

# State Office of Administrative Hearings



Cathleen Parsley  
Chief Administrative Law Judge  
November 17, 2010

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

Re: SOAH Docket No. 582-09-5328; TCEQ Docket No.2009-0929-UCR; In Re:  
Application of Deer Creek Ranch Water Co., LLC, to Change its Water Rates and  
Tariff Under Certificate of Convenience and Necessity No. 11241 in Travis and  
Hays 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 **December 7, 2010**. Any replies to exceptions or briefs must be filed in the same manner no later than **December 17, 2010**.

This matter has been designated **TCEQ Docket No. 2009-0929-UCR; SOAH Docket No. 582-09-5328**. 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 "William G. Newchurch".

William G. Newchurch  
Administrative Law Judge

WGN:nl  
Enclosures  
cc: Mailing List

**STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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**SERVICE LIST**

**AGENCY:** Environmental Quality, Texas Commission on (TCEQ)  
**STYLE/CASE:** DEER CREEK RANCH WATER CO LLC  
**SOAH DOCKET NUMBER:** 582-09-5328  
**REFERRING AGENCY CASE:** 2009-0929-UCR

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**STATE OFFICE OF ADMINISTRATIVE  
HEARINGS**

**ADMINISTRATIVE LAW JUDGE**  
**ALJ WILLIAM G. NEWCHURCH**

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xc: Docket Clerk, State Office of Administrative Hearings

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

<b>APPLICATION OF DEER CREEK</b>	<b>§</b>	<b>BEFORE THE STATE OFFICE</b>
<b>RANCH WATER CO., LLC, TO</b>	<b>§</b>	
<b>CHANGE ITS WATER RATES AND</b>	<b>§</b>	<b>OF</b>
<b>TARIFF UNDER CERTIFICATE OF</b>	<b>§</b>	
<b>CONVENIENCE AND NECESSITY NO.</b>	<b>§</b>	<b>ADMINISTRATIVE HEARINGS</b>
<b>11241 IN TRAVIS AND HAYS</b>	<b>§</b>	
<b>COUNTIES</b>	<b>§</b>	

**PROPOSAL FOR DECISION ON REMAND**

**I. INTRODUCTION**

On September 29, 2010, the Texas Commission on Environmental Quality (Commission or TCEQ) considered during its open meeting the Administrative Law Judge's (ALJ's) Proposal for Decision (PFD) and Proposed Order regarding the application of Deer Creek Ranch Water Co., LLC (Utility). Based on its interim decisions at that meeting, the Commission issued an interim order on October 5, 2010, remanding the case to the State Office of Administrative Hearings (SOAH) for several purposes and including directions and instructions (Interim Order).

The ALJ recommends that the Commission adopt the attached Proposed Order on Remand, which reflects the evidence in the record and the interim decisions, directions, and instructions in the Commission's Interim Order.

**II. INTERIM RATES AND ESCROW IMPLEMENTATION PROVISIONS**

On October 15, 2010, the ALJ held a telephonic prehearing conference. The following appeared:

<b>PARTY</b>	<b>REPRESENTATIVE</b>
Deer Creek Ranch Water Co., LLC (Applicant)	Randall B. Wilburn
Executive Director (ED)	Brian D. MacLeod
Office of Public Interest Counsel (OPIC)	James B. Murphy
AGX, Inc. and Anne Hawken	David M Gottfried
Jennifer Jones	self

Prior to that conference, the ED filed a motion to set interim rates equal to the rates that the Commission had approved before the Application in this case was filed. The ED also filed a motion asking the ALJ to order the Applicant to take certain actions to implement the Commission's escrow order that was contained in its Interim Order. The Applicant objected to the ED motions, but the ALJ granted both of them pursuant his authority set out in 30 TAC § 291.29.

The interim rates are the same as the rates that the Commission had approved before the Application in this case was filed. The ALJ ordered the interim rates into effect on October 15, 2010, and ordered that they were to be reflected in any rate bill sent to the Applicant's customers on or after that date. The interim rates will remain in effect until a final decision is made in this case.

Additionally, to implement the Commission's escrow order, the ALJ ordered the Applicant to:

- provide all parties with a copy of the escrow agreement for deposit of all monies collected from customers in excess of the prior rate within 10 days;
- file with the ED and the parties the monthly statement on that account by the 10th day of each month after the establishment of the escrow account; and
- act in compliance with all of the escrow requirements found in 30 TAC § 291.30.

The ALJ specified that his escrow account implementation order would apply to all proposed rate amounts that the Applicant had collected prior to the interim rates going into effect. Additionally, the escrow account would be the repository for all rates collected from customers after the Agenda date, September 29, 2010, in excess of the rates authorized before the filing of the Application in this proceeding. The escrow account must specify that no withdrawals are allowed from the account without approval of the Executive Director.

### III. HEARING ON THE MERITS OF THE REMAND

On November 5, 2010, after giving the required notice, the ALJ convened a hearing on the merits of the remand, which was attended by the following parties:

<b>PARTY</b>	<b>REPRESENTATIVE</b>
Applicant	Randall B. Wilburn
ED	Brian D. MacLeod
OPIC	James B. Murphy
AGX, Inc. and Anne Hawken	David M Gottfried

Additionally, several other protesting parties who are customers of the Applicant attended, but did not formally appear or participate. However, when the ALJ asked them, they informally indicated that the ALJ should assume that they agreed with Mr. Gottfried's arguments and agreements on behalf of his clients.

The parties that attended the remand hearing, including the Applicant, agreed that the attached Proposed Order on Remand<sup>1</sup> accurately reflects the Commission's interim decisions, instructions, and directions in the Interim Order. While it agreed that the form of the Proposed

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<sup>1</sup> ED Ex. 20. The ALJ has made very minor changes to note that an additional day of hearing was held on November 5, 2010; the dates of the original PFD and the Remand; change references from Finding of Fact No. 235 to 234 in Conclusion of Law No. 16 and Ordering Provision No. 1; and make writing style corrections.

