

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

August 5, 2013

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

Re: **SOAH Docket No. 582-12-6250; TCEQ Docket No. 2012-0786-UCR; In 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**

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 **August 26, 2013**. Any replies to exceptions or briefs must be filed in the same manner no later than **September 4, 2013**.

This matter has been designated **TCEQ Docket No. 2012-0786-UCR; SOAH Docket No. 582-12-6250**. 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 cursive script that reads "William G. Newchurch".

William G. Newchurch
Administrative Law Judge

WGN/Ls
Enclosures
cc: Mailing List

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STYLE/CASE: BFE WATER COMPANY
SOAH DOCKET NUMBER: 582-12-6250
REFERRING AGENCY CASE: 2012-0786-UCR

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HEARINGS**

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

APPEAL BY BFE WATER COMPANY § BEFORE THE STATE OFFICE
OF THE RATEMAKING ACTION OF §
THE CITY OF CRESSON AND § OF
MOTION FOR INTERIM RATE §
RELIEF IN PARKER COUNTY, § ADMINISTRATIVE HEARINGS
APPLICATION NO. 37311-A

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OF THE RATEMAKING ACTION OF §
THE CITY OF CRESSON AND § OF
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RELIEF IN PARKER COUNTY, § ADMINISTRATIVE HEARINGS
APPLICATION NO. 37311-A**

PROPOSAL FOR DECISION

I. INTRODUCTION

BFE Water Company (BFE) has appealed an order of the City of Cresson (Cresson or City) setting the rates that BFE may charge for retail water service within the City. Cresson did not approve the rate increase that BFE had sought. BFE asks the Texas Commission on Environmental Quality (Commission) to grant its appeal, approve the full increase, and allow it to levy surcharges to recover the rate revenue it lost since its proposed effective date and its expenses of prosecuting its rate-increase application before Cresson and this appeal. The following are parties in this case:

| PARTY | REPRESENTATIVE |
|--|----------------------------------|
| BFE | Lambeth Townsend & Eileen McPhee |
| Executive Director (ED) | Kayla Murray |
| Office of Public Interest Counsel (OPIC) | Scott Humphrey |
| Cresson | Ron Becker |
| Harold Scott Perdue and Bourland Field Estates Homeowners' Association, Inc. (HOA) | Harold Scott Perdue |

Mr. Perdue, the HOA, and the City (Protestants) ask the Commission to overrule BFE's appeal its entirety and deny BFE's request to recover lost revenue and rate-case expenses. While disagreeing with BFE on some specific points, the ED and OPIC believe BFE has demonstrated that its entire requested rate increase is justified and should be approved. The ED agrees that BFE should be allowed to recover its rate-case expenses, with some disallowances, but proposes a longer period to recover the rate-case expenses than BFE seeks. OPIC believes that the public

interest would justify the Commission limiting the amount of rate-case expenses that BFE may recover. Neither the ED nor OPIC addresses BFE's request to recover lost revenue.

The Administrative Law Judge (ALJ) concludes that the appeal should be sustained, at least in part. Because the ALJ asks the ED to recalculate certain items based on the record and the ALJ's conclusions in this Proposal for Decision (PFD), the ALJ does not recommend specific rates in this PFD. Instead, the ALJ will recommend rates in his letter to the Commission concerning exceptions. However, the ALJ agrees with the ED's recommendations except on minor points and anticipates recommending rates very similar or identical to what BFE seeks and the ED proposes. Assuming that will prove out and subject to reconsideration if it does not, the ALJ recommends that the Commission allow BFE to levy surcharges to recover its lost revenue and rate-case expenses.

II. CASE HISTORY

The history of this case is quite complicated. On January 27, 2009, BFE filed with Cresson an application to increase its rates (Previous Application).¹ Cresson's City Council held a public hearing on the Previous Application on April 14, 2009, but did not take action.² On July 23, 2009, BFE's owner, Richard L. Bourland, wrote a letter to Cresson asking the City to make a decision in August 2009 on the Previous Application.³ On September 8, 2009, the City Council voted to take no action on BFE's Previous Application, and on October 7, 2009, Cresson's mayor informed BFE the City Council's vote would allow BFE to submit its application directly to the Commission.⁴

¹ Cresson Ex. 1, attach. L at 1.

² Applicant Ex. 1 at 4 & attach. A; City Ex. 1, attach. L.

³ ED Ex. A, attach. B.

⁴ ED Ex. A, attach. C.

On October 6, 2009, BFE filed with the Commission a slightly different application, proposing to increase its rates effective January 16, 2010 (Application).⁵ The Commission received that Application on October 12, 2009, and accepted it for filing on December 16, 2009. Subsequently, the Commission staff concluded that it had accepted the Application in error because Cresson had not adopted an ordinance to relinquish the City's original jurisdiction to the Commission before the Application was filed, as required by the Texas Water Code.⁶ Apparently construing the October 6, 2009 Application as the same one BFE had filed with Cresson in January 2009, the Commission staff "returned" the Application to Cresson on June 11, 2010.⁷

After the Commission staff "returned" the Application, Cresson began, on February 21, 2011, to exercise jurisdiction over it and scheduled a preliminary hearing for March 7, 2011.⁸ On August 23, 2011, Cresson ordered BFE to deposit into an escrow account all monies received or to be received from the sale of water after May 31, 2011, that was attributable to any increase in rates in effect prior to January 16, 2011.⁹ Cresson slightly amended that escrow order on September 13, 2011.¹⁰ On January 12, 2012, Cresson set interim rates for BFE that were lower than the rates BFE had proposed in the Application.¹¹

On January 24, 2012, Cresson's City Council issued a final order fixing BFE's rates.¹² The final rates were lower than those BFE had proposed in the Application. For most of Cresson's customers, the rates set by the City were even lower than what they were being charged before BFE applied for an increase. Additionally, Cresson denied BFE's request to recover its expenses of seeking the rate increase; disbursed to BFE's customers funds in the

⁵ ED Ex. A, attach. A; Tr. at 97-98.

⁶ ED Ex. A, attach. E & F.

⁷ ED Ex. A, attach. F at 2.

⁸ ED Ex. A, attach. G.

⁹ ED Ex. A, attach. H.

¹⁰ ED Ex. A, attach. I.

¹¹ ED Ex. A, attach. J. *Compare to previous rates set out at ED Ex. A, attach. A at 34 & 35 of 41.*

¹² ED Ex. A, attach. G.

escrow account into which the City had previously ordered BFE to deposit rate-increase collections; and ordered BFE to refund to its customers the amounts, plus 4.0% interest, that BFE had collected that exceeded the rates the City finally set.¹³

On February 14, 2012, Cresson formally surrendered its original jurisdiction to regulate water utilities within its city limits to the Commission.¹⁴ However, that was after the City had exercised its jurisdiction to set BFE's rates that are at issue in this case.

On March 13, 2012, BFE filed a petition (appeal) asking the Commission to review Cresson's action setting BFE's rates.¹⁵ BFE served copies of the appeal on Cresson, Mr. Perdue, and the HOA.¹⁶ On May 9, 2012, the appeal was referred to the State Office of Administrative Hearings (SOAH) for hearing. On May 11, 2012, the Commission's Chief Clerk mailed notice of a preliminary hearing to BFE, Cresson, Mr. Perdue, the HOA, the ED, and OPIC.¹⁷ On June 7, 2012, the ALJ held a preliminary hearing as indicated in the notice, found that the Commission and SOAH had jurisdiction to consider the appeal, and admitted the parties.

BFE filed a motion to set interim rates, in accordance with 30 Texas Administrative Code § 291.29(d). After considering that motion at the preliminary hearing in accordance with the process set out in § 291.29, the ALJ granted the motion on June 8, 2012.

Below is a table showing the subsequent significant procedural events in this case:

| DATE | EVENT |
|--------------------------|---|
| June 7-September 7, 2012 | Case abated for settlement talks, as requested by parties. |
| October 10, 2012 | Deadline to submit written discovery requests on Applicant. |
| November 12, 2012 | Deadline for BFE to respond to written discovery requests. |
| November 27, 2012 | Deadline to submit written discovery requests to parties other than |

¹³ ED Ex. A, attach. K. *Compare to previous rates set out at ED Ex. A, attach. A at 34 & 35 of 41.*

¹⁴ ED Ex. BDD 14.

¹⁵ ED Ex. A.

¹⁶ ED Ex. A at 11.

¹⁷ ED Ex. B.

| | |
|-------------------|--|
| | BFE. |
| December 17, 2012 | Deadline for BFE to prefile its direct-case evidence. |
| January 4, 2013 | Deadline to file objections to BFE's direct case. |
| February 1, 2013 | Deadline to file responses to objections to BFE's prefled direct-case evidence. |
| February 1, 2013 | Deadline for parties other than BFE and the Executive Director (ED) to prefile their direct-case evidence. |
| February 18, 2013 | Deadline to file objections to prefled direct-case evidence of parties other than the BFE and the ED. |
| March 4, 2013 | Deadline to file responses to objections to prefled direct-case evidence of parties other than BFE and the ED. |
| March 11, 2013 | Deadline for ED to prefile direct-case evidence. |
| March 20, 2013 | Deadline to file objections to ED's prefled direct-case evidence. |
| March 27, 2013 | Deadline to file responses to objections to ED's prefled direct-case evidence. |
| April 1, 2013 | Telephonic prehearing conference to rule on objections to prefled evidence. |
| April 2-3, 2013 | Evidentiary hearing. |
| May 23, 2013 | Deadline to submit written closing arguments. |
| June 6, 2013 | Deadline to submit replies to written closing arguments |

III. SUMMARY OF RATES

The following table summarizes the rates in effect before BFE filed the January 16, 2010 Application seeking an increase, the rates BFE seeks in that Application, the interim and final rates the City approved, and the interim rates set by the ALJ that are now in effect:

| MONTHLY BASE RATES INCLUDING 0 GALLONS (per residential meter diameter) | | | | | |
|---|------------------------|-------------------------------|------------------------------|----------------------------|-----------------------------|
| | Previous ¹⁸ | BFE's Requested ¹⁹ | City's Interim ²⁰ | City's Final ²¹ | ALJ's Interim ²² |
| 5/8 or 3/4 inch | \$24.00 | \$38.50 | \$24.62 | \$15.72 | \$35.22 |
| 1 inch | \$40.00 | \$96.25 | \$61.54 | \$47.93 | \$87.72 |
| 1 ½ inch | \$80.00 | \$192.50 | \$80.00 | \$80.00 | \$175.22 |

¹⁸ ED Ex. A, attach. A at 35 of 41.

¹⁹ ED Ex. A, attach. A at 35 of 41.

²⁰ ED Ex. A, attach. J.

²¹ ED Ex. A, attach. K.

²² Order No. 1 at 2.

| | | | | | |
|--------|----------|----------|----------|----------|----------|
| 2 inch | \$128.00 | \$308.00 | \$128.00 | \$128.00 | \$280.22 |
| 3 inch | \$240.00 | \$673.20 | \$240.00 | \$240.00 | \$612.22 |
| 4 inch | \$400.00 | NA | \$400.00 | \$400.00 | NA |

| GALLONAGE CHARGES (per 1,000 gallons) | | | | | |
|---|------------------------|-------------------------------|------------------------------|----------------------------|-----------------------------|
| | Previous ²³ | BFE's Requested ²⁴ | City's Interim ²⁵ | City's Final ²⁶ | ALJ's Interim ²⁷ |
| First 5,000 gallons | \$2.00 | \$3.22 | 2.00 | \$2.81 | \$3.00 |
| Next 10,000 gallons | \$2.00 | \$3.72 | 2.00 | \$2.81 | \$3.00 |
| Next 15,000 gallons | \$3.25 | \$4.22 | 3.25 | \$3.31 | \$3.50 |
| After 30,000 gallons | \$4.00 | \$4.22 | 4.00 | \$3.81 | \$4.00 |

| MISCELLANEOUS FEES | | | | | |
|---------------------------------|------------------------|------------------------------|------------------------------|----------------------------|-----------------------------|
| | Previous ²⁸ | BFE' Requested ²⁹ | City's Interim ³⁰ | City's Final ³¹ | ALJ's Interim ³² |
| Tap fee | \$500.00 | \$500.00 | \$500.00 | \$500.00 | NA |
| Reconnect fee, non-payment | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |
| Reconnect fee, customer request | \$40.00 | \$40.00 | \$40.00 | \$40.00 | NA |
| Transfer fee | \$35.00 | \$35.00 | \$35.00 | \$35.00 | NA |
| Late charge | 10% | 10% | \$5.00 | \$5.00 | NA |
| Return check charge | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |
| Deposit | \$50.00 | \$50.00 | \$50.00 | \$50.00 | NA |
| Meter test fee | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |

²³ ED Ex. A, attach. A at 35 of 41.

²⁴ ED Ex. A, attach. A at 35 of 41.

²⁵ ED Ex. A, attach. J.

²⁶ ED Ex. A, attach. K.

²⁷ Order No. 1 at 2.

²⁸ ED Ex. A, attach. A at 35 of 41.

²⁹ ED Ex. A, attach. A at 35 of 41.

³⁰ ED Ex. A, attach. J.

³¹ ED Ex. A, attach. K.

³² Order No. 1 at 2.

IV. JURISDICTION

The legislature has specifically delegated to the Commission the power to hear and decide appeals of decisions of municipalities concerning the water rates a retail public utility may charge. Texas Water Code § 13.043(a) provides:

Any party to a rate proceeding before the governing body of a municipality may appeal the decision of the governing body to the commission. . . . An appeal under this subsection must be initiated within 90 days after the date of notice of the final decision by the governing body by filing a petition for review with the commission and by serving copies on all parties to the original rate proceeding. . . .

On January 24, 2012, the City Council issued “AN ORDER BY THE CITY COUNCIL OF CRESSON, TEXAS MAKING A FINAL DETERMINATION ON THE BFE DEVELOPMENT CORP. DBA BFE WATER COMPANY RATE INCREASE APPLICATION THAT HAD AN EFFECTIVE DATE OF JANUARY 16, 2010.”³³ On March 13, 2012, BFE filed the petition for review of that order,³⁴ and served copies of that petition on Cresson, Mr. Perdue, and the HOA.³⁵

Because the City’s decision determined the rates that BFE may charge, under both its corporate and assumed name, BFE was beyond doubt a party to the proceeding before the City Council that led to the City Council’s decision. Certificate of Convenience and Necessity (CCN) No. 12899 was issued to “BFE Development Corporation dba BFE Water Company.”³⁶ Nevertheless, the Protestants contend that the Commission lacks jurisdiction to consider BFE’s appeal. The ALJ reviews those objections below and concludes that the Commission has jurisdiction to consider BFE’s appeal.

