

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

March 17, 2010

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

Re: SOAH Docket No. 582-08-1719; TCEQ Docket No. 2008-0164-UCR;
Rate/Tariff Change Application of HHJ, Inc., d/b/a Decker Utilities

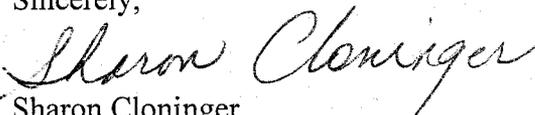
Dear Mr. Trobman:

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

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the original documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than April 6, 2010. Any replies to exceptions or briefs must be filed in the same manner no later than April 16, 2010.

This matter has been designated **TCEQ Docket No. 2008-0164-UCR; SOAH Docket No. 582-08-1719**. 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,


Sharon Cloninger
Administrative Law Judge

SC/lh
Enclosures
cc: Mailing List

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STYLE/CASE: HHJ, INC / DECKER UTILITIES

SOAH DOCKET NUMBER: 582-08-1719

REFERRING AGENCY CASE: 2008-0164-UCR

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HEARINGS**

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SOAH DOCKET NO. 582-08-1719
TCEQ DOCKET NO. 2008-0164-UCR

APPLICATION OF HHJ, INC. DBA § BEFORE THE STATE OFFICE
DECKER UTILITIES TO CHANGE ITS §
WATER AND SEWER TARIFF IN §
MONTGOMERY COUNTY, TEXAS § OF
§
§ ADMINISTRATIVE HEARINGS

TABLE OF CONTENTS

I. PROCEDURAL HISTORY AND DESCRIPTION OF EVIDENCE PRESENTED 2

A. Procedural History..... 2

B. Description of Evidence Presented 3

 1. Original Hearing on the Merits 3

 2. Hearing on Remanded Issue 4

II. BACKGROUND 8

A. Decker’s History..... 8

B. Decker’s Bankruptcy 9

III. UNSUPPORTED GENERAL LEDGER EXPENSES SHOULD BE DISALLOWED 11

A. Decker’s Methodology 11

B. The ED’s Methodology 12

C. OPIC’s Position 12

D. ALJ’s Analysis and Conclusion 13

IV. COST OF SERVICE 14

A. Return on Invested Capital 14

 1. Invested Capital, Also Referred to as Rate Base..... 14

a.	Decker's Evidence and Argument.....	15
i.	how Mr. Fenner determined original cost.....	16
ii.	original cost, depreciation, and net book value	17
b.	ED's Evidence and Argument.....	18
i.	how Mr. Mach determined original cost.....	18
ii.	original cost, depreciation, and net plant.....	19
iii.	Staff's argument against Decker's calculations.....	20
2.	Rate of Return	21
a.	Decker's Evidence and Argument.....	21
i.	Decker's efforts and achievements regarding conservation of resources, quality of service, efficiency of operations, and quality of management.....	23
b.	ED's Evidence and Argument.....	26
3.	ALJ's Analysis and Recommendation	28
B.	Allowable Expenses.....	29
1.	Operations and Maintenance Expense	29
a.	Salaries and Wages	30
i.	Decker's evidence and argument	30
ii.	The ED's evidence and argument	32
b.	Contract Labor.....	33
i.	Decker's evidence and argument	33
ii.	The ED's evidence and argument	34
c.	Utility Expenses.....	34
d.	Repairs and Maintenance.....	34
i.	Decker's evidence and argument	34
ii.	ED's evidence and argument.....	35
iii.	ALJ's recommendation.....	36

e.	Office Expenses	36
i.	Decker's evidence and argument	36
ii.	ED's evidence and argument.....	36
iii.	ALJ's recommendation.....	37
f.	Accounting and Legal Expenses	37
i.	Decker's evidence and argument	37
ii.	ED's evidence and argument.....	38
iii.	ALJ's recommendation.....	38
g.	Insurance Expenses.....	38
i.	Decker's evidence and argument	38
ii.	ED's evidence and argument.....	39
iii.	ALJ's recommendation.....	39
h.	Miscellaneous Known and Measurable Decreases.....	39
i.	Reductions in Other Revenue	40
j.	Payments to Affiliated Interests.....	40
2.	Depreciation Expense	41
3.	Assessments and Taxes Other Than Income Taxes	41
a.	Decker's Evidence and Argument.....	41
i.	Payroll taxes	41
ii.	Property taxes and Texas business tax	41
b.	ED's Evidence and Argument.....	42
4.	Federal Income Taxes on a Normalized Basis.....	42
a.	Decker's Evidence and Argument.....	42
b.	ED's Evidence and Argument.....	43
V.	RATE DESIGN	43
A.	Decker's Evidence and Argument.....	44

B. ED's Evidence and Argument..... 45

C. ALJ's Analysis and Recommendation 47

VI. ALJ'S RATES CONCLUSIONS 47

VII. CURRENT RATE CASE EXPENSES 47

VIII. CONCLUSION..... 50

**SOAH DOCKET NO. 582-08-1719
TCEQ DOCKET NO. 2008-0164-UCR**

APPLICATION OF HHJ, INC. DBA DECKER UTILITIES TO CHANGE ITS WATER AND SEWER TARIFF IN MONTGOMERY COUNTY, TEXAS	§ § § § § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS
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AMENDED PROPOSAL FOR DECISION

On June 26, 2009, the Texas Commission on Environmental Quality (the Commission or TCEQ) considered during its open meeting the Proposal for Decision (PFD) and Proposed Order in this case. After considering the recommendation of the Administrative Law Judge (ALJ), the Commission determined to remand this matter to the State Office of Administrative Hearings (SOAH) for an additional hearing to give the parties the opportunity to more fully address the issue of the undocumented cost of service expenses of HHJ, Inc. d/b/a Decker Utilities (Decker).¹ To minimize confusion, this Amended PFD addresses all issues in the case; hence, re-reading the original PFD should not be necessary. This Amended PFD recommends adoption of the water and sewer rates proposed by the Executive Director (ED) of the Commission during the remand proceeding.

Decker seeks Commission approval to change water and sewer rates for the Decker Oaks and Village at Decker Oaks subdivisions in Montgomery County, Texas, and to recover associated rate-case expenses from its customers. Decker seeks a total revenue requirement of \$827,243,² including \$269,120 for its water service and \$558,123 for its sewer service.³ Further, Decker seeks to recover rate-case expenses in the amount of \$30,197.23,⁴ amortized over two years as a surcharge added to customers' monthly bills.

¹ The Commission issued its Interim Order on July 21, 2009.

² An annual rate increase of \$351,760 for water and sewer combined is requested. ED Ex. A.

³ Pre-filed Testimony of Debi Loockerman, CPA, Decker Ex. 1, at 22.

⁴ Decker's Replies to Closing Arguments, at 10-11. All referenced closing arguments relate to the original

The protesting ratepayers (Protestants) oppose the proposed rate increase, while the ED recommends adjustments that would reduce the proposed rates to an annual revenue requirement of \$685,485, including \$217,129 for water and \$468,563 for sewer.⁵ The Office of Public Interest Counsel (OPIC) adopts the ED's recommendation.⁶

After considering the issues and evidence presented, the ALJ recommends that the Commission grant Decker's request to increase rates, but with the modifications proposed by the ED at the remand proceeding. Further, the ALJ recommends that the Commission authorize Decker to recover rate case expenses in the amount of \$29,397.23⁷ over two years as a surcharge to customers' monthly bills.

I. PROCEDURAL HISTORY AND DESCRIPTION OF EVIDENCE PRESENTED

A. Procedural History

On November 15, 2007, Decker filed an application (the Application)⁸ with the TCEQ to change its water and sewer utility rates as allowed under the Commission rule found at 30 TEX. ADMIN. CODE (TAC) § 291.22. The Commission received 280 protests, representing more than 10 percent of the 542 water and sewer customers served during the test year, and exceeding the percentage required for review of rate actions, as set out in TEX. WATER CODE ANN. § 13.187 and 30 TAC § 291.27. Accordingly, on January 31, 2008, the Commission referred this matter to SOAH for a contested case hearing to determine whether the proposed rates are just and reasonable, in compliance with the law, and to establish the rates. The Commission issued notice of the

proceeding unless specifically noted as being filed following the remand hearing.

⁵ ED Exs. HH2 and LL2 from the remand proceeding.

⁶ OPIC Closing Argument on Remand, at 5.

⁷ Decker requested \$30,197.23 in rate case expenses including a prospective expense of \$800 for Mr. Zeppa to prepare a motion for rehearing. The ALJ is persuaded by the ED's Replies to Closing Arguments at 11 that \$800 to prepare a motion for rehearing should be disallowed.

⁸ Attachment to Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 24-88.

preliminary hearing on February 12, 2008, and Decker's customer account manager sent the notice to all of Decker's customers on March 29, 2008.

On April 15, 2008, ALJ Sharon Cloninger conducted a preliminary hearing in this case, at which time jurisdiction and proper notice were established, and the following were designated as parties to this proceeding: Decker, Protestants, the ED, and OPIC.

The hearing on the merits convened on October 14, 2008, in Houston, Texas. Applicant appeared through its attorney, Mark H. Zeppa; Protestants appeared through their representatives, Stacy Y. McCoy-Moquin and Larry Osborne; the ED appeared through Erin Selvera and Trey Jackson, staff attorneys; and OPIC appeared through Christina Mann, staff attorney. At the end of the day, the parties asked for a recess to discuss settling the case. The parties were unable to reach a settlement, and the hearing on the merits reconvened on November 6, 2008, in Austin, Texas, with all parties participating in the proceeding. The record closed January 12, 2009, after the parties submitted written closing arguments and replies. The hearing was not transcribed.

Following issuance of the Commission's Interim Order, a preliminary hearing was held October 5, 2009, at SOAH in Austin, Texas. The evidentiary hearing on the remanded issue was held November 30, 2009. The proceedings were not transcribed. The record closed January 18, 2010, after the ED and OPIC submitted closing arguments. Decker and Protestants did not submit written closing arguments or replies.

B. Description of Evidence Presented

1. Original Hearing on the Merits

Decker introduced the testimony of five witnesses: Debi Loockerman, CPA, who sponsored the financial portions of the Application; Bret Fenner, PE, who sponsored the plant and depreciation schedules and the rate design portion of the Application; Robert Weedn, Decker's president and

plant operator; Jeffrey Powell, Decker's office manager; and Mr. Zeppa, to establish his fees in relation to rate-case costs.

Protestants introduced the testimony of one witness, Ms. McCoy-Moquin, but presented no technical or expert testimony to rebut or comment on the case presented by Decker.

Instead, the disputed issues were raised by the ED's staff (Staff), who conducted an audit, served discovery, and prepared direct testimony related to the financial and technical aspects of the Application. The ED called two witnesses: Sheresia Perryman,⁹ a TCEQ accountant/auditor, who addressed cost of service or revenue requirement; and Kha Mach, P.E.,¹⁰ who worked at the time in the Utilities & Districts Section of the Water Supply Division of the TCEQ, and presented the ED's recommendations concerning quality of service, depreciation, water loss and consumption, and proposed water and sewer rate designs. Amended pre-filed testimony of Ms. Perryman and Mr. Mach was offered and admitted at the November 6, 2008 reconvened hearing, after Ms. Perryman revised her numbers in response to Ms. Loockerman's testimony.

2. Hearing on Remanded Issue

The remand hearing was for the limited purpose of allowing Decker, the ED, Protestants and OPIC to address those cost of service expenses not documented by Decker in the first hearing on the merits. The expenses were contained in Decker's general ledger, but were not supported by receipts, invoices, or check stubs.

⁹ Decker asserted for the first time in its Replies to Closing Arguments related to the original hearing that Ms. Perryman is not an expert. *See* Decker's Replies to Closing Arguments, at 4. Decker did not object to the reliability of Ms. Perryman's testimony before trial or when it was offered. Decker neither objected to the expert testimony of Ms. Perryman pursuant to TRE 104(c) nor moved to exclude or disqualify Ms. Perryman as an expert during the hearing. Decker's complaint that Ms. Perryman is not an expert is untimely and, to the extent it is an objection, is overruled. *See* ED's Reply to Closing Arguments, at 5-6, for a full discussion of the timeliness issue. In addition, the ED complains of Decker's filing of Replies to Closing Arguments without first filing a closing argument; the ALJ accepts Decker's Replies to Closing Arguments. *See* ED's argument at ED's Reply to Closing Arguments, at 1-2.

¹⁰ Mr. Mach left employment with the TCEQ between the October 14, 2008 proceeding and the November 6, 2008 reconvened hearing.

The Texas Water Code and TCEQ rules provide that in the course of evaluating a rate/tariff change application, the ED may request additional information from any utility. If the utility fails to provide within a reasonable time the necessary documentation or other evidence that supports the costs and expenses as shown in the application, the Commission may disallow those unsupported costs or expenses. TEX. WATER CODE ANN. § 13.187(c) and 30 TAC § 291.28(4).

