

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

July 19, 2013

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

VIA FACSIMILE NO. 512/239-5533

Re: SOAH Docket No. 582-11-1468; TCEQ Docket No. 2010-1841-UCR; *In Re: Application of SJWTX, Inc. d/b/a Canyon Lake Water Service Company to Change Water Rates; CCN No. 10692; In Comal and Blanco Counties*

Dear Mr. Trobman:

We have reviewed the exceptions to the Supplemental Proposal for Decision (PFD) prepared in response to the Interim Order issued by the Texas Commission on Environmental Quality (Commission or TCEQ) on April 2, 2013. In their Supplemental PFD, the ALJs found that the Executive Director (ED) had not double-deducted the Startzville Wastewater Treatment Plant (WWTP) from the rate base of the SJWTX, Inc., d/b/a Canyon Lake Water Service Company (CLWSC). In addition, the ALJs declined to address certain issues that, in their opinion, went beyond the April 2, 2013 Interim Order. The ALJs also recommended that the Commission issue the revised proposed order attached to the Supplemental PFD.

In response, CLWSC filed exceptions to the Supplemental PFD (Exceptions) on June 24, 2013. On July 8, 2013, the ED and the Coalition for Equitable Water Rates (Coalition) filed responses to CLWSC's Exceptions. This letter addresses those submittals.

Double-Removal of Startzville Wastewater Treatment Plant

As set out in the Supplemental PFD, the ALJs conclude that the ED did not remove the Startzville WWTP twice from CLWSC's rate base. When it originally filed its Application, CLWSC included the Startzville WWTP in its list of assets, and that asset list is found in CLWSC Exhibit 1.¹ In both his response to Order No. 18 and his response to CLWSC's Exceptions, the ED clearly explained how he began with the asset list in the Application in CLWSC Exhibit 1 and addressed the inappropriate inclusion of the Startzville WWTP in the asset list for a water utility. By following the steps in the ED's explanation, the ALJs determined that the ED properly removed the Startzville WWTP from CLWSC's rate base, and there was no double-deduction of the WWTP. The ALJs agree with the ED that he properly accounted for the Startzville WWTP in his rate base, as modified by the ALJs in their PFD.

Other Mathematical Errors

On remand, CLWSC argued that there are mathematical errors in the rate base calculation because the amounts cannot be reconciled. In their Supplemental PFD, the ALJs determined that CLWSC's arguments regarding the alleged mathematical errors in the rate base calculation went beyond the scope of the Interim Order.² However, to address these arguments, the ED demonstrated in his extensive response to CLWSC's Exceptions that the rate base calculations did in fact "add up."³ The ALJs have reviewed the ED's explanation and find that he adequately explained his calculations of CLWSC's rate base. The ALJs conclude that both the ED's rate base calculations and the calculations in the PFD are correct. The ALJs recommend that the Commission reject CLWSC's exception on this issue.

¹ CLWSC Ex. 1, pp. 200, 221.

² Supp. PFD, p. 4.

³ ED Response to CLWSC's Exceptions, pp. 4-8.

Refunds to Former Customers

In its Exceptions, CLWSC argued that the Interim Order limited refunds to only current customers. The ALJs fully addressed CLWSC's arguments in their Supplemental PFD and recommended that the Commission overrule CLWSC's exception on this issue.

Rate Case Expenses

In its Exceptions, CLWSC asserts for the first time that a recent Austin Court of Appeals opinion holds that the Commission's application of the 51% rule amounts to an unlawful confiscation of its right to recover rate-case expenses. The ALJs disagree that the case has precedential value to CLWSC's recovery of rate-case expenses. In particular, on June 14, 2013, the Austin Court of Appeals issued its opinion in *Oncor Elec. Delivery Co., LLC v. Public Util. Comm. of Texas* (PUC).⁴ In that case, the court of appeals overturned a PUC order that denied Oncor's request to recover rate-case expenses incurred in previous rate cases. In its Exceptions, CLWSC urges the Commission to allow the recovery of its rate-case expenses based on this case because the court stated that "regulatory agencies should allow recovery of any expense shown to be actual, necessary, and reasonable to avoid conflict with PURA's mandate to allow utilities to recover their operating expenses and a reasonable return."⁵

The facts of the *Oncor* case are very different from the facts presented here. The PUC had a practice that allowed utilities to recover rate-case expenses incurred in one rate case in a subsequent rate case, and a utility needed no preauthorization to do so. However, in *Oncor*, the PUC denied Oncor's request for rate-case expenses from previous dockets because Oncor had not obtained preauthorization to seek such expenses in subsequent cases. According to the court of appeals, Oncor had no notice of this new preauthorization requirement, this new requirement

⁴ 2013 Tex. App. LEXIS 7334 (Tex. App.—Austin 2013, no pet. h.).

⁵ CLWSC Exceptions, p. 13.

deviated from the PUC's past practices, and the PUC imposed this new requirement after the time Oncor could have acted to protect its interests.

In this case, the Commission adopted its 51% Rule in 2006, long before CLWSC filed its Application in 2010.⁶ Therefore, unlike Oncor, CLWSC had notice that "[a] utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate."⁷ As pointed out by the Coalition in its reply to CLWSC's Exceptions, the Commission has consistently applied this rule in previous rate cases, and the Commission is not deviating from its typical practices in this case. For these reasons, the facts of this case distinguish it from *Oncor*, and the ALJs conclude that *Oncor* does not serve as a basis for CLWSC's recovery of its rate-case expenses in light of its failure to meet the 51% Rule.

