Control Number: 43922

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PROJECT NO. 35141

SETTING INTEREST RATES FOR CALENDAR YEAR 2009	§ §	PUBLIC UTILITY COMMISSION OF TEXAS

ORDER

The Public Utility Commission of Texas is required by section 183.003 of the Texas Utilities Code to set for calendar year 2009 the rate of interest on deposits held by utilities; and, pursuant to P.U.C. SUBST. R. 25.28(c), 25.28(d), 25.480(d), 25.480(e), 26.27(a)(3), and 26.27(b)(3), it is required to set for calendar year 2009 the rate of interest to be applied to overcharges and certain undercharges by a utility. The Commission therefore orders that:

1. The interest rate for calendar year 2009 on deposits held by utilities **SHALL** be 2.09 percent.
2. The interest rate for calendar year 2009 for overcharges and certain undercharges by a utility **SHALL** be 3.21 percent.

SIGNED AT AUSTIN, TEXAS the 3Rd day of December, 2008.

PUBLIC UTILITY COMMISSION OF TEXAS

BARRY T. SMITHERMAN, CHAIRMAN

DONNA L. NELSON, COMMISSIONER

KENNETH W. ANDERSON, JR., COMMISSIONER

SOAH DOCKET NO. 582-09-4288
TCEQ DOCKET NO. 2009-0505-UCR

WATER RATE/TARIFF CHANGE APPLICATION OF DOUBLE DIAMOND UTILITIES CO. IN HILL, PALO PINTO, AND JOHNSON COUNTIES, TEXAS, APPLICATION NO. 36220-R	§ § § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

DIRECT TESTIMONY OF
BRIAN DICKEY
PLAN & GROUNDWATER REVIEW SECTION
WATER SUPPLY DIVISION
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
APRIL 29, 2010

Index of Attachments

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Q. Please state your name and business address.

A. Brian David Dickey, 12015 Park 35 Circle, Building F, Austin, Texas.

Q. By whom are you currently employed, and how long have you been employed there?

A. I have been employed by the Texas Commission on Environmental Quality (TCEQ or Commission) since November 1999. My current position is General Engineering Specialist III.

Q. Please state your educational background.

A. I graduated with a Bachelor's degree in Mechanical Engineering from Texas Tech University in 1994.

Q. Please describe your work responsibilities.

A. My responsibilities include reviewing and processing applications to obtain or amend certificates of convenience and necessity (CCNs); reviewing rate change applications and appeals; assisting with the negotiation of settlements; preparing testimony and exhibits for rate hearings for investor-owned, nonprofit, and governmental water and sewer utilities; conducting rate-related inspections of water and sewer utility systems within the state; and reviewing water utility plans and specifications. I have attached a copy of my resume (**Attachment BDD-1**).

Q. How many separate cases have been previously assigned to you?

A. I have been assigned over 250 separate cases during my tenure at the Commission.

Q. Have you ever testified as an expert witness in contested matters before the State Office of Administrative Hearings (SOAH)?

A. Yes. In addition to filing prefiled testimony in several contested utility cases, I have also provided live testimony.

Q. On which applications have you provided live testimony?

A. I have testified at five hearings concerning contested CCN applications and seven hearings concerning contested rate change applications. The five hearings concerning CCN applications were the City of Southlake (SOAH Docket No. 582-02-0834), the City of Shenandoah (SOAH Docket No. 582-06-0968), the City of McKinney (SOAH Docket No. 582-06-2663), Town of Prosper (SOAH Docket No. 582-03-1994), and Mustang Special Utility District (SUD) (SOAH Docket No. 582-08-1318). The seven hearings concerning rate applications were Waterco, Inc. (SOAH Docket No. 582-04-6463), Chisholm Trail SUD (SOAH Docket No. 582-05-0003), Buena Vista Water Supply Co. (SOAH Docket No. 582-05-7838), Buena Vista Water Supply Co. (SOAH Docket No. 582-08-2245), Deer Creek Ranch Water Co., LLC (SOAH Docket No. 582-09-5328), Double Diamond Utilities Co. (DDU) (SOAH Docket No. 582-08-0698), and Multi-County Water Supply Corporation (SOAH Docket No. 582-09-2557).

Q. In connection with SOAH Docket No. 582-09-4288, TCEQ Docket No. 2009-0505-UCR, have you reviewed the cost of service studies, testimonies, and other information filed with the Commission?

A. Yes, I have.

Q. What is the purpose of your testimony?

A. I will present the Executive Director's (ED's) recommendation for a rate design for water service, primarily focusing on the engineering and other technical criteria.

Q. Please explain the scope of your participation in the present proceeding.

A. My participation regarding SOAH Docket No. 582-09-4288 can be summarized as follows:

1. I reviewed the application for a water rate increase filed by DDU on October 23, 2008, and all discovery materials filed in this case, including all documents provided in response to the ED's requests for production.
2. I developed a depreciation schedule for the capital assets according to the Commission's rules found in title 30, chapter 291 of the Texas Administrative Code and chapter 13 of the Texas Water Code. **Attachment BDD-2** is my depreciation schedule for The Cliffs. **Attachment BDD-3** is my depreciation schedule for The Retreat. **Attachment BDD-4** is my depreciation schedule for White Bluff.
3. I used the monthly billing and meter size information provided in attachment 11 of the application and provided in electronic format by DDU in response to the ED's July 10, 2009, request for information (RFI) (**attachment BDD-9**) to determine the amount of water billed to the customers in each tier and the connection counts for each system at the end of the test year.
4. I designed the ED's recommended water rates for DDU according to the Texas Water Code and the Commission's rules using the revenue requirement recommendations provided by Ms. Elsie Pascua, the TCEQ auditor assigned to this case, in her testimony. **Attachment BDD-5** is my rate design for The Cliffs. **Attachment BDD-6** is my rate design for The Retreat and White Bluff.
5. I analyzed the amount of water pumped and the amount of water billed to the customers to calculate the systems' average line losses. **Attachments BDD-7, BDD-15,** and **BDD-16** are my connection count and line loss calculations.

Q. What is a depreciation schedule?

A. A depreciation schedule is an inventory of the water system facilities with original costs and installation dates. Each asset is given a standard service life. Based on straight-line depreciation, the annual depreciation for each asset is determined by dividing the original cost by the service life.

Q What test year did you consider when preparing your testimony?

A. I used the test year of January 1, 2007, through December 31, 2007, contained in the application.

Q. Why did you use the test year contained in the application?

A. According to section 13.002(22) of the Texas Water Code, a utility's rate application must be based on the most recent twelve-month period for which representative operating data is available that ended less than twelve months before the utility filed its application. The test year expenses can then be adjusted for known and measurable changes under section 291.31(b) of the TCEQ's rules. In its application, DDU calculated its proposed rates based on historic test year expenses (January 1, 2007, through December 31, 2007) as adjusted for known and measurable changes (January 1, 2008, through December 31, 2008).

<u>Section 291.21(m) Requirements</u>

Q. How many tariffs is DDU seeking in its application?

A. DDU is seeking two tariffs, one for The Cliffs and one for The Retreat and White Bluff combined.

Q. What requirements does a utility have to meet to be able to consolidate multiple systems in one tariff?

A. Under section 291.21(m) of the TCEQ's rules, a utility must show that the systems included in the consolidated tariff are substantially similar in terms of facilities, quality of service, and cost of service and that the tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.

Q. Are the water systems at The Retreat and White Bluff substantially similar in terms of facilities?

A. No. Both systems do utilize groundwater, pressure tanks, ground storage tanks, and distribution lines. However, it is unknown whether these two systems will ever be at a similar capacity level. Mr. Chris Ekrut, witness for DDU, stated on page 11 of his testimony that substantial similarity between the systems must be determined over time. However, the White Bluff subdivision currently has 562 connections, and The Retreat currently has only 60 connections. DDU has not provided any time line showing how long it will take to reach full build-out at The Retreat, meaning the White Bluff customers could be subsidizing The Retreat customers for many years to come. DDU may be able to show in a future rate application that the systems will conceivably reach a similar build-out level, but the evidence provided by DDU does not show that at this time.

Q. Are the water systems at The Retreat and White Bluff substantially similar in terms of quality of service?

A. No. The system at The Retreat is ten years newer than the system at White Bluff. Furthermore, each system is operated separately, as each one has its own certified operator on staff to operate and repair the system.