Order on Remand was correct and in accord with the Interim Order, the Applicant noted that it was not waiving its prior exceptions to the initial PFD or its objections to and motion for rehearing on the Interim Order.

#### IV. SUMMARY

The ALJ recommends that the Commission adopt the attached Proposed Order on Remand.

**SIGNED November 17, 2010.**



**WILLIAM G. NEWCHURCH**  
**ADMINISTRATIVE LAW JUDGE**  
**STATE OFFICE OF ADMINISTRATIVE HEARINGS**

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**



**AN ORDER  
GRANTING IN PART AND DENYING IN PART THE APPLICATION OF DEER  
CREEK RANCH WATER CO., LLC TO INCREASE ITS WATER RATES UNDER  
CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11241 IN TRAVIS AND  
HAYS COUNTIES, TEXAS  
SOAH DOCKET NO. 582-09-5328  
TCEQ DOCKET NO. 2009-0929-UCR**

On \_\_\_\_\_, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Deer Creek Ranch Water Co., LLC to increase its water rates under Certificate of Convenience and Necessity No. 11241 in Travis and Hays Counties, Texas. A Proposal for Decision (PFD) was presented by William G. Newchurch, an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH), who conducted a contested case hearing concerning the application on March 22 and 23 and November 5, 2010, in Austin, Texas.

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

**I. FINDINGS OF FACT**

**Introduction**

1. Deer Creek Ranch Water Co., LLC (Applicant or Utility) has applied to increase its rates for the water service it provides under its Certificate of Convenience and Necessity (CCN) No. 11241 in Travis and Hays Counties, Texas.

2. The following are the parties in this case:

<b>PARTY</b>	<b>REPRESENTATIVE</b>
Applicant	Randall B. Wilburn
Executive Director (ED)	Brian D. MacLeod
Office of Public Interest Counsel (OPIC)	James B. Murphy
AGX, Inc.	David M. Gottfried
Anne Hawken	David M. Gottfried
Jennifer Jones	self
Cristina Chavez	self
Royce H. Henderson	self
Chris Elder	self
Jonathan McCabe	self
Bradley and Stephanie Weaver	selves

3. Except as otherwise noted, AGX, Inc.; Anne Hawken; Jennifer Jones; Cristina Chavez; Royce H. Henderson; Chris Elder; Jonathan McCabe; and Bradley and Stephanie Weaver are referred to collectively as Protestants.

4. The following are the key events in this case:

<b>DATE</b>	<b>EVENT</b>
February 27, 2009	Application filed.
February 28, 2009	Notice of rate increase mailed to customers.
May 1, 2009	Effective date of rate increase.
July 31, 2009	Notice of preliminary hearing mailed to customers.
August 13, 2009	Preliminary hearing.
September 4, 2009	Discovery began.
September 11, 2009	Parties identified applicable statutory and regulatory law.
October 2, 2009	Deadline to serve written discovery requests.
November 6, 2009	Applicant to prefile its direct case in writing, including all testimony and exhibits.
November 20, 2009	Parties other than Applicant and ED to prefile their direct cases in writing, including all testimony and exhibits.
December 23, 2009	ED files his direct case in writing, including all testimony and exhibits.
January 8, 2010	Deadline to take depositions.
January 22, 2010	Deadline to file objections to and motions to strike any prefiled evidence.
January 29, 2010	Deadline to file responses to objections and motions to strike prefiled evidence.

February 5, 2010	Mediated settlement conference. Agreement was not reached during the mediation.
February 12, 2010	Prehearing conference to set times and orders of witnesses and rule on pending objections and motions.
March 22, 2010	Hearing on the merits (HOM) of case began.
March 23, 2010	End of HOM.
April 6, 2010	Transcript delivered.
April 27, 2010	Deadline to file written closing arguments.
May 4, 2010	Deadline to file replies to closing arguments.
July 1, 2010	PFD.
October 5, 2010	Remand to SOAH
November 5, 2010	Remand Hearing

### **Affiliates**

5. Deer Creek Ranch, Inc. (Land Company) is the managing member of the Utility.
6. Sam Hammett is the General Manager of the Utility. He also is president of and owns shares in the Land Company.
7. As defined by TEX. WATER CODE ANN. (Water Code) § 13.002(2), the Land Company and Sam Hammett are affiliates of the Utility.

### **Overview of Revenue Requirement Dispute**

8. The Applicant originally claimed that its adjusted test year revenue requirement was \$498,225, but ultimately revised that downward to \$403,236.
9. As set out below, the Utility's just and reasonable revenue requirement is \$176,473.

### **Operational Expenses**

#### **Post-Test Year Inflation Adjustments**

10. The test year for this case is July 1, 2007, through June 30, 2008.

11. The Utility proposed a post-test year inflation adjustment of 10% for many expense items.
12. 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 (TAC) §291.31(a) and (b).
13. "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. Water Code § 13.002(22).
14. There is not sufficient evidence to show that the Applicant's proposed 10% adjustments for inflation are based on known and measurable changes.
15. All of the Applicant's proposed 10% inflation adjustments should be disallowed.

### **Salaries and Wages**

16. The Applicant seeks \$51,600 for salaries and wages.
17. The salary and wages amount should be reduced to \$12,915.
18. The Applicant contends that it paid \$49,200 for salaries during the test year: \$24,600 to Chris Aaron, who is the Applicant's full time licensed water operator, and \$24,600 to Sam Hammett, the Chief Operations Officer.
19. The Utility also included a 5% post-test year adjustment to give each employee a merit and cost of living increase.
20. The Utility pays an independent contractor—Professional General Management Services, Inc. (PGMS)—for water operations, office administration, customer service, preparation of annual reports, *etc.*
21. During the test year, the Applicant paid PGMS \$57,489.93 for those services, which it included as a contract labor expense.

