the net book value of the Texas Landing Subdivision system per 82 customers versus the net book value of the Goode City system per 14 customers, as Mr. Venoitte set forth, suggests that the systems are not similar. Adding the cost of approximately \$30 of expenses per month per customer³ would mean that Texas Landing Subdivision's costs per customer are half of those of the Goode City customers. However, because the Polk County customers are served by the same water and sewer systems, the more appropriate figuring would perhaps be to compare the combined costs of the Texas Landing Subdivision and the Mangum systems with those of Goode City's system. Those costs would likely be more similar, but the ALJ has insufficient information from which to derive a finding.

As previously noted, the protestants complain that they were deprived of due process of law when they were not notified of TLU's 1999 application adding Mangum Estates to its CCN and when TLU applied in 2005 to add Goode City to its CCN, and thus they are at a distinct disadvantage when they attempted to protest the consolidation of the rates. Although the protestants have a point that they were never given notice of service area expansions that they might eventually have to pay for, notice of a CCN amendment is only required to be given to persons who are located in the area proposed to be added to a certification. 30 TAC § 291.106.

OPIC and the protestants also assert that the costs assessed must be substantially similar based upon the costs assessed during the test year. In contrast, as the applicant and the ED successfully argued in the *Aqua Texas* case, TLU and the ED contend that cost of service should not be determined based on a snapshot of the test year or retrospectively, but over time, including prospectively. *Aqua Texas* PFD at 27, 38. In support of its position, 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 Landings, it is reasonable to

³ The ALJ derived this figure from ED Ex. 1 at Exhibit SP-2.

assume that the expenses and additional revenue for each system relatively off-set each other and balance out.

ED Ex. B at 12. By using the long-term approach, the rates will also take care of the increased maintenance, improvement and replacement costs of the older system over time. *Aqua Texas*, PFD at 27.

Notably, the facts of this case are more similar to those of *Double Diamond* than *Aqua Texas*. For example, as in the *Double Diamond* case, this case involves two to three water systems, in contrast to the 335 water systems of the *Aqua Texas* case. *Aqua Texas*, PFD at 7. As a result, the ALJ's last paragraph discussing the cost-of-service issue could just as easily apply in this case:

The ALJ appreciates the position of the McCartneys that the ratepayers at the Retreat may pay higher rates if the Commission requires different rates for the Retreat and White Bluff water systems. The Retreat is a relatively new development with few ratepayers paying the expenses of a system designed to serve more connections. Nevertheless, as pointed out by OPIC, by combining the Retreat and White Bluff water systems under one rate, an older, established development would be subsidizing the newer development. This would not result in water rates that are just and reasonable for the White Bluff ratepayers.

Double Diamond, PFD at 19-20.

Nevertheless, because no Commission rules required TLU to provide the cost of service of each water system and because *Aqua Texas* was established precedent before TLU filed its case, TLU's burden of proof was minimal, and with the support of the ED, TLU made its case.

IV. REVENUE REQUIREMENT

A. Invested Capital and Return

Revenue requirement represents the amount of revenue required to cover reasonable and necessary expenses incurred by the utility and to provide the utility with a fair and reasonable return on the invested capital needed to provide the service, which is also known as rate base.

Revenue requirement represents the amount of revenue required to cover reasonable and necessary expenses incurred by the utility and to provide the utility with a fair and reasonable return on the invested capital needed to provide the service, which is also known as rate base.

To determine the amount of a utility's invested capital, a utility's net book value, working cash allowance,⁴ and materials and supplies are added together as components of invested capital. 30 TAC § 293.31(c)(2). Developer contributions are then deducted from the total to determine the total invested capital since developer contributions are not included in the rate base.⁵ The resultant weighted rate of return is used to calculate the amount of the utility's return on invested capital. The return is included in the utility's revenue requirement.

Below is a TLU's calculation of its invested capital and return for its water systems as set forth in its corrected application schedules. TLU Ex. 24 at 002246, Table IV.E.

⁴ A reasonable allowance up to one-eighth of total annual operations and maintenance expense. 30 TAC § 291.31(c)(2)(B)(iii).

⁵ Developer contributions are considered contributions in aid of construction. 30 TAC § 293.31(c)(3)(A)(iv).

Net Book Value	\$167,041 ⁶
Working Cash Allowance	\$7,463
Materials and Supplies	0
Subtotal	\$174,504
Developer Contributions	0
Total Invested Capital	\$174,504
Rate of Return	12%
Return	\$20,940

1. TLPOA's Position

As mentioned previously, based upon TLU's initial application, which set forth a net book value of \$146,025,⁷ TLPOA's witness David Venoitte derived a net book value of \$124,679, upon which he derived a return of \$14,961 using a of 12% rate of return. TLPOA Ex. 6.

2. The ED's Position

Plant in Service	\$200,455
Accumulated Depreciation	-\$24,108
Net Plant	\$176,347
Working Cash Allowance	6,914
Developer Contribution-in-aid-of-Construction	-\$20,326
Total Invested Capital	\$162,935
Rate of Return	9.48%
Return	\$15,446

⁶ The amount of \$167,041 was apparently derived from Table III.B, the derivation of which is not clear in the record.

⁷ TLU Ex. 1 at 002100, Table III B.

3. Invested Capital

One of the biggest disputes that TLU has with Staff's revisions is the ED's removal of \$20,326 attributed to developer contribution-in-aid-of-construction from the amount of invested capital. The \$20,326 represents the value of portions of the Goode City water system paid for and owned by Evergreen Country, L.L.C., Mr. Sheffield's development company, at the time TLU's application was filed. The property consists of distribution lines valued at \$14,076.28 and a well valued at \$6,250. Ownership of the property was not transferred to TLU until May 18, 2009, three days before the hearing. The ALJ finds that \$20,326 of developer contribution-in-aid-of-construction should be removed from net plant.

The ED notes that the Commission's rules clearly state that any asset that is a contribution-in-aid-of-construction, whether from a developer or customers, is not to be included when determining the cost of service of rate base, although a utility may claim depreciation for the property. 30 TAC § 291.31(b)(1)(B) and (c)(3)(A)(iv). In this case, Mr. Adhikari included the assets in his depreciation schedule. ED Ex. 2 at KA-1 (the assets are described in the depreciation schedule as "Well-GC" and "Distrib. System" acquired June 30, 2005).

TLU witness Marvin Morgan testified that it was reasonable to include the properties as a capital asset of TLU because they were paid for by David Sheffield's other company:

[T]he practical matter it's David Sheffield taking the assets out of one pocket and putting it in his other. So to me, there's no difference even though they're two separate legal entities. And as far as I'm concerned, as soon as the water was turned on to Goode City, those became Texas utility assets—Texas Landing Utilities assets

Tr. at 208-209. Mr. Morgan also testified that since there is no Commission rule on the subject of known and measurable changes, a change can be accepted by the Commission up to the time of the final decision in a rate case, which may take several years to litigate. Tr. at 506-07.

TLU's position is not convincing. The ED also contends that 30 TAC § 291.25(b), which states that, "A utility filing for a change of rates under the Texas Water Code, §13.187 shall be prepared to go forward at a hearing on the data which has been submitted under subsection (a) of this section," limits what may be considered at the hearing to the data that is submitted in the rate filing package. 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.

The outcome in *In re Application of North Orange Water & Sewer, L.L.C. to Change Water and Sewer Rate*, TCEQ Dkt. No. 2003-0597-UCR; SOAH Dkt. No. 582-03-3827, raised by TLU is also not on point, as Staff noted. Although the ED in that case acquiesced in the property being treated as invested capital, the issue addressed was whether the depreciation expense for the plant and equipment acquired after the test year should also have been included in the cost of service. *North Orange*, PFD at 19. In this case, the ED has provided for the depreciation expense in the cost of service because the property in question was currently used and useful developer contributed property. 30 TAC § 291.31(b)(1)(B). Moreover, the allowance for known and measurable changes applies only to expenses such as depreciation. 30 TAC § 291.31(b).

At a minimum, any substantial change in the rate filing application should be in place by the time an applicant's prefiled testimony is filed, which in this case was October 10, 2008, so that the other parties have the opportunity to evaluate and make any counter-recommendations. Or as Staff points out, TLU could have set forth good cause why the change should be permitted at such a late time, as set out in 30 TAC § 291.25(g). Furthermore, Mr. Sheffield may have derived a benefit from the property being owned by his limited liability corporation rather than his individually-owned utility company, as suggested by Mr. Morgan's testimony. Tr. at 40, 166-67, 194-95.

