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APPLICATION OF RIO CONCHO § BEFORE THE STATE OFFICE
AVIATION, INC. FOR A § OF
RATE/TARIFF CHANGE § ADMINISTRATIVE HEARINGS

**RIO CONCHO AVIATION, INC.'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

Respectfully submitted,

By: 


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CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested to all parties on this the 3rd day of April, 2017.


John J. Carlton

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EXCEPTIONS TO THE PROPOSAL FOR DECISION**

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RIO CONCHO AVIATION, INC.'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION

COMES NOW, Rio Concho Aviation, Inc. ("Rio Concho") and files this its Exceptions to the Proposal for Decision ("PFD") and proposed Order. In support thereof, Rio Concho respectfully shows the following:

I. INTRODUCTION, JURISDICITON AND BACKGROUND SUMMARY
(PFD PARTS I-111)

Rio Concho has extensive objections to and concerns regarding the PFD and proposed Order. As acknowledged – and deemed reasonable by the Administrative Law Judges ("ALJs") – Rio Concho has spent approximately \$100,000 to follow the Commission's process in an effort to obtain an approximately \$30,000 per year increase in its revenue requirement. The ALJs' PFD and proposed order essentially assert that Rio Concho did not present enough evidence to justify its requested increase in rates. How much more cost would have been necessary to meet the ALJs requirements? There is a significant problem with the Commission's program for regulation of rates for smaller utilities when it costs a minimum of \$100,000 to try to obtain a rate increase that is a mere 30% of that amount. Something in the Commission's program must change or the small family owned businesses that provide water and wastewater services across this state will be forced out of business. Much of this exception document come directly from Rio Concho's initial brief and reply brief in an effort to reduce Rio Concho's costs in the face of what appears to be a foregone conclusion that its requested increase will be denied and its revenues will be reduced to a level that is less than it has ever received from rates.

Rio Concho is a small investor owned water utility company operating under CCN No. 12835 at the Hicks Airfield in Fort Worth, Texas, since 1995. Rio Concho serves approximately

240 customers¹ and is a Class C utility under Texas Water Code §13.002(4-c), which defines all public utilities that provide retail water and sewer utility service to fewer than 500 taps as Class C utilities. Rio Concho opted to file an application for a rate/tariff change on March 22, 2106, as a Class B utility in an effort to increase its rates to a level that would allow it to recover its reasonable and necessary operating expenses and earn a reasonable return on its rate base² because the Class C application only allowed a 1.57% rate increase during 2016.³ Rio Concho's rates and fees, as previously approved in Commission Docket No. 43728, would have generated an annual revenue of \$118,373.58 during the test year.⁴ Rio Concho proposes increasing its total revenue requirement to \$151,097.22, which includes \$1,793.91 in rate case expenses that Rio Concho has agreed to separately surcharge, resulting in a proposed revenue increase of \$30,929.73.⁵ Rio Concho asserts that this increase in the revenue requirement will "(1) permit the utility a reasonable 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; and (2) preserve the financial integrity of the utility."⁶

Rio Concho initially proposed April 26, 2016, as the effective date the rate/tariff change. Notice of the application was sent to customers on March 19, 2016. On April 25, 2016, the Commission issued Order No. 1 deeming Rio Concho's application sufficient but suspending the effective date of the rate/tariff change for 265 days, until January 16, 2017, and referring the matter to the State Office of Administrative Hearings ("SOAH"). The Commission issued its Preliminary Order setting forth the issues to be considered in this matter on May 23, 2016. The SOAH Judges conducted the hearing on the merits on December 5 and 6, 2016. During the hearing on the merits, Rio Concho moved and the other parties agreed on the record to extend the

¹ Exhibit RCA-2, page 8, line 10.

² Direct Testimony of Barbie Brunson, Exhibit RCA-1, page 14, lines 7- 15.

³ Commission Docket No. 45320, Order, adopted November 20, 2015.

⁴ Direct Testimony of Debi Loockerman, Exhibit Staff-3A, p. 19, line 20.

⁵ Staff Exhibit 13, page RCA000914, lines 32 and 20, and page RCA000915, line 6.
(\$151,097.22 - \$1,793.91 - \$118,373.58 = \$30,929.73).

⁶ Texas Water Code, §13.183(a).

effective date to May 16, 2017, with a relate back date of January 16, 2017.⁷ The SOAH Judges granted Rio Concho's motion as agreed to by the parties.⁸

IV. REVENUE REQUIREMENT

Rio Concho excepts to the ALJs recommendations regarding the revenue requirement. Rio Concho asserts that the standards used by the ALJs to evaluate the evidence presented and determinate the revenue requirements are not consistent with state law or the Commission's rules.

Ratemaking for retail water and sewer utilities is governed by Chapter 13, Subchapter F of the Texas Water Code.⁹ Under this subchapter, the Commission is required to "ensure that every rate made, demanded, or received by any utility ... shall be just and reasonable."¹⁰ In a ratemaking proceeding, the utility bears the burden of proof to show that the proposed rates are just and reasonable.¹¹

A utility's rates are based upon the utility's cost of rendering service.¹² A utility's cost of service is comprised of two components: allowable expenses and return on invested capital.¹³ The term "invested capital" is also referred to as the "rate base."¹⁴

Allowable expenses are characterized as expenses that are reasonable and necessary to provide service to the ratépayers, and determined by gathering expense information during a historical test year and making adjustments for known and measurable changes.¹⁵ Allowable expenses may include expenses for operations and maintenance, depreciation, and taxes,¹⁶ but

⁷ Tr. 15:12-22 (Dec. 5, 2016)

⁸ Tr. 15:23-16:3 (Dec. 5, 2016)

⁹ Tex. Water Code§ 13.181.

