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**APPLICATION OF RIO CONCHO
AVIATION, INC. FOR A
RATE/TARIFF CHANGE**

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**BEFORE THE STATE OFFICES
OF
ADMINISTRATIVE HEARINGS**

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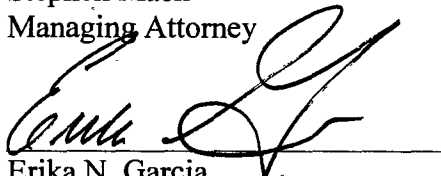
COMMISSION STAFF'S INITIAL BRIEF

Respectfully submitted,

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Dated: January 11, 2017

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COMMISSION STAFF'S INITIAL BRIEF

COMES NOW the Staff (Staff) of the Public Utility Commission of Texas (Commission), representing the public interest, and files this Initial Brief. The deadline for initial briefs is January 11, 2017. Therefore, Staff's Initial Brief is timely filed. In support of its Initial Brief, Staff states the following:

I. INTRODUCTION AND SUMMARY

The Commission recently approved agreed rates for Rio Concho Aviation Inc.'s (Rio Concho's) water system in December of 2015 in Docket No. 43728.¹ The settlement rates agreed to by Rio Concho were for a \$31.00 base bill and \$5.50 per 1000 gallons,² which Staff and Rio Concho agree would currently generate \$116,037.³ Three months after the Commission approved the settlement rates, Rio Concho filed this case seeking an additional 23.66% increase.⁴

Rio Concho does not provide any reasonable justification for increasing the recently approved rates. To the contrary, Rio Concho's case is about increasing shareholder compensation. The following table lists the revenue requirement items that are paid directly to shareholders as direct or indirect compensation:

¹ Staff Ex. 11 (*Application of Rio Concho Aviation, Inc. for a Rate/Tariff Change*, Docket No. 43728, Final Order).

² *Id.* at Attachment 1, Section 1.0.

³ Ex. RCA-8 at 11 (Rebuttal Testimony of Randal Manus).

⁴ Ex. RCA-2 at 1 (Rio Concho's Application for Rate/Tariff Change).

Table 1 Rio Concho's Proposed Increase to Shareholder Value			
	Rio Concho Proposed	Staff Recommendation	Staff Adjustments
Revenue Requirement	\$146,984	\$111,936	
Overall Return ⁵	\$11,004.77	\$5,322.00	(\$5,683)
Compensation			
Barbie Brunson	\$41,568.12	\$41,568.12	\$0
Kevin Brunson	\$14,435.00	\$3,600.00	(\$10,835)
Depreciation	\$10,526.66	\$5,197.00	(\$5,330)
Life Insurance/Retirement Benefit	\$6,000.00	\$0.00	(\$6,000)
Total	\$83,534.55	\$55,687.12	(\$27,847)
% of Proposed Revenue Requirement Dedicated to Shareholder Compensation	56.83%	49.75%	

As may be seen, \$83,534.55 or 56.83% of Rio Concho's proposed revenue requirement flows directly to shareholders as equity return, capital reimbursement, or shareholder compensation. Staff supports many of Rio Concho's proposals to compensate shareholders as reasonable and necessary. For example, a reasonable return on investment, reasonable compensation, and depreciation are all necessary components of a cost of service. However, as will be more fully addressed below, Staff opposes Rio Concho's proposals to compensate shareholders for an unreasonable and highly inflated return, unnecessary and unreasonable contract labor for equity owners, a personal vehicle, personal life insurance and retirement, and other unreasonable expenses. Of Staff's recommended adjustments, \$27,847, or roughly 79%, are attributable to cost of service items paid directly to shareholders, exclusive of the flow through effect that federal income taxes, taxes other than federal income taxes, and cash working capital would have to increase these adjustments.

⁵ Although both Rio Concho's and Staff's overall return have a debt component, Rio Concho itself has no debt expense. The debt expense proposed by Rio Concho is actually a personal loan of Mrs. Brunson for her personal vehicle. As such, the overall return, comprised of a debt and equity component, are actual returns to shareholders.

II. REVENUE REQUIREMENT [PO ISSUES 3, 5, 6, 19]

Staff recommends a cost of service of \$114,272 less other revenues of \$2,336, resulting in a revenue requirement of **\$111,936**.⁶ This cost of service includes a return of \$5,322 and total invested capital of \$78,723.⁷ Staff's adjustments to Rio Concho's cost of service are summarized in the below table:⁸

Table 2			
Cost of Service Adjustments			
Expense or item	Rio Concho Requested	Staff Adjustment	Staff Recommended
Contract Labor	\$28,457	\$(12,752) ⁹	\$15,705
Transportation	3,971	(1,108)	2,863
Employee Benefits	13,788	(6,000)	7,788
Professional Services	1,675	(163)	1,513
Insurance	2,546	(589)	1,957
Miscellaneous	7,031	(1,035)	5,996
Federal Income Tax	1,803	(1,003)	800
Depreciation	10,527	(5,330) ¹⁰	5,197
Return	11,004	(5,682)	5,322
Total adjustments to Cost of Service		\$(33,662)	

A. Operations and Maintenance Expenses [PO Issue 20]

B. Administrative and General Expenses [PO Issue 21]

Under 16 TAC §24.31(b), only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. Staff recommends adjustments to the following expenses:

Contract Labor

In its Application, Rio Concho requested \$28,456.94 in contract labor expenses.¹¹ Schedule II-8 shows \$4,000.00 for leak detection, \$14,435.00 in officer compensation for Kevin

⁶ Staff Ex. 3A at 0000021 (Redacted Direct Testimony of Debi Loockerman).

⁷ Staff Ex. 3A at 0000021.

⁸ Table 1, Staff Ex. 3A at 0000007 (Rate Case Expense Adjustment of \$1,794 removed in accordance with Rio Concho's stipulated removal of that expense from its requested revenue requirement. Tr. at 317:22-318:8).

⁹ Staff's adjustment is updated from the original table to reflect that Rio Concho is only seeking \$14,435 of Mr. Brunson's test year compensation of \$16,835 (Tr. at 102:2-10) and the \$1,101.94 error in requested expenses (Tr. at 485:16-486:4).

¹⁰ Staff's adjustment is updated from the original table to reflect Staff's allowance of \$700.92 for a lamp and sideboard in the depreciation schedule (Tr. at 330:23-331:4).

Brunson, and a known and measurable change of \$1,470 as components of that \$28,456.94.¹² The remaining \$8,551.94 that make up the requested contract labor expenses are not listed out. At the hearing on the merits, Rio Concho witness Randal Manus testified that the other requested contract labor expenses are meter reading costs of \$2,130, his consultant fees of \$2,880, Brad Hilliard (plumber) expenses of \$490, Jimmy Martin (contractor) expenses of \$50, and Link's Backhoe Services of \$1,900.¹³ However, the total of those expenses is \$7,450, which Mr. Manus agreed leaves \$1,101.94 in requested contract labor expenses which he was unable to account for.¹⁴ It appears that Rio Concho's total requested contract labor expenses were overstated by that amount, and Staff recommends that \$1,101.94 be disallowed.

Staff also recommends that the appropriate compensation for Mr. Brunson is \$3,600 annually, which results in a \$10,835 adjustment.¹⁵ Mr. Brunson's requested \$14,435 compensation for management services is duplicative of those performed by Barbie Brunson, and back up services only used once in the test year is excessive, unreasonable, and not necessary for the provision of water service for a utility of Rio Concho's size.

Rio Concho asserts that Mr. Brunson's compensation encompasses "strategic overall planning of the water utility, anything we have planned in the future, any tasks that need to be completed and things that we're looking into as far as monitoring the water system."¹⁶ First, as Staff witness Debi Loockerman testified, a water operation of this size does not require both a manager and an executive president to provide adequate service, and in the open market, the utility would not survive competition if it paid for both positions.¹⁷ Second, this vague, overarching description of Mr. Brunson's role lists job duties that would be performed by Ms. Brunson, who works over 170 hours per month operating the system.¹⁸ It is clear from the

¹¹ Ex. RCA-2 at 17.

¹² *Id.* at 17.

¹³ Tr. at 483:22-484:12, referring to Staff Ex. 15 (Rio Concho's Response to Staff RFI 1-6).

¹⁴ *Id.* at 485:16-486:4.

¹⁵ While Staff witness Ms. Loockerman recommended a \$13,235 adjustment to Mr. Brunson's compensation, this adjustment was based on his total test year compensation of \$16,835. As Rio Concho only seeks to recover \$14,435 of that compensation in its revenue requirement (Tr. at 102:2-10), Staff has revised its adjustment.

¹⁶ Tr. at 40:20-41:6.

¹⁷ Staff Ex. 3A at 0000009.

¹⁸ *See* Ex. RCA-1 at 9 (Direct Testimony of Barbie Brunson).

evidence presented in this case that Ms. Brunson is the person who runs Rio Concho, and tends to the needs of the utility. Any function that Mr. Brunson may perform as an executive could easily be performed by Ms. Brunson.¹⁹ Further, it is unclear how much time per month Mr. Brunson actually spends performing these executive duties, as he is principally a farmer and rancher, sits on the board of directors for a livestock auction company and an organic soil material recycling company,²⁰ is heavily involved in the development of an airport and municipal golf course in Jacksboro Texas,²¹ manages Rio Concho's restaurant lease,²² and presumably does work related to Rio Concho's tie-down leases and fuel operations.