B. Rate of Return

The applicable law found at 30 TAC § 291.31(c) states:

The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and shall fix the rate of return in accordance with the following principles.

(1)(A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

(1)(B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

(1)(C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

(1)(C)(i) Debt capital. The cost of debt capital is the actual cost of debt.

(1)(C)(ii) Equity capital. The cost of equity capital must be based upon a fair return on its value. . . .

The parties disagree about the proper rate of return that should be assessed on the invested capital. Rate of return is the percentage, when multiplied by the invested capital, that provides a utility with a return on invested capital to meet its obligations to investors and debtors and to compete for future capital in the financial markets. Rate of return consists of the cost of debt and return on equity. TLU Ex. D at 11. The cost of debt is the interest paid on money owed. Return on equity is based upon market conditions and investor expectations and should reasonably be set to attract capital. TLU Ex. D at 11-12, 29.

1. TLU's Position

TLU notes that its capital structure consists of 100% equity and 0% debt. TLU Ex. D at 27. TLU is requesting a rate of return on equity of 12%, and thus an overall rate of return of 12% because it has no debt. TLU Ex. D; TLU Ex. 1 at 002062, 002077. TLU asserts that since 1997, the Commission has used the risk premium methodology to determine a standard reasonable rate of return on equity. TLU Ex. D at 27-29. TLU's expert Marvin Morgan testified that a 12% return on equity is reasonable and consistent with Commission practice and Commission precedent. TLU Ex. D at 29-30. He testified further that in all the water and wastewater utility rate applications that he has done over the past 15 years, the presumptive rate of 12% is considered a "safe harbor" rate. Tr. at 521.

Relying on the *Aqua Texas* decision, TLU notes that the Commission found that a 12% return on equity was reasonable in light of *Aqua Texas*' risk and the capital-intensive nature of water and sewer utilities. TLU Ex. 43-- Order Approving Application of Aqua Utilities, Inc. to Change Water and Sewer Rates, TCEQ Dkt. Nos. 2004-1671-UCR and 2004-1120-UCR at 15 (finding of fact no. 73) (Sept. 23, 2008). TLU asserts that the 12% 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. Tr. at 516-17. Mr. Morgan testified that if a 12% rate of return on equity is acceptable for a larger utility such as *Aqua Texas*, it should also be acceptable for a small utility like TLU, which has a greater risk. Tr. at 184. TLU also asserts that the 12% rate of return on equity is consistent with those rates of return obtainable on alternative investments involving similar risks and to attract equity capital if needed in the future. TLU Ex. D at 29-30; tr. at 516-517.

Mr. Morgan also testified about the origin of the Commission's use of the 12% rate of return on equity as the presumptive standard, based upon a Baa utility bond priced at approximately 8% with 400 basis points added as a risk premium, when water rate cases were transferred from the Public Utility Commission of Texas to the Texas Water Commission. Tr. at 516-17. In response to the ED's and TPLOA's position that a different methodology should be

used, TLU contends that such an approach runs afoul of constitutional standards, citing *Duquesne Light Co. v. Baraschi*, 488 U.S. 299 (U.S. 1989). In that decision the court stated: “[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.” Tr. at 315. TLU contends that if the rate of return worksheet is used in this case, as recommended by the ED, it would constitute a new method of calculating rate of return on equity counter to Commission precedent.

TLU asserts that the Commission’s rate/tariff change application form that TLU used to file its applications presents the standard 12% rate of return on equity as a valid option. In support of its position, TLU notes that the form provides three options that the applicant may choose: (1) an average equity return established by the staff each year and included with the Annual Report Instructions; (2) an interest rate that is fair that is less than the rate established by staff; or (3) use of the rate of return worksheet, which is attached to the instructions. TLU Ex. 1 at 002060 and 002075; *see also* ED Ex. 1 at SP-13 at 12, the application instructions document. TLU admits that Option (1) is problematic because the Annual Report Instructions do not mention an “average equity return” But TLU contends that Ms. Perryman testified that the 12% is the “average equity return” established by staff as a safe harbor rate. Tr. at 382. TLU also noted that the 12% rate of return on equity used in the application was based on advice given by Philip Gibbons, who works for Superior Water Systems or Management, a subcontractor recommended by Staff. He told Kim Comstock, who filed TLU’s initial application and is TLU’s office manager, that 12% was the standard rate of return that the Commission approved time and again. Tr. at 98-100.

2. ED's Position

Using the rate of return worksheet, the ED determined that a 9.48% rate of return would yield a fair return on invested capital and would assure confidence in TLU's financial integrity. The ED admits that the Commission has approved a 12% rate of return in other rate applications, but notes that the rate of return has become an increasingly debated and challenged issue and that TLU has the burden of establishing that its proposed rate of return is just and reasonable. TEX. WATER CODE ANN. § 13.184(c). The ED contends that the only factor that TLU considered in deriving the 12% rate of return was the amount of the capital expended since 1997 on its systems and how that related to regulatory and environmental risks. TLU Ex. D at 30. The ED also pointed to the testimony of Mr. Morgan in which he admitted that he did not consider the factors established in the Water Code and the Commission rules when he picked the 12% rate of return because he "used the 12 per cent rate of return forever," and dismissed the principles in the rules as penalties for bad management. Tr. at 182, 185. Staff also notes that Mr. Morgan's position was that, "If it's good enough for Aqua Texas, it's good enough for us." Tr. at 173.

The ED contends that the result in *Aqua Texas* is distinguishable from this one. In *Aqua Texas*, the utility had both debt and equity. When the weighted cost of capital methodology was used to determine the final rate of return, Aqua Texas's final rate of return was 8.44%. *Aqua Texas*, PFD at 61, 64. As previously noted, TLU has no debt. Therefore, the ED does not use the weighted cost of capital methodology, but relies solely on the principles set forth in the Water Code and the Commission's rules. ED Ex. 1 at 10; tr. at 396. Furthermore, the ED gave the issue greater scrutiny in this case because TLU's application was contested. Applicants are warned in the rate filing instructions that "If your application is contested, the staff will compute your rate of return based on the rate of return worksheet." ED Ex. 1 at SP-13 at 12. The ED's witness Ms. Perryman used the rate of return worksheet, which takes into consideration all of the required factors that the Commission must consider when determining rate of return, to determine the appropriate rate of return for TLU. ED Ex. 1 at 8.

3. 12% Rate of Return

Despite what TLU suggests, Ms. Perryman did not testify that 12% is the “average equity return” established by staff as a safe harbor rate. Offhandedly, she did not know what the average equity return rate established by staff is and only stated that the average equity return established by the staff is 12% “if there’s debt and then there’s the weighted cost that’s applied.” Tr. at 381-82. And TLU provided no support for the proposition that Mr. Gibbons’ proposed rate of return is binding on the Commission.

That 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, and neither is relying on the presumed rate of return of 12% on equity awarded in the *Aqua Texas* case, which was processed in a different economic time. Guaranteeing a 12% rate of return on equity forever would clearly be arbitrary. Furthermore, Finding of Fact No. 73 of the *Aqua Texas* case does not state, as TLU suggests, that investors in water and sewer utilities can generally expect to recover a 12% return on equity. It stated 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.” The ALJ is not aware of any evidence being presented in this case, about the returns of other investments of similar risk at this time, except for Mr. Morgan’s conclusory statement. And the *Aqua Texas* case loses its relevance as time progresses.

Although use of the rate of return worksheet is optional, TLU chose the risk of not using it and relied instead on a non-existent safe harbor of 12%. Because TLU did not meet its burden of proving the need for a 12% rate of return, the ALJ relies largely on the rate of return worksheet developed by Staff. ED Ex. 1 at SP-9.

