

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

December 19, 2008

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2008 DEC 19 PM 1:45
CHIEF CLERKS OFFICE

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

Re: SOAH Docket No. 582-08-2245; TCEQ Docket No. 2007-1878-UCR; In Re:
Application of Buena Vista Water System to Change its Water Rates and Tariff,
Certificate of Convenience and Necessity No. 11656, Burnet County, Texas

Dear Mr. Trobman:

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

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the original documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than **January 8, 2009**. Any replies to exceptions or briefs must be filed in the same manner no later than **January 20, 2009**.

This matter has been designated **TCEQ Docket No. 2007-1878-UCR ; SOAH Docket No. 582-08-2245**. All documents to be filed must clearly reference these assigned docket numbers. Copies of all exceptions, briefs and replies must be served promptly on the State Office of Administrative Hearings and all parties. Certification of service to the above parties and an **original and eleven copies** shall be furnished to the Chief Clerk of the Commission. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in black ink, appearing to read "William G. Newchurch".

William G. Newchurch
Administrative Law Judge

WGN:nl
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cc: Mailing List

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STYLE/CASE: BUENA VISTA WATER SYSTEM
SOAH DOCKET NUMBER: 582-08-2245
REFERRING AGENCY CASE: 2007-1878-UCR

**STATE OFFICE OF ADMINISTRATIVE
HEARINGS**

**ADMINISTRATIVE LAW JUDGE
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SOAH DOCKET NO. 582-08-2245
TCEQ DOCKET NO. 2007-1878-UCR

2008 DEC 19 PM 1:45

APPLICATION OF BUENA VISTA §
WATER SYSTEM TO CHANGE ITS §
WATER RATES AND TARIFF, §
CERTIFICATE OF CONVENIENCE §
AND NECESSITY NO. 11656, BURNET §
COUNTY §

BEFORE THE STATE OFFICE
OF
ADMINISTRATIVE HEARINGS
CHIEF CLERKS OFFICE

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BEFORE THE STATE OFFICE
OF
ADMINISTRATIVE HEARINGS
CHIEF CLERKS OFFICE

PROPOSAL FOR DECISION

I. INTRODUCTION

Kathie Bryant, doing business as Buena Vista Water System, has filed an application to increase the rates that she charges for the retail water utility service that she provides under Certificate of Convenience and Necessity (CCN) No. 11656, in Burnet County, Texas. The Executive Director (ED), the Office of Public Interest Counsel (OPIC), and Michael Wortham and John Miloy (Protestants) contend that the proposed increase would not be just and reasonable and should be denied. They also argue that Buena Vista should not be allowed to recover its rate-case expenses.

The Administrative Law Judge (ALJ) recommends that the Commission deny Ms. Bryant's application and request to recover rate case expenses. He also recommends that the Commission order her to:

- immediately cease collecting the rates proposed in this case;
- immediately commence collecting fair and reasonable rates as ordered by the Commission in this case, which will be lower than both the proposed rates and lower than the existing rates that the Commission had approved before Buena Vista filed the application to increase rates;

- refund or credit to customers all sums collected since the effective date of the rates at issue in this case that exceeded the rates approved by the Commission in this case, plus six percent interest on the over-collections;
- review any future construction and purchase costs closely and maintain her records by National Association of Regulatory Utility Commissioners (NARUC) property accounts; and
- use separate accounts for her water-business expenses and non-water-business expenses.

II. JURISDICTION

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

III. PROCEDURAL HISTORY

Buena Vista is not a separate entity; it is simply Ms. Bryant's trade name. In this Proposal for Decision (PFD), however, it is frequently necessary to distinguish between utility activities and expenses and Ms. Bryant's personal activities and expenses. To limit confusing and awkward writing, the ALJ will refer to the utility business in a gender-neutral manner, as Buena Vista, Applicant, or Utility. The ALJ will refer to Ms. Bryant by name only when the discussion concerns her private activities.

Buena Vista filed its application on June 11, 2007.¹ Notices of the application were mailed to Buena Vista's customers on July 17, 2007. The effective date of the increase was September 1, 2007.²

¹ ED Ex. 1, attach. EP 8.

² ED Ex. A.

More than ten percent of the Utility's customers filed protests by the applicable deadline. On March 13, 2008, the Commission's Chief Clerk referred the application to the SOAH for hearing. On March 20, 2008, the Chief Clerk mailed notice of a preliminary hearing to the Applicant; and on April 1, 2008, the Applicant mailed that same notice to its customers and affected municipalities.

On June 2, 2008, the ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

PARTY	REPRESENTATIVE
Buena Vista	Kathie Bryant
ED	Ron M. Olson
OPIC	Eli Martinez
Protestants	Michael Wortham

The ALJ held the hearing on the merits of the application on October 13, 2008, and all of the Parties appeared. However, George Freitag and Nancy Donnelly, rather than Ms. Bryant, represented the Applicant at the hearing on the merits. The ALJ left the record open until October 27, 2008, for the Parties to present evidence and argument concerning Buena Vista's rate case expenses.

IV. WITNESSES

The following witnesses testified in this case:

WITNESS	PARTY	SUBJECT
Nancy Donnelly	Buena Vista	all issues
Michael Wortham	Protestants	various issues
Elsie Pascua	ED	cost of service and revenue requirement
Brian David Dickey	ED	rate design

V. APPLICABLE LAW

In setting the rates for water service, the Commission must fix a utility's overall revenues at a level that will:

- (1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and
- (2) preserve the financial integrity of the utility.³

Buena Vista has the burden of proving that its proposed rates are just and reasonable. Water Code § 13.184(c) provides:

In any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change, if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable.

The Commission is generally prohibited from setting rates that would allow Buena Vista to earn more than a fair return on its capital that is used and useful in providing water service. Water Code § 13.184(a) states:

Unless the commission establishes alternate rate methodologies in accordance with Section 13.183(c), the commission may not prescribe any rate that will yield more than a fair return on the invested capital used and useful in rendering service to the public. . . .

The Commission has adopted rules concerning alternative rate methods. Buena Vista offered no argument or evidence to show that its rates should be set according to such an alternative method.

³ TEX. WATER CODE ANN. (Water Code) § 13.183(a).

The Commission may promulgate reasonable rules and regulations with respect to the allowance or disallowance of certain expenses for ratemaking purposes.⁴ Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered.⁵ "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing.⁶

Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. The inclusion of construction work in progress is an exceptional form of rate relief to be granted only on the demonstration by the utility by clear and convincing evidence that the inclusion is in the ratepayers' best interest and is necessary to the financial integrity of the utility. Original cost is the actual money cost or the actual money value of any consideration paid, other than money, of the property at the time it shall have been dedicated to public use, whether by the utility that is the present owner or by a predecessor, less depreciation. Utility property funded by explicit customer agreements or customer contributions in aid of construction, such as surcharges, may not be included in invested capital.⁷

Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility except for property provided by explicit

⁴ Water Code 13.185(g).

⁵ 30 TEX. ADMIN. CODE (TAC) §291.31(a) and (b).

⁶ Water Code § 13.002(22).

⁷ Water Code § 13.185(b).

customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service.⁸

Under 30 TAC § 291.31(b)(1), allowable expenses, to the extent they are reasonable and necessary, and subject to that section, may include, but are not limited to, the following general categories:

(A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), §13.185(e));

(B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;

(C) assessments and taxes other than income taxes;

(D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, §13.185(f), if applicable);

(E) reasonable expenditures for ordinary advertising, contributions, and donations; and

(F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

⁸ Water Code § 13.185(j).

Certain types of expenses are specifically not allowed as a component of cost of service.⁹ Among those that are relevant to this case are expenditures found by the Commission to be unreasonable or unnecessary, including civil penalties or fines.¹⁰

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

(A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:

(i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;

(ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;

(iii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC, §13.185(e);

(iv) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and

(B) working capital allowance to be composed of, but not limited to, the following:

(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

(ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, §13.185(e); and

⁹ Water Code § 13.185(h) and 30 TAC § 291.31(b)(2).

¹⁰ Water Code § 13.185(h)(3) and 30 TAC § 291.31(b)(2)(I).

(iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management.¹¹

Under 30 TAC § 291.31(c)(1), the return on invested capital is the rate of return times invested capital. The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital. The Commission fixes the rate of return in accordance with the following principles.

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

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

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

¹¹ Water Code § 13.184 (b).

VI. OVERVIEW OF THE PROPOSED RATE INCREASE

Buena Vista serves only residential customers. At the end of the test year, on December 31, 2006, it had 119 customers with 5/8 or 3/4-inch meters and three customers with 1-inch meters. The Applicant set its proposed rates in order to have an opportunity to recover revenue of \$94,943.¹² If granted, its rates would increase as follows¹³:

	CURRENT	PROPOSED
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	\$40.00
Base monthly rate for 1-inch meter with zero gallons	\$48.41	\$53.41
Charge per 1,000 gallons	\$2.75	\$3.25
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00
Meter test fee	\$0	\$25.00

VII. REVENUE REQUIREMENT

A. Clarifying the Revenue Requirement Claimed by Buena Vista

Just getting a handle on the revenue requirement that the Applicant claims is a challenge. Nancy Donnelly is a certified public accountant and performs accounting services for the Applicant. She is also the sister of Kathie Bryant, who owns Buena Vista. According to Ms. Donnelly, Buena Vista filed for a rate increase because it incurred a loss in every calendar year from 2001 through 2007. She testified that Buena Vista collected \$64,209 in revenue on its water sales during the test year, but ended up losing \$23,427. According to Ms. Donnelly, that

¹² ED Ex. 1, subex. EP-8, p. 14 of 41 (as marked).

¹³ ED Ex. 1, subex. EP-8, second to last page.

was because Buena Vista spent \$87,636 during the test year, which included \$22,789 as a cost of sales and an additional \$64,847 in other expenses.¹⁴

However, the \$87,636 in test-year costs and expenses that Ms. Donnelly claimed in her testimony was significantly higher than the amount that Buena Vista reported in its application to change its rates. In the TCEQ rate-change application form, Buena Vista reported that its total cost of service during the test year was \$75,193, before deducting for \$1,072 in other revenue.¹⁵ The \$12,443 difference between the test-year cost of service in the application and Ms. Donnelly's testimony was never really explained. However, when questioned by the ALJ during the hearing, the Applicant clarified that it was seeking rates based on the numbers set out in the application form. Based on that, the ALJ will limit his review to the revenue requirement sought in Buena Vista's application form.

