

# State Office of Administrative Hearings



Cathleen Parsley  
Chief Administrative Law Judge  
October 1, 2010

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

Re: SOAH Docket No. 582-09-3549; TCEQ Docket No. 2009-0372-UCR; In Re:  
Application for a Water Rate/Tariff Change of Wiedenfeld Water Works, Inc.,  
Certificate of Convenience and Necessity No. 12052 in Kerr, Kendall, and  
Medina Counties

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 **October 21, 2010**. Any replies to exceptions or briefs must be filed in the same manner no later than **November 1, 2010**.

This matter has been designated **TCEQ Docket No. 2009-0372-UCR ; SOAH Docket No. 582-09-3549**. All documents to be filed must clearly reference these assigned docket numbers. All exceptions, briefs and replies along with certification of service to the above parties shall be filed with the Chief Clerk of the TCEQ electronically at <http://www10.tceq.state.tx.us/epic/efilings/> or by filing an original and seven copies with the Chief Clerk of the TCEQ. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in black ink, appearing to read "Lilo D. Pomerleau".

Lilo D. Pomerleau  
Administrative Law Judge

LDP:nl

Enclosures

cc: Mailing List

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**STYLE/CASE:** WIEDENFELD WATER WORKS INC

**SOAH DOCKET NUMBER:** 582-09-3549

**REFERRING AGENCY CASE:** 2009-0372-UCR

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**STATE OFFICE OF ADMINISTRATIVE  
HEARINGS**

**ADMINISTRATIVE LAW JUDGE**

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SOAH DOCKET NO. 582-09-3549  
TCEQ DOCKET NO. 2009-0372-UCR

APPLICATION FOR A WATER § BEFORE THE STATE OFFICE  
RATE/TARIFF CHANGE OF §  
WIEDENFELD WATER WORKS, INC., § OF  
CERTIFICATE OF CONVENIENCE §  
AND NECESSITY NO. 12052 IN KERR, § ADMINISTRATIVE HEARINGS  
KENDALL, AND MEDINA COUNTIES §

TABLE OF CONTENTS

I. INTRODUCTION .....	1
II. JURISDICTION .....	2
III. PROCEDURAL HISTORY.....	2
IV. OVERVIEW OF THE PROPOSED RATE INCREASE.....	3
V. CONTESTED ISSUES.....	4
A. Application Was Not Properly Amended.....	4
1. ED’s Position.....	4
2. Applicant’s Position .....	5
3. ALJ’s Analysis.....	5
B. Consolidation of Systems .....	7
1. Water Conservation .....	7
2. Substantially Similar Systems: Facilities and Quality of Service .....	8
3. Substantially Similar Systems: Cost of Service .....	9
a. Applicant’s Argument .....	10
b. OPIC’s Argument .....	11
c. Westwood’s Argument .....	12
d. ED’s Position .....	14
e. ALJ’s Analysis.....	15
C. Allowable Expenses .....	17
1. Salaries and Wages.....	18
2. Contract Labor .....	20
3. Chemicals for Treatment.....	20

4.	Utilities.....	20
5.	Repairs, Maintenance, and Supplies .....	21
6.	Office Expenses.....	22
7.	Accounting and Legal Fees.....	23
8.	Insurance.....	23
9.	Rate Case Expense .....	23
10.	Miscellaneous Expense.....	24
11.	Payroll Taxes .....	26
12.	Property and Other Taxes.....	26
13.	Federal Income Taxes .....	27
14.	Annual Depreciation and Amortization .....	27
	a. ED's Position .....	28
	b. Westwood's Position .....	33
	c. Applicant's Position .....	34
	d. ALJ's Analysis.....	36
D.	Return on Invested Capital.....	38
	1. Working Cash Allowance, Materials and Supplies, and Customer Deposits.....	39
	2. Rate of Return .....	39
	a. Applicant's Position .....	39
	b. ED's Position .....	40
	c. ALJ's Recommendation .....	41
E.	Rate Design.....	42
VI.	REFUNDS .....	44
VII.	MISCELLANEOUS MATTERS.....	44
	A. Miscellaneous Fees.....	44
	B. Conservation Rates.....	45
	C. Transcription Costs .....	45

**SOAH DOCKET NO. 582-09-3549**  
**TCEQ DOCKET NO. 2009-0372-UCR**

<b>APPLICATION FOR A WATER</b>	<b>§</b>	<b>BEFORE THE STATE OFFICE</b>
<b>RATE/TARIFF CHANGE OF</b>	<b>§</b>	
<b>WIEDENFELD WATER WORKS, INC.,</b>	<b>§</b>	<b>OF</b>
<b>CERTIFICATE OF CONVENIENCE</b>	<b>§</b>	
<b>AND NECESSITY NO. 12052 IN KERR,</b>	<b>§</b>	<b>ADMINISTRATIVE HEARINGS</b>
<b>KENDALL, AND MEDINA COUNTIES</b>	<b>§</b>	

**PROPOSAL FOR DECISION**

**I. INTRODUCTION**

Wiedenfeld Water Works, Inc. (WWW or Applicant) has filed an application to increase the rates for its retail water utility service. WWW operates 13 water systems and seeks to consolidate and change the rates for 12 of its systems: Cedar Springs, Center Point, Heritage Park, Hills n' Dales, Oak Ridge Estates, Platten Creek, Rocky Creek, Southern Hills, Verde Park, Westwood Park, Windwood Oaks, and Woodhaven MHP. WWW does not seek a rate change for Vista Hills.

The Executive Director (ED), the Office of Public Interest Counsel (OPIC), and Westwood Park ratepayers (Westwood) contend that WWW failed to meet its burden of proof to demonstrate that its systems are substantially similar in terms of cost of service and provided insufficient documentation for all the costs and expenses listed in its application. The ED recommends that WWW's rates should revert back to their levels before the filing of this application. Westwood proposes rates lower than those previously in effect.

The Administrative Law Judge (ALJ) agrees that WWW has not met its burden of proof. WWW failed to establish that it has similar costs for all 12 systems. In general, WWW presented little evidence to support its application, and its legal argument was unpersuasive. WWW appeared to rely on the ED's rate case evaluation. However, WWW not the ED bears the burden of proof. Moreover, the ED recommends denial. For the reasons set out more thoroughly below, the ALJ recommends that the application be denied.

The ALJ also recommends that the Commission set WWW's rates at those levels existing before WWW filed its application in September of 2008. WWW should also be ordered to

refund or credit to customers all sums collected since the effective date of the rates at issue in this hearing that exceeded its tariffed rates, plus 3.21% interest on the over-collections.

## II. JURISDICTION

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

## III. PROCEDURAL HISTORY

On September 12, 2008, WWW filed its application to increase its rates and consolidate its tariff for 12 water systems under Certificate of Convenience and Necessity (CCN) No. 12052. The 12 water systems are located in Kerr, Kendall, and Medina Counties, Texas. The rates became effective on an interim basis on December 20, 2008, subject to the Commission's review.

More than ten percent of WWW's customers filed protests by the applicable deadline, and the Commission's Chief Clerk referred the rate application to the State Office of Administrative Hearings (SOAH). On June 11, 2009, the Chief Clerk mailed notice of a preliminary hearing to WWW. 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.<sup>1</sup> However, WWW added a "personal invitation" to attend the hearing, which included unauthorized language that may have discouraged attendance.<sup>2</sup>

On July 28, 2009, Administrative Law Judge Lilo D. Pomerleau held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

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<sup>1</sup> ED Ex. C.

<sup>2</sup> ED Ex. D.

PARTY	REPRESENTATIVES
WWW	R. Charles Wiedenfeld
ED	Stephanie Skogen, James T. Aldredge
Office of Public Interest Counsel (OPIC)	Blas J. Coy, Jr.
Windwood Oaks	Steve and Deanna Caraway
Heritage Park	Bill Wilson
Westwood	Santos Hernandez; Hanson Paul Leblanc, III

Because the Applicant added unauthorized language to the notice, WWW was required to send a third notice to the ratepayers, which provided notice of a second preliminary hearing, which was held on August 26, 2009. On October 8, 2008, a SOAH mediator held mediated settlement conference at the Kendall County Courthouse in Boerne, Texas. A settlement was not reached. Subsequent to the mediation, Windwood Oaks reached a settlement with WWW and withdrew as a party in this matter. Heritage Park also withdrew as a party before the hearing.

The ALJ held the hearing on the merits on May 5-6, 2010, and the following parties appeared and participated.

PARTY	REPRESENTATIVES
WWW	Mark H. Zeppa; Mary Alice Boehm-McKaughan
ED	Stephanie Skogen, James T. Aldredge
Office of Public Interest Counsel (OPIC)	James B. Murphy
Westwood	Randall B. Wilburn

**IV. OVERVIEW OF THE PROPOSED RATE INCREASE**

As noted previously, WWW operates 12 water systems in Texas that are the subject of this case, with three different tariffs. One tariff applies to nine water systems—Cedar Springs, Center Point, Heritage Park, Hills n’ Dales, Platten Creek, Rocky Creek, Southern Hills, Verde

Park and Woodhaven MHP. Westwood Park, Windwood Oaks, and Oak Ridge Estates each have different tariffs. WWW is seeking one tariff that would cover all of its systems.<sup>3</sup>

## V. CONTESTED ISSUES

### A. Application Was Not Properly Amended

#### 1. ED's Position

The ED points out that, under TEX. ADMIN. CODE § 291.25(g), a rate application may be modified on a showing of good cause. In his prefiled testimony, R. Charles Wiedenfeld, owner and president of WWW, stated that he was making multiple revisions to WWW's application, including a change to the requested rates.<sup>4</sup> The ED took issue with these revisions because WWW never filed a request to amend its application and did not present good cause to the ED before the case was referred to SOAH or to the ALJ after it was referred. The ED argues that WWW's application has not been officially revised, and the September 12, 2008, application is the version of the application at issue in this case.

The ED acknowledges that § 291.25(g) does not explicitly state that an applicant must move to amend its application; however, the ED notes that any other reading of the rule would render it ineffective. According to the ED, when an applicant amends its application after filing, it potentially deprives the other parties of an opportunity to audit the utility's records, seek discovery responses, and provide direct testimony regarding those changes. The ED further notes that such unhindered changes result in the other parties never being sure exactly which application they need to seek information for, analyze, and respond to, forcing them to redo their analyses every time the applicant makes another change.

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<sup>3</sup> ED Ex. 2, Adhikari direct at 6.

<sup>4</sup> E.g., WWW Ex. 2, at 28:11-18 (recategorize pressure tanks), 34:6-7 (amended invested capital), 45:20-46:5 (new requested rates).

Indeed, this is what occurred in this case. Leila C. Guerrero-Gantioqui, TCEQ auditor, testified that there are multiple discrepancies between the numbers found in Mr. Wiedenfeld's testimony and the revised application, Schedule C, attached to his testimony.<sup>5</sup> Accordingly, the ED contends that the other parties still do not know which numbers they need to analyze and discuss. The ED argues that this is the type of situation § 291.25(g) attempts to avoid. Therefore, the ED asserts that the September 2008 application is the applicable application. Moreover, it is the one the ED used to analyze WWW's proposed rate changes.

## **2. Applicant's Position**

Applicant responds that WWW provided corrected schedules before the ED filed its direct case and that such evidence was admitted into the record without objection. Applicant claims that if the ED needed more time to analyze the amended application, it should have requested a continuance. Applicant also argues that 30 TEX. ADMIN. CODE § 291.25(c) permits WWW to provide more information in support of its rate change request through its prefiled testimony and exhibits.

## **3. ALJ's Analysis**

The TCEQ's rule at 30 TEX. ADMIN. CODE § 291.25(c) provides:

An original of the completed rate filing package and the number of copies specified in the application form shall be submitted and filed with the commission. In the event that the proposed rate change becomes the subject of a hearing, *the commission may require or allow, in addition to copies of the rate filing package, prefiled testimony and exhibits in support of the rate change request.* (Emphasis added.)

Whereas, 30 TEX. ADMIN. CODE § 291.25(g) states: "The items in the rate filing package may be modified on a showing of good cause."

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<sup>5</sup> ED Ex. 1, Guerrero-Gantioqui direct at 4-5.

The ALJ is not persuaded by Applicant's arguments. The rule at subsection(c) states that a utility shall submit an *original* of the completed rate filing package and, if there is a hearing, *copies* of the rate filing package testimony, and exhibits in support of the proposed rate change. WWW's interpretation of the rule—that no showing of good cause is needed based on the language of subsection (c)—renders subsection (g) meaningless. As to Applicant's contention that the ED could and should have requested a continuance, the ALJ notes that WWW bears the burden of proof in this matter. The application, even before it was amended, was clearly difficult to analyze. For instance, the numbers in support of the rate change include one water system (Vista Hills) that is not even part of this case.

Having found support for the ED's position in the TCEQ's rules, the ALJ notes that many applicants find errors during the discovery process. Certainly the rules and the practice at the TCEQ contemplate the filing of corrections to an application.<sup>6</sup> However, that is not what occurred in this case. Rather, Mr. Wiedenfeld presented changes, not corrections, to its rate change request (debt, rate of return, invested capital, income tax) but did not provide any invoices or other supporting documentation in support of these revisions. Moreover, Mr. Wiedenfeld's "amended application" provided only a partial schedule (Section VI—Utility Income & Expense Information Water), which made it difficult for the ED analysts to see how WWW had allocated the fixed and variable expenses.<sup>7</sup>

In ruling on this issue, the ALJ finds it unnecessary to hold that an applicant must file a request showing good cause because, in this case, WWW's amended application is incomplete and inaccurate. For instance, although Applicant states that it settled with Windwood Oaks, its "revised" application still includes a rate change. The ALJ concludes that Applicant's revised or amended application is incomplete and contains errors that hindered the ability of the parties and, in particular, the ED, from conducting a proper analysis. Thus, this Proposal for Decision (PFD) also analyzes the application as originally filed.