Q. Do DDU's proposed rates for The Retreat and White Bluff promote water conservation for single-family residences and landscape irrigation?

A. Yes. The proposed inclining block gallonage rates can promote water conservation for single family residences and landscape irrigation.

Q. Based on the substantial similarity issue, what is your recommendation regarding DDU's application?

A. I recommend that DDU's application be denied for The Retreat and White Bluff. Under section 291.12 of the TCEQ's rules, DDU bears the burden of proof in this case. As Ms. Pascua discussed in her testimony, DDU has not met the section 291.21(m)(1) requirements with regard to cost of service. DDU's calculations and proposed rates are based on the consolidation of the two systems. The failure to meet its burden of proof on the consolidation issue results in a failure to meet its burden of proof on the proposed rates. Therefore, I recommend that DDU's application be denied for The Retreat and White Bluff. However, in order to provide a complete analysis of the application, Ms. Pascua and I are presenting what the ED's recommendation would have been regarding the proposed rates for The Retreat and White Bluff in addition to The Cliffs if DDU had met the tariff consolidation requirements.

<u>Analysis of DDU's Water Systems</u>

Q. Did you analyze the possibility of excessive line loss, and if so, what were your findings?

A. Yes, I did. I analyzed the systems' line losses by comparing the number of gallons pumped for the test year with the number of gallons billed for that same year. However, I was only able to analyze the line loss for The Cliffs and White Bluff. DDU provided monthly water pumped summaries for each system. I have attached these documents to my testimony as **attachment BDD-8**. According to the summary for The Retreat, DDU did not know the total number of gallons pumped in the months of January through September in 2007. Without a total number of gallons pumped for the year, I could not calculate the line loss for The Retreat. However, using attachment 11 to the application and the yearly water pumped summary for White Bluff, I was able to calculate a line loss for White Bluff of 31.3% (**attachment BDD-7**). I also used attachment 11 to the application and the yearly water pumped summary for The Cliffs to determine that DDU billed its customers for 43.3% more water than it pumped at The Cliffs (**attachment BDD-15**).

Q. **Why is line loss important?**

A. When a utility cannot account for a large amount of water, it often indicates excessive leaks or inefficient operations. It also results in extra costs for pumping and treating, which are passed along to the customers through higher rates. The maximum line loss for a typical system that is considered acceptable by the TCEQ for ratemaking purposes is 15%. Line loss above 15% may indicate that the utility is not efficiently operated and could be grounds for making adjustments to the cost of service so the customers do not have to pay for pumping and treating water they did not use.

Q. **What recommendations do you have regarding line loss in this case?**

A. Because DDU did not provide the total gallons pumped for The Retreat, had a line loss greater than 30% at White Bluff, and may be billing for more water than it is treating at The Cliffs, I am recommending that Ms. Pascua not give DDU credit for having less than 12% or less than 10% unaccounted-for water in steps G.5 and H.5, respectively, in the rate of return worksheets.

Regulatory Asset

Q. **Does DDU want to create a regulatory asset in the amount of $307,376 to recover past cash advances?**

A. Yes. Mr. Chris Ekrut, witness for DDU, discussed on page 18 of his testimony that in the past, the utility chose to borrow money from its parent company, Double Diamond Delaware, Inc., instead of filing rate increase applications. DDU now seeks to recover the balance remaining on those cash advances at the beginning of the test year by categorizing it as an asset and amortizing it over five years. According to page 22 of attachment 10 to the application, DDU allocated $307,376 of the total cash advance amount of $554, 319 to the water systems. Page 4 of attachment 5 to the application then shows that $152,552 of the $307,376 was allocated to The Retreat and White Bluff, and the other $154,824 was allocated to The Cliffs.

Q. **Have you reviewed Ms. Nelisa Heddin's, witness for the White Bluff Subdivision Ratepayers, testimony in regard to this regulatory asset?**

A. Yes, I have.

Q. **Do you agree with Ms. Heddin's analysis?**

A. Yes, I do. As Ms. Heddin stated on page 29 of her testimony, DDU is not required to file another rate application. Therefore, if they were allowed to include the loans as a regulatory asset, they could continue to collect that money for more than five years, thereby collecting from its customers an amount greater than what was originally loaned.

Q. **Should DDU's customers be required to pay for the cash advances as a regulatory asset?**

A. No, they should not. In addition to the arguments made by Ms. Heddin, section 13.185(e) of the Texas Water Code states, "Payment to affiliated interests for costs of any services, or any property, right, or thing, or for interest expense may not be allowed either as capital cost or as expense except to the extent that the regulatory authority finds that payment to be reasonable and necessary." DDU had the right to request a rate change annually but chose to not do so for several years, incurring additional debt instead. Receiving the cash advances was not necessary; it was a choice. Furthermore, it is not reasonable for DDU to expect its customers to pay for the cash advances now and in this manner, which would allow DDU to collect the entire amount in only five years when it was incurred over more years than that, to earn return and depreciation on that amount, to collect that money twice when it was spent on assets and expenses, and to impose an interest rate that has already been reduced by Ms. Pascua in her weighted average rate of return calculations. Most importantly, a cash advance by its very nature is not currently used and useful property; it is money temporarily given to someone that has to be returned, i.e. paid back. It does not belong to the borrower and, therefore, is not the borrower's property. Therefore, the regulatory asset created to recover cash advances in the amount of $554,319 should be disallowed.

<u>**Asset Depreciation**</u>

Q. What have you done to verify the installation dates and original costs of DDU's assets?

A. I performed a site inspection of the three water systems on November 14, 2008, with attorneys Ms. Stefanie Skogen and Ms. Ruth Takeda. I visited DDU's office with Ms. Pascua to perform an audit of DDU's financial records on July 22 and 23, 2009, which was preceded by the RFI letter dated July 10, 2009 (**attachment BDD-9**). I also reviewed the trending study prepared by Dr. Victoria Harkins, P.E., witness for DDU, and the

TCEQ's official CCN files to attempt to identify any rate case order involving DDU that may have established a rate base.

Q. What is trending?

A. Trending takes the known cost of an asset on a known date and determines the cost of the asset at a different point in time. It can be used by a utility that does not have supporting documentation for an asset listed in its depreciation schedule to try to support the claimed original cost of the asset. The Handy-Whitman Index of Public Utility Construction Costs (**attachment BDD-17**) provides the cost index numbers by year for various utility equipment to use to calculate the cost of each type of equipment at a certain point in time.

Q. Did you, Ms. Pascua, or another ED staff member recommend to DDU that it have a trending study done for the assets for which it did not have supporting documentation?

A. No. I did state at the evidentiary hearing for DDU's last water rate application, SOAH Docket No. 582-08-0698, that one option for supporting its asset costs was to obtain a trending study, but ED staff did not actually *recommend* that DDU commission a trending study.

Q. Is rate base established every time the TCEQ issues an order in a rate case?

A. No. The TCEQ's Utilities and Districts Section's policy requires the utility to request the establishment of rate base at the time the utility files its rate application. However, the Commission may establish rate base in an order it issues in a rate case following a contested case hearing and proposal for decision even if the applicant did not request it in the application.

Q Did you find any orders in the TCEQ's official CCN file establishing a rate base for

DDU?

A. No.

Q. Do you have any adjustments to the original cost, annual depreciation, accumulated depreciation, and/or net plant value for any of the assets presented in the application?

A. Yes. I reviewed the water utility plant items in detail. I have made some adjustments to the depreciation schedule as a result of my review of the information. After making my adjustments, I used the straight-line depreciation method as required by the TCEQ's rules to calculate the net plant values for the rate base for each system. As a result, for The Cliffs, I calculated an original cost of $1,278,952, accumulated depreciation of $464,119, net plant value of $815,833, annual depreciation of $41,557, and developer contribution of $447,600. These calculations are in **attachment BDD-2**. For The Retreat, I calculated an original cost of $1,645,052, accumulated depreciation of $208,222, net plant value of $1,436,830, annual depreciation of $52,944, and developer contribution of $453,279. These calculations are in **attachment BDD-3**. For White Bluff, I calculated an original cost of $3,678,675, accumulated depreciation of $1,216,416, net plant value of $2,462,259, annual depreciation of $97,039, and developer contribution of $1,793,240.83. These calculations are in **attachment BDD-4**. I provided this information to Ms. Pascua to use in her cost of service calculations.