22. During the first half of 2007, the Land Company had a tax ID number, but the Utility did not. Since the second half of 2007, the Utility has had its own tax ID number.
23. In the first half of 2007, salary amounts for Mr. Hammett and Mr. Aaron were reported under the Land Company's tax ID number.
24. W2s for 2007 show that Chris Aaron and Sam Hammett were together paid only \$24,600.
25. Mr. Aaron had his own company, Aaron Maintenance, for which he worked ten hours a week during the test year.
26. The evidence is insufficient to show that Mr. Aaron worked full time for the Utility during the test year. One-half of the test year salary claimed for Chris Aaron, \$12,300, should be disallowed.
27. The 5% post-test year adjustment for a merit raise for Mr. Aaron is known and measurable and should be allowed.
28. The evidence is insufficient to show that the salary paid to Mr. Hammett was an appropriate affiliate transaction.
29. The \$24,600 claimed for Mr. Hammett's salary should be entirely disallowed.

### **Contract Labor**

30. The Applicant seeks \$75,766 for contract labor. Of that amount, \$13,000 should be disallowed, and the remainder should be allowed as reasonable and necessary.
31. Of that contract labor amount, \$14,430 should be disallowed, and the remainder should be allowed as reasonable and necessary expenses of providing service.
32. The evidence is insufficient to show that \$2,000 paid to Aaron's Maintenance was a necessary and reasonable expense to provide water service, and it should be disallowed.

33. Jeanne Cutrer works for Cutrer Administration at the Utility's office and handles customer phone calls and billing for the Utility, but PGMS also handles those tasks.
34. The Utility's phone number and address do not appear on customer's bills. Instead, the phone number and address on the bills belong to PGMS.
35. The evidence is insufficient to show that it was necessary and reasonable to provide water service for the Utility, which had only 367 customers at the end of the test year, to have paid both PGMS and Cutrer Administration for similar and overlapping contract services.
36. The \$11,000 paid to Cutrer Administration should be disallowed.
37. Tank cleaning is not required every year.
38. A \$2,876 expense that the Utility paid for tank cleaning should be allowed as a reasonable and necessary annual expense.

#### **Water Purchased From LCRA**

39. The Utility claims \$158,732 should be included in its cost of service for water purchased from the Lower Colorado River Authority (LCRA). This entire amount should be disallowed.
40. During the test year, the Utility spent \$98,206.40 to purchase water from LCRA. All of that purchase was for water consumed from February 2008 through June 2008.
41. The \$158,732 sought by the Utility is based on post-test year adjustments projecting that water consumption from February 2008 through June 2008 would continue for a full year and that water costs would increase by 10% due to inflation.
42. The evidence is insufficient to show that these post-test year adjustments are based on known and measurable changes.

43. Pursuant to a settlement agreement in a prior case in February 2005, the Utility's customers are already paying a pass through charge for water the Utility purchases from LCRA.
44. There is no reason to include a component in cost of service and higher base rates based on estimated costs of purchasing LCRA water when the Applicant is already authorized to directly pass through and recover the exact costs and can seek to amend the surcharge calculation method if it is deficient.

#### **Water Testing / Chemicals**

45. The Applicant seeks \$5,131 for water testing and chemicals. This was a necessary and reasonable expense of providing water service.

#### **Utilities (Electrical)**

46. The Applicant claims an expense of \$8,693 for electric utility service. This was a necessary and reasonable expense to provide water service.

#### **Repair and Maintenance**

47. The Applicant seeks to include \$4,519 for repair and maintenance.
48. Of that claimed repair and maintenance expense, \$411 should be disallowed, and the remainder should be allowed.
49. During the test year, the Applicant incurred \$4,108 in repair and maintenance expenses, and the claimed amount includes a 10% post-test year inflation adjustment of \$411.
50. The evidence is insufficient to show that the inflation adjustment is based on a known and measurable change.

## **Materials and Supplies**

51. The Utility seeks \$13,147 for materials and supplies. This was a necessary and reasonable expense to provide water service.

## **Office Expense**

52. The Applicant claims \$4,066 for office expenses. This entire amount should be disallowed.
53. The expense is for office space in a building owned by Ward Energy.
54. Space for both the Utility and the Land Company are included in the same lease, though each has a physically distinct office. The square footage is nearly the same: 175 square feet for the Land Company and 170 square feet for the Utility. The Applicant split the lease expense equally between the Land Company and the Utility.
55. The Utility also owns a service building where the office could be moved, and the office expense could be eliminated.
56. PGMS, which already provides many contract management services for the Utility, could run the entire operation, which would mean no office space was needed.
57. Utility office space is not needed for Jeanne Cutrer of Cutrer Administration, since its services unreasonably duplicate PGMS's.
58. Utility office space is not needed for Sam Hammett. The evidence is insufficient to show that he works for the Utility halftime and his salary is an appropriate affiliate expense.
59. The evidence is insufficient to show that the expense of the office space was reasonable and necessary to provide service.

### **Auto Expense**

60. The Utility claims an auto expense of \$2,830. That is approximately 50% of the cost of a mortgage loan paid for a Ford F150 truck.
61. The truck is used by two affiliates of the Utility: the Land Company and Mr. Hammett.
62. It is reasonable to allocate 50% of the expense of the truck to the Utility.
63. The truck was purchased in 2006 and has a service life of five years.
64. After subtracting accumulated depreciation, the truck has a remaining net value of \$9,343.00.
65. The claimed \$2,830 expense for the truck should be disallowed, and the truck's \$9,343.00 remaining net value should be added to invested capital, with a service life of five years. That will yield a return on that value plus annual depreciation of \$3,398.04.

