

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



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

June 18, 2010

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

Re: Southern Water Corporation; SOAH Docket Nos. 582-09-2068 and 582-09-2069; TCEQ
Docket Nos. 2008-1830-UCR and 2008-1811-UCR

Dear Ms. Castañuela:

Attached is the Executive Director's Reply to Exceptions to the Proposal for Decision for the above-referenced case. If you have any questions or comments, please contact me at (512) 239-0750.

Sincerely,

A handwritten signature in black ink, appearing to read "B MacLeod", with a long horizontal line extending to the right.

Brian MacLeod
Environmental Law

cc: Mailing list

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

SOAH DOCKET NOS. 582-09-2068 and 582-09-2069
TCEQ DOCKET NOS. 2008-1830-UCR and 2008-1811-UCR

APPLICATION OF SOUTHERN WATER	§	BEFORE THE TEXAS COMMISSION
CORP FOR A WATER AND SEWER	§	
RATE/TARIFF CHANGE IN HARRIS	§	ON
COUNTY	§	
	§	ENVIRONMENTAL QUALITY
APPEAL OF SOUTHERN WATER CORP	§	
FROM A WATER AND SEWER RATE-	§	
MAKING DECISION OF THE CITY OF	§	
HOUSTON	§	
	§	
(SEWER CCN NO. 20500 WATER CCN	§	
NO. 11389)	§	

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

COMES NOW the Executive Director of the Texas Commission on Environmental Quality, by and through a representative of the Commission's Environmental Law Division, and files this reply to exceptions to the Administrative Law Judge's (ALJ's) Proposal for Decision (PFD).

Southern Water Corp (SWC) questioned the rate of return on equity that the ALJ included in the PFD. This reply will briefly lay out the issue raised by SWC in its exceptions and then will give a summary of the response to that issue before giving a more detailed discussion.

Summary of SWC's arguments regarding the rate of return

Southern Water Corp (SWC) argues that "Judge Walston omitted the controlling law which governs all utility ratemaking in the United States." SWC cites the *Bluefield* case and the *Hope* case as the controlling law that was omitted. SWC then argues that because its witness said 12% is the right rate of return to apply to its equity and because the Commission has always given 12% in recent cases that the rate of 12% is the appropriate rate. SWC also contends that because the ED's witness could not explain clearly how she arrived at her recommended rate,

that the ED's evidence should be disregarded. SWC finally asserts that the "Rate of Return Worksheet is an invalid tool and cannot be used to calculate the equity return..." All of these contentions are without merit.

Summary of argument replying to these exceptions:

Briefly, the responses to SWC's arguments are as follows:

1. The *Bluefield*¹ and *Hope*² cases state general principles rather than set specific rates and also state that a single rate for all utilities that applies for all time is not appropriate. The *Bluefield* case stands for the proposition that a state imposed rate that includes a too low a rate of return can be confiscatory and therefore void because it violates the United States Constitution. There is no indication that the rate is confiscatory that can be located in the record. The *Hope* case does not specifically address the rate of return issues in detail but instead stands for the proposition that rates have to allow a utility to attract capital as well as must be "just and reasonable." The rate of return in the proposal for decision and which the ED recommended is more reflective of the policies explained in these two Supreme Court cases than the Applicant's proposed rate.
2. The testimony of Mr. Martin on the rate of return is not persuasive. He gave no details to support his conclusory testimony. Furthermore, his testimony that the Commission has approved of 12% in recent cases and that the 12% rate is authorized by the instructions is incorrect.
3. By focusing on the confusion in the cross examination of the ED's witness, SWC ignores the fact that it has the burden of proof on the rate of return, and that even if the ED's witness gave inadequate testimony (which is not the case), the failure of an opposing party to negate an issue does not mean that the party with the burden of proof can claim that its position on an issue is established by default of another party. SWC's exceptions

¹ *Bluefield Waterworks & Improvements Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923)

² *Federal Power Commission v. Hope Natural Gas*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944)

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

to the PFD also do not adequately address the factors that are to be considered in determining whether a rate of return is appropriate that are outlined in TWC § 13.184 and 30 TAC § 291.31(c)(1). While SWC claims generally that “this portion of SWC’s evidentiary case was not neatly compartmentalized under the return heading, but was found throughout the cost of service testimonies and exhibits,” such a claim is insufficient to present the Commission or the ALJ with guidance as to where in the record such evidence can be found.

4. While the ED does not have the burden of proof on the appropriate rate of return, the ED’s evidence shows that its rate of return meets the *Bluefield* and *Hope* tests and considers all of the factors required to be considered by statute and rule. SWC’s contention that “the Rate of Return Worksheet is an invalid tool” is therefore without merit. The worksheet has been accepted by the Commission as a valid tool in past cases.

Below these positions are explained in more detail.

The *Bluefield* and *Hope* Cases

There is no doubt that the 1923 and 1944 United States Supreme Court cases are the seminal cases that outline the constitutional requirements for utility rates set by a state. However, these cases do not set any particular rate or set a standard method of calculating the rate. The *Bluefield* case states the following general test for setting a rate of return.

The company contends that the rate of return is too low and confiscatory. What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or

speculative ventures. 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. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Bluefield, 262 U.S. 679, 693

The reasoning of *Bluefield* does not support the concept that a utility can justify a rate of return by having its witness state the conclusion that 12% is necessary to attract capital and then claim a 12% rate of return is the correct rate in perpetuity. In fact, the opinion states that one fixed rate for all time is definitely not the correct approach. Specifically, the opinion states that a "rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally."

The *Hope* case has been cited as refining the test in *Bluefield*, but actually still uses a fairly amorphous standard. Specifically, Justice Douglas wrote the following in the *Hope* case when discussing the constitutional limitations on actions taken by the Federal Power Commission:

[T]he Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' *Id.*, 315 U.S. at page 586, 62 S.Ct. at page 743, 86 L.Ed. 1037. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. *Id.*, 315 U.S. at page 586, 62 S.Ct. at page 743, 86 L.Ed. 1037. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. Cf. **288 Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U.S. 287, 304, 305, 314, 53 S.Ct. 637, 643, 644, 647, 77 L.Ed. 1180; West Ohio Gas Co. v. Public Utilities Commission (No. 1), 294 U.S. 63, 70, 55 S.Ct. 316, 320, 79 L.Ed. 761; West v. Chesapeake & Potomac Tel. Co., 295 U.S. 662, 692, 693, 55 S.Ct. 894, 906, 907, 79 L.Ed. 1640 (dissenting opinion). It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then

important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences. Cf. Railroad Commission v. Cumberland Tel. & T. Co., 212 U.S. 414, 29 S.Ct. 357, 53 L.Ed. 577; Lindheimer v. Illinois Bell Tel. Co., supra, 292 U.S. at pages 164, 169, 54 S.Ct. at pages 663, 665, 78 L.Ed. 1182; Railroad Commission v. Pacific Gas & E. Co., 302 U.S. 388, 401, 58 S.Ct. 334, 341, 82 L.Ed. 319.

Hope, 320 U.S. 591, 602

The *Hope* case also gave more guidance on the general guidelines for setting the rate of return. Specifically the Court wrote

The rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that 'regulation does not insure that the business shall produce net revenues.' 315 U.S. at page 590, 62 S.Ct. at page 745, 86 L.Ed. 1037. But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. Cf. Chicago & Grand Trunk R. Co. v. Wellman, 143 U.S. 339, 345, 346, 12 S.Ct. 400, 402, 36 L.Ed. 176. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. See State of Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Commission, 262 U.S. 276, 291, 43 S.Ct. 544, 547, 67 L.Ed. 981, 31 A.L.R. 807 (Mr. Justice Brandeis concurring). The conditions under which more or less might be allowed are not important here. Nor is it important to this case to determine the various permissible ways in which any rate base on which the return is computed might be arrived at. For we are of the view that the end result in this case cannot be condemned under the Act as unjust and unreasonable from the investor or company viewpoint.

Id. 320 U.S. at 603

The *Bluefield* and *Hope* constitutional standards for the limits on the government's ability

to set rates are not violated in this case. There is no indication that the rate resulting from the ED's calculations resulted in unjust and unreasonable rates. Moreover, both the cases make it clear that a single, "fixed-in-stone" rate is not the appropriate rate because both cases acknowledge that each utility application may be different and that the rates of return can change over time.

The *Bluefield* and *Hope* cases actually support the ED's method of calculation because the ED's approach related the rate of return to current market rates with particular calculations that related to this particular utility, while SWC's approach is to claim that one-size-fits-all at 12% because their witness gave conclusory testimony that 12% is the right rate and the rate everyone gets. The ED's method more accurately estimates a rate that would "be commensurate with returns on investments in other enterprises having corresponding risks." *Id.*

The ED uses the most current Baa Public Utility Bond average as a starting point. The City of Houston's exhibit 3 listed these rates month by month and a review of this exhibit shows the rate is not constant, but changes. The Public Utility Bond average is chosen as a benchmark because applicants for rate changes are retail public utilities and therefore in a similar enterprise. Bonds are used to raise capital, and the return on those bonds reflects the rate that is necessary to attract investors. Therefore, it is a logical starting point for calculating a rate of return commensurate with other enterprises with similar risks (public utility enterprise bond rate used as a bench mark for water retail public utility enterprise rate of return).

By contrast, the applicant used rate of return that is more inconsistent with *Bluefield* and *Hope* than the rate the ED used. The Applicant chose a single rate of 12% which it claims (mistakenly) is given to all utilities in rate cases and which it claims (mistakenly) is the default presumptive rate of return on the application. A single rate of return for all water utilities does not recognize that a "rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally." *Bluefield*, 262 U.S. 679, 693.

The Applicant's Witnesses gave insufficient support for the applicant's requested rate of return and the stated basis for the requested rate of 12% is incorrect.

Ironically, the Applicant argues that the ED's witness was unqualified to give an opinion

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

on the appropriate rate of return, while its witness has the same qualifications as the ED's witness. Both have degrees in accounting, both are Certified Public Accountants (CPAs)³, and both are members of the Society of CPAs for the jurisdiction in which they are certified.⁴ SWC writes in its exceptions to the Proposal for Decision that the ED's witness "did not present the Rate of Return Worksheet as a qualified risk analysis or any other generally accepted method of calculation equity return." The same blanket indictment could be lodged against its own witness. SWC's witness gave broad statements that 12% was the rate necessary to attract capital and was the cause of the utilities ability to amass huge cash reserves and to operate the system with no debt without giving any "qualified risk analysis."

In addition to the fact that the same charge made against the ED's witness applies with at least equal force to its witness, SWC's assertions that 12% is the rate of return the TCEQ is approving for other utilities and that the instructions state that 12% is the presumptive rate of return are incorrect. A 12% rate of return was neither accepted nor approved in either of the two most recent rate cases that have gone to the Commission.⁵

In the *Double Diamond* rate case, the Commission denied the application in its entirety because the applicant failed to meet its burden of proof, but the Commission's November 12, 2009,⁶ order makes clear statements regarding the propriety of using the rate of return worksheet as opposed to asserting a simple 12% rate of return. Specifically, finding of fact number 53 recites the following: "DDU should have prepared the ROR worksheet for each individual water system and determined whether the water system met the conditions in the worksheet to determine the appropriate ROR." Furthermore, finding of fact number 55 reads thusly: "DDU erroneously calculated an ROR of 12 percent."

In the most recent rate case dealing with the rate of return that has been presented to the Commission, the application of *Texas Landing Utilities* (TLU), the ALJ's PFD⁷ denied a request (similar to the one made in this case) for a "presumptive" 12% rate of return and discussed the

³ SWC's witness is certified by Texas. The ED's witness is certified in the Philippines.

⁴ This information for the SWC witness is found in schedule A or Applicant Exhibit 3, the prefiled testimony of John Martin. This information for the ED witness is found in ED Exhibit 1, the prefiled testimony of Leila Guerrero-Gantioqui, page 2 lines 17-21.

⁵ Those cases were the application of Double Diamond to increase its rates (TCEQ Docket No. 2007-1708-UCR) and the application of Texas Landing Utilities to increase its rates (TCEQ Docket No. 2007-1867-UCR).

⁶ A copy of that order is filed with this reply and is labeled "Attachment 1."

