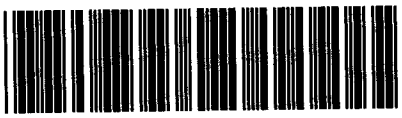

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SOAH DOCKET NO. 582-09-4288

TCEQ DOCKET NO. 2009-0505-UCR

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

PREFILED DIRECT TESTIMONY AND EXHIBITS

OF

CHRIS EKRUT

ON BEHALF OF

DOUBLE DIAMOND UTILITIES COMPANY, INC.

MARCH 1, 2010

PREFILED DIRECT TESTIMONY AND EXHIBITS OF
CHRIS EKRUT
ON BEHALF OF
DOUBLE DIAMOND UTILITIES COMPANY, INC.

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Chris Ekrut. I am a Manager with J. Stowe & Co., Inc. My business address is 1300 E. Lookout Dr., Ste. 100, Richardson, Texas 75082.

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I received my undergraduate degree, a Bachelor of Arts with a major in Public Administration, from West Texas A&M University in 2003, graduating with honors. I then received a Master's in Public Administration from the University of North Texas in 2005, again graduating with honors. While pursuing my Master's Degree, I served as an intern with R.W. Beck, Inc. ("R.W. Beck"), and officially joined the Company in 2005 as a Consulting Analyst upon completion of my degree. I left R.W. Beck in April 2008 to join J. Stowe & Co., LLC. ("J. Stowe & Co.") as a Senior Consultant, and was promoted to Manager in December 2009. In 2009, I also received my certification as an Associate in Project Management by the Project Management Institute. My professional resume is herein included as Exhibit DDU-16.

Q. GENERALLY, WHAT DOES YOUR WORK WITH J. STOWE & CO. ENTAIL?

A. I have provided a broad range of consulting services to the utility industry, including, but not limited to:

- Cost of service and rate design studies
- Litigation support
- System valuations
- Operational and organization studies
- Socioeconomic impact analysis

- Business Plan development
- Program / Project Management

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?

A. I am presenting testimony on behalf of Double Diamond Utilities Company, Inc., referred to herein as "Double Diamond", "DDU", and/or "the Utility."

Q. CAN YOU PLEASE DEFINE THE SYSTEMS THAT ARE THE SUBJECT OF THIS PROCEEDING?

A. DDU currently is authorized to provide water service from three (3) water systems. These systems, listed below in Table 1, are all subject to this proceeding:

Table 1 – List of Water Systems Subject to Proceeding	
Water System	PWS ID
The Cliffs	1820061
The Retreat	1260127
White Bluff	1090073

II. PURPOSE AND SCOPE

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. J. Stowe & Co. was retained by DDU to assist the Utility in preparing and filing the rate change application that is subject of this proceeding. The purpose of my testimony is to provide background on the procedures and methodologies utilized to prepare the application and the requested rates.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE COMMISSION ON COST OF SERVICE AND/OR RATE MATTERS?

A. No, I have not.

Q. WHAT ATTACHMENTS ARE YOU SUPPORTING AS PART OF YOUR TESTIMONY?

A. In addition to my resume, I am supporting the application (Exhibit DDU-1) and other attachments and schedules that are included and discussed throughout my testimony.

Q. WHAT PORTIONS OF THE APPLICATION ARE YOU SPONSORING AS PART OF YOUR TESTIMONY?

A. I am sponsoring all portions of the applications not sponsored by Mr. Gracy.

III. SUMMARY OF APPLICATION PROCESS

Q. YOU PREVIOUSLY TESTIFIED THAT YOU WERE RETAINED BY THE UTILITY TO ASSIST IN PREPARING AND FILING THE APPLICATION THAT IS THE SUBJECT OF THIS PROCEEDING. CAN YOU PLEASE SUMMARIZE THE PROCESS YOU WENT THROUGH IN PREPARING THE APPLICATION?