### **Auto Expense Gasoline**

66. The Applicant seeks \$1,525 in auto gasoline expenses for the Ford F150 truck.
67. To account for its use by the affiliates, the Utility claims 50% of the actual test year gasoline expense for the F150 truck.
68. The Applicant increased that test year gasoline cost by 10% to account for estimated post-test year inflation.
69. The evidence does not show that the inflation adjustment is based on known and measurable changes.
70. The inflation adjustment should be disallowed.

71. The reasonable and necessary cost of gasoline to provide water service is \$1,386.

### **Telephone Expense**

72. The Utility claims a telephone expense of \$3,861, which includes the cost of Chris Aaron's cell phone, an office phone, and internet and long distance services. No inflation adjustment was included.

73. The \$3,861 was a necessary and reasonable expense to provide water service.

### **Printing Expense**

74. The Utility claims a \$352 printing expense, which includes the test year amount of \$320 and a 10%, \$30 inflation adjustment.

75. The evidence does not show that the inflation adjustment was based on a known and measurable change in costs.

76. The \$30 inflation adjustment should be disallowed.

### **Equipment Rental Expense**

77. The Applicant seeks to include \$5,083 for equipment rented during the test year to repair and maintain its water system. It proposes no inflation adjustment to this expense.

78. The evidence is insufficient to show that the Utility spent \$5,082.68 for equipment rental and that it was reasonably needed to provide water service.

79. The entire \$5,083 claimed by the Applicant for equipment rental should be disallowed.

## **Insurance Expense**

80. The Applicant claims an insurance expense of \$14,559 for health insurance for the Utility's employees and for general and facility damage insurance. That includes an upward adjustment of 10% to account for anticipated post-test year inflation.
81. Of the claimed amount, \$7,751 should be allowed as a reasonable and necessary expense and the remainder should be disallowed.
82. The general and facilities damages insurance, which totals \$2,266.06 paid to Galloway Insurance, was a necessary and reasonable cost of providing water service.
83. The evidence does not show that the inflation adjustment of \$1,324 is based on a known and measurable post-test year change.
84. The Utility paid \$3,417 during the test year to Union Insurance for vehicle insurance for the F150 truck previously discussed.
85. Fifty percent of the auto insurance expense, or \$1,709, should be disallowed due to the use of the truck by the Utility's affiliates that was not necessary or reasonable to provide water service.
86. The claimed test year expense for health insurance is \$7,552.55.
87. The health insurance policy covers Susan and Sam Hammett and Chris Aaron.
88. There is no evidence that Susan Hammett is an employee of the Utility.
89. The evidence is insufficient to show that Mr. Aaron worked full time for the Utility during the test year.
90. The evidence is insufficient to show that Mr. Hammett worked full time for the Utility during the test year.

91. Based on the above, it would be reasonable to disallow 50% of the claimed health insurance expense, or \$3,776.

### **Postage Expense**

92. The Applicant seeks to include \$423 in its cost of service for postage expense. This includes the \$385 that it actually spent during the test year and a 10% inflation adjustment.
93. The evidence is insufficient to show that the inflation adjustment is a known and measurable post-test year change; hence, it should be disallowed.
94. Expenses for postage totaling \$385 are reasonable and necessary.

### **Payroll Tax Expense**

95. The Applicant seeks to include \$4,030 in its cost of service for its payroll taxes. This includes a claimed actual test year expense of approximately \$3,840 and an adjustment to account for post-test year salary inflation that it anticipates.
96. The payroll tax amount should be 7.65% of the salary amount.
97. As discussed above, the necessary and reasonable adjusted salary amount is \$12,915.
98. Based on the above, the Utility's necessary and reasonable payroll tax expense to provide service is \$988.

### **Property and Other Taxes**

99. The Utility claims \$7,110 for property taxes. That includes claimed test year taxes of \$6,470 and a 10% inflation adjustment of \$640.

100. The evidence is insufficient to show that the inflation adjustment is a known and measurable change. It should be disallowed.
101. The evidence is insufficient to show that the Utility's test year property taxes were \$6,470.
102. The Utility's necessary and reasonable test year property tax expense to provide water service was \$6,152, which should be allowed.

### **Miscellaneous Expense**

103. During the test year, the Utility had minor miscellaneous expenses of \$683 for supplies, TCEQ inspections, and solid waste disposal that were necessary and reasonable to provide water service.

### **Loans**

104. The Applicant originally sought to include \$13,932 in cost of service for interest payments to Wells Fargo Bank and interest and principle payments to Mr. Hammett for loans allegedly borrowed to pay for operation and maintenance expenses.
105. The Utility also originally included \$95,809 for interest payments on funds allegedly borrowed from Frost Bank for capital projects.
106. The Utility has withdrawn both of the above requests and neither the \$13,932 nor the \$95,809 should be included in its costs of service.

### **Professional Fees**

107. The Applicant seeks \$13,380 in cost of service for professional fees that it incurred during the test year. That includes \$2,560 for accounting fees and \$9,330 for routine

legal fees. It also includes \$1,520 for five years to recover \$7,588 spent on legal fees related to the Applicant last rate case, which was settled.

108. The accounting work was performed during the test year, July 1, 2007, through June 30, 2008, but concerned a tax return for a prior tax year.
109. Prior to the second half of 2007, the Utility did not have its own tax ID number and used the tax ID number for the Land Company because they were treated as one entity for tax purposes.
110. Based on the above, the tax work performed for a year before the test year must have been for the Land Company and the Utility as a combined entity, not just for the Utility.
111. Fifty percent, or \$1,280, of the accounting fees should be disallowed because the accounting work was performed for both the Utility and the Land Company. The remaining \$1,280 should be allowed as a necessary and reasonable expense.
112. Of the routine legal fees, \$6,612 was for non-recurring work related to a transmission line improvement, which should be removed from cost of service and recovered through an amortization charge of \$1,322 per year for five years. The remaining \$2,718 in routine legal expenses should be allowed as a reasonable and necessary expense.
113. Rate case expenses for a prior case for which the Commission approved a settlement should not be recoverable in a subsequent rate case unless the settlement specifically provided for that possible recovery.
114. The \$1,520 for five years that the Utility seeks to include for legal expenses for a prior rate case should be disallowed.