Mr. Brunson is not a certified operator, so any backup functions he performs must be supervised by Ms. Brunson.²³ If the benefit of having a backup after-hours contractor is to prevent Ms. Brunson from being "responsible for the utility 24/7,"²⁴ this benefit will not be realized by compensating Mr. Brunson to answer calls she will also have to attend. Ms. Brunson received two quotes for on-call emergency services, which were \$750 per month and \$700 per month, and each included one minor service call per week.²⁵ While still higher than Staff's recommendation, either of these providers would offer the same back-up function currently served by Mr. Brunson, and for almost half what Mr. Brunson is being paid.

During the test year, Mr. Brunson responded to only one call after-hours, which was not an emergency.²⁶ And when an emergency occurred during business hours on October 23, 2015, neither of the Brunsons were available to respond and Mr. Manus was called to perform the necessary repairs.²⁷ While Ms. Brunson testified that "Kevin is always responsive when the crisis

¹⁹ See Ex. RCA-7 at 3-4 (Rebuttal Testimony of Kevin Brunson). Many of the functions Mr. Brunson lists as performed during the test year are either duplicative of tasks Ms. Brunson testified she performed, or are tasks that she would be expected to perform as operator and manager of the system.

²⁰ Tr. at 457:22-458:2.

²¹ *Id.* at 458:12-15.

²² Ex. RCA-1 at 6.

²³ 30 TAC § 290.46(e); Staff Ex. 3A at 0000010; Tr. at 62:14-19.

²⁴ Ex. RCA-6 at 7 (Rebuttal Testimony of Barbie Brunson).

²⁵ Staff. Ex. 9 (Rio Concho's Response to Staff RFI 4-4(e)).

²⁶ Tr. at 62:10-13; Staff Ex. 7 (Rio Concho's Response to Staff RFI 4-2).

²⁷ Staff Ex. 5 (Rio Concho's Response to Staff RFI 3-4).

event occurs. . . he is at the airport within minutes,”²⁸ she also presented conflicting testimony that she contacts Mr. Manus if Mr. Brunson is “not available to get there fast enough.”²⁹ The cost of Mr. Brunson’s contract labor is not only unnecessary, it is an unreasonable attempt to further compensate equity owners in the utility. Staff witness Ms. Loockerman’s recommended compensation for Mr. Brunson of \$300 per month is more than reasonable, considering the amount of work his position actually requires.

Staff further recommends an additional reduction of \$815 in contract labor related to meter reading, based on meter reading contract labor costs of \$2,945 for the test year.³⁰ Using that cost, the known and measurable change for meter reading is \$655, not \$1,470 as Rio Concho alleges.³¹ In rebuttal, Rio Concho witness Mr. Manus testified that the meter reading contract labor costs provided to Staff on page RCA000264 of Staff Exhibit (Ex.) 15 were “in error and not from the test year.”³² Mr. Manus argued that Staff witness Ms. Loockerman made an error by using these figures, and should have instead used the meter reading contract labor costs as shown a few pages later on page RCA000268 of Staff Ex. 15. The figures provided to Staff that show a total meter reading contract labor cost of \$2,945 for the test year were never updated.³³ And during the hearing on the merits, Mr. Manus actually referred counsel for Staff to page RCA000264 of Staff Ex. 15, to these figures, to explain the full breakdown of contract labor costs.³⁴ Because of the conflicting information that Rio Concho provided and never clarified, Staff continues to recommend this adjustment.

Office

Rio Concho has requested two offices in its cost of service: a “main office”³⁵ or “corporate office”³⁶ located at the Brunson home, and an airport office located on site at Hicks

²⁸ Ex. RCA-1 at 20.

²⁹ Tr. at 43:22-23.

³⁰ Staff Ex. 3A at 0000011; *see* Staff Ex. 15 at RCA000264 (A Meter Reader \$1535.02 plus B Meter Reader \$415.00 plus C Meter Reader \$870.00 plus D Meter Reader \$125.00 equals a total cost of \$2,945).

³¹ Staff Ex. 3A at 0000011.

³² Ex. RCA-8 at 10 (Rebuttal Testimony of Randal Manus).

³³ *See* Tr. at 476:8-13.

³⁴ Tr. at 100:14-101:11.

³⁵ Ex. RCA-4 at 14 (Direct Testimony of Randal Manus).

³⁶ Ex. RCA-1 at 22.

Airfield.³⁷ Rio Concho has only requested rent for the airport office,³⁸ and therefore claims that there is no expense to the ratepayers associated with the inclusion of the main office.³⁹ However, there is a significant cost to the ratepayers, because Rio Concho has claimed business miles for travel between the main office and the utility.⁴⁰ This enables Ms. Brunson to expense the miles she commutes between her home and her workplace at the utility. As Staff witness Ms. Loockerman testified, businesses do not generally pay the commuting miles of their employees, and the IRS does not allow commuting miles to be included as business expenses.⁴¹

Ms. Loockerman testified that she has never seen a stand-alone system with less than 500 connections be allowed more than one office in its cost of service.⁴² Rio Concho has not presented any evidence to show why a second office is reasonable and necessary to provide utility service to its ratepayers. In fact, Ms. Brunson testified that she could perform all of the functions involved in running the utility at the airport office, and has before.⁴³ The inclusion of the second office in Rio Concho's cost of service is entirely for the convenience of Ms. Brunson, and does not benefit the ratepayers in any way.

Staff recommends that the airport office be the one office allowed in Rio Concho's cost of service. First, the airport office is more convenient for service to the customers and for operations and maintenance to the plant because it is located onsite.⁴⁴ Second, all of the functions which are currently performed at the main office⁴⁵ could be completed at the airport office. Third, the airport office allows Rio Concho to comply with 16 TAC § 24.81(d), which requires a

³⁷ Ex. RCA-1 at 22.

³⁸ See Staff Ex. 3A at 0000012.

³⁹ Ex. RCA-4 at 14 (Mr. Manus: "No charge has ever been made that would affect the ratepayers for this main office space in Aledo").

⁴⁰ Staff Ex. 3A at 0000012; see Ex. RCA-4 at 14-15.

⁴¹ Staff Ex. 3A at 0000013.

⁴² *Id.* at 0000011.

⁴³ Tr. at 72:15-19.

⁴⁴ Staff Ex. 3A at 0000012.

⁴⁵ See Ex. RCA-1 at 10 ("My day begins at our corporate office in Aledo, Texas, where mail is received, opened, and processed. I perform accounting work, such as entering checks and payments on the computer, generating delinquency reports, preparing deposits, activity scheduling, returning customer phone calls and email requests for information and questions about billing, owner changes, etc.").

utility to have a local office within 20 miles of its service area. Since Rio Concho has never applied for or been granted a waiver of this requirement,⁴⁶ it must have a local office.

Transportation Expense

RCA Ex. 4 provides the mileage calculations for the Audi SUV used to support Rio Concho's requested transportation expense.⁴⁷ From these calculations, Staff witness Ms. Loockerman removed the commuting miles as discussed above, and concluded that the Audi is used for utility business 15.9% of the total miles driven.⁴⁸ Because the vehicle is used less than 50% for business, Staff recommends that the IRS mileage rate, which includes depreciation, insurance, repairs, tires, maintenance, gas, and oil be used, rather than actual expenses. The below table summarizes this adjustment:⁴⁹

Table 3 Transportation Expenses		
Staff Adjustment	Miles	Dollars
Mileage only allowed		
Route 1-3 times/week	0	
Route 2-2 times/week, 33 ⁵⁰ miles x 52	3,432	
Route 3 (no change)	134.4	
Route 4-2 times/month x 12 times 37.7 ⁵¹	904.8	
Route 5 (no change)	415	
Route 6 (no change)	415	
Total @ .54/mile (IRS rate for 2016) ⁵²	5,301.2	\$2,863
Requested Auto		(3,971⁵³)
Recommended reduction		1,108

Employee Benefits

Rio Concho proposes that Ms. Brunson, the only full time employee of the utility, receive health insurance, life insurance, and retirement benefits. Ms. Brunson's retirement benefit

⁴⁶ Tr. at 200:15-17.

⁴⁷ Ex. RCA-4 at 15.

⁴⁸ Staff Ex. 3A at 0000013.

⁴⁹ *Id.* at 0000014, Table 2.

⁵⁰ Staff Ex. 3A at Attachment DL-3, 0000041, Google Maps, route 2.

⁵¹ *Id.* at 0000043, Google Maps, route 4.

⁵² *Id.* at 0000044, IRS mileage list.

⁵³ Ex. RCA-2 at 6, line 8.

expense is \$387 per month.⁵⁴ The life insurance expense is \$113⁵⁵ per month, and pays a benefit of \$150,000. ⁵⁶ Ms. Brunson testified that she does not pay any employee contribution toward these insurance benefits.⁵⁷ Instead, these costs are borne entirely by Rio Concho's ratepayers.

