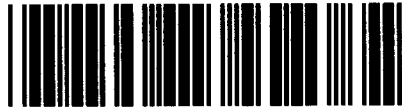




Control Number: 43922



Item Number: 3

Addendum StartPage: 0

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The first step in determining the requested level of O&M expenses was to assign each Double Diamond Account to a classification used by the TCEQ within the rate application. Page 1 of 22 of Attachment 10 to the application illustrates each account maintained by the Utility during the test year, along with the TCEQ category of expense to which it was assigned.

The second step was to remove from the booked values those items which are not allowed per TCEQ rules or are otherwise contained within the cost of service. The following discusses those adjustments that were made:

- 1) \$394 was removed for Employee Golf Expense
- 2) \$2,824 was removed for Equipment / Lease Recurring as this represents an intra-company payment for Equipment included within the requested rate base
- 3) \$5,544 was removed for Vehicle / Lease Recurring as this represents an intra-company payment for Vehicles included within the requested rate base
- 4) \$59,176 was removed from Notes Payable – Prior Yr Deficit as this represents the amounts paid in the Test Year by the Utility to the parent Company for previous cash advances. This amount is proposed to be recovered through deferred accounting treatment as discussed earlier.
- 5) \$134,397 was removed from Notes Payable – Land Improvements as this represents the amounts paid in the Test Year by the Utility to the parent Company for previous debt issued to fund capital investment. This capital investment is contained within the requested rate base.

1 These adjustments are illustrated in detail on Page 1 of 22, Attachment 10 to the
2 application.

3 The third and final step was to directly assign or allocate expenses to either the water or
4 wastewater service function of the utility. Details regarding the allocation of expenses
5 are also contained in Attachment 10 to the application.

6 **Q. COULD YOU PLEASE DISCUSS HOW EXPENSES WERE ASSIGNED OR**
7 **ALLOCATED TO THE WATER AND WASTEWATER SERVICE FUNCTIONS**
8 **AS PART OF THE APPLICATION?**

9 A. To allocate the O&M expenses to the water and wastewater systems, I obtained copies of
10 the Utility's detailed trial balance, which lists, by line-item, each expense, the date it was
11 posted, and a brief description of what the expense entailed. Using this information, I
12 directly assigned expenses to the water and wastewater service functions where sufficient
13 detail existed. Where sufficient detail did not exist in the Utility's records, I developed
14 allocation factors which reflected what caused the particular cost to be incurred. All
15 assignments and allocations are specifically detailed in Attachment 10 to the application.

16 **Q. DID THE ASSET EVALUATION PERFORMED BY DR. HARKINS HAVE AN**
17 **IMPACT ON THE UTILITY'S REQUESTED LEVEL OF OPERATIONS AND**
18 **MAINTENANCE EXPENSES?**

19 A. Yes.

20 **Q. CAN YOU PLEASE EXPLAIN THESE CHANGES?**

21 A. Within the Test Year, DDU expensed some items that Dr. Harkins has capitalized and
22 included within the requested rate base. Table 14 illustrates the accounts impacted and
23 quantifies the changes made:

Table 14 – Summary of Asset Evaluation O&M Adjustments			
<u>Account</u>	<u>Application Value</u>	<u>Capitalized Expense</u>	<u>Adjusted Value</u>
Groundwater Systems			
R&M – Water Plant	\$ 129,288	\$ (84,209)	\$ 45,079
R&M - Distribution Lines	35,096	(3,551)	31,545
Surface water Systems			
R&M – Water Plant	\$ 188,334	\$ (75,488)	\$ 112,846
R&M - Distribution Lines	17,394	(1,318)	16,076

1

2 Additionally, some expenses within the application have been allocated to the respective
3 water and wastewater utilities based on the gross cost of original plant investment. These
4 accounts include:

- 5 • Employee Compensation
- 6 • Referral Bonus
- 7 • Bonus Commission
- 8 • Hourly Wages
- 9 • Payroll Burden
- 10 • Other Employee Expense
- 11 • Vehicle Expense
- 12 • Vehicle Fuel Expense
- 13 • Equipment Fuel Expense
- 14 • Equipment Lease Payment
- 15 • Insurance
- 16 • R&M Building
- 17 • R&M Equipment
- 18 • Taxes & Licenses (unless directly assigned)

1 Table 15 presents the change in the plant allocation factors based on the Asset Evaluation.

Table 15 – Summary of Impacts to Plant Allocation Factors			
<u>Account</u>	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
Groundwater Systems			
Application Factor (GWPLANT)			
\$	\$ 2,974,997	\$ 1,692,623	\$ 4,667,620
%	63.74%	36.26%	100.00%
Adjusted Factor (GWPLANT)			
\$	\$ 4,780,636	\$ 3,750,000	\$ 8,530,636
%	56.04%	43.96%	100.00%
Surface water Systems			
Application Factor (SWPLANT)			
\$	\$ 3,747,502	\$ 1,927,463	\$ 5,674,965
%	66.04%	33.96%	100.00%
Adjusted Factor (SWPLANT)			
\$	\$ 1,185,625	\$ 794,000	\$ 1,979,625
%	59.59%	40.11%	100.00%

2

3 **Q. HOW DID THE ASSET EVALUATION CHANGE THE UNDERLYING**
 4 **OPERATIONS AND MAINTENANCE DATA CONTAINED WITHIN THE**
 5 **APPLICATION?**

6 A. The Asset Evaluation did not change the underlying data presented in the application; the
 7 data is simply being reclassified. For example, some operations and maintenance
 8 expenses within the Test Year have been capitalized as a result of the Asset Evaluation.
 9 The data has not changed, but the classification of the data as an asset versus an expense
 10 has changed. The effect of this change in classification is to decrease operations and
 11 maintenance expense and increase rate base, along with all attendant impacts to working
 12 cash allowance, return, income taxes, and depreciation expense. This resulted in an

1 overall decrease in the requested revenue requirement for the Utility's Groundwater
2 customers, which directly benefits the Utility's customers.

3 **Q. CAN YOU PLEASE SUMMARIZE THE TOTAL LEVEL OF O&M EXPENSES**
4 **INCLUDED IN THE UTILITY'S REVENUE REQUIREMENT TAKING INTO**
5 **ACCOUNT THE IMPACT OF THE ASSET EVALUATION?**

6 A. The requested summary is presented in Table 16 below:

Table 16 – Summary of Requested O&M Expenses			
<u>TCEQ Category</u>	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Salaries and Wages	\$ 121,878	\$ 81,381	\$ 203,259
Contract Labor	2,824	3,633	6,456
Purchased Water	0	10,846	10,846
Chemicals	5,048	5,001	10,050
Utilities	104,288	27,961	132,249
Repairs / Maintenance / Supplies	88,890	132,512	221,402
Office Expenses	4,440	5,122	9,562
Accounting & Legal Fees	10,100	18,674	28,774
Insurance	16,244	7,813	24,057
Miscellaneous	60,334	77,156	137,490
Total O&M	\$ 414,046	\$ 370,099	\$ 784,145

7

8 **XI. TAXES OTHER THAN INCOME**

9 **Q. WITHIN THE APPLICATION, THE UTILITY IS REQUESTING RECOVERY**
10 **OF TAXES OTHER THAN INCOME TAXES, IS THIS CORRECT?**

11 A. Yes. The Utility is requesting the recovery of payroll taxes, property tax, and other taxes
12 and licenses.

1 Q. HOW WAS THE REQUESTED LEVEL OF TAXES OTHER THAN INCOME
2 TAX DETERMINED?

3 A. The requested level of taxes other than income taxes was determined in the same manner
4 as the O&M expenses contained within the application. The actual expenses incurred by
5 the utility for the Test Year in these accounts were totaled and either directly assigned or
6 allocated to the water and wastewater service functions utilizing various allocation
7 factors. The allocation of payroll taxes is illustrated on Page 4 of 22, Attachment 10 to
8 the application. The assignment and/or allocation of property tax is contained on Page 19
9 of 22, Attachment 10 to the application. Finally, the assignment and/or allocation of
10 other taxes and licenses is illustrated on Page 18 of 22, Attachment 10 to the application.

11 **XII. OTHER REVENUES**

12 Q. COULD YOU PLEASE EXPLAIN WHAT "OTHER REVENUES" ARE
13 INCLUDED WITHIN THE APPLICATION?

14 A. As detailed in Attachment 10, the "other revenues" included in the application consists of
15 Water Tap Revenue, Reconnect / Transfer fees, Other Income, and Interest Income.

16 Q. WHY ARE TAP FEE REVENUES INCLUDED AS PART OF "OTHER
17 REVENUES"?

18 A. The Utility records expenses associated with performing taps as an O&M expense. These
19 expenses, which are included in the application, must be offset by the amount of expense
20 borne by the customer. By including both the tap expense and offsetting revenue, only
21 the incremental expense not currently covered by tap fee revenue is included in the cost
22 of service.