¹⁰ Tex. Water Code§ 13.182(a).

¹¹ Tex. Water Code§ 13.184(c).

¹² 16 TAC 24.31(a).

¹³ *Id.*

¹⁴ 16 TAC 24.31(c)(2).

¹⁵ 16 TAC 24.31(b).

¹⁶ 16 TAC 24.31(b)(1).

may not include expenses for legislative advocacy, political activity, or other unreasonable or unnecessary expenses.¹⁷ These standards do not require that the utility's expenses be the lowest possible cost. They just require that the utility's expenses be a reasonable cost and necessary to the operation of the utility.

The rate of return is expressed as a percentage of invested capital.¹⁸ It allows a utility an opportunity to earn a return on its invested capital and preserve the financial integrity of the utility.¹⁹ It also permits a utility to meet its credit obligations and reasonably compete in the financial markets for future capital, namely, a return on equity.²⁰ The primary task of setting a rate of return is to determine the cost of capital.

The cost of capital is the composite of the cost of the various classes of capital used by the utility: (1) "debt capital is the actual cost of debt", *i.e.* interest on debt; and (2) equity capital is based upon a fair return on its value, *i.e.* dividends or earnings.²¹

Before a rate of return can be fixed, the Commission must determine what percentage of the utility's cost of capital is debt and what percentage is equity capital. Once the percentage is set for each element, a weighted cost of capital is ascertained by multiplying that percentage amount by the cost of the particular element. The combined weighted values represent the overall rate of return which is then applied to the rate base.²²

In addition to considering the utility's capital structure, the Commission must also consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management.²³ Moreover, in any proceeding involving any proposed change of rates, including

¹⁷ 16 TAC 24.31(b)(2).

¹⁸ 16 TAC 24.31(c)(1).

¹⁹ *Id.*

²⁰ *Id.*

²¹ 16 TAC 24.31(c)(1)(B)(i) and (ii).

²² Exhibit RCA- 2, page 30, line 7.

²³ Tex. Water Code § 13.1 84(a) & (b); 16 TAC §24.31(c)(1)(B).

rate of return, the burden of proof shall be on the utility to show that the proposed change is just and reasonable.²⁴

However, the Commission must also apply the following regulatory principles in determining a fair rate of return:

... 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....

(B) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.²⁵

Lastly, there are two United States Supreme Court rulings that are oft-cited as establishing the legal criteria for determining a fair rate of return for regulated industries such as utilities: *Bluefield Water Works and Improvement Co. v. Public Service Comm 'n of West Virginia*²⁶ and *Federal Power Comm 'n v. Hope Natural Gas Co.*²⁷ In *Bluefield*, the United States Supreme Court stated that:

A public utility is entitled to such rates as will permit it to earn a return on the value of property which it employs for the convenience of the public equal to that general being made ... on investments in other business undertakings which are attended by corresponding risks and uncertainties.²⁸

²⁴ Tex. Water Code § 13.184(c).

²⁵ 16 TAC §24.31(c)(1)

²⁶ *Bluefield Water Works and Improvement Co. v. Public Service Comm 'n of West Virginia*, 262 U.S. 679 (1923).

²⁷ *Federal Power Comm 'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

²⁸ *Bluefield* at 692.

In the *Hope* decision, the United States Supreme Court broadened the concept of a reasonable return to allow for increasing national competition for capital:

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 on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.²⁹

A. Operations and Maintenance Expenses

The Preliminary Order identified the issue of “What are the utility’s reasonable and necessary operation and maintenance expenses?”³⁰ The Commission’s rules define those expenses as “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 (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in TWC §13.185(e))... Within the application form, these are the expenses that are “volume related” – including purchase water, power expense-production only and other volume related expenses – and “non-volume relate exp.” – including employee labor, materials, contract work, transportation expenses and other plant maintenance.³¹

Rio Concho provided support for \$82,178.83 in operations and maintenance expenses.³² These expenses in aggregate are all reasonable and necessary for the operation of the utility. The Commission Staff and Ratepayers questioned Rio Concho’s expenses related to the following: Mr. Brunson’s compensation of \$14,400 per year; meter reading expenses of \$3600 per year; and vehicle operating expenses of \$3,971.22 per year. The ALJs further included reductions to Rio Concho’s cell phone All other operations and maintenance expenses were uncontested.

²⁹ *Hope* at 603.

³⁰ Preliminary Order, May 23, 2016, Issue 20.

³¹ Commission Staff Exhibit 13, page RCA000914, lines 1-9.

³² *Id.* at lines 4 and 10.

a. Kevin Brunson Compensation

Rio Concho excepts to the ALJs findings and conclusions regarding Mr. Brunson's compensation. Rio Concho's requested contract labor expenses for Kevin Brunson are reasonable and necessary. Mr. Brunson receives compensation for his on-call and after-hours responses to issues at the water system and his management and strategic planning services related to the water system. He is paid \$1200 per month for these services as contract labor.³³ Rio Concho must have after-hours and on-call responses and the other services that Mr. Brunson provides in order to provide water services to the customers. Mr. Brunson testified, not only does he spend time responding to emergencies and after-hours calls no matter how long they take, he evaluates and implements programs to improve system operations,³⁴ such as increased system pressure and back-up power.³⁵ The question is not whether his services are necessary, but whether the cost for them is reasonable. By comparison, the cost to retain a company to be on stand-by for infrequent emergency calls would be at least \$700 per month, but that cost does not cover more than one minor call per week or the use of any equipment or parts,³⁶ which Mr. Brunson does provide as part of his compensation.³⁷ In addition, Mr. Brunson's assistance with the other aspects of operating the water system is important because Ms. Brunson already spends more than 170 hours each month working on the system.³⁸ Mr. Brunson's proposed compensation is reasonable and should be included in its entirety in the revenue requirement.