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<sup>6</sup> Of course, a utility cannot amend its application to increase rates above the amounts noticed to ratepayers.

<sup>7</sup> ED Ex. 1, Guerrero-Gantioqui direct at 4; compare ED Ex. 1, Att. LG-1 to WWW Ex. 1, Wiedenfeld direct at Schedule C.

## **B. Consolidation of Systems**

Applicant states that one of the “most significant issues in this case is whether WWW should be permitted to consolidate 12 of its 13 systems under one regional tariff.”<sup>8</sup> Despite this assertion, Applicant presented little evidence in support of its consolidation request. WWW is required to show that the systems included in the consolidated tariff are substantially similar in terms of facilities, quality of service, and cost of service and that the proposed rates promote water conservation.<sup>9</sup>

The ED and OPIC contend that WWW presented sufficient evidence showing that its facilities and quality of service are similar. However, both the ED and OPIC argue that WWW failed to demonstrate that its systems have a similar cost of service. Westwood contends that WWW failed: (1) to demonstrate similarity in its systems; and (2) to show that the rates promote water conservation.

### **1. Water Conservation**

Applicant argues that the proposed rates promote water conservation because the rates: (1) do not include a gallonage fee; (2) include drought contingency rates; and (3) increase as a customer uses more water.

Only Westwood contests Applicant on this issue. Westwood argues that WWW presented no calculations showing that its rates did in fact encourage water conservation.

ED witness Kamal Adhikari testified that he believed that the proposed rate design, with two tiers of charges (\$4 per 1,000 gallons for up to 10,000 gallons and \$6 for anything above), demonstrated that the rates are likely to promote conservation.<sup>10</sup>

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<sup>8</sup> WWW initial brief at 30.

<sup>9</sup> TEX. ADMIN. CODE (TAC) § 291.21(m).

<sup>10</sup> Tr. at 181.

The evidence on this issue is scant. WWW did not provide any testimony on the subject of water conservation in prefiled testimony. However, with the uncontroverted testimony of Mr. Adhikari, the ALJ find sufficient evidence that the structure of the proposed rates promotes water conservation.

## **2. Substantially Similar Systems: Facilities and Quality of Service**

Mr. Wiedenfeld, the main testifying witness for the utility, testified that all WWW systems are dependent upon groundwater and are substantially located within the same area, mostly in Kerr County, Texas. Mr. Wiedenfeld explained that the three systems that do not currently have the same rates, Oak Ridge Estates, Westwood Park, and Windwood Oaks, are located within seven miles of one another. WWW has a business office in Center Point, Texas, through which all customer service, billing, accounting, and clerical operations are performed. WWW has two full-time licensed operators, David Jones and Mr. Wiedenfeld, and an office worker. These personnel serve all WWW systems.<sup>11</sup>

ED witness Mr. Adhikari testified that WWW adequately demonstrated that the WWW systems are substantially similar in terms of facilities and quality of service.

Westwood argues that the water for the 12 systems comes from three different aquifers—the Edwards Aquifer, the Middle Trinity Aquifer, and the Lower Trinity Aquifer—with some different water quality that affects how long pumps last. Westwood also notes that 11 of the systems use sequestration as a treatment process; Rocky Creek does not. Westwood also argues that the 12 systems are of varying age and, if consolidated, the customers receiving service from the newer systems will have to subsidize those served by the older systems.<sup>12</sup>

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<sup>11</sup> Mr. Wiedenfeld has been a state-licensed water/sewer utility operator for over 20 years and is responsible for the daily operation of the water systems owned by WWW. WWW Ex. 1, Wiedenfeld direct at 1, 4-5; Ex. 5, Wiedenfeld supplemental, affidavit at 3.

<sup>12</sup> Tr. 336-337, 349-350; WWW Ex. 1, application at 6; ED Ex. 1, Guerrero direct at LG-1.

The ALJ finds sufficient evidence that WWW's 12 systems have substantially similar facilities. Mr. Adhikari testified that he personally inspected all the systems and found that they all use groundwater, have wells, groundwater system tanks, pumps, and the same kind of inspections for chlorine. Moreover, WWW serves the same types of community—a residential area.<sup>13</sup> Although the systems draw from different aquifers and may have some differences in pump sizes or tanks, the rules require only that the systems have *substantially* similar facilities. The evidence establishes this requirement.

Concerning quality of service, WWW serves all of its systems from one office, using the same employees to perform customer service, billing, accounting, and clerical operations. The ALJ finds sufficient evidence that WWW's 12 systems have substantially similar quality of service.

### **3. Substantially Similar Systems: Cost of Service**

As to demonstrating whether WWW's systems are substantially similar in terms of cost of service, the Applicant provided only one general ledger with all the costs of the systems combined and a combined profit and loss statement. The ED, OPIC, and Westwood argue that WWW has not provided sufficient, basic information to demonstrate the expenses for each system, which means that it cannot demonstrate whether its systems have substantially similar costs of service.

WWW did not provide separate cost of service studies for each system. The ALJ does not find a Commission rule or case precedent requiring a utility to do so. However, the Applicant must present sufficient information showing how the systems are substantially similar in terms of the overall costs.

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<sup>13</sup> Tr. 185-187.

**a. Applicant's Argument**

WWW argues that, in answering certified questions in the *Aqua Texas* case, the Commission "quite clearly states that a rate filing application initiating a change in rates and proposing to consolidate more than one system under a single tariff is not required to contain information showing the systems are substantially similar and the rate promotes water conservation."<sup>14</sup> Applicant further notes that the *Aqua Texas* case holds that a utility is not required to provide a system-by-system cost of service study.<sup>15</sup>

WWW argues that, in terms of meeting its burden of proof, it is reasonable to designate a cost of service per water system based upon dividing the total cost of service by the number of customers in a water system. Applicant contends that, using this method, the cost of service per WWW customer may be calculated per water system because:

The operations and maintenance costs per customer for the nine already consolidated systems is \$317.22. The operations and maintenance costs per customer for the customers in the Oak Ridge Estates System are \$317.16. For Westwood Park System it is \$318.17 and for Windwood Oaks System it is \$314.48. From these numbers, one can see that the costs per customer are substantially similar.<sup>16</sup>

In doing its calculations, WWW used the operations and maintenance cost of service number \$243,009 (WWW's proposed O&M cost of service minus Vista Hills O&M cost %) and a total customer count of 766 with 596 customers in the consolidated systems, Oak Ridge 39 customers, Westwood 97 customers, and Woodhaven 24 customers.

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<sup>14</sup> Applicant initial brief at 33, citing to *Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc.*, TCEQ Docket Nos. 2004-1671-UCR and 2004-1120-UCR, SOAH Docket Nos. 582-05-2770 and 582-05-2271.

<sup>15</sup> Citing *Aqua Texas* PFD at 33-34.

<sup>16</sup> WWW initial brief at 33.

**b. OPIC's Argument**

In briefs, OPIC presented the Commission's recent actions on the issue of consolidation. In *Aqua Texas*, the Commission approved a request seeking to consolidate rates for 335 water and wastewater systems across the state, divided into four regions. OPIC noted that the Commission determined, as related to cost of service, that the water and sewer systems':

[C]osts of service are substantially similar within each tariff region for reasons including, but not limited to, the following: a) all systems share operations and maintenance costs that are either identical or at least substantially similar on a per customer basis; b) Costs within each region are affected by intra-regional similarities such as regional hydrology and geology and similar intra-regional regulatory requirements; and c) all systems' capital components are substantially similar, resulting in similar repair and replacement costs over the life of those components on a per customer basis.<sup>17</sup>

OPIC further noted that the Proposal for Decision in the *Aqua Texas* case established that: (1) the Commission should look at the costs of the systems over time, including prospectively, and (2) the utility does not need to provide a cost of service study for each individual system.<sup>18</sup>

However, subsequent to the *Aqua Texas* case, the Commission denied the consolidated rate change application of a utility with only three water systems.<sup>19</sup> In *Double Diamond*, the Commission determined that Double Diamond did not present evidence on consolidation and "did not show how the . . . water systems are substantially similar in terms of their cost of service."<sup>20</sup> In that case, the ED prepared his own cost of service calculation by determining the revenue requirement for each system and calculating a per meter equivalent. Because the

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<sup>17</sup> OPIC citing to *Order Approving the Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc. to Change Water and Sewer Rates* (Sept. 23, 2008), at 10–11.

<sup>18</sup> See *Aqua Texas* PFD at 33–34.

<sup>19</sup> *Double Diamond Utilities*, TCEQ Docket No. 2007-1708-UCR, SOAH Docket No. 582-08-0698.

<sup>20</sup> *Order Denying the Application of Double Diamond Utilities to Increase Its Rates* (Nov. 12, 2009), at 5, ¶ 30–31.

revenue requirements for one system differed from another so greatly, the PFD concluded that one system would be subsidizing another.<sup>21</sup>

*Texas Landing Utilities*, the most recent rate consolidation case heard by the Commission, was remanded for additional evidence.<sup>22</sup> However, the protestants in that case presented the testimony of an accountant, who determined that the costs of service were not substantially similar; the applicant also presented an accountant with ratemaking experience who disagreed; and the ED argued in favor of consolidation. The ALJ determined that the burden of proof was minimal and, with the support of the ED, *Texas Landing Utilities* “made its case.”<sup>23</sup>

For any rate consolidation case, OPIC states that what is needed is an analysis of the revenue requirement (cost of service) per meter connection. However, OPIC notes that, in this case, ED witness Ms. Guerrero-Gantioqui testified that she was unable to make this comparison. OPIC aptly observed that:

[I]ndividual studies for each system are not required to proved consolidation.

On the other hand, although it is not a demanding evidentiary burden, Applicant must do more than assert substantial similarity and do some rough, somewhat erroneous calculations on a profit and loss statement.<sup>24</sup>

**c. Westwood’s Argument**

Westwood takes issue with Applicant’s contention that the Commission, after the *Aqua Texas* case, does not require a utility to submit information proving whether the systems are substantially similar and whether the rate promotes water conservation. Rather, notes Westwood, the Commission stated that such proof does not need to be included in the initial application, but the utility is still required to prove the similarity of systems at the hearing.

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<sup>21</sup> *Double Diamond* PFD at 19–20.

<sup>22</sup> *Texas Landing Utilities*, TCEQ Docket No. 2007-1867-UCR, SOAH Docket No. 582-08-1023.

<sup>23</sup> *Texas Landing Utilities* PFD at 9.

<sup>24</sup> OPIC initial brief at 5.

In terms of WWW's actual proof in this case, Westwood notes that there is no separate cost of service breakdown for each system. Mr. Wiedenfeld has never performed individual cost of service studies for his 12 systems.<sup>25</sup> As to Applicant's argument (calculations) that the cost of service per WWW customer may be calculated per water system, Westwood notes the following:

- WWW's argument is new evidence, unsupported by testimony because the term "cost per customer" is not part of the record.
- WWW calculations are incorrect and irrelevant. Simple algebra explains the error in WWW's calculations because whether you divide the total O&M cost by the total number of customers or a system's percentage of the total O&M costs by the number of system customers, the product is the same number:

Total Cost per Customer =  $\$243,009 / 766$  customers =  **$\$317.24$**

Westwood cost per Customer

Westwood costs =  $(\$243,009 * 97 / 766)$  customers =  $\$30,772.68$

Cost per customer =  $\$30,772.68 / 97$  customer =  **$\$317.24$**

Woodhaven cost per Customer

Woodhaven costs =  $(\$253,009 * 24 / 766)$  customers) +  $\$7,613.86$

Cost per customer =  $\$7,613.86 / 24$  customers =  **$\$317.24$**

Oak Ridge cost per Customer

Oak Ridge costs =  $(\$243,009 * 39 / 766)$  customers) +  $\$12,372.52$

Cost per customer =  $\$12,372.52 / 39$  customers =  **$\$317.24$**

- Without an actual total O&M cost per system, it is impossible to compare costs per customer per system, and there is no evidence in the record of actual O&M costs per system.

Westwood claims that what little information there is in the record demonstrates that the cost of service for the 12 systems is not similar. For example, annual depreciation costs for Cedar Spring customers (\$89.48) and Center Point customers (\$30.63) are very different. Similarly, there are different costs for utilities: Cedar Springs (\$27.70) and Heritage Park (\$59.42). Westwood also argues that the water quality in the three aquifers differs, and a system with poor water quality will require equipment replacement more often—increasing the cost.<sup>26</sup>

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<sup>25</sup> Tr. at 22.

<sup>26</sup> See ED Ex. 2, Adhikari direct at KA-5, profit and loss statement; Tr. at 345-346; Tr. 336-338.

Finally, Westwood notes that if a utility cannot prove that its separate systems are substantially similar, it cannot prevail in its request for a rate change.

