

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

February 8, 2011

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

Re: SOAH Docket No. 582-08-2863; TCEQ Docket No. 2008-0093-UCR; In Re: APPEAL OF THE RETAIL WATER AND WASTEWATER RATES OF THE LOWER COLORADO RIVER AUTHORITY

Dear Mr. Trobman:

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

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than February 28, 2011. Any replies to exceptions or briefs must be filed in the same manner no later than March 10, 2011.

This matter has been designated **TCEQ Docket No. 2008-0093-UCR; SOAH Docket No. 582-08-2863**. All documents to be filed must clearly reference these assigned docket numbers. All exceptions, briefs and replies along with certification of service to the above parties shall be filed with the Chief Clerk of the TCEQ electronically at <http://www10.tceq.state.tx.us/epic/efilings/> or by filing an original and seven copies with the Chief Clerk of the TCEQ. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in black ink, appearing to read "H. D. Card".

Henry D. Card
Administrative Law Judge

HDC/lh
Enclosures
cc: Mailing List

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STYLE/CASE: LOWER COLORADO RIVER AUTHORITY
SOAH DOCKET NUMBER: 582-08-2863
REFERRING AGENCY CASE: 2008-0093-UCR

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SOAH DOCKET NO. 582-08-2863
TCEQ DOCKET NO. 2008-0093-UCR

APPEAL OF THE RETAIL WATER § BEFORE THE STATE OFFICE
AND WASTEWATER RATES OF THE §
LOWER COLORADO RIVER § OF
AUTHORITY § ADMINISTRATIVE HEARINGS

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APPEAL OF THE RETAIL WATER § BEFORE THE STATE OFFICE
AND WASTEWATER RATES OF THE §
LOWER COLORADO RIVER § OF
AUTHORITY § ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION

I. INTRODUCTION AND SUMMARY

This is an appeal by retail customers of water and wastewater rates set by the Lower Colorado River Authority (LCRA) on August 22, 2007, for the West Travis County (WTC) Regional Water and Wastewater systems. The Administrative Law Judge (ALJ) is unable to make a revenue requirement determination based on the information available to him. He reaches findings and conclusions on the specific issues raised at the hearing that at least would reduce LCRA's rate increase. He recommends the staff of the Texas Commission on Environmental Quality develop rates based on the Commission's final Order.

On the specific issues raised at the hearing, the ALJ finds as follows:

Budgeted or Historical Test-Year Basis for Rates. LCRA set the rates at issue based on its budget forecast for Fiscal Year (FY) 2010. The rates were set in three yearly steps, with the final step to reach the FY 2010 level. The ALJ concludes a retail public utility may set rates based on a future budget. In this instance, however, the budget forecast for FY 2010 was not reliable enough for ratesetting on August 22, 2007. Likewise, the FY 2008 budget forecast, which was based on 2006 information, was not reliable enough for ratesetting. Actual FY 2007 information should be used to establish the rates.

Use of Volume as an Allocator for Shared and Indirect O&M Expenses. LCRA failed to prove that relative system volume is a cost-causative factor that should be used to allocate its

shared and indirect O&M expenses. Direct labor should be used to allocate those expenses, based on the evidence presented at the hearing.

Reasonableness of Specific O&M Expenses. With some exceptions, LCRA proved the reasonableness of its specific O&M expenses.

Debt Service Expense. LCRA proved the reasonableness of its debt service calculations.

Debt Service Coverage. LCRA proved the reasonableness of its debt service coverage calculation approach. LCRA's impact fees should not be used to offset debt service coverage expense.

Community Development Expense. LCRA properly assessed community development expenses against the WTC systems.

Non-Rate-Revenues. The Commission should not require LCRA to include an excess capacity revenue contribution in its non-rate revenues.

Rate Case Expenses. LCRA should not recover its rate case expenses. If the Commission disagrees with the ALJ's recommendations or otherwise finds rate case expenses should be recovered, that issue should be remanded for determination of the appropriate amount and recovery mechanism, based on the evidence already in the record.

II. DESCRIPTION OF LCRA AND APPELLANTS

LCRA is a political subdivision of the State of Texas, created and functioning as a non-profit conservation and reclamation district under Article XVI, Section 59 of the Texas Constitution.¹ It is also a retail public utility as defined in TEX. WATER CODE ANN.

¹ For clarity and efficiency, parts of this description and other parts of this Proposal for Decision are taken from parties' testimony or written arguments. An organization chart for LCRA can be found at Exhibit SZ-2, attached to the direct testimony of LCRA witness Suzanne Zarling, LCRA Ex. 1.

§ 13.002(19). LCRA provides energy, water, and wastewater, and community services. LCRA is organized into five business units: (1) Wholesale Power Services; (2) Transmission Electric Services; (3) Water Services; (4) Community Services; and (5) Corporate Services.²

The Water Services Business Unit (WSBU) operates the Highland Lakes dams and hydroelectric generating facilities; provides water and wastewater utility services; and manages surface water resources. WSBU itself is divided into four operating units: (1) Water and Wastewater Utility Services (WWUS); (2) Raw Water; (3) Hydroelectric; and (4) Irrigation.

WWUS operates LCRA's water and wastewater systems. In 2007, LCRA owned and/or operated 40 water and wastewater systems that provided service across mostly rural and suburban Central and South Central Texas, serving a population of over 250,000 in 13 counties. WWUS, in turn, is divided into four geographic regions: (1) the Williamson County Region; (2) the Southwest Region; (3) the Hill Country Region; and (4) the West Travis County Region. WWUS accounts for approximately 1.5 percent of LCRA's total revenues.³

LCRA first entered the retail water and wastewater business in the 1990s. LCRA witness Suzanne Zarling described LCRA's utility systems as falling into a few descriptive categories. The first category is small systems, commonly serving fewer than several hundred connections. Those systems often were constructed by developers and either turned over to the residents or to small entities that did not have the means to make needed capital improvements. The second category is systems where LCRA got involved to address regulatory, environmental, or public health concerns. A third category is systems built to serve LCRA facilities. The fourth category is regional systems designed to provide efficient services to meet needs in growing areas that cross jurisdictional boundaries. The West Travis County (WTC) systems, which are the subject of this case, fall into the last category.

² The Corporate Services Business Unit (CSBU) provides support to the other units and its costs are assigned or allocated to those units.

³ Tr. Vol. 1 at 80.

The WTC Region consists of two potable water systems (the WTC Regional Water System and the Glenlake Water System), one wastewater treatment and collection system (the WTC Regional Wastewater System), two wastewater collection systems (West Lake Hills Wastewater System and Rollingwood Wastewater System), and a raw water intake and pumping system (Lakeway Regional Raw Water System). LCRA acquired the WTC Regional Water System in 1994 and the WTC Regional Wastewater System in 2000.

The WTC Regional Water System served approximately 4,200 retail water meters and seven wholesale meters at the end of FY 2007.⁴ According to Kelly Payne, Senior Engineer for LCRA Water Services Engineering and Planning, demand is better measured by Living Unit Equivalents (LUEs) than by connections, because of variability in meter sizes and demand. By that measure, the WTC Regional Water System served approximately 7,600 LUEs at the end of FY 2007, consisting of about 2,200 wholesale LUEs and about 5,400 retail LUEs. It served several areas and subdivisions, including the City of Bee Cave (Bee Cave) and the Lake Pointe subdivision.⁵

At the end of FY 2007, the WTC Regional Wastewater System served approximately 1,700 total LUEs. It served the Lake Pointe Subdivision, the Falconhead and Spanish Oaks Subdivisions, and commercial development in Bee Cave and its ETJ along FM 2244, RM 620, and State Highway 71.⁶

This case is an appeal by Bee Cave and the West Travis County Municipal Utility District Nos. 3 and 5 (the Districts) of the rate increase for the WTC Regional Water Systems and an appeal by only the Districts of the rate increase for the WTC Regional Wastewater System.⁷

⁴ LCRA's FY 2007 was from July 1, 2006, through June 30, 2007.

⁵ LCRA Ex. 2 (Payne Testimony), pages 9-10. An LUE is defined as the water demand for a typical single-family residential unit.

⁶ LCRA Ex. 2, pages 16-17.

⁷ During the hearing, the Districts' exhibits were marked "WTC." The ALJ found that designation confusing in writing this Proposal because of the many "W" acronyms involved in this case. Therefore, he uses "the

Bee Cave is a small, but rapidly growing city in Travis County, west of Austin. The Districts are municipal utility districts that provide service in the Lake Pointe subdivision, near Bee Cave.

The area served by those systems is hilly, rugged, and remote from reliable water supplies. It is also environmentally sensitive. Many of the WTC Regional Water System’s customers in the Bee Cave area use high volumes of water, particularly in the summer months. The average summer water use in that area is 25,000 gallons per month. The high volume is significant in this case, because LCRA allocates much of its shared and indirect operating costs among its regions and systems according to the volume of water use.

The other WWUS Region that was discussed at some length in this proceeding was the Hill Country Region. That region contained 17 non-contiguous rural water systems, two wastewater systems, and one biosolids composting facility in five counties to the west of Austin. Although the number of water customers for WTC Water was approximately the same as for the Hill Country Region in August of 2007 (4,176 for WTC Water and 4,076 for the Hill Country Region), the volumes of water used were considerably different: 2,120,325,300 gallons for WTC Water and 359,949,593 gallons for the Hill Country Region.⁸

III. JURISDICTION, NOTICE, AND PROCEDURAL HISTORY

The Commission has jurisdiction over these appeals pursuant to TEX. WATER CODE ANN. § 13.043. The relevant portions of that section state:

* * *

(b) Ratepayers of the following entities may appeal the decision of the governing body of the entity affecting their water, drainage, or sewer rates to the commission:

Districts,” as they themselves did in their written arguments. If Bee Cave and the Districts are referred to collectively, they will be referred to as “Appellants.”

⁸ Ex. BC-8, Tr. Vol. 1, pages 51-57, 115-116.

* * *

(4) a district or authority created under Article III, Section 52, or Article XVI, Section 59, of the Texas Constitution that provides water or sewer service to household users;

* * *

(c) An appeal under Subsection (b) of this section must be initiated by filing a petition for review with the commission and the entity providing service within 90 days after the effective day of the rate change or, if appealing under Subdivision (b)(2) or (5) of this section, within 90 days after the date on which the governing body of the municipality or affected county makes a final decision. The petition must be signed by the lesser of 10,000 or 10 percent of those ratepayers whose rates have been changed and who are eligible to appeal under Subsection (b) of this section.

* * *

(e) In an appeal under Subsection (b) of this section, the commission shall hear the appeal de novo and shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken. The commission may establish the effective date for the commission's rates at the original effective date as proposed by the service provider, may order refunds or allow a surcharge to recover lost revenues, and may allow recovery of reasonable expenses incurred by the retail public utility in the appeal proceedings. The commission may consider only the information that was available to the governing body at the time the governing body made its decision and evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings. The rates established by the commission in an appeal under Subsection (b) of this section remain in effect until the first anniversary of the effective date proposed by the retail public utility for the rates being appealed or until changed by the service provider, whichever date is later, unless the commission determines that a financial hardship exists.

* * *

(h) The commission may, on a motion by the executive director or by the appellant under Subsection (a), (b), or (f) of this section, establish interim rates to be in effect until a final decision is made.

(i) The governing body of a municipally owned utility or a political subdivision, within 30 days after the date of a final decision on a rate change, shall provide individual written notice to each ratepayer eligible to appeal who resides outside the boundaries of the municipality or the political subdivision. The notice must

include, at a minimum, the effective date of the new rates, the new rates, and the location where additional information on rates can be obtained.

(j) In an appeal under this section, the commission shall ensure that every rate made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly shall be just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of customers. The commission shall use a methodology that preserves the financial integrity of the retail public utility. For agreements between municipalities the commission shall consider the terms of any wholesale water or sewer service agreement in an appellate rate proceeding.

The Commission received petitions of appeal from Appellants on November 30, 2007, which was less than 90 days after the rates were set and therefore within the 90-day time limit established by TEX. WATER CODE ANN. § 13.043(c) and 30 TEX. ADMIN. CODE (TAC) § 291.41(c). It referred the petitions to the State Office of Administrative Hearings (SOAH). SOAH has jurisdiction over all matters relating to the conduct of a hearing in this proceeding, including the preparation of a proposal for decision with findings of fact and conclusions of law, pursuant to TEX. GOV'T CODE ANN. § 2003.047 and TEX. WATER CODE ANN. § 5.311.

Although the matter was first referred to SOAH in January of 2008, the administrative record was not transferred until May 16, 2008, and the affidavit of public notice was filed on August 4, 2008. The preliminary hearing was held August 19, 2008. At the preliminary hearing, jurisdiction was established and the following parties were designated: LCRA, Bee Cave, the Districts, the Office of Public Interest Counsel (OPIC)⁹, and the Commission's Executive Director. No discovery or hearing schedule was set, to allow the parties the opportunity for further discussions.

Those discussions continued into February of 2009, when LCRA informed the ALJ that the parties had reached what LCRA described as a temporary procedural impasse. One of the issues about which the parties could not agree was whether LCRA or the Appellants had the burden of proof in the proceeding. The Appellants and OPIC contended LCRA had the burden

⁹ OPIC did not participate in the hearing, but submitted a written closing argument on two issues.

of proof. LCRA and the Executive Director claimed the Appellants had the burden of proof pursuant to TEX. WATER CODE ANN. § 49.2122.

After briefing, the ALJ ruled in favor of the Appellants, concluding that LCRA had the burden of proof in this proceeding.¹⁰ Subsequently, the ALJ set a procedural schedule. Because potentially conflicting interpretations of TEX. WATER CODE ANN. § 49.2122 had been issued in other SOAH cases, however, the ALJ abated that procedural schedule. The ALJs in this and the two other cases sent joint certified questions to the Commission on May 1, 2009.

The Commission issued its Interim Order answering those certified questions on August 20, 2009. In that Order, the Commission determined that a district whose ratepayers have appealed under TEX. WATER CODE ANN. § 13.043(b) must still demonstrate that its rates are just and reasonable. The Commission further determined that TEX. WATER CODE ANN. § 49.2122(b) only creates a presumption that *customer classes*, as opposed to rates, established by a district are properly established absent a showing that the district action establishing the classes was arbitrary and capricious. Therefore, LCRA has the burden of proof in this proceeding.

After the Commission's Interim Order, the ALJ granted Bee Cave's motions to end the abatement of the proceedings and to set interim rates at the level of LCRA's second-step increase. The parties agreed that the Commission, in deciding this appeal, must consider only information available to LCRA's governing body at the time the rates were set. The parties did not otherwise agree on the type of information LCRA was required to use, however.

As mentioned above, in setting its rates, LCRA used its budget forecast for FY 2010, as set out in its FY 2007 Business Plan. The Appellants contend that LCRA's rates must be based on a historical test year adjusted for known and measurable changes. LCRA contends that its rates may be set on a future budget. Initially, the ALJ proposed to certify that question to the Commission as well. In discussing the language of the potential certified questions, however,

¹⁰ See Order No. 3 (March 26, 2009)

several parties cited SOAH Docket No. 582-05-0003, TCEQ Docket No. 2004-0979-UCR, *Petition Requesting Review of Chisholm Trail Special Utility District's Rate Increase Pursuant to Texas Water Code Section 13.043*. (PFD issued Feb. 8, 2006; Order issued May 3, 2006) (*Chisholm Trail*). After reviewing those pleadings and that case, which is discussed in more detail later in this Proposal for Decision, the ALJ determined the Commission had already decided that a retail public utility may use a future budget to support its proposed rates. Therefore, the ALJ decided not to certify that question and instead set a procedural schedule that would have led to a hearing in May-June 2010.¹¹

Chisholm Trail did not address whether it is appropriate and legal to use a budget or forecast for several years in the future to set rates. The parties continue to disagree on that issue, on whether LCRA's evidence and approach meet the *Chisholm Trail* standard, and generally on whether the rates adopted by LCRA on August 22, 2007, were just, reasonable, and not unreasonably preferential, prejudicial, or discriminatory, as required by TEX. WATER CODE ANN. § 13.043.

LCRA requested reconsideration of the procedural schedule, contending the schedule denied LCRA due process because it required LCRA to file its direct testimony and exhibits before engaging in full discovery on the other parties. LCRA also requested reconsideration of the interim rate issue. The ALJ denied those requests.¹²

On April 1, 2010, Appellants filed a Motion for Summary Disposition. The ALJ denied the motion in an order issued April 27, 2010. The existence of that motion, however, plus a scheduling conflict involving one of LCRA's witnesses,¹³ convinced the ALJ that the procedural schedule needed to be revised. He reset the hearing for August 23-September 3, 2010.

¹¹ See Order No. 10 in this proceeding.

¹² See Order Nos. 11 and 12.

¹³ LCRA had asked that witness Suzanne Zarling be allowed to present her direct testimony and exhibits at the schedule June 25, 2010 prehearing conference instead of at the beginning of the hearing because Ms. Zarling would be out of the country during the hearing dates.

On May 6, 2010, LCRA moved to set separate hearing dates for rate-case-expense issues. The ALJ granted that motion over Bee Cave's opposition.

LCRA filed its Motion to Limit Scope of Hearing on August 17, 2010. In that motion, LCRA sought to preclude parties from admitting into the record any evidence (1) regarding the establishment of different rates among customer classes from the West Travis County Regional Water and Wastewater Systems and (2) any information regarding the rates at issue that was not available to the LCRA Board at the time the rates were adopted, other than information pertaining to rate case expenses and possible surcharges or refunds. After hearing argument at the prehearing conference, the ALJ granted the motion with regard to the second issue (information not available to the Board) and denied it with regard to the first issue. The evidence was limited to information that was available at the time, regardless of whether the Board actually reviewed it. The ALJ also declined to adopt the list of issues proposed by Bee Cave.

On August 24, 2010, LCRA filed its Motion for Assessment of Recording and Transcription Costs. Appellants responded to that motion on September 20, 2010. LCRA requested that those costs be divided between it and the Appellants. The Appellants requested that LCRA pay those costs. That motion was carried with the case and is addressed in this Proposal.

The hearing on the merits was convened August 23, 2010, and adjourned September 8, 2010, after eleven days of hearing.¹⁴ The rate-case-expense phase was convened November 9, 2010, and adjourned November 10, 2010. The parties filed their initial written closing arguments on October 29, 2010. They filed their written replies, which also addressed the rate-case-expense issues, on December 10, 2010. The record closed on December 13, 2010, with the filing of the Executive Director's supplement to his reply.