In its application, Buena Vista also contended that its rates should be set to allow it to recover an additional \$20,822 over and above its claimed test-year expenses. According to the Applicant, this additional amount is to account for known and measurable post-test-year changes in its cost of service.

B. Overview of Revenue Requirement Dispute

The ED, the OPIC, and the Protestants do not believe that Buena Vista has carried its burden of proving all of the test-year costs of services and post-test-year known and measurable changes that it claims. Ms. Pascua prepared a table that summarizes the revenue-requirement dispute between the Applicant and the ED.¹⁶ However, Ms. Pascua did not include a \$600 post-test-year adjustment for depreciation that the Applicant included in its application. Adjusting

¹⁴ Buena Vista Ex. 1.

¹⁵ ED Ex. 1, subex. EP-8, p. 14 of 41 (as marked).

¹⁶ ED Ex. 1, subex. EP-3.

Ms. Pascua's table to show that as a Staff adjustment and rounding off to the nearest dollar results in the following summary of the Applicant's and the ED's positions:

SUMMARY OF REVENUE REQUIRMENT DISPUTE					
	TEST YER PER APPLICANT (a)	APPLICANT ADJUSTMENT (b)	APPLICANT TEST YEAR (c)=(a)+(b)	STAFF ADJUSTMENT (d)	STAFF TEST YEAR (e)=(c)+(d)
Operations and Maintenance	\$65,149	\$9,039	\$74,188	\$-21,330	\$52,858
Depreciation and Amortization	\$7,248	\$600	\$7,848	\$-2,753	\$5,095
Other Taxes	\$2,796	\$679	\$3,475	\$-1,738	\$1,737
Federal Income Taxes	\$0	\$1,588	\$1,588	\$-304	\$1,284
Return	\$0	\$8,916	\$8,916	\$-1,641	\$7,275
Revenue Requirement	\$75,193	\$20,822	\$96,015	\$-27,766	\$68,249
Other Revenues – Taps	\$-1,072		\$-1,072	\$0	\$-1072
Base Rate Revenue	\$74,121	\$20,822	\$94,943	\$-27,766	\$67,177

In contrast, Mr. Wortham argues that the adjusted cost of service that the Applicant proposed should be reduced even more, by a total of \$39,523.

The ALJ cannot find that Buena Vista has proven that it is entitled to the full amount of the revenue requirement that it claims in its application. For this reason, he recommends that the Commission deny Buena Vista's application to change rates.

C. Comingling of Expenses and Funds

The Utility's financial records include numerous expenses that have nothing to do with providing water services. They are personal expenses of the owner, Ms. Bryant.¹⁷ At least one bank account names both Ms. Bryant and Buena Vista as joint account owners. Ms. Bryant has at least one other bank account in only her name. Several credit card invoices list only

¹⁷ ED Ex. 1, subex. EP-9, first set of pages, pp. 31 et seq., second set of pages, pp. 1 et seq., and third set of pages, pp. 1 et seq.

Ms. Bryant as the account owner. Some of the credit cards bills were paid using the joint-account checks and some were paid using checks written on Ms. Bryant's personal account.¹⁸

Making analysis even more complicated, Ms. Pascua testified that Ms. Bryant has an office in her home that she uses to conduct Buena Vista's business. The office represents 7.24 percent of the home's floor space.¹⁹

Thus, before Buena Vista's test-year costs of service can be determined, the expenses of running its water business must be separated from Ms. Bryant's personal expenses. The Utility did not do that, but ED witness Elsie Pascua attempted to. Ms. Pascua holds a B.S. in business administration and has over 35 years of experience in bookkeeping, auditing, budgeting, and accounting in the private and governmental sectors. She has been with the TCEQ for 15 years and employed for the last 11 as an accountant and auditor reviewing and processing over 250 rate-change applications and appeals. Working with Mr. Dickey (who took the lead on depreciation, technical criteria, and rate design), Ms. Pascua reviewed Buena Vista's application and found several problems.

Ms. Pascua reviewed the underlying transactions and testified that the credit cards were used in the test year to purchase \$52,973 in goods and services. Of that, only \$9,441 was for water service expenses. The remaining \$43,532 was for Ms. Bryant's personal expenses. Yet joint-account checks were used to pay \$32,580 of the credit card charges, personal checks were used to pay \$7,300 of the credit card charges, and the remaining charges from 2006 had not been paid at the time of the hearing.²⁰

¹⁸ ED Ex. 1, subex. 13.

¹⁹ ED Ex. 1, pp. 5 *et seq.*

²⁰ ED Ex. 1, pp. 5 and 6.

Throughout the hearing, Ms. Donnelly argued but did not offer evidence that Ms. Bryant must have returned the \$32,580 in personal expenses from her separate account to her joint account with Buena Vista. If not, Ms. Donnelly argued, Buena Vista would not have had sufficient cash flow to pay other expenses. Ms. Donnelly continually returned to this as if she thought this was a key point in the case. It was not.

In responding to Ms. Donnelly, Ms. Pascua repeatedly noted that she was not trying to reconcile cash flows into and out of the joint account that Ms. Bryant holds with Buena Vista. Instead Ms. Pascua attempted to determine the expenses that Buena Vista necessarily and reasonably paid to provide water service. To the extent that she found expenses that met those standards, she included them in cost of service. When asked by the ALJ, Ms. Pascua confirmed that she did not deduct Ms. Bryant's personal expenses from the total of the expenses legitimately incurred to provide water service. Instead, she separated them from each other.

To avoid comingling and other problems in the future, Mr. Dickey recommended that the Commission order Buena Vista to review any future construction and purchase costs closely and maintain its records according to NARUC property accounts. The ALJs heartily agrees. In fact, he would go further. The ALJ recommends that the Commission also order Ms. Bryant to use separate accounts for her water-business expenses and non-water-business expenses in the future. Review of rates becomes much more complicated when funds and expenses are comingled. Moreover, in a rate case in which Buena Vista has the burden of proof, comingling of personal and water-business expenses casts a cloud of doubt over all of its expenses and works to its disadvantage.

D. Return on Invested Capital

In its application, Buena Vista contends that it should receive a return of \$8,916 on the capital it invested to provide water service. The ED contends that the return should instead be \$7,275. The following table summarizes the disagreement between the Applicant and the ED:

INVESTED CAPITAL AND RETURN SUMMARY²¹			
	Applicant Amount	Staff Adjustment	Staff Amount
Plant In Service	\$145,476	\$-39,895	\$105,851
Accumulated Depreciation	\$-77,784	\$26,217	\$-51,567
Net Plant	\$67,692	\$-13,678	\$54,014
Working Cash Allowance	\$9,274	\$-2,667	\$6,607
Total Invested Capital	\$76,966	\$-16,345	\$60,621
Rate Of Return	11.58%	0.42%	12.00%
Return	\$8,916	\$-1,641	\$7,275

1. Invested Capital

Throughout the ED's review and the hearing, Buena Vista was not very forthcoming. Ms. Pascua testified that she and Mr. Dickey asked Buena Vista to provide them with copies of financial records from 2007. They needed to review those because the Applicant claimed post-test-year adjustments based on costs incurred in 2007. But the Applicant failed to produce those documents. Additionally, Buena Vista refused to make copies of documents that the ED asked for following an audit that Ms. Pascua and Mr. Dickey conducted in 2008 in preparation for this case.²²

Buena Vista put forward very little evidence in its direct case. It offered just two pages of prefiled testimony by Ms. Donnelly and an attached spreadsheet, purportedly showing its income and expenses for the last six years.²³ Even the Protestants offered more evidence than the Utility.²⁴ Buena Vista did not even prefile its own application as evidence. Instead the ED

²¹ ED Ex. 1, subex. EP-4.

²² ED Ex. 1, pp. 4 *et seq.*

²³ Buena Vista Ex. 1.

²⁴ Wortham Ex. 1.

prefiled the application,²⁵ along with detailed ledgers, and other evidence that supported the application.

As Mr. Dickey noted when testifying, the Utility, not the ED, has the burden of proof. Thus, Mr. Dickey and Ms. Pascua reviewed documentation that the Utility provided to them. To the extent that there are evidentiary gaps concerning invested items and expenses, Buena Vista failed to carry its burden and must suffer the consequences.

Mr. Dickey prepared a depreciation schedule for all of the Applicant's investments that he could confirm.²⁶ Mr. Dickey holds a bachelor's degree in mechanical engineering, has been employed by the Commission since 1999, has worked on over 226 rate cases in that time, and has often testified concerning depreciation and rate design. Mr. Dickey developed the ED's invested capital recommendation, which is set out in the table above. Except as discussed below, Mr. Dickey was able to confirm the invested capital amounts that Buena Vista claimed in its application. To the extent he could not and recommends disallowances, no party disputes those disallowance except as discussed below.

Because Buena Vista provided no detailed evidence concerning the original cost, accumulated depreciation, and net book value of its invested capital, and because Mr. Dickey was sufficiently qualified to testify on those subjects, was credible, conducted a detailed analysis of available documentation, and provided a more detailed analysis, the ALJ adopts Mr. Dickey's analysis except as discussed below.

In its application, Buena Vista claimed that its original cost of well pumps was \$5,869, against which had accumulated \$5,285 in depreciation, which left a net book value of \$584. Based on his analysis of Buena Vista's documentation, Mr. Dickey concluded that the Utility's

²⁵ ED Ex. 1, subex. EP-8.

²⁶ ED Ex. 2, subex. BDD3.

original cost of various kinds of pumps was \$5,933.67, minus \$5,283, leaving \$649.67 in net plant. The ALJ concludes that Buena Vista has invested \$65.67 more in pumps than it stated in its application.

Mr. Dickey included \$348.40²⁷ for the original cost of a chemical feed pump that the Utility had originally claimed as a cost of treatment, but he reclassified it. After depreciation of \$96, its net book value is \$253. He also added \$1,791 for a turbidity monitor, with depreciation of \$1,221, leaving net plant of \$570. The ALJ adopts these recommendations by Mr. Dickey.

With regard to chlorinators, the Utility claimed \$5,052 in original cost, accumulated depreciation of \$1,990, leaving \$3,062 in net plant. Mr. Dickey confirmed that \$1,159 was spent for a chlorinator, but it has been fully depreciated and should be disallowed. He was able, however, to conclude that Buena Vista had spent \$1,487 for a chlorine tester. Its accumulated depreciation was \$843, yielding net plant of \$644. As far as the ALJ can tell, Mr. Dickey was not clear as to whether these proposed changes should be added to or are already reflected in Buena Vista's claimed invested capital. The ALJ asks the ED to clarify this in his exceptions.