23

XIII. SUMMARY OF TOTAL REVENUE REQUIREMENT

1

2 **Q. COULD YOU PLEASE SUMMARIZE THE TOTAL REVENUE REQUIREMENT**
3 **PRESENTED IN THE APPLICATION?**

4 **A.** Table 17 below summarizes the total requested revenue requirement contained within the
5 application:

Table 17 – Summary of Application Revenue Requirement			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
O&M Expense	\$ 517,955	\$ 472,796	\$ 990,751
Payroll Taxes	12,725	13,055	25,780
Property and other Taxes	3,352	2,454	5,806
Annual Depreciation and Amortization	117,281	81,214	198,495
Income Taxes	33,796	15,364	49,160
Return	116,124	52,790	168,914
Other Revenues	(12,116)	(9,622)	(21,738)
Total Revenue Requirement	\$ 789,117	\$628,051	\$ 1,417,168

6

7 **Q. DOES THE ABOVE TABLE 17 REPRESENT THE REVENUE REQUIREMENT**
8 **BEING REQUESTED BY THE UTILITY IN THIS PROCEEDING?**

9 **A.** No. The results presented in the table above do not take into account the results of the
10 Asset Evaluation, recommended by Commission Staff, and performed by Dr. Harkins.
11 DDU requests that the ALJ consider the impact of this Study in determining the Utility's
12 revenue requirement.

13 **Q. PLEASE PROVIDE A SUMMARY OF THE UTILITY'S REQUESTED**
14 **REVENUE REQUIREMENT TAKING INTO ACCOUNT THE RESULTS OF**
15 **THE ASSET EVALUATION?**

16 **A.** The Utility's requested revenue requirement is contained in Table 2 above.

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XIV. DEVELOPMENT OF BILLING DETERMINANTS

Q. HOW WAS THE NUMBER OF CUSTOMERS UTILIZED FOR RATE DESIGN IN THE APPLICATION DETERMINED?

A. The number of customers utilized for rate design is equivalent to the customers indicated in the billing records of the Utility as of December 2007. Table 18 below provides a summary of the number of customers, by meter size.

Table 18 – Summary of Customers			
<u>Meter Size</u>	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
5/8"	585	215	800
1"	18	12	30
1 1/2"	9	1	10
2"	10	15	25
3"	0	1	1
Total Customers	622	244	866

Q. HOW WAS THE BILLED CONSUMPTION UTILITIZED FOR RATE DESIGN DETERMINED IN THE APPLICATION?

A. To determine the volumes used in rate design, the billed consumption for the utility was reviewed for the Test Year. At the same time, data on precipitation was reviewed from the National Weather Service for the Test Year. As indicated by National Weather Service records, and illustrated in Table 19 below, all three subdivisions experienced greater than normal rainfall during the Test Year. As such, the volume of water used by customers was lower than normal.

1

Table 19 – Departure from Normal Precipitation			
	<u>The Retreat</u>	<u>The Cliffs</u>	<u>White Bluff</u>
Weather Station	Cleburne	Palo Pinto	Whitney Dam
Station Number	411800	416766	419715
Departure from Normal Precipitation (Inches)			
2006	(0.32)	(7.34)	(6.49)
2007	19.69	13.55	28.00
<i>Note: Whitney Dam Station Records Incomplete in 2006 and 2007</i>			

2

3 Given the higher level of precipitation than normal, and in an effort to ensure the
 4 development of fair and equitable rates, the Utility has chosen to utilize a level of
 5 “normalized consumption” on which to develop rates.

6 **Q. HOW WAS THE LEVEL OF NORMALIZED CONSUMPTION DETERMINED?**

7 A. The level of normalized consumption was developed by taking the consumption, by
 8 1,000 gallon block, for Calendar Year 2006 and 2007 and averaging the two years. The
 9 same was done for the number of customers by 1,000 gallon block. The average
 10 consumption for the two years was then divided by the average customers for the two
 11 years to develop a normalized consumption per connection within each 1,000 block.

12 To project consumption, the number of meters as of December 2007 was annualized and
 13 then distributed to the 1,000 gallon blocks based on the 2006 and 2007 average
 14 distribution of customers. Once the projected level of customers was distributed across
 15 the blocks, the number of customers was multiplied by the normalized average
 16 consumption per connection, by block, to develop the projected normalized consumption
 17 for rate design.

1 The development of the normalized consumption levels are illustrated in Attachment 11
 2 to the application. Table 20 summarizes the normalized billing determinants used for rate
 3 design purposes.

4

Table 20 – Summary of Normalized Billing Determinants (Gallons)			
<u>Rate Block</u>	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
0 – 3,000	18,121,934	5,162,972	23,284,906
3,001 – 10,000	27,873,599	6,617,750	34,491,349
10,001 – 15,000	12,540,199	2,892,268	15,432,466
15,001 – 20,000	8,987,213	2,088,824	11,076,038
20,001 +	52,707,629	11,628,544	64,336,174
Total	120,230,574	28,390,358	148,620,933

5

6

XV. RATE DESIGN

7

Q. WHAT RATE DESIGN IS THE UTILITY REQUESTING IN ITS APPLICATION?

8

9

A. The Utility is requesting a two-part rate design consisting of (1) a meter charge, which escalates based on the size of the meter, and (2) a five (5) block inclining volumetric charge. The requested blocks are as follows:

10

11

12

- 0 – 3,000

13

- 3,001 – 10,000

14

- 10,001 – 15,000

15

- 15,001 – 20,000

16

- 20,001 +

1 Q. BASED ON THE PERFORMANCE OF THE ASSET EVALUATION AND THE
2 IMPACT ON THE UTILITY'S REQUESTED REVENUE REQUIREMENT, IS
3 THERE A CORRESPONDING IMPACT TO THE UTILITY'S REQUESTED
4 RATES?

5 A. Yes. DDU is requesting that a lower consolidated rate be approved for the systems at
6 White Bluff and The Retreat. The Utility's request for rates at The Cliffs is unchanged.

7 Q. PLEASE SUMMARIZE THE RATES BEING REQUESTED IN THIS
8 PROCEEDING.

9 A. The rates being requested by the Utility are contained in Table 3 above.

10 **XVI. RATE NOTICE**

11 Q. IN THE NOTICE OF PROPOSED RATE CHANGE DELIVERED TO
12 CUSTOMERS, WHAT WAS THE TOTAL ANNUAL REVENUE INCREASE
13 FOR GROUNDWATER AND SURFACE WATER CUSTOMERS?

14 A. The proposed total annual revenue increase for Groundwater and Surface Water
15 Customers was \$152,173 and \$94,812, respectively. The calculation of these numbers is
16 illustrated in Attachment 12 to the Application.

17 Q. WERE THESE INCREASES CALCULATED ON THE UTILITY'S CURRENTLY
18 APPROVED RATES?

19 A. No. At the time the application was filed, DDU's proposed rates under its 2006 Test
20 Year Water Rate Application were in effect.

1 Q. HAVE YOU CALCULATED THE INCREASES RESULTING FROM THE
2 UTILITY'S CURRENTLY APPROVED RATES AND THE REQUESTED RATES
3 PRESENTED IN TABLE 3 ABOVE?

4 A. Yes. The Utility's requested rates proposed to generate \$219,741 and \$235,589 in
5 additional revenue from Groundwater and Surface Water customers, respectively. This
6 amounts to a total rate revenue increase of \$455,330 based on the Utility's currently
7 approved rates. Schedule CDE-8 (Exhibit DDU-26) provides the proof of revenues
8 generated under the Utility's currently approved rates as compared to the revenue
9 generated under the Utility's requested rates.

10 **XVII. RATE CASE EXPENSES**

11 Q. IS DDU REQUESTING RECOVERY OF RATE CASE EXPENSES AS PART OF
12 THIS PROCEEDING?

13 A. It is my understanding that DDU is requesting recovery of rate case expenses.

14 Q. CAN YOU PLEASE PROVIDE A SUMMARY OF THE RATE CASE EXPENSES
15 INCURRED BY THE UTILITY THROUGH THE PROVISION OF SERVICES
16 BY J. STOWE & CO. RELATED TO THIS APPLICATION?

17 A. As of February 15, 2010, J. Stowe & Co. has billed the Utility \$46,962 for services
18 provided related to this application. Schedule CDE-9 (Exhibit DDU-27) provides a
19 summary of the hours billed to DDU by members of J. Stowe & Co. along with a brief
20 description of the tasks performed.

21 Q. DOES THIS REPRESENT THE UTILITY'S TOTAL REQUEST?

22 A. No. This figure represents only those expenses incurred by J. Stowe & Co. as of
23 February 15, 2010. Expenses associated with legal counsel and engineering consulting

1 have also been incurred and recovery of those expenses is also requested. Additionally,
 2 these figures will need to be updated prior to a final determination on rate case expenses
 3 by the Commission. Based on numbers provided by DDU on February 26, 2010, the
 4 Utility has incurred the following total rate case expenses:

5	• Jackson Walker, LLP	\$ 56,343
6	• Armburst & Brown, LLP	48,426
7	• Harkins Engineering	10,675 (1/2 of \$21,350)
8	• J. Stowe & Co.	<u>46,962</u>
9	Total	\$ 162,406

10
 11 **Q. WERE THE EXPENSES INCURRED BY J. STOWE & CO. REASONABLE,**
 12 **NECESSARY, AND SPECIFIC TO THIS APPLICATION?**

13 A. Yes.

14 **Q. HAVE YOU BENCHMARKED THE UTILITY'S REQUESTED RATE CASE**
 15 **EXPENSES AGAINST OTHER CONTESTED RATE CASES TO DETERMINE**
 16 **WHETHER THE REQUESTED EXPENSES ARE REASONABLE?**

17 A. Yes. The Commission recently considered the Proposal for Decision in TCEQ Docket
 18 No. 2007-1867-UCR. This particular case involves many of the same issues faced by
 19 DDU, including consolidation of systems under a single rate.