Ms. Brunson asserts that if she is performing the job functions for which another water utility would provide employee benefits, then she is entitled to receive the same such benefits.⁵⁸ She testified that she conducted online research and found that certain positions at other water utilities included health insurance, dental, life insurance, 401(k), and vacation time.⁵⁹ However, Ms. Brunson's research was limited to online job postings, and she testified that she was unsure whether these utilities were similarly sized to Rio Concho⁶⁰ or whether these benefits were employer or employee funded.⁶¹ Ms. Brunson listed the Texas Water Development Board (TWDB) and the Texas Northern Trinity Groundwater District as examples of two utilities that she researched.⁶² The TWDB is not a utility, but a state agency. Because the functions of the TWDB are different than those of a water utility, it is unlikely that it offers comparable positions to that of a utility operator. Further, because TWDB's employees are employees of the State of Texas, those employees' benefits will not be comparable to what can be supported by a small water system with a single employee. Similarly, the Texas Northern Trinity Groundwater Conservation District is a water district with three employees.⁶³ The district's size and function is not comparable to Rio Concho. Ms. Brunson also stated that "some of the companies that have acquired other small water utilities located in close proximity of my utility receive those

⁵⁴ See Tr. at 75:4-6 (Ms. Brunson: The combined cost of the retirement and life insurance policy is \$500 per month).

⁵⁵ Tr. at 447:3-8.

⁵⁶ *Id.* at 447:1-2.

⁵⁷ *Id.* at 74:14-16.

⁵⁸ *Id.* at 124:24-127:5.

⁵⁹ *Id.* at 73:4-9.

⁶⁰ *Id.* at 73: 20-22.

⁶¹ *Id.* at 74:10:13.

⁶² *Id.* at 73:10-19.

⁶³ Texas Northern Trinity Groundwater Conservation District, <http://ntgcd.com/staff-page/> (accessed by Staff on Jan. 3, 2017).

benefits.”⁶⁴ Again, a company large enough to acquire small water utilities is not a fit comparison for Rio Concho.

Rio Concho witness Mr. Manus testified that in determining the appropriate employee benefits for Ms. Brunson, he “looked at Ms. Brunson strictly as an employee, without any other connection to Rio Concho.”⁶⁵ However, in determining whether Ms. Brunson’s employee benefits are a reasonable and necessary expense for Rio Concho, it is absolutely crucial to examine the benefits in the context of the utility. As Mr. Manus himself conceded, small water systems tend to have less benefits for employees.⁶⁶ Staff witness Ms. Loockerman testified that very few, if any, Class C water utilities that have requested rate increases at the Commission (or previously at the TCEQ) have asked for life insurance or retirement.⁶⁷ Rio Concho’s requested retirement and life insurance benefit costs are excessive for a 243-connection utility with one employee, and in an open market the costs of those benefits would likely drive the utility out of business.⁶⁸ Staff is not arguing that is not appropriate for Ms. Brunson to have a life insurance policy, or a retirement benefit. However, the cost of these benefits is properly borne by Ms. Brunson, or taken out of the profits of the utility, and is not an allowable expense to impose on ratepayers.

Mr. and Ms. Brunson assert that the life insurance policy is a key employee policy, and that the benefit would provide the utility the money to hire a replacement for Ms. Brunson.⁶⁹ However, if Rio Concho found itself in the position of having to replace Ms. Brunson, it could simply hire another manager/operator. Staff’s recommended revenue requirement includes a \$41,568 per year salary for that position,⁷⁰ which could be offered to a qualified replacement candidate. Rio Concho does not need a \$150,000 benefit, which is equal to 3.6 times the annual salary for this position, to ensure that it can hire a replacement operator. It would be unreasonable to require utilities to carry life insurance on employees for the benefit of the utility.

⁶⁴ Tr. at 74:7-9.

⁶⁵ Ex. RCA-4 at 16.

⁶⁶ *Id.*

⁶⁷ Staff Ex. 3A at 0000014.

⁶⁸ *Id.*

⁶⁹ Tr. at 443:3-6 (Barbie Brunson); Tr. at 456:14-24 (Kevin Brunson).

⁷⁰ Staff Ex. 3A at 0000008.

And in the unfortunate event that the policy is triggered, Staff would not want to be in the position of requiring the benefit to be credited to the utility and its customers instead of to Ms. Brunson's family.

Additionally, at the time of the filing of this application, the beneficiary of the life insurance policy was Mr. Brunson.⁷¹ The \$150,000 policy would have benefited the Brunson family personally, with only possible incidental benefit to the water utility and its ratepayers. On August 16, 2016, the beneficiary was changed to Rio Concho.⁷² At the hearing on the merits Ms. Brunson testified that to change the beneficiary she simply contacted her insurance broker, and that there was no cost associated with making the change.⁷³ Her testimony demonstrates the ease with which she can change the beneficiary of the policy. Therefore, there is no guarantee that this policy will truly serve as a key employee insurance policy for Rio Concho, and that the beneficiary will not be again revised at the end of this proceeding.

For these reasons, Staff recommends disallowing \$1,334 for annual life insurance and \$4,666 for retirement expense. Staff has not proposed any adjustment to Ms. Brunson's health insurance benefit.

Professional Services

As Staff witness Ms. Loockerman testified, Rio Concho's professional services expenses should be reduced by one-half the cost of the preparation of its tax return, as the tax return includes expenses for Rio Concho's tie-down leases, restaurant lease, and fuel operations.⁷⁴ The water utility should not take on the entire cost of the preparation of a tax return that includes three other businesses. The cost of the tax return preparation for the test year was \$325, so Staff recommends that Rio Concho's claimed professional services expense be reduced by half that amount, or \$163.⁷⁵

⁷¹ Staff Ex. 12 at 1.

⁷² *Id.* at 2.

⁷³ Tr. at 442:18-24.

⁷⁴ Staff Ex. 3A at 0000015.

⁷⁵ *Id.*

Miscellaneous Expenses

Staff witness Ms. Loockerman recommended a total reduction of \$1,035 to Rio Concho's requested miscellaneous expense.⁷⁶ This included a disallowance of a \$600 clothing expense, which Rio Concho witness Ms. Brunson testified is for the purchase of replacement clothing for clothing damaged by work at the utility.⁷⁷ However, the purchase of new clothing for utility employees and/or contractors is not an expense that is reasonable and necessary to provide service to the ratepayers.⁷⁸

Ms. Loockerman also recommended disallowing the cost of a Sam's Club membership of \$34.50⁷⁹ from Rio Concho's cost of service, which also included a Costco membership. While it is reasonable for Rio Concho to have a membership to either Sam's Club or Costco, it is a duplicative and unnecessary expense to maintain two memberships to stores that sell largely the same products. At the hearing on the merits, Rio Concho witness Ms. Brunson seemed to attempt to distinguish them by testifying that Sam's Club is geared more toward businesses and Costco is more towards personal shopping.⁸⁰ However, her testimony does not justify the two memberships, particularly since Rio Concho is a business and should not have personal shopping needs.

Finally, Ms. Loockerman recommended disallowing \$365.95 for meal expenses that were not incurred in connection to travel, and \$34.64 for valet parking in Austin.⁸¹ Valet parking is not a reasonable and necessary expense for providing utility service to ratepayers. While Ms. Brunson testified that the meals were provided sometimes to prevent service work interruption on the job site,⁸² the receipts do not allow Staff to evaluate which of those meals were provided for that purpose, to whom they were provided, and what time-sensitive services were being performed.⁸³ Rio Concho had the opportunity to clarify this information through redirect or rebuttal, but never did so.

⁷⁶ *Id.*

⁷⁷ Tr. at 442:2-8; *see* Ex. RCA-6 at 9.

⁷⁸ *See* Staff Ex. 3A at 0000015.

⁷⁹ *Id.*

⁸⁰ Tr. at 81:12-17.

⁸¹ Staff Ex. 3A at 0000015.

⁸² Ex. RCA-6 at 9.

⁸³ *See* Staff Ex. 3A, Attachment DL-3 at 0000080-85.

C. Other Expenses [PO Issue 23]

Staff has no adjustments to Ms. Brunson's salary, and has not identified any other expenditures listed in 16 TAC § 24.31(b)(2)(I) in this proceeding. Staff reserves the right to address this issue in its Reply Brief as needed.

D. Affiliate Transactions [PO Issue 25]

Rio Concho's only affiliate transaction is the rent payment that the utility makes to Barbie Land Development for office space at Hicks Airfield.⁸⁴ TWC § 13.185(e) requires that any payment by a utility to an affiliated interest only be allowed if the payment is reasonable and necessary. Such a finding must be supported by specific statements demonstrating that the cost to the affiliate of each item in question and the price charged by the affiliate to the utility is no higher than the price that would be charged to unaffiliated entities.⁸⁵ According to Ms. Brunson's testimony, comparable office space close to but not at Hicks Airfield rents for \$800 per month.⁸⁶ This amount was determined using the help of a licensed realtor.⁸⁷ Presumably, Barbie Land Development could rent the on-site office to an unaffiliated entity for approximately that amount. The price that Barbie Land Development charges its affiliate, Rio Concho, in rent for the office space is \$500 per month.⁸⁸ Therefore, the price charged for the affiliate transaction is no higher than prices that would be charged to unaffiliated persons or corporations. Accordingly, the rent transaction between Rio Concho and its affiliate, Barbie Land Development, for suitable, on-site office space meets the reasonable and necessary test of TWC § 13.185(e).⁸⁹

E. Depreciation [PO Issues 11, 26]

Staff recommends that \$25,277.60 of Rio Concho's requested plant in service be disallowed for a total adjusted amount of \$180,754 to be included in invested capital. In applying to increase its water rates, Rio Concho confirmed that the utility's customer base and usage

⁸⁴ See Exhibit RCA-2 at 23 (Schedule II-13 Office Services and Rentals); see also Exhibit RCA-6 at 8-9 (affirming that affiliate Barbie Land Development is the entity from whom Rio Concho rents the office space).