Q. Has the ultrafiltration (UF) membrane unit at The Cliffs been approved for use?

A. No, it has not. On March 31, 2008, Mr. James "Red" Weddell, P.E. denied the exception DDU needed to be able to use the unit. I have attached a copy of his letter (**attachment BDD-10**). Because DDU cannot legally use the UF membrane unit, the unit is not used and useful in providing service. Therefore, under section 291.31(b) and (c), any costs and expenses associated with the UF membrane unit must be disallowed. I will discuss this in more detail below.

Q. What do you mean by the phrase "used and useful"?

A. Section 13.185(b) of the Texas Water Code requires that rates "be based on the original cost of property used by and useful to the utility in providing service." In other words, the regulatory concept of "used and useful" considers what portion of an asset is actually being used by the utility to provide service to its customers. If all or a portion of an asset has been installed but is not in use because it is not currently needed, it is not "used and useful" and should not be included as an allowable expense or as part of the rate base because current ratepayers should not have to pay for plant built to serve future ratepayers. Once an asset becomes used and useful, it is then fair to consider it for allowable expense and rate base treatment, assuming its implementation was prudent. The "used and useful" principle is one of fairness and risk avoidance. It ensures that ratepayers bear the costs of their service and that the utility bears the risk of incurring costs for facilities that were constructed only to serve projected future growth. Without "used and useful," there would be no limitation on how far into the future utilities could build for and require cost recovery from captive ratepayers. To allow a utility to claim depreciation and net plant for excess capacity in a system that has been over-designed would shift the risk associated with building that excess capacity to current ratepayers.

Q. Could you please describe what adjustments you made to the depreciation schedules?

A. I made following adjustments:

1. I was unable to match up the invoices provided during discovery and during the audit with the depreciation schedules provided during the audit and in the application. Therefore, I used Dr. Harkins' depreciations schedules, which are exhibits DDU-13, DDU-14, and DDU-15, as well as exhibit DDU-25, which DDU provided during discovery to create **attachments BDD-2** (The Cliffs), **BDD-3** (The Retreat), and **BDD-4** (White Bluff), which are my individual depreciation schedules with descriptions of DDU's assets.

2. For the White Bluff assets that Dr. Harkins trended in her analysis, as summarized on page 6 of exhibit DDU-15, I allowed depreciation on the assets so the depreciation account can be funded and those assets can be replaced in the future. I did the same for The Cliffs trended assets, which Dr. Harkins summarized on page 4 of exhibit DDU-14. However, a trending study only establishes what the original cost of an asset could have been and does not establish who paid for the asset. Because DDU has not shown that it paid any portion of the trended assets' costs, I categorized the assets as 100% developer-contributed. This can be seen on **attachment BDD-2** for The Cliffs and **attachment BDD-4** for White Bluff.

3. For the trended pipes installed in 1991 at White Bluff, Dr. Harkins used a Handy Whitman Cost Index of 146. However, the correct cost index is 193. I used the Handy Whitman Cost Index of 193 to calculate the correct trended cost for the installed pipe. Please see **attachment BDD-17** for this value and **attachment BDD-4** for the calculations.

4. For White Bluff, I calculated an invoice-supported price for the 4-inch pipe in the amount of $206,485.00. I deducted this amount from the trended cost for the 4-

inch pipe for a total original cost of $1,294,773.97 ($1,501,258.97-$206,485.00). This adjustment can be seen on **attachment BDD-4**.

5. I added assets to the depreciation schedules for The Cliffs and White Bluff which Ms. Pascua reclassified from the utility's expenses. I have designated these items as "Reclassified Assets" in **attachment BDD-2** for The Cliffs and **attachment BDD-4** for White Bluff.

6. For The Cliffs, I adjusted the annual depreciation and net plant values to $0 for the following assets to reflect that they have fully depreciated out: engineering with an original cost of $1,388.00; engineering with an original cost of $488.75; engineering with an original cost of $2,175.00; engineering with an original cost of $3,411.90; and engineering master plan with an original cost of $420.50. These adjustments can be seen on **attachment BDD-2**.

7. For The Cliffs, I calculated an invoice-supported price for the 4-inch pipe in the amount of $135,763.53. I deducted this amount from the trended cost for the 4-inch pipe for a total original cost of $129,981.19 ($265,744.72-$135,763.53). This adjustment can be seen on **attachment BDD-2**.

8. According to Mr. Randy Gracy, witness for and president of DDU, DDU purchased The Cliffs' water system around 1993. Because DDU has not shown that the original owner or it paid any portion of the trended assets' costs installed prior to 1993, I categorized the assets as 100% developer-contributed. This can be seen on **attachment BDD-2.**

9. Because the UF membrane unit at The Cliffs is not used and useful, I disallowed the UF unit with an original cost of $277,469.46 and the J&JOILF Wiring for

New UF System with an original cost of $5,463.50 by making their used and useful percentages zero. These adjustments can be seen on **attachment BDD-2**.

10. TCEQ rule section 290.45(b)(1)(C)(ii) requires a water system with sixty connections to have a total storage capacity of 200 gallons per connection, or 12,000 gallons. At The Retreat, a water system with sixty connections, DDU currently provides 100,000 gallons of ground storage capacity via a ground storage tank. Because DDU is only required to have 12,000 gallons in storage capacity, only 12% of the ground storage tank is used and useful. The total cost of the 100,000-gallon ground storage tank was $62,558.81 ($50,683.81 for the tank plus $11,875 to erect the tank). I am disallowing 88%, or $55,051.75, of the ground storage tank not used and useful by adjusting the percent used and useful to 12%. Please see **attachment BDD-3** for these adjustments.

11. TCEQ rule section 290.45(b)(1)(C)(iv) requires a water system with sixty connections to have a total pressure tank capacity of 20 gallons per connection, or 1,200 gallons. At The Retreat, a water system with sixty connections, DDU currently provides 8,000 gallons of pressure tank capacity. Because DDU is only required to have 1,200 gallons in pressure tank storage capacity, only 15% of the pressure tank is used and useful. The total cost of the 8,000-gallon ground pressure tank was $15,776.00. I am disallowing 85%, or $13,496.00, of the pressure tank as not used and useful by adjusting the percent used and useful to 15%. Please see **attachment BDD-3** for these adjustments.

<u>**Rate Design**</u>

Q. What revenue requirement did you use in your calculation of the ED's

recommended water rates for White Bluff and The Retreat?

A. I used the annual revenue requirement of $752,618.00 calculated by Ms. Pascua and shown in **attachment EP-31**.

Q. **What revenue requirement did you use in your calculation of the ED's recommended water rates for The Cliffs?**

A. I used the annual revenue requirement of $366,908.00 calculated by Ms. Pascua and shown in **attachment EP-5**.

Q. **Did you prepare a rate design for The Retreat and White Bluff using Ms. Pascua's calculated revenue requirement and DDU's proposed rates?**

A. Yes, my rate design is attached (**attachment BDD-6**).

Q. **How did you calculate the total revenue that would be generated by the proposed gallonage charges for those two systems?**

A. I calculated the revenue generated by the gallonage charges by multiplying the requested inclining block rates listed in the notice and the gallons billed in 2007 for each tier. For example, DDU billed for 2,570,087 gallons in the 0-3,000 gallons tier. At $2.00/1,000 gallons, that tier would generate $5,140.00. Adding the values for all the tiers, the total revenue that would be generated is $512,385.00. Please see **attachment BDD-6** for these calculations.

Q. **How did you calculate the total revenue that would be generated by the proposed base rates for the two systems?**

A. I multiplied the total number of customers for each meter size by the corresponding base rate times twelve months. For example, a 1-inch meter with a base rate of $97.50 would generate $21,060.00 over twelve months. Adding the values for all the meter sizes, the total revenue that would be generated is $353,340.00. Please see **attachment BDD-6** for these calculations.

Q. What would be the total revenue generated by the base rates and the gallonage charges?

A. Adding the base rate revenue of $353,340.00 to the gallonage charge revenue of $512,385.00 gives a total revenue of $865,725.00.

Q. Did you prepare a rate design for The Cliffs based on Ms. Pascua's calculated revenue requirement and DDU's proposed rates?

A. Yes, my rate design is attached (**attachment BDD-5**).

Q. How did you calculate the total revenue that would be generated by the proposed gallonage charges for The Cliffs?

A. I calculated the revenue generated by the gallonage charges by multiplying the requested inclining block rates listed in the notice and the gallons billed in 2007 for each tier. For example, DDU billed for 1,128,734 gallons in the 0-3,000 gallons tier. At $2.60/1,000 gallons, that tier would generate $2,935.00. Adding the values for all the tiers, the total revenue that would be generated is $268,979.00.