**d. ED's Position**

The ED agrees with Westwood that Applicant's calculations should actually result in the exact same O&M cost per connection for all the systems, because calculating the O&M cost per connection at each system is the same as dividing the total O&M cost by the total number of connections. The ED argues that Applicant assumes there are no O&M costs that can be attributed to specific systems and that such information is not available; however, as discussed below, Ms. Guerrero-Gantioqui was able to identify some specific costs for Vista Hills (the one system not subject to this rate application) and removed those specific costs. The ED concludes that some specific costs for other systems may also be identified, but WWW failed to do so.

The ED witness Ms. Guerrero-Gantioqui testified that WWW had not demonstrated that the systems are substantially similar in terms of cost of service because it provided only one general ledger with all the costs of the systems combined.<sup>27</sup> The ED states that, without showing what the expenses were for each system, let alone the final cost of service for each system, WWW has not provided the basic information that would demonstrate whether its systems have substantially similar costs of service.

As to what information WWW did provide, the ED notes that the only number comparison that WWW engaged in was to point out that the systems' current rates are the same or substantially similar. The ED agrees that, after the number of gallons included in the base rate is taken into account, the base rates differ at most by \$5 and the gallonage charges at most by \$2.40.<sup>28</sup> However, it has not been established that any of those rates were set by the Commission after a contested case hearing. The last application for the nine systems currently charged the same rates, filed in 2005, was not contested. When asked about the Westwood and Oak Ridge

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<sup>27</sup> Tr. at 82.

<sup>28</sup> WWW Ex. 5, affidavit at 3.

Estates systems, Mr. Wiedenfeld was unsure as to whether their last rate applications were contested and thought the Oak Ridge Estates case may have settled.<sup>29</sup> The ED states that if the systems' current rates were established by a settlement or other means, they were not based on a cost of service set by the Commission under a rigorous review that occurs during the contested case process. The ED surmises that the current rates are not necessarily an accurate reflection of the exact costs of service for the systems.

**e. ALJ's Analysis**

The following consists of the information provided to the ED during discovery to show how the systems are substantially similar:

Systems differ negligibly, since all systems are near same age, use groundwater from same Aquifer and wells having similar depths and pumping costs. Quality of service similar being within 50 miles of each system. Cost of living throughout each system is similar. Increasing block rates have been effective since June 2005.

Documentation: See WWW Inc's Asset depreciation schedule in application.<sup>30</sup>

Subsequent to discovery, Applicant presented some testimony but not enough detail for the ED's accountant to determine that the 12 systems have similar costs. Although Applicant noted that the issue of consolidation is one of the most significant issues in this case, WWW proffered little persuasive evidence on the issue. Moreover, Applicant's calculations, presented in briefs, are not in evidence and are inaccurate.

In sum, the ALJ thoroughly agrees with OPIC's observation:

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<sup>29</sup> Tr. at 69-70.

<sup>30</sup> WWW Ex. 5, Wiedenfeld supplemental at 5-6 of 11 and next page.

In order for the Commission and the ED to evaluate an application for consolidated rates, it is necessary for the applicant to provide sufficient information on its costs of service for each system, even if full individual ledgers are unavailable. Otherwise, it is possible for applicants to shield the issue of consolidation from Commission review and use a lack of recordkeeping to prove consolidation when it may not be warranted.<sup>31</sup>

In this case, the ALJ found Mr. Wiedenfeld to be an experienced utility operator, who has received and maintained professional training in this field. Mr. Wiedenfeld demonstrated a clear working knowledge of his 12 systems. But he is a biologist not an accountant and, despite his on-the-job expertise in the operations and regulation of Texas investor owned utilities, he did not provide important details to prove the need for both consolidation and a rate increase.<sup>32</sup> The ALJ cannot recommend the adoption of system-wide rates without knowing whether one system would be subsidizing another. If one of the water systems in this application were subsidizing another system or all other systems, it would not result in just and reasonable water rates for that system. Although ED witness Mr. Adhikari testified that he did not believe the older water systems were subsidizing the newer systems, Mr. Adhikari's testimony was based on his examination of the systems from an engineering perspective and his recommended depreciation rate, he did not examine the remaining cost of service components—Ms. Guerrero-Gantioqui undertook those tasks.<sup>33</sup>

One may argue that the *Aqua Texas* case does not require a cost of service study for each water system. However, that case involved 335 water and wastewater systems across the state, divided into four regions. Moreover, as noted by the ED, the *Aqua Texas* case examined the O&M cost on a per system and on a per customer basis. Yet this case differs greatly from *Aqua Texas* because WWW seeks consolidation of 12 water systems with three different tariffs. The *Double Diamond* and *Texas Landing Utilities* cases are much more similar to this one, yet

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<sup>31</sup> OPIC initial brief at 5-6.

<sup>32</sup> WWW Ex. 2, Wiedenfeld direct at 1-2. This is in contrast to the testimony provided in the *Texas Landing Utilities* case, where a certified public accountant with ratemaking experience testified about the similar costs. *Texas Landing Utilities* PFD at 9. However, although the ALJ recommended consolidation, the case was remanded.

<sup>33</sup> ED Ex 2, Adhikari direct at 4; Tr. at 200-201.

Applicant fails to address the precedent established by *Double Diamond* and the uncertainty presented by *Texas Landing Utilities*. The ALJ finds that there was significantly more information to make an informed decision in those more similar cases.

For the reasons stated above, the ALJ finds that WWW presented insufficient evidence to establish that its 12 systems share similar costs of service and recommends denial of WWW's application. The ALJ recognizes the possibility that the Commission might not agree that the application should be denied because the Applicant has failed to show that rate consolidation is warranted. Therefore, the ALJ considered the evidence on each rate component as if rate consolidation was appropriate. That discussion and the ALJ's recommendations follow below.

### C. Allowable Expenses

WWW argues that it incurred operations and maintenance expense (O&M) of \$236,636 based upon the cost of providing water utility services to its customers over its 2007 12-month test year, plus known and measurable changes.<sup>34</sup>

The ED's analysis of the application is presented as if WWW had met the consolidation requirements. In order to make a recommendation, the ED first needed to determine the connection counts for each system because the supporting documentation provided by the Applicant listed inconsistent connection counts for the 12 systems, did not match the total connection count, and included a connection count for Vista Hills, which is not included as part of this application. ED witness Mr. Adhikari believed that a connection count of 753, taken from numbers provided in discovery, was the most reliable because it was the closest to the number found in the application and also covered all of the year 2007.<sup>35</sup>

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<sup>34</sup> As discussed above, WWW revised its application with the filing of its direct testimony on February 4, 2009. WWW now indicates that it has \$246,636 in O&M expenses, which it contends are reasonable and necessary for the utility to provide continuous and adequate water service. WWW Ex. 1, application; WWW Ex. 2, Wiedenfeld direct, Sch. C at 6 of 10.

<sup>35</sup> ED Ex. 2, Adhikari direct at 9, KA-5. The application listed 767 connections and the profit/loss worksheet listed 766, including 13 Vista Hills customers. WWW Ex. 1, application at 15 of 34.

Additionally, the ED made several adjustments to reflect the removal of expenses for the Vista Hills system. Using the connection count of 753, Ms. Guerrero-Gantioqui determined that Vista Hills' customers make up 1.7% of total WWW customers and used that percentage for allocation of expenses if the application did not identify which expense was specifically for Vista Hills.<sup>36</sup>

The ED's proposed adjustments to WWW's application are detailed below.<sup>37</sup> Applicant agrees with \$3,627 in adjustments relating to costs associated with Vista Hills but contests adjustments made to salaries and wages, repairs/maintenance/supplies, rate case expenses, and miscellaneous expenses.

#### **1. Salaries and Wages**

Applicant requested \$110,153 for salaries and wages in its initial application and \$100,139 in its revised application, subtracting an amount that was attributed to known and measurable changes. WWW's general ledger as of December 31, 2007, and its profit/loss statement by class both list payroll expenses totaling \$101,222.31.<sup>38</sup>

Using WWW's 2007 and 2008 W2s, Ms. Guerrero-Gantioqui determined that WWW had four temporary employees who were terminated in either 2007 or 2008: Matthew R. Livernois, with a salary of \$3,636; Billy Rhodes, with a salary of \$4,080; Emily Sullivan, with a salary of \$828; and Joseph Nezat, with a salary of \$3,589. Because these employees no longer work for WWW, Ms. Guerrero-Gantioqui found that their salaries are nonrecurring and subtracted them. She also determined that the salaries and wages amount in the application was higher than the amount in the W2s, \$93,672, so she subtracted the difference of \$16,481. After making her

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<sup>36</sup> ED Ex. 1, Guerrero-Gantioqui direct at 1, 6.

<sup>37</sup> In discussing the contested rate case issues, the ALJ has borrowed liberally from the extensive briefs filed by the ED, Applicant, and Westwood.

<sup>38</sup> ED Ex. 1, Guerrero-Gantioqui direct, LG-1 (application) at 14 of 30; WWW Ex. 2, Sch. C, revised application at 6 of 10.

deductions, she allocated 1.7% of the subtotal, \$1,386, to the Vista Hills system. Based on the above, Ms. Guerrero-Gantioqui recommended that the salaries and wages amount in the application be reduced by \$30,000, which results in a total for salaries and wages of \$80,153.<sup>39</sup>

Westwood ratepayers agree with the ED's removal of the temporary employees' salaries because these charges are non-recurring costs and the inclusion of such would artificially raise the utility's annual revenue requirement.

Except for the adjustment related to the Vista Hills system, Applicant argues that the ED's adjustments are not supported by the evidence, law, or accounting principals. WWW contends that Ms. Guerrero-Gantioqui removed salaries because the employees were not permanent. WWW also takes issue with Ms. Guerrero-Gantioqui's adjustment of \$16,481 because that amount was based on the W-2 forms. WWW contends that "[m]any tax saving devices may be employed by an employer to lower an employees' reported income or tax purposes; this does not reduces the amount of money that WWW spent for reasonable and necessary wages . . . ."

The ALJ does not find sufficient evidence to support the amount requested by WWW. Mr. Wiedenfeld only casually referenced his employees on two occasions: he stated that he retains additional help or contractors "as needed."<sup>40</sup> He also stated that the salaries of his "staff" are shown on the application in Section II.<sup>41</sup> However, Section II in the original application lists only Mr. Wiedenfeld, with a salary of \$32,000; David Jones, with a salary of \$27,000; and Cynthia Ingram, with a salary of \$20,000 (total \$79,000). He did not testify about temporary workers and their duties and supplied no information as to the reasonableness or necessity of their services. As to the reduction relating to amounts not listed on 2007 W-2s, the ALJ notes that Applicant bears the burden of proving that its expenses are reasonable. Although

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<sup>39</sup> ED Ex. 1, Guerrero-Gantioqui direct at 8-9; Att. LG-6, LG-8, LG-13 at 4-5, LG-14 at 3-4.

<sup>40</sup> WWW Ex. 2, Wiedenfeld direct at 4.

<sup>41</sup> *Id.* at 5.

Mr. Wiedenfeld's testimony was "sworn," it was not verified by any evidence other than the W-2's. Accordingly, the ALJ recommends a total expense of \$80,153 for salaries and wages

## **2. Contract Labor**

WWW requested \$2,250 for contract labor in its application. Ms. Guerrero-Gantioqui allocated 1.7% of that amount, \$38, to the Vista Hills system. This resulted in a total for contract labor of \$2,212.<sup>42</sup> Applicant does not dispute this adjustment.

## **3. Chemicals for Treatment**

WWW requested \$7,825 for chemicals in its application. Ms. Guerrero-Gantioqui allocated 1.7% of that amount, \$133, to the Vista Hills system. This resulted in a total for chemicals of \$7,692.<sup>43</sup> Applicant does not dispute this adjustment.

## **4. Utilities**

WWW requested \$30,473 for utilities (electricity, telephone, and trash) in its application, which included a known and measurable change of \$598. Ms. Guerrero-Gantioqui was able to determine that WWW had incurred electricity expenses for the Vista Hills system in the amount of \$885, so she subtracted that amount rather than allocating 1.7% of the total electricity expenses. WWW's telephone and trash expenses totaled \$3,846, so she allocated 1.7% of that amount, \$65, to Vista Hills. Ms. Guerrero-Gantioqui recommends a total for utilities of \$29,523.<sup>44</sup> The ALJ agrees with Ms. Guerrero-Gantioqui's adjustments.

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<sup>42</sup> ED Ex. 1, Guerrero-Gantioqui at LG-1, at 14, 9, att. LG-6.

<sup>43</sup> *Id.* at 9, att. LG-6.

<sup>44</sup> *Id.* at 10, att. LG-6.

## 5. Repairs, Maintenance, and Supplies

WWW requested \$50,338 for repairs, maintenance, and supplies in its application. Ms. Guerrero-Gantioqui recommended a total expense of \$49,043 for repairs, maintenance, and supplies. Ms. Guerrero-Gantioqui determined that \$12,357 of what Applicant requested was not listed in WWW's general ledger or supported by invoices or other documentation, so she subtracted that amount. She found that \$10,000 of the miscellaneous expenses was attributed to vehicle expenses that should have been included in this category, so she added that amount to this category. She also located an additional \$1,910 in supported vehicle expenses that had not been included in the application, so she added that amount. The \$11,910 in vehicle expenses consisted of fuel (\$9,753), license (\$146), and maintenance (\$2,011) expenses. After making her deductions and additions, she allocated 1.7% of her subtotal, \$848, to the Vista Hills system.<sup>45</sup>

Westwood supports Ms. Guerrero-Gantioqui's adjustment because there is no supporting documentation for \$12,357.