⁸⁵ TWC § 13.185(e).

⁸⁶ Ex. RCA-1 at 23.

⁸⁷ *Id.*

⁸⁸ *Id.* at 22; Exhibit RCA-2 at 23 (Schedule II-13).

⁸⁹ See Staff Ex. 3A at 0000012.

historically remain unchanged.⁹⁰ Rio Concho's proposed rate increase is driven by the addition of proposed new investments that the utility has purchased, including the purchase of a new vehicle, a television, video playback equipment, and other office equipment.⁹¹ The new vehicle and other equipment purchased are water system facilities or plant, which depreciate over the course of their services lives.⁹² Utility plant included in the depreciation schedule must be used and useful for the production and delivery of utility service and must be dedicated to such service.⁹³ The Commission's ratemaking power includes the discretion to disallow improper expenses.⁹⁴ Further, it is well established that a utility's final rate must relate to its actual cost of providing the charged-for service.⁹⁵ Therefore, Staff recommends that the following items be disallowed and not included in Rio Concho's depreciation schedule because they are not related to the provision of water service: (1) the personal Audi vehicle and (2) the television, associated television equipment, video playback equipment, and DVD.⁹⁶ As Staff witness Elisabeth English testified at the hearing on the merits, while it is Staff's position that \$700.92 is an excessive cost for a lamp and sideboard, Staff will no longer oppose the inclusion of these items in the depreciation schedule.⁹⁷

Rio Concho claimed the original cost for the Audi attributable to the utility is \$24,600.00, with a five year service life accumulating \$4,920.00 depreciation value per year.⁹⁸ Staff recommends disallowing the inclusion of the Audi in the cost of service for several reasons. First and foremost, the golf cart and truck owned by Rio Concho are sufficient to service the utility's service area. Rio Concho's service area is limited to the Hicks Airfield and serves 243

⁹⁰ Ex. RCA-2 at 51 (Attachment 2); see Ex. RCA-8 at 8 (Mr. Manus: Given the lack of growth and consistency of customer usage over the years. . .).

⁹¹ Staff Ex. 1 at 0000006 (Direct Testimony of Elisabeth English).

⁹² *Id.* at 0000009.

⁹³ See TWC § 13.185(b); 16 TAC § 24.31(b)(1)(B).

⁹⁴ *Suburban Util. Corp. v. Pub. Util. Comm'n of Texas*, 652 S.W.2d 358, 362 (Tex. 1983).

⁹⁵ *Black v. City of Killeen*, 78 S.W.3d 686, 694 (Tex. App.-Austin 2002, pet. denied); accord, *Suburban Util. Corp. v. Public Util. Comm'n of Texas*, 652 S.W.2d 358, 362 (Tex. 1983).

⁹⁶ Staff Ex. 1 at 0000009-11.

⁹⁷ Tr. at 330:20-333:14.

⁹⁸ *Id.*

connections.⁹⁹ Rio Concho is providing a similar type of service to these connections, which are airplane hangars,¹⁰⁰ and are located in a single, relatively small geographic area.¹⁰¹ The golf cart is sufficient for checking meters and getting between airplane hangars around the property. For instances when large haulage might be required and no contractor's vehicle is available, the truck should be sufficient. Ms. Brunson confirmed during cross-examination that despite its age, the truck is in service and used and useful.¹⁰² Acquiring a third vehicle, and a luxury vehicle at that, is not reasonable for the provision of service at a utility of this size. Second, as Staff witness Ms. Loockerman testified, the Audi is primarily used for commuting from the Brunson's home in Aledo to Rio Concho's service area at Hicks Airfield in Fort Worth, which does not relate to the provision of water service.¹⁰³ Furthermore, utility-related activities that Ms. Brunson claims to perform with the Audi, such as banking, attending training conferences and Commission hearings, and dropping off water samples at the public health department,¹⁰⁴ may all be compensated for by Staff's proposed mileage costs being included in Rio Concho's cost of service.¹⁰⁵ Third, the Audi's true use is as a personal vehicle, not as a capital asset of Rio Concho. This is first evidenced by the fact that Ms. Brunson purchased it in her name rather than under Rio Concho's name. During cross-examination, Ms. Brunson asserted that the Audi was purchased in her name because Rio Concho could not get a loan to purchase the vehicle.¹⁰⁶ However, Ms. Brunson's testimony directly contradicts that statement by affirming that Rio Concho can obtain a loan in the utility's name at a variety of interest rates.¹⁰⁷ The most obvious

⁹⁹ Ex. RCA-1 at 4.

¹⁰⁰ Ex. RCA-6 at 4.

¹⁰¹ Staff Ex. 1 at 0000010 (The service area is approximately 77 acres and that the water utility facilities are adjacent to the water office).

¹⁰² Tr. at 180:22-181:15 (Q: Sheets: How about July 23rd...? A: Brunson: That's probably when I had to use the dually...It's a Ford dually pickup truck that uses diesel.).

¹⁰³ Staff Ex. 3A at 0000012-13.

¹⁰⁴ Ex. RCA-1 at 24.

¹⁰⁵ Staff Ex. 1 at 0000010.

¹⁰⁶ Tr. at 68:24-69:1.

¹⁰⁷ Ex. RCA-1 at 28 (Ms. Brunson: Based upon my research and inquiry at our local bank, the water system could obtain a loan for somewhere between 7.58% and 17.7% for 24-month note."); Ex. RCA-6 at 3. Ms. Brunson confirmed on cross examination that she only checked at one bank to obtain these quotes, so it is possible that other banks would have also been willing to make a loan to Rio Concho and potentially at even better rates (Tr. at 439:23-440:3).

evidence of its use as a purely personal vehicle though is the fact that it is a luxury model and is used by Ms. Brunson primarily for commuting. For these reasons, Staff recommends that the Audi, at a cost of \$24,600, be disallowed.

Rio Concho also included a television, wall mount, antenna, video player, and DVD in its proposed depreciation schedule at an original cost of \$677.60.¹⁰⁸ Staff recommends disallowing the inclusion of these items because they do not serve a purpose for providing retail water utility service.¹⁰⁹ Ms. Brunson justifies the need for such equipment by arguing that they are necessary to utility operations for two reasons: to monitor the weather and to watch training videos.¹¹⁰ However, the utility owns a laptop computer which is capable of both monitoring weather and playing DVDs to watch training videos. Ms. Brunson even affirms that she keeps the laptop with her at all times,¹¹¹ and accordingly the laptop is more readily available for such uses than a stationary television and video equipment. These reasons alone support Staff's disallowance of these items, as they are purely a redundant cost to the utility. Staff further notes that the television is likely being used primarily for personal entertainment purposes as, for instance, the DVD included was not for a training video but rather was a comedy film.¹¹² It is self-evidently unjust and unreasonable for customers to pay for equipment used predominantly for personal entertainment of utility employees. For these reasons, Staff recommends that the inclusion of the television and related equipment, at a cost of \$677.60, be disallowed.

With the disallowance of the Audi, television, and video playback equipment, Staff's adjustments have the following effect on depreciation:¹¹³

¹⁰⁸ Ex. RCA-2 at 52 (Attachment 3).

¹⁰⁹ Staff Ex. 1 at 0000011.

¹¹⁰ Ex. RCA-6 at 4.

¹¹¹ Tr. at 209:6-7.

¹¹² The DVD was for a film entitled "Dumb and Dumber." Tr. at 115:17-116:1.

¹¹³ Staff notes that Table 4 does not include the reduction of \$75.23 that Rio Concho conceded was improperly included for a compressor that was already fully depreciated (Tr. at 495:10-496:4).

Table 4				
Adjustments to Depreciation				
	Rio Concho Requested ¹¹⁴	Staff's Adjustments	Plant Fully Depreciated	Staff Recommended
Original Cost Total	\$210,581.85	(\$25,277.60)	(\$4,550)	\$180,754
Annual Depreciation	\$10,526.66	(\$5,329.66)	\$0	\$5,197
Accumulated Depreciation	\$124,343.11	(\$10,538.11)	\$0	\$113,805
Net Plant	\$86,277.97	(\$19,289.49)	\$0	\$66,949

F. Taxes

1. Federal Income Tax Expense [PO Issue 29]

If Staff's recommended changes to Rio Concho's cost of service are adopted, Staff recommends a corresponding reduction to federal income taxes consistent with those changes and the resulting change on the normalized tax calculation. This tax calculation is included in Staff Ex. 3A, Attachment DL-3, Schedule I(c).¹¹⁵

2. Other Assessments and Taxes [PO Issue 28]

Staff's Initial Brief does not address this issue, but reserves the right to address this issue in its Reply Brief as needed.

G. Return on Invested Capital [PO Issues 9, 14]

Staff recommends an invested capital base of \$79,240, which includes the components shown in the following table:¹¹⁶

¹¹⁴ Original table in Staff Ex. 1 used Rio Concho's requested numbers from its Application, this table has been modified to use Rio Concho's more current requested numbers as shown in Staff Ex. 13 at RCA000920.

¹¹⁵ Staff Ex. 3A at 000030.