¹⁴ The hearing was not held Friday, August 27 or Monday, September 6, 2010.

IV. DESCRIPTION OF THE RATE INCREASES

The LCRA Board of Directors adopted new rates for the WTC Regional Systems on August 22, 2007. The Board set the rates based on LCRA's budget projections for FY 2010, to increase in three steps, effective October 1, 2007, 2008, and 2009.¹⁵ The water system revenue requirement for FY 2010, not including raw water expense, was \$13,578,764, compared to FY 2006 revenues of \$6,635,631. The wastewater system revenue requirement for FY 2010 was \$2,884,274, compared with FY 2006 revenues of \$1,324,042.¹⁶ The comparison of revenues to the FY 2010 revenue requirements is somewhat deceiving, because LCRA's cost-of-service study anticipated that a substantial portion of the increased revenues would be achieved through increased connections.¹⁷ Nevertheless, the rate increases are substantial.

The adopted water rates increased both the base charges and the volume charge, which itself increases with higher consumption levels. The rates were designed to minimize the base-rate increases and recover the remainder through the volumetric rates. The median residential water usage in the WTC system at the time of the rate increase was just below 10,000 gallons per month. For a residential customer using 10,000 gallons in the Bee Cave District, the final rate would result in a monthly bill of \$82.65, which is an increase of \$29.95 per month over the bill before the rate increases.

The adopted rates would also increase both the monthly base charge and the volume charge for wastewater customers. For a residential customer with a winter average of 10,000 gallons, the final rate would result in a monthly bill of \$109.50, which is an increase of \$52.00 per month over the bill before the rate increases.¹⁸

¹⁵ LCRA's Staff originally intended to present the rate changes to the Board in September of 2006 as a two-step increase. That plan was postponed to allow an audit of the Water Wastewater Operating Unit and its financial options by the Barrington-Wesley Group (BWG) and to seek input from customers. Eventually the three-step increase was adopted on August 22, 2007. See LCRA Ex. 1 pages 22-23.

¹⁶ See LCRA Ex. 1 (Zarling testimony), Exhs. SZ-7, pages 41 and 149, and SZ-13 and SZ-14.

¹⁷ See SZ-7 at Tables 2W and 2S.

¹⁸ LCRA Ex. 1, Exh. SZ-9, page 19. The entire three-phase rate increase schedule is included in Exh. SZ-9.

The impetus for the rate increase began in the mid-2000s.¹⁹ In January 2005, LCRA formed an internal group called the Water Utility Oversight Group (WUOG) to analyze the water and wastewater finances and operations. LCRA also commissioned an independent assessment of the WWUS operations from R. W. Beck. Among other observations, R.W. Beck concluded rate increases were needed in many systems, including the WTC Regional Systems, to cover the cost of providing services. LCRA hired Rimrock Consulting to perform a cost-of-service study for the WTC Regional Systems. Although it included some historical information for reference, that cost-of-service study was designed only to allocate the revenue requirements. Those revenue requirements themselves, and the underlying information for FY 2007-2010, were supplied by LCRA based on its budgets for those fiscal years as of the time of the study. Those budgets had their foundation in the FY 2007 business planning process.²⁰

LCRA's Staff originally intended to present the rate changes to the Board in September of 2006 as a two-step increase. That plan was postponed to allow an audit of the Water Wastewater Operating unit and its financial option by the Barrington-Wesley Group (BWG) and to seek input from customers. Eventually the three-step increase was adopted on August 22, 2007. *See* LCRA Ex. 1 pages 22-23. The first two steps did not correspond to the calculated revenue requirements for FY 2008 and 2009.²¹

V. LCRA'S USE OF BUDGET FOR RATESETTING

A. Use of Historic Test Year or Future Budget

As mentioned above, this rate appeal is governed by TEX. WATER CODE ANN. § 13.043(j), the relevant portion of which states:

¹⁹ The water rates were previously raised in 2003; the wastewater rates were previously raised in 2004. LCRA Ex. 1, page 20,

²⁰ Tr. Vol. 1 at 18, 126.

²¹ LCRA Ex. 1, pages 22-25; LCRA Ex. 6 (Flores Testimony), page 9.

(j) In an appeal under this section, the commission shall ensure that every rate made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly shall be just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of customers. The commission shall use a methodology that preserves the financial integrity of the retail public utility

TEX. WATER CODE ANN. § 13.002 defines both "retail public utility," "test year," and "utility:"

(19) "Retail public utility" means any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.

* * *

(22) "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.

* * *

(23) "Water and sewer utility," "public utility," or "utility" means any person, corporation, cooperative corporation, affected county, or any combination of these persons or entities, other than a municipal corporation, water supply or sewer service corporation, or a political subdivision of the state, . . . owning or operating for compensation in this state equipment or facilities for the transmission, storage, distribution, sale, or provision of potable water to the public or for the resale of potable water to the public for any use or for the collection, transportation, treatment, or disposal of sewage or other operation of a sewage disposal service for the public, other than equipment or facilities owned and operated for either purpose by a municipality or other political subdivision of this state or a water supply or sewer service corporation

All the parties agree that LCRA is a retail public utility under the statute. Appellants contend that Section 13.002(22) and other statutory provisions, rules and Commission precedent require LCRA to present a historic test year, adjusted for known and measurable changes, to prove the reasonableness of the rates under appeal. LCRA, OPIC, and the Executive Director

contend that LCRA may base its rates on a future budget.²² The ALJ concludes LCRA, OPIC, and the Executive Director are correct.

Appellants are correct that the first sentence of Section 13.002(22) specifically refers to “a retail public utility” in its definition of “test year.” Neither that definition nor any other section of the statute or the Commission’s rules requires a retail public utility to use a historic test year, or any test year, in setting its rates, however. The second sentence of Section 13.002(22), which sets out the requirement for a rate filing, refers only to “a utility,” not to “a retail public utility.” LCRA is not a “utility” under the statute.

Bee Cave cites the legislative history of Section 13.002(22) to support its position.²³ The ALJ agrees that the Legislature knowingly added “retail public utility” to the definition of “test year” in 1989, when it added that term to many subsections of Section 13.002. It is equally true, however, that despite that definition, the Water Code nowhere states that a retail public utility must use a historic test year, or any test year, in establishing its rates or proving them reasonable on appeal.

The statute does give the Commission broad rulemaking power to implement its regulatory mandate.²⁴ To that end, the Commission has adopted 30 TAC ch. 291,

to establish a comprehensive regulatory system under Texas Water Code Chapter 13 to assure rates, operations, and services which are just and reasonable to the consumer and the retail public utilities, and to establish the rights and responsibilities of both the retail public utility and consumer.²⁵

Under that comprehensive scheme, the Commission has adopted two separate subchapters for utility rate change filings under TEX. WATER CODE ANN. § 13.187:

²² Although OPIC and the Executive Director agree with LCRA on this issue, they do not support LCRA’s use of the Fiscal Year 2010 budget as the basis for its rates.

²³ See Bee Cave’s Closing Argument, pages 11-15.

²⁴ TEX. WATER CODE ANN. § 13.041(b).

²⁵ 30 TAC § 291.01.

Subchapter B, which applies to applications to the Commission to change rates, and Subchapter C, for ratemaking appeals, such as this one. Subchapter B specifically sets out the type of information the utility must provide, including a proscription that

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.²⁶

Subchapter C contains no similar language and is far less restrictive in general. Under that Subchapter, the Commission does not mention the use of a test year and charges itself simply with ensuring

that every rate made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly is just and reasonable. Rates must not be unreasonably preferential, prejudicial, or discriminatory but must be sufficient, equitable, and consistent in application to each class of customers. The commission shall use a methodology that preserves the financial integrity of the retail public utility.

Unlike in Subchapter B, no particular methodology is delineated for achieving those goals. The ALJ concludes that neither the Water Code nor the Commission's rules require a retail public utility to present test-year data to establish the reasonableness of its rates on appeal.

Chisholm Trail is the one of two cases to address the ratemaking requirements for a retail public utility on appeal to the Commission. In that case, ratepayers of Chisholm Trail Special Utility District appealed a water rate increase. Whether Chisholm Trail's rate design produced rates that were just, reasonable, and nondiscriminatory to all groups of ratepayers was the major PFD issue, although some minor cost of service issues were also considered.

Chisholm Trail conducted a cash-basis cost-of-service study that utilized the District's 2002-2003 audited fiscal year expenses as the test year for calculation of the District's cost of

²⁶ 30 TAC § 291.31(b).

service. The test year expenses were then adjusted for known and measurable changes, based on the District's 2003-2004 fiscal year budget.

The ALJ and the Commission determined Chisholm Trail's approach was lawful and established the reasonableness of the revenue requirement on which its rates were based. In Finding of Fact No. 17, the Commission stated:

17. It is reasonable and appropriate for the District to adjust its test year expenses according to its budgeted expenses.
 - a. The calculation of a utility's costs of service using budgeted expenses is appropriate for a political subdivision.
 - b. Virtually all political subdivisions calculate the cost of service using budgeted expenses.
 - c. This practice is consistent with standard ratemaking principles provided the budget is a reliable forecast of anticipated expenses.
 - d. The District's actual expenses were within 3% of its budget, indicating the District's budget is a reliable forecast of anticipated expenses.

Although LCRA had a cost-of-service study performed, it did not set its revenue requirement based on that study, but rather on its FY 2010 budget projections. *Chisholm Trail* does not endorse LCRA's specific methodology, but it establishes a general proposition that a retail public utility may use its budgeted expenses in setting its rates, provided that budget is a reliable forecast of anticipated expenses.²⁷

Both Bee Cave and the Districts also cited a more recent case, SOAH Docket No. 582-09-0660, TCEQ Docket No. 2008-1481-UCR, *Application of North San Saba Water Supply*

²⁷ The LCRA cost-of-service study contains the statement, "If the authority were to be confronted with a water or sewer rate challenge, it would be required by the TCEQ to present a cost-of-service study based on a 'test year' or a historical year for which actual utility costs are known and are supported by audited cost figures." LCRA Ex. 1, Exh. SZ-7, page 3. Although that statement is certainly germane to this issue, the ALJ has not relied upon it in reaching his decision, partly LCRA because witness Mickey Fishbeck, who prepared the study, disavowed it, but primarily because that opinion would not bind the Commission. See LCRA Ex. 5 (Fishbeck Testimony, page 10).

Corporation to Change Its Water Rates Under Certificate of Convenience and Necessity No. 11227 in San Saba County (PFD issued March 25, 2009; Order issued June 2, 2010) (*North San Saba*) for the proposition that a retail public utility must use a historic test year, adjusted for known and measurable changes, to develop rates that are just and reasonable. *North San Saba* was an appeal under TEX. WATER CODE ANN. § 13.043 of a water rate increase. In that case, the Board of North San Saba WSC had received a notice of a rate increase by its primary supplier, the City of San Saba. The Board reached the decision to increase rates by considering its net operating loss, then increasing the rates by the same percentage as the City of San Saba had increased its rates. The Board did not perform a cost-of-service study or perform any additional calculations or studies to determine the new rate amount.

At the *North San Saba* hearing, the Executive Director presented his own cost-of-service study prepared by the Commission's Staff. The Executive Director determined the rate increase was not justified. The ALJ and the Commission agreed.

The Commission determined that North San Saba WSC had not met its burden of proving the rate increase was necessary. The decision in that case, however, does not stand for the proposition that a retail public utility must use a historic test year, adjusted for known and measurable changes. The Proposal for Decision, in fact, says the opposite:

North San Saba was not required to conduct a rate study and did not conduct one.

* * *

[I]t was still North San Saba's burden to show that the increased rates were just and reasonable. North San Saba has not met this burden. This is not to say that North San Saba needed a formal rate study. It did, however, need to provide more information to support a 35% rate increase.²⁸

OPIC, in its Reply to Closing Arguments, provided the best analysis of this issue. OPIC concluded that neither the statute nor the rules nor Commission decisions require a retail public utility to use a historical test year to set its rates. LCRA's use of its FY 2010 budget instead,

²⁸ *North San Saba* PFD at pages 7-8.

however, placed significant additional burdens on Appellants, the Commission Staff, and LCRA itself in determining whether the rate increase was justified.

B. LCRA'S Use of FY 2010 Budget

Although *Chisholm Trail* and the statutes and rules allow a retail public utility to use a budget to set rates, that determination does not settle the issue of whether LCRA's ratemaking approach, which used FY 2010 budget information to set rates in August of 2007, is allowable. LCRA argues, obviously, that it is. Appellants and the Executive Director argue that it was not. While Appellants contend FY 2007 information, adjusted for known and measurable changes, should have been used, the Executive Director contends LCRA should have used the FY 2008 cost-of-service study budget, because it was the most recent future year available beyond August 22, 2007.

Ms. Zarling testified that each year LCRA adopts a five-year budget for planning purposes, with spending authorized for the first year. The budget is usually not revised during the year, but is revisited and revised the subsequent year:

Q Each year LCRA presents for approval by the board of directors a five-year budget. It is a -- we call it the business plan, and when we present it to the board, it is an indication to the board of what expenses we expect to have over the next five years, what revenue we expect to generate over the next five years, what will drive those costs, capital improvements or O&M increases. And then the board actually approves the business plan and approves spending for the first year of that five-year budget cycle.

Q Now, is there any difference, in your opinion, between a budget and a forecast?

A In my opinion, all budgets are forecasts because until you're actually doing the work, you don't know how it's going to work out. And when we prepare a budget, we prepare what we believe is a five-year budget. It's really important to us, and particularly, in the water and wastewater utility business, because we have so many infrastructure improvements that have to be made, and we have to plan when those improvements will need to come online and start planning how we're going to fund those improvements as they come online. So just having a one-year budget

wouldn't really give us an adequate look, so it is a five-year budget for our purposes.

Q Now, just to clarify, because I thought I heard you say that every year a budget is presented to your board, but it has information in it about five years. So each year the presentation is made. Are adjustments made to the budget only at that time, during the yearly presentation to the board? How are adjustments to the budget handled, I guess, is the question?

A Typically adjustments to the budget are just made the following year as we bring a new business plan. There may be some circumstances under which a budget would be amended during a year, and I can't think of any. I don't recall having done that.²⁹

Appellants and the Executive Director argued that the budgets for the outer years were not budgets at all, but merely forecasts of future spending and revenues. LCRA contended just as vigorously that the years beyond the first year of the business plan are part of the budget and should be treated as such. Although *Chisholm Trail* discussed and approved the use of budgeted expenses, the use of the word “budget” does not automatically make a retail public utility’s anticipated expenses just and reasonable, which is the underlying criterion for setting rates set out in TEX. WATER CODE ANN. § 13.043(j). In *Chisholm Trail*, the Commission found that the budget must be “a reliable forecast of anticipated expenses.” Even if the Commission had never made that finding, it is axiomatic that rates must reflect costs. LCRA argued that its budgeting process was thorough and comprehensive, but the evidence also showed that the budget is reevaluated each year. Indeed, not all of the elements of the FY 2010 budget shown in the cost-of-service study were thoroughly or comprehensively determined—for example, allocated expenses were merely increased three percent per year to account for anticipated inflation.³⁰ Even the most thorough and comprehensive analysis, moreover, cannot necessarily see years into the future. The ALJ finds that FY 2010 budget data was not a reliable forecast of anticipated expenses for setting rates in 2007. The use of that data was not just and reasonable.

²⁹ Tr. Vol. 1 at 36-38.

³⁰ Tr. Vol. 7 at 1371.

Bee Cave argues that because LCRA's ratemaking approach was unreasonable, the rates should necessarily revert to the pre-August 2007 levels. The ALJ disagrees. TEX. WATER CODE ANN. § 13.043(e) states:

In an appeal under Subsection (b) of this section, the commission shall hear the appeal de novo and shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken.

In support of its position, Bee Cave cites a recent TCEQ case, *Application of Double Diamond Utilities, Inc. to Change Rates*,³¹ for the proposition that an applicant's rates should be rolled back to previous levels when it fails to meet its burden of establishing its proposed rates were just and reasonable. That case was decided under a different statutory provision, however. Moreover, the issue in that case was whether the rates should be rolled back to their previous level or should be set below that level, as suggested by the evidence. Although both Appellants' witnesses advocated dramatic cuts in the WTC systems' expenses, neither suggested the rates be set below the pre-August 22, 2007 levels. *Double Diamond* is not germane to this case.

LCRA points out that the rates would be higher if FY 2007 data were used, because the higher revenue requirement in FY 2010 was mitigated by the anticipated growth in connections. That contention was not disputed.³² Be that as it may, reliable data should still be used.

LCRA takes that argument one step further, observing that if had used FY 2007 data to increase its rates, higher rates would have resulted immediately, to the detriment of the ratepayers.³³ LCRA still would have been free to phase-in any increase, however.

³¹ SOAH Docket No. 582-08-0698, TCEQ Docket No. 2007-1708-UCR (PFD issued June 15, 2009, Order issued Nov. 13, 2009).

³² LCRA's Closing Argument at 23; LCRA Ex. 6 (Flores testimony) at 19-20. That calculation depends on the FY 2007 expenses and revenues for the WTC Systems being accurate, just and reasonable, a condition that the Appellants dispute.

³³ See LCRA Ex. 11 (Kellicker Rebuttal), page 4; LCRA Ex. 6, page 17

C. Basis for Calculating Revenue Requirement

Executive Director witness Debi Loockerman used the cost-of-service study's FY 2008 figures to calculate LCRA's revenue requirement. The LCRA Board approved the FY 2008 budget before August 22, 2007. However, the cost-of-service study was finished in September 2006 and used actual data approximately through April or May of 2006.³⁴ Therefore, the figures used by Ms. Loockerman were not actual FY 2008 budget figures, but were projections themselves based on data that were more than a year old at the time the rates were set. Although Ms. Loockerman believed LCRA's use of a FY 2010 budget for ratesetting was inappropriate based on the lack of reliability for such a projection, she believed the FY 2008 projections were adequate.

The ALJ disagrees. It would have been reasonable for LCRA to have used its actual FY 2008 budget, set in the summer of 2007, to set rates in August of 2007. The cost-of-service study's projected FY 2008 budget, based on data more than a year old, was not a reliable forecast of anticipated expenses. As Ms. Loockerman herself stated,

I don't think you can accurately predict the future anyway. I think as you go out further in time it gets less accurate.³⁵

A one-page summary WTC Water System budget for FY 2008 is in the record at BC Exhibit 75.³⁶ That budget differs from the FY 2008 cost-of-service study figures used by the Executive Director in many respects,³⁷ calling into question the accuracy of the FY 2008 forecast.