According to WWW, Ms. Guerrero-Gantioqui made a mistake because she did not include \$8,164 in lab fees. WWW states that the "ED Staff Accountant agrees these should have been included in the expenses."<sup>46</sup> The ED takes issue with both WWW's argument and statement. Ms. Guerrero-Gantioqui agreed that the lab fees, if documented, are a reasonable expense and should be included as rate case expenses. However, she did not find lab fees listed in the general ledger, and she testified that WWW did not provide a breakdown of the fees to the ED.<sup>47</sup>

The ALJ finds sufficient evidence that WWW paid \$8,164 in 2007 for lab fees. A subheading in the general ledger is titled "Lab Fees" with a list of dates, name, and amounts.

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<sup>45</sup> *Id.*

<sup>46</sup> WWW initial brief at 13, citing Tr. at 166.

<sup>47</sup> Tr. at 166-167; 175.

However, there is no indication which water system incurred lab fees. Therefore, the ALJ finds it reasonable to allocate 1.7% of that amount, \$139, to the Vista Hills system.

These adjustments are set out below:

	\$50,338	WWW's initial request
minus	\$12,357	ED's deduction for unsupported expenses (including lab fees)
plus	\$11,910	vehicle expenses moved from miscellaneous and amounts ED added that WWW did not include
minus	\$848	vehicle expenses attributed to Vista Hills
plus	\$8,164	for lab fees as per ALJ's recommendation
<u>minus</u>	<u>\$139</u>	Vista Hills' share of lab fees
	\$57,068	ALJ's total recommendation

## 6. Office Expenses

WWW requested \$3,676 for office expenses in its application. Ms. Guerrero-Gantioqui discovered that an affiliate, WW&W Consulting, had paid WWW \$1,800 for the rental of WWW's office space and \$1,500 for the use of WWW's office supplies. Because these payments were income from a source other than WWW's customers, Ms. Guerrero-Gantioqui testified that they should have been classified as other revenue. However, WWW had deducted them from its office expenses instead. Therefore, Ms. Guerrero-Gantioqui reclassified these payments to other revenues, which added \$3,300 to this category. After making this addition, she allocated 1.7% of her subtotal, \$119, to the Vista Hills system. Ms. Guerrero-Gantioqui recommends a total for office expenses of \$6,857.<sup>48</sup> The ALJ agrees with Ms. Guerrero-Gantioqui's recommendation.

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<sup>48</sup> ED Ex. 1, Guerrero-Gantioqui direct at 10-11.

**7. Accounting and Legal Fees**

WWW requested \$3,185 for accounting and legal fees in its application. Ms. Guerrero-Gantioqui found that \$2,050 of this amount was for license and permit fees that were not accounting or legal fees, so she reclassified that amount to miscellaneous expenses. After making this deduction, she allocated 1.7% of her subtotal, \$19, to the Vista Hills system. This resulted in a final total for accounting and legal fees of \$1,116.<sup>49</sup> The ALJ agrees with Ms. Guerrero-Gantioqui's reclassification and adjustment.

**8. Insurance**

WWW requested \$3,420 for insurance expenses in its application. Ms. Guerrero-Gantioqui allocated 1.7% of this amount, \$58, to the Vista Hills system. This results in a total for insurance expense of \$3,362, and the ALJ recommends allowing that amount.<sup>50</sup>

**9. Rate Case Expense**

Under 30 TEX. ADMIN. CODE § 291.28(7), a utility can recover its rate case expenses if the expenses are reasonable, necessary, and in the public interest. However, if the increase in revenue generated by the rate set by the Commission is less than 51% of the increase in revenue the proposed rate would have generated, the utility cannot recover any rate case expenses.<sup>51</sup>

Applicant presented testimony that its rate case expenses will be approximately \$22,380 and that those expenses are reasonable and necessary.<sup>52</sup> However, because the ED recommends no rate change in this case, the increase in revenue generated by the ED's recommended rate is

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<sup>49</sup> *Id.* at 11.

<sup>50</sup> ED Ex. 1, Ms. Guerrero-Gantioqui direct at 11-12, att. LG-6.

<sup>51</sup> *Id.*; 30 TEX. ADMIN. CODE § 291.28(8).

<sup>52</sup> WWW Ex. 3, Zeppa direct at 3.

zero. As the ED notes, zero is less than 51% of the increase in revenue WWW's proposed rates would have generated.

Therefore, if the Commission adopts the ED's recommended rates, WWW cannot recover its rate case expenses. The ED notes that the Commission would need to approve an increase in revenue of at least \$30,419 for WWW to be able to recover any rate case expenses under the 51% rule.<sup>53</sup>

Because the ALJ does not recommend approval of at least 51% of the rate revenue increase that WWW seeks, the ALJ recommends that the Commission disallow all of WWW's rate case expenses. If the Commission finds that Applicant is entitled to rate case expenses, the ALJ recommends that they be surcharged to all affected customers over a two-year amortization period.<sup>54</sup>

#### 10. Miscellaneous Expense

WWW requested \$60,632 for miscellaneous expenses in its application. After analyzing the application, Ms. Guerrero-Gantioqui recommended a total for miscellaneous expenses of \$4,394, which is a decrease of \$56,238. She recommended the following specific changes:

- WWW claimed \$36,250 for the utility's interest expense for its debt. She stated that this is not an appropriate expense because loan interest is already included in the calculation of the utility's return. If WWW also collected that amount as a miscellaneous expense, it would collect the amount from its customers twice. Ms. Guerrero-Gantioqui disallowed this amount from miscellaneous expense.<sup>55</sup> Applicant and Westwood agree with this deduction.

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<sup>53</sup> Using the systems' connection counts, volume of gallons billed, and current rates to calculate the revenue generated by Wiedenfeld's current rates equals \$386,043. ED Ex. 1, Ms. Guerrero-Gantioqui direct, att. LG-1 at 23, 25, 27, 29; ED Ex. 2, Adhikari direct, atts. KA-2, KA-5. According to Staff's calculations, WWW's proposed rates would generate \$445,688 in revenue. *Id.*, att. KA-3. Fifty-one percent of the difference between those two numbers is \$30,419 ( $[(445,688-386,043)*0.51]$ ).

<sup>54</sup> WWW Ex. 3, Zeppa direct at 5.

<sup>55</sup> ED Ex. 1, Ms. Guerrero-Gantioqui direct at 13.

- WWW claimed \$10,000 for vehicle expenses. As explained above, Ms. Guerrero-Gantioqui reclassified this amount to repairs, maintenance, and supplies.<sup>56</sup> Applicant disagrees with this recommendation.
- WWW claimed \$11,962 for the accelerated depreciation of retired assets. However, assets are depreciated according to 30 TEX. ADMIN. CODE § 291.31(b)(1)(B) and depreciation is not an O&M expense under section 291.31(b)(1)(A). Accordingly, Ms. Guerrero-Gantioqui deducted \$11,962 from miscellaneous expense.<sup>57</sup> Applicant and Westwood agree with this deduction.
- As noted above in Section VI.C.6, Ms. Guerrero-Gantioqui reclassified \$2,050 to miscellaneous expenses from accounting and legal fees.<sup>58</sup>
- After making these additions and deductions, she allocated 1.7% of her subtotal, \$76, to the Vista Hills system.<sup>59</sup>

Applicant contends that its miscellaneous expense should total \$12,344. However, WWW provides no support for this number. In briefs, Applicant specifically agreed with two deductions, has generally not objected to the Vista Hills-related deductions, and made no argument concerning the reclassification of accounting and legal fees. Although Applicant disputes the reclassification for vehicle expenses, claiming it is contrary to basic accounting principles, it provides no support for its dispute with Ms. Guerrero-Gantioqui's decision to reclassify this particular entry (or the reclassification of accounting and legal fees). Ms. Guerrero-Gantioqui explained that the category "miscellaneous expenses" is used if an expense cannot be classified in any other account, but the vehicle expenses are classified as auto repairs. Therefore, she moved it from this account and placed that entry under repairs and maintenance. Although she could not cite to a specific accounting principle, she did state that her recommendation was the practice of the ED accounting staff.<sup>60</sup>

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<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 13, att. LG-6.

<sup>59</sup> ED Ex. 1, Ms. Guerrero-Gantioqui direct at 13.

<sup>60</sup> Tr. at 104-109. At the hearing, Applicant questioned Ms. Guerrero-Gantioqui about her reclassification of accounting and legal fees. Tr. at 109-112.

The ALJ finds that Ms. Guerrero-Gantioqui's suggested changes are reasonable. Although Ms. Guerrero-Gantioqui could not cite to a particular accounting principle for her suggested reclassifications, her explanation was reasonable and not refuted by any witness. Accordingly, the ALJ recommends a total for miscellaneous expense of \$4,394.

## 11. Payroll Taxes

WWW requested \$1,191 for payroll taxes in its application. Using the 2007 W2s, Ms. Guerrero-Gantioqui multiplied the salary for each employee by 7.65% to calculate the Social Security and Medicare taxes, which totaled \$6,238. She also computed the amount of federal and state unemployment taxes by multiplying the applicable tax percentage times the salary amount for which employers are taxed, which totaled \$168 for the federal taxes and \$729 for the state taxes. After adding these three amounts together, she allocated 1.7% of her subtotal, \$121, to the Vista Hills system. This resulted in a final total for payroll taxes of \$7,014.<sup>61</sup>

Applicant notes that Ms. Guerrero-Gantioqui adjusted WWW's payroll taxes to match her recommended expense level. WWW does not dispute the method of calculation, only the amount of the underlying payroll to be taxed.

Consistent with the ALJ's previous recommendations, the ALJ adopts Ms. Guerrero-Gantioqui's amount. Additionally, the ALJ recommends the use of Ms. Guerrero-Gantioqui's undisputed method of calculating payroll taxes.

## 12. Property and Other Taxes

WWW requested \$16,379 for property and other taxes in its application. Ms. Guerrero-Gantioqui allocated 1.7% of that amount, \$278, to the Vista Hills system. This resulted in a final

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<sup>61</sup> ED Ex. 1, Ms. Guerrero-Gantioqui direct at 13, att. LG-8; 26 U.S.C. § 3111(a), (b)(6) (2006); LG-6.

total for property and other taxes of \$16,101.<sup>62</sup> As there is no dispute on this issue, the ALJ adopts Ms. Guerrero-Gantioqui's recommendation.

### 13. Federal Income Taxes

Applicant requested \$26,566 for income taxes in its application (\$24,967 in its revised application). Based on her adjusted numbers, Ms. Guerrero-Gantioqui calculated the income taxes by using the taxable income (\$55,027) and applicable tax rate (25%). The taxable income was calculated by subtracting the total invested capital times the weighted average long-term debt interest rate from WWW's return on invested capital. Using the taxable income, Ms. Guerrero-Gantioqui calculated a final total for income taxes of \$11,675.<sup>63</sup>

Applicant notes that Ms. Guerrero-Gantioqui calculated federal income taxes (FIT) based upon the ED's proposed return. Where there are discrepancies between the amounts of taxes proposed to be recovered by WWW and the ED, they were based on the use of different proposed amounts of return. WWW does not disagree with how the ED calculated FIT but disagrees about the basis for the taxed income.

For the reasons noted below, the ALJ adopts both Ms. Guerrero-Gantioqui's recommended method of calculating FIT and the amount of FIT.

### 14. Annual Depreciation and Amortization

WWW contends that its original cost for plant is \$1,523,475, with an annual depreciation of \$61,975. The ED, based on the original application, finds that WWW's original cost for plant is \$1,543,458, with an accumulated depreciation of \$494,897, and an annual depreciation of \$46,794.<sup>64</sup>

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<sup>62</sup> *Id.* at 13-14, att. LG-6.

<sup>63</sup> ED Ex. 1, Guerrero-Gantioqui direct at 13; att. LG-1, LG-5, JG-6.

<sup>64</sup> ED Ex. 2, Adhikari direct, KA-1 at 12. The ED notes in its reply briefs that there were some errors in

In support of its depreciation expense, WWW provided 15 pages of schedules (Attachment 3B) for each of its water systems and, for all systems, its office and equipment. Attachment 3B contained figures for the date of installation, service life, original cost, annual and accumulated depreciation, and net plant.<sup>65</sup>

At the hearing, WWW submitted an exhibit that highlights the differences with the ED's recommendations, but it also made changes to the schedules found in Attachment 3B. For instance, on the Cedar Springs system, WWW changed the date of installation on two sets of water pumps, two sets of booster pumps, distribution plant, etc. These and other changes increased net plant by approximately \$4,202 for that system. On the Montebello system, WWW added a sanitary control easement dated March 1999 and December 2000, with annual depreciation of \$431 and \$6,625. WWW now seeks an additional \$6,559 in net plant for this system. While Mr. Wiedenfeld testified about these easements, there is no other support for these changes and no party had an opportunity to analyze the new information. Additionally, on the Cedar Springs system, WWW changed the dates of installation for well pumps, booster pumps, structures, storage tanks pressure tanks, distribution system piping, and a meter loop.<sup>66</sup>

**a. ED's Position**

The ED's witness, Mr. Adhikari, found that the total original cost listed on the application did not match the total original cost that he calculated when he added the original costs for all the assets listed in the depreciation schedules for the individual systems.<sup>67</sup> The original costs from those depreciation schedules totaled \$1,543,458. Because he could not

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Mr. Adhikari's depreciation analysis but this resulted in a "negligible change to the ED's recommended revenue requirement" increased it to \$329,133 from \$326,211. ED reply brief at 6.