Shortly before the hearing, Mr. Dickey confirmed that another \$2,603.95 had been spent in December 2006 for another chlorinator. The ALJ does not find that \$2,603.95 item in Mr. Dickey's depreciation schedule.²⁸ The ALJ cannot tell if Mr. Dickey forgot to include it, meant to include it but did not update the schedule, or did not include it because it was not yet in service during the test year, though it had been purchased. For now, the ALJ does not propose to add the \$2,603.95 to invested capital, but asks the ED to clarify this point in his exceptions to this proposal for decision (PFD).

²⁷ There is a discrepancy between the text of Mr. Dickey's testimony, where he states \$399.21 and his table and the invoice, showing \$348.40. Compare ED Ex. 2. p. 5 and subex. BDD-3, p.1 and BDD-8. The ALJ concludes the number shown on the invoice is correct.

²⁸ ED Ex. 2, subex. BDD-3.

In its application, Buena Vista claimed an original cost of \$3,114 for meters, with depreciation of \$1,862, leaving \$1,252 in net book value. However, Mr. Dickey testified that customers have already paid for those meters through their tap fees. As Mr. Dickey concluded, customers should not have to pay for them a second time through rates. That is correct.²⁹ Thus, the ALJ concludes that the \$1,252 for meters should not be included in net plant in service for the purpose of calculating Buena Vista's return on investment.

Mr. Dickey was able to confirm a portable turbidimeter, which had an original cost of \$1,009, accumulated depreciation of \$534, leaving net plant of \$475. He was also able to agree that two replacement meters were in service, with original costs of \$90.04 and \$378.88, depreciation of \$15 and \$208, leaving \$75 and \$171 in net invested capital. The ALJ finds that those invested capital amounts should be included.

Ms. Donnelly repeatedly asked questions suggesting that Mr. Dickey had not been thorough in looking for capital items, such as meters that could be include in invested capital. As that questioning illustrates, Buena Vista acted as if the ED had the burden of supporting the application. Instead, Buena Vista has that burden. The Applicant did not show that additional meters are in service. The ALJ cannot find that there is sufficient evidence to add additional meters to invested capital beyond those about which Mr. Dickey testified. The ED should clarify the amount of the disallowances for meters in his exceptions.

For office equipment, the Utility claimed in it application that it had originally spent \$3,542, which was depreciated by \$2,492, leaving \$1,050. Mr. Dickey could not agree. He could not confirm \$1,210 at all. But he found that \$810.79, \$962.52, and \$480.19 had been spent for a computer, billing software, and a credenza, respectively. However, the first two items have been fully depreciated.³⁰ For the credenza, after depreciation of \$346, \$134 was left in invested

²⁹ 30 TAC § 291.31(c)(2)(iv).

³⁰ ED Ex. 2, subex. BDD-3, p. 2.

capital. The ALJ concludes that the amount of office equipment included in investment capital is \$134, which is \$916 less than the Utility claimed.

Mr. Dickey testified that Buena Vista spent \$349.99 for a printer in July 2007, but that was many months after the end of the test year. The ALJ sees no basis for including that printer in invested capital, which was not used to provide water service during the test year.

In its application, Buena Vista included \$10,497 in its net book invested capital for a Dodge truck with an original cost of \$18,524 and accumulated depreciation of \$8,027.³¹ The application form specifies that a vehicle is to be depreciated in a straight line over five years, and Buena Vista offered nothing to dispute that. It correctly calculated the annual depreciation of \$3,705,³² but then calculated accumulated depreciation of \$8,017, which would only cover 2.166 years, or two years and two months, of depreciation.

Mr. Dickey recommends two adjustments. He testified that Ms. Bryant told him during an audit and inspection on September 3, 2008, that the truck was used for both personal and business use. For that reason, he included only 50 percent of the original cost of the Dodge truck, which is \$9,262. Mr. Dickey also calculated accumulated depreciation differently. In his depreciation schedule, he noted that the truck was put in service on October 1, 2003, which meant that it had depreciated for three years and three months by the end of the test year, on December 31, 2006. This led Mr. Dickey to calculate the value that was used and useful to provide water service was \$9,262 (\$18,524 times 0.5), the annual depreciation was \$ 1,852 (\$9,262 divided by 5), the accumulated depreciation at the end of the test year was \$6,020 (\$1,852 times 3.25), and the net plant in service was \$3,242 (\$9,262 minus \$6,020).

³¹ ED Ex. 1, subex. EP-8, p. 10 of 41 (as marked).

³² $\$18524/5 = \3704.80 .

There is no evidence to show that the truck was put in service only 2.166 years before the end of the test year as Buena Vista assumed in its calculation. The ALJ adopts Mr. Dickey's method of calculating depreciation for the Dodge truck, but not his assumption that 50 percent of the truck's use was for the water business.

Buena Vista offered no mileage logs or other specific evidence to show the extent to which the Dodge truck was used for the water business. Instead, it argues that Ms. Donnelly also has a Ford truck that she uses for personal purposes. That may be true, but it does not show that the Dodge is used 100 percent for the water business. Instead, Ms. Bryant admitted to Mr. Dickey that it was not when she told him that she also used the Dodge for her personal business.³³

Mr. Dickey did not support his estimate that the Dodge truck was used 50 percent for the water business with any data. He simply split the truck's original cost in half because there were two uses, one of which was for water service.³⁴

Ironically, the most detailed and persuasive evidence concerning the percentage of miles that the Dodge truck was used for the water business was that offered by Mr. Wortham. He testified that he and other customers have seen Ms. Bryant driving the Dodge from her home to the water plant nearly every day, which would be a round trip of 1.5 miles and equate to 550 miles per year. He conceded that the total water-business use might be as high as 1,000 miles per year, but argued that the remaining use was more likely personal. He noted that Buena Vista offered no mileage log or other information to show that the Dodge truck was used more than that for the water business. Mr. Wortham estimated, based on the odometer reading and the years in use, that the Dodge truck was driven 6,200 miles per year. Thus, Mr. Wortham argued

³³ ED Ex. 2, p. 8.

³⁴ ED Ex. 2, p. 8.

that only 16 percent of the Dodge truck's use was for the water business. The ALJ adopts that analysis.

Mr. Wortham contends that all costs for the Dodge truck, which he claims total \$8,485 per year, should be deleted from cost of service. The ALJ does not agree. The ALJ cannot understand Mr. Wortham's calculation of \$8,485, which he does not explain. Moreover, 16-percent use is not zero use.

Based on the above, the ALJ concludes that the original cost of the Dodge truck was \$18,524, the value that was used and useful to provide water service was \$2,964 (\$18,524 times 0.16), the annual depreciation was \$593 (\$2,964 divided by 5), its accumulated depreciation at the end of the test year was \$1,927 (\$593 times 3.25), and its net plant was \$1,037 (\$2,964 minus \$1,927). Because Buena Vista included \$10,497 in its net book invested capital for the Dodge truck, the ALJ concludes that \$9,460 should be disallowed from its claimed invested capital.

2. Rate of Return

Along with many other factors, the quality of a utility's services, the efficiency of its operations, and the quality of its management are considerations in determining a utility's return on invested capital.³⁵ Mr. Wortham testified, without objection or contradiction, that Buena Vista often provided poor quality water to its customers and regularly over-billed them. He stated that the Applicant has notified customers on several occasions that trihalomethanes in the water were extraordinarily high and the problem has not been corrected. Also, he noted that chlorine levels fluctuate wildly, resulting in corrosion of customers' pipes. According to Mr. Wortham, Buena Vista did not make refunds for two years following its last rate case. At the end of that case, the Commission's denied the proposed increase and ordered the Utility to refund the amounts that it had over-collected by implementing the increase while that case was

³⁵ 30 TAC §291.31(c)(1)(B).

pending. Mr. Wortham acknowledged that some adjustments to customers' bill were made later, but Ms. Bryant was unable to explain those adjustments to customers or even what they were for. There was no evidence to contradict Mr. Wortham on these points.³⁶

No other evidence was offered concerning the rate-of-return factors. In its Application, Buena Vista used a 12-percent rate of return to calculate the return it sought. Mr. Pascua used that same percentage. No party disputed the 12-percent rate of return. The ALJ recommends that the Commission allow Buena Vista a 12-percent return on its invested capital.

3. Return on Invested Capital Summary

The ALJ is not able to provide a final calculation of the return on invested capital until after the ED's exceptions are filed. However, he proposes at least an \$11,342 reduction in the net plant invest capital amount that the Utility claimed in its application:

ALJ'S PRELIMINARY CALCULATION OF NET PLANT INVESTED	
Claimed	\$67,692
Pumps	\$66
Turbidity Monitor	\$570
Meters	\$-1,252
Office Equipment	\$-916
Printer Purchase In July 2007	\$-350
Dodge Truck	\$-9,460
Net Plant (preliminary calculation)	\$56,350

Assuming a 12-percent return on capital, as the ALJ recommends, that \$11,342 minimum reduction in net plant would lead to at least a \$1,361 reduction in the return to which Buena Vista is entitled.

³⁶ Wortham Ex. 1, p. 9.

E. Operation and Maintenance Expenses

1. Salary or Contract Services and Payroll Taxes

Buena Vista included \$15,000 in expenses and post-test-year adjustments for the salary paid to Ms. Bryant. It also included \$1,738 for payroll taxes on Ms. Bryant's salary and on the amount that Ms. Donnelly was paid for her services.

The ED does not question that either of them was paid or that Ms. Bryant's salary was a necessary and reasonable expense of providing water service. However, the ED proposes to disallow the payroll-tax amount because it was never paid.

Ms. Pascua testified that Buena Vista listed those taxes as an expense in its records in 2006, but later reversed that designation and listed that amount as retained earnings. This leads the ED to contend that the \$15,000 paid to Ms. Bryant should still be included as a cost of service but reclassified from salary to contract service and that the \$1,738 payroll tax amount should be disallowed.

Ms. Donnelly acknowledged that the payroll taxes were never paid, but claimed that was because funds were not available to pay them. She explained that they remain due and payable. She noted that the Utility filed a return with the United States Internal Revenue Service (IRS) for a least one quarter indicating that it owed a portion of the payroll taxes. According to the Applicant, that means the full amount is owed to the IRS, though not yet paid, and should be included in its cost of service. Ms. Pascua testified that an expense that is accrued in a test year should be included as an expense of that test year even if not paid to a later date.