Pursuant to the Interim Order and the ED's request for additional documentation to support Decker's claimed cost of service expenses, Decker offered copies of some of the invoices and canceled checks that had not been produced in response to the ED's request prior to the original hearing.¹¹ The records were supported by Jan Velkovich, Decker's Office Manger and Chief Custodian of records. The information provided by Ms. Velkovich included copies of invoices and checks, excerpts from Decker's general ledger and credit card receipts to document expenses incurred by the utility for costs related to auto and truck, job materials, landscaping and telephone. Upon cross examination by Protestants, Ms. Velkovich conceded she had no personal knowledge of the information contained in the documents because she was not a Decker employee during the test year. Consequently, she was not able to answer questions regarding the substance of the documents.

Testimony of the ED's witness Ms. Perryman established that not all of the invoices and check stubs provided by Decker to the ED on September 25, 2009, warranted allowance of disputed costs.¹² Specifically, Ms. Perryman disallowed \$1,602.06 of the additional checks and invoices for repairs and maintenance because \$602.06 in job materials was outside the test year and there was insufficient information to establish whether \$1,000 in charges was for personal expenses or business expenses.¹³ Additionally, Ms. Perryman disallowed \$3,080.88 in office expenses because no invoice was provided and there was no supporting documentation to indicate the expense was for utility

¹¹ HHJ Ex. AA.

¹² ED Ex. DD2 lists the costs allowed by Ms. Perryman.

¹³ See ED Ex. EE2. Ms. Perryman disallowed three invoices for job materials, which fall into the repairs and maintenance category.

business.¹⁴ Furthermore, Ms. Perryman did not consider any of the invoices for expenses that Decker's consultant Ms. Loockerman had documented as personal expenses (*i.e.*, non-utility expenses) in her work papers.¹⁵ Ms. Perryman testified that the ED's recommended cost of service included reductions in the following categories of costs based on lack of receipts, invoices, or other supporting documentation to establish the charges were for utility business: repairs, maintenance, and office expenses.¹⁶ In addition to the recommended reductions in Decker's proposed costs of service, the ED adjusted the allocation of debt for the Hybernia National Bank loan it had recommended in the original proceeding to match the allocation used by Decker in its application.¹⁷

The ED provided several exhibits outlining the costs and expenses allowed and disallowed by ED staff as well as the ED's analysis via spreadsheets of the operations, maintenance, and tax calculations, the weighted and invested capital calculations, the revenue requirement, and the rate design.¹⁸ The disallowance of \$602.06 for job materials and other undocumented expenses resulted in changes to the totals allowed for the repairs and maintenance category of which job materials is a component. The ED allocated the disallowed amounts equally between water and sewer and presented a revised amount for each.

The revised total for repairs and maintenance recommended by the ED was \$8,221.33 allocated as \$4,110.66 to water and \$4,110.66 to sewer.¹⁹ The ED also added back in an amount of \$2,129.50 to water and the same amount to sewer which had been previously disallowed by Decker

¹⁴ See ED Ex. EE2. Ms. Perryman disallowed 12 invoices for telephone expenses which is categorized under office expenses.

¹⁵ Ms. Perryman did not consider \$258 in auto and truck expenses (invoice no. 6050), \$701.41 in job materials (invoice no. 6240), and a total of \$3,229.59 in landscaping expenses (invoice no. 6260, check nos. 1084, 1902, and 6455). See HHJ Ex. 1, Attachment D, bates page 86 (work papers of Debi Loockerman).

¹⁶ ED Ex. EE2.

¹⁷ The ED changed the allocation of 50 percent each for water and sewer to 82 percent for sewer and 18 percent for water in accordance with Decker's application and as recommended by the ALJ in the original PFD at pages 42-43.

¹⁸ The ED offered exhibits CC through PP. The ED filed revised versions CC2 through PP2 on December 1, 2009, without objection and at the direction of the ALJ.

¹⁹ ED Ex. DD2.

in the original Application and then inadvertently disallowed again by the ED. The total expenses allowed then resulted in an amount of \$6,240.16 for water and the same amount for sewer.²⁰

ED witness Heidi Graham, Engineering Specialist in the ED's Water Supply Division, addressed the depreciation portion of Decker's cost of service and the rate design. She testified that she did not make any changes to the depreciation calculations used by Mr. Mach, ED witness at the original proceeding. She testified that she incorporated Staff's disallowance of some of Decker's claimed expenses in her calculations. Based on Ms. Graham's revised exhibits, the ED recommends a water base rate of \$17.98 with a gallonage charge of \$2.29 per thousand gallons and a sewer base rate of \$50.90 with a gallonage charge of \$4 per thousand gallons.

Neither Protestants nor OPIC presented witnesses. Their participation in the hearing focused on cross-examination of Mr. Weedn. Mr. Weedn testified at the remand hearing that for 10 years, he has used one credit card for both personal expenses and utility business. He said he pays the monthly bill, then presents receipts to Decker's bookkeeper for reimbursement for the utility-related credit card charges. He said he no longer has receipts that would distinguish utility expenses from personal expenses charged on the credit card. In its written closing argument, OPIC noted that it found Mr. Weedn's testimony in response to cross-examination to show a troubling disregard for adequate record keeping and questionable business practices including the commingling of personal and business activities and expenses. OPIC noted that the commingling of expenses is a significant factor in Decker's inability to provide adequate support for business-related costs.²¹

²⁰ ED Ex. DD2.

²¹ OPIC's Closing Argument on Remand Proceeding, at 2-3.

II. BACKGROUND

A. Decker's History

Decker operates as a single utility with an integrated water and sewer system in Montgomery County, Texas, under authority of Water Certificate of Convenience and Necessity (CCN) No. 12841 and Sewer CCN No. 20833. Its two service areas—residential subdivisions called Decker Oaks and The Village at Decker Oaks—are close together, receive water and sewer service from the same plant, and are within 20 miles of Decker's business office in Tomball, Harris County, Texas.²²

Decker's original rates were established at the utility's inception on April 13, 1999. Until the Application was filed, Decker had never requested a rate increase. According to Mr. Weedn, who is Decker's president, sole stockholder/director, and chief utility plant operator, Decker has been operating at a loss, subsidized until recently by the development company he owned.²³

New rates, as proposed in the Application, have been imposed since February 1, 2008, pending the outcome of this proceeding.²⁴ Under Decker's requested rates, the total cost to customers for 10,000 gallons of water would increase from \$27.75 per month to \$48.78 per month, and for 30,000 gallons of water, from \$50.75 per month to \$94.58 per month. The existing sewer rate for 10,000 gallons would increase from \$70 per month to \$184.67 per month.²⁵

The utility's water production facilities consist of two groundwater wells, two groundwater storage tanks, seven booster pumps, and two pressure storage tanks. The distribution system consists

²² Pre-filed Testimony of Robert Weedn, Decker Ex. 3, at 7.

²³ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 1 and 12; Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 17.

²⁴ ED Ex. A; Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 17.

²⁵ ED Ex. A; Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 53.

of PVC piping with mains varying in size from eight inches to two inches in diameter. The entire water plant is surrounded by a wooden intruder-resistant fence.²⁶

The utility's sewer treatment facilities consist of the original 87,000 gallons per day (gpd) treatment plant with an additional 400,000 gpd of wastewater treatment plant (WWTP) capacity added in 2005. The collection system's PVC piping varies in size from ten inches to six inches in diameter. The system also has two lift stations. After the Application was filed, the treatment plant was enclosed with an intruder-resistant fence, and the blower building was outfitted with soundproofing insulation and surrounded by a wooden fence.²⁷

Decker is certified by the Commission as a regional service provider. When obtaining a permit for the WWTP, Decker included a future growth component in the third phase for the WWTP to serve an expanded service area. Currently, there is little alternate sewer service capacity near the Decker service area. The Commission found there was a need for all of Decker's sewer capacity when the TCEQ approved the utility's most recent TPDES wastewater permit.²⁸

B. Decker's Bankruptcy

According to Mr. Weedn, Decker filed for bankruptcy in October 2007 because the utility could not repay the \$1.581 million debt incurred for the 2005 WWTP construction.²⁹ He explained that a rate increase to insure the utility pays its own way became a key component of the bankruptcy reorganization,³⁰ so the Application was filed a month later, in November 2007.

²⁶ Pre-filed Testimony of Mr. Fenner, Decker Ex. 2, at 4.

²⁷ Neither of these capital improvements was added to Decker's recommended original cost for sewer plant and equipment in the Application. Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 5.

²⁸ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 5.

²⁹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 49 (Application, at 24); Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 4.

³⁰ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 12.

Mr. Weedn said that at Decker's inception the utility was so small that its day-to-day operations had to be subsidized by its affiliated development companies at the rate of about \$20,000 per month. The subsidy continued as long as development was ongoing, through about 2006. He noted that the affiliated development companies did not contribute to original plant cost.³¹ As the number of customers increased, it became necessary to add WWTP capacity to meet service demands of both the existing customer base and the customer base projected to need service once Decker's CCN areas are built out.³² During the several years it took to permit, finance, and construct the new WWTP, the development companies continued to subsidize Decker's operations.³³

Traditionally, Decker relied on its development affiliates to generate enough cash flow to fund necessary utility capital plant additions. Decker did not have the cash reserves to fund construction of the new, expanded WWTP, so borrowed money for the project.³⁴ Mr. Weedn expected the real estate operations to generate enough cash to supplement Decker's utility earnings to service the bank debt. As the local real estate market crashed, Decker found itself unable to meet all its financial obligations for debt service and utility operations. Rather than allow utility services to decline, Mr. Weedn decided to seek reorganization of Decker's debt in bankruptcy in October 2007. A Plan of Reorganization was filed a year later, in October 2008, and was approved. As of the October 14, 2008 hearing date, Decker was in the post-petition phase of the bankruptcy process, according to Mr. Weedn.³⁵ The bankruptcy status was not updated at the November 30, 2009 remand proceeding.

³¹ Recording of October 14, 2008 proceeding, beginning at approximately 36:08 minutes in segment HOM 2 of 4. Decker presented no documentary evidence in support of Mr. Weedn's claim, either at the original hearing or at the remand proceeding.

³² Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 4 and 12.

³³ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 12.

³⁴ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 5. Mr. Weedn states the loan was from Capital One; the Application shows the loan to be from Hybernia National Bank. *See* Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 49 (Application, at 24). The ALJ finds the witnesses are referring to the same loan.

³⁵ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 5 and 12; recording of October 14, 2008 proceeding, beginning at approximately 33:51 minutes and again at 41:31 minutes in the HOM 2 of 4 segment.

As of the October 2008 hearing date, the utility was in Mr. Weedn's control as "debtor in possession." Decker was being operated in the same fashion as before, but under a very tight budget set by the bankruptcy court. Day-to-day operating expenses were covered by the budget, but major expenditures had to be approved by the bankruptcy court.³⁶ Non-routine and ordinary Decker expenses had to be paid for from utility operations' cash flow.

No bankruptcy-related costs were included in Decker's original rates. Therefore, Mr. Weedn said he knows the customers have not paid any bankruptcy costs in the rates charged for the water and sewer utility service they are consuming. He said customers are not being billed for any ongoing bankruptcy expenses.³⁷ Ms. Loockerman testified that any bankruptcy-related expenses used in the Application are representative of the normal level of legal and accounting expenses expected for a regulated utility.³⁸

III. UNSUPPORTED GENERAL LEDGER EXPENSES SHOULD BE DISALLOWED

A. Decker's Methodology

During the test year, Decker did not maintain separate water and sewer records. Decker is a very small utility system compared to most public water systems in Texas, and both water and wastewater service are provided to all customers.³⁹ In Ms. Loockerman's opinion, it was reasonable for Decker to maintain books in the aggregate for these reasons. When separate records are not kept,

³⁶ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 5-6.

³⁷ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 5.

³⁸ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 6.

³⁹ During the test year, there were 542 water customers and 542 sewer customers. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 4. Mr. Weedn testified at the November 6, 2008 reconvened hearing that up to 20 customers either have water service only, or a second water tap for irrigation purposes only. Recording of November 6, 2008 proceeding, beginning at approximately 2:31:07 hours.

reasonably allocating costs between water and sewer is an acceptable means of determining separate rates, she said.⁴⁰

Ms. Loockerman said she determined Decker's revenue requirement based on the January – December 2006 test year by reviewing Decker's financial statements, including the general ledger; removing from her calculations any non-recurring expenditures and non-utility expenses that were not recoverable from customers; and making adjustments for known and measurable changes. She also reviewed financial information for the months available after the 2006 test period, up to the November 2007 filing of the Application. She interviewed Decker's employees and reviewed selected invoices reflecting test-year expenses.⁴¹

B. The ED's Methodology

Although Ms. Loockerman's testimony includes an explanation of her calculations regarding expenses,⁴² Staff argues the receipts and supporting documentation that Decker provided to Staff were insufficient to justify the amounts claimed. The ED's recommended cost of service includes reductions to the following categories of costs based on lack of receipts, invoices, or other supporting documentation: repairs, maintenance, and supplies; office expenses; accounting and legal fees; notes payable expenses; federal income taxes; and return on net invested capital.⁴³

C. OPIC's Position

OPIC argues that Decker attempted to dismiss the ED's concerns that invoices or receipts do not exist for many of the claimed costs by demanding that Ms. Perryman point to a specific statute or

⁴⁰ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 4.

⁴¹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 3.

⁴² ED's Closing Argument, at 2-3, referring to Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 5-14.