4. Rate of Return Worksheet

Although TLU contends that the rate of return worksheet should not be used in this case, in the alternative, it suggests that it should be completed differently than the way the ED and TLPOA completed it (TLPOA Ex. 11 and ED-SP-9), as demonstrated by TLU Ex. 46, which produces a rate of return of 14.46%. TLU asserts that instead of the 6.48% relied upon by the ED, which was the Baa Public Utility Bond average for 2006, 8.46% should be used in Step A because Step A of the worksheet calls for the "Most current Baa Public Utility Bond average," and reflects a known and measurable change. According to TLU, 8.46% was the rate at the end of December 2008. Tr. at 518. TLU even suggests that a more current rate should be used. The ALJ is not swayed by TLU's argument, however. As the TLPOA suggests, TLU is relying too much on known and measurable changes. Furthermore, the term known and measurable change does not refer to changes in the financial market. 30 TAC § 291.31(b).

a. Step A

Step A of the worksheet begins with the most current Baa Public Utility Bond average, which Ms. Perryman testified means the bond average at the time of the test year 2006, which was 6.48%. Tr. at 358; TLU Ex. 36 at 3.

b. Steps B, D, and E

Three of the worksheet steps were largely undisputed. All the parties agreed that 2% should be added at Step B for TLU's being a utility with 200 or fewer customers. TLPOA stops there, recommending a rate of return of 8.48%. Regarding Step D, TLU did not meet the criteria, because as its witness Ms. Comstock admitted, even though she believes TLU has a greater than 10 percent weekender population, TLU does not meet the three other criteria of Step D, which

requires that two out of four criteria be met. Tr. at 473-74. The parties, including TLU also agreed that TLU should not get an additional percentage point for Step E. Tr. at 365, 474.

c. Step G

Although the ED also found that TLU met four of the five criteria of Step G, entitling it to an additional percentage point, TLPOA disagrees. The five criteria are: (1) well-maintained, up-to date books and records; (2) effective communications and good customer relations; (3) consistently timely in meeting reporting requirements and payment of fees; (4) fiscally responsible with respect to rate filings, including completeness, accuracy and frequency; and (5) less than 12% unaccounted for water. The only criterion that the ED did not believe that TLU met was criterion 5 because TLU had unaccounted for water loss of 13.83% in the 2006 test year. TLU Ex. 17. TLU does not dispute the assessment but contends that, as Mr. Morgan testified, TLU should not be penalized for not chasing water leaks when unaccounted for water loss is 15% or below, in accordance with the American Water Works Association standards. Tr. at 209-13. Based upon the clear standard set forth in criterion 5, the ALJ determines that TLU should not get credit for less than 12% unaccounted for water.

As referred to, TLPOA contends that TLU does not have well-maintained, up-to-date books and records because Ms. Comstock admitted that the transfer of assets from another of Mr. Sheffield's companies to TLU did not occur as planned and because Mr. Morgan had to amend TLU's application. But having reviewed TLU's general ledgers and invoice documentation, Ms. Perryman found them to be well-maintained and up-to date. TLPOA's points are not convincing evidence to controvert Ms. Perryman's testimony. Therefore, the ALJ finds that TLU's books were well maintained and up-to-date. Tr. at 108-09; 142-44.

With regard to criterion 2 of Step G, the evidence is not so clear. Because of the low number of customer complaints against TLU, Ms. Perryman concluded that TLU has effective

communications and good customer relations. TLU pointed out that Ms. Comstock and Ms. Mann have good relations with TLU's customers and personally know just about everyone in the system, and, as noted, several of the TLU ratepayers hugged Ms. Mann outside the hearing room. Tr. at 475, 487-88. Nevertheless, Mr. Sheffield's relationship with his customers is not so friendly. Much of the rancor may be derived from resentment about the Texas Landing Subdivision having to subsidize Mr. Sheffield's land developments at the expense of the needs of the aging Texas Landing Subdivision water system and his alleged failure to meet with customers early on in the proceeding to discuss settlement. Tr. at 49-51, 302. Even Ms. Perryman admitted that based upon what she heard at the hearing, it does not appear the utility has effective communications and good customer relations. Tr. at 385. Nevertheless, disagreements stemming from this application should not be factored into the equation. Therefore, the ALJ concludes that TLU is entitled to a percentage point for meeting Step G.

d. Step C

Step C requires that two criteria be met. Ms. Perryman initially gave TLU a percentage point for meeting Step C, but took away the 1% when she learned at the hearing that TLU's affiliated companies have access to revenues that could be used to support utility operations. Tr. at 361. As the ED noted, Mr. Sheffield testified that TLU relies on affiliated companies Tejas Properties and Sheffield Family, L.P., to operate the water system. TLU Ex. A at 8. Tejas Properties manages the properties that Mr. Sheffield develops. TLU Ex. A. at 10. The Sheffield Family, L.P., manages planning and finances for TLU and handles large repairs. In particular, Sheffield Land, Inc., used a Kubota tractor that it owns to make line repairs and install lines for TLU's benefit during the test year. TLU Ex. A at 12. TLU asserts, however, that there was no evidence presented showing that the operations of TLU are actually being paid for by affiliates. Tr. at 518-19.

Access to a tractor paid for by another company is clear evidence that affiliated companies exist with access to revenues. Furthermore, the discussion of Evergreen, L.L.C.

above, is additional evidence in support of the ED's position. Therefore, TLU is not entitled to a percentage point for meeting Step C.

e. **Step F**

Ms. Perryman testified that TLU met only two of the four criteria of Step F, rather than the three required: (1) "2 complaints or less per year to TCEQ" for a water system with less than 200 customers and (4) "good faith efforts to solve any current problems." Ms. Perryman found that TLU did not meet the 2nd criterion, which requires that there be "No major deficiencies in the most recent PWS inspection report." After reviewing the most recent PWS report and consulting with Mr. Adhikari, she found that there were two deficiencies, track numbers 229955 and 230068, for failure to meet the Commission's minimum water system capacity requirements. Tr. at 370; TLU Ex. 4 at 000794. Mr. Adhikari testified that the issues relating to the minimum capacity requirements are considered to be major violations. Tr. at 440-41.

TLU notes that Ms. Perryman relied on TLU's last PWS inspection report of March 2006. TLU Ex. 4. According to TLU, track no. 229955 concerned a minimum service pumping capacity standard and track no. 230068 concerned a minimum storage capacity requirement. TLU Ex. 4 at 000794. TLU contends that it has addressed both issues. TLU Ex. 6; TLU Ex. 44. TLU contends that although Mr. Adhikari noted on cross-examination that the failings were considered to be "major" by the Commission's region inspector, he seemed unsure. Tr. at 439-40. TLU also noted that Ms. Mann did not consider the failings to be a major deficiency and that they were easily resolved. Tr. at 485. TLU also noted the lack of a standard is problematic.

Although TLU suggests that Mr. Adhikari was unsure whether the failings are major, that assessment does not appear to be the case. His testimony was clear that his "understanding is the issue with the minimum capacity requirement," is "considered to be [a] major" violation. Tr. at 440. And though Ms. Mann considered the failing to be easily resolved, the resolution involved

the installation of a new ground storage tank, a capital improvement, which took some time to install. Tr. at 486. Therefore, the ALJ finds that TLU failed to meet criterion 2 of Step F.

With regard to the 3rd criterion which requires that there be "No current or prior enforcement actions under current management within the last 3 years," Ms. Perryman testified that there was an enforcement action relating to TLU's failure to prevent inflow and infiltration from impacting the wastewater treatment plant and collection system occurring on August 26, 2008. Ms. Perryman testified further that since the referral was in the enforcement database, at least a notice of violation was issued. Tr. at 371.

In response, TLU noted the similarity to a voluntary agreement that it entered into on August 28, 2008, relating to five unauthorized inflow and infiltration discharges between April 20, 2004, and October 28, 2006. TLU Ex. 45. According to TLU, the agreement was a voluntary measure that TLU entered into because of issues noted in a Commission November 2006 wastewater system inspection, not because of an alleged violation. TLU further argues that an enforcement action is one initiated by the ED and one that involves the filing of the Executive Director's Preliminary Report or petition, which has not occurred. 30 TAC §§ 70.4, 70.101, 70.103.

Although the Commission may not have initiated a formal enforcement action, it referred to a November 1, 2006, violation in a letter dated November 28, 2006, and noted that it had enforcement powers to ensure compliance. TLU Ex. 7. Furthermore, 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. Furthermore, the last page of the agreement notes that "in return for the Owner's agreement and adherence to these terms, the Commission will withhold further enforcement action related to the noted deficiencies." TLU Ex. 45. Therefore, the ALJ finds that TLU should not get credit for meeting

criterion 3. Because the ALJ finds that TLU failed to meet three criteria of Step F, it is not entitled to an additional percentage point.

f. Step H

With regard to Step H, which requires that four out of five criteria be met, Ms. Perryman found that TLU had a drought contingency plan included in its tariff and a conservation plan that encouraged the use of water conservation devices, efficient lawn watering, or xeriscaping, and, therefore, met criteria 2 and 3 of Step H. Ms. Perryman found, however, that TLU did not meet the other three criteria.