20 While rate case expenses are still under review by the ALJ in this proceeding and a Final
 21 Order is pending, Finding of Fact No. 16 in the Proposed Order indicates the Utility
 22 incurred \$142,314.81 in reasonable and necessary expenses through May 22, 2009.
 23 Subsequent affidavits filed indicate total rate case expenses will total approximately
 24 \$171,063.75. According to the Proposal for Decision, Texas Landing Utilities serves
 25 approximately 229 customers (143 water and 86 sewer). Based on these figures, Texas
 26 Landing Utilities incurred rate case expenses of approximately \$747 per connection.

1 At present, DDU has incurred approximately \$162,406 in total rate case expenses to-date.
2 As of December 2007, DDU had 866 water customers. On a per connection basis, DDU
3 has incurred approximately \$187.53 in rate case expense per connection, which is
4 approximately \$559 less than the amount spent in the Texas Landing Utilities case.
5 Given this comparison, in my opinion, DDU's expenses can be considered reasonable.

6 **XVIII. CONCLUSION**

7 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8 A. Yes. However, with the Administrative Law Judge's permission I would request the
9 right to amend, delete and/or add to my testimony as additional facts become known.

EXHIBIT "B"

(ATTACHED)

Double Diamond Utilities Co.
(The Retreat)

Water Tariff Page No. 2
Revision Date / /

(Water Utility Name)

SECTION 1.0 - RATE SCHEDULE

Section 1.01 - Rates

Monthly base rate including 0 gallons

Meter Size:

Residential

3/4" or 1"	\$ 39.00
1"	\$ 97.50
1 1/2"	\$ 195.00
2"	\$ 312.00
3"	\$ 585.00
Other: _____"	\$ _____

Gallonge Charge (over Minimum):

0 - 3,000	\$2.00 per 1,000 gallons
3,001 - 10,000	\$2.75 per 1,000 gallons
10,001 - 15,000	\$3.80 per 1,000 gallons
15,001 - 20,000	\$5.25 per 1,000 gallons
20,001 and over	\$7.25 per 1,000 gallons

Regulatory Assessment Fee1%

A REGULATORY ASSESSMENT, EQUAL TO ONE PERCENT OF THE CHARGE FOR RETAIL WATER SERVICE ONLY, SHALL BE COLLECTED FROM EACH RETAIL CUSTOMER

Section 1.02 - Miscellaneous Fees

TAP FEE \$ 675.00

TAP FEE IS BASED ON THE UTILITY'S ACTUAL COST FOR MATERIALS AND LABOR FOR STANDARD RESIDENTIAL CONNECTION OF 1/2" X 1/2" METER.

RECONNECTION FEE

THE RECONNECT FEE WILL BE CHARGED BEFORE SERVICE CAN BE RESTORED TO A CUSTOMER WHO HAS BEE DISCONNECTED FOR THE FOLLOWING REASONS:

a) Non payment of bill (Maximum \$25.00).....	\$ 25.00
b) Customer's request	\$ 25.00
Or other reasons listed under Section 20CF of this tariff	

TRANSFER FEE \$ 25.00

THE TRANSFER FEE WILL BE CHARGED FOR CHANGING AN ACCOUNT NAME AT THE SAME SERVICE LOCATION WHEN THE SERVICE IS NOT DISCONNECTED.

LATE CHARGE (Not more than \$5.00 or 10%)(Indicate one) \$ 10%

A ONE TIME PENALTY MADE ON DELINQUENT BILLS BUT MAY NOT BE APPLIED TO ANY BALANCE TO WHICH THE PENALTY WAS APPLIED IN A PREVIOUS BILLING.

RETURNED CHECK CHARGE \$ 30.00

CUSTOMER DEPOSIT (Maximum \$50)..... \$ None

METER TEST FEE (actual cost of testing the meter up to)..... \$ 25.00

THIS FEE MAY BE CHARGED IF A CUSTOMER REQUESTS A SECOND METER TEST WITHIN A TWO YEAR PERIOD AND THE TEST INDICATES THAT THE METER IS RECORDING ACCURATELY.

RATES LISTED ARE EFFECTIVE ONLY IF THIS PAGE HAS TCEQ APPROVAL STAMP

EXHIBIT "C"

(ATTACHED)

Double Diamond Utilities Co.
(White Bluff)

(Water Utility Name)

Water Tariff Page No. 2
Revision Date / /

SECTION 1.0 - RATE SCHEDULE

Section 1.01 - Rates

Monthly base rate including 0 gallons

Meter Size:

Residential

5/8" or 3/4"	\$ 31.01
1"	\$ 77.51
1 1/2"	\$ 155.03
2"	\$ 248.04
3"	\$ 465.08
Other: _____"	\$ _____

Gallonge Charge (over Minimum):

0 - 3,000	\$1.59 per 1,000 gallons
3,001 - 10,000	\$2.19 per 1,000 gallons
10,001 - 15,000	\$3.02 per 1,000 gallons
15,001 - 20,000	\$4.17 per 1,000 gallons
20,001 and over	\$5.76 per 1,000 gallons

Regulatory Assessment Fee1%

A REGULATORY ASSESSMENT, EQUAL TO ONE PERCENT OF THE CHARGE FOR RETAIL WATER SERVICE ONLY, SHALL BE COLLECTED FROM EACH RETAIL CUSTOMER

Section 1.02 - Miscellaneous Fees

TAP FEE \$ 675.00

TAP FEE IS BASED ON THE UTILITY'S ACTUAL COST FOR MATERIALS AND LABOR FOR STANDARD RESIDENTIAL CONNECTION OF 1/2" X 1/2" METER

RECONNECTION FEE

THE RECONNECT FEE WILL BE CHARGED BEFORE SERVICE CAN BE RESTORED TO A CUSTOMER WHO HAS BEE DISCONNECTED FOR THE FOLLOWING REASONS:

- a) Non payment of bill (Maximum \$25.00)..... \$ 25.00
 - b) Customer's request \$ 25.00
- Or other reasons listed under Section 20CF of this tariff

TRANSFER FEE \$ 25.00

THE TRANSFER FEE WILL BE CHARGED FOR CHANGING AN ACCOUNT NAME AT THE SAME SERVICE LOCATION WHEN THE SERVICE IS NOT DISCONNECTED

LATE CHARGE (Not more than \$5.00 or 10%)(Indicate one)..... \$ 10%

A ONE TIME PENALTY MADE ON DELINQUENT BILLS BUT MAY NOT BE APPLIED TO ANY BALANCE TO WHICH THE PENALTY WAS APPLIED IN A PREVIOUS BILLING

RETURNED CHECK CHARGE \$ 30.00

CUSTOMER DEPOSIT (Maximum \$50)..... \$ None

METER TEST FEE (actual cost of testing the meter up to)..... \$ 25.00

THIS FEE MAY BE CHARGED IF A CUSTOMER REQUESTS A SECOND METER TEST WITHIN A TWO YEAR PERIOD AND THE TEST INDICATES THAT THE METER IS RECORDING ACCURATELY

RATES LISTED ARE EFFECTIVE ONLY IF THIS PAGE HAS TCEQ APPROVAL STAMP

Volumetric Charge (Per 1,000 gal.)			
0 – 3,000	\$ 2.62	\$ 2.93	\$ 1.59
3,001 – 10,000	3.60	3.38	2.19
10,001 – 15,000	4.98	5.71	3.02
15,001 – 20,000	6.87	9.65	4.17
20,001 +	9.49	16.28	5.76

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VI. DEFERRED ACCOUNTING TREATMENT OF CASH ADVANCES

Q. WITHIN THE APPLICATION THE COMPANY IS REQUESTING DEFERRED ACCOUNTING TREATMENT BY THE COMMISSION FOR CERTAIN EXPENSES. COULD YOU PLEASE EXPLAIN THIS FACET OF THE APPLICATION?

A. Yes. Historically, the parent company of the Utility has provided money to the Utility to cover funding shortfalls in lieu of the Utility applying for rate increases. This action was taken due to the fact that all of the System's were installed in new residential developments which, at the time, had limited customers. Had the Utility chosen to increase rates at the time, the cost of providing service would have been spread over such a small number of customers driving rates up, possibly to levels considered unaffordable. By deferring these costs, rates were held at lower levels allowing the customer base to grow.

Under the agreement between the Utility and its parent, the Utility must pay back the funds used to cover funding shortfalls. However, under the utility basis of revenue requirement determination, without deferred accounting treatment, there is no way for the Utility to recover the necessary funds to repay its parent. As such, DDU is requesting deferred accounting treatment for these monies and is requesting that the Commission

1 authorize the creation of a regulatory asset to allow the Utility to recover these funds as
2 growth occurs on the system on an on-going basis.