³³ ED Ex. A, attach. K at 3 (numbered as 1).

³⁴ ED Ex. A.

³⁵ ED Ex. A at 11.

³⁶ Cresson Ex. 1, attach. C at 1.

A. Assumed Name

The Protestants argue that the Commission has no jurisdiction over this appeal because the holder of the CCN whose rates are in dispute, BFE Development Company, did not file an appeal within 90 days of Cresson's decision, as required by Texas Water Code § 13.043(a). According to Cresson, the appeal was filed by BFE Water Company, a name BFE Development Company assumed without filing an assumed-name certificate as required to conduct business in Texas. In support of its argument, Cresson cites portions of the Texas Business and Commerce Code³⁷ and claims they require an entity to file a certificate to do business in Texas under an assumed name and prohibit court actions by an entity that has not. Cresson also cites *State v. Thomas*³⁸ and contends it stands for the proposition that laws concerning actions "in the courts" include actions before a state regulatory agency, such as the Commission.

No other party agrees with the Protestants' assumed-name challenge to the Commission's jurisdiction. Neither does the ALJ.

The Protestants are urging the Commission to weigh in on an issue that the Legislature has not given the Commission authority to decide: whether BFE has complied with legal requirements for using an assumed name. They make arguments under the Texas Business and Commerce Code, but point to no law specifically authorizing the Commission to determine whether BFE has complied with the requirements of that code.

The powers of a state agency, like the Commission, are limited, and agencies may not on a theory of necessary implication from a specific power, function, or duty expressly delegated, erect and exercise what really amounts to a new and additional power or one that contradicts the statute, no matter that the new power is viewed as expedient for administrative purposes.³⁹ The

³⁷ Tex. Bus. & Comm. Code §§ 71.101, 71.103 & 71.201.

³⁸ *State v. Thomas*, 766 S.W.2d 217 (Tex. 1989).

³⁹ *Texas Industrial Energy Consumers v. CenterPoint Energy Houston Electric, LLC*, 324 S.W.3d 95, 106 (Tex. 2010); *Pub. Util. Comm'n v. GTE-Southwest, Inc.*, 901 S.W.2d 401, 407 (Tex. 1995) (quoting *Sexton v. Mount*

Protestants cite *State v. Thomas* in support of their argument, but that case concerned the right of the Attorney General of Texas, on behalf of state agencies, to intervene in electric-utility rate cases before the Public Utility Commission of Texas. It did not address whether the Commission, or any other agency, has jurisdiction to interpret, apply, and enforce assumed-name laws.

The ALJ concludes the Commission does not have jurisdiction to determine whether BFE has complied with assumed-name laws, much less sanction BFE if it has failed to comply with them, as the Protestants claim. The Protestants' assumed-name objection to the Commission's jurisdiction to consider BFE's rate appeal should be overruled.

B. Second Rate Filing Was Not Prohibited

The Protestants raise another jurisdictional challenge. They claim that the Commission has no jurisdiction to consider BFE's appeal because Texas Water Code § 13.187(p) states:

Except to implement a rate adjustment provision approved by the regulatory authority by rule or ordinance, as applicable, or to adjust the rates of a newly acquired utility system, a utility or two or more utilities under common control and ownership may not file a statement of intent to increase its rates more than once in a 12-month period, unless the regulatory authority determines that a financial hardship exists. If the regulatory authority requires the utility to deliver a corrected statement of intent, the utility is not considered to be in violation of the 12-month filing requirement.

No other party concurs with this argument by the Protestants. While it is true that BFE filed two statements of intent to change its rates within 12 months, the ALJ does not conclude that BFE's appeal at issue in this case was filed in violation of Texas Water Code § 13.187(p)'s prohibition.

Olivet Cemetery Ass'n, 720 S.W.2d 129, 137-38 (Tex. App.-Austin 1986, writ ref'd n.r.e.)). See also *Pub. Util. Comm'n v. City Pub. Serv. Bd.*, 53 S.W.3d 310, 316 (Tex. 2001).

As previously explained, on January 27, 2009, BFE filed the Previous Application with Cresson.⁴⁰ Subsequently, on September 8, 2009, the City Council voted to take no action on the Previous Application, and on October 7, 2009, Cresson's mayor formally informed BFE that the City Council's vote would allow BFE to submit its application directly to the Commission.⁴¹ On October 6, 2009, BFE filed the Application with the Commission, which was slightly different and proposed to increase BFE's rates, effective January 16, 2010.⁴² However, the Commission staff later concluded that it had accepted the Application in error because Cresson had not relinquished its original jurisdiction. On June 11, 2010, the Commission staff "returned" the Application to Cresson.⁴³ After that, the City Council began to exercise jurisdiction over the Application, and eventually, on January 24, 2012, the City Council finally set rates for BFE's water service with an effective date of January 16, 2010.⁴⁴

Cresson raised this same second-application jurisdictional objection at the preliminary hearing. At that time, the ALJ concluded that the evidence and stipulations showed that BFE had not delivered a statement of intent to its customers, as required by Texas Water Code § 13.187(a), concerning its January 27, 2009 Previous Application. Based on that, the ALJ concluded that the January 27, 2009 Previous Application was void, and Cresson never acquired jurisdiction over it. Accordingly, the ALJ found that only one application—the one originally filed with the Commission on October 6, 2009; transferred to Cresson on July 11, 2010; and on which Cresson finally acted on January 24, 2012, to set BFE's rates—was filed within a 12-month period, within the meaning of Section 13.187(p).

The Protestants claim that additional evidence introduced during the hearing on the merits shows that the ALJ's conclusion on that point was incorrect. Mr. Bourland testified during the hearing that BFE filed the Previous Application with Cresson on January 27, 2009,

⁴⁰ BFE Ex. 1 at 4.

⁴¹ ED Ex. A, attach. C.

⁴² ED Ex. A, attach. A; Tr. at 97-98.

⁴³ ED Ex. A, attach. F at 2.

⁴⁴ ED Ex. A, attach. K.

and when his memory was refreshed, he agreed that BFE had provided notice of that Previous Application to its customers.⁴⁵ Additionally, Mr. Becker testified that he discovered when reviewing his personal records after the preliminary hearing that he had received notice of the January 2009 Previous Application.⁴⁶ Given the additional evidence, the ALJ concludes that BFE did provide customers with notice of the January 27, 2009 Previous Application.

Nevertheless, the ALJ still does not find that BFE filed a prohibited second application within 12 months. That is because the 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.

The ALJ reaches this conclusion based on extremely tangled facts. As discussed previously, Cresson's City Council voted on September 8, 2009, to take no action on BFE's January 27, 2009 Previous Application, and Cresson's mayor indicated that would allow BFE to submit its application directly to TCEQ.⁴⁷ The City Council's action can be interpreted in at least three ways.

The first interpretation is that the current appeal concerns the Previous Application filed on January 27, 2009, on which Cresson took no action, despite having jurisdiction, until Cresson finally set BFE's rates on January 24, 2012. That interpretation would lead to a more negative result for BFE's ratepayers. As explained in the remainder of the PFD, the ALJ concludes that BFE is entitled to increase its rates. If that increase is based on the Previous Application pending since January 27, 2009, BFE would be entitled to surcharge customers for the difference between the rates to which it is entitled and the rates customers paid over a four-year period. That would result in very large surcharges.

⁴⁵ Tr. 97-99.

⁴⁶ Tr. 350-351.

⁴⁷ ED Ex. A, attach. C.

The second interpretation is that Cresson denied the January 27, 2009 Previous Application on its merits, which gave BFE a right to appeal that decision to the Commission. BFE's October 6, 2009 Application could be seen as an inartful appeal of the Cresson's denial of BFE's January 27, 2009 Previous Application. That would mean that the Commission had jurisdiction to consider the appeal, the Commission's staff should not have sent it back to Cresson, and Cresson's action after that was nothing more than a legally unnecessary, lengthy delay. It would also mean, as under the first interpretation, that BFE is entitled to surcharge its customers for over four years of rate under-collection.

The third and most reasonable interpretation is that Cresson concluded that it had no jurisdiction over the January 27, 2009 Previous Application, dismissed it for lack of jurisdiction, and directed BFE to file a corrected application with the Commission, which Cresson believed had jurisdiction to consider the application. That is the interpretation most consistent with the action the Cresson City Council took and the mayor's subsequent description of that action.

It may be, as the Commission staff later concluded, that Cresson was incorrect in concluding that it had no jurisdiction over the January 27, 2009 Previous Application. In theory, BFE could have appealed to the Commission and asked it to review and reverse Cresson's final determination that Cresson lacked jurisdiction. BFE did not file such an appeal. Instead, BFE accepted Cresson's dismissal of BFE's January 27, 2009 Previous Application. Rather than an appeal, BFE filed with the Commission a new "APPLIATION FOR A RATE/TARIFF CHANGE"⁴⁸ on October 6, 2009, which was consistent with instructions from Cresson and as allowed by Texas Water Code § 13.187(p).

Although the October 26, 2009 Application was initially filed with the Commission, the Commission staff subsequently transferred it to Cresson, because Cresson had original jurisdiction over it. By February 21, 2011, at the latest, Cresson assumed jurisdiction over the

⁴⁸ ED Ex. A, attach. A at 5 of 41.

October 26, 2009 Application, when it issued a notice of a preliminary hearing to be held on March 7, 2011.⁴⁹

Given the above, the ALJ concludes that BFE has not filed a second application to change its rates in violation of Texas Water Code § 13.187(p). The Protestants' objection to jurisdiction on that ground should be overruled.

C. Jurisdictional Conclusion

The ALJ concludes that BFE was entitled under Texas Water Code § 13.043(a) to appeal Cresson's January 24, 2012 decision on BFE's October 26, 2009 Second Application and the Commission has jurisdiction to consider BFE's appeal.

V. BURDEN OF PROOF

The parties agree that BFE has the burden of proof in this case. In any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change, if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable.⁵⁰

VI. COST OF SERVICE

A. Applicable Law

Texas Water Code § 13.043 provides:

(a) . . . The commission shall hear the appeal de novo and shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken and may include reasonable expenses incurred in the appeal

⁴⁹ ED Ex. A, attach. G.

⁵⁰ Tex. Water Code § 13.184(c).

proceedings. The commission may establish the effective date for the commission's rates at the original effective date as proposed by the utility provider and may order refunds or allow a surcharge to recover lost revenues. The commission may consider only the information that was available to the governing body at the time the governing body made its decision and evidence of reasonable expenses incurred in the appeal proceedings.

...

(j) In an appeal under this section, the commission shall ensure that every rate made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly shall be just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of customers. The commission shall use a methodology that preserves the financial integrity of the retail public utility. . . .

The Commission may not include for ratemaking purposes any expenditure that it finds to be unreasonable, unnecessary, or not in the public interest.⁵¹ Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses.⁵² In setting the rates for water service, the Commission must fix a utility's overall revenues at a level that will "(1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and (2) preserve the financial integrity of the utility."⁵³

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.⁵⁴ "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before

⁵¹ Tex. Water Code § 13.185(h)(3).

⁵² 30 Tex. Admin. Code § 291.31(a) and (b).

⁵³ Tex. Water Code § 13.183(a).

⁵⁴ 30 Tex. Admin. Code § 291.31(a) and (b).

the date on which the utility made the rate filing.⁵⁵ The test year for this case is January 1 through December 31, 2008.⁵⁶

Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. Original cost is the actual money cost or the actual money value of any consideration paid, other than money, of the property at the time it shall have been dedicated to public use, whether by the utility that is the present owner or by a predecessor, less depreciation. Utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital.⁵⁷

B. Parties' Positions

BFE's expert⁵⁸ and the ED's experts⁵⁹ testified and in its post-hearing brief Cresson conceded⁶⁰ that the following amounts are just, reasonable, and should be allowed in BFE's cost of service:

| Item | BFE | ED | Cresson |
|-----------------------|------------|-----------|----------------|
| Salaries | \$3,800 | \$0 | \$0 |
| Contract services | \$9,600 | \$9,852 | \$9,852 |
| Chemicals & treatment | \$0 | \$5,772 | \$5,771.75 |
| Utilities | \$5,166 | \$4,877 | \$4,877.35 |
| Repairs & maintenance | \$891 | \$3,546 | \$3,545.56 |
| Office expense | \$285 | \$285 | \$285 |
| Accounting and legal | \$0 | \$876 | \$876 |
| Insurance | \$1,783 | \$410 | \$410 |
| Miscellaneous | \$150 | \$275 | \$275 |

⁵⁵ Tex. Water Code § 13.002(22).

⁵⁶ ED Ex. A, attach. A at 14 of 41.

⁵⁷ Tex. Water Code § 13.185(b).

⁵⁸ BFE Ex. 2.

⁵⁹ ED Exs. DL 1, DL 2 & BDD 1 at 3-13.

⁶⁰ Cresson's Closing at 36.

| | | | |
|-----------------------------------|-----------------|-----------------|--------------------|
| Ad valorem taxes | \$0 | \$142 | \$142 |
| Depreciation | \$8,910 | \$8,136 | \$6,472 |
| Return on invested capital | \$20,821 | \$23,123 | \$0 |
| Federal income tax - normalized | \$3,706 | \$4,080 | \$0 |
| Total cost of service | \$55,112 | \$61,374 | \$32,506.66 |
| Other revenues – tap fees | \$0 | \$(500) | \$0 |
| Net recoverable from rates | \$55,112 | \$60,874 | \$32,506.66 |

In its closing, BFE changed its position somewhat. It now agrees that the determinations of the ED’s witnesses on each of the above items, except salaries, is reasonable and supports them.

Mr. Perdue and the HOA did not offer a comprehensive summary of their position on all cost-of-service items. They do, however, specifically propose disallowing the entire amounts for return on investment and income tax and contend that BFE has not provided substantive documentation for its expense items.⁶¹

Both BFE’s expert, Bret Fenner and the ED’s expert, Debi Loockerman, have sufficient expertise to offer reliable expert opinions on whether utility expenses are just reasonable and allowable in cost of service. Mr. Fenner has owned and operated a water utility with 90 customers and served as a receiver for two utilities with 24 and 25 customers, respectively.⁶² He is currently president of B&D Environmental, Inc., which specializes in utility management and consulting. He previously worked as a manager for AquaSource, Inc., specializing in regulatory compliance and due diligence for acquisitions. Before that, he worked for the Commission’s predecessor agency, as an analyst of water and wastewater rates and regulations. Overall, Mr. Fenner has more than 20 years of experience in ratemaking for regulated water utilities.⁶³

⁶¹ Perdue and HOA Closing.