The ALJ concludes that Buena Vista more likely than not continues to owe the payroll taxes, though it has not yet paid them, and that the portion of them that was reasonable and necessary to provide service was a test-year expense. For that reason, he concludes that the \$15,000 should not be reclassified from salaries to contract services.

In the section of this PFD concerning Accounting and Legal Expenses, the ALJ concludes that \$4,200 of what Buena Vista paid Ms. Donnelly for accounting was reasonable and necessary to provide water service, but \$2,300 of it was not and should be disallowed. Based on that, he concludes that the portion of the \$1,738 in payroll taxes that was related to that \$2,300 should be disallowed because that portion of the taxes was not reasonable and necessary to provide water service. The remainder of that \$1,738 was reasonable and necessary and should be included in cost of service. The ALJ is not able to make a precise calculation of those allowable and disallowable tax amounts and the ED should furnish them in his exceptions to this PFD.

2. Office Expenses

In its Application, the Utility claims that it spent \$9,759 during the test year for office expenses to provide water service. The ED proposes a \$4,480 disallowance for office expenses. The ALJ agrees with the ED.

Of the \$4,480, a disallowance of \$4,137 is to deduct an expense for electricity that was booked as both an office and a utility expense. There is no dispute that the double booking should be removed.

As previously noted, the Utility's office is also Ms. Bryant's home. Buena Vista claims to pay Ms. Bryant \$3,000 per year as rent and to pay a share of the other expenses of the home/office. Mr. Wortham contends that it is double dipping to claim both rent and expenses. The ALJ cannot agree. The double-dipping argument boils down to a contention that the rental payment included all expenses, but there is no evidence of that.

There is evidence, however, that not all of the non-rent office expenses were necessary and reasonable to provide water service. In fact, some of those expenses had no reasonable connection to the provision of water service during the test year. Those include the cost of

sealing Ms. Bryant's driveway, property taxes for a personal lot, and taxes paid for 2005, which was before the test year. For these, Ms. Pascua suggests a \$135 disallowance. Buena Vista offered no countervailing argument. The ALJ agrees that the \$135 should be disallowed.

Other expenses, including Dish Satellite, personal phones, and residential propane, trash pickup, electricity, property tax, etc. were at least loosely connected to the provision of water service according to Ms. Pascua, but she concluded that the amount booked to the Utility was excessive. Because 7.24 percent of Ms. Bryant's home is used as an office, Ms. Pascua reasoned that 7.24 percent of those expenses were incurred to provide water service. Ms. Pascua's allocation results in a disallowance of \$208. The ALJ agrees that is a reasonable method of allocating a share of these expenses to the water business and that \$208 should be disallowed.

3. Repairs and Maintenance

The ED proposes a \$3,730 disallowance of alleged repair and maintenance expenses and adjustments. The ALJ agrees.

In its test year expenses, Buena Vista double-booked \$240 for electrical repair. There is no dispute that it should be removed. The Utility also included \$330 as water service expenses for items that were actually personal repair and maintenance expenses of Ms. Bryant and Tracy Dubose, her daughter. Those, too, should be disallowed.

Buena Vista also included a post-test-year adjustment to its repair and maintenance expenses to add \$3,200 for what were clearly costs necessary to provide water service in 2007. Those included cleaning the sedimentation basin and sludge disposal. The ED proposes to disallow this \$3,200. The ED does not dispute that Buena Vista incurred these expense after the test year, needed to pay them to provide water service, or paid reasonable prices for them. Instead, Ms. Pascua testified that these types of expenses recur and that adding them as a post-

test-year adjustment would inappropriately compensate the Utility twice for the same category of expense. She is correct.

Any specific expense is incurred only once, but a utility will usually incur similar expenses in subsequent years. Thus, test year expenses are used to calculate rates for future years because they are rough estimates of expenses in future years. Of course, circumstances sometime change after the test year, and certain types of expenses can be reasonably expected to be higher or lower in the future than they were in the test year. A test-year expense can be adjusted for purposes of setting rates if the anticipated degree of change in future years is known and measurable.

Even after subtracting the disallowances recommended above, Buena Vista's cost of service would still include \$4,756 for repair and maintenance. That is because it spent that amount during the test year. In future years when the proposed rates would apply, Buena Vista repair and maintenance expenses might be higher or lower than \$4,756, but it would have that amount built into its rates.

Should Buena Vista have an extra \$3,200—a total of \$7,956—built into its rates to account for repair and maintenance expenses in each future year just because it spent \$3,200 for certain items in the year after the test year? There is no evidence that its annual repair and maintenance expense would regularly be that much higher. In fact, the evidence shows that the Utility did not spend a total of \$7,956 even in 2007. Ms. Donnelly testified that the Applicant spent \$5,484 for repair and maintenance in 2007. There is no evidence that even that \$728 difference between the test year and 2007 represents a known and measurable change that would likely continue. The ALJ concludes that Ms. Pascua is correct and the \$3,200 post-test-year adjustment for repair and maintenance expenses should be disallowed.

4. Accounting and Legal Expenses

The ED proposes to disallow \$2,300 in accounting and legal expenses. The ALJ agrees.

There is no evidence that the Utility paid any expense during the test year for legal services. Buena Vista included \$500 for accounting service rendered by Ms. Donnelly for a previous rate-change application that was filed in 2004. Thus, the expense was incurred before the test year and was not a change after the test year. It should be disallowed.

Much of the service that Ms. Donnelly provided during the test year was personal accounting for Ms. Bryant, not accounting related to Buena Vista. As discussed above, Ms. Bryant used the same checking accounts and credit cards for her personal expenses and those related to her water-service business. Ms. Pascua examined the transactions listed in the accounting ledgers that the Utility provided to her. She testified that the personal transactions totaled at least \$29,990. That is approximately 40 percent of the revenue requirement that Buena Vista proposes and 44 percent of revenue requirement that the ED recommends. Based on that, the ALJ concludes that a large percentage of the \$6,500 accounting expense was not reasonable or necessary to provide water service and should be disallowed.

What portion of the amount that the Utility actually paid for accounting services during the test-year was reasonable and necessary to provide water service? Determining that is more complicated since the person who provided and was paid for those services, Ms. Donnelly, is the sister of Buena Vista's owner, Ms. Bryant. Arguably, that makes Ms. Donnelly an affiliate of Buena Vista.³⁷ In any event, their relationship raises a suspicion that Buena Vista paid Ms. Donnelly more than what was necessary and reasonable to handle the water-business accounting. It is not really necessary to determine if Ms. Donnelly is an affiliate. Whether she is

³⁷ Water Code § 13.002(2).

or not, only that portion of the test-year accounting expense that was necessary and reasonable to provide water service may be included in Buena Vista's rate calculations.³⁸

Ms. Pascua testified, based on her 11 years of experience reviewing over 250 rate applications for the Commission, that utilities that are similar in size to Buena Vista pay \$350 per month for accounting services. Ms. Donnelly, who both represented Buena Vista at the hearing and testified for it, claimed that amount was overly low for the amount of work that she did but offered no specific evidence to show that a comparable utility would have paid more.

The ALJ found Ms. Pascua's testimony persuasive. He finds that Buena Vista's accounting expense that was reasonable and necessary to provide water service was \$350 per month, or \$4,200 for the year. Thus, he concludes that \$2,300 of the \$6,500 that Buena Vista claimed in its application for legal and accounting expenses should be disallowed.

5. Insurance Expense

The ED proposes to disallow \$852 of Buena Vista claimed insurance expense. The ALJ agrees with the ED.

Ms. Pascua testified that the \$852 was to pay for a life insurance policy for Ms. Bryant that names her estate as the beneficiary. That was not an expense necessary to provide water service. In fact, it had nothing to do with providing water service. It was a purely personal expense of Ms. Bryant to benefit her heirs. The ALJ concluded that the \$852 should be disallowed.

Mr. Wortham argues that the \$3,250 that Buena Vista paid for Ms. Bryant's health insurance should also be disallowed because it is a personal expense. While it is certainly a

³⁸ Water Code §§ 13.183(1) and 13.185(e).

benefit to her, the ALJ takes official notice that it is very common for businesses to provide health insurance benefits to their employees and officers.³⁹ Given that, the ALJ cannot agree that the health insurance cost should be disallowed.

6. Miscellaneous Expenses

The ED proposes to reduce the miscellaneous expense component by \$9,428, from \$19,254 to \$9,826. The ALJ finds that the miscellaneous expense amount should be reduced by \$9,682, from \$19,254 to \$9,572.

Actually, the ED believes that Buena Vista failed to include \$5,230 in legitimate miscellaneous expenses that were necessary and reasonable to provide water service during the test year. Ms. Pascua found these when she reviewed Buena Vista's accounting. There is no evidence to contradict her conclusion. The ED recommends that \$5,320 be added to the Applicant's cost of service, and the ALJ agrees. However, that additional amount is more than offset by other amounts that should be disallowed.

Ms. Pascua testified that the alleged test-year expenses included \$974 for personal expenses for Ms. Bryant and her family that were not necessary to provide water service. These include:

- \$304 for insurance and expenses for a Ford truck;
- \$299, which is 50 percent of the insurance and other expenses for the Dodge truck that was used for both water and personal business, as previously discussed;
- \$271 for credit-card interest due to non-utility expenses; and
- \$50 in 2006 and \$50 in 2007 for a property owners' association fee on a personal lot.

³⁹ Any party wishing to object to this taking of official notice should include that objection in its exceptions to this PFD.

There is no evidence to show that these apparently personal items were necessary to provide water service. The ALJ concludes that this \$974 should be removed from cost of service.

Additionally, as discussed under cost of capital, the ALJ can only conclude that 16 percent of the use of the Dodge truck was for the water business. This leads him to also conclude that only the 16 percent of the insurance expense, or \$95.68, was necessary and reasonable to provide water service. That means that \$203.32 more than the \$299 that the ED proposes should be disallowed.

Additionally, Buena Vista included \$1,353 for a Commission regulatory assessment fee that the Utility separately collected from its customers. The ALJ recommends that this \$1,353 double-collection be disallowed.

Buena Vista also included \$600 for penalties that it paid during the test year due to a TCEQ enforcement action. This cost of paying for its violations was not a cost of providing water service to its customers. Instead, a penalty or fine is specifically disallowed.⁴⁰ The ALJ concludes this \$600 should be disallowed.