⁷ A copy of that PFD is filed with this reply and is labeled "Attachment 2."

rate of return worksheet with approval. When the case went to the Commission's Agenda on February 10, 2010, the Commission generally approved of the PFD, but did not issue an order because of questions regarding the reasonableness of the rate case expenses claimed by the applicant and the PFD's treatment of line loss. The Commission remanded the case to the ALJ on those two issues only. On page 18 of that PFD, the ALJ disposed of the claim that there is a 12% presumptive rate of return. Specifically, the ALJ explained the weakness of this claim as follows⁸:

That prior utilities have been rewarded 12% rates of return just because they asked and no one stepped forward to protest is no basis for doing so in this case, and neither is relying on the presumed rate of return of 12% on equity awarded in the *Aqua Texas* case, which was processed in a different economic time. Guaranteeing a 12% rate of return on equity forever would clearly be arbitrary. Furthermore, Finding of Fact No. 73 of the *Aqua Texas* case does not state, as TLU suggests, that investors in water and sewer utilities can generally expect to recover a 12% return on equity. It stated that, "A 12% rate of return on equity is reasonable in light of *Aqua Texas*' risk and the capital-intensive nature of water and sewer utilities and is consistent with returns available from other investments with similar risk." The ALJ is not aware of any evidence being presented in this case about the returns of other investments of similar risks at this time, except for Mr. Morgan's conclusory statement. And the *Aqua Texas* case loses its relevance as time progresses.

The ALJ went on to conclude that "[b]ecause TLU did not meet its burden of proving the need for a 12% rate of return, the ALJ relies largely on the rate of return worksheet."

At least two findings of fact in that case also are relevant. Finding of Fact number 39 provides as follows: "Although TLU does not have debt and is financed with 100% equity, TLU is not entitled to a rate of return of 12%." Finding of Fact number 40 provides as follows: "Use of the rate of return worksheet was appropriate in this case."

Not only is SWC's contention that the Commission has a 12% presumptive rate of return incorrect, but its contention that the application instructions allows a 12% presumptive rate of return is also incorrect. The instructions do not authorize a 12% presumptive rate of return in a contested case as shown by ED-3, the relevant application instruction, which provides as

⁸ Page 18 of the PFD

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

follows: "Note: If your application is contested, the staff will compute your return based on the rate of return worksheet." ED-4 is the complete instruction packet and includes the rate of return worksheet: the same worksheet the ED's witness completed in calculating the rate of return. The application completed by SWC was admitted as the Applicant's exhibit 1. A review of that exhibit also reveals that there is no instruction recommending a 12% presumptive rate of return. Page 12 of the application found in Applicant's exhibit 1 provides as follows for completing the rate of return portion of the application: "NOTE: You may choose an average equity return established by the staff each year and included with the Annual Report Instructions **OR** an interest rate that you think is fair that is less than the rate established by the Staff **OR** to use the Rate of Return Worksheet which is attached to these instructions."⁹ The application instructions do not list 12% as a presumptive rate of return. The Annual Report Instructions referred to in the application was never offered into evidence or discussed. The Annual Report Instructions that would have been available to the applicant do not contain any reference to an average equity return rate.¹⁰

Burden of Proof

Under Section 13.184(c) of the Texas Water Code and Section 291.12 of the Commission's rules, the Applicant has the burden of proof to show that its requested rates are just and reasonable. Specifically, TWC § 13.184(a) includes the following in what the applicant must prove: "the commission may not prescribe any rate that will yield more than a fair return on the invested capital used and useful in rendering service to the public." Furthermore, TWC § 13.184(b) includes the following in what the applicant must prove: "In fixing a reasonable return on invested capital, the regulatory authority shall consider, in addition to other applicable factors,

⁹ It is important to note that the application form is filed in all rate cases and that many of those cases are not contested. With that in mind, the ED would point out that the relevant application instruction for contested cases provides as follows: "Note: If your application is contested, the staff will compute your return based on the rate of return worksheet." Therefore, even if the form did provide that a 12% rate of return could be requested, the situation changes when the case goes to a contested case hearing.

¹⁰ The Annual Report Instructions for the relevant year are included with this reply as "Attachment 3." The fact that the application instructions refer to a rate that is to be listed in a report but which is not in the report is an anomaly that Staff plans to remedy. For the purposes of this case, however, there is no authorization for a presumptive 12% rate of return as asserted by SWC.

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

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." TCEQ rule 291.31(c) expands on the Water Code's directive thusly:

- (1) The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return... and *shall* fix the rate of return in accordance with the following principles.
 - (A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.
 - (B) The Commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.
 - (C) The Commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case the utility shall consider the utility's cost of capital, which is a component of the cost of various classes of capital used by the utility.¹¹

The applicant only provided conclusory testimony and did not explain why the rate would not yield more than a fair rate of return, 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. Such conclusory statements have been considered insufficient to sustain the burden of proof in past cases. In particular, as discussed above, in the Double Diamond PFD, the ALJ wrote that the "ALJ is not aware of any evidence being presented in this case about the returns of other investments of similar risks at this time, except for Mr. Morgan's conclusory statement." The ALJ concluded in that case that the applicant had not met its burden of proof.

¹¹ 30 TEX. ADMIN. CODE § 291.31(c)(1) (emphasis added)

The applicant attempts to compensate for its failure to meet its burden by pointing to alleged infirmities in the ED's evidence. While the ED's evidence is competent and supports the PFD's finding on the rate of return as will be explained below, such insufficiency could not supply by default the proof that the applicant is required to develop.¹²

The ED's approach and the Rate of Return Worksheet applies the constitutional, statutory, and regulatory standards for setting a rate of return appropriately

The ED has discussed the proper elements to consider in setting a rate and the rate of return worksheet properly accounts for these elements. Therefore it is an essential tool in setting rates rather than, as the applicant suggests, an "invalid" tool. In order to demonstrate the usefulness of the worksheet, a discussion of each line on the sheet follows:

- Line A- Most current Baa average. This is the starting point for the rate, with seven opportunities for upward adjustment listed below. This rate is in a similar industry therefore meets the "similar enterprise return" test from *Hope* and *Bluefield*.
- Line B Add 2% for utilities with 200 or less customers. This allows flexibility for smaller utilities that still have to invest large amounts of money with few customers to recover the investment from. This meets the flexibility requirements and the need to attract capital implied in *Bluefield* and *Hope*. It also addresses the need to protect the financial integrity of the utility discussed in the Texas Water Code and the Commission rules.
- Line C Add 1% if the utility can demonstrate that it has both: Debt/Equity ratio is greater than 60% AND and no affiliated companies with access to revenues or other funds to

¹² See *Kenyon v. Bender*, 174 S.W.2d 110 (Tex.Civ.App. -- Beaumont,1943) writ ref'd. (holding that "One who seeks to recover against another must introduce competent evidence, whether direct or circumstantial, which tends reasonably to establish his cause of action, and from which the material issues upon which he relies for recovery can be reasonably inferred, and he cannot cast his adversary on evidence amounting to no more than conjecture, surmise or suspicion, merely because his case is difficult to prove." *Kenyon v. Bender*, 174 S.W.2d 110, 112 (Tex.Civ.App. - Beaumont,1943) writ ref'd.

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

support utility operations. These factors would take into consideration the need for a higher rate of return to protect the financial integrity of a utility.

- Line D Add 1% if the utility can demonstrate that it has at least two of the following conditions: (1) unstable population; (2) commercial customers account for 15% of revenues; (3) low growth; (4) aging system. All these factors would tend to show that the utility would need a higher rate of return in order to attract capital. It also reflects the specific needs of that utility to raise capital to replace assets. It also considers the growth of the service area. Both of these are specific considerations listed in 30 TAC § 291(c)(1)(C), which specifically provides that 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."
- Line E Add 1% if the utility is a stand alone sewer system with no agreement for either billing and collection or discontinuance for nonpayment from the water supplier. The absence of such an agreement would make the utility's ability to collect rates more difficult. Therefore it helps the utilities financial stability and thus its ability to raise capital if it can collect a higher rate of return.
- Line F Add 1% if the utility can demonstrate that it has at least 3 of the following 4 conditions: (1) number of complaints; (2) no major deficiencies in the most recent PWS inspection report; (3) no current or prior enforcement actions under current management within the past 3 years; (4) good Faith efforts to solve any current problems. These factors take into account the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, which are rate of return considerations under TWC § 13.184(b) and 30 TAC § 291.31(c)(1)(B)
- Line G Add 1% if the utility can demonstrate that it has at least 4 of the following 5 conditions: (1) well-maintained, up-to-date books and records; (2) effective communications and good customer relations; (3) consistently timely in meeting

reporting requirements and payment of fees; (4) exhibit fiscal responsibility with respect to rate filings, including completeness, accuracy and frequency; (5) less than 12% unaccounted for water. These factors take into account the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, which are rate of return considerations under TWC § 13.184(b) and 30 TAC § 291.31(c)(1)(B)

- Line H Add 1% if the utility can demonstrate that it has at least 4 of the following 5 conditions: (1) rate structure – any two of the following: a –zero gallons in minimum bill, b- gallonage rate set high enough to encourage conservation, c- use of inclining blocks; (2) drought contingency plan included in tariff and enforced; (3) conservation plan including encouragement of the use of water conserving devices, efficient lawn watering, or xeriscaping; (4) program to educate the customers about the nature of the system, its production distribution ability, PWS standards, and the need for water conservation; (5) unaccounted for water (a) is less than or equal to 10% and/or successful program to reduce losses (ex. Leak detection and repair) (within last 3 years 25% reduction since program implemented). These factors take into consideration the efforts and achievements of the utility in the conservation of resources, which are rate of return considerations under TWC § 13.184(b) and 30 TAC § 291.31(c)(1)(B)

The ED's rate of return worksheet is a template that focuses on the considerations required by the statutes and rules regarding the rate of return. The worksheet also allows for the flexibility, protection of the financial integrity of the utility, and the need for a utility to attract capital that is required by *Bluefield* and *Hope*. While there is some vagueness in the worksheet, such gray areas are inherent in rate setting cases. As the United States Supreme Court stated in the *Hope* case

It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the

product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.

Hope, 320 U.S. 591, 602

Conclusion

The applicant had the burden of proof to demonstrate that the rate of return requested met the considerations outlined in the statute. The Applicant did not meet this burden. In the applicant's exceptions to the PFD it posits that the PFD's recommended rate of return calculation is erroneous because it did not consider the *Bluefield* and *Hope* requirements of protecting the financial stability of the utility and setting a rate that would consider the risks of that particular utility by utilizing a rate for a comparable enterprise. However, a review of the method employed by the ED and adopted in the PFD shows that it meets the constitutional test and brings into consideration the criteria set by statute. The rate of return worksheet is a useful tool for focusing the inquiry on those specific factors.

WHEREFORE, PREMISES CONSIDERED, the ED requests the Commission to disregard SWC's exception to the PFD's recommended rate of return.

Respectfully Submitted,

TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

Robert Martinez, Director
Environmental Law Division

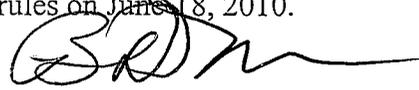
By 
Brian D. MacLeod
Staff Attorney
Environmental Law Division
State Bar of Texas No. 12783500

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

P.O. Box 13087; MC 173
Austin, Texas 78711-3087
Phone: (512) 239-0750
Fax: (512) 239-0606

CERTIFICATE OF SERVICE

This is to certify that all parties on the attached Mailing List have been sent a copy of the foregoing document in accordance with TCEQ and SOAH rules on June 18, 2010.