Furthermore, the Texas Water Code vests the TCEQ with the discretion to "promulgate rules and regulations with respect to the allowance or disallowance of certain expenses for ratemaking purposes."⁸ In addition, section 5.103(c) of the Texas Water Code requires the TCEQ to follow its rules until it properly changes those rules.⁹ Accordingly, the 51% Rule is applicable to this case because the TCEQ adopted this rule in 2006 before CLWSC filed its Application, and the TCEQ has not changed or repealed the rule.

As a final matter, the Coalition argues that the findings of fact (FOF) regarding CLWSC's rate-case expenses should be changed to reflect that the expenses are unreasonable and unnecessary. In their initial PFD, the ALJs proposed FOF No. 130, which found that CLWSC's rate-case expenses of \$856,742.42 were reasonable and necessary. The Coalition

⁶ 31 Tex. Reg. 8106 (Sep. 22, 2006).

⁷ 30 Tex. Admin. Code § 291.28(8).

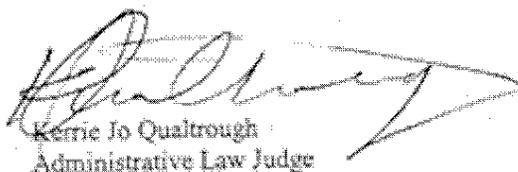
⁸ Tex. Water Code § 13.185(g).

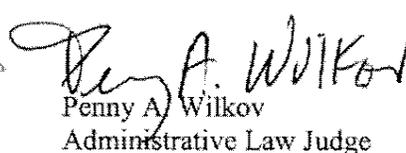
⁹ Tex. Water Code § 5.103(c).

suggests that this reasonable and necessary finding be deleted. The Coalition also proposes that FOF No. 141 be changed to reflect that CLWSC's rate-case expenses are unreasonable and unnecessary as a matter of law.¹⁰

The ALJs conclude that changing the FOFs regarding CLWSC's rate-case expenses as proposed by the Coalition would exceed the scope of the Commission's Interim Order. However, the ALJs agree with the Coalition that the findings may be erroneous because, by enacting the 51% Rule, the Commission intended the rule to specify those instances where rate-case expenses are unreasonable, unnecessary, and against the public interest as a matter of law.¹¹ At the time the ALJs initially proposed FOF No. 130 in the PFD, the ALJs did not know whether CLWSC's final rates would satisfy the 51% Rule, and the initial FOF No. 130 was based on an assessment of the evidence presented by CLWSC to prove its rate-case expenses. Therefore, because the TCEQ intended the 51% Rule to determine whether expenses would be considered unreasonable, unnecessary, and not in the public interest, it may be appropriate to change those findings as suggested by the Coalition. However, the ALJs do not make that recommendation because such a change would exceed the scope of the Interim Order.

Sincerely,


Kerrie Jo Qualtrough
Administrative Law Judge


Penny A. Wilkov
Administrative Law Judge

xc: Attached Service List

¹⁰ Coalition Replies to CLWSC's Exceptions, pp. 6-7.

¹¹ 31 Tex. Reg. 8106, 8107 (Sep. 22, 2006).

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STYLE/CASE: SJWTX INC / CANYON LAKE WATER SERVICE CO
SOAH DOCKET NUMBER: 582-11-1468
REFERRING AGENCY CASE: 2010-1841-UCR

**STATE OFFICE OF ADMINISTRATIVE
HEARINGS**

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State Office of Administrative Hearings



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Chief Administrative Law Judge

February 25, 2013

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Re: SOAH Docket No. 582-11-1468; TCEQ Docket No. 2010-1841-UCR; *In Re: Application of SJWTX, Inc. d/b/a Canyon Lake Water Service Company to Change Water Rates; CCN No. 10692; In Comal and Blanco Counties*

Dear Mr. Trobman:

On December 3, 2012, the Administrative Law Judges (ALJs) issued their proposal for decision (PFD) in this case. SJWTX, Inc. d/b/a Canyon Lake Water Service Company (CLWSC), the Coalition for Equitable Water Rates (CEWR), and the Executive Director (ED) of the Texas Commission on Environmental Quality (Commission or TCEQ) filed timely exceptions to the PFD and replies to the other parties' exceptions. This letter contains the ALJs' recommendations regarding those exceptions and replies.

1. Rate Design

In their PFD, the ALJs requested that the ED perform the necessary rate calculations to incorporate the recommendations made in the PFD. The ED complied and filed Attachment B to the ED's "Exceptions to the Proposal for Decision" (Exceptions). The ED also corrected a miscalculation in the ALJs' recommended office expenses, as will be discussed below. In addition, the parties noted that the ALJs had not recommended that CLWSC adopt a tiered-rate structure, and the ALJs agree with the parties that the tiered rate structure should be implemented to encourage conservation.

CLWSC generally agrees with the ED's rate design found in Attachment B to the ED's Exceptions. However, CLWSC points out that the ED's proposed rate design only includes base rates and a multi-tiered rate-design structure for 5/8 x 3/4 meters.¹ The ED did not propose base

¹ CLWSC Reply to Exceptions, p. 20.

rates and multi-tiered, volumetric rates for larger meters. CLWSC requests inclusion of base rates and multi-tiered volumetric rates for the larger meters using the consumption blocks proposed in its Application.² CLWSC also requests that the Commission approve its proposed uncontested miscellaneous fees.³ CLWSC further proposes that the parties have an opportunity to confer on any rate design prior to entry of a final, rate-setting order. CLWSC prefers that any adjustments be made to the monthly minimum charges rather than the gallonage charges.