In a prior rate case, the Commission found that Buena Vista had overcharged its customers and ordered it to refund the overcharge with interest. In the current case, Buena Vista bizarrely claims that the \$428 in interest that it paid customers during the test year because it over-charged them during the prior rate case was a miscellaneous expense of providing service to those customers. Thus, it seeks not only to recover the interest once but to indefinitely recover it each year. The ALJ finds that the interest paid on the prior overcharge was not an expense that was necessary for Buena Vista to provide water service. The ALJ finds that the \$428 should be disallowed.

⁴⁰ Water Code § 13.185(h)(3) and 30 TAC § 291.31(b)(2)(I).

Buena Vista incurred a \$9,966 engineering expense during the test year. No party questions that expense was necessary and reasonable to provide water service. However, the ED does object to including the full amount of that item in Buena Vista's cost of service. Instead, Ms. Pascua recommended that the cost should be amortized over three years, so only one third of it, \$3,322, would be included in cost of service. That way, Buena Vista will recover that unusually large non-recurring cost once over a three-year period rather than indefinitely each year. The ALJ agrees that the engineering expense should be amortized over three years, as Ms. Pascua recommends. Thus, the ALJ agrees that \$6,644, which is two-thirds of the \$9,966 engineering expense, should be disallowed.

Based on his review of discovery by the ED, Mr. Wortham argues that \$17,000 in miscellaneous expense may have been double counted. Perhaps he is referring the disallowances that the ED proposes that are discussed elsewhere in the PFD. Perhaps Mr. Wortham is referring to other disallowances that the ED has not chosen to press. In any event, Mr. Wortham did not provide detailed evidence to allow the ALJ to evaluate the proposed \$17,000 disallowance. For that reason, the ALJ cannot recommend that proposed disallowance.

In addition to miscellaneous costs incurred during the test year, Buena Vista includes \$4,710 for allegedly known and measurable changes in those costs that occurred after the test-year. But when Ms. Pascua reviewed the underlying expenses, she found that they were not known and measurable changes in the Applicant's cost of service. Instead, they were second helpings of the same types of expenses that occur every year, such as automobile expenses, bank charges, rental equipment, repairs and maintenance, etc. A year's worth of expenses like these is already included among the test-year expenses. The ALJ concludes that the \$4,710 should be disallowed.

Based on the above, the ALJ concludes that Buena Vista's claimed miscellaneous expense should be reduced by \$9,682, as set out below and rounded off to the nearest dollar:

MISCELLANEOUS EXPENSES SUMMARY	
Item	Amount
Claimed	\$19,254
Unclaimed	\$5,230
Personal expenses	\$-675
Dodge truck insurance	\$-502
Regulatory assessment separately collected	\$-1,353
Enforcement penalties	\$-600
Previously overcharged interest	\$-428
Portion of amortized engineering fee	\$-6,644
Recurring expense claimed as post-test-year adjustment	\$-4,710
Total	\$9,572

7. Federal Income Taxes

No party questions that the federal incomes taxes that a utility must pay on its return on invested capital is a legitimate cost of providing water service. Based on the \$8,916 return that the Utility claimed that it was entitled to in its application, Buena Vista claimed an additional \$1,588 to cover its income taxes. Based on Mr. Dickey's and her analyses, Ms. Pascua calculated that Buena Vista was instead entitled to a \$7,275 return, which resulted in a \$1,284 income tax expense. She showed her method of calculating the tax expense, which is 15 percent on income up to \$42,500.⁴¹ That calculation method was not disputed, and the ALJ adopts it.

However, the ALJ does not completely agree with either the Utility or the ED concerning the amount of Buena Vista's used-and-useful invested capital. Moreover, to the extent that the ALJ disagrees with the ED, the ALJ he cannot calculate a specific invested capital amount. This leaves the ALJ also unable to calculate a specific return in dollars or the federal income taxes based on that return. The ALJ asks the ED to address these matters in his exceptions to the PFD and to provide the appropriate calculations.

⁴¹ ED Ex. 1, subex. EP-5.

8. Rate-Case Expenses

In its application, Buena Vista included \$500 for rate-case expenses in its test-year costs of service. However, it offered no evidence to show that it had incurred any such expenses in the test year. The ALJ concludes that \$500 should be disallowed.

However, as agreed by the parties at the end of the hearing, Buena Vista, on October 20, 2008, submitted a list of the expenses that it claimed it incurred in this proceeding and asked that it be allowed to recover them, either as a cost of service or through a surcharge. In addition to the \$500 set out in the application, Buena Vista claimed to have incurred \$7,887 in 2008 to prepare and present its case. On October 27, 2008, the ED responded and argued that Buena Vista should not be allowed to recover any of those expenses because it has not substantially prevailed in this case. The ALJ agrees with the ED.

Commission rule 30 TAC § 291.28(7) and (8) provide

(7) A utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest.

(8) A utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.

In its application for this case, Buena Vista proposed to increase its revenue by \$14,431.13.⁴² Even without the additional disallowances that the ALJ asks the ED to calculate and provide in his exceptions, the disallowances that the ALJ recommends above total at least \$22,545, as set out below:

⁴² ED Ex. 1, subex. EP 8, unnumbered page headed "NOTICE OF PROPOSED RATE CHANGE."

PRELIMINARY CALCULATION OF RECOMMENDED DISALLOWANCES	
Expense Item	Disallowance
Return on invested capital (preliminary calculation)	\$1,361
Office Expenses	\$4,480
Repairs And Maintenance	\$3,370
Accounting And Legal Expenses	\$2,300
Insurance Expense	\$852
Rate Case Expense	\$500
Miscellaneous Expenses	\$9,682
Total	\$22,545

Thus, none of the proposed \$14,431.13 increase should be approved. Given that and in accordance with 30 TAC § 291.28(7) and (8), the ALJ concludes that none of Buena Vista's expenses to prepare and present this rate case were necessary and reasonable costs of providing service and the Utility's request to recover them should be denied.

F. Financial Integrity

In some cases, a utility's financial integrity might be at risk if it charged only the amounts necessary to recover a reasonable return on its investment over and above its reasonable and necessary expenses. The Water Code allows the Commission to set rates at a level necessary to preserve a utility's financial integrity.⁴³ However, Buena Vista offered no evidence that it was at risk of a financial collapse.

Buena Vista argues that it has lost money providing water service for several years. But the above analysis shows something else. The claim of losses appears to have been based on the improper inclusion of certain non-utility expenses as utility expenses. Those included personal expenses of Ms. Bryant and her family that were not necessary to provide water service and other necessary utility expenses that were unreasonably costly, such as the high cost of

⁴³ Water Code § 13.183 (a)(2).

accounting services provided by Ms. Donnelly. Once those are removed, Buena Vista has made a reasonable profit, at least in the test year. In fact, its profit was excessive.

VIII. RATE REDUCTION

The ED concludes that the proposed rates are excessive and recommends that the Commission deny Buena Vista's application to increase its rates. However, the ALJ concludes that more is required. Water Code § 13.187(h) provide:

If, after hearing, the [Commission] finds the rates currently being charged or those proposed to be charged are unreasonable or in violation of law, the regulatory authority shall determine the rates to be charged by the utility and shall fix the rates by order served on the utility.

In its application for this case, Buena Vista proposed to increase its revenue by \$14,431.13.⁴⁴ Even without the additional cost-of-service disallowances that the ALJ asks the ED to calculate and provide in his exceptions, the disallowances that the ALJ recommends above total at least \$22,435. Thus, at a minimum, Buena Vista's pre-application rates are set to collect at least \$8,003.87 more than is necessary and reasonable to provide service and recover a reasonable return on its invested capital. The ALJ will refine the over-collection amount once he reviews the exceptions and the additional calculations that he has asked the ED to provide. The ALJ recommends that the Commission set the Utility's rates at levels that will eliminate any over-collection.

IX. RATE DESIGN

Once a utility's reasonable and necessary cost of service is calculated, that cost must be apportioned among its customers. To do that, each cost item must be separated into fixed and

⁴⁴ ED Ex. 1, subex. EP 8, unnumbered page headed "NOTICE OF PROPOSED RATE CHANGE."

variable components. The fixed portion should be recovered through base rates per meter and the variable portion should be recovered by a per-1000-gallons charge.⁴⁵ When some customers receive service through larger meters, each of their meters is equivalent to several smaller meters; and an equivalency factor must be included to account for that difference.⁴⁶ No party disputes these principles.

At the end of the test year, Buena Vista served only residential customers and had 119 customers with 5/8- or 3/4-inch meters and three customers with 1-inch meters. Each 1-inch meters is equivalent to 7.5 of the 5/8- and 3/4-inch meters.⁴⁷

In its application, Buena Vista divided each of its cost of service items into fixed and variable components according to the percentages set out in the application form. In his testimony, Mr. Dickey did nearly the same, though he treats miscellaneous and payroll-tax expenses differently. He did not explain why he differed. The ALJ recommends that the Commission adopt the percentage splits set out in the application form and below:

⁴⁵ 30 TAC § 291.32(c).

⁴⁶ ED Ex. 2, subex. BDD-4.

⁴⁷ ED Ex. 1, EP-8, p. 10.

DIVISION OF COSTS OF SERVICE IN TO FIXED AND VARIABLE PERCENTAGES		
Item	Fixed	Variable
Salaries and wages	50	50
Contract labor	90	10
Purchased water	0	100
Chemicals for treatment	0	100
Utilities (electricity)	0	100
Repairs/maintenance/supplies	50	50
Office expenses	50	50
Accounting and legal fees	100	0
Insurance	100	0
Rate case expenses	100	0
Miscellaneous	50	50
Payroll taxes	50	50
Property and other taxes	100	0
Annual depreciation and amortization	100	0
Income taxes	100	0
Return	100	0

Once again, the ALJ cannot furnish specific calculations of the dollar value of each fixed and variable expense or the resulting rates without further assistance from the ED. The ALJ asks the ED to furnish the necessary calculations in his exceptions.

X. REFUNDS

Based on the above, the ALJ has concluded that Buena Vista has failed to carry its burden of proving that its proposed rates should be adopted. Mr. Wortham testified, without contradiction, that the Utility has been collecting the rates proposed in this case since they went into effect on September 1, 2007. Water Code § 13.187 (i) provides:

... Unless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate finally ordered plus interest as determined by the regulatory authority.

The ED proposes, through Mr. Dickey, that the Commission order Buena Vista to refund or credit to customers all sums collected during the pendency of this rate proceeding in excess of the rates finally ordered in this case, plus six percent interest.⁴⁸ No other party addressed this point. The ALJ recommends that the Commission adopt the ED's proposal to order a refund, plus interest.

