

Bryan W. Shaw, Ph.D., *Chairman*
Carlos Rubinstein, *Commissioner*
Toby Baker, *Commissioner*
Zak Covar, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

September 4, 2013

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

Re: Appeal by BFE Water Company of the ratemaking action of the City of Cresson and motion for interim rate relief in Parker County, Application No. 37311-A; SOAH Docket No. 582-12-6250; TCEQ Docket No. 2012-0786-UCR

Dear Ms. Bohac:

Enclosed for filing with the Texas Commission on Environmental Quality is the original plus seven copies of "The Executive Director's Replies to Exceptions to the Proposal for Decision" for the above-referenced matter.

Please contact me at (512) 239-4761 if you have any questions.

Sincerely,

Handwritten signature of Kayla Murray in cursive.

Kayla Murray
Staff Attorney
Environmental Law Division

Enclosure

cc: Mailing List

CHIEF CLERKS OFFICE

2013 SEP -4 PM 4: 16

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

SOAH DOCKET NO. 582-12-6250
TCEQ DOCKET NO. 2012-0786-UCR

2013 SEP -4 PM 4: 12
CHIEF CLERKS OFFICE
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

APPEAL OF THE § BEFORE THE TEXAS
CITY OF CRESSON'S § COMMISSION
ORDER SETTING RATES § ON
FOR BFE WATER COMPANY § ENVIRONMENTAL QUALITY

THE EXECUTIVE DIRECTOR'S REPLIES TO THE EXCEPTIONS TO THE PROPOSAL FOR DECISION AND PROPOSED ORDER

TO THE HONORABLE COMMISSIONERS OF THE TCEQ:

COMES NOW, the Executive Director ("ED") of the Texas Commission on Environmental Quality ("TCEQ" or "Commission") and files these replies to the exceptions to the Administrative Law Judge's ("ALJ") Proposal for Decision ("PFD") and proposed order in the above-captioned matter.

I. INTRODUCTION

On August 26, 2013, the following parties, in addition to the ED, filed exceptions to the ALJ's August 5, 2013 PFD and proposed order: Bourland Field Estates Water Company ("BFE"), the City of Cresson ("City"), and Scott Perdue (on behalf of himself and the BFE Homeowners' Association). Since the ED has addressed at length in previous filings many of the issues raised, and since the ALJ's PFD was exceptionally thorough and the ED agreed with the majority of it, the ED will briefly address the main issues raised in the exceptions.

II. JURISDICTION

The City and Mr. Perdue both raised a jurisdictional challenge in their exceptions. This challenge consists of an assertion that BFE is in violation of the 12-month filing requirement pursuant to TEXAS WATER CODE ("TWC") § 13.187(p). As noted in the PFD, this is a challenge that these two parties raised at the preliminary hearing on June 7, 2012. The ALJ found their challenge lacked merit and dismissed it. The City and Mr. Perdue raised this challenge again in their respective closing arguments and again, in his PFD, the ALJ found this challenge to be without merit.

To summarize what has already been discussed extensively, BFE filed a rate increase application with the City on January 27, 2009. On October 7, 2009, the City told BFE it had surrendered jurisdiction over BFE's rates to the TCEQ and to therefore

file a rate application with the TCEQ. BFE did so on October 6, 2009. The TCEQ ultimately returned the application to BFE on June 11, 2010, stating that the City had not properly relinquished jurisdiction to the TCEQ, and thus, the City still had original jurisdiction over BFE's rates. This application was transferred to the City on July 11, 2010, and the City set rates for BFE on January 24, 2012.

At the preliminary hearing, the ALJ determined that the January 27, 2009 application was void since BFE did not send notice to its customers pursuant to TWC § 13.187(a), and therefore BFE was not in violation of TWC § 13.187(p). New evidence was introduced at the hearing on the merits that led the ALJ to conclude that BFE *had* provided notice to its customers of the January 27, 2009 application. However, the ALJ still found that BFE was not in violation of TWC § 13.187(p) because "...(T)he greater weight of the evidence shows that Cresson concluded that it did not have jurisdiction over the January 27, 2009 Previous Application, dismissed it, and directed BFE to file a corrected application with the TCEQ. Thus, in accordance with the last sentence of Texas Water Code § 13.187(p), the October 6, 2009 Application did not violate the 12-month filing prohibition."¹ The ED concurs with the ALJ's analysis supporting this conclusion, as well as the conclusions that BFE was entitled to appeal the City's decision on BFE's October 26, 2009 application and that the Commission has jurisdiction to consider this appeal.