The 1st criterion requires that the utility demonstrate that it has a rate structure consisting of two of the following: (a) zero gallons included in minimum bill, (b) gallonage rate set high enough to encourage conservation (> \$2.00/1000 gal.), and (c) use of inclining blocks, *i.e.*, higher use pays a higher cost. According to Ms. Perryman, TLU's proposed rates did not implement any of the above. TLU Ex. 1 at 002088.

TLU admits that its current rates and proposed rates do not include zero gallons in the minimum bill, but notes that its rate design can easily be converted to include a zero gallons rate, which Mr. Morgan has developed. In addition, TLU states that its existing and proposed volumetric gallonage rate is \$2 per 1,000 gallons. Although TLU may be willing to change its rates to include zero gallons in the minimum bill, its \$2 per 1,000 gallons rate is equal to, and not greater than \$2 per 1,000 gallons. Therefore, TLU does not meet criterion 1 of Step H.

The 4th criterion requires the utility to demonstrate that it has a program to educate customers about the nature of the system, its production and distribution ability, PWS standards, and the need for water conservation. Ms. Perryman testified that TLU did not provide any documentation to show that it had such a program. Tr. at 374. In response, TLU contends that

its educational insert program and direct contact with its customers about ways to conserve water meets this part. Tr. at 489. TLU also complains that Ms. Perryman did not consider or request information about TLU's billing insert program or other educational efforts. TLU's complaint is not well-founded. It is not the ED's job to prove up TLU's case. Responding to individual phone calls is not a program to educate, and the insert information that Ms. Comstock described addressed water quality, and not conservation. Tr. at 488, 497-98. Therefore, TLU does not meet criterion 4 of Step H.

To get credit for the 5th criterion of Step H, TLU must demonstrate that it had 10% or less unaccounted for water loss or had a successful leak detection and repair program to reduce unaccounted for water loss by 25% within the last three years. According to the ED, TLU's unaccounted for water loss was 13.83%. TLU Ex. 17. Furthermore, according to the ED, TLU did not demonstrate that it had a successful program to reduce unaccounted for water loss over the last three years. TLU again complains that Ms. Perryman did not request information from TLU about its program to reduce losses. TLU contends that the evidence shows that it has an ongoing program to detect and repair water leaks in an effort to reduce water losses and that it provided evidence that there has been a greater than 25% reduction in line loss from 21% in 2006 to 13.06% in 2008. TLU Exs. 17 and 40 at 5. The ED responds that although TLU claims that there was a 25% reduction in total *line* loss, it failed to demonstrate that it successfully reduced unaccounted *water* loss by 25%. The ALJ does not understand the distinction between line and water loss that the ED is making. But even if the ALJ were to find that TLU meets the 5th criterion of Step H, TLU will have met only three criteria. Therefore, TLU is not entitled to a percentage point for meeting Step H.

g. ALJ's Recommendation

Based upon the above, the ALJ has determined that TLU is entitled to a rate of return of 9.48% as proposed by the ED. Invested capital that TLU is requesting of \$20,940 is reduced by

\$5,494.00 to \$15,446 for water. And the return on net invested capital is reduced by \$1,575.00 \$5,932 for wastewater. ED Ex. 1 at 8 and ED-SP-1, SP-3, SP-5, SP-7.

C. Tap Fees

Another contested issue between TLU and the ED is TLU's proposed tap fees. TLU has proposed an increase in tap fees based upon estimates received from outside contractors as to what tap installations might actually cost. TLU Exs. 1, 32. TLU contends that its proposed tap fees are reasonable. The ED contends that TLU has provided no documentation to support its assertion that they are reasonable. Without the proper documentation to establish what the actual costs would be, the ED recommends that the tap fee in the tariff be set forth as "Actual Cost." In response, TLU contends that the term "actual cost" would not alert new customers about the cost that they would be expected to pay for a new connection to the water system and would create administrative difficulties. Although the ED found the concern to be reasonable, the resulting outcome, nevertheless, should not be an increase in the tap fees. Because TLU did not meet its burden of proof, the tap fees should remain as they are in the current tariff.

D. Revenue Requirement

1. TLU's Position

The revenue requirement amounts originally proposed in TLU's applications are:

Water: \$87,769

Sewer: \$46,585

TLU Ex. 24 at 00248 and 00249.

In reviewing TLU's application, the ED proposed some adjustments to expenses, which were generally not opposed by TLU. The ED recommended that repairs, maintenance, and supplies in the amount of \$4,369 be reduced for water. The ED also increased accounting and legal/management and operations expenses for water by \$3,454, and reduced the same amount for wastewater. ED Ex. 1 at 5-7.

After reducing repairs and maintenance by \$4,369 and making additional adjustments, TLU is requesting revenue requirements in the amounts of:

Water	\$83,499
Sewer	\$46,944
Total	\$130,433

TLU Closing Argument at 67.

2. ED's Position

Because of reduced rate of return that the ED is recommending, it also reduced federal income taxes by \$980 for water and \$365 for wastewater. ED Ex. 1 at 7.

The ED proposes the following revenue requirement for water:

Operations and Maintenance	\$55,310.00
Depreciation and Amortization	\$5,772.94
Other Taxes	\$500.00
Federal Income Taxes	\$2,725.76
Return	\$15,446.00
Revenue Requirement	\$79,754.71
Other Revenues - Taps	-\$4,472.00
Base Rate Revenue	\$75,282.71

The ED proposes the following revenue requirement for sewer:

Operations and Maintenance	\$37,310
Depreciation and Amortization	\$1,833
Other Taxes	\$294
Federal Income Taxes	\$1,046
Return	\$5,932
Revenue Requirement	\$46,416
Other Revenues - Taps	-\$1,742
Base Rate Revenue	\$44,674

ED Ex. 1 at SP-1 and SP-5.

Based upon the ED's recommendations and adjustments and including the rate of return of 9.48%, which produces a return of \$15,446, the ALJ recommends that the annual revenue requirement be set at \$75,283 for water and \$44,674 for waste water. Using the figures proposed in Mr. Adhikari's testimony, TLU will need to charge a base rate of \$32 per connection with zero gallons included and a gallonage charge of \$2.36 per 1,000 gallons for water and a base rate of \$30.14 per connection with zero gallons included and a gallonage charge of \$3.18 per 1,000 gallons for wastewater. ED Ex. 2 at 19, 21 and KA-5 and KA-6.

V. OTHER ISSUES

A. Line Loss

Another issue in dispute is the percentage of line loss to be included in rate design. Line loss is the difference between the number of gallons of water pumped and the number of gallons billed during the test year. According to the ED, the amount of TLU's line loss in 2006 was

9,310,010 – 7,376,330 = 1,933,680 gallons or 21%, of which 646,500 gallons were accounted for, leaving 1,287,180 gallons, or 14%, unaccounted for. TLU Ex. 17. According to the ED, TLU contends that it should be able to recover all of the 21% of line loss through its rates. The ED notes that including the extra 14% would require customers to pay higher rates to fund the loss of unaccounted for water.

According to Mr. Adhikari, “When a utility cannot account for a large amount of water, it often indicates excessive leaks or inefficient operations.” Mr. Adhikari also testified that the total line loss for a typical water system is around 15%. ED Ex. 2 at 11. To promote water conservation and to prevent utilities from passing along the cost of inefficient operations to their customers, the ED’s practice is to allow no more than 15% total line loss in the calculation of the utility’s rates. According to the ED, the 15% threshold represents water loss attributable to the normal operations of the utility. The reasoning behind the practice is to promote water conservation and to prevent customers from having to subsidize inefficient operations of the utility. Therefore, the ED recommends that only the accounted for line loss of 7% be included in the rate design, to ensure that the ratepayers only fund the amount of line loss resulting from the normal operations of the utility

TLU admits that there was an abnormally high spike in water loss during 2006 of which 7% was attributed to line flushing or leaks that were detected and repaired. TLU Exs. 17, 37-40. According to TLU witness Mr. Morgan, TLU should not be penalized for unaccounted for line loss that is less than 15% in light of the American Water Works Association’s (AWWA’s) standard that line losses less than 15% are not worth looking for. Tr. at 186-87. The ED responds that after subtracting 1% line loss for system flushing, TLU still had 20% line loss in the test year. TLU Ex. 17.