<sup>65</sup> Curiously, on the copy of WWW's original application at Schedule B. Original Cost & Depreciation Schedule—Water, which is attached to Ms. Guerrero-Gantioqui's direct testimony, ED Ex. 1 at LG-1, there is a handwritten line, "P 1-15" under "see attachments." And LG-1, a copy of the application, includes 15 pages of detailed depreciation columns. Yet WWW Ex. 1, a copy of its application, does not include the handwritten line "P1-15," which means that Applicant provided no detailed numbers proving its depreciation request (such as dates of installation).

<sup>66</sup> Compare ED Ex. 1, Guerrero-Gantioqui, att. LG-1 (application) versus WWW Ex. 10 at 1, 5; Tr. at 295-296.

<sup>67</sup> ED Ex. 1, Guerrero-Gantioqui direct, att. LG-1 at 10, 14.att. 3B; ED Ex. 2, Adhikari direct at 12.

determine the source of the difference between the two original costs and Attachment 3B to the application provided a more detailed list of the assets than Table III.B, Mr. Adhikari used his calculated original cost, based on Attachment 3B, as the starting value before making his adjustments.<sup>68</sup>

While Mr. Adhikari used the original costs listed in Attachment 3B, he did not use the service lives found in that attachment if they deviated from the recommended service lives found in Table III.B of the TCEQ application because Staff did not receive supporting documentation from WWW justifying those different service lives.<sup>69</sup> Mr. Adhikari testified that the service life is part of an asset's cost; it determines over what period of time the asset will be depreciated, which in turn determines the accumulated depreciation, annual depreciation, and net plant value for that asset at any point in time.<sup>70</sup> The ED argues that he would have expected to receive information regarding altered service lives in response to a discovery request propounded in this case.

Another issue was that the service lives presented in the application for certain types of assets were inconsistent across the various systems. For example, the well at Cedar Springs had a service life of 25 years, the well at Center Point had a service life of 30 years, and the well at Heritage Park had a service life of 50 years. Because of the lack of supporting documentation and inconsistent service lives, Mr. Adhikari used the TCEQ-suggested service lives listed in Table III.B of the application.<sup>71</sup>

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<sup>68</sup> ED Ex. 2, Adhikari direct at 12, att. KA-1, at 12.

<sup>69</sup> During discovery, the ED requested "all other invoices or other supporting documents for the costs of all the individual assets" that WWW claimed in its application. Tr. at 376.

<sup>70</sup> The ED notes that Mr. Adhikari's depreciation schedule, Att. KA-1 in ED Ex. 2, demonstrates this concept. Looking at the entry for masonry at the Cedar Springs system on page 1, a service life of 30 years and an original cost of \$583 results in an annual depreciation of \$19.43 (583/30). The item was installed 28.5 years before the end of the test year on June 30, 1979, so the accumulated depreciation is \$553.85 (28.5\*19.43). This means the net plant value, *i.e.*, the remaining value, of the asset is \$29.15 [583-553.85 or 19.43\*(30-28.5)].

<sup>71</sup> ED Ex. 1, Guerrero-Gantioqui direct at att. LG-1 at 10, att. 3B 1-3.

Starting with the original costs in the application and the TCEQ-suggested service lives, Mr. Adhikari made the following adjustments to the depreciation schedule based on information gathered during his inspection of the twelve systems on July 15, 2009.<sup>72</sup>

- A ground storage tank had been located at the Rocky Creek system but had been moved to the Cedar Springs system. Therefore, Mr. Adhikari moved that tank from the Rocky Creek depreciation schedule to the Cedar Springs schedule.<sup>73</sup>
- At the Rocky Creek system, one well had been plugged, meaning it was no longer in use. Depreciation is only allowed “on all *currently used* depreciable utility property owned by the utility . . . .”<sup>74</sup> Because the well was not in use, Mr. Adhikari disallowed the item by changing its used and useful percentage to 0%.<sup>75</sup>
- At the Southern Hills system, WWW had two ground storage tanks that it was not using for storing water but rather for storing miscellaneous supplies, such as spare parts and tools. The tanks were not being used for a purpose that would have justified the cost incurred for them, i.e. were not being used for their intended purpose. Using these tanks for supply storage was not even necessary because WWW had a storage facility at its office location. However, because the tanks were being used to serve the utility and were not fully depreciated out, Mr. Adhikari only reduced their used and useful percentages to 50%.<sup>76</sup>
- For the Verde Park system, WWW claimed two well pumps on its depreciation schedule.<sup>77</sup> However, Mr. Adhikari inspected the system on July 15, 2009, and there was only one pump located at the system. Therefore, Mr. Adhikari reduced the used and useful percentage of one well pump to 0%. Verde Park also had two ground storage tanks that were not being used to provide service but rather served as backups. Because they are not currently used, Mr. Adhikari stated that WWW could not claim the full amount of depreciation for them. However, he only reduced their used and useful percentages to 50%. because the two tanks were in good condition and could be used to serve the utility in the future.<sup>78</sup>

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<sup>72</sup> ED Ex. 2, Adhikari direct at 8-10.

<sup>73</sup> *Id.* at 12:13-14, att. KA-1, at 1, 6.

<sup>74</sup> 30 TEX. ADMIN. CODE § 291.31(b)(1)(B) (West 2010) (emphasis added); *accord* TEX. WATER CODE § 13.185(j) (Vernon 2008).

<sup>75</sup> ED Ex. 2, Adhikari direct at 12, att. KA-1, at 6.

<sup>76</sup> *Id.* at 12, att. KA-1, at 8.

<sup>77</sup> ED Ex. 1, Guerrero-Gantioqui direct, att. LG-1, att. 3B 11.

<sup>78</sup> ED Ex. 2, Adhikari direct at 8, 12-13, att. KA-1, at 9. *See* TEX. WATER CODE § 13.185(j) (Vernon 2008) (depreciation only allowed on currently used assets); 30 TEX. ADMIN. CODE § 291.31(b)(1)(B) (West 2010).

- At the Westwood system, WWW had eight ground storage tanks total.<sup>79</sup> Some of the tanks were grouped together on WWW's depreciation schedule, so there are only four ground storage tank entries instead of eight. When Mr. Adhikari conducted his inspection, he observed that four tanks, or two sets of tanks as they are depicted in the depreciation schedule, were not being used to provide service but rather served as backups. Because they are not currently used, Mr. Adhikari could not allow WWW to claim the full amount of depreciation for them.<sup>80</sup> However, because those four tanks could be used to serve the utility in the future, Mr. Adhikari only reduced their used and useful percentages to 50%.<sup>81</sup>
  
- At the Woodhaven system, Mr. Adhikari could not locate a wood structure claimed in WWW's depreciation schedule.<sup>82</sup> Because Mr. Adhikari could not verify the asset's existence, he disallowed the item by reducing its used and useful percentage to 0%.<sup>83</sup>

After making all these adjustments, Mr. Adhikari calculated a final total for annual depreciation of \$46,794.<sup>84</sup>

In reply briefs, the ED compared Mr. Adhikari's calculations, found in attachment KA-1 to his prefiled testimony and compared them to attachment 3B in the application. The ED found several acquired dates that Mr. Adhikari changed in error. The ED provided the following list:

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<sup>79</sup> *Id.* att. LG-1 att. 3B 12; Tr. at 290.

<sup>80</sup> ED Ex. 1, Guerrero-Gantioqui direct, att. LG-1; att. 3B 12; ED Ex. 2, Adhikari direct at 13, att. KA-1, at 10; Tr. at 290, 317. *See* TEX. WATER CODE § 13.185(j) (Vernon 2008) (depreciation only allowed on currently used assets); 30 TEX. ADMIN. CODE § 291.31(b)(1)(B) (West 2010).

<sup>81</sup> ED Ex. 2, Adhikari direct at 13, att. KA-1 at 10.

<sup>82</sup> *Id.* att. LG-1 att. 3B 14; ED Ex. 2, Adhikari direct at 13:6-8, att. KA-1 at 11.

<sup>83</sup> ED Ex. 2, Adhikari direct at 13, att. KA-1, at 11.

<sup>84</sup> *Id.* at 13, att. KA-1, at 12.

SYSTEM	DESCRIPTION	ACQUIRED DATE	ACTUAL DEPR. LIFE	ANNUAL DEPR.	ACCUM. DEPR.	NET PLANT
Hills 'n Dales	Distrib. System - 2" - 1,000 l.f.	7/31/96	11.42	\$49	\$562	\$1,898
	Distrib. System - 4"- 900 l.f.	3/31/69	38.75	\$357	\$13,842	\$4,018
	Distrib. System - 3"- 6,400 l.f.	4/30/72	35.67	\$416	\$14,831	\$5,959
	Distrib. System - 6"- 600 l.f.	3/31/99	8.75	\$47	\$414	\$1,952
	Distrib. System - 6"- 2,670 l.f.	6/30/05	2.5	\$415	\$1,038	\$19,706
	Distrib. System - 4"- 1,142 l.f.	6/30/05	2.5	\$199	\$498	\$9,457
	Distrib. System - 3"- 400 l.f.	6/30/05	2.5	\$14	\$36	\$682
	Distrib. System - 2"- 324 l.f.	6/30/05	2.5	\$23	\$58	\$1,098
Montebello	Booster Pump <5 hp	2/28/97	10.84	\$0	\$360	\$0
Verde Park	Hypochlorinator (Stenner Dig.)	5/31/05	2.58	\$135	\$349	\$327
	Hypochlorinator	11/30/06	1.08	\$140	\$152	\$548
Westwood	Meters 1 - 1"	11/30/06	1.08	\$5	\$5	\$95
	Meters 20 - 5/8"x3/4"	7/31/07	0.42	\$34	\$14	\$659
Office equipment	1994 Dodge	5/31/04	3.58	\$979	\$3,509	\$1,386

According to the ED, these changes resulted in a negligible change to the ED's recommended revenue requirement, increasing it to \$329,133, and to the ED's calculation of Wiedenfeld's base rate using a gallonage charge of \$4/1,000 gallons, increasing it to \$17.10.<sup>85</sup>

<sup>85</sup> The revenue requirement listed on page 25 of the ED's initial brief was \$326,211. The base rate using \$4/1,000 gallons as the gallonage charge listed on page 26 of the ED's initial brief was \$16.78.

**b. Westwood's Position**

Westwood takes issue with WWW's depreciation methodology. Westwood notes that Mr. Wiedenfeld "simply 'booked' the purchase price of some of the systems, including the Westwood Park system, instead of using the original purchase price of the items."<sup>86</sup> Mr. Wiedenfeld testified on this issue as follows:

Q: How much did you pay for Westwood, \$80,000? Is that correct?

A: Yes, sir. And actually that was a combination of-- another water system was combined in that price.

Q: Which water system was that?

A: Oak Ridge.

...

Q. What was your basis for distributing the funds between the two systems?

A: The basis was where I had some indication of the cost—initial cost of the item, that's how I entered it as, you know, original cost. I made judgment calls as to the value upon looking at the, you know, condition of the system. When somebody says it's been there for so long, you know, when I had some kind of verbal communication that—and it appeared that a piece of equipment had an age on it, from that then I looked at costs—similar costs at that time frame and did them as—and again, I distributed the cost, the purchase price, through the remaining plant that I felt like had some service life left in it.

Q: So you just kind of went out there and looked at what was working and what wasn't and kind of put a dollar value to what was working and kind of discounted what wasn't?

A: Right.<sup>87</sup>

Westwood argues that by not calculating depreciation based upon the date of installation, the utility artificially raised the plant's net value and the utility's return on investment.

Additionally, Westwood notes that WWW included duplicate items in its depreciation study, which were not corrected by Exhibit 10 in WWW's rebuttal case. As an example, for the Cedar Springs system, Applicant included a listing under the heading "Wells" for two-inch well

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<sup>86</sup> Westwood reply brief at 18.

<sup>87</sup> Tr. at 33-34.

pipings, installed in May 2005 at an original cost of \$1,493.03 and a net plant of \$895.82, but this same asset is listed again under the heading “Well Pumps” with the same amounts. Mr. Wiedenfeld admitted those amounts were duplicates.<sup>88</sup>

Westwood also takes issue with Applicant’s delay in starting depreciation. Rather than beginning depreciation in the year of purchase, WWW begins depreciation on January 1 of the next year after purchase. Westwood contends that the delay in calculating depreciation artificially raises the plant net value and the utility’s return on investment.

**c. Applicant’s Position**

According to WWW, Mr. Adhikari testified that he did not intend to change the year of the acquired dates in WWW’s depreciation schedule, and if he did it was a mistake. As an example, Applicant provides the ED’s recommended depreciation amounts for the Cedar Springs water system: there are ten instances where WWW updated (in Exhibit 10 of its rebuttal case) the year of the acquired date for an asset. Applicant claims that Mr. Adhikari failed to recognize these revised installation dates, which greatly reduced WWW’s rate base in this system. Applicant provided the following table to highlight its concerns on this system:<sup>89</sup>

Cedar Springs Asset	Cost	WWW Install Date	ED Staff Install Date	Net Book Value of Plant using ED and WWW Service Lives (SL)	
		Correct Date	Wrong Date		
Well Pump 5hp F&W 16 stage	\$2, 654.86	June 2004	June 30, 1999	WWW 5yr SL \$796.46	ED 10yr SL \$398.28
Well Pump Elect. Controls	\$676.00	June 2004	June 30, 1999	5yr SL \$202.80	30yr SL \$484.49
Booster Pumps 2hp F&W	\$400.00	June 2004	June 30, 1992	3yr SL \$0	5yr SL \$0

<sup>88</sup> Tr. at 50, *see* WWW Ex. 10 at 1.