The ALJs and Commission Staff simply ignore this fact when recommending that Mr. Brunson's compensation be reduced to \$3600 annually, or \$300 per month. Their recommendation is unreasonable, particularly when considering that, if Rio Concho did not contract with Mr. Brunson and instead contracted with another party, it would cost at least \$8400 per year. But, Mr. Brunson's assistance does not stop with these stand-by services. He also

³³ Tr. 40:20 through 41:6.

³⁴ Exhibit RCA- 7, page 3, line 9 through page 4, line 16.

³⁵ Tr. 459:3 through 461:7 (Testimony of Kevin Brunson)(December 6, 2016).

³⁶ Commission Staff Exhibit 9, pages RCA000911 and RCA000912.

³⁷ Exhibit RCA- 6, page 7, lines 11-13, and Exhibit RCA- 1, page 23, lines 13-15.

³⁸ Exhibit RCA- 1, page 9, line 21.

helps with the other aspects of operating the water system, including evaluating and implementing programs to improve system operations,³⁹ such as increased system pressure and back-up power.⁴⁰ The utility having him available for this additional work is important because Ms. Brunson already spends more than 170 hours each month working on the system.⁴¹ Compensating Mr. Brunson an additional \$500 each month for his additional services is reasonable. Commission Staff's proposal would not reasonably compensate Mr. Brunson for the value of his services, which are necessary to the operation of the utility.

b. Meter Reader Compensation

Rio Concho excepts to the ALJs findings and conclusions regarding meter reading compensation. Rio Concho pays \$300 per month for meter reading services. Even though some of these payments are to individuals related to the owners of Rio Concho and could be considered affiliated transactions, they are more than reasonable. Rio Concho received a quote to provide meter reading services for \$3.50 per connection per month, which would result in a cost of \$840 per month for those services that Rio Concho only pays \$300 for. Ms. Loockerman erroneously recommends a reduction of \$655 because she simply does not understand that the \$1470 increase in known and measurable changes shown in the application⁴² is the difference between the meter reading expenses incurred during the test year (\$2,130)⁴³ and the proposed new cost (\$3600). The full known and measurable increase of \$1,470 should be included in the revenue requirement. By using its contract meter readers, Rio Concho is saving its customers \$550 per month or \$6600 each year. Incredibly, the ALJs proposes to eliminate Rio Concho's meter reading expenses. Given the market cost for meter reading services, Rio Concho's requested \$300 is more than reasonable.

³⁹ Exhibit RCA- 7, page 3, line 9 through page 4, line 16.

⁴⁰ Tr. 459:3 through 461:7 (Testimony of Mr. Brunson)(December 6, 2016).

⁴¹ Exhibit RCA- 1, page 9, line 21.

⁴² Exhibit RCA- 2, Schedule II-8.

⁴³ Commission Staff Exhibit 17A, page RCA000083.

3. Vehicle Expenses

Rio Concho excepts to the ALJs findings and conclusions regarding vehicle expenses. Commission Staff and Ratepayers argue that the SUV is an unnecessary luxury for the personal benefit of Ms. Brunson. However, as Ms. Brunson testified, this 2015 model was used, included all-wheel drive, is large enough to hold supplies, and is highly rated for safety and reliability.⁴⁴ As Ms. Brunson testified, she uses this vehicle for utility business for more than 60% of its total miles.⁴⁵ Consequently, Rio Concho is only seeking 60% of this vehicle in its rate base.

The gasoline, repairs and other operating expenses for the SUV related to the utility operations totaled \$3,971.22 during the test year.⁴⁶ This is 60% of the total vehicle expenses.⁴⁷ Ms. Brunson testified that approximately 62% of the vehicles mileage, or 19,627 miles per year, is for water system matters.⁴⁸ This amount is supported by Mr. Manus' calculations.⁴⁹

The ALJs recommend disallowing these expenses and replacing them with the IRS mileage rate for reimbursement. This position is entirely based upon the erroneous determination that the vehicle is only used for utility purposes 15.9% of the time.⁵⁰ As her rationale for excluding the vehicle expenses claimed by Rio Concho, ALJs cite to Ms. Loockerman's testimony that asserts that it is unreasonable for Rio Concho to have two offices.⁵¹

However, Rio Concho is not seeking to recover any expenses associated with its corporate office, a fact the Ms. Loockerman acknowledges.⁵² Rio Concho has established an office at the utility system simply in an effort to comply with the Commission rule on office

⁴⁴ Tr. at 208:3-19 (Testimony of Ms. Brunson) (December 5, 2016).

⁴⁵ Exhibit RCA- 1, page 24, lines 13-14.

⁴⁶ Exhibit RCA- 2, page 18

⁴⁷ Exhibit RCA- 1, page 25, line 14 through page 26, line 3.

⁴⁸ Exhibit RCA- 1, page 24, lines 13-14.

⁴⁹ Exhibit RCA- 4, page 14, line 1 through page 15, line 17.

⁵⁰ Commission Staff Exhibit 3A, page 12, lines 15-20.

⁵¹ *Id.*, page 10, lines 17-19.

⁵² *Id.*, page 11, lines 2-3.

location without seeking an exemption for the location of their corporate office. Ms. Brunson conducts work for the water system at both offices.⁵³ Had Rio Concho secured an exemption for the corporate office location, Ms. Loockerman's rationale would fail without question. Consequently, the mileage between the two offices is appropriately business mileage. The SUV operating expenses are necessary for the operation of the utility system as explained by Ms. Brunson.⁵⁴ Allocation of 60% of the SUV operating expenses is reasonable given that the mileage used for utility purposes exceeds that level.