TLU also complains that the penalty that the ED is recommending does not account for the increased expenses attributable to water loss, such as the electricity needed for additional

pumping. Mr. Morgan recommends including the entire 21% of line loss in TLU's rate design and using the total volume billed in test year 2006. Tr. at 186-87, 507-08.

The ALJ agrees with the ED that customers should not be required to pay for unexplained line loss. Although 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. Furthermore, Mr. Morgan's testimony was not as certain as TLU contends. He stated that "I think AWWA standard is that if your line losses are less than 15 percent, it's not worth looking for," and he assumed that the Commission's policy on line losses to be recovered from customers is 15 percent "because of the purchase water pass-through clause." Tr. at 187. Yet no additional information was provided in support of his position. Accordingly, 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%. And presumably, TLU's expenses in the test year, such as for electricity usage, was accounted for in the test year. Therefore, the appropriate amount of line loss to be included in the rate design is 7%.

B. Rate Case Expenses

TLU is seeking rate case expenses for \$52,955 in consulting fees and \$89,359.81 in legal fees totaling \$142,314.81, as of the end of the hearing. TLU indicated that additional rate case expenses will be incurred for writing closing arguments and replies and appearing at the Commission's agenda meeting. Tr. at 138, 233. The ED generally supports an applicant's recovery of reasonable rate case expenses in accordance with 30 TAC § 291.28(7). Although Ms. Perryman had concerns about both TLU attorneys billing for time spent at the mediation and on conference calls and Mr. Morgan's fluctuating rates, the ED did not recommend any reductions and ultimately did not challenge the reasonableness of TLU's expenses. Tr. at 379-80.

The protestants contend that TLU's expenses should not be recovered because they are unreasonable, were unnecessary, and not in the public interest. They note that by the time this case is over TLU will likely have \$200,000 in rate case expenses, in contrast to the ultimate annual revenue requirement increase of approximately \$70,000 per year. They question not whether the work was done, but whether it was reasonable to devote so much time to the litigation of simple issues.

Although the ALJ is sympathetic with protestants' position, without specific numbers the ALJ has little or nothing to work with. That TLU's attorneys' fees were three times the protestants' attorney is not that surprising in that the protestants did not have the burden of proof in this case. Furthermore, the approximate revenue requirement of \$70,000 will be spread over a number of years.

TLU recommends recovering its expenses through a surcharge on customers' bills. TLU also advocates charging only the customers living in the Texas Landing Subdivision because only they protested the application. Although the ED agrees that the expenses should be recovered through a surcharge, the ED and OPIC state otherwise along with the protestants. As the ED stated, when a rate is protested, the benefits resulting from the protest apply to all ratepayers. The ALJ agrees that the surcharge should be assessed on all the ratepayers because the protestants rightfully questioned the similarity of the cost of service of the three water systems and the rate of return.

C. Surcharge Dispute

The protestants argue that TLU has over-collected a surcharge that it was authorized to collect from a prior 1997 rate settlement and assert that they are due a refund from the over-collection. Tr. at 42-44. The protestants note that only after its protest did TLU admit its error in over-collecting the allowed surcharge. Protestants contend that TLU's attempt to placate the

protestants by refunding the amounts over-collected at a 1.17% interest rate is not appropriate. Protestants contend that TLU should be ordered to immediately refund in full all over-collected funds plus interest. The ED contends that the surcharge dispute is not relevant to this proceeding, nor is it the proper venue. With regard to the excess rates charged by TLU since November 26, 2007, the ED recommends that the customers be given a credit or refund of all such sums collected plus interest over the same period of time that the excess rate was collected, which the ALJ supports. TEX. WATER CODE ANN §13.187(i),

The protestants also contend that the over-collected amount should be excluded from rate base as customer contribution-in-aid-of-construction. In response, the ED states that the request is contrary to the Commission's rules and notes that assets bought with customer contributions will not receive a return or depreciation. According to the ED, TLU has claimed \$37,990 in customer contributions for water and \$15,144 in customer contributions for sewer. TLU Ex. 24. The ALJ finds that the amounts claimed should be included in rate base as customer contribution-in-aid-of-construction.

D. Utility in Question

The protestants argue that since the rate application was filed under the wrong utility name, Texas Landing Utilities, L.L.C., the proposed rate increase should not be approved. The ED notes that although Texas Landing Utilities, L.L.C., is listed on the front page of the application, the applicant in this case is Texas Landing Utilities, because to become a limited liability company, TLU had to file a sale, transfer, merger application with the Commission, which it failed to do. Tr. at 39-40. According to the ED, the incorrect name on the application did not nullify the filing because the documents giving notice to ratepayers of the rate increase correctly identified TLU as the utility and that was specific enough to place the ratepayers on notice that their rates could increase. TLU Ex. 32. Moreover, TLU is the same name listed as the certificate holder on the utility's CCN.

E. Transcription Costs

According to 30 TAC § 80.23(d)(1), the Commission will consider the following factors in allocating reporting and transcription costs among the other parties:

(d) Assessment of reporting and transcription costs.

- (1) Upon the timely filed motion of a party or upon its own motion, the commission may assess reporting and transcription costs to one or more of the parties participating in the proceeding. The commission shall consider the following factors in assessing reporting and transcription costs:
 - (A) the party who requested the transcript;
 - (B) the financial ability of the party to pay the costs;
 - (C) the extent to which the party participated in the hearing;
 - (D) the relative benefits to the various parties of having transcript;
 - (E) the budgetary constraints of a state or federal administrative agency participating in the proceeding;
 - (F) in rate proceedings, the extent to which the expense of the rate proceeding is included in the utility's allowable expenses; and
 - (G) any other factor which is relevant to a just and reasonable assessment of costs.

The Commission will not assess transcript costs against the ED or the OPIC. 30 TAC § 80.23(d)(2).

Because the hearing was scheduled for more than one day, TLU arranged for a court reporter to record and transcribe the hearing on the merits. At the conclusion of the hearing, the court reporter prepared a transcript and submitted it to the Chief Clerk. TLU, TLPOA, OPIC, and the ED utilized the transcript in making their closing arguments and responses.

TLU's position is that each party should bear its own costs for copies of the transcript, but that other costs should be split 50/50 to the extent that they are not included in TLU's recoverable rate case expenses. TLPOA notes in its response that it has received no indication of the cost of the transcription, other than that which it incurred for its own copies of the transcripts. TLPOA objects to the overall costs being placed upon the ratepayers. And TLPOA complains that TLU spent undue time during the last day of the hearing scrutinizing the ED's use of the rate of return worksheet.

TLU essentially blames TLPOA for there even being a hearing that needed to be transcribed. Nevertheless, TLPOA provided a substantial service in this case. Therefore, the ALJ recommends that TLU be assessed the full cost of the reporting and transcription costs for the hearing to be recovered in rate case expenses from all the ratepayers.

V. RECOMMENDATION

The ALJ recommends that the Commission adopt the attached order approving the application for rate changes with modifications.

SIGNED November 24, 2009.



KATHERINE L. SMITH
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



**AN ORDER
APPROVING THE APPLICATION OF TEXAS LANDING UTILITIES
TO CHANGE WATER AND SEWER RATES
SOAH DOCKET NO. 582-08-1023
TCEQ DOCKET NO. 2007-1867-UCR**

On _____, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Texas Landing Utilities to change its water rate and tariff in Polk and Montgomery Counties, Texas, under Certificate of Convenience and Necessity No. 11997 and to change its sewer rate and tariff in Polk County, Texas, under Certificate of Convenience and Necessity No. 20569. Administrative Law Judge Katherine L. Smith of the State Office of Administrative Hearings (SOAH) presented a Proposal for Decision (PFD) recommending that the Commission approve the requested rate changes with modifications. After considering the PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

I. FINDINGS OF FACT

General and Procedural Findings

1. David L. Sheffield d/b/a Texas Landing Utilities (TLU) holds Water Certificate of Convenience and Necessity (CCN) No. 11997 in Polk and Montgomery Counties, Texas, and Sewer CCN No. 20569 in Polk County, Texas.