⁶² Tr. 237.

⁶³ BFE Ex. 2 at 3.

Ms. Loockerman is a certified public accountant with more than 20 years of government and private sector experience in Texas auditing, financially analyzing, and setting water rates.⁶⁴

C. Uncontested Expenses Supported By Invoices

Ms. Loockerman recommends allowing the following cost-of-service items, which are supported by invoices or billings that she reviewed:⁶⁵

| ITEM | AMOUNT |
|-----------------------|-----------------|
| Contract services | \$9,852 |
| Chemicals & treatment | \$5,772 |
| Utilities | \$4,877 |
| Repairs & maintenance | \$3,546 |
| TOTAL | \$24,047 |

These expenses are not specifically contested by any party. Mr. Fenner recommended allowing some of these expenses and somewhat different amounts,⁶⁶ but did not dispute Ms. Loockerman's analysis, which was more thorough.

The ALJ was persuaded by Ms. Loockerman's analysis. The ALJ finds that these items were reasonable and necessary for BFE to provide service during the test year and should be allowed for purposes of setting BFE's rates.

D. Contested Expense Not Supported By Invoices

The following items were not supported by invoices or billings that Ms. Loockerman reviewed, but Ms. Loockerman recommends that they be allowed:⁶⁷

⁶⁴ ED Ex. DL 1 at 2.

⁶⁵ ED Ex. DL 1 at 7-10.

⁶⁶ BFE Ex. 2 at 4-10, 16.

⁶⁷ ED Ex. DL 1 at 7-10.

| ITEM | AMOUNT |
|----------------------|----------------|
| Office expense | \$285 |
| Accounting and legal | \$876 |
| Insurance | \$410 |
| Miscellaneous | \$275 |
| Ad valorem taxes | \$142 |
| TOTAL | \$1,988 |

Mr. Fenner recommended allowing some of these expenses and somewhat different amounts,⁶⁸ but did not dispute Ms. Loockerman's analysis, which was more thorough. No party disputes that expenses like these are necessary to provide water service or that BFE incurred some level of expense of each of these types during the test year. However, Mr. Perdue and the HOA claim that the Commission has held in prior cases that an applicant is required to provide receipts to substantiate all expense claims.

It certainly is true that the ALJ has recommended disallowing expense items that were not supported by invoices, and the Commission has disallowed those items.⁶⁹ However, those disallowances were due to an overall lack of credible evidence to support the expense items, not just because no invoice was in evidence. The ALJ is aware of no law or precedent that requires a written invoice as evidence to prove an expense item.

In large part, the evidence supporting these items is Ms. Loockerman's expert opinion based facts or data she reviewed. An expert's opinion in her area of expertise is admissible into evidence,⁷⁰ even if her opinion is based on facts or data that are not admissible, as long as experts in her field rely on those types of facts or data to form expert opinions.⁷¹

⁶⁸ BFE Ex. 2 at 4-10, 16.

⁶⁹ *E.g. 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*, TCEQ Docket No. 2009-0929-UCR, SOAH Docket No. 582-09-5328 (PFD at 13, 14, 21, 26, 34)(Jul. 1, 2010) & (Commission Order at 5, 6, 10, 14)(Feb. 22, 2011).

⁷⁰ Tex. Rule of Evidence 701.

⁷¹ Tex. Rule of Evidence 703.

The \$285 office expense was recorded on BFE's general ledger.⁷² The \$876 accounting expense was prorated for the full year from five monthly billings that Ms. Loockerman reviewed.⁷³ Ms. Loockerman estimated BFE's test year insurance expense for its water utility properties based on its payment of \$17,828, as invoiced, for insurance for all of its property for the period from May 12, 2010, to May 12, 2012, and multiplying that amount by 2.3%, which is the percentage of BFE's property devoted solely to providing water service.⁷⁴ The \$275 miscellaneous expense was due to amounts paid to the Commission in 2009 for licenses, fees, and permits, and was reflected in BFE's general ledger for that year.⁷⁵

Ironically, Ms. Loockerman determined the ad valorem tax expense based on a calculation Mr. Becker originally made that was not admitted into evidence, but which Ms. Loockerman concluded was reasonable, necessary, and appropriate. The ad valorem tax estimate was derived by using the \$146,130 appraised value of the 23.354 acres of property BFE owns and multiplying that by the fraction of that land on which BFE's water facilities are located (1.1 acres or 4.7% of the total) and the local tax rate of \$2.0635 per \$100 valuation.⁷⁶

The ALJ concludes that these expenses, totaling \$1,988, should be included in BFE's cost of service. The evidence shows that they were incurred during the test year, adjusted for known and measurable changes, reasonable, and necessary for BFE to provide service.

E. Salaries

The only salary amount that BFE seeks to include in its cost of service is \$3,800 that Mr. Bourland drew from BFE on the last day of the test year, December 31, 2008.⁷⁷ BFE claims that Mr. Bourland was paid this amount for his management of BFE's water-service business.

⁷² ED Ex. DL 1 at 8-9.

⁷³ ED Ex. DL 1 at 9.

⁷⁴ ED Ex. DL 1 at 9. $\$146,130/\$100*.047*\$2.0635=\141.72 .

⁷⁵ ED Ex. DL 1 at 10 & Ex. DL 8.

⁷⁶ ED Ex. DL at 10 & Ex. DL 9.

⁷⁷ Cresson Ex. 1, attach. J at TCEQ 000016.

Cresson proposes to disallow this amount, claiming BFE has not shown that this was a necessary and reasonable expense. The ED's expert, Ms. Loockerman, did not recommend allowing the \$3,800 because she could not tell why BFE paid Mr. Bourland that amount.⁷⁸ The ALJ finds that the claimed \$3,800 salary expense should be disallowed.

It is far from clear that the \$3,800 paid to Mr. Bourland in 2008 was for his management of BFE's water utility business. In fact, Mr. Bourland testified that he did not charge BFE for management of the water business until 2011.⁷⁹ Even if Mr. Bourland misspoke and actually did receive the \$3,800 in 2008 as compensation for his management of BFE's water utility, there are several other problems with the \$3,800 expense.

It is not clear that BFE needed to pay Mr. Bourland \$3,800 in 2008 to manage its water utility. During the test year, BFE paid Kort Water Inc. (Kort) and subsequently One Source Water Management Company, LLC, (One Source) \$800 per month to manage BFE's water utility business.⁸⁰ Those payments are included in the uncontested contract-services expenses discussed above. Given the payments to Kort and One Source for management of BFE's water-utility business, it is unclear what additional water-utility management work BFE needed Mr. Bourland to perform. Mr. Bourland's explanation of the water-utility management work he performed was not very specific. He testified:

I write checks to people who need to have money. I make all the decisions. I have discussed things with the man who actually comes out and takes care of things. He calls me when anything breaks; deposits, telephone calls, like any business. . . . I don't make all the decisions. I delegate some to Mr. Garcia, who runs One Source Water Company, because I'm not going to be involved in the minutia of reading meters and things like that. . . . Make all the decisions like running any business. Any business requires someone at the top to make decisions and do the things that's [sic] required to run that business.⁸¹

⁷⁸ Tr. 478.

⁷⁹ Tr. 128.

⁸⁰ ED Exs. DL 1 at 7 & DL 3.

⁸¹ Tr. 130-131.

It is also not clear that Mr. Bourland performed those general tasks solely to manage BFE's water-utility business. Mr. Bourland owns BFE and manages all of its business activities, not just BFE's water-utility business, from the same office. He testified that the water and other business were kept separated,⁸² but he did not explain how, and no other evidence shows a clear line of separation between BFE's businesses.

Because Mr. Bourland owns BFE,⁸³ he is an "affiliate" of BFE. Texas Water Code § 13.002(2)(A) defines "[a]ffiliated interest" or "affiliate" to mean, among other things, "any person . . . owning or holding directly or indirectly five percent or more of the voting securities of a utility" The legal standard for including a payment to an affiliate in a utility's cost of service is higher than for other cost-of-service items. Texas Water Code § 13.185(e) provides:

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

Even if Mr. Bourland was paid the \$3,800 solely for necessary management of BFE's water business, it is not clear that was a reasonable amount to pay him and not higher than what he was paid for his work for other affiliates. Mr. Fenner testified that Mr. Bourland charges \$40 per hour for his management services for the utility. At that hourly rate, the \$3,800 averages to approximately eight hours per month managing the utility. Mr. Fenner testified that eight hours was a reasonable amount of time to spend each month managing a utility of BFE's size and \$40 was reasonable amount per hour to pay for management services. In fact, Mr. Fenner would have asked for more than \$40 per hour if he had managed the utility.⁸⁴

⁸² Tr. 20-21.

⁸³ BFE Ex. 1 at 3.

⁸⁴ BFE Ex. 2 at 6; Tr. 218-220.

It might be true that Mr. Fenner's water-utility management services are worth \$40 or more per hour because he is an experienced owner and manager of a water utility and has broad experience in the field. There is, however, no evidence that Mr. Bourland's management services are worth \$40 per hour. There is no evidence that Mr. Bourland has ever managed a water utility before, and Mr. Bourland testified that no one has ever offered to pay him \$40 per hour for any sort of management services.⁸⁵ Additionally, there is no evidence concerning what Mr. Bourland was paid to manage BFE's non-utility business; hence, there is no evidentiary basis to conclude that the \$3,800 per year BFE supposedly paid him to manage its water-business was not higher than what BFE paid him to manage its other business activities.

Given the above, the ALJ does not find that the \$3,800 BFE paid to Mr. Bourland was a necessary and reasonable cost of BFE's providing water utility service and not higher than what Mr. Bourland charged BFE for management of BFE's other business activities. The ALJ concludes that the \$3800 should be disallowed.

F. Return On and Of Investment

Under 30 Texas Administrative Code § 291.31(c), the return on invested capital is the rate of return times invested capital. BFE seeks a total return of \$23,123 on the capital it has invested to provide water utility service. This is the return that the ED recommends, and BFE has modified its earlier position and now supports the ED's recommendation. The Protestants contend that BFE has no capital investment on which it is entitled to earn a return.

The ALJ concludes that BFE should be allowed a return on and of its capital investment in accordance with the ALJ's findings below.

⁸⁵ Tr. 128-129.

1. Invested Capital

In its Application, BFE originally claimed the net book value of its plant in service was \$171,878.⁸⁶ After further review, Mr. Fenner testified that the net book value was \$194,272.⁸⁷ In its post-hearing brief, however, BFE changed its position again. It now supports the calculation by the ED’s expert witness, Brian Dickey, that BFE’s net plant in service is worth \$202,299. That calculation is set out in Mr. Dickey’s depreciation analysis⁸⁸ and reproduced below:

| DEPRECIATION ANALYSIS | | | | | | | | |
|---|---------------|---------------|---------------|-----------------------|---------------------------------|----------------|----------------|-----------|
| Description | Acquired Date | Used & Useful | Original Cost | Economic Life (years) | Actual Depreciated Life (years) | Annual Deprec. | Accum. Deprec. | Net Plant |
| Land | | 100% | 0 | n/a | n/a | n/a | n/a | \$0 |
| Water Well plus 10% engineering fees | 15-Oct-98 | 100% | \$83,480 | 50 | 10.21 | \$1,670 | \$17,050 | \$66,430 |
| 40 hp 150 gpm well pump plus 10% engineering fees | 15-Oct-98 | 100% | \$24,196 | 10 | 10.21 | \$0 | \$24,196 | \$0 |
| well pump invoice No. 00039390000 | 15-Sep-08 | 100% | \$35,903 | 10 | 0.29 | \$3,590 | \$1,052 | \$34,851 |
| Booster pump 5 hp plus 10% engineering fees | 15-Oct-98 | 100% | \$880 | 5 | 10.21 | \$0 | \$880 | \$0 |
| Booster pump 5 hp plus 10% engineering fees | 15-Oct-98 | 100% | \$880 | 10 | 10.21 | \$0 | \$880 | \$0 |
| Booster pump 2 hp plus 10% engineering fees | 15-Oct-98 | 100% | \$440 | 10 | 10.21 | \$0 | \$440 | \$0 |
| Hypochlorinator plus 10% engineering fees | 15-Oct-98 | 100% | \$385 | 10 | 10.21 | \$0 | \$385 | \$0 |

⁸⁶ ED Ex. A, attach. A at 10 of 41.

⁸⁷ BFE Ex. 2 at 8-10 & attach. F.

⁸⁸ ED Exs. BDD 1 at 8 & BDD 12.

| | | | | | | | | |
|---|-----------|------|------------------|----|-------|----------------|-----------------|------------------|
| Masonry pump house | 15-Oct-98 | 100% | \$6,402 | 30 | 10.21 | \$213 | \$2,179 | \$4,223 |
| Ground storage 84,000 gallons ⁸⁹ | 15-Oct-98 | 100% | \$27,009 | 50 | 10.21 | \$540 | \$5,516 | \$21,493 |
| Pressure tank 500 gallons plus 10% engineering fees | 15-Oct-98 | 100% | \$1,320 | 50 | 10.21 | \$26 | \$270 | \$1,050 |
| Pressure tank 500 gallons plus 10% engineering fees | 15-Oct-98 | 100% | \$1,320 | 50 | 10.21 | \$26 | \$270 | \$1,050 |
| Pressure tank 500 gallons plus 10% engineering fees | 15-Oct-98 | 100% | \$1,320 | 50 | 10.21 | \$26 | \$270 | 1,050 |
| Distrib. system | 15-Oct-98 | 100% | \$76,341 | 50 | 10.21 | \$1,527 | \$15,592 | \$60,748 |
| Fire hydrants | 15-Oct-98 | 100% | \$6,000 | 50 | 10.21 | \$120 | \$1,225 | \$4,775 |
| 4-inch well collection line plus 10% engineering fees | 15-Oct-98 | 100% | \$234 | 50 | 10.21 | \$5 | \$48 | \$186 |
| Water plant piping plus 10% engineering fees | 15-Oct-98 | 100% | \$2,200 | 50 | 10.21 | \$44 | \$449 | \$1,751 |
| Electrical plus 10% engineering fees | 15-Oct-98 | 100% | \$3,850 | 30 | 10.21 | \$128 | \$1,311 | \$2,539 |
| Meters | 15-Oct-98 | 0% | \$0 | 20 | 10.21 | \$0 | \$0 | \$0 |
| Double service connection | 15-Oct-98 | 0% | \$0 | 20 | 10.21 | \$0 | \$0 | \$0 |
| Single service connection | 15-Oct-98 | 0% | \$0 | 20 | 10.21 | \$0 | \$0 | \$0 |
| Fencing and gates plus 10% engineering fees | 15-Oct-98 | 100% | \$3,960 | 20 | 10.21 | \$198 | \$2,022 | \$1,938 |
| Compressor plus 10% engineering fees | 15-Oct-98 | 100% | \$440 | 20 | 10.21 | \$22 | \$225 | \$215 |
| TOTALS | | | \$276,560 | | | \$8,135 | \$74,260 | \$202,299 |

The Protestants primarily claim that all of BFE's water-service assets were contributed by the developer; hence, BFE is not entitled to a return on them. The other parties do not agree with that contention, and neither does the ALJ.