Brian D. MacLeod
Staff Attorney
Environmental Law Division

Mailing List
Southern Water Company
SOAH DOCKET NO. 582-09-2069
TCEQ DOCKET NO. 2008-1811-UCR

The Honorable Thomas H. Walston
Administrative Law Judge
State Office of Administrative Hearings
P.O. Box 13025
Austin, Texas 78701-3025
Tel: (512) 475-4993
Fax: (512) 475-4994

The City of Houston
Alton J. Hall, Jr.
Epstein, Becker, Green, Wickliff & Hall, P.C.
1000 Louisiana Street, Suite 5400
Houston, Texas 77002
Tel: (713) 750-3100
Fax: (713) 750-3101

TCEQ Public Interest Counsel
Scott Humphrey
P.O. Box 13087 (MC 103)
Austin, Texas 78711-3087
Tel: (512) 239-0574
Fax: (512) 239-6377

Southern Water Corporation
Mark H. Zeppa
4833 Spicewood Springs Road #202
Austin, Texas 78759-8436
Tel: (512) 346-4011
Fax: (512) 346-6847

TCEQ Chief Clerk:
Docket Clerk
TCEQ Office of Chief Clerk
P.O. Box 13087 (MC 105)
Austin, Texas 78711-3087
Fax: (512) 239-3311

Attachment 1

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AN ORDER DENYING THE APPLICATION OF DOUBLE DIAMOND UTILITIES TO INCREASE ITS RATES; TCEQ DOCKET NO. 2007-1708-UCR; SOAH DOCKET NO. 582-08-0698

On October 7, 2009, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Double Diamond Utilities (DDU) to change its water rates and its tariff in Hill, Palo Pinto, and Johnson Counties, Texas, under Certificate of Convenience and Necessity No. 12087. A Proposal for Decision (PFD) was presented by Kerrie Jo Qualtrough, an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH).

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

I. FINDINGS OF FACT

Procedural History and Jurisdiction

1. DDU provides retail water utility service under Certificate of Convenience and Necessity No. 12087, in Hill, Johnson, and Palo Pinto Counties, Texas.
2. DDU operates three water systems serving three separate developments: White Bluff water system (Hill County), the Retreat water system (Johnson County), and the Cliffs water system (Palo Pinto County).

3. In addition to its three water systems, DDU operates three wastewater systems, one for each development.
4. Notices of the proposed rate change were mailed to DDU's customers on July 27, 2007.
5. On August 2, 2007, DDU filed its application to increase its water rates and amend its tariff.
6. The effective date of the increase was September 28, 2007.
7. In December 2007, DDU filed an additional application to supplement the August 7, 2007 application. These two applications are collectively referred to as the "2007 application."
8. More than ten percent of DDU's customers filed protests by the applicable deadline.
9. On October 24, 2007, the Commission's Chief Clerk referred the application to SOAH for hearing.
10. On November 14, 2007, the Chief Clerk mailed notice of a preliminary hearing to DDU.
11. On November 29, 2007, SOAH issued an order requiring that the preliminary hearing be held in Hillsboro, Texas, on February 5, 2008.
12. On December 13, 2007, the Chief Clerk mailed the revised notice of a preliminary hearing to DDU.
13. DDU mailed the revised notice of the preliminary hearing to its customers on January 9, 2008.
14. The notice contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.

15. On February 5, 2008, an ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

PARTY	REPRESENTATIVE
DDU	Michael Skahan
Executive Director (ED)	Stephanie Skogen
Office of Public Interest Counsel (OPIC)	Eli Martinez
White Bluff Subdivision Ratepayers (WBSR)	Shari Heino
Jack and Sandra McCartney	Themselves
The Cliff's Subdivision Ratepayers	Todd McCall

16. No party disputes either the Commission's or SOAH's jurisdiction.
17. The ALJ held the hearing on the merits of the application on February 23-24, 2009, and all of the parties appeared and participated.

Overview of the Proposed Rate Increase

18. At the end of the 2006 test year, on December 31, 2006, the three water systems combined had the following number of metered connections:

Metered Connections: All three subdivisions	Total
5/8" X 3/4"	749
1"	38
1 1/2"	10
2"	31
Total	828

19. In its August 2007 application, DDU asserted that it had a revenue requirement of \$1,281,476.
20. In the December 2007 application, DDU asserted it had a revenue requirement of \$1,043,958.

21. In both the August and December 2007 applications, DDU calculated its revenue requirement by combining the financial information for all three water systems. DDU did not calculate the revenue requirement for each water system separately.
22. In its application, DDU requested to change its rates as follows:

	Previous Rates	August 2007 Application	December 2007 Application
The Cliffs - Minimum Bill			
5/8"	\$ 30.00	\$ 52.00	NA
1"	50.10	127.00	NA
1 1/2"	99.90	253.00	NA
2"	159.80	405.00	NA
3"	320.00	757.00	NA
Gallonage Charge per 1000 gallons			
1,001-10,000 Gallons	\$ 1.85	\$ 2.60	NA
10,001-20,000 Gallons	4.75	5.20	NA
Over 20,001 Gallons	6.75	7.80	NA
White Bluff and the Retreat - Minimum Bill			
5/8"	\$30.00	\$42.00	\$42.00
1"	\$50.10	\$65.00	\$65.00
1 1/2"	\$99.90	\$128.00	\$128.00
2"	\$159.80	\$280.00	\$280.00
3"	\$320.00	\$425.00	\$425.00
Gallonage Charge per 1000 gallons			
1,001-10,000 Gallons	\$1.85	\$2.50	\$2.50
10,001-20,001 Gallons	\$2.10	\$2.75	\$2.75
Over 20,001 Gallons	\$4.75	\$5.25	\$3.20

23. On September 28, 2007, DDU began charging the rates in the August 2007 application.

24. The December 2007 application reduced the volumetric rate for over 20,001 gallons for the White Bluff and the Retreat ratepayers from the rate of \$5.25 per thousand gallons to \$3.20 per thousand gallons.
25. DDU prepared a notice to the White Bluff and the Retreat ratepayers. This notice reflecting the lower rate of \$3.20 per thousand gallons over 20,001 gallons was included in the December 2007 application. DDU did not send notice of the reduction in the requested rate to the White Bluff and Retreat ratepayers and did not charge the ratepayers the lower gallonage charge found in its December 2007 application.
26. DDU charged the rates in its August 2007 application until December of 2008.
27. On October 23, 2008, DDU submitted another application for a rate increase, which is not the subject of this case.
28. The rates at issue in this proceeding were in effect approximately 15 months.

Multiple Systems Consolidated Under One Tariff and Rate Design

29. Prior to filing its August 2007 application, DDU utilized the same two-rate structure for the three subdivisions: The ratepayers in White Bluff and the Retreat paid the same rate while the Cliffs ratepayers paid a different rate. DDU continues this same rate structure in its 2007 application.
30. DDU did not present evidence on why the two water systems should be consolidated under one rate.
31. DDU did not show how the Retreat and the White Bluff water systems are substantially similar in terms of their costs of service.

Developer Contributions and the Effect on Invested Capital

32. DDU did not include developer contributions in either the August 2007 or December 2007 application for test year 2006.
33. DDU acquired assets from 2001 through June 2006 that had a “developer cost.” Some of these asset additions include “CL Lake pump improvements,” “CL water system improvement,” “RT Phase 1 & 2 Water/Sewer,” and “RT water well & tank.”
34. There were \$930,547 worth of developer contributions for the White Bluff and the Cliffs water systems. For the “WB” and “CL” water systems, there was \$249,153.86 in developer contributions in aid of construction in 1998.
35. DDU’s subsequent application for a rate change, dated October 24, 2008, listed \$1,904,489 in developer contributions. DDU’s October 23, 2008 rate change application also showed that for the vast majority of developer contributed assets listed, the installation dates occurred before the 2006 test year that is the subject of this proceeding.
36. Developers contributed a percentage of the cost of some of DDU’s assets. DDU’s application should have identified some amount of developer contributions to accurately determine DDU’s total invested capital.
37. DDU claimed a total invested capital of \$1,840,362 in its December 2007 application. The accuracy of this amount is questionable in light of DDU’s failure to account for developer contributions.

General Concerns with DDU’s Application

38. DDU’s accounting documents in the evidentiary record do not separate expenses and assets for the water systems from those for the wastewater systems.

39. Few of the amounts in DDU's exhibits match the corresponding entries in the application. DDU's accounting documents and invoices do not generally reconcile with its application.
40. DDU's witnesses did not have sufficient knowledge of the application to answer specific questions about how the entries in the application were determined.
41. DDU did not provide a sufficient explanation of its application and the proposed rates. Amounts in the application could not be verified through either DDU's exhibits or its witnesses.

One Combined Revenue Requirement for Three Water Systems

42. DDU grouped all three water systems together to develop one revenue requirement. For the test year 2006, DDU's revenue requirement for all three systems combined was \$1,043,958 as shown in the December 2007 application. DDU did not demonstrate how just and reasonable rates for the three separate water systems could be derived from one revenue requirement.
43. The Cliffs, the Retreat, and the White Bluff water systems are different in terms of age, size, type of development served, cost of service, and sources of water.
44. DDU should have prepared three separate revenue requirements for the three separate water systems.

Return on Invested Capital

45. DDU listed the assets for each water system in its depreciation schedule in the December 2007 application. DDU then totaled the entries for all three systems and added in DDU's general items to obtain the total net book value. DDU's general items include backhoes and trucks that are used for both the water and wastewater systems. DDU did

not show that it allocated the cost of its general items between the water and wastewater systems.

46. Rounded to the nearest dollar, the following table summarizes DDU's depreciation schedule and annual depreciation expense:

	Total Original Cost	Total Annual Depreciation	Total Net Book Value
General Items	\$300,100	\$ 26,502	\$ 94,295
The Cliffs	898,290	63,504	305,309
The Retreat	603,709	18,591	552,969
White Bluff	1,167,269	35,965	813,434
Total	\$2,969,368	\$144,562	\$1,766,007

47. DDU did not provide sufficient evidence to prove the original cost of all of the assets it claimed in its depreciation schedule in the application.

48. There is no prior TCEQ order establishing a rate base for any of DDU's water systems.

Invested Capital, Rate of Return, and Return

49. To determine its invested capital for all three systems combined, DDU showed on its application a net book value of \$1,766,007, working cash allowance of \$72,855, and materials and supplies of \$1,500 for a total of \$1,840,362. DDU showed \$0 for developer contributions.
50. In calculating a utility's invested capital, developer contributions are subtracted from the utility's total of net book value, working cash allowance, and materials and supplies.
51. To calculate its rate of return (ROR), DDU used one worksheet for all three water systems combined.

52. The three DDU water systems combined do not constitute a small water system of 200 or less connections. The three DDU water systems combined do not constitute a stand alone sewer system. The three DDU water systems combined do not meet both the conditions of aging system and unstable population listed on the TCEQ's ROR worksheet.
53. DDU should have prepared the ROR worksheet for each individual water system and determined whether the water system met the conditions in the worksheet to determine the appropriate ROR.
54. Other than a general conclusion that it met the factors in the ROR worksheet, DDU did not present specific evidence demonstrating how it met the other factors in the ROR worksheet.
55. DDU erroneously calculated an ROR of 12 percent.
56. In determining the weighted average cost of debt that DDU has in the three water systems, DDU showed an unpaid balance of \$734,990 on a loan from Double Diamond Delaware, Inc. DDU claimed an interest rate of 10 percent on the loan from its parent company, Double Diamond Delaware, Inc. DDU used this 10 percent interest to calculate its weighted rate of return.
57. DDU is a Qualified S Corporation of Double Diamond Delaware, Inc. and is not treated as a separate company for federal tax purposes. DDU's assets, liabilities, and all items of income, deduction, and credit are treated as those of Double Diamond Delaware, Inc. Any income incurred by DDU belongs to the parent company, including any interest on the loan that DDU collects from its customers through its rates.
58. Double Diamond Delaware, Inc. and DDU are affiliated interests.

59. In calculating just and reasonable rates, 10 percent is not an appropriate interest rate for a loan from an affiliated interest because a loan between affiliated interests is not an arm's length transaction.
60. DDU did not demonstrate that the 10 percent interest rate paid to its affiliated interest was reasonable and necessary.
61. In determining the weighted average cost of investment/equity, DDU listed \$3,024,118 as its equity in the three water systems combined. DDU did not prove how it calculated that it had \$3,024,118 in equity in the water systems.
62. DDU used the erroneous calculation of 12 percent from the ROR worksheet to calculate its weighted average cost of investment/equity.
63. In its December 2007 application, DDU's revenue requirement in Table VI.A. claimed a return of \$216,054. This is a \$2,572 discrepancy from the amount of DDU's return of \$213,462 shown in DDU's application at Table IV.E, line [H].
64. Based on errors in calculating its ROR, its weighted average costs of debt and equity, and its failure to include developer contributions in its total invested capital calculations, DDU erroneously calculated its return.