⁴³ ED's Closing Argument, at 2-3, referring to Ms. Perryman's amended testimony, ED Ex. 1-A. Staff maintained its position at the remand proceeding.

rule that requires privately-owned water utilities to keep such records.⁴⁴ OPIC points out that Decker's strategy ignores its burden to demonstrate that the rate is just and reasonable as required by 30 TAC § 291.12. OPIC agrees with the ED that an applicant must have some record of expenses other than a general ledger entry when requiring water and wastewater consumers to pay additional funds to an entity that has a monopoly on providing those services. OPIC acknowledges that water and wastewater service providers have every right to charge a tariff that accurately reflects a cost of service and earns a rate of return, but argues it is the responsibility of those providers to present documentation supporting the claimed expenses. OPIC agrees with the ED that expenses that cannot be verified should not be borne by the consumer.⁴⁵

D. ALJ's Analysis and Conclusion

During the original proceeding, Staff recommended disallowing Decker's claimed expenses that were supported only by the utility's general ledger. In her original PFD, the ALJ recommended that the unsupported expenses be allowed. However, at the June 26, 2009 open meeting, the Commission remanded the case to SOAH to give Decker a second opportunity to produce the underlying documentation requested by Staff. Decker did not provide Staff with all of the requested underlying documentation.

In the first proceeding, Decker provided its general ledger as well as invoices, check stubs, and receipts that supported some, but not all, of the expenses contained in the Application. Under applicable law, the Commission may disallow the unsupported claimed expenses.

The following law applies:

The utility's rate/tariff application must include information the regulatory authority requires by rule. If the utility fails to provide

⁴⁴ Recording of November 6, 2008 reconvened hearing, beginning at approximately 18:30 minutes.

⁴⁵ OPIC Closing Argument, at 5.

within a reasonable time after the application is filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application, the regulatory authority may disallow the non-supported costs or expenses. TEX. WATER CODE ANN. § 13.187(c).

The ED or Commission may request additional information from any utility in the course of evaluating the rate/tariff change request, and the utility shall provide that information within 20 days of receipt of the request, unless a different time is agreed to. If the utility fails to provide within a reasonable time after the application is filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application, the Commission may disallow the unsupported costs or expenses. 30 TAC § 291.28(4).

Having considered the arguments, the facts of this case, and applicable law, the ALJ recommends that the Commission disallow certain expenses for which Decker did not provide supporting documentation, as requested by the ED, in determining Decker's water and sewer rates.

IV. COST OF SERVICE

Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. 30 TAC § 291.31(a).

A. Return on Invested Capital

The return on invested capital is the rate of return times invested capital. 30 TAC § 291.31(c).

1. Invested Capital, Also Referred to as Rate Base

As set out in 30 TAC § 291.31(c)(2), the rate of return is applied to the rate base. Under 30 TAC § 291.31, components to be included in determining the rate base are:

(c)(2)(A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:

(c)(2)(A)(i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or a predecessor;

(c)(2)(A)(ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;

(c)(2)(B) working capital allowance to be composed of, but not limited to, the following:

(c)(2)(B)(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

(c)(2)(B)(ii) reasonable prepayments for operating expenses (prepayment to affiliated interests) are subject to the standards set forth in TEX. WATER CODE ANN. § 13.185(e); and

(c)(2)(B)(iii) a reasonable allowance for up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

a. Decker's Evidence and Argument

Mr. Fenner defined net book value as the value of the useful life of the plant calculated from the original installed cost of all plant items minus the total accumulated depreciation. Net book value is used to establish the rate base and provides an investor-owned utility, such as Decker, an opportunity to earn a return on its invested capital.⁴⁶

⁴⁶ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 6-7. Exhibit BWF-1 summarizes Mr. Fenner's water plant and equipment calculations; exhibit BWF-2 summarizes his sewer plant and equipment calculations. Note that the total accumulated depreciation in BWF-2 should be \$305,966, to reflect the change made following Mr. Fenner's testimony regarding the total accumulated depreciation for man holes. Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

For the water plant, Mr. Fenner recommended an original cost of \$669,258; annual depreciation of \$20,255; accumulated depreciation of \$105,182; and net book value of \$564,076. For the sewer facilities, Mr. Fenner recommended an original cost of \$2,827,441; annual depreciation of \$57,018; corrected accumulated depreciation of \$305,966; and net book value of \$2,624,293.⁴⁷

Mr. Fenner calculated the depreciation expense, using the TCEQ's recommended useful life for each of the plant items. He said depreciation is recognized as a line item in the cost of service that allows the utility to recover the cost of an asset over the useful life of that asset. The TCEQ requires straight-line depreciation which is calculated by taking the original cost of an asset, such as a pump, and dividing that cost by the number of years of its recommended useful life.⁴⁸

i. how Mr. Fenner determined original cost⁴⁹

Mr. Fenner explained that no historical records are on file with the TCEQ regarding Decker's original cost of the plant, design considerations, and installation dates, because Decker has not previously filed a rate change application. Since that information is not on file, Mr. Fenner used inspections, interviews, and a records search to determine the original installed cost, annual depreciation, total accumulated depreciation, and net book value for both the water and sewer plants and equipment that is used and useful in providing water and sewer service to Decker's customers.⁵⁰ The date of installation was determined either by a search of historical records or information provided by the utility.⁵¹

⁴⁷ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7.

⁴⁸ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 6. *See also* Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 18-19, and at 35 for the Original Cost and Depreciation Schedule—Water (Application, at 10) and at 47 for the Original Cost and Depreciation Schedule—Sewer (Application, at 22).

⁴⁹ *See* 30 TAC § 291.31(c)(2)(A)(i).

⁵⁰ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 3.

⁵¹ Mr. Fenner testified that trend analysis is an acceptable alternative for determining original plant value when invoices are not available.

Mr. Fenner testified that he determined Decker's original plant value through trending, because no original cost invoices were available.⁵² Mr. Fenner described trending as a method of taking the known cost of an item, such as a storage tank, at a known date and determining the cost of that item at a different point in time based on construction cost changes or trends over the years.⁵³ He used the Handy-Whitman Index of Public Utility Construction Costs (the Handy-Whitman Index), the standard used by regulatory entities to perform trending analysis. This publication provides ratios of construction costs for utility equipment for every year since the early 1900s, he said.⁵⁴

ii. original cost, depreciation, and net book value

For Decker's water plant, Mr. Fenner recommended an original cost of \$669,258; annual depreciation of \$20,255; accumulated depreciation of \$105,182; and net book value of \$564,076.⁵⁵ For Decker's sewer facilities, Mr. Fenner recommended an original cost of \$2,827,441; annual depreciation of \$57,018; and net book value of \$2,624,293.⁵⁶ If corrected based on his testimony at hearing, Mr. Fenner's accumulated depreciation figure becomes \$305,966,⁵⁷ which yields a net book value of \$2,521,374.⁵⁸

⁵² Recording of October 14, 2008 proceeding, beginning at approximately 1:40:00 hours.

⁵³ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 8.

⁵⁴ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7-8. See exhibit BWF-3 for Mr. Fenner's trend analysis for water and sewer cost items.

⁵⁵ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7.

⁵⁶ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7.

⁵⁷ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7. Note that although the accumulated depreciation is listed as \$203,148 in his pre-filed testimony, he testified at hearing that the \$101 figure used for accumulated depreciation for man holes in BWF-2 should have been about \$101,000. If the \$10,302 in annual depreciation is multiplied by 10 years, as listed in exhibit BWF-2, the total is \$103,020. If \$101 is subtracted from the listed accumulated depreciation of \$203,148, and \$103,020 is then added to the remainder of \$203,047, the total accumulated depreciation is \$305,966. Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

⁵⁸ The incorrect \$101 for man holes is added back in to the recommended net plant of \$2,624,293, for a sum of \$2,624,394. The correct accumulated depreciation of \$103,020 is then subtracted from \$2,624,394, for a net

b. ED's Evidence and Argument

For water plant, Mr. Mach calculated an original cost of \$516,259; annual depreciation of \$15,983; accumulated depreciation of \$83,350; and a net value of \$427,910.⁵⁹

Mr. Mach's calculated original cost of the sewer plant is \$2,404,722; annual depreciation is \$48,546; accumulated depreciation is \$237,601; and net value is \$2,167,120.⁶⁰

Mr. Mach conducted a field inspection of Decker's facilities on April 8, 2008, and verified that the items claimed in the Application's depreciation schedules are used and useful in providing water and sewer service to Decker's customers. Mr. Mach said he used the depreciation schedules in the Application, without making any adjustments, because this is Decker's first rate change application.⁶¹

i. how Mr. Mach determined original cost

At the remand proceeding, ED witness Ms. Graham adopted Mr. Mach's determination of original cost and net plant.⁶² Mr. Mach's adjustments to Decker's water plant were not based on original costs claimed in the Application, because Decker did not provide any receipts to verify original costs or explain how the costs submitted in the Application were developed. Instead, Mr. Mach's adjustments were based on the Handy-Whitman Index, using Bulletin No. 162, published July 1, 2005.⁶³

plant of \$2,521,374.

⁵⁹ Mr. Mach's amended testimony, ED Ex. 2-A, at 7; *see* exhibits ED-KM-1 and ED-KM-1a for comparison purposes.

⁶⁰ Mr. Mach's amended testimony, ED Ex. 2-A, at 7-8; *see* exhibits ED-KM-2 and ED-KM-2a for comparison purposes.

⁶¹ Mr. Mach's amended testimony, ED Ex. 2-A, at 5-6.

⁶² *See* ED exhibits GG2 and KK2.

⁶³ Mr. Mach's amended testimony, ED Ex. 2-A, at 7; *see* exhibits ED-KM-1 and ED-KM-1a to compare the ED's calculations with those of Decker's expert.

Neither were Mr. Mach's adjustments to Decker's sewer plant based on original costs claimed in the Application. Again, Decker did not provide any receipts to verify original cost or explain how original cost was developed as listed in the Application.⁶⁴ Instead, Mr. Mach calculated the ratio between the Handy-Whitman Index of 2000 and the Handy-Whitman Index, Bulletin 162, published July 1, 2005 (the year of the WWTP expansion). The trended cost is the product of cost quotes, the number of units, the Handy-Whitman Index ratio, and the city cost index.⁶⁵

For both the water plant and sewer plant calculations, values for the original cost, annual depreciation, accumulated depreciation, and net plant value were figured using Mr. Mach's price quotes and calculated trended costs, and city cost indexes provided in Decker's supplement dated July 29, 2008, the straight line depreciation method, and no salvage value, as required by TCEQ rules to calculate the net plant values for the rate base.⁶⁶

ii. original cost, depreciation, and net plant

For water plant, Mr. Mach calculated an original cost of \$516,259; annual depreciation of \$15,983; accumulated depreciation of \$83,350; and a net value of \$427,910.⁶⁷

Mr. Mach's calculated original cost of the sewer plant is \$2,404,722; annual depreciation is \$48,546; accumulated depreciation is \$237,601; and net value is \$2,167,120.⁶⁸

⁶⁴ Mr. Mach's amended testimony, ED Ex. 2-A, at 7-8; see exhibits ED-KM-2 and ED-KM-2a to compare the ED's calculations with those of Decker's expert.

⁶⁵ Mr. Mach's amended testimony, ED Ex. 2-A, at 8; see exhibits Ex. ED-KM-1 for water and ED-KM-2 for sewer.

⁶⁶ Mr. Mach's amended testimony, ED Ex. 2-A, at 7-8.

⁶⁷ Mr. Mach's amended testimony, ED Ex. 2-A, at 7; see exhibits ED-KM-1 and ED-KM-1a to compare the ED's calculations with those of Decker's expert. See also remand proceeding exhibit ED-GG2.

⁶⁸ Mr. Mach's amended testimony, ED Ex. 2-A, at 7-8; see exhibits ED-KM-2 and ED-KM-2a to compare the ED's calculations with those of Decker's expert. See also remand proceeding exhibit ED-KK2.

iii. Staff's argument against Decker's calculations

Staff argues that Mr. Mach testified as to which versions of the Handy-Whitman Index he used to conduct his trending analysis, while Mr. Fenner did not specify which version of the Handy-Whitman index he used to establish the rates and calculate the trended costs.⁶⁹

In addition, Staff points out that Mr. Fenner's testimony regarding accumulated depreciation for sewer utility plant contains errors affecting the net book value for the system. Specifically, during cross examination, Mr. Fenner acknowledged that the total accumulated depreciation for the sewer utility plant as evidenced in BWF-2 is incorrect because the 10-year remaining life for the manholes should be in the neighborhood of \$101,000 instead of \$101 as listed.⁷⁰ Staff concludes that because of this miscalculation, Mr. Fenner's net book value is incorrect.⁷¹

Both Mr. Fenner and Mr. Mach agreed that trending analysis is more an art than a science. Mr. Fenner could not recall exactly which Handy-Whitman Index he used to perform the trending analyses for original costs of the water and sewer plants, but testified it was the version he had purchased in 2007. According to Mr. Mach, both of them started their calculations with the 2000 Handy-Whitman Index; but they differ as to the year 2000 replacement cost for certain items.⁷² The ALJ recommends that Mr. Mach's calculations for depreciation be adopted by the Commission because his methods and results are more thorough and accurate than Mr. Fenner's.