⁸⁹ In ED Ex. BDD 12, Mr. Dickey referred to a 21,000-gallons tank, but as discussed below other evidence shows that the tank capacity is 84,000 gallons.

Cresson alternatively contends that the net value of BFE's water plant is \$175,580.⁹⁰ This valuation is not supported by expert-opinion testimony, and the ALJ does not entirely understand how Cresson derived it from the evidence. Beyond that, the Protestants claim that certain specific assets should not be included in BFE's rate base. Those claims are examined below.

The ALJ concludes that Mr. Dickey's depreciation analysis is correct on all points, but two. The ALJ find that only 44% of the capacity of BFE's 84,000-gallon water storage tank is necessary, and useful to provide water utility service. The ALJ also does not find that the original cost of many of BFE's assets should be increased by 10% to account for related engineering and legal fees.

a. Used and useful

Both Mr. Fenner and Mr. Dickey visited BFE's site and investigated its utility assets in detail. Mr. Fenner found the assets in good working order, and Mr. Dickey did not dispute that point.⁹¹ The Protestants do not dispute that most of BFE's assets set out in the depreciation analysis table are used and useful in providing water service. However, they challenge including the fire hydrants and a portion of a storage tank in BFE's rate base. The ALJ finds that all of the assets listed in the depreciation analysis, except for a portion of a storage tank, are used by and useful to BFE in providing water service.

i. Fire hydrants

There are six fire hydrants on BFE's system.⁹² While conceding that fire hydrants, as such, are not used to provide water service,⁹³ BFE contends that the hydrants are used and useful

⁹⁰ Cresson's Closing at 29-30.

⁹¹ BFE Ex. 2 at 10; ED Ex. BDD 1 at 7.

⁹² Tr. 182.

⁹³ Tr. at 250.

as valves to flush its water system, which is necessary to provide water utility service. Both Mr. Fenner⁹⁴ and Mr. Dickey agreed on that point.⁹⁵ This is a matter on which the ALJ and the Commission must rely on the opinions of experts. No testifying expert disputed the evidence that the hydrants are used and useful as flush valves. The ALJ finds that the six fire hydrants are used and useful to BFE in providing water utility service.

ii. Storage Tank

BFE has an 84,000-gallon tank that it uses to store water for subsequent delivery to its customers. No party disputes that BFE uses this tank, but the Protestants argue that a portion of it is not useful to serve BFE's 35 connections.

BFE originally planned to build a 21,000-gallon storage tank.⁹⁶ Mr. Bourland testified that he was advised by a drilling consultant that it would be wiser to buy a larger, 84,000-gallon tank to occasionally vent hydrogen sulfide gas.⁹⁷ It is uncontested that BFE's water comes from a well drawing from the Trinity Sands and contains significant quantities of hydrogen sulfide, which has a putrid odor.⁹⁸ Relying on the consultant's advice, Mr. Bourland chose to build the 84,000-gallon tank, which BFE put into service on October 29, 1998.⁹⁹

Mr. Dickey testified that BFE must have a storage capacity of at least 200 gallons per connection, as required by a Commission rule.¹⁰⁰ That would mean BFE needs at least 7,000 gallons of storage for its 35 connections. Cresson concedes that BFE needs the capacity to store 13,600 gallons of water. It relies on BFE's 1998 CCN application, which anticipated that

⁹⁴ Tr. at 250-251.

⁹⁵ ED Ex. BDD 1 at 8.

⁹⁶ ED Ex. A, attach. A, 2-page insert following 10 of 41.

⁹⁷ Tr. at 142.

⁹⁸ Tr. at 402.

⁹⁹ BFE Ex. 2 at 27.

¹⁰⁰ 30 Tex. Admin. Code § 290.45(b)(1)(B)(ii).

BFE would eventually serve 68 customers.¹⁰¹ Cresson appears to be taking the position that BFE needs 200 gallons of storage capacity, the minimum required by the Commission's rule, multiplied by the 68 connections that BFE will need to serve at full build-out.¹⁰²

Other evidence shows that BFE already needs even more storage capacity. Mr. Dickey calculated that during the peak month of the test year, July 2008, BFE's 35 customers used 1,135,200 gallons, which is an average of 36,619 gallons per day. Mr. Dickey testified that he had never seen a subdivision with that high a consumption pattern. That led Mr. Dickey to conclude that BFE needs at least 36,619 gallons of storage capacity to meet its customers' demand for water.¹⁰³

Additionally, Mr. Dickey testified that BFE needs the remaining 47,381 gallons of tank capacity to vent hydrogen sulfide gas before it goes to the distribution system.¹⁰⁴ But when cross-examined, Mr. Dickey admitted that he could not be sure that a larger tank capacity would increase the off-gassing of hydrogen sulfide.¹⁰⁵ Nor did BFE offer any expert evidence to show that the additional tank capacity was needed and useful to vent offensive smelling, hydrogen sulfide gas.

The ALJ concludes that only 44% of the capacity of BFE's 84,000-gallon water storage tank is necessary, used, and useful to provide water utility service. That was the capacity needed to store the 36,619-gallon average water demand from BFE's customers during the peak month of the test year, July 2008. It may be that additional capacity would be useful to vent hydrogen sulfide gas, but the evidence was not sufficient to show that is true. BFE offered no evidence on that point and Mr. Dickey could not explain it when challenged.

¹⁰¹ Cresson Ex. 1, attach. B at 3 of 10 (as marked).

¹⁰² 68 connections * 200 gallons connection = 13,600 gallons.

¹⁰³ ED Exs. BDD 1 at 10-11 & BDD 6 (last page); Tr. at 534.

¹⁰⁴ ED Ex. BDD 1 at 11.

¹⁰⁵ Tr. 532-35.

iii. Well Pump

The City proposes disallowing the \$24,033 cost of a well pump that was installed in either 1998 or 2008.¹⁰⁶ It is not completely clear, but the ALJ believes that the City is referring to a pump that the Application indicates was installed in September 2008 and cost \$24,003.¹⁰⁷ Both Mr. Fenner and Mr. Dickey included a pump installed in September 2008 in their list of plant assets. Mr. Fenner valued it at \$32,639.¹⁰⁸ Mr. Dickey valued it at \$35,903, which includes a 10% engineering-fee adjustment to the cost of a \$32,639 asset.¹⁰⁹ Moreover, the pump installed in September 2008 cost \$32,639, as indicated in the invoice,¹¹⁰ not \$24,003 as indicated in the Application.

The City does not dispute that this pump is used and useful. Instead, the City argues that BFE should not be allowed to include that cost of the pump in rate base because BFE should have paid for the pump with funds in a reserve account that it indicated it would create when it obtained the CCN. The City's proposal to disallow the cost of the pump is contrary to the way in which water-utility rates are set.

A utility is entitled to rates that will give it a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses.¹¹¹ With rare exceptions¹¹² not applicable to the pump, the source of funds the utility uses to make the investment makes no difference. The CCN application indicated BFE would create a reserve account and fund it with amounts BFE obtained from sale of its stock and, at least by inference, BFE's earnings.¹¹³ There is no

¹⁰⁶ Cresson Closing at 29, 31-32.

¹⁰⁷ ED Ex. A, attach. A at 10 of 41.

¹⁰⁸ BFE Ex. 2 at 25.

¹⁰⁹ ED Ex. BDD 12.

¹¹⁰ BFE Ex. 2 at 29.

¹¹¹ Tex. Water Code § 13.183(a).

¹¹² See 30 Tex. Admin. Code § 291.31(c)(3).

¹¹³ ED Ex. BDD 8 at 16.

indication that BFE would fund the reserve with amounts obtained cost-free from customers or waived its right to earn a return on and of capital investments made in the future with funds in the reserve account. The ALJ sees no grounds for disallowing the cost of the pump.

b. Original Cost

In BFE's original 1998 CCN application,¹¹⁴ its prior, uncontested 2002 application to change its rates,¹¹⁵ and its Application at issue in this case,¹¹⁶ BFE claimed the same original costs for its water-utility equipment. It also claimed a 5% upward adjustment to those values to account for contingencies and a 10% upward adjustment to account for legal and engineering costs. All told, the original costs stated in the Application add up to \$254,112.13.

However, BFE's previous and current claims concerning its original costs assumed a 21,000-gallon water storage tank with an estimated original cost of \$13,000. Instead, BFE built an 84,000-gallon tank with an original cost of \$27,009. That would raise the original cost of BFE's invested capital to \$268,121.13.¹¹⁷

Determining a utility's rate base is a very complex inquiry, and the Commission must largely rely on the opinions of utility-rate experts to make that determination. Only two experts testified in this case concerning BFE's rate base and depreciation expense: Mr. Fenner and Mr. Dickey. Mr. Fenner's qualifications are described above. Mr. Dickey holds a bachelor's degree in mechanical engineering, and has worked for the Commission since 1999. He has reviewed and processed over 250 water and sewer utility-rate and CCN applications and testified in hearings concerning them.¹¹⁸

¹¹⁴ ED Ex. BDD 8 at 37-38.

¹¹⁵ ED Ex. BDD 9 at 7-8.

¹¹⁶ ED Ex. A, attach. A, 2-page insert following 10 of 41 & ED Ex. BDD 11.

¹¹⁷ $\$254,112.13 + (\$27,009 - \$13,000) = \$268,121.13$.

¹¹⁸ ED Exs. BDD 1 at 2-3 & BDD 2.

Mr. Fenner could not find the original invoices to determine the original cost of some of BFE's assets. For them, he prepared a trending analysis using the Handy Whitman Index, a City Cost Index, and a Location Factor to estimate the original cost of each asset.¹¹⁹ Mr. Dickey agreed that using such a trending study to determine the original costs of assets is acceptable when invoices cannot be located, and he concluded that Mr. Fenner's trending study supported the original costs included in the Application.¹²⁰ There is no evidence indicating that Mr. Fenner prepared the trending study incorrectly.

Mr. Fenner concluded that the original cost of BFE's plant was \$289,557.¹²¹ As indicated in the depreciation analysis table, Mr. Dickey calculated that the original cost of BFE's assets totaled \$276,560, lower than Mr. Fenner found. Because BFE now supports it, the ALJ primarily focuses below on Mr. Dickey's calculation.

To prepare his analysis, Mr. Dickey began with the original costs of those items as stated in BFE's Application.¹²² He split and re-categorized some items without changing the total amounts involved,¹²³ and the ALJ sees no need to address those non-substantive changes.

Mr. Dickey deleted the costs of meters and double- and single-service connections, which cumulatively accounted for \$13,800 of BFE's claimed original cost, because the costs of those items are recovered through tap fees rather than rates.¹²⁴ This disallowance approximately accounts for the overall difference between Mr. Dickey's and Mr. Fenner's calculations of original cost, though they differ on certain details. No party disputes this \$13,800 disallowance, the ALJ agrees with it as well, and it is already reflected in Mr. Dickey's depreciation analysis table set out above.

¹¹⁹ BFE Ex. 2 at 10-12 & attach. F.

¹²⁰ ED Ex. BDD 1 at 7.

¹²¹ BFE Ex. 2 at 12 & attach. F.

¹²² ED Ex. A, attach. A, 2-page insert following 10 of 41 & ED Ex. BDD 11.

¹²³ ED Ex. BDD 1 at 8-11.

¹²⁴ ED Ex. BDD 1 at 8.

Additionally, Mr. Dickey reduced the original cost of BFE's pump house from \$10,000, as claimed in the Application, to \$6,402, as Mr. Fenner calculated in his trending study. Mr. Dickey determined that only 50 feet of 4-inch water well collection line was installed at the site, instead of 800 feet as stated in the Application, and he reduced the original cost of that asset from \$3,400 to \$212.40, or \$234 after including a 10% adjustment for engineering fees.¹²⁵ This undisputed disallowance is also already reflected in the depreciation analysis table above.

Because he agreed with BFE that the entire 84,000-gallon storage tank was used and useful, Mr. Dickey increased the original cost of that item from \$13,000, which was the estimated cost of the originally planned 21,000-gallon tank, to \$27,009, which Mr. Fenner's trending analysis estimated as the original cost of the 84,000-gallon tank cost.¹²⁶ As discussed above, however, the Protestants oppose that adjustment, and the ALJ concludes that only 44% of the capacity of BFE's 84,000-gallon water storage tank is necessary, used, and useful to provide water utility service. Accordingly, the ALJ finds that only \$11,883.96 should be allowed for the 84,000-gallon tank, and \$15,125.04 should be disallowed from the original-cost amount listed in the depreciation analysis table.

In its estimated cost of capital assets that was originally prepared in 1998 and later included in its Application at issue in this case, BFE included two adjustments: an additional 5% to account for contingencies and an additional 10% to account for engineering and legal costs.¹²⁷ Neither Mr. Fenner nor Mr. Dickey included the 5% contingency adjustment in their original cost calculations; the ALJ sees no basis for including it in BFE's original cost.

However, Mr. Dickey did increase the original cost of certain assets by 10% to account for engineering and legal fees. He testified that the Commission's rules require a licensed professional engineer to submit all plans to the Commission for review and approval before construction and noted that the Commission staff approved BFE's plans after they were

¹²⁵ ED Ex. BDD at 8-11.

¹²⁶ BFE Ex. 2 at 27.