B. Administrative and General Expenses

The Preliminary Order identified the issue of "What are the utility's reasonable and necessary administrative and general expenses?"⁵⁵ The Commission's application form for Class B utilities includes office salaries, management salaries, employee pensions & benefits, purchased power-Office only, bad debt expense, office services & rentals, office supplies & expenses, professional services, insurance, regulatory (rate case) expense, regulatory (other) expense and miscellaneous expenses.⁵⁶

Rio Concho provided evidence to support \$40,891.28 in administrative and general expenses.⁵⁷ These expenses are all reasonable and necessary for the operation of the utility. The Commission Staff and Ratepayers questioned Rio Concho's expenses related to the following:

1. Employee Benefits

Rio Concho excepts to the ALJs findings and conclusions regarding Ms. Brunson's employee benefits.

⁵³ Exhibit RCA- 1, page 10, lines 3-15.

⁵⁴ *Id.* at page 23, line 9, through page 24, line 7.

⁵⁵ Preliminary Order, May 23, 2016, Issue 20.

⁵⁶ Commission Staff Exhibit 13, page RCA000914, lines 11-22.

⁵⁷ *Id.* at line 23.

a. Ms. Brunson Retirement Benefits

As Rio Concho's sole and more than full-time employee, Ms. Brunson is entitled to a reasonable retirement benefit. The expense for her retirement benefits is less than \$400 per month.⁵⁸ But even this benefit will only provide Ms. Brunson with \$1200 per month at age 70, which is not an excessive or unreasonable amount for retirement considering her over 20-year commitment to the utility. The ALJs agree with Commission Staff's position that, because – once again – Rio Concho is a small utility system, its employees should not have retirement benefits paid for by the utility. Rio Concho provided several examples of utility companies that provide retirement benefits, and while the ALJ and Commission Staff may not have liked those comparisons, Commission Staff provided absolutely no evidence other than Ms. Loockerman's testimony that Ms. Brunson's retirement benefit was not appropriate.

Ms. Brunson has worked full-time for 21 years for the utility. It is her only full-time job.⁵⁹ The expense for her retirement benefits is \$4666 per year.⁶⁰ The benefits will provide Ms. Brunson with \$1200 per month at age 70, which is not an excessive or unreasonable amount for retirement considering her long commitment to the utility. As Mr. Manus testified, retirement benefits are commonly accepted and expected within the full-time workforce.⁶¹

b. Key Employee Insurance

Rio Concho also requested that its expense for a key employee life insurance policy be included in its reasonable and necessary expenses. This policy was erroneously issued with Mr. Brunson as the beneficiary and characterized as a life insurance policy. That error has been corrected, and Rio Concho Aviation is now the beneficiary.⁶² The policy provides insurance against the impact of the sudden loss of Ms. Brunson, who is responsible for the day-to-day operation of the utility and critical to its success. The cost for this policy is only \$113 per

⁵⁸ Commission Staff Exhibit 3A, page 13, line 6 (\$4666/12).

⁵⁹ Exhibit RCA- 1, page 19, lines 1-8.

⁶⁰ Commission Staff Exhibit 3A, page 13, line 6.

⁶¹ Exhibit RCA- 4, page 16, lines 7-14.

⁶² Exhibit RCA- 6, page 9, line 18, through page 10, line 2.

month.⁶³ The policy will pay Rio Concho \$150,000 to help defray the costs of replacing Ms. Brunson, who has been the utility operator for the past 20 years. The ALJs agree with Commission Staff's position that Rio Concho could simply hire someone the next day, but that is not the way the world works. There would be delay in hiring, short term expenses required to get immediate help, training and other sorts of unknown expenses to deal with the transition.⁶⁴ The \$150,000 insurance payment would defray those transition costs and assist this small family owned business through what would be a difficult time.

2. On-Site Office Rent

Rio Concho excepts to the ALJs findings and conclusions regarding its office rent expenses.

Rio Concho has established an office at the water system location by renting office space for \$500 per month from an affiliated entity, Barbie Land Development.⁶⁵ Under Code § 13.185(e), Rio Concho must prove that any payment by a utility to an affiliated interest is reasonable and necessary. A finding under this rule must be supported by "specific statements setting forth the cost to the affiliate of each item or class of items in question and a finding that the price to the utility is no higher than prices charged by the supplying affiliate to its other affiliates, *or to unaffiliated persons or corporations.*"⁶⁶

Rio Concho's rent includes utilities. The Ratepayers argue that this rent is unreasonable. But a survey of office spaces for lease in the area shows that lesser offices space, the rent for which does not include utilities and that is further away from the water system is available for \$800 per month.⁶⁷ The ALJs state that they do not find Rio Concho's evidence compelling. The Ratepayer's argument relies on speculative calculations that are not based upon any evidence in

⁶³ Tr. at 447:3-8 (Testimony of Ms. Brunson) (December 6, 2016).

⁶⁴ Tr. at 456:14 through 457:5 (Testimony of Mr. Brunson) (December 6, 2016).

⁶⁵ Exhibit RCA-1, page 22, line 22

⁶⁶ Code § 13.185(e) (emphasis added).

⁶⁷ Exhibit RCA- 4, page 17, lines 12-15; and Exhibit RCA- 10

the record. The only facts in the record demonstrate that Rio Concho is saving at least \$300 per month, and \$3600 each year, below the market rate for office space by renting from its affiliate.

