

Bryan W. Shaw, Ph.D., *Chairman*
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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution
August 2, 2010

Honorable William Newchurch
State Office of Administrative Hearings
Administrative Law Judge
300 West 15th Street, Suite 502
Austin, Texas 78701

Re: Deer Creek Ranch Water Co., LLC
SOAH Docket No. 582-09-5328; TCEQ Docket No. 2009-0929-UCR

Dear Judge Newchurch:

Please find attached the Executive Director's Response to Exceptions filed by Deer Creek Ranch Water Company, LLC for the above-referenced case. If you have any questions or comments please contact me at (512) 239-0750.

Sincerely,

A handwritten signature in black ink, appearing to read "B. MacLeod".

Brian MacLeod
Environmental Law

Enclosure

cc: Mailing list

SOAH DOCKET NO. 582-09-5328
TCEQ DOCKET NO. 2009-0929-UCR

APPLICATION OF DEER CREEK	§	BEFORE THE TEXAS
RANCH WATER CO., LLC TO	§	COMMISSION
CHANGES ITS WATER RATES	§	
AND TARIFF UNDER	§	ON
CERTIFICATE OF CONVENIENCE	§	
AND NECESSITY NO. 11241 IN	§	
TRAVIS AND HAYS COUNTIES	§	ENVIRONMENTAL QUALITY

**THE EXECUTIVE DIRECTOR'S RESPONSE TO EXCEPTIONS FILED BY
DEER CREEK RANCH WATER COMPANY, LLC.**

TO THE HONORABLE COMMISSIONERS:

COMES NOW THE EXECUTIVE DIRECTOR (ED) OF THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY (TCEQ) and files this Executive Director's Response to Exceptions Filed by Deer Creek Ranch Water Company, Inc.

Introduction

Deer Creek Ranch Water Company, LLC, has filed exceptions that include many statements that appear not to track the record properly and has cited many cases, rules, and statutes for propositions that the citations do not support. To address each of these shortcomings would be confusing and counterproductive because the Administrative Law Judge's (ALJ) Proposal for decision already appropriately addresses the law and the facts. The ED will focus on the major problems with the exceptions raised by the Applicant.

The PFD properly disposed of all the issues and should be adopted. The Applicant has created a confusing corporate maze and then attempts to use the confusion to its advantage by creating a haze that is difficult to see through. The ALJ was able to pierce this haze and shine the light of reality on the cost situation of this application. Just one of the maneuvers employed that caused the haze was the leasing of assets and the claim that this lease was approved by a Sales, Transfer, Merger (STM) order. This issue will be

discussed in more depth later, but is included here to lay the background in which this case exists. Below is a short discussion of this event:

The Applicant and its predecessor filed an application to sell the CCN to the Applicant while the predecessor was in the middle of a difficult enforcement action. The CCN had formerly been held by Deer Creek Ranch, Inc., and was transferred to Deer Creek Ranch Water Company, LLC. Both entities are controlled and operated solely by Sam Hammett. The application for the transfer of the CCN also had attached to it a lease of assets from the prior CCN holder to the new CCN holder (perhaps to indicate that it had the facilities necessary to provide continuous and adequate water service, but not to approve the reasonableness of the cost of the lease). These were assets that the customers had already paid for through rates paid to the prior CCN holder. Because the statute and rules regarding STMs employ the word “lease,”¹ the Applicant claims that approval of the STM must also have approved the lease because it was mailed with the application. A reading of the order shows that there was no approval of the lease.² Additionally, as will be shown below, STM application are reviewed to see if the buyer has the financial, managerial, and technical ability to provide a continuous and adequate supply of water service to the customers. It is not a method of avoiding customer review of a cost item in a rate application. Customers cannot initiate a contested case hearing on an STM, but they can for a rate case.³ If the Applicant had attached his entire “562 page four inch binder” to the STM application, under its analysis, the customers would be foreclosed from questioning a single page. The inequity of including the lease in the costs goes beyond just failing the affiliated interest test. It violates common sense. The customers had already paid for all of these assets through their rates paid to a company solely owned and controlled by Sam Hammett. It is unconscionable to require the customers to now pay for a lease of these same assets through their rates to a new company solely owned and controlled by Sam Hammett.

¹ The statute is referring to a lease of a CCN and not to a lease as a cost item.

² A copy of the order is attached.

³ 30 TAC § 291.28 lays out how customers get a hearing on a rate application. 30 TAC § 291.109 lays out how hearings can be requested on STM applications. Customers may not refer an STM case to a hearing by themselves. An STM is a CCN action, not a rate action. It transfers the CCN, it does not establish elements of a rate.

Factual Background

Deer Creek Ranch Water Company, LLC, and its affiliate Deer Creek Ranch, Inc. have had difficulties in the past with providing a continuous and adequate supply of water to customers. Of the many cases that Deer Creek has been involved in there are four main cases that provide a context that clarifies the “big picture” of this rate case. The first was a 1986 rate case in which the rate base was decreased significantly by customer contributions and which set rate base and depreciation for the remaining invested capital after the customer contributions were deducted. The second was a rate case settled in February 2005. In that case, the ratepayers agreed to pay a surcharge in order to pay for water system improvements with priority given to obtaining a reliable source of Lower Colorado River Authority (LCRA) water. The third was a sales transfer, merger (STM) case in which Deer Creek Ranch Water Co., LLC, purchased the CCN from Deer Creek Ranch, Inc. The fourth was a rate case settled in July 2007. In that case a pass through clause was added to Deer Creek Water Co., LLC’s tariff that allowed Deer Creek to pass through to its customers the charges billed to it by LCRA for wholesale treated water.

Below the ED outlines its position on the main issues in the case that are relevant to the exceptions filed by the Applicant.

The focus of a rate case is the utility’s cost of service, not protecting the financial integrity of the utility.

The Applicant rests much of its argument on protecting the financial integrity of the utility. While Texas Water Code section 13.183 does indicate that one of the goals in setting rates is to protect the financial integrity of the utility, such a factor cannot be used to allow a utility to collect a rate that recovers unreasonable costs. Otherwise, there would be no limit to what costs a utility could recover because, regardless of what it spent and borrowed, it would always be able to collect whatever was necessary to pay the costs regardless of how unreasonable they may be. Texas Water Code § 13.185(h)(3) provides that the regulatory authority may not include for ratemaking purposes “any expenditure found by the regulatory authority to be unreasonable, unnecessary, or not in the public

interest, including executive salaries, advertising expenses, legal expenses, and civil penalties or fines.” The statutes and rules make it abundantly clear that the focus of rate cases is the cost of service and not ensuring an Applicant that it can always make a profit regardless of its costs. Section 291.31 (a) of the Texas Administrative Code provides that “Rates are based upon a utility’s cost of rendering service.” Section 13.185(b) of the Texas Water Code provides the following, which also indicates how unusual it would be to include other costs simply to protect the financial integrity of the utility:

Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. The inclusion of construction work in progress is an exceptional form of rate relief to be granted only on the demonstration by the utility by clear and convincing evidence that the inclusion is in the ratepayers' best interest and is necessary to the financial integrity of the utility. Construction work in progress may not be included in the rate base for major projects under construction to the extent that those projects have been inefficiently or imprudently planned or managed.