A. In preparing the application, I first requested financial and operating data from the Company. From this information, I relied on a number of documents provided including the following:

- DDU's 1999, 2001, and 2006 Rate Applications;
- DDU's 2006 and 2007 Depreciation Statements and other documentation supporting the Utility's assets;
- DDU's 2007 Financial Statements;
- DDD's 2007Audited Financial Statements;
- Listing of Notes Payable from DDU to DDD as of 12/31/2004, 12/30/06, and 12/30/07;

- DDU Detailed Trial Balance and Statement of Operations for the 2007 Test Year;
- 2007 Employee and Labor Transfer Information; and
- Customer and Billing Information for 2006 and 2007

Once the documents were collected. I reviewed them and then prepared the application based on the data provided. As I will discuss later in my testimony, much of the information was reformatted to fit within the TCEQ application and some expenses were allocated to reflect the provision of water and wastewater service by the Utility. Once the revenue requirements were determined, I also worked with Mr. Gracy to develop the alternative, inclining-block rate design requested in the application.

IV. SUMMARY OF UTILITY'S REQUESTED REVENUE REQUIREMENT AND RATES

Q. IS DDU REQUESTING THE REVENUE REQUIREMENT AS CONTAINED WITHIN THE APPLICATION?

A. No. DDU is requesting a lower revenue requirement be approved for the consolidated Groundwater systems at White Bluff and The Retreat.

Q. PLEASE EXPLAIN WHY DDU'S REQUEST HAS CHANGED?

A. As I stated earlier, based on Commission Staff recommendation, DDU engaged Dr. Victoria Harkins to perform an Asset Evaluation in support of its requested rate base. The results of Dr. Harkins study have impacted the utility's requested revenue requirement. These impacts will be addressed and quantified within my testimony.

Q. CAN YOU PLEASE SUMMARIZE THE REVENUE REQUIREMENT DDU IS REQUESTING BE APPROVED BY THE COMMISSION.

A. Table 2 below presents the requested summary. Additionally, Schedule CDE-1 (Exhibit DDU-19) compares this revenue requirement to the original revenue requirement presented within the application.

Table 2 – Summary of Requested Revenue Requirement

	Groundwater	Surface Water	Total
O&M Expense	$ 414,046	$ 370,099	$784,145
Payroll Taxes	11,189	10,196	21,384
Property and other Taxes	3,332	2,412	5,744
Annual Depreciation and Amortization	185,223	73,069	258,291
Income Taxes	53,661	19,863	73,524
Return	184,380	68,249	252,629
Other Revenues	(12,116)	(9,622)	(21,738)
Total Revenue Requirement	$ 839,713	$ 534,266	$ 1,373,979

Q. WITH THE LOWERING OF DDU'S REQUESTED REVENUE REQUIREMENT, IS THE UTILITY ALSO REQUESTING A REDUCTION IN THE REQUESTED RATES?

A. Yes. DDU is requesting lower rates be approved for the consolidated Groundwater systems at White Bluff and The Retreat.

Q. PLEASE SUMMARIZE THE REQUESTED RATES.

A. Table 3 below illustrates the rates DDU is requesting as part of this application.

Table 3 – Summary of Requested Rates		
	Groundwater	Surface Water
Meter Charge		
5/8"	$ 34.72	$ 52.00
1"	86.80	130.00
1 ½"	173.60	260.00
2"	277.77	416.00
3"	520.81	780.00
Volumetric Charge (Per 1,000 gal.)		
0 – 3,000	$ 1.78	$ 2.60
3,001 – 10,000	2.45	3.00
10,001 – 15,000	3.38	5.07
15,001 – 20,000	4.67	8.56
20,001 +	6.45	14.45

Q. WILL THE ABOVE REQUESTED RATES GENERATE LESS REVENUE THAT WHAT WAS INCLUDED IN THE NOTICE PROVIDED TO THE UTILITY'S CUSTOMERS?

A. Yes. The above requested rates will generate approximately $839,713 and $474,104 from Groundwater and Surface Water Customers, respectively, for a total of $1,313,817. The rates noticed within the application for Groundwater customers proposed to generate approximately $943,064, for a total decrease in revenue generation of $103,351 ($943,064 - $839,713). A proof of revenue generation for the requested rates and utilizing the billing determinants from the application is contained in Schedule CDE-2 (Exhibit DDU-20).

V. MULTIPLE SYSTEMS CONSOLIDATED UNDER A SINGLE TARIFF

Q. IS DDU REQUESTING TO CONSOLIDATE MULTIPLE SYSTEMS UNDER A SINGLE TARIFF AS PART OF THIS APPLICATION?

A. Yes. Of the three water systems, DDU is seeking the Commission's approval to consolidate the groundwater systems at White Bluff and The Retreat under a single rate. DDU is proposing a separate rate for the surface water system located at The Cliffs.