<sup>89</sup> WWW Ex. 10; ED Ex. 2, KA-1; *See also* Tr. at 243, 328. Calculation: Amount of Cost/Service Life X Remaining Life = annual depreciation. Then take the difference in number of years times annual depreciation amount = change to net book value. Please recall that we are calculating this depreciation as of the end of 2007.

Booster Pumps 3hp F&W	\$400.00	June 2004	June 30, 1992	3yr SL \$0	10yr SL \$0
Structures Roof replaced	\$310.33	June 2004	June 30, 1986	12yr SL \$219.82	30yr SL \$98.36
Masonry 10x12	\$583.33	June 2004	June 30, 1979	5yr SL \$175.23	30yr SL \$48.73
Storage Tanks 2000 masonry	\$5, 342.00	June 2004	June 30, 1979	25yr SL \$4,594.12	50yr SL \$2,403.90
Pressure Tank 1620 gal	\$1,359.37	June 2004	June 30, 1985	11yr SL \$926.84	50yr SL \$775.00
Distribution 2"Sch 40-2750' 20	\$7, 358.08	June 2004	June 30, 1979	6yr SL \$3,065.85	20yr SL \$0
Distribution 1&1/2" Sch 40-1750	\$4, 732.76	June 2004	June 30, 1979	5yr SL \$1,419.83	20yr SL \$0
Total				\$11,400.95	\$4,208.76
Remaining Net Book Value				\$11,400.95	\$4,208.76
ED Staff Understatement to Rate Base on Cedar Springs System Due to Use of Incorrect Install Dates					\$7,192.19

Applicant also takes issue with Mr. Adhikari's proposed service lives because he followed the TCEQ recommended economic lives of the utility's plant. Applicant believes that Mr. Wiedenfeld has a better knowledge of the economic life of the WWW equipment than does Mr. Adhikari, who relied on the TCEQ's standard service lives.

Applicant also argues that the ED erred in calculating depreciation expense through the use of straight line depreciation with no salvage value. In support for this argument, WWW cites to Senate Bill 2306, which became effective June 19, 2009.<sup>90</sup> As noted by the ED, this case was filed on September 12, 2008, before the effective date of the statute and before the TCEQ adopted rules to effectuate the law, as required by the bill. Moreover, as noted by the ED, there

<sup>90</sup> Act of June 19, 2009, 81st Leg., R.S., ch. 1242, § 1, 2009 Tex. Sess. Law. Serv. . 3965 (Vernon) (codified at TEX. WATER CODE ANN. § 13.131(c)).

was no supporting documentation providing the retired date, acquired date, original cost, and reason for early retirement.<sup>91</sup> Applicant's argument on this issue is not supported by fact or law.

**d. ALJ's Analysis**

The ALJ finds that, although Mr. Adhikari made a few mistakes in calculating some of the depreciation rates, those errors were minor. In addition to the ones listed by the ED in briefs, Mr. Adhikari also noted that he used a May 30, 1994 purchase date for a 1994 Dodge but the acquired date should have been May 30, 2004. This adds \$979 to annual depreciation.<sup>92</sup> However, Mr. Adhikari made no error when he: (1) used the dates of installation provided by WWW in its application; (2) used the standard service lives listed in the TCEQ water rate change application; (3) calculated depreciation from the acquired date; and (4) included only assets that he could determine were used and useful.

Applicant changed the installation dates of a significant amount of plant for the Cedar Springs system without explanation. Mr. Adhikari made no error in not using those changed installation dates because there was no underlying support for those changes.

Concerning the appropriate service life, the ALJ agrees that an experienced water operator might have a better understanding of the economic life of plant assets on the systems that he is familiar with, such as wells, chlorinators, etc. However, Mr. Wiedenfeld provided only conclusory statements as to how he determined the service life of an asset:

I have developed my own service life on some occasions, and primarily the areas are in the wells. I have done an analysis since I've owned water systems in the eighties, and I have had—the average service life of the wells are about 28 years. And I have no well currently in operation that's essentially over 30 years.<sup>93</sup>

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<sup>91</sup> Tr. at 206.

<sup>92</sup> Tr. at 299-300; *see* ED Ex. 2, Adhikari direct at Att. KA-1 at 12.

<sup>93</sup> Tr. at 329.

Mr. Wiedenfeld testified that he prepared an analysis of different service lives based on his experience, but did not present it with his application.<sup>94</sup> More specifically, Mr. Wiedenfeld does not explain why he used a 25-year service life for the well at Cedar Springs (the ED used 50); a 30-year service life for the wells at the Center Point, Rocky Creek, Silver Creek, Southern Hills, Verde Park, Woodhaven, and Platten Creek water systems (the ED used 50 for these); a 50-year service life for wells at Heritage Park and Windwood Oaks (the ED also used 50); a 30-year service life for wells at Hills & Dales, Montebello, and Westwood systems (same as the ED, 30 years); and a 20-year service life for the well at Oak Ridge (the ED used 50).<sup>95</sup> Mr. Wiedenfeld testified that, if he purchased a system but did not have documentation for the age of an asset, he “relied on my experience and value of what I felt like the asset was worth.”<sup>96</sup> But he also admitted that the depreciation schedules do not indicate when he made an acquisition adjustment.<sup>97</sup> The ALJ believes that Mr. Wiedenfeld has a working knowledge of and a developed expertise for the water systems he operates and would weigh his testimony accordingly, but there is simply no support for the numbers beyond his brief statement that most wells last only 30 years.

As to the date for a utility to begin booking depreciation, the ALJ agrees that Mr. Adhikari did not provide a rule or statute requiring depreciation to begin once an asset is purchased. He did testify that once an asset goes into service, that date is when you begin to book depreciation.<sup>98</sup> Mr. Wiedenfeld also did not provide a rule, statute, or precedent for booking depreciation beginning January of the next year. However, the ALJ found the ED’s argument on this issue persuasive. If a utility begins depreciation on an asset later the date when the asset actually begins to depreciate, it may not collect the entire original cost of that asset by the time the asset’s service life has ended.

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<sup>94</sup> Tr. at 354.

<sup>95</sup> WWW Ex. 10.

<sup>96</sup> Tr. at 367.

<sup>97</sup> Tr. at 367.

<sup>98</sup> Tr. at 271.

Finally, Mr. Adhikari's disallowance for items that he determined were not used and useful was reasonable.

The ALJ finds that the ED's depreciation expense should be used in this case, with the changes noted by the ED and Mr. Adhikari (as reflected in the ED's table and for the 1994 Dodge).

#### **D. Return on Invested Capital**

In its original application, WWW indicated a net book value of \$1,060,348, working cash allowance of \$33,994, and materials and supplies of \$2,000. WWW showed \$0 for developer contributions. The application indicated \$1,096,342 in total invested capital with a 9.4% rate of return. However, in testimony, WWW revised its invested capital (rate base) to \$1,093,178. WWW requested a rate of return (ROR) of 8.84%, which would allow a return on investment of \$96,637.<sup>99</sup>

The ED calculated WWW's invested capital at \$1,032,243, its ROR 8.41%, and a return on investment of \$86,816.<sup>100</sup> Applicant argues that the ED's numbers are unsupported by the evidence and will not result in water rates that will preserve WWW's financial integrity.

Invested capital is calculated by determining the net plant (plant in service minus accumulated depreciation) plus working cash allowance, materials and supplies (inventory) minus customer deposits. This forms total invested capital to which the ROR is applied, resulting in the utility's return.

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<sup>99</sup> WWW Ex. 1, application at Bates 13 of 34; WWW Ex. 2, Wiedenfeld direct, Sch. C at 5 of 10.

<sup>100</sup> ED Ex. 1, Guerrero-Gantioqui direct, LG-4.

## **1. Working Cash Allowance, Materials and Supplies, and Customer Deposits**

As noted above, Applicant calculated a working cash allowance of \$33,994. ED witness Ms. Guerrero-Gantioqui calculated a working cash allowance of \$23,044. The allowance is a computation based on 30 TEX. ADMIN. CODE § 291.31(c)(2)(B)(iii) based on the amount of O&M times 1/8 plus materials and supplies. This computation will depend on the amount of O&M for WWW.

WWW takes issue with Ms. Guerrero-Gantioqui's removal of \$2,000 from materials and supplies. Ms. Guerrero-Gantioqui testified that she could not locate those items in the WWW general ledger and did not receive any invoices itemized for that stated purpose.<sup>101</sup> In rebuttal testimony, WWW did not address this issue nor present any evidence in support of this amount. In briefs, WWW argues the amount can be gleaned somehow from the general ledger. It cannot. Therefore, the ALJ agrees with the removal of \$2,000 from materials and supplies.

Applicant agrees with the ED that the customer deposits of \$4,750 should be subtracted from its rate base.

## **2. Rate of Return**

### **a. Applicant's Position**

Applicant argues that TEX. WATER CODE ANN. § 13.183(1) requires a return based on a utility's actual capital structure, not some TCEQ work sheet. Applicant contends that it presented ample evidence that its requested ROR of 8.84% is just and reasonable, within the presumptive ROR of 12%, based on Commission precedent, and allows WWW a reasonable return on its investment. WWW argues that the ED's recommended ROR is based upon an incorrect cost of service and net plant, an unsupported worksheet, and incorrect legal

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<sup>101</sup> ED Ex. 1, Guerrero-Gantioqui direct at 15, LG-4.

assumptions.

Specifically, Applicant states that the TCEQ Water Rate Application presents three different options for calculating a ROR: (1) an average equity return established by Staff each year and included in the Annual Report Instructions; (2) a rate that is fair and less than the rate established by the Staff; or (3) use of the ROR worksheet in the Commission's application instructions.<sup>102</sup> WWW took the second approach by using the "Presumptive Rate of Return." Applicant argues that there is ample evidence that WWW's use of the presumptive ROR is a more accurate predictor of WWW's actual financial risk. Although WWW presented no evidence of this, WWW did rely upon the discussion and decision in the *Aqua Texas* case.

As to the ED's calculation of the ROR using the worksheets, Applicant notes that Ms. Guerrero-Gantioqui was unable to fully explain the underlying rationale behind the worksheets. For instance, she used the annual percentage bench mark for Moody's BAA Utility Bond Yield for the test year, which was provided by her managers. WWW argues that the ED never attempted to calculate whether Staff's proposed equity return would preserve WWW's financial integrity, as required by TEX. WATER CODE ANN. § 13.183(a)(2).

**b. ED's Position**

Ms. Guerrero-Gantioqui testified that most utilities' capital structures consist of two types of capital—debt and equity—with each having its own costs. A weighted cost of capital is the sum of the weighted average of the costs of debt and equity and is the most appropriate means for determining the weighted average ROR for a utility with both debt and equity. WWW has outstanding debt, so Ms. Guerrero-Gantioqui calculated a weighted cost of capital by subtracting the company's debt, \$451,793, from the ED's calculated amount of invested capital, \$1,032,243, to get \$580,450 for its equity value.<sup>103</sup>

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<sup>102</sup> WWW Ex. 7, application instructions. Tr. at 131-132.

<sup>103</sup> WWW Ex. 1, Guerrero-Gantioqui direct at 16.

Ms. Guerrero-Gantioqui also adjusted the interest rate of two loans to WWW, which is owned by Mr. Wiedenfeld. One loan is from WW&W Consulting, a sole proprietor consulting business, and carries an 8% interest rate. A second loan is from Mr. Wiedenfeld to WWW with a 10% interest rate. Ms. Guerrero-Gantioqui testified that, because these are loans from affiliates, the payment of interest expense to an affiliated interest must be shown to be reasonable and necessary under TEX. WATER CODE § 13.185(e). WWW did not provide an explanation of these interests rates; therefore, Ms. Guerrero-Gantioqui adjusted the loans by reducing them to the average of the interest rates for the loans WWW had obtained in the loan market (the average of three loans from Wells Fargo) at 7.25%.<sup>104</sup>

Ms. Guerrero-Gantioqui then calculated the weighted average ROR for each loan and the weighted average cost of equity. Adding all the weighted costs of debt and equity resulted in her recommended weighted average ROR, or weighted cost of capital, of 8.41%. Multiplying 8.41% times the ED's invested capital results in a return of \$86,816.<sup>105</sup>

**c. ALJ's Recommendation**

Mr. Wiedenfeld proposed a 10% ROR based on his understanding that the TCEQ has a 12% presumptive ROR. Applicant's argument that there is a 12% presumptive ROR is not supported by Mr. Wiedenfeld's testimony or by the Commission's decision in *Aqua Texas*. Rather, the TCEQ has "has consistently allowed a 12% return on equity on the basis that it is similar to the returns available from other investments of similar risk."<sup>106</sup> In this case, WWW presented no evidence showing how WWW's systems compare with those of the *Aqua Texas* case, in terms of similar risk.