Burden of Proof

The record in this case is very confusing. The receipts attached to the application reference the predecessor, the Applicant, several variations of business names that include the words “Deer Creek,” and the individual who owns and controls all of these entities. The employees of the Applicant were carried on the books of the predecessor for years after the STM was approved. The persons with the most personal knowledge of the business never testified (Sam Hammett and the other alleged employee). Instead, consultants offered the direct testimony for the Applicant along with the accountant for all of Sam Hammett’s businesses. Ferreting out how the Applicant’s recommendation is just and reasonable is nearly impossible because of (1) the lack of financial distinction between Deer Creek Ranch Inc (the land company) and Deer Creek Water (the Applicant and CCN holder), (2) the lack of clarification on the overlapping duties of PGMS, the employees, and the independent contractor, (3) the attempt to get a return on old assets that were already paid for by selling off the CCN and then leasing these same assets back

to Applicant and then also attempting to get a return on assets pledged as collateral on a loan, (4) a complete lack of accounting for the escrowed funds for “improvements to the water system,” and (5) many other confusing convolutions of law and fact proffered by the Applicant.

The blurring of the line between Deer Creek Water and Deer Creek Inc. does not inure to the benefit of the Applicant. Because the evidence is hazy, the ED could only make its best estimate of what amount of expenses and invested capital are reasonable and necessary to support the financial integrity of the utility. Generally, confusion and lack of clarity indicate that the burden of proof has not been met, and the burden of proof in this case is on the utility.⁴ 30 TAC § 291.12 and 30 TAC § 291.25(b).

Standard of Review

The Applicant completely misinterprets the ALJ’s discussion of how expenses paid to affiliated interests are to be analyzed in a rate case. Because the ALJ stated that a higher level of scrutiny is required for investigating the reasonableness of the expenses in transactions with affiliated interests, the Applicant argues that the judge is applying more than the preponderance of the evidence test. The “higher standard of review” referred to is not, as the Applicant stated “mythical” -- it is exactly what section 13.185(e) of the Texas Water Code calls for. The ALJ did not indicate that this was the standard of review for the entire case, but was a shorthand explanation of the regulatory standard for reviewing particular cost items when the cost is being paid to an affiliated interest. Section 13.185(e) provides the following: “Payment to affiliated interests for costs of any services, or any property, right or thing, or for interest expense may not be allowed either as capital cost or as expense except to the extent that the regulatory authority finds that payment to be reasonable and necessary. A finding of reasonableness and necessity must

⁴ One who seeks to recover against another must introduce competent evidence, whether direct or circumstantial, which tends reasonably to establish his cause of action, and from which the material issues upon which he relies for recovery can be reasonably inferred, and he cannot cast his adversary on evidence amounting to no more than conjecture, surmise or suspicion, merely because his case is difficult to prove. *Kenyon v. Bender*, 174 S.W.2d 110 (Tex.Civ.App. -- Beaumont,1943) writ ref’d.

include specific statements setting forth the cost to the affiliate of each item or class of items in question and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates or divisions for the same item or items, or to unaffiliated persons or corporations.” The terms of the statute show that cost items from an affiliated interest that an Applicant wants to include in its cost of service requires findings that are not required for all cost items. This is not, as the Applicant suggests, an invented standard of review unfounded in law, it is a clear requirement of statute.

The standard of review is again confused by the Applicant when it argues that it only needs to present a *scintilla* of evidence to establish a fact. This is not a correct explanation of what the preponderance of the evidence means. It is defined in Black’s Law Dictionary as follows: “**Preponderance of the evidence.** Evidence which is of greater weight or more convincing than evidence which is offered in opposition to it; that is, evidence which as a whole shows the fact to be proved is more probable than not.” A *scintilla* of evidence does not prove that the fact is probably true. The *scintilla* concept applies to what is necessary to avoid summary judgment and directed verdicts. It is not a standard of review that can establish facts. Black’s Law Dictionary defines *scintilla* of evidence as follows: “**Scintilla of Evidence.** A spark of evidence. A metaphorical expression to describe a very insignificant or trifling item or particle of evidence used in a statement of the common-law rule that if there is any evidence at all in a case, even a mere *scintilla*, tending to support a material issue, the case cannot be taken from the jury, but must be left to their decision.” Contrary to the Applicant’s argument that a *scintilla* of evidence can be used to establish a fact, the *scintilla* only means that a summary disposition of the case is inappropriate and that the case must be heard and the trier of fact will determine what weight, if any, will be attached to that *scintilla* when determining what was proved by the preponderance of evidence as more likely than not. In this case the ALJ heard the evidence and attached the appropriate weight to it.

Affiliated Interests

TWC 13.185 (e) provides:

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

The PFD correctly found that Deer Creek Inc., Deer Creek Water, and Sam Hammett are affiliated interests. The indications of this are myriad. Here are a few:

1. The lease between Deer Creek Inc and Deer Creek Water is signed by Sam Hammett as the president of both and indicates that Deer Creek Inc. is a Majority owner of Deer Creek Water. (BDD 11 attached to ED 2).
2. Deer Creek Inc, Deer Creek Water, and Sam Hammett use the same accountant (TR P 99 L 13-24)
3. Sam Hammett is the president of Deer Creek Water and Deer Creek Inc. (TR P 100 L 3-5)
4. Deer Creek Inc. and Deer Creek Water have a common lease (TR P 101 L 11-19)
5. The truck used by Deer Creek Water was purchased from Hammett Motor Company, and the installment contract shows the buyer to be Sam Hammett. (BDD 16). The truck is used by Deer Creek Water, Deer Creek Inc., and Sam Hammett. (TR P 182 L 2-9)
6. Sam Hammett is an employee of Deer Creek Inc. and Deer Creek Water
7. Deer Creek Inc. and Deer Creek Water keep common books and Deer Creek Inc received bills in the name of Deer Creek Water (TR P 116 L 21 – P117 L 8)
8. The collateral pledged for Deer Creek Water's loan was provided by Deer Creek Inc. (TR P 510 L 1-18)

9. Deer Creek Inc reported wages to the IRS that were paid to employees of Deer Creek Water, and for federal income tax purposes are “one and the same.” (TR P 534 L 2-14)
10. The invoices attached to the application use the names of the two entities interchangeably

The ALJ disallowed several cost items based on the Applicant’s failure to meet the standards established by statute for dealings with affiliated interests. One of particular importance is the lease of facilities from the predecessor CCN holder to the Applicant. The Applicant argues that the TCEQ’s approval of the STM was approval of the lease. (TR P 390 L18 - P 391 L 4). The argument is unpersuasive. The adjudicating paragraph of the STM order states that the CCN is transferred and not that the lease was found to be appropriate. (BDD-12). Under rule 291.112(b) it is made clear that a reference to a “lease” refers to a lease of a CCN, not a lease of tangible property. The same section points out that the purpose of an STM approval is to assure that the purchaser is capable of rendering adequate and continuous service, not to approve the reasonableness of a specific line item cost that the purchaser may incur.

Because Deer Creek Inc. and Deer Creek Water are affiliated interests, the lease may not be allowed either as a capital cost or as an expense except to the extent that the regulatory authority finds the payment to be reasonable and necessary. Texas Water Code § 13.185(e). The statute provides that such a finding “must include specific statements setting forth the cost to the affiliate of each item or class of items in question and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates or divisions for the same item or items, or to unaffiliated persons or corporations.” There is no evidence that could support such a finding. Therefore the lease is not an allowable expense.

