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Docket No. 44236; SOAH Docket No 473-15-4944.WS
Custom Water Company, LLC, Application for a Rate/Tariff Change (page 1)

Direct Case Submission by Cris A. Lemon, C.P.A.

My client, Custom Water Company, L.L.C and its sole member, Edward A. Fenoglio have submitted and filed an application dated January 12, 2015 with the Commission. Mr. Fenoglio and staff prepared this application from financial information compiled on a cash basis of accounting. The test year encompasses part of calendar year 2013 and 2014. I have reviewed the application for Mr. Fenoglio and found notable details prevalent to this rate case.

Both the Montague and Oak Shores water systems required substantial upgrades. For the Montague System, requirements were to drill new wells. Estimates were gathered which projected the cost per well at $300,000 plus engineering and completion. Mr. Fenoglio was able to reduce this cost because he is a licensed Water Well Driller and Pump Installer (TX License #2817). This allowed him to bid out specifics of the project rather than rely on a contractor providing a "turn key" cost. Therefore, instead of approximately $700,000 in cost for the two wells, actual costs came in at approximately $300,000. In the case of Oak Shores, requirements were to replace the storage tanks. Again, because of his license, this was completed with a significant reduction in costs to the system customers. This does raise a point of potential revision to the rate application. Mr. Fenoglio does draw income from the water company; however, it is not reflected as a true salaried position. His knowledge, expertise, and certification saved thousands in cost to upgrade the systems. We are looking at the reasonable cost that a small water system would pay an operator with similar credentials. We are also taking steps to properly report and categorize this as a salaried expense.

For income tax purposes, Custom Water Company, L.L.C uses the accelerated depreciation method; however, a record is simultaneously kept using the straight-line method. Assets are recorded using both so as to maximize income taxes while keeping an accurate record of acceptable PUC depreciation guidelines. With adding these new assets, we are reviewing the depreciation schedule of the water company. In doing this, we are looking at the book value of the old wells and storage tanks to

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determine if there is any continued value to the water systems. Our depreciation schedule lists wells, pumps, and water distribution assets placed in service in 1984, 1989 and 1990. The Commission considers some of these assets to have a 50 year service life. The remaining book value of the assets would need to be considered if they are still in use or of no value to the water company.

In reviewing this application, I have looked at various financial ratios. Any public utility has a significantly large debt-to-equity ratio. The new assets placed into service, has significantly increase the water company's debt. These loans are structured on a ten year payout which significantly increases the monthly cash flow requirement. We are continuing to review the company's working capital requirements in order to determine adequate cash flow. Both Montague and Oak Shores water systems are in rural areas. Most banks are not interested in the long-term financing of such assets. This equates to a short loan payout with a high monthly payment requirement.

The Company lists several "heavy equipment" type assets on its depreciation schedule. One of these heavy equipment assets is a backhoe machine. Because Mr. Fenoglio has the required certifications, he is able to utilize this equipment to service the water system while reducing costs to customers. In these rural areas, a qualified and certified water system contractor with the necessary equipment would be difficult to rely on. These systems are at least 30 to 50 miles from a recognized city. Ownership of these assets allows him to repair and/or construct necessary system upgrades or additions. It is also allows for a timely response to a water outage given TCEQ's time frame requirements.

Over the past few years, Mr. Fenoglio has loaned the company money in which to cash flow expenses associated with the new assets. These loans and repayments have been better documented as we move to allocate a reasonable salary for Mr. Fenoglio. In the past, Mr. Fenoglio has allowed the system to "pay him back" as funds were available without having a structured payback schedule. Great effort has been made to properly record these transactions and to account for a note payable balance due the shareholder.

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Custom Water Company, LLC, Application for a Rate/Tariff Change (page 3)

Direct Case Submission by Cris A. Lemon, C.P.A.

Being a customer of the Montague system himself, Mr. Fenoglio has tried to maintain reasonable water rates. Requirements to upgrade system assets have forced necessary action to raise more revenue to offset debt costs and increased expenses. This application represents a reasonable effort to increase revenues. We are continuing to revise various aspects of the application. We do reserve the right modify these numbers.

Respectfully,

Cris A. Lemon, C.P.A.