¹²⁷ ED Ex. A, attach. A, 2-page insert following 10 of 41.

submitted by a license professional engineer. Mr. Dickey reasoned that this was adequate to show that BFE had spent an additional 10%, as previously estimated, and increased the original costs of the capital items, except for the 84,000-gallon ground storage tank and a pump building, by 10%. Because he was less sure that additional expense was incurred for the ground storage tank and pump building, he did not include a 10% increase for those items.¹²⁸

Mr. Perdue and the HOA contend that BFE did not ask for the inclusion of the 10% fee adjustment, but the ALJ does not agree. The 10% adjustment for legal and engineering costs was included in the estimated costs for the capital items that BFE included in its Application;¹²⁹ hence, it was requested by BFE. Mr. Perdue and the HOA also argue that there is no proof that BFE actually incurred these legal and engineering costs. With this, the ALJ agrees.

If a utility is using physical assets to provide service, one can infer, absent proof to the contrary, that the utility incurred some expense to acquire them. For that reason, and in the absence of better proof, it is reasonable to estimate the original costs of physical assets and include those costs in rate base. On the other hand, legal and engineering services have no physical existence; hence, there must be some other proof that the utility actually incurred costs for them and they should be capitalized.

In this case, there is insufficient proof that BFE actually incurred engineering and legal costs related to its capital items. The Application only includes a rough estimate of the expenses that would be incurred in the future for these professional services. No invoices or other documents are in evidence to show that they were actually incurred. Mr. Bourland did not testify that he subsequently incurred such expenses.

Based on the submission and approval of plans, Mr. Dickey apparently inferred three things: (1) BFE paid some amount to the professional engineer who submitted the plans to the Commission, (2) the work was closely connected to the construction of the physical assets and

¹²⁸ ED Exs. BDD at 10 & BDD 8 at 60-62; Tr. 506-508.

¹²⁹ ED Ex. A, attach. A, 2-page insert following 10 of 41.

should be capitalized, and (3) BFE paid the engineer 10% of the underlying cost of the physical asset for the work. The ALJ does not find those inferences reasonable. Accordingly, he concludes that all of the 10% upward adjustments for engineering expenses related to the capital items should be disallowed in the absence of evidence that BFE actually incurred costs for these professional services.

2. Working Capital

BFE's Application requested a working-capital allowance, sometimes referred to as a working-cash allowance.¹³⁰ Both Mr. Fenner and Ms. Loockerman also recommended including a working-capital allowance.¹³¹ This is in accord with 30 Texas Administrative Code § 291.31(c)(2)(C)(iii), which provides for a working-capital allowance of one-eighth of a utility's 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).

No party opposes the inclusion of working-capital allowance. The ALJ concludes it should be allowed.

3. Cost of Capital

a. Cost-free Capital

The Protestants contend BFE incurred no cost to obtain the invested capital that it uses to provide water service because all of the capital was contributed by a developer. Rule 30 Texas Administrative Code § 293.31(c)(3) provides:

¹³⁰ ED Ex. A, attach. A at 13 of 41.

¹³¹ BFE Ex. at 7, 22; ED Exs. DL 1 at 11 & DL 2.

Terms not included in rate base. Unless otherwise determined by the commission, for good cause shown, the following items will not be included in determining the overall rate base.

(A) Miscellaneous items. Certain items that include, but are not limited to, the following:

...
(iv) contributions in aid of construction; and

(v) other sources of cost-free capital, as determined by the commission.

In accord with that rule, the Protestants claim BFE is not entitled to a return on its invested capital. No other party agrees with the Protestants on this point. The ALJ does not find that BFE obtained its invested capital from a developer as a cost-free contribution.

The Protestants' developer-contribution argument is not supported by preponderant evidence. BFE is both the water utility and developer of the subdivision, Bourland Field Estates, where it provides service. Thus, there is not a separate real estate development company that might have donated property to the utility.

Mr. Bourland owns BFE, but the evidence does not show that he contributed cost-free assets to BFE to provide water service. There are certainly no contracts, deeds, or other legal documents in evidence wherein Mr. Bourland, or anyone else, donated cost-free assets to BFE without expecting a return as an investor. Based on his professional experience, Mr. Fenner testified that a developer typically enters into a contract with a utility to establish that there is a developer contribution.¹³² Mr. Fenner found nothing indicating a developer had contributed property to BFE.¹³³ After reviewing the Application, a prior application, and other BFE documents, Mr. Dickey could find nothing that indicated BFE had received a developer contribution.¹³⁴

¹³² Tr. 229.

¹³³ Tr. 247-248.

¹³⁴ ED Ex. BDD 1 at 12-13.

The only statement by Mr. Bourland referring to any kind of developer contribution is in a history of the water company that he prepared, where he wrote: "Some of the infrastructure that distributes water into the subdivision is what you refer to as developer[']s contribution. The water plant is not in property platted or owned by Bourland Field Estates. It is located on property owned by Bourland Field, Inc."¹³⁵

What Mr. Bourland meant by that is not clear. When asked about it during the hearing, Mr. Bourland said he meant that others, including Mr. Becker and Mr. Perdue, referred to the water distribution facilities as developer contribution, but not he.¹³⁶ In fact, Mr. Bourland repeatedly denied ever making a developer contribution, stated that he intended to earn a return on the utility assets owned by BFE, and denied that the cost of the lots sold to the customers included the cost of the water system.¹³⁷

Mr. Perdue testified that during a rate hearing the City held on November 2, 1011, Mr. Bourland acknowledged that he recovered the cost of the water system through lot sales.¹³⁸ The transcript of that hearing is not in evidence. The ALJ attaches no evidentiary weight to Mr. Perdue's interpretation of what Mr. Bourland said. There are no contracts, deeds, or other legal documents in evidence showing that BFE or Mr. Bourland conveyed any right to water-system assets or reduced-cost water service to customers when they bought lots in the subdivision.

In the absence of 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. They point to the fact that BFE sold 38 lots in the subdivision at a cost of \$65,000 or more per lot,¹³⁹ which would have covered the cost of the water system many

¹³⁵ Cresson Ex. 1, attach. L at 1.

¹³⁶ Tr. 103-115.

¹³⁷ BFE Ex. 1 at 7; ED Ex. BDD 1 at 12; Tr. 18-19, 58-59, 102.

¹³⁸ Perdue Ex. 1 at 10.

¹³⁹ Tr. 122-23,

times over.¹⁴⁰ They also contend that BFE's lack of debt and charging lower water rates in previous years somehow shows that BFE obtained cost-free, developer-contributed facilities to provide water.¹⁴¹ The ALJ does not find that the evidence provides a reasonable basis for inferring BFE received cost-free developer contributions.

The ALJ does not conclude that Mr. Bourland, or anyone else, gave cost-free property to BFE to provide water service. There is far too little evidence to prove or infer that Mr. Bourland or BFE gave away hundreds of thousands of dollars of assets in this way.

b. Debt Capital

BFE has no debt.¹⁴² No party argues otherwise. The ALJ concludes that no portion of the cost of BFE's invested capital is due to the cost of debt.

c. Equity Capital

In the Application, BFE asked for a 7% overall rate of return.¹⁴³ In his prefiled testimony, Mr. Fenner recommends a 10.57% overall rate of return.¹⁴⁴ Ms. Loockerman recommends an 11.25% overall rate of return.¹⁴⁵ The City argues that the rate of return should be no higher than 7%. The ALJ concludes that BFE's reasonable rate of return is 11.25%.

Unless the Commission establishes alternate rate methodologies, the Commission may not prescribe any rate that will yield more than a fair return on the invested capital used and useful in rendering service to the public. In fixing a reasonable return on invested capital, the Commission must consider, in addition to other applicable factors, the efforts and achievements

¹⁴⁰ Cresson Closing at 26-28.

¹⁴¹ Cresson Ex. 1 at 4, 7, 10; Perdue and HOA Closing at 1-3; Perdue Ex. 1 at 9-11.

¹⁴² BFE Ex. 2 at 22.

¹⁴³ ED Ex. A, attach. A at 12 of 41.

¹⁴⁴ BFE Ex. 2 at 9, 23-24.

¹⁴⁵ ED Exs. DL 1 at 12-13 & DL 11.

of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management.¹⁴⁶

Under 30 Texas Administrative Code § 291.31(c)(1), the Commission also fixes the rate of return in accordance with the following additional principles:

(A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

...

(C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility. . . .

Both Mr. Fenner and Ms. Loockerman used the rate-of-return worksheet that has been included the Commission's rate-application instructions since at least September 6, 2012.¹⁴⁷ Ms. Loockerman testified that the rate she proposes is based primarily on the average 7.25% return for a Baa rated public utility bond during the test year, which rating represents the highest risk for public utilities. She added two percent to recognize the increased risk of a small utility, like BFE, serving less than 200 connections. She added: (1) another one percent because BFE serves a low growth area, and (2) another one percent because BFE had no major deficiencies in its most recent inspection and no current enforcement actions within the three-year period including the test year, and BFE made good-faith efforts to solve any current problems.¹⁴⁸

The difference between Ms. Loockerman's and Mr. Fenner's recommendation is due primarily to Mr. Fenner's using a lower interest rate of 5.57% for the Baa bond rating,¹⁴⁹ while

¹⁴⁶ Tex. Water Code § 13.184(a) & (b) & 30 Tex. Admin. Code § 291.31(c)(1)(B).

¹⁴⁷ See date on ED Ex. DL 11.

¹⁴⁸ ED Exs. DL 1 at 12-13 & DL 11.

¹⁴⁹ BFE Ex. 2 at 23.

Ms. Loockerman used 7.25%. However, Ms. Loockerman supported her choice with documentation showing the average Baa bond yield for each month during the test year, which she then averaged to reach 7.25%.¹⁵⁰ BFE supports Ms. Loockerman's recommendation.

The City offered neither testimony from a utility-rate expert nor detailed citations to evidence in the record to support the rate of return it recommends. Setting a rate of return is a complex task, and the Commission must primarily rely on the opinions of experts in that field. The City argues that BFE's management failings justify a low rate of return. While generally arguing that BFE is poorly managed and the quality of the water it provides is poor, the City cites no evidence to contradict Ms. Loockerman's testimony that BFE had no major deficiencies in its most recent inspection, no current enforcement actions within the three-year period including the test year, and made good faith efforts to solve any current problems.

The ALJ agrees with Ms. Loockerman's analysis and sees no basis for deviating from the work-sheet methodology that the Commission has used in recent years to determine rate of return. The ALJ concludes that BFE's rates should be set using an 11.25% rate of return.

4. Depreciation

Depreciation expense is based on original cost and computed on a straight line basis over the useful life of the asset as approved by the Commission. With exceptions not relevant to this case, depreciation is allowed on all currently used and useful depreciable utility property owned by the utility. Depreciation must account for net salvage value.¹⁵¹

Mr. Dickey's method of calculating BFE's depreciation and net plant are included in the depreciation analysis table set out above. His methodology is not disputed by any party. According to Mr. Dickey, BFE acquired each of its water-service assets on October 15, 1998, except for a well pump that it acquired on September 15, 2008, as discussed above. He provided

¹⁵⁰ ED Ex. 10.

¹⁵¹ 30 Tex. Admin. Code § 291.31(b)(1)(B).

the expected economic life for each category of assets. Using those facts and his determinations of the original cost, use, and usefulness of each asset, Mr. Dickey calculated the annual depreciation, actual depreciated life, accumulated depreciation, and net plant amounts for each asset as of the date BFE filed the Application.¹⁵²

The ALJ concludes that Mr. Dickey's undisputed method of calculating depreciation and net plant are correct. That includes the acquisition dates, economic lives, and actual depreciation lives Mr. Dickey used.

Because the ALJ disagrees with Mr. Dickey concerning the original cost and use and usefulness of certain assets, however, the annual depreciation, accumulated depreciation, and net plant amounts will need to be recalculated. The ALJ requires assistance, based on the record, to recalculate these amounts. The ALJ requests the ED to provide that recalculation in his exceptions to the PFD. The other parties may respond to the ED's recalculation in their replies to exceptions.

G. Federal Income Tax

Federal income tax on a normalized basis is an allowable expense.¹⁵³ Ms. Loockerman calculated BFE's allowable federal income taxes based on adjusted test year revenue, less expenses, and using the lowest business tax rate of 15% published by the Internal Revenue Service.¹⁵⁴ It appears that Mr. Fenner used the same methodology, though he calculated a different amount because he assumed different inputs.¹⁵⁵ In its closing brief, BFE indicated that it agreed with Ms. Loockerman's methodology.¹⁵⁶

¹⁵² ED Ex. BDD 12.

¹⁵³ 30 Tex. Admin. Code § 291.31(b)(1)(C) &(D).

¹⁵⁴ ED Exs. DL 1 at 14-14 & DL 2.

¹⁵⁵ BFE Ex. 2 at 8, 22.

¹⁵⁶ BFE Closing Brief at 17.

The City argues that no amount should be allowed for federal income taxes because BFE paid no income taxes during the test year.¹⁵⁷ However, BFE and the ED propose calculating federal income tax as a known and measurable change. Ms. Loockerman testified that the BFE Water Company's income and expenses are reported on Schedule C of Form 1040, as a personal business expense of Mr. Bourland, who would pay any taxes owed.¹⁵⁸ Rather than allowing a tax amount equal to what Mr. Bourland actually paid during the test year, Ms. Loockerman calculated a normalized tax amount, as required by a Commission rule.¹⁵⁹

The same Commission rule requires federal income tax to be calculated in accordance with Texas Water Code § 13.185(f) if applicable. The City contends that statute is applicable, but BFE and the ED claim it is not. Texas Water Code § 13.185(f) states:

If the utility is a member of an affiliated group that is eligible to file a consolidated income tax return and if it is advantageous to the utility to do so, income taxes shall be computed as though a consolidated return had been filed and the utility had realized its fair share of the savings resulting from the consolidated return, unless it is shown to the satisfaction of the regulatory authority that it was reasonable to choose not to consolidate returns. The amounts of income taxes saved by a consolidated group of which a utility is a member due to the elimination in the consolidated return of the intercompany profit on purchases by the utility from an affiliate shall be applied to reduce the cost of those purchases. The investment tax credit allowed against federal income taxes to the extent retained by the utility shall be applied as a reduction in the rate-based contribution of the assets to which the credit applies to the extent and at the rate as allowed by the Internal Revenue Code.