The ALJs agree with CLWSC that the final rate structure should include base rates for all meter sizes and multi-tiered, volumetric rates using the consumption blocks proposed in the Application. The ALJs also agree that the parties should be given an opportunity to confer and possibly reach an agreement on the rate structure once the Commission determines CLWSC's revenue requirement. If agreement on a rate design is reached, then Finding of Fact (FOF) No. 117 could then be filled in to reflect the agreed rate design.

2. CLWSC's Request to Reopen the Record

In its response to the parties' closing arguments, CLWSC objected to the new schedules the ED and CEWR had attached to their respective closing arguments. CLWSC stated:

In addition to the substantive issues pertinent to this case, CLWSC is obligated to highlight a new procedural irregularity. Both the ED and CEWR attached new schedules to their closing argument briefs which are plainly outside the record evidence. CLWSC has not had the opportunity to cross-examine its opponents' respective witnesses who prepared these schedules or to offer evidence in rebuttal. Like the old schedules offered by its opponents, the new schedules *contain serious, substantive errors on their face* and perhaps more that would be revealed under cross-examination. However, without the ability to cross-examine the witnesses who created these schedules and to offer additional evidence as to those errors, CLWSC's case is prejudiced. *CLWSC respectfully requests that the ALJs strike the new schedules.* The ALJs *should not* base their PFD on these schedules in any event, but certainly not without permitting CLWSC the opportunity to cross[-]examination and rebuttal⁴

In his closing arguments, the ED claimed that the new schedules represented "a better approach" to the calculation of annual depreciation, in addition to the correction of one error.⁵ When calculating his proposed net plant for CLWSC, the ED inadvertently deducted the Startzville wastewater treatment plant (WWTP) twice from his proposed net plant. The new schedules attached to his closing arguments corrected that error. The ED did not recommend the correction of any other errors or miscalculations contained in the evidentiary record.

² CLWSC Reply to Exceptions, p. 22.

³ The ALJs agree with CLWSC regarding its miscellaneous fees and have proposed to add new FOF No. 117a, as set out in a subsequent section of this letter.

⁴ CLWSC Resp. to Closing, pp. 2-3 (emphasis added).

⁵ ED Closing, p. 29.

CEWR also attached new schedules to its closing arguments. Like the ED, CEWR argued that its new schedules provided a calculation to remove contributions in aid of construction (CIAC) from CLWSC's rate base through amortization, based on the weighted average useful life of CLWSC's pre-acquisition assets.⁶ CEWR stated that it relied on the record evidence to make this calculation.

After reviewing the parties' closing arguments, responses, and objections, the ALJs agreed with CLWSC that the schedules constituted new evidence submitted after the close of the evidentiary record. Therefore, the ALJs granted CLWSC's request to exclude the ED's new schedules and only considered the record developed during the evidentiary hearing in their analysis.⁷

Now, CLWSC seeks to reverse the ALJs' ruling and have the ED's new schedules admitted into the record. CLWSC alleges that the ED's new schedules correct "mistakes" that result in a \$1,059,247 reduction in CLWSC's net plant.⁸ The ED responded that the only mistake in the record in need of correction was the double-deduction for the Startzville WWTP. The ED asserts that the effect of this error on original cost "is less than a single percent," and correction of this error is a simple calculation that could be done at Agenda.⁹

CEWR argues that CLWSC objected to the schedules in its closing arguments, and it is too late now for CLWSC to change its position. If the record is reopened regarding the ED's schedules, CEWR requests that the record should also be reopened regarding its schedules that the ALJs excluded based on CLWSC's objection.

The ALJs do not recommend that the Commission grant CLWSC's request to reopen the record. CLWSC originally requested that the ED's schedules be excluded from the record, and the ALJs granted that request. Further, the ED's schedules were not wholesale corrections to the evidentiary record, because the only error in need of correction is the double-deduction for the Startzville WWTP. As stated by the ED, he can easily remedy that error without the necessity of reopening the record. For these reasons, the reasons stated in the PFD, and the ED's and CEWR's responses to CLWSC's request, the ALJs recommend that the Commission deny CLWSC's motion to reopen the record.

In the event the Commission disagrees and grants CLWSC's request to reopen the record, the ALJs recommend that the record be reopened to consider CEWR's new schedules, as well. The legal basis for the ALJs' exclusion of both CEWR's and the ED's schedules is the same: In the ALJs' opinion, both schedules presented new evidence outside the evidentiary record. As the ALJs will discuss below, CEWR's proposal may provide another method to remove the CIAC and cost-free capital from CLWSC's rate base, which may result in further reductions to

⁶ CEWR Closing, p. 30-31.

⁷ PFD, pp. 29-30. See Tex. Gov't Code § 2001.141(c) (findings of fact may only be based on evidence in the record and officially noticed).

⁸ CLWSC Exceptions, p. 20.

⁹ ED Reply to Exceptions, p. 12.

CLWSC's revenue requirement. In addition, if the matter is remanded based on CLWSC's motion to reopen the record, the ALJs request guidance from the Commission on whether the rate-case expenses for the remand are to be recovered from CLWSC's customers, especially because the schedules were originally excluded from the evidentiary record at CLWSC's request.