Operation and Maintenance Expenses

65. For each expense category, DDU presented one amount for all three water systems combined.
66. DDU should have calculated the expenses for each water system separately.

Salary Expenses

67. In its application, DDU claimed that its salary expense was \$272,369 for all three water systems combined.

68. DDU did not demonstrate that the \$272,369 in salary expenses claimed in its application was an allowable expense that was reasonable and necessary to provide water service.

Purchased Water

69. In its application, DDU indicated that it incurred a purchased water expense of \$7,363.

70. DDU did not demonstrate that the amount of \$7,363 as a purchased water expense is an allowable expense that is reasonable and necessary to provide water service.

Chemicals

71. In its application, DDU indicated that it incurred \$12,300 as a chemical expense for the three water systems combined.

72. DDU did not demonstrate how the claimed amount for chemical expenses excluded expenses for the wastewater systems.

73. DDU did not demonstrate that the amount of \$12,300 as a chemical expense is an allowable expense that is reasonable and necessary to provide water service.

Utilities (electricity)

74. In its application, DDU listed \$58,775 in electric utility expenses, purportedly for the three water systems combined.

75. DDU did not demonstrate how the claimed amount for electric utility expenses excluded expenses for the wastewater systems.

76. DDU did not demonstrate that the amount of \$58,775 in electric utility expenses is an allowable expense that is reasonable and necessary to provide water service.

Repairs/Maintenance/Supplies

77. In its application, DDU listed \$203,729 as an allowable expense for repairs, maintenance, and supplies for all three water systems combined.
78. DDU did not demonstrate how the claimed amount for the expense of repairs, maintenance, and supplies excluded expenses for the wastewater systems.
79. DDU did not demonstrate that the amount of \$203,729 for the expense of repairs, maintenance, and supplies is an allowable expense that is reasonable and necessary to provide water service.

Office Expense

80. DDU included the amount of \$5,500 as an office expense in its application.
81. DDU did not demonstrate how the claimed amount for office expenses excluded expenses for the wastewater systems.
82. DDU did not demonstrate that the amount of \$5,500 as an office expense is an allowable expense that is reasonable and necessary to provide water service.

Accounting and Legal Fees

83. In its application, DDU represented that it incurred \$6,100 as an allowable expense for accounting and legal fees.
84. DDU did not demonstrate how the claimed amount for the expense of accounting and legal fees excluded expenses for the wastewater systems.
85. DDU did not demonstrate that the amount of \$6,100 as an expense for accounting and legal fees is an allowable expense that is reasonable and necessary to provide water service.

Insurance

- 86. In its application, DDU indicated an amount of \$12,200 as an allowable expense for insurance.
- 87. DDU did not demonstrate how the claimed amount for insurance expenses excluded expenses for the wastewater systems.
- 88. DDU did not demonstrate that the amount of \$12,200 as an insurance expense is an allowable expense that is reasonable and necessary to provide water service.

Rate Case Expense

- 89. In its application, DDU claimed \$4,500 for rate case expenses.
- 90. DDU did not demonstrate that the amount of \$4,500 as a rate case expense is an allowable expense that is reasonable and necessary to provide water service.
- 91. DDU's rates as a result of the hearing are less than 51 percent of the increase in revenue that would have been generated by DDU's proposed rate.

Payroll Taxes

- 92. In its application, DDU claimed \$90,789 in expenses for payroll taxes.
- 93. DDU did not demonstrate how the claimed amount for payroll expenses excluded expenses for the wastewater systems.
- 94. DDU did not demonstrate that the amount of \$90,789 for payroll tax expenses is an allowable expense that is reasonable and necessary to provide water service.

Property and Other Taxes

- 95. DDU claimed \$4,500 in property and other taxes.
- 96. DDU did not demonstrate how the claimed amount for the expense of property and other taxes excluded expenses for the wastewater systems.

97. DDU did not demonstrate that the amount of \$4,400 for property and other tax expenses is an allowable expense that is reasonable and necessary to provide water service.

Annual Depreciation and Amortization

98. DDU calculated its annual depreciation expense for all three water systems combined.

99. In the depreciation schedule included in its December 2007 application, DDU listed the amount of \$144,560.90 as an annual depreciation expense. In its revenue requirement found on its Table VI.A. of its application, DDU listed the amount of \$144,573 as its amount of annual depreciation. This is a \$12 discrepancy between the amounts shown for this expense in its application.

100. DDU failed to provide sufficient documentation to support its depreciation schedule and the amount of its depreciation expense in its application.

101. DDU failed to demonstrate that the amount of \$144,573 for annual depreciation is an allowable expense that is reasonable and necessary to provide water service.

Federal Income Taxes

102. As set out in the application, DDU calculated its claimed income tax by taking its claimed return of \$213,482 and subtracting the product of its claimed total invested capital (\$1,840,362) and its claimed 10 percent weighted cost of debt capital, to derive a taxable income of \$29,446. Based on that income, DDU listed an income tax expense of \$5,206.

103. Since DDU did not properly calculate its total invested capital, its ROR, and its return, DDU did not properly calculate its federal income tax expense.

104. DDU did not demonstrate that the amount in its application for its federal income tax expense is an allowable expense that is reasonable and necessary to provide water service.

Return

105. Since DDU did not properly calculate its total invested income and its ROR, DDU did not properly calculate the amount of its return.

Other Revenues

106. DDU did not enter any amount for other revenues in its revenue requirement.

107. The evidence does not indicate that DDU recovered \$48,336 in tap fees during the test year as other revenues.

108. For each water system, \$0 is the proper amount for "other revenues."

Financial Integrity

109. Although DDU has operated at a loss between 2001 and 2006, DDU is not at risk of financial collapse if the application to change its rates is denied.

Rate Design

110. In its application, DDU calculated a monthly base rate per meter of \$49.22 through its calculations of fixed and variable costs and total meter equivalents.

111. *(blank)*

112. DDU proposed two rates: one rate for the Cliffs water system and a different rate for the White Bluff and the Retreat water systems.

113. The notice to the Cliffs ratepayers was included in DDU's August 2007 application but was not included in the December 2007 application. The notice showed that the Cliffs ratepayers would pay a \$52 monthly base rate that included 1,000 gallons. There would

also be the following gallonage charges per 1,000 gallons over the minimum: \$2.60 per 1,000 gallons, 1,001-10,000 gallons; \$5.20 per 1,000 gallons, 10,001-20,000 gallons; \$7.80 per 1,000 gallons, 20,001 gallons and over thereafter.

114. Although DDU reduced the revenue requirement in its December 2007 application by \$237,518, DDU did not revise the Cliffs' rates.

115. DDU's August 2007 application included a notice to White Bluff and the Retreat ratepayers with a \$42 monthly base rate that included 1,000 gallons. DDU indicated that the White Bluff and Retreat ratepayers would pay the following gallonage charges: \$2.50 per 1,000 gallons, 1001-10,000 gallons; \$2.75 per 1,000 gallons, 10,001-20,001 gallons; and \$5.25 per 1,000 gallons, 20,001 gallons thereafter.

116. In DDU's December 2007 application, DDU reduced its revenue requirement by \$237,518 and revised the notice for the White Bluff and the Retreat ratepayers. The only change in the rates for these two developments was in the highest tier of the gallonage charges. DDU reduced the amount per 1,000 gallons used over 20,001 gallons from \$5.25 to \$3.20.

117. Even though DDU lowered its gallonage charge for the highest tier for the White Bluff and the Retreat ratepayers in its December 2007 application, DDU did not charge the lower rate and did not send out the December 2007 notice.

118. DDU charged the rates in the August 2007 application from September 28, 2007 until December of 2008, when the rates requested in DDU's October 2008 rate application went into effect. Therefore, the rates requested in the August 2007 application were in effect for approximately 15 months.

119. DDU did not demonstrate how it calculated two rates from one revenue requirement.

120. DDU did not demonstrate how the proposed gallonage charges were determined.
121. DDU did not demonstrate how much revenue would be recovered from its proposed rates.
122. DDU did not demonstrate whether the revenue from its proposed rates would fail to meet, meet, or exceed its revenue requirement.

Refunds

123. DDU collected the proposed rates between September 28, 2007 and December 2008.

Miscellaneous Items

124. DDU's application requested tariff charge increases for 1) tap fee from \$400 to \$525; 2) returned check charge from \$20.00 to \$30.00; 3) customer deposit from \$0 to \$50.00; and 4) meter test fee from \$0 to \$25.00. No other parties contested these increases and the ED indicated that these increase are approvable.
125. DDU should review any future construction and purchase costs closely and maintain its records by National Association of Regulatory Utility Commissioners property accounts.

Transcription Costs

126. DDU was required to pay the cost of recording and transcription subject to an allocation of those costs among all the parties at the end of the case.
127. DDU, WBSR, OPIC, and the ED benefitted from the use of a transcript.
128. DDU did not request that the reporting and transcription costs be allocated among the parties.
129. No party presented evidence or argument on the issue of assessment of reporting and transcription costs.
130. The assessment of the reporting and transcription costs is not an issue in this case.

II. CONCLUSIONS OF LAW

Procedural History and Jurisdiction

1. DDU is a retail public utility. TEX. WATER CODE ANN. § 13.002(19).
2. DDU is a water and sewer utility. TEX. WATER CODE ANN. § 13.002(23).
3. The Commission has jurisdiction to consider an application for a rate increase filed by a water and sewer utility. TEX. WATER CODE ANN. § 13.042(e).
4. All required notices of the application and the contested case hearing on it were given as required by law. TEX. WATER CODE ANN. § 13.187; TEX. GOV'T CODE ANN. §§ 2001.051 & 2001.052.
5. The ALJ conducted a contested case hearing and proposed a decision on the application under the authority of chapter 2003 of the Texas Government Code and chapter 13 of the Texas Water Code.

Multiple Systems Consolidated Under One Tariff and Rate Design

6. "Every utility is required to file tariffs showing all rates that are subject to the jurisdiction of the regulatory authority." The utility's rules and regulations are part of the tariff. TEX. WATER CODE ANN. § 13.136(a).
7. The TCEQ defines tariff as "[t]he schedule of a retail public utility containing all rates, tolls, and charges stated separately by type or kind of service and the customer class, and the rules and regulations of the retail public utility stated separately by type or kind of service and the customer class." 30 TEX. ADMIN. CODE (TAC) § 291.3(48).
8. Before multiple systems can be consolidated under a single tariff or rate design, a utility must meet certain conditions. "A utility may consolidate its tariff and rate design for more than one system if: the systems included in the tariff are substantially similar in

terms of facilities, quality of service, and cost of service; and the tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.” 30 TAC § 291.21(m); *see also* TEX. WATER CODE ANN. § 13.145(a).

9. DDU has the burden of proving that its proposed rates are just and reasonable. TEX. WATER CODE ANN. § 13.184(c).

10. Based on the above Findings of Fact, DDU failed to meet its burden of proof that the Retreat and White Bluff water systems are substantially similar in terms of their costs of service.

11. Because the costs of service for the two systems are not substantially similar, DDU has not met the 30 TAC § 291.21(m)(1) requirements and the White Bluff and the Retreat

water systems cannot be consolidated under a single rate design.

Developer Contributions and the Effect on Invested Capital.

12. Developer contributions are not included in a utility's invested capital. 30 TAC § 291.31(c)(3)(A)(iv) & (v).

13. Based on the above Findings of Fact, DDU included developer contributions in its claimed total invested capital, although the exact amount cannot be determined.

Return

14. The Commission, in setting the rates for water service, must fix a utility's overall revenues at a level that will permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses and preserve the financial integrity of the utility. TEX. WATER CODE ANN. § 13.183.

15. The Commission is generally prohibited from setting rates that would allow DDU to earn more than a fair return on its capital that is used and useful in providing water service. TEX. WATER CODE ANN. § 13.184(a).
16. The Commission may promulgate reasonable rules with respect to the allowance or disallowance of certain expenses for ratemaking purposes. TEX. WATER CODE ANN. § 13.185(g).
17. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered. 30 TAC § 291.31(a) & (b).
18. "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing. TEX. WATER CODE ANN. § 13.002(22).
19. Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. Utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital. TEX. WATER CODE ANN. § 13.185(b).

20. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service. Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility, except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. TEX. WATER CODE ANN. § 13.185(j).

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

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

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

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

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

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

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

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

- (ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, § 13.185(e); and
- (iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

22. In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management. TEX. WATER CODE ANN. § 13.184 (b).

23. 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 an expense except to the extent that the regulatory authority finds that payment is reasonable and necessary. TEX. WATER CODE ANN. § 13.185(e).

24. Based on the above Findings of Fact, DDU did not meet its burden of proof that the interest expense on the loan from its affiliated interest, Double Diamond Delaware, Inc., is reasonable and necessary.

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

- (A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.
- (B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.
- (C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

26. Based on the above Findings of Fact, DDU failed to meet its burden of proof that its calculations regarding total invested capital, rate of return, and return comply with the TCEQ's rules.

Revenue Requirement

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

- (A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), §13.185(e));
- (B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;

- (C) assessments and taxes other than income taxes;
- (D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, § 13.185(f), if applicable);
- (E) reasonable expenditures for ordinary advertising, contributions, and donations; and
- (F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

28. Certain types of expenses are not allowed as a component of cost of service, such as those expenditures found by the Commission to be unreasonable or unnecessary, including civil penalties or fines. TEX. WATER CODE ANN. § 13.185(h)(3); 30 TAC § 291.31(b)(2)(I).

29. Based on the above Findings of Fact, DDU failed to meet its burden of proof that its claimed allowable expenses are reasonable and necessary to provide water service.

Rate Design

29. The Commission has adopted rules concerning alternative rate methods. 30 TAC § 291.34. To ensure that retail customers receive a higher quality, more affordable, or more reliable water or sewer service, to encourage regionalization, or to maintain financially stable and technically sound utilities, the Commission may utilize alternate methods of establishing rates. The Commission shall assure that rates, operations, and service are just and reasonable to the consumers and to the utilities.

30. *(blank)*

31. Based on the above Findings of Fact and Conclusions of Law, reverting to DDU's existing rates instead of setting lower rates is justified in order to preserve DDU's financial integrity.

32. Based on the above Findings of Fact and Conclusions of Law, DDU has failed to meet its burden of proving that its application should be granted. DDU has failed to meet its burden of proof that its proposed rates are just and reasonable.
33. Based on the above Findings of Fact and Conclusions of Law, DDU's application for a change in its water utility rates should be denied.

Rate Case Expenses

34. Regarding rate case expenses, 30 TAC § 291.28(7) and (8) provide:

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

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

35. Based on the above Findings of Fact and Conclusions of Law, DDU has failed to demonstrate that its rates should be increased. Therefore, in accordance with 30 TAC § 291.28(7) and (8), DDU should not be allowed to recover any rate case expenses for this case.
36. Based on the above Findings of Fact and Conclusions of Law, DDU's rates should revert back to those in effect before the filing of the August 2007 application to change DDU's water rates.

Refund

36. "Unless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate finally ordered plus interest as determined by the [Commission]." TEX. WATER CODE ANN. § 13.187(i).

37. Based on the above Findings of Fact and Conclusions of Law, DDU should refund or credit to its customers all sums collected from September 28, 2007, which was the effective date of the rates at issue in this case until December 2008, that exceed the rates approved by the Commission in this case, plus 3.21% interest on the over-collection.

Transcription Costs

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

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

39. The Public Interest Counsel may not appeal a ruling, decision, or other act of the Commission. TEX. WATER CODE ANN. § 5.275.
40. The Executive Director may not appeal a ruling, order, or other act of the Commission. TEX. WATER CODE ANN. § 5.356.
41. The Commission may not assess reporting or transcription costs to the Public Interest Counsel and the ED who, as statutory parties, are precluded by law from appealing any ruling, decision, or other act of the Commission. 30 TAC § 80.23(d)(2).
42. Based on the above Findings of Fact and Conclusions of Law, DDU shall be assessed the full amount of the reporting and transcription costs.

III. EXPLANATION OF CHANGES

1. The Commission sustained the ED's Exceptions regarding Findings of Fact Nos. 69 and 111 and Conclusions of Law Nos. 30 and 37, as recommended by the ALJ in her reply to the parties' post-PFD submissions. The Commission deleted the second sentence in Findings of Fact Nos. 69: "The Cliffs is the only surface water-based system." The Commission added the ED's proposed phrases to Conclusion of Law No. 37 in order to identify all sums collected from September 28, 2007 until December 2008. The Commission deleted the sentences proposed for Finding of Fact No. 111 and Conclusion of Law No. 30 regarding an alternative rate method for calculating rates, and left these two provisions "(blank)" in order to avoid the confusion from re-numbering the findings of fact and conclusions of law.
2. The Commission sustained the ED's suggested typographical-style corrections to Findings of Fact Nos. 5, 17, 22, 27, 35, 99, and 115 and Conclusion of Law No. 38 as set

out in the ED's Exceptions, pages 11 - 12, as recommended by the ALJ in her reply to the parties' post-PFD submissions. The Commission amended Finding of Fact No. 5 in order to correct DDU's application filing date to August 2, 2007. The Commission amended Finding of Fact No. 17 in order to identify the year 2009. The Commission amended Finding of Fact No. 22 in order to correct DDU's tiered gallonage charge categories to match DDU's notice. The Commission amended Finding of Fact Nos. 27 and 35 in order to correct DDU's latest application filing date to October 23, 2008. The Commission amended Finding of Fact No. 99 in order to correct the table reference to Table VI.A. The Commission amended Finding of Fact No. 115 in order to correct DDU's middle tiered gallonage charge range to 20,001 to match DDU's notice. The Commission amended Conclusion of Law No. 38 in order to correct the citation to section 80.23(d)(1):

3. The Commission sustained the DDU's exception regarding Ordering Provision No. 3 to allow DDU to either refund or credit, over a 15 month timeframe, amounts it received from its customers that exceed the rates finally set in this case.

4. The Commission determined to add Ordering Provision No. 9 to require that the Chief Clerk mail a copy of the Order to all parties.

5. The Commission based the reversion to DDU's existing rates in order to address the issue of DDU's financial integrity. The Commission determined to amend Finding of Fact No. 109 to state: "Although DDU has operated at a loss between 2001 and 2006, DDU is not at risk of financial collapse if the application to change its rates is denied." The Commission determined to amend Conclusion of Law No. 31 to state: "Based on the above Findings of Fact and Conclusions of Law, reverting to DDU's existing rates instead of setting lower rates is justified in order to preserve DDU's financial integrity."

The Commission determined to amend Ordering Provision No. 3 to add the following at the end of the provision: "DDU's Tariff shall continue to reflect its previously approved water rates."

6. The Commission determined to change the ALJ's proposed interest rate that applies to refunds or credits of DDU's overcharges. The Commission acknowledged that the Public Utility Commission has set refund interest rates for calendar year 2009 at 3.21%, based on the 90-day US prime commercial paper rate over the prior twelve months. The Commission determined to amend Conclusion of Law No. 37 and Ordering Provision No. 3 to specify a 3.21% interest rate for refunds/credits for DDU's overcharges.
7. The Commission determined to change the approve DDU's other Tariff charges. The Commission determined to replace Finding of Fact No. 124 with: "DDU's application requested tariff charge increases for 1) tap fee from \$400 to \$525; 2) returned check charge from \$20.00 to \$30.00; 3) customer deposit from \$0 to \$50.00; and 4) meter test fee from \$0 to \$25.00. No other parties contested these increases and the ED indicated that these increase are approvable." The Commission determined to amend Ordering Provision No. 1 to add the sentence: "DDU's requested tariff charge increases for tap fee, returned check charge, customer deposit, and meter test fee are approved."

IV. ORDERING PROVISIONS

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

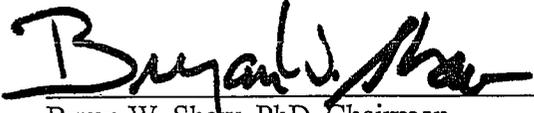
1. The application of Double Diamond Utilities to increase the rates that it charges for the retail water utility service that it provides under Certificate of Convenience and Necessity No. 12087 in Hill, Johnson, and Palo Pinto Counties, is denied. DDU's requested tariff charge increases for tap fee, returned check charge, customer deposit, and meter test fee are approved.
2. DDU shall immediately cease collecting the rates it proposed in this case.
3. Over a 15 month timeframe, DDU shall refund or credit to customers all sums collected between September 28, 2007 and December of 2008, that exceed the rates approved by the Commission in this case, plus 3.21% interest on the over-collection. DDU's Tariff shall continue to reflect its previously approved water rates.
4. DDU shall review any future construction and purchase costs closely and maintain its records by National Association of Regulatory Utility Commissioners property accounts.
5. DDU shall be assessed the full amount of the reporting and transcription costs.
6. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
7. The effective date of this Order is the date the Order is final, as provided by 30 TAC § 80.273 and Texas Government Code § 2001.144.
8. If any provision, sentence, clause, or phrase of this Order is for any reason held to be

invalid, the invalidity of any provision shall not affect the validity of the remaining portions of this Order.

9. The Office of the Chief Clerk shall mail a copy of the Order to all parties.

ISSUED: **NOV 12 2009**

TEXAS COMMISSION
ON ENVIRONMENTAL QUALITY


Bryan W. Shaw, PhD, Chairman
For the Commission

**WATER UTILITY TARIFF
FOR**

Double Diamond Utilities Company, Inc.
(Utility Name)

10100 N. Central Expressway, Suite 400
(Business Address)

Dallas, Texas 75231
(City, State, Zip Code)

(214) 706-9801
(Area Code/Telephone)

This tariff is effective for utility operations under the following Certificate of Convenience and Necessity:

12087

This tariff is effective in the following counties:

Hill, Palo Pinto, and Johnson

This tariff is effective in the following cities or unincorporated towns (if any):

None

This tariff is effective in the following subdivisions and public water systems:

The Cliffs (PWS #1820061), The Retreat Water Supply (PWS #1260127), and White Bluff (PWS #1090073).

TABLE OF CONTENTS

The above utility lists the following sections of its tariff (if additional pages are needed for a section, all pages should be numbered consecutively):

SECTION 1.0 -- RATE SCHEDULE.....	2
SECTION 2.0 -- SERVICE RULES AND POLICIES	6
SECTION 3.0 -- EXTENSION POLICY	13
SECTION 4.0 -- DROUGHT CONTINGENCY PLAN	18
APPENDIX A -- SAMPLE SERVICE AGREEMENT	
APPENDIX B -- APPLICATION FOR SERVICE	

SECTION 1.0 - RATE SCHEDULE

Section 1.01 - Rates

Meter Size	Monthly Minimum Charge	Gallonge Charge
5/8" or 3/4"	\$30.00 (Includes 1,000 gallons)	\$1.85 per 1000 gallons, 1001 - 10,000 gallons
1"	\$50.10	\$4.75 per 1000 gallons, 10,001 -20,000 gallons
1½ "	\$99.90	\$6.75 per 1000 gallons, 20,001 gallons and thereafter
2"	\$159.80	
3"	\$320.00	

FORM OF PAYMENT: The utility will accept the following forms of payment:

Cash , Check , Money Order , Credit Card , Other (specify) _____

THE UTILITY MAY REQUIRE EXACT CHANGE FOR PAYMENTS AND MAY REFUSE TO ACCEPT PAYMENTS MADE USING MORE THAN \$1.00 IN SMALL COINS. A WRITTEN RECEIPT WILL BE GIVEN FOR CASH PAYMENTS.

REGULATORY ASSESSMENT 1.0%
TCEQ RULES REQUIRE THE UTILITY TO COLLECT A FEE OF ONE PERCENT OF THE RETAIL MONTHLY BILL.

Section 1.02 - Miscellaneous Fees

TAP FEE \$525.00
TAP FEE COVERS THE UTILITY'S COSTS FOR MATERIALS AND LABOR TO INSTALL A STANDARD RESIDENTIAL 5/8" or 3/4" METER. AN ADDITIONAL FEE TO COVER UNIQUE COSTS IS PERMITTED IF LISTED ON THIS TARIFF.

TAP FEE (Large meter) Actual Cost
TAP FEE IS THE UTILITY'S ACTUAL COST FOR MATERIALS AND LABOR FOR METER SIZE INSTALLED.