The Applicant attempts to interpose the argument that because it does not have any other person it leases to or employs that the statutory test cannot be met. This argument would undermine the entire purpose of the statute. The purpose is to require proof that dealings with affiliated interests are standard, free market, “arm’s length” transactions. Setting up sweetheart deals with affiliated interests and then not doing any similar

transactions with other entities should not be a ruse allowed to circumvent the statute's purpose. There was no evidence offered to prove that these were fair, arm's length transactions. On the contrary, the evidence suggests that these transactions were suspicious (the lease was never provided; Sam Hammett claimed to oversee the daily operations but claimed to live in Mississippi when responding to a request that he be available at trial; Sam Hammett claimed to be the person who responded to customer complaints while the phone number and address for communicating with the utility were those of its operating subcontractor, etc.). If a company is allowed to avoid the proof required by the statute for dealings with affiliated interests by only doing the transaction with the affiliate, certainly such dealings would still fail the general reasonableness test for all costs of service.

Of particular interest is the lease of equipment between the affiliated interests, which should be disallowed in its entirety. BDD-10 attached to ED-2 is a 1986 rate case order reflecting that the customers contributed \$105,559.91 to capital. (Findings of Fact numbers 24-25). It also found that Deer Creek's depreciation expense was \$3,092. (Finding of Fact number 36). The order also found that Deer Creek's total invested capital (after the deduction of customer contributions) was \$21,872. (Finding of Fact number 13). Because the utility was allowed annual depreciation of \$3,092 and had total invested capital of \$21,872, the entire remaining invested capital in existence in 1986 would have been recovered in a little over 7 years. Therefore, by 1994, the assets in place before 1986 would have been fully depreciated. The invested capital would have been covered by the prior customer contributions to capital primarily, with the remainder covered by the annual depreciation, which it recovered through rates. The Applicant maintains that the facilities referenced in the 1986 order are the same as those which it is now leasing from Deer Creek Inc. (Applicant's closing argument, Page 23 final paragraph). Regardless of the twists and turns of ownership and shared books, the bottom line is that the customers already paid for these facilities and to make them pay for leasing the same items is inequitable. Furthermore, in addition to paying for the lease of these assets, the Applicant wants to include the assets in the rate base and have the customers pay for these same assets again. (Prefiled testimony of Donald Rauschuber,

Exhibit A-20, P 29 L 28 – P 30 L 12.) The Applicant then estimated what those facilities cost, and then added them on to the invested capital. (TR P 213 L 1 – P 214 L 1).

The Applicant's approach of taking assets that were already completely depreciated out and then estimate their value and then put them back into the invested capital is untenable. The problem is then exacerbated when the Applicant also wants to charge the customers for a lease from an affiliated interest for these same assets. This is worse than double dipping. It is triple dipping.

The argument that the approval of the STM was an approval of the lease is untenable. Approval of an STM is not approval of specific line cost items in general ledger. The referral to a lease in section 291.109(d) needs to be analyzed in the context of that entire rule. The rule is not intended to require or govern an investigation of the reasonableness of specific cost items, but an investigation into whether "the person purchasing or acquiring the water system can demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service." 30 TAC § 291.109(b). Additionally, the context of the rule also reveals that the reference to a lease concerns lease of a CCN, not a lease of personal or real property. Rule 291.109 lays out the process for how an STM is reported and initiated. Rule 291.112 concerns the actual transfer after the STM investigation is completed. Subsection b of rule 291.112 recites the following: "Sale, assignment, or lease of certificate of convenience and necessity....[A] utility...may not sell, assign, or lease a certificate of convenience and necessity...unless the Commission finds that the purchaser, assignee, or lessee is capable of rendering adequate and continuous service...."

The 10% upward adjustment of costs is not a known and measureable adjustment.

The Applicant makes several confusing arguments when it attempted to increase everything from postage to the taxes it must pay based on the idea that 3% seemed like what inflation was and that in the test year it obtained an increase of 8.7% in customers.

The first and most glaring mistake made by the Applicant is its insistence that "The ALJ's claim that the Commission sets rates on the historical test year is utterly

false.”⁵ Ironically, what is utterly false is the idea that rates are not based on a historical test year. There is hardly a more established fact in rate review. The entire application form is based on reporting test year data. The Applicant filed its application using test year data and argued its case based on that test year data. If further proof be necessary, Rule 291.31(b) provides that in “computing the utility’s allowable expenses, only the utility’s historical test year expenses as adjusted for known and measurable changes may be considered.” So the claim that rates are based on an historical test year is not “utterly false.” On the contrary, it is the ONLY thing that can be considered, with an exception for known and measureable adjustments.

The instructions for making known and measurable adjustments require more support than what was provided. (ED 3). Specifically, page 2 of 27 in the first part of ED-3 (the instructions) states the following when discussing known and measureable entries to the application: “You cannot include the increase if you simply think that something is going to increase.” Additionally, and making the requirement even clearer, the following language is found on page 15 of 41 in the second part of ED-3 (the application): “Changes in cost must be known and measureable and supported by invoices or other documentation.” In order to justify the 10% “known and measureable” increase in costs, the Applicant refers to a predicted increase in customers of 8.7%. While the evidence supporting this is insufficient⁶, even if it is taken as true, it should not have any impact on increasing the rates because an increase in the number of customers will not leave the utility short on either the base rate or the gallonage rate.

The utility’s fixed costs are collected through the base rate and an increase in the number of customers will yield more than enough money to cover the fixed costs. The annual fixed costs are divided by the number of connections. If there are more connections than those reflected in the application, the utility will over-collect the base rate. The current number of customers paying the base rate will cover the entire fixed costs of the utility. Therefore, funds received from any new customers paying the base

⁵ Page 10 of the Applicant’s exceptions to the PFD

⁶ The Applicant bases its 8.7% projection on the observation that “Mr. Rauschuber expected an increase in the number of customers by 8.7% in the adjusted test year, as evidence of the historic increase in customers annually.” Applicant’s reply brief p. 7 first paragraph, line 1 and 2. There was no indication that the trend was unending. One year’s increase does not mean that every year the same increase will be expected.

rate will be a windfall to the utility. If the 8.7% increase is taken to be true, then the effect on known and measureable adjustments should be to DECREASE the base rate by 8.7%.

The utility's variable costs are collected through the gallonage rate. The variable costs are divided by the number of gallons billed. Theoretically, each gallon billed covers the variable costs associated with that gallon. Therefore, pumping more gallons of water to customers should have no effect on recovering the costs associated with providing those additional gallons. Because the variable costs are divided by the gallons billed, the variable costs will always be covered regardless of the number of gallons pumped. The variable costs will go up as the gallons used increases, but so will the revenues for the gallons sold.

Therefore, if any credence is to be given to the "guesstimate" of the 10% known and measureable adjustment, 8.7% of that guess should not be considered unless it is used to decrease the base rate.

Finally, the engineer's guess that inflation is 3% is too speculative to justify any consideration. Here the ED agrees with the Applicant's argument that "soothsayers" can't divine an inflation rate. Perhaps an economics expert could, but none was offered.

The Applicant also misplaces reliance on the AWWA manual reference to a projected test year. Protestant's expert Bret Fenner testified that the AWWA manual is a nationwide publication and is meant to be helpful to regulating authorities and utilities in the entire country. He further testified that many other states use a projected test year while Texas uses an historical test year. He also testified that the AWWA manual excerpt used by the Applicant referred to a situation where a projected test year was used.

The Applicant also attempts to argue that projected test years are routinely used by the Commission because such was the practice in the Chisholm Trial Special Utility District (SUD) case, but that case is completely inapplicable to this case. The rule that requires all costs of service to be analyzed based on the historic test year is found in that part of the rules dealing with the Commission's original jurisdiction over "utilities." Chisholm Trail SUD is a retail public utility, but not a utility.⁷ The Commission's jurisdiction over SUDs is purely appellate and the rule requiring an historical test year

⁷ The definition of utility found in Rule 291.3(50) and (51) excludes SUDs.

only applies to the Commission's original jurisdiction. Therefore any reference to the Chisholm Trail SUD case is inapplicable.