3. Rate Base

A. CLWSC's Exceptions

The ALJs have reviewed CLWSC's exceptions regarding the calculation of rate base, including its arguments about the ALJs' determination that the trending study was unreliable as an estimate of original cost. The ALJs are not persuaded by CLWSC's exceptions. For the reasons stated in the PFD, the booked costs are the most reliable estimate in this record of the original cost of the pre-acquisition assets, not CLWSC's trending study. Further, it is the ALJs' opinion that CLWSC failed to remove CIAC, accumulated deferred federal income tax, and other sources of cost-free capital from its proposed rate base. Therefore, it remains the ALJs' recommendation that CLWSC did not meet its burden of proving its proposed rate base complies with Tex. Water Code § 13.185(b) and 30 Tex. Admin. Code § 291.31(c). The ALJs decline to amend their PFD based on CLWSC's exceptions and recommend that the Commission adopt the ALJs' proposed FOFs and conclusions of law (COL).

In its reply to the ED's Exceptions regarding rate base, CLWSC states that the PFD fails to address regionalization and the impact of the Commission's decision on the future acquisition of troubled water systems.¹⁰ The ALJs reviewed CLWSC's proposed rate base to determine compliance with Tex. Water Code § 13.185(b) and 30 Tex. Admin. Code § 291.31(c). Neither the statute nor the rule provides for valuing a utility's rate base differently to encourage regionalization. Therefore, the ALJs did not address regionalization in their analysis of whether CLWSC met its burden of proof regarding its proposed rate-base valuation.

B. CEWR's Exceptions

CEWR's primary exception addresses the ALJs' recommendation on CLWSC's rate base. CEWR excepts to the ALJs' rejection of the purchase price of the WSC's assets as the original cost and the conclusion that there was good cause to include CIAC in CLWSC's rate base for those pre-acquisition assets, pursuant to 30 Tex. Admin. Code § 291.31(c)(3).

CEWR asserts that adopting the ALJs' analysis regarding good cause to include CIAC would be arbitrary for several reasons: (1) it would contravene Tex. Water Code § 13.185(b); (2) there are no standards on what constitutes good cause; and (3) no prior case has held that a lack of records constitutes good cause to ignore a statute.¹¹ CEWR points out that the good cause issue was not litigated during the contested case hearing because no party argued the issue.

¹⁰ CLWSC Reply to Exceptions, p. 8.

¹¹ CEWR Exceptions, p. 5.

CEWR correctly points out that good cause to include CIAC was not specifically raised by the parties. However, CLWSC's valuation of its rate base in compliance with 30 Tex. Admin. Code § 291.31(c) was the dominant issue in this case. After analyzing the parties' various positions on this issue, the ALJs concluded that none of the parties had presented a rate base that fully complied with 30 Tex. Admin. Code § 291.31(c), and the evidentiary record did not establish a way to effectively remove those items in a manner that complied with 30 Tex. Admin. Code § 291.31(c). Nevertheless, in the ALJs' opinion, the evidentiary record established that it would be difficult, if not impossible, for CLWSC to determine which asset was procured through CIAC or cost-free capital. Therefore, the ALJs concluded that good cause existed to support their recommended rate base, pursuant to 30 Tex. Admin. Code § 291.31(c)(3). The parties were aware that compliance with 30 Tex. Admin. Code § 291.31(c) was an issue in this case. For this reason, the ALJs determined that it was proper to rely on the good-cause exception found in 30 Tex. Admin. Code § 291.31(c)(3) as support for their recommended rate base.

Based on the evidentiary record, the ALJs have recommended a rate base that serves as the basis for just and reasonable rates. Therefore, the ALJs recommend that the Commission overrule CEWR's exceptions on the rate base and adopt the proposed FOFs and COLs on this issue without reopening the evidentiary record, as discussed above.

C. ED's Exceptions

The ED's primary exception addresses the ALJs' reluctance to use a negative acquisition adjustment to remove cost-free capital from CLWSC's rate base. The ED points out that although the PFD finds good cause to include CIAC within CLWSC's rate base, the ALJs did not specifically find that there was good cause to allow a utility to earn a return on the net book value of assets it purchased at a much lower price.¹² The ED asserts that the PFD allows CLWSC to include cost-free capital in its rate base without a finding of good cause to do so.

The ED correctly asserts that the reasons stated in the PFD regarding good cause relate to the inclusion of only CIAC in CLWSC's rate base. The ALJs' reasoning did not include a discussion of whether good cause exists to include cost-free capital attributable to the difference between the purchase price of the WSC's assets and the net book value of those assets. CLWSC responds that there is good cause because it is not possible to determine which specific assets were acquired through cost-free capital and it is not appropriate to reduce CLWSC's rate base by an aggregate amount.¹³

The ALJs have considered the evidence, closing arguments and responses, and exceptions and replies, regarding the ED's proposed negative acquisition adjustment. Although the use of a negative acquisition adjustment may be appropriate in the abstract, the ALJs declined to recommend a negative acquisition adjustment in this case. Therefore, the ALJs do not recommend any changes to FOF No. 68 and FOF No. 107 to include a negative acquisition adjustment.

¹² ED Exceptions, p. 5.

¹³ CLWSC Reply to Exceptions, p. 4.