Q. ACCORDING TO THE TEXAS WATER CODE, WHAT REQUIREMENTS MUST BE MET TO ENABLE A UTILITY TO CONSOLIDATE SYSTEMS UNDER A SINGLE TARIFF?

A. Texas Water Code ("TWC") § 13.145(a) states:

> "A utility may consolidate more than one system under a single tariff only if:
>
> (1) The systems under the tariff are substantially similar in terms of facilities, quality of service, and cost of service and;
>
> (2) The tariff provides for rates that promote water conservation for single-family residences and landscape irrigation."

Q. ARE YOU AWARE OF OTHER GUIDANCE OR PRECEDENT TO GUIDE A UTILITY WITH REGARDS TO THE REQUIREMENTS OF TWC §13.145(A)?

A. Yes. The Commission approved consolidation of systems under regional rates in SOAH Docket Nos. 582-05-2771 and 582-05-2770, Application by Aqua Utilities, Inc. d/b/a Aqua Texas, Inc., and AquaSource Development Company d/b/a Aqua Texas, Inc. to change their water and sewer tariffs and rates in various counties, and appeal of rate-making actions of various municipalities denying requested changes to water and sewer tariffs and rates ("Aqua Texas case"). The Commission also recently approved

"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(c) 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(c) 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(c).**" (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)

Q. COULD YOU PLEASE PROVIDE A SUMMARY OF THE KEY ASPECTS OF THE ALJ'S DISCUSSION WHICH PROVIDED A BASIS FOR THE

COMMISSION'S APPROVAL OF CONSOLIDATED RATES IN THE AFOREMENTIONED PROCEEDING?

A. In summary, the following important points can be taken from the above discussion:

Substantial similarity between systems must be determined over time;

One goal of regionalization is the spreading of costs over systems in a region;

A cost of service study cannot be used to determine substantial similarity as it merely highlights the differences between systems.

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

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

Q. YOU TESTIFIED EARLIER AS TO THE REQUIREMETNS FOR CONSOLIDATION PURSUANT TO THE TEXAS WATER CODE REGARDING

THE SIMILARITY OF SYSTEMS. IN YOUR OPINION, ARE THE FACILITIES AT WHITE BLUFF AND THE RETREAT SUBSTANTIALLY SIMILAR?

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

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

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

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

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

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

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

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

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

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[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

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

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

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

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

Q. ON WHAT IS YOUR OPINION BASED?

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

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

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

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

Table 4 – Comparison of Original Plant Investment per Lot

	The Retreat	White Bluff
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

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

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

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

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

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

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

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

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

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

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

Table 5– Summary of Non-Consolidated Rates

	The Retreat	The Cliffs	White Bluff
Meter Charge			
5/8"	$ 51.07	$ 58.60	$ 31.01
1"	127.67	146.50	77.51
1 ½"	255.34	293.00	155.03
2"	408.55	468.80	248.04
3"	766.03	879.00	465.08

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

VI. DEFERRED ACCOUNTING TREATMENT OF CASH ADVANCES

Q. WITHIN THE APPLICATION THE COMPANY IS REQUESTING DEFERRED ACCOUNTING TREATMENT BY THE COMMISSION FOR CERTAN 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

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

Q. HAS THE COMMISSION PREVIOUSLY GRANTED DEFERRED ACCOUNTING TREATMENT?

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

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

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

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

VII. RATE BASE / INVESTED CAPITAL

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

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

Table 6 – Application Level of Investor Supplied Capital

	Groundwater	Surface Water	Total
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

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

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

Table 7 – Application Rate Base Summary

	Groundwater	Surface Water	Total
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

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

A. Yes. That is my understanding.

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

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

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

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

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

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

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

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

Table 8 – Requested Water Rate Base Resulting from Asset Evaluation			
	Groundwater	Surface Water	Total
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

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

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

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

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

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

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

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

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

Table 9 –Impact to Working Cash Allowance from Asset Evaluation

	Groundwater	Surface Water	Total
Application level of O&M Expense	$ 517,955	$472,797	$990,751
Working Cash Allowance (1/8th 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 (1/8th 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)

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

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

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

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

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

Table 10 – Impact of Asset Evaluation of Developer Contributed Capital

	Groundwater	Surface Water	Total
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