Salaries and Wages

The evidence regarding who provided what services for the Applicant was vague and overlapping. No employee or principal of the utility offered any testimony. While the ED originally argued in closing arguments that a certain salary level was appropriate, upon review of the PFD, the ED concurs with the ALJ's analysis.

There are many factors that made discerning the appropriate salary level problematic. The first is that the alleged employees were loosely moved back and forth on the books between Deer Creek Water (the Applicant and current CCN holder) and Deer Creek Ranch, Inc. (the prior CCN holder and the land development company that owns the facilities "leased" to Deer Creek Ranch Water). The second factor is that PGMS⁸, Walter Stewart⁹ and the Jeanne Cutrer¹⁰ duplicate much of what the Applicant alleges the employees of the company do.

The tax records and the blurred line between Deer Creek Inc. (the owner of the facilities used by Deer Creek Water and maintained by Deer Creek Water's employees) and Deer Creek Water (the CCN owner and the Applicant)

The blurring of the line between Deer Creek Water and Deer Creek, Inc., does not inure to the benefit of the Applicant. Because the evidence is hazy, the ED could only make its best estimate of what amount of salaries are reasonable and necessary to support the financial integrity of the utility. Generally, confusion and lack of clarity indicate that

⁸ A firm retained by Deer Creek Water presumably to provide "backup" for administrative services, billing, and plant operations.

⁹ An accounting firm hired to take care of major financial operations such as tax filing and the preparation of financial statements for Deer Creek Water, Deer Creek Inc., and Sam Hammett.

¹⁰ Contract Labor hired by the Applicant to do light administrative duties, billing, and answering the phones.

the burden of proof has not been met, and the burden of proof in this case is on the utility.¹¹ 30 TAC § 291.12 and 30 TAC § 291.25(b).

The Applicant's representation that the ED's witness admitted that the Applicant paid \$49,200 in salaries during the test year is incomplete. There is no confusion between the test year and the calendar year. In the test year the Applicant did pay \$49,200, but this represented a 110% increase from what it paid in salaries for the calendar year immediately preceding the test year. A utility should not be allowed to inflate expenses during the test year that are inconsistent with the historical reality of its expenses. The ED's witness indicated that the documents filed with the IRS reveal that in the third and fourth quarters of 2007, Deer Creek Water paid \$24,600 (\$12,300 in each quarter)(TR P 202-203) The record also reveals that the total wages paid by Deer Creek Water for all of calendar year 2007 were \$24,600. (ED 6). In calendar year 2008 total wages paid were \$51,250. The ED's witness, Elsie Pascua, testified that in her "30 years of experience in auditing, budgeting, and accounting, etc. [she had] not seen such a large increase in salaries in the utility business. The salary increase of 110% [sic] can not be supported by the increase in the number of connections and does not appear to be reasonably based on the increase in job responsibilities." (ED-1, P 9, L 17-21).

The Applicant's attempts to justify the higher salary level are unpersuasive and actually reveal that the salaried employees may be working for Deer Creek Inc. instead of Deer Creek Water. The Applicant's witness, Walter Stewart, first implied that Sam Hammett was the only employee of Deer Creek Inc. (TR P 111, L 1-10). Later, on rebuttal, the same witness relented and stated that the reason why Deer Creek Water did not report any wages paid in the 1st and 2nd quarter of 2007 was that "from January 1 to June 30 '07, all salaries for the water company and the ranch were paid under the ID number of Ranch, Inc., not Water Company, LLC." (TR P 532, L 22-25). This occurred despite the fact that the transfer of the CCN was completed in July 2005. (BDD-12, attached to ED 2).

¹¹ One who seeks to recover against another must introduce competent evidence, whether direct or circumstantial, which tends reasonably to establish his cause of action, and from which the material issues upon which he relies for recovery can be reasonably inferred, and he cannot cast his adversary on evidence amounting to no more than conjecture, surmise or suspicion, merely because his case is difficult to prove. *Kenyon v. Bender*, 174 S.W.2d 110 (Tex.Civ.App. -- Beaumont,1943) writ ref'd.

The Applicant also attempted to avoid having any portion of the salaries of Sam Hammett and Chris Aaron allocated to Deer Creek Ranch by claiming that Deer Creek Ranch was dormant. However, Deer Creek Ranch pledged its stock and land to secure a loan for Deer Creek Water in March 2008 (Exhibit A-33). Deer Creek Ranch also maintains an office (interestingly, the Applicant split the rental amount and the truck expense but not the salaries or other items that could be commonly used). Mr. Stewart testified that both entities were active during the test year (TR P 534, L 15-20). Additionally, three of the lots pledged as security by Deer Creek Inc. for the loan to Deer Creek Water in March 2008, were no longer owned by Deer Creek at the time of trial (TR P 440, L 3-7). These all indicate that Deer Creek Inc. is still in business, renting office space, and selling lots.

Mr. Stewart testified that Deer Creek Inc. has only one employee, Sam Hammett. Therefore, the Applicant argued, Deer Creek Inc. is not paying Chris Aaron. However, much of Chris Aaron's work actually benefits Deer Creek Inc. Deer Creek still owns all the facilities and leases them to Deer Creek Inc. Chris Aaron's services involve maintaining those facilities. He installs taps, fixes leaks, does weld repairs, does tap cuts, and maintains the fencing and the property. Maintaining those facilities is a benefit to the owner of those facilities, and that owner is Deer Creek Inc. The Applicant's witness split the truck expense 50/50 because it is used by and for Deer Creek Inc. at times. If 50% of the truck expense is attributable to Deer Creek Inc., the time spent by Chris Aaron driving the truck to maintain facilities owned by Deer Creek Inc. should also be attributed to Deer Creek Inc.

Upon reviewing the PFD, the ED agrees that the Applicant failed in meeting its burden of proof, and agrees with the ALJ's recommendation on salaries. This is especially true when considering the duplication of services from PGMS. The PGMS contract was never provided to the parties or the court. When the ED went to review the records that were made available in response to a request for production, no copy of the contract was found. Because the contract is under the control and custody of the Applicant, who has the burden of proof, any uncertainty about the contents of the contract

should be resolved against the Applicant.¹² The testimony regarding what PGMS does for the Applicant was scanty. The most detailed testimony came from Don Rauschuber, who stated that PGMS “provides billing services for Deer Creek Ranch Water, LLC. They provide backup water sampling and testing and backup repair services for Chris Aaron.” (TR P 191 L 2-6). The invoices from PGMS reveal more detail of the services provided. (Schedule B attached to A-4). The invoices include the following descriptions of items billed: office administration, billing supplies, postage, BACT sampling¹³, customer service inspections, retrieving and delivering boil water notices, meeting with the TCEQ and Chris Aaron for limited site survey and to perform spot checks, late notices, mailing out newsletter with monthly invoices, respond and assist with leaks, service truck, parts, gathering monitoring data for the TCEQ, planning and attending TCEQ inspection, transferring pictures to the TCEQ, responding to inspection inquiry, drafting demand letters to the post office for reimbursement, meeting with TCEQ at plant to review provisions of court injunction, sending rate notices to customers, gathering TDH samples, sending notice to all customers of improvements to the water system, and more.