Q. How did you calculate the total revenue that would be generated by the proposed base rates?

A. I multiplied the total number of customers for each meter size by the corresponding base rate times twelve months. For example, a 1-inch meter with a base rate of $130.00 would generate $18,720.00 over twelve months. Adding the values for all the meter sizes, the total revenue that would be generated is $240,240.00.

Q. What would be the total revenue generated by the base rates and the gallonage

charges?

A. Adding the base rate revenue of $240,240.00 to the gallonage charge revenue of $268,979.00 gives a total revenue of $509,219.00.

Q. What are your recommended rates for The Retreat and White Bluff?

A. The current rates for these systems are $1.85/1000 gallons for 1,001 to 10,000 gallons, $2.10/1,000 for 10,001 to 20,000 gallons, and $4.75/1,000 for 20,001 gallons and thereafter with a base rate of $30.00, which includes 1,000 gallons, for a 5/8-inch meter. This rate structure generates a revenue of $573,528 (**attachment BDD-11**), which is lower than the ED's recommended revenue requirement for the two systems by $179,090.00. Therefore, the utility would have been entitled to increase its rates to make up the difference. The utility has proposed a gallonage charge of $2.00/1,000 gallons for 0 to 3,000 gallons, $2.75/1,000 for 3,001 to 10,000 gallons, $3.80/1,000 for 10,001 to 15,000 gallons, $5.25/1,000 for 15,001 to 20,000 gallons, and $7.25/1,000 for 20,001 gallons and over with a base rate of $39.00, including zero gallons, for a 5/8-inch meter. Using Ms. Pascua's $752,618.00 revenue requirement and the proposed gallonage charges requested by DDU, I have adjusted the base rate in my rate design so that the over/under recovery amount is as close to zero as possible. This resulted in a base rate of $26.52 for a 5/8-inch meter. My rate design, which includes the base rates for the other meter sizes, is attached (**attachment BDD-12**).

Q. What are your recommended rates for The Cliffs?

A. The current rates for this system are $1.85/1,000 gallons for 1,001 to 10,000 gallons, $4.75/1,000 for 10,001 to 20,000 gallons, and $6.75/1,000 for 20,001 gallons and thereafter with a base rate of $30.00, including 1,000 gallons, for a 5/8-inch meter. This generates a revenue of $253,103 (**attachment BDD-19**), which is lower than the ED's revenue requirement by $113,805. Therefore, the utility is entitled to a rate increase to make up the difference. The utility proposed a gallonage charge of $2.60/1,000 gallons for 0 to 3,000 gallons, $3.00/1,000 for 3,001 to 10,000 gallons, $5.07/1,000 for 10,001 to 15,000 gallons, $8.56/1,000 for 15,001 to 20,000 gallons, and $14.45/1,000 for 20,001 gallons and over with a base rate of $52.00, including zero gallons, for a 5/8-inch meter. Using Ms. Pascua's $366,908 revenue requirement and the proposed gallonage charges requested by DDU, I have adjusted the base rate in my rate design so that the over/under recovery amount is as close to zero as possible. This resulted in a base rate of $21.21 for a 5/8-inch meter. My rate design, which includes the base rates for the other meter size, is attached (**attachment BDD-18**).

Q. Do you have any recommendations regarding DDU's proposed miscellaneous fees?

A. In my professional experience, I believe that the miscellaneous fees proposed by DDU for all the systems are reasonable. Also, those costs are not determined or calculated based on the consolidation of the water systems but rather are independent from the rate calculations. Therefore, I recommend approval of the proposed miscellaneous fees for all the water systems.

Q. Do you have a recommendation regarding customer refunds for The Cliffs?

A. Yes, under section 291.29(h) of the TCEQ's rules, unless the parties agree otherwise, the utility must "refund or credit against future bills all sums collected in excess of the rate finally ordered plus interest as determined by the commission in a reasonable number of monthly installments." Because the ED is not recommending the full rate increase, DDU will have to refund the difference collected between the rates established by the

Commission and the proposed rates. This difference should be refunded over how many months the proposed rates were collected, which cannot be determined until the Commission issues an order in this case. I also recommend that the interest rate applied to the refunds be 3.21%, which was the PUC's interest rate for overcharges for the year 2009 (**attachment BDD-17**). Because the proposed rates will have been charged mostly in 2009, applying the interest rate for that year is appropriate.

Q. Do you have a recommendation regarding customer refunds for White Bluff and The Retreat if the two systems are found to be substantially similar?

A. Yes, it is the same as my recommendation for customer refunds for The Cliffs.

Q. Do you have a recommendation regarding customer refunds for White Bluff and The Retreat if the two systems are found to not be substantially similar?

A. Yes. Because the ED is recommending no rate increase, DDU would have to refund the difference collected between its current rates, which the rates charged would revert back to, and its proposed rates. This difference should be refunded over how many months the proposed rates were collected, which cannot be determined until the Commission issues an order in this case. Again, the interest rate that should be applied to the refunds is 3.21%.

<u>CONCLUSION</u>

Q. What are the ED's final recommendations in this case?

A. Because the water systems at White Bluff and The Retreat are not substantially similar, I recommend that DDU's proposed rate changes for those two systems be denied and that the rates for those two systems be reverted back to their current rates. Because DDU showed that it is entitled to a partial rate increase for The Cliffs, I recommend that the rates in the attached tariff (**attachment BDD-13**) for The Cliffs water system be approved. I also recommend that the miscellaneous fees for all systems be approved and that the customers of all systems be issued refunds based on the ED's recommend rates at an interest rate of 3.21%.

Q. What would be your recommendation regarding White Bluff and The Retreat if the two systems are found to be substantially similar?

A. In that case, because DDU showed that it would be entitled to a partial rate increase, I would recommend that the rates in the attached tariff (**attachment BDD-14**) for The Retreat and White Bluff water systems be approved and that the customers of those systems be issued refunds based on the ED's recommended rates at an interest rate of 3.21%.

Q. Does this conclude your prefiled testimony?

A. Yes, it does, but I reserve the right to supplement this testimony during the course of the proceeding as new evidence is presented.

VERIFICATION

THE STATE OF TEXAS §
§
COUNTY OF TRAVIS §

BEFORE ME, the undersigned authority, on this day personally appeared Brian Dickey, known to me to be the person whose name is subscribed below and after having been duly sworn, on his oath stated the following: that the information set forth in the foregoing prefiled testimony was assembled by the Executive Director's attorney of record, that he has personal knowledge of the information contained within the foregoing prefiled testimony, and that this information is true and correct to the best of his knowledge and belief.

Brian Dickey

Brian Dickey

SUBSCRIBED AND SWORN TO BEFORE ME on this the 29th day of April, 2010, to certify which, witness my hand and seal of office.

Cheryl Arredondo
Notary Public
State of Texas
My Commission Expires
August 11, 2013

Cheryl Arredondo

NOTARY PUBLIC
STATE OF TEXAS

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

2010 APR 29 PM 3: 59

CHIEF CLERKS OFFICE

CERTIFICATE OF SERVICE

I certify that on April 29, 2010, a copy of the foregoing document was sent by first class, agency mail, electronic mail, and/or facsimile to the persons on the attached Mailing List.

Stefanie Skogen

Stefanie Skogen, Staff Attorney
Environmental Law Division

Mailing List
Double Diamond Utility Co., Inc.
SOAH Docket No. 582-09-4288
TCEQ Docket No. 2009-0505-UCR

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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

2010 APR 29 PM 3:57

CHIEF CLERKS OFFICE

Texas Commission on Environmental Quality

Protecting Texas by Reducing and Preventing Pollution

April 29, 2010

The Honorable Richard R. Wilfong
State Office of Administrative Hearings
300 West 15th Street, Room 504
Austin, Texas 78701-1649

Re: Water Rate/Tariff Change Application of Double Diamond Utilities Co., Certificate of Convenience and Necessity No. 12087, in Hill, Palo Pinto, and Johnson Counties, Texas, Application No. 36220-R; SOAH Docket No. 582-09-4288; TCEQ Docket No. 2009-0505-UCR

Dear Judge Wilfong:

Please find enclosed the Executive Director's (ED's) Direct Testimony of Elsie Pascua and Direct Testimony of Brian David Dickey. For the ED's order of witnesses, Ms. Pascua shall testify first, followed by Mr. Dickey. Please let me know if you have any questions.