2. Texas Landing Utilities, L.L.C. d/b/a Texas Landing Utilities is a limited liability company owned and managed by David L. Sheffield.
3. On September 27, 2007, David L. Sheffield and Texas Landing Utilities, L.L.C. submitted Applications to Change Water and Sewer Tariffs and Rates for Texas Landing Utilities, CCN Nos. 11997 and 20569 in Polk and Montgomery Counties, Texas, Application Nos. 35838-R and 35840-R (the Applications) to the Commission.
4. TLU's proposed water and sewer rate/tariff changes include increased retail water and sewer utility service rates, changes to miscellaneous fees and charges, and a request for a consolidated water rate schedule and a consolidated sewer rate schedule.
5. On October 13, 2007, the Commission accepted the Applications for filing and declared them administratively complete.
6. TLU timely and properly provided notice of the proposed rate changes to its ratepayers and affected persons.
7. The proposed rate increases in the Applications became effective on November 26, 2007.
8. Within 60 days of the effective date of the proposed rate changes at least 10 percent of TLU's customers filed protests to the rate changes.
9. On November 27, 2007, the Commission referred the Applications to SOAH for a contested case hearing. The proceeding was styled and numbered as follows: TCEQ Docket No. 2007-1867-UCR/SOAH Docket No. 582-08-1023; Application for a Water Rate/Tariff Change of Texas Landing Utilities, 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.
10. Notice of the hearing in this docket was provided to all affected persons.

11. On February 11, 2008, a preliminary hearing convened in this docket, at which time the following parties were admitted and designated: TLU, the Executive Director (ED), the Office of Public Interest Counsel (OPIC), Bill Bryan, David Veinotte and John Stacey for themselves and as members of the Texas Landing Homeowners Association and subdivision.
12. At the February 11, 2008, preliminary hearing, a defect was found in the notice of that hearing in that the notice failed to apprise the customers of TLU in Montgomery County of the change in their water and sewer rates/tariffs. The proceeding was abated for 45 days to allow for TLU to issue a supplemental notice of hearing and to provide a deadline for intervention of parties.
13. A second preliminary hearing was convened on May 28, 2008, and TLU, ED, Mr. Bryan, Mr. Stacey, and Texas Landing Homeowners Association subdivision appeared. No persons not present at the February 11, 2008, preliminary hearing appeared or requested to be added as designated parties at the May 28, 2008, preliminary hearing.
14. On January 9, 2009, Order No. 10 Ruling on Motion to Dismiss was issued ordering that the Texas Landing Subdivision be dismissed as a party and that the Texas Landing Homeowners Association be properly recognized as the Texas Landing Property Owners Association (TLPOA).
15. The hearing on the merits was held on May 21-22, 2009. TLU appeared through its attorneys, Paul Terrill and Geoffrey Kirshbaum. The ED appeared through staff attorney Ron Olson. OPIC appeared through staff attorney Eli Martinez. TLPOA, Mr. Veinotte, Mr. Bryan, and Mr. Stacey appeared through their attorneys, Michael Deitch and Brian Deitch.
16. TLU, the ED and TLPOA each presented evidence during the hearing on the merits.
17. TLU was instructed by the ALJ to supplement its rate case expense evidence at the post-Proposal for Decision and post-Exceptions to the Proposal for Decision stages of this case by affidavit with an opportunity for response by other parties.

Consolidated Rates

18. TLU has an approved water tariff that applies to two systems serving multiple subdivisions in Polk and Montgomery Counties.
19. TLU has an approved sewer tariff applicable to a single sewer system serving a number of subdivisions in Polk County.
20. TLU's existing water and sewer tariffs contain multiple rate schedules applicable to connections within the various subdivisions served by TLU.
21. TLU's Applications seek water and sewer tariffs with consolidated water and sewer rate schedules applicable to all TLU connections.
22. TLU's regional water tariff reflects similarity in the depth of groundwater, system and regulatory requirements, and physical characteristics such as regional geology.
23. TLU's water system facilities served under its regional tariff are substantially similar for reasons including, but not limited to, their sources of water, the components of each system, the types of piping, the design and construction of the systems, facilities, the types of systems, and the types of customer usage that they serve.
24. TLU's water systems within its regional tariff provide substantially similar quality of service, including the following:
 - a. both use state-approved technologies and facilities;
 - b. both provide service that achieves the Commission's and EPA's drinking water standards; and
 - c. both provide water treatment that achieves the Commission's and EPA's drinking water standards.

25. TLU's water systems' costs of service are substantially similar within its regional tariff for reasons including the following:
 - a. both systems share operations and maintenance costs that are either identical or at least substantially similar on a per customer basis;
 - b. both systems' capital components are substantially similar, resulting in substantially similar repair and replacement costs over the life of those components on a per customer basis.
26. No comparison between TLU sewer facilities serving subdivision areas in Polk County is required because the facilities constitute a single sewer system with a shared wastewater treatment plant uniformly providing service throughout TLU's Sewer CCN No. 20569 service area.
27. TLU's consolidated water rate schedule tariff will promote water conservation by including zero gallons in the base rate.
28. TLU's consolidated water rate schedule tariff will promote water conservation by including a gallonage charge of \$2.42 for each additional 1,000 gallons above the minimum which requires ratepayers to pay more as their consumption increases.

Rate Base, Allowable Expenses, and Revenue Requirement

29. TLU's proposed rates are based on a 12-month test year ending December 31, 2006, as adjusted for known and measurable changes.
30. During the test year, TLU provided water and sewer utility service to fewer than 200 total customers with water and sewer connections in three Polk County subdivisions and water connections in one Montgomery County subdivision.
31. During the test year, TLU provided water utility service to 143 active Polk and Montgomery County water connections in the Texas Landing, Mangum Estates Sections 1 and 2, Bull

Frog Basin, and Goode City subdivisions.

32. During the test year, TLU provided sewer utility service to 86 active Polk County sewer connections in the Texas Landing, Mangum Estates Sections 1 and 2, and Bull Frog Basin subdivisions.
33. TLU's requested water and sewer rate/tariff changes included the requested rates and miscellaneous charges set forth in the notice sent to customers in 2007. TLU implemented the proposed rates effective November 26, 2007.
34. TLU's amount of invested capital should be reduced by \$20,326 because it is developer contribution-in-aid-of-construction.
35. The \$20,326 represents the value of portions of the Goode City water system paid for and owned by Evergreen County, L.L.C., Mr. Sheffield's development company at the time TLU's application was filed.
36. Because the property is used and useful in providing water service, depreciation of the property is appropriate.
37. Based upon the calculation found at **Exhibit C**, TLU's total invested capital is \$162,935 for its water service.
38. Based upon the calculation found at **Exhibit F**, TLU's total invested capital is \$62,569 for its wastewater service.
39. Although TLU does not have debt and is financed with 100% equity, TLU is not entitled to a rate of return of 12%.
40. Use of the rate of return worksheet was appropriate in this case.
41. In accordance with Step A of the worksheet, the Baa Public Utility Bond average during the time of the test year was 6.48%.

42. Because TLU is a utility with 200 or fewer customers, it is entitled to two additional percentage points in accordance with Step B of the worksheet.
43. TLU is entitled to an additional percentage point because it meets four of the five criteria of Step G: (1) well-maintained, up-to date books and records; (2) effective communications and good customer relations; (3) consistently timely in meeting reporting requirements and payment of fees; and (4) fiscally responsible with respect to rate filings, including completeness, accuracy and frequency.
44. TLU failed to meet enough criteria of the remaining steps on the worksheet to make it eligible for additional percentage points,
45. Based on the rate of return work sheet, TLU is entitled to a rate of return of 9.48%.
46. Using the rate of return of 9.48%, TLU's return on its total invested capital of \$162,933 for water is \$15,446.
47. Using the rate of return of 9.48%, TLU's return on its total invested capital of \$62,569 for wastewater is \$5,932.
48. Tap fees should remain as they are in the current tariff.
49. TLU had reasonable and necessary expenses, as reflected by the test year data and as adjusted for known and measurable changes and further adjustments as set forth in column (e) of **Exhibits B and E**.
50. The expenses set forth in **Exhibits B and E** are reasonable and necessary to provide service to TLU's ratepayers.
51. During the test year, TLU had line loss of 1,933,680 gallons, that is, 21% of the 9,310,010 gallons of water that were pumped, of which 646,500 gallons were accounted for, leaving 1,287,180 gallons, or 14%, unaccounted for. The appropriate amount of line loss to be

included in the rate design is 7% because customers should not be required to pay for unexplained line loss.