PGMS services duplicate what Sam Hammett and Chris Aaron are getting paid for.¹⁴ In fact, the Applicant’s witness even stated that a system could be run entirely by independent contractors and that Deer Creek Water could be entirely operated by contract labor. (TR P 198 L 3-21). The Applicant alleged that Sam Hammett “heads up” daily operations in terms of customer relations and operating the business. (TR P 201 L 10-20). He allegedly answers calls, pays bills, and keeps accounts. PGMS appears to handle many of the operations issues and customer relations issues.¹⁵ The accounts are supposedly handled by Jeanne Cutrer (TR P 204 L 17 – P 205 L 4) and Walter Stewart (TR P 99 L 13-24). Additionally, if Mr. Hammett is in charge of answering phone calls, his duty would be quite light. Deer Creek Water’s phone number and address don’t

¹² “Where evidence is peculiarly within knowledge or control of a party, its failure to produce it raises presumption that, if offered, evidence would have been unfavorable to it.”
Edwards v. Shell Oil Co., 611 S.W.2d 904 (Tex.Civ.App.—Eastland 1981) writ ref’d n.r.e.

¹³ For nearly every month, therefore, its services for sampling are more than “back up”.

¹⁴ PGMS also duplicates the service of Jeanne Cutrer, as will be shown later.

¹⁵ The invoices from PGMS indicate that they worked with Chris Aaron on occasion, but Sam Hammett’s name does not appear on any of the invoices.

appear on the customer's bills. The phone number and address on the bills belong to PGMS. (TR P 207 L13- P210 L 5 and ED 4).

The evidence on who performs what services for the Applicant as employees or independent contractors is vague and overlapping. The Applicant has the burden of proving that the costs are reasonable and necessary. (30 TAC sections 291.12, 291.25(b), and 291.31) The Applicant has not met this burden but instead has muddied the water with factors such as reporting employees' salaries on another entity's books. Creating a confusing, nearly opaque record may be a good strategy for a party resisting an application, but it works to the detriment of the party with the burden of proof.

The Water Boy Purchases

The ED recommends and the PFD concurred that the Water Boy charges¹⁶ be taken out of the rate calculations. Alternatively, if it were to be included, it should not be deducted from the customer surcharge contributions because those amounts should be applied to invested capital instead. The only appropriate method to recover this expenditure would be to include it as a surcharge because it is not a recurring expense.

The Water Boy purchases should not be included in the rate calculations.

Deer Creek Water should not be allowed to charge its customers for its mismanagement in the name of protecting its financial integrity. Rule 291.31(b) states that "only those expenses that are reasonable and necessary to provide service to ratepayers should be included in allowable expenses." The Applicant confuses the issue by arguing that exclusion of this cost works as a penalty against the utility and this rate case is not an enforcement action. Deer Creek Water's analysis is backward. Disallowing this unreasonable expense is not done to penalize the utility, but to avoid penalizing the customers with an expense incurred only because the utility was mismanaged.

¹⁶ These are purchases of bottled water that became necessary because the system could not provide water.

Deer Creek has been the subject of enforcement actions because of an inadequate system to serve its customers. It had agreed to an injunction prohibiting it from having more than 115 connections. (ED 2, P 7 L 1-4, BDD-8). During the test year (the third and fourth quarter of 2007 and the first and second quarters of 2008) it had 300 connections. (ED 2 P 7 L 6-9).

Deer Creek also entered an agreement in February 2005 in which it was allowed to collect a surcharge of \$12 per month per customer in order to assist it in making improvements to the system and have an adequate water supply. (BDD 5 attached to ED 2). Instead of totally focusing its efforts on making improvements, Deer Creek Inc. pursued a sales, transfer, merger to get a new company Deer Creek Water, to hold the CCN and to which it would lease its facilities, which led to the corporate/business entity shell game that made this case particularly difficult to unravel. Therefore, the continued mismanagement of the utility may well have been the cause of the need to haul water in. The customers should not be penalized by having to finance the expensive result of the utility's mismanagement.

If the Waterboy purchases are to be included in the rate calculations, they should be recovered as a surcharge instead of deducted from the customers' contributions to capital.

The ED agrees with the ALJ's recommendation on this cost item, but needs to add more analysis in order to refute some representations made in the Applicant's exceptions in the event the Commission allows inclusion of this cost. The Applicant argues that the bottled water expenses should be paid for with funds that the customers provided to pay for capital improvements. Two concepts underlie the idea that in no event should the amount paid to purchase bottled water be deducted from the earlier customer surcharge: (1) the surcharge was intended to finance improvements in the system necessary to obtain a reliable source of water from the LCRA; and (2) Assets purchased with customer contributions are not to be included in annual depreciation or in invested capital.

The surcharge rate case was settled in 2005 when the customers agreed to pay a surcharge in order to get Deer Creek to get a reliable source of water from LCRA. While the Applicant represented that the “actual mediated settlement” was its A-38, this representation is incorrect. A-38 did not include the signed “case settlement record,” which is found in the true complete settlement attached to ED 2 as BDD-5. The next to the last page of this exhibit includes a handwritten provision stating that the surcharge was “to pay for improvements to the system.” Additionally, even the truncated A-38 includes the following provisions: “The utility will give priority to expenditures for acquisition of LCRA treated surface water,” and “the utility will consider the construction of an additional well only after all reasonable attempts to obtain LCRA treated surface water have been exhausted.” (TR P 558 L 1-10). The Applicant attempted at the end of the hearing to lay a predicate for the argument that the purchased water that was hauled in was bottled with LCRA water and therefore in compliance with the agreement. (TR P 678 L 4-22). This inference is so obviously against the spirit of the agreement that responding to it is unnecessary.¹⁷

Because customer contributions to capital are not to be included in annual depreciation or in invested capital, the Waterboy purchases should not be deducted from the escrowed funds. Depreciation expense is not allowed if the assets were “funded by customer contributions in aid of construction.” 30 TAC 291.31(b)(1)(B). Additionally, “utility property funded by ... customer contributions in aid of construction such as surcharges may not be included in original cost or in invested capital. 390 TAC 291.31(b)(2)(A)(iv). If the customer contributions are used to pay for hauled water (which is consumed and gone – definitely not an improvement to the water system), then the customer contributions are never used to decrease the depreciation expense or invested capital. Instead, the utility has the benefit of using the customers money to pay for the results of its poor management, and the utility still gets the full depreciation expense as well as a return on its outlays for hooking up to LCRA.

¹⁷ Even the Applicant’s witness felt compelled in all candor to respond to this line of questioning with “I don’t know.”

The Applicant's argument that allowing recovery of the expense through a surcharge¹⁸ is "trading one surcharge for another" is specious. Allowing the escrowed funds to be applied as customer contributions to capital gives the customers the future benefit of lower depreciation expense and lower invested capital – a benefit they would not receive if the prior surcharge collections are applied to a non recurring cost.

While, the ED agrees with the PFD that the Waterboy expenses be disallowed as an unreasonable expense resulting from mismanagement, if the Applicant convinces the Commission that it is an allowable expense, customer contributions for capital improvements should not be raided to pay for an expense item.

Judicial Admission rather than Judicial Notice

The Applicant argues that the ALJ erred in taking judicial notice that Mr. Hammett lived in Mississippi as one of the factors in determining that his salary should be disallowed.¹⁹ Without going into whether this was an appropriate fact for judicial notice, it should be noted that it was an appropriate fact to be considered "judicially admitted."