### **Lease for the Pre-1985 Assets**

115. On March 1, 2005, the Utility and its affiliated Land Company entered into a surface and facilities lease agreement (Lease). It gave the Utility the right to use certain assets that were constructed prior to July 1985 (Pre-1985 Assets).
116. The Utility originally claimed that the Pre-1985 Assets should be included in its rate base, but it has withdrawn that request.
117. The rent stated in the Lease was \$1,125 per month for the first year, and the Lease included a rent adjustment clause for subsequent years.
118. The Applicant seeks to include an annual amount of \$13,500 in cost of service for the Lease.
119. The entire \$13,500 should be disallowed.
120. At one time, the Land Company held the CCN that the Utility now holds, used the Pre-1985 Assets to provide water service then, and still owns those assets.
121. On October 4, 1985, the Land Company still held the CCN and filed a rate change application with the Commission's predecessor agency, hereafter also referred to as "the Commission."
122. On April 15, 1986, the Commission issued an order approving that application in part and denying it in part.
123. In that 1986 order, the Commission found the original costs of certain assets, including the Pre-1985 Assets, which are set out below:

<b>Asset</b>	<b>Original Costs 1986 Order</b>
Well	\$16,523.58
100000-gallon storage tank	\$35,000
Distribution system	\$120,170
Office furniture and equipment	\$253
<b>TOTAL</b>	<b>\$171,946.58</b>

124. In the 1986 Order, the Commission also found that:
- a) Only 50% of the distribution system, or \$60,085, was used and useful;
  - b) \$3,000 of the 100,000-gallon tank's cost was unreasonable;
  - c) Customers had contributed \$105,560, which had to be deducted from rate base; and
  - d) \$7,988 in depreciation had accumulated.
125. After make those deductions, the Commission found in the 1986 Order that the Land Company only had \$18,882 in net plant that was used and useful to provide service. The Commission also found that the depreciation expense was \$3,092 per year.
126. On July 15, 2005, the Commission approved the transfer of the CCN from the Land Company to the Utility (CCN Transfer Order).
127. The CCN Transfer Order did not generally authorize the Utility to lease facilities and lines from the Land Company and did not approve the specific March 1, 2005, Lease.
128. The CCN Transfer Order stated, "... Certificate of Convenience and Necessity No. 11241 [was] transferred in accordance with the terms and conditions set forth in the certificate." The certificate stated, "[The Land Company's] facilities and lines were transferred to [the Utility] (CCN No. 11241) in Hays and Travis Counties."
129. The Pre-1985 Assets that were found used and useful in Commission's 1986 Order would have been fully depreciated and had no remaining net value if they had been transferred to the Utility as directed in the CCN Transfer Order.

130. Circumstances have changed since the 1986 Order was issued, and the entire distribution system is now used and useful. Thus, the other 50% of the distribution system assets, with an original cost of \$60,085, is now used and useful.
131. Additionally, the following Pre-1985 Assets are also used and useful now: electric and control facilities with a projected original cost of \$2,000 and a hydropneumatic tank with a projected original cost of \$12,600.
132. Those additional Pre-1985 Assets, worth \$72,685, have accumulated depreciation since they were put into use.
133. The annual payment of \$13,500 to lease the Pre-1985 Assets gave the Utility's affiliated Land Company more than an 18.57% annual return on those assets with an original cost of \$72,685. Once depreciation was subtracted from the original costs of those assets, the return would be even higher.
134. The evidence is insufficient to show that the Lease is an appropriate affiliate transaction.

### **Working Cash Allowance**

135. The Utility should be allowed a working cash allowance equal to one-eighth of its 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).  
30 TEX. ADMIN. CODE (TAC) § 291.31(c)(2)(B)(iii).
136. The Utility reasonable and necessary working cash allowance is \$15,805.

### **Return on Investment**

137. The Applicant seeks a total return on investment of \$111,910.

**Invested Capital**  
**Assets Owned by Others Not Included**

138. The Applicant claims that it is entitled to earn a return on \$2.71 million in assets that Mr. Hammett personally owns (Hammett Assets) and has pledged as collateral for a \$1.6 million loan to the Utility from Frost Bank to the Applicant.
139. These include two of Mr. Hammett's brokerage accounts with Frost Brokerage Services, his shares in the Land Company, and certain real estate lots at the Land Company's development.
140. All of the Hammett Assets should be removed from the Utility's rate base because they are not the Utility's assets.

**Assets Owned by the Utility**

141. The Applicant claims that it has used and useful capital assets that were constructed after June 2000 with an original cost of \$1,325,069.
142. As set out below, the original cost of the Utility's in-plant assets that are used and useful to provide service is \$1,043,135. After deducting accumulated depreciation, the net plant is \$1,035,372.

**New Ground-Storage Water Tank**

143. The Utility has a new 109,500-gallon, ground-storage water tank (New Tank).
144. Eighty-eight percent of the New Tank is not reasonably useful to provide service.
145. Eighty-eight percent of the New Tank's original cost, or \$78,945.78, should be disallowed, and the remainder should be allowed.