The ED also made a recommendation in his Exceptions regarding future net acquisition adjustments. In the conclusion section of his closing arguments, the ED argued that CLWSC should be required to amortize the net acquisition adjustment as of the end of the test year, but should also be required to separately account for future purchases without amortization or rate treatment until a future rate case can address the purchases.¹⁴ Specifically, the ED requested that:

CLWSC treat each separate acquisition adjustment occurring after March 31, 2010, in compliance with the Texas Water Code and keep separate accounting of such within the acquisition adjustment account for determination of treatment in future rate cases, and that the net acquisition adjustment dealt with in the current case be unadjusted by future acquisition adjustment so that the treatment determined in this case is retained¹⁵

In his Exceptions, the ED again requested an accounting order regarding future purchases.¹⁶ CLWSC responded that the ED's insistence on an accounting order is beyond the scope of this hearing and was raised for the first time in the ED's closing arguments.¹⁷

The ED placed this request only in the conclusion section of his closing arguments, and the PFD did not address this issue. Further, the ALJs agree with CLWSC that this proposal appears to be outside the scope of this proceeding because it concerns future acquisitions. For this reason, the ALJs recommend that the Commission overrule this exception.

4. Rate of Return

CLWSC filed exceptions concerning the overall rate of return, including the ALJs' cost of debt and return on equity determinations. As outlined in the PFD, the ED advocated a rate of return of 6.18%; CLWSC requested a rate of return of 8.67%; and the ALJs recommended a rate of return of 6.46%.

CLWSC excepted to inclusion of an intercompany loan at 2.25% interest in the cost of debt and calculation of the return on equity based the Rate of Return Worksheet (worksheet) used by the ED. For the reasons stated in the PFD and as recapped here, we do not recommend any change to the 6.46% proposed rate of return.

A. Cost of Debt

In regards to the ED's inclusion of the intercompany loan at 2.25% interest in the cost of debt, CLWSC argues that the Commission should disregard the "actual debt" requirement and

¹⁴ ED Exceptions, p. 13-14.

¹⁵ ED Closing, p. 48.

¹⁶ ED Exceptions, pp. 13-14.

¹⁷ CLWSC Reply to Exceptions, p. 15. A review of the record indicates that the ED's witness, Debi Loockerman, testified regarding such future acquisition adjustments. ED-DL-1A, pp. 3-4.

substitute a "hypothetical capital structure," an estimated rate sufficient to attract new capital. Alternatively, CLWSC proposes that the Commission substitute a debt component it deems "reasonable," due to the lack of an arms-length transaction between the two affiliates, CLWSC and SJW Corp. We disagree with these assertions.

As noted in the PFD, the facts support the determination that CLWSC had a legal obligation to repay the debt, including the following: (1) the loan was reported on the intercompany notes payable worksheet provided by CLWSC; (2) the loan was listed on a statement of cash flow provided by CLWSC as "borrowing from a line of credit;" (3) the loan was listed in the financial statement of SJW Corp.; (4) the loan has existed on CLWSC's books since 2007; (5) the loan has increased from a balance of \$1 million to \$11,250,000 with the interest incrementally increasing; (6) SJW Corp. has been charging and receiving interest for the use of its money; (7) CLWSC has made intermittent payments on the principal; and (8) the loan has never been reduced to zero or written off CLWSC's or SJW Corp.'s books. Therefore, in the ALJs' opinion, the preponderant evidence does not support CLWSC's position, and the ALJs recommend that CLWSC's exceptions on this issue be overruled.

B. Return on Equity

CLWSC excepts to the ALJs' decision to rely on the worksheet to establish CLWSC's return on equity. It re-urges its position that a 12% or higher rate of return should be allowed, as recommended by its expert witness. The worksheet applies the rate of return principles set out in the Texas Water Code and the current rules; ensures access to credit and equity markets; and accounts for systems with higher risks to capital. Further, the ED's witness, Debi Loockerman, provided credible testimony on the practicality of the worksheet, despite her seemingly contradictory testimony made while she was in private practice. It should also be noted that the PFD recommended an upward adjustment from the ED's recommended return on equity of 9.88%, to 10.88% based on CLWSC's seasonal population. For these reasons and other reasons set out in the PFD, the ALJs recommend that the Commission overrule CLWSC's exceptions on this issue.

5. Expenses

A. Bad Debt/Office Expenses

Regarding office expenses, CEWR and the ED pointed out in their exceptions that the ALJs disallowed \$47,736 in office expenses; an amount grounded upon CLWSC's assumption that its bad debts would increase with its higher rates. Because the ALJs were not aware that this amount had not been deducted from the test year amount proposed in the ED's exhibit, the ALJs did not deduct this amount from the rate-setting calculations in the PFD and in proposed FOF Nos. 89 and 90. Accordingly, the ALJs agree with the ED's correction to this expense and have made corresponding changes to their proposed FOFs.

The ED also provided various calculations that are impacted by the correction. Specifically, the removal of \$47,736 from office expenses led to changes in working capital, federal income taxes, and the reduction in rate base for accumulated deferred federal income tax.

As shown below in a subsequent section, the ALJs have inserted the appropriate amounts in their proposed FOFs and COLs to reflect the ED's flow-through calculations.

B. Other Expenses

CLWSC excepted to the PFD's recommendations on corporate allocations, employee benefits, director's fees, and normalized expense adjustments. The ALJs weighed the parties' evidence and arguments on these issues in the PFD. CLWSC's exceptions reassert the arguments the ALJs have already considered and rejected. Therefore, the ALJs recommend that the Commission overrule CLWSC's exceptions on these issues and adopt the FOFs and COLs in the ALJs' Proposed Order.