The statement made by the Applicant's attorney constituted a judicial admission. When an attorney makes a statement of fact at a tribunal, the statement can be trusted as true and constitutes a judicial admission. At the pretrial hearing there was discussion as to whether Mr. Hammett could be available for trial because he did not prefile testimony. The attorney for the Applicant stated that it would be difficult because Mr. Hammett resided in Mississippi.²⁰ Statements such as these are judicial admissions. The Houston First District Court of Appeals offers the following example:

¹⁸ The ED's primary position is that the expense not be allowed at all

¹⁹ Before going further, it should be noted that this was not the sole basis for disallowing the salary, but just an additional factor of support.

²⁰ The ALJ's memory of the statement is different than the Applicant's. The ED has been unable to discover if the pretrial hearing was taped and therefore cannot confirm which memory is more accurate. Based upon recall, the ALJ's description is more accurate. However, a judicial admission is unnecessary to reveal that Mr. Hammett's employment with the utility was shown to be redundant by the fact that he was represented to be a person who would respond to complaints when the bills did not list his address or phone number, but instead those of a management company, PGMS.

Moreover, appellant's attorney admitted the agency of Taylor to the court in one of his arguments to let in certain excluded testimony:

MR. McCARTY: ... On the first ground, by his last testimony he has testified that there was a connection between Mr. Joe Taylor and B.W.B. Controls. And in fact, B.W.B. Controls, Mr. Bergison [sic] president of the company, had instructed him to talk to Mr. Taylor, thereby making Mr. Taylor an agent for the purpose of discussing these particular areas of the connection between the products.

McCarty's statement was deliberate, clear and unequivocal, and would appear to be a judicial admission, binding appellant to the position stated. Texas Processed Plastics, Inc. v. Gray Enterprises, Inc., 592 S.W.2d 412 (Tex.Civ.App.-Tyler 1979, no writ); National Savings Insurance Co. v. Gaskins, 572 S.W.2d 573 (Tex.Civ.App.-Fort Worth 1978, no writ).

Carroll Instrument Co., Inc. v. B.W.B. Controls, Inc., 677 S.W.2d 654. 659 (Tex.App.—Houston [1 Dist] 1984, no writ).²¹

The judicial admission is unnecessary to support the ALJ's finding because there was other evidence indicating that Mr. Hammett's services were not reasonably necessary to operate the utility, however, it must be kept in mind that it is not the burden of those opposing the rate increase to show that a cost is just and reasonable, and the evidence supporting such a claim offered by the Applicant's hired witnesses was weak and limited, and mainly comprised of opinions without support. The ALJ attached the proper weight to that evidence, considered the evidence that these duties were duplicated by PGMS, and the admission that Mr. Hammett did not even reside in Texas, and found that his salary was not a reasonable or necessary expense of the utility. No witness with personal knowledge of what Mr. Hammett did in operating the business testified.²² Mr. Hammett did show up for the trial, but never took the stand and filed no prefiled testimony.

²¹ The statement made in that case was not under oath. *In the interest of MN.* 262 S.W. 3d 799 (Tex. 2008) (the case referred to by the Applicant as showing such statements must be made under oath) is inapplicable. In that case an appellant attempted to explain a late filing to the Court of appeals by claiming that her counsel mis-calendared the time for post-trial filings. The Court held that these sort of statements usually must be made under oath if they are to be used as evidence in such a situation, but that such a rule would not block consideration of the statement in that case. The situation in this case is different.

²² The witnesses were only familiar with the Applicant's books and equipment. They were not involved in day-to-day operations.

Therefore, the witness with the best knowledge of what he did for the company never offered any testimony. The lack of adequate proof of the necessity of this expense is the Applicant's own responsibility.

Purchased Water – Reservation Fee

In a prior rate case the utility placed a pass through clause in its contract to cover the costs of the LCRA contract. The case was settled and the pass through clause was inserted into the utility's tariff. In the present case, the utility proposed to put the proceeds of the pass through into the application as "other revenues" and to include the amounts paid to LCRA as an allowable expense in order to capture parts of the payments to the LCRA that were not recovered in the pass through.

The Applicant contends that the pass through clause omitted the water rights reservation fee that is based on the difference between the amount of water actually purchased during the previous calendar year and the amount of water reserved for the contract. (TR P 589 L 21- P 590 L3 and P 658 L 17 – P 659 L 4). The Applicant estimated the amount that it would purchase based on actual usage that did not begin until February or March of 2008. (TR P 660 LN 14 – P662 L 22). The test year ended in June of 2008. Schedule AA attached to A-4 (page 32 of 35) shows the estimate is based on actual usage from February through June of the test year. These are typically low water usage months.

The Applicant's approach is unsound. To begin with, it is too speculative. Known and measureable adjustments must be fairly certain. Additionally, the Applicant argues that more and more customers are expected when trying to justify having two 100,000 gallon storage tanks to serve 357 customers. Furthermore, the estimate is based on low usage months. If this speculation is allowed, the utility will continue to collect this amount even when usage increases, which can be expected because the estimate months were low water usage months and, if the Applicant's argument is true that it needs more storage because it anticipates more connections in the future.

The most appropriate way for the utility to recover a portion of the pass through that was not included in the settlement is to make application to change the pass through formula. That would most accurately reflect the cost rather than a speculative guess. The utility had the opportunity to work this into the pass through rate settlement, but did not.

The Rate of Return

The argument proffered by the Applicant that the Commission has established a default rate of return is unsustainable. The Applicant had maintained that a vague reference to a 10 to 15 percent rate of return and averaging that at 12.5% is “the long standing Commission-approved methodology.”²³ When replying to exceptions, the Applicant fell back to the position that the Commission lets everyone get 12%, so it should get that, too. The Applicant further argues that the ED’s method of calculating the rate of return somehow changes past Commission practice. There is no basis for this assertion whatsoever. Section 13.184 of the Texas Water Code and Rule 291.31(c) spell out what is to be considered in setting the rate of return. The Applicant did not address any of the considerations set out in this statute and in this rule promulgated by the Commission. Additionally, the use of the rate of return worksheet does reflect these considerations. Finally, the rate of return worksheet is part of the application package – hardly an unexpected and unprecedented item as implied by the Applicant.

The rate of return worksheet covers all of the factors in the statute and rule regarding the rate of return. The Commission in several recent cases has made it clear that there is no default rate of return and has recognized the usefulness of the rate of return worksheet. Contrary to the assertion in Applicant’s exceptions, the rate of return worksheet is not a “complicated calculation.” It only requires a person to be able to find the Baa Public Utility Bond average (or call the TCEQ to get the number which is suggested and listed on the form) and then to add up to 9 points to that figure if the listed conditions are met. There is no indication that there were “multiple mathematical mistakes” by Ms. Pascua as simply asserted with no record citation by the Applicant and

²³ Applicant’s Closing Argument

inserted for the purpose of persuasion in the Applicant's exceptions.²⁴ There also is no indication that the Baa utility bond average rate was the wrong starting point as implied by the Applicant's exceptions. It is the starting point listed on the form which was included in the application, but ignored by the Applicant, who preferred to claim that the Commission always gives 12% without considering a single factor required to be accounted for in the statutes and rules under which the Commission determines the appropriate rate of return.

While the ED had proposed a different rate of return in closing arguments than that included in the PFD, the ED was convinced by the reasoning of the PFD that the rate of return recommended therein is the appropriate rate because of the unusual situation of this utility.

Adjustments to the Invested Capital

The ED supports the PFD's adjustments to invested capital, but will highlight the most central issue.