3 **Q. HAS THE COMMISSION PREVIOUSLY GRANTED DEFERRED**
4 **ACCOUNTING TREATMENT?**

5 A. Yes. The Commission routinely grants deferred accounting treatment when allowing
6 recovery of rate case expenses per 30 TAC §291.28(7). In the Aqua Texas case,
7 deferred accounting treatment was granted in two instances; first, for rate case expenses
8 and, second, to recover deferred expenses related to the proposed phasing-in of rates.

9 **Q. WHAT IS THE UTILITY'S SPECIFIC REQUEST WITH REGARDS TO THE**
10 **DEFERRED ACCOUNTING TREATMENT OF THE CASH ADVANCES IT**
11 **RECEIVED?**

12 A. Given that all but one of the cash advances was a five (5) year balloon note and matures
13 on or before 12/31/2010, the Utility is requesting deferred accounting treatment through
14 the creation of a regulatory asset in the amount of \$554,319, which is equivalent to the
15 outstanding balance of the cash advances at the beginning of the Test Year, with the asset
16 being amortized over a five (5) year period. The regulatory asset is proposed to be
17 allocated \$284,012 and \$270,307 to the groundwater customer group and surface water
18 customer group, respectively, to recognize which water and wastewater systems benefited
19 from the incurrence of the advance. Finally, these amounts are further allocated to the
20 water and wastewater service functions based on the number of customers specific to
21 each grouping (i.e., groundwater vs. surface water) of customers. The calculations
22 supporting the deferred accounting treatment are contained on Page 22 of Attachment 10
23 to the application.

1 Please note that to recognize the Utility's prior 2006 Test Year water rate application, I
 2 have amortized the regulatory asset beginning in 2006.

3 **VII. RATE BASE / INVESTED CAPITAL**

4 **Q. COULD YOU SUMMARIZE THE LEVEL OF INVESTED CAPITAL**
 5 **PRESENTED IN THE APPLICATION?**

6 A. The level of investor supplied capital presented in the application is summarized in Table
 7 6 below:

Table 6 – Application Level of Investor Supplied Capital			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Net Book Value of Assets	\$ 2,691,631	\$ 625,991	\$ 3,317,622
Working Cash Allowance	64,744	59,100	123,844
Less: Developer Contributions	(1,699,742)	(204,747)	(1,904,489)
Total Investor Supplied Capital	\$ 1,056,633	\$ 480,344	\$ 1,536,977

8
 9 **Q. COULD YOU ALSO PLEASE PROVIDE A SUMMARY OF THE ORIGINAL**
 10 **COST, ACCUMULATED DEPRECIATION, ANNUAL DEPRECIATION, AND**
 11 **NET BOOK VALUE FOR ASSETS PRESENTED WITHIN THE APPLICATION?**

12 A. The original cost, accumulated depreciation, annual depreciation, and net book value of
 13 water assets presented in the application are summarized in Table 7 below:

Table 7 – Application Rate Base Summary			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Original Cost	\$ 3,260,334	\$ 961,808	\$ 4,222,142
Accumulated Depreciation	(568,703)	(335,817)	(904,520)
Net Book Value	\$ 2,691,631	\$ 625,991	\$ 3,317,622
Annual Depreciation	\$ 117,281	\$ 81,214	\$ 198,495

14

1 Q. YOU TESTIFIED EARLIER THAT TCEQ STAFF RECOMMENDED THAT
2 DDU PERFORM AN ASSET EVALUATION IN SUPPORT OF ITS REQUESTED
3 RATE BASE. IS THIS CORRECT?

4 A. Yes. That is my understanding.

5 Q. COULD YOU PLEASE EXPLAIN THE IMPACT THE ASSET EVALUATION
6 HAS ON THE NUMBERS YOU PRESENTED IN TABLE 7 ABOVE?

7 A. Based on the numbers presented by Dr. Harkins, DDU's rate base is greater than what
8 was originally presented in the application.

9 Q. CAN YOU PLEASE QUANTIFY THE INCREASE IN RATE BASE RESULTING
10 FROM THE WORK PERFORMED BY DR. HARKINS?

11 A. Schedule CDE-5 (Exhibit DDU-23) presents the requested quantification

12 Q. HAVE YOU PERFORMED A COMPARISON BETWEEN THE ASSETS
13 PRESENTED IN THE APPLICATION AND THE ASSET LISTING
14 DEVELOPED THROUGH THE CONDUCT OF THE ASSET EVALUATION?

15 A. Yes. This comparison is contained in Schedule CDE-6 (Exhibit DDU-24).

16 Q. BASED ON THE NUMBERS PRESENTED BY DR. HARKINS, COULD YOU
17 PLEASE PROVIDE A SUMMARY OF DDU'S REQUESTED RATE BASE?

18 A. Table 8 below presents a summary of DDU's requested rate base as a result of the Asset
19 Evaluation:

1

Table 8 – Requested Water Rate Base Resulting from Asset Evaluation			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Original Cost	\$ 4,933,188	\$ 1,340,448	\$ 6,273,636
Accumulated Depreciation	(1,084,759)	(436,501)	(1,521,260)
Net Book Value	\$ 3,848,429	\$ 903,947	\$ 4,752,376
Annual Depreciation	\$ 185,223	\$ 73,069	\$ 258,291

2

3 **Q. BASED ON THE WORK PERFORMED BY DR. HARKINS, ARE THERE**
 4 **OTHER IMPACTS TO THE UTILITY'S LEVEL OF INVESTED CAPITAL**
 5 **PRESENTED IN THE APPLICATION?**

6 A. Yes. The level of working cash allowance is impacted as well as the level of developer
 7 contributions.

8 **Q. PLEASE EXPLAIN THE IMPACT ON THE UTILITY'S WORKING CASH**
 9 **ALLOWANCE?**

10 A. In accordance with 30 TAC §291.31(c)(2)(B)(iii), DDU's requested working cash
 11 allowance is set equivalent to 1/8th of its operations and maintenance ("O&M") expenses.
 12 However, Dr. Harkins has identified some expenses during the Test Year which should
 13 have been capitalized by the utility, instead of included as an O&M expense. By
 14 capitalizing these items into rate base, the utility's operations and maintenance expenses
 15 are decreased and, as a result, the level of working cash allowance must also be
 16 decreased.

17 Additionally, as will be discussed later, some of the O&M expenses within the
 18 application have been allocated to the respective water and sewer utilities based on
 19 original cost of plant investment. Including the original cost resulting from the Asset

1 Evaluation alters the allocation of expenses between the water and sewer utility, further
2 impacting O&M expenses and the working cash allowance.

3 **Q. CAN YOU PLEASE QUANTIFY THE IMPACT TO WORKING CASH**
4 **ALLOWANCE?**

5 A. Table 9 shows the reduction in operations and maintenance expense and the resulting
6 reduction in the Utility's requested working cash allowance:

Table 9 - Impact to Working Cash Allowance from Asset Evaluation			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Application level of O&M Expense	\$ 517,955	\$472,797	\$990,751
Working Cash Allowance (1/8 th O&M)	\$64,744	\$59,100	\$123,844
Adjusted level of O&M Expense (based on Asset Evaluation)	\$ 414,046	\$ 370,099	\$ 784,145
Working Cash Allowance (1/8 th O&M)	\$ 51,756	\$ 46,262	\$ 98,018
Reduction in O&M Expense	\$ (103,909)	\$ (102,697)	\$ (206,606)
Reduction in Working Cash Allowance	\$ (12,988)	\$ (12,838)	\$ (25,826)

7

8 **Q. PLEASE EXPLAIN HOW THE LEVEL OF DEVELOPER CONTRIBUTIONS**
9 **IDENTIFIED WITHIN THE APPLICATION IS IMPACTED BY THE ASSET**
10 **EVALUATION PERFORMED BY DR. HARKINS?**

11 A. It is my understanding that it has been the practice of the Utility's Parent Company to pay
12 for 80% of the initial assets, including all distribution mains and lines, during the
13 construction of a water and sewer system. The remaining 20% was then paid by the
14 Utility. Beyond initial construction, all assets and maintenance are funded 100% by the
15 Utility. To determine the appropriate level of these contributions by the parent company,

1 Mr. Gracy has identified those assets, subject to the 80% payment by the parent company
 2 from the asset listing produced by Dr. Harkins. This listing is presented herein as
 3 Schedule CDE-7 (Exhibit DDU-25).

4 **Q. CAN YOU PLEASE QUANTIFY THE IMPACT OF THIS ADJUSTMENT TO**
 5 **DEVELOPER CONTRIBUTIONS?**

6 A. Table 10 illustrates the total Parent Company contributed assets contained within the
 7 application as compared to the amount identified by Mr. Gracy resulting from the asset
 8 evaluation.

Table 10 – Impact of Asset Evaluation of Developer Contributed Capital			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Application Value	\$ 1,699,742	\$ 204,747	\$ 1,904,489
Adjusted Values (as identified by Mr. Gracy)	2,222,479	329,195	2,551,674
Variance	\$ 522,737	\$ 124,448	\$ 647,185

9

10 **Q. PLEASE SUMMARIZE THE UTILITY’S LEVEL OF INVESTED CAPITAL**
 11 **BASED ON THE RESULTS OF THE ASSET EVALUATION?**

12 A. Table 11 below presents the requested level of invested capital in accordance with the
 13 results of the Asset Evaluation.