The ED notes that section 1501 of the Internal Revenue Code states that, “[a]n affiliated group of corporations shall . . . have the privilege of making a consolidated return . . . in lieu of separate returns.”¹⁶⁰ Thus, according to the ED and BFE, Texas Water Code § 13.185(f)'s reference to “affiliated group” means an affiliated group of corporations, not individuals or shareholders, like Mr. Bourland.

¹⁵⁷ Cresson Ex. 1, attach. S at 00089.

¹⁵⁸ Tr. 455.

¹⁵⁹ 30 Tex. Admin. Code § 291.31(b)(1)(D).

¹⁶⁰ 26 USC § 1501.

The ALJ agrees with the ED and BFE that Texas Water Code § 13.185(f) does not apply. That statute applies to utilities affiliated with corporations that are allowed to file a consolidated tax return. In this case, there is only one corporation, BFE Development Company, which has chosen to operate its water utility business as BFE Water Company.

The fact that Mr. Bourland chose to treat BFE's water business as a personal business on his own tax return makes things more complicated. Ms. Loockerman calculates federal income taxes as if BFE's water operation was a standalone business earning the revenue requirement that will be determined in this case, minus expenses, and applies the lowest business tax rate. The ALJ concludes that Ms. Loockerman methodology for calculating BFE's taxes is just, reasonable, known, and measurable and recommends that the Commission adopt that methodology.

Because the ALJ does not agree with the ED on some issues, the federal income tax amount will need to be recalculated. The ALJ requires assistance, based on the record, with this recalculation. The ALJ requests the ED to provide that recalculation in its exceptions to the PFD. The other parties may respond to the ED's recalculation in their replies to exceptions.

VII. TAP FEES

Ms. Loockerman concluded that BFE realized \$500 during the test year from tap fees, and proposes to subtract \$500 from the amount of BFE's revenue requirement that is recoverable through rates.¹⁶¹ No party disputes her conclusion on that point, and the ALJ concludes that the Commission should adopt it.

¹⁶¹ ED Exs. DL 1 at 15 & DL 2.

VIII. RATE DESIGN

A. Rates Proposed by BFE and the ED

As previously indicated, BFE has requested a certain set of rates in its Application to recover its claimed cost of service. Following his analysis of the Application, Mr. Dickey proposed a set of rates that is the same as the one BFE requested except for a change in the monthly base rate for a 3-inch meter and elimination of the base rate for a 4-inch meter. These changes will impact no one, because no BFE customer has a 3- or 4-inch meter. In its Closing, BFE changed its position and now supports the rates that Mr. Dickey recommended. OPIC does not oppose those rates. Mr. Dickey's recommended rates are set out below:

| MONTHLY BASE RATES INCLUDING 0 GALLONS (residential per meter diameter) | |
|---|----------|
| 5/8 or 3/4 inches | \$38.50 |
| 1 inch | \$96.25 |
| 1 ½ inch | \$192.50 |
| 2 inch | \$308.00 |
| 3 inch | \$577.50 |

| GALLONAGE CHARGES (per 1,000 gallons) | |
|---|--------|
| First 5,000 gallons | \$3.22 |
| Next 10,000 gallons | \$3.72 |
| Next 15,000 gallons | \$4.22 |
| After 30,000 gallons | \$4.22 |

| MISCELLANEOUS FEES | |
|---------------------------------|----------|
| Tap fee | \$500.00 |
| Reconnect fee, non-payment | \$25.00 |
| Reconnect fee, customer request | \$40.00 |
| Transfer fee | \$35.00 |
| Late charge | 10% |
| Return check charge | \$25.00 |
| Deposit | \$50.00 |
| Meter test fee | \$25.00 |

Mr. Perdue and the HOA oppose the rates recommended by the ED and BFE. The City opposes them as well, except for the reconnect fee for non-payment, the transfer fee, and the deposit.¹⁶² Cresson also proposes a set of rates that is very different from that recommended by BFE and the ED.¹⁶³

The ALJ does not find that Cresson's rate proposal is supported by the evidence. It assumes costs of service amounts that the ALJ rejects above. Moreover, designing rates is a complicated subject on which the Commission must largely rely on the opinions of experts. Cresson's rate-design methodology is not supported by expert-opinion evidence; hence, the ALJ does not find that Cresson's rate-design methodology is correct and sees no need to examine it in detail.

On the other hand and as previously discussed, Mr. Dickey and Mr. Fenner have sufficient expertise to offer expert opinions concerning rate design, and their opinions concerning the design of BFE's rates are in evidence.¹⁶⁴ Thus, Mr. Dickey's rate-design methodology, which BFE and the ED support, is based on the evidence, and the ALJ considers it below.

¹⁶² Cresson Closing at 42-43.

¹⁶³ Cresson Closing at 36-43.

¹⁶⁴ ED Exs. BDD 1 at 14-18 & BDD 3 & 4; BFE Ex. 2 at 11-12 (adopting by reference ED BDD Ex. 1, attach. A at 35 of 41).

B. Rates Design Inputs and Methodology

Mr. Dickey’s rate design depends on the number of BFE’s customers in each meter-size category and their equivalents during the test year and the segregation of cost-of-service items into fixed costs, to be recovered through base rates, and variable costs, to be recovered through gallonage charges. Mr. Dickey’s determinations of these inputs are not disputed by any party and are set out below:

| CALCULATION OF EQUIVALENTS¹⁶⁵ | | | |
|---|--------------------|-------------------|--------------------|
| Meter size | Connections | Multiplier | Equivalents |
| 5/8 or 3/4 inches | 32 | 1.00 | 32 |
| 1 inch | 3 | 2.50 | 7.5 |
| 1 ½ inch | 0 | 5.00 | |
| 2 inch | 0 | 8.00 | |
| 3 inch | 0 | 15.00 | |
| 4 inch | 0 | 25.00 | |

| FIXED AND VARIABLE COSTS¹⁶⁶ | | |
|---|------------------|---------------------|
| Item | Fixed (%) | Variable (%) |
| Salaries | 50 | 50 |
| Contract services | 90 | 10 |
| Chemicals & treatment | 0 | 100 |
| Utilities | 0 | 100 |
| Repairs & maintenance | 50 | 50 |
| Office expense | 50 | 50 |
| Accounting and legal | 100 | 100 |
| Insurance | 100 | 0 |
| Miscellaneous | 50 | 50 |
| Ad valorem taxes | 100 | 0 |
| Depreciation | 100 | 0 |
| Return on invested capital | 60 | 40 |
| Federal income tax - normalized | 60 | 40 |
| Rate-case expense | 50 | 50 |
| Other revenues – tap fees | 60 | 40 |

¹⁶⁵ ED Exs. BDD 1 at 16-17 & BDD 3.

¹⁶⁶ ED Exs. BDD 1 at 14-15 & BDD 4.

The ALJ concludes that Mr. Dickey's rate design methodology based on the above inputs is just and reasonable.

C. Rate Recalculation

Because the ALJ does not agree with the ED on some issues, the ALJ asks the ED in his exceptions to submit a recalculation of base rates and gallonage charges based on the ALJ's conclusions in this PFD and the record. The other parties may respond to the ED's recalculation in their replies to exceptions.

IX. LATE CHARGE

In setting BFE's rates, Cresson denied BFE's request to levy a 10% charge on customers who pay their bills late and instead authorized BFE to collect a \$5.00 late charge.¹⁶⁷ However, 30 Texas Administrative Code § 291.87(c) allows a utility to charge either \$5.00 or 10% for late payment of a bill and does not restrict a utility's choosing one or the other. The ALJ concludes that the Commission should permit BFE to levy a 10% late charge, as BFE has chosen in accordance with 30 Texas Administrative Code § 291.87(c).

X. UNDER RECOVERY

As set out above, on August 23, 2011, Cresson ordered BFE to deposit into an escrow account all monies received or to be received from the sale of water after May 31, 2011, that was attributable to any increase in rates in effect prior to January 16, 2011.¹⁶⁸ Cresson slightly

¹⁶⁷ ED Ex. A, attach. J & K. Cresson alleges that BFE has charged customers more than \$5.00 for late payment and asks that the Commission order BFE to calculate and refund to customer any over-collection. Cresson Closing at 40-41. The ALJ does not recommend that the Commission issue such an order. That dispute is in the nature of an enforcement action and outside the scope of this case.

¹⁶⁸ ED Ex. A, attach. H.

amended that escrow order on September 13, 2011.¹⁶⁹ On January 12, 2012, Cresson set interim rates for BFE that were lower than the rates BFE had proposed.¹⁷⁰ On January 24, 2012, Cresson's City Council issued a final order fixing BFE's rates and requiring BFE to refund rate over-collections with 4.0% per year interest.¹⁷¹ The final rates were lower than those for which BFE had applied. When BFE appealed Cresson's rate determination to the Commission, BFE also filed a motion to set interim rates, in accordance with 30 Texas Administrative Code § 291.29(d). After considering that motion at the preliminary hearing in accordance with the process set out in Section 291.29, the ALJ granted the motion on June 8, 2012.

The ALJ is asking the ED to recalculate BFE's rates based on the record and the determinations that the ALJ makes in this PFD. Thus, the ALJ cannot yet recommend specific rates that the Commission should set. Nevertheless, it is sufficiently clear that the ALJ will recommend rates that are higher than the rates set by Cresson and set by the ALJ as interim rates. In accordance with 30 Texas Administrative Code §§ 291.29(i) and 291.41(e)(4), BFE should be allowed to recover in a reasonable number of monthly installments the revenue that it lost because the rates Cresson set and the interim rates the ALJ set were lower than the final rates that the ALJ will recommend in this case.

The ALJ asks the ED to submit in his exceptions calculations, based on the record, of the surcharges that BFE would need to assess over 24 and 36 months to recover the revenue it lost because Cresson and the ALJ set its rates at levels lower than BFE was entitled to charge. The other parties may respond to the ED's calculation in their replies to exceptions.

XI. RATES-CASE EXPENSES

A utility may recover rate-case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public

¹⁶⁹ ED Ex. A, attach. I.

¹⁷⁰ ED Ex. A, attach. J. *Compare to previous rates set out at ED Ex. A, attach. A at 34 & 35 of 41.*

¹⁷¹ ED Ex. A, attach. G.

interest.¹⁷² BFE claims that it has incurred \$193,913.13 in reasonable and necessary rate-case expenses seeking approval of the rates at issue in this case.¹⁷³ The expenses include:

- \$162,459.55 in legal fees, incurred beginning in February 2011;¹⁷⁴
- \$18,320.00 for Mr. Bourland's services;¹⁷⁵
- \$1,200 in escrow fees;
- \$3,366 for a contract secretary who prepared three rates applications for BFE; and
- \$8,567.58 for Mr. Fenner's consulting services.¹⁷⁶

A. Necessary and Reasonable Expenses

The Protestants propose disallowing all of BFE's claimed rate-case expenses. They contend that the evidence does not show that BFE is entitled to recover at least 51% of the rate increase revenue it seeks in this case; hence, 30 Texas Administrative Code § 291.28 bars BFE's recovery of any of its rate-case expenses. While the ALJ requires assistance to recalculate the revenue requirement, he generally agrees with the ED overall and proposes relatively minor disallowances that should not amount to more than 49% of the revenue increase that BRE seeks.¹⁷⁷ For that reason, and subject to reconsideration after the revenue requirement is recalculated, the ALJ does not conclude that all of the BFE's rate-case expenses should be disallowed.

¹⁷² 30 Tex. Admin. Code § 291.28(7).

¹⁷³ BFE Closing at 23; BFE Ex. 14. **In its closing, BFE asked that the record be reopened to admit BFE Ex. 14.** The exhibit provided additional evidence concerning the rate-case expenses BFE incurred beyond those set out in BFE Exs. 1, 3, 4, 5 & 6 and estimated additional expenses BFE would incur in replying to closing arguments; reviewing, taking exception to, and replying to exceptions by others concerning the PFD; and preparing for the Commission meeting during which the PFD will be considered. No party filed an objection to the motion to reopen the record. **The motion is granted, and BFE Ex. 14 is admitted into evidence.**

¹⁷⁴ BFE Ex. 1, errata attach. B & attach. C & BFE Exs. 3, 4, 5 & 14.

¹⁷⁵ BFE Ex. 1 at 8-9 & errata attach. B & BFE Ex. 14 at 1.

¹⁷⁶ BFE Ex. 1 at 8-9, errata attach. B & attach. C & BFE Exs. 4, 6 & 14.

¹⁷⁷ ED Ex. DL 1 at 24-25.

The ED proposes five specific disallowances totaling \$26,069. Ms. Loockerman testified that BFE incurred \$2,973 of the legal fees in September and October 2011 to present an incorrect legal argument that the City had lost jurisdiction over the Previous Application due to inaction.¹⁷⁸ She also proposed disallowing \$210 because \$30 per hour for Mr. Fenner's case-related travel was reasonable, but the \$60 per hour he actually charged was not.¹⁷⁹ The ED also claims that there is no evidence to support the alleged \$1,200 escrow payment. In his closing argument, the ED also proposes to disallow \$18,320 paid for Mr. Bourland's services, and \$3,366 paid for a contract secretary to prepare three rates applications. The ED contends that the contract secretary was Mr. Bourland's late wife, both of whom are affiliates of BFE, and there is no evidence showing that these payments comply with the rigorous standards for allowing recovery of payments to affiliates, which are discussed above in the PFD.

BFE responds that it reasonably argued in the public interest that the City lost jurisdiction in order to avoid all of the rate-case expenses that it later incurred in this case. It also contends that its witness, Lambeth Townsend, testified that all of Mr. Fenner's expenses, including travel, were reasonable and necessary,¹⁸⁰ there is no evidence that the contract secretary was Mr. Bourland's wife, Mr. Bourland testified BFE was required to pay the \$1,200 to Cresson for the City's rate-case expenses,¹⁸¹ and all of the amounts paid to Mr. Bourland and the secretary were reasonable and necessary.

The ALJ agrees with the ED's arguments that \$26,069 should be disallowed from BFE's rate-case expenses. The evidence cited by BFE is not sufficient to show that these expenses were necessary, reasonable, and complied with the standards for transactions with affiliates.

The ALJ concludes that BFE's remaining \$167,844.13 of rate-case expenses were reasonable and necessary. Mr. Townsend is a very experienced utility lawyer and BFE's lead

¹⁷⁸ ED Ex. DL 1 at 21.

¹⁷⁹ ED Ex. DL 1 at 22.

¹⁸⁰ BFE Ex. 3 at 7-8.