⁶⁹ ED's Closing Argument, at 3, citing Mr. Fenner's pre-filed testimony, Decker Exh. 1, at 7-8. The ALJ takes the ED's point to be that Mr. Mach's trending analysis is more reliable than Mr. Fenner's is, but notes that Mr. Mach testified that Mr. Fenner used the year 2000 Handy-Whitman Index. Recording of October 14, 2008, beginning at approximately 31:12 minutes in segment HOM 4 of 4.

⁷⁰ Recording of October 14, 2008 proceeding, beginning at approximately 1:50:01 hours in segment HOM 1 of 4.

⁷¹ See footnote 92 in this Proposal for Decision for figures adjusted based on the ED's Closing Argument, at 3-4. See Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 7, table 2.

⁷² Recording of October 14, 2008 proceeding, HOM 4 of 4, beginning at approximately 31:12 minutes.

2. Rate of Return

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

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

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

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

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

(1)(C)(i) Debt capital. The cost of debt capital is the actual cost of debt. 30 TAC § 291(c)(1)(C)(i)

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

a. Decker's Evidence and Argument

Ms. Loockerman used a weighted rate of return of 9.5557 percent for both water and sewer, because debt has not been separated into water and sewer categories by Decker.⁷³ She arrived at the 9.5557 percent weighted rate of return by allowing a return of 12-percent interest on Decker's total

⁷³ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 37 and 49 (Application, at 12 and 24).

investment/equity of \$1,687,543, weighted with 6.3514-percent interest on Decker's debt of \$1,500,826.⁷⁴ She testified that it is reasonable to use the rate of return for the utility as a whole as the rate of return for water and sewer services, because the water and sewer plant are part of one company, and debt obtained was used by both water and sewer system assets.⁷⁵

Ms. Loockerman explained her choice of 12 percent for the rate of return on equity capital as reasonable, for the following reasons:⁷⁶

- Over the past decade and even before, a 12-percent rate of return has been consistently recommended and used by the TCEQ staff in calculating return dollars.
- The recommended 12-percent rate is substantially higher than returns for other investments, because small water utilities in Texas are considered high-risk operations. They are subject to a high level of regulation, variations in water supply (rainfall and the quality of water obtained from various sources), and generally a small number of connections over which to spread costs. They are subject to weather conditions such as hurricanes and lightning strikes. Their rates are determined based on what the TCEQ believes to be reasonable and necessary.
- Generally, for a utility of Decker's size, it is difficult to borrow funds using only investor-owned utility assets, and normally the owner must personally sign for utility debt, putting his personal assets at risk if the utility should fail.

To calculate return, Ms. Loockerman started with a net book value (total debt and equity) of \$3,188,369.⁷⁷ When net book value is multiplied by 9.5557 percent, the result is a return of \$308,509. Ms. Loockerman allocated 18 percent of the return, or \$55,532, to water and 82 percent of the return, or \$252,977, to sewer. She used the following calculations to arrive at the allocation percentages:

⁷⁴ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 37 and 49 (Application, at 12 and 24).

⁷⁵ The rate base is made up primarily of net plant and equipment used and useful in providing service to the public. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 20 and 22.

⁷⁶ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 21. *See also* Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 37 and 49 (Application, at 12 and 24).

⁷⁷ In her pre-filed testimony, Ms. Loockerman uses \$3,228,544, but in her calculations, she uses \$3,188,369. *See* Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 21, compared to her calculations at Decker Ex. 1, at 38 and 50 (Application, at 13 and 25). The discrepancy was not addressed at hearing; the ALJ finds \$3,188,369 to be correct (\$1,687,543 in equity plus \$1,500,826 in debt equals \$3,188,369).

- When net water plant of \$564,076 is divided by total net plant of \$3,188,269, the quotient is 18 percent. The result of multiplying the total return of \$308,509 times 18 percent is \$55,532.⁷⁸
- When net sewer plant of \$2,624,293 is divided by total plant of \$3,188,369, the quotient is 82 percent. The result of multiplying the total return of \$308,509 times 82 percent is \$252,977.⁷⁹

i. Decker's efforts and achievements regarding conservation of resources, quality of service, efficiency of operations, and quality of management⁸⁰

Conservation of resources

Mr. Weedn said that to minimize the cost of water and sewer service, Decker does as much in-house as possible to avoid using contractors. The utility buys in bulk, when that option is available, and at the best price possible. Mr. Weedn insures expenditures are necessary.⁸¹

Quality of service

Mr. Fenner inspected Decker's water facilities and found them to be in good condition, well maintained, and in compliance with the minimum water system capacity requirements found at 30 TAC § 290.45. Mr. Fenner found the sewer facilities to be in "fairly good condition," noting that an intruder resistant fence and sound insulation for the blower that were needed at the time of inspection have since been added. The sewer facilities meet applicable wastewater treatment requirements.⁸²

⁷⁸ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 38, 50, and 83 (Application, at 13, 25, and Attachment C).

⁷⁹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 38, 50, and 84 (Application at 13, 25, and Attachment C).

⁸⁰ See 30 TAC § 291(c)(1)(B).

⁸¹ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 11.

⁸² Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 5-6.

Decker has been under a sewer enforcement action by the TCEQ, primarily related to past effluent permit violations that are resolved now that the new WWTP is on line and in balanced commercial operation. Decker has been cited for treating third-party waste from port-o-potties without the proper TDPEs permit. When instructed by the TCEQ that there was a technical difference between port-o-potty waste and waste received through pipes, Mr. Weedn immediately started the process to apply for an industrial wastewater permit as an additional permit to the WWTP.⁸³

According to Mr. Powell, two or three monitoring-violation notices were sent out in 2006: “boil water” notices were sent out when the TCEQ reported it had not received Decker’s monthly microbial reports; once, a positive BacT sample was taken and a boil water notice was issued; finally, all local water companies issued “boil water” notices after Hurricane Rita as a precautionary measure.⁸⁴

The environmental quality investigation conducted in 2006 resulted in only one minor violation that was corrected and resolved to the TCEQ’s satisfaction.⁸⁵ According to Mr. Mach, all violations contained in the TCEQ investigative reports have been resolved, except for the most recent sewer violation found on March 20, 2008, related to complying with the 150-foot buffer zone requirements of 30 TAC § 309.13(e). He said both the water and sewer system meet the TCEQ’s minimum design standards except for the 150-foot buffer zone requirement.⁸⁶

⁸³ Mr. Weedn’s pre-filed testimony, Decker Ex. 3, at 9.

⁸⁴ Mr. Powell’s pre-filed testimony, Decker Ex. 4, at 11. The ALJ notes that Hurricane Rita occurred in 2005, not in 2006.

⁸⁵ Mr. Fenner’s pre-filed testimony, Decker Ex. 2, at 5 and 6. *See also* 30 TAC § 291(c)(1)(B).

⁸⁶ Mr. Mach’s amended testimony, ED Ex. 2-A, at 5.

Efficiency of operations

Decker has two licensed plant operators on call to meet TCEQ requirements. Mr. Weedn is the chief licensed operator and Aucoin & Associates is the contracted operator. One of the operators is available 24 hours daily for emergencies such as service problems and outages.⁸⁷

On a daily basis, Aucoin & Associates tests the water for chlorine residual per TCEQ-prescribed protocols, Mr. Weedn said, and runs daily operational tests for sewer system compliance with TCEQ standards. The company checks the water wells and pump stations to insure that everything is operating properly. Every year TCEQ sends inspectors to perform detailed inspections of the system. TCEQ staff take water samples annually to be tested at Decker's expense at state-approved labs and conduct periodic inspections and tests. Personnel from state-approved labs come by monthly, or more often if necessary, to take samples of treated effluent for independent testing.⁸⁸ Mr. Weedn himself makes periodic inspections of the water and sewer system.⁸⁹

Quality of management

Mr. Weedn said that during the test year and to date, he usually spent more than 40 hours per week actively working on Decker-related business.⁹⁰ Currently, he is not selling new homes or developing new subdivisions, and both Decker and Mr. Weedn personally are in bankruptcy. He considers bankruptcy work related to Decker to be utility business as part of the necessary management of a company required to continue to operate under state-issued licenses and permits.⁹¹

⁸⁷ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 10; Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 8

⁸⁸ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 8-9.

⁸⁹ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 8.

⁹⁰ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 3.

⁹¹ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 4.

Mr. Weedn said customer service and utility service billing was formerly under the control of his estranged wife, Susie Weedn. He said he recently learned that Ms. Weedn did not always follow the TCEQ rules when applying tariffs or when dealing with customers. Ms. Weedn is now barred by court order from the Decker office and these areas are now managed by Mr. Powell and Leigh Ann Johnson, customer service manager.⁹²

Mr. Powell, Decker's office manager, stated that staff in charge of security deposit transactions is familiar with the regulations regarding handling and maintaining these funds, and interest has been applied to all qualifying deposit refunds since September 2007. He said his predecessor, Ms. Weedn, did not comply with all of the TCEQ regulations for security deposits.⁹³

Mr. Powell said he and Ms. Johnson try to follow the TCEQ rules exactly as written.⁹⁴ Mr. Weedn said Decker employees are authorized to contact Mr. Zeppa for interpretation of TCEQ rules and their application to specific situations to ensure Decker is in compliance.⁹⁵ For instance, after hearing billing complaints at the preliminary hearing in this proceeding, Decker's staff reviewed its billing practices with Mr. Zeppa and now correctly applies the tariffs that were incorrectly applied by Ms. Weedn, Mr. Powell said. He also noted that no customer bills were processed using estimates, as opposed to meter readings, in the 2006 test year.⁹⁶

b. ED's Evidence and Argument

At the remand proceeding, Ms. Perryman recommended a return of 8.8541 percent on invested capital for the water plant, and a return of 9.0749 percent on capital invested for the sewer

⁹² Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 10.

⁹³ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 4; *see* 30 TAC § 291(c)(1)(B)

⁹⁴ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 6.

⁹⁵ Mr. Weedn's pre-filed testimony, Decker Ex. 3, at 11.

⁹⁶ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 7.

plant.⁹⁷ Staff used the weighted average cost of capital total as its recommended rate of return.⁹⁸ Ms. Perryman said the weighted cost of capital is an appropriate method to be used to derive a fair rate of return for a utility such as Decker which has both debt and equity capital. She said the return must be fair and reasonable, and should be consistent with the returns available from other investments of similar risk.⁹⁹

Staff arrived at the weighted cost of capital for *water* as set out in Schedule I(d) at ED Ex. GG2:

Payee	Principal	Interest Rate	Percentage	Weighted Avg.
Hybernia National Bank	\$267,567.00	6.75%	59.92%	4.04%
Universal Premium Acceptance Corporation	\$ 0	12.74%	0%	0%
EQUITY	\$178,963.17	12.00%	40.08%	4.81%
TOTAL	\$446,530.17		100.00%	8.8541%

For water, Staff proposes to reduce Decker's proposed return of \$55,532 on net invested capital by \$15,996. Staff calculated its recommended return of \$39,536 by adding the net plant of \$427,910 plus working capital allowance of \$18,621, a total of \$446,530, and multiplying that sum times 8.8541 percent.¹⁰⁰

⁹⁷ The percentages set out in exhibits ED-GG2 and ED-KK2 represent a change from those set out in Ms. Perryman's amended testimony for the original hearing, Decker Ex. 1-A, at 9.

⁹⁸ Ms. Perryman's amended testimony, Decker Ex. 1-A, at exhibits ED-SP-2 and ED-SP-6.

⁹⁹ Ms. Perryman's amended testimony, ED Ex. 1-A, at 10.

¹⁰⁰ ED Ex. GG2.

Staff's calculations for its rate of return for *sewer* are set out in ED Ex. KK2:

Payee	Principal	Interest Rate	Percentage	Weighted Avg.
Hybernia National Bank	\$1,218,916.88	6.75%	55.72%	3.76%
Universal Premium Acceptance Corp.	\$ 0	12.74%	0.00%	0.00%
EQUITY	\$ 968,787.73	12.00%	44.28%	5.31%
TOTAL	\$2,187,704.61		100.00%	9.0749%

For sewer, Staff proposes to reduce Decker's proposed total invested capital of \$2,527,219 by \$339,514, down to \$2,187,705. Ms. Perryman calculated Staff's recommended return on invested capital for wastewater by multiplying a rate of return of 9.0749 percent times total invested capital of \$2,187,705 (net plant of \$2,167,120 plus working capital allowance of \$20,584¹⁰¹) to arrive at \$198,531.¹⁰²

3. ALJ's Analysis and Recommendation

Both Decker and the ED recommended a 12 percent rate of return on invested capital, a rate the ALJ finds to be reasonable based on Ms. Loockerman's testimony regarding the investment risk associated with small Texas utilities. Over all, the ALJ finds the ED's calculations for rate of return on invested capital as presented in the ED's remand proceeding exhibits to be reasonable and

¹⁰¹ Ms. Perryman calculated the working capital allowance based on the Commission rule found at 30 TAC § 291.31(c)(2)(B)(iii), which states working capital allowance is computed as one-eighth of operation and maintenance expenses. The rule states the return on invested capital is the rate of return times invested capital. The rate of return is applied to the rate base. Components to be included in the rate base are as follows:... working capital allowance to be composed of, but not limited to, the following:... a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes). Ms. Perryman's amended testimony, ED Exh. 1-A, at 9-10. See exhibits ED-SP-2 and ED-SP-6.