In its exceptions, the City asserted that the ALJ neglected to adhere to the Texas Attorney General's interpretation of Texas Supreme Court rulings by not determining whether BFE violated certain sections of the TEXAS BUSINESS AND COMMERCE CODE ("TBCC").² In arguing this point, the City cited Texas Attorney General Opinion No. GA-0727, which the City interpreted as opining that "state agencies such as the TCEQ must not create rulings that deviate from the Legislature's intent in statutes irregardless (sic) of where the statute exists relative to other statutes"³In fact, the opinion examined the narrow issue of whether a state agency's administrative rule was inconsistent with language in a statute, and concluded that a state court would likely decide that a rule that is inconsistent with a statute is invalid.⁴The ED agrees with the ALJ that determining whether BFE has complied with certain provisions of the TBCC is beyond the scope of the TCEQ's delegated authority. The opinions cited by the City do not require the TCEQ to interpret and apply all potentially relevant statutes; they merely opine that state agencies may not enact rules that conflict with statutes. As the City has failed to assert that any specific Commission rule is inconsistent with any specific statutory provision, including those in the TBCC, the ED agrees with the ALJ's conclusion that the TCEQ does not have jurisdiction to determine whether BFE complied with certain TBCC provisions and did not err in failing to do so.

¹ PFD at page 11.

² City of Cresson's Exceptions to the PFD at pages 3-5.

³ City of Cresson's Exceptions to the PFD at page 3.

⁴ Atty Gen. Op. No. GA-0727. The City also relied on Texas Attorney General Letter Opinion No. 94-069 and Open Records Request No. 588, stating that the definition of "courts" includes an administrative forum.

III. DEVELOPER CONTRIBUTION

Throughout this case, one of the main issues that the City and Mr. Perdue have raised is whether BFE received developer contributions. Developer contributions are monies that a developer reimbursed to the utility for the construction of the facilities.⁵ As the ED stated in his closing arguments, “BFE did not list any developer contributions in either its current application or the 2002 application. Mr. Bourland testified in both his prefiled testimony and at the evidentiary hearing that he never intended for BFE to report developer contributions. He also testified that the lot prices did not include the cost of the water system. No evidence, such as contracts or other legal documents, was presented during the hearing to show that the sale of the lots would include the cost of the water system. If the cost of the lots had included the cost of the system, the water system would have been paid for by the purchases of the lots and the utility would not have had to make any investment and therefore would not be entitled to a return on its investment. Moreover, in BFE’s 1998 Certificate of Convenience and Necessity (“CCN”) application, BFE Development Corp. d/b/a BFE Water Co. listed a note payable of \$156,868.00 for its first year of business in its five-year projected balance sheets. It also listed a note payment of \$12,839.52. If BFE did not intend to finance the equipment, then it likely would not have listed a note payable amount or a note payment in the projections. The listing of these notes indicates that BFE’s plant was funded through an investment by the owner and not through developer contribution.”⁶

As noted in the PFD, since there was no “significant direct evidence of a developer contribution to BFE, the Protestants point to unrelated evidence and attempt to infer from it that there must have been a developer contribution.”⁷ The City and Mr. Perdue point again to this unrelated evidence in their exceptions to the PFD. For the reasons outlined above, the ED maintains his position that BFE has not benefited from developer contributions and is thus entitled to an 11.25% rate of return recommended in ED expert Debi Loockerman’s prefiled testimony.

IV. TAXES

Mr. Perdue asserts that the ED improperly interpreted Mr. Bourland’s tax returns, resulting in an unfounded determination regarding BFE’s allowable income tax. While Mr. Perdue is correct that the ED used the information gathered from Mr. Bourland’s tax returns for the purpose of developing his recommendations, the ED did not act improperly. Ms. Loockerman testified at the hearing on the merits that she examined both BFE’s and Mr. Bourland’s tax returns during her review and determined that BFE’s income tax for the water system was reported on Mr. Bourland’s personal tax return and not BFE’s tax return, which addressed the income tax for BFE Development, Inc.⁸ Accordingly, she correctly calculated BFE’s allowable income tax expense on a normalized basis using BFE’s income tax information located in Mr. Bourland’s tax

⁵ 30 TAC § 291.86(c)(2).