146. In addition to the New Tank, the Utility still uses a 100,000-gallon ground storage tank that was built before July 1985 (Old Tank). The Old Tank is one of the Pre-1985 Assets that is owned by the Land Company and Leased by the Utility.
147. Under 30 TAC § 290.45(b)(2)(E), a utility must have a storage capacity of 200 gallons per connection.
148. The Utility had 367 connections at the end of the test year.
149. The Old Tank's 100,000-gallon volume provides significantly more than the 73,400 gallons of storage necessary to achieve the required 200 gallons per connection.
150. Two areas that the Utility may serve in the future have 131 and 67 lots.
151. To serve its 565 current and possible future connections would eventually require 113,000 gallons of ground storage capacity, which are 13,000 more than the Old Tank provides.
152. The difference between the 367 end of test year customers and 565 customers is a very large 54% post-test year increase.
153. The 200 gallons per connection storage requirement is only a minimum. 30 TAC § 290.45(a)(1).
154. Greater capacity may be required if a normal operating pressure of 35 psi, or 20 psi during unusual conditions, cannot be maintained. 30 TAC § 290.45(a)(2).
155. Alternative capacity requirements, in lieu of the required minimums, may be allowed upon a detailed showing that is approved by the ED. 30 TAC § 290.45(g).
156. There is no evidence to show that more than the minimum storage capacity is necessary to maintain a pressure of 35 psi, or 20 psi in unusual conditions.

157. There is no evidence to show that more than the required minimum storage capacity has been approved by the ED or that the Utility has even applied for such approval.
158. Only 13,000 gallons, or 12%, of the New Tank's capacity is used and useful to provide storage.
159. The LCRA contract requires a physical separation (air gap) between LCRA's wholesale water supply and the Applicant's retail water supply.
160. An air gap prevents backflow of water to the LCRA.
161. There is no air gap at the site of the Old Tank.
162. The New Tank provides the air gap. Water from LCRA is piped to the top of the tank and allowed to fall to the bottom, so the empty upper portion of the tank space is the physical separation between the LCRA inflow and the Utility's water at the bottom of the tank.
163. The Old and New Tanks are approximately one mile apart.
164. The air gap could not be placed near the Old Tank because the Utility's internal plumbing would have to be used to pump water there, thus the Utility's system would not be physically separated from LCRA's.
165. A 50,000-gallon tank could have been used to supply the air gap.
166. The evidence is insufficient to show that the full \$89,711.11 expense of the New Tank was reasonable to provide an air gap.

### **Plugging of South and North Wells**

167. The Utility seeks to include in its rate base \$1,794.33 that it spent to plug its South well and \$2,116.83 that it spent to plug its North well.

168. The plugging expenses for the North and South wells were incurred on June 29 and 30, 2005, which were before the test year.
169. The wells had already been fully depreciated; hence, they are no longer used and useful to provide service.
170. A plugged well can no longer be used for a backup water supply.
171. The costs of plugging the wells were neither capital investments with ongoing useful lives that are used and useful to provide service nor test year operational expenses.
172. The expenses of plugging the North and South wells should be entirely disallowed.

### **Well Pumps**

173. In its requested rate base, the Utility included \$4,282.41 for a well pump put in service on June 9, 2000, and \$12,208.34 for a well pump put in service on August 18, 2003.
174. The evidence does not show that these well pumps are used and useful to provide water service.
175. These costs of the well pumps should be disallowed.

### **Fire Hydrants**

176. In its requested rate base the Utility included \$23,800 that was paid to install seven fire hydrants.
177. Fire protection is not retail water service.
178. The cost of the fire hydrants should be disallowed.

## **Truck**

179. As discussed above in this Order, no portion of the cost of the 2006 F150 truck should be allowed as an operating expense.
180. The \$9,343 remaining net value of the 2006 F150 truck should be included in invested capital, with a service life of five years and annual depreciation expense of \$3,398

## **Invested Capital Reduction Due To Customer Contribution**

181. As of April 30, 2009, the Utility's customers had paid \$167,781 under a surcharge adopted in settlement of a rate case in 2005.
182. The Commission approved a settlement agreement in that case, which authorized the Utility to collect a surcharge of \$12.00 per month per customer for five years to collect sufficient revenue to pay for improvements to the water system.
183. The Utility's invested capital should be reduced by the entire \$167,781 that the customers have paid in accordance with the surcharge provided for in the settlement of the rate case in 2005.

## **Return on Investment**

184. The Utility claims that the reasonable rate of return on its invested capital is 12.5%.
185. The reasonable rate of return on the Utility's invested capital is 6.0%.

## **Cost of Equity**

186. The Commission has adopted a rate of return worksheet and included that in its rate change application instructions. Starting with the most current average return on Baa

rated public utility bonds as a base, the worksheet provides for upward adjustments of up to 8.0% for certain systems.

187. The rate of return worksheet is consistent with and applies rate of return principles set out in the Water Code and the current rules. Water Code § 13.184 and 30 TAC § 291.31(c)(1).
188. The rate of return worksheet ensures access to credit by starting with the current rate of return on publicly traded bonds, which reflect debt with a zero risk of return.
189. The rate of return worksheet ensures access to equity markets by allowing for upward adjustments to reflect systems with higher risks to capital, including systems with small numbers of customers, low growth, unstable populations, and aging facilities.
190. Upward adjustments are also allowed when the Utility's management conserves water resources and provides high quality of service and good management.
191. The Commission has approved a 12% rate of return for some utilities in the past, but not higher.
192. The average rate of return on Baa public utility bonds for the last 12 months, according to Moody's, was 7.45%.
193. Given the current 7.45% Baa bond rate and the possibility of upward adjustments totaling 8.0%, the calculation methodology set out in the worksheet allows for the possibility of a 15.45% rate of return.
194. The rate of return worksheet is reasonably consistent with the Commission's historical practice and potentially more generous to a utility.
195. No upward adjustments to the Utility's rate of return are warranted under the Commission's rate of return worksheet.

196. The evidence is insufficient to show that a rate of return on equity higher than 7.45% would be necessary and reasonable.
197. Using the rate of return worksheet method of calculation, the Utility's reasonable return on equity would be 7.45%.