In the absence of a reliable budget adopted close in time to the actual rate increase, the ALJ finds LCRA's actual FY 2007 data should be the starting point for ratesetting in this case.

³⁴ Tr. Vol. 7 at 1392-93.

³⁵ Tr. Vol. 11 at 2241.

³⁶ BC Ex. 75 was supplied by LCRA in response to a discovery request asking for the FY 2008 budget. LCRA's Treasurer and former Controller James Travis, however, stated he had never seen that document and was not familiar with it. Tr. Vol. 4 at 643-48. No corresponding WTC Wastewater System budget sheet is in the record.

³⁷ For example, BC Ex. 75 shows lower debt service cost and higher operations and maintenance expense.

LCRA provided not only the final actual expense numbers, but underlying data supporting those numbers. Those actual figures were available at the time the Board set the rates that are at issue in this case.

The actual FY 2007 figures are not without flaws as a ratesetting tool. They do not reflect LCRA's most current adopted budget at the time the rates were set (using the budgetary approach), nor do they include known and measurable changes (using the more traditional approach applicable to investor-owned utilities).³⁸ Nevertheless, they have the advantage of being actual figures, not long-term projections. Both Bee Cave witness Nelisa Heddin and Districts' witness Donald Rauschuber recommended the use of FY 2007 actual data in setting rates.³⁹

VI. REVENUE REQUIREMENT AND RATE DESIGN

Exhibit SK-4, attached to the direct testimony of LCRA Manager of Corporate fiancé Stephen Kellicker, is a comparison of the WTC Systems' FY 2007 budget to actual revenues and expenses. That exhibit is summarized below:⁴⁰

<i>WTC WATER</i>	Budget	Actual
Revenues (excluding impact fees)	\$11,138,415	\$8,414,847
Direct O&M	1,453,960	1,954,429
Shared & Indirect O&M	<u>3,575,023</u>	<u>3,946,888</u>
Total O&M Expenses	5,028,983	5,901,317
Debt Service	4,602,758	4,549,074

³⁸ LCRA witness Jack Stowe listed some types of "known and measurable" adjustments in his rebuttal testimony, LCRA Ex. 12, pages 7-8. Bee Cave's and the District's witnesses both made downward adjustments, which they considered to be known and measurable, to the FY 2007 figures.

³⁹ Bee Cave Ex. 1, page 10; Districts Ex. 1, page 31.

⁴⁰ SK-4 breaks the O&M expenses into numerous categories. Because they are so numerous, the ALJ shows only the sub-totals and totals above. Because LCRA calculated an underrecovery, the "actual" community development expense number does not represent funds actually contributed by ratepayers.

Operations Reserve ⁴¹	57,650	179,997
Times Coverage @ 1.25	1,150,692	1,137,269
Community Development	298,333	298,333
Total Expenses	\$11,138,415	\$12,065,990
Net Over (Under) Recovery	0	(\$ 3,651,143)

WTC WASTEWATER	Budget	Actual
Revenues (excluding impact fees)	\$3,332,947	\$1,781,351
Direct O&M	506,589	609,681
Shared & Indirect O&M	<u>436,364</u>	<u>437,779</u>
Total O&M Expenses	942,953	1,047,459
Debt Service	1,844,074	1,857,034
Operations Reserve	0	47,340
Times Coverage @ 1.25	461,020	464,259
Community Development	84,901	84,901
Total Expenses	\$ 3,332,947	\$ 3,500,993
Net Over (Under) Recovery	0	(\$ 1,719,642)

A. O&M Expenses

Appellants challenged LCRA's O&M expenses on two fronts. Appellants challenged LCRA's procedure for allocating shared and indirect expenses. In particular, Appellants claimed LCRA's use of water and wastewater volumes to allocate cost-center expenses among the various systems inappropriately transferred costs from low-volume systems, such as the Hill Country Region, to high-volume systems, such as Appellants. Allocation methodology aside, both Bee Cave witness Heddin and Districts witness Rauschuber also analyzed and eliminated a number of direct and shared and indirect expenses because, in their opinion, those expenses

⁴¹ Although Exh. SK-4 shows expenses for Operations Reserve, LCRA did not seek to recover operations reserve expense separately in its cost-of-service study, as that was accomplished through the debt service coverage. See LCRA Ex. 1, Exh. SZ-7, page 41; Tr. Vol. 5, pages 843-44.

should have been capitalized, were unrelated to providing service, or were non-recurring or otherwise unreasonable.

1. Allocation of Shared and Indirect Expenses

All work performed by LCRA, including work that benefits the WTC Regional Systems, is recorded on LCRA's books and records via work order entries. That procedure applies to all direct and shared/indirect costs. When a work order is set up, a combination of components from LCRA's chart of accounts is assigned to that work order. That combination directs the transaction to a specific business unit or units and cost center(s). Direct and indirect operating and support costs that are attributed to the WTC Regional Systems may originate in any business unit in LCRA, depending on the services provided and received. Operating costs originate primarily in the WSBU and may include costs from other operating units within the WSBU, such as the WWUS. Support costs and shared/indirect costs originate in the WSBU and the CSBU.⁴²

Four general cost pools contain costs that ultimately are allocated to the WTC Regional Systems and other systems. Those cost pools are:

1. Corporate Services level expenses (CSBU);
2. Water Services Business Unit (WSBU) expenses, which represent
 - (a) WSBU Internal Overhead expenses and
 - (b) New Business Development expenses;
3. WWUS expenses, which represent
 - (a) WWU Common Expenses and
 - (b) Retail Customer Services expenses; and
4. West Travis County Region (WTCR) level expenses, which represent
 - (a) Region general expenses and
 - (b) Operating Center expenses.

⁴² See LCRA Ex. 3 (Travis Testimony), pages 6-8. LCRA's structure is described on pages 2-3 of this Proposal.

The procedures for allocating the various costs is described in LCRA's Cost Allocation Manual (CAM) and two memoranda.⁴³

The CSBU costs are assigned to the other business units by direct charging or, when that is not deemed feasible, through allocation. Those CSBU residual expenses are allocated to those units through various means, such as head count (human resources) or operating revenues (overall governance costs, such as the General Manager and the Board). The amount allocated to WWUS is first allocated to systems where there is no volume⁴⁴ based on the percentage of direct labor of the system. The remainder is allocated to the volume-drive systems based on their relative volumes.

WSBU Internal Overhead costs are allocated to the four operating systems (of which WWUS is one) based on relative labor hours. As with the corporate residual costs, the WWUS share is first allocated to systems where there is no volume based on the percentage of direct labor of the system. The remainder is allocated to the volume-driven systems based on their relative volumes.

WSBU New Business Development expenses are allocated between the Raw Water Operating Unit and WWUS based on their pro-rata share of direct charges from the New Business Development group. WWUS's share is allocated between the four regions based on relative number of households, then within the WTC Region based on volume.

WWUS Common expenses also are first allocated to systems where there is no volume based on the percentage of direct labor of the system. The remainder is allocated to the volume-driven systems based on their relative volumes.

⁴³ The CAM is attached to Mr. Travis' direct testimony as JT-6. The memoranda are attached to Mr. Kellicker's testimony as SK-19 and 20. The clearest description of the process, which the ALJ has used liberally, is found in Mr. Kellicker's rebuttal testimony (LCRA Ex. 11) at pages 7-8.

⁴⁴ LCRA owns, but does not operate those systems.

WWUS Customer Service expenses are allocated to the various systems based on the relative number of retail customers.

WTC Region Operating Center expenses are allocated based on direct labor charges of operations staff.

WTC Region general expenses are allocated to systems based on the relative volume.

Appellants dispute the propriety of using relative volumes as an allocator. The use of relative volume as the primary allocator for shared and indirect costs began in FY 2006. Before that time, costs were allocated based on a spreadsheet model. The allocation approach was not consistent throughout LCRA; LCRA determined it needed a consistent approach. After considering other approaches, LCRA determined volume, which was common throughout the systems, was the best method for allocating shared and indirect costs that could not be directly assigned.

The results of using volume as an allocator were significant. In FY 2004, the WTC Water system had \$1,862,356 in allocated shared and indirect O&M costs. In FY 2005, it had \$4,164,403 in allocated shared and indirect O&M costs. Although overall costs increased somewhat, much of the shared and indirect O&M increase was due to the revised allocation formula.⁴⁵

Appellants describe the change in allocation methodology as a “Robin Hood” approach. They cite the November 2006 BWG audit, which observed:

LCRA originally entered the WWUS business to enable the communities served to receive high quality water and wastewater service which met environmental standards; without LCRA’s support, safe water and/or wastewater service for the impacted communities might have been at risk. Given the extent of the required

⁴⁵ LCRA Ex. 1, Exh. SZ-7, page 40-41. Although the change in allocation methodology took effect in FY 2006, the cost-of-service study restated the previous year’s figures for comparative purposes. In that study, therefore, the effects of the methodology change appear between FY 2004 and FY 2005.

investments and operating costs, some of the individual systems were not able to cover their operating and debt service costs. To help finance the cost of these systems which could not cover their own costs, LCRA pursued a strategy to obtain and/or grow other WWUS systems in high growth markets with the intention of having these growth markets generate sufficient revenue to cover their own operating and debt service expenses and help offset any losses of the systems with more limited growth potential.⁴⁶

Ms. Zarling, the Executive Manager of the WSBU, stated such an approach was not appropriate and was not in the Business Plan.⁴⁷

Appellants nevertheless point out that the WTC Systems are in growing areas, while many of the Hill Country Region systems are smaller systems with fewer financial means and with potential regulatory, environmental and public health issues.⁴⁸ Under LCRA's procedures for allocating shared and indirect costs, which rely extensively on relative volumes, considerably more costs were allocated to the WTC Region than to the Hill Country Region. In the Hill Country cost-of-service study, upon which rates were also set on August 22, 2007, the Hill Country Region's allocated shared and indirect O&M costs for FY 2007 were \$66,000. In contrast, the WTC Region cost-of-service study set its allocated shared and indirect costs for FY 2007 at \$3,575,024.⁴⁹

In Appellants' view, the WTC systems were more efficient, which should imply fewer overhead and other fixed costs per customer for those systems than for others. Appellants argued that increased volume is not the cause of increases in the types of fixed costs that LCRA allocated by volume.

⁴⁶ LCRA Ex. 1, Exh. SZ-8, page I-9. The BWG Audit also endorsed LCRA's cost allocation processes, although Appellants believed BWG did not look specifically at allocations within WWUS. The ALJ has not pursued that issue further because no one from BWG offered testimony in this proceeding.

⁴⁷ Tr. Vol. 1, pages 89-92.

⁴⁸ LCRA Ex. 1, pages 10-11; Tr. Vol. 1, pages 92-101.

⁴⁹ Tr. Vol. 9, pages 1665-1666; Bee Cave Ex. 72, page 21780. The Hill Country Region rates were based on the FY 2007 budget, rather than the FY 2010 budget. Tr. Vol. 9, pages 1662-1663.

Ms. Heddin, who testified on the issue for Bee Cave, stated she had never seen volume used to allocate overhead costs. She believed that direct labor would be a more reasonable basis for allocating the costs from WWUS to the individual systems, and so recommended.

Appellants also questioned the extent to which LCRA relies on allocation of charges from cost pools versus direct charging. In Appellants' opinion, LCRA has the ability to direct-charge a much higher percentage of its work to individual systems. Indeed, under the cost-of-service study, approximately 70 percent of the WTC Water O&M costs were allocated costs.⁵⁰ LCRA replied that the additional time and effort to produce work orders and direct-charge for tasks performed would increase costs and reduce efficiency. This Proposal does not address that issue specifically, because the Commission must deal with the information as it was recorded and presented by LCRA.

As LCRA witness Stephen Kellicker explained, he was assigned in 2005 to develop a cost allocation methodology that was consistent and fair. He and other LCRA personnel chose volume as an allocator after a thorough analysis of the cost pools and possible alternative allocators. The other allocators analyzed were direct labor, direct costs, revenues, volume, and hybrid of those allocators. They determined that allocations based on direct labor from the operating unit down to the system level were "not accurately reflecting the level of effort from the cost pools." Mr. Travis also testified that direct labor generally measures "the amount of time spent by plant personnel assigned to a system related to other systems" rather than "the total number of labor hours devoted to all aspect of operating any particular system. . . ."⁵¹

LCRA witness Jack Stowe also addressed Ms. Heddin's analysis. He testified that volume was a reasonable and acknowledged allocator. He noted that volume was used both in the gas and electric industries and pointed to other water districts that use volume in the allocation process.⁵²

⁵⁰ LCRA Ex. 1, Exh. SZ-7, page 41.

⁵¹ Tr. Vol. 5 at 980; LCRA Ex. 10 (Travis Rebuttal), page 9.

⁵² LCRA Ex. 12 (Stowe Rebuttal), pages 13-15.

Both Mr. Travis and Mr. Kellicker emphasized that volume was chosen not only because it is common to the systems, but also because it is a cost-causative factor. Mr. Travis stated:

Volume or units of water produced is a cost causative factor that is appropriate for cost pools accumulated at the Water and Wastewater Utility (W/WW) operation unit level. At this level, all costs included in these cost pools are shared only among the water and wastewater treatment plants. Volume of treated output is the product of these plants, therefore it is reasonable to allocate shared costs on this measureable statistic that pertains to all the recipients of allocated costs.⁵³

Mr. Kellicker testified:

Volume, which is the unit of production, is also an appropriate cost causative factor among the Water and Wastewater utilities, especially for pooled support costs. Volume represents the unit of production, and is the main function or product of that system. Thus, costs that are pooled together in support of the overall utility should be allocated based on the output of that utility.⁵⁴

As Appellants point out, neither Mr. Travis nor Mr. Kellicker has ever run a water system. Although treated water may be the end product of the individual systems, the record contains no credible evidence that the costs that are allocated by LCRA vary in accordance with the volume of water. Although Mr. Kellicker stated that various other allocators were considered and found inadequate, LCRA did not produce any study or written document to that effect. The use of volumes as an allocator appears to have been primarily, if not entirely, an accounting determination rather than an engineering or operations one:

Q: I just have one more question, and that is, did you consult with any other consultants experienced in ratemaking in coming up with volume as an allocator?

A: No, I didn't consult with consultants. I relied upon the accounting staff that have CPAs in our corporate accounting group, as well as the background and knowledge I have had from my own studies in either cost accounting or accounting-type college study. But mainly relied on our corporate cost

⁵³ LCRA Ex. 10, page 9.

⁵⁴ LCRA Ex. 11, page 9.

accounting group who have more experience in developing this, not just for us but -- when I say us, not just for the utility but for the generation side and the transmission side as well.

Q One I just have one more question, more question. Are you aware of any other retail public utility that uses volume as an allocator?

A No, I'm not aware.⁵⁵

During cross-examination, LCRA senior engineer Mr. Payne identified several types of costs that were included in the cost pools but would not necessarily increase according to volume, such as operations personnel, maintenance, telecommunications, security, safety and environmental activities, and technology services.⁵⁶

Although Mr. Stowe discussed other districts that use volume as an allocator, his cross-examination established that none of those systems use volume as an allocator of shared and indirect costs within its system as does LCRA. One of the systems he mentioned, Tarrant Regional Water District, is a raw water provider that uses volume solely to determine the rate to be charged its raw water customers.⁵⁷

The ALJ finds LCRA failed to prove the reasonableness of its use of relative volumes to allocate shared and indirect costs. On the surface, the use of volume appears to skew costs toward the WTC systems. Certainly the shared and indirect costs allocated to the WTC Region are strikingly greater than those allocated to the Hill Country Region, although the number of connections is approximately the same. If the shared and indirect costs increased according to volume, that discrepancy would be reasonable. There is no credible evidence that those costs increase according to volume, however. Although treated water may be an end product that is common to at least all the water systems, the evidence does not show that the allocated costs increase in relation to the volume of that end product.

⁵⁵ Tr. Vol. 5, pages 897-98; see also Tr. Vol. 6, pages 1133-35.

⁵⁶ Tr. Vol. 3, pages 431-435.

⁵⁷ Tr. Vol. 8, pages 1480-81.

Direct labor, as recommended by Ms. Heddin, may not be an ideal measure for cost allocation. The ALJ expects that a hybrid approach, using various factors for various types of costs, would be more accurate. That is not available in this case, however. The ALJ finds that direct labor more closely approximates cost causation and should be used instead. Although Ms. Heddin did not address WTC Wastewater, the ALJ finds her allocation methodology should be used for WTC Wastewater also.

If the ALJ understands Ms. Heddin's testimony correctly, she would use direct labor as the allocator for all costs from WWUS down to the system level.⁵⁸ As was discussed above, however, some costs, *e.g.* WWUS Customer Service expense, are allocated now using factors other than volume. Those allocation methods are reasonable. The ALJ finds that only the WWUS allocations using volumes should be changed.

Ms. Heddin proposed a number of reductions to the underlying expenses themselves, which are discussed in the next section of this Proposal. Her schedules reflect the cumulative adjustments, rather than only her proposed change in allocation methodology. She stated, however, that using direct labor instead of volume as an allocator would reduce the WTC Water System O&M expenses by more than \$3 million.⁵⁹ The ALJ has no way of checking that figure, but it seems high given the overall expense levels. The parties should address the scope of that adjustment, to the extent they are able, in their exceptions and replies to this Proposal.

2. O&M Expense Disallowances

Although LCRA based its rate increase on its FY 2010 budget forecast, it presented data for FY 2007, both in support of those budget projections and in anticipation of the other parties' opposition to its approach. Messrs. Kellicker and Travis testified that those costs were accurate, reasonable, and necessary.⁶⁰

⁵⁸ Bee Cave Ex. 1, pages 44-45.

⁵⁹ Ms. Heddin did not discuss the effect on WTC Wastewater, because Bee Cave did not appeal that increase.

⁶⁰ LCRA Exs. 3 and 4. See also LCRA Ex. 6 (Flores Testimony).