Table 11 –Asset Evaluation Level of Investor Supplied Capital			
	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Net Book Value of Assets	\$ 3,848,429	\$ 903,947	\$ 4,752,376
Working Cash Allowance	51,756	46,262	98,018
Less: Developer Contributions	(2,222,479)	(329,195)	(2,551,674)
Total Investor Supplied Capital	\$ 1,677,709	\$ 621,014	\$2,298,720

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VIII. RATE OF RETURN

Q. WHAT RATE OF RETURN IS DDU REQUESTING IN THIS APPLICATION?

A. As illustrated on Table IV.D of the application, DDU is requesting a rate of return of 10.99%. This rate of return is predicated on the Parent Company’s capital structure of 50.47% debt and 49.53% equity, with a return on equity (“ROE”) of 12.00% and a cost of debt of 10.00%.

Q. WHAT RULES GOVERN THE DETERMINATION OF A FAIR RATE OF RETURN FOR THE UTILITY IN THIS PROCEEDING?

A. Texas Water Code §13.183 through §13.185, and the Texas Administrative Code, at 30 TAC §291.31, speak to the determination of a fair rate of return for a utility. Specifically, 30 TAC 291.31(c)(1)(a) states that “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.”

A. Capital Structure

Q. YOU TESTIFIED EARLIER THAT DDU HAS USED ITS PARENT COMPANY’S CAPITAL STRUCTURE IN THE DETERMINATION OF DDU’S REQUESTED RATE OF RETURN. CAN YOU EXPLAIN WHY DDU IS REQUESTING TO USE ITS PARENT COMPANY CAPITAL STRUCTURE IN CALCULATING RATE OF RETURN?

A. DDU is a wholly-owned subsidiary of DDD and currently does not obtain capital from the financial markets. DDU depends completely on its parent company for its capital

1 financing needs. As such, DDU is requesting to utilize the capital structure of its parent
2 company in this proceeding.

3 **Q. HOW WAS THE CAPITAL STRUCTURE EMPLOYED IN THE APPLICATION**
4 **DEVELOPED?**

5 A. As DDU's only source of capital is its parent company, DDD, DDD's capital structure, as
6 contained within its 2007 audited financial statements, has been utilized in the
7 application. DDD's capital structure as of December 31, 2007 is summarized in Table 12
8 and is further detailed in Attachment 8 of the application:

Table 12 – Double Diamond Delaware Capital Structure			
Debt Component			
Notes Payable to Affiliates		\$ 100,000	
Notes Payable		113,897,749	
Debt Subtotal		<u>\$ 113,997,749</u>	50.47%
Equity Component			
Total Shareholder's Equity		\$ 111,852,358	
Equity Subtotal		<u>111,852,358</u>	49.53%
Total		<u>\$ 225,850,107</u>	100.00%

9

10 **Q. HAS THE COMMISSION PERMITTED OTHER UTILITIES TO ASSUME THE**
11 **PARENT COMPANY CAPITAL STRUCTURE IN DETERMINING RATE OF**
12 **RETURN?**

13 A. Yes. In SOAH Docket Nos. 582-05-2770 and 582-05-2771, Aqua Texas was permitted
14 to assume the capital structure of its parent, Aqua America, as its hypothetical capital
15 structure. Specifically, in the PFD in that proceeding, the ALJs stated:

1 “The proper method for determining the appropriate overall weighted rate of
2 return involves combining and averaging Aqua Texas’ cost of debt and the rate of
3 return shareholders are entitled to earn on common equity in the company. In this
4 case, it is not straightforward to determine Aqua Texas’ capital structure, because
5 the operating utilities are wholly owned subsidiaries of a parent company. They
6 have no debt or equity in their own names. Rather, they propose to use the capital
7 structure of their parent corporation in calculating a rate of return in this case.
8 The ALJs find this is appropriate.”³
9

10 The Commission ultimately agreed with the ALJs in the adoption of the Final Order. The
11 use of the parent Company’s capital structure was also requested by Monarch Water
12 Utilities, Inc., a division of Southwest Water Inc., in SOAH Docket No. 582-08-1341;
13 TCEQ Docket No. 2007-1896-UCR. This case reached settlement prior to a contested
14 case hearing before the Commission.

15 **Q. IS THERE INDUSTRY PRECEDENT ON THE USE OF THE PARENT**
16 **COMPANY CAPITAL STRUCTURE IN DETERMINING RATE OF RETURN?**

17 **A.** Yes. The American Water Works Association (“AWWA”) M1 Manual, at Page 41,
18 states “If the water utility is a subsidiary of another company (holding company), the
19 parent company’s capital structure may be deemed to provide the appropriate weighting
20 of the costs of capital.”⁴

³ Proposal for Decision, SOAH Docket Nos. 582-05-2770 and 582-05-2771. Page 62

⁴ American Water Works Association, Manual of Water Supply Practices, Principles of Water Rates, Fees, and Charges, “AWWA M1”, Fifth Edition

1 **B. Cost of Debt**

2 **Q. YOU PREVIOUSLY TESTIFIED THAT 10% WAS USED AS THE COST OF**
3 **DEBT IN THE APPLICATION. HOW WAS THIS AMOUNT DETERMINED?**

4 A. The 10% cost of debt contained within the application is based on a review of the
5 comparable interest rates on debt issued to the Utility from financial institutions and its
6 Parent Company. Specifically, In 2000, DDU received a loan from RDO Financial at
7 10.9% for equipment purchases and from the Bank of Whitney at 10.50% for capital
8 investment. Both of these notes were paid off prior to the Test Year. As of the Test
9 Year, all capital needs of DDU are met by DDD and carry a 10% interest rate. 10%
10 represents the lowest interest rate on any of the Utility’s past and current debt.

11 **C. Cost of Equity**

12 **Q. YOU PREVIOUSLY TESTIFIED THAT 12% WAS USED AS THE COST OF**
13 **EQUITY IN PREPARING THE APPLICATION. IS THIS CORRECT?**

14 A. Yes.

15 **Q. HOW WAS THE 12% COST OF EQUITY ARRIVED AT?**

16 A. The 12% cost of equity represents the presumptive cost of equity historically granted by
17 the TCEQ in contested rate proceedings. In SOAH Docket No. 582-03-2283, *Appeal of*
18 *Tall Timbers Utility Company, Inc. to Review the Rate Making Actions of the City of*
19 *Tyler*, the “ED argued that 12% is the cost of equity recommended by the ED in rate of
20 return calculations” The PFD in this case goes on to state that “this presumptive 12%
21 cost of equity has been accepted by the ED since at least January 2001 . . .”⁵. Further, to

⁵ Proposal for Decision, SOAH Docket No. 582-03-2283, Page 30.

1 my knowledge, a 12% cost of equity has been granted in all but one contested investor-
2 owned water utility proceeding in the state since at least 2001. The Commission orders
3 granting a 12% return on equity include:

- 4 • SOAH Docket No. 582-03-2283, *An Order on Appeal of Tall Timbers Utility*
5 *Company, Inc. to Review the Ratemaking Actions of the City of Tyler for Sewer/Tariff*
6 *Increase in Smith County Sewer CCN 20694*
- 7 • SOAH Docket No. 582-05-7838, *An Order setting Retail Water Rates for Don M.*
8 *Bryant d/b/a Buena Vista Water System, Under CCN No. 11656*
- 9 • SOAH Docket No. 582-03-3827, *An Order approving the Applications of North*
10 *Orange Water & Sewer LLC., to Change Water and Sewer Rates*
- 11 • SOAH Docket No. 582-97-0899, *An Order Setting Retail Sewer Rates for*
12 *Tanglewood Water Company, Inc.*
- 13 • SOAH Docket No. 582-04-6463, *An Order Setting Retail Water Rates for WaterCo.,*
14 *Inc., under CCN 10130 in Trinity and Walker Counties*
- 15 • SOAH Docket Nos. 582-05-2770 and 582-05-2771, *An Order approving the*
16 *Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua*
17 *Texas, Inc. to Change Water and Sewer Rates.*

18 **Q. DID YOU COMPLETE THE RATE OF RETURN WORKSHEET ASSOCIATED**
19 **WITH THE RATE FILING PACKAGE INSTRUCTIONS?**

20 A. The Rate of Return worksheet was completed and is included herein as Exhibit DDU-18.

21 **Q. WHAT RETURN ON EQUITY RESULTED FROM THE COMPLETION OF**
22 **THE WORKSHEET?**

23 A. 11.45%

1

2 Q. WHAT IN YOUR OPINION WOULD BE THE IMPACT IF DDU WAS
3 GRANTED A 11.45% RETURN ON EQUITY AS OPPOSED TO THE 12%
4 RETURN ON EQUITY HISTORICALLY APPROVED BY THE COMMISSION?