3. Professional Services Expense

Rio Concho does not except to the ALJs recommendations for professional services expense.

4. Insurance

Rio Concho excepts to the ALJs findings and conclusions regarding its property insurance premium. Rio Concho requested expenses for property and liability insurance totaling \$2,546. The property and liability coverage is an airport liability policy because the property and water system is located on an airport. Rio Concho witness Mr. Manus testified that the water system sits on two parcels of land. One parcel contains the well, and taxes and assessments are allocated 100% to the utility. The other, larger parcel contains land used by the Brunsons in other businesses: Rio Concho estimates that approximately 25% of the larger parcel is used for the water system and 25% of costs are allocated for that parcel of land.⁶⁸

The total property insurance premium is \$3,014, with \$1,044 allocated to Rio Concho. Ms. Brunson testified that the allocation of the property insurance premium approximates the square footage of the properties (both parcels) used by each of the Brunsons' businesses.⁶⁹ The total liability insurance premium is \$2,695, with \$912.47 allocated to Rio Concho. Mr. Manus testified that Rio Concho historically allocated one-third of the liability policy premiums to the utility.⁷⁰

The ALJs recommended a reduction solely based upon testimony by the Ratepayers that Ms. Brunson's allocation for the insurance was faulty. Rio Concho's evidence supports its requested amount.

⁶⁸ Exhibit RCA- 4, page 20 (Manus direct).

⁶⁹ Exhibit RCA-1, pages 26-27 (B. Brunson direct).

⁷⁰ Exhibit RCA-4, page 10 (Manus direct).

5. Office Supplies and Expenses

Rio Concho's will not except to the ALJs' recommended \$45 reduction in office supplies even though the only basis for the exclusion was that those office supplies could also have been school supplies.

6. Miscellaneous Expenses

a. Clothing

Rio Concho excepts to the ALJs findings and conclusions regarding clothing expense. Rio Concho requested \$600, or \$50 per month, to recover the expenses associated with clothing used when Ms. Brunson is in the field, digging trenches, replacing water lines, and performing other repairs. Ms. Brunson testified that operators such as she are exposed to harsh chemicals, mud, and environments that damage clothing.⁷¹ Rio Concho's evidence supports the reasonableness of spending \$600 per year for clothing.

b. Retail Memberships

Rio Concho excepts to the ALJs findings and conclusions regarding its retail memberships. Ms. Brunson testified that Sam's Club is geared more toward business while Costco contains items that are more personal, which is why she uses both of them.⁷²

c. Travel Expenses

Rio Concho excepts to the ALJs' findings and conclusions regarding its travel expenses. The Brunsons traveled to Austin in August 2015 for a water utility conference. They seek recovery of expenses for a hotel room for two nights, and related meals. Expenses for travel to training are reasonable and recoverable through rates.

d. Cell Phone Expenses

Rio Concho excepts to the ALJs' findings and conclusions regarding its cell phone expense. Ratepayer Mr. Sheets makes a blanket statement without referring to any evidence that Rio Concho is claiming \$1,987 for two cell phone numbers. Rio Concho's only claimed phone

⁷¹ Exhibit RCA-6, page 9 (B. Brunson rebuttal).

⁷² Tr. at 81.

expense is this. Expenses for a telephone line are clearly necessary for the operation of a water utility and Mr. Sheets unsupported testimony should not be given any weight.

e. Audi Connect Expenses

Rio Concho excepts to the ALJs' findings and conclusions regarding its Audi connect expense. Ms. Brunson testified that she used the Audi Connect to connect to the internet when in the office at the airport, a fact that the ALJs fail to recognize in making their recommendations.⁷³ A water utility's expense to maintain an internet connection – especially one as low as \$30 per month is reasonable and necessary to the cost of operating the utility.

D. Depreciation

Rio Concho excepts to the ALJs' findings and conclusions regarding depreciation. The Preliminary Order identified the issues of "what is the original cost of the property used and useful in providing water service to the public at the time the property was dedicated to public use?" and "What is the amount, if any, of accumulated depreciation on such property?"⁷⁴ In addition, it identified the related issues of "what is the reasonable and necessary depreciation expense?" and "For each class of property, what are the proper and adequate depreciation rates (including service lives and salvage values) and methods of depreciation?"⁷⁵

Rio Concho's requested invested capital and proposed depreciation are shown in detail on attachment 3 to the application.⁷⁶ The Commission Staff and Ratepayers questioned the appropriateness of a television, DVD player, wall mount and antenna as assets that were used and useful to Rio Concho. The total cost of those assets was \$670.60, and the annual depreciation is \$135.52 per year.⁷⁷ However, Ms. Brunson testified on rebuttal that she uses those assets to monitor the weather and conduct video training while in the office.⁷⁸ Mr.

⁷³ Tr. 174.

⁷⁴ Preliminary Order, Issues 11, citing Texas Water Code § 13.185(b) and 16 TAC §24.31(c)(2)(A)-(B).

⁷⁵ Preliminary Order, Issue 26, citing Texas Water Code § 13.185(j) and 16 TAC §24.31(b)(l)(B).

⁷⁶ Exhibit RCA- 2, page 32, row 20, column E and Commission Staff Exhibit 13, page RCA000914, line25.

⁷⁷ Exhibit RCA- 2, Attachment 3.

Brunson testified at length about the significance of weather impacts on the operation of the system and the need to monitor it closely.⁷⁹

In addition, the Commission Staff and the Ratepayers questioned the appropriateness of including invested capital and depreciation for 60% of the used 2015 SUV acquired by Ms. Brunson to operate the water system. As discussed above in Section A.3., the SUV is necessary for the operation of the water system, and the expenses incurred by the utility related to the SUV are reasonable since only 60% of the SUV's total costs, including its net asset value and depreciation, are allocated to the utility.