Bee Cave and the Districts both proposed significant downward adjustments to the O&M expenses for WTC Water. The Districts proposed significant downward adjustments to the O&M expenses for WTC Wastewater also.

a. Bee Cave's Adjustments

Bee Cave's discussion and adjustments for WTC Water are found on pages 51-77 and 83-90 of Ms. Heddin's testimony and the related schedules.⁶¹ In making her proposed adjustments, Ms. Heddin reviewed the General Ledger for the following cost centers: WTC Water, WTC Region, WTC Operating Center, Retail Services, WWUS, New Business Development, and WSBU.⁶² Partly in response to testimony by LCRA witness Jack Stowe, she began her analysis by comparing costs and personnel attributed to WTC Water to the appropriate costs for a stand-alone system. Mr. Stowe testified those costs were reasonable for utilities of WTC's size. In Ms. Heddin's opinion, those costs were excessive.⁶³

Although Mr. Stowe, Ms. Heddin, and Districts' witness, Mr. Rauschuber, all conducted such comparisons, the ALJ does not describe them in detail because he did not find them particularly helpful in determining whether particular expenses were reasonable. On cross-examination, Mr. Rauschuber was asked what role benchmarking plays in this proceeding. In reply, he stated:

As far as my testimony is concerned, I don't believe it plays a role per se. Again it's the inclusion of cost of service line items which are not appropriate to have in a customer rate base.⁶⁴

⁶¹ Bee Cave Ex. 1, *et al.* Corrections to the testimony and schedules were admitted as Bee Cave Ex. 87 and discussed at the beginning of Ms. Heddin's testimony at the hearing.

⁶² Ms. Heddin did not receive and therefore did not review a general ledger for the CSBU cost center.

⁶³ Bee Cave Ex. 1, pages 51-65.

⁶⁴ Tr. vol. 11, page 2061.

Ms. Heddin then analyzed LCRA’s employee benefits. She referred to Mr. Stowe’s testimony, in which he stated that LCRA benefits comprise 27.85% of salaries and FICA is 7.65%. Ms. Heddin stated that the actual allocated benefits amount were in excess of 50%. She believed LCRA, in allocating the hourly rate for individuals’ time, was improperly using the standard hours per year of 2,080 hours, which did not consider leave time, when the employee did not work. She also contended that benefits should not be allocated at all, but should be directly tracked and assigned for each employee, because the LCRA average percentage might not be the same for WTC Water employees and other LCRA employees.⁶⁵

Ms. Heddin next identified a number of particular O&M expenses, recorded in various cost centers, which in her opinion either were not prudent and necessary in providing service to WTC customers, should have been capitalized instead of expensed, and/or should have been direct-charged to avoid cross-subsidization.⁶⁶

Description	Amount	Exhibit No.
Rate and Financial Analysis--		
Salaries and Benefits	\$114,431	BC-24
Rate and Financial Analysis--		
Other Expenses	18,948	BC-25
Legal Services—Salaries	15,294	BC-51.
Legal Services—Other Expenses	22,276	BC-26 ⁶⁷
Damages from O&M Injuries	62,825	BC-27
Employee Service Awards and		
Deferred Compensation	286,623	BC-28
Equipment and Software	195,243	BC-29
First Night Austin/Texas Parks &		

⁶⁵ Bee Cave Ex. 1, pages 65-68.

⁶⁶ Bee Cave Ex. 1, pages 68-71. Except for the legislative advocacy expense, the amounts shown are the underlying cost center amounts, not the amounts ultimately allocated down to WTC Water.

⁶⁷ The ALJ added up only \$19,956 in expenses on that exhibit. A sub-total appears to have been added twice to the total on page 3.

Wildlife Department	22,500	BC-30
“Practicing Perfection”	34,550	BC-31
Real Estate Acquisition	2,653	BC-32
Strategic Planning--		
Salaries	357,900	BC-51
Strategic Planning--		
Other Expenses	12,702	BC-33
Executive Oversight—Other Interest	10,896	BC-34
Miscellaneous	40,810	BC-35
“Develop the Water/Wastewater B”—		
Other Interest	16,459	BC-36
Legislative Advocacy	10,069	NA

Ms. Heddin also objected to the Community Development charge assessed to WTC Water, which is discussed elsewhere in this Proposal.

Ms. Heddin next discussed various types of cost center expenses which, in her opinion, should have been directly charged rather than allocated. Those included salaries and other expenses for rate and financial analysis, develop and management of projects, internal legal services, outside legal services, internal engineering services, outside engineering services, and damages from operations. She stated she could not go back and directly assign those expenses herself due to lack of information.⁶⁸

The next category of expenses analyzed by Ms. Heddin was costs which she stated were incorrectly identified as expenses, but should have been capitalized. Those included \$450,572 in construction management, engineering and related costs charged to WTC Water, WSBU, or the WWUS business unit.⁶⁹

⁶⁸ Bee Cave Ex. 1, pages 73-74.

⁶⁹ Bee Cave Ex. 1, pages 75-77.

After analyzing the costs she considered unreasonable, Ms. Heddin proposed adjustments to the WTC Water revenue requirement and rates. She removed various expenses from the various cost centers. From WTC Water, she deleted salaries for Construction Coordinator, Construction Inspector, Construction Worker, and Utility Projects Coordinator, as well as Engineering salaries and salaries, because they should have been capitalized. She further removed the salaries for Financial and Rate Analysis because they did not reflect normal annual operating expenditures. She added those later as capitalized assets or amortized costs.⁷⁰

For the WTC Region, Ms. Heddin removed all Engineering salaries because they should have been direct-charged. Because of lack of data, she did not re-include any of those costs as direct charges. She likewise removed the salaries for Financial and Rate Analysis.⁷¹

Ms. Heddin made no adjustments to WTC Operating Center expenses. For Retail Services, she removed all salaries for Construction Worker, Contract Specialist, and Project Manager because they should have been capitalized and direct-charged.⁷²

For WWUS, for the same reasons as described above, Ms. Heddin removed all salaries for Legal Services, Construction Coordinator, Construction Workers, Engineers, Project Managers, Utility Projects Coordinator, Real Estate, and Rates and Financial Analysis.⁷³

Ms. Heddin removed all charges for New Business Development because, in her opinion, the services were not prudent and necessary to serve WTC Water customers.⁷⁴

For the particular O&M expenses, set out in the table above, which in her opinion either were not prudent and necessary in providing service to WTC customers, Ms. Heddin adjusted

⁷⁰ Bee Cave Ex. 1, page 84, Bee Cave Ex. 39

⁷¹ Bee Cave Ex. 1, pages 84-85, Bee Cave Ex. 40.

⁷² Bee Cave Ex. 1, page 85, Bee Cave Ex. 42.

⁷³ Bee Cave Ex. 1, page 85, Bee Cave Ex. 43.

⁷⁴ Bee Cave Ex. 1, page 85, Bee Cave Ex. 44.

each cost center accordingly, incorporating her proposed benefits adjustment.⁷⁵ Ms. Heddin finally allocated her revised cost center expenses to WTC Water, by various means, using direct labor where appropriate and available.⁷⁶

b. Districts' Adjustments

Districts' Witness Donald Rauschuber, P.E., reviewed the General Ledger for FY 2007 in examining the expenses for the WTC systems. Like Ms. Heddin, Mr. Rauschuber testified LCRA had overstated its labor burden for benefits and FICA. He then examined the expenses for WTC Water. Mr. Rauschuber eliminated salaries he determined were related to capital projects, which he stated should be capitalized instead of expensed, and made corresponding adjustments to LCRA's plant and equipment. Examples of salaries he excluded were those of Construction Support, WS Civil Engineering, and Construction Management for the Hill Country Galleria, Los Robles Development, the Village Oaks Project, and others. Mr. Rauschuber also eliminated salaries related to Financial and Rate Analysis, which he considered non-recurring. For the same reasons, Mr. Rauschuber eliminated pay premiums expenses and made downward adjustments to labor burden.⁷⁷

Mr. Rauschuber also examined WTC Materials and Supplies, vehicles, and outside services. As above, he adjusted those expenses downward, because he determined they were related to capital projects or were non-recurring. For the same reasons, he eliminated minor expenses for employee business expenses, cell phone usage, postage and freight, and permits and application fees.⁷⁸

After looking at those WTC expenses, Mr. Rauschuber turned to the expenses from the cost centers. Mr. Rauschuber examined the line items set out in several LCRA exhibits, (SK-9

⁷⁵ Bee Cave Ex. 1, pages 86-88.

⁷⁶ The specific methods for the various cost centers are set forth on Bee Cave Ex. 1, pages 88-89.

⁷⁷ Districts Ex. 1, pages 62-65.

⁷⁸ Districts Ex. 1, pages 67-70.

and SK-13-18) and eliminated those that, in his opinion, were not (1) directly related to providing retail water service to WTC water customers (2) prudent, reasonable, and necessary to WTC water customers, and (3) recurring costs for WTC water customers.⁷⁹ Mr. Rauschuber recommended a decrease of \$2,181,568 in those expenses.

Finally, Mr. Rauschuber deleted the WTC Water raw water reservation fee. He noted that LCRA does not have a contract for the system and advocated that current customers should not be saddled with the cost of reserving water for future WTC customers.⁸⁰

Overall, Mr. Rauschuber recommended a \$2,907,086 decrease in WTC Water O&M expenses.

Mr. Rauschuber followed his examination of the WTC Water expenses with an examination of the WTC Wastewater expenses. Although the amounts were of course different, he testified that similar adjustments should be made both to direct and allocated wastewater expenses for expenses that should be capitalized or were not recurring, such as those related to capital projects and financial and rate analysis. He proposed a decrease of \$140,468 in expenses allocated from the various cost centers and deletion of the raw water charge and reservation fee. He recommended an overall O&M expense decrease of \$291,352 for WTC Wastewater .

c. LCRA Rebuttal

LCRA presented rebuttal testimony from Messrs. Travis, Kellicker, and Stowe regarding O&M expenses. Those witnesses observed that LCRA's rates were not set according to actual FY 2007 costs. However, they addressed the adjustments made by Bee Cave and the Districts.

⁷⁹ Districts Ex. 1, pages 71-76.

⁸⁰ Districts Ex. 1, page 75.

Mr. Travis testified that Ms. Heddin had incorrectly described shared costs as “indirect” costs in her analysis. Although LCRA does have indirect costs, other costs she examined were costs, such as operations staff, that were direct but shared among the various systems. Mr. Travis then testified that Ms. Heddin had deleted many such shared costs merely because they were allocated rather than directly assigned. Mr. Travis presented LCRA’s Capitalization and Unitization Accounting Guidance.⁸¹ In Mr. Travis’ opinion, neither Ms. Heddin nor Mr. Rauschuber offered support for their opinions regarding capitalization.

Mr. Kellicker offered more extensive rebuttal. He pointed out that Ms. Heddin had misidentified some direct costs as allocated costs in her testimony. With regard to benefits, Mr. Kellicker explained that leave benefits are not separately loaded into the accounting system as an adder during the annual business planning process. The planning assumption is that each budgeted position is expected to be paid for at least 2,080 hour each year. By using 2,080, LCRA included the total cost of leave in developing its budget. Mr. Kellicker further explained that the actual base labor paid as compensation for leave does not get charged as labor to the systems; related costs for leave are recorded in benefit accounts. Therefore, LCRA’s benefits accounting was accurate.

Mr. Kellicker took issue with Ms. Heddin’s deletion of expenses for entire types of staff salaries and related expenses. He criticized Ms. Heddin for relying solely on job titles. He stated that LCRA’s construction and engineering staff provide routine, recurring work at its facilities. Mr. Kellicker testified that all the charges listed as expenses were for O&M activities and should not be capitalized. Mr. Kellicker agreed with Mr. Travis that Ms. Heddin had improperly lumped shared expenses with indirect expenses. He stated that, regardless of the allocation methodology, those costs are directly related to operating the water systems.⁸²

Mr. Kellicker stated that Mr. Rauschuber had made his adjustments to allocated costs based on department names, without considering the activities performed. He discussed the

⁸¹ LCRA Ex. 10, Exh. JT-27.

⁸² LCRA Ex. 11, pages 17-18.

kinds of services contained in the various cost centers. As examples, Engineering Services would budget time to support maintenance programs and activities with the region, as well as helping develop the capital plan and consult on operations issues. Construction Services would budget time to support maintenance programs and activities within the region. Rates and Analysis' activities would include business and financial analyses of individual systems, financial monitoring and tracking, and developer reimbursement information. Legal Services would review contracts, meet with developers, and support the general needs of the utility, such as drafting or reviewing Board agenda items. He described the New Business Development cost pool as including engineers analyzing possible additions to the system, managers conducting discussions with developers, municipalities, and community leaders regarding system additions, and rates and analysis personnel providing financial analysis of potential additions and acquisitions. For Rate Analysis in particular, Mr. Kellicker stated those personnel provided ongoing financial support activities, such as developing annual budgets and monitoring monthly financial performance. Mr. Kellicker provided descriptive information regarding those functions and activities for each of the cost pools.⁸³

With regard to raw water, Mr. Kellicker stated that LCRA has committed to reserve raw water for the utilities despite the lack of a contract with itself. To delete the raw water charges would require raw water customers to subsidize retail customers.⁸⁴

Regarding the wastewater expenses, Mr. Kellicker made much the same observations as he did for the water expenses.⁸⁵

Mr. Stowe explored some of the same themes as Mr. Kellicker. He observed that LCRA employees, regardless of their titles, act in a variety of operational capacities. Engineering Services activities, for example, generally include reviewing developer applications, performing inspections, monitoring regulatory compliance, co-ordinating engineering activities with

⁸³ LCRA Ex. 11, pages 22-30. The ALJ has not summarized all the activities described by Mr. Kellicker for each pool.

⁸⁴ LCRA Ex. 11, pages 31-32. *See also* Tr. Vol. 11, pages 2133-2142.

⁸⁵ LCRA Ex. 11, pages 32-33.

regulatory bodies, and so on. Mr. Stowe opined that normal recurring engineering costs should not be capitalized, as that would require LCRA to incur debt to pay those costs. He stated that LCRA's rate analysts engage in recurring activities that would be performed by finance or outside personnel in a stand-alone utility.

Mr. Stowe observed that Mr. Rauschuber had stated, but then ignored, the definition of a "cash-needs approach" to ratemaking. Although that definition includes recovery of cash capital outlays, Mr. Rauschuber had removed such outlays during his expense adjustments. Instead, Mr. Rauschuber's approach would require debt financing of all such expenditures.⁸⁶

During cross-examination, Mr. Rauschuber was asked about many of the types of expenses he recommended be capitalized. He agreed he had not suggested capitalizing or disallowing them as nonrecurring in the Chisholm Trail case, in which he took part as Chisholm Trail's General Manager.⁸⁷

Mr. Stowe also addressed some of the particular O&M adjustments proposed by Ms. Heddin and set out above in this Proposal. Mr. Stowe stated that LCRA was not seeking recovery of expenses for damages from operations and employee injuries, employee service awards and deferred compensation, equipment and software, First Night and the Texas Parks and Wildlife Department, "Practicing Perfection," certain real estate acquisitions, strategic planning salaries and other expenses, executive oversight other interest expense, certain miscellaneous items, "Develop the Water/Wastewater B," other interest expense, or legislative advocacy expense.⁸⁸ That statement was not explored at the hearing, so it was not clear whether Mr. Stowe meant that LCRA was not seeking recovery because it had used the FY 2010 budget to set rates or whether he agreed with Ms. Heddin that those expenses were non-recurring or unrelated to water system operations.

⁸⁶ LCRA Ex. 11, page 38, Districts Ex. 1, page 33.

⁸⁷ Tr. Vol. 11, pages 2079-2096.

⁸⁸ LCRA Ex. 12, pages 32-33.

d. ALJ's Analysis

The ALJ found LCRA persuasive, for the most part, regarding the expense disallowances proposed by Bee Cave and the Districts. Ms. Heddin's and Mr. Rauschuber's deductions were based on their examination of job and department titles. Mr. Kellicker and Mr. Stowe provided persuasive testimony that those positions perform recurring operational duties and should be included, either directly or through partial allocation, in the WTC systems, expenses. Mr. Stowe established that, under the cash-needs approach, a retail public utility can and should recover capital cash outlays. Both Mr. Kellicker and Mr. Stowe persuasively explained LCRA's labor accounting method as well.

During the cross-examination of Mr. Rauschuber, there was a discussion of broad versus specific recurring costs. The ALJ found that distinction germane to this discussion. In eliminating costs they deemed non-recurring, Appellants proposed what they deemed to be known and measurable changes to the WTC FY 2007 actual costs. The ALJ finds those changes generally were not known and measurable, however. Even if a specific cost, *e.g.* the cost of a vehicle or the cost of an inspection, will not be repeated the next year, it is not known that overall vehicle costs or inspection costs will change. Mr. Rauschuber followed that approach, at least for some items, in his presentation in *Chisholm Trail*.⁸⁹

The ALJ therefore, finds, with a few exceptions, that LCRA's actual FY 2007 direct O&M expenses, along with the underlying cost pool expenses, were just, reasonable, and useful in providing service, and that the adjustments proposed by Bee Cave and the Districts should not be made.⁹⁰ One group of exceptions is the particular O&M adjustments, proposed by Ms. Heddin, that Mr. Stowe said LCRA is not seeking to recover. In Ms. Heddin's testimony, those expenses began with "Damages from Operations and Employee injuries" and ended with

⁸⁹ Tr. Vol. 11, pages 2079 *et seq.*

⁹⁰ That finding is subject to the ALJ's previous finding that the volume allocation methodology should not be followed.

“legislative advocacy.” Whatever Mr. Stowe meant by his observation, he did not rebut Ms. Heddin’s adjustments.⁹¹

For the most part, Ms. Heddin’s proposed adjustments for Rate and Financial Analysis salaries and related expenses and Legal Services, described in the same section of her testimony, should not be made. LCRA proved those expenses were reasonable and related to providing service. However, \$18,536 in outside services for rate analysis was paid to Rimrock Consulting, which prepared the cost-of-service study in this case. The ALJ agrees that is not a normal operating expense and should be excluded from WTC Water’s O&M expenses.⁹²

The excluded expenses are from various cost pools at various levels of the LCRA organization. They should be allocated to (or rather, from) WTC Water in the manner set out in Ms. Heddin’s testimony, with the exception of her related adjustments for benefits and FICA.⁹³

Finally, the ALJ agrees with LCRA that the raw water reservation fee should be included in the WTC Water expenses. As far as the ALJ could tell, LCRA did not provide rebuttal testimony concerning the raw water charges or reservation fees for the wastewater system. On the other hand, the ALJ could not find those fees in the actual numbers he reviewed. To the extent those fees exist, they should be disallowed as proposed by the Districts.