¹⁰² ED Ex. KK2.

necessary. In the original proceeding, the ED recommended allocation of the Hybernia National Bank debt equally between water and sewer based on the number of connections. The ALJ rejected that recommendation in the original PFD and Staff adopted the allocation of 18 percent for water and 82 percent for sewer at the remand hearing.

B. Allowable Expenses

Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered. 30 TAC § 291.31(b). The components of allowable expenses, to the extent they are reasonable and necessary, may include, but are not limited to, operations and maintenance expense; depreciation expense; assessments and taxes other than income taxes; federal income taxes; reasonable expenditures for ordinary advertising, contributions, and donations; and funds expended in support of membership in professional or trade associations. 30 TAC § 291.31(b)(1).

1. Operations and Maintenance Expense

As set out in 30 TAC § 291.31(b)(1)(A), operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service is allowed, but payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in TEX. WATER CODE ANN. § 13.185(e).¹⁰³

¹⁰³ Payment to affiliated interests for costs of any services, or any property, right or thing, or for interest expense may not be allowed either as capital cost or as expense except to the extent that the regulatory authority finds that payment to be reasonable and necessary. A finding of reasonableness and necessity must include specific statements setting forth the cost to the affiliate of each item or class of items in question and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates or divisions for the same item or items, or to unaffiliated persons or corporations. TEX. WATER CODE ANN. § 13.185(e). See the "payments to affiliated interests" section of this PFD.

Ms. Loockerman described her methodology for allocations in Texas as reasonable and accepted by the industry. She said all her allocations for operations and maintenance—with the exceptions of repairs and maintenance, federal income tax, and the Texas business tax—are based on the number of connections for water and sewer, which were equal at the end of the test year (542 connections each). Where information was available, she allocated repairs and maintenance expenses directly to the water or sewer cost of service. All other repairs and maintenance expenses were allocated by number of connections.¹⁰⁴ For federal income taxes and the Texas business tax, she pro-rated the allocation based on the different revenue requirements for water and sewer excluding taxes.¹⁰⁵

Overall, the ALJ finds most of Ms. Loockerman's calculations for allowable expenses to be reasonable and necessary to provide service to the ratepayers. But the Commission may disallow expenses not supported by invoices, receipts, and/or check stubs. Staff recommends disallowance of expenses in its calculations that remain unsupported by documentation after the remand hearing. The ALJ recommends that Staff's calculations for allowable expenses be adopted by the Commission.

a. Salaries and Wages

i. Decker's evidence and argument

Ms. Loockerman found test year salaries and wages to total \$104,748 for four permanent positions: two full-time office staff, a plant superintendent or foreman;¹⁰⁶ and Mr. Weedn, the owner, manager, and certified operator of Decker.¹⁰⁷ Ms. Loockerman explained that Mr. Weedn's compensation does not appear in the expenses portion of Decker's general ledger, but as "draws,"

¹⁰⁴ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 4-5.

¹⁰⁵ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 87-88 (Application, at Attachment D, at 2-3).

¹⁰⁶ Decker's plant superintendent Paul Ramirez is not a certified operator. Under TCEQ rules, a utility of Decker's size needs two certified operators. Decker has contracted with Aucoin & Associates to provide a second certified operator. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 7 and 11-12. *See also* the "contract labor" section of this PFD.

¹⁰⁷ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 6.

which are a form of compensation.¹⁰⁸ After accounting for those draws, Ms. Loockerman shows salary expenses of \$146,000 in the adjusted test year, an amount she characterizes as reasonable for a utility the size of Decker.¹⁰⁹

She said as a utility with 542 connections each for water and sewer, Decker needs at least two office personnel to manage billing, customer service questions, telephones, bookkeeping, and to back each other up. Decker also needs two certified operators, as required by TCEQ rules for this size utility. She said a plant superintendent or foreman is needed for immediate repairs and maintenance; maintaining the aesthetic quality of the plant; repairs of the plants, lines, and pumps; meter reading and replacement; customer lockouts and reconnects; and giving visitors and government employees on official business access to the plant.¹¹⁰

Ms. Loockerman said the \$42,000 she included in the salary expenses of \$146,000 for Mr. Weedn's compensation is reasonable, and his services are necessary.¹¹¹ Since Decker's inception in the late 1990s, Mr. Weedn has managed operations and administration, provided certified operator services required by TCEQ rules, made executive decisions for the utility, supervised staff and day-to-day operations, been the engineer of the plant, and represented the utility in public and in legal matters. Mr. Weedn works 65-80 hours per week on utility management and operations. In Ms. Loockerman's view, Mr. Weedn's services continue to be necessary and reasonable to Decker's operations and to providing good water and sewer service to its customers.¹¹²

Ms. Loockerman arrived at \$42,000 in compensation for Mr. Weedn after considering the following factors: he worked 65-80 hours per week for the utility in the historical test year and the

¹⁰⁸ The bankruptcy court classifies these draws as compensation for services rendered, not as note payments. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 7 and 9.

¹⁰⁹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 6, and 86 (Application, Attachment D).

¹¹⁰ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 7.

¹¹¹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 10. The bankruptcy court allowed \$84,000 in compensation for Mr. Weedn. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 9.

¹¹² Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 7-9.

following year; he continues to be on call around the clock; he could commute the approximately 30 miles from Tomball to Houston and make substantially more than the \$42,000 included in the cost of service doing basically the same job, and probably with less overtime; the Division Manager for the City of Houston's solid waste management department makes between \$49,010 and \$75,452 annually (2008 position); and Houston and Tomball obtain employees from the same labor pool.¹¹³

Ms. Loockerman concludes that if Mr. Weedn were not compensated for the duties he performs, Decker would probably have to hire a business manager plus a licensed water/sewer operator, at a cost for those two salaries that would exceed the \$42,000 in salary requested for Mr. Weedn in the Application.¹¹⁴

Ms. Loockerman allowed \$104,000 to pay Decker's two office personnel and the plant superintendent. The 2007 salary total for these three employees was only \$65,999, but contract labor in the amount of \$27,570 was used (mostly for clerical and office help) when salaried personnel were gone, bringing the 2007 total to \$93,569.¹¹⁵ Although this is \$10,431 less than the \$104,000 projected for these three positions, Ms. Loockerman believes the \$104,000 allocation still should be used. She explained that because office personnel are paid by the hour rather than on salary, one could expect reasonable variation from the projected changes.¹¹⁶

ii. The ED's evidence and argument

The ED presented no evidence or argument related to salaries and wages.

¹¹³ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 10.

¹¹⁴ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 8.

¹¹⁵ Actual contract labor of \$27,570 (mostly for office and clerical help) in 2007 does not include the second certified plant operator as shown in Ms. Loockerman's known and measurable changes; the contract for the new operator did not go into effect until February 1, 2008. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 10-11.

¹¹⁶ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 10-11.

b. Contract Labor

i. Decker's evidence and argument

Ms. Loockerman allowed \$26,400 in her revenue requirement for contract labor, including \$4,800 in miscellaneous contract labor for the test year and a known and measurable increase of \$21,600 for a second certified plant operator.¹¹⁷ Ms. Loockerman explained that Decker retained the services of the second certified plant operator in February 2008 to meet TCEQ requirements for a utility of Decker's size.¹¹⁸ The base contract price is \$1,500 per month, or \$18,000 per year. Additional hours are billed at \$45 per hour. Her known and measurable changes include the base \$18,000 plus \$3,600 for 60 additional hours of service, for a total of \$21,600.

In Ms. Loockerman's opinion, including this known and measurable change in allowable expenses is reasonable even though it did not occur until 2008, because the new rates for this Application were not effective until February 1, 2008, which means the proposed rates are actually being set for 2008, not for 2007. She said no future rate case will recover the 2008 operator contract expenditures because any future rate cases will be effective after February 1, 2009. She said the second operator revenue requirement would be inappropriately lost by Decker if this known and measurable change is not allowed in this rate case. She also pointed out that to disallow this known and measurable change would penalize Decker for adding a second operator as required by the TCEQ.¹¹⁹

¹¹⁷ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 11.

¹¹⁸ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 11-12.

¹¹⁹ Ms. Loockerman did not know of any statutes or rules followed by Texas utility rate analysts that limit post-test year known and measurable changes to the 12 months following the test year. She is only aware of an instruction in sections VI(2)—water and VI(2)—sewer of the rate filing package directing an applicant to explain any known and measurable changes listed that occurred in the 12 months following the test year. As a professional rate consultant and former TCEQ rate staff member, she does not believe that an instruction in the rate filing package carries the weight of statute or rule. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 12-13, 40, and 52 (Application at 15 and 27).

ii. The ED's evidence and argument

The ED did not challenge Decker's contract labor expenses.

c. Utility Expenses¹²⁰

The test year utility cost of \$46,280 is reasonable and necessary to provide water and wastewater service to the public, according to Ms. Loockerman. Although utility costs increased to \$60,697 in 2007, she did not include the \$14,417 increase in known and measurable changes.¹²¹ She said if any other types of expenses are decreased to reflect 2007 costs, then this increase and any others must be counted to obtain a fair cost of service.¹²²

d. Repairs and Maintenance

i. Decker's evidence and argument

The \$45,996 in repairs and maintenance included in the cost of service is reasonable and necessary to provide service to Decker's customers, according to Ms. Loockerman. She said non-utility items, misclassified items, and discontinued items were removed from Attachment D in the Application.¹²³ Where information was available, she allocated repairs and maintenance expenses

¹²⁰ The evidence did not establish whether utility costs include anything other than expenses for electricity.

¹²¹ Ms. Loockerman testified she could not justify her charge to re-calculate the cost of service for this known and measurable change, so did not do so. She noted that Decker will recover enough revenue to do without the added \$14,417 if its recommended cost of service and a reasonable rate of return are approved by the Commission. Recording of October 14, 2008 proceeding, beginning at approximately 1:05:28 hours in segment HOM 1 of 4. The ALJ recommended in the original PFD—but withdraws in this Amended PFD—that the \$14,417 be added to utility expenses listed in the application. The ALJ is persuaded by Ms. Perryman's testimony at the remand proceeding that it is not the Commission's practice to allow an applicant to claim expenses that were not in the original application, as it would alter the numbers in the application.

¹²² Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 13.

¹²³ The known and measurable changes for repairs and maintenance expenses are allocated equally between water and sewer, except for one \$1,500 payment that is removed only from sewer, bringing the total expense for water to \$15,141 and for sewer to \$30,855. See Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 86 (Application, Attachment D, at 1).

directly to the water or sewer cost of service. All other repairs and maintenance expenses were allocated by number of connections.¹²⁴ She noted that repairs and maintenance expenses will vary from year to year, pointing out that in 2005, Decker's federal income tax return showed \$78,368 in repairs, maintenance, and plant maintenance, while the 2007 repairs and maintenance expense was only \$33,583. But she speculated that in 2007, some repair and maintenance costs were probably delayed due to the bankruptcy court action and budgetary limitations.¹²⁵

ii. ED's evidence and argument

As presented in the remand proceeding, Ms. Perryman recommends reducing repairs, maintenance, and supplies expense shown to be \$45,996 in the Application by \$878 for water and \$881 for wastewater.¹²⁶ Part of the reduction is recommended because the invoice for \$602.06 in job materials reviewed by Ms. Perryman was outside the test period. The remaining recommended disallowance is because Decker did not provide invoices or other documentation to support the expenses during Staff's April 2008 audit or during the discovery period for either the original proceeding or the remand proceeding.¹²⁷ Staff was not able to arrive at Ms. Loockerman's allocation¹²⁸ because there was no supporting documentation to identify which invoices were specifically for water and which were for wastewater. Therefore, Staff allocated 50 percent for water and 50 percent for sewer, because each service has 542 connections.¹²⁹

¹²⁴ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 4-5.

¹²⁵ Ms. Loockerman's pre-filed testimony, Decker Exh. 1, at 14.

¹²⁶ Exhibits ED-FF2 and ED-JJ2.

¹²⁷ Ms. Perryman's amended testimony, ED Exh. 1-A, at 4-5.

¹²⁸ Staff incorrectly states that Ms. Loockerman's allocation was 18 percent for water and 82 percent for sewer.

¹²⁹ Ms. Perryman's amended testimony, ED Exh. 1-A, at 4-6. See exhibits ED-SP-1 and ED-SP-5 for details related to the reductions; also, refer to exhibits ED-SP-11, ED-SP-14, and ED-SP-15.

iii. ALJ's recommendation

The ALJ finds that the \$602.06 expense for job materials incurred outside the test period should be disallowed, as should the unsupported expenses of \$878 for water and \$881 for wastewater.

e. Office Expenses

i. Decker's evidence and argument

Office expenses of \$24,717 are reasonable and necessary for Decker to provide service to its customers, Ms. Loockerman said. As set out in Attachment D of the Application, Ms. Loockerman removed substantial non-utility expenses from this category. She increased rent expense due to a change in Decker's lease contract resulting in additional conference and storage space being used by the utility. She noted that the higher rent payments began after the historical test year,¹³⁰ so included the 2007 rent increase as a \$7,788 known and measurable change.¹³¹

ii. ED's evidence and argument

Staff recommends reducing office expenses shown to be \$24,717 in the Application by \$3,656, or \$1,828 each for water and sewer.¹³² At the original hearing, Ms. Perryman said Decker did not provide invoices or other supporting documents for \$4,818.24 in office expenses, including telephone expenses of \$1,983, when requested by Staff during the April 2008 audit and the discovery period, so Staff could not determine if the expenses were for the utility or for personal use.¹³³

¹³⁰ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 14.