¹¹⁶ *Id.* at 000017, Table 3- modified as indicated in footnotes in table.

Table 5			
Adjustments to Invested Capital			
	Rio Concho Requested ¹¹⁷	Staff Adjustments ¹¹⁸	Staff Recommended
Plant in Service- Original Cost	\$210,852	(29,828)	\$180,754
Accumulated Depreciation	(124,343)	10,538	(113,805)
Cash Working Capital	15,834	(3,176)	12,291
Invested Capital	101,623	(22,466)	\$79,157

Plant in Service- Original Cost

Staff's adjustments to Rio Concho's plant in service consists of the disallowance of the Audi SUV and television, which are discussed above in section II(E).

Accumulated Depreciation

Staff's adjustments to Rio Concho's accumulated depreciation are discussed above in section II(E).

Cash Working Capital

Staff's recommended changes to cash working capital are due to flow through calculations from adjustments to operation and maintenance, administrative, and general expenses.¹¹⁹ Ms. Loockerman recommends a ratio of 1/8 of expenses be used for cash working capital, which produces a calculation of 1/8 times \$98,331, which equals \$12,291.¹²⁰

III. RATE OF RETURN

Staff recommends that Rio Concho be permitted the opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses. Staff's proposed overall rate of return is 6.76%, which is calculated as follows:¹²¹

¹¹⁷ Original table in Staff Ex. 3A used Rio Concho's requested numbers from its Application, this table has been modified to use Rio Concho's more current requested numbers as shown in Staff Ex. 13 at RCA000920.

¹¹⁸ Staff adjustments modified from original table to reflect Staff's allowance of \$700.92 for a lamp and sideboard in the depreciation schedule (Tr. at 330:23-331:4).

¹¹⁹ See Staff Ex. 3A at 0000018.

¹²⁰ *Id.*

¹²¹ See Staff Ex. 2 at 00005 (Direct Testimony of Andrew Novak).

Table 6 Staff Recommended Overall Rate of Return			
	Capital Structure	Rate	Weighted Average
Debt	50%	5.03%	2.52%
Equity	50%	8.48%	4.24%
Total	100%		6.76%

As will be discussed more fully below, Staff's overall rate of return is based upon the expert recommendation of Staff witness Andrew Novak and is a reasonable rate of return given the comparable returns for regulated water utilities.

A. Return on Equity [PO Issue 8]

Staff witness Andrew Novak recommends a reasonable return on equity of 8.48%. Mr. Novak relied upon constitutional standards, statutory standards, and complex economic models in his analysis. Mr. Novak arrived at his recommended return on equity by relying on the discounted cash flow (DCF) method widely accepted by the Commission. Mr. Novak's DCF analysis employed a spot dividend yield, a 52-week dividend yield and earnings growth forecasts.¹²² Mr. Novak also used a proxy group of water utilities from a publicly available and non-controversial source.¹²³

The Texas Water Code prohibits the Commission from prescribing any rate that will yield more than a fair return on invested capital used and useful in rendering service to the public.¹²⁴ Mr. Novak's recommendation fits squarely within the requirements established by the Texas Water Code. Finally, Mr. Novak relied upon the constitutional standards set forth by the U.S. Supreme Court in *Federal Power Commission v. Hope Natural Gas Company* (Hope) (1944) and *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia* (Bluefield) (1923).¹²⁵

In contrast, although Rio Concho hired and presented a witness capable of testifying as to a rate of return computed using traditional constitutional, statutory, and economic standards,¹²⁶

¹²² Staff Ex. 2 at 000006.

¹²³ *Id.* at 000006-7.

¹²⁴ TWC § 13.184.

¹²⁵ Staff Ex. 2 at 000004 (discussing *Hope*, 320 U.S. 591 (1944); *Bluefield*, 262 U.S. 679 (1923)).

¹²⁶ Tr. at 414:11-20.

Rio Concho chose instead to rely on the simplified formula presented in rate filing packages as an alternative to be used where no party is contesting the rate of return on equity.

B. Cost of Debt [PO Issues 8, 13]

Given that Rio Concho has no debt, Staff recommends a hypothetical market based cost of debt of 5.03%. Staff's recommendation is based on the average rate for Baa utility bonds for every month for the test year used for this application.¹²⁷ Staff's hypothetical cost of debt is a reasonable approximation of the cost of debt for a regulated water utility.

In contrast, Rio Concho used a hypothetical cost of debt based upon the interest rate charged to Mrs. Brunson for the loan on her personal vehicle.¹²⁸ Rio Concho's proposed hypothetical cost of debt has no bearing on the cost of debt for a regulated water utility such as Rio Concho. Moreover, Rio Concho has not provided any credible evidence as to what a reasonable cost of debt would be for a regulated water utility such as Rio Concho. The only evidence introduced was an unqualified lay opinion of Mrs. Brunson as to the interest rates that her bank would charge Rio Concho for an unsecured 24 month loan.¹²⁹ However, Mrs. Brunson was unable to speculate as to the difference in rates that a bank would be willing to lend to the utility on a secured basis as opposed to an unsecured basis.¹³⁰ Finally, it should be noted that Staff's recommended hypothetical cost of debt is 113 basis points higher than Rio Concho's proposed hypothetical cost of debt.

C. Capital Structure [PO Issue 7]

Staff recommends a hypothetical capital structure of 50% debt and 50% equity.¹³¹ Staff's recommended capital structure is based upon the optimal capital structure as reported by Valueline Investment Survey water proxy group.¹³² Staff's recommended capital structure is a reasonable approximation of the optimal capital structure for regulated water utilities.

¹²⁷ Staff Ex. 2 at 000005-6.

¹²⁸ Ex. RCA-4 at 23 (Q: How was it [the requested debt rate] determined? A: Using the interest rate on a single debt item.)

¹²⁹ Ex. RCA-1 at 28.

¹³⁰ Tr. at 166:20-22 (Ms. Brunson: I have no comment. I'm not familiar with all that [the difference in feasibility of obtaining or interest rate between a secured loan as opposed to an unsecured loan], how it works really. I've never investigated that with a bank specifically.)

¹³¹ Staff Ex. 2 at 000005.

¹³² *Id.* at 000007.

In contrast, because Rio Concho has no actual debt of its own, Rio Concho employs a hypothetical capital structure by imputing the personal debt of Mrs. Brunson for her personal vehicle as the total debt of Rio Concho. However, Rio Concho's proposed level of debt has no bearing on the optimal level of debt for a regulated water utility. Rio Concho's proposed level of debt would overcompensate shareholders at the expense of ratepayers, as discussed more fully below.

D. Overall Rate of Return [PO Issue 8]

As stated above, Staff's recommended overall rate of return is 6.76%, based upon reliable and accepted market indices and economic analyses. The following table compares the revenue requirement and federal income tax impact of Staff's recommended overall rate of return to the revenue requirement and federal income tax impact of Rio Concho's proposed overall rate of return:

Table 7¹³³ Comparison of Revenue Requirement Effect of Return With Taxes @ 15%			
	Rio Concho	Staff	Difference
Debt	\$ 788.50	\$ 2,559.79	\$ 1,771.29
ROE w/ Taxes	\$ 11,984.97	\$ 5,077.08	\$ (6,907.89)
Overall ROR w/ Taxes	\$ 12,773.47	\$ 7,636.87	\$ (5,136.60)

As may be seen, Staff's recommendation more than triples the revenue requirement impact of debt cost as compared to Rio Concho's recommended debt costs. This is a result of Staff's recommendation of a higher cost of debt than proposed by Rio Concho and a capital structure more appropriately balanced with debt. At the same time, Staff's proposed recommendation only reduces the revenue requirement impact of equity and federal income taxes by a little more than half.

Staff's recommendation on the overall rate of return reflects the fact that ratepayers should not be required to compensate shareholders for higher levels and costs of equity than

¹³³ Staff Ex. 18 (Demonstrative). It is important to note that although Staff has several recommended adjustments to Rio Concho's invested capital, the above table assumes Rio Concho's proposed level of invested capital for both Rio Concho's overall return as well as Staff's overall rate of return in order to isolate the revenue requirement impacts associated with the difference between the two recommendations. It is also important to note that the revenue requirement impact of the recommended return on equities is grossed up for federal income tax expenses assumed at 15%, which is uncontested in this proceeding.

reasonable and necessary to operate a water utility. Water utilities such as Rio Concho are regulated monopolies. As such, the capital structure and costs of debt and equity to be approved by the Commission should be market based substitutes for the overall return that would be reasonably expected to accrue to shareholders in a competitive environment. In a competitive environment, natural competitive forces would require Rio Concho to reduce the level of overall return to reflect a market based capital structure and costs of debt and equity. Staff's recommended overall cost of capital provides a reasonable proxy for the overall cost of capital that would be required in order to be competitive in a non-monopolistic environment.