B. Debt Service Expense

LCRA’s actual expense summary for FY 2007 shows debt service expense of \$4,549,074 for WTC Water and \$1,857,034 for WTC Wastewater. Messrs Travis and Kellicker explained LCRA’s debt issuance procedures and the debt service calculations.

⁹¹ To reiterate, except for legislative advocacy, those amounts were from the cost pools and would have to be adjusted to reach the WTC Water O&M expenses.

⁹² That expense was booked to WTC Water. See Bee Cave Ex. 25.

⁹³ See Bee Cave Ex. 1, pages 87-89.

Because LCRA does not earn a return on investment and cannot have taxing authority, it has two sources of funds: revenues produced from operations and proceeds from the issuance of debt. Mr. Travis explained that LCRA issues debt as an entity, rather than by individual operating units or systems. LCRA system debt is assigned to each business unit and operating unit, including WSBU and ultimately the WTC systems, based on their respective pro rata shares of capital activity that is debt-funded. At the time the system debt is issued, that debt is specifically assigned to the appropriate capital project expenditures being financed. For example, if the WTC Region systems debt-funded capital spending represented 2% of the total LCRA debt-financed capital spending, those systems would receive 2% of the debt from the bond issuance. Actual debt service is the sum of all payment schedules for all debt assigned from each revenue bond issue. If a debt-service projection is required to develop a budget, an estimate is developed using assumptions about financing costs, total capital spending, and completion dates, along with revenue projections. The projected debt is then added to the actual debt service for total debt service in a budget.⁹⁴

Mr. Travis provided schedules that listed the original cost, depreciation, and net book value for assets in the WTC Regional systems. According to those schedules, as of June 30, 2006, the net book value of the WTC Regional Water System was \$74,936,544 and the net book value of the WTC Regional Wastewater system was \$27,492,632. Those figures included completed capital projects and those in the planning and construction phases. Mr. Travis also testified that the debt assignment was tracked and maintained by debt issues. He provided schedules that set forth the debt assigned by bond series to the WTC Regional Systems. For FY 2006, the actual debt service for debt assigned to WTC Water was \$4,060,405, compared with the FY 2007 budget amount of \$4,602,758 and the FY 2007 actual amount of \$4,549,074. For FY 2006, the actual debt service for debt assigned to WTC Wastewater was \$1,799,855,

⁹⁴ LCRA Ex. 3, pages 14-16.

compared to the FY 2007 budget amount of \$1,844,074 and the FY 2007 actual amount of \$1,857,034.⁹⁵

Mr. Kellicker reviewed parts of Mr. Travis' testimony, including the actual debt service numbers. His testimony was primarily concerned with explaining the calculation of debt service for future years in the cost-of-service study. Because the ALJ has determined actual FY 2007 information should be used, he will not discuss the details of that calculation in this Proposal.⁹⁶

Ms. Heddin, on behalf of Bee Cave, took issue with LCRA's debt service calculations for WTC Water. Ms. Heddin stated LCRA had not justified its debt service requirements for the system. She testified that LCRA had not provided adequate documentation to show how the amount of debt-funded capital project spending for WTC Water was determined.

According to Ms. Heddin, LCRA's own documents called into question its debt service calculations. She pointed out that the debt service calculations for FY 2007-2010 in one of Mr. Travis' schedules, JT-15, did not correspond to the cost-of-service study. She also expressed concern that the outstanding par value of the future debt in LCRA's estimates was more than the original book value. She pointed out that the par value should be less than the original book value. Beginning with the original book value, Ms. Heddin applied deferred debt, impact fee payments, and capital contribution amounts to recalculate a maximum outstanding principle balance of \$50 million. Using that recalculated amount, and excluding any further increases in debt because, in her opinion, future debt would not necessarily be associated with assets needed to provide service to WTC Water customers, Ms. Heddin calculated an annual debt service payment for WTC Water of \$2,749,814.

⁹⁵ LCRA Ex. 3, pages 18-19; LCRA Ex. 4, Exh. SK-4.

⁹⁶ If the Commission disagrees with the ALJ and chooses to allow rates to be set based on the FY 2010 budget forecast, it can review Mr. Kellicker's discussion at LCRA Ex. 4, pages 21-23,

The Districts' witness, Mr. Rauschuber, did not challenge the debt service expense amount for WTC Water for FY 2007. The Districts did contend that LCRA's future debt service calculations in its cost-of-service study were overstated due to delays in construction and high interest rate projections.⁹⁷

Mr. Rauschuber did challenge the debt service expense amount for WTC Wastewater. Mr. Rauschuber pointed to \$14,493,252 in facility costs set out on Mr. Travis's schedules that were not directly necessary to provide service to customers in the Districts. Specifically, those projects related to new developments such as Falconhead, Spanish Oaks, and the Hill Country Galleria. In Mr. Rauschuber's opinion, LCRA should have required the developers of those projects to have paid the entire costs of those assets and to have contributed the capital facilities. He described that as a normal process for retail public utilities. Excluding the debt service on those facilities would reduce the FY 2007 actual debt service expense from \$1,857,034 to \$1,030,130.⁹⁸

Although their witnesses did not mention that issue in their testimonies, Appellants also observed that the Hill Country Region did not have any debt service in its cost of service, because LCRA had chosen to defease the debt for that region.⁹⁹

Messrs. Kellicker and Travis presented rebuttal testimony on the issue of debt service expense. Because Mr. Kellicker's testimony was directed at LCRA's projected future debt service expense, as reflected in the cost-of-service study, the ALJ does not summarize it in this Proposal.¹⁰⁰

Mr. Travis stated that Ms. Heddin had misinterpreted his schedules. One of the schedules showed only the actual debt service that has been assigned the WTC Water system. The other

⁹⁷ Districts' Closing Arguments, pages 28-31.

⁹⁸ Districts' Ex. 1, pages 90-91.

⁹⁹ Bee Cave Ex. 72, pages 21780-21781; Tr. Vol. 1, pages 156-157

¹⁰⁰ See LCRA Ex. 11, pages 10-12.

included future debt service related to debt funding of future capital additions. Therefore, the two were not inconsistent.

Mr. Travis disagreed with Ms. Heddin's contention that LCRA had not adequately documented its assignment of debt to WTC Water. He stated LCRA had provided reimbursement letters from FY 2000-2007 that provided a monthly tracking of spending on each LCRA capital project, including WTC Regional capital projects in progress.¹⁰¹ LCRA also provided the commercial paper tracking worksheet for November 2004 through March 2006 for the WSBU, which breaks down commercial paper issued to each area, including WTC Water, along with official statements for LCRA system revenue bond issuance from FY 1999 through FY 2006. He testified JT-15 shows the debt assigned to WTC Water in FY 2006. Mr. Travis further explained that engineers and project managers evaluate the components of completed assets in determining their assignment, and that costs are tracked through reimbursement letters and underlying spreadsheets.¹⁰²

Mr. Travis also testified Ms. Heddin's comparison of booked value to par value was improperly done. In making her comparison, he stated, Ms. Heddin failed to consider depreciation, the fact that there are WTC Regional Water system projects that are complete and in-service and in the process of being classified to individual assets, and WTC Regional Water system assets that are in various stages of construction, for which debt has been issued. When those are totaled, he argued, the total net book value of the WTC Regional Water System assets is \$74,936,544.78. Mr. Travis also said that Ms. Heddin had misstated the total outstanding par value of debt, by failing to include WTC Water's share of the WTC Region common assets. Mr. Travis testified that the total par value was less than the book value of the assets.

Mr. Travis stated that Ms. Heddin's \$50 million figure was miscalculated for several reasons. First, she started with an incorrect figure. Second, she mistakenly attributed all impact fee revenue to principal of the outstanding par value. Third, her capital contribution figure

¹⁰¹ A portion of one such letter is in evidence as Bee Cave Ex.78.

¹⁰² Tr. Vol. 4, pages 713-728.

already included impact fees, which meant she had double-counted those fees. Last, her deferred debt figure was not included in JT-15.

Mr. Travis mistakenly asserted that Mr. Rauschuber had recommended no change to either the WTC Water or WTC Wastewater debt service. Although Mr. Rauschuber did not challenge the WTC Water debt service figure, he did propose reducing the WTC Wastewater debt service figure by \$826,904.¹⁰³ On cross-examination, however, Mr. Rauschuber agreed that the Districts, before the purchase of the systems by LCRA, had issued bonds for developer facilities. He also agreed that the purchase agreement acknowledged that LCRA could serve new water and wastewater customers outside the Districts.¹⁰⁴

The ALJ found Mr. Travis to be credible on the issue of WTC Water's debt service. Although LCRA did not offer a written policy for the assignment of assets, Mr. Travis clearly described the process and rationale for those assignments, as well as offering documents and testimony showing how the debt is assigned and tracked. He also pointed out several incorrect assumptions in Ms. Heddin's debt calculation. The ALJ finds the FY 2007 actual debt service of \$4,549,074 for WTC Water to be reasonable.

The ALJ also finds the FY 2007 actual debt service of \$1,857,034 for WTC Wastewater to be reasonable. The cross-examination of Mr. Rauschuber established that the Districts themselves had not required developers to pay 100 percent of the costs for capital facilities and that LCRA is entitled to provide service to customers outside the Districts.

Although the defeasement of the Hill Country Region debt provided support for Appellants' argument that the regions were treated differently, LCRA proved its debt service expense was reasonable and related to the WTC systems.

¹⁰³ LCRA Ex. 10, page 17; Districts Ex. 1, page 91.

¹⁰⁴ Tr. Vol. 10, pages 2040-2047; Districts Ex. 1, Exh. DGR-5.

C. Operations Reserve Expense

LCRA Board Policy 301 sets out LCRA's operating reserves policy. Under that policy, LCRA is to maintain the following target levels of operating reserves:

Six months of average debt service on all outstanding debt, and two months of average operation and maintenance expenses. . . .

These reserves will be collected through base retail, wholesale or fuel rates. During periods of increasing debt service due to large capital expenditures, reserve levels may be met though borrowing to mitigate rate impacts.¹⁰⁵

LCRA debt-funds its operating reserves.¹⁰⁶ Although the actual FY 2007 figures show an operations reserve expense of \$179,997 for WTC Water and \$47,340 for WTC Wastewater based on the rates in effect at that time, LCRA did not seek additional funding for operations reserves.¹⁰⁷ LCRA included operations reserve expense in its FY 2007 expenses to account for incremental amounts not recovered. Because of the ALJ's recommended decrease in O&M expenses, however, an additional amount for operations reserve is not required.

D. Debt Service Coverage Expense

As explained above, LCRA issues debt system-wide. Under its bond covenants and Policy 301, LCRA is required to maintain debt service coverage of 1.25 percent. Policy 301 states, in part:

301.301 Debt Service Coverage. To provide a margin of safety in LCRA's financial affairs, revenue levels will be set to target a debt service coverage ratio of 1.25x of the total debt service for all debt obligations Rates and prices for individual business units, products and services will be set to

¹⁰⁵ LCRA Ex. 3, Exh. JT-7, page 4. An earlier version of Policy 301 is included in Ms. Fishbeck's testimony, LCRA Ex. 4, Exh. MF-14, page 4.

¹⁰⁶ Districts' Brief, page 32; LCRA Ex. 4, Exh. SK-25

¹⁰⁷ LCRA Ex. 1, Exh. SZ-7, page 41. See also LCRA Ex. 5 (Fishbeck Testimony), pages 28-29.

produce appropriate revenue levels commensurate with specific economic, contractual and other risk factors. It is recognized that specific rates and prices may not be set to achieve the 1.25x coverage target in certain LCRA business activities; however, LCRA will target an overall 1.25x coverage.

It continues:

301.302 Rates and Prices. LCRA will design rates and prices that, to the extent possible remain competitive, cover the cost of specific services, allow each business unit (other than Community Services) to be self-supporting, unless otherwise approved by the Board, and provide a stable and predictable flow of revenues. . . .¹⁰⁸

To meet that policy, LCRA calculated debt service coverage expense for WTC Water and WTC Wastewater equal to 25 percent of the corresponding debt service expense.

Mr. Travis testified LCRA's debt service coverage policy was reasonable and provides security to bondholders. He stated that coverage was used for the benefit of the WTC systems. Fund that may be available after operating reserves and capital will be used to fund capital project spending at the WTC Regional level or for funding unforeseen operating expenses. He believed LCRA had properly calculated the amount of debt service coverage to be included in the WTC rates.¹⁰⁹

Ms. Fishbeck stated that inclusion of a 1.25x coverage multiplier is typical in cost-of-service studies.¹¹⁰ Along the same line, Mr. Stowe stated he could not think of any cash-basis cost-of-service study for government-owned utilities in which debt service coverage had not been recognized in the revenue requirement. He described its inclusion as not only reasonable, but necessary. He also stated that, if the targeted coverage is achieved, the additional funds are

¹⁰⁸ LCRA Ex. 3, Exh. JT-7, pages 2-3.

¹⁰⁹ LCRA Ex. 3, pages 16-17.

¹¹⁰ LCRA Ex. 5, pages 29-30.

used by the utility for funding capital outlays, operations reserves, or paying down outstanding indebtedness.¹¹¹

Appellants objected to the debt service coverage expense calculation for several reasons. First, they pointed out that individual units or systems are not required to maintain coverage of 1.25x. LCRA's debt service coverage, as an entity, is well above that level. Second, Appellants contended LCRA had miscalculated the coverage ratio. Policy 301 defines "debt service coverage" as follows:

Debt service coverage is the ratio of that fiscal year's ending total revenues minus total operating and maintenance expenses (net of depreciation, amortization, and other revenue and expense exclusions resulting from prior period funding), divided by scheduled debt service on all obligations as approved in the Business Plan.¹¹²

Both Ms. Heddin and Mr. Rauschuber pointed out that LCRA had excluded impact fees from its debt service coverage calculation. As defined by TEX. LOCAL GOV'T CODE ANN. § 395.001(4), an impact fee is

a charge or assessment imposed by a political subdivision against new development in order to generate revenue for funding or recouping the costs of capital improvements or facility expansions necessitated by and attributable to the new development.

Although not operating revenues, impact fees are part of total revenues.¹¹³

In addition to Policy 301, Mr. Rauschuber quoted one of LCRA's bond covenants for 2006. That covenant states:

For purposes of the Policies, debt service coverage is the ratio of a period's ending total revenues minus total operating and maintenance expense

¹¹¹ LCRA Ex. 7, pages 24-26.

¹¹² LCRA Ex. 3, Exh. JT-7, page 1.

¹¹³ Bee Cave Ex. 1, page 79; Tr. Vol. 5, page 834.

(net of depreciation, amortization and other appropriate adjustments), divided by scheduled debt service on all obligations payable from such revenues. . . .¹¹⁴

Mr. Rauschuber testified that LCRA had collected \$3,590,325 in impact fees for WTC Water and \$505,925 in impact fees for WTC Wastewater, which more than offset the proposed debt service coverage expense for each.¹¹⁵

In support of Mr. Rauschuber’s argument, the Districts pointed to a portion of a presentation to the LCRA Board regarding the FY 2008 Business Plan, in which impact fees were used as part of a debt service coverage calculation for the WTC Region. The Districts also cited an email to Ms. Fishbeck from LCRA employer John Paul Sanchez, included in Ms. Fishbeck’s cost-of-service study workpapers, showing continuing water and wastewater impact fees for both systems for FY 2007-2010.¹¹⁶ According to that email, sent in July of 2006, LCRA expected the following water and wastewater impact fees:

WTC Water Impact Fees (\$1000s)			
FY07	FY08	FY09	FY10
2,594	4,152	3,334	3,609

WTC Wastewater Impact Fees (\$1000s)			
FY07	FY08	FY09	FY10
525	642	499	482

Ms. Heddin also excluded indirect O&M and capital expenses from the debt service coverage calculation, on the theory that the utility would pay its outside vendors before paying itself and would forego capital projects if necessary to pay bond obligations. Ms. Heddin removed indirect O&M expenses from the debt service calculation and determined that, with that

¹¹⁴ Districts Ex. 1, page 79.

¹¹⁵ Districts Ex. 1, pages 80, 93-94, Exh. DGR-24.

¹¹⁶ Districts Exs. 40 and 49; Tr. Vol. 7, page 1381; LCRA Ex. 5, Exh. MF-10, page 10. Ms. Fishbeck did not use impact fees for debt service in her cost-of-service study. Tr. vol. 7, page 1402.

adjustment, WTC Water would meet its debt service coverage obligations without additional revenue from ratepayers. She did not perform a calculation including impact fees.¹¹⁷

In addition, both Ms. Heddin and Mr. Rauschuber stated that LCRA allows times-coverage monies to be used outside the system where they are generated; therefore, those monies could be “swept” away to LCRA’s general fund. Ms. Heddin observed that no LCRA policy requires those monies to stay within the system from which they are collected. Mr. Rauschuber noted that the cost-of-service study did not show any coverage revenues returning to the WTC systems.¹¹⁸

Bee Cave further contended LCRA has been inconsistent in its treatment of debt service coverage. It reiterated that LCRA has defeased all the debt from the Hill Country Region and pointed out that Ms. Fishbeck did not include any amount for debt service coverage in her cost-of-service study for the Camp Swift Wastewater system.¹¹⁹

Finally, the District claimed LCRA is calculating its impact fees illegally. TEX. LOCAL GOV’T CODE ANN. § 395.012(b) states:

Projected interest charges and other finance cost may be included in determining the amount of impact fee only if the impact fees are used for the payment of principal and interest on bonds.

One of the exhibits attached to Mr. Payne’s testimony is the WTC Regional Water System Capital Improvements Plan and Impact Fee Calculation for Development Between 2006 and 2015 (2006 Impact Fee Study). Page 26 of that study sets out the calculation for the amount

¹¹⁷ Bee Cave Ex. 1, page 80.

¹¹⁸ Bee Cave Ex. 1, pages 82-83; Districts Ex. 1, pages 80-81.