¹³¹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 86 (Application, Attachment D, at 1).

¹³² Exhibits ED-FF2 and ED-JJ2.

¹³³ ED Ex. CC2 at 1-2. *See also* Ms. Perryman's amended testimony for the original hearing, ED Ex. 1-A, at 6-7; *see* exhibits ED-SP-1 and ED-SP-5 for details; *see also* exhibits ED-SP-9, ED-SP-10, ED-SP-12, ED-SP-14, and ED-SP-15.

Despite having an opportunity to provide underlying documentation pursuant to the Interim Order, Decker only proved up \$1,162.24 of the unsupported expenses. A total amount of \$21,060.71 in office expenses was proven to be reasonable and necessary for Decker to provide water and sewer service to its customers.¹³⁴

iii. ALJ's recommendation

The ALJ recommends that Decker's proposed amount of \$24,717 in office expenses be reduced to \$21,060.71.

f. Accounting and Legal Expenses

i. Decker's evidence and argument

Ms. Loockerman believes her recommended \$9,071 in allowable expenses for accounting and legal costs is below what Decker will actually incur in the foreseeable future, but the requested amount is reasonable to impose on customers. She said she did not use the historical test year number for accounting and legal expenses, because of costs associated with the bankruptcy proceedings, as well as with TCEQ enforcement and permitting activities.¹³⁵ She amortized legal expenses over 2006 and 2007, producing a decrease of \$774 in the historical test year expense; in 2007, the actual legal expenses came to \$8,296, after \$9,000 in rate case expenses were excluded.¹³⁶ The \$9,071 recommendation represents normalized legal and accounting expenses over a two-year period.¹³⁷

¹³⁴ ED exhibits FF2 and JJ2.

¹³⁵ Ms. Loockerman's calculations may be found at Decker Ex. 1, at 87 (Application, Attachment D, at 2).

¹³⁶ Ms. Loockerman testified she does not know how much of the \$8,296 is for the bankruptcy proceedings. Recording of October 14, 2008 proceeding beginning at approximately 15:50 minutes in segment HOM 1 of 4.

¹³⁷ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 15.

ii. ED's evidence and argument

Staff recommends removing legal and accounting fees in an equally allocated reduction of \$1,173 each for water and sewer, because Decker did not provide invoices or other documentation to support these expenses during the April 2008 audit or the discovery period.¹³⁸ Despite having the opportunity to provide additional supporting documentation to the ED for the remand proceeding, Decker did not do so. As in the original hearing, Ms. Perry found Decker's documentation supports only \$3,362.50 in legal and attorney fees.¹³⁹

iii. ALJ's recommendation

The ALJ finds the evidence shows that legal and attorney fees of \$3,364.50 are reasonable and necessary for Decker to provide water and sewer service to its customers.

g. Insurance Expenses

i. Decker's evidence and argument

Ms. Loockerman said the requested \$18,741 for insurance cost of service is reasonable and necessary to provide service to Decker's customers.¹⁴⁰ The expense includes \$17,083 for liability and auto insurance, and \$1,658 for life insurance on Mr. Weedn, which is a reasonable benefit to him as Decker's owner. She noted that the total insurance cost in 2007 increased to \$27,131, but said she did not use the figure as a known and measurable change, because the increased amount was out of the range of reasonableness. She removed interest expense from the cost of insurance, because interest expense is excluded from the cost of service in the utility methodology of rate making.¹⁴¹

¹³⁸ Ms. Perryman's amended testimony, ED Ex. 1-A, at 7-8; *see* exhibits ED-SP-1 and ED-SP-5; *see also* exhibits ED-SP-14 and ED-SP-15.

¹³⁹ Exhibits ED-FF2 and ED-JJ2.

¹⁴⁰ Staff agrees with Ms. Loockerman's figure. *See* ED exhibits FF2 and JJ2.

¹⁴¹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 16 and 87 (Application, Attachment D, at 2).

ii. ED's evidence and argument

Ms. Perryman proposes the reduction in notes payable expenses of \$7,171 apiece for water and sewer, for a total of \$14,342, because the note payable to Universal Premium Acceptance Corporation for a loan for insurance payments to Darryl Forbes Insurance Agency was also submitted under insurance expenses.¹⁴² Ms. Perryman testified that she counted the \$14,342 under insurance expenses rather than under notes payable,¹⁴³ whereas Ms. Loockerman included the \$14,432 to Universal Premium Acceptance Corporation as a combined note payable for both water and sewer, at 12.74 percent interest.¹⁴⁴

iii. ALJ's recommendation

The ALJ finds that Ms. Perryman correctly counted the \$14,342 under insurance expenses rather than under notes payable.

h. Miscellaneous Known and Measurable Decreases

Ms. Loockerman adjusted the cost of service for a known and measurable decrease of \$5,776 due to removal of non-utility items and the regulatory assessment fee from the historical test year expenses.¹⁴⁵

¹⁴² Ms. Perryman's amended testimony, ED Ex. 1-A, at 8; *see* exhibits ED-SP-2 and Ex. ED-SP-6 for additional detail about the reductions; *see also* ED-SP-13, which is a copy of the Premium Finance Agreement and Disclosure Statement.

¹⁴³ Recording of November 6, 2008 reconvened hearing beginning at approximately 16:28 minutes.

¹⁴⁴ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 37 and 49 (Application, at 12 and 24).

¹⁴⁵ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 17-18, and 87 (Application, Attachment D, at 2). In a note on Attachment D, Ms. Loockerman explains she amortized the actual 2006 accounting and legal expenses of \$9,845 over 2006 and 2007, for \$4,923 per year; she also amortized the actual 2007 accounting and legal expenses of \$8,296 (\$17,296 less \$9,000 in rate case expense) over 2007 (as a known and measurable change) and 2008 to arrive at \$4,148 per year. Her total accounting and legal expense for the adjusted test year is \$9,071 (\$4,923 plus \$4,148) divided evenly between water and sewer for \$4,536 each.

i. Reductions in Other Revenue

Ms. Loockerman said she reduced revenues in 2007 by \$13,290, because no new tap fees were collected, since Mr. Weedn's development company did not construct buildings that year.¹⁴⁶ She reduced tap fees to zero, but counted \$3,125 in other miscellaneous fees as revenue.¹⁴⁷

j. Payments to Affiliated Interests

In response to concerns that Decker might be paying utility expenses that should be billed to its affiliated development company, Mr. Powell explained there are five Reliant Energy accounts because there are separate meters and accounts for each of the two sides of the office, the lift station, the sewer plant, and the water plant. He said Decker pays for goods and services used by or benefiting the utility regardless of whose name the supplier puts on the invoice.

Mr. Powell also testified that Decker's affiliated companies used to share space with the utility, but Decker currently is the only occupant of the space at 617 W. Main in Tomball, Texas, and pays the full lease, which was considered Decker's sole expense within the bankruptcy.¹⁴⁸

Also, checks totaling \$45,704.46 were written from Decker to Decker Oaks Development II, Ltd., in 2006 for expenses that were at the time being "split" between the companies. Mr. Powell explained that the payment to North West Pool and Landscape was for occasional maintenance of the lawn at the water and sewer plants.¹⁴⁹

¹⁴⁶ No development had occurred as of March 1, 2008. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 22.

¹⁴⁷ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 22.

¹⁴⁸ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 8.

¹⁴⁹ Mr. Powell's pre-filed testimony, Decker Ex. 4, at 9. No further evidence was presented regarding the splitting of costs between Decker and the development companies, although Protestants elicited testimony from Mr. Weedn that the Decker Oaks homeowners association pays the electric bill for the pump used at the retention pond located at the same address as Decker's lift station. Mr. Weedn clarified that the retention pond is for storm drainage and is not part of Decker's plant. Recording of October 14, 2008 proceeding, beginning at approximately 11:49 minutes in segment HOM 2 of 4.

2. Depreciation Expense

Depreciation expense is based on original cost and computed on a straight line basis over the useful life of the asset as approved by the Commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service. 30 TAC § 291.31(b)(1)(B). The specifics of the depreciation expenses are discussed under the invested capital section of the PFD.

3. Assessments and Taxes Other Than Income Taxes¹⁵⁰

a. Decker's Evidence and Argument

i. Payroll taxes

Due to Decker's higher expenditure for salaries in 2007, Ms. Loockerman calculated a known and measurable increase to payroll taxes of \$14,600. She said no payroll tax payments at all were recorded in the appropriate expense category of Decker's 2006 general ledger.¹⁵¹

ii. Property taxes and Texas business tax

Ms. Loockerman found a total known and measurable decrease of \$2,764 for Decker's property taxes and the Texas business tax (formerly the Texas franchise tax). Property taxes were reduced from \$6,964 (more than one year's worth) to the 2006 invoiced amount of \$1,124, for a decrease of \$5,840. Decker's Texas business tax liability was calculated based on the new revenue requirement and House Bill 3 signed by Governor Rick Perry replacing the franchise tax in Texas,

¹⁵⁰ See 30 TAC § 291.31(b)(1)(C).

¹⁵¹ Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 18 and 87 (Application, Attachment D, at 2).

for a known and measurable increase of \$3,076. The net change was \$3,076 (business tax) minus \$5,840 (property tax), for a decrease of \$2,764.¹⁵²

b. ED's Evidence and Argument

The ED presented no testimony regarding payroll taxes or business tax.

4. Federal Income Taxes on a Normalized Basis¹⁵³

a. Decker's Evidence and Argument

Ms. Loockerman's calculation of \$107,511 for federal income tax is based on the gross cost of service for water and sewer combined, because Decker is an integrated utility and is subject to tax rates on the gross cost of service rather than separately for water and sewer.¹⁵⁴ To arrive at the \$107,511 figure, Ms. Loockerman calculated a normalized federal income tax based on the adjusted test-year revenue requirement less expenses.¹⁵⁵

¹⁵² Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 18 and 87 (Application, Attachment D, at 2). Attachment D shows property tax to be allocated equally between water and sewer, and Texas business tax is allocated on basis revenue requirement excluding taxes: Water--\$228,631/707,181 x \$3,076= \$994; Sewer--\$478,550/707,181 x \$3,076 = \$2,082.

¹⁵³ See 30 TAC § 291.31(b)(1)(D).

¹⁵⁴ Ms. Loockerman took the combined water and sewer revenue requirement of \$833,492, subtracted the income tax expense of \$107,511 as well as the \$18,800 expense for other taxes, and arrived at a revenue requirement of \$707,181 excluding taxes. The \$107,511 was then allocated on basis revenue requirement excluding taxes: Water - \$228,631/707,181 x \$107,511 = \$34,758; Sewer - \$478,550/707,181 x \$107,511 = \$72,753. See Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 18, and 87-88 (Application, Attachment D, at 2-3).

¹⁵⁵ Ms. Loockerman used the federal tax rates for corporations for 2007 from CCH's 2007 Master Tax Guide, at 136-137. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 19-20. Normalization is required by 30 TAC § 291.31(b)(1)(D). Ms. Loockerman explained that under the normalization approach, tax laws allow accelerated expenditures that defer current year tax liability more evenly over the years, and match the estimated normalized liability with the period in which the tax expense would be incurred, if tax laws did not cause variations. This practice closely parallels generally accepted accounting principles for matching revenues with expenses in a year. If the normalization approach is not used, revenue from Decker's current customers would be used to pay little or no taxes, and future Decker customers would pay more taxes. In addition, the actual tax liability could vary from year-to-year due to tax law changes. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 19-20.

b. ED's Evidence and Argument

At the remand hearing, Ms. Perryman proposed \$3,790 in federal income tax liability for water and \$46,867.39 in federal income tax for sewer, for a total revenue requirement of \$50,657.39 for federal income tax (including the surtax exemption), as opposed to the \$107,511 listed in the Application.¹⁵⁶ In the original hearing, Staff used per-connection allocation for federal income tax, which divides the liability equally between water and sewer.¹⁵⁷ But at the remand proceeding, Staff adopted the allocation of 18 percent for water and 82 percent for sewer recommended by the ALJ in the original proceeding.¹⁵⁸

V. RATE DESIGN

The water and sewer tariffs submitted in the Application comply with 30 TAC ch. 291.¹⁵⁹ The proposed rates listed in the Application are as follow:¹⁶⁰

<u>Water</u>		<u>Sewer</u>	
<u>Minimum Bill</u>		<u>Minimum Bill</u>	
5/8" or 3/4"	\$25.88	5/8" or 3/4"	\$64.67
1"	\$64.70	1"	\$64.67
1 1/2"	\$129.40	1 1/2"	\$64.67
2"	\$207.04	2"	\$64.67
3"	\$388.20	3"	\$64.67
4"	\$517.60	4"	\$64.67
6"	\$569.36	6"	\$64.67

¹⁵⁶ ED exhibits FF2 and JJ2.

¹⁵⁷ Ms. Perryman's amended testimony, ED Ex. 1-A, at 8-9; see exhibits ED-SP-1 and ED-SP-4 for a more detailed calculation of income taxes related to water service; see exhibits ED-SP-5 and ED-SP-8 for a more detailed calculation of income taxes related to wastewater service.

¹⁵⁸ See PFD at 42-43.