There were no other challenges, besides paving, to the proper inclusion of the Rio Concho water system assets or the depreciation of those assets as shown in the Application.⁸⁰

1. Audi Q5

The ALJs' exclusion of the Audi Q5 is related to their findings regarding the mileage and expenses. As argued above, the inclusion of the vehicle and its expenses is appropriate and the depreciation costs should be included accordingly.

2. Paving

The ALJs cite Ratepayer Mr. Grace's testimony that there are almost yearly paving projects around the Airfield. Rio Concho's paving costs for areas over the utility's water lines were \$6011.12.⁸¹ Mr. Sheet's argument cites to documents that are not evidence and not part of the record.⁸²

3. Television and Related Items

The ALJs concluded that television, DVD player and wall mount should not be included in the office equipment. All of these items are reasonable for a working office environment and

⁷⁸ Exhibit RCA- 6, page 4, lines 14-15.

⁷⁹ Tr. 461:21 – 462:9 (Testimony of Kevin Brunson) (December 6, 2016).

⁸⁰ Exhibit RCA- 2, Attachment 3.

⁸¹ Staff Exhibit 13, page RCA000927

⁸² Ratepayers' Initial Brief, Attachments 12 and 13, are not evidence in this proceeding.

are included in the application materials, and Ms. Brunson generally testified about their use in providing the utility service.⁸³

4. Office Equipment

The ALJs concluded that chairs and a lamp and sideboard should not be included in the office equipment. All of these items are reasonable for a working office environment and are included in the application materials, and Ms. Brunson generally testified about their use in providing the utility service.⁸⁴

E. Taxes

1. Federal Income Tax Expense

Rio Concho does not except to the methodology used by the ALJs to calculate federal income tax, only the numbers used to do so, which flow from the determinations of rate base and return.

2. Other Assessments and Taxes

Rio Concho does not except to the ALJs findings and conclusions regarding other assessments and taxes.

F. Return on Invested Capital

Rio Concho excepts to the ALJs' findings and conclusions regarding return on invested capital to the extent they rely upon the recommended rate base, debt/equity structure and rate of return. The Preliminary Order identified the issues of: "what are the reasonable and necessary

⁸³ Tr. 82.

⁸⁴ Exhibit RCA-1, p. 9 (Ms. Brunson Direct) and Tr. 116.

components of the utility's invested capital?";⁸⁵ and the related issue of "what is the reasonable and necessary working capital allowance for the utility?"⁸⁶

Rio Concho's requested invested capital and proposed depreciation are shown in detail on attachment 3 to the application.⁸⁷

V. RATE OF RETURN

A. Return on Equity

Rio Concho excepts to the ALJs' findings and conclusions regarding return on equity. The Preliminary Order identified the issue of "what is the appropriate overall rate of return, return on equity, and cost of debt for the utility?"⁸⁸ The ALJs adopt the Commission Staff's position.

Rio Concho proposed a return on equity of 12.49% consistent with the calculations set forth in the Commission's Class B rate application form and its instructions.⁸⁹ The Commission Staff's witness, Mr. Novak, agreed that Rio Concho had prepared the 12.49% rate of return on equity correctly.⁹⁰ Mr. Manus calculated the 12.49% rate by adding the prescribed risk factor of 7% for Class C utilities⁹¹ to the Baa Bond Ratings for Public Utilities.⁹²

Despite acknowledging that Rio Concho correctly completed the application in calculating the rate of return on equity, Mr. Novak recommends a much lower rate of return that does not take into account the risks recognized by the Class B application form and its instructions adopted by the Commission on September 17, 2015. And despite acknowledging

⁸⁵ Preliminary Order, Issue 9, citing 16 TAC §24.31(c)(2).

⁸⁶ Preliminary Order, Issue 14, citing 16 TAC §24.31(c)(2)(C).

⁸⁷ Exhibit RCA- 2, page 32, row 20, column E and Commission Staff Exhibit 13, page RCA000914, line25.

⁸⁸ Preliminary Order, Issue 8.

⁸⁹ Exhibit RCA- 2, page 30, and Exhibit 13, pages 9 and 10

⁹⁰ Tr. 373:3 (Testimony of Andrew Novak) (December 6, 2016).

⁹¹ Exhibit RCA- 13, page 10.

⁹² Exhibit RCA- 2, Attachment 5.

the increased risks for a smaller utility, like Rio Concho, on cross examination,⁹³ Mr. Novak continued to recommend a return on equity that results in an approximate 29.3% reduction in pro forma equity value for the Rio Concho water system.⁹⁴ The reduction in value is driven by Mr. Novak's failure to recognize the risk, which Mr. Scheig does incorporate into his analysis.⁹⁵ Mr. Scheig's report explains in detail why applying a risk premium of 5.6% is appropriate for Rio Concho due to its relatively small capitalization, resulting in an appropriate cost of equity for Rio Concho of 12.3%, which is nearly the same as the 12.49% that results from following the Commission's instructions.⁹⁶

Without accounting for the increased risk, the Commission Staff recommends an inadequate return on equity of 8.48%. The Commission rules require that the rate of return allow a utility an opportunity to earn a return on its invested capital and preserve the financial integrity of the utility.⁹⁷ Mr. Novak's recommendation fails to do either.

Commission Staff argues that Mr. Novak relied upon "complex economic models" in his analysis. In fact, Mr. Novak used only one model. Mr. Scheig's testimony demonstrates that Mr. Novak failed to account for risk associated with smaller utilities by using several different models, including the one used by Mr. Novak. By using the models correctly and taking risk into account, Mr. Scheig's model reached very different results.