Disallowance of 88% of the Excess Storage Capacity Represented by the New 100,000 Gallon Storage Tank

The original purpose of the new storage tank was to create an air gap, because the old storage tank was inappropriate to use to meet this requirement of the LCRA contract. Mr. Wheeler characterized it as "the primary function of the new tank." (TR P 26 L20 - P 27 L 4) The old 100,000 gallon tank did not have an air gap. (p.27 L 12-14).²⁵ If the primary function was to provide an air gap, that could have been done without purchasing a 100,000 gallon tank.

The first analysis of whether 200,000 gallons of storage is excessive shows that it is excessive. First, the letter from Wheeler's firm states that the system was designed to serve 666 connections even though at the time it only had 300 connections. (p.304 L1-

²⁴ There is no indication in the record that a single mathematical mistake was made in Ms. Pascua's calculations, much less "multiple mistakes."

²⁵ Concern has been raised by the protestants that the excess storage capacity is to serve new customers who buy lots from Mr. Hammett's other companies. Mr. Fenner testified that the fairest way to handle such expansion is by collecting developer contributions. (p.305 L-25 – p. 306 L 23) Because the developer is affiliated with the utility, the situation is worthy of consideration.

p.305 L25) Rule 290.45(b)(2)(E) requires a total storage capacity of 200 gallons per connections. That would mean that 200,000 gallons of storage could serve 1,000 customers. The estimate of the number of customers currently on the Deer Creek Water System varied from 357 (p. 438 L 17-20) to 404 (p. 354 L 6-9). Even with 404 customers, the total storage required would only be 80,800.

The Applicant attempted to extend on the argument by asserting that the LCRA contract required design criteria of 1.3 gallons per minute per connection to account for a peaking factor. Furthermore, Applicant argues that the contract allows only 400 gallons per minute to be supplied “max day,” and that storage capacity was necessary to make up the shortage (p. 581 L 23 – p. 586 L 2). While the questioning was posed in the form of a hypothetical posited in the record during trial on the merits, and difficult to follow, even if it is assumed to be true, it does not justify the excess storage. To begin with, the basic rule is that the gallon per minute requirement found in 290.45(j)(2) is .6 gallons per minute. Using the same mathematical calculation utilized by the Applicant, and assuming the 402 connections used in the Applicant’s hypothetical, with the 0.6 number, the gallons per minute would be 241.2, which is much lower than the 400 gallons per minute allowed under the contract. Additionally, if the number of connections is actually 357, as Mr. Fenner testified, the number of gallons per minute at 1.3 per connection would be 464.1, which is 64.1 short of the 400 number. Using the same formula as the Applicant, that would equate to 92,304 gallons, yet the system wants the customers to pay for 200,000 gallons of storage.

The ED submits that the Applicant’s attempt to justify the excessive storage is not adequately explained. And even if the logic is accepted, the storage is still excessive.

Finally, the crux of the Applicant’s argument, that the excess capacity is needed to provide more water, is still not persuasive. The Applicant indicated that its well is meant to be an emergency supply source (p. 581 L 4-5) and did not factor in whether that could make up any shortage.

Other issues

The number of issues and the scattering of confusing arguments in the Applicant's exceptions makes responding to each and every one of them more confusing than helpful. The ED has focused on the key issues in the case, but is adding this section to address additional issues. Should the Commission desire further briefing on any issue omitted from this reply, the ED will provide such briefing. In any event, the ED will be prepared at Agenda to address any questions not addressed in this reply. Below, issues that did not fit neatly under any one headline are discussed.

A claim similar to the Applicant's assertion that the utility needs to recover enough to service its loans was rejected in an Austin Court of Appeals case. In *Texas Water Commission v. Lakeshore Utility Company*, 877 S.W.2d 814 (Tex. App. – Austin 1994, writ denied) the Austin Court of Appeals dealt with a similar situation in which a utility claimed that it had to recover enough money to pay for loans it obtained to keep the system operational. The court focused its rejection of the utility's position on the failure of the utility to carry its burden of proof. The conflict in that case centered on the utility's assertion that the Water Code required that rates be adequate to protect the financial integrity of the utility and the Commission's assertion that the utility had the burden of proof to show that the proposed rate was just and reasonable. *Id.* 877 S.W.2d at 817-818. The court held that the utility "failed to carry this burden; [the utility] did not demonstrate how the loan proceeds were contributed to the systems that provided services to [the customers]. [The utility] merely presented testimony that the loan proceeds were used to cover shortfalls in the utilities' operating revenues. Without knowing how the loan proceeds were spent, the Commission could not properly determine that the loan payments were reasonable and necessary for [the utility's] provision of services to these customers." *Id.*, 877 S.W.2d at 819. In the present case there is a similar lack of proof of where the loan proceeds were invested in the utility.

Insurance expense. The PFD disallows health insurance for Sam Hammett's family members who do not work for the utility. The Applicant argues that "there is no Commission rule or provision in the Water Code that declares family-member insurance

not to be a reasonable and necessary expense.”²⁶ This argument is of no weight. The rules only list a few examples of expenses that are not allowable. The list is not meant to be all inclusive. The rules also do not provide that insurance for pets of employees is unreasonable, but certainly that would not be considered a reasonable expense because it was not enumerated as a disallowed cost. The Applicant continues to inaccurately maintain that there was no evidence to show that Sam Hammett’s wife’s insurance would also be paid for by the customers of the utility under the Applicant’s request for a rate increase. The Applicant misstates the record when arguing Ms. Pascua provided no basis for decreasing the insurance expense because Sam Hammett’s wife was included in the policy. Ms. Pascua testified that the policy she reviewed showed Ms. Hammett on it. (TR P 500 L 15-18). The Applicant objected to the testimony, but the objection was overruled.

Attorney’s Fees for the past rate case. The Applicant argues on page 34 of its exceptions that when it applied for a tariff change to include a pass through provision for the LCRA purchase water contract, it had no opportunity to recover its rate case expenses and therefore it must be allowed to recover those rate case expenses in this case. This position has no basis in law. The Applicant argues that the pass through was applied for under section 13.136 of the Texas Water Code²⁷ and that it was not brought under section 13.187 and therefore it could not get its rate case expenses because , as the Applicant writes: “A tariff change, as was the addition of a pass through provision, is not a rate change subject to section 13.187 of the Texas Water Code.” This postulation is completely contradicted by the language of the rules discussing how pass through clauses are to be administered. Rule 291.21(h)(2) provides that applications for pass through provisions “must be approved by the Commission in a rate proceeding. A proposed change in the method of calculation of the provision must be approved in a rate proceeding.” A pass through application is a rate proceeding. Under Rule 291.28(7) a utility may recover reasonable rate case expenses in a noticed rate case proceeding.

²⁶ Page 30 of the Applicant’s Exceptions to the PFD

²⁷ The reference to section 13.136 must have been a typographical error as that section deals with a subject unrelated to pass through applications.

Furthermore, the case was settled. Presumably, the settlement was achieved in part by not including any rate case expenses in the settlement.

New evidence asserted in the exceptions cannot resurrect the \$23,800 expense for fire hydrants. On page 43 of the Applicant's exceptions to the PFD, the Applicant for the first time asserts that the fire hydrants were actually intended to be flush valves. The ED's argument for disallowing this expense was that fire protection is not a requirement for providing continuous and adequate water service. In no pleading, discovery response, briefing, or, most important, evidence was this proposition offered. If it were offered, the parties would have been able to investigate the reasonableness of using fire hydrants as flush valves and the alternative pricing that could be obtained. The ED maintained that fire protection is not a requirement for a CCN holder and therefore the cost was not reasonable. Shifting the argument and providing new evidence at the exceptions to PFD stage is too late. No reasonable inquiry can be made into whether this should be an allowable cost at this point.