Q. PLEASE SUMMARIZE THE UTILITY'S LEVEL OF INVESTED CAPITAL BASED ON THE RESULTS OF THE ASSET EVALUATION?

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

Table 11 –Asset Evaluation Level of Investor Supplied Capital

	Groundwater	Surface Water	Total
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

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

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

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

A. As DDU's only source of capital is its parent company, DDD, DDD's capital structure, as contained within its 2007 audited financial statements, has been utilized in the application. DDD's capital structure as of December 31, 2007 is summarized in Table 12 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	$ 113,997,749	50.47%
Equity Component		
Total Shareholder's Equity	$ 111,852,358	
Equity Subtotal	111,852,358	49.53%
Total	$ 225,850,107	100.00%

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

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

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

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

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

A. Yes. The American Water Works Association ("AWWA") M1 Manual, at Page 41, states "If the water utility is a subsidiary of another company (holding company), the parent company's capital structure may be deemed to provide the appropriate weighting of the costs of capital."[4]

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[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

B. **Cost of Debt**

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

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

C. **Cost of Equity**

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

A. Yes.

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

A. The 12% cost of equity represents the presumptive cost of equity historically granted by the TCEQ in contested rate proceedings. In SOAH Docket No. 582-03-2283, *Appeal of Tall Timbers Utility Company, Inc. to Review the Rate Making Actions of the City of Tyler,* the "ED argued that 12% is the cost of equity recommended by the ED in rate of return calculations" The PFD in this case goes on to state that "this presumptive 12% 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.

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

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

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

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

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

A. 11.45%

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

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

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.[6] *(emphasis added)*
>
> From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends of the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confident in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[7]

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

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[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)

X. OPERATIONS AND MAINTENANCE EXPENSES

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

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

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

A. Table 13 below presents the requested summary:

Table 13 – Summary of O&M Expenses Presented in Application

TCEQ Category	Groundwater	Surface Water	Total
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

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

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

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.

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

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

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

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

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

A. Yes.

Q. CAN YOU PLEASE EXPLAIN THESE CHANGES?

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

Table 14 – Summary of Asset Evaluation O&M Adjustments			
Account	Application Value	Capitalized Expense	Adjusted Value
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

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

- Employee Compensation
- Referral Bonus
- Bonus Commission
- Hourly Wages
- Payroll Burden
- Other Employee Expense
- Vehicle Expense
- Vehicle Fuel Expense
- Equipment Fuel Expense
- Equipment Lease Payment
- Insurance
- R&M Building
- R&M Equipment
- Taxes & Licenses (unless directly assigned)

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

Table 15 – Summary of Impacts to Plant Allocation Factors			
Account	Water	Sewer	Total
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%

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

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

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

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

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

Table 16 – Summary of Requested O&M Expenses

TCEQ Category	Groundwater	Surface Water	Total
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

XI. TAXES OTHER THAN INCOME

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

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

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

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

XII. OTHER REVENUES

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

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

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

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

XIII. SUMMARY OF TOTAL REVENUE REQUIREMENT

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

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

Table 17 – Summary of Application Revenue Requirement

	Groundwater	Surface Water	Total
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

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

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

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

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

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

Meter Size	Groundwater	Surface Water	Total
5/8"	585	215	800
1"	18	12	30
1 ½"	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.

Table 19 – Departure from Normal Precipitation			
	The Retreat	The Cliffs	White Bluff
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
Note: Whitney Dam Station Records Incomplete in 2006 and 2007			

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

Q. HOW WAS THE LEVEL OF NORMALIZED CONSUMPTION DETERMINED?

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

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

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

Table 20 – Summary of Normalized Billing Determinants (Gallons)			
Rate Block	Groundwater	Surface Water	Total
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

XV. RATE DESIGN

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

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:

- 0 – 3,000
- 3,001 – 10,000
- 10,001 – 15,000
- 15,001 – 20,000
- 20,001 +

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

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

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

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

XVI. RATE NOTICE

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

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

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

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

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

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

XVII. RATE CASE EXPENSES

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

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

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

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

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

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

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

• Jackson Walker, LLP	$ 56,343
• Armburst & Brown, LLP	48,426
• Harkins Engineering	10,675 (1/2 of $21,350)
• J. Stowe & Co.	46,962
Total	$ 162,406

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

A. Yes.

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

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

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

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

XVIII. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

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