52. TLU's annual revenue requirement should be set at \$75,283 for water and \$44,674 for wastewater, as set forth in column (e) of Exhibits A and D.
53. TLU will need to charge a base rate of \$32.20 per connection with zero gallons included and a gallonage charge of \$2.36 per 1,000 gallons of water and a base rate of \$30.14 per connection with zero gallons included and a gallonage charge of \$3.18 per 1,000 gallons for wastewater.

Rate Case Expenses

54. As of May 22, 2009, TLU incurred reasonable and necessary rate case expenses of \$142,314.81 in preparing, filing, and litigating this rate case.
55. As of _____, after issuance of the Proposal for Decision, the filing of Exceptions to the Proposal for Decision, and Replies to those exceptions, TLU has incurred reasonable and necessary rate case expenses of and additional \$ _____.
56. Rate case expenses in this case were not a normal, recurring expense of TLU's operations.
57. It is reasonable and appropriate for TLU to recover its reasonable rate case expenses as a surcharge in the amount of \$ _____ per customer account per month, effective _____ after adoption of this Order, and to remain in effect until TLU has recovered the total sum of its reasonable and necessary rate case expenses, which total \$ _____.

II. CONCLUSIONS OF LAW

General and Procedural Conclusions

1. TLU is an investor-owned "public utility," "utility," and "water and sewer utility" as defined in TEX. WATER CODE ANN. § 13.002(23).

2. It was proper in this case for either David L. Sheffield or Texas Landing Utilities, L.L.C. to file the applications for Texas Landing Utilities.
3. The Commission has jurisdiction to consider TLU's Applications for water and sewer rate/tariff changes pursuant to TEX. WATER CODE ANN. §§ 13.042 and 13.181.
4. An Administrative Law Judge conducted a contested case hearing and issued a proposal for decision on TLU's proposed water and sewer rate/tariff changes under TEX. GOV'T CODE ANN. ch. 2003, TEX. WATER CODE ANN. ch. 13, and 30 TEX. ADMIN. CODE chs. 80 and 291.
5. Proper notice of the Applications was given by TLU as required by TEX. WATER CODE ANN. §§ 13.187, 13.043, 30 TEX. ADMIN. CODE §§ 291.22 and 291.28 and TEX. GOV'T CODE ANN. §§ 2001.051 and 2001.052.

Consolidated Rate

6. The Texas Landing Subdivision and Goode City water and sewer systems are substantially similar in terms of facilities, quality of service, and cost of service within the meaning of TEX. WATER CODE ANN. § 13.145.
7. TLU's water tariff promotes water conservation for single-family residences and landscape irrigation within the meaning of TEX. WATER CODE ANN. § 13.145.
8. TLU has complied with the requirements of TEX. WATER CODE ANN. § 13.145.
9. TLU is entitled to receive a consolidated water rate schedule applicable to TLU's entire water CCN No. 11997 service area as part of its approved water tariff.
10. TLU is entitled to receive a consolidated sewer rate schedule applicable to TLU's entire sewer CCN No. 20569 service area as part of its approved sewer tariff.

Rate Base, Allowable Expenses, and Revenue Requirement

11. The invested capital amounts set forth in **Exhibits C and F** are based on the original cost of

property used and useful by TLU in providing service, less depreciation, in accordance with TEX. WATER CODE ANN. § 13.185.

12. Any asset that is a contribution-in-aid-of-construction from a developer is not to be included when determining the cost of service of rate base, although a utility may claim depreciation for the property. 30 TAC § 291.31(b)(1)(B) and (c)(3)(A)(iv).
13. The revenue requirements presented in TLU's application after being adjusted by modifications set forth in the above Findings of Fact as reflected in **Exhibits A and D** are based on TLU's reasonable and necessary operating expenses, within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.185.
14. The revenue requirements presented in TLU's application with modifications as reflected in **Exhibits A and D** are sufficient to provide TLU with a reasonable opportunity to earn a fair and equitable return on its invested capital while preserving its financial integrity within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.184.
15. The rates and gallonage charges set forth in Finding of Fact No. 52 are just and reasonable; are not unreasonably preferential, prejudicial, or discriminatory, and are sufficient, equitable and consistent in application in accordance with TEX. WATER CODE ANN. § 13.182.

Rate Case Expenses

16. Rate case expenses in the amount of \$142,314.81 through May 22, 2009, were reasonable and necessary expenses within the meaning of TEX. WATER CODE ANN. §§ 13.183(a)(1) and 13.185(d) and (h), and 30 TEX. ADMIN. CODE §§ 291.28(7) and 291.31(b).
17. TLU's additional rate case expenses incurred after May 22, 2009 in the amount of \$ _____ were also reasonable and necessary within the meaning of TEX. WATER CODE ANN. §§ 13.183(a)(1) and 13.185(d) and (h), and 30 TEX. ADMIN. CODE §§ 291.28(7) and 291.31(b).
18. TLU may recover all rate case expenses, including those incurred after May 22, 2009,

through a monthly surcharge of \$_____ per customer account per month until TLU has recovered the total amount paid of \$_____. Recovery of rate case expenses through such a surcharge complies with 30 TEX. ADMIN. CODE § 291.21(k) for collection of revenues over and above the usual cost of service.

III. ORDERING PROVISIONS

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY, IN ACCORDANCE WITH THESE FINDINGS OF FACT AND CONCLUSIONS OF LAW, THAT:

1. The application of Texas Landing Utilities to increase the rates that it charges for the retail water utility service that it provides under Certificate of Convenience and Necessity (CCN) No. 11997 in Polk and Montgomery Counties and to increase the rates that it charges for retail wastewater service that it provides under Certificate of Convenience and Necessity No. 20569 in Polk County is approved with modifications.
2. Within _____ days, TLU shall refund or credit to customers all sums collected between November 26, 2007, and January 2010, that exceed the rates approved by the Commission in this case, plus interest on the over-collection over the same period of time that the excess rate was collected.
3. TLU shall be assessed the full amount of the reporting and transcription costs.
4. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
5. The effective date of this Order is the date the Order is final, as provided by 30 TEX. ADMIN. CODE § 80.273 and TEX. GOV'T CODE ANN. § 2001.144.

6. If any provision, sentence, clause, or phrase of this Order is for any reason held to be invalid, the invalidity of any provision shall not affect the validity of the remaining portions of this Order.

ISSUED:

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

**Buddy Garcia, Chairman
For the Commission**

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
 Utility Name: Texas Landing Utilities
 Docket Number: 35838-R - WATER

8:55 AM
 22-May-09

SCHEDULE I - REVENUE REQUIREMENT

	TEST PERIOD PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
Operations and Maintenance	\$52,025.00	\$4,200.00	\$56,225.00	-\$915.00	\$55,310.00
Depreciation and Amortization	\$8,478.00	-\$1,090.00	\$7,388.00	-\$1,615.06	\$5,772.94
Other Taxes	\$500.00	\$0.00	\$500.00	\$0.00	\$500.00
Federal Income Taxes		\$3,706.00	\$3,706.00	-\$980.24	\$2,725.76
Return		\$20,940.00	\$20,940.00	-\$5,494.00	\$15,446.00
Revenue Requirement	\$61,003.00	\$27,756.00	\$88,759.00	-\$9,004.29	\$79,754.71
Other Revenues - Taps	-\$4,472.00		-\$4,472.00	\$0.00	-\$4,472.00
Base Rate Revenue	\$56,531.00	\$27,756.00	\$84,287.00	-\$9,004.29	\$75,282.71
Base Rate Revenue Deficiency			\$0.00	-\$9,004.29	-\$9,004.29

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landing Utilities
 Docket Number: 35838-R - WATER
 Test Period: From: 1/1/2006 To: 12/31/2006

8:54 AM
22-May-09

SCHEDULE I(a) - OPERATIONS & MAINTENANCE

	TEST PERIOD PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
SALARIES	\$0.00	\$0.00	\$0.00		\$0.00
CONTRACT SERVICES	\$7,620.00	\$3,600.00	\$11,220.00		\$11,220.00
PURCHASED WATER	\$0.00	\$0.00	\$0.00		\$0.00
CHEMICALS AND TREATMENT	\$1,791.00	\$0.00	\$1,791.00		\$1,791.00
UTILITIES	\$3,657.00	\$0.00	\$3,657.00		\$3,657.00
REPAIRS AND MAINTENANCE	\$17,424.00	\$0.00	\$17,424.00	-\$4,369.00	\$13,055.00
OFFICE EXPENSE	\$1,425.00	\$0.00	\$1,425.00		\$1,425.00
ACCOUNTING AND LEGAL/MANAGEMENT AND OPERATIONS	\$14,040.00	\$0.00	\$14,040.00	\$3,454.00	\$17,494.00
INSURANCE	\$0.00	\$600.00	\$600.00		\$600.00
RATE CASE EXPENSE	\$0.00	\$0.00	\$0.00		\$0.00
MISCELLANEOUS	\$6,068.00	\$0.00	\$6,068.00		\$6,068.00
TOTAL	\$52,025.00	\$4,200.00	\$56,225.00	-\$915.00	\$55,310.00