5 A. The granting of an 11.45% return over the 12% historically approved by the Commission
6 would be a direct violation of the key ratemaking standards established by the U.S.
7 Supreme Court in the *Bluefield* and *Hope* decisions, as summarized below:

8 A public utility is entitled to such rates as will permit it to earn a return on the
9 value of the property which it employs for the convenience of the public equal to
10 that generally being made at the same time and in the same general part of the
11 country on investments in other business undertakings which are attended by
12 corresponding risks and uncertainties; but it has no constitutional right to profits
13 such as are realized or anticipated in highly profitable enterprises or speculative
14 ventures.⁶ (*emphasis added*)

15 From the investor or company point of view, it is important that there be enough
16 revenue not only for operating expenses, but also for the capital costs of the
17 business. These include service on the debt and dividends of the stock. By that
18 standard the return to the equity owner should be commensurate with returns on
19 investments in other enterprises having corresponding risks. That return,
20 moreover, should be sufficient to assure confident in the financial integrity of the
21 enterprise, so as to maintain its credit and to attract capital.⁷
22
23

24 The presumptive 12% return on equity represents the Commission's determination of the
25 returns available on investments of similar risk within the State of Texas. Further, if
26 DDU is not allowed a 12% return, it would diminish the utility's ability to attract capital
27 as investors have come to rely on the Commission's 12% presumptive return. Failure to

⁶ *Bluefield Water Works v Public Service Commission*, 262 U.S. 679 (1923)

⁷ *Federal Power Commission v Hope Natural Gas Co.*, 320 U.S. 591 (1944)

1 grant a 12% return on equity would represent an unreasonable return and which would be
2 discriminatory on DDU and could potentially erode the financial stability of the utility.

3 **Q. IN YOUR OPINION, DOES THE RATE OF RETURN GENERATED BY**
4 **COMPLETING THE RATE OF RETURN WORKSHEET COMPLY WITH THE**
5 **PRINCIPLES AS IDENTIFIED IN THE HOPE AND BLUEFIELD DECISIONS?**

6 A. No, it does not.

7 **Q. PLEASE EXPLAIN.**

8 A. The *Hope* and *Bluefield* decisions require that a rate of return (1) be comparable to the
9 same or similar business ventures in the same general geographic location with the same
10 attendant risks, and (2) preserve the Company's ability to attract capital. The rate of
11 return worksheet does not take into account either of these principles. Instead, the
12 worksheet relies on primarily qualitative, and in some cases subjective, criteria to
13 produce a quantitative result which does not account for the financial condition of the
14 Utility.

15 **IX. INCOME TAXES**

16 **Q. COULD YOU PLEASE EXPLAIN HOW INCOME TAXES WERE**
17 **CALCULATED IN THE APPLICATION?**

18 A. Income taxes have been calculated per the methodology contained in the application. A
19 35% federal income tax rate has been used for purposes of calculating income tax.

1 X. OPERATIONS AND MAINTENANCE EXPENSES

2 Q. WHAT DO TCEQ RULES ALLOW TO BE INCLUDED IN A RATE
3 APPLICATION AS OPERATIONS AND MAINTENANCE EXPENSE?

4 A. 30 TAC §291.31(A) states that the cost of service may include “operations and
5 maintenance expense incurred in furnishing normal utility service and in maintaining
6 utility plant used by and useful to the utility in providing such service . . .”

7 Q. CAN YOU PLEASE SUMMARIZE THE LEVEL OF OPERATIONS AND
8 MAINTENANCE EXPENSE PRESENTED IN THE APPLICATION?

9 A. Table 13 below presents the requested summary:

Table 13 – Summary of O&M Expenses Presented in Application			
<u>TCEQ Category</u>	<u>Groundwater</u>	<u>Surface Water</u>	<u>Total</u>
Salaries and Wages	\$ 131,082	\$ 98,301	\$ 229,384
Contract Labor	2,824	3,633	6,456
Purchased Water	0	10,846	10,846
Chemicals	5,048	5,001	10,050
Utilities	104,288	27,961	132,249
Repairs / Maintenance / Supplies	177,796	209,927	387,723
Office Expenses	4,440	5,122	9,562
Accounting & Legal Fees	10,100	18,674	28,774
Insurance	18,475	10,005	28,479
Miscellaneous	63,902	83,326	147,228
Total O&M	\$ 517,955	\$ 472,796	\$ 990,751

10

11 Q. HOW WAS THE REQUESTED LEVEL OF OPERATIONS AND
12 MAINTENANCE EXPENSE DETERMINED FOR THE APPLICATION?

13 A. The requested level of Operations and Maintenance (“O&M”) expense included in the
14 application is derived from the DDU Statement of Operations and detailed Trial Balance
15 for the Test Year.

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— ~~“The ALJs, however, believes that the test year / snapshot approach is inconsistent with the Legislature’s strong preference for regionalization, because it would make it exceedingly difficult to consolidate tariffs. TWC § 13.183(e) places the goal of ‘encouraging regionalization’ on par with the most fundamental rate setting goals of the Commission — ensuring high quality, affordable, reliable water and sewer service, and the financial integrity of the state’s utilities. These goals are so important that Section 13.183(e) authorizes the Commission to facilitate them through ratemaking methodologies beyond the normal parameters for ratemaking.” (Page 24, emphasis added)~~

— ~~“It is significant that regionalization is mentioned as equivalent with the Commission’s fundamental goals in water and sewer ratemaking, because the Protestants have argued that any legislative preference for regionalization does not include the concept of spreading system costs over all customer in the region. . . . The ALJs . . . find that there is nothing . . . that supports the proposition that regional tariffs should not have the goal of spreading system costs over the region.” (Pages 24-25)~~

— ~~“The ED and Aqua Texas assert that the sharing of high costs of investment and maintenance by all the systems in a region is exactly the point of regionalization, resulting in revenue stability for the utility and the avoidance of rate shock for customers. The ALJs find that such cost sharing is consistent with the goals of rate setting outlined in TWC §13.183(e).” (Page 25, emphasis added)~~

— ~~“There is little system-specific information on the factors in Section 13.145(a)(1). It is for this reasons that the Protestants and OPIC generally argue that Aqua Texas failed to meet its burden under that statute. Whether cost of service studies were conducted is somewhat moot, though, because Aqua Texas admits that many systems would appear dissimilar if they had done so and compare the systems as Protestants propose. Even more telling, Protestants’ own expert acknowledges that using cost of service studies would render the same system substantially different from itself from year to year.” (Page 34)~~

— ~~“The ALJs do not believe that substantial similarity means that you line up the systems next to each other, each test year, and that they must all be ‘practically the same.’ There will always be differences between systems, it is a matter of whether there are substantial differences under Section 13.145.” (Page 42-43)~~

1 ~~Q. COULD YOU PLEASE PROVIDE A SUMMARY OF THE KEY ASPECTS OF~~
2 ~~THE ALJ'S DISCUSSION WHICH PROVIDED A BASIS FOR THE~~
3 ~~COMMISSION'S APPROVAL OF CONSOLIDATED RATES IN THE~~
4 ~~AFOREMENTIONED PROCEEDING?~~

5 ~~A. In summary, the following important points can be taken from the above discussion:~~
6 ~~Substantial similarity between systems must be determined over time;~~
7 ~~One goal of regionalization is the spreading of costs over systems in a region;~~
8 ~~A cost of service study cannot be used to determine substantial similarity as it~~
9 ~~merely highlights the differences between systems.~~

10 ~~Q. WHAT IS YOUR UNDERSTANDING AS TO WHY DDU IS SEEKING TO~~
11 ~~CONSOLIDATE THE WHITE BLUFF AND THE RETREAT SYSTEMS UNDER~~
12 ~~A SINGLE RATE?~~

13 ~~A. It is my understanding that since the amendment to DDU's CCN in approximately 2003~~
14 ~~to include The Retreat, both White Bluff and The Retreat customers have paid the same~~
15 ~~rates. DDU seeks the continuation of this practice as both are groundwater systems~~
16 ~~subject to the administration of the same groundwater conservation district. On the other~~
17 ~~hand, The Cliffs, which is a surface water system, is substantially different from The~~
18 ~~Retreat and/or White Bluff. Finally, TWC § 13.189(b) states "a utility may not establish~~
19 ~~and maintain any unreasonable differences as to rates of service either as between~~
20 ~~localities or as between classes of service." Given that The Retreat and White Bluff are~~
21 ~~substantially similar systems providing same or similar service, consolidating these~~
22 ~~systems under a single rate complies with this provision of the Texas Water Code.~~

1 ~~Q. YOU TESTIFIED EARLIER AS TO THE REQUIREMENTS FOR~~
2 ~~CONSOLIDATION PURSUANT TO THE TEXAS WATER CODE REGARDING~~
3 ~~THE SIMILARITY OF SYSTEMS. IN YOUR OPINION, ARE THE FACILITIES~~
4 ~~AT WHITE BLUFF AND THE RETREAT SUBSTANTIALLY SIMILAR?~~

5 ~~A. Yes. Both are groundwater systems, located within the Prairielands Groundwater~~
6 ~~Conservation District and are, or will be, subject to the District's jurisdiction regarding~~
7 ~~groundwater production. These systems both meet the minimum water system design~~
8 ~~standards of the TCEQ. Both possess ground storage tanks, pressure tanks, and the~~
9 ~~necessary distribution mains, lines, and customer services to provide continuous and~~
10 ~~adequate service to customers. Both systems use chlorination for water treatment.~~