METER RELOCATION FEE Actual Relocation Cost, Not to Exceed Tap Fee
THIS FEE MAY BE CHARGED IF A CUSTOMER REQUESTS THAT AN EXISTING METER BE RELOCATED.

METER TEST FEE \$25.00
THIS FEE WHICH SHOULD REFLECT THE UTILITY'S COST MAY BE CHARGED IF A CUSTOMER REQUESTS A SECOND METER TEST WITHIN A TWO-YEAR PERIOD AND THE TEST INDICATES THAT THE METER IS RECORDING ACCURATELY. THE FEE MAY NOT EXCEED \$25.

RATES LISTED ARE EFFECTIVE ONLY
IF THIS PAGE HAS TCEQ APPROVAL STAMP

SECTION 1.0 - RATE SCHEDULE (CONT.)

RECONNECTION FEE

THE RECONNECT FEE MUST BE PAID BEFORE SERVICE CAN BE RESTORED TO A CUSTOMER WHO HAS BEEN DISCONNECTED FOR THE FOLLOWING REASONS (OR OTHER REASONS LISTED UNDER SECTION 2.0 OF THIS TARIFF):

- a) Non payment of bill (Maximum \$25.00).....\$25.00
- b) Customer's request that service be disconnected.....\$25.00

TRANSFER FEE.....\$25.00

THE TRANSFER FEE WILL BE CHARGED FOR CHANGING AN ACCOUNT NAME AT THE SAME SERVICE LOCATION WHEN THE SERVICE IS NOT DISCONNECTED

LATE CHARGE (EITHER \$5.00 OR 10% OF THE BILL)..... 10%

TCEQ RULES ALLOW A ONE-TIME PENALTY TO BE CHARGED ON DELINQUENT BILLS. A LATE CHARGE MAY NOT BE APPLIED TO ANY BALANCE TO WHICH THE PENALTY WAS APPLIED IN A PREVIOUS BILLING.

RETURNED CHECK CHARGE.....\$30.00

RETURNED CHECK CHARGES MUST BE BASED ON THE UTILITY'S DOCUMENTABLE COST.

CUSTOMER DEPOSIT RESIDENTIAL (Maximum \$50).....\$50.00

COMMERCIAL & NON-RESIDENTIAL DEPOSIT..... 1/6TH OF ESTIMATED ANNUAL BILL

GOVERNMENTAL TESTING, INSPECTION AND COSTS SURCHARGE

WHEN AUTHORIZED IN WRITING BY TCEQ AND AFTER NOTICE TO CUSTOMERS, THE UTILITY MAY INCREASE RATES TO RECOVER INCREASED COSTS FOR INSPECTION FEES AND WATER TESTING 30 TAC 291.21(K)(2).

LINE EXTENSION AND CONSTRUCTION CHARGES:

REFER TO SECTION 3.0--EXTENSION POLICY FOR TERMS, CONDITIONS, AND CHARGES WHEN NEW CONSTRUCTION IS NECESSARY TO PROVIDE SERVICE.

RATES LISTED ARE EFFECTIVE ONLY
IF THIS PAGE HAS TCEQ APPROVAL STAMP

SECTION 1.0 - RATE SCHEDULE (CONT.)

Section 1.01 - Rates

<u>Meter Size</u>	<u>Monthly Minimum Charge</u>	<u>Gallonage Charge</u>
5/8" or 3/4"	\$30.00 (Includes 1,000 gallons)	\$1.85 per 1000 gallons, 1001 - 10,000 gallons
1"	\$50.10	\$2.10 per 1000 gallons, 10,001 -20,000 gallons
1½ "	\$99.90	\$4.75 per 1000 gallons, 20,001 gallons and thereafter
2"	\$159.80	
3"	\$320.00	

FORM OF PAYMENT: The utility will accept the following forms of payment:

Cash , Check , Money Order , Credit Card , Other (specify) _____

THE UTILITY MAY REQUIRE EXACT CHANGE FOR PAYMENTS AND MAY REFUSE TO ACCEPT PAYMENTS MADE USING MORE THAN \$1.00 IN SMALL COINS. A WRITTEN RECEIPT WILL BE GIVEN FOR CASH PAYMENTS.

REGULATORY ASSESSMENT 1.0%
 TCEQ RULES REQUIRE THE UTILITY TO COLLECT A FEE OF ONE PERCENT OF THE RETAIL MONTHLY BILL.

Section 1.02 - Miscellaneous Fees

TAP FEE \$525.00
 TAP FEE COVERS THE UTILITY'S COSTS FOR MATERIALS AND LABOR TO INSTALL A STANDARD RESIDENTIAL 5/8" or 3/4" METER. AN ADDITIONAL FEE TO COVER UNIQUE COSTS IS PERMITTED IF LISTED ON THIS TARIFF.

TAP FEE (Large meter) Actual Cost
 TAP FEE IS THE UTILITY'S ACTUAL COST FOR MATERIALS AND LABOR FOR METER SIZE INSTALLED.

METER RELOCATION FEE Actual Relocation Cost, Not to Exceed Tap Fee
 THIS FEE MAY BE CHARGED IF A CUSTOMER REQUESTS THAT AN EXISTING METER BE RELOCATED.

METER TEST FEE \$25.00
 THIS FEE WHICH SHOULD REFLECT THE UTILITY'S COST MAY BE CHARGED IF A CUSTOMER REQUESTS A SECOND METER TEST WITHIN A TWO-YEAR PERIOD AND THE TEST INDICATES THAT THE METER IS RECORDING ACCURATELY. THE FEE MAY NOT EXCEED \$25.

RATES LISTED ARE EFFECTIVE ONLY
 IF THIS PAGE HAS TCEQ APPROVAL STAMP

TEXAS COMM. ON ENVIRONMENTAL QUALITY
 35771-R, 12087, SEPTEMBER 28, 2007
 APPROVED TARIFF BY *[Signature]*

SECTION 1.0 - RATE SCHEDULE (CONT.)

RECONNECTION FEE

THE RECONNECT FEE MUST BE PAID BEFORE SERVICE CAN BE RESTORED TO A CUSTOMER WHO HAS BEEN DISCONNECTED FOR THE FOLLOWING REASONS (OR OTHER REASONS LISTED UNDER SECTION 2.0 OF THIS TARIFF):

- a) Non payment of bill (Maximum \$25.00).....\$25.00
- b) Customer's request that service be disconnected.....\$25.00

TRANSFER FEE.....\$25.00

THE TRANSFER FEE WILL BE CHARGED FOR CHANGING AN ACCOUNT NAME AT THE SAME SERVICE LOCATION WHEN THE SERVICE IS NOT DISCONNECTED

LATE CHARGE (EITHER \$5.00 OR 10% OF THE BILL) 10%

TCEQ RULES ALLOW A ONE-TIME PENALTY TO BE CHARGED ON DELINQUENT BILLS. A LATE CHARGE MAY NOT BE APPLIED TO ANY BALANCE TO WHICH THE PENALTY WAS APPLIED IN A PREVIOUS BILLING.

RETURNED CHECK CHARGE\$30.00

RETURNED CHECK CHARGES MUST BE BASED ON THE UTILITY'S DOCUMENTABLE COST.

CUSTOMER DEPOSIT RESIDENTIAL (Maximum \$50).....\$50.00

COMMERCIAL & NON-RESIDENTIAL DEPOSIT..... 1/6TH OF ESTIMATED ANNUAL BILL

GOVERNMENTAL TESTING, INSPECTION AND COSTS SURCHARGE

WHEN AUTHORIZED IN WRITING BY TCEQ AND AFTER NOTICE TO CUSTOMERS, THE UTILITY MAY INCREASE RATES TO RECOVER INCREASED COSTS FOR INSPECTION FEES AND WATER TESTING 30 TAC 291.21(K)(2).

LINE EXTENSION AND CONSTRUCTION CHARGES:

REFER TO SECTION 3.0--EXTENSION POLICY FOR TERMS, CONDITIONS, AND CHARGES WHEN NEW CONSTRUCTION IS NECESSARY TO PROVIDE SERVICE.

RATES LISTED ARE EFFECTIVE ONLY
IF THIS PAGE HAS TCEQ APPROVAL STAMP.

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



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

November 13, 2009

TO: Persons on the attached mailing list.

RE: Double Diamond Utilities Company, Inc.
TCEQ Docket No. 2007-1708-UCR; SOAH Docket No. 582-08-0698
Certificate of Convenience and Necessity No. 12087

Decision of the Commission on Application.

The Texas Commission on Environmental Quality ("TCEQ" or "Commission") has made a decision on the above-referenced application. Enclosed with this letter is a copy of the Commission's order and tariff. Unless a Motion for Rehearing ("MFR" or "motion") is timely filed with the chief clerk, as described below, this action of the Commission will become final. A MFR is a request for the Commission to review its decision on the matter. Any motion must explain why the Commission should review the decision.

Deadline for Filing Motion for Rehearing.

A MFR must be received by the chief clerk's office no later than 20 days after the date a person is notified of the Commission's order on this application. A person is presumed to have been notified on the third day after the date that this order is mailed.

Motions may be filed with the chief clerk electronically at <http://www10.tceq.state.tx.us/epic/efilings/> or by filing an original and 7 copies with the Chief Clerk at the following address:

LaDonna Castañuela, Chief Clerk
TCEQ, MC-105
P.O. Box 13087
Austin, Texas 78711-3087
Fax: 512/239-3311

In addition, a copy of the motion must be sent on the same day to each of the individuals on the attached mailing list. A certificate of service stating that copies of the motion were sent to those on the mailing list must also be sent to the chief clerk. The procedures for filing and serving motions for rehearing and responses are located in 30 Texas Administrative Code (TAC) §80.272 and 30 TAC §1.10-1.11. The hardcopy filing requirement is waived by the General Counsel pursuant to 30 TAC §1.10(h).

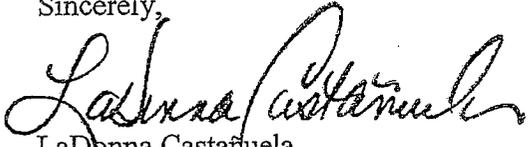
The written motion must contain (1) the name and representative capacity of the person filing the motion; (2) the style and official docket number assigned by SOAH or official docket number

assigned by the Commission; (3) the date of the order; and (4) a concise statement of each allegation of error.

Unless the time for the Commission to act on the motion is extended, the MFR is overruled by operation of law 45 days after a person is notified of the Commission's order on this application.

If you have any questions or need additional information about the procedures described in this letter, please call the Office of Public Assistance toll free at 1-800-687-4040.