¹¹⁹ The defeasement of the Hill Country Region debt was discussed at Tr. Vol. 5, pages 836-37. The Camp Swift study was admitted into evidence as Bee Cave Ex. 85. Although no debt service coverage was included in the results, the study states, “Revenue requirements were tested for a times coverage of 1.25; if the coverage was not met with a combination of O&M, debt service and operations reserve requirements, an additional time coverage amount was added to revenue requirements.”

of impact fee per LUE, and includes interest as part of that calculation. Mr. Travis testified that LCRA uses impact fees both to pay principal and interest on bonds and to cash fund projects.¹²⁰

Executive Director witness Debi Loockerman did not challenge LCRA's inclusion of debt service coverage in its rate calculations. She believed, however, that coverage collections within the West Travis County Region should match disbursements within the Region. Therefore, she recommended that debt service coverage actually collected through rates, if any, should be accounted for in a restricted fund to be used for only capital improvements or reduction of debt service within the West Travis County Region, or for contributions to operating reserves as required by the LCRA Board of Directors.¹²¹

Messrs. Travis and Stowe offered rebuttal to Appellants' arguments regarding debt service coverage. Mr. Travis took issue with Ms. Heddin's characterization of debt service coverage as profit LCRA is making off the WTC Water system rather than a true cost of service. Mr. Travis stated coverage is a source of funds for the system's share of operating reserves, revenue-funded capital and corporate capital.

Mr. Travis stated LCRA excludes impact fees when developing rates because of the need for certainty in revenue stream. He observed that LCRA's accounting policy identifies funding of capital expenditures as the first use of any impact fees received, which reduces the amount of debt that must be issued. Mr. Travis stated he was not aware of any statutory, regulatory, or bond covenant requirement for including impact fees in the calculation of debt service coverage. He offered a copy of Standard & Poor's Rating Review for LCRA, dated April 26, 2006. Standard & Poor's review excluded non-operating income from its debt service calculations because it considered that to reflect a more accurate view of year-to-year financial performance.

¹²⁰ LCRA Ex. 2, Exh. KP-4; Tr. Vol. 4, pages 758-765. Mr. Travis was not familiar with KP-4 and could not explain the calculations or their significance.

¹²¹ ED Ex. 1, pages 11-12.

It also observed that the WSBU had achieved less than a 1.25x coverage ratio with revenues from operations.¹²²

Mr. Travis also critiqued Ms. Heddin's elimination of indirect and other O&M expenses from the debt service calculation. He believed Mr. Rauschuber's use of impact fees received to offset debt service coverage requirements was inappropriate. If such a calculation were made, however, the revenues should reflect only the amount of revenues used, deferring any received-but-not-used fees. For WTC Water, that unused amount in FY 2007 was \$518,500.¹²³

Mr. Stowe began his rebuttal discussion of debt service coverage by stating that the only authoritative source on the subject is the entity's actual bond covenants and formal financial policy. After referring to those, he also provided a copy of a City of Pflugerville document stating that Pflugerville's bond covenants require operating revenues to exceed operating expenses by 1.25x and that Standard & Poor's and Moody's require that same coverage ratio. Mr. Stowe acknowledged that inclusion of the coverage ratio in the revenue requirement may generate funds in excess of actual expenses, but he stated those funds are restricted and most commonly used to fund ongoing capital requirements.

Mr. Stowe observed further that impact fee revenues can only be expended for the projected capital improvements and projected financing costs included in the calculated fee and that, under certain conditions, are subject to refund until completion of the project upon which they were calculated. Therefore, until used, those fees represent a liability rather than revenue. Mr. Stowe pointed out that impact fee revenues are not operating revenues.

¹²² LCRA Ex. 10, Exh. JT-26, page 7. S&P also stated, however, without discussing details, that the WSBU was self-supporting in FY 2005.

¹²³ LCRA Ex. 10, pages 19-20, 23-24. Mr. Travis did not address Mr. Rauschuber's WTC Wastewater calculation. For FY 2007, the corresponding unused impact fee balance for WTC Wastewater appears to be \$779,117. Districts' Ex. 1, Exh. DHR-24.

Mr. Stowe, like Mr. Travis, criticized Ms. Heddin's recalculation of expenses for the purposes of determining debt service coverage.¹²⁴

During cross-examination, Mr. Rauschuber agreed that Chisholm Trail, of which Mr. Rauschuber was General Manager at the time of its rate application, did not include its impact fees as revenues for ratemaking purposes. Mr. Rauschuber explained that it did not do so because Chisholm Trail had two separate funds, one for operations and maintenance and one for capital improvements, the latter of which included the impact fees.¹²⁵

Also on cross-examination, LCRA witness Travis testified that, although coverage monies would be intended for use within the WTC systems, they could be transferred to the general fund. Mr. Kellicker agreed.¹²⁶

Because LCRA issues debt on an entity-wide basis, bond covenants do not require the WTC systems to reach a 1.25x debt service coverage. Nevertheless, the ALJ agrees with LCRA that it is reasonable to require the systems to reach that coverage level. Debt service coverage, if kept within the system, is a legitimate cost of providing service. If the WTC systems were exempt from that cost, other LCRA systems or business units would be subsidizing them.

The ALJ does not agree with the O&M expense adjustments proposed by Ms. Heddin for Bee Cave in calculating debt service coverage. The WTC systems should cover all their expenses, not just the direct ones.

The ALJ reaches no decision or recommendation on whether LCRA is calculating impact fee illegally, as alleged by the Districts. The provisions of Chapter 395 do not address ratemaking. If LCRA is calculating those fees in a manner contrary to the law, that issue should be raised in a different forum.

¹²⁴ LCRA Ex. 12, pages 34-37.

¹²⁵ Tr. Vol. 10, pages 1978-79; Tr. Vol. 11, pages 2150-51.

¹²⁶ Tr. Vol. 5, pages 889-90; Tr. Vol. 7, pages 1293-94.

There was a great deal of conflicting evidence on the issue of whether impact fees should be counted as revenues to offset debt service coverage requirements. LCRA's bond covenants and its Policy 301 mention total revenues. The bond rating companies use operating revenue, however, to determine debt service coverage ratios. The presentation to the Board regarding the FY 2008 Business Plan included impact fees as revenues. Chisholm Trail, on the other hand, did not include impact fees as revenues in setting debt service coverage.

Considering the actual FY 2007 financial information, the ALJ finds impact fees should not be used to offset debt service coverage expense. As discussed by the parties and as shown in Districts Exhibits WTC 46 and WTC 48, LCRA used the FY 2007 impact fee revenues to revenue-fund WTC Water and WTC Wastewater capital projects. In doing so, it reduced potential debt financing of those projects. The FY 2007 impact fee revenues were not available for debt service coverage because they were used for that purpose. The ALJ further finds LCRA properly calculated the debt service expense for setting rates.

The ALJ agrees with Appellants and the Executive Director that LCRA does not have adequate policies in place to ensure that debt service coverage remains within the system. Therefore, as recommended by Ms. Loockerman, debt service coverage actually collected through rates, if any, should be accounted for in a restricted fund to be used for only capital improvements or reduction of debt service within the West Travis County Region, or for contributions to operating reserves as required by the LCRA Board of Directors.

E. Community Development Expense

LCRA includes a Community Development Expense item in its revenue requirement for the WTC systems and other revenue-generating enterprises. That revenue is used to fund community development and other activities which LCRA is authorized to perform, but which otherwise would have no source of funding. Those activities include community and economic development, parks operations, natural resource services, resource planning and development,

public safety, environmental laboratory services, and watershed monitoring and maintenance. LCRA is authorized to provide those services and engage in those activities.¹²⁷

LCRA Board Policy 301 states that three percent of utility budgeted gross revenues shall be charged for community development activities.¹²⁸ For ratemaking purposes, because that would be a circular calculation, the amount was estimated as three percent of: total O&M expenses, plus debt service costs, plus operation reserves included in rates, plus times coverage included in the rates, less miscellaneous revenues offsetting rate requirements, less LUE reservation charges offsetting rate requirements.¹²⁹

Appellants objected to the imposition of the Community Development expense. They noted it was unrelated to the cost of providing services to utility customers. They observed that the activities covered by the Community Development expense were not mandated by the Legislature, but only authorized. They noted that one of LCRA's own witnesses, Mr. Stowe, stated that such an expense was not a reasonable cost of service unless it was mandated.¹³⁰ Bee Cave also argued that the community development expense is not an actual out-of-pocket expense incurred by the WTC systems and could be subsumed into debt service coverage if debt service coverage were allowed, because the debt service coverage funds can be used for purposes outside the WTC systems.¹³¹ Appellants further objected that community development funds were used for inappropriate purposes such defeasement of the Hill Country Region's debt¹³² and

¹²⁷ TEX. WATER CODE ANN. §§ 152.151, *et. seq.* and 26.0135; TEX. SPEC. DIST. LOC. LAWS CODE ANN. § 8503.001(b). Ms. Zarling described the community development activities in more detail during cross-examination. Tr. Vol. 1, pages 206-208.

¹²⁸ LCRA Ex. 3, Exh. JT-7, page 5.

¹²⁹ LCRA Ex. 5 (Fishbeck Testimony), page 30.

¹³⁰ Tr. Vol. 8, pages 1515-1516.

¹³¹ Bee Cave Response Brief, page 43; Tr. Vol. 7, page 1374.

¹³² Tr. Vol. 1, pages 156-157; Vol. 6, page 1142.

contributions to Austin's First Night celebration.¹³³ Ms. Heddin also stated that the Community Development expense should already be covered through raw water sales.¹³⁴

The ALJ finds that the Community Development expenses are reasonable costs for the LCRA system and should be part of the expenses assessed against the WTC systems. A complete reading of TEX. SPEC. DIST. LOC. LAWS CODE ANN. Chapter 8503 makes it clear that LCRA is both authorized and expected to engage in the non-revenue-generating types of expenses covered by the Community Development funds. Section 8503.011(b) acknowledges that LCRA may receive revenues in excess of O&M expenses, debt service costs, *et cetera*, and may apply those revenues to "any corporate purpose."

Although Mr. Stowe apparently did not believe the Community Development expenses should be included, the ALJ disagrees with that opinion based on the law, LCRA's policy, and the other witnesses' testimonies. Because the debt service coverage is to be retained within the system as recommended by the Executive Director, the Community Development expense should not be incorporated into the debt service coverage expense as suggested by Bee Cave. Section 8503.011(b) allows LCRA to use the Community Development funds for any corporate purpose; that may include defeasement of debt and community activities within the Board's discretion. Raw water reservation sales may cover raw water costs and perhaps an additional amount, but the evidence did not show how they would cover the WTC systems' share of Community Development expenses.

For ratemaking, because of the circular nature of that calculation, the Community Development expense amount should be calculated in the manner described by Ms. Fishbeck for the cost-of-service study.

¹³³ The First Night expenditure (which the ALJ has recommended not be included as an expense item) apparently was for a water conservation booth or exhibit at that event. Tr. Vol. 1, pages 212-215.

¹³⁴ Bee Cave Ex. 1, page 71.

F. Non-Rate Revenues

The LCRA non-rate operating revenues for FY 2007 included: 1) Excess Capacity Reserves; 2) LUE Reservation Charges; 3) Raw Water/Effluent Revenues; and 4) Other /Miscellaneous Revenues, as well as wholesale water revenues. Those revenues are counted as credits and used to offset the revenue requirements.¹³⁵ Although the ALJ was unable to find the exact amounts for these revenues for FY 2007 in the record, the parties agree that these were the types of operating revenues used by LCRA in its cost-of-service study to set its rates.¹³⁶

Mr. Kellicker explained that “excess capacity reserves” do not originate from ratepayers, but are funds contributed by LCRA to the WTC systems to account for capacity constructed to serve future, rather than current customers. He presented an analysis conducted by LCRA to determine the amount of that “excess” amount, which was considered to be the amount above the capacity used by current customers, plus a 15% minimum reserve. According to LCRA, the percentage of capacity not used by current customers for FY 2007 was 17% above that minimum reserve, or \$763,000. Both Mr. Kellicker and Ms. Zarling testified that LCRA was not required by law or regulations to make that contribution.¹³⁷ Ms. Zarling stated that even in FY 2010, the rates would not have recovered the WTC Systems’ full cost of service because of the excess capacity revenue component.¹³⁸ Thus, LCRA’s presentation portrayed the excess capacity revenues both as a principled calculation based on the amount of capacity needed to serve current customers and as a contribution provided to alleviate the rate impact on the WTC Systems.

In their closing arguments, both the Executive Director and the Districts argued that the excess capacity reserve funding should be included as part of the WTC Systems’ revenues in

¹³⁵ LCRA Ex. 4, pages 27-28.

¹³⁶ See Districts Ex. 1, page 77. Those actual FY 2007 figures may be buried in the record somewhere; if not, they should be able to be determined and agreed upon.

¹³⁷ LCRA Ex. 4, pages 28-30, Exh. SK-28; Tr. Vol. 1, pages 118-120. In subsequent budget years, the excess capacity reserve revenue amounts were higher.

¹³⁸ LCRA Ex. 1, page 26.

setting rates. The Executive Director agreed that the contribution was not required by law, but observed that funding the excess capacity eliminates the need for current or future debt financing. The Districts contended that without the excess capacity contribution, LCRA would be double-charging for that capacity through both rates and impact fees.¹³⁹ LCRA did not address that issue in either its initial or reply argument.

The ALJ finds that the excess capacity revenues should not be included as part of LCRA's non-rate revenues for determining the just and reasonable rates in this proceeding. Both Ms. Zarling and Mr. Kellicker testified that neither statutes nor regulations required LCRA to provide that revenue source. As Mr. Payne testified, facilities are rarely 100 percent utilized when built.¹⁴⁰ Facilities are built not only to serve new customers, but to serve all customers, both current and new, as the system grows. The ALJ does not find that LCRA would be double-charging, because at least for FY 2007, impact fee revenues were already used to revenue-fund capital improvement and reduce debt financing.

The Commission may determine that, for policy reasons, LCRA should contribute for excess capacity on the system. Neither LCRA nor any other party argued with the rationale that future ratepayers should pay for the capacity used to serve them. LCRA included those contributions as an offset to the revenue requirements on its own volition, based on its own calculations. In the absence of a rule or statutory provision mandating such contributions, however, the ALJ does not recommend requiring LCRA to make them.

Appellants also contended that non-rate revenues were understated because they did not include revenues from inspection fees.¹⁴¹ It is not clear to the ALJ whether that was the case for FY 2007; the record was not developed completely enough on that issue for the ALJ to recommend any revenue adjustment.

¹³⁹ Executive Director Closing Argument, pages 23-25; Districts Closing Argument, pages 35-37.

¹⁴⁰ Tr. Vol. 2, pages 399-400.

¹⁴¹ Bee Cave Response Brief, page 36.

Finally, the Districts appeared to argue that impact fee revenues should be directly included as an offset to the WTC revenues.¹⁴² As was discussed above, those fees are not operating revenues but were used for revenue-funding capital projects. They should not be used as a revenue offset to the WTC expenses.

G. Rate Design

LCRA witness Angie Flores and Executive Director witness Heidi Graham testified regarding rate design. Because LCRA and the Executive Director found LCRA's three-step rate increase to be reasonable and Appellants recommended the previous rates be re-established, however, there were no rate design issues in this case. The alternatives advocated were all (LCRA and the Executive Director) or nothing (Appellants). Ms. Graham recommended adoption of LCRA's rates.

The ALJ is not sure what revenue requirement his recommendations would yield or, of course, what revenue requirement the Commission's decision would yield. Therefore, the revenue requirement in the ordering provisions of the Proposed Order has been left blank, with the appropriate amount, and ultimately the rates, to be determined. The ALJ recommends that if the rates are changed, the rate design should follow that set out in Ms. Graham's testimony.

VII. MISCELLANEOUS ISSUES

A. Refunds/Recovery of Lost Revenues

TEX. WATER CODE ANN. § 13.043(e) allows the Commission to order refunds or allow a surcharge to recover lost revenues in a rate appeal.

The rates currently in effect are interim rates set at the level of Phase 2 of LCRA's three-phase increase. LCRA witness Flores testified that, if the rates ultimately set are above that

¹⁴² Districts Closing Argument, pages 34-35.

level, LCRA should be allowed to recover the lost revenues. Ms. Flores recommended that those revenues should be calculated from October 1, 2009 (the date on which the third step would have gone into effect) until the date of the Commission's Order. A surcharge would then be calculated by taking the amount of the lost revenues for each system (WTC Regional Water and Wastewater) divided by the number of active LUEs at the time of the Commission Order, to be collected over a period of 24 months, or until the revenue was recovered. She further recommended that the lost revenues be determined by taking actual billing data for the period beginning October 1, 2009, through the date of Commission Order. The ALJ finds Ms. Flores' approach should be adopted if the rates ultimately adopted are above the current interim level. Because all WTC Wastewater customers are also customer of WTC Water, only one surcharge would be required.

If, on the other hand, the rates ultimately adopted are below the current level, refunds should be ordered. There was less testimony on the mechanics of any possible refund, although Mr. Rauschuber recommended they be accomplished over a 24-month period. The ALJ finds, if the rates ultimately adopted are below the current interim level, refunds should be calculated in the same manner as recommended by Ms. Flores for potential lost revenues. The refunds should be accomplished over a 24-month period.

B. Apportionment of Transcript Costs

LCRA requested that transcript costs be apportioned among the parties pursuant to 30 TAC § 80.23(d). In particular, LCRA requested that transcript costs be apportioned among LCRA, Bee Cave, and the Districts based on the number of pages for each of those parties' participation. For the portion of the transcript prepared before the rate-case-expense phase, the amounts would be:

LCRA	\$2,949.72
Bee Cave	6,010.47
Districts	4,560.06

Appellants opposed LCRA's request.

The Commission's rule, 30 TAC § 80.23(d), states:

80.23(d) Assessment of reporting and transcription costs.

- (1) Upon the timely filed motion of a party or upon its own motion, the commission may assess reporting and transcription costs to one or more of the parties participating in the proceeding. The commission shall consider the following factors in assessing reporting and transcription costs:
 - (A) the party who requested the transcript;
 - (B) the financial ability of the party to pay the costs;
 - (C) the extent to which the party participated in the hearing;
 - (D) the relative benefits to the various parties of having a transcript;
 - (E) the budgetary constraints of a state or federal administrative agency participating in the proceeding;
 - (F) in rate proceedings, the extent to which the expense of the rate proceeding is included in the utility's allowable expenses; and
 - (G) any other factor which is relevant to a just and reasonable assessment of costs.
- (2) The commission will not assess reporting or transcription costs to statutory parties who are precluded by law from appealing any ruling, decision, or other act of the commission.
- (3) In any proceeding where the assessment of reporting or transcription costs is an issue, the judge shall provide the parties an opportunity to present evidence and argument on the issue. A judge shall include in the proposal for decision a recommendation for the assessment of costs.