11 ~~Q. HAS THE ED'S STAFF TAKEN A POSITION ON THE SUBSTANTIAL~~
12 ~~SIMILARITY OF THE FACILITIES AT THESE TWO SYSTEMS?~~

13 ~~A. Yes. In his testimony in SOAH Docket No. 582-08-0698, Mr. Brian Diekey testified at~~
14 ~~Page 4 of 17, Lines 13-14 that "the two systems [White Bluff and The Retreat] do appear~~
15 ~~to have substantially similar facilities." He goes on to state "both systems utilize~~
16 ~~groundwater, pressure tanks, ground storage tanks, and distribution lines."~~

17 ~~Q. AS ANOTHER REQUIREMENT OF THE TEXAS WATER CODE, IS IT YOUR~~
18 ~~OPINION THAT THE QUALITY OF SERVICE PROVIDED AT WHITE BLUFF~~
19 ~~AND THE RETREAT IS SUBSTANTIALLY SIMILAR?~~

20 ~~A. Yes. Both systems provide water that meets at least the minimum service standards~~
21 ~~required under TCEQ rules. Further, as I have previously testified, the waters utilized by~~
22 ~~both systems are governed by the same groundwater conservation district.~~

23

1 ~~Q. HAS THE ED'S STAFF TAKEN A POSITION ON THE SUBSTANTIAL~~
 2 ~~SIMILARLITY OF THE QUALITY OF SERVICE PROVIDED AT WHITE~~
 3 ~~BLUFF AND THE RETREAT?~~

4 ~~A. Yes. In his testimony referenced earlier, Mr. Diekey states at Page 4 of 17, Lines 13-14,~~
 5 ~~"the two systems [White Bluff and The Retreat] do appear to have [a] substantially~~
 6 ~~similar . . . quality of service."~~

7 ~~Q. AS ANOTHER REQUIREMENT OF THE TEXAS WATER CODE, IS IT YOUR~~
 8 ~~OPINION THAT THE CURRENT RATES AND THE REQUESTED RATES AT~~
 9 ~~WHITE BLUFF AND THE RETREAT PROMOTE WATER CONSERVATION~~
 10 ~~FOR SINGLE-FAMILY RESIDENCES AND LANDSCAPE IRRIGATION.~~

11 ~~A. Yes. Both the current and requested rates at White Bluff and The Retreat include an~~
 12 ~~inclining block volumetric charge and no gallons included within the base rate.~~
 13 ~~According to the Texas Water Conservation Implementation Task Force ("TWCITF"),~~
 14 ~~which was charged by the 78th Texas Legislature through Senate Bill 1094 to evaluate~~
 15 ~~matters regarding water conservation in the state, conservation pricing structures "include~~
 16 ~~increasing unit prices with increased consumption."¹ Further, the TWCITF also~~
 17 ~~recognized that minimum monthly water allotments may work counter to conservation~~
 18 ~~and, therefore, are not recommended.² As such, DDU has not included any gallons~~
 19 ~~within the minimum bill of its requested rate structure.~~
 20

¹ Water Conservation Implementation Task Force, Water Conservation Best Management Practices Guide, Texas Water Development Board Report 362, November 2004, Pg. 19

² Ibid, Pg. 19

1 ~~Q. DOES THE ED'S STAFF AGREE THAT THE USE OF INCLINING BLOCK~~
2 ~~VOLUMETRIC WATER RATES PROMOTE WATER CONSERVATION?~~

3 ~~A. Yes. In his testimony in SOAH Docket No. 582-08-0698, at Page 4 of 17, Lines 17-18,~~
4 ~~the ED's witness Mr. Diekey stated that an "inclining block rate[s]" generally~~
5 ~~promotes water conservation for single family residences and landscape irrigation."~~

6 ~~Q. IS IT YOUR OPINION THAT THE TEXAS WATER CODE REQUIREMENT~~
7 ~~CONCERNING SUBSTANTIAL SIMILARITY REGARDING COST OF~~
8 ~~SERVICE IS MET UNDER THIS APPLICATION?~~

9 ~~A. Yes. The cost of service at White Bluff and The Retreat is substantially similar.~~

10 ~~Q. ON WHAT IS YOUR OPINION BASED?~~

11 ~~A. My opinion is based on Commission precedent concerning the standards for determining~~
12 ~~substantial similarity in cost of service.~~

13 ~~Q. PLEASE EXPLAIN HOW, IN YOUR OPINION, THE COST OF SERVICE AT~~
14 ~~WHITE BLUFF AND THE RETREAT ARE SUBSTANTIALLY SIMILAR?~~

15 ~~A. According to 30 TAC § 291.31, components of cost of service include operations and~~
16 ~~maintenance expenses, depreciation, income taxes, and a reasonable rate of return. In all~~
17 ~~these areas, White Bluff and The Retreat are substantially similar when viewed over time.~~
18 ~~As testified to by Dr. Harkins, the original cost of water plant investment at White Bluff~~
19 ~~and The Retreat is approximately \$3.0 million and \$1.7 million, respectively. Based on~~
20 ~~information provided by Mr. Gracy, and included herein as Exhibit DDU-17 and~~
21 ~~presented in Table 4 below, the White Bluff subdivision consists of 3,263 acres while~~
22 ~~The Retreat subdivision consists of 3,034 acres. Further, the White Bluff subdivision~~
23 ~~currently has 6,314 lots platted while The Retreat subdivision has 1,931 lots platted.~~

1 ~~When examining the ratio of lots to acres platted, there are approximately 2.16 lots per~~
 2 ~~acre at White Bluff (6,314 lots / 2,918 acres) and 1.69 lots per acre at The Retreat (1,931~~
 3 ~~lots / 1,145 acres). Assuming this represents the average development density for each~~
 4 ~~subdivision, the White Bluff system will ultimately serve approximately 7,048 lots (2.16~~
 5 ~~lots per acre x 3,263 acres) while The Retreat system will ultimately serve approximately~~
 6 ~~5,127 lots (1.69 lots per acre x 3,034 acres). Given the number of lots, the cost of~~
 7 ~~original water plant investment is approximately \$437 and \$332 per lot at full~~
 8 ~~development for White Bluff and The Retreat, respectively.~~

Table 4— Comparison of Original Plant Investment per Lot		
	<u>The Retreat</u>	<u>White Bluff</u>
Total Acreage		
—Platted	1,145	2,918
—Not Developed	1,889	345
Total Acreage	3,034	3,263
Total Lots Platted	1,931	6,314
Ratio of Lots to Acres Platted	1.69	2.16
Total Lots at Full Development	5,127	7,048
Total Original Cost of Plant Investment	\$1,700,104	\$ 3,080,532
Investment per Lot at Full Development	\$331.60	\$437.08

9

10 ~~As The Retreat is the less developed subdivision, it follows that plant investment will~~
 11 ~~presently be lower, but will grow over time. In other words, the above analysis indicates~~
 12 ~~that the plant investment per lot at White Bluff and The Retreat will be substantially~~
 13 ~~similar when viewed over time at full development.~~

14

15

1 ~~Given that the systems are substantially similar in facilities and the level of original cost~~
2 ~~investment is substantially similar, it follows that, over time, the fixed operations and~~
3 ~~maintenance costs of each system will also be similar.~~

4 ~~Further, given that the systems utilize similar facilities, as previously testified to by~~
5 ~~TCEQ staff, it would follow that the annual depreciation expense on the systems will be~~
6 ~~substantially similar over time as the depreciable lives of the systems are both set~~
7 ~~according to the TCEQ system of accounts.~~

8 ~~Finally, return on investment in the two systems will also be the same over time as the~~
9 ~~rate of return requested by the Utility is applicable to both systems. Further, as income~~
10 ~~tax is derived directly from the rate of return, it will also be substantially similar between~~
11 ~~the two systems over time.~~

12 ~~Q. WHAT, IN YOUR OPINION, IS THE ADVANTAGE OF SYSTEM~~
13 ~~CONSOLIDATION TO THE WHITE BLUFF AND THE RETREAT~~
14 ~~RATEPAYERS?~~

15 ~~A. By consolidating rates at White Bluff and The Retreat, the long term cost of providing~~
16 ~~service and performing capital investment can be spread over a larger number of~~
17 ~~customers. Prospectively over time, this results in potentially lower and more stable rates~~
18 ~~for both groups of customers as the unit cost of providing service and performing capital~~
19 ~~investment is lower than what might be experienced for each system individually in the~~
20 ~~long term.~~

1 Q. WHILE YOU HAVE TESTIFIED THAT COST OF SERVICE SIMILIARILTY
 2 MUST BE VIEWED OVER TIME, FOR PURPOSES OF THIS APPLICATION,
 3 HAVE YOU DEVELOPED THE COST OF SERVICE FOR EACH INDIVIDUAL
 4 SYSTEM FOR THE TEST YEAR?