The use of the TCEQ's worksheet to calculate ROR is supported by precedent (for instance, the *Texas Landing Utilities* case) and is, of course, found in the TCEQ water rate

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<sup>104</sup> *Id.* at 16-17, LG-4; WWW Ex. 2, Wiedenfeld direct at 1; Tr. at 32.

<sup>105</sup> WWW Ex. 1, Guerrero-Gantioqui direct at 16-17, LG-4.

<sup>106</sup> *Aqua Texas* PFD at 64.

application. Ms. Guerrero-Gantioqui explained that she obtained the current Baa Public Utility Bond average for 2007, and added points for good management (low number of complaints, no enforcement actions, etc.); added point for a well maintained system and up-to-date books, etc.; and a good rate design.<sup>107</sup> Ms. Guerrero-Gantioqui's adjustments to the affiliate loan amounts were reasonable. There seemed to be no mathematical errors in her ROR calculations.

The ALJ agrees that the ED demonstrated how the ED calculated the ROR, how the ROR is based on the law, and that it takes WWW's performance into account. Accordingly, the ALJ recommends approval of the ED's calculated ROR of 9.48% on equity, which was used to calculate the weighted average ROR of 8.415 %.

#### **E. Rate Design**

The ALJ has found that WWW failed to meet its burden of proof for consolidation of its rates. Therefore, the ALJ agrees with the ED and OPIC that WWW's application should be denied.

However, if the Commission finds that WWW met its burden, the ALJ has consistently found the ED's adjustments to the application are better supported by the evidence. Mr. Adhikari calculated WWW's fixed and variable costs using the annual revenue requirement determined by Ms. Guerrero-Gantioqui, gallons billed, and the connection count. He then calculated a gallonage charge of \$3.10/1,000 gallons and a base rate for a 5/8" meter of \$21.13, which includes zero gallons.<sup>108</sup> To see what the base rate would be if he used WWW's proposed gallonage charge, Mr. Adhikari used the lowest-tier gallonage charge of \$4/1,000 gallons to calculate a base rate for a 5/8" meter of \$16.78, including zero gallons. Mr. Adhikari's calculated rate is significantly lower than Wiedenfeld's proposed base rate of \$30, including zero gallons and lower than the current rate for 598 of WWW's 753 connections.<sup>109</sup>

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<sup>107</sup> ED Ex. 1, Guerrero-Gantioqui direct at LG-7.

<sup>108</sup> Ex. ED-2, at 15:6-8, att. KA-3.

<sup>109</sup> ED Ex. 2, Adhikari direct at 14-15.

The ED notes that Mr. Adhikari's calculated \$16.78 base rate is lower than the current base rate, \$26, including zero gallons, for a majority of WWW's customers. Therefore, the ED asserts that even if WWW had demonstrated that its systems are substantially similar, it has not provided sufficient support for any change to its current rates and recommends that WWW's proposed rate change be denied. The ED recommends that rates should revert back to the systems' current rates. Westwood disagrees with the ED and recommends that the Commission establish a rate lower than existing rates.

The ALJ does not agree with Westwood that a lower rate should be established. First, WWW proposed a rate increase, not a rate reduction, and therefore does not bear the burden of proving that its current rates are just and reasonable.<sup>110</sup> Second, the ALJ agrees with the ED that reinstating WWW's current rates is a fair balance between assisting the WWW's financial integrity and protecting the customers by denying an unsupported rate change. Third, there is no evidence in the record to show what rate reduction amounts would be fair and reasonable.

For the reasons discussed above, the ALJ agrees with the ED that WWW's rates should revert back to the current rates, which are as follows:<sup>111</sup>

- Southern Hills, Hills 'n Dales, Woodhaven, Center Point, Verde Park, Rocky Creek, Platten Creek, Heritage Park, and Cedar Springs - base rate for a 5/8" meter of \$26, including zero gallons, and a gallonage charge of \$4/1,000 gallons for 0-10,000 gallons and \$6/1,000 gallons for over 10,000 gallons;
- Westwood – base rate for a 5/8" meter of \$28.20, including 2,000 gallons, and a gallonage charge of \$1.60/1,000 gallons for over 2,000 gallons; and
- Oak Ridge Estates – base rate for a 5/8" meter of \$34, including 2,000 gallons, and a gallonage charge of \$2/1,000 gallons for over 2,000 gallons.
- Windwood Oaks reached a settlement with WWW.<sup>112</sup>

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<sup>110</sup> 30 TEX. ADMIN. CODE § 291.12.

<sup>111</sup> ED Ex. 1, Guerrero-Gantioqui direct at LG-1, at 23.

<sup>112</sup> WWW Ex. 2, Wiedenfeld direct at 45.

## VI. REFUNDS

Mr. Adhikari testified that, under 30 TEX. ADMIN. CODE § 291.29(h), a utility must “refund or credit against future bills all sums collected in excess of the rate finally ordered plus interest as determined by the Commission in a reasonable number of monthly installments.” Because WWW has not met its burden of proof in this case, WWW should provide a full refund of the excess revenues collected since its interim rates went into effect plus interest. Mr. Adhikari recommends that the refund be recovered over the same number of months that the proposed rates were collected, effective when the Commission issues an order in this case. Mr. Adhikari also recommended an interest rate of 3.21%, which is the Public Utility Commission of Texas (PUC) interest rate for the year 2009, because the over charges primarily occurred during 2009.<sup>113</sup>

Westwood recommends a full refund plus interest, calculated at a rate of 10% because this is the rate Mr. Wiedenfeld testified that he considered to be reasonable for interest on his loan to WWW.

The ALJ does not find that a 10% interest rate is reasonable. Rather, the ALJ finds Mr. Adhikari’s use of the 2009 PUC interest rate more reasonable for a utility refund. Accordingly, the ALJ adopts the ED’s recommendations concerning refunds.

## VII. MISCELLANEOUS MATTERS

### A. Miscellaneous Fees

No party contested Applicant’s miscellaneous fees. Mr. Adhikari testified that these fees are reasonable.<sup>114</sup> Accordingly, the ALJ recommends that they be approved for all 12 systems.

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<sup>113</sup> ED Ex. 2, Adhikari direct at 17, Att. KA-8.

<sup>114</sup> ED Ex. 2, Adhikari direct at 15-16.

**B. Conservation Rates**

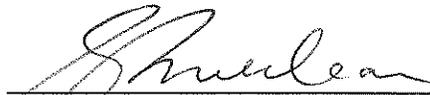
Mr. Adhikari testified that WWW currently charges its proposed conservation rates to all its systems except Westwood and Oak Ridge Estates and proposes to charge those two systems the same conservation rates as the others. The ED recommends approval of the conservation rates for all twelve systems because: (1) those rates have been previously approved for a majority of WWW's systems; (2) they are not based on the utility's revenue requirement; (3) the rates are not increasing; and (4) they are used solely to promote water conservation. However, the ED further recommends that if the conservation rates are charged to the customers because drought contingency plans are triggered, any revenue from those rates that exceeds the utility's usual cost of service must be accounted for separately, used for capital improvements, and reported in future rate applications as customer contributions in aid of construction.<sup>115</sup>

The ALJ finds the ED's recommendations concerning conservation rates are reasonable and adopts them.

**C. Transcription Costs**

Applicant agrees that it should pay for the transcription costs because the protesting intervenors did not unnecessarily protract discovery or the hearing.

**SIGNED October 1, 2010.**

  
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**LILO D. POMERLEAU**  
**ADMINISTRATIVE LAW JUDGE**  
**STATE OFFICE OF ADMINISTRATIVE HEARINGS**

<sup>115</sup> ED Ex. 1, Guerrero-Gantioqui direct at LG-1; ED Ex. 2, Kalahari direct at 15-16.

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**



**AN ORDER  
DENYING THE APPLICATION OF WIEDENFELD WATER WORKS, INC.  
UTILITIES TO INCREASE ITS RATES  
SOAH DOCKET NO. 582-09-3549  
TCEQ DOCKET NO. 2009-0372-UCR**

On \_\_\_\_\_, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Wiedenfeld Water Works, Inc. (WWW) to change its water rates and its tariff in Kerr, Kendall, and Medina Counties, Texas, under Certificate of Convenience and Necessity No. 12052. A Proposal for Decision (PFD) was presented by Lilo D. Pomerleau, 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. WWW provides retail water utility service under Certificate of Convenience and Necessity No. 12052, in Kerr, Kendall, and Medina Counties, Texas.
2. WWW operates 13 water systems, 12 of which are the subject of this application, under three tariffs. The 12 systems are Cedar Springs, Center Point, Heritage Park, Hills n'

Dales, Oak Ridge Estates, Platten Creek, Rocky Creek, Southern Hills, Verde Park, Westwood Park, Windwood Oakes, and Woodhaven.

3. The WWW system that is not part of this application is Vista Hills.
4. On September 10, 2008, notices of the proposed rate change were mailed to WWW's customers other than those at the Windwood Oaks and Oak Ridge Estates water systems.
5. On September 30, 2008, notices of the proposed rate change were mailed to WWW's customers on the Windwood Oaks and Oak Ridge Estates water system.
6. On September 12, 2008, WWW filed its application to increase its water rates and amend its tariffs.
7. The effective date of the increase was December 20, 2008.
8. More than ten percent of WWW's customers filed protests by the applicable deadline.
9. On March 27, 2009, the Commission's Chief Clerk referred the application to SOAH for hearing.
10. On June 11, 2009, the Chief Clerk mailed notice of a preliminary hearing to WWW.
11. WWW mailed the notice of the preliminary hearing to its customers on June 19, 2009.
12. 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.
13. The notice contained an additional, unauthorized statement, which may have discouraged ratepayers from attending the preliminary hearing.
14. On July 21, 2009, an ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

<b>PARTY</b>	<b>REPRESENTATIVES</b>
WWW	R. Charles Wiedenfeld
ED	Stephanie Skogen, James T. Aldredge
Office of Public Interest Counsel (OPIC)	Blas J. Coy, Jr.
Windwood Oaks	Steve and Deanna Caraway
Heritage Park	Bill Wilson
Westwood Park ratepayers (Westwood)	Santos Hernandez; Hanson Paul Leblanc, III

15. The ALJ ordered that a second preliminary hearing be convened in case any ratepayer was discouraged from attending the first preliminary hearing.
16. On July 29, 2009, the Chief Clerk mailed notice of a second preliminary hearing to WWW.
17. WWW mailed the notice of the second preliminary hearing to its customers on August 3, 2009.
18. 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.
19. On August 26, 2009, an ALJ held a second preliminary hearing as indicated in the notice.
20. Subsequent to the preliminary hearings and before the hearing on the merits, Windwood Oaks reached a settlement with WWW and withdrew as a party.
21. Subsequent to the preliminary hearings and before the hearing on the merits, Heritage Park withdrew as a party.
22. No party disputes either the Commission's or SOAH's jurisdiction.

23. The ALJ held the hearing on the merits of the application on May 5-6, 2010, and the following parties attended:

<b>PARTY</b>	<b>REPRESENTATIVES</b>
WWW	Mark H. Zeppa; Mary Alice Boehm-McKaughan
ED	Stephanie Skogen, James T. Aldredge
OPIC	James B. Murphy
Westwood	Randall B. Wilburn

24. The record closed August 6, 2010, with the filing of reply briefs.

#### **Overview of the Proposed Rate Increase**

25. At the end of the 2007 test year, on December 31, 2007, the 12 water systems combined had approximately 753 metered connections.
26. One tariff applies to nine water systems—Cedar Springs, Center Point, Heritage Park, Hills n’ Dales, Platten Creek, Rocky Creek, Southern Hills, Verde Park and Woodhaven MHP. Westwood Park, Windwood Oaks, and Oak Ridge estates each have different tariffs.
27. WWW requested to change its rates as follows:

	Previous Rates	Application
<b>So. Hills, Hill'nDales, Woodhaven, Center Point, Verde Park, Rocky Creek, Platten Creek, Vista Hills</b>		
5/8 in. or 3/4 in.	\$ 26.00	\$ 30.00
1 in.	65.00	75.00
1 1/2 in.	130.00	150.00
2 in.	208.00	240.00
3 in.	390.00	450.00
Gallonage Charge		
For each add. 1000 gallons up to 10000	\$ 4.00	For each add. 1000 gallons up to 10000 \$ 4.00
Over 10,001 Gallons	\$ 6.00	Over 10,001 Gallons \$ 6.00
<b>Oak Ridge Estates</b>		
5/8 in. or 3/4 in.	\$ 34.00	\$ 30.00
1 in.		75.00
1 1/2 in.		150.00
2 in.		240.00
3 in.		450.00
Gallonage Charge		
For each add. 1000 gallons over 2,000 gallons	\$ 2.00	For ea. add. 1000 gallons up to 10000 \$4.00
		Over 10,001 Gallons \$6.00
<b>Westwood Park</b>		
5/8 in. or 3/4 in.	\$ 28.20	\$ 30.00
1 in	47.09	75.00
1 1/2 in.	93.91	150.00
2 in.	150.31	240.00
3 in.		450.00
Gallonage Charge		
For each 1,000 over 2,000 gallons	\$ 1.60	For ea. add. 1000 gallons up to 10000 \$ 4.00
Over 10,001 gallons	\$ 00	Over 10,001 Gallons \$ 6.00

28. On December 20, 2008, WWW began charging the rates in its application.
29. The rates at issue in this proceeding are still in effect.