XI. RECOMMENDATION

The ALJ recommends that the Commission adopt an order denying Buena Vista's application to increase rates and ordering the Utility to:

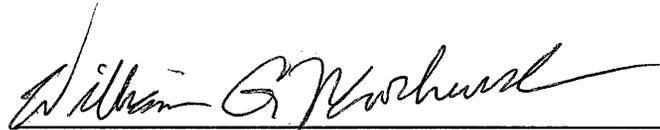
- immediately cease collecting the rates proposed in this case;
- immediately commence collecting fair and reasonable rates as ordered by the Commission in this case, which will be lower than both the proposed rates and lower than the existing rates that had been approved by the Commission before Buena Vista filed the application to increase rates;
- refund or credit to customers all sums collected since the effective date of the proposed rates at issue in this case that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection;
- review any future construction and purchase costs closely and maintain her records by NARUC property accounts; and
- use separate accounts for her water-business expenses and non-water-business expenses.

Because the ALJ is requesting the ED to furnish numerous calculations in his exceptions to this PFD to reflect the ALJ's conclusions, the ALJ is not able to furnish a completed proposed order at this time. Instead, the ALJ has attached a preliminary proposed order and will furnish a

⁴⁸ ED Ex. 2, p. 12.

revised proposed order when he recommends how the Commission should rule on any exceptions that may be filed.

SIGNED December 19, 2008.

A handwritten signature in cursive script, reading "William G. Newchurch". The signature is written in black ink and is positioned above a horizontal line.

**WILLIAM G. NEWCHURCH
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS**

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AN ORDER

DENYING THE APPLICATION OF BUENA VISTA WATER SYSTEM TO INCREASE ITS RATES, ORDERING IT TO LOWER THE RATES IT WAS CHARGING BEFORE IT FILED ITS APPLICATION, AND CHANGING ITS TARIFF UNDER CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11656, BURNET COUNTY, TEXAS

**SOAH DOCKET NO. 582-08-2245
TCEQ DOCKET NO. 2007-1878-UCR**

On _____, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Kathie Bryant, doing business as Buena Vista Water System, to change water rates and tariff, under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas. A Proposal for Decision (PFD) was presented by William G. Newchurch, an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH).

After considering the ALJ's PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

I. FINDINGS OF FACT

Introduction

1. Kathie Bryant, does business as Buena Vista Water System, and provides retail water utility service under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas.

2. Although Buena Vista is not a separate entity and is simply Ms. Bryant's trade name, it is frequently necessary in this Order to distinguish between utility activities and expenses and Ms. Bryant's personal activities and expenses.
3. To limit confusing and awkward writing, this Order will refer to the utility business in a gender-neutral manner, as Buena Vista, Applicant, or Utility and will refer to Ms. Bryant by name only when the discussion concerns her private activities and expenses.

Procedural History and Jurisdiction

4. On June 11, 2007, Buena Vista filed its application to increase its water rates and amend its tariff.
5. The effective date of the increase was September 1, 2007.
6. Notices of the application were mailed to Buena Vista's customers and other affected parties on July 17, 2007.
7. More than ten percent of the Utility's customers filed protests by the applicable deadline.
8. On March 13, 2008, the Commission's Chief Clerk referred the application to SOAH for hearing.
9. On March 20, 2008, the Chief Clerk mailed notice of a preliminary hearing to the Applicant; and on April 1, 2008, the Applicant mailed that same notice to its customers and affected municipalities.
10. The notice contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference

to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.

11. On June 2, 2008, the ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

PARTY	REPRESENTATIVE
Buena Vista	Kathie Bryant
ED	Ron M. Olson
OPIC	Eli Martinez
Protestants	Michael Wortham

12. No party disputes either the Commission's or SOAH's jurisdiction.
13. The ALJ held the hearing on the merits of the application on October 13, 2008, and all of the Parties appeared. However, George Freitag and Nancy Donnelly, rather than Ms. Bryant, represented the Applicant at the hearing on the merits.
14. Nancy Donnelly is the sister of Buena Vista's owner, Ms. Bryant.
15. The ALJ left the record open until October 27, 2008, for the Parties to present evidence and argument concerning Buena Vista's rate case expenses.

Overview of the Proposed Rate Increase

16. Buena Vista serves only residential customers. At the end of the test year, on December 31, 2006, it had 119 customers with 5/8 or 3/4-inch meters and three customers with 1-inch meters.

17. The Applicant set its proposed rates in order to have an opportunity to recover revenue of \$94,943.

18. If granted, Buena Vista's rates would change as follows:

	CURRENT	PROPOSED
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	\$40.00
Base monthly rate for 1-inch meter with zero gallons	\$48.41	\$53.41
Charge per 1,000 gallons	\$2.75	\$3.25
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00
Meter test fee	\$0	\$25.00

19. The proposed increase in rates would increase the Utility's revenue by \$14,431.13.

Comingling of Expenses and Funds

20. The Utility's financial records include numerous expenses that have nothing to do with providing water services. They are personal expenses of the owner, Ms. Bryant.

21. When utility and non-utility funds and expenses are comingled, review of rates becomes much more complicated and a cloud of doubt is cast over all of the expenses and investments claimed by the utility.

22. To avoid comingling and related problems in the future, Ms. Bryant should:

- a. review any future construction and purchase costs closely and maintain her records according to National Association of Regulatory Utility Commissioners (NARUC) property accounts; and

b. use separate financial and accounting for her Buena Vista water-utility business.

Revenue Requirement

23. On the TCEQ rate-change application form, Buena Vista reported that its total cost of service during the test year was \$75,193, before deducting for \$1,072 in other revenue.
24. In its application, Buena Vista also contended that its rates should be set to allow it to recover an additional \$20,822 over and above its claimed test-year expenses. According to the Applicant, this additional amount is to account for known and measurable post-test-year changes in its cost of service.
25. An overview and breakdown of the Applicant's claimed revenue requirement is given below:

	TEST YER PER APPLICANT (a)	APPLICANT ADJUSTMENT (b)	APPLICANT TEST YEAR (c)=(a)+(b)
Operations and Maintenance	\$65,149	\$9,039	\$74,188
Depreciation and Amortization	\$7,248	\$600	\$7,848
Other Taxes	\$2,796	\$679	\$3,475
Federal Income Taxes	\$0	\$1,588	\$1,588
Return	\$0	\$8,916	\$8,916
Revenue Requirement	\$75,193	\$20,822	\$96,015
Other Revenues – Taps	\$-1,072		\$-1,072
Base Rate Revenue	\$74,121	\$20,822	\$94,943

Return on Invested Capital

26. In its application, Buena Vista contends that it should receive a return of \$8,916 on the capital it has invested to provide water service.

Invested Capital

27. The Utility claims that it has usefully invested and used \$67,692 in capital to provide water service.
28. Except as discussed below, in the amounts that it claims, Buena Vista has usefully invested and used capital to provide water service in the amounts that it claims and no party contends otherwise.
29. In its application, Buena Vista claimed that its original cost of well pumps was \$5,869, against which had accumulated \$5,285 in depreciation, which left a net book value of \$584.
30. The Utility's original cost of various kinds of pumps was actually \$5,933.67, minus \$5,283 for depreciation, leaving \$649.67 in net plant.
31. Buena Vista has invested \$65.67 more in pumps than it stated in its application.
32. The Utility properly included \$348.40 for the original cost of a chemical feed pump but misclassified it as a cost of treatment. That cost should be reclassified. After depreciation of \$96, the chemical feed pump's net book value is \$253.
33. The Company failed to include \$1,791 for a turbidity monitor in its claimed invested capital, with depreciation of \$1,221, leaving net plant of \$570. This amount should be added to invested capital.

34. With regard to chlorinators, the Utility claimed \$5,052 in original cost, accumulated depreciation of \$1,990, leaving \$3,062 in net plant.
35. The Utility originally spent \$1,159 for a chlorinator; but it has been fully depreciated, and no investment for it should be allowed.
36. Buena Vista spent \$1,487 for a chlorine tester that it had either not claimed or misclassified. Its accumulated depreciation was \$843, yielding additional net plant of \$644.
37. In December 2006, Buena Vista spent another \$2603.95 for another chlorinator. This additionally amount was/was not used and useful to provide service during the test year and should/should not be added to invested capital.
38. In its application, Buena Vista claimed an original cost of \$3,114 for meters, with depreciation of \$1,862, leaving \$1,252 in net book value.
39. Customers have already paid for those meters through their tap fees and should not have to pay for them a second time through rates. The \$1,252 for meters should not be included in net plant in service for the purpose of calculating Buena Vista's return on investment.
40. The Applicant has a portable turbidimeter in service, which had an original cost of \$1,009 and has accumulated depreciation of \$534, leaving \$475 as net plant in service.
41. The Utility has two replacement meters in service, with original costs of \$90.04 and \$378.88, depreciation of \$15 and \$208, leaving \$75 and \$171 in net invested capital.
42. There is insufficient evidence to add additional meters to invested capital beyond those discussed above.

43. For office equipment, the Utility claimed in its application that it had originally spent \$3,542, which was depreciated by \$2,492, leaving \$1,050 in service.
44. There is no evidence to support \$1,210 of the claimed original cost of office equipment.
45. For a computer, billing software, and a credenza in service, the Utility spent \$810.79, \$962.52, and \$480.19, respectively. However, the first two items have been fully depreciated. After depreciation of \$346, the credenza's net plant of \$134 is still usefully invested and used to provide service.
46. The amount of office equipment included in investment capital is \$134, which is \$916 less than the Utility claimed. The \$916 should be disallowed.
47. Buena Vista spent \$349.99 for a printer in July 2007, but that was not used to provide water service during the test year.
48. In its application, Buena Vista included \$10,497 in its net book invested capital for a Dodge truck with an original cost of \$18,524 and accumulated depreciation of \$8,027.
49. A vehicle is to be depreciated in a straight line over five years.
50. The Dodge truck was put in service on October 1, 2003, which meant that it had depreciated for three years and three months by the end of the test year, on December 31, 2006.
51. The Dodge truck has been driven an average of 6,200 miles per year for all purposes.
52. The Dodge truck is used for both utility and no-utility purposes.