Sincerely,



LaDonna Castañuela
Chief Clerk

LDC/ms

Enclosures

Double Diamond Utilities Company, Inc.
TCEQ Docket No. 2007-1708-UCR
SOAH Docket No. 582-08-0698

FOR THE APPLICANT:

Ali Abazari
Jackson Walker L.L.P.
100 Congress Avenue, Suite 1100
Austin, Texas 78701

Michael R. Skahan
Double Diamond Utilities Co.
10100 North Central Expressway, Suite 600
Dallas, Texas 75231

INTERESTED PERSONS:

Todd McCall
70 Oyster Bay Court
Graford, Texas 76449
*Representing the Cliffs Subdivision
Ratepayers*

Jack D. and Sandra McCartney
6300 Annanhill Street
Cleburne, Texas 76033

Shari Heino
Mathews & Freeland, L.L.P.
327 Congress Avenue, Suite 300
Austin, Texas 78701
*Representing the White Bluff Subdivision
Ratepayers*

Denis M. Hanley, Sr.
12213 Rolling Oaks WB69
Whitney, Texas 76692

FOR THE EXECUTIVE DIRECTOR
via electronic mail:

Stephanie Skogen, Staff Attorney
Texas Commission on Environmental Quality
Environmental Law Division MC-173
P.O. Box 13087
Austin, Texas 78711-3087

Brian Dickey, Technical Staff
Texas Commission on Environmental Quality
Water Supply Division MC-153
P.O. Box 13087
Austin, Texas 78711-3087

FOR OFFICE OF PUBLIC ASSISTANCE
via electronic mail:

Bridget Bohac, Director
Texas Commission on Environmental Quality
Office of Public Assistance MC-108
P.O. Box 13087
Austin, Texas 78711-3087

FOR PUBLIC INTEREST COUNSEL
via electronic mail:

Eli Martinez, Attorney
Texas Commission on Environmental Quality
Public Interest Counsel MC-103
P.O. Box 13087
Austin, Texas 78711-3087

FOR THE CHIEF CLERK
via electronic mail:

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

* The Honorable Kerrie Jo Qualtrough
Administrative Law Judge
State Office of Administrative Hearings
P. O. Box 13025
Austin, Texas 78711-3025

* Courtesy Copy via inter-agency mail

Attachment 2

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

TO: DOCKET CLERK
OFFICE OF CHIEF CLERK
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
P.O. BOX 13087
AUSTIN, TX 78711-3087

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

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

1 Original Proposal for Decision with 10 copies

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


Signature of Receiving Party

Date

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2009 NOV 24 PM 4:33
CHIEF CLERKS OFFICE

KLS/Ls

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

November 24, 2009

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

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2009 NOV 24 PM 4:38
CHIEF CLERKS OFFICE

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

Dear Mr. Trobman:

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

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

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

Sincerely,

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

Katherine L. Smith
Administrative Law Judge

KLS/Ls
Enclosures
cc: Mailing List

William P. Clements Building
Post Office Box 13025 ♦ 300 West 15th Street, Suite 502 ♦ Austin Texas 78711-3025
(512) 475-4993 Docket (512) 475-3445 Fax (512) 475-4994
<http://www.soah.state.tx.us>

STATE OFFICE OF ADMINISTRATIVE HEARINGS

AUSTIN OFFICE
300 West 15th Street Suite 502
Austin, Texas 78701
Phone: (512) 475-4993
Fax: (512) 475-4994

SERVICE LIST

AGENCY: Environmental Quality, Texas Commission on (TCEQ)
STYLE/CASE: TEXAS LANDING UTILITIES
SOAH DOCKET NUMBER: 582-08-1023
REFERRING AGENCY CASE: 2007-1867-UCR

STATE OFFICE OF ADMINISTRATIVE
HEARINGS

ADMINISTRATIVE LAW JUDGE
ALJ KATHERINE L. SMITH

REPRESENTATIVE / ADDRESS

PARTIES

DOCKET CLERK
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
OFFICE OF THE CHIEF CLERK
PO BOX 13087
AUSTIN, TX 78711
(512) 239-3300 (PH)
(512) 239-3311 (FAX)

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

RON OLSON
STAFF ATTORNEY
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
ENVIRONMENTAL LAW DIVISION
P.O. BOX 13087, MC-173
AUSTIN, TX 78711-3087
(512) 239-0608 (PH)
(512) 239-0606 (FAX)
rolson@tceq.state.tx.us

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

BILL BRYAN
235 BRANDING IRON
LIVINGSTON, TX 77351
(936) 321-6758 (PH)

TEXAS LANDING PROPERTY OWNERS ASSOCIATION

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2009 NOV 24 PM 4: 4
CHIEF CLERKS OFFICE

ELI MARTINEZ
PUBLIC INTEREST COUNSEL
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
12100 PARK 35 CIRCLE, MC-103, BUILDING F
AUSTIN, TX 78753
(512) 239-6363 (PH)
(512) 239-6377 (FAX)
elmartin@tceq.state.tx.us

OFFICE OF PUBLIC INTEREST COUNSEL

DAVID VEINOTTE
174 BUFFALO CT
LIVINGSTON, TX 77351
(936) 566-5566 (PH)

TEXAS LANDING PROPERTY OWNERS ASSOCIATION

JOHN STACEY
154 BUFFALO CT.
LIVINGSTON, TX 77351
(936) 566-5994 (PH)

TEXAS LANDING PROPERTY OWNERS ASSOCIATION

GEOFFREY P KIRSHBAUM
ATTORNEY AT LAW
THE TERRILL FIRM, P.C.
810 WEST 10TH STREET
AUSTIN, TX 78701
(512) 474-9100 (PH)
(512) 474-9888 (FAX)

TEXAS LANDING UTILITIES

MICHAEL DEITCH
LAW OFFICES OF MICHAEL DEITCH
800 RIO GRANDE
AUSTIN, TX 78701
(512) 474-1554 (PH)
(512) 474-1579 (FAX)

TEXAS LANDING PROPERTY OWNERS ASSOCIATION

xc: Docket Clerk, State Office of Administrative Hearings

TABLE OF CONTENTS

I. JURISDICTION AND PROCEDURAL HISTORY..... 1

II. BACKGROUND 2

III. CONSOLIDATED WATER RATE 3

 A. Facilities, Quality of Service, and Conservation 5

 B. Cost of Service 6

IV. REVENUE REQUIREMENT 10

 A. Invested Capital and Return..... 10

 1. TLPOA's Position 11

 2. The ED's Position..... 11

 3. Invested Capital 12

 B. Rate of Return 14

 1. TLU's Position..... 15

 2. ED's Position 17

 3. 12% Rate of Return..... 18

 4. Rate of Return Worksheet 19

 a. Step A..... 19

 b. Steps B, D, and E..... 19

 c. Step G..... 20

 d. Step C..... 21

 e. Step F..... 22

 f. Step H..... 24

 g. ALJ's Recommendation 25

 C. Tap Fees 26

 D. Revenue Requirement 26

 1. TLU's Position..... 26

 2. ED's Position 27

V. OTHER ISSUES 28

 A. Line Loss..... 28

 B. Rate Case Expenses..... 28

C. Surcharge Dispute..... 31
D. Utility in Question..... 32
E. Transcription Costs..... 33
V. RECOMMENDATION..... 34

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

II. BACKGROUND

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

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

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

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

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

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

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

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

III. CONSOLIDATED WATER RATE

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

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

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

Moreover, the conclusion in *Aqua Texas* upon which TLU relies, is even less relevant in light of the Commission’s more recent decision in *Application of Double Diamond Utilities, Inc. to Change its Water Rates and Tariff in Hill, Palo Pinto, and Johnson Counties, Texas*, *Application No. 35771-R*, 582-08-0698, adopted at the open meeting on Oct. 7, 2009. In *Double Diamond*, the ALJ found that although the Commission had approved the applicant’s rate structure in the past, the applicant was not relieved of its burden because the Commission had not found in a prior contested case that systems were substantially similar and should be consolidated under a single tariff. PFD at 18-19 (June 15, 2009).

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

A. Facilities, Quality of Service, and Conservation

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

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

With regard to quality of service, the evidence is uncontroverted that the two water systems operate very similarly and provide the same quality of customer service to customers with respect to its public drinking water supply and that they comply with the Commission's drinking water rules, which implement the EPA's drinking water standards. TLU Ex. C at 6-8, 14-15, 17. ED Ex. 2 at 9-10; tr. at 442.

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

B. Cost of Service

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

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

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

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

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

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

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

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

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

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

By taking the repairs & maintenance expense, fixed costs shared between the two water systems, depreciation expense, and assumptions of revenue generated from new taps for Goode City and comparing that to Texas Landings, it is reasonable to

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

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

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

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

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

Double Diamond, PFD at 19-20.

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

IV. REVENUE REQUIREMENT

A. Invested Capital and Return

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

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

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

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

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

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

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

1. TLPOA's Position

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

2. The ED's Position

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

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

⁷ TLU Ex. 1 at 002100, Table III B.

3. Invested Capital

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

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

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

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

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

TLU's position is not convincing. The ED also contends that 30 TAC § 291.25(b), which states that, "A utility filing for a change of rates under the Texas Water Code, §13.187 shall be prepared to go forward at a hearing on the data which has been submitted under subsection (a) of this section," limits what may be considered at the hearing to the data that is submitted in the rate filing package. Allowing TLU to benefit from the transfer of assets three days before the hearing, a year-and-a-half after the application was filed, without taking into consideration other changes, is unfair.

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

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

B. Rate of Return

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

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

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

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

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

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

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

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

1. TLU's Position

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

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

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

used, TLU contends that such an approach runs afoul of constitutional standards, citing *Duquesne Light Co. v. Baraschi*, 488 U.S. 299 (U.S. 1989). In that decision the court stated: “[A] State’s decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.” Tr. at 315. TLU contends that if the rate of return worksheet is used in this case, as recommended by the ED, it would constitute a new method of calculating rate of return on equity counter to Commission precedent.

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

2. ED's Position

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

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

3. 12% Rate of Return

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

That prior utilities have been rewarded 12% rates of return just because they asked and no one stepped forward to protest is no basis for doing so in this case, and neither is relying on the presumed rate of return of 12% on equity awarded in the *Aqua Texas* case, which was processed in a different economic time. Guaranteeing a 12% rate of return on equity forever would clearly be arbitrary. Furthermore, Finding of Fact No. 73 of the *Aqua Texas* case does not state, as TLU suggests, that investors in water and sewer utilities can generally expect to recover a 12% return on equity. It stated that, "A 12% return on equity is reasonable in light of Aqua Texas' risk and the capital-intensive nature of water and sewer utilities and is consistent with the returns available from other investments of similar risk." The ALJ is not aware of any evidence being presented in this case, about the returns of other investments of similar risk at this time, except for Mr. Morgan's conclusory statement. And the *Aqua Texas* case loses its relevance as time progresses.

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

4. Rate of Return Worksheet

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

a. Step A

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

b. Steps B, D, and E

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

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

c. Step G

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

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

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

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

d. Step C

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

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

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

e. Step F

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

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

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

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

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

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

Although the Commission may not have initiated a formal enforcement action, it referred to a November 1, 2006, violation in a letter dated November 28, 2006, and noted that it had enforcement powers to ensure compliance. TLU Ex. 7. Furthermore, the agreement that TLU signed was identified as Enforcement Case No. 36746. That TLU may have entered into a preemptive agreement, saving the Commission the trouble of bringing a formal action based upon its inspection, does not mean that there was not an enforcement action. Furthermore, the last page of the agreement notes that "in return for the Owner's agreement and adherence to these terms, the Commission will withhold further enforcement action related to the noted deficiencies." TLU Ex. 45. Therefore, the ALJ finds that TLU should not get credit for meeting

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

f. Step H

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

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

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

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

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

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

g. ALJ's Recommendation

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

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

C. Tap Fees

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

D. Revenue Requirement

1. TLU's Position

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

Water: \$87,769

Sewer: \$46,585

TLU Ex. 24 at 00248 and 00249.

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

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

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

TLU Closing Argument at 67.

2. ED's Position

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

The ED proposes the following revenue requirement for water:

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

The ED proposes the following revenue requirement for sewer:

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

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

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

V. OTHER ISSUES

A. Line Loss

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

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

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

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

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

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

The ALJ agrees with the ED that customers should not be required to pay for unexplained line loss. Although the line loss in 2006 may have been an anomaly, it is not appropriate for ratepayers who will be paying rates on a going-forward basis to pay for something that was beyond their control. Furthermore, Mr. Morgan's testimony was not as certain as TLU contends. He stated that "I think AWWA standard is that if your line losses are less than 15 percent, it's not worth looking for," and he assumed that the Commission's policy on line losses to be recovered from customers is 15 percent "because of the purchase water pass-through clause." Tr. at 187. Yet no additional information was provided in support of his position. Accordingly, the customers should only pay for the amount of line loss resulting from the normal operation of the utility, which in this case is 7%. And presumably, TLU's expenses in the test year, such as for electricity usage, was accounted for in the test year. Therefore, the appropriate amount of line loss to be included in the rate design is 7%.

B. Rate Case Expenses

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

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

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

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

C. Surcharge Dispute

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

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

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

D. Utility in Question

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

E. Transcription Costs

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

(d) Assessment of reporting and transcription costs.

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

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

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

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

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

V. RECOMMENDATION

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

SIGNED November 24, 2009.



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

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



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

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

I. FINDINGS OF FACT

General and Procedural Findings

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

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

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

Consolidated Rates

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

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

Rate Base, Allowable Expenses, and Revenue Requirement

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

Frog Basin, and Goode City subdivisions.