IV. RATE DESIGN [PO ISSUES 1, 2]

In assessing the appropriate rate design for a utility, the Commission must ensure that every utility's rate is just and reasonable.¹³⁴ Rates must not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of consumers.¹³⁵ Rio Concho has only a single customer class, so rate design in this case primarily involves rate allocation decisions between fixed and variable components. As Staff witness Ms. English stated in her direct testimony, a successful rate design will allow a predictable revenue based on cost of service.¹³⁶ To best achieve a predictable revenue and ultimately provide an equitable bill for customers, those elements of Rio Concho's cost of service that are directly related to its water demand should be recovered through the variable component of the rate design, the volumetric rate per thousand gallons.¹³⁷ The remaining elements of cost of service will then be recovered through the fixed base rate. This is equitable because a customer's bill will be tied to the volume of their demand, which ensures appropriate conservation and also minimizes the risk of unintended subsidies to other customers.¹³⁸

In a proceeding initiated by the service provider to propose a rate change, that service provider (if they are a retail public utility) has the burden of proof to show that the proposed

¹³⁴ TWC § 13.182(a)

¹³⁵ TWC § 13.182(b).

¹³⁶ Staff Ex. 1 at 0000009.

¹³⁷ *Id.*

¹³⁸ *Id.*

change is just and reasonable.¹³⁹ Rio Concho's application proposed increasing its retail water rates by raising the fixed base rate from \$31.00 to \$39.75 per month per connection¹⁴⁰ and the volumetric rate per 1,000 gallons from \$5.50 to \$7.05.¹⁴¹ However, Staff's independent assessment of the revenue requirement and subsequent calculations lead Staff to recommend that the base rate be set at \$33.69 and the volumetric rate at \$3.20.¹⁴² Rio Concho claims that it increases the volumetric rate slightly to encourage water conservation, although it did not detail how this adjustment is quantified.¹⁴³ Staff notes though that the average Rio Concho customer in the test year only used approximately 53 gallons of water per day, which is significantly lower than the average residential water customer's use of 93 gallons per day.¹⁴⁴ Therefore, to the extent that conservation was the reason for the variance in Rio Concho's volumetric rate from Staff's, that is not a sufficient reason to meet Rio Concho's burden to show that its proposed rate design is just and reasonable. Staff's proposed base rate and gallonage rate are the more equitable because they strictly allocate variable costs of service to the volumetric rate and fixed costs of service to the base rate.¹⁴⁵

As previously noted, a utility's final rate must relate to its actual cost of providing the charged-for service.¹⁴⁶ In Staff's analysis of the revenue requirement, Staff recommends that several expenses in Rio Concho's requested cost of service be disallowed because they are not related to providing water service, including most prominently the Audi vehicle, increased costs for contract labor, employee health insurance benefits, and the addition of employee life insurance and retirement benefits. These disallowances make up the majority of the difference between Staff's recommended rate design and Rio Concho's requested rates.

¹³⁹ 16 TAC § 24.12.

¹⁴⁰ Ex. RCA-2 at 48. Staff notes that Rio Concho's base rate does not include any volume of water with that fixed rate.

¹⁴¹ Ex. RCA-4 at 7 adjusted Rio Concho's requested volumetric rate from \$7.67 per 1,000 gallons to \$7.19, and Staff Ex. 13 further adjusted the requested volumetric rate from \$7.19 per 1,000 gallons to \$7.05.

¹⁴² Staff Ex. 1 at 0000011-12.

¹⁴³ Ex. RCA-6 at 6.

¹⁴⁴ Staff Ex. 1 at 0000008.

¹⁴⁵ *Id.* at 0000012.

¹⁴⁶ *Black v. City of Killeen*, 78 S.W.3d 686, 694 (Tex. App.-Austin 2002, pet. denied); *Suburban Util. Corp. v. Public Util. Comm'n of Texas*, 652 S.W.2d 358, 362 (Tex. 1983); see also TWC § 13.185(b).

In accordance with the testimony of Ms. English and Ms. Loockerman, Staff's recommended rates represent an equitable allocation of volumetric costs directly tied to usage and do not include charges for costs un-related to the provision of water utility service.

V. RATE CASE EXPENSES

Staff and Rio Concho agree that if the Commission approves a rate that generates \$131,820 or more in revenue, then Rio Concho may recover its reasonable and necessary rate case expenses. Staff recommends that the amount of Rio Concho's reasonable and necessary rate case expenses is \$87,627.49, which should be recovered through a per-connection surcharge over five years. This amount does not include any anticipated expenses to appeal this docket.

A. Recovery of Rate Case Expenses [PO Issue 35]

Rio Concho may only recover rate case expenses if the increase in revenue generated by the rate determined by the Commission after a contested case hearing is at least 51% of the increase in revenue that would have been generated by Rio Concho's proposed rate.¹⁴⁷ At the hearing on the merits, counsel for Rio Concho stipulated that Rio Concho would remove the \$1,794 in rate case expenses included in its requested revenue requirement,¹⁴⁸ resulting in an adjusted requested revenue requirement of \$146,984. This results in the following calculation, which Staff and Rio Concho agree on:¹⁴⁹

$$A^{150} = 51\% \times (\$146,984^{151} - \$116,037^{152})$$

$$A = 51\% \times (\$30,947)$$

$$A = \$15,783$$

Therefore, both Staff and Rio Concho are in agreement that if the Commission approves a revenue requirement less than **\$131,820** (\$116,037 plus \$15,783), Rio Concho should not recover any rate case expenses from its customers.¹⁵³ And if the Commission approves a rate that

¹⁴⁷ 16 TAC § 24.33(b); Staff Ex. 3A at 0000018.

¹⁴⁸ Tr. at 317:22-318:8.

¹⁴⁹ See Ex. RCA-8 at 11.

¹⁵⁰ 51% of Rio Concho's requested increase.

¹⁵¹ Revenues at Rio Concho's requested rates.

¹⁵² Revenues at the previously approved rates.

¹⁵³ Ex. RCA-8 at 11.

generates \$131,820 or more in revenue, Staff and Rio Concho agree that Rio Concho would be permitted to recover its reasonable and necessary rate case expenses.

B. Amount of Rate Case Expenses that are Just, Reasonable, and Necessary, and in the Public Interest [PO Issue 35]

RCA Ex. 18, filed after the hearing on the merits by permission, shows a summary of rate case expenses totaling \$106,564.63.¹⁵⁴ However, this amount does not reflect some of the prior requested expenses shown in Staff Ex. 6A, which Staff has included in the below table under “Other Expenses.” With the addition of these expenses, which Staff believes Rio Concho is still requesting, the total amount of rate case expenses is \$108,155.53. If the Commission approves a rate that generates \$131,820 or more in revenue, then Staff recommends that Rio Concho recover rate case expenses as provided in the below table:

Table 8			
Adjustments to Rate Case Expenses			
Name of Consultant	Rio Concho Requested	Staff Adjustments	Staff Recommended
Randal Manus	\$6,286.70	(\$3,990)	\$2,296.70
The Carlton Law Firm	\$88,916.52	(\$5,577.50)	\$83,339.02
ValueScope	\$10,005.67	(\$10,005.67)	\$0
Barbie Brunson	\$1,355.74	(\$368.07)	\$987.67
Other Expenses	\$1,590.90	(\$586.80)	\$1,004.10
TOTAL	\$108,155.53	(\$20,528.04)	\$87,627.49

In making the above adjustments, Staff is not challenging the professionalism or veracity of Rio Concho’s witnesses. Nor is Staff challenging the experts’ right to be compensated for their services. Rio Concho has been paying, and remains obligated to continue paying, their agreed upon compensation. The question is whether sufficient evidence has been marshalled to prove that Rio Concho, in its capacity as a water utility, is entitled to reimbursement from its water customers for the amount it obligated itself to pay its consultants.

¹⁵⁴ Ex. RCA-18 at 2 (Rio Concho’s Submission of Rate Case Expenses).

1. Randal Manus Invoices

The generic description of “Rate Case 2015” provided in most of Mr. Manus’ invoices¹⁵⁵ does not provide Staff with any detail to determine the reasonableness of the expense. With the exception of the seven invoices¹⁵⁶ which Staff recommends should be allowed, Mr. Manus’ invoices do not describe the task performed, or define the duration of the task. Mr. Manus was asked during cross-examination to provide detail as to what tasks he performed for 6.5 hours on January 19, 2016, and for 5.5 hours on January 28, 2016, and he was unable to recall any details.¹⁵⁷ Mr. Manus was also asked about a more recent invoice dated September 7, 2016, and while he stated that the work billed “most likely had to do with my testimony” he testified that he would have to check the dates to confirm.¹⁵⁸ A reasonableness determination includes an analysis of whether the tasks performed were reasonable, whether the amount of time spent on each task was reasonable, and whether the work being performed was duplicative. Without any of these details, Staff does not have adequate information to determine whether the services Mr. Manus provided were reasonable. Further, Rio Concho had the opportunity to clarify this information through redirect or rebuttal, but never did so.

Additionally, Rio Concho included the total amount of Mr. Manus’ June 7, 2016 invoice¹⁵⁹ in its requested rate case expenses,¹⁶⁰ though Mr. Manus testified that the \$30.00 line item on that invoice for “Chlorine Pump Serviced” was not related to this case, and was not intended to be included in the amount of requested rate case expenses.¹⁶¹ Per Mr. Manus’ own testimony, that \$30.00 is not reasonable because it is not related to this case, and cannot be recovered from customers.

¹⁵⁵ See generally Staff Exs. 6A, 6B, and 6C (Rio Concho’s Original, First Supplemental, and Second Supplemental Responses to Staff RFI 4-1).

¹⁵⁶ See Staff Ex. 6A at RCA000870, RCA000871, RCA000875, RCA000881, RCA000885, RCA000887; RCA Ex. 18 at 3.

¹⁵⁷ Tr. at 105:22-107:2.