Mr. Novak's reduction in value will essentially render Rio Concho unable to secure loans or equity investment for replacement or additional utility infrastructure. Mr. Novak analysis is fundamentally flawed. As he acknowledge on cross-examination, even the utilities that he used as part of his barometer group were earning a return on equity for their shareholders of 12.5% and 13.5% based upon the most pessimistic source – Value Line.⁹⁸ If Rio Concho is only

⁹³ Tr. 381:1 through 387:15 (Testimony of Andrew Novak) (December 6, 2016).

⁹⁴ Exhibit RCA- 9, Rebuttal Testimony of Gregory E. Scheig, p. 4, lines 17-20, and

⁹⁵ Rio Concho Exhibit 9B, pages 6-7.

⁹⁶ *Id.* at 7.

⁹⁷ 16 TAC 24.31(c)(1).

⁹⁸ Tr. 385:19-25; Tr. 391:18-22; Tr. 393:5-11 (Testimony of Andrew Novak) (December 6, 2016).

allowed a return on equity of 8.48%, why would anyone want to invest their money in it when they could achieve a substantially higher return investing in these larger systems?

The Commission's application form and instructions support a return on equity of 12.49%, which would allow Rio Concho to remain viable and competitive in the equity markets. The Commission rules require that the rate of return allow a utility an opportunity to earn a return on its invested capital and preserve the financial integrity of the utility.⁹⁹ Mr. Novak's recommendation fails to do either. His approach simply results in the inability for small utility systems, like Rio Concho, to function in the Texas regulatory environment by putting them on a lower tier than the large utility systems.

B. Cost of Debt

Rio Concho excepts to the ALJs' findings and conclusions regarding cost of debt. The Preliminary Order identified the issues of "what is the appropriate overall rate of return, return on equity, and cost of debt for the utility?";¹⁰⁰ and "does the utility have any debt? If so, what is the cost of that debt?"¹⁰¹ The ALJs adopt the Commission Staff's recommendations.

Rio Concho's only debt is a 60% allocated portion of a 3.9% loan for the vehicle acquired by Ms. Brunson, which was taken in the name of Ms. Brunson because the utility could not obtain the loan.¹⁰² Mr. Novak calculated a hypothetical cost of debt based upon the Baa Moody's bond rating of 5.03%.¹⁰³ But Ms. Brunson could secure a loan from her bank for an amount up to \$15,000 at a rate of 8.4%, but only if she personally guaranteed the loan.¹⁰⁴ Clearly, the bank recognized the risk involved with making a loan to a small company like Rio Concho. Mr. Novak failed to do so in his analysis by simply using the Baa Moody's utility bond

⁹⁹ 16 TAC 24.31(c)(1).

¹⁰⁰ Preliminary Order, Issue 8.

¹⁰¹ *Id.*, Issue 13.

¹⁰² Tr. 68:22 through 69:1 (Testimony of Barbie Brunson) (December 5, 2016).

¹⁰³ Commission Staff Exhibit 2, Direct Testimony of Andrew C. Novak, page 6, lines 1-4.

¹⁰⁴ Tr. 440:10-23 (Testimony of Barbie Brunson) (December 6, 2016).

rating, and he even acknowledged that he did not know if his barometer companies were included in the Moody's rating determinations.¹⁰⁵

If a hypothetical debt rate is going to be used, it should be the 8.4% rate that Ms. Brunson was quoted by her bank.

C. Capital Structure

Rio Concho excepts to the ALJs' findings and conclusions regarding capital structure. The Preliminary Order identified the issue of "what is the appropriate debt-to-equity capital structure of the utility?"¹⁰⁶ Once again the ALJs adopt the Commission Staff's recommendations.

Rio Concho's actual debt-to-equity ratio is approximately 80% equity and 20% debt, as set forth in the application.¹⁰⁷ For a small system like Rio Concho, this ratio is appropriate. As discussed above, Rio Concho's cost of debt will likely be much higher than what is typical for other larger utility systems. Commission Staff proposes the use of a hypothetical 50-50 debt-to-equity ratio because that is typical of much larger water and sewer utility systems.¹⁰⁸ Once again, Commission Staff's proposals result in financial hardship to this small utility by undermining Rio Concho's ability to attract capital for investment.

D. Overall Rate of Return

Rio Concho excepts to the ALJs' findings and conclusions regarding overall rate of return to the extent that it relies upon the findings and conclusions related to return on equity, cost of debt and capital structure. The Preliminary Order identified the issue of "what is the appropriate overall rate of return, return on equity, and cost of debt for the utility?"¹⁰⁹

¹⁰⁵ Tr. 404:1-4 (Testimony of Andrew Novak) (December 6, 2016).

¹⁰⁶ Preliminary Order, Issue 7.

¹⁰⁷ Exhibit RCA- 2, page 30.

¹⁰⁸ Commission Staff Exhibit 2, page 7, lines 9-14.

¹⁰⁹ Preliminary Order, Issue 8.

Rio Concho's proposed overall rate of return is 10.78%.¹¹⁰ This overall rate of return is calculated following the Commission's instructions and using Rio Concho's actual cost of debt. The Commission Staff proposes to deviate from those instructions by applying a hypothetical debt-to-equity ratio, applying a hypothetical cost of debt and a return on equity that are both based upon types of utility systems that are fundamentally different from Rio Concho, which is a small family owned business.