¹⁵⁹ Mr. Mach's amended testimony, ED Ex. 2-A, at 9.

¹⁶⁰ Ms. Loockerman's pre-filed testimony, at 58-61 (Application, at 33-36). Decker's rates as charged before February 1, 2008, are set out in the Ms. Loockerman's pre-filed testimony, at 60 (Application, at 35).

Gallonge Rate
\$2.29 for each 1,000 gallons
over the minimum

Gallonge Rate
\$4.00 for each 1,000 gallons
over the minimum

A. Decker's Evidence and Argument

Mr. Fenner's proposed water rates are based on a water revenue requirement of \$269,120 and a sewer revenue requirement of \$558,123 as recommended by Ms. Loockerman.¹⁶¹ Mr. Fenner makes the following changes to the rates proposed in the Application, adopting the meter equivalent multipliers recommended by Mr. Mach for the 4" and 6" water connections.¹⁶²

Water

Sewer

Minimum Bill

Minimum Bill

5/8" or 3/4"	\$25.88
1"	\$64.70
1 1/2"	\$129.40
2"	\$207.04
3"	\$388.20
4"	\$647.00
6"	\$1,294.00

5/8" or 3/4"	\$64.67
1"	\$64.67
1 1/2"	\$64.67
2"	\$64.67
3"	\$64.67
4"	\$64.67
6"	\$64.67

Gallonge Rate
\$2.29 for each 1,000 gallons
over the minimum, with zero
gallons included in the
minimum bill.

Gallonge Rate
\$4.00 for each 1,000 gallons
over the minimum, with zero
gallons included in the
minimum bill.¹⁶³

Mr. Fenner testified that when he changed the equivalency factor, he did not change the customer equivalents for the 2006 test year. He agreed that Mr. Mach's calculation of 641.5 customer or meter equivalents for water would be more representative of the correct number for

¹⁶¹ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 9. See also exhibits BWF-4 and BWF-5.

¹⁶² Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 8-9. Recording of October 14, 2008 proceeding, beginning at approximately 1:51:52 hours in segment HOM 1 of 1.

¹⁶³ Mr. Fenner's pre-filed testimony, Decker Ex. 2, at 9.

Decker than the 613.5 customer or meter equivalents he used. He also stated that increasing the customer or meter equivalents from the 613.5 he used to the 641.5 recommended by Mr. Mach would result in a decrease in his water rate design.¹⁶⁴

B. ED's Evidence and Argument

For her rate design, Ms. Graham used annual revenue requirements of \$217,129 for water and \$468,562 for sewer as calculated by Ms. Perryman.¹⁶⁵ The ED's proposed rates, which reflect changes both to Decker's existing water and sewer rates, are set out below.¹⁶⁶

Water

Minimum Bill

5/8" or 3/4"	\$17.98
1"	\$44.95
1 1/2"	\$89.90
2"	\$143.84
3"	\$269.71
4"	\$449.51
6"	\$899.02
8"	\$1,438.43

Gallage Rate

\$2.29 for each 1,000 gallons over the minimum¹⁶⁷

Sewer

Minimum Bill

5/8" or 3/4"	\$59.28
1"	\$50.90
1 1/2"	\$50.90
2"	\$50.90
3"	\$50.90
4"	\$50.90
6"	\$50.90
8"	\$50.90

Gallage Rate

\$4.00 for each 1,000 gallons over the minimum based on winter month average of water consumption¹⁶⁸

¹⁶⁴ Recording of October 14, 2008 proceeding, beginning at approximately 01:51:52 hours in segment HOM 1 of 1. See also Fenner's pre-filed testimony, Decker Ex. 2, at 8-9, and Decker Ex. BWF-4.

¹⁶⁵ ED exhibits OO2 and PP2.

¹⁶⁶ ED exhibits 002 and PP2.

¹⁶⁷ Mr. Mach recommends that Decker keep its current rate base of \$19.70 per month for a 5/8" or 3/4" size meter connection, and a gallage rate of \$1.15 per 1,000 gallons. Mr. Mach's amended testimony, ED Ex. 2-A, at 10. But note this recommendation differs from the figures contained in exhibit ED-KM-5 attached to his testimony.

¹⁶⁸ Mr. Mach's amended testimony, ED Ex. 2-A, at 10-11. Mr. Mach recommends winter month average consumption for sewer gallage because water usage activities during fall, summer, and spring can be indoor or

As is typically done by the TCEQ in calculating meter equivalents for water, Mr. Mach used the equivalent factors for the different sizes of meters from the American Water Works Association (AWWA), which is the ratio of rated meter capacity for each meter size relative to a 5/8" or 3/4" meter. The base rate calculated for a 5/8" or 3/4" meter multiplied by the respective equivalent factor of the particular size meter will result in the base rate for that size meter. For example, the equivalent factor for a 1" meter is 2.5. So, the base rate for a 1" meter will be the base rate of a 5/8" or 3/4" meter multiplied by 2.5. In accordance with the AWWA Manual M6 (1972, second edition), Mr. Mach used a meter equivalency factor of 50 for a 6" meter instead of a factor of 22 as listed in the Application.

Applying the equivalency factors, Mr. Mach recommends using 641.5 equivalent active water connections for water rate design, instead of the 542 connections listed in the Application. He recommends using 542 sewer connections for water rate design, which is the number of active sewer connections listed in the Application.¹⁶⁹

Mr. Mach attempted to analyze the possibility of excessive line loss, but the Application did not list the number of gallons pumped during the test year for him to compare with the 34,374,080 gallons that were billed to customers that year. Mr. Mach contacted the Lone Star Groundwater Conservation District (LSGCD), and found Decker had reported to the LSGCD that it had pumped 31,541,657 gallons of water during the test year, which is less than the number of gallons billed to

outdoor. Outdoor water usage activities such as irrigating or gardening do not transport wastewater to the sewer plant. During December, January, and February, most water usage is indoors, resulting in wastewater transporting to the sewer plant for treatment. Therefore, Mr. Mach recommends Decker use the winter month average to better reflect the ratepayers' actual flow of wastewater to the sewer plant. *See also* Mr. Mach's amended testimony, ED Ex. 2-A, exhibit ED-KM-6.

¹⁶⁹ Table 2.2 in Water Meters of AWWA Manual M6 second edition shows a 5/8" displacement meter at 20 gallons per minute (gpm) maximum rate capacity and a 6" displacement meter at 1,000 gpm maximum rate capacity. The ratio of 1,000 gpm to 20 gpm yields a meter equivalency factor of 50. *See* Mr. Mach's amended testimony, ED Ex. 2-A, at 9-10.

customers. Mr. Mach said based on that information, he had to assume line loss is minimal. He used 34,374,080 gallons—the amount billed to ratepayers—in his rate design.¹⁷⁰

C. ALJ's Analysis and Recommendation

The evidence establishes that for water rates, a customer or meter equivalent factor of 641.5, as calculated by Mr. Mach and agreed to by Mr. Fenner, should be used instead of the 613.5 customer or meter equivalent used in establishing Decker's proposed rates.¹⁷¹

VI. ALJ'S RATES CONCLUSIONS

The ALJ recommends that the Commission approve the water and sewer rates proposed by the ED. Staff's rate design incorporates Ms. Perryman's calculations based on cost of service expenses supported by underlying documentation.

Decker should refund any over recovery of rates that occurred during the pendency of this rate proceeding at 1.17 percent interest as a credit on customer's bills over a two-year period; customers who no longer receive service from Decker should receive a direct refund for the amount of over collection.¹⁷²

VII. CURRENT RATE CASE EXPENSES

As set out in 30 TAC § 291.28(7), a utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest. Under 30 TAC § 291.31(b)(2)(I), any expenditure found by the

¹⁷⁰ Mr. Mach's amended testimony, Ex. 2-A, at 6; *see* exhibits ED-KM-3 for water and ED-KM-4 for sewer.

¹⁷¹ *See* Mr. Fenner's pre-filed testimony, Decker Exh. 2, at exhibit BWF-4.

¹⁷² Ms. Perryman's amended testimony, ED Ex. 1-A, at 11. The 1.17 percent interest rate is set by the Public Utility Commission of Texas in 2004 for overbillings and underbillings. *See* Exh. EDSP-17, "Historical Record of Interest Rates Set by the Public Utility Commission, PUC" and 16 TAC § 25.28(c) (3)(A).

Commission to be unreasonable, unnecessary, or not in the public interest, including rate case expenses, may be disallowed as a component of cost of service.

Decker seeks to recover \$30,197.23 in estimated rate-case expenses associated with this proceeding, in addition to the \$3,250 associated with filing the Application before the proposed rates were challenged. The \$3,250 is included in Decker's proposed cost of service.¹⁷³ Decker did not submit additional estimated rate-case expenses associated with the remand proceeding.

Staff asserts that the \$800 included in Decker's rate case expense to pay for anticipated motions for rehearing should not be recovered.¹⁷⁴ Staff argues that although not specifically prohibited by rule or statute, allowing the recovery of costs associated with motions for rehearing assumes that Decker did not meet its burden to show that the requested rates are just and reasonable and thus did not prevail in the contested case hearing. Forcing customers to pay additional expenses in situations where the applicant has failed to meet its burden is not in the public interest. Additionally, Staff argues, allowing recovery of expenses attributed to a motion for rehearing would require the Commission to issue an order containing speculative costs associated with the preparation of such a motion. There would be no verification of the amount of time associated with the preparation of the motion or any other associated expenses. This in turn could call in to question the validity, finality, and enforceability of the order. Allowing for recovery of these costs would also open the door for applicants to abuse the system by collecting money for a cost that may or may not be incurred. Moreover, allowing an applicant to recover expenses for the preparation of a motion for

¹⁷³ Ms. Loockerman included the \$3,250 of rate case expense associated with filing the Application in the revenue requirement, because rate case expense is part of the normal operating expense for any regulated utility. Decker paid the Application fee out of normal operating funds, using working capital. If the \$3,250 is removed from normal operations, Decker would not be allowed working capital acknowledgement for this expense. Ms. Loockerman recommends that the Application filing expense of \$3,250 be amortized over two years in the cost of service, and any additionally incurred rate case expense due to the evidentiary proceedings be amortized over two years as a surcharge added to customers' monthly bills upon presentation of invoices and estimated completion costs. Ms. Loockerman's pre-filed testimony, Decker Ex. 1, at 16-17.

¹⁷⁴ ED's Replies to Closing Arguments, at 11-12

rehearing is contrary to the procedural processes applicable in a contested case hearing to ensure that only the reasonable and necessary expenses are recovered.¹⁷⁵

The ALJ agrees with Staff that Decker's inclusion of anticipated costs of \$800 for motions for rehearing is improper, not in the public interest, against TCEQ rules and the Texas Water Code, and should be denied. Accordingly, the ALJ finds that Decker's requested rate case expense should be reduced by \$800, from \$30,197.23 to \$29,397.23.

In addition, Staff points out that Protestants submitted written settlement offers to Decker on October 14, 2008, and October 20, 2008, and both offers were rejected.¹⁷⁶ Under 30 TAC § 291.28(9), a utility may not recover any rate case expenses incurred after the date of a written settlement offer by all ratepayer parties if the revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than or equal to the revenue that would have been generated by the rate contained in the written settlement offer. The ALJ, appropriately, is unaware of the content of the written settlement offers, so cannot determine whether the requirements of 30 TAC § 291.28(9) will be met if the rates recommended in this Proposal for Decision are approved by the Commission. However, the ALJ agrees with Staff that if the Commission adopts rates that will generate revenue less than or equal to the amount that would have been generated by the rates contained in Protestants' settlement offers, the rate case expenses incurred after October 20, 2008, should be denied. The parties should address the issue further in their exceptions.

¹⁷⁵ Staff cites TEX. WATER CODE ANN. § 13.187(c) and 30 TAC § 291.28(4). ED's Replies to Closing Arguments, at 11.

¹⁷⁶ ED's Replies to Closing Arguments, at 11.

VIII. CONCLUSION

As modified by Staff, Decker's proposed rates contained in the Rate/Tariff Change Application filed with the TCEQ on November 15, 2007, are reasonable and necessary to provide water and sewer service to the ratepayers. Further, Decker has proved that it should recover \$29,397.23 in rate case expenses.

SIGNED March 17, 2010.



SHARON CLONINGER
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AN ORDER Approving the Application of HHJ, Inc. d/b/a Decker Utilities to Change Water and Sewer Rates; TCEQ Docket No. 2008-0164-UCR; SOAH Docket No. 582-08-1719

On _____, the Texas Commission on Environmental Quality (Commission) considered the application of HHJ, Inc. d/b/a Decker Utilities for water and sewer rate/tariff change and for recovery of rate case expenses through imposition of a surcharge on water and sewer customers. Administrative Law Judge (ALJ) Sharon Cloninger of the State Office of Administrative Hearings (SOAH) presented an Amended Proposal for Decision (Amended PFD) recommending that the Commission approve the requested rate changes, with modifications. After considering the Amended PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

General and Procedural Findings

1. HHJ, Inc. d/b/a Decker Utilities (Applicant) holds Water Certificate of Convenience and Necessity (CCN) No. 12841 and Sewer CCN No. 20833.
2. On November 15, 2007, Applicant submitted to the Commission its application for water and sewer rate/tariff changes for CCN Nos. 12841 and 20833 (the Application), for its integrated utility system located in Montgomery County, Texas.
3. Applicant seeks an increase in revenues for water service in the amount of \$351,760.