C. Depreciation, Federal Income Tax, and Other Taxes

CLWSC excepted to the adoption of the ED's depreciation expense amount, income tax, and other tax recommendations. These expenses are dependent upon the determination of CLWSC's rate base. As discussed above, the ALJs recommend that the Commission overrule CLWSC's exceptions regarding its rate base. Accordingly, the ALJs recommend that the Commission overrule CLWSC's exceptions on these expenses.

D. Rate-Case Expenses within Cost of Service

In its application, CLWSC included in its cost of service \$57,250 in rate-case expenses.¹⁸ However, CLWSC presented the following expert testimony regarding the impropriety of including such rate-case expenses in its cost of service:

[What we are proposing] through my testimony is backing that \$114,000 [in rate-case expenses] out of the cost of service and taking all costs related to the rate-case expenses, and recovering those as a surcharge, that's what the Commission has consistently done in every rate case for the last ten years.¹⁹

Consistent with this testimony, the ALJs recommended that the rate-case expenses be removed from CLWSC's cost of service and recovered through a surcharge, if CLWSC qualified to recover its expenses.²⁰

In its exceptions, CLWSC now seeks to add back into its cost of service the \$57,250 in rate-case expenses.²¹ CLWSC takes this position if its cost of service is insufficient to produce rates that will meet the 51% Rule found in 30 Tex. Admin. Code § 291.2(8).

¹⁸ This expense equates to approximately \$114,000 for two years.

¹⁹ Tr. p. 1616.

²⁰ PFD, p. 70.

²¹ CLWSC Exceptions, pp. 47-48.

The ALJs have reviewed CLWSC's exceptions and decline to amend the PFD or the Proposed Order to include within the cost of service the \$57,250 in rate-case expenses. As CLWSC's expert testified, the Commission has not included these expenses within a utility's cost of service for the last 10 years. Further, as stated in the PFD, it would skew the 51% Rule calculation for the utility's benefit if rate-case expenses were included.²² For the reasons stated here and in the PFD, the ALJs decline to amend the PFD or change the proposed FOFs and COLs and recommend that the Commission overrule CLWSC's exceptions on this issue.

6. Rate Collection True-Up Recommendation

In its exceptions, CLWSC argues that it should be allowed to impose a surcharge on its customers to collect any under-collection between the proposed and interim and the final rate determined in this proceeding. CLWSC asserts that the effective date of any final rate is October 27, 2010.

The ALJs recommend that the Commission overrule CLWSC's exceptions regarding the appropriate date to calculate refunds or surcharges. The dates relied on by the ALJs were those dates noticed by CLWSC in its August 27, 2012 Notice of Proposed Rate Change.²³ CLWSC's exceptions do not change the ALJs' recommendation, and the ALJs recommend that the Commission overrule CLWSC's exceptions on this issue.

Both CEWR and the ED suggested language to be used to modify the FOFs addressing the true-up issue.²⁴ CEWR points out that the ALJs' proposed FOF No. 115 does not address the situation presented by the PFD, where the proposed and interim rates are higher than the final rates proposed by the ALJs. The ALJs agree with CEWR's exception and change their proposed FOF No. 115 as follows:

FOF No. 115. The true-up in this proceeding relates back to the noticed effective date of March 15, 2011, for rates that exceed the Phase 1 rates put in place by CLWSC on October 27, 2010. The true-up relates back to October 27, 2010 for rates that are less than the Phase 1 rates.

7. Rate-Case Expense Recommendations

A. CLWSC's Exceptions

The ALJs have reviewed CLWSC's exceptions on this issue and the parties' responses. The ALJs are not persuaded that their recommendations regarding the specific categories of rate-case expenses should be changed. Therefore, the ALJs recommend that the Commission overrule CLWSC's exceptions on this issue and adopt the ALJs' proposed FOFs and COLs.

²² PFD, pp. 120-121.

²³ PFD, p. 90-91.

²⁴ CEWR Exceptions, p. 13; ED Exceptions, pp. 26-27.

B. The ED's Exceptions

The ED is concerned about a sentence in the PFD and how it will be interpreted in future cases. On the issue of whether CLWSC had excess attorneys attending depositions and participating in the evidentiary hearing, the ALJs stated that “[b]ecause this was a very complex case, the ALJs will not second guess attorney strategy or preparation.”²⁵

This case presented complex issues in need of resolution through a contested-case hearing. The ALJs did not intend to imply that a utility could recover its rate-case expenses for any number of attorneys in every contested case hearing on any rate-change application. The ALJs' recommendation is based on the complexities presented in this specific case. The ALJs conclude that the facts of this case make it unique, and the referenced sentence should not be construed to apply in any other rate-case proceeding.

8. CLWSC's Ability to Recover its Rate-Case Expenses (Applicability of 51% Rule and Settlement Rule)

In its replies to the parties' exceptions, CLWSC argues for the first time that the ED's method for calculating whether CLWSC has met the 51% Rule in 30 Tex. Admin. Code § 291.28(8) is deficient because it does not consider an accounting mechanism called the “matching principle.”²⁶ However, CLWSC's arguments regarding the matching principle are untimely and constitute evidence submitted after the close of the evidentiary record.

CLWSC did not cross-examine Ms. Loockerman on the matching principle after she testified that CLWSC did not meet the 51% Rule and was not entitled to recover its rate-case expenses. Nor did CLWSC present evidence on the matching principle during its rebuttal case. In its closing arguments, CLWSC stated: “The formula offered by the ED in ED Ex. 9 is generally correct, but the numbers are not.”²⁷ CLWSC did not argue in either its closing arguments or replies that the ED's 51% Rule calculation was fundamentally defective for its failure to apply the matching principle. In reliance on the evidentiary record and arguments before them, the ALJs adopted the ED's formula to calculate whether CLWSC would meet the 51% Rule threshold.²⁸

The ALJs recommend that the Commission disregard CLWSC's matching principle arguments and its 51% Rule calculations because the arguments are untimely and constitute new evidence submitted after the evidentiary record has closed. Regarding whether the Commission

²⁵ PFD, p. 112.