¹⁸¹ BFE Ex. 1 at 6, 8.

counsel in this case. Ms. Loockerman has extensive experience and expertise in reviewing rate-cases expenses. They testified that the rates per hour and the number of hours billed by BFE's attorneys and consultant were reasonable, typical, necessary, and warranted by BFE's burden of proof and the extent of the opposition to its requested rate increase.¹⁸² There is no evidence to contradict their testimony.

Additionally, BFE includes in its legal expenses the \$1,610 and \$1,529 that it was invoiced by the court reporter for the transcript of the hearing on merits of this case.¹⁸³ The cost of the transcript may be assessed among the parties based on consideration of the several factors, including whether it is included in the utility's allowable expenses in a rate proceeding.¹⁸⁴ The ALJ concludes that the cost of transcript is allowable as a rate-case expense which BFE should be assessed and allowed to recover from its customers as a rate-case expense.

B. Proposed Public Interest Disallowance

OPIC is concerned about the overall quantity of BFE's rate-cases expenses, approximately \$168,000, compared to the amount of its revenue requirement, approximately \$61,000. Despite the evidence showing that BFE's rate-case expense are reasonable and necessary, OPIC proposes to disallow 65% of them, claiming that would be in the public interest.

OPIC suggests that no customer should be required to pay more than 1% of a utility's otherwise allowable rate-cases expenses. Because BFE only has 35 customers, BFE would only be allowed to recover 35% of its rate-case expenses under OPIC's approach. OPIC cites no prior case in which a public-interest disallowance like the one it proposes was imposed.

The ALJ does not recommend the Commission's adoption of OPIC's public-interest disallowance of 65% of BFE's reasonable and necessary rate-case expenses. One purpose of

¹⁸² BFE Ex. 3 & ED Ex. DL 1 at 15-22.

¹⁸³ BFE Ex. 14, attach. Lloyd Gosselink invoice of May 22, 2013, at 3 & attach. Kennedy Reporting Service, Inc. invoices of April 18 & 25, 2013.

¹⁸⁴ 30 Tex. Admin. Code § 80.23(d)(1)(F).

regulating water utilities is to assure rates that are just and reasonable to retail public utilities, as well as consumers.¹⁸⁵ OPIC's proposed treatment of rate-case expenses is one-sided and would effectively deprive utilities serving less than 100 customer of the ability to charge just and reasonable rates.

Under OPIC's proposal, BFE would realize a net loss of almost two years of rate revenue after paying its necessary and reasonable expense of showing in this case that its proposed rates are just and reasonable. OPIC's recommendation would make it impossible for a utility serving less than 100 customers to ever recover all of its necessary and reasonable costs of complying with the rate-setting process. Moreover, the intensity of the opposition to a rate increase, no matter how incorrect, would increase a utility's net loss. OPIC correctly notes that this case was routine and straightforward except for spirited advocacy by protesting ratepayers. There is no evidence that BFE inflated its rate-case expenses, yet BFE needed to spend nearly three times its annual revenue requirement to respond to that opposition. The ALJ fails to see how BFE could continue to provide service while withstanding the net loss that OPIC proposes.

C. Rate-case Expense Surcharge

To minimize the impact on customers, several parties propose that BFE be allowed to recover its rate-case expenses through a surcharge collected from each customer over varying periods of time. Ms. Loockerman testified that the Commission's general practice is to allow rate-case expenses to be surcharged to customers over a period of two years, but the Commission has occasionally allowed recovery over a longer period.¹⁸⁶ In his post-hearing brief, the ED cites a case¹⁸⁷ and claims that in it the Commission allowed recovery of a large rate-case expense over seven years in order to assist the ratepayers. Despite reading the Commission's final order from that case, the ALJ is unable to verify the length of the recovery term allowed in it.

¹⁸⁵ Tex. Water Code § 13.001(c).

¹⁸⁶ ED Ex. DL 1 at 22.

¹⁸⁷ See *An Order Approving the Application of Texas Landing Utilities to Change Water and Sewer Rates*; TCEQ Docket No. 2007-1867-UCR; SOAH Docket No. 582-08-1023 (Sept. 12, 2011).

The City recommends allowing recovery through a \$10 per month per connection surcharge. Assuming BFE continues to have 35 connections, charges them each \$10 per month, and collects a total of \$350 per month, it would take BFE approximately 480 months, or forty years, to recover its \$167,844.13 in allowable rate-case expenses. The ALJ concludes that requiring BFE to wait that long to recover its reasonable and necessary rate-case expenses would be unjust and unreasonable. The \$10 per month per connection surcharge proposed by the City should not be adopted.

BFE proposes to levy a surcharge that would allow it to recover its rate-case expenses over 18 months, or until fully collected from the active number of connections.¹⁸⁸ If the term is longer, BFE is concerned that some customers will leave its system before it can recover its allowable rate-case expenses. Assuming BFE continues to have 35 connections, BFE would need to levy a monthly surcharge of \$266.42 on each connection to recover its reasonable and necessary \$167,844.13 of rate-case expenses over 18 months. The ALJ concludes that requiring customers to pay that much each month would be unjust and unreasonable.

Because the amount of the allowable rate-case expenses is large and the number of customers is small, the ED recommends allowing BFE to levy a surcharge under which it would recover its allowable rate-case expenses over a five-year period.¹⁸⁹ Assuming BFE continues to have 35 connections, BFE would need to levy a monthly surcharge of \$79.93 per connection to recover its reasonable and necessary \$167,844.13 of rate-case expenses over 60 months, or 5 years.

The Commission has no good choices for allowing BFE to recover its necessary and reasonable rate-case expenses. Compliance with the legal requirements regulating utility rates is staggeringly expensive in the face of intense opposition. When a utility serves a very small number of connections, allocating large, but completely legitimate, rate-case expenses results in shockingly high customer surcharges. However, a utility is entitled to a reasonable opportunity

¹⁸⁸ BFE Closing at 26.

¹⁸⁹ ED Reply at 5-8.

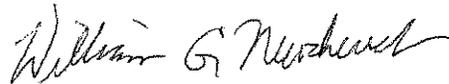
to recover the expenses that the regulatory system requires it to incur to obtain a rate increase to which it is entitled.

Like the ED, the ALJ concludes that allowing BFE to recover its reasonable and necessary \$167,844.13 of rate-case expenses through a surcharge over 60 months, or 5 years, is the least bad choice. The ALJ recommends that the Commission approve that surcharge, which will result in a monthly surcharge of \$79.93 per customer.

XII. SUMMARY

The ALJ recommends that the Commission adopt the attached proposed order with revisions that the ALJ will submit following receipt of the ED's recalculations based on the ALJ's recommendation.

SIGNED August 5, 2013.



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

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



**AN ORDER GRANTING, IN PART, THE APPEAL BY BFE WATER COMPANY OF
THE RATEMAKING ACTION OF THE CITY OF CRESSON IN PARKER COUNTY;
APPLICATION NO. 37311-A;
TCEQ DOCKET NO. 2012-0786-UCR;
SOAH DOCKET NO. 582-12-6250**

On _____, the Texas Commission on Environmental Quality (Commission) considered the appeal by BFE Water Company (BFE) of the ratemaking action of the City of Cresson in Parker County, Application No. 37311-A. 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 hearing concerning the appeal on April 2-3, 2013, 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

1. The Commission has issued Certificate of Convenience and Necessity (CCN) No. 12899 to "BFE Development Corporation dba BFE Water Company," which authorizes BFE to provide retail water utility services to customers in a portion of the City of Cresson, Texas (Cresson or City).
2. On January 27, 2009, BFE filed with Cresson an application to change its rates (Previous Application).

3. On September 8, 2009, the Cresson City Council voted to take no action on the Previous Application; and on October 7, 2009, Cresson's mayor formally informed BFE that the City Council's vote would allow BFE to submit its application directly to the Commission.
4. Based on the above Finding of Fact, Cresson concluded that it did not have jurisdiction over the Previous Application, dismissed it, and directed BFE to file a corrected application with the Commission.
5. As advised by Cresson, on October 6, 2009, BFE filed with the Commission a corrected application, proposing to increase its water rates effective January 16, 2010 (Application).
6. Subsequently, the Commission staff concluded that it had accepted the Application in error because Cresson had not adopted an ordinance relinquishing the City's original jurisdiction to the Commission before the Application was filed.
7. On June 11, 2010, the Commission staff forwarded the Application to Cresson.
8. On February 21, 2011, Cresson began to exercise jurisdiction over the Application and scheduled a preliminary hearing for March 7, 2011.
9. On August 23, 2011, Cresson ordered BFE to deposit into an escrow account all monies received or to be received from the sale of water after May 31, 2011, that was attributable to any increase in rates in effect prior to January 16, 2010. Cresson amended that escrow order on September 13, 2011.
10. On January 12, 2012, Cresson set interim rates for BFE that were lower than the rates BFE had proposed in the Application.

11. On January 24, 2012, Cresson's City Council issued a final order fixing BFE's rates. The final rates were lower than those BFE had proposed in the Application. Additionally, Cresson denied BFE's request to recover its expenses of seeking the rate increase; disbursed to BFE's customers funds in the escrow account into which the City had previously ordered BFE to deposit rate-increase collections; and ordered BFE to refund to its customers the amounts, plus 4.0% interest, that BFE had collected that exceeded the rates the City finally set.
12. On March 13, 2012, BFE filed this appeal asking the Commission to review Cresson's actions setting BFE's rates based on the Application.
13. BFE served copies of the appeal on Cresson, Harold Scott Perdue, and the Bourland Field Estates Homeowners' Association, Inc.
14. On May 9, 2012, the appeal was referred to SOAH for hearing.
15. On May 11, 2012, the Commission's Chief Clerk mailed notice of a preliminary hearing to BFE; Cresson; Harold Scott Perdue; the Bourland Field Estates Homeowners' Association, Inc.; the Commission's Executive Director (ED); and the Commission's Office of Public Interest Counsel (OPIC).
16. On June 7, 2012, the ALJ held a preliminary hearing as indicated in the notice, found that the Commission and SOAH had jurisdiction to consider the appeal, and admitted the following parties:

| PARTY | REPRESENTATIVE |
|--|----------------------------------|
| BFE | Lambeth Townsend & Eileen McPhee |
| ED | Kayla Murray |
| OPIC | Scott Humphrey |
| Cresson | Ron Becker |
| Harold Scott Perdue and the Bourland Field Estates Homeowners' Association, Inc. | Harold Scott Perdue |

17. On May 30, 2012, BFE also filed a motion to set interim rates, in accordance with 30 Texas Administrative Code § 291.29(d). After considering that motion at the preliminary hearing in accordance with the process set out in § 291.29, the ALJ granted the motion on June 8, 2012.
18. The following tables summarize BFE's rates and fees in effect before BFE filed the October 6, 2009 Application, the rates and fees BFE proposed in that Application, the interim and final rates and fees the City approved, and the interim rates and fees set by the ALJ that are now in effect:

| MONTHLY BASE RATES INCLUDING 0 GALLONS (per residential meter diameter) | | | | | |
|---|----------|-----------------|----------------|--------------|---------------|
| | Previous | BFE's Requested | City's Interim | City's Final | ALJ's Interim |
| 5/8 or 3/4 inch | \$24.00 | \$38.50 | \$24.62 | \$15.72 | \$35.22 |
| 1 inch | \$40.00 | \$96.25 | \$61.54 | \$47.93 | \$87.72 |
| 1 ½ inch | \$80.00 | \$192.50 | \$80.00 | \$80.00 | \$175.22 |
| 2 inch | \$128.00 | \$308.00 | \$128.00 | \$128.00 | \$280.22 |
| 3 inch | \$240.00 | \$673.20 | \$240.00 | \$240.00 | \$612.22 |
| 4 inch | \$400.00 | NA | \$400.00 | \$400.00 | NA |

| GALLONAGE CHARGES (per 1,000 gallons) | | | | | |
|---|----------|-----------------|----------------|--------------|---------------|
| | Previous | BFE's Requested | City's Interim | City's Final | ALJ's Interim |
| First 5,000 gallons | \$2.00 | \$3.22 | 2.00 | \$2.81 | \$3.00 |
| Next 10,000 gallons | \$2.00 | \$3.72 | 2.00 | \$2.81 | \$3.00 |
| Next 15,000 gallons | \$3.25 | \$4.22 | 3.25 | \$3.31 | \$3.50 |
| After 30,000 gallons | \$4.00 | \$4.22 | 4.00 | \$3.81 | \$4.00 |

| MISCELLANEOUS FEES | | | | | |
|------------------------------------|----------|-------------------|----------------|--------------|---------------|
| | Previous | BFE' Requested | City's Interim | City's Final | ALJ's Interim |
| Tap fee | \$500.00 | \$500.00 | \$500.00 | \$500.00 | NA |
| Reconnect fee, non-payment | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |
| Reconnect fee, customer request | \$40.00 | \$40.00 | \$40.00 | \$40.00 | NA |
| Transfer fee | \$35.00 | \$35.00 | \$35.00 | \$35.00 | NA |
| Late charge | 10% | 10% | \$5.00 | \$5.00 | NA |
| Return check charge | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |
| Deposit | \$50.00 | \$50.00 | \$50.00 | \$50.00 | NA |
| Meter test fee | \$25.00 | \$25.00 | \$25.00 | \$25.00 | NA |