4. Under the Application, the proposed rate increases were effective as of February 1, 2008.
5. Applicant timely provided notice of the proposed rate changes to its ratepayers and affected persons.
6. Within 60 days of the effective date of the proposed rate changes, at least 10 percent of Applicant's customers filed protests to the rate changes.
7. On January 31, 2008, the Commission referred the Application to SOAH for a contested case hearing.
8. On March 29, 2008, notice of the hearing in this docket was provided to all affected persons.
9. On April 15, 2008, a preliminary hearing convened in this docket, at which time jurisdiction was taken and the following parties were admitted and designated: Applicant; the Executive Director (ED) of the Commission; the Office of Public Interest Counsel (OPIC); and Angela Arndt, Todd Arndt, Douglas Mendez, Stacy McCoy-Moquin, Richard Muse, and Larry Osborne (collectively, Protestants).
10. A hearing on the merits of the Application was held on October 14, 2008, at the SOAH field office in Houston, Texas. Applicant appeared through its attorney, Mark H. Zeppa; the ED appeared through Erin Selvera and Trey Jackson, staff attorneys; OPIC appeared through Christina Mann, staff attorney; and Protestants appeared through their representatives Ms. McCoy-Moquin and Mr. Osborne. The hearing recessed for the parties to negotiate a settlement. After the parties were unable to reach a settlement, the hearing reconvened on November 6, 2008, in Austin, Texas, with all parties participating in the proceeding.
11. The record closed on January 12, 2009, after the parties submitted written closing arguments.
12. SOAH issued a Proposal for Decision on March 12, 2009.
13. The Commission considered the PFD on June 26, 2009.

14. The Commission issued an interim order on July 21, 2009, remanding the case to SOAH for an additional hearing on the issue of Applicant's undocumented cost of service expenses.
15. On November 30, 2009, a hearing on the remanded issue was convened at SOAH in Austin, Texas. Applicant appeared through its attorney, Mark H. Zeppa; the ED appeared through Erin Selvera, Staff Attorney; OPIC appeared through Blas Coy, Public Interest Counsel; and Protestants appeared through their representatives Ms. McCoy-Moquin and Mr. Osborne.
16. The record closed January 18, 2010, after the parties had an opportunity to submit written closing arguments and responses.
17. During the test year, which ran from January 1-December 31, 2006, Applicant provided water and sewer service to 542 connections.
18. Applicant requested by its Application the following rates, which it implemented on February 1, 2008:

<u>Water</u>		<u>Sewer</u>	
<u>Minimum Bill</u>		<u>Minimum Bill</u>	
5/8" or 3/4"	\$25.88	5/8" or 3/4"	\$64.67
1"	\$64.70	1"	\$64.67
1 1/2"	\$129.40	1 1/2"	\$64.67
2"	\$207.04	2"	\$64.67
3"	\$388.20	3"	\$64.67
4"	\$517.60	4"	\$64.67
6"	\$569.36	6"	\$64.67
 <u>Gallonage Rate</u>		 <u>Gallonage Rate</u>	
\$2.29 for each 1,000 gallons over the minimum		\$4.00 for each 1,000 gallons over the minimum	

Salary and Wage Expenses

19. Applicant's reasonable and necessary salary and wage expenses are \$146,000 for providing water and sewer service.

- a. Applicant's utility, which has 542 connections each for water and sewer, requires at least two office personnel, two certified operators, and one plant superintendent to provide adequate service to its customers.
- b. Salaries and wages of \$104,000 annually are required to pay Applicant's two office personnel and plant superintendent.
- c. A salary of \$42,000 annually is required to pay Robert Weedn, Applicant's owner and manager, and one of its certified operators.

Contract Labor Expenses

20. During the test year, Applicant incurred \$4,800 in miscellaneous contract labor, mainly for office and clerical work; after the test year, Applicant hired a second certified operator, as required for a utility of Applicant's size, at a cost of \$21,600 per year.
21. The aforementioned contract labor expenses incurred during the test year and after as known and measurable changes were reasonable, necessary, and typical.

Repair and Maintenance Expenses

22. During the test year, Applicant incurred \$44,236.97 that was reasonable and necessary to provide service.
23. Applicant's repair and maintenance expenses of \$45,996 used in determination of its rate request should be adjusted to disallow undocumented expenses of \$881 that were not shown to be reasonable and necessary to provide service.

Office Expenses

24. In calculating the rates sought in this proceeding, Applicant claimed total rent expenses of \$7,788 per year, which is split equally between the water and sewer systems. This amount accurately reflects Applicant's reasonable and necessary rent expenses.

25. Applicant's calculated office expenses of \$24,717—which includes the \$7,788 in rent—is not reasonable and necessary for Applicant to provide service to its customers.
26. Including the cost of rent, Applicant's underlying documentation supports reasonable and necessary office expenses of \$21,062.

Legal and Accounting Expenses

27. Applicant has not shown all of its claimed legal and accounting expenses of \$9,071 normalized over the test year and 2007 were reasonable and necessary for Applicant to provide service to its customers.
28. Applicant's underlying documentation supports legal and accounting expenses of \$6,728.

Insurance Expenses

29. Applicant's insurance expense of \$18,741 is reasonable and necessary to provide water and sewer service to its customers.
30. Applicant's insurance expenses of \$14,432 counted as a note payable to Universal Premium Acceptance Corporation should be deleted from the debt portion of the Application, and counted only as part of insurance expenses.

Utility Expenses

31. Applicant's \$46,280 test year expenses for utilities, including electricity, was reasonable and necessary to provide water and sewer service.

Rate Case Expenses

32. Applicant incurred reasonable and necessary rate case expenses in this matter in the amount of \$29,397.23 for preparation of the Application, including deriving the original plant and equipment costs, developing the proposed rate/tariff changes, filing fees, notice costs, and participation by experts and counsel in the contested case hearing.

33. Applicant did not submit rate case expenses associated with the remand proceeding.
34. Rate case expenses in this case were not a normal, recurring expense of operation.

Net Invested Capital

35. The Application shows Applicant's net book value for plant and equipment as \$564,076 for the water system and \$2,624,293 for the sewer system. These amounts do not accurately reflect the correct net book values for Applicant's plant and equipment.
36. Original plant and equipment costs were derived from a combination of historic data and application of trending analysis.
37. The reasonable and necessary net book value for Applicant's plant and equipment is \$427,910 for the water system.
38. The reasonable and necessary original cost of Applicant's sewer system plant was \$2,404,722, the annual depreciation is \$48,546, the accumulated depreciation is \$237,601, and the net book value is \$2,167,120.

Depreciation

39. In its Applications, as revised at the hearing, Applicant determined that it had annual depreciation expense of \$20,255 for the water system and \$57,018 for the sewer system. These amounts do not accurately reflect the correct depreciation expenses incurred by Applicant.
40. The reasonable and necessary annual depreciation expense for the water system is \$15,983 and for the sewer system is \$48,546.

Rate of Return

41. Twelve percent (12%) is a fair return on investment for Applicant to receive because it is reasonable in light of Applicant's weighted cost of capital and is consistent with the returns available from other investments of similar risk.
42. Applicant pays 6.75 percent interest on its debt to Hybernia National Bank.
43. Applicant's reasonable weighted cost of capital for water is 8.8541 percent and for sewer is 9.0749 percent.

Rate Design

44. Applicant incorrectly used 613.5 customer or meter equivalents in its water rate design. The correct customer or meter equivalent for water rate design is 641.5.

Refunds

45. Because of the adjustments adopted by the Commission in this order, Applicant has received an over-recovery of rates (*i.e.*, overpayment by customers) while this rate case was pending.
46. Accounting for interest, the total refunds due to Applicant's customers for overcharges is \$ _____ for the water system and \$ _____ for the sewer system.

Miscellaneous

47. Non-rate fees and charges, and service policies in the proposed rate/tariff are consistent with Commission rules and with tariffs approved by the Commission for other similarly-situated utilities.

CONCLUSIONS OF LAW

48. Applicant is a public utility as defined in TEX. WATER CODE ANN. § 13.002(23).
49. The Texas Commission on Environmental Quality has jurisdiction to consider an application for a rate increase filed by a public utility, pursuant to TEX. WATER CODE ANN. § 13.181.

50. The ALJ conducted a contested case hearing and issued a proposal for decision on the Applicant's proposed water and sewer rate/tariff changes under TEX. GOV'T. CODE ANN. ch. 2003, TEX. WATER CODE ANN. ch. 13, and 30 TEX. ADMIN. CODE chs. 80 and 291.
51. Proper notice of the Application was given by the Applicant as required by TEX. WATER CODE ANN. § 13.187, 30 TEX. ADMIN. CODE §§ 291.22 and 291.28, and TEX. GOV'T. CODE ANN. §§ 2001.051 and 2001.052.
52. The invested capital amounts set forth in the Findings of Fact above are based on the original cost of property used by and useful to the Applicant in providing service, less depreciation, in accordance with TEX. WATER CODE ANN. § 13.185.
53. The revenue requirements are based on Applicant's reasonable and necessary operating expenses, within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.185.
54. The revenue requirements are sufficient to provide Applicant with a reasonable opportunity to earn a fair and equitable return on its invested capital while preserving its financial integrity, within the meaning of TEX. WATER CODE ANN. §§ 13.183 and 13.184.
55. The rates and fees to be charged by Applicant, as approved by the Commission in this Order, are just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and sufficient, equitable, and consistent in application to each class of customer in accordance with TEX. WATER CODE ANN. §§ 13.182, 13.189, and 13.190.
56. Rate case expenses in the amount of \$29,397.23 were a reasonable and necessary cost within the meaning of TEX. WATER CODE ANN. § 13.185(d) and (h), and recovery of these costs through a monthly surcharge of \$ _____ per customer for two years, or until the amount is paid, complies with 30 TEX. ADMIN. CODE § 291.21(k) for collection of revenues over and above the usual cost of service.

57. The following rates are appropriate to implement the Commission's rulings in this matter:

<u>Water</u>		<u>Sewer</u>	
<u>Minimum Bill (including 0 gallons)</u>		<u>Minimum Bill (including 0 gallons)</u>	
5/8" x 3/4"	\$ 17.98	5/8" x 3/4"	\$ 50.90
1"	\$ 44.95	1"	\$ 50.90
1-1/2"	\$ 89.90	1-1/2"	\$ 50.90
2"	\$143.84	2"	\$ 50.90
3"	\$ 269.71	3"	\$ 50.90
4"	\$ 449.51	4"	\$ 50.90
6"	\$ 899.02	6"	\$ 50.90
8"	\$ 1,438.43	8"	\$ 50.90
Gallage Rate		Gallage Rate	
\$ 2.29 per each 1,000 gallons		\$ 4.00 per each 1,000 gallons	

58. The appropriate interest rate to be applied to overcharges collected by the Applicant during the pendency of this rate case is 1.17 percent. After accounting for interest at this rate, the total refunds due customers for overcharges is \$ _____ for the water system and \$ _____ for the sewer system.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY THAT:

1. The Application of HHJ, Inc. d/b/a Decker Utilities for water and sewer rate/tariff changes are granted as modified by, and to the extent set forth in, the above Findings of Fact and Conclusions of Law.
2. The request of HHJ, Inc. d/b/a Decker Utilities to apply a surcharge to recover rate case expenses in the amount of \$29,397.23, to be recovered as a monthly surcharge of \$ _____

to each water and sewer customer for two years or until paid, is approved. The surcharge shall be discontinued at such time as the amount of \$29,397.23 is recovered.

3. HHJ, Inc. d/b/a Decker Utilities shall refund customers, for a period of _____ months, the amount of \$ _____ per water connection per month and \$ _____ per sewer connection per month for the over-recovery of rates that occurred during the pendency of this rate proceeding. This refund shall occur in the form of a credit on customers' bills. Customers who no longer take service from HHJ, Inc. d/b/a Decker Utilities shall have the total amount of refund paid directly to them.
4. HHJ, Inc. d/b/a Decker Utilities shall file a report to the Commission's Utilities and Districts Section, Water Supply Division, demonstrating compliance with the refund requirements of this Order. This report shall be filed each quarter until such time that all overcharges have been refunded.
5. HHJ, Inc. d/b/a Decker Utilities shall file a tariff reflecting the rates approved by the Commission within 10 days of the date of this Order.
6. HHJ, Inc. d/b/a Decker Utilities shall notify customers by mail of the final rate structure within 30 days of the date of this Order and shall include the statement required by 30 TEX. ADMIN. CODE § 291.28(5) along with the first bill to customers implementing the rates approved by this Order.
7. The effective date of this Order is the date the Order is final, as provided by TEX. GOV'T CODE ANN. § 2001.144 and 30 TEX. ADMIN. CODE § 80.273.
8. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief not expressly granted herein, are hereby denied for want of merit.

9. The Chief Clerk of the Texas Commission on Environmental Quality shall forward a copy of this Order and tariff to the parties.
10. If any provision, sentence, clause, or phase of this Order is for any reason held to be invalid, the invalidity of any portion shall not affect the validity of the remaining portions of the Order.

Issue Date:

TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

Buddy Garcia, Chairman