²⁶ CLWSC Reply to Exceptions, pp. 24-27; Att. B.

²⁷ CLWSC Rate-Case Expense Closing Arguments, p. 17.

²⁸ PFD, p. 121. As pointed out by CEWR on page 13 of its Exceptions, there is an error on page 121 of the PFD. In the equation to determine the difference between the revenue generated by CLWSC's proposed rates and its previous rates, the ALJs included \$6,917,199 as the amount of revenues generated by CLWSC's previous rates. The correct amount is \$6,917,243. Finding of Fact No. 131 in the ALJs' Proposed Order regarding this issue contains the correct amount, \$6,917,243, and need not be corrected.

has the discretion to apply the 51% Rule, the ALJs agree with CEWR and the ED that the 51% Rule is not discretionary according to the Code Construction Act.²⁹

Further, according to the calculations performed by the ED, the Settlement Rule in 30 Tex. Admin. Code § 291.28(9) does not preclude CLWSC's recovery of rate-case expenses if the Commission adopts the recommendations in the PFD. Therefore, the ALJs have amended the FOFs and COLs in the Proposed Order to reflect that the Settlement Rule is not a bar to CLWSC's recovery of rate-case expenses.

The ALJs recommend that the Commission overrule CLWSC's exceptions on its ability to recover its rate-case expenses. The revenue generated by the rates recommended by the ALJs is 48.7% of the revenue that would have been generated by CLWSC's proposed rates.³⁰ Therefore, CLWSC has failed to satisfy the 51% Rule and is not entitled to recover its rate-case expenses from its customers. Accordingly, the ALJs have amended the FOFs and COLs in their Proposed Order regarding the 51% Rule.

9. CLWSC's Proposed Findings of Fact and Conclusions of Law

CLWSC attached to their Exceptions proposed FOFs and COLs. Given the ALJs' recommendations regarding CLWSC's Exceptions, the ALJs do not recommend the adoption of CLWSC's proposed FOFs and COLs.

10. Revisions to Proposed Order

In a few of their proposed FOFs and COLs, the ALJs left blanks to be filled in once the ED performed the calculations necessary to implement the ALJs' recommendations. In addition, the ED and CEWR made suggested changes to various findings and conclusions. For example, as pointed out by CEWR and the ED in their Exceptions, it is necessary for the ALJs to correct proposed FOFs regarding the amount of CLWSC's office expenses and its flow-through effect. In addition, because CLWSC did not meet the 51% Rule and is not entitled to recover its rate-case expenses, the ALJs recommend changes to the Ordering Provisions in their Proposed Order.

The ALJs also amend FOF No. 117 to reflect that CLWSC's rate design should include base rates for all meter sizes and multi-tiered, volumetric rates based on the consumption blocks proposed by CLWSC in its Application. The actual rates can be calculated once the Commission determines CLWSC's revenue requirement.

Based upon the parties' exceptions and responses, the ALJs make the following revisions to their Proposed Order. To assist the Commission, the ALJs have footnoted the source of the proposed changes.

²⁹ Tex. Gov't Code § 311.016(5) (The term "may not," as used in 30 Tex. Admin. Code § 291.28(8), imposes a prohibition and is synonymous with the term "shall not.").

³⁰ ED Exceptions, p. 20; Att. D.

FOF No. 68. CLWSC's rate base is.³¹

Item	Amount
Original Cost	\$64,206,901
Accumulated Depreciation	<11,248,825>
Net Book Value	\$52,958,076
Working Cash Allowance	625,726 619,759
Materials and Supplies	361,235
Prepayments	4,900
ADFIT	<268,037> <354,922>
Developer CIAC	<14,812,965>
Advances	<772,550>
Total Rate Base (Total Invested Capital)	\$38,096,384 \$38,003,533

FOF No. 89. The reasonable and necessary office expense, including bad debt expense, unadjusted for normalization, is ~~\$332,128~~ \$284,392.³²

FOF No. 90. The following expenses are reasonable and necessary to provide service to the ratepayers:³³

Category	Amount
Salaries	\$1,084,930.55
Contract Services	289,988
Purchased Water	1,141,619
Chemicals and Treatment	91,100
Utilities	459,763
Repairs and Maintenance	996,704
Office Expense	-332,128 <u>284,392</u>
Accounting and Legal	84,359
Insurance	311,422
Miscellaneous	213,798
Total	\$5,005,811.55 \$4,958,076

FOF No. 93. CLWSC's reasonable and necessary annual federal income taxes total \$709,845.³⁴

³¹ ED Exceptions, Att. B, p. 5.

³² ED Exceptions, p. 18; CEWR Exceptions, pp. 12-13.

³³ ED Exceptions, p. 25.

³⁴ ED Exceptions, p. 25.