Sincerely,

Stefanie Skogen

Stefanie Skogen
Staff Attorney
Environmental Law Division

Enclosure

cc: Mailing List

SOAH DOCKET NO. 582-09-4288
TCEQ DOCKET NO. 2009-0505-UCR

WATER RATE/TARIFF CHANGE APPLICATION OF DOUBLE DIAMOND UTILITIES CO. IN HILL, PALO PINTO, AND JOHNSON COUNTIES, TEXAS, APPLICATION NO. 36220-R	§ § § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

DIRECT TESTIMONY OF
ELSIE PASCUA
UTILITIES & DISTRICTS SECTION
WATER SUPPLY DIVISION
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY
APRIL 29, 2010

Index of Attachments

Attachments	Details
EP-1	Schedule relating to DDU's revenue requirement for The Retreat's water system
EP-2	Schedule relating to DDU's revenue requirement for The Retreat's water system
EP-3	Schedule relating to DDU's revenue requirement for The Retreat's water system
EP-4	Schedule relating to DDU's revenue requirement for The Retreat's water system
EP-5	Schedule relating to DDU's revenue requirement for The Cliffs' water system
EP-6	Schedule relating to DDU's revenue requirement for The Cliffs' water system
EP-7	Schedule relating to DDU's revenue requirement for The Cliffs' water system
EP-8	Schedule relating to DDU's revenue requirement for The Cliffs' water system
EP-9	Schedule relating to DDU's revenue requirement for White Bluff's water system
EP-10	Schedule relating to DDU's revenue requirement for White Bluff's water system
EP-11	Schedule relating to DDU's revenue requirement for White Bluff's water system
EP-12	Schedule relating to DDU's revenue requirement for White Bluff's water system
EP-13	Schedule relating to staff adjustments to the cost of service for The Retreat's water system
EP-14	Schedule relating to staff adjustments to the cost of service for The Cliffs' water system
EP-15	Schedule relating to staff adjustments to the cost of service for White Bluff's water system
EP-16	Schedule relating to staff adjustments to salaries and the payroll burden for all three water systems
EP-17	Schedule relating to staff calculations of the rates of return (RORs)
EP-18	Schedule relating to staff expense allocations between the three systems
EP-19	Direct Assignment and Allocation of Labor Transfer Expense
EP-20	DDU's general ledgers for 2007 with staff notations
EP-21	DDU's general ledgers for 2007 with staff notations
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EP-24	relating to Aqua America's interest rates for the long-term debt of its subsidiaries
EP-25	DDU's ROR worksheet calculation (Ex. DDU-18) with staff notations

EP-26	DDU's comparison of its requested revenue requirement versus the revenue requirement in the application (Ex. DDU -19) with staff notations
EP-27	DDU's Reconciliation of 2007 Booked Values to 2007 Test Year Application Values
EP-28	DDU's Non-Consolidated Cost of Service and Revenue Requirement for all three systems (Ex. DDU-21) with staff notations
EP-29	DDU's outstanding loans (Attachment 9 to the application)
EP-30	relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems
EP-31	relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems
EP-32	relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems
EP-33	relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems
EP-34	relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems
EP-35	Resume of Elsie Pascua

Q. Please state your name and business address for the record.

A. Elsie N. Pascua, 12015 Park 35 Circle, Building F, Austin, Texas.

Q. By whom are you currently employed and in what capacity?

A. I am currently employed by the Water Supply Division of the Texas Commission on Environmental Quality (TCEQ or Commission) as an Accountant/Auditor.

Q. Please describe your current job responsibilities.

A. My responsibilities include reviewing and processing contested and uncontested rate applications; sale, transfer, and merger applications; applications to obtain and amend certificates of convenience and necessity; rate appeals; and cost of obtaining service appeals filed with the TCEQ. For contested applications, I attend and participate in settlement negotiations and prepare testimony and exhibits for evidentiary hearings. My work also involves conducting audits of the books and records of both water and sewer utilities and performing special or management audits for both water and sewer utilities.

Q. Please describe your educational background and your past professional experience.

A. I graduated with a Bachelor of Science degree in Business Administration with a major in Accounting from the Philippine School of Business Administration. I attended a year of graduate studies at Manuel L. Quezon University. I have over thirty-five years of experience in bookkeeping, auditing, budgeting, and accounting in the private and governmental sectors. My private sector experience includes the Philippine Scout Veterans Security Agency, Inc., Fema Trading Corp., Monterey Institute of International Studies, Rainier Mortgage Corp., and GDP Corp. My governmental experience includes the VII Corps Finance Group of the United States Army and the TCEQ. I have been employed at the TCEQ for fifteen years and have been at my current position primarily in the areas of water and sewer rate analysis for eleven years. I have attached my resume as **Attachment EP-34**.

Q. In the course of your employment in the ratemaking area, approximately how many rate applications and rate appeals have you reviewed?

A. I have reviewed more than 300 rate applications and rate appeals.

Q. Approximately how many of these rate applications have been contested?

A. I have participated in approximately 225 contested rate application matters.

Q. Have you taken any formal ratemaking seminars or training classes?

A. Yes. I attended the National Association of Regulatory Utility Commissioners (NARUC) school in October 1998 and May 2009. I have also attended rate training classes held internally at the TCEQ.

Q. What is the NARUC school?

A. It is a week-long intensive training course regarding the ratemaking process which includes a review of a practical rate application.

Q. Have you previously testified live at contested rate case hearings, and if so, how many?

A. Yes, I have testified live at approximately seventeen contested rate case hearings.

Q. In connection with SOAH Docket No. 582-09-4288, have you performed an examination and review of the rate application and supporting information provided by Double Diamond Utilities Co. (DDU)?

A. Yes, I have.

Q. What standards did you apply during your review?

A. I performed my review according to the ratemaking standards established by chapter 13 of the Texas Water Code and title 30, chapter 291 of the Texas Administrative Code.

Q. In connection with SOAH Docket No. 582-09-4288, have you performed a site visit and audit of the utility's records, and if so, when?

A. Yes. Mr. Brian Dickey, TCEQ staff engineering specialist assigned to this case, and I visited DDU's office to perform an audit and examination of the utility's records on July 22 and 23, 2009.

Q. Please explain the purpose of your testimony.

A. The purpose of my testimony is to present the Executive Director (ED) of the TCEQ's recommendation as to the reasonable costs of service and revenue requirements for the test period contained in DDU's rate application.

Q. What is meant by the term "cost of service"?

A. The cost of service is part of the ratemaking formula set forth in section 291.31 of the TCEQ's rules. One component of the cost of service is the amount of revenue required to cover all reasonable and necessary expenses incurred by the utility in providing service to its customers. The other component allows the utility an opportunity to earn a fair and reasonable return on its invested capital used in providing service.

Q. What documentation do you typically examine to determine if the applicant has supported its cost of service?

A. I examine copies of invoices, general ledgers, and other financial records and documentation submitted by the utility during the course of the case for costs that occurred during the test period.

Q. What test period have you used to review DDU's cost of service?

A. I have used the test period of January 2007 through December 2007, as adjusted for known and measurable changes for the year ending December 2008.

Q. Why have you used this test period?

A. This is the test period used by DDU in its rate/tariff change application filed on October 23, 2008. **Attachment EP-23** shows the application filing date. The entire application can be found in Exhibit DDU-1.

Q. Did you review the cost of service listed in the application?

A. Yes.

Q. How did DDU list the cost of service in the application?

A. DDU listed the combined cost of service on page 14 of the application for all three water systems, which are The Retreat, The Cliffs, and White Bluff.

Q. Did you prepare a separate cost of service for each water system?

A. Yes.

Q. Why did you prepare three separate costs of service rather than one cost of service as DDU did in its application?

A. In the application, DDU provided one cost of service but then two rates without fully demonstrating how it calculated those two rates from the one cost of service. I needed to know the cost of service for each system to see how the separate rates were calculated and address whether the water systems at The Retreat and White Bluff are substantially similar in terms of cost of service.

Q. Why did you need to determine if the systems at The Retreat and White Bluff are substantially similar in terms of cost of service?