### **Cost of Debt**

198. At the end of the test year, the Utility owed Frost Bank \$1,596,816 for loans with an annual interest rate of 6.0%.
199. The Utility also had an auto loan of \$18,860 at 7.49% interest. That should be reduced by \$9,430, to reflect the allocation of 50% of the auto debt to the Utility and 50% to the non-utility.

### **Using a Weighted Cost of Capital Is Not Reasonable In This Case**

200. The net value of the Utility's used and useful assets is \$1,035,372; however, its total debt is \$1,606,246.
201. The Utility has negative equity; it owes \$568,006 more than the net value of its used and useful invested capital.
202. When a utility has negative equity, all of its invested capital has been financed with debt.
203. When a utility has outstanding debt and positive equity, using a weighted cost of capital properly prevents the utility receiving a greater than reasonable rate of return on its invested capital.
204. Using a weighted cost of capital approach for a utility with negative equity would not be reasonable because it would result in a return that was lower than the cost of the debt that the utility used to acquire its used and useful invested capital.

205. Because the Utility has borrowed at 6.0% interest more than the net value of its currently used and useful invest capital, the Utility's reasonable rate of return on its invested capital is 6.0%.
206. Because the net value of the Utility's used and useful assets is \$1,038,240 and its reasonable rate of return in 6.0%, the Utility's reasonable and necessary return on investment is \$63,071.

### **Annual Depreciation**

207. Based on the above Findings of Fact, the Utility's reasonable and necessary annual depreciation expense is \$31,278.

### **Other Expenses Federal Income Taxes**

208. The Applicant has requested that \$9,519 be included in the cost of service for the payment of federal income taxes. This amount should be disallowed.
209. The annual interest that the Utility owed on its debt during the test year exceeded the reasonable return on its invested capital that was used and useful to provide service.
210. The Utility will have negative income and owe no federal income tax.
211. The Utility's reasonable expense for federal income tax is zero.

### **Rate Case Expense**

212. The Applicant contends that its expenses for this rate case as of the time it filed its application totaled \$27,230. This amount should be disallowed.
213. The Utility also claims that it had approximately another \$100,000 in rate case expenses, but there is no evidence in the record to support that claim.

214. The Utility applied to increase its revenue by \$104,000 per year.
215. The Utility's just and reasonable rates would generate \$177,575 of revenue per year.
216. The evidence does not show that the increase in revenue generated by the Utility's just and reasonable rates would be at least 51% of the increase in revenue that would have been generated by the Utility's proposed rates.

### **Cost of Service**

217. Based on the above, the Utility's necessary and reasonable cost of service is \$227,925.

### **Other Revenues**

218. The Utility's other revenues must be subtracted from its total expenses to determine the Utility's net cost of service.
219. The Utility properly included \$50,350 of other revenue in its rate calculation, thus reducing the amount it would need to recover through rates.
220. Additionally, the Utility included \$145,921 in other revenue to account for its revenue from the LCRA pass-through surcharge that its customers paid during the test year. This amount should be deleted from other revenue due to the disallowance of \$158,732 that the Applicant included in its cost of service for water purchased from LCRA.

### **Financial Integrity**

221. To preserve its financial integrity, the Applicant claims that the Commission must: (1) approve all of the known and measurable changes it claims, (2) include an amount to allow it to make its entire loan payment—not just pay interest, and (3) allow its investors to make some profit.

222. The evidence is insufficient to show that the Utility's rates should be set at higher levels than they otherwise would be in order to protect the Utility's financial integrity.
223. To the extent that the Utility's claimed post-test year changes have not been shown known, measurable, and otherwise appropriate, they should not be approved.
224. The Utility has negative equity.
225. The evidence is insufficient to show that the Utility's shareholder equity has been wiped out due to low rates and high service costs or cash flow problems resulting from necessary construction of facilities not yet in rate base.
226. The evidence is insufficient to show that the Utility's current rates are significantly lower than necessary to cover its reasonable costs of service.
227. The largest liability on the Utility's balance sheet is for a \$1,596,816 loan from Frost Bank. That loan exceeds the total \$1,264,726 value that the Utility claims on its balance sheet for all of its facilities.
228. After the Frost Bank loan, the next largest liabilities are \$202,119 owed to Mr. Hammett and \$193,132 owed to the Land Company, both of which are affiliates of the Utility.
229. Together Mr. Hammett and the Land Company completely control the Utility.
230. The evidence is insufficient to show why the affiliates authorized so much borrowing in the Utility's name, much less to show that it was necessary to provide service.
231. The affiliates who control the Utility have:
  - a) acquired in the Utility's name far more assets than necessary to serve the Utility's customers now or in the reasonably foreseeable future;
  - b) borrowed in the Utility's name very large amounts of money that were not necessary to provide service to the Utility's customers;

- c) borrowed in the Utility's name more money that exceeds the value of all of its assets, including those not currently necessary to provide service;
- d) borrowed very large amounts of money relative to the Utility's size and stockholder's invested capital; and
- e) borrowed a very large percentage of the above amounts from themselves.

232. The Utility's owners and managers have irresponsibly managed the Utility's finances.

**Rate Design**

233. The Utility has only residential customers with 3/4-inch or smaller meters. There is no evidence that it will have other types of customers in the future.

234. The Utility's monthly rates currently, as originally proposed, and as it finally revised them during this case are set out below:

<b>Monthly Rates</b>	<b>Current</b>	<b>Originally Proposed</b>	<b>Revised</b>
Base rate (1/2"x3/4" inch meter)	\$35.00	\$64.00	\$61.00
0 to 2000 gal.	\$0	\$5.00	\$5.00
2001 to 10000 gal.	\$3.00	\$6.00	\$6.00
10001 to 20000 gal	\$4.00	\$7.00	\$7.00
20001 gal thereafter	\$5.00	\$8.00	\$8.00

**Transcription Costs**

235. Because the hearing was scheduled for more than one day, the ALJ ordered the Applicant to arrange for and pay a court reporter to record and transcribe the hearing on the merits and to deliver the original transcript to the ALJ and two copies to the TCEQ's Chief.