FOF No. 110: CLWSC's audited books include approximately \$3.2 million in costs that represent an amount paid in the transaction with the Bexar Metropolitan Water District and Bulverde to acquire a large CCN service area.³⁵

FOF No. 115. The true-up in this proceeding relates back to the noticed effective date of March 15, 2011, for those rates that exceed the Phase 1 rates put in place by CLWSC on October 27, 2010. The true-up relates back to October 27, 2010, for rates that are less than the Phase 1 rates.³⁶

FOF No. 117. The following rate structure will recover CLWSC's revenue requirement:³⁷

Monthly Minimum Charge by Meter Size

Size in inches	Charge
5/8	
3/4	
1	
1 1/2	
2	
3	
4	
6	
Bulk	

Charges Per 1,000 Gallons (G)

Size in inches	Charge
5/8 x 3/4	\$ ___ first 2,000G
	\$ ___ next 8,000G
	\$ ___ next 15,000G
	\$ ___ over 25,000G
3/4	\$ ___ first 4,000G
	\$ ___ next 16,000G
	\$ ___ next 30,000G
	\$ ___ over 50,000G
1	\$ ___ first 6,000G
	\$ ___ next 24,000G

³⁵ ED Exceptions, p. 26.

³⁶ CEWR Exceptions, p. 13.

³⁷ Once the Commission determines CLWSC's revenue requirement, the ED should prepare a rate design based on the meter sizes and consumption blocks proposed by CLWSC in its Application.

	\$ _____ next 45,000G
	\$ _____ over 75,000G
Meter size greater than 1	\$ _____ all gallons

FOF No. 117a. The miscellaneous service fees and tariff provisions not contested in the contested case hearing and set forth in the tariff attached to the Application are reasonable.³⁸

FOF No. 134. CLWSC's just and reasonable rates as determined by the Commission after this contested case hearing will generate \$9,180,677 in annual revenue.³⁹

FOF No. 135. CLWSC's just and reasonable rates as determined by the Commission after this contested case hearing will increase its annual revenue by \$2,263,434.⁴⁰

FOF No. 136. \$2,263,434 is 48.7% of \$4,651,199.⁴¹

FOF No. 137. CLWSC's new rates generate revenue that is less than 51% of the increase in revenue that would have been generated by CLWSC's proposed rate.⁴²

FOF No. 140. [This FOF should be omitted because it is duplicative of FOF No. 134.]

FOF No. 141. [This FOF should be omitted because CLWSC did not meet the 51% Rule and is not entitled to recover rate-case expenses.]

FOF No. 142. [This FOF should be omitted because CLWSC did not meet the 51% Rule and is not entitled to recover rate-case expenses.]

FOF No. 143. [This FOF should be omitted because CLWSC did not meet the 51% Rule and is not entitled to recover rate-case expenses.]

COL No. 27. Based on the findings of fact and conclusions of law, CLWSC may not recover its rate-case expenses because the just and reasonable rates determined by the Commission in this contested case is less than 51% of the increase in revenue that would have been generated by CLWSC's proposed rates.

COL No. 29. Based on the findings of fact and conclusions of law, the Settlement Rule does not preclude CLWSC's recovery of its rate-case expenses because the

³⁸ CLWSC Reply to Exceptions, p. 22.

³⁹ ED Exceptions, p. 27; Att. D.

⁴⁰ ED Exceptions, pp. 27-28; Att. D.

⁴¹ ED Exceptions, p. 28; Att. D.

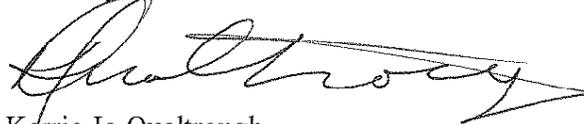
⁴² ED Exceptions, p. 28.

~~Commission's final ordered rates would generate more revenue than CEWR's written settlement offer. CLWSC _____ recover any rate case expenses incurred after the date of a written settlement offer by all ratepayer parties because the revenue generated by the just and reasonable rate determined by the Commission in this contested case hearing is _____ the revenue that would have been generated by the rate contained in CEWR's written settlement offer.~~⁴³

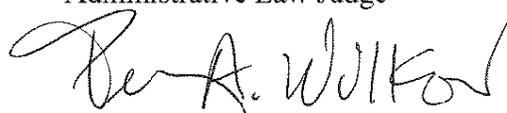
Ordering Provision No. 2. The request of Canyon Lake Water Service Company to apply a surcharge to recover rate-case expenses in the amount of \$856,74.42, to be recovered as a monthly surcharge of \$ _____ to each water customer for two years or until paid, is denied approved. ~~The surcharge shall be discontinued at such time as the amount of \$ _____ is recovered.~~⁴⁴

Ordering Provision No. 3. Canyon Lake Water Service Company will calculate the difference between what each customer paid under its proposed rates and interim rates and the final rates as determined by the Commission and shall refund that amount to each customer over the same number of months that the customer paid the interim or proposed rates. ~~shall submit a semi-annual report to the TCEQ, Water Supply Division, beginning six months after the date of this order, showing the total surcharge collected and the remaining balance.~~

Sincerely,



Kerrie Jo Qualtrough
Administrative Law Judge



Penny A. Wilkov
Administrative Law Judge

/nl

xc: Attached Service List

⁴³ ED Exceptions, p. 29.

⁴⁴ ED Exceptions, p. 30.

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STYLE/CASE: SJWTX INC / CANYON LAKE WATER SERVICE CO
SOAH DOCKET NUMBER: 582-11-1468
REFERRING AGENCY CASE: 2010-1841-UCR

**STATE OFFICE OF ADMINISTRATIVE
HEARINGS**

**ADMINISTRATIVE LAW JUDGE
ALJ KERRIE QUALTROUGH**

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