19. The test year for the October 6, 2009 Application is January 1 through December 31, 2008.

20. The following table summarizes BFE's invested capital used and useful to provide retail water service during the test year. For each capital asset, the table lists the acquisition date, the percentage used and useful to provide retail water service, reasonable original cost, expected economic life, actual depreciated life, annual depreciation, accumulated depreciation, and net plant value:

| DEPRECIATION ANALYSIS | | | | | | | | |
|-----------------------------------|---------------|---------------|---------------|-----------------------|---------------------------------|----------------|----------------|-----------|
| Description | Acquired Date | Used & Useful | Original Cost | Economic Life (years) | Actual Depreciated Life (years) | Annual Deprec. | Accum. Deprec. | Net Plant |
| Land | | 100% | 0 | n/a | n/a | n/a | n/a | \$0 |
| Water well | 15-Oct-98 | 100% | \$75,891 | 50 | 10.21 | | | |
| 40 hp 150 gpm well pump | 15-Oct-98 | 100% | \$21,996 | 10 | 10.21 | | | |
| Well pump invoice No. 00039390000 | 15-Sep-08 | 100% | \$32,638 | 10 | 0.29 | | | |

| | | | | | | | | |
|----------------------------------|-----------|------|----------|----|-------|---------|----------|----------|
| Booster pump 5 hp | 15-Oct-98 | 100% | \$800 | 5 | 10.21 | | | |
| Booster pump 5 hp | 15-Oct-98 | 100% | \$800 | 10 | 10.21 | | | |
| Booster pump 2 hp | 15-Oct-98 | 100% | \$400 | 10 | 10.21 | | | |
| Hypochlorinator | 15-Oct-98 | 100% | \$350 | 10 | 10.21 | | | |
| Masonry pump house | 15-Oct-98 | 100% | \$6,402 | 30 | 10.21 | \$213 | \$2,179 | \$4,223 |
| Ground storage 84,000 gallons | 15-Oct-98 | 44% | \$27,009 | 50 | 10.21 | | | |
| Pressure tank 500 gallons | 15-Oct-98 | 100% | \$1200 | 50 | 10.21 | | | |
| Pressure tank 500 gallons | 15-Oct-98 | 100% | \$1200 | 50 | 10.21 | | | |
| Pressure tank 500 gallons | 15-Oct-98 | 100% | \$1200 | 50 | 10.21 | | | |
| Distribution system | 15-Oct-98 | 100% | \$76,341 | 50 | 10.21 | \$1,527 | \$15,592 | \$60,748 |
| Fire hydrants | 15-Oct-98 | 100% | \$6,000 | 50 | 10.21 | \$120 | \$1,225 | \$4,775 |
| 4-inch well collection line | 15-Oct-98 | 100% | \$212.50 | 50 | 10.21 | | | |
| Water plant piping | 15-Oct-98 | 100% | \$2,000 | 50 | 10.21 | | | |
| Electrical | 15-Oct-98 | 100% | \$3,500 | 30 | 10.21 | | | |
| Meters | 15-Oct-98 | 0% | \$6,900 | 20 | 10.21 | \$0 | \$0 | |
| Double service connection | 15-Oct-98 | 0% | \$6,900 | 20 | 10.21 | \$0 | \$0 | |
| Single service connection | 15-Oct-98 | 0% | \$300 | 20 | 10.21 | \$0 | \$0 | |
| Fencing and gates | 15-Oct-98 | 100% | \$3,600 | 20 | 10.21 | | | |
| Compressor | 15-Oct-98 | 100% | \$400 | 20 | 10.21 | | | |
| TOTALS | | | | | | | | |

21. There are six fire hydrants on BFE's system. The fire hydrants are used and useful as valves to flush BFE's water system, which is necessary to provide water utility service.

22. During the peak month of the test year, July 2008, BFE's 35 customers used 1,135,200 gallons of water, which is an average of 36,619 gallons per day. This is a very high consumption pattern.
23. BFE needs at least 36,619 gallons of storage capacity to meet its customers' demand for water.
24. Forty-four percent, or 36,619 gallons, of the capacity of BFE's 84,000-gallon water storage tank is necessary, used, and useful to provide water utility service.
25. The remaining 56%, or 47,381 gallons, of the capacity of BFE's 84,000-gallon water storage tank is not necessary, used, and useful to provide water utility service.
26. The costs of BFE's meters and double- and single-service connections are recovered through tap fees rather than rates.
27. BFE did not use developer-contributed or other forms of cost-free capital to provide retail water service.
28. BFE has no debt. No portion of the cost of BFE's invested capital is due to the cost of debt.
29. BFE's reasonable rate of return on its invested capital is 11.25% because:
 - a. The average return for a highest risk, Baa rated public-utility bond during the test year was 7.25%;
 - b. The risk to BFE's capital is higher because it is a small utility serving less than 200 connections and a slowly growing area;

- c. BFE had no major deficiencies in its most recent inspection and no current enforcement actions within the three-year period including the test year; and
 - d. BFE has made good-faith efforts to solve any current problems.
30. BFE’s reasonable and necessary federal income tax expense should be calculated as a known and measurable change based on its adjusted test year revenue determined in this appeal, less expenses, and using the lowest business tax rate of 15% published by the Internal Revenue Service.
31. The reasonable and necessary federal income tax expense that should be included in BFE’s cost of service is \$ _____.
32. BFE realized \$500 during the test year from tap fees, which should be subtracted from the amount of BFE’s revenue requirement that is recoverable through rates.
33. The following table summarizes BFE’s necessary and reasonable costs of services during the test year as adjusted for known and measurable changes:

| Item | Amount |
|-----------------------------------|---------------|
| Salaries | \$0 |
| Contract services | \$9,852 |
| Chemicals & treatment | \$5,772 |
| Utilities | \$4,877 |
| Repairs & maintenance | \$3,546 |
| Office expense | \$285 |
| Accounting and legal | \$876 |
| Insurance | \$410 |
| Miscellaneous | \$275 |
| Ad valorem taxes | \$142 |
| Depreciation | |
| Return on invested capital | |
| Federal income tax - normalized | |
| Total cost of service | |
| Other revenues – tap fees | \$(500) |
| Net recoverable from rates | |

- 34. In accordance with 30 Texas Administrative Code § 291.31(c)(2)(C)(iii), BFE’s necessary and reasonable cost of service should include a working-capital allowance of one-eighth of BFE’s 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).
- 35. BFE’s working-capital allowance should be \$ _____.
- 36. The following table summarizes the average number of BFE’s customers in each meter-size category and their equivalents during the test year:

| CALCULATION OF EQUIVALENTS | | | |
|-----------------------------------|--------------------|-------------------|--------------------|
| Meter size | Connections | Multiplier | Equivalents |
| 5/8 or 3/4 inches | 32 | 1.00 | 32 |
| 1 inch | 3 | 2.50 | 7.5 |
| 1 ½ inch | 0 | 5.00 | |
| 2 inch | 0 | 8.00 | |
| 3 inch | 0 | 15.00 | |
| 4 inch | 0 | 25.00 | |

- 37. The following table segregates BFE’s allowable costs-of-service items into fixed costs, which should be recovered through base rates, and variable costs, which should be recovered through gallonage charges:

| FIXED AND VARIABLE COSTS | | |
|---------------------------------|------------------|---------------------|
| Item | Fixed (%) | Variable (%) |
| Salaries | 50 | 50 |
| Contract services | 90 | 10 |
| Chemicals & treatment | 0 | 100 |
| Utilities | 0 | 100 |
| Repairs & maintenance | 50 | 50 |
| Office expense | 50 | 50 |
| Accounting and legal | 100 | 100 |
| Insurance | 100 | 0 |
| Miscellaneous | 50 | 50 |
| Ad valorem taxes | 100 | 0 |
| Depreciation | 100 | 0 |
| Return on invested capital | 60 | 40 |
| Federal income tax - normalized | 60 | 40 |
| Rate-case expense | 50 | 50 |
| Other revenues – tap fees | 60 | 40 |

38. In setting BFE's rates, Cresson denied BFE's request to levy a 10% charge on each customer who pays a bill late and instead authorized BFE to collect a \$5.00 late charge.
39. Since the January 16, 2010 effective date, BFE has lost \$_____ of revenue because the rates and fees Cresson set and the interim rates the ALJ set were lower than the final rates approved in this Order.
40. In the proceedings before Cresson, SOAH, and the Commission concerning its October 6, 2009 Application to increase its water rates effective January 16, 2010, BFE incurred \$167,844.13 in rate-case expenses that were reasonable, necessary, and in the public interest: \$159,486.55 in legal fees, which were incurred beginning in February 2011 and include the cost of the transcript of the hearing on the merits; and \$8,357.58 for consulting services.

II. CONCLUSIONS OF LAW

1. BFE is a retail public utility. Tex. Water Code §§ 13.002(19) and 13.002(23).
2. The Commission has jurisdiction to hear and decide BFE's appeal of the decisions of Cresson concerning the water rates BFE may charge. Tex. Water Code § 13.043(a).
3. SOAH has jurisdiction to conduct a contested case hearing and issue a proposal for decision in this case. Tex. Gov't. Code ch. 2003.
4. Proper notices of the appeal and hearing were given. Tex. Gov't Code §§ 2001.051 & 2001.052; 30 Tex. Admin. Code § 291.41.
5. BFE has the burden of proof on all issues in this case. Tex. Water Code § 13.184(c).
6. BFE has not filed a second application to change its rates in violation of Texas Water Code § 13.187(p).
7. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. 30 Tex. Admin. Code § 291.31(a) & (b).
8. Under 30 Texas Administrative Code § 291.31(c), the return on invested capital is the rate of return times invested capital.
9. The invested capital amounts set forth in the Findings of Fact reflect the reasonable original cost of property used by and useful to BFE in providing service, less depreciation. Tex. Water Code § 13.185.

10. The rate of return set forth in the Findings of Fact will yield a fair, but no greater, return on the invested capital used and useful in rendering service to the public and considers the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management. Tex. Water Code § 13.184(a) & (b); 30 Tex. Admin. Code § 291.31(c)(1)(B).
11. The depreciation expenses set forth in the Findings of Fact are based on BFE's original costs and computed on a straight line basis over the useful life of each asset over the expected or remaining life of the asset. 30 Tex. Admin. Code § 291.31(b)(1)(B).
12. The federal income tax expense set forth in the Findings of Fact is calculated on a normalized basis. 30 Tex. Admin. Code § 291.31(b)(1)(C) & (D).
13. The costs of service set forth in the Findings of Fact are BFE's reasonable and necessary operating expenses incurred during the test year as adjusted for known and measurable changes. Tex. Water Code §§ 13.002(22), 13.183 & 13.185; 30 Tex. Admin. Code § 291.31(a) & (b).
14. The costs of service set forth in the Findings of Fact are sufficient to provide BFE with a reasonable opportunity to earn a fair and equitable return on its invested capital while preserving its financial integrity. Tex. Water Code §§ 13.183 & 13.184.
15. Commission rule 30 Texas Administrative Code § 291.87(c) allows a utility to charge either \$5.00 or 10% for late payment of a bill and does not restrict a utility's choosing one or the other.
16. BFE's late charge should be 10% of the unpaid bill, as BFE has chosen in accordance with 30 Texas Administrative Code § 291.87(c).

17. The evidence does not show that Texas Water Code § 13.185(f) applies to BFE for purposes of calculating its allowable federal income tax expense.

18. In accordance with Texas Water Code §§ 13.182, 13.189, and 13.190, the following rates and fees for BFE are just; reasonable; not unreasonably preferential, prejudicial, or discriminatory; sufficient; equitable; and consistent in application to each class of customers and should be approved:

| MONTHLY BASE RATES INCLUDING 0 GALLONS (residential per meter diameter) | |
|---|--|
| 5/8 or 3/4 inches | |
| 1 inch | |
| 1 ½ inch | |
| 2 inch | |
| 3 inch | |

| GALLONAGE CHARGES (per 1,000 gallons) | |
|---|--|
| First 5,000 gallons | |
| Next 10,000 gallons | |
| Next 15,000 gallons | |
| After 30,000 gallons | |

| MISCELLANEOUS FEES | |
|---------------------------------|----------|
| Tap fee | \$500.00 |
| Reconnect fee, non-payment | \$25.00 |
| Reconnect fee, customer request | \$40.00 |
| Transfer fee | \$35.00 |
| Late charge | 10% |
| Return check charge | \$25.00 |
| Deposit | \$50.00 |
| Meter test fee | \$25.00 |

19. The above rates and fees are the rates and fees Cresson should have fixed in the action from which BFE appealed and include reasonable expenses incurred in the appeal proceedings. Tex. Water Code § 13.043(a).

- 20. In accordance with 30 Texas Administrative Code § 291.28(7), the rate-case expenses, including attorney fees, set forth in the Findings of Fact are reasonable, necessary, and in the public interest.

- 21. BFE should be authorized to levy a surcharge of \$_____ per month per connection until it has recovered its \$167,844.13 of rate-case expenses, including attorney fees, that are reasonable, necessary, and in the public interest.

- 22. In accordance with 30 Texas Administrative Code §§ 291.29(i) and 291.41(e)(4), BFE should be allowed to recover in a reasonable number of monthly installments the revenue that it lost because the rates Cresson set and the interim rates the ALJ set were lower than the final rates that are approved in this Order.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY THAT:

- 1. BFE’s appeal is granted in part.

- 2. BFE’s rates and fees are approved as set out below:

| MONTHLY BASE RATES INCLUDING 0 GALLONS (residential per meter diameter) | |
|--|--|
| 5/8 or 3/4 inches | |
| 1 inch | |
| 1 ½ inch | |
| 2 inch | |
| 3 inch | |

| GALLONAGE CHARGES (per 1,000 gallons) | |
|---|--|
| First 5,000 gallons | |
| Next 10,000 gallons | |
| Next 15,000 gallons | |
| After 30,000 gallons | |

| MISCELLANEOUS FEES | |
|---------------------------------|----------|
| Tap fee | \$500.00 |
| Reconnect fee, non-payment | \$25.00 |
| Reconnect fee, customer request | \$40.00 |
| Transfer fee | \$35.00 |
| Late charge | 10% |
| Return check charge | \$25.00 |
| Deposit | \$50.00 |
| Meter test fee | \$25.00 |

3. BFE is authorized to levy a surcharge of \$ _____ per month per connection until it has recovered the \$ _____ of revenue that it lost since the January 16, 2010 effective date because the rates Cresson set and the interim rates the ALJ set were lower than the final rates approved in this Order.
4. BFE is authorized to levy a surcharge of \$ _____ per month per connection until it has recovered its \$167,844.13 of rate-case expenses, including attorney fees, that are reasonable, necessary, and in the public interest.
5. BFE shall file a tariff reflecting the rates approved by the Commission within 10 days of the date of this Order.
6. BFE shall notify customers by mail of the final rate structure within 30 days of the date of this Order and shall include the statement required by 30 Texas Administrative Code § 291.28(5) along with the first bill to customers implementing the rates approved by this Order.

7. The effective date of this Order is the date the Order is final, as provided by Texas Government Code § 2001.144 and 30 Texas Administrative Code § 80.273.
8. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief not expressly granted herein, are hereby denied for want of merit.
9. If any provision, sentence, clause, or phase of this Order is for any reason held to be invalid, the invalidity of any portion shall not affect the validity of the remaining portions of the Order.
10. The Chief Clerk of the Texas Commission on Environmental Quality shall forward a copy of this Order and tariff to the parties.

Issue Date:

TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

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