5 A. Yes. Schedule CDE-3 (Exhibit DDU-21) presents the cost of service and revenue
 6 requirement developed for each individual system for the Test Year and reflecting the
 7 results of the Asset Evaluation performed by Dr. Harkins. However, I would again
 8 reiterate, as found in the Aqua Texas case, that the cost of service developed for a single
 9 year will only serve to highlight the differences in systems and does not assist in viewing
 10 similarity over time as required by Commission precedent.

11 Q. HAVE YOU ALSO CALCULATED THE RATES REQUIRED FROM EACH
 12 SYSTEM ON A STAND-ALONE OR NON-CONSOLIDATED BASIS TO
 13 ACHIEVE THE UTILITY'S REQUESTED REVENUE REQUIREMENT?

14 A. Yes. Table 5 below presents the rates required on a stand-alone basis to achieve the
 15 requested revenue requirement as adjusted to reflect the results of the asset evaluation.
 16 Proof of revenue generated under the illustrated rates below is also contained in Schedule
 17 CDE-4 (Exhibit DDU-22).

Table 5- Summary of Non-Consolidated Rates			
	<u>The Retreat</u>	<u>The Cliffs</u>	<u>White Bluff</u>
Meter Charge			
5/8"	\$ 51.07	\$ 58.60	\$ 31.01
1"	127.67	146.50	77.51
1 1/2"	255.34	293.00	155.03
2"	408.55	468.80	248.04
3"	766.03	879.00	465.08

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ARMBRUST & BROWN, PLLC
ATTORNEYS AND COUNSELORS

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CHIEF CLERKS OFFICE

AMY L. LOERA
(512) 435-2375
aloera@abaustin.com

October 14, 2010

VIA HAND DELIVERY

Richard Wilfong
Administrative Law Judge
State Office of Administrative Hearings
300 W. 15th Street, Suite 502
Austin, Texas 78701

Re: SOAH Docket No. 582-09-4288; TCEQ Docket No. 2009-0505-UCR; Application of Double Utilities Company, Inc. to Change Water Rate Tariff for Service in Hill, Palo Pinto, and Johnson Counties

Dear Judge Wilfong:

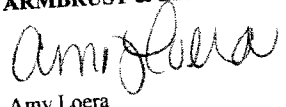
Enclosed for filing in the above referenced case is a Joint Motion to Withdraw Testimony and Stipulate Agreed Rates for the White Bluff and The Retreat Subdivisions.

Please acknowledge receipt of the above by file-stamping the extra copy of this letter, and return to me via courier.

Thank you for your attention to this matter. If you have any questions, please do not hesitate to contact me.

Sincerely,

ARMBRUST & BROWN, PLLC



Amy Loera
Legal Secretary to John J. Carlton

Enclosure

cc: TCEQ Chief Clerk
Stefannie Skogen
Shari Heino
James B. Murphy
Phillip Day:
Jack D. McCartney & John T. Bell

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SOAH DOCKET NO. 582-09-4288

TCEQ DOCKET NO. 2009-0505-UCR

CHIEF CLERKS OFFICE

APPLICATION OF DOUBLE
DIAMOND UTILITIES COMPANY,
INC. TO CHANGE WATER RATE
TARIFF FOR SERVICE IN HILL, PALO
PINTO, AND JOHNSON COUNTIES

§
§
§
§
§
§
§

BEFORE THE STATE OFFICE

OF

ADMINISTRATIVE HEARINGS

**JOINT MOTION TO WITHDRAW TESTIMONY AND STIPULATE AGREED RATES
FOR THE WHITE BLUFF AND THE RETREAT SUBDIVISIONS**

TO THE HONORABLE ADMINSTRATIVE LAW JUDGE:

Double Diamond Utilities, Co. ("DDU"), The Retreat Homeowners Group ("TRHG") and Lou Storm, John Bass, Karen Williams, Thomas Gibson and John Weatherman (collectively, the "WBSR"), (DDU, TRHG, and WBSR collectively referred to as the "Parties") file this Joint Motion to Withdraw Testimony and Stipulate Agreed Rates for the White Bluff and The Retreat subdivisions. The Executive Director of Texas Commission on Environmental Quality ("ED") and the Office of Public Interest Counsel of the Texas Commission on Environmental Quality ("OPIC") have reviewed the agreed upon rates and have no objections to issuance of an order imposing those rates within the White Bluff and The Retreat subdivisions.

**I.
BACKGROUND**

DDU and TRHG entered into an agreement as of July 21, 2010 settling their disputes regarding this proceeding and SOAH Docket No. 582-09-6112 and TCEQ Docket No. 2009-1264-UCR, which relate to sewer utility rates ("Sewer Docket"). DDU also entered into an agreement with WBSR effective June 25, 2010 regarding rates under this proceeding and the Sewer Docket.

The parties to this motion now desire to withdraw certain testimony and pleadings that have been filed in this proceeding and stipulate to certain rates for The Retreat subdivision and the White Bluff subdivision.

**II.
WITHDRAWAL OF TESTIMONY**

A. WBSR hereby withdraws all of its testimony filed in this docket, including the testimony filed by Nelissa Heddin on March 29, 2010.

B. To the extent any documents filed by TRHG can be construed to be testimony in this docket, TRHG hereby withdraws that testimony in its entirety.

C. DDU hereby withdraws the following testimony:

1. the following portions of the prefiled testimony of Randy Gracy
 - a. page 2, lines 14 and 15
 - b. page 12, line 14 through page 15, line 14; and
2. the following portions of the prefiled testimony of Chris Ekrut.
 - a. page 5, lines 16 and 17 beginning with the second sentence
 - b. page 6, lines 10 and 11 beginning with the second sentence
 - c. page 8, line 1 through page 16, line 20
 - d. page 17, line 7 at the sentence beginning with "However...."
through line 10.

In addition, it is the intention of DDU to withdraw any testimony regarding the consolidation of the rates for the water systems serving The Retreat and White Bluff subdivisions. Copies of Mr. Gracy's and Mr. Ekrut's revised testimony showing the withdrawn testimony as blacklined text are attached as Exhibit "A".

III. WITHDRAWAL OF PLEADINGS

- A. TRHG hereby withdraws any and all objections to any prefiled testimony filed in this proceeding.
- B. WBSR hereby withdraws any and all objections to prefiled testimony filed in this docket.

IV. AGREEMENTS

The Parties hereby stipulate and agree to the following:

- A. The rate schedule attached as Exhibit "B" for The Retreat subdivision that became effective on June 30, 2010. DDU has also agreed not to file an application to increase rates for The Retreat subdivision before January 1, 2012, and not seek to recover any rate case expenses in this docket from TRHG. TRHG has agreed that DDU will not be required to make any refunds for amounts collected prior to the implementation of agreed rates.
- B. The rate schedule attached as Exhibit "C" for the White Bluff subdivision that became effective on June 1, 2010. DDU has also agreed not to file an application to increase rates for the White Bluff subdivision before January 1, 2012 and not seek to recover any rate case expenses in this docket from WBSR. WBSR has agreed that DDU will not be required to make any refunds for amounts collected prior to the implementation of agreed rates.

In addition, DDU hereby amends its request for rate approval for the White Bluff and The Retreat subdivisions to be consistent with the rates and charges shown on the rate schedules attached as Exhibits "B" and "C".

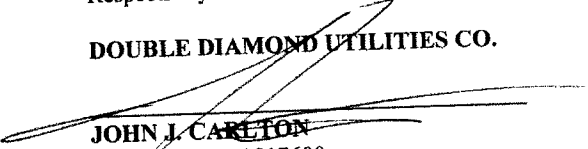
The Parties further request that the Final Order in this proceeding be issued consistent with the terms of the settlement agreements for the White Bluff and The Retreat subdivisions.

**V.
PRAYER**

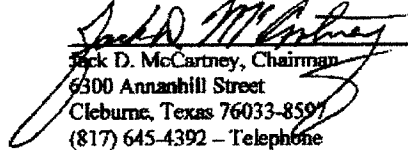
The Parties respectfully request that the Administrative Law Judge grant this Joint Motion to Withdraw Testimony and Stipulate Agreed Rates for the White Bluff and The Retreat subdivisions in this docket and issue an order consistent with this Motion and the terms of the settlement agreements restated above.

Respectfully submitted,

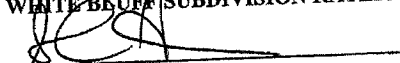
DOUBLE DIAMOND UTILITIES CO.


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(512) 703-2785 - Facsimile

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was delivered via facsimile,
via first class mail, via electronic mail or by hand delivery on the 14 day of October,
2010 to the following:

Richard Wilfong
Administrative Law Judge
300 West 15th Street, Suite 502
Austin, Texas 78701

Shari Heino
Mathews & Freeland, L.L.P.
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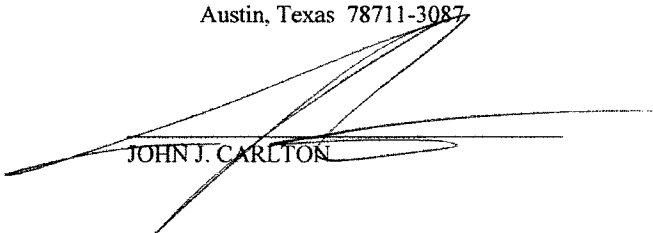
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