A. Under section 291.21(m)(1), if DDU wishes to consolidate those systems under a single tariff, it must show that the systems are substantially similar in terms of cost of service. Therefore, I did two cost of service evaluations to determine if the costs are substantially similar. Based on these evaluations, the total cost of service for White Bluff is $500,180.00 with a per meter equivalent cost of $61.66 per month, and the total cost of service for The Retreat is $254,641.00 with a per meter equivalent cost of $268.61 per month **Attachments EP-1** and **EP-9** show the cost of service calculations for The Retreat and White Bluff, respectively, and **Attachments BDD-7** and **BDD-16** to Mr. Dickey's testimony show the connection counts and meter equivalents for the two systems. My calculations show that the cost of service per meter equivalent at White Bluff is 77% higher than the same amount for The Retreat. Furthermore, DDU employs a separate utility manager, utility operator, and utility assistants for the two systems, showing that DDU operates these two systems separately and that the two systems do not share all their costs. Because the costs of service for the two systems are so different and the two systems are operated separately, I do not believe that The Retreat and White Bluff are substantially similar in terms of cost of service. Mr. Dickey will discuss the other factors found in section 291.21(m) in his testimony.

Q. **Did you read the other parties' prefiled testimonies, exhibits, and discovery responses and all other information submitted by the other parties?**

A. Yes.

Q. **Was your testimony prepared by you as a result of your review and examination of these items?**

A. Yes.

Q **At the audit conducted in July 2009, what records did DDU provide for you to review?**

A. DDU provided invoices, general ledgers, W2s, a list of affiliated companies, and other financial records for 2007 and 2008.

Q. **While reviewing the financial records, did you notice anything that caught your attention with regard to the general ledgers, and if so, please explain?**

A. Yes, I noticed that all three water systems also have a companion sewer system. DDU's statement of operations and the general ledgers for 2007 listed the combined expenses for DDU's water and sewer systems. DDU did not provide general ledgers which separated the expenses for the water systems from the expenses for the sewer systems. Instead, DDU provided multiple allocation methods for separating the water and sewer expenses in its application, which is not the way to determine the true and accurate expenses and other income for each type of system. In addition, DDU listed several assets as expenses rather than depreciating them in the depreciation schedule. If those assets remained in the expense categories, DDU would recoup the entire cost of those assets year after year until it files a new rate change application.

Q. **Do you have any schedules included with your testimony?**

A. Yes.

Q. **Who prepared these schedules?**

A. I did.

Q. Would you please describe what is presented on these schedules?

A. I have included the following schedules:

1. **Attachments EP-1 through EP-4**, relating to DDU's revenue requirement for The Retreat's water system.
2. **Attachments EP-5 through EP-8**, relating to DDU's revenue requirement for The Cliffs' water system.
3. **Attachments EP-9 through EP-12**, relating to DDU's revenue requirement for White Bluff's water system.
4. **Attachment EP-13**, relating to staff adjustments to the cost of service for The Retreat's water system.
5. **Attachment EP-14**, relating to staff adjustments to the cost of service for The Cliffs' water system.
6. **Attachment EP-15**, relating to staff adjustments to the cost of service for White Bluff's water system.
7. **Attachment EP-16**, relating to staff adjustments to salaries and the payroll burden for all three water systems.
8. **Attachment EP-17**: relating to staff calculations of the rates of return (RORs).
9. **Attachment EP-18**: relating to staff expense allocations between the three systems.

Q. What other documents have you also included with your testimony?

A. I have also included the following documents:

1. **Attachment EP-19**: Direct Assignment and Allocation of Labor Transfer Expense, WP-2, attachment 10 to the application with staff notations.
2. **Attachments EP-20 through EP-22**: DDU's general ledgers for 2007 with staff notations.

3. **Attachment EP-23**: cover page of DDU's rate change application.

4. **Attachment EP-24**: relating to Aqua America's interest rates for the long-term debt of its subsidiaries.

5. **Attachment EP-25:** DDU's ROR worksheet calculation (Ex. DDU-18).

6. **Attachment EP-26:** DDU's comparison of its requested revenue requirement versus the revenue requirement in the application (Ex. DDU -19) with staff notations.

7. **Attachment EP-27:** DDU's Reconciliation of 2007 Booked Values to 2007 Test Year Application Values.

8. **Attachment EP-28:** DDU's Non-Consolidated Cost of Service and Revenue Requirement for all three systems (Ex. DDU-21).

9. **Attachment EP-29**: DDU's outstanding loans (Attachment 9 to the application).

10. **Attachment EP-30 through 33:** relating to DDU's combined revenue requirement for The Retreat's and White Bluff's water systems.

11. **Attachment EP-34:** Resume of Elsie Pascua.

Q. Can you explain in greater detail what is shown on these attachments?

A. **Attachments EP-1** through **EP-18** and **EP-30** through **EP-33** are true and correct copies of the schedules I prepared for this proceeding. **Attachments EP-19** through **EP-23** and **EP-25** through **EP-29** are provided as reference materials for my cost of service adjustments. Other than staff notations, these exhibits were not prepared by me directly but were prepared by DDU. An explanation of some of these exhibits is listed below.

<u>The Retreat:</u>

In **Attachment EP-1**, column (c) itemizes the 2007 test year revenue requirement as presented in DDU's general ledger for The Retreat. Column (d) represents my proposed adjustments to DDU's requested revenue requirement for its test year. Column (e) shows my proposed revenue requirement.

Attachment EP-2 contains a more detailed explanation of my calculations for operations and maintenance, other taxes, and federal income taxes.

Attachment EP-3 shows my calculations of the weighted cost of capital, invested capital, and return.

Attachment EP-4 shows my calculation of the federal income taxes.

<u>The Cliffs:</u>

In **Attachment EP-5**, column (c) itemizes the 2007 test year revenue requirement as presented in DDU's general ledger for The Cliffs. Column (d) represents my proposed adjustments to DDU's requested revenue requirement for its test year. Column (e) shows my proposed revenue requirement.

Attachment EP-6 contains a more detailed explanation of my calculations for operations and maintenance, other taxes, and federal income taxes.

Attachment EP-7 shows my calculations of the weighted cost of capital, invested capital, and return.

Attachment EP-8 shows my calculation of the federal income taxes.

<u>White Bluff:</u>

In **Attachment EP-9**, column (c) itemizes the 2007 test year revenue requirement as presented in DDU's general ledger for White Bluff. Column (d) represents my proposed adjustments to DDU's requested revenue requirement for its test year. Column (e) shows my proposed revenue requirement.

Attachment EP-10 contains a more detailed explanation of my calculations for operations and maintenance, other taxes, and federal income taxes.

Attachment EP-11 shows my calculations of the weighted cost of capital, invested capital, and return.

Attachment EP-12 shows my calculation of the federal income taxes.

Q. **As a result of your examination of DDU's rate application and additional information supplied by the utility, have you proposed any adjustments to the utility's requested revenue requirements for its water systems?**

A. Yes, I used DDU's application, general ledgers, and statement of operations for 2007 as a baseline for the costs of service and revenue requirements, subject to the adjustments outlined below. Please refer to **Attachments EP-13 through EP-18** for my recommended adjustments. Items listed in the general ledgers must be supported by invoices or other documentation, so I made adjustments to expenses listed in the general ledger that were not supported by such documentation.

Q. **In their prefiled testimonies, Dr. Victoria Harkins, P.E. and Mr. Chris Ekrut, witnesses for DDU, stated they were making revisions to DDU's application. Did you and Mr. Dickey use those revisions as the baseline for your analyses of the application?**

A. No, we did not. DDU's witnesses are attempting to amend the application, which under section 291.25(g) of the TCEQ's rules can only be done upon a showing of good cause. This means DDU needed to file a motion with the administrative law judge seeking a finding of good cause and, therefore, permission to amend its application. Because DDU has not filed such a motion, Mr. Dickey and I used the original application as our baseline. However, in some instances, we did make some of the same changes made by DDU's witnesses when we believed those changes were justified.