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

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

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

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

Rate Case Expenses

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

II. CONCLUSIONS OF LAW

General and Procedural Conclusions

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

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

Consolidated Rate

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

Rate Base, Allowable Expenses, and Revenue Requirement

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

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

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

Rate Case Expenses

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

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

III. ORDERING PROVISIONS

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

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

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

ISSUED:

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Buddy Garcia, Chairman
For the Commission

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

8:55 AM
 22-May-09

SCHEDULE I - REVENUE REQUIREMENT

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

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

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

8:54 AM
 22-May-09

SCHEDULE I(a) - OPERATIONS & MAINTENANCE

	TEST PERIOD PER COMPANY (a)	COMPANY ADJUST (b)	COMPANY TEST YEAR (c)=(a)+(b)	STAFF ADJUST (d)	STAFF TEST YEAR (e)=(c)+(d)
SALARIES	\$0.00	\$0.00	\$0.00		\$0.00
CONTRACT SERVICES	\$7,620.00	\$3,600.00	\$11,220.00		\$11,220.00
PURCHASED WATER	\$0.00	\$0.00	\$0.00		\$0.00
CHEMICALS AND TREATMENT	\$1,791.00	\$0.00	\$1,791.00		\$1,791.00
UTILITIES	\$3,657.00	\$0.00	\$3,657.00		\$3,657.00
REPAIRS AND MAINTENANCE	\$17,424.00	\$0.00	\$17,424.00	-\$4,369.00	\$13,055.00
OFFICE EXPENSE	\$1,425.00	\$0.00	\$1,425.00		\$1,425.00
ACCOUNTING AND LEGAL/MANAGEMENT AND OPERATIONS	\$14,040.00	\$0.00	\$14,040.00	\$3,454.00	\$17,494.00
INSURANCE	\$0.00	\$600.00	\$600.00		\$600.00
RATE CASE EXPENSE	\$0.00	\$0.00	\$0.00		\$0.00
MISCELLANEOUS	\$6,068.00	\$0.00	\$6,068.00		\$6,068.00
TOTAL	\$52,825.00	\$4,200.00	\$56,225.00	-\$915.00	\$55,310.00

SCHEDULE I(b) - OTHER TAXES

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

SCHEDULE I(c) - FEDERAL INCOME TAXES

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

EXHIBIT B

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

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

8:58 AM
 22-May-09

SCHEDULE I(d) - WEIGHTED COST OF CAPITAL

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

SCHEDULE I(e) - INVESTED CAPITAL & RETURN

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

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Utility Name: Texas Landfill Utilities

Docket Number: 35840-R - SEWER

8:57 AM

22-May-09

SCHEDULE I - REVENUE REQUIREMENT

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

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

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

8:56 AM
 22-May-09

SCHEDULE I(a) - OPERATIONS & MAINTENANCE

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

SCHEDULE I(b) - OTHER TAXES

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

SCHEDULE I(c) - FEDERAL INCOME TAXES

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

Attachment 3

WATER AND WASTEWATER UTILITIES ANNUAL REPORT INSTRUCTIONS

This year's Annual Report consists of 11 sections. This information will assist you with the current and future improvement needs of your utility and identify your long term planning business strategies. The following instructions match the sections on the Annual Report form and describe the information needed to complete each section. Read the section numbers below, and then complete the corresponding sections on the Annual Report form that is attached with these instructions.

1. **UTILITY INFORMATION.**

This information should reflect the official address and phone number of the utility. The Contact Person should be the individual that the Commission may contact if there are any questions about this report.

2. **UTILITY BACKGROUND.**

Enter the water Certificate of Convenience and Necessity (CCN) number.

Enter the number of Public Water Systems (PWS) owned by the utility.

Enter the sewer (wastewater) CCN number.

Enter the number of wastewater systems owned by the utility.

Enter the Discharge Permit number. (This number is referenced on the CCI and other correspondence from the TCEQ.)

3. **REVENUES.**

Enter the utility's total revenues generated during the reporting period January 1, 2007 through December 31, 2007. If it is necessary to estimate, indicate the estimated amount by following the amount with the letter "E" (Example: "\$2,550 E"). If the utility provides both water and sewer services, the revenues and expenses should be allocated between water and sewer to the extent possible. For revenues and expenses for which no allocation has been made, enter an estimate based on a reasonable method of allocation, such as ratio of water to sewer customers.

(NOTE: Do not include the Regulatory Assessment Fee collected and remitted to the TCEQ in this section.)

4. **EXPENSES.**

Enter all figures for each of the listed items. All entries need to be accurate.

Office Expenses include telephone, computer, postage and bank charges.

Repairs/Maintenance/Supplies include transportation expenses such as gas, auto repairs, etc.

Depreciation & Amortization may be estimated or stated as unknown. The amount of depreciation used for tax purposes may be reported, but that amount would be subject to recalculation for the purposes of a rate case.

Regulatory Expenses include lab fees, system fees, licensing fees, and operator training.

(NOTE: Do not include the Regulatory Assessment Fee collected and remitted to the TCEQ in this section.)

5. **OPERATING ITEMS.**

Enter all debt information. All information should be complete and accurate.

Enter the Regulatory Assessment Fee amount submitted to the TCEQ.

Enter the effective date of the last rate change.

6. **CUSTOMER INFORMATION.**

Enter the number of connections at the beginning of the year and at the end of the year in the appropriate columns.

7. **WATER PRODUCTION & CONSUMPTION.**

Enter the total amount of water produced by the wells or purchased from a water supplier, as measured by the utility's master meter.

Enter the total water sold/billed as measured by customer meters (This number, or estimate, should be available even if the utility bills are a flat rate.)

Enter how much water was lost. To calculate water loss, subtract water produced from water sold.

$$A - B = C \text{ (water loss in gallons)}$$

Enter percent of water lost.

$$(C \div A) \times 100 = \text{Percent Water Loss}$$

(Note: If your water loss is more than 10%, you may contact the Utilities & Districts Section for referral to a leak detection program at 512/239-4691.)

8. **WASTEWATER TREATED.**

Enter the total amount of wastewater treated as measured by the flow meter at your plant or other measurement of sewage volume. Enter the amount spent on treatment.

9. **UTILITY MANAGEMENT & OPERATIONS ASSESSMENT.**

Complete all questions in this section. This information will assist the utility and TCEQ in determining and assessing current utility managerial practices and capabilities of public water systems. Defining and developing current/future strategies will enhance the opportunity for effective and efficient operational performance.

10. **REMARKS.**

Provide explanations as necessary on any of the above items. Attach additional page(s) as needed to clarify or further explain any item in this report.

11. **SWORN STATEMENT.**

The owner or owner's representative *must* complete and sign this section. If the owner or owner's representative is not available, please attach a letter to the report explaining the reason the owner or owner's representative was unable to sign.

MAILING & CONTACT INFORMATION

Please send the completed form, with any attachments, to the following address:

**Texas Commission on Environmental Quality
Water Supply Division
Utilities Financial Review Team (MC-153)
P.O. Box 13087
Austin, Texas 78711-3087**

If you have suggestions or comments for improving this report, submit them along with the report. If you have questions about the report or problems completing it, please call 512/239-4691 for assistance.

The Texas Commission on Environmental Quality is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age or disability in employment or in the provision of services, programs, or activities.

In compliance with the Americans with Disabilities Act, this document may be requested in alternate formats by contacting the Utilities & Districts Section at 512/239-4691.

WATER AND WASTEWATER UTILITIES

ANNUAL REPORT

of

Exact Legal Name of Utility/Respondent

Certificate of Convenience and Necessity (CCN) No.

Submitted to the

State of Texas



Texas Commission on Environmental Quality

for the

Calendar Year Ended December 31, 2007

Section 1: Utility Information

Utility Name	_____
Address	_____ _____
<input type="checkbox"/>	Please check this box if your Official Address, which is noted on the enclosed letter, has changed.
Telephone Number	_____ Fax Number _____
E-mail Address	_____
Contact Person	_____ Title _____
Check the business ownership entity of the utility as filed with the Internal Revenue Service	
<input type="checkbox"/> Individual	<input type="checkbox"/> Partnership
<input type="checkbox"/> Corporation	<input type="checkbox"/> NonProfit Association

Section 2: Utility Background

Water CCN No.	_____	Number of PWSs	_____
		PWS ID No.	_____
		PWS ID No.	_____
		(if the Utility has more PWS ID Nos., please indicate in Section 10)	
Sewer CCN No.	_____	Number of Wastewater Systems	_____
Discharge Permit No.	_____		
Discharge Permit No.	_____		
	(if the Utility has more Discharge Permit Nos., please indicate in Section 10)		

Section 3: Revenues

	Water	Wastewater	Total
			Water + Wastewater
OPERATING REVENUES:			
Utility Service/Sales			
Fees (Tap, Reconnection, etc.)			
OTHER REVENUES:			
Please Identify:			
TOTAL REVENUES			

Section 4: Expenses

	Water	Wastewater	Total
			Water + Wastewater
Salaries & Wages			
Contract Labor			
Purchased Water			
Chemicals for Treatment			
Utilities (electricity)			
Repairs/Maintenance/Supplies			
Office Expenses			
Professional Fees (Accounting, Legal)			
Insurance			
Depreciation & Amortization			
Miscellaneous (describe in remarks below)			
Subtotal			
Taxes:			
Federal Income Taxes			
Property and Other Taxes (Payroll, etc.)			
Regulatory Expenses (Rate Case, Permits)			
Other (describe in remarks below)			
TOTAL EXPENSES			

Remarks: _____

Section 5: Operating Items

Debt Information:

Annual interest expense on long and/or short term debt? \$ _____
 Annual principal payment on debt? \$ _____
 Annual interest rate on debt? _____ %
 Annual debt principal and interest? \$ _____
 Principal balance on outstanding debt at end of this reporting period? \$ _____

Regulatory Assessment Fee:

What was the Regulatory Assessment fee amount submitted to TCEQ for the
 Calendar Year 2007? \$ _____

Rate Change:

What was the effective date of the last Rate Change? _____

Section 6: Customer Information

Connection Type	Number of Connections at	
	Beginning of Calendar Year 2007	End of Calendar Year 2007
Water		
Total		

Connection Type	Number of Connections at	
	Beginning of Calendar Year 2007	End of Calendar Year 2007
Wastewater		
Total		

Section 7: Water Production & Consumption

- A What is the total amount of water produced/pumped? _____ gallons
B What is the total amount of water sold/billed? _____ gallons
C How much water was lost? _____ gallons
What is the total percent of water loss? _____ %

To calculate the above, please reference the attached document Water and Wastewater Utilities Annual Report Instructions.

Comments? _____

Section 8: Wastewater Treated

What is the total amount of wastewater treated? _____ gallons

Comments? _____

Section 9: Utility Management & Operations Assessment

Utility Policy and Procedures

- Do you have an Application Form or Formal Process for New Customers? Yes No
- Do you have a copy of your approved tariff and drought contingency plan for customers to review? Yes No
- Do you have Written Operating Procedures for Routine Operations? Yes No
- Do you have Written Emergency Actions Plan(s)? Yes No
- Do you have Written Personnel Procedures? Yes No
- Do you have Risk Management & Safety Policies? Yes No
- Do you have Customer Service Policies? (including billing & collection)? Yes No
- Do you have a Written Budget? (normally updated annually)? Yes No

Did you or any utility staff attend the annual Water Supply Division Conference/Trade Fair or any other utility/business related conferences this year? If so, please list them in Section 10.

Yes No

Do you record complaints or keep a complaint log?

Yes No

Is a customer service representative, water system employee, or answering service accessible by phone at all times to all customers?

Yes No

Rules and Regulations

If you own/operate a public water system, do you have a copy of 30 TAC Chapter 290?

Yes No

If you own/operate a sewer system, do you have a copy of 30 TAC 314?

Yes No

Do you have a copy of the Utility Regulation TAC 30 Rule, Chapter 291?

Yes No

Do you have a copy of the Texas Water Code Chapter 13?

Yes No

Administrative Information

Do you notify customers prior to shutting down the system for repairs?

Yes No Sometimes Only if greater than 2 hours

How do you keep your customers informed?

Billing Statements Newsletter Meetings

Other _____

Are water records kept separate from other business and personal records?

Yes No

Are records kept for additions to fixed assets?

Yes No

Is the financial position of the system reviewed at least quarterly?

Yes No

Are accounting records for water and wastewater kept separately?

Yes No

Utility Assistance

If your answer to any question above is "No", would you be receptive to financial, managerial or technical assistance at no cost to the utility?

Yes No