53. Ms. Bryant drives the Dodge truck from her home to the water plant nearly every day, which would be a round trip of 1.5 miles and equate to at least 550 miles per year for utility service.
54. The Dodge truck is driven up to 1,000 miles per year for utility purposes, and no party contends otherwise.
55. Sixteen percent of the Dodge truck's use is for utility purposes.
56. Based on the above, the original cost of the Dodge truck was \$18,524, the value that was used and useful to provide water service was \$2,964 (\$18,524 times 16 percent), the annual depreciation was \$593 (\$2,964 divided by 5), its accumulated depreciation at the end of the test year was \$1,927 (\$593 times 3.25), and its net plant in service was \$1,037 (\$2,964 minus \$1,927) at the end of the test year.
57. Because Buena Vista included \$10,497 in its net book invested capital for the Dodge truck, \$9,460 should be disallowed from its claimed invested capital amount.
58. Based on the above, the Utility's net capital invested in water service is \$ _____ as shown below:

CALCULATION OF NET PLANT INVESTED	
Claimed	\$67,692
Pumps	\$66
Turbidity Monitor	\$570
Meters	\$-1,252
Office Equipment	\$-916
Printer Purchase In July 2007	\$-350
Dodge Truck	\$-9,460
Other Disallowances	
Net Plant	

Rate of Return

59. The Applicant has notified customers on several occasions that trihalomethanes in the water were extraordinarily high and the problem has not been corrected.
60. In the water that the Applicant provides to its customers, chlorine levels fluctuate wildly, resulting in corrosion of customers' pipes.
61. At the end of its last rate case, the Commission denied the rate increase proposed by the Utility and ordered Buena Vista to refund with interest the amounts that it had over-collected by implementing the increase while that case was pending.
62. Buena Vista did not make the ordered refunds for two years following its last rate case.
63. Some adjustments to customers' bill were made after two years, but Buena Vista was unable to explain those adjustments to customers.
64. Buena Vista often provides low quality water to its customers and regularly over-bills them.
65. In its current application, Buena Vista uses a 12-percent rate of return to calculate the return on investment that it seeks.
66. No party disputes the 12-percent rate of return.
67. Based on the above, Buena Vista should receive a 12-percent return on its usefully invested and used capital.

Return on Invested Capital Summary

68. Based on the above, the just and reasonable 12-percent return on Buena Vista's \$ _____ of capital usefully invested and used to provide water service is \$ _____.

Operation and Maintenance Expenses Salary or Contract Services and Payroll Taxes

69. In its application, Buena Vista included \$15,000 in expenses and post-test-year adjustments for the salary paid to Ms. Bryant.
70. Ms. Bryant's salary is a necessary and reasonable expense of providing water service.
71. Buena Vista also included \$1,738 in its application for payroll taxes on Ms. Bryant's salary and on the amount that Ms. Donnelly was paid for her services during the last year.
72. Buena Vista listed the \$1,738 in payroll taxes as an expense in its records in 2006, but never paid that amount to the United States Internal Revenue Service (IRS).
73. The Utility filed a return with the IRS for a least one quarter indicating that it owed a portion of the payroll taxes.
74. An expense that is accrued in a test year should be included as an expense of that test year even if not paid until a later date.
75. Buena Vista continues to owe the payroll taxes, though it has not yet paid them, and the portion of them that was reasonable and necessary to provide water service was a test-year expense.

76. As set out below in this Order, \$4,200 of what Buena Vista paid Ms. Donnelly for accounting was reasonable and necessary to provide water service, but \$2,300 of it was not.
77. The portion of the \$1,738 in payroll taxes that was related to Ms. Bryant's \$15,000 salary and to the \$4,200 that Buena Vista reasonably and necessarily paid Ms. Donnelly for accounting related to water service was a necessary and reasonable expense of providing water service.
78. Based on the above, the necessary and reasonable amount of payroll taxes to provide water services during the test year was \$_____.
79. Based on the above, \$_____ of the \$1,738 that Buena Vista claimed in its application for payroll taxes was not reasonable or necessary to provide water service and should be disallowed.

Office Expenses

80. In its Application, the Utility claims that it spent \$9,759 during the test year for office expenses to provide water service.
81. Of the amount Buena Vista claimed for offices expenses, \$4,137 was also claimed as an expense for electricity service. The duplicative \$4,137 claimed as an office expense should be disallowed.
82. The Utility's office is in Ms. Bryant's home.
83. The cost of sealing Ms. Bryant's driveway, property taxes for a personal lot, and taxes paid for 2005 were claimed as office expenses but were not necessary and reasonable to

provide water service during the test year. The \$135 claimed for them should be disallowed.

84. Some of the claimed office expenses were for services provided to Ms. Bryant's home that were partially necessary to provide water service and partially for her personal benefit. These included Dish Satellite, personal phones, and residential propane, trash pickup, electricity, property tax, *etc.*
85. The Utility office occupies 7.24 percent of the floor space in Ms. Bryant's home.
86. Based on the above, 7.24 percent of the expenses described in Finding of Fact No. 84 were necessary and reasonable to provide water service; hence, \$208 of those office expenses should be disallowed.

Repairs and Maintenance

87. In its test year expenses, Buena Vista double-booked \$240 for electrical repair, which should be disallowed.
88. In its application, the Utility claimed \$330 that was actually for personal repair and maintenance expenses of Ms. Bryant and Tracy Dubose, her daughter. This \$330 should be disallowed.
89. Buena Vista claims a post-test-year adjustment to its repair and maintenance expenses to add \$3,200 that it necessarily and reasonably spent for repair and maintenance in 2007, after the test year, to provide water service. Among other things, this amount includes the costs of cleaning the sedimentation basin and for sludge disposal.
90. There is no evidence that Buena Vista's annual repair and maintenance expenses in the future would regularly be \$3,200 higher than what it spent in the test year.

91. Based on the above, the claimed \$3,200 post-test-year adjustment in repair and maintenance expenses is not based on known and measurable changes in the cost of providing water service after the test year and should be disallowed.

Accounting and Legal Expenses

92. Ms. Donnelly provided all of the accounting service that Buena Vista claims as expenses to provide water service.

93. Ms. Donnelly also provided accounting services to Ms. Bryant for her non-utility, personal transactions.

94. In its application, Buena Vista claimed \$500 for accounting service rendered by Ms. Donnelly concerning a previous rate-change application that was filed in 2004. This expense was incurred before the test year and should be disallowed.

95. In its application, Buena Vista also claimed \$6,500 in expenses for accounting services provided by Ms. Donnelly during the test year.

96. Ms. Bryant used the same checking accounts, credit cards, and accounting ledgers for her personal expenses and those related to her water-service business.

97. The personal transactions totaled at least \$29,990, which is approximately 40 percent of the revenue requirement that Buena Vista proposes in its application.

98. Based on the above, much of the accounting service that Ms. Donnelly provided during the test year was personal accounting for Ms. Bryant that was not related to Buena Vista's provision of water service.

99. Utilities that are similar in size to Buena Vista typically pay \$350 per month, or \$4,200 per year, for accounting services.
100. Based on the above, Buena Vista's accounting expense that was reasonable and necessary to provide water service during the test year was \$350 per month, or \$4,200 for the year. Thus, \$2,300 of the claimed test-year accounting expense should be disallowed.

Insurance Expense

101. Buena Vista claims a test-year expense of \$852 that was used to pay for a life insurance policy for Ms. Bryant that names her estate as the beneficiary.
102. The \$852 paid for the life insurance was a purely personal expense of Ms. Bryant to benefit her heirs and not an expense necessary to provide water service. The \$852 should be disallowed.
103. It is very common for businesses to provide health insurance benefits to their employees and officers.
104. The \$3,250 that Buena Vista paid during the test year for Ms. Bryant's health insurance was a necessary and reasonable expense of providing water service.

Miscellaneous Expenses

105. In its application, Buena Vista failed to claim \$5,230 in legitimate miscellaneous expenses that were necessary and reasonable to provide water service during the test year. That \$5,320 should be added to the Applicant's cost of service.

106. The test-year expenses claimed by the Utility included \$675 for personal expenses for Ms. Bryant and her family that were not necessary to provide water service and should be disallowed. These included:
 - a. \$304 for insurance and expenses for a Ford truck;
 - b. \$271 for credit-card interest due to non-utility expenses; and
 - c. \$50 in 2006 and \$50 in 2007 for a property owners' association fee on a personal lot.
107. As discussed above, only 16 percent of the use of the Dodge truck was for the water business.
108. Based on the above, only 16 percent of the insurance expense for the Dodge truck, or \$95.68, was necessary and reasonable to provide water service.
109. Based on the above, \$502.32 of the insurance expense for the Dodge truck should be disallowed.
110. Buena Vista claims \$1,353 for a Commission regulatory assessment fee that the Utility separately collected from its customers. This \$1,353 should be disallowed.
111. Buena Vista claims \$600 for penalties that it paid during the test year due to a TCEQ enforcement action. This \$600 was not a cost of providing water service to its customers and should be disallowed.
112. In a prior rate case, the Commission found that Buena Vista had overcharged its customers and ordered it to refund the overcharge with interest.
113. In the current case, Buena Vista claims that the \$428 in interest that it paid customers during the test year because it over-charged them during the prior case was a miscellaneous expense of providing service to those customers during the test year

114. The interest paid on the prior overcharge was not an expense that was necessary for Buena Vista to provide water service, and the \$428 should be disallowed.
115. Buena Vista incurred a \$9,966 engineering expense during the test year, which was necessary and reasonable to provide water service.
116. The \$9,966 engineering expense was unusually large relative to the Utility's cost of service and will not recur each year.
117. The \$9,966 engineering expense should be amortized over three years, so only one third of it, \$3,322, would be included in cost of service. That way, Buena Vista will recover that cost once over a three-year period rather than indefinitely each year.
118. Based on the above, \$6,644, which is two-thirds of the \$9,966 engineering expense, should be disallowed.
119. In addition to miscellaneous costs incurred during the test year, Buena Vista claims \$4,710 for allegedly known and measurable changes in those costs that occurred after the test-year.
120. This \$4,710 does not represent known and measurable changes in the Applicant's cost of service, but the same types of expenses that occur every year, such as automobile expenses, bank charges, rental equipment, repairs and maintenance, etc.
121. A year's worth of expenses like the above is separately claimed among the test-year expenses.
122. Based on the above, the \$4,710 should be disallowed.