Q. **What adjustments did you make to DDU's requested revenue requirements?**

A. The following are m y proposed adjustments to DDU's revenue requirement for each water system:

<u>The Retreat (Accounting Code 6090):</u>

DDU did not separate the revenue requirement for The Retreat and White Bluff in its application. In order to determine the revenue requirement for each system, I used the allocations provided in Attachment 10 to the application and **Attachments EP-26** and **EP-28** to arrive at each system's revenue requirement. Please refer to **Attachment EP-18** for my allocation and starting value for each expense category. For The Retreat, I calculated an operations and maintenance expense of $44,045 after making the following adjustments:

1. **Salaries and Wages are reduced by $16,877.00.**

   I reduced the salaries and wages by $16,877.00. According to **Attachment EP-27**, The Retreat's water system's share of DDU's salaries totaled $24,204.00. Starting with that amount, I removed the salaries for employees who were terminated during 2007 and 2008, which totaled $23,762.00, but added the salaries for employees who were hired in 2008, which totaled $6,885.00. I calculated my proposed adjustments using the 2007 and 2008 W2s for each employee, with the 2008 W2s depicting the known and measurable changes to the test year. Please refer to **Attachments EP-13** and **EP-16** for these adjustments.

2. **Chemicals for Treatment are reduced by $28.00.**

   I reduced chemicals for treatment by $28.00. According to the general ledgers, this amount was for sewer testing, which is a sewer expense, not a water expense. Please refer to **Attachment EP-13** for this adjustment.

3. **Repairs/Maintenance/Supplies are reduced by $13,506.00.**

   I reduced repairs/maintenance/supplies by $13,506.00. I removed $742.00 for an item that DDU returned but did not record a corresponding credit in the general ledger and $409.00 for Wallele connect lift station, as this is a sewer expense. Also, I reclassified $12,355.00 to the depreciation schedule for assets to reflect the same adjustment that Dr. Harkins made in her depreciation schedule. Please refer to **Attachment EP-13** for these adjustments.

4. **Accounting and Legal Fees are reduced by $4,892.00.**

I reduced the accounting and legal fees by $4,892.00. I removed the following expenses: wastewater permit for $1,215.00, sewer rate case expense for $1,067.00, and wastewater engineering master plan for water and sewer for $2,400.00 (half of $4,800.00 for the sewer portion). These are sewer expenses, not water expenses. I also disallowed $210.00 for a TCEQ penalty against James E. Lyles for not having a required occupational license, as the customers should not have to pay for this legal violation. The net effect of these adjustments results in a negative amount for this expense account because DDU had allocated the expenses instead of using the actual amount in the general ledger, which is $7,292.00. Please refer to **Attachment EP-13** for these adjustments.

5. **Payroll Taxes are reduced by $162.00.**

I reduced the payroll taxes by $162.00 for the portion of the payroll tax burden that corresponds with my salary adjustments. I subtracted $836.00 for employees terminated in 2007 and 2008 and added $674.00 for employees hired in 2008. Please refer to **Attachments EP-13** and **EP-16** for these adjustments.

<u>The Cliffs (Accounting Code 8090):</u>

DDU provided a separate cost of service for The Cliffs in the amount of $488,305.00. In order to determine the revenue requirement for each system, I used the allocations provided in Attachment 10 to the application and **Attachments EP-26** and **EP-28** to arrive at each system's revenue requirement. Please refer to **Attachment EP-18** for my allocation and starting value for each expense category. For The Cliffs, I calculated an operations and maintenance expense of $270,782.00 after making the following adjustments:

1. **Salaries and Wages are reduced by $28,034.00.**

I reduced the salaries and wages by $28,034.00. According to **Attachment EP-26,** The Cliffs' water system's share of DDU's salaries totaled $98,301.00. Starting with that amount, I removed the salaries for employees who were terminated during 2007 and 2008, which totaled $57,640.00, but added the salaries for employees who were hired in 2008, which totaled $29,606.00. I calculated my proposed adjustments using the 2007 and 2008 W2s for each employee, with the 2008 W2s depicting the known and measurable changes to the test year. Please refer to **Attachments EP-14** and **EP-16** for these adjustments.

2. **Chemicals for Treatment are reduced by $1,449.00.**

I removed $1,449.00 for sewer chemicals, as that is a sewer expense, not a water expense. Please refer to **Attachment EP-14** for this adjustment.

3. **Repairs/Maintenance/Supplies are reduced by $142,427.00.**

I reduced repairs/maintenance/supplies by $142,427.00. I removed $19,484.00 for a reverse osmosis (RO) unit rental and $860 for an electric hook-up for the RO unit because that particular RO unit was disconnected in May 2007. I also removed $1,105.00 for an ultrafiltration (UF) pilot study because, as Mr. Dickey will testify to, the TCEQ has not approved the use of the UF unit. I reclassified $74,357.00 to the depreciation schedule for assets to reflect the same adjustment that Dr. Harkins made in her depreciation schedule. I also reclassified another $46,621.00 to the depreciation schedule for assets, which are listed in **Attachment BDD-2**. Please see **Attachment EP-14** for these adjustments.

4. **Accounting and Legal Fees are reduced by $30,104.00.**

I reduced the accounting and legal fees by $30,104. I removed $28,025.00 for engineer expenses that should be included in the depreciation schedule once the applicable asset is constructed. I recommend that DDU maintain a log for each asset listing each engineering service for that asset so it can track those costs in the future. I also removed sewer rate case expenses for $1,067.00 and preparation and submittal of DMRs, 8/2005-1/2007 for $1,012.00. These are both sewer expenses, not water expenses. The net effect of these adjustments results in a negative amount for this expense account because DDU had allocated the expenses instead of using the actual amount in the general ledger, which is $32,603.00. Please see **Attachment EP-14** for these adjustments.

5. **Payroll Taxes are reduced by $696.00.**

I reduced the payroll taxes by $696.00 for the portion of the payroll tax burden that corresponds with my salary adjustments. I subtracted $3,594.00 for employees terminated in 2007 and 2008 and added $2,898.00 for employees hired in 2008. Please refer to **Attachments EP-14** and **EP-16** for these adjustments.

White Bluff (Accounting Code 9090):

DDU did not separate the revenue requirement for The Retreat and White Bluff in its application. In order to determine the revenue requirement for each system, I used the allocations provided in Attachment 10 to the application and **Attachments ED-26** and **ED-28** to arrive at each system's revenue requirement. Please refer to **Attachments EP-15** and **EP 16** for my allocation and starting value for each expense category. For White Bluff, I calculated an operations and maintenance expense of $318,245.00 after making the following adjustments:

1. **Salaries and Wages are reduced by $9,982.00.**

I reduced the salaries and wages by $9,982.00. According to **Attachment EP-27**, White Bluff's water system's share of DDU's salaries totaled $106,853.00. Starting with that amount, I removed the salaries for employees who were terminated during 2007 and 2008, which totaled $42,342.00, but added the salaries for employees who were hired in 2008, which totaled $32,360.00. I calculated my proposed adjustments using the 2007 and 2008 W2s for each employee, with the 2008 W2s depicting the known and measurable changes to the test year. Please refer to **Attachments EP-15** and **EP-16** for these adjustments.

3. **Repairs/Maintenance/Supplies are reduced by $102,698.00.**

I reduced repairs/maintenance/supplies by $102,698.00. I reclassified $82,228.00 to the depreciation schedule for assets to reflect the same adjustment that Dr. Harkins made in her depreciation schedule. I reclassified another $17,563.00 to the depreciation schedule for assets, which are listed in **Attachment BDD-4**. I also removed $2,706.00 for sludge pumping and $200.00 (half of $400.00 for the sewer portion) of a water and sewer expense. These were sewer expenses, not water expenses. Please refer to **Attachment EP-15** for these adjustments.

4. Accounting and Legal Fees are reduced by $7,138.00.

I reduced the accounting and legal fees by $7,138.00. I removed a wastewater engineering service expense for $4,710.00, a water and sewer consulting services expense for $1,361.50 (half of $2,723.00 for the sewer portion), and a sewer rate case expense for $1,067.00. These were sewer expenses, not water expenses. The net effect of these adjustments results in a negative amount for this expense account because DDU had allocated the expenses instead of using the actual amount in the general ledger, which is $11,512.00. Please refer to **Attachment EP-15** for these adjustments.

5. Miscellaneous expenses are reduced by $519.00.

I reduced the miscellaneous expenses by $519.00 by removing half of $1,038 for a backhoe rental, as half of the expense was for the golf course. Please refer to **Attachment EP-15** for this adjustment.

6. Payroll Taxes are reduced by $761.00.

I reduced the payroll taxes by $716.00 for the portion of the payroll tax burden that corresponds with my salary adjustments. I subtracted $3,929.00 for employees terminated in 2007 and 2008 and added $3,168.00 for employees hired in 2008. Please refer to **Attachments EP-15** and **EP-16** for these adjustments.