SCHEDULE I(b) - OTHER TAXES

	TEST YEAR PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
AD VALOREM TAXES			\$0.00		\$0.00
PAYROLL TAXES			\$0.00		\$0.00
OTHER TAXES-MISC	\$500.00		\$500.00		\$500.00
NON-REVENUE RELATED	\$500.00	\$0.00	\$500.00	\$0.00	\$500.00
TWC ASSESSMENT			\$0.00		\$0.00
REVENUE RELATED TAXES	\$0.00	\$0.00	\$0.00		\$0.00
TOTAL OTHER TAXES	\$500.00	\$0.00	\$500.00	\$0.00	\$500.00

SCHEDULE I(c) - FEDERAL INCOME TAXES

REVENUE REQUIREMENT	\$79,754.71
LESS:	
OPERATIONS AND MAINTENANCE	-\$55,310.00
DEPRECIATION AND AMORTIZATION	-\$5,772.94
OTHER TAXES	-\$500.00
INTEREST EXPENSE	\$0.00
TAXABLE INCOME	\$18,171.76
TAXES @ FACTOR :	\$0.15
SUB-TOTAL	\$2,725.76
LESS:	
SURTAX EXEMPTION :	\$0.00
FEDERAL INCOME TAXES	\$2,725.76

EXHIBIT B

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landing Utilities
 Docket Number: 35838-R - WATER

8:58 AM
 22-May-09

SCHEDULE I(d) - WEIGHTED COST OF CAPITAL

PAYEE	PRINCIPAL AS OF	INTEREST RATE	PERCENTAGE	WEIGHTED AVERAGE
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
EQUITY	\$162,935.00	9.48%	100.00%	9.48%
TOTAL	\$162,935.00		100.00%	9.4800%

SCHEDULE I(e) - INVESTED CAPITAL & RETURN

	COMPANY AMOUNT (a)	STAFF ADJUST (b)=(c)-(a)	STAFF AMOUNT (c)
PLANT IN SERVICE	238,445	-37,990	200,455
ACCUMULATED DEPRECIATION	\$30,289.00	-6,181	24,108
NET PLANT	208,156	-31,809	176,347
WORKING CASH ALLOWANCE	\$7,463.00	-549	6,914
MATERIALS AND SUPPLIES		0	
CUSTOMERS DEPOSITS		0	
INVESTMENT TAX CREDITS		0	
DCIAC		-20,326	-20,326
TOTAL INVESTED CAPITAL	215,619	-52,684	162,935
RATE OF RETURN	9.71%	-0.23%	9.48%
RETURN	20,940	-5,494	15,446

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landing Utilities

Docket Number: 35840-R - SEWER

8:57 AM
22-May-09

SCHEDULE I - REVENUE REQUIREMENT

	TEST PERIOD PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
Operations and Maintenance	\$39,614.00	\$1,150.00	\$40,764.00	-\$3,454.00	\$37,310.00
Depreciation and Amortization	\$2,888.00	\$0.00	\$2,888.00	-\$1,054.98	\$1,833.02
Other Taxes	\$294.00	\$0.00	\$294.00	\$0.00	\$294.00
Federal Income Taxes	\$0.00	\$1,412.00	\$1,412.00	-\$365.18	\$1,046.82
Return	\$0.00	\$7,507.00	\$7,507.00	-\$1,575.00	\$5,932.00
Revenue Requirement	\$42,796.00	\$10,069.00	\$52,865.00	-\$6,449.16	\$46,415.84
Other Revenues - Taps	-\$1,742.00		-\$1,742.00	\$0.00	-\$1,742.00
Base Rate Revenue	\$41,054.00	\$10,069.00	\$51,123.00	-\$6,449.16	\$44,673.84
Base Rate Revenue Deficiency			\$0.00	-\$6,449.16	-\$6,449.16

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landing Utilities
 Docket Number: 35840-R - SEWER
 Test Period: From: 1/1/2006 To: 12/31/2006

8:56 AM
 22-May-09

SCHEDULE I(a) - OPERATIONS & MAINTENANCE

	TEST PERIOD PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
SALARIES	\$0.00	\$0.00	\$0.00		\$0.00
CONTRACT SERVICES	\$5,150.00	\$550.00	\$5,700.00		\$5,700.00
PURCHASED WATER	\$0.00	\$0.00	\$0.00		\$0.00
CHEMICALS AND TREATMENT	\$1,154.00	\$0.00	\$1,154.00		\$1,154.00
UTILITIES	\$4,724.00	\$0.00	\$4,724.00		\$4,724.00
REPAIRS AND MAINTENANCE	\$7,852.00	\$0.00	\$7,852.00		\$7,852.00
OFFICE EXPENSE	\$1,383.00	\$0.00	\$1,383.00		\$1,383.00
ACCOUNTING AND LEGAL/MANAGEMENT AND OPERATIONS	\$14,040.00	\$0.00	\$14,040.00	-\$3,454.00	\$10,586.00
INSURANCE	\$0.00	\$0.00	\$0.00		\$0.00
RATE CASE EXPENSE	\$0.00	\$600.00	\$600.00		\$600.00
MISCELLANEOUS	\$5,311.00	\$0.00	\$5,311.00		\$5,311.00
TOTAL	\$39,614.00	\$1,150.00	\$40,764.00	-\$3,454.00	\$37,310.00

SCHEDULE I(b) - OTHER TAXES

	TEST YEAR PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
AD VALOREM TAXES	\$0.00		\$0.00		\$0.00
PAYROLL TAXES	\$0.00		\$0.00		\$0.00
OTHER TAXES-MISC	\$294.00		\$294.00		\$294.00
NON-REVENUE RELATED	\$294.00	\$0.00	\$294.00	\$0.00	\$294.00
TWC ASSESSMENT			\$0.00		\$0.00
REVENUE RELATED TAXES	\$0.00	\$0.00	\$0.00		\$0.00
TOTAL OTHER TAXES	\$294.00	\$0.00	\$294.00	\$0.00	\$294.00

SCHEDULE I(c) - FEDERAL INCOME TAXES

REVENUE REQUIREMENT	\$46,415.84
LESS:	
OPERATIONS AND MAINTENANCE	-\$37,310.00
DEPRECIATION AND AMORTIZATION	-\$1,833.02
OTHER TAXES	-\$294.00
INTEREST EXPENSE	\$0.00
TAXABLE INCOME	\$6,978.82
TAXES @ FACTOR :	\$0.15
SUB-TOTAL	\$1,046.82
LESS:	
SURTAX EXEMPTION :	\$0.00
FEDERAL INCOME TAXES	\$1,046.82

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landing Utilities
 Docket Number: 35840-R - SEWER

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SCHEDULE I(d) - WEIGHTED COST OF CAPITAL

PAYEE	PRINCIPAL AS OF	INTEREST RATE	PERCENTAGE	WEIGHTED AVERAGE
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
			0.00%	0.00%
EQUITY	\$62,569.00	9.48%	100.00%	9.48%
TOTAL	\$62,569.00		100.00%	9.4800%

SCHEDULE I(e) - INVESTED CAPITAL & RETURN

	COMPANY AMOUNT (a)	STAFF ADJUST (b)=(c)-(a)	STAFF AMOUNT (c)
PLANT IN SERVICE	84,685	-15,144	69,541
ACCUMULATED DEPRECIATION	\$7,329.00	4,307	11,636
NET PLANT	77,356	-19,451	57,905
WORKING CASH ALLOWANCE	\$4,660.00	4	4,664
MATERIALS AND SUPPLIES	\$0.00	0	
CUSTOMERS DEPOSITS		0	
INVESTMENT TAX CREDITS		0	
DCIAC		0	0
TOTAL INVESTED CAPITAL	82,016	-19,447	62,569
RATE OF RETURN	9.15%	0.33%	9.48%
RETURN	7,507	-1,575	5,932