¹⁵⁸ *Id.* at 107:18-108:1.

¹⁵⁹ Staff Ex. 6A at RCA000866.

¹⁶⁰ See Ex. RCA-18 at 2.

¹⁶¹ Tr. at 107:9-14.

2. The John Carlton Law Firm Invoices

Rio Concho's refusal to voluntarily extend its effective date after its counsel's health issues prevented a timely hearing on the merits caused a significant amount of additional and unnecessary work for all parties involved. Rio Concho maintained its refusal even after Staff offered a relate back date that would preserve the utility's ability to collect a higher rate from customers as of January 16, 2017, should that be the result of this proceeding, thereby removing any prejudice from an extension.¹⁶² Ultimately, after multiple conferences between counsel, filings from Staff and Rio Concho, and two prehearing conferences, Rio Concho reversed its position and agreed to the extension that was originally discussed. Rio Concho's position was unreasonable, and any rate case expenses that were incurred as a result of defending this position are not necessary, reasonable, or in the public interest. While it is Rio Concho's right to assert any position in support of its rate application, the associated costs are not recoverable from ratepayers if they are not reasonable. The following table, derived from invoices contained in RCA Ex. 18, shows Staff's recommended disallowances of rate case expenses on the issue of the extension of Rio Concho's effective date:

Table 9 John Carlton Law Firm Invoices Relating to Effective Date Issue			
Date	Description Provided	Time Billed	Amount Billed
11/07/16	Work regarding supplemental discovery responses; Teleconference with E. Garcia regarding suspension period.	0.5	\$162.50
11/08/16	Teleconference with E. Garcia regarding rate suspension; draft correspondence to B. Brunson regarding same.	0.6	\$195.00
11/14/16	Receive and review correspondence from K. Brunson regarding PUC rate suspension; draft response; Receive and review reply.	0.4	\$130.00
11/15/16	Work regarding rate suspension issues; Teleconference with S. Mack regarding suspension issues and potential agreement; draft correspondent to K. Brunson and B. Brunson regarding same.	0.7	\$227.50
11/16/16	Teleconference with E. Garcia regarding possible agreed motion regarding suspension of rates and relation back date for rates.	0.4	\$130.00
11/28/16	Review discovery responses; review PUC staff testimony regarding contested issues; Teleconference with E. Garcia.	2.1	\$682.50

¹⁶² See Ex. RCA-18 at 2 of 31; see also Staff's Supplement to Request to Postpone Hearing on the Merits at 1 (Nov. 29, 2016).

11/29/16	Teleconference with E. Garcia's office; Receive and review correspondence from E. Garcia regarding prehearing conference request; draft correspondence to B. Brunson regarding same; work regarding cross examination.	2.5	\$812.50
11/30/16	Receive Staff's Supplement to Request to Postpone Hearing on the Merits; receive SOAH Order No. 10 Notice of Prehearing Conference; calendar date and time. (Amy Leora)	0.3	\$52.50
12/01/16	Prepare for prehearing conference; participate in prehearing conference; Teleconference with K. Brunson and B. Brunson; continue hearing preparation.	2.8	\$910.00
12/02/16	Teleconference with K. Brunson regarding testimony; prepare for cross-examination of witnesses; draft motion to extend effective date; draft correspondence to B. Brunson and K. Brunson regarding same; Teleconference with B. Brunson and R. Manus; Teleconference with G. Scheig; Teleconference with E. Garcia regarding motion and court reporter.	6.5	\$2,112.50
12/05/16	Attend Hearing on the Merits	0.5 ¹⁶³	\$162.50 ¹⁶⁴
	TOTAL		\$5,577.50

In some of the entries in the above table, there are other tasks listed in the description that are not related to the effective date issue (not in bold). Because there is not sufficient information for Staff to separate out only the time that was billed to the effective date issue, Staff has disallowed the entire time entry.

3. ValueScope Invoices

The expenses incurred in hiring ValueScope are not reasonable, necessary, or in the public interest. Mr. Scheig was not hired in this matter as a rate of return expert, and the scope of his testimony did not include a recommendation on an appropriate rate of return for Rio Concho.¹⁶⁵ Instead, Mr. Scheig was hired to provide a valuation of Rio Concho, applying both Rio Concho's requested rate of return and Staff witness Mr. Novak's recommended rate of

¹⁶³ A prehearing conference was held immediately prior to the hearing on the merits on 12/5/16 to discuss the effective date issue. The prehearing conference began at 8:59 a.m. (Tr. at 3:3). A break was taken from 9:15 a.m. to 9:21 a.m. for Rio Concho to consult with counsel (Tr. at 14:16), then the discussion regarding the effective date was resumed and concluded. Based on these times indicated in the transcript, Staff has estimated half an hour was spent on this issue.

¹⁶⁴ Counsel for Rio Concho's invoices show an hourly rate of \$325.00. Half an hour at that rate is \$162.50.

¹⁶⁵ Ex. RCA-9 at 4 (Line 5- "Although I have not been asked to develop a recommended rate of return in this proceeding . . .") (Rebuttal Testimony of Greg Scheig).

return. This valuation was provided in addition to Mr. Manus' rate of return rebuttal testimony.¹⁶⁶ Rio Concho has the ability to hire experts as it sees fit to support its rate application; however, the associated expenses are only recoverable from Rio Concho's water customers where they are reasonable or necessary. Because the Commission does not use utility valuations in setting rates, the cost of hiring Mr. Scheig and ValueScope to provide that analysis was not reasonable or necessary, and should not be recovered from customers.

4. Barbie Brunson Hearing Related Expenses

RCA Ex. 18 lists \$1,355.74 in expenses from Barbie Brunson for December 4-6, 2016, and provides hotel, parking, and restaurant receipts in the last seven pages of the exhibit.¹⁶⁷ The following restaurant receipts show only the total amount of the check, and do not provide an itemized list of the food and drinks purchased: Outback Steakhouse for \$49.61, Pappadeaux for \$122.79, Mimi's Café for \$50.68, and Pappasito's for \$92.99. The total amount of the check does not provide Staff adequate information to determine how many meals were purchased, the cost of those meals, or whether any alcohol was purchased. Additionally, there is a receipt for \$52.00 that has no information about where the charge was incurred. While there is a handwritten note on the receipt that says "Water hearing- Greg, John, Kevin, Randy, Barbie" Staff has no way to evaluate what was purchased, where it was purchased, or why. The description on each item on the receipt simply reads "DEPT02".¹⁶⁸ Without any of those details, Staff cannot evaluate the reasonableness of these restaurant expenses, and recommends they be disallowed.

5. Other Expenses

Staff Ex. 6A includes \$1,590.90 of requested rate case expenses that are not shown in RCA Ex. 18. The below table shows these requested expenses, and Staff's adjustments:

¹⁶⁶ See Ex. RCA-8 at 3-6.

¹⁶⁷ Ex. RCA-18 at 2.

¹⁶⁸ *Id.* at 2nd to last page.

<p align="center">Table 10 Rate Case Expenses Not Included in RCA Ex. 8</p>				
Expense Description	Page of Staff Ex. 6A	Rio Concho Requested	Staff Adjustments	Staff Recommended
Shipping Receipt/UPS Store	RCA000853	\$28.06	(\$0)	\$28.06
Copies, Stamps/UPS Store	RCA000854	\$191.76	(\$0)	\$191.76
Shipping Receipt/UPS Store	RCA000855	\$80.29	(\$0)	\$80.29
Shipping Receipt/UPS Store	RCA000858	\$30.99	(\$0)	\$30.99
Shipping Receipt/USPS	RCA000859	\$22.95	(\$0)	\$22.95
Shipping Receipt/UPS Store	RCA000862	\$17.66	(\$0)	\$17.66
Shipping Receipt/UPS Store	RCA000863	\$204.19	(\$0)	\$204.19
Shipping and Copies/UPS Store	RCA000864	\$18.39	(\$0)	\$18.39
Fax and Copies/UPS Store	RCA000864	\$39.89	(\$0)	\$39.89
Shipping receipt/UPS Store	RCA000865	\$75.55	(\$0)	\$75.55
Notary, Scan, Email/UPS Store	RCA000867	\$8.79	(\$0)	\$8.79
Checks payable to A and C for record copy of PUC rate case	RCA000868	\$40.00	(\$40.00)	\$0
Illegible receipt	RCA000869	\$19.86	(\$19.86)	\$0
Parking Receipt	RCA000869	\$15.00	(\$0)	\$15.00
Handwritten notation- Check #1094	RCA000869	\$36.00	(\$0)	\$36.00
Chuy's Receipt	RCA000872	\$60.50	(\$60.50)	\$0
Chuy's Receipt	RCA000872	\$10.05	(\$2.49)	\$7.56
Natty Flat Smokehouse	RCA000872	\$28.06	(\$28.06)	\$0
Expedia Hotel Booking	RCA000873	\$287.72	(\$287.72)	\$0
Cefco #74 Fuel Receipt	RCA000874	\$27.62	(\$0)	\$27.62
Cefco #74 Food Receipt	RCA000874	\$13.73	(\$0)	\$13.73
Trudy's Receipt	RCA000874	\$58.34	(\$58.34)	\$0
Carillion Restaurant Receipt	RCA000874	\$64.83	(\$64.83)	\$0
Notary/UPS Store	RCA000876	\$6.00	(\$0)	\$6.00
County Clerk Receipt- CCRs and Bylaws	RCA000877	\$133.16	(\$0)	\$133.16
Scan, Email/UPS Store	RCA000879	\$6.50	(\$0)	\$6.50
Parking Ticket	RCA000882	\$25.00	(\$25.00)	\$0
Toll Bill	RCA000883	\$17.12	(\$0)	\$17.12
Notary/UPS Store	RCA000884	\$6.00	(\$0)	\$6.00
Scan/UPS Store	RCA000884	\$11.86	(\$0)	\$11.86
Toll Bill	RCA000886	\$5.03	(\$0)	\$5.03
TOTAL		\$1,590.90	\$586.80	\$1,004.10

On Staff Ex. 6A, page RCA000868 there is a handwritten note indicating that "Check 1086" was made out to A¹⁶⁹ for \$20, and "Check 1087" to C¹⁷⁰ for \$20, then below is written "Record Copy of PUC [...] Rate Case." There is no explanation provided for why Rio Concho

¹⁶⁹ Name redacted as per agreement at hearing on the merits.