⁶ ED’s closing arguments at pages 4-5.

⁷ PFD at page 35.

⁸ Transcript, page 470, lines 24-25.

return. Because Mr. Bourland listed BFE's taxable income on his personal account and was responsible for paying federal income tax on it, the ED maintains his position that BFE may recover this amount through its cost of service.

V. FIRE HYDRANTS

The City and Mr. Perdue both take issue with the ALJ's finding that BFE's fire hydrants are used and useful. They both recommend that gate valves be installed to flush the system. However, the City testified at the hearing on the merits that the fire department has used the fire hydrants for fire protection, as well as to refill the fire department's trucks. This makes it clear that the BFE subdivision is receiving the benefit of the fire hydrants being used for fire protection. Therefore, the ED maintains his position that the ALJ agreed with in the PFD – that the fire hydrants are used and useful and BFE should be allowed to recover its full investment in those fire hydrants through depreciation and return. Furthermore, even if the fire hydrants were removed from the cost of service, that would result in the ED's calculated base rate of \$61.11 being reduced by \$1.55 to \$59.56. This still leaves ample room for BFE to support its proposed base rate of \$38.50.⁹

VI. LOW GROWTH

The City raises a new argument in its exceptions – that the rate of return for BFE should not include a 1% increase for low growth. The City's basis for this argument is the Water and Wastewater Utilities Annual Report.¹⁰ However, because the City did not raise this issue previously, the ED recommends that this argument be rejected by the ALJ and the Commissioners. If the City's argument is accepted, the ED recommends that the PFD's recommended rate of return be upheld based on the evidence in the record and the ED's recommendation.

Relying on her expertise in calculating return on investment and current TCEQ practices, Ms. Loockerman determined that it was appropriate to give BFE credit when calculating the rate of return to encompass "the risk of a smaller business"¹¹ based on low growth. As discussed in her prefiled testimony, Ms. Loockerman made this determination in light of Texas's economic environment and after reviewing documents listing appropriate rates of return for similarly-situated utilities from California.¹² Accordingly, the ED's recommended rate of return appropriately relies on established practice and expertise, takes into account the low growth rate of the area, and is reasonable in light of the size of the utility and its management practices.

⁹ If the City determines that it does not want the fire hydrants to be used for fire protection in the subdivision, then it must instruct BFE to paint the fire hydrants black pursuant to TEXAS HEALTH AND SAFETY CODE § 341.0357.

¹⁰ City's Exceptions to the PFD, page 8.

¹¹ Direct Testimony of Debi Loockerman, page 13, lines 2-3.

¹² Direct Testimony of Debi Loockerman, page 13, lines 5-10.

VII. RATE CASE EXPENSES

BFE takes issue with the ALJ's adoption of the ED's recommendation that \$2,973 in legal expenses and \$1,200 in rate case expenses be disallowed. The ED maintains his position that these two amounts should not be recovered by BFE. The ED disallowed \$2,973 in legal expenses for time associated with BFE's argument before the City that the City had lost jurisdiction. Ms. Loockerman recommended this reduction after deciding that the time spent forming this legal position was not reasonable, necessary, and in the public interest.¹³ Additionally, the ED disallowed \$1,200 in rate case expenses associated with BFE's escrow payment to the City. Although Mr. Bourland testified that BFE paid the required escrow amount to the City, and as explained in the ED's closing arguments,¹⁴ the ED maintains that BFE has not met its burden of proof regarding this expense and should therefore not recover this amount through its rate case expenses.

VIII. CONCLUSION

The ED maintains his recommendation that the Commission approve BFE's proposed rates. The ED also maintains his recommendation that the surcharges be recovered over 24-months, which is the same amount of time that the rates were in place.

¹³ ED-BDD-6 at page 21, lines 4-7.

¹⁴ ED's Closing Arguments, page 9.

Respectfully Submitted,

Texas Commission on Environmental Quality

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REPRESENTING THE
EXECUTIVE DIRECTOR OF THE
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ENVIRONMENTAL QUALITY

CERTIFICATE OF SERVICE

I certify that on September 4, 2013, a copy of the foregoing document was sent by first class, agency mail, electronic mail, and/or facsimile to the persons on the attached Mailing List.

Kayla Murray
Kayla Murray, Staff Attorney

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SOAH Docket No. 582-12-6250
TCEQ Docket No. 2012-0786-UCR

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