Refunds. The Applicant states that it should not be required to make refunds because it does not have the money to pay for them. This is consistent with its position that the entire purpose of setting rates is to protect the financial integrity of the utility. It is also as consistently ill-advised and inappropriate. Utilities are granted CCNs to provide a continuous and adequate supply of water service. They are not granted to provide a continuous and adequate flow of income to the utility. A utility's financial integrity is important in order to ensure that they have adequate funds to pay for what is necessary to provide that continuous and adequate supply of water service and to attract sufficient capital to make large improvements when necessary, but it is not a reason to abandon the fact that, in the end, it is the customers whose supply of water with a price based on the actual cost of service that is the primary focus of what water rate regulation is about. The customers should not be burdened with having to pay a rate that could not be justified simply because the utility has been mismanaged. Additionally, the utility's financial situation is not clearly disclosed in the record. It is clear that its affiliates have a very thin corporate wall with the Applicant as one pledged its assets for a loan benefiting the

utility, and the other guaranteed loans for over a million dollars with the to be used by the Applicant. Simply put, if the customers were overcharged, financial difficulty is not a defense to paying back to them what the utility was never authorized to collect. Furthermore, the statute clarifies that the refunds shall be made. Section 13.187(i) provides as follows: "Unless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate finally ordered plus interest as determined by the regulatory authority."

Conclusion and Effect on Rate Case Expenses in the Present Application

Because the PFD will not generate 51% of the increase in revenue that would have been generated by the utility's proposed rate, the utility may not recover any rate case expenses (ED-2 p. 23 L 5 – p. 24 L 6, 30 TAC § 291.28(8))

WHEREFORE, PREMISES CONSIDERED, the ED the Commission to approve the PFD and to adopt the findings of fact and conclusions of law as revised by the information provided in the ED's statement of no exceptions requested by the ALJ.

Respectfully Submitted,

TEXAS COMMISSION ON
ENVIRONMENTAL
QUALITY

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CERTIFICATE OF SERVICE

The undersigned certifies that the foregoing document was served on all parties on the attached mailing list in accordance with SOAH and TCEQ rules on August 2, 2010.

A handwritten signature in black ink, appearing to read "B. D. Marshall". The signature is written in a cursive style with a horizontal line underneath it.

Staff Attorney

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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

July 26, 2005

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RE: Deer Creek Ranch Water Company, LLC
CCN No. 11241

This letter is your notice that the Texas Commission on Environmental Quality (TCEQ) executive director has issued final approval of the above-named application.

You may file a **motion to overturn** with the chief clerk. A motion to overturn is a request for the commission to review the TCEQ executive director's approval of the application. Any motion must explain why the commission should review the TCEQ executive director's action.

A motion to overturn must be received by the chief clerk within 23 days after the date of this letter. An original and 11 copies of a motion must be filed with the chief clerk in person or by mail. The Chief Clerk's mailing address is Office of the Chief Clerk (MC 105), TCEQ, P.O. Box 13087, Austin, Texas 78711-3087. On the same day the motion is transmitted to the chief clerk, please provide copies to Stephanie Bergeron, Environmental Law Division Director (MC 173), and Blas Coy, Public Interest Counsel (MC 103), both at the same TCEQ address listed above. If a motion is not acted on by the commission within 45 days after the date of this letter, then the motion shall be deemed overruled.

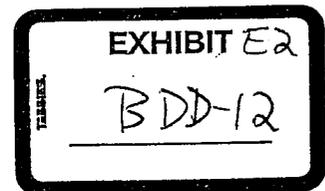
Individual members of the public may seek further information by calling the TCEQ Office of Public Assistance, toll free, at 1-800-687-4040.

Sincerely,

LaDonna Castafiuella
Chief Clerk

LDC/mm

cc: Blas Coy, TCEQ Public Interest Counsel (MC 103)



Kathleen Hartnett White, *Chairman*
R. B. "Ralph" Marquez, *Commissioner*
Larry R. Soward, *Commissioner*
Glenn Shankle, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

July 26, 2005

Mr. Randall B. Wilburn, Attorney
Clark, Thomas & Winters
Deer Creek Ranch Water Co., LLC
300 West 6th Street, Suite 1500
Austin, Texas 78701

Re: Application from Deer Creek Ranch Water Company, LLC to Lease Facilities and to Transfer Certificate of Convenience and Necessity (CCN) No. 11241 from Deer Creek Ranch, Inc. in Hays and Travis Counties; Application No. 34654-S
Order, transferring CCN No. 11241

CN: 600703797; RN: 104256375

Dear Mr. Wilburn:

Enclosed is a certified copy of an order and a copy of the Certificate of Convenience and Necessity issued by the Commission in the above referenced application.

You are now authorized to provide utility service in accordance with your approved tariff and the rules and regulations of the Commission.

If you have any questions, please contact Ms. Tuyet Truong by phone at 512/239-0605, by fax at 512/239-6190, by email at ttruong@tceq.state.tx.us, or if by correspondence, include MC 153 in the letterhead address.

Sincerely,

A handwritten signature in cursive script that reads "Earl Lott".

Earl Lott, Section Manager
Utilities & Districts Section
Water Supply Division

EL/TT/ac

Enclosures

cc: mailing list

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



APPLICATION NO. 34654-S

IN THE MATTER OF THE
APPLICATION OF DEER CREEK
RANCH WATER COMPANY, LLC TO
LEASE FACILITIES AND TO
TRANSFER CERTIFICATE OF
CONVENIENCE AND NECESSITY NO.
11241 FROM DEER CREEK RANCH,
INC. IN HAYS AND TRAVIS
COUNTIES, TEXAS

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BEFORE THE
TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

On JUL 15 2005, the Executive Director of the Texas Commission on Environmental Quality pursuant to Chapters 5 and 13 of the Texas Water Code considered the application of Deer Creek Ranch Water Company, LLC to lease facilities and to transfer Certificate of Convenience and Necessity No. 11241 from Deer Creek Ranch, Inc. in Hays and Travis Counties, Texas.

No person has requested a public hearing on the application;

Notice of the application was given to all affected and interested parties;

The criteria set forth in *Texas Water Code* Sections 13.246(c), 13.254, and 13.301 have been considered; and

The certificate transfer requested in this application is necessary for the service, accommodation, convenience, and safety of the public.

Now, therefore, be it ordered by the Texas Commission on Environmental Quality that the application is granted and Certificate of Convenience and Necessity No. 11241 be transferred in accordance with the terms and conditions set forth herein and in the certificate.

IT IS FURTHER ORDERED that Deer Creek Ranch Water Company, LLC shall serve every customer and applicant for service within the area certified under Certificate of Convenience and Necessity No. 11241 and that such service shall be continuous and adequate.

Texas Commission on Environmental Quality



**TRANSFER OF
CERTIFICATE OF CONVENIENCE AND NECESSITY**

To Provide water Service Under V.T.C.A., Water Code
and Texas Commission on Environmental Quality Substantive Rules

Certificate No. 11241

Certificate No. 11241 was transferred by Order of the Commission in
Docket No. 34654-S. Deer Creek Ranch, Inc.'s facilities and lines
were transferred to Deer Creek Ranch Water Company, LLC (CCN
No. 11241) in Hays and Travis Counties.

Please reference Certificate No. 11241 for the location of maps and other information related
to the service area transferred.

Certificate of Convenience and Necessity No. 11241 is hereby TRANSFERRED by order
of the Texas Commission on Environmental Quality.

Issued Date: **JUL 15 2005**


For the Commission