123. Based on the above, Buena Vista's claimed miscellaneous expense should be reduced by a total of \$9,682, as set out below and rounded off to the nearest dollar:

MISCELLANEOUS EXPENSES SUMMARY	
Item	Amount
Claimed	\$19,254
Unclaimed	\$5,230
Personal expenses	\$-675
Dodge truck insurance	\$-502
Regulatory assessment separately collected	\$-1,353
Enforcement penalties	\$-600
Previously overcharged interest	\$-428
Portion of amortized engineering fee	\$-6,644
Recurring expense claimed as post-test-year adjustment	\$-4,710
Total	\$9,572

Federal Income Taxes

124. In its application, the Utility claimed \$1,588 as its income tax expense on the return as investment that is claimed.
125. The federal incomes tax that a utility must pay on its return on invested capital is a legitimate cost of providing water service.
126. For income up to \$42,500, the tax expense is 15 percent.
127. Based on the above, the income tax expense necessary and reasonable to provide water service is \$_____, and \$_____ should be disallowed from the amount claimed by Buena Vista.

Rate-Case Expenses

128. In its application, Buena Vista included \$500 for rate-case expenses in its test-year costs of service, but there is no evidence that it spent that amount for that purpose during the test year. The \$500 should be disallowed.
129. On October 20, 2008, Buena Vista submitted a list of the expenses that it claimed it incurred in this proceeding and asked that it be allowed to recover them, either as a cost of service or through a surcharge.
130. In that submission, Buena Vista claimed to have incurred \$7,887 in 2008 to prepare and present this case.
131. Because Buena Vista has not substantially prevailed in this proceeding, the claimed rate-case expenses should be disallowed.

Financial Integrity

132. In some cases, a utility's financial integrity might be at risk if it charged only the amounts necessary to recover a reasonable return on its investment that was used and useful to provide service over and above its reasonable and necessary expenses.
133. There is no evidence that Buena Vista is at risk of a financial collapse.

Rate Design

134. Once a utility's reasonable and necessary cost of service is calculated, that cost must be apportioned among its customers. To do that, each cost item must be separated into fixed and variable components.

135. When some customers receive service through larger meters, each of their meters is equivalent to several smaller meters; and an equivalency factor must be included to account for that difference.
136. At the end of the test year, Buena Vista served only residential customers and had 119 customers with 5/8- or 3/4-inch meters and three customers with 1-inch meters.
137. Each 1-inch meters is equivalent to 7.5 of the 5/8- and 3/4-inch meters.
138. The Utility's costs of service should be divided into fixed and variable percentages by major categories as set out below:

DIVISION OF COSTS OF SERVICE IN TO FIXED AND VARIABLE PERCENTAGES		
Item	Fixed	Variable
Salaries and wages	50	50
Contract labor	90	10
Purchased water	0	100
Chemicals for treatment	0	100
Utilities (electricity)	0	100
Repairs/maintenance/supplies	50	50
Office expenses	50	50
Accounting and legal fees	100	0
Insurance	100	0
Rate case expenses	100	0
Miscellaneous	50	50
Payroll taxes	50	50
Property and other taxes	100	0
Annual depreciation and amortization	100	0
Income taxes	100	0
Return	100	0

139. Based on the above, Buena Vista's fixed and variable costs of service by major categories are as set out below:

FIXED AND VARIABLE COSTS OF SERVICE		
Item	Fixed	Variable
Salaries and wages		
Contract labor		
Purchased water		
Chemicals for treatment		
Utilities (electricity)		
Repairs/maintenance/supplies		
Office expenses		
Accounting and legal fees		
Insurance		
Rate case expenses		
Miscellaneous		
Payroll taxes		
Property and other taxes		
Annual depreciation and amortization		
Income taxes		
Return		

Refunds

140. The Utility has been collecting the rates proposed in its application since they went into effect on September 1, 2007.

II. CONCLUSIONS OF LAW

1. Kathie Bryant, doing business as Buena Vista Water System, is a retail public utility under Texas Water Code Ann. (Water Code) § 13.002(19) and a public utility under Water Code § 13.002(23).
2. The Commission has jurisdiction to consider an application for a rate increase filed by a retail public water utility, pursuant to Water Code § 13.042(e).

3. All required notices of the application and the contested case hearing on it were given as required by law, including Water Code § 13.187 and Tex. Gov't Code Ann. (Government Code) §§ 2001.051 and 2001.052.
4. The ALJ conducted a contested case hearing and proposed a decision on the application under the authority of chapter 2003 of the Government Code and chapter 13 of the Water Code.
5. Water Code § 13.183(a) requires the Commission, in setting the rates for water service, to fix a utility's overall revenues at a level that will:
 - a. permit the utility a reasonable opportunity to earn a reasonable return on its i invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and
 - b. preserve the financial integrity of the utility.
6. Buena Vista has the burden of proving that its proposed rates are just and reasonable. Water Code § 13.184(c).
7. The Commission is generally prohibited from setting rates that would allow Buena Vista to earn more than a fair return on its capital that is used and useful in providing water service. Water Code § 13.184(a).
8. The Commission may promulgate reasonable rules and regulations with respect to the allowance or disallowance of certain expenses for ratemaking purposes. Water Code 13.185(g).
9. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's

historical test year expenses as adjusted for known and measurable changes may be considered. 30 TEX. ADMIN. CODE (TAC) §291.31(a) and (b).

10. "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing. Water Code § 13.002(22).
11. Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. Utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital. Water Code § 13.185(b).
12. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service. Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility, except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Water Code § 13.185(j).
13. Under 30 TAC § 291.31(b)(1), allowable expenses, to the extent they are reasonable and necessary, and subject to that section, may include, but are not limited to, the following general categories:

(A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), §13.185(e));

(B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;

(C) assessments and taxes other than income taxes;

(D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, §13.185(f), if applicable);

(E) reasonable expenditures for ordinary advertising, contributions, and donations; and

(F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

14. Certain types of expenses are not allowed as a component of cost of service. Among those that are relevant to this case are expenditures found by the Commission to be unreasonable or unnecessary, including civil penalties or fines. Water Code § 13.185(h)(3) and 30 TAC § 291.31(b)(2)(I).

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

(A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:

(i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;

(ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;

(iii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC, §13.185(e);

(iv) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and

(B) working capital allowance to be composed of, but not limited to, the following:

(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

(ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, §13.185(e); and

(iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

16. In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management. Water Code § 13.184 (b).
17. Under 30 TAC § 291.31(c)(1), the return on invested capital is the rate of return times invested capital. The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital. The Commission fixes the rate of return in accordance with the following principles.

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

(B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the

efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

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

18. Based on the above Findings of Fact and Conclusions of Law, \$_____ should be disallowed from the \$94,943 revenue requirement that Buena Vista claimed in its application, as set out below:

CALCULATION OF DISALLOWANCES	
Expense Item	Disallowance
Return on invested capital (preliminary calculation)	
Payroll taxes	
Office Expenses	\$4,480
Repairs and Maintenance	\$3,370
Accounting and Legal Expenses	\$2,300
Insurance Expense	\$852
Rate Case Expense	\$500
Miscellaneous Expenses	\$9,682
Federal income taxes	
Total	

19. The Commission has adopted rules concerning alternative rate methods. 30 TAC § 291.34.
20. Buena Vista has not applied and there is no evidence to show that its rates should be set according to such an alternative method.
21. The Water Code allows the Commission to set rates at a level necessary to preserve a utility's financial integrity. Water Code § 13.183 (a)(2).

22. There is no evidence that any portion of the proposed rate increase is necessary to preserve Buena Vista's financial integrity.
23. Based on the above Findings of Fact and Conclusions of Law, Buena Vista has failed to carry its burden of proving that any portion of the \$14,431.13 increase in revenue that it proposed in its application should be approved.
24. Based on the above Findings of Fact and Conclusions of Law, none of the proposed \$14,431.13 increase should be approved and Buena Vista's application to increase its rates should be denied.
25. Commission rule 30 TAC § 291.28(7) and (8) provide:

(7) A utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest.

(8) A utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.

26. Based on the above Findings of Fact and Conclusions of Law, none of Buena Vista's expenses to prepare and present this rate case were necessary and reasonable costs of providing service and the Utility's request to recover those rate case expenses should be denied.
27. Water Code § 13.187(h) provides:

If, after hearing, the [Commission] finds the rates currently being charged or those proposed to be charged are unreasonable or in violation of law, the regulatory authority shall determine the rates to be charged by the utility and shall fix the rates by order served on the utility.

28. Based on the above Findings of Fact and Conclusions of Law, the \$ _____ that should be disallowed from the \$96,015 that the Buena Vista claimed as its revenue requirement exceeds the \$14,431.13 increase in revenue included in that \$96,015.
29. Based on the above Findings of Fact and Conclusions of Law, Buena Vista's current rates are designed to recover \$ _____ more than its necessary and reasonable cost of service, including a return on and of its capital usefully invested and used to provide service.
30. Based on the above Findings of Fact and Conclusions of Law, Buena Vista's pre-application rates should be reduced so as to reduce its revenue by \$ _____.
31. The fixed portion of a utility's cost of service should be recovered through base rates per meter and the variable portion should be recovered by a per-1000-gallons charge. 30 TAC §291.32(c).
32. Based on the above Findings of Fact and Conclusions of Law, Buena Vista rates should be changed as follows:

	CURRENT	NEW
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	
Base monthly rate for 1-inch meter with zero gallons	\$48.41	
Charge per 1,000 gallons	\$2.75	
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00
Meter test fee	\$0	\$25.00

33. Water Code § 13.187 (i) provides:

... Unless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate finally ordered plus interest as determined by the [Commission].

34. Based on the above Findings of Fact and Conclusions of Law, Buena Vista should refund or credit to customers all sums collected since September 1, 2007, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection

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 Kathie Bryant, doing business as Buena Vista Water System, to increase the rates that she charges for the retail water utility service that she provides under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas, is denied.
2. Ms. Bryant shall immediately cease collecting the rates she proposed in this case.
3. Ms. Bryant shall immediately begin collecting the following rates:

	CURRENT	NEW
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	
Base monthly rate for 1-inch meter with zero gallons	\$48.41	
Charge per 1,000 gallons	\$2.75	
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00

Meter test fee	\$0	\$25.00
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4. Within _____ days, Ms. Bryant shall refund or credit to customers all sums collected since September 1, 2007, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection.
5. Ms. Bryant shall review any future construction and purchase costs closely and maintain her records by NARUC property accounts.
6. Ms. Bryant shall immediately begin using separate financial accounts and accounting for her Buena Vista water-utility business.
7. 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.
8. The effective date of this Order is the date the Order is final, as provided by 30 TAC § 80.273 and Gov't Code § 2001.144.
9. As required by Water Code § 7.059, the Commission's Chief Clerk shall forward a copy of this Order to Ms. Bryant.

10. 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**