<u>**The Retreat & White Bluff (Accounting Codes 6090 and 9090)**</u>:

The adjustments that I made above for The Retreat and White Bluff individually also apply to their combined revenue requirement. This results in a combined operations and maintenance expense of $362,290. Please refer to **Attachment EP-31** for this calculation.

Q. **How did you calculate Federal Income Tax for The Retreat, The Cliffs, and White Bluff?**

A. The federal income tax amounts listed in column (e) of **Attachment EP-2** (The Retreat), **Attachment EP-6** (The Cliffs), **Attachment EP-10** (White Buff), and **Attachment EP-32** (The Retreat and White Bluff) are the product of each system's taxable income times the applicable percent tax rate listed on **Attachment EP-4** (The Retreat), **Attachment EP-8** (The Cliffs), **Attachment EP-12** (White Bluff), and **Attachment EP-33** (The Retreat and White Bluff).

Q. **How did you compute the Notes Payable for The Retreat, The Cliffs, and White Bluff?**

A. Looking at Attachment 9 to the application, the balance on the notes payable at the end of the test year was $644,729.00. Out of this amount, DDU is seeking to recover $554,319.00 as a regulatory asset for deferred expenses, which Mr. Dickey will elaborate on in his testimony. Staff identified $140,028.00 as the remaining outstanding loan balance as of December 31, 2007, as follows: $49,423.00 for The Cliffs, $58,380.00 for White Bluff, and $32,225.00 that was not identified as being for a particular system. I allocated the loans for The Cliffs and White Bluff between the water and sewer systems based on their connection counts. I also allocated the $32,225.00 loan between the water and sewer systems for all three subdivisions based on the number of connections with the following result: $9,023.00 for The Cliffs, $2,256.00 for The Retreat, and $20,946.00 for White Bluff.

DDU obtained its loans from Double Diamond-Delaware, Inc. (DD-DI), DDU's parent company, at an interest rate of 10%. I recommend that the Commission apply an interest rate of 4.87% to the loans in lieu of the 10% rate because DDU's loan transaction was with an affiliated company with an affiliated interest, i.e. it was not an arm's length transaction. This is the interest rate that another parent company, Aqua America, Inc., imposed upon a loan to its utility subsidiary, Aqua Texas, Inc. Please see **Attachment EP-24** for more information about the Aqua Texas loan. The payment of interest expense to an affiliated interest must be shown to be reasonable and necessary under section 13.185(e) of the Texas Water Code. With DD-DI loaning money to its subsidiary and then asking the subsidiary's customers to pay 10% interest on those loans, DDU needed to demonstrate that the interest rates were reasonable and necessary. DDU's parent company can obtain a much lower rate for bulk loans than DDU can by itself, so the interest rate on a loan from DD-DI should be lower than the interest rate DDU could obtain on its own. Furthermore, in DD-DI's consolidated audited financial statements, the auditor indicated that advances from DD-DI to its affiliates do not bear interest. This can be found on page 17 of Attachment 8 to the application. DDU is a Qualified Subchapter S Subsidiary of DD-DI and is not treated as a separate company for federal tax purposes. Rather, its assets, liabilities, and all items of income, deduction, and credit are treated as those of the parent S Corporation, DD-DI. Therefore, any income incurred by DDU belongs to the parent company, including any interest on the loan that DDU collects from its customers through its rates. DDU did not show that the 10% interest rate was reasonable and necessary, so it should be reduced.

Q. What is your recommendation for rate case expenses?

A. DDU indicated that it had incurred $162,406.00 for rate case expenses as of February 26, 2010. This amount does not include any rate case expenses for the hearing on the merits through the Commission's agenda. DDU has not provided all the invoices for its rate case expense. I recommend that DDU submit its rate case expense invoices as they are incurred and billed. For each system for which DDU can support a rate change and meet the rate case expense requirements found in section 291.28(7)-(9) of the TCEQ's rules, staff recommends that the rate case expenses be recovered through a surcharge to DDU's water customers over a twenty-four month period. The surcharge should be calculated by dividing the total amount of reasonable and necessary rate case expenses by the current number of water customers and then dividing that number by twenty-four so the amount can be collected from all current and future water customers for twenty-four months or until the total amount is collected, whichever occurs first. For each system that the Commission does not grant a rate change, staff recommends denying rate case expenses for that system, as DDU cannot collect rate case expenses for that system under section 291.28(8).

Q. Has the Commission issued an order regarding rate case expenses in the Texas Landing Utilities, SOAH Docket No. 582-08-1023?

A. No. Because of the extraordinary amount of rate case expenses that Texas Landing is seeking to recover, the Commission remanded the case back to the State Office of Administrative Hearings (SOAH) to hold an additional hearing regarding rate case expenses.

Q. How did you compute the Working Cash Allowance for The Retreat, The Cliffs, and White Bluff?

A. Based on section 291.31(c)(2)(B)(iii), I computed an allowance of one-eighth of my recommended operations and maintenance expenses for each system. Please refer to **Attachment EP-3** (The Retreat), **Attachment EP-7** (The Cliffs), **Attachment EP-11** (White Bluff), and **Attachment EP-32** (The Retreat and White Bluff) for the computed amounts.

Q. How did you compute the Total Invested Capital for each system?

A. I added each system's working cash allowance to its net plant and subtracted its developer contributions. The values for net plant and developer contributions came from Mr. Dickey's depreciation schedules for The Retreat (**Attachment BDD-3**), The Cliffs (**Attachment BDD-2**), and White Bluff (**Attachment BDD-4**). This resulted in a total invested capital of $981,880.00 for The Retreat (**Attachment EP-3**), $445,145.00 for The Cliffs (**Attachment EP-7**), $708,799.00 for White Bluff (**Attachment EP-11**), and $1,690,679 for The Retreat and White Bluff (**Attachment EP-32**).

Q. How did you compute your recommended RORs?

A. I used the TCEQ's ROR worksheet. Based on Moody's BAA Public Utility Bond average for the test year, which was 7.45%, plus various risk factors for operating a water system, I calculated an ROR of 9 45% (**Attachment EP-17**) and a weighted average ROR of 8.85% (**Attachment EP-7**) for The Cliffs, and ROR of 11.45% (**Attachment EP-17**) with a weighed average ROR of 11.43% (**Attachment EP-3**) for The Retreat, an ROR of 10.45% (**Attachment EP-17**) with a weighted average ROR of 9.83% (**Attachment EP-11**) for White Bluff, and an ROR of 10.45% (**Attachment EP-17**) with a weighted average ROR of 10.18% (**Attachment EP-32**) for The Retreat and White Bluff combined.

Q. In computing the recommended RORs for DDU, what basic principles guided your analysis?

A. The ROR is the revenue earned by a utility from its operations over and above its allowable operating expenses and is expressed as a percentage of invested capital. The ROR must be reasonable, 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. Section 291.31(c) describes all the ROR requirements

Q. How did you calculate your recommended returns?

A. I multiplied each system's total invested capital times its weighted average ROR to calculate the return for each system. For The Cliffs, 8.85% times $445,145.00 resulted in a return of $39,389.00. Please refer to **Attachment EP-7** for this calculation. For The Retreat, 11.43% times $981,880.00 resulted in a return of $112,277.00. Please refer to **Attachment EP-3** for this calculation. For White Bluff, 9.83% times $708,799.00 resulted in a return of $69,643.00. Please refer to **Attachment EP-11** for this calculation. For The Retreat and White Bluff combined, 10 18% times $1,690,679 resulted in a return of $172,124. Please refer to **Attachment EP-32** for this calculation.

Q. What are your final revenue requirement recommendations in this case?

A. After making my and Mr. Dickey's adjustments to the utility's requested cost of service, I recommend the following revenue requirements:

Attachment EP-1, The Retreat - $253,430.00

Attachment EP-5, The Cliffs - $366,908.00

Attachment EP-9, White Bluff - $489,275.00

Attachment EP-30, The Retreat and White Bluff – $752,618.00

Q. What is the purpose of calculating the proposed revenue requirements?

A. The values I calculated will be used by Mr. Dickey for preparing the ED's recommended rates in this case.

Q. Does this conclude your prefiled testimony?

A. Yes, however, I reserve the right to supplement this testimony during the course of the proceeding as new facts arise.