236. The Applicant paid for the court reporter as ordered and the transcript was delivered. Thus, the Applicant can pay for the cost of the transcript.

237. Because the ALJ ordered the transcript, no party requested it, though a party may have ordered one or more copies for its own use.

238. The Applicant and the Protestants fully participated and benefited from the transcript, as evidenced by their post-hearing briefs.
239. Because the evidence does not show that an increase of at least 51% of the revenue that the Applicant applied for is warranted, it would be more just for the Applicant to be assessed the entire cost of the transcript, except for the cost of copies that the Protestants ordered, if any, for their own use.

## **II. CONCLUSIONS OF LAW**

1. Applicant is a public utility as defined in Water Code § 13.002(23).
2. The Commission has jurisdiction to consider an application for a rate increase filed by a public utility, pursuant to Water Code § 13.181.
3. The ALJ conducted a contested case hearing and issued a proposal for decision on the Applicant's proposed water rate changes under TEX. GOV'T. CODE ANN. (Government Code) ch. 2003, Water Code ch. 13, and 30 TAC chs. 80 and 291.
4. Proper notice of the Application was given by the Applicant as required by Water Code § 13.187, 30 TAC §§ 291.22 and 291.28, and Government Code §§ 2001.051 and 2001.052.
5. The Applicant has the burden of proof on all issues in this case. Water Code § 13.184(c).
6. The invested capital amounts set forth in the Findings of Fact above are based on the original cost of property used by and useful to the Applicant in providing service, less depreciation, in accordance with Water Code § 13.185.
7. The revenue requirements are based on Applicant's reasonable and necessary operating expenses, within the meaning of Water Code §§ 13.183 and 13.185 and the Commission's rules.

8. The revenue requirements are sufficient to provide Applicant with a reasonable opportunity to earn a fair and equitable return on its invested capital while preserving its financial integrity, within the meaning of Water Code §§ 13.183 and 13.184.
9. The rates and fees to be charged by Applicant, as approved by the Commission in this Order, are just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and sufficient, equitable, and consistent in application to each class of customer in accordance with Water Code §§ 13.182, 13.189, and 13.190.
10. The doctrine of collateral estoppel or issue preclusion applies in administrative law cases and precludes the relitigation of identical issues of fact that have been actually litigated between the same parties or those in privity with the original parties. *Coalition of Cities for Affordable Util. Rates v. Public Util. Comm'n*, 798 S.W.2d 560, 564-65 (Tex. 1990).
11. Those in privity with a party may include persons who exert control over the action, persons whose interests are represented by the party, or successors in interest to the party. *Dairyland County Mutual Ins. Co. of Texas v. Childress*, 650 S.W.2d 770, 773-74 (Tex. 1983).
12. Within the context of this case, the affiliated Utility and Land Company are in privity with one another.
13. The doctrine of collateral estoppel applies and bars the relitigation of the Commission's determinations in the 1986 Order concerning the Pre-1985 Assets.

### **Financial Integrity**

14. Water Code § 13.183(a)(2) does not require the Commission to fix a utility's overall revenues at a level that will preserve the financial integrity of a utility when the utility's owners have irresponsibly managed its finances.

15. The Utility has failed to show that its rates should be set at a higher level to preserve its financial integrity.

### Approved Rates

16. The findings of fact listed above support the following rates:

<b>Monthly Rates</b>	<b>Approved</b>
Base rate (1/2" x 3/4" inch meter)	\$33.16
0 to 2000 gal	\$0
2001 to 10000 gal	\$3.00
10001 to 20000 gal	\$4.00
20001 gal thereafter	\$5.00

However, because this rate is below the Utility's previously approved rates, the application is denied in its entirety and the rates are set at the Utility's previously approved rates as listed in Finding of Fact number 234.

17. The claimed rate case expenses should be disallowed, in accordance with 30 TAC § 291.28(8).

### Refunds

18. 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. Water Code § 13.187(i).
19. The Utility has been collecting the proposed rates since they went into effect on May 1, 2009.
20. After accounting for interest, the total refunds due customers for overcharges would be \$ 52.65 per customer per month if paid back over 17 months.
21. The reasonable rate of interest on the overcharge balance until repaid is 0.61%.

22. The Utility should refund or credit to customers all sums collected since May 1, 2009, which was the effective date of the rates at issue in this case, that exceed the rates finally approved by the Commission in this case plus 0.61% interest on the over-collection.

### **Transcript Costs**

23. In accordance with the factors set out in 30 TAC § 80.23, the costs of recording and transcribing the hearings in this case should be assessed as follows:
  - a) The Protestants should bear the cost of the copy of the transcript, if any, that they ordered for their own use; and
  - b) The remaining transcript costs should be assessed against the Applicant.

### **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 Deer Creek Ranch Water Co., LLC to increase its water rates under Certificate of Convenience and Necessity No. 11241 in Travis and Hays Counties, Texas, is denied in its entirety and the rates are set at the utility's previously approved rates as listed in Finding of Fact number 234.
2. The Utility should refund or credit to customers all sums collected since May 1, 2009, which was the effective date of the rates at issue in this case, that exceed the rates finally approved by the Commission in this case plus 0.61% interest on the over-collection. The refund of \$52.65 per customer per month shall be made over a 17-month period to begin with the first billing period after this order is signed.

### **Transcript Costs**

3. In accordance with the factors set out in 30 TAC § 80.23, the costs of recording and transcribing the hearings in this case should be paid by the Applicant.
4. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
5. The effective date of this Order is the date the Order is final, as provided by 30 TAC § 80.273 and Gov't Code § 2001.144.
6. The Commission's Chief Clerk shall forward a copy of this Order to each of the parties.
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.

### **ISSUED:**

### **TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**

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