As is discussed below, the ALJ recommends LCRA not be allowed to recover its requested rate case expenses. If the Commission follows that recommendation, LCRA should also pay for the transcript expenses, pursuant to 30 TAC § 80.23(d)(1)(F).

If the Commission determines that LCRA should recover some or all of its rate case expenses, the ALJ recommends that LCRA pay half the transcript costs and Appellants pay the other half, to be divided equally between them.¹⁴³ None of the factors set forth above, other than 80.23(d)(1)(F), especially favor one side over the other. The ALJ disagrees with LCRA's proposal to divide the transcript according to the number of pages each party used, because LCRA, as the party with the burden of proof using prefiled written testimony, would naturally use less hearing time in examination than would cross-examining parties.

¹⁴³ The Executive Director and OPIC (which did not participate in the hearing) are barred from assessment of transcript costs under 30 TAC § 80.23(d)(2).

C. Rate Case Expenses

TEX. WATER CODE ANN. § 13.043(e) also states that the Commission “may allow recovery of reasonable expenses incurred by the retail public utility in the appeal proceedings.”¹⁴⁴ Neither the Water Code nor the Commission’s rules set out guidelines for how that determination should be made.

In this case, LCRA seeks recovery of \$959,490.97 in rate case expenses, which includes attorneys’ fees, consultants’ fees, transcript costs, and other miscellaneous expenses.¹⁴⁵ The expenses were broken into broad categories as follows:

<u>Attorneys Fees</u>	
Freeman & Corbett LLP (invoices dated 11/9/07-2/2/09)	\$ 14,135.00
McCall, Parkhurst & Horton LLP (invoice dated 8/13/10)	760.00
Jackson Walker LLP (invoices dated 1/14/10-10/18/10)	<u>764,607.09</u>
Subtotal	779,502.09
<u>Consultants</u>	
J. Stowe & Co., Inc. (invoices date 1/19/10-9/10/10)	97,903.94
Rimrock Consulting co. (invoices dates 11/1/07-9/10/10)	<u>63,025.63</u>
Subtotal	160,929.57
<u>Expenses</u>	
Kennedy Reporting Services, Inc.	17,273.85
Texas Depo	1,767.31
Pro Courier Services	<u>18.15</u>
Subtotal	19,059.31
Total	\$959,490.97 ¹⁴⁶

A two-day hearing was held on the rate-case-expense issue on November 9-10, 2010.

¹⁴⁴ See also 30 TAC § 291.41(e)(2) and (5).

¹⁴⁵ LCRA Ex. 1 (S-4); Tr. Vol. 12, page 2398-99; LCRA’s Closing Argument on Rate Case Expenses, page 2.

¹⁴⁶ LCRA Closing Argument on Rate Case Expenses, page 2. Of the \$17,273.85 in Kennedy Reporting expenses, \$13,520.25 was related to transcript costs for the evidentiary hearing.

In support of its request, LCRA presented testimony from Ms. Zarling, Associate General Counsel James Rader and Mr. Stowe, along with associated invoices and other business records. LCRA contended a significant portion of the total expense was generated by Appellants' "novel interpretations of law" as well as "the breadth of the issues presented, the extraordinary volume of discovery conducted by Appellants; and the highly contentious manner in which Appellants have prosecuted this appeal." Ms. Flores and Ms. Zarling testified about the method of recovering those expenses, recommending they be recovered through a 24-month surcharge on all current and future active connections.¹⁴⁷

The Executive Director agreed the expenses were reasonable and recommended a 36-month surcharge on only the customers in the rate districts that filed the appeals, which would divide the expenses among approximately 3,683 of the Region's 4,925 connections.¹⁴⁸

Appellants argued LCRA should not recover its rate case expenses because it should not prevail on appeal. Bee Cave also cited the Commission's rule regarding utilities' (as opposed to retail public utilities') rate-case-expense recovery, 30 TAC § 291.28(8), which states:

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.

Although that rule does not apply to this appeal, Bee Cave argued it should be used as a guide.

Appellants challenged the reasonableness of LCRA's requested expenses for several reasons. They contended LCRA's use of the FY 2010 budget forecast caused the complexity of the case, that the Jackson Walker law firm's¹⁴⁹ hourly rates were too high and that they were

¹⁴⁷ LCRA Closing Argument on Rate Case Expenses, pages 1-2; LCRA Ex. 9, page 4; Tr. Vol. 12, pages 2518-2519. Again, because all wastewater customers are also water customers, there would be only one surcharge.

¹⁴⁸ Executive Director Reply to Closing Argument, pages 13-27, especially pages 24-27.

¹⁴⁹ Jackson Walker is the outside law firm that handled later procedural matters and the hearing itself.

inadequately supervised, that Ms. Fishbeck's work was inadequately described, and that Mr. Stowe's fees were inadequately supported. The Districts also argued that LCRA performed duplicative work, unreasonably hired outside counsel and consultants when in-house counsel and personnel would have sufficed, and inappropriately used couriers and overnight mail and ordered multiple copies of transcripts in the manner of "large Dallas-based law firms."¹⁵⁰

In this Proposal, the ALJ finds in LCRA's favor on most issues. On the two most contentious issues, however—the use of the FY 2010 budget forecasts to set rates and the use of volume as an allocator for shared and indirect expenses—the ALJ finds in favor of Appellants. The use of the FY 2010 budget forecast, in particular, added an inordinate amount of complexity to the case, because the parties were discussing at least three ratemaking concepts (the FY 2010 budget forecast, the FY 2008 budget forecast, and actual FY 2007 expenses).

Because the Proposal finds against LCRA on those issues, and because the ALJ's findings would lead to at least a significant reduction from LCRA's third-phase rates, the ALJ finds that LCRA should not receive its rate case expenses in this case. Therefore, the ALJ does not analyze the specifics of the rate case expense evidence in this Proposal. If the Commission disagrees with the ALJ's determinations, or for other reason finds LCRA should receive rate case expenses, ALJ recommends that issue be remanded to the ALJ for determination of the appropriate rate-case-expense amount (including transcript costs) and surcharge methodology. That determination can and should be done without additional hearing or briefing, based on the existing record.

D. LCRA's November 17, 2010 Board Resolution

In their Reply to Closing Arguments, the Districts requested the ALJ to take official notice of an LCRA Board Resolution dated November 17, 2010, which directed the General Manager to endeavor to sell the water and wastewater utilities.¹⁵¹ The ALJ declines to take

¹⁵⁰ Districts Reply to Closing Arguments, pages 40-41.

¹⁵¹ Districts Reply to Closing Arguments, pages 31-32.

official notice, because that resolution was after August 22, 2007. He has not considered it in reaching his findings and conclusions in this case.

E. Matters to Be Addressed in Exceptions

As has been discussed, the ALJ is unable to determine a revenue requirement or rates based on his recommendations. The parties should, to the extent they are able, set out the dollar relationship between those recommendations, the rates before August 22, 2007, and the interim rates currently in effect.

SIGNED February 8, 2011.



HENRY D. CARD
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



**AN ORDER
REGARDING THE APPEAL OF THE RETAIL WATER AND WASTEWATER RATES
OF THE LOWER COLORADO RIVER AUTHORITY
SOAH DOCKET NO. 582-08-2863
TCEQ DOCKET NO. 2008-0093-UCR**

On _____, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the appeals of the retail water and wastewater rates set by the Lower Colorado River Authority for its West Travis County Regional Water and Wastewater Systems. A Proposal for Decision (PFD) was presented by Henry D. Card, 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

Description of LCRA and Appellants

1. The Lower Colorado River Authority (LCRA) is a political subdivision of the State of Texas, created and functioning as a non-profit conservation and reclamation district under Article XVI, Section 59 of the Texas Constitution.
2. LCRA provides energy, water and wastewater, and community services.

3. LCRA is organized into five business units: (1) Wholesale Power Services; (2) Transmission Electric Services; (3) Water Services; (4) Community Services; and (5) Corporate Services.
4. The Water Services Business Unit (WSBU) operates the Highland Lakes dams and hydroelectric generating facilities; provides water and wastewater utility services; and manages surface water resources.
5. WSBU itself is divided into four operating units: (1) Water and Wastewater Utility Services (WWUS); (2) Raw Water; (3) Hydroelectric; and (4) Irrigation.
6. WWUS operates LCRA's water and wastewater systems. In 2007, LCRA owned and/or operated 40 water and wastewater systems that provided service across mostly rural and suburban Central and South Central Texas, serving a population of over 250,000 in 13 counties.
7. WWUS, in turn, is divided into four geographic regions: (1) the Williamson County Region; (2) the Southwest Region; (3) the Hill Country Region; and (4) the West Travis County Region.
8. WWUS accounts for approximately 1.5 percent of LCRA's total revenues.
9. LCRA first entered the retail water and wastewater business in the 1990s.
10. LCRA's utility systems fall into a few descriptive categories. The first category is small systems, commonly serving fewer than several hundred connections. Those systems often were constructed by developers and either turned over to the residents or to small entities that did not have the means to make needed capital improvements. The second category is systems where LCRA got involved to address regulatory, environmental, or public health concerns. A third category is systems built to serve LCRA facilities. The

fourth category is regional systems designed to provide efficient services to meet needs in growing areas that cross jurisdictional boundaries. The West Travis County (WTC) systems, which are the subject of this case, fall into the last category.

11. The WTC Region consists of two potable water systems (the WTC Regional Water System and the Glenlake Water System), one wastewater treatment and collection system (the WTC Regional Wastewater System), two wastewater collection systems (West Lake Hills Wastewater System and Rollingwood Wastewater System), and a raw water intake and pumping system (Lakeway Regional Raw Water System). LCRA acquired the WTC Regional Water System in 1994 and the WTC Regional Wastewater System in 2000.
12. The WTC Regional Water System served approximately 4200 retail water meters and seven wholesale meters connections at the end of Fiscal Year (FY) 2007.
13. Demand is better measured by Living Unit Equivalent (LUEs) than by connections, because of variability in meter sizes and demand. By that measure, the WTC Regional Water System served approximately 7,600 LUEs at the end of FY 2007, consisting of about 2,200 wholesale LUEs and about 5,400 retail LUEs. It served several areas and subdivisions, including the City of Bee Cave (Bee Cave) and the Lake Pointe subdivision.
14. At the end of FY 2007, the WTC Regional Wastewater System served approximately 1,700 total LUEs. It served the Lake Pointe Subdivision, the Falconhead and Spanish Oaks Subdivisions, and commercial development in Bee Cave and its ETJ along FM 2244, RM 620, and State Highway 71.
15. Bee Cave is a small, but rapidly growing city in Travis County, west of Austin.

16. West Travis County Municipal Utility District Nos. 3 and 5 (the Districts) are municipal utility districts that provide service in the Lake Pointe subdivision, near Bee Cave.
17. The area served by the WTC Systems is hilly, rugged, and remote from reliable water supplies. It is also environmentally sensitive.
18. Many of the WTC Regional Water System's customers in the Bee Cave area use high volumes of water, particularly in the summer months. The average summer water use in that area is 25,000 gallons per month.
19. LCRA allocates much of its shared and indirect operating costs among its regions and systems according to the volume of water use.
20. The Hill Country Region contains 17 water non-contiguous rural water systems, two wastewater systems, and one biosolids composting facility in five counties to the west of Austin.
21. Although the number of water customers for WTC Water was approximately the same as for the Hill Country Region in August of 2007 (4,176 for WTC Water and 4076 for the Hill Country Region), the volumes of water used were considerably different: 2,120,325,300 gallons for WTC Water and 359,949,593 gallons for the Hill Country Region.

Notice and Procedural History

22. The LCRA Board of Directors adopted new rates for the WTC Regional Systems on August 22, 2007.
23. On November 30, 2007, the Commission received petitions of appeal from Bee Cave and the Districts of the rate increase for the WTC Regional Water System and from the Districts for the WTC Regional Wastewater System.

24. Although the matter was first referred to SOAH in January of 2008, the administrative record was not transferred until May 16, 2008, and the affidavit of public notice filed August 4, 2008.
25. The preliminary hearing was held August 19, 2008. At the preliminary hearing, jurisdiction was established and the following parties were designated: LCRA, Bee Cave, the Districts, the Office of Public Interest Counsel (OPIC), and the Commission's Executive Director. No discovery or hearing schedule was set, to allow the parties the opportunity for further discussions.
26. Discussions continued into February of 2009, when LCRA informed the ALJ that the parties had reached what LCRA described as a temporary procedural impasse. One of the issues about which the parties could not agree was whether LCRA or the Appellants had the burden of proof in the proceeding.
27. On August 20, 2009, the Commission issued its Interim Order answering certified questions sent to it by SOAH and determining that LCRA had the burden of proof.
28. After the Commission's Interim Order, the ALJ granted Bee Cave's motions to end the abatement of the proceedings and to set interim rates at the level of LCRA's second-step increase.
29. The hearing on the merits was convened August 23, 2010, and adjourned September 8, 2010, after eleven days of hearing. The rate-case-expense phase was convened November 9, 2010, and adjourned November 10, 2010. The parties filed their initial written closing arguments on October 29, 2010. They filed their written replies, which also addressed the rate-case-expense issues, on December 10, 2010. The record closed

on December 13, 2010, with the filing of the Executive Director's supplement to his reply.

Description of the Rate Increases

30. The Board set the rates for the WTC systems based on LCRA's budget projections for FY 2010, to increase in three steps, effective October 1, 2007, 2008, and 2009.
31. LCRA's cost-of-service study anticipated that a substantial portion of the increased revenues would be achieved through increased connections. Nevertheless, the rate increases are substantial.
32. The adopted water rates increased both the base charges and the volume charge, which itself increases with higher consumption levels.
33. The median residential water usage in the WTC system at the time of the rate increase was just below 10,000 gallons per month. For a residential customer using 10,000 gallons in the Bee Cave District, the final rate would result in a monthly bill of \$82.65, which is an increase of \$29.95 per month over the bill before the rate increases.
34. The adopted rates would also increase both the monthly base charge and the volume charge for wastewater customers. For a residential customer with a winter average of 10,000 gallons, the final rate would result in a monthly bill of \$109.50, which is an increase of \$52.00 per month over the bill before the rate increases.
35. LCRA hired Rimrock Consulting to perform a cost-of-service study for the WTC Regional Systems.
36. Although it included some historical information for reference, the Rimrock cost-of-service study was designed only to allocate the revenue requirements. Those revenue requirements themselves, and the underlying information for FY 2007-2010, were

supplied by LCRA based on its budgets for those fiscal years as of the time of the study.

Those budgets had their foundation in the FY 2007 business planning process.

37. LCRA set its revenue requirement on the FY 2010 budget projections.
38. LCRA's Staff originally intended to present the rate changes to the Board in September of 2006 as a two-step increase. That plan was postponed to allow an audit of the Water Wastewater Operating unit and its financial option by the Barrington-Wesley Group (BWG) and to seek input from customers.
39. The three-step increase adopted on August 22, 2007, set rate increases to occur on October 1, 2007, October 1, 2008, and October 1, 2009.
40. The first two steps of the rate increase did not correspond to the calculated revenue requirements for FY 2008 and 2009.

LCRA's Use of FY 2010 Budget for Ratesetting

41. Each year LCRA adopts a five-year budget for planning purposes, with spending authorized only for the first year.
42. The budget is usually not revised during the year, but is revisited and revised the subsequent year.
43. Not all of the elements of the FY 2010 budget shown in the cost-of-service study were thoroughly or comprehensively determined—for example, allocated expenses were merely increased three percent per year to account for anticipated inflation.
44. Even the most thorough and comprehensive analysis cannot necessarily see years into the future.

45. The FY 2010 budget data was not a reliable forecast of the WTC Systems' anticipated expenses for setting rates in 2007; therefore, the use of that data was not just and reasonable.

The actual FY 2007 data, if just and reasonable for ratesetting, would result in slightly higher rates than the FY 2010 data, because the higher revenue requirement in FY 2010 was mitigated by the anticipated growth in connections.

Basis for Calculating Revenue Requirement

46. The LCRA Board approved the FY 2008 budget before August 22, 2007.

47. The cost-of-service study was finished in September 2006 and used actual data approximately through April or May of 2006.

48. The cost-of-service study's figures for FY 2008 were not actual FY 2008 budget figures, but were projections themselves based on data that were more than a year old at the time the rates were set.

49. It would have been reasonable for LCRA to have used its actual FY 2008 budget, set in the summer of 2007, to set rates in August of 2007.

50. The projected FY 2008 budget in the cost-of-service study, based on data more than a year old, was not a reliable forecast of the WTC systems' anticipated expenses for setting rates in 2007; therefore, the use of that data would not be just and reasonable.

51. In the absence of a reliable budget adopted close in time to the actual rate increase, LCRA's actual FY 2007 data should be the starting point for ratesetting in this case.

52. The actual FY 2007 figures were available at the time the Board set the rates that are at issue in this case.

O&M Expenses

Use of Volume As Allocator

53. All work performed by LCRA, including work that benefits the WTC Regional Systems, is recorded on LCRA's books and records via work order entries. That procedure applies to all direct and shared/indirect costs.
54. When a work order is set up, a combination of components from LCRA's chart of accounts is assigned to that work order. That combination directs the transaction to a specific business unit or units and cost center(s).
55. Direct and indirect operating and support costs that are attributed to the WTC Regional Systems may originate in any business unit in LCRA, depending on the services provided and received. Operating costs originate primarily in the WSBU and may include costs from other operating units within the WSBU, such as the WWUS. Support costs and shared/indirect costs originate in the WSBU and the CSBU.
56. Four general cost pools contain costs that ultimately are allocated to the WTC Regional Systems and other systems. Those cost pools are:
 1. Corporate Services level expenses (CSBU);
 2. Water Services Business Unit (WSBU) expenses, which represent
 - (a) WSBU Internal Overhead expenses and
 - (b) New Business Development expenses;
 3. WWUS expenses, which represent
 - (a) WWU Common Expenses and
 - (b) Retail Customer Services expenses; and
 4. West Travis County Region (WTCR) level expenses, which represent

- (a) Region general expenses and
- (b) Operating Center expenses.