VI. RATE DESIGN

Rio Concho excepts to the ALJs' findings and conclusions regarding rate design to the extent it relies upon the ALJs' findings for the revenue requirement and does not acknowledge the unique design necessary for this small airport property. The Preliminary Order identified the issues of "what is the appropriate methodology to determine just and reasonable rates in this docket?"¹¹¹; and "what are the just and reasonable rates for the utility that are sufficient, equitable, and consistent in application to each customer class and that are not unreasonably preferential, prejudicial, or discriminatory?"¹¹²

Rio Concho proposes an alternative rate design that will keep the base rate below \$40 per customer in order to avoid having customers who use little water disconnecting from the system because of a high base rate.¹¹³ Rio Concho customers use an average of approximately 1620 gallons per month.¹¹⁴ Because usage is so low, keeping the base rate near but not above \$40 preserves the financial integrity of the system. If the ALJs' recommendation is followed for Rio Concho's requested expenses, the base rate will be unreasonable high for lower water usage

¹¹⁰ Exhibit RCA- 2, page 30, line 7.

¹¹¹ Preliminary Order, Issue 1.

¹¹² Preliminary Order, Issue 2, citing Texas Water Code § 13.182.

¹¹³ Tr. 516:25 through 517:16 (Testimony of Kevin Brunson) (December 6, 2016).

¹¹⁴ Exhibit RCA- 2, page 11, column C, line 4, divided by 12 months, divided by page 8, column E, line 10 (4,662,400 gallons in test year/12 months/240 customers = 1619 gallons/customer/month).

customers, and high water usage customers will not have as much incentive to reduce consumption.¹¹⁵

VII. RATE CASE EXPENSES

Rio Concho excepts to the ALJs' findings and conclusions regarding rate case expenses, to the extent the expenses of its rate of return expert, Mr. Scheig, and its accounting consultant are excluded. The Preliminary Order identified the issues of "what are the utility's expenses incurred in this rate proceeding that are just, reasonable, necessary, and in the public interest?";¹¹⁶ and the related questions of "does that amount include any anticipated expenses to appeal this docket that are just, reasonable, necessary, and in the public interest? Should the utility be able to recover its reasonable and necessary rate-case expenses from ratepayers? If so, how should such expenses, if any, be recovered by the utility?"

Rio Concho should be allowed to recover all of its rate case expenses. The Commission rules provide that:

A utility may recover rate-case expenses, including attorney fees, incurred as a result of filing a rate-change application pursuant to TWC §13.187 or TWC §13.1871, only if the expenses are just, reasonable, necessary, and in the public interest.¹¹⁷

And that:

A utility may not recover any rate-case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.¹¹⁸

Rio Concho has proven its requested revenue requirement increase of \$30,929.73. The threshold for allowing recovery of rate case expense recovery in this case is 51% of that amount, or \$15,774.16. Rio Concho has exceed that amount.

¹¹⁵ Tr. 516:25 through 517:16 (Testimony of Kevin Brunson) (December 6, 2016).

¹¹⁶ Preliminary Order, Issue 35, citing 16 TAC §24.33.

¹¹⁷ 16 TAC §24.33(a).

¹¹⁸ 16 TAC §24.33(b).

A. Amount of Rate Case Expenses that are Just, Reasonable, and Necessary, and in the Public Interest

Rio Concho provided evidence of \$106,564.63 in rate case expenses for this matter.¹¹⁹ Detailed invoices documenting these expenses have been produced to all parties for review. Mr. Manus' fees and expenses were \$6,286.70 for his services in responding to discovery, preparing prefiled direct and rebuttal testimony, reviewing other testimony, and participating in the pre-hearing and hearing process through the end of the hearing. Mr. Scheig's fees and expenses were \$10,005.67, and were solely related to responding to Mr. Novak's deviation from the application instructions and procedures by reviewing the application, Mr. Novak's testimony and working papers, preparing rebuttal testimony and participating in the hearing. Mr. Carlton's fees and expenses were \$88,916.52 through the end of the hearing on December 6, 2016, and were related to his work in reviewing the application, participating in settlement conferences, responding to discovery requests, preparing discovery to serve on the other parties, preparation of prefiled direct and rebuttal testimony, review of other parties' testimony, preparation for and participation in the hearing and costs for copies, deliveries and other expenses. In addition, Ms. Brunson has incurred travel expenses related to participation in meetings with Commission staff, the settlement conferences, prehearing conferences, and the hearing on the merits that are not included in Exhibit RCA- 18.

This case could not have been processed by Rio Concho for any less. The Commission's process is burdensome and expensive for utility systems. A simple application for a \$30,000 increase in revenue requirement in a 240 customer system has taken over a year, required responses to over 100 questions through discovery and required hundreds of hours of work by consultants and the family owners of this small utility. Rio Concho has undergone an excruciatingly burdensome process in an effort to obtain a relatively small increase in its revenue * requirement. Commission Staff has evaluated and scrutinized every single invoice and accounting entry for this small family owned business. The proposed increase in rates for customers of the Rio Concho system would have been approximately \$13.09 per month for the average user of 1620 gallons in the Rio Concho system. Even with the increase, the proposed

¹¹⁹ Exhibit RCA- 18.

base rates are less than the base rates for the neighboring Aquá Texas system and the costs to an average Rio Concho customer using 1600 gallons of water would be about the same.¹²⁰

B. Surcharge

The Preliminary Order identified the issue of “if a refund or surcharge results from this proceeding, how and over what period of time should that be made?”¹²¹

Rio Concho proposes recovering its rate case expenses over the typical two-year period, which would result in a surcharge of \$18.50 per customer per month.

¹²⁰ Ratepayers Exhibit 2.

¹²¹ Preliminary Order, Issue 37, citing Texas Water Code §13.1871.