**General Concerns with WWW's Application**

30. Along with the February 4, 2010 prefiled testimony of R. Charles Wiedenfeld, WWW owner and president, WWW amended its application.
31. The amended application contained changes, not just corrections, to the numbers supporting the rate change request and also contained multiple discrepancies in the schedules supporting the application.
32. The amended application did not change the proposed rates.
33. WWW failed to include documentation in support of the revisions found in the amended application, which hindered the parties' ability to analyze the application.
34. The ED's analysis is based on the original application.

**Consolidation**

35. WWW grouped 12 water systems together to develop one revenue requirement. For test year 2007, WWW's claimed revenue requirement for all 12 systems combined was \$453,912 as shown in the September 12, 2008 application. WWW did not demonstrate how just and reasonable rates for the three separate water systems could be derived from one revenue requirement.
36. All WWW systems are dependent upon groundwater and are substantially located within the same area, mostly in Kerr County, Texas.
37. The three systems that do not currently have the same rates, Oak Ridge Estates, Westwood Park, and Windwood Oaks, are located within seven miles of one another.

WWW has a business office in Center Point, Texas, through which all customer service, billing, accounting, and clerical operations are performed. WWW has two full-time licensed operators, David Jones and Mr. Wiedenfeld, and an office worker, which serves all systems.

38. WWW had only one general ledger showing the expenses for all 13 systems (including Vista Hills).
39. WWW did not show how the 12 water systems are substantially similar in terms of their costs of service.

**Operation and Maintenance Expenses**  
**Salary Expenses**

40. In its application, WWW claimed that its salary expense was \$110,153 for all water systems combined, including Vista Hills, which is not subject to this rate change.
41. WWW did not demonstrate that the \$110,153 in salary expenses claimed in its application was an allowable expense that was reasonable and necessary to provide water service.
42. The ED demonstrated that WWW's salary expense totaled \$80,153 for the 12 systems.

**Contract Labor**

43. In its application, WWW requested \$2,250 for contract labor.
44. The ED allocated 1.7%, \$38, for the Vista Hills water system.
45. WWW demonstrated \$2,212 for contract labor reasonable and necessary to provide water service.

## **Chemicals**

46. In its application, WWW requested \$7,825 as a chemical expense for the 13 systems combined.
47. The ED allocated 1.7%, \$133, for the Vista Hills water system.
48. WWW demonstrated \$7,692 for chemical expenses reasonable and necessary to provide water service.

## **Utilities**

49. In its application, WWW requested \$30,473 in utility expenses for the 12 water systems.
50. The ED subtracted \$885 in utility expenses attributable to Vista Hills.
51. WWW demonstrated \$29,523 for utilities expenses reasonable and necessary to provide water service.

## **Repairs/Maintenance/Supplies**

52. In its application, WWW listed \$50,338, as an allowable expense for repairs, maintenance, and supplies for all 12 water systems.
53. The ED properly moved \$10,000 in vehicle expenses from the miscellaneous expenses category to the repair, maintenance, and supplies category and added \$1,910 in documented vehicle expenses.
54. The ED properly allocated 1.7%, \$848, to the Vista Hills water system.
55. Applicant incurred \$8,025 in lab fees.
56. It is proper to allocate 1.7% of \$8,025 or \$139 in lab fees to the Vista Hills system.

57. WWW demonstrated that the amount of \$57,068 for the expense of repairs, maintenance, and supplies is an allowable expense that is reasonable and necessary to provide water service.

#### **Office Expense**

58. WWW included the amount of \$3,676 as an office expense in its application.

59. Income was improperly deducted from office expenses; therefore, the ED added \$3,300 to this category and subtracted 1.7% from the subtotal or \$119 for the Vista Hills system.

60. The ED demonstrated an amount of \$6,857 as office expense is reasonable and necessary for WWW to provide water service.

#### **Accounting and Legal Fees**

61. In its application, WWW represented that it incurred \$3,185 as an allowable expense for accounting and legal fees.

62. The ED reclassified fees for license and permits to miscellaneous expenses and allocated 1.7%, \$19, to the Vista Hills system.

63. The ED demonstrated \$1,116 for the expense of accounting and legal fees is reasonable and necessary for WWW to provide water service.

#### **Insurance**

64. In its application, WWW indicated an amount of \$3,420 as an allowable expense for insurance.

65. The ED allocated 1.7%, \$58, for the Vista Hills water system.

66. WWW demonstrated that the amount of \$3,362 as an insurance expense is an allowable expense that is reasonable and necessary to provide water service.

### **Rate Case Expense**

67. In its application, WWW claimed \$22,380 for rate case expenses.

68. WWW's just and reasonable rates demonstrated in this hearing are less than 51 percent of the increase in revenue that would have been generated by WWW's proposed rates.

### **Miscellaneous Expense**

69. In its application, WWW claimed \$60,632 in miscellaneous expense but WWW now seeks \$12,344 in miscellaneous expenses.

70. The ED's additions and deductions to this category are reasonable.

71. The ED demonstrated that the amount of \$4,394 for miscellaneous expense is reasonable and necessary for WWW to provide water service.

### **Payroll Taxes**

72. In its application, WWW claimed \$1,291 in expenses for payroll taxes.

73. The ED's calculations and deductions to this category are reasonable, resulting in a total of \$7,014 for payroll taxes reasonable and necessary for WWW to provide water service.

### **Property and Other Taxes**

74. WWW claimed \$16,379 in property and other taxes.

75. The ED allocated 1.7% of that amount, \$278, to the Vista Hills system.

76. WWW demonstrated that the amount of \$16,101 for property and other tax expenses is an allowable expense that is reasonable and necessary to provide water service.

## **Federal Income Taxes**

77. As set out in the application, WWW calculated an income tax expense of \$26,566.
78. Since WWW did not properly calculate its total invested capital, its ROR, and its return, WWW did not properly calculate its federal income tax expense.

## **Annual Depreciation and Amortization**

79. WWW calculated its annual depreciation expense for all 12 water systems combined.
80. In the depreciation schedule included in its application, WWW listed the amount of \$61,975 as an annual depreciation expense.
81. WWW failed to provide sufficient documentation to support its depreciation schedule and the amount of its depreciation expense in its application.
82. WWW failed to demonstrate that the amount of \$61,975 for annual depreciation is an allowable expense that is reasonable and necessary to provide water service.

## **Invested Capital, Rate of Return, and Return**

83. To determine its invested capital for all 12 systems combined, WWW showed on its application a net book value of \$1,060,348, working cash allowance of \$33,994, and materials and supplies of \$2,000. WWW showed \$0 for developer contributions.
84. To calculate its rate of return (ROR), WWW used one worksheet for all 12 water systems combined.
85. WWW erroneously calculated an ROR of 9.4 %.
86. In determining its weighted average cost of debt, WWW included loans from its owner, R. Charles Wiedenfeld, and from WW&W Consulting, a sole proprietorship owned by

Mr. Wiedenfeld. WWW claimed an interest rate of 10 percent on these loans and used this 10 percent interest to calculate its weighted rate of return.

87. WW&W Consulting and Mr. Wiedenfeld are affiliated interests of WWW.
88. 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.
89. WWW did not demonstrate that the 10 percent interest rate paid to its affiliated interest was reasonable and necessary.
90. Based on errors in calculating its ROR, its weighted average costs of debt and equity, WWW erroneously calculated its return.
91. WWW's reasonable and necessary ROR is 9.48 percent on equity, and its reasonable and necessary weighted average ROR is 8.415%.

### **Return**

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

### **Conservation Rates**

93. WWW currently charges its proposed conservation rates to all of its systems except Westwood and Oak Ridge Estates.
94. It is reasonable to allow WWW to charge Westwood and Oak Ridge Estates the proposed conservation rates because: (a) those rates have been previously approved for a majority of WWW's systems; (b) they are not based on the utility's revenue requirement; (c) the rates are not increasing; and (d) they are used solely to promote water conservation.

### **Rate Design**

95. WWW did not demonstrate whether the revenue from its proposed rates would fail to meet, meet, or exceed its revenue requirement.
96. The ED calculated a base rate of \$21.13 per month for a 5/8 inch meter including zero gallons and a gallonage rate of \$3.10 per 1,000 gallons.
97. A comparison of the ED's calculated base rate with the WWW proposed rate indicates that WWW is unable to support its requested rates.
98. The ED's calculated base rate is lower than the WWW current rate for 598 of 753 connections.

### **Financial Integrity**

99. WWW is not at risk of a financial collapse if this application to change its rates is denied.

### **Refunds**

100. WWW collected the proposed rates from December 20, 2008, until present.
101. It is reasonable to apply 3.21%, the interest rate adopted by the Public Utility Commission of Texas for the year 2009, to the refund amount owed by WWW.

### **Miscellaneous Fees**

102. WWW demonstrated that miscellaneous fees, such as deposits and return check charges, for all 12 systems are reasonable.

### **Transcription Costs**

103. WWW 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.

104. Westwood, OPIC, and the ED benefited from the use of a transcript.
105. WWW did not request that the reporting and transcription costs be allocated among the other parties.
106. No party presented evidence or argument on the issue of assessment of reporting and transcription costs.
107. The assessment of the reporting and transcription costs is not an issue in this case.

## **CONCLUSIONS OF LAW**

### **Procedural History and Jurisdiction**

1. WWW is a retail public utility. TEX. WATER CODE ANN. § 13.002(19).
2. WWW is a water 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 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

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 § 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 TEX. ADMIN. CODE § 291.21(m); *see also* TEX. WATER CODE ANN. § 13.145(a).
9. WWW 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, WWW failed to meet its burden of proof that the Cedar Springs, Center Point, Heritage Park, Hills n’ Dales, Oak Ridge Estates, Platten Creek, Rocky Creek, Southern Hills, Verde Park, Westwood Park, Windwood Oakes, and Woodhaven water systems are substantially similar in terms of their costs of service.
11. Because the costs of service for the 12 systems are not shown to be substantially similar, WWW has not met the 30 TEX. ADMIN. CODE § 291.21(m)(1) requirements and the 12 water systems cannot be consolidated under a single rate design.

## **Return**

12. 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.
13. The Commission is generally prohibited from setting rates that would allow WWW 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).
14. 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).
15. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's historical test year expenses as adjusted for known and measurable changes may be considered. 30 TEX. ADMIN. CODE § 291.31(a) & (b).
16. "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).

17. 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).
18. 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).
19. The rate of return is applied to the invested capital, also referred to as rate base. 30 TEX. ADMIN. CODE § 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).
20. 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).
21. 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).

22. Based on the above Findings of Fact, WWW did not meet its burden of proving that the interest expense on the loans from its affiliates, WW&W Consulting and R. Charles Wiedenfeld, are reasonable and necessary.
23. Under 30 TEX. ADMIN. CODE § 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.
24. Based on the above Findings of Fact, WWW failed to meet its burden of proving that its calculations regarding total invested capital, rate of return, and return comply with the TCEQ's rules.

## Revenue Requirement

25. Under 30 TEX. ADMIN. CODE § 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.
26. 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 TEX. ADMIN. CODE § 291.31(b)(2)(I).

27. Based on the above Findings of Fact, WWW failed to meet its burden of proving that the total of its claimed allowable expenses is reasonable and necessary to provide water service.

### **Rate Design**

29. The Commission has adopted rules concerning alternative rate methods. 30 TEX. ADMIN. CODE § 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. There is no evidence that any portion of the proposed rate increase is necessary to preserve WWW's financial integrity.

31. Based on the above Findings of Fact and Conclusions of Law, WWW has failed to meet its burden of proving that its application should be granted. WWW has failed to meet its burden of proving that its proposed rates are just and reasonable.

32. Based on the above Findings of Fact and Conclusions of Law, WWW's application for a change in its water utility rates should be denied.

### **Rate Case Expenses**

33. Regarding rate case expenses, 30 TEX. ADMIN. CODE § 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.

34. Based on the above Findings of Fact and Conclusions of Law, WWW has failed to demonstrate that its rates should be increased. Therefore, in accordance with 30 TEX. ADMIN. CODE § 291.28(7) and (8), WWW should not be allowed to recover any rate case expenses for this case.
35. Based on the above Findings of Fact and Conclusions of Law, WWW's rates should revert back to those in effect before the filing of its application to change WWW'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, WWW should refund or credit to its customers all sums collected since December 20, 2008, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus 3.21% percent 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 TEX. ADMIN. CODE § 80.24(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 TEX. ADMIN. CODE § 80.23(d)(2).
42. Based on the above Findings of Fact and Conclusions of Law, WWW should be assessed the full amount of the reporting and transcription costs.

### 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 Wiedenfeld Water Works, Inc. to increase the rates that it charges for the retail water utility service that it provides under Certificate of Convenience and Necessity No. 12052 in Kerr, Kendall, and Medina Counties, is denied.
2. WWW shall immediately cease collecting the rates it proposed in this case.
3. Within \_\_\_\_\_ days, WWW shall refund or credit to customers all sums collected between December 20, 2008, and the present, that exceed the rates approved by the Commission in this case, plus 3.21% percent interest on the over-collection.
4. WWW shall be assessed the full amount of the reporting and transcription costs.
5. 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.
6. The effective date of this Order is the date the Order is final, as provided by 30 TEX. ADMIN. CODE § 80.273 and Texas Government Code § 2001.144.
7. 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.

8. The Commission's Chief Clerk shall forward a copy of this Order to each party.

**ISSUED:**

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**

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**Buddy Garcia, Chairman**  
**For the Commission**