57. The CSBU costs are assigned to the other business units by direct charging or, when that is not deemed feasible, through allocation. Those CSBU residual expenses are allocated to those units through various means, such as head count (human resources) or operating revenues (overall governance costs, such as the General Manager and the Board). The amount allocated to WWUS is first allocated to systems where there is no volume based on the percentage of direct labor of the system. The remainder is allocated to the volume-drive systems based on their relative volumes.
58. WSBU Internal Overhead costs are allocated to the four operating systems (of which WWUS is one) based on relative labor hours. As with the corporate residual costs, the WWUS share is first allocated to systems where there is no volume based on the percentage of direct labor of the system. The remainder is allocated to the volume-driven systems based on their relative volumes.
59. WSBU New Business Development expenses are allocated between the Raw Water Operating Unit and WWUS based on their pro-rata share of direct charges from the New Business Development group. WWUS' share is allocated between the four regions based on relative number of households, then within the WTC Region based on volume.
60. WWUS Common expenses also are first allocated to systems where there is no volume based on the percentage of direct labor of the system. The remainder is allocated to the volume-driven systems based on their relative volumes.
61. WWUS Customer Service expenses are allocated to the various systems based on the relative number of retail customers.

62. WTC Region Operating Center expenses are allocated based on direct labor charges of operations staff.
63. WTC Region general expenses are allocated to systems based on the relative volume.
64. LCRA's use of relative volume as the primary allocator for shared and indirect costs began in FY 2006.
65. Before FY 2006, costs were allocated based on a spreadsheet model. The allocation approach was not consistent throughout LCRA; LCRA determined it needed a consistent approach. After considering other approaches, LCRA determined volume, which was common throughout the systems, was the best method for allocating shared and indirect costs that could not be directly assigned.
66. The results of using volume as an allocator were significant. In FY 2004, the WTC Water system had \$1,862,356 in allocated shared and indirect O&M costs. In FY 2005, it had \$4,164,403 in allocated shared and indirect O&M costs. Although overall costs increased somewhat, much of the shared and indirect O&M increase was due to the revised allocation formula.
67. The WTC Systems are in growing areas, while many of the Hill Country Region systems are smaller systems with fewer financial means and with potential regulatory, environmental and public health issues.
68. Under LCRA's procedures for allocating shared and indirect costs, which rely extensively on relative volumes, considerably more costs were allocated to the WTC Region than to the Hill Country Region.
69. In the Hill Country cost-of-service study, upon which rates were also set on August 22, 2007, the Hill Country Region's allocated shared and indirect O&M costs for FY 2007

were \$66,000. In contrast, the WTC Region cost-of-service study set its allocated shared and indirect costs for FY 2007 at \$3,575,024.

70. Although treated water is the end product of the individual systems, the record contains no credible evidence that the costs that are allocated by LCRA vary in accordance with the volume of water.
71. Although Mr. Kellicker stated that various other allocators were considered and found inadequate, LCRA did not produce any study or written document to that effect.
72. The use of volumes as an allocator appears to have been primarily, if not entirely, an accounting determination rather than an engineering or operations one.
73. Several types of costs were included in the cost pools but would not necessarily increase according to volume, such as operations personnel, maintenance, telecommunications, security, safety and environmental activities, and technology services.
74. LCRA failed to prove the reasonableness of its use of relative volumes to allocate shared and indirect costs.
75. Direct labor more closely approximates cost causation and should be used instead as a cost allocator for ratesetting in lieu of relative volumes, for both WTC Water and WTC Wastewater.

Specific O&M Expenses

76. Although LCRA based its rate increase on its FY 2010 budget forecast, it presented data for FY 2007, both in support of those budget projections and in anticipation of the other parties' opposition to its approach.
77. Leave benefits are not separately loaded into the accounting system as an adder during the annual business planning process. The planning assumption is that each budgeted

position is expected to be paid for at least 2,080 hour each year. By using 2,080, LCRA included the total cost of leave in developing its budget.

78. The actual base labor paid as compensation for leave does not get charged as labor to the systems; related costs for leave are recorded in benefit accounts.
79. LCRA's benefits accounting was accurate.
80. LCRA's construction and engineering staff provide routine, recurring work at its facilities.
81. Engineering Services budgeted time to the cost pools to support maintenance programs and activities with the region, as well as helping develop the capital plan and consult on operations issues.
82. Construction Services budgeted time to support maintenance programs and activities within the region.
83. Rates and Analysis' activities included business and financial analyses of individual systems, financial monitoring and tracking, and developer reimbursement information.
84. Legal Services reviewed contracts, met with developers, and supported the general needs of the utility, such as drafting or reviewing Board agenda items.
85. The New Business Development cost pool included engineers analyzing possible additions to the system, managers conducting discussions with developers, municipalities, and community leaders regarding system additions, and rates and analysis personnel providing financial analysis of potential additions and acquisitions.
86. Rate Analysis personnel provided ongoing financial support activities, such as developing annual budgets and monitoring monthly financial performance.

87. LCRA has committed to reserve raw water for the utilities despite the lack of a contract with itself. To delete the raw water charges would require raw water customers to subsidize retail customers.
88. The cash-needs approach to ratemaking includes recovery of cash capital outlays.
89. LCRA is not seeking recovery of expenses for damages from operations and employee injuries, employee service awards and deferred compensation, equipment and software, First Night and the Texas Parks and Wildlife Department, "Practicing Perfection," certain real estate acquisitions, strategic planning salaries and other expenses, executive oversight other interest expense, certain miscellaneous items, "Develop the Water/Wastewater B," other interest expense, or legislative advocacy expense.
90. With a few exceptions set out in the following Findings, LCRA's actual FY 2007 direct O&M expenses, along with the underlying cost pool expenses, were just, reasonable, and useful in providing service.
91. The following particular O&M expenses should be deleted before calculating the WTC Water O&M expenses:

Description	Amount	Exhibit No.
Rate and Financial Analysis--		
Salaries and Benefits	\$114,431	BC-24
Rate and Financial Analysis--		
Other Expenses	18,948	BC-25
Legal Services—Salaries	15,294	BC-51.
Legal Services—Other Expenses	22,276	BC-26
Damages from O&M Injuries	62,825	BC-27
Employee Service Awards and		
Deferred Compensation	286,623	BC-28
Equipment and Software	195,243	BC-29
First Night Austin/Texas Parks &		
Wildlife Department	22,500	BC-30

“Practicing Perfection”	34,550	BC-31
Real Estate Acquisition	2,653	BC-32
Strategic Planning--		
Salaries	357,900	BC-51
Strategic Planning--		
Other Expenses	12,702	BC-33
Executive Oversight—Other Interest	10,896	BC-34
Miscellaneous	40,810	BC-35
“Develop the Water/Wastewater B”—		
Other Interest	16,459	BC-36
Legislative Advocacy	10,069	NA

92. With the exception of legislative advocacy, the excluded expenses are from various cost pools at various levels of the LCRA organization. They should be allocated to (or rather, from) WTC Water in the manner set out in Ms. Heddin’s testimony, without her proposed related adjustments for benefits and FICA.
93. The \$18,536 in outside services for rate analysis paid to Rimrock Consulting is not a normal operating expense and should be excluded from WTC Water’s O&M expenses.
94. The raw water reservation fee should be included in the WTC Water expenses.
95. To the extent those fees exist, the raw water charges or reservation fees for WTC Wastewater should be disallowed as proposed by the Districts.

Debt Service Expense

96. LCRA’s actual expense summary for FY 2007 shows debt service expense of \$4,549,074 for WTC Water and \$1,857,034 for WTC Wastewater
97. Because LCRA does not earn a return on investment and cannot have taxing authority, it has two sources of funds: revenues produced from operations and proceeds from the issuance of debt.

98. LCRA issues debt as an entity, rather than by individual operating units or systems.
99. LCRA system debt is assigned to each business unit and operating unit, including WSBU and ultimately the WTC systems, based on their respective pro rata shares of capital activity that is debt-funded.
100. At the time the system debt is issued, that debt is specifically assigned to the appropriate capital project expenditures being financed.
101. Actual debt service is the sum of all payment schedules for all debt assigned from each revenue bond issue.
102. As of June 30, 2006, the net book value of the WTC Regional Water System was \$74,936,544 and the net book value of the WTC Regional Wastewater system was \$27,492,632. Those figures included completed capital projects and those in the planning and construction phases.
103. LCRA provided adequate documentation to show how the amount of debt-funded capital project spending for WTC Water and WTC Wastewater were determined.
104. The FY 2007 actual debt service of \$4,549,074 for WTC Water was reasonable.
105. The FY 2007 actual debt service of \$1,857,034 for WTC Wastewater was reasonable.

Operations Reserve Expense

106. Under Policy 301, LCRA is to maintain the following target levels of operating reserves:
Six months of average debt service on all outstanding debt and two months of average operation and maintenance expenses.
107. LCRA debt-funds its operating reserves.

108. LCRA included some operations reserve expense in its FY 2007 expenses to account for incremental amounts not recovered.
109. Because of the decrease in O&M expenses, an additional amount for operations reserve is not required.

Debt Service Coverage Expense

110. Under its bond covenants and its Policy 301, LCRA is required as an entity to maintain debt service coverage of 1.25 percent.
111. Debt service coverage, if kept within the system, is a legitimate cost of providing service.
112. If the WTC systems were exempt from the debt service cost, other LCRA systems or business units would be subsidizing them.
113. It is reasonable to require the systems to reach the debt service coverage level of 1.25x.
114. LCRA used the FY 2007 impact fee revenues to revenue-fund WTC Water and WTC Wastewater capital projects. In doing so, it reduced potential debt financing of those projects.
115. Impact fees should not be used to offset debt service coverage expense.
116. LCRA reasonably calculated debt service coverage expense for WTC Water and WTC Wastewater equal to 25 percent of the corresponding debt service expense.
117. Debt service coverage actually collected through rates, if any, should be accounted for in a restricted fund to be used for only capital improvements or reduction of debt service within the West Travis County Region, or for contributions to operating reserves as required by the LCRA Board of Directors.

Community Development Expense

118. LCRA Board Policy 301 states that three percent of utility budgeted gross revenues shall be charged for community development activities.
119. For ratemaking purposes, because that would be a circular calculation, the community development amount was estimated as three percent of: total O&M expenses, plus debt service costs, plus operation reserves included in rates, plus times coverage included in the rates, less miscellaneous revenues offsetting rate requirements, less LUE reservation charges offsetting rate requirements.
120. The community development revenue is used to fund community development and other activities which LCRA is authorized to perform, but which otherwise would have no source of funding. Those activities include community and economic development, parks operations, natural resource services, resource planning and development, public safety, environmental laboratory services, and watershed monitoring and maintenance.
121. LCRA is authorized to provide the services and engage in the activities accomplished by the community development revenues.
122. The Community Development expenses are reasonable costs for the LCRA system and should be part of the expenses assessed against the WTC systems.
123. Because the debt service coverage is to be retained within the system as recommended by the Executive Director, the Community Development expense should not be incorporated into the debt service coverage expense as suggested by Bee Cave.

Non-Rate Revenues

124. The LCRA non-rate operating revenues for FY 2007 included: 1) Excess Capacity Reserves; 2) LUE Reservation Charges; 3) Raw Water/Effluent Revenues; and 4) Other /Miscellaneous Revenues, as well as wholesale water revenues. Those revenues are counted as credits and used to offset the revenue requirements.
125. "Excess capacity reserves" do not originate from ratepayers, but are contributed by LCRA to the WTC systems to account for capacity constructed to serve future, rather than current, customers.
126. LCRA should not be required to include an excess capacity revenue contribution in its non-rate revenues.

Rate Design

127. The rate design set out by the Executive Director was reasonable and should be used in establishing the rates in this case.

Refunds/Recovery of Lost Revenues

128. The rates currently in effect are interim rates set at the level of Phase 2 of LCRA's three-phase increase.
129. If the rates ultimately set are above that level, LCRA should be allowed to recover the lost revenues.
130. If lost revenues are to be recovered, those revenues should be calculated from October 1, 2009 (the date on which the third step would have gone into effect) until the date of the Commission's Order. A surcharge should then be calculated by taking the amount of the lost revenues for each system (WTC Regional Water and Wastewater) divided by the number of active LUEs at the time of the Commission Order, to be collected over a

period of 24 months, or until the revenue is recovered. The lost revenues should be determined by taking actual billing data for the period beginning October 1, 2009 through the date of Commission Order.

131. Because all WTC Wastewater customers are also customers of WTC Water, only one surcharge would be required.
132. If the rates ultimately adopted are below the current level, refunds should be calculated in the same manner as recommended by LCRA for potential lost revenues, and be accomplished over a 24-month period.

Apportionment of Transcript Costs

133. LCRA should pay the hearing transcript expenses.

Rate Case Expenses

134. LCRA seeks recovery of \$959,490.97 in rate case expenses, which includes attorneys' fees, consultants' fees, transcript costs, and other miscellaneous expenses.
135. The requested expenses were broken into broad categories as follows:

Attorneys Fees

Freeman & Corbett LLP (invoices dated 11/9/07-2/2/09)	\$ 14,135.00
McCall, Parkhurst & Horton LLP (invoice dated 8/13/10)	760.00
Jackson Walker LLP (invoices dated 1/14/10-10/18/10)	<u>764,607.09</u>
Subtotal	779,502.09

Consultants

J. Stowe & Co., Inc. (invoices date 1/19/10-9/10/10)	97,903.94
Rimrock Consulting co. (invoices dates 11/1/07-9/10/10)	<u>63,025.63</u>
Subtotal	160,929.57

Expenses

Kennedy Reporting Services, Inc.	17,273.85
Texas Depo	1,767.31
Pro Courier Services	<u>18.15</u>
Subtotal	19,059.31

Total

\$959,490.97¹

136. A two-day hearing was held on the rate-case-expense issue on November 9-10, 2010.
137. Because this Order finds against LCRA on its use of the FY 2010 budget forecast and its use of relative volumes as an allocator, and because this Order would lead to at least a significant reduction from LCRA's third-phase rates, LCRA should not recover its rate case expenses in this case.

II. CONCLUSIONS OF LAW

1. The Texas Commission on Environmental Quality (the Commission) has jurisdiction over these appeals pursuant to TEX. WATER CODE ANN. § 13.043.
2. The petitions of appeal were filed within the 90-day time limit set by TEX. WATER CODE ANN. § 13.043(c) and 30 TEX. ADMIN. CODE (TAC) § 291.41(c).
3. SOAH has jurisdiction over all matters relating to the conduct of a hearing in this proceeding, including the preparation of a proposal for decision with findings of fact and conclusions of law, pursuant to TEX. GOV'T CODE ANN. § 2003.047 and TEX. WATER CODE ANN. § 5.311.
4. All required notices of the application and the contested case hearing on it were given as required by law. TEX. WATER CODE ANN. § 13.187; TEX. GOV'T CODE ANN. §§ 2001.051 & 2001.052.
5. A district whose ratepayers have appealed under TEX. WATER CODE ANN. § 13.043(b) must still demonstrate that its rates are just and reasonable.

¹ LCRA Closing Argument on Rate Case Expenses, page 2. Of the \$17,273.85 in Kennedy Reporting expenses, \$13,520.25 was related to transcript costs for the evidentiary hearing.

6. TEX. WATER CODE ANN. § 49.2122(b) only creates a presumption that *customer classes*, as opposed to rates, established by a district are properly established absent a showing that the district action establishing the classes was arbitrary and capricious.
7. LCRA has the burden of proof in this proceeding.
8. LCRA is a retail public utility under TEX. WATER CODE ANN. § 13.002(19).
9. TEX. WATER CODE ANN. § 13.002(19) does not require a retail public utility to use a test year, as defined in § 13.002(22) in setting its rates.
10. A retail public utility may use a future budget to set its rates, provided the budget is a reliable forecast of anticipated expenses. SOAH Docket No. 582-05-0003, TCEQ Docket No. 2004-0979-UCR, *Petition Requesting Review of Chisholm Trail Special Utility District's Rate Increase Pursuant to Texas Water Code Section 13.043*. (PFD issued Feb. 8, 2006; Order issued May 3, 2006) (*Chisholm Trail*).
11. The rates set by LCRA should not automatically revert to the pre-August 2007 levels. Instead, the Commission shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken. TEX. WATER CODE ANN. § 13.043(e).
12. The rates established by this Order are just and reasonable, as required by TEX. WATER CODE ANN. § 13.043(j).
13. The rates established by this Order are not unreasonably preferential, prejudicial, or discriminatory but sufficient, equitable, and consistent in application to each class of customers, as required by TEX. WATER CODE ANN. § 13.043(j).
14. The methodology used to set the rates preserves the financial integrity of the retail public utility, as required by TEX. WATER CODE ANN. § 13.043(j).

15. TEX. WATER CODE ANN. § 13.043(e) allows the Commission to order refunds or allow a surcharge to recover lost revenues in a rate appeal.
16. If the rates established by this Order are below the interim rates currently in effect, LCRA shall refund the difference in the manner set out in the Findings of Fact that are part of this Order.
17. If the rates established by this Order are above the interim rates currently in effect, LCRA shall be allowed to recover the lost revenues in the manner set out in the Findings of Fact that are part of this Order.
18. Transcript costs should be assessed against LCRA, pursuant to 30 TAC § 80.23(d)(1)(F).
19. LCRA should not recover its rate case expenses pursuant to TEX. WATER CODE ANN. § 13.043(e).

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. Based on the above, the appeals of the City of Bee Cave and West Travis County MUD Nos. 3 and 5 from the rates set by the Lower Colorado River Authority (LCRA) for the West Travis County Regional Water System, and the appeal of West Travis County MUD Nos. 3 and 5 from the rates set by LCRA for the West Travis County Regional Wastewater System, are granted in part and LCRA is authorized to collect the following rates: _____.
2. Debt service coverage actually collected through rates, if any, should be accounted for in a restricted fund to be used for only capital improvements or reduction of debt service

within the West Travis County Region, or for contributions to operating reserves as required by the LCRA Board of Directors.

3. LCRA shall be assessed the full amount of the reporting and transcription costs.
4. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
5. The effective date of this Order is the date the Order is final, as provided by 30 TEX. ADMIN. CODE § 80.273 and TEX. GOV'T CODE ANN. § 2001.144.
6. If any provision, sentence, clause, or phrase of this Order is for any reason held to be invalid, the invalidity of any provision shall not affect the validity of the remaining portions of this Order.

ISSUED:

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Bryan W. Shaw, Ph.D., Chairman
For the Commission