¹⁷⁰ Name redacted as per agreement at hearing on the merits.

wrote two checks to meter readers and requested them as rate case expenses, and Staff cannot determine whether those expenses were necessary or reasonable.

The receipt located on page RCA000869 is completely illegible, and all that can be made out is the handwritten amount of \$19.86. Again, this does not provide sufficient information for a reasonableness determination.

The following restaurant receipts show only the total amount of the check, and do not provide an itemized list of the food and drinks purchased: Chuy's for \$60.50, Natty Flat Smokehouse for \$28.06, Trudy's for \$58.34, and the Carillion Restaurant for \$64.83. The total amount of the check does not provide Staff adequate information to determine how many meals were purchased, the cost of those meals, and whether any alcohol was purchased. Additionally, at the hearing on the merits Ms. Brunson testified that A and C were present at the meals at Chuy's and Natty Flat Smokehouse.¹⁷¹ When asked why A and C traveled to Austin, Ms. Brunson testified that it was because they were associated with the utility through their role as contract meter readers and wanted to "be a part of it".¹⁷² While A and C's interest in a rate case proceeding is admirable, they were not necessary parties at any proceeding, and the cost of their meals as observers is not a reasonable or necessary rate case expense. Without detailed receipts, it is not possible to exclude only the food and drink ordered by A and C, except for the receipt on RCA000872 for "Queso" and "Beverage," where Ms. Brunson testified the "Beverage" was C's Dr. Pepper.¹⁷³

The requested hotel charge of \$287.72¹⁷⁴ is supported only by an Expedia booking confirmation page, not an actual receipt from the hotel. This booking confirmation does not give the name or the location of the hotel, and does not prove that the reservation was actually used, and not later cancelled or modified. During the hearing on the merits, Ms. Brunson testified that she stayed at this hotel while in Austin for a settlement conference in this matter.¹⁷⁵ However, she was unable to recall the name of the hotel.¹⁷⁶ Without a receipt showing the bare minimum

¹⁷¹ Tr. at 85:20-23; 87:16-20.

¹⁷² *Id.* at 184:14-23.

¹⁷³ *Id.* at 87:4-15.

¹⁷⁴ Staff Ex. 6A at RCA000873.

¹⁷⁵ Tr. at 85:4-8.

¹⁷⁶ *Id.* at 85:13-23.

hotel information, such as the name and location, Staff is unable to confirm that this expense was even incurred. Further, Rio Concho had the opportunity to clarify this information on rebuttal, and did not do so.

Rio Concho also seeks to recover the cost of a \$25 parking ticket from its water customers.¹⁷⁷ Ms. Brunson's testimony at the hearing was that the parking fine was an appropriate rate case expense because she received the ticket while parked and attending a settlement conference related to this case.¹⁷⁸ However, a fine incurred for a violation of the law is not a reasonable or necessary rate case expense. Even Mr. Carlton, counsel for Rio Concho, testified that a \$25 parking fine would not be reasonable.¹⁷⁹

C. Surcharge [PO Issue 37]

Staff witness Ms. Loockerman testified that if Rio Concho is eligible to recover rate case expenses, those reasonable and necessary expenses should be recovered from the customers through a per-connection surcharge over two years.¹⁸⁰ However, at the time of Staff's recommendation, no rate case expense invoices have been filed. Due to substantial changes in circumstances, Rio Concho's requested rate case expenses as shown in RCA Ex. 18 now total \$106,564.63,¹⁸¹ and \$108,155.53 with the inclusion of the expenses in Staff Ex. 6A. Staff's recommendation is that only \$87,627.49 of those expenses are just, reasonable, necessary, and in the public interest. The below table illustrates the monthly surcharge that would be imposed on each Rio Concho customer over two years, three years, and five years in order to collect rate case expenses both at Rio Concho's requested amount and Staff's recommended amount:

Table 11					
Monthly Surcharge Amount to Collect Rate Case Expenses					
	Total Rate Case Expense	Connection Count	Surcharge for 24 months	Surcharge for 36 months	Surcharge for 60 months
Rio Concho's Requested	\$108,155.53	243	\$18.55	\$12.36	\$7.42
Staff's Recommended	\$87,627.49	243	\$15.02	\$10.02	\$6.01

¹⁷⁷ Staff Ex. 6A at RCA000882.

¹⁷⁸ Tr. at 84:13- 85:3.

¹⁷⁹ Tr. at 229:9-14.

¹⁸⁰ Staff Ex. 3A at 0000021.

¹⁸¹ Ex. RCA-18 at 2.

As the table shows, imposing the surcharge over two years to collect Rio Concho's requested rate case expenses would result in an additional \$18.55 being added to each customer's monthly bill, and to recover Staff's recommended expenses would be an addition \$15.02 per month. Staff is concerned that this amount, and even the surcharge amount if collected over three years, would place an undue burden on Rio Concho's customers. Therefore, Staff recommends that if Rio Concho is able to recover its reasonable and necessary rate case expenses, that it be accomplished through a surcharge over five years to ensure that the recovery is not unduly burdensome on the ratepayers.

VI. INTERIM RATES AND EFFECTIVE DATE [PO ISSUE 38, 39]

In its notice to customers, Rio Concho proposed an effective date of April 26, 2016.¹⁸² On April 25, 2016, a Commission ALJ issued Order No. 2, suspending the rate change effective date for 265 days, from April 26, 2016 to January 16, 2017, pursuant to TWC § 13.1871(g) and 16 TAC § 24.26(a)(2).

On November 29, 2016, Staff filed a Supplement to its Request to Postpone Hearing on the Merits advising the ALJ and the parties that Rio Concho was unwilling to voluntarily extend the January 16, 2017 effective date to accommodate the rescheduled hearing on the merits. On December 1, 2016, the ALJ held a telephonic prehearing conference to discuss the effective date issue. At the prehearing conference Rio Concho continued its refusal to extend the effective date, and the ALJ established an expedited procedural schedule that would allow a Proposal for Decision to be considered by the Commission at the January 12, 2017 open meeting. On December 2, 2016, Rio Concho "reluctantly"¹⁸³ filed a motion to extend the effective date of its proposed rates to August 23, 2016, which would extend the 265-day suspension date to May 16, 2017, and requested a relate back date of April 25, 2016.

At a prehearing conference held on December 7, 2016, after discussion, the parties unanimously agreed that the effective date of the proposed rates would be extended to August 23, 2016, which extends the 265-day suspension date to **May 16, 2017**, and that there would be a relate back date of **January 16, 2017**. The ALJs approved this agreement.¹⁸⁴ Therefore,

¹⁸² Rio Concho's Notice of Proposed Rate Change, filed with Application (Mar. 22, 2016).

¹⁸³ Rio Concho Aviation, Inc.'s Motion to Extend Effective Date and Establish "Relate Back" Date at 2 (Dec. 2, 2016).

¹⁸⁴ See SOAH Order No. 11 at 1 (Dec. 19, 2016).

consistent with that agreement, Staff recommends that Rio Concho's interim rates, which are the current rates it is charging customers, go into effect on January 16, 2017. After the Commission makes a final determination in this matter, Rio Concho shall provide refunds or collect surcharges relating back to January 16, 2017.

VII. ISSUES NOT ADDRESSED [PO ISSUES 4, 10, 12, 15, 16, 17, 18, 22, 24, 27, 30, 31, 32, 33, 34, 36]

Preliminary Order Issues 4, 10, 12, 15, 16, 17, 18, 22, 24, 27, 30, 31, 32, 33, 34, and 36 are not applicable to this proceeding, and are therefore not addressed.

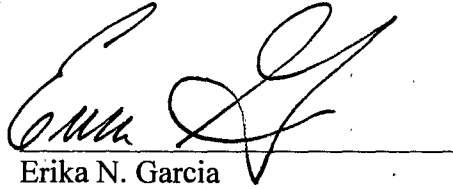
VIII. CONCLUSION

For the reasons discussed above, Staff respectfully requests that the presiding officer issue a proposal for decision that adopts Staff's above recommendations.

SOAH DOCKET NO. 473-16-3831.WS
PUC DOCKET NO. 45720

CERTIFICATE OF SERVICE

I certify that a copy of this document was served on all parties of record on January 11, 2017, in accordance with 16 TAC § 22